



“SURFING”

The Stock Market: A Beacon of Innovation

Throughout history, the stock market has been a reflection of human innovation. Technological advancements in various sectors, such as medicine, healthcare, transportation, and computing, can be observed through the lens of capital markets. As investors, it is important to recognize that selling out of our portfolios essentially means betting against human innovation—a wager that may prove unwise in the long run.

Waves of Innovation:

The first wave of innovation began in the late 1700s and was driven by waterpower, textiles and iron. At this time, the Philadelphia Stock Exchange was formed, and the Industrial Revolution was in full force. The second wave began in the mid-1800s with steam power, rail and steel, propelling further innovation and industrial advancement. Railroad stocks were the most popular investment at that time. The next wave of innovation was primarily electricity, chemicals and the internal-combustion engine arriving in the early 1900s. Tobacco, steel, utilities and rail companies dominated the trading volume as the euphoria of innovation gave way to exuberance. In approximately 1950, the fourth wave of innovation began with the onset of aviation, electronics and petrochemicals. The “Nifty Fifty” became an informal designation of large companies trading on the New York Stock Exchange and included IBM, Coca-Cola, Eastman Kodak, Sears, Proctor & Gamble, and General Electric. The fifth wave of innovation was built on digital networks and software. Investors gobbled up shares of anything with “Dot com” in its name as the internet became a household tool in the 1990s. Cisco, Dell, Lucent, Yahoo, and America Online were some of the decade’s biggest winners. Many argue that we are entering the sixth wave of innovation with artificial intelligence, robots, drones and cleaner technology.

Interestingly, some of the aforementioned companies have become long, enduring stalwarts that make up the corporate landscape today and some have ceased to exist despite their innovative lead during a wave of innovation. This is yet another great reminder that not all great innovators are great investments. Not all great products make a great company. We, as consumers, can love a product or an innovation but we must think differently as investors.

Especially when the markets start to get excited by innovation, it is crucial to stay disciplined and go back to core tenets that lead to successful investing. Vigilantly watching how CEOs, as capital allocators, navigate rapid growth becomes even more crucial during an innovation wave. Prioritizing low capital intensity businesses, particularly in inflationary environments, while also ensuring responsible use of debt by companies must continue to remain at the forefront of investment decisions. Additionally, monitoring competitive threats and regulatory challenges is fundamental to owning businesses as the wave brings with it tremendous and rapid change.

Stock Market Performance:

Back to the present day, in 2023, the stock market has witnessed remarkable performance in the face of much uncertainty. Many professionals argue that the stock market is forward looking and it “prices in” adverse events as it may very well have in 2022 with a 20% decline in the S&P 500. Just as the market sees waves of innovation, it is also expected that we see waves of uncertainty. Last year the market was likely pricing in such uncertainties and economic challenges as:

1. The war between Russia and Ukraine
2. Rising interest rates, which inherently slows growth.
3. Rapid inflation in food and labor costs as the economy rebounded from supply chain issues that followed the Covid shutdown.
4. Tensions with China that are leading to a largescale, geographic shift in manufacturing.
5. A banking crisis that led to the demise of three of the country's larger regional banks.

New Realities:

The market is beginning to accept these adversities and has begun to look ahead again. Despite these adversities still persisting in 2023, we are seeing some pockets of strength. Some sectors are beginning to outperform as the market once again returns to the power of innovation. Sectors that are seeing inflows of capital seeking innovation:

1. **Technology:** Companies at the forefront of innovation, such as those involved in cloud computing, artificial intelligence, and cybersecurity have experienced remarkable growth as digital transformation continues to reshape industries. Technology spending for corporations is essential and unavoidable. Having 2022 to test and challenge novice management teams has allowed some companies to emerge stronger. Managements had to weather a tough storm and this fire they have walked through has separated "the wheat from the chaff."
2. **Healthcare:** The healthcare sector has thrived throughout the pandemic as governments increased funding for research and innovation. Advancements in pharmaceuticals, biotechnology, and healthcare services continue to propel healthcare investment. Companies focusing on innovative treatments, therapies, and healthcare solutions have delivered strong returns over the long term.
3. **Renewable Energy:** With increasing global emphasis on sustainability and clean energy, the renewable energy sector has flourished. Solar, wind, and other green energy companies have attracted significant capital, driven by growing demand and government initiatives.
4. **E-commerce and Digital Services:** The shift towards online shopping and digital solutions has been accelerated, leading to substantial gains for companies operating in e-commerce, digital payment systems, and online marketplaces. The convenience and accessibility offered by these services, along with Covid lockdowns, have boosted their growth.
5. **Electric Vehicles:** The growing interest in electric vehicles and the transition to a greener transportation system have driven the performance of electric vehicle manufacturers and related infrastructure companies. Increased consumer adoption and supportive government policies have contributed to their success.
6. **Global Manufacturing Shift:** With supply chain woes fresh in their minds and as tensions with China escalate, manufacturers are scrambling to move manufacturing closer to home. This is impacting real estate, labor and also leading to strong transportation innovation.

A Bright Future:

We are steadfastly optimistic about the future and the power of human innovation. Waves of uncertainty often create tremendous opportunities to embrace the potential for continued growth and prosperity. And although we are ready to ride the waves of innovation, we will do so with discipline and unwavering focus on what not only makes an amazing product, but what also makes an amazing investment.

As always, we are here to address any questions or concerns you may have. We value our partnership with you and appreciate your trust. We hope you are enjoying your summer and perhaps enjoying some "waves" that are not economic in nature.



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