

The forecast for fourth quarter 2025 real GDP (net GDP adjusted for inflation) is approximately 1.2% year-over-year. This represents a deceleration following a stronger than expected first half for 2025, which was supported by resilient consumer spending and high levels of Artificial Intelligence (AI) investments. Inflation remains above the 2% target for the Fed with stubborn persistence, primarily driven by elevated shelter components i.e. housing costs. Inflation risks from tariffs are expected to put upward pressure on prices. Most businesses are absorbing the higher costs, although the full impact of the tariffs will filter into the economy over the next few quarters and remain an unknown risk to the inflation outlook.

The US labor market is weakening, with the pace of job creation declining on a month over month basis. Job creation is concentrated in a few sectors such as healthcare, while manufacturing employment has fallen. There may be underlying strains weighing on consumer strength, particularly among lower income households. Factors include student loan repayments, high borrowing costs, and elevated prices. The aggregate data that is presented may be masking some of this stress, as higher income tiers continue to spend robustly.

The Federal Reserve September rate cut is described as insurance against an economic slowdown. All is challenging for Federal Reserve dealing with mixed signals from inflation and a slowing job market. The Fed dual mandate of controlling inflation and promoting full employment creates tough navigation - even when the seas are relatively calm. Despite the headwinds described, the US equity markets remain near record highs, driven by strong corporate earnings, along with gains in large cap technology companies. Slightly elevated valuations are being supported by lower rates and continued earnings growth.

There is significant policy uncertainty associated with the current administration, ranging from trade and fiscal policy to potential new tariffs, stricter immigration rules, and changes to tax policy, all of which could influence economic performance. Global headwinds: Major economies, including China and parts of Europe are slowing. Geopolitical tensions create uncertainty for the global and US outlook.

One of the most critical resources in 2025 and beyond will be compute power. Policy makers around the world are pouring billions upon billions into semiconductors and cloud infrastructure - not only to gain an economic edge, but also to lead in Artificial Intelligence. A fair example would be the recently signed contract with Open AI earlier this month - the largest cloud contract in history - with Oracle. \$300 billion worth of computing power across five years. The deal will require 4.5 gigawatts (GW) of power capacity, more than all the energy created by the Hoover Dam - which produces 4.0 gigawatts of power annually.

As impressive as the AI chips are, they demand enormous amounts of electricity. The Department of Energy predicts that AI specific electricity use will grow 33% per year for the foreseeable future. This is a mind-boggling number. AI spending is broadening to governments. The connection between semiconductors and defense is increasing. Global defense budgets are expanding rapidly. Global military spending will grow from just under 3 trillion in 2024 to potentially 4 trillion by 2030, with an increasing portion allocated to satellites, autonomous ships and AI enabled fighter jets.

The macro view: Labor markets appear to be softening while small businesses are cutting back on wage hikes. CEOs across industries are talking about white collar automation. Historically periods of weak labor demand have often coincided with waves of automation. It seems no coincidence that businesses are investing heavily in AI, just as hiring slows. Compute power is the new energy. Nations are stockpiling it and companies are monetizing. The question: will the new jobs being created to coordinate with AI driven models and practices offset those jobs lost through technological advances? Add to the mix the potential wave of construction and manufacturing jobs that may be created over the next few years with the tremendous recent influx of investment into the United States. Interesting but unpredictable times might be a way to describe what we are experiencing.

The Feds recent rate cut creates opportunity for equities to move higher as borrowing cost ease and liquidity improves. Consumer sentiment should increase with lower mortgage rates, in turn boosting spending in housing demand which could fuel market momentum.