CLEARING THE FOG

As the federal government reopens – slowly – investors and policymakers will be able once again to use “hard” official data on jobs and prices to analyze the economy. Will markets react? Or will they be focusing, as they have this week, on the Federal Reserve and the likely path for interest rates?

Hawkish comments from a number of Fed policymakers – including Cleveland President Beth Hammack who will join the decision-making FOMC next year – sent US equities tumbling earlier this week, after a wobbly start to November last week. By Friday’s close, US markets were positive for the week but still negative on the month. Globally, markets excluding the US are positive for the month. Pricing for a December cut in rates has now slipped to less than 50%. At the end of October, a further 25 bp cut was seen as a virtual shoe-in, with five further declines expected in 2026.

Rapid policy changes, notably on tariffs and trade, have led to uncertainty and shifting economic forecasts since President Trump took office in January. The fog thickened when the Administration stopped collecting and publishing key data for prices and the labor market as the government began a record-long shutdown – reaching its 43rd day by the time Congress moved to end it. Even when the government is fully back, it is likely that data for October will never become available, and that data for September will be missing key elements.

Markets have mostly taken the uncertainty in stride. For a while, enthusiasm over the growth prospects from AI drowned concerns about whether consumer demand might be slipping with a weaker labor market and still high inflation – as mentioned by RockCreek founder & CEO Afsaneh Beschloss on Bloomberg’s “The Close”. That optimism slipped in November, with US equities down 1.6% month to date. Bond markets are slightly positive. The dollar has weakened, although it is still off its lows of the year. Gold increased by 2.0% in November month to date. European, Japanese and EM equities are outperforming the US so far this month as well, extending their notable outperformance YTD.

While strong earnings and hopes of easier money continued to buoy US equities until this month, chatter has increased about whether the AI boom is now bubbly. The seven largest companies in the index now account for 35% of the S&P 500. They have powered the market’s rise this year as well as last year about half of the market rise, while investment associated with AI accounted for the bulk of the growth in the US economy in the first half of 2025. Much of the recent good news in venture and private equity are also linked to AI in one way or another. And the boom in real investment in data centers and power has accounted for a measurable share of growth in the US economy so far this year, taking over, even if briefly, from consumer spending as the main source of economic growth.

At the same time, the US and global economy have so far weathered the impact of the suddenly high – and variable – tariffs imposed by the US more successfully than predicted six months ago. Growth is expected to be slower this year than last. But few expect recession. Before the federal shutdown stopped the publication of inflation numbers, there was no sign of a sharp spike from tariffs. Inflation was sticky, nevertheless, holding close to 3%.

Looking ahead to the end of this year and into 2026, RockCreek sees three themes for investors, against the backdrop of continued uncertainty in particular on tariffs and their impact.

- ***Is the AI investment and stock market boom sustainable?*** Views – and evidence – are divided. Valuations are certainly high. But so is the promise of economic transformation and productivity growth that could come from widespread development of AI, including building the data centers and power that it needs to drive the economy. We were early investors in data centers and Open AI. We expect application of AI to be an important area in 2026. Constraints on power needed for compute may inhibit infrastructure returns in the future. Private credit is increasingly funding this investment.

- ***How far can interest rates fall without risking inflation – and is Fed independence a variable to worry about?*** The Fed has been slower in cutting rates than the market has expected since easing began in September 2024. Chair Jerome Powell struck a cautious note about 2026 after the Fed's October policy meeting. Since then, a number of Fed voters – most recently Susan Collins of the Boston Regional Fed – have suggested that a cut in December may not be warranted. Powell's term as Chair ends in May. There may be less resistance from a new chair to President Trump's vocal push to lower rates sharply.

- ***Is the jobs market softening?*** A slowdown in hiring may be a feature of the new landscape of sharply reduced immigration rather than reflective of weaker demand for labor. If labor demand is weakening as well as supply, that could have a snowball effect. Higher unemployment leads households to slow down spending.

IS IT A BUBBLE – AND IF SO, DOES THAT MATTER FOR THE ECONOMY?

Investors have been faced with two divergent views of the economy this year. Disruption to the global economy from President Trump's shifting tariff policy has not been as costly as expected – at least so far. It is also unclear if it has led to bringing actual net new investments – despite the headlines. The impact on productivity and efficiency of changing supply chains and shifting trade relations may show up over time. In the near-term, inflation has not risen sharply. But many Americans are still very concerned about affordability, including for housing, groceries and borrowing. Meanwhile, the stock market reflects a strong belief in the economic possibilities of an AI revolution. Siddarth Sudhir, Managing Director and Co-CIO at RockCreek, joined Illinois State Treasurer Michael Frerichs and Colorado State Treasurer Dave Young to discuss housing affordability and investments, as well as investing in data centers and AI-related infrastructure at the For The Long Term DC Forum.

Skeptics point to the evidence that early business adopters of AI have not seen a big bounce in productivity or earnings. Past industrial shifts have left many companies, including first movers, bankrupt. Others note that, like the railroad boom in the mid-19th century or the creation of fiber-optic networks 150 years later, the AI boom now is leading to real investments that will likely continue to have economic value, even if the original investors may lose out. Afsaneh Beschloss discussed the state on RockCreek's use of AI in investing as well as where she sees the best global growth opportunities for investors during CNBC's Delivering Alpha investor summit. Watch here. There is a history of "productive" bubbles, as eminent economist and former Warburg Pincus senior partner William Janeway points out in a thoughtful new piece.

ARE INTEREST RATES STILL HEADING DOWN: WILL INFLATION HEAD UP?

After the Fed cut the Fed funds policy rates 25 basis points in October, it seemed likely that it would follow up with a further 25 basis point cut at its December meeting. That is no longer true. An unusual split in the FOMC is now a risk, with Fed Presidents Susan Collins, of Boston, and Jeffrey Schmid, of Kansas City, also warning that inflation remains too high. At the same time, three Governors – Stephen Miran, just appointed by President Trump, Michelle Bowman and Christopher Waller – have favored easier money. However, Chair Powell manages the December meeting, the current Fed policymaking group will likely be cautious about promising more easing in 2026 until it can see more data. A bias to cut is likely, given signals of weakening labor market. But inflation is still running above the 2% target. Chair Powell will not want his legacy to be inflation stuck at 3%, where it has been for much of the year.

Next year will bring unusual change to the Fed when President Trump nominates a new Chair at the end of Powell's term in May. This week's news that Atlanta Federal Reserve President Raphael Bostic is stepping down in February, when his 5-year term ends, is a reminder of how quickly change can come next year. Bostic is not a voting member of the Fed this year or next. But his increasingly hawkish tone may have been an influence. As noted above, Hammack, who becomes a voting FOMC member in 2026, has just commented that rates seem appropriate with no reason to cut right now.

AN APPARENTLY STATIC LABOR MARKET CREATES A PUZZLE

In the first flush of recovery from the pandemic, labor market churn hit record highs. Workers moved jobs into better-paying and more productive work. Employers increased hiring sharply but still posted many more vacancies than there were unemployed workers to fill. Labor force participation climbed. The "very, very tight" labor market, as Chair Powell characterized it, led to worries about wage inflation and a wage-price spiral. That did not happen. Instead, the labor market began to cool. Payroll data showed a sharp slowdown in job growth. But the sharp drop in immigration – legal and illegal – has made it hard to determine whether the static labor market is a reflection more of supply than demand. All eyes will be on the unemployment data for November – to be released in early December if the government opens fully. If demand for labor is slackening, unemployment will rise.

The patchy data available in the last six weeks from private sources, including company announcements, suggests that job growth has continued to slacken in Q4, and firings have become more common. So far, GDP growth has held up better than expected this year, with forecasts now mostly close to 2% for the year. The puzzle for the future is whether the demographic change with fewer workers will translate into permanently lower GDP growth.

CLIMATE CHANGE CONTINUES: LUCKILY, SO DOES THE ENERGY TRANSITION

The US has withdrawn from climate negotiations. The issue of climate change has shifted from the front burner of debate, while improving energy productivity is even more center stage given the huge demand for power and water from data centers. The conversation has moved from limiting global warming to 1.5 degrees Celsius to competitiveness, efficiency, and a bigger emphasis on nature. COP30 is now meeting in Belém, Brazil with a difficult task ahead of negotiators, as described by CFR senior fellow Alice Hill. Ten years after the Paris Agreement, it is clear that while countries are falling behind in their ambitious commitments, local officials and companies are pursuing increased energy efficiency and cleaner fuels for their price competitiveness rather than to make political statements. The environmental costs of pollution – visible in Delhi, for example, where air pollution is a major health threat – as well as the financial impact on insurance companies of extreme weather events, are new factors raising awareness of the need for change. Similarly, there has been increased interest in nature in Belém, and in the US, as an important determinant of economic growth. Despite changes in national government rhetoric, and those of Bill Gates recently, economics and technology are pushing the energy transition ahead. According to the IEA's World Energy Outlook, renewable energy and natural gas have been fueling affordable growth while reducing emissions. Rapid advances in technology have also driven down the cost of solar panels and electric vehicle batteries by more than 80% since 2014, making clean energy and transport more accessible and efficient worldwide. The big debate has moved to fulfilling the enormous power needs of data centers more economically and efficiently, both favoring cleaner fuels.

EQUITIES

As we near the tail end of the Q3 corporate earnings season, the overall picture remains one of resilience. S&P 500 companies delivered more than 13% earnings growth year-over-year alongside revenue growth above 8%. Over 80% of companies beat analyst expectations, and while technology continued to lead, strength extended across financials, industrials, and healthcare as well. The main cautionary note was the rise in negative earnings guidance – a concern given that valuation multiples remain at or near historical highs.

In the past few weeks, however, market leadership has started to shift. A momentum unwind has pushed growth stocks to underperform value, driven in part by elevated valuations and renewed scrutiny of AI-related spending plans. Consumer-oriented and cyclical sectors are also under pressure amid growing demand concerns, prompting hedge funds to cut exposure sharply in consumer discretionary. At the same time, short sellers have become more active in targeting technology names, reflecting broader skepticism around stretched positioning and the durability of recent gains.

Outside the US, international equities offer a more differentiated story. In Japan, strong corporate-governance reforms and active shareholder engagements are driving healthy buybacks and balance-sheet improvements. Europe is again outperforming, fueled by its value-heavy sector mix and relatively modest exposure to narrow, AI-dependent mega-tech, making lower valuations and higher dividends more appealing. Meanwhile, equities in South Korea and Taiwan are under pressure as investors pull back from semiconductor-heavy tech segments facing renewed scrutiny. China, however, is holding up – helped by relatively modest valuations, timely policy support, improving export trends and a gradual shift of domestic savings into equities – even as structural risks persist.

FIXED INCOME

So far in November, fixed income performance has been notably muted. The Bloomberg Global Aggregate and US Aggregate are close to unchanged. As discussed above, a dearth of official economic data against the backdrop of what appears to be a slowing labor market and a burgeoning fiscal deficit has left these markets unsure of which way to trend. On the margin, it would seem bond traders are positioning for a marginally weaker economy with credit spreads widening in October and somewhat in November, but not by enough to undo the effect of falling interest rates. Rates have struggled to find direction following the hawkish cut from the Fed last month. Going into the meeting, as many as five cuts were priced for 2026, and another cut at the December meeting this year was a foregone conclusion. Now markets are pricing only three cuts in 2026 with just a barely fifty-percent chance of a cut in December now expected.

The most interesting part of fixed income markets over the past few weeks has been bond issuance related to AI capital expenditures. The most recent headline-grabbing transaction was a $30 billion, six bond offering of senior unsecured debt by Meta, effectively doubling the company's total debt. This followed closely on the heels of the largest ever individual investment grade bond issuance ever – a $27.3 billion, ~24 year maturity, amortizing bond issued by Beignet Investor LLC, a joint venture between Meta and Blue Owl to finance a single, massive data center in Louisiana.

Given this large amount of concentrated issuance, questions around demand naturally begin to arise. Looking at spreads of the Meta bonds when issued vs. the AA index (comparable credit rating), the bonds around the weighted average maturity of that index trade 30-40bps wider than index spread. There is often a new issue premium in the market, but this is notably wider than the ~10-20 premium demanded of Alphabet bonds issued just a few days later. The total indebtedness of Alphabet is still less than Meta, but its total debt outstanding has increased substantially for both companies. Two trades do not a trend make, but it would seem at this point, the market is relatively happy to fund this type of growth via debt markets – but more aggressive players may need to start paying higher premiums in the not-too-distant future.

CURRENCIES – A PENNY FOR YOUR THOUGHTS?

A major theme of markets in 2025 has been the weakening dollar. Indeed, its fall has been much like Mike Campbell's fortune in The Sun Also Rises – gradual, then sudden. Yet, in recent weeks, the Greenback has begun to gain back some of that lost ground. Broadly speaking, it is still 8% weaker on the year, but expectations of a less dovish Fed gave it a meaningful boost higher. The structural headwinds of diversification by international investors remain, but the efforts taken in earnest during late Q1 and early Q2 have potentially slowed with portfolios inching closer to their new normal. Gold remains a favorite alternative – up 5% in November and nearly 60% in 2025, and some emerging market currencies such as the Hungarian Forint, Brazilian Real, and Colombian Peso, have begun to pass developed market peers for outperformance against the dollar this year. The extent of future declines remains to be seen but is something investors are watching closely.

Finally, and very briefly, in a sad turn for the nostalgic, the US Mint officially ceased production of the penny on November 12. In addition to the general decline of physical money transactions, the coin's low value has made it generally irrelevant while costing nearly four cents to manufacture! I guess we will all just have to get used to pinching our nickels. Or will the nickel be next?