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November 10, 2025

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The Bull Market Continues

- After 40 days, it looks like the Federal government shutdown is nearing an end.
- Some signs of softness in labor market, but apparently due to AI efficiencies
- Trump tariffs could be overturned by Supreme Court
- Moderately good economic growth expected in 2026 (~2.5% real, 5.0% nominal)
- Earnings for the S&P 500 have been beating expectations, and our models suggest earnings growth of 8% in 2026
- Valuations have raised fears of a correction, but the data doesn't really support such conjecture.
- The U.S. has characteristics that support ongoing exceptionalism.
- The dollar's exchange rate is expected to be stable in the year ahead.

Seven Democrats and one Independent U.S. Senators broke rank and voted to support a procedure that would allow the Federal government to reopen. The closure of the government dragged on for more than 40 days because most people, when polled, said that the shutdown really didn't affect them. Some on the Republican side even said this was a good exercise that demonstrated which government employees were not really needed. Unneeded employees could be fired, and money would be saved. Such people will be disappointed to learn that the deal guarantees that fired employees will get rehired. The deal is finally coming because food assistance programs used by more than 40 million Americans ran out of money. Also, air traffic controllers, who have not been getting paid, started calling in sick and flight delays have developed. Flight delays are one thing that most people--especially politicians who fly a lot--really dislike. It's not clear how fast things will get back to normal, but probably within a week or two all will be good.

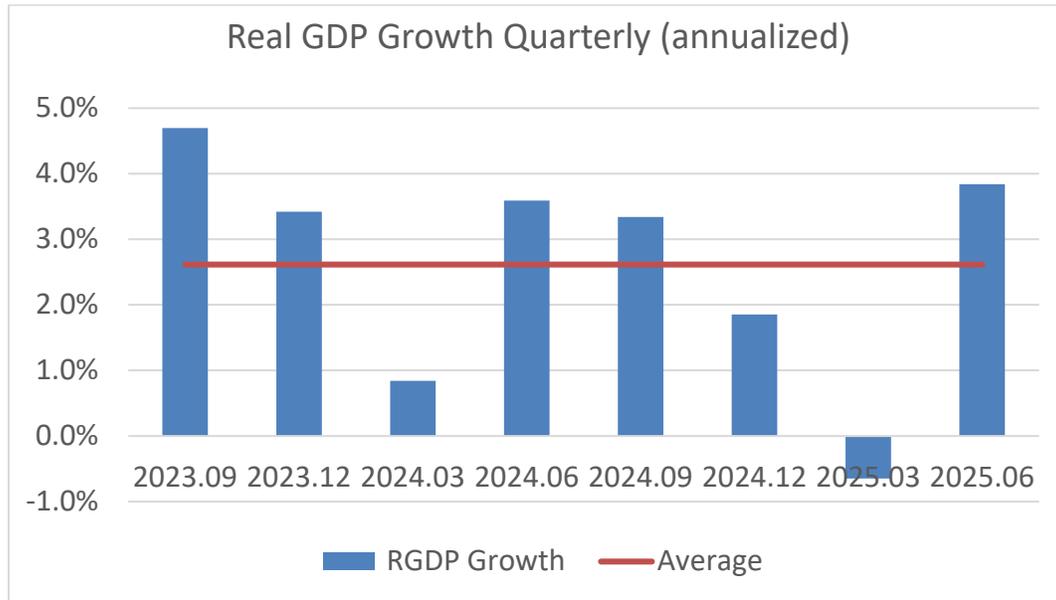
One consequence of the government shutdown is the lack of economic data being produced, but there have been signs of labor softness. Private data sources have indicated a slowdown in the labor market. Organizations including Bank of America, Goldman Sachs and the private equity firm Carlyle Group have all written that their data shows job losses. And a private employment consulting firm known as Challenger issued a report indicating that large companies cut 153,000 jobs in October, triple the 54,000 in September. This data is narrow and incomplete. It does not, for example, indicate the "new hires" side of the equation. The biggest areas of cuts Challenger

cited was Technology (33k), where AI Integration is underway, and Warehouses (48k) where jobs are increasingly being automated. For perspective, there are about 160 million people employed in the U.S. With the government likely to reopen soon, we will get the official data which may or may not confirm some of the more anecdotal reports.

Because of labor market concerns, the Federal Reserve cut interest rates by ¼ point, as expected, at the October 29th meeting. Chairman Powell had some surprisingly hawkish commentary during his press conference. Whereas the futures markets had been close to 100% certain that another ¼ cut was coming in December, Powell made clear that “a cut is not a foregone conclusion--far from it”. He also said the FOMC committee had strongly differing views about how to proceed in December. In fact, Kansas City Fed President Jefferey Schmid voted against cutting interest rates at the October meeting because of his concern about continuing inflation. The futures markets are now showing only a 70% chance of a rate cut in December. Again, a big part of the issue is a lack of data and uncertainty as to the effects of tariffs on inflation.

Interestingly, the U.S. Supreme Court heard oral arguments on November 5th regarding the legality of Trump’s imposition of tariffs. A decision could come as soon as next month. If the court rules against Trump, it could be that not only would the tariffs end, but it could also mean that the hundreds of billions of dollars already collected would have to be refunded. On the other hand, we haven’t heard much yet about whether the Congress could push through a law giving Trump such powers if the court rules against him. Interestingly, if the tariffs end, we could end up with inflation and interest rates quickly move lower. Ironically, the nation and Trump could benefit if he loses the court ruling.

The U.S. economy should continue to grow at about a 2.5% real rate in 2026, but growth is coming in a new way. The economy grew at a 3.8% annualized rate in the second quarter and an average rate of 2.6% over the past eight quarters. But we have already seen significant indications that technology companies are substituting software engineers with AI, healthcare is using AI for administrative tasks, and manufacturers using AI to optimize supply chains, predictive maintenance and automation. Amazon warehouses are transforming into virtual robot cities. That 2.5% rate of real GDP growth could come nearly entirely from productivity enhancements and very little from growth in the labor force. This phenomenon is not only due to AI and robotics, it is also a reflection of the fact that the labor force is not growing as it did in the past due to retirements of the “baby boom” generation as well as the effects of Trump’s immigration policies.



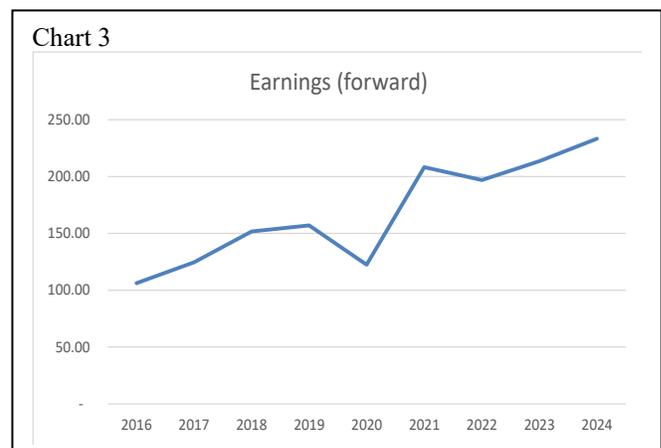
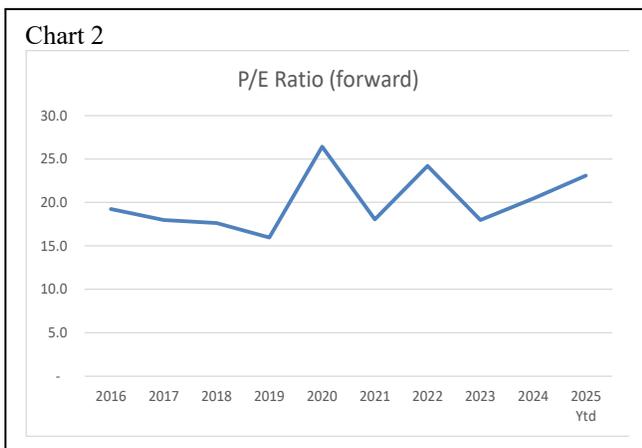
Corporate earnings growth for the third quarter of 2025 has been very strong. According to data reported by Zacks Research, 389 companies in the S&P 500 have reported third quarter results as of November 5th. Total earnings are up 14.6% versus the prior year, with revenues increasing 8.3%. Of those companies that reported, 83.5% beat earnings estimates and 75.6% beat revenue estimates. Earnings beats, however, do not have the effect they did previously. Corporate managers have learned over years that it’s best to be conservative in issuing earnings “guidance,” so that they can proudly announce that they beat expectations when actual results come out. Naturally, the expectation to beat expectations becomes normalized. Now, it’s not unusual to see a stock decline in price on the day they announce that the company beat expectations—perhaps because they beat, but not by enough. The markets adjust to everything.

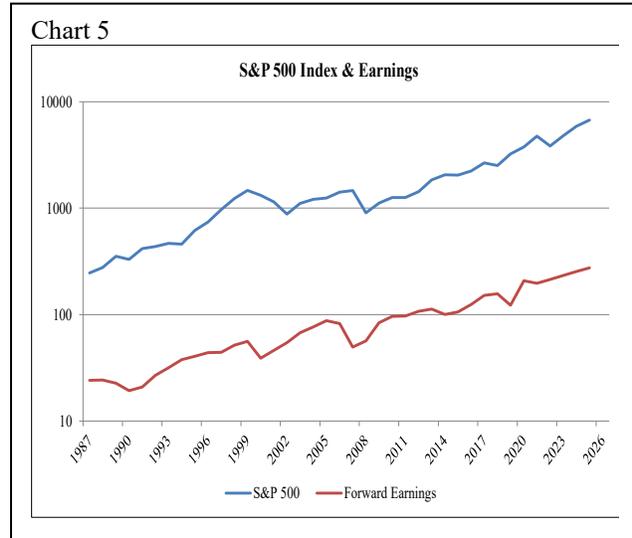
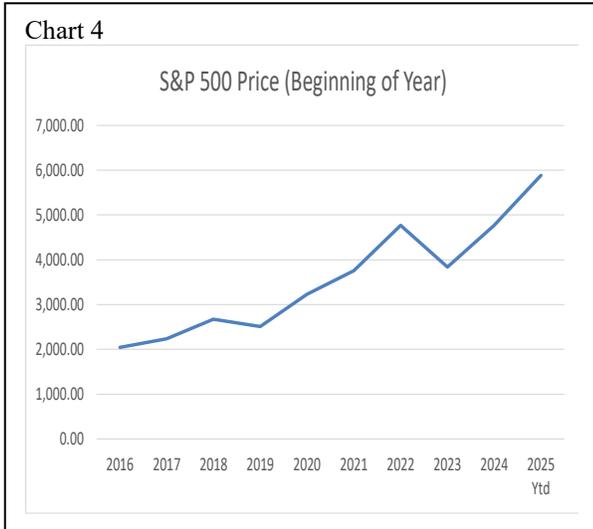
In 2026, we expect earnings for the S&P 500 to increase 8.0% to 275, from the 255 estimated for full year 2025 (see table 1 below). Built into our model is a nominal GDP estimate of 5.0% (2.5% real and 2.5% inflation), and our expectation that currency exchange rates will hold fairly steady. More than a third of the earnings of the S&P 500 is estimated to be derived from business overseas, and a weaker dollar helps boost corporate earnings. A stronger dollar depresses earnings. However, our expectation is that the dollar will hold fairly steady (discussed more below). S&P 500 revenue is forecast to rise 5.6% next year and net margins should expand slightly to 12.6% from 12.3%.

Table 1 S&P 500	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025 Ytd	2026e
Price (Beginning of Year)	2,043.94	2,238.83	2,673.61	2,506.85	3,230.78	3,756.07	4,766.18	3,839.50	4,769.83	5,881.63	6,744.00
Earnings (forward)	106.26	124.51	151.60	157.12	122.37	208.21	196.95	213.53	233.36	254.67	274.99
P/E Ratio (forward)	19.2	18.0	17.6	16.0	26.4	18.0	24.2	18.0	20.4	23.1	24.5
Total Return	12.0%	21.8%	-4.4%	31.5%	18.4%	28.7%	-18.1%	26.3%	25.0%	17.5%	

Source: S&P Global, Factset, FVCM

There has been a lot of speculation of late that the market could have a correction because of “valuations.” Anything is possible, but we find the argument unpersuasive. In 2020, for example, the S&P 500 started the year at 3230.78 and a forward P/E of 26.4, which was higher than the current forward P/E of 24.5. Did the S&P 500 correct in 2020? No. The total return in 2020 was 18.4%. Looking at Chart 2 below, the P/E seems to always be high in recent years. Maybe that’s because of the positive economic and earnings developments in the U.S. During that same period, you can see earnings trending higher in Chart 3, and stock prices following suit in Chart 4. Indeed, looking at stock prices and earnings back to 1987 (Chart 5) it’s clear that stock prices rise because earnings rise. The valuation, which is the spread between the two lines, bounces around but is not the decisive factor. Growth and profitability is decisive. Hence, we would not be so bold as to call for a correction because valuations remain high. Volatility will always be with us. But as long as fundamental developments remain positive, the stock market should be generally fine.





The Rich Get Richer?

This is an old observation that obviously has some truth to it. Yes, especially in a dynamic economy like the U.S., there has always been many cases of people and family’s making and losing a fortune. It happens. But often those same people fight back and end up making a fortune again, because many of the qualities that led to the first fortune enabled them to do so again. Walt Disney’s Laugh-O-Gram went bankrupt in 1921 only for him to come back and build the Disney empire. Steve Jobs built Apple into a tech giant by the time he was 30, only to lose control and be ousted. He then founded NeXT which was sold to Apple in 1996 and then he regained his power and control. Donald Trump became a billionaire in the 1980s real estate boom, but ended up with a negative net worth after the 1990s real estate contraction. He came back. Not only do some people have resiliency, so do some countries. Are countries in other parts of the world catching up to the U.S., or falling further behind?

There are reasons for continued US exceptionalism:

1. The US has highly developed capital markets which is well paired with an entrepreneurial spirit. "Innovative companies that want to scale up in Europe are hindered at every stage by the lack of a Single Market and an integrated capital market, stopping the cycle of innovation in its tracks. As a result, many European entrepreneurs prefer to seek financing from US venture capitalists and scale up in the US market." - Mario Draghi 2024.
2. US has lower energy costs. European industrial energy (the lifeblood of an economy) costs almost 3x more than industrial energy in the United States. This divergence began in the late 1990's

and has accelerated since. Perhaps relying solely on costly intermittent renewables while phasing out reliable baseload sources like nuclear power, and avoiding proven domestic energy technologies like hydraulic fracturing, may align with certain environmental priorities, but it risks higher energy costs, reduced grid reliability, and ultimately means the loss of competitiveness and the offshoring of manufacturing jobs.

3. US has more business-friendly tax, labor and regulatory policy. The European regulatory environment surrounding Big tech and AI is simply the latest in a series of anti-business actions taken by Europe in recent years.

Not to pick on Europe. Many of the anti-business conditions in S. America, Africa and parts of Asia remain and will almost certainly prevent many of those places from catching up with business developments in the U.S. The trends shown the chart below will likely continue.

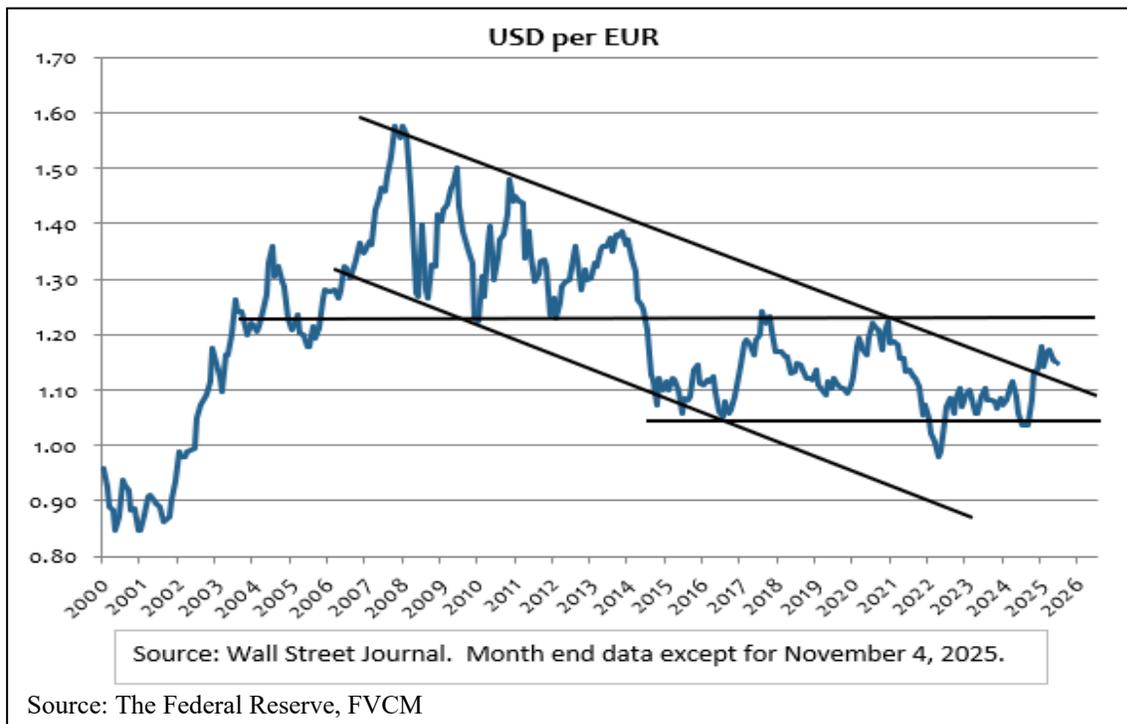
Real Gross Domestic Product Index 1995=100



U.S. Dollar Stabilization

After a good run for some foreign currencies, the USD has again started to assert itself. In some ways, the dollar’s renewed stability is more a function of problems overseas than strengths in the U.S. The Japanese Yen continues to weaken because of a deteriorating budget situation and economic weakness. Similarly, the political and financial chaos in France is weighing on the Euro,

as is the continued recessionary conditions in Germany. Keep in mind, according to the IMF, total government expenditure in France absorbs 57% of the national GDP. In Germany it's 48%. In the US it's 36%. This lower level of government expenditure makes it much easier to manage the level of taxation and debt versus countries with a much larger government burden. Currencies are notoriously difficult to forecast, but we suspect that the USD-EUR will remain in a range in the year ahead since both growth and interest rates will likely remain higher in the U.S.



In conclusion, despite some signs of labor weakness and continued high valuation levels, it appears prudent to maintain exposure to equities thanks to a good earnings outlook. Corrections, when they do occur, often strike when investors don't expect them. Two types of errors occur. One, investors may sell only to watch prices continue to rise. Then perhaps you get a 15% correction but only after you stood on the sidelines watching the market rise 25%. The other problem is if you correctly time the market when selling, you have to know when to rebuy. Keep in mind: In every single market pullback—every case—has been followed by a market recovery and new highs. Too often market timers end up standing on the sidelines watching stock prices recover from a correction. With solid fundamentals in place, long-term investors are positioned to benefit by staying the course.



U.S. MARKET REPORT

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