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Magnificent 7: Caveat Emptor!

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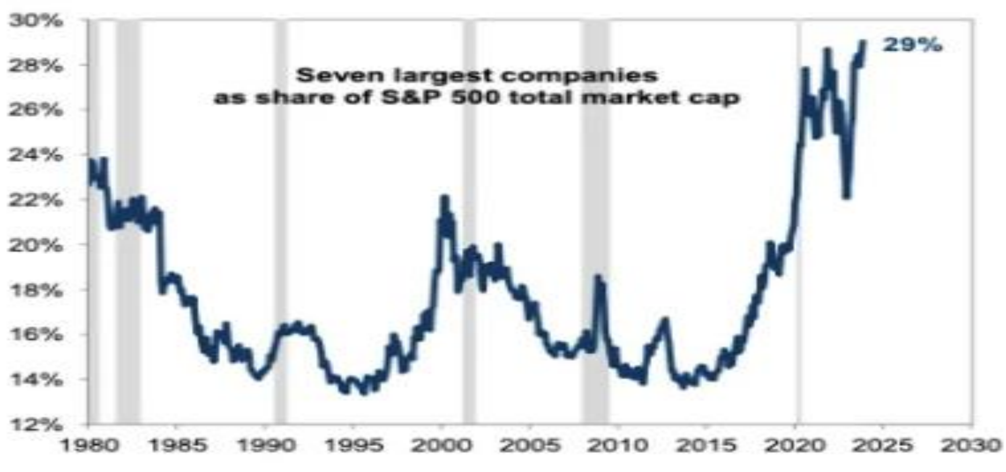
As pension watchdogs, Ryan ALM is always interested and concerned about trends that may affect the funded status of pensions. Since the major asset holding of most pensions is the S&P 500, we are on the alert for anything that may affect this valuable asset. I recently attended a CFA dinner where Rob Arnott, founder and chairman of Research Affiliates a subdivision of PIMCO was the guest speaker. Rob is quite articulate and brilliant on his assessments and forecasts. He was concerned about the valuation of the Magnificent 7 and thought the P/E multiples may not be sustainable. I share Rob's concerns for the following reasons.

Apple became the first $3 trillion market valuation in America's history. The seven largest capitalized technology stocks (i.e. the Magnificent 7) have been the main driver of returns for the S&P 500 for several years and certainly in 2023 YTD. As of December 1, this group had a total return = 98.79% based on the Bloomberg Magnificent Seven *equal weighted* index. At the same time the S&P 500 has a YTD return of 20.96%. According to BOA Global Investment Research, the Mag 7 account for 29.6% of the S&P 500 market capitalization. The newly released Bloomberg Large Cap index without the Magnificent 7 (B500XM7T) posted a YTD return of 7.6% which is 36.4% of the YTD S&P 500 return of 20.96%. This means that the Mag 7 has a YTD weighted group return of 13.33% which accounts for 63.6% of the S&P 500 YTD return (as of 12/01/23).

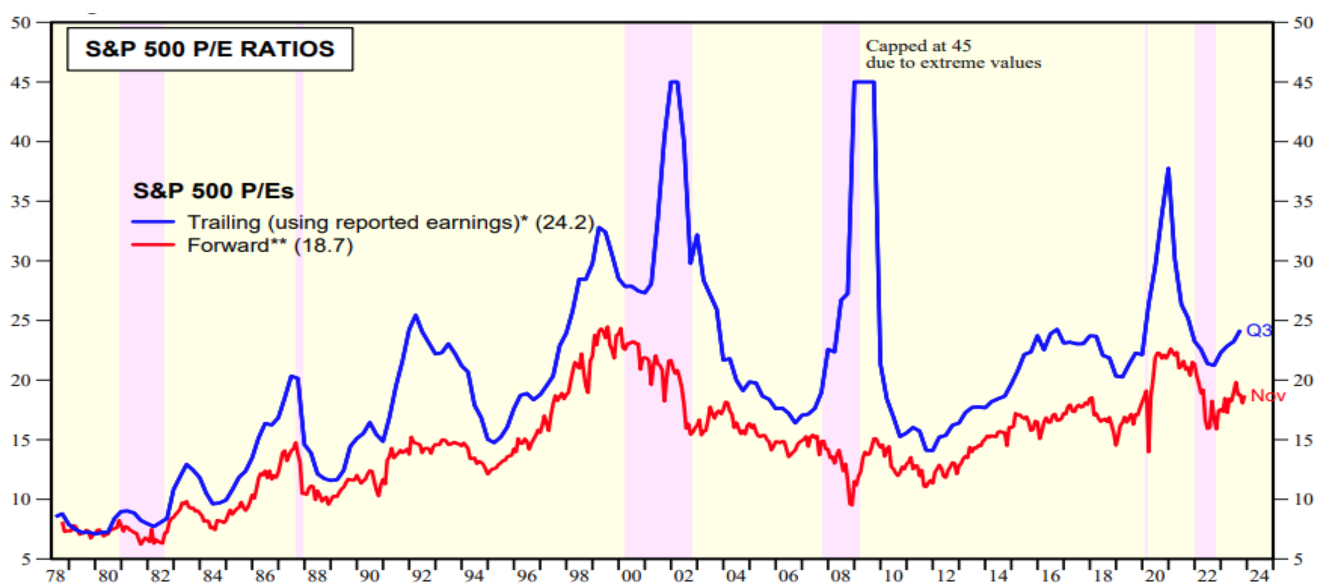
Exhibit 22: Share of largest seven companies' market cap in S&P 500 is at an all-time high



Source: Compustat, Goldman Sachs Global Investment Research

The Mag 7 should continue to grow well given their product line, market share, higher sales growth, higher margins, strong balance sheet and greater re-investment ratio in their market. The main question is one of valuation. Although it may be hard to assess a proper P/E multiple for each of the Mag 7, the wide array of P/E multiples and comparison to the market seem quite overvalued… S&P 500 multiple = 24.2x current and 18.7x forward (source: Yardeni). Tesla at 76.9x current/61.7x forward seems hard to justify especially with earnings growth of -6.1% over the last 12 months. Alphabet, Apple, Meta and even Microsoft trailing 12 months EPS growth do not seem robust enough to merit their valuation either.

Stock Symbol	Company	PE current	PE forward	Market Capitalization	EPS Growth 5-year Avg.	EPS Growth Last 12 mos.
GOOG	Alphabet	25.38x	19.80x	$1.66 trillion	25.4%	3.4%
AMZN	Amazon	76.69x	41.03x	$1.52t	63.0%	74.1%
AAPL	Apple	31.55x	27.16	$3.01t	14.4%	0.3%
META	META	28.10x	18.17x	$0.82t	8.9%	3.1%
MSFT	Microsoft	36.08x	28.76x	$2.77t	18.4%	10.5%
NVDA	Nvidia	61.48x	22.61x	$1.15t	27.7%	264.5%
TSLA	Tesla	76.87x	61.72x	$0.76t	40.5%	-6.1%
	S&P 500	**24.2x**	**18.7x**	**$37.7t**		



Goldman Sachs Global Investment Research is forecasting a 6% growth for 2024 for the S&P 500. This does not validate the P/E multiples of the S&P 500.

"Investors should be skeptical of history-based models.
Beware of geeks bearing formulas"
Warren Buffett