

ICR® 3rd Quarter Newsletter – October 2025

Markets continued to bounce back from the tariff-induced scare in April, with the S&P 500 posting a 7.8% gain in the second quarter. With the artificial intelligence craze in full swing (more on that later), technology stocks continued to lead the way with a 13.2% gain. Consumer staples was the only sector that posted a negative return (-2.4%), perhaps a concerning sign of cracks in the seemingly strong economy. Small cap stocks outpaced their larger counterparts, posting a 12% gain for the quarter, but that came on the heels of a negative first half for the asset class.

Foreign markets rallied along with the U.S., gaining a little over 4% during the third quarter, as measured by the MSCI EAFE index for developed markets. Emerging markets performed even better, rising 10% largely on the back of China whose Shanghai Index surged almost 13%. While a weakening U.S. dollar has been a tailwind for foreign investments over the past year, the currency was flat during the quarter and the strong performance from EM stocks was a result of double-digit year-over-year earnings growth.

Bond rates drifted slightly lower in the third quarter with the ten-year treasury going from 4.23% to 4.15%. At its September meeting, the Federal Reserve resumed cutting rates and, by a slim 10-9 margin, indicated two more quarter-point cuts by the end of the year. Given such a close vote, it may be a 50-50 proposition whether we do see cuts at each of the two remaining meetings or only one.

Gold continued its impressive run, gaining another 17% in the third quarter as central banks around the world continued to stockpile the precious metal. Those banks have been transitioning away from the U.S. dollar and towards gold for over five years, but the pace of that change has increased dramatically in the past year. As seen in the chart to the right, the total central bank reserves in gold has recently surpassed U.S. Treasury holdings. Fueled by tariff-induced uncertainty and rising geopolitical tensions, governments and private investors alike have turned to gold as a safe haven.

Exhibit 12: Foreign official US Treasury and central bank gold holdings since 2000

Central banks now own more gold than Treasuries

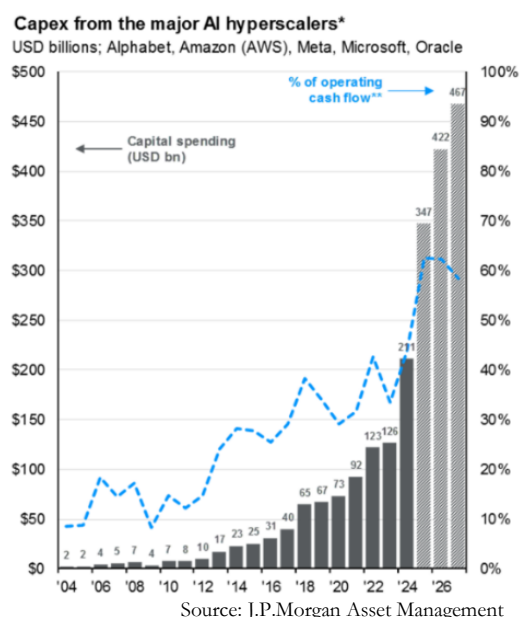


Source: Bloomberg, BofA Global Research

Dot-Com Bubble Version 2.0?

In addition to gold, the other story has been the rush to invest in anything AI-adjacent, which has kept the stock market plowing ahead despite tariffs, a government shutdown, and the ever-present geopolitical uncertainty. The surge in enthusiasm over AI has led to comparisons with the frenzied buying of internet stocks in the late 1990s and the resulting market crash. In the same way the internet changed our lives, AI will too, but there's no denying that it's become a crowded space. According to CB Insights, there are over 1,300 AI startups with valuations over \$100 million and around 500 with valuations above \$1 billion. Five years from now, it's not hard to imagine that there will be the AI-equivalents of Pets.com or eToys.com. There will probably also be AI-equivalents of Amazon which lost over 90% of its value in the dot-com crash, but at least managed to survive.

There are some differences between the dot-com bubble and the rise of AI. First, while there are many startups trying to get into the game, the biggest players in the space are already huge, well-diversified, profitable companies and they are aggressively investing in the infrastructure to support AI. As seen in the chart, analysts are forecasting that over the next three years, the AI “hyperscalers” will invest around 60% of their operating cash flow into capital expenditures. Another reason to believe that this AI-related rally may have some legs is that governments around the world have a vested interest in seeing their countries develop AI technology to enhance economic growth and strengthen national security, as evidenced by the Stargate Project, a public-private partnership aimed at developing more AI infrastructure.



The question remains whether the run-up in stock prices will be justified in the form of future earnings. The hyperscalers are profitable companies now not because of their involvement in AI, but rather, despite it. Will the massive data centers being built lead to profits or will they be the equivalent of the enormous amount of fiber optic cables laid during the dot-com bubble? Some estimates showed that 90% of those cables went unused in the short run, a disastrous outcome for the companies that invested so heavily in them. Ironically, innovations since then have been able to utilize those once-dormant cables, but that’s little solace to the companies that lost millions at the time. Similarly, the data centers will surely prove useful, but when and how that translates into profits remains to be seen.

The world is changing quickly and can often feel overwhelming. Please don’t hesitate to reach out with questions or concerns about how any of this – or anything else – may affect your financial goals. As always, thank you for the privilege of managing your wealth.

Sincerely,

James A. Heine

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James L. Cobb

James L. Cobb

Market Report (as of 9/30/25)

Index	2025 (%)	3-Year Annualized (%)	5-Year Annualized (%)
S&P 500	13.7	23.1	14.7
Dow Jones Industrial Average	9.1	17.3	10.8
U.S. Aggregate Bond Index	6.1	4.9	-0.5
MSCI EAFE (Foreign Index)	22.3	18.5	8.3

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