State of Play

The Magnificent Seven

25 January 2024

The S&P 500, a market index that tracks the performance of 500 of the largest companies listed on stock exchanges in the United States, hit new highs this week. This was mainly driven by seven stocks, dubbed the Magnificent Seven: Alphabet (Google), Amazon, Apple, Meta, Microsoft, Nvidia and Tesla. What are the reasons behind this and will it continue? The Commercial Team at Santander Asset Management share their thoughts in this week's State of Play.

Key highlights from this week's Autumn Statement

- What's driven the S&P 500 rally?
- Artificial Intelligence (AI) enthusiasm
- Another Dotcom Bubble?

What's driven the S&P 500 rally?

The S&P 500 index is made up of 500 different companies. Because the market capitalisation (how big a company is) of the companies is used to weight the index, the performance of the larger companies has a greater impact on the index's overall performance. The Magnificent Seven have a huge impact on the performance of the S&P 500 because of their size, which has collectively grown in market value by more than 60% since October 2022 and now accounts for around 29% of the S&P 500's market value.[1]

However, having such a large foothold within the index can work both ways. These seven stocks have previously dragged the performance of the index down during the later months of 2022.[1] Tesla is still behind where it was in October 2022, but the company's share price has increased by more than 64% in the past 12 months, accounting for about 3% of the S&P 500 rally on its own.[1]

So, what is the driving force behind the positive performance of the Magnificent Seven?

Artificial Intelligence (AI) enthusiasm

You have most probably noticed the recent noise around AI during the last couple of years. With ChatGPT's chatbot releasing at the end of 2022, it redefined the standards of AI, proving that machines can indeed 'learn' the complexities of human language and interaction. Since its release, companies have been looking at ways of making and adopting similar technology. With the Magnificent Seven all operating across every major segment of the technology industry, they stand to benefit from the popularity and growth of AI.

Nvidia has been a major benefactor of the recent surge in AI popularity. Nvidia designs and sells graphics processing units for gaming, cryptocurrency mining, and professional applications, as well as chip systems for use in vehicles and robotics.[2] They have emerged as the market leader in computer chips that are designed to process AI workloads, and demand continues to surge as more businesses seek to develop AI applications.[3] This surge in demand resulted in skyrocketing growth through 2023 and investors flocked to buy their shares, resulting in a gain of over 200% for the year.[4]

It's a similar story for the other members of the Magnificent Seven. Amazon, Microsoft and Alphabet (Google) supply millions of companies worldwide with cloud services and the processing capacity required to create AI through centralised data centres. Meta is using AI to show more relevant content for its users and Apple is looking to develop its own version of ChatGPT. Tesla is currently developing its own AI-powered autonomous self-driving vehicle technology. All seven companies are trying to innovate and accommodate this new technology, and the enthusiasm for AI has benefited their respective share prices, with this continuing into 2024.

Another Dotcom Bubble?

The rapid rise in popularity and shares, such as Nvidia, could raise concerns that we may be entering another Dotcom bubble. The dotcom bubble was a rapid rise in US technology share valuations fuelled by investments in Internet-based companies in the late 1990s. The value of these shares grew exponentially during the Dotcom Bubble, with the Nasdaq 100 (includes 100 of the world's largest non-financial companies) rising from under 1,000 to more than 5,000 between 1995 and 2000. Things started to change in 2000, and the bubble burst between 2001 and 2002 with shares entering a bear market. The crash that followed saw the Nasdaq 100 fall 76.81%.[5]

However, here are three key reasons why the current enthusiasm for AI differs from that of the Dotcom Bubble:

1. Company valuations are lower

A key metric that helps investors decide whether a company is overvalued or undervalued is something called a price to earnings ratio (P/E). In short, the P/E ratio shows what the market is willing to pay today for a stock based on its past or future earnings. A high P/E could mean that a stock's price is high relative to its earnings and possibly overvalued. Conversely, a low P/E might indicate that the current stock price is low relative to its earnings.[6] Stock valuations are currently much lower than they were at the peak of the Dotcom bubble and the P/E ratio of the Nasdaq 100 is significantly lower than it was in 2000.[7]

2. Companies are more established

Before the Dotcom Bubble burst, the optimism for internet-related stocks led to a number of technology companies initial public offerings (IPO). This is when a privately owned company lists its shares on a stock exchange, making them available for purchase by the general public. Many of these companies were relatively new and unprofitable, resulting in them going bust once the bubble burst. Recently, there have been fewer IPOs and those that have gone public have been much more established. A large number of businesses using AI are well-established, publicly traded businesses, such as the Magnificent Seven.

3. Investors are more cautious

Fund flow is the cash that flows into and out of various financial assets for specific periods of time. During the Dotcom bubble, fund flows into shares* increased by 76% from 1999 to 2000.[9] In contrast, 2023 was the equivalent of the second-lowest positive organic fund flow growth rate since Morningstar have been collecting data.[10]

*Combined ETF and Mutual Fund Flows to Equity Funds.

The Magnificent Seven has dominated the US stock market but their dominance doesn't yet flag the same risks when compared to the Dotcom Bubble. Nevertheless, given the strong performance of these shares over an extended period—which has continued in 2024—a market correction (a market decline that is more than 10%, but less than 20%) may occur if these shares become too expensive. Santander Asset Management will continue to monitor the rise in AI enthusiasm and will adjust our portfolios accordingly.

Market update

It was a mixed week for global shares, as mentioned, US markets hit record highs on the back of technology stocks continuing to push onwards. Japanese shares continued their strong start to 2024, with the Nikkei rising by over 1% and at the time of writing, being up over 7% year to date.[11] In comparison, the FTSE 100 hit a seven-week low this week as UK inflation rose unexpectedly, albeit by a small amount, dampening hopes of an early interest rate cut from the Bank of England.[12] European markets also fell by an average of approximately 1% and China's economic woes continued with the Hang Seng index seeing a fall of 5% in the week and over 10% year to date.[13] The struggles of the world's second-largest economy could well weigh on global economic growth in 2024 and will be watched closely.

The value of seeking guidance and advice

It is important to seek advice and guidance from a professional financial adviser who can help to explain how to build an appropriate financial plan to match your time horizons, financial ambitions and risk comfort. If you already have a plan in place or have already invested, it is important to allocate time to review this to ensure this remains on track and appropriate for your needs.

Note: Data as at 25 January 2024.

[1] The New York Times, 12 October 2024
[2] Investopedia, 2 December 2022
[3] The Motley Fool, 16 January 2024
[4] The Motley Fool, 10 January 2024
[5] Investopedia, 13 June 2023
[6] Forbes, 22 March 2023
[7] Barron's, 23 January 2023
[8] Warrington College of Business, 19 January 2024
[9] Investment Company Institute, 24 January 2024
[10] Morningstar, 31 December 2023
[11] Reuters, 23 January 2024
[12] Reuters, 17 January 2024
[13] Investing.com, 23 January 2024

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Important Information