

Funds in focus: [Brompton U.S. Cash Flow Kings ETF \(KNGU\)](#)

As we approach 2025, notable shifts are occurring within the equity markets. After a strong period led by the so-called "Magnificent 7", the seven largest stocks in the S&P 500, the performance differential between these tech leaders and the rest of the S&P 500 is narrowing. As of November 30, 2023, the Magnificent 7 stocks (Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla, and Meta) accounted for 71% of the S&P 500's year-to-date returns, but this figure dropped to just 42% for the same period ending November 30, 2024, reflecting material broadening of market performance¹. We expect this trend to continue as we head into 2025, creating potential investment opportunities in smaller and mid-sized companies.

Are the Magnificent 7 Losing Their Momentum?

Analysts forecast that the disparity in earnings growth between the Magnificent 7 and the remaining stocks in the S&P 500 (often referred to as the S&P 493) will continue to diminish. What was anticipated to be a 30% gap in earnings growth for 2024 is projected to narrow to just 6% by 2025 and further to 4% by 2026².

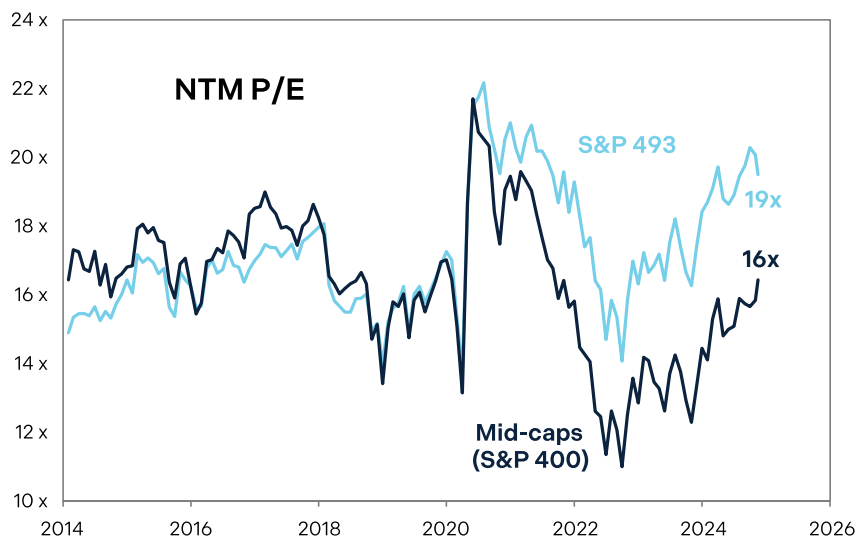
Though the Magnificent 7 may still deliver strong performance, the narrowing earnings growth differentials, combined with broader economic trends, suggest the wider market, particularly mid-cap and small-cap stocks, could begin to perform more favourably.

Mid-Caps: Ready for Growth in 2025

Looking at the broader market, we believe mid-cap stocks will benefit from the favourable economic conditions projected for 2025. The S&P MidCap 400 Index is more correlated to U.S. GDP growth and components of GDP such as private investment and consumption than the S&P 500.³ As consumer demand, business investment, and overall economic activity strengthen, these mid-sized companies may be well-positioned for growth.

Mid-cap stocks within the S&P 400 are forecasted to show faster earnings growth than both small and large-cap stocks in 2025. With stronger quality characteristics compared to small-caps and a price-to-earnings (P/E) ratio of around 16x, significantly below the 19x ratio for the S&P 493, mid-caps represent a potentially attractive opportunity for investors seeking a balance of value and growth².

Mid-Caps Trade at Lower Valuations Than the S&P 493
(12-month Forward P/E)



Source: Goldman Sachs Global Investment Research, November 18, 2024.

Trade Winds and Regulatory Changes: A Bright Prospect for Mid-Caps

Beyond economic growth, evolving trade policies and regulatory dynamics could also positively impact mid-cap stocks within the S&P 493. The Magnificent 7, which have trillion dollar valuations, rely heavily on international markets and may face increased risks from geopolitical tensions and trade uncertainties, while the S&P MidCap 400 index has a greater percentage of revenue generated domestically compared to the S&P 500 Index, providing some insulation from these global trade challenges³.

With the recent U.S. presidential election behind us, there is a growing sentiment that regulatory uncertainty may ease soon. Should the regulatory environment become more favourable, particularly in sectors such as technology, healthcare, and energy, mid-cap companies could experience increased activity in mergers and acquisitions (M&A). Larger firms, encouraged by stable financial conditions and rising CEO confidence, are likely to consider acquisitions of mid-cap companies that can provide growth opportunities at potentially lower costs than larger counterparts.

M&A Activity: A Catalyst for Growth

The combination of steady economic progression, supportive financial conditions, and increasing CEO confidence may lead to an uptick in M&A activity in 2025. As regulatory barriers ease, mid-cap companies could find themselves in a prime position for acquisition, unlocking new growth potential. Merrill Lynch anticipates that a rise in M&A activity that provide additional upside for mid-cap stocks⁴.

The Bottom Line: A Mid-Cap Comeback May be in Play

In conclusion, while the Magnificent 7 have been the primary market driver in recent years, the outlook for 2025 suggests a more balanced marketplace may be emerging. As economic growth continues to exceed expectations, mid-cap and small-cap stocks could benefit from solid earnings performance and favourable macroeconomic conditions. With appealing valuations, enhanced growth prospects, and reduced exposure to international trade risks, the S&P 493, particularly its mid-cap stocks, offers a potentially attractive investment opportunity.

Brompton's Approach

For investors looking to participate in these trends, **Brompton U.S. Cash Flow Kings ETF (KNGU)** may be a suitable option. KNGU is designed to replicate, to the extent reasonably possible and before fees and expenses, the performance of the Brompton Index One U.S. Cash Flow Kings Index (the "Index"). The Index tracks the performance of mid to large capitalization U.S. equities whose issuers exhibit high free cash flow relative to their enterprise value. Companies that generate high levels of free cash flow tend to be well-established, financially stable, and have a competitive advantage in their respective industries. By investing in KNGU, individuals can gain exposure to U.S. mid-cap and large-cap stocks that are well-positioned to benefit from the evolving market landscape.

¹ Source: LSEG DataStream.

² Source: Goldman Sachs Global Investment Research, November 18, 2024.

³ Source: S&P MidCap 400, S&P Global, March 2024

⁴ Source: Merrill Lynch CIO Viewpoint, October 2024.

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INTEGRITY
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Investor Relations
PHONE 416.642.6000
TOLL FREE 1.866.642.6001
FAX 416.642.6001
info@bromptongroup.com
www.bromptongroup.com

Address
Bay Wellington Tower,
Brookfield Place
181 Bay Street
Suite 2930, Box 793
Toronto, Ontario M5J 2T3