

Investing in the Stock Market

Through late June the S&P 500 is up over 14% in the first half of 2024 and up over 25% in the last 12 months but that growth has been largely fueled by the 6 largest stocks in the index: Apple(AAPL), Amazon(AMZN), Alphabet(GOOG), Meta Platforms(META), Microsoft(MSFT), and Nvidia(NVDA). The top 10 stocks in the S&P 500 make up a record high 35% of the index.

These stocks are technology stocks that trade at very high multiples. This means that the enormous growth potential of future earnings is already priced into these stocks. A more diversified portfolio of the 500 stocks where each of the 500 stocks make up .2% of the index as represented by Invesco S&P 500 Equal Weight ETF(RSP) returned only 4.3% for the first half of the year and only 13.68% for the last year.

Clearly any index with that is overweight NVDA would have outperformed. What can investors learn from this information? NVDA is trading at 73 times earnings and the S&P 500 is trading at 29 times earnings. Therefore, either the handful of stocks that have been driving the growth of the index will continue to grow their earnings at a rapid pace and ultimately justify their current lofty valuations or the S&P 500 index will need to correct.

For investors, the combination of big index weightings and lofty valuations poses a risk. If investors were to suddenly decide to take profits, weakness in that sector alone could be enough to trigger a bear market, notes independent Wall Street researcher Jim Paulsen. If the top stocks have a pullback because of earnings that don't meet expectations, they could drop significantly. "Because of their outsized weightings—the S&P 500 Index could suffer a 20%+ decline," he writes.

One way to mitigate the risk of investing in overvalued sectors is to invest in an equal weight index like RSP. The fund's allocation to technology stocks is a significant, but not overwhelming 16%. Its portfolio is trading at 18 times earnings, compared to 28.4 for the S&P 500.

Singer Wealth Advisors is an SEC registered investment advisory firm. Registration with the SEC does not imply a certain level of skill or training. Discuss with your financial/tax professionals before investing. Past performance does not guarantee future results. Material provided for informational purposes only.