Domestic Equities

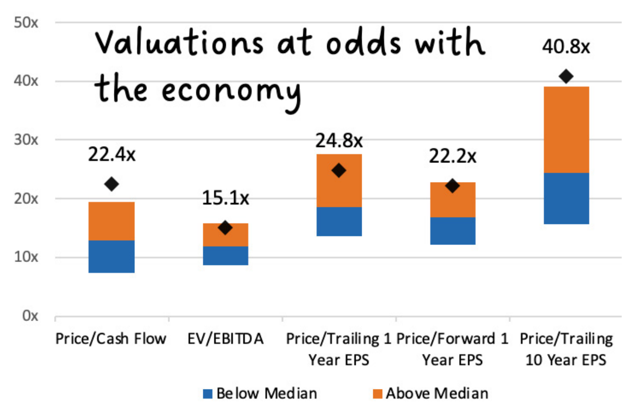
Large Cap

Authors: Crit Thomas, CFA, CAIA / Erik M. Aarts, CIMA / Tim Paulin, CFA

August 5, 2025

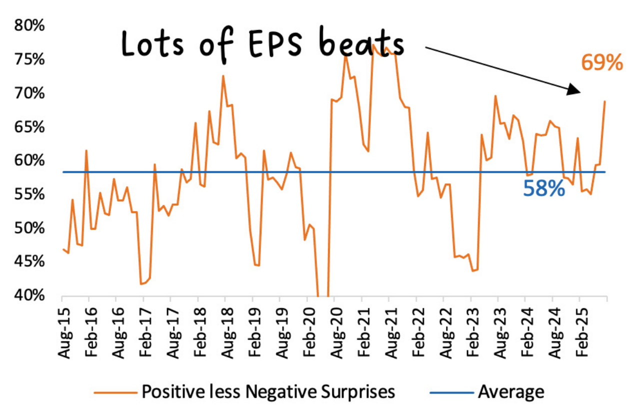
- We are maintaining our neutral stance on large cap blend equities. However, when factoring in both Growth and Value exposure, our overall tactical positioning is slightly underweight. This reflects elevated price risk stemming from moderately restrictive monetary policy, unpredictable Presidential directives, and stretched valuations.
- We expect market volatility to increase this fall, with both upside and downside risks rising. Historically, September has been the weakest month for the S&P 500, and a correction is possible. We continue to hold a slightly defensive posture, though we would likely take advantage of any major market selloffs.
- Large cap stocks appear priced for either a second half earnings recovery or significant rate cuts, neither of which seems likely. While uncertainty around tariff deals is beginning to resolve, questions remain regarding their economic and earnings impact. Additionally, a court ruling against the administration's tariff approach could introduce a new dose of uncertainty.
- **Earnings: what's not to like?** With 66% of S&P 500 companies having reported, second quarter results have largely exceeded expectations, highlighting companies' ability to execute in a challenging environment. Yet, the market's tepid response, so far, suggests the market had already discounted a strong earnings season.
- Companies appear to have absorbed much of the initial tariff costs. However, forward guidance suggests many will attempt to pass those costs onto consumers in the second half of the year.
- Elevated large cap stock valuations imply expectations for a business cycle recovery. While the economy is likely to remain resilient, resilience is not the same as a recovery. With only moderate earnings growth expected and valuations already high, forward returns are likely to be more pedestrian.
- The macro backdrop remains highly fluid, with market sentiment susceptible to abrupt shifts. This could lead to periods of indiscriminate buying or selling, creating potential opportunities for active managers.

S&P 500 Index Valuation Ranges



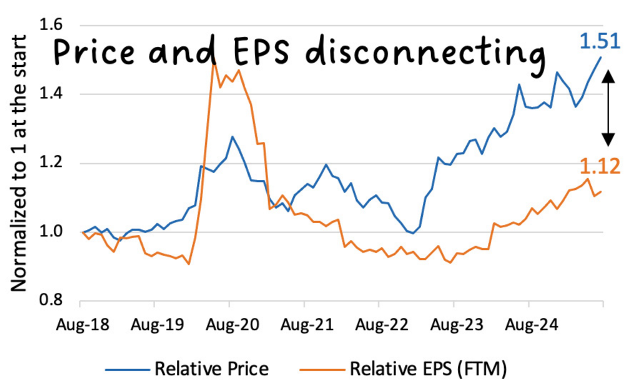
Source: Bloomberg. Based on monthly observations starting in 1996. The minimum and maximum ranges are set to the 5th and 95th percentiles, respectively, to remove outliers. Average percentile rank: 94% as of Jul 2025

S&P 500 Index Net Earnings Surprise



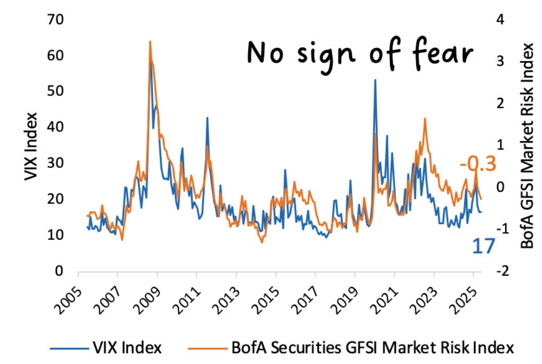
Source: Bloomberg. 10 years of monthly data through Jul 2025

S&P Top 50 Index versus S&P 500 Equal Weighted Index



Source: Bloomberg. 7 years of monthly data through Jul 2025

Market Risk Measures



Source: Bloomberg. 20 years of monthly data through Jul 2025

GFSI Market Risk Index is a measure of future price swings implied by option markets in global equities, rates, currencies and commodities. Levels greater (less) than 0 indicate more (less) stress than is normal.

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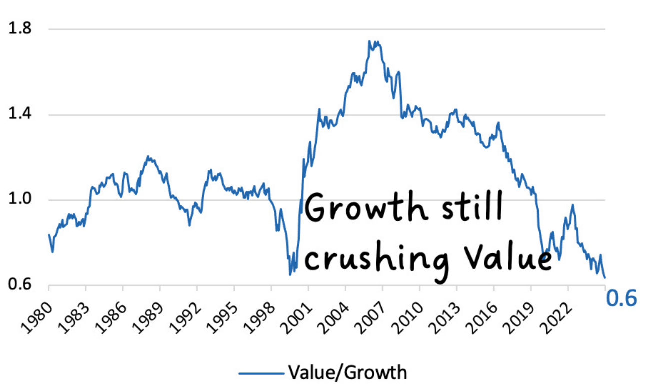
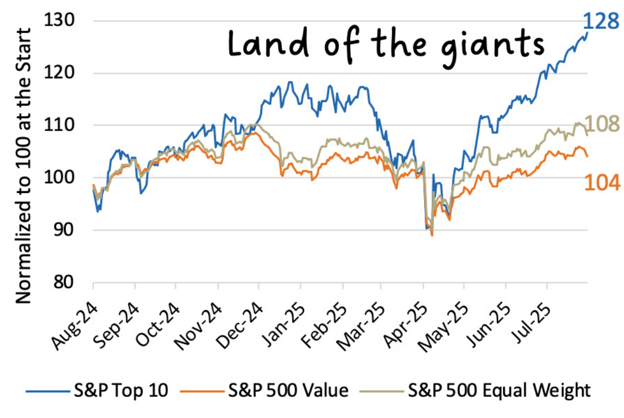
- We continue to tactically hold a moderate underweight in Growth and remain neutral on Value.
- The Technology sector has been on a tear, up almost 50% since the April lows, driven almost entirely by multiple expansion. The earnings growth implied by current valuations appears to exceed consensus expectations of 18% in 2025 and 17% in 2026.
- Growth stocks typically have high earnings beat rates, and this quarter is no exception. However, even assuming a historical level of beats on consensus growth expectations, current pricing looks too high. That said, recent tax law changes are likely to depress earnings growth (due to greater expensing of capital spending) and increase cash flow. Notably, second quarter measures of cash flow growth are significantly higher than those of EPS.
- Growth's recent strong performance has been concentrated and AI-driven. The top five stocks in the Russell 1000 Growth Index comprised 46% of the index at the end of July. These companies are either funding the buildout of AI capacity or providing the tools (semiconductors) to run AI. According to Renaissance Macro, AI-related spending added more to first half GDP than consumer spending.
- Thus far, the AI narrative has been more about infrastructure buildout than monetization. Historically, the adoption of new technologies has been slowed by infrastructure constraints. For example, railroad tracks, electrical transmission lines, and fiber optics were needed before railroads, electricity, and the internet could flourish. With AI, this constraint is less severe, given near-universal access to the internet. As a result, AI adoption may proceed faster than past innovations.
- As AI shifts from buildout to usage, its economic impact will broaden. Currently, AI is most impactful where work is repetitive, data-rich, high-volume, and rules-based. We note that many industries that reflect these characteristics, such as **financial institutions, industrials, real estate, and business services,** are more aligned with **Value indexes** than Growth.

Relative Total Returns: Russell 1000 Value Index/Russell 1000 Growth Index



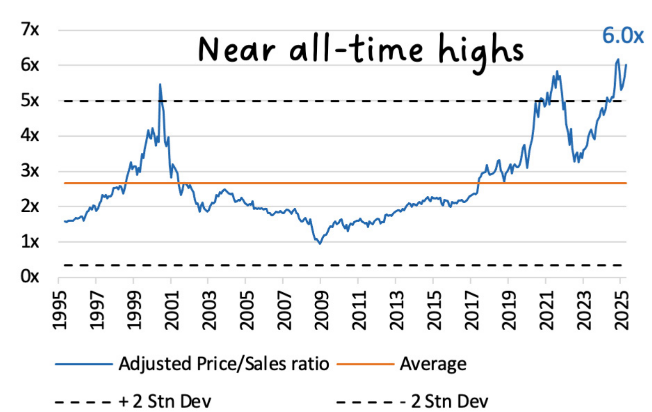
Source: Bloomberg. 45 years of monthly data through Jul 2025

1 Year Price Returns



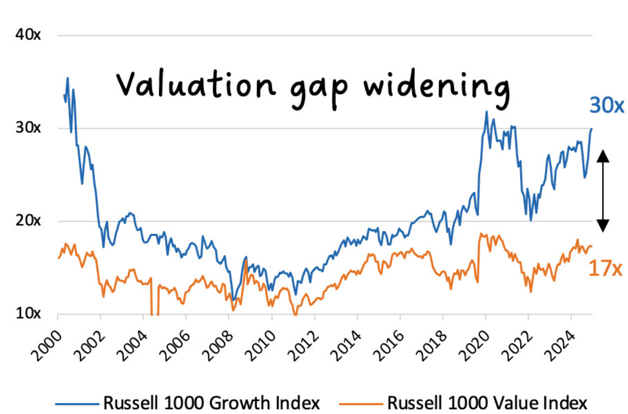
Source: Bloomberg. 1 year of daily data through Jul 31 2025

Russell 1000 Growth Index



Source: Bloomberg. 30 years of monthly data through Jul 2025

Price/Earnings Ratios: Forward 12 Months



Source: Bloomberg. 25 years of monthly data through Jul 2025

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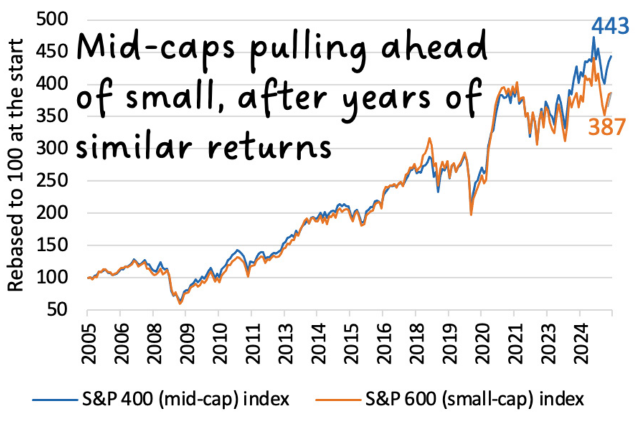
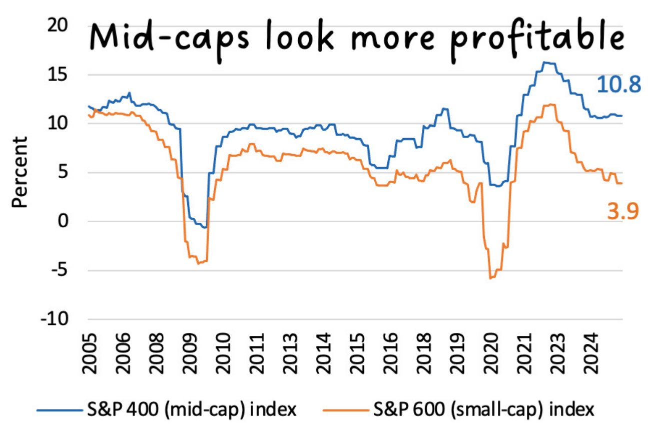
- We continue to favor mid caps over small caps, which we see as offering the best risk/reward balance in the current market.
- Historically, small and mid cap indexes traded closely, but that relationship has decoupled over the past five years as mid caps outperformed. Several factors help explain this shift:
  - **Structural & Sector Differences:** Mid caps have greater exposure to industrials, tech, and health care, sectors that have benefited from both structural and cyclical tailwinds. Small caps are more heavily weighted toward low-growth cyclicals and financials, which are struggling amid rate volatility and tighter credit. This sector tilt gives mid caps a higher exposure to quality and growth factors.
  - **Superior Profitability & Financial Strength:** Mid caps now exhibit operating margins and ROEs that are nearly double those of small caps, an important divergence from the pre-2019 norm. And unlike mid caps, small caps carry higher leverage and are more exposed to floating-rate debt, increasing their vulnerability to rising rates.
- This has been one of the strongest earnings seasons for both mid and small caps. This is encouraging, though only about half of the reports are in, and upward revisions to full-year estimates have been limited so far. Small caps upside has been driven by the staples sector – diverging from large cap staples, which have been struggling with weaker consumer demand and tariffs. Mid cap upside has come from industrials and financials, in line with large cap trends.
- In terms of sector diversification and profitability, Mid caps are increasingly resembling the equal-weighted S&P 500, yet they continue to trade at a discount. We believe that mid caps may offer a compelling substitute for broad large cap exposure, particularly for investors seeking diversification, quality, and valuation.
- In a slower growth economy with uncertain policy direction, we believe mid caps offer a more attractive balance of opportunity and risk. While small caps may outperform in a sharp recovery or aggressive Fed easing cycle, we believe mid caps present a better quality-for-risk tradeoff in the near term.

Relative Price Performance



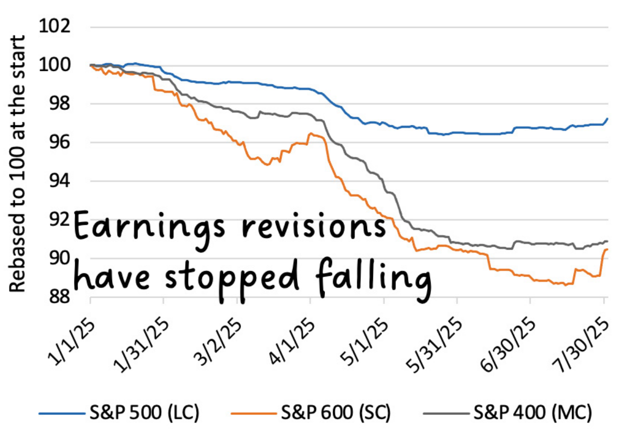
Source: Bloomberg. 20 years of monthly data through Jul 2025.

Return on Common Equity



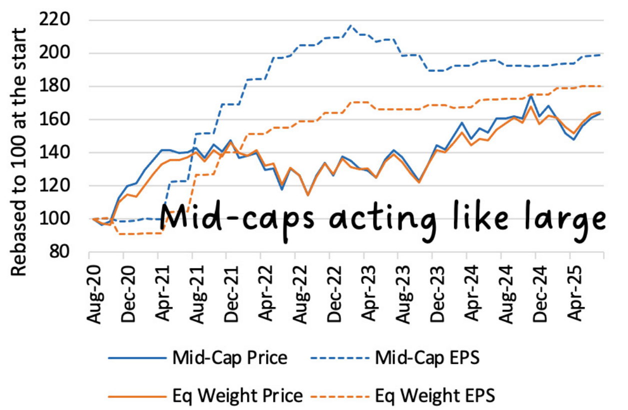
Source: Bloomberg. 20 years of monthly data through Jul 2025

Year-to-Date 2025 EPS Revisions



Source: Bloomberg. Daily bottom-up analyst estimates through Jul 31 2025

S&P 400 vs. S&P 500 Equal Weighted



Source: Bloomberg. 5 years of monthly data through Jul 2025. EPS measured over rolling trailing 12 months.

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Market Characteristics

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The Indexes mentioned are unmanaged statistical composites of stock market or bond market performance. Investing in an index is not possible.

Total Returns

							EPS Growth Estimate	
	July 2025	YTD	2024	2023	2022	2021	2025	2026
S&P 500 Index	2.2%	8.6%	25.0%	26.3%	-18.1%	28.7%	7%	12%
S&P 500 Index Equal Weighted	1.0%	5.8%	13.0%	13.8%	-11.5%	29.6%	4%	12%
S&P 500 Value Index	0.9%	4.2%	12.3%	22.2%	-5.3%	24.9%	4%	11%
Russell 1000 Value Index	0.6%	6.6%	14.4%	11.4%	-7.6%	25.2%	4%	11%
S&P 500 Growth Index	3.4%	12.6%	36.1%	30.0%	-29.4%	32.0%	13%	14%
Russell 1000 Growth Index	3.8%	10.1%	33.4%	42.7%	-29.1%	27.6%	9%	15%
S&P 400 Index	1.6%	1.8%	13.9%	16.4%	-13.1%	24.8%	1%	17%
S&P 600 Index	0.9%	-3.6%	8.7%	15.9%	-16.1%	26.8%	3%	18%
Russell 2000 Index	1.7%	-0.1%	11.5%	16.9%	-20.4%	14.8%	-3%	25%

Valuations

	P/E (TTM)	Percent Rank	P/E (FTM)	Percent Rank	P/CF	Percent Rank	P/S	Percent Rank
S&P 500 Index	26.9x	91%	21.3x	91%	22.4x	98%	3.3x	100%
S&P 500 Index Equal Weighted	21.0x	79%	16.2x	70%	13.7x	92%	1.7x	83%
S&P 500 Value Index	21.1x	93%	17.3x	98%	17.2x	93%	2.1x	99%
Russell 1000 Value Index	20.1x	87%	16.3x	87%	16.6x	96%	1.9x	95%
S&P 500 Growth Index	35.1x	96%	26.6x	96%	30.2x	100%	6.4x	99%
Russell 1000 Growth Index	37.4x	87%	29.0x	91%	28.7x	96%	6.2x	100%
S&P 400 Index	19.5x	35%	14.9x	44%	11.6x	59%	1.4x	87%
S&P 600 Index	21.5x	45%	13.5x	19%	11.2x	35%	1.1x	77%
Russell 2000 Index	51.8x	90%	20.0x	62%	15.5x	86%	1.4x	90%

Fundamentals

	Dividend Yield	Percent Rank	Profit Margin	Percent Rank	ROE	Percent Rank	Net Debt / EBITDA	Percent Rank
S&P 500 Index	1.2%	5%	13.4%	97%	18.4%	94%	1.5	24%
S&P 500 Index Equal Weighted	1.9%	61%	9.1%	65%	11.5%	53%	2.6	53%
S&P 500 Value Index	2.0%	17%	10.9%	95%	14.3%	90%	2.0	37%
Russell 1000 Value Index	2.0%	9%	10.4%	86%	12.2%	58%	2.1	20%
S&P 500 Growth Index	0.6%	11%	19.8%	97%	29.2%	86%	0.6	23%
Russell 1000 Growth Index	0.5%	4%	18.3%	100%	35.7%	96%	0.6	8%
S&P 400 Index	1.5%	50%	8.2%	89%	10.8%	60%	2.4	39%
S&P 600 Index	1.8%	88%	6.7%	93%	3.9%	14%	4.0	86%
Russell 2000 Index	1.5%	62%	4.2%	52%	0.0%	19%	4.5	76%

For Index Definitions see: TouchstoneInvestments.com/insights/investment-terms-and-index-definitions

Source: Bloomberg. Percent ranks are based on 30 years of monthly data as of the end of July; EPS growth estimates based on consensus bottom-up analyst estimates

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A Word About Risk

Investing in fixed-income securities which can experience reduced liquidity during certain market events, lose their value as interest rates rise and are subject to credit risk which is the risk of deterioration in the financial condition of an issuer and/or general economic conditions that can cause the issuer to not make timely payments of principal and interest also causing the securities to decline in value and an investor can lose principal. When interest rates rise, the price of debt securities generally falls. Longer term securities are generally more volatile. Investment grade debt securities which may be downgraded by a Nationally Recognized Statistical Rating Organization (NRSRO) to below investment grade status. U.S. government agency securities which are neither issued nor guaranteed by the U.S. Treasury and are not guaranteed against price movements due to changing interest rates. Mortgage-backed securities and asset-backed securities are subject to the risks of prepayment, defaults, changing interest rates and at times, the financial condition of the issuer. Foreign securities carry the associated risks of economic and political instability, market liquidity, currency volatility and accounting standards that differ from those of U.S. markets and may offer less protection to investors. Emerging markets securities which are more likely to experience turmoil or rapid changes in market or economic conditions than developed countries.

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