

## Sketchy IPO Behavior

The SpaceX IPO is going to dominate the financial press for the next couple of weeks, and there is already a bit of hand-wringing over it. Some of the concern focuses on how companies going public are supposed to, in exchange for the general public's money, make themselves accountable to the shareholders who have invested in it. SpaceX founder Elon Musk slammed the door on accountability. Even though he'll hold just over 40% of the company's post-IPO equity, he'll maintain 85% voting control, which means no mere shareholder will be permitted to challenge his decisions.

The prospectus also mandates that investors cannot initiate a class-action lawsuit. If Chairperson Musk decides to put all of the company's profits into his own pocket, there is no mechanism to challenge the decision. He cannot be fired as CEO unless he agrees.

Other areas of concern focus on the fact that the company is going public at a valuation that is more than 100 times revenues—for a company that happens to have been unprofitable since inception. (By comparison, the average multiple of stocks in the S&P 500—most of which tend to generate actual profits—is roughly 20.)

But a more interesting concern is how the stock is elbowing its way into the Nasdaq 100 index at a valuation that is almost certainly inflated. Somehow, Musk or the brokerage team selling SpaceX shares in the IPO market convinced Nasdaq to change its inclusion rules this one time—from a 12 month waiting period after the IPO (to prove its price stability) to a new 'fast entry' rule that allows the new publicly-traded stock into the Nasdaq club after just 15 trading days.

Nasdaq also waived a less well-known rule that required at least 10% of a company to be sold to public investors before it can be listed. The SpaceX IPO will sell just five percent of its total shares; in fact, one could argue that, even after it raises \$75 billion from the general public, SpaceX won't be a true public company for the reasons listed above.

SpaceX will soon become the one of the largest components of the tech-related index—an estimated 7.4% of its total value based on the current IPO valuation. That means other stocks will have to 'move over' in order to make room for it. In practical terms, an index fund that tracks the Nasdaq 100 would have to sell proportionate shares of the other stocks to buy SpaceX shares at the current price.

By one estimate, Apple computers, which makes up roughly 9% of the Nasdaq index at the moment, would have to be trimmed down to 8.3%—meaning index funds will drop billions of Apple shares on the market over the next week or two. This is not because Apple did anything wrong or reported earnings issues; it is simply because the index math demanded a reallocation.

All of the other companies in the Nasdaq index will experience the same stock dump, which could depress share prices of other tech firms.

One index that has held its ground on its rules of inclusion is the S&P 500. The widely covered index requires that companies show a profit before they can join its club. That might not happen with SpaceX until and unless it has constructed data centers in the sky and has employees walking around the surface of Mars.

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