

Equity Newsletter

4th Quarter 2025

First Trust

We hold a balanced, moderately positive view of U.S. equities, and we expect continued economic expansion for now. Dovish monetary policy, fiscal spending and outsized technology-driven capital investment provide key support for equities, in our view. That said, prudence still requires a balanced stance towards U.S. equities, as Artificial Intelligence (AI) investment enthusiasm has contributed to elevated equity valuation levels, especially for key beneficiaries of the AI boom. Other risks worth monitoring closely include any resurgence in tariff and trade uncertainty, or any evidence that the labor market is significantly weakening. As such, we continue to favor exposure to dividend paying equities and quality growth companies, while emphasizing the technology and financial sectors.

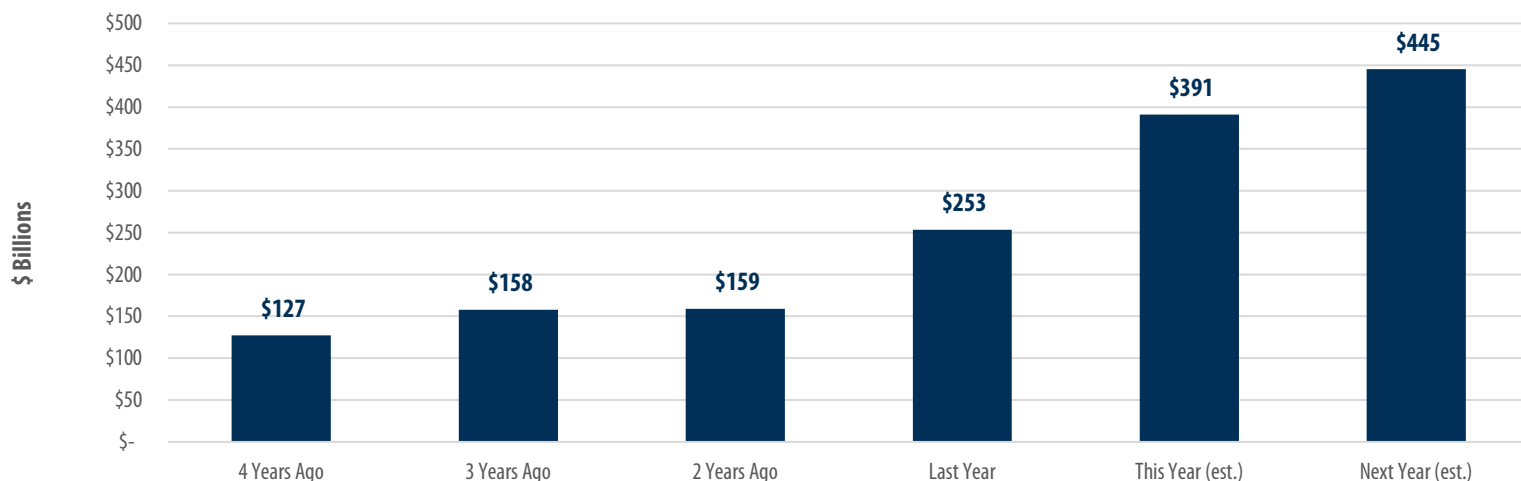
AI - If You Build It, Will They Come?

As the massive AI story continues to unfold and dominate the stock market, many companies that have made announcements to spend heavily on capital expenditures to build AI infrastructure have been rewarded with outsized gains in their stock prices. Look no further than Oracle's announcement on September 9th that they will rapidly increase spending on AI infrastructure after signing an enormous deal with OpenAI to provide computing power to the company from 2027 until 2032. Oracle's stock soared 36% the next day. That stock price surge may be appropriate... or not. In our view, the market is rewarding future **projected revenue** streams and showing little concern (or regard) for the **committed outlay** of most of Oracle's cash flows, plus additional balance sheet leverage for the foreseeable future, to generate those revenues. In addition, the entire focus is on the massive revenue increases in the future. What are the profit expectations? No one is quite sure at this point.

To be fair, it is extremely difficult to project future revenues and earnings far into the future. All this spending may turn out great for shareholders. However, we believe a better option may be the companies that are benefiting from all this AI spend. In other words, who is getting all this money over the next several years? A recent study by McKinsey projects \$5.2 trillion in data center spending through 2030. Their breakout of costs: 60% (\$3.1 trillion) to technology developers and designers that produce hardware and semiconductor equipment, and 40% (\$2.1 trillion) for building the massive buildings and installing all the energy equipment and electrical components to make everything work.

In our view, the better risk/reward proposition may be investing in the companies that are the recipients of the projected spend versus the ones paying the bills and expecting that spend to translate into future profits. That said, if the build continues at this frantic pace, many industrial companies, tech companies that are supplying hardware and software to build out the AI space, energy companies, and financials (insurers on all these assets and lenders on AI leverage) may be the true winners.

Combined AI CapEx Spending of Major Tech Companies*



Source: Capital IQ. Data as of 9/30/25. The chart is for illustrative purposes and does not represent any actual investment.

*Actual and projected CapEx from Amazon, Microsoft, Google, Meta, Oracle. There is no guarantee that past trends will continue, or projections will be realized.

Past performance is no guarantee of future results.

AI CapEx (capital expenditure) Spending is the investment companies make to acquire, upgrade, and maintain the long-term, physical and intangible assets needed to develop and operate AI technology. CapEx is a strategic investment in long-term assets that is depreciated over time on a company's financial statements.

References to specific securities should not be construed as a recommendation to buy or sell and should not be assumed to be profitable.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.



Sector Views

Communication Services

- Internet and streaming firms are investing in Artificial Intelligence (AI) to increase monetization and improve efficiency.
- Risk of increasing regulation, anti-trust scrutiny for mega-cap internet; however AI increases the possibility of new competition to mega-cap internet incumbents.
- Streaming media is increasing mix of ad supported revenue to improve profitability.

Consumer Discretionary

- Low unemployment and strong wages are current positives for consumption, but declining job openings and a falling quit rate may indicate the potential for labor market normalization favoring employers.
- Cumulative impact of inflation in recent years remains painful for consumers, especially on the lower end of income distribution.
- Easing Fed policy may buttress demand for rate sensitive purchases such as housing and autos.
- Increasing e-commerce penetration, automation of warehouses are secular positives to profitability.

Consumer Staples

- Defensive sector, but offers what we see as relatively meager growth.
- Valuation not particularly attractive, in our view.

Energy

- We are relatively cautious towards energy given risks to oil prices, but note that energy sector equities provide strong free cash flow generation.
- While U.S. sanctions on Russian and Iranian crude oil are in force, OPEC, including Saudi Arabia, has eased oil production quotas. Non-OPEC supply growth may increase over time as well.
- The U.S. economy is a key source of demand for energy, and we believe the U.S. will avoid recession in the immediate term. That said, oil consumption could be impacted by any slowdown in macroeconomic growth.
- Risk to global oil demand from any tariff re-escalation.
- Geopolitical tail risks to oil supply exist due to tensions in Middle East between Israel and Iran, although any resolution to Ukraine and Russia conflict would ease oil supplies.

Financials

- We expect a more industry friendly regulatory stance towards banking, including less scrutiny of mergers, and easing of capital requirements.
- Investment banking revenue and trading expected to strengthen amid increased capital markets activity and market volatility, respectively.
- Commercial and industrial (C&I) loan growth may accelerate in upcoming quarters amid pent-up demand, and potentially lower rates. Businesses may also borrow more if the regulatory environment becomes more favorable with the current administration.
- Credit quality remains reasonable. That said, any significant rise in unemployment would increase delinquencies.
- Valuation levels are attractive, in our view.

Healthcare

- Provides opportunity to invest in growth that is less correlated to the business cycle, that said, policy uncertainty remains significant in the sector.
- Focus within the pharma industry is on key drugs such as GLP-1s for obesity, and the need for innovation to build pipelines and re-accelerate growth.
- Biotechnology stands to benefit from secular innovation, and potentially increasing merger activity as cash rich Big Pharma is motivated to replenish their pipelines, additionally, funding environment for smaller biotechnology firms may ease over time.
- The growth of the life science tools industry may be muted as biopharma and hospitals remain focused on maintaining spending discipline. Government and academic research spending is also important to the industry.
- Valuation is attractive in the sector, in our opinion.

Industrials

- Demand for CapEx is a secular driver that may benefit the sector, as firms are motivated to reshore supply chains and increase productivity in a tight labor market.
- Increasing infrastructure requirements to support data centers is another key secular driver for some industrial firms.
- ISM Manufacturing PMI continues to indicate cyclical weakness in industrial activity.
- Tariff policy is a risk to industrial exports.
- Defense industry names benefit from increasing geopolitical risk, as well as potential increases in defense spending on the part of U.S. allies over time.
- Valuation in sector is reasonable, in our view.

Information Technology

- We expect robust information technology corporate spending driven both by AI related capital spending, and a potential recovery in end markets outside of AI, such as traditional enterprise servers.
- Key semiconductor end markets such as AI, high bandwidth memory, and vehicle electrification stand to benefit from secular tailwinds.
- We prefer quality within the sector, particularly firms with strong corporate balance sheets and reasonable valuation.

Materials

- On a cyclical basis, risks to international growth from trade tensions, and weakness in Chinese construction are headwinds to basic materials demand.
- We believe incremental demand from clean energy grid infrastructure and electric vehicle transition is a secular positive for some metals, such as copper.
- Materials sector stands to benefit over time from policies and investment designed to reshore supply chains and improve resource security amid geopolitical tensions.

Real Estate Investment Trusts (REITs)

- Higher yielding sector sensitive to interest rate movements, stands to benefit if rates decline.
- Data center REITs provide a strong secular opportunity but are sensitive to the information technology spending environment on a cyclical basis.

Utilities

- Defensive, dividend paying nature more attractive in times of macroeconomic uncertainty.
- Utilities are sensitive to interest rate movements, a potential positive if rates have peaked.
- Data center power consumption is a source of secular growth in electricity demand.

DEVELOPED MARKETS

Europe

- Inexpensive valuation in comparison to U.S. stocks.
- EU governments have shown a greater willingness to stimulate their economies with fiscal policy initiatives. For instance, Germany announced a €500 Billion infrastructure fund, and exemptions from debt brakes for defense spending.
- European Central Bank may continue to ease policy, as moderate inflation and Euro strength provide leeway for the central bank to focus on stimulating growth.
- Potential for increase in Chinese imports redirected from U.S. may negatively impact balance of trade.
- European sentiment stands to benefit from any de-escalation of the Ukraine/Russia conflict.
- Geopolitical risk from increased influence of populism on national politics within Eurozone and tariff policy.

United Kingdom

- Manufacturing PMI surveys point to contraction in industrial activity.
- The Bank of England expected to gradually ease interest rate policy, while fiscal policy may tighten in the November budget, potentially including tax increases or welfare reform.
- Inexpensive valuation in comparison to U.S. stocks.

Japan

- Business sentiment may continue to improve post the Japan-U.S. tariff deal, and we expect robust capital expenditures to support corporate profits.
- Bank of Japan may embark on a modest tightening cycle as the Japanese economy improves, potentially strengthening the Yen as the Fed eases.
- Japan benefits from “friend-shoring” and increased secular demand for advanced technology exports such as automation equipment.
- Structurally low return on equity, although some corporate governance reforms have been implemented by the Tokyo Stock Exchange.
- Challenging demographics may limit long-run potential economic growth.

Australia

- Commodity exporter which stands to benefit when commodity prices rise.
- Exports of raw materials to China key driver of economic growth.

Canada

- U.S. is key trading partner, stands to benefit from strong U.S. growth, but increased tariffs and protectionism impact Canadian exports.
- Energy and metals exporter, which stands to benefit when oil prices rise and demand for basic materials is strong, would suffer from a U.S. recession or a decline in oil prices.

EMERGING MARKETS

Emerging Asia

- Chinese policymakers have introduced fiscal and monetary stimulus measures to buttress growth. That said, the Chinese macro picture remains murky, as potential weakness in international trade and Chinese real estate investment are key risks.
- Rising geopolitical tensions present risk to supply chains for key technologies and materials, and complicate U.S. firms’ decisions to invest in China. Chinese exports to U.S. are likely to remain impacted by U.S. tariff policy, in our view.
- India currently in trade dispute with U.S. because of Russian oil purchases, but exclusion of generic pharmaceuticals from U.S. tariffs is good news for India’s pharma industry. We expect easier fiscal policy via tax reform, and dovish policy on the part of the Reserve Bank of India (RBI) to provide tailwinds to India’s growth.

Latin America

- Mexican economy stands to benefit from exports to U.S., but would be negatively impacted by any eventual U.S. recession. Over time, supply chain diversification away from China may be a structural tailwind to exports.
- Populist election results impact sentiment towards the region, as fiscal discipline may be called into question.
- Brazil and Latin America overall are sensitive to demand for commodity exports.
- Tariffs are a risk to the region, but Mexico benefits from more favorable terms for U.S.-Mexico-Canada-Agreement (USMCA) compliant goods.



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First Trust Advisors L.P. | First Trust Portfolios L.P.

1-866-848-9727 | www.ftportfolios.com