Osprey
PRIVATE WEALTH

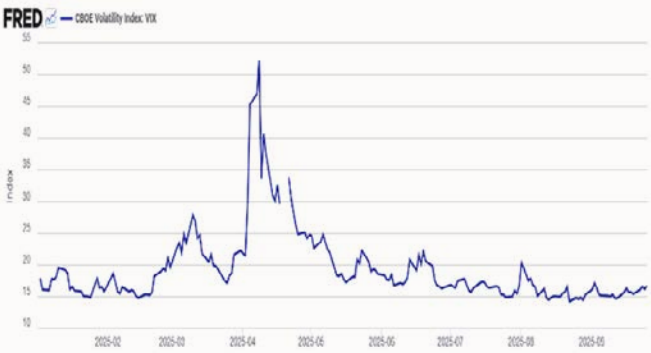
October 2025 Commentary

"The world is still in the initial stages of a technological revolution that will have profound effects on the way we work and live our daily lives. Exactly how quickly things change, and whether they are for the better is a worthy debate."

During the third quarter, the market continued its upward trajectory following the April lows. The S&P recorded multiple new closing highs during the past three months and closed up 8% for the third quarter and up 14% for the year thus far.

Investors enjoyed the "relative calmness" of the market as volatility as measured by the CBOE Volatility Index (VIX) remained subdued throughout the quarter. The threat of tariffs lost some of its ability to provoke anxiety as investors perceived the pronouncements as more of a negotiating tool rather than a serious long-term risk to international trade.

Shaded areas indicate U.S. resessions.



Source: Chicago Board Options Exchange via FRED®
Shaded areas indicate U.S. resessions.

This allowed investors to focus on more traditional concerns such as the state of the overall economy, corporate earnings, and the outlook for inflation.

The Economy

Despite general anxiety about the current state of political discourse in this country, and the policy shifts regarding international trade, the economy has held up better than most economists expected.

Although the economy as measured by GDP decreased at a 0.5% rate in the first quarter, the second quarter GDP number bounced back to a very healthy 3.8% rate.

Shaded areas indicate U.S. resessions.

Source: U.S. Bureau of Economic Analysis via FRED®

It is important to note that the likelihood of tariffs on international trade caused these numbers to become distorted. GDP in the first quarter was weighed down by a significant increase in imports as companies tried to beat the implementation of tariffs. During the second quarter, the inverse was true, imports decreased significantly, and this boosted the reported second quarter GDP.

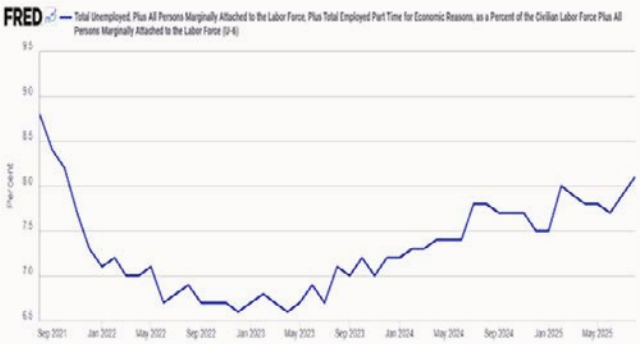
Currently, various economists are suggesting third quarter GDP growth will be anywhere between 1.3% (Philly Fed) and 3.3% (Atlanta Fed). As the whipsaw effects from “tariffs on” vs. “tariffs off” dissipates, we would expect the economy to continue to show moderate growth with GDP numbers for the rest of the year somewhere in the 2.5% - 3.5% range.

Jobs Recession

Given the uncertainty of the direction of the economy, many companies have decided to reduce hiring of new employees. This has caused a pickup in the unemployment rate from a very low 3.5% to the current rate of 4.3%. While this is still considered to be near the economically healthy “full employment” rate of 4%, digging deeper into the numbers reveals a weaker jobs market.

Recent college graduates have found it much harder to find jobs. Additionally, layoffs are becoming more prevalent, particularly in the Government, Technology and Retail sectors and especially for non-profit organizations.

Shaded areas indicate U.S. resessions.



Source: U.S. Bureau of Economic Analysis via FRED®

The chart above (known as U-6) shows that the percentage of those workers who are either unemployed, marginally employed or have given up has risen to 8.1% as of August. Excluding the pandemic, this is the highest rate recorded since 2017.

It is our expectation that the percentage of those unemployed or underemployed will continue to rise over the coming months as dislocations from economic uncertainty, international trade, automation, and the AI revolution continue to evolve. Rising unemployment has now caught the attention of the Federal Reserve as we will discuss further later in this commentary.

Consumer Sentiment

The psyche of the consumer has been severely tested over the past year or so and not surprisingly this has affected their outlook on the economy. With consumers expressing concerns about trade, jobs, AI, and the rise in political tensions, it is not hard to understand why consumer sentiment has been depressed.

Shaded areas indicate U.S. resessions.

Source: University of Michigan via FRED®

As you can see from the chart above, consumer sentiment has rarely been this negative over the past decade and is more emblematic of times when the economy is in or entering a recession.

With consumer sentiment numbers in the doldrums, one might expect to see poor retail sales numbers, but this has not been the case. As you can see from the chart above, retail sales have been running at a healthy growth rate of over 4%. How is this possible?

When we look further into the numbers, we find that this is due to the lopsided strength of the consumer base. While the lower end of the socioeconomic scale is worried about continued inflation and their employment, wealthy consumers continue to account for a growing share of U.S. consumer spending. Consumers in the top 10% of income distribution now account for 49.2% of total spending. This is up from 48.5% in the first quarter and according to Mark Zandi from Moody's Analytics it is the highest percentage going back to 1989.

The Fed and Interest Rates

As mentioned previously, the lack of new jobs and the increase in the unemployment rate have attracted the attention of the Federal Reserve. The Fed has a dual mandate, to keep inflation under control, ideally around 2%, and to keep unemployment low, ideally close to 4%.

Up until the past month or so, the Fed has been primarily focused on bringing down the rate of inflation. They have been largely successful in this regard as the yearly rate of inflation has dropped from a high of 8.5% in 2022 to a more reasonable 2.9% recently. Although this is still above their stated 2% target, the Fed has recently decided that the risk of higher unemployment takes precedence.

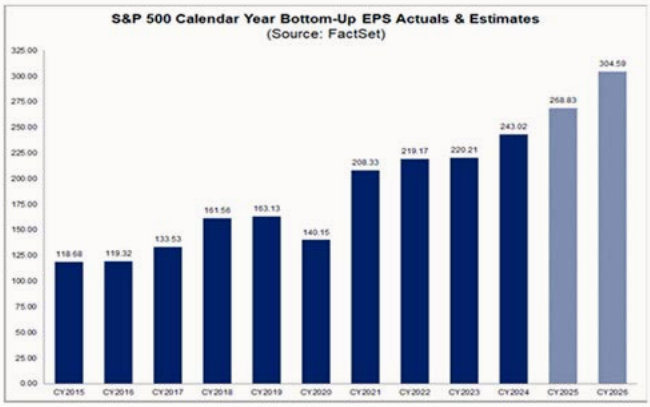
At the September Federal Open Market Committee (FOMC) meeting, the Fed decided to cut the Fed Funds interest rate by one quarter of a percentage point to a range of 4 – 4.25%. This marked an important shift in their focus from inflation to unemployment. Additionally, they indicated their current forward-looking intention (known as the "dot plot") is to cut interest rates two more times this calendar year with the likelihood of further cuts in 2026.

Their hope is that they have done an adequate job of bringing down inflation and that by lowering rates a few times over the coming months they can provide economic insurance that unemployment does not get materially worse. The Fed finds itself in the unenviable position of trying to walk a fine line. If they err by moving too slowly to lower rates they risk a spike in unemployment. If, on the other hand, they err by moving too quickly, they risk a resurgence of inflation.

The Market

As mentioned at the beginning of our commentary, volatility has dropped to the point where one must ask if investors are too complacent. The market, as measured by the S&P 500, continues to push higher, marking over a dozen new closing highs this quarter alone. After having risen by more than 20% in each of the last two previous years, the market is on pace for a third double-digit return in a row.

Investor confidence is driven by a number of factors. First, investors received good news in April with the passage of the "Big Beautiful Bill" which ensured that their tax rates would not be going up. Second, investors saw the drop in inflation coupled with a slightly deteriorating jobs market as the perfect recipe for the Fed to begin to lower interest rates. Investors are betting this will give a boost to the economy and therefore corporate earnings.



As the chart above shows, earnings for this year and next are expected to grow at approximately 11% and 13%, respectively. On the surface this projected strong earnings growth is great news.

However, we note a couple of concerning details worth considering.

First, as you can see from the previous chart, the overall valuation of the S&P 500 as measured by the forward price to earnings (P/E) ratio is high by historical standards.

Second, as you can see from the chart below, the weight in the S&P 500 of the Top 10 holdings has continued to rise to historic levels and now represents over 39% of the entire S&P 500.

This level of concentration in just ten names is a double-edged sword. Assuming these companies can continue to grow at above average rates, then it is quite possible that the market has further room to run. If, however, these companies should falter for any reason, then the market could suffer a significant pullback. While we do not currently anticipate near-term disappointment, we are very cognizant of the market's heavy reliance on such a few names.

Artificial Intelligence

Of course, one of the most significant reasons the market and especially the top 10 companies in the S&P 500 have done so well over the past couple of years has been the impact of, and the investment in artificial intelligence (AI).

The world is still in the initial stages of a technological revolution that will have profound effects on the way we work and live our daily lives. Exactly how quickly things change, and whether they are for the better is a worthy debate.

On the one hand, we are promised a world full of new capabilities to harness knowledge as never before to enable us to make significant advances in medicine, transportation, manufacturing, time management, etc. On the other hand, there is also the risk that AI will usher in an era of disruption for workers and that artificial intelligence could even pose a threat to our well-being.

Currently any company that is perceived as even a tangential beneficiary of AI is seeing significant appreciation in their stock price while conversely, many other names are suffering if they are deemed to be vulnerable to the rapid pace of change. One thing for certain is that the AI revolution will not be cheap!

There are regular announcements from technology companies outdoing each other about the tens or even hundreds of billions of dollars that they plan to spend to build out the necessary data centers. All the largest technology companies, including the Magnificent 7 names along with companies such as Broadcom and Oracle are racing to build massive scale for what they perceive as an insatiable demand for computing power.

The biggest announcement of the quarter came from a private company called Open AI, the creator of ChatGPT, which is led by Sam Altman. Altman points out that ChatGPT has seen a 10x surge in usage in the past 18 months. He is so convinced about the future demand for computing power that Open AI announced their intention to spend $850 billion in capital expenditures over the next several years.

As part of this build-out plan, Open AI signed a $100 billion deal with Nvidia to purchase their most advanced chips. The deal also included a significant investment in Open AI by Nvidia. Microsoft has similarly signed a big deal and made a significant investment in Open AI.

These cross-party deals while impressive, have also started to raise questions with skeptics pointing to a “circular financing model” whereby companies create ever larger deals that depend on each other.

Power Demand

One logistical problem with all these grand capital expenditure announcements is that there may not be enough electricity for them to come to fruition. According to reports, Open AI's build out alone would require 17 gigawatts of power. This is the equivalent of 17 nuclear plants or 9 Hoover Dams. The question is where is all this power going to come from and how long will it take to build that scale of infrastructure?

The two most recent reactors built from the ground up are Vogtle Unit 3 and 4 in Georgia which after a decade since inception were completed in 2023 and 2024, respectively. Their significance is that they are the first two nuclear reactors built in the U.S. in the last 40 years. The U.S. will have to allow a much faster permitting process to have a chance of producing the necessary electricity. We will also have to further develop our other means of producing electricity and significantly upgrade the national grid so that this vast amount of needed power can be effectively delivered.

The need for more energy generation and the ability to transmit, manage and modulate that energy is surely an area that deserves investor focus. We continue to look for suitable investments in these areas. Several names that have caught our attention but are not currently attractive from a valuation perspective are GE Vernova (GEV), NextEra Energy (NEE), Vertiv Holdings (VRT), Quanta Services (PWR) and a relatively newly public company Oklo (OKLO), a fission power reactor company that currently has no revenues, but has significant backing from BlackRock, Vanguard and Sam Altman.

International Strength

While the S&P 500 has had a decent year so far, investors have looked abroad to gain diversification away from the political turmoil and general sense of uncertainty in the United States. Additionally, countries in Europe and the Emerging Markets have been lowering interest rates for over a year to try and stimulate their economies.

Although the Eurozone's GDP growth rate is currently only running at about 1.5%, the reduction in interest rates has provided an attractive environment for investors. Despite the ongoing threat of tariffs, the Emerging Markets are continuing to experience their delayed economic rebound from the pandemic and are currently experiencing GDP growth of approximately 4%.

Investors in both regions have been rewarded with the iShares Europe ETF (IEV) and iShares MSCI Emerging Markets ETF (EEM) each posting returns of 30% through the end of the third quarter.

Gold Continues to Shine

Gold has had a stand-out year so far, up over 40% to $3,800 per ounce, as several catalysts that drive the price of gold have all come together at once. Gold is regarded as a refuge from the high rate of inflation we have experienced over the past five years.

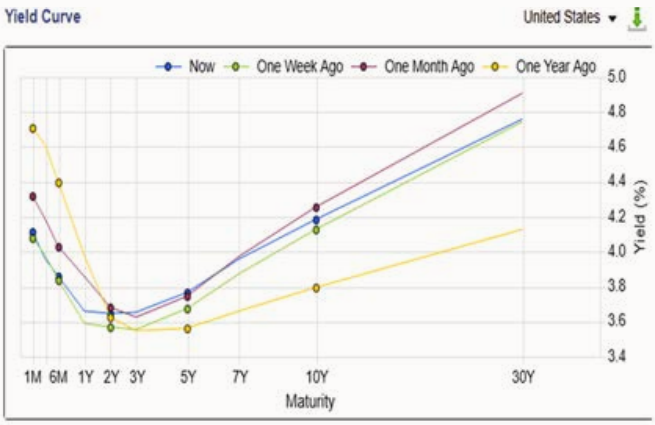
Gold is also seen as a hedge against the devaluation of sovereign currencies including that of the United States, which has seen the value of the dollar decrease by more than 11% year to date. This is the largest drop in the value of the dollar since 1973 but may not necessarily continue.

Lastly, gold can be a haven in times of international turmoil. The continuing wars in Ukraine and the Middle East along with the ongoing international trade war, feed into this way of thinking. There is a chance that this trade has further to go as the catalysts are unlikely to resolve themselves in the near term.

Gold alone as a commodity does not produce any revenue or earnings and is tax inefficient as it is considered a collectible and taxed at a higher rate than equities. Physical gold adds other potential expenses including storage and transportation. While gold can generate non-correlated performance compared to other asset classes, we note that from 1971-2024, the S&P 500 had a higher long-term average annual return of 11.52% versus gold's 8.19%.

Fixed Income

Fixed Income has continued to fulfill its dual role both as a provider of a steady stream of income and to reduce the overall volatility of an investor's portfolio.



As you will see from the chart above, short-term interest rates have dropped significantly as it has become clear that the Fed was warming to the idea of cutting rates. Long-term rates, on the other hand, have risen as concerns over a resurgence in inflation or the possibility of a debt crisis weigh on investors.

Corporate bond yield spreads over Treasuries have narrowed and offer only a modest improvement in yield. Municipal bonds offer an attractive comparable yield for those investors in high tax brackets.

We continue to utilize individual bonds and bond ladders where appropriate to provide income and reduce volatility.

Q4 Outlook

As we look at the remainder of the year, we are cognizant that the S&P 500 is trading at an elevated price to forward earnings multiple of 22x. At an event on September 23, Fed Chaiman Jerome Powell stated, “by many measures, equity prices are fairly highly valued.” However, he also went on to say that “this was not a time of elevated financial stability risks.”

We agree with the Fed Chairman’s assessment that the market in general is fairly highly valued. That being said, statistics suggest that the U.S. economy and the market are in a decent place. The AI revolution is in full swing for the foreseeable future, S&P 500 earnings are anticipated to grow by over 10% both this year and next. Inflation has moderated, and short-term interest rates are expected to fall further as the Fed takes out an insurance policy on the economy.

With respect to AI, cycles of overinvesting and underinvesting have marked every past technological revolution. For now, capital spending on AI seems nearly limitless, but eventually, there may be disappointment and a commensurate pullback in these names. The challenging part is that there is no way of knowing when that time is.... It could be in a quarter or two, or it could be in a year or two.

We see AI as an important innovation and investment theme which we have and will continue to participate in. There are interesting companies that we have identified and would like to invest in, but we do not want to chase these names if their valuations are not compelling to us. We will continue to review oversized positions and take a disciplined approach to investing in companies with strong fundamentals that trade at a reasonable valuation.

~ The Team at Osprey

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