Equity Evolution: Passive Funds, Private Growth, and the Wealth Effect

Global macro views increasingly highlight how today's equity markets differ markedly from those of the past. While sustainable earnings remain the fundamental driver of valuations, several other factors now appear to be playing an outsized role in shaping market dynamics.

Below are three key factors driving equity markets:

1) The Rise of Passive Investing
Passive Exchange-Traded Funds (ETFs) that track indices have surged globally, capturing the majority of investment flows and creating ongoing challenges for active managers. This has led to greater concentration in large-cap stocks, raising the risk of "index bubbles" where passive inflows sustain elevated prices regardless of underlying fundamentals.

2) Companies Staying Private Longer
Historically, public equity markets served as the primary vehicle for companies to raise capital through Initial Public Offerings (IPOs). However, in an era of abundant private equity and venture capital, many high-growth businesses are delaying IPOs or remaining private indefinitely. This shift diverts growth opportunities away from listed markets, often placing them beyond the reach of retail investors.

At the same time, many listed companies continue aggressive share buyback programs, often funded by low-cost debt to enhance shareholder returns. Both trends have the effect of reducing the supply of publicly traded equity.

3) The Wealth Effect
As global equity markets, particularly in the US, grow faster than the underlying economy, they have become an implicit lever for government and central banks. Rising stock prices boost household wealth, supporting consumer confidence and spending, which policymakers aim to sustain to drive economic activity.

In the US, the public stock market capitalisation now exceeds $67 trillion, compared with an economy of roughly $30 trillion. The top 10% of households own nearly 90% of this wealth and account for about half of all consumer spending.

Investors should be mindful that these and other factors can continue to have an outsized influence on equity prices and valuations.

Ian De Lange CA(SA)
Chief Investment Officer

If you have any questions, Ian and our team would love to hear from you on global@seedinvestments.co.za.

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