“Carry”ing on in the equity market

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A wise pundit once said, when markets are going crazy: “Don’t just do something; stand there!” In recent days, we’ve reached out to some of the equity strategists, economists and stock analysts who help us manage more than $115 billion in assets. They are divided on their outlooks for a U.S. recession or slowdown in coming quarters, but they generally remain positive about the power of American companies to profit from long-term trends. Here’s a sample of the thoughts they’ve shared with us in recent days.

A discernable shift in momentum

Going into August, as strategists for model portfolios offered by Equitable Investment Management, our team recently discerned a shift in equity momentum that led us to reduce slightly our tactical overweighting in equities over bonds. We remain sanguine about the outlook for the U.S. economy, and about the outsized growth prospects for U.S. tech companies. We remain well-diversified, however, owning growth and value funds, inside the U.S. and out, up and down the capitalization spectrum. We are patient investors who anticipate these equity holdings will provide attractive gains.

Markets under pressure

Mike Rode, a senior investment director at American Century Investments, summarizes the current market turmoil this way: Worries about slightly higher unemployment and what that portends for future economic growth, along with a mega-cap tech stock hangover, have raised the fear factor for equity investors. Why? The equity market has had such an attractive run, that more restrained earnings projections for AI stocks contributed to a sense that valuations had been extended too far to sustain. He points out that, as recently as July, the market appeared as strong as ever. ”Beneath the surface, however, there was a significant rotation from mega-cap technology stocks to small-caps and other areas of the market that have been lagging in recent years,” he explained.

American Century sees an economic slowdown as the most likely future scenario, and they will be watching earnings reports, the U.S. Federal Reserve meetings, and unemployment rates closely for clues. In the meantime, they remain constructive on the market outlook. “We believe market dislocations like this create opportunities for active managers ready to capitalize on unwarranted moves,” he said.

Secular drivers support small caps

Nancy Prial, chief investment officer at Essex Investments, wrote this week to say that, although the uptick in this month looked to be of a similar magnitude to that of previous crises, in fact factors support a more benign view. Increases in the Cboe Volatility Index in 2008 during the banking meltdown, and in 2020 at the peak of the Covid-19 lockdowns, reached levels similar to those recently. “In both of those cases, the market was correct that there was a recession on the horizon (credit-driven in 2009, and a very-short-lived one in 2020). In her view, however, current conditions do not necessarily predict a deep recession—or even a mild one. “Small-cap stocks, in particular remain attractively priced with earnings coming in better than expected; an improving interest-rate and inflation environment; and favorable secular drivers,” she continued. Prial sees the strength in reshoring/infrastructure rebuilding; smart defense spending; and expansion of the U.S. power grid among trends that should drive revenue and earnings growth in a number of Russell 2000 Index components. “Suppliers to these industries are over-represented in the small-cap space,” she concluded.

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