Market Commentary

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At the beginning of 2023, there was a lot of pessimism included in market expectations on the heels of a bad 2022 for investors, which included the worst rout on record for bonds and a steep drawdown in equities.

This pessimism was not unwarranted: inflation was still a major problem, corporate earnings expectations were being slashed, and the yield curve was deeply inverted.

Most people expected an economic recession, and this was rational. On top of this, we had a “banking crisis” in March, brought on by the Fed’s rate squeeze intended to curtail inflation. All of this suggested maybe it was going to be a year resembling 2022.... or worse! If there was ever a time when a market timing decision was a no-brainer, this was it!

But what happened? The market rallied on the expectation that widespread adoption of Artificial Intelligence would usher in a new era of productivity and profits growth. The market zoomed. Here’s a look at the returns through July 7th:

Feedback

What observations can we make from the above?

This is a uniquely narrow market.

A certain kind of stock ripped in the first half. Note the QQQ (the 100 largest NASDAQ stocks) above is the dominant return YTD at 37%. Close behind it is the broader NASDAQ at 30%, followed by the S&P at 14.5%, and the Russell 2000 Index (small cap stocks) at 6.7%. We did a note on the market breadth subject a couple of weeks ago.

The bottom line is if you didn't have some exposure to the top ten stocks by market cap (think Apple, Microsoft, Nvidia, Meta, Amazon, Alphabet), you were basically left in the dust. This is why index composition awareness is vital for active investors. If you miss the big ones, you are left in the dust because the return gaps are so large.

The forecast is still generally positive.

Even for the broader stock market, this is a decent year if it keeps playing out this way. For example, a 13% return in a calendar year for Small Caps is good. So, a lesson here could be not to get too caught up in "fear of missing out" (FOMO) if the risks entailed in holding some of these AI beneficiaries is not right for you.

Buy or Not to Buy – A Personal Decision

These market moves have created a group of very expensive large cap tech stocks. There might be a better time to enter the foray into these stocks. If nothing else, the 1999 run up in tech stocks to stratospheric PE's and then their 2000 rout might be instructive for what may happen here. Patience and circumspection are in order.

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As we enter the second quarter's earnings announcement cycle, we will undoubtedly learn a lot. We will learn whether reacceleration in earnings is in the offing. We will learn how cyclically sensitive industries and companies are faring. We will learn whether the AI hype is following through to revenues and earnings. It should be an instructive earnings season.

Against this backdrop the lessons learned (or re-learned) in the first half bear repeating:

1. Be aware of the index composition and know what the largest names are. A decision to own or not own can have big implications.
2. Be careful not to get sucked into the allure of timing markets. It's very difficult and usually ends up costing you money.

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