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October flip: Earnings went up, prices went down

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Mark Twain had a warning for this time of year: “October. This is one of the peculiarly dangerous months to speculate in stocks. The others are July, January, September, April, November, May, March, June, December, August, and February.” Twain was poking fun at speculators, but October proved him right, and he was wise enough to leave November on the list. October was a hard month for anyone who owned only the biggest technology companies and a pleasant one for nearly everyone else. Then election week happened.

In October, the S&P 500 slipped 0.9 percent to 7,580, one penny above where it stood on May 29. The Nasdaq Composite fell 5.3 percent. The Dow Jones Industrial Average rose 1.7 percent. Give every company in the S&P 500 an equal weight, and the index rose 4.9 percent, beating the market capitalization weighted version by the widest margin since April 2009. Nine of 11 sectors rose, led by energy at about 14 percent. Only technology and communication services fell. In September, they were the only two sectors that rose. Together they make up close to half the index. Last month, a dozen very large companies held the index up, while everyone else had a correction. October flipped that.

Why did the giants stumble? The answer is a phrase worth learning: free cash flow, which is the money a business has left after paying for its operations and the buildings and equipment it needs. For two years, Wall Street applauded every dollar the largest technology companies spent on artificial intelligence. In late October, it started asking for the receipt. Alphabet, Microsoft, Amazon and Meta spent about $202 billion on property and equipment in the third quarter; that’s roughly $26 billion more than their operations yielded. Alphabet’s cloud business more than doubled, yet its spending outran its cash, and the stock fell nearly 13 percent in a day. The share price of Microsoft, the one member of the group with cash to spare, barely moved. The market did not reject artificial intelligence but rather started grading it.

Skeptics and believers agree that AI technology works and will continue to gain widespread adoption. The argument is about how businesses are paying for it. Unlike 2000, when the

market paid enormous prices for companies with no earnings, the ones leading this build-out are the most profitable businesses on the planet — and they still fund most of it from their own cash flow. The speculation lives at the edges: private valuations that assume everything goes right, data centers financed with debt, companies whose entire business is a plan to rent chips. Some of that money will be lost, and it should be.

Interest rates sharpened investors' pencils. On Oct. 5, the 10-year Treasury yield closed at 5.31 percent, highest since 2002, before the bond market blinked and the yield fell to 4.94 percent by month's end. The Federal Reserve held its benchmark rate at 3.75 percent to 4 percent on Oct. 28 and called the economy strong and inflation elevated. The economy grew at a 3.4 percent annual rate in the third quarter, and consumer prices rose 3.7 percent from a year earlier.

Then came Election Day and market whiplash. On Nov. 3, voters handed both the House and the Senate to the party that does not hold the White House. The market takes no sides, and on Nov. 4, it cheered the prospect of fewer sweeping laws in either direction. The Dow jumped 3 percent for its best day since April 2025. On Nov. 5, the same market decided a new Congress might impede the data center build-out. Qualcomm and Arm reported soft demand for the chips that go into phones rather than data centers, and the fast money went back to selling chipmakers. The S&P 500 had its worst day since the tariff scare of April 2025. The Nasdaq slid into a correction, and the semiconductor index lost more than a 10th of its value — its worst day since March 2020.

There is a lot to sort out, and it will not be sorted by Thanksgiving. Oil answers to negotiators nobody controls, and the fast money has not finished selling. The Fed will meet in December, and two of its members already want to hike. Congress will change hands in January with questions about data centers and their impacts on communities. There will likely be more volatile trading days before the dust settles. However, history after midterms leans the right way: since World War II, the S&P 500 has never fallen in the 12 months following October of a midterm year.

With wild swings like this, we remind clients of one thing. A stock price is an opinion that changes every second. Earnings are a fact that arrives every quarter. The opinions have been changing dramatically day to day, and the facts did not move. The same technology companies that got dumped on this past Thursday grew their earnings by about 23 percent in the third quarter, and the S&P 500 earnings grew year over year by about 30 percent. The index has gone nowhere since May, while the profits underneath it kept climbing. Thursday did not make these businesses riskier. It made them cheaper. That is not the same thing, though it never feels that way at the time.

We have been doing this long enough to have been told, with great certainty, that it was the end of growth investing in 1987, 2000, 2008, 2020 and last April. Twice in the past two years, technology stocks were pronounced dead. In January 2025, a Chinese startup's cheap model knocked 17 percent off Nvidia in a day, and the stock made a new high by June. Last April, the S&P 500 fell 10 percent in two days on tariffs, and the best single day since 2008 came three trading days later. Anyone who sold into the panic was selling to someone who had read a little history. Investors who own businesses with strong balance sheets, recurring revenues and robust free cash flow, spread across companies in many industries, do not need to guess when the fear will pass.

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