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Dear Client:

As we completed our 2023 client reviews, much of the conversations revolved around the extraordinary impact of the largest market-cap companies -- the “Magnificent 7” -- on the S&P 500’s vigorous 2023 gain. This month’s observation is therefore very much client driven. The massive bull run in technology stocks -- specifically the rally in artificial intelligence-related stocks -- drove the most top-heavy stock market in decades, with the share of the top 7 largest companies in the S&P 500 accounting for 30% of the S&P500 market cap (but just 20% of the aggregate index earning). These seven companies (Apple, Microsoft, Amazon, Nvidia, Google, Tesla, and Meta) accounted for 71% of 2023’s advance.

The shared thesis for these companies is that increasing access to artificial intelligence (AI) will boost the drivers of capitalism -- productivity and innovation -- and the source of this expectation begins within the silicate semiconductor chips produced by Nvidia. The poster child for this movement grew an astonishing 239% in 2023, accounting for 25% of the Magnificent 7’s index contribution. The calendar might have flipped, but that hasn’t stopped the stocks’ remarkable ascent. Through February, the S&P500 is +7.1% YTD and the astounding rise of Nvidia continues apace, up an additional +60% YTD and accounting for ~28% of the S&P 500’s gains so far in 2024. With a $1.8 trillion market-cap, Nvidia is now the world’s third-most valuable public company, behind Microsoft ($3.0T) and Apple ($2.8T). Improbably, Nvidia is now larger than Amazon, Google, an oil behemoth Saudi Aramco. The company is worth more than both the totality of the Hong Kong (Hang Seng) and Canadian (TSE) stock markets. It is also now worth more than the 23 companies in the S&P Energy sector...*combined*. As the total 4Q net income of the Energy sector was ~$147B vs. $20B for Nvidia, this is of course absurd, but that’s the power of momentum. As a recent (3/1) Wall Street Journal headline opined, “It’s Nvidia’s Stock Market. You Choose How to Live in It”.

This buildup of expectations (and euphoria) in AI was amplified by Microsoft during its January 30 earnings call, “We are applying AI at scale by infusing AI across every layer of our tech stack, we’re winning new customers and helping drive new benefits and productivity gains across every sector.” IBM indicating much the same, stating in its 1/24 earnings call that the company saw its book of business for WatsonX and other generative AI offerings double sequentially in Q4 -- not YoY, but from Q3 levels.

So, in what we might call the Nvidia market moment, it’s easy to feel left behind if you don’t own it, which is why it’s vital to put things in perspective (beginning with not beating yourself up or piling on in order to catch up -- that rarely ends well). It’s important to remember that your portfolio has meaningful exposure to the AI boom through portfolio companies Broadcom, IBM, Meta, Microsoft, and Applied Materials. Yes, billions are being spent on Nvidia GPUs -- indeed they seem to be the only game in town -- but they aren’t. Still, the lack of numerous suppliers of GPUs is stimulating a feeding frenzy with no pricing constraints. Huge investments in AI-related hardware and software are being made and Nvidia’s lead will dissipate as other manufacturers bring customized, unique products to market, but that is many quarters out.

From an economic perspective, AI-related capex will incrementally support GDP -- but it’s just 7% of all capex (and 1% of GDP), so it’s far from an economy-wide game changer -- unlike its impact on the stock market (Piper Sandler). The issue of concentration is also set to get worse, which is bad news for the rest of the market as tech valuations outpace fundamentals. So, while Nvidia (and the Magnificent 7) will remain the stars of the show, this handful of companies is not representative of our very large economy.

Regards,

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