U.S. Equities: Defanging a Major Market Misconception

In a preview of a forthcoming Lord Abbett whitepaper, our experts debunk the myth that the current market advance is being led chiefly by gains in "Big Tech" names.

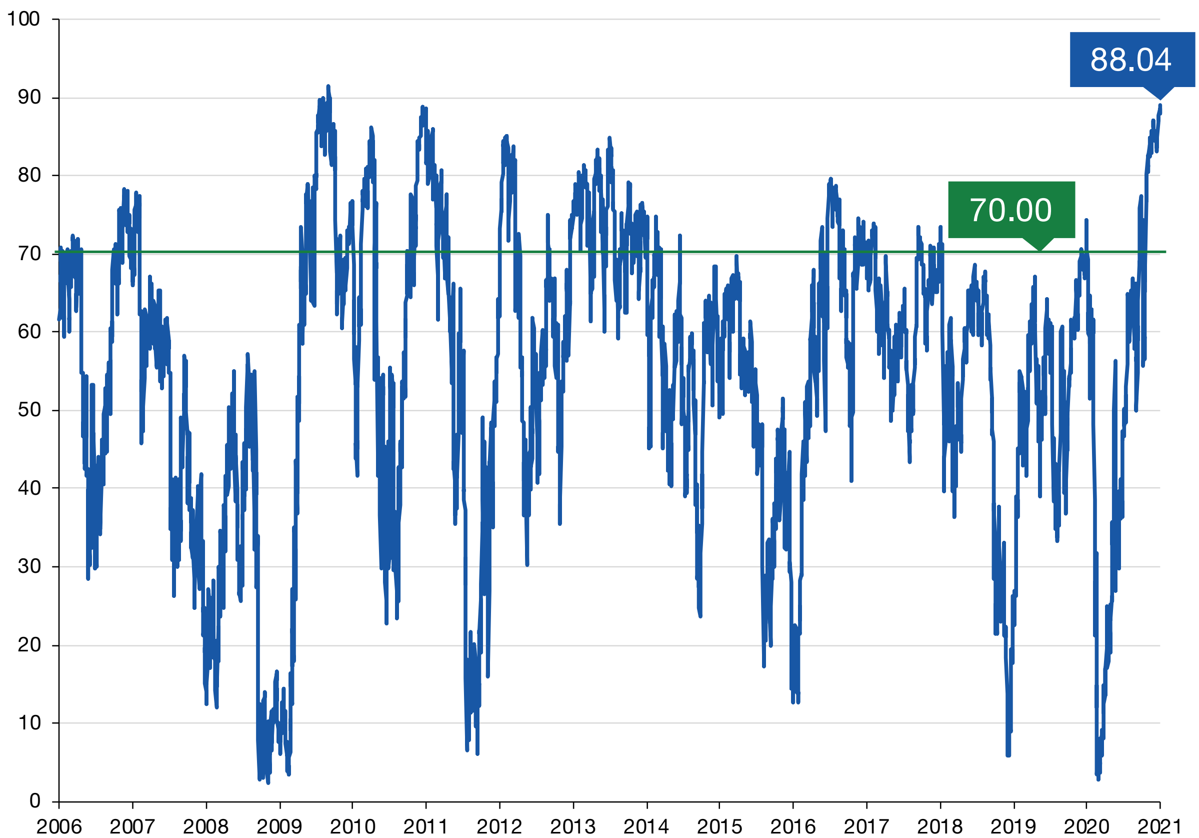
Featured Contributors

Brian Foerster, CFA
Investment Strategist

Melanie Coffin, CFA
Associate Investment Strategist

Figure 1. U.S. Equities Are Not Short of Breadth

Percentage of stocks in the Russell 3000 Index trading above their 150-day moving average for the period January 20, 2006–January 21, 2021



Source: FactSet. Data as of January 21, 2021. A moving average (MA) is a technique often used in technical analysis (see below) that smooths price histories by averaging daily prices over some period of time. The percentage of stocks in a given benchmark trading above or below a selected moving average is a common measure of market breadth, or how many stocks are taking part in a given move in an index or on a stock exchange.

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U.S. Equities

Here, *Market View* presents an excerpt from a whitepaper, "Five Equity Myths that May Be Derailing Investors", scheduled to publish the week of February 1. We urge you to read or download the full article when it becomes available.

Myth: "It's a narrow market"

Narrow leadership (i.e., when gains in market indexes are led by a relatively small number of stocks) has at certain times in history presaged a bear market in U.S. equities. Right now, we are hearing claims from some commentators that the current market advance is being paced by a small cadre of mega caps, and that it's an unhealthy market otherwise. This seems like a nice yarn considering all the fun acronyms currently characterizing "Big Tech" (FANG, FAAMG etc.),[1] whose strong price appreciation has captured investor and media attention, but actual data suggests the exact opposite.

How so? There is incredibly strong *breadth* in the equity market today, in our view. One way we monitor market breadth is through the percentage of constituents within the Russell 3000® Index that are trading above their individual 150-day moving average (MA). As Figure 1 shows, this indicator has exhibited particular strength over the most recent quarter, with over 80% of stocks in the Russell 3000 trading above their individual 150-day MA. We think this greater participation reflects in part a rebound in cyclical stocks because of investor expectations of a strengthening U.S. economic recovery in 2021, as COVID-19 vaccines are rolled out on a large scale, enabling an end to the pandemic crisis.

Historically, this strength typically has been a bullish signal over the intermediate and long-term periods, as increasing breadth has been an indication of strong forward returns. Based on data stretching back to 1994, when more than 70% of the constituents of the broader market (as represented by the S&P 500® Index) are trading above their 200-day moving average, there have been above-average returns over the next six to 12 months.[3]

Critics may point out that the high percentage of constituents trading above their respective 150-day moving averages suggests an impending pullback. In our view, and based on the history cited above, the more likely potential outcome is a strong equity market in 2021, with a modest consolidation in breadth. That remains a bullish scenario. As we have noted, we expect over the next decade a widening separation between winners and laggards as a result of technological innovation, which will undoubtedly moderate the high level of breadth today. But we believe a significant number of innovation-oriented companies will continue to deliver outsized fundamental strength, while many durable and oversold names should make strong comebacks this year and beyond. To be sure, there likely will also be permanent casualties from COVID along with continued secular decline in some vulnerable areas of the economy.

Thus, in such a period where breadth is so strong, and earnings are likely continue outpacing low expectations, we believe equity markets remain attractive, but it is imperative for investors to consider a selective approach based on rigorous fundamental research.

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1 Investors have encountered a bewildering variety of acronymic descriptors of leading mega cap technology shares, formed by varying combinations of the first letters of Facebook, Google or its parent Alphabet Inc., Amazon, Netflix, Apple, and Microsoft.

2 **Market breadth** or **market participation** refers to how many stocks are taking part in a given move in an index or on a stock exchange. One common measure of market breadth is the percentage of stocks in a given benchmark trading above or below a selected **moving average**. A moving average is a technique often used in technical analysis that smooths price histories by averaging daily prices over a defined period.

3 "Screening for New Leadership: Momentum Supported by Q4 Tailwinds," Oppenheimer Equity Research, October 17, 2020.

A Note about Risk: The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of particular companies and/or sectors in the economy. While growth stocks are subject to the daily ups and downs of the stock market, their long-term potential as well as their volatility can be substantial. Value investing involves the risk that the market may not recognize that securities are undervalued, and they may not appreciate as anticipated. Smaller companies tend to be more volatile and less liquid than larger companies. Small cap companies may also have more limited product lines, markets, or financial resources and typically experience a higher risk of failure than large cap companies. The value of an investment in fixed-income securities will change as interest rates fluctuate and in response to market movements. As interest rates fall, the prices of debt securities tend to rise. As rates rise, prices tend to fall.

No investing strategy can overcome all market volatility or guarantee future results.

Forecasts and projections are based on current market conditions and are subject to change without notice. Projections should not be considered a guarantee.

This *Market View* may contain assumptions that are "forward-looking statements," which are based on certain assumptions of future events. Actual events are difficult to predict and may differ from those assumed. There can be no assurance that forward-looking statements will materialize, or that actual returns or results will not be materially different from those described here.

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Glossary and Index Definitions

The Russell 3000® Index measures the performance of the largest 3000 U.S. companies representing approximately 98% of the investable U.S. equity market.

The S&P 500® Index is widely regarded as the standard for measuring large cap U.S. stock market performance and includes a representative sample of leading companies in leading industries.

Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.

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