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December was a Bomb

The movement in stock prices in December was radical. The S&P 500 index was down 2.5% for the month, but that number tells only a small part of the story. In December there were only 52 companies out of the S&P 500 that went up in value while 448 declined. Even more radical was the performance gap: Those 52 companies that went up in value had an average gain of 5.2%. The 448 that went down in value had an average decline of 7.8%. The biggest positive contributor to the S&P 500 in December was Broadcom, which was up 43% in one month! This type of volatility and variance between winners and losers is highly unusual but reflects the type of capital markets that we are now witnessing.

Table 1: S&P 500 Biggest Positive Contributors in December

Company	November Price Close	December Price Close	% of S&P 500	Monthly Returns	Weighted Return
BROADCOM INC	$162.08	$231.84	1.5%	43.0%	0.64%
APPLE INC	$237.33	$250.42	7.1%	5.5%	0.39%
TESLA INC	$345.16	$403.84	1.9%	17.0%	0.32%
ALPHABET INC-A	$168.95	$189.30	1.9%	12.0%	0.23%
AMAZON.COM INC	$207.89	$219.39	3.8%	5.5%	0.21%
ALPHABET INC-C	$170.49	$190.44	1.6%	11.7%	0.19%
META PLATFORMS	$574.32	$585.51	2.5%	1.9%	0.05%
PALANTIR TECH	$67.08	$75.63	0.3%	12.7%	0.03%
BOEING CO	$155.44	$177.00	0.2%	13.9%	0.03%
ARISTA NETWORKS	$101.46	$110.53	0.2%	8.9%	0.02%

We are living in a world of global capital markets and social media like never before. There are few good theories that could explain why some stocks could perform so well at the same time other stocks perform so poorly, particularly over such a short span like a month. The difference in performance (52 stocks up an average of 5.2% and 448 down 7.8%) may be explainable in light of a number of factors:

- Thanks to the Internet, we are seeing information quickly spread globally.
- Technology, including cryptocurrencies, is facilitating the flow of capital.
- Social media is contributing to radical moves in stocks. For example, in 2021 a number of U.S. hedge funds experienced large losses when participants (mostly young people) of a

Reddit "subreddit" called r/wallstreetbets, spread the call to buy and drove up the stock price of GameStop, Inc., and other money losing stocks, and caused a short squeeze. Hedge funds short the stocks had to buy them back at higher prices and absorb losses.

- The idea of Artificial Intelligence (AI) has captured the global imagination. As it is, the United States is the primary locus of this development and the largest, most prominent tech companies are in the U.S.
- In the 1990s, the Internet was still in its infancy and information did not spread globally as easily it does now. The tech bubble in the late '90s was created mostly by American excess enthusiasm, or irrational exuberance as Fed Chairman Greenspan once called it. Today, the great enthusiasm surrounding AI is much more a global phenomenon. Capital from around the world is fueling this market.
- Five years ago, wealthy Chinese wanted nothing more than to invest their capital into domestic real estate. Today the Chinese real estate market is imploding, and Chinese are looking for every possible legal means and otherwise to get capital out of China. Much of that is making its way to the U.S.
- Europe's government policies of promoting high cost "green energy," high taxation, very high levels of business regulation and control, and high social costs--among other reasons, have horribly hobbled European enterprise. We even see the world's premier industrial manufacturers in Germany wither. This is an environment that will export capital.
- U.S. investors are certainly participants in the concentrated moves in the huge U.S. tech stocks. But it's also worth considering that investors outside of the U.S., will gravitate and wish to invest in big names that they know and heard about, especially as the Internet and social media spread ideas easily. Apple's sales are up a mediocre 5.6% over the past year, and yet the stock was up 5.5% just in the month of December and trades at nosebleed 36 times trailing earnings. How is this explainable except that even in rural India people know about Apple smartphones, and the world believes the way to get rich is own Apple stock.

The market is not divided simply between tech and everything else, it's super big and well-known tech, versus everyone else. Chart 1 below shows the performance of the S&P 500 versus the S&P equal weighted. The S&P 500 is weighted so that a company with $400 billion worth of stock trading in the markets has twice the impact of a company with $200 billion in stock. Consequently, companies with market capitalizations of nearly $4 trillion, like Apple and Nvidia, have an extraordinarily disproportionate impact on the index. Furthermore, when people buy ETFs, like the SPY, which is a replica of the S&P 500, most of the capital inflow goes to these stocks since the managers are trying to replicate the performance of the index. These flows can only enhance the exaggerated moves in the super big tech stocks. So we see the S&P 500 was up 22.96% in 2024, whereas the same stocks equally weighted were up only 10.47%.

Chart 1

The models are broken. Traditional measures of valuation are not working. Models that analysts have historically used to measure things like fair value are not working, and mostly stopped working around the time of the pandemic. Not discussed in detail here is the effect of the large increase in the global money supply in recent years, but it is one of the factors that has distorted traditional analysis. We are living in a time when Broadcom, the trillion-dollar company that was up 43% in December, trades at 22 times sales. Not 22 times earnings, 22 times sales. There are no traditional models that can readily explain this. Valuations such as this reflect the bids of a global audience enamored with the glistening shine of AI and big-name big tech.

Trends like this can go on for long periods, as we saw in the 1990s, and 2025 could be another good year for stocks in general and big tech in particular. However, investors should keep in mind a famous observation made by Herb Stein, Senior Fellow at the American Enterprise Institute: "If something cannot go on forever, it will stop." The U.S. economic fundamentals remain strong. Government debt is high, but private debt has fallen in recent years. Taxes are low and likely to decline even further. The new administration is planning many business-friendly policies like removing government barriers to more energy production and removing mandates to convert to high-cost green energy. Other regulations will be eliminated, and government bureaucracy and spending will be reduced. For three decades our strategy has to focus on good fundamentals and good values. This strategy sometimes feels unsatisfying when extreme conditions exist, but it also ensures that investors avoid unknowable and immeasurable risk. Because of the enormous impact that the super large cap stocks have on indexes like the S&P 500, ETFs based on those indexes carry the type of significant risk we seek to avoid. Over time, smaller size and value have performed better than large and expensive.