

# BUBBLE TALK

Equity markets reached new record highs over the past month, reigniting debate over whether we're in bubble territory. Heightened U.S. equity valuations and concentrated market leadership fuel this concern—but context matters. Markets rarely move in straight lines, and short-term pullbacks, while uncomfortable, are a normal part of the cycle.

The Shiller price-to-earnings ratio and other major valuation metrics point to expensive U.S. equity market conditions relative to both history and global peers. Yet valuation alone is a poor timing tool; expensive markets can stay that way for a long time. We believe valuation is a better guide for long-term return expectations than short-term tactical positioning.

Comparisons to the late-1990s tech bubble often miss a critical point: today's market leaders are fundamentally stronger. While technology's index weight is above that era, so is its earnings contribution. Current mega-cap firms boast strong profits and free cash flow with business models grounded in recurring revenue streams and global scale—a different foundation than the speculative optimism that held up valuations in the dot-com era.

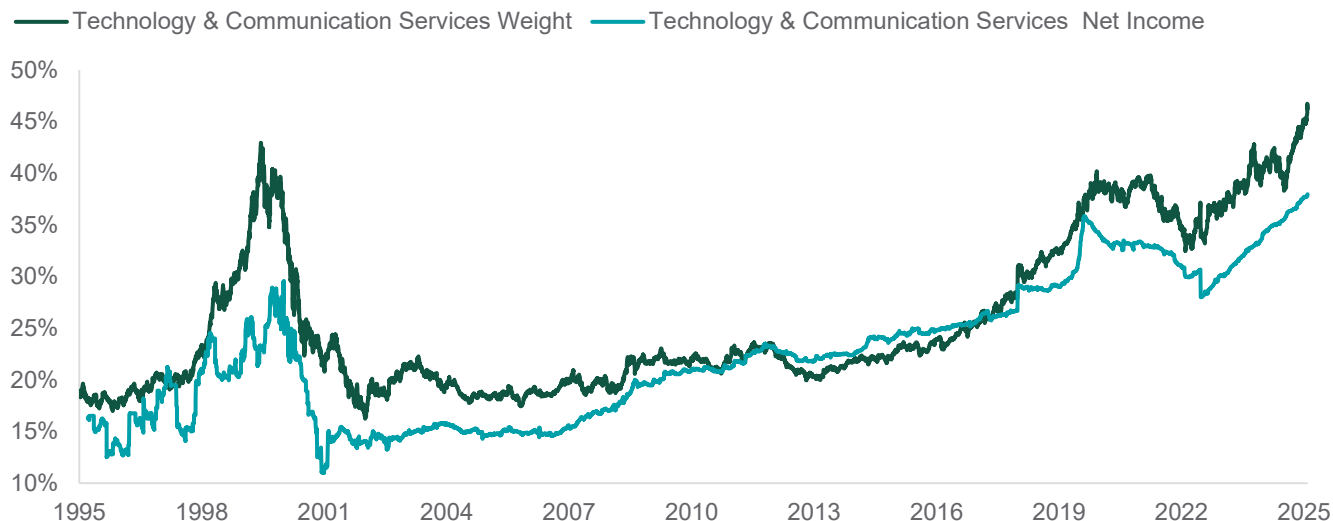
Still, concentration risk should not be ignored. The top ten stocks in the U.S. have driven around 60% of this year's gains.

Encouragingly, forecasts suggest profit growth will continue to broaden beyond these giants in 2026. Bull markets usually don't end because they've aged; they need a catalyst—such as tight policy or a deterioration in earnings momentum. By historical measures, this rally could still be mid-cycle.

In our view, equity market gains have been underpinned by healthy fundamentals. We maintain a cautiously optimistic outlook, as we expect that earnings growth will support future returns. To be sure, there are several risks, such as continued labor market deterioration, expanding government and corporate debt levels, hawkish policy shifts, and high expectations around artificial intelligence. While risks don't negate the bigger picture, they certainly warrant ongoing analysis. For now, we retain a tactical risk-on tilt with a preference for equities over fixed income.

## INCREASING WEIGHT, INCREASING EARNINGS

SHARE OF S&P 500 INDEX



Source: Northern Trust Asset Management, FactSet. Weight is by market capitalization and net income is 12-month forward net income. Data from September 1995 through October 2025. Historical trends are not predictive of future results.

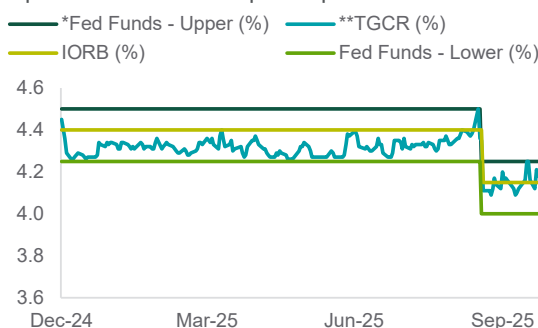
## Interest Rates

We've been monitoring repo and money market conditions for signs of stress, and signals that quantitative tightening (QT, or balance sheet reduction) may be coming to an end. Earlier in October, Chair Powell commented on upward pressure on repo rates, prompting speculation that QT may end imminently. Ultimately, the Fed announced that QT will end December 1st. It became clear to policymakers and market strategists that we had reached the tipping point between "abundant" and "ample" reserves.

While repo rates have been trading near, and even above, the top end of the target range, we haven't seen signs of spill over into other markets or asset classes, including T-Bills. Financing has become more expensive for most repo market participants, with some opting to tap the Fed's Standing Repo Facility (SRF), but repo markets have continued to function. It's plausible that repo rates continue to trade around the top of the target range even after QT ends. Adjustments to administered rates like Interest On excess Reserve Balances (IORB) or the SRF would likely bias money market rates lower within the target range. While QT is ending, there will continue to be plenty worth monitoring in money markets as we head into year end.

## FROM ABUNDANT TO AMPLE

Repo rates have seen upward pressure.



Source: Northern Trust Asset Management, Bloomberg. \*Also the rate on Standing Repo Facility. TGCR = U.S. Tri-Party General Collateral Rate (\*\*also a measure of repo rates); IORB = Interest On excess Reserve Balances. Data from 12/31/2024 through 11/12/2025. Historical trends are not predictive of future results.

- Quantitative tightening will end on December 1st, but repo rates may remain under pressure.
- This shouldn't be mistaken for quantitative easing.
- Money market conditions will continue to be worth watching as we head into year end.

## Credit Markets

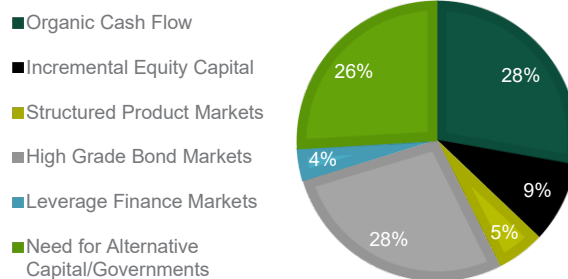
October saw relatively subdued issuance activity in the high-yield market, but notable trends are emerging. One of the most significant is the rise in funding for AI-related capital expenditures. A handful of these transactions entered the high-yield space last month, reflecting the ongoing surge in demand for data centers and power infrastructure to support AI growth. The global buildout of data centers and AI capabilities is shaping up to be an extraordinary capital markets event, with estimated costs around \$5 trillion. Financing this scale of investment will likely require participation from every corner of public markets, alongside private credit, alternative capital providers, and government support. The magnitude of these commitments carries implications for credit markets.

AI and data center development are likely to drive a re-acceleration of high yield market growth after shrinking post-COVID. While there is capacity for meaningful funding from high yield, the history of previous "new largest sector" episodes—such as telecom in the 1990s and energy from 2010–2015—has been poor. These precedents deserve careful consideration as the sector evolves today.

## ALL HANDS ON DECK

Financing the AI buildout will require broad participation.

### AI/DATA CENTER FUNDING SOURCES



Source: J.P. Morgan estimates that assumes permanent financings. Data as of 10/31/2025.

- AI-related capital expenditures are driving new high-yield issuance.
- Financing the global AI buildout will involve public markets, private credit, and government support.
- The history of "the new largest sector" has been poor. Those episodes deserve careful consideration today.

## Equities

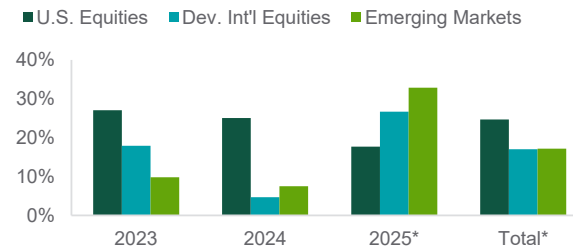
Markets rallied in October after a sharp pullback early in the month as U.S.–China trade tensions flared. U.S. equities gained 2.4%, extending their rebound to 39% from April 8 post-Liberation Day lows. Developed markets ex-U.S. added 1.1%, while emerging markets rose 4.2%, led by tech heavyweights. Technology dominance deepened: in the U.S., the Magnificent Seven plus Broadcom now represent 39% of the S&P 500, nearly double their share at the end of 2022. Meanwhile, the S&P 500 Equal Weighted Index again lagged its cap-weighted counterpart.

Resilience remains the main theme. Beyond trade issues, investors shook off the longest U.S. government shutdown and Fed Chair Powell's comments on a December rate cut as "not a foregone conclusion." Robust Q3 earnings comforted investors, with most AI darlings delivering and guiding higher. Following early-month volatility, the CBOE Volatility Index (VIX) quickly retreated and remains near long-run averages. Macro and fundamental tailwinds continue to support equities. While valuations are elevated, strong earnings justify an overweight to risk assets. We maintain our preference for global equities more broadly.

## A GLOBAL RALLY

Resilience remains the main theme in 2025.

### RETURNS SINCE 12/31/2022



Source: Northern Trust Asset Management, MSCI. \*2025 and total data are through 10/31/2025 (total is annualized). U.S., Dev. Int'l, and Emerging Markets are MSCI USA, MSCI World ex-U.S. and MSCI Emerging Markets, respectively. Past performance is not indicative or a guarantee of future results. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index.

- Equities rebounded strongly after early volatility, with continued leadership from technology and AI themes.
- A resilient economy, lower recession risks, and strong corporate earnings have provided a solid foundation.
- We maintain a broad tactical overweight to global equities with no major regional preference.

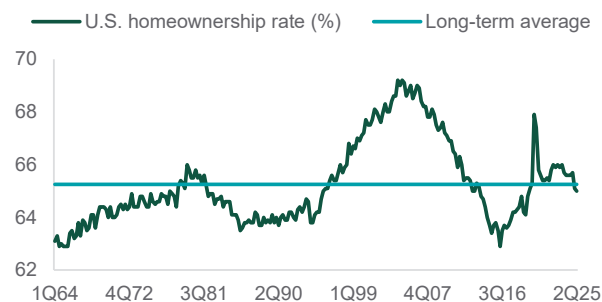
## Real Assets

Rental housing continues to play a vital role in the U.S. housing market. The national homeownership rate has averaged around 65%, peaking in 2004 before bottoming out in 2016. Today, we are hovering near that long-term average, and demographic trends—such as delayed household formation and affordability constraints—suggest that homeownership rates may remain rangebound for the foreseeable future.

The housing shortage is most acute among low-income households, where supply is constrained. In contrast, many markets still offer affordability for median-income earners. A key challenge in this supply gap is misalignment. Much of the new construction has focused on high-end units, leaving a gap in the development of affordable housing. This imbalance exacerbates accessibility issues for lower- and middle-income renters. The issue is not solely about increasing quantity—it's about ensuring the right type of housing is available. Addressing these challenges requires a holistic and localized approach from policymakers, investors, and housing developers alike.

## HOMEOWNERSHIP HICCUP

Rental housing remains a cornerstone of the resi-market.



Source: Northern Trust Asset Management, U.S. Census Bureau. Data through the second quarter (2Q) of 2025. Historical trends are not predictive of future results.

- Homeownership appears rangebound from here, considering demographic trends, and expected supply and demand.
- Affordable housing development has lagged the luxury cohort.
- We reaffirm our overweight to global listed infrastructure and underweight to global real estate.

## POSITIONING SCENARIOS

### Reflation (20% probability)

Policies of the U.S. administration have a net stimulative effect, leading to above-trend growth, persistent inflation and a pause in the Fed rate-cutting cycle.

### Soft Landing (45% probability)

Global growth slows but remains positive via two potential paths: i) tariff policy eases; ii) the U.S. economy is more resilient than expected and avoids a major deterioration in the consumer backdrop.

### Supply Restraint (30% probability)

Supply-side shocks from higher tariffs in addition to broader policy uncertainty weigh on consumer and corporate activity while halting the disinflationary process until a recession takes shape.

### Stagflation (5% probability)

Initially similar to the Supply Restraint scenario, but the rise in inflation is more persistent. As a result of slower monetary policy support, the recession is deeper and longer.

Note: Probabilities are assumed from proprietary research and are subject to change.

## DEFINITIONS

**S&P 500 Equal Weighted Index:** The equal-weighted version of the widely-used S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the index is allocated a fixed weight – or 0.2% of the index total at each quarterly rebalance..

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