SUMMER 2024

As our Spring 2024 newsletter was written during an early April blizzard, the soft breezes and sunshine of this July day are a welcome change. Investors were cheered as well during the second quarter of the year as stocks continued to advance and as measured by the S&P 500, have posted a total return of 15.3% year to date.

Once again, however, the advance of the S&P 500 both in the 2nd quarter and year to date was concentrated in a few giant technology stocks while the broader market was stagnant. In a recent Wall Street Journal article by James McIntosh[1], he points out that the average stock in the S&P 500 hasn't made any progress since early 2022 and more than half are down since then. The article states that the broader Russell 2000 Index, which includes smaller cap stocks, is down 17% from its peak valuation in November of 2021 and is flat year to date.

The S&P 500 and NASDAQ indices have been driven by a relatively few stocks with one, NVIDIA, powering a large part of the advance over the past 2 years. NVIDIA, a semiconductor company with the leading chips used in Artificial Intelligence has gained 148% in 2024 and has advanced over 200 % in the last 12 months. The stock gained a remarkable 800% since late 2022 and is now one of the largest companies in the world by capitalization. The weighting of NVIDIA in the S&P 500 is now over 6%, in line with Microsoft and Apple. Indeed, the top ten stocks in terms of capitalization represent 37% of the S&P 500 and have been driving the returns of the index.

According to the J.P. Morgan Asset Management 3rd Quarter Guide to Markets[2], the so-called Magnificent Seven (Alphabet, Apple, Amazon, Meta, Microsoft, NVIDIA and Tesla) rose 33% year to date and were responsible for 61% of the returns of the index. The remaining stocks in the S&P 500 rose 5% year to date and produced 39% of the index returns. On another measure, according to J.P. Morgan,

[1] Wall Street Journal June 20, 2024, James McIntosh

[2] JP Morgan Asset Management 3rd Quarter Guide to Markets

the Price/Earnings Ratio (P/E) of the top 10 stocks by capitalization in the index is 30.3X compared to 17.8X for the rest of the 500.

The earnings contribution of the top 10 stocks (representing 37% of the index) in the S&P 500 is 26.8% of total earnings according to J.P. Morgan. By comparison, the earnings contribution of the top 10 stocks (representing about 28% of the index) in 2000 was only 10% of the total. In 2000, the P/E of the top 10 stocks was over 45X so at least the valuation of today's giants is more reasonable than it was prior to the bursting of the Dot Com bubble in 2000. It is not our contention that a major correction is imminent only that the power of the Magnificent Seven or Top Ten can work both ways. In 2022 the S&P declined by 18.1% and the large cap technology stocks fared far worse than the index with an average loss for the Magnificent Seven of 44% according to JP Morgan.

We believe the prospects for many of the top 10 stocks are bright, but we are somewhat concerned by valuations, particularly in comparison to many top-quality companies not participating fully in the current market advance. Enthusiasm regarding Artificial Intelligence is warranted as JPMorgan estimates that almost $200 billion will be invested this year in AI projects. However, much of this money will go to infrastructure such as data centers and improving electricity production among other ancillary investments. The AI revolution may not just be a boon for semiconductor and software companies.

In addition to opportunities outside the technology sector in the U.S. market, foreign developed and emerging markets are appealing as well. Again, according to JP Morgan, U.S. equities represent about 64% of the total world market versus a long-term average of around 50%. Valuations of foreign developed and emerging markets are far more reasonable than in the large cap U.S. growth stocks. Small cap stocks also seem relatively attractive.

While we won't hazard a prediction, in the years since 1980 when the S&P 500 advanced by over 10% in the first half of the year, Argus Research states that 81% of the time the index moved even higher in the second half [3]. Presidential election years have also been generally positive, but this may be a unique contest this time. We are concerned about the concentration of returns in a few giant stocks. Whether this is reversed by a dramatic decline in some of the giants or, more optimistically,

[3] Argus Research Market Watch July 1, 2024

is mitigated by the broadening of the returns as more stocks participate in any further advance is the question.

We recommend reviewing portfolios to consider changes in asset allocation, selective profit taking if appropriate and in general, ensuring that we are following our long-term investment strategy. We wish you all the best this summer,

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