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LINCOLN INVESTMENT | WEALTH ARCHITECTS

The Outsized Performance of The Magnificent Seven, November 2023

U.S. stocks have risen sharply in 2023 with a small number of technology companies driving an ever-increasing share of stock market gains. While the 10.69% year-to-date total return for the large-cap benchmark S&P 500 Index, as of 10/31/2023, shows it has been a “good year” for stocks, that is not the whole story. The U.S. stock market has seen the median return for shares in the S&P 500 Index rise merely 1.1% in 2023. Similarly, the S&P Equal Weight Index is down 2.4% year-to-date, showing how outsized the performance of The Magnificent Seven – AAPL, MSFT, GOOGL, AMZN, NVDA, META and TESLA – has primarily driven the market upward.

Bank of America analyst Michael Hartnett coined The Magnificent Seven term (The Seven) to describe seven of America's top technology giants. The companies in the S&P 500 index are weighted by their market capitalization. Larger companies have a higher weighting and, therefore, have a greater influence on the index's price. The Seven companies are worth about $10.4 trillion in combined market capitalization, making up about 27.7% of the S&P 500's total $37.7 trillion in total market capitalization.

The influence of The Seven goes both ways. If those tech giants suffer a substantial downdraft, it could drag the entire S&P 500 Index down. The stellar performance of The Seven has also raised the stakes in future earnings reports and more importantly, valuations. The average forward price-to-earnings ratios in The Seven is about 33.5, compared to the S&P 500’s average P/E of 18.92.

At the same time, Treasury yields at 16-year highs are providing investment competition to stocks with U.S. government bonds now offering risk-free yields of around 5% or more. Complicating the outlook is the relentless climb in interest rates and Treasury yields, which has been driven by a mix of Federal Reserve hawkishness in the face of a strong economy and worries over the U.S. fiscal picture. Growth and tech companies are seen as being more vulnerable to higher yields, as their typically robust projected future cash flows are valued less when investors can earn more from risk-free government bonds.

Now with bonds offering attractive yields, investors have more choices and should ultimately allocate differently. The reallocation of funds going forward suggests lower returns and more difficulty for The Seven to maintain their leadership, which leads to the benefits of a properly diversified portfolio. One of the most important characteristics of any investment portfolio is its diversity. Portfolio diversification helps offset exposure in any single position, and helps investors protect themselves against wide swings in key sectors. By spreading your investments across different assets and sectors, you minimize the effect of a specific investment not working out. Diversification allows you to take advantage of different trends and opportunities across asset classes, geographic regions and individual investments. If your portfolio was diversified across multiple asset classes aligning with your risk tolerance and time horizon, then you did not see the great run-up The Seven has seen YTD. This is by design, and a prudent long-term investing strategy.