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FCM Weekly Market Notes

The Post IPO Portfolio

Last week we talked about some of the challenges of the spate of new issuance; this week we have some more detailed thoughts on portfolio implications now that SpaceX has (finally!) launched.

SpaceX was up 19% on its first day. The average IPO is up 18.8% on its first day, according to academic research—just a normal first day. And the average IPO under-performs its benchmark a year after launch—let's see how closely SPCX follows that piece of IPO history.

For most investors, the individual stock matters far less than the portfolio implications of a wave of new equity supply and thinking through how to navigate an even more tech-heavy index landscape.

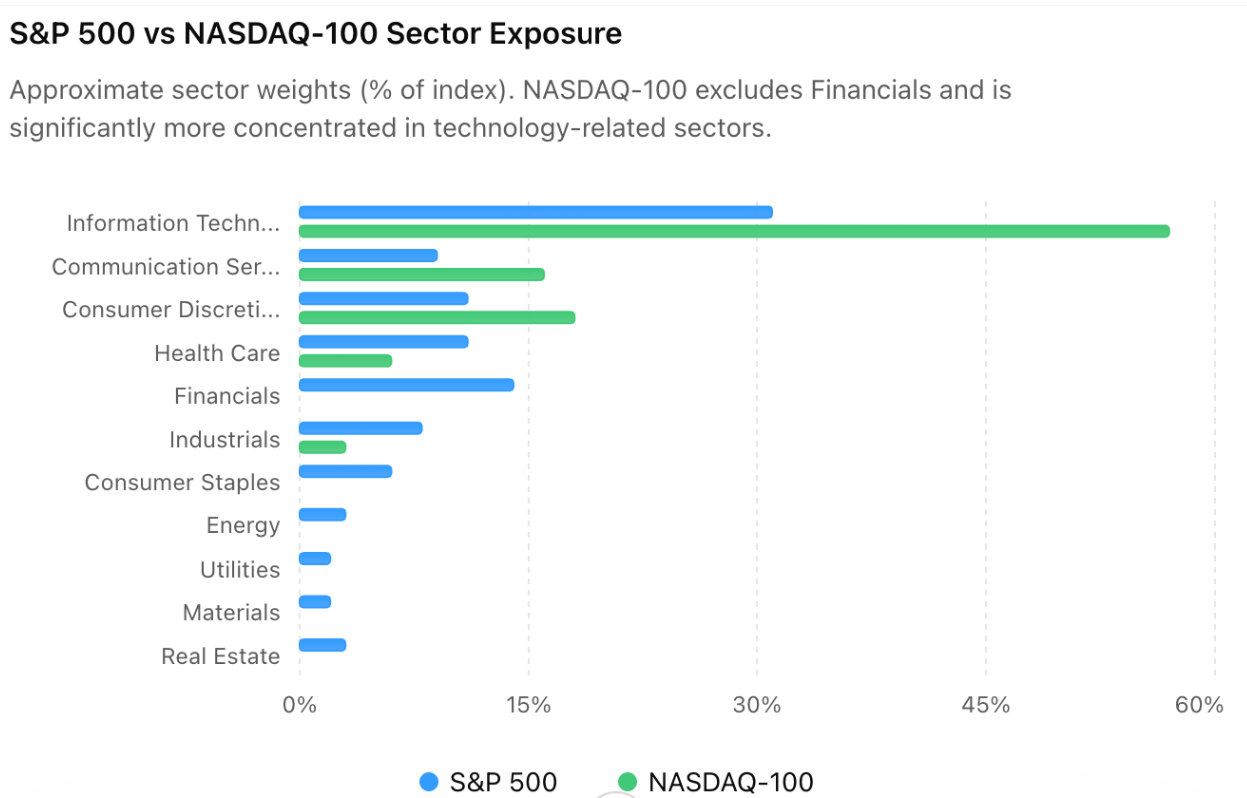
This year will mark a jarring shift from an equity landscape that is shrinking to one that is flat or even growing.

All other things equal, this should result in lower expected total returns for the equity market. Historically, buybacks have accounted for far more shrinkage in equity supply than have IPOs so the new IPOs coupled with fewer buybacks from mega-tech will also contribute to a more balanced supply picture than recent history.

Be More Strategic with Passive

Because SPCX is moving into the Nasdaq and not the S&P at least to start, passive investors now need to re-think portfolio strategy. More aggressive passive investors who owned QQQ versus SPY over the past three years were rewarded with returns 29% larger but the risks of maintaining that strategy rises, given that tech concentration will soar even further.

Comparing the two indices looks like this, and we doubt that investors have considered how this comparison will look after the new IPOs:



How should investors who have passive indices as core holdings navigate around this? If QQQ is a core holding, the obvious first choice as an additional holding is the financial sector ETF, XLF. SPY investors might consider a similar strategy. Both communication and consumer discretionary are dominated by what are essentially tech holdings as well.

Healthcare would be another sector to add exposure to. But keep in mind that Tesla and Amazon are 47% of consumer discretionary; Meta and Alphabet are a third of communications. So, of the top 10 holdings in each sector, those 4 represent 80%. They represent little if any true diversification.

Another strategy we favor is to consider factor funds—these funds aggregate stocks across sectors that share similar characteristics with less single sector risk. High dividend and low volatility stocks can both be accessed in a single ETF as a very tech-lite complement to passive (but not completely tech free).

As we pointed out last week, value funds often load up on mega-tech and are a surprisingly poor choice in a heavier tech passive world. Of course large cap growth should not be a satellite holding given its high concentration to mega-cap tech in virtually every offering.

One surprising alternative might be a momentum strategy as a tactical addition. While most investors might view that as simply another flavor of go-go tech, the performance dispersion between momentum and large cap growth this year has been startling (performance shown is versus S&P):

Given that the momentum factor is based on price, the tech holdings are more varied, and they can include holdings like Caterpillar or Exxon. As mega-cap tech migrates from an asset lite and debt-free space to data center heavy and consistent debt issuers, a distinction between different types of tech—as these two factor funds illustrate—might allow for more diversification even if both are under the tech umbrella. Overall, this would obviously be a more tactical holding whose prerequisite for buying has to be an overall buoyant equity framework.

Investors who want to lower exposure to either QQQ and SPY because of a higher tech concentration could consider a higher allocation to small caps. While that avoids some of the concentration it does not lower overall market risk as the indices are highly correlated:

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Rolling 3-Year Correlation: Russell 2000 vs Nasdaq-100

Illustrative rolling 36-month correlation between small-cap (Russell 2000) and large-cap growth (Nasdaq-100) total returns across market regimes.

Correlation values are estimated rolling 36-month correlations based on index return behavior (2021–2026).

Another diversifier that might seem intuitively obvious would be more international exposure. However, as we will show in an upcoming piece your results are highly dependent on the path of the US dollar—a strong dollar and US equities will out-perform, almost without fail, while the opposite is also true. In emerging markets, South Korea is essentially a tech bet with Hynix and Samsung representing 45% of the index. While that has driven EM as an asset class, it also has become a highly correlated part of the entire tech investment thesis.

For those reasons our view is that international exposure should be more tactical than most naïve, retail investor off-the -shelf models that suggest a static allocation presume.

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So investors will ultimately be grappling with more market risk as new tech supply continues to hit the market (and, as a reminder, plenty more SPCX supply will come to market over the next six months!). A final way to address both the overall risk of lower market returns with more supply and the tech concentration would be options strategies on passive indexes that give up some upside in exchange for income. This would mitigate the downside risk, and tech heavy indices will certainly trade with more volatility which would make selling those options more valuable going forward.

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