January 13, 2022

US Strategy Snapshot

BMO Capital Markets

Investment Strategy

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High-Multiple Stocks – Proceed With Caution

Bottom Line: High-multiple stocks have been selling off in early 2022 trading amid the uptick in yields, expectations for a faster Fed balance sheet runoff, and prospects of three rate hikes this year. Given the increased likelihood of a March liftoff by the Fed, this performance trend is not necessarily uncommon as the quintile of S&P 500 stocks with the highest valuations has typically struggled in the months leading up to prior tightening cycles and during the length of the cycle, especially on a risk-adjusted basis. On top of that, the recent outsized gains posted by these high-multiple names in relation to their historical norms give us further reason to believe that this group may face some price weakness in the coming months and could potentially re-rate lower. With all that said, these developments have in no way altered our call for the overall market. We remain confident in our 2022 year-end S&P 500 price target of 5,300, which implies a 12.1% gain from the latest close as our work shows the broader market, along with most sectors, have performed just fine leading up to and during the length of these tightening cycles.

Main Points:

- High-Multiple Stocks Getting Hit Early in 2022
- Stocks With Highest Multiples Have Typically Posted Poor Risk-Adjusted Returns Prior to and During Tightening Cycles
- Recent Performance Trends of Higher Multiple Names Could Put Them at Risk in Coming Months
- Fed Tightening Does NOT Signify Doom for US Stock Market Performance
- Most Sectors Tend to Perform Pretty Well in Lead-Up to Initial Interest Rate Hike

US Strategy – S&P 500 Targets

Price Target Model	2022E
DDM	5,300
Fair Value P/E	5,100
Price Target	**5,300**
EPS Target Model	**2022E**
Macro Regression	$260
Bottom-Up Consensus	$221
Normalized EPS	$191
EPS Target	**$245**
Implied P/E	**21.6x**

Source: BMO Capital Markets Investment Strategy.

US Strategy – Recommended S&P 500 Sector Weightings

Sector	Opinion	Tgt. Wgt.
Communication Services	MW	11.0%
Consumer Discretionary	OW	13.5%
Consumer Staples	UW	4.0%
Energy	MW	3.0%
Financials	OW	13.0%
Health Care	MW	12.0%
Industrials	OW	8.5%
Information Technology	MW	27.5%
Materials	OW	3.5%
Real Estate	MW	2.5%
Utilities	UW	1.5%

Source: BMO Capital Markets Investment Strategy.

OW: Overweight
MW: Market Weight
UW: Underweight

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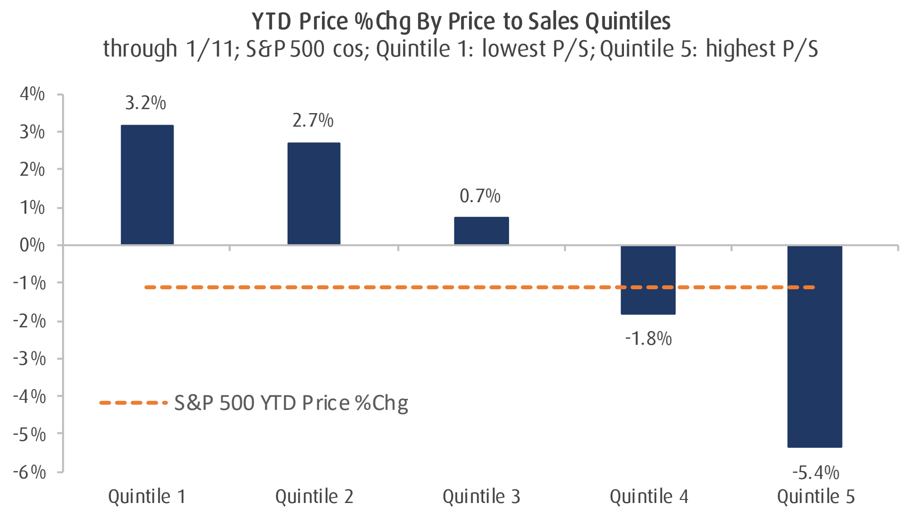
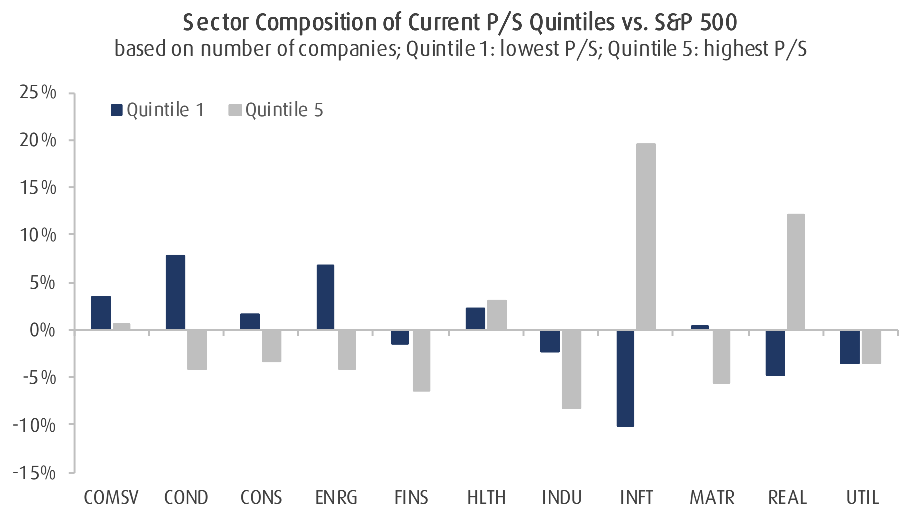
High-Multiple Stocks Getting Hit Early in 2022

S&P 500 Stocks With Highest P/S Ratios Have Dropped More Than 5% YTD



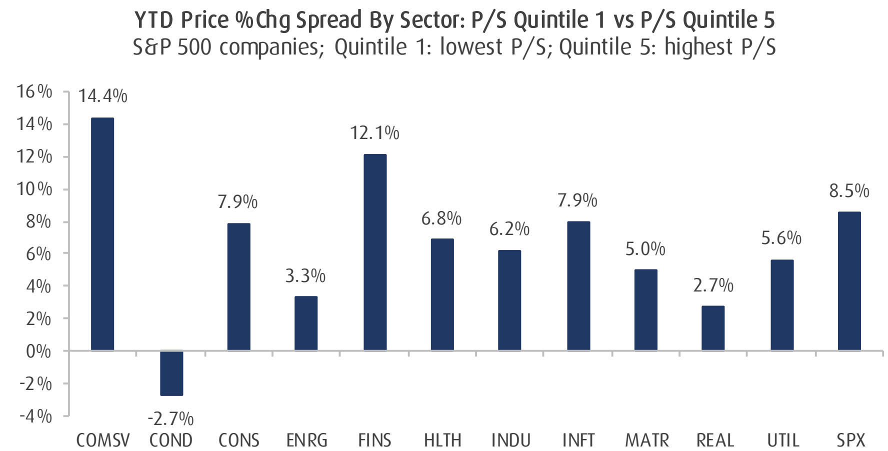
Source: BMO Investment Strategy Group, FactSet, Compustat.

Yes, a Sizeable Amount of High-Multiple Names Comes From Technology...



Source: BMO Investment Strategy Group, FactSet, Compustat.

...However, Trend of High P/S Stocks Trailing Low P/S Stocks Is Present Across Sectors



Source: BMO Investment Strategy Group, FactSet, Compustat.

- Looking at price action in 2022, there is no doubt that high-multiple stocks have been getting hit, which has largely been a function of the backup in yields, expectations for a faster Fed balance sheet runoff, and prospects of three rate hikes this year.
- Indeed, S&P 500 stocks ranked in the highest 20% by price to sales ratios (Quintile 5) have logged an average YTD loss of 5.4% through 1/11, compared to the 1.1% S&P 500 drop, and the 3.2% gain posted by the 20% of stocks with the lowest P/S multiples (Quintile 1).
- These performance trends have once again shone the spotlight back on Technology. Yes, a sizeable amount of the high-multiple names come from the Tech sector. However, this trend of high-valuation stocks selling off and underperforming their low-valuation counterparts has not been confined to Technology.
    - ✓ The Quintile 1 – Quintile 5 YTD performance spread is currently positive for ten of 11 GICS sectors, highlighting the struggles of higher-multiple names across the market. In fact, Communication Services and Financials have seen the biggest performance deltas between the highest and lowest P/S stocks.
- Therefore, from our perspective, the recent price action has not provided a reason to completely sell out of any particular sector, but instead highlighted the differentiation that exists among stocks in each sector and the importance of stock selection.

Stocks With Highest Multiples Have Typically Posted Poor Risk-Adjusted Returns Prior to and During Tightening Cycles

Historically, S&P 500 Stocks With Highest P/S Multiples Fared Worst in Months Prior to Start of Fed Tightening Cycles

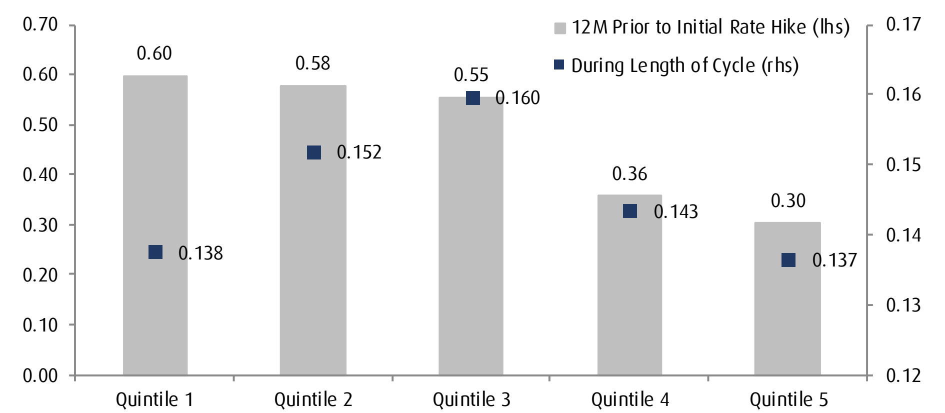
Average Price Performance of S&P 500 Price to Sales Quintiles Leading Up to Initial Fed Interest Rate Hikes and During Length of Tightening Cycle
includes '94, '04, '16 cycles; performance during length of cycle is annualized

P/S Quintile	-12M	-6M	-3M	During Length of Cycle
Quintile 1	24.9%	11.5%	7.7%	3.9%
Quintile 2	19.9%	8.4%	5.9%	2.4%
Quintile 3	17.7%	9.0%	5.6%	3.3%
Quintile 4	10.4%	5.4%	3.8%	3.3%
Quintile 5	9.6%	2.5%	0.4%	3.8%

Source: BMO Investment Strategy Group, FactSet, Compustat, Haver, FRB.

Risk-Adjusted Returns for Highest P/S Stocks Were Poor During Length of Previous Tightening Cycles, but so too Were the Risk-Adjusted Returns for Lowest P/S Stocks

Average Sharpe Ratios of S&P 500 P/S Quintiles Leading Up To Initial Fed Interest Rate Hikes and During Length of Tightening Cycle
includes 1994, 2004, and 2016 cycles



Source: BMO Investment Strategy Group, FactSet, Compustat, Haver, FRB.

- The performance struggles of high valuation stocks at this point in the cycle does not appear to be uncommon when examining previous periods of Fed tightening.

- For instance, in the lead-up to the 1994, 2004, and 2016 Fed tightening cycles (see page five for exact start and end dates), the S&P 500 stocks with the highest P/S multiples, defined as Quintile 5, logged the weakest returns by far compared to Quintiles 1 through 4. (We excluded the 1999-2000 tightening cycle from this analysis as that period coincided with the height of the dotcom bubble and is not comparable to the current period, in our view)

  - ✓ In the three, six, and 12 months prior to the initial Fed rate hike, Quintile 5 stocks posted average gains of 0.4%, 2.5%, and 9.6%, respectively. By contrast, Quintile 1 stocks averaged gains of 7.7%, 11.5%, and 24.9% during that same three-, six-, and 12-month lead-up, respectively.

- More important, the highest-multiple S&P 500 stocks also recorded the lowest risk-adjusted returns, on average, of any of the five groups with a Sharpe ratio (average of monthly returns/standard deviation of average monthly returns) of 0.30.

- To be clear, we are not recommending that investors go pile into the stocks with the lowest valuations in the index. We are simply pointing out that the highest-multiple stocks could be vulnerable to price weakness in the months ahead given their historical performance trends around previous Fed tightening cycles.

- During the duration of past tightening cycles, average annualized price gains were pretty similar across the five P/S groups with returns for Quintiles 1 and 5 particularly close (3.9% and 3.8%). On a risk-adjusted basis, while the Sharpe ratios for Quintiles 1 and 5 were still similar, Quintile 3 stocks saw the strongest risk-adjusted returns, on average, during the length of the past tightening cycles.

Recent Performance Trends of Higher-Multiple Names Could Put Them at Risk in Coming Months

Recent Price Gains for High P/S Stocks Have Greatly Exceeded the Average Gains Exhibited by These Stocks Leading Up to Previous Fed Tightening Cycles

Average Price Performance of S&P 500 Price to Sales Quintiles Leading Up to Initial Fed Interest Rate Hikes During Prior Tightening Cycles
includes '94, '04, '16 cycles

P/S Quintile	-12M	-6M	-3M
Quintile 1	24.9%	11.5%	7.7%
Quintile 2	19.9%	8.4%	5.9%
Quintile 3	17.7%	9.0%	5.6%
Quintile 4	10.4%	5.4%	3.8%
Quintile 5	9.6%	2.5%	0.4%

Average Price Performance of S&P 500 Price to Sales Quintile Leading Up to Current Period Ending 12/31/21

P/S Quintile	-12M	-6M	-3M
Quintile 1	29.7%	3.7%	6.8%
Quintile 2	27.4%	5.9%	7.9%
Quintile 3	25.9%	8.0%	8.6%
Quintile 4	25.4%	9.2%	10.2%
Quintile 5	26.7%	12.1%	10.2%

Source: BMO Investment Strategy Group, FactSet, Compustat, Haver, FRB.

Current LTM Gain of Quintile 5 is 2.8x That of Average Performance 12M Prior to Fed Tightening, While Current LTM Gain for Lower Multiple Stocks Are Closer to Averages

Ratio of Average Price Performance of S&P 500 Price to Sales Quintiles for Current Period (12/31/21) vs Performance Leading Up to Initial Fed Interest Rate Hikes During Prior Tightening Cycles

P/S Quintile	-12M	-6M	-3M
Quintile 1	1.2x	0.3x	0.9x
Quintile 2	1.4x	0.7x	1.3x
Quintile 3	1.5x	0.9x	1.5x
Quintile 4	2.5x	1.7x	2.7x
Quintile 5	2.8x	4.9x	27.8x

Source: BMO Investment Strategy Group, FactSet, Compustat, Haver, FRB.

- Since the market is expecting the Fed to raise interest rates in March, we wanted to examine the recent price returns of the S&P 500 P/S quintiles and compare them to the historical average returns leading up to the tightening cycles of 1994, 2004, and 2016. This data is highlighted in the tables to the left with the top table displaying performance prior to past tightening periods and the bottom table showing performance for the period ending December 2021.

- In 2021, all five P/S groups put in solid performances as average returns ranged from 25% to 30%, while the highest-multiple stocks topped gains in the trailing three- and six-month periods with Quintile 5 rising 10.2% and 12.1%, respectively.

- That being said, as we mentioned on the previous page, the stocks with the highest valuations registered the weakest gains, on average, during the lead-up to past Fed tightening cycles with Quintile 5 logging price returns of just 0.4%, 2.5%, and 9.6% in the three-, six-, and 12-months pre-initial rate hike, respectively. As such, the recent price returns for Quintile 5 stocks have been significantly higher than historical averages.

    - ✓ For instance, for the six- and 12-month periods ending 12/31/2021, price returns for Quintile 5 were 4.9x and 2.8x higher than those returns seen in the six and 12 months leading into previous tightening cycles. Contrastingly, the returns for the lower-multiple quintiles have been more in line with their historical averages.

- The fact that these high-multiple stocks have run up so much over recent periods in relation to their historical norms gives us further reason to believe that this group may face some price weakness in the coming months and could potentially re-rate lower.

Fed Tightening Does NOT Signify Doom for US Stock Market Performance

During Prior Tightening Cycles, S&P 500 Posted 7.5% Avg Gain 12M Post-Initial Rate Hike

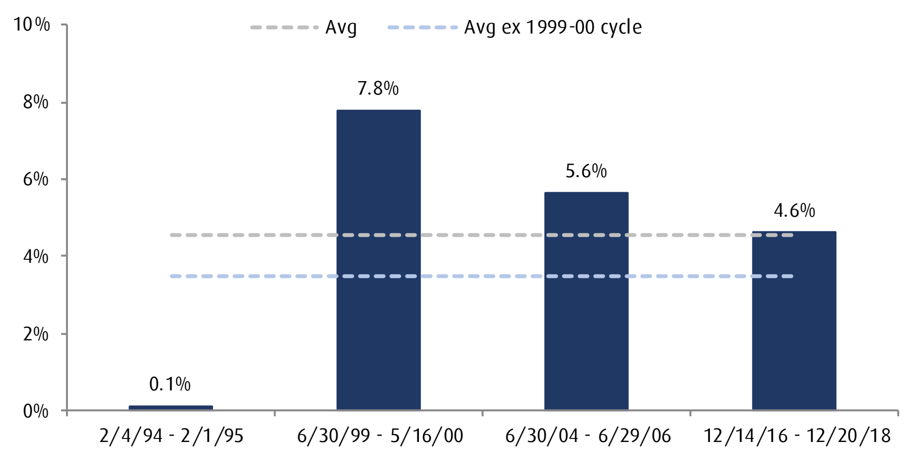
S&P 500 Average Price Performance Pre- and Post-Initial Fed Interest Rate Hike at Start of Tightening Cycle

	Mos Prior to Initial Fed Rate Hike			Mos After Initial Fed Rate Hike		
Date of Initial Interest Rate Hike in Tightening Cycle	-12M	-6M	-3M	+3M	+6M	+12M
2/4/1994	4.5%	4.7%	2.7%	-3.9%	-2.4%	1.9%
6/30/1999	21.1%	11.4%	5.5%	-6.6%	6.7%	6.0%
6/30/2004	17.1%	2.8%	1.2%	-2.3%	6.4%	4.4%
12/14/2016	11.4%	8.6%	6.0%	5.0%	8.2%	17.7%
Average	**13.5%**	**6.9%**	**3.9%**	**-1.9%**	**4.7%**	**7.5%**
Average excluding 1999 cycle	**11.0%**	**5.4%**	**3.3%**	**-0.4%**	**4.0%**	**8.0%**

Source: BMO Investment Strategy Group, FactSet, Haver, FRB.

S&P 500 Registered a Low Single-Digit Annualized Gain, on Average, During Previous Fed Tightening Cycles

S&P 500 Average Annualized Price Performance During Tightening Cycles



Source: BMO Investment Strategy Group, FactSet, Haver, FRB.

- Despite our belief that higher-multiple stocks could be vulnerable to some price weakness in the months ahead as interest rates move higher and the Fed continues to remove liquidity, we remain confident in our broader market call, which is for the S&P 500 index to finish 2022 at 5,300, implying a 12.1% gain from the latest close.

- Looking at the previous tightening cycles, the S&P 500 logged a 5.4% average gain (excluding 1999 cycle) in the six months prior to the initial interest rate hike by the Fed and a 3.3% average gain in the three-month lead-up.

- Yes, US stocks have struggled in the initial three months after the Fed's first rate hike of the cycle with the S&P 500 logging a slight loss. However, the index has done fairly well thereafter, gaining 4%, on average, in the subsequent six months and an average of 8% in the 12 months post-rate hike.

- During the entirety of the tightening cycles, the S&P 500 registered a 4.5% average annualized price gain across the 1994-95, 1999-2000, 2004-06, and 2016-18 periods. Even when excluding the 7.8% jump during the tech bubble run-up, the average annualized gain for the index still comes in at 3.5%.

- As such, despite the abundance of rhetoric related to Fed tightening and its supposed negative implications for market performance, our work shows that the S&P 500 can do just fine during these tightening cycles.

Most Sectors Tend to Perform Pretty Well in Lead-Up to Initial Interest Rate Hike

Eight Sectors Posted Gains, on Average, in the 3M Prior to the Initial Fed Rate Hike

S&P 500 Avg Sector Performance Pre- and Post-Initial Fed Rate Hike at Start of Tightening Cycle
includes '94, '99, '04, '16 cycles; REAL uses last two cycles only; official prices used for COMS/TELS
performance during cycle is annualized; Red: Negative; Green: OP SPX; White: Positive, but UP SPX

	Mos Prior to Initial Fed Rate Hike			During Length of Cycle	Mos After Initial Fed Rate Hike		
	-12M	-6M	-3M		+3M	+6M	+12M
COMS	20.3%	3.1%	1.7%	-4.6%	-1.3%	2.3%	-4.0%
COND	13.5%	8.6%	2.9%	0.4%	-2.7%	4.9%	1.7%
CONS	1.4%	0.4%	-0.3%	-1.6%	-3.8%	0.2%	1.6%
ENRG	18.8%	10.8%	7.5%	5.8%	-1.2%	-0.6%	7.4%
FINS	11.5%	8.8%	6.5%	-0.3%	-2.9%	1.0%	3.4%
HLTH	2.1%	1.4%	-1.5%	8.1%	-2.7%	0.8%	13.2%
INDU	19.0%	11.3%	9.4%	2.2%	-2.1%	3.5%	3.7%
INFT	29.9%	12.6%	6.0%	19.9%	0.9%	15.5%	24.9%
MATR	15.7%	10.8%	10.2%	-2.2%	-2.1%	5.2%	-2.6%
REAL	8.0%	-1.5%	-4.7%	11.0%	2.6%	13.6%	17.5%
UTIL	5.6%	-3.8%	0.5%	5.0%	-0.7%	2.2%	9.9%
SPX	**13.5%**	**6.9%**	**3.9%**	**4.5%**	**-1.9%**	**4.7%**	**7.5%**

Source: BMO Investment Strategy Group, FactSet, Haver, FRB.

Excluding '99 Cycle, Most Sectors Still Logged Gains Prior to and During Tightening Cycles

S&P 500 Avg Sector Performance Pre- and Post-Initial Fed Rate Hike at Start of Tightening Cycle
includes '94, '04, '16 cycles ; REAL uses last two cycles only; official prices used for COMS/TELS
performance during cycle is annualized; Red: Negative; Green: OP SPX; White: Positive, but UP SPX

	Mos Prior to Initial Fed Rate Hike			During Length of Cycle	Mos After Initial Fed Rate Hike		
	-12M	-6M	-3M		+3M	+6M	+12M
COMS	8.7%	-1.0%	-1.7%	-2.3%	0.9%	3.0%	-0.3%
COND	10.2%	6.3%	2.8%	-0.2%	-0.7%	4.2%	4.0%
CONS	3.9%	3.5%	0.3%	4.2%	-0.7%	3.2%	7.2%
ENRG	21.2%	8.6%	6.4%	4.8%	-1.0%	0.0%	9.0%
FINS	13.2%	8.2%	7.4%	1.7%	1.3%	4.3%	7.8%
HLTH	-0.7%	2.9%	0.2%	9.6%	-0.2%	3.7%	13.7%
INDU	19.8%	9.5%	9.0%	0.5%	-1.1%	3.9%	4.8%
INFT	16.9%	8.5%	4.5%	10.8%	-0.4%	6.5%	17.6%
MATR	19.4%	7.3%	7.1%	0.8%	0.1%	6.9%	4.8%
REAL	8.0%	-1.5%	-4.7%	11.0%	2.6%	13.6%	17.5%
UTIL	6.1%	-4.8%	-2.4%	4.9%	1.0%	6.9%	13.8%
SPX	**11.0%**	**5.4%**	**3.3%**	**3.5%**	**-0.4%**	**4.0%**	**8.0%**

Source: BMO Investment Strategy Group, FactSet, Haver, FRB.

- *The two tables on the left show average sector-level performance during past tightening periods with the top table including the 1994-95, 1999-2000, 2004-06, and 2016-18 cycles and the bottom table excluding the 1999-2000 cycle. The top table is primarily for display purposes. The below text will reference the average performance from the bottom table, which excludes the 1999-2000 cycle as Tech gains were heavily inflated during this bubble period and distorted some of the averages.*

- In addition to the broader market, most sectors also performed fairly well during the lead-up to Fed tightening with five groups outpacing the S&P 500 in the three months prior to the initial interest rate hike and eight groups logging gains, led by Industrials, Financials, and Materials.

- Similar to the S&P 500, some sectors struggled in the three months post-rate hike as six groups exhibited losses, on average, with Industrials and Energy faring worst. However, performance recovered thereafter with ten sectors logging average gains of at least 4% in the 12-month period post-rate hike and six sectors eclipsing the average S&P 500 gain.

- During the length of the Fed tightening cycles, five S&P 500 sectors logged above-market average annualized price gains and nine groups were in the black. Real Estate, Technology, and Health Care topped average returns during the past tightening periods, while Communication Services and Consumer Discretionary were notable laggards.

Recent US Strategy Research Reports

Date	Title
	Comments, Snapshots, and Factor Focus Reports
12/16/2021	US Strategy Comment: Notes From the Road – The Year Ahead Edition
12/8/2021	US Strategy Factor Focus: Inflation and US Factor Performance Implications
10/28/2021	US Strategy Snapshot: Four Quick Points Worth Noting
10/21/2021	US Strategy Snapshot: Here Comes the Recovery in Shareholder Distributions
10/14/2021	US Strategy Comment: Rising Rates Not an Automatic Sell Signal for Technology
9/30/2021	US Strategy Snapshot: Expect More of the Same in Q4
9/22/2021	US Strategy Snapshot: Financials Weakness Represents a Buying Opportunity
9/16/2021	US Strategy Comment: Stay Overweight Industrials and Materials
9/9/2021	US Strategy Snapshot: Providing Some Context on Market Rhetoric
9/3/2021	US Strategy Snapshot: Detailing the Upward Revisions to Our Price & EPS Targets
8/30/2021	US Strategy Snapshot: Revising Our 2021 S&P 500 Price and EPS Targets Higher
8/19/2021	US Strategy Snapshot: Too Much Taper Vapor
8/13/2021	US Strategy Snapshot: Small Cap and Mid-Cap Check-Up
7/29/2021	US Strategy Snapshot: Quality and Dividend Growth Over Traditional Defensives
7/22/2021	US Strategy Snapshot: Maintain Core, Seek Opportunity When It Comes to Tech
7/15/2021	US Strategy Snapshot: Two Market Realities and a Sector Opportunity
	Monthly Reports
1/6/2022	US Strategy: US Chartbook – January 2022
1/6/2022	US Strategy: US Factor Profiles – January 2022
	Podcasts & Videocasts
11/24/2021	Videocast: BMO Virtual Fireside Chat With Brian Belski – 2022 Year Ahead for the US & Canada
10/22/2021	Podcast – 2021 – We Are in the Home Stretch
7/16/2021	Podcast - 2021 Mid-Year Update
1/26/2021	Podcast - COVID-19: The Biden Presidency and What Lies Ahead
12/15/2020	Podcast - COVID-19: What Comes Next
11/20/2020	Podcast - 2021 Market Outlook - The Year Ahead for the U.S. and Canada
	Investment Strategy Snapshots and Special Reports
11/18/2021	Investment Strategy: 2022 Market Outlook - The Year Ahead for the U.S. and Canada
	Canadian Strategy
	Please call or e-mail us to be added to our standalone Canadian Strategy research

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Distribution of Ratings (January 12, 2022)

Rating category	BMO rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	StarMine Universe~
Buy	Outperform	52.9 %	28.2 %	59.4 %	55.4 %	60.8 %	57.7%
Hold	Market Perform	45.9 %	21.4 %	39.1 %	43.4 %	38.2 %	37.5%
Sell	Underperform	1.1 %	33.3 %	1.5 %	1.2 %	1.0 %	4.8%

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.

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**** Reflects rating distribution of all companies covered by BMO Capital Markets equity research analysts.

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~ As of April 1, 2019.

Ratings Key (as of October 2016)

We use the following ratings system definitions:
OP = Outperform - Forecast to outperform the analyst's coverage universe on a total return basis;
Mkt = Market Perform - Forecast to perform roughly in line with the analyst's coverage universe on a total return basis;
Und = Underperform - Forecast to underperform the analyst's coverage universe on a total return basis;
(S) = Speculative investment;
Spd = Suspended - Coverage and rating suspended until coverage is reinstated;
NR = No Rated - No rating at this time; and
R = Restricted - Dissemination of research is currently restricted.

The total return potential, target price and the associated time horizon is 12 months unless otherwise stated in each report. BMO Capital Markets' seven Top 15 lists guide investors to our best ideas according to different objectives (CDN Large Cap, CDN Small Cap, US Large Cap, US Small Cap, Income, CDN Quant, and US Quant have replaced the Top Pick rating).

Prior BMO Capital Markets Rating System

(April 2013 - October 2016)
http://researchglobal.bmocapitalmarkets.com/documents/2013/rating_key_2013_to_2016.pdf

(January 2010 - April 2013)
http://researchglobal.bmocapitalmarkets.com/documents/2013/prior_rating_system.pdf

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