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Investment Institute

Market Commentary

Weekly perspective on current market sentiment May 8, 2024

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Last week's S&P 500 Index: +0.6%

S&P 500 optimism

Key takeaways

- Large-cap equities have rallied since the lows last October, and we think there is more upside ahead through 2025.
- While we doubt the S&P 500 Index can trade much beyond the recent highs this year, there are portfolio opportunities.

The bad news is the S&P 500 Index (SPX or the Index) is currently trading very close to the midpoint of our year-end 2024 target range (5,200). The good news is the Index sits almost 10% below the midpoint of our year-end 2025 target range (5,700). That is an attractive return in our view over the next 19 months or so, especially when also taking dividends into account. While it is good that large-capitalization equities have rallied nicely since the lows of last October, we think there is more upside when looking further down the road.

The better-than-expected economy of the past 12 months and the enhanced prospects we see through the end of next year have been the main ingredients in our rationale to bump up our economic outlook and earnings estimates for the SPX. Remember, it is the economic environment that allows companies to produce earnings. While some sectors may see benefits due to newer technologies (i.e., artificial intelligence or AI) or discoveries that would be in demand whether the economy is good or bad, most SPX members are tied to a large extent to the economy. The better the economy, the more opportunities there are to produce and grow earnings for the individual companies making up the Index. We are looking for the domestic economy to grow above 2% this year and next.

Even with our doubts that the SPX can trade meaningfully beyond the recent highs over the balance of this year, we do think there are potential portfolio opportunities where we believe investors can take advantage. We have been favoring trimming positions in three sectors that have outperformed the SPX (two quite noticeably) over the past 12 months: Information Technology (rated neutral), Communication Services (rated neutral), and Consumer Discretionary (rated unfavorable). Investors previously carrying these sectors at our suggested weightings are likely overweight those sectors in their portfolios now. Through reallocation from this suggested trimming process, we favor bringing the Industrials, Materials, Energy, and Health Care sectors above their market weights in portfolios.

We believe that there will still likely be downside opportunities created in equities as continued readings well above the Federal Reserve's longer-term 2% inflation target will likely keep interest rates higher for longer. While we do see the economy continuing to slow and inflation coming down modestly in coming quarters, we have only two rate cuts penciled in over the balance of this year and one in 2025. The risk is that there will be fewer cuts than we expect, not more.

We believe a big positive as we look ahead is on the benefits to profitability of cost controls and increased efficiencies and productivity. In recent quarters, companies have reminded investors over and over again that protecting and ultimately expanding profit margins are major goals. Labor-cost increases are also moderating. We believe a combination of these factors should drive profitability for large-cap domestic corporations over the course of this year and next.

Risk considerations

Forecasts, estimates, and projections are not guaranteed and are based on certain assumptions and views of market and economic conditions which are subject to change.

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.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. **Materials** industries can be significantly affected by the volatility of commodity prices, the exchange rate between foreign currency and the dollar, export/import concerns, worldwide competition, procurement and manufacturing and cost containment issues. . The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. Some of the risks associated with investment in the **Health Care** sector include competition on branded products, sales erosion due to cheaper alternatives, research and development risk, government regulations and government approval of products anticipated to enter the market.

Definitions

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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