Market Update:

February 14, 2024

Yesterday's inflation data sent equity markets sharply lower in the biggest downward move for the market so far this year. For the vast majority of stocks, the year has gotten off to a soft start. The equal weighted Russell 1000 was down by 2.56% YTD through yesterday. The Russell 2000 index of small cap stocks was down 3.02% YTD and remains more than 15% below its peak level reached in 2021. Even prior market leaders Apple (-3.76%) and Tesla (-25.95%) are not performing in today's market. But the overall market level is up due to a narrowing number of large cap tech stocks that have seen outsized gains, with a few names tied to the AI theme going parabolic in recent weeks.

Amazon and Facebook soared following their respective earnings reports, and Nvidia is yet to report Q4 earnings but has outpaced its mega-cap rivals. In each case, insiders have responded by unloading a meaningful share of their holdings. The relative performance of these names has led to the highest concentration ever in the S&P 500, with the top 5 names now accounting for nearly 25 percent of the overall market. That compares to about 18 percent at the height of the dot com bubble in 1999/2000. The bottom line is the market is very narrow, has been driven by a narrowing number of names that have very expensive valuations, and the overall market will be vulnerable to changes in speculative intensity amongst these top names.

The recent GDP and employment reports showed robust activity. These reports along with the theme of moderating inflation and the Fed projecting a series of interest rate cuts has led market participants to largely abandoned fears that the economy will experience a recession in the coming year. But yesterday's inflation report showed stickiness within core services inflation. That trend will likely persist until there is further slowing in economic activity and labor demand. The primary reason that economic performance has appeared as resilient as it has in recent quarters has been due to ever growing deficit spending by the federal government. The federal deficit exceeded overall economic growth during the fourth quarter, and debt outstanding rose in excess of deficit spending for the quarter. Nobody knows exactly where a tipping point might be, but this is clearly unsustainable.

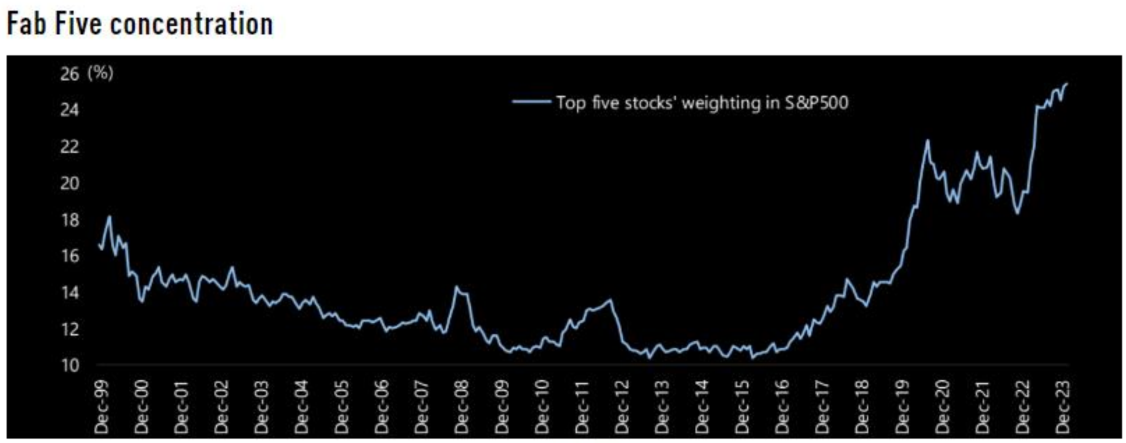
For the past 6 months government, education and healthcare employment have been the dominant drivers of job growth, accounting for over 50 percent of total payroll gains. That is not a typical mix of job gains in the robust economic environment implied by GDP gains over the past couple of quarters. The household survey of employment suggests that labor market conditions are not as robust as the payroll numbers imply, with full-time employment down over the past year while part-time employment and multiple job holders have risen. Leading economic indicators remain very weak, and persistent inflation will preclude the Fed from pre-emptively cutting interest rates. ***We continue to believe recession odds remain elevated and markets are now much more vulnerable as they have moved to dismiss that likelihood.***

China, the second largest global economy, is under severe pressure. The weakness reflects a number of factors, but excessive bank credit growth and overinvestment in the property sector are amongst the major economic imbalances China faces. Property giant Evergrande was ordered to liquidate in late

January, leading to some contagion across the Chinese markets as they accelerated sharply lower. The divergence between the US and Chinese markets is palpable, and many of the tech companies that have been market drivers have significant exposure to China.

We continue to think we'll have a very volatile year in 2024.

Chart 1. Record level of concentration in the top 5 stocks, far surpassing the dot com bubble in 1999/2000. Leadership in the group is changing with Apple and Tesla lagging.

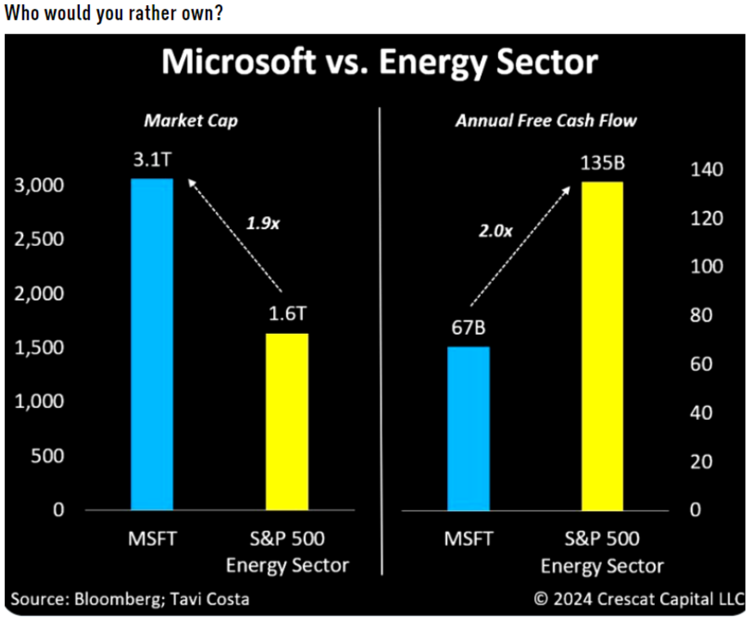


Source: Jefferies

Top five stocks' weight in S&P500.

Chart 2. Microsoft, arguably the best value of the megacap names, nevertheless is valued at roughly 2X the entire energy sector while generating half the free cash flow of energy.

Who would you rather own?



Source: Crescat

"With a $3 trillion market cap, Microsoft is twice the size of the entire energy sector in the S&P 500, which generates double Microsoft's annual free cash flow."

Chart 3. NVidia has become one the favorite AI names in the market, contributing to the parabolic path in its share price. In the past 2 months its value has increased more than the value of TSLA and is valued equal that of the entire Chinese equity market

Smells like drunken bullish frenzy

Source: Refinitiv

1. NVDA market cap up one whole TSLA over the past 2 months.
2. NVDA market cap is now same as China stock market (H shares worth around $1.7tn).
3. 200 day moving average $265 lower...

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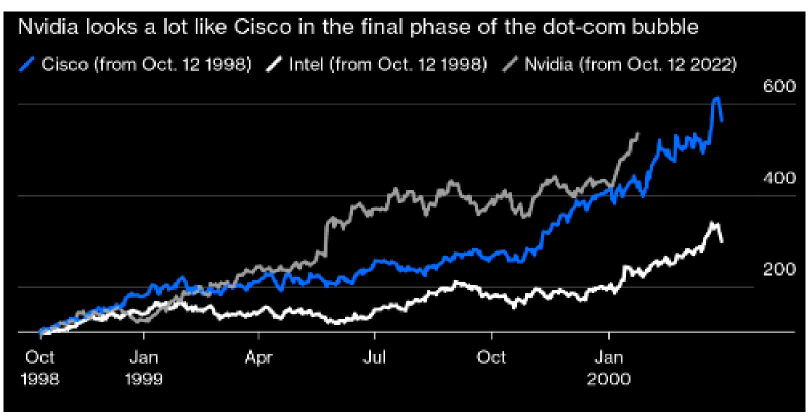
Chart 4. NVidia comparison to Cisco and Intel in the late stages of the dot com bubble.

NVDA - Cisco flavor?

There are some similarities...



Source: Bloomberg/Authers

Chart 5. Earnings releases have lifted individual stocks but not the market. 2024 earnings expectations have been falling since September, and Q4 reports did little to change the trajectory.

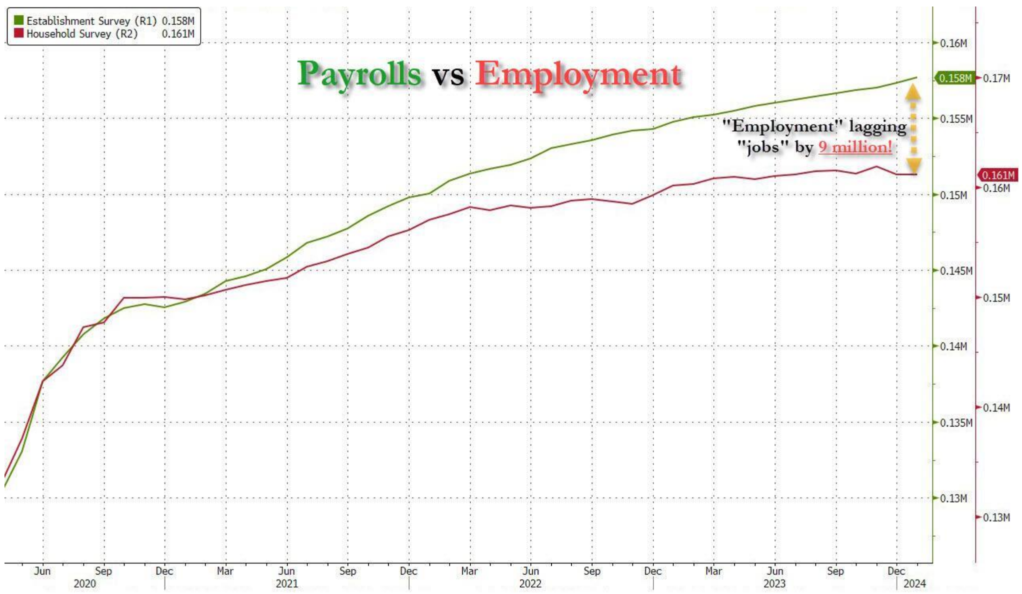
EPS new fresh lows

Source: Datastream

Chart 6. This chart preceded the CPI report yesterday, but it shows on average a flat year for the average large cap stock prior to yesterday's decline.

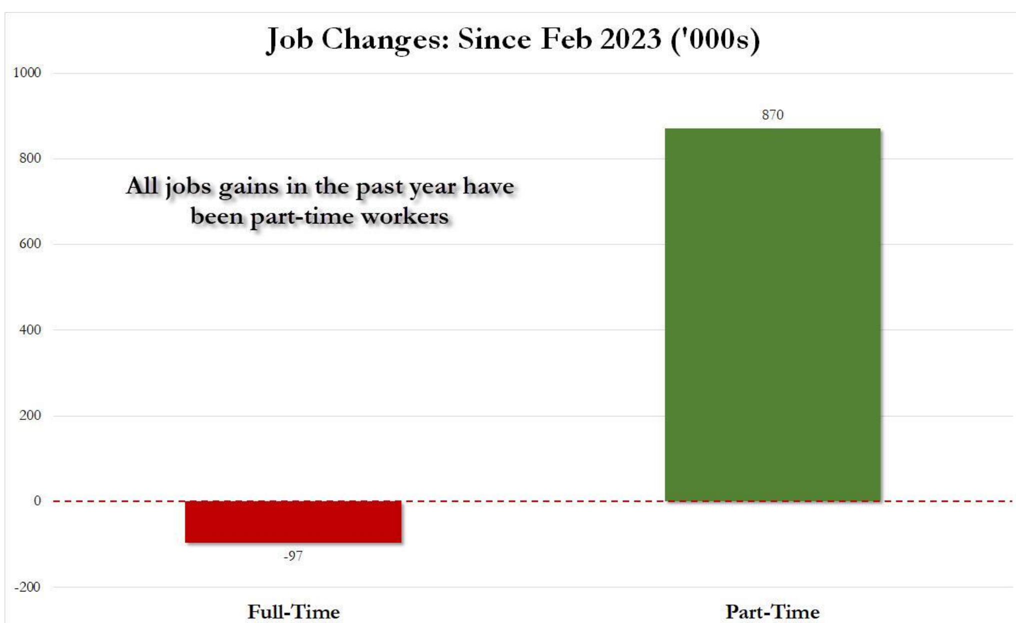
Source: ZeroHedge

Chart 7. Payrolls were reported up by a much better than expected 353K in January. Government, education, and healthcare have been the primary sources of employment growth for the past 6 months.



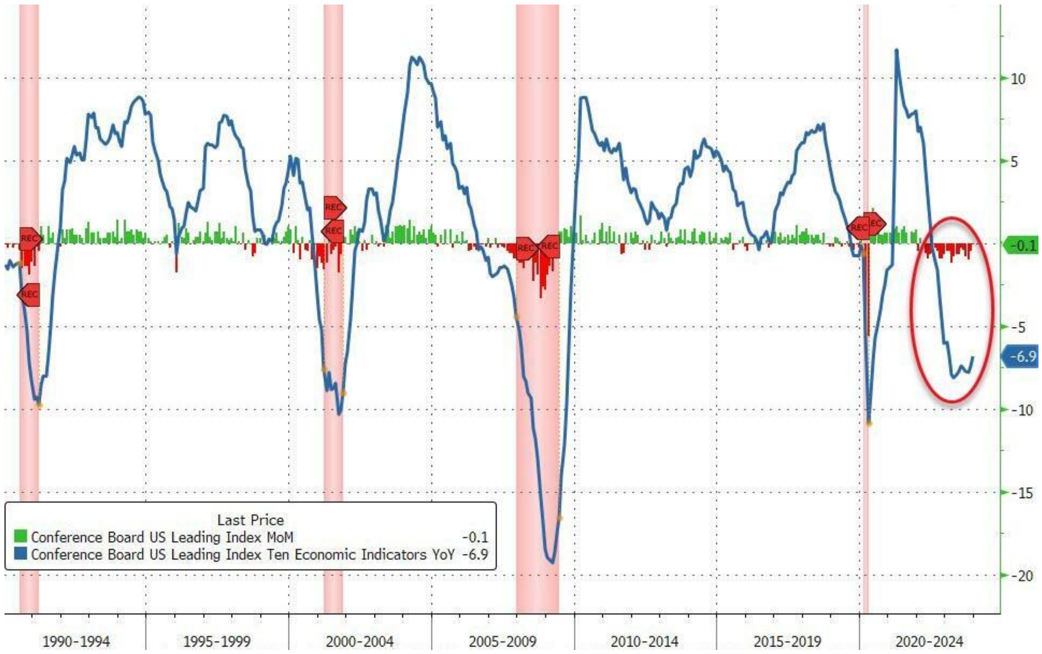
Source: ZeroHedge

Chart 8. The household survey has diverged negatively with payrolls, perhaps reflecting the jump in part-time work and multiple jobholders (counted only once as an employed person).



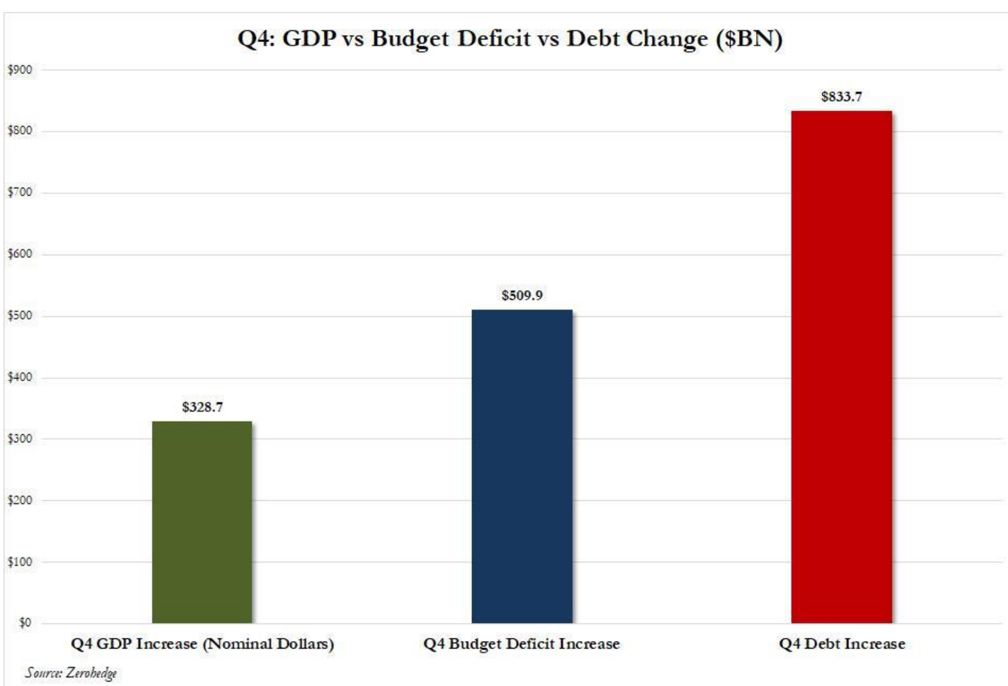
Source: ZeroHedge

Chart 9 – Leading economic indicators continue to point toward weakness.



Source: ZeroHedge

Chart 10 – The large increase in deficit spending by the Federal government in Q4 is the story behind the economic resilience and "American exceptionalism" the press is reporting regarding economic performance.



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