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FOMO [i]

Well, we can all breathe a sigh of relief! The pundits and Talking Heads have opined that the stock market has resumed a bull market!

There are a few things lost in translation of these headline pronouncements!

- Stock Market or a Market of Stocks?
- What Lies Beneath?
- Psychological or Behavioral considerations?
    - Recency Bias
    - Confirmation Bias
    - Fear of Missing Out

The S&P 500 is a capitalization-weighted index of the 500 leading companies and covers approximately 80% of available market capitalization.[ii] The 10 largest stocks in the S&P 500 (and their return through Friday 6/10/23) and their contribution to the return of the S&P 500 Index are shown in the table below:

#	Company	Symbol	Weight	YTD Return	Contribution
1	Apple Inc	AAPL	7.46%	0.39%	2.9%
2	Microsoft Corp	MSFT	6.74	0.36	2.4
3	Amazon.com Inc	AMZN	3.05	0.46	1.4
4	Nvidia Corp	NVDA	2.64	1.65	4.4
5	Alphabet Inc Cl A	GOOGL	2.02	0.38	0.8
6	Tesla Inc	TSLA	1.82	0.98	1.8
7	Alphabet Inc Cl C	GOOG	1.77	0.38	0.7
8	Berkshire Hathaway Inc Cl B	BRK.B	1.68	0.08	0.1
9	Meta Platforms Inc Class A	META	1.64	1.20	2.0
10	Unitedhealth Group Inc	UNH	1.28	-0.06	-0.1
			30.10%		**16.4%**

The top 10 stocks in the S&P 500 Index comprise over 30% of the Index. These leading "Mega-Cap Tech" stocks, account for a combined return of over 16% year-to-date through Friday the 10th.[iii]

The return for the entire S&P 500 year-to-date is approximately 12.0%.[iv]

The math suggests that the other 490 stocks in the index have a combined loss of -4.0% year-to-date. Put another way, an investor's return this year depends largely on whether and how much one owns of the "Magnificent Seven". The "Magnificent Seven", which omit GOOG, BRK.B,and UNH, have all exploded because of their involvement in one or more aspects of Artificial Intelligence.

Tony Sacconaghi, Managing Director and Senior Research Analyst at Bernstein Research has noted this is the most concentrated market leadership ever.[v]

While the S%P 500 has indeed risen 20% from its October low, meeting the technical definition of a "bull market"; however, the evidence would suggest that this is still a market of stocks, with significant divergence among individual names. The AI-fueled frenzy has all of the hallmarks of an emotionally-driven surge in one hot segment of the market. While there is no doubt AI is here to stay and will have huge implications going forward, the related stocks are trading at forward price-to-earnings multiples that imply very high growth expectations over the near-term, and, to actually see the anticipated benefits AI will deliver will take years, not weeks! When these stocks consolidate their gains and become more reasonably priced (and some of the helium escapes!) they will be excellent long-term investments.

What Lies Beneath

While the stocks noted above have run far and fast thus far in 2023, another key concern is the narrow representation in the S&P performance. Traditional "defensive" sectors of the market that one would expect to hold their value if a recession is coming have lagged other sectors. Specifically, in terms of sector ETFs: Energy (XLE) -7.0%; Utilities (XLU) -5.8%; Healthcare (XLV) -4.0%; and Financials (XLF) – 3.07%.

Two sector ETFs that have posted positive gains mask underlying weakness because they are dominated by one or two individual stocks. Consumer Discretionary (XLY) is +24% Y-T-D; its two largest constituents are AMZN (25.4% weighting) and TSLA (17.8%). Again, their combined return EXCEEDS the return to XLY year-to-date by 5 full percentage points! Similarly, the Communications ETF (XLC) has returned 31% Y-T-D, while the top 5 constituents, including META (25% weighting), GOOGL and GOOG (25% combined), NFLX (5%) and CMCSA (4%) account for a gain of over 43%!

The take-away here is that stocks that have been running up have been doing so at a breakneck pace and virtually all are tagged with the "AI" badge. These select stocks are capturing the headlines and masking weakness across the broader market. Only in the last week has the Defense sector and some Industrials begun to rally to some small extent.

The other curious sector flying in the face of the common wisdom is Homebuilders. Ordinarily, recession clouds on the horizon and rising interest rates typically shut down the housing market and, consequently builders. In today's topsy-turvy world, the supply of existing homes available for sale is greatly constrained as homeowners with sub-4% mortgages are reluctant to confront today's 7% mortgage rates. Through April, sales of existing homes are down over 23%. At the same time, younger generations are in or approaching prime home-ownership years and the only inventory is new construction. As a result, despite all logic to the contrary, new home sales are up almost 12% and the Homebuilders ETF (XHB) is up 20% Y-T-D.[vi]

Not everything below the surface is sanguine!

Behavioral Considerations

The S&P 500has been positive for the past 4 weeks. Until the week ended June 10th, the Nasdaq had been positive for 6 weeks. Headline inflation appears to be moderating. The labor market and wages are showing some signs of slackening. The debt ceiling debate is no longer a headline obstacle and the regional banking fears appear to have abated.

Following a tough investing year in 2022, investors were quick to seize on the AI rally, providing a constructive reason to be increasingly positive on the markets. We are observing data points that appear to confirm our outlook and, for the past several weeks, the clouds on the horizon seem to be lifting. These circumstances often give rise to what Behavioral Finance experts term “recency bias” and “confirmation bias”. Specifically, we tend to hear and believe information that is consistent with our beliefs, suspending our objectivity. This can be even more pronounced when the preponderance of recent information tends to confirm our beliefs.

No one wants to miss out on the next leg higher in the market. Yes, **Fear of Missing Out (“FOMO”).**

Do not underestimate the power of this behavioral bias. Originally coined in 2004, the term refers to a phenomenon associated with social media networking sites. Initially, there is the perception that one is “missing out” on others’ engagements or activity on the site, followed by compulsive behavior to maintain those social connections. Numerous books, and articles have been devoted to comprehending the power of this psychological influence and how to overcome this tendency (bias). The SEC has even written about the topic in their Investor Education site, “Say “NO GO to FOMO”. [i]

With CNBC, Fox Business, Bloomberg, Yahoo Finance, Google Finance and Apple’s “Stocks” app pre-installed on iPhones, pretty hard to avoid stock market news. Then there are the quips by friends, golf or pickle-ball partners, “ did you see XXX? Up 32% last week!” Very easy to find yourself hearing what you want to believe and feeling like you are missing out!

However, what if the preponderance of information, when viewed objectively is not as “bullish” as we seem to think? Mega-Cap tech stocks have powered higher at an astonishingly rapid pace, masking tepid performance from large parts of the stock market or even other stocks within sectors that are dominated by 1 or 2 high-octane names. With the major market indices hitting fresh highs for the year, nearly 48% of stocks remain BELOW their 200-day average.[vii] FOMO is a powerful sub-conscious motivator to jump on the bandwagon, often just as the momentum turns the other way.

As investors, it can be frustrating to feel like you are not participating as fully in the run-up as you think you should; however, as investors, the job is to invest for the longer-term and not get caught up in the headlines and social media posts about the “new” bull market. Invest in strong companies with good balance sheets, dominant market positions in their industry and generating strong positive cashflows. Sure, some of these stocks will perform like rocket ships at times, while others will languish, but it is important to remember that the market of stocks is cyclical and goes through periods of consolidation, with leadership rotating among different sectors based on investors' collective view of the prospects for the economy and a company in particular.

While the Mega-Cap technology stocks are providing much needed leadership, now is a time to tread carefully until other economically sensitive sectors of the market catch the wind in their sails. Opportunity cost is a lot cheaper than investment losses.

All the best,

Jim

James W. Graves
Managing Director

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[i] https://www.ncbi.nlm.nih.gov/pmc/articles/PMC8283615/#:~:text=Fear%20of%20missing%20out%20(FoMO,to%20maintain%20these%20social%20connections.
[ii] https://www.slickcharts.com/sp500
[iii] https://www.barchart.com/my/watchlist?viewName=39611&orderBy=symbol&orderDir=asc
[iv] https://www.spglobal.com/spdji/en/indices/equity/sp-500/#overview
[v] CNBC broadcast 6-12-2023
[vi] Source: barchart.com
[vii] https://www.barchart.com/stocks/quotes/$MMTH/technical-chart