



SPINNAKER TRUST

From the Helm

JULY 2024

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SECOND QUARTER 2024 MARKET REVIEW

Stop me if you've heard this before! Mega-cap Technology stocks are pulling the S&P 500 to repeat new all-time highs. Yet, the equal-weight S&P 500, the Dow Jones, and small-cap indexes are significantly lagging, i.e. the average stock is not doing too much so far in 2024.

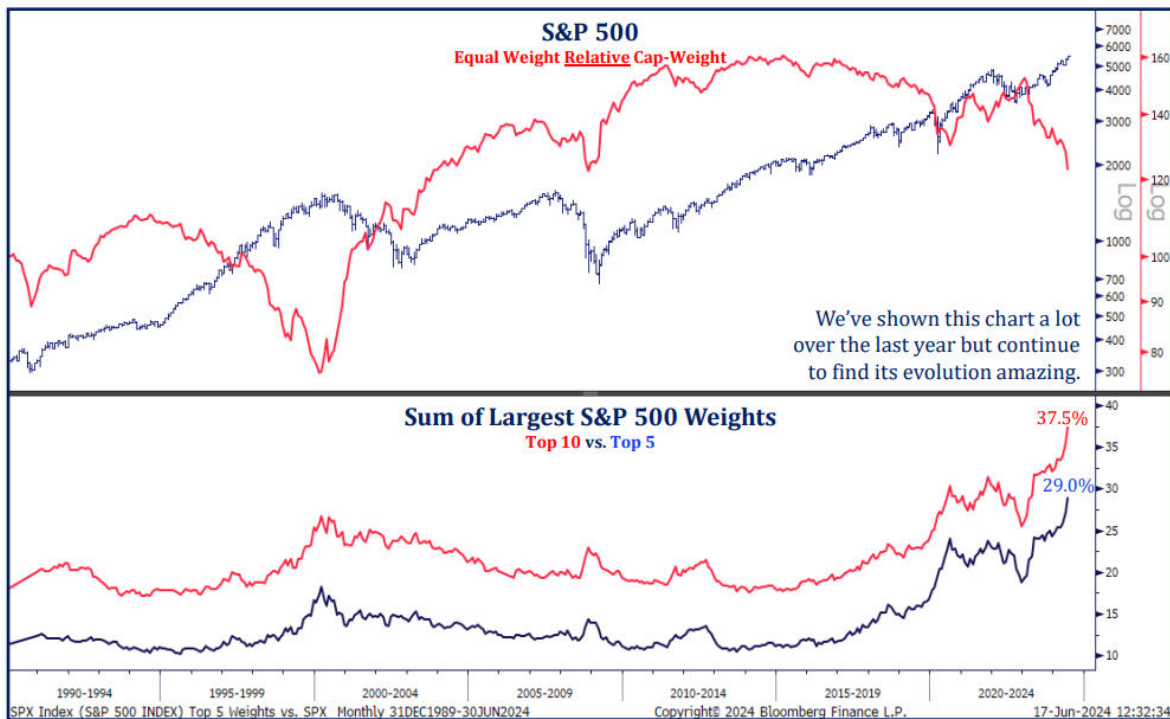
The S&P 500's 15.2% year-to-date gain is the best start to any presidential election year in history. The index has hit 29 new all-time highs this year, averaging more than one per week. At 5,460 (the closing level of Q2 2024), the S&P 500 is now above every 2024 year-end Wall Street price target save one. The leading economic sectors so far this year are Technology (up 27.8%), Communications Services (up 26.1%), and

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Financials (up 9.3%). The weakest sectors were Real Estate (down -4.1%), Materials (up 3.1%), and Consumer Discretionary (up 5.2%). Of note, the index is now 25% higher than it was when the Fed started its aggressive rate hiking cycle in March 2022, raising serious questions about the efficacy of monetary policy in the U.S.

The market remains bloated in terms of valuation, sentiment, and positioning. The Nasdaq 100, S&P 500, and U.S. small-cap indexes are trading at 29.5xs, 22.4xs, and 13.4xs 2024 earnings estimates, respectively. As mentioned above, the S&P 500 is up 15.2% for the year. The Nasdaq 100 is up 17.3%, the equal weight S&P 500 is up 5.0%, small-cap stocks are up 1.6%, and the Dow Jones is up 4.7%. International stocks are up 5.6% year-to-date as, until recently, Europe and the UK had joined Japan as strong performers. The Emerging Markets index has risen 6.6% this year, a pleasant change from a multi-year trend of substantial underperformance. The broad U.S. bond market is down -0.7% for the year as higher interest rates have offset high absolute yields. Gold is up 12.5% for the year, while broad commodities have risen by 5.6%.



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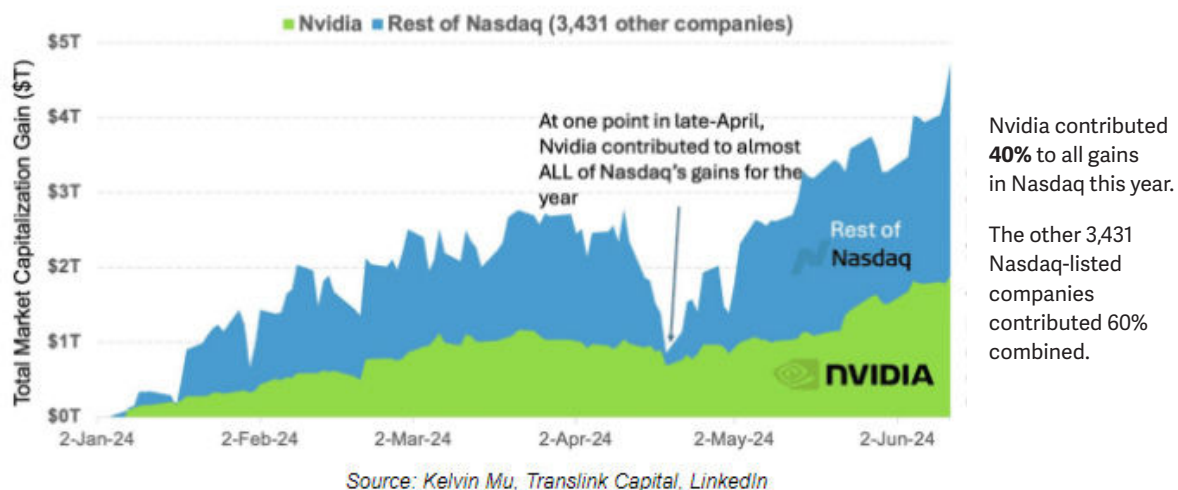
IT'S GOOD TO BE KING

A new king of global equity markets has been crowned, and its name is Nvidia (ticker: NVDA). The stock has risen by 200% over the last year. Five years ago, Nvidia was barely in the top-50 companies in the S&P 500; a semiconductor design chip company serving gaming and cryptocurrency mining. Today, Nvidia has been competing with Apple and Microsoft to be the most valuable company in the world after having gained \$1 trillion in market-cap in one month's time. It briefly held the top spot for a single day last week, only the 12th stock to be on top since the 1930s.

A few fun facts:

- The S&P 500 is up 15.2% in the first half of this year. If Nvidia was excluded, the index would have risen by 10.7%. If all the largest Technology stocks were excluded, S&P 500 returns would have been 6.3%.

- Today, Nvidia's market-cap is larger than the GDP of UK, France and Germany.
- It is larger than the entire cryptocurrency market combined.
- Nvidia is larger than all publicly traded small companies in the U.S.
- It is 6xs the market-cap of Wal-Mart.
- It is larger than Amazon and Berkshire Hathaway combined.
- The company's market cap is larger than the entire U.S. oil & gas industry.
- Nvidia recently went from \$2 to \$3 trillion in market cap in 23 trading days.
- Over the last three years, Nvidia's rolling correlation to the S&P 500 has been relatively high at 0.65%. However, over the last thirty days, that correlation has fallen to 0.14%, or close to zero. Why does this matter? It means that recently Nvidia has traded as its own ecosystem as investors pile into a specific security rather than a sector or theme.
- So far in 2024, Nvidia has accounted for 40% of the gains in the Nasdaq index. At one point in late April, it contributed 100% of the Nasdaq's gains for the year.



With net income of \$43 bn versus \$86bn for Microsoft and \$100bn for Apple, investors are clearly expecting significant growth in the years to come. With profit margins of 53% versus 36% for Microsoft and 26% for Apple, investors are also betting that Nvidia will maintain its competitive advantage. The stock now trades at over 21xs forward sales, up from 12xs two months ago. Microsoft trades at 12xs sales and Apple 8xs.

To shift to the land of options, which are becoming increasingly important as drivers of equity markets overall, the notional value in options on Nvidia exceeded the notional value of stock options on the S&P 500 itself during the month of June. In our opinion, the miraculous performance of Nvidia is largely due to momentum tied to the buying of call options. These outstanding call options function as a turbo charger. The more Nvidia's stock price rises, the more options activity increases, which makes the stock rise even faster. This decouples the correlation between Nvidia's performance and that of the broader market.

While there is certainly a casino element to some of the action in Nvidia's stock recently, it should be noted that the fundamentals of the business are very strong. CEO Jensen Huang is creating "moats" (barriers to entry) around the core parts of his business. He is doing so across three core areas: 1.) Software (CUDA), 2.) Networking, and 3.) Proprietary Cloud. The CUDA software stack is the standard for GPU computing, creating an ecosystem for developers, software and applications. The second leg of the moat is on the networking side,

which is required to operate and build a full-rack server. Nvidia has plans to integrate this business, hurting companies like Dell, HPE, and Super Micro Computer. The final leg of the moat is moving into the cloud. Nvidia is starting to move laterally, providing its own cloud service, competing directly with its largest client, Microsoft.

These are ambitious and potentially transformative initiatives, but other semiconductor and software players are not going to cede the leadership of the most exciting segments of the semiconductor industry easily. Whether Nvidia can strengthen their moats and fight off the coming challenges from numerous well-funded competitors, only time will tell. But this has already been the most extraordinary accumulation of market value we have ever seen.



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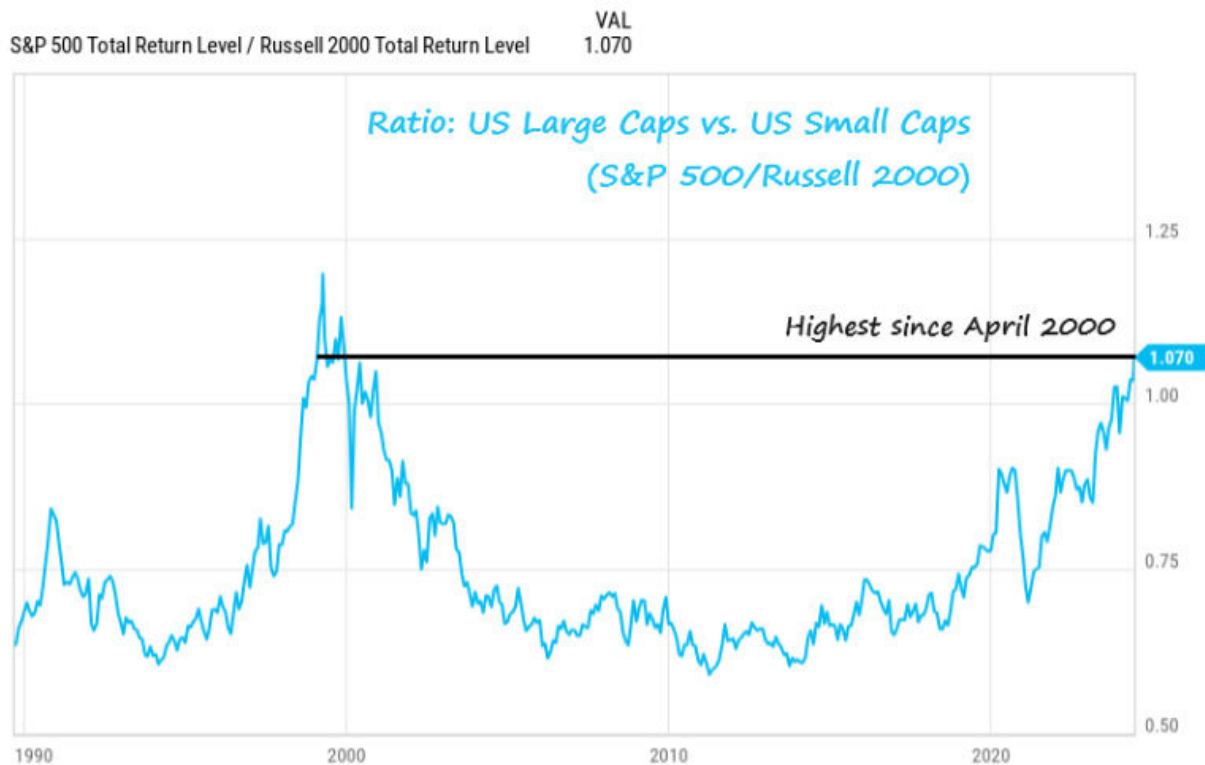
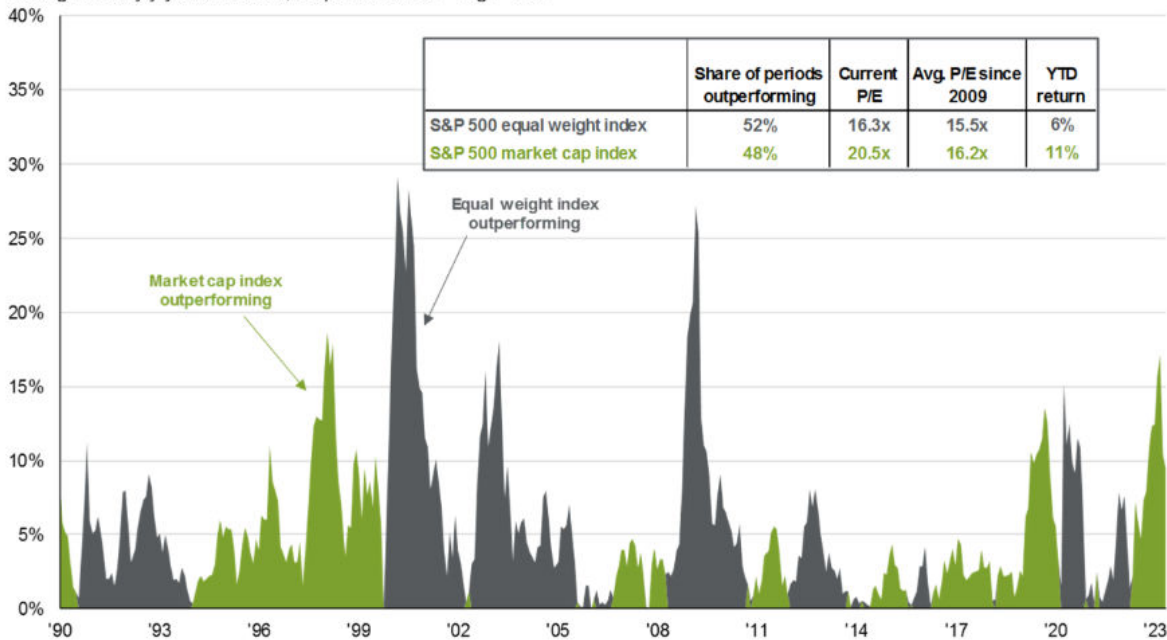
A BEAR MARKET IN DIVERSIFICATION

Diversification is the hallmark of the investment industry for individuals, pensions, and endowments alike. For the last 18 months, and really for much longer than that, there has been a notable bear market in diversification. Only twice in the last 12 years has a traditionally diversified portfolio outperformed the S&P 500. So far in 2024, the equal-weight S&P 500 index has underperformed the S&P 500 market-cap weighted by a record amount. Just during the second quarter of this year, large Technology stocks outperformed the average U.S. stock by 12%.

The ratio of large to small-cap stocks has moved up to its highest level since April of 2000, as the Tech bubble was bursting.

S&P 500 market cap and equal weight relative performance

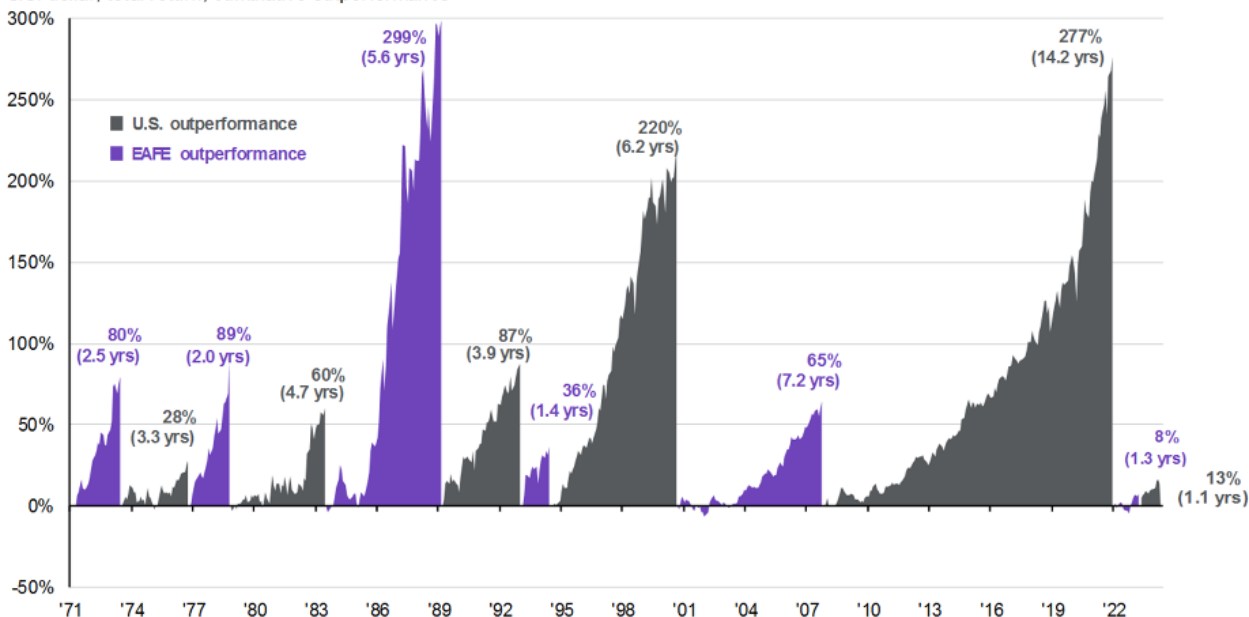
Rolling monthly y/y total returns, outperformance = high - low



Likewise, the ratio of U.S. to international stock performance is at another record high, extending its streak of outperformance to 16 years. This is, by far, the longest period of U.S. dominance. Over the last 16 years, the S&P 500 is up 457%, while developed international markets have risen by 96% and emerging markets by 48%.

MSCI EAFE and MSCI USA relative performance

U.S. dollar, total return, cumulative outperformance



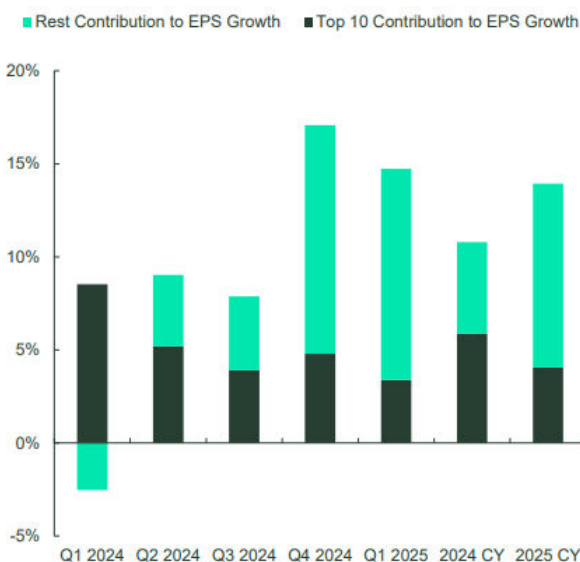
What do all these statistics and historical analogs have in common? Large-cap, U.S. Technology stocks. Our country and stock markets have benefitted from the creation and growth of some of the most successful and innovative companies that the world has ever seen. How long can this go on? For the first time in history, there are three companies in the U.S. with market capitalizations higher than \$3 trillion.

Why is it that the average U.S. stock remains in a holding pattern, while the widely held and acclaimed “Big Tech” stocks that dominate the market-cap weighted index continue to grow both earnings and cash flow in a robust fashion?

Top 10 Firms as a Percent of Total S&P 500 Market Cap



S&P 500 Earnings: Top 10 by Market Cap vs. The Rest of S&P 500



Nvidia is the most recent example of U.S.-based technology companies that have become dominant global players with tens of billions in annual profits and hundreds of billions of market capitalization. Their growth and the outsized multiples of earnings that investors are willing to assign to these companies have contrasted sharply with developed economies around the world which have emerged from the pandemic with weak demographics, high fiscal deficits and accumulated debts, inflationary pressures and increased geopolitical tensions.

These technology companies provide dramatic improvements in efficiency for businesses and individuals worldwide, as well as new sources of entertainment and opportunities for connection – and consumers and businesses are prepared to pay for these advances. Today, the promise of artificial intelligence suggests that we may still be in the early innings in terms of efficiency gains and possible new avenues of entertainment, and so the elevated multiples may ultimately prove to be justified.

But throughout history, the great technological advances – electricity, railroads, automobiles, the internet – have all resulted in misdirected investments and dramatic losses even as these technologies gradually permeated everyday life. Maintaining a balanced posture with exposure to today's technology companies but a watchful eye on potential excesses will be critical for investors navigating the current environment.

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SECOND HALF OF 2024: MARKET OUTLOOK

Investors are generally tempted to take gains and sell a market that is up by so much in the first half of the year. However, equity market strength generally begets strength, and momentum is powerful. Since 1954, when the S&P 500 was up by double-digits in the first half of any given year, the move in the second half of the year was 7.7% and higher nearly 83% of the time.

Investors were quite bearish for much of 2022 and early 2023. It appears that, just this year, the equity market chase is on. Strategists cannot upgrade their S&P 500 year-end target prices fast enough, and professional investors have been forced to get involved. While inflation, the housing market, consumer spending and the jobs' environment all appear to be slowing, there appears to be no major imbalances in the economy today other than the government deficit. This is a unique type of macro goldilocks environment as growth should not be strong enough to meet the expectations currently embedded in stocks but is too strong for bonds to get the Fed easing cycle necessary to overcome large government supply dynamics.

This being an election year, markets typically roar ahead in November and December no matter the electoral outcome. Further, markets typically peak in December or January of any given year, which suggests a smooth runway for the next several months. However, valuations and sentiment are quite frothy within the Technology complex. Any misstep by one of the large companies (Nvidia in particular) in terms of earnings or the demand picture could have undue, negative influence on the equity market.

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WELCOME SCOTT!

Please join us in welcoming Scott Stefanowicz as the new Director of Portfolio Management. Scott most recently worked in portfolio management at Key and was the Head Trader at HM Payson. He has over 20 years of experience. Scott lives with his wife and four children in Portland.

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WELCOME JEN!

Jennifer Healy joined our team in early April as an Account Administrator. She comes to us with over 20 years of administration experience, most recently with Southern Maine Healthcare as an Executive Administrative Assistant.



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