Nothing lasts forever

De Beers' iconic slogan "A Diamond is Forever" is one of the most successful and enduring marketing campaigns in world history. However, since 1948 a lot has changed in the world of gemstones as a wave of undetectable synthetic diamonds is threatening to expose the artifice behind a multi-billion-dollar industry. As investors, we must be cautious not to assume that certain trends can continue indefinitely.

Looking back over 50 years, we've analysed some of the most profitable trades (from our perspective). Across asset classes, regional investments, and sector allocations, these trades would have yielded annualized returns ranging from +11% to +18% over periods spanning 8 to 22 years.

1970 – 1988 : The dominant U.S. Nifty 50 large caps shares failed to live up to their exorbitant market expectations making way for leadership from the rest of the developed markets, especially Japan.

1987 – 2000: In the wake of Black Monday, U.S. stocks climbed from the abyss to setup the foundation for technology stocks to lead the way until the early 2000's.

2000 – 2008: The bust of the dotcom bubble as well as the global financial crisis suppressed U.S. stock valuations whilst strong emerging market growth caused energy demand to exceed supply.

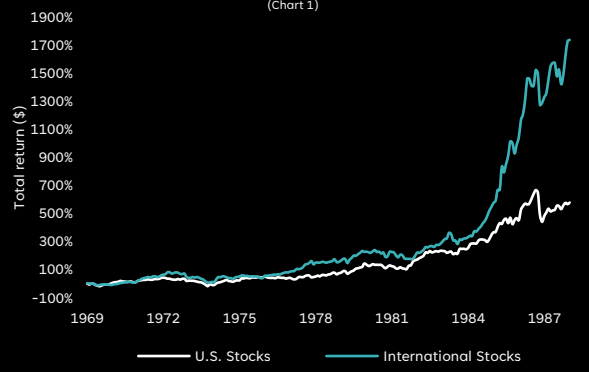
2009 – 2023: In the aftermath of the global financial crisis, prolonged periods of low interest rates and excess liquidity reigned the markets that led to high demand for U.S. stocks especially technology companies.

In many ways, the periods mentioned above reflect the rise and subsequent pull back of the American Dream. Each time a certain subset of companies becomes "the only investment worth owning", they eventually give way to a new form of leadership.

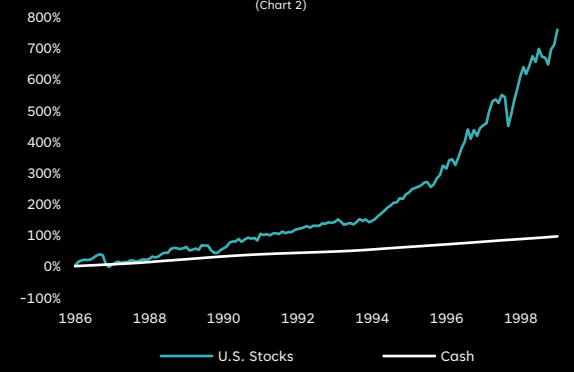
Currently we find ourselves in a situation where the U.S. is the most obvious trade after being "uninvestable" at the beginning of the bull market in 2009. Analysing the current artificial intelligence movement, it is increasingly difficult not to jump on this bandwagon. No technology since the steam engine promised this much productivity gain in such a short period of time. Nvidia announced their new Blackwell chip that is said to be between seven and 30 times faster than the H100, while consuming a fraction of the power — about 25 times less, to be precise. This level of engineering is nothing short of spectacular and promises to take our civilization to the next frontier.

Analysing current positioning data from retail investors to hedge fund managers, we are in the 1st percentile (huge outlier) of overweight positioning in U.S. equities and especially the magnificent 7 companies. A recent Wall Street Journal article citing Vanda Research mentioned that the average individual's stock portfolio has 40% of its value tied up in just three technology stocks.

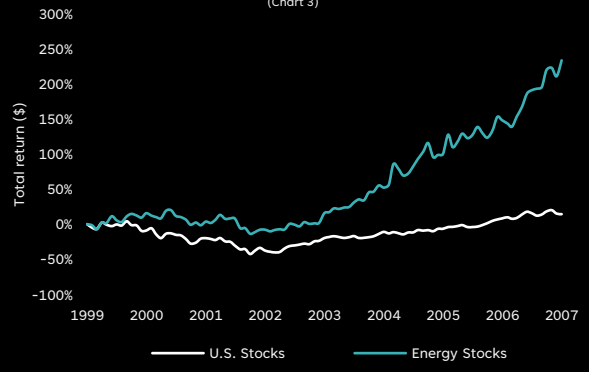
U.S. vs International stocks
(Chart 1)



U.S. stocks vs cash
(Chart 2)



U.S. vs Energy stocks
(Chart 3)



U.S. stocks vs cash
(Chart 4)

Source: Bloomberg, FactSet Research Systems.

Data: U.S. stocks: S&P 500, International Stocks: MSCI EAFE, Cash: ICE BOFA 1-3 Month Treasury Bills, Energy Stocks: S&P 500 Energy Index.

Magnificent 7: Apple, Microsoft, Google parent Alphabet, Amazon, Nvidia, Meta Platforms and Tesla

The past performance of an index is not a guarantee of future results.

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However, let's be clear: we do not advocate for the imminent demise of the U.S. stock market. Instead, we ask ourselves whether there might be real opportunities hiding in plain sight. Structural shifts in the global economy often serve as the breeding ground for future leadership. These shifts encompass various factors, including inflation, interest rate regimes, de-globalization, productivity changes, and even demographics.

To quote the great investor from Omaha (Warren Buffet), "Price is what you pay, value is what you get". Looking at history as our guide, eventually high valuations and unattainable growth expectations lead to disappointment and significant devaluation. Chart 5 speaks to the rise and fall of the trades we identified above.

Add a touch of crowding and market concentration, and we may find ourselves at a crucial juncture for diligent portfolio managers. While we hold positions in great quality companies like Nvidia, Alphabet, Microsoft, and Apple in our portfolios, the ultimate success will depend on the sizing of these positions.

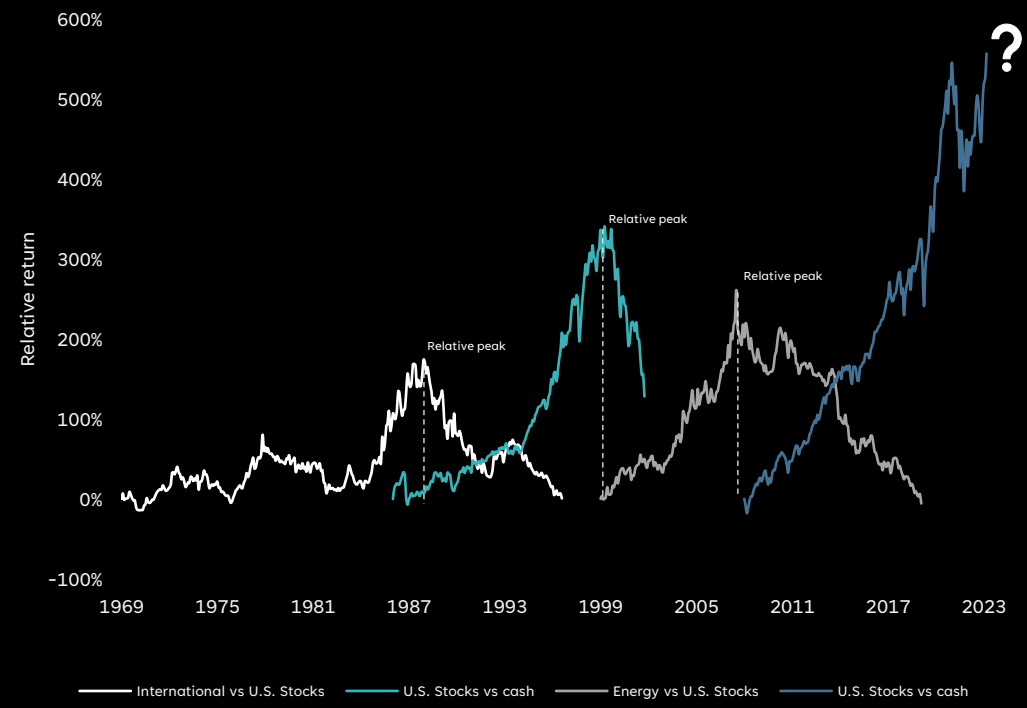
Some areas we find compelling in the current market backdrop include, but are not limited to:

- Emerging Asia (Is China's 2008 behind them? | Remember the U.S. was also "uninvestable" in late 2008).
- High free cash flow generating businesses that can reward investors immediately with share buybacks and dividends, as appose to some of the companies that promise earnings into the future.
- Quality covered call strategies that can utilise derivates to provide a buffer as and when the markets eventually correct.

Last month we wrote about how all-time highwe delve into what the potential risks are for complacency and crowding out.s can be scary, but that it isn't bearish at all. This month In investing it is all about keeping clients invested for the long run and one tool to do this, is to manage the risk of the portfolio. Especially when it comes to drawdowns.

It is impossible for us to sit here today and say that the U.S. will underperform China for the next decade, but we can look at the past and weigh up the odds, construct better diversified portfolios to not lay awake at night waiting for that one earnings call that could lead to an eventual sell-off in the magnificent 7 companies.

Rise and fall of the best trades
(Chart 5)



Source: Bloomberg, FactSet Research Systems.
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