3Q 2025
Market Commentary

The dictum “a rising tide lifts all boats” does not appear to be the case in today’s market. A close comparison to the current environment might be the late 1990s whereby indexes made new highs at the same time as the average company stock was declining. In fact, the majority of stocks had begun their descent by 1998 while indexes were making new highs on an almost daily basis. We have not quite reached this point, yet since this time last year the technology component of the S&P 500 has increased over 30% while consumer staples, healthcare, energy and basic materials have all declined.

Herein lies a paradox which will inevitably resolve itself in due course. The present contradiction is that technology—Artificial Intelligence (AI) in particular—cannot continue to grow, let alone thrive, without electricity infrastructure, energy or basic materials. Much has been written about electric utilities facing the best environment in years due to insatiable demand from AI data centers. This demand cannot be met, however, without additional power generation which can only come from a few sources. The first is from renewables, but is not likely to figure prominently as it is an intermittent source and the current administration is determined to de-emphasize wind and solar. Hydropower is also facing issues as our rivers flow less than they used to. The Hoover Dam generates significantly less power today than when it was completed and is at risk of shortly reaching inactive levels, a problem both for the region’s power generation and for the agriculture sector in many surrounding states which rely on its resource. Power generation can come from nuclear but nuclear power plants need to be built, uranium needs to be enriched, and spent fuel needs to be stored and disposed of. The U.S. imports a significant quantity of enriched uranium from Russia—this poses a slight problem based on the geopolitically fraught environment we find ourselves in. Power generation can also come from oil, coal, and natural gas, all of which the U.S. has in abundance yet contributes to greenhouse gasses. All to say that electricity generation cannot increase without many, if not all, of the above sources of power. AI data centers also require significant copper, steel, aluminum, piping, water and cement in order to be built and operational. Yet the technology sector in the S&P 500 is up by nearly a third in the last year while sectors providing those required inputs have declined. This market concentration has become so pernicious (or perhaps virtuous if one only owns the S&P?) that technology—Nvidia, Microsoft, Apple, etc., consumer discretionary—primarily Amazon and Tesla, and communications—primarily Alphabet and Meta, make up nearly 60% of the overall S&P 500. On the other hand, energy, basic materials and utilities in total add up to under 7% of the index.

The economist Herb Stein famously said: “if something cannot go on forever, it will stop.” As we look towards the end of 2025 with many issues being ignored, we cannot but wonder when some form of inevitable mean reversion will take place. For the most part, we are positioned in areas that should benefit from a reversion in this unsustainable phenomenon, which as we’ve described, has happened in years past. History does, in fact, rhyme and we trust that it will once again.

As we go to press, the government has been shut down for the first time since the last Trump presidency and the 15th time since the early 1980s. It appears as though our representatives' ability to compromise is at its nadir, offering less hope than previous times about reaching a constructive compromise. The current Office of Management and Budget (OMB) and Trump administration are working together in order to capture fiscal savings not altogether different from those that DOGE touted earlier this year. We are somewhat skeptical that those benefits will result in positive economic growth and are fearful that markets are ignoring some of the less-than-ideal consequences. It is clear that the U.S. needs to reign in our overall spending. Yet the other side of the ledger, perhaps the more powerful one, remains economic growth. Some of the administration's measures are clearly stimulative with some, like lowering certain regulatory burdens, arguably being necessary. Yet they have been offset, at least in the short run, such that the net effect may be negligible.

Since Liberation Day, U.S. equity markets have discounted all the positives that have resulted from a number of recent actions. Tax cuts have been extended, regulation is being lowered, energy prices have declined meaningfully, the U.S. dollar has weakened and the Fed is beginning the process of lowering rates. All of these salubrious actions nevertheless appear fully discounted in the indexes. What is not discounted is the likelihood that global economic growth will be lower prospectively. Tax rates will not be an incremental benefit; they simply won't go up, as had been expected. The weak dollar which benefits multinationals is offset by tariffs which raise prices. Lower energy costs reduce transportation as well as many input costs—think plastic packaging, chemicals, homebuilding materials such as siding and plumbing, travel, among some of the benefits. Yet overall consumer spending may struggle to increase. Investors have resigned themselves to paying higher valuation multiples despite the possibility of slower growth. Consensus currently assumes that recent tailwinds to the economy will continue. We might ask some of the following questions: What if geopolitical tensions result in oil and other commodity prices increasing from here? What if the U.S. dollar once again becomes a haven and increases relative to other currencies due to geopolitical events? What if some of our exports, including agriculture, continue to shrink, as many have been doing? Any one of these could impede U.S. economic growth prospects and all of them are in part outside of our control.

We are not suggesting these are the most likely outcomes. We are nonetheless suggesting that today's valuations strongly imply investors are ignoring any of these possibilities.

As for us, we prefer to invest by not simply considering the upside but also paying attention to where downside risks may lurk. We have always kept a keen eye on capital preservation while simultaneously seeking opportunities that others tend to ignore.