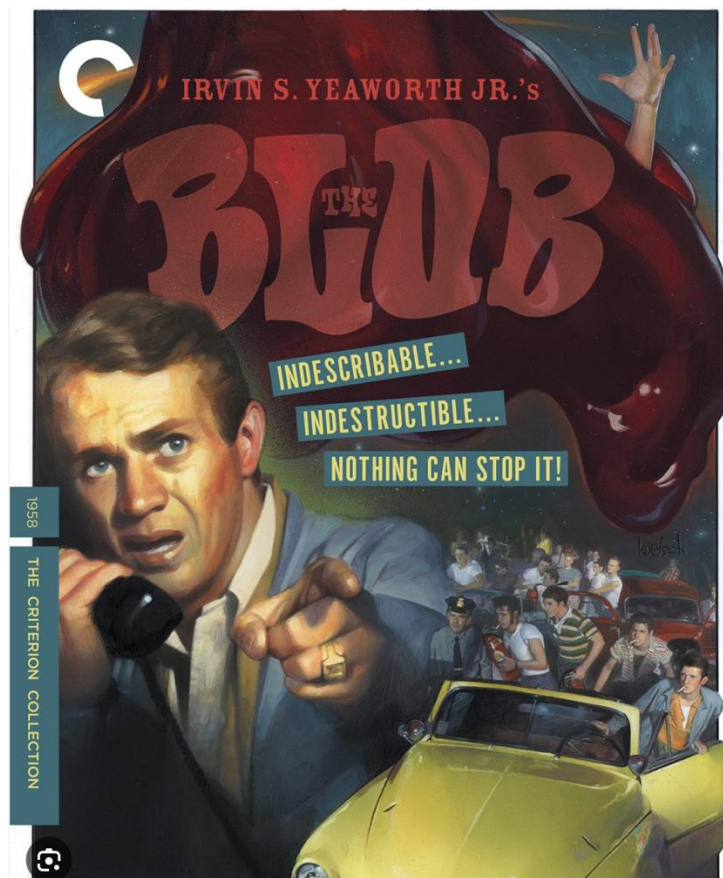




The Blob



Indescribable, Indestructible, nothing can stop it!

In 1958, a meteorite crashes to the ground in rural Pennsylvania releasing a small jelly-like globule of a blob, that consumes all living things that it touches. As it slowly oozes into town, growing larger with each individual it comes in contact with, we wonder if there is anything that can stop it.

Today's "Blob" is a bit different than our classic horror movie Blob, but it is still causing fear and concern among many. The "Blob" I'm referring to today goes by several names, The Magnificent Seven, The Mega-Cap Eight, The Super Six, or more simply The Top-10. These are the ten largest stocks in the S&P 500 by market capitalization.

As of 1/29/24 they were:

| Company | Market Capitalization | % of S&P 500 |
|---------------------------|-----------------------|--------------|
| Microsoft | \$3.033 T | 6.06% |
| Apple | \$2.944 T | 5.88% |
| Alphabet (Google) | \$1.910 T | 3.82% |
| Amazon | \$1.648 T | 3.29% |
| NVIDIA | \$1.518 T | 3.03% |
| Meta Platforms (Facebook) | \$1.025 T | 2.05% |
| Berkshire Hathaway | \$828.02 B | 1.65% |
| Eli Lilly | \$611.82 B | 1.22% |
| Tesla | \$601.58 B | 1.20% |
| Broadcom | \$566.07 B | 1.13% |

-J.P. Morgan Research

The fear comes from a concern that these ten behemoths have an outsized influence on the S&P 500, the U.S. stock market, and the Global stock market. That they have grown so large that they jeopardize our current bull market.

How large has this “Blob” grown? As of the end of 2023, the top 10 stocks accounted for a historically high 32.1% of the S&P 500.

Weight of the top 10 stocks in the S&P 500

% of market capitalization of the S&P 500



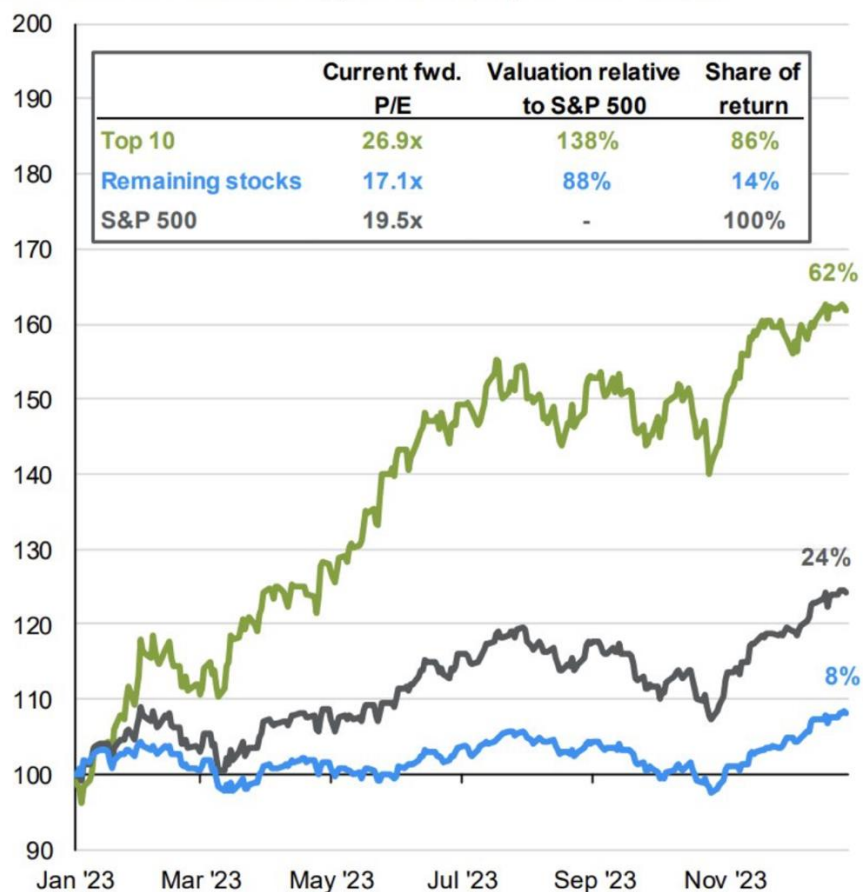
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The 2,000 stocks in the Russell 2000 Small-Cap index combined are smaller than Microsoft or Apple. Microsoft or Apple are larger than the entire Energy sector, Real Estate sector, Materials sector, or Utilities sector. The MSCI All-World Index has a higher weight in these Top-10 companies than its weight in Japan, United Kingdom, China, Canada, and France **combined**.

Last year these ten stocks accounted for 86% of the S&P 500's 26% total return.

Performance of the top 10 stocks in the S&P 500

Indexed to 100 on 1/1/2023, price return, top 10 held constant



-J.P. Morgan Research

We've experienced concentration in the Top 10 stocks before; we had the Nifty 50 back in the 1960's, the energy giants in the 1980's, and the Dot-com bubble of the late '90's. Each of these historic periods of concentration were eventually followed by the subsequent collapse of these behemoths. Is this time different?

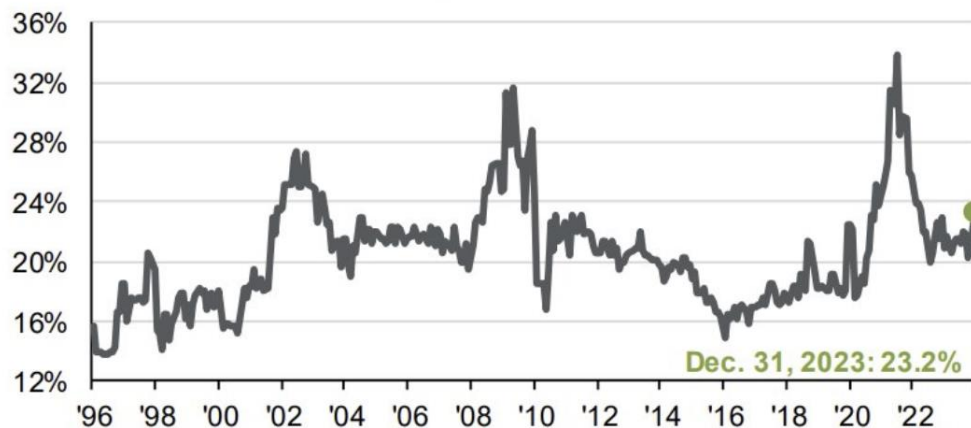
It is said that "It's different this time", are the four most dangerous words in investing, but in reality, it's always a little different. One of the things that makes this time different is the profitability and growth prospects of these companies. The Top-10 have an average profit

margin of 25.7%, which is more than double the S&P 500's average of 11.6%. As the chart above shows, this higher profit margin is being rewarded with a higher Price-to-Earnings ratio of 26.9x versus the other 490 stocks at 17.1x.

The chart below shows the Top-10's contribution to overall trailing earnings in the S&P 500. What you notice here is that in periods of economic distress (2002, 2008-09, & 2021) when earnings collapse, the Top-10 have a higher overall weighting. This is one of the reasons money is flowing to these names today...they are thought of as the safe haven.

Earnings contribution of the top 10 in the S&P 500

Based on last 12 months' earnings



-J.P. Morgan Research

Another way of looking at these huge companies, with wide competitive moats, is that they are the waterfront property of the stock market: always in demand, prone to getting overpriced, susceptible to occasional storms. Highly desirable real estate always sells at a premium due to its scarcity and quality.

Today's Top-10 are the "Quality" stocks of the S&P 500; they have the highest margins, highest cash flows, and strongest balance sheets. This has made the overall S&P 500 more of a quality index – less cyclical but also more expensive. Quality is trading at a rich premium to its history, but the story is equally about defensiveness as it is growth. This Blob doesn't fit the narrative of a dangerous speculative melt-up, it feels more defensive.

In our classic horror movie, the locals tried to kill the Blob with bullets, fire, and electricity to no avail. Eventually discovering that the only thing that stops the Blob from growing is freezing it.

Can anything stop the markets Blob? Yes, but what and when? It could be creative destruction, as new competitors rise up to take share. It could be that they collapse under the sheer weight of their valuations (no trees grow to the sky). It could be from government intervention. Or, like our movie Blob, it may be from the freezing of a global recession. Time will tell. None of this is a

recommendation to buy or sell any of these stocks, I'm just making you aware of a major force impacting the markets.

Market Update:

Looking at the broad market, 2024 is off to a pretty good start, the S&P 500 made new highs and was up 1.59% for the month of January. But like 2023, most of this outperformance came from our "Blob" stocks. The tech heavy NASDAQ is up 1.82%, while the equal-weighted S&P 500 is down -0.58%, and the Small-cap Russell 2000 is down -3.90%.

On the fixed-income front we saw the 10-year Treasury yield rise from 3.86% to a high of 4.18%, only to settle at 3.96%. Chairman Powell of the Fed said that our first rate cut probably won't happen in March, since the economy continues to be fairly strong and inflation is still above the Fed's 2% target. The U.S. Aggregate Bond Index was down -0.15%, High-Yield returned 0.12%, and money market funds returned about 0.45%.

As always, be careful out there.

Chris Wiles, CFA



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