FAHNESTOCK ASSET MANAGEMENT

of Oppenheimer & Co. Inc.

Craig W. Hutchison
Managing Director
Senior Portfolio Manager

Andrew A. Westhuis, CFA, CFP
Managing Director
Senior Portfolio Manager

382 Springfield Avenue, Suite 400
Summit, NJ 07901
Phone 908-273-2100
Fax 908-273-0788
Toll Free 800-522-785

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Dear Client,

"How's the market doing?" is a common question. The stock market? The bond market? The supermarket? We don't sell vegetables so "THE MARKET" people usually want to discuss is stocks and we know to quote the S&P500. As mega cap technology companies have ballooned in size, six companies have eclipsed the other 494 in the S&P500 distorting its usefulness as a measure of domestic stocks/the economy.

The S&P500 is the most popular American stock index and is comprised of 500 companies meant to be representative of the economy. A company is eligible for inclusion if worth more than $15.8 billion, trades at least 250,000 shares per month, is headquartered in the US, and has a record of positive earnings. It is a market cap weighted index so the weight of a given company is directly proportional to its size. The more a company is worth, the larger it's impact on the index.

The six largest companies in the S&P500 are all in the technology sector, and represent 28.1% of the index, roughly the same percentage occupied by the bottom 400 companies combined. Microsoft is so large that if it were to disappear, it would have the same impact on the S&P500 as the bottom 240 companies going bankrupt simultaneously.

	Weighting SP500	Size (in trillions of USD)
Microsoft	7.15%	$3.06
Apple	6.3%	$2.85
Nvidia	4.53%	$1.96
Amazon	3.71%	$1.81
Alphabet	3.68%	$1.67
Meta Platforms	2.52%	$1.07

The returns of these six companies are highly correlated and cumulatively were responsible for roughly 60% of the S&P500's returns in 2023 due to their exposure to the boom in artificial intelligence. We aren't financial renegades and certainly maintain exposure to the technology sector and we have participated in the boom in AI through ownership in Advanced Micro Devices and Synopsys. We continue to be constructive on the theme long term but also recognize that, in the short term, booms have the habit of becoming bubbles, and bubbles have the habit of popping. We manage risk in portfolios by taking profits as securities appreciate and will continue to do so for AI related stocks if the exuberance continues, something indices do not do.

These six stocks are priced for perfection and should the AI narrative deteriorate they could have an outsized negative impact on index returns. Our contention is that such a large allocation to just six stocks in one sector is an imprudent lack of diversification. If the SP500 were your portfolio manager they would be in violation of their fiduciary duty.

A properly diversified portfolio includes more asset classes than just large cap tech stocks. It should include small/mid-sized companies that tend to be more nimble and are less likely to be over owned and over analyzed by every mutual/hedge fund and bank/brokerage analyst on Wall Street. It is also critical to own foreign companies. In 2023 there were roughly 3,700 American companies on US exchanges, down from 5,164 in 1980. In that same timeframe the number of publicly traded companies globally has tripled from 17,728 to over 55,000. Globalization and overseas growth has greatly amplified the attractiveness and menu of available investments.

Bonds are perhaps the ultimate diversifying complement to a stock portfolio as they tend to outperform in downturns and are especially attractive given current interest rates. Expanding asset classes beyond just large and mega sized companies reduces correlations which dampens volatility in a portfolio and allows for slow and steady long term growth.

“THE MARKET” – the S&P500 – has morphed into a proxy for one asset class, mega cap American tech stocks. You own a diversified portfolio that includes large, medium and small companies, both foreign and domestic as well as fixed income. You don’t own “THE MARKET”.

As always, if you would like to review how your portfolio is constructed to meet your goals in the context of your tolerance for risk we would love to hear from you!

Sincerely,

Craig W. Hutchison
Managing Director
Senior Portfolio Manager

Andrew A. Westhuis, CFA, CFP
Executive Director
Portfolio Manager