Choreo

JUNE 2024

Market Perspectives: *Summer* Simmer

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MARKET PERSPECTIVES: SUMMER SIMMER

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Rita: Do you ever have Deja Vu?

Phil: Didn't you just ask me that?

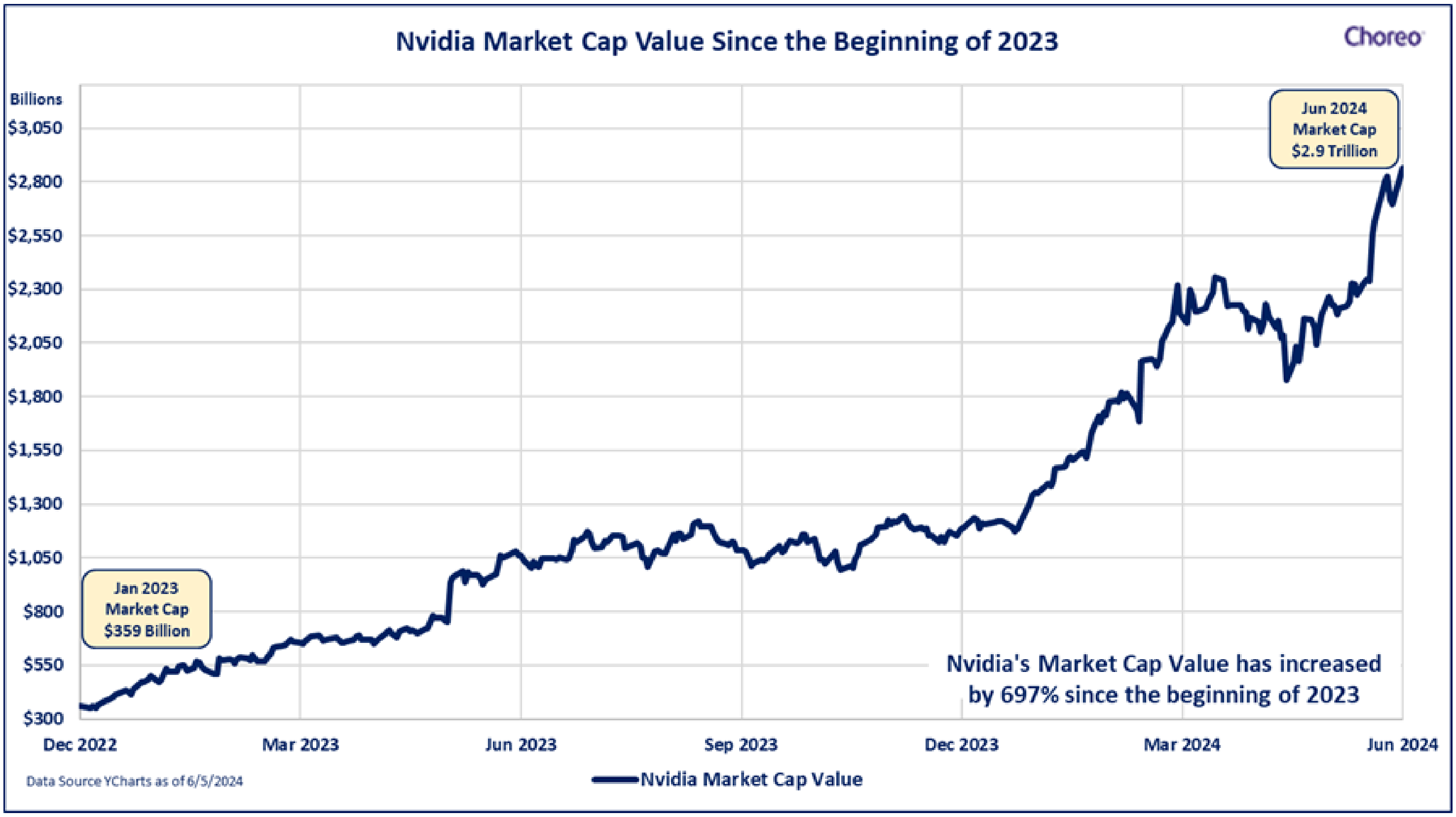
~Bill Murray and Andie McDowell from "Groundhog Day" (1993)

- Markets around the world are currently trading near all-time highs. Much of the credit has been given to the resilience of the economy, as inflation slowly cools.
- The Federal Reserve (the "Fed") remains on hold for interest rate cuts (or even possibly hikes) pending more trends in inflation data.
- This month, we explore less commonly discussed aspects of the market and the implications of each in the months and years ahead.

The summer of 2024 has arrived, bringing with it beaches, swimming, golf, and time with family and friends - all while enjoying the warmer temperatures. For many in the U.S., it feels like we've skipped straight from "it's too cold" to "it's way too hot." Investors today have been and continue to be primarily focused on inflation and interest rates. Simmering beneath the surface, market structure, (like the seasons), is inherently complex, unpredictable and subject to rapid change. It's true that the Fed, interest rates and inflation have defined the post-Covid recovery period. However, there are many factors which drive stock prices and some less discussed topics that are influencing markets overall. Some of these factors can often dominate headlines, while others go almost unnoticed, yet still drive economic forces and markets. Below we highlight a few such factors which have become forces worthy of discussion.

ARTIFICIAL INTELLIGENCE

The first of such factors is the rapid advancements in artificial intelligence ("AI"), a theme underpinning market performance since the beginning of 2023 - nearly 18 months ago. Nvidia, widely seen as the leading beneficiary of AI technology, exemplifies this impact. Nvidia manufactures the graphics processing units (GPUs) essential for AI and machine learning applications. Nvidia has experienced explosive growth, with its market value surging from approximately $350 billion in January 2023 to approximately $3 trillion in June 2024. This remarkable rise has made Nvidia the 2nd largest company in the U.S., behind only Microsoft and exceeding that of Apple.



The remarkable rise can also be seen in the financial metrics growth with sales (revenues) more than doubling in just over a year.

	Beginning of 2023	Today	Change Since 2023
Market Cap	$359 Billion	$3.0 Trillion	725%
Revenue	$26 Billion	$60 Billion	126%
Expenses	$16 Billion	$27 Billion	66%
EBITDA	$7.4 Billion	$50.6 Billion	581%
Net Income	$9.7 Billion	$28 Billion	205%
Earnings per Share	$3.91	$12.05	208%
PE Ratio (Forward)	44.7	44.6	0%

Data Source: YCharts, Trailing 12-month calculations

As AI technology transitions from early-stage winners to second-stage adopters, it will increasingly serve consumer interests. Initially, however, early gains are expected to be seen in corporate-level efficiencies as technological advancements in both the manufacturing and service sectors lead to improved organizational methods and business practices. These productivity gains may show up in margin improvement once the impacts are felt, which may follow a period of higher spending. Early-stage winners also happen to be mega-cap tech companies (i.e., cloud computing, semiconductors). However, it's widely expected AI will be adopted across sectors and industries over the longer term. Improved global efficiencies, which may be coming, could offer the potential for increasing profits, which, in the long run, are a factor in driving stock prices.

JAPAN BACK TO ALL-TIME HIGHS (NOT SEEN SINCE 1980)

In 1980, the Nikkei Index, the benchmark for Japanese equities, began the decade trading at ¥6,556. By the end of 1989, the index advanced to ¥38,915, good for a 19.5% annualized return. It wasn't just equities that flew higher, real estate values surged too. By 1987, the Imperial Palace, which occupied just 1.31 square miles, was estimated to be worth more than the entire state of California![1] The environment wouldn't persist much longer, however. By September 1990, the Nikkei was down 48%, ultimately declining 80% into 2003. Real estate valuations followed. It wasn't until earlier this year, more than three decades from the market peak in 1990, that the Nikkei would once again attain all-time highs.

The story of Japan over the last 40 years underscores the unpredictability of asset prices. While Japanese stocks have gone nowhere for four decades the country remained one of the most technologically advanced countries in the world and a crucial player in global relations throughout this period. This disconnect highlights a host of other important issues one may consider when investing such as valuations, debt levels, and demographics, all of which have challenged the Japanese economy. Similarly to the last four decades, investors can expect that asset prices will remain highly unpredictable. However, the return to new all-time highs is notable and has our attention. This highlights the benefit of diversifying across various assets to manage risk. The chart below highlights various country-specific performance since 2009 and it goes without saying that identifying the winners year to year is an unattainable feat.

[1] https://www.reuters.com/markets/asia/japans-crazy-1980s-bubble-dim-memory-nikkei-hits-record-high-2024-02-22/#:~:text=Land%20values%20in%20Tokyo%20rose,real%20estate%20value%20of%20California

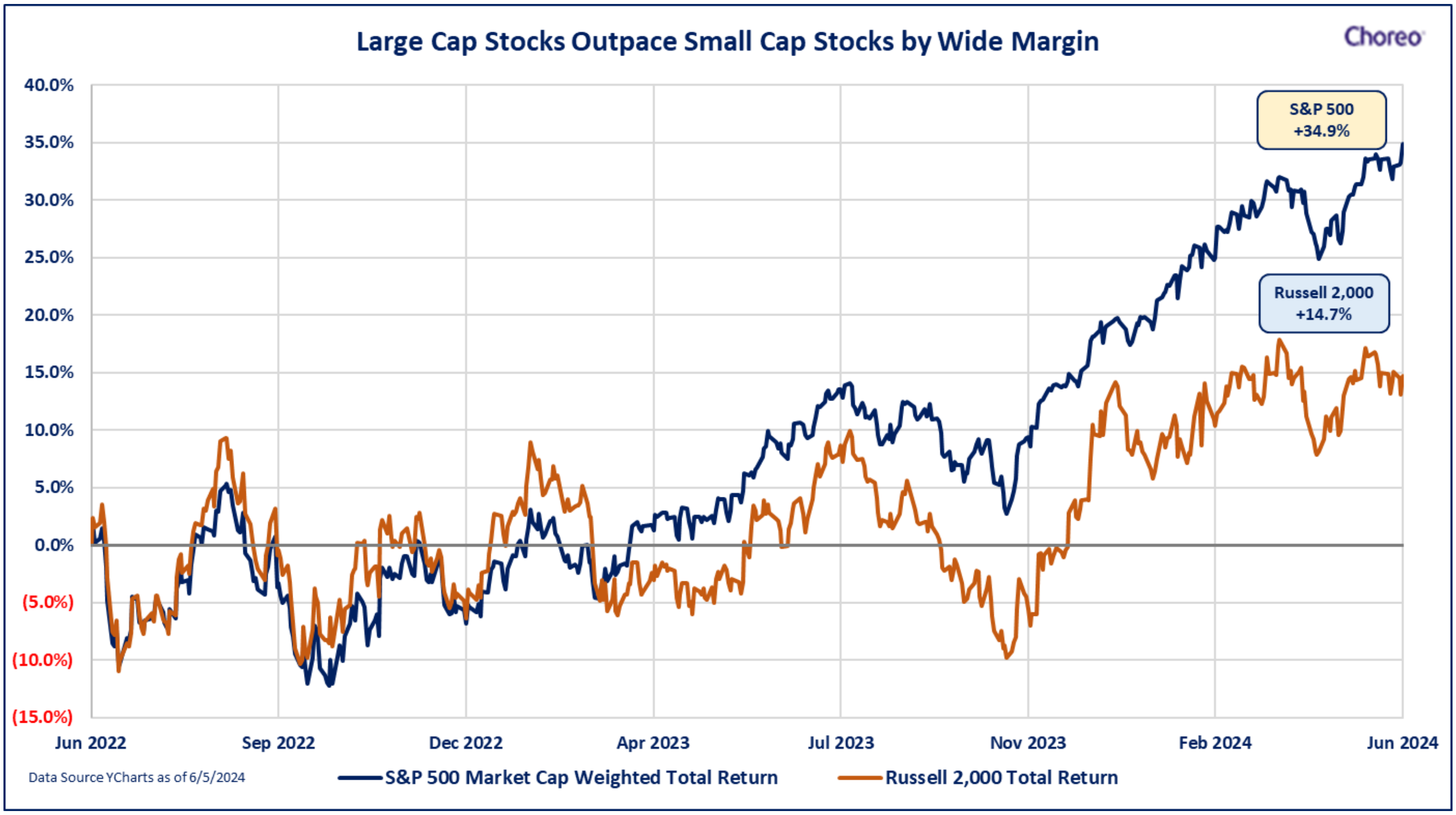
Country Equity Performance 2009 to 2023

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
India 102.8%	South Korea 27.2%	USA 2.0%	Germany 32.1%	USA 32.6%	India 23.9%	Japan 9.9%	Canada 25.5%	China 54.3%	USA (4.5%)	USA 31.6%	South Korea 45.2%	USA 27.0%	United Kingdom (4.8%)	USA 27.1%	USA 11.2%
Australia 76.8%	Canada 21.2%	United Kingdom (2.5%)	India 26.0%	Germany 32.4%	USA 13.4%	USA 1.3%	Australia 11.7%	South Korea 47.8%	India (7.3%)	Canada 28.5%	China 29.7%	Canada 26.9%	Australia (5.1%)	Germany 24.0%	Japan 9.5%
South Korea 72.1%	India 20.9%	Australia (10.8%)	China 23.1%	France 27.7%	China 8.3%	France 0.8%	USA 11.6%	India 38.8%	Australia (11.8%)	France 27.0%	USA 21.4%	India 26.7%	India (7.5%)	South Korea 23.6%	China 9.2%
China 62.6%	Japan 15.6%	South Korea (11.8%)	France 22.8%	Japan 27.3%	Canada 2.2%	Germany (1.3%)	South Korea 9.2%	France 29.9%	France (11.9%)	China 23.7%	India 15.9%	France 20.6%	Canada (12.2%)	France 22.3%	United Kingdom 8.6%
Canada 57.4%	USA 15.4%	Canada (12.2%)	Australia 22.3%	United Kingdom 20.7%	Australia (3.2%)	India (6.1%)	France 6.0%	Germany 28.5%	Japan (12.6%)	Australia 23.1%	Japan 14.9%	United Kingdom 18.5%	France (12.7%)	India 21.3%	Germany 8.1%
United Kingdom 43.4%	Australia 14.7%	Japan (14.2%)	South Korea 21.5%	Canada 6.4%	Japan (3.7%)	South Korea (6.3%)	Germany 3.5%	Japan 24.4%	United Kingdom (14.1%)	Germany 21.7%	Germany 12.3%	Australia 9.6%	Japan (16.3%)	Japan 20.8%	France 6.2%
France 33.3%	Germany 9.3%	France (16.0%)	USA 16.1%	Australia 4.3%	United Kingdom (5.4%)	United Kingdom (7.5%)	Japan 2.7%	United Kingdom 22.4%	Canada (16.6%)	United Kingdom 21.1%	Australia 8.9%	Germany 5.9%	USA (19.5%)	Canada 16.4%	India 5.8%
USA 27.1%	United Kingdom 8.8%	Germany (17.5%)	United Kingdom 15.3%	South Korea 4.2%	France (9.0%)	China (7.6%)	China 1.1%	USA 21.9%	China (18.7%)	Japan 20.1%	Canada 6.2%	Japan 2.0%	Germany (21.6%)	Australia 14.9%	Canada 2.5%
Germany 26.6%	China 4.8%	China (18.2%)	Canada 9.9%	China 4.0%	Germany (9.8%)	Australia (9.8%)	United Kingdom 0.0%	Australia 20.2%	South Korea (20.5%)	South Korea 13.1%	France 4.7%	South Korea (7.9%)	China (21.8%)	United Kingdom 14.1%	Australia 1.0%
Japan 6.4%	France (3.2%)	India (37.2%)	Japan 8.4%	India (3.8%)	South Korea (10.7%)	Canada (23.6%)	India (1.4%)	Canada 16.9%	Germany (21.6%)	India 7.6%	United Kingdom (10.4%)	China (21.6%)	South Korea (28.9%)	China (11.0%)	South Korea (5.6%)

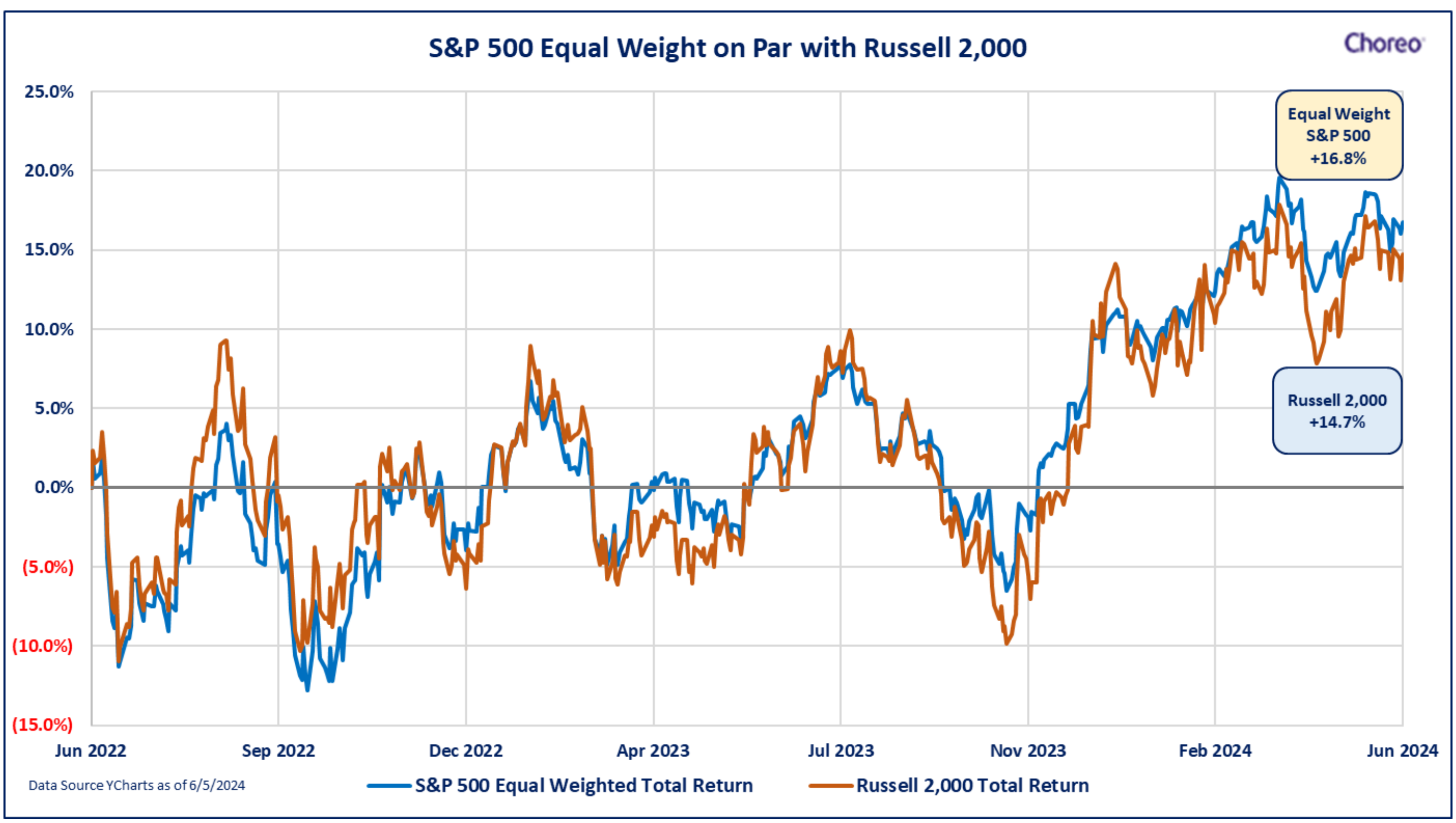
Data Source: Y Charts as 6/4/24
Country Indices: MSCI USA, MSCI China, MSCI Japan, MSCI India, MSCI France, MSCI United Kingdom, MSCI Canada, MSCI Germany, MSCI Australia and MSCI Korea

SMALL CAP STOCKS

Small cap stocks have meaningfully underperformed large cap stocks for many years. The chart below of the S&P 500 and the Russell 2000 highlights the divergence of performance over the last several years: the S&P 500 +34.9% is outperforming the Russell 2000 substantially. This disparity is largely due to the exceptional performance of mega-cap technology companies, known as the “Magnificent 7”: Microsoft, Apple, Nvidia, Amazon, Alphabet, Meta, and Tesla. These companies are competitively positioned and have greatly influenced overall market performance given their outsized weighting in the index performance (the S&P is market-cap weighted meaning that the larger the company, the more impact on the overall index).



However, it's important to consider a key historical concept: markets may have components of cyclicality. What led markets previously may not lead moving forward. When we exclude the influence of the Magnificent 7 by using the S&P 500 Equal-Weight Index effectively stripping out the outsized impact of a handful of stocks, the performance differences with the Russell 2000 become less pronounced, as shown in the graph below.



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As temperatures heat up, so has the economy in recent months. To date, economic conditions have simmered and have yet to boil over. We began this note with a line from the classic comedy "Groundhog Day" where Bill Murray's character lives the same day repeatedly, with each iteration slightly different due to his actions and improvements (we won't spoil the ending if you have not seen it).

The ongoing quest for a sound investment process emphasizes focusing on the long-term, as short-term data can be misleading and repetitive. Investing can feel a bit like deja vu, with many similarities in shorter term recurring data. However, by zooming out we can discern differences and potential shifts, as discussed above. Sometimes, recognizing these shifts can be challenging and it may even be difficult to perceive these differences, as perfectly summed up in another scene in "Groundhog Day."

Phil: Do you ever have Deja Vu, Mrs. Lancaster?

Mrs. Lancaster: I don't think so, but I could check with the kitchen.

~Bill Murray and Angela Paton from "Groundhog Day (1993)"

We hope you all enjoy the start of summer and as always, we encourage you to reach out to your Choreo advisor with any questions or comments.

Disclosures

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