MARKET MINUTE

With McGAREL

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March was an awful month for U.S. equities as the S&P 500 Index fell almost 6%. All sectors were negative except Energy (+3.9%) and Utilities (+0.3%), while the Magnificent 7 ("Mag 7") sectors led the rout. Information Technology (Apple, Microsoft, NVIDIA), Communication Services (Alphabet, Meta), and Consumer Discretionary (Amazon, Tesla) all fell over 8% and were the three worst performing sectors.

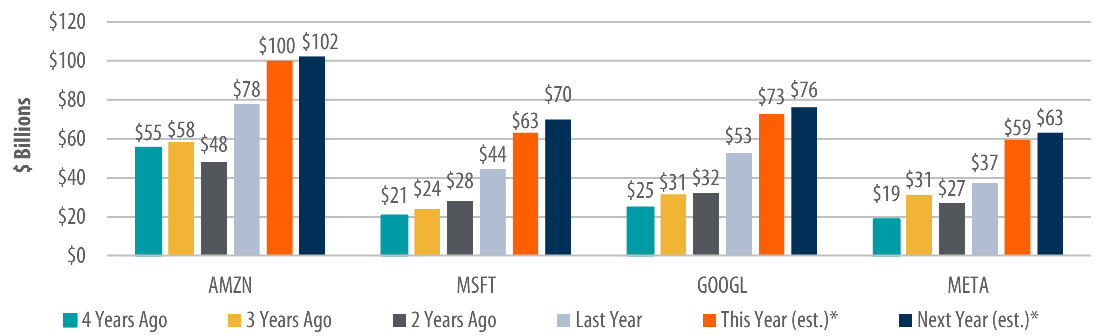
Year-to-date, the S&P 500 Index is now down over 4% and there are all sorts of reasons being given for the negative returns. Tariffs, inflation fears, interest rates, geopolitical events, a possible recession are all legitimate threats to equities today. But why is the Mag 7 and their sectors taking the brunt of the beating relative to others?

Our view is the market simply needed to reset valuations amid all those issues but, mostly, the Artificial Intelligence (AI) trade became too overvalued with too many looming questions. The Mag 7 growth story today is all about AI. Look no further than the capital expenditure ("capex") increases in Chart 1 to see the massive bet the four hyperscalers are making on AI.

The selloff has thus far taken some of the excessive valuation multiple out of the mega cap Mag 7 which had been trading at a large premium to the rest of the market. That started to change in late January with the release of DeepSeek, a Chinese AI model which was developed using much less computing power than prior cutting-edge models. DeepSeek raised questions about the necessity for the massive AI capex from the U.S. players and the potential return on that spending. Until that point the Mag 7 had been riding an ever-growing wave of momentum driven by AI-related spending and there was little reason to question the forecasts. From the close on January 24, just prior to the DeepSeek announcement through the end of March, the Mag 7 were down over 18% while the S&P 500 Index was down 7.8% and the broader equal weight S&P 500 Index was down 4.5%. Additionally, expectations of earnings-per-share (EPS) growth for the Mag 7 fading down to something more in-line with the rest of the S&P 500 Index was more reason for that valuation premium to compress [Chart 2].

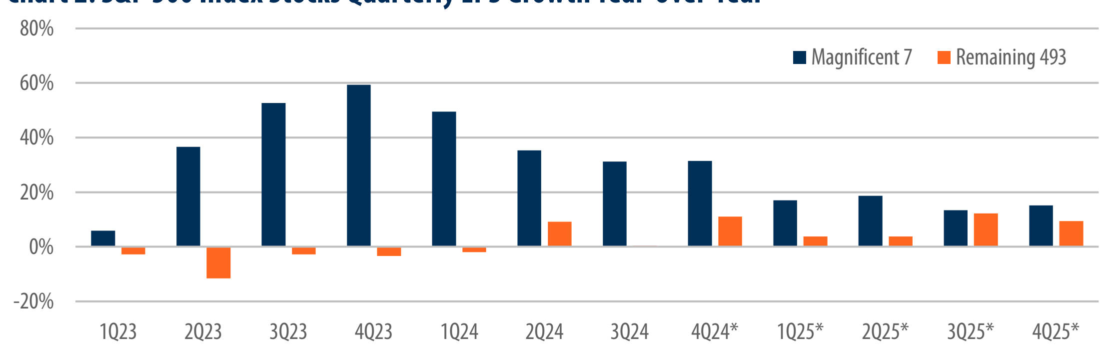
We view the broadening of the market thus far in 2025 as healthy and more a response to excessive valuation in a narrow part of the market than fears of an imminent recession, though no doubt investors are more worried about that now than a quarter ago. This highlights the need to stay diversified and focus on valuation in capital allocation decisions.

Chart 1: Mega Tech Capital Expenditures



Source: Capital IQ. Data as of 31/3/2025 and capital expenditures are based on fiscal year-end. *Estimates are based on projected capital expenditures for Mega Tech Stocks.

Chart 2: S&P 500 Index Stocks Quarterly EPS Growth Year-Over-Year



Source: S&P Capital IQ. Data as of 31/3/2025. There can be no assurance past trends will continue or projections realized.*Forecast based on quarterly consensus earnings estimates.

Past performance is no guarantee of future results.

The **S&P 500 Index** is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance.

Magnificent 7 (Mag 7): AAPL: Apple Inc. MSFT: Microsoft Corporation. NVDA: NVIDIA Corporation. GOOGL: Alphabet Inc. AMZN: Amazon.com, Inc. META: Meta. TSLA: Tesla, Inc.

Earnings per share (EPS) is the monetary value of earnings per outstanding share of common stock for a company during a defined period of time, often a year.

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Index data is for illustrative purposes only and not indicative of any actual investment. Indices are unmanaged and investors cannot invest directly in an index. Index returns do not reflect any fees, expenses, or sales charges. These returns were the result of certain market factors and events which may not be repeated in the future.

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