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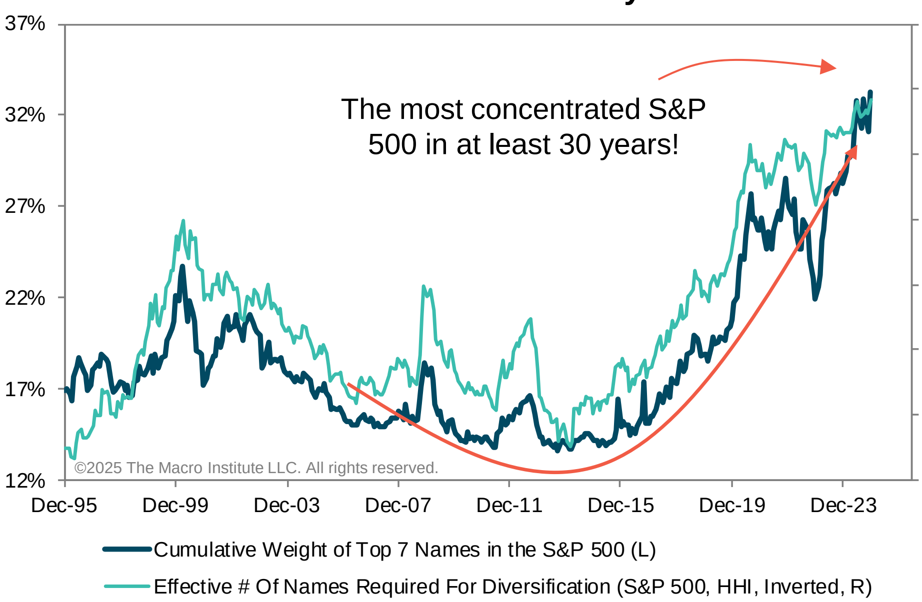
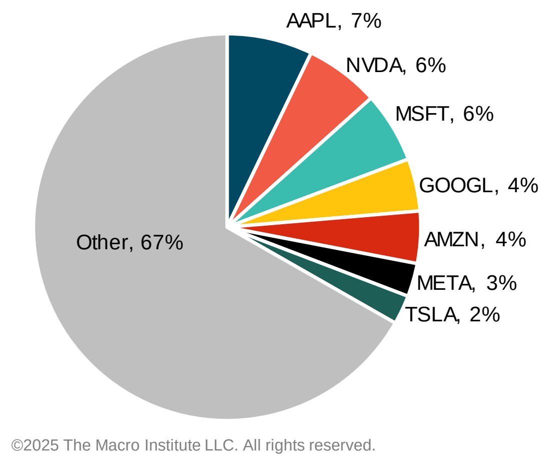
The End Of *The Magnificent 7* As We Know It

What's not to like about *The Magnificent 7*? After all, these are quality companies that have delivered fantastic returns for investors over the years. History is littered with groups of stocks with catchy names that dominated investor interest for some time but then faded: we had the FAANGs before *The Magnificent 7,* the BRIC countries in the early 2000s, and the Nifty 50 back in the 1970s. What all these themes have in common is that they were hugely popular at the height of their respective heydays and were often viewed as a quasi-permanent fixture. However, they all eventually came to pass. We are not saying that *The Magnificent 7* are on their deathbed, but when we look at the macro influences that have supported their leadership, they are changing, and not in a good way for these stocks.

Index Concentration At Extremes By Most Measures



S&P 500 Constituents By Size



The Mag 7 make up 33% of the S&P 500, which could amplify risk if these companies underperform.

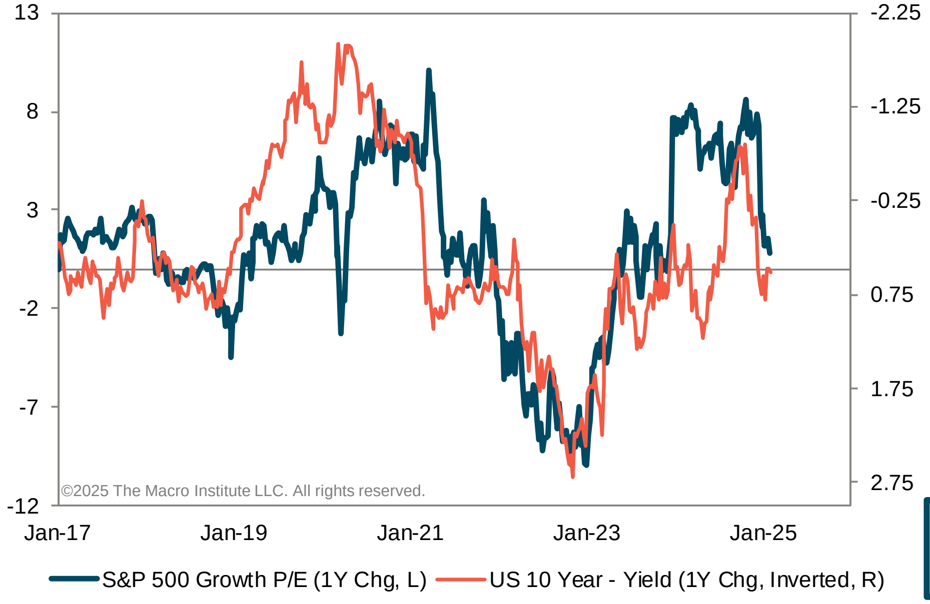
For certain, these historical themes that dominated market leadership had various macro influences. There are important differences between the drivers of the BRIC-related stocks of the commodity cycle and the bowling stock mania of the early 1960s. Still, there are some common elements that allow us to gain perspective on where that leadership may be headed. Indeed, all these thematic stories came to dominate "high-momentum" screens at some point. Momentum does have repeatable patterns when it comes to macro, and those influences argue for a major shift in what constitutes "high momentum" in 2025.

The Magnificent 7 is up there when it comes to leadership themes and how they stack up historically. The chart above reveals that those seven stocks now account for one-third of the S&P 500's market cap. Meanwhile, the HHI Index (mostly used in M&A analysis) reveals that an investor could achieve nearly perfect diversification by owning as little as 40 stocks. For perspective, you needed nearly 150 names back in 2013 to achieve this feat. In this week's report, we look at macro forces and how they influence the "high-momentum" basket, and *The Magnificent 7* more specifically. Hope you find value in this. Best, Francois

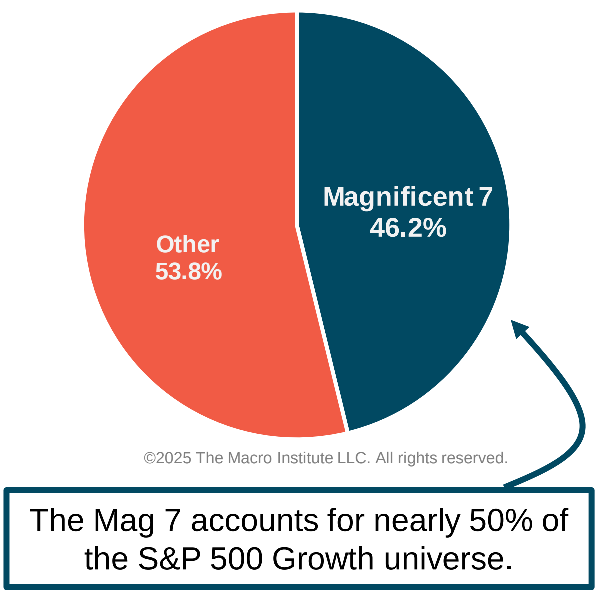
The Magnificent 7 VERY Vulnerable To A Resumption In Fed Tightening

Every investor needs to understand that the S&P 500 is not the same index that it once was. This is especially true for seasoned folks (like me!) who rely on their experience, as the composition of the benchmark today is dramatically different than it used to be. A mere 15 years ago, cyclical sectors (i.e., Value oriented) accounted for the vast majority of market capitalization whereas the index is now overwhelmed by Growth stocks. This has altered how the index reacts to macro variables.

Higher Interest Rates Negatively Impact Growth Stocks



Mag 7 A Big Influence On S&P Growth



Growth stocks are now the S&P 500's largest segment, and *The Magnificent 7* accounts for almost half of Growth's market cap. Worded differently, the Growth bias and index concentration are part of the same story. We know that Growth is more sensitive to changes in interest rates than Value. As we learned in 2022, this is no longer the index than can rise unchallenged during a Fed tightening cycle as it did in 1999 or 2004-2006 when it was predominantly cyclical. We now live with an index that has a VERY different relationship to interest rates than in recent decades.

Valuation Disparity At Extremes … Stealth Bull Market In The Making?

Risk #1:

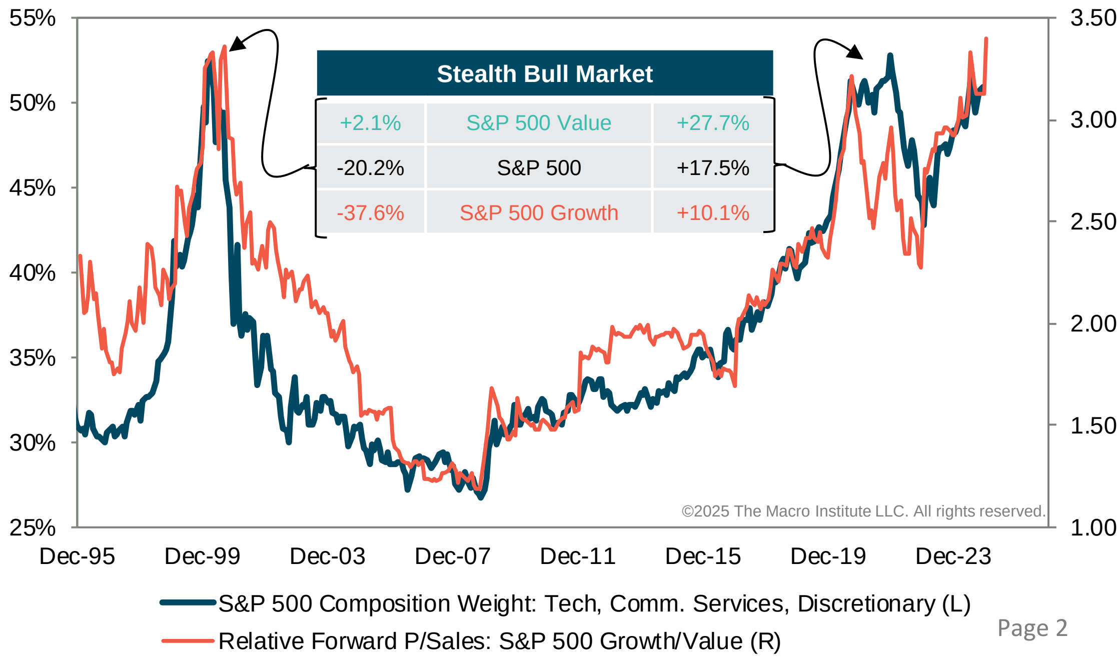
Cyclical Recovery Leads To A Pullback In Growth

Risk #2:

Rising Interest Rates Weigh On Growth P/Es

Risk #3:

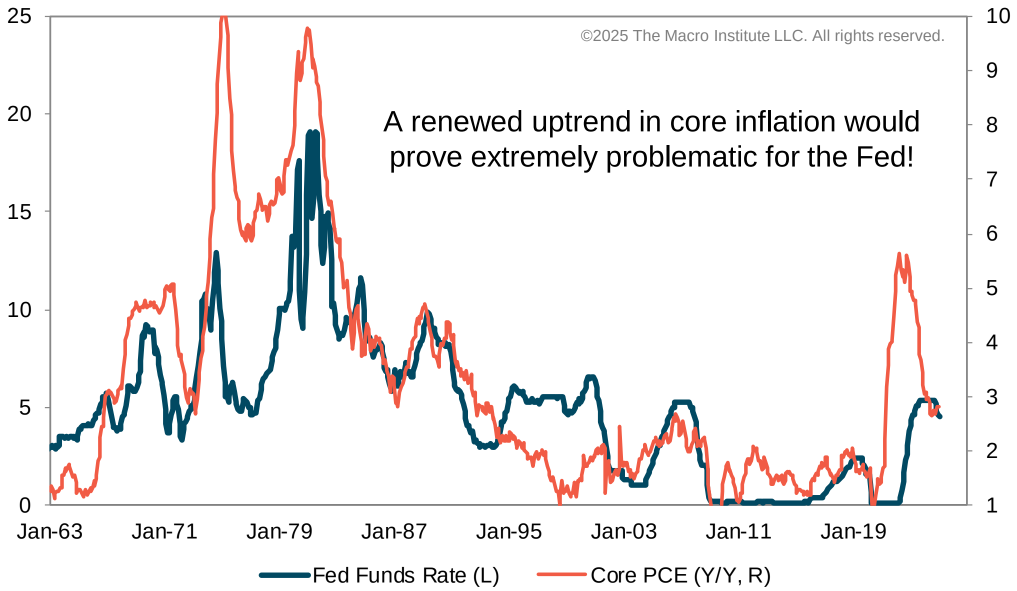
Crowding Often Triggers Panic Selling Across History



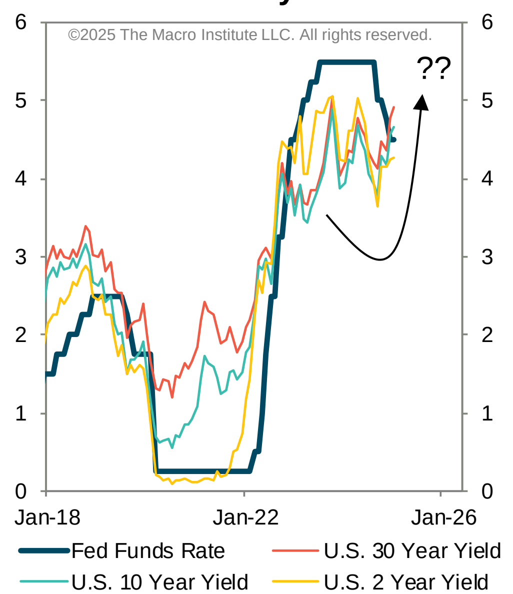
Fed Resuming Tightening More Likely Than Consensus Believes

We have made the case several times for a recovery in inflation this year, a development that should gradually turn the Fed more hawkish and probably leads to a resumption in tightening later in 2025 (see *The Fed On Track To Tighten Policy Despite Mounting Pressures*). Fed tightening is usually associated with improving economic prospects, which we expect in 2025, and that's a backdrop that usually benefits cyclical stocks. Growth stocks usually fare better when the economy is lackluster, and inflation and interest rates are a non-issue.

Another Inflation Surprise For The Fed In 2025?

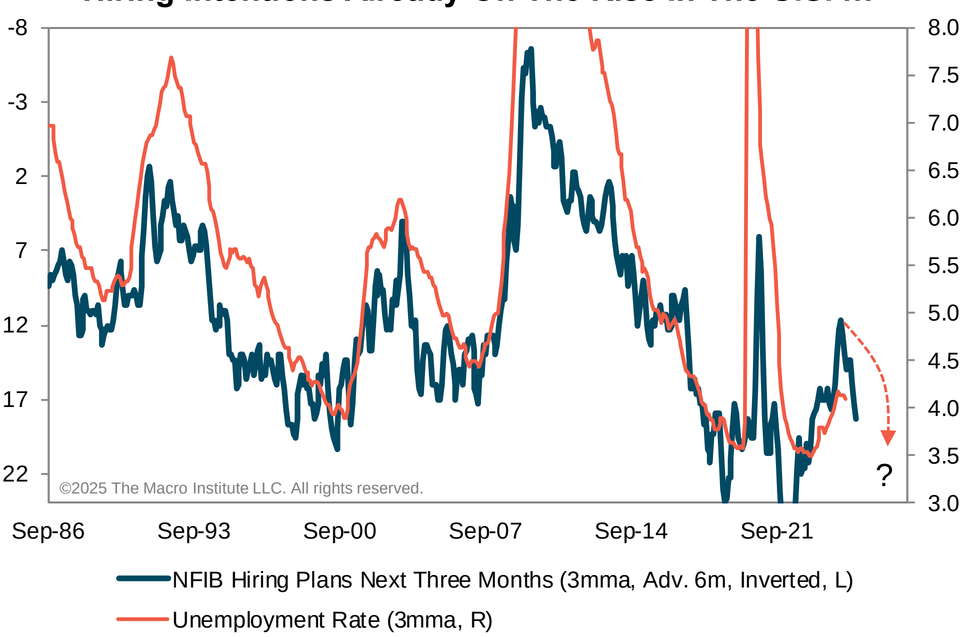


Bonds At Mercy Of Fed?!?

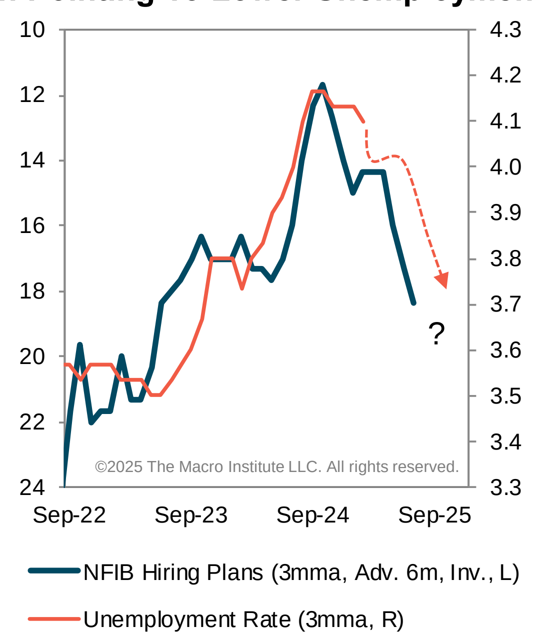


It's not like the Fed is completely unaware that inflation poses a risk, BUT their main concern has to do with tariffs (as of today, tariffs have been postponed on all three countries initially targeted). Tariffs could, of course, have a large impact on inflation. That said, there is a bigger story at play --- the recovery in LEIs of employment at a time when there is not a lot of excess capacity in labor markets. In essence, there is already a dynamic at play for inflation to recover this year without even considering the effects that tariffs could bring. For the Fed, tariffs are a bit like the supply-chain story of 2021.

Hiring Intentions Already On The Rise In The U.S. …



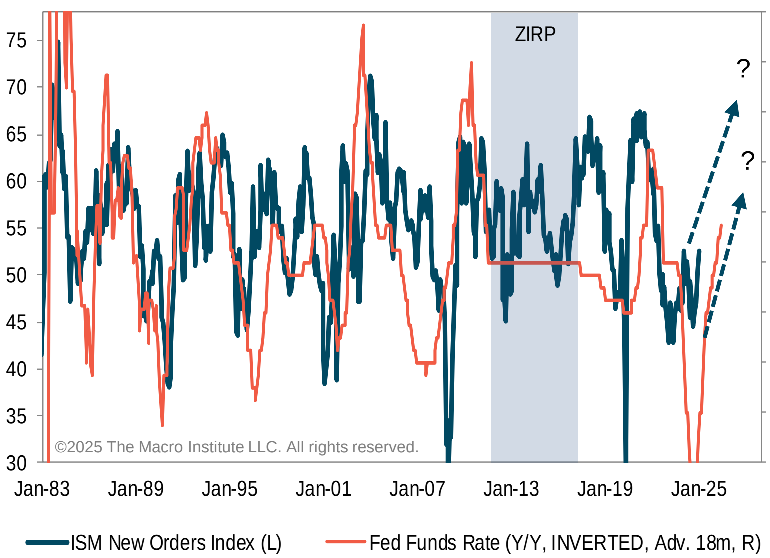
… Pointing To Lower Unemployment!



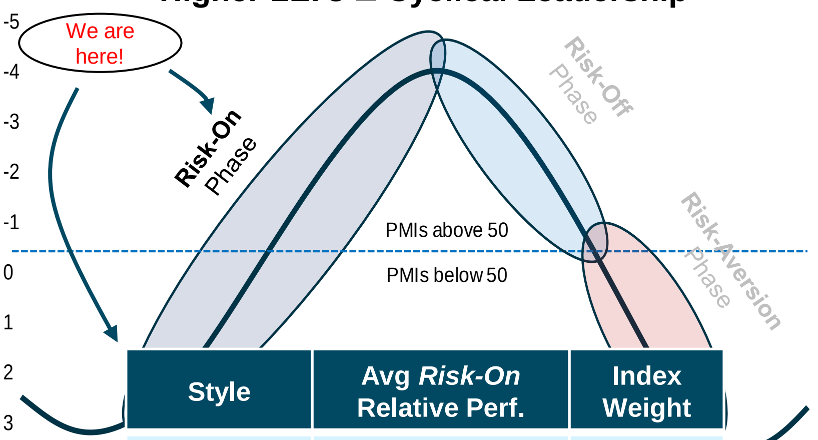
A Re-Accelerating Economy … A Problem For The Mag 7?

There is a lot of uncertainty when it comes to policy in 2025, and tariffs more specifically. Again, we have already sown the seeds of an inflationary rebound, which is a problem for Growth stocks. There is another threat as well—the budding recovery in LEIs from the lagged effects of the end of Fed tightening AND the rate cuts that followed. The chart below argues that LEIs are likely to improve throughout 2025 and into 2026. How is this a problem for Growth stocks? This development lifts the appeal of cyclicals (i.e., Value), so Growth and *The Magnificent 7* are no longer the only game in town.

LEI's Have Bottomed For The Foreseeable Future



Higher LEI's ≅ Cyclical Leadership



Style	Avg *Risk-On* Relative Perf.	Index Weight
Value	**+11.9%**	**26%**
Growth	+6.2%	55%

There are plenty of relationships like the chart above that argue for a rebound in economic prospects (read: LEIs) in 2025. A recovery like this is typically a world where leadership broadens as the rising tide lifts all boats. This is the "Risk-On" phase of the cycle where Value typically outpaces Growth (see image above right), and where "Low Momentum" starts to lead the charge (see table below right). At the end of the day, past trends in interest rates usually drive this relationship as the chart below argues. It points to the equal-weighted S&P 500 outpacing the cap-weighted index.

A Broadening In Leadership Not Typically Kind For Momentum

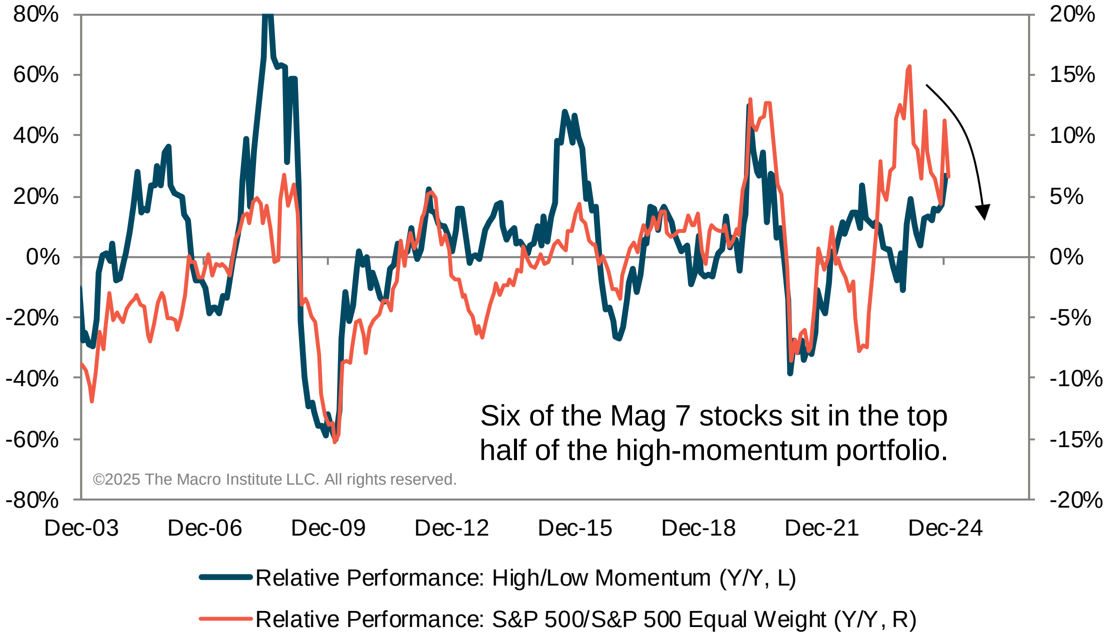
PMI Rebound Playbook

Risk-On Phase	
Asset	Equities > Bonds
Style	Value > Growth
Size	Small > Large
Sectors	Cyclicality
Factors	• High Beta • High Volatility • Book Yield • Low Momentum • Earnings Yield

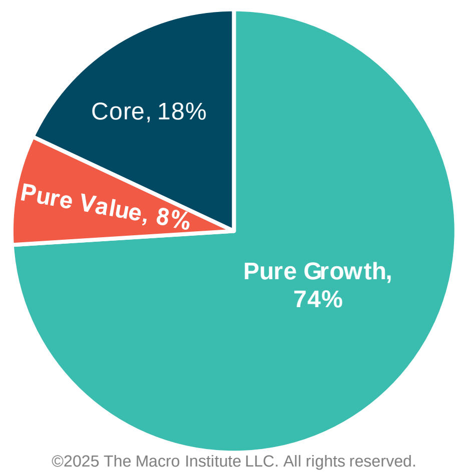
High-Momentum And Growth Largely The Same Thing In 2025

Let's review what we know and downplay the things that carry uncertainty for the time being. We know the economy has little excess capacity—certainly compared to what is seen in the wake of prior Fed tightening cycles—and that there is stimulus in the pipeline (Fed rate cuts + improving bank lending standards). This is a recipe for an eventual return in inflationary pressures, which likely results in a resumption in monetary tightening. We also know that Growth P/Es, and those of The Magnificent 7 by extension, are more sensitive to Fed policy (rates) than the rest of the market. An important point to understand is that the current basket of high-momentum stocks is dominated by Growth.

High Momentum Is An Explicit Bet On The Market Leaders



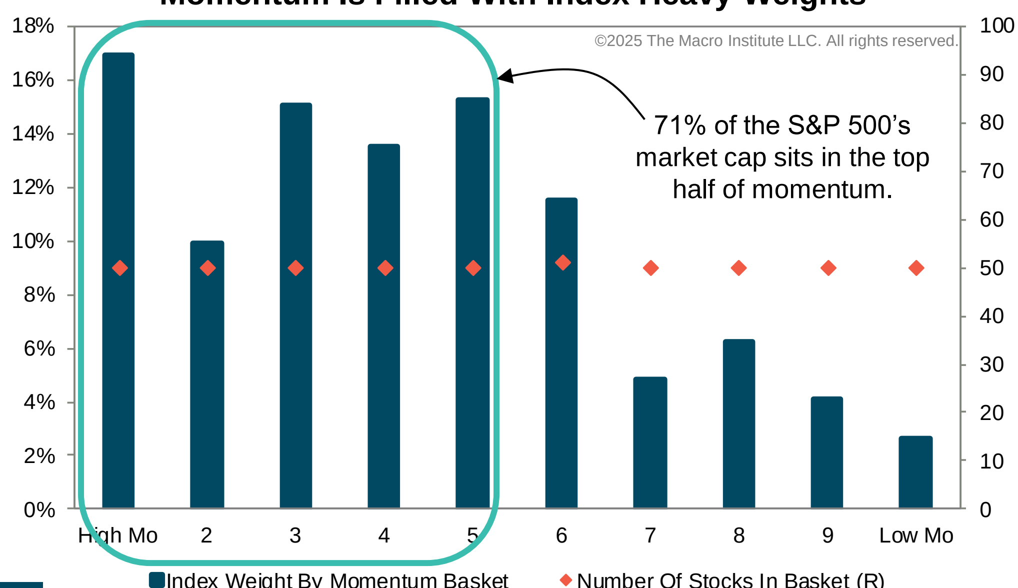
The High-Momentum Basket



Roughly ¾ of the names in the "high-momentum" basket are Pure Growth stocks.

A deeper dive into the breakdown of momentum reveals that leadership has been skewed toward large stocks while the laggards have been, on average at least, smaller in size. It's also clear that the top deciles of momentum are dominated by Growth (Pure Growth accounts for 74% of the high-momentum basket) and therefore Cyclicals populate most of the low-momentum deciles. This dynamic is not unusual in the right historical context (i.e., after a Fed tightening cycle), but this is the point in the cycle where it begins to reverse and a recovery in LEIs is typically the starter pistol that gets it going.

Momentum Is Filled With Index Heavy-Weights



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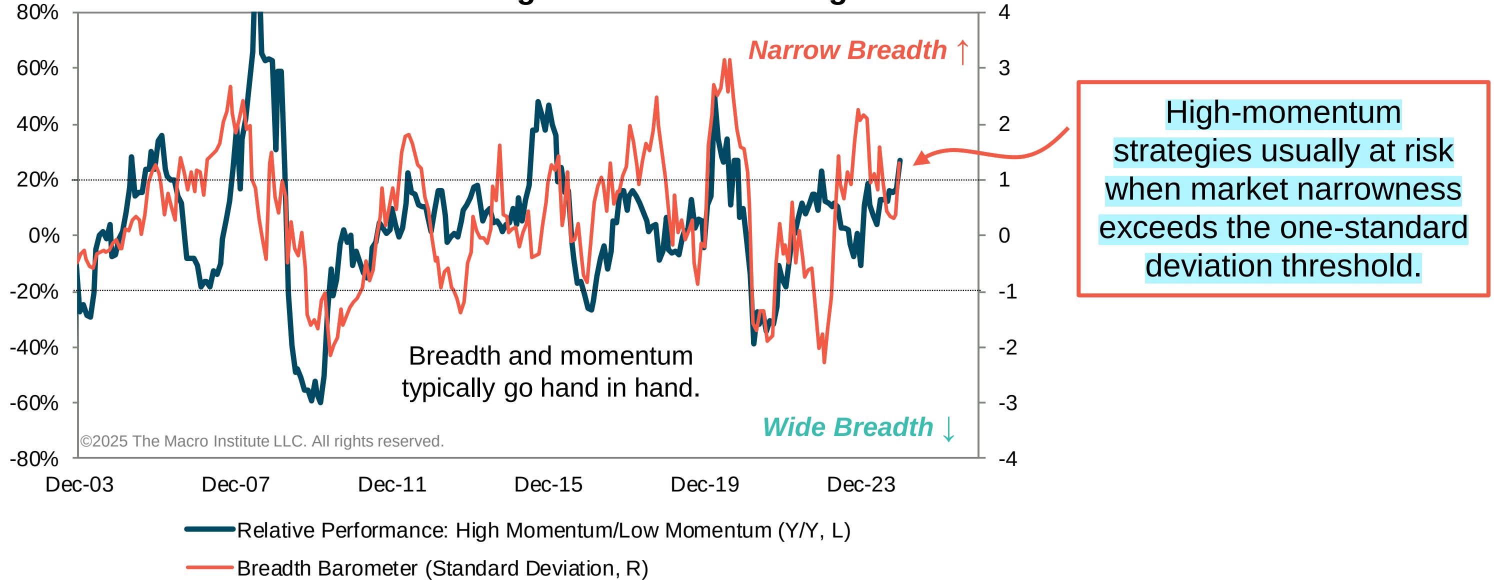
Market Breath And Momentum Strategies Are Overlapping Concepts

Thus far, we've made the case for an inflationary recovery in 2025, a development that would likely bring about an eventual resumption in Fed tightening. This is a problem for Growth stocks given their extreme sensitivity to changes in interest rates. Simultaneously, the recovery part of that story should revive interest in Cyclicals as they look increasingly attractive. We also know that Growth and momentum are related concepts. It's not a stretch from here to understand that all of this is intertwined with market breadth. Breath is narrow AND high-momentum has worked. Two parts of the same story.

Breadth Barometer Sitting At Extreme Readings



The chart above shows that high-momentum strategies have worked well within an increasingly-narrow market in the current cycle. This is normal, as the two concepts have been related for decades. Is there anything we can learn from this state of things? History says yes! The table below reveals that when breadth reached a 1-standard deviation extreme historically, high-momentum underperformed relative to low-momentum. The gap in performance amounts to an average of a little over 600 basis points in the subsequent 12 months. We are currently beyond that threshold at 1.3 standard deviations. This type of extreme is associated with an even greater disparity between momentum extremes—well over 800 basis points in the following year.

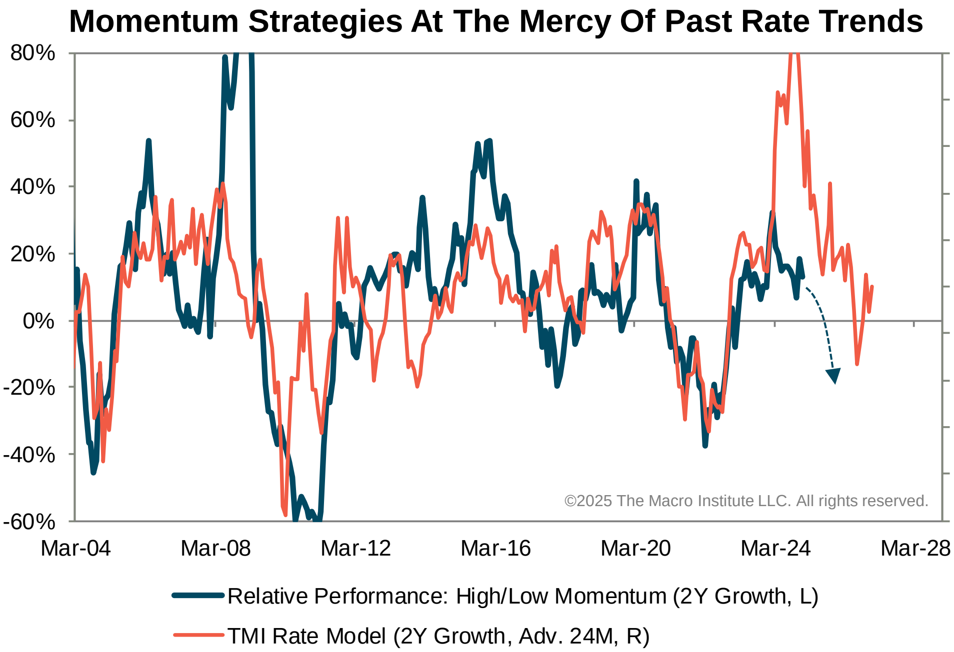
Performance Of Momentum At Breadth Extremes

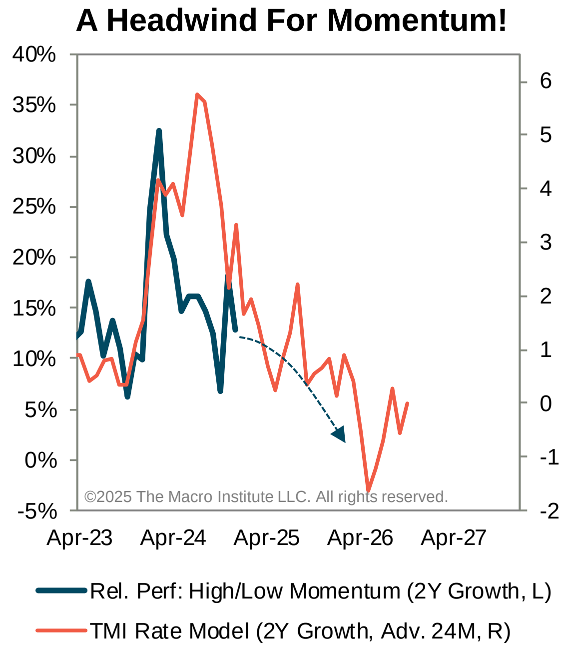
High-to-Low Momentum Basket Forward Returns	
Breadth: +1 Std Deviation	
Next 12 Months	-6.01%
Next 18 Months	-6.41%
Breadth: +1.25 Std Deviation	
Next 12 Months	-8.43%
Next 18 Months	-8.39%

Today's Breadth Barometer currently sits around 1.3 standard deviations above the historical mean arguing that high-momentum stocks are at risk.

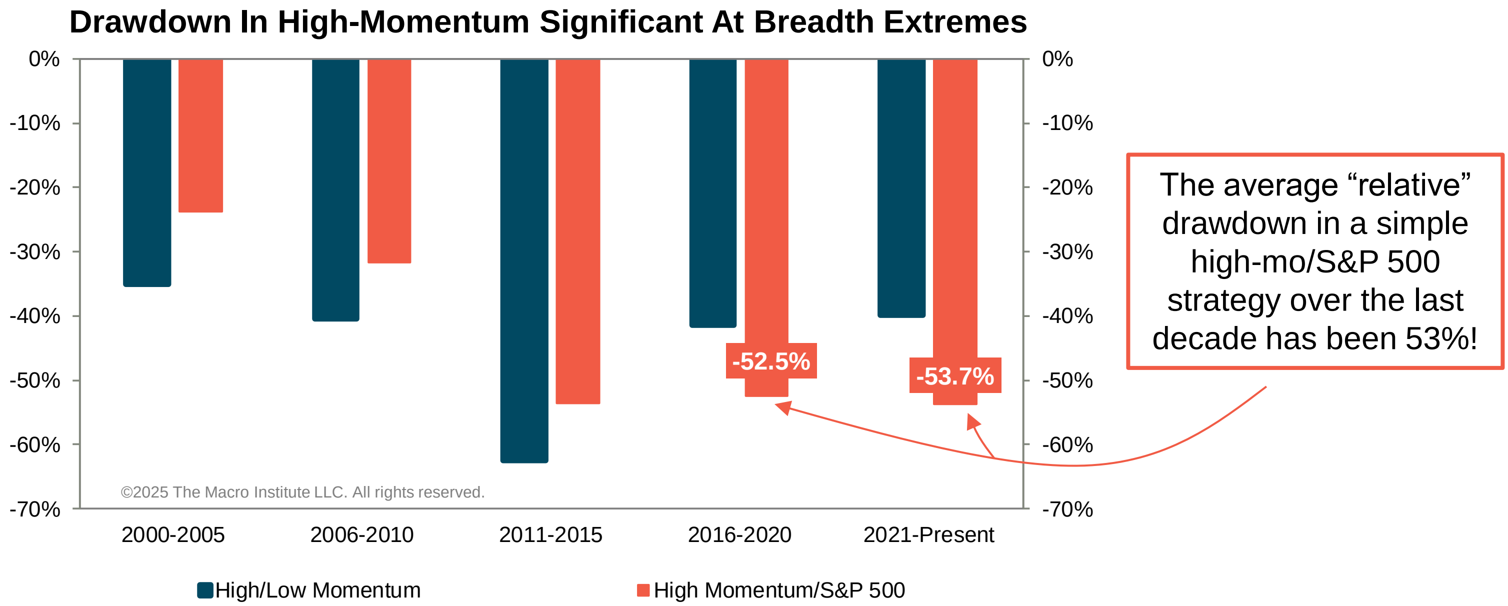
The Impact Of Interest Rates On Momentum Magnified By Growth Bias

A quick glance at the chart below makes it clear that trends in interest rates have had an influence on momentum strategies over time, and today's significant growth bias in the S&P 500 Index makes this relationship even more relevant. In our minds, it seems clear that the relative dynamic below will hold in the coming years. Worded differently, we expect the stocks currently in the low-momentum basket to gain investor interest as the economy reaccelerates (cyclical/value bias) while a rebound in interest rates proves a headwind for the growth-heavy, high-momentum cohort.





Momentum strategies come in all flavors. They usually become popular in trending markets, especially when the economy is lackluster and investors gravitate toward themes that are working (i.e., stable revenues, which is a characteristic found in Growth). The downfall of momentum typically comes when a recovery in the economy takes hold and investors return to the downtrodden stocks—and these stocks are usually Cyclicals. These turning points in momentum can be brutal. Drawdowns in the relative returns of high-to-low momentum stocks have exceeded 50% on several occasions.

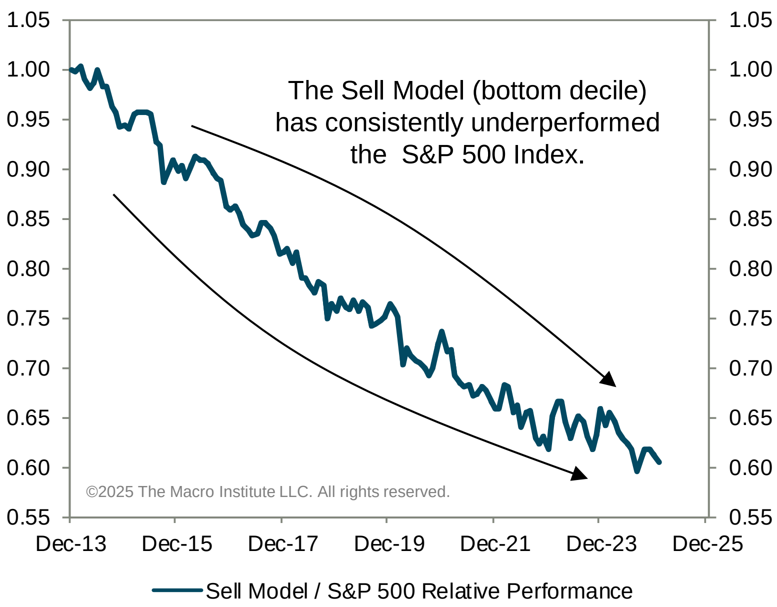


Max Drawdown When Breadth Is At Extremes (>1.25 SD)

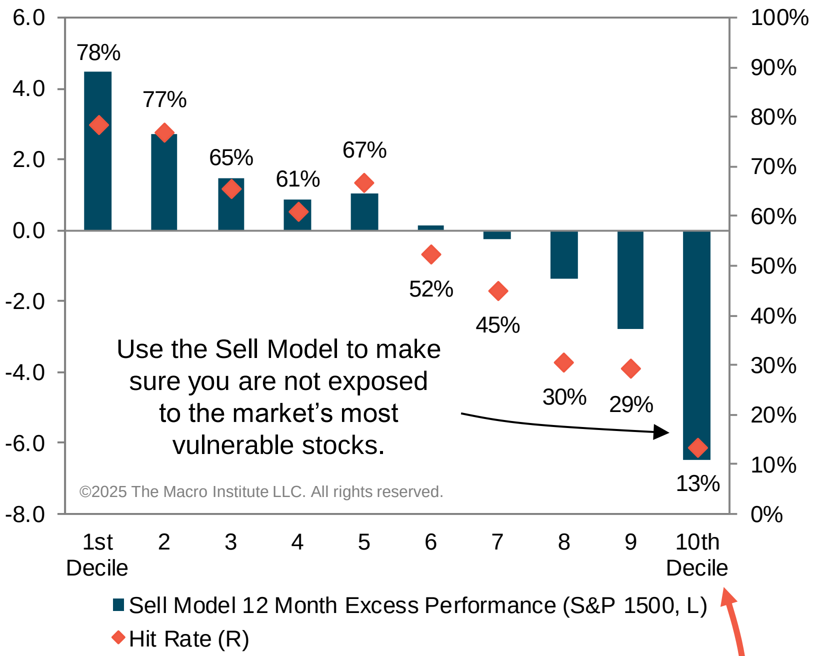
How Does High-Momentum Basket Stack Up Against The TMI Sell Model?

There is a case to be made for a change in market leadership as the macro backdrop evolves in 2025. This does not mean that every high-momentum stock will underperform, but it does suggest that the odds are skewed against those stocks as the economy reaccelerates. A way to further narrow the field of vulnerability is to see which names also show up in the TMI Sell Model. This “bottom-up” screen was first created back in 2007-08, and we have published regular updates ever since (see details of the model here). This is our way of combining macro and micro, and a few prominent names show up as at risk.

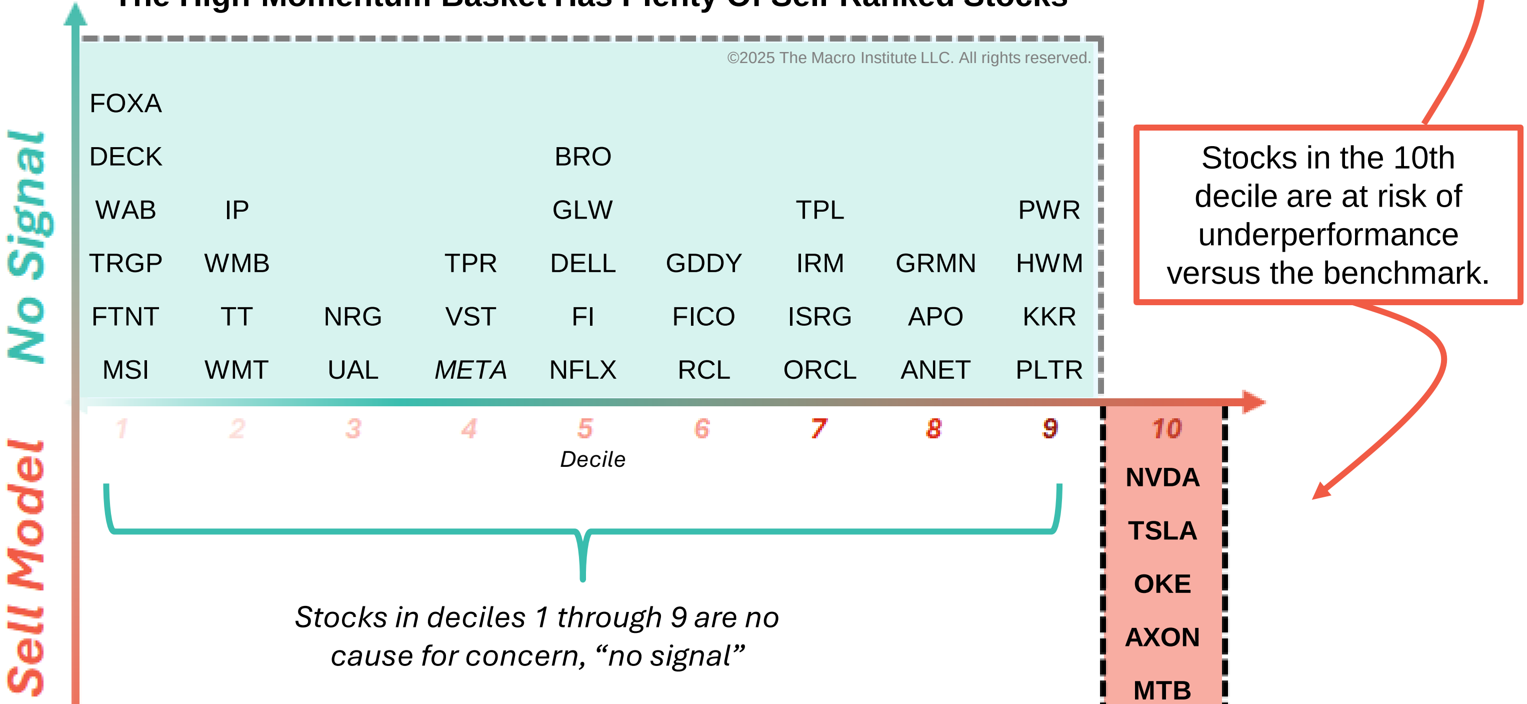
TMI Sell Model For Protection Of Profits



Names In Decile 10 Typically Underperform



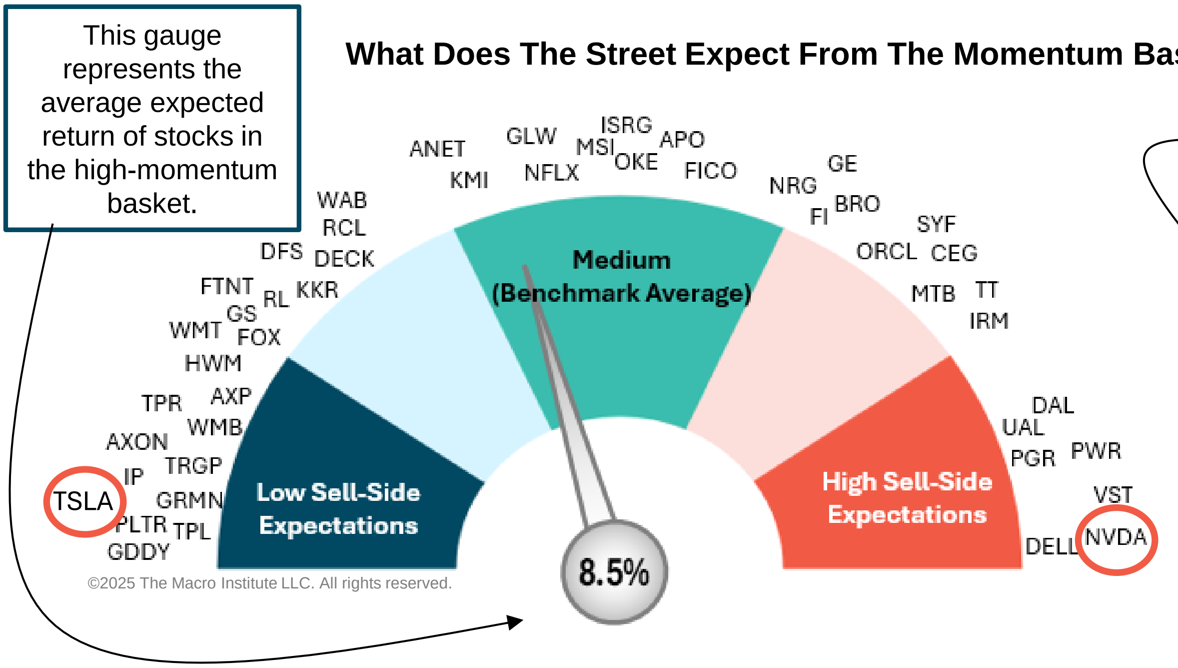
The High-Momentum Basket Has Plenty Of Sell-Ranked Stocks



What Are The Other Attributes Of The High-Momentum Basket?

Stocks that rank in the bottom of the sell model are not necessarily doomed—we are merely trying to stack the odds in our favor by combining the macro and the micro. We expect most PMs conduct their own bottom-up research, but the TMI Sell Model is our proxy of this process. A few other variables we consider to assess risk are expectations and valuations. There are two stocks from *The Magnificent 7* flagged by the TMI Sell Model, BUT expectations for their performance does not reflect that risk. The sell side already expects NVDA to rise 40ish percent this year, but TSLA to flounder of sorts. Again, none of this guarantees anything about the road ahead, but it does add one more layer to the puzzle.

What Does The Street Expect From The Momentum Basket?

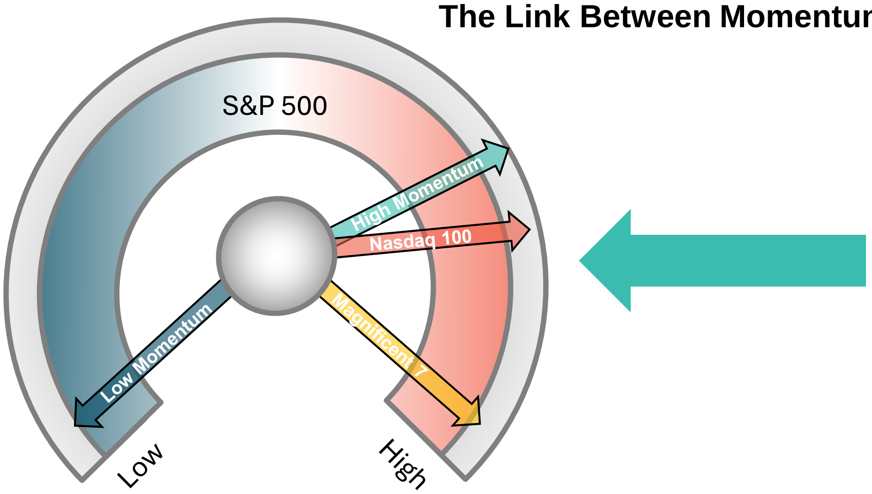


Highest price target stocks In High-Momentum basket

Symbol	Expected Return
DELL	49%
NVDA	41%
UAL	24%
VST	22%
IRM	22%
DAL	21%
PWR	19%
PGR	16%

The variable that really separates the low-momentum basket of stocks from the high-momentum bucket is valuation. The stocks that comprise the low-momentum basket have lower valuations than the overall S&P 500 (not surprising given its cyclical skew). Meanwhile, the high-momentum basket currently sports a valuation that is well above that of the S&P 500 and is not that far from that of the Nasdaq 100 (also not surprising given its growth skew). Interestingly, *The Magnificent 7* is even more extreme in valuation. Of course, there are plenty of other differences between the low-mo crowd and the Mag 7, but this is the most extreme. Key thing to know here is that, broadly defined, low valuation tends to generate a lot alpha when economic prospects (i.e., LEIs) are in recovery mode.

The Link Between Momentum & Valuation

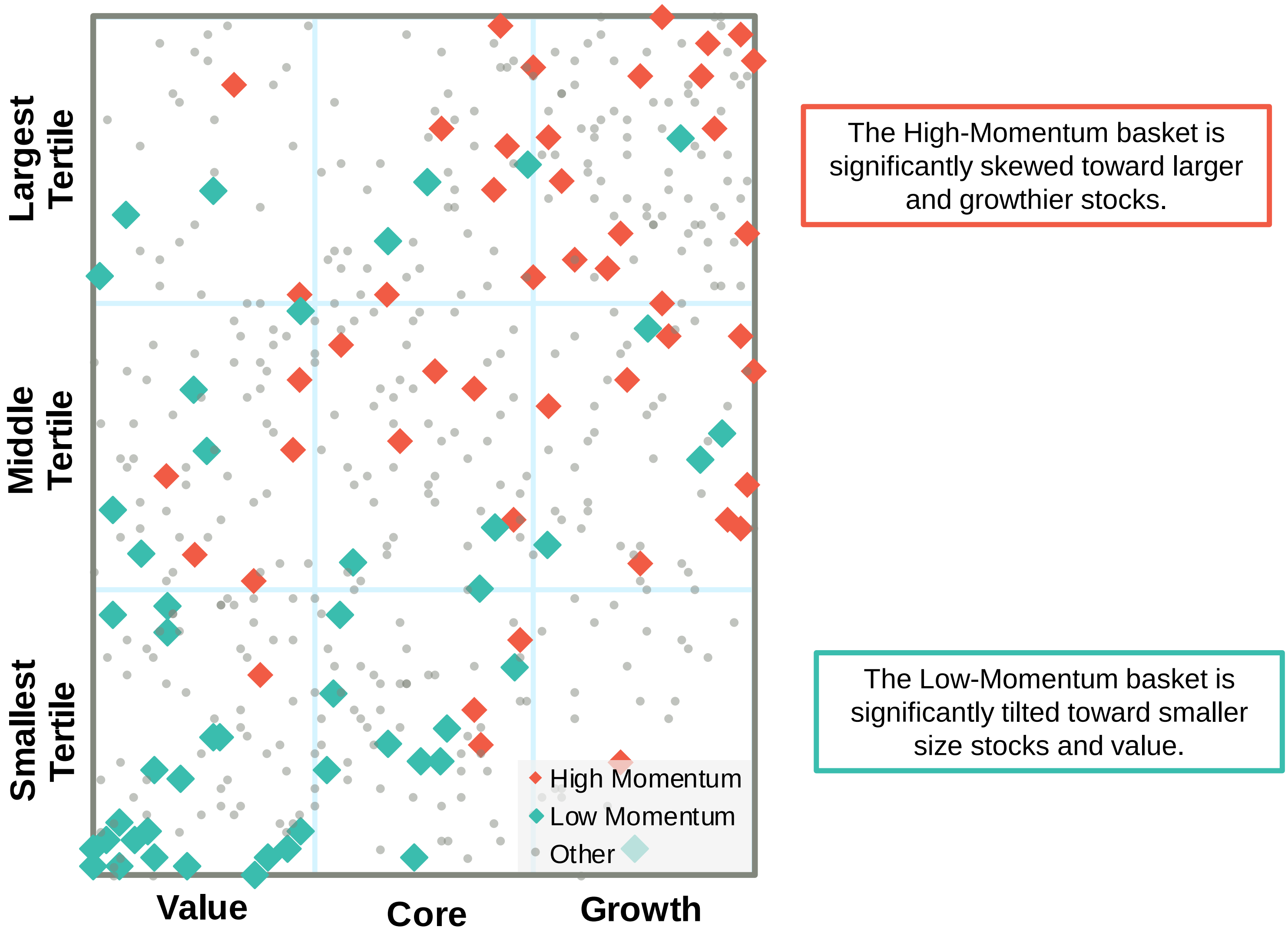


Valuation is probably *THE* variable that currently differentiates low-momentum stocks from their high-momentum counterparts.

How Does High And Low Momentum Stack Up Across Size & Style?

The answer to the question posed in the page title is not all that complicated. Indeed, a quick glance at the size & style matrix below makes it quite clear that there are more red dots, or those representing the high-momentum basket, concentrated in the upper end corner where size is larger than average and style skews toward growth. The green dots, representing the stocks from the low-momentum cohort, are mostly in the lower left quadrant given their overall smaller average size and the value skew that comes with this group. This is a bit obvious, of course, but it is a great way to visualize the difference.

Where Does Momentum Land For Size And Style?

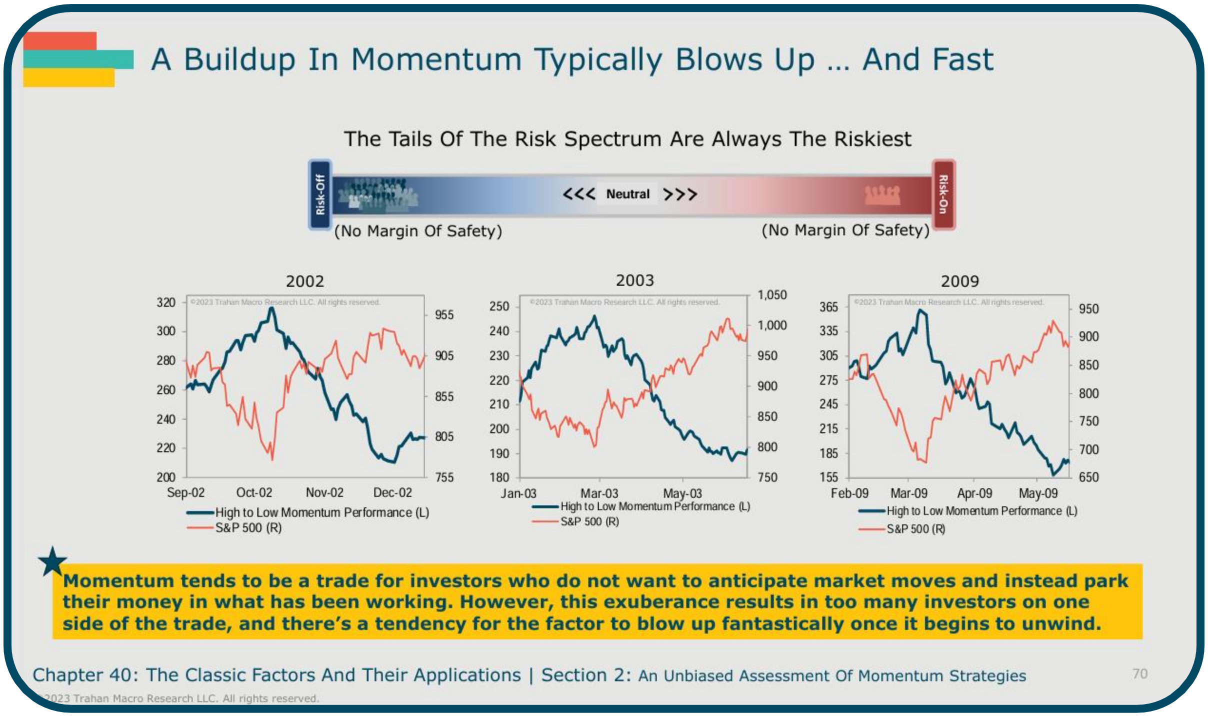


Again, there is nothing earth shattering about the chart above. We have already shown that the high-momentum basket skews larger and growthier, an unsurprising fact given that this is where many of *The Magnificent 7* land. Meanwhile, the low-momentum cohort, and its large value and cyclical bias, is inevitably going to look a bit like a mirror image. This is not going to explain every stock, but it is easy to see that one universe mostly populates the upper right end corner and vice versa.

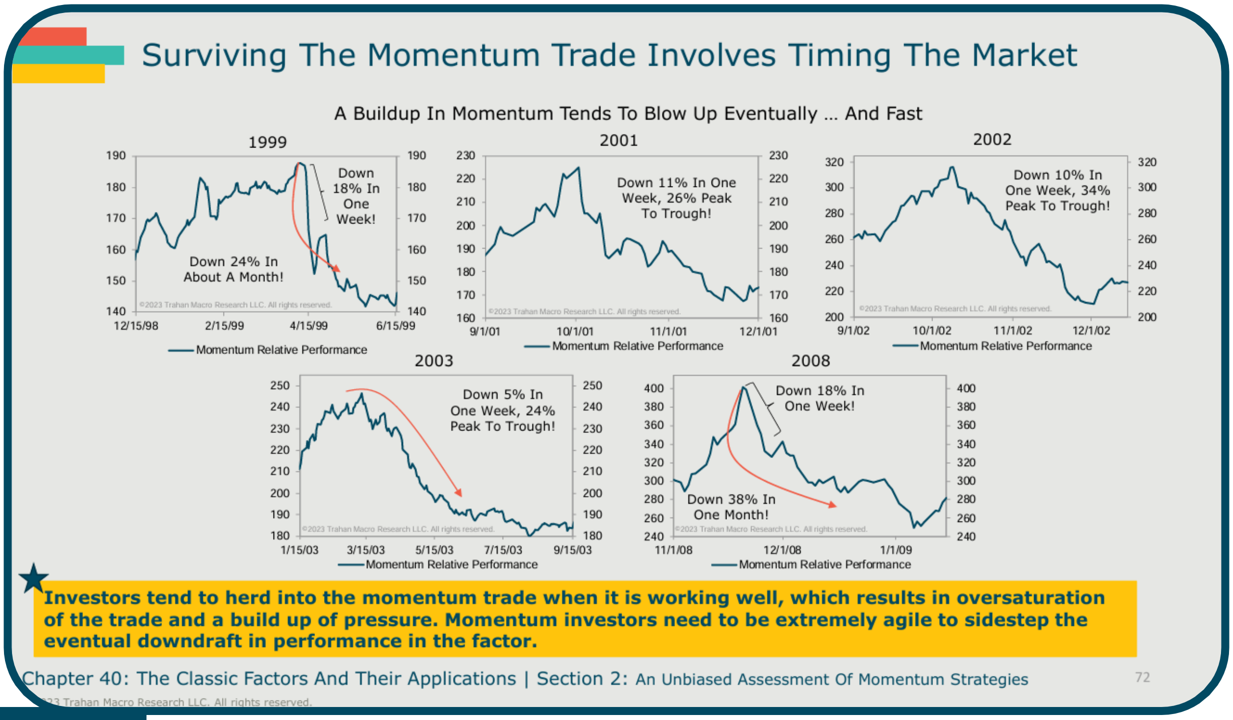
We have made this point countless times, but it's the most important takeaway from this report and the current backdrop we are facing. A reacceleration in leading indicators (we have used the ISM New Orders Index as a proxy throughout this report) is historically associated with cyclical leadership AND a bias toward more "risk-taking." These two characteristics will inevitably favor smaller indices like the S&P 600 Small-Cap Index and the Russell 2000 given their compositions.

Annex: Additional Considerations About Momentum (1/2)

We are not huge fans of momentum as a factor in stock selection models. There are many reasons for this, but the main one is that "momentum" stealthily embeds a lot of other characteristics and investors sometimes deviate from their goals by simply following what has worked. Regardless, it periodically gains popularity, and we do cover it extensively in the Macro Specialist Designation program (M^2SD). This Annex covers some important reminders about "momentum" from the M^2SD curriculum.

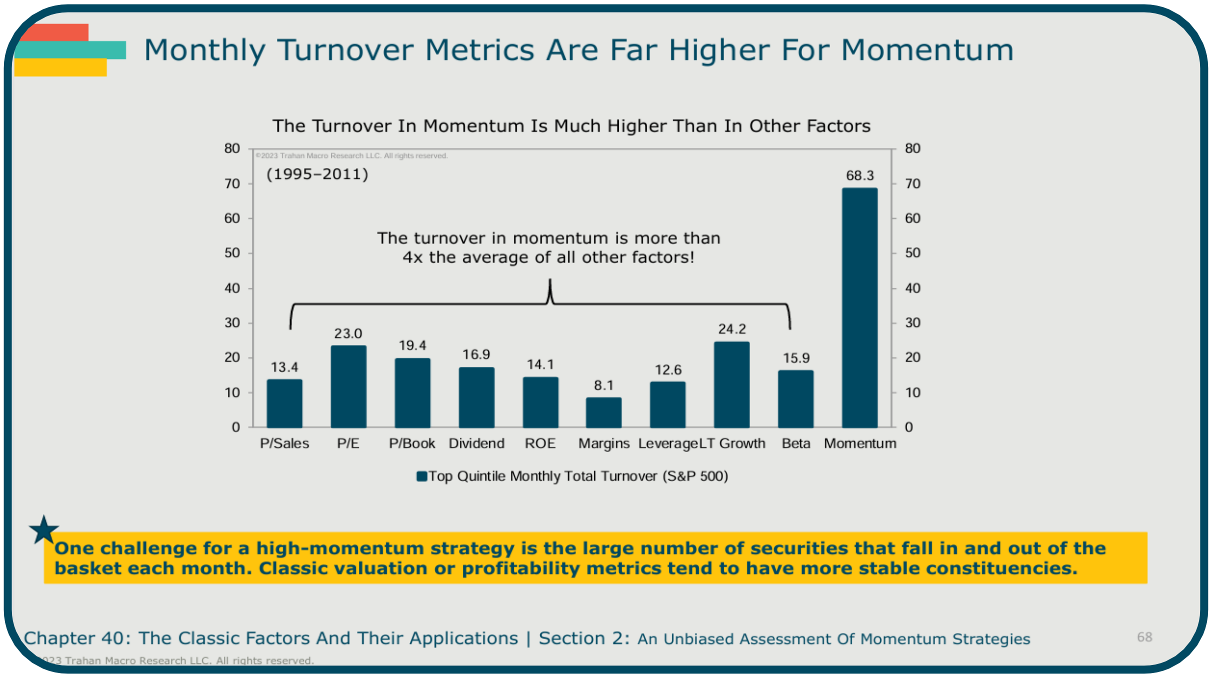


Momentum often works great until it unravels very quickly. The slide above is from Chapter 40 of the M^2SD curriculum and shows just how quickly markets go from rewarding a factor, high-momentum in this case, to the exact opposite. It also reveals that this tends to happen when the overall Index is turning higher. This is not the key conclusion, however. Rather, momentum tends to reverse when economic prospects turn higher. This is what prompts the sudden change in leadership.



Annex: Additional Considerations About Momentum (2/2)

Another consideration to be aware of when it comes to momentum is that there is often a large difference between a theoretical back test and real-time performance. This is related to liquidity and the fact that it is often difficult to invest in some of the smaller high-momentum names. Similarly, momentum typically involves a much more active management style than using other factors. This is explained by the fact that price momentum changes far more often than factors related to balance sheet items.



Investors are often surprised by this statement, but PMs should root against momentum. This sounds weird, especially after a period of high-momentum alpha, but the data is clear. Indeed, **there is an inverse relationship between the efficacy of high-momentum and the performance of active management.** This is related to index concentration and the fact that a recovery in LEIs broadens leadership and brings support to low-momentum names. This should be a good year for active management.