



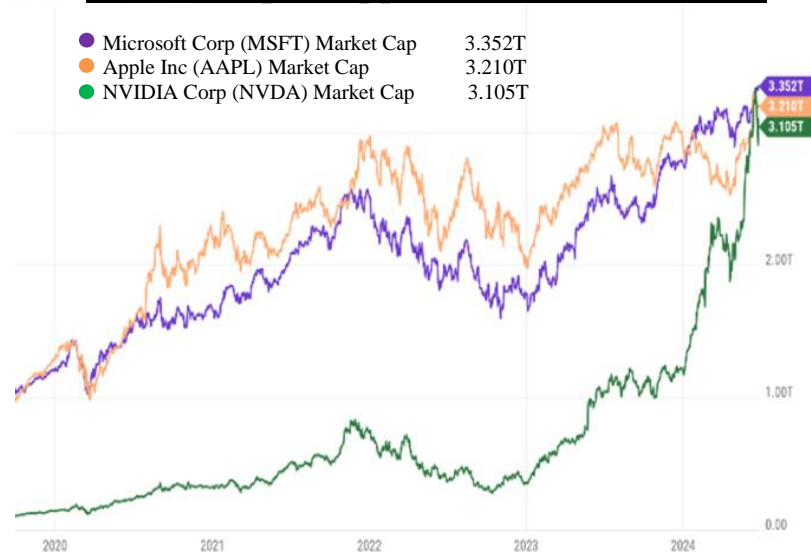
Quarterly Investment Commentary

SECOND QUARTER, JUNE 2024

After a brief pause in April, the bull market continued its advance as U.S. stock indexes climbed higher for the better part of the second quarter. The Dow Jones Industrial Average, S&P 500, and NASDAQ have all set record highs during the quarter despite a widening disparity in returns. Year-to-date, the S&P 500 and NASDAQ indexes are up 15% and 18% respectively, while the Dow Jones Industrial Average and the mean return for a stock listed on the S&P 500 are tracking around 5%¹. The performance gap between some of these widely used benchmarks and the “average” stock is largely due to the configuration of the index and its exposure to companies benefiting from the Artificial Intelligence (AI) boom. For example, the Dow Jones Industrial average is made up of a significant number of “old economy” stocks operating in traditional industries, whereas it’s been well publicized that the S&P 500 and NASDAQ have a growing concentration in those stocks linked to the technology sector—including one that has become the posterchild for the AI market surge.

Nvidia Corp., a semiconductor company which was relatively obscure just a few years ago, momentarily surpassed Apple and Microsoft as the most valuable U.S. business during the second quarter. The company has seen its valuation by investors skyrocket from \$145 billion at the end of 2019 to around \$3 trillion today. Comparisons are being made to Cisco Systems’ rapid rise from obscurity during the dot-com bubble. Cisco, which sells hardware to connect homes and businesses to the internet, overtook Microsoft as the most valuable U.S. company in March 2000.

Market Cap of Apple, Microsoft, & Nvidia



Walter Deemer, a longtime market technician who began his career in 1962 and has penned several books including *When the Time Comes to Buy You Won't Want to*, wrote the following on March 3, 2000:²

“We are hardly about to quarrel with the idea that Cisco (to pick on what is on the verge of becoming the biggest company in the world in terms of market capitalization) is a better company than, say, Sears; quite obviously, it is. But investors are not buying Cisco, the company; investors are buying Cisco, the stock—and what seems to be lost on the part of many of the aforementioned money managers in their “buy-the-New Economy” reasoning process is the fact that just because Cisco is a better company than Sears, Cisco is not automatically a better stock too. Relative valuation must also be considered.”

¹ As measured by the Invesco S&P Equal Weight Index

² Walter Deemer’s Special Report, “Arrogance”, March 3, 2000

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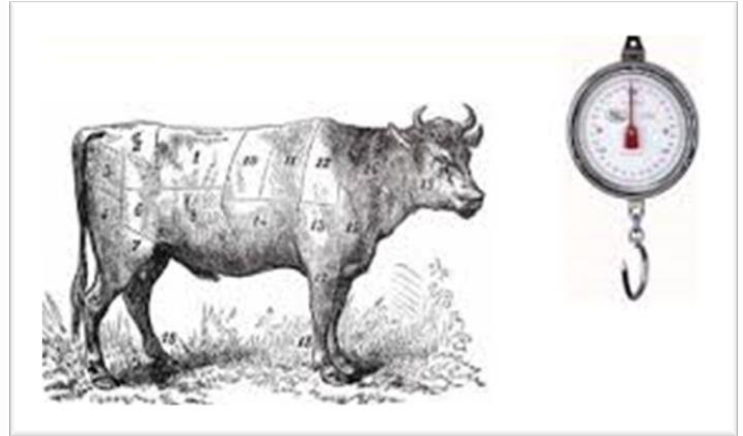


These words proved to be prescient as not long after they were written Cisco's stock price cratered when business vanished and the dot-com bubble burst. The stock price has still not surpassed its peak almost 25 years later. It is a cautionary tale of chasing returns, as there are likely investors out there today who purchased Cisco near the peak and are still patiently waiting for the price to get back to "breakeven"—probably muttering to themselves, "Any day now."

Although there are similarities to Cisco and Nvidia's ascent, there are also a few differences. For one, Cisco's stock price traded well above 100x earnings estimates at its height, whereas Nvidia currently trades around 45x next year's estimates—still very expensive but not totally absurd, if (emphasis on if) its growth trajectory continues. Over the past several years, Nvidia's sales growth and profitability have been remarkable; that said, it's not the past but the future that matters. Investors are betting on a very bright future for Nvidia, one they believe justifies its current lofty price. That future also depends on the growth and broad adoption of the newer AI technology, which is promising but less certain, as is Nvidia's role in it. No one will argue that both Cisco Systems and Nvidia are fantastic companies, but valuation is an important factor when considering an investment. As Warren Buffett so eloquently put it, "A good company can be a bad investment at the wrong price."

The Wisdom of Crowds?

In 1906, the statistician Sir Francis Galton attended a livestock fair in Plymouth, England. He discovered that a friendly competition was underway to see which of the townspeople could come closest to guessing the weight of an ox when it was butchered and dressed. Around 800 people entered the contest; some were expert farmers and butchers while others knew little about livestock. As you can imagine, the guesses were all over the board, some very high, others very low, a few fairly sensible. Galton collected the documented guesses after the competition was over and found that the average guess from the crowd was 1,197 pounds. This was remarkably close to the actual weight of 1,198 pounds.



What Galton ultimately discovered was that under the right circumstances groups of people can make surprisingly accurate decisions when opinions are aggregated, even if the information they possess is imperfect. This is a simplified illustration of the power of collective judgement, or the wisdom of crowds, which has been incorporated into various fields, such as polling and crowdsourcing.

Markets are also considered an aggregator of opinion. People of various levels of ability (education, insight, emotion, and wealth) come together to set a price on an asset, whether for a stock, bond, copper, farmland, baseball card, etc. A simplified model of the stock market is a tug-of-war between optimists that think the price will go up and pessimists who think it's going down. The stock price reflects a sort of equilibrium at which both parties are satisfied. It's generally accepted that the stock market does a good job of pricing assets efficiently over longer periods of time; however, it's not infallible over the short term. Because markets are made up of people, and people are prone to emotions, stock prices can reflect and amplify the sentiment of investors at that moment—both on the upside and downside. At the extremes, herd behavior can painfully overestimate or underestimate future opportunities and values causing mispricing. The wisdom of crowds can turn into the madness of crowds under the right circumstances.

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Assessing the mood of the markets and monitoring valuations is an important function when gauging future return potential. Higher valuations generally accompany limited upside potential over the near term as the rosy outlook for growth has already been priced in. High valuations also introduce some added risk, as assets are less able to absorb bad or unforeseen news without a sharp repricing. As noted in previous commentary, we're not overly pessimistic about the economic outlook or the future of AI. However, areas of the stock market today appear more speculative than guarded, while higher valuations pose some additional risk and challenges in finding compelling opportunities. We want to stick to our knitting. Swinging for the fences by abandoning high-quality companies for the hot stock of the moment or going "all-in" on the companies linked to a new technology is generally not a good investment strategy. We prefer the singles and doubles approach. A small-ball strategy doesn't focus on flashy or unpredictable events but on making small, repeatable shifts that compound into positive results over time. Today, this involves broad diversification in our equity exposure, including owning some international stocks with more reasonable valuations. We reiterate the view that bond yields are attractive at current levels and help to balance out some of the risks in the equity markets. As the bull market continues its onward pace, we want to stay rational and focus on sound long-term strategies.

Firm Updates



- AMI would like to welcome and introduce our summer intern Adam Lee. Adam will be a junior at Indiana University this fall, double majoring in Finance and Accounting at the Kelley School of Business. He is a 2022 graduate of Bishop Dwenger High School and outside of the office enjoys golfing and relaxing at his family's home on Sylvan lake. Adam has been a great addition to our office this summer and a big help on numerous projects. We hope he enjoys his time with AMI and maybe learns a little something along the way.
- AMI clients now have access to the new Client Portal, which launched in April. The portal offers secure, personalized access to financial holdings, up-to-date performance data, asset allocation information, capital gains data, and quarterly investment reports. If you are interested or have questions regarding the AMI Client Portal, please feel free to contact the office for assistance.
- We are also excited to announce the arrival of Shelby Carmichael's second child, Teagan, at the end of May. Both mom and baby boy are doing well. We wish them all the best as they navigate the wonderful chaos of parenthood once again.
- Lastly, we want to announce that Ben Shively has been added as a partner to the firm. Ben has 25 years of investment experience and joined AMI in 2021 as a portfolio manager and advisor.

Past performance is no guarantee of future performance. All investments contain risk and may lose value. Any views expressed within this document are the views of AMI Investment Management and/or the authors. They are subject to change at any time without notice. Any graphs, charts or formulas included within this document that depict historical relationships may not be valid during future periods and should not be relied upon to make investment decisions. This material is distributed for informational purposes only and should not be considered as investment advice or as a recommendation of any particular investment security, strategy or investment product.