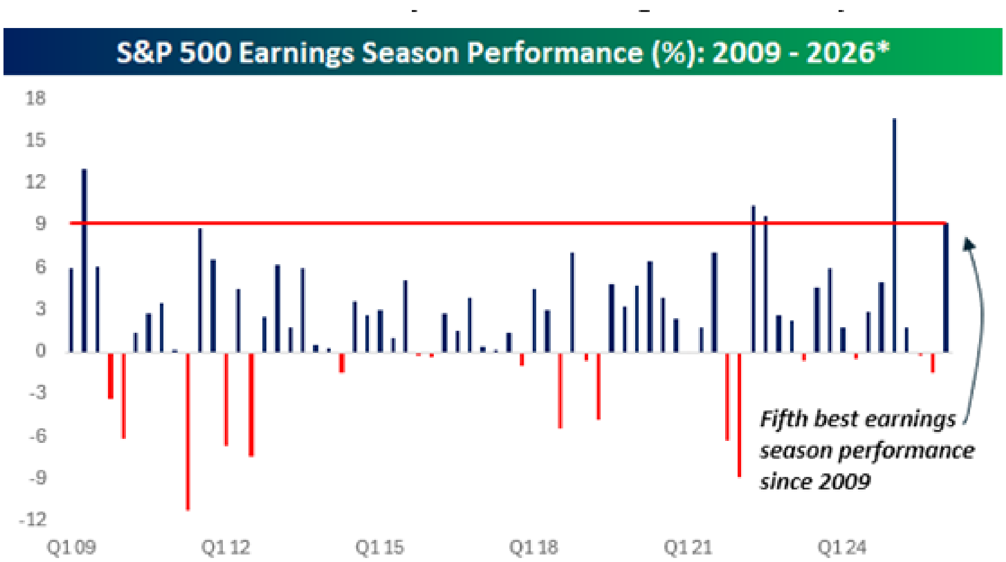
Stocks continued their march higher last week – the S&P 500 gained 0.9%. The catalyst for the market's resilient rally remains strong earnings growth, which continues to impress to the upside. Nvidia's earnings release on Wednesday afternoon was the highlight given that it's the largest company in the world, commanding more than $5 trillion in market capitalization and a nearly 8% weighting within the S&P 500. Not surprisingly, the company again posted a strong beat and raised forward guidance, a common theme for Nvidia quarter after quarter. While the stock's post-earnings move was muted, this was a fresh data point reaffirming strong demand across the AI ecosystem, which bodes well for the market's growth outlook.



**Earnings season is measured as performance from Friday before major banks first report through Walmart (WMT) report.*

Source: Bespoke Investment Group

While the market's underlying fundamentals are nothing short of stellar (i.e., greater than 20% expected annualized earnings growth through the end of next year), I believe investor skittishness is keeping valuation levels in check. Bespoke Investment Group said it best with their *"Stocks High, Sentiment Low"* Morning Lineup headline on May 21. This is actually a blessing for long-term investors given it prevents valuation levels from becoming too frothy. The S&P 500 is trading at roughly a 19-20x multiple compared to next year's earnings estimate, barely elevated compared to historical norms, while earnings growth is forecasted at nearly 3x the historical average. Unlike the unconstrained euphoria and speculative frenzy of the late 1990s, in my view investors remain far too sanguine and skeptical this time around. This suggests that many areas within the market that are positioned as key AI beneficiaries remain very reasonably valued for investors considering new or higher allocations.

I believe the reason for this healthy investor skepticism is twofold. Investors keenly remember the pain which followed the tech boom of the 1990s and are cautious not to make the same mistake again. While this technology boom is being fueled by real fundamentals (i.e., high revenue and profit growth) versus speculation (elevated valuations), the similar price action gives many formerly wounded market participants pause. In addition, fears regarding the Iran conflict and higher energy costs, as well as elevated inflation readings, suggest macro concerns are also weighing on investors' minds. These two factors are likely keeping a lid on valuation levels and preventing this rally from going parabolic.

The macro concerns are real – higher gas prices are pressuring consumer wallets while rising inflation suggests upward pressure regarding interest rates, both of which are net negatives for the economy. And both of these factors also have market implications – a more strained consumer, for example, has less discretionary income which pressures consumer goods companies. Nevertheless, I'd strongly argue that these two macro headwinds, while notable, are significantly less important compared to the key secular driver fueling this bull market and profit boom – the unprecedented level of AI-related capital expenditures.

AI-driven enterprise spending is expected to reach roughly $900 billion this year compared to $500 billion in 2025. And the ramp is expected to only increase further over the coming years. Considering that U.S. corporate profits are running at roughly $4 trillion annually, it's apparent that both the level of AI capital spending and the growth are an extremely powerful force driving profit expansion that is unlikely to recede anytime soon.

There's always plenty of headline noise, especially in today's world. Since the depths of the 2008/09 Financial Crisis there has seemingly been a severe recession (or outright depression) right around the corner at every turn due to (insert macro event or concern here). I say this not to minimize the merits of prudent risk management but rather to emphasize the importance of investor focus and discipline. Optimal portfolio management requires setting a long-term strategy, focusing on the key drivers impacting holdings (i.e. corporate earnings), and positioning the portfolio accordingly. This is generally a much more prudent recipe for success as an investor versus knee-jerk portfolio decisions tied to every recent news development.

In essence, as investors it's our job to separate the impactful drivers from the noise and remain keenly focused on constructing the portfolio to deliver the most optimal risk-adjusted returns. And to never lose sight of the forest for the trees. In the current environment, I'd argue the forest is the powerful tailwind of AI-driven capital investment while macro events, while concerning at times, are more trees blowing in the wind versus risks to the bullish secular story.

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