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US equity market: all bets are on one card!

Moritz Kraemer -- Chief Economist

LBBWResearch@LBBW.de

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High valuation and high concentration call for caution

The stock markets, especially in the USA, seem to be unperturbed by anything. In the last two years alone, the S&P 500 index has risen by over 45%, and by over 80% in the last five years. In the last decade by over 220%! Great for those who were fully invested. Congratulations!

The S&P 500 climbs to ever loftier heights

There have always been setbacks that put investors' nerves to the test. Most recently after Donald Trump's surreal "Liberation Day" at the beginning of April. But then the "TACO trade" gained the upper hand again: Trump Always Chickens Out – Trump always chickens out. It won't be that bad...

The final positive impetus came from Trump's favourite enemy, Federal Reserve Chairman Jay Powell, when he waved a fence post in Jackson Hole last week and opened the door wide for an interest rate cut in mid-September.

Irrational exuberance 2.0?

There is a growing danger that the sheer boundless optimism of investors will turn into naivety. The premise that presidents who bark don't bite seems increasingly naive to me. With his behaviour, most recently with the grandiloquently announced dismissal of Fed Governor Lisa Cook (for which he has no legal basis) or the unilateral ignoring of supposed tariff agreements with the EU, the President is demonstrating that he is not in the mood for jokes. The TACO trade is therefore risky. It is said that barking dogs have bitten after all. Trump seems to me to be such a barking dog.

The risks of Trumponomics are still being smiled away

The increasingly lofty valuations of US equities therefore also mark growing drop heights should something unfortunate happen. A simple measure of the high valuation is the so-called Warren Buffet indicator. It measures the market value of stock corporations as a multiple of the US national product. At the peak of the dot.com bubble, this value was a historically high 1.5. Today, the market value of stock corporations exceeds 2.1 times the annual US value added.

The US stock market is extremely concentrated

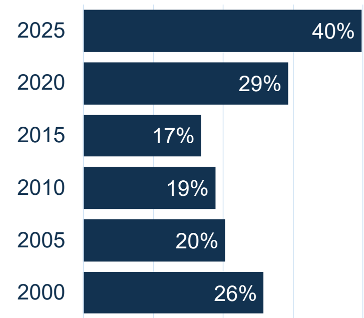
However, the comparison with the internet bubble is not entirely fair. In contrast to back then, today's tech giants have high (and growing) profits. This was not the case for most of the Internet hopefuls at the turn of the millennium. At the same time, however, the market is much more concentrated today than it was back then. The ten largest stocks in the S&P 500 account for 40% of market capitalisation (see Fig. 1). The remaining 490 just account for the remaining 60 %.

Such a concentration is without historical parallel. In contrast to the meteoric rise of AI shares, the valuation of the average company in the S&P 500 has fallen back to the level of 2003! There is stagnation across the market. The rally is being driven by fewer and fewer stocks.

There is also an extreme concentration of sectors. Eight of the ten most valuable companies are technology groups whose high valuations are consistently driven by immense hopes for the expected blessings of artificial intelligence (see Fig. 2). But also by the expectation that the immense investments, for example in data centres, will remain high-margin. However, if the market for AI services becomes more competitive than is currently the case, then the tech giants will all be in the same leaky boat. The brief DeepSeek shock at the beginning of the year now seems to have been forgotten. Investors seem to think it is almost impossible that the current AI kings could be toppled from their thrones. The fact that Sam Altman of all people, founder and CEO of OpenAI, the company behind ChatGPT, recently spoke of AI stocks being caught up in a speculative bubble is also rubbing off on investors. As long as the music plays, the dancing will continue.

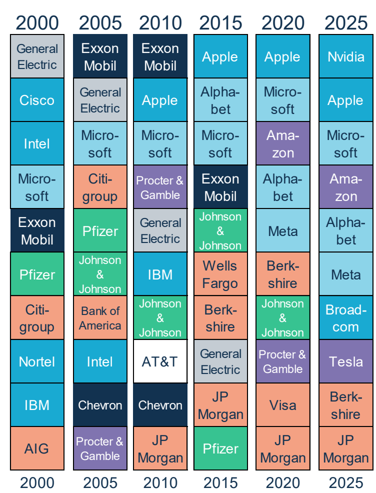
LBBW Research is confident that artificial intelligence will have a significant productivity-enhancing effect in many areas. At the same time, however, we remain cautious in view of the high valuations and recommend a rather defensive positioning. We see the S&P 500 Index ending the year at 6200 points, from a current index value of 6466.

Fig. 1: Market capitalisation of the top 10 companies as a share of the S&P 500



Source: LSEG, LBBW Research.

Fig. 2: Composition of the top 10 stocks in the S&P 500 by market capitalisation



Source: LSEG, LBBW Research, 15 August in each case. The companies are sorted from top to bottom by market capitalisation

We advise defensive positioning

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