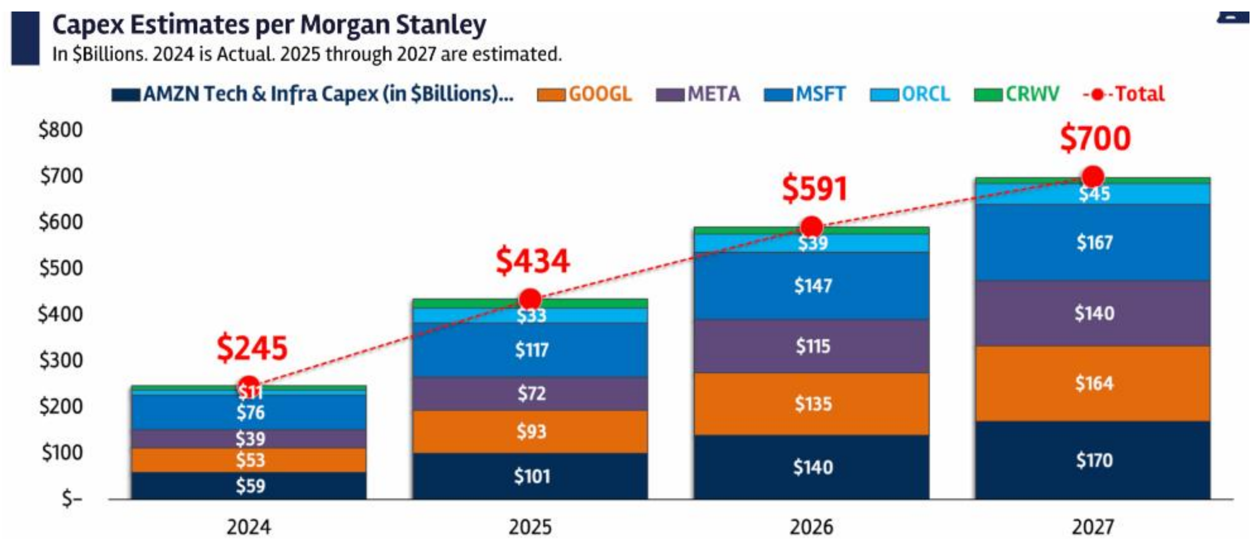
Market choppiness continued last week; the S&P 500 finished roughly flat while selling continued early this week. I believe the recent selling pressure has been largely driven by profit-taking across high-performing growth stocks as investors appear to be questioning the forward outlook for large technology companies. Some Fed officials have also pivoted towards a more hawkish stance over the past couple of weeks, expressing a more cautious outlook regarding the inflation backdrop and additional rate cuts over the immediate term.

Looking at the bigger picture, the pullback has been modest; the index is less than 5% below recent highs. While some growth stocks, many of which are among the year's best performers, have fared meaningfully worse, in my view recent softness should be viewed as a healthy pause versus cause for concern. Markets are likely recalibrating based on renewed investor skepticism regarding the AI-fueled rally, while there appears to be some degree of rotation occurring beneath the surface (i.e. selling some high-flyers and rotating into other sectors/stocks).

While there have been some renewed bearish calls from a handful of notable pundits, the fundamental backdrop remains extremely strong. Corporate profits are surging, with growth likely accelerating going forward, driven by the current capital investment boom.

<u>Capital Spending Estimates Provided by Morgan Stanley</u>



Source: Morgan Stanley, A Wealth of Common Sense

There have been some signs of stress for lower-end consumers (i.e. rising subprime auto loan delinquencies, etc.) but overall spending levels and credit metrics reflect an expansionary backdrop versus an imminent recession. With healthy consumer spending and robust business investment trends, profit expansion should continue, which suggests the current bull market may be simply taking a breather before the next leg higher.

Investor skepticism is a potent ingredient that fuels healthy, sustainable bull markets. The multi-decade gains which followed the "death of equities" in the 1970s and the 2008 Financial Crisis are the most notable examples which come to mind. Given that the Fear and Greed Index[1] currently sits at 15 (out of 100), while bearish prognosticators are practically clamoring on top of each other to proclaim a market top every day, it seems skepticism is certainly in ample supply. This is the type of behavior which keeps markets rational and prevents excessive froth.

Investors remember all too well the pain following the tech rally of the 1990s. And for good reason – after five straight years of 21-38% gains to close out the 20th century, the S&P 500 got cut by more than half during the bear market which immediately followed. However, in my view the comparisons to the current technology boom are unwarranted. First, valuation levels are much lower this time around – earnings multiples for today's market leaders pale in comparison to the dot-com peak. Furthermore, today's technology behemoths are significantly more profitable with very little reliance on debt funding given the massive amounts of free cash flow they generate. In essence, today's boom is driven by capital investment and underlying profits whereas the 1990s bull market was largely fueled by excessive speculation.

<u>S&P 500 P/E Ratio Adjusted For Profit Margins</u>

Source: S&P Global, Ritholtz Wealth Management, Duality Research

Nvidia's earnings release is the big event this week. I believe the company will likely post robust earnings results and offer bullish guidance; whether or not the stock reacts favorably or poorly remains to be seen. Nevertheless, given the strong fundamental backdrop, I view current weakness as a potential buying opportunity for long term investors.

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