

October 2025

MARKET COMMENTARY

Prepared by Theresa Gusman



**The Little Engine
That Could - or
Runaway Train?**

Overview



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October, 2025

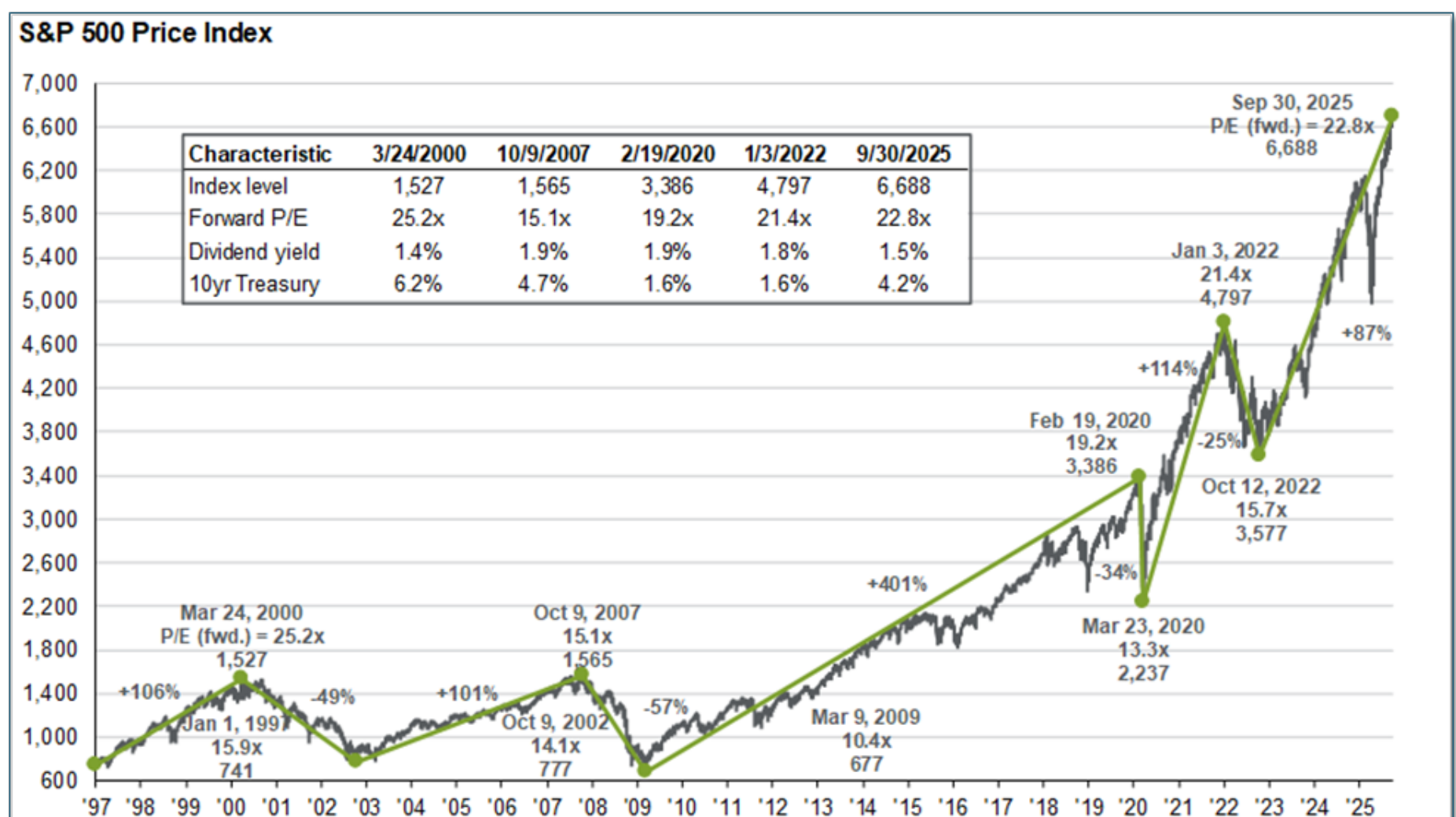
Led by an 11.4% surge in the NASDAQ, global equity markets (as measured by the MSCI ACWI index) advanced 7.7% in the third quarter, bringing the year-to-date gain to 18.9%. As global equity markets moved higher, the “Magnificent Seven” outperformed the other 493 S&P 500 stocks in the S&P 500, growth outperformed Value, Mega Cap outperformed SMID, and the US outperformed the Rest of the World. The S&P 500 is now at an all-time high having advanced 199% from its COVID low and 87% from the 2022 bottom.

The US economy, and (especially) corporate earnings remain resilient, and inflation and unemployment (both marginally higher) are in check. Renewed uncertainty surrounding tariffs, the growing specter of a prolonged government shutdown and emerging credit worries - all of which could constrain economic activity might dampen market sentiment in the near term.

However, the Artificial Intelligence (AI) boom - and its “real world” benefits - continue to power ahead full force suggesting the market will continue the chug ahead, rather than hurtling off a cliff.

Many investors sold out of equity positions in early April, reacting to initial tariff announcements with fear, reentered in the second quarter amid fear of missing out (FOMO), and are now sitting on significant gains. Recent market whiplash underscores the importance of maintaining perspective and avoiding emotional investment decisions. Staying invested in a well-diversified, professionally managed portfolio - particularly through turbulent periods - remains the most reliable way to achieve long-term goals. It is all about time in the market, not market timing.

Figure 1. S&P 500 at Inflection Points - Bull and Bear Markets, 1996 to Date



Source: J.P. Morgan Asset Management Guide to the Markets – U.S. Data are as of September 30, 2025

Investor Concerns and Market Realities

Investors - including us - are conflicted. The economy looks healthy, yet valuations are stretched and headlines about the resurgence of the trade war with China, the government shutdown, and the possible credit risk, along with commentaries about the AI boom turning to bust dominate the news. At such moments, it's worth recalling the enduring Wall Street adage:



“The market can stay irrational longer than you can remain solvent.”

— John Maynard Keynes

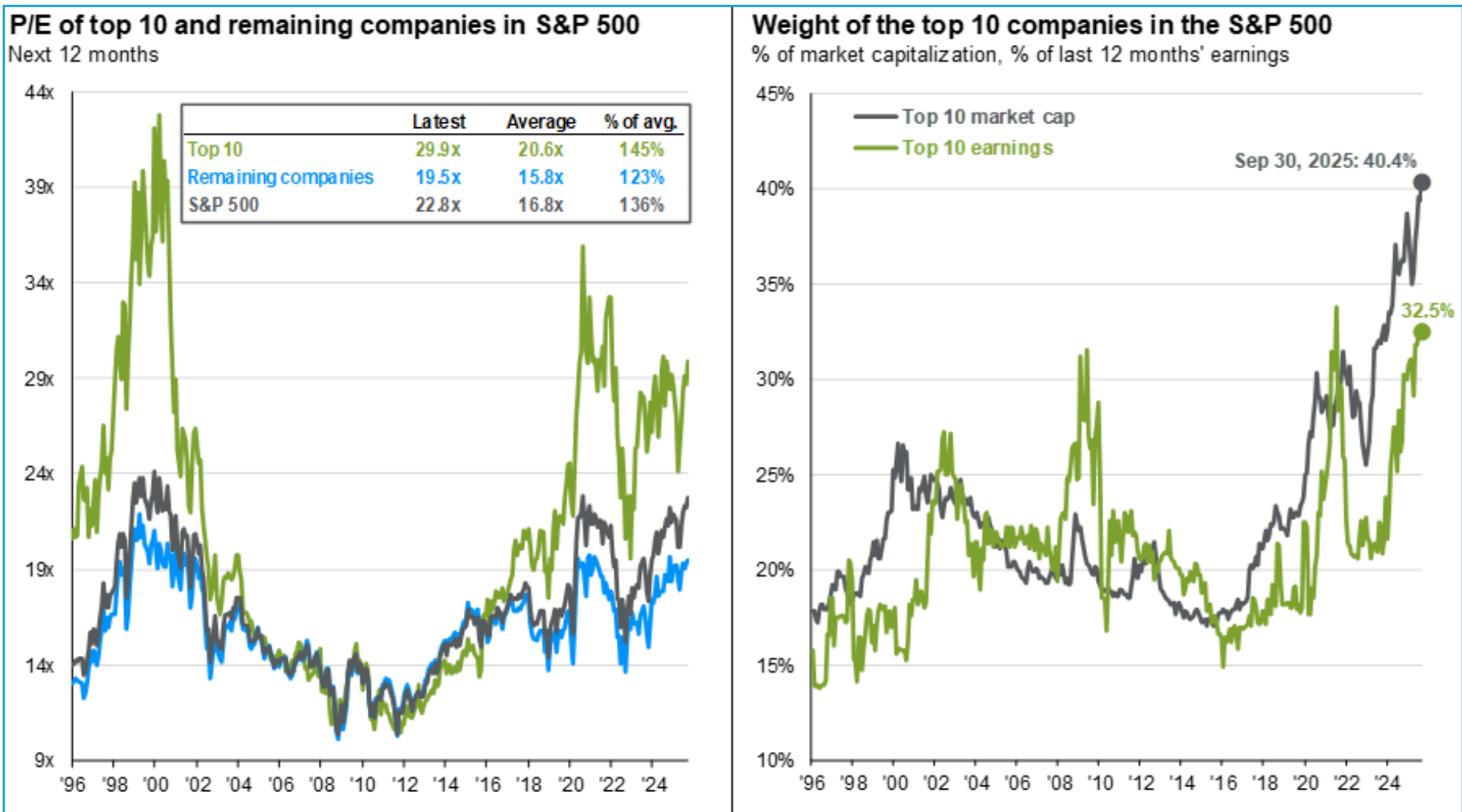


The lesson isn't to abandon discipline but to recognize that markets rarely move in lockstep with fundamentals. Liquidity, momentum, and behavioral biases can sustain valuations that defy logic far longer than most investors expect - and the immediate real-world benefits of the AI boom along with real companies, providing real services, and earning real money suggest this is not a repeat of the Dotcom bubble. Investors who attempt to time market reversals often miss the next leg higher; those who remain diversified and patient often prevail.

The trends that emerged following the April 3rd tariff tantrum prevailed in the third quarter.

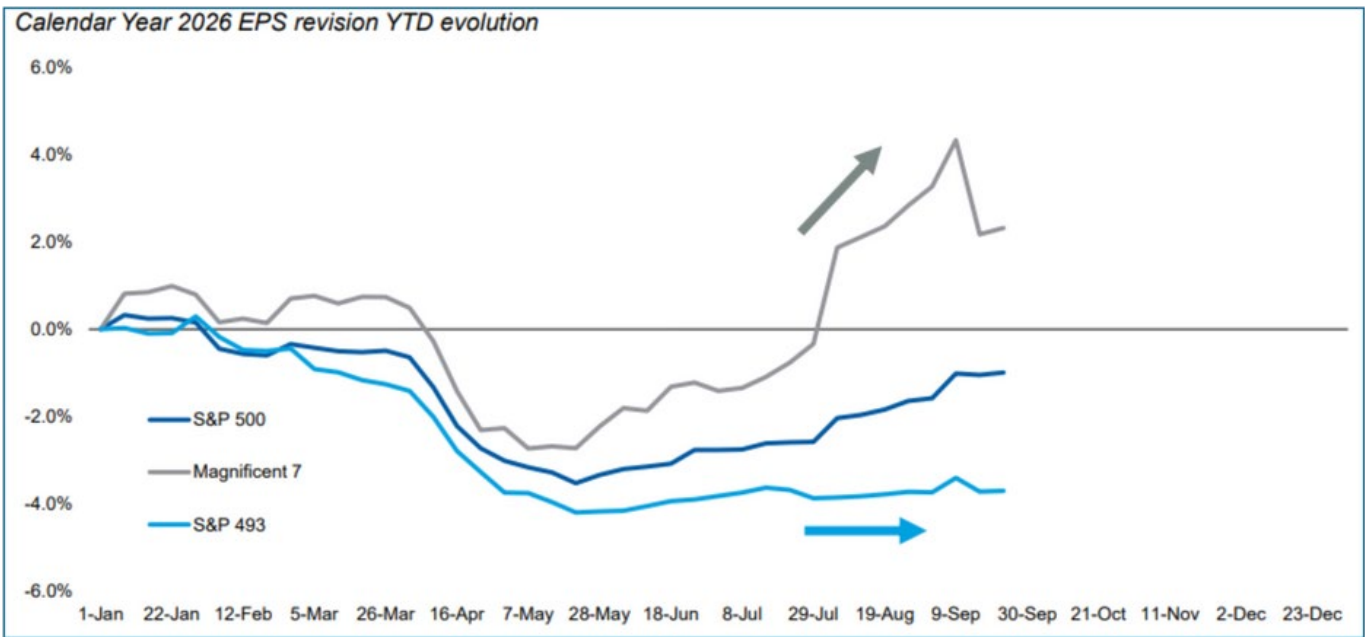
- **Equity markets became more concentrated.** Eight of the 10 largest companies in the S&P 500 are direct AI beneficiaries. As of September 30th, these companies comprised as all-time high 40.4% of the S&P 500 and 32.5% of earnings (see Figure 2). Their P/Es are significantly higher than the other 400 S&P 500 constituents, which is justified. Since May 2025, Magnificent Seven were the primary driver of positive earnings revisions, while revisions for the other 493 companies are stalling (see Figure 3). In fact, according to Eaton Vance, earnings expectations for the S&P 493 (ex Mag 7) have not recovered from April's downgrades.

Figure 2. S&P 500: Index Concentration (Data as of Sept. 30, 2025)



Source: J.P. Morgan Asset Management Guide to the Markets - FactSet, Standard & Poor's J.P. Morgan Asset Management, Data as of September 30, 2025

Figure 3. The Mag-Seven Continues To Drive Positive Revisions in US, Data as of Sept. 22, 2025

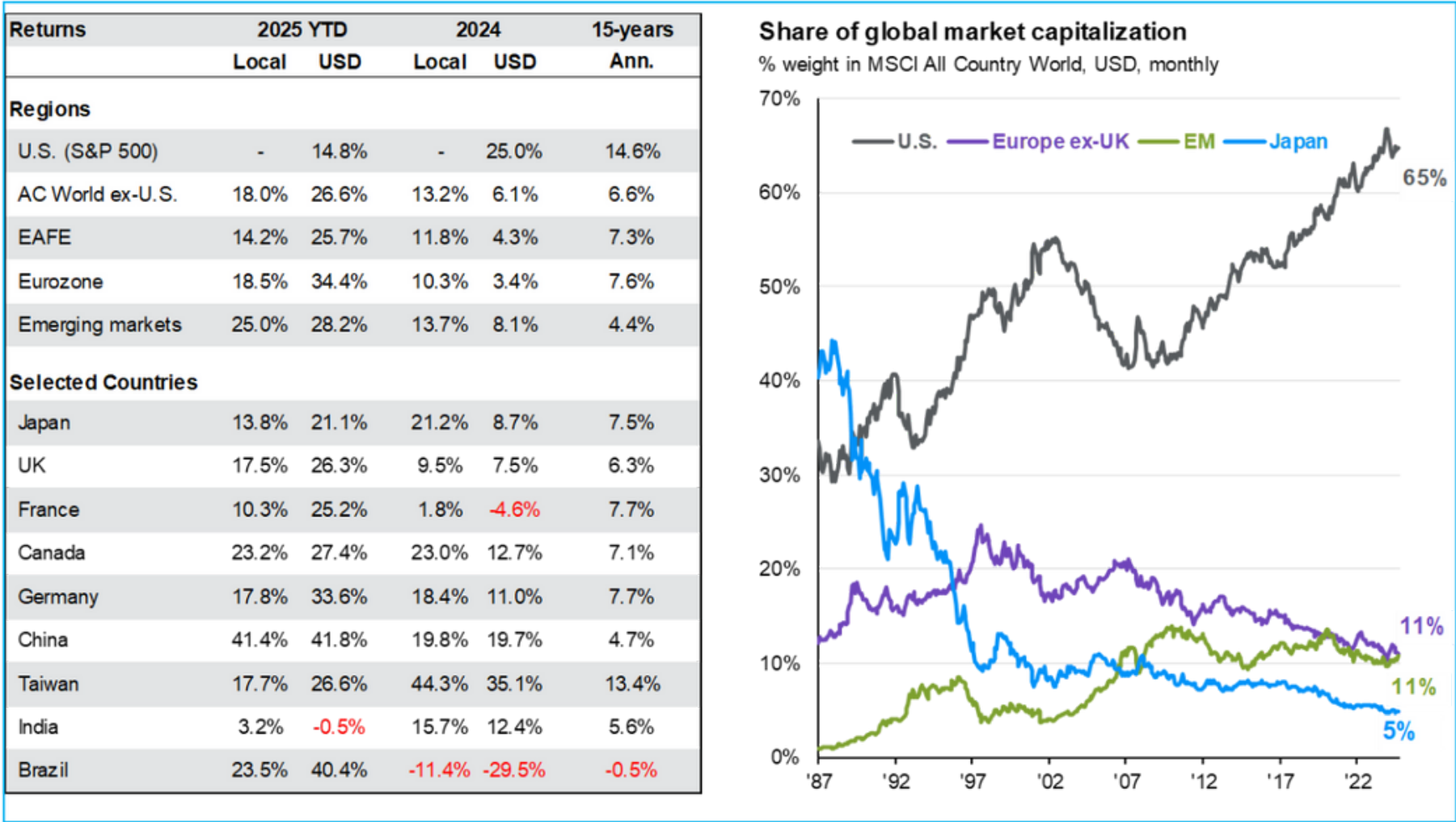


Source: Eaton Vance The Beat - Bloomberg, MSIM. As of September 22, 2025

- **The US outperformed the Rest of the World.** Following extraordinary first quarter outperformance and more modest outperformance in the second quarter, international equities underperformed the US in the third quarter. As shown in

Figure 4, nearly three-quarters of the 12-percentage point outperformance of international markets (ACWI, ex US) relative to the S&P 500 can be attributed to US dollar weakness. Although the NASDAQ was the top performing index in the third quarter, rising 11.4%, and it is now up 17.96% year-to-date, it continues to underperform major international markets. China (+41.8%) is the top performing market year to date, followed by Germany (+33.6%). Given US technology dominance and the current Administration’s focus on inward capital investment, deregulation, and lower taxes, we believe the US could continue its winning ways among global equity markets over the next several quarters.

Figure 4. Global Equity Markets Performance, As of Sept. 30, 2025



Source: J.P. Morgan Asset Management Guide to the Markets - U.S. Data are as of July 18, 2025

- **Small cap and growth outperformed.** Growth stocks outperformed across the large-, mid-, and small-cap all other categories in the third quarter (see Figure 5).

Figure 5. US Equity Style Box Performance, Sept. 30, 2025

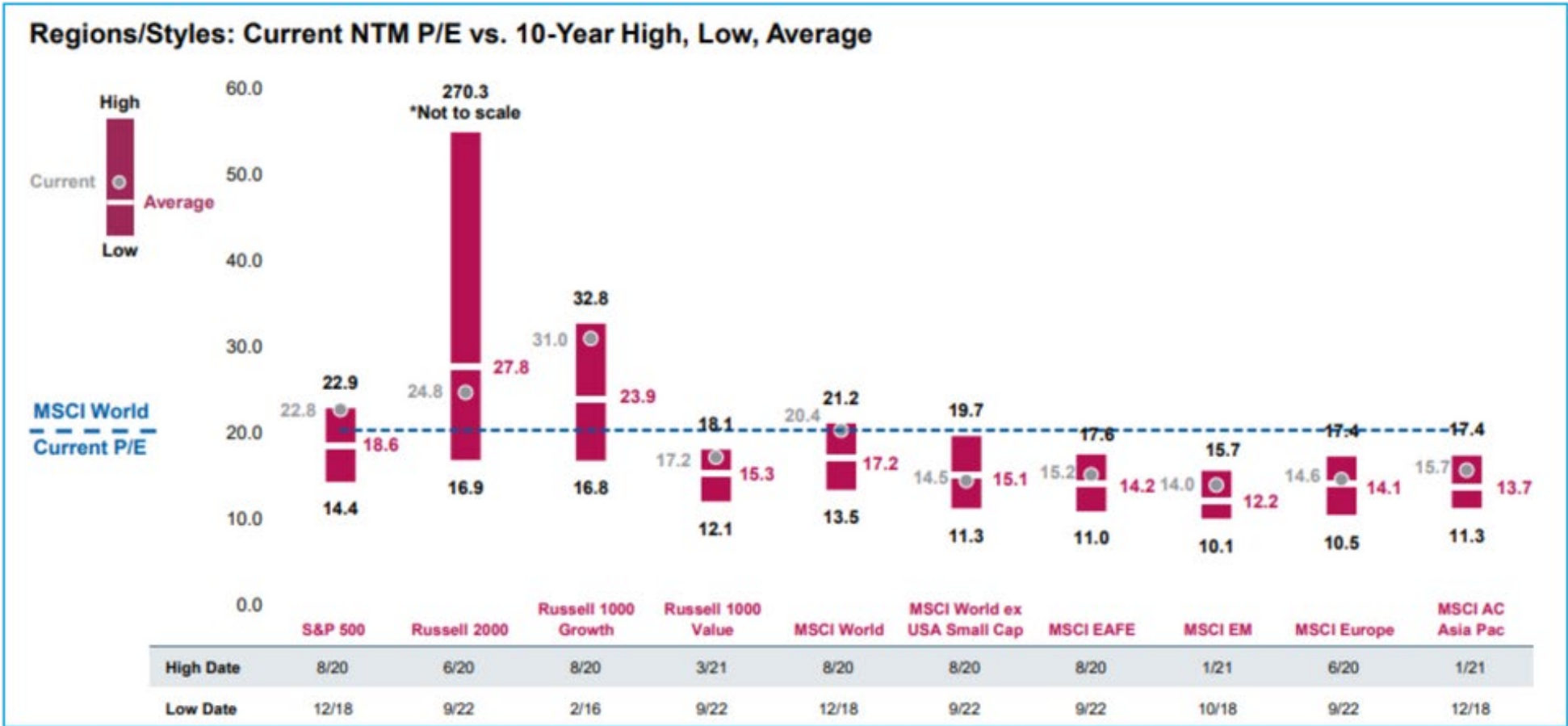


Source: Morningstar -- Data are as of September 30, 2025

Growth, Valuations, and the Balance Between Optimism and Risk

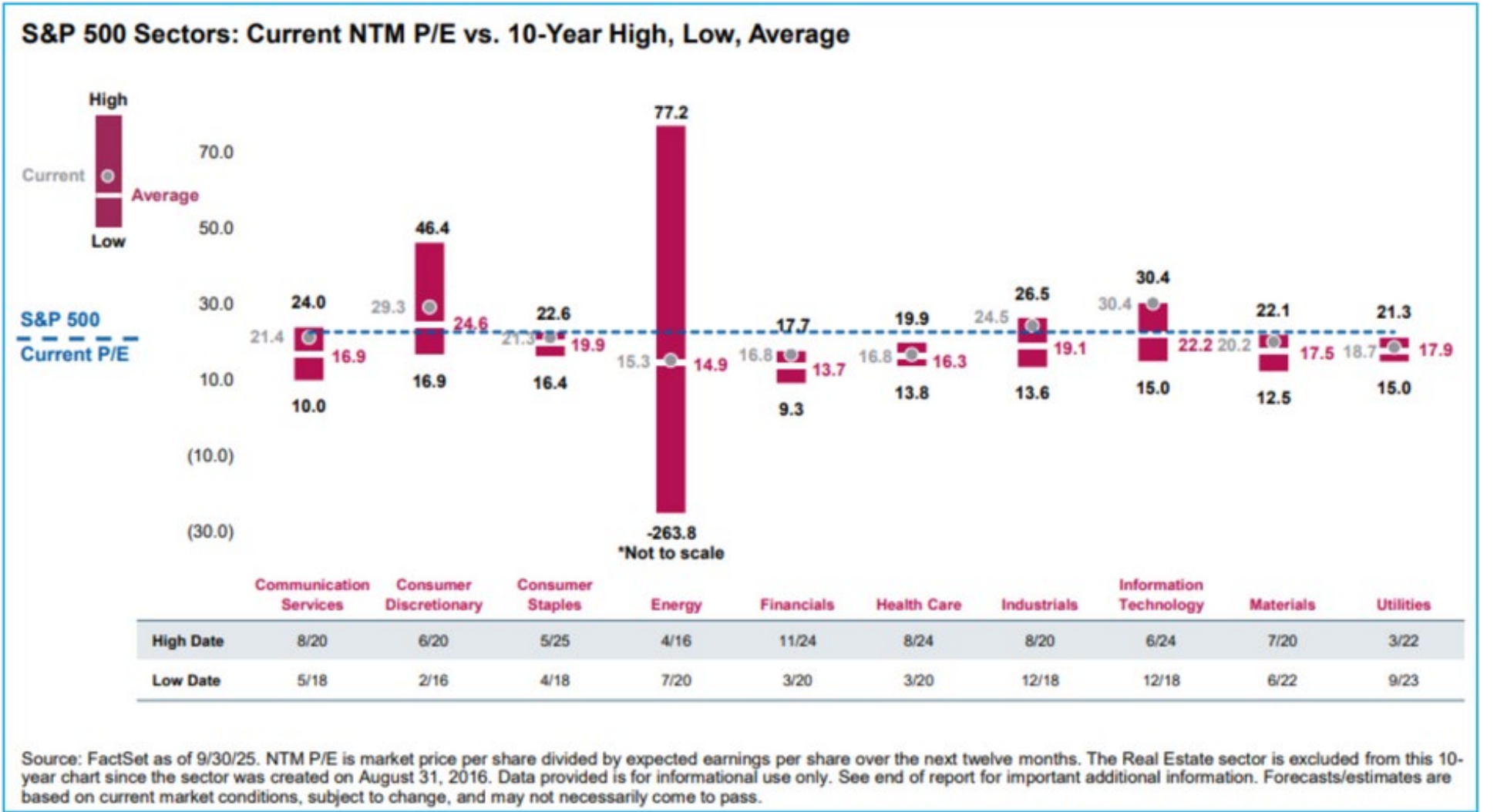
Underpinned by large cap growth valuations, the forward P/E of the S&P 500 is near the top of its 10-year range (see Figure 6). Superior and accelerating earnings growth continue to support 10-year high technology valuations (see Figure 7), corporate balance sheets generally are strong, margins are robust (and expanding), and global liquidity is ample. Small cap and international equities remain more attractively valued – but this may be justified by their inferior growth rates.

Figure 6. Valuation Analysis - Regions/Styles: Current NTM P/E v 10-year High, Low, Average, Sept. 30, 2025



Source: Eaton Vance, The Beat October 2025

Figure 7. Valuation Analysis - S&P 500 Sectors: Current NTM P/E v 10-year High, Low, Average, Sept. 30, 2025



Source: Eaton Vance, The Beat October 2025

To put the growth differential in perspective, Figures 6 and 7 show the expected growth rate of the Magnificent 7 and the Other 493 companies in the S&P 500. According to FactSet, overall, the blended earnings growth rate for the S&P 500 in the third quarter is 8.5%. The “Magnificent 7” companies are expected to report year-over-year earnings growth of 14.9% in the third quarter. Excluding these seven companies, the blended earnings growth rate for the remaining 493 companies in the S&P 500 would be – a still strong but far less spectacular – 6.7% in the third quarter.

Figure 8. Valuation Analysis - S&P 500 Sectors: Current NTM P/E v 10-year High, Low, Average, Sept. 30, 2025

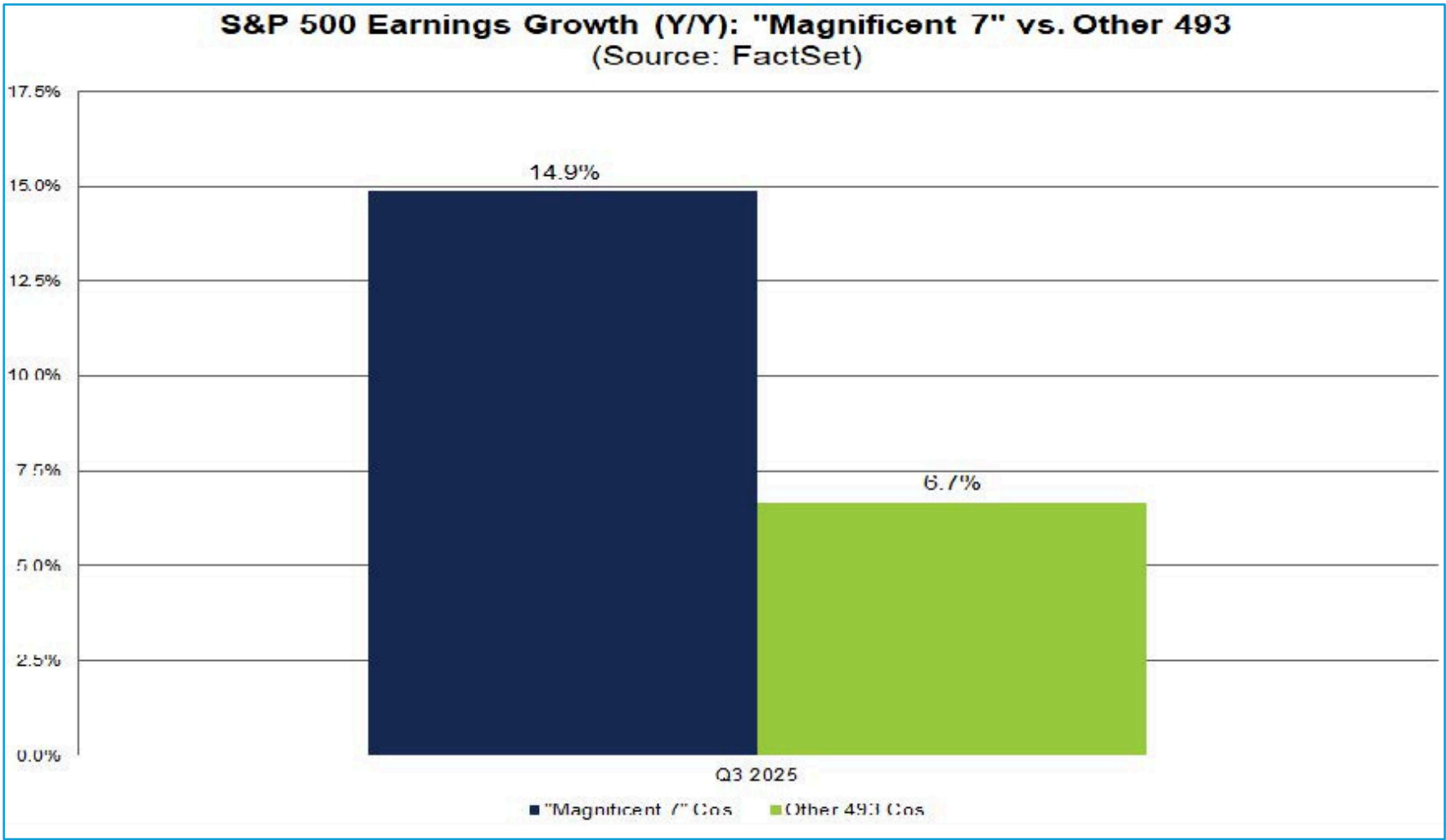
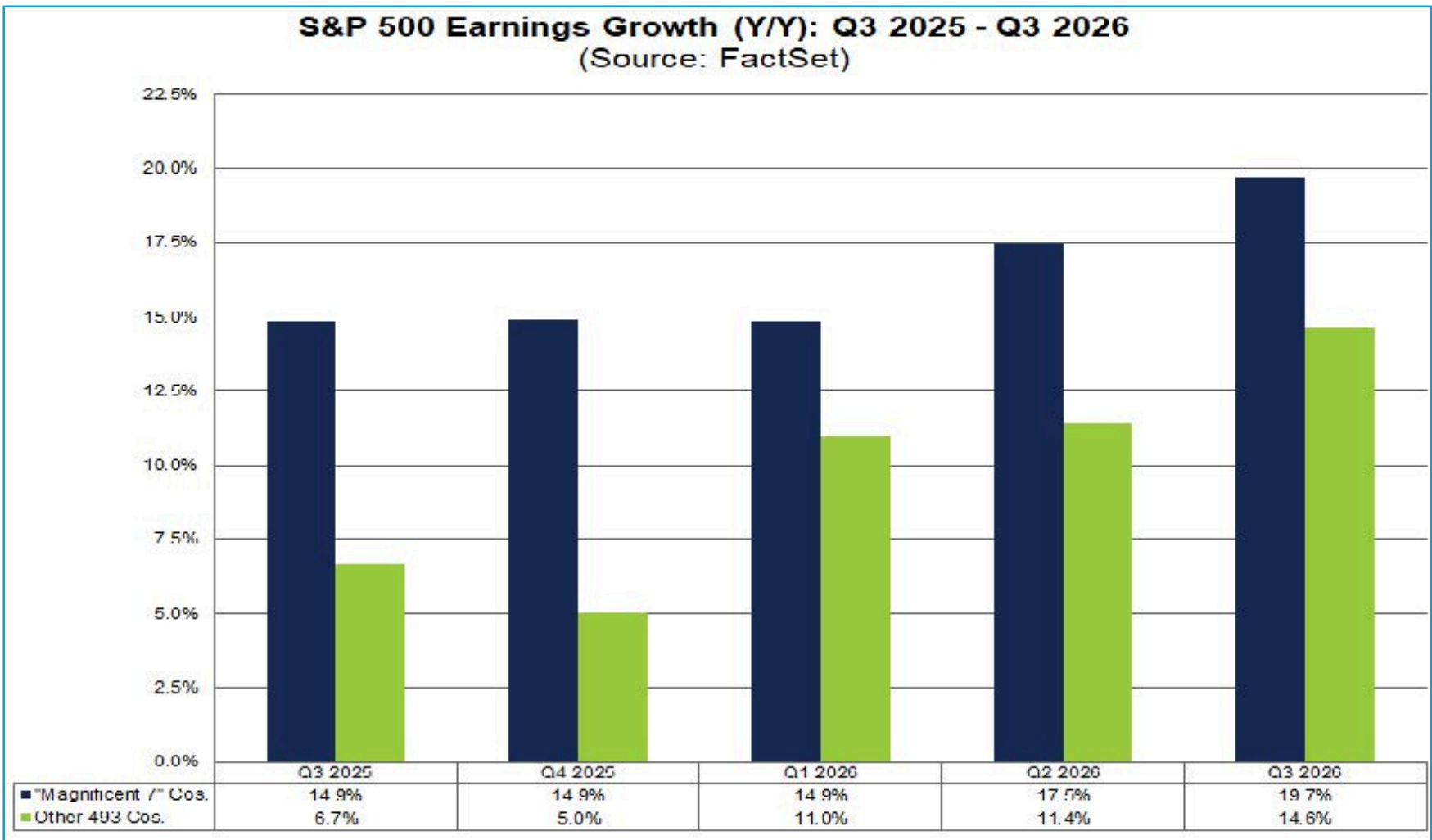


Figure 9. Valuation Analysis - S&P 500 Sectors: Current NTM P/E v 10-year High, Low, Average, Sept. 30, 2025



The US government shutdown – now entering its fourth week – and renewed trade tensions with China increase near term uncertainty but pose limited long-term risk to the equity market. Historically, each week of shutdown trims quarterly GDP by roughly 0.1 percentage point, with lost activity typically recovered once operations resume. And we’ve all learned that reacting to every trade pronouncement from Washington and its international counterparts is an exercise in futility. In the end, the shutdown will end, trade deals will be worked out to the benefit of both parties, markets will calm, and inflation and unemployment should remain in check. This brings us to the question we are asked more than any other: Will the AI boom turn to bust?

The AI Boom v the Dot-Com Bubble: Excesses, and Evidence

The AI boom – and its “real world” benefits -- continue to power ahead full force suggesting the market will continue to move higher – albeit at a slower pace given current valuations – rather than collapsing under the weight of AI. The immediate real-world benefits of the AI boom along with *real* companies, providing *real* services, and earning *real* money suggest this is not a repeat of the dot-com bubble.

The AI boom correctly draws comparisons to the dot-com mania of the late 1990s. Both are periods when technological promise, liquidity, and leverage drove valuations higher. Both cycles were born of the belief that new technology would transform every industry. In 1999, the internet promised friction-free commerce; today, AI promises friction-free cognition. Massive capital spending echoes the telecom build-out of the late 1990s. According to Morgan Stanley, AI infrastructure investment could reach \$2 trillion by 2028, with \$1.5 trillion financed through debt – rivaling the borrowing spree that fueled the fiber-optic glut 25 years ago. Then as now, market exuberance finds creative valuation metrics: “eyeballs” in 1999; “tokens trained,” “parameters processed,” and “compute scale” today. Both eras share a conviction that market share now will translate into profits later and circular financing – where suppliers invest in their customers to fuel purchases – has again become commonplace. Nvidia, Microsoft, AMD, and Oracle are simultaneously investors, suppliers, and creditors to the same AI startups that buy their chips or cloud capacity.

Unlike 1999’s unprofitable startups, today’s AI infrastructure is backed by highly profitable, cash-rich tech giants (see Figure 10). In fact, as shown in Figure 11, a low 19% of tech companies are currently unprofitable, compared with 36% at the peak of the dotcom bubble in the first quarter of 2000. Finally, tech valuations relative to the MSCI ACWI index are significantly below their 1999-2000 peak (see Figure 12). This suggests that – even if the AI boom ultimately turns to bust, it may have further (possibly significantly further) to run.

Figure 10. Net Debt as a Percentage of Market Cap, August 27, 2025

Sector	Net debt % market cap
Information Technology	1%
Health Care	13%
Industrials	15%
Communication Services	16%
Consumer Discretionary	17%
Materials	18%
Consumer Staples	18%
Energy	24%
Real Estate	43%
Financials	47%
Utilities	69%

Source: UBS, as at 27 August 2025. Data is for MSCI World Sector Indices excluding the Financials sector. 'Net debt as % of market cap' is a measure of the net debt on a company's balance sheet as a percentage of its total market capitalisation. **Past performance does not predict future returns.**

Figure 11. Tech Company Profitability, 1Q 1996 - 3Q 2025

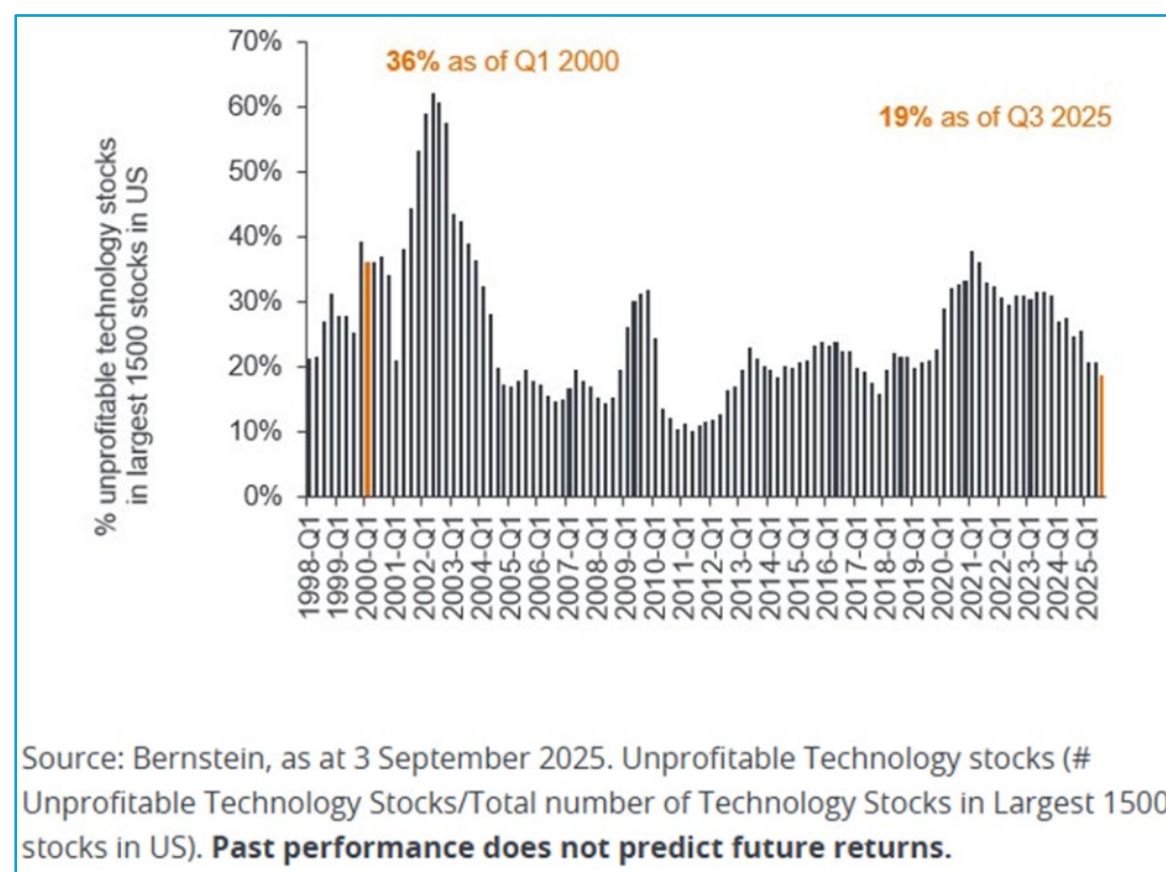
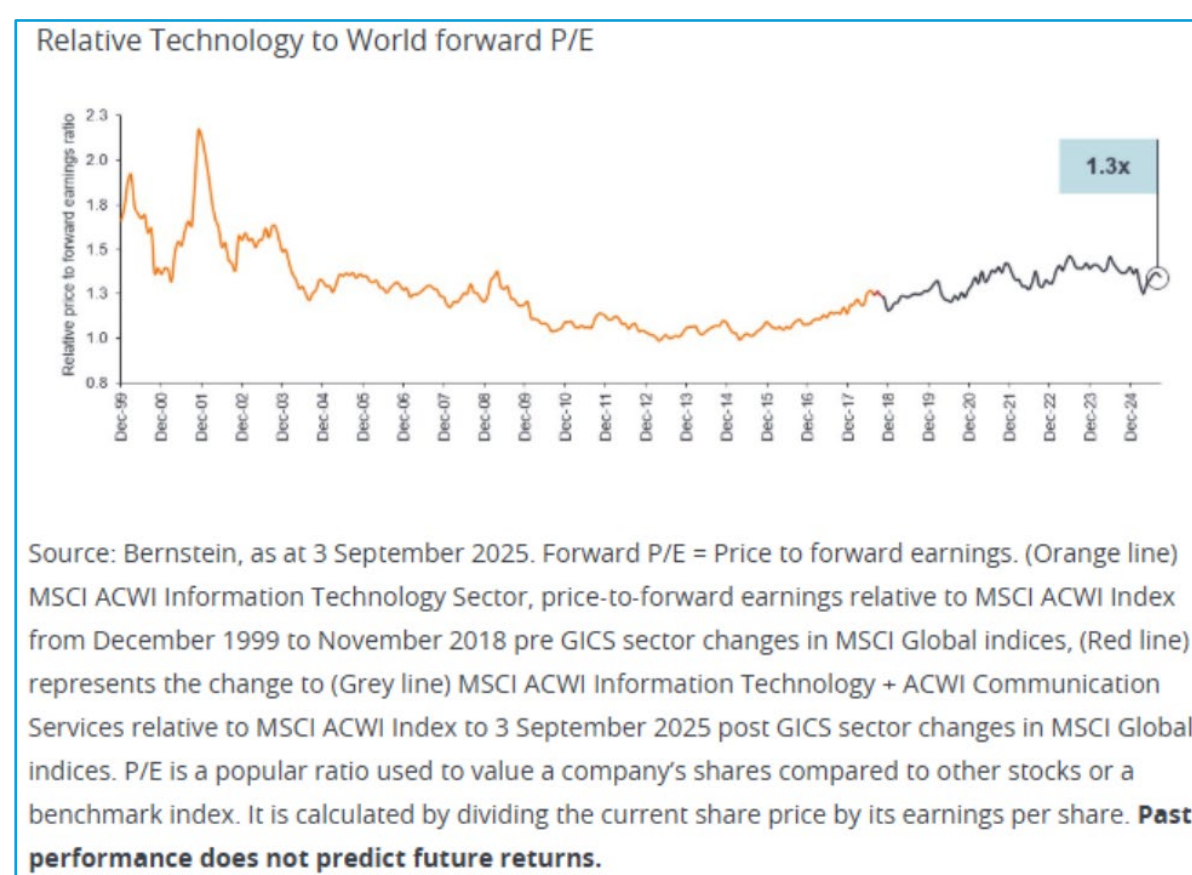


Figure 12. Tech Company P/E Relative to the MSCI ACWI, As of Sept. 3, 2025



In addition to considering the echoes of the dotcom era, the excesses reflected in novel valuation metrics and circular financing, and evidence that the AI boom may have additional upside, AI differs from dotcom in the tangible impact it is having across the economy. AI has been a huge game changer for many of us personally, and some of the productivity statistics and antidotes we have gathered from industries ranging from financial services to pharmaceuticals to energy and defense are truly eye popping. These outcomes reinforce that AI's benefits are real, quantifiable, and growing.

For example, in their recent earnings announcements, JPMorgan, Citi, and Goldman Sachs each reported significant cost savings from AI-driven automation and code generation.

- JPMorgan Chase reported that its AI-enabled coding assistant has boosted developer productivity by 10–20% and generated approximately \$1.5 billion in annual cost savings across fraud detection, payments, and operations.
- Citigroup says AI automation now frees up 100,000 developer hours each week, accelerating product delivery and compliance work.
- Goldman Sachs expects further headcount efficiencies under its “OneGS 3.0” initiative, linking workforce reductions directly to AI-driven workflow automation.

The Convergence of Purpose and Performance Among Investors and Corporations

Values-Aligned strategies were mixed in the third quarter. Renewable energy rebounded, while the performance of broader strategies was directly correlated with exposure to US mega cap companies (see Figure 13). For example, the tech-heavy MSCI KLD 400 index advanced 8.7% in the third quarter, about in line with the S&P 500, while other broad values-aligned strategies underperformed. We look for excess performance to resume as we move through the current period of Values-Aligned investing backlash.

Like the accelerating move toward personalized values alignment in investment strategies, companies are quietly reinforcing their commitment to sustainability – not because it’s fashionable but because it makes good business sense. According to Deloitte’s 2025 Global C-Suite Sustainability Report 83% of companies increased sustainability investments over the past year, and individual companies are choosing the environmental, social, and governance projects best suited for their growth, cost structure, and resource management. Of more than 2,100 C-Suite executives surveyed worldwide, 81% said sustainability initiatives improved financial performance, 69% said the initiatives generated new revenue opportunities, and 57% indicated they delivered measurable cost savings. Nearly three-quarters (74%) cited investor and client expectations as a primary reason for continued ESG investment, underscoring the need for a clear commitment to engaging companies from the advocacy and proxy voting perspectives.

In other words, purpose and performance are converging among both corporations and investors. For corporations, the best way forward is to identify the sustainability projects best aligned with their objectives. For investors, we believe the best way forward for values-focused Advisors and their clients is to emphasize education, accessibility, transparency, and personalization in in their interactions, and portfolio management, proxy voting, and corporate advocacy efforts. Our Values Aligned Direct Index Solution (VADIS) and proxy voting and advocacy efforts enable advisors to educate their clients and work with them to identify the Values Set best aligned the client’s view of the world, incorporate those Values into the client’s personal Investment Universe, and construct a portfolio and advocacy plan targeting the client’s long-term financial and impact objectives.

As we know, the market reflects the world as it is today. Values-aligned investors invest in the world as they want it to be and look to achieve long-term financial and impact goals aligned with their values. At First Affirmative, we remain convinced investors must take responsibility for the impact their money has in the world. Since 1988, we have served individuals and institutions seeking to achieve financial returns and align their portfolios with their values to meet both their financial and impact objectives. VADIS represents the future of hyper-customized portfolio management and enables clients to invest in the world as they want it to be. By combining trusted personal financial advice, leading sustainable and responsible investment expertise, and scalable technology, VADIS enables advisors to provide personalized portfolios aligned to each client's financial goals and values.

Figure 13. Selected Sustainability - Themed ETFs - Third Quarter 2025 Returns

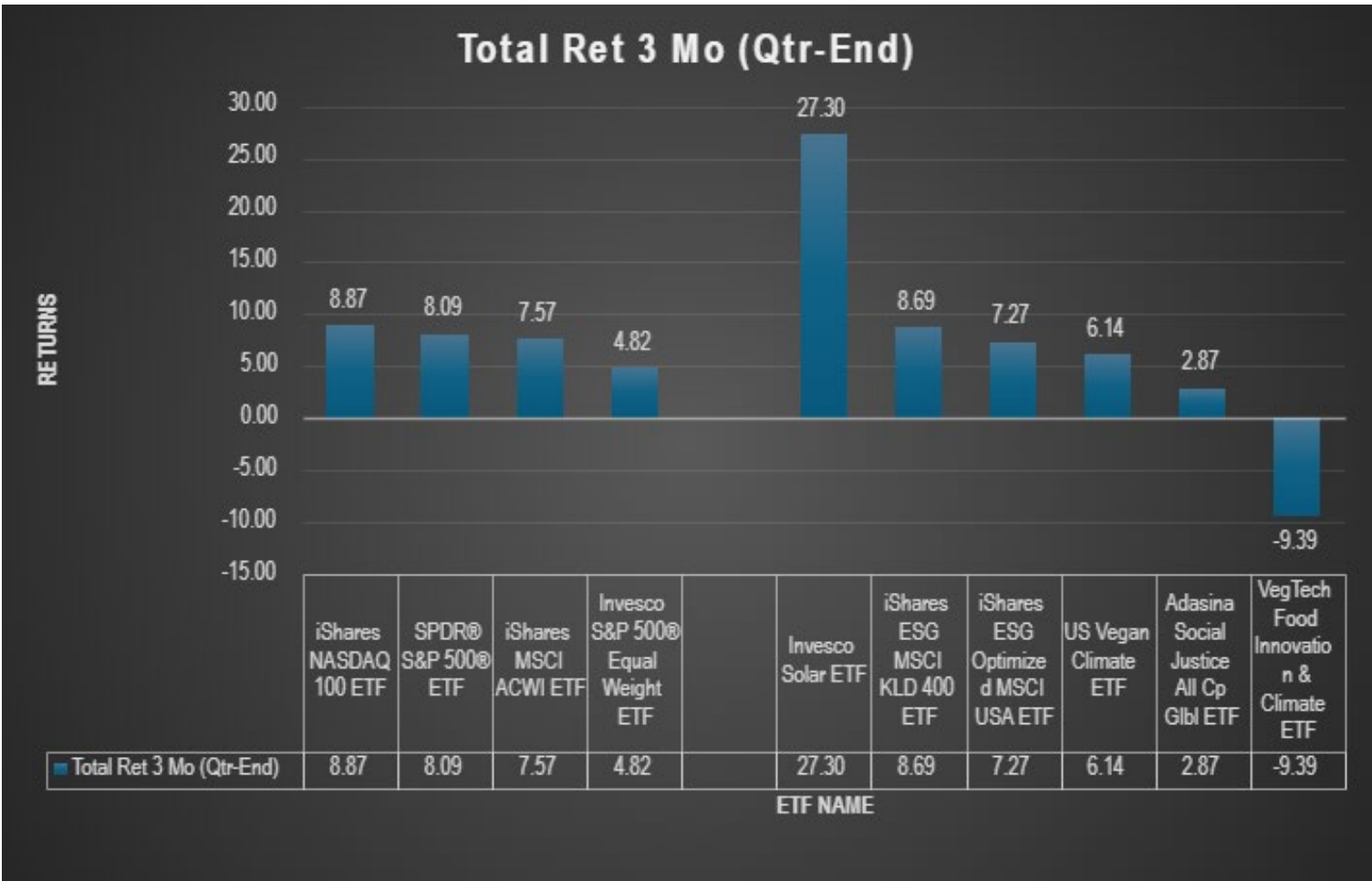
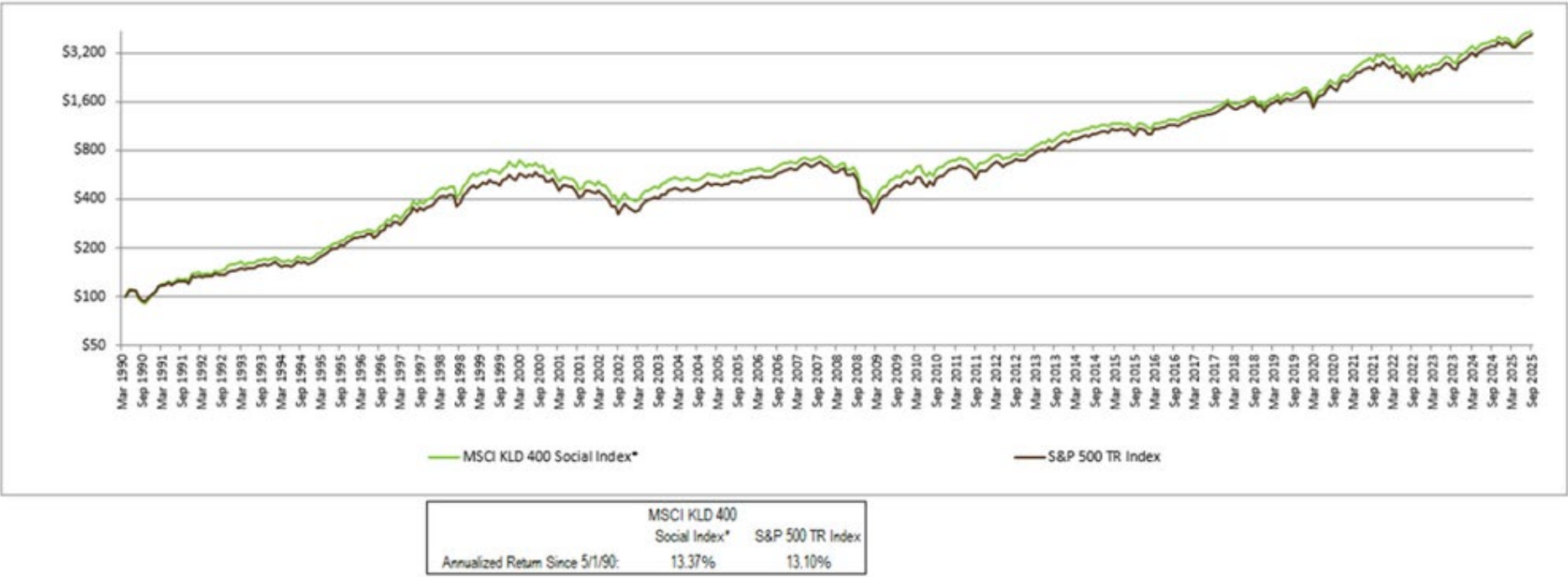


Figure 14. MSCI KLD 400 vs S&P 500 Indices, Sept. 30, 2025



Source: Morningstar. *Data prior to 9/1/2010 is that of the MSCI KLD 400 Social Index GR, while data since 9/1/2010 is that of the MSCI KLD 400 Social Index NR. Indices are unmanaged groups of securities. Index performance does not include the impact of cash, fees, or transaction costs. Investors cannot invest directly in indices but may purchase mutual funds or other investment products designed to track the performance of various indices.



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