

Cash Flow and Carey



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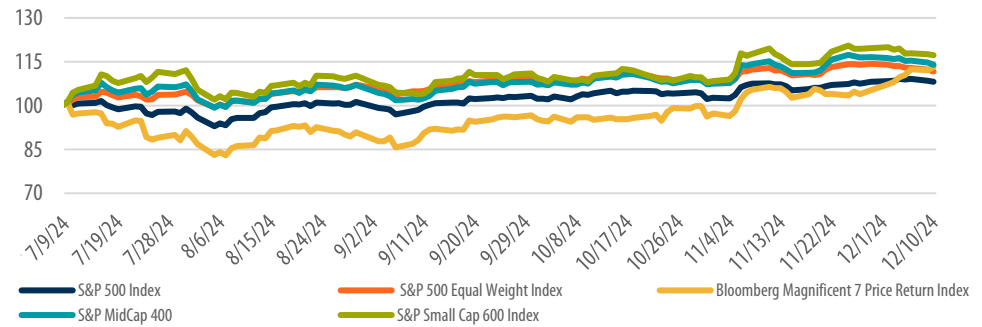


This chart is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions and other expenses incurred when investing. Investors cannot invest directly in an index. The S&P 500 Index is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance. The S&P 500 Equal Weighted Index is the equal-weight version of the S&P 500 Index. The Bloomberg Magnificent 7 Price Return Index is an equal-dollar weighted equity benchmark consisting of a fixed basket of 7 widely-traded companies in the U.S. The S&P MidCap 400 Index is a capitalization-weighted index which measures the performance of the mid-range sector of the U.S. stock market. The S&P SmallCap 600 Index is an unmanaged index of 600 companies used to measure small-cap U.S. stock market performance.

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Worth the Weight?

Daily Price Returns Since 7/9/24



Source: Bloomberg. Daily observations from 7/9/24 to 12/10/24, normalized to a factor of 100.
Past Performance is no guarantee of future results.

View from the Observation Deck

In a previous post ([click here](#)), we noted that Jerome Powell’s commentary to the Financial Services Committee on 7/9/24 appeared to have set the stage for a dramatic shift in the performance of small cap stocks relative to their large cap counterparts. For today’s post, we set out to expand our observations to include the price-only returns of the Bloomberg Magnificent 7, S&P 500 Equal Weighted, and S&P MidCap 400 Indices. The chart above includes the price-only returns of the specified indices from 7/9/24 to 12/10/24, normalized to a factor of 100. To avoid overcrowding the chart, the S&P 100 Index was removed from our dataset.

On 7/8/24, prior to Powell’s address, the federal funds rate futures market indicated there was a 72.0% chance that the Federal Reserve (“Fed”) would cut its policy rate at its September meeting. That expectation surged following his remarks, rising to 98.0% on 7/23/24.

As we now know, the Fed would cut its policy rate at both its September and November meetings. Currently, the federal funds target rate (upper bound) sits at 4.75%, down from 5.50% in July.

Investors increasingly expect another rate cut in December.

On 12/11/24 the federal funds rate futures market indicated that there was a 99% chance the Fed would reduce its policy rate at its next meeting, up from a 66% chance less than two weeks ago on 11/29/24.

Valuations for the S&P 500 Equal Weight, S&P SmallCap 600, and S&P MidCap 400 Indices remain more attractive than those of the Bloomberg Magnificent 7 and broader S&P 500 Indices.

As of 12/11/24, the price-to-earnings ratios for each of the indices in today’s chart were as follows: Bloomberg Magnificent 7 Index (42.43); S&P 500 Index (25.52); S&P 500 Equal Weighted Index (19.32); S&P MidCap 400 Index (18.54); and S&P SmallCap 600 Index (18.52).

For reference, the total returns for the five indices in today’s chart were as follows (7/9/24 – 12/10/24):

- S&P SmallCap 600 Index: 18.00%
- S&P MidCap 400 Index: 14.66%
- Bloomberg Magnificent 7 Index: 13.40%
- S&P 500 Equal Weighted Index: 12.50%
- S&P 500 Index: 8.82%

Takeaway

As today’s chart clearly shows, market breadth has widened considerably since Powell’s speech in July. In our view, the catalysts behind this phenomenon, including lower interest rates, increasingly attractive valuations among smaller market capitalizations, and strong 2025 earnings estimates, will likely lead to further diversification into smaller companies. Earnings for the S&P Small Cap 600 Index are estimated to increase by 17.49% year-over-year (y-o-y) in 2025, the most of any index in today’s chart. For comparison, the 2025 earnings growth estimates for the remaining indices were as follows: Bloomberg Magnificent 7 Index (16.51%); S&P MidCap 400 Index (13.11%); S&P 500 Equal Weighted Index (12.71%); and S&P 500 Index (12.59%). Notably, earnings growth is expected to increase for all but one of the indices presented today. At 16.51%, the Mag 7 Index’s 2025 earnings growth estimate falls far short of 2024’s estimated earnings growth rate of 68.37% (as of 12/11/24). As always, these are estimates and are subject to constant revision. As investors begin to plan for 2025, we trust they will be asking: “what investments are worth the weight they’ve been assigned in my portfolio?” and adjusting accordingly.