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Don’t look back in anger

US equities are worth rolling with, but the market is broadening...

Update
30 August 2024

Hopefully those of you who tried to get tickets for next year’s Oasis comeback tour were successful. I like some of their early stuff, but can’t say I would pay the £74.25 to £206.25 asking price. I always preferred (and have seen more than once) Blur, anyway.

For a disinterested observer like me, the announcement that Oasis would reform after what seemed to be a very acrimonious feud between the Gallagher brothers seemed a quite unlikely comeback. Perhaps their fans were less surprised. This year is 30 years since the band’s first album, Definitely Maybe, was released, after all.

Who knows how long Noel and Liam’s comeback will last. Most likely, it will be longer than Nvidia’s bounce back in recent months. Having fallen into a bear market (shares were down 35.5% at one point on 05/08/24, having started falling on 18/06/24), the following three weeks saw a bounce of 45% after US Federal Reserve chair Jay Powell confirmed interest rates would fall imminently.

No doubt many investors (me included) will be looking back in anger not having pounced on the chipmaking giant’s shares after they had fallen by about two-thirds between November 2021 and October 2022.

I even wrote an article extolling the virtues of chipmakers (known then by the acronym MANGO) in May 2022, when Nvidia’s share price (adjusted for their recent stock split) was $17. Today, it’s about seven times higher.

This week’s second quarter results show, though, that it’s far too late to jump on the Nvidia bandwagon. Its chips, which are powering the artificial intelligence revolution, continue to be well in demand. Record Q2 sales of $30 billion were 122% higher than the same period last year and even ahead of analysts’ estimates of $28.6 billion. Its Q3 forecast of $32.5 billion also beat consensus estimates.

So far, so good. So, how come shares immediately fell 10% in after-market trading? The share price ended Wednesday at $125.61, but opened on Thursday at $121. Essentially, it was Nvidia’s profits that disappointed. Operating income rose an astonishing 174% to $18.64 billion, but fell ever so slightly short of the $18.8 billion analysts had predicted.

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As one market strategist said: “This is a great company that is still growing revenue at 122%, but it appears the bar was just set a tad too high this earnings season.”

There was good news elsewhere. In an early 94th birthday present for Warren Buffett, Berkshire Hathaway became the first non-technology company to surpass $1 trillion in value. This milestone came not long after it was revealed that Berkshire had sold half of its stake in the smartphone maker Apple, stashing the profits into cash and short-term US government bonds.

For those of a bearish tilt, this suggests that US equities’ AI-fuelled bull run is well and truly over; that Buffett is raising cash for when stocks plunge and become cheaper.

Now, I wouldn’t say that I’m a particularly bullish person, but I read the recent movements in a different way.

I had expected a fall as steep as 35%-plus for Nvidia to drag down the S&P 500 into a bear market, too. Yet, the 9% fall from peak to trough didn't even fall into correction territory (which, as you will know, is a fall of 10% or more).

Indeed, while Nvidia's shares fell about 5% on Thursday, other tech stocks rose. Even fellow chipmaker TSMC saw a share price jump of 1.5%. Maybe this is just a continued broadening out of market leadership.

If this is the case, there are a few areas that look potentially interesting – and none of them are a play on Nvidia.

The first and most obvious lie with US equity investment companies. Two strategies to consider are income-focused and small-cap ones.

BlackRock Sustainable American Income (BRSA) would be a beneficiary of increased appetite for the former. One only has to look at the positive share price reaction when Facebook owner Meta said it would start paying a dividend to see that income dividends remain prized for many investors. With a yield of 4%, a discount of 7.7% and an average price-to-earnings ratio of 12.7x, the investment case looks compelling.

In a similar vein, **Middlefield Canadian Income (MCT)**, which yields 4.9% and is on a 15% discount, could benefit from similar trends.

The two small-cap investment trusts have already seen a big narrowing of discounts, but remain attractive. Nvidia may soon show that the saying 'elephants can't gallop' is true. Rather than make investors go running for cash returns that will start to dwindle as interest rates fall, perhaps they'll reallocate to smaller companies.

If they do, a wall of cash could be a boon for both **Brown Advisory US Smaller Companies (BRSA)** and **JPMorgan US Smaller Companies (JUSC)**.

One other area it's worth making the case for is healthcare. This is an area that gives investors a more defensive profile. No matter how the economy is doing, people will always need to get their ailments treated. Given the world's population is getting increasingly older, fatter, sicker and richer, demand should continue to hold up.

Bellevue Healthcare (BBH) is well positioned to benefit from a renaissance not only in the healthcare sector, but in the broader US market, given 97.5% of its portfolio is in American companies, most of which are in the small and mid-cap space.

Nvidia's fair value according to the research firm Morningstar is about $105, suggesting that, even after the fall in its share price, the stock is overvalued. Considering it takes up a big portion of the S&P 500, some might say it's worth starting to look elsewhere for gains. I suspect investors should roll with it for a little longer, and just think outside the box for different ways to get their exposure to the American dream.

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