



Where's the Beef?

In recent weeks, I have harped on the warming signs currently present in the S&P 500.

The biggest potential problem facing investors in the near future is that the index is market-cap weighted. The current top stocks not only account for approximately 40% of the index weight, but they also account for about 40% of the year's gains in 2025.

Valuations are rich. So rich that even some of the biggest beneficiaries of the melt-up in AI-driven stocks suggest there's a bubble brewing.

Market breadth remains weak despite the index reaching an all-time high. The fact that so few stocks are participating in the rally is a sign of market weakness. Not strength.

Another way to look at market valuation is the earnings yield on the index. The earnings yield is the inverse of the price-to-earnings ratio on the index.

Here's a chart of the *inflation*-adjusted earnings yield on the S&P 500.

Recently, it has nose-dived to *negative* 2 percent.

That's the worst earnings yield of my lifetime. And, I'm no spring chicken anymore! The last time it got this low was in the early to mid-1970s. That ultimately proved to be a terrible period for stocks.

So...where's the beef?

There's just no meat on the bone. Relative to interest rates elsewhere, the S&P 500 isn't that competitive.

Companies can outgrow the currently rich valuations. But if they don't, the market-cap-weighted index is in *big* trouble.

I'm skeptical of the growth prospects in the near future.

Here's why.



It was recently announced that Nvidia made a \$100 billion investment in OpenAI. OpenAI's CEO recently stated that the market is in a bubble, as I noted a few weeks ago.

But that's not why I am concerned. Instead, I have seen all of this before. It never ends well.

In these situations, what often happens is "boomerang revenue". Here's how it works:

I invest in you. Then you buy my product. I book the revenue. My business is growing, and everything is going well. But, were you in a position to buy my product without my investment?

Did I finance my customer to buy my product?

Maybe. Maybe not. However, it's usually "maybe" much more often than it's "maybe not."

Back in my early days of forensic accounting, focusing on technology companies, my number one strategy for identifying companies about to get their ass kicked was those engaged in boomerang transactions.

No other strategy worked better. Now, we are seeing the same types of shenanigans we saw in the last bubbles.

Here we go again!

Markets change. Human nature does not.

Of course, this is not just any company doing it. *It's the biggest company in the world.*

So, we must be skeptical of the earnings quality. This is not a court of law. Every company is guilty until proven innocent. And, this stuff doesn't pass the sniff test.

Now, that doesn't mean the market will suddenly collapse tomorrow. But the red flags are piling up.

And, if Nvidia takes it on the chin over the next couple of quarters, so too will other big AI players. Then we could easily find ourselves with the S&P 500 *down* 20% even if the other 490 stocks are *up*.

Yes, that's how out of whack these companies are with respect to their market-cap weightings.

I am betting this is precisely what will happen. Therefore, in all oversold markets in the future, until further notice, I will favor the equal-weighted S&P 500 (ticker: RSP) instead of the traditional market-cap-weighted index.

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