

A Rotation in the Stock Market

On July 11, the U.S. Department of Labor reported that the Consumer Price Index (CPI) fell slightly in June compared to May, dropping the year-over-year inflation rate to 3%. This marked the lowest annual inflation rate since the Federal Reserve began raising interest rates in March 2022, raising investor confidence that the Federal Reserve will cut interest rates later this year. The stock market reacted to the inflation news with a surge in the relative prices of smaller companies that, in many cases, could benefit most from lower borrowing costs. These gains came at the expense of many of the mega-cap stocks that have led the market advance since the beginning of last year.

Rotation in the stock market can be seen in the difference in performance of the S&P 500 and the S&P 500 calculated on an equal-weighted basis. For the year-to-date through July 10, the S&P 500 outperformed the equal-weighted index by 13.5 percentage points. From July 10 through the end of the month, however, the equal-weighted index outperformed the S&P 500 by 5.8 percentage points. Is this outperformance of the equal-weighted index likely to continue? History suggests that the answer is “yes”.

The chart below shows the relative price of the equal-weighted S&P versus the S&P 500 over the past 20 years. While the equal-weighted index has outperformed over time, it has had several significant periods of underperformance, most recently over the past several years. July’s price action, however, is reminiscent of that seen in late 2008 and early 2009, when the equal-weighted index first began to outperform following a previous period of underperformance. After the 2008-2009 bottoming period, the equal-weighted index went on to outperform over most of the next 5–7 years.

Price History⁽¹⁾

S&P 500 Equal-Weighted Index / S&P Cap-Weighted Index



Data from 12/31/2004–7/31/2024; 12/31/2004 = 1.00

⁽¹⁾ Past performance is not indicative of future returns.

Source: FactSet

While July’s relative performance of the equal-weighted S&P was impressive, it may be just the beginning of further relative gains.

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REFERENCED INDEX

(Indices are unmanaged and are not available for direct investment.)

Consumer Price Index (CPI)—CPI is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. It is calculated by taking price changes for each item.

S&P 500 Index—The S&P 500 Stock Index is a market capitalization weighted index and consists of 500 stocks chosen for market size, liquidity and industry group representation.

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