Summer 2023

In early 1848, word got out that gold had been discovered at Sutter's Mill in the Sacramento Valley. By June, many of San Francisco's shops and businesses were boarded up, as three-quarters of the male population of the city left to go mining. By 1850, the news had spread around the world, and 25% of California's population had been born outside the U.S. The hysteria was aptly named "The Gold Rush."

In the years since, the financial markets have had several similar periods, when a group of companies (or countries) were proclaimed gold, given a catchy moniker, and investors flocked to them.

In the late sixties and early seventies, it was a lot of seemingly invincible stocks, dubbed the "The Nifty Fifty." Inclusion in the club meant the companies had a strong balance sheet, high profits, and high growth rates and were bought to be held—FOREVER. Blue chips. The group included nuggets like McDonald's, IBM, and GE, and pyrite like Polaroid, Sears, and Xerox.

Not surprisingly, since human emotions are one valve of the market's heart, no real lessons were learned, or, at least, heeded. And the pattern of giving a clever (or silly, depending on your take) name to a hot new investment trend continued.

In the nineties, "The Four Horsemen"—Microsoft, Cisco, Dell, and Intel—dominated the market, accounting for as much as 60% of the Nasdaq price movement in 1999 and taking the Nasdaq Composite to its all-time high in 2000, the year the dot-com bubble burst.

In the mid-2000s, the acronym "BRIC"—Brazil, Russia, India, and China—was coined for the prevailing belief that long-term growth in those emerging economies would surpass that of the world's richest nations. It soon became clear that wasn't the case, and the idea faded.

In 2013, Jim Cramer, who loves to dub, popularized "FANG"—Facebook, Amazon, Netflix, and Google—and in 2017 added Apple to form "FAANG," calling the companies "totally dominant in their markets."

Today, the industry buzz phrase, and craze, is "The Magnificent Seven," which also includes Meta (formerly Facebook), Alphabet (formerly Google), Amazon, and Apple, and adds Microsoft, Tesla, and NVIDIA. (We're guessing "MAMA ANT" didn't test well.) The enthusiasm for these companies is so high that they currently make up 28% of the S&P 500's value. (Fun fact, the index actually has 503 stocks.) Those same seven companies are responsible for 45% of the Nasdaq.

In anticipation of the question, we own six of the seven companies, though we're not close to as saturated. (We currently don't own Tesla due to its expensive valuation of 58 times next year's expected earnings.)

Perhaps the only thing getting more attention on Wall Street than the Magnificent Seven is artificial intelligence (AI). No coincidence. Nearly all the septet of companies are considered leaders in generative AI. And others have taken note. To grasp the fixation with and fervor over AI, realize the number of companies who mentioned the technology—developing or using it—in their public earnings reports just hit an all-time high with 110 companies mentioning it in their earnings calls with investors. If this need for companies to be associated with the hottest technology sounds familiar, there's a reason. Unless we've got some Generation Alpha readers (budding Alex P. Keatons?), you've lived through an analogous time.

In The Atlantic, Joe Pinsker notes a 2001 study from the University of Purdue that analyzed the outcomes of 95 companies that had added ".com," ".net," or "Internet" to their names during the dot-com bubble. They discovered, on average, the companies' stock values increased 74 percent over the period of time from five days before the name-change announcement to five days afterward. Pinsker notes that, more striking, "this effect was spread across all the firms studied—even those that didn't do business on the Internet." This caused its authors to conclude that the market's behavior indicated "a mania on the part of investors."

Are we in an AI bubble now? If so, it's likely in its infancy. At the dot-com peak, technology stocks had risen 119% over the immediately preceding twelve months. In contrast, this year technology stocks are up a modest 43% (after last year's plunge, something that didn't happen during the heady dot-com bull market). The tech sector is now trading at 26 times the next twelve-months earnings forecast, far below the dot-com bubble's acme of 54.8.

Bubble or no bubble (or "baby bubble," as Bank of America recently categorized it), things could change quickly with a rate hike from the Fed. Regardless, it's unlikely to end in the giant pop of bubbles past. Mostly because the companies in today's market are equipped with much stronger fundamentals. Many of the early coveted internet companies of the 1990s, for example, had insanely high valuations and unrealistic earnings expectations.

AI isn't going anywhere and will no doubt be a game-changer across industries. But it's in its infancy. Throughout history, emerging technologies, and the stocks associated with them, have gone through lots of ups and downs. And slews of new companies emerge vying for investment, bringing even more opportunities. For now, we're focused on the practical implications of AI and how it might affect the economy. As investors, we're buying the companies that are established in the field, as noted by our owning nearly all the "Magnificent Seven," but also companies that provide infrastructure and computing power to those who are developing the potential AI engines.

Which brings us back to the gold rush. During that time, more fortunes were made by merchants than by miners. Studebaker made and sold enough wheelbarrows to start one of America's great automobile fortunes. William Fargo and Henry Wells opened an office in San Francisco. Levi Strauss saw the need for sturdy work pants and redesigned his canvas business. As AI and the mania around it grows, we also want to be the dry goods store, not always chasing the gold, but supplying those who come looking to make their fortunes.