Seeking Alpha

Nvidia Is Hiding The Cracks Beneath The Stock Market Surface

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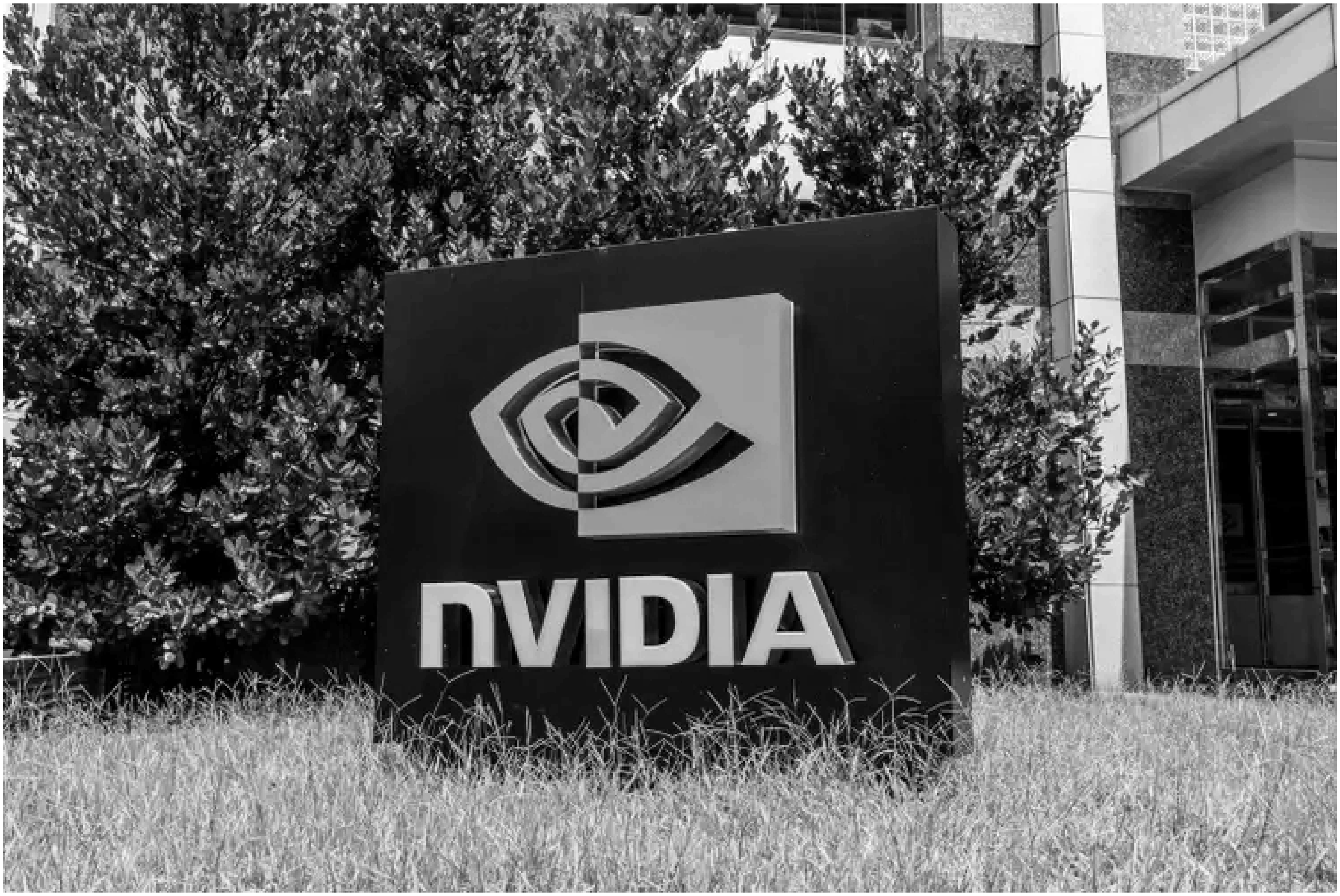
Mott Capital Management
Investing Group Leader

Summary

- Indexes with Nvidia are making new highs, while those without are struggling since March peak.
- Market breadth is weakening, with fewer stocks making new highs and more making new lows.
- Nvidia's overwhelming influence on the market is masking underlying weakness, potentially leading to a costly mistake.
- I am Mott Capital, aka Michael Kramer, a former buy-side trader and portfolio manager with 30 years of experience. I lead Reading The Markets, an investing group designed to help you position your portfolio to benefit from macro trends and thematic growth opportunities.



BING-JHEN HONG

It has become a tale of two markets: those indexes with Nvidia and those where NVIDIA (NVDA) is neutralized or absent. The indexes that either have Nvidia as equal weight or are absent altogether have struggled since peaking in March, while market cap-weighted indexes with Nvidia have made new highs.

The indexes with Nvidia give a false sense of comfort and belief that the equity markets are strong, and for those who do not assess the risk correctly, it could be a costly mistake down the road.

Breadth Is Weaker

While some might have you believe that market breadth is broadening, it not only hasn't, but it has been narrowing. The advance-decline line for the S&P 500 peaked in the middle of May and has been trending lower since, while the S&P 500 has gone on to make a new high.

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This has also been the case with a broader measure, as noted by the New York Stock Exchange Advance-Decline line. That advance-decline line peaked in the middle of May as well and has been trending lower since.

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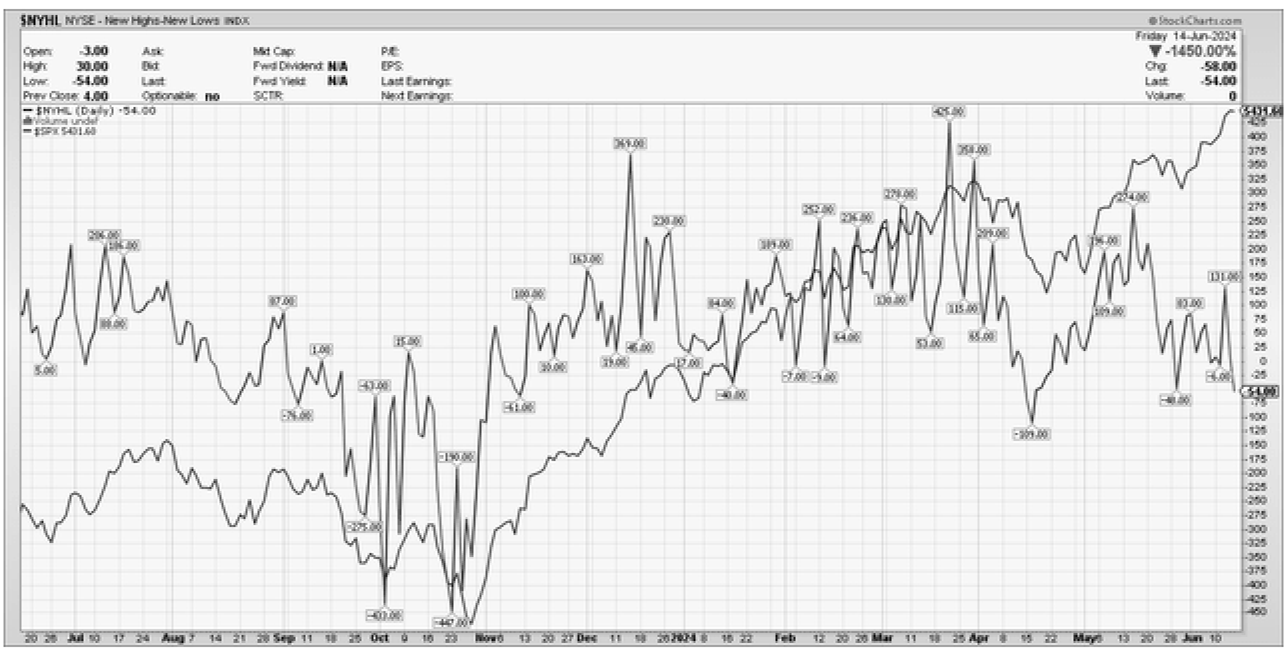
New Highs Vs. New Lows

The number of stocks making new highs versus new lows on the NYSE is also falling. This peaked in mid-March at 425 and has been trending low since. The most recent new high came on June 12, just 131.



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What's worse is that the cumulative number of stocks on the NASDAQ making new highs minus new lows has typically trended in the same direction as the price action over the past 40 years. But that has not been the case for more than a year now, with the cumulative number of new highs minus new lows continuing to fall even though the NASDAQ has seen a massive rally.

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Nvidia Overwhelms

The data since the middle of May shows that Nvidia has wholly overwhelmed the market. The Bloomberg 500, which can be used as a proxy for the S&P 500, has advanced by 2.46% and shows that since May 17, Nvidia has accounted for 81.1% of the gains in the Bloomberg 500 and that 156 stocks have moved up while 345 have moved lower. Apple (AAPL) is the second-biggest gainer, adding 29.9%. This means that the Bloomberg 500 would be lower without Nvidia and Apple. Over that same time, the S&P 500 rose by 2.54%, with 153 stocks advancing and 351 stocks declining.

B500 2024/5/17-2024/6 Group By None Date Range 5/17/24 - 6/15/24

Start	1907.32	End	1954.19
Net Chg	+46.87	% Chg	+2.46%
Current	501	#Up	156
Additions	1	#Down	345
Removals	1	#Unch	0

Leaders

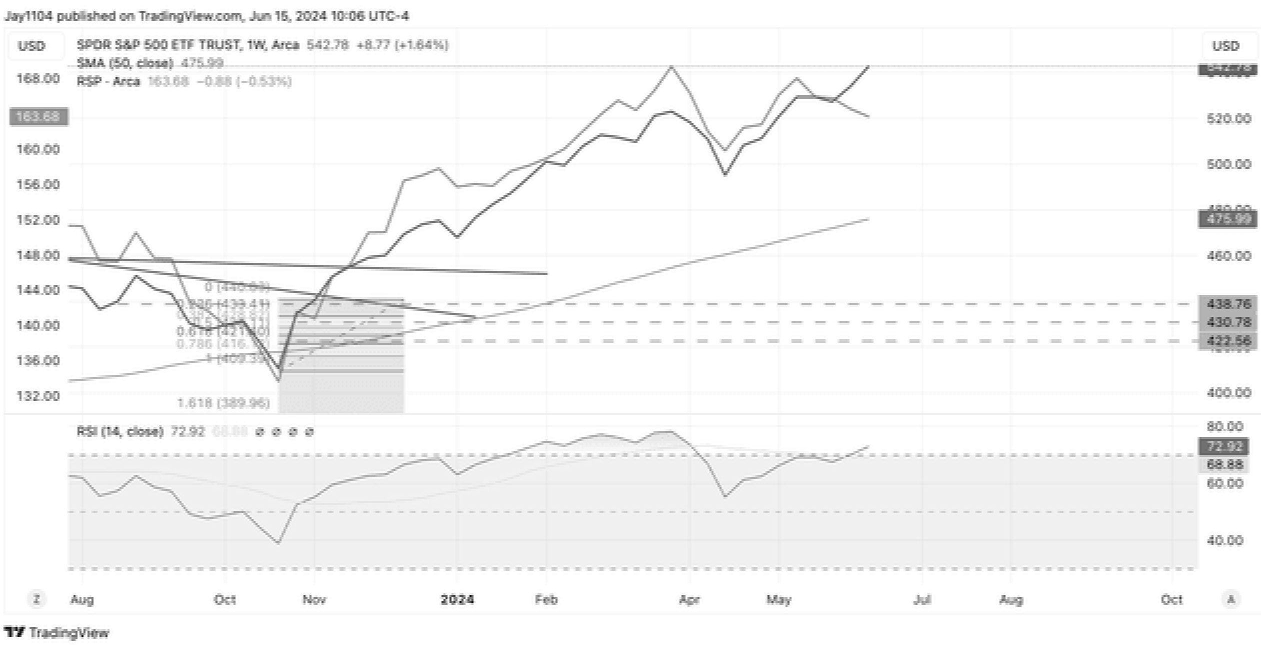
Ticker	End Prc	% Chg	Points	%Idx Mv
1. NVDA UW	131.88	+39.78%	+38.018	+81.11%
2. AAPL UW	212.49	+11.93%	+14.026	+29.92%
3. MSFT UW	442.57	+5.13%	+6.826	+14.56%
4. AVGO UW	1735.04	+22.87%	+6.268	+13.37%
5. LLY UN	878.45	+13.92%	+3.882	+8.28%
6. META UW	504.16	+6.64%	+2.975	+6.35%
7. COST UW	855.67	+7.89%	+1.181	+2.52%
8. ORCL UN	138.13	+13.07%	+1.086	+2.32%
9. QCOM UW	215.33	+11.87%	+1.086	+2.32%
10. NFLX UW	669.38	+9.64%	+1.074	+2.29%

Laggards

Ticker	End Prc	% Chg	Points	%Idx Mv
1. CRM UN	231.94	-18.53%	-2.107	-4.50%
2. XOM UN	109.11	-7.43%	-1.685	-3.59%
3. JPM UN	193.78	-4.29%	-1.059	-2.26%
4. PEP UW	163.81	-9.83%	-1.045	-2.23%
5. UNH UN	497.12	-4.63%	-0.950	-2.03%
6. JNJ UN	145.54	-4.90%	-0.769	-1.64%
7. INTU UW	595.70	-8.83%	-0.668	-1.43%
8. CVX UN	152.57	-5.29%	-0.641	-1.37%
9. CAT UN	321.47	-8.34%	-0.631	-1.35%
10. V UN	270.66	-3.28%	-0.615	-1.31%

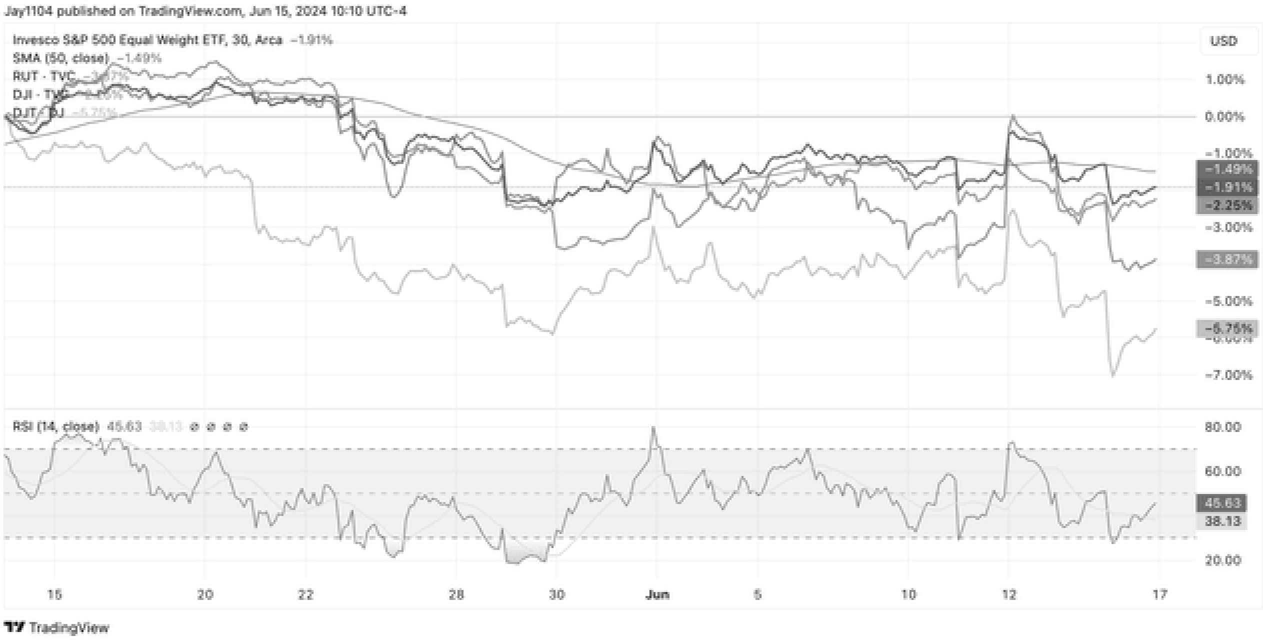
Bloomberg

The narrowing of the breadth has been a theme for not weeks but months. The narrative started with the Magnificent 7 in the summer months of 2023, which turned into a group of just three by the start of 2024. But now, it seems to be a convincing one left to carry the rest of the market while breadth deteriorates and the more balanced equal weight indexes trend lower. The S&P 500 Equal Weight ETF (RSP) has fallen four weeks in a row, which amounts to a decline of about 3%, which is not much on its own, but compared to the market cap weighted S&P 500 ETF (SPY), which has advanced more than 2.5% over the same time.



TradingView

The RSP hasn't even been able to surpass its highs since last seen in March, and has moved sideways more or less over that time. That could be said of the Dow Jones Industrials and Transports and the Russell 2000.

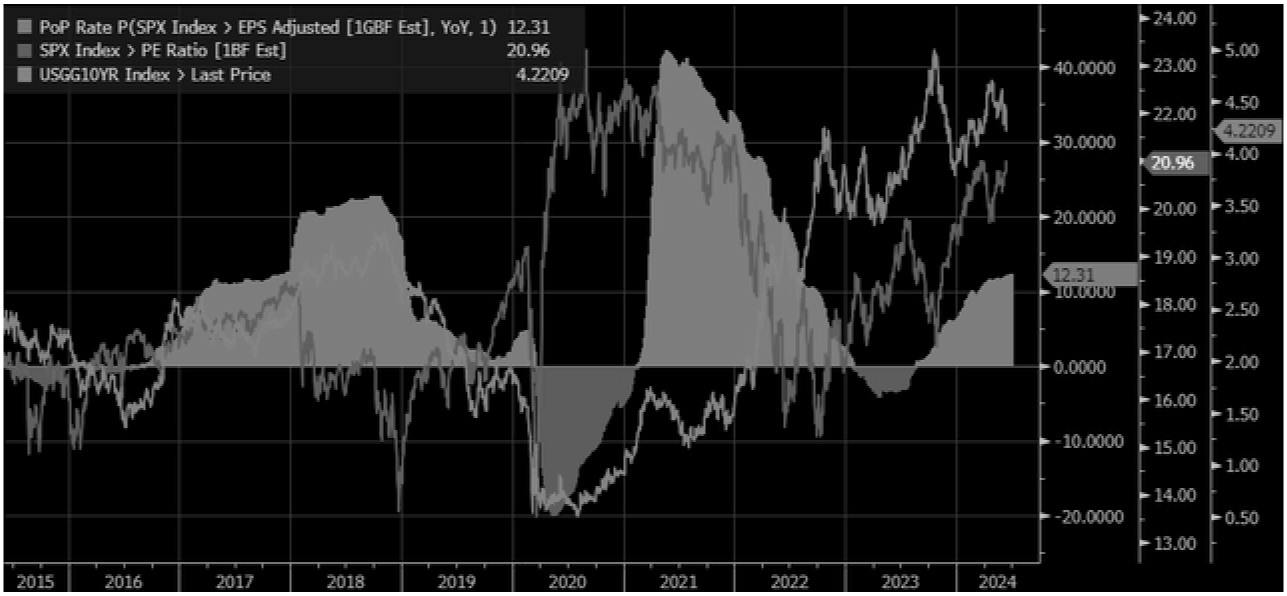


TradingView

This isn't to say that the market is due for a violent move lower, but it is to say that once Nvidia sees a turn in momentum, its influences wane, and they will wane at some point; that the true nature of the market will take over again. For now, even if something changes beneath the surface in the market, the S&P 500 and the NASDAQ 100 mask that weakness because Nvidia can essentially cover that weakness up.

Paying More But Getting Less

What is also extremely odd about this market is that the blended 12-month earnings growth is expected to be 12.3%, with a 4.25% 10-year rate and a PE ratio of about 21. Meanwhile, in 2017 and 2018, the blended growth rate was north of 12%, with a 10-year Treasury rate of 3.25% or lower and a PE ratio of about 18.5. So, in theory, one is getting a much higher risk-free rate of return, getting lower growth, but paying a higher multiple to own the overall index.



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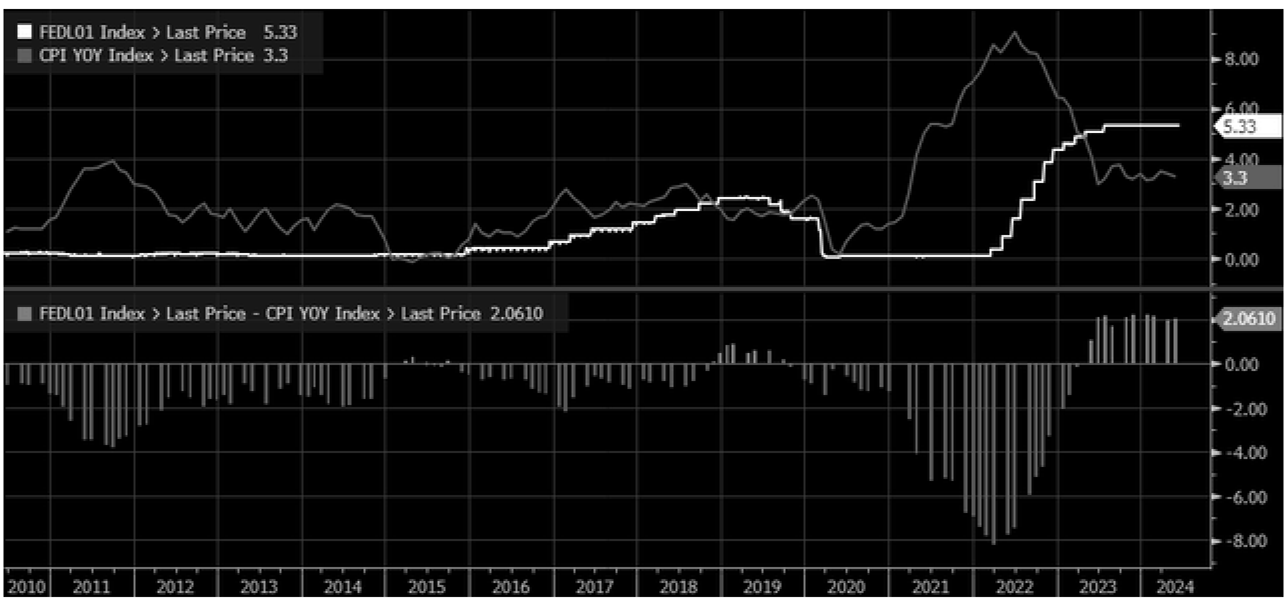
The other odd thing is that monetary policy today is much tighter than it was during those times, which calls into question why investors are willing to pay more to own the index today than in the past.



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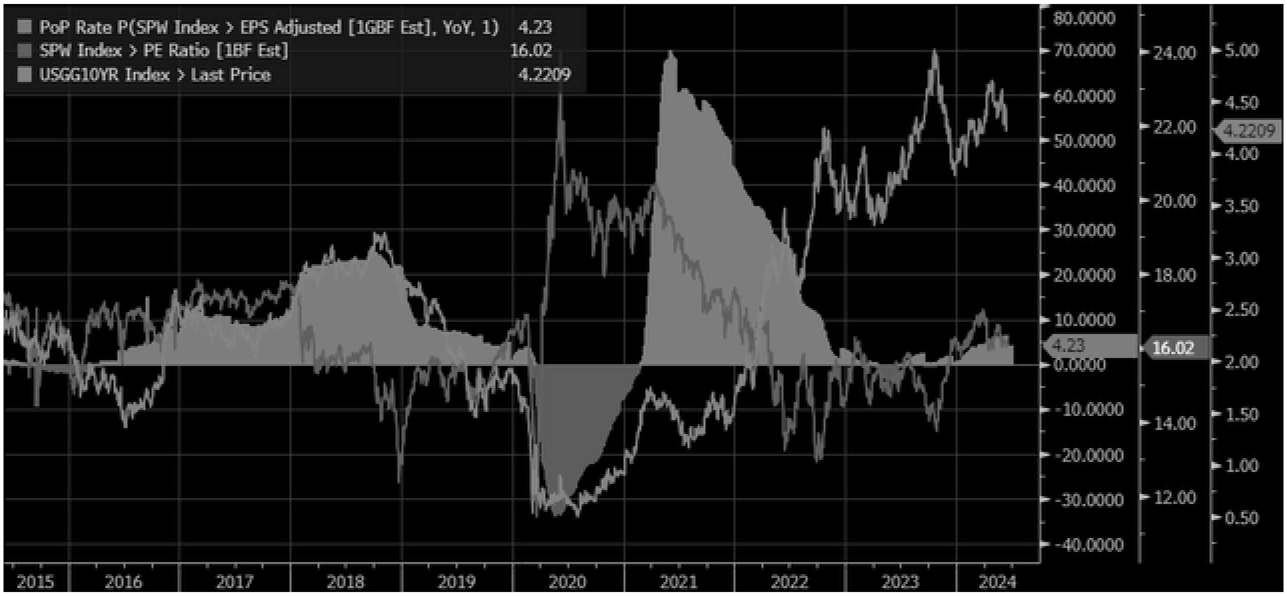
When looking at the S&P 500 Equal weight, we find that PE multiples today are comparable with where they were in the 2017 and 2018 periods. Today's growth rate is less at 4.25% versus a growth rate of 10% or more during 2017 and 2018 and a lower 10-year rate. So again, we find here that the market cap weight indexes are likely being distorted by just a handful of names, much more so than in the past, and at this point, it would seem that much of that distortion is due to just one stock. Still, investors seem willing to pay the same multiple for less growth.



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At this point, the market is not as strong as it appears, and it appears strong because Nvidia is just able to mask the weakness of the breadth beneath the surface. Perhaps this will last some time longer, and the game can be played until Nvidia reports in August, but at some point, if the breadth continues to weaken and indexes continue to diverge, then being alert is about the best you can do.

This article was written by

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He leads the investing group Reading The Markets where he helps members better understand what is driving trading and where the market is likely heading, both short and long-term. Features of the investing group include: daily written commentary and videos analyzing the driving factors behind price action, general macro trend education to help members make well-informed decisions based on market conditions, interest rates, currency movements and how they all interact, chat for questions and community dialogue, and regular Zoom videos sessions to discuss current ideas and answer questions. Learn more.

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