

# Is the ‘great equity rotation’ finally coming?

Published 24 July 2024

**Pierre Debru**

Head of Research, WisdomTree Europe.

## Key Takeaways

- 10 July marked the potential start of an equity rotation away from the Magnificent Seven and towards the rest of the market
- This equity rotation is supported by upcoming Fed rate cuts, the earning growth gap between the “Magnificent Seven” and the rest of the market and the probable small-cap rally post-US election
- Such a rotation will force investors to rebalance portfolios towards more diversified portfolios and smaller cap portfolios like the one proposed in this blog
- Related Products WisdomTree Global Quality Dividend Growth UCITS ETF - USD Acc, WisdomTree US Quality Dividend Growth UCITS ETF - USD Acc, WisdomTree Artificial Intelligence UCITS ETF – USD Acc, WisdomTree Megatrends UCITS ETF - USD Acc Find out more

Over the last 18 months, the “Magnificent Seven” have dominated markets’ performance and narrative ad nauseam. For a while, it felt like nothing could stop their march forward, and they would defy gravity for years to come. But in markets, like in life, nothing is forever.

On 10 July, The Magnificent Seven may finally have met a worthy opponent in the form of a strong Consumer Price Index (CPI) print. Since the Bureau of Labor Statistics published a lower-than-expected CPI at +3% year-on-year and core CPI at +3.3%, markets appear to have finally pivoted. In the space of a week, the Russell 2000 jumped 9.2% while the Nasdaq lost -4.2%. In the same period, the S&P 500 equal weight outperformed the S&P 500 by 4.3%.

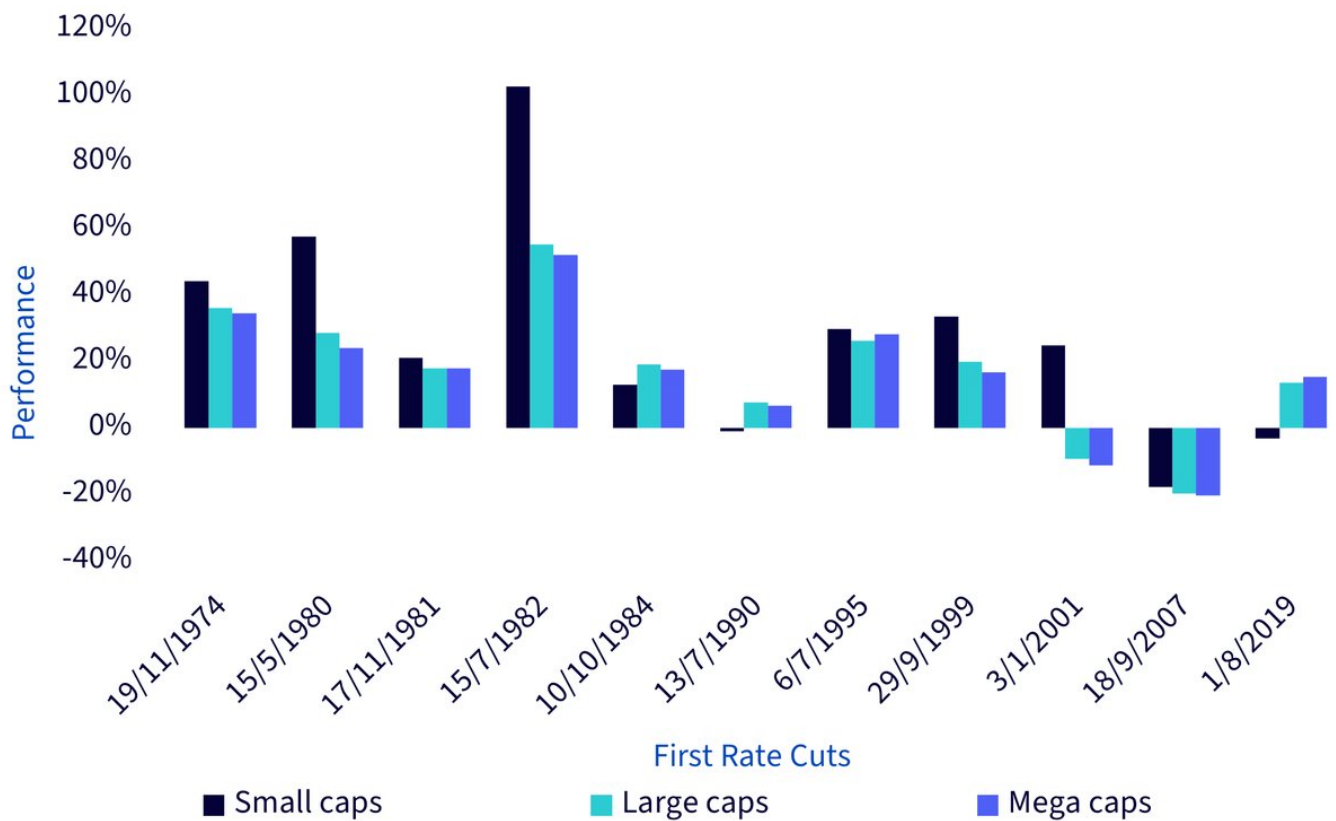
This rotation away from the Magnificent Seven and towards smaller caps, while impossible to predict in terms of the timing or magnitude, has been a long time coming. **At WisdomTree, we believe a few catalysts may be aligning, leading to the establishment of a wider and longer trend in which the market broadens, the remaining 493 stocks in the S&P 500 as well as small caps rebound and play catch-up with the Magnificent Seven.**

## The Fed is finally cutting

Firstly, the Federal Reserve (the Fed) is moving towards its first interest rate cut in September. The markets read the July CPI print as the final confirmation that the Fed needed and reacted accordingly. Rate cuts are economically very beneficial to all companies, even more so to companies that must borrow to invest or are not profitable yet. In other words, it tends to benefit smaller cap companies more.

- In nine out of the last 11 rate cut cycles (Starting in 1974), equities have gained in the first 12 months following the first cut.
- In six of those nine cycles, small caps outperformed large caps and mega caps.
- Also, in the two cycles when equities performed negatively, small caps beat large caps and mega caps as well, even posting positive returns in one of those two instances.

**Figure 1: Historical performance in the 12 months following the first rate cut**

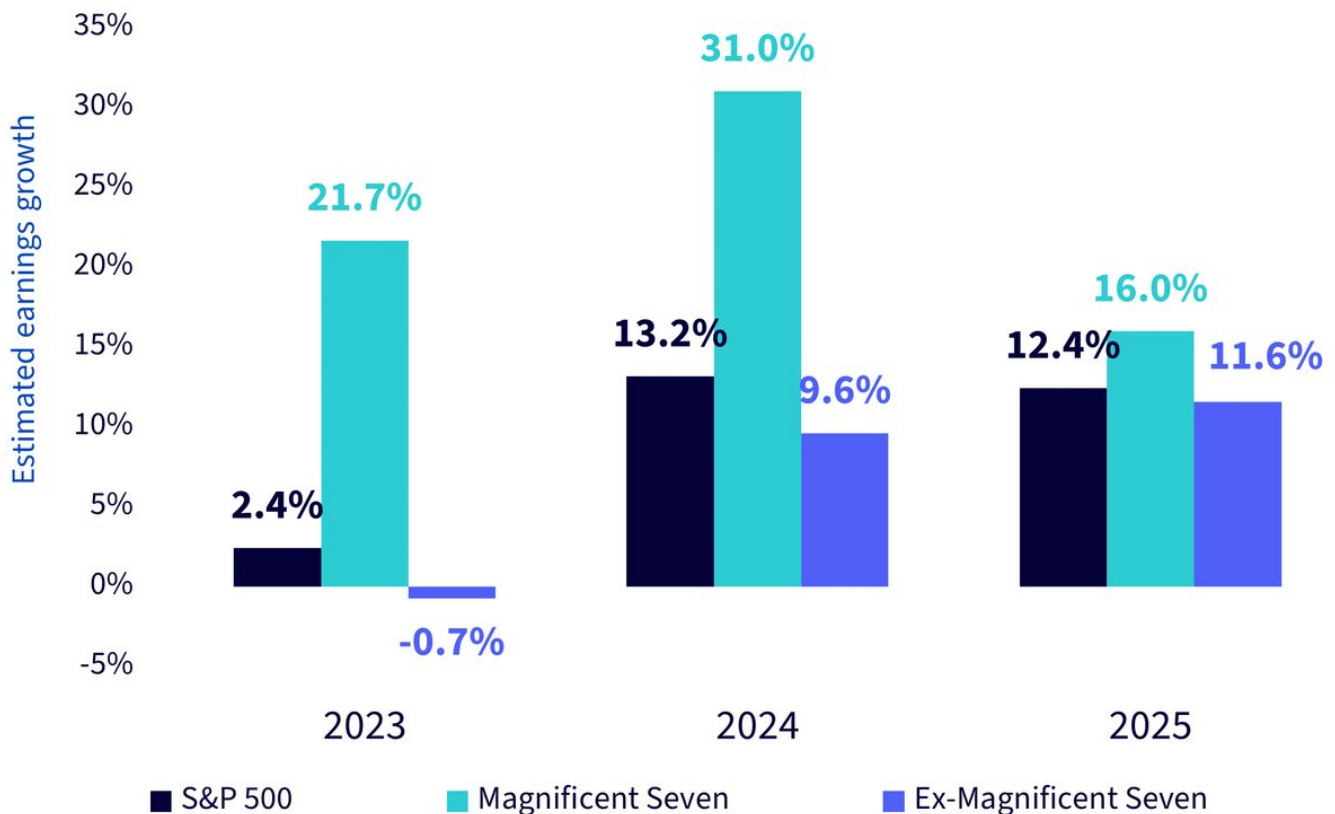


Sources: WisdomTree and Ken French, data as of May 2024, which represents the latest date of available data. Small Caps: Low 30% portfolio. Large Caps: High 30% Portfolio. MegaCaps: high 10% portfolio. Market: all CRSP firms incorporated in the U.S. and listed on the NYSE, AMEX or NASDAQ. **Historical performance is not an indication of future performance, and any investments may go down in value.**

## The gap in earnings is finally closing

Secondly, the gap in earnings growth expectations between the Magnificent Seven and the rest of the market is closing significantly towards the end of the year. While the Magnificent Seven exhibited much higher earnings growth in 2023 and the first half of 2024, the rest of the market is catching up. Q4 2024 and 2025's estimates are broadly similar across the two groups. This should create opportunities for stocks outside those seven mega caps to capture investors' attention and catch up.

## Figure 2: Earnings growth for US Equities

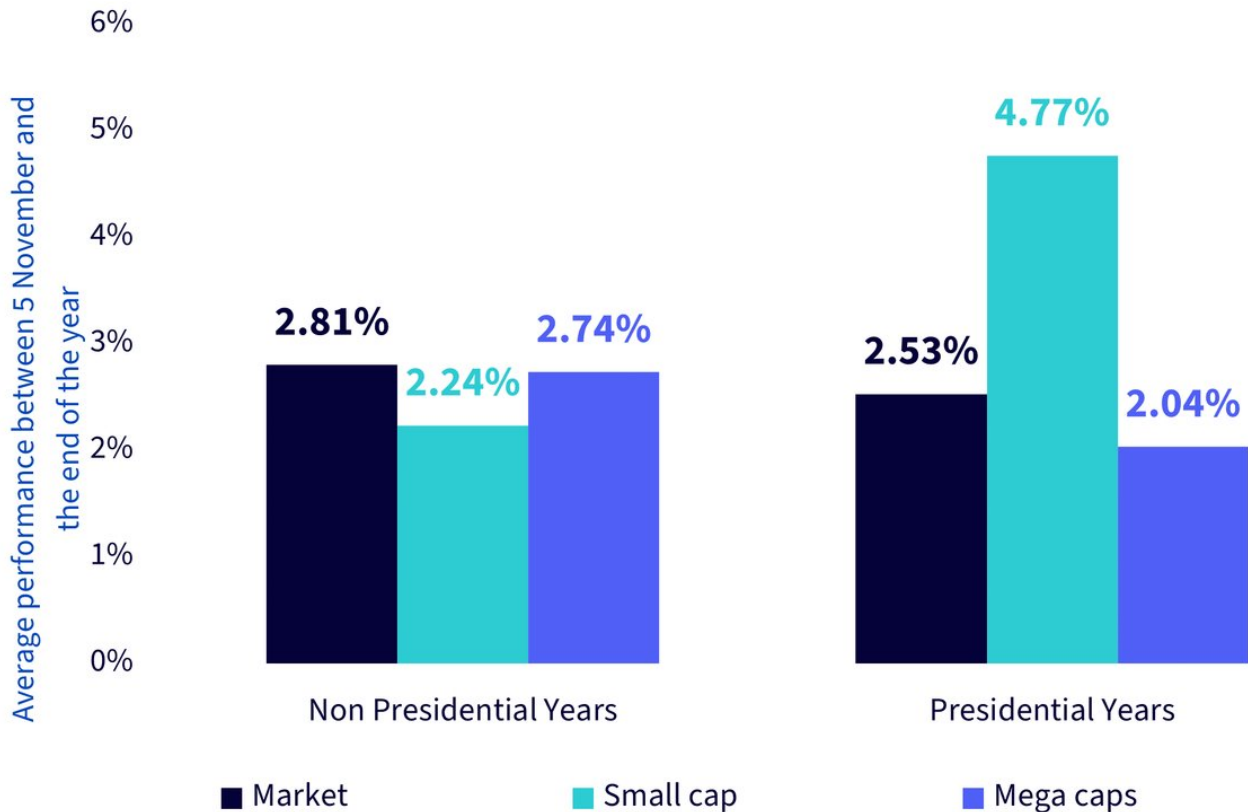


Sources: WisdomTree, FactSet. As of end of June 2024. **Historical performance is not an indication of future performance, and any investments may go down in value.**

## The US Presidential election and an end-of-year small cap rally

Finally, the US presidential election creates significant uncertainty that tends to weigh on markets. Historically, once the election's results are known, uncertainty lifts, which very often creates a late-year small cap rally. Figure 3 shows that, after the last 15 elections, small caps returned on average 4.77% until the end of the year, while they only returned 2.24% in non-presidential years. On average, small caps beat the market in presidential years, and mega caps underperformed.

## Figure 3: Average performance of US equities in election and non election years



Sources: WisdomTree and Ken French, data as of May 2024, which represents the latest date of available data. Small Caps: Low 30% portfolio. Large Caps: High 30% Portfolio. MegaCaps: high 10% portfolio. Market: all CRSP firms incorporated in the U.S. and listed on the NYSE, AMEX or NASDAQ. **Historical performance is not an indication of future performance, and any investments may go down in value.**

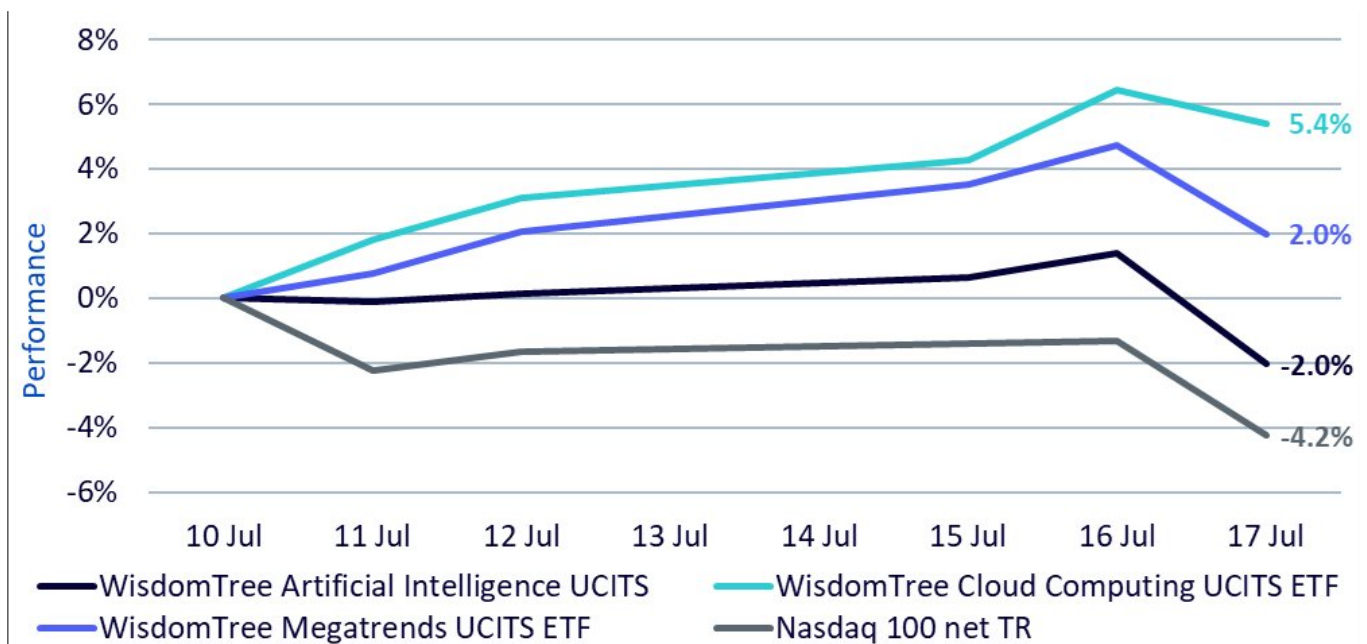
## Adapting equity portfolios for the potential great rotation

Considering those evolving market conditions, investors may need to consider changing their equity positioning and focusing outside mega caps and the Magnificent Seven. Three potential shifts could be to:

1. Shift investments in the Artificial intelligence (AI) theme from a single-minded focus on Nvidia and semiconductors towards smaller, pure-play companies, particularly software companies. This part of the AI market has suffered compared to Semiconductors in the last eight months, but last week's performance has shown their potential may be awakening. For example, the [WisdomTree Artificial Intelligence UCITS ETF](#), which focuses on pure-play companies that tend to derive most of their revenue from AI, delivered an outperformance of 2.2% over the last week versus the Nasdaq 1001. It also outperformed the mega cap-focused Nasdaq Global AI and Big Data index by 1.6% over the period1. This rotation toward software could also benefit Cloud and Cybersecurity. The [WisdomTree Cloud Computing UCITS ETF](#) jumped 5.4% over the last week, beating the Nasdaq 100 by almost 10%1.

- Shift US and Global core equity investments away from Magnificent Seven heavy strategies to more diversified strategies. [High-quality, dividend-growing companies](#) tend to deliver good upside capture and defensiveness in uncertain periods. This could help investors weather the uncertainty of the next few months while benefitting from the equity rotation. The [WisdomTree US Quality Dividend Growth UCITS ETF](#) and [WisdomTree Global Quality Dividend Growth UCITS ETF](#) have both outperformed their market cap-weighted benchmarks by 1.4% and 1.6%, respectively, since 10 July 20241.
- Restart investment into smaller cap companies with a thematic lens. The [WisdomTree Megatrends UCITS ETF](#) delivers a diversified portfolio of smaller cap, pure-play thematic companies across 16 themes (from AI to Clean Energy through HealthTech and Aging Population). With less than 5% investment in the Magnificent Seven and less than 50% exposure to large caps, this ETF can deliver high structural growth and exposure to the equity rotation at valuations that are still lower than big tech mega caps. This ETF has outperformed the Nasdaq 100 by 6.22% since the 10 July 20241.

**Figure 4: WisdomTree Thematic ETFs are benefitting from the equity rotation**



Source: WisdomTree, Bloomberg. From 10-17 July 2024. In USD. All indices are net TR. **Historical performance is not an indication of future performance, and any investments may go down in value.**

1 Source: WisdomTree, Bloomberg. From 10-17 July 2024. In USD. All indices are net TR. **Historical performance is not an indication of future performance, and any investments may go down in value.**

## Important Risks Related to this Article

### IMPORTANT INFORMATION

**Marketing communications issued in the European Economic Area (“EEA”):** This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

**Marketing communications issued in jurisdictions outside of the EEA:** This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

**For professional clients only. Past performance is not a reliable indicator of future performance. Any historical performance included in this document may be based on back testing. Back testing is the process of evaluating an investment strategy by applying it to historical data to simulate what the performance of such strategy would have been. Back tested performance is purely hypothetical and is provided in this document solely for informational purposes. Back tested data does not represent actual performance and should not be interpreted as an indication of actual or future performance. The value of any investment may be affected by exchange rate movements. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice. These products may not be available in your market or suitable for you. The content of this document does not constitute investment advice nor an offer for sale nor a solicitation of an offer to buy any product or make any investment.**

An investment in exchange-traded products (“ETPs”) is dependent on the performance of the underlying index, less costs, but it is not expected to match that performance precisely. ETPs involve numerous risks including among others, general market risks relating to the relevant underlying index, credit risks on the provider of index swaps utilised in the ETP, exchange rate risks, interest rate risks, inflationary risks, liquidity risks and legal and regulatory risks.

The information contained in this document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares in the United States or any province or territory thereof, where none of the issuers or their products are authorised or registered for distribution and where no prospectus of any of the issuers has been filed with any securities commission or regulatory authority. No document or information in this document should be taken, transmitted or distributed (directly or indirectly) into the United States. None of the issuers, nor any securities issued by them, have been or will be registered under the United States Securities Act of 1933 or the Investment Company Act of 1940 or qualified under any applicable state securities statutes.

This document may contain independent market commentary prepared by WisdomTree based on publicly available information. Although WisdomTree endeavours to ensure the accuracy of the content in this

document, WisdomTree does not warrant or guarantee its accuracy or correctness. Any third party data providers used to source the information in this document make no warranties or representation of any kind relating to such data. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.

This document may contain forward looking statements including statements regarding our belief or current expectations with regards to the performance of certain assets classes and/or sectors. Forward looking statements are subject to certain risks, uncertainties and assumptions. There can be no assurance that such statements will be accurate and actual results could differ materially from those anticipated in such statements. WisdomTree strongly recommends that you do not place undue reliance on these forward-looking statements.

This document contains a comparison of financial products contained within the relevant prospectus and/or based on publicly available information, some of which has been prepared by third parties. While such sources are believed to be accurate as at their date of publication, WisdomTree does not warrant, guarantee or otherwise confirm the accuracy or correctness of any information contained herein and any information or opinions related to the products detailed herein may change over time. Any third parties used to source the information in this document make no warranties or claims of any kind

relating to such data. Investors should read the prospectus and other applicable offering documents for each product and consider the investment objectives, risks, charges and expenses carefully before investing.

### **WisdomTree Issuer ICAV**

The products discussed in this document are issued by WisdomTree Issuer ICAV ("WT Issuer"). WT Issuer is an umbrella investment company with variable capital having segregated liability between its funds organised under the laws of Ireland as an Irish Collective Asset-management Vehicle and authorised by the Central Bank of Ireland ("CBI"). WT Issuer is organised as an Undertaking for Collective Investment in Transferable Securities ("UCITS") under the laws of Ireland and shall issue a separate class of shares ("Shares") representing each fund. Investors should read the prospectus of WT Issuer ("WT Prospectus") before investing and should refer to the section of the WT Prospectus entitled »Risk Factors<sup>1/4</sup> for further details of risks associated with an investment in the Shares.

### **WisdomTree Artificial Intelligence UCITS ETF**

Nasdaq® and the Nasdaq CTA Artificial intelligence Index are registered trademarks of Nasdaq, Inc. (which with its affiliates is referred to as the "Corporations") and are licensed for use by WisdomTree Management Limited. The WisdomTree Artificial Intelligence UCITS ETF (the "Fund") has not been passed on by the Corporations as to its legality or suitability. Shares in the Fund are not issued, endorsed, sold, or promoted by the Corporations. THE CORPORATIONS MAKE NO WARRANTIES AND BEAR NO LIABILITY WITH RESPECT TO THE FUND.

## WisdomTree Cloud Computing UCITS ETF

Nasdaq® is a registered trademark of Nasdaq, Inc. (which with its affiliates is referred to as the “Corporations”) and is licensed for use by WisdomTree Management Limited. The WisdomTree Cloud Computing UCITS ETF (the “Fund”) has not been passed on by the Corporations as to its legality or suitability. Shares in the Fund are not issued, endorsed, sold, or promoted by the Corporations. THE CORPORATIONS MAKE NO WARRANTIES AND BEAR NO LIABILITY WITH RESPECT TO THE FUND.

The information set forth in the BVP Nasdaq Emerging Cloud Index is provided for informational and discussion purposes only and is not intended to be, and shall not be regarded or construed as, a recommendation for a transaction or investment or financial, tax, investment or other advice of any kind by Bessemer Venture Partners (“BVP”). BVP makes no warranty or representation regarding any such information or the data presented in such materials. BVP and/or pooled investment vehicles which it manages, and individuals and entities affiliated with such vehicles, may purchase, sell or hold securities of (a) issuers that are constituents of the BVP Nasdaq Emerging Cloud Index or (b) the Fund itself from time to time and at any time, including in advance of or following an issuer being added to or removed from the BVP Nasdaq Emerging Cloud Index.

The information attributable to BVP is provided for informational and discussion purposes only and is not intended to be, and shall not be regarded or construed as, a recommendation for a transaction or investment or financial, tax, investment or other advice of any kind by BVP. BVP makes no warranty or representation regarding any such information or the data presented in such materials.

### Notice to Investors in Switzerland – Qualified Investors

This document constitutes an advertisement of the financial product(s) mentioned herein.

The prospectus and the key investor information documents (KIID) are available from WisdomTree’s website: <https://www.wisdomtree.eu/en-ch/resource-library/prospectus-and-regulatory-reports>

Some of the sub-funds referred to in this document may not have been registered with the Swiss Financial Market Supervisory Authority (“FINMA”). In Switzerland, such sub-funds that have not been registered with FINMA shall be distributed exclusively to qualified investors, as defined in the Swiss Federal Act on Collective Investment Schemes or its implementing ordinance (each, as amended from time to time). The representative and paying agent of the sub-funds in Switzerland is Société Générale Paris, Zurich Branch, Talacker 50, PO Box 5070, 8021 Zurich, Switzerland. The prospectus, the key investor

information documents (KIID), the articles of association and the annual and semi-annual reports of the sub-funds are available free of charge from the representative and paying agent. As regards distribution in Switzerland, the place of jurisdiction and performance is at the registered seat of the representative and paying agent.

### For Investors in France:

The information in this document is intended exclusively for professional investors (as defined under the MiFID) investing for their own account and this material may not in any way be distributed to the public. The distribution of the Prospectus and the offering, sale and delivery of Shares in other jurisdictions may be restricted by law. WT Issuer is a UCITS governed by Irish legislation, and approved by the Financial Regulatory as UCITS compliant with European regulations although may not have to comply with the same rules as those applicable to a similar product approved in France. The Fund has been registered for marketing in France by the Financial Markets Authority (Autorité des Marchés Financiers) and may be distributed to investors in France. Copies of all documents (i.e. the Prospectus, the Key Investor Information Document, any supplements or addenda thereto, the latest annual reports and the memorandum of incorporation and articles of association) are available in France, free of charge at the French centralizing agent, Societe Generale at 29, Boulevard Haussmann, 75009, Paris, France. Any subscription for Shares of the Fund will be made on the basis of the terms of the prospectus and any supplements or addenda thereto.

**For Investors in Malta:** This document does not constitute or form part of any offer or invitation to the public to subscribe for or purchase shares in the Fund and shall not be construed as such and no person other than the person to whom this document has been addressed or delivered shall be eligible to subscribe for or purchase shares in the Fund. Shares in the Fund will not in any event be marketed to the public in Malta without the prior authorisation of the Maltese Financial Services Authority.

**For Investors in Monaco:** This communication is only intended for duly registered banks and/or licensed portfolio management companies in Monaco. This communication must not be sent to the public in Monaco.