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SUMMARY

- Both today's and the 90's rally were technology driven.
- However, today's multiples aren't as stretched, and cash flow is more abundant, in our view.
- We do not believe the stock market is in the late stages of a 'bubble.'

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No Bubble Yet

How the Current Market is Different from the 1990s

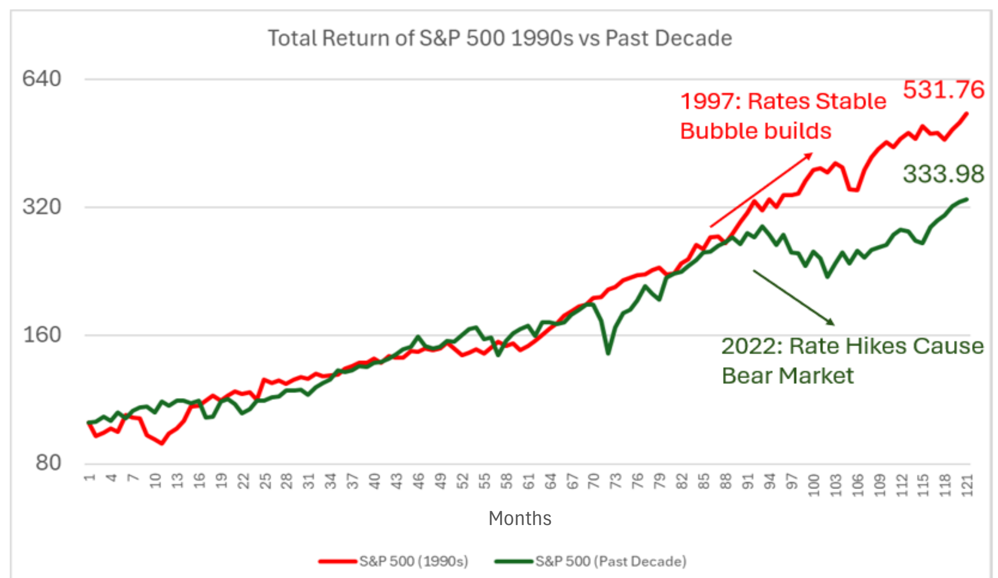
There is a common saying that 'history doesn't repeat itself, but it rhymes.' This adage rings particularly true in the world of investing. With every bull market, prognosticators point to how past rallies have ended to predict what will eventually impede the current one. And while it is true that each bull market eventually ends, understanding company fundamentals can make a huge difference in determining when to head for the exit, versus when to stay invested.

In comparison to our current market rally, we believe it is the bull market of the late 1990s that investors seem infatuated with. In this *Weekly View*, we will demonstrate how these two markets 'rhyme' with one another, but also make our case for why we do not believe we are on the verge of a bursting bubble.

Two Tech-Driven Rallies, With Different Fundamentals

The bull market of the 'roaring 90s' was defined by the nascent technological boom brought on by the internet. As such, it was the US tech sector that drove returns. Similarly, today the shift to cloud computing and the proliferation of internet-based applications have driven the market for the last decade, with artificial intelligence seemingly poised to continue or even accelerate that drive going forward.

Chart 1: Market Returns Rhyme, Then Deviate
Rate Hike Cycle in 2022 changed the narrative



Source: Bloomberg, RiverFront. Red line: data monthly beginning 1/1/1990- 1/1/2000; Green line: data monthly 6/1/2014-5/30/24. Past performance is no guarantee of future results. Shown for illustrative purposes. Not indicative of RiverFront portfolio performance.

Looking at Chart 1, we can see that the two markets were in sync for about the first eight years of the decade. However, the two series diverge around 2022 and 1997, respectively. In 2022, fears over stagflation and rising rates derailed the S&P 500 returns, causing this divergence. However, it also compressed the market's price-to-earnings (P/E) multiple, potentially providing more longevity to the rally. Since the 1990s did not have this drawdown, returns continued to run and the eventual bubble was formed.

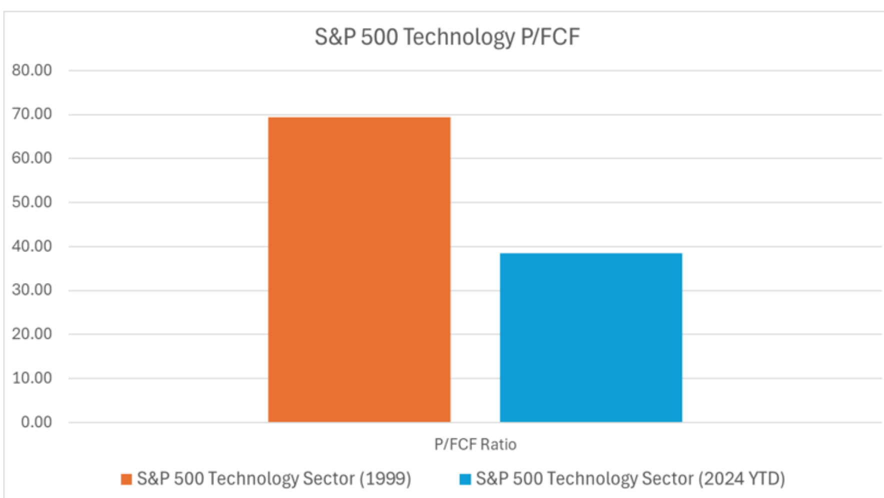
Still, the 'rhymes' between the two bull markets continue to give investors pause, in our view; because the 1990s bull market ended in the 'dot com' bubble, some view an 'AI' bubble as an inevitability. However, we do not necessarily believe we are on the precipice of a technology bubble and if we are, we are in the early stages.

One thing backing these beliefs is current valuations. When looking at P/E ratios, the S&P 500 is currently trading at 24.3 times earnings, below the 28.6 times earnings of 1999. The discrepancy is bigger for the tech sector, which is trading at 38.2 times earnings vs 49.2 during 1999. This relative cheapness suggests to us that there is less enthusiasm in the market than during the 'dot com' bubble and S&P earnings are currently keeping up with market returns.

In chart 2 to the right, we identify what we believe to be a more important distinction between 1999 and today. Free cash flow multiples (price divided by free cash flow) are much lower today particularly in the technology sector, which is over 30 points cheaper using this metric. Free cash flow is the cash leftover after a company's operating expenses and any capital expenditures. The cash flow that modern technology sector companies can consistently generate is something we see as the defining feature of the current market. In the 1990s, early internet companies were almost entirely valued based on potential growth rather than current earnings or cash flows. On the other hand, while current technology companies have strong organic growth potential, they also generate plenty of cash flows, which they can use to acquire complementary technology or buy back shares as a way to enhance shareholder return.

Chart 2: 'Under the Hood' Today's Market Looks More Sustainable

FCF points to key differences in today's technology sector



Source: Bloomberg, RiverFront. Data daily through 6/7/24. Past performance is no guarantee of future results. Shown for illustrative purposes. Not indicative of RiverFront portfolio performance.

Conclusion: There's No Bubble, so What?

We do not believe that the current market, and particularly the technology sector, is on the precipice of a bubble bursting. Valuations, while stretched, are nowhere near the euphoric levels of the late 90's, and – unlike the 90's - companies are currently generating substantial amounts of cash, which we believe means they can naturally grow into their multiples over time. Based on these factors, if we are in a bubble, we believe we are only in the early stages.

Further, we don't necessarily view a bubble as an inevitability, due to the current macro environment. Looking at current CPI (3.4% year-over-year for the month of April), that level is well above the levels we saw in the late 90s (CPI averaged 2.37% from 1995-1999). Additionally, we believe the Fed is currently more hawkish than they were in the 1990s. Tying these together, we see that the Fed is in a position where it will need to keep fighting inflation and we are unlikely to see an environment conducive to creating a bubble. Given this belief, it follows that we believe investors should be more focused on the Fed and inflation when determining portfolio allocations, rather than valuation concerns.

Regardless of whether this bull market finds its end in a bubble or not, our risk management process will be focused on a variety of measures, both 'bottoms-up' and 'top-down.' By combining global macro and fundamental analysis (as well as technical work) we believe that we will be able to identify cracks in markets that may not be apparent by a single measure (such as P/E) and adjust our portfolios accordingly when we deem appropriate.

From a current portfolio perspective, we remain overweight relative to global benchmarks in the US technology sector. Specifically, we believe that mega cap technology equities are well positioned for the current market. These companies generate high levels of free cash flow that can be used for M&A (mergers and acquisitions) and to sustain R&D (research and development) without the need for capital markets. This second point is particularly pertinent given the current rate environment, where companies that are forced to refinance are taking on much higher interest rates.

Risk Discussion: All investments in securities, including the strategies discussed above, include a risk of loss of principal (invested amount) and any profits that have not been realized. Markets fluctuate substantially over time, and have experienced increased volatility in recent years due to global and domestic economic events. Performance of any investment is not guaranteed. In a rising interest rate environment, the value of fixed-income securities generally declines. Diversification does not guarantee a profit or protect against a loss. Investments in international and emerging markets securities include exposure to risks such as currency fluctuations, foreign taxes and regulations, and the potential for illiquid markets and political instability. Please see the end of this publication for more disclosures.

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All charts shown for illustrative purposes only. Technical analysis is based on the study of historical price movements and past trend patterns. There are no assurances that movements or trends can or will be duplicated in the future.

Stocks represent partial ownership of a corporation. If the corporation does well, its value increases, and investors share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Bonds represent a loan made by an investor to a corporation or government. As such, the investor gets a guaranteed interest rate for a specific period of time and expects to get their original investment back at the end of that time period, along with the interest earned. Investment risk is repayment of the principal (amount invested). In the event of a bankruptcy or other corporate disruption, bonds are senior to stocks. Investors should be aware of these differences prior to investing.

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa). This effect is usually more pronounced for longer-term securities). Fixed income securities also carry inflation risk, liquidity risk, call risk and credit and default risks for both issuers and counterparties. Lower-quality fixed income securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer. Foreign investments involve greater risks than U.S. investments, and can decline significantly in response to adverse issuer, political, regulatory, market, and economic risks. Any fixed-income security sold or redeemed prior to maturity may be subject to loss.

Technology and Internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

Index Definitions:

Standard & Poor's (S&P) 500 Index measures the performance of 500 large cap stocks, which together represent about 80% of the total US equities market.

Definitions:

Stagflation is an economic cycle characterized by slow growth and a high unemployment rate accompanied by inflation. Economic policymakers find this combination particularly difficult to handle, as attempting to correct one of the factors can exacerbate another.

The price-to-earnings (P/E) ratio measures a company's share price relative to its earnings per share (EPS). Often called the price or earnings multiple, the P/E ratio helps assess the relative value of a company's stock. It's handy for comparing a company's valuation against its historical performance, against other firms within its industry, or the overall market.

The Consumer Price Index (CPI) measures the monthly change in prices paid by U.S. consumers. The Bureau of Labor Statistics (BLS) calculates the CPI as a weighted average of prices for a basket of goods and services representative of aggregate U.S. consumer spending.

The term cash flow refers to the net amount of cash and cash equivalents being transferred in and out of a company. Cash received represents inflows, while money spent represents outflows.

Free cash flow to equity is a measure of how much cash is available to the equity shareholders of a company after all expenses, reinvestment, and debt are paid. FCFE is a measure of equity capital usage.

Mega cap is a designation for the largest companies in the investment universe as measured by market capitalization. While the exact thresholds change with market conditions, mega cap generally refers to companies with a market capitalization above $200 billion.

When referring to being "overweight" or "underweight" relative to a market or asset class, RiverFront is referring to our current portfolios' weightings compared to the composite benchmarks for each portfolio. Asset class weighting discussion refers to our Advantage portfolios.

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