Market Commentary

Weekly perspective on current market sentiment **June 20, 2024**

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Last week's S&P 500 Index: +1.6%

Market breadth, revisited

Key takeaways

- We know that just a small number of stocks are carrying the S&P 500 Index to a series of new record highs.
- Typically, in past cycles, as the stock market is making a meaningful top, just a few of the biggest growth names are carrying the load.

Although it has been a big topic in the financial media at various times since the late-October 2023 S&P 500 Index (SPX) lows, it has been a while since we took a good look at market breadth. It's never a bad idea to have a feel as to whether lots of stocks are participating as the index marches to a series of new record highs or if the advance is being led by only a smaller number of big-capitalization companies. Wide participation in a rising market is a good sign. It has been common in past cycles, as the stock market is coming into a meaningful top, that the biggest growth names are the ones carrying the load. That certainly appears to be the case with a subset of the "Magnificent 7"[1] notching strong rallies as this handful of growth/technology companies, most with strong ties to the much-hyped artificial-intelligence (AI) theme, pull the SPX and NASDAQ Composite Index higher.

First, let's address the 800-pound gorilla in the room: the small number of stocks that are contributing the bulk of the SPX return this year. According to Bloomberg data, through May 31, 2024 the top five contributors to the index's return were responsible for nearly 58% of the SPX gain. That means the remaining 498 companies (there are 503 companies currently in the SPX) contributed slightly more than 42% to the overall return. The average return of the top five has been 40.8% while the rest of the index members averaged less than 5%. Clearly, the rally this year has been very narrow.

Another easy way to see what is going on from a different angle is to examine the performance of the SPX relative to the performance of the Russell 2000 Index (RTY) small-capitalization index and the S&P 100 (also known as the OEX), which is composed of the largest 100 capitalization companies in the SPX. Early in a new cycle, as investors anticipate and eventually see clearing skies on the horizon, they are typically more willing to take on additional risk and buy smaller companies as represented by the RTY. The RTY dramatically underperformed the SPX through May (+2.1% vs. +10.6%, respectively). Over that same time frame, the OEX was up 12.8%. That is another reflection of narrow market breadth and a noticeable negative when trying to gauge the underlying strength of the overall stock market.

From yet another angle, let's take a look at industry group participation. Of the 124 sub-industry groups (each group made up of individual stocks) with representation in the SPX, 78 have posted positive returns year-to-date through May but only 36 have higher returns than the SPX.

The bottom line is, from a market-breadth standpoint, an analysis of the performance data through May shows a narrow array of stocks driving the SPX to new record highs. As the economy slows, our preference is to trim the overvalued Tech and Communication Services sectors and replace with undervalued Industrials, Energy, Materials, and Health Care sectors.

[1] The Magnificent Seven stocks include Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla.

Risk considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Growth stocks** may be more volatile than other stocks and there is no guarantee growth will be realized. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. Some of the risks associated with investment in the **Health Care** sector include competition on branded products, sales erosion due to cheaper alternatives, research and development risk, government regulations and government approval of products anticipated to enter the market. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. **Materials** industries can be significantly affected by the volatility of commodity prices, the exchange rate between foreign currency and the dollar, export/import concerns, worldwide competition, procurement and manufacturing and cost containment issues.

Definitions

NASDAQ Composite Index measures the market value of all domestic and foreign common stocks, representing a wide array of more than 5,000 companies, listed on the NASDAQ Stock Market.

Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.

Russell 3000® Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

S&P 100 Index measures large cap company performance and consists of up of 100 major, blue chip companies across diverse industry groups. The primary criterion for index inclusion is the availability of individual stock options for each constituent.

An index is unmanaged and not available for direct investment.

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