MAJOR TREND INDEX

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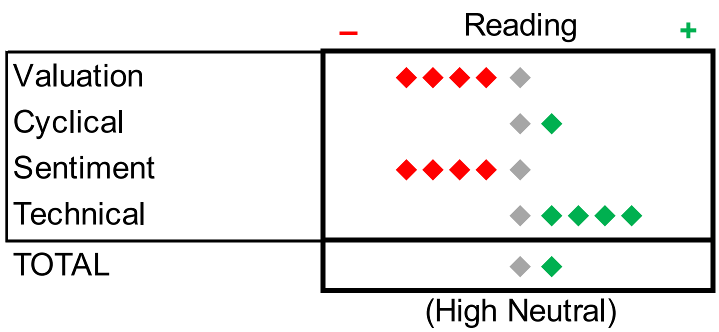
Major Trend Index



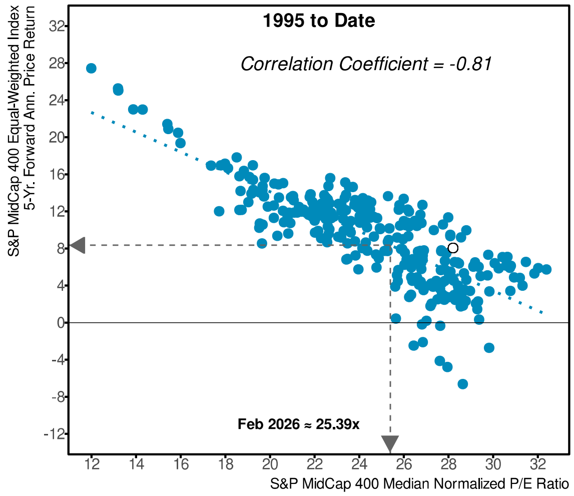
As the market sorts out the self-inflicted tariff mess, the Major Trend Index closed out the third week of February at High Neutral. Net equity exposure in Leuthold tactical accounts remained at 59%.

The S&P 500 ended last Friday smack dab in the middle of its contemporary trading boundaries. Three months of bouncing between 6,800 and 7,000 is starting to cause some concern for the "World's Reserve Index," especially among the chartists. Based on our technical measures, the overall message is still quite positive for the S&P 500, but we concede that a range-bound index cannot score well indefinitely. For now, the non range-bound trend work for the "ancillary" indexes and the resulting improvement in breadth scores leave us comfortable with the current "rotation over risk-off" narrative.

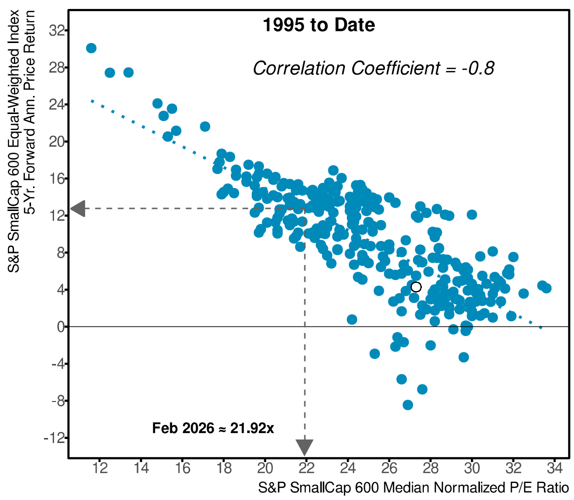
In the Cyclical category, Friday's soft preliminary GDP growth rate for Q4 (+1.4%) was a rare miss for economic data released in 2026. The Citi U.S. Economic Surprise Index has swung decidedly positive this year and is still enjoying its best levels since early 2024. With earnings season in its final stages, Q4 estimates for S&P 500 EPS have increased 5% since the start of reporting. This follows the same script of the previous two quarters, where projections played catch-up as earnings results were tallied. Lest we break into unplowed bubble valuation levels (especially the cap-weighted S&P 500), a solid EPS growth story must remain intact.

Speaking of valuations, we've seen some rare upgrades in that category of measures. With the recent, modest pullback in rates, a handful of the yield-adjusted line items for the S&P 500 have gone from ugly to just unattractive… the best one can hope for in the cap-weighted large-cap space these days.

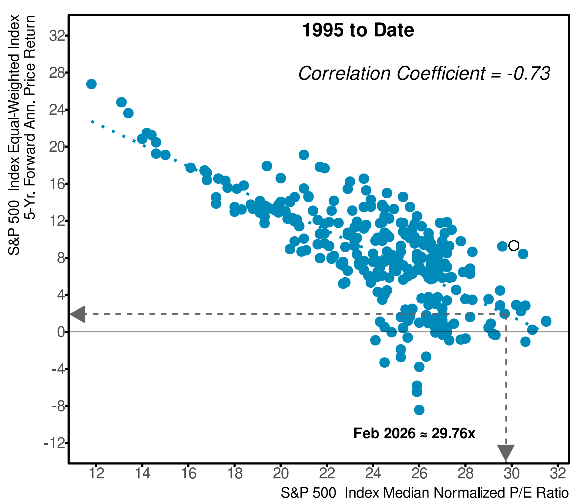
S&P MidCap 400 Median Normalized P/E VS. 5-Yr Forward Returns for S&P MidCap 400 EW Index



S&P SmallCap 600 Median Normalized P/E VS. 5-Yr Forward Returns for S&P SmallCap 600 EW Index



S&P 500 Index Median Normalized P/E VS. 5-Yr Forward Returns for S&P 500 Index EW Index



The outperformance in the mid and small-cap space, of late, inspired us to refresh a study that's provided some hope in the recent history of stretched multiples. With limited earnings history for Mid and Small-Cap Indexes, we turn to our extensive database of "median" valuations for the S&P 400, 500, and 600.

Since 1995, the correlation between the median Normalized P/E ratio and the five-year annualized return for the Equal Weighted S&P 400 is a solid -0.81. The regression line drawn through the associated scatterplot suggests annualized price returns for mid caps of around +8% (based on the current 25.4x P/E ratio). Obviously past performance is no guarantee of future results, but tacking on a percent or two for dividends gets you to a pretty healthy +10% return. The latest dot added is in white, which denotes February 2021's P/E multiple of 28x. Since that time, the S&P 400 has exceeded our regression's forecast, with a price return of +8%.

The same exercise for the S&P 600 Index produced a very similar correlation coefficient of –0.8. Its current median Normalized P/E multiple of 21.9x would match up with an even more impressive five-year equal-weighted annualized return of around +12%. Underperformance of small caps is evident in the most recent dot (February 2021), which failed to achieve the regression line's estimate (28x P/E ratio, +4% price return).

Turning to large caps, the correlation between the median Normalized P/E ratio and the five-year annualized return for the Equal-Weighted S&P 500 is weaker than the other two at –0.73. The current median P/E multiple of 29.7x falls in the 94th percentile of observations of the past 30 years and projects an annualized return of only +3% into 2031. High valuations have not hindered (absolute) returns for the Equal Weighted S&P 500 over the last five years. An even higher starting point (30x in February 2021) returned an annualized +10% five years later, destroying the regression line's barely positive estimate.

Over the long term, these initial P/E multiple conditions have been very good predictors of future returns. In recent years, however, the model's forecasts haven't been as successful as in the past. For those thinking they have missed the boat on mid and small-cap outperformance, this study suggests otherwise.