Nvidia – The Magnificent "One"?

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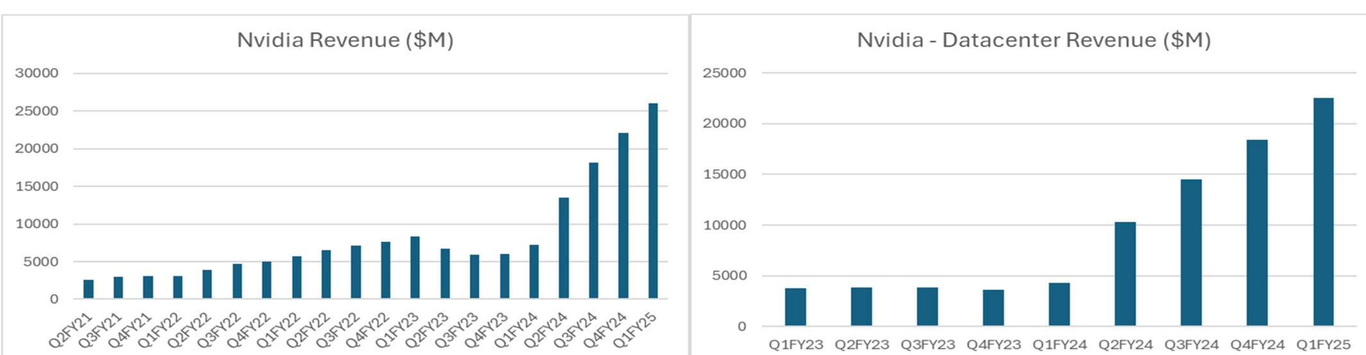
"The Most Important Stock on Planet Earth"

Recently, the stock that is on everyone's mind and which seems to permeate every client conversation is Nvidia. And for good reason – Nvidia's results in the 3rd week of May were probably the most anticipated quarterly earnings of the entire season. Nvidia has been called by Goldman Sachs "the most important stock on planet Earth" – and we would agree with this title, given the company's influential weighting on indices (it briefly passed Apple as the 2nd largest weight on the S&P 500 Index) and its status as the bellwether stock for all things artificial intelligence (AI).

Nvidia's earnings results did not disappoint – rather it was a confirmation that the AI spending cycle is alive and well. Nvidia met the already sky-high street expectations by delivering a quarter that demonstrated its remarkable growth trajectory remains intact. Revenue of $26 billion represented 262% year-over-year growth, with $22.6 billion of that coming from datacenters (which represented an incredible 427% y/y growth rate)[1].

Indeed – the growth that Nvidia has experienced over the past 12 months is nothing short of astounding. Recall that Nvidia's stock first gapped up after it shocked the street by raising guidance in the first quarter of last year from $7 billion to $11 billion – at the time rightfully seen as an unparalleled guide for the following quarter. And yet, exactly a year later, Nvidia's guidance for next quarter is $28 billion – more than 2.5x that original higher guidance figure.

Figure 1 – Nvidia Revenue Growth (LHS), Datacenter Revenues (RHS)



Source: Nvidia Company Reports, as of June 1, 2024

[1] Source: Nvidia company reports, as of May 22, 2024

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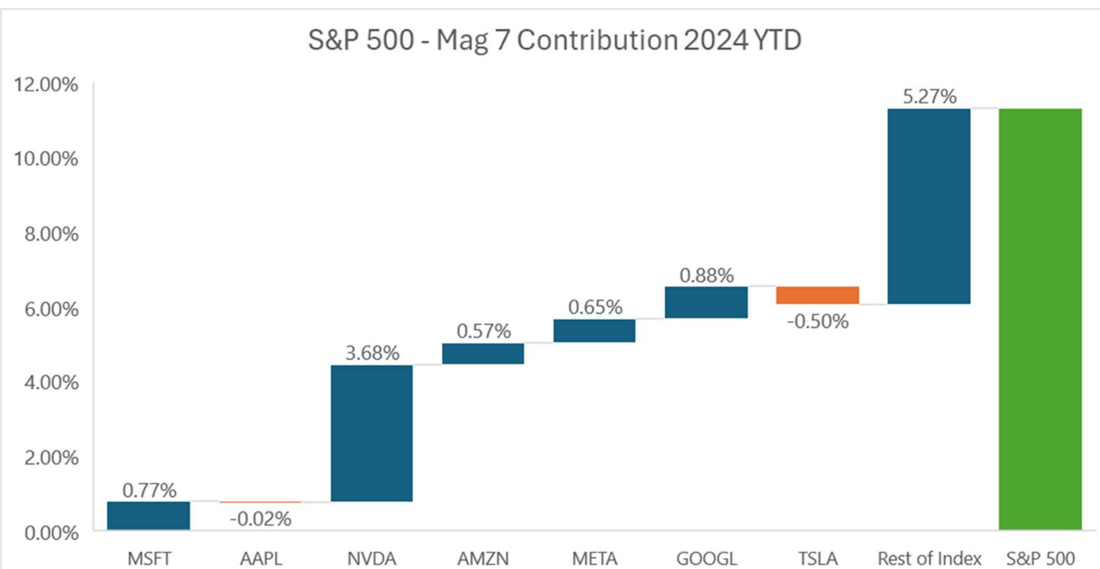
The good news kept on coming. In its quarterly results, the company noted that the new Blackwell chips are in full production, should begin shipping later this year, and that demand is expected to remain well ahead of supply well into next year. Companies such as Amazon, Google, Meta, Microsoft, OpenAI, Oracle, Tesla, and xAI were cited as among the organizations expected to adopt Blackwell, which delivers up to 4x faster training and 30x faster inference compared to the current H100 chips and extends Nvidia's technology lead over its competition.

Indeed, commentary from the large cloud-service providers (hyperscalers) during the quarter indicated that generative-AI spending and capital expenditure (capex) is alive and well. These tech giants are continuing to dedicate tens of billions of dollars towards AI infrastructure. Meta opened their earnings call by talking about a "multi-year investment cycle". In Amazon's quarterly results, they discussed higher capex in 2024 "driven by higher infrastructure capex to support growth in AWS, including generative AI". Similarly, Microsoft on its quarterly call described its capex being expected to "increase materially" in coming quarters thanks to AI investments, while Google said in its Q1 results that it spent $12 billion on capex during the quarter on servers and datacenters, and expects spending to remain at or above those levels for the remainder of the year.

The Market Leader in 2024

Nvidia's blowout results allowed it to continue its remarkable rally in 2024, as the stock blew through the $1000 mark following the earnings result. Through the first five months of the year, Nvidia's shares are up 121%, making it far and away the best performing stock on the S&P 500 and outperforming the rest of the Magnificent 7 stocks by a large margin. So far year-to-date, Nvidia represents nearly 33% of the S&P 500 return, which is nearly as much as the "other 493" stocks combined. The move has made Nvidia on the cusp of becoming the 2nd most valuable company by market cap in the world behind Microsoft.

Figure 2 – S&P 500 Magnificent 7 Contribution Year-to-Date



Source: AGF Investments, Bloomberg, as of May 31, 2024. *Rest of Index include the remaining 493 stocks in the S&P 500 Index. One cannot invest directly in an index**. Past performance is not indicative of future results.** This is not a recommendation to buy or sell securities.

Yet despite Nvidia's meteoric rise, it is not expensive – its forward P/E remains fairly reasonable, relative to its own history (as illustrated in Figure 3) and particularly relative to its growth. This is because although Nvidia's share price appreciation has been tremendous, it has not kept pace with the company's even more robust earnings growth, which has brought its multiple down.

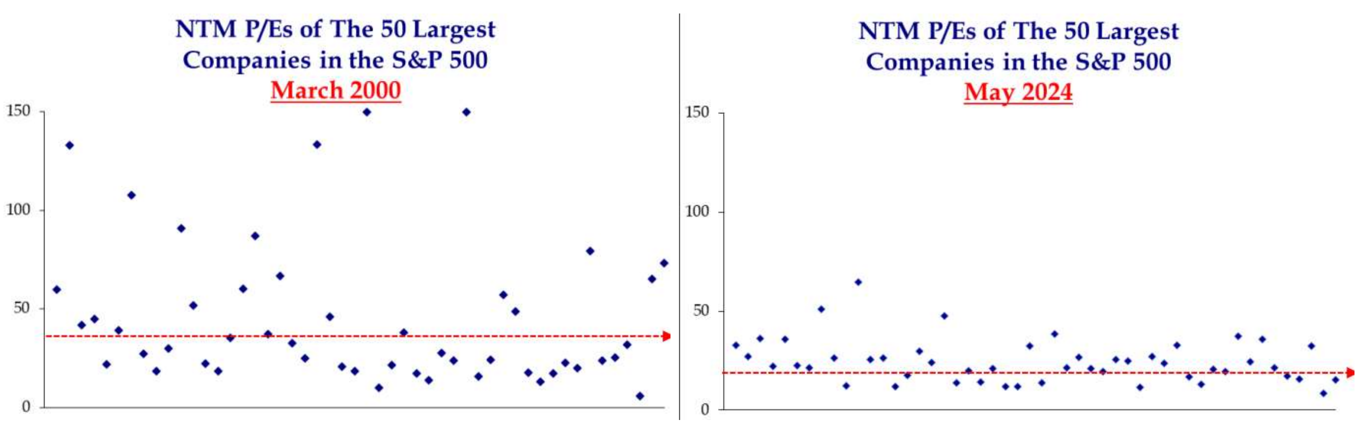
Figure 3 – Not That Expensive – Nvidia Forward P/E

Source: Factset, Oppenheimer, as of May 23, 2024

Comparisons with the 1990's Technology Bubble

That reasonable valuation relative to Nvidia's growth is important to keep in mind, given that the incredible run of Nvidia as well as that of the broader market has led to many comparisons to the market run of the late 1990's. While in both cases the stock market encountered the early stages of a transformative technology (the internet during the 1990's and AI today), today's valuations are not comparable to those in the technology bubble of the late 1990's, as illustrated in Figure 4. The median forward P/E of the top 50 stocks in the S&P 500 today is 22x, which is lower than the 31x multiple it had in the late 1990's.

Figure 4 – Valuations – Forward P/E's During Tech Bubble (LHS) vs. Today (RHS)

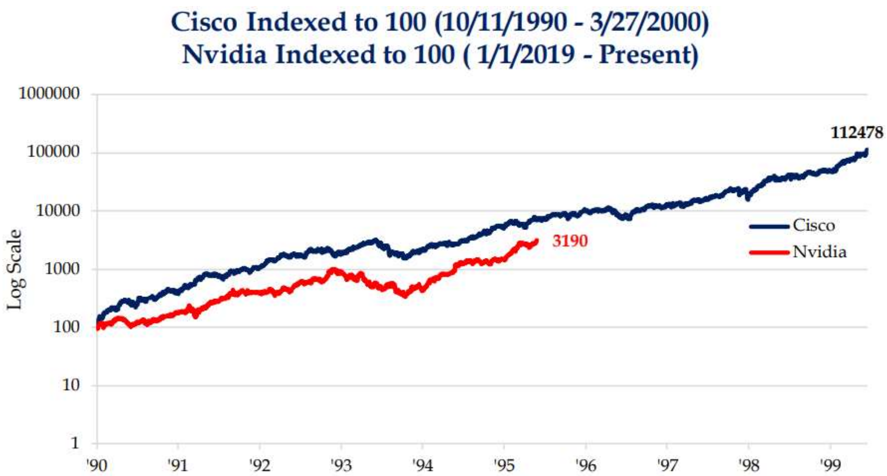


Source: Strategas Research, as of May 28, 2024. NTM represents next twelve months. Red line represents median NTM P/E of the 50 largest stocks.

Perhaps the company that Nvidia is most often compared to from the 1990's technology bubble is Cisco Systems. Like Nvidia, Cisco was the "picks and shovels" player of the internet age, providing the networking equipment that enabled much of the internet. Between 1995 and 2000, Cisco's revenue surged 850%, from about $2 billion to $19 billion, with its stock price appreciating an incredible 3800%.

But there are some stark differences between Cisco of the late 1990's and Nvidia today. First, Nvidia has a long way to go before approaching the run that Cisco had in the 90's. Moreover, the overall investing environment is not comparable – the late 90's was associated with investor exuberance and a mania around equity markets, as illustrated in the valuations seen in the previous exhibit. Net flows were piling into equities back then – that is not the case today, with net flows into equities barely positive since the Global Financial Crisis.

Figure 5 – A Long Way to Go Before 1990's Scenario

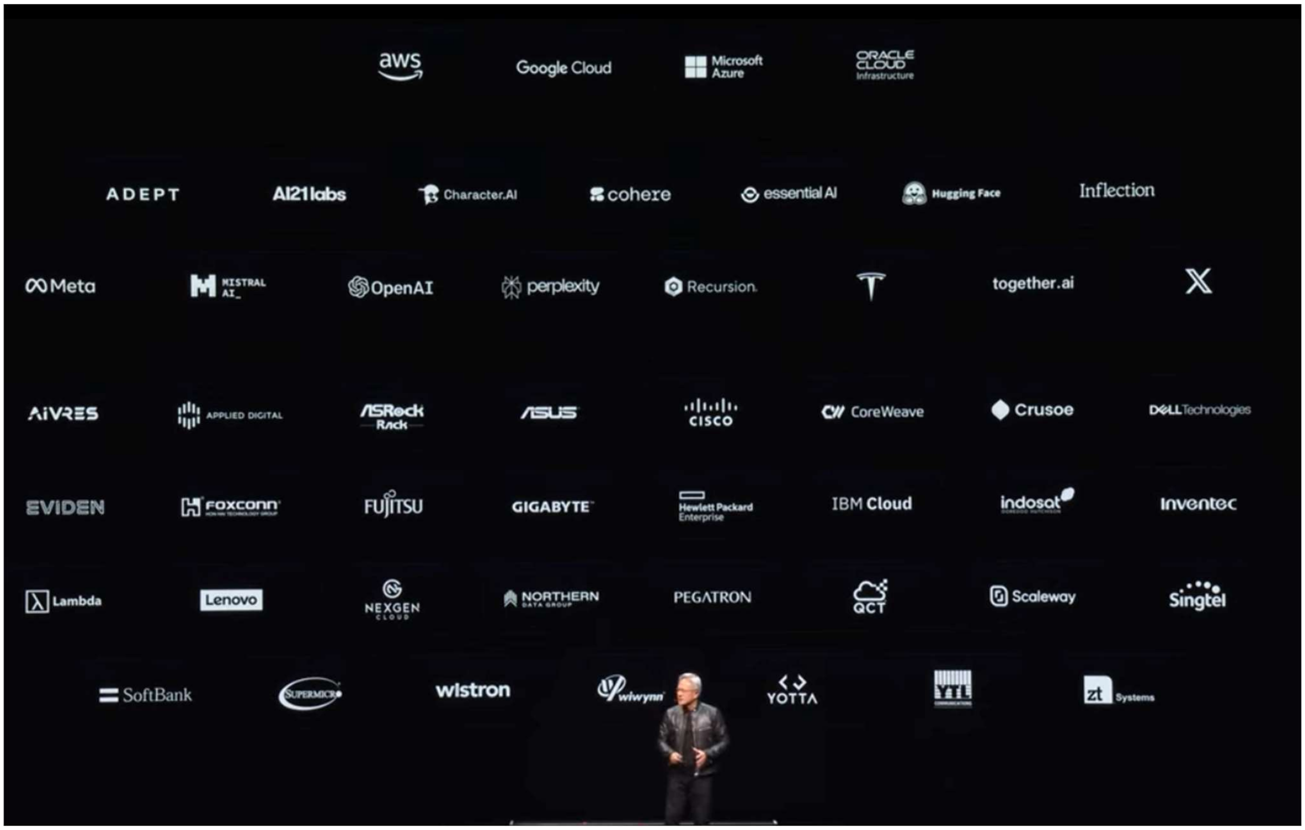


Source: Strategas Research, as of May 28, 2024

Second, in the 1990's, Cisco was heavily selling into the telecommunications industry, one that was prone to larger swings in capex cycles. Today, Nvidia is selling to the most cash-rich companies in the world such as Microsoft, Google, Amazon, and Meta, who are all competing with one another to build out their AI capabilities. In fact, if the capex figures of the hyperscalers including Oracle are added up, it comes to approximately $200 billion, which is the approximate size of the oil and gas industry. But it is not just the hyperscalers – although in Nvidia's recent quarterly results, it specified that 45% of its datacenter revenues came from these large companies, it is also seeing demand from all customer types. In a keynote speech this weekend, CEO Jensen Huang highlighted a who's who list of partners.

Third, we believe that Nvidia has a wider moat – not only because its new generation of chips builds on its technology lead over its competitors (it just announced its new Rubin graphics processing unit (GPU) architecture to come in 2026), but also because Nvidia's Cuda software platform, which gives developers tools to use Nvidia's GPU's to build AI models, is a key differentiator and a difficult-to-replicate ecosystem.

Figure 6 – Nvidia Partners Highlighted at Computex (June 2, 2024)



Source: Computex conference keynote speech, as of June 2, 2024. For illustrative purposes only. This is not a recommendation to buy or sell securities.

Staying Ahead of Consensus

This is not to say that Nvidia's remarkable growth will continue forever. Given the law of large numbers, we anticipate it will inevitably slow down at some point. While investment cycles into AI will continue to be elevated (and growing) for the foreseeable future, eventually that spending will reach a steady-state and the growth in spending will decelerate. As such, one question we have been spending time thinking about is when does the market begin discounting a slowing down of Nvidia's growth and/or capex spending by the hyperscalers? After all, the stock market is a leading indicator and will try to anticipate such a deceleration in growth. In our view, that could potentially happen as early as later on this year.

For now though, capex intentions for this year are already set, and they translate into continued robust demand for Nvidia's chips. Moreover, with earnings growth improving for corporations, that should help capex and adds to the visibility for Nvidia in the near-term.

A final thought – when we were considering Nvidia as a purchase candidate last year, the thought process was along the lines of *"if we were starting a portfolio today, what stocks should be in the portfolio?"* Clearly, we believed that Nvidia fit the bill – and today, we continue to believe that to be the case. However in the same way that objective thinking helped us back into Nvidia last year, we will have to apply the same discipline in thinking about the months ahead for what has clearly been *the* market leader for 2024.

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