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Domestic Equities

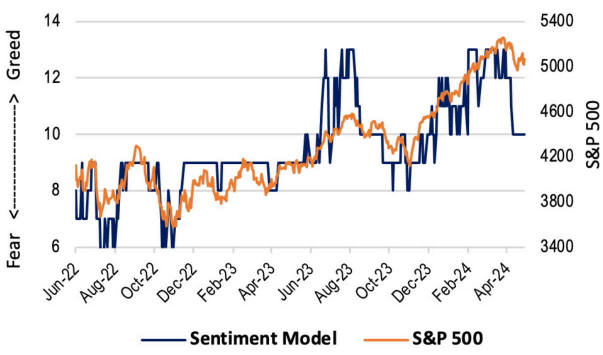
Large Cap

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

MAY | 2024

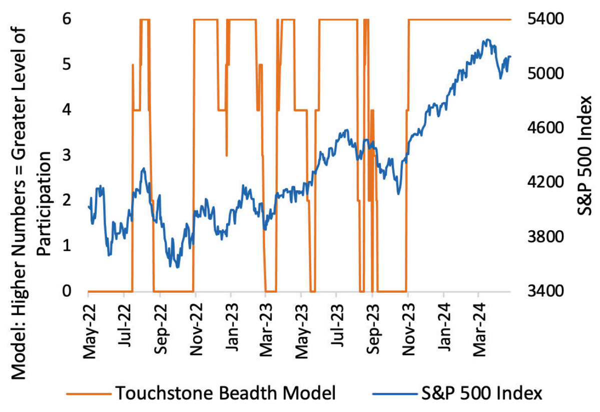
- Most of the past month was characterized by a steady stream of economic data illustrating the challenges faced by the Fed in its efforts to pull off an economic soft landing. Inflation's downward trajectory continues to flatten out at a higher rate than targeted and consumer spending remains elevated. Coming into the year markets expected the Fed to make approximately 6 rate cuts for the year. By the end of April, the expected range was 1 or 2. The exception to the bad news was the April jobs report which showed weaker-than-expected job creation, softer wages, and hours worked.
- The S&P 500 Index dropped about 4% in April as economic data releases took investor attention away from what has been another strong earnings season. While most stocks fell in April, the bias toward the largest stocks in the index remained. The top 10 stocks in the index outperformed the S&P 500, while the equal weighted S&P 500 index underperformed.
- Market sentiment fell with the market. However, market breadth remained high with all 10 sectors trading above their 200-day moving average and 6 sectors above their 50-day average. Individually, 72% of stocks in the S&P 500 were trading above their 200-day moving average at the end of April.
- We tactically added to large caps during the month. While historically high valuations remain a potential headwind, other factors such as better-than-expected earnings, lower odds of a recession, and the Fed biased towards easing all help to alleviate valuation concerns.

Touchstone S&P 500 Sentiment Model



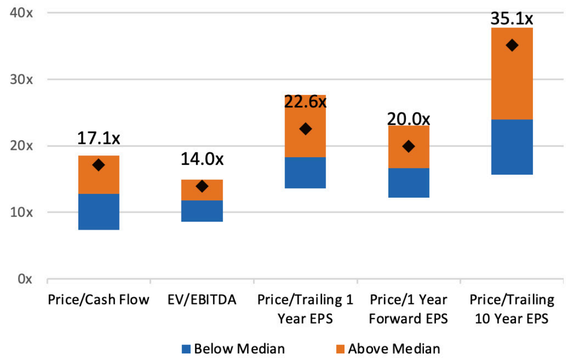
Source: Bloomberg. 2 years of daily data through May 3 2024; Model based on deviations from trent, option activity, AAII surveys, and the Credit Suisse Fear Barometer.

S&P 500 Breadth Model



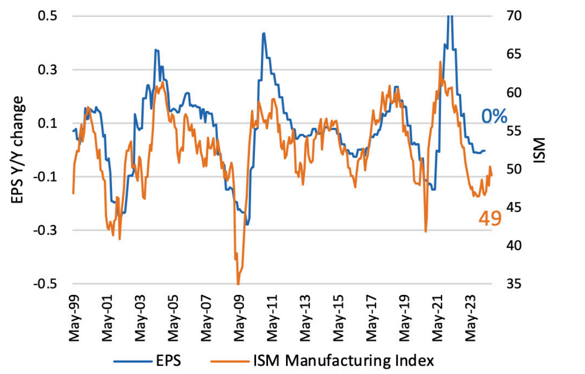
Source: Bloomberg. 2 years of daily data through May 3 2024. Model composed of measures of individual stock and sector participation.

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: 85%as of Apr 2024

S&P 500 Index EPS and ISM Manufacturing



Source: Bloomberg. 26 years of monthly data through Apr 2024. ISM advanced 5 months.

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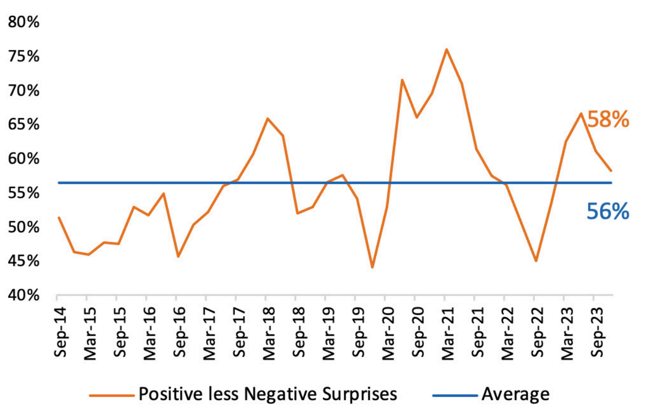
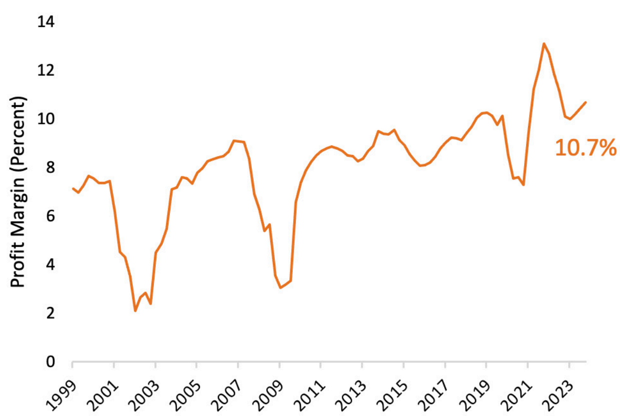
- As of May 3, 80% of the companies in the S&P 500 had reported 1Q EPS. 77% of those companies posted EPS that were better than expected, which was above the 10-year average, and in line with the 5-year average. 61% of the companies reported revenues that were above expectations, which was below the historical averages indicating that margin expansion drove the majority of EPS surprises. So far net EPS surprises were 61%, putting this quarter ahead of the last.
- While it is difficult to assign EPS surprises by style as a portion of many companies are represented in both indexes, our analysis suggests that Growth companies performed modestly better as evidenced by increased 2024 EPS estimates for the Growth indexes. That said EPS surprises were more balanced across styles than seen in past quarters.
- Sectors with large Value index weights (Financials, Industrials, and Heath Care) saw better than expected EPS growth. On the Growth side, Technology, Communications, and Consumer Discretionary all saw better than expected EPS growth.
- Over the course of earnings season the Value and Growth indexes have produced similar returns.
- We recognize our slight overweight to Value is akin to walking on a tightrope given current market conditions. Nothing has changed the fact that the S&P 500 is top-heavy with mega-cap growth. A soft landing implies no recession, and thus little cyclical rebound. Higher for longer interest rates put more pressure on asset-intensive businesses, which are much more likely to be Value companies. Still, forward EPS comparisons are much easier for Value stocks than Growth stocks.

S&P 500 Index Earnings Surprise



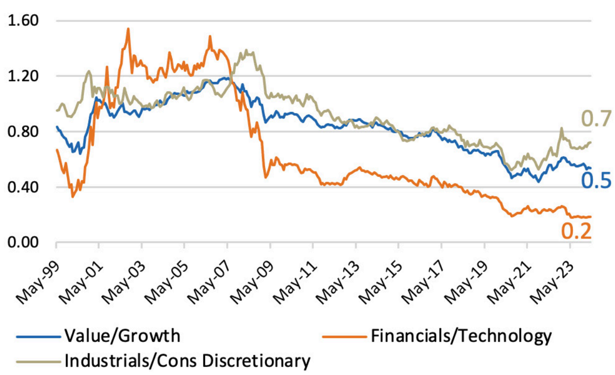
Source: Bloomberg. 10 years of quarterly data through Dec 2023

S&P 500 Index Profit Margin



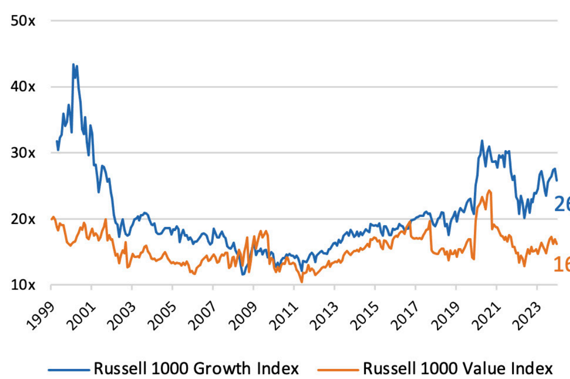
Source: Bloomberg. 25 years of quarterly data through Mar 2024

S&P 500 Relative Performance by Style and Sector



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

Price/Earnings Ratios: Trailing 12 Months



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

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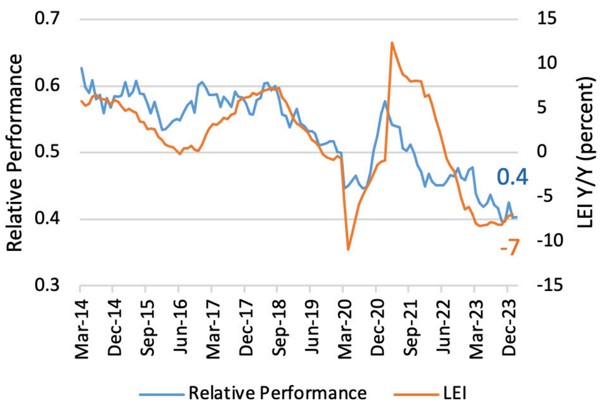
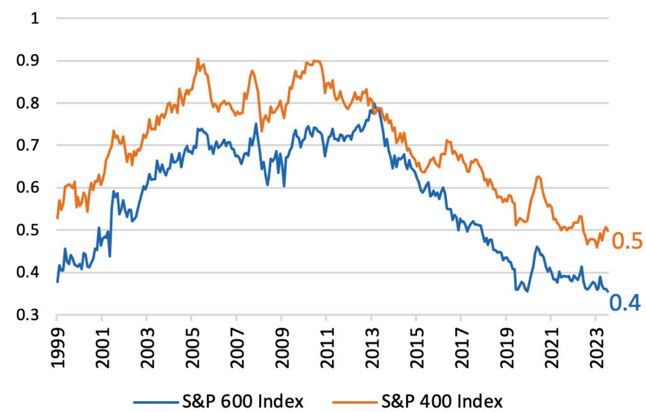
- We eliminated our overweight to small-cap stocks in April on concerns that interest rates will stay elevated for longer than previously expected. Higher interest rates historically undercut earnings growth for small-cap stocks more than large- and mid-caps because of a greater reliance on floating rate financing structures relative to their larger peers.
- Over the past decade both small- and mid-cap stocks have underperformed large-caps despite delivering much stronger earnings growth than large-caps. The performance difference comes down to the change in P/E multiples. Large-caps have seen significant multiple expansion while small- and mid-caps have experienced multiple contraction.
- The rational argument for this divergence in multiples would be that the future EPS growth potential for large-caps has increased measurably over small- and mid-cap companies. While this appears true in the short-term, we have not found evidence to support this over the longer term. Valuation differentials are at extremes, which would suggest more than just a cyclical adjustment.
- We believe that sentiment has played a larger role with investors chasing performance instead of fundamentals. Over time we believe investors will return to fundamentals and multiples will readjust.
- We had expected that a pivot in Fed policy would act as a catalyst for that readjustment. An expected delay in that pivot may have pushed out the timing for small- and mid-cap outperformance.

Small Cap Cyclicality



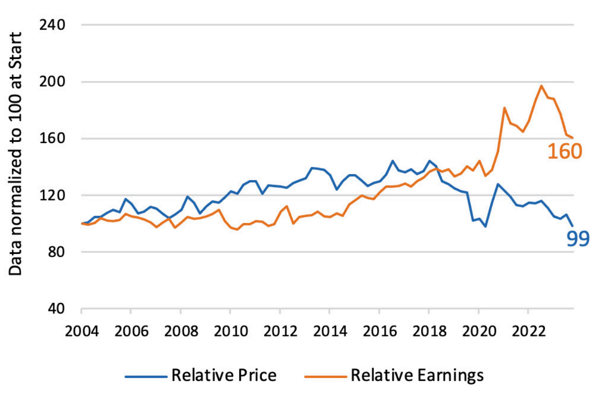
Source: Bloomberg. 10 years of monthly data through Apr 2024, LEI through Mar 2024

Price/Sales Relative to S&P 500 Index



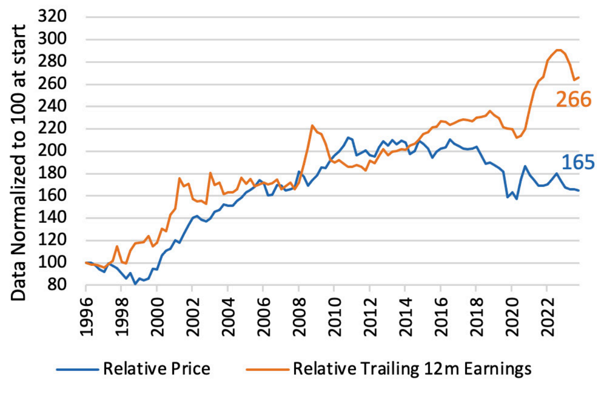
Source: Bloomberg. 25 years monthly data through Apr 2024

S&P 600 Index/S&P 500 Index



Source: Bloomberg. 20 years of quarterly data fro year-end 2007 through Mar 2024

S&P 400 Index/S&P 500 Index



Source: Bloomberg. 28 years of quarterly data through Mar 2024

Domestic Equities

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	
	April 2024	YTD	2023	2022	2021	2020	2024	2025
S&P 500 Index	-4.1%	6.0%	18.8%	-18.1%	28.7%	18.4%	10%	13%
S&P 500 Index Equal Weighted	-4.9%	2.7%	6.0%	-11.5%	29.6%	12.8%	6%	13%
S&P 500 Value Index	-4.3%	3.4%	14.2%	-5.2%	24.9%	1.4%	5%	11%
Russell 1000 Value Index	-4.3%	4.3%	6.0%	-7.5%	25.2%	2.8%	3%	12%
S&P 500 Growth Index	-3.9%	8.3%	23.1%	-29.4%	32.0%	33.5%	17%	15%
Russell 1000 Growth Index	-4.2%	6.7%	31.7%	-29.1%	27.6%	38.5%	24%	15%
S&P 400 Index	-6.0%	3.3%	6.6%	-13.1%	24.8%	13.7%	5%	15%
S&P 600 Index	-5.6%	-3.3%	6.0%	-16.1%	26.8%	11.3%	-2%	17%
Russell 2000 Index	-7.0%	-2.2%	6.5%	-20.4%	14.8%	20.0%	17%	30%

Valuations

	P/E (TTM)	Percent Rank	P/E (FTM)	Percent Rank	P/CF	Percent Rank	P/S	Percent Rank
S&P 500 Index	24.1x	84%	18.3x	77%	17.1x	92%	2.8x	95%
S&P 500 Index Equal Weighted	19.7x	66%	14.8x	43%	12.1x	78%	1.7x	83%
S&P 500 Value Index	18.4x	76%	14.5x	68%	13.0x	83%	1.7x	89%
Russell 1000 Value Index	18.6x	75%	14.1x	60%	12.5x	85%	1.8x	93%
S&P 500 Growth Index	32.6x	92%	23.3x	88%	23.3x	94%	5.7x	96%
Russell 1000 Growth Index	33.2x	81%	23.7x	78%	23.8x	85%	4.6x	93%
S&P 400 Index	18.7x	24%	13.5x	20%	10.6x	34%	1.4x	89%
S&P 600 Index	17.9x	19%	12.1x	7%	8.7x	14%	1.0x	53%
Russell 2000 Index	35.7x	67%	18.1x	42%	11.8x	31%	1.3x	81%

Fundamentals

	Dividend Yield	Percent Rank	Profit Margin	Percent Rank	ROE	Percent Rank	Net Debt / EBITDA	Percent Rank
S&P 500 Index	1.4%	16%	10.7%	94%	18.1%	95%	1.4	15%
S&P 500 Index Equal Weighted	2.0%	70%	7.1%	79%	12.9%	83%	2.5	52%
S&P 500 Value Index	2.3%	49%	8.5%	92%	13.9%	89%	1.7	19%
Russell 1000 Value Index	2.2%	26%	8.6%	88%	12.5%	60%	1.9	11%
S&P 500 Growth Index	0.7%	14%	16.7%	93%	31.0%	92%	0.7	28%
Russell 1000 Growth Index	0.7%	13%	13.1%	96%	34.5%	96%	0.8	21%
S&P 400 Index	1.6%	65%	6.4%	90%	11.5%	68%	2.5	45%
S&P 600 Index	2.0%	96%	2.9%	40%	5.2%	26%	3.8	84%
Russell 2000 Index	1.5%	69%	1.5%	30%	2.1%	29%	4.3	73%

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 April; 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.

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