

# THE SENTIMENT LIFECYCLE” – A CHECK IN ON WHERE SENTIMENT STANDS TODAY

Sir John Templeton's wisdom that “bull markets are born on pessimism, grow on scepticism, mature on optimism, and die on euphoria,” offers a valuable framework for understanding the development of market cycles.

CHART 1  
THE EVOLUTION OF SENTIMENT THROUGHOUT A MARKET CYCLE



***“Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria.”***

- Sir John Templeton

In the depths of the 2022 bear market, fears of high inflation, aggressive rate hikes and geopolitical tensions sent investor sentiment to some of the lowest levels on record. Extreme pessimism peaked in the summer and depressed equity markets and valuations laid the foundations for this new bull market. As equity markets rebounded sharply in early 2023, many investors remained on the sidelines, fearful of another downturn and sceptical the recovery was real. Markets climbed the “wall of worry” higher while those on the sidelines awaited the recession that never happened.

Today we appear to be in the early stages of optimism, and this is being reflected in equity fund flows. Confidence in a soft landing seems to be much more widespread and investors are coming to terms with improving fundamentals. Good news is back to being “good” after almost two years of “good news is bad news”. Market breadth has also improved significantly, and gains are being seen beyond just the tech sector and the AI heavyweights.

The growing optimism continues to be supported by the resilience of corporate earnings and stronger than expected economic data which gives us confidence. A healthy amount of

caution still exists and is well demonstrated by the frequent comparisons of companies like Nvidia to the tech bubble. But the reality is that if we truly were in a euphoric state, no one would be talking about the impending bubble bursting because everyone would be piling into equities on the fear of missing out.

A deeper look at the fundamentals further confirms the stark differences between the tech sector today and in the late 90s. We'll stick with the example of Nvidia, the AI posterchild up over 1000% since its June 2022 bear market low and compare it with Cisco in the late 90s. Chart 2, on the left, highlights Cisco's insane price return was driven solely by margin expansion (increase in Price/Earnings multiples as expectations for growth skyrocketed) whilst their earnings barely expanded. Naturally when the cloud lifted and earnings fell short, the stock price collapsed to levels more consistent with the company's actual earnings potential. Nvidia on the other hand, has seen earnings growth outpace their stock market return, resulting in a contracting forward P/E ratio. Chart 3 on the right paints a very different picture to the one on the left. In other words, it's not hype today, its earnings growth on the back of huge increases in demand for their AI chips.

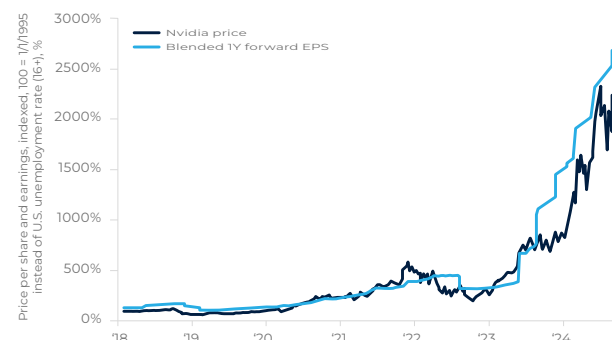
CHART 2  
CISCO'S SHARE PRICE IN THE LATE 90'S WAS DISCONNECTED FROM ITS EARNINGS

Price per share and earnings, indexed, 100 = 1/1/1995



CHART 3  
WHILE NVIDIA'S EARNINGS GROWTH TODAY HAS OUTPACED ITS SHARE PRICE RETURN

Price per share and earnings, indexed, 100 = 1/1/1995



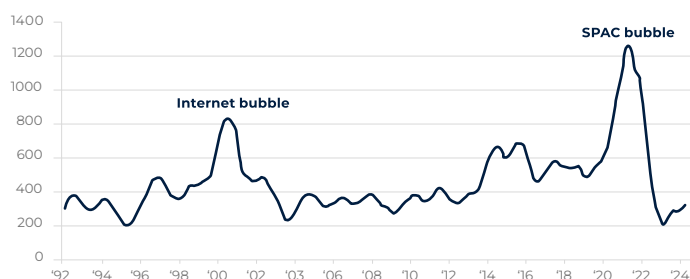
Source: Bloomberg Finance L.P., J.P. Morgan. (LHS) data January 1, 1995, to December 31, 2002. (RHS) data January 1, 2018, to 5

Yet as we navigate this phase of growing optimism, we must be much more aware of signs of euphoria brewing. Some of the things we are keeping an eye out on include:

**1. IPO Activity:** a spike in IPO activity can be a sign of euphoria, especially if we are seeing a big increase in speculative or low-quality companies choosing to go public. So far in 2024, we have seen an uptick in IPO activity, particularly in the tech sector, as companies chose to take advantage of favourable market conditions. However, activity has remained muted as compared to previous bubbles as shown in Chart 4, and it has predominantly been by late stage, high quality companies.

#### CHART 4 IPO ISSUANCE HAS BEEN MUTED

Rolling 12m equity IPO issuance, Thousands USD

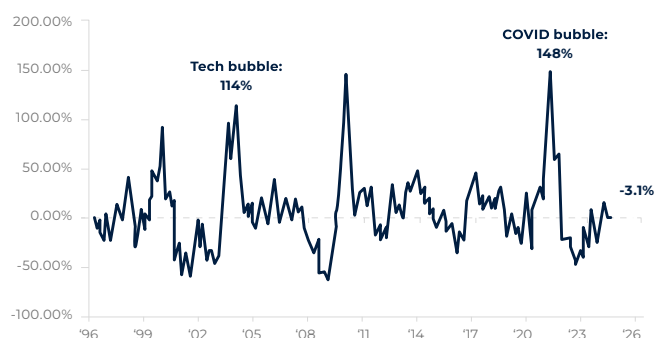


Source: Haver Analytics, J.P. Morgan. Data as of June 30, 2024.

**2. Unprofitable Companies' Returns:** when markets become euphoric, investors are willing to take on more risk amidst the belief they can only stand to gain. In past periods this has meant even unprofitable companies have been rewarded, a clear sign the market may be overheating. Chart 5 shows that contrary to the late 90s, today's rally has not been propped up by unprofitable companies as investors steer clear, suggesting we are still some way off from the onset of euphoria.

#### CHART 5 INVESTORS HAVE NOT REWARDED UNPROFITABLE COMPANIES IN THIS RALLY

Unprofitable companies in Russell 3000, rolling 12-month total return, %

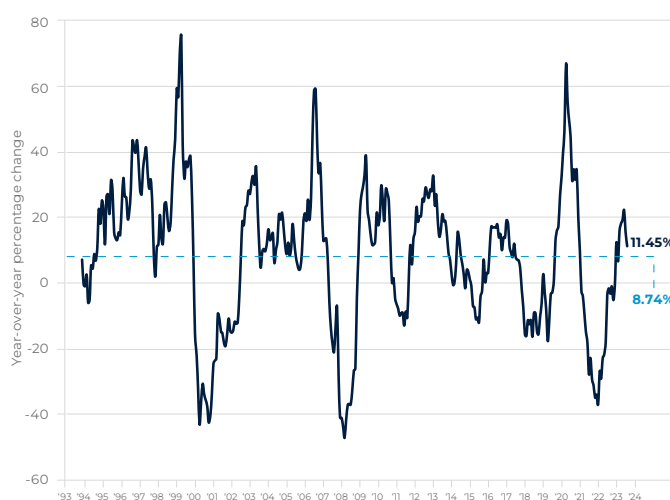


Source: FactSet, Bloomberg, J.P. Morgan. Data as of June 30, 2024.

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**3. Margin Debt Balances:** are another indication of how much risk investors are willing to take, choosing to increase leverage as their risk appetite rises. Chart 6 indicates that while margin debt balances at brokers and dealers have increased notably since 2022 as investors have become more confident, we have not seen it spike well above long-term averages as we would expect in a full state of euphoria.

#### CHART 6 DEBIT BALANCES IN MARGIN ACCOUNTS AT BROKERS/DEALERS



Source: FactSet. Data as of July 31, 2024.

Currently, the various indicators we track to gauge sentiment remain in check. A combined analysis of sentiment with deep fundamental research of the macroeconomic and corporate environment gives a more rounded view of where we are in the market cycle. All three elements suggest this bull market still has some legs to run so enjoy it while it lasts. A time will eventually come to be more cautious but for now let the power of compounding work its magic.

#### Sigma Investment Committee