Harris Associates

PRIVATE WEALTH MANAGEMENT

Caution amidst a concentrated equity market and contentious elections

June 2024

"The opportunity is greatest where assets are least efficiently priced."
David Swensen

The pandemic seemingly had a way of blending years together and whether something happened in 2020 or 2021…"who's to say?" The year-to-date in stocks does not feel immune to that phenomenon. The calendar reads "2024," but given the market movement and the headlines driving those moves, investors can be forgiven for wondering if we're still locked into 2023: narrow market breadth, the stubbornness of inflation, elevated interest rates and question of when hawkish central banks will begin cuts, global conflict, among a myriad of other concerns.

Last year the "magnificent seven" took the mantle from its FANG and FAANG predecessors as the name du jour for market leaders. Those seven stocks contributed disproportionately to the broad market's return, but there was an expectation that the positive performance broadening we saw in the market's fourth quarter would be a harbinger for 2024. Quite the opposite has played out thus far this year.

Through June 30, a scant 5 stocks have driven approximately 55% of the S&P 500's positive return for the year. Distilled further, a single stock accounts for nearly one-third of the market's overall return and only 3 stocks were needed to fuel 86% of the market's second quarter appreciation. This is the most concentrated the market has been in at least 20 years, according to Fidelity.

If we look at the performance of the S&P 500 total return (where each stock is weighted by market cap) versus its equal-weighted cousin, there is a 10-percentage point differential through six months. Only 25% of the S&P 500 components have outperformed the index thus far, and the average stock is up only 5.1%. The broadening we saw at the end of last year did not sustain when the calendar flipped.

In a "what have you done for me lately" world, the question then becomes what does the go-forward look like with the market at an all-time high? To be clear, past is not always prologue and prior performance is not a guarantee of future results. But we have seen these types of movies before and maintain confidence in our process and philosophy. While not directly equivalent, some of the current artificial intelligence (AI) enthusiasm does harken back to the dotcom bubble and companies being valued 3-4x more expensive than the market. That's not to say the companies riding that tailwind are in peril akin to pets.com or companies of that ilk, but rather to suggest that perhaps exuberance should be tempered.

When looking at an S&P 500 trading at nearly 23x 2025 earnings, it looks on the inefficiently priced towards the expensive side. This is mostly because the top end of the market is trading at such rich multiples of earnings. To be sure, some of 2024's high-fliers driving the price of the market higher can and will grow into their earnings multiple; it has happened in the past. But the expansion of those multiples mostly from AI-enthusiasm does merit a certain degree of caution and picking those definitive winners in a nascent industry can come with peril. We are happy to own Alphabet as a firm. But we got involved when the competitive dynamics in search were more known. Had we invested in the early innings, we'd be much happier. But perhaps we'd be more disappointed had we assumed Yahoo or AskJeeves would be the eventual search champion.

A rich valuation on the overall market does not mean we are devoid of opportunity today, however. The equal-weighted S&P 500 is priced at only 15x earnings, so there are areas of cheapness for active managers such to capitalize on the two-tiered market we have seen over the last 18 months. For comparison's sake, our composite portfolio is trading near 11x our estimate of next year's earnings and we continue to be proactive in moving on from things which have reached our estimate of intrinsic value in favor of more attractive opportunities.

"For 240 years, it's been a terrible mistake to bet against America. The babies being born in America today are the luckiest crop in history."
-Warren Buffet

If everything old is new again, is it all the same story? Seemingly the one new major variable has been surrounding global politics; namely contentious elections in major economic powers such as Great Britain, France and the United States. Given the proximity to home for most of our clients, the last is at the forefront of minds and its potential impact on personal investments.

At Harris Associates, we are focused on business valuation through the political and economic cycle. This does not mean we are ignorant to macroeconomic or political machinations and potential impacts to business value, but that our focus needs to be maintained on what a company is worth without over-indexing to potential reactions to the ever-changing political winds from the nation's capital.

Logically, investors expect some volatility in markets during major election seasons, especially when large policy issues such as entitlements, corporate taxes and the regulatory environment for businesses are being discussed. But volatility is opportunity and letting personal candidate preference bleed into your investments is a recipe for underperformance.

Investors have been well served historically to keep politics out of portfolios. For example, every elected President in the

1900s and 2000s have served in office through a recessionary period save two: our current President Joe Biden and Bill Clinton. The latter narrowly escaped that unenviable distinction as he left office in January of 2001 and the US entered recessionary territory in March of that year. Additionally, every president since Herbert Hoover has been in office during essentially a bear market.

Those anecdotes are negative in connotation (bear market, recession) but it should still be noted that despite those challenges in a President's term, the average S&P 500 full-term return for all presidents from 1872 through 2023 has been 28.8% over a four-year term. So while most presidents oversee a recession, bear market, or both, investors who maintain conviction to persevere through various political environments are rewarded. Lastly, according to a study in the New York Times from 1977 through May of 2024, investors saw between ~2-10x higher returns investing apolitically versus investing only when a preferred political party was in the Oval Office.

Whether political wariness or trepidation from a concentrated market that has seen more than 30 record closes thus far in 2024, investors are understandably exercising caution. By focusing on investing in a diversified, inexpensive portfolio and business fundamentals, we believe we're well-positioned for what is to come next.

As always, we thank you for entrusting us with your investment assets and your continued support. Lastly, the best compliment we can receive is a referral from a satisfied client. We appreciate your referrals and handle them with the utmost care.

Thomas W. Delaney, CFA
Portfolio Manager

Back Row: Andrew Gluck, Zorica Zdravkovic, Kaylin Price, Mike Mangan, Kate Feit, Mark Small, Alexander Cyrus
Front Row: Ian Horvath, Alix Havey, Emily Neumark, Tom Delaney

Past performance is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. All returns reflect the reinvestment of dividends and capital gains and the deduction of transaction costs.

The specific securities identified and described in this report do not represent all the securities purchased, sold, or recommended to advisory clients. There is no assurance that any securities discussed herein will remain in an account's portfolio at the time one receives this report or that securities sold have not been repurchased. It should not be assumed that any of the securities, transactions, or holdings discussed herein were or will prove to be profitable.

The information, data, analyses, and opinions presented herein (including current investment themes, the portfolio managers' research and investment process, and portfolio characteristics) are for informational purposes only and represent the investments and views of the portfolio managers and Harris Associates L.P. as of the date written and are subject to change without notice. This content is not a recommendation of or an offer to buy or sell a security and is not warranted to be correct, complete or accurate. Certain comments herein are based on current expectations and are considered "forward-looking statements". These forward looking statements reflect assumptions and analyses made by the portfolio managers and Harris Associates L.P. based on their experience and perception of historical trends, current conditions, expected future developments, and other factors they believe are relevant. Actual future results are subject to a number of investment and other risks and may prove to be different from expectations. Readers are cautioned not to place undue reliance on the forward-looking statements.

The S&P 500 Total Return Index is a float-adjusted, capitalization-weighted index of 500 U.S. large-capitalization stocks representing all major industries. It is a widely recognized index of broad, U.S. equity market performance. Returns reflect the reinvestment of dividends. This index is unmanaged and investors cannot invest directly in this index.

Investing in value stocks presents the risk that value stocks may fall out of favor with investors and underperform growth stocks during given periods.

Harris Associates L.P. does not provide tax or legal advice. Please consult with a tax or legal professional prior to making any investment decisions.

©2024 Harris Associates L.P. All rights reserved.

SCM-3905PWM-10/24