

# MARKET MINUTE

With McGAREL



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*Past performance is no guarantee of future results.*

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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. An index does not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown. **Forward price-to-earnings (P/E)** of a stock is the price divided by the estimated EPS for the next 4 quarters. The **median monthly forward price-to-earnings (P/E) ratio** is used for the premium or discount relative to the market.

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## QUALITY...AT ANY PRICE?

Last year was a spectacular year for the U.S. equity markets. Almost a repeat of 2023 in many ways. Stocks, as measured by the S&P 500 Index ("Index"), returned 25% in 2024, following a 26.3% return in 2023, resulting in a total return of 57.9% over the two-year period. In fact, the Index has delivered annual returns exceeding 25% in four of the past six calendar years.

Artificial Intelligence (AI)-driven mega-cap technology stocks, led by the Magnificent Seven ("Mag 7"), followed up a stellar 2023 (average return 112%) with another market-beating year in 2024 (average return 55%). Growth stocks outperformed value stocks in 2023 and 2024. We have been in a quality growth trade throughout most of 2023 and 2024 and it is easy to identify the Mag 7 as some of the top quality and growth stocks in the market.

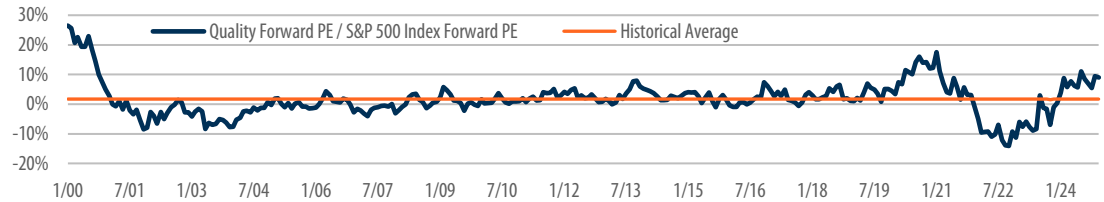
In both of the last two years, quality, along with momentum, have dominated the factor returns. Importantly, however, these spectacular returns these last two years came after the quality factor finished dead last in 2022 and traded at its biggest discount to its average versus the Index in over 20 years (11.3% discount on 12/31/2022). However, as we look at the factors as we enter 2025, quality no longer trades at a discount to its long term average but instead at a 9% premium as of 12/31/2024 [Chart 1]. The longer term average of the quality factor is a 2% premium to the Index. So quality now trades at one of its highest premiums versus the Index over the last 20 years as we start the new year. Not the same value proposition it was at the end of 2022, in our view.

We don't mean to bash high-quality stocks in any way. Companies with high returns on equity, consistent earnings growth, and low long-term debt to market capitalization, remain compelling in our view. We regard buying quality stocks as the most comfortable positioning of all the factors shown above. Who doesn't? It is easy to buy, hold, and articulate why you own a great company, in our opinion.

However, quality doesn't win the race every year, and "threepeats" are indeed rare as shown in Chart 2. History actually shows that yield, low volatility, and value typically perform quite well in years after momentum and quality have led the way. We believe reallocating some of the profits from the last few years into a diversified basket of solid companies with rising dividend streams seems like a prudent move in the new year.

These may not be the same stocks that have worked the last few years and that everyone is gushing about. However, if history serves as a guide, 2025 may be a year where value, low volatility, and yield factors deliver for investors.

**Chart 1: Quality Premium / Discount to the S&P 500 Index**



Source: Bloomberg & Capital IQ. Monthly data is calculated from 1/31/00 to 12/31/24. Top 30% of stocks by return-on-equity from a universe of the largest 1,000 U.S. stocks with at least \$1 million dollars in average daily volume over the last 3 months and 12 months of trading history.

**Chart 2: Market Cap Weighted Annual Factor Returns vs. S&P 500 Index**

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Top	Value	Mom	Mom	Size	Value	Low Vol	Size	Value	Mom	Value	Mom	Low Vol	Size	Size	Low Vol	Value	Size	Quality	Mom	Value	Quality	Low Vol	Quality	Mom	Value	Yield	Quality	Mom
	38.2%	37.0%	49.5%	11.6%	6.9%	-10.8%	43.9%	20.1%	18.9%	22.9%	20.1%	-27.2%	38.8%	27.4%	12.2%	20.4%	41.0%	14.5%	5.6%	24.3%	26.8%	-0.7%	36.7%	35.8%	30.2%	-0.1%	28.8%	35.1%
2	Low Vol	Quality	Quality	Yield	Size	Yield	Value	Size	Value	Yield	Quality	Quality	Value	Mom	Yield	Size	Mom	Index	Low Vol	Yield	Mom	Mom	Index	Quality	Yield	Value	Index	Quality
	36.9%	35.6%	27.9%	10.4%	3.1%	-11.0%	39.8%	18.0%	12.1%	22.1%	13.3%	-31.5%	34.4%	24.1%	9.9%	17.7%	36.9%	13.7%	1.8%	18.8%	22.6%	-3.0%	31.5%	26.1%	29.7%	-3.6%	26.3%	30.4%
3	Quality	Index	Index	Low Vol	Yield	Mom	Index	Yield	Index	Low Vol	Index	Yield	Quality	Value	Quality	Index	Value	Yield	Index	Size	Low Vol	Index	Size	Index	Index	Low Vol	Size	Index
	36.5%	28.6%	21.0%	10.0%	1.9%	-14.5%	28.7%	12.5%	4.9%	17.9%	5.5%	-34.5%	27.5%	18.5%	5.3%	16.0%	35.8%	13.4%	1.4%	16.9%	22.6%	-4.4%	27.9%	18.4%	28.7%	-8.2%	20.4%	25.0%
4	Yield	Low Vol	Size	Value	Low Vol	Size	Yield	Low Vol	Size	Quality	Low Vol	Size	Index	Yield	Index	Mom	Index	Low Vol	Yield	Index	Index	Quality	Value	Low Vol	Quality	Index	Mom	Low Vol
	33.9%	17.4%	12.5%	7.3%	-5.3%	-16.3%	26.7%	12.1%	4.8%	16.7%	5.3%	-35.8%	26.5%	16.8%	2.1%	15.6%	32.4%	13.1%	-0.8%	12.0%	21.8%	-4.8%	27.6%	17.3%	28.3%	-18.1%	17.5%	18.1%
5	Index	Yield	Low Vol	Quality	Value	Mom	Quality	Quality	Index	Size	Mom	Yield	Index	Size	Low Vol	Quality	Quality	Mom	Quality	Low Vol	Value	Yield	Yield	Size	Low Vol	Quality	Value	Value
	33.4%	15.1%	4.1%	-8.3%	-8.9%	-16.8%	25.7%	11.5%	4.7%	15.8%	2.0%	-36.1%	20.8%	15.1%	-0.9%	14.5%	31.9%	12.1%	-1.7%	11.4%	15.5%	-6.8%	27.5%	17.0%	24.9%	-18.6%	12.3%	16.3%
6	Mom	Value	Yield	Index	Index	Quality	Quality	Mom	Yield	Size	Yield	Index	Low Vol	Quality	Mom	Quality	Yield	Value	Size	Quality	Yield	Size	Mom	Yield	Size	Size	Yield	Yield
	33.2%	12.7%	-1.4%	-9.1%	-11.9%	-18.4%	21.4%	10.9%	4.5%	13.9%	0.7%	-37.0%	18.2%	13.2%	-2.8%	14.0%	29.6%	10.7%	-5.1%	9.6%	15.0%	-10.6%	26.6%	-2.1%	17.9%	-19.2%	7.1%	14.7%
Bottom	Size	Size	Value	Mom	Mom	Index	Low Vol	Index	Low Vol	Mom	Value	Value	Mom	Low Vol	Value	Yield	Low Vol	Size	Value	Mom	Size	Value	Low Vol	Value	Mom	Quality	Low Vol	Size
	21.5%	0.9%	-1.5%	-27.4%	-16.5%	-22.1%	19.3%	10.9%	2.8%	10.6%	-6.3%	-48.0%	12.4%	11.5%	-6.1%	13.4%	27.4%	8.3%	-6.1%	4.8%	14.7%	-14.1%	26.0%	-7.0%	16.7%	-23.5%	6.9%	13.8%

**Value:** Lowest price-to-book | **Momentum (Mom):** Highest 12 month price change | **Quality:** Highest return-on-equity | **Size:** Lowest market capitalization | **Low Volatility (Low Vol):** Lowest 1 year price variability | **Dividend Yield:** Highest dividend yield

Source: Capital IQ. As of 12/31/24. Returns are total returns. Top 30% of stocks by factor are selected from a universe of the largest 1,000 U.S. firms with \$1 million in average daily volume over the last 3 months and 12 months of trading history. Stocks are then market cap weighted.