building better balance

2024 mid-year outlook

Diversification opportunities ahead

Broader earnings growth is just the beginning

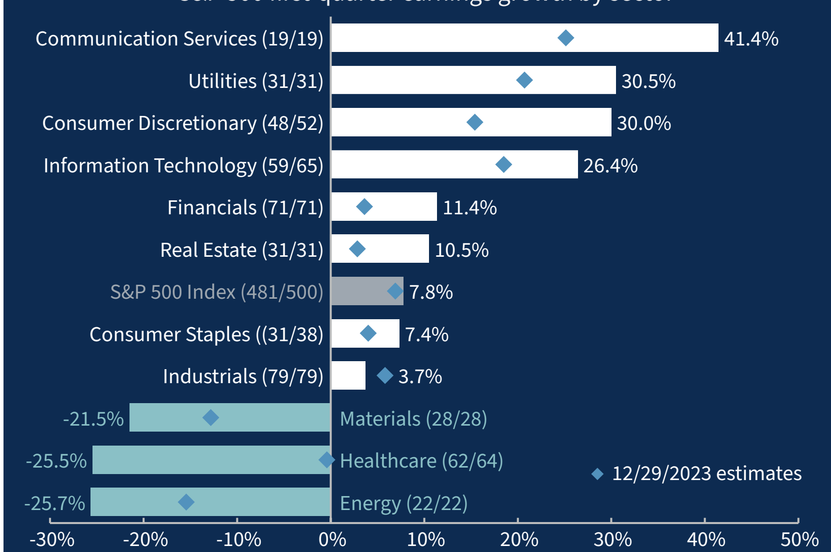
For more than a year, a handful of mega-cap technology companies have dominated the market narrative.

Now that's starting to change, thanks to an emerging set of portfolio diversification opportunities across a range of different sectors, market caps, and geographies.

"There's a lot more that's working in this market beyond just the mega-caps at the top of the S&P 500 Index," Matt Orton, CFA, Chief Market Strategist at Raymond James Investment Management, said in his mid-year outlook. To start, he said, look at the growth of corporate earnings, which have:

- Beaten expectations so far in 2024,[1]
- Broadened beyond the information technology and consumer discretionary sectors, and
- Been fueled by long-term secular growth drivers and megatrends in the broader economy.

Earnings have been much better than expected:
S&P 500 first-quarter earnings growth by sector



Source: Bloomberg Intelligence, as of 5/31/24. The numbers in parentheses indicate the number of companies that have reported first-quarter earnings so far, followed by the total number of companies in each category.

[1] Unless otherwise indicated, all data cited is sourced from Bloomberg as of May 31, 2024.

"I believe there's a very clear path to continue to realize the earnings broadening that's taking place."

Matt Orton, CFA
Chief Market Strategist
Raymond James
Investment Management

Orton believes the broadening in earnings hasn't yet been reflected in the price of the market – but it will be. There are plenty of ways today to redeploy capital into areas that haven't taken off yet, he said, and there are a lot of pockets of value and opportunity within the overall market. Leading the way were technology earnings, which turned first, and those have been reflected in technology share prices. Going forward, he expects this trend to continue across a variety of key themes.

Themes to consider

Artificial intelligence 2.0 – Companies in sectors and industries that have nothing to do with information technology will be critical for realizing the growth and buildout of the AI revolution, because it is expected to require massively increased electric generation and capital expenditures. Longer-term, look for AI to drive innovation across the economy, from software to finance to healthcare.

Small caps – Valuations are near historic lows compared to large caps, and the Russell 2000® Index is trading 15% below its all-time high. Yet merger and acquisition activity in small caps is robust. It wouldn't take much money coming off the sidelines for small caps to move – and move rapidly. It's important to be selective and consider high-quality companies.

Infrastructure – A lot of this is related directly to AI and is expected to drive capital expenditures over the next two years in areas that include electrical equipment, machinery, mining, and materials.

Defense and aerospace – As elsewhere, AI plays a role, but so does heightened geopolitical instability.

Dividend growers – Have performed well so far in 2024, and dividend growth is important when inflation is high. A lot of high-quality companies still trade at low valuations because they tend to be concentrated in sectors where earnings inflections are just starting.

Reshoring – Is driving growth in manufacturing and construction in the United States, with higher corporate capital expenditures on the horizon. Abroad, reshoring also benefits India, Mexico, and several other Latin American nations.

India and Japan – In emerging markets, Orton has been bullish on India for two years and returned from a recent trip impressed with its opportunity set, growing middle class, young working population, earnings growth, and aggressive infrastructure spending (34 kilometers of highways are being built per day, according to the National Highways Authority of India).

In developed markets, Orton likes Japan's focus on corporate reform, governance, and returning cash to shareholders. Other bright spots: exports, the end of deflation, and pension and central bank reforms.

"What ties everything together are these strong secular growth megatrends that underpin the fundamentals of the market and the economy as a whole," Orton said. "It makes sense to think about how to build balance and breadth in your overall portfolio, and there is much to lean into."

S&P 500 Index's

TOP 5

companies contributed

100%

of its quarter-to-date gains*

*Bloomberg as of 6/21/2024

But the doubters are saying…

… the market is so narrow

The S&P 500 Index is undeniably concentrated at the top, but Orton noted that the growth of the index's largest companies has been supported by strong fundamentals and the fact that the U.S. economy itself has become more growth-oriented than it was decades ago.

"We can complain about the dominance of these mega-cap names, and a few in particular, but we need to recognize that this is in fact a bull market," he said. "There are still a lot of good things happening beneath the surface, and that's where I think we're going to see some moves starting for the rest of the year."

"Just because we are in a narrow market is no excuse for not thinking about leaning into some of those themes," he said.

Not your father's index

The S&P 500 has a vastly different composition than it did in the 1990s

Source: Bloomberg, as of 5/31/24. Growth sectors are information technology, communications services, and consumer discretionary. Value sectors are financials, consumer staples, energy, and materials.

… we're at all-time highs

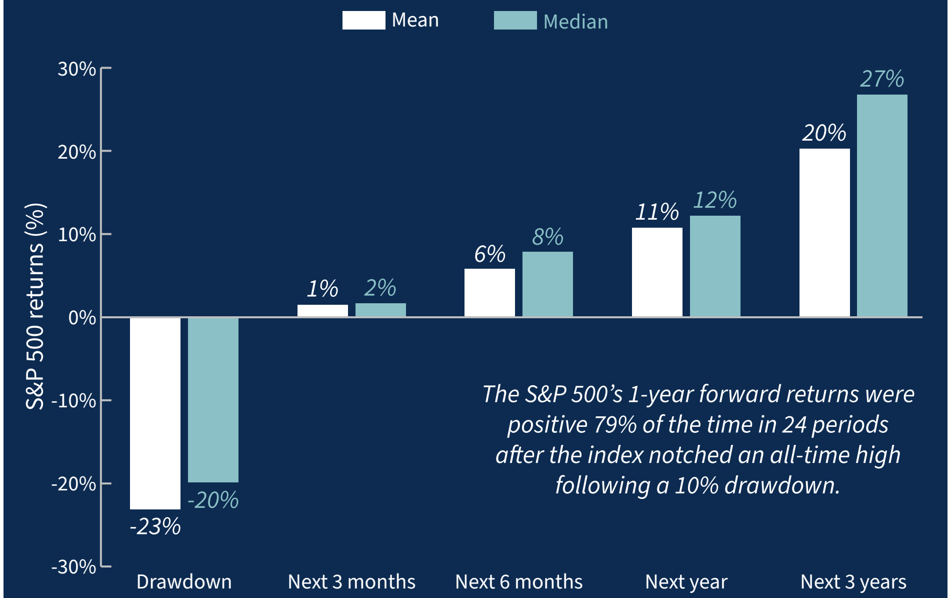
First, Orton said, it's okay that the market is hitting all-time highs – 29 so far in 2024 as of June 14 – because that's not unusual in a bull market backed by a fundamentally strong economy.

While economic growth is moving back to its long-term trend – a healthy development from an inflation-focused perspective – Orton said the U.S. economy enjoys inflecting earnings growth that is starting to broaden, a robust labor market, and the prospect (at some point) of lower interest rates.

And since 1950, the S&P 500 Index has consistently posted positive returns when it hits an all-time high following a draw-down of at least 10%. "We should embrace that, because over the longer-term, you will tend to see more gains," he said.

Don't fear an all-time high. Embrace it.

S&P 500 returns since 1950 following all-time highs after drawdowns of at least 10%



Source: Bloomberg, as of 5/31/24.

… why not just stay in cash?

It makes no sense to have an overweight position in cash when the U.S. Federal Reserve (Fed) is moving toward cutting interest rates, Orton said.

Going back to 1989, cash has unambiguously underperformed the Bloomberg Aggregate Bond Index and the Bloomberg Intermediate Government/Credit Index over the 1-, 3- and 5-year periods following the end of a Fed rate-hiking cycle.

"It's incredibly expensive to miss bull markets," he said. "There are opportunities to look for value in pockets of the market, and I believe it's vital to stay invested when the economy is strong and when the market is doing well. That is how you build wealth over the long term.

"And unfortunately, right now, there's still so much cash that is sitting on the sidelines with investors who are not participating in this rally."

Cash is not king when rates start to fall

Annualized returns following pauses in Fed rate-hiking cycles

	1-year return			3-year return			5-year return		
Federal funds rate hike cycle ended	S&P U.S. Treasury Bill 0–3 Month Index	Bloomberg Intermediate Government/ Credit Index	Bloomberg U.S. Aggregate Bond Index	S&P U.S. Treasury Bill 0–3 Month Index	Bloomberg Intermediate Government/ Credit Index	Bloomberg U.S. Aggregate Bond Index	S&P U.S. Treasury Bill 0–3 Month Index	Bloomberg Intermediate Government/ Credit Index	Bloomberg U.S. Aggregate Bond Index
2/24/1989	n/a	11.7%*	12.7%*	n/a	11.7%*	12.6%*	n/a	10.2%*	11.0%*
2/1/1995	5.6%	14.6%	17.1%	5.3%	8.9%	10.2%	5.2%	6.7%	7.3%
5/6/2000	6.0%	12.9%	13.7%	3.4%	10.7%	11.1%	2.6%	7.2%	7.8%
6/29/2006	5.1%	6.0%	6.5%	3.0%	6.2%	6.6%	1.8%	6.2%	6.6%
12/19/2018	2.2%	7.0%	8.8%	1.0%	4.0%	4.9%	1.9%	2.3%	1.0%
Average	**4.7%**	**10.3%**	**11.8%**	**3.2%**	**8.3%**	**9.1%**	**2.9%**	**6.1%**	**6.7%**

Source: Bloomberg, as of 12/19/23.
*Based on monthly returns rounded to the nearest month-end.

"Hating on the market just because it's narrow or because we're at all-time highs ignores so much more that's going right," Orton said. "Those who have sat on the sidelines for the past 12-plus months have missed out on a very important bull market and long-term wealth creation opportunity."

Risk Information:

Investing involves risk, including risk of loss.

Diversification does not ensure a profit or guarantee against loss.

Disclosures:

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Sector investments are companies engaged in business related to a specific sector. They are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification.

Investing in small cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor. The prices of small company stocks may be subject to more volatility than those of large company stocks.

International investing presents specific risks, such as currency fluctuations, differences in financial accounting standards, and potential political and economic instability. These risks are further accentuated in emerging market countries where risks can also include possible economic dependency on revenues from particular commodities or on international aid or development assistance, currency transfer restrictions, and liquidity risks related to lower trading volumes.

Definitions

Breadth describes the relationship between the median and the mean of a market index. When a few data outliers result in a mean that is substantially larger (or smaller) than the median of the full data set, then the performance of the entire index is being driven by a “narrow” selection of companies. An index supported by “broad” market movements is one where the median is closer to the mean.

Dividend payers are the companies that distribute a portion of their profits to shareholders in the form of a dividend.

A drawdown is a decline in the returns of a security or group of securities, as measured over a period from the peak of returns to their trough.

An earnings inflection marks a sudden change in the direction and rate of change of earnings growth. Earnings inflections can lead to either positive or negative change.

Earnings per share (EPS) is calculated as a company's profit divided by the outstanding shares of its common stock. The resulting number serves as an indicator of a company's profitability.

Forward returns reflect returns that take place after a particular event or point in time.

Generative artificial intelligence (GenAI) is a form of artificial intelligence that can create new content that includes text, audio, code, video, and images.

Growth investing is a stock-buying strategy that focuses on companies expected to grow at an above-average rate compared to their industry or the market.

Market capitalization, or market cap, refers to the total dollar market value of a company's outstanding shares of stock.

Mega-cap stocks are the largest publicly traded companies as measured by market capitalization. Generally, this refers to companies with market capitalizations over $200 billion.

A megatrend is a widespread and long-term macroeconomic, technological, social, environmental, political, or other change that may develop slowly at first but that has a major, ongoing impact once it gets underway. Megatrends are distinct from smaller trends in business, economic, or other spheres of activity that have less far-reaching or enduring effects.

Overweight describes a portfolio position in an industry sector or some other category that is greater than the corresponding weight level in a benchmark portfolio.

Reshoring describes the effort to bring manufacturing and other services back to the United States from overseas operations.

Secular stocks are characterized by having consistent earnings over the long term constant regardless of other trends in the market. Secular companies often have a primary business related to consumer staples most households consistently use whether the larger economy is good or bad.

Value investing is an investment strategy that involves picking stocks that appear to be trading for less than their intrinsic or book value.

Indices

The Bloomberg U.S. Aggregate Bond Index is composed of the total U.S. investment-grade bond market. The market-weighted index includes Treasuries, agencies, commercial mortgage-backed securities (CMBS), asset-backed securities (ABS) and investment-grade corporates.

The Bloomberg Intermediate U.S. Government/Credit Index measures the performance of the non-securitized component of the U.S. Aggregate Index with maturities of 1-10 years, including Treasuries, government-related issues, and corporates. It is a subset of the U.S. Aggregate Index.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 7% of the total market capitalization of the Russell 3000® Index.

The S&P 500 Index measures change in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 80% of the investable U.S. equity market.

The S&P U.S. Treasury Bill 0-3 Month Index is designed to measure the performance of U.S. Treasury bills maturing in 0 to 3 months.

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