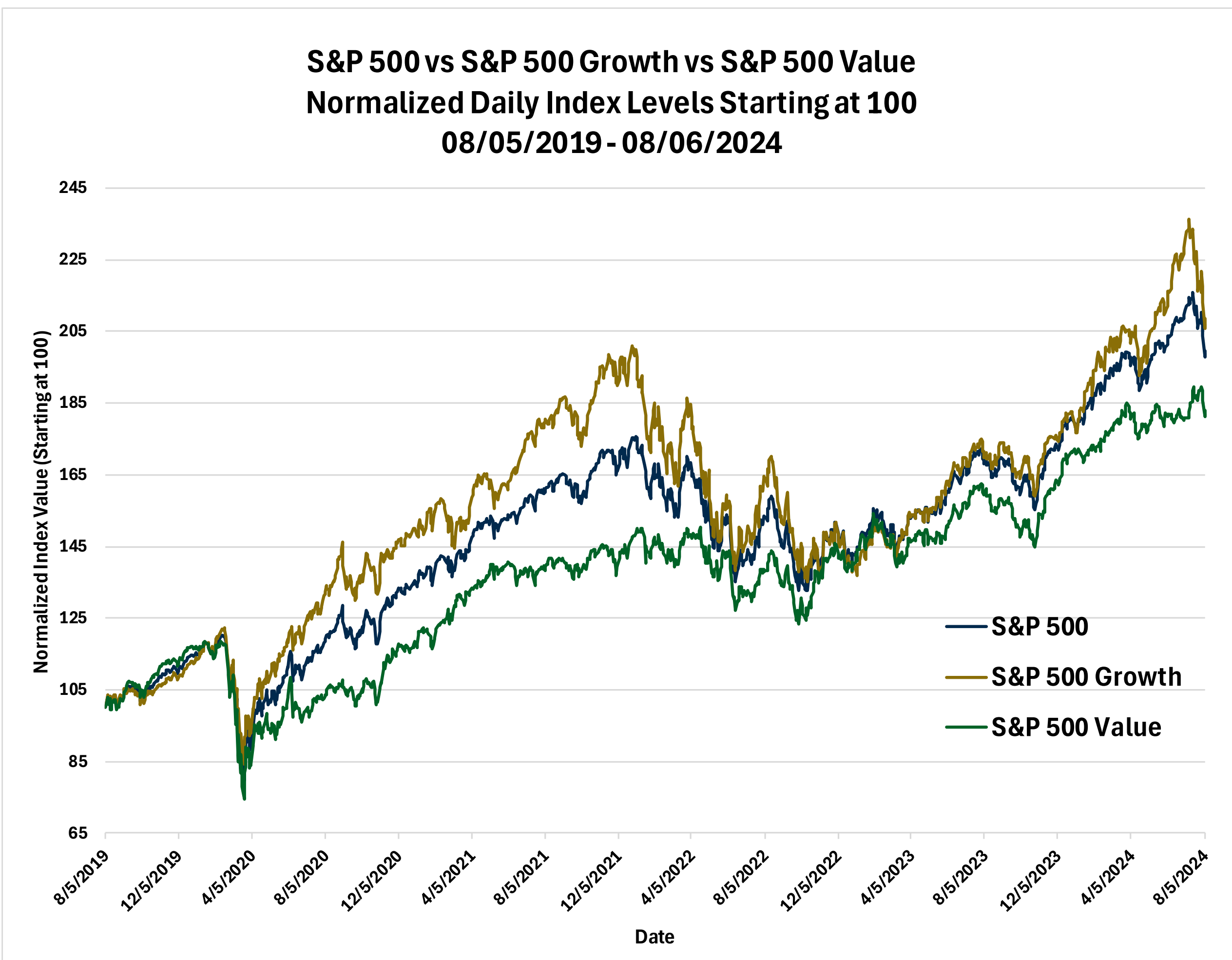
DOES THE S&P 500 HAVE TOO MUCH GROWTH?

Over recent years, market participants have observed that the S&P 500 Index increasingly resembles a growth investment. This shift is primarily due to its market capitalization-weighted structure, which has amplified the influence of growth-centric stocks, particularly the "Magnificent 7" – Microsoft (MSFT), Apple (AAPL), Nvidia (NVDA), Alphabet (GOOG), Amazon.com (AMZN), and Tesla (TSLA). As of April 2024, these seven stocks collectively constituted approximately 30% of the S&P 500 Index.[1]

The daily returns of the S&P 500 and the S&P 500 Growth Index have closely mirrored each other since the 2022 market lows following the broad stock market decline triggered by the Federal Reserve's interest rate hikes to curb elevated inflation.



Data Source: S&P Global
An investment cannot be made in an Index.
Past Performance is No Guarantee of Future Results.

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Over the past year, growth has maintained a relatively high correlation with the S&P 500, whereas value has become less correlated compared to the previous 20-year period. The correlation between the S&P 500 and the S&P 500 Growth Index was 0.94 over the last year, compared to 0.97 over the previous 20 years, remaining steady. However, the correlation between the S&P 500 and the S&P 500 Value Index was 0.89 over the last year, declining from 0.96 over the previous 20 years.

Last 1-Year Correlation S&P 500 vs S&P 500 Growth vs S&P 500 Value

08/01/2023 – 07/31/2024

	S&P 500	S&P 500 Growth	S&P 500 Value
S&P 500	1.00	0.94	0.89
S&P 500 Growth		1.00	0.69
S&P 500 Value			1.00

Previous 20-Year Correlation S&P 500 vs S&P 500 Growth vs S&P 500 Value

08/01/2003 – 07/31/2023

	S&P 500	S&P 500 Growth	S&P 500 Value
S&P 500	1.00	0.97	0.96
S&P 500 Growth		1.00	0.85
S&P 500 Value			1.00

Data Source: Morningstar; Monthly Returns.
An investment cannot be made directly in an Index.
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Notably, the S&P 500 Growth Index and the S&P 500 Value Index are becoming less correlated with each other. The correlation over the past year is just 0.69 compared to a correlation of 0.85 over the previous 20 years.

BTS cautions that if this trend continues, portfolios with core positions that track the S&P 500 Index may continue to become over-exposed to risks specific to growth stocks. Growth stocks, typically characterized by high valuations and expectations of future earnings, may be more sensitive to deteriorating economic conditions and weaker market sentiment. When the economic conditions deteriorate or sentiment sours, growth stocks may suffer more significant declines than their value counterparts.

This over-exposure to growth stocks may pose several risks:

1. **Increased Volatility**: Growth stocks may be more volatile than value stocks. In periods of market downturns or economic uncertainty, growth stocks reliant on leverage and debt may experience larger fluctuations and potential losses.
2. **Earnings Growth Dependency**: Growth stocks may price in strong future earnings scenarios and may trade at high multiples. Any slowdown in earnings growth can lead to price corrections.
3. **Market Sentiment Dependence**: Growth stocks can be reliant on optimistic market sentiment and high investor expectations. If market sentiment shifts or growth projections are not met, these stocks may lose value quickly.

Investing in value stocks, on the other hand, offers several potential benefits:

1. **Lower Volatility**: Value stocks, which are often characterized by lower price-to-earnings ratios and stable earnings, may be less volatile than growth stocks. This may lead to more stable return performance, especially in economic uncertainty.
2. **Income Generation**: Value stocks may be more likely to pay dividends, providing steady income streams for investors. This may be attractive for those seeking regular income from their investments or for those looking to dollar cost average into more shares. Long-term dividends can play an important role in total return.
3. **Defensive Characteristics**: Companies with long track records of strong fundamental performance through prior difficult periods are often categorized as value stocks. These stocks may provide a defensive cushion when markets sell off.

Conclusion:

While growth stocks offer the potential for higher returns, they may also come with higher risks. When investors buy funds that track the S&P 500 Index as a core position, they may believe they are purchasing a well-diversified portfolio that encompasses the entire U.S. stock market and that includes both growth and value investments. This, however, in our view has been disrupted as market participants have increasingly rewarded a small set of growth stocks with strong past performance and strong future earnings potentials. In turn, we believe this has left portfolios disproportionately vulnerable to the risks of growth mentioned above. In our view, a slowdown in the economy or lower expectations of future earnings growth may both result in significant declines in growth-centric stocks compared to value-oriented investments.

An Investor may be able to balance the risks of the S&P 500's over-exposure to growth by allocating to high quality value stocks. This may provide diversified returns in the event of market volatility caused by economic or earnings deterioration.

S&P 500; S&P 500 Growth Index; S&P 500 Value Index Standard Performance

	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
S&P 500	16.70%	22.15%	9.60%	15.00%	13.15%	10.50%
S&P 500 Growth Index	21.95%	26.92%	7.60%	16.30%	14.96%	11.21%
S&P 500 Value Index	10.81%	16.78%	11.01%	12.54%	10.57%	9.39%

*As of 7/31/2024. Data Source: Morningstar; Monthly Returns.**

S&P 500 Inception: 9/11/1989; S&P 500 Growth and S&P 500 Value Inception: 1/3/1994

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Citations:

[1]https://www.investors.com/etfs-and-funds/sectors/sp500-magnificent-7-stocks-dominate-even-more-now/

Disclosure:

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Important Risk Information:

Investing, including investing in mutual funds, involves risk, including possible loss of principal. There is no assurance that any strategy will achieve its investment objective. The value of fixed income securities will fluctuate with changes in interest rates. Defaults by fixed income issuers could also harm performance. Lower quality bonds known as "high yield" or "junk" bonds, present greater risk than bonds of higher quality, including an increased risk of default. An economic downturn or period of rising interest rates could adversely affect the market for these bonds and reduce the Portfolio Manager's ability to sell its bonds. The use of leverage within a strategy will indirectly cause additional expenses and could potentially magnify the gains or losses. Diversification does not ensure a profit or guarantee against loss. Value investing involves the risk that investments made in undervalued securities may not appreciate in value as anticipated or that undervalued securities may remain undervalued for long periods of time.

Definitions:

The S&P 500 is an index that includes 500 leading companies in leading industries of the U.S. economy and is a proxy for the total stock market. Returns shown are total returns with dividends reinvested.

The S&P 500 Growth Index measures constituents from the S&P 500 that are classified as growth stocks based on three factors: sales growth, the ratio of earnings change to price, and momentum.

The S&P 500 Value Index measures constituents from the S&P 500 that are classified as value stocks based on three factors: the ratios of book value, earnings, and sales to price.

Correlation measures how two securities move in relation to one another based on monthly returns.

**Index returns are for illustrative purposes only. Investors cannot invest directly in an index. Unmanaged index returns do not reflect any fees, expenses or sales charges.*

Source: ***Morningstar and Bloomberg (for index returns)***

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