

Key Insights

- **Volatility Masks Continued Recovery:** S&P 500's modest 0.25% November gain obscured dramatic intra-month swings - a 4.5% plunge from November 12-20 amid the government shutdown followed by a powerful 4.77% recovery rally.
- **Style and Size Rotation Accelerates:** November marked a notable reversal as value stocks surged 2.66% versus growth's 1.68% decline, with Russell Top 50 mega-caps plunging 10.91% while small-cap Russell 2000 gained 0.96% - dramatically narrowing large-caps' year-to-date advantage to just 7.52% versus small-caps' 13.45%.
- **Record Corporate Profitability:** According to FactSet, 83% of S&P 500 companies beat Q3 estimates - the strongest since Q2 2021 - with 13.4% blended earnings growth marking the fourth consecutive double-digit quarter, 8.4% revenue growth (highest since Q3 2022), and record 13.1% net profit margins (highest since at least 2009).
- **K-Shaped Consumer Creates Market Vulnerability:** The economy rests on a "top-heavy Jenga tower" as the top 10% of earners account for 49.2% of spending (highest since 1989) supported by \$8 trillion in stock market gains, while lower-income households face a record 6.65% subprime auto delinquencies (highest since 1994), creating acute top-spender vulnerability to any equity market downturn.
- **Fed Cut Expectations Support Santa Rally Prospects:** Traders price December rate cut as near-certain despite government shutdown data disruptions, with historical patterns suggesting year-end gains when S&P 500 rises September through November. However, this pattern is not a guarantee and is secondary to the broad economic picture and current market conditions.
- **Gold and International Outperformance Persists:** Gold extended its stellar run with 5.91% November gains

pushing YTD returns to an exceptional 61.53%, while international developed markets (+28.79% YTD) and emerging markets (+30.37% YTD) maintained substantial outperformance versus the S&P 500's 17.79%, even as crypto tumbled 19.41% in November leaving it down 13.32% YTD.

Monthly Recap

November 2025 was defined by pronounced volatility as markets navigated a government shutdown, shifting Federal Reserve (Fed) expectations, and a sharp rotation in sector leadership. The S&P 500 Index eked out a modest 0.25% gain for the month, masking significant intra-month swings. The Nasdaq Composite declined 1.45% while small-caps showed resilience with the Russell 2000 Index rising 0.96%. The "Magnificent 7" tech giants posted a 1.12% decline, reflecting broader headwinds in the technology sector.

A Tale of Two Halves – Extreme Intra-Month Volatility:

The month's seemingly calm returns obscured dramatic swings beneath the surface. From November 12 through November 20, the S&P 500 plunged 4.5% as the government shutdown darkened economic data releases and consumer sentiment fell to near-record lows. The University of Michigan survey showed 71% of respondents expecting unemployment to rise, while the absence of the monthly payrolls report heightened uncertainty. However, from November 20 through month-end, markets staged a powerful 4.77% recovery rally as traders maintained confidence in a December Fed rate cut despite the data void. The Nasdaq 100 endured its worst week since April during the selloff, with artificial intelligence (AI)-related stocks bearing the brunt of profit-taking after their torrid year-to-date (YTD) surge.

The Recovery Story Continues: From the April 8 bottom through November, equity markets have posted extraordinary gains with the S&P 500 surging 38.55%, the

The James Investment Research Team



Brian Culpepper, CKA
President & CEO
Portfolio Manager



Fall Ainina, Ph.D., CFA
Director of Research
Vice President



Brian Shepardson, CFA, CIC
Vice President
Portfolio Manager



Trent D. Dysert, CFA
Associate Director of Research
Portfolio Manager

Nasdaq climbing 53.68%, and the Russell 2000 advancing 43.19%. The Magnificent 7 index has delivered an exceptional 67.12% recovery, completely erasing the steep February-April declines (S&P 500 -18.75%, Nasdaq -23.77%) and pushing indices substantially beyond previous highs.

Growth vs Value and Market Cap Dynamics: November marked a notable reversal in style leadership. Value stocks surged with Russell 3000 Value advancing 2.66% versus growth's 1.68% decline. Despite this monthly rotation, year-to-date leadership remains firmly with growth at 18.82% versus value's 14.94%. Mega-caps faced significant headwinds, with the Russell Top 50 plunging 10.91% in November, dramatically narrowing their year-to-date advantage to 7.52% versus small-caps' 13.45%.

Sector Performance: November sector leadership shifted dramatically toward defensive and cyclical value names. Health Care led with an impressive 9.29% gain, followed by Materials (+4.35%), Consumer Staples (+4.05%), and Energy (+2.63%). Financials added 1.83%, Real Estate gained 1.88%, and Utilities rose 1.72%. On the downside, Technology declined 4.81%, reflecting profit-taking in AI high-flyers after Wall Street executives warned of frothy valuations. Consumer Discretionary fell 1.45%, Industrials dropped 0.88%, and Communication Services managed a modest 0.51% gain. Year-to-date sector leadership shows Technology is still dominant at 23.67%, followed by Utilities (+22.23%) and Communication Services (+20.25%).

Corporate Strength Provides Solid Foundation: Corporate America is delivering results that exceed even elevated expectations. According to FactSet, with 95% of S&P 500 companies having reported Q3 2025 results, 83% have surpassed profit estimates - the strongest performance since Q2 2021 - particularly impressive given that analysts had raised their forecasts heading into earnings season. The blended earnings growth rate stands at 13.4%, marking the fourth consecutive quarter of double-digit earnings growth. Revenue growth of 8.4% represents the highest rate since Q3 2022, with all eleven sectors reporting positive year-over-year revenue gains. Information Technology leads sector earnings growth at 28.4%, followed by Utilities (+23.8%) and Financials (+23.5%). According to S&P Global Market Intelligence, this strength spans multiple sectors, from financial institutions like JPMorgan Chase and Morgan Stanley to industrial giants and consumer staples companies demonstrating pricing power despite elevated costs. Notably, according to FactSet, the "Magnificent 7" companies reported earnings growth of 18.4%, though this represents their lowest growth rate since Q1 2023, with Meta Platforms' one-time tax

charge of \$15.93 billion weighing on the group. Excluding Meta, the remaining six companies would have reported 30.4% growth. The S&P 500's net profit margin of 13.1% marks the highest level since at least 2009, demonstrating exceptional corporate profitability. According to S&P Global Market Intelligence, large corporations are expressing confidence about navigating regulatory uncertainty and maintaining robust capital expenditure plans, providing a crucial anchor of stability during periods of economic data uncertainty.

International Markets Mixed: International markets showed divergent performance in November. MSCI World ex-US gained 1.07% while MSCI Emerging Markets declined 2.38%. Year-to-date, international outperformance remains substantial: emerging markets +30.37%, international developed markets +28.79%, both ahead of the S&P 500's 17.79% return. From April's recovery bottom, emerging markets have advanced 38.93% while international developed markets gained 31.35%.

Fixed Income Stability and Alternative Asset Volatility: Bonds showed steady performance with the Bloomberg US Aggregate gaining 0.62% and 20+ Year Treasuries rising 0.27%, as rate cut expectations remained intact. High-yield corporates added 0.58%. The 10-year Treasury yield declined to 4.07%, reflecting flight-to-quality during the equity selloff. The Bloomberg Galaxy Crypto Index tumbled 19.41% in November as Bitcoin lost 8% in a single week, leaving the asset class down 13.32% year-to-date despite its remarkable 48.16% surge from the April lows. Commodities continued their positive trajectory with 2.90% November gains, extending their year-to-date return to 11.80%. The Bloomberg US Dollar Spot weakened 0.25% in November, down 7.01% year-to-date. Gold continued its stellar run with 5.91% November gains, pushing its year-to-date return to an exceptional 61.53%.

Forward Estimates and Valuation: Looking ahead, according to FactSet, analysts project earnings growth of 7.5% for Q4 2025 and 11.8% for full-year 2025, with acceleration expected into 2026. The forward 12-month price-to-earnings (P/E) ratio for the S&P 500 stands at 21.5, above both the 5-year average (20.0) and 10-year average (18.7), though notably below the 22.8 level recorded at the end of September. Since September 30, index prices have declined 2.2% while forward earnings estimates have increased 3.2%, reflecting earnings strength offsetting price weakness. Analysts project a 21% increase in the S&P 500 over the next 12 months, with Information Technology (+26.6%) and Consumer Discretionary (+26.4%) sectors expected to lead gains.

Market Outlook: November's volatility underscored the market's sensitivity to both macroeconomic policy and Fed expectations. Despite the government shutdown's disruption to economic data releases and the sharp intra-month drawdown, equity fund flows remained supportive with eight consecutive weeks of inflows. Traders continue to price in a December rate cut as a near-certainty, with the labor market showing signs of cooling that keep Fed easing on track into early 2026. The dramatic sector rotation away from technology toward defensive and value names suggests investors are positioning for a potentially more uncertain environment, even as the broader bull market remains intact. With the recovery from April's lows now exceeding 38% for the S&P 500 and 67% for the Magnificent 7, and corporate earnings continuing to exceed expectations with record profit margins, markets face the dual challenge of digesting remarkable gains while navigating ongoing fiscal uncertainty and valuation concerns.

Topic of the Month: State of the Consumer: November/December 2025

The US consumer presents a highly bifurcated picture, often described as a "K-shaped" economy, where affluent consumers - buoyed by asset price gains and AI-fueled investment booms - continue to spend, while lower- and middle-income households face increasing financial strain, debt pressure, and anxiety about job security. This structural divide has profound implications for the stock market, creating both near-term opportunities (including the potential for a Santa rally) and significant longer-term vulnerabilities. The economy's dependence on three narrow "A-Pillars" - Affluent consumers, Artificial Intelligence investment, and Asset price gains - makes it highly susceptible to shocks, particularly any downturn in equity markets.

The K-Shaped Economy: A Structural Divide

The Upper Arm: Affluent Consumers Driving Aggregate Spending

The aggregate economy remains resilient primarily because of the strong spending habits of the wealthiest Americans. High-income Americans (the top 10% of the income distribution) accounted for 49.2% of total US consumer spending in Q2 2025 - the highest share recorded since 1989. The top fifth of earners now account for almost two-thirds of spending. This elevated spending is supported by rising wealth driven by asset price gains:

the S&P 500 has added approximately \$8 trillion in value this year, largely propelled by AI investment exuberance. Household net worth rebounded by \$7.1 trillion (4.2%) in Q2 due to rising stock prices and real estate values. High-credit-score borrowers and those who pay off their credit card balances monthly were largely unaffected by the Federal Reserve's restrictive interest rates, maintaining their spending on innovation, trusted brands, and larger pack sizes.

The Lower Arm: Financial Distress and Spending Contraction

In stark contrast, the bottom 80% of income earners face severe financial strain. Their spending since the pandemic has merely kept pace with inflation. Record auto loan delinquencies highlight the distress: the share of subprime borrowers at least 60 days past due reached 6.65% in October - the highest level since 1994. Deep subprime consumers (credit scores 300-500) face average interest rates of approximately 16% for new car loans and 21.6% for used cars. Over 28% of trade-ins toward new-car purchases carried negative equity in Q3, the highest since Q1 2021. These consumers are pulling back on discretionary spending, using coupons more often, buying cheaper store brands, eating out less, and deferring larger repairs.

Stock Market Implications: Support and Vulnerability

Current Market Support and the "A-Pillars"

The stock market's current strength is built upon what a Bloomberg analyst called the three interconnected "A-Pillars." First, AI-fueled investment has propelled the market, with the "Magnificent 7" mega cap technology firms continuing to dominate earnings growth. Investment forecasts for AI-related infrastructure spending have surged to approximately \$500 billion for 2025, up from roughly \$200 billion just a year ago. The Nasdaq 100 Index has hit record highs, with its annualized return-to-volatility ratio of 1.9 over the past six months, comparable to levels near the peak of the dot-com bubble in 1999. Second, asset price gains have boosted the net worth of wealthier Americans, creating a wealth effect that encourages continued spending. Third, affluent consumer spending - now nearly half of all US consumption - provides the demand that supports corporate earnings.

Market Vulnerability: The "Top-Heavy Jenga Tower"

Economists warn that the economy's reliance on high-income, high-net-worth households makes it "highly

vulnerable,” comparing it to a “top-heavy Jenga tower.” A downturn in the stock market is identified as a potential trigger that “would knock the wind out of these high-income households” and raise recession risks. The unequal economic backdrop is reflected in diverging S&P 500 earnings estimates, with mega cap tech maintaining dominance while others struggle with tariffs and consumer strains. If labor conditions deteriorate, the spending gap between rich and poor could increasingly impact retailers and the broader market. Nearly 70% of consumers in the Conference Board survey believe a recession is likely in the next 12 months - matching peak recession angst levels from 2023.

The “Buy the Dip” Phenomenon

Investor behavior has become institutionalized around “buying the dip.” ETF inflows now surge after every market stumble, with investors treating weakness as opportunity rather than risk. This reflex has become the engine of the current bull market: the S&P 500 ETF (SPY) has averaged a 0.56% gain in the week after declines this year, with rebounds occurring more than half the time following weekly drops. Years of relatively calm markets - including a streak of 354 consecutive sessions without a 2% S&P 500 drop - have trained investors to step in at the first hint of weakness. However, this “muscle memory” could prove dangerous if a more sustained downturn materializes.

Santa Rally Prospects: Seasonal Patterns and Caution

Historical patterns suggest potential for a year-end rally. When the S&P 500 rises from September through November, it often extends those gains in December. Talk of a “Santa rally” is generally consistent with above-average returns over the shorter term. However, there is an important caveat: the earlier seasonal excitement begins, the more the downward skew to returns. The fact that seasonal hype has started early this year suggests that festive redemption may not triumph in the face of a “Scrooge-like market.” The bull market is expected to remain intact as long as large federal budget deficits and AI spending continue, but there is reason to worry that support could unravel as economic distress builds among the general population.

Monetary Policy Impact: The Fed’s Role in Bifurcation

The Federal Reserve’s restrictive monetary policy has actively contributed to the K-shaped bifurcation. Credit card interest rates move closely with the federal funds rate, and the resulting higher rates caused low-credit-score borrowers - particularly those carrying balances - to cut their spending, while high-credit-score borrowers

were generally unaffected. An increase in credit card APR reduced aggregate card spending, with the reduction being about twice as large among balance-carrying account holders and those with low credit scores. Large, profitable firms making AI capital expenditures are not sensitive to interest rates, while investments by financially constrained small firms are reacting strongly - further concentrating market-supporting growth in a few large companies. Although inflation remains above target, slower growth at the bottom of the economy suggests the federal funds rate remains restrictive with room to cut. Traders see the odds of a December rate cut as more likely than not, and anticipated Fed cuts are expected to steady the labor market and broaden profit growth beyond big tech.

Tariff Impact: Pricing Pressure and Consumer Strain

Tariffs have significantly impacted retail dynamics, encouraging retailers to rein in promotions and leading to shallower discounts in key categories. Many shoppers noted that Black Friday deals seemed more muted compared to 2024. Online discounts were anticipated to be shallower in categories worst hit by tariffs: electronics (29.0% average discount vs. 30.1% in 2024), toys (27.0% vs. 28.0%), and appliances (18.0% vs. 19.2%). Imported goods have grown 6.6% more expensive since last year. The tariff impact creates a dilemma for retailers: if discounts are not deep enough, many potential buyers - particularly price-sensitive lower-income households - may hold off on purchases. Recent tariff negotiations have generally not resulted in lower consumer prices. Prices on core goods, which are most directly affected by tariffs, have risen fast, and if companies exhaust substitution options, inflation could rise further. Consequently, over half of Americans now expect to spend at least the same amount this holiday season primarily reflecting the impact of higher prices rather than increased consumption.

Regulatory Uncertainties and Corporate Response

Despite regulatory uncertainty, large corporations are expressing confidence about navigating the environment and maintaining robust capital expenditure plans - providing a crucial anchor of stability during periods of economic data uncertainty. The concentration of market strength in mega cap technology firms, particularly those benefiting from AI investment, means that any regulatory changes affecting these companies could have outsized market impacts. Negotiations between retailers and suppliers during periods of peak tariff uncertainty have affected final pricing and promotional strategies. The ongoing fiscal policy environment, including large federal

budget deficits, continues to provide support for the economy and markets, but raises longer-term questions about sustainability and potential policy shifts.

Deteriorating Sentiment and Labor Market Anxiety

Consumer confidence surveys have been broadly weak despite overall economic growth. The Conference Board's November figure was the lowest reading since the April tariff tantrum. The University of Michigan sentiment index fell in November to one of the lowest levels on record (51), with views of personal finances being the dimmest since 2009. Concerns about the labor market are significant: the probability of personal job loss climbed in November to its highest level since July 2020. Labor market fragility is highlighted by rising underemployment (U6 rate at its worst level since 2021), rising youth unemployment, and the gap between Black and White unemployment rates returning to a 2-to-1 ratio. These sentiment indicators suggest underlying consumer weakness that aggregate spending data may obscure.

Recent Spending Activity: Black Friday and Beyond

Black Friday 2025 demonstrated that US consumers continue to spend, signaling resilience. Total retail sales (excluding autos) were up 4.1% year-over-year, surpassing the 3.4% growth in 2024. Online sales showed particular strength, jumping 10.4%, compared to modest 1.7% growth in-store. Spending growth on apparel (+5.7%) and jewelry (+2.75%) was strong, with restaurant spending up 4.5%. However, this strength is narrowly concentrated among the wealthiest consumers benefiting from asset gains, reinforcing the structural economic split. In October, the Visa US Spending Momentum Index inched forward slightly to 98.6, with discretionary spending momentum offsetting declines in non-discretionary and restaurant categories. Prior to the holiday period, September retail sales showed loss of momentum, rising only 0.2% month-over-month, with control-group sales falling 0.1% for the first time in five months. This consumer behavior may be due to concerns over the pending government shutdown and its subsequent resolution.

Conclusion: Investment Implications

The state of the US consumer underscores a stock market environment characterized by narrow support and hidden vulnerabilities. While headline spending numbers show resilience and the potential for a Santa rally exists, this strength is concentrated among the wealthiest consumers benefiting from asset gains - the very gains that depend on continued market strength. The economy's dependence on the spending habits of the top tier means that any shock to their financial pillars, such as a prolonged and extensive market downturn, could quickly expose the underlying weakness of the majority of US consumers. Investors should consider:

- The reflexive "buy the dip" behavior may provide near-term support but could amplify losses if sentiment shifts materially.
- Fed rate cuts, while supportive, may take time to flow through to the constrained consumer segments driving the economic divergence.
- Tariff-driven inflation and pricing pressures continue to strain lower-income consumers and could impact retailers dependent on this demographic.
- The concentration of market returns in AI-benefiting mega caps creates sector-specific risk and opportunity.
- Deteriorating consumer sentiment and labor market anxiety may serve as leading indicators of broader economic stress not yet reflected in aggregate data.

The "top-heavy Jenga tower" analogy aptly captures the current risk profile: impressive height built on an increasingly narrow base. Portfolio positioning should account for both the near-term momentum supporting risk assets and the structural vulnerabilities that could precipitate a more pronounced correction if the affluent consumer pulls back.

Sincerely,

The James Research Team



JAMES

INVESTMENT RESEARCH, INC.

This material is distributed by James Investment Research, Inc. and is for information purposes only. No part of this document may be reproduced in any manner without the written permission of James Investment. It is provided with the understanding that no fiduciary relationship exists because of this report. Opinions expressed in this report are the opinions of James Investment and are subject to change without notice. James Investment assumes no liability for the interpretation or use of this report. Investment conclusions and strategies suggested in this report may not be suitable for all investors and consultation with a qualified investment advisor is recommended prior to executing any investment strategy. All rights reserved. Copyright © 2025 James Investment.