June 2024 Market Commentary

Simple Man

Forget your lust for the rich man's gold
All that you need is in your soul
And you can do this, oh, baby, if you try
All that I want for you, my son, is to be satisfied
And be a simple kind of man
Oh, be something you love and understand
Baby, be a simple kind of man
Oh, won't you do this for me son, if you can?
https://www.youtube.com/watch?v=Mqfwbf3X8SA
Lynyrd Skynyrd – Simple Man

I'm not sure what it is about human nature, but for some reason we often equate complexity with brilliance. We prefer the complex to the simple and understandable. But over the years, the brightest people I have met have one thing in common…the ability to make inherently complex things simple and understandable.

There are individuals and firms in the investment management business, who invest enormous sums, to convince you that investing is so complicated that you can't possibly do it without their complicated models, jargon, or advice. The hard truth is that investing is built on the foundation of some rather simple rules:

- Understand your emotional strengths and weaknesses.
- Build a portfolio that protects you from your weaknesses, and maximizes your strengths.
- Think like an owner, not a trader.
- Make time your ally, allow the power of compounding to work its magic.

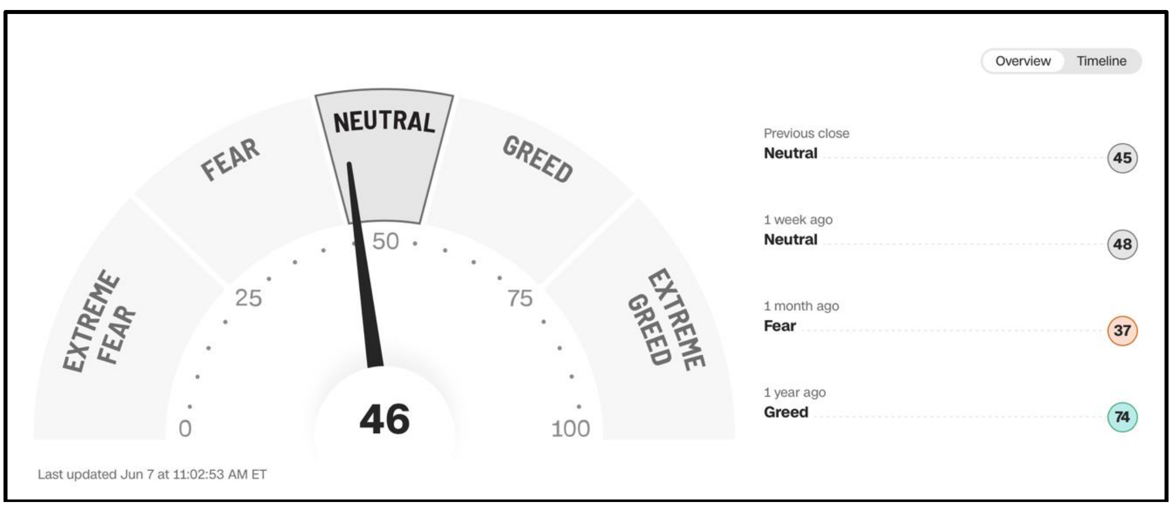
Simple doesn't necessarily mean easy though. Emotions are very powerful forces, and it can take decades to understand our own emotional tendencies. The two basic human emotions are Fear and Greed.

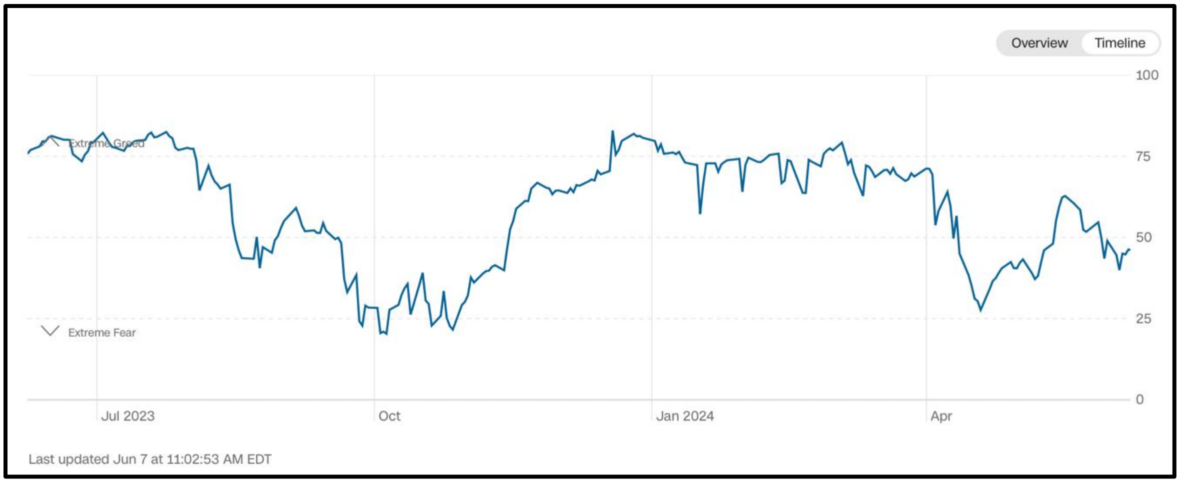
Fear is generally thought of as the fear of loss, but it is also the fear of volatility, and has even morphed into the fear of missing out (FOMO). If you are a long-term investor, the only fear you should really be concerned with is the fear of loss, permanent capital loss. Volatility is actually a long-term investors friend; it creates opportunities for you to capitalize on others' emotions. And FOMO is really greed masquerading as fear.

Greed is more complicated than fear. As Gordon Gekko taught us in Wall Street, ***"Greed is good. Greed is right. Greed works. Greed clarifies, cuts through, and captures the essence of the evolutionary spirit. Greed, in all of its forms…greed for life, for money, for love, knowledge…has marked the upward surge of mankind."***

Where greed becomes a problem is when it crosses "the line". That "line" is different for different people, but generally if you are putting a significant amount of your capital at risk of permanent loss, you've let greed get the best of you.

One of the indicators I like to look at to take the pulse of the markets current state of fear and greed is the CNN Fear & Greed Index.



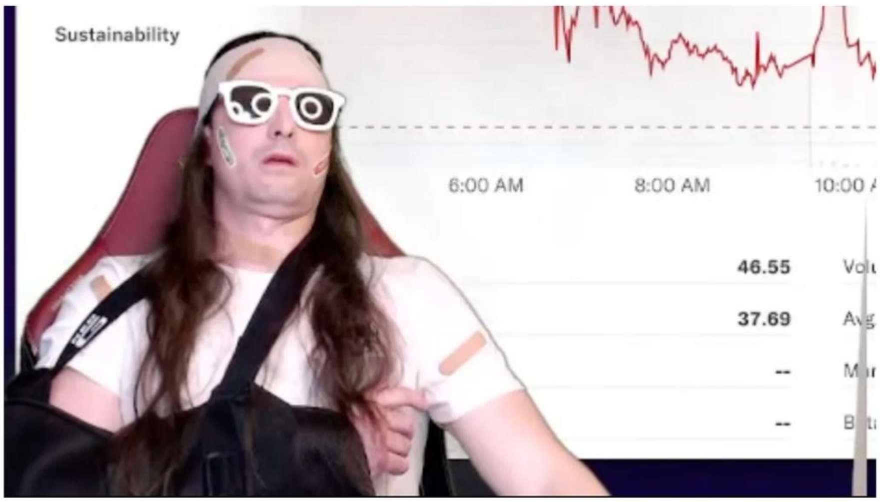


This index currently shows a Neutral reading of 46. Historically it's been a pretty good indicator at the extremes. When market participants are at extreme fear it's generally a good time to become more bullish, and when market participants are at extreme greed its usually a good time to get defensive. As Warren Buffett says, *"Be fearful when others are greedy, and greedy when others are fearful."*

There are other forces at work that play into people's willingness to be more greedy or fearful, and one of those is desperation. I've written before about the emotional toll inflation plays on investors. When inflation is high, individuals obviously struggle to keep up. This struggle often manifests itself in an increased level of desperation and risk taking. We have clearly seen this happening more frequently, with an increased rise in option trading, penny stock trading, and Meme stock trading.

Roaring Kitty (real name Keith Gill) has reemerged recently to send GameStop on another wild ride. His followers call themselves “Degen” which is a self-deprecating identity traced back to “degenerate gambler”. These individuals openly state that they feel that the only way they can possibly get ahead is by gambling, taking inordinately large risks for the potential of hitting the jackpot.

<u>Roaring Kitty Gets Rekt</u>



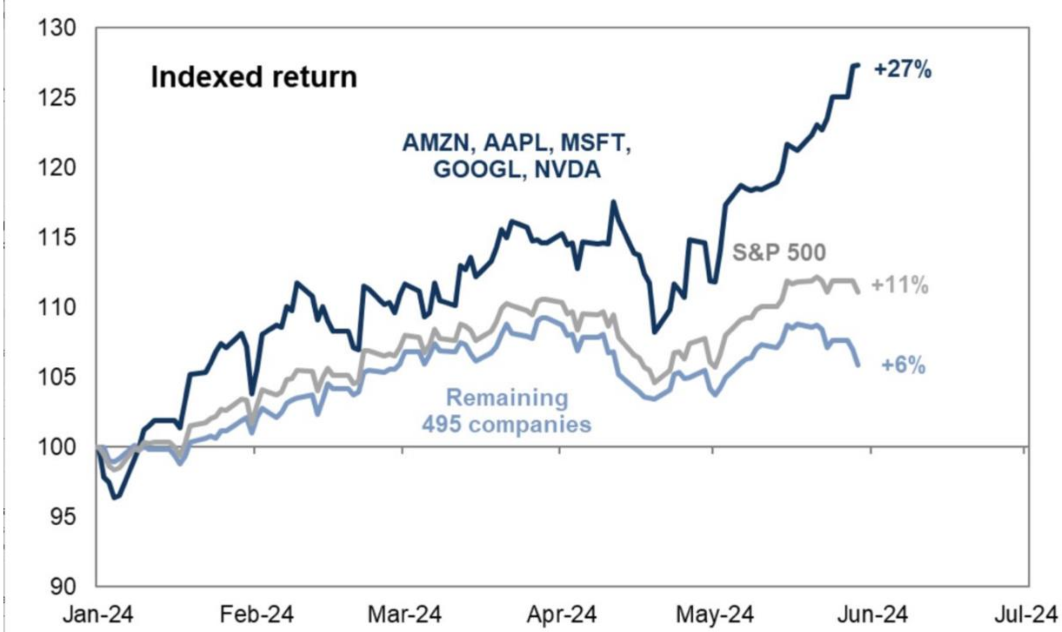
Roaring Kitty during his June 7, 2024 livestream. Image: YouTube

One of the things we try to take advantage of in our equity portfolios is the market’s volatility and the volatility in individual stocks we own. We assign a target weight to each stock, and when the market moves that stock, we review it and determine whether we should adjust our target, or buy or sell depending on the price move. This is just one way to use the markets fear and greed to your advantage.

The trick to this seemingly easy analysis is that sometimes there are very good reasons to be fearful and very good reasons to be greedy. Just look at the current boom in artificial intelligence (AI). Where do we draw the line between the good greed that Gordon Gekko preached about, and the excessive greed that’s going to blow holes in many portfolios?

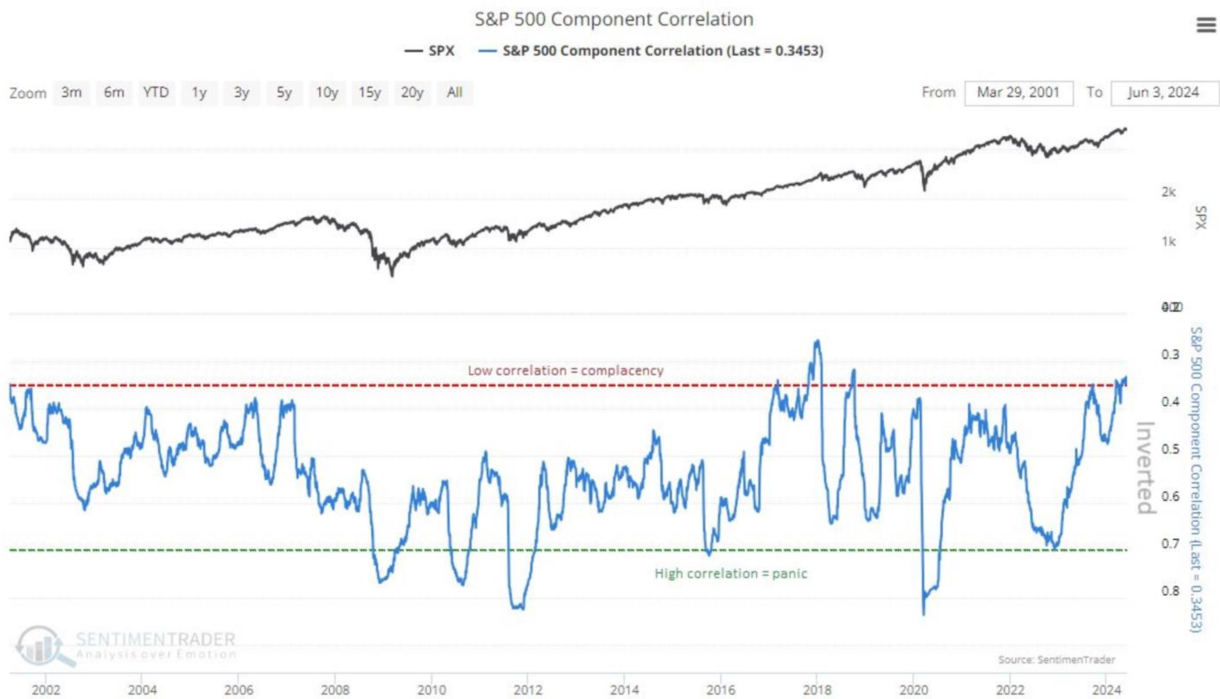
Clearly AI is going to change, mostly for the better, many aspects of our lives. It’s going to distort economic data; unemployment may go up but productivity may go up faster causing GDP growth to accelerate. It may foster new drug discoveries, new energy discoveries, and greater overall efficiencies. It will certainly disrupt many entrenched businesses. How much should we be willing to pay for these stocks? Separating the reality from the hype is the art.

To put things in perspective: The bulk of the S&P 500's performance so far this year has come from five tech heavyweights; Amazon, Apple, Microsoft, Alphabet, and Nvidia. This tech group of five has gained 27% year-to-date. The rest of the S&P 500, the other 495, is up 6%, while the equal-weighted S&P 500 is up only 5.6%.

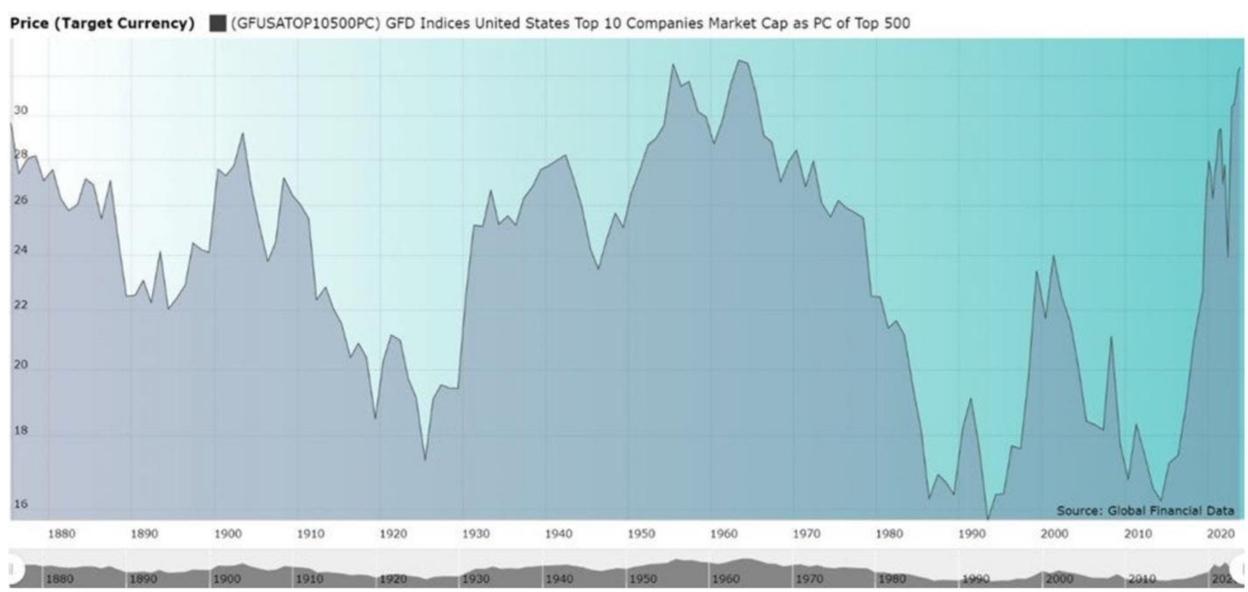


Source: Goldman Sachs Global Investment Research, Daniel Chavez as of 5/31/24. Past performance is not indicative of future returns.

Market concentration like this usually means we also have low correlations between stocks. In other words, stocks are not all moving in the same direction. This is a pretty good indicator of complacency, and a decent indicator of a near-term market top. This indicator works very well identifying buying opportunities during panics, when all stocks all sold together (i.e., March 2020 Covid bottom).



It's been a very long time since we've had so much of the market dominated by the 10 largest companies. We reached similar levels of concentration in the 1950's and 1960's. While many investors usually think of elevated concentration as a sign of downside risk, Goldman Sachs has found that the S&P 500 rallied more often than it declined during the 12 months following peak concentration. Even the 1964 peak found that the ongoing bull market continued to move higher as market concentration declined.



Here is a list of the top 10 companies in the S&P 500 as of June 7, 2024. These 10 companies now account for 36.10% of the entire S&P 500. It's hard to wrap your head around just how large the top three are…more than 5x the size of lowly #10 JPMorgan!

S&P 500 Top Ten Holdings		
1	Microsoft	7.00%
2	Nvidia	6.64%
3	Apple	6.27%
4	Alphabet (Google)	4.26%
5	Amazon	3.75%
6	Meta Platforms	2.41%
7	Berkshire Hathaway	1.66%
8	Eli Lilly	1.48%
9	Broadcom	1.37%
10	JPMorgan Chase	1.26%
	Total Top 10	**36.10%**

There are some really interesting forces at work in the markets today, powerful forces like inflation and artificial intelligence. These forces are impacting both individuals and investors behavior in ways we haven't seen before, making economic data less reliable when compared to history.

Our key has been to simply focus on those companies who've proven their ability to manage through nearly any environment. As Damon Runyon so eloquently said, ***"The race is not always to the swift, nor the battle to the strong, but that is the way to bet."*** In a world with increased uncertainty this makes the most sense to us. This is no time to bet on a turnaround or an up-and-comer, give us a proven entity.

Boy, don't you worry, you'll find yourself
Follow your heart and nothing else
And be a simple kind of man

As always, be careful out there.
Chris Wiles, CFA

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