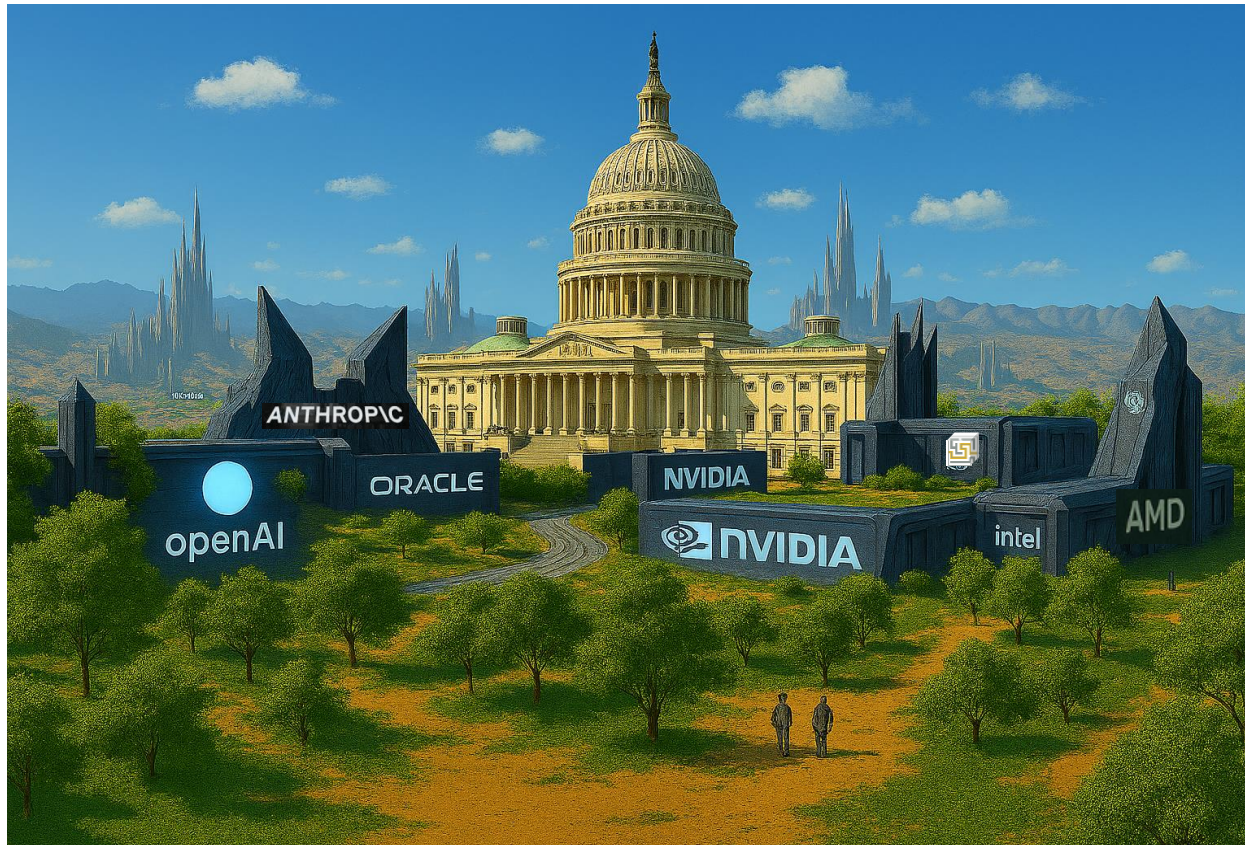


## Quarterly Review and Strategy Update

**3<sup>rd</sup> Quarter 2025**



- ❖ The financial markets cheered the Federal Reserve's interest rate cut, dismissing risks posed by persistent inflation, the government shutdown and heightened valuations
- ❖ U.S. equity markets hit all-time highs while international and emerging markets also generated strong Dollar returns
- ❖ The massive spending in Artificial Intelligence raises questions about the sector's impact on the economy, technology valuations and returns on investment

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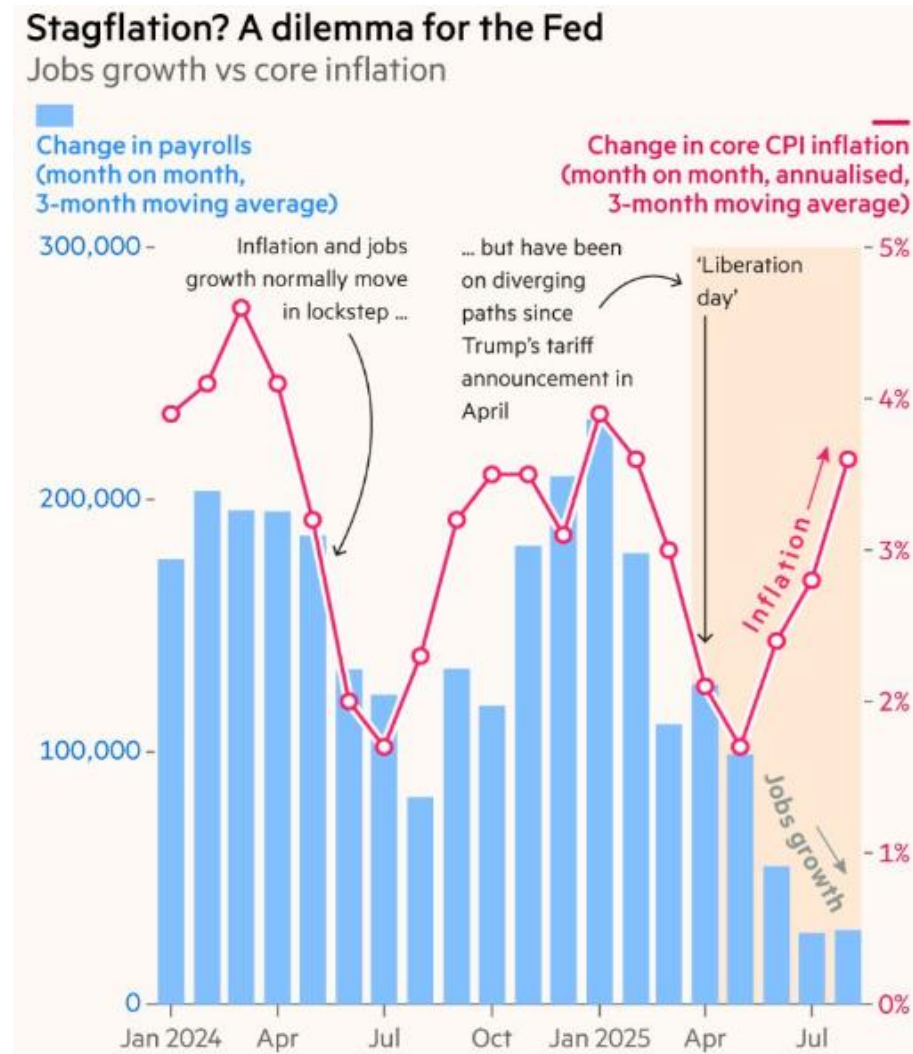
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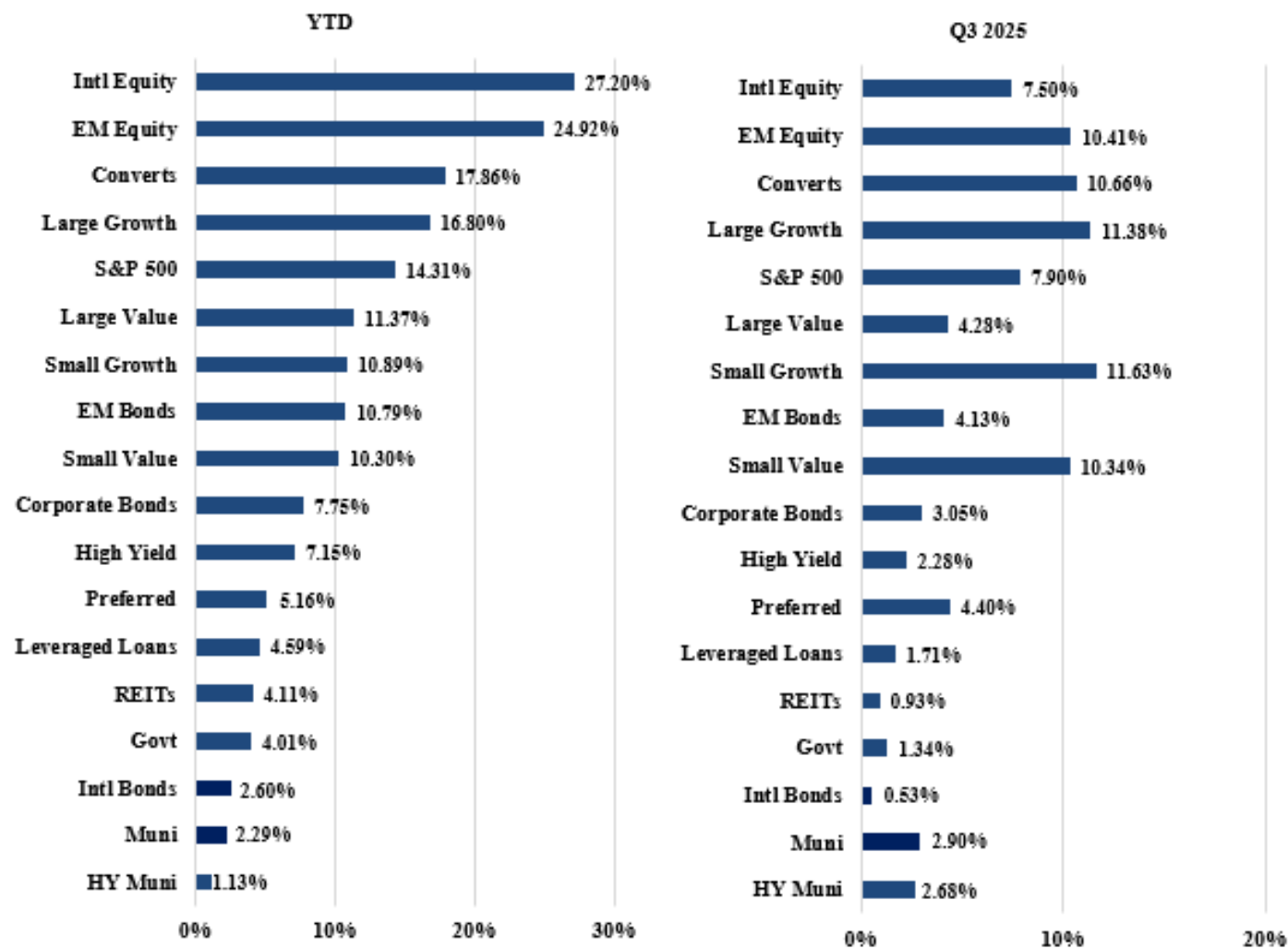
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- ❖ **Stagflation?** The chart on the right encapsulates Jay Powell’s dilemma. While the Federal Reserve cut rates by a quarter point in September – Powell called it a “risk management cut” to hedge against labor market weakness. The board remains divided over the pace of future cuts. Stephen Miran, a Fed Governor and the Chair of the Council of Economic Advisors was the lone dissenting vote at the meeting, calling for a 0.5% cut.
- ❖ **Inflation** rose by 2.9% in August following 2.7% increases in June and July, driven by higher food, vehicles, gas and shelter costs. So, inflation is still stubbornly above the Fed’s 2% target and had been for quite some time.
- ❖ Meanwhile **job growth is clearly slowing**. The economy added only 22,000 jobs in August, and revisions from the Bureau of Labor Statistics showed that 911,000 fewer jobs were created in the 12 months through March 2025 than initially reported – the largest downward revision since 2000. The ratio of vacancies to the unemployed, which rose to 2 times in 2022, is now back down to under 1, showing that the job market has become more balanced. The number of people quitting voluntarily and workers filing for initial unemployment claims have both been very stable. The overall unemployment rate rose to 4.3%, a level that most economists would consider to represent “full employment.” The administration’s immigration policies are muddying the picture. Industries that depend on migrant workers, such as agriculture and construction, are complaining of worker shortages.
- ❖ If we step back from the details, **U.S. GDP growth** is still robust, rising 3.8% in the 2<sup>nd</sup> quarter, revised upwards from 3.3%. Strong consumer spending and a 30% fall in imports more than offset weakness in housing, government spending (DOGE cuts) and business investment. There seems to be a disconnect between this data and consumer confidence, which has collapsed to Covid pandemic levels. Respondents cite worries about their jobs, inflations and political divisions.
- ❖ **The health of the economy is hard to assess due to the uncertainties created by the President’s tariff policy.** A "reciprocal" baseline tariff of 10% applies to imports from most countries. A few countries have been penalized – for example, India was hit with a 50% rate for buying oil from Russia. An exemption for \$800 duty-free imports was terminated, tariffs have been imposed on specific products (for example, 50% for steel and aluminum imports), and a 100% tariff was placed on branded and patented drugs. However, no deal has been struck with China and the Supreme Court will not hear oral arguments on their legality until November.
- ❖ The final quarter of the year will be impacted by the resolution to a potential government shutdown, and Christmas shopping – most analysts expect much lower spending this year.



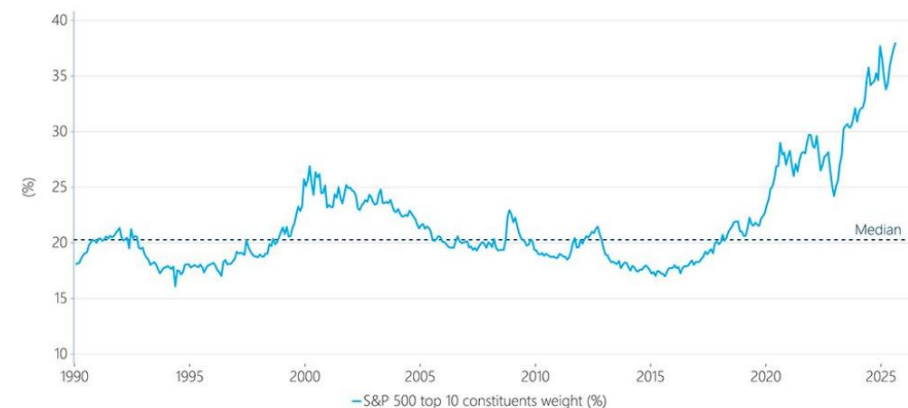
Source: FT, FRED, Hakyung Kim, Alan Smith



- ❖ All major asset classes generated positive returns in the 3<sup>rd</sup> quarter, a phenomenon we have not seen since the 3<sup>rd</sup> quarter last year, when the Fed cut rates by 0.5%. Back then Jay Powell said, “We will do everything we can to support a strong labor market as we make further progress towards price stability.” It seems that his views have not changed.
- ❖ Equity valuations are stretched and may not justify oversized bets in growth stocks, so investors should trim allocations to their target weights. As we approach year end, investors should consider tax-loss harvesting to offset gains.
- ❖ New equity allocations should focus on sectors where they are probably under-weight, such as value, small cap, international and emerging markets.
- ❖ In bonds we recommend keeping durations short to capture attractive yields at the shorter end of the curve.
- ❖ In alternatives we suggest that investors maintain their target allocations to hedge funds, private credit and private equity, and take a barbell approach to real estate, complementing core holdings with opportunistic allocations.

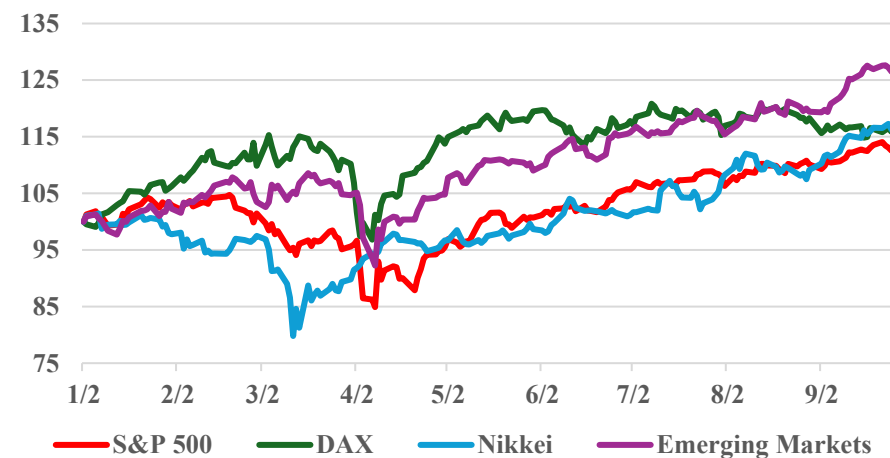
- ❖ **The equity markets** were boosted by the cut in interest rates, with the S&P 500 Index appreciating by 7.8% during the 3<sup>rd</sup> quarter (14% year-to-date), and the NASDAQ Index up 11.2% for the quarter and 17.5% for the year. Factset estimates 3<sup>rd</sup> quarter revenues for S&P companies to grow by 6.3% and earnings by 7.9%. The market is clearly enamored with the potential of AI productivity. Companies that provide AI-related products and services in particular provided forward guidance that exceeded what analysts were expecting
- ❖ **Market concentration** has increased, with the top 10 stocks in the S&P 500 now 40% of its market capitalization and 33% of its earnings. Fear of missing out on the rally and the belief that “winner takes all” in technology has fueled flows into large tech stocks. Should we be worried? Historically high levels of concentration have had little correlation with future returns. The biggest industry represented in the market at each point in time has reflected the major driver of economic growth, so the dominance of technology might not be alarming.
- ❖ **A small cap Renaissance?** The Russell 2000 just hit a new all-time high, its first record since November 2021. The Index is up 10% in the third quarter and 9% for the year. While they have underperformed their large cap peers by almost 47% over the past three years, small cap stocks may surge with lower interest rates. Neither tariffs nor a weaker Dollar appear to have hurt small companies. Valuations remain compelling relative to large caps.
- ❖ **International and Emerging Markets** stocks have outperformed U.S. equities by the widest margin in 30 years. Europe is up 25%, Germany 35% and Japan 35% in Dollar terms. Valuations are still at the widest discount to the U.S. in 20 years. European defense, Asian semiconductors and developed markets financials have been the biggest positive themes. International investors have continued to move out of U.S. assets due to tariff polices and weakening in the Dollar, benefiting international markets.
- ❖ **Has the market become too complacent?** Despite the risks – the government shutdown; unresolved tariff negotiations, particularly with China; the lack of clear consensus on the state of the economy – the VIX volatility index has barely budged since Liberation Day, standing at 16, well below its 20-year average of 19.6. The market may see more gains if the Federal Reserve cuts interest rates in December.

Market Cap of Top 10 Stocks in the S&P 500 Index



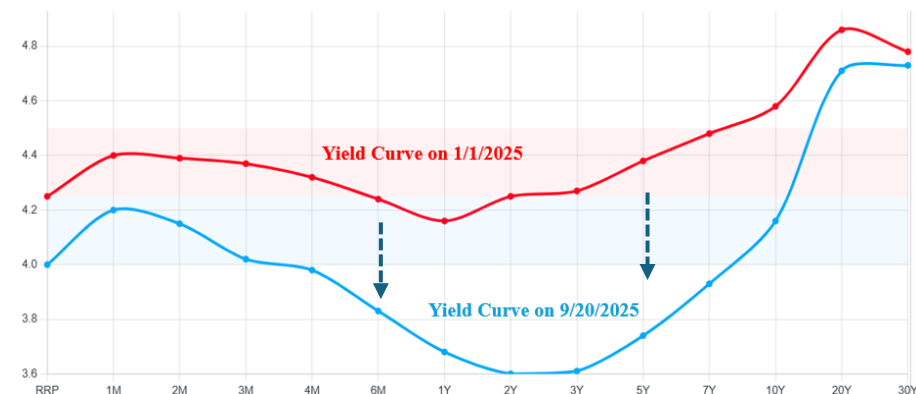
Source: Barclays

Performance of Global Equity Markets in 2025



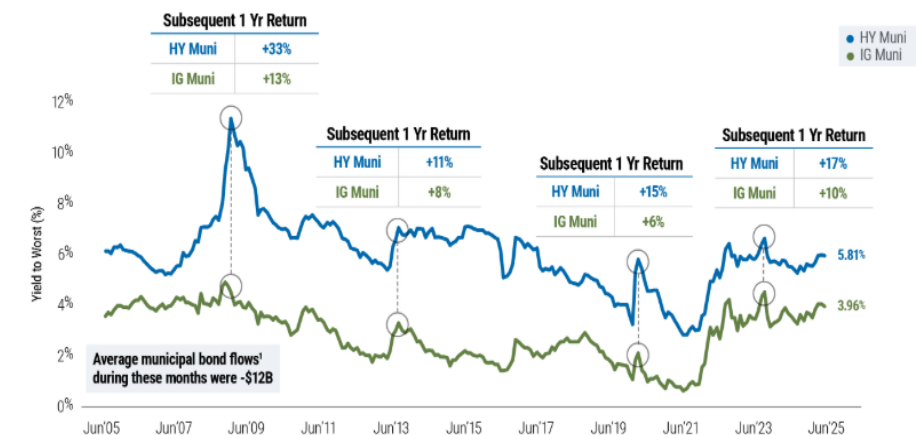
- ❖ **Fixed Income markets generated** gains in the 3<sup>rd</sup> quarter as short-term interest rates fell following the Federal Reserve's cut in the Fed Funds rate. Longer-term rates remained stable. 3-month T-bill yield fell 40 basis from 4.3% to 2.9%, but the 2-year Note only declined from 3.7% to 3.6% and the 10-year was unchanged at 4.2%. The change in interest rates this year has centered around the “belly” of the curve, reducing the base rates for much of corporate debt issuance. This rate environment has resulted in gains for almost all credit strategies this year.
- ❖ Nevertheless, **credit spreads** have continued to fall to perilous levels. Microsoft debt has been trading at yields lower than bonds issued by the U.S. government. BBB spreads, at under 1%, are at their tightest levels since 1993, and junk bond BB spreads are at 1.8%, the lowest since 2007. While the term “priced to perfection” may be overused, the market clearly believes that credit stress is negligible. Defaults have been around 3.4% for U.S. high-yield bonds and 6% for leveraged loans, lower compared to historical averages and well below the crisis levels seen during the housing crisis or the pandemic.
- ❖ **Municipal bonds** have been the only asset class in fixed-income that has not generated strong returns for the year, due to increased supply (issuers needed to cover budget gaps as Covid support has ended), rising longer-dated yields, and uncertainty about the tax-exempt status of Munis with the expiration of the 2017 Tax Cuts and Jobs Act. As a result, the ratio of Munis to Treasuries has risen to 61%/69%/89% respectively for 5/10/30 year bonds, making them very attractive for higher-bracket taxpayers. The U-shaped Muni yield curve persists, making a barbell strategy attractive for income-oriented investors.
- ❖ **Will a prolonged government shutdown impact Treasury investors?** Past shutdowns have lasted an average of 8 days. Treasury issuance and redemptions should not be impacted. However, the uncertainties created by the halt in data released by government agencies (such as the unemployment report published by the Bureau of Labor Statistics) may lead to greater volatility as traders operate in the dark. The shutdown may also exacerbate concerns that foreign investors have about the growing U.S. federal deficit and the Dollar.
- ❖ At current yields bonds offer positive inflation-adjusted returns and capital protection, offsetting potential volatility in equities. Investors should be aware that stock-bond correlations could become high in the event of a major equity market correction.

### Treasury Yield Curve Change In 2025



Source: treasuryyieldcurve.com

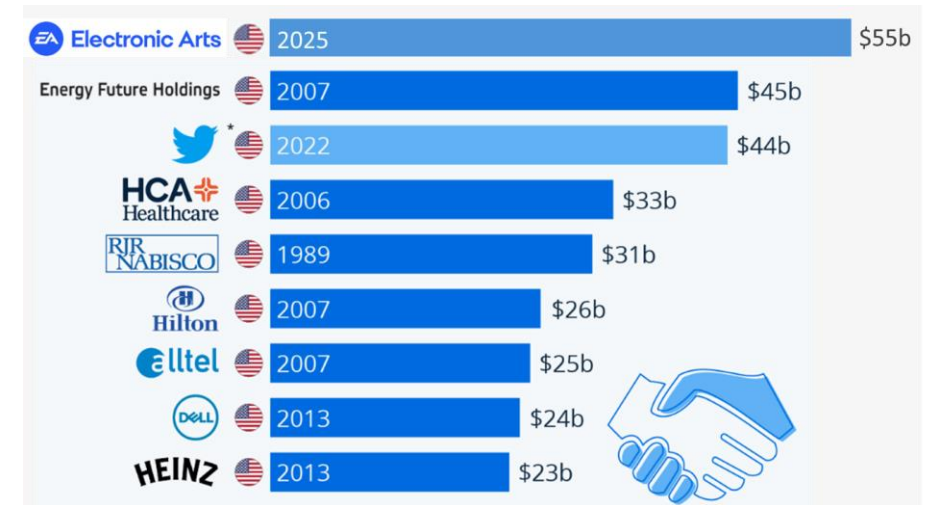
### Attractive Starting Yields May Offer Opportunities



Source: Pimco

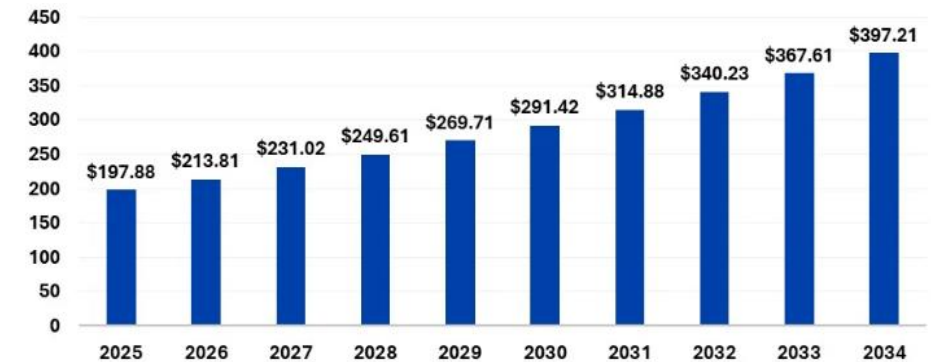
- ❖ Electronic Arts, the video-game maker behind The Sims, Madden NFL, and FIFA, is being taken private in a \$55 billion deal, **the largest leveraged buyout ever**. Saudi Arabia’s Public Investment Fund, private equity firm Silver Lake and Jared Kushner’s Affinity Partners, will buy the company, financed with a \$20 billion loan from J.P. Morgan in the biggest LBO financing package ever. While Wall Street hopes the deal will spur more M&A activity, others worry that its elements – a sovereign wealth fund, a 25% premium over its stock price, and a huge debt burden – signal a market top.
- ❖ Until dealmaking resumes, **GP-led continuation vehicles will continue to be an exit option for many Private Equity sponsors**. They now represent over half of the secondary market. Instead of selling companies to their industry peers or other Private Equity funds, sponsors are placing them with a new set of investors, returning capital to existing partners. While skeptics claim that this shows their portfolio valuations are too high and is just a way of continuing to earn fees, research suggests that these investments have generated good returns with lower risk, due to the improvements that the sponsors have made, lower leverage and sponsors having more skin in the investment.
- ❖ While leveraged buyouts are facing challenges, other private strategies are performing well. **Transportation** weathered the Covid pandemic and is now benefiting from strong fundamentals and rising inflation. In aircraft leasing, Boeing and Airbus continue to struggle to ramp up production, leading to aircraft shortages and higher rental yields. Railcars have performed well due to modest supply and demand from the chemical and oil industries. Even in global shipping, where traffic growth is expected to slow to just 0.5% this year due to tariffs, global conflicts, congested ports and climate change (the Panama canal is low from droughts), freight rates have climbed.
- ❖ **Finally, has private Real Estate bottomed out?** The ODCE index of institutional assets has returned 3.5% over the past 12-months, led by industrial, retail and residential assets, while office and hospitality continue to struggle. Fund redemption queues have eased, and transaction activity is increasing. Core strategies offer income that is an alternative to bonds. There are opportunities to acquire high-quality assets from stressed owners unable to refinance them. Debt defaults are rising, even in multifamily where developers who financed at ultra-low rates are struggling with higher debt service costs.

## Largest Buyouts in History



Source: Statista

## Aircraft Leasing Market Size Forecasts, US\$ billions



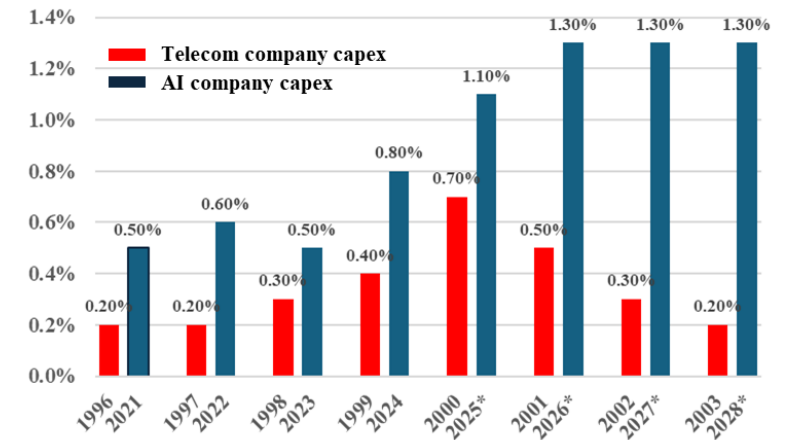
Source: Precedence Research

# Are We In An AI Bubble?

3<sup>rd</sup> Quarter 2025

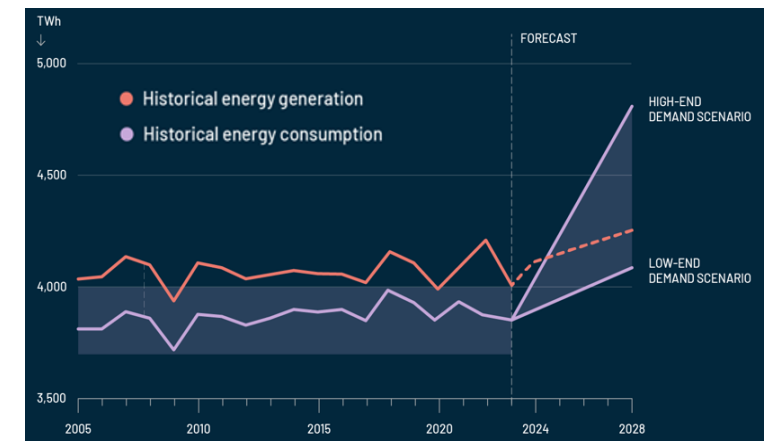
- ❖ The “hyperscalers,” including Amazon, Microsoft, Alphabet and Meta , have spent a staggering \$400 billion in capital expenditures this year for data centers, GPUs and power infrastructure. These investments (as well as projected spending) represents a greater percentage of GDP than the spending by telecom companies in the 1990’s internet bubble. Will this spending pay off, or lead to bankruptcies and wealth destruction similar to the telecoms?
- ❖ **No one knows what the return on AI investment might be.** The hyperscalers are engaged in an arms race in the belief that there will be a few winners that will capture monopolistic revenues. Some AI companies are making money – Anthropic’s revenue have grown to \$5 billion just 2 ½ years after its launch – but a report from MIT suggests that while tools such as ChatGPT have been rapidly adopted, “enterprise AI solutions have a 95% failure rate” and have not improved the bottom line for companies. It may just be too early for AI tools to have meaningful impact on productivity.
- ❖ OpenAI committed to buy **\$300 billion** of computing services from Oracle. Oracle pledged to buy **\$40 billion of** Nvidia chips, and Nvidia agreed to invest **\$100 billion** in OpenAI. Will these circular transactions create real economic value, or are the parties creating the illusion of growth to boost valuations and stock prices? After the announcements, Oracle’s stock shot up nearly 36%, briefly making founder Larry Ellison the wealthiest man in the world. Anthropic, a private company, just raised \$13 billion at a \$183 billion valuation, just 6 months after its last financing round in March when it was valued at \$61 billion! What happens to these plans if equity markets correct?
- ❖ The massive scale of capital needed to develop AI cannot be met from any company’s near-term retained earnings but may require a web of collaboration amongst semiconductor makers, database vendors and software developers. Nvidia’s announcement that it would invest \$5 billion into rival Intel is a reflection of this new order. However, these dependencies may pose systemic risks to both markets and the broader economy.
- ❖ A major constraint in the forecasts for AI growth is power. According to the International Energy Agency’s analysis, electricity consumption from AI, data centers and cryptocurrencies is expected to **double by 2026**. The industry agrees that supply chain bottlenecks (backlog of turbines), transmission interconnection queues (as long as 6 years in ERCOT), technological challenges (small modular nuclear is untested) and regulatory hurdles mean that power supply may be unable to keep up with demand, and delay AI adoption.
- ❖ It took several years for winners who could take advantage of the infrastructure that was built to emerge after the bursting of the telecom bubble. Cautious exposure to venture capital, private equity, real estate and public stocks will provide insights into the winners in the AI revolution.

Capital Expenditures In Dot.com And AI As A Percentntage of GDP



Source: The Felder Report, SoFi, Bloomberg

U.S. electricity Demand vs. Generation



Source: Submer

# Disclaimer

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## VIEW CAPITAL RIA, LP

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### **Glossary and Index Definition**

- Alerian MLP Index (MLP) - The Alerian MLP Index is a composite of the 50 most prominent energy master limited partnerships calculated by Standard & Poor's using a float-adjusted market capitalization methodology. The index is disseminated by the New York Stock Exchange real-time on a price return basis (NYSE: AMZ). The corresponding total return index is calculated and disseminated daily through ticker AMZX.
- Barclays Capital U.S. Municipal Index – The U.S. Municipal Index covers the USD-denominated long-term tax-exempt bond market. The index has four main sectors: state and local general obligations, revenue bonds, insured bonds, and prefunded bonds. Many of the sub-indices of the Municipal Index have historical data to January 1980. In addition, several subindices based on maturity and revenue source have been created, some with inception dates after January 1980 but no later than July 1, 1993. In January 1996, Barclays Capital also began publishing a non-investment grade municipal bond index and “enhanced” state specific indices for Arizona, Connecticut, Maryland, Massachusetts, Minnesota, and Ohio. These indices are published separately from the Barclays Capital Municipal Bond Index.
- BofA Merrill Lynch Convertible Bond Index (Convertibles) - The BofA Merrill Lynch Convertible Bond Index tracks the performance of US dollar denominated convertible bonds issued in the US domestic market. In addition, qualifying securities must have at least one-year remaining term to final maturity, a fixed coupon schedule and a minimum amount outstanding of \$100 million.
- BofA Merrill Lynch Perpetual Preferred Securities Index (Preferred) - The BofA Merrill Lynch Fixed Rate Preferred Securities Index tracks the performance of US dollar denominated preferred securities issued in the US domestic market. Qualifying securities must be rated investment grade (based on an average of Moody's, S&P and Fitch) and must have an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).
- BofA Merrill Lynch US High Yield Master II Index – This index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.
- BofA Merrill Lynch EM External Debt Sovereign Index – This index tracks the performance of US dollar-denominated debt issued by sovereign issuers in countries belonging to emerging markets.
- BofA Merrill Lynch Mortgage Master Index – This index tracks the performance of US dollar-denominated mortgage securities.
- BofA Merrill Lynch Municipal Bond Index – This index tracks the performance of US dollar-denominated investment grade tax-exempt bonds.

## Disclaimer (Continued)

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- Credit Suisse Leveraged Loan Index – This index tracks the investable market of the U.S. dollar denominated leveraged loan market. It consists of issues rated “5B” or lower, meaning that the highest rated issues included in this index are Moody’s/S&P ratings of Baa1/BB+ or Ba1/BBB+. All loans are funded term loans with a tenor of at least one year and are made by issuers domiciled in developed countries.
- JP Morgan Emerging Market Bond Index (EMBI+) - The Emerging Markets Bond Index Plus tracks total returns for traded external debt instruments in the emerging markets. The instruments include external-currency-denominated Brady bonds, loans and Eurobonds, as well as U.S. dollar local markets instruments. The EMBI+ is concentrated in instruments from the three major Latin American countries (Argentina, Brazil, and Mexico), reflecting the size and liquidity of these external debt markets. The non-Latin countries are represented in the index by Bulgaria, Morocco, Nigeria, the Philippines, Poland, Russia, and South Africa.
- MSCI Emerging Market Index (Emerging Market Equities) - The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of March 2015, the MSCI Emerging Markets Index consisted of the following 23 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Türkiye, and United Arab Emirates.
- MSCI Frontier Market Index – The MSCI Frontier Market Index is a free float-adjusted market capitalization index designed to measure equity market performance of the frontier markets. As of March 2015, the MSCI Frontier Markets Index consists of the following 24 frontier market country indices: Argentina, Bahrain, Bangladesh, Bulgaria, Croatia, Estonia, Jordan, Kenya, Kuwait, Lebanon, Lithuania, Kazakhstan, Mauritius, Morocco, Nigeria, Oman, Pakistan
- Russell 2000 Index (TR) - The best-known of a series of market-value weighted indices published by the Frank Russell Company. The index measures the performance of the smallest 2,000 companies in the Russell 3000 Index of the 3,000 largest U.S. companies in terms of market capitalization.
- Russell 1000 Index (TR) –A market-value weighted indices published by the Frank Russell Company. The index measures the performance of the largest 1,000 companies in the Russell 3000 Index of the 3,000 largest U.S. companies in terms of market capitalization.
- S&P 500 Index (TR) -Widely regarded as the best single gauge of the U.S. equities market, this world-renowned index includes 500 leading companies in leading industries of the U.S. economy. S&P 500 is a core component of the U.S. indices that could be used as building blocks for portfolio construction. It is also the U.S. component of S&P Global 1200. Total return (TR) provides investors with a price-plus-gross cash dividend return. Gross cash dividends are applied on the ex-date of the dividend.
- FTSE NAREIT US Real Estate Index Series – The FTSE NAREIT US Real Estate Index Series is designed to present investors with a comprehensive family of REIT performance indexes that span the commercial real estate space across the US economy, offering exposure to all investment and property sectors. In addition, the more narrowly focused property sector and sub-sector indexes provide the facility to concentrate commercial real estate exposure in more selected markets.
- Data Sources: Bloomberg, L.P., JPMorgan, BofA Merrill Lynch, Standard and Poors, Barclays Capital, Alerian, Morningstar Direct, MSCI, HFR, Goldman Sachs, Trading Economics, HIS Markit, Eurostat, Eaton Vance.
- n, Romania, Serbia, Slovenia, Sri Lanka, Tunisia, Ukraine, and Vietnam.