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The NVIDIA Hype

Article by: Nick Stenger, *Chief Executive Officer, Financial Advisor*
Phone: (630) 912-8295 | Email: nick.stenger@stengerfamilyoffice.com

As of July 10th, 2024, Nvidia's market cap was $3.32 trillion, up 215% the past 12 months and 3,082% the past 5 years. We recorded an episode of our podcast, "Bullish" on September 2nd, 2023 entitled, **"Nvidia Lives Up to the Hype,"** when the stock traded around $470, predicting it could double the next 12 months. Even our expectations were blown away. Pre-split, the stock jumped to $1,330 in just 10 months. Now the question on investors' minds is the company's future path and if the general S&P 500 Index is overvalued thanks to AI and hype surrounding companies such as Nvidia, AMD, and Broadcom.

Remember, determining the proper valuation for companies and the stock market is a basic math equation discounted by prevailing interest rates. When you multiply their future profits by an earnings multiple, you end up with the company's expected future value. For example, Nvidia is expected to produce nearly $60 billion in profit next year. At a $3.32 trillion valuation, Nvidia now trades at a 55 forward price-to-earnings (P/E) ratio. While high in comparison to the S&P 500's forward P/E of 20, it's only slightly higher than its own 5-year average of 40 times. Not to mention, Nvidia is expected to produce $104 billion of revenue next year versus $11.7 billion in 2019. Is the company overvalued? It depends if you think other companies will wipe out their competitive advantage. If you think about Nvidia only as a technology company, its reasonable to believe their moat to be narrow. It's not investment advice, but we think this logic is wrong for two reasons. First, Nvidia is far ahead of the competition. Secondly, we think about the chip business as a commodity-style industry. Saying Nvidia could be destroyed by competitors at this stage would be like saying Chevron will destroy ExxonMobil because both produce oil and gas. What's more important is the total size of global demand for high-speed computing and AI chips.

Most of Wall Street's "perma-bears" are missing the big picture, comparing today's stock market to 1999. In the 90's, the S&P 500 Index traded at over 44 times earnings, over 2x pricier than it trades today. Secondly, tech stocks in the 90's traded at 100, 200, 300 or even higher multiples, compared with today's tech stocks at 40 times earnings. While 40 is certainly higher than 5 years ago, earnings are still growing at a substantial pace. If earnings keep expanding alongside multiples, the stock market will not enter bubble territory. The opposite is true of the 90's – earnings were stagnating, and multiples were expanding exponentially.

Another false narrative consistently pitched by perma-bears is so-called lack of "market breadth." They say only 7 or 8 stocks are driving the S&P 500 to new highs. This couldn't be further from the truth. The equal weighted version of the S&P 500 is only 3% lower than its all-time high with large banks, energy companies and healthcare companies up over 10% year to date. Since when was a 10% return by July such a bad thing? Of 38 mega-cap U.S. companies, 25 are up over 10% in 2024. Further, there are 231 large-caps, 282 mid-caps and 322 small-caps up over 10% year-to-date. So far in 2024, Eli Lilly is up 61%, Walmart is up 34%, JP Morgan is up 22%, and Procter & Gamble is up nearly 14%, none of which are "AI stocks."

The narrative that only Nvidia and AI hype are leading the market is just wrong. Hundreds of other stocks are making regular 52-week highs and producing fantastic returns for investors. Yes, the Nvidia hype is real, but so is the hype around the S&P 500. In our opinion, the current market is not a fantasy but rather based on real companies producing real earnings.

At some point, we'll be due for a correction. If valuations rise to unsustainable levels, markets will correct. They could also correct during a "Black-Swan" event like COVID, 2008 & 2009, or some other geo-political conflict. You can spend your entire life worrying about what *might* happen and miss the amazing stories of what *is* happening with entrepreneurs and technological innovation. In fact, some people worry their whole portfolio away, looking at their stocks multiple times per day, freaking out any time markets go down a few points. A far better strategy is buying strong America companies and holding them for a long time, ignoring the day-to-day carnival barking of Mr. Market as Ben Graham describes. In the short run, companies trade on emotions, a bad quarter, or what the Fed is doing. In the long run, companies trade on value creation and earnings. Ignore the doom and gloom and stick to your plan. If you don't have a plan, get one…and soon.

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NICK STENGER
CHIEF EXECUTIVE OFFICER
FINANCIAL ADVISOR

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Stenger Family Office LLC. 400 E. Diehl Road, Suite 550, Naperville, IL 60563