TERRA NOVA
ASSET MANAGEMENT

# Nov 2026 Highlights

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## In Brief

U.S. equity markets weakened in October as investors reassessed valuations and the sustainability of AI-related capital spending. The S&P-500 declined 3.1% from its October 6 record high, while the Nasdaq fell 7.8% from its peak. The correction was concentrated in large Technology and AI-related companies rather than the broader market. The equal-weighted S&P-500 gained 4.9% since September 30, suggesting that market participation continued to broaden despite weakness in the major indexes. Long-term Treasury yields also retreated from their recent highs, with the 10-year yield declining more than 30 basis points during October. Concerns about the pace and profitability of AI infrastructure investment contributed to increased volatility in both equity and credit markets. Nevertheless, corporate earnings expectations remain strong, with forward earnings reaching new highs across large, mid- and small-cap companies. The market is increasingly distinguished between companies benefiting from AI investment and those facing rising capital requirements without sufficiently visible returns. The central question is whether continued earnings growth can sustain equity valuations as investors become more selective.

## Economy

The U.S. economy accelerated in the third quarter, with real GDP growing at an annualized rate of 3.4%, compared with 2.2% in the second quarter. Consumer spending increased 3.8%, while strong business investment, particularly in AI infrastructure, information-processing equipment and software, remained an important driver of growth. The Atlanta Fed's GDP Now model currently estimates fourth-quarter growth at 3.2%, suggesting continued economic momentum. October indicators suggest that the economy entered the fourth quarter on solid footing. The S&P Global Composite PMI eased from 58.4 in September to 57.6 in October, still indicating robust business expansion. Consumer confidence improved to 91.7 from 84.2, supported partly by easing gasoline prices and more favorable assessments of business conditions. Nevertheless, inflation concerns persisted, and consumers indicated weaker intentions to purchase durable goods and services. The economy therefore remains stronger than expected, supported by substantial capital investment and resilient business activity. The key question is whether productivity gains and AI-related investment can sustain expansion without adding to inflationary pressure.

## Labor Market

The U.S. labor market continues to soften, although layoffs remain exceptionally low, while unemployment edged up to 4.2%. Employment gains for July and August were revised downward, reinforcing the trend toward slower hiring. Average hourly earnings increased, suggesting that wage pressures are moderate. October data indicate that employers remain reluctant to reduce existing workforces. Initial unemployment claims declined to 194,000 in the week ended October 24, while the four-week average fell to 196,750. Nevertheless, announced job cuts have been concentrated on Technology, Transportation and Food Production, reflecting restructuring, cost pressures and the growing influence of AI on workforce requirements. These announcements have not translated into widespread layoffs across the economy. The labor market therefore remains characterized by low hiring and low layoffs. While this reduces the immediate risk of a sharp increase in unemployment, sustained weakness in job creation could eventually weigh on consumer confidence and spending.

## Monetary Policy

The Federal Reserve left its benchmark interest rate unchanged at 3.75%–4.00% at its October 28 meeting, following a 25-basis-point increase in September. The decision was not unanimous: two policymakers favored

another rate increase, reflecting continued concerns about inflation. The Fed described economic growth as strong, supported by resilient consumer spending, robust capital investment and improving productivity. The Federal Reserve operates under a dual mandate: maximum employment and price stability. These objectives can sometimes conflict. While inflation remains above the Fed's 2% target, the labor market is showing signs of slower hiring. Raising interest rates further could help contain inflation but also weaken employment and economic growth. Conversely, easing monetary policy prematurely could allow inflationary pressures to persist. We anticipate two additional quarter-point rate increases, reflecting our assessment that inflation risks remain significant and economic growth is sufficiently resilient to withstand further tightening. However, this is our forecast rather than a commitment by the Fed. A more pronounced deterioration in employment or a sustained decline in inflation could alter the outlook. The Fed's challenge is to balance both mandates without unnecessarily jeopardizing the economic expansion.

## Corporate Earnings

Third-quarter corporate earnings remain a major source of support for U.S. equities. With 60% of S&P-500 companies having reported, blended earnings growth stands at 30.2% year-over-year, compared with 29.1% expected at the end of September. Revenues are growing 13.4%, and 82% of reporting companies have exceeded earnings estimates, above the historical average of 77%. However, the magnitude of positive earnings surprises was smaller than usual, suggesting that analysts had already anticipated much of the improvement. Earnings strength extends across all eleven S&P-500 sectors, with seven reporting double-digit growth, led by Energy, Information Technology and Materials. Higher oil prices have substantially boosted Energy profits, while semiconductor demand and continued AI investment remain important drivers of Technology earnings. Nevertheless, profitability remains concentrated: excluding Technology and Energy, earnings growth for the remaining sectors is estimated at approximately 9%. Looking ahead, analysts expect fourth-quarter earnings to increase 28.4% and full-year 2026 earnings to grow 32.9%. The forward price-to-earnings ratio of 18.7 is below its five- and ten-year averages. Corporate fundamentals therefore remain strong, although investors are becoming more selective as they assess whether continued AI-related capital spending will generate sufficient returns to justify valuations.

## Food for Thought

Is AI creating a new period of American economic expansion, or is capital investment running ahead of the eventual returns?

The scale of the current AI investment boom invites comparisons with some of the largest infrastructure expansions in American history. According to Apollo Global Management, AI-related capital spending is projected to average approximately 1.9% of U.S. GDP between 2022 and 2029, compared with 2.3% during the railroad expansion of 1865–1890 and 1.1% during the telecommunications boom of 1996–2003. Capital expenditure estimates for five major technology companies in 2027 have more than doubled over the past year, reaching approximately $1.1 trillion. The economic benefits are already becoming visible in data centers, semiconductors, power generation and new business formation. But AI may also fundamentally change the composition of employment. Routine administrative work, entry-level analysis, basic programming and customer service appear particularly vulnerable, while demand is growing for AI engineers, cybersecurity specialists, electricians, power infrastructure workers and automation technicians. The more important long-term development may be the emergence of entirely new businesses and services made economically viable by AI. The employment transition will not necessarily be smooth. New positions may require different skills, qualifications and locations from those being displaced. Higher productivity could support economic growth and corporate profitability without a corresponding increase in

employment, at least initially. History also reminds us that technological success does not guarantee attractive investment returns. Railroads and telecommunications transformed the economy, but many investors financing those expansions suffered substantial losses. AI could produce a similar divergence between economic benefits and financial returns. The central question is whether productivity gains, new businesses and revenues ultimately generated by AI will justify the extraordinary capital being committed. AI may prove enormously successful for the American economy even if some of its largest investors are not.

## Market Outlook

We remain cautiously constructive on U.S. equities. Corporate earnings and economic growth continue to provide a solid foundation, but elevated valuations, uncertainty surrounding monetary policy and the scale of AI-related capital investment warrant greater selectivity. While the recent market correction has created opportunities, further volatility cannot be ruled out, particularly if earnings expectations weaken or interest rates remain elevated longer than anticipated. We have been underweighted in Technology for some time and have avoided excessive exposure to individual stocks. The recent correction offers opportunities to selectively add high-quality technology companies at more attractive valuations, while maintaining a diversified portfolio.

In fixed income, our working expectation is for two additional quarter-point Federal Reserve rate increases, although the outcome will depend on inflation and employment developments. We have reduced our holdings of bonds that offered limited downside protection and reinvested the proceeds in short-term Treasury bills. This preserves liquidity and limits interest-rate sensitivity while allowing us to reassess longer-term maturities as conditions evolve.

Ultimately, the long-term direction of financial markets depends on the strength of the economy, the purchasing power and credibility of its currency, and corporate earnings. The United States retains considerable advantages through its innovative businesses, deep capital markets and capacity to adapt. Nevertheless, fiscal imbalances, inflation, geopolitical tensions and the risk of excessive investment cannot be ignored. We believe these strengths support a positive long-term outlook, while the challenges argue for diversification, valuation discipline and sufficient liquidity to take advantage of opportunities as they arise.

Your Terra Nova Team