MARKET MINUTE

WITH McGAREL

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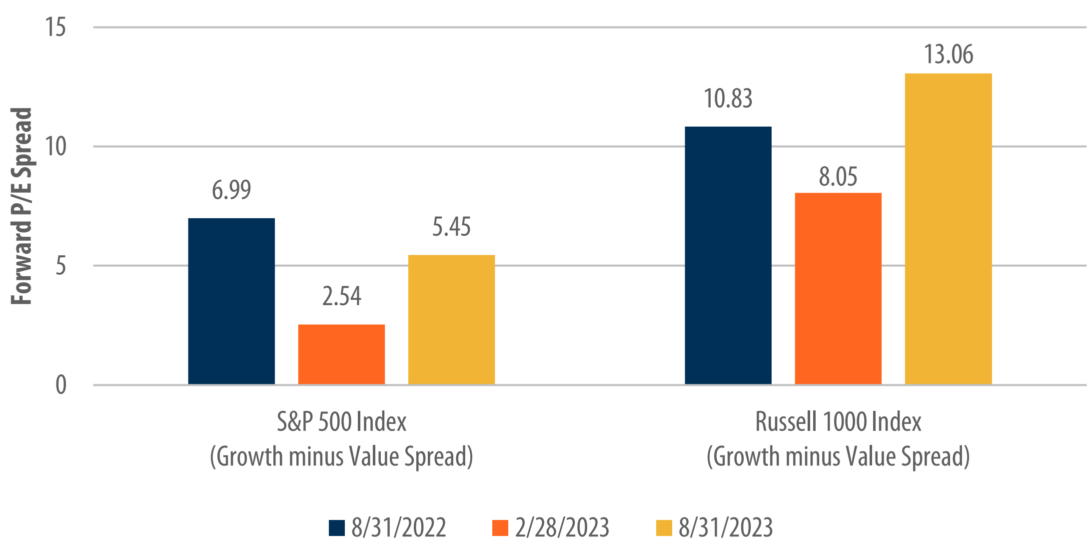
One year ago, in the September 2022 Market Minute, we highlighted the large valuation spread between growth and value stocks [see chart below]. At that point, the Federal Reserve ("Fed") had hiked interest rates 4 times on the year from 0.25% to 2.5%. We forecasted that the higher interest rate environment intended to combat inflation would narrow the valuation spread between growth stocks (considered long duration assets that benefit from low interest rates) and value stocks. From August 31, 2022 to February 28, 2023, that is what happened. As the Fed continued to raise interest rates rapidly, going from 2.50% to 4.75% over a series of four rate increases, the S&P 500 Value Index did outperform the S&P 500 Growth Index by over 13% (7.9% vs -5.4%). As a result, the growth/value forward P/E multiple spread narrowed as noted in the chart below.

The last six months have been a different story. The Fed raised interest rates another 3 times by 25 basis points per hike to an effective rate of 5.50%. By March, Artificial Intelligence (AI) euphoria was in full-swing and we came to know the Magnificent 7 (AAPL, MSFT, GOOG, AMZN, NVDA, TSLA & META), seven of the largest companies in the world. From February 28, 2023 to August 31, 2023, the S&P 500 Growth Index outperformed the S&P 500 Value Index by just over 11% (8.7% vs 19.9%). As a result, the valuations of growth stocks once again widened relative to value stocks.

Over the course of the 12 months ended August 31, 2023, the S&P 500 Value Index still outperformed its growth counterpart by 3.8% (17.2% vs 13.4%). What gives us pause is the valuation spread between growth and value stocks has reverted to where it was a year ago, yet the economic landscape is much different now. In fact, for the Russell 1000 Index, the valuation spread between growth and value is actually higher today than it was a year ago. This does not make sense to us. We expect the negative effect of higher rates to have an increasing impact on future economic activity. Therefore, our message remains the same as a year ago. We expect the valuation spread between growth and value stocks to narrow again in the coming quarters as tangible evidence of the impact of higher rates becomes more noticeable to investors. We prefer an overweight to value versus growth and, together with attractive valuation, we view companies with rising dividends as compelling in what we expect to be a lower equity return environment going forward.

Growth Minus Value Index Forward P/E Spread



Source: Bloomberg.

The **S&P 500 Index** is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance. Investors cannot invest directly in an index. The **Russell 1000 Index** represents the top 1,000 companies by market capitalization in the United States. **Forward Price-to-Earnings (P/E)** is the price of a stock divided by estimated forward earnings.