SEG U.S. Equity Report

Q4 2024

SUMMARY

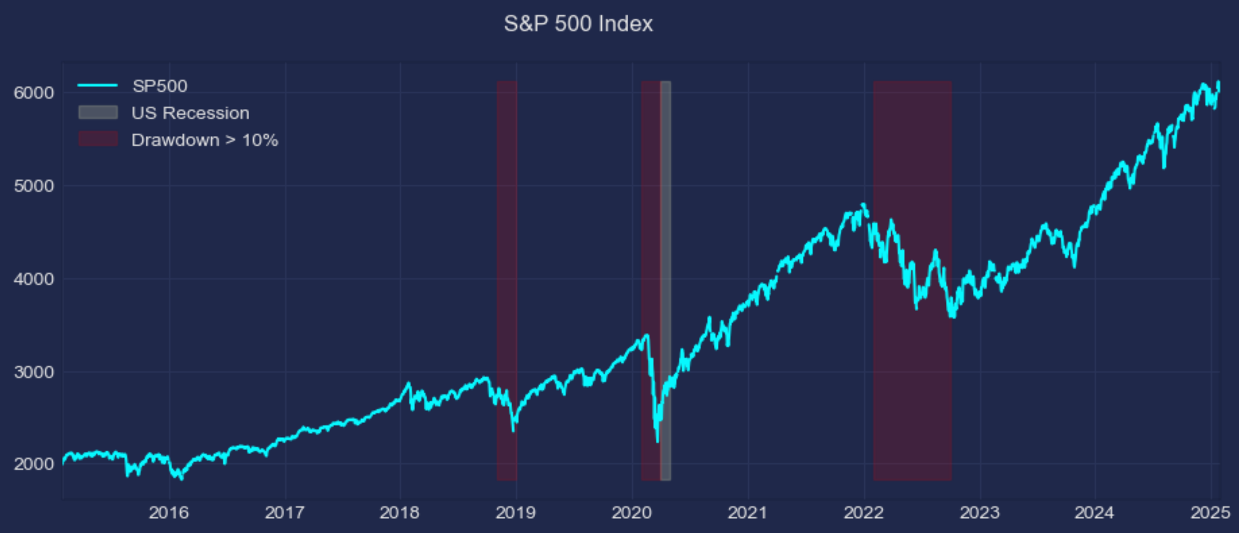
US equities had another solid quarter, but gains were not evenly distributed. US Large Growth equities rose by 8.05%, starkly contrasting with US Large Value stocks, which fell by 2.21%. Over the year, Large Growth stocks soared by 34.32%, far outpacing the 13.87% gain of Large Value stocks. Market breadth was narrow, with Mid-Cap and Small-Cap stocks underperforming. Mid-Cap stocks gained 0.12%, while Small-Cap stocks lost 0.79%. Despite an election, market uncertainty was low until late December when the Federal Reserve's hint at fewer rate cuts for 2025 caused volatility, leading to some profit-taking and a minor market retreat. The expected volatility for the quarter increased by 3.71%, with the VIX up 39.36% over the year. Sector performance was varied; only four of the eleven sectors advanced in Q4. Consumer Discretionary, Financials, and Telecom were the quarter's top performers, with gains of 10.16%, 6.85%, and 6.47%, respectively. Conversely, Materials, Healthcare, and Real Estate sectors saw significant declines, with losses of 13.63%, 10.20%, and 8.67%.

The uneven performance of U.S. stocks has taken the market to unprecedented concentration levels, with the "Magnificent Seven" tech giants (Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta, and Tesla) now accounting for over 30% of the S&P 500's market capitalization. This concentration level is unparalleled in the last 60 years, reflecting the dominance of these mega-cap companies in the market. The impact of this concentration extends globally, with U.S. firms comprising 67% of global market capitalization, mainly due to these tech behemoths. Further, market valuations look rich. While trailing P/E ratios for the largest companies are notably high, forward P/Es are elevated but not at record levels, indicating market expectations of continued growth. Much of this anticipated growth is tied to the success of AI products, with significant AI CAPEX investments by these companies. However, small-cap earnings continue to underperform.

Despite the U.S. economy's projected strength in 2025, high valuations, potential policy changes, and global economic risks warrant caution in the U.S. equity market. This concentration, while reminiscent of bubble conditions, differs from past bubbles due to these companies' technological advantages, scale, high profits, and margins. However, the market's heavy reliance on a small group of firms and the speculative interest in AI, massive CAPEX spending, and crypto markets raise concerns about potential overvaluation and market vulnerability. As a result, investors should approach the U.S. equity market cautiously, considering the possible risks that could alter the current trajectory of economic strength and market performance.

We do see some opportunities in the market. For example, defensive stocks look attractive in relative terms. Stocks in the Consumer Staples sector look particularly appealing to those in Consumer Discretionary. Knowledge—and research-focused healthcare stocks will likely be one of the primary beneficiaries of AI. The technology of LLMs (Large-Language Models) brings the cost of research without having to fork out vast amounts of CAPEX spending. Energy stocks that will supply the electricity to power AI computing will also likely benefit.

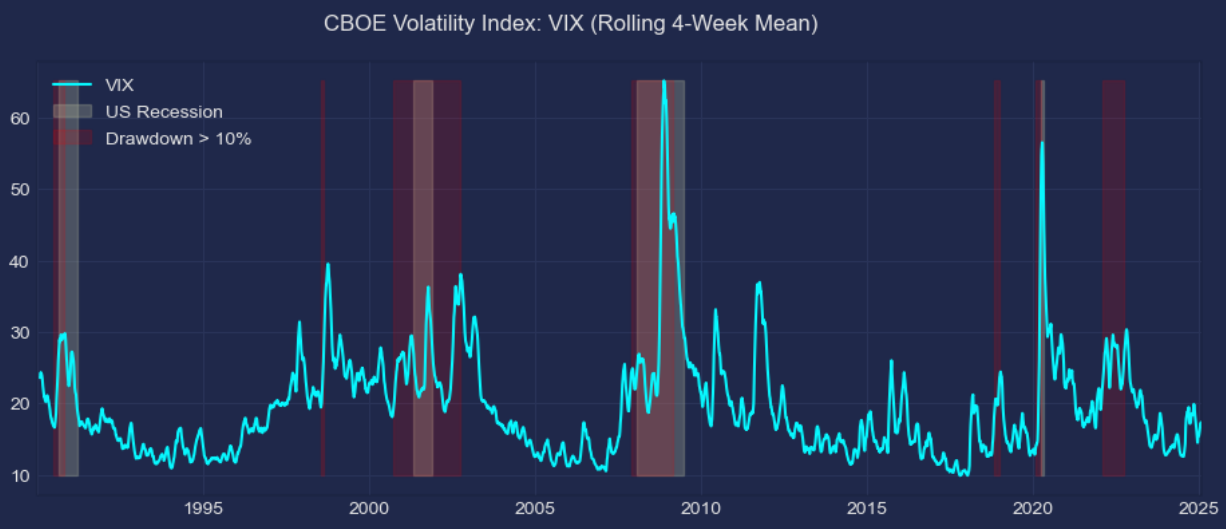
S&P 500 upward march remains intact.



	2024-02	2024-03	2024-04	2024-05	2024-06	2024-07	2024-08	2024-09	2024-10	2024-11	2024-12	2025-01
S&P 500 Monthly Price Return (%)	5.17	3.1	-4.16	4.8	3.47	1.13	2.28	2.02	-0.99	5.73	-2.5	3.16

SEG Research | Data: US Federal Reserve Bank of St.Louis | 1/28/2025

S&P 500 options volatility has ticked up.



	2025-01	2025-01	2025-01	2025-01	2025-01	2025-01	2025-01	2025-01	2025-01	2025-01	2025-01	2025-01
VIX (Rolling 4-Week Mean)	16.72	16.91	17.02	17.11	17.18	17.25	17.3	17.34	17.35	17.32	16.97	16.7

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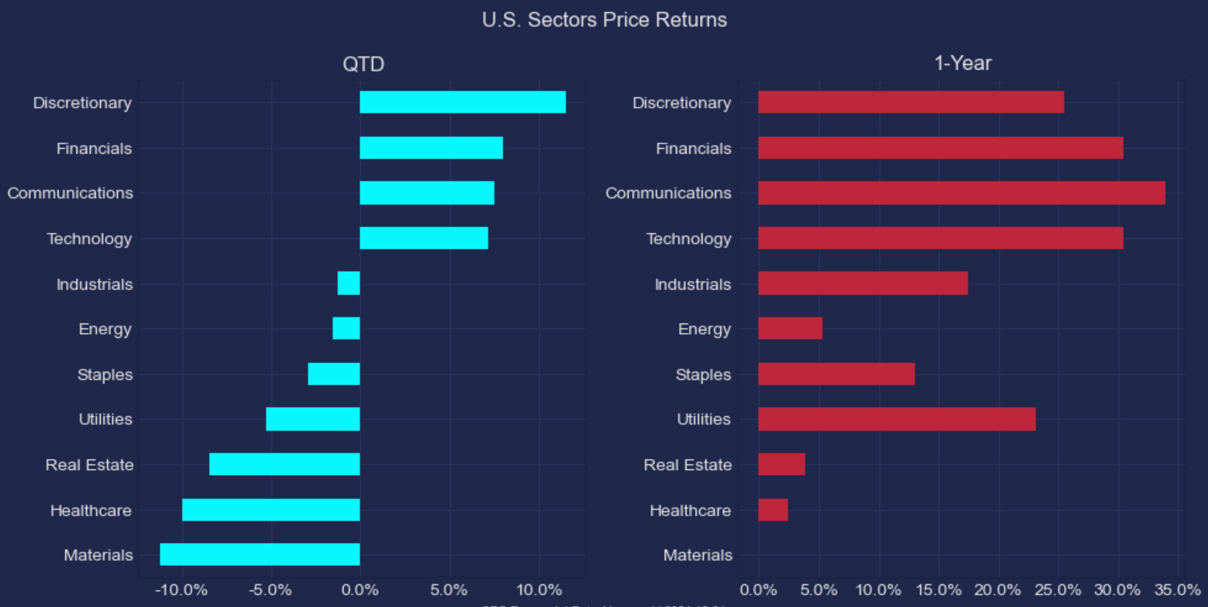
Sector performance was mixed. Some of the worst performers were the defensive sectors, such as consumer staples, healthcare, and utilities. On the other hand, consumer discretionary stocks were the top performers. It appears that the market does not expect an economic slowdown.



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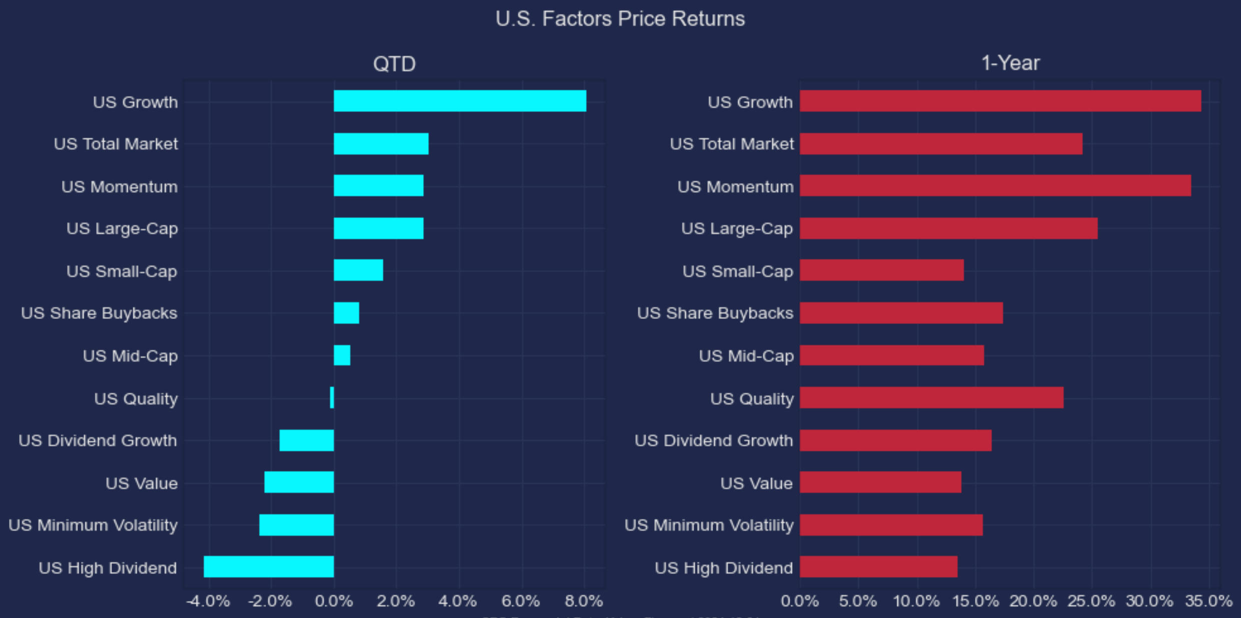
Similarly, the risk-on factors such as growth and momentum outperformed.



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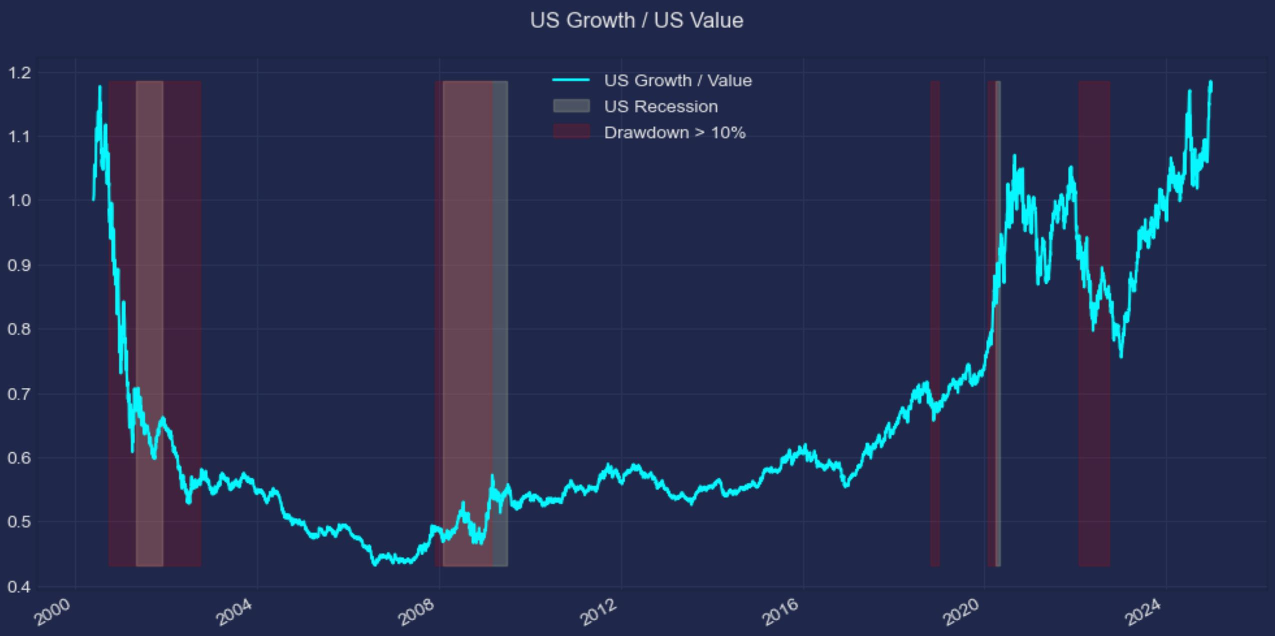
US growth stocks continue to outperform relative to value stocks. We have not seen this type of relative outperformance since the late 1990s tech bubble.



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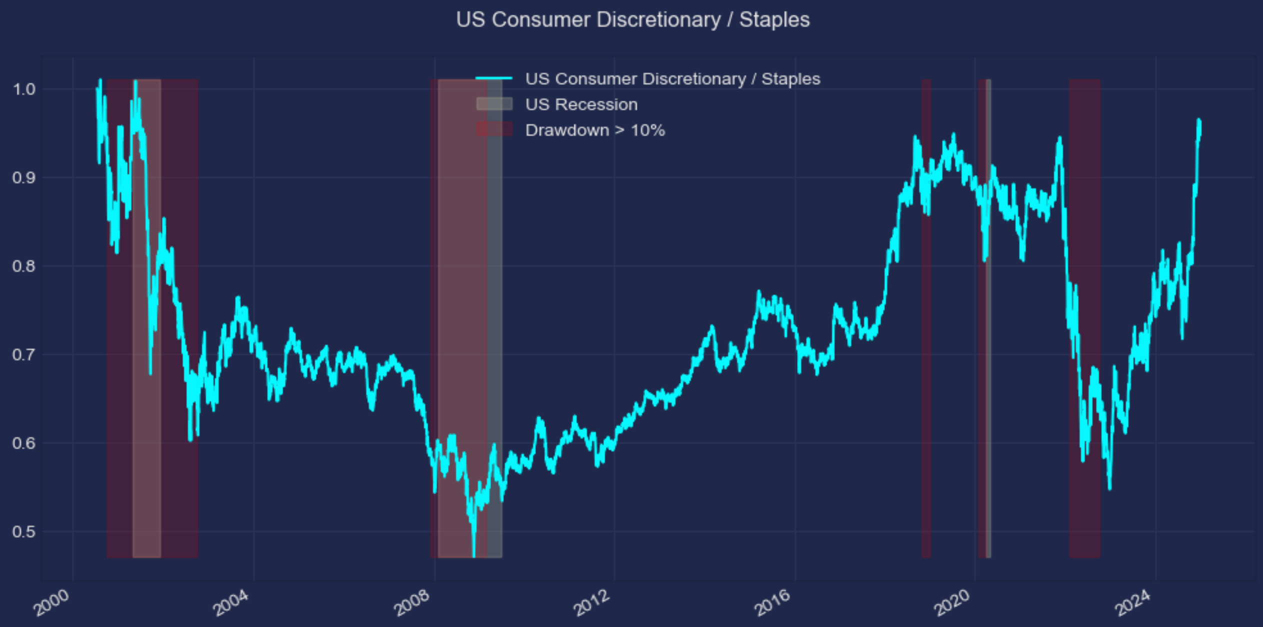
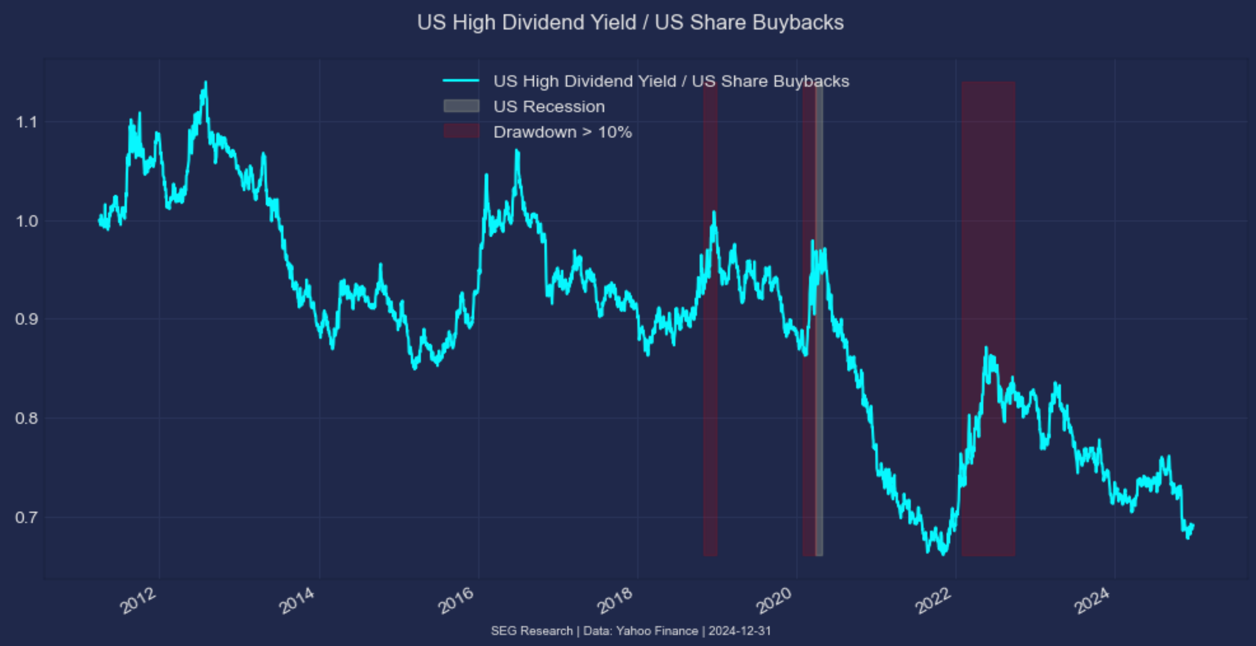
Similarly, consumer discretionary stocks have outperformed consumer staples by a significant margin since the Great Recession of 2008.

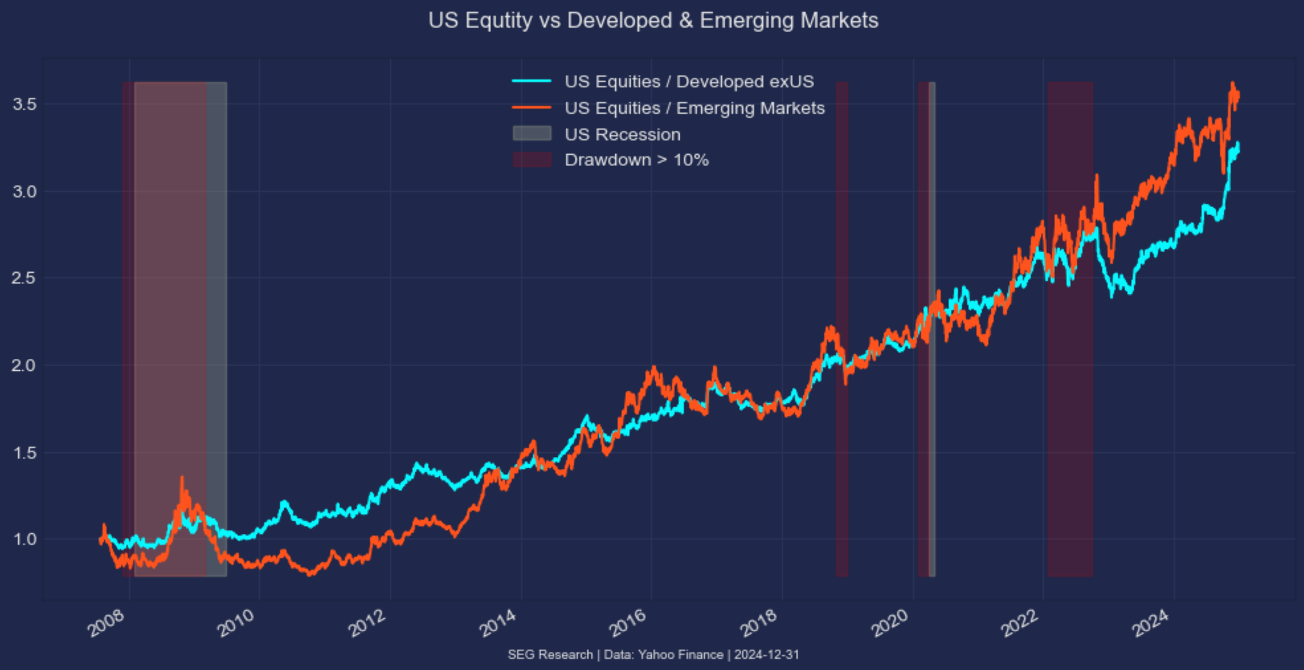


SEG Research | Data: US Federal Reserve Bank of St.Louis | 2024-12-31

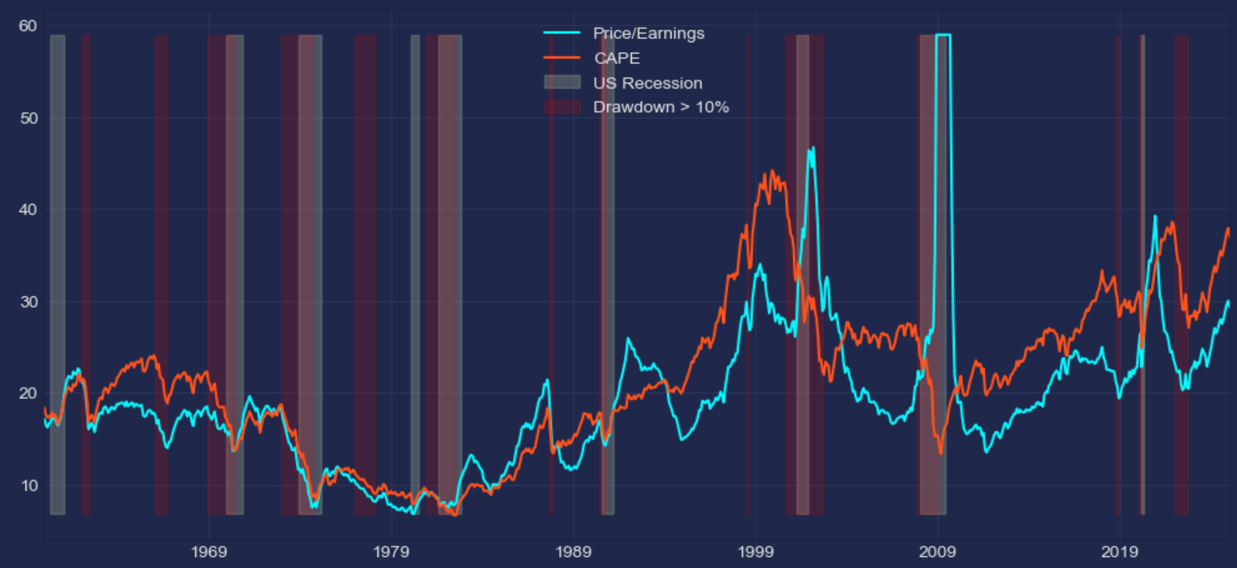
Share buybacks have outperformed high dividend yield stocks.



Since the Great Recession, US stocks have been on an absolute tear relative to other regions.



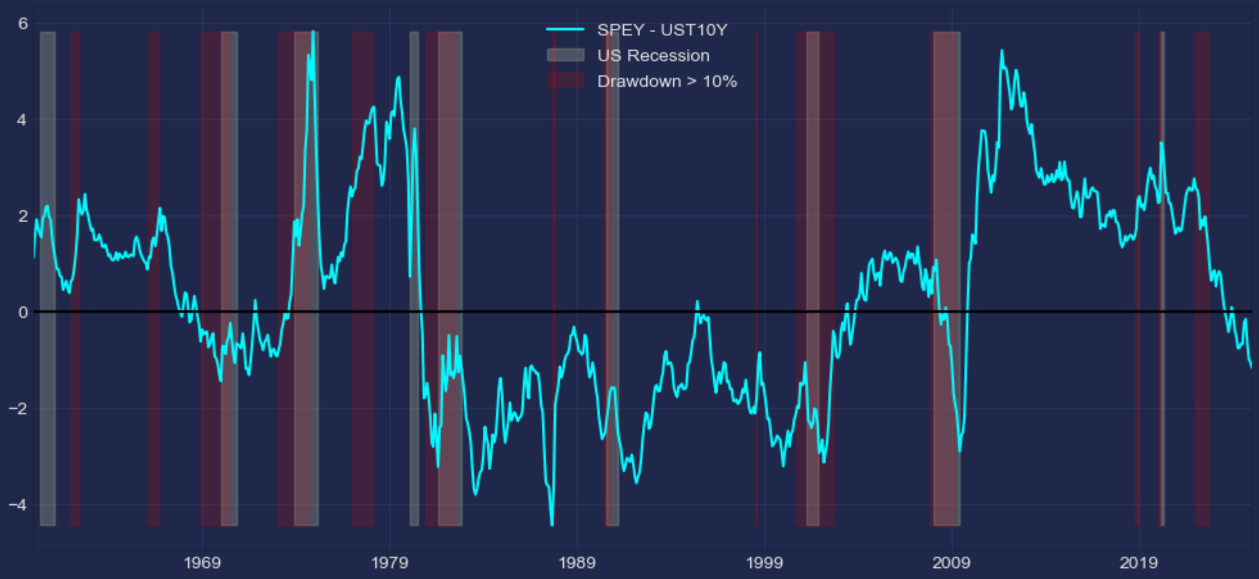
The Price-to-Earnings and the Cyclically Adjusted Price-to-Earnings (CAPE) ratios are elevated.



US Price/Earnings & CAPE Ratio

SEG Research | Data: Shiller Data | 2024-12-31

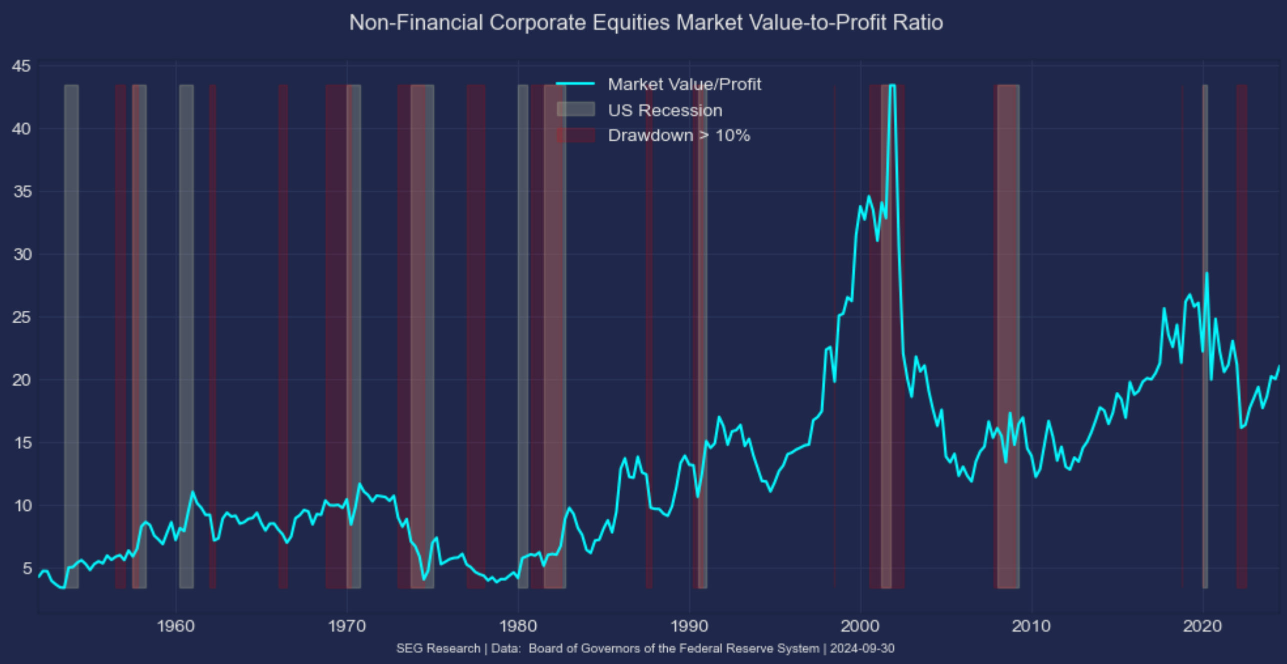
The US earnings yield has moved below the 10-year treasury yield.



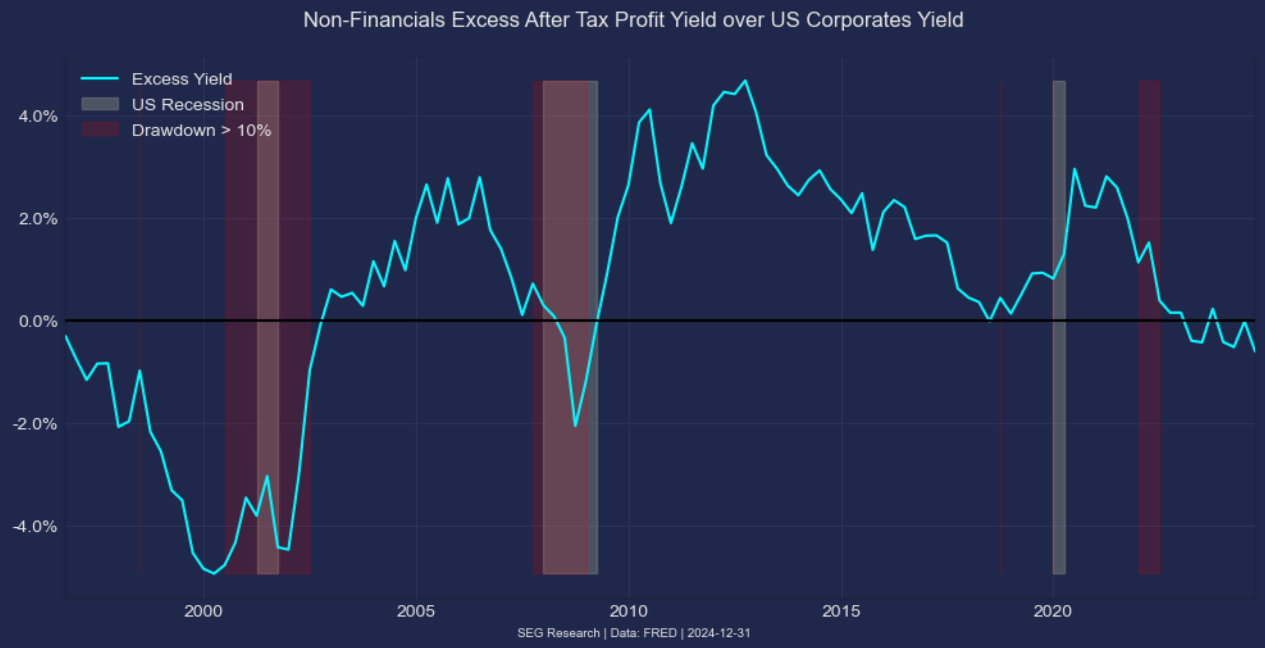
US Earnings Yield minus 10-Year Treasury Yield

SEG Research | Data: Robert Shiller Data | 2024-12-31

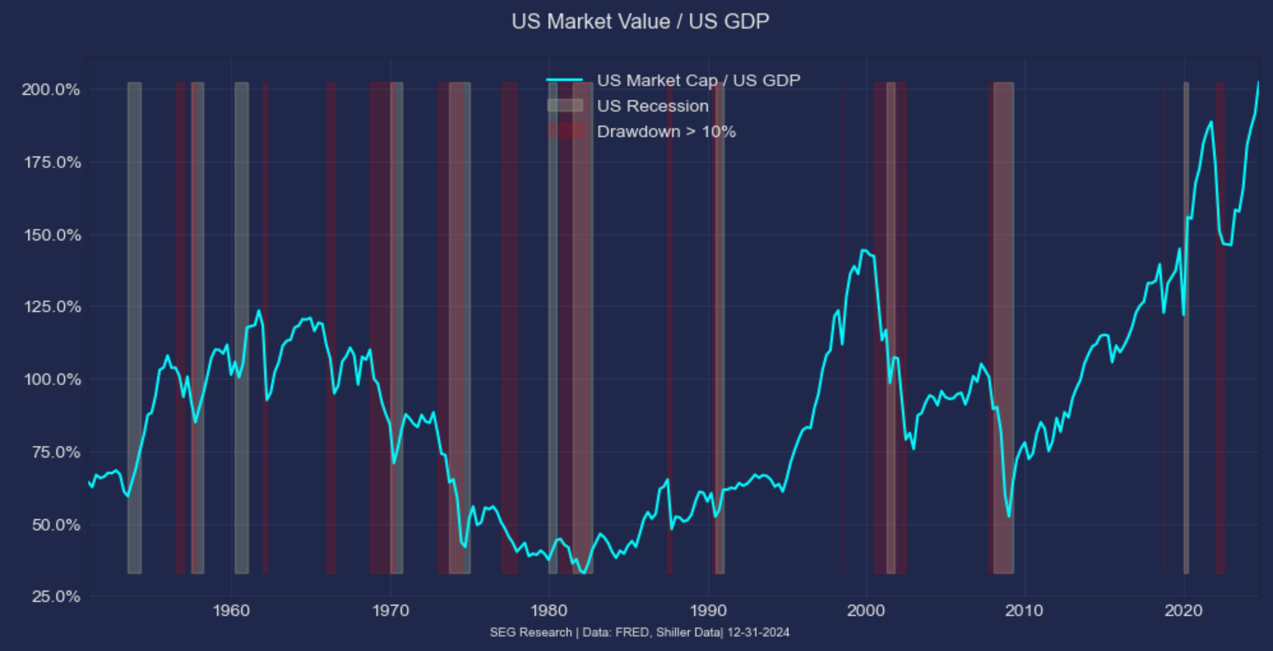
Unlike in the 2000s bubble, US non-financial corporate equities are more profitable.



Similarly, the excess profit yield over corporates is negative but not near the levels seen in the late 1990s.



However, US equity market capitalization is at a record high relative to the GDP. This is only possible because of the US dominance in the global equity market.



We believe that this cycle is driven by CAPEX spending. If we see signs of slower CAPEX spending, we expect the market to correct.