Heartwood
Investment Management

02 June 2017

Investment Insight

Weekly Insight

The S&P 500: Appearances can be deceptive

Having edged to a new record high again this week, it is inevitable that investors are typically viewing the S&P 500 Index as overvalued. However, all might not be as it first appears.

It is telling that nearly half of this year's overall return of the S&P 500 has been driven by just ten stocks, mainly from the internet and software industries. These include index heavyweights Apple, Amazon, Facebook and Microsoft. The top ten contributors trade on a forward price-to earnings ratio of 23 times, effectively distorting and raising the overall valuation level of the S&P 500.

More broadly, growth stocks are now trading at their highest premium to value stocks since early 2016. Much of their outperformance has been driven by investors reallocating into technology funds from other sector funds. This trend has coincided with a period (since March) of falling interest rates, falling oil prices and fading expectations of US fiscal easing. In consequence, value stocks' underperformance has been led by energy, telecommunications and financials. It is no surprise that US bank stock prices have suffered as the US treasury yield curve has reversed its post-election steepening trend, where ten-year interest rates have declined more than two-year interest rates. Indeed, a few of the major US bank stock prices are hitting bear market territory (commonly seen as a 20% fall) from their post-election peaks.

With the value/growth differential widening again this year, we believe there are pockets of opportunities within the US equity market. Based on the assumptions that (1) US corporate profitability continues to improve; (2) economic conditions remain supportive and (3) any announcement of future policy action by the Trump administration is enough to support sentiment (given expectations are now so low), then we would expect to see these value areas of the market recoup some of the losses suffered as the 'reflation trade' has unwound.

Michael Stanes
Investment Director

Clear Thinking

Contact

To find out more about the Heartwood strategies, visit our website or contact your local representative.

Important Information

Registered Head Office: No.1 Kingsway, London, WC2B 6AN | Registered in England Number: 4132340
020 7045 2600 | heartwoodgroup.co.uk | Part of the Handelsbanken Group