

# CASTING A WIDER NET:

CAN THE MAJORITY TURN THE  
TIDE ON THE MINORITY



**T**he seas of the market are vast and deep, yet in recent years, a few oversized fish have captured all the attention, creating waves impossible to ignore. These 'Magnificent 7' (Mag 7) stocks have powered equity markets to remarkable heights, overshadowing broader opportunities lurking just below the surface. As we peer into this year, it's time to explore beyond familiar waters. Casting a wider net for opportunities within U.S. equities will be key for investors aiming to uncover the hidden potential of 2025.

In our previous outlook, Defying Gravity, we argued that the Mag 7 couldn't defy market forces forever after contributing a whopping 63% to the index's return.

### Mag 7 Has Helped Fuel S&P 500 Performance

Indexed to 100 on 1/1/2021, price return



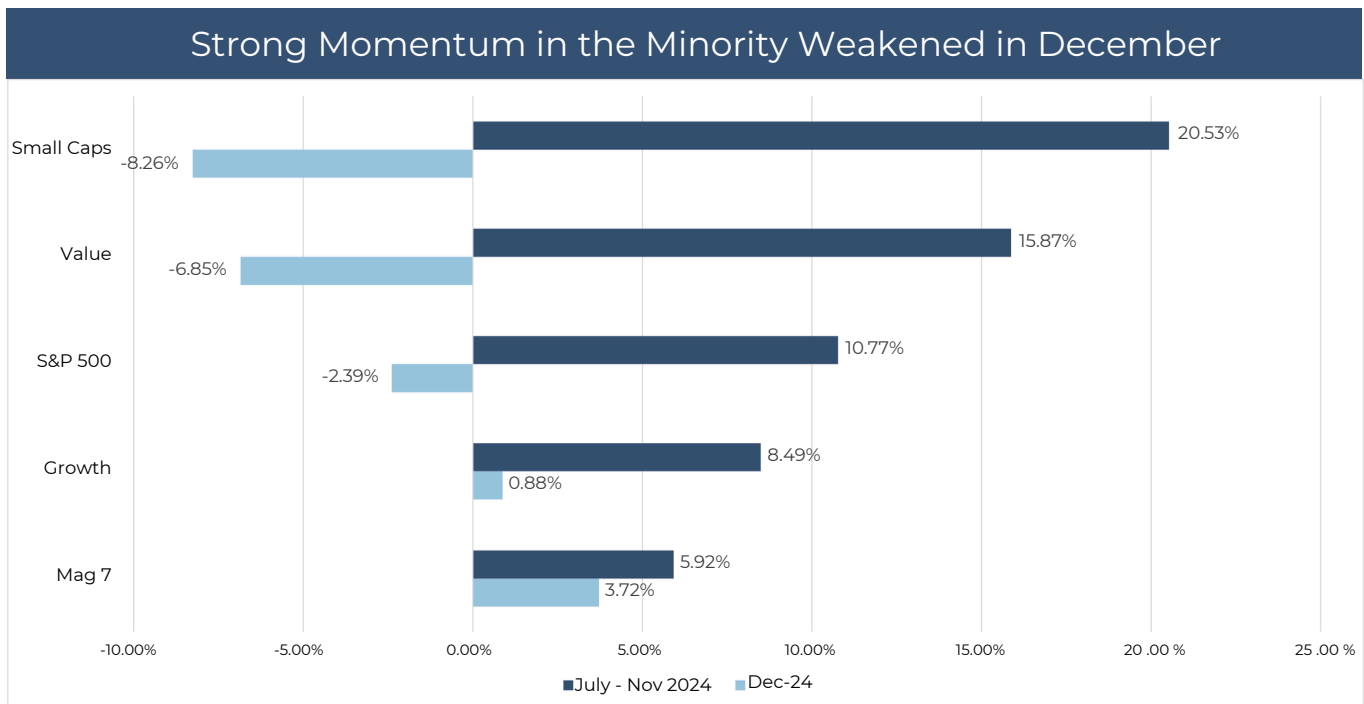
Source: JP Morgan Guide to the Markets. Data as of December 31, 2024  
 \*\*Share of returns represent how much each group contributed to the positive despite negative performance in 2022

That what goes up must eventually find balance and be recalibrated. It was predicated not that the group would underperform, but that its dominance would begin to wane. After the 63% contribution, that number fell to a still astounding 55% in 2024, defying expectations. As we look to this year, we argue that market conditions are riper for a more substantial erosion of this dominance.

The real treasure lies in incorporating overlooked corners of the market into investors' portfolios, extending beyond the focus of the Mag 7.

**“The stage is set for the smaller fish in the sea to make a splash.”**

With a resilient economy, prospects of rate stabilization, supportive policies from the new administration, and transformative artificial intelligence (AI) waves migrating to other areas, the stage is set for the smaller fish in the sea to make a splash. This tide began to shift in the second half of 2024, as markets began pricing in outcomes of the then upcoming election, anticipated Fed rate cuts, and stable economic growth. These conditions allowed areas away from mega-cap tech to outperform. However, the recent rise in yields and increased volatility has posed challenges to this momentum, reminding investors of the complexities in navigating these new waters.



Source: Bloomberg, Waterloo Capital.

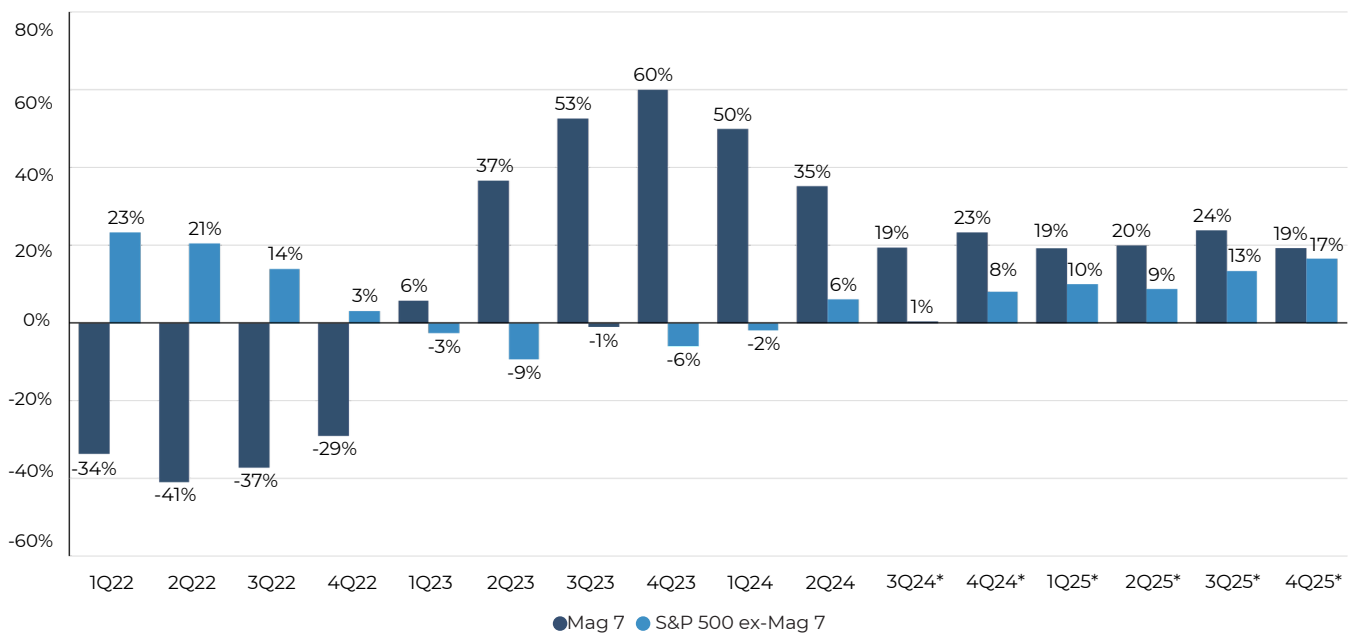
We still see compelling opportunities within this space; however, you'll need a smaller boat to take on what lurks below. Success depends on agility and precision, as being selective will be key to avoiding potential pitfalls in lower quality areas. Certain cyclical sectors are well-positioned to benefit from a robust consumer base and a resilient economy, while Financials could gain traction from policy shifts coming out of Washington, offering promising prospects for growth. We're also focusing on specific opportunities in data centers and energy, as the expanding influence of AI continues to drive demand for computing power and sustainable energy solutions.

The driving point of this theme in 2025 is that the market landscape should provide better tailwinds for equities broadly, particularly on the earnings front. While index-level earnings growth is set to accelerate, the real story lies below the surface: a shift in the composition of this growth. Diving deeper, the extraordinary earnings growth of the Mag 7 is expected to wind down from its elevated levels, creating room for other areas of the market to shine. The focus here isn't solely on the level of earnings but on their rate of change. This dynamic opens the door for the other 493 names in the index, whose earnings growth is reaccelerating, to close the gap and play a larger role in supporting market returns.

“The door is open for the other 493 names whose earnings growth is reaccelerating, to close the gap and play a larger role in supporting market returns.”

**As Mag 7 Earnings Growth Decelerates in 2025, the Rest of the Market Catches Up**

Exhibit 3: Pro-forma EPS, y/y

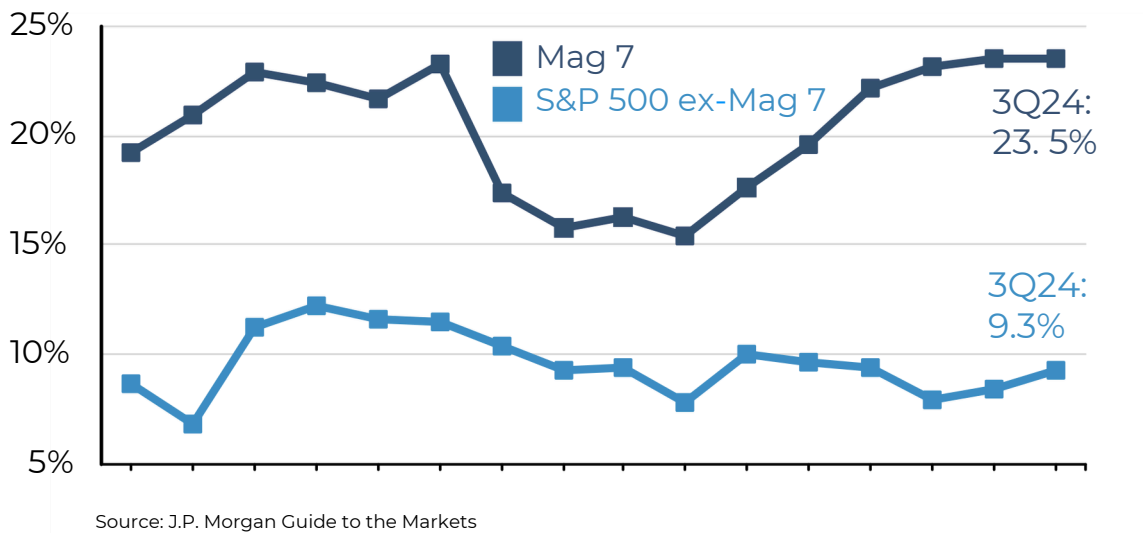


Source: FactSet, J.P. Morgan Asset Management. Data are as of November 15, 2024.

Though the Mag 7 may see a deceleration in earnings growth, it’s worth noting that they’re slowing from historically high levels of growth and profitability. These mega-cap giants aren’t falling behind, they’re simply shifting gears. The pendulum isn’t likely to swing too far as they continue to benefit from strong secular tailwinds. Their operational efficiency, cost leadership, and dominant market positions have enabled robust free cash flow and profit margins nearly twice those of their peers. Downside risks such as slower economic growth or unfavorable monetary and fiscal policy shifts, remain in play, but these giants are uniquely positioned to weather these storms as seen in December. If uncertainty in markets reigns supreme, investors will likely place a premium on quality, potentially sparking a flight to safety trade further supporting the Mag 7.

Profit Margins

Quarterly earnings/sales



“These mega-cap giants aren’t falling behind, they’re simply shifting gears.”

The narrative is evolving, not dying. While the Mag 7 can still deliver outperformance, it won’t mirror the meteoric and disproportional gains of recent years. The broader market is beginning to show signs of life, presenting intriguing opportunities beyond these mega-cap names. However, this isn’t a call to abandon ship. Portfolios should aim for balance, recognizing the potential in other areas while still appreciating the enduring strength of these titans. Don’t count them out, just adjust expectations.

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