

# State of the Markets

From the desk of Darrell L. Cronk



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## Four signals above the noise

*"The stock market is a giant distraction from the business of investing." — John Bogle*

Signal-to-noise ratio is an engineering term. It is a comparison between the clarity of a desired signal against the din of background noise. The signal is the useful and meaningful information that you are trying to detect. The noise is random and unwanted variations that interfere with the signal.

In the early days of telephone communication, the way to bring greater clarity to the signal was by reducing noise. Today, on most smartphone cameras, noise reduction is a built-in feature, removing the random speckles of light and grainy textures to make the subject of our photos pop.

Signal-to-noise ratio can apply to the cyclical change in seasons, as well. We sense the days shortening, we feel a chill in the morning air on the commute to work, and we hear flocks of geese squawking as they fly in formation on their annual migration south. Clear signals that autumn has entered the building. Yet even these signals can be obscured by the noise of stubborn summer resisting its retreat — pay too much attention to that unseasonable hot spell or to the oak trees in Central Park that are the last to surrender their green leaves to reds and yellows, and you can miss the signal for the noise.

In 2025, few would deny that we live in a noisy world. Every day, investors hear the sound and fury of change — pressure on the Federal Reserve (Fed), world alliances re-ordering, negotiating bluster confused for policy, and the sweep of innovations like artificial intelligence (AI) and digital assets swinging day-to-day market movements.

It's easy for investors to stew in the negative news cataloguing everything that could go wrong. But I'm not sure that's the best way for long-term investors to survey the landscape.

In times of great change, it becomes the work of an investment strategist to reorient investors to the signals that will be most material to their long-term success, so they can rise above the noise, get a clear picture of the full battlefield, and understand strategically what it will take to advance their portfolios over a long-term time horizon.

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## Above the noise, a bright horizon

Like an airplane ascending through thick clouds, when we rise above the noise, we at some point emerge into clear skies — and sometimes even with a sunrise or sunset painting the horizon. Similarly, when I force myself to rise above the noise of day-to-day markets, I see bright secular trends on the horizon that have the potential to extend this bull market clear through 2026 and beyond. These four signals resonate most with me:

### 1. Fiscal clarity above the trade noise

It's hard for any of us to avoid the piercing media reminders, and frankly the daily evidence, that we are bitterly partisan and ever more divided. However, when we open the lens to a wider angle, we see two very different presidential administrations that have made large investments in long-term growth opportunities that should continue to benefit the companies investors own.

The One Big Beautiful Bill Act, signed into law by President Donald Trump on July 4, 2025, allows for sizable increases in the expensing of equipment, higher deduction limits for research and development and manufacturing infrastructure, and looser interest-deduction limits for companies. Lost in the noise of the tax-cut extensions is the reality that companies should enjoy a lift to margins and earnings, boosts to the bottom line overlooked as the media focuses on calculating the costs to companies of absorbing new tariffs. Also included in this new law are strong catalysts for consumers from an expanded child tax credit, higher standard income deduction tax limits, and increases in the state and local tax (SALT) deduction.

As much as the new law is favorable for companies, the tangible fiscal clarity this legislation brings into the foreseeable future, enabling companies and individuals to quantify the tax and financial impacts, has boosted markets.

The Infrastructure Investment and Jobs Act, signed into law by President Joe Biden in 2021 to repair and modernize the nation's infrastructure, has seen just 50% of the \$1.2 trillion allocated so far. And the CHIPS and Science Act, signed into law by President Biden in 2022 to support technology innovation in the U.S. and to strengthen the U.S. semiconductor industry, still has yet to be fully allocated as the push to strengthen onshore supply chains remains a top priority across political parties.

Add to those revenue drivers a pendulum swing toward deregulation — most prominently in Energy, Financials, and Health Care — and we see the potential for material relief on the expense side of the balance sheet, as well.

### 2. AI revolution above spending noise

Change is the one constant with investing. Prescient investors understand that great wealth and great innovation are made at the two extremes of the founder level and disruptor level. Rarely do both coincide simultaneously, but when they do, you get monumental periods of transformation like the industrial revolution, the development of the internet, and now the emergence of AI.

The challenge of this AI revolutionary cycle is that it is larger, moving faster, and more compressed than past periods of seismic economic and technological change. Simply put, it will wait for no one. While the pace quickens, the spending to support this infrastructure is simply staggering. McKinsey & Company estimates for AI infrastructure spend alone are close to \$7 trillion by 2030, driven by explosive demand for data centers, compute power, and semiconductors. And at this year's Blackstone symposium for Chief Investment Officers (CIOs), it was estimated that for every \$1 spent on AI, another \$3 will be spent on the infrastructure to support it.

If we look at AI over the length of an innovation cycle — measured in years, not trading sessions — it's easier to detect the signals of early-cycle development. Technology companies are opening new private data centers, utility companies are harnessing power generation for those data-center buildouts, and industrial and materials companies are winning new customers. Fully one third of all capital expenditures (capex) for the S&P 500 this year will be from the technology sector, but it's not limited to just the technology vertical. The tenacles of AI are reaching horizontally across almost every sector and industry.

In our view, we are closer to the beginning than the end of a new capex super-cycle. The additional power and energy needs alone to fuel the AI revolution may be its largest constraint. The demand for reliable and sustainable energy to power the various needs of AI, cybersecurity, cryptocurrency engines, autonomous vehicle growth, reindustrialization of domestic supply chains for manufacturing, and global increases in national defense budgets is beginning to outstrip supply. Even the historically small and defensive Utilities sector is morphing into a growth sector — its current \$2.4 trillion market capitalization projected to double in the next 10 years.

### **3. Monetary policy direction clarity above Fed composition noise**

Historically, when the Fed cuts rates without an impending recession, equities have done very well. In fact, in the last 40 years, every time the Fed has cut interest rates by more than 75 basis points, the U.S. economy has experienced a recession. By the Fed's own dot-plot projections, it anticipates cutting 100 basis points between this year and next if you include its September 17 cut of 25 basis points. (100 basis points equal 1%.)

So, the important question to ask is this: Are the classic preconditions for a recession like a commodity shock, excess private sector or financial leverage, or an asset bubble on the cusp of bursting evident in today's economy or markets? If the economy was close to hitting a wall, it would historically show up in areas like banks or the Financials sector, where we'd see either tepid loan growth or rising delinquencies and defaults from consumers or businesses begin to depress stock prices.

The Financials sector of the S&P 500, as of September 22, is at an all-time high, and there are only a very few times when the Fed has cut interest rates with Financials at or close to their all-time highs. Those periods were historically very good for markets. Also, if concerns about growth were rising, we would see credit spreads in lower-quality areas of the bond market begin to widen. Currently, both investment-grade and high-yield credit spreads are showing no warning signs.

The point is that monetary policy stimulus without an economic recession historically has been very powerful for economic and market growth. We will remain vigilant for any signals that may warn of a change in course, but as of now, the lights remain green.

### **4. Market breadth expansion above concentration noise**

Over the past couple of years, we've warned that a few mega stocks were driving markets higher. Get some bad news on a couple of those mega stocks, like the news from China in January that DeepSeek found a more efficient way to do generative AI, and markets can drop precipitously. In January, that news wiped out nearly \$1 trillion in market capitalization for U.S. technology stocks, reminding us why narrow advances can be dangerous for investors.

As we sit here today, in the first days of autumn, equity valuations look high by historical standards, but when we dig deeper and view the S&P 500 Index on an equal-weighted basis, we get a different signal.

The S&P 500 Equal Weight Index reminds us that while a few mega stocks can create a lot of noise, most

large-cap stocks today are reasonably priced. As market breadth expands and strength broadens into other sectors beyond just technology, we believe investors can find good value even as earnings growth strengthens.

Another reason for optimism is the piles of dry powder sitting on the sidelines. The Fed may have begun bringing down short-term rates, but money market balances, at \$7 trillion or so, remain at all-time highs. Not all of this will get reinvested — \$4 trillion is structured cash (such as the cash consumers and institutions set aside to use every day) — but if the Fed lowers rates, as we expect, those funds are likely to look for a new home. And we believe some portion of it will find its way into equities, bonds, real estate, and commodities.

One more point: Historically, when equity valuations are high, and deregulation is in the air, we get a resurgence in merger-and-acquisition activity. Companies plump with cash on the balance sheet, riding all-time high equity prices that can help monetize deals, have tended to more aggressively seek out synergies to unlock new value for growth. In 2025, merger-and-acquisition activity is up over 30% year over year and initial public offerings (IPOs) are up over 60% year over year. And what we've seen through history is that when merger-and-acquisition deals are robust, equity markets have tended to perform well.

## Looking forward

I've been thinking about signal-to-noise ratios as the calendar flips from summer to autumn.

If we take time to notice, we can see the telltale signals that summer is fading away. Squirrels scurry nervously about, collecting acorns or pinecones for winter storage. The sun that hurried to rise all summer long begins to sleep in later, and the windows are dark as we prepare for our day. The market calendar is nearly ready to flip from the third quarter to the fourth — into what always feels to me like the fastest quarter of the year, and which has historically been one of the best.

Market noise is an unavoidable part of managing investments and has reliably proven a stumbling block for both the experienced and novice investor alike through the years. One of the pioneers of modern portfolio theory, the late Fischer Black, stated that market “noise” should be distinguished from “information” and showed in his work almost 40 years ago that more trading occurred from market noise than from evidenced information deserving to be acted upon. Distinguishing between the two is where wise investors differentiate themselves from the herd.

So today, when we step back from the noise and surveil the landscape at a higher level, we see some secular themes that could drive profits, productivity, and pricing power within markets for years to come. Of course, there are plenty of risks to monitor, economic and geopolitical, but rarely do so many favorable conditions — an early and strong capex spending cycle, fiscal clarity, falling interest rates, deregulation, a massive technology revolution, and a manufacturing reshoring renaissance — align simultaneously. When they have, historically, it has been a good environment for markets.

For investors, the signal, sharpened by tracking fundamental trends over time, is the real focus. The noise, delivered daily in headlines and sound bites, simply confuses. We'll keep our eyes focused on the horizon; that is where the battle is really won and where real wealth can be generated.

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