

The market rose another 2.6% in October, bringing year-to-date gains to over 15%; not too shabby given the previous two years of 20%+ returns. October is a busy month for investors, as many companies report their third quarter results. Markets pay close attention to those results, as well as the forecasts companies provide on their earnings calls.

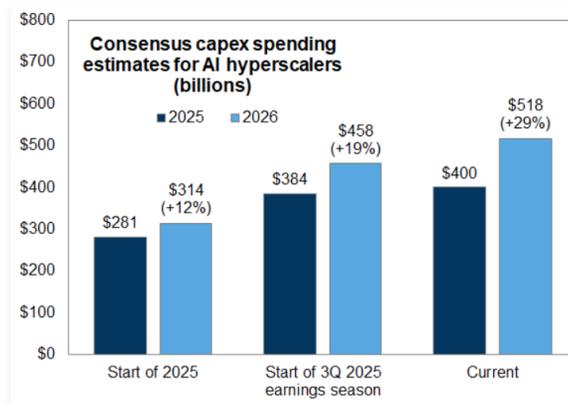
So far, the results have been good. Through the end of October, 317 S&P 500 companies had reported, with 64% beating expectations. According to Goldman Sachs, in its 25 years of data, the frequency of positive earnings surprises has only been surpassed during the 2020–2021 “Covid years.” Importantly, sales have also beaten estimates. Aggregate sales growth of 6% is nicely above the 4% expected growth coming into the quarter.

While results have been solid, stock reaction has been surprisingly muted. On average, shares of companies that reported positive surprises rose just over 0.3%, compared to a more typical +1%. Reasons for the ho hum response are many, including a relatively expensive market, trade uncertainty, and the ongoing government shut down.

As you would expect, attention has been focused on the “Magnificent 7” and those companies with considerable exposure to artificial intelligence (AI). Here, too, results have been somewhat different than what investors might have expected. Meta (formally Facebook) reported revenue growth 26% year-over-year. With expected sales for the year of nearly \$200B, 26% growth is quite a jump. Yet, Meta’s stock fell after its results were announced. Contrast that with Alphabet (Google’s parent). Alphabet’s revenue rose nearly 16% year-over-year. Again, a considerable lift for a company expected to post nearly \$400B in sales for its fiscal year. Yet Alphabet’s stock rose in the next day of trading.

What is true of both companies, and of the other AI-exposed hyperscalers (Amazon, Microsoft and Oracle), is that capital spending (CapEx) is on the rise.

Exhibit 8: Change in capex estimates for AI hyperscalers
AI hyperscalers include AMZN, GOOGL, META, MSFT, ORCL



Source: FactSet, Goldman Sachs Global Investment Research

While the majority of the hyperscalers have the cash flow to cover this higher spend level, investors continue to wonder how much further CapEx will rise, and what the ultimate return on those billions will be.

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Sincerely,

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