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Investment Institute

Market Commentary

Weekly perspective on current market sentiment **February 28, 2024**

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Last week's S&P 500 Index: +1.7%

After a brief departure, market breadth remains narrow

Key takeaways

- Historically, as the stock market is coming into a meaningful top, the biggest growth names are carrying the load.
- From a market-breadth standpoint, a narrow array of stocks is still pushing the indexes to new record highs.

Breadth matters, especially when looking at equity rallies to new record highs, as has been the case with the S&P 500 Index (SPX) in recent weeks. In other words, it is important to know if lots of stocks are participating in the advance as the equity market marches to record highs or if the rally is being led by only a smaller number of mega-capitalization companies. Broad participation in a rising market is generally a good sign for a rally's persistence. It has been common in past cycles, as the stock market is coming into a meaningful top, that the biggest growth names are the ones carrying the load and taking the SPX and other major indexes higher. The financial media have been hammering home for most of the past 12 months the observation that the rally in the stock market is due to rising stock prices for just a handful of growth/technology companies.

Perhaps the easiest way to see what is going on is to examine the performance of the SPX relative to the performance of the Russell 2000 Index (small-capitalization index) and the S&P 100 Index (also known as the OEX), which is composed of the 100 largest-cap companies in the SPX. Early in a new cycle, as investors anticipate and eventually see clearing skies on the horizon, they are typically more willing to take on lesser-quality smaller companies as represented by the Russell 2000 Index. These firms might not have the strongest balance sheets, the most reliable cash flow, or the widest product line but, nonetheless, will likely benefit from the broad recovery that lies ahead.

But we are not there yet in this cycle. The Russell 2000 Index has dramatically underperformed both the SPX and the OEX over the trailing 12-month period at the time of this writing. The OEX is beating the SPX and leading the charge higher. That is a clear reflection of decreasing market breadth and is a meaningful negative when trying to gauge the underlying strength of the overall stock market. We currently rate U.S. small-cap stocks as most unfavorable (our lowest rating). There was a brief period, lasting only two months, where the small-cap index outperformed the OEX and the SPX after the stock market hit the lows in late October.

From another angle, let's take a look at industry-group participation. Of the 74 industry groups (each group made up of individual stocks) represented in the S&P 500 Index, 49 have posted positive returns over the past 12 months. Of those groups with positive returns, only 15 have beat the return of the SPX over that time frame according to Bloomberg data.

The bottom line is, from a market-breadth standpoint, an analysis of the current data shows a narrow array of stocks (the biggest of the big) pushing the indexes to new record highs. That is a meaningful concern and helps support our belief that limited equity upside lies ahead over the balance of this year.

Risk considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks.

Definitions

Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index. The Russell 3000® Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

S&P 100 Index measures large cap company performance and consists of up of 100 major, blue chip companies across diverse industry groups. The primary criterion for index inclusion is the availability of individual stock options for each constituent.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

An index is unmanaged and not available for direct investment.

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