Goodbye Bear, Hello Bull....Now the Rest of The Story

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The Bear Market that began in 2022 appears to be in the rearview mirror, so what type of stock market have we seen since the beginning of 2023? So far, in 2023, what we have seen comparing the overfocused on S&P 500 and Nasdaq to broader measures of the equity market is akin to a mirage. The divergence in performance between the Nasdaq, S&P 500, and Dow Jones Industrial Average has been stark. Looking more closely, the performance variance between these major indices has been driven by stark asset class and market capitalization performance differences.

Index/Asset Class/Market Cap	YTD (1/1/23 to 5/30/23) Performance
S&P 500	9.65% *
Nasdaq	23.60% **
Dow Jones Industrial	- 0.72% *
S&P 500 Technology	33.95% *
S&P 500 Financials	-6.77% *

*S&P Global/Dow Jones

**Nasdaq

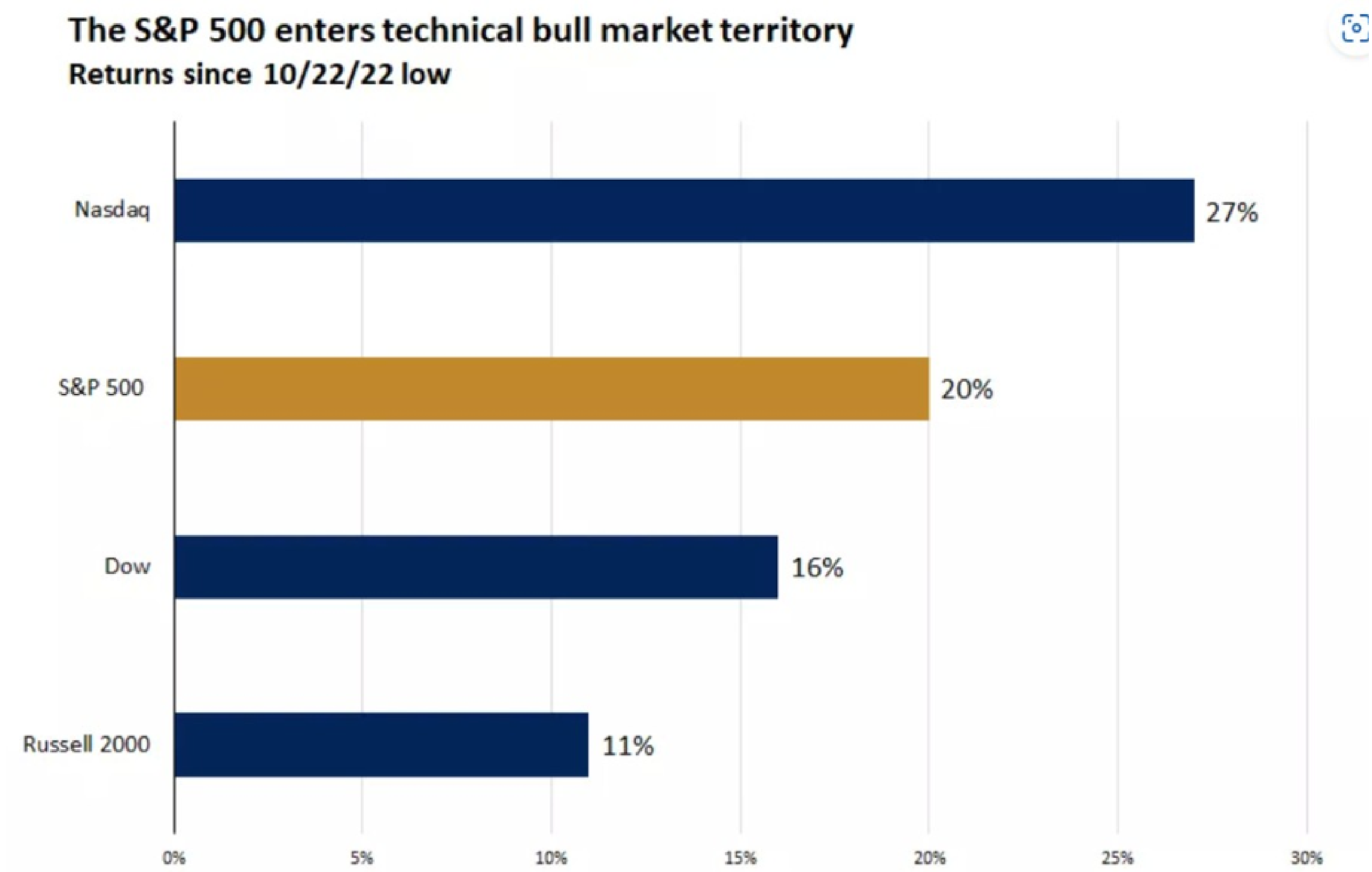
Individuals cannot invest in an index.

The first five months of 2023 present a stark case of "have and have not" performance by industry sector, size, and style. Large Capitalization technology, particularly that handful of mega-cap technology company stocks, advanced over three times that of the broad S&P 500 and outperformed the worst-performing sector, Financials, by nearly 40%.

In the illustration below, produced by Calamos Investments, one can see the significant divergence in five-month performance between company size and investment style (growth, core, and value).

As of	YEAR-TO-DATE		
6/1/2023	VALUE	CORE	GROWTH
LARGE	-1.43	9.30	20.76
MID	-3.17	0.61	7.62
SMALL	-5.04	-0.04	4.86

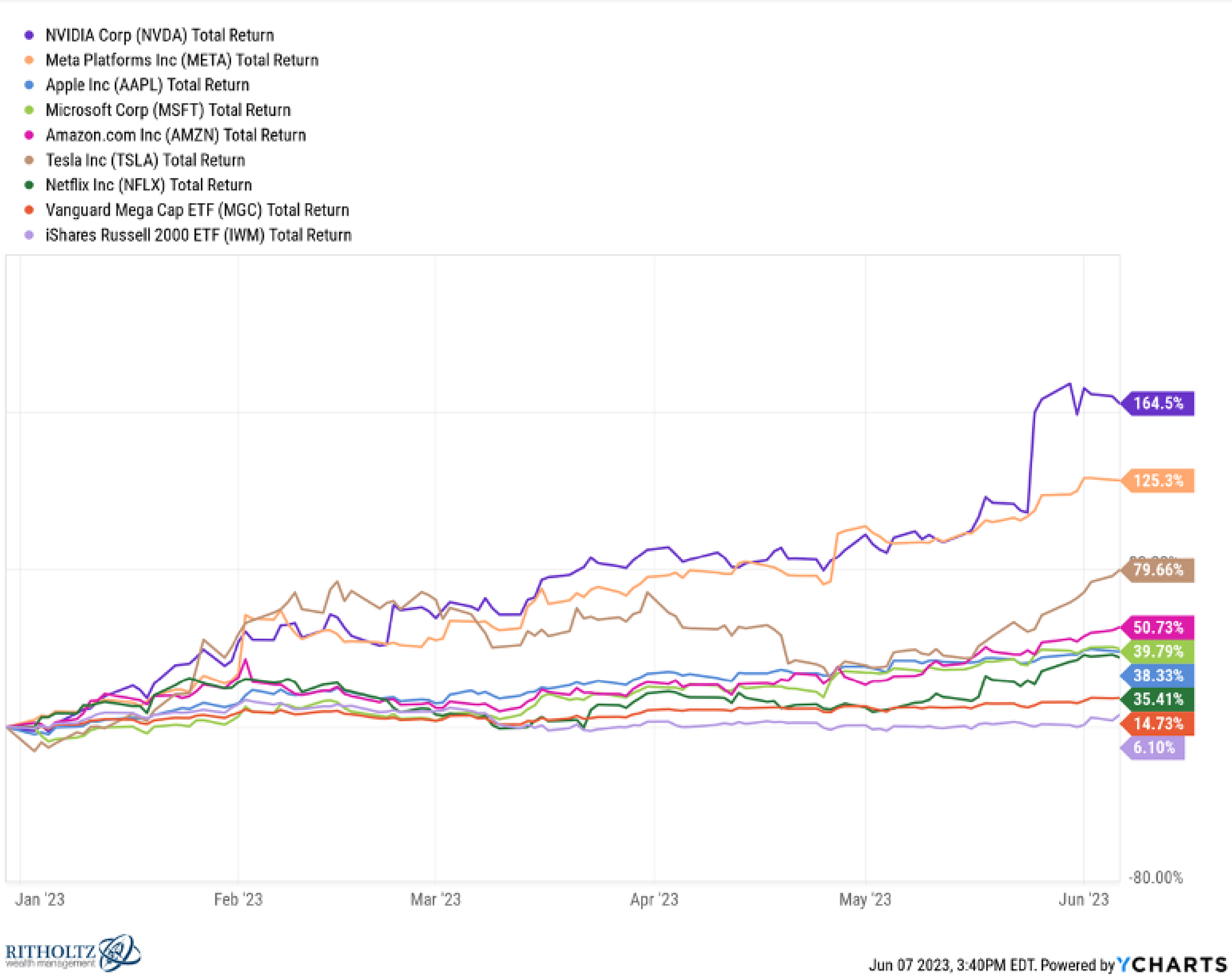
Since the end of May, the S&P 500 technically emerged from its Bear Market that began in early 2022. But in keeping with the theme of this commentary, the S&P 500 does not tell the whole story. See the illustrations below, the first provided by Syz Group, which better illuminate those parts of the market that pushed the S&P 500 into Bull Market territory and those of the market that are still digging out of last year's Bear Market.



Source: Bloomberg

As you will see below, a handful of the very largest technology and communications services companies listed on the Nasdaq exchange had explosive moves higher this year, and all of those companies are large contributors to the market capitalization-weighted S&P 500. Those small number of multi-hundred million dollar or even multi-trillion-dollar companies which drove both the Nasdaq returns and S&P 500 returns so far in 2023 are not disproportionately represented in the Dow Jones Industrial Average and are completely absent from the Russell 2000 index of small and mid-sized companies.

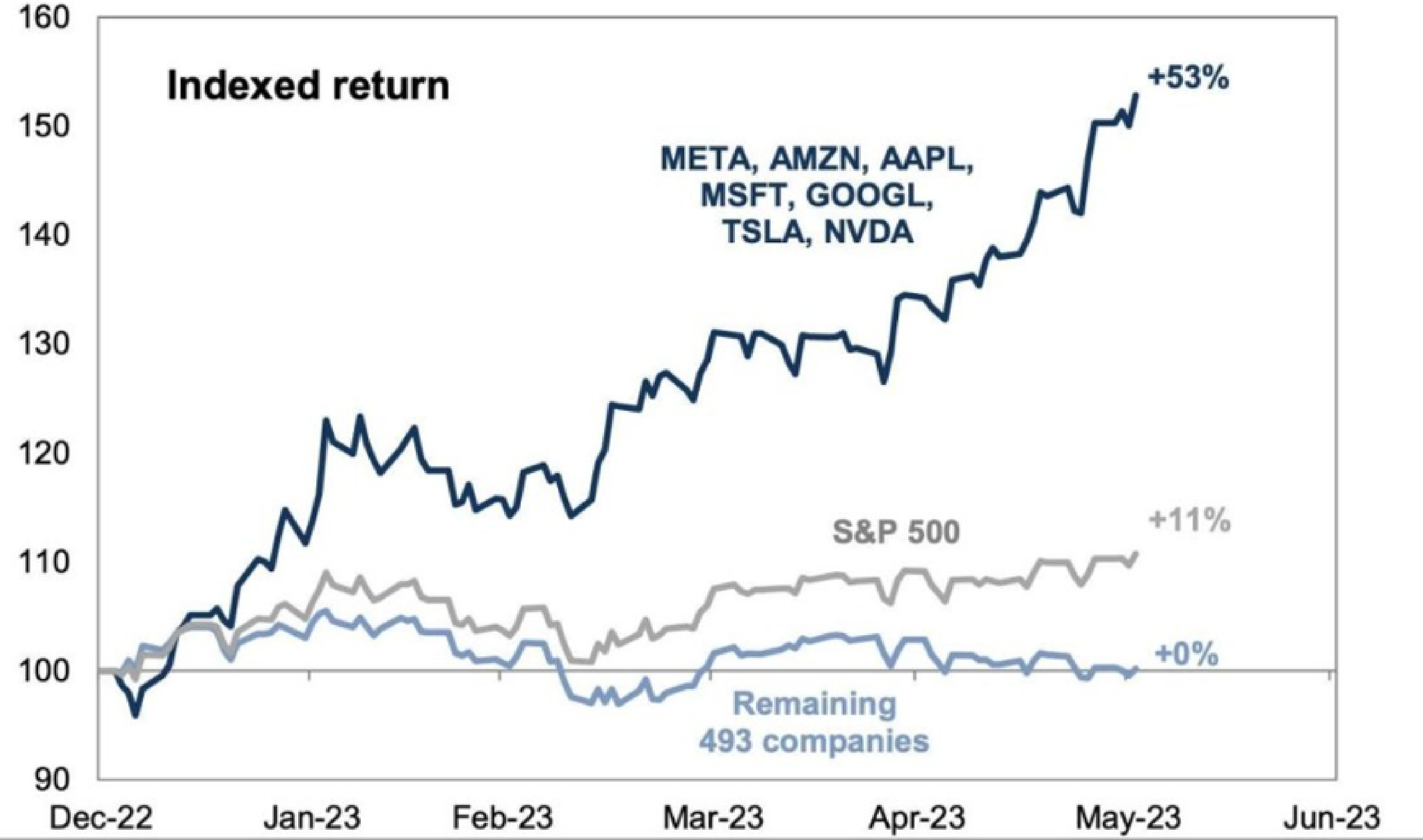
The chart below was produced by Ritholtz using data from YCharts and shows the stark performance divergences discussed above at the individual stock level of Mega Cap Technology and Communication Services companies versus the broad small-cap benchmark, the Russell 2000:



To put a “cherry on top” of this discussion, Syz Group provided another fascinating graph that illustrates that simply looking at top-line index average returns can be and currently is extremely misleading if one does not know what goes into calculating such top-line numbers and just how distorted a market cap-weighted index returns can be by the performance of a very small number of very large constituents:

Exhibit 2: Mega-cap tech has led the market higher YTD

as of June 1, 2023



Source: FactSet, Goldman Sachs Global Investment Research

The fact that the S&P 500 has technically begun a new Bull Market is important because it is the index most synonymous in the minds of investors of the “market.” So, one can accurately say that we are in a new Bull Market, but that is not the whole story. As shown in the preceding charts and illustrations, large market segments remain solidly in a Bear Market.

Understanding how market performance is calculated and how individual sectors, investment styles, asset classes, and specific stocks impact a given index return is not a straightforward and easy-to-comprehend process. We frequently field clients' questions regarding account performance and how it compares to what the broad markets do at any given time. As illustrated above, such questions often have complex answers. Our initial qualification when fielding such questions is that our discipline and process do not attempt to manage correlations with any particular market index. Beyond that process qualification, the answer to questions comparing the performance of an account to the broad market boils down to the security composition of an account from a market capitalization size and industry constituency standpoint versus what the material outperforming factors within an index that was driving performance during a given period.

We are pleased that the broad S&P 500 has exited the longest Bear Market since 1948. We are very aware that the segments of the broad market that powered the 20% plus appreciation of the market cap-weighted index are very narrow and concentrated. Thus, we continue to see significant opportunities for many of our holdings and new ideas to appreciate significantly in the coming months and years. We expect continued positive returns from the broad market through the end of 2023. If we get, as we expect, modest rate cuts from the Federal Reserve by the end of 2023 to bring real rates down in response to inflation levels between 2.50% and 3.00%, we should see continued bullishness in the equity markets into 2024. From a Yahoo Finance article titled, The S&P 500 has entered a bull market. Here's what history says will happen next, "research from Bank of America indicates the S&P 500 rises 92% of the time in the 12 months following the start of a bull market, compared to the historical 75% average over any 12 months dating back to the 1950s."

One last comment on "the market" and a common error many investors make. For many investors, the market is the S&P 500, and a gauge of whether or not "the market" is under-valued, over-valued, or under-valued at a given period is the P/E ratio of the S&P 500. Much has been written about how the market cannot continue to advance this year because its P/E ratio is higher than its historical average, which has, since the Great Financial Crisis, been around 18X earnings. Current measures of the S&P 500 forward P/E ratio, which varies by whose current year earnings estimates are used, is nearly 19X. As an active manager of predominately individual company stocks, the P/E ratio of a market-cap-weighted 500 company index is almost meaningless. A peer of mine, whom I regularly consult with on market-related matters, Shaun Rowles of UBS, wrote in his June 9, 2023, commentary titled The Rowles Report the following:

Let us first examine the evolution of earnings for the S&P 500 as published by Howard Silverblatt of S&P Global. As we can see in the chart below, current estimates for EPS (Earnings per Share) for the S&P 500 are currently at $218.29. Frequent readers will note that this is an increase from prior projections just two months ago.

OBSERVATION	Q1 2023	Q2 2023	Q3 2023	Q4 2023	2023E	2024E	PRICE	2023E P/E	2024 P/E
3/31/2022	$57.09	$60.74	$63.50	$65.46	$246.79		4530.41	18.36	
6/30/2022	$58.79	$60.94	$63.80	$65.48	$249.01		3785.38	15.20	
9/30/2022	$56.75	$58.97	$60.45	$62.37	$238.54		3585.62	15.03	
12/30/2022	$53.36	$55.89	$58.09	$59.15	$226.49		3839.50	16.95	
3/31/2023	$50.16	$53.78	$56.49	$57.95	$218.38	$245.35	4109.31	18.82	16.75
Current	$52.53	$52.79	$55.63	$57.34	$218.29	$244.47	4267.52	19.55	17.46
Change QTR	4.72%	-1.84%	-1.52%	-1.05%	-0.04%	-0.36%	3.85%	3.89%	
Change fr Q2,'22	-10.65%	-13.37%	-12.81%	-12.43%	-12.34%		12.74%	28.60%	

Howard Silverblatt S&P Global June 7th, 2023.

Based on these projections, the market is currently trading at 19.55 P/E (price to earnings) which may seem high relative to the historical average of 16.01 (as reported by Multpl 6/9/23). But if we look closer, a funny thing happens.

The estimates for the S&P 400 for calendar year 2023 are $167.86, which suggests that the current P/E level for the 400 smallest companies in the S&P 500 index is currently trading at 15.07, which is by no means an outrageous price multiple. What does that mean?

I read what Shaun wrote, and it reinforced what I see in our portfolios. Small-sized domestic publicly traded companies are coming out of last year's Bear Market as inexpensive as I have seen them since the

Great Financial Crisis. As active equity managers, we were very optimistic because of just how inexpensive many of our most widely held stocks are; however, with the valuation data that Shaun points out, he validates our view.

Disclosure:

Advisory services are offered through CS Planning Corp., an SEC-registered investment advisor.

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1 The Standard & Poor's 500, or simply the S&P 500, is a stock market index tracking the performance of 500 large companies listed on stock exchanges in the United States. It represents the stock market's performance by reporting the risks and returns of the biggest companies. Investors use it as the benchmark of the overall market, to which all other investments are compared.

2 The NASDAQ Composite Index is a large market-cap-weighted index of more than 2,500 stocks, American depositary receipts (ADRs), and real estate investment trusts (REITs), among others. Along with the Dow Jones Average and S&P 500, it is one of the three most-followed indices in US stock markets. The composition of the NASDAQ Composite is heavily weighted towards information technology companies.

3 The Dow Jones Industrial Average (DJIA), also known as the Dow 30, is a stock market index that tracks 30 large, publicly-owned blue-chip companies trading on the New York Stock Exchange (NYSE) and the Nasdaq.

4 The Russell 2000 index is an index measuring the performance approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest US stocks. The Russell 2000 serves as a benchmark for small-cap stocks in the United States.

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