Touchstone Investments®
DISTINCTIVELY ACTIVE®

Domestic Equities

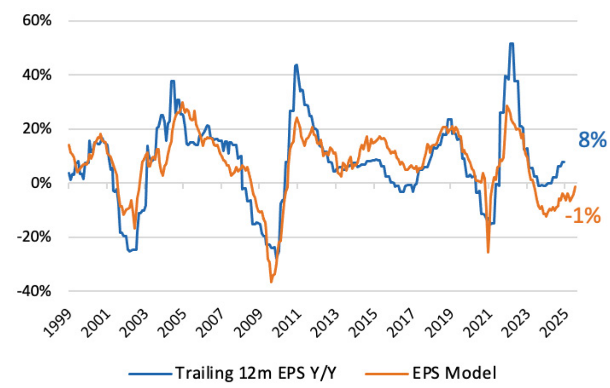
Large Cap

Authors: Crit Thomas, CFA, CAIA / Erik M. Aarts, CIMA / Brian Cheyne, CFA, CIMA

January 15, 2025

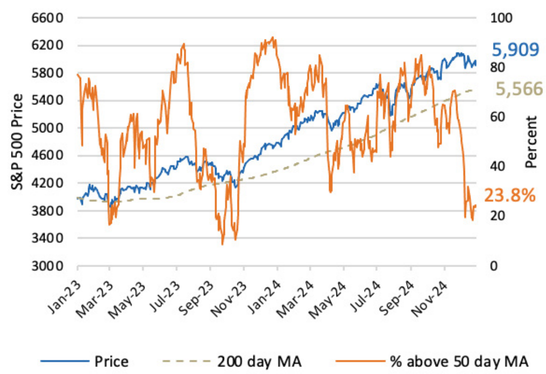
- We maintain a slight overweight position given expected continued economic resilience, normalizing monetary conditions, and likely business-friendly policies from the Trump administration. While valuations remain stretched, history shows such conditions can persist for multiple quarters or even years before normalizing.
- Large caps gained in the fourth quarter despite a late December pullback as interest rates rose. In recent decades, stock movements have been more closely tied to earnings trends than to interest rate changes. Although rate movements cannot be entirely dismissed, equity gains with a 100 basis point rise in the 10 year yield is notable.
- The S&P 500 started to lose it's footing in December. Market breadth declined significantly and by year end, fewer than 25% of index constituents were trading above their 50-day moving average, the lowest level of the year. This reflects both a weakening in the market's momentum and an opportunity to diversify beyond a narrow group of leading stocks to potentially benefit from the next market rotation.
- Bottom-up earnings growth expectations for 2025 are expected to accelerate and margins are anticipated to improve by 1 percentage point relative to 2024. However, we question these assumptions. While inflation has been moderating, it remains above the Federal Reserve's target. Sticky inflation could hinder margin expansion by sustaining elevated wage and input costs, especially in lower margin industries.
- An earnings growth acceleration would be unusual given expectations for slower economic growth in 2025 compared to 2024, driven by reduced consumer and government spending. We believe earnings growth estimates may come down into the single digits unless the economy reaccelerates.
- We believe the Trump administration's policies will be broadly stimulative but not without risks. Understanding how aggressively the new administration will pursue its policy agenda will help us make more informed decisions for future investment opportunities. Tariffs remain a focal point, though their scope and impact are uncertain. While tariffs could disrupt the economy, any significant effects are unlikely until later in the year.

Touchstone S&P 500 EPS Model



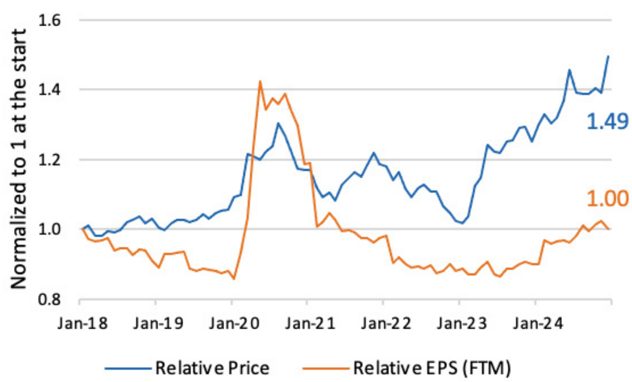
Source: Bloomberg. EPS Model looks forward 7 months, actual EPS through Dec 2024; Model composed of 10y Yield, LEI, and Mfg New Orders

S&P 500 Index Participation



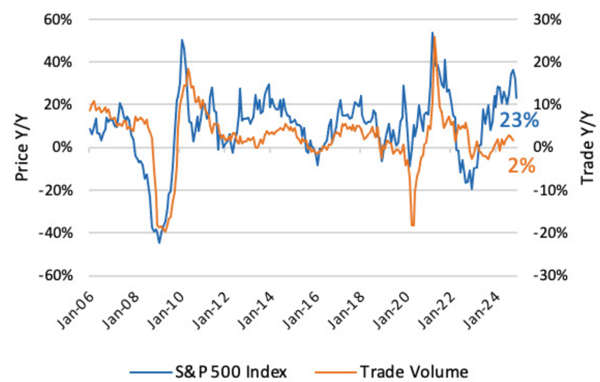
Source: Bloomberg. 2 years of daily data through Jan 6 2025. MA = Moving Average

S&P Top 50 Index versus S&P 500 Equal Weighted Index



Source: Bloomberg. 7 years of monthly data through Dec 2024

Global Trade Volume



Source: Bloomberg. 20 years of monthly data through Dec 2024 and trade data through Oct 2024

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Growth and Value

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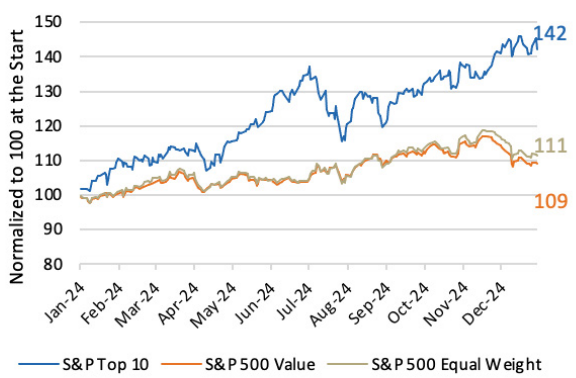
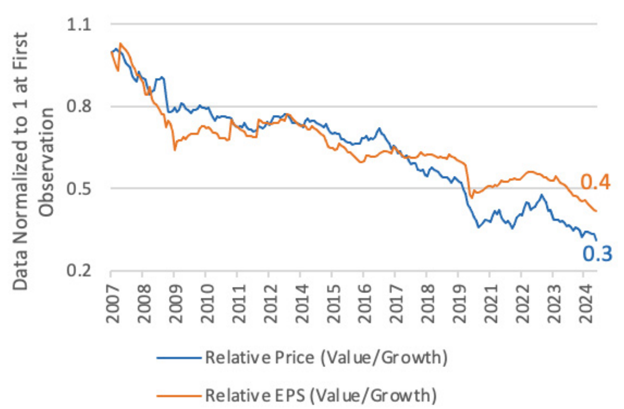
- We maintain a moderate underweight position in Growth stocks and a slight overweight in Value stocks. Growth stock valuations remain elevated, while earnings growth is expected to slow from historically high levels.
- The value-oriented Financials sector is expected to benefit significantly from the new administration's policies. Reduced regulatory burdens could lower capital requirements, freeing up resources for increased lending or other activities that support economic growth and drive revenue and earnings growth. Additionally, merger and acquisition activity, muted in recent years, could rise, boosting revenue through higher investment banking fees.
- Financials' earnings growth is projected to be around 9% in 2025. While our focus typically remains on large cap Growth and Value stocks, expanding the view to small caps offers a more constructive perspective. The S&P 600 Financials index is expected to achieve 20% earnings growth in 2025. Financials make up 18% of the small cap index compared to 13% in the S&P 500, supporting our small cap overweight, as discussed in the following content.
- Technology remains the sector with the highest growth expectations, but growth is slowing for its largest companies, which have seen substantial growth in recent years. In 2026, Microsoft and Nvidia are expected to experience significant earnings growth slowdowns compared to 2024, though both are still projected to outpace overall market growth. Among the Mag-7 stocks, only Tesla and Nvidia are expected to have higher earnings growth than the broad Technology sector.
- The trajectory of relative optimism and pessimism among sectors may have shifted since the election. We are monitoring earnings revisions, but it is unclear if this is the start of a sustainable trend.
- Value stocks, as measured by the Russell 1000 Value Index, had a solid 2024, gaining more than 14%, but once again overshadowed by Growth. The primary risk to our positioning is that Growth earnings remain strong and continue to outpace the potential of Value stocks.

1 Year Price Returns



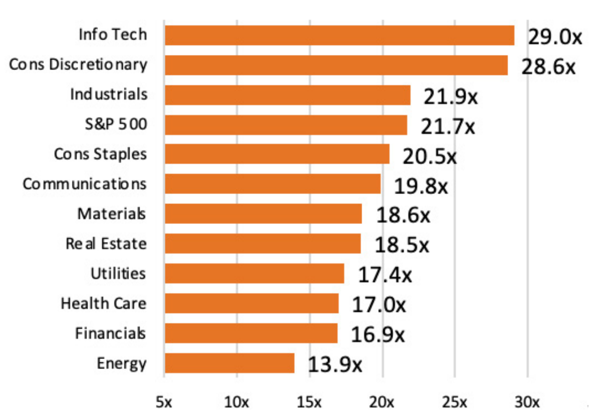
Source: Bloomberg. 1 year of daily data through Jan 07 2025

Russell 1000 Value and Growth Indexes



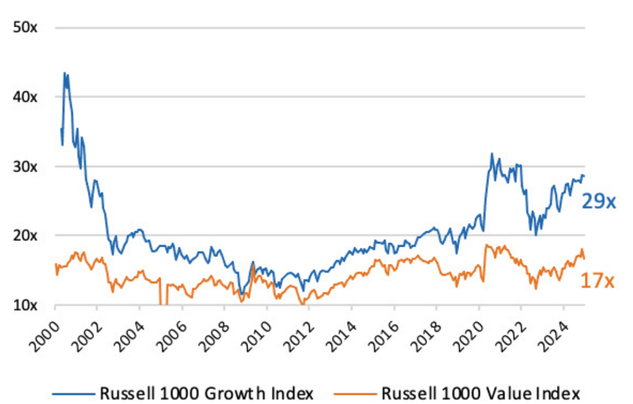
Source: Bloomberg. 18 years of monthly data through Dec 2024

S&P 500 Index Sector Forward P/E Ratios



Source: Bloomberg. All data as of Jan 7 2025

Price/Earnings Ratios: Forward 12 Months



Source: Bloomberg. 25 years of monthly data through Dec 2024

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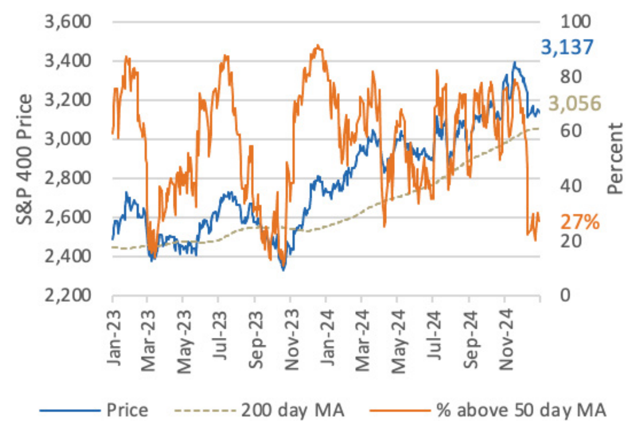
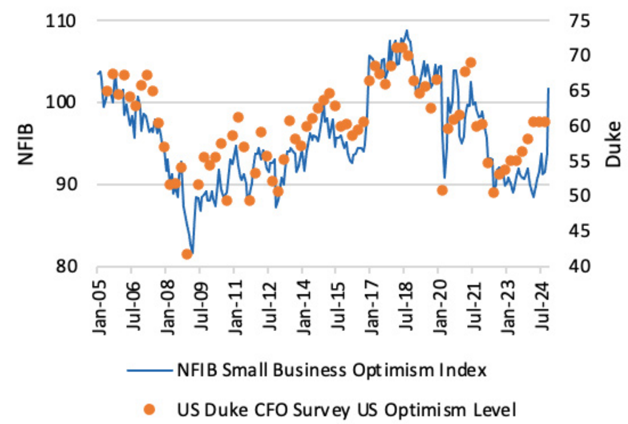
- Last month, we highlighted the strong post-election performance of small and mid cap stocks, which we believed was unsustainable. Both asset classes gave up their gains as the year ended. However, our emphasis on valuations and fundamentals keeps us overweight in both asset classes.
- Entering the Q4 earnings season, small caps are projected to achieve only 3% earnings growth compared to the same period in 2023, while large caps are expected to grow by 8%. However, small cap earnings growth for the same period in 2025 is forecast at 22%, approximately 50% higher than large caps. This outsized growth potential partly reflects base effects, as small cap earnings declined in 2024. While actual results may differ from estimates, we anticipate future earnings strength shifting away from large caps.
- Unless Q4 earnings fall significantly short of expectations, mid cap earnings are likely to post low single-digit growth for 2024. For 2025, mid cap earnings growth is expected to be similar to large caps. Like small caps, mid cap valuations are more attractive than those of large caps. On a forward price-to-earnings basis, mid cap valuations are slightly below the median of the past 28+ years. Historically, starting valuations at today's levels have delivered above average 10-year returns. We see a favorable balance of opportunities and risks in mid caps.
- Both small and mid cap asset classes experienced a significant decline in breadth during the final month of the year, similar to large caps. Breadth levels neared or fell below those seen in mid-April, when markets reacted sharply to higher-than-expected inflation, dampening optimism. Unlike large caps, small caps lack dominant companies capable of offsetting broad weakness. For instance, the 10 largest stocks in the S&P SmallCap 600 and S&P 500 indices represent approximately 6% and 40% of the index, respectively.
- Our small cap overweight has been partly driven by the potential for lower interest rates. A condition for lower rates is reduced inflation, which improved significantly in 2024. However, recent Fed comments have raised concerns that inflation poses a greater risk than previously anticipated, suggesting fewer rate cuts may occur in 2025. Less economic resilience and/or fewer interest rate cuts would erode confidence in our positioning.

S&P 400 Index Participation



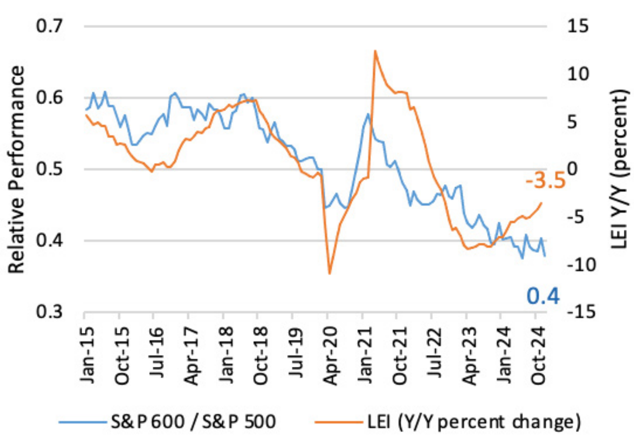
Source: Bloomberg. 2 years of daily observations through Jan 7 2025. MA = Moving Average

CFO Optimism Surveys



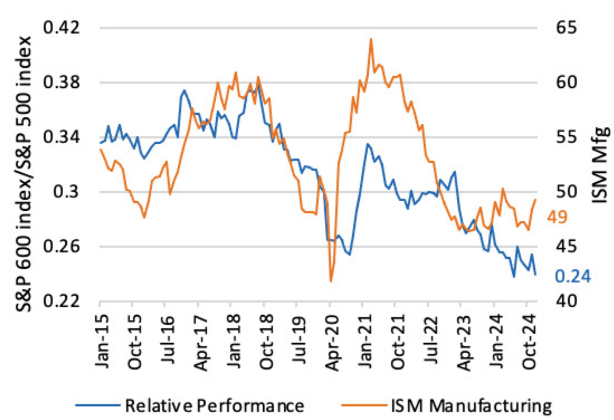
Source: Bloomberg. 20 years of observations. NFIB has monthly data through Nov 2024. Duke has quarterly data through Sept 2024.

Small Cap Cyclicality



Source: Bloomberg. 10 years of monthly data through Dec 2024, LEI through Nov 2024

Small Cap Cyclicality



Source: Bloomberg. 10 years of monthly data through Dec 2024

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Market Characteristics

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The Indexes mentioned are unmanaged statistical composites of stock market or bond market performance. Investing in an index is not possible.

Total Returns							EPS Growth Estimate	
	December 2024	YTD	2023	2022	2021	2020	2024	2025
S&P 500 Index	-2.4%	25.0%	26.3%	-18.1%	28.7%	18.4%	9%	12%
S&P 500 Index Equal Weighted	-6.3%	13.0%	13.8%	-11.5%	29.6%	12.8%	4%	11%
S&P 500 Value Index	-6.8%	12.3%	22.2%	-5.3%	24.9%	1.4%	7%	21%
Russell 1000 Value Index	-6.8%	14.4%	11.4%	-7.6%	25.2%	2.8%	-1%	10%
S&P 500 Growth Index	0.9%	36.1%	30.0%	-29.4%	32.0%	33.5%	5%	11%
Russell 1000 Growth Index	0.9%	33.4%	42.7%	-29.1%	27.6%	38.5%	24%	16%
S&P 400 Index	-7.1%	13.9%	16.4%	-13.1%	24.8%	13.7%	1%	12%
S&P 600 Index	-8.0%	8.7%	15.9%	-16.1%	26.8%	11.3%	-11%	17%
Russell 2000 Index	-8.3%	11.5%	16.9%	-20.4%	14.8%	20.0%	-14%	39%

Valuations	P/E (TTM)	Percent Rank	P/E (FTM)	Percent Rank	P/CF	Percent Rank	P/S	Percent Rank
S&P 500 Index	26.5x	90%	21.6x	93%	21.9x	99%	3.2x	98%
S&P 500 Index Equal Weighted	19.6x	64%	16.5x	79%	13.3x	92%	1.7x	76%
S&P 500 Value Index	19.5x	85%	17.6x	99%	17.4x	94%	1.8x	90%
Russell 1000 Value Index	19.9x	84%	16.3x	88%	16.0x	96%	1.9x	94%
S&P 500 Growth Index	35.2x	97%	27.4x	97%	26.6x	100%	6.6x	100%
Russell 1000 Growth Index	37.4x	87%	28.9x	91%	28.9x	97%	6.1x	100%
S&P 400 Index	20.1x	42%	15.7x	60%	11.6x	60%	1.5x	93%
S&P 600 Index	22.5x	52%	15.1x	47%	11.0x	32%	1.1x	84%
Russell 2000 Index	56.9x	91%	26.3x	93%	13.1x	48%	1.4x	92%

Fundamentals	Dividend Yield	Percent Rank	Profit Margin	Percent Rank	ROE	Percent Rank	Net Debt / EBITDA	Percent Rank
S&P 500 Index	1.3%	7%	10.5%	93%	17.6%	89%	1.5	24%
S&P 500 Index Equal Weighted	1.9%	65%	6.1%	49%	11.4%	54%	2.7	63%
S&P 500 Value Index	2.0%	17%	7.7%	71%	12.6%	77%	1.9	29%
Russell 1000 Value Index	2.1%	18%	7.8%	69%	11.9%	55%	2.1	17%
S&P 500 Growth Index	0.6%	14%	17.6%	97%	32.0%	95%	0.7	28%
Russell 1000 Growth Index	0.6%	6%	15.0%	99%	34.7%	94%	0.6	8%
S&P 400 Index	1.5%	50%	6.0%	88%	10.7%	57%	2.3	34%
S&P 600 Index	1.7%	86%	2.6%	33%	4.2%	17%	4.0	87%
Russell 2000 Index	1.4%	43%	0.6%	23%	0.7%	22%	4.5	78%

For Index Definitions see: TouchstoneInvestments.com/insights/investment-terms-and-index-definitions

Source: Bloomberg. Percent ranks are based on 30 years of monthly data as of the end of December; EPS growth estimates based on consensus bottom-up analyst estimates

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The Touchstone Asset Allocation Committee (TAAC) consisting of Crit Thomas, CFA, CAIA – Global Market Strategist, Erik M. Aarts, CIMA – Vice President and Senior Fixed Income Strategist, and Brian Cheyne, CFA, CIMA – Senior Investment Strategy Specialist, develops in-depth asset allocation guidance using established and evolving methodologies, inputs and analysis and communicates its methods, findings and guidance to stakeholders. TAAC uses different approaches in its development of Strategic Allocation and Tactical Allocation that are designed to add value for financial professionals and their clients. TAAC meets regularly to assess market conditions and conducts deep dive analyses on specific asset classes which are delivered via the Asset Allocation Summary document. Please contact your Touchstone representative or call 800.638.8194 for more information.

A Word About Risk

Investing in fixed-income securities which can experience reduced liquidity during certain market events, lose their value as interest rates rise and are subject to credit risk which is the risk of deterioration in the financial condition of an issuer and/or general economic conditions that can cause the issuer to not make timely payments of principal and interest also causing the securities to decline in value and an investor can lose principal. When interest rates rise, the price of debt securities generally falls. Longer term securities are generally more volatile. Investment grade debt securities which may be downgraded by a Nationally Recognized Statistical Rating Organization (NRSRO) to below investment grade status. U.S. government agency securities which are neither issued nor guaranteed by the U.S. Treasury and are not guaranteed against price movements due to changing interest rates. Mortgage-backed securities and asset-backed securities are subject to the risks of prepayment, defaults, changing interest rates and at times, the financial condition of the issuer. Foreign securities carry the associated risks of economic and political instability, market liquidity, currency volatility and accounting standards that differ from those of U.S. markets and may offer less protection to investors. Emerging markets securities which are more likely to experience turmoil or rapid changes in market or economic conditions than developed countries.

Performance data quoted represents past performance, which is no guarantee of future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than performance data given. ***For performance information current to the most recent month-end, visit TouchstoneInvestments.com/mutual-funds.***

Please consider the investment objectives, risks, charges and expenses of a fund carefully before investing. The prospectus and the summary prospectus contain this and other information about a fund. To obtain a prospectus or a summary prospectus, contact your financial professional or download and/or request one at TouchstoneInvestments.com/resources or call Touchstone at 800.638.8194. Please read the prospectus and/or summary prospectus carefully before investing.

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