

Markets Have Tunnel Vision

This week, the market's attention was laser-focused on one event. It overshadowed the FOMC minutes from January's meeting and 20-year bond auction. All eyes were focused on the outcome of NVIDIA's earnings report. As the week unfolded, the S&P 500 faced downward pressure leading up to Wednesday, testing the lower boundary of the ascending channel established since November 1st of the previous year. However, sentiment swiftly shifted post-NVIDIA's report, prompting a notable reversal. The anticipation was so palpable that CNBC even initiated a countdown clock ahead of the report—a move that some analysts view as a potential signal of an impending bubble, if not one already in motion.



The latest FOMC Minutes largely echoed Jerome Powell's previous remarks, offering few novel insights. However, they did amplify discussions around potential QT tapering and highlighted concerns regarding stress in the commercial real estate sector. Notably, over 70% of these loans are held by regional banks, which are currently supported by the BTFP program set to conclude in March. While these factors are known, they underscore persistent challenges in the economy. While not immediate causes for concern, they highlight ongoing issues that won't be easily remedied by a few rate adjustments. Some key takeaways from the meeting include:

- The Federal Reserve's January 2024 meeting highlighted solid economic expansion, with GDP growth exceeding expectations but at a moderated pace from the previous quarter.

- Labor market conditions remained tight, with strong job gains and a stable unemployment rate, though inflation eased yet stayed above the 2% target.
- Economic outlook uncertainties and inflation risks were noted, with the Committee highly attentive to inflationary pressures.
- Discussions included the potential peak of the tightening cycle, the importance of balancing demand and supply, and the ongoing effort to bring inflation sustainably toward the 2% objective.
- The reduction of the Federal Reserve's securities holdings continued as planned, contributing to the policy strategy for macroeconomic objectives.
- The potential adjustments to the pace of the balance sheet runoff were considered as part of the broader discussion on monetary policy tools and their effectiveness in maintaining economic stability and reaching the Fed's targets.

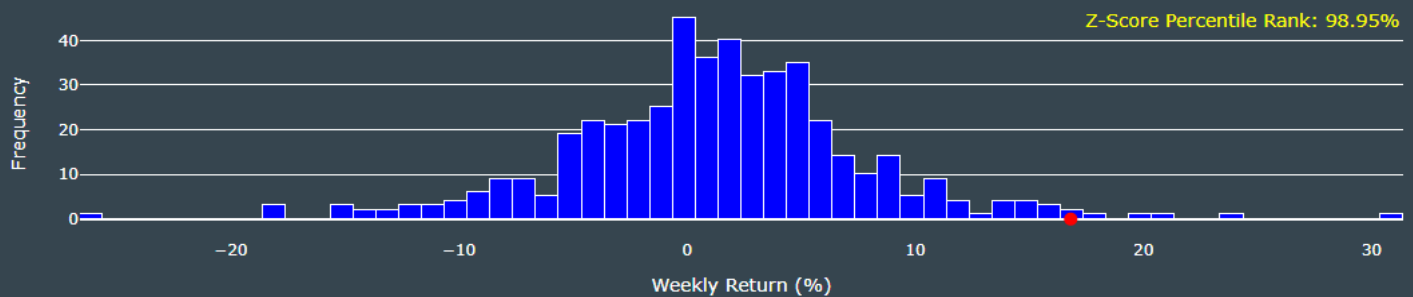
Recent bond auctions, particularly on the longer end of the yield curve, have been underwhelming, with the 20-year bond auction this week experiencing a 3.3 basis points tail. A "tail" in bond auctions refers to the difference between the yield of the lowest bidder who was allocated bonds and the current market yield. This indicates that the bonds were sold at higher yields/lower prices than where 20-year Treasuries were trading in the market, effectively pushing market rates upwards. Despite this, the market has largely overlooked these results. While the 20-year tenure isn't deemed as critical, the auction's outcome, alongside higher trending rates, is noteworthy. Both the 10-year and 30-year yields have crossed the 4.3% threshold. Although these developments have yet to significantly impact markets, they are likely to draw attention if the trend continues.

NVIDIA's earnings exceeded expectations, catapulting the stock price by 15% on Thursday. This performance didn't just elevate NVIDIA's shares; it had a ripple effect across the entire market. Companies even remotely linked to NVIDIA received a bid and were pushed higher. Year-over-year, NVIDIA's earnings were up by an impressive 265%, primarily fueled by a 408% surge in Data Center revenues. In Q4 23, their total revenue was reported at \$20 billion, with \$18.4 billion stemming from Data Centers.



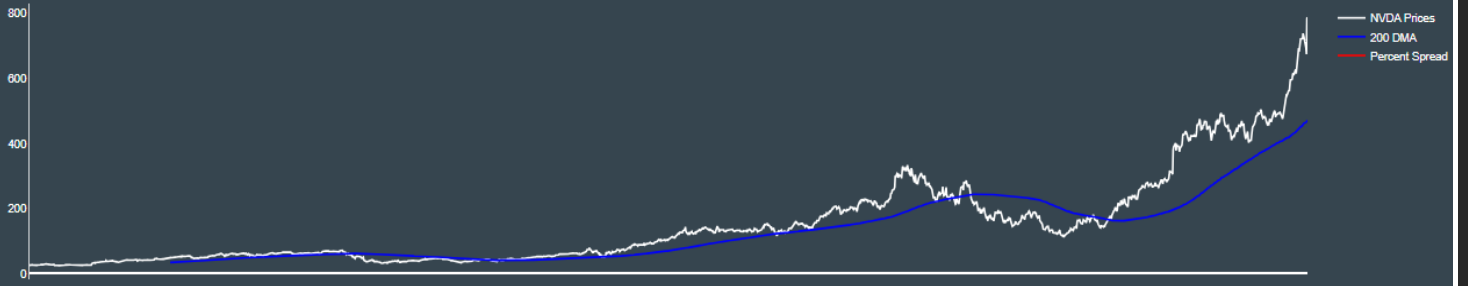
To put in perspective the increase in share price NVIDIA had, it ranks in the 98th percentile of all returns in a 5 day period since 2015. This is a \$1.7 trillion dollar company moving 16% higher in a week.

Distribution of Weekly Returns for NVDA



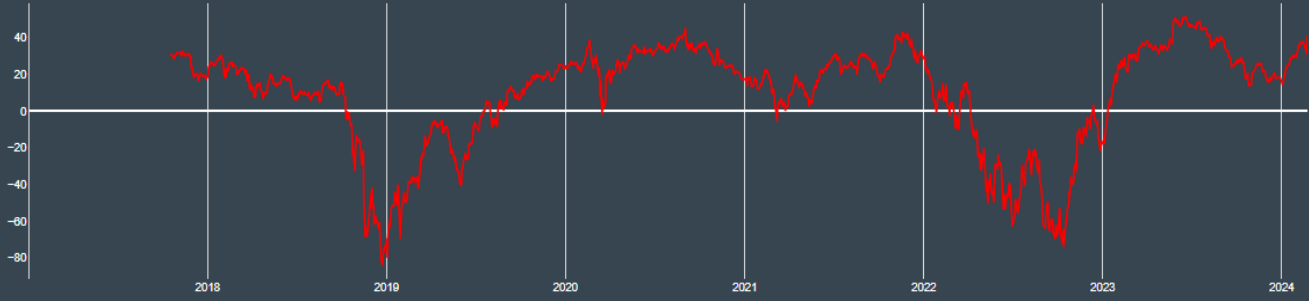
NVIDIA's current trading price stands at \$788, marking a 60% surge year-to-date. However, the stock appears overbought across all technical indicators and is significantly deviated from its 200-day moving average. With a market capitalization of \$1.7 trillion, NVIDIA's valuation is 6% of the GDP of the U.S.. Despite some fundamental justifications for this valuation, much of the anticipated upside seems already factored into the price. Their net profit margins, standing at 55%, are akin to those seen in a monopoly. Such high margins can attract new entrants to the market, particularly given the substantial market share potential. Major tech giants like Apple and Google, among others, are key customers of NVIDIA. However, they may explore developing their own technology to reduce dependency and avoid hefty markups imposed when buying from NVIDIA. The recent upward trajectory appears excessive, and for NVIDIA to justify its current valuation, it would need to achieve a staggering 24% annualized earnings growth over the next decade. This would propel their profits to over \$600 billion per year, suggesting they would dominate the entire semiconductor market. Such an ambitious growth target raises questions about the sustainability of the stock's current valuation. This will continue to be a key player in the A.I. story and may continue to move higher but it is hard to justify getting involved at this price.

NVDA



Date

Deviation from 200 DMA



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