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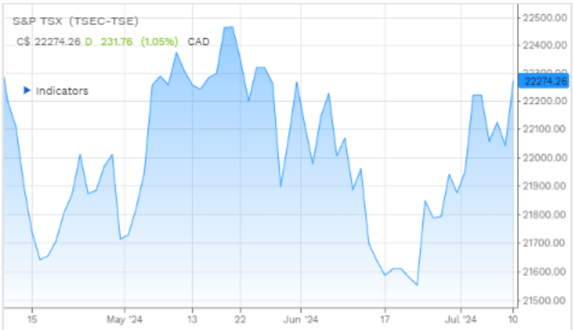
Thursday, July 11, 2024

Second Quarter 2024

The second quarter was much like the first in that the few mega cap growth stocks powered the S&P 500 and the NASDAQ indices to new highs. Indices not dominated by giant technology companies, such as the Canadian stock market, went mostly sideways in the second quarter, consolidating their gains from the first quarter. In both Canada and the U.S. sectors such as Financials, Health Care, Real Estate, and Utilities were weak in the second quarter.

An interesting comparison can be made between the S&P 500 illustrated on the left with the Vanguard Exchange Traded Fund (VOO) and the Invesco S&P 500 Equal Weight ETF (RSP) on the right. Over the last three months the S&P 500 went steadily higher, the equal weight version went sideways.

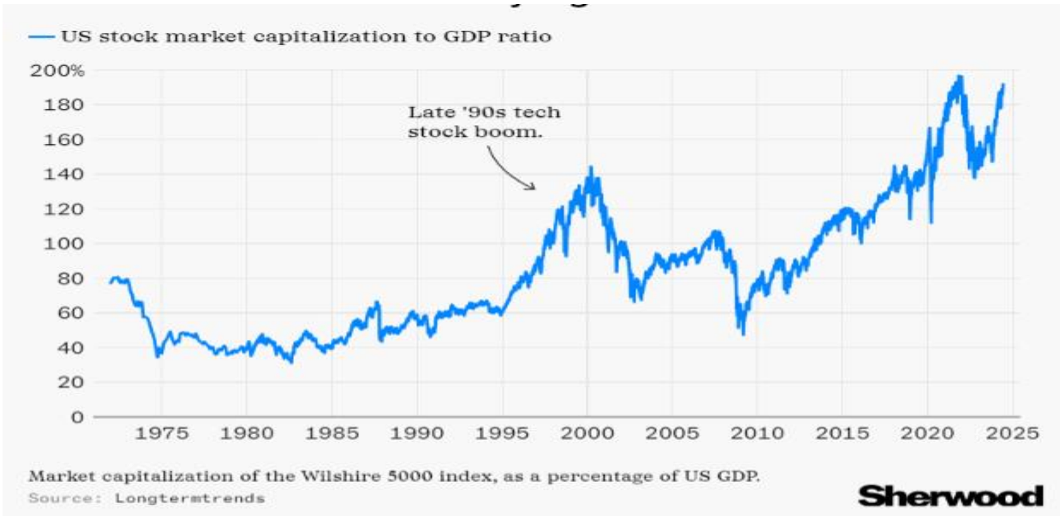
The S&P 500 Index is a capitalization weighted index so the more a stock goes up, the larger percentage of the index it becomes. The half dozen largest companies now make up about 30% of the S&P500. The equally-weighted S&P 500, where each of the S&P 500 stocks carry the same weight, is a better representation of how the average stock has been doing. Canadian stocks, illustrated by the S&P TSX on the left and the Dow Jones Industrial Average of 30 U.S. blue chips on the right, appear much more like the average S&P 500 stock.



Derek Horstmeyer, writing in the Wall Street Journal (July 3rd) "explored how the composition of the S&P 500 has shifted over time. In the 1970's, industrials and materials made up 26% of the S&P 500, but this has decreased over time and now stands at just 10.6%. Conversely, information tech and financials made up 13% of the S&P 500 in the 1970's before becoming the dominant sectors. Today, financials and information tech comprise 42% of the index by weight, with tech representing 29 percentage points of that figure. In fact, 6 of the top 7 positions in the S&P 500 by weight are in the tech sector currently. This means that investors' largest risk in holding the S&P 500 is the same as holding tech firms directly – interest-rate risk, lofty price valuations and heady growth rate expectations." To badly paraphrase Winston Churchill, never in the field of investing was so much owed by so many to so few.

On June 18th Fundstrat set out the dilemma confronting investors now. On the one hand cash and money market funds hit a record of $6.12 trillion U.S. in June. Investors are understandably comfortable with the 5% return on U.S. cash. A portion of this cash presumably could be tempted into stocks when the long-awaited cuts in the Federal Reserve's short- term interest rates occur.

On the other hand, the huge gains in the giant tech stocks have made the U.S. stock market expensive. Warren Buffett made famous what became known as the 'Buffett Indicator' in an article in Fortune in 2001, after the internet tech stock boom. The last time I used this indicator, in April of 2009, it was to illustrate how cheap stocks were after the financial crisis. Fundstrat used it last month; "The indicator is the total stock market capitalization – i.e., the total value on paper of the stocks that are publicly traded – as a share of GDP. At least according to the Buffet Indicator, stocks seem to be overvalued. That is not a reason to sell, as, for the largest companies, globalization has expanded profit-making opportunities to the entire world, meaning that the U.S. economy may no longer be the best denominator in Buffett's equation…Still, amid all the AI-related excitement, Buffett's commonsense stat may be worth casting an eye on once in awhile." (Fundstrat, June 18)



For most of the last ten years, in early July I have run the TRY (Training Regatta for Youth) at Pointe Claire Yacht Club. Last week we had 100 kids between 8 and 19 years old competing in four classes of sailboats in the biggest youth regatta in the Montreal area. In addition to 100 young sailors, we had 45 volunteers and many spectators. As is often the case, now I need a holiday after my holiday. Fair winds to you. Thanks for reading.

Sincerely,

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Please visit us at www.georgestedman.com