In the Markets Now

Concentration and bubbles

We believe in the old saying: a picture is worth a thousand words. Here, we aim to recap recent market action and provide some perspective to investors.

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February 2024

TAKING STOCK OF THE CURRENT MARKET

One of the most common themes I hear when talking to clients and advisors is worries about the concentration of the stock market. At the beginning of this year, the top 5 stocks in the S&P 500 accounted for over 25% of the market cap of the entire index, marking the highest level of "top-heaviness" in at least 35 years (dot-com bubble included). This raises questions both about the overall health of the market – despite being at all-time highs – and about whether a bubble is forming in the mega-cap Tech stocks accounting for the index's concentration. Let's briefly dig into both questions.

It is true that mega-cap Tech has been market leadership and a dramatic outperformer of late (the cherry on top coming via Nvidia's blowout earnings report). What's less discussed is that both the Health Care and Industrials sectors are at all-time highs, with Financials, Consumer Staples, and Materials all ~5% or less from new records, as well. **Perhaps the best example of market breadth, however, is the recent performance of the S&P 500 Equal Weight (i.e., all 500 stocks get equal representation), which made a new 25-month high last week and sits only 1% below its all-time record.** Big Tech remains leadership amid the AI proliferation and resilient U.S. economy, but the overall market is far from narrow.

Furthermore, strength abroad is expanding. Japan, India, France, Mexico, and Taiwan are all at or near all-time highs, with plenty of other markets rallying alongside them. The MSCI All Country World ex-USA index is less than 1% from a new record despite China, one of its biggest weights, being in a deep bear market.

As to the second question, I'm a bit more conflicted. On one hand, there are certainly signposts that enthusiasm for AI is a bit frothy (a la the internet in the late 1990s). At the same time, the companies at the top of the market today are primarily profitable, cash-rich, and low debt enterprises. It's not that they can't fall (just look at 2022), but the rich valuations are much more backed up by earnings power and fundamentals than was the case during the speculation seen by late-1999 and 2000.

Another way to look at the question is via Strategas' bull market top checklist, where they have 0 of 9 items checked (compared to 9 of 9 in 2000 and 2007). **Though the market sits near all-time highs, evidence that the current bull market should peter out in the near-term is scant.** Is a correction likely? Absolutely. They're inevitable, even in good times. But the overall market setup looks pretty solid, and while sentiment is something to watch, any unearned euphoria seems in check for now.

Strategas' Bull Market Top Checklist

Indicator	2000	2007	Today	Comments
Blow-off top	✓	✓	X	While investors are paying elevated multiples with an underwhelming risk/reward profile, December's euphoria has cooled.
Heavy inflows into equity market funds	✓	✓	X	Net inflows into equity funds are underwhelming compared to money market funds. There still appears to be cash on the sidelines
Big pick-up in M&A activity	✓	✓	X	M&A activity has seen a pickup recently, especially in the energy sector. There will likely need to be a significant increase to feel frothy.
IPO activity	✓	✓	X	IPO activity has been rather lackluster thus far and there are few signs it will turn euphoric in the near-term.
Rising real interest rates	✓	✓	X	The more inflation comes down, the more restrictive real rates become. For now, they are below levels seen at the start of recessions.
Weakening upward earnings revisions	✓	✓	X	Earnings revisions have begun to turn higher. Based on figures reported by S&P, operating and reported earnings have bottomed.
Erosion in # of stocks making new highs	✓	✓	X	Breadth has expanded significantly during the current rally.
Shift towards defensive leadership	✓	✓	X	There have been no durable signs of a shift towards defensive leadership.
Widening credit spreads	✓	✓	X	High-yield and investment grade credit spreads remain tight by any historical standard.

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