

CJ's Weekly Market Memo

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The Economy: Navigating Through Uncertainty with Resilience

We're living through interesting times. The Federal Government shutdown has entered its third week with little resolution in sight, and betting markets are increasingly wagering this could stretch past month's end. While 19 economic releases have been delayed, including heavy hitters like the jobs report and CPI, we're not flying completely blind. Private sector data continues to paint a picture of an economy that's holding up better than the pessimists predicted.

Consumer spending remains the backbone of this expansion. The Chicago Fed's weekly retail sales estimate looks healthy, First Data's merchant services show spending up a solid 4.6% year-over-year, and auto sales have been running north of 16 million SAAR for three straight months. That's acceleration, not deceleration. Small business sentiment, as measured by the NFIB, has improved for three consecutive months following the spring tariff shock, with hiring plans in the 69th percentile since 1986. These aren't the numbers of an economy rolling over.

On the international front, China's trade data surprised to the upside with exports rising 8.3% YoY despite the U.S. falling to under 10% of their export destinations. Their financial markets showed remarkable resilience this week—the CSI 300 closed down just 0.5% on Monday despite Friday's 2%+ selloff in U.S.-listed China equities. Meanwhile, LVMH's better-than-expected results, driven by "encouraging" Chinese demand, suggest the world's luxury consumers haven't gone into hibernation.

The tariff story continues to evolve. President Trump's Friday threat of additional 100% tariffs on Chinese imports over critical minerals sparked that late-week volatility, but over the weekend both he and Vice President Vance walked back the rhetoric without offering concessions. The Pentagon is reportedly exploring up to \$1 billion in critical mineral purchases to reduce this pressure point. Business uncertainty, as measured by the Fed's Beige Book, has fallen 20% sequentially and is now less than half its April peak. Companies are adapting.

Market Technical Condition: Elevated VIX Meets Resilient Prices

Here's where things get fascinating from a technical standpoint. Thursday saw the VIX close above 25 while the S&P 500 finished less than 2% from all-time highs—a rare combination that Sherwood News noted has historically occurred during manic market phases like the Tech Bubble peak and the 2020-2021 SPAC craze. Since 1997, this dynamic happened 35 times between 1997 and March 2000, only 3 times after that peak, then didn't resurface until August 2020 during the run to 2021 highs.

What does this tell us? The simple explanation is that moves in stock prices reflect a collective reluctance to sell despite elevated valuations, so hedging flows are prevalent and volatility trades at a premium. We'd argue the "stay long, but hedge" dynamic is visible everywhere. Oracle crashed nearly 10% on cloud margin concerns a couple weeks back. Regional banks got crushed Thursday on fraud-related credit write-downs at two lenders, despite broadly solid credit quality across the banking sector this earnings season. Markets aren't immune to bad news—they're just not convinced by the bearish gospel, which counterintuitively extends the bull run.

Mid-week, we saw spot VIX trading higher than the 90-day VIX futures, a clear sign of intense near-term stress. Yet according to Bespoke's comprehensive market measures, the market still isn't technically overbought. Small-cap value stocks had their best week in months, and some junky, low-priced stocks with questionable fundamentals started to run. That's typically a yellow flag that requires caution, though not necessarily a red one.

The AI basket continues to trade more than one standard deviation above its 50-DMA, firmly in overbought territory. Over the past month, AI Infrastructure names rose 11.4% (83rd percentile move) versus a more modest 3.8% for AI Implementation stocks (57th percentile). France led global equity performance this week with a 4.4% surge, while China's Hang Seng was the worst performer, down 3.8%. The dollar strengthened modestly within its trading range, and the 10-year yield fell below 4%, which our fair value model suggests puts rates in "moderate rich" territory—not drastically cheap for bonds, but not expensive either.

Bottom line: volatility is elevated, hedging is widespread, but price action remains constructive. That's actually a healthy setup for continued gains, assuming fundamentals cooperate.

Earnings Season & Looking Ahead: Banks Deliver, AI Continues to Impress

Earnings season kicked off with authority this week, and the results were better than feared. According to FactSet, the blended Q3 earnings growth rate for the S&P 500 now stands at 8.5%, above the 7.9% expected at quarter-end. Of the 12% of companies that have reported, 86% beat EPS estimates (well above the 77% one-year average) and 84% topped sales expectations (versus a 67% one-year average). Companies are reporting earnings 5.9% above expectations and sales 1.5% above consensus.

The big money-center banks set the tone. Wells Fargo delivered a 7% EPS beat with provisions 42% below estimates—its best earnings-day move since 2009. JPMorgan, Bank of America, Citigroup, Morgan Stanley, and Goldman Sachs collectively reported trading revenues up 20.6% YoY, with investment banking revenues soaring—equity underwriting was up an eye-popping 46% YoY. These aren't numbers consistent with economic pessimism. Loan growth was healthy, credit quality was strong, and management commentary was constructive about client activity.

Guidance matters enormously from here, particularly from banks and AI-related names. TSMC kicked things off overseas with a 10% EPS beat and raised full-year revenue guidance to "mid-30%" growth in USD terms (up from 30%), citing AI demand that's "stronger than we thought three months ago." The company expects its latest 2nm processors to have even higher profitability than prior nodes. ASML followed with orders 10% above expectations and 2026 sales guidance that won't fall below 2025 levels, driven by "continued positive momentum around investments in AI." These are the data centers and semiconductors that are the picks and shovels of the AI boom—and they're telling us demand is accelerating, not decelerating.

On the consumer side, Synchrony Financial—the co-brand credit card lender for Amazon, Lowe's, Walmart's Sam's Club, and others—delivered a 30% EPS beat with charge-offs down 16% YoY and 30+ day delinquencies down 39 bps YoY. These numbers are the opposite of what you'd expect if the consumer were rolling over. Domino's reported its strongest comparable store sales growth since Q1 2024, up 5.2% YoY. JB Hunt smashed estimates by 20% on structural cost removal and higher productivity. Snap-On's EPS turned positive YoY after two quarters of decline historically a good leading indicator that recession fears are overblown.

A Few Curveballs Worth Noting:

1. **Pfizer's Obesity Drug Surprise:** Pfizer emerged as an unexpected winner this week after President Trump declared war on obesity, sending GLP-1 drug stocks higher.

While Novo Nordisk and Eli Lilly have dominated this space, PFE's danuglipron program suddenly looks more attractive in a policy environment that might subsidize or incentivize obesity treatments. This is the kind of headline-driven rotation that can create opportunity.

2. **VIX Term Structure Stress:** That mid-week technical signal—spot VIX higher than 90-day VIX futures—indicated intense stress. But here's the thing: stress doesn't equal tops. It equals hedging. And hedging costs money, which means those holding hedges have a vested interest in the market going higher to recoup those costs.
3. **Junky Stocks Running:** Yes, some low-priced, earnings-free names started to catch a bid this week. That's worth watching. But Bespoke's data shows the market still isn't overbought by historical standards, and small-cap value (not junk) led the charge. This feels more like rotational broadening than speculative blow-off.
4. **AI Skeptics Keep Calling the Top:** Professional talking heads continue predicting the end of the AI boom. I learned early in my 50+ year career that there's always a broader market for negative opinions, being negative and wrong is forgivable but being bullish and wrong gets you run out of the prediction business. So, the incentives are skewed toward caution. But the data, from TSMC, ASML, Nvidia's ongoing deal flow, Oracle's massive cloud commitments, and the big banks' investment banking surge—says AI infrastructure spending is accelerating, not peaking. I'm going with the data.
5. **A Truism from 1970:** When I first started in this business back in 1970, our NYSE floor partner told me something I've never forgotten: "Investors can remain bullish far longer than they can stay bearish." That wisdom has held up for over half a century. Bull markets climb a wall of worry, and this one has plenty of bricks left—government shutdowns, tariff threats, geopolitical tensions, election uncertainties. Yet corporate earnings are growing, consumers are spending, and the AI buildout is in the early innings. Don't underestimate the staying power of a bull market with fundamental support.

Looking Ahead: Rest of 2025 and Early 2026

We're heading into the final stretch of 2025 with the S&P 500 up 13.7% YTD and less than 2% from all-time highs. That's impressive given the headwinds. The government shutdown will eventually end, and when it does, we'll get a flood of delayed economic data. I suspect much of it will confirm what private sector indicators are already telling us: the economy is

growing at a modest but steady pace, the consumer is holding up, and corporate America is navigating tariffs and uncertainty with more agility than the bears anticipated.

The big question for Q4 is guidance. If banks continue to report healthy loan growth and stable credit, and if AI infrastructure companies like TSMC, ASML, and Nvidia keep raising targets, this market has room to run into year-end. Seasonality is typically favorable from late October through December, and we've already worked off some of the froth from the September highs.

For early 2026, the setup looks constructive. Earnings growth in the high single digits is sustainable if margins hold and revenue growth stays in the mid-single-digit range. The Fed is in a holding pattern, but easier financial conditions and falling Treasury yields (if we stay below 4% on the 10-year period) would provide a tailwind. Election-year volatility will pick up but remember election years are historically positive for stocks, and incumbents running for reelection have a strong incentive to keep the economy humming.

Geopolitical risks remain—China-U.S. tensions, Middle East instability, Ukraine-Russia dynamics—but none of these appear likely to derail the domestic economy or corporate earnings in the near term. If anything, defense and infrastructure spending could provide additional fiscal support.

In short, stay invested, stay diversified, and don't let the noise shake you out. The fundamentals are sound, earnings are growing, and the bull market has more room to run. Will there be pullbacks? Of course. But pullbacks in a bull market are buying opportunities, not reasons to panic.

Here's to finishing 2025 strong and starting 2026 even stronger.

CJ Brott

Chairman Emeritus

Capital Ideas

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