

Q3 2025 Edition
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The Aurora Project

Market Research

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Market Outlook – Q3

From The Aurora Project

Q3 2025 marked the first “normal” quarter in over a year, a welcome shift after the market uncertainty coinciding with the election in Q4 2024, the global allocation reset of Q1, and the risk-on rally of Q2. Markets found steadier footing, with volatility drifting lower and credit spreads staying tight, signaling confidence in earnings durability and corporate efficiency. The S&P 500 gained 7.8% with global equities advancing in tandem and U.S. small caps finally broke out after a long stretch of underperformance with a 12% return.

Big Tech remained central, driving 70% of the S&P’s advance, yet the story was less one-dimensional than earlier in the year. Apple, Alphabet, and Tesla, all first-half laggards, added meaningfully to returns. Sector leadership was narrow, with Technology, Consumer Discretionary, and Communications delivering most of the quarter’s gains. Consumer Staples was the only negative group, underscoring persistent risk-on appetite, while Utilities emerged as an unexpected winner given their growing role as a “stealth AI play”.

The quarter carried a sense of stability that has been absent for much of the past year: every dip was quickly bought, the VIX drifted from mid-16’s in July lower into the 14s and market moves felt comprehensive rather than chaotic. After months of shocks dominating the narrative, Q3 provided investors with a familiar three-month period that they could both understand and trust. This backdrop has helped rebuild confidence heading into the final quarter of the year.

Fundamental

Fundamentals reinforced the sense of stability that defined Q3. Corporate margins hovered near record highs at 12.7%, just shy of the 13.1% peak from 2021, while Q2 earnings season delivered 10.3% growth versus the 4.9% expected. Broad-based upside surprises and rising Q3 estimates highlighted the strength of U.S. corporate fundamentals.^[1] Real GDP growth for Q2 2025 was revised upward to a 3.8% annualized rate, recovering from a weak Q1, with year-over-year growth reaching approximately 2.1% in Q2 2025. Household balance sheets remain sturdy, with debt service ratios near 11%, consistent with historical norms. Consumption, which accounts for 68% of GDP, remains resilient; nearly half of all spending (49%) is driven by the top 10% of earners.^[2]

Inflation continues to moderate, with CPI running at 2.9% and shelter at 3.6%. Blackstone (via their rent data of 2.1%) implies CPI is closer to 2.4% as well as Truflation (live data) hovering around 2% for many weeks now.^[3] Bond markets remain calm, the 10-year Treasury yield eased from 4.232%

to 4.154% and the 20-year slipped from 4.788% to 4.705%. The MOVE index, a proxy for bond-market volatility, has declined from 137 to 69 since the April peak. These dynamics do not signal stress. The U.S. dollar's dominance remains stable, supported by deep liquidity, unmatched safe-asset demand, and entrenched use in reserves and transactions. While modest reductions in foreign Treasury holdings have occurred, there is no clear signal of large-scale sovereign exits. The dollar continues to function as the anchor of global finance, even in an era of shifting reserve dynamics.^[4]

The scale of AI capex growth is staggering. In 2020, hyperscaler capital spending was \$73bn. By 2024 it had nearly tripled to \$211bn, 2025 estimates are \$347B and projections show it rising to \$467bn by 2027.^[5] That implies AI infrastructure investment will increase more than sixfold in just seven years. While per-dollar-value remains to be proven, the sheer magnitude of spend appears inevitable. These Hyperscalers and Mega-cap Platforms, once celebrated for asset-light, high-margin business models, have the balance sheets and financing channels to sustain record outlays. Recent guidance and industry data confirm the trajectory is still increasing. Yet the pace will moderate, with quarterly growth rates projected to fall from 70% in 2025 to just 17% q/q by mid-2026 and lower thereafter.^[5]

Less than one-third of AI-related investment has been captured in official GDP statistics. Since 2022, roughly \$160 billion in AI capital expenditure has occurred, yet only about \$45 billion has flowed through to BEA accounts.^[6] Much of the spending on semiconductors, model training, and cloud infrastructure is classified as intermediate inputs rather than fixed investment, effectively reducing imports rather than boosting domestic output. This accounting quirk masks one of the largest capex booms in decades and leaves a hidden impulse of growth still working its way through the economy.

Concerns over consumer credit stress remain overstated. While student loan repayments present a headwind for a portion of households, they function more as a modest drag on discretionary spending than a systemic shock. As noted earlier, the broader consumption picture remains underpinned by higher-income households, which account for roughly half of total spending. With fiscal deficits set to expand, reshoring driving new investment, and Fed policy easing on the horizon, the policy mix remains slightly supportive.^[7] The U.S. economy has repeatedly shown resilience to shocks, making a recession unlikely absent a prolonged fiscal pullback or widespread layoffs across the public and private sectors. While the current government shutdown introduces short-term uncertainty, it does not yet resemble true austerity in scale or duration.

- [1] DataTrek Research, *Morning Briefing: August 5, 2025* (Colas & Rabe, 2025)
- [2] Jonnelle Marte, "Top 10% of Earners Drive a Growing Share of U.S. Consumer Spending," Bloomberg, September 16, 2025
- [3] Jon Gray, "On the Economy, AI and Where to Invest Now," Blackstone Insights (2025)
- [4] Board of Governors of the Federal Reserve System, *The International Role of the U.S. Dollar — 2025 Edition* (FEDS Notes, July 18, 2025)
- [5] J.P. Morgan Asset Management, *Guide to the Markets — U.S., 4Q 2025*, as of September 30, 2025
- [6] Goldman Sachs Global Investment Research, *U.S. Daily: A Primer on the Impact of AI on the GDP Statistics* (Briggs & Dong, 2025)
- [7] Committee for a Responsible Federal Budget, "August 2025 Budget Baseline," CRFB (August 2025)

A Note on Crypto

Crypto continues to reflect sentiment shifts more than it poses systemic threats. At approximately \$3.8 trillion, the total crypto market cap is insignificant when set against U.S. household wealth of \$176.3 trillion. Nvidia, valued at \$4.5 trillion, already exceeds the size of the entire crypto asset class and stands nearly equal to the U.K. equity market's \$4.8 trillion market capitalization. Gold, with a \$26 trillion market, provides another useful comparison. It has endured four drawdowns of 30% or more in the last 50 years, a historical lens that may foreshadow how Bitcoin's long-term trajectory could unfold. For now, leverage in crypto markets remains minimal relative to GDP or total market capitalization, placing the asset class less as a risk to financial stability and more as an evolving pillar of how value is defined and stored globally. We remain interested in the investment profile offered by this asset class for its speculative and potential future value.

Technical

Q3 brought a meaningful broadening in market participation. The Russell 2000 reclaimed the 2,242 level and extended its rally to finish the quarter at 2,436, putting new all-time highs within reach. This renewed strength in small caps signals improving breadth beneath the surface, a healthy counterbalance to the ongoing dominance of large-cap leadership.

By contrast, the S&P 500 and Nasdaq 100 have continued their steady ascent, notching new highs almost weekly. Yet both indices are now testing the upper limits of momentum. Daily and weekly RSI readings show bearish divergences developing compared to mid-2024. While such divergences on weekly charts can unfold slowly, they often emerge late in an advance and give credence to waning participation. On an absolute basis, RSI levels for both indices remain near the 70 range, indicating overbought conditions. Together, these signals suggest momentum may be stretched, leaving markets more sensitive to consolidation or a short-term correction.

As of October 3, rolling 100-day returns for the Nasdaq 100 stand at **+18.77%**, just above its one-sigma range of **-6% to +18%**, while the S&P 500's **+14.91%** return sits slightly outside its range of **-3.5% to +14%**. Both indices remain within historically normal volatility bounds, but their positioning at the upper edge of those bands opens the case for cooling rather than acceleration.

Relative performance still favors growth. The QQQ/SPY ratio continues to make new relative highs, reflecting sustained leadership from Megacap technology. When that relationship eventually reverses, it should align with broader momentum exhaustion. For now, the resurgence in the Russell 2000 provides a constructive offset, suggesting that even as the largest benchmarks approach overbought extremes, the underlying bull trend remains technically intact, as it increases in maturity.



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