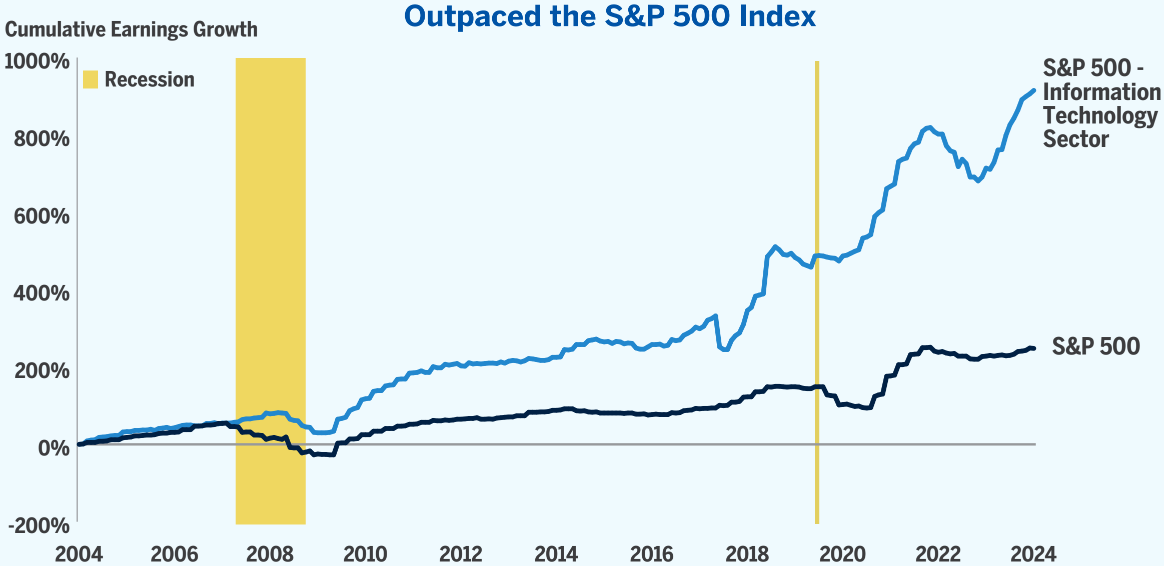
Rational Exuberance?

Within the S&P 500 Index, the Information Technology (Tech) sector has been the largest contributor to overall market returns over the past two decades. This outperformance has been driven by strong earnings growth, but as sentiment moves higher, could strong share price performance within the Tech sector continue?

Technology Earnings Growth Has Dramatically Outpaced the S&P 500 Index



Source: FactSet, Standard and Poor's. Chart data from 9/30/2004 through 9/30/2024, showing the monthly change in the trailing twelve months of earnings.

- In the chart above, earnings in the Tech sector have grown nearly four times faster, or 5.1% annually, than the overall S&P 500 Index over the past two decades. This exceptional earnings growth has been a key factor in the sector's 5.8% annual outperformance over the same time period. In our view, the main driver of the Tech sector's compounded earnings growth is its companies' ability to improve their business models through innovations such as cloud computing. These advancements have not only propelled profitability but also translated into sustained share price appreciation.
- While Tech sector price-to-earnings (P/E) multiples are higher than their historical average—29.0x compared to 18.1x over the past two decades—the chart above is a good reminder that earnings drive stock prices over the long-term for high growth companies, in our view.[1] Consider that a company that grows its earnings 20% annually for a decade would more than triple its share price, returning 12% annually even if its P/E ratio were cut in half, all else equal.
- Valuation metrics such as P/E may be volatile over the near-term, but even if they do decline, we believe that companies that are well positioned for sustained long-term earnings growth, such as those engaged in artificial intelligence, cloud computing, and software may produce strong returns for investors over the long-term.

[1] Source: FactSet and Standard & Poor's. The historical average of the S&P 500 – Information Technology Sector was calculated from September 2004 through September 2024 on a monthly basis.

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The S&P 500 Index is an index of large company stocks considered to be representative of the U.S. stock market. The S&P 500 Information Technology Index is a sector-specific index that tracks the performance of the technology companies within the broader S&P 500, including industries such as software, hardware, IT services, and electronics. The indices presented are provided for illustrative purposes, reflect the reinvestment of dividends and do not assess fees and expenses that would have the effect of reducing returns. Investors cannot invest directly in any index. The index performance does not represent the returns of any portfolio advised by Fred Alger Management, LLC and actual client results might differ materially than the indices shown.

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Earnings per share (EPS) is the portion of a company's earnings or profit allocated to each share of common stock.

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