

Fidelity Viewpoints®: Market Sense

Week 179 November 4, 2025

TRANSCRIPT

SPEAKERS:

Heather Hegedus Jurrien Timmer Chris Lin

HEATHER HEGEDUS: Hey there, everybody. Thank you so much for making the time to join us today for our *Market Sense*. I'm Heather Hegedus with Fidelity. It is the first week of November already. Can you believe it? And quarter three earnings season has been a winner, with big tech companies, once again, leading the pack.

At the same time, we're also seeing a wave of company layoffs in the headlines and a government shutdown that, as of tomorrow, will be the longest in history. And speaking of Washington, another thing to keep tabs on, tomorrow, the Supreme Court is going to be considering whether the president has the authority to unilaterally impose tariffs on nearly every country under a Federal Emergency Powers law.

Also, today, more immediately here, we're seeing a pullback in stocks right now as Wall Street CEOs sounded the alarm about high tech valuations. But just a reminder—and we like to say this all the time here on *Market Sense*, folks—today is just one day in the market. And things can change, day by day, and even hour by hour. So perhaps, not enough to really cause concerns yet.

And to talk about how things are going, we are joined today, as we often are, by Fidelity's director of global macro, Jurrien Timmer, who's going to be talking to us today about the potential investor implications. We are also thrilled today to be welcoming a new guest to *Market Sense*. I'm talking about Chris Lin, who is a seasoned portfolio manager here at Fidelity with a focus on large-cap growth and the tech industry. And he's going to be talking with us today about the AI revolution, AI stock valuations, and where he sees this transformative technology going in the future.

I'm really excited for this conversation today, super timely. Thanks to both of you for taking the time out of your busy schedules to join me today.

CHRISTOPHER LIN: Thanks so much for having me. Glad to be here.

JURRIEN TIMMER: Great to have you, Chris. And I can tell the audience, you're in for a treat.

HEATHER: Absolutely. This is going to be a fantastic conversation. So today is Tuesday, November 4. Jurrien, let's start with you. Today's correction notwithstanding, of course, the stock market has been on a solid streak of advancing to new all-time highs. Its strength has really been an earnings story right now. We're seeing that, again, in quarter 3 earnings as they continue to come in.

So far, over half of the companies in the S&P have reported their results. And as I said in the intro, the results have been very strong. So I was hoping you could unpack that for us today and talk a little bit more about what may be going on underneath the hood here.

JURRIEN: Yeah. So until today's decline, which is not modest, but we have to put that in perspective of a very, very solid run higher this year, the S&P up around 17%. The market has a lot to smile about right now, because earnings season, which we've actually had about 70% of the market reporting now, and beating estimates by an average of 500 basis points or 5 percentage points.

So a very, very robust earnings season coming on the heels of three recent quarters—the second quarter, the first quarter, and the fourth quarter of last year. So the market is enjoying a good string of earnings. And this is happening at a time when the Fed is cutting rates. And whether it will continue to cut in December or not remains to be seen, but that's generally considered a tailwind.

And the bond market is pretty quiet. And remember, we've talked about this many times this year. When bond yields start to spike up towards 4 and 1/2, 5, the stock market doesn't tend to like that. And so the bond market has been very quiet.

So we're now in year four of this bull market that began in October of 2022. And the first year of that bull market was all PE-driven, as is very typical of a first year, because the market anticipates an earnings recovery. And so it pushes price up before the earnings does, and therefore the PE ratio, the price-to-earnings ratio, goes up.

In year two, we had earnings joining. And earnings grew 11%, still amplified by valuations. And now in 2025, valuations have taken a little bit of a backseat. They're not down, but they're not up either from last year. And earnings right now are on schedule to grow another 11% this year. So it's what you want to see if you want to be invested in the stock market.

The question always becomes one about valuation, and, of course, the things that are driving it. And this is why we have Chris on the show, of course, today.

HEATHER: Yeah. Let's bring Chris in right now. Chris, I'd love to talk to you, too, about quarter three earnings, Mag Seven. So AI is leading some market volatility today, as we mentioned, over some valuation concerns. Been a very strong quarter three earnings season, as Jurrien talked about. I'd love to get your perspective on this as a large-cap growth stock portfolio manager. Do you think the staggering cost of building AI infrastructure may be what is starting to test nerves on Wall Street?

CHRISTOPHER: Yeah, I do. I think that's part of it. The reason why people are starting to think about this more is just that, even for companies as large as the Mag Seven, the Magnificent Seven, which includes companies like Microsoft, Google, Apple, Amazon, and some of the largest tech companies in the world, this amount of capital that they're spending into artificial intelligence or AI is pretty staggering. And so the investors in the stock market, rightfully so, in my opinion, are asking, is there going to be a return on this investment?

HEATHER: Well, no question here, Chris, another huge question that is dominating the headlines right now that we're hearing from investors is the question, are we in an AI bubble at this point? And just to make sure everybody knows what I mean by that, I mean a run up in prices of tech stocks that may be fueled by some overhyped excitement about AI that could lead to that bubble eventually bursting. Similar scenarios did happen in '99, with the dot-com bubble bursting, in 2008.

So understandably, that's been on that's been top of mind on investors' minds. And we've been getting a lot of questions from our *Market Sense* viewers about how to detect potential warning signs. So I'll just pose the question to you, do you think we're in an AI bubble?

CHRISTOPHER: Yeah, thanks. So it is absolutely the number one question that I get a lot, just having studied the technology industry and AI specifically for a while. And the short answer is, I don't know. But I'm going to tell you how I think about it. So first, why is everybody so excited for AI?

And if you go back to the advent of the transistor, which was invented around the 1950 time frame, we've had four major waves of computing. You had the mainframe in the '60s and '70s. You've had the desktop in the '80s and '90s. You've had the web in the '90s and the 2000s. And we are living in the era of mobile, which is the 2010s and the 2020s.

And I bring this up because if one had been able to correctly identify and invest in the winner of each of those respective waves, that person probably could have just gone to the beach and still would have ended up a very wealthy person. And so I feel pretty confident that the next major computing wave could be AI. And that's why there's so much excitement for it. And that's why the investors are paying so much attention to it. And that's why we're spending so much time on it. So that's why people are excited for it.

And so going back to your question, are people overly excited about it right now? And are we in a potential exuberant bubble? And I think, really, one's time frame is a very critical factor to assess this question. In the long arc of time over 10, 20 years, I actually think AI is just getting started. And I think it has the potential to be one of the most profound technologies of our generation.

And so from that perspective, I would say that it perhaps is underhyped. However, I think the spirit of the question is actually like, could we be in a near-term bubble, such that people are just too excited and sentiment oftentimes moves a little bit too fast? And there my answer is I'm not sure. I don't think you can actually know if you're in a bubble until it potentially pops. And the reason why is because you just don't know what the technology is capable of in the near term. And so it's very hard to know.

I would say that most technological transitions do have cycles. And so I don't think that AI should necessarily be unique from that perspective. And what I mean by cycle is a digestion period or a correction, whereby a lot of that exuberance is not able to keep up with the fundamental trends. And so we have to have companies and stocks actually grow into their potential over time.

Another related question that I think about a lot is how the market might be so concentrated in what's called the Magnificent Seven stocks, the Mag Seven. And again, these are the largest tech companies in the world, including Apple, Google, Microsoft, Facebook, and Amazon, Tesla, NVIDIA. And one thing that I would just give people context around is that while these companies and stocks have been able to really capture a lot of the stock market returns over the past couple of years, they've actually become almost—excuse me—over 70% of the S&P 500's earnings growth. And so there's a reason why a lot of the investors are gravitating towards these stocks because they are kind of really capturing a lot of the rents in the stock market.

HEATHER: So similar to a recession, we may not know if we're in an AI bubble until it's actually happening.

JURRIEN: And Heather, can I just add something? Because Chris made a brilliant point. We like to use the word "bubble" a lot. I think it's probably one of the more overused words out there. And bubbles, by definition, are chaotic events. They're like not rational, because if they were rational, it wouldn't be a bubble.

So if they were easy to figure out with a linear mind, then it just never would be a bubble. So bubbles, by definition, if they happen, only make sense in hindsight and not in real time. And that's why it's a favorite pastime of people, but it's a question without an answer right now.

HEATHER: Yeah. Well, that's great insight, too, Jurrien. And I did want to ask you to put this together for investors, too, who are concerned about maybe being over concentrated in AI. How much of a risk is that these days? And how could investors think about the role of tech in a portfolio right now?

JURRIEN: For me?

HEATHER: Yeah.

JURRIEN: Yes. So certainly concentration risk is a thing, right? The Mag Seven is like 36% of the S&P 500. And the S&P 500, even though most of the stocks, maybe 2/3 to 70% of them are going up, they're just being trounced by the performance of the Mag Seven, which are up, I believe, fourfold since the bull market began. And to Chris's point, even though the price is up fourfold, their earnings are up threefold, which means that the PE, which is up, hasn't really done—hasn't been the primary factor.

But concentration risk is a thing, because if those seven stocks ever decide to go down, the S&P 500, the index as we know it, would go down, because they're just too big for it to be otherwise. So you could be the best stockbroker in the world or you can have a passive index or ETF exposure, and the index would go down even if most of the stocks go up if the Mag Seven were to go down in a meaningful way.

And so we have to think about how do you diversify in a portfolio like that. Do you go international? Do you go, what we call down cap, to smaller stocks? But it's something we need to remember. And it's something that we need to keep in mind when we rebalance and build a diversified portfolio, that we don't go out over our skis, being all in on this one segment, even though it's a very large part of the market.

HEATHER: Yeah. Let's talk to Chris about this question of portfolio mix, too, Chris. And I'll bring in a couple of viewer questions here, too. Just for your background, Chris, most of our viewers are people who are investing on their own. We got questions from people who registered for our show ahead of time on fidelity.com.

Cheryl and Tammy wrote to us, and they said they were concerned they potentially missed the AI wave. Somebody else wrote in to say, just not really sure where to start when it comes to AI. So I was hoping that you could speak, at a high level, about your process when it comes to picking stocks. And if you could walk us through what you are looking for as a fund manager.

CHRISTOPHER: Sure. Thanks for the question. So I've thought about this a lot. And I would describe my investing philosophy—I affectionately call it durability at a reasonable price, or DARP, if you will. And so, to me, what I found is most asset mispricings are usually a function

of people over or underestimating how long something is going to last. So some people might think that something is temporary, when, in fact, it's probably a little bit more permanent, or they'll think it's more permanent, when, in reality, it's very temporary.

And so I really focus on how long something's going to last. And just to make it more concrete, I might contrast that to, let's just say, something like magnitude. So for example, I care less about how fast something is going to grow. I care more about how fast it can grow for a long time.

And so if something can go really fast, but it can only do that for a very short period of time, I'm really not interested in that. Then it's basically a fad. And so the question is, what do I think is durable? And so whenever I'm investing in a company or meeting with an analyst or thinking about what is actually durable, I ask three key questions.

And so the first one is, does this company sell something that people need? And then question number two is, can anyone else do it? And then the last question is, what do I have to pay for this?

HEATHER: Wow. You make it sound so simple. Like, basic questions there, but perhaps investors don't ask that enough, right?

CHRISTOPHER: This is literally the foundation of every conversation that I have. And there are a lot more details that go on top of that. But at the center of the problem is me trying to really figure out these three things.

And now, of course, the execution is more important than just being able to ask the questions. And figuring out the answers to these questions is more difficult than answering—excuse me—asking them, too. But this is the foundation of what I actually try to do, is just try to answer these three questions.

HEATHER: I think it also comes down to, when it comes to AI, trying to determine who might be an AI winner and an AI loser in this AI race. So how do you think about who might be at risk from being disrupted by AI?

CHRISTOPHER: Yeah. So this is something that we're thinking about a lot in the tech industry in particular, but really any industry, because AI is such a foundational technology. It can influence a lot of different industries.

But some of the key characteristics that I think about a lot, one is, I think, a little bit about whether or not somebody has a digital-only business, and specifically if somebody has a digital only business that might monetize through a per seat subscription model. So like, let's just say, for example, a per employee per month revenue model, that's something that I might think about, just because AI has the potential to influence that a lot.

Another thing that I might think about is actually whether or not the complexity in that product, if it's digital, is really high or really low. So something that might be, let's just say simple, but not necessarily scalable is another thing that I'm like, wow, that might be something that's ripe for being influencer disrupted by AI. And then more generally, I just think about, yeah, is something that is very static, very repetitive, but doesn't scale? Those are the three characteristics I think about with respect to something potentially being disrupted.

HEATHER: And we've already seen that not all jobs are safe from this AI revolution, Chris. We've seen that in the layoffs just recently with this softer jobs market. So I guess this would be a better question for Jurrien, because we talked to you a lot, Jurrien, about the economic impact of things and macro. Do you see AI potentially having a long-term impact on the economy, or is it more of a short-term impact?

JURRIEN: Well, we've had, of course, many, many waves in economic history of, I guess we can call it, creative destruction, where a new technology is created, and it displaces a certain part of the workforce. And then those people have to basically get different jobs.

I mean, in the old days, banks would have people adding numbers, ledgers by hand. And then we got the calculator. So those people had to go do something else. So yes, I'm sure to some degree, some jobs will get displaced, especially information-based jobs that are not like manual, not physical. A paralegal at a law firm looking through thousands of documents for some kind of case evidence or something, that could probably be done through AI fairly easily.

And so it could happen. But my understanding—and Chris, correct me if I'm wrong—is that right now, AI is thought of more as a smart assistant that makes people better, rather than robots that replace people. But who knows where it ultimately leads?

CHRISTOPHER: And you've seen that even in major and in major industries, so it's more of an assistant as opposed to a replacement.

HEATHER: And I think a lot of folks are hoping that stays the case. But we've even seen—I'm not giving Fidelity any ideas here, but even AI webcast presenters and TV presenters. We've seen AI used in very creative ways.

Chris, I think for a lot of people, it's still unclear, to that point about, hey, what the future of AI is, how it might be used in the future, what the future state of this all is. I think the most common way that people are familiar with AI right now is ChatGPT, right? That became a household name. We're seeing everyone from families to organizations, big companies using ChatGPT, the leading generative AI product. So can you talk about what you see for the future when it comes to generative AI?

CHRISTOPHER: Yeah. So everybody probably understands what ChatGPT is, but I would just say that ChatGPT is one product of a larger technology that's called generative AI. And so what is generative AI? It uses something called a Large Language Model, or an LLM—you might have heard about this in the press—to generate content on demand at very low or marginal cost.

And while that's a really simple statement, don't let that fool you. Because anything that you see or hear is a form of content. And so think about that with respect to being able to be generated on demand, anything that you can see or hear.

So it could just be you at some point sitting down for a movie. And this generative AI could say like, wow, OK, Chris is in a stressful mood. Maybe he wants to watch a really laid back movie, and they literally generate it for me on demand. It's not something that's pre-produced or anything like that, but the content is actually generated right there for you.

HEATHER: You're saying it wouldn't just be picking which movie to watch, it would make the movie for you.

CHRISTOPHER: Correct. So instead of actually retrieving some sort of information or selecting, it is generating it when it did not exist just one second before. And so being able to do that at scale, at low cost is really powerful. And that's actually what ChatGPT is actually doing. It's generating text. Again, that's something that you can see for you on demand based on data that it's actually accumulated on the internet.

But let's be more practical. So Google actually just released a really neat technology and paper the other week talking about how it's using AI to potentially treat cancer. And I thought that was actually one of the more fascinating papers that I've read in a long time, because, again, it's being able to find patterns in data and content for it to be able to produce in front of you.

HEATHER: There's so many different applications. We could talk about, like Jurrien, we could have an hour conversation on this. We do have to wrap, but I wanted to quickly ask you what you think people should be looking out for in the AI space within the next year. What should we be tuned into?

CHRISTOPHER: So I think the foundation of this whole thing is just whether or not the models keep improving. That is absolutely number one. If the models don't keep improving, we've got to ask some questions. And I think that the advent of the reasoning models that you've seen really over the past year have been really impressive. And this is when a model actually gives you a better response by being able to think for longer after you ask it a question.

The other question that's more practical is just, are these companies making money? Are the companies that are making these products being able to generate a return on all this investment that they're putting into the ground. Because at the end of the day, shareholders want free cash flow and returns. Otherwise, people are going to start to question what they're doing.

And then, lastly, one thing that is really fascinating to me is just whether or not we get better enterprise adoption. So consumers can adopt technology readily at their own pace because they're able to do what they want, and they can move fast. Enterprises have a lot of interdependencies. They have rules. They have governance. They have fiduciary duties and clients. And so they might be a little bit more hesitant to adopt newer technologies, like generative AI. So that's something that we're also paying attention to.

HEATHER: Super simple, but really smart questions, and just a really thought-provoking conversation, Chris. Thank you so much for making the time to come on. We like to end the show with a quick Timmer's Take on what Jurrien's watching right now. Perhaps outside of AI, Jurrien, what else are you watching right now?

JURRIEN: So earnings season has been a win, so we can move on from there. The Fed just moved, so we can move on from there as well. So I would say the most interesting thing to watch right now is the Supreme Court hearings on the administration's tariffs via the IEEPA, as we call it, and whether that pokes any holes into current trade relations.

HEATHER: And you think it could have a real market impact, depending on what happens.

JURRIEN: If the tariffs are rolled back, it could, yes, for sure.

HEATHER: All right. Thank you so much, Jurrien and Chris, for this super timely discussion today. We couldn't have timed this show better with market events today. If you are interested in tech investments, you can do your own research with our free Fidelity ETF Screener. And you can find that at Fidelity.com/InvestingInETFs. Click on Sectors, and you can see the tech ETFs that are available to you.

On behalf of Jurrien Timmer and Chris Lin, I'm Heather Hegedus. Another fantastic episode. A big thank you, again, to both of you. Remember, we are on live Tuesdays at 2:00 Eastern. Hope to see you then.

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