

GW&K MARKET INSIGHTS

Transcript of 3Q25 conversation with Harold Kotler and Bill Sterling,
moderated by Dan Fasciano



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We invite you to [listen to](#) our quarterly conversation with Harold Kotler, Bill Sterling, and moderator Dan Fasciano as they review events from the third quarter of 2025 and discuss:

- How a resurgence of capitalism, expectations for lower interest rates, and the transformative potential of AI have the potential to continue to drive market growth;
- Policy and economic risks, including ongoing tariff policies under the Trump administration and their impact on inflation and consumer spending; and
- How broader economic growth could benefit a wide range of asset classes in the coming year, including small-cap stocks, international markets, and bonds.

Edited transcript

Dan Fasciano: Welcome to the Third Quarter Client Conference call for GW&K Investment Management. This call represents the views and opinions of GW&K Investment Management and does not constitute investment advice, nor should it be considered predictive of any future market performance.

My name is Dan Fasciano, Director of Private Wealth here at GW&K. Joining me on today's call is Harold Kotler, GW&K's Founder-Chairman and Chief Investment Officer, as well as Bill Sterling, our Global Strategist.

Harold, I'll start with you. You've maintained a bullish posture throughout the year, particularly when others did not this past April. Recently, you've highlighted three reasons behind the move higher. Can you share those reasons and whether you see them sustaining over the next 12 to 18 months?

Harold Kotler: My pleasure. I outlined three in my quarterly letter: that capitalism is back, lower interest rates, and the AI revolution. So just quickly, the ability to think positively towards corporate capitalism and mergers and opportunity and have the government less involved and less restrictive, I think is incredibly important. And, and I think it will benefit the general economy.

Secondly, interest rates will, on the short end, definitely come down 2 or 3 times, and I suspect on the long end, although, people doubt that because of inflation fears. But I think the long end will come down too. More importantly, short rates will come down. And the third is the AI revolution. People are trying to figure out what it really means — and I believe that no one has the capability of fully understanding what this revolution really means. I think even people who are in the AI business don't understand where it's all going — it's a whole new beginning. It's incredibly exciting. I think it really allows corporations over time to increase their earnings and therefore justify their present multiples.

Dan Fasciano: You just mentioned earnings, and there are some out there who say valuations are stretched. When you hear that and you hear people say we're due for a pullback, how do you respond?

Harold Kotler: I don't worry about a pullback. There have been too many years over the course of my life when I've seen people try to time events, and the failure rate is pretty high. And secondly, yes, multiples on current earnings seem high — except if earnings keep on going up or earnings surprise people. And if AI really is a revolutionary approach to business and efficiency can be built in and we can get better margins, then the stock market may not be totally overvalued. Is it fully valued? Yeah. Does it mean it's going to go down? It doesn't mean it's going to go down. And there's opportunity.

Dan Fasciano: Bill, Harold mentioned capitalism, rates, and AI. Homing in on AI as being one of the forces behind the market's ascent, you've done a deeper dive into some of the realities and potential scenarios tied to the AI investment set. Would you share some of the highlights of your analysis?

Bill Sterling: It's pretty clear that AI has become a macro driver now. For example, AI-related investment grew at an incredible 27% rate in the first half of the year. And that meant that it contributed roughly half of GDP growth in the US, even though it accounts for only about 6% of GDP. And if you look at the investment plans of the tech giants, those have continued to accelerate.

So we've got the top four hyperscalers — Amazon, Google, Meta, and Microsoft — accounting now for nearly half of all tech spending. And tech in turn accounts for roughly half of all capital spending. So the concentration of the stock market with the top 10 names accounting for about 40% of market cap, that clearly reflects the dominance of the large tech companies and their very impressive cash-generating ability.

In my mind, the key question is when the markets will start demanding that these companies show a concrete return on investment on their massive capex (capital expenditure). Especially since the GPUs they're investing in have a pretty short shelf life, compared to traditional capex projects, maybe 2 or 3 years, not 20 years. So the depreciation expenses will be pretty enormous, while those business models and cash-generation potential of the AI products are still untested.

There's no doubt that AI technology, like Harold says, is amazing and likely to be transformative. But the history of other transformative tech booms — whether it was railroads in the 1800s, radio in the 1920s, or fiber optic cable in the 1990s — has often been a bumpy road because you can never know if you've overinvested until you've overinvested.

I think the bull case is just to relax and take the view that it's now 10 pm and this party will go on until at least 4 am — and I think that may well be the case. I do get the sense it's very early days in this boom, but the ROI (return on investment) question is probably going to come up again and again over the next few years.

Dan Fasciano: Bill, if it's 10 pm and the party goes on until 4 am, tomorrow at noon or 1:00 pm, what will that party have looked like? Can you give us some perspective — say five years out, how will we be talking about AI?

Bill Sterling: Well, I wish I knew. I completely agree with Harold that we really can't have a very firm view on what it will be like five years from now. There are people in Silicon Valley much smarter than me who believe that many of these companies will achieve, so-called AGI, artificial general intelligence — complete human level intelligence — by about 2027 or 2028. And that would be truly transformative. That would enable AI-based so-called drop in remote workers that will be able to substitute for almost any type of human worker that does office work. I think the big AI companies don't just want to make money charging \$20 a month for copilots that help you type emails or do web searches and so on. They want to charge \$2,000 a month to fully replace human workers making six-figure salaries. So there's a huge economic payoff if that happens, but obviously some adjustment issues for society as well.

Dan Fasciano: Really great perspective, which leads me to a question for you, Harold. We've talked a fair amount about AI so far. When you look at the larger investment landscape, however, are there opportunities in asset classes where you see value or a lack of value in the world today?

Harold Kotler: I think this trend is going to carry many companies to better valuations. Certainly, the small cap stocks have been under a lot of pressure and underperformed dramatically, and that has a lot to do with short-term interest rates, which will be coming down. And the bond market also, ironically, could have a great run here as interest rates come down. So the truth is it's not the exclusion, it's the inclusion, of many areas that may do well. We've had great returns in our international investing, and small caps are trying to find a footing. We have portfolios that have lagged, but I think over the next 12 months, many of them will all be in sync and all will do well.

Dan Fasciano: You're mentioning small cap stocks and by just about all measures — price to earnings, price to sales, price to book — there's just a disconnect between valuations and small cap and large cap right now, Harold. What do you think the catalyst will be to close or narrow that delta?

Harold Kotler: I don't know if it's going to close it, but I think it will narrow because there's always periods where some sector underperforms and people throw the baby out with the bathwater and say, it'll never come back. But that is never the case. They always find a reason to grow and improve. And in this case, I think short-term interest rates, free capitalism, all the things we're talking about, their participation in AI — maybe not directly, but to the benefit of their earnings potential. Good management will pick up on the opportunities that exist.

Small caps still have great managers who are trying to fulfill their earnings potential, and they will. I think large caps will also do well. Which does better? Truthfully, I could care less. The point is I think it's a market that will be much broader and much more successful in all aspects.

Dan Fasciano: That's great. Now you're making me wonder, and Bill, let me steer it back to you. I want to widen the lens just a bit. There's going to come a time when tariffs aren't part of the investment dialog. But today is definitely not one of those days. President Trump did some saber rattling earlier in talking about a new round of tariffs on China. Beyond that, are you seeing

anything manifest from a fundamental standpoint? Are you seeing anything make its way through consumer activity, through import prices?

Bill Sterling: I'd say putting aside whether we might be going back to those punitive 100% plus tariffs on China, businesses have adapted surprisingly well to the tariffs that have been put in place so far. I think most economists think there's still likely to be some modest upward pressure on inflation and some downward pressure on consumer spending in coming months as more costs get passed on to consumers. But the US Federal Reserve (Fed) expects the bump in prices to be transitory and something they can look through from a policy perspective, and I agree with that view.

Dan Fasciano: We're 10 months or so into the Trump administration. And tariffs have been a backdrop throughout. You've been watching this closely and had views. Is it possible now for you to handicap how this plays out going into next year?

Bill Sterling: I think aside from the China issue, there's still some big unknowns, like whether the Supreme Court will strike down the so-called IEEPA (International Emergency Economic Powers Act) emergency tariffs that make up 70% of the new structure of tariffs. But even if that's the case, it's widely assumed that the administration will try to replace those emergency tariffs with new tariffs under some different legal cover. But that could drag on the issue for many months into the new year and create a continuing cloud of uncertainty. At the end of the day, I see new tariffs that we've gotten so far as equivalent to the introduction of a national sales tax.

So yes, there are short-term disruptive effects when you put on new taxes, and those are unavoidable. But after that people adjust and life goes on, and that's what I think is going to happen.

Dan Fasciano: Let me stick, Harold, with the looking out into your crystal ball kind of game here, if you will. It's not an entirely fair question, but when you look out a ways for possible excesses, what would you be looking for as an early indication that the bullish story for stocks, in particular, is coming to a cyclical pause or a break? Is it going to be valuations, too much liquidity chasing a limited number of viable businesses? What will you be looking for?

Harold Kotler: If you don't mind, I'm going to reverse that question. When people stop talking about a bubble and stop talking about tariffs and stop talking about the world coming to an end and stop talking about how the sky is falling, then I will be worried. But as long as the attitude is so negative and the press out there and people don't believe anything about anything, it just tells me this is a bull market. I've never seen in my years — maybe one other time — this kind of negativity, and depressing attitude. Everything that is positive can be negative. Everything that seems to have real opportunity is turned into failure. It's unbelievable that people can't just accept some opportunities. I'm not defending all Trump's policies. All I'm saying is it's not all negative. And that kind of negativity tells me it's a bull market.

Bill Sterling: Dan, I'll just jump in too and say, I'm old enough to have lived through Japan's bull market. I was over there in the '80s and consumer confidence was through the roof at the top of

that bull market. In the US right now, consumer confidence is close to multi-decade lows. But if you look at the most recent so-called tech bubble, the dotcom bubble in the late '90s, consumer confidence then was through the roof as well. That kind of generalized euphoria is more of a mark of a top. And we're nowhere close to that now, like Harold is saying. There is widespread pessimism, and that's usually not the sign of a top.

Harold Kotler: And also, when they compare this market to 1998 – 2000, it's so unfair. Those companies were selling at 100 times sales. Now we're worried about companies selling at 30 or 40 times earnings, with earnings growth of 20% or 30%. You cannot compare the two periods. It's just when people start to draw back and say “this is like...” you really know a) they don't know what they're talking about, and b) it's just automatic fear that penetrates the system. That tells me that there's more buyers than sellers. That's all.

Dan Fasciano: It's great perspective from the two of you. Bill, let me follow up. There's a lot of moving parts, and the one that comes to my mind is this growth versus inflation trade off. Thematically, how do you see things playing out over the next 6 to 12 months? Are there any indicators, domestic or global, that have grabbed more of your attention in 2025?

Bill Sterling: After we saw a somewhat more sluggish consumer in the first half of the year, along with the continued weakness in housing and manufacturing, I think there's a case looking forward for a pretty broad based, like Harold said, reacceleration in growth next year, thanks to both lower interest rates and tax cuts for consumers and businesses, along with the deregulation wave that he mentioned too. Notably, I think there are going to be big tax refunds that should help the consumer early next year. Business spending should get a pretty nice boost from the full capex and R&D expensing provisions that are in the new tax code. So I think the prospects for lower interest rates, growth reacceleration, and deregulation are all reasons we've seen small caps begin to outperform large caps in recent months.

On the indicator question, I think watching the labor market's going to be important because it's so critical to the Fed's thinking. And more than looking at the monthly job growth data, which gets a lot of attention, I think the unemployment rate is going to be key. And that's because, with weak labor supply growth due to the collapse in immigration, the unemployment rate will be a better measure of whether there's true slack in the economy that would permit the Fed to be more aggressive with rate cuts.

My best guess is we'll get about five rate cuts between now and the end of next year. And with an estimated \$9 trillion of cash sitting on household balance sheets, lower rates will probably divert a pretty substantial amount of that cash into other asset classes like stocks, bonds, and foreign markets.

Harold Kotler: I totally agree with what Bill said, and that small caps will do very well. But it doesn't mean that any other sector won't do well. It's not either or. Small caps can do well for different sets of reasons: interest rates coming down, businesses getting more efficient, earnings growing. But the large caps, with their incredible capital spending boom, can do incredibly well too. And bonds will do well in the same environment. To use an old phrase, this could be a perfect

environment for all classes of investing. One doesn't have to make choices. One should diversify and participate in all of them.

Dan Fasciano: That's really helpful perspective as we approach the end of the year and head into next year. I want to thank both of you for sharing your thoughts.

Listeners: Both Harold and Bill have some written commentary out on our website, www.gwkinvest.com. So if you want to understand more about what they're thinking currently, cast your attention in that direction. As always, should anyone listening have follow up questions, please feel free to [get in touch](#) with your GW&K advisor.

To all of our friends and clients, please enjoy your holiday season and the end of the year. We look forward to reconvening in January. Stay well.

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