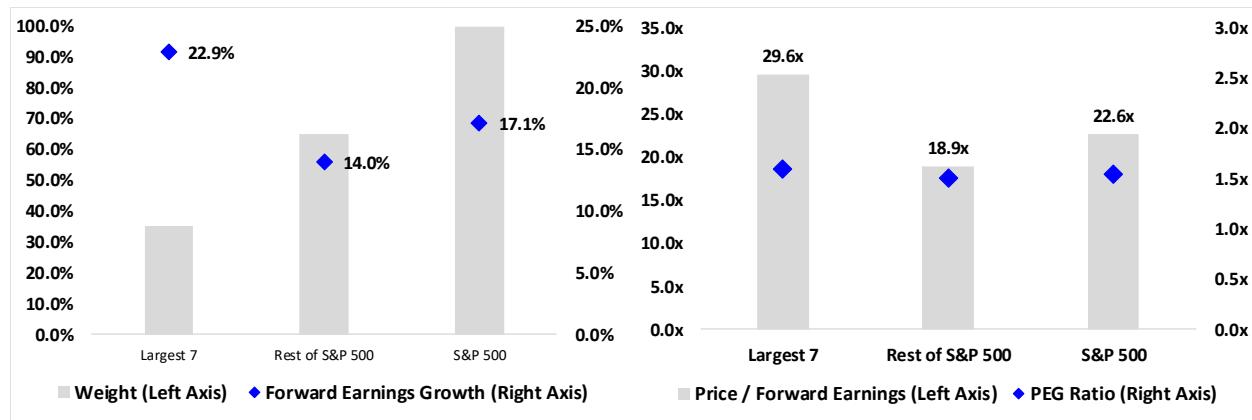


Earnings season kicked into high gear last week – five of the largest seven U.S. public companies reported quarterly results. While the stock price reactions were mixed, the results and guidance were robust across the board. Customer demand remains strong while the capital investment fueling the AI ecosystem continues to accelerate. This gives us further confidence that the secular trend driving the current bull market, unprecedented levels of capital spending from the largest technology companies, remains well intact and will likely only increase going forward.

The "megacap" companies, each with equity capitalizations in the trillions, command outsized attention given their significant market impact. Collectively, the seven largest public companies comprise just over a third (35%) of the S&P 500. The monumental amount of capital investment committed by these businesses has meaningfully boosted the broader economy and lifted corporate earnings. Meanwhile, the massive free cash flow generated from these behemoths is a testament to their market dominance, scale, and ability to generate attractive returns on invested capital. Not surprisingly, these companies command higher valuation levels compared to the rest of the market while delivering more promising growth outlooks. Nevertheless, earnings growth is expected to ramp up across other sectors also as the benefits from increased capital spending spread across the broader economy. Excluding the largest seven companies, S&P 500 profits are expected to grow by 14% next year, which is well above the historical average of roughly 8%.

S&P 500: Largest Seven Companies Vs. Rest of the Index – Valuation and Growth



Source: S&P Global

Given the robust growth outlook, stock valuations aren't astoundingly expensive compared to history in my view. This, of course, assumes that companies continue to deliver impressive results. So far, that's been the case, although the bar has certainly been raised going forward. Any shock event which interrupts the current capital spending boom would significantly dampen the bullish narrative. While the horizon appears bright, the margin for error has narrowed and companies will likely see their stock prices severely punished if future results underperform.

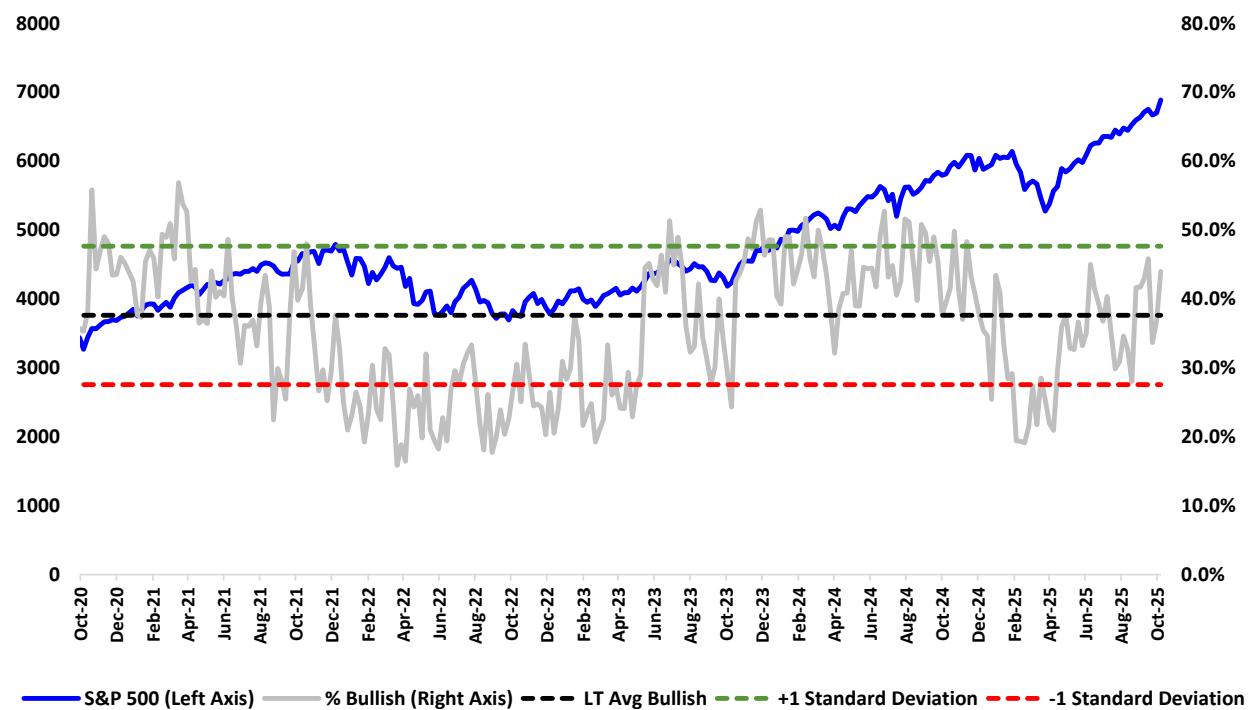
Despite the fundamental strength underlying this market, many skeptics remain. As Fundstrat's Tom Lee put it, "This is the most hated V-shaped rally." I couldn't agree more.

Watching the news, one might assume the sky is falling and that we're currently in a bubble similar to the end of the 1990s. Fortunately, the data simply doesn't agree. Some of the recurring fear-mongering narratives I've heard recently: the consumer is severely stressed, credit risk is a major concern, and we are witnessing "late cycle behavior" with a likely recession just around the corner. The reality is that consumer incomes and spending levels are rising at a healthy clip, credit metrics (defaults, debt service coverage, etc.) for consumers and businesses remain strong, and GDP growth is accelerating along with corporate earnings.

The good news is that this wide-spread investor skepticism keeps markets rational and helps prevent bubble-like conditions from forming. Despite the impressive rally from the early April lows, bullish sentiment (measured by the AAII Sentiment Survey) is still below where it started the year and only slightly above the historical average. The euphoric conditions which typically coincide with a market top, like at the end of the 1990s, are simply not present today. In my view, this suggests that the rally has room to run. Many institutional investors who exited the market near the lows may still be under allocated to stocks.

Given accelerating earnings growth, a more dovish Fed, and still muted investor sentiment I remain bullish over the near and medium term. Furthermore, the recent thawing of tensions between the U.S. and China helps mitigate the risk of a prolonged trade war while reducing friction costs for U.S. businesses. I believe the current environment remains fertile for this bull market to continue into next year and beyond. Should investor sentiment become meaningfully more bullish, this could result in frothier market conditions, albeit likely at higher price levels. For now, I remain optimistic regarding the outlook for corporate profits as earnings estimates keep getting revised higher and results continue to surprise to the upside for the largest and most consequential American companies.

S&P 500 Versus Bullish Investor Sentiment



Source: *The American Association of Individual Investors Sentiment Survey, S&P Global*

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