Time: Long and Short **Q2 2024**

As must have been observed and puzzled over throughout the ages, the days are long, but the years are short. Somehow, we're already halfway through 2024. And it was a great half for a handful of mega cap tech names. Nvidia, Alphabet (Google), Microsoft, Meta (Facebook), and Amazon accounted for nearly 60% of the S&P 500's 15% year-to-date return. That's unusual but not unprecedented. Remarkably, Nvidia alone produced 30% of the entire gain. Our friends at Empirical Research Partners calculate that Nvidia's contribution is the largest in the last century. That's saying something, and we'll dig a bit further into that shortly. But first we'll finish the quarterly house-cleaning. The S&P 500 returned just over 4% for the second quarter, but would have been down 1% without the Magnificent 7's (the above-mentioned stocks plus Apple and Tesla) 17% advance. Small caps declined 3% in the quarter and are up only 2% for the year. Bond returns were slightly negative in the quarter as the 10-year U.S. Treasury bond yield rose modestly.

The concentration of equity returns echoes last year, so let's put the whole period in context. The average stock really hasn't gone anywhere since the Fed began raising rates in early 2022…while the Magnificent 7 are up almost 70%. I doubt very seriously that any pundit predicted such a lopsided outcome, but that doesn't mean it's illogical. The Fed's about-face on inflation and panicked rate increases was time-tested, rally-killing medicine, bringing fears of recession top of mind. Naturally, most stocks struggled, and continue to do so as inflation remains above target and the Fed has yet to relent on rates. The potential of artificial intelligence (AI), on the other hand, has set a select few companies free from earthly concerns.

Because delivering AI as a service requires billions of dollars of investment in cutting edge computing capacity, the dominant cloud providers (Alphabet, Microsoft, Meta, and Amazon) plus a select few others we believe are the only companies capable of making such a commitment. Several are already incorporating AI add-ons into their product offerings. As to the revenue and profit potential of AI as a software service, only time will tell. It's just begun, and projections, in our opinion, aren't worth much.

But backing up just a little, Nvidia changed the game. Nvidia's leap forward in GPU (graphics processing units) capability touched off a new era of machine learning and AI, heretofore not possible. Just a little over a year ago Nvidia's data center business was projected to have annual revenues of around $12 billion, give or take. Over the next twelve months it will be closer to $100 billion. Never in the history of markets has a big business grown at that rate. Not even close. The number is so overwhelmingly large that investors can't help but believe the AI promise is enormous, despite it's nascency. The feeding frenzy around Nvidia is taken as proof-positive that AI is gonna be huge. Not only is the cart before the horse, we're not even sure there is a horse. But there certainly is something; we just don't know what. Is the market justified in its exuberance? Maybe. One can imagine miracles, and much darker things.

But let's plant our feet back on firmer ground. First quarter earnings were generally solid with most businesses posting revenue growth and some margin expansion. Second quarter earnings are likely to show a similar trend as real time measures of the economy show it continues to grow. Our view remains that interest rates at current levels will gradually slow growth and bring inflation to the Fed's 2% target. We're close to a Fed rate cut—likely sometime before the end of the year. If we don't end up falling into recession, something we still believe can be avoided, then a seismic change in market leadership is possible. The market's performance concentration won't last forever. When everybody's on one side of the boat, a stampede to the other is more likely. The Forgotten 493 (S&P 500 minus Mag 7) plus a multitude of smaller businesses might just catch a bid as it becomes clearer that this economic cycle has legs.

Finally, a couple of thoughts on the election. First, neither candidate has shown any interest in our ruinous fiscal deficits, so don't expect fiscal austerity to kill the economic expansion. And, I hate to say this, but the days are likely to get really long as November approaches.   But it'll only be a short time before we're in 2025. Enjoy the summer!

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