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# Are the Magnificent Seven losing momentum?

Slowing earnings growth, regulatory rulings, and a shift in leadership suggest change may be on the horizon



For the past 18 months, one question has dominated conversations about the U.S. equity market: How much longer can the Magnificent Seven continue to outperform? No one can say for sure, and while it's true that cracks are potentially beginning to show in the fundamentals of these tech-related mega caps, predicting a market top has always been a murky business.

A few things are clear, however, and worth noting. The first is the sheer magnitude of the largest companies' outperformance of the broader market: The Magnificent Seven have generated nearly 60% of the S&P 500 Index's return year to date through June; in 2023, that figure was 62%. The performance disparity between these few stocks and the rest of the market has been so severe that the Magnificent Seven now represent more than 30% of the S&P 500 Index—and that's after accounting for a recent drawdown. Within growth stocks, the imbalance is even more exaggerated: Just three stocks in the Russell 1000 Growth Index represent one-third of the index.

## 1972-1973 Nifty Fifty

Year	S&P 500 performance	Equal-Weighted S&P 500 performance
1972	▶ 19.0%	9.8%
1973	▶ -14.7	-21.5
1974	-26.5	▶ -22.9
1975	37.2	▶ 54.4
1976	23.9	▶ 35.7
1977	-7.2	▶ -2.0
1978	6.6	▶ 8.2
1979	18.6	▶ 28.7

## 1998-1999 Dot-Com Bubble

Year	S&P 500 performance	Equal-Weighted S&P 500 performance
1998	▶ 28.6%	12.2%
1999	▶ 21.0	12.0
2000	-9.1	▶ 9.6
2001	-11.9	▶ -0.4
2002	-22.7	▶ -18.2
2003	28.7	▶ 41.0
2004	10.9	▶ 17.0
2005	4.9	▶ 8.1

## 2023-2024 Magnificent 7

Year	S&P 500 performance	Equal-Weighted S&P 500 performance
2023	▶ 26.3%	11.8%
TTM 6/30/24	▶ 24.6	13.9



Source: Morningstar, as of June 30, 2024. TTM stands for trailing twelve months. See last page for definitions. It is not possible to invest directly in an index. Past performance does not guarantee future results.

in Microsoft’s Azure platform, slowing revenue growth in Alphabet’s YouTube advertising business, ongoing operating losses at Meta’s Reality Labs division, and recent antitrust rulings in Europe against Apple’s App Store and music platform. Tesla’s earnings, meanwhile, disappointed as operating profits slid 33% year-over-year on lower automotive sales prices and stiffer electric vehicle competition.

The second observation is that these kinds of periods of concentrated outperformance in the stock market are not unprecedented—think the Nifty Fifty in the early 1970s and the Dot-Com Bubble in the early 2000s. And when these streaks end, as they invariably do, the reversals can be sudden and severe.

Consider that in 2023 and again through June of 2024, the returns for the S&P 500 Index (which is cap weighted, meaning individual stocks’ weightings are proportional to their overall market value) were roughly double that of an equal-weighted investment in those same 500 companies. Similar patterns of outperformance took place with both the Nifty Fifty and with tech stocks in 1998–1999. In both cases, when the trend reversed course, an equal-weighted S&P 500 went on to outperform the standard cap-weighted index for six years in a row.

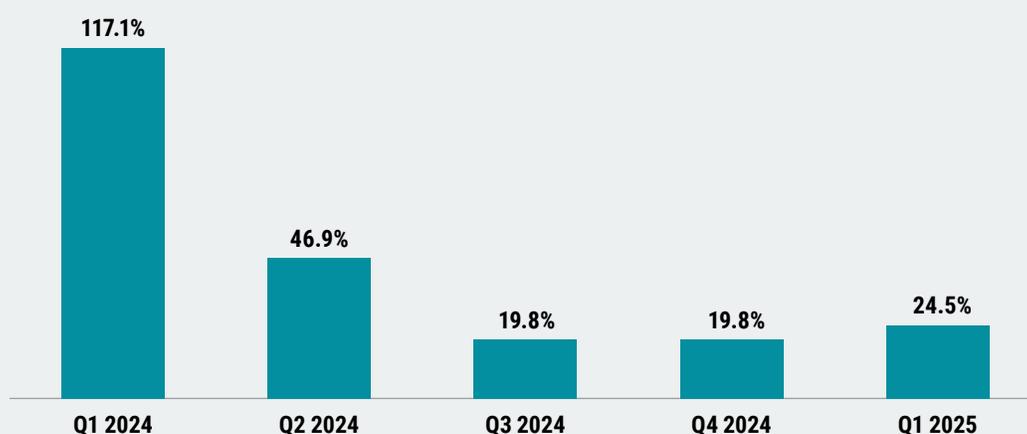
There’s no single reason behind these reversals, but there is a common theme: Companies with lofty valuations tend to come with equally high expectations attached. When growth stalls or fails to meet those high expectations—whether through heightened competition, increased regulation, or management missteps—the consequence has often been a swift repricing.

## Recent results for Magnificent Seven companies have raised concerns

Could we be experiencing early indications of a market reversal? So far, the Magnificent Seven companies have reported mixed results in the second quarter of 2024. Apple reported earnings per share marginally above expectations, but revenue declined year-over-year after a fall in iPhone sales. Microsoft, Alphabet, Amazon, and Meta all exceeded earnings expectations, but reported ongoing challenges with different parts of their businesses: questionable sustainability of growth

Beyond these near-term headwinds, other challenges remain for the tech titans. Begin with the regulatory risks, which appear to only be mounting: Regardless of which party is in power next year, the appetite in Washington, D.C., for tighter regulations is substantial—and a risk we feel investors should monitor. In addition, many of these companies have begun what's likely to be a years-long process of building out their artificial intelligence (AI) capabilities. This process has already come with a huge price tag, but so far the returns on investment are unknown. When AI's revenue potential is better understood for these early adopters, there's no guarantee investors will find the investment to have been an attractive use of capital.

### Magnificent 7 year-over-year earnings growth is poised to dramatically decelerate



Source: FactSet, as of August 30, 2024. Figures after Q2 2024 are forecasts.

Lastly, it's worth thinking about U.S. growth stocks through a more global lens—including as it relates to the U.S. dollar. During past periods of a strengthening USD, growth stocks in the United States have fared relatively well as asset prices rose and multiples expanded. Since the start of 2023, the USD has essentially moved sideways, after peaking in late 2022. With the Fed likely to begin cutting interest rates in September, it's a fair question to ask whether the USD is poised to weaken further, which historically has favored value over growth stocks, as multiples in many parts of the equity market compress.

### Value stocks appear poised for an earnings rebound

All of these factors considered, looking ahead the expectations are for the Magnificent Seven's earnings growth by the fourth quarter to decelerate to a rate only slightly higher than that of the Russell 1000 Growth Index. Meanwhile, large-cap value stocks are expected to continue strengthening their earnings figures, rebounding from around 3% growth in Q2 to more than 15% by year end.

The question facing investors is how much they're willing to pay for these levels of earnings growth. As of this writing, the Russell 1000 Value Index reflected a price/earnings ratio of about 17x; the cheapest of the Magnificent Seven, meanwhile, had a P/E of about 24x, and two of the seven were over 50x. If the momentum fueling the rise of the Magnificent Seven stalls, it could suggest a meaningful resurgence in value-oriented and smaller-capitalization stocks.

One month of data is too little from which to draw any meaningful conclusions, but it is noteworthy that the worst-performing sector over the first six months, Real Estate, led the market in July, while the two best-performing sectors through June, Information Technology and Communication Services, were the only two posting losses in that month. Similarly, value outperformed growth across all market capitalizations in July, while small- and mid-cap stocks outperformed large caps.

### Market leadership on a sector level saw a significant shift in July

	JULY		YTD
Real Estate	7.22%	Information Technology	25.57%
Utilities	6.78	Communication Services	21.60
Financials	6.46	Financials	17.28
Industrials	4.90	Utilities	16.98
Materials	4.39	Energy	13.34
Health Care	2.65	Industrials	13.03
Energy	2.11	Consumer Staples	11.09
Consumer Staples	1.93	Health Care	10.67
Consumer Discretionary	1.66	Materials	8.61
Information Technology	-2.09	Consumer Discretionary	7.42
Communication Services	-4.01	Real Estate	4.62

Source: Bloomberg, as of August 1, 2024. Past performance does not guarantee future results.

## Diversification may be more important—and challenging—than usual

Only hindsight will reveal precisely when investors have lost their appetite for today's high-flying tech stocks. But we can say with confidence that, over the long term, valuation matters in the equity market, and that chasing yesterday's winners rarely ends well. Consider the recent, short-lived turmoil that hit the markets at the beginning of August and erased approximately \$800 billion in market value of the Magnificent Seven in just one day.

Investors following a passive or index-oriented approach may discover too late just how exposed they are to the fortunes of a handful of tech-related mega caps. If history is any guide, when market leadership changes, that change can often be both abrupt (as 2022 as for tech) and protracted (it took roughly 15 years for tech stocks to recapture their highs from 2000). We believe achieving a meaningful level of diversification in today's market requires a hands-on, active approach—and after the spike in volatility in early August, we'd suggest investors prepare for the possibility of more turbulence on the horizon before it arrives.

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**The Dot-Com Bubble** refers to a stock-market bubble primarily involving Internet-related securities that began in the late 1990s and peaked in early 2000. **The Magnificent Seven** refers to seven growth-oriented, tech-related companies: Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla. **The Nifty Fifty** was a group of fifty large-cap, blue-chip stocks that gained notoriety in the 1960s and 1970s due to their relatively high earnings growth and correspondingly high valuations. **The Russell 1000 Growth Index** tracks the performance of those large-cap U.S. equities in the Russell 1000 Index with growth style characteristics. **The Russell 1000 Value Index** tracks the performance of those large-cap U.S. equities in the Russell 1000 Index with value style characteristics. **The S&P 500 Index** tracks the performance of the 500 largest companies traded in the United States. It is not possible to invest directly in an index.

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