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Profit Margin Moonshot

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In classical capitalist theory, high profits attract competition. This erodes margins over time, leading to mean reversion, or a fall back to the average.

But over the past 20 years, large cap US companies (driven by the technology sector) have defied this pattern. Here's why:

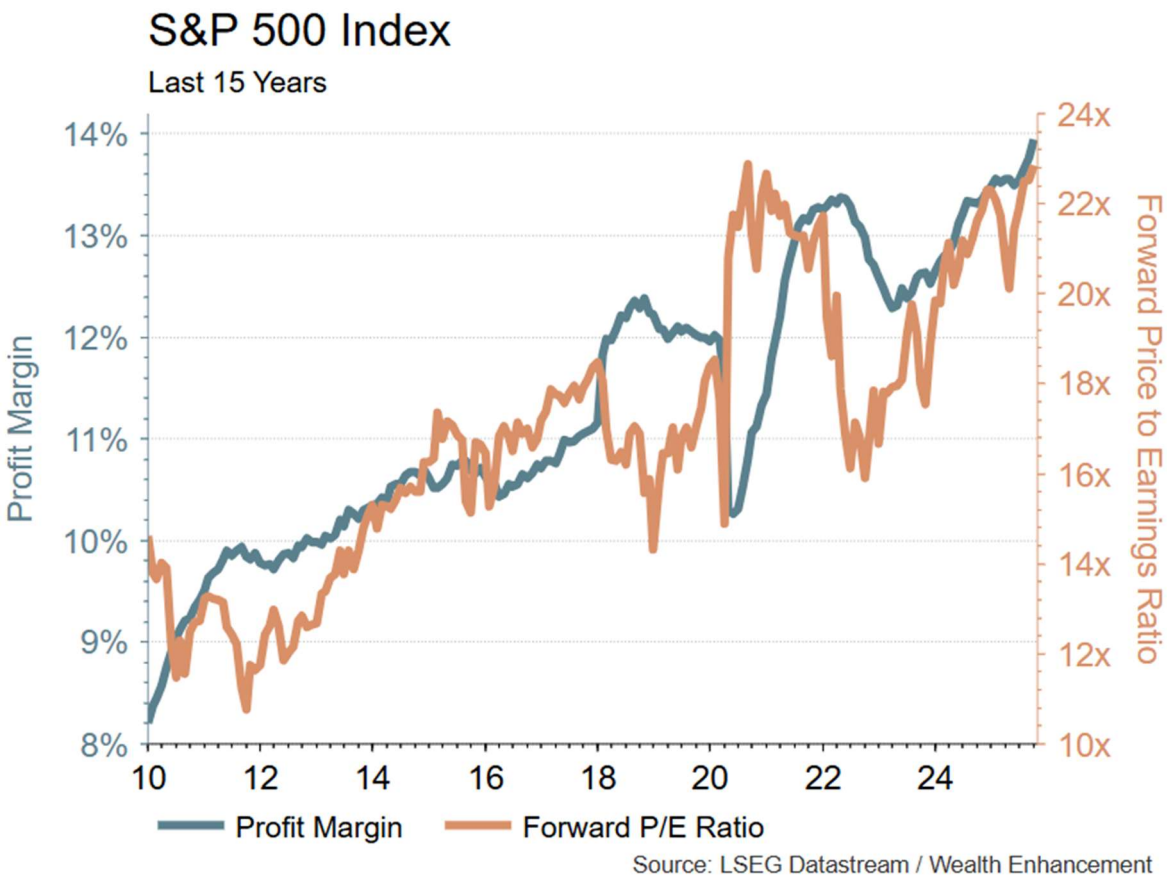
Platforms like Google, Meta, Amazon, and Microsoft benefit from network effects — the more users they have, the more valuable the service becomes. This creates winner-takes-all dynamics, where scale reinforces dominance.

Tech firms rely heavily on intellectual property, data, and algorithms, which are hard to replicate. These assets don’t depreciate like physical capital. They often scale with minimal marginal cost. This allows firms to maintain high margins even as they grow.

Many tech firms have used global tax structures to minimize effective tax rates, boosting net profits. Regulatory frameworks have sometimes lagged behind innovation, allowing firms to grow without traditional constraints.

As profit margins have increased, investors have become willing to pay higher valuation multiples. In 2010, companies had average profit margins of around 9%, and investors typically paid 12x to 14x earnings. Today, with margins closer to 14%, investors are paying around 23x earnings, reflecting greater confidence in sustained profitability.

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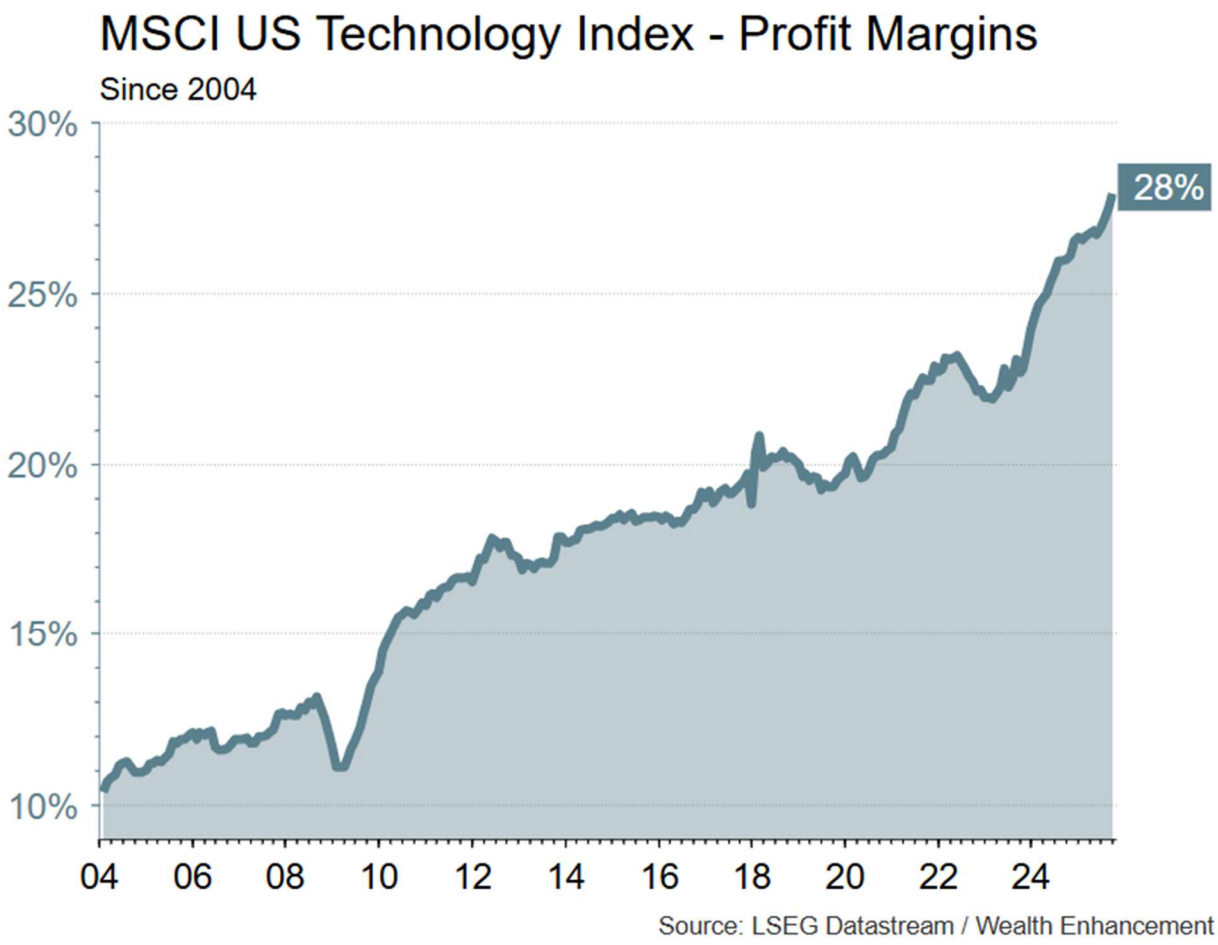
The overall market's key contributor to margins was the technology sector. There's a strong argument that some tech firms exhibit monopoly-like behavior.

Big Tech has acquired hundreds of startups, often preemptively, to eliminate future competition. This has led to concentration of innovation within a few firms.

Firms like Google (search), Meta (social), Amazon (e-commerce/cloud), and Apple (mobile ecosystem) have dominant market shares. They often set prices, control platforms, and dictate terms to suppliers and developers.

Operating margins for the technology sector increased from 11% to 28% over the past 20 years. These margins are not typical in competitive markets, suggesting pricing power and lack of competition.

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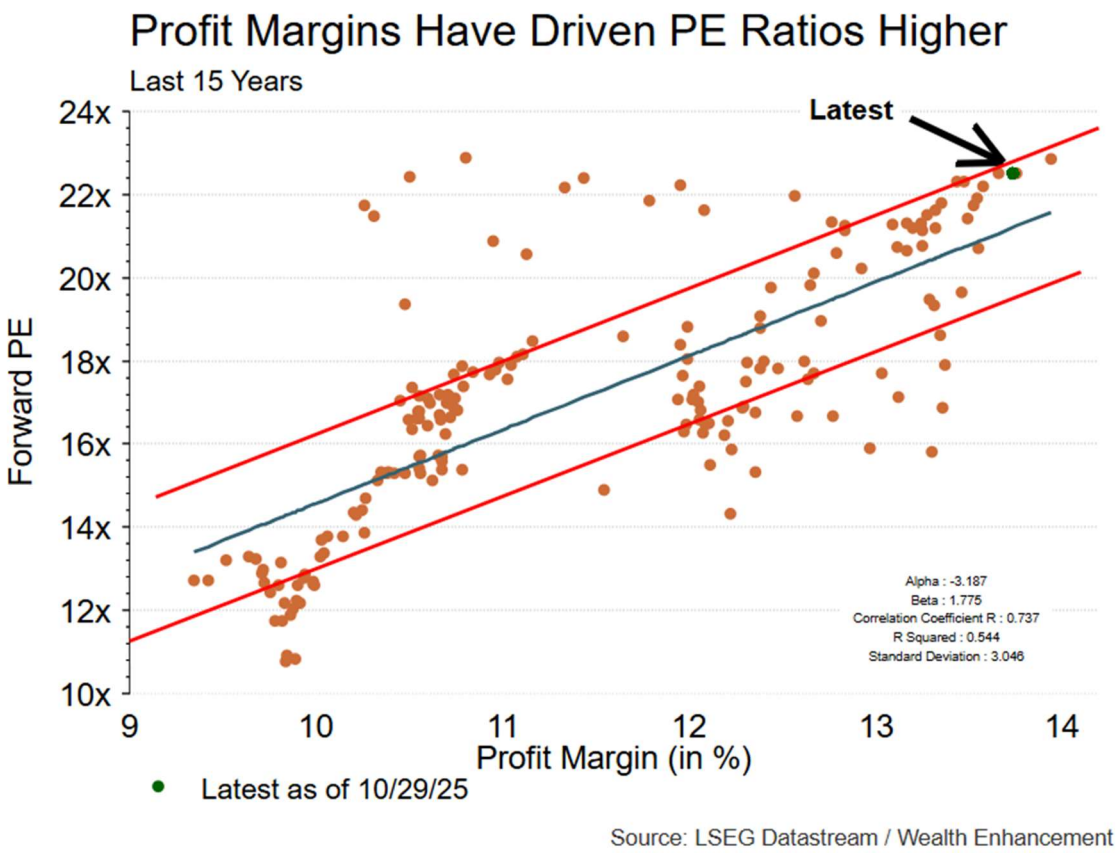


The largest technology companies invested $400 billion this year on AI spending. This is changing the makeup of these companies from historically asset-light (software) to asset-heavy (data center).

Markets recognize a clear path for investment, but the challenge lies in the low revenue generation for AI today. Additionally, the need to upgrade chips every few years adds to ongoing costs, increasing the financial burden.

Relative to the past 15 years, current market valuations are near the upper end of their historical trend range. This is after accounting for the amazing margins.

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As equities have rallied sharply since the April lows, their weight in portfolios — whether for endowments, pensions, or families — has drifted above target allocations. Most investors operate under an **Investment Policy Statement (IPS)**, which outlines strategic asset class targets and risk parameters. With equities now overweight relative to those targets, we could see rebalancing activity pick up as allocators bring portfolios back in line.

At the same time, markets are entering a seasonally strong period, supported by tailwinds from tax legislation and lower interest rates. These forces may continue to drive momentum — even as disciplined portfolio management begins to reassert itself.

The information is not intended as a recommendation. The opinions are subject to change at any time and no forecasts can be guaranteed. Investment decisions should always be made based on an investor's specific circumstances. Investing involves risk, including possible loss of principal. 2025-9865

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