

May 31, 2023

Dear Client:

As we continue our journey through the ever-changing financial market landscape, we wanted to take a moment to shed light on a trend currently at play in the stock indexes this year. It is no secret that the market has experienced considerable gains in recent months. However, the lion's share of these gains can be attributed to a select set of AI-related technology and consumer companies. The S&P 500 has entered a new bull market, up 21% from the October 12, 2022 low. While still lower by 10.5% from its January 3, 2022 peak, it's a notable achievement at a time of slowing economic growth and higher funding costs. Despite occasional volatility, fueled by various global events and economic factors, many stocks have reached record highs. Nevertheless, in a cap-weighted index such as the S&P, there continues to be a significant level of stock market concentration whereby a handful of companies exert a substantial influence on overall market returns.

Indeed, while the market-cap weighted S&P 500 has returned +9.6% in the year to date through month-end, the "equal-weight" version of the index is down 0.7%. The vast majority of that gain has been due to big rallies in a handful of its largest constituents: Apple, Microsoft, Amazon, Nvidia, Google, Tesla, and Meta (Facebook). Combined, these seven companies account for ~83% of the year-to-date advance. A market-cap weighted portfolio of these companies has returned ~40%, compared to only ~2% for the next 95 largest constituents in the S&P 500, and less than 1% for one of the remaining 400 firms (Bloomberg).

The unifying performance-driver for these behemoths is artificial intelligence (AI). One of the key reasons why AI-centric stocks are driving markets is the widespread recognition of its transformative potential. AI has the ability to automate tasks, analyze vast amounts of data, and make predictions and recommendations with incredible accuracy. This technology enables companies to gain valuable insights, make data-driven decisions, and develop innovative products and services. As a result, businesses across industries are investing heavily in AI to gain a competitive edge and capitalize on the benefits it can offer.

While AI's impact on various industries cannot be overstated, it's not as new as commonly thought. AI-related technology has, for many years, revolutionized the way businesses operate -- from optimizing production processes to enhancing customer experiences. It is however less abstract, and new the new fascination around ChatGPT, a generative AI chatbot that has taken the worlds of academics and finance by storm, with its "human-like" attributes is a prime example. In finance especially, the potential of AI to streamline operations, improve efficiency, and unlock revenue streams has attracted significant attention from investors, leading to a surge in the value of AI-related stocks. Companies specializing in large language models, machine learning, robotics, and automation have experienced remarkable market appreciation.

To be clear, the surge in the large-cap stocks is linked to speculation about recent AI breakthroughs, rather than a strong economic backdrop for Corporate America in general. The concentration of gains in a select few stocks underscores the importance of diversification in one's investment portfolio. While these tech leaders have demonstrated their prowess -- and your portfolio has exposures to four of the seven companies -- relying solely on their performance exposes investors to increased risk. It is crucial to maintain a diversified portfolio to navigate the ever-changing market dynamics. While the AI revolution presents vast potential, it is crucial to differentiate between companies driving innovation in this space and those riding the coattails of market hype.

Regards,



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U.S. Large Cap Equity Strategy