



THE BERKSHIRE OBSERVER

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Commentary
2Q 2023

EQUAL AND OPPOSITE FORCES

July 2023

2023 market performance draws a stark contrast compared to 2022. Last year, growth was pummeled, dragging most major indices down. Now, through mid-year, investor appetite pulled a 180 and just a handful of mega-cap tech stocks launched the S&P 500 and growth indices higher. Value indices are closer to flat YTD, however, performance narrowness and concentration are on full display. For example, the top 10 stocks contributed about 13% to the S&P's 16% return. The remaining 490 S&P 500 stocks were up a lackluster 3%. Furthermore, to call the Russell Large Growth Index diversified is likely a misnomer at the moment. As of 6.30.2023, the 10 largest market cap names in the Russell Large Growth make up over 50% of the entire index!

Top 10 Individual Stock Contributors to Index Performance in 2023

Name	Total Return 12/31/22 to 6/30/23	Contribution to Index Total Return	Avg. Index Weight
S&P 500	16.79		
APPLE INC	49.72	3.01	6.94
MICROSOFT CORP	42.66	2.40	6.13
NVIDIA CORP	189.54	2.16	1.94
AMAZON.COM INC	55.19	1.31	2.71
META PLATFORMS-A	138.47	1.18	1.34
ALPHABET INC-A & C	35.67	1.15	3.43
TESLA INC	112.51	1.15	1.45
BROADCOM INC	57.11	0.41	0.79
ADV MICRO DEVICE	75.87	0.26	0.43
ELI LILLY & CO	28.94	0.26	0.87
Top 10 Contribution to Index Return		13.27	

Top 10 Individual Stock Detractors to Index Performance in 2022

Name	Total Return 12/31/21 to 12/31/22	Contribution to Index Total Return	Avg. Index Weight
S&P 500	-18.17		
APPLE INC	-26.40	-1.89	6.86
AMAZON.COM INC	-49.62	-1.88	3.17
MICROSOFT CORP	-28.02	-1.71	5.80
TESLA INC	-65.03	-1.66	1.91
ALPHABET INC-A & C	-39.09	-1.66	3.81
META PLATFORMS-A	-64.22	-1.26	1.19
NVIDIA CORP	-50.27	-0.90	1.33
PAYPAL HOLDINGS	-62.23	-0.33	0.32
WALT DISNEY CO/T	-43.91	-0.32	0.60
NETFLIX INC	-51.05	-0.30	0.36
Bottom 10 Contribution to Index		-11.93	

We believe the investment dichotomy from the past few years creates openings for those remaining disciplined. On the other hand, it poses a real threat to those who are not. Investors enticed by chasing what's hot, can dismantle even the best financial plans. Consider, if you chased what was working over the past couple of years, here are the results:

- Buy growth at the end of 2021 – Russell Growth -29% for 2022
- Buy value at the end of 2022 – Russell Large Value +5.50% YTD for 2023

Results that leave an investor far behind owning one index or the other over the same period of time.

We identify; however, these recent and dramatic performance dispersions in investing styles may challenge investor patience. 2022 was a notable year for dividend and value strategies. Most dividend indices were roughly flat, while the S&P 500 languished, down nearly 20%. Growth and momentum as factors got smoked, while dividends, value and profitability held up much better. Now, midway through 2023, "equal and opposite" forces shape YTD performance. Dividends, value and profitability are all negative factors. On the other side of the performance spectrum, familiar faces sit near the top (Facebook, Amazon, Apple, Microsoft, Google, Tesla, and Nvidia) and drove nearly the ENTIRE S&P 500 YTD performance. We'd agree these 7 are great companies; they have superior balance sheets, strong earnings, cash flow, and dominant businesses. The issue is valuation, which to say the least, is extended. For example, Nvidia, an artificial intelligence and gaming chip maker, trades for approx. 40 times trailing SALES. Meta, up over 130% this year, has lackluster growth but still trades at 22x forward earnings.

So the big question is – "Will this narrow performance persist?"

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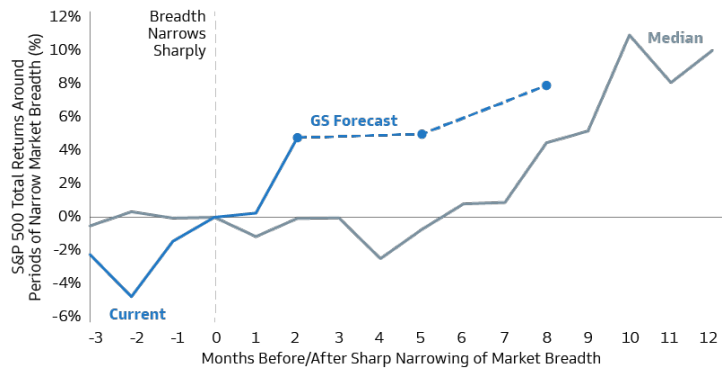
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- Valuation Does Matter

Perhaps, but be mindful that the risk of performance whiplash appears very high at the moment. We recognize disciplines move in and out of favor, but we've found sticking to cogent long-term investment processes and patience tend to be more successful than darting in and out of markets – We do however, suspect the market regains balance in the not-so-distant future.

(Source: Bloomberg)

“Past episodes of similar breadth have delivered lackluster short-term performance, but returns have historically surged a median 10% in the 12 months following. A “catch-up” effect from remaining index constituents reflects a key catalyst sustaining this rally.”



Source: Bloomberg, GS GIR, and GS Asset Management. As of June 14, 2023.

AI BREAKTHROUGH?

We suspect the AI investing mindset is behind some of the “market narrowness”. Flashbacks of 99’ surface as investors are clamoring to “get in”. Similar to AI today, in 99’, the internet seemingly permeated every investor’s mind. Market pundits squawked about the haves and have-nots. Microsoft, Cisco, Intel, Oracle, GE and IBM were all “market darlings” of the dot-com era and surged in value and market cap, creating concentration in the indices -- much like today. In fact, many of these stocks went up 10x in just a few years and valuations were pushed to extreme levels.

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2 observations/lessons feel comparable today:

1. **Valuation does matter:** Similar to the dot.com era stocks, AI investors appear to be paying huge premiums for this “feel good” trade. In hindsight, those who paid premiums for the market darlings during the dot.com era ended up with abysmal returns over the next decade. These companies weren’t bad businesses, they were just way too expensive.

Returns for “Market Darlings”: 3/31/2000 - 3/31/2010

- Microsoft (MSFT) (-32.39%), General Electric (GE) (-52.85%), Cisco (CSCO) (-66.33%), Intel (INTC) (-61.15%), Oracle (ORCL) (-33.51%), IBM (IBM) +20.84
- Furthermore, for every name on this list, there were dozens more “dot.com stocks” that no longer exist.

2. **Companies are adaptive:** Every company became an internet company. Yes, the internet paradigm didn’t just benefit a handful of early pioneers... the technology broadened out and all or most companies figured out how to adapt and best leverage. This technology shift led to increased productivity across the broader economy and created secular tailwinds for the following decades. We envision a very similar path for AI. The handful of companies grouped in the AI trade are not the only ones that will likely benefit... Business leaders across the globe are exploring AI business applications. And just like the internet, AI will likely permeate all sectors of the economy and provide tailwinds for the decade ahead.

(Source: Bloomberg)

CONCLUDING REMARKS

Despite all the earlier banking turmoil, recession chatter and influence of the Fed, we would like to remind investors that historically the U.S. stock market has been incredibly resilient, and staying the course is likely beneficial in the long run. Chasing the hot “dot”, panic selling and overreacting are rarely good ideas in investing. Over time the effects of compounding stock prices and dividends can be dramatic, but it takes time and discipline. Thank you for your continued trust and support, and we look forward to updating you in the next quarter.

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