Weekly Update

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- The government reopens
- AI monetization concerns fester (in certain areas)
- What did the government shutdown cost?
- Wage growth has flipped
- Cash Flow over Capex
- Broad-based growth in revenues
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week
- Positioning

	Last	5d %	YTD %	1yr %
S&P 500	6,851	0.8%	17.5%	15.5%
QQQ	$621.57	-0.3%	22.0%	21.5%
US 10 YR	4.08%	4.16%	4.57%	4.47%
USD/DXY	99.5	100.2	108.5	106.5
VIX	17.5%	18.0%	17.4%	14.0%
Oil	$58.36	-2.1%	-18.5%	-14.1%

*10yr, DXY, and VIX are levels not changes
** Oil is front month futures, beware

Right when we started to worry about the economic effects of the government shutdown, the government is no longer shutdown! Flight cancellations and unpaid military really crank up the heat. But the nervousness around the monetization of Artificial Intelligence persists. The financial press is writing more about the debt deals that are being used to fund some of the giant AI data centers/campuses. This has been a growing concern of ours. But we also know the use of quirky debt is concentrated in a few players (see below). As many analysts have pointed out, the overall investment impulse is lower than other periods of emerging technologies. Again, the key here is the growth of cash flow relative to new capex spending. We do not care if ChatGPT goes the way of dial-up internet as long as the whole ecosystem is making money (perhaps including OpenAI's other businesses).

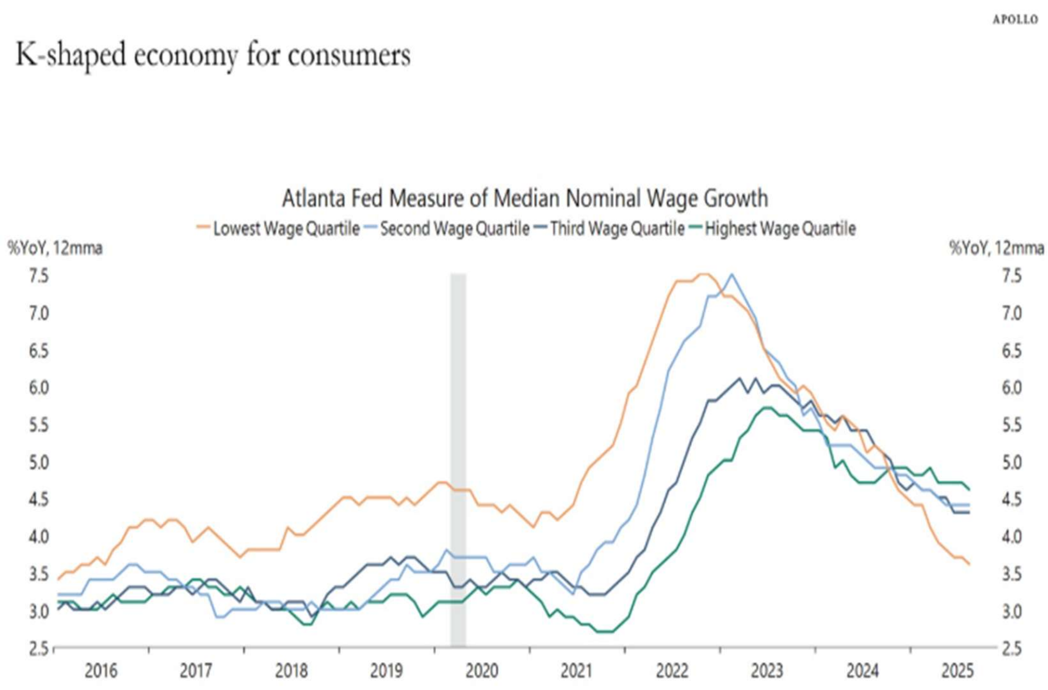
But with these understandable jitters come the click-bait stuff. Michael Burry reiterated his short stance by taking a page out of the Chanos playbook…they are pointing out the generous depreciation cycles of these chips (they contend that they must be replaced much sooner than the companies are claiming). This very well could be true…again, it all comes down to monetization…renting out GPUs might not be a great business. But utilizing different levels of chips for different tasks seems more than plausible (and thus no need to replace every single chip every single year etc.). The headline that Softbank sold its entire stake in Nvidia spooked some. Of course, Softbank did this so they could fund their investment in OpenAi. Not exactly refuting the bull case for Artificial Intelligence no matter how much we disagree with Softbank (on many things). On the macro side, some pundits are pointing out the growth in the Treasury General Account. The idea that when the TGA grows, there is less money being pumped into the economy. This has pressured short-term funding markets higher. Normally this is a red flag for the economy…but not when it is an artificial interruption to activity. Well, sure; the government has been closed. For what it is worth, JP Morgan says the average IRS refund will be about $4k. Even without Trump parachute money (tariff rebate, health insurance savings, whatever other populist idea they can dream up), this will be a tailwind for the economy.

- What did the government shutdown cost?

As for the government shutdown, the bulls say, "we told you so…and nothing happened to the economy." The bears say the foregone spending can never be undone (or done). Obviously both sides are exaggerating, but the truth is closer to those in the bull camp. Most analyses peg the lost economic activity at about 1% of GDP (annualized) over the six-week period. This roughly translates to a notional decline of 0.12%. And of that, even the skeptics will submit that the economy will recover about 80% of this when the government reopens. And this is against a backdrop of an accelerating economy in the 3Q. The Atlanta Fed just increased its nowcast for 3Q GDP to 4.0%. Goldman increased its forecast to 3.7%. The NY Fed's forecast is much lower at 2.3%. But they cast their numbers in a probability range…they think with 50% probability that growth will be between 1.3% and 3.4%. (We do not find much value in this. We think the Atlanta Fed number is poorly constructed when it is released early in the quarter, but it gains efficacy throughout the releases.) Bottom line: 3Q was good, the shutdown will take some growth from 4Q, but the economy will get most of it back later in 4Q and into 1Q next year. (A big caveat here is that 4Q GDP was already looking lower than 3Q…more tariff impacts and slowing labor perhaps. The reversal of some of Trump's tariffs could be another impulse for the economy assuming refunds will be made.)

- Wage growth has flipped

Lower income workers experienced strong wage growth in the pre-Virus Fear years. But since the inflation spike associated with the free money parade in the aftermath of the entire economy being shut down, this group is experiencing more sluggish wage growth. This fits into the same odd dynamic of a slowing labor market within a strong economy.



One interesting piece of conflicting data is in Retail. Off-price retailers are outperforming Specialty retailers.

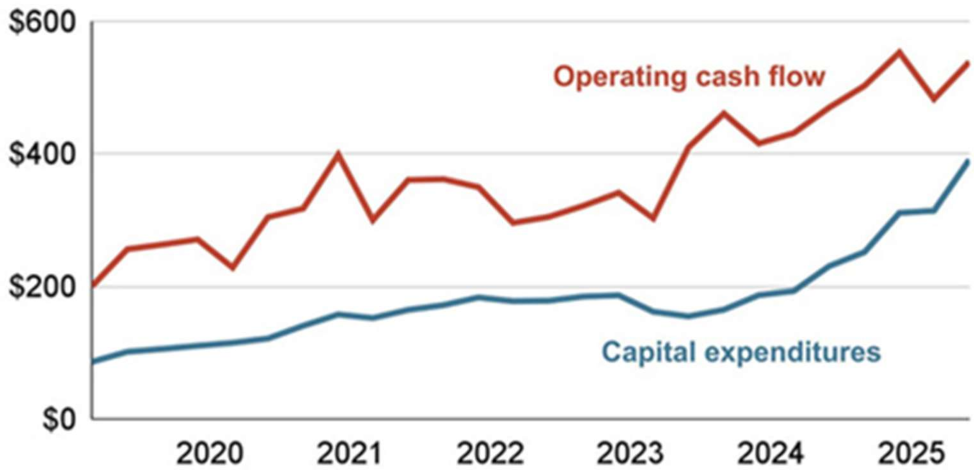
For the record, we are retiring "K-shaped economy" from our lexicon. It is the most overused terminology in the idiot-pundit circles (Apollo are not idiots…far from it). We might make this a semi-recurring segment. We have already retired the words "cohort" and "whilst" as signs of bloviation.

- Cash Flow over Capex

John Mauldin (thoughtful economist who writes in plain English) had a good weekly letter basically saying exactly what we have been saying: Employment might be softening (with signs of stabilizing), but the broad economy is still booming because of Artificial Intelligence. The big worry is what will be the path of monetization. For all the fear of increased use of debt financing (accompanied by boneheaded comments from OpenAI) with the spiraling capex commitments, operating cash flows are still keeping pace. This simple chart is probably the most important one to monitor (Mauldin sourced it from Understanding AI).

Big tech cash flow is still bigger than capex

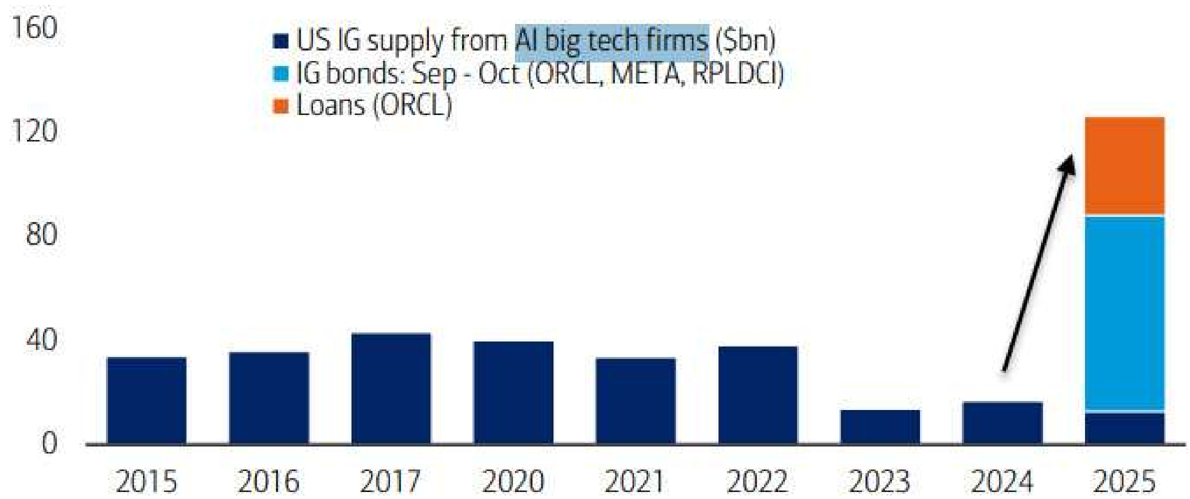
Google, Amazon, Meta, Microsoft, Oracle (billions of 2025 dollars)



But we surely do not want to minimize the surge in debt. Here is a chart from Merrill. They say the operating cash flows are still good, but any meaningful uptick in spending or decrease in cash flow could lead to a crossing of the Rubicon.

Exhibit 1: Borrowing to fund AI datacenter spending exploded in September and so far in October

IG bond market supply from META ($30bn), ORCL ($18bn) and RPLDCI ($27bn) totaled $75bn, and that's not counting the $38bn loan tied to Oracle.



Note: "AI big tech firms" include the following: AMZN, GOOGL, META, MSFT, ORCL.

Source: BofA Global Research

BofA GLOBAL RESEARCH

- ➢ Broad-based growth in revenues

One of the bear arguments is that Earnings are concentrated in the Mag 7. While Technology has been the lead dog, Revenues have been strong and accelerating across the board (ex-Energy…drill-baby-drill has its drawbacks). And do not look now, but left-for-dead Health Care is making a comeback.

Sector	Today	1 Oct	1 Jul
Consumer Discretionary	7.1%	3.9%	2.3%
Consumer Staples	4.2%	2.8%	2.6%
Energy	1.1%	-2.0%	-6.9%
Financials	7.8%	3.4%	2.7%
Health Care	10.3%	7.9%	6.9%
Industrials	6.6%	4.5%	3.9%
Materials	5.1%	4.4%	3.8%
Real Estate	7.7%	6.3%	5.9%
Technology	16.1%	14.7%	11.2%
Communication Services	8.4%	7.1%	5.1%
Utilities	6.9%	5.9%	6.5%
S&P 500	**8.1%**	**5.7%**	**4.2%**

Source: LSEG I/B/E/S

Exhibit 8. 2025Q3 Actual Revenue Growth

	S&P 500
Today	8.1%

Source: LSEG I/B/E/S

- Other economic data is mixed

We got that Weekly ADP Employment data that we noted last week. It was a drop of -11.25k of Private Payrolls. This flipped from the initial data point of +14.25k. The monthly report in October was positive with a gain of 42k. Recently, we surmised that while employment data was still weak, it was showing signs of recovery. We think the "alternative" data (ie nongovernment) is a little more mixed. For what it is worth, Goldman says this "alternative" data usually has a two month lead over the actual Jobless Claims data (which is perceived to be the best real-time government data).

Small Business Optimism remained flattish.

The average 30-year mortgage rate ticked up a touch from 6.31% to 6.34%.

Weekly Mortgage Applications ticked up slightly.

Weekly Redbook Retail Sales increased to 5.9% from 5.7%.

- Where did all the crypto money go?

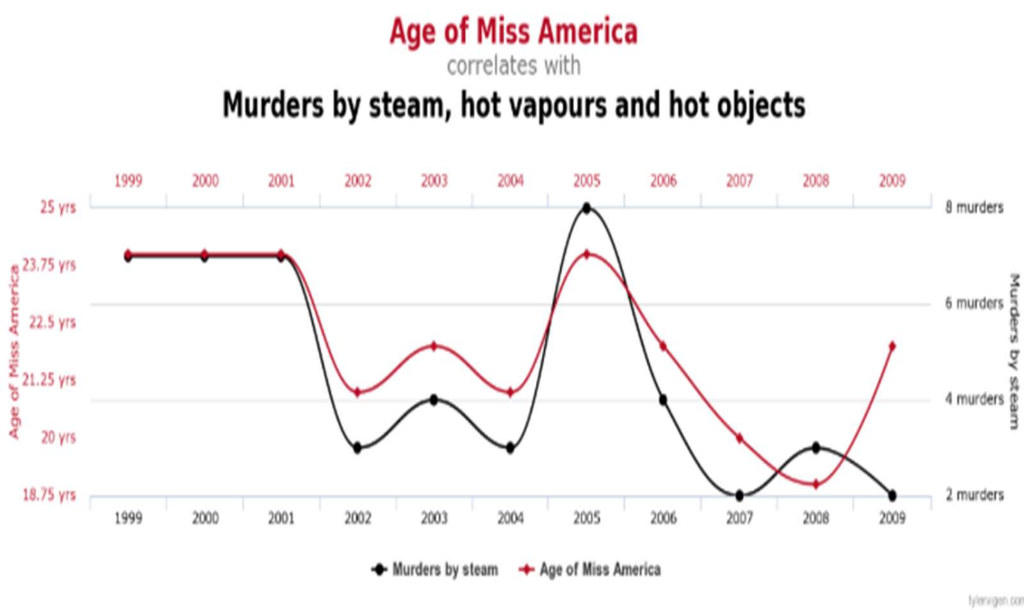
Stablecoins are an interesting creation of the crypto world. Basically, these are dollar backed deposits that can be transferred instantly on the blockchain…no more middlemen taking a chunk out of your bounty (likely illegally gotten or at least illegally transferred, but that is not the point…there are real world uses for a freely transferable, global, USD-backed currency.) one of the gripes from the traditional finance guys is that nobody really knows if your deposits are actually backed by USD. Circle, the USD regulated stablecoin, is above board on this. It is a publicly traded company, so it has clear disclosures. Tether, on the other hand, is the world largest stablecoin that is not sanctioned in the US. It is some sort of Italian and El Salvadorian mash-up without any real disclosures other than empty promises. Tether is now trying to launch a stablecoin in the US. It plans on doing this by having the US-based video service Rumble buy the German data center company, Northern Data. Tether owns controlling stakes in both of these companies. Rumble is going to be the initial distributor of the new stablecoin…there will be a Rumble Wallet. Rumble wants to get into the data center business because it wants to expand into email and file storage.

If you have a deposit on Tether, we are not sure you want this backed by an investment in money losing video service and a data center trying to unseat Google and Microsoft in the email world.

- Chart Crime of the week

Murder by hot vapors? Is this chart creator harkening back to Jamie Lee Cutis in 1981?

And who knew this would be a beauty pageant themed letter (more below).



- Quick Hits
  - MoviePass, the movie ticket subscription service that has had some ups and downs (including bankruptcy), has launched a movie-based prediction market. This will include betting topics such as award winners and critics's ratings. It will also operate a fantasy competition in which you draft celebrities…for what we have no idea.
  - A contestant during the Miss World Chile pageant sang an original song of her "death metal" band called Decessus.
  - In the Miss Universe pageant, a judge called Miss Mexico "dumb." The contestant was kicked out after responding.
  - Amherst beat Willaims 14-13 in the 140th edition of The Biggest Little Game in America.
  - Scorigami? Amherst's 14 points were a combination of four field goals and a returned two-point conversion. Now that is exciting football!

- In 1995, the font page of the New York Times declared, “Amherst beats Willaims in 0-0 tie.”
- Scorigami! Houston beating Jax 36-29 is the 1094th unique score in NFL history.
- The Carolina Panthers have not won a game as the betting favorite in over four years (0-11).
- The coastline of Lake Superior is over 500 miles longer than the entire eastern coast of the US.
- The US is the 14th largest shipbuilder in the world.
- Sonder Hotel filed chapter 7 bankruptcy so quickly that they had to kick guests out of their hotels.
- Atlantic City taxi fares are capped at $13 (if travel is within the city limits). (Loose correlation to our Miss America theme.)

TSLAQ: Not much to report from Musk land since he won approval for his gigantic Tesla pay package last week. Well, the one notable thing is that he has been focusing almost exclusively on xAI and SpaceX.

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