



Bubble watch

Kelly Bogdanova – San Francisco

A growing chorus on Wall Street is warning a bubble may be forming in the U.S. stock market. But before thinking this AI-led rally could be too much of a good thing, investors should note some key differences vs. the Tech Bubble peak 24 years ago, along with other healthy signs we see today. While a near-term pullback can't be ruled out, we argue this is not Tech Bubble 2.0.

The S&P 500's rally since late October 2023 ranks up there with some of the biggest moves within a short time frame in market history, and the index continues to rack up new all-time highs.

The dominance of the so-called Magnificent 7 technology-oriented stocks (Apple, Microsoft, Alphabet, Amazon.com, NVIDIA, Tesla, and Meta Platforms) that are leveraged to artificial intelligence (AI)—especially in the past year—can't help but harken back to the Tech Bubble about a quarter century ago.

The Magnificent 7 stocks as a group have surged over 80 percent in the past year, whereas the S&P 500 has climbed around 27 percent through Mar. 4, 2024. When the Magnificent 7 and other technology-oriented stocks are excluded from the S&P 500, the gain is a much more modest 10.8 percent, as the chart shows.

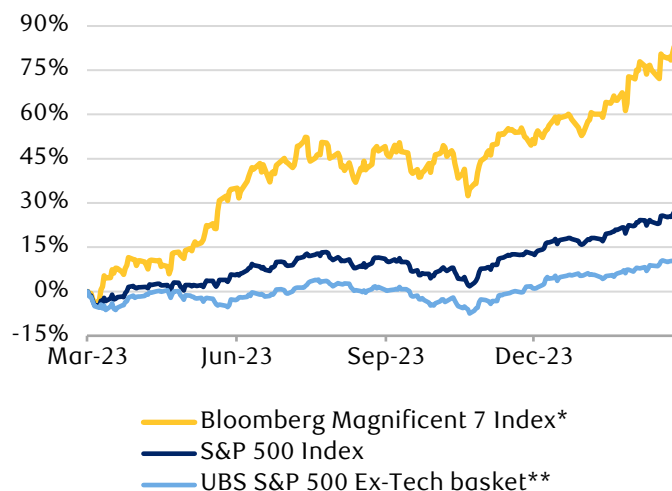
With such stark differences between tech and non-tech, it's no wonder we're starting to get questions about whether tech stocks are getting bubbly again.

Broad-minded

First, we think it's important to distinguish between market trends of the past year and the rally that began following the low in late October.

Magnificent 7 stocks surged over the past year

One-year U.S. large-capitalization equity returns



* The Bloomberg Magnificent 7 Index tracks Apple, Microsoft, Alphabet, Amazon.com, NVIDIA, Tesla, and Meta Platforms.

** The UBS S&P 500 Ex-Tech basket tracks the performance of the S&P 500 excluding the Information Technology and Communication Services sectors, plus Tesla and Amazon. Effectively, this excludes technology-related stocks in the S&P 500.

Source - Bloomberg, RBC Wealth Management; data range 3/6/23–3/4/24; price returns (not including dividends)

For perspectives on the week from our regional analysts, please see [pages 3-4](#).

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Priced (in USD) as of 3/6/24 market close (unless otherwise stated). Produced: 3/7/24 4:32 pm ET; Disseminated: 3/7/24 4:35 pm ET

The Magnificent 7 stocks and technology-oriented stocks in general have dominated both periods. But market performance has broadened out since late October.

Financials, Industrials, and Real Estate—diverse economically sensitive sectors—have risen over 20 percent. Their gains are up there with the three sectors boosted by Magnificent 7 stocks: Information Technology, Communication Services, and Consumer Discretionary, as the chart shows. Market performance has gone beyond just the Magnificent 7, and we view this as a healthy sign.

Since late October, in addition to AI enthusiasm, the market has been driven by solid Q4 earnings results combined with optimism about 2024 profit growth. It also has been supported by sturdy economic data and declining inflation, along with investor anticipation that the U.S. Federal Reserve will start cutting interest rates at some point this year.

That was then, this is now

Second, we think it’s important to consider the key differences between the Tech Bubble peak in March 2000 and conditions today.

The combined price-to-earnings (P/E) ratio of the Magnificent 7 is much lower than that of the so-called “Four Horsemen” stocks (Intel, Microsoft, Cisco Systems, and Dell), the group that powered the Tech sector higher back in the bubble days.

Today, the Magnificent 7 trailing 12-month P/E is 38.3x, whereas 24 years ago the Four Horsemen P/E was an extremely pricey 82.7x, according to Bloomberg.

Beyond the Four Horsemen, part of the rally during the Tech Bubble era was fueled by companies with no earnings and some that barely had operational track records. These were dot-com firms that went public practically overnight—and collapsed almost as rapidly.

That’s not the case this go-around. The AI move and rally in other Tech stocks has been fueled by established firms with years of profits in the books, long operational track records, and experienced management teams.

Furthermore, there are valuation disparities between then and now. The S&P 500 as a whole, the S&P 500 excluding the Tech sector, and the five largest stocks by market capitalization are all less expensive today than they were 24 years ago, as the lower chart shows.

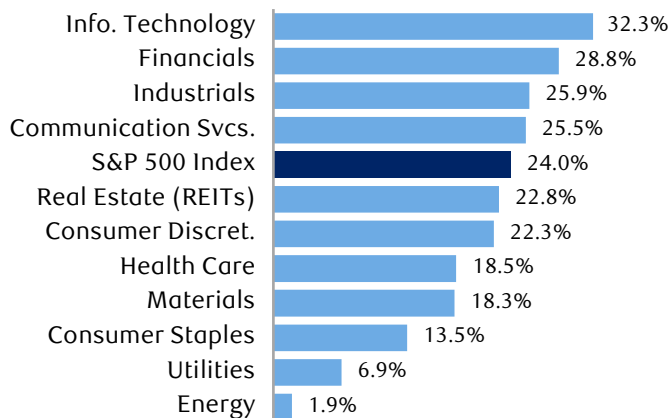
Staying invested and vigilant

At this stage, we don’t think this is Tech Bubble 2.0. But this is no reason to throw caution to the wind.

The S&P 500’s surge since late October ranks with some of the biggest moves within a short time frame in market history. We think the market is bound to take a breather at some point and a pullback can’t be ruled out. But precursors of bear markets—lofty investor sentiment and declining market breadth—are not yet in evidence.

A broad group of sectors has delivered 20%+ returns

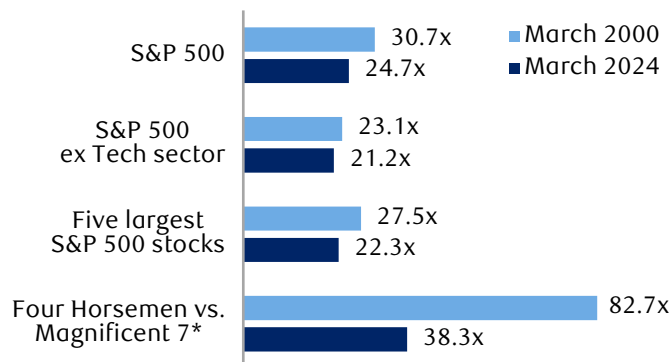
S&P 500 Index & sector returns since the 10/27/23 market low



Source - RBC Wealth Management, Bloomberg; data through 3/6/24; price returns (not including dividends)

U.S. large-cap valuations during the Tech Bubble peak in 2000 versus now

Trailing 12-month price-to-earnings ratios



* “Four Horsemen” was the nickname for four large leading technology stocks from 1996–2002: Intel, Microsoft, Cisco Systems, and Dell. “Magnificent 7” is today’s nickname for seven large leading technology-related stocks: Apple, Microsoft, Alphabet, Amazon.com, NVIDIA, Tesla, and Meta Platforms.

Source - Bloomberg Intelligence, RBC Wealth Management, Bloomberg; March 2024 data as of 3/4/24

Even though valuations are below where they were during the Tech Bubble peak in March 2000, the market is not inexpensive today. Valuations are above average and stretched, in our assessment, and typically don’t stay at such levels for long periods of time.

RBC Global Asset Management Inc. Chief Economist Eric Lascelles estimates that the risk of a U.S. recession is about 40 percent. While this is down from about 70 percent last year, the risk is elevated compared to periods of economic calm. Some leading indicators are still signaling that an economic contraction can’t be ruled out, especially if employment deteriorates and/or inflation becomes sticky or increases.

We think these factors should be reflected by maintaining Market Weight positioning in U.S. equities with a watchful eye on market trends.

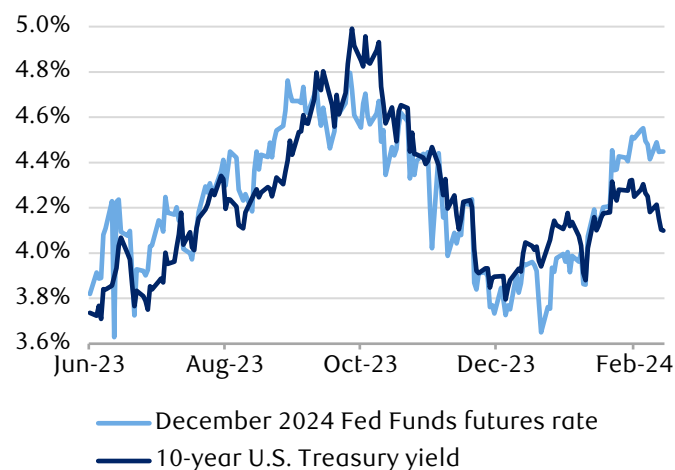
UNITED STATES

Atul Bhatia, CFA – Minneapolis

■ **In Congressional testimony this week, Fed Chair Jerome Powell returned to the same themes policymakers have been emphasizing for months.** He acknowledged progress in bringing inflation down, but highlighted strong labor markets and a robust economy as reasons to delay rate cuts until there is greater certainty the Fed will achieve its longer-term goal of 2% inflation. Given the consistency of recent central bank speakers, there was little immediate market impact from Powell's remarks. Interest rate futures that track expected year-end policy rates, for instance, were within 3 basis points (bps) of their prior close during and immediately after Powell's testimony.

■ **The Fed's Beige Book—an anecdotal survey of the economy—that was released Wednesday showed slowing economic growth and better labor availability.** Importantly, multiple businesses reported consumers shifting to lower-cost alternatives in the face of new price hikes. Overall, the Beige Book presented a picture of the economy that would, in our view, likely support rate cuts within the relatively near future. But it's important to remember that prior iterations presented a similar picture, only for the official data to reflect strong growth and upward price pressures. Recent data such as the ADP National Employment Report and the Job Openings and Labor Turnover Survey gave some credence to the Beige Book's message. However, we believe investors will look for confirmation from the official Nonfarm Payroll report due out later this week.

Bond yields are range-bound as investors ponder mixed data and Fed



Source - Bloomberg, RBC Wealth Management; data through 3/6/24

■ **Bond yields have remained in a relatively tight range amidst the economic and policy crosscurrents.** The 10-year U.S. Treasury yield, for instance, closed March 6 at 4.1%, the midpoint of its 3.88%–4.32% year-to-date trading range. Corporate bond indexes have shown similar stability while turning in better price performance. Credit spreads, which track the relative performance of government and corporate bonds, have declined in recent months, indicating better price performance by riskier bonds. The high-yield CDX Index, an agglomeration of credit derivatives on 100 of the largest sub-investment-grade issuers, is lower by nearly 20 bps in 2024, reflecting the ongoing outperformance of risky assets.

CANADA

Luis Castillo & Sean Killin – Toronto

■ **The Bank of Canada (BoC) maintained its 5.0% policy rate at this week's meeting,** marking the fifth consecutive pause since the last rate hike in July 2023. BoC Governor Tiff Macklem acknowledged the broadening of disinflationary pressures across the consumer price basket as goods inflation moderated further in January. That said, core services inflation remains elevated, and Macklem clearly expressed that policymakers will require further evidence of weakening price growth to begin easing monetary policy. With economic growth still sturdy and the labour market remaining resilient, Canada's economy seems to be handling tighter financial conditions better than consensus expectations, but downside risks remain elevated. Easing expectations appear to be tempered by anticipation of future rate cuts, and markets are now pricing in roughly three 25 basis point cuts by the end of the year. Investors will likely await more clarity on forward policy expectations at the BoC's next meeting on April 10.

■ **Canadian GDP growth picked up at the end of 2023 with an annualized gain of 1.0% in Q4,** stronger than the BoC assumed in the January Monetary Policy Report. Most of the economy's growth came from net trade, while domestic demand declined. Within the demand category, consumer spending rose by a modest 1% and business investment fell by nearly 10% on an annualized basis, a worrying sign given Canada's lagging productivity. With the return to growth in Q4, Canada's economy avoided a technical recession in the second half of 2023. But technical recession or not, Q4 was the third consecutive quarter of below-trend growth and the sixth straight quarter of declining GDP per capita. The economy appears to be feeling the effects of higher interest rates, and a shift from excess demand to excess supply should be disinflationary over time. Unfortunately, evidence of disinflation remains hard to come by.

EUROPE

Frédérique Carrier & Thomas McGarrity, CFA – London

■ **As widely expected, the European Central Bank kept the deposit rate unchanged at 4% at its March meeting.**

Even though it kept some optionality, stressing data dependency and a focus on incoming wage data, markets are now pricing in an 80% probability of a June cut and for the deposit rate to reach 3% at year-end.

■ **We upgraded European equities to Market Weight from Underweight.** Lead indicators suggest economic activity may have troughed with the global manufacturing cycle seemingly rebounding and euro area services improving. Consumer sentiment has perked up as a tight labour market and diminishing inflationary pressures have underpinned real income growth. A lower interest rate environment in the second half of the year would be a further relief, in our opinion. Overall, we find European equities valuations remain undemanding.

■ **Our long-term bias remains to high-quality global leaders with structural growth tailwinds.** However, in the short to medium term, we believe there are also cyclical opportunities related to the manufacturing cycle troughing in sectors such as Industrials.

■ **To shore up his political party's popularity, the Chancellor of the Exchequer Jeremy Hunt announced net tax cuts of £12.7B for fiscal 2024–2025, and £5.2B for 2028–2029.** Despite these cuts, the bulk of which are targeted at workers, the tax burden remains the highest in seven decades. The tax reductions could prove to be a modest boost to GDP growth and have marginal impact on inflation, in our view. The Bank of England is nevertheless likely to remain cautious. The market tentatively expects the first rate cut is likely in Q3 2024, though with little conviction.

■ **We recently downgraded UK equities to Underweight.** While their valuations are depressed, we see few catalysts in the near term to unlock this value. We think the market's defensive attributes are ill suited to an environment in which the U.S. economy is displaying signs of acceleration. We believe some domestic stocks may start to perform well once the Bank of England starts to cut interest rates, but that remains many months away.

ASIA PACIFIC

Jasmine Duan – Hong Kong

■ **The National People's Congress (NPC), China's highest legislative body, commenced its annual session on Tuesday.** The seven-day event is pivotal for setting China's economic growth target and policy direction for the year ahead. The NPC set a GDP growth target of "around 5%" in 2024, maintaining the same target as last year and aligning with market expectations.

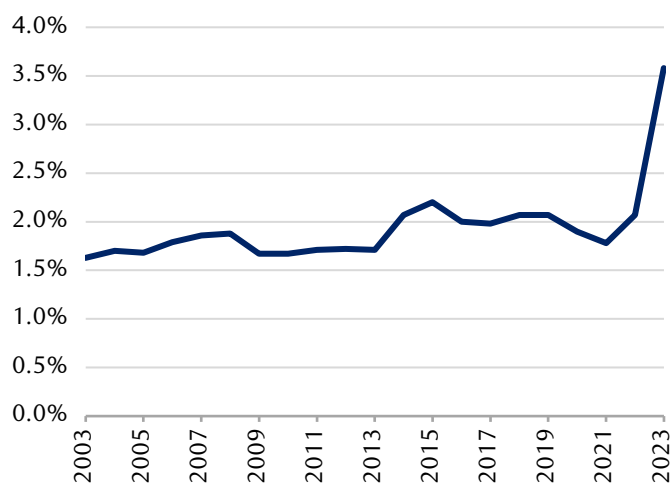
■ **However, the announcement of the official fiscal deficit target, set at 3% of GDP, disappointed investors,** falling short of the anticipated 3.2%–3.5% range. The combined issuance of special treasury bonds to fund major projects and local government special bonds suggests that the total augmented fiscal deficit will be around 11.9% of GDP, which is largely flat versus 2023's 11.8% of GDP. Investors are concerned the stimulus may not be strong enough to bolster the economy.

■ **The policy agenda announced at the NPC appears to remain supply-side oriented.** The government is maintaining its emphasis on upgrading supply chains, accelerating the development of emerging industries such as new electric vehicles, and supporting research and development in cutting-edge technologies including biotech, hydrogen energy, and advanced materials. Last month, policymakers pledged to support a consumer goods trade-in program that aims to stimulate consumption through subsidies. However, details of the program have yet to be announced, leading to slight investor disappointment.

■ **In Japan, nominal cash earnings for workers rose 2% y/y in January,** surpassing the revised 0.8% increase in December. Early negotiation results released by UA Zensen, the largest industrial union in Japan with over 1.8 million members, indicated that full-time workers at 25 unions achieved average wage growth of 6.7%, notably higher than last year's 5.3% increase. Investors are monitoring the wage hike, as it may influence the country's inflation trajectory and the Bank of Japan's interest rate decisions.

Wage growth of Japan's largest trade union group shows signs of progress

Average annual wage increase



Source - Japanese Trade Union Confederation, Bloomberg, RBC Wealth Management; annual data 2003–2023

MARKET Scorecard

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	5,104.76	0.2%	7.0%	26.1%	17.9%
Dow Industrials (DJIA)	38,661.05	-0.9%	2.6%	15.6%	15.0%
Nasdaq	16,031.54	-0.4%	6.8%	37.3%	20.4%
Russell 2000	2,068.09	0.6%	2.0%	8.9%	3.4%
S&P/TSX Comp	21,593.96	1.1%	3.0%	5.3%	0.9%
FTSE All-Share	4,199.15	0.9%	-0.8%	-3.1%	8.1%
STOXX Europe 600	498.21	0.7%	4.0%	7.3%	18.1%
EURO STOXX 50	4,915.49	0.8%	8.7%	13.9%	38.2%
Hang Seng	16,438.09	-0.4%	-3.6%	-20.2%	-25.0%
Shanghai Comp	3,039.93	0.8%	2.2%	-8.5%	-11.8%
Nikkei 225	40,090.78	2.4%	19.8%	42.0%	54.3%
India Sensex	74,085.99	2.2%	2.6%	23.0%	36.4%
Singapore Straits Times	3,136.14	-0.2%	-3.2%	-3.2%	-2.8%
Brazil Ibovespa	128,890.23	-0.1%	-3.9%	23.1%	12.6%
Mexican Bolsa IPC	55,258.91	-0.3%	-3.7%	2.5%	3.6%
Gov't bonds (bps change)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Treasury	4.106%	-14.4	22.7	14.8	237.5
Canada 10-Yr	3.350%	-14.0	24.0	-0.3	168.2
UK 10-Yr	3.991%	-13.3	45.4	12.5	278.3
Germany 10-Yr	2.322%	-8.9	29.8	-42.7	239.1
Fixed income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	4.81%	0.7%	-1.0%	4.4%	-6.2%
U.S. Investment-Grade Corp	5.31%	0.7%	-0.9%	6.7%	-4.2%
U.S. High-Yield Corp	7.80%	0.3%	0.6%	10.7%	5.7%
Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot \$/oz)	2,146.75	5.0%	4.1%	16.2%	8.9%
Silver (spot \$/oz)	24.16	6.5%	1.5%	14.8%	-6.0%
Copper (\$/metric ton)	8,400.75	0.0%	-0.7%	-5.5%	-21.5%
Oil (WTI spot/bbl)	78.15	-0.1%	9.1%	-2.9%	-32.4%
Oil (Brent spot/bbl)	82.92	-0.8%	7.6%	-3.8%	-29.8%
Natural Gas (\$/mmBtu)	1.93	3.7%	-23.3%	-25.0%	-61.6%
Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	103.3860	-0.7%	2.0%	-0.9%	4.8%
CAD/USD	0.7400	0.5%	-2.0%	0.7%	-5.8%
USD/CAD	1.3514	-0.5%	2.0%	-0.7%	6.2%
EUR/USD	1.0897	0.9%	-1.3%	2.0%	-0.3%
GBP/USD	1.2729	0.8%	0.0%	5.9%	-3.8%
AUD/USD	0.6564	1.0%	-3.6%	-2.5%	-10.9%
USD/JPY	149.4400	-0.4%	6.0%	9.9%	30.2%
EUR/JPY	162.8400	0.5%	4.6%	12.2%	29.7%
EUR/GBP	0.8561	0.0%	-1.2%	-3.6%	3.6%
EUR/CHF	0.9613	0.6%	3.5%	-3.3%	-4.1%
USD/SGD	1.3390	-0.5%	1.4%	-0.5%	-1.6%
USD/CNY	7.1975	0.1%	1.4%	3.8%	13.9%
USD/MXN	16.8800	-1.0%	-0.5%	-6.2%	-19.4%
USD/BRL	4.9455	-0.5%	1.8%	-4.1%	-2.4%

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Tuesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing.

Examples of how to interpret currency data: CAD/USD 0.74 means 1 Canadian dollar will buy 0.74 U.S. dollar. CAD/USD -2.0% return means the Canadian dollar fell 2.0% vs. the U.S. dollar year to date. USD/JPY 149.44 means 1 U.S. dollar will buy 149.44 yen. USD/JPY 6.0% return means the U.S. dollar rose 6.0% vs. the yen year to date.

Source - Bloomberg; data as of 3/6/24

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			Count	Percent
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Hold [Sector Perform]	575	39.66	154	26.78
Sell [Underperform]	46	3.17	6	13.04

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