

A quarterly newsletter with cues and views covering capital markets

## INSIDE

### Losing Sight (of Volatility)

Will the Fed successfully pilot policy decisions without disrupting calm waters and rising asset prices?

### Stuck Between Elevated Inflation and Slowing Job Growth

Key economic indicators for a data dependent Fed

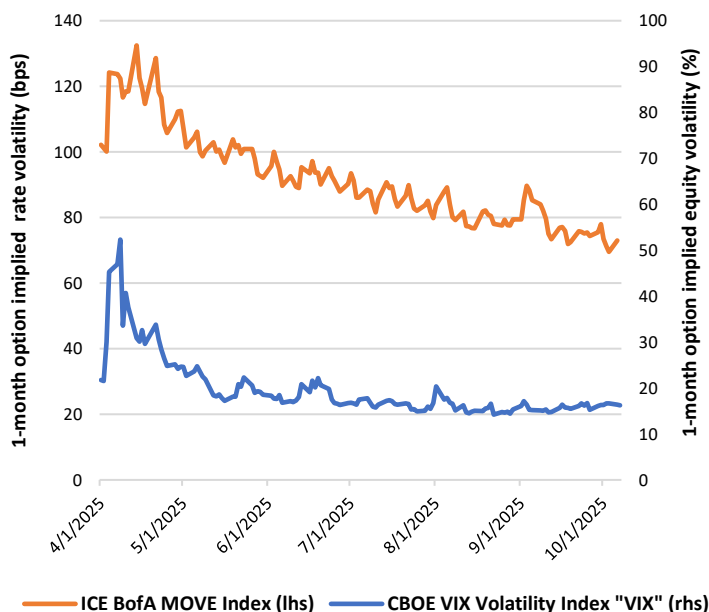
### Both Eyes on AI

Do equity gains for AI companies reflect the risks of ambitious capital investment plans?

### Distracted by a Shiny Object

The strongest tailwinds have blown in favor of precious metals. What are the key drivers and will they persist?

**Exhibit 1: Interest Rate & Equity Market Volatility**



Source: Bloomberg L.P., CBOE Global Markets, ICE BofA Merrill Lynch

## Losing Sight (of Volatility)

By Tim Senechalle, CFA

In a market that is not void of headlines and potential headwinds, fundamental and technical strength have endured and contributed to exceptional investment returns across market segments. As we shift into the final quarter of 2025, our ongoing pursuit of risk-adjusted returns is challenged by expensive asset prices and reduced margins for error. Within public markets, rising valuations reflect diminished volatility in interest rates, credit performance, and equity returns.

Dampened volatility may persist, supported by a resilient economy, spending growth, reduced regulation, and a more accommodative Federal Reserve. We will be closely watching Fed Funds Futures markets and pricing for the December 2026 contracts. These contracts have steadied in recent months at an implied 3.0% rate or the equivalent of four to five rate cuts through the end of next year, according to Bloomberg data.

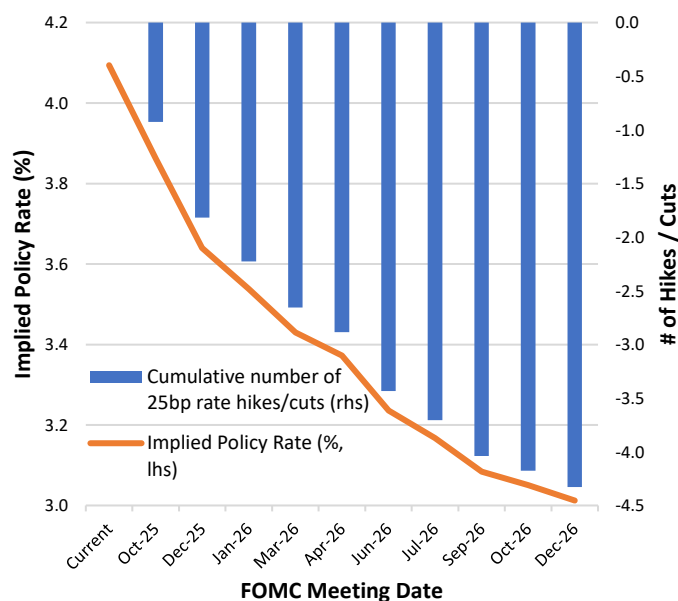
Developments in the labor market and with inflation expectations will shape the Fed's near-term path, as we explore here later. Should changing economic conditions drive an expected shift in Fed policy, the recent pattern of limited market volatility could be disrupted. We will also be monitoring impact on Fed Funds Futures pricing and the slope of the Treasury yield curve stemming from upcoming changes to the Federal Reserve Board of Governors and the annual rotation of voting Federal Reserve regional bank Presidents.

## Stuck Between Elevated Inflation and Slowing Job Growth

By Marco Bravo, CFA

The Federal Reserve's shift toward cutting interest rates was a major development in the third quarter. This pivot was driven by a series of weak jobs reports, which brought the three-month average down to just 29,000 through August. Prior to signs that the labor market was softening, the Fed had remained focused on persistently high inflation - running above its 2% target - and concerns that tariffs could keep inflation elevated beyond acceptable levels. However, during his August speech at Jackson Hole, Fed Chair Jerome Powell signaled a change in stance by emphasizing three key points: (1) "downside risks to employment are rising," (2) "the base case for the effects from tariffs is that they will be relatively short lived," and (3) "with policy already restrictive, an adjustment may be warranted". At its September meeting, the Fed delivered what the market was expecting, cutting interest rates by 25 basis points to a target range of 4.00%-4.25%. In its updated projections, the Fed's dot plot indicated expectations for two additional 25 basis points cuts over the remaining two meetings of 2025, followed by one more 25 basis points cut in 2026. Markets, however, appear to be more dovish than the Fed. As illustrated in Exhibit 2, futures markets are currently pricing in four to five 25 basis points cuts through the end of 2026, bringing the implied policy rate down to around 3%.

**Exhibit 2: FOMC Rate Change Expectations Based on Fed Funds Futures**



Source: Chicago Board of Trade, Federal Funds Futures as of 10/6/2025, Bloomberg

The key question facing both Fed officials and market participants is just how weak the labor market truly is - or whether it's weaker at all? With tighter immigration policies complicating the matter, it's difficult to ascertain if the recent slowdown is due to supply or demand. The labor market today can best be described as one of low hiring and low firing. Weekly initial jobless claims have remained relatively stable, signaling no signs of accelerated layoffs. The August JOLTS data showed job openings remaining largely unchanged from the previous month, with the layoff rate also holding steady, suggesting some stabilization in labor demand. However, as Exhibit 3 illustrates, the rise in unemployment has pushed the ratio of job openings to unemployed workers to below 1, which is the lowest level in over five years.

**Exhibit 3: Job Openings to Total Unemployed**



Source: Bureau of Economic Analysis, Bloomberg

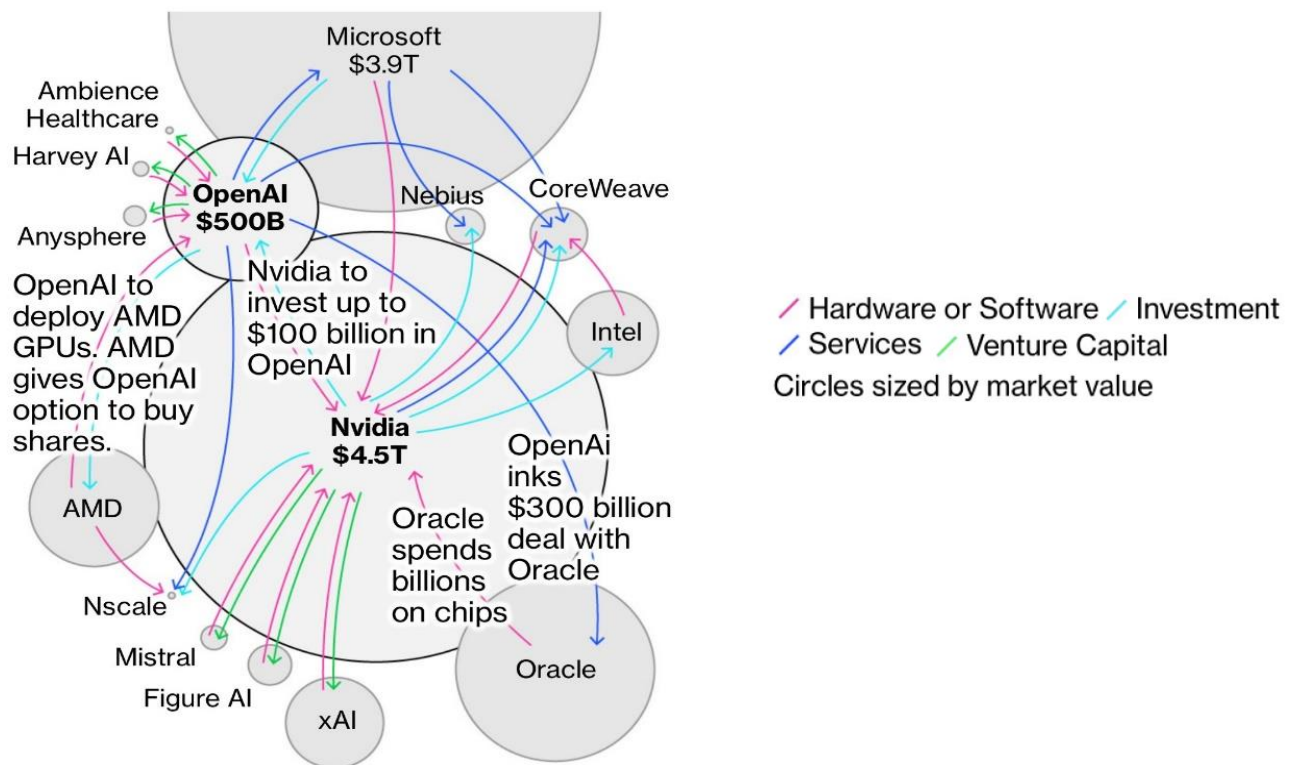
The Fed has emphasized that the future path of monetary policy will remain data-dependent, with policymakers assessing the relative risks to both inflation and employment at each meeting. However, with several key economic reports delayed due to the ongoing government shutdown, the Fed may choose to cut at the October meeting, depending on the shutdown's duration, to avoid falling behind the curve. In the meantime, we will closely monitor labor market indicators that remain accessible, including ISM employment components for both the manufacturing and services sectors, as well as consumers and small business sentiment regarding job availability. Once the shutdown ends, initial jobless claims and layoff rates will be key forward-looking signals for gauging the direction of the labor market and shaping expectations for further policy action.

## Both Eyes on AI

By Garrett Dungee, CFA

The latest tech capital spending cycle is being driven by massive investments in AI infrastructure, with OpenAI and Nvidia at the center of an increasingly complex web of financial commitments and partnerships. Oracle, for example, is heavily exposed to counterparty risk due to its multi-year, \$300 billion contract with OpenAI, which now accounts for most of Oracle's remaining performance obligations (RPOs) that total \$455 billion over the next five years. This concentration risk is compounded by OpenAI's cash burn, \$2.5 billion in the first half of 2025, and ambitious revenue targets, estimated to reach \$200bn by 2030, which heighten the risk for all partners involved.

## Exhibit 4: Circular Web of the AI Ecosystem



Source: Bloomberg News Reporting

Oracle's capital spending to support OpenAI will be front-loaded, leading to negative free cash flow and requiring creative off-balance sheet financing like JV structures (Stargate), project financing, and asset-backed leasing. The expected \$100bn of incremental financing stresses the confines of an investment-grade credit. The scale and interconnectedness of these deals mean that execution risk - access to financing, power availability, and the ability to convert contracted workloads into revenue are critical. If OpenAI's growth or financial stability falters, its partners—including Oracle, AMD, Nvidia, and CoreWeave—face significant financial and operational risks due to their deep commitments and reliance on OpenAI's projected success.

Source: Bloomberg L.P., data through 10/6/2025

# Distracted by a Shiny Object

By Peter Wirtala, CFA

For investors accustomed to the long-term dominance of the US equity market Q3 presented an interesting development, in fact a continuation of a trend that has stood out all year. Gold, the classic "safe-haven" asset, has significantly outperformed US stocks, driven by a confluence of political uncertainty, persistent inflation concerns, and a structural shift in global central bank policy.

## Performance Snapshot

While the S&P 500 has continued its upward trajectory, with mega-cap issues in particular maintaining momentum, gains have been relatively modest in Q3 2025 compared to the explosive rally in gold. While large-cap stocks rose just over 8% in Q3, gold jumped 16.7%. YTD the divergence is even starker, with equities up a respectable 14.8% vs a remarkable 47.1% for the precious metal. The magnitude of this nine-month move suggests gold's outperformance is not a one-off event, but is rather rooted in several significant macro themes.

## Key Drivers of Gold's Outperformance

The recent surge in gold reflects its traditional role as a portfolio stabilizer, coupled with new structural demand dynamics:

### 1. Heightened Political and Economic Uncertainty (The "Safe-Haven" Play)

The main catalyst driving safe-haven demand has been the heightened domestic political instability in the US, particularly the looming threat of a US government shutdown (now realized). This risk, coupled with ongoing trade uncertainty and the prospect of new tariffs, has prompted investors to seek refuge in non-government-backed assets like gold.

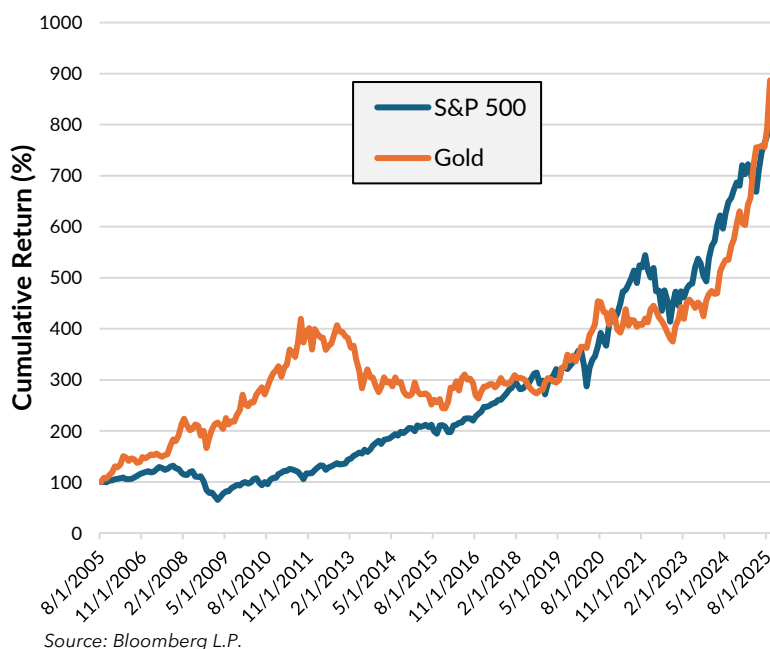
### 2. Persistent Inflation and Monetary Policy Expectations

Despite the Fed's long campaign of quantitative tightening, inflation has remained persistently above-target. The market is increasingly pricing in further Fed rate cuts in the near future, driven by signs of labor market softening and the need to support the economy. Gold is traditionally viewed as a hedge against inflation. Also, lower short-term rates reduce the opportunity cost for holding non-income-producing assets like gold, improving its relative attractiveness.

### 3. Structural Central Bank Demand

Probably the most significant long-term driver is the unprecedented, continuous gold-buying spree by global central banks. For the last few years central banks (particularly outside the G7 nations) have been aggressively accumulating gold. Total central bank gold purchases measured 1,045 metric tons in 2024, the 3<sup>rd</sup> year in a row demand exceeded 1,000 tons. This policy shift is driven by a desire to diversify reserves and reduce reliance on the US Dollar (USD), and as a hedge against rising geopolitical risk. This "price-insensitive" institutional demand raises the floor for the gold price and potentially represents a structural shift in the global financial architecture.

Exhibit 5: 20 Years of Diversification



## **Investment Implications**

Overall, so long as elevated geopolitical tensions, domestic political gridlock, and expectations for a more accommodative Fed policy persist, gold's performance is likely to enjoy a tailwind.