



WEEKEND READING

Shedding the light on what's happening - our world - our finances - our times

Recognize Extremes – Revisited...again.

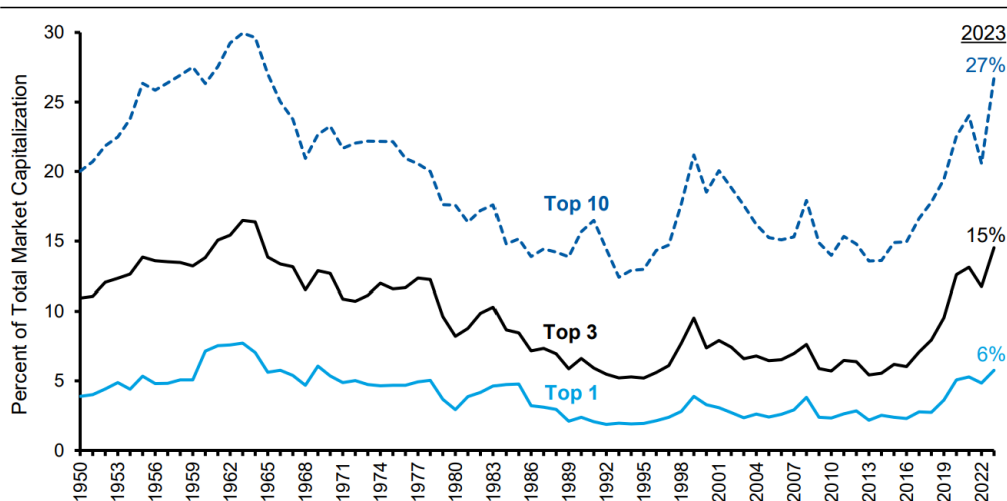
Gotta Have Mag-7?

In case you missed it, the Magnificent-7 are...Apple (AAPL), Alphabet (GOOG and GOOGL), Amazon (AMZN), Meta Platforms (META), Microsoft (MSFT), NVIDIA (NVDA), and Tesla (TSLA). This group has dominated the performance of US equity markets recently.

In 2014 the top 10 companies represented roughly 14% of the S&P500 total value. At the end of June, the top 10 represented over 35%. Morgan Stanley explains:

https://www.morganstanley.com/im/publication/insights/articles/article_stockmarketconcentration.pdf?1717517980691

Exhibit 1: Stock Market Concentration in the U.S., 1950-2023



Source: FactSet; Compustat; U.S. Securities and Exchange Commission, Annual Reports, see www.sec.gov/reports; Counterpoint Global.

Note: Universe includes companies listed on the New York Stock Exchange, NASDAQ, and NYSE American stock exchanges, excluding American depositary receipts; Market capitalizations reflect calendar year-end.

Morgan Stanley notes the Top 10 centration at the end of 2023 was 27%. At the end of June 2024 that concentration is over 35% with the Magnificent 7 representing 31% of the total

and the majority of the market gains this year. The current concentration is higher than the early 60's Go-Go stock craze. Nvidia has gained more market value in the past year than the total GDP of Sweden.

It's all so 90's.

Recall Nortel Networks (who?).

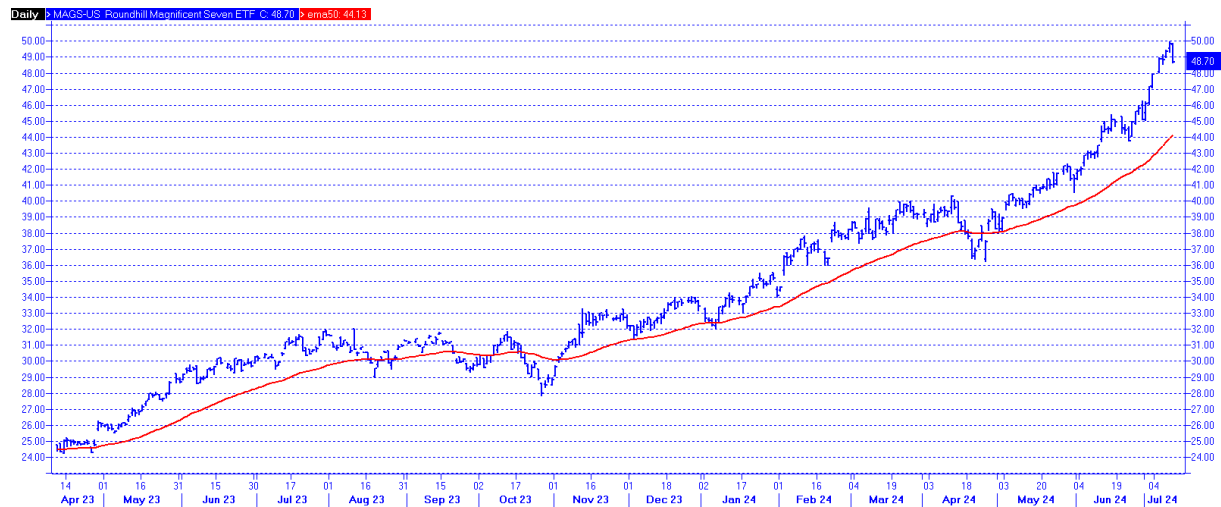
<https://en.wikipedia.org/wiki/Nortel>

At peak prices of \$124 per share in Sept 2000, Nortel represented close to 35% of Canada's TSX Composite index. At the time, we held Nortel via stock spin-offs from our holdings of the parent company BCE Inc (Bell Canada Enterprises). Our clients' received cost per share via the spin-off was in the \$18-\$24 range. We sold portions at \$50, \$74, and \$95. After sales, our goal was to hold roughly 15-20% of the original positions. Selling on the way up, we faced clients who were excited about Nortel's prospects in telecommunication technology's 'New Paradigm' and angry at the capital gains tax they paid on realized gains. We were accused of 'not getting it', to which we plead guilty. That was the point. We didn't 'get' the valuation.

We missed the \$124 top. When the price started to collapse, we sold the final rump-end at \$24-\$35. By August 2002, with the price at 47 cents clients weren't angry anymore.

It turned out Nortel's management had been less than truthful with earnings results. When prices go parabolic, insiders get very, very rich. The temptation to fiddle the books is strong. Investors don't want to hear bad news, the financial media gets advertising dollars and the investment industry gets its cut. Nobody wants the party to end. When the truth comes out, there is a tendency to blame regulators, Greedy Big Business, a 'rigged stock market' or even the Fat-Cat Capitalist system. That one in the mirror? Not their fault.

Roundhill Investments Magnificent Seven ETF (MAGS-US-\$48.66)



Source: Refinitiv, NBF, Hilberry

https://www.roundhillinvestments.com/assets/pdfs/mags_factsheet.pdf



Responding to investor enthusiasm, Roundhill Investments brought the first 'Magnificent Seven' ETF in April, 2023. The ETF has gained 65%. With an internal MER of 0.29% the fund is cheap to own. Rebalanced quarterly to even dollars, it's also cheap and easy to run, no costly wisdom required. At a current market cap of \$712 million, the ETF is providing a cool \$2.06 million in annual revenues to Roundhill for minimal effort or risk. As demand for the ETF expands new units are created. The revenue to Roundtree has gained nicely since creating the MAGS ETF. Taking a cue from McDonalds, one can get rich feeding appetites. If the product is cheap and fast, all the better. Indigestion? Someone else's problem.

We don't take issue with creatively solving problems, coming up with new and clever ways to deliver what investors want efficiently. If those 'products', just happen to hand lucre to the issuer's that's okay too. On the other hand, understanding who gets paid for what, and the marketing incentives involved can be useful. Nothing is free. Particularly advice on the web.

Microsoft and Nvidia are Mag-7 constituents. A client asked for our take on both names this week. The following is a condensed and edited extract from our reply to the client on July 9. Prices are as of Monday July 8 close. We'll call him Dave. **Sources for the following data are as follows: Historical valuation ratios: Valueline. Historical price history: Refinitiv. Dollar-return calculations: Hilberry. Current ratios: Refinitiv/Hilberry**

Dave,

RE: AI and investor enthusiasm.

Summary: Recognize extremes.

What does this mean? In our experience, no matter how exciting new developments are, investors tend to over-anticipate the short-term impact, seeking price reward that 'everyone knows' is coming and overpay, while underestimating the longer-term impacts.

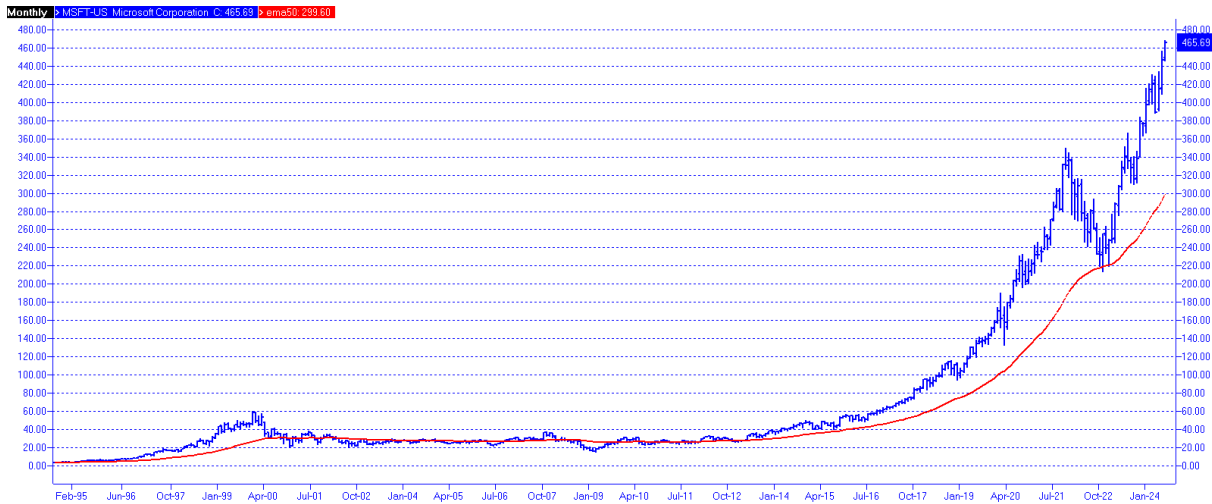
Experience says the patient/cautious approach to valuing future revenue streams and refusing to pay up during heady times might miss out on initial spectacular gains, yet often permits one to purchase the same company farther into the real-world business results that 'everyone knows' will happen, at lower prices...assuming that business succeeds.

It is rare for stocks with parabolic price charts going straight up, to then moderate that price growth by continuing to climb at a more gradual level. Far more often what goes straight up, goes straight down. This has little to do with the fundamentals of the business model in question. It's all about greed followed by fear.

Example Microsoft.

Microsoft has been a wonderful company with rock-solid financials, at the cutting edge of a world-changing industry. The first price chart is from 1995 onwards. From the current view MSFT looks like a perpetual winner.

Microsoft (MSFT-US-\$465.69 July 8, 2024 close) Jan 1995-July 2024 – monthly ranges



Source: Refinitiv, Hilberry, NBF

Adjusted for splits, the stock has moved from 1995’s price range of \$1.82-\$3.40 per share to today’s \$465. \$10,000 invested in late 1995 at \$3.40 is now worth \$1.37 million. A truly life-changing 137-fold gain in value.

Did that gain make sense? Split-adjusted, Microsoft’s 1995 sales per share were 31.5 cents. Cash flow was 9 cents and earnings per share were 7.5 cents. Using the 1995 yearly average price of \$2.61 investors were paying 8.3 times sales, 29 X cash flow and 35 X earnings.

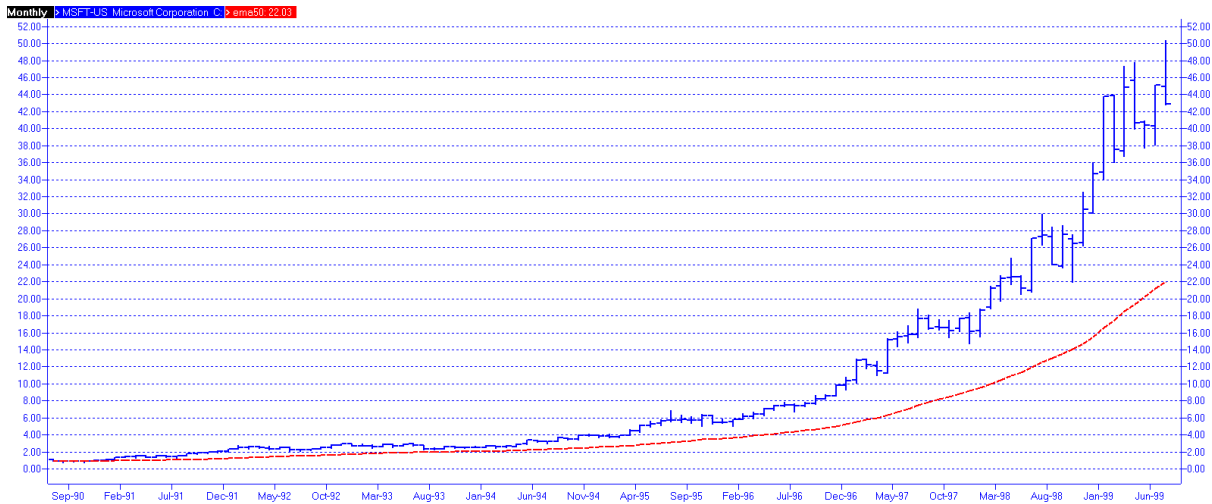
MSFT 2024 projected per-share items: Sales \$32.95, Cash-flow \$14.20 and Earnings Per share: \$11.65. Sales have grown 104-fold, Cash-flow 157 X and earnings per share 155 X. So yes, the stock price paid in 1995 was rewarded more handsomely than the ratios paid for the earnings at the time...eventually.

Look closer at the chart for the period 1999 to 2014.

From 1995 \$3.65 at year-end the price ran to \$50.38 in 1999. 1995’s \$10,000 was worth \$137,000 in June/1999, a 13-fold increase in less than 4 years. Here is what Microsoft’s chart looked like in 1999.



Microsoft (MSFT-US) July/1990 (\$0.92) to July/1999 (\$50.38) monthly ranges.



Source: Refinitiv, Hilberry, NBF

Recall after 1999, Microsoft’s earnings went on to spectacular growth. Going back to the first chart we see the stock price plummeted from \$50 in July/1999 to \$20 in Dec/2000, rebounded to around \$30 in Nov/2004, then collapsed to lows around \$15 in Mar/2009. Microsoft’s stock price didn’t break the 1999 \$50 level again until Nov/2014 and didn’t permanently remain above \$50 until Oct/2015. A 70% loss that takes 15 years to repair is very hard to tolerate. How many buyers who paid \$50 in 1999 are still holding MSFT today?

The red-line on the charts is the average of the previous 50-months plotted over time. The 50 month moving average price on the 1995-2024 chart is currently \$299.60. Prices look elevated vs. Microsoft’s recent history. Periods of extreme valuations vs. the moving average were regularly followed by disappointing price returns. This for a company that delivered spectacular business results. Recall those results might have not turned out that way.

Current prices vs fundamentals?

Today Microsoft trades at the following ratios to trailing results.

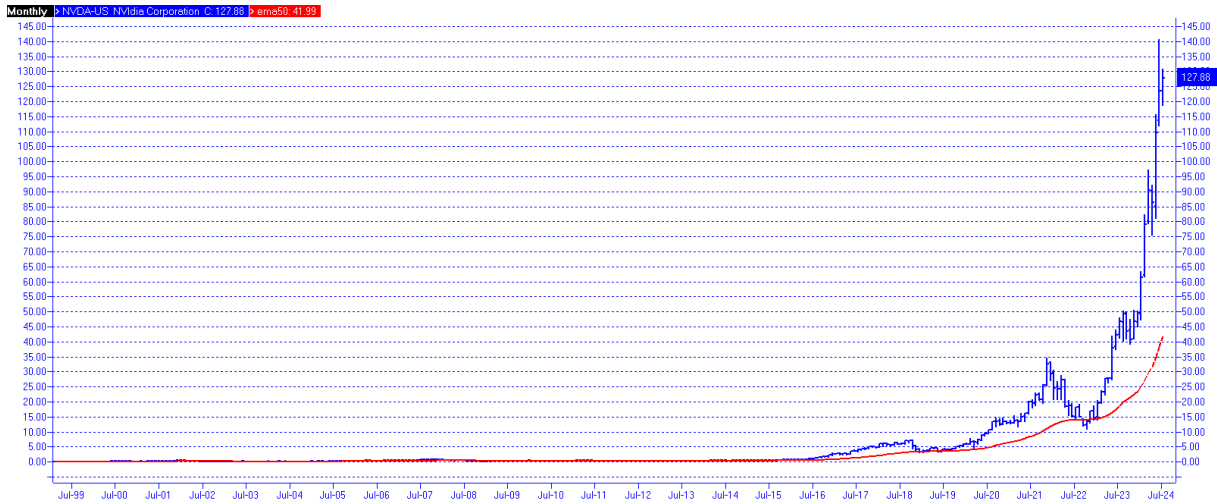
- Price/Revenue: 14.6
- Price/Cash Flow: 31.3
- Price/Earnings: 40.4

Today’s price-to-fundamental ratios are higher than what investors paid for Microsoft’s business in 1995 BEFORE Microsoft’s spectacular expansion from Bill Gates-in-a-garage to a world-dominating firm. MSFT’s future rate of growth is unlikely to be as strong. While we admire the company, we fear the price.



Here is Nvidia.

Nvidia Corp (NVDA-US-\$127.88 | 8-Jul-2024) Feb/1999 \$0.05 -July/2024 \$127.88 monthly ranges



Source: Refinitiv, Hilberry, NBF

Uhhmmmm. Does this look familiar?

DISCLAIMER: We do not hold positions in Microsoft or Nvidia in our model portfolios over which we have trading authority.

Why not own hot stocks, then sell before they drop?

This notion relies on hindsight. Parabolic price charts confirm that investors don't know how to value a company. If 'everyone knows' the future belongs to a given company, why would sellers be willing to accept \$3.60 per Microsoft share in 1990 for a company that is going to be worth \$50 by 2000 or \$5 dollars for NVidia in 2019 when the price will be \$127 5-years later? Marketers of investment services will claim to have predicted these returns. Online chat discussions will be full of gurus and pundits saying the same. Your brother-in-law may be one of them. The faster and farther the prices rise, the more brilliance is claimed. And then it isn't. The chat goes dark, leaving life-altering losses.

Looking at the price chart for Nvidia, a drop from \$125 to \$30 would take the price back to that bump on the chart in Jan/2022 being 'only' 5 times higher than the 2019 \$5 price.

We think our job is to defend savings clients have spent a lifetime accumulating against the ravages of inflation and tax in their retirement. If we get them as clients early enough, we can help compound their savings for the future. Avoiding financial melt-down helps. Experience says overpaying is a fast way to wiping out savings and the tendency to overpay is strongest when everyone else is. Avoiding selling at extreme low, when everyone else is also helps. Recognizing extremes at both ends of investor emotion matters. Valuation is the tool.



Who wouldn't want to make this money? The problem is we can't predict those price gains in advance. We find predictive claims of others don't hold up to scrutiny. We aren't the croupier at the casino roulette wheel. As an investment advisor, it's hard to sometimes say 'No' but we think that's our duty. We may have to refuse some opportunities. We think we are in an environment of extreme enthusiasm for some (but not all) sectors. We see more excesses in the US than Canada.

How to handle extremes.

*Do not buy them! If one has managed to arrive on an idea/sector before the herd and sees spectacular, extreme increases in price that were well beyond the original notion, **you weren't smart, you were lucky.** Experience says recognize those extremes and trim on gains. Initial success can lead to disaster if greed encourages one to place all the chips on the winner. This is hard to avoid.*

Trimming gains ensures you lock in extraordinary winnings. It also means you might experience 'opportunity cost' on the way up. It can be very painful to sell 25% of the holdings at \$70, to see that block trade at \$130 a month or two later.

NOTE: Setting up a small 'Casino' account can help scratch the itch. As the Casino account value must be small enough that losses don't matter, winnings aren't likely to matter much either!

Experience says allowing others to make initial huge returns helps avoid the frequently paired losses. As with Microsoft, experience says selling into and, more importantly, avoiding buying into, parabolic price charts may permit one to buy more cheaply later. Keeping a close eye on valuations helps guide these ideas..

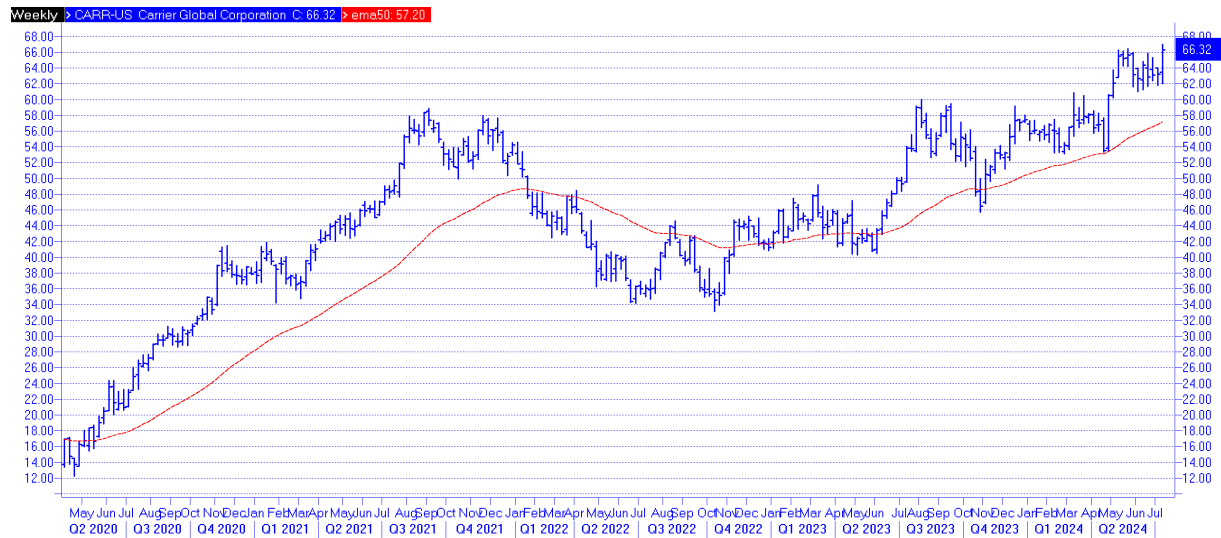
Hope this helps provide perspective."

What do we like today?

Temperatures hitting 35-C in Duncan this week reminds us of air conditioning (AC). Texas saw 45-C recently. Estimates are that climate change will cause higher-high temps. AC may be one reason for the US Southwest boom. If global temperatures continue to rise, AC will no longer be a 1st world vacation luxury. AC technology is currently power-hunger , requiring a flexible power grid than can deliver on-demand surges in power during day time peak demand. . India's economy looks to be improving with infrastructure being a prime factor. 8-10% of India's 1.4 billion population has air-conditioning. This is a huge potential market.

<https://www.iea.org/commentaries/keeping-cool-in-a-hotter-world-is-using-more-energy-making-efficiency-more-important-than-ever>

Carrier Global Corp (CARR-US-\$66.32) weekly ranges 2020-2024



Source: Refinitiv, NBF, Hilberry

We hold shares of AC manufacturer **Carrier Global**. It's been a winner so far.

The price to 12 mos. predicted earnings ratio for CARR is 23X. Not cheap but far lower than Microsoft and Nvidia's trailing P/E. At current prices Carrier looks to be fair value.

DISCLOSURE: I hold Carrier Global personally, for family members and for client accounts over which I have trading authority. We have traded in the security within the past 60 days.

While we're somewhat more cautious on the US than Canada, keep this in perspective. We think the next major move for inflation, short-term interest rates and taxes in the US and Canada is down. This should provide consumer relief and support equity prices in both markets. We're not lowering our overall equity exposure. We're careful where we put it.

Have a Great Weekend

Steve & Anna Hilberry



FOR THE RECORD Intraday: July 12, 2024

DOW INDUSTRIALS:	40,107
S&P 500:	5,634
S&P/TSX COMP:	22,717
WTI:	\$82.70
LOONIE IN \$USD:	\$0.7338 \$US

July 12, 2024

HILBERRY GROUP



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