Yardeni Research

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Morning Briefing

Banks, Auto Loans & AI Surveillance

Check out the accompanying chart collection.

Executive Summary: The big banks likely earned big bucks during Q3, with several winds at their backs. But their Q4s should be more problematic, Jackie explains. … And: Several big banks were lenders for a used car dealer serving illegal aliens, Tricolor Holdings, which now has gone belly up. While the banks' writedowns won't be large, the issue highlights the effects on the auto industry of the Trump administration's mass deportations. … For all its benefits, AI can also be means to undesirable ends. Our Disruptive Technologies segment highlights allegations that Oracle's tech solutions facilitate the Chinese government's surveillance and control of its citizenry.

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Financials I: Watching the Clouds Rolling in. Two weeks ago, the big banks looked like they would have an easy Q3 reporting season. And they still should. It's Q4 that's looking more problematic, with a number of high-profile issues looming on the horizon.

In Q3, the banks should have benefited from a steeper yield curve, increased loan production, and booming capital markets. Going forward, it will be interesting to hear what the banks have to say about consumer credit quality, as delinquencies have been creeping up in credit card and auto loans. We'll also be listening for any impact that Trump Tariff Turmoil (TTT) and the government shutdown are having on the economy in general.

Fortunately, investors may have more to win than to lose during the upcoming bank earnings season, as bank-related stocks have sold off sharply in recent weeks. The ytd gain in the S&P 500 Diversified Banks industry has shrunk to 17.3% as of Friday's close, down from a 25.6% gain at its record high in late September. Likewise, the S&P 500 Investment Banking and Brokerage industry's stock price index's ytd return remains a healthy 28.5%, but it too has fallen 4.2% from its record high in late September. Meanwhile, the S&P 500 Regional Banks stock price index fell into negative territory, -0.4% ytd, erasing its peak gain of 11.1% on September 4 (*Fig. 1*).

Here's a look at some of the areas we'll be examining as the banks and brokers report their Q3 results:

(1) *Steeper yield curve.* Banks still make a lot of money doing the basics: borrowing short term and lending long term. So they've benefited as the Federal Reserve's four interest-rate cuts in this easing cycle have caused a steeper drop in the short end of the yield curve than the longer end.

The difference between the 10-year Treasury bond yield minus the federal funds rate is 4bps, a sharp improvement from -166bps the week of September 13, 2024 (*Fig. 2*). Likewise, the spread between the 10-year Treasury yield and the two-year Treasury yield has increased to 53bps from -108bps in July 2023 (*Fig. 3*).

At the same time, the loans and leases that commercial banks have extended have increased to a collective $13.1 trillion as of October 1, up from $12.0 trillion at the start of 2023 and $10.3 trillion two years prior (*Fig. 4*). FDIC insured institutions reported a collective net interest margin of 3.3% in Q2, which was up from 3.2% in the year-ago quarter (*Fig. 5*). It should have continued to improve during Q3.

(2) *Watching consumer credit.* US consumers largely remain employed, and the 90-day delinquency rates on home mortgages and home equity loans in Q2 both remained under one percentage point. But delinquencies in other loan categories have been increasing.

The percentage of credit card loans that are more than 90 days delinquent jumped to 12.3% in Q2 from roughly 8% in 2023, while the percentage of delinquent auto loans has inched up to 5% from about 4% two years ago. Student loan debt delinquencies have increased to 10.2%, up from almost nothing when repayments were paused prior to October 2023 (*Fig. 6*).

These trends may mean that banks needed to increase their loan loss provisions during Q3.

(3) *Booming capital markets.* Banks and brokers with large capital markets operations likely did well in Q3 due to the booming IPO and bond markets, numerous M&A deals, and stock indexes that hit new highs.

Corporate bond issuance jumped to a 12-month sum of $2.1 trillion in August, up sharply from only $1.3 trillion two years prior. Likewise, equity issuance has surged to $180 billion during the 12 months ended August 2025 from a 29-year low of only $5.7 billion in April 2023 (*Fig. 7*).

Underpinning the strong capital markets has been continued improvement in corporate earnings. Industry analysts expect S&P 500 companies' collective Q3 forward earnings to grow 9.8% y/y (*Fig. 8*). And the Atlanta Fed's *GDPNow* model projects Q3 GDP growth at 3.8% y/y.

Q4 market gains may be tougher to come by. Investors are antsy about the high stock valuations in the technology industry and the billions of dollars being spent to build data centers for artificial intelligence (AI)—see our October 9 *Morning Briefing* for more on that. Also weighing on investors' minds are the risks that TTT and the government shutdown might take measurable tolls on the economy and financial markets.

President Donald Trump's tariffs are a dual edged sword for affected companies: They can pass tariff costs along to customers by raising prices, running the risk that sticker shock slows their sales, or absorb the costs, running the risk that their profit margins and earnings suffer.

TTT heated up last week when China placed new restrictions on the export of rare earth minerals and Trump responded with 100% tariff threat on Chinese imports into the US, as William discussed in Monday's *Morning Briefing*. But the markets—despondent on Friday—turned optimistic on Monday after Trump posted on Truth Social: "Don't worry about China, it will all be fine! Highly respected President Xi just had a bad moment. He doesn't want Depression for his country, and neither do I."

The longer the government shutdown drags on, the longer some government employees will face delayed paychecks and some government contractors will be out of work entirely. Skeleton staffing at the Securities and Exchange Commission has brought the IPO market to a halt. The travel industry may be hurt soon if delays at airports increase due to a shortage of air traffic controllers. Hopefully, lawmakers will hash out a budget bill sooner rather than later.

Financials II: One-Off or Warning? Tricolor Holdings sold used cars and provided subprime financing primarily to Hispanics in the Southwest, who often had little financial history and no Social Security numbers. In its *press release*, Tricolor used all the right buzzwords, describing itself as an “fintech innovator that utilizes artificial intelligence” across its loan portfolio. It now faces fraud allegations. In September, it filed for bankruptcy protection, listing JP Morgan, Fifth Third, and Barclays among its lenders.

These are huge institutions, so even the large *writedown* that Fifth Third is taking on its $200 million loan to Tricolor shouldn’t be a major problem. And while the almost $2 billion of *asset-backed securities* that Tricolor sold are trading at *sharp discounts*, they are a drop in the $2 trillion asset-backed securities market.

The bankruptcy could be a warning about the impact that Hispanic deportations are having on the broader economy. Lucky Lopez, a self-described auto expert and YouTuber, *warns* that Hispanic auto buyers have disappeared for various deportation-related reasons: Folks worried about deportation don’t buy new cars. Those with financed cars have been giving the keys back to lenders, often leaving lenders with cars worth less than their loans’ value. Deportees certainly aren’t making loan payments; their cars may be held by the government or sitting in driveways unbeknownst to lender banks. In worst cases, abandoned cars may be stripped for parts. Or cars may be driven over the border to Mexico by folks who are self-deporting. Lucky Lopez didn’t estimate how many cars may be affected.

Last week, Pepsi’s CEO *told CNBC* that Hispanics haven’t been gathering as frequently, and that’s impacting snack sales. There were an estimated 7.4 million *undocumented Hispanic immigrants* in the US in 2019. Tricolor’s bankruptcy maybe a warning both about coming problems in the private debt markets as well as the impact that the undocumented immigrant community is having on the economy.

Hopefully, bank CEOs will address these topics in this week’s earnings calls.

Disruptive Technologies: AI, Oracle & Big Brother. In this new world of AI, we tend to focus on all of the positives it can bring to our lives by doing things faster, smarter, and more efficiently. But there is also a darker side to AI: Governments and law enforcement agencies can use it to establish a surveillance state.

To understand what happens when AI and technology are used to control populations, one need only look at China. There, the government has used AI and other technologies to keep tabs on their citizens, particularly the minority Muslim population.

Oracle is one of the US companies most closely associated with providing technology that enables government surveillance programs. It has also gained a much higher profile of late due to its close relationship with the Trump administration.

Let's take a look at Oracle CEO Larry Ellison's views on AI, his many high-profile deals, and how the technology that his company creates has helped the Chinese government:

(1) *Ellison on AI.* Oracle's Ellison has an *optimistic view* of what AI will bring to humanity. He has said that video surveillance via a vast network of cameras used in security systems, police body cameras, and vehicle dash cameras will ensure that both individuals and the police are on their best behavior. Oracle has the technology to monitor the video in real time and alert the authorities when something's amiss. It takes pride in its work with law enforcement departments, both at home and abroad.

(2) *Oracle in China.* Skeptics, however, worry that AI will be used to create a surveillance state, which is problematic in countries where the police or government institutions can't be trusted to use the technology appropriately. China, for example, has been known for its extensive, technology-enhanced surveillance of its population. The systems may keep crime to a minimum, but they also ensure that the Chinese government can squelch brewing dissent among its people and control its Muslim minority.

Critics of Oracle say the company sells its technology solutions to brokers in China, who turn around and sell the tech to Chinese governmental institutions that use it to oppress portions of the population.

"The scope of data Oracle's systems helped process is staggering: facial recognition images, license plate numbers, DNA profiles, religious activity logs, all funneled into Oracle-powered databases, filtered for 'pre-crime' signals by software like Endeca," writes Luke Hogg in a September 4 *blog post* on *The National Interest*. "This predictive policing infrastructure, *integrated into platforms* such as China's Integrated Joint Operations Platform (IJOP), enabled officials to track entire populations in real time and algorithmically flag 'suspicious' persons for possible detention. In Xinjiang, Oracle's code quietly became an instrument of oppression." Hogg questions how US can do business with a company that's helping China oppress its population.

(3) *Ellison's stature grows.* Oracle's business in China and Ellison's opinions about AI are getting attention as the company and its leader have become increasingly linked to President Trump and some of the largest technology deals of the year. Ellison is a well-known Trump supporter, having donated to his campaigns and advised the President. In a

recent *Wired* *article*, Ellison was dubbed the “shadow president.” And in roughly the past year, Ellison and/or Oracle have been directly involved with Stargate, TikTok, and the purchase of Paramount Global.

Ellison was one of the three main players at the White House when President Trump *announced* the massive Stargate project, created to jumpstart the buildout of data centers across the US. More recently, OpenAI *signed a contract* with Oracle to purchase $300 billion in computing power over roughly five years, starting in 2027.

Last year, Ellison financed most of the $8 billion bid made by his son David’s firm, Skydance Media, to purchase Paramount Global, which owns the Hollywood studio, CBS, MTV, and other properties that create news and content. The deal received Federal Communications Commission approval in July, and Oracle was *in talks to receive* a $100 million annual contract to provide cloud services for the entertainment company.

Paramount Skydance has made a takeover bid for Warner Bros Discovery, which was rejected as being too low. Paramount Skydance is *now talking to* private equity firms, including Apollo Global Management, to join in a larger bid that could be worth more than $60 billion. It’s unclear whether the elder Ellison is involved with funding the new deal. Warner Bros. Discovery owns CNN, HBO, the Discovery Channel, and film studios.

Oracle is also involved with President Trump’s plan to make TikTok’s US operations controlled by US organizations. Under the current proposal, Oracle, Silver Lake, and the MGX investment fund *will control* roughly 45% of TikTok’s US business, leaving ByteDance with less than a 20% equity stake. Oracle is expected to oversee TikTok’s security operations and provide cloud computing services for one of the most popular social media platforms in the US. While President Trump announced an executive order approving the proposed deal, the Chinese government has yet to officially confirm the deal’s approval.

Given the many deals that Ellison and Oracle are involved in, it’s no wonder everything that Ellison says regarding AI is grabbing attention these days.

Calendars

US: Tues: NFIB Small Business Optimism Index 100.5; IEA Monthly Report; Powell; Bowman; Waller; Collins. **Wed:** Empire State Manufacturing Index -0.5; MBA Mortgage Applications; Fed Beige Book; IMF Meetings; Bostic; Waller; Miran. (Source: FX Street)

Global: **Tues:** Eurozone ZEW Economic Sentiment 30.2; Germany CPI 0.2%m/m, 2.4%y/y; Germany ZEW Economic Sentiment 41.7; UK Unemployment Rate 4.7%; China M2 8.5%y/y; China CPI 0.2%m/m, -0.2%y/y; China PPI -2.3%y/y, Bailey. **Wed:** Eurozone Industrial Production -1.8%m/m; German Bube Monthly Report; France CPI -1.0%m/m,1.2%y/y; Spain CPI -0.4%m/m, 2.9%y/y; Japan Industrial Production -1.2%; Japan Core Machinery Orders 0.5%m/m, 4.8%y/y; De Guindos; Buch; Ramsden; Breeden; Tamura. (Source: FX Street)

Strategy Indicators

S&P 500/400/600 Forward Earnings (*link*): During the October 10 week, forward earnings rose simultaneously for LargeCap and SmallCap for a 20th straight week. LargeCap's forward earnings rose for a 21st straight week, its longest winning streak since it did so for 38 weeks through the September 13, 2024 week. MidCap's recovery has slow-walked at times, dropping in four of the 21 weeks since it bottomed during the May 16 week. SmallCap's has risen for 20 straight weeks since it bottomed during the May 23 week, its longest winning streak since it did so just over four years ago for 25 weeks through the August 27, 2021 week. LargeCap's forward earnings rose 0.2% w/w to its 19th straight weekly record high. MidCap's dropped 0.2% w/w to 0.6% below its record high during the September 19 week. SmallCap's rose 0.5% w/w to a 23-month high and is 8.5% below its June 2022 record. Forward earnings had bottomed in early 2023 for these three indexes following 2022's year of cost-cutting. Since then, LargeCap's forward earnings has soared 31.1% from its 54-week low during the week of February 1, 2023; MidCap's has slowly gained 10.0% from its 55-week low during the week of March 10, 2023; and SmallCap's has jumped 7.2% from a very recent 42-month low during the May 23 week. These three indexes' forward earnings downtrends from mid-2022 to early 2023 and again during Trump's Tariff Turmoil were relatively modest compared to their deep double-digit percentage declines during the Great Virus Crisis and the Great Financial Crisis. Here are the latest consensus earnings growth rates for 2024, 2025, and 2026: LargeCap (9.7%, 9.9%, 14.0%), MidCap (0.4, 0.6, 17.8), and SmallCap (-10.2, 4.5, 17.0).

S&P 500/400/600 Valuation (*link*): Valuations fell for all three of these indexes during the October 10 week. LargeCap's forward P/E fell 0.6pt w/w to a five-week low of 22.1 from 22.7, which was its highest level since the January 8, 2021 week when forward earnings was still recovering from the Covid-19 shutdown. It's now 5.1pts above the seven-month low of 17.0 during the October 27, 2023 week. That compares to a 30-month low of 15.1 at the end of September 2022 and an 11-year low of 11.1 during March 2020. MidCap's forward P/E fell 0.7pt w/w to a 10-week low of 15.6, and is down from a 32-week high of 16.4 during the September 5 week. It's now 1.5pts below its 40-month high of 17.1 during the November 29 week and 3.4pts above the 12-month low of 12.2 in October 2023. That compares to a record high of 22.9 in June 2020 when forward earnings was depressed and an 11-year low of 10.7 in March 2020. SmallCap's forward P/E fell 0.8pt w/w to 14.9 from a 33-week high of 15.7. It's 2.0pts above its 17-month low of 12.9 during the April 4 week and 4.3pts above its 14-year low of 10.6 in September 2022, but remains 2.2pts below its 41-month high of 17.1 during the November 29 week. That compares to a record high of 26.7 in early June 2020 when forward earnings was depressed, and a record low of 10.2 in November 2009 during the Great Financial Crisis. The forward P/Es for the SMidCaps have been mostly below LargeCap's since August 2018. MidCap's P/E is at a 29% discount to LargeCap's P/E, matching its 26-year low 29% discount during the April 10 week. That compares to a 19% discount during the March 2, 2023 week, which matched its best reading since October 14, 2021. SmallCap's P/E is at a 32% discount to LargeCap's P/E, not much above its 13-month-low 33% discount during the August 7 week. That compares to a 23% discount during the November 29 week, which was its best reading since the March 2, 2023 week. It's now just 1ppt above its 24-year-low 34% discount during the July 5, 2024 week. SmallCap's P/E is at a 5% discount to MidCap's, up from a 13-month low 6% discount at the end of July and a 20-year-low 10% discount in late 2021. Prior to that, from 2003 to 2018, SmallCap's P/E had been mostly above MidCap's, and both were above LargeCap's.

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