

Bubble Meter Signals Frothiness in Certain Areas: Is Big Brother's Passive Money at Play?

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As the year draws to a close, I revisit my simple yet effective method for gauging the stock market's bullishness and bearishness: counting how many large companies are trading at more than 10x forward sales.

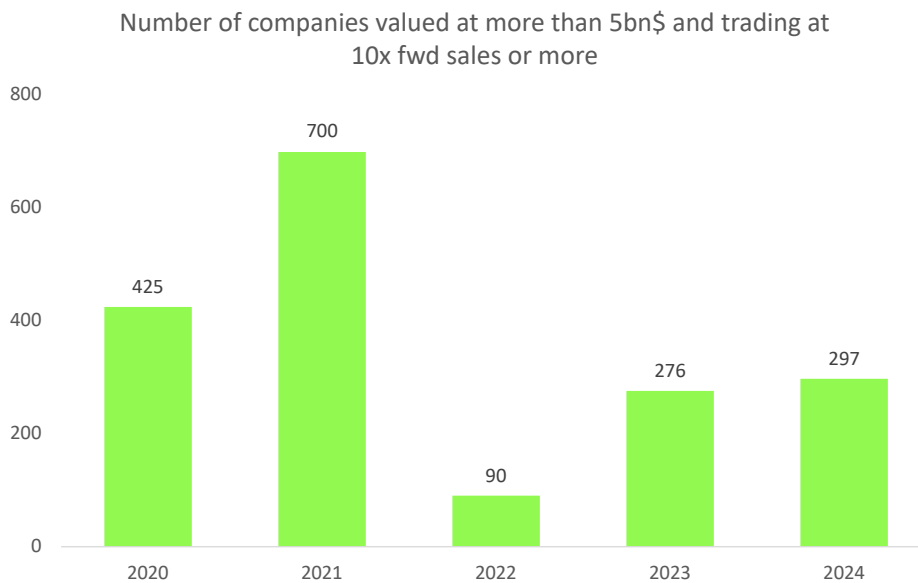
Global stock markets have risen by an impressive 27% in 2024 (measured in euros), largely driven by US equities, with additional support from a 5% stronger US dollar. US corporate earnings grew by 10% this year, while European earnings remained flat. As a result, higher valuations in the US have been the main driver of the performance gap between the two markets.

What's Behind Higher Valuations?

Typically, higher valuations reflect expectations of stronger future earnings or lower interest rates. In 2024, these factors are bolstered by enthusiasm around artificial intelligence (AI) and hopes for a dovish pivot in monetary policy. But there's another significant development: the rise of passive investing. For the first time, capital in passive index funds (\$16 trillion) has surpassed that in active funds (\$14 trillion).

To put this in context, the global tradeable equity universe stands at \$68 trillion. Retail investors, sovereign wealth funds, founders, and other active investors collectively hold the remaining \$38 trillion. Despite this, the growing dominance of passive funds—driven by index providers rather than company fundamentals—has undeniable influence over market dynamics.

Bubble meter



2024 Bubble Meter: Nvidia Reigns Supreme

This year's bubble meter is crowned by Nvidia, which boasts a market capitalization of \$3.36 trillion and trades at a lofty 26x forward sales. Other ultra-large-cap companies trading above the 10x forward sales threshold include Microsoft, Tesla, Broadcom, Eli Lilly, Novo Nordisk, and Netflix.

One standout case is **Palantir**, which has been the S&P 500's top performer of 2024. After joining the index in September, it surged by 325% for the year, buoyed by passive fund inflows that follow the dictates of "Big Brother" index providers, irrespective of valuation or fundamentals.

Palantir: A Case Study in Growth Expectations

Palantir's meteoric rise has left it with a market cap of \$167 billion, despite expected 2025 revenues of just \$3.5 billion—implying a valuation of 48x forward sales. This prompts an intriguing question: how much growth is required to justify such a premium valuation?



If Palantir achieves an extraordinary 40% annual revenue growth over the next 20 years—a feat no large company has ever sustained—it would generate \$3 trillion in annual revenues by 2044. Assuming a 35% free cash flow margin and a valuation multiple of 25x forward earnings, Palantir could have a market cap of \$25 trillion. That’s a compounded annual growth rate (CAGR) of 28%—an exceptional outcome that would comfortably beat market returns.

However, even at 20% annual revenue growth—a world-class rate—Palantir's 2044 revenues would reach \$135 billion. With the same free cash flow and valuation assumptions, this would yield a market cap of \$1.1 trillion, delivering a respectable 10% annual return over 20 years.

The risks are clear: if Palantir’s growth trajectory falters, the downside could be significant. As we’ve seen with Tesla and Beyond Meat, strong fundamentals and sustained growth are essential for maintaining high valuations.

No Alarm Bells—Yet

My 2024 roadmap remains a work in progress, and while signs of frothiness are evident in some areas, the overall market sentiment does not yet warrant alarm.

