FSA INVESTMENT GROUP

GROUND CONTROL TO MAJOR TOM

In the iconic song, *Space Oddity*, David Bowie tells the story of an astronaut named Major Tom, who Ground Control informs that a malfunction has occurred in his spacecraft. Still, Major Tom does not get the message and remains in space in awe of what he sees, with no clue that his spacecraft is damaged. As we review the market landscape, in many ways, it feels like the U.S. stock market is acting like Major Tom. With the buzz of Artificial Intelligence and its promise to transform businesses, resulting in higher future profits for some of the largest technology companies, the S&P 500 is up 14.3 percent year-to-date (through June 16th). However, when we look underneath the surface, we see a market that is not as healthy as it first appears.

The signs of a strong market usually exhibit broad participation by most stocks. Diving deeper, we can see that this has not been the case, as 86% of the year-to-date return of the S&P 500 can be attributed to the *Magnificent 7* -- Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta, and Telsa. According to Howard Silverblatt of S&P Dow Jones Indices, excluding these companies, the S&P 500 would have returned 1.9% year-to-date(1). The performance of the S&P 500 index is now the most concentrated it has been since the 1970s. In fact, Apple is worth more than the entire Russell 2000 of smaller US companies at $2.9 Trillion. To put this into perspective, in 2019, Apple had a value of $672 Billion compared to the Russell 2000 value of $2 Trillion.

Another reliable gauge for the market's health is to compare the S&P 500, which is market cap weighted (2) (i.e. companies with a higher total market value receive a higher weighting in the index) versus the S&P 500 equal weighted index (see **Figure 1**). For the first 5 months of the year, the Equal-weighted index was actually down 1.4% while the S&P 500 was up 8.9%. June has been a good month for both indices, but it still does not reflect healthy stock market internals. As it stands now, the Equal-weighted S&P 500 is lagging the market cap weighted index by the greatest degree than at any time since 1990.

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ABOUT OUR FIRM

We are dedicated to providing investment management and strategic wealth planning to Indian tribes and high net worth individuals. Simply put, we strive to be our client's trusted advisor.

As a financial advisory firm, our primary focus is to provide unbiased opinions that are designed to achieve long term investment results. FSA Investment Group does this with the highest levels of trust, integrity and respect while always collaborating using a team approach. We are dedicated to professionally supporting, educating, and providing informed direction to each and every client.

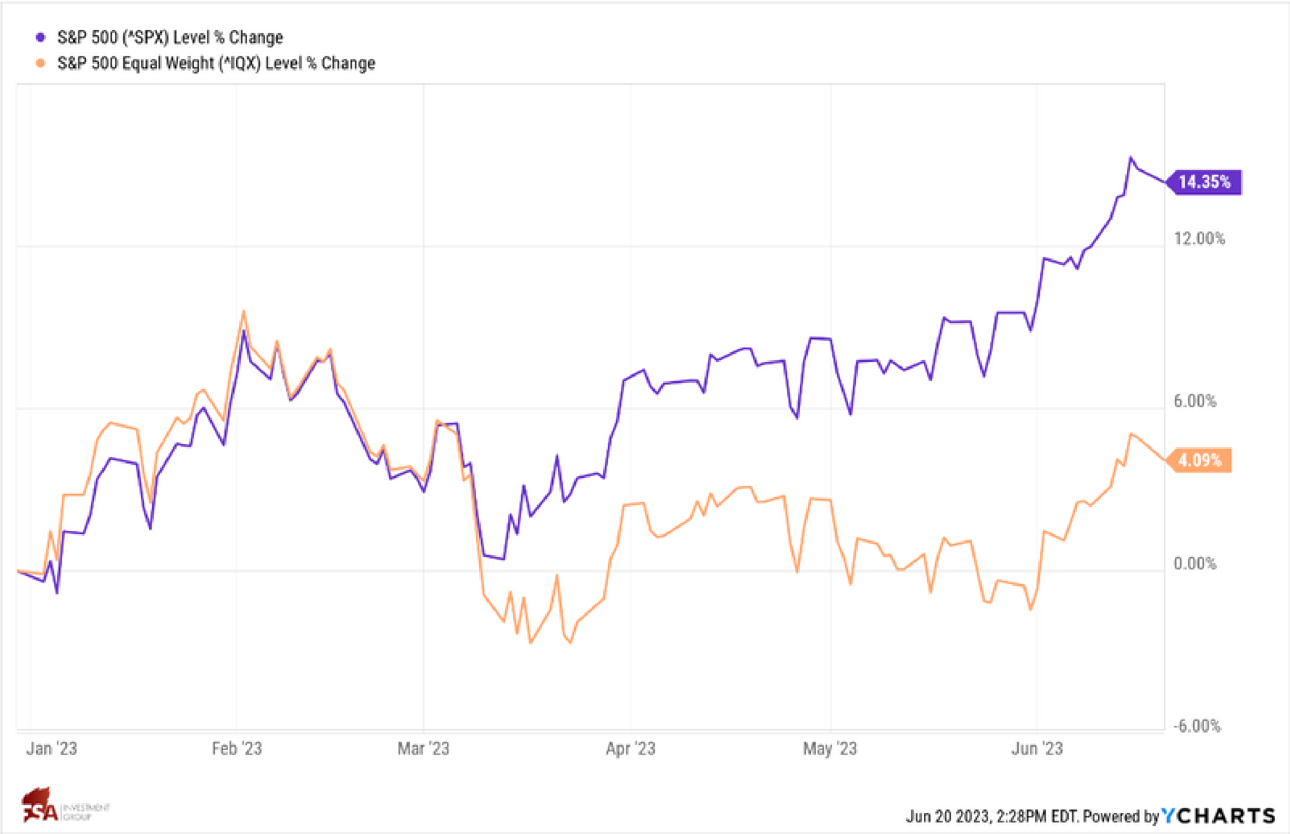

Figure 1: *FSA Investment Group, yCharts; as of June 20th, 2023*

Another method we use to gauge participation is to view the percentage of stocks that are trading above their 200-day moving average. As it stands, 63% of the S&P 500 companies are above the 200-day average, which is respectable, but not at the 80-90% you expect to see during a bull market.

The oddity of this market is not only in the price action, but also in the fundamentals. According to FactSet [3], S&P 500 earnings growth has been negative 8% for the first half of 2023. For the 2nd Quarter 2023, estimated earnings decline of 6.4% would market the largest earnings decline since the COVID driven 2nd Quarter 2020. For the 2nd half of 2023, Wall Street analysts are expecting 9 percent earnings growth, thereby resulting in flat earnings for the full year 2023. This expected earnings growth is with the backdrop of higher interest rates, tighter credit and slowing economic growth. While the market's bullishness on earnings could transpire, there remains a lot of unknowns as to the lagged effects of raising interest rates over 500 basis points in less than 15 months. This is the first time in the history of the Federal Reserve Senior Loan Officer Study that the Federal Reserve has hiked interest rates while lending standards are this tight. Furthermore, this is the first time the Fed has tightened with S&P 500 earnings trending lower.

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What does all of this mean for the market? Investors are caught between fear of missing out and concerns that the market has run too far, too fast, coupled with elevated valuations and economic headwinds. As we review the landscape, we believe investors can be rewarded by holding cash which is yielding 5% (as of June 20th, 2023) and have some dry powder if the market does experience some volatility. During these times of narrow leadership, either we will see the rest of the market start to outperform the *Magnificent 7*, or these 7 stocks lead the overall market lower. While we are excited about AI and its future, it is still too early to tell if this is revolutionary or evolutionary. For now, as we look at our indicators of slowing economic growth, inverted yield curve and tighter monetary policy, we maintain our defensive positioning.

As Bowie's lyrics for Major Tom exclaim, *"Here am I floating 'round my tin can, Far above the moon, Planet Earth is blue, and there's nothing I can do."* Fortunately, as investment advisors we are Ground Control and we do have a plan. We will continue to monitor the situation and maintain a stance of keeping higher levels of cash. However, if the economy continues to show resilience, this may usher us to turn less defensive and towards our more neutral, strategic positioning.

1. https://www.statista.com/chart/30219/main-contributors-to-s-p-500-gains-in-2023/
2. https://www.investopedia.com/terms/c/capitalizationweightedindex.asp
3. https://insight.factset.com/what-is-driving-the-expected-rebound-in-sp-500-earnings-growth-in-q4-2023