Flash Economics

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The divergence of stock market indices for technology stocks and all equities in the United States

Especially since 2020, we have seen a divergence between stock market indices and stock market valuations, which shows that the divergence between stock market indices is not due solely to the results of companies, technology stocks and the equity market as a whole. We document this divergence by looking at trends in the Nasdaq and the S&P, as well as those of the 'Magnificent 7' (Apple, Microsoft, Alphabet, Amazon, Tesla, Meta, Nvidia).

We look at similar episodes in the past to see whether and how the valuation gap between technology stocks and the equity market has been maintained or corrected.

We see that, between 1998 and 2002, the stock market indices (Nasdaq and S&P) diverged, then converged again; and that, between 1998 and 2008, the dynamics of P/E ratios (Nasdaq and S&P) were similar (divergence then convergence).

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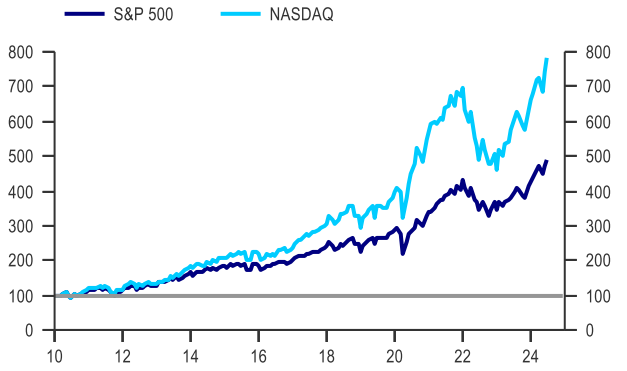
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Divergence between stock market indices and P/Es for technology stocks and the equity market

This divergence is obvious if we compare:

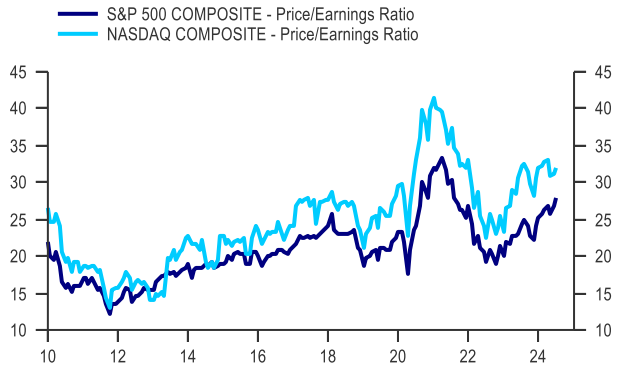
- the Nasdaq and the S&P, in terms of indices (Chart 1) and P/E ratios (Chart 2)

Chart 1
S&P and Nasdaq stock market indices (100: 2010M1)



Source: LSEG Datastream, Patrick Artus Conseil

Chart 2
S&P and Nasdaq P/E ratio

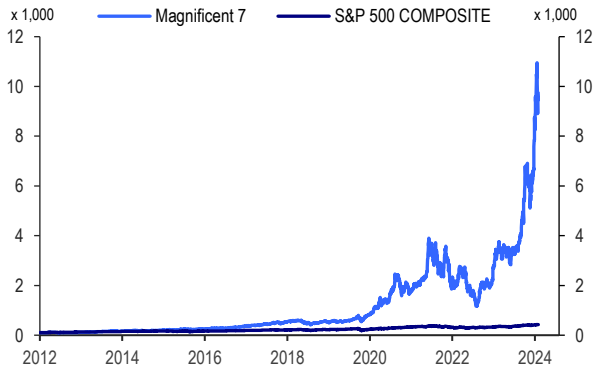


Source: LSEG Datastream, Patrick Artus Conseil

We can see that the divergence of indices between technology stocks and the equity market is not due solely to the results of technology companies, since there is a divergence between P/E ratios, which corrects for the differences between observed profits and expected profits;

- the "Magnificent 7" and the S&P (Chart 3), with the rise being concentrated on a handful of technology stocks (Apple, Microsoft, Alphabet, Amazon, Tesla, Meta, Nvidia). Since the start of 2024, we should in fact be talking about the Magnificent 6 (Chart 4), with Tesla's share price declining.

Chart 3
Stock market indices of Magnificent 7 & S&P (100: 01/06/2012)



Source: LSEG Datastream, Patrick Artus Conseil

Chart 4
Stock price of Tesla (100: 01/06/2012)



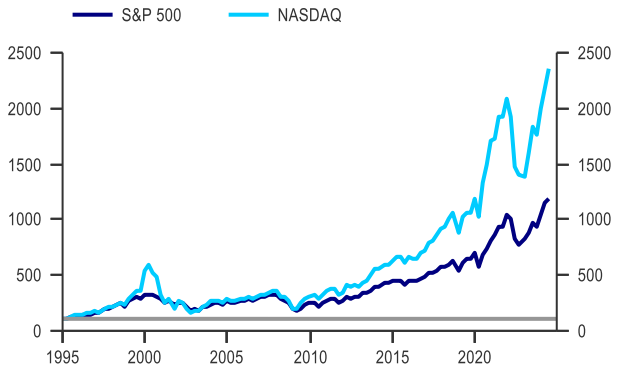
Source: LSEG Datastream, Patrick Artus Conseil

The key question is whether this divergence between indices is permanent or transitory.

Lessons from the past

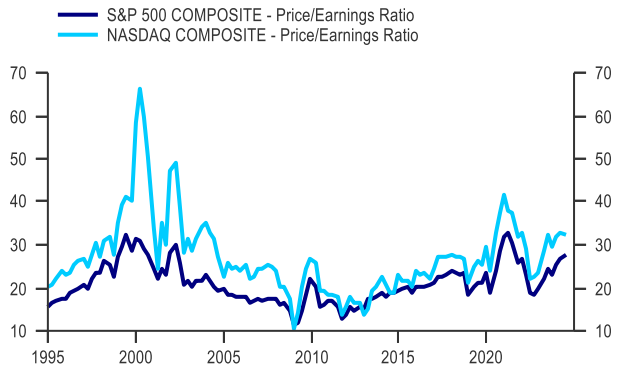
We compare the Nasdaq and S&P indices and P/E ratios since 1995 (Charts 5 and 6).

Chart 5
S&P and Nasdaq stock market indices (100 : 01/01/1995)



Source: LSEG Datastream, Patrick Artus Conseil

Chart 6
S&P and Nasdaq P/E ratio



Source: LSEG Datastream, Patrick Artus Conseil

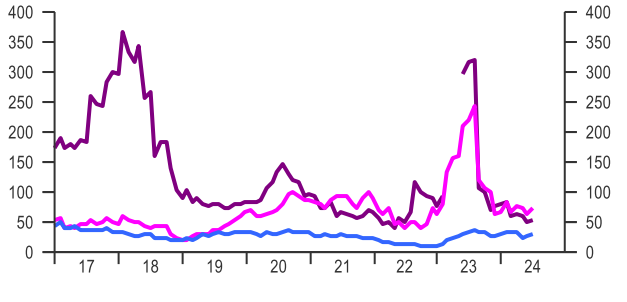
We can see that from 1998 until 2002 (for stock market indices) and until 2008 (for P/E ratios), the Nasdaq's valuation is higher than that of the S&P, but that stock market prices and valuations subsequently converge.

The correction in the spread between the indices comes from the downward correction in the Nasdaq P/E:

It was a downward revision of earnings per share expectations that caused the downward correction in the technology stock index. Could the same thing happen today?

Charts 7a/7b show the P/E ratios of the Magnificent 6.

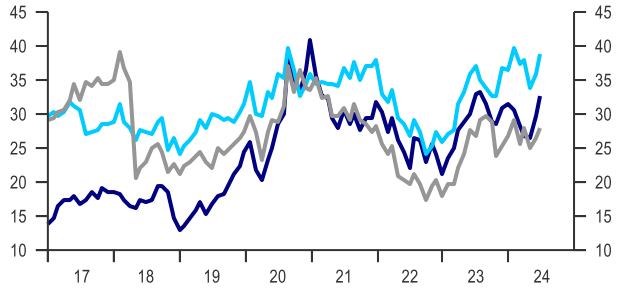
Chart 7a
Meta, Nvidia and Amazon P/E ratio



Source: LSEG Datastream, Patrick Artus Conseil

Note: The absence of some 2023 P/E data for Amazon is due to negative earnings per share in 2022.

Chart 7b
Apple, Microsoft and Alphabet P/E ratio



Source: LSEG Datastream, Patrick Artus Conseil

We are seeing a convergence of P/E ratios, except for Nvidia and Amazon. So, as it was the case between 2002 and 2008, we should not rule out a convergence in the P/Es of technology companies and other companies. The high P/Es now only concern Amazon and Nvidia.

Summary: a central issue for equity asset allocation

If the divergence between the US stock market valuations of the Magnificent 6 (Apple, Microsoft, Alphabet, Amazon, Meta, Nvidia) and those of the market as a whole were to last, it would be a sign of permanently stronger earnings per share growth for the Magnificent 6 (which are no longer 7 in 2024) than for the other companies, and would therefore lead to portfolios being concentrated around the 6 stocks. However, past experience shows that the share prices and P/Es of technology companies (Nasdaq) and other companies (S&P), after diverging, converge again after a few years.

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