

PALLAS PERSPECTIVE

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EQUITY MARKET SENTIMENT HAS TURNED BULLISH: STRONG RECENT PERFORMANCE MAY BE DUE FOR A PAUSE

Returns in the U.S. equity market have continued the upward march in 2024. Driving the positive returns has been positive economic growth, stable interest rates, positive earnings (at least from the mega caps), and improving investor sentiment. The last factor, investor sentiment, has been a historically good contra indicator for future returns. Bearish sentiment reached a one-year high over 50% and well above the historical average for the week ending 11/1/2023 and has since receded to under 25%. The S&P 500 has risen by nearly 20% over that period.

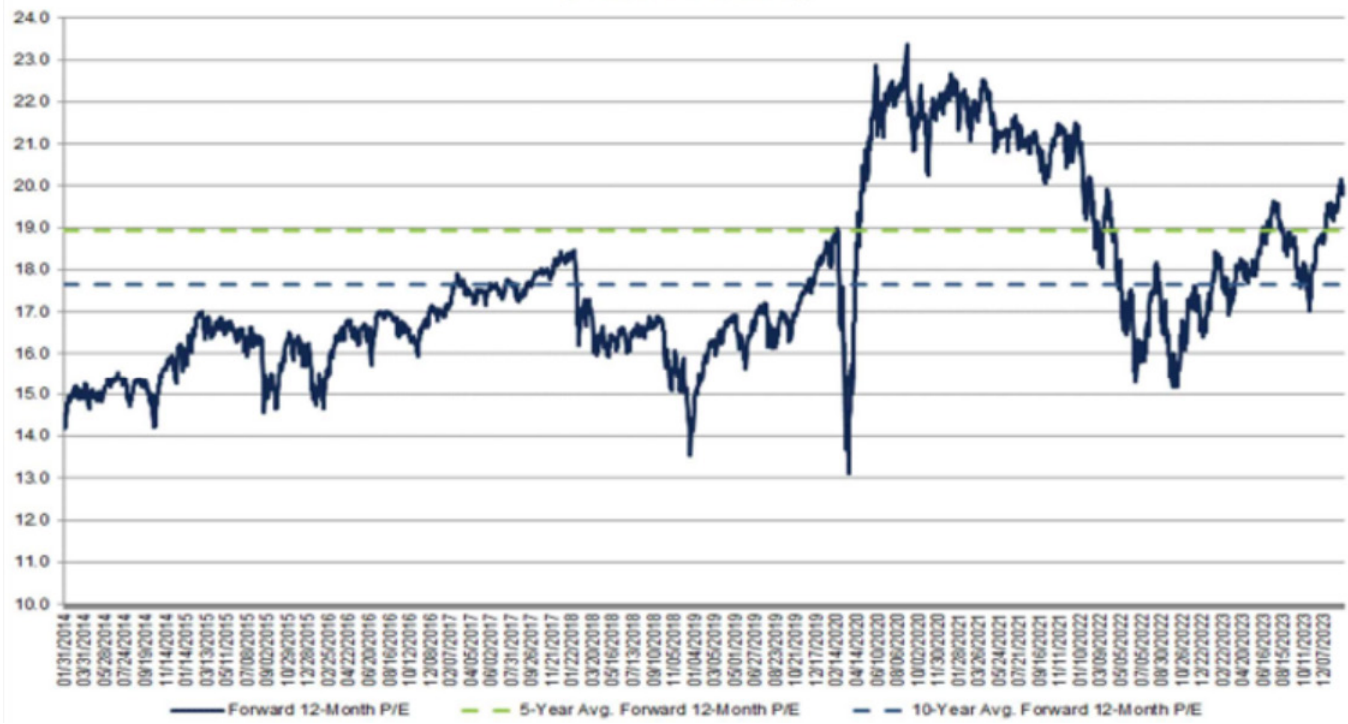
WHAT DIRECTION DO AAI MEMBERS FEEL THE STOCK MARKET WILL BE IN THE NEXT 6 MONTHS?



Source: American Association of Individual Investors

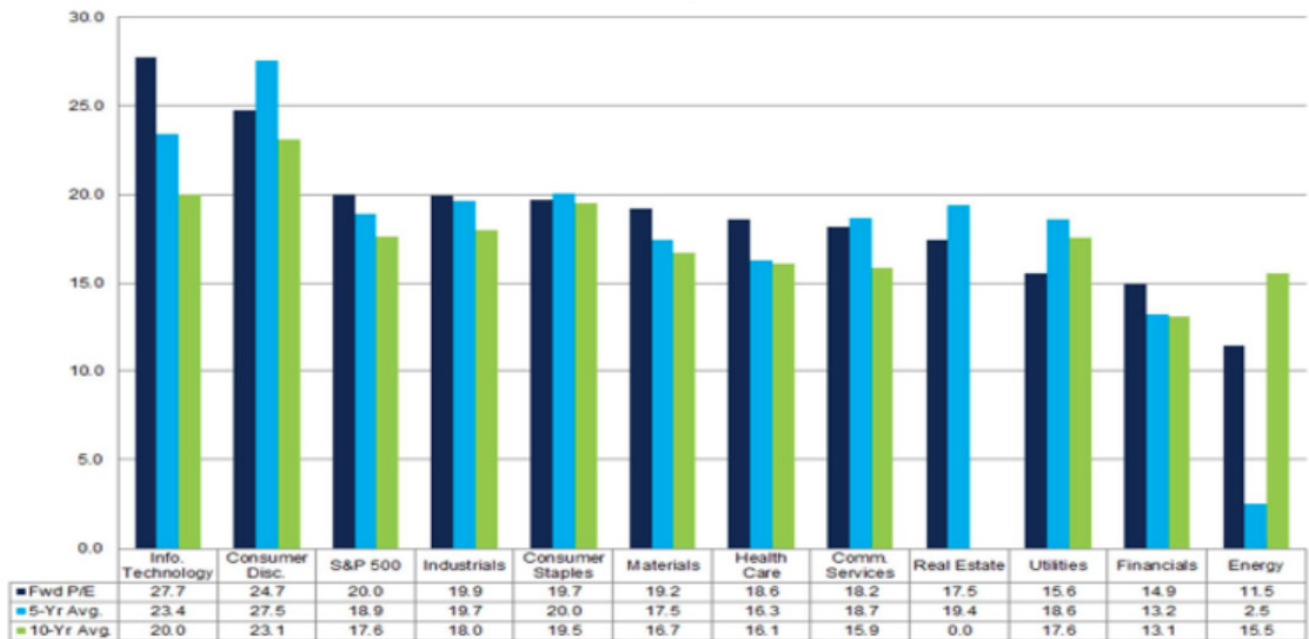
However, now that negative sentiment has fallen, other market indicators are now flashing yellow. Notably among these is valuation multiples. Over the past few months, valuation multiples have been expanding faster than forward earnings expectations, serving as a key driver for market appreciation. The forward price-to-earnings ratio (P/E) has moved back above 20X, a level well above longer-term averages. However, dispersion exists for P/E multiples when breaking out sectors of the economy. Technology is currently trading well above history, while most other sectors are trading in line with history or, in the case of utilities, well below history.

S&P 500 FORWARD 12-MONTH P/E RATIO: 10 YEARS



Source: Factset

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While relatively bullish investor sentiment and elevated valuation metrics suggest near term caution, ultimately earnings growth will drive the market over the longer term. The potential for technology to deliver strong long-term growth above that of other sectors may well justify the premium at which it trades. However, elevated multiples also reflect high expectations for the future and a higher bar for the sector and companies to clear.

At Pallas Capital Advisors, we seek to balance growth expectations and valuation with our equity selection and allocation. The current market dynamic suggests diversification and a longer-term outlook for equities to allow earnings to drive returns. Near-term bullish sentiment and valuation suggests a pause in markets may be in order.