

Part 2: Once in a Decade Opportunity to Diversify Away From the “Magnificent Seven”



Markets Rally in November

Amid increasing hopes that the Fed is done raising rates, softer inflation data, lower yields, and better than expected Q3 earnings, equities were up in November as all three major US stock market indices snapped a three-month losing streak. The Nasdaq Composite was up 10.8% while the S&P 500 gained 9.1%, both posting their best month since July 2022. The Dow Jones Industrial Average also increased 9.2%, notching its best month since October 2022. US value (+9.6%) was among the best performers, followed by US large-caps (+9.1%) and US growth (+8.7%). Bonds were also up as investment grade corporates rose 7.6%, municipal bonds gained 5.7%, and high yield credits increased 4.9%. Commodities produced mixed returns as silver (+10.3%) and gold (+2.5%) were up while crude oil (-6.5%) and broad-based commodities were down (-2.4%).

Exhibit 1: Trailing Returns as of November 30, 2023

Index/ETF	1-Mo	3-Mo	YTD	1-Y	3-Y	5-Y
Equities						
US Value (IVE)	9.57%	2.66%	15.66%	11.17%	12.15%	10.50%
US Large-Caps (SPY)	9.13%	1.71%	20.68%	13.74%	9.66%	12.49%
US Growth (IVW)	8.70%	0.88%	25.13%	15.60%	6.53%	13.14%
US Mid-Caps (SPMD)	8.51%	-2.60%	7.16%	1.15%	7.33%	7.84%
International Developed Equities (IEFA)	8.32%	0.96%	11.72%	9.80%	3.64%	5.80%
US Small-Caps (SPSM)	8.31%	-3.98%	2.90%	-4.01%	5.84%	6.17%
Broad-based Emerging Markets (IEMG)	8.08%	1.20%	7.37%	4.69%	-2.93%	2.85%
US Fixed Income						
Investment Grade Corporate Bonds (LQD)	7.57%	1.25%	4.33%	2.71%	-5.59%	2.20%
Municipal Bonds (MUB)	5.71%	1.72%	3.23%	2.97%	-0.92%	1.96%
High Yield Credit (HYG)	4.88%	2.12%	8.09%	6.19%	0.58%	3.10%
US Aggregate Bond Index (AGG)	4.59%	0.28%	1.89%	1.00%	-4.49%	0.69%
US Treasury 7-10 Year (IEF)	4.55%	-0.68%	-0.12%	-1.61%	-6.51%	0.02%
Treasury Inflation Protected Notes (TIP)	2.77%	0.08%	1.34%	0.00%	-1.69%	2.56%
Commodities						
Silver (SLV)	10.25%	3.31%	5.04%	13.23%	3.19%	11.67%
Gold (GLD)	2.53%	4.85%	11.27%	14.54%	4.24%	10.32%
Broad-based Commodities (BCI)	-2.41%	-2.82%	-6.26%	-8.66%	12.56%	5.78%
Crude Oil (USO)	-6.50%	-6.55%	0.04%	-0.13%	31.35%	-3.96%

Source: FactSet. Data as of November 30, 2023.

Fed Pauses But Doesn't Rule Out Future Hikes

The Federal Reserve kept interest rates unchanged at the November FOMC meeting, leaving the fed funds rate at the 5.25–5.50% range. Although the central bank paused for a second consecutive meeting, Fed Chairman Jerome Powell stated, “The process of getting inflation sustainably down to 2% has a long way to go.” He also expressed that the full effects of restrictive monetary policy have not yet materialized, and the committee didn't rule out future rate hikes. On a more positive note, Powell acknowledged that wage increases have come down, and that the risks of tightening too much or too little have become more balanced. Last week's FOMC Minutes revealed that most officials see rates remaining restrictive for some time, echoing the Fed's higher for longer messaging. However, on the back of softer October inflation prints, markets seem to be pricing in rate cuts sooner as stocks have rallied with longer-dated yields simultaneously falling from recent highs. Fed funds futures now signal up to five 25bps rate cuts in 2024, with the first occurring as early as May.

Financial Conditions Loosen

Speculating lower interest rates ahead, investors rushed in to buy bonds, pushing down the yield on the 10-year US Treasury from 4.90% on October 31st to 4.36% on November 30th. As a result, US financial conditions as per Goldman Sachs' index have loosened significantly. As elevated longer-dated yields were aiding the works of restrictive monetary policy, could their decline complicate future interest rate decisions for the Fed?

Exhibit 2: Goldman Sachs US Financial Conditions Index



Source: The Daily Shot. Data as of November 20, 2023.

Forward Bond Returns Look Attractive

Given the level of starting yields, hypothetical forward returns for bonds look appealing (bond prices and interest rates are inversely related). LPL Financial forecasts that just a 50bps decrease in interest rates would cause the Bloomberg US Treasury Index to gain over 8% in the next twelve months. As the bond indices in Exhibit 3 are high in quality, some may refer to this as a possibility to earn equity-like returns without equity-like risks.

Exhibit 3: Hypothetical 12M Forward Returns – Interest Rate Scenario Analysis

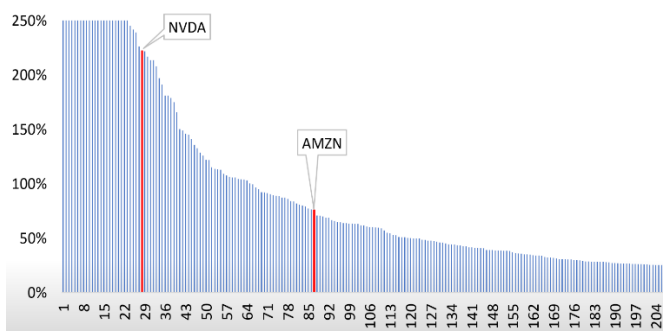
Change in Interest Rates	-1.0%	-0.5%	No Change	+0.5%	+1.0%
Bloomberg US Aggregate Bond Index	12.4%	9.5%	5.2%	3.8%	1.0%
Bloomberg MBS Index	13.2%	10.3%	5.4%	4.5%	1.6%
Bloomberg US Treasury Index	11.4%	8.6%	4.7%	3.1%	0.4%
Bloomberg US Corporate Index	13.7%	10.5%	5.8%	4.2%	1.0%
Bloomberg Intermediate Corp Index	10.0%	8.2%	5.8%	4.7%	2.9%

Source: LPL Financial. Data as of November 20, 2023. Return forecasts are hypothetical and based on a twelve-month forward horizon.

How Magnificent are the Seven Stocks?

In our September commentary, we wrote that there was a once in a lifetime opportunity to diversify away from the “Magnificent Seven.” These stocks have vastly driven equity market gains this year, but are they worth their expensive valuations? When analyzing 900 constituents in the S&P 900 Index, 207 companies saw earnings growth greater than 25% over the last twelve months. More interestingly, only two of the “Magnificent Seven” stocks (NVDA & AMZN) make that list. In the event of a soft landing and a continued earnings recovery, this suggests that there may be more attractive opportunities across other cheaply valued stocks with appealing growth potential.

Exhibit 4: S&P 900 Stocks with >25% 12M EPS Growth



Source: FactSet, Astoria Portfolio Advisors. Data as of November 30, 2023. Trailing EPS growth calculations use quarterly last twelve months reporting basis.

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Will Market Cap Dominance Continue?

Currently, market cap weighted strategies pose heightened concentration risk, with the top seven companies in the S&P 500 Index making up almost 30%. Though such a weighting methodology has outperformed in 2023, history implies that this approach may not continue to in the future. As seen below, the S&P 500 Equal Weight Index has historically outperformed the S&P 500 Index, which is market cap weighted, when the economy comes out of a recession as market breadth increases on the back of improved economic conditions.

Exhibit 5: S&P 500 Equal Weight / S&P 500 (Mkt Cap)



Source: FactSet, Astoria Portfolio Advisors. Data from January 31, 1990, through November 30, 2023. Calculations use monthly price returns. January 31, 1990 = \$100. Past performance is not indicative of future results. Indices are typically not available for direct investment, are unmanaged, and do not incur fees or expenses.

Which Indicators are we Monitoring for a Recession or Recovery?

- 1) Un-inversion of US Treasury Yield Curve: When the spread between the 2-year and 10-year Treasury yield turns positive after it has inverted, it has historically signaled a recession is close.
- 2) Leading economic indicators troughing: The Conference Board Leading Economic Index has declined for 19 straight months; longest since GFC.
- 3) Profits recovery: Q3 S&P 500 earnings growth was positive; the prior three quarters saw declines.
- 4) ISM Manufacturing/Services PMIs steady in expansionary territory (above 50): Manufacturing is at 46.7; services is at 51.8 but trending down.
- 5) Improvement in credit/lending standards: These are likely to stay tight as long as rates are elevated.
- 6) Increasing market breadth: The S&P 500 continues to outperform the S&P 500 Equal Weight.
- 7) Reset in valuations: Further decreases could create buying opportunities.