

C Y P R E S S

ASSET MANAGEMENT, INC.



MARKET COMMENTARY

October, 2025

2025 3Q ASSET PERFORMANCE

	QTD	YTD
S&P 500 Total Return	8.12%	14.83%
NASDAQ	11.43%	17.96%
Dow Jones	5.67%	10.47%
Russell 2000	12.39%	10.39%
World ex. US	8.03%	17.97%
Gold (\$3859/oz)	16.36%	46.61%
Oil (\$62.37/bbl)	-4.21%	-13.12%
Long Term Treasury (4.72%)	2.54%	5.85%

As of September 30, 2025

Third Quarter 2025 Market Summary

In its strongest 3Q since 2020, the S&P 500 rose 8% to bring 2025 year-to-date gains to 14.8% against a backdrop of continued economic resilience and strong earnings growth. Earnings growth has been pivotal, beating expectations throughout the year, and accelerating in the quarter with estimates for Q3 showing an 8.0% year-over-year increase.

AI and a Surge in Earnings Power the Market

While corporate earnings grew broadly across 8 of the 11 S&P 500 industry sectors, it was driven primarily by the historic surge in AI investments and technology. Market sector leadership remained in the hands of Information Technology, where earnings are projected to surge ahead 20% on the back of unrelenting demand for AI infrastructure and cloud computing, propelled by standout performers like Nvidia and Broadcom. Communication Services followed closely driven by digital advertising and content streaming innovations from Alphabet and Meta. AI-related power and infrastructure demand is also benefiting industrial and materials stocks as well as utilities. Financials, supported by a resilient consumer, lower short-term rates and a pickup in investment banking and investor risk appetite, rounded out the top performers with double-digit earnings growth projections led by bellwethers JP Morgan and Goldman Sachs. Military and defense are also undergoing historic innovation – a combination of technology change in the form of AI, cybersecurity, drones and robotics that is radically altering modern warfare and boosting spending. So, this is a broad-based growth driven equity market but one clearly dominated by the AI boom and technological innovation.

This is a very dynamic economy and a very dynamic time in history. Remember also these are high stakes “mega trends” in which initially best of breed companies - that have resources most companies cannot even dream about - lead the way. We see this reflected in the market, with performance concentrated in the Magnificent 7 and other S&P 500 mega cap leaders. The barriers to better performance from small caps and most mid cap companies remain formidable in this environment.

A Dangerous World

Despite continued geopolitical conflicts around the world and rising cold war competition with China over trade and resources centered on semiconductors, the AI arms race and vital rare earth minerals on which our modern technological economy depends, markets stayed resilient. This sectoral rotation toward growth-oriented areas like tech and services highlights the market's confidence in the structural trends discussed above. So far at least better-than-expected earnings are outweighing investor concerns over the intensifying U.S.- China conflict. And the market has some powerful tailwinds behind it in the near term, discussed below, but we cannot ignore that the geopolitical risk meter is high, and needs to be closely monitored.

4Q Outlook and Beyond: *Earnings and Monetary Firepower vs. Valuation*

Looking ahead to the remainder of 2025 and into early 2026, stocks should continue to be supported by anticipated double-digit earnings growth and AI-driven spending. However, valuations are stretched, with the index trading at around 22.5 times forward earnings, leaving little margin for error in a high-valuation environment. An old investing maxim is “don’t fight the Fed”, and today the monetary tailwinds are picking up. The Fed is on track to cut two times before year end and continue rate cuts in the 1H2026 potentially easing to near 3%. Fed Chair Powell recently suggested that the central bank may soon end quantitative tightening (QT), or, in simpler terms, stop reducing the size of its bond holdings thereby moving monetary policy from “somewhat restrictive” to “somewhat accommodative”. There is an estimated \$7 trillion in cash money market funds on the sidelines – some of which will presumably be driven off the sidelines by lower rates and find its way into stocks. In a dangerous world and expensive stock market we certainly are glad to have these tailwinds.

Q4 2025 Outlook: Big Picture

- Current mid-cycle economy good for U.S. stocks, can last for many years, and corporate earnings continue to beat expectations
 - Fed rate hike cycle is over and rate cut cycle has begun
- Inflation has come down but tariffs and trade issues complicate outlook, while job growth may be slowing
- AI spending boom, favorable pro-business growth policies of Trump administration including deregulation, investment incentives & lower tax rates
- Decades-long trade imbalances and geopolitical shifts challenge the framework of post WWII global world order

POSITIVE	NEGATIVE
• U.S. Economy Still In Mid-Cycle Growth Phase with growth, jobs, and inflation approaching equilibrium	Restructuring of Global World Order: Tariffs and China cold-war tensions add to economic uncertainty
• The U.S. remains the indispensable market	• Wars in Ukraine and Middle East & Flashpoints of Conflict in Taiwan, Korea, and Asia Pacific
• Fed Rate Cut Cycle Began Fall 2024, further cuts expected over next 12 months	• Market Valuation: At about 22 times forward earnings markets reflect a high level of investor confidence in outlook
• AI & Technology Investment Spending Boom appears to have legs and to be a critical foundation in the high stakes global battle for technological advantage	• US National Debt at Record High Level (\$38T), @1.25x Greater than Nominal GDP: Challenge to U.S. Debt Markets and Interest Rates

SPECIAL TOPIC: Semiconductor Cold War

The global economy, including the United States, depends on Taiwan's semiconductor industry—particularly Taiwan Semiconductor Manufacturing Company (TSMC)—for leading-edge chips, which are essential for advanced technologies. TSMC dominates this market, producing over 90% of the world's most advanced logic chips, with Taiwan accounting for more than half of global semiconductor manufacturing capacity. This reliance has intensified due to geopolitical tensions, supply chain disruptions like the 2021 chip shortage, and the growing demand for AI and high-performance computing. The U.S., despite being a leader in chip design, outsources most fabrication to Taiwan, making it vulnerable to China or natural disasters in the region. Industries particularly vulnerable include:

- **Aerospace and defense:** Reliance on advanced chips for avionics, missiles, and radar systems could lead to immediate disruptions in production and national security risks.
- **Healthcare:** Medical devices, imaging equipment, and diagnostic tools depend on high-end semiconductors, exacerbating shortages in critical supply chains.
- **Automotive:** Electric vehicles and autonomous systems require leading-edge chips, as seen in the 2021 shortages that halted production lines worldwide.
- **Compute, Consumer electronics and AI:** Smartphones, computers, data centers, and AI hardware from companies like Apple, Nvidia, and Google are heavily tied to TSMC's output, potentially stalling innovation and economic growth.

Potential solutions focus on diversification and resilience:

- **Onshoring and nearshoring:** The U.S. CHIPS and Science Act has spurred investments, including TSMC's \$100 billion commitment to build advanced fabs in Arizona, aiming to boost domestic production. Similar efforts are underway in Japan, Germany, and other allies. For this to be successful the U.S. must expedite its regulatory and permitting process or we have little chance of succeeding as a state-of-the-art manufacturer. It took 2 decades for TSMC to develop from its early years of producing low value low margin commodity chips to become the globally dominant powerhouse it is today. This slow build was enabled by steady government support and subsidies, massive reinvestments, a uniquely skilled and tireless work force, and the patience to endure years of low returns – not something easy to replicate.
- **Supply chain reconfiguration:** Governments and companies are pursuing “friend-shoring” to allies, enhancing China export controls, and investing in alternative suppliers like Samsung and Intel to reduce Taiwan's monopoly.
- **Technological advancements:** Long-term R&D in next-generation manufacturing, such as EUV lithography and chip design improvements, could distribute production more evenly, though full independence may take years due to Taiwan's entrenched expertise and specialized equipment barriers developed over years of high-volume production.

China Rare Earth Dependence: Can We Scale Domestic Production

China dominates the global rare earth elements (REE) supply chain, controlling 70% of mining production and nearly half of known reserves, driven by low costs, subsidies, and lax regulations. Its processing and refining dominance is even stronger at ~90%, including near-monopolies on heavy REEs crucial for magnets in EVs, robotics, wind turbines. and military equipment. China recently began to require exporters of rare

earths to get licenses to sell their goods internationally—and those licenses have been slow to come when they’ve come at all - heightening vulnerabilities. For the US, time is critical as full domestic processing could take a decade. It is imminent that we prioritize diversifying via allied hubs (e.g., DoD's \$258M for Lynas in Texas, \$400M for MP Materials), forging partnerships with Australia and Canada, building stockpiles, and reforming permitting --which averages 10 years due to regulations and litigation. To accomplish this the Administration could adopt a "wartime footing" by suspending regulations and fast-tracking projects via executive action. If only the US government had taken the threat of dependence on China’s rare earth minerals more seriously when it had the chance, China wouldn’t hold the trump card now.

While we have turned away from fossil fuels, nuclear power, and mining of critical metals & minerals to focus on alternative energy solutions (mostly sourced in China), China builds a new coal plant every month, has 28 nuclear power plants under construction, and grows its carbon resources around the world at the same time. We can no longer afford to “deindustrialize” ourselves to China and need to utilize our plentiful and reliable North American resources.

