



Quarterly Economic Update

December 12, 2025



MACROECONOMIC COMMENTARY

Economic Outlook

By Bobby Long

As investors, we turn to various forms of qualitative and quantitative data to assess the current state of economic conditions and determine whether certain economic trends are improving or deteriorating. With a vast amount of information to filter, significant importance is placed on the accuracy and quality of data, along with the timeliness and standardization of data over long periods to make accurate assessments of both short- and longer-term trends. Historically, U.S. governmental agencies have been a relied upon source of information at the national level. According to the Bipartisan Policy Center, the United States Federal Statistical System (FSS) is a sprawling collection of more than 100 agencies, units, and programs across the federal government, and its best-known components collect and produce national economic data that is widely viewed as the global gold standard for such data. The government compiles this economic data to inform public policy, guide business decisions, and provide a factual basis for understanding the economy for citizens. This data is crucial for policymakers to manage the economy, for businesses to make strategic plans, and for researchers and individuals to make informed decisions. The Bureau of Economic Analysis (BEA), the Bureau of Labor Statistics (BLS), and the U.S. Census Bureau are three of the larger agencies that provide widely relied upon national data on economic growth, inflation, and labor conditions. Two events over the past few months have disrupted the flow of data and called into question the integrity of the information provided to the public.

The most recent impactful event was the government shutdown, which has led to the delayed release of federal economic data. The shutdown ran from October 1 to November 12, lasting 43 days. The reopened government is now working to release the data, but it has left the economic picture a little cloudier with the lack of information. September data has been trickling out. October data is mostly still delayed, and some data from this period will never be released. November data should be released, but will also be delayed.

The other event was the public firing of the BLS Commissioner by President Trump in a social media post, with allegations of manipulating labor data for political purposes and a lengthy history of inaccuracies. This followed the release of a weaker-than-expected jobs report for the month of July and significantly weaker revisions to the two previous months' numbers, which at the time were counter to more positive economic messaging. The BLS has historically been viewed as a non-partisan agency, and the firing has raised concerns across party lines on the future independence of the agency and the data it provides. More recently, the nomination of the new BLS Commissioner was pulled due to a lack of support and bipartisan concerns regarding the nominee's independence. Regardless of whether there is any truth to the allegations, it introduces a loss of confidence in the credibility and integrity of federal economic data.

A real underlying issue is reflected in this event. Concerns have been shared in economic circles about the collection methods and declining response rates from household and business surveys used to collect the data. The pattern of weaker revisions to previous job numbers reflects lower participation rates and less timely responses, impacting the

integrity and reliability of the data. The chart below shows how these survey response rates have declined over the past 10 years, which can help explain the larger monthly revisions and indicate some deterioration in the quality and reflectiveness of the numbers.

Increasing Challenges to Timely Survey Responses

Response rates for the two surveys that go into the Bureau of Labor Statistics' monthly jobs report—the survey of businesses and the survey of households. Y-axis does not start at 0.

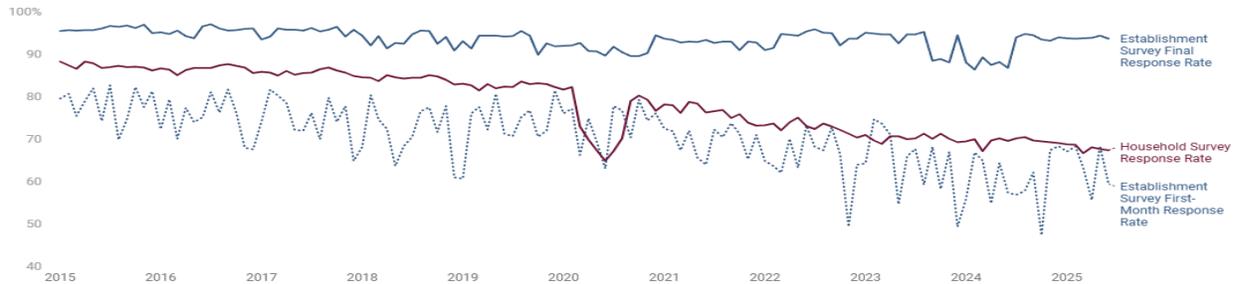


Chart: Emerson Sorrick • Source: BLS • Get the data • Created with Datawrapper

Outside of any partisan allegations of data manipulation, it is important that collection methods evolve as needed to preserve the integrity of these important measures, and this highlights that there are some persistent underlying issues here that need to be addressed. It is also vital that nonpartisan independence and transparency are maintained so that the impact of public policy can be evaluated on a factual basis.

Third quarter Gross Domestic Product (GDP) has not been released. The initial estimate was due to be released by the Bureau of Economic Analysis on October 30. This estimate will now be released on December 23.

Over the past several months, consumers have continued spending but have dialed back purchases somewhat. The BEA's personal consumption expenditure data has not been released since August. The U.S. Census Bureau released September retail sales figures in late November, which showed that monthly spending remained positive through the end of the third quarter but continued a softening trend.

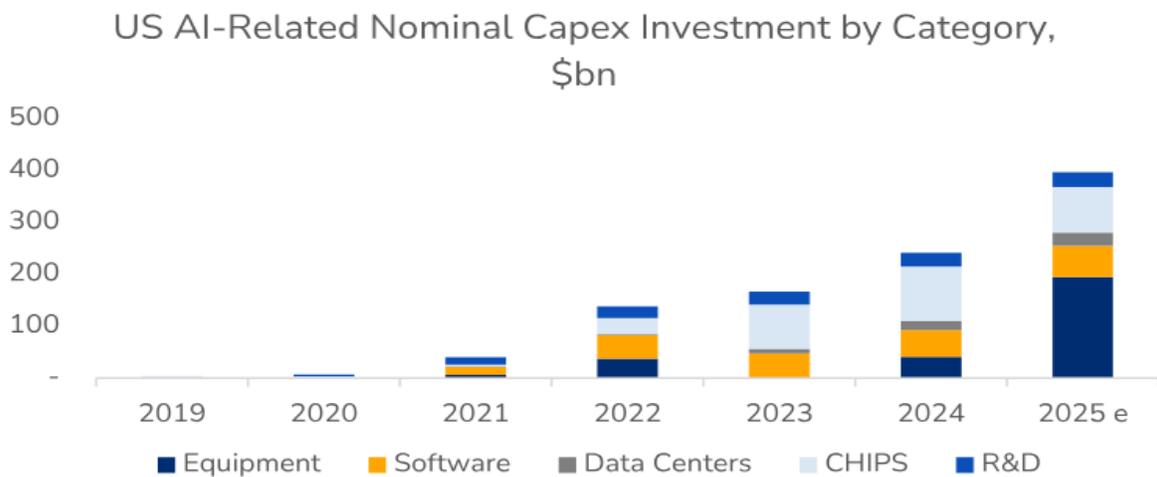


Source: US Census Bureau



Without hard data for October and November, we look to other sources to get a read on spending trends. Costco reports sales monthly, and the data does a good job of tracking the official retail sales measure. Their October nominal sales rose 0.8% over the prior month, with real sales increasing 0.4%. Mastercard SpendingPulse data recorded a 4.1% increase in Black Friday spending over the prior year. This consisted of a 1.7% increase from in-store sales and a 10.4% increase from online sales. Several discretionary retailers such as Kohl's, Abercrombie & Fitch, and Best Buy have recently increased their sales outlook for the remainder of the year. These are all positive anecdotes for broader consumer spending trends. Other retailers like Walmart and T.J. Maxx have noted a more cautious consumer. Home Depot has warned many consumers are holding off on big-ticket home purchases. Restaurant sales have also been a little sluggish. This is reflective of the K-shaped economy, where the wealthier shoppers are largely still spending and the middle to lower income consumers have become more selective. If labor conditions hold, several tailwinds can increase consumer spending power as we move into the next year. The Federal Reserve may lower short-term rates further, banks have increased their willingness to lend, and tax relief from the One Big Beautiful Bill will increase disposable income.

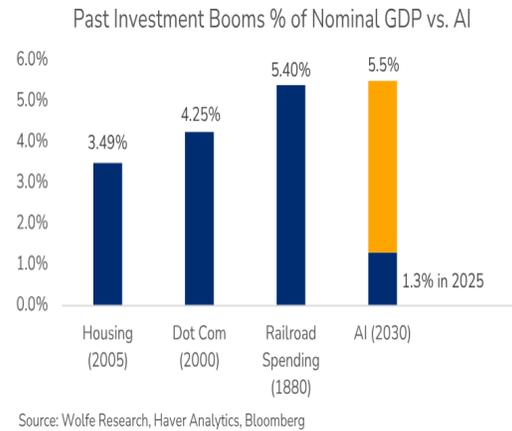
AI-related capex spending continues to be an important driver of economic activity. Much of this spending has been focused on building out AI-related structures like data centers, power generation, and electronic manufacturing facilities. The next phase will be furnishing these facilities with computers, servers, specialized machinery, communication equipment, and electrical equipment. With big numbers being thrown around, it is hard to distinguish the actual spending and to quantify the impact. The chart below provides a current estimate of AI-related capex investment. Wolfe Research estimates this has reached roughly \$400B in 2025, which equates to about 1.3% of GDP.



Source: Wolfe Research, Haver Analytics as of Q2 2025

Note: Includes related equipment and R&D, as well as software, data center, and CHIPS structures deviation from 2013-2017 trends.

Nvidia's CEO Jensen Huang has forecasted 40% annualized growth through 2030, which would put AI-related capex at \$2.2T in 2030, equivalent to 5.6% GDP. The chart on the right makes some comparisons of the current and forecasted capex relative to some of the past investment booms. Current investment is still modest relative to these periods, but the 2030 estimates approach levels that have proved to be overinvestment peaks.

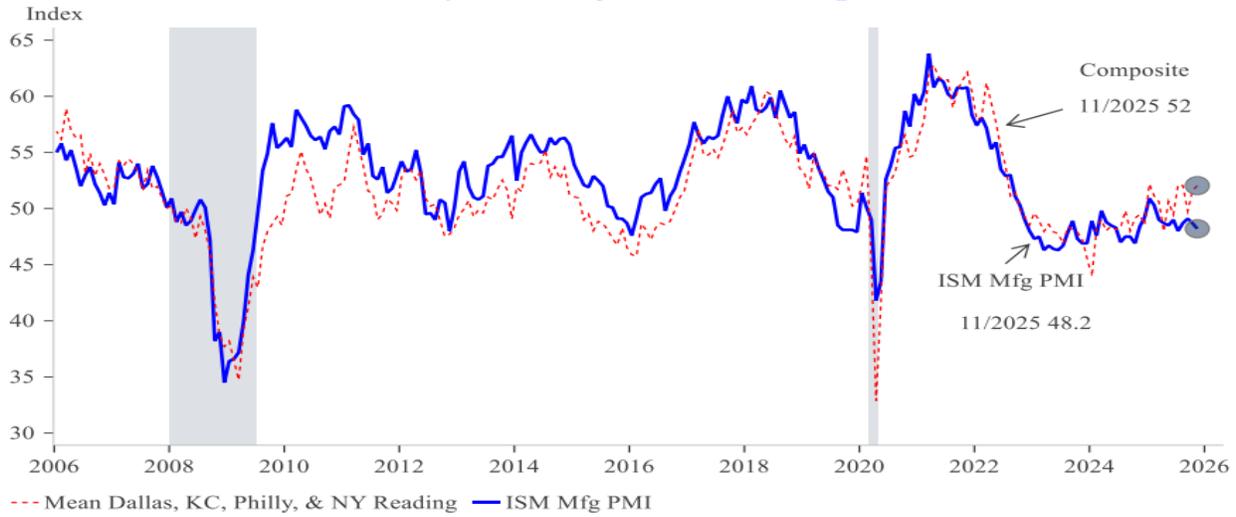


Many companies are touting the gains in productivity already from AI investments. This commentary is hard to quantify, and any discussion around increased productivity seems premature with the technology still in the early stages. The hope is that AI will unleash a wave of productivity growth that will support rising real incomes and living standards. According to Morgan Stanley Research, the United States has experienced five major innovation cycles since the 18th century that have reshaped the economy with marked increases in productivity and standards of living. These include the industrial revolution (late 18th to mid-19th century), the development of steam power, railroads, and steel production (mid-19th to early 20th century), electricity and the internal combustion engine (early 19th to mid-20th century), electronics and aviation (mid-20th century), and the internet and digital networks (late 20th century). An AI-innovation cycle would represent the sixth.

One other source of GDP growth support could come through foreign direct investment. Foreign investment pledges to the administration have totaled \$8.8 trillion. There are questions on how much of this is actually deliverable, the net effects on trade, and the timeline; however, investment pledges from some countries like Japan and Korea may prove to provide a real near-term boost to domestic growth.

Manufacturing data continues to paint a cloudy picture. Regional Fed manufacturing data has been more constructive, but the ISM Manufacturing PMI index for November fell 0.5% to 48.2% and continues to trend below 50 in contraction territory. Four of the five components were negative, with new orders and employment weakening further. Tariffs and uncertainty were widely cited as weighing on demand and depressing activity. The chart on the following page overlays the ISM Manufacturing PMI with a regional composite of Dallas, Kansas City, Philadelphia, and New York activity.

ISM-Adjusted Regional Fed Composite



The BLS’s employment reports were also impacted by the government shutdown. The September data had been largely collected ahead of the shutdown or electronically self-reported during the shutdown. However, the release of the September Employment Situation report was delayed by more than six weeks and only released on November 20. The BLS has announced they will not publish the October Employment Situation report, but will release payroll data from the establishment survey for that month with the November report scheduled December 16. The household survey data was not collected for the month of October.

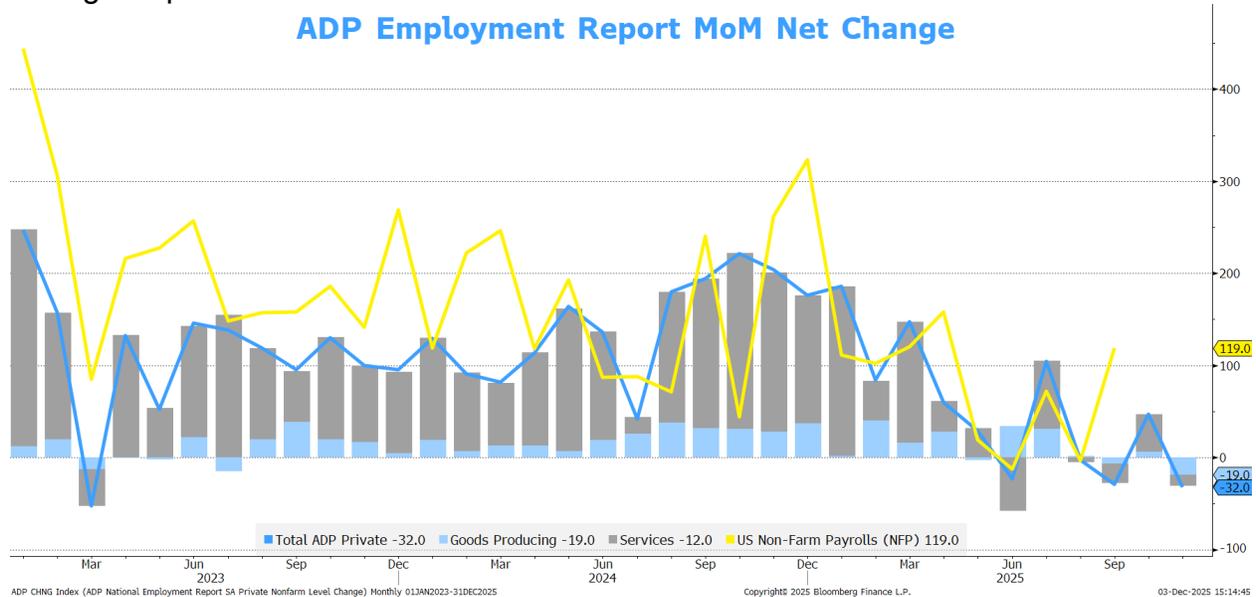
Nonfarm payroll employment increased by 119,000 in September. This was an improvement over the prior four weaker months and followed the decline of 4,000 jobs in August. The unemployment rate moved slightly higher to 4.4%, ticking up another tenth of a percent as it had done the previous two months. The chart on the right shows the breakdown of the job gains and the three-month trend through September. An increase in cyclical hiring contributed to additions in the construction, health care, and leisure and hospitality industries. Manufacturing, transportation, and professional and business services shed jobs for the month. Government payrolls improved for the month, but deferred DOGE resignations are expected to have a negative impact on the October numbers.

Payrolls MoM

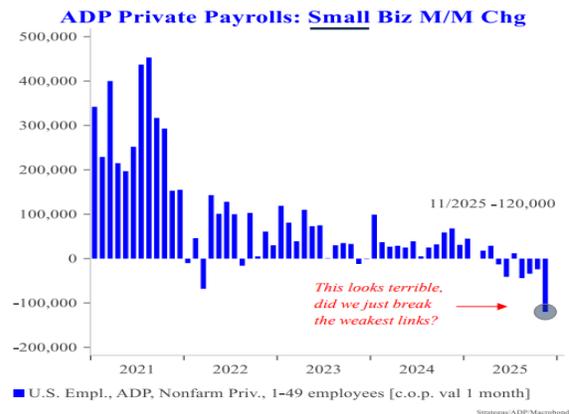
	9/30/2025	8/31/2025	7/31/2025
Total NonFarm	119	-4	72
Total Private	97	18	56
<i>Goods Producing</i>	10	-32	-16
Mining and Logging	-3	-3	-4
Construction	19	-14	-3
Manufacturing	-6	-15	-9
<i>Private Service-providing</i>	87	50	72
Wholesale Trade	9	-8	-4
Retail Trade	14	3	6
Transportation	-25	3	-5
Utilities	0	-1	0
Information	0	-7	-6
Financial Activities	5	-15	1
Professional and Business Services	-20	-17	-13
Health Care	43	27	55
Social Assistance	14	13	17
Private Educational Services	2	4	9
Leisure and Hospitality	47	32	9
Other Services	-2	17	5
Government	22	-22	16

Source: Wolfe Research, Haver Analytics, as of Sep 30, 2025

ADP private payroll employment is current and recorded a decline of -32,000 jobs in November. According to their data, payrolls have fallen in four of the past six months. The chart below shows the weaker trend in ADP payrolls and overlays nonfarm payrolls through September.



The slowdown in November was broad-based and led by a pullback among small businesses. Small businesses, defined as companies with fewer than 50 employees, shed 120,000 jobs. This was the largest one month decline since May 2020. Over the past three months, smaller firms have cut 178,000 jobs from their payrolls versus large firms that added 143,000 jobs.



Job openings have also been declining. We look to private sector sources that track job openings, such as the Indeed Job Postings Index and the LinkUp 10,000 Index to get a current view on labor conditions. Both have trended lower through this year but have diverged more recently. The Indeed index has ticked higher over the past couple of weeks, versus the LinkUp index that has moved lower. We place more confidence in the LinkUp index due to the collection methods. The Indeed index aggregates its data from direct postings through Indeed and from other job boards across the internet, capturing more data but also some duplication of job postings. LinkUp aggregates U.S. job openings directly and exclusively from the websites of the top 10,000 employers, producing a cleaner set of data. As the following chart shows, the trend indicates slowing job demand from employers with conditions weakening further over the past month.

Daily LinkUp 10,000

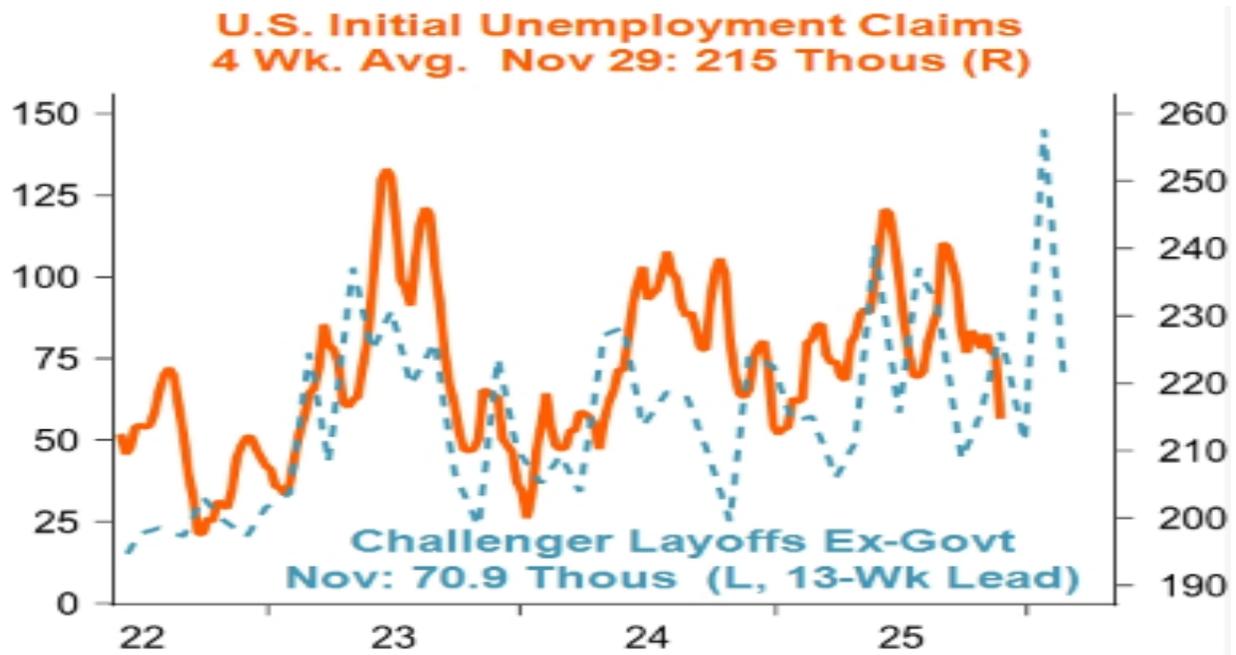


For much of the year, labor softness has been reflected in slower hiring and declining job postings, however, we have seen an uptick in layoff announcements. The Federal Reserve Bank of Cleveland's measure of monthly WARN notices moved sharply higher for the month of October, with 39,006 Americans receiving advance notice of layoffs as required under the Worker Adjustment and Retraining Notification Act. While this should not be viewed in isolation, it has only registered higher in 2008, 2009, 2020, and earlier this year.

Challenger, Gray, & Christmas has also reported an increase in layoff announcements. The Challenger Report from October saw the sharp rise of 153,074 job cuts announced. The November report recorded a more modest but still elevated 71,321 layoffs. Through the first eleven months of this year, employers have announced 1,170,821 job cuts, which compares to 761,358 for the same period of the prior year. This is only the sixth time since 1993 that job cuts have exceeded 1.1 million for the similar period, with the others occurring in 2001, 2002, 2003, 2009, and 2020.

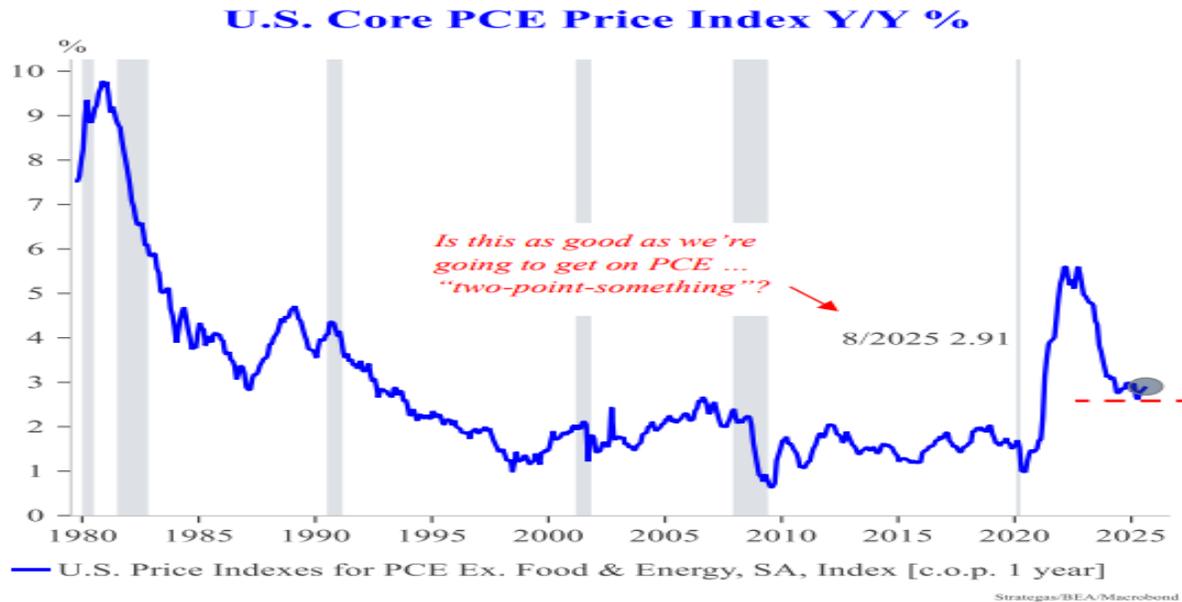
The four-week average of initial unemployment claims has been moving in a sideways channel, but initial claims did fall sharply over the most recent Thanksgiving-shortened week. The four-week average of continuing claims had been drifting modestly higher again over the past couple of months, however, the recent release reported a decline and revised the prior week's claims substantially lower. The Conference Boards "jobs plentiful less jobs hard to get" index has also moved lower with "plentiful" moving lower at a faster pace than "hard to get" is moving higher. Altogether, this suggests that job separations have been increasing and employers are reducing hiring plans, but that unemployed workers are still largely able to find employment. The continuing claims data seem to indicate that re-employment is just taking a little more time at this stage.

We could see another uptick in initial claims over the next several weeks based on the layoffs announced in October, but we have already seen job cut announcements back off from those elevated levels. The following chart overlays the initial claims data and Challenger layoff data ex-government, implying that any uptick could be temporary.



Labor markets still appear okay, but conditions have clearly softened and payroll gains have stalled. Reduced hiring trends combined with the uptick in layoffs indicate weakening labor conditions. The rise in unemployment of younger workers is somewhat concerning, and recent college grads are struggling to find jobs. The unemployment rate for workers age 20-24 has reached 9.2%. We need labor markets to stabilize here or further deterioration may begin to spread across the broader economy.

The Consumer Price Index (CPI) report for the month of October was cancelled. The BLS said it would publish some of the October data where possible with the November report, but that it would be unable to retroactively obtain much of the data that was not collected during the shutdown. The November CPI report will now be released on December 18. BLS employees were recalled during the shutdown to produce and publish the already collected data for the September report so that the Social Security Administration could calculate its annual cost-of-living adjustment. September CPI increased 0.3% over the prior month. This followed a 0.4% increase in August. Core CPI increased 0.2% in September after a 0.3% increase in August. Both CPI and core CPI increased 3.0% over the 12-month period ending in September. The BEA's PCE Price Index data for September increased 2.8% year over year. Inflationary pressures seem to have stabilized for now, but at a level above the Federal Reserve's two percent target as shown in the following chart. Looser labor conditions are helping ease wage pressures and lower oil prices are also helping.



The K-shaped economy is becoming increasingly reliable on higher net worth consumers. This is offsetting the weaker middle- and lower-income consumer that is seeing disposable income shrink. Auto loans and housing costs are squeezing lower end consumers. Upper income brackets will likely keep spending as long as equity markets and housing values hold up. Wage gains are moderating while cost of living is still rising for many families. It will be difficult for consumer spending to be a significant source of incremental growth. AI-related capex is playing a more important role. AI capex can drive activity, but incremental growth rates will moderate as the spending continues. We will need to see activity broaden out and non-AI capex pick up. Housing is unlikely to provide a significant boost any time soon unless mortgage rates move substantially lower. Corporate profits are still healthy and CEO confidence that revenues will increase over the next twelve months has improved. Tariff pressures are still working their way through the economy, but it has been absorbed okay so far. Whether these can continue to be absorbed by consumers or begin hitting profit margins harder remains a question going forward. Credit weakness appears isolated for now and bank lending standards are becoming less restrictive. Sluggish labor conditions are manageable at this point, but they are wobbling. A tip of the scale in labor markets could set off problems if job losses begin mounting. The economy is working its way through a slowdown and there is a path through without a recession, but AI spending strength and labor markets will be the determining factor. On the other side, productivity growth could be meaningful if AI lives up to its expectations. When considering the impact AI technologies may have on labor markets, Federal Reserve Board Governor Christopher Waller recently concluded in a speech that “we must let the disruption occur and trust that the long-run benefits will exceed any short-run costs.” The idea is that new jobs and increased productivity will come over the long run.

RSA PORTFOLIO STRATEGY

Fixed Income Strategy

By Lance Lachney

At the time of our last economic update, fiscal year 2025 was drawing to a close. In mid-September, the Federal Open Market Committee (FOMC) picked up where it left off late last year and reduced the federal funds rate by 25 basis points. Policymakers had been on hold this calendar year after lowering short-term rates by a total of 100bps in the previous one. The widely expected move was in response to the apparent deterioration in labor supply and demand. Chairman Powell described the move as a “risk management cut,” and the committee’s updated economic projections pointed to an increase in growth coupled with a slightly higher inflation forecast. Treasury yields pushed higher during the latter half of the month due to stronger than expected retail sales and an upward revision in personal consumption during the second quarter. Investment grade corporates outperformed during this time as spreads approached levels not witnessed in this millennium. The RSA finished its fiscal year accumulating returns over 3.50% within its fixed income portfolios.

	Oct 10	Change (bp)				Oct 10	Change (bp)		
	2025	Week	MTD	YTD		2025	Week	MTD	YTD
High Grade	81	6	5	-1	High Yield	318	38	38	26
Financials	80	6	5	-3					
Industrials	80	6	5	-1					
Utilities	89	5	4	1					

Source: CreditSights, BoFA/M/L Indices (COA0)

Source: CreditSights, BoFA/M/L Indices (H0A0)

The beginning of the new fiscal year happened to coincide with the shutdown of the federal government. Consumer confidence data highlighted concerns about the current state of the labor market, often described as one of limited hiring and firing. Credit markets came under pressure as trade tensions escalated with China, leading to subsequent volatility in equity markets. Concerns within private credit ensued after a couple of defaults in the sector left investors worried about potential systemic risks. High yield spreads widened over 30bps during this time as the 10-year Treasury fell below 4.00%. Corporate credit recovered a fair amount later in the month, benefiting from strong earnings and a more benign outlook for inflation. The October FOMC meeting produced another 25bp move bringing the federal funds range to 3.75-4.00%. However, there were dissenting votes

Exhibit 1: Fed Dec cut pricing dropped to 30% on Nov 19

Market pricing for the December Fed cut dropped from 68% at the start of the month to 30% by Nov-19 before rebounding to 83% by month end.



Source: Bloomberg

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in both directions as one member voted for no action to be taken while a recently appointed member opted for a 50bp reduction. The FOMC Chair’s statements carried a hawkish tilt, indicating that a December move was “not a foregone conclusion.” The market responded accordingly, pushing treasury yields higher in short order. Policymakers also announced that it was concluding its Quantitative Tightening (QT) program, reinvesting the principal payments from its mortgage holdings into treasury bills going forward.

After the Chairman’s comments, the market-implied probability of a December rate cut greatly diminished. The absence of essential information from the Bureau of Labor Statistics (BLS) became a substantial hurdle for investors throughout November. Investment-grade corporate spreads leaked wider amid heavy supply as the return on investment of Artificial Intelligence (AI) projects was questioned. Hawkish rhetoric from a few Fed officials and an expansion in service activity reduced the odds of a December move to approximately 30%. Financial markets have witnessed quite a reversal over the last couple of weeks as the government has reopened, prominent members of the Fed have publicly pushed for an additional rate cut, and news that Kevin Hassett, Director of the National Economic Council, has emerged as the front-runner to replace Jerome Powell at the conclusion of his term. Interest rates fell through the remainder of the month as consumer sentiment declined further on dim labor market expectations. While investment grade spreads widened at the margin, positive total returns were achieved for a sixth consecutive month.

Exhibit 6: November supply was the highest on record for the calendar month

The \$138bbn issued in November was the highest on record for the calendar month, above the prior record of \$121bn in November 2017.



Source: BofA Global Research

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There were minor adjustments made to the fixed income portfolio during this time. Although corporate credit spreads have weakened, they remain relatively stable and tight from a historical perspective. While the fund maintains its overweight corporate positioning, it has allowed maturities to roll off and redeploy most of the proceeds into Treasury and mortgage-backed securities. Default levels remain negligible within the investment-grade universe; however, the fund is reluctant to be overly aggressive due to valuation and its vast outperformance over the last three years.

Exhibit 1: U.S. IG & HY Monthly Statistics

	Investment Grade				High Yield			
	Current	November Change	YTD '25 Change	YTD '24 Change	Current	November Change	YTD '25 Change	YTD '24 Change
OAS	80 bps	2 bps	0 bps	-21 bps	269 bps	-12 bps	-18 bps	-59 bps
YTW	4.76%	-6 bps	-57 bps	-1 bps	6.57%	-21 bps	-92 bps	-45 bps
Total Return	-	0.65%	7.99%	4.14%	-	0.58%	8.01%	8.66%
Excess Return	-	-2 bps	+92 bps	+252 bps	-	+0 bps	+217 bps	+523 bps
Supply (\$ bn)	-	140.0 bn	1,619.0 bn	1,512.0 bn	-	21.7 bn	298.3 bn	267.8 bn
Fund Flows (\$ bn)	-	+27.8 bn	+320.6 bn	+367.4 bn	-	-1.0 bn	+17.7 bn	+30.6 bn

Source: Wells Fargo Securities, Bloomberg Index Services, Dealogic, and EPFR Global.

Looking ahead, policymakers are poised to reduce short-term interest rates at the next FOMC meeting a few days from now. One should not expect Chairman Powell to lean heavily in either direction with his comments given that vital employment data will be released the following week. It appears that the labor market continues to soften, and it is likely that policymakers will respond accordingly absent a reacceleration of inflation expectations. The unanswered question is how the shape of the yield curve will respond. The intermediate and longer end of the curve remain range bound as consumer spending keeps the economy afloat. How long can this dynamic continue if downside risks to employment come to fruition? Is there a floor in which rates are unable to breakthrough given the concerns of Fed composition and independence as well as long-term fiscal deficiencies, domestic and abroad? It is possible that some variation of Quantitative Easing (QE) may be restored to achieve the administration's goal of lower long-term interest rates. Or long-dated Treasury yields may fall due to the one thing that market participants have all but discarded - a recession.

Domestic Equity Strategy

By Hunter Bronson

Overview

U.S. equities have once again proven resilient in 2025, navigating a year defined by sharp factor rotations, pockets of volatility, and a complex macro backdrop. Despite meaningful swings in sentiment - from the April “Liberation Day” selloff, to the summer-fall rally, to the brief “AI bubble” scare in November - the equity market enters 2026 supported by strong earnings, anchored inflation expectations, and substantial fiscal stimulus scheduled to arrive early next year.

Our large-cap active domestic equity portfolio outperformed the S&P 500 by over 175 basis points during fiscal year 2025 (19.35% vs. 17.58%). This relative strength reflects our disciplined, valuation-conscious investment philosophy, which tends to outperform during periods of increased dispersion, rising macro uncertainty, and pullbacks in richly priced segments of the market.

Looking ahead, the investment landscape offers a blend of opportunities and challenges. Corporate fundamentals remain healthy, and several policy tailwinds - including the OB3 tax refunds and bonus depreciation incentives - should support growth in 2026. At the same time, elevated valuations in parts of the market, a softening labor backdrop, and questions surrounding the efficiency of AI-driven capital spending require attention. We remain optimistic but disciplined.

Market Performance in 2025: A Year in Three Acts

1. Liberation Day and the Spring Pullback

The year’s first major turning point occurred in April, when a combination of shifting monetary expectations, surging Treasury yields, and a sudden liquidation of momentum-heavy technology names drove the major indexes into a sharp but short-lived correction. While the downturn was unsettling, it ultimately revealed the underlying stability of corporate earnings and economic growth.

2. The Summer–Fall Rally

From May through October, equities staged an impressive rebound. Earnings proved remarkably strong, guidance skewed positive, and economic activity stabilized more quickly than feared following the government shutdown. Breadth improved modestly, and the S&P 500 advanced to new highs on the back of robust corporate profitability.

3. The November AI Mini-Panic

A brief period of volatility followed in November, as investors grappled with the increasing capital intensity of AI-related spending. Announcements of elevated 2026 capex plans from large technology companies triggered concerns about future returns on incremental investment. However, signs of improving liquidity, alongside stabilizing macro data, drove a swift reversal, and equities regained their footing heading into year-end.

Together, these episodes underscored the market's resilience, even as leadership narrowed and valuation pressures mounted in certain segments.



Figure 1: The S&P 500 continued its multi-year run of resilience, having only broken trend during the "Liberation Day" turbulence in CY25

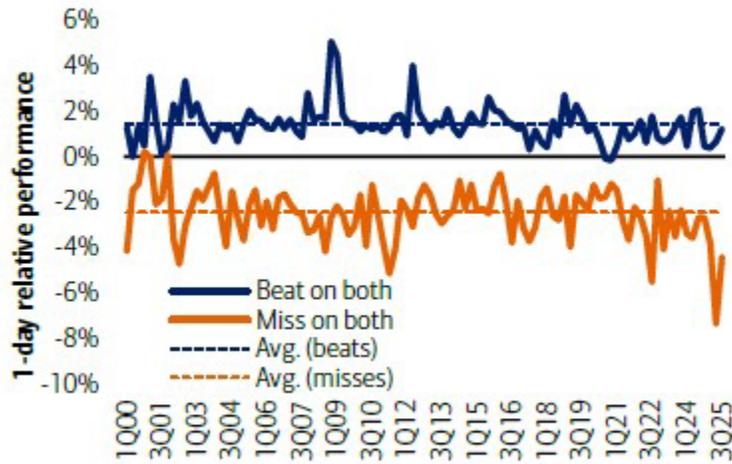
Corporate Earnings & Valuations

Corporate America delivered one of its strongest earnings seasons in years in the third quarter. More than 80% of S&P 500 companies beat 3Q estimates, the highest rate since 2021. Revenue trends remained healthy, margins expanded from mid-year lows, and guidance for 2026 is notably constructive. Consensus expectations have revenue growing at 7-9% and earnings expanding between 13-14% in 2026.

Yet even exceptional results have not always translated into significant share-price gains. Market reactions to earnings announcements have been muted relative to history, suggesting that valuations in many areas are already pricing in strong execution. Strong momentum and expectations during the summer left little room for positive surprises.

We believe this dynamic further reinforces the importance of valuation discipline and thoughtful security selection - an environment well suited to our investment philosophy.

Rel. 1-day post-reporting performance (vs. S&P 500) on EPS & sales surprise (1Q00-3Q25, as of 11/21/2025)



Source: FactSet, BofA US Equity & Quant Strategy

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Figure 2: Earnings beats have been rewarded modestly, while negative surprises have been punished more severely than is usual

To that point, valuations remain elevated, particularly in long-duration, mega-cap growth stocks. On nine of the twenty valuation metrics tracked by major strategists, the S&P 500 is more expensive today than at the peak of the 2000 tech bubble. The Shiller Cyclically Adjusted P/E ratio - now near 40x - is at levels reached only once before in modern history (2000).

S&P 500 valuation metrics, today (10/25) vs. 2000

	Current	March 2000	Today vs. 2000
Trailing PE	26.5	29.4	Cheap vs. 2000
Trailing GAAP PE	30.7	29.4	Expensive vs. 2000
Forward Consensus PE	23.6	24.6	Cheap vs. 2000
Trailing Normalized PE	29.9	34.5	Cheap vs. 2000
Median Forward P/E	18.5	15.3	Expensive vs. 2000
Shiller PE	39.1	43.0	Cheap vs. 2000
P/BV	5.7	5.3	Expensive vs. 2000
EV/EBITDA	20.2	15.7	Expensive vs. 2000
Trailing PEG	1.9	2.1	Cheap vs. 2000
Forward PEG	1.7	1.8	Cheap vs. 2000
P/OCF	21.1	19.1	Expensive vs. 2000
P/FCF	39.4	55.3	Cheap vs. 2000
EV/Sales	3.7	2.9	Expensive vs. 2000
ERP (Market-Based)	577.0	232.0	Cheap vs. 2000
Normalized ERP	182.4	-87.2	Cheap vs. 2000
S&P 500 Div. Yld. vs. 10yr Tsy. Yld.	0.3	0.2	Cheap vs. 2000
S&P 500 in WTI terms	113.9	50.1	Expensive vs. 2000
S&P 500 in Gold terms	1.7	5.4	Cheap vs. 2000
S&P 500 vs. R2000 Fwd. P/E	1.5	1.3	Expensive vs. 2000
S&P 500 Market Cap/GDP	1.9	1.3	Expensive vs. 2000

Source: FactSet, BofA US Equity & Quant Strategy

BofA GLOBAL RESEARCH

Figure 3: Roughly half of widely followed valuation metrics are at least as expensive today as in the year 2000, but the details matter.

While valuations are historically high, they must be interpreted in context. First, the index composition and leadership today is of much higher quality, with more stable earnings and less leverage than in past cycles. Additionally, the shift toward asset-light business models (software, services, etc.) with better margins has structurally raised fair multiples. Finally, return on invested capital remains unusually strong in large parts of the market, particularly the hyper-scalers and AI beneficiaries. The Dot-Com bubble saw extreme equity valuations being applied to companies that never generated a dollar of profit. While valuation extremes should give us pause, it is unfair to blindly compare the two periods.

Even so, valuation expansion is likely to play a far smaller role in future returns, as P/E ratios simply can't grow by 15% per year forever. Going forward, earnings, cash flow generation, and return on incrementally invested capital will be the dominant drivers of equity performance over the long haul.

Valuation expansion drove recent equity gains

Earnings growth took a back seat as valuations have powered global equity returns since 2022



Sources: Barclays Private Bank, LSEG Datastream, November 2025

Figure 4: Three-year trailing earnings have compounded at 3%, while valuations have expanded at a 14% clip.

Macroeconomics & The Fed

Despite dealing with a couple of major curveballs throughout the year, underlying economic growth has remained remarkably resilient. Most recently, the record-long government shutdown created gaps in official data and temporarily depressed hiring, consumption, and confidence across the board. Payroll employment growth slowed sharply, particularly among younger workers, and the unemployment rate drifted higher.

Inflation remains a central debate for the Federal Reserve, but underlying trends are encouraging. Market-based inflation expectations, while slightly higher than the Fed would like, are well anchored, shelter inflation is cooling steadily, tariff pass-through has been far lower than feared, and wage-growth pressures have eased as labor-market slack has increased.

JP Morgan’s research finds that imported goods selling prices have risen only 5% in 2025 despite higher tariff rates, reflecting substitution, misclassification of goods, and margin absorption by importers. Whether the government continues to look the other way on the “misclassification” of goods and importers continue to sacrifice margin remains to be seen.

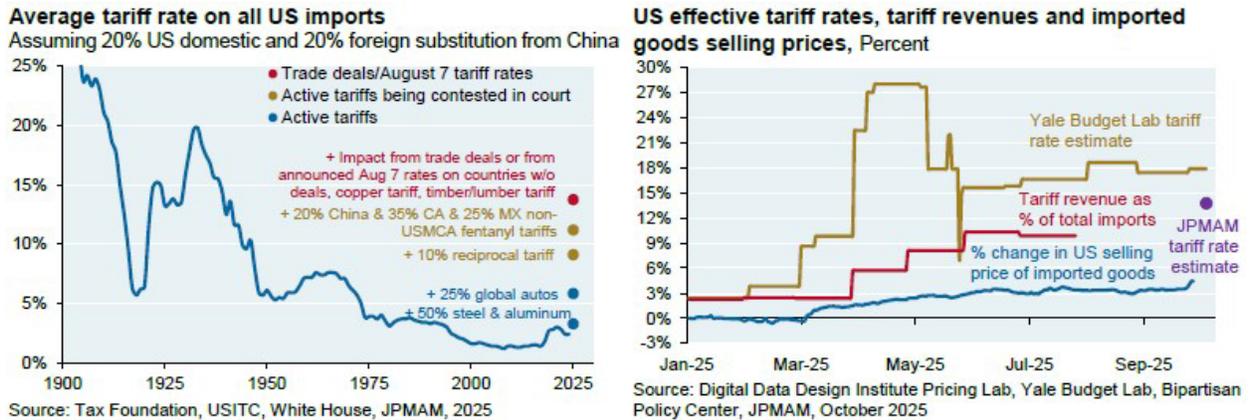


Figure 5: Despite all the sound and fury, imported goods prices are only up 5%.

While inflation continues to moderate, the labor market bears closer watching. Payroll gains have slowed dramatically - at least partially because of the shutdown - and unemployment has risen on the margin. Historically, unemployment tends to move in a nonlinear and self-reinforcing fashion - a dynamic that warrants attention as we enter 2026.

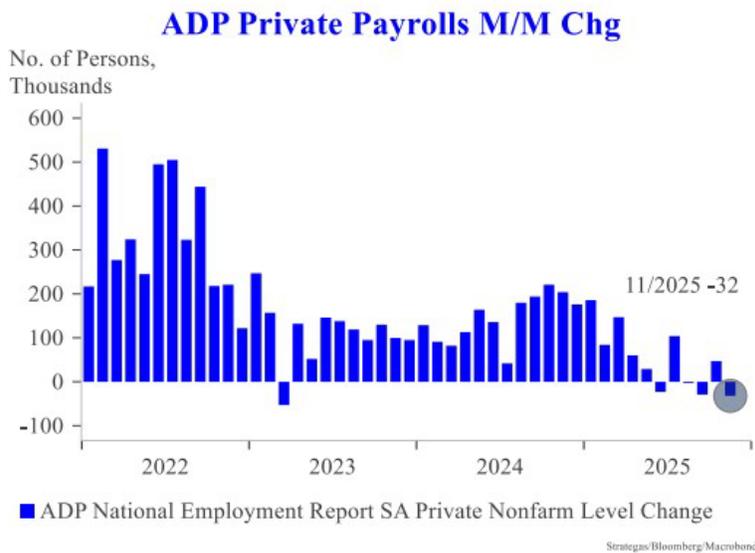


Figure 6: Payrolls appear to be rolling over.

The Federal Reserve enters its December meeting more divided than at any point during Chair Powell's tenure. Policymakers disagree not only on the proper policy path, but on the core question of which risk matters more - full employment or inflation. Hawks emphasize lingering inflation risks and robust consumer spending. Doves points to weakening labor indicators and tariff-related demand destruction. The center lacks conviction, particularly following months without official economic data due to the shutdown.

Despite this uncertainty, markets currently price in a high probability of a December cut, followed by additional easing in 2026. Financial conditions remain supportive, and history suggests that equity markets rarely peak at the beginning of monetary easing cycles.

The AI Capex Boom

The most visible storyline this year has been the scale and speed of AI-related capital spending. What began as a steady buildout of compute capacity has accelerated into a capital cycle that now exceeds any major corporate investment wave in recent decades. Hyper-scaler capex is projected to reach roughly \$400 billion in 2025 and more than \$500 billion in 2026, surpassing the peak spending once associated with global energy supermajors and representing more than a third of all domestic capex spend. This reflects a shared conviction among the largest technology firms that AI capability is now a strategic necessity.

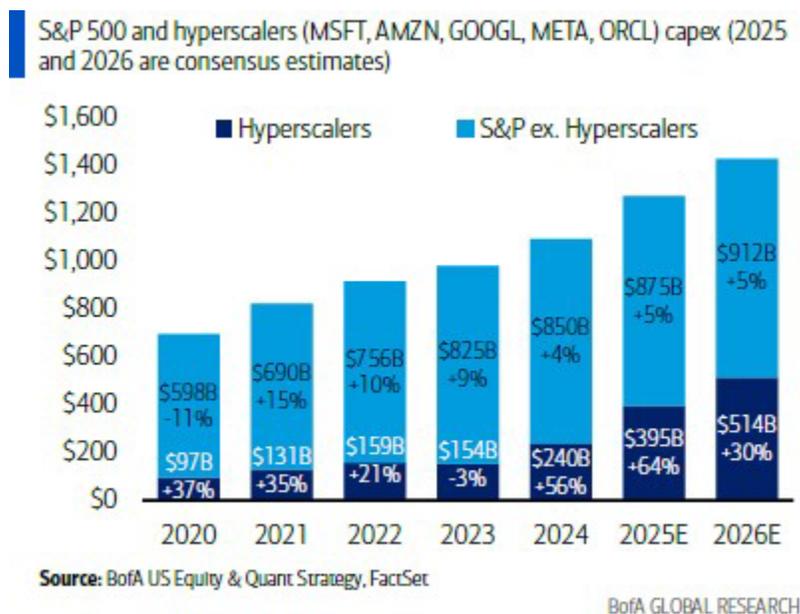


Figure 7: Hyper-scaler capex is eating the world.

Yet the financial profile of this spending introduces near-term uncertainty. Free cash flow growth among the hyper-scalers has slowed as capital intensity rises, and several firms have begun tapping debt markets to fund the next leg of expansion, as internal capital sources are no longer adequate. The market's response in October and November offered a preview of how investors are likely to evaluate this dynamic in 2026: even record revenue and operating performance were overshadowed by announcements of larger-

than-expected spending plans. Investors appear increasingly focused on the question of whether the next dollar of investment will earn the same return as the last.



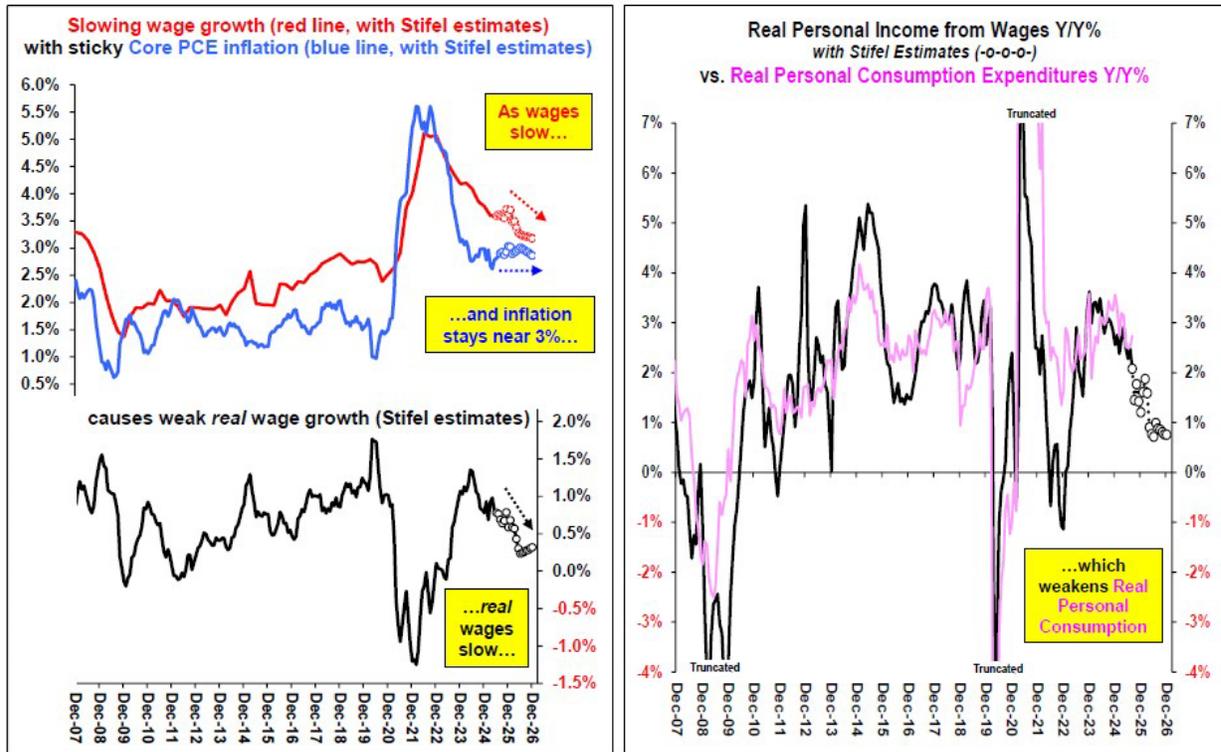
Figure 8: Big Tech is borrowing at least 3x their decade average to fund AI growth.

These concerns are reinforced by evidence of thin margins and complex financing structures across portions of the AI ecosystem. Some cloud providers are accepting narrow gross margins to secure early AI workloads, and several startups have pre-sold capacity at slim spreads to lock in funding. These arrangements illustrate intense competition for early AI share but also point to the difficulty of assessing long-term economics from today's vantage point.

History provides useful perspective. Major technological shifts - from railroads to fiber optics - often begin with ambitious investment cycles, periods of overbuild, and eventual consolidation before productivity gains fully materialize. AI may follow a similar arc. Its long-term potential remains substantial, but the transition from possibility to realized economic value is rarely linear. For investors, the result will likely be a wider dispersion of outcomes within the technology sector and beyond and a greater premium on fundamental analysis.

Looking Ahead to 2026...

The consumer enters 2026 in a mixed but broadly stable position. Higher-income households have remained steady contributors to spending, supported by strong wage growth and durable balance sheets. Middle-income households continue to face elevated costs in insurance, utilities, and certain services, while lower-income groups have benefited from targeted tax relief that has helped offset rising prices.



Source: Bloomberg data, Stifel Research and forecasts.

Figure 9: Real wage growth and spending should continue to moderate, but have support from 2026 fiscal spending.

Importantly, the consumer outlook brightens meaningfully as the calendar turns. OB3 tax refunds are expected to reach households beginning in February, and additional provisions from the OB3 legislation take effect later in the year. These measures provide support at a moment when hiring slowed temporarily due to the government shutdown and pockets of softness have appeared in white collar employment. The timing, in effect, helps cushion the economy from near-term volatility and provides a bridge to a more stable growth environment. All-in, OB3 fiscal provisions are expected to add up to a half a percentage point to GDP in 2026.

Large cultural and sporting events scheduled for 2026 - including the FIFA World Cup and the nation's 250th anniversary celebrations - should also contribute to service-sector strength. Beyond these cyclical forces, ongoing growth in healthcare and gig-economy employment continues to provide a floor under overall household income.

As mentioned, fiscal policy amplifies these trends. More than \$150 billion in consumer incentives and over \$135 billion in corporate tax benefits are slated to reach the economy over the next 12-18 months, with the legislative architecture intentionally designed to shift the largest effects into 2026. This fiscal impulse arrives at an opportune time and may help offset any lingering softness in early-year employment data.

... And Beyond

Looking beyond the next several quarters, several structural factors continue to shape the long-run economic landscape. Demographic trends remain a defining force. Birth rates remain below replacement levels, and net immigration - historically a key driver of U.S. labor-force expansion - has fallen meaningfully. With fewer workers entering the labor pool and participation no longer rising, the economy's future growth path will depend increasingly on productivity improvements. AI has the potential to provide such gains, but the timing and amplitude of that contribution are both uncertain.

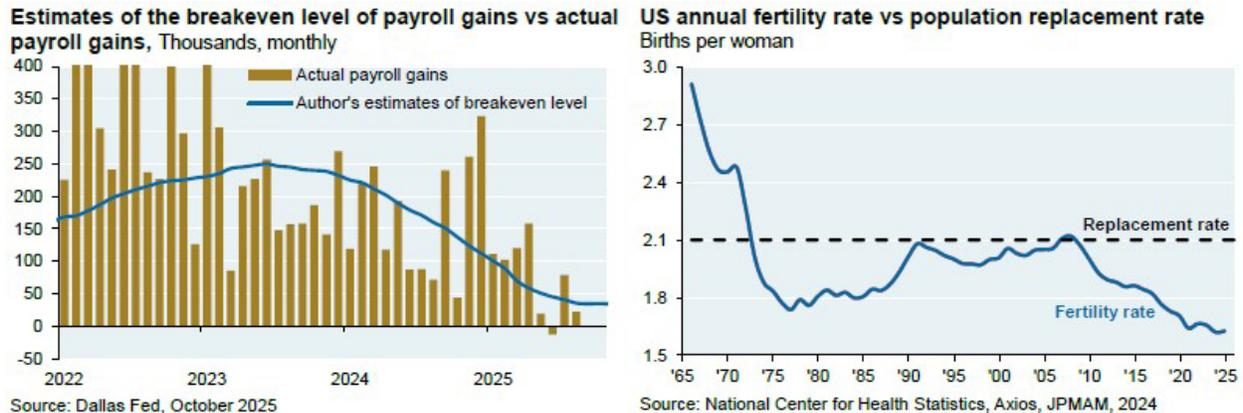
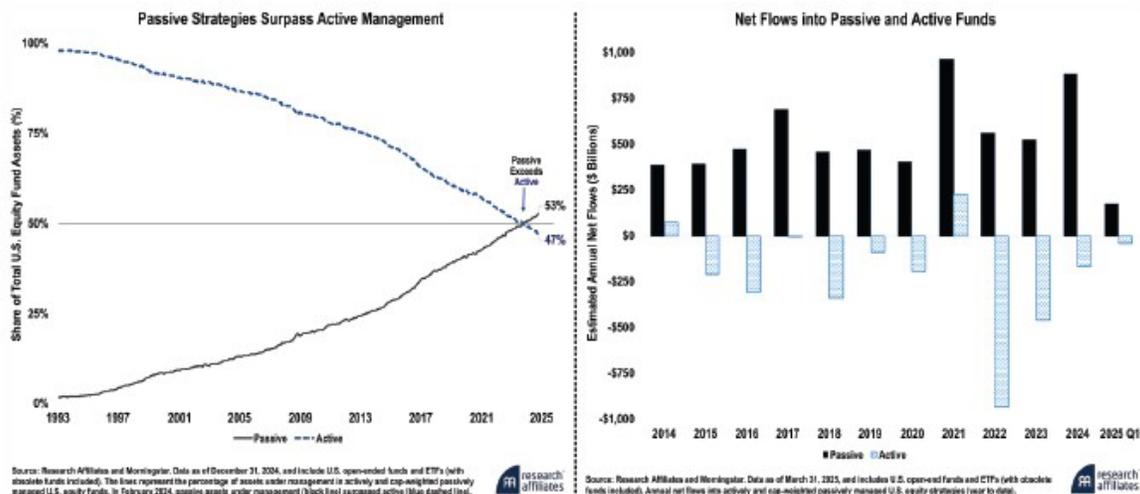


Figure 10: We can't replace workers fast enough. Productivity will need to fill the gap.

A second structural shift involves the continued rise of passive investing. Passive vehicles now represent more than half of U.S. equity ownership, surpassing actively managed assets for the first time. While this transition has reduced costs for many investors, it also changes the mechanics of market behavior. Passive flows tend to reinforce price trends and may dampen traditional channels of price discovery. This dynamic is not necessarily destabilizing, but it does create a market environment that can appear unusually placid in one moment and disproportionately reactive in the next.



Source: Research Affiliates

Figure 11: Passive (read: valuation insensitive) fund flows now dominate active flows.

Finally, the buildup of public and private debt introduces a slow-burning constraint. Larger federal borrowing needs and increased corporate issuance - particularly among technology companies financing large-scale AI infrastructure - raise the system's sensitivity to changes in interest rates and growth expectations. These debt dynamics do not pose immediate risks but should remain in focus when assessing the durability of valuation regimes and the trajectory of long-term real rates. Increasing public debt is nothing new, but rapidly rising private debt levels injects fragility into the system.

Portfolio Implications and Final Thoughts

The market environment entering 2026 continues to reward a disciplined, valuation-conscious approach. Periods like the one we experienced in 2025 - defined by elevated valuations, rising capital intensity in parts of the market, and an uneven macro backdrop - tend to favor investors who focus on durable cash flows, balance-sheet strength, and sensible capital allocation. These principles contributed meaningfully to our relative outperformance this year and remain central to how we are positioned today.

We expect dispersion to stay elevated as companies work to demonstrate tangible returns on substantial AI-related investment. This shift should create opportunities for active managers able to differentiate between businesses with clear, defensible pathways to earnings growth and those whose valuations rely more heavily on optimistic assumptions. Our portfolio continues to emphasize companies with stable fundamentals, prudent leverage, and proven ability to compound value through a variety of market environments.

Looking ahead, we see a constructively balanced landscape. Corporate profitability remains strong, inflation expectations are steady, and a significant fiscal impulse will reach the economy in early 2026. While risks tied to the labor market and the capital intensity of AI remain, these challenges appear manageable in light of the resilience and adaptability of U.S. companies. As market leadership broadens and investors grow more attentive to valuation, we believe our investment discipline is well aligned with the opportunities that lie ahead.

We enter 2026 with cautious optimism-confident in the strength of the U.S. corporate sector, clear-eyed about the uncertainties, and committed to the patient, fundamentals-driven process that has served us well over time.

The Rare Earth Elements Trap

By Michael McNair

Every society carries a few shared ideas that function like public heuristics. The social value of a heuristic is that it spreads widely and enables mass coordination without requiring everyone to understand the underlying logic. The risk is that simplicity invites misuse. If we do not understand what makes a principle work, we will apply it in places where it does not.

In the United States, one of the strongest of these axioms is the unwavering faith in free markets. While our commitment to market solutions has driven our greatest successes, it becomes a recipe for failure when we treat it as a universal rule rather than a principle with specific requirements. Markets only function properly when competition is undistorted, and firms face similar costs, risks, and rules. But we invoke this maxim so reflexively that we fail to recognize when foreign subsidies have destroyed these preconditions.

China's recent rare earth export [bans](#) have weaponized our lack of nuance for geopolitical leverage. Decades of state support helped China gain a stranglehold on critical supply chains. These subsidies drove down the expected returns needed to attract private investment in the West, even as we assured ourselves that the market will provide. In the face of such distortions, market fundamentalism does not deliver supply, it delivers dependency. If the U.S. wants capacity in these essential industries, we must match subsidies, but in a limited, transparent, pro-market way.

China's dominance of critical supply chains doesn't negate the merits of capitalism; it only shows the danger of relying on a heuristic that we refused to qualify.

The Rare Earth Example

In 2010, Molycorp completed an initial public offering to finance the restart of its [Mountain Pass mine](#), aiming to establish itself as the United States' only domestic rare-earth producer and challenge China's dominance in processing and refining. When China restricted exports to Japan after a [maritime dispute](#) that year, rare earth prices spiked and Molycorp's stock soared over 400%.

After using export pressure for political leverage, Beijing lifted the export restrictions and flooded the market, driving prices below what any unsubsidized Western producer could sustain. Despite being America's only player in this critical industry, Molycorp couldn't compete against state-backed rivals and went bankrupt, ensuring U.S. dependency on China.

The lesson was that China would weaponize critical supply chains when needed, then use subsidies to prevent Western competition from emerging. We spent years warning policymakers, but the response was always the same: "In America, markets decide." They couldn't grasp that subsidized competition makes market-based investment impossible.

Management at MP Materials, Molycorp's successor, explained to us that China operated "lotteries" in which firms could apply for free equipment. MP applied repeatedly. After consistent rejections, it became clear that the game was rigged and only their Chinese competitors would be allowed to win. These targeted giveaways to domestic producers constitute clear violations of World Trade Organization's [subsidy rules](#). When support isn't genuinely broad-based and open, it qualifies as a specific subsidy subject to countervailing duties. The "lottery" system was a dog-and-pony show designed specifically to skirt WTO rules by creating the appearance of openness while, in practice, systematically excluding foreign competitors. MP management insists there's no technological gap with their Chinese competitors, but that it's impossible to compete when they must buy equipment that their rivals receive for free.

The Pro-Market Remedy

The solution isn't to abandon markets but to restore their preconditions. When foreign subsidies distort returns, targeted risk-sharing can reestablish the payoffs necessary for private investment, while preserving competition, price discovery, and accountability.

Critics are right to worry about picking winners, creating uncompetitive firms, and crowding out private capital. These risks are real, which is why any intervention must be designed with market discipline at its core. This means maintaining competitive pressure throughout the process, ensuring private capital remains the primary driver, and letting public support play a catalytic rather than dominant role. The goal should be temporary intervention that corrects market distortions resulting from foreign interference, not a permanent government presence.

With those principles in mind, the recent Department of War [investment](#) in MP Materials is a textbook example of how to structure a pro-market partnership. The U.S. government took a 15% equity stake to give it real skin in the game and align the incentives of public and private investors. The DOW also committed to buy the company's full output for ten years at \$110 per kilogram, well above the current market price of \$60 that's improperly depressed by subsidized Chinese production. That floor price gives MP the revenue certainty it needs to justify capital expenditures necessary for building new facilities.

The MP deal is also a win for American taxpayers. If the company's profits exceed \$140 million, the government receives the first \$30 million of additional profit, then receives half of anything above \$170 million. In other words, taxpayers benefit twice. They gain a secure supply of a critical input, and then share in the profits if the project outperforms expectations. These government commitments unlocked \$1 billion in private loans from J.P. Morgan and Goldman Sachs, proving that public financing can catalyze significant private investment when structured properly. Since the announcement, MP's stock price has surged 135%, and the government's stake has already appreciated by \$700 million.

Industrial policy can therefore restore market incentives when foreign subsidies have destroyed them. The private sector leads, public support catalyzes, and both sides have aligned incentives to succeed. No permanent government presence, no endless

subsidies, just support until domestic scale, know-how, and supply chains are built and the firm can compete on its own on a level playing field.

Tariffs may also serve as part of the industrial policy toolkit, but they are insufficient on their own. Tariffs can reallocate production to the U.S. by raising the cost of imports, but only if domestic capacity already exists. In industries where production is non-existent—like rare earth refining—there is no domestic supply to shift to.

Moreover, firms making decades-long capital investments can't rely on tariffs that might disappear with the next election cycle. That's why matching subsidies are essential. Equity stakes, guaranteed offtakes, and risk-sharing provide the certainty needed to trigger investment and build capacity that trade tools can then protect.

America's Own Playbook

Critics calling the Trump Administration's recent strategic investments "un-American" ignore 230 years of precedent. Since Alexander Hamilton's 1791 *Report on Manufactures* argued for supporting infant industries, the United States has consistently paired public capital with private enterprise when markets couldn't deliver strategic capacity.

There has been a consistent pattern: identify critical supply chains, inject public support where private returns are insufficient, then return control to markets once expertise and capacity exist. The transcontinental railroad emerged from massive federal land grants. During World War II, the Defense Plant Corp. built thousands of factories, leased them to private firms, and then sold them back after the war. When Japan threatened our semiconductor industry in the 1980s, Sematech used funding and guaranteed demand from the U.S. government to restore American competitiveness.

The recent Trump Administration investments—including its partnership with MP Materials—follow this exact template. When China controls 90% of the rare earth refining needed for defense systems, leaving it to "pure" market forces guarantees continued dependency.

Restoring Competition

China's rare earth export licensing regime proves what we've long warned: when rivals subsidize critical industries, "letting the market decide" means letting Beijing decide.

The solution isn't to abandon markets but to level the playing field so private enterprise can compete and build capacity. Today's supply chain crisis demands limited, transparent risk-sharing that enables competitive domestic firms to match state-backed rivals.

If we refuse to subsidize these industries, we'll remain dependent on geopolitical adversaries for materials essential to economic and military security. Our trillion-dollar defense budget will be rendered worthless if China controls the components needed to sustain operations. The real question isn't whether to intervene, but how to do so while preserving market discipline. Our history provides the blueprint; we need only the wisdom to use it.