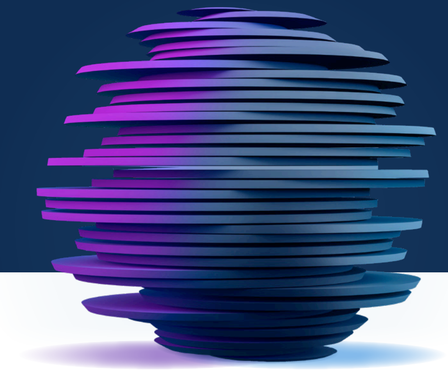
Building better balance



Key themes to consider

"There are plenty of areas worth exploring in the market that may not have taken off yet," said Matt Orton, CFA, Chief Market Strategist at Raymond James Investment Management.

He also believes there are a lot of pockets of value and opportunity within the overall market, and this earnings season can help to illuminate them. He believes the big banks provide a good example: strong earnings bolstered by a rebound in merger and acquisition (M&A) activity was apparently rewarded by investors while companies posting earnings and guidance misses were taken to the woodshed. Going forward, Orton expects this trend to continue across a variety of key themes:

Artificial intelligence 2.0 – Companies in sectors and industries outside of information technology will be critical for realizing the growth and buildout of the AI revolution, Orton said, because the buildout will require massively increased electric generation and capital expenditures. Consider looking to AI over the longer term to drive innovation across the economy, from software to finance to healthcare.

Dividend growers – Dividend growers, as represented by the S&P U.S. Dividend Growers Index, have performed well so far in 2024, especially during the recent correction, when their 1- and 3-month returns outpaced those of the S&P 500 index, as of Aug. 30, 2024. Orton said dividend growth is important to offset inflation elsewhere. Yet he noted that a lot of high-quality companies still trade at low valuations because they tend to be concentrated in sectors where earnings inflections are just starting.

Small caps – Valuations are near historic lows compared to large caps, and the Russell 2000® Index is trading 15% below its all-time high. Earnings expectations remain strong later this year and we're seeing robust M&A activity in small caps, in part reflecting the value that exists. Orton said it wouldn't take much money coming off the sidelines for small caps to move – and move rapidly. Consequently, he said, it's important to be selective and to consider high-quality companies.

Infrastructure – A lot of this is related directly to AI and is expected to drive capital expenditures over the next two years in areas that include electrical equipment, machinery, mining, and materials.

Defense and aerospace – As elsewhere, AI plays a role, but so does heightened geopolitical instability.

Reshoring – Is driving growth in manufacturing and construction in the United States as geopolitical strife fuels deglobalization and underscores the importance of sovereign self-reliance. Abroad, Orton said, reshoring may also benefit India, Mexico, and several other Latin American nations

India and Japan – In emerging markets, Orton has been bullish on India for two years and returned from a recent trip impressed with its opportunity set, growing middle class, young working population, earnings growth, and aggressive infrastructure spending (34 kilometers of highways are being built per day, according to the National Highways Authority of India).

In developed markets, Orton likes Japan's focus on corporate reform, governance, and returning cash to shareholders. Other bright spots: exports, the end of deflation, and pension and central bank reforms. Recent volatility in the country doesn't affect the long-term thesis, he said. Rather, it has simply made valuations cheaper and increased the need for selectivity.

"What ties everything together are these strong secular growth megatrends that underpin the fundamentals of the market and the economy as a whole," Orton said. "It makes sense to think about how to build balance and breadth in your overall portfolio, and there is much to lean into."

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Sector investments are companies engaged in business related to a specific sector. They are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification.

Investing in small cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor. The prices of small company stocks may be subject to more volatility than those of large company stocks.

International investing presents specific risks, such as currency fluctuations, differences in financial accounting standards, and potential political and economic instability. These risks are further accentuated in emerging market countries where risks can also include possible economic dependency on revenues from particular commodities or on international aid or development assistance, currency transfer restrictions, and liquidity risks related to lower trading volumes.

Definitions

Breadth describes the relationship between the median and the mean of a market index. When a few data outliers result in a mean that is substantially larger (or smaller) than the median of the full data set, then the performance of the entire index is being driven by a “narrow” selection of companies. An index supported by “broad” market movements is one where the median is closer to the mean.

Dividend payers are the companies that distribute a portion of their profits to shareholders in the form of a dividend.

An earnings inflection marks a sudden change in the direction and rate of change of earnings growth. Earnings inflections can lead to either positive or negative change.

Growth investing is a stock-buying strategy that focuses on companies expected to grow at an above-average rate compared to their industry or the market.

Guidance refers statements from the managers of publicly traded companies that indicate whether they expect to realize near-term profits or losses and why.

Market capitalization, or market cap, refers to the total dollar market value of a company’s outstanding shares of stock.

A megatrend is a widespread and long-term macroeconomic, technological, social, environmental, political, or other change that may develop slowly at first but that has a major, ongoing impact once it gets underway. Megatrends are distinct from smaller trends in business, economic, or other spheres of activity that have less far-reaching or enduring effects.

A miss is when a company’s reported earnings or other business results fall short of pre-release estimates or are worse than the expectations of analysts and others who follow the company’s stock.

Quality investing is a strategy that seeks to invest in companies with low debt, stable earnings, consistent asset growth, and strong corporate governance, as reflected in financial metrics such as ratios of return to equity and debt to equity, as well as to earnings variability.

Reshoring describes the effort to bring manufacturing and other services back to the United States from overseas operations. Secular stocks are characterized by having consistent earnings over the long term constant regardless of other trends in the market.

Secular companies often have a primary business related to consumer staples most households consistently use whether the larger economy is good or bad.

Index

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 7% of the total market capitalization of the Russell 3000® Index.

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The S&P U.S. Dividend Growers Index is designed to measure the performance of U.S. companies that have followed a policy of consistently increasing dividends every year for at least 10 consecutive years. The index excludes the top 25% highest-yielding eligible companies from the index.

The S&P 500 Index measures change in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 80% of the investable U.S. equity market. Individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance.

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