Equities in Focus

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A Change of Seasons

Sector leadership in key US equity indices has taken on a different look in the opening months of this year. What are some reasons why this is happening, and what may cause it to continue?

Key Takeaways

1. **Sector leadership has changed**—Leaders and laggards from the past two years have changed places so far in 2025.
2. **What is causing all this?**—Extended valuations in crowded trades and an earnings convergence story are among the reasons.
3. **Rates can influence breadth**—The relationship between Treasury Rates and market breadth are meaningful.

While two months does not make a long-term trend, the change in the S&P 500's year-to-date sector leadership is not inconsequential (*Display 1*). While popular investor sectors such as communication services and technology have dominated US large cap market returns in recent years (thanks in part to AI and cloud computing), tech stocks in particular have struggled versus others from a return standpoint in 2025.

Drivers of the Rotation

Some notable contributors to these shifting sands range from concerns surrounding AI monetization after so much money being spent by large tech firms relating to it, to tariff fears and what that could mean for inflation. Consequently, more defensive sectors such as health care and consumer staples have benefitted from this quest for safety, and their lower valuations have been icing on the cake. But what equity markets ultimately respond to most is earnings growth. And as (*Display 2*) shows for both this year and 2026, the earnings growth for the S&P 500 and US large cap stocks, excluding the Magnificent 7 (Mag 7), are closing in on the latter. Combine that, along with many stocks outside of this formally coveted cohort were trading at a discount to the Mag 7, underscores the long held maxim that price matters, especially in periods of change and uncertainly.

Our View

Time will tell if this texture change continues, but we believe an important driver that could extend its runway is lower interest rates. There has been a strong relationship between S&P 500 market breadth and 10-Year US Treasury Note yields, as shown on (*Display 3*). If rates continue to go lower this year, as we expect, more stocks may attract investor attention beyond a select group, which would likely further accrue to the benefit of active managers' 2025 relative returns.

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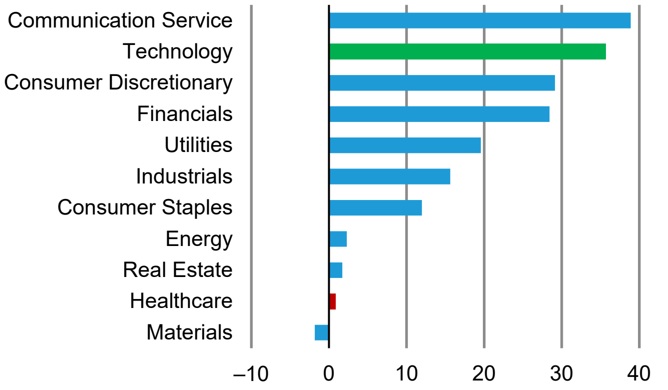
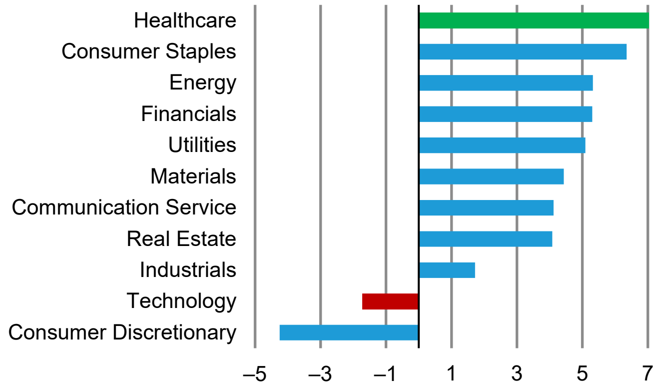
Display 1: S&P Index 2024 Sector Performance
Percent

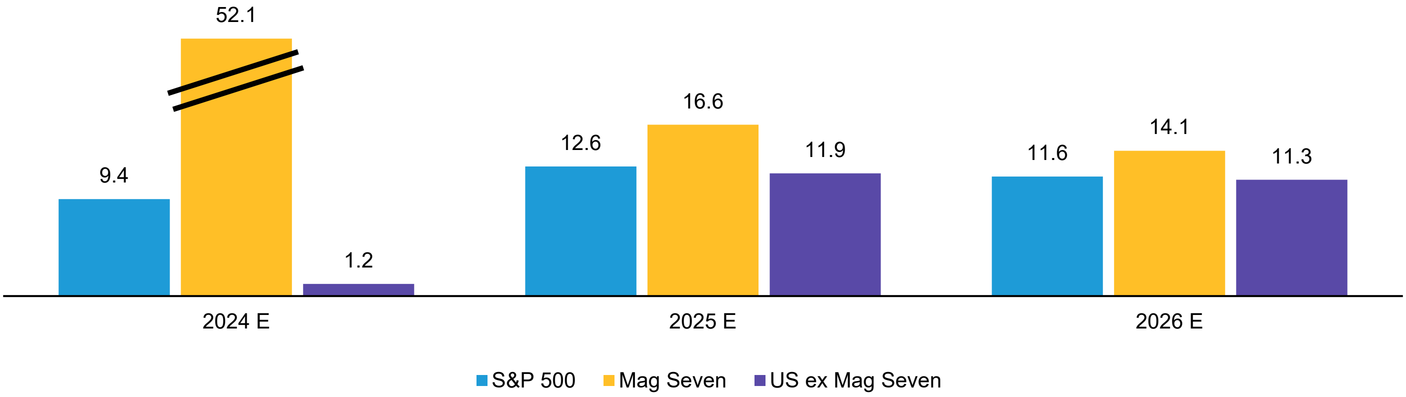


Display 1: S&P 500 Index YTD through February 24, 2025 Sector Performance (Percent)



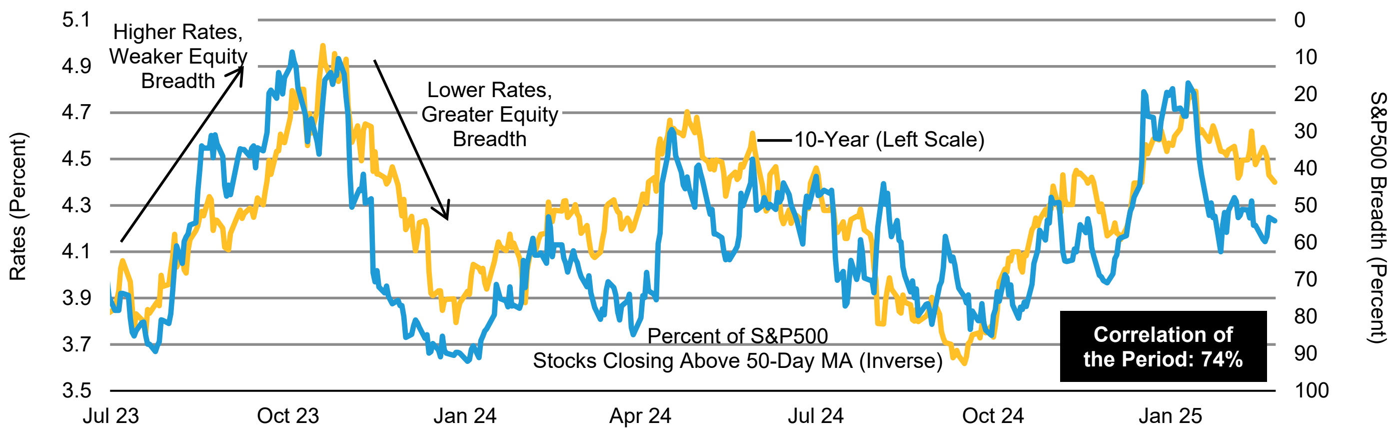
Past performance does not guarantee future results.
Source: Bloomberg and AB

Display 2: Consensus EPS Growth
Percent



Current analysis does not guarantee future results.
Mag Seven is represented by the UBS Mag 7 Index and US ex Mag Seven by the Bloomberg US Large Cap ex Mag 7 Index. All in USD terms.
As of December 11, 2024
Source: Bloomberg and AB

Display 3: 10 Year Treasury Yield Versus S&P500 Market Breadth



Past performance does not guarantee future results. Analysis provided for illustrative purposes only and is subject to revision.
MA: moving average
As of February 24, 2025
Source: Bloomberg, S&P and AB

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Some of the principal risks of investing include Market Risk, Currency Risk, Derivatives Risk, OTC Derivatives Counterparty Risk, Allocation Risk, Overseas Assets Risk, Systemic Risk, Turnover Risk, Illiquid Securities Risk, Leverage Risk, Equities Risk, Concentrated (Focused Portfolio) Risk, Smaller-Capitalization Companies Risk and Long/Short Strategies Risk.

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