Touchstone Investments®
DISTINCTIVELY ACTIVE®

Domestic Equities

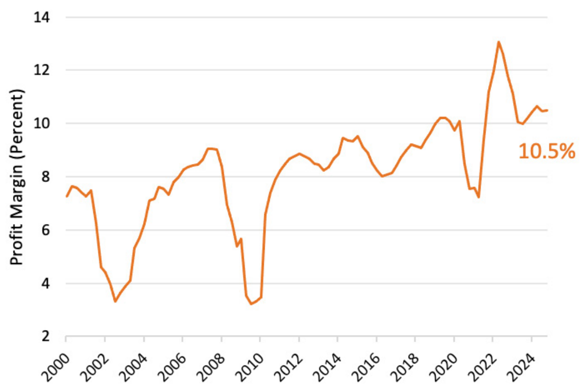
Large Cap

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

December 18, 2024

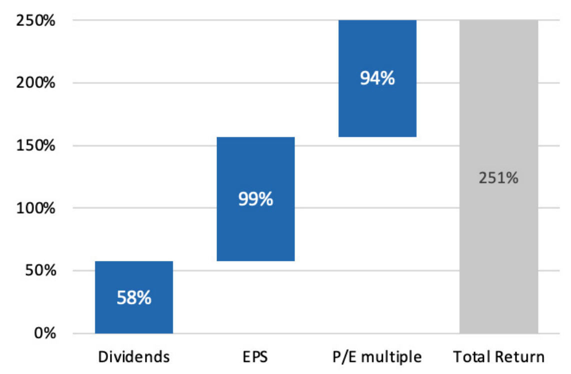
- Our slight overweight to large cap remains in place. As recently as this past summer, we expressed concerns about stretched large cap valuations. That concern remains. Valuations have risen approximately 15% over the past six months but have remained relatively flat since the election. While we believe starting valuations are important for multi-year investment horizons, we recognize that they can stay elevated in the short term. Hence, we maintain our tactical overweight.
- With the most recent quarterly earnings season concluded, investors are shifting focus to 2025. Bottom-up expected earnings growth for next year has stabilized around 12.5% after 3Q earnings season ended. While margins are still forecasted to increase in 2025, we question this assumption. If margins remain flat compared to 2024, earnings growth for next year could be halved relative to current expectations.
- The past two years have delivered strong S&P 500 returns – more than 20% in 2023 and on pace for similar results in 2024. This is an uncommon occurrence for consecutive 12-month periods. Historically, fewer than 7% of consecutive 12-month periods since 1929 have seen the S&P 500 gain at least 20%. Rarer still is achieving similar gains for a third consecutive period, which has happened less than 2% of the time historically.
- Sentiment remains high, but we, like others, are skeptical of another year of 20%+ returns. For now, top-down strategists' year-end targets do not appear to expect another banner year for large caps. We currently fall in line with consensus expecting earnings growth to drive returns as opposed to multiple expansion.
- We are currently more constructive on domestic equities compared to non-U.S. equities, as we believe the economy has more tailwinds than headwinds. Policies expected from the new administration should foster an environment favorable to equities. However, too much economic momentum may risk inflationary pressures, potentially leading the Fed to pause policy normalization which could dampen consumer sentiment and spending.

S&P 500 Index Profit Margin



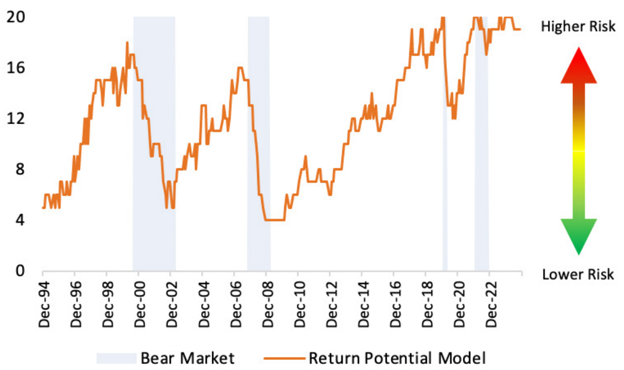
Source: Bloomberg. 25 years of quarterly data through Dec 2024

S&P 500 Index Return Composition



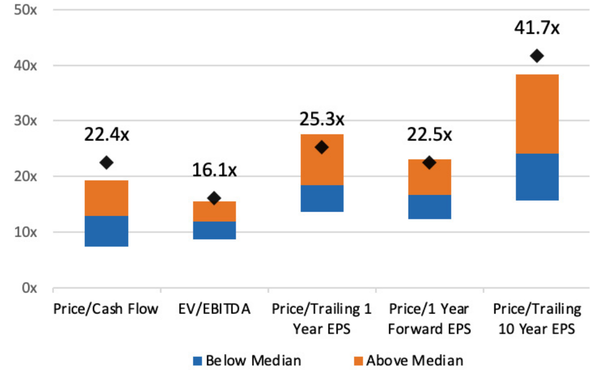
Source: Bloomberg. Cumulative total returns over the last 10 years through Nov 2024

Touchstone Fundamental Equity Risk Model



Source: Bloomberg. 30 years monthly data through Oct 2024; Risk model based on S&P 500 Index valuation metrics (EV/EBITDA, P/S, P/CF), profit margin, Unemployment Rate and LEI.

S&P 500 Index Valuation Ranges



Source: Bloomberg. Based on monthly observations starting in 1996. The minimum and maximum ranges are set to the 5th and 95th percentiles, respectively, to remove outliers. Average percentile rank: 95% as of Nov 2024

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Growth and Value

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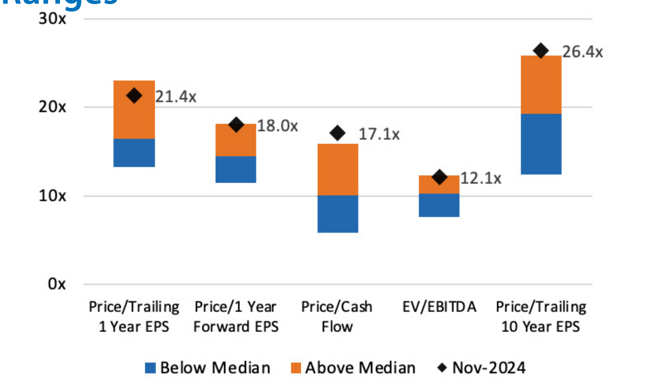
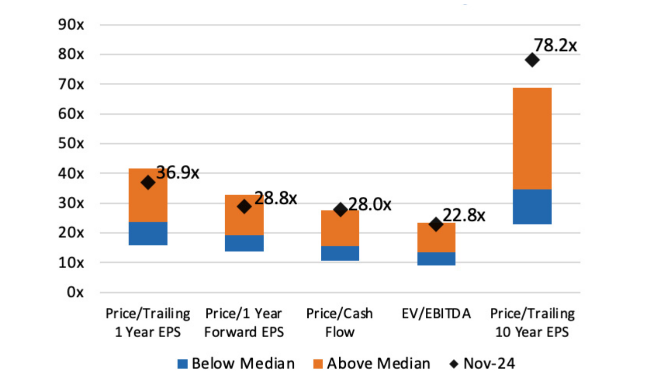
- We maintain a moderate underweight in Growth and a slight overweight in Value. Allocating between Value and Growth remains challenging, as mega-cap technology stocks, with their strong earnings potential and elevated valuations, create a stark contrast with the broader U.S. equity market, particularly Value stocks.
- Based on bottom-up analyst estimates, the Value style appears disadvantaged relative to Growth, given muted earnings growth expectations over the next two years. However, such estimates tend to be less dependable over longer periods. We believe relative valuations already reflect much of this disparity in earnings growth.
- All sectors except Energy and Financials are expected to achieve double-digit earnings growth. The Energy sector, one of the larger influences in Value style, contributes to its weaker earnings growth outlook relative to Growth.
- While Value stocks hold an absolute valuation advantage over Growth stocks, valuations for both styles remain at the higher end of their historical ranges since the mid-1990s. Growth's relative valuation premium over Value is also elevated. Our analysis of five distinct valuation multiples over nearly 30 years shows Growth's premium over the Value index ranks in the top 15% of historical observations, surpassed only during the early stages of the tech bubble deflation in 2000.
- Value stocks could benefit more from policy changes than Growth stocks. The Value universe includes sectors with historically higher effective tax rates, which could benefit on a relative basis should corporate taxes get cut. Growth stocks derive a larger portion of their revenue from overseas. If the dollar strengthens under the new administration's U.S.-centric policies, the translation of foreign earnings into dollars could erode Growth's overall earnings performance.

Russell 1000 Value Index Valuation Ranges



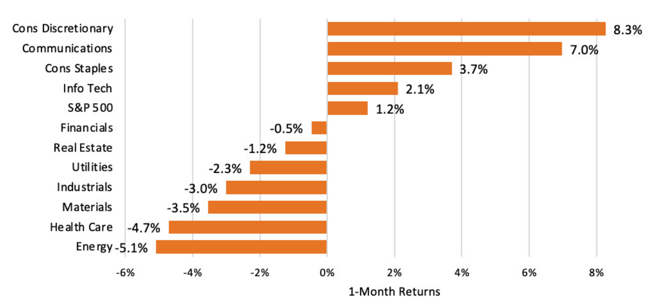
Source: Bloomberg. Monthly data starting in 1996. The minimum and maximum ranges are set to the 5th and 95th percentiles, respectively, to remove outliers. Average percentile rank: 95% as of Nov 2024

Russell 1000 Growth Index Valuation Ranges



Source: Bloomberg. Monthly data starting in 1996. The minimum and maximum ranges are set to the 5th and 95th percentiles, respectively, to remove outliers. Average percentile rank: 92% as of Nov 2024

S&P 500 Index Sector Price Returns



Source: Bloomberg. All data as of Dec 10 2024

Relative Total Returns: Russell 1000 Value Index/Russell 1000 Growth Index

Source: Bloomberg. 45 years of monthly data through Nov 2024

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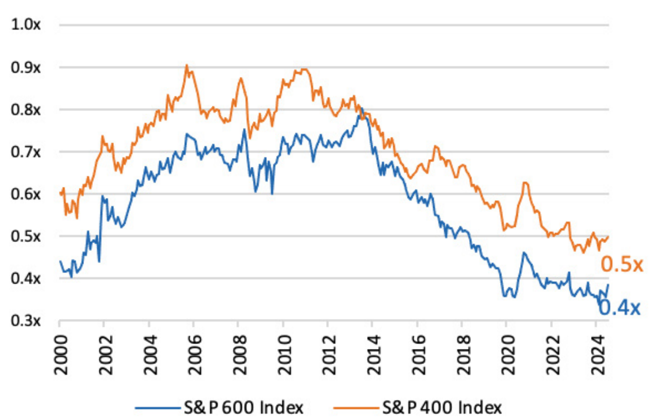
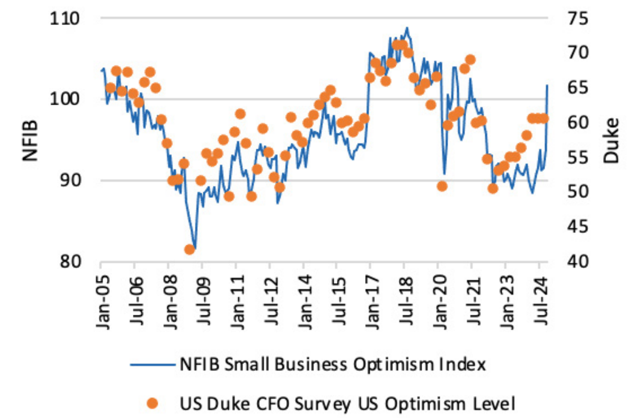
- We maintain overweight positions in mid caps and small caps, as both earnings growth potential and valuations support moving down cap. Following the election, small and mid caps rallied, posting November gains of 9% and 11%, respectively. While this pace is likely unsustainable, it highlights optimism surrounding anticipated new policies from Washington, D.C.
- Earnings growth expectations for 2025 are strongest for small caps at 18%, a 500 basis point premium over large caps, while mid cap expectations match those of large caps. For 2026, small and mid cap earnings growth expectations are at least 4 percentage points higher than for large caps.
- Small business and corporate finance leaders have shown notable optimism since the election, with surveys now indicating greater optimism among smaller firms compared to larger firms. A similar trend occurred after the 2016 election and was followed by several quarters of small cap outperformance.
- That said, today's economic backdrop differs from 2016. While unemployment is lower, it is beginning to creep upward, opposite to the trend seen in 2016. Additionally, the current interest rate environment is more restrictive and unlikely to return to the accommodative levels of 2016 and 2017.
- The period between the dot.com bubble and the Great Financial Crisis strongly favored small and mid caps. While we do not predict a repeat, there are some parallels. Relative valuations favor small caps more today than in the early 2000s, and economic growth remains positive. It is worth noting that during this period, small caps outperformed large caps cumulatively by approximately 80%, despite some declines early in the window.
- We are in a period dominated by macroeconomic and political headlines rather than earnings reports. Until the new administration is sworn in and begins implementing policies, there will be considerable uncertainty regarding their scope and impact. We believe these policies will ultimately be constructive and will use greater clarity to reassess our current positioning.

Price/Sales Relative to S&P 500 Index



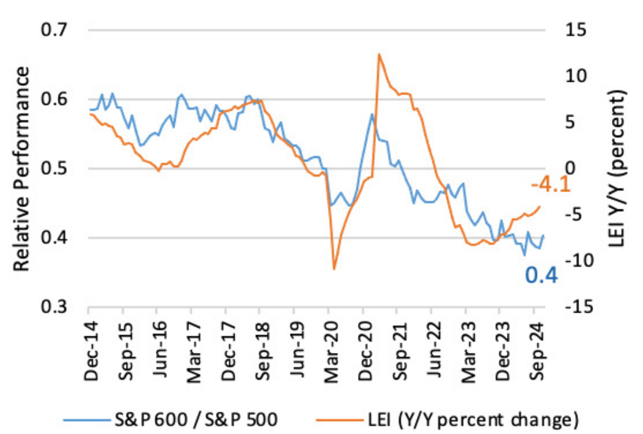
Source: Bloomberg. 25 years monthly data through Nov 2024

CFO Optimism Surveys



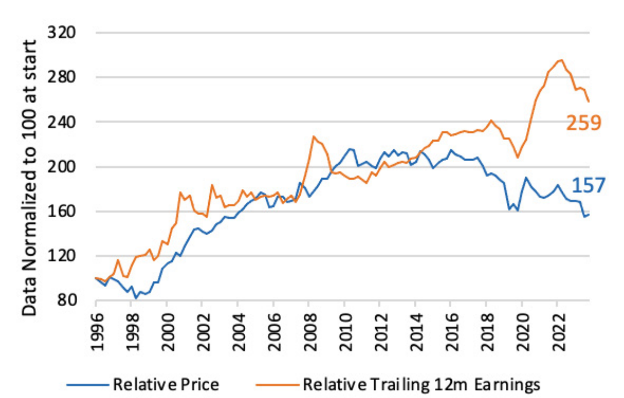
Source: Bloomberg. 20 years of observations. NFIB has monthly data through Nov 2024. Duke has quarterly data through Sept 2024.

Small Cap Cyclicality



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

S&P 400 Index / S&P 500 Index



Source: Bloomberg. 28 years of quarterly data through Sep 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	
	November 2024	YTD	2023	2022	2021	2020	2024	2025
S&P 500 Index	5.9%	28.1%	26.3%	-18.1%	28.7%	18.4%	9%	12%
S&P 500 Index Equal Weighted	6.4%	20.6%	13.8%	-11.5%	29.6%	12.8%	2%	12%
S&P 500 Value Index	5.8%	20.5%	22.2%	-5.3%	24.9%	1.4%	17%	10%
Russell 1000 Value Index	6.4%	22.8%	11.4%	-7.6%	25.2%	2.8%	-1%	11%
S&P 500 Growth Index	5.9%	34.9%	30.0%	-29.4%	32.0%	33.5%	1%	15%
Russell 1000 Growth Index	6.5%	32.2%	42.7%	-29.1%	27.6%	38.5%	24%	16%
S&P 400 Index	8.8%	22.7%	16.4%	-13.1%	24.8%	13.7%	0%	13%
S&P 600 Index	10.9%	18.1%	15.9%	-16.1%	26.8%	11.3%	-11%	17%
Russell 2000 Index	11.0%	21.6%	16.9%	-20.4%	14.8%	20.0%	-8%	41%

Valuations

	P/E (TTM)	Percent Rank	P/E (FTM)	Percent Rank	P/CF	Percent Rank	P/S	Percent Rank
S&P 500 Index	27.0x	92%	22.1x	96%	22.4x	99%	3.2x	100%
S&P 500 Index Equal Weighted	20.9x	77%	17.8x	97%	14.2x	94%	1.8x	91%
S&P 500 Value Index	20.9x	92%	17.4x	99%	18.7x	96%	1.9x	95%
Russell 1000 Value Index	21.3x	93%	17.4x	96%	17.1x	97%	2.0x	97%
S&P 500 Growth Index	34.4x	95%	27.9x	98%	26.4x	100%	6.6x	100%
Russell 1000 Growth Index	36.9x	86%	28.7x	91%	28.0x	96%	5.4x	98%
S&P 400 Index	21.7x	65%	16.9x	84%	12.3x	75%	1.6x	96%
S&P 600 Index	24.4x	62%	16.3x	72%	11.9x	45%	1.2x	91%
Russell 2000 Index	62.2x	92%	26.3x	94%	16.7x	93%	1.5x	96%

Fundamentals

	Dividend Yield	Percent Rank	Profit Margin	Percent Rank	ROE	Percent Rank	Net Debt / EBITDA	Percent Rank
S&P 500 Index	1.2%	6%	10.5%	93%	17.6%	89%	1.5	21%
S&P 500 Index Equal Weighted	1.7%	43%	6.1%	49%	11.5%	54%	2.7	63%
S&P 500 Value Index	2.1%	31%	7.7%	71%	12.6%	77%	1.9	29%
Russell 1000 Value Index	1.9%	7%	7.8%	69%	11.9%	56%	2.0	17%
S&P 500 Growth Index	0.6%	12%	17.6%	96%	32.0%	95%	0.7	27%
Russell 1000 Growth Index	0.6%	6%	13.7%	96%	35.4%	96%	0.7	19%
S&P 400 Index	1.4%	38%	6.0%	87%	10.6%	55%	2.3	32%
S&P 600 Index	1.6%	80%	2.6%	33%	4.2%	17%	4.0	83%
Russell 2000 Index	1.3%	23%	0.6%	22%	0.7%	22%	4.4	75%

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 November; 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.

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