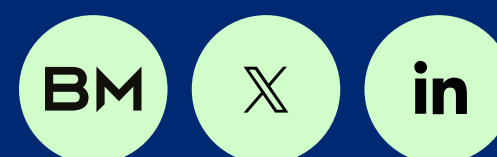


The Rise of Nvidia


and the Market's Herd Mentality

August 2024



BM BROOKS
MACDONALD

Henrietta Walker, Head of the Investment Specialist Team, discusses the meteoric rise of Nvidia, the chip maker, and if we should be worried about its dominance.



We have recently seen equity markets reach all-time highs, led by just a few stocks which are beneficiaries of generative AI (Artificial Intelligence).

This trend is a classic example of investor herding behaviour, where investors follow the crowd due to fear of missing out or FOMO, leading to exaggerated market movements.

Nvidia: the stats

The rise of Nvidia has been extraordinary. In less than two years, it's increased by around 8 times in value and by 160% year to date. That is remarkable for a company currently worth over \$3 trillion in value. From a benchmark and diversification perspective, Nvidia is now about 7% of the S&P 500 and 5% of the MSCI World Index. This one sector of the global economy is a dominant force within markets. Megacap tech is a huge driver of returns, including all these AI names, which comprise about a third of the S&P 500 and a fifth of the MSCI World Index.

Should we be worried about the rise?

Nvidia's meteoric share price rise is not without risks. To many, its share price performance looks like a risk-free investment – nothing can go wrong. However, many of these companies are also customers of each other, with Microsoft, Meta Platforms, Amazon and Alphabet estimated to be among the top four customers based on revenue. All four are looking to compete directly by designing their own AI chips – the powerhouse behind AI. We're asking how much underlying revenue and capital expenditure there is to justify these valuations across this cohort of companies.

Innovation is key, but concentration is a risk

Generative AI is a crucial factor in the future of the global economy and a driver of market returns, but we need to be conscious of the associated risks. We think about position sizes, risks, and concentration, which are critical to the thought process. This meteoric rise in Nvidia's share price leads us to question what's fair value for this company. For many, buying is based on benchmark risk rather than the appropriate price and historically that behaviour can sometimes result in a meaningful correction.

We want to ensure we appropriately manage our risks and position sizes. One of the most important investing principles is that the price you pay for something determines the return you get.

Focusing on the fundamentals

While the markets focus on the US tech market and Nvidia, we are finding opportunities elsewhere to maintain balance in our portfolios. It's important to consider fundamentals to unlock some of the value we see elsewhere. The UK is an interesting opportunity set compared to peers on a valuation basis. The UK's price-to-earnings ratio (P/E) is about 11 times while the US market's is closer to 21, indicating that the US market could be overvalued.

Market participants have already recognised the UK's attractiveness, with mergers and acquisitions on the rise. Another promising factor for the UK is that it's a good diversifier, including more defensive-style investments: healthcare, financials and energy stocks.

Balancing risk and reward

Our approach is to look for scenarios where assets can outperform. Then we build portfolios around those metrics where we see more fundamental value to offset some more momentum-driven behaviour. We look to the broadest opportunity set, focusing on fundamentals. While we've seen a lot of market concentration, especially now, we want to reassure our investors that we seek adequate portfolio diversification and a balance between value and growth styles in order to achieve the best risk-adjusted returns possible.

Important information

The information in this article does not constitute advice or a recommendation and investment decisions should not be made on the basis of it. This article is for the information of the recipient only and should not be reproduced, copied or made available to others. The price of investments and the income from them may go down as well as up and neither is guaranteed. Investors may not get back the capital they invested. Past performance is not a reliable indicator of future results.

Brooks Macdonald is a trading name of Brooks Macdonald Group plc used by various companies in the Brooks Macdonald group of companies. Brooks Macdonald Group plc is registered in England No: 04402058. Registered office: 21 Lombard Street London EC3V 9AH. Brooks Macdonald Asset Management Limited is regulated by the Financial Conduct Authority. Registered in England No: 03417519. Registered office: 21 Lombard Street, London EC3V 9AH.

Brooks Macdonald International is a trading name of Brooks Macdonald Asset Management (International) Limited. Brooks Macdonald Asset Management (International) Limited is licensed and regulated by the Jersey Financial Services Commission. Its Guernsey branch is licensed and regulated by the Guernsey Financial Services Commission and its Isle of Man.

More information about the Brooks Macdonald Group can be found at brooksmacdonald.com