US Large Cap Commentary

June| 2024

Big Tech Dominance Continues

Bloomberg Headline
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Market Strategists Abandon S&P 500 Targets, calling them "no longer useful"

Market commentators love to make predictions. But Piper Sandler & Co recently eliminated its price target for the S&P 500, saying the index is being driven by just a handful of heavily weighted stocks and targets are therefore no longer very useful. And Bloomberg analyst Jonathan Levin hopes more firms follow suit.

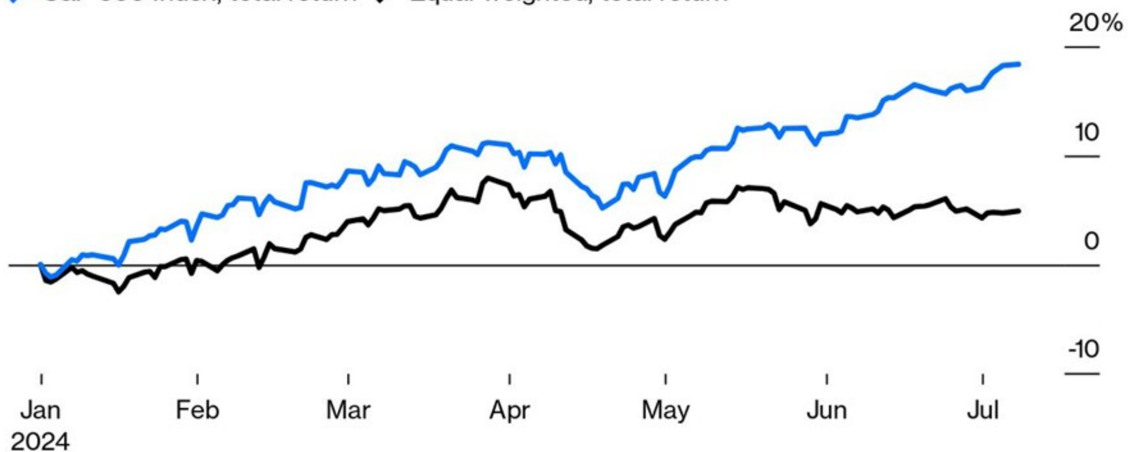
We are not market timers, but headlines like this are a little concerning…and tend not to bode well for markets. Let's take a deeper look…

Big Tech Dominance

Big Tech continues its dominance, with the Top 7 stocks now accounting for 31% of the market cap of the S&P 500. That's an average weighting of 4.4% for these top 7 names, versus 0.1% for the other 493 stocks in the index. NVDA is a huge driver of this trend, of course, with its 150% YTD return and 7% S&P weighting.

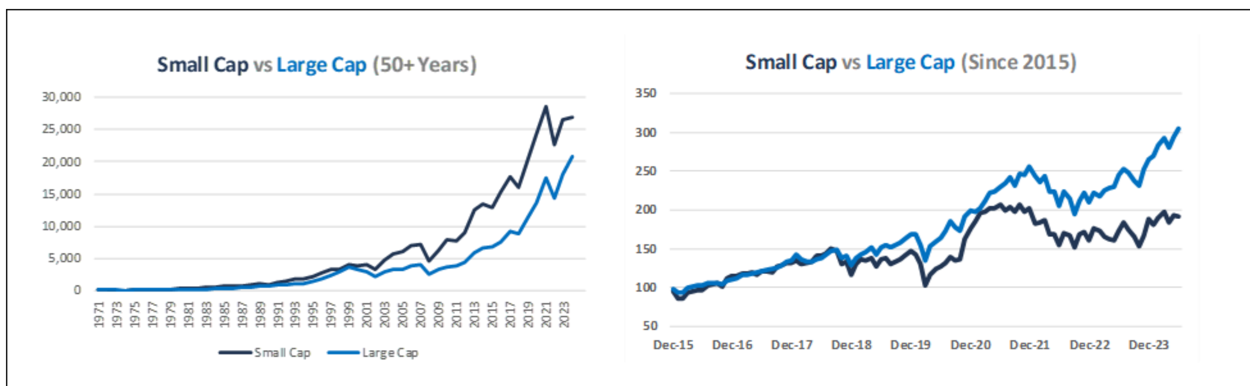
Market Cap Weighted vs Equal Weighted

Based on the above, you would expect the market cap weighted S&P 500 index would outperform the equal weighted index. And it has…to the tune of 10.2% through June 30 (15.3% vs 5.1%).



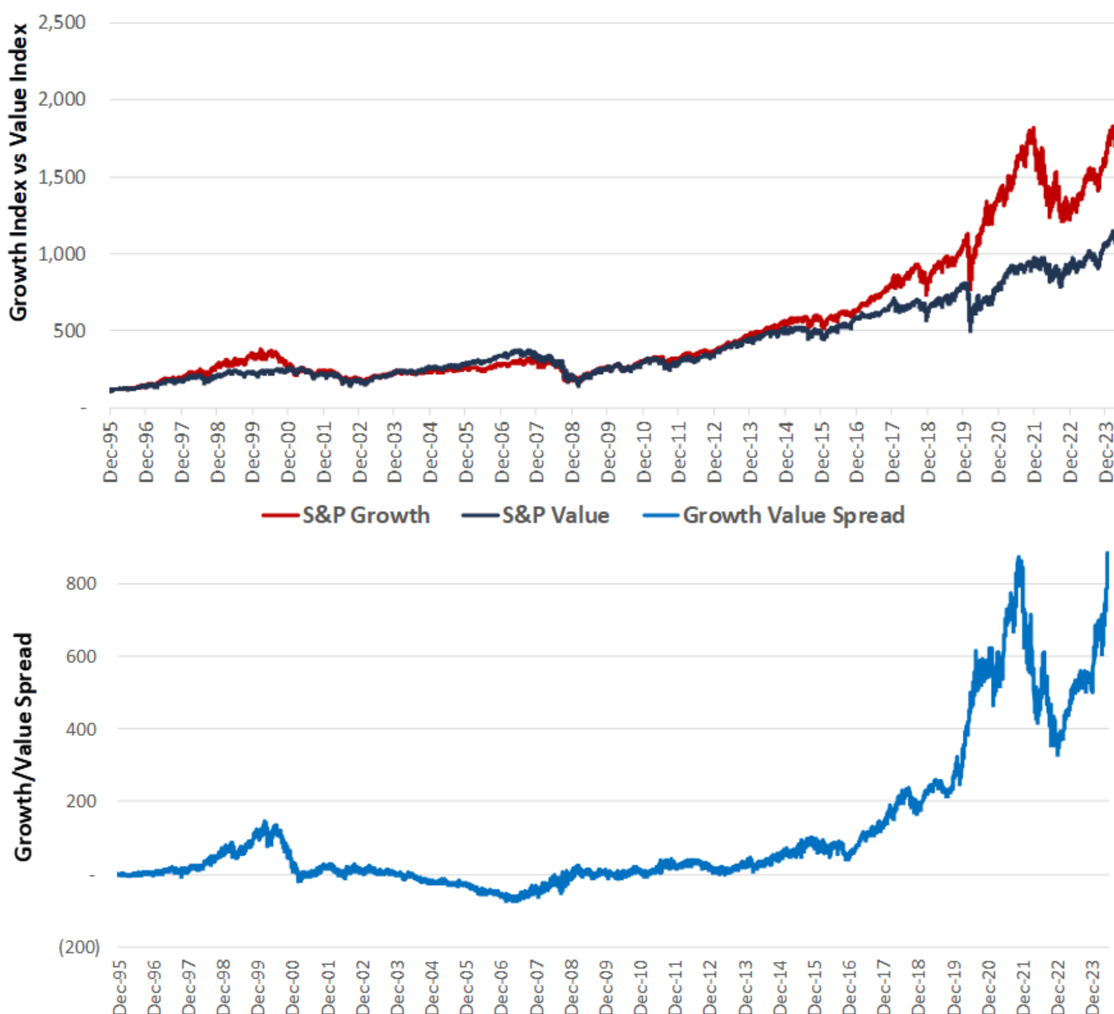
Large Caps Continue To Dominate Small Caps

This same theme applies as you go down cap as well. The Russell 2000 index turned in a paltry 1.7% return in the first half, compared to 15.3% for large caps. And, while small caps have traditionally outperformed large caps over the long run (see below, left), it has been a very different story over the past 6-7 years (below, right).



Growth vs Value

We track the S&P growth and value indices on a cumulative basis. Growth has now fully recovered from its 2022 selloff, and the growth-value spread (royal blue line in bottom chart) is back to its all-time highs. Interestingly, the value index (dark blue line in top chart) continues its steady climb and is at all-time highs as well. As income-oriented covered call managers, we are happy to see this. Our composite is also at all-time highs, but our high-quality portfolio is positioned very well to outperform if/when the next correction arrives.

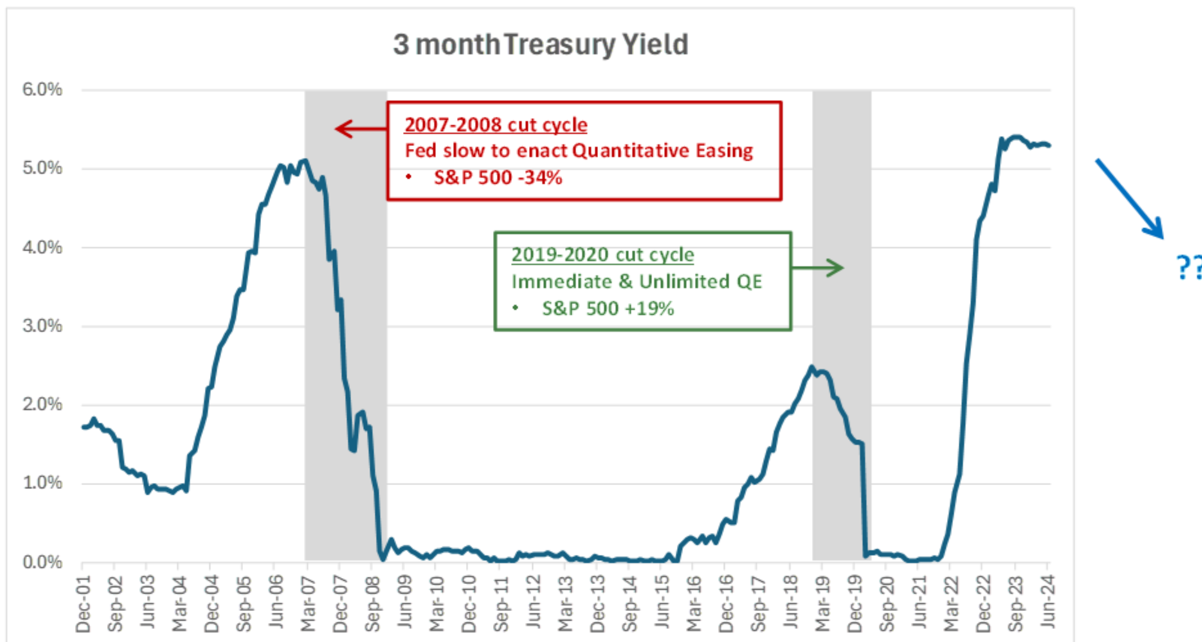


Outlook: Rate Cuts On The Horizon

There's no doubt that much of the current rally can be attributed to the expectation of rate cuts and potential quantitative easing. Inflation came in at 3.0% this month, very close to achieving the 2 handle the Fed wants to see. And the jobs market is slowing, strengthening the case for cuts. After the inflation reading, the probability of a rate cut by September soared to 87%.

There is still much debate about how this will affect markets, however. Some analysts say cuts only arrive in response to economic weakness/recession, and that's bad for markets. Others say it's a signal that the Fed is willing to step in and save the day. Both have been true in recent years (see chart below). In our view, it's all about how the Fed responds to the slowing economy. And by this we mean QE, not the actual rates themselves. When we dipped into recession in 2008-09, the Fed was slow to enact QE

(quantitative easing) and the market **declined 34%** during the 21-month rate cut cycle. In contrast, the Fed turned the spigots on immediately when the economy shut down in 2020 and the market **rallied 19%** as a result. See below.



- It's still all about the Fed
- Liquidity (QE) actually matters more than rates
- Slow QE in 2008 crushed stocks, while immediate QE in 2020 fueled rally
- Moderate inflation is typically good for stocks and bad for bonds

Q2 Performance

Our strategy turned in a 3.5% return in Q2. The S&P 500 (market cap weighted) index was up 4.3% in Q2, but NVDA accounted for 2.7% of that (meaning the other 499 stocks turned in a 1.6% return). The equal weight S&P was -2.6% for the quarter. Our strategy was up 13.0% for the first half of the year, a solid result considering our NVDA underweight and disparity amongst stocks.

Portfolio Highlights

The strongest and weakest contributors to our Q2 return are as follows:

TOP FIVE PERFORMERS	
Stock	**Return**
NVDA	48.6%
AAPL	23.0%
ANET	21.8%
AVGO	21.5%
GOOGL	20.8%
Median	**21.8%**

BOTTOM FIVE PERFORMERS	
Stock	**Return**
LULU	-23.5%
DIS	-18.9%
LOW	-13.0%
STLD	-12.3%
CMCSA	-10.1%
Median	**-13.0%**

We bought WPM and added to our positions in ABBV, IBM & NVDA during Q2. Our NVDA position is now 3.5%, still substantially lower than its weighting in the S&P 500 (7.0%). We sold Comcast, PayPal & Franco-Nevada (all on fundamental weakness) and trimmed our positions in ANET & META to make room for NVDA.

Key Takeaways

- We turned in a strong second quarter in 2024, slightly under-performing our top=heavy benchmark but at lower risk.
- Most economists are projecting mid-single digits for equity returns over the next 7-10 years. Our continued focus on quality and disciplined approach to management put us in a great position to succeed in today's uncertain environment.
- Bankruptcies are trending up and expected to continue to rise as companies are forced to refinance their debts into higher rate debt. Many businesses will struggle in the coming years, but our insistence on quality and aversion to credit risk positions us well.
- We will continue to stick to our knitting. All of our positions are high quality and designed to deliver equal parts income and appreciation. This approach has created alpha for us in the past.
- We are ready for whatever the market throws at us.

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