NAPATREE CAPITAL

July 18, 2024

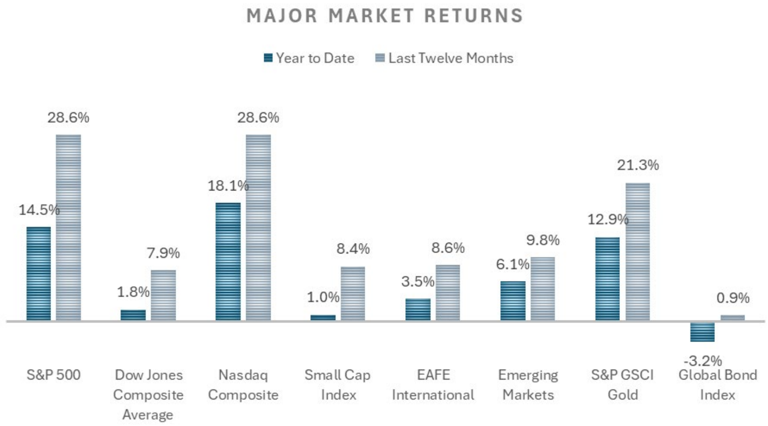
Dear Friends,

As the year progresses past the halfway point, I'd like to highlight some market dynamics which we think will become common themes in the second half of the year. Most importantly, the significant one-sidedness in outperformance from the largest public companies, mostly in the tech sector, has created an extremely top-heavy market. What exactly does that mean? When the price of a company's stock increases, their market capitalization – or total value – increases. The larger the valuation, the heavier the weighting in the S&P 500. According to JP Morgan (chart below), the top ten stocks in the index equate to 40% of the total value of that index, which means that fewer than 3% of the stocks in the index have an oversized influence on market swings. It also means that if you hadn't invested in those ten stocks, it would be nearly impossible to produce returns in line with the S&P 500.

The boom in artificial intelligence is a major factor for the outsized performance of shares of large tech companies, which dominate the top ten.

Consequently, valuation is now skewed to an historic degree. That group of stocks is trading at a price to earnings ratio (P/E) of 30x, while the remaining 490 stocks trade at a multiple of less than 18x earnings. There have been two periods in the past thirty years marked by a high concentration of stocks driving the market with a similar gap in valuation to what we are seeing today: the fourth quarter of 2019 and the third quarter of 1999. Both times preceded major turns in stock prices. History may not repeat, but it often rhymes. Momentum is a powerful factor in investing and AI has created a frenzy and a "fear of missing out" mentality that we haven't seen since the dot com craze.

This is not to say a bubble is about to burst. But there is mounting evidence that a rotation into more of the 'blue chip' type companies may start to unfold. One data point to consider: the Dow Jones Industrial Average is up 8% in the past twelve months and less than 2% in 2024 (through June 30). The Nasdaq Composite has returned 29% and 18% in those same time periods. As an illustration below are returns for the major indexes:



Given the current trends, we expect to see better performance from shares of undervalued stocks. In other words, smaller companies and those not at the center of the AI boom should start to garner attention from investors, with emphasis on *should*. But the human psyche, as we've written about many times, is a critical factor in investing. Fear and greed drive stock prices in the short term. And very often overpriced stocks – or markets – stay overpriced for a long period of time. Timing a change in the market is a fool's errand, which is why we remain patient and disciplined in our approach, as always.

Napatree Capital Update
You may have seen increased trading activity recently due to our semi-annual rebalance of accounts. There are no major changes; we consider your long-term objective and the nuances of each client's situation when trading (i.e. taxes). Cash levels may be a bit higher than usual in the near term but will be invested in higher yielding money markets until better opportunities unfold for that cash.

In more exciting news, our business continues to steadily grow. Hopefully you read the announcement about Aaron Simmons, who joined the firm in April. Aaron has more than 25 years of experience as a portfolio manager and advisor, having most recently worked as a senior member of the Washington Trust Wealth Management group. He helps strengthen an already deep bench and enhances our expertise to deliver the most positive experience – and results – for our clients.

Thanks for your continued support and trust in our ability to manage your wealth.

Jeff Liguori
Managing Director | Chief Investment Officer