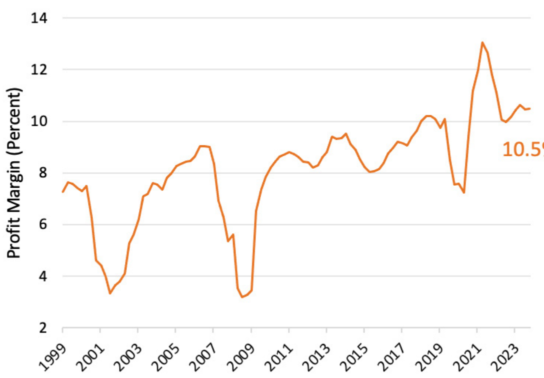
Authors: Crit Thomas, CFA, CAIA / Erik M. Aarts, CIMA / Brian Cheyne, CFA, CIMA

November 13, 2024

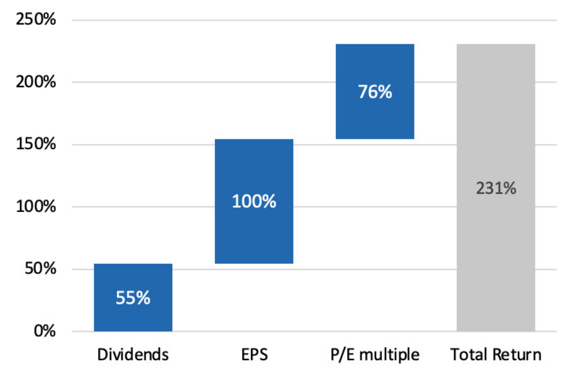
- Following the U.S. elections, we increased our large cap allocation, offsetting this with a reduction in emerging markets. This adjustment reflects our belief that the new administration's policies will be more constructive for domestic companies relative to overseas companies.
- Last month we questioned 2025 earnings growth estimates of 14%. Since then, expectations have been reduced to 12%. While earnings were revised down modestly, S&P 500 gained approximately 5%. The S&P 500's forward P/E ratio has only been higher than current levels twice in the past 25 years: during the late-stage dot-com bubble and in 2020/2021 when stock prices surged as earnings declined due to a pullback in consumer spending. Starting valuations are crucial to investment returns; the higher the initial valuation, the greater the likelihood that long-term returns will fall below average, although valuations could continue to rise in the near term.
- Projected profit margin growth of nearly 1 percentage point seems optimistic. Margin growth aligns with revenue growth expectations, but 2025 economic growth is forecast to slow compared to 2024, which could constrain revenue. Operating margins are projected to reach their highest level in over a decade. Tariffs remain a risk, as they contributed to margin declines when implemented in 2018.
- That said, we are not negative on earnings, the economy is expected to grow, the secular AI trend remains strong, businesses may benefit from reduced regulations, and corporate tax cuts appear likely. And with easier monetary conditions we remain relatively constructive, despite high valuations.
- Despite the likely sweep of the executive and legislative branches, the practicalities of governance may limit the incoming administration's willingness to implement all of the campaign promises and/or enact them to their full extent.

S&P 500 Index Profit Margin



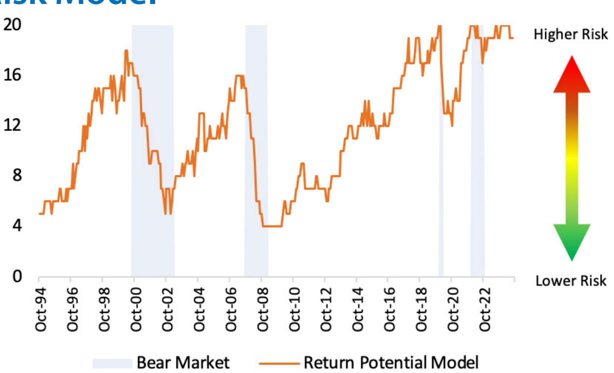
Source: Bloomberg. 25 years of quarterly data through Sep 2024

S&P 500 Index Return Composition



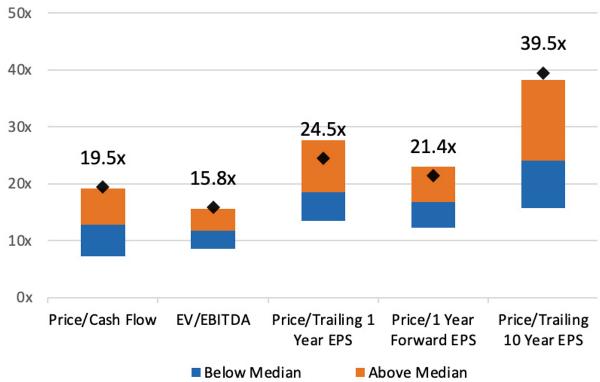
Source: Bloomberg. Cumulative total returns over the last 10 years through Oct 2024

Touchstone Fundamental Equity Risk Model



Source: Bloomberg. 30 years monthly data through Sep 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: 93% as of Oct 2024

Domestic Equities

Growth and Value

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

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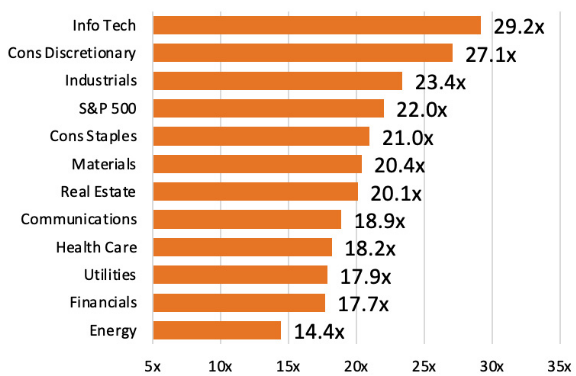
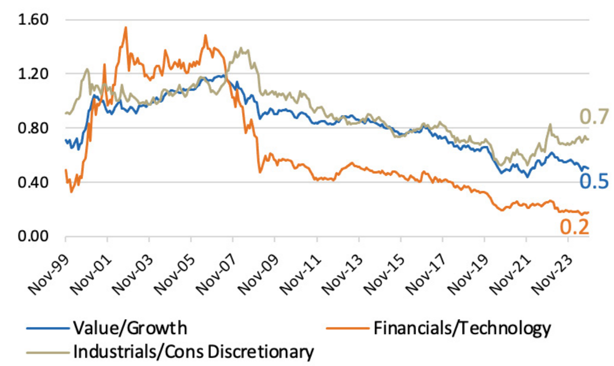
- We are maintaining a moderate underweight in Growth while holding a slight overweight in Value. The allocation between Value and Growth stocks remains challenging, as mega cap technology stocks, with their potential earnings growth and high valuations, create a stark contrast with the broader U.S. equity market, especially Value stocks.
- Large cap growth stocks have been primarily driven by high expectations around the secular AI trend as core AI infrastructure is developed. Historically, it often takes many years for new technology adoption to significantly impact sales and earnings. Additionally, the exceptional earnings growth seen in AI focused companies will be difficult to sustain.
- Value companies typically possess more tangible assets (e.g., factories), while Growth companies are generally asset light (e.g., cloud-based). Despite these differences, stock returns are heavily influenced by their valuations. In theory, stocks with different fundamentals should be priced such that investors are indifferent between them, as their future prospects are balanced through valuation adjustments.
- Utilities have performed well in 2024, driven by increased AI related energy demand and investor interest in yield as rates have declined. As one of the most heavily taxed sectors, Utilities could benefit from potential tax reductions. Industrials, also highly taxed, may benefit from stronger domestic growth.
- Financials could be a dark horse in the Value segment this year due to stronger net interest margins, especially if the Fed continues to lower short-term rates while longer-term yields remain elevated due to market forces.

S&P 500 Index Sector Forward P/E Ratios



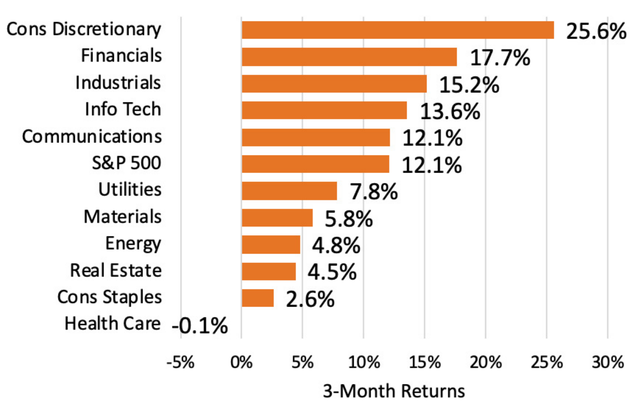
Source: Bloomberg. All data as of Nov 8 2024

S&P 500 Relative Performance by Style and Sector



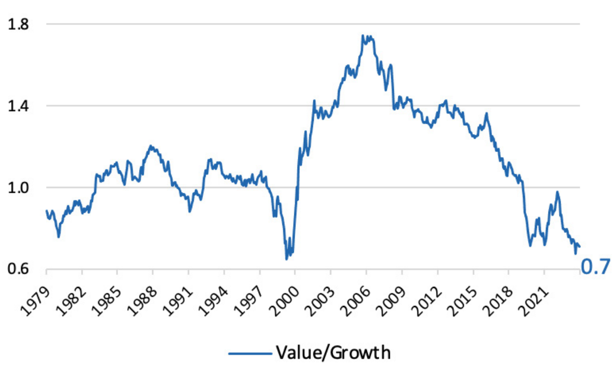
Source: Bloomberg. Cumulative total returns over the last 10 years through Oct 2024

S&P 500 Index Sector Price Returns



Source: Bloomberg. All data as of Nov 8 2024

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



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

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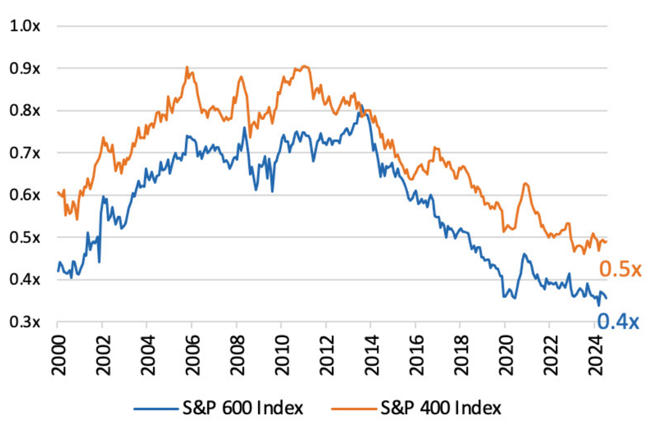
Small and Mid-Caps

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

November 13, 2024

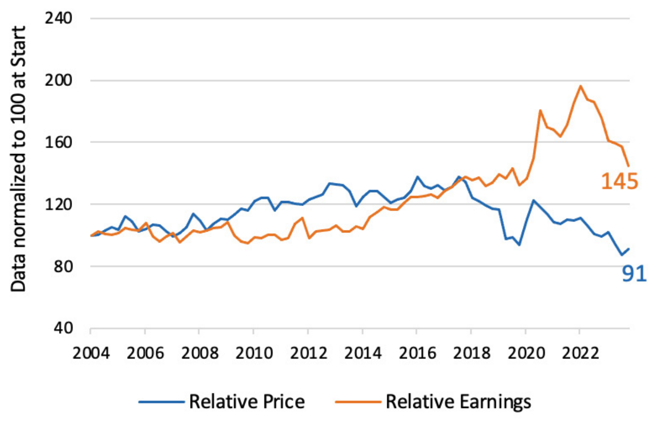
- We maintain overweight positions in mid caps and small caps, as both earnings growth potential and valuations support moving down cap.
- The results of the U.S. election may provide additional tailwinds for small and mid caps compared to large caps. Regulations are expected to ease which could reduce costs for companies and increase profits. Reduced antitrust concerns could spark M&A activity. Small and mid cap lower valuations could make them attractive targets for larger companies to boost growth.
- Corporate tax cuts could be forthcoming. Companies have been paying higher taxes in recent years as some provisions from the 2017 tax cuts expired, and President-elect Trump has promised further reductions to the base tax rate. Small and mid caps generally source more of their profits domestically, as such they are likely to benefit more from a lower domestic tax rate than larger companies with significant international exposure.
- Looking ahead to 2025, small caps are projected to have strong earnings growth – up 17% – as they rebound from a low base following two years of declines. Forecasted earnings are still slightly below 2022 levels, while current valuations are only slightly higher. Mid cap earnings are expected to rise by 14% in 2025. Although mid cap valuations aren't as attractive as they were at the beginning of the year, they remain favorable relative to their own history and to large caps.
- While we remain optimistic, we recognize that risks have increased. We have viewed the recent rate cuts, beginning in September and confirmed in the most recent Fed meeting, as favorable for small caps. However, stimulative fiscal policies and stronger economic growth could keep inflation elevated, which could challenge the assumption of lower rates going forward.

Price/Sales Relative to S&P 500 Index



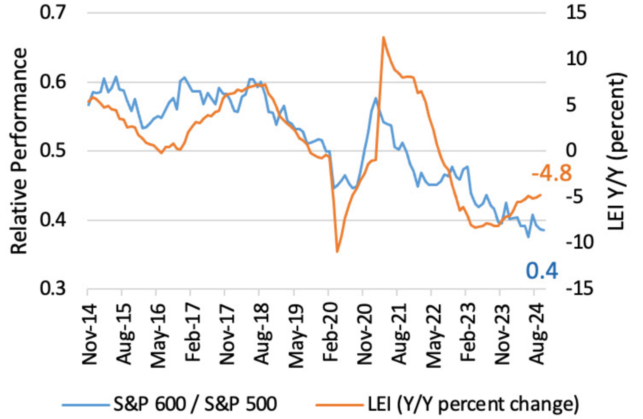
Source: Bloomberg. 25 years monthly data through Oct 2024

S&P 600 Index / S&P 500 Index



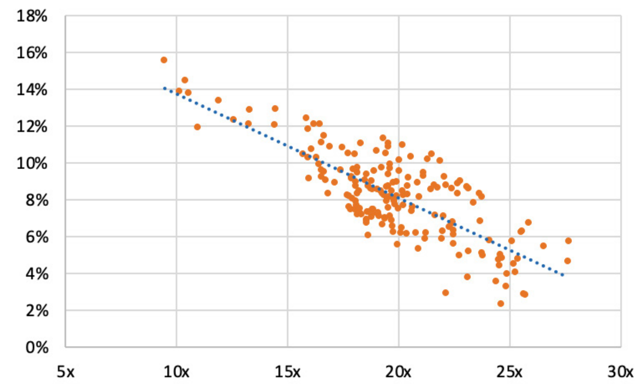
Source: Bloomberg. 20 years of quarterly data through Sep 2024

Small Cap Cyclicality



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

S&P 400 Index Historic P/E and Subsequent 10y Return



Source: Bloomberg. Monthly TTM P/E observations from 1998 through 2013. The latest TTM P/E as of Oct 2024 was 17.2x.

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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	
	October 2024	YTD	2023	2022	2021	2020	2024	2025
S&P 500 Index	-0.9%	21.0%	18.8%	-18.1%	28.7%	18.4%	9%	12%
S&P 500 Index Equal Weighted	-1.6%	13.3%	6.0%	-11.5%	29.6%	12.8%	2%	13%
S&P 500 Value Index	-1.3%	13.9%	14.2%	-5.2%	24.9%	1.4%	17%	11%
Russell 1000 Value Index	-1.1%	15.4%	6.0%	-7.5%	25.2%	2.8%	-1%	11%
S&P 500 Growth Index	-0.6%	27.4%	23.1%	-29.4%	32.0%	33.5%	1%	15%
Russell 1000 Growth Index	-0.3%	24.1%	31.7%	-29.1%	27.6%	38.5%	23%	16%
S&P 400 Index	-0.7%	12.7%	6.6%	-13.1%	24.8%	13.7%	0%	14%
S&P 600 Index	-2.6%	6.4%	6.0%	-16.1%	26.8%	11.3%	-10%	17%
Russell 2000 Index	-1.4%	9.6%	6.5%	-20.4%	14.8%	20.0%	-7%	41%

Valuations

	P/E (TTM)	Percent Rank	P/E (FTM)	Percent Rank	P/CF	Percent Rank	P/S	Percent Rank
S&P 500 Index	26.0x	89%	20.9x	89%	19.5x	97%	3.1x	98%
S&P 500 Index Equal Weighted	20.6x	75%	16.6x	83%	12.9x	90%	1.7x	87%
S&P 500 Value Index	19.8x	87%	16.3x	95%	14.8x	88%	1.8x	92%
Russell 1000 Value Index	19.9x	85%	16.3x	88%	14.0x	90%	1.9x	94%
S&P 500 Growth Index	34.4x	95%	26.4x	95%	25.7x	98%	6.3x	99%
Russell 1000 Growth Index	34.7x	83%	27.2x	87%	26.3x	92%	5.1x	97%
S&P 400 Index	20.1x	42%	15.5x	55%	11.4x	55%	1.5x	95%
S&P 600 Index	20.1x	34%	14.5x	36%	10.1x	25%	1.1x	75%
Russell 2000 Index	42.7x	81%	23.2x	84%	14.5x	74%	1.4x	94%

Fundamentals

	Dividend Yield	Percent Rank	Profit Margin	Percent Rank	ROE	Percent Rank	Net Debt / EBITDA	Percent Rank
S&P 500 Index	1.3%	10%	10.5%	94%	17.8%	93%	1.5	27%
S&P 500 Index Equal Weighted	1.8%	52%	6.5%	56%	12.2%	65%	2.8	69%
S&P 500 Value Index	2.2%	39%	7.9%	77%	12.9%	78%	1.9	32%
Russell 1000 Value Index	2.1%	16%	7.9%	74%	11.6%	54%	2.1	17%
S&P 500 Growth Index	0.6%	14%	17.5%	96%	32.3%	96%	0.7	32%
Russell 1000 Growth Index	0.6%	8%	13.7%	96%	35.4%	97%	0.7	19%
S&P 400 Index	1.5%	49%	5.9%	85%	10.5%	54%	2.5	46%
S&P 600 Index	1.8%	88%	3.1%	48%	5.4%	29%	4.0	87%
Russell 2000 Index	1.4%	46%	0.7%	22%	0.8%	22%	4.8	88%

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 October; EPS growth estimates based on consensus bottom-up analyst estimates

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Authors: Crit Thomas, CFA, CAIA / Erik M. Aarts, CIMA / Brian Cheyne, CFA, CIMA **November 13, 2024**

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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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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TSF-2695-DE-2411