THE 2026 FIELD GUIDE TO MACRO & MARKETS

A MANUAL FOR INVESTING IN TODAY'S AI & INFLATION-FOCUSED PARADIGM

This guide is for everyone—from the newest interns to the most experienced Wall Street veterans—who wants to get a better handle on how macro forces influence markets. Macro is back in the spotlight in 2026 and investors are laser-focused on what's happening with oil and interest rates. Our goal here is to break down the key themes we're watching in 2026 and to discuss the myriad of ways macro influences markets over time. Please email us at strategy@psc.com with any questions or if you'd like to set up a call with the team.

If you've enjoyed our work this year, we'd really appreciate your support in the ***Institutional Investor All-America Equity Research Poll***. It's VERY important to us, and your support would mean a lot!

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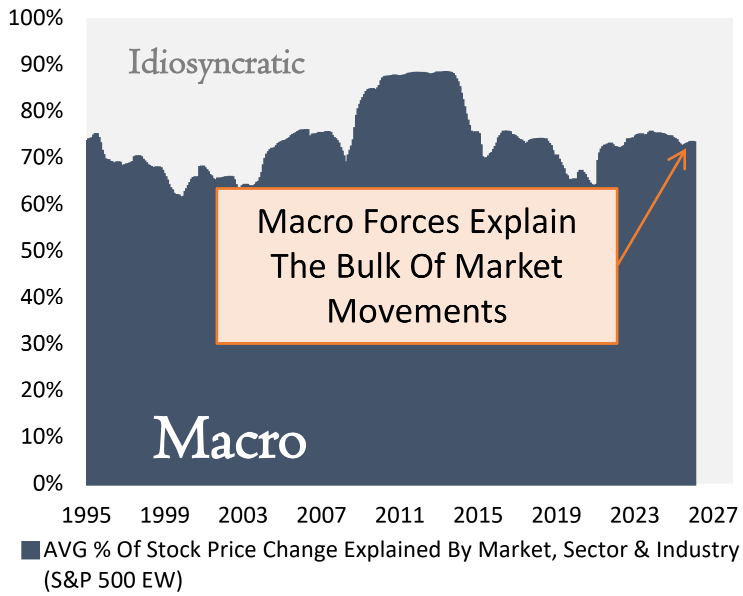
THE IMPORTANCE OF MACRO

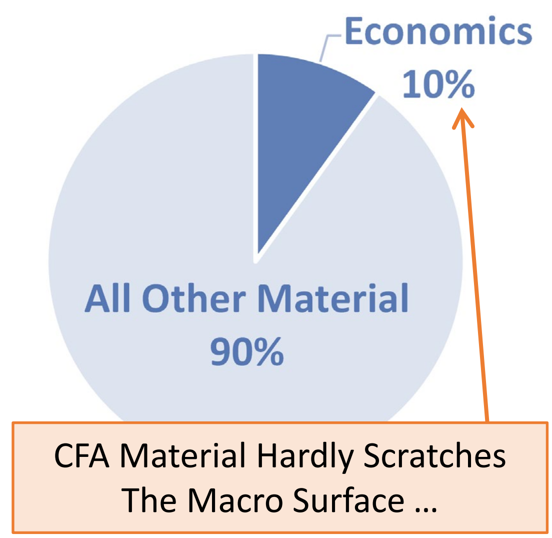
Macroeconomic forces remain the primary driver of financial markets. Our analysis indicates that approximately 70% of equity price movement is attributable to the broader macro narrative, with company-specific idiosyncrasies accounting for the remaining 30%. This creates a persistent disconnect: while most market participants are trained in a bottom-up analytical framework, they often struggle to navigate periods where macro forces dictate market direction.

Macro Plays A Huge Role In Explaining Market Moves

Stock Price Explained By Macro

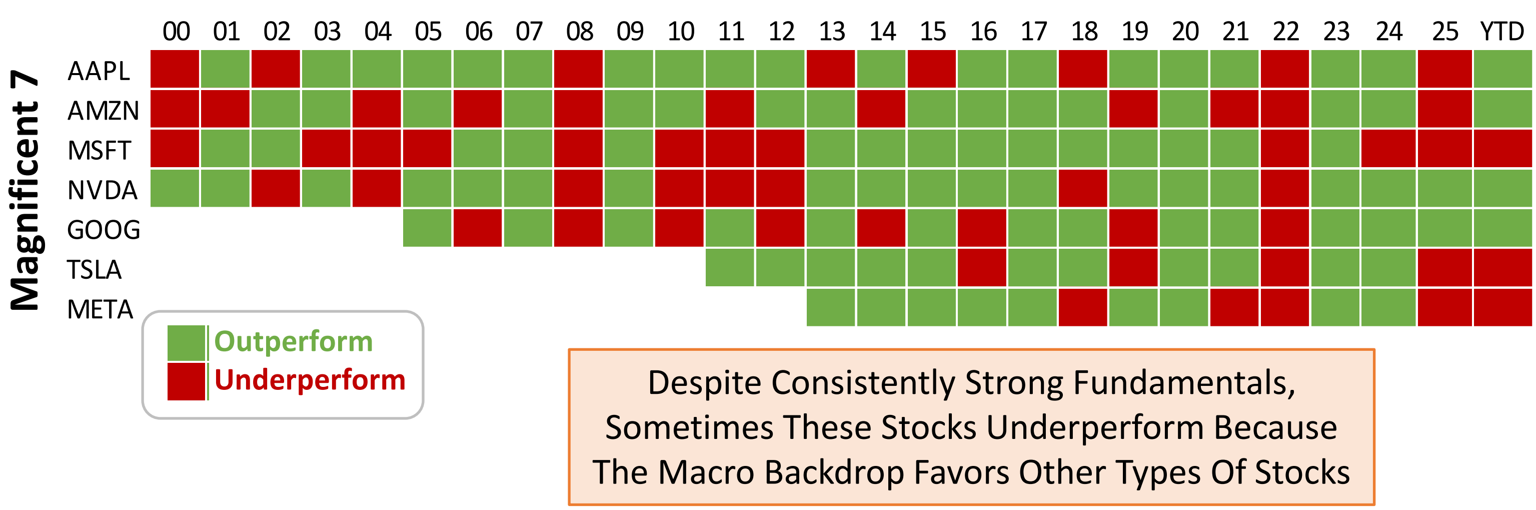


CFA Level 1 Topics



A great company is not always a great investment. This discrepancy is typically a function of the macro environment, which dictates leadership across different economic regimes. Because investor appetite shifts between recovery and contraction, even the strongest companies can underperform. Relying solely on fundamentals ignores the reality that macro forces—not just company-specific performance—drive relative returns.

Outperformance Is Not Guaranteed …
Even For The Most Successful Companies In The World



1. A Paradigm Shifts In Markets; Inflation Is Now The Biggest Risk

Beyond the rise of AI, the most significant market evolution in recent years is the paradigm shift in how investors perceive growth and inflation. From the late 1990s through the COVID-19 pandemic, inflation anxiety was absent, and slowing growth represented the primary market risk. Since 2022, however, investors have feared higher inflation and rising rates more than economic deceleration.

After Decades Of Low Inflation And Falling Rates,
The Inflation Shock Of 2022 Rekindled Inflation Fears For The First Time Since The 1970s

1. The 1970s Stagflation Experience

The last period where inflation volatility caused a paradigm shift in investor behavior, leading stock prices to move in contrast to interest rates.

2. Two Decades Of Disinflation: 80s-00s

It took two decades of disinflation for investors to no longer fear inflation. This led to the next paradigm shift in 2000.

3. Decade Of ZIRP & QE: 2010s

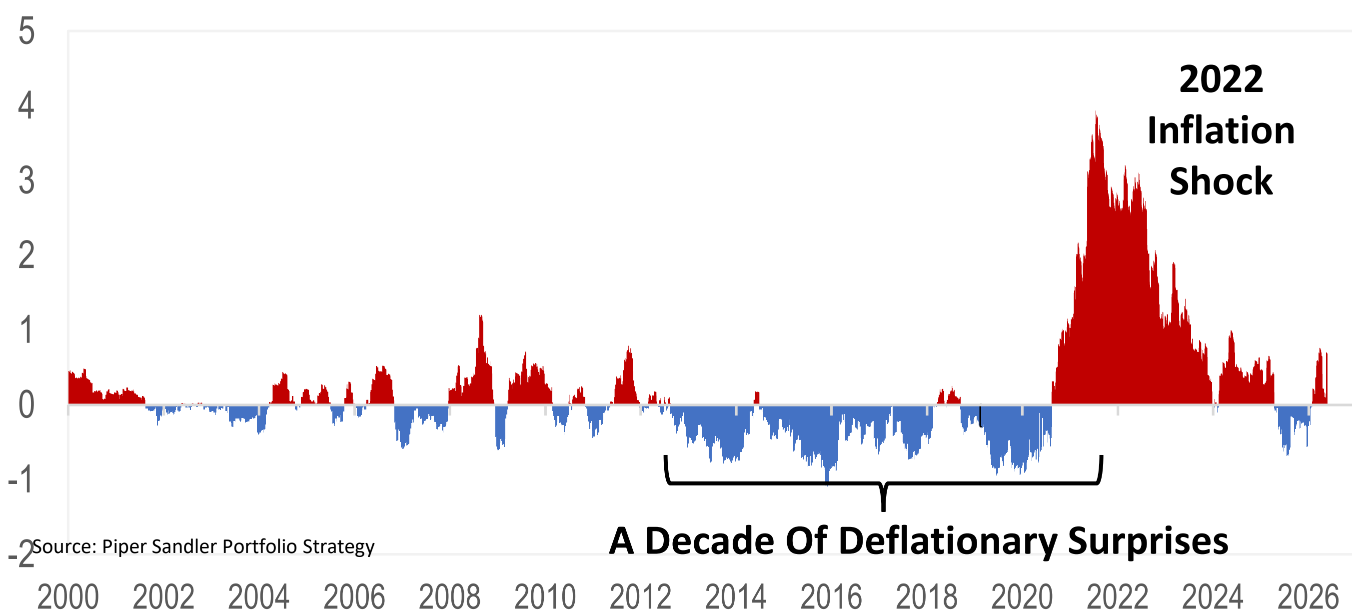
The GFC was followed by years of *deflation* fear, leading to a very positive correlation between interest rates and stock prices.

4. '22 Inflation Scare

Record stimulus combined with a supply shock led to the first inflation scare since the 70s; a perfect storm for investors used to low rates and deflation fears.

All Of What's Occurred Over The Past 50 Years Has Contributed To Today's Paradigm Shift

Bloomberg Inflation Surprise Index

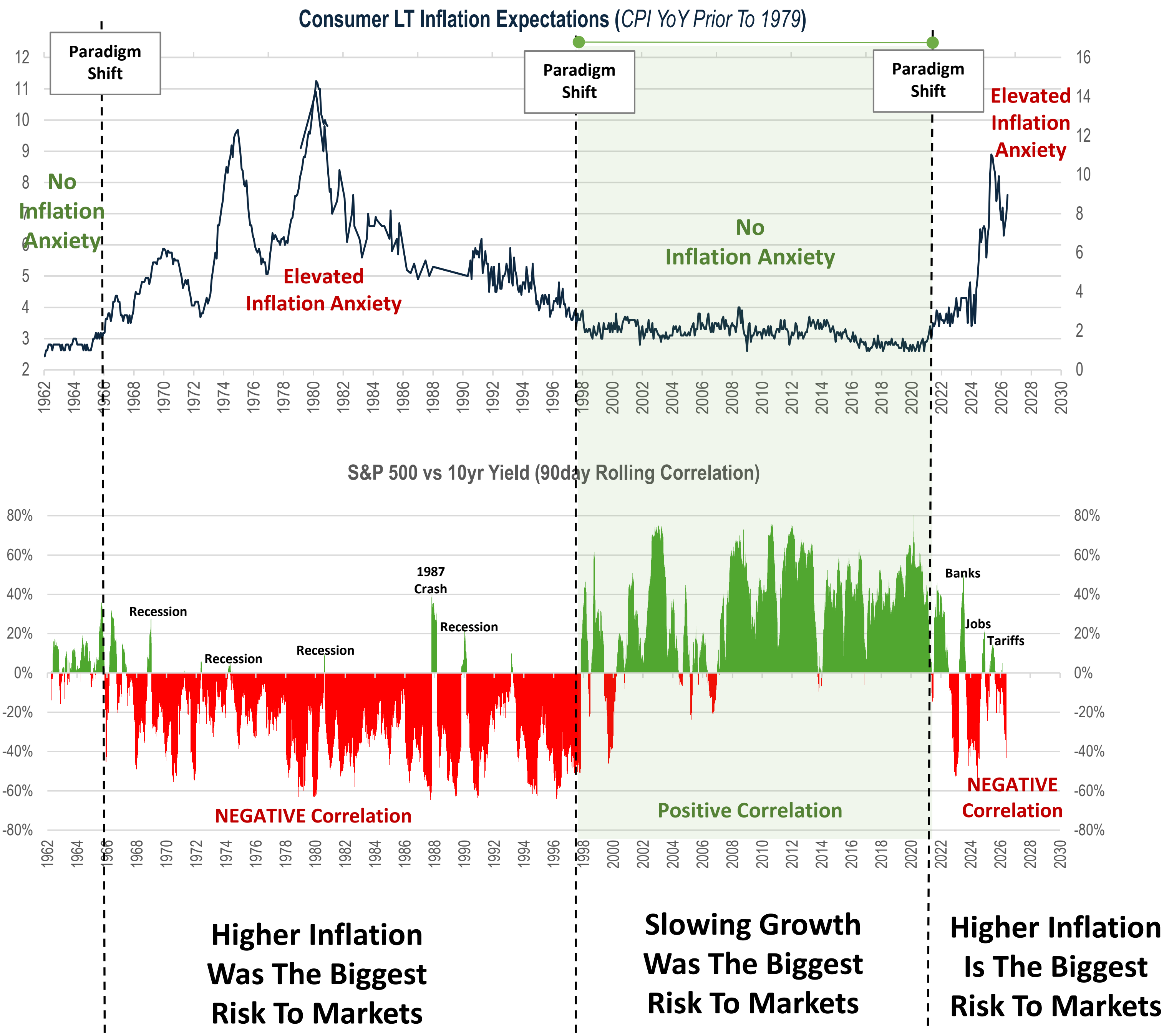


Source: Piper Sandler Portfolio Strategy

1. A Paradigm Shifts In Markets; Inflation Is Now The Biggest Risk

The 2022 inflation shock fundamentally changed how markets work, creating an environment that many investors haven't experienced in their careers. We have effectively returned to a pre-1990s regime where inflation is the primary driver of market sentiment. In this environment, the relationship between interest rates and stocks has shifted back to a classic "tug-of-war": Rising rates act as a headwind, putting pressure on stock valuations whereas falling rates acts as a tailwind, providing support for equity prices. This negative correlation—where rates and stocks move in opposite directions — has once again become the dominant force shaping today's market landscape.

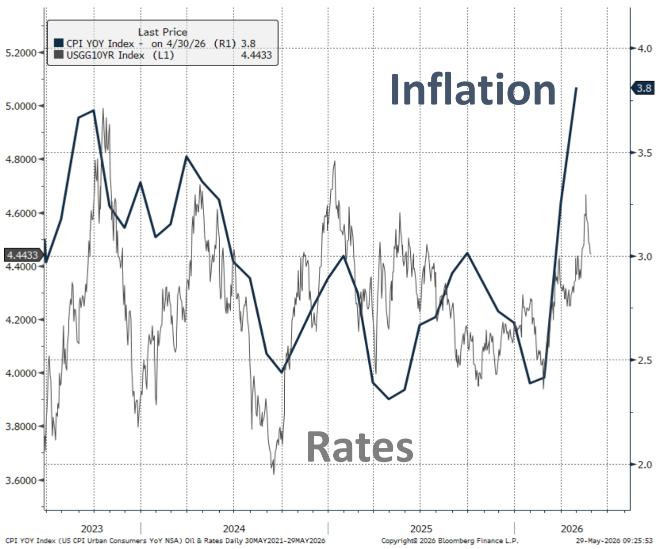
When Inflation Anxiety Is Elevated,
Equities And Interest Rates Are Usually Negative Correlated



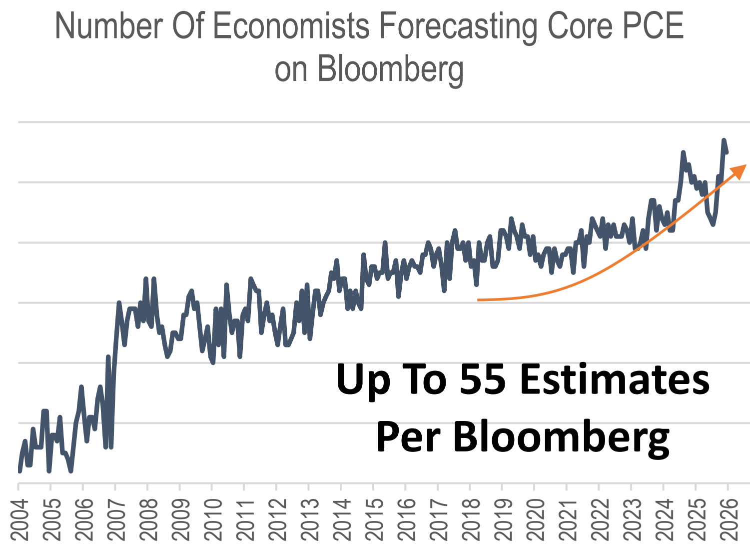
Equities Rise When Rates Fall & Struggle When Rates Rise

In today's paradigm, rates have been closely following the path of inflation and Wall Street is more tuned into inflation data than we've ever seen before!

Inflation has Been The Key Driver Of Interest Rates …

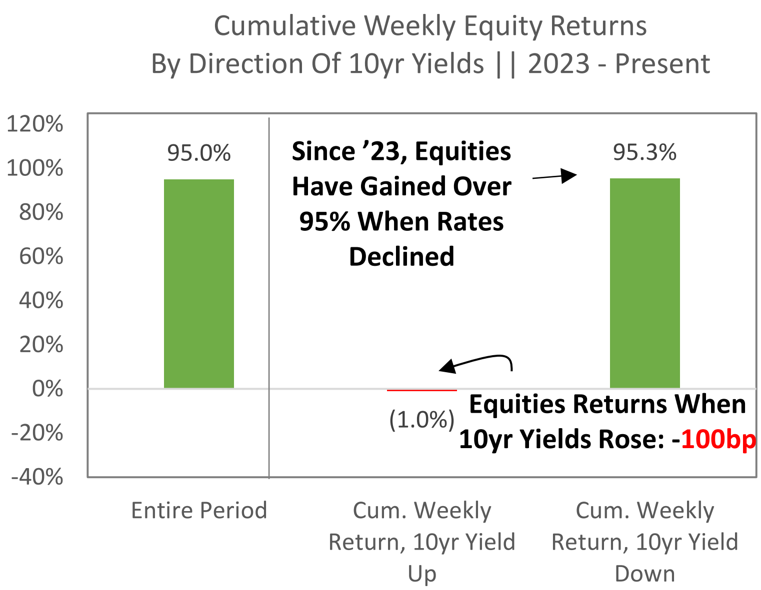


… And There Have Never Been So Many Inflation Watchers!

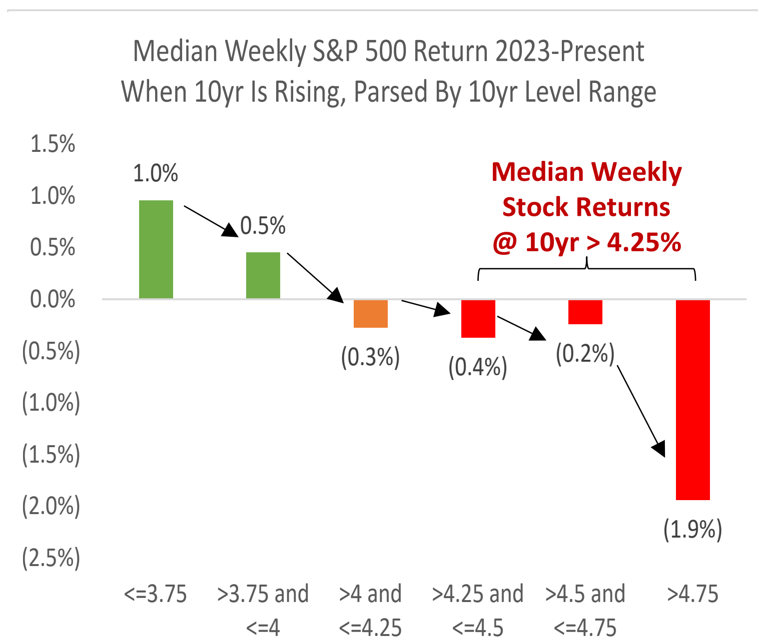


Over the last several years (since the inflation shock), the S&P 500 is up almost 100%. What's striking is that all of those gains came in weeks when rates were falling. If we look only at weeks where rates were rising, the market has been down cumulatively over that period.

Equity Returns: Yields Up vs Down



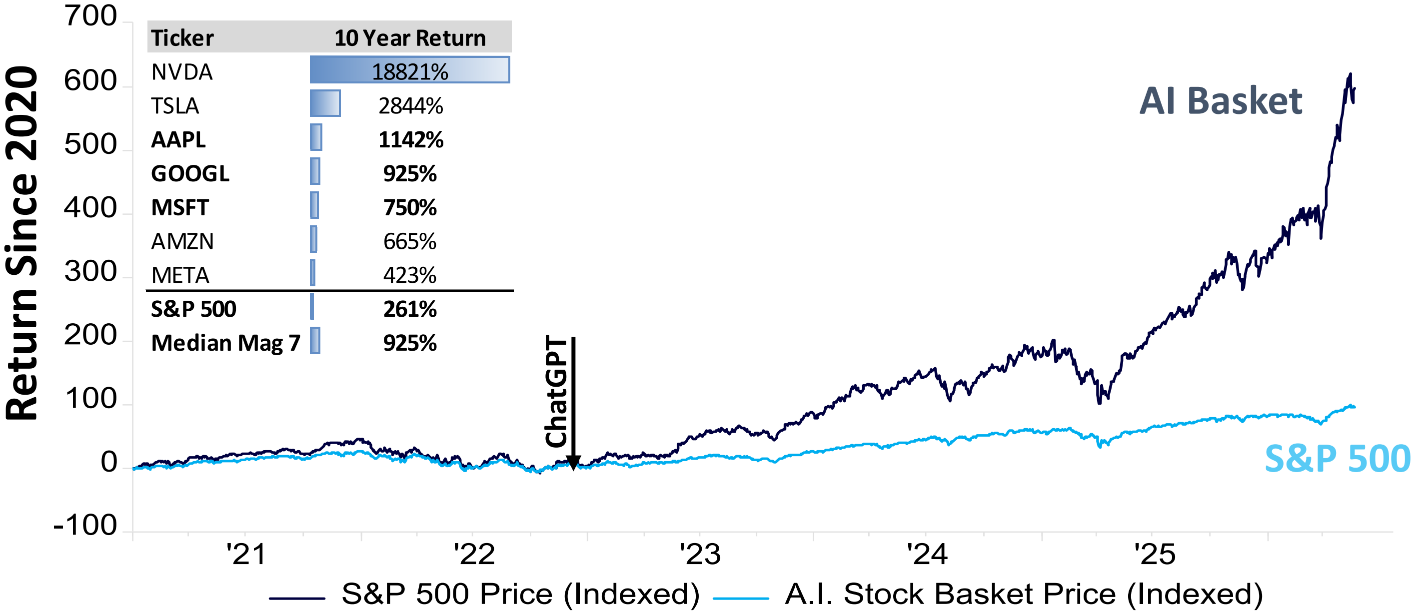
Equity Returns: Yields Rising At Various Levels



AI-Fueled Markets: AI Has Been The Only Game In Town

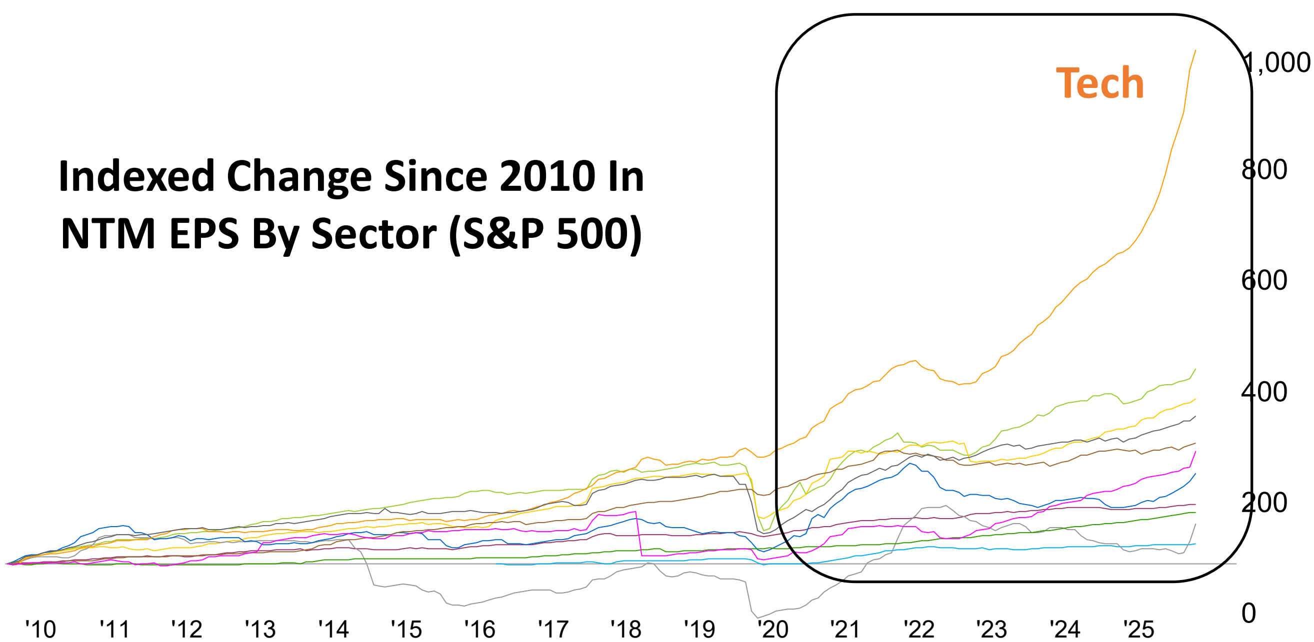
The structure of U.S. equity markets has evolved significantly over the past decade. The ascent of the "Magnificent Seven" and the ongoing AI infrastructure buildout have fundamentally altered the index's return profile and composition. The chart below illustrates this divergence, comparing the performance of AI-sensitive equities against the S&P 500. We also show below a table of the massive returns for the Mag 7. Given their outsized index weight and exceptional performance, these leaders have created a high hurdle for the broader market, making it increasingly difficult for non-AI-exposed equities to keep pace with the benchmark.

AI Has Dramatically Changed The Landscape For Investors



Ticker	10 Year Return
NVDA	18821%
TSLA	2844%
AAPL	**1142%**
GOOGL	**925%**
MSFT	**750%**
AMZN	665%
META	423%
S&P 500	**261%**
Median Mag 7	**925%**

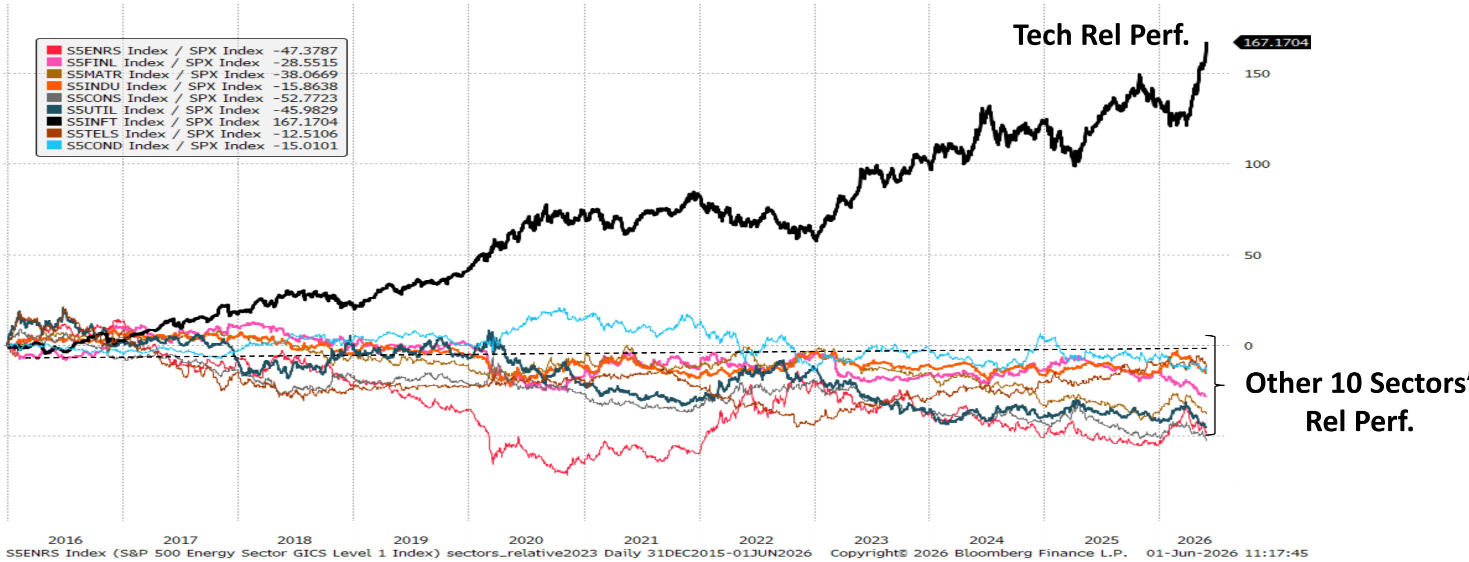
Earnings Growth Has Been Concentrated To The Tech Sector



AI-Fueled Markets: Tech Has Caused Sector Distortion

Tech's enormous outperformance, and concentration in the market, has meant that all other sectors have seen relative underperformance over the last 10 years. Additionally, Tech's persistent leadership has propelled the large cap growth index to be the best-performing index of the size and style boxes 7 of the last 8 years!

Every Other Sector Has Underperformed Amidst Tech's Size & Strength



Tech's Strength Has Led To Persistent Leadership Of Large Cap Growth

Tech's strength has pushed Large Cap growth to The Top Of The Pack.

Tech makes up more than 52% of the Large Cap Growth Index!

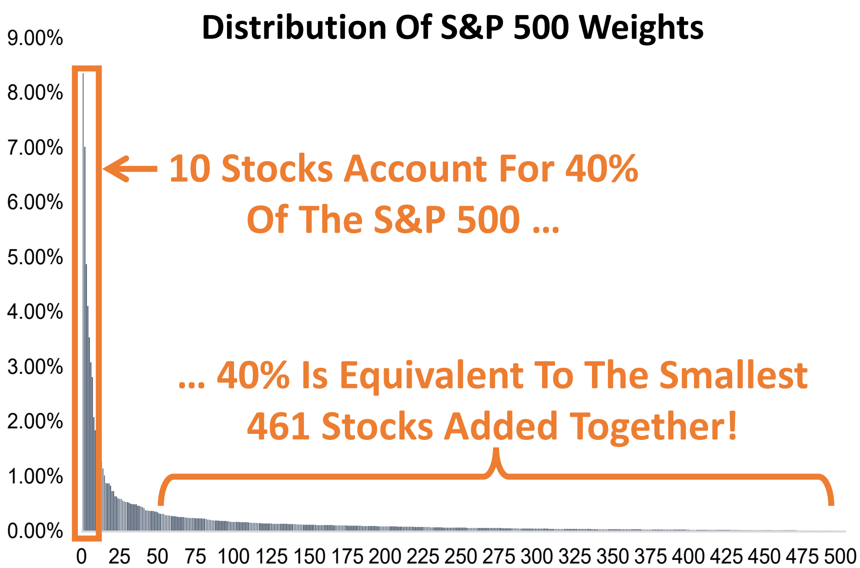
2018	2019	2020	2021	2022	2023	2024	2025
-1% Lg Growth	29% Lg Growth	32% Lg Growth	31% Lg Growth	-7% Lg Value	28% Lg Growth	35% Lg Growth	21% Lg Growth
-5% Sml Growth	29% Lg Core	21% Mid Growth	29% Sml Value	-9% Mid Value	24% Lg Core	23% Lg Core	16% Lg Core
-6% Lg Core	29% Lg Value	18% Sml Growth	28% Mid Value	-13% Sml Value	20% Lg Value	15% Mid Growth	11% Lg Value
-10% Sml Core	25% Mid Growth	16% Lg Core	27% Lg Core	-14% Mid Core	16% Mid Growth	12% Mid Core	6% Mid Growth
-11% Lg Value	24% Mid Core	12% Mid Core	25% Sml Core	-17% Sml Core	15% Sml Growth	10% Lg Value	6% Mid Core
-11% Mid Growth	24% Mid Value	10% Sml Core	23% Mid Core	-19% Lg Core	14% Mid Core	9% Mid Value	5% Mid Value
-12% Mid Core	22% Sml Value	1% Mid Value	22% Lg Value	-20% Mid Growth	14% Sml Core	8% Sml Growth	4% Sml Value
-14% Mid Value	21% Sml Core	0% Sml Value	22% Sml Growth	-22% Sml Growth	13% Mid Value	7% Sml Core	4% Sml Core
-14% Sml Value	20% Sml Growth	-1% Lg Value	18% Mid Growth	-30% Lg Growth	12% Sml Value	5% Sml Value	4% Sml Growth

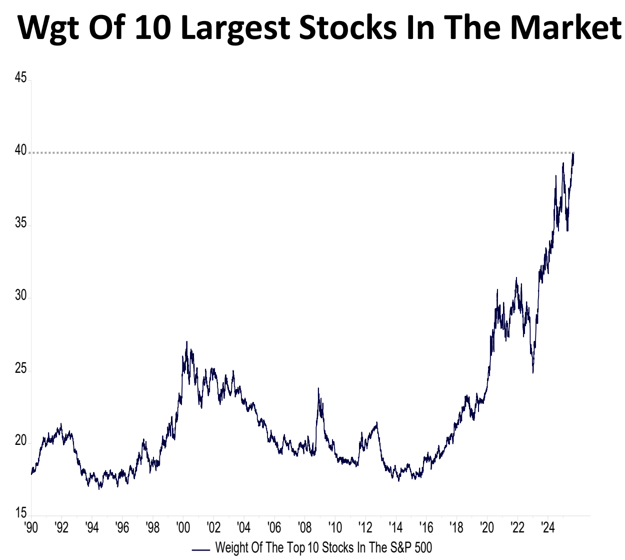
S&P Indices

Equities More Concentrated & Crowded Than Ever Amidst AI

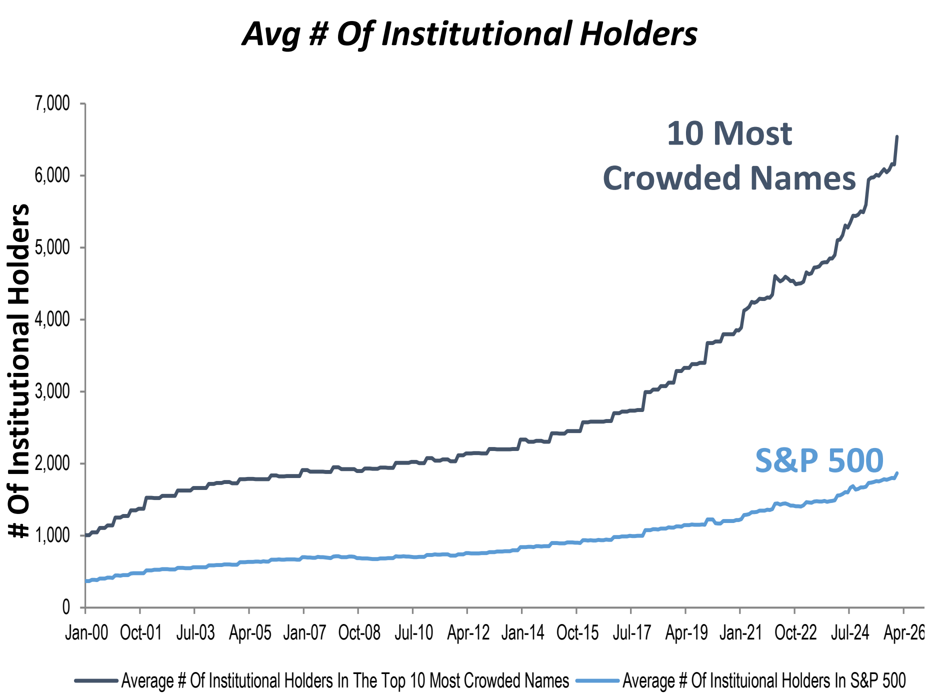
Market leadership has become increasingly narrow over the last decade, compelling investors to hold mega-cap names to remain competitive with the benchmark. With the top ten stocks now representing 40% of the S&P 500, concentration is at a historic peak. This is further evidenced by institutional crowding; the ten most popular names now average over 6,000 institutional owners, marking a new record for the industry!

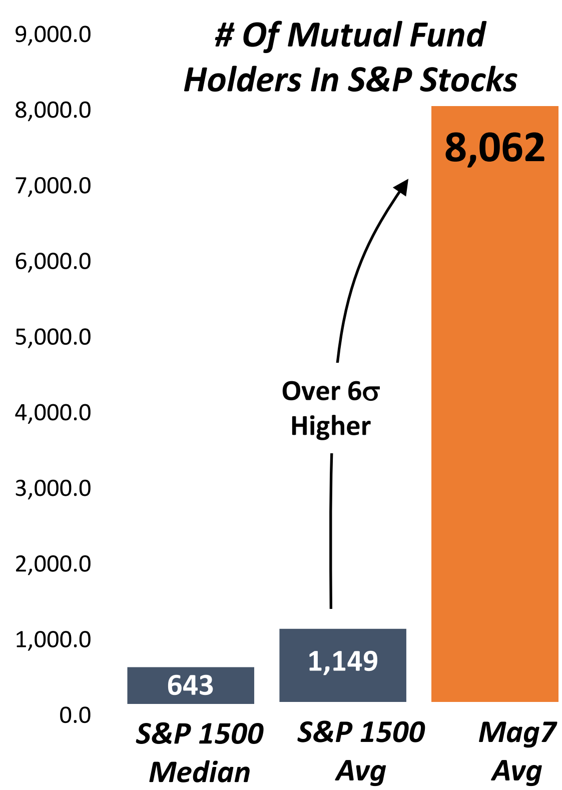
US Equities Have Never Been This Concentrated





US Equities Have Become Increasingly Concentrated

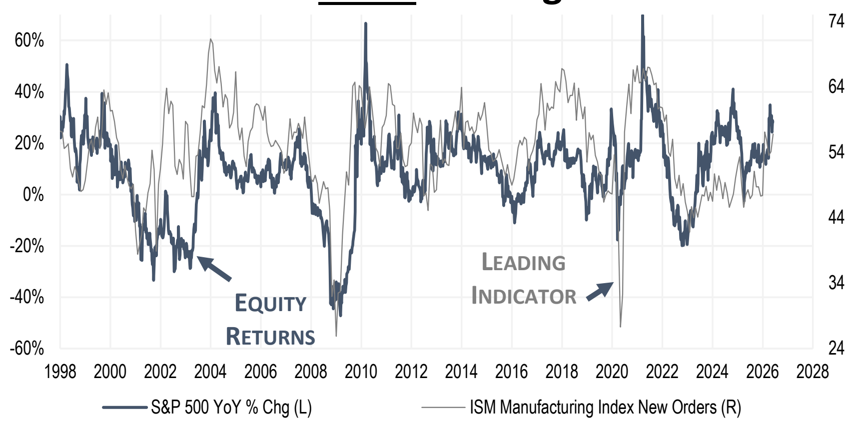




3 Flavors Of Economic Data: Leading, Coincident, And Lagging

Despite the structural shifts observed recently, the economy and equity markets remain subject to cyclical forces. These cyclical dynamics persist within broader structural trends, driving periodic investor rotations between cyclical, defensive, and high-quality positioning. Consequently, monitoring the business cycle—through both economic data and market leadership trends—remains paramount.

Stocks Move WITH Leading Indicators



(EQUITY RETURNS) (LEADING INDICATOR)

If you've studied financial statement analysis, you know that there is a lot of data! There is just as much macro data and understanding which data is most influential for markets is key to success. Macro data can be broken into leading, coincident and lagging. Leading economic indicators are most important for investors given that markets trend WITH leading indicators. Coincident and lagging indicators serve more as confirmation than market-moving information.

1st Leading Indicators

- **Stock prices - S&P 500**
- Mfg weekly hours
- Initial claims
- Manufacturers' new orders, consumer goods,
- **ISM Index of New Orders**
- New orders, nondefense capital goods ex. air
- Building permits
- Leading Credit Index
- Yield Curve
- Consumer Sentiment

STOCK MARKET AND PMIS

2nd Coincident Indicators

- Personal income less transfer payments
- Manufacturing and trade sales
- Industrial production
- Employee payrolls
- GDP

GDP

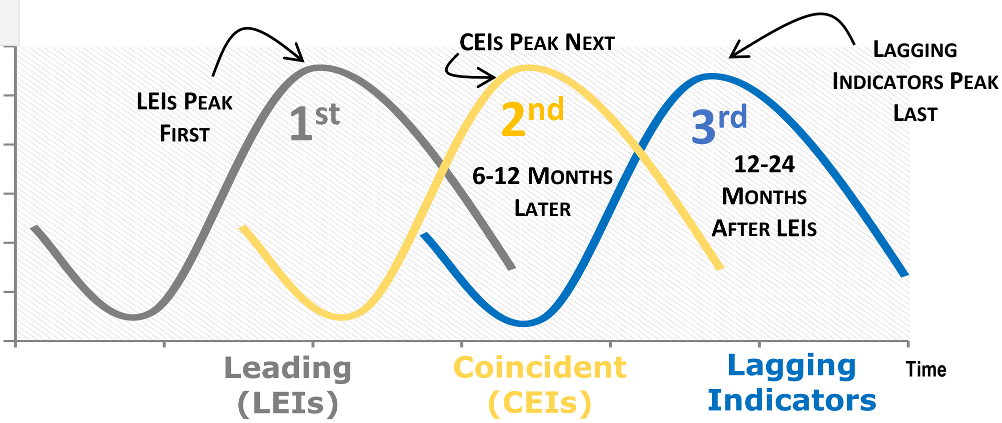
PRIME RATE

3rd Lagging Indicators

- C&I loans
- Change in CPI for services
- Average duration of unemployment
- Change in labor cost
- Ratio of consumer installment credit to personal income
- Ratio of mfg and trade inventories to sales
- Average prime rate

Leading Economic Indicators (LEIs) Peak BEFORE Coincident & Lagging Indicators

Leading Indicators Tell You Where Coincident And Lagging Data Is Headed

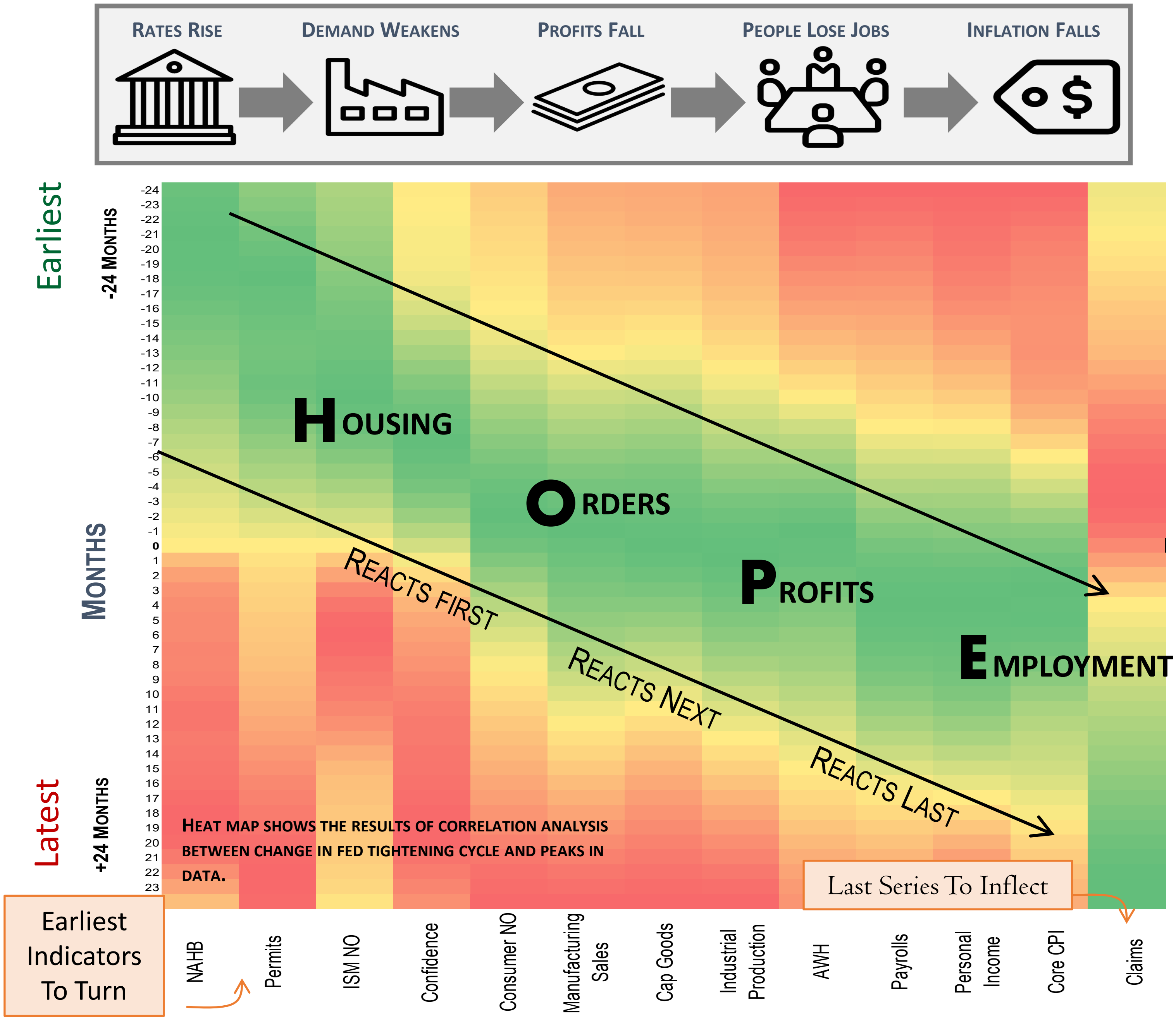


Source: [The Conference Board Leading Economic Index® for the United States]

HOW DOES THE ECONOMY RESPOND TO CHANGES IN MONETARY POLICY?

While forecasting the business cycle will always be a challenging task, the way the economy reacts to policy trends is consistent. We developed our H.O.P.E framework as a blueprint for how changes in rates impact the economy. A rise in rates first impacts the extremely "rate-sensitive" Housing sector. A few quarters later you start to see weaker data in other sectors of the economy like manufacturing. This is when measures of New Orders decline. A few quarters after that, you begin to see Profits weaken as sell-side research analysts take down their estimates for future earnings. Finally, well after a sharp rise in interest rates, employment deteriorates and the economy goes into "recession". It can take up to two years for the rise in rates to flow through and eventually hit employment.

Stimulus Shows Up In Leading Indicators First, Then Eventually Everywhere Else



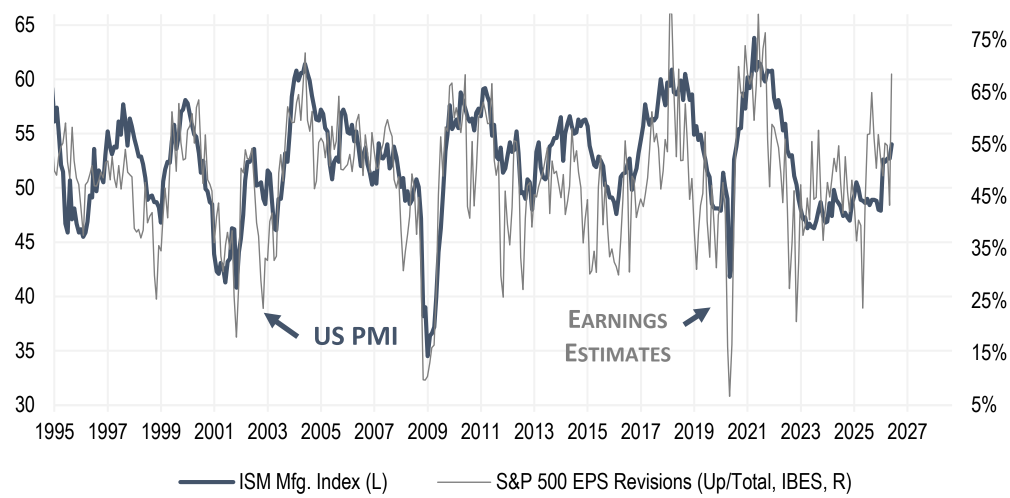
Purchasing Managers Indices (PMIs) Are A Type Of Leading Indicator

PMIs fall under the umbrella of Leading Economic Indicators (LEIs) and they are our favorite type of LEI due to their high correlation with earnings. There are several PMIs out there with different regions of focus (US national, US regionals, Global, etc.) and slightly different methodologies, but the concept is the same. These PMIs are monthly surveys of Purchasing Managers. The participants are asked if things are better, the same, or worse than the prior month and the index is calculated as a diffusion index.

Leading Indicators

- **Stock prices - S&P 500**
- Mfg weekly hours
- Initial claims
- Manufacturers' new orders, consumer goods,
- **ISM Index of New Orders (PMI)**
- New orders, nondefense capital goods ex. air
- Building permits
- Leading Credit Index
- Yield Curve
- Consumer Sentiment

PMIs Are A Proxy Of Earnings



What Is The ISM Purchasing Manager Index (PMI)?

ISM Manufacturing PMI

Monthly survey of a committee of purchasing and supply executives across the country.

		Weight
New Orders	Reflects the levels of new orders from customers.	20%
Production	Measures the rate and direction of change, if any, in the level of production.	20%
Employment	Reports the rate of increase or decrease in the level of employment.	20%
Supplier Deliveries	Reveals if deliveries from suppliers are faster or slower.	20%
Inventories	Reflects the increases and/or decreases in inventory levels.	20%

Companies are asked about month-over-month changes in these indicators. They can respond with:

- Higher
- Same
- Lower

Fundamental analysts consider the same exact information when carrying out channel checks!

What Does The PMI Tell Us About Growth?

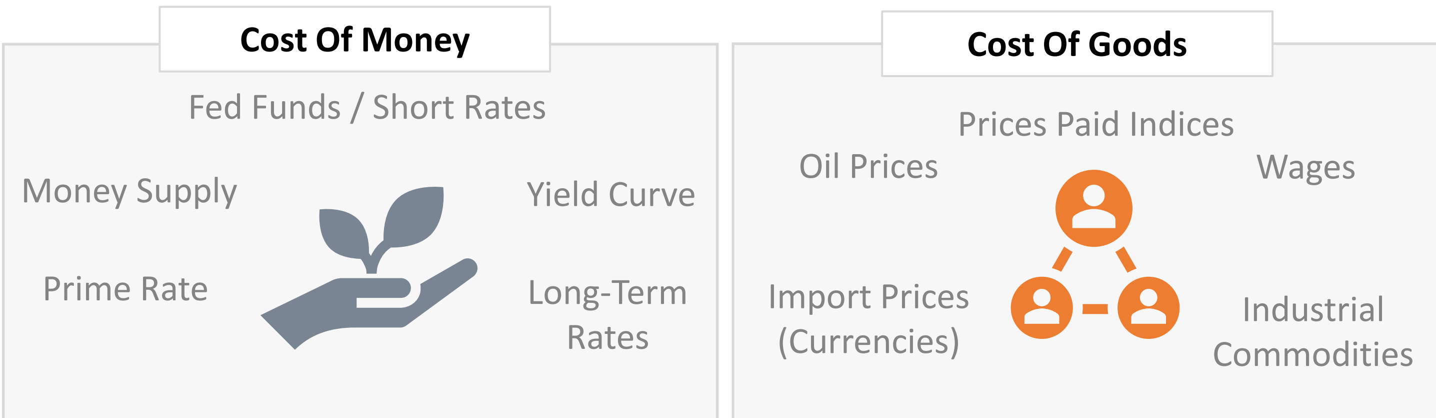
"A PMI® index over 50 represents growth or expansion within the manufacturing sector of the economy compared with the prior month. A reading under 50 represents contraction, and a reading at 50 indicates an equal balance between manufacturers reporting advances and declines in their business."

Source: Institute for Supply Management - PMI Frequently Asked Questions

How Do We Forecast Leading Indicators?

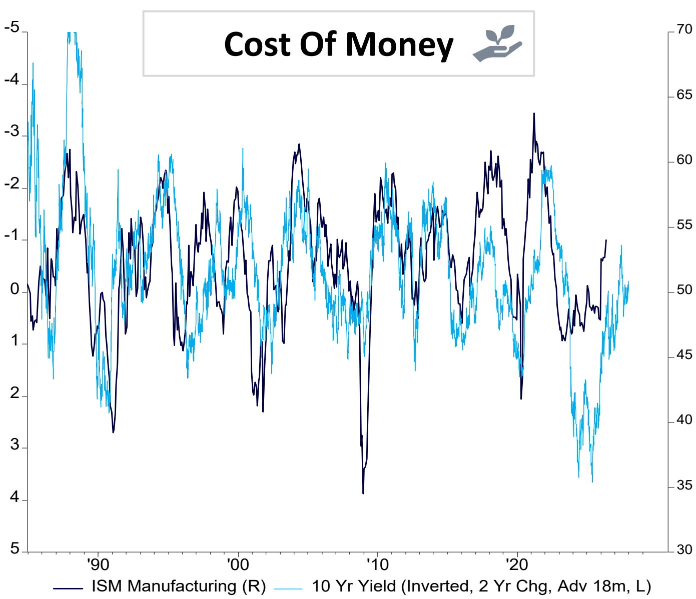
Forecasting the ebb and flow of the business cycle (i.e. PMIs and earnings) involves understanding how and why there are cyclical trends. Our take is that the cycle is largely a reflection of the amount of “stimulus” or “tightening” in the system. We refer to stimulus and tightening in a broad sense; for example, stimulus refers to a decline in the cost of money (i.e. lower rates) or the cost of goods (i.e. falling commodity prices, wages).

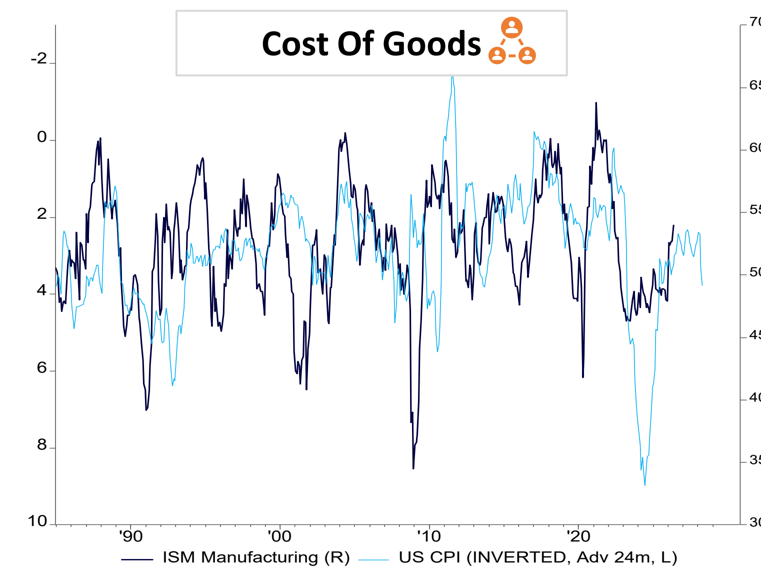
Which Macro Measures Help To Forecast The Business Cycle?



Two important lessons we’ve learned from studying history are 1) it is the **change** and not the **level** of the cost of money/goods that is useful for forecasting the business cycle and 2) it takes many quarters for this stimulus/tightening to have an impact on PMIs & Earnings. Below we show two of our favorite charts. The chart on the left shows the change in 10-yr interest rates, inverted and advanced 18 months on one of our favorite PMIs (the ISM New Orders Index). By inverting and advancing the bond yield series, we are showing that a rise in rates takes about 18 months to weigh on PMIs and vice versa when rates fall.

Changes In the Cost Of Money & The Cost Of Goods Can Be Used To Forecast PMIs





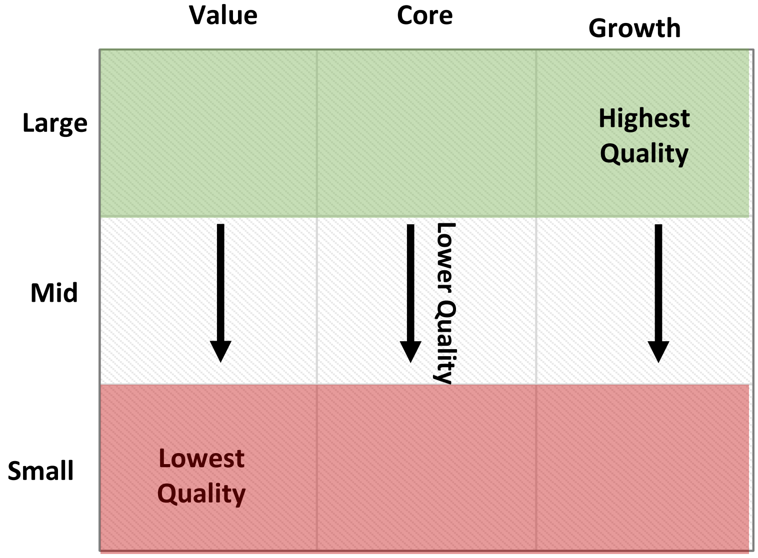
The “Costs” Lead PMIs By 1-2 Years

THERE IS A SPECTRUM OF QUALITY ACROSS SIZE & STYLE BOXES

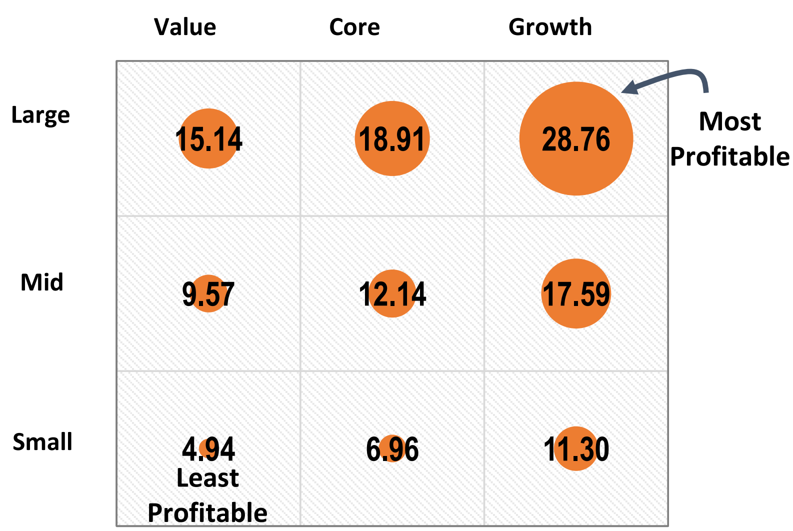
There are varying cyclical sensitivities and quality profiles across the varying size and style boxes. For example, LCG has the highest ROE and lowest debt/equity ratio, and smallest % of stocks with negative earnings whereas Small Cap Value is at the opposite extreme.

The Smaller And More Value-Oriented …. The Lower Quality!

QUALITY SPECTRUM



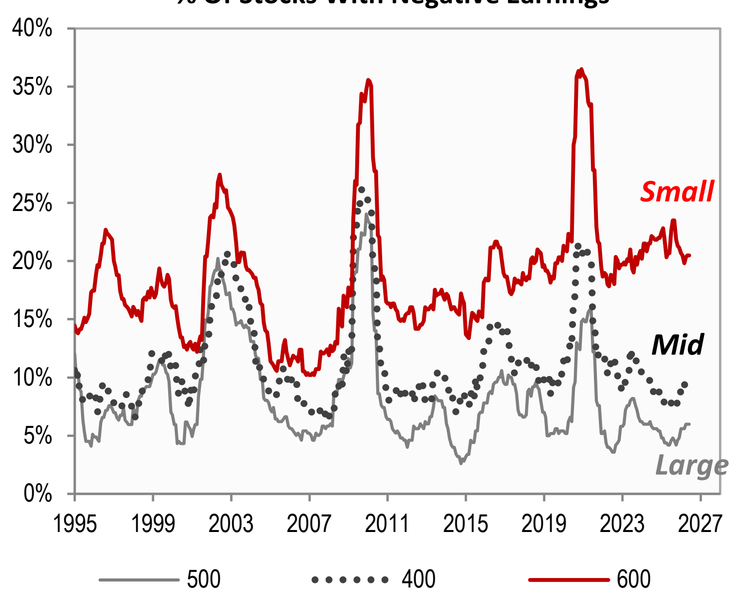
ROE



Another way to think about the cyclicality of size and style boxes is to look at the % of stocks within each universe that have negative earnings. The smaller you are, the larger the % of nonprofitable stocks. Stocks with weaker fundamentals (i.e. smaller and cheaper/value-oriented) are more sensitive to swings in the business cycle.

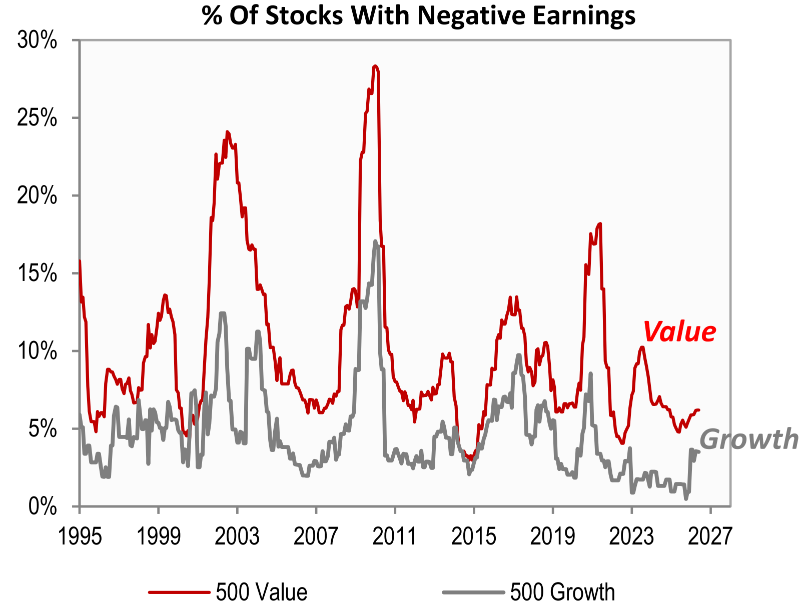
Size – Small Caps Most At Risk

% Of Stocks With Negative Earnings



Style – Value Most At Risk

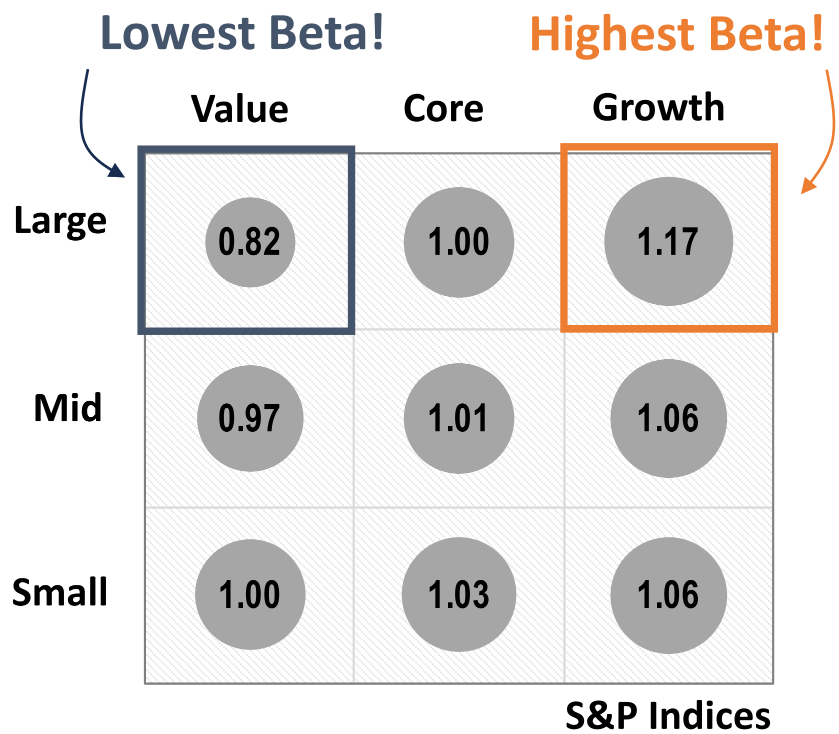
% Of Stocks With Negative Earnings



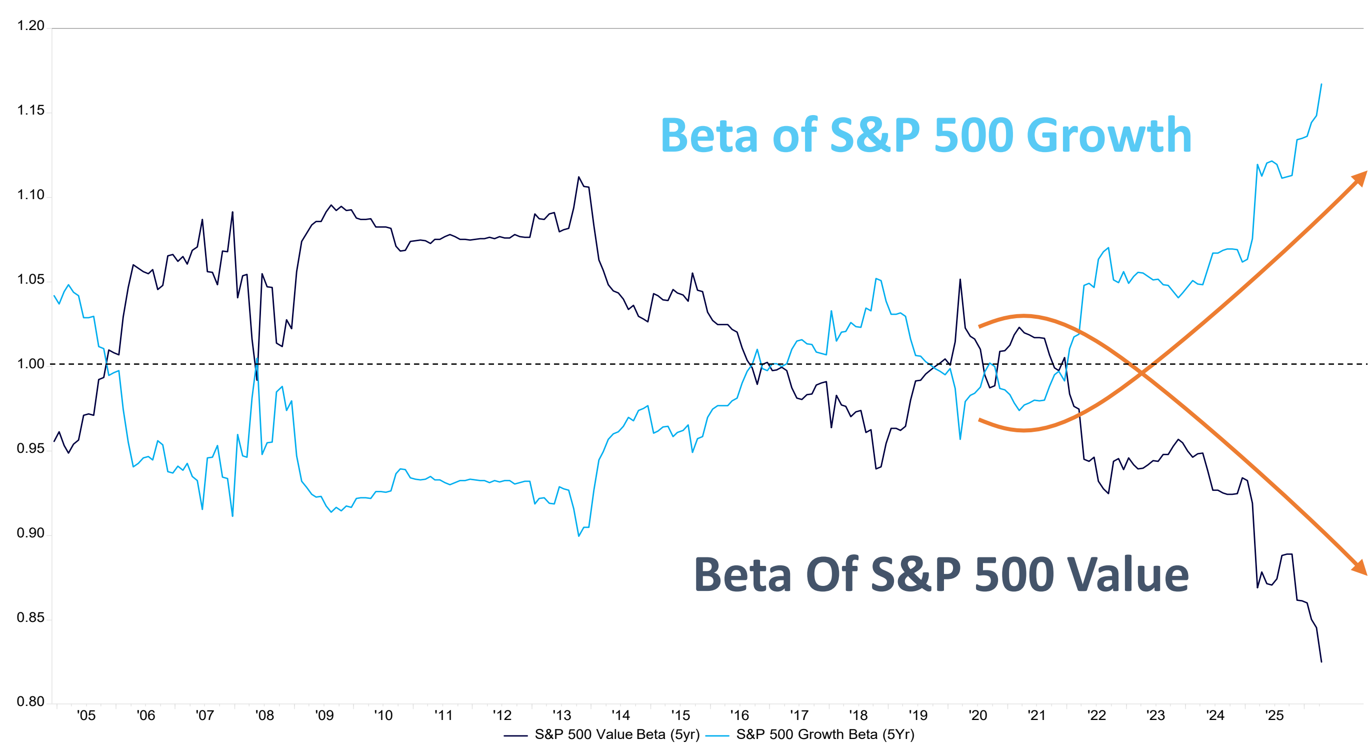
2. Value Used To Be High Beta, Now It's Low Beta (I.E Defensive)

Size and style indices have shifted significantly over the last decade. Most notably, large-cap value—historically a high-beta, cyclically sensitive area—has become quite defensive. Conversely, large-cap growth, once the lowest-beta segment, is now the highest-beta despite still being the most profitable. Sector biases have fueled this transition; specifically, the AI trade has transformed technology into a high-beta sector. Consequently, market segments with significant tech exposure have followed suit: large-cap growth is now heavily overexposed to tech, while large-cap value remains significantly underexposed.

5 Yr Beta By Size/Style



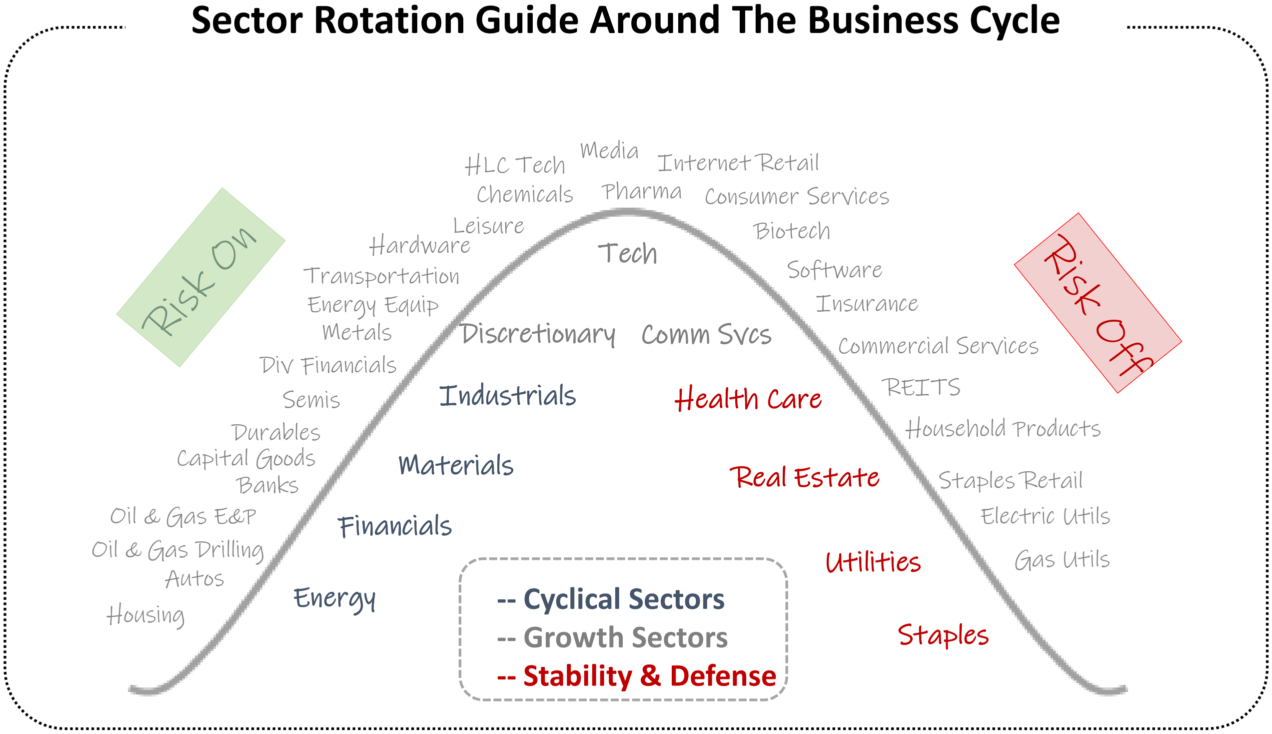
The Beta Of The Value & Growth Indices Have Completely Switched Places



A GUIDE TO SECTOR ROTATION AROUND THE BUSINESS CYCLE

Sector selection on its own can be daunting – which sectors should you overweight/underweight and when? However, when placing sector selection in the context of the macro business cycle, the picture gets clearer. The diagram below is a simplified illustration of sector rotation around the cycle. Note that in the following pages we highlight that sector investing has several flaws and our preference is to focus on factors or even industries.

Sector Rotation Guide Around The Business Cycle



The Contribution Of Each Sector To The S&P 500 Varies Dramatically Depending On Its Weight

			Index Level Data		
SP500 Sectors	**Weight**	**# Of Stocks**	**P/E**	**ROE**	**Beta**
Information Technology	38.6%	73	25.74	40.1	1.33
Financials	11.3%	76	14.54	14.1	0.86
Communication Services	10.4%	21	20.96	22.1	1.12
Consumer Discretionary	9.7%	48	27.48	26.0	1.25
Health Care	8.3%	59	17.44	24.3	0.58
Industrials	8.3%	79	24.86	25.9	0.99
Consumer Staples	4.5%	36	21.64	28.4	0.48
Energy	3.1%	21	13.08	16.6	0.38
Utilities	2.1%	31	17.78	11.7	0.58
Materials	1.8%	26	17.63	16.8	0.92
Real Estate	1.8%	31	18.33	17.7	0.99

INDUSTRY EXPOSURES: WHICH TO OWN FOR VARIOUS MACRO BACKDROPS

Below we identify the industries that are most positively and negatively correlated to growth, inflation and risk. There are many different industries within each sector and not all of those groups have the same (or even similar) macro sensitivities.

Growth

MORE CYCLICAL

Industry Name	Correl With US PMIs
Real Estate Management & Development	0.79
Residential REITs	0.75
Life Sciences Tools & Services	0.67
Personal Care Products	0.67
Leisure Products	0.64
Diversified REITs	0.64
Distributors	0.53
Textiles Apparel & Luxury Goods	0.53
Air Freight & Logistics	0.52
Banks	0.49
Automobile Components	0.46
Ground Transportation	0.45
Metals & Mining	0.44
Consumer Finance	0.44
Capital Markets	0.43
Paper & Forest Products	0.39
Containers & Packaging	0.38
Automobiles	0.38
Energy Equipment & Services	0.37
Oil Gas & Consumable Fuels	0.35
Chemicals	0.33
Health Care Providers & Services	0.31
Professional Services	0.29
Specialty Retail	0.26
Technology Hardware Storage & Peripherals	0.26
Marine Transportation	0.25
Water Utilities	0.20
Financial Services	0.19
Media	0.19
Electronic Equipment Instruments & Components	0.18
Broadline Retail	-0.15
Consumer Staples Distribution & Retail	-0.16
Hotels Restaurants & Leisure	-0.16
Trading Companies & Distributors	-0.18
Household Durables	-0.18
Commercial Services & Supplies	-0.19
Household Products	-0.19
Aerospace & Defense	-0.21
Semiconductors & Semiconductor Equipment	-0.31
Biotechnology	-0.32
Diversified Consumer Services	-0.35
Industrial Conglomerates	-0.35
Wireless Telecommunication Services	-0.38
Diversified Telecommunication Services	-0.43
IT Services	-0.43

LESS CYCLICAL

Inflation

HIGH CPI BENEFICIARY

Industry Name	Correl With Inflation Breakevens
Residential REITs	0.54
Diversified REITs	0.53
Oil Gas & Consumable Fuels	0.45
Energy Equipment & Services	0.40
Ground Transportation	0.35
Life Sciences Tools & Services	0.33
Health Care Providers & Services	0.32
Financial Services	0.32
Technology Hardware Storage & Peripherals	0.31
Distributors	0.31
Automobiles	0.28
Real Estate Management & Development	0.27
Professional Services	0.26
Food Products	0.24
Water Utilities	0.24
Multi-Utilities	0.24
Health Care Technology	0.24
Personal Care Products	0.24
Metals & Mining	0.23
Chemicals	0.22
Beverages	0.22
Pharmaceuticals	0.21
Marine Transportation	0.21
Gas Utilities	0.21
Consumer Staples Distribution & Retail	0.20
Household Products	0.19
Air Freight & Logistics	0.19
Containers & Packaging	0.17
Insurance	0.17
Electric Utilities	0.16
Media	-0.10
Construction Materials	-0.11
Electronic Equipment Instruments & Components	-0.11
Construction & Engineering	-0.13
Wireless Telecommunication Services	-0.16
Independent Power and Renewable Electricity Pr	-0.18
Diversified Telecommunication Services	-0.21
Electrical Equipment	-0.21
Hotels Restaurants & Leisure	-0.23
Machinery	-0.27
Building Products	-0.27
Semiconductors & Semiconductor Equipment	-0.30
IT Services	-0.33
Household Durables	-0.43
Industrial Conglomerates	-0.52

LOWER CPI BENEFICIARY

Risk

RISING RISK BENEFICIARY

Industry Name	Correl With BAA Spreads
Beverages	0.87
Food Products	0.84
Pharmaceuticals	0.81
Multi-Utilities	0.78
Oil Gas & Consumable Fuels	0.76
Gas Utilities	0.74
Electric Utilities	0.74
Biotechnology	0.72
Household Products	0.71
Health Care Providers & Services	0.70
Water Utilities	0.66
Consumer Staples Distribution & Retail	0.61
Energy Equipment & Services	0.53
Aerospace & Defense	0.52
Insurance	0.48
Technology Hardware Storage & Peripherals	0.45
Financial Services	0.44
Chemicals	0.42
Diversified REITs	0.42
Distributors	0.41
Ground Transportation	0.39
Health Care Technology	0.38
Diversified Consumer Services	0.38
Wireless Telecommunication Services	0.30
Tobacco	0.29
Commercial Services & Supplies	0.27
Professional Services	0.27
Diversified Telecommunication Services	0.16
Air Freight & Logistics	0.14
Trading Companies & Distributors	0.14
Software	-0.25
Textiles Apparel & Luxury Goods	-0.27
Construction Materials	-0.28
Capital Markets	-0.36
Real Estate Management & Development	-0.38
Media	-0.39
Passenger Airlines	-0.43
Electrical Equipment	-0.45
Household Durables	-0.48
Industrial Conglomerates	-0.49
Banks	-0.50
Broadline Retail	-0.51
Building Products	-0.56
Consumer Finance	-0.61
Semiconductors & Semiconductor Equipment	-0.63

FALLING RISK BENEFICIARY

Three Reasons To Be Wary Of Sector Investing

From a high-level perspective, there are three clear identifiable issues with sector investing today: 1) several sectors are dominated by just a few a stocks; 2) sector investing can lead to unintended exposures - stocks within the same sector often have VERY different fundamental profiles; and 3) time series analysis on sector performance is spotty at best as macro sensitivities and fundamental attributes of a sector can shift massively over time (e.g., today's Energy sector fundamentals are not the same as in 2013).

Sector Investing Has Three Issues That Can Create Unintended Bets

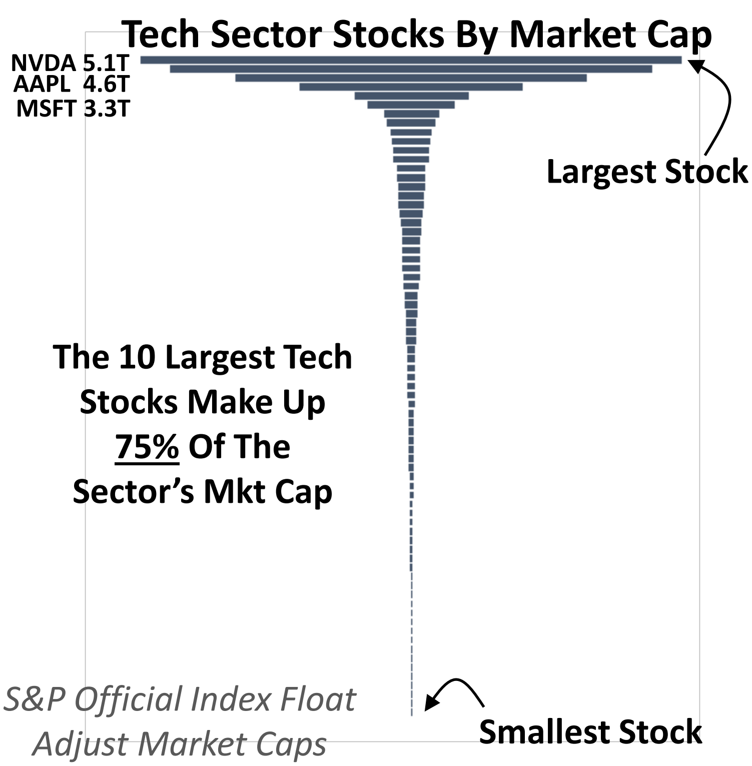
1) Concentration Bias: A Few Stocks Can Explain The Entire Sector

2) Sectors Can Have A Diverse Range Of Fundamental Attributes

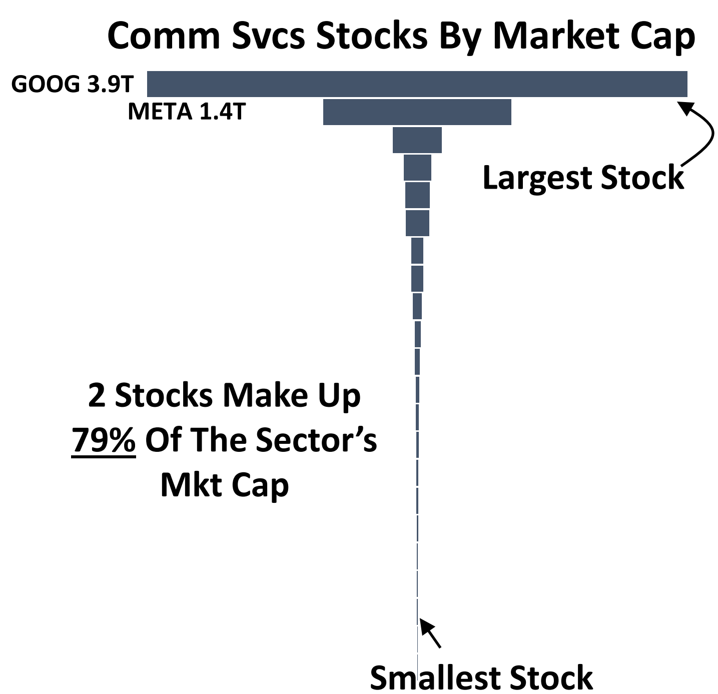
3) Sectors Change Over Time (Constituents, Fundamentals, etc.)

Conclusion: Where Possible, Focus On Factors Over Sectors

1) Concentration Bias: A Few Stocks Can Explain The Entire Sector



S&P Official Index Float Adjust Market Caps



… Three Reasons To Be Wary Of Sector Investing

2) Sectors Can Have A Diverse Range Of Fundamental Attributes

Fundamental attributes can have enormous variation within sectors. For example, the chart below shows there is a significant range of P/Es within each sector. We prefer not to think of sectors as "value" and "growth" because there can be many stocks within these sectors that differ from the overall sector's valuation. Even within a high-P/E sector like Tech, there are plenty of stocks with valuations that are low relative to the market overall.

There Is A Wide Range Of Valuations Within Sectors

Valuation (NTM P/E)

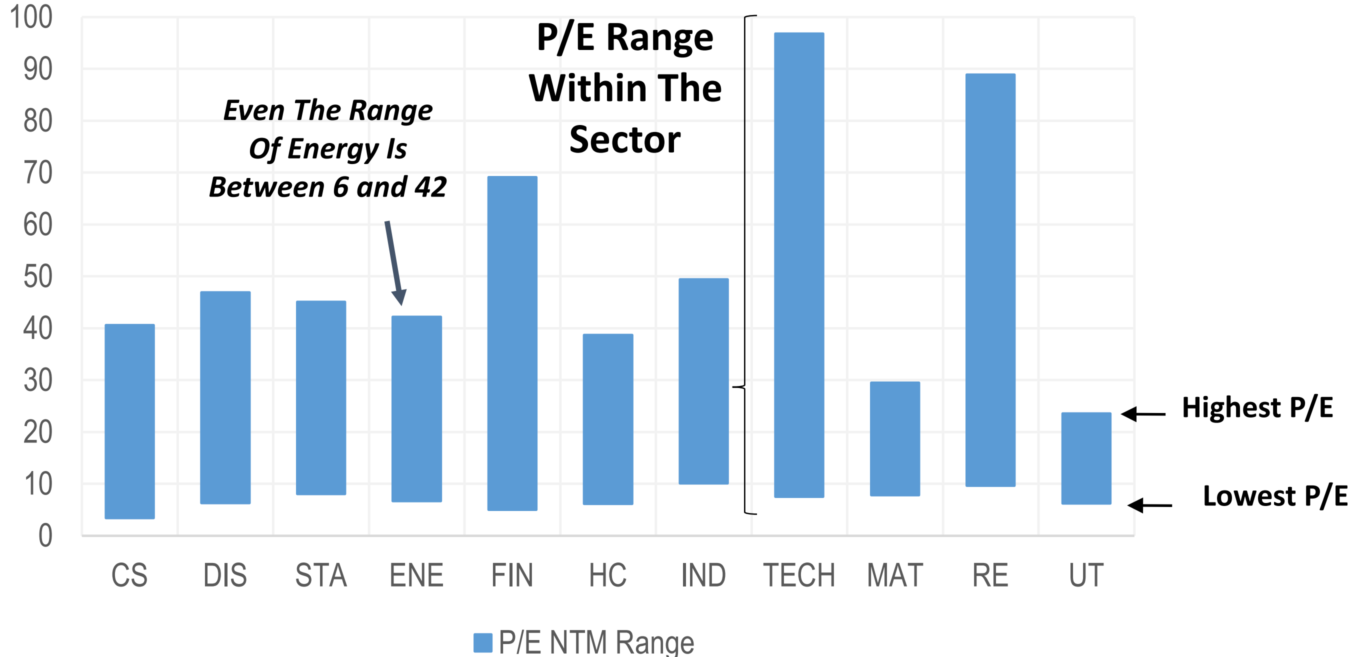
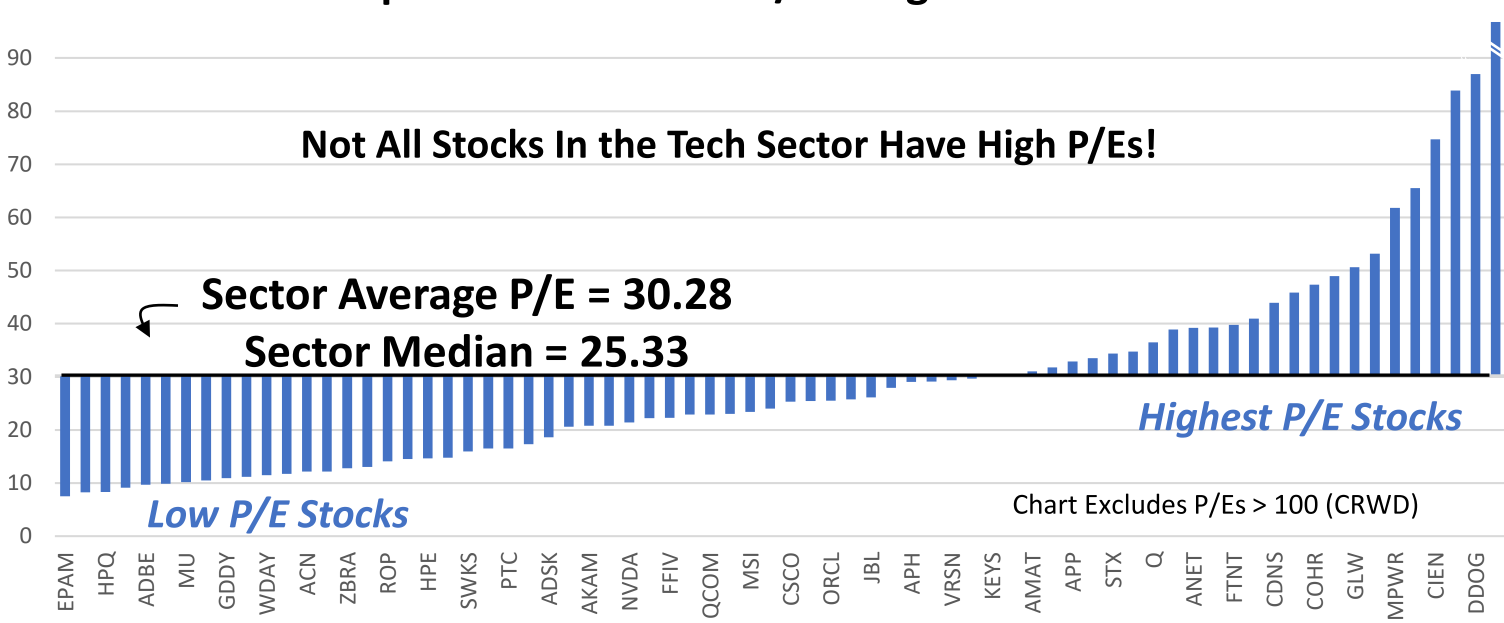


Chart Excludes Stocks With P/Es > 100 (5 Stocks)

Source: Piper Sandler

Sector Example: A Look At The P/E Range Within S&P 500 Tech

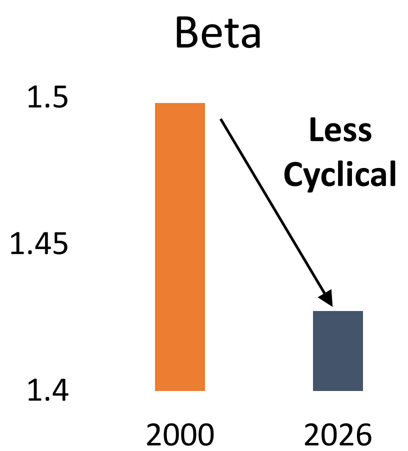


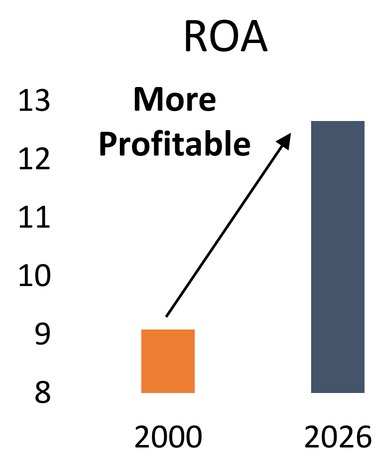
… Three Reasons To Be Wary Of Sector Investing

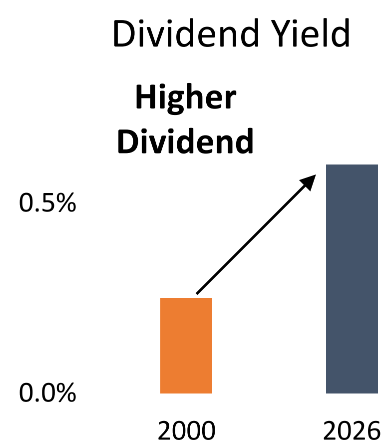
3) Sector Dynamics Change Over Time: Tech Example

Another issue with sectors is that the fundamental attributes can shift significantly over time. A prime example is a comparison of the tech sector back in 2000 compared to today. In recent decades, the sector has become lower beta and increasingly stable and profitable. Investors that are doing any analysis to see how the Tech sector fared in historical periods as a blueprint for the road ahead should be aware that the sector today is not the same as it was back then.

Sector Traits Can Evolve Over Time (I.e. Tech Today Is Very Different From Tech In 2000)

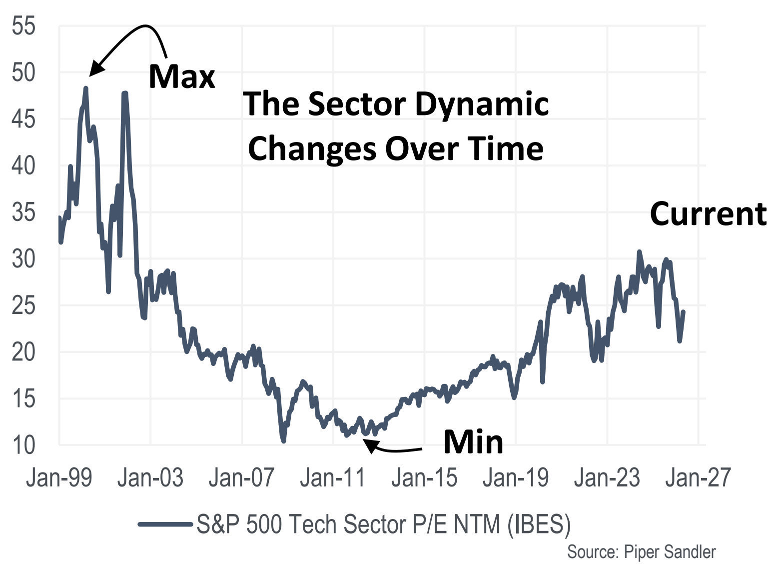


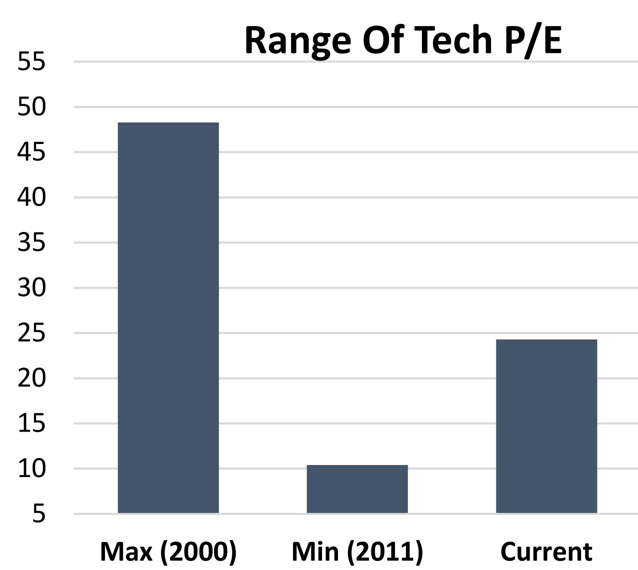




The Tech Sector Has Become More Mature And Higher Quality In Recent Decades.

The P/E Of The Tech Sector Has Had Huge Swings In Recent Decades



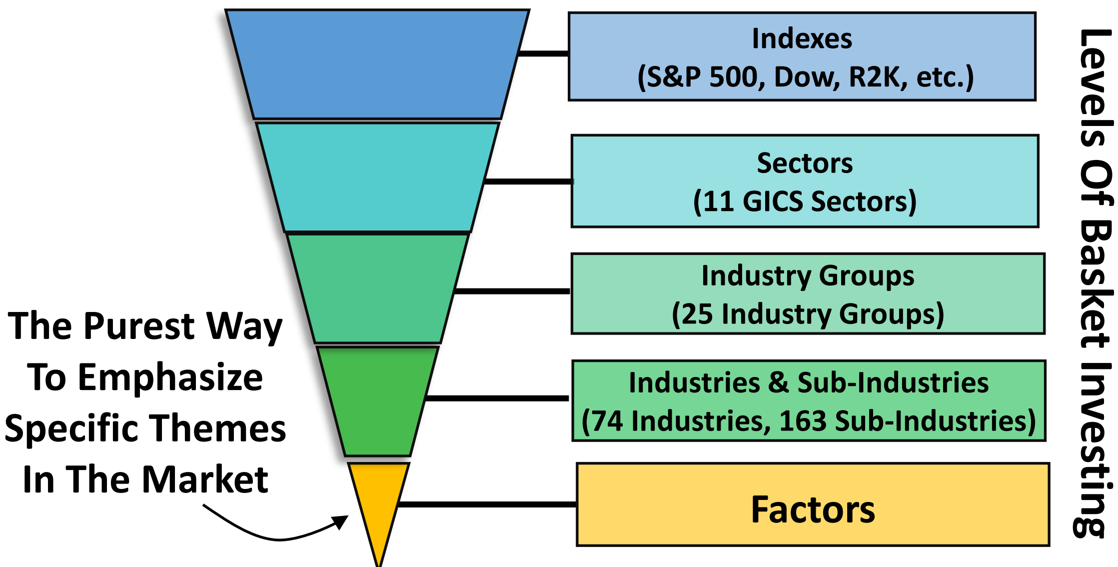


The Tech Sector Isn't Constant Over Time… See The Next Page For GICS Changes!

Factor Baskets Are More Targeted Than Sector Baskets

Factors are our favorite way to emphasize themes in the market as, in our opinion, they are the purest way to invest. Below we show that factors are preferred to even the sub-groups within the GICS system (i.e. industry and subindustry level). Once you get into these small sub-industries, you tend to have names with very similar profiles, but often there are just a few names, making the group tough to analyze. Our favorite way to get around these issues, and to get at the heart of emphasizing themes in the market, is with sector-neutral factor baskets. *Note: A sector neutral high beta basket would include the stocks with the highest beta within each sector.*

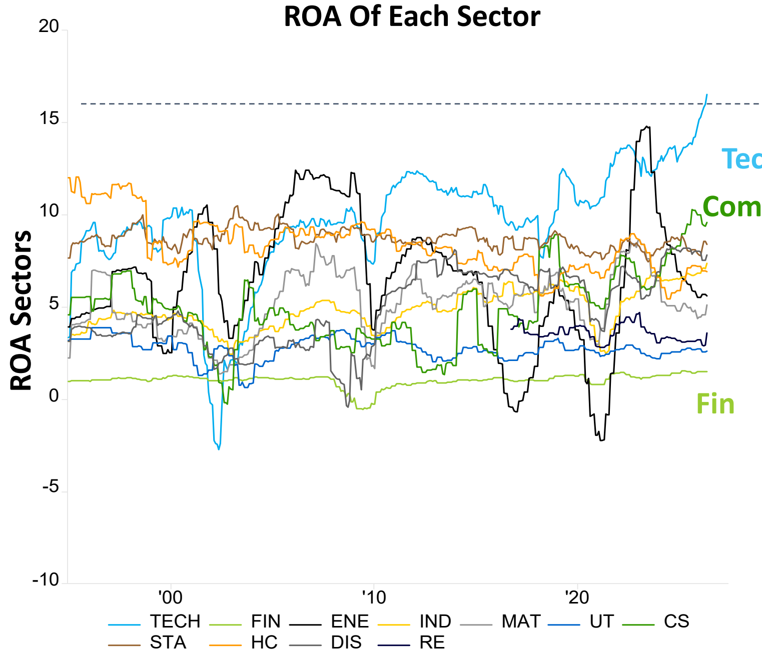
2. Factors Are The Purest Way To Express Macro Views



If you want to emphasize high profitability (e.g., ROA), you are better off looking at the factor level vs the sector level. In other words, screening for the top quintile (i.e top 20%) of stocks across **all** sectors will consistently give you a basket of stocks with a higher ROA than even the most profitable sector (i.e. tech).

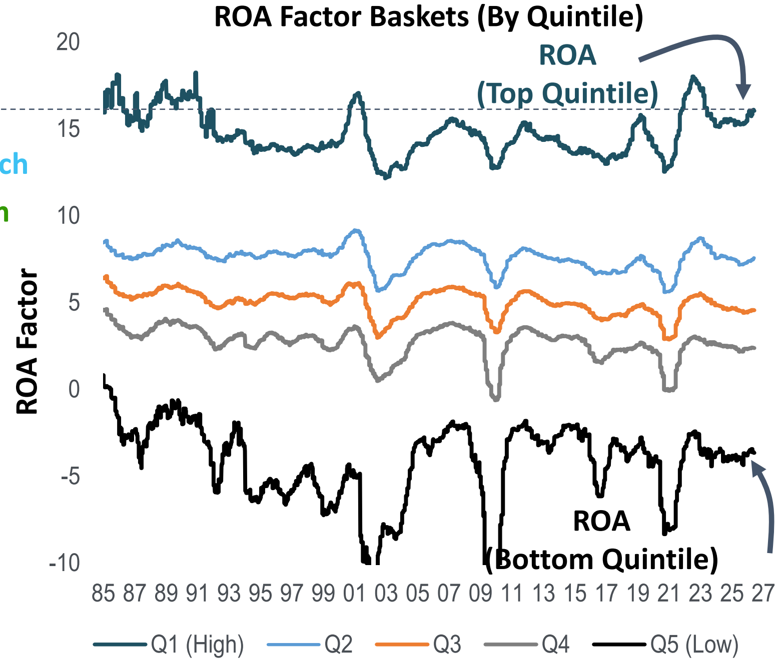
GICS Sectors – Profitability

ROA Of Each Sector



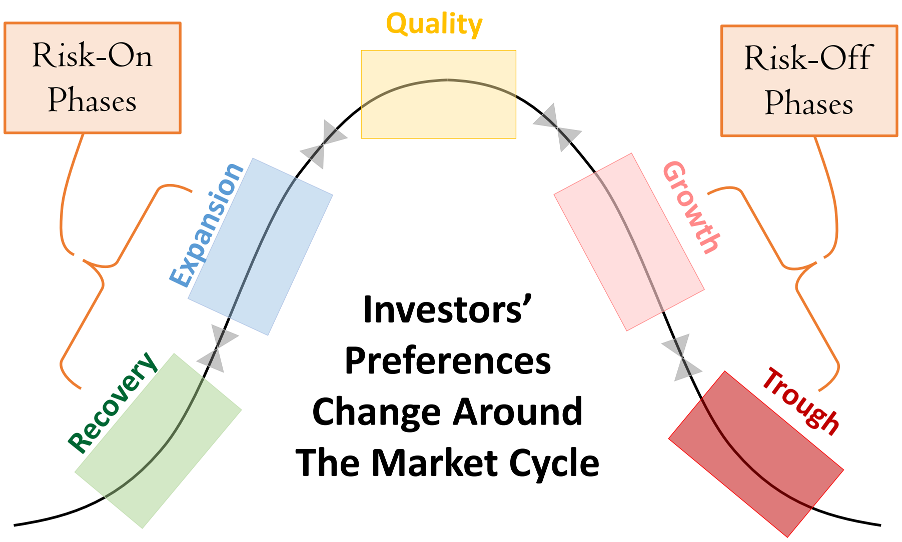
Factor Baskets - Profitability

ROA Factor Baskets (By Quintile)



FACTOR LEADERSHIP CHANGES WITH THE MACRO BACKDROP

Similar to sector selection (page 15), factor selection can be aided by putting it in the context of the business cycle. But first, what are factors? A factor is a characteristic common to a group of stocks. To invest in a factor means to choose stocks that all have relatively similar measurements for that characteristic. For example, investing in high beta means to target a basket of stocks that all have relatively high betas compared to their peers. On this page, we show how factor leadership tends to change around the business cycle. Generally, riskier factors like high beta tend to outperform during the recovery portion of the cycle while more defensive factors like strong profitability or interest coverage outperform later in the cycle when growth slows.



Recovery

Period of strongest returns led by strong P/E expansion

Factor Leaders:

High Beta
Low P/E NTM
High Dispersion

Expansion

Period of strong market returns and narrowing leadership.

Factor Leaders:

High Book Yield
Low P/E NTM
High Cash Flow Yield

Quality

Average returns are positive but low led by EPS growth.

Factor Leaders:

High FCF Yield
High ROE
Low EPS Variance

Growth

Returns are typically still positive, but EPS growth begins to slow materially.

Factor Leaders:

High EPS Growth
Low Sales Variance
High ROIC

Trough

Returns are typically negative with BOTH EPS and P/E falling.

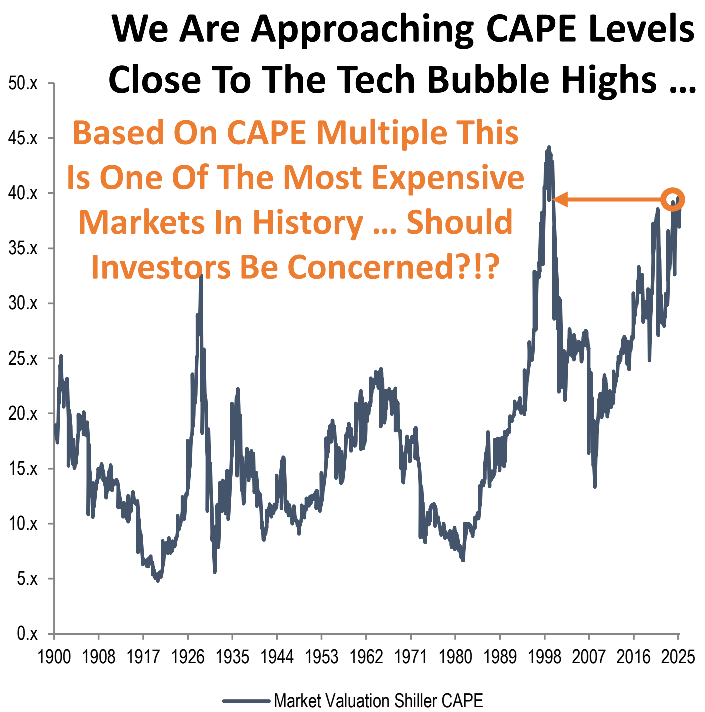
Factor Leaders:

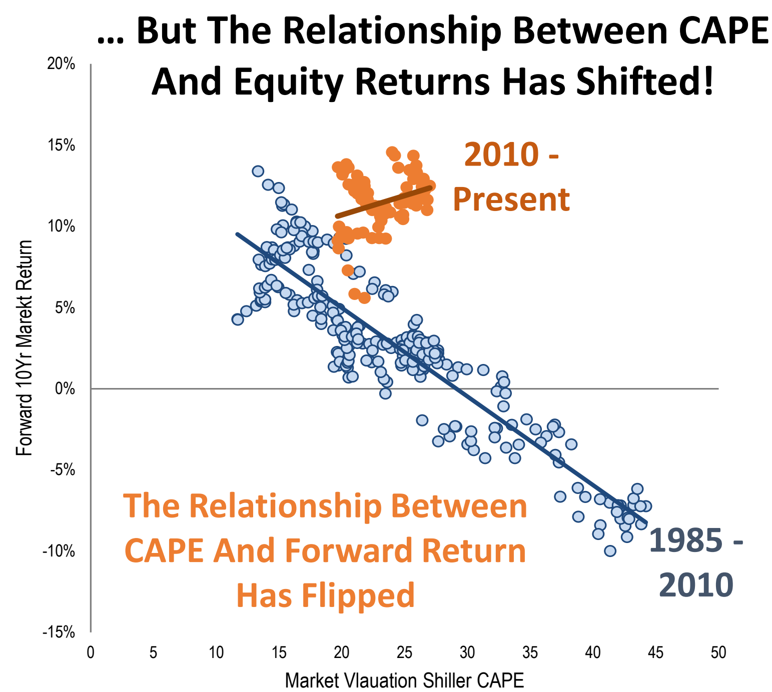
Low Beta
Low Debt to Equity
High Interest Coverage

Visit Our Factor Dashboard For Factor Performance, Analytics, Attribution, etc.

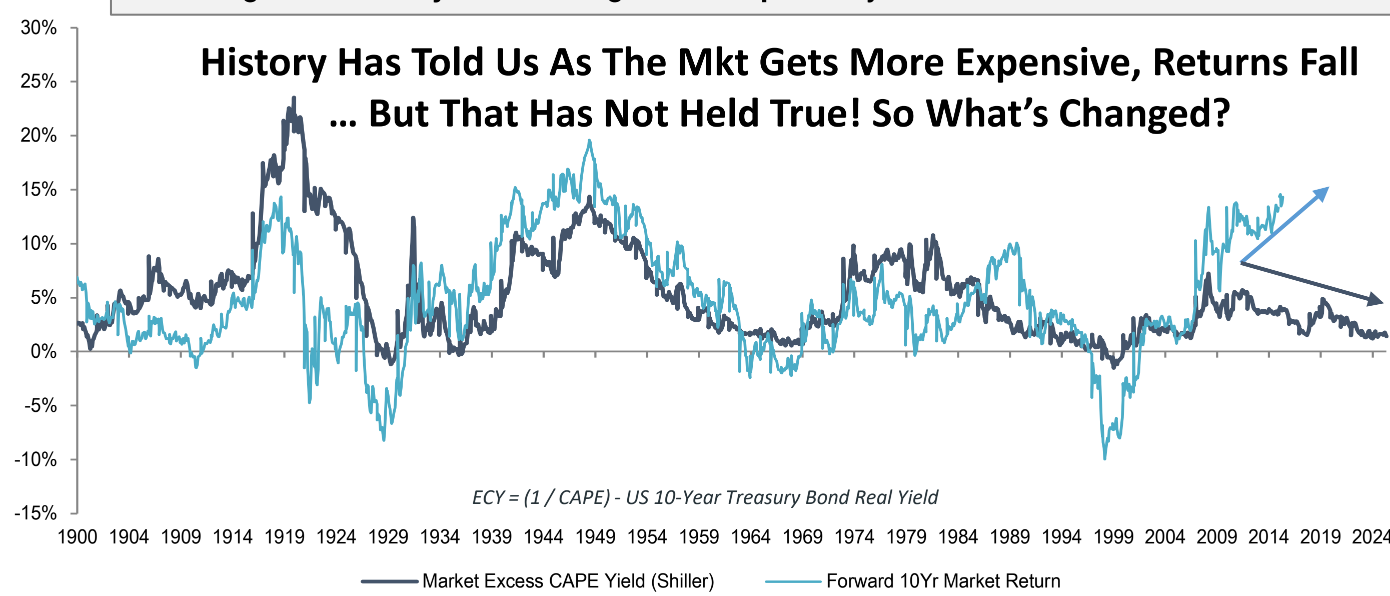
Traditional Valuation Signals Have Broken Down

People love to talk about valuation, but one of the most significant shifts for investors in recent decades is the decreased efficacy of valuation as a tool for stock picking and market timing. While value stocks consistently outperformed during the Great Moderation of the 1980s and 90s, growth stocks—typically more expensive names—have outperformed more regularly since the Global Financial Crisis. Furthermore, elevated valuations for the broader equity market have not led to lower returns as they historically did. As shown on the following page, structural changes in the equity market have diminished the utility of comparing current valuations to historical norms.





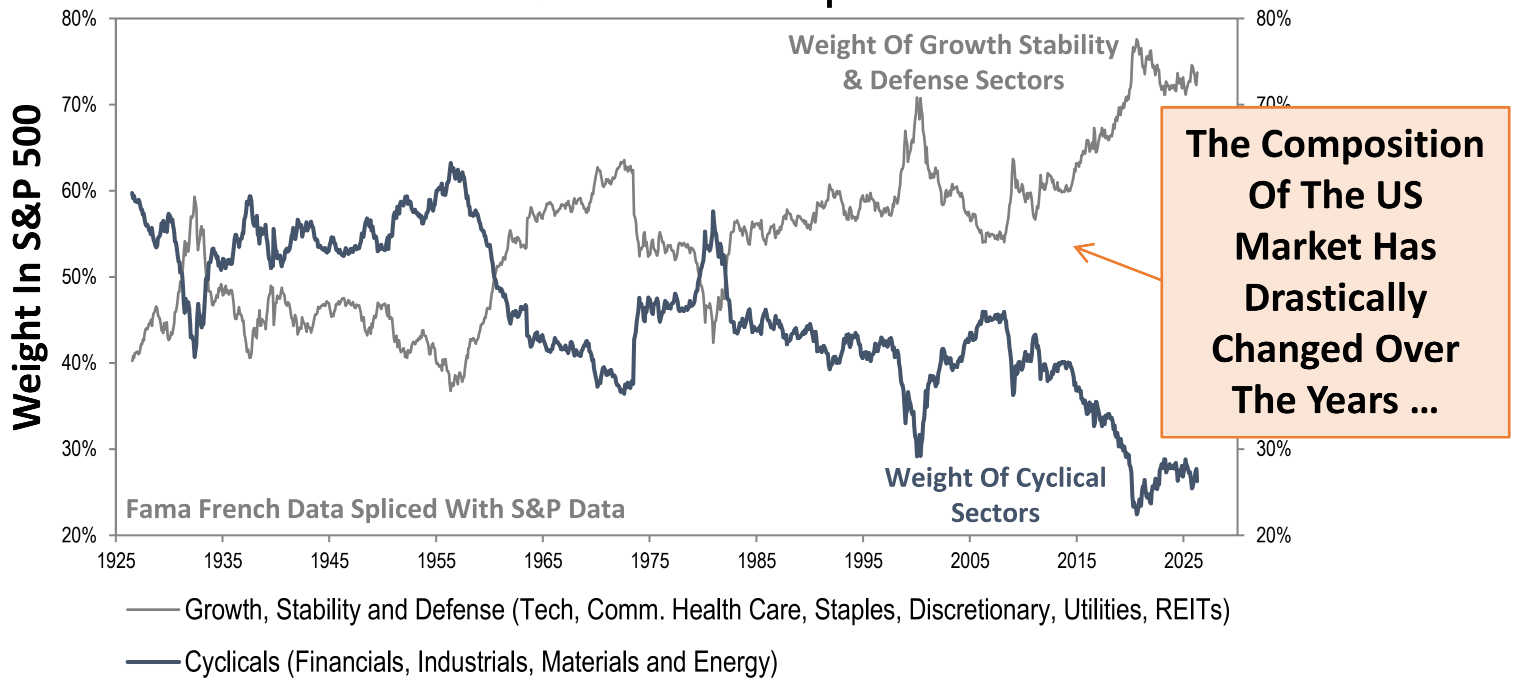
The **CAPE ratio**, also called the **cyclically adjusted price-to-earnings ratio** or **Shiller P/E ratio**, is a stock market valuation metric that compares a company's or index's current share price to its **average inflation-adjusted earnings over the past 10 years**



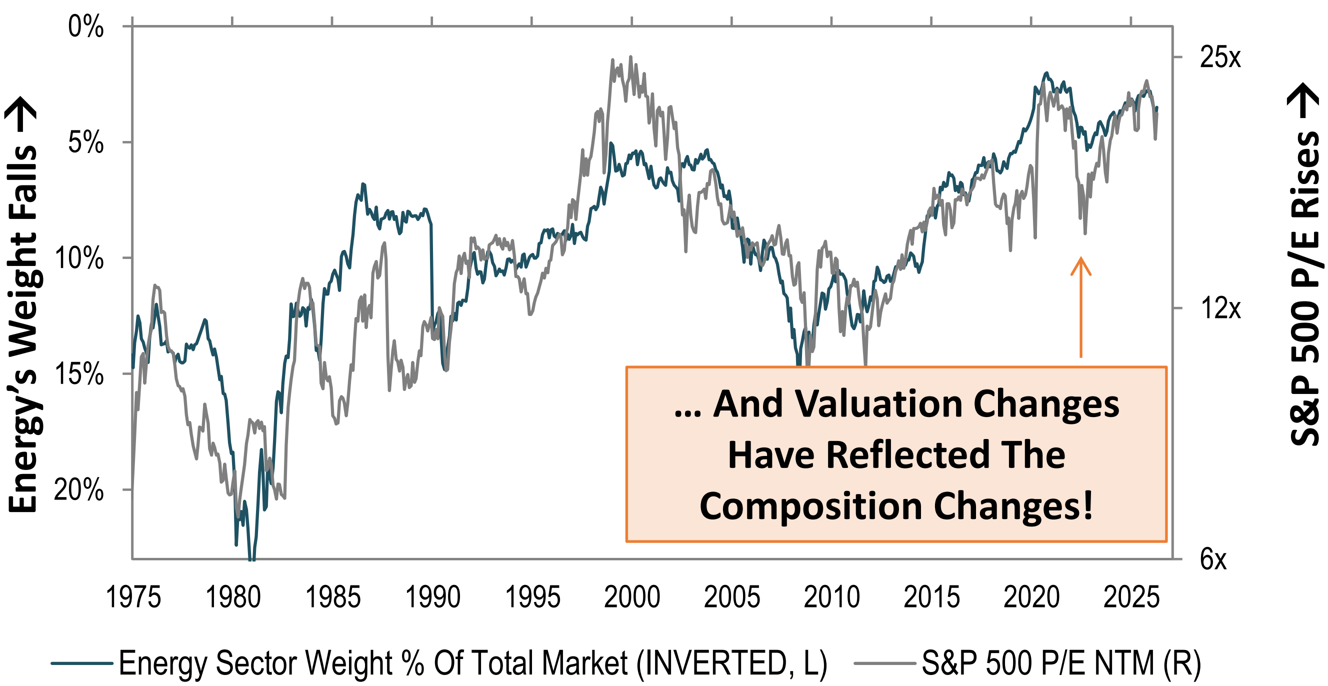
Composition Changes Over Time … And Plays A Big Role In Valuation

While there are a myriad of issues with looking at aggregate market valuations as a timing tool, today we want to highlight one consideration that nearly every valuation model misses … Index composition. As illustrated below, not only does index composition change over time, it has a dramatic impact on the aggregate market multiple. An index with a high weight of cyclical sectors tends to have a lower multiple compared to indices where the composition tends to be heavy in growth and defensive sectors.

S&P 500 Index Composition

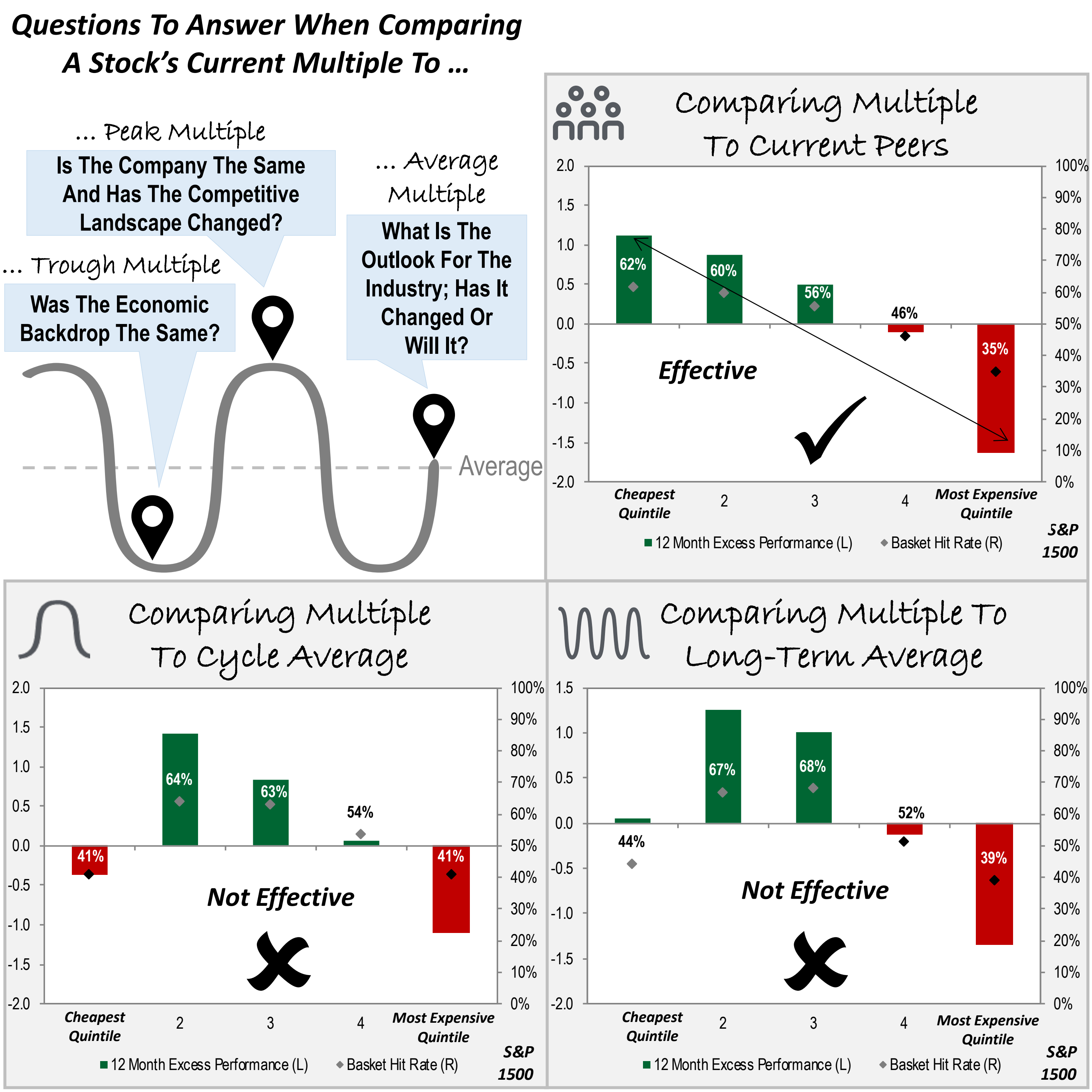


When Energy Becomes A Larger Share In The Market … The P/E Falls



THE RIGHT WAY TO USE VALUATION

Investors often turn to valuation as a reason to purchase individual stocks. We've found that evaluating a stock's valuation relative to its peers, rather than to its own long-term average, is a far more profitable way to use valuation. The bar charts below illustrate the performance of using valuation in three different ways. The only one that demonstrates monotonic performance is when using valuation cross-sectionally (i.e. investing in stocks that look cheap relative to peers).

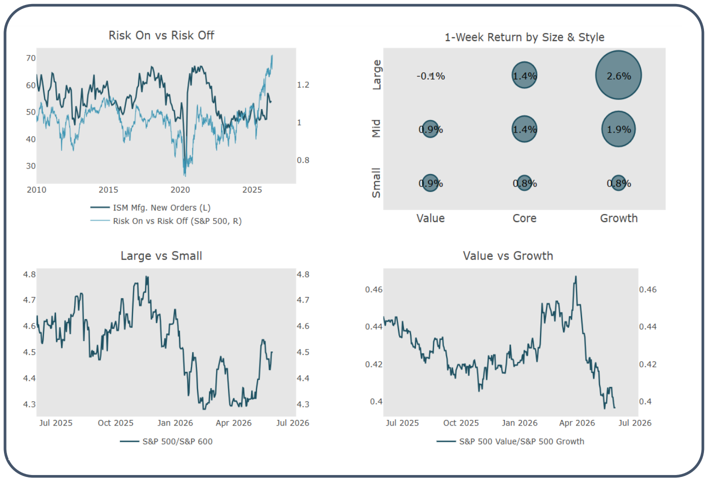


Highlighting 4 Of Our Most Popular Portal Tools

In recent years, our Portfolio Strategy Portal has become an integral part of the team's offerings. The interactive portal was designed to help clients become smarter and more informed about global macro data and market leadership trends. Below we highlight four of the most popular tools. Check them out and let us know what questions you have! Email strategy@psc.com to schedule a walkthrough with someone on the team.

Chartbooks

(Keep An Eye On Markets)



Visit The Dashboard

Model Dashboard

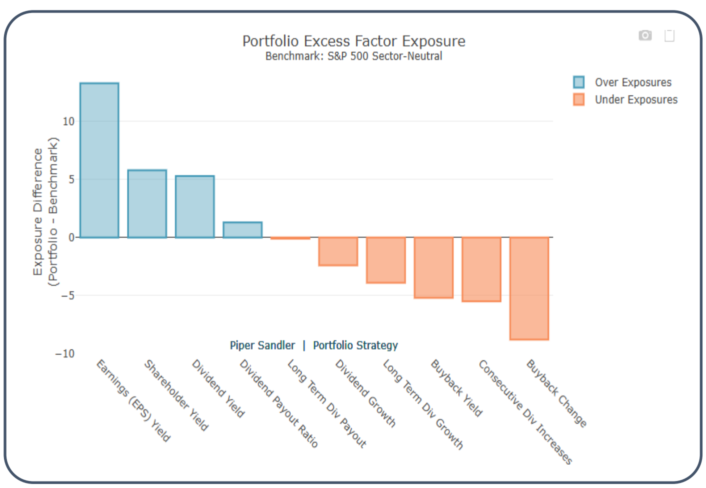
(Our Top Buys & Sells)

Ticker	Name	Model Rank (May-29-26)	Price (USD)	MCap (USD M)	Sector	Industry
AES	AES Corporation	1	14.67	10448	Utilities	Independent Power and Renewable Electricity Producers
JPM	JPMorgan Chase & Co.	1	299.31	807021	Financials	Banks
APH	Amphenol Corporation Class A	1	148.76	182469	Information Technology	Electronic Equipment Instruments & Components
LLY	Eli Lilly and Company	[illegible]	[illegible]	[illegible]	[illegible]	Pharmaceuticals
TPR	Tapestry, Inc.	1	[illegible]	[illegible]	Consumer [illegible]	Textiles Apparel & Luxury Goods
DLTR	Dollar Tree, Inc.	1	116.44	23114	Consumer Staples	Consumer Staples Distribution & Retail
NEM	Newmont Corporation	1	109.81	117826	Materials	Metals & Mining
ALL	Allstate Corporation	1	206.09	53131	Financials	Insurance
EXPD	Expeditors International of Washington, Inc.	1	157.99	21152	Industrials	Air Freight & Logistics
FIX	Comfort Systems USA, Inc.	1	1828.21	64329	Industrials	Construction & Engineering
CINF	Cincinnati Financial Corporation	1	157.42	24463	Financials	Insurance

Visit The Dashboard

My Portfolio Tool

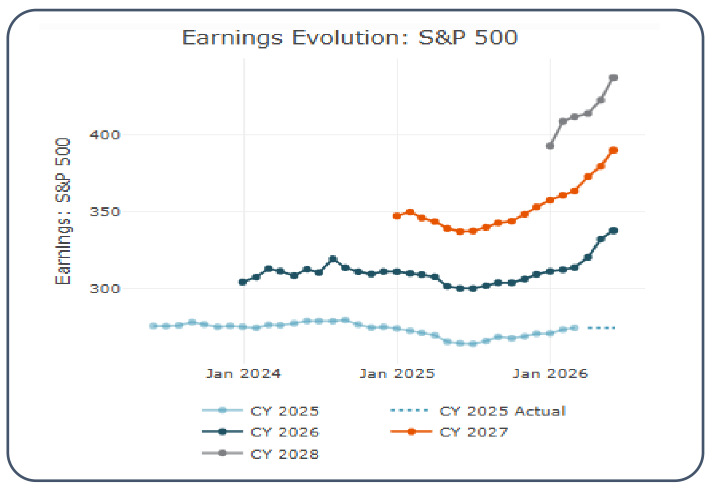
(Analyze Your Portfolio)



Visit The Dashboard

Valuation & Earnings Dashboard

(One-Stop Shop For EPS & Valuation)



Visit The Dashboard

Email us at Strategy@psc.com for a guided tour of the portal

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