



MARKET COMMENTARY

BERGOS
PRIVATE BANK



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As Bergos' Chief Equity Strategist, Frederik Carstensen leads the top-down equity strategy. He is a member of the investment committee and regularly comments on events in the international capital markets.

AFTER THE REPORTING SEASON: WHAT'S NEXT FOR THE MAGNIFICENT 7?

The US equity market recently reached another major milestone. In early February the S&P broke the 5000 level for the very first time. "It's important to note, though, that this rise was largely driven by a limited number of highly capitalized technology stocks, resulting in an unusually high market concentration," remarks Frederik Carstensen, Chief Equity Strategist at Bergos. "Despite this concentration, these sector leaders again showed their worth in the latest reporting season, even under the highest expectations, and they look set to retain a dominant position. Given the significant weighting these tech giants have in US and global equity indices, this development is highly relevant for all equity investors," he notes.

Mega cap stocks on the rise

Just seven stocks – Apple, Amazon, Alphabet, Meta, Microsoft, Nvidia and Tesla – make up almost 30% of the S&P 500. These companies have accounted for more than half of the increase in the S&P 500 since the start of 2023. The performance of some of these stocks over this period is remarkable: Nvidia has quadrupled, Amazon has doubled, Microsoft and Alphabet are up 70% and 60% respectively.

"The price increases are justified. The latest quarterly reports from these companies show three main factors that have led to their record highs. First, earnings growth has picked up again after stagnating in 2022, providing ongoing support. Second, valuations are still reasonable, even after the latest rise. Third, the potential of artificial intelligence (AI) is accelerating, and those companies are both the initiators and the beneficiaries of this trend," says Carstensen.

But not all members of the Magnificent 7 have shined equally. Tesla, for instance, is the weakest link in the chain and recently dropped out of the list of the world's ten largest companies. Some market players are even asking if the car maker really belongs in the Magnificent 7. As a result, there is now talk of the Fabulous Five, with Apple and Tesla being excluded from the Magnificent 7.

Earnings growth of the Magnificent 7 remains promising compared with the index

“The earnings story of these seven companies started with the cost cutting brought in after the pandemic-induced technology boom in 2020 turned into a decline in 2022 and part of 2023,” Carstensen remarks. Because of the fall in demand in all business areas, companies with high scalability like Microsoft, Amazon and Google cut spending to protect their profit margins.

Valuations still appropriate, even after the recent rally

Even after the remarkable performance by the Magnificent 7 in 2023, there have been no signs of weakness so far this year. “Valuations have indeed risen, but much of the increase is due to rising earnings forecasts for the coming year. What is indisputable, however, is that these mega caps are trading at a premium to the rest of the S&P 500. In view of the robust earnings growth, though, we need to analyze the valuations after adjusting for that growth. This approach is known as the price to earnings to growth ratio, and suggests that the valuations of the Magnificent 7 are still appropriate,” says Carstensen.

Potential of artificial intelligence is continuously increasing

The launch of AI is leading to huge investments in the technology sector and the first clear results are already apparent. At Microsoft, for example, AI investments contributed twice as much to the expansion of the cloud business as in the previous quarter. Microsoft, Meta, Alphabet and Amazon are likely planning further capital spending on server centers to support this steady growth. These investments should create more sources of revenue for companies like Nvidia and other chip manufacturers. Moreover, the accelerated introduction of these technologies is also expected to have an impact far beyond the tech and tech-based sectors.

Although many large companies and the broad equity market are still benefiting, the current environment suggests the need for an increasingly selective approach. “A third of the stocks in the S&P 500 are still down since the start of 2023 and there is the potential for other themes like healthcare innovation and continued consumer resilience to support the recovery in some areas going forward. Given the diversity of earnings outlooks, both within and between sectors, careful stock selection can help achieve promising returns. The current environment therefore appears to be favorable for active equity managers, as the latest performance of the Magnificent 7 illustrates,” concludes the Swiss private bank's equity expert.



Bergos AG is an independent Swiss private bank with headquarters in Zurich and offices in Geneva. It emerged from Joh. Berenberg, Gossler & Co. KG, it has been active in the Swiss financial centre for international private clients and entrepreneurs for over thirty years. The Swiss private bank specializes in asset management and advisory services. For its more than 100 employees, the focus is on providing advice in all known liquid and non-liquid asset classes, as well as in alternative investments such as real estate, private equity or art. It provides entrepreneurial clients with access to M&A and other corporate finance services. Bergos AG offers private clients, entrepreneurs and their families a holistic service spanning several generations, which, in addition to investment recommendations, aims at security, neutrality, internationality and cosmopolitanism.

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