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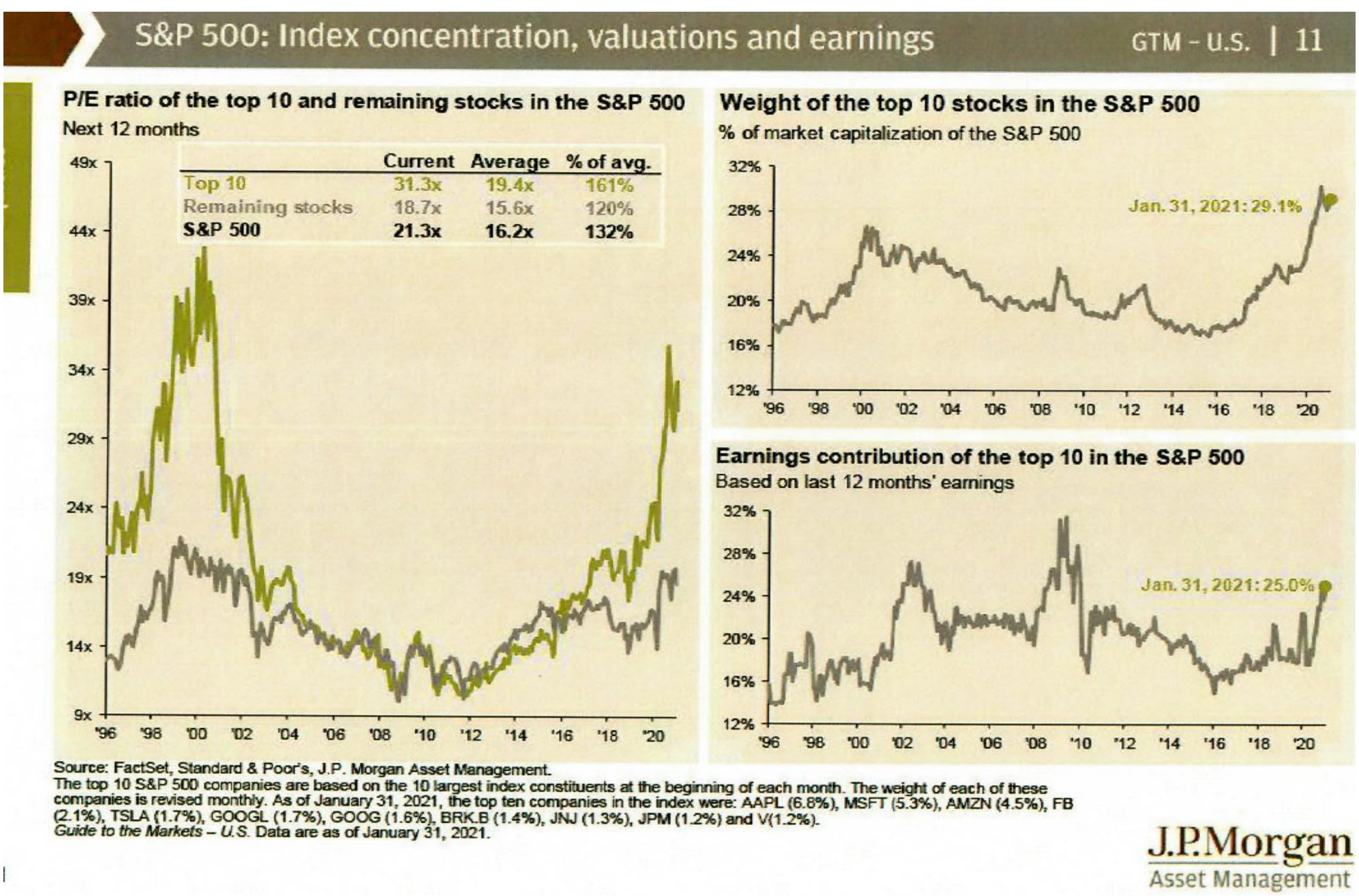
Portfolio Talk **Market Update 2/19/2021**

We've talked in past Portfolio Talk's about markets that are narrow in scope, meaning the majority of the return of a given stock index (S&P 500) is garnered from a few stocks. This was apparent in 1998-2000 during the Tech Bubble, again in 2005-2007 with financial firms and the housing bubble and again in 2020-to present day. While today's concentration in a few positions has not gotten to the levels in the past, we are starting to see the beginnings of this scenario.



As evidenced by the chart above, the 10 largest positions in the S&P 500, ranked by capitalization as of January 31, 2021 were Apple (6.8%), Microsoft (5.3%), Amazon (4.5%), Facebook (2.1%), Tesla (1.7%), Google A shares (1.7%), Google B Shares (1.6%), Berkshire B Shares (1.4%), Johnson & Johnson (1.3%), JPMorgan (1.2%) and Visa (1.2%). Google has two different classes of stock that are offered on the markets. So, 28.8% of the return of the S&P 500 comes from 10 companies while 71.2% comes from the remaining 490 companies in the index. What is also suggestive of increased concentration is the relationship of the P/E ratio to the top 10 largest companies (31.3x) verses the remaining companies (16.7x) and the average (18.7x). This supports the reasons why large cap growth has outperformed large cap value over the last decade. Earnings have exploded, led by technology, but will these large companies begin to regress to the mean due to their enormous size? Can Apple become a $4 trillion company when just a year or so ago it was the first company to break the $1 trillion mark, quickly followed by Google and Microsoft. Kind of like Roger Bannister breaking the 4-minute mile!

It's our belief that the growth will slow, and this will highlight the value in other large cap companies that may have the capacity to grow larger for longer. Examples might include companies in healthcare, infrastructure, financials (especially fintech) and clean energy. Fundamentals do still count. Investors will need to stick to a discipline that reviews those fundamentals routinely as returns could become harder to achieve. Often times this leads some to the glamours of quick profits from the likes of GameStop's. Focus and patience, "investing in what you know" as Fidelity's infamous Magellan Fund portfolio manager Peter Lynch use to say. While I'm happy that we have 6 of the 10 largest cap positions in the S&P 500 in the portfolio (Apple, Microsoft, Google, J&J, JPMorgan and Visa) I'm also pleased that we have a well-diversified portfolio encompassing other large cap companies whose disciplines cover areas I mentioned above. As Wayne Gretzky use to say, "I skate to where the puck is going, not to where it's been". Chasing return is a dangerous game. We believe that investing and being patient with companies while they fulfill their potential is the secret to success.

Economic News

- Monday:
  - Markets Closed
- Tuesday:
  - Empire State Manufacturing Index for Feb., 12.1 vs 5.9 expected and 3.5 previously…positive.
- Wednesday:
  - Retail Sales for Jan., 5.3% vs. 1.2% expected and -1.0% previously…very good!
  - Retail Sales Ex-autos for Jan., 5.9% vs. 1.0% expected and -1.8% previously…very good!
  - Producer Price Index-Final Demand for Jan., 1.3% vs. 0.4% expected and 0.4% previously…could signal higher inflation. Need to watch closely.
  - Industrial Production for Jan., 0.9% vs. 0.5% expected and 1.3% previously…good.
  - Capacity Utilization for Jan., 75.6% vs. 74.8% expected and 74.9% previously…holding.
  - Business Inventories for Dec., 0.6% vs. 0.5% expected and 0.5% previously…holding.
  - Household Debt for Q4, 1.4% vs. 0.6% previously…increasing.
- Thursday:
  - Initial Jobless Claims (state, SA) for Feb. 13th, 861,000 vs. 770,000 expected and 848,000 previously…holding.
  - Continuing Jobless Claims (state, SA) for Feb. 6th, 4.49 million vs. 4.56 million previously…holding.
  - Housing Starts (SAAR) for Jan., 1.58 million vs. 1.68 million expected and 1.67 million previously…excellent.
  - Building Permits (SAAR) for Jan., 1.88 million vs. 1.67 million expected and 1.70 million previously…excellent.
  - Import Price Index for Jan., 1.4% vs. 1.0% expected and 1.0% previously…importing inflation!
  - Philadelphia Fed Manufacturing Index for Feb., 23.1 vs 19.2 expected and 26.5 previously…holding.

- Friday:
    - Markit Manufacturing PMI (flash) for Feb., 58.5 vs. 59.0 expected and 59.2 previously…holding.
    - Markit Services PMI (flash) for Feb., 58.9 vs. 58.0 expected and 58.3 previously…holding.
    - Existing Home Sales (SAAR) for Jan., 6.69 million vs. 6.66 million and 6.76 million previously…excellent.

The economy and markets continue to perform well given the economic relief packages put forth to bridge the gap in achieving herd immunity. The question is still, what will be the effect given the pent-up demand for both the economy and markets when the vaccine is distributed? Will we have a roaring "20's? It appears that most economic forecasts for GDP are starting to elevate. Goldman Sachs just raised their 1st quarter growth forecast to 6.8% from 6.6%. Morgan Stanley did the same raising theirs to 6.4% from 6.0%. Will this belief be enough to push the economy for the next 12 to 24 months? It's going to be an interesting journey regardless of how "growthy" it gets. Having confidence that we've defeated the invisible enemy will be inspiring!

The political theater surrounding the GameStop debacle was quite interesting, NOT! But then again, I wasn't expecting much. Was there market manipulation that caused the near collapse of Robinhood? This is what congress needs to determine and find ways to prevent the possible reoccurrence.

FACTSET issued their Earnings Scorecard on February 12th stating with 74% of the companies in the S&P 500 reporting actual results, 80% reported positive earnings surprises and 78% positive revenue surprises. When the economy fully recovers companies should be in good shape to lever their improving revenue given the cost cutting that has transpired.

Johnson & Johnson's vaccine gets its Emergency Use Authorization (EUA) hearing next Thursday. Hopefully the hearing goes well, and approval is granted…. the more the merrier!

Stay Safe!!

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