

MARKET MINUTE

WITH MCGAREL



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Past performance is no guarantee of future results.

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The **Russell 1000® Growth Index** measures the performance of the large-cap growth segment of the U.S. equity universe. Investors cannot invest directly in an index. The **Russell 1000® Value Index** measures the performance of the large-cap value segment of the U.S. equity universe. **Forward Price-to-Earnings (P/E)** is the price of a stock divided by estimated forward earnings. **Relative Earnings Contribution** measures the difference between a sector's contribution to 2024 forecasted earnings and its weight in the index.

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There is no assurance any forecasts will be achieved.

Which growth stocks?

While Warren Buffett gets all the credit, his right hand man, Charlie Munger, who passed away on November 28th at age 99, is credited with convincing Buffett to not only purchase companies that were priced cheaply but also consider buying companies with “wonderful businesses selling at reasonable prices.” In effect, Munger was telling Buffett that paying more for quality growth stocks can be an attractive opportunity. We heartily agree.

While we continue to prefer an overweight to value stocks over growth stocks based on a historically outsized valuation gap between the two styles [Chart 1], there is plenty of room in our stock allocation for growth stocks. The simple way we look at growth stocks is to focus on earnings growth and steer our exposure to sectors with good earnings growth at attractive valuations.

At the beginning of 2022, those “wonderful businesses selling at reasonable prices” were difficult to find as the zero interest rate environment and the fear of missing out (“FOMO”) trade that dominated 2021 made growth stocks exceptionally expensive no matter where you looked. Even this year, it’s been the Magnificent 7 (Apple, Microsoft, Amazon, Google, Nvidia, Meta, and Tesla) trade that has garnered almost all the growth returns while the rest of the growth trade has trailed those names significantly.

We all can be captured by great past performance but investors should always focus on tomorrow’s returns and opportunities. And, in our view, the dominance of the Magnificent 7 this year has left behind some growth stories with attractive earnings power and good relative valuations that present some of the best opportunities in the market today.

What may surprise investors is that it is not just a technology story. The Magnificent 7, which are all tech or tech plus companies, have conditioned investors that technology is synonymous with growth and is the only game in town for growth stocks. In fact, all 11 sectors in the Russell 1000® Growth Index have growth stories.

And looking at the Russell 1000® Growth Index, the sectors expected to overearn their weight in the Index with above market growth in 2024 are communication services, financials and health care [Chart 2]. Outside of communication services (over 93% of its weight is in GOOG/GOOGL, META and NFLX), these may not be your traditional growth sectors. In our view, multiple expansion, which drove growth returns this year, will be replaced by actual earnings growth powering returns in the new year. The technology and consumer discretionary sectors are forecast to have above average earnings growth in 2024, however their high valuations indicate they will underearn their expected contribution to the Index. The combined 2024 forward price-to-earnings (P/E) multiple of communication services, financials and health care is 22x versus the combined forward multiple of information technology and consumer discretionary of 31x.

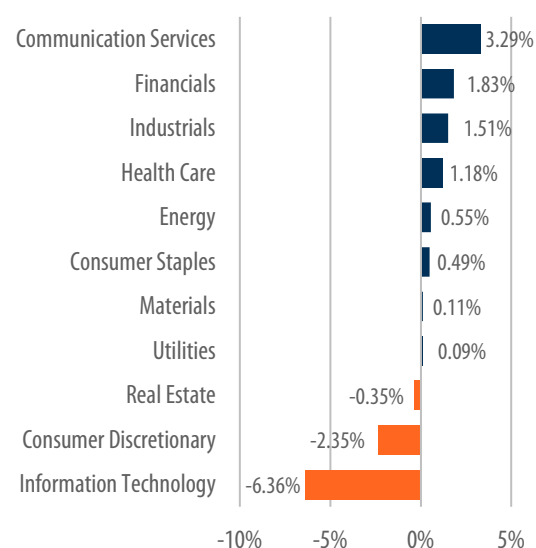
Even as we view a 60/40 value to growth allocation as appropriate at the style level in the current environment, we certainly want to own growth stocks! Our preference is to focus on the cohort of growth stocks that have the most attractive relative earnings growth at a good valuation. Increasingly, it appears those opportunities reside in communication services, financials, and health care despite the recent focus on the technology sector.

Chart 1: Russell 1000® Growth vs. Value Index Forward P/E



Source: Bloomberg. Data from 6/29/01 - 11/30/23.

Chart 2: Russell 1000® Growth Index 2024 Estimated Relative Earnings Contribution



Source: S&P Capital IQ. Data as of 11/30/23.