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CHIEF INVESTMENT OFFICE

Investment Insights

Downside Thrust to Upside Burst

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Our Year Ahead theme for 2027 is *A Decisive Moment For Markets in a "Show Me" Year*. This theme is already filtering through the capital markets in an accelerated and sharp manner. Some may say the past couple of weeks have been characterized as a perfect storm in which a number of major concerns hit at once. We don't necessarily disagree with this line of thinking, but we believe the downside thrust correction in Equities is not abnormal in midcycle phases, particularly in midterm election years. At its most elementary level, investors question the level of growth in the economy and profits in midcycle environments. The fuse could be lit for a number of reasons but generally the sharp negative price action we are currently experiencing is a "fear of much slower growth" than expected combined with a potential policy error, which could exacerbate the slower growth concern. When the Federal Reserve (Fed) raises interest rates and questions swirl about peak profitability and lower quality areas exhibit balance sheet concerns, investors reprice assets. In today's more concentrated, momentum-driven market structure, repricing can be quick and without regard. This is where we are now. We understand the concern because when you question "the base" (profitability), you are reluctant to maintain a risk-on posture. However, we view this current episode as an overly extreme reaction to concerns regarding the Artificial Intelligence buildout and technical breakdowns. But the data suggests we are not in the midst of a major change to the underlying trend. This trend being above-average growth in the economy, profits, and maintenance of record margins. Investors, unfortunately, will have to wait until the next earnings cycle for confirmation of this view. In the meantime, headlines and concerns will dominate the investment environment.

We are likely to experience significant rallies and more bouts of negative volatility in the coming weeks. This is a time to step back, reassess the macro base case, examine portfolio positions and rebalance where appropriate. This rebalancing should be diversified within Equities, higher-quality and more Value-oriented in nature and include major growth themes that have been indiscriminately repriced too low, in our view. We expect to have this opportunity prior to closing out the year, which should prepare portfolios for an upside thrust as the earnings picture showcases a better-than-expected growth outlook overall.

Our view of the Tale of the Tape

The S&P 500 Index is down some 11.5% from October 6 to November 20 while the Nasdaq 100 has fallen almost 20% in the same time frame. The Technology sector peaked in June, while the Philadelphia Semiconductor Index has fallen by more than 40% from its late-June high. Finally, small-capitalization shares as measured by the Russell 2000 are down over 15% since the middle of August. We are in a period of an accelerated move lower with a variety of concerns occurring at the same time. Rational thought about the back half of the midcycle environment is not being discussed or even contemplated. The concern centers on the direction, magnitude and speed of a slower growth environment.

What we believe has happened?

- The major power shift to Democrats during the midterm election wave has created new concerns around the level of growth in the Artificial Intelligence (AI) buildout (namely data centers).
- Idiosyncratic developments at the leading company across the compute capital investment chain have exacerbated the growth concerns.
- New concerns of a policy error have developed as talk of sharper-than-expected interest rate hikes has entered the equation.
- Lower-quality credit spreads have widened as questions about the return on investment and financing availability for the AI buildout have gathered momentum.

What's our view and how should we think about the next moves across the capital markets in the coming months?

- We expect back-and-forth rallies and negative drafts lower until we get better news on the AI growth story and we get through the Federal Open Market Committee meeting on December 9. With potentially calmer views on future Fed policy and positive surprises in capital investment spend, we expect the back-and-forth to give way to an upside thrust. In the meantime, the market could stabilize on corporate buybacks as positioning is at extreme bearish levels.
- The Q4 earnings announcements early in 2027 should help reinforce the solid growth outlook and the view that we are still in the early innings of the digital infrastructure buildout.
- Lower commodity and compute prices plus a challenging residential real estate market could begin to change the inflation outlook for the better.
- A market in better balance with improved valuations without a substantial change to the underlying growth thesis is a potential opportunity for long-term investors to rebalance Equity allocation upward.

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Nasdaq 100 Index is a stock market index comprising 100 of the largest non-financial companies listed on the Nasdaq stock exchange.

Philadelphia Semiconductor Index is a market-cap-weighted index focusing on 30 leading semiconductor firms, offering insights into the tech market.

Russell 2000 Index is a U.S. stock market index that tracks the performance of approximately 2,000 small-cap companies.

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