US Equities
Investment comment

October 31, 2025

Document intended mainly for professional investors

The facts: With the government shutdown blocking the release of most indicators, investors focused on earnings and companies' comments to assess the state of the US economy. This looked resilient but uneven. Domestic and international politics remained messy in the backdrop.

The Democrats and the Republicans kept sticking to their respective positions around the US budget and, despite rising fears that the dispute could backfire against congressmen in general, there was little hope of seeing the "shutdown" come to an end any time soon. **One of the most visible effects for investors was that economic indicators, most of which are compiled by government-funded departments, were not released**. The Bureau of Labor Statistics, which is part of the Department of Labor, however managed to publish September inflation data (which were slightly lower than expected) but not the much awaited employment metrics. A handful of indicators produced by private bodies were also available. This was the case of the ISM indices, which were rather soft: at 49.1, the Manufacturing index was up but still below 50, whereas that for Services was down to 50, its second lowest level in 15 months. The Conference Board's Consumer Confidence index was also mixed: the September release was revised up, but remained lower than the previous one, and the October sentiment was further down. A few other indicators, which we usually do not pay much attention to, like the University of Michigan's monitoring of sentiment, were also slightly down. Housing however appeared to fare a little better, with a surprising rebound of the NAHB index (from 32 in September to 37) and decent existing home sales, according to the National Association of Realtors.

Despite the lack of economic data, the Federal Reserve decided to cut its target rate again, by 25 basis points. Most members of the committee supported that decision, although Donald Trump's ally Stephen Miran continued to push for a 50 bps cut, while another director voted to keep rates unchanged. Overall, **the outcome was in line with most investors' expectations but, in his post-FOMC comments, Jay Powell warned that a new cut in December was far from granted**.

For lack of macroeconomic references to assess the state of the US GDP, the first batch of quarterly corporate results and accompanying comments was closely watched, although it could not be considered fully representative because of sector biases. **So far, the season looked similar to the previous one, with a relatively low percentage of companies missing consensus expectations, and rather vague comments about the future**. Financials were among the first companies to report. The largest groups generally did well, with the help of drivers such as M&A and trading, and their moderate provisioning was viewed as reassuring news about credit risk. There was more nervousness around regional banks, though, as investors assessed the significance of two recent bankruptcies in the auto sector. Spare parts manufacturer First Brands and used car retailer Tricolor (whose business involves subprime lending) both sought "chapter 11" protection in recent weeks. Jamie Dimon's comment on this issue ("when you see a cockroach, there are probably more") sent a shockwave through the private credit market. As regards the other sectors, reported earnings were generally strong and well above

expectations, including in consumer-facing industries, where not only staples categories, but also carmakers and airlines, surprised positively. Some, like Coca Cola, admitted that lower income customers were under pressure, but their rising margins showed that more affluent consumers were still spending. **Some analysts linked this resilience to a "wealth effect" supported by recent wage hikes and the levels reached by the real estate and equity markets**. Retailers will report later in the season but several airlines talked of a solid demand for premium seats, thus fueling the view that consumer had generally been resilient. Many executives however also highlighted the uncertainties and remained reluctant to look too optimistic about the fourth quarter or 2026. Several large groups, such as Amazon and UPS, announced tens of thousands layoffs. They did not link their decision to a particular concern, but it looked as if the focus on productivity was back in favor. In several cases, agentic's growing ability to perform administrative tasks was linked to job cut announcements. AI-related businesses continued to issue upbeat forecasts on the back of a continuing order flow, which came mostly from hyperscalers and other large players. **This did not prevent investors from growing increasingly concerned about the possibility of an AI bubble**.

Domestic politics did not make much noise, but courts continued to regularly reject decisions made by the Trump administration on symbolic topics, such as sending the army to fight crime in cities managed by key opponents. The project to build a large ballroom at the White House also triggered many critics. The demolition of the East wing of the mansion started without any authorization, since the commission in charge of approving projects impacting historical monuments had been fired by the President. In addition, the financing of the reconstruction looked rather opaque, as **the list of contributors supposed to cover all of the cost included a lot of companies which generate billions of revenue from contracts with the US federal government**.

Things remained fluid on the geopolitical front. Early in October, the USA, helped by a number of Middle-Eastern countries, managed to broker a ceasefire between Israel and the Hamas. **There was no sign to indicate that this would last more than a few days, and sporadic fights resumed almost immediately**, before escalating throughout the rest of the month. This did not prevent Donald Trump from advertising his "long-term peace" deal and, more generally, his own involvement to end several other conflicts. He started his trip to Asia attending the signature of a treaty between Cambodia and Thailand. The war in Ukraine, however, proved more difficult to present as a success, and it even threatened to revive the trade war, which had largely disappeared from the headlines since most tariffs had stabilized a relatively manageable levels. As a matter of fact, a vague peace plan, aiming to freeze Russian positions in the East of Ukraine, failed to gain much support in the international community, and **there was plenty of evidence that Moscow was trying to buy time without truly negotiating**. The White House thus decided to increase its pressure and impose sanctions against countries which continue to buy Russian oil, or whose airlines fly over Russia. Several major Chinese energy companies thus announced that they were stopping their imports… and Beijing soon announced additional controls on exports of rare earth and other resources. Donald Trump thus threatened to use his favorite retaliation, a 100% tariff on goods imported from China. Meanwhile, other levers were used in the backdrop, with Washington threatening to stop buying cooking oil from China if the latter did not resume its soybeans orders. This escalation stopped towards mid-month, after several high-level contacts between the two countries, and the announcement that their leaders would meet in Korea on October 30. They actually met and, like in the previous negotiation, the winner did not seem to be the one who made the most emphatic comments in the media. **Washington not only dropped its plan to massively raise tariffs on Chinese goods, but even cut them by ten percentage points, to get Beijing to resume its exports of rare earth for some time**.

The effects: The S&P 500 index performed well in October (+2.32% with net dividends) but, once again, this was driven by a minority of stocks in very specific sectors rather than a broad-based rally. Despite a few incidents in the last few days, we ended the month well ahead of our benchmark.

As often in the last few years, the S&P 500 index strongly outperformed the average return of its components. Its equal-weighted version lost 0.98%, thus trailing the official, size-weighted benchmark by 330 bps. As a matter of fact, only 146 of the basket's 500 constituents were ahead of the index. Most of the "Mag7s" did well, together with a number of other very large companies. To make things even trickier, the earnings season and other announcements brought surprises or relief, and **the magnitude of price movements was unusually high, including in the case of rather large companies**.

For the second consecutive month, Technology was, by far, the best-performing sector, as **the AI theme continued to attract investors towards the semiconductor and data storage industries**. Advanced Micro Devices, whose computing chips are increasingly viewed as a serious option for those seeking to diversify away from Nvidia, was the market's best performer with a 58.3% return in October. Micron Technology gained 33.7% as memory chips are another beneficiary of the accelerated spending on datacenter projects, and Teradyne was just behind with its testing systems used, among others, by the semiconductor industry. The top 30 returns in the S&P 500 index also comprised many other names in semiconductors (Intel), semiconductor equipment (Lam Research, Applied Materials), storage (Western Digital) and servers (Dell Technologies). Nvidia was lower in the ranking (+8.5%) but **this was enough to make it the first company to exceed $5trn in market value**.

Surprisingly, **the second strongest category was Healthcare, a much more defensive, less trendy sector** which nevertheless returned about 3.5%. Quarterly results were the main driver as companies as diverse as Cardinal Health (in drug distribution), Intuitive Surgical (surgical technology), Thermo Fisher Scientific (Life Science equipment), Regeneron Pharmaceuticals (biotechnology) and many others exceeded expectations and made positive comments about the outlook.

While Communication Services often tend to move like Technology, it was not the case this time, and they only gained 1.75%, behind Consumer Discretionary and even Utilities. Alphabet, which reported strong results across a vast majority of its activities, gained about 15.7%, but **Meta Platforms weighed as investors started to feel uncomfortable with the company's colossal investments in AI infrastructure and talents**. In addition, Netflix was impacted by a tax dispute in Brazil (which harmed its margins) and its potential interest in buying Warner Bros Discovery. The more traditional media were weak too, as Paramount Skydance also appeared among the potential suitors for the same target, and News Corp suffered from a tough competition and a slowdown in the real estate ads market.

At the other end of the return ranking were Materials, which lost 5.1%. Gold and silver metal prices were softer in the second half of the month, but **the sector's performance was mainly harmed by Mosaic (-20.8%), a fertilizer producer which was downgraded by several analysts** after reporting a disappointing phosphate output. International Paper (-16.7%) also weighed when it posted an unexpected loss in the third quarter, as it closed several paper mills and incurred accelerated depreciations. Financials (-2.9%)

underperformed the broad index significantly. As explained above, the large banks (which reported their third quarter results early in the month) pushed the whole sector up, but this did not last as concerns developed around credit risks at smaller lenders.

This unusual performance pattern also had puzzling effects on the market's investment style. The S&P 500 Growth index led its Value peer by a comfortable 230 bps, but the gap was only 11 bps in the "Pure" family of indices, which saw both of its benchmarks go down slightly.

Despite its underweight stance on most "Mag7s" and other overly expensive AI plays, our strategy did well in October. As we entered the last week of the month, we were more than 250 basis points ahead of our benchmark, but two incidents harmed us in the last few days. Our final gross return was 3.85%, or 153 bps ahead of the S&P 500 net return index. **This put us a whopping 483 bps ahead of the benchmark's equal-weighted version, which statistically represents the performance of a randomized stock selection process**, and which we have been beating consistently and substantially over time since the inception of the strategy.

Two of our holdings went sharply down in the last few days of October, following their results announcements. One of them, smart meter specialist Itron, exceeded expectations on all available metrics, and issued a strong earnings guidance for the fourth quarter, but it made a small negative adjustment to its revenue forecast, and suggested that some orders might be delayed due to customers' budget constraints. The management stressed that the deal pipeline was intact, estimated that it was seeing about 25% more opportunities than at the end of last year, and reaffirmed its 2027 financial targets, but the stock lost almost 25% in the following session. **This gave us an opportunity to reweight our position at an attractive price**. More seriously, Fiserv, which offers payment processing services and related financial solutions, released very disappointing revenue and profit figures, reduced its 2025 organic growth forecast (which had already been cut from 12 to 10% in July) to only 3.5-4% and issued a weak preliminary guidance for 2026. **This, together with an unexpected management reshuffle, caught the financial community by surprise**. Most investors were very confident about the security which, according to LSEG / IBES, had 29 Buy recommendations and six Hold ratings among its 36-analyst coverage. The news thus led the stock down almost 45% in the following session, and another few percentage points were lost the next day.

Fortunately, the rest of our portfolio was strong even in that period, and we had accumulated a large advance over the benchmark before these events, which allowed October to remain a decent month performance-wise.

Our best holdings were three Industrials followed by three Technology stocks. Many of these were boosted by a "beat and raise" announcement when they reported their quarterly results. This was the case for our top three performers, Nextracker, Vertiv Holdings and ATI. Intel, which again did very well, also exceeded expectations, but it also benefited from other factors, such as the presentation of its first commercial chip based on the new 18A technology. Except for ATI, which produces special steels and alloys and whose strength was based on a strong demand and pricing in the aerospace industry, these holdings all had some sort of exposure to AI. It was also the case for the next two performers, which did not even report results in October, but gained 18.5% and 17.8% respectively. **We also benefited from the strength of Alphabet, which remains our only overweight position among the Mag7s**, and whose "full-stack approach" to AI is firing on all cylinders. It also seems that a growing number of investors are becoming conscious of Waymo's potential in driverless transportation. Our other outperformers were more diverse, with stocks in Healthcare (pharmaceuticals like Lilly and Vertex as well as services in research, hospital management and drug distribution), retail, etc. Morgan Stanley eventually remained our only financial holding that ended the month ahead of the S&P 500 index.

Overall, our stock selection had a very positive impact in Industrials, Communication Services, Healthcare and, to a lesser extent, Materials and Consumer Discretionary. Only

the above-mentioned incidents on Fiserv and Itron made that impact negative on Financials and IT, and we also enjoyed a marginal, favorable contribution from our lack of exposure to Consumer Staples and Real-Estate.

Our decisions: After carefully reviewing several potential sales, especially among our recent top performers, we finally considered that there was more potential left. As visibility remained low, and did not warrant a strategic shift in our key bets, we kept the portfolio unchanged.

Among the holdings we would consider to liquidate, Intel was a particularly tricky case in many aspects. Its strong outperformance of the past few months suggested that it might be time to take our profits, and the usual valuation metrics, which are difficult to apply in a turnaround environment, made the stock look extremely expensive. However, the recent rally reflected mainly a number of "deals" made with the US Government and corporations such as Nvidia, which both reinforced the company's balance sheet and illustrated some external confidence in its strategy. These factors however remained secondary behind those we had in mind when we selected the stock. The restructuring is taking place at an accelerated pace since the new CEO joined and reshuffled a large part of the management team, and Intel recently confirmed that it was on plan to start mass production on its new 18A platform before year-end, a key step in its catch-up effort to come back in the servers market. We thus considered that there was more to come on that side if execution was living up to expectations. In particular, we hope this roll-out to open the door for more growth in the Products division (which designs Intel-branded chips) but also more significant contracts for the Foundry segment. At a time of geopolitical tensions, as more players aim to diversify away from Asian manufacturers, **a US-based manufacturing capacity will be a strong advantage… as soon as it has proven its competitiveness**.

Although we did not change anything to our holdings list, some characteristics of our portfolio were modified during the month. This came either from the impact of market movements on our benchmark's structure, or from the revision of companies' fundamental characteristics. On the one hand, **our holdings' target weights (which are primarily a function of their risk parameters) remain rather stable, while index weights vary with market movements**. This has caused a gradual reduction of our overweight on Technology, which is now less than two percentage points based on target weights, and we are comfortable with this. We also turned slightly underweight on Industrials, which is not necessarily intended. On the other hand, the very strong results reported by most of holdings are visible in the comparison of our portfolio's ratios to those of its benchmark. According to Graphene Investments' calculations using LSEG/IBES and Factset data, **our selection's median earnings growth in 2025 is now expected to be 15.25%, up more than 1.5 percentage points from last month, whereas the same calculation for the index hardly moved up** from 7.68% to 7.76%. Earnings revisions are also much more positive for our selection than for the index, and the gap in long-term growth forecasts also increased in our favor. As a result, despite our strong outperformance in October, the portfolio's P/E ratio (based on twelve-months-forward earnings) went down lately, whereas is was up for the market.

The outlook: Our general scenario remains unchanged. The US economy is doing better than most, but its resilience is fragile and threats, ranging from unpredictable politics to unrealistic expectations about AI, are building up. We thus remain cautious about overhyped investment themes.

One month after the beginning of the government shutdown, the lack of fresh economic indicators makes it difficult to assess the exact trend of the US economy. Our view prior to this "blackout" was that activity had started to slow very gradually as a result of its normal cycle as well as the general uncertainty caused by the Trump administration's policy. However, we thought that it continued to offer an impressive resilience overall. **In the absence of any major event that could have caused an inflection in either direction, we do not see any reason to alter this view,** all the more as companies' comments in the first half of the earnings season did not seem to point to something different. It is true, though, that this scenario's degree of certainty has probably receded lately, simply because it is a synthesis of multiple components, each of which became more contrasted in the last few months, and depends on more unpredictable, exogenous influences.

Tariffs, for example, probably boosted demand for a while as orders were pulled forward, but this should now be behind us. Given that their final level was generally lower than initially feared, the impact on inflation may be less serious than we thought. **Prices however look poised to go up anyway** because, whether companies keep their current supply schemes in place or find a way to produce in the USA, their costs will increase too much to be fully absorbed by margins. In the longer-term, **we do not expect the government's policy to prove really successful at triggering a re-industrialization**. Admittedly, some of the investment projects, which currently make the headlines in the media, will probably materialize, but this only concerns those which would have taken place anyway because of global trends such as the development of AI and its implications on datacenters and power generation. In many other areas, it would take years and huge subsidies to make US facilities competitive against overseas manufacturing. These jobs are not those the US population wants, nor those for which it has been educated or trained. We therefore do not believe that sensible corporate managers will go ahead with heavy, risky investments unless they are sure that the political pressure is there to stay. In this respect, opinion polls, where the President's popularity resumed its deterioration recently, may play a role in pushing executives to announce what the administration wants, but drag their feet when it comes to executing. As Newsweek noted on the basis of a Morning Consult survey in one of its October issues, **the President's net approval rate has now turned negative in each of the "swing states"**, whose vote should, as usual, be decisive in next year's mid-term elections.

We continue to view AI as the US economy's most interesting growth engine for the medium- and long-term. At the moment, it is mainly benefiting to a limited range of infrastructure players, who cater to power generation or the multiple specialties needed in datacenters. From compute to data storage, from connectivity to cooling, technologies are progressing very fast and, while China is not far behind in several areas, the US ecosystem remains in the best position to surf the wave. However, we believe that, for most early adopters in the professional sphere, the productivity advantages will take time to materialize. For the moment, they will probably remain limited to areas where the challenge suits the technology well, particularly when the time saved on a task is more important than the result's perfection, or when that task is repetitive. We already stressed in the past that very few companies currently have the data and technical capabilities to train models, and get the very best out of the technology. This is why, **although it may look old-fashioned or overly cautious in the current hype, we do not invest "flat out in everything AI"**. We have a significant exposure, but remain extremely selective because, while the potential is almost

limitless, it will take time to figure out how it can be used at its best. For every other game-changing technology, the path to becoming a mainstream solution involved periods of unrealistic dreams followed by disappointments, revised ambitions and disruptions by new comers. We are conscious that, contrary to the internet and prior technical revolutions, this one is supported by cash-rich companies, which can keep going for a long time, but we don't think that "this time will be different". **We don't see AI having a more linear development**, all the more as, unlike other key innovations of the last decades, it is easy to imagine the many ethical threats that will appear along the path.

We thus keep a significant exposure to many other sectors, such as Healthcare, whose innovation capabilities and resilience could prove useful at some stage despite the Trump administration's pressures in the short-term. **We also like companies, which are undergoing an attractive transformation as part of a turnaround effort or a strategic plan focused on external growth**. Many of our holdings meet these criteria, especially among Industrials and consumer-related stocks. Their quarterly results announcements, which are expected in the coming weeks, may not be as smooth as they have been for Technology, but we are watching far beyond.

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