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Investment Perspectives

Stocks: Broader Market Opportunity in Five Charts

Strong earnings across a wider group of equities and lower inflation may be key to expanding the market's potential.

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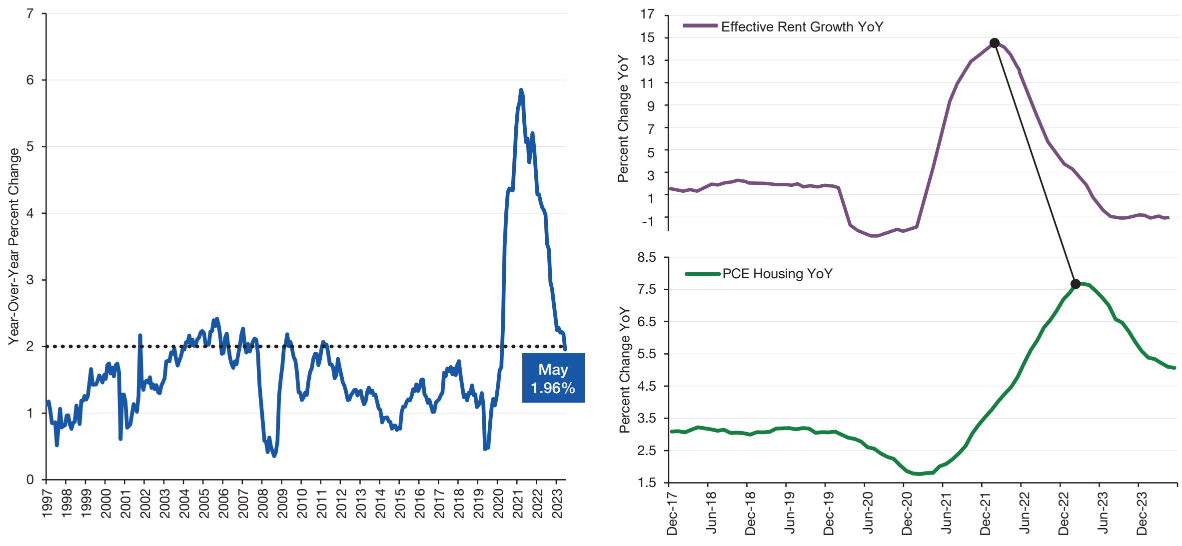
After years of unprecedently narrow leadership in the equity markets, many investors are wondering what it will take for the rally to spread to the rest of the market. We believe two drivers are likely: The first is a favorable resolution on the direction of inflation. The second is improved earnings growth for the rest of the market.

Potential Catalysts for Broader Equity Participation

After a few hot inflation reports to start the year, the broad disinflation trend that began a year ago is resuming. Core inflation, ex-housing, is already running at the U.S. Federal Reserve's (Fed) 2% target (Figure 1, left), and there are reasons to believe that shelter, as calculated in official inflation statistics, will slow to match market-based leading indicators, such as the RealPage effective rent growth (Figure 1, right). The July Consumer Price Index (CPI) print confirmed this belief, as inflation data came in lower than expected.

Figure 1.

U.S. Core Personal Consumption Expenditure (PCE), ex-housing, year-over-year (YoY) percent change, December 31, 1997-May 31,2024 (left), U.S. PCE Housing YoY percent change, December 31, 2017-May 31, 2024 (bottom right), RealPage Effective Rent Growth YoY percent change, December 31, 2017-May 31, 2024 (top right)



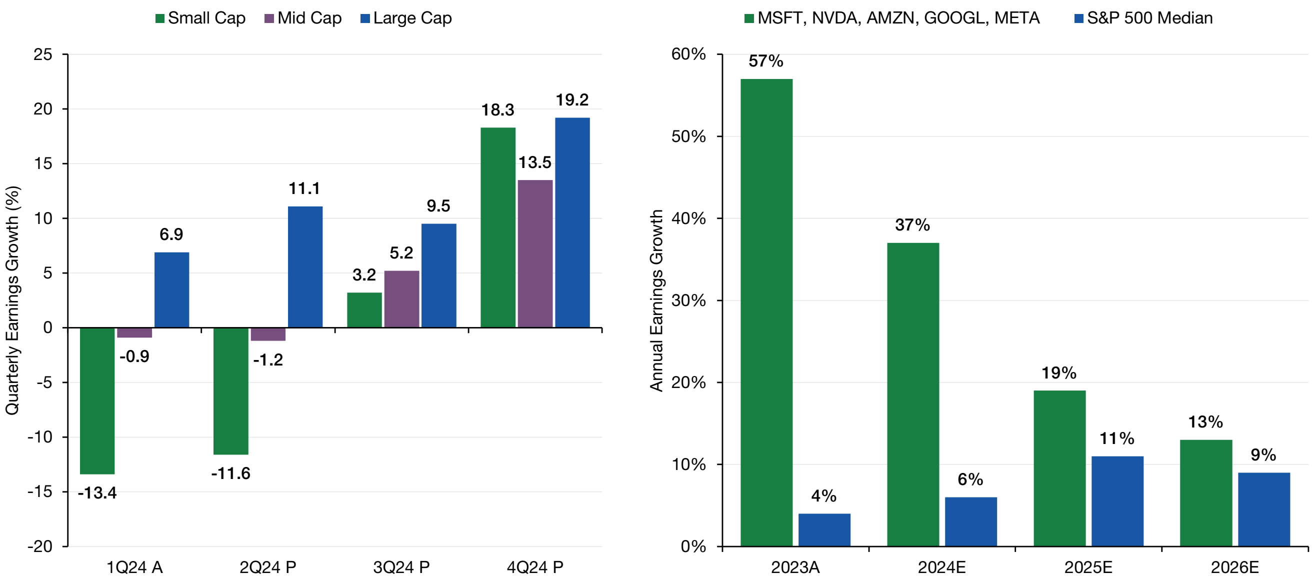
Source: Bloomberg, U.S. Bureau of Economic Analysis (BEA), and Evercore ISI Weekly Economic Report, June 9, 2024. Data as of June 30, 2024 (left) and May 31, 2024 (right). The historical data shown in the chart above are for illustrative purposes only and do not represent any specific portfolio managed by Lord Abbett.

Following the softer CPI print, we saw a dramatic rally in small capitalization (cap) stocks. On the day of the release (Thursday, July 11, 2024), the Russell 2000® Index was up over 2.5%, while the NASDAQ (National Association of Securities Dealers Automated Quotations) was down nearly 2%. The magnitude of this price action and subsequent follow-through support our view that clarity around the direction of inflation should encourage investors to step out on the risk curve beyond the "Magnificent 7" and embrace other large, mid, and small cap stocks. (Note: Please see the annual performance table at the end of this material.)

At the same time, the differential in earnings growth between large companies and small companies should close in the second half of 2024 and into 2025 (see Figure 2).

Figure 2. Strong Earnings Growth Increases Potential Opportunities in Equities

Actual and projected quarterly earnings growth rates of small, mid, and large cap companies, as of May 24, 2024 (left), and actual and estimated annual earnings growth rates of the companies shown and the S&P 500® Index as of June 17, 2024



Source: FactSet, Standard & Poor's, and Jefferies (left) and Goldman Sachs Global Investment Research (right). Data as of May 24, 2024 (left panel) and June 17, 2024 (date of report, right panel). MSFT=Microsoft. NVDA=NVIDIA. AMZN=Amazon. GOOGL=Alphabet. META=Meta. Earnings growth as measured by growth in net income. **Past performance is not a reliable indicator or guarantee of future results.** The historical data shown in the chart above are for illustrative purposes only and do not represent any specific portfolio managed by Lord Abbett.

After a torrid stretch of outperformance in 2023 and into the start of 2024 by large caps, earnings growth for small and mid cap stocks is set to improve to the mid-teens, matching the earnings growth of large cap stocks (Figure 2, left). Furthermore, the earnings growth of MSFT, NVDA, AMZN, GOOGL, and META is set to decelerate as the earnings growth of the rest of the S&P 500 is expected to accelerate (Figure 2, right).

The gap in performance between the S&P 500 Index and the Russell 2000 Index, since the Fed signaled the end of its hiking campaign at the end of October 2023, has narrowed dramatically since the CPI print and the onset of earnings season. From the end of October 2023 through July 18, 2024, small caps have led large caps, with the Russell 2000 up 51.7% and the S&P 500 Index up 49.4%. While this recent outperformance has led investors to speculate on the sustainability of the rally, we expect returns from all stocks (not just the Mag 7!) to improve as earnings growth accelerates, and investors gain confidence in the price they are paying for earnings as clarity on inflation and rates continues to improve.

We believe Lord Abbett equity portfolios are well positioned to potentially take advantage of this environment. A unifying principle for our portfolios is that we seek to invest in quality companies with durable competitive advantages led by excellent management teams. We do this in growth and value stocks and in U.S. and non-U.S. companies. Low economic growth favors those companies that grow with predictable revenue and resilient earnings, regardless of the economic cycle. Higher cost of capital raises barriers to entry and favors high-quality businesses with competitive advantages and leaders that can intelligently allocate capital in efforts to maximize returns. And finally, the rapid pace of innovation favors businesses led by exceptional management teams with a willingness, even a paranoia, to embrace change and to adapt, or die.

Past Performance of Selected Indices (Calendar Year):

	S&P 500 Index	Russell 2000 Index	Russell Midcap Index	Russell 1000 Index
2023	26.29	15.09	17.23	24.51
2022	-18.11	-21.56	-17.32	-20.41
2021	28.71	13.70	22.58	24.76
2020	18.40	18.36	17.10	18.87
2019	31.49	23.72	30.54	28.89

NOTE: Past performance is no indication or guarantee of future results.
Source: Bloomberg, S&P Dow Jones Indices, and FTSE Russell. Performance of the indices may be affected by changes in the exchange rates between the currency denomination of the composites and indices and any non-U.S. dollar denomination.

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Equity Investing Risks

The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of 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.

Fixed-Income Investing Risks

The value of investments in fixed-income securities will change as interest rates fluctuate and in response to market movements. Generally, when interest rates rise, the prices of debt securities fall, and when interest rates fall, prices generally rise. High yield securities, sometimes called junk bonds, carry increased risks of price volatility, illiquidity, and the possibility of default in the timely payment of interest and principal. Bonds may also be subject to other types of risk, such as call, credit, liquidity, and general market risks. Longer-term debt securities are usually more sensitive to interest-rate changes; the longer the maturity of a security, the greater the effect a change in interest rates is likely to have on its price.

The credit quality of fixed-income securities in a portfolio is assigned by a nationally recognized statistical rating organization (NRSRO), such as Standard & Poor's, Moody's, or Fitch, as an indication of an issuer's creditworthiness. Ratings range from 'AAA' (highest) to 'D' (lowest). Bonds rated 'BBB' or above are considered investment grade. Credit ratings 'BB' and below are lower-rated securities (junk bonds). High-yielding, non-investment-grade bonds (junk bonds) involve higher risks than investment-grade bonds. Adverse conditions may affect the issuer's ability to pay interest and principal on these securities.

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Glossary & Index Definitions

Consensus estimate is an aggregate forecast of a public company's expected earnings based on the combined estimates of all analysts that cover the stock.

The **U.S. Federal Reserve** (Fed) is the central bank of the United States. The federal funds (fed funds) rate is the target interest rate set by the Fed at which commercial banks borrow and lend their excess reserves to each other overnight.

Growth stocks may be characterized as equities of companies that have demonstrated better-than-average gains in earnings in recent years and that are expected to continue delivering high levels of profit growth. Growth equities typically carry higher price-to-earnings multiples than the broader market, high earnings growth records, and greater volatility than broader market. Secular growth stocks are stocks of companies whose economic performance is relatively immune to economic cycles.

Value stocks may be characterized as equities of companies that have fallen out of favor with investors but still have good fundamentals, or new companies that have yet to be recognized by investors. Value stocks typically feature lower price-to-earnings multiples than the broader market, and often industry peers, and somewhat lower volatility than the overall equity market.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index.

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.

Market capitalization: The U.S. Financial Industry Regulatory Authority, or FINRA, defines the following categories of stocks based on their market value: mega cap stocks, $200 billion or more; large cap stocks, between $10 billion and $200 billion; mid cap stocks, between $2 billion and $10 billion; small cap stocks, between $250 million and $2 billion; and micro cap stocks, less than $250 million.

The "Magnificent Seven" (Mag 7) are mega cap stocks that include Apple, Amazon, Alphabet, Meta Platforms, Microsoft, NVIDIA, and Tesla.

Net income is a company's income minus cost of goods sold, expenses, depreciation and amortization, interest, and taxes for an accounting period. It is also called the bottom line on a company's income statement.

The Nasdaq is an American stock exchange based in New York City. It is the most active stock trading venue in the U.S. by volume, and ranked second on the list of stock exchanges by market capitalization of shares traded in the U.S.

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