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Fast and Furious (Part One of Two)

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This week we attended the 40th annual conference of the Florida Public Pension Trustees Association in Orlando. Attendees included municipal pension board members, plan sponsors and administrators. In Monday's keynote presentation we highlighted various macroeconomic factors investors face today.

While researching for our talk, we came across this interesting fact (tip of the hat to Van Hesser's *Three Things in Credit*): *"42% of the companies in the Russell 2000 index are unprofitable."* We had to rewind the tape to make sure we hadn't misheard. Yup, almost half of the smaller companies from the broader Russell index are losing money.

Now it's fair to ask whether some of these companies are investing for growth, hence cash flow negative, or expenses are simply outpacing revenues. And it would be helpful to compare today's measure with the last five years to see if higher rates could be the culprit.

To some extent, businesses being under financial pressures should not be a surprise. The cost of debt capital has soared over the past two years. The cost of energy and housing and some raw materials continues to be higher than historical averages. Growth is slowing in the US with some economists scaling back from previous GDP estimates of 2.4% to 1.5%.

Yet public equity markets have demonstrated marked exuberance this year in the face of those headwinds. All indices have hit record levels, with only the DJIA off from its 40,000 high. Of course, stocks have been propelled by sector focus, with almost 20% of the Dow being tech stocks, and an even greater share for the S&P 500 (30%).

The Magnificent Seven, representing 40% of the Nasdaq 100, is an extreme example of industry concentration. The market cap of Nvidia alone was $3 trillion at one point, vying with Apple and Microsoft as the world's most valuable company. So much for diversification. Great when tailwinds are supporting that sector, but when they're not you may get caught in a downdraft.

Are valuations in AI and tech overblown? We look to the experts for that answer. But concerns about rapid climbs in stock prices can lead to pullbacks, as we saw this week when NVDA (Nasdaq) lost $430 billion of value in three days. Such is life in the fast and furious tech lane.

Back in the credit lane our observations suggest growth is slowing for middle-market companies. Even in business services and other defensive arenas supported by private equity sponsors, we've seen revenue increases in the mid-single digits, not the low double digits prior to the Fed's rate hikes.

Next week we take a look at sector performance in private credit and how it makes sense to compare to the tailwinds seen today in some public equities.