Capital Ideas

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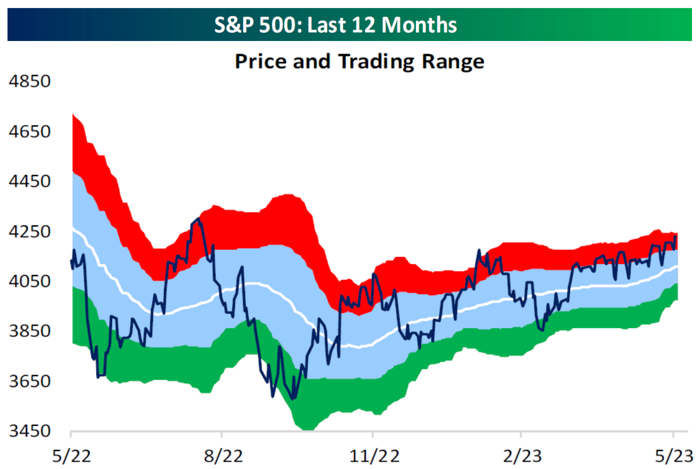
Capital Ideas Advisors
12720 Hillcrest Rd., Suite 910
Dallas, TX 75230

Dear Reader,

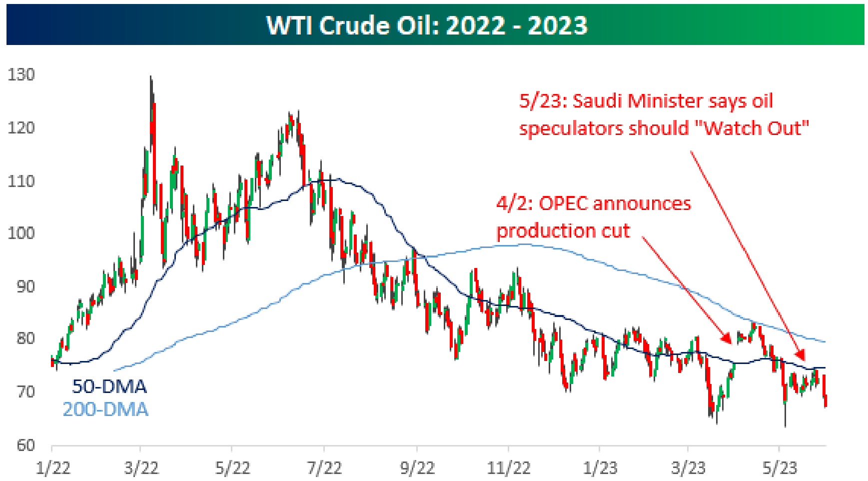
In May, it was more of the same – the largest technology companies with scale and promising growth prospects were the clear winners. During the month, the Invesco QQQ (an ETF which tracks the NASDAQ 100 Index) posted an 8% gain while RSP (an ETF which tracks the equal-weighted S&P 500 Index) was 4% lower. This dispersion highlights the strength of the largest technology stocks and has been a consistent theme throughout 2023.

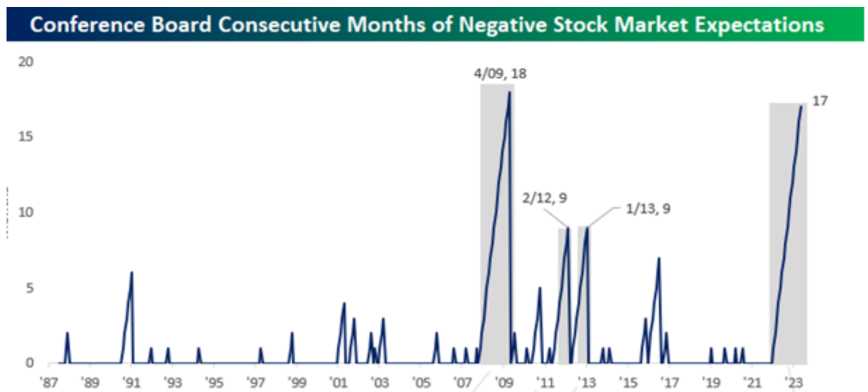


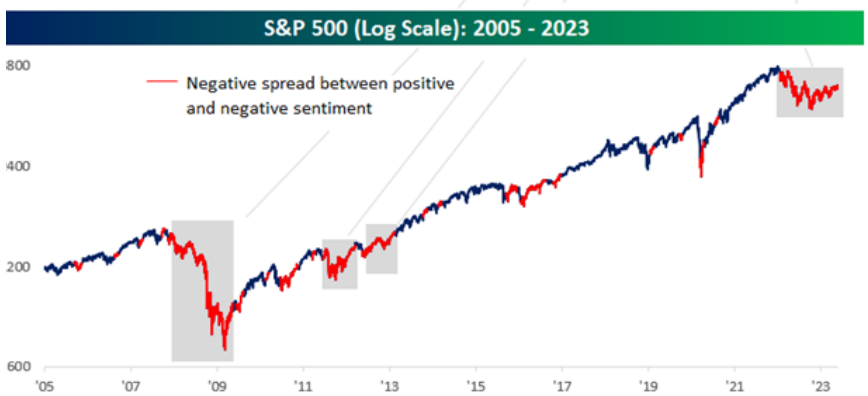
Source: Bespoke Investment Group

We expect this trend to continue as investors flock to companies with proven operating models, strong balance sheets, and clear earnings growth. In our mind this is a "show me" market, suggesting stocks delivering strong earnings results and a positive forward outlook will continue being rewarded. At the same time companies not meeting expectations with unproven or questionable business models will be punished with little support at even much lower prices. As the cost of money is higher the market is clearly seeking both high returns on invested capital and visibility towards growth in the near future. Many of the largest technology companies fit these criteria well and have provided strong leadership in kick-starting what we now believe is a new bull market. That belief was confirmed when the S&P 500 crossed above the 4189 level.

With the debt ceiling drama now out of the way without much fanfare, a welcome contrast relative to 2011 when the market quickly fell roughly 20%, much of the attention has now turned back to inflation and the Fed. One recent positive concerning inflation has been the decline in oil prices. At the end of May crude prices fell back below $70. This was a welcome relief from $100/barrel plus levels consumers and businesses were facing a year ago. While the Fed typically focuses on core inflation data when setting interest rate policy, lower energy prices nevertheless greatly reduce production costs for businesses, lessening the need to raise prices in order to maintain profit margins. Furthermore, lower fuel prices support demand for other goods and services given consumers have higher levels of discretionary income otherwise spent at the pump or on utility bills. While pessimists will quickly suggest this is driven by weaker demand across the globe, this price relief also likely reflects more available supply and lower fears regarding near-term price spikes. This should be generally positive for the economy overall.







Source: Bespoke Investment Group

Investor sentiment remains incredibly bearish, which we believe has been supporting stock prices. Exacerbating the situation has been a continuing barrage of concerning headlines, such as large banking failures, uncertainty regarding the debt ceiling, Fed policy, and inflation fears. Aside from the strength across large technology companies, this strong contrarian indicator is the most convincing data point regarding the prospect for a continued rally in our view.

Despite the S&P 500 being up 9.6% thus far in 2023, the percent of investors who are bullish (as measured by the American Association of Individual Investors) ended May at 27.4%, virtually flat compared to 26.5% at year-end 2022 and significantly lower compared to the historical average of 37.5%. The percentage of bearish investors stood at 39.7%, lower compared to 47.6% at the end of last year but well above the 31.1% historical average. This indicator can be a useful tool when assessing the risk of a market decline as sentiment falls, resulting in selling pressure, or a rally as formerly pessimistic investors finally put dollars back to work. As an example, bullish sentiment reached as high as 62% at the end of the 1990s (with a staggeringly low 11% bears) at the peak of the dot-com bubble. This bullish crescendo of positive sentiment preceded the brutal three-year bear market to follow. On the flip side, bullish investors totaled well under 20% of survey participants in early 2009 as the S&P 500 set its low of 666. Interestingly, during March - April 2020, as the market was plummeting bullish sentiment averaged 32.3% and never fell below 23.7% during those months. We believe sentiment readings are a useful inverse indicator of future market direction. As such we feel the extremely bearish sentiment levels that have persisted throughout 2023 support our view that the current stock market rally has further room to run. Given these beliefs we will be looking to put some of your excess cash to work utilizing investments suitable for your specific needs.

As always, we thank you for your patronage and encourage you to call us with any questions or concerns.

Sincerely,

C. J. Brott

CJ Brott

Karen Burns

Karen Burns

Andrew Kerai