



# Market Commentary

Weekly perspective on current market sentiment

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Last week's S&P 500 Index: +1.1%

## Equity market rotation doesn't change our outlook

### Key takeaways

- Underneath the surface of volatile headlines, equity markets continued to show signs of rotation and broadening out consistent with our expectations that economic growth will accelerate this year.
- The bottom line is that we believe the rotation is a prelude to broad equity gains this year.

We have been expecting more volatility this year, which features midterm elections, a new Federal Reserve (Fed) chairman, and the potential for the fourth year of a bull market following three straight years of 15% plus gains in the S&P 500. The combination of novelty (Fed leadership change) and events that historically have tested market confidence seems likely while the market sensitivity to headlines has deepened.

Underneath negative headlines, we see good news for equity markets. Markets continued to show signs of rotation and broadening out. The Russell 2000, Russell Midcap, and the S&P 500 Equal Weighted Index are all outperforming the market-cap-weighted S&P 500. These signs have been consistent with our expectations that economic growth will accelerate this year.

In addition, headlines have focused on the fact that fourth-quarter consensus earnings estimates for the S&P 500 began at 8.4% before accelerating to about 13% currently. What may not be as well known is that small- and mid-cap stocks (Russell 2000 and Russell Midcap Indexes) have exceeded fourth-quarter earnings estimates as well by healthy margins.

Economically cyclical areas of the market also continued to outperform globally. Similar to the U.S., developed- and emerging-market equities have been led year-to-date for the most part by cyclical sectors, also consistent with a global economy accelerating.

We remain positive on artificial intelligence (AI) broadly, but volatility in the information technology space has been a dominant theme this year — and really since last October. Initially the fears focused on capital-equipment spending, and now investors' fear that software (particularly application software) could be replaced in some areas as AI tools are proliferating. In the meantime, we expect cyclical companies to potentially benefit when the global economy is growing above average as it is now, which is an additional factor that supports the broadening out of markets.

The bottom line is that we believe the rotation mentioned above is a prelude to broad equity gains this year. While the tug of war in headlines will likely continue to create volatility in equity markets, we favor staying nimble. We believe this market chop is an opportunity for new cash in U.S. Large Cap Equities and the Financials sector, which has pulled back and remains among our favorite sectors.

We also upgraded Emerging Market Equities last year to neutral as its benchmark index (MSCI Emerging Markets Index) composition is heavily weighted toward cyclical sectors while also considering the Technology sector with much lower price-to-earnings multiples than Developed Market ex-U.S. Equities.

Going forward, we'll continue looking through headline volatility to focus on the economic and earnings improvement that we expect.

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### 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. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **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.

### Definitions

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

Russell 1000® Index measures the performance of the 1,000 largest companies in the Russell 3000 Index, which represents approximately 90% of the total market capitalization of the Russell 3000 Index.

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.

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.

Russell Midcap® Index measures the performance of the 800 smallest companies in the Russell 1000 Index.

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.

S&P 500 Equal Weighted Index (EWI) includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight - or 0.2% of the index total at each quarterly rebalance.

An index is unmanaged and not available for direct investment.

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