

Thoughts from our investing consultant
August 2023

Despite a notably steep “wall of worry,” including ongoing banking system strains, persistent inflationary pressures, and the most aggressive Federal Reserve (Fed) tightening campaign in four decades, performance across the markets in the second quarter appeared overwhelmingly positive. Domestic asset classes and sectors generally witnessed meaningfully stronger performance during the quarter than their international brethren, which likely reflects the U.S. economy’s relative resilience amid incrementally tighter monetary conditions.

In the second quarter, significant performance gains were experienced within the mega-cap technology sector (*more on that later*), despite the space’s embedded interest rate sensitivity. Returns for the first six months of 2023 have been impressive for stocks with the S&P 500 up nearly 17% and nearly 20% over the past twelve months. This strongly outpaced most other asset classes like small cap stocks (*up 8.1% YTD*), international developed stocks (*up 11.7% YTD*), emerging market stocks (*up 4.9% YTD*), and bonds (*up 2.1% YTD*). Just as striking has been the difference between US large cap growth stocks versus US large value stocks. Year to date, growth stocks have outpaced value stocks by over 24 percentage points! Compare that to 2022 when value outpaced growth by nearly 22 percentage points. Behold the power of diversification and, fortunately, the Foundation has exposure to both growth and value investments.

But if we peel back the onion a layer or two, we see some interesting data. While the S&P 500 has done remarkably well in 2023, it is a very narrow band of stocks driving overall return. In fact, what we’ve witnessed is the top 10 stocks of the S&P 500 have generated over 75% of the total index YTD return. Meaning, the remaining 490 stocks of the S&P 500 returned only one-quarter of the total return of the index. Looking broader, if we examine the global stock market of about 3000 stocks, about half the return came out of six stocks. Apple, Amazon, Facebook, Tesla, Microsoft, and Nvidia. Truly a “tail wagging the dog” situation. To illustrate, Nvidia (*a semi conductor chip maker that stands to benefit considerably in the Artificial Intelligence revolution*), was up over 200% in the first 6 months of the year! The Foundation has exposure to these high flying stocks and has participated in their market run. But we don’t want to have outsized reliance on a select number of stocks driving the Foundation returns. We focus on a diversified portfolio of stocks (be they large or small, growth or value, US or foreign, and even public or private) to generate the bulk of our returns.

As we always do, it's important to stress that the portfolio is positioned for long-term growth to benefit future generations and near-term yield to benefit current generations. The allocation for the Quad Cities Community Foundation remains valid and is positioned for long-term outperformance by stocks. As this specific handful of stocks cools and returns back to earth, the Foundation remains in a position to benefit from the next rally, regardless of what asset classes are participating. As a result, approximately 51% of the Foundation investments are allocated to US stocks with another 18% allocated to non-US stocks. Bonds total 25% and real estate, and cash total another 6%. We believe this diversified portfolio is the smoothest path to long-term returns so we focus on "trends" and not "events".

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