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# Stepping Up to the Plate: A Quarter to Remember

QUARTERLY NEWSLETTER

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# Stepping Up to the Plate:

## A Quarter to Remember



By Mike Harris, Chief Investment Officer

Last newsletter, we described the backdrop as a “Goldilocks window with a touch of fragility.” Growth was holding, inflation was sticky but manageable, the Dollar was weak, and volatility was drifting lower. Earnings were accelerating, and we had visibility into potential rate cuts ahead. We suggested it was a good backdrop to be in—so long as the fragile balance wasn’t disturbed.





That proved to be the right frame. Q3 played out accordingly: US GDP growth accelerated to 3%+, earnings beat expectations at +11%, the Dollar stayed soft, and volatility fell back to multi-year lows, pushing markets higher.

So, where does that leave us heading into Q4?

We may be entering a rare “broadening” phase layered on top of the Goldilocks setup already in place. Growth isn’t surging, but it is steadily strengthening.

The consumer remains stubbornly resilient. Headline Retail Sales accelerated to +5.0% year-over-year last month. Income growth, credit expansion, and lower savings have kept spending intact. Add in serial equity market all-time highs, positive earnings revisions, tight credit spreads, and a powerful CapEx cycle — and you get reinforcing momentum that continues to fuel expansion.

None of these dynamics point to imminent recession. Rather, they argue for a continuation of a Goldilocks backdrop as we enter the 4th quarter.

## Earnings Growth

Earnings once again came in stronger than expected last quarter, up +12%. If Q4 estimates hold, it will mark the 9th consecutive quarter of earnings growth.

Revenues also reaccelerated, rising +6.3% vs. +4.8% expected, underscoring the improving rate of change.

Breadth continues to expand: 8 of 11 sectors reported earnings growth, and 10 of 11 showed positive revenue growth. Looking ahead, analysts have raised 2026 estimates and now expect +13% earnings growth.

Fun Fact: Fortune 500 companies are operating at the highest profit margins ever recorded: 13%. For context: margins were ~10% a decade ago and ~8% two decades ago.

## Consumer Resilience

Income growth is accelerating, credit expansion is active, and record-high asset prices are feeding directly into consumption. Remember: the top 10% of households account for roughly 50% of all spending. The top slant of the K-shaped economy keeps powering higher, while the bottom slant stagnates.

Retail sales continue to post +5% year-over-year growth. Remember consumption is a function of what we make (income) + what we have (savings) + what we borrow (credit). Incomes are rising, Americans have a surplus of savings and credit is becoming looser.

There are stress points. Subprime auto lending has deteriorated, with lower-income households facing high borrowing costs (credit cards, auto loans). These loans are a small slice of the overall credit system, so the risk is contained, but it’s a red flag for that segment, and more verification of the bifurcation of the haves and have-nots continues to widen.

Contrast that with middle and upper-income households: wages are rising, mortgage rates have eased (30-year from 7.25% → 6.25%), and the average homeowner has \$190K+ in tappable equity. Cash-out refis and HELOCs are ticking up, adding incremental firepower. While not necessarily prudent, it does support spending.

The spread between credit card rates and HELOCs is now ~14 percentage points, making debt consolidation appealing. Younger borrowers tapping home equity leads to balance sheet repair and future consumption support.

If the labor market continues to soften without breaking — and it remains historically firm — there’s little sign of systemic consumer stress. On the contrary, spending looks poised to continue, and may even strengthen further.

## Valuations

Valuations remain elevated (90th+ percentile historically), but are currently supported by accelerating earnings and record profitability. Earnings estimates have been revised higher, and fundamentals for the top 10 S&P names remain meaningfully stronger than the other 490. Concentration is high, but not without justification.

The expectation is that strength will broaden out over the next few quarters. Expensive valuations typically matter when growth slows — but with growth accelerating, elevated multiples are likely to persist.

## Volatility Backdrop, Sentiment and the Flows

After spiking to 60 in April (feels like a long time ago), the VIX volatility index has collapsed back into the teens. Realized volatility has compressed as well, with daily market moves averaging closer to 0.5% — historically a very low level.

This decline has been self-reinforcing: volatility-sensitive funds are adding long exposure, and risk-on flows have accelerated. Both remain supportive of equities. Interestingly, many large commercial traders are still net short — positioning that could turn into additional fuel if markets keep grinding higher.

One might expect sentiment to be exuberant after such a strong quarter. It's not. The AAII Bull/Bear survey sits well below 2024 levels, far from the extremes seen at prior market peaks. That disconnect is worth paying attention to.

## Global Landscape: Growth Continues

While US narratives fixate on tariffs and the Fed, the global economy continues to quietly expand.



- **Europe:** steady but unspectacular growth, but growth nonetheless.
- **Emerging Markets:** Brazil remains firm, China is showing stabilization. Mexico, Argentina, India as examples adding firm growth to the ledger.
- **Dollar weakness (-10% YTD):** continues to ease financial conditions abroad, fueling emerging market performance.

Parts of Asia are capitalizing on AI-driven semiconductor demand; While Emerging market resource-rich nations benefit from commodity flows. Momentum isn't euphoric, but it too has been broadening—and that helps the Global growth backdrop.

## Policy, Politics & Powell

The Fed enters Q4 in a familiar bind: inflation remains stubbornly sticky at 2.8-2.9% and likely to inch back towards 3%. So, nowhere near the Fed's 2% target mandate, in fact, they don't even model that happening for another 2 years. Are they going to up the inflation mandate down the road? Maybe up to 3%? That is a question for another time, but relevant if one is paying attention. Inflation has not been extinguished and the Fed is easing.

The labor market is softening but not breaking. This creates the room for rate cuts and why the Fed did a 25 bps cut in September. But there is not the urgency for aggressive easing either. Current expectations: two cuts are being priced in for the remainder of this year and 2.5 more in 2026. That would get the Fed Funds Rate all the way down to 3-3.25% by year-end 2026.

- **Housing remains key.** Lower mortgage rates could reignite activity, providing an incremental growth tailwind. We are seeing a touch of this thus far.
- **Fiscal firehose continues.** "Nothing stops this train" remains the implicit doctrine, with deficits piling up but growth supported. The current administration has outright stated they want to run this economy hot, and this is precisely what's happening. How long can we outrun the debt. More of a rhetorical question, but we certainly are for now.

The Federal Reserve is set to continue to cut rates into an economic expansion, which has historically been quite Bullish. Will this time be any different? We don't think so.



## Thematic Leadership

**From Narrow to Broad:** After three years of narrow leadership, breadth is beginning to improve. We are looking at more Cyclical parts of the market. Think Consumer Discretionary, Industrials, Financials, Technology, Communication Services etc. On the Factor front think Small Caps, think momentum, think Cyclical growth.

**Secular Tech Still Strong:** AI buildout and capital expenditures in compute, chips, and infrastructure remain exceptionally strong — and are broadening their reach well beyond tech. This wave of investment demands everything from infrastructure and industrials to subcomponents, energy, grid, telecom, water, and raw materials. Each is benefiting from one of the largest CapEx cycles in decades. Recent earnings underscore the momentum: CapEx growth is running at an extraordinary pace, with clear signs it still has room to continue.

**Commodities & Currencies:** Ongoing weakness and devaluation of the US Dollar continues to reverberate. Gold has surged more than 45% year-to-date, while cryptocurrencies have benefited from the stronger Bitcoin/USD cross and broader digital asset momentum. With money

supply elevated and Treasury debt issuance climbing, there's little to suggest these trends are nearing an end in the near term.

## Transition Into Q4

We are entering another favorable macro backdrop: Here's our quick Bullish points in rapid fire:

Weakening labor data, yes but not recessionary, remains supportive → lower yields. Fed Easing. Low oil prices. Record profit margins. Tight credit spreads, IPO market opening → liquidity plentiful. Improving Earnings estimates & breadth. Firm soft economic data. Government deficits continue → spending aid continues on. Corporate & household credit growth accelerating.

This is not the classic post-recession rebound. We haven't had that reset. Instead, it's a broadening of ongoing expansion. After years of narrow leadership, that broadening may be the story of late 2025 into 2026.

The Fed is cutting rates into an expansion, and history shows that's not a negative precedent. Quite the opposite. More inflation risk may come with it, but that's a challenge for future quarters.

Risks remain: valuations are full, policy missteps are possible, and volatility is always one geopolitical shock away. But the growth opportunity set is widening and that makes any single shock harder to derail the trend.

## Bringing it Home – It is Playoff Baseball Afterall

The past quarter validated our prior view: Goldilocks with fragility. Q4 adds a new wrinkle — breadth and broadening, easing some of that fragility. If macro data stabilizes and accelerates, earnings widen, and the Fed stays supportive, this could be one of the healthiest backdrops in some time.

Nothing is guaranteed. But history shows that in Goldilocks regimes like this, equities tend to perform well. We have been active, taking swings and moving metaphoric players around the bases to participate and will continue to do so. Our eyes are open as always, grounded in analysis and process, we remain Bullishly optimistic. If the facts change, so will we.

Until then, batter up.

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