Market Breadth

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Last Week's S&P 500 Index:
-2.1%

Key takeaways

- *Market Breadth is an important indicator that helps investors understand where we are in the cycle.*
- *Breadth has tended to narrow as the stock market approaches its ultimate cycle peak. This can play out over a 12-24 month period.*

With the coronavirus and fourth-quarter earnings taking up most of the financial market conversation bandwidth over the last couple of weeks, we thought it might be interesting to shift gears for a bit and take a look at something else. Do note that the coronavirus was discussed last week in this piece ("Demand"), and what was anticipated to be, overall, not a very exciting earnings reporting season has lived up to expectations with earnings per share (EPS) showing just 0.3% growth thus far versus the year-ago period with 45% of the S&P 500 reporting.

There has been much discussion and debate over where we are in this economic cycle. From our perspective, we are likely in the final one-third of the cycle but believe the modest-growth/modest-inflation environment we have been living with has a good chance of continuing over the course of at least this year. While the probability of a recession occurring at some point in 2020 is not zero, we do believe it is low. Given that, we recommend that investors remain fully invested in a diversified portfolio. From current levels to the midpoint of our 2020 year-end target range for the S&P 500 suggests a gain of just over 6%, excluding dividends.

One of the traits typically exhibited by the stock market as the major indices track toward their eventual ultimate highs of the cycle is a narrowing of breadth. In other words, fewer and fewer stocks tend to lead the market higher. Most of the time, it's the biggest of the large-cap growth stocks (i.e., S&P 100-type issues) that are at the forefront of a final charge that may play out over a 12-24 month period. Times of stress traditionally also result in the largest-cap growth names leading, resulting in the S&P 500 Index (SPX) outperforming the S&P Equal Weight Index (SPXEW) as money flows toward the shares of what are typically perceived to be more dependable and less risky companies. That has been the case since the coronavirus became a daily topic over the last two weeks or so. But two weeks doesn't necessarily mean a new trend is in place.

In actuality, the performance differential between the SPX and SPXEW started to slightly widen last year around the beginning of November. Prior to that, and for a number of years, the performance differential typically favored the SPX by around 2% in any given 6-12 month timeframe. But this differential has still been well below those seen prior to the March 2000 SPX top or the March 2002 SPX highs that preceded meaningful bear markets. It makes sense to us that for a period of time surrounding coronavirus uncertainties that money would flow to larger-cap, more dependable companies. But given our macroeconomic outlook, we believe this is more of an aberration than the start of a noticeable trend.

The performance differential between the SPX and the SPXEW is an indicator that we are watching closely. It is one part of the cycle puzzle that we try to piece together on a regular basis. It is likely that as the market moves at some point toward the final top in this cycle breadth will narrow quite noticeably. For now, the differential is not sending negative signals, and we continue to look for a positive return for stocks this year.

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All investing involves risks including the possible loss of principal. Equity securities are subject to market risk which means their value may fluctuate in response to general economic and market conditions and the perception of individual issuers. Investments in equity securities are generally more volatile than other types of securities.

Definitions

An index is unmanaged and not available for direct investment.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

S&P 500® Equal Weight Index (EWI) is the equal-weight version of the widely-used S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight - or 0.2% of the index total at each quarterly rebalance.

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