Third Quarter | 2025

How Much More Fun Can We Have?

TK Viewpoint

We abstained from including numbers in our last newsletter due to the considerable uncertainty and confusion around policy, tariffs, and taxes. Clarity is building and affords more confidence in projecting estimates for the rest of the year and 2026.

The projections for earnings and GDP growth for 2025 and 2026 are very constructive. Based on YTD numbers and estimates for the 4th quarter, we expect GDP to grow ~2% this year and ~2.4% next year. We are estimating ~$275 in S&P 500 earnings per share in 2025 and ~$300 for 2026. This assumes an ~9% growth in earnings year over year. S&P500 is up ~13% YTD at the end of the 3rd quarter with a 24x multiple on 2025 earnings and 22x multiple on 2026 earnings. As Jerome Powell, head of the Federal Reserve said, “fairly highly valued.”

There can be no doubt that it has been and continues to be, all about AI and the top 10 companies in the world driving growth in capital expenditures, revenue, and implementation of Artificial Intelligence. The fervor around AI is reminiscent of the 90s when it was all about the internet and building out the “The Web.” However, the quality and conviction of earnings is high, especially relative to the early days of the internet when few of the companies were profitable.

We are on the cusp of a three-peat: 3 consecutive years of double-digit gains for the S&P500. We saw this previously in 2019, 2020, and 2021. You may remember 2022 was horrible! Can we hope for a 4th year…in 2026? The last time that happened was 1998…the late 90s. It is appropriate to point out that in 100 years of market history, investors experienced 74 years of gains and 26 years of losses to achieve an average double-digit gain.

The breadth of participation of the full market is low. That is not entirely bad news as it relates to the valuation of the rest of the 490 companies in the S&P500. If we focus on those other 490 companies or apply an equal weighting to all 500, the market is trading closer to ~18x earnings and a more sustainable historical average.

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It should not be lost on anyone the comparisons we are making. The risks we see are anecdotal; Nvidia investing in Intel and Open AI (competitors and customers). This is reminiscent of vendor financing from the 90s. Alternative asset managers, who have historically only been available to “accredited investors,” endowments, and sovereign wealth funds are courting retail investors and 401k plans for investment opportunities in “Alternative Private Investments.”

The two major wars between Ukraine and Russia and Israel and Hamas, both tragically rage on. Both conflicts have economic impacts on trade and oil in particular. The domestic political battles also have an economic impact. How long will a government shut down last? Will the Supreme Court rule the tariff strategy as legal and how does that impact our fiscal deficit?

We are not all paranoid and cynical. There are fundamental reasons to be optimistic. The Federal Reserve has begun a campaign to lower interest rates which is stimulating to the economy and, in particular, small and emerging companies. Inflation has been under ~3%. While stubbornly above the preferred ~2% rate, it appears to be stuck rather than rising. Employment data has softened of late, but the unemployment rate is low by most standards. Perhaps most importantly, the 2025 OBBBA solidifies corporate tax benefits for tax rates, depreciation and amortization which should increase earnings and profit margins.

Like the Fed, we too have a dual mandate; provide bespoke financial advice and manage your money for growth and income or a defensive posture, when needed. We take that responsibility VERY seriously! We have enjoyed exceptional performance this year again and we are equally committed to both continued participation in a market that provides opportunity and a capital preservation stance WHEN needed.

Thank you for your enduring trust and confidence in our process! We remain at your service and grateful for the privilege!

Yours,

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