

UNDERSTANDING MARKET BIFURCATION

In recent conversations with clients, we have been spending a lot of time using the term “bifurcation” to describe the sharp divide between the fortunes of two distinct groups. We have used it to discuss the ‘bifurcated consumer’, where the top 10% of earners now represent 50% of consumer spending in the US. This number has been trending steadily higher for decades, but it is jarring to realize that such a small proportion of people account for half of consumer spending while lower-income households cut back. We have also used the term to discuss the ‘bifurcated economy’, where businesses are booming in industries exposed to the seismic growth in spending on Artificial Intelligence (“AI”). Meanwhile, residential and non-residential/non-AI construction spending is weak, the consumer demand environment is tepid, and tariffs are creating headaches for small businesses.

BIFURCATED STOCK MARKET: PERFORMANCE & SECTOR ANALYSIS

It is not surprising that the bifurcation theme extends to the stock market as well. The S&P 500 has returned 14.8% through the first three quarters of 2025, having rallied strongly since the Liberation Day panic in early April. However, only four of the market’s 11 sectors, representing 55% of the index weight, are outperforming this year. Superficially, these outperforming sectors: Information Technology, Communications Services, Industrials, and Utilities appear to represent a healthy mix of businesses. After all, Communication Services includes telecom and cable companies, and broadcast networks. Industrial enterprises are varied across end markets including construction, aerospace, defense, and logistics. Utilities are traditionally slower-growth businesses that offer attractive dividend yields and portfolio security during periods of market turmoil. This year, however, the outperformers in these sectors driving the market higher have a common theme — AI.

Our analysis suggests that over 75% of the market return through September 30th is driven by companies benefiting from the buildout of AI.

Table 1: S&P 500 Returns through 3Q25

Sector	Index Weight	Total Return	Contribution to Return
Communication Services	10.2%	24.5%	2.3%
Information Technology	34.7%	22.2%	7.4%
Industrials	8.3%	18.3%	1.6%
Utilities	2.4%	17.6%	0.4%
Financials	13.5%	12.6%	1.8%
Materials	1.8%	9.3%	0.2%
Energy	2.9%	6.9%	0.1%
Real Estate	1.9%	6.1%	0.1%
Consumer Discretionary	10.5%	5.4%	0.6%
Consumer Staples	4.9%	3.9%	0.2%
Health Care	8.9%	2.6%	-0.1%
Total	100.0%	14.8%	14.8%

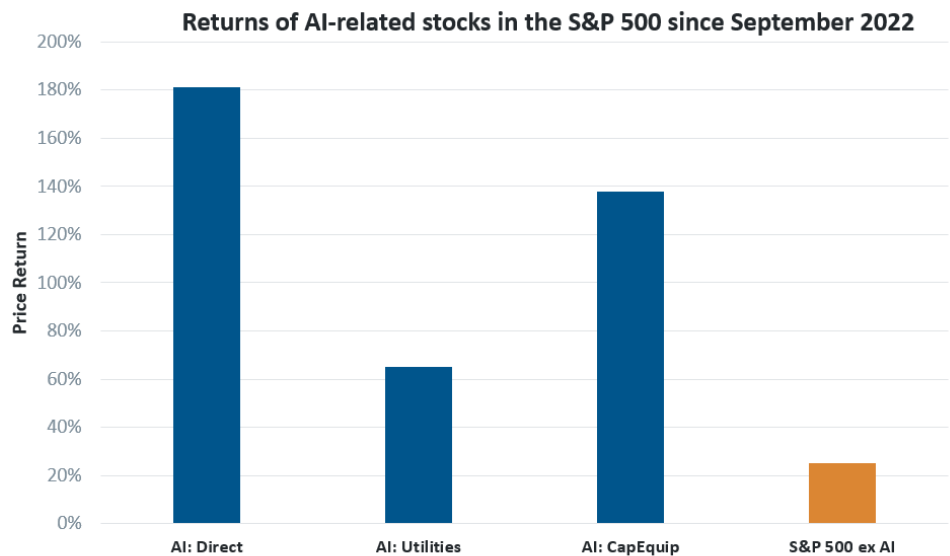
Source: FactSet

SECTOR DEEP DIVE: AI'S IMPACT

In Communication Services, the market contribution has been primarily driven by Alphabet, Meta, and Netflix. The first two of those are key players in the AI race. Alphabet and Meta alone account for 76% of the sector's contribution.

Industrials are, admittedly, a very diversified sector and encompass several themes that have been well-received by investors this year. These include a rebound in the aerospace industry and strong defense spending to support geopolitical conflicts. But another major theme in industrials has centered around the massive buildout of data centers and the infrastructure required to support them. We estimate that companies with meaningful AI exposure represent about 30% of the sector's S&P weight and about 48% of the sector's contribution to S&P 500 returns.

The Utilities sector does have a few high-flying AI "plays" that have seen exceptionally strong returns this year. However, more important is that the market is now beginning to wake up to the fact that Utilities more broadly will benefit if the AI buildout hype becomes a reality. Simply put, the country does not currently generate enough electricity to satisfy the surge in demand expected over the next 3-5 years. As providers of a resource that is soon to be scarce, Utilities stand to benefit from increased power demand.



Sources: Bloomberg, J.P. Morgan, September 22, 2025

It is no surprise that the Technology sector has significant AI exposure. Key players include hyperscalers, semiconductor companies, networking companies, fiber optic businesses, and companies that provide memory for computers. We estimate ~2/3 of the Tech sector has direct AI exposure, a figure that includes NVIDIA (23% sector weight) and Microsoft (20% weight) but excludes Apple (19% weight). What is unique about the Tech sector is that companies not included in the "AI beneficiaries" column have generally been tagged as "AI victims" by the market, which has adopted a "shoot first, ask questions later" approach to whether software businesses (for example) will survive the AI revolution. As such, while the Tech sector contributed 7.42 percentage points (pp) of the market's return, AI beneficiaries added 8.07pp, while AI victims reduced that amount by 0.65pp.

MARKET CONCENTRATION & BROADER AI INFLUENCE

We estimate that AI-exposed companies across the four sectors discussed represent ~75% of the total stock market's year-to-date return. However, these sectors do not include financial firms investing in and lending to AI-driven businesses, energy companies helping build the infrastructure to support data centers, or even Amazon or Tesla, two additional major players in the AI race. Combine these, and we think the bifurcated nature of the current market becomes even more pronounced.

PORTFOLIO STRATEGY: DIVERSIFICATION & RISK MANAGEMENT

While exploring market phenomena is a helpful exercise, we uphold the belief that maintaining an equity portfolio that is diversified across sectors, business drivers, and even thematic exposures is a fundamental aspect of achieving attractive risk-adjusted returns over time. We are also acutely aware that history offers many examples of bubbles forming around similar types of explosive buildouts, even when the technology ultimately proved to be revolutionary and the hype was ultimately justified. To that end, we are closely watching for signs of excess – be it leverage, valuation, or other factors – to appropriately balance our enthusiasm for coming AI developments against concerns that these waves often result in permanent loss of capital.