MarketGrader

BARRON'S 400

Our Latest Take On U.S. Equities

December 2022

Key Barron's 400 Index Discussion Points – December 2022

1. Investors continue to underestimate the impact higher interest rates will have on risk assets in 2023. Many investors are treating the current environment as a short-term tactical rotation across asset classes, whereas we think the effects will be more profound. Avoid concentration in large cap growth stocks.

2. Large cap stocks are still too expensive. Time to lean into smaller names with attractive valuations (avoid value traps, which are likely to underperform in a recession). Small-caps are poised to outperform large-caps in the next decade based on valuations.

3. Pay close attention to company quality. You may use the 'earnings season' feature in MarketGrader (see demo) to identify companies with earnings momentum. Focus also on companies with pricing power and defensible business models (expanding margins).

1. Higher interest rates will continue to impact large cap growth stocks

S&P 500 Concentration Risk

Top 10 Holdings: 25% of Index Weight

Top 20 Holdings: 35% of Index Weight

Top 50 Holdings: 52% of Index Weight

Smallest company in S&P 500: Vontier Corp. (VNT), Market Cap: $3.0 billion

The Barron's 400 Index has **108** companies smaller than VNT. It's worth looking at the quality of their earnings and their valuation for perspective.

Sources: MarketGrader, FactSet

1. Higher interest rates will continue to impact large cap growth stocks

Following a decade of outperformance by large cap stocks over small cap stocks, strategists predict superior returns for small caps in the decade ahead.

Bank of America Securities "calculates that small-caps are 30% cheaper than large-caps now, the biggest discount since the dot-com stock bubble more than two decades ago" … "and predicts 12% yearly returns for small-caps over the coming decade … five points more than large-caps."

Research Affiliates estimates that "small-caps are priced to beat large-caps by 3.7% a year over the next five years."

Source: "They Might Be Small, But the Payoff Looks Big." Barron's Magazine, December 5, 2022.

2. Large cap stocks are still too expensive

S&P 500 Concentration Risk

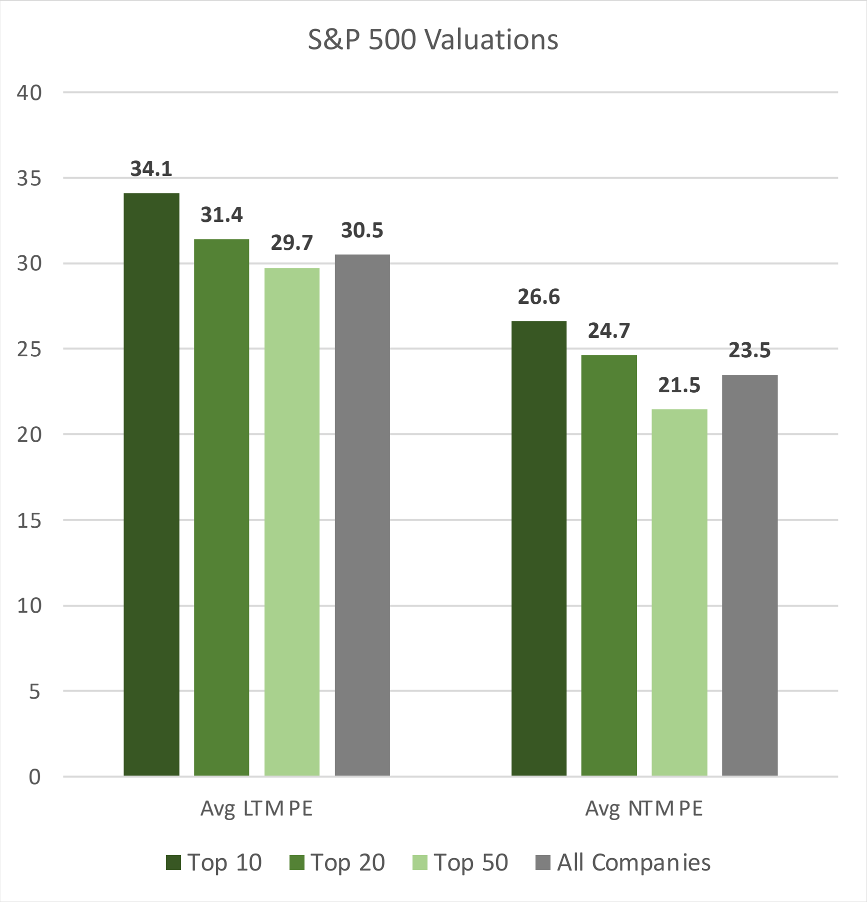
Top 10 Holdings: 25% of Index Weight

Top 20 Holdings: 35% of Index Weight

Top 50 Holdings: 52% of Index Weight

The 10 largest companies in the S&P 500 are 12% more expensive than the entire index (on a trailing 12-month basis) and 13% more expensive on a forward-looking basis.

(Valuations exclude unprofitable companies.)



Sources: MarketGrader, FactSet

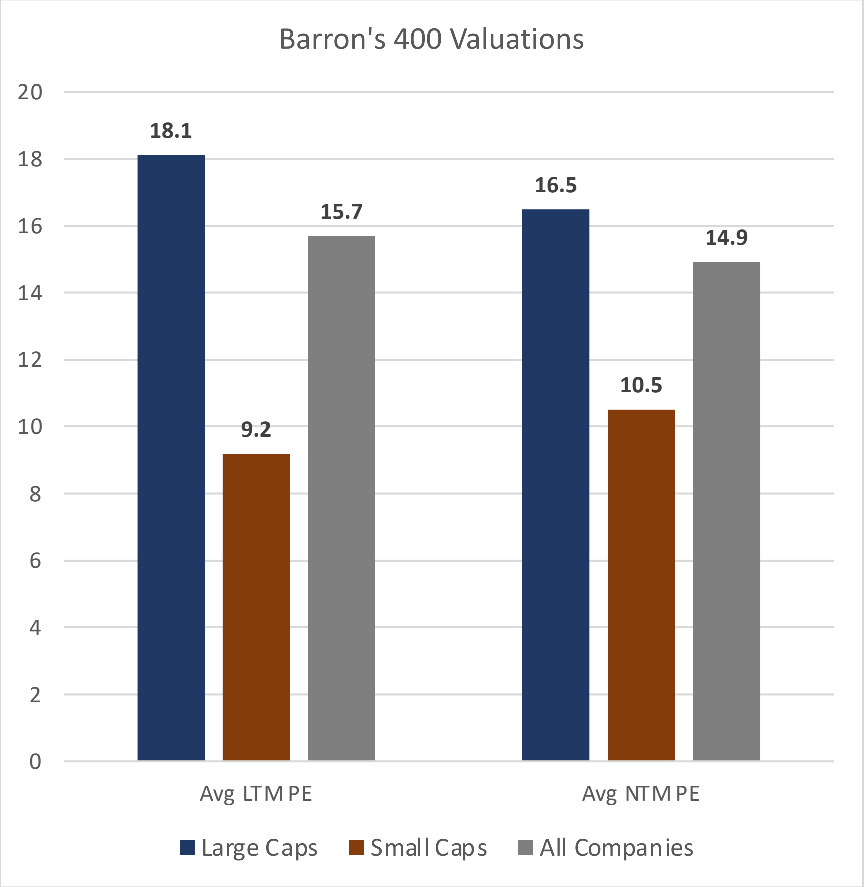
2. Large cap stocks are still too expensive

Barron's 400 Breakdown

(Using smallest company in S&P 500 at $3.0 billion)

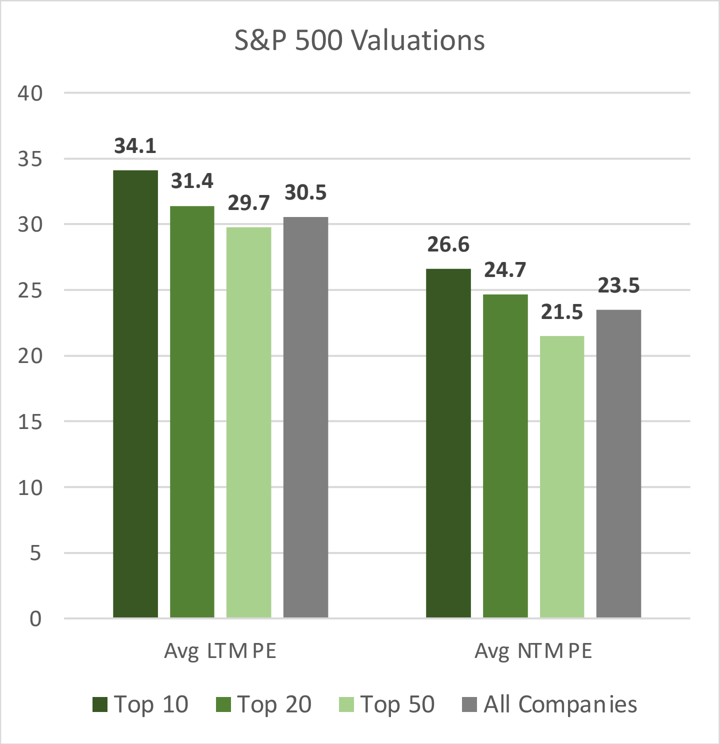
Large Caps (290 companies)	72% of Index Weight
Small Caps (108 companies)	27% of Index Weight

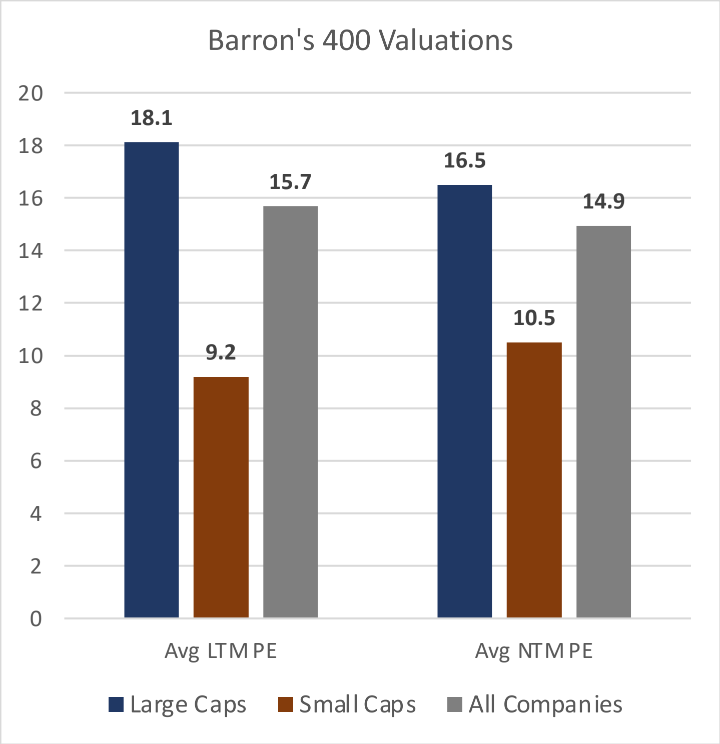
The smallest companies in B400 are 41% cheaper than the overall index (on a trailing 12-month basis) and 30% cheaper on a forward-looking basis.



Sources: MarketGrader, FactSet

2. Large cap stocks are still too expensive





The Barron's 400 Index is almost 48% cheaper than the S&P 500 on a trailing 12-month basis and 55% cheaper on a forward-looking basis. All valuations are based on simple average P/E ratios, excluding companies with negative earnings.

Sources: MarketGrader, FactSet

3. Quality matters: focus on earnings and margins

S&P 500 Earnings Surprises

(For most recent earnings season, covering Q3 2022 reports)

The top 50 companies in the index, accounting for 52% of its weight, had an average earnings surprise of 3.6%, or 33% lower than the average surprise for all index constituents.

Earnings surprise is defined as reported quarterly EPS relative to the consensus analyst estimate leading to the report.

Sources: MarketGrader, FactSet

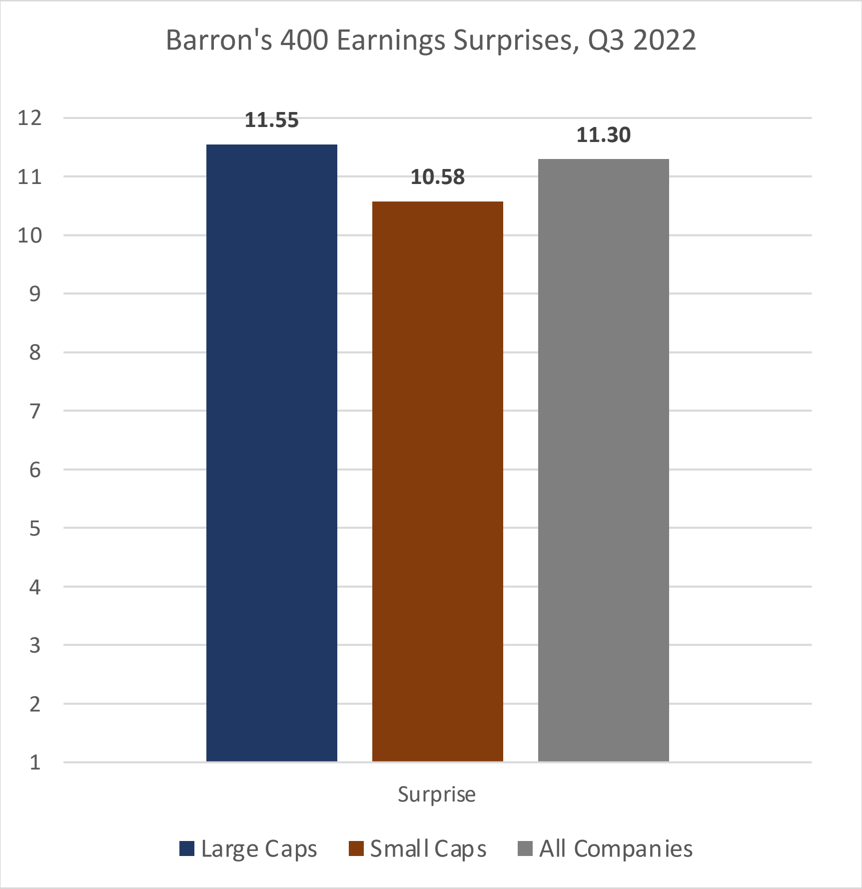
3. Quality matters: focus on earnings and margins

Barron's 400 Earnings Surprises

(For most recent earnings season, covering Q3 2022 reports)

B400 constituents had an average earnings surprise of 11.3% during Q3, 2022, more than **double** the average earnings surprise for all S&P 500 index constituents.

Earnings surprise is defined as reported quarterly EPS relative to the consensus analyst estimate leading to the report.



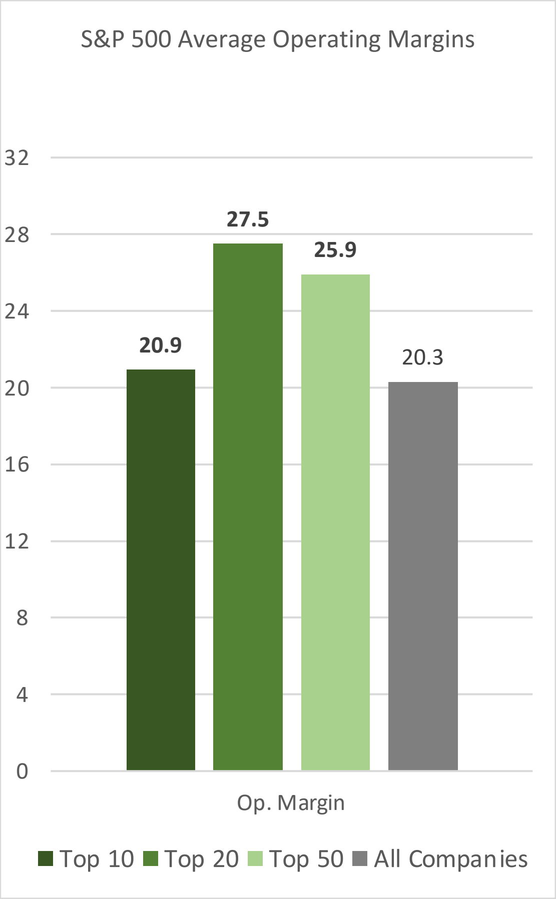
Sources: MarketGrader, FactSet

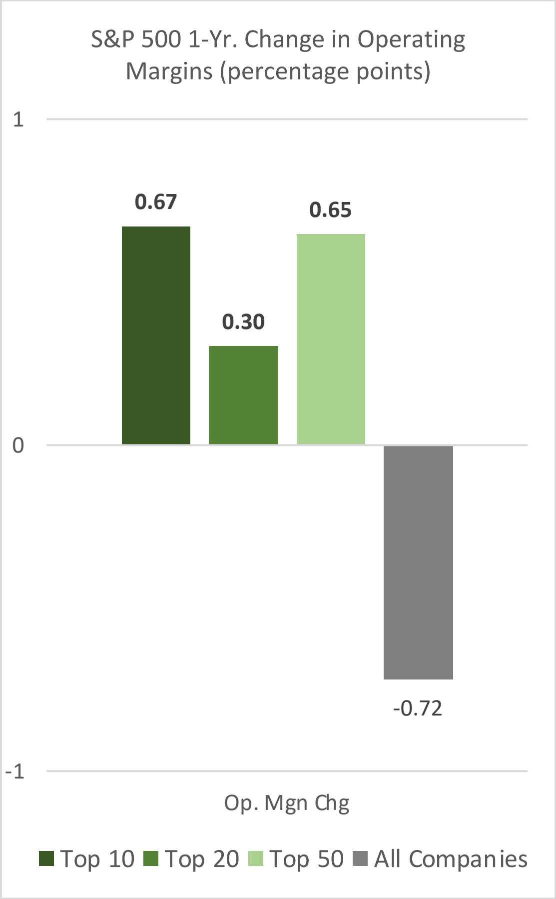
3. Quality matters: focus on earnings and margins

S&P 500 Operating Margins

(Based on current 12-month trailing data)

Although S&P 500 Index constituents have healthy operating margins, which average 20%, these have eroded in the last 12 months by almost a full percentage point.





Sources: MarketGrader, FactSet

3. Quality matters: focus on earnings and margins

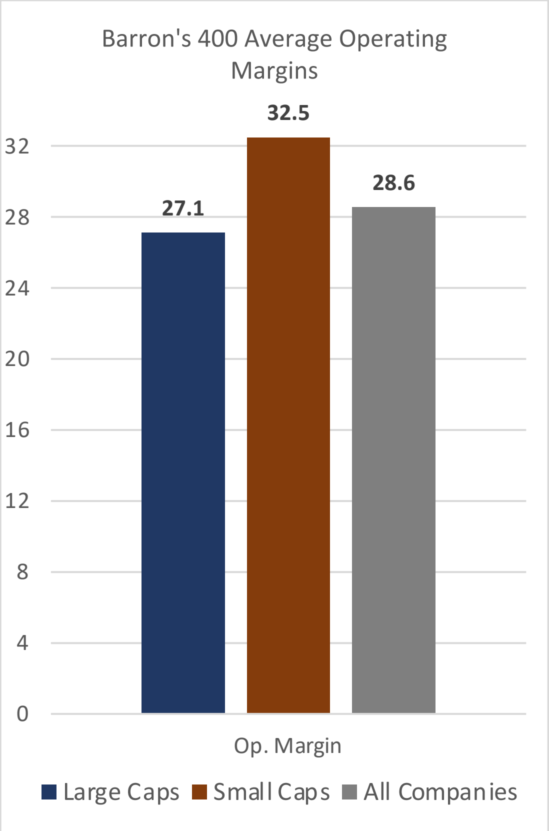
Barron’s 400 Operating Margins

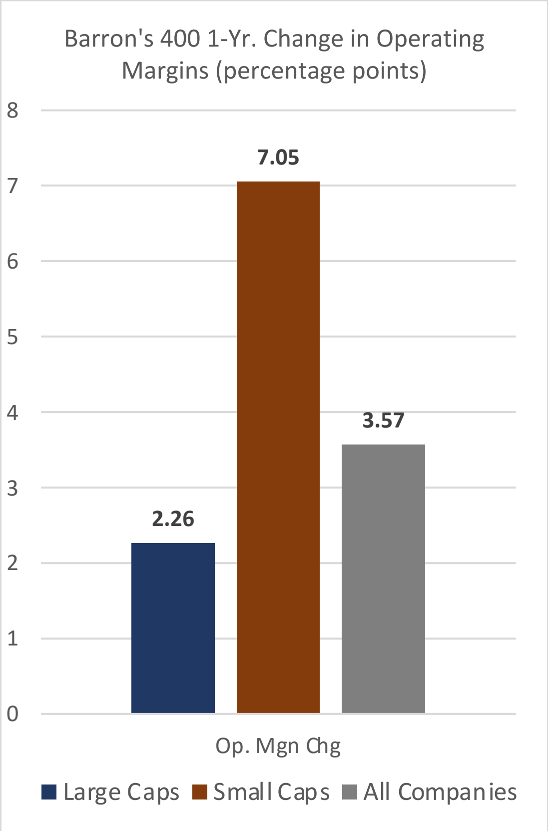
(Based on current 12-month trailing data)

B400 constituents have average operating margins of 28.6%, more than eight points higher than the average for the S&P 500’s constituents.

Small caps showed robust margin expansion in the last year, averaging seven percentage points, to an average of 32.5%.

However, your benchmark matters: 33% of Russell 2000 Index members have negative earnings.





Sources: MarketGrader, FactSet