

U.S. stocks face a broadening, not a rotation

In recent years, the U.S. stock market has been dominated by the “Magnificent Seven” technology stocks, but there are signs this once-monolithic group of large-cap growth firms is beginning to fragment. The outperformance of the Magnificent Seven propelled the S&P 500 to new highs earlier this year and resulted in the index becoming concentrated to an unprecedented degree.

Performance within the group is now diverging, however — as of late May, NVIDIA, Meta, Microsoft, and Amazon have continued to outpace the market, while Apple, Alphabet, and Tesla have begun to lag. As the benefits of AI technology are unlikely to be evenly spread

among the members of the Magnificent Seven, further dispersion within the group can be expected.

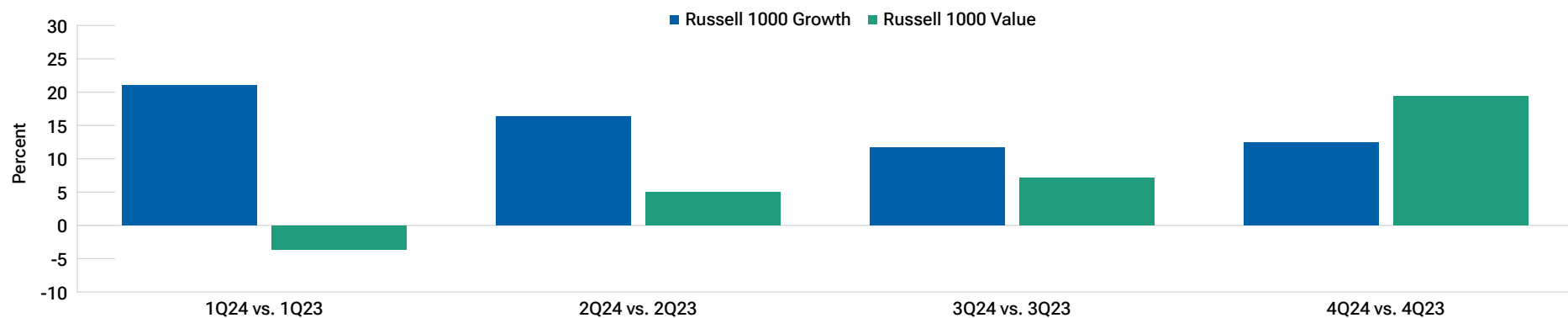
Fewer cuts should favor value stocks

Meanwhile, value stocks could be primed for a comeback as investors seek to diversify their exposure beyond the Magnificent Seven, particularly given growing expectations that the higher rate environment will persist. If the Fed only makes a few cuts or does not cut at all, value companies should benefit as they have tended to be more rate-sensitive and have typically fared better in a world where interest rates

Past performance is not a reliable indicator of future performance and is subject to change.

Value stocks look poised for earnings resurgence

(Fig. 5) Estimated earnings per share of value stocks set to outstrip growth stocks later this year



As of May 13, 2024.

Source: FTSE Russell (see Additional Disclosures).

Actual outcomes may differ materially from estimates.

Each time period shows the estimated year-over-year change in quarterly earnings for growth and value stocks for each quarter this year.

remained higher for longer. And while value stocks have begun to perform better in recent months, they continue to trade at a significant discount to growth stocks. If conditions continue to favor value stocks—as we believe they will—the dominance of growth stocks may start to fade.

Small-cap stocks are trading at a major discount to larger companies after struggling for several years against high inflation and a steep rise in borrowing costs. While the persistence of a higher rate environment could limit the upside of small-cap stocks, the earnings of smaller firms should improve if rates come down.

A widening opportunity set

Although we believe that value—and possibly small-cap—stocks may begin to challenge the dominance of large-cap growth stocks, it is important to stress the difference between a broadening of the market's opportunity set and a rotation between market styles, sectors, or capitalization. We are not predicting the imminent demise of the Magnificent Seven—rather, we anticipate a continued broadening of opportunities to include more companies and sectors across the market that may have lagged in recent years.

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Peter Bates, CFA
*Portfolio Manager,
Global Equities*

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