

AI and Buybacks: Is the S&P 500's Rally Built to Last?

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Executive Summary

The S&P 500's latest run-up is powered by a shrinking group of mega-cap names, just ten stocks now account for around 40% of the index's market cap. That's a concentration not seen in decades. The combination of Fed easing and a wave of record-breaking buybacks is adding fuel to the fire, but it's also creating risks: equity inflation that outpaces the economy, and a rally that stands on a narrow foundation. AI's leadership is real, but the story is fragile, tariffs, policy shifts, and fickle global capital all add volatility. Near-term gains are plausible, but the underpinnings are shaky.

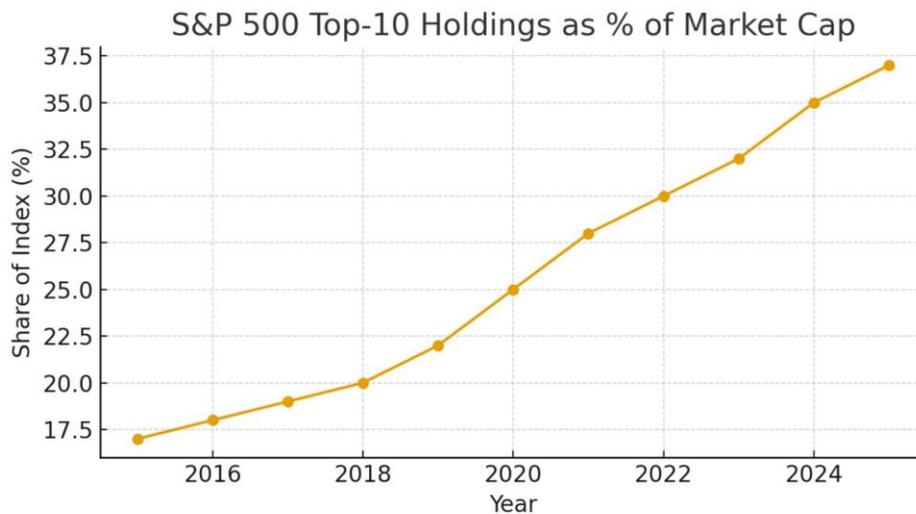
1. AI and Tech: Real Leadership or Fragile Concentration?

The largest names in AI and cloud computing are entrenching their dominance, with monetization accelerating fast. Take Salesforce, for example: its Data Cloud + AI annual recurring revenue (ARR) hit \$1.2 billion, a leap of about 120% year-over-year. In just one quarter, Salesforce ingested 22 trillion records (up 175% Y/Y), and almost 60% of its top 100 deals now include Data Cloud and AI features (Salesforce, 2025a; Salesforce, 2025b). Earlier, Salesforce disclosed that in FY25, its Data Cloud + AI ARR crossed \$900 million, again, a 120% jump (SiliconANGLE, 2025; Salesforce, 2025c). And the momentum isn't just new logos: over 40% of Q2 AI/Data bookings came from existing customers upgrading (Salesforce, 2025a).

The trend is visible across the board. Microsoft's Azure AI, AWS's generative-AI tools, and Google Cloud's Vertex AI are finding their way deeper into enterprise stacks, turning usage into high-margin revenue streams.

But here's the catch: this leadership comes with a heavy dose of risk. As of 2025, the top 10 S&P 500 companies control about 40% of the index's total market capitalization, the highest concentration seen in decades (Apollo Academy, 2025; Osborne Partners, 2025). Nvidia alone now represents over 8% of the S&P 500 (Investors Observer, 2025; Slickcharts, 2025). Some estimates say just 10 stocks have been responsible for 80% of the index's recent gains (Seeking Alpha, 2025).

Chart 1: S&P 500 Top 10 Holdings as % of Market Cap (2015–2025)



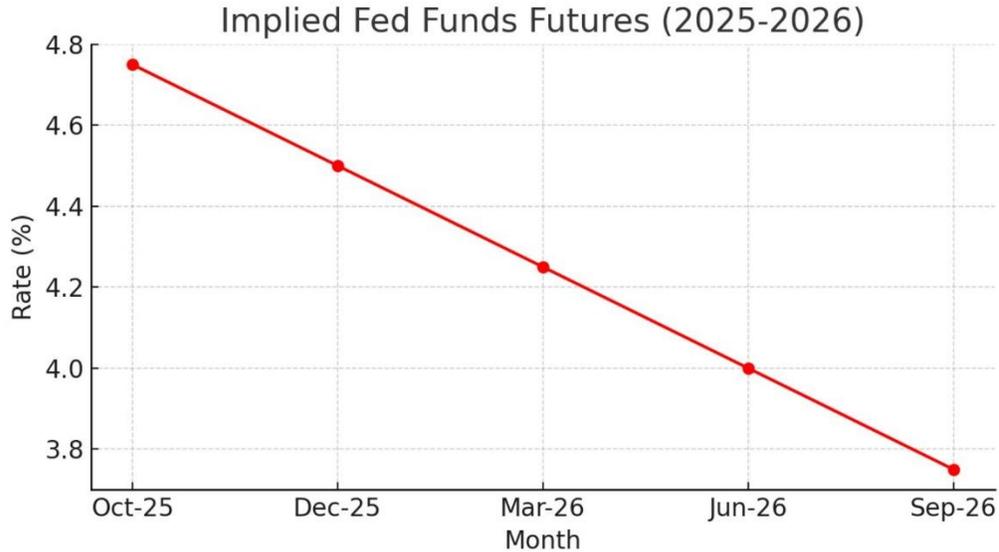
The top 10's share has nearly doubled since 2015, sharply raising concentration risk.

In short, AI leadership is real, but the rally rests on a very narrow base. Whether this era of dominance proves sustainable will depend on whether smaller firms can catch up, whether the giants can keep delivering, and how the market digests so much value concentrated in so few hands.

2. Fed Easing and the Buyback Boom

Markets are betting on a slow and steady path of Fed easing through 2025–2026. Lower rates mean higher equity multiples; future earnings look more valuable when discounted less. But it also raises the risk that financial engineering, not real growth, is driving the market (Federal Reserve, 2025; SSGA, 2025; Morgan Stanley, 2025).

Chart 2: Implied Fed Funds Futures (2025–2026)

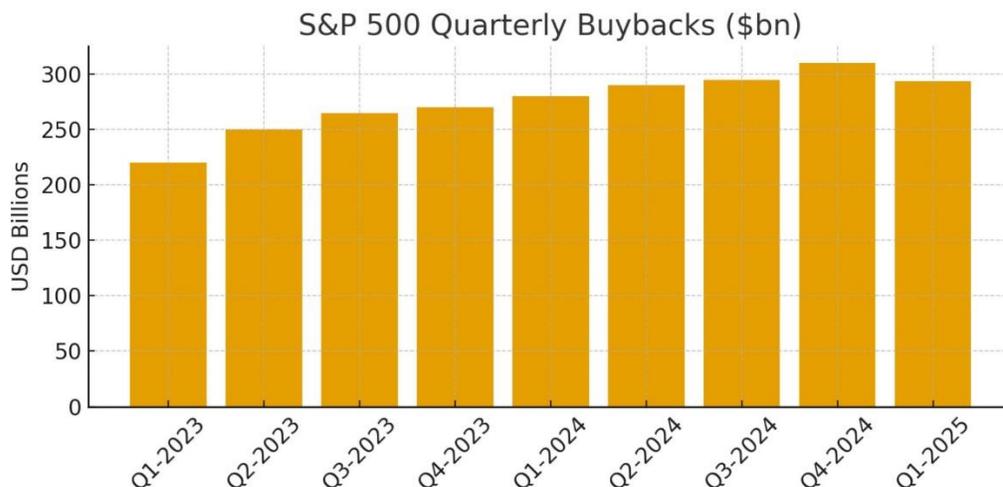


Expectations for steady easing are keeping multiples elevated but may also push markets toward overreliance on buybacks.

With borrowing costs low, companies are leaning harder into buybacks. In Q1 2025 alone, S&P 500 firms spent \$293.5 billion repurchasing their own shares, a 21% jump from the previous quarter and nearly 24% higher year-over-year (S&P Dow Jones Indices, 2025; S&P Global, 2025). Over the 12 months ending March 2025, buybacks hit \$999.2 billion, just shy of the \$1 trillion mark. By mid-August 2025, announced buybacks had already topped \$1 trillion, faster than any prior year (Bloomberg, 2025). Full-year forecasts see buybacks reaching \$1.9 trillion globally, with the U.S. accounting for about 2.6% of its market cap (JPMorgan, 2025; Investing.com, 2025).

JPMorgan Chase, for instance, just rolled out a new \$50 billion buyback program (JPMorganChase, 2025). The logic is simple: buybacks boost earnings per share (EPS) by shrinking the share count, even if revenue growth isn't keeping up. The result? Higher equity prices, increasingly untethered from the real economy.

Chart 3: S&P 500 Quarterly Buybacks (\$bn, 2023–2025)



Buyback activity has surged, with 2025 on pace for a record-setting year.

3. Tariffs and Political Optics: Short-Term Relief, Long-Term Drag

With another election cycle approaching, tariffs are once again front and center, advertised as proof of tough economic policy and a way to insulate domestic industries. In the short run, they can offer a lift to sectors like steel and manufacturing. But if you zoom out, the picture darkens. The evidence is pretty clear: tariffs raise consumer prices, erode purchasing power, and weigh on GDP (Budget Lab, Yale, 2025a; Federal Reserve Board, 2025a; Richmond Fed, 2025).

Recent data from the Yale Budget Lab (2025a) shows just how dramatic the shift has been. After a new round of tariffs, the effective U.S. tariff rate jumped by 14.5 points, landing at 16.9%, territory not seen since the days of the Smoot-Hawley Act in the 1930s. The knock-on effects are already showing up: consumer prices are up 1.8%, and GDP is projected to drop by nearly a full percentage point in 2025, with more pressure expected in the years ahead (Budget Lab, Yale, 2025b). While these tariffs are slated to raise \$2.7 trillion in gross tax revenue from 2026 to 2035, almost half a trillion dollars will be erased by weaker economic growth (Budget Lab, Yale, 2025b).

The Federal Reserve's numbers back this up: tariffs imposed in early 2025 nudged core goods PCE prices up by 0.3%, which fed through to a 0.1% rise in overall core PCE inflation (Federal Reserve Board, 2025a). A broad global move toward higher tariffs would likely shave 0.8% off world GDP, with the U.S. taking the biggest hit (Federal Reserve Board, 2025b).

You can see the historical and current impact of tariffs side by side in the table below:

Table 1: Tariff Levels and Macroeconomic Effects Across Historical and 2025 Scenarios

Period	Avg Tariff Rate (%)	GDP Impact (%)	Inflation Impact (%)
1930s (Smoot-Hawley)	19.8	-5.0	6.0
2018–2019 Trade War	8.0	-0.4	0.3
2022 Peak (Post-COVID)	3.5	-0.2	0.2
2025 Tariffs (Yale Budget Lab)	16.9	-0.9	1.8
2025 Broad Tariff Scenario (Fed)	16.9	-0.8	0.3

Tariff rates represent effective averages; GDP and inflation impacts are approximate percentage changes relative to baseline, as reported by Yale Budget Lab (2025), Federal Reserve Board (2025), and historical research (Furceri et al., 2019).

The sectoral effects are just as lopsided. Tariffs may help firms that compete with imports in the short term, but they end up penalizing downstream industries and consumers. For instance, Yale’s analysis suggests apparel prices could spike by 17% under the April 2025 tariff package, reducing the average household’s purchasing power by over \$2,000 (in 2024 dollars). Retailers, tech hardware producers, and automakers are all feeling the squeeze from higher input costs.

Global research lines up with this story: tariff hikes reliably cut output and raise uncertainty, chilling investment for years (Furceri et al., 2019; Dellmo, 2025).

The takeaway: Tariffs may have political appeal, but they’re inflationary and contractionary at their core. They make the economy more volatile, squeeze household budgets, and provide little lasting support for the broader market (Ignatenko et al., 2025).

4. U.S. vs. Global Capital Flows

The U.S. is still a magnet for global capital, but flows are starting to rotate. In June 2025 alone, foreign investors bought \$192 billion in U.S. securities (Trading Economics, 2025a). May saw \$311.1 billion in aggregate inflows (Trading Economics, 2025b). Yet, the tide is shifting Europe pulled in over \$100 billion year-to-date, while U.S. equity funds lost nearly \$87 billion (Reuters, 2025a). Asia (excluding China) saw \$100 billion in inflows over the past nine months, as money diversifies away from the U.S. (Reuters, 2025b).

Emerging markets are a mixed bag. Chinese debt attracted \$30.8 billion in net inflows in just one month, the highest since March, while non-Chinese emerging market equities brought in \$10 billion. The MSCI EM index is up 17% year-to-date, compared to 9.5% for the S&P 500 (Reuters, 2025c). Still, IMF data for Q1 2025 show that on net, emerging markets faced portfolio outflows, underscoring the fragility of these moves (IMF, 2025).

Table 1: Comparative Capital Flows by Region, 2025

Region	Capital Flows 2025	Performance Indicators
United States	\$192B (June) / \$311.1B (May) inflows	Remains a strong draw for foreign capital
Europe	\$100B inflows (YTD); U.S. equity funds -\$87B	More stable than U.S.; gaining market share
Asia (ex-China)	\$100B inflows (9 months)	Diversification beyond U.S.; rising flows
Emerging Mkts	China debt +\$30.8B (1 mo); non-China EM +\$10B	Volatile; MSCI EM up 17% YTD vs. S&P 500 up 9.5%

Sources: Reuters (2025a, 2025b, 2025c), Trading Economics (2025a, 2025b), IMF (2025)

Bottom line: Capital inflows can boost U.S. equities by adding liquidity and narrowing risk premiums, but these flows are fickle. Relative valuation, yields, geopolitics, or regional risks can cause quick reversals, as seen in the shift toward Europe and Asia in 2025.

5. Can the Rally Keep Running?

The next 12–18 months for equities come down to two sets of forces:

Upside Drivers

- **AI Leadership:** In 2024, global private AI investment reached \$33.9 billion, up nearly 19% (Stanford HAI, 2025). Future-focused firms are doubling down, with about 15% of 2025 budgets going to AI agents; these firms are expected to see double the revenue growth and 40% better cost reductions versus laggards (BCG, 2025). AI and tech stocks drove outsized returns in early 2025 (BlackRock, 2025).
- **Fed Easing:** Markets see a high chance of a 25bp Fed cut as soon as September 2025 (Morgan Stanley, 2025), with the path pointing to moderate cuts through 2026 (Federal Reserve, 2025). Lower rates could bolster equity multiples (SSGA, 2025).
- **Buybacks:** Cheap borrowing lets companies keep buying back shares, mechanically lifting EPS even when underlying growth is modest. But overreliance is a risk.

Key Risks

- **Concentration Fragility:** This year’s gains are crowded into a few mega-cap tech names. Citadel notes that about \$0.35 of every SPY dollar flows into the “Magnificent 7,” raising the stakes for any stumble (Citadel, 2025). The S&P 500 earnings yield is near historic lows, ~3.7%, trailing even 3-month T-bills at ~4.22% (SSGA, 2025).
- **Tariffs and Trade:** New tariffs or retaliatory moves, especially those targeting tech supply chains, could hit earnings and inject volatility.

- **Disconnect from Fundamentals:** If stock prices keep rising but GDP and profits stagnate, the rally could lose its foundation. Emerging market growth forecasts are already cooling to about 2.4% annualized in H2 2025 (J.P. Morgan, 2025).

In all, the likeliest scenario is a continued rally, supported by AI, Fed easing, and buybacks, but with an uneasy reliance on financial engineering rather than broad-based growth. A sharp reversal remains a real risk if a few mega-cap names miss or if policy shifts sharply.

Probabilistic Outlook (Qualitative Forecast):

- 30–50% chance of continued near-term upside, thanks to AI, Fed policy, and buybacks
- 30–40% chance of a sharp reversal if a few mega-caps disappoint or policy pivots

Investor Takeaways

1. **Trim concentration risk:** Don't let your portfolio ride entirely on the top 10 mega-caps; look for opportunities in mid-cap and non-tech growth names.
2. **Favor pricing power:** Companies that can pass on costs to customers will be better placed if tariffs and inflation flare up.
3. **Scrutinize EPS drivers:** Dig into whether EPS growth is coming from real business gains or just buybacks.
4. **Hedge tail risks:** Gold and defensive assets are still smart insurance.
5. **Watch real-economy data:** Ultimately, GDP, capex, and small/mid-cap earnings will tell you if the market's foundation is healthy.

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