

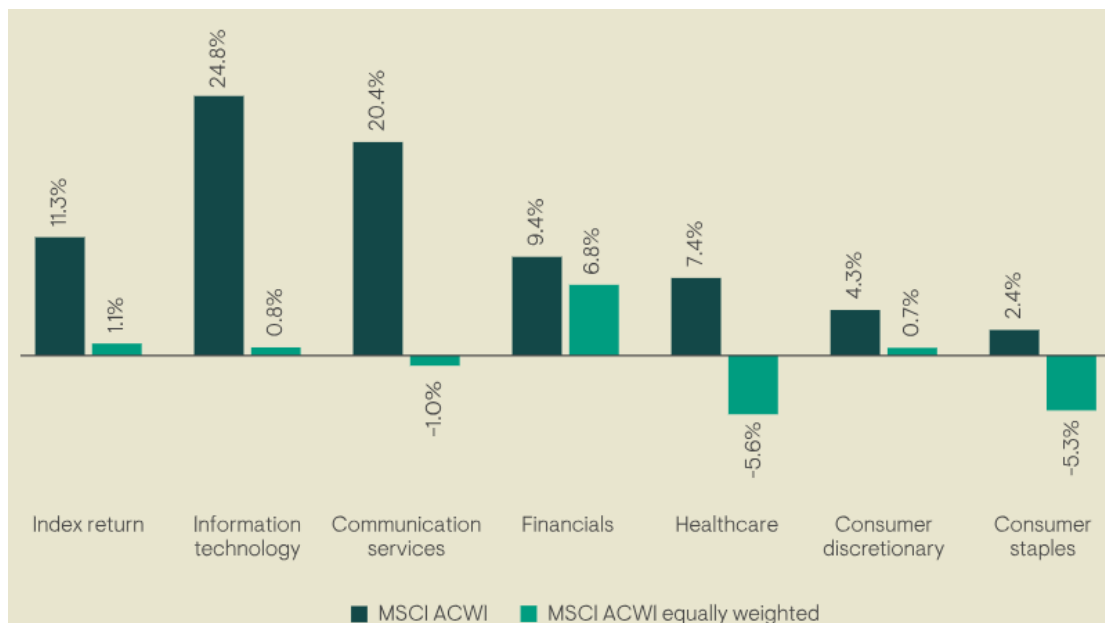
Quality Insights: Navigating an increasingly concentrated market

Ninety One

The narrow leadership in global equities is unprecedented. It is also dangerous. Clyde Rossouw, Head of Quality at Ninety One, explains why markets do not appear as healthy as the headlines suggest, and that there are several warning signs that investors should be cognisant of.

Recent dynamics in the equity markets have been unprecedented. Headline figures suggest that equities marched on upwards in the first half of 2024, driven predominantly by US tech euphoria as we move towards a future dominated by artificial intelligence. However, while this is completely accurate, a closer examination helps understand the full extent of this narrow market and unveils some warning signs that investors should be cognisant of.

When looking at the global equity benchmark – the [MSCI ACWI](#) – which captures close to 3,000 companies across nearly 50 developed and emerging markets, it rose by 11% in the first six months of the year. On an equal weighted basis – stripping out the effect of market capitalisation – it was up closer to 1%, and actually fell in the second quarter. Analysis of the predominant drivers of the index paints an even more stark picture. The IT sector within the ACWI is up close to 25% this year, however this becomes 1% on an equal-weighted basis, with similar dynamics at play in communication services.



Source: Ninety One, FactSet, 30 June 2024. Chart shows year-to-date total returns, in USD, of the MSCI sectors.

Closer inspection of the core drivers – a handful of megacaps – also illustrates the extraordinary nature of today's market. During the famed dotcom bubble at the turn of the century, the top 10 of the S&P accounted for just over 25% of the full 500-member index. Following its collapse, this drifted down to about 15% about a decade ago, but since 2014, the concentration has crept higher again, before surging up above 35% in the past couple of years. This leaves any investors exposed to the full index – or an

overweight towards these tech behemoths – open to a significant amount of concentration risk should sentiment turn.

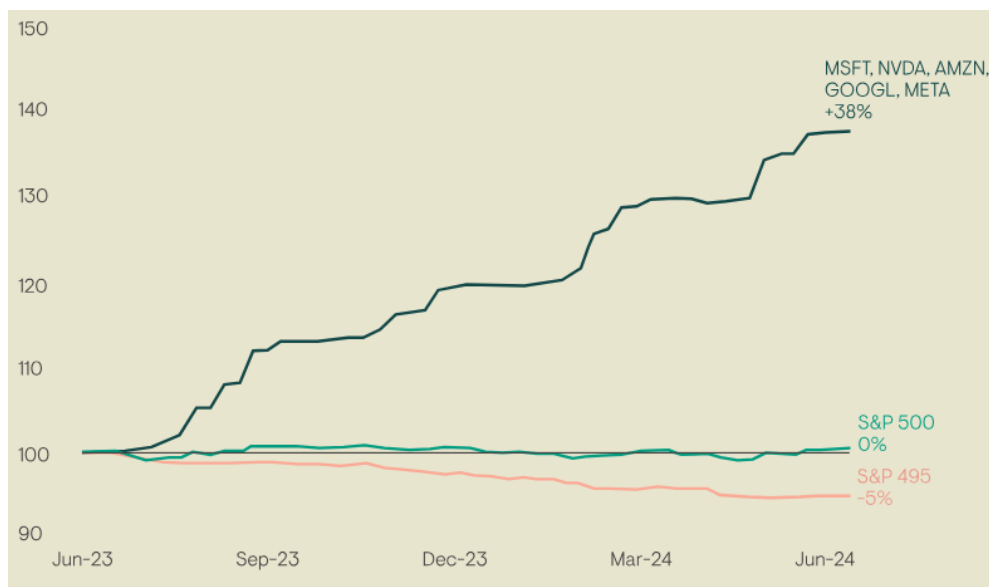


Source: Ninety One, FactSet, 30 June 2024. Chart shows the combined weighting of the top 10 constituents of the S&P 500 since June 1994.

The move in the past two years has been especially striking. The total market capitalisation of the [Magnificent Seven](#) stocks was US\$16 trillion at the end of June, up from US\$12.3 trillion at the turn of the year (with much of this down to NVIDIA).¹ The cohort added more than US\$5 trillion in 2023. That figure alone would comfortably place them as the third largest economy in the world, behind the US and China. For context, Germany – the third largest economy – generates about US\$4.6 trillion of GDP each year.²

However, for all this momentum, it is important to establish what is happening with the fundamentals. After all, earnings and free cash flow growth [is what drives long-term share price performance](#). While inflationary pressures are certainly easing, the market has revised its outlook for rates, which are expected to stay higher for longer. This will impact both businesses and consumers alike. We are seeing signs of moderation in the US economy, with GDP for the first quarter missing expectations. In addition, there have been negative earnings revisions year-to-date for the S&P 500 if one excludes the top five performers (Microsoft, Nvidia, Amazon, Alphabet and Meta). There is also underlying weakness in the US consumer coming through; retail sales have weakened, and excess

savings accumulated following Covid have been eroded from US\$2.1 trillion in August 2021 to negative US\$72 billion in March 2024.



Source: Morgan Stanley Research, 13 June 2024. Chart shows the change in consensus 2024 EPS for the S&P 500 ex-mega cap tech (Microsoft, Nvidia, Amazon, Alphabet, Meta), the full S&P 500 and the S&P 495 (excluding the five stocks), indexed to 100.

Recent dynamics in the market have strongly favoured momentum, growth and cyclical, proving to be a headwind for purist quality exposure. Proven earnings resilience is likely to become more important in this stretched near-term market with an increasingly uncertain outlook. Portfolios consisting of resilient compounders that have successfully compounded cash flows at sustainably high levels of profitability should be well placed to outperform in the coming years. Strong fundamentals have been the bedrock of returns over time. We believe it's only a matter of time before the market returns to this historical norm.