



## Are Those Seven Stocks Still Magnificent?

Six months ago, at the end of the third quarter of 2023, the S&P 500 was posting a very healthy aggregate return of 13.1%. But a look below the surface revealed that the market's returns were being disproportionately driven by a small group of companies that had come to be known as the *Magnificent 7* (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA and Tesla). Though they are variously classified among the discretionary, communications, and technology sectors of the S&P 500, they could all be thought of as technology or "stealth technology" companies, with few diversifying qualities. What's more, if you didn't own these seven companies, there was a good chance your stock portfolio was in the red, as those few stocks accounted for a third of S&P 500's market value and almost the entirety of the index's 13% year-to-date return at that time.

Fast-forward to 2024. At the end of the first quarter, most of those seven stocks were still flying

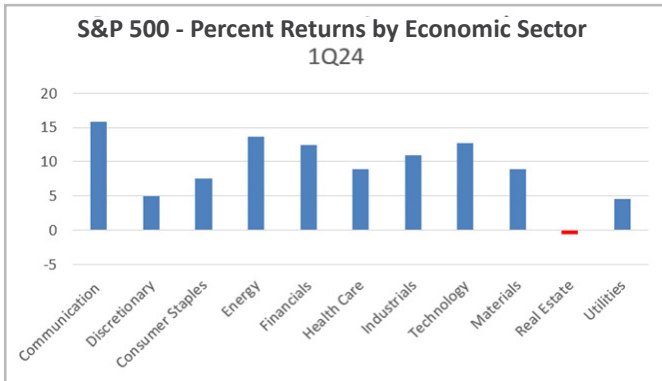


Figure 1 - Source: Northern Trust Asset Management

though Apple and Tesla were down 11% and 29% respectively. But the market rally was expanding. Of the eleven economic sectors in the S&P 500, only real estate was down (and only slightly) for the quarter. All the rest were solidly in positive territory and driving the market higher with broad-based participation, continuing a six-month trend.



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### Market Indices

As of March 31, 2024, the S&P 500 was up a strong 10.6%, though Growth stocks were still besting Value. The Russell 1000 Growth Index posted an 11.4% gain while the Russell 1000 Value trailed at 9%. Small-Cap and International stocks both lagged large, US

Index Returns as of 3/31/2024	Q1 2024	1 Year
<b>S&amp;P 500</b>	10.56%	29.88%
<b>Russell 1000 Value</b>	8.99%	20.27%
<b>Russell 1000 Growth</b>	11.41%	39.00%
<b>Russell 2000 Value</b>	2.90%	18.75%
<b>Russell 2000 Growth</b>	7.58%	20.35%
<b>Dow Jones US Real Estate</b>	-0.36%	10.56%
<b>MSCI EAFE (net)</b>	5.78%	15.32%
<b>MSCI Emerging Markets (net)</b>	2.37%	8.15%
<b>Bloomberg US Aggregate Bond</b>	-0.78%	1.70%
<b>Bloomberg Global Treasury ex. US</b>	-3.81%	-2.75%
<b>Bloomberg High Yield Bond</b>	1.47%	11.15%

Figure 2 - Source: Northern Trust Asset Management

companies, with the weakest performers being Small-Cap Value and Emerging Markets, as shown in figure 2. What was the catalyst for all these gains? A large factor was a growing expectation of falling interest rates, which ironically led to modestly higher rates and a downward drift in the returns of high-quality fixed income benchmarks. The standard measure of fixed income performance, the Bloomberg US Aggregate Bond Index, slipped 0.78% as intermediate bond yields rose about 30-40 basis points during the quarter. High yield bonds, however, gained 1.5%.

### Economic Resilience

So why would expectations of lower interest rates result in higher interest rates? The Fed aggressively raised short-term interest rates in 2022 and 2023 to curtail surging inflation. With inflation falling from near 9% to around 3 or 4%, the Fed could begin to ease its tight monetary policy, reducing fears of economic recession

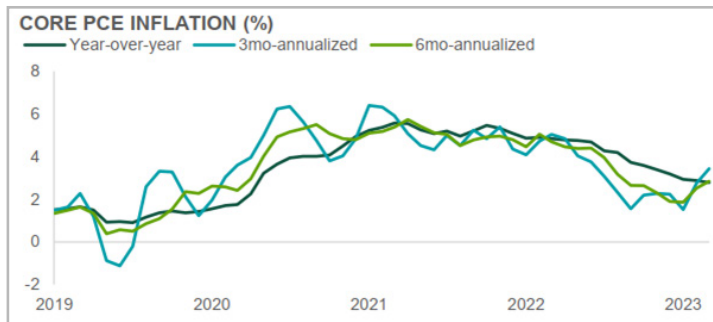


Figure 3 - Source: Northern Trust Asset Management

and buoying economic investment. Meanwhile, steady and healthy job gains, improved indicators of manufacturing activity, and continued strength in home sales sustained modest economic growth for the near-term. A year ago, an economic recession was a foregone conclusion. Today, concerns of recession have been again pushed into the future, allowing longer-term interest rates to drift higher.

Nevertheless, the fight against inflation remains a stubborn one and the economy's resilience despite relatively high interest rates will keep the Fed vigilant. Its 2% inflation target is not merely elusive, but inflation actually ticked higher in recent months, trending closer to 4%, so the expectations of rate cuts have also been pushed to the future. Most economists expect interest rates to be higher for longer, providing investors with more opportunities to lock in the currently-higher rates. Though the Fed has clearly telegraphed its pause in rate hikes and expectations that the next move will be a cut, it is also in no hurry to cut rates in the face of persistent inflation. The current consensus seems to be for three, quarter-point rate cuts beginning no sooner than September, and possibly not before the November elections.

Another, and more intrinsically economic, reason for recent economic resilience is capitalist innovation – most notably realized in the form of artificial intelligence (AI). AI offers the promise of greater efficiencies through technological advancement, allowing machines to take on the more mundane (but increasingly complex) tasks of production, while freeing people to engage in the

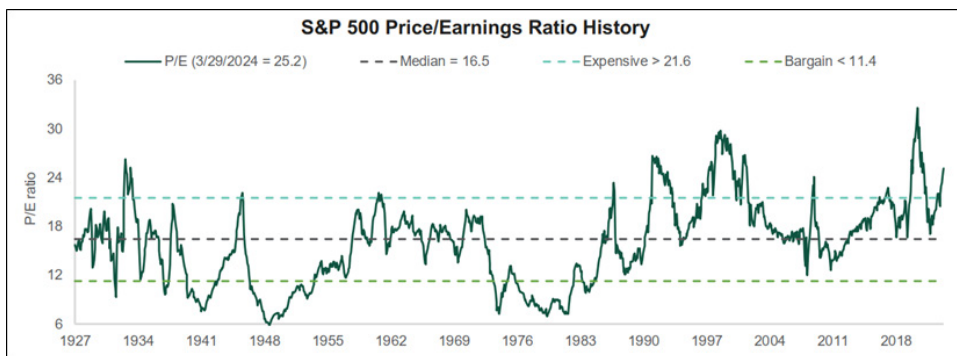


Figure 4 - Source: Northern Trust Asset Management

### Opportunity or Risk?

more cognitive and interpersonal skills – a benefit to the manufacturing and service sides of the economy. These promised benefits are the primary fuel behind the surging performance of the *Magnificent 7* stocks discussed earlier. NVIDIA, the most prominent of AI semiconductor companies jumped 82% during the first quarter on the strength of rapid earnings growth expected to result from the implementation of AI technologies.

For equity investors, a key question will be: “Are stock prices too high?” The answer may be, “yes, and no.” In truth, the market should be viewed not merely as a whole, but also in parts. A comparison of the S&P 500's price/earnings ratio relative to its long-term history suggests that the index as a whole is expensive, with a quarter-end P/E ratio of 25.2 times earnings. That is more than one standard deviation above its long-term average – an indicator of an expensive market (see figure 4 above). But a more careful review suggests that certain sectors look significantly more expensive than others. For example, the large-cap, US technology sector appears most pricey relative to its historical P/E range, while the energy sector looks cheapest by the same historical comparison. But the *non-US* technology sector looks fairly valued when compared to its own historical P/E range. In fact, foreign stocks overall look more attractively priced than US companies, but sometimes these comparative differences in the relative valuations of various markets and sectors can persist for long periods.

Further, a more nuanced analysis of the technology sector suggests that some companies that appear overpriced on a P/E basis can actually look cheap when projections of strong earnings growth are factored in. The implication here is that careful analysis of a company's prospects may be as important as the general economic environment. That requires extensive research, and for investors without the resources or the will to do it, broadly diversified asset-class investing is a safe and effective alternative.

On the bond side, the current level of interest rates seems to offer an opportunity to gain reasonable income without taking on excessive risk, as long as the Fed remains resolved to fight inflation. Bonds also look reasonably priced when yields are compared to the stock market's earnings yield – a comparison of the relative values of bonds and stocks.

As always, especially in heady days of market returns, prudent investors will rebalance their oversized holdings and asset classes back to their long-term targets. This effectively applies the principle to buy low and sell high, and keeps investors in step with their financial plans.