Fort Washington Investment Advisors, Inc.
A member of Western & Southern Financial Group

MONTHLY SPOTLIGHT:

AI's Higher Bar: From Demand to Returns

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MONTHLY MARKET PULSE – NOVEMBER 2026

HIGHLIGHTS

- **Market Rotation:** Headline index performance masked a meaningful rotation beneath the surface, as AI-related leaders experienced a significant sell-off while market leadership broadened, evidenced by a 5% rise in the S&P 500 Equal Weight Index.
- **Federal Reserve (Fed):** Following a 25-basis-point hike in September, the Fed held the policy rate unchanged at the October meeting, while Chair Kevin Warsh highlighted changes to the meeting schedule.
- **High Expectations:** Market reactions to recent earnings reports suggest that expectations for AI investment remain high, as attention shifts to financing costs and return on investment. We take a closer look at these reactions in this month's *Spotlight*.

MACRO INSIGHTS

October Surprise in Market Leadership

WHAT HAPPENED

October produced a striking reversal in market leadership. The S&P 500 declined 0.9% and the Nasdaq fell 5.3%, but the equal-weighted S&P 500 gained 5.0%, outperforming the capitalization-weighted index by nearly six percentage points. The Russell 2000 also finished modestly higher. **Unlike September, weakness in the headline indexes masked considerably stronger performance beneath the surface.**

The reversal was most pronounced among the year's AI-related leaders. Semiconductors fell more than 15%, with memory stocks down more than 20%, while several large technology companies also declined sharply. At the same time, Energy gained 14%, Consumer Staples 11%, Utilities 10%, and Health Care nearly 10%. By month-end, approximately 60% of S&P 500 companies were trading above their 50-day moving averages, up from roughly 20% in late September.

Importantly, the rotation occurred despite strong corporate fundamentals. Third-quarter S&P 500 earnings are on pace to grow approximately 30% from a year ago, with more than 80% of companies exceeding earnings expectations. Economic growth also remained resilient, with third-quarter GDP expanding at a 3.4% annualized rate.

Interest rates provided additional support. **The 10-year Treasury yield declined approximately 35 bps during October,** reversing much of September's increase. Concerns surrounding future growth and the financing requirements of the AI buildout helped offset persistent inflation and fiscal concerns.

The Fed left interest rates unchanged as expected. Inflation remains above target and economic activity has remained resilient, but softer employment data provided some evidence that restrictive monetary policy is having an effect. Another rate increase remains possible, although market expectations for the path of rates have moderated.

WHAT IT MEANS

October brought a sharp decline in Treasury yields and significant weakness in technology stocks, but little evidence of a broad equity selloff. Instead, investors sought safety in Treasuries while capital rotated toward other areas of the equity market.

That is an encouraging development. September demonstrated how higher interest rates were weighing on the average company even as large technology stocks supported the major indexes. **October demonstrated the opposite: weakness among the largest technology companies obscured considerably better performance across the broader market.** In fact, the equal-weighted S&P 500 recovered nearly all of its September decline.

The weakness among AI-related stocks is particularly notable because there has been little evidence that underlying demand has weakened. Cloud growth remains strong, AI capacity continues to be absorbed quickly, and companies continue to describe constraints across compute, data centers, power, and networking. **The debate appears to be shifting from whether AI demand exists to what it will cost to meet that demand and what returns those investments will ultimately generate.**

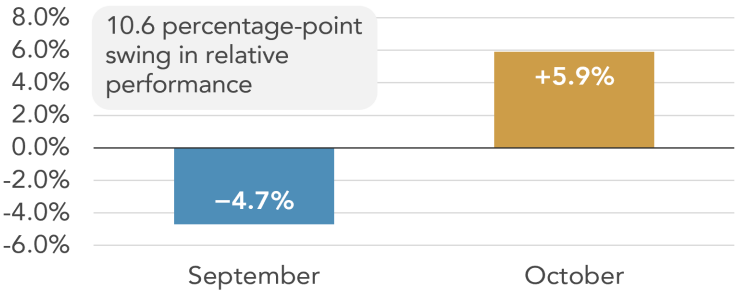
That distinction matters more as the scale of investment grows. The largest technology companies remain exceptionally profitable and financially strong, but capital requirements are increasing rapidly at the same time that the cost of capital remains elevated. **This month's *Spotlight* examines the market's rising standard of proof for AI investment, as attention shifts from the strength of demand toward capital requirements, financing costs, and ultimately the returns generated on that investment.**

We remain constructive toward equities. **Corporate earnings remain strong, economic growth has been resilient, and improving market breadth suggests opportunities are broadening beyond a relatively narrow group of companies.** October also offered an important reminder that weakness in the major indexes does not necessarily mean weakness in the broader market—just as September demonstrated that strength in those indexes did not necessarily mean strength beneath the surface.

Market Leadership Reversed Sharply in October

After lagging significantly in September, the equal-weighted S&P 500 outperformed the cap-weighted index by nearly six percentage points in October.

EQUAL-WEIGHTED S&P 500 VS. S&P 500



Source: FactSet.

CHRISTOPHER D. SHIPLEY
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WHAT TO WATCH

With inflation still above the Fed's forecast, investors will monitor incoming price data for indications of the path of monetary policy. Consumer spending appears resilient, though higher energy prices are weighing on spending in other areas, warranting continued monitoring. Headlines around the conflict in the Middle East will continue to create volatility in energy markets.

- Inflation releases are likely to coincide with elevated market volatility. The Consumer Price Index (CPI) will be in focus on November 10, followed by the Producer Price Index (PPI) on November 13. The Personal Consumption Expenditures (PCE) Price Index will be released on November 25.
- On November 6, the nonfarm payroll report will provide another data point on the state of the labor market. Meanwhile, retail sales data on November 17 will bring further insight into the durability of consumer spending.

MONTHLY SPOTLIGHT



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AI's Higher Bar: From Demand to Returns

DEMAND IS NOT THE ISSUE

Third-quarter earnings season is underway. Several technology companies reported this past week. One message was consistent: AI-related ***demand*** remains strong. Microsoft and Alphabet pointed to AI as a major cloud growth driver. Amazon said newly installed AI capacity is being absorbed quickly. Supply remains tight across compute, data centers, power, and networking.

However, the market's reaction has been more mixed.

THE COST OF MEETING AI DEMAND

We may be nearing a shift in the AI debate. For the past several years, investors focused on whether AI demand would materialize. The focus is now shifting toward what it costs to meet that demand and how quickly record capital spending can translate into earnings, free cash flow, and attractive returns.

The scale of the buildout explains the higher hurdle. Based on guidance, Amazon, Alphabet, Microsoft, and Meta are on pace to spend roughly $730 billion in combined 2026 capital expenditures—nearly 80% above 2025 levels.

For perspective, $730 billion is comparable to the projected annual economic output of Belgium or Ireland.

At that scale, utilization, monetization, financing costs, and payback periods simply matter more. A higher cost of capital raises the hurdle further.

GOOD IS NO LONGER GOOD ENOUGH

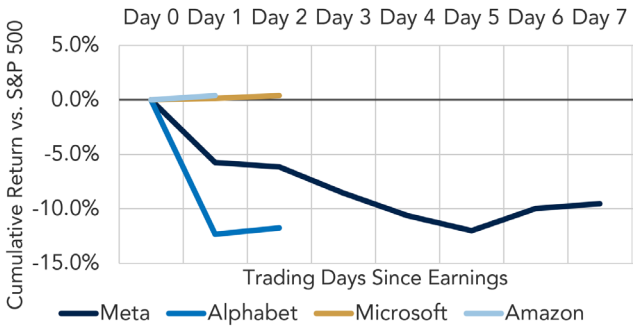
Recent earnings offer different examples of the same issue. Meta's core business remains strong, yet investors focused on the scale and likely duration of its AI buildout. Alphabet reported exceptional cloud growth, but investors also weighed softer-than-expected search monetization, negative free cash flow, and another large increase in capital spending ahead. AI can be both a new growth engine and a potential disruptor to the profit pool funding the buildout.

Microsoft presented a cleaner operating picture. Azure growth accelerated, margins held up, and cash generation remained healthy. Amazon also showed strong AWS growth and profitability, while quarterly capital spending came in far above expectations.

The stock reactions illustrate the higher bar. Strong operating results did not translate into uniformly strong stock performance. Investors appear more willing to look through a strong quarter if spending is rising faster than expected or the path to cash returns remains unclear.

STRONG AI DEMAND, A HIGHER MARKET HURDLE

Cumulative post-earnings performance relative to the S&P 500 | Day 0 = pre-report close.



WHO PAYS FOR THIS?

These businesses are not capital-constrained in the traditional sense. As the scale of AI investment grows, though, how that investment is funded is becoming part of the return equation. Microsoft priced a $25 billion debt offering, its first U.S. investment-grade offering since 2017, while Meta outlined nearly $100 billion of potential equity financing.

None of this signals balance-sheet stress. It does illustrate how the size of the buildout is broadening the funding toolkit. For investors, the question is not simply whether these companies can fund the investment, but whether the returns ultimately justify both the capital being committed and the cost of funding it.

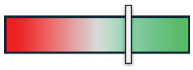
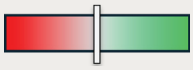
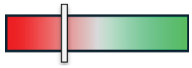
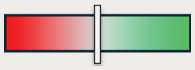
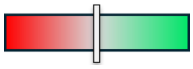
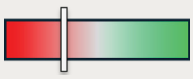
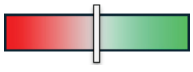
The opportunity remains significant. Demand is strong and supply is constrained. What is changing is the market's standard of proof. Strong growth alone may no longer be enough. Investors increasingly want evidence that AI demand can be monetized efficiently, converted into cash flow, and generate attractive returns on the capital being committed.

Chart source: Stock Analysis and S&P 500 historical prices. Returns through October 30, 2026. Relative return equals company cumulative price return minus S&P 500 cumulative price return. Lines end at the latest completed post-earnings trading day available for each company.

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CURRENT OUTLOOK

TOPIC	VIEW	MoM CHANGE	COMMENTARY
MACROECONOMIC VIEWS			
Economic Growth		–	▸ Growth expectations for 2027 are for roughly trend growth (~2%) as **capital expenditures rise and stable consumer spending** contribute to economic expansion. The conflict in the Middle East continues to create volatility in energy markets, causing uncertainty for investors and consumers. ▸ Job growth and jobless claims remain steady, keeping the unemployment rate largely range bound. ▸ Risks remain elevated amid geopolitical tensions, sticky inflation, and uncertainty surrounding both monetary and trade policy.
Inflation		–	▸ Market expectations suggest that **inflation will remain above 3% until early 2027.** In addition to elevated energy prices and AI-driven pressures, economic activity remains resilient enough to keep inflation risks elevated. ▸ **Core PCE inflation** is running at 3.1% year-over-year. Goods inflation should moderate if oil prices ease, but service inflation has remained relatively firm, held up by shelter and transportation. ▸ The impact on inflation from tariffs has lessened as the initial price effects are unlikely to repeat and the administration has not fully replaced the tariffs struck down by the Supreme Court. Energy prices remain an important factor for inflation as the conflict in Iran persists.
Monetary Policy		–	▸ The FOMC **held the policy rate steady** at the October meeting, after a 25-basis-point hike in September. Current market pricing is forecasting two more hikes through the first half of 2027, with a hike at the December meeting more likely than not. ▸ During the October meeting, Chair Warsh indicated that the Committee will adjust its meeting format next year, with one meeting reserved for discussion rather than a policy vote. In 2028, that will increase to two meetings. ▸ The Committee remains **focused on achieving price stability in a timely manner** as the economy continues to grow and the labor market remains stable.
Fiscal Policy		–	▸ Investors will focus on assessing the implications of the midterm election results on fiscal policy, AI regulation, and the Iran conflict. ▸ Capital expenditure plans continue to underpin growth, aided by accelerated depreciation. However, aggregate fiscal policy is expected to have a negative impact on GDP over the next couple of years. ▸ Flexibility within fiscal policy remains low, as federal debt levels continue to increase and **higher interest costs** consume a larger portion of government outlays. The CBO projects the federal deficit to be 5%–6% of GDP over the next several years.
MARKET VALUATIONS			
Rates			▸ Interest rates declined during October as rate volatility remained elevated, but broader risk-off sentiment provided a bid for fixed income. Concerns over fiscal deficits, hyperscaler issuance, and monetary policy uncertainty remain a focus for investors. The curve flattened as longer-term rates declined more aggressively. The 10-year Treasury ended around 4.9%. ▸ We anticipate that the expected **path of policy rates will continue to shift** with new information related to the Iran conflict, FOMC communication, and inflation data. ▸ **Interest rates are within our fair-value range,** resulting in a largely neutral duration bias at current levels.
Credit		–	▸ Credit spreads widened during the month, improving relative value, but current levels are still toward the **expensive end relative to historical averages.** Strong corporate fundamentals should support spreads. ▸ Investment Grade (IG) spreads (10-year BBB industrials) widened and ended the month at their 35th percentile. High Yield spreads (single-B corporates) also widened, ending at their 24th percentile since the 1990s.
Equity		–	▸ While the **S&P 500 ended October down a modest 0.9%,** the Nasdaq Composite fell 5.3% amid increased scrutiny around AI spending and returns. The S&P 500 remains up 11.8% YTD on a total-return basis, while 2026 earnings growth is expected to exceed 30%. ▸ **Market leadership broadened meaningfully in October, reversing the narrowing seen during the third quarter.** Since mid-October, the equal-weighted S&P 500 has outperformed the capitalization-weighted index by nearly 6% and is now ahead on a year-to-date basis, as weakness in mega-cap growth and AI-related stocks was offset by strength across a broader swath of the market. ▸ **S&P 500 valuations became more attractive, ending October around 18x forward earnings,** down from 19.0x at the end of September and roughly 22x at the start of the year. Fundamentals and earnings growth remain healthy, while increased scrutiny around AI capital spending and the timing of returns has contributed to recent multiple compression.

MARKET DATA & PERFORMANCE | AS OF 10/31/2026

U.S. SNAPSHOT	CURRENT	6 MONTHS PRIOR	1 YEAR PRIOR
Core Inflation (YoY)	3.1	3.1	2.7
Unemployment Rate	4.2	4.3	4.4
Real GDP (YoY)	2.1	2.6	2.6
Retail Sales (YoY)	6.3	4.1	2.8
30-Year Mortgage Rate	7.2	6.3	6.2
10-Year Treasury Yield	4.9	4.4	4.1
US Corporate IG Yield	5.8	5.1	4.8
US Corporate HY Yield	8.3	7.0	6.8

TOTAL RETURNS

ASSET CLASS	MTD	QTD	YTD	1 YEAR	3 YEARS*	5 YEARS*
EQUITY						
Russell 3000 Index	-0.6%	-0.6%	11.7%	12.0%	23.1%	11.0%
S&P 500 Index	-0.9%	-0.9%	11.8%	12.1%	23.4%	12.1%
S&P MidCap 400 Index	1.9%	1.9%	12.0%	14.3%	17.4%	7.2%
Russell 2000 Index	0.6%	0.6%	14.4%	14.8%	20.8%	5.6%
MSCI World Index	-0.8%	-0.8%	11.2%	12.5%	22.8%	11.0%
MSCI World ex USA Index	-0.2%	-0.2%	10.4%	15.0%	21.2%	9.6%
FIXED INCOME						
Bloomberg US Aggregate Index	2.4%	2.4%	-0.5%	-0.1%	5.5%	-0.2%
US Corporate Investment Grade	2.1%	2.1%	-0.9%	-0.5%	6.3%	0.0%
US Corporate High Yield	0.3%	0.3%	0.4%	1.6%	8.6%	3.7%
Emerging Market Debt	1.5%	1.5%	-0.5%	0.4%	10.5%	2.0%
US Treasury (7–10 Year)	3.0%	3.0%	-1.9%	-1.6%	4.5%	-1.3%
Cash	0.4%	0.4%	3.1%	3.8%	4.6%	3.9%

Source: Fort Washington and Bloomberg. *Returns for periods greater than one year are annualized. Past performance is not indicative of future results.

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