Q&A with Investment Strategy

Takeaways From 3Q25 Earnings Season

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3Q25 EARNINGS SEASON: WHAT DID WE LEARN?

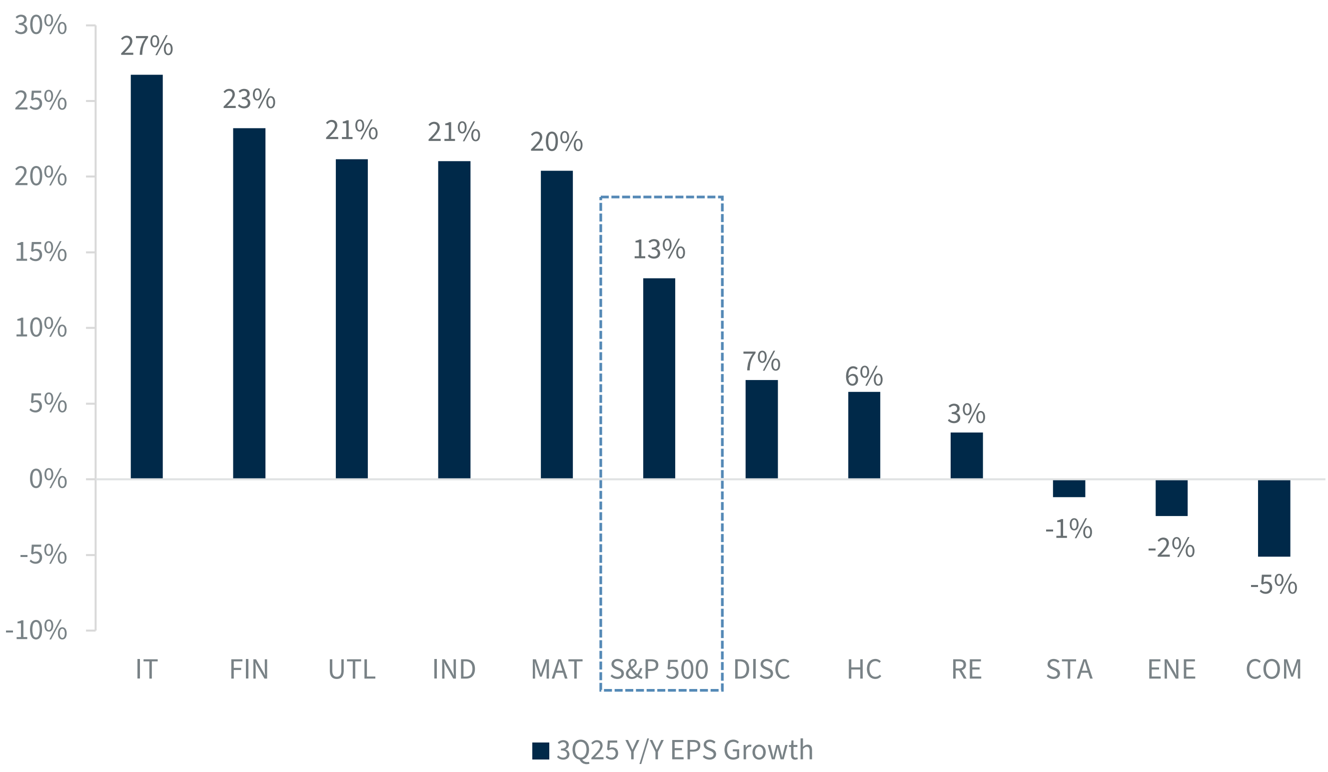
In 3Q25, corporate America faced a challenging operating environment, with headwinds including weaker demand among economically stressed consumers as well as rising cost pressures from tariffs. Despite that backdrop, aggregate profitability remains on solid footing. In fact, the S&P 500 is on track to post 13% YoY EPS growth in 3Q25, marking the fourth consecutive quarter of double-digit growth. Furthermore, 82% of S&P 500 companies topped consensus EPS estimates, the highest beat rate since 2Q21. Today we will delve into the key insights that we gleaned from earnings season.

WHICH SECTORS DROVE THE S&P 500's EARNINGS GROWTH?

The better than expected 3Q25 results came in large part from just two of the eleven sectors. Earnings growth in Technology (+27%) and Financials (+23%) together contributed more than four-fifths of the S&P 500's aggregate YoY EPS growth in 3Q25. By contrast, earnings were down YoY in Consumer Staples, Energy, and Communication Services.

Taking into account the reported results for the past three quarters (1Q25 through 3Q25) and consensus estimates for 4Q25, full-year EPS growth for the S&P 500 is tracking to 12%, accelerating from 9% in 2024. In the lead are Technology and Communication Services, while Energy and Consumer Staples are at the bottom of the spectrum. Unsurprisingly, this bifurcation is reflected in year-to-date equity performance: Technology is leading the way with a 27% gain, whereas Consumer Staples is lagging, up just ~3%.

Technology And Financials Led EPS Growth In 3Q25



Source: FactSet. Data as of 11/7/2025.

HOW ARE COMPANIES ADAPTING TO TARIFFS?

As new country-level tariff rates took effect on August 7, the US weighted average tariff rate increased from 13% to 16%—the highest in approximately 90 years. However, the impact of tariffs varies widely from sector to sector and even from company to company. The reasons for this variability include any given company's dependence on imports, supply chain flexibility, and competitive value proposition. We should also underscore that 3Q25 results reflect only a partial quarter with the new tariffs, and in some cases, it may be 4Q25 or even the first half of 2026 before the full magnitude of the tariff impact becomes evident.

Meanwhile, companies are working to mitigate the cost of tariffs, typically using multiple strategies.

- First, there is pass-through: firms are raising prices of their products, so that consumers are absorbing some, if not all, of the tariff costs. However, this approach carries some risk of reducing demand, particularly if cash-strapped consumers pull back. In general, the more value-added sectors (Technology, Health Care) are better able to pass through higher costs, whether tariff-related or otherwise, compared to sectors such as Materials or Consumer Staples.
- Second, firms are negotiating prices within their supply chain—again, the efficacy of this approach can vary widely.
- Third, some imports can be shifted from high-tariff markets (e.g., India) to lower-tariff markets (e.g., Vietnam). Along the same lines, there is reshoring, though it typically takes years to build new domestic manufacturing capacity.
- Finally, and perhaps most commonly, firms are working to boost efficiency and productivity—which sometimes includes cutting headcount—and these savings can offset tariff costs.

The key takeaway: margins are holding up surprisingly well this year despite the sharp escalation in tariffs. Corporate America has navigated the current environment relatively unscathed, protecting its margins through a combination of price increases, cost cuts, and mitigation strategies.

WHAT DO TECH COMPANY RESULTS TELL US ABOUT THE AI BOOM?

Technology, the largest S&P 500 sector—comprising a record 35% of the S&P 500's market cap—continues to be supported by the mainstreaming of AI technology. To date, this megatrend has been highly resilient and largely insulated from macro disruptions. Also taking into account the tech-related mega-caps in the Communication Services and Consumer Discretionary sectors, the broader tech ecosystem makes up nearly half of the S&P 500's market cap.

As our readers may recall, we refer to the six largest tech-related mega-caps as the MAGMAN composite: Microsoft, Apple, Google, Meta, Amazon, and Nvidia. This grouping of companies posted 17% Y/Y EPS growth in 3Q25, nearly double the 10% growth among the rest of the S&P 500. Looking ahead to 2026, consensus earnings estimates for MAGMAN have been revised upward by 6% YTD, whereas the rest of the index has seen 2026E EPS revised downward by 4% over the same period.

Additionally, AI-related capital spending plans came in above expectations, with the four largest hyperscalers altogether expecting to invest more than $450 billion in 2026. This illustrates that AI demand continues to exceed supply. Monetization of this investment remains paramount, and 3Q25 results for MAGMAN showed that AI has led to meaningful acceleration in cloud computing revenue growth. There is, however, a side effect to all this capex: several of these companies are now engaged in substantial debt issuance, which is putting upward pressure on their borrowing costs.

*MAGMAN represents a composite of Microsoft, Apple, Google, Meta, Amazon, Nvidia. The foregoing is not a recommendation to buy or sell MAGMAN stocks.

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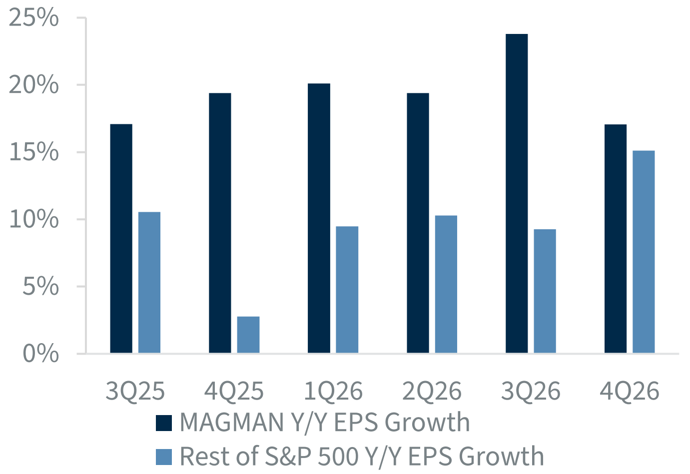
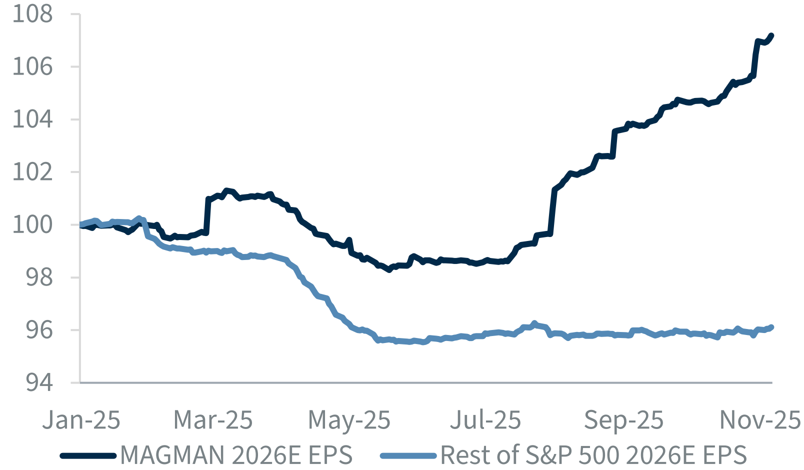
Mega-Cap Tech EPS Growth Outpaces The Rest Of The Market



2026 EPS Revision Trends Favor Mega-Cap Tech

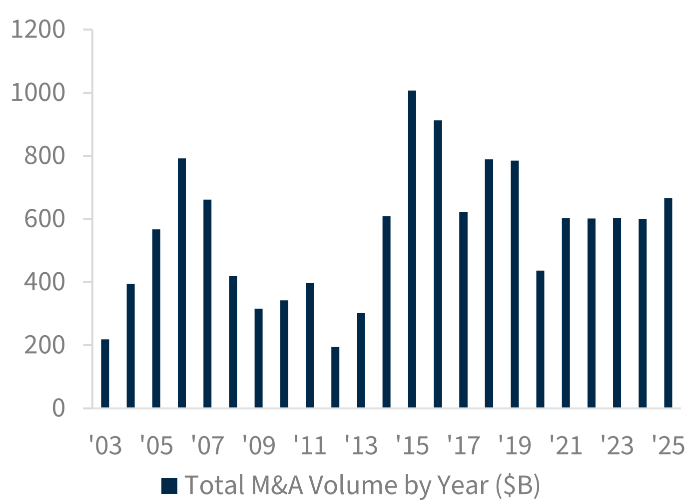


ARE THE GOOD TIMES BACK IN THE FINANCIALS SECTOR?

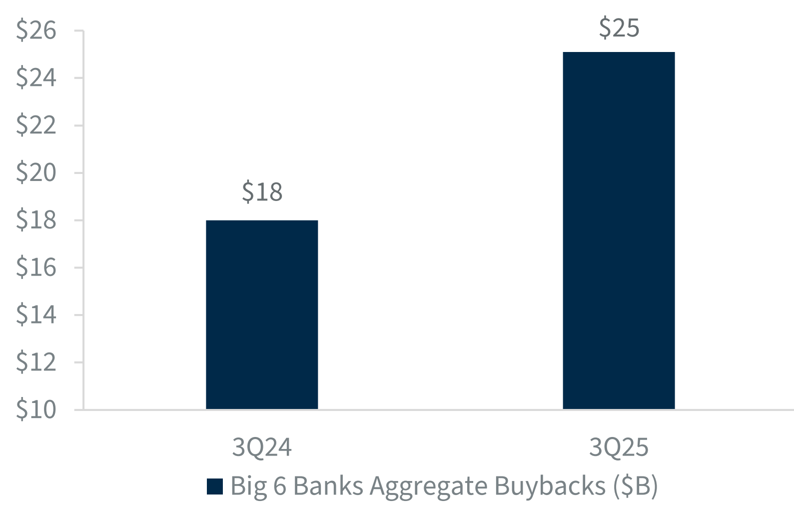
While strength in the Technology sector is clearly a well-known story at this point, the Financials sector has been less impressive in recent years. Here are some reasons that explain Financials' 23% EPS growth in 3Q25—the second-strongest quarter over the past three years. First, investment banking and capital markets activity—which is a key earnings contributor for the largest financial institutions in particular—is gradually rebounding from its COVID-era trough. IPOs remain slow compared to pre-COVID levels—competition from SPAC deals is here to stay—but 2025 is up on a YoY basis. With markets near all-time highs and CEOs feeling more optimistic, M&A volume has surpassed $660 billion YTD, the highest since 2019.

Second, as regulatory pressure from Washington has subsided, banks are spending more of their earnings on share repurchases; buybacks among the six largest US-based financial institutions are up 39% YoY. Finally, while inflationary pressure on consumers is mounting, and labor market weakness is evident, overall loan delinquency rates have been mild thus far. That said, delinquencies in auto and school loans are on the rise. We look at this as a key variable to watch over the next few quarters, particularly as it relates to subprime borrowers.

M&A Recovery Is Underway



Bank Buybacks Jump 39% YoY



Source: FactSet. Data as of 11/7/2025.

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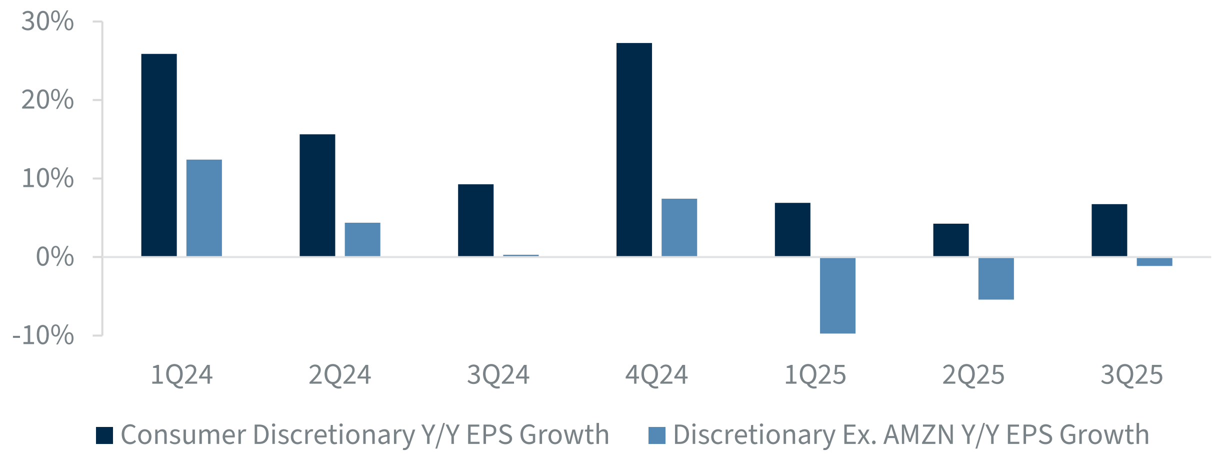
WHAT DO 3Q25 RESULTS REVEAL ABOUT CONSUMER SPENDING?

Walmart, Target, and several other big-box retailers are set to report next week. But based on the results thus far from consumer-facing companies, US consumers are facing a multitude of pressures. Case in point: two of the largest players in the packaged foods industry—Kraft Heinz (known for its condiments) and Mondelez (owner of Oreos)—reduced full-year sales guidance. Both companies are seeing consumers—especially, though *not* solely, in the US—shifting their grocery buying habits toward store brands and other cost-conscious options. Input costs are also elevated—for example: tariffs on coffee from Brazil and cocoa beans from West Africa—which helps explain why both companies' 3Q25 margins were down YoY. You may be asking: if companies such as these are seeing margin pressure, does that mean firms in the agricultural space are benefiting? Actually, no. ADM, a top processor of corn and soybeans, cut full-year EPS guidance. Big picture: times are tough across the Consumer Staples sector.

The Consumer Discretionary sector comprises a wide range of industries, so it can be difficult to generalize. That said, consumers continue to prioritize experiences over goods in their spending habits. This translates, on the whole, into better results among hotels and airlines compared to manufacturers of apparel, furniture, and electronics. For example, Delta and United highlighted robust demand—a trend that has been in place since the pandemic. Within specific industries, there are signs of a bifurcated (or 'K-shaped') economy: weak spending among low-income consumers but resilience among high-earners. For example, upscale fashion brand Ralph Lauren reported double-digit sales growth in North America, while Hyatt's top-line growth was boosted by its luxury brands. On the flip side, McDonald's traffic from lower-income customers was down. To make things more complicated, a single company—Amazon, which includes businesses outside the consumer arena—has an outsized impact on the sector's profitability. The sector overall posted 3Q25 EPS growth of 7% YoY, but if Amazon were excluded, EPS would be down 1%.

A Single Mega-Cap Has Outsized Influence On Consumer Discretionary EPS



THE BOTTOM LINE

It has been a strong 3Q25 earnings season overall, albeit with lopsided performance as we delve into sector-level fundamentals. Technology and Financials contributed disproportionately to EPS growth. By contrast, results from the consumer-facing sectors are mostly in weak shape. For investors, this underscores the importance of selectivity. And, across the board, how companies adapt to tariffs will remain a key question to watch into 2026.

Source: FactSet. Data as of 11/7/2025.
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