Managed Asset Portfolios

MAP VIEWS

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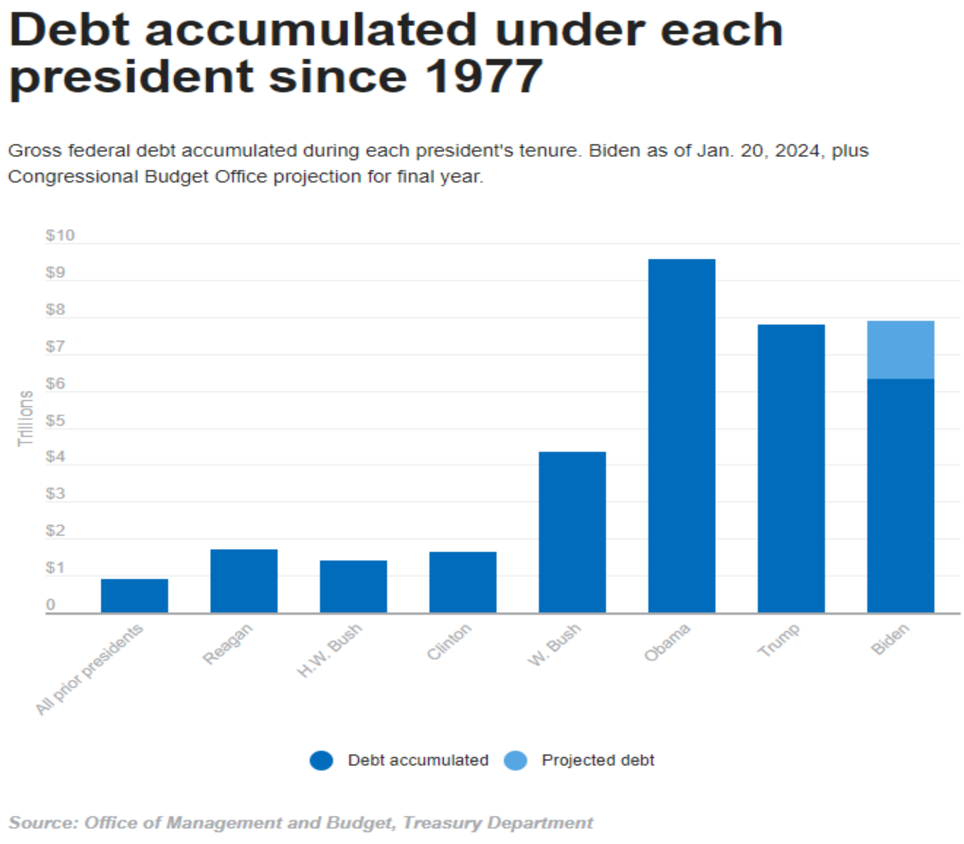
Stocks powered ahead during the first half of the year on the back of an unprecedented advance by Nvidia, despite a rise in interest rates. During the year's first half, the S&P 500 advanced about 15 percent, with about one-half of that return coming solely from Nvidia. Furthermore, AI-themed stocks have contributed to half of the returns of the MSCI ACWI. Remarkably, Nvidia's market capitalization at the end of the quarter exceeded $3 trillion. To put this in perspective, Nvidia has added more market capitalization in six months than the legendary investor Warren Buffet has generated for Berkshire Hathaway in his entire career.

Make no mistake: Nvidia is an incredible company. Their chips are the backbone of the Artificial Intelligence (AI) movement. Their earnings reports have been stellar: incredible top-line growth, margins, orders, etc. On the negative side, approximately one-half of their revenues come from just seven customers (including Microsoft, Meta, Alphabet, Amazon, and Telsa). Nvidia chips cost between $20,000 and over $80,000 each. This cost limits their potential customer base to only the biggest and best-capitalized companies. Currently, Nvidia has no direct competitors, which means they have enormous pricing power. Advanced Micro Devices and Intel are working on competing products, but it will be a while before they are true competitors because of a software advantage Nvidia has developed. We believe the more significant threat is from customers such as Meta, Amazon, and Alphabet designing their own AI chips. While it appears that Nivida still has a couple of years of advantage over its competitors, with gross profit margins north of 75 percent, its customers will surely welcome competition, which will eventually take pricing, and therefore Nvidia's margins lower.

At the mid-point of the year, interest rates were higher than at the start, but they have pulled back a bit from the peak levels of April, as some view the economy as beginning to slow. While there have been some cracks appearing in the economy, particularly when it comes to the working-class consumer, such as in new home sales, retail sales, unemployment, and manufacturing, there have been glimmers of hope in other areas. Higher-end wealthier consumers are also faring better than their lower income counterpart.

The political parties will begin hosting their respective national conventions, with the Republican National Convention scheduled for the week of July 15, 2024, embarking on the homestretch to the November elections. We are not going to forecast the outcome of elections, as even professional pollsters have challenges accurately predicting their outcomes. With the caveat that there is the potential for the candidates to change prior to the election, this election is unique, as we have had the benefit of having both candidates in office previously. We had four years of President Trump and nearly four years of President Biden. While both candidates view the world from different lenses, they have one thing in common as the chart below depicts: they do not have an aversion to deficit spending. Even ignoring 2020, considering the uniqueness of the pandemic and economic shutdown, the U.S. still ran close to a trillion-dollar deficit in 2019.



The Federal Government will likely spend about six trillion dollars next year regardless of the election outcome. A number that outpaces tax receipts by about two trillion dollars. How the money is spent will differ depending on the political outcome, but the bottom-line figures will be about the same. President Biden would likely allocate more of the budget towards green energy initiatives and social programs while President Trump would likely ramp up infrastructure and military spending. Either way, expenditures will likely continue. As we indicated in previous publications, do not underestimate the impact government spending has had on the U.S. economy since the pandemic.

Federal government spending accounts for about 23 percent of GDP. Since World War II, there have only been two other times when government spending has accounted for a more significant percentage of the economy: 2008 – 2009 and 2020-2021; once during a Global Financial Crisis and once during a global pandemic. There have not been any unusual events to justify such deficit spending. The spending, however, did help power the economy to greater than expected growth and played a significant factor in keeping inflation elevated. As we have stated many times before, we believe the two percent or lower inflation era has passed (except during a recession), and the new norm will likely be in the three to four percent range.

The yield curve has been inverted for over 700 days. This represents the longest stretch for an inverted yield curve without a recession. The inverted yield curve has historically been a reliable indicator of an impending recession. What is different this time? For starters, it is essential to note that periods of economic expansion generally do not end because of old age. They ended with an event. The most recent recession was caused by the shutdowns stemming from the COVID-19 pandemic. Before that, the housing bubble burst in 2008. Before that, it was the combination of the bursting of the dot-com bubble and the tragedies of September 11th. What will be the next event? No one knows for sure. It could be an election dragged out in the courts, heightened aggression in the Middle East, or any number of other geopolitical risks. For more on this subject, please see MAP's upcoming thought piece next month, "A Murder Mystery: What Kills the Economy?"

We are confident that by staying disciplined and focused on the longer-term picture, we can navigate current market conditions and deliver upon our goal of providing our clients with superior, long-term risk-adjusted returns. But make no mistake, we continue to analyze the markets daily and change portfolios when we believe opportunities present themselves. As an example, we added Apple to our Balanced Composites in April when investors doubted the company's AI progress, and we added a small weighting in Alphabet (parent company of Google) to our Global Equity and U.S. Multi-Cap Value Composites during the second quarter of this year, as we believe the company's valuation (currently about that of the broader market) did not reflect their longer-term opportunities. We continue to have oversized weights in Consumer Staples and Healthcare due to their defensive characteristics, modest valuations, and attractive dividend yields. Such weightings have hindered performance during the current risk-on environment, but we believe should provide stability when the tide shifts towards a more risk-off environment.

Thank you for allowing us to serve as your investment advisor. It is a responsibility we do not take for granted or lightly. We work diligently to deliver the best possible risk-adjusted returns throughout complete market cycles. Please reach out to your MAP representative with any questions or concerns. We hope everyone has a safe and enjoyable summer.

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