AI Risks Cloud the Market & Economic Outlook



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Weekly Market Summary

In an extremely volatile week due to U.S. mid-term elections witnessing a Democrat sweep, equities were lower (S&P 500 -2.67%). Election effects on AI (to include datacenters) were the big story. Best sectors were consumer discretionary (+2.68%) and communication services (+2.26%); worst sectors were energy (-11.88%) and technology (-6.93%).

Market Analysis: The Road Ahead for Investors

We continue to be broadly upbeat about the global economic outlook, but risks have risen that an unwinding of the AI trade will trigger growth fears in the coming months. As goes investor sentiment toward AI, so too will go sentiment toward bonds and risk assets more generally and ultimately economic sentiment. Should AI hold up and the economic expansion is sustained, then inflationary pressures will persist and bond yields will likely have another upleg. Last week's decline in oil prices, if it continues, could provide short-term headline inflation relief but it would be positive for economic growth and ultimately add to the pressure on core inflation. A tilt in favor of equities would still be appropriate but rising bond yields would temper equity returns and induce higher volatility.

On the other hand, if the AI trade falters under the weight of unachievable 2027 earnings growth expectations, it could easily trigger an economic growth scare that would also drag down equity prices and bond yields. The pronounced weakness in semiconductor, neocloud and datacenter stock prices in recent weeks is a clear warning that such an outcome may be on the horizon. The average stock could be steady in such a scenario, but with technology stocks still accounting for some 30% of global market capitalization, the damage to overall equities would be significant. This is not yet our base-case scenario, but the warning signs for an equity downgrade are mounting.

The Election

1. It is hard to overstate the magnitude of the Democrat shellacking of the Republicans. However, we view this as less of a pro-blue wave and more of an anti-red wave. (This assertion is consistent with most exit polling.)
2. Much of the defeat can be laid at the feet of President Trump. (Failure to lead the war effort with clear goals and consistency, inserting weak Republicans into races even at the expense of incumbents, and a bellicose, non-unifying, non-edifying tone.)
3. At this juncture, both political parties are struggling to find a center and create some forward planning and progress. Both need to in order to have a chance to lead the country. While some common ground is likely to be found between President Trump and the Democratic Congress, significant acrimony is likely, as the positioning for 2028 will begin shortly.
4. Looking to 2028, the Republicans will have to unite the MAGA and recently quiet traditional wing of the party. Likewise, the Democrats will have to pull together the traditional Democrat and progressive wings of their party. The list of interested presidential candidates is likely to be long on both sides of the aisle.
5. The midterm election is likely to mark the end of "low" tax rates. Individual (especially people at the high end), corporate, estate, and capital gains tax rates will surely not go down, but may begin to rise past the 2028 election.

AI

1. AI has clearly moved from the first phase of a new technology, where nearly all are winners (or potential winners), to a more differentiated investment environment.
2. This second phase began when the "circular financing" question mark started more than a year ago. Beyond financing concerns, investors are now asking if earnings estimates are too high (e.g., Amazon and Alphabet a couple of weeks ago.)
3. Translating capex into earnings and free cash flow is still in front of us, where another separation of winners and losers will occur.
4. Data centers will be built! The locations will change to some degree, it will take longer, and it will be more expensive.
5. Bottom line: AI is still an amazing and transformative technological development. There will be great good (e.g., productivity) achieved, and sadly, poor and "evil" uses will develop and require some self-policing and undoubtedly some government regulation. (We will monitor this space for any values-based scoring changes.)

Markets

1. While economic growth remains reasonably robust, it remains the case that (at least at the lower end) consumers are spending by lowering savings rates. That can't persist forever.
2. Post this countertrend rally in bonds, good growth, stubborn inflation, and significant borrowing needs (AI and the government) will likely push rates up again. The Fed is not done raising rates.
3. For a good equity market to continue, earnings estimates will need to be met or exceeded (as has been the case all year).

4. Stocks are in an indigestion mode. Many technical signs over the last couple of months pointed to potential turmoil and volatility. Stocks are likely to fail (in 2026) to advance by a double-digit percentage for only the third time in 10 years. (This was one of our 2026 10 Predictions.)
5. High levels of intra-market volatility will undoubtedly continue. Technology continues (and is likely to continue) to have the biggest winners and biggest losers.

Market & Economic Highlights

1.	**PCE inflation (the Fed's favorite inflation measure) rose 0.5% m/m and 3.6% y/y (i.e., way above the Fed's 2.0% target)**, while the savings rate dropped to 3.8% (the lowest level since 2022).
2.	**The October jobs report was strong, with a better-than-expected (165,000) payroll gain** along with significant upward revisions of prior months. Average hourly earnings advanced 0.4% (3.1% y/y), a bit disappointing. The unemployment rate stayed at a low 4.1%.
3.	**U.S. high-yield credit spreads have expanded – one of the reasons equities have sold off**.
4.	**With 70+% of companies reporting 3Q earnings, 65% have exceeded consensus revenue estimates, and 85% have beaten earnings estimates** (revenues +2.6% surprise, earnings +2.6% surprise) – strong, but the weakest surprise so far this year.
5.	**The VIX jumped to nearly 30**, the highest level since so-called Liberation Day.
6.	**Generally speaking, money continues to rotate viciously within the stock market, rather than exiting**.
7.	**The P/E ratio for the S&P 500 continues to fall on the back of strong earnings. (Now 18.5 versus 23.5 early this year.)**
8.	**In the 12 months post-mid-term elections, stocks have advanced (each time since 1938) with an average gain of 14.8%.**
9.	**A reaction to the big up market on Wednesday (day after the election) was likely a reaction to 1) uncertainty lifted, 2) Trump indicating a willingness to work with Democrats, and 3) falling oil prices. The Thursday decline was a sizing up of the impact of the Democrats sweep on the AI investment boom.**
10.	Given the scale of the GOP losses in the midterm, and with the math of the seats up in 2028, further gains for Dems are possible. **If a Democrat is elected president in 2028, tax rates will likely increase in 2029**.

Weekly Index Performance

U.S. Equity Market Performance

Equity markets (Index total return %)	Last Week	Year-to-Date
Dow Jones	-0.94	8.06
S&P 500	-2.67	8.78
NASDAQ	-3.37	6.25
Russell 1000	-2.90	8.29
Russell 1000 Growth	-4.98	-5.15
Russell 1000 Value	-0.49	23.88
Russell 2000	-2.90	11.05

S&P 500 Sector Performance

S&P equity sectors (Index total return %)	Last Week	Year-to-Date
Communication Services	2.26	-9.30
Consumer Discretionary	2.68	0.51
Consumer Staples	0.97	19.44
Energy	-11.88	40.92
Financials	1.14	5.72
Health Care	-0.07	20.93
Industrials	-2.83	5.80
Information Technology	-6.93	11.36
Materials	-0.44	15.46
Real Estate	1.89	12.75
Utilities	-0.68	3.24

International Equity Market Performance

International equity markets (Index total return %)	Last Week	Year-to-Date
MSCI ACWI	-2.02	8.94
MSCI ACWI ex U.S.	-0.01	11.00
MSCI EAFE	0.85	10.45
MSCI EM	-1.44	11.82

Fixed Income Market Performance

Fixed Income markets (Index total return %)	Last Week	Year-to-Date
Bloomberg U.S. Agg Bond TR	0.49	-0.06
Bloomberg U.S. Corp High Yield TR	0.38	0.78
Bloomberg U.S. Govt/Credit TR	0.44	-0.20
Bloomberg U.S. T Bill 1-3 M TR	0.05	3.17

Alternative Investment Performance

Alternatives (Index total return %)	Last Week	Year-to-Date
Real Estate (FTSE NAREIT)	2.43	14.46
Commodities (DJ)	-4.47	26.82
Global Listed Private Equity (Red Rocks)	0.74	-9.14
Currencies (DB G10 Currency Future)	-0.89	12.11

Source: Bloomberg as of Nov. 6, 2026

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