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Forget big tech. Boring companies are the new hot stocks

IAN MCGUGAN || September 21, 2024

The stock market has a new crush: solid, sensible companies.

The shares of many of these steady but unexciting businesses have outpaced the broad market in recent months. Loblaw Companies Ltd. L-T -0.06% decrease, the much-maligned grocer, has surged 33-per-cent higher since January. Power producer Hydro One Ltd. H-T +0.65% increase has gained nearly 18 per cent over those same nine months. Royal Bank of Canada has enjoyed a 24-per-cent advance.

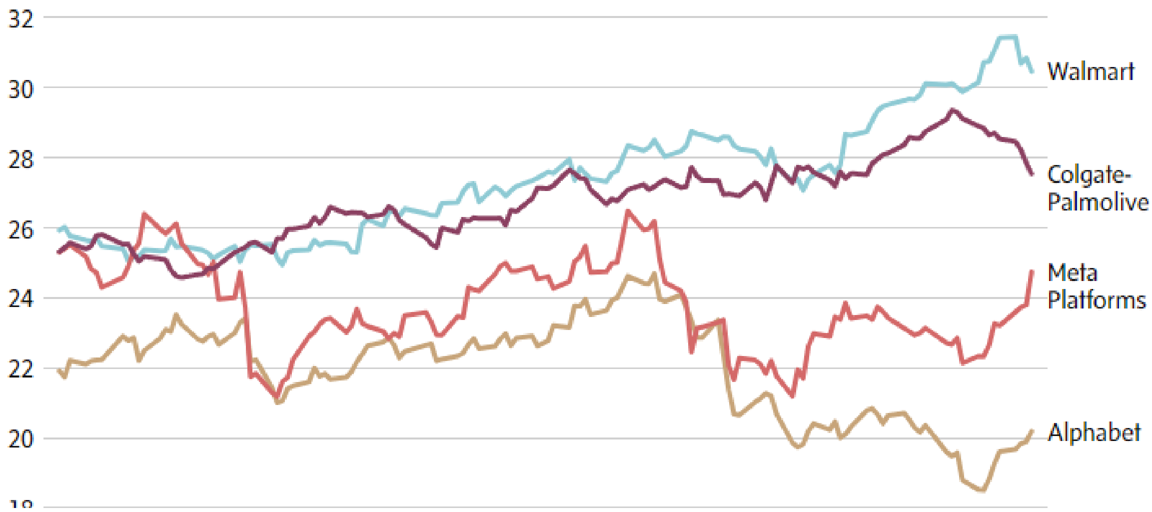
In the United States, a similar story prevails. Discount giant Walmart Inc. WMT-N +0.52% increase has rocketed 45-per-cent higher this year, while soap-and-toothpaste maker Colgate-Palmolive Co. CL-N +0.43% increase has gained 26 per cent and banker JPMorgan Chase & Co. has climbed 22 per cent.

If nothing else, the market-thumping performance of these staid stocks shows how the narrative is shifting. A few months back, it was a handful of big tech companies – the Magnificent Seven – dominating investors' thoughts and driving the market higher.

Not any more. The Magnificent Seven have diverged, with three of them producing ho-hum recent results. Tesla Inc. shares have actually lost money for investors so far this year, while returns at Alphabet Inc. and Microsoft Corp. have lagged behind the overall market.

Bricks beat clicks

Shares of brick-and-mortar retailers such as Walmart and consumer-staples giants such as Colgate-Palmolive now trade at higher stock market valuations than the shares of online behemoths such as Meta Platforms and Alphabet. (Forward price-to-earnings ratios)



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Investors are growing increasingly fond of more humdrum and predictable sectors. In a remarkable shift, U.S. consumer staples stocks have performed better than U.S. information technology shares over the past three months. Heck, even boring old utilities have been outpacing the U.S. tech sector this quarter.

So should investors count on these trends continuing? A lot depends on what you think is driving the market's change of heart.

Optimists will tell you the new affection for consumer staples, banks and utilities reflects growing confidence the U.S. will avoid a recession. If the world's biggest economy is headed toward a soft landing, it makes sense to bet on continued strong spending by North American consumers, broad increases in corporate profits and a general rise in share prices.

Pessimists take the opposite view. They see the market shift as an indication investors are willing to pay a premium for defensive stocks. According to this view, investors are positioning themselves for an uncertain U.S. election this fall and a murky economic future by loading up on reliable old-school stocks with the size and market heft to navigate whatever may come.

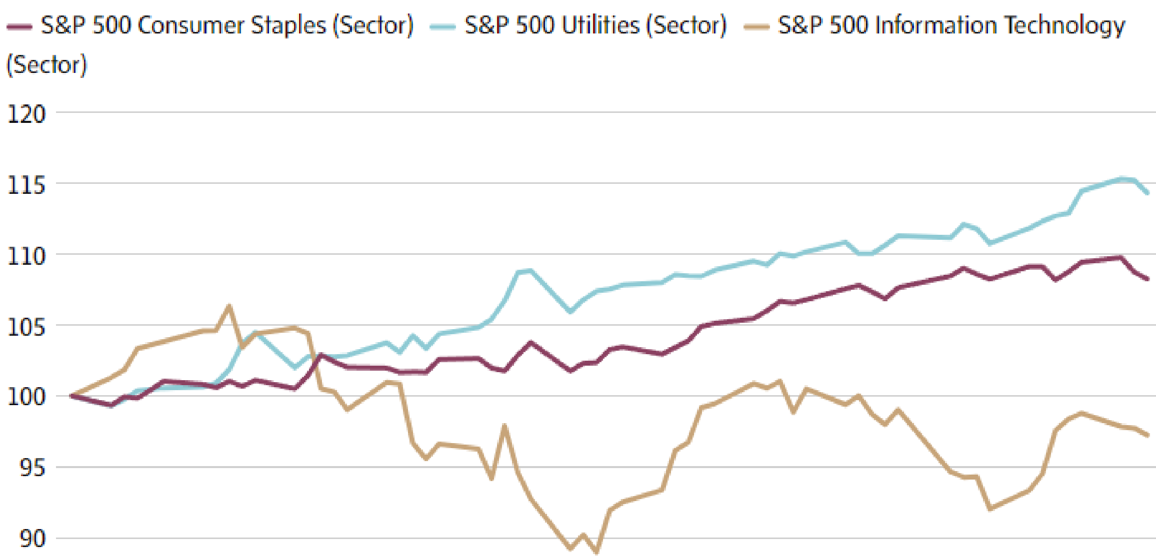
At least for now, the latter view seems more likely to be true. Consumer discretionary stocks – luxury goods makers, airlines, hoteliers and the like – are generally lagging the market, which is not what you would expect if people were positioning themselves for boom times. Meanwhile, gold and bitcoin – assets perceived as havens – continue to perform well. This, too, suggests investors remain nervous about what lies ahead.

The question is whether anxious investors are going too far in pursuit of perceived safety and paying too much for a sense of security. Say what you will about the long-term merits of solid and sensible companies, but many have now soared into a giddy stratosphere.

Consider Walmart. After its mammoth run-up this year, the world's largest retailer is trading for 30 times its estimated earnings for the year ahead – a price-to-earnings (P/E) multiple that seems more appropriate for a fast-expanding startup than a sedately growing giant.

A shift in fortunes

Over the past three months, boring has beat sexy, with consumer staples stocks and even utilities faring better than info tech shares. (S&P 500 sector performance from June 28 to Sept. 18, with 100 being starting point for each sector)



Loblaw, Hydro One and Colgate-Palmolive are also selling for hefty multiples of their earnings and dividends. Meanwhile, financial institutions such as JPMorgan and Royal Bank seem fully priced after their recent run-ups. (It's noteworthy that the analysts at Veritas Investment Research now have "sell" or "reduce" ratings on all Big Six Canadian banks.)

The valuations on some oh-so-sensible stocks are now higher than on some Magnificent Seven stocks. Think about that for a moment: Would you rather own Walmart at 30 times forward earnings or Meta Platforms Inc. at 25 times? Colgate-Palmolive at 28 times or Google parent Alphabet at 20 times?

Whatever your answer, it's clear that the market is no longer assigning an automatic premium to online giants. If anything, investors appear to be leaning in the other direction and favouring bricks-and-mortar operators.

This is a mixed blessing. Yes, it’s good that some of the Magnificent Seven obsession has faded away. However, the current enthusiasm for more defensive stocks seems fragile, too. Investors may want to remind themselves that there is no such thing as an inherently safe stock: Pay too much and even the most rock-solid business can generate disappointing returns.

How can investors navigate this awkward stretch? They may want to remind themselves that stocks are somewhere between fully valued and very expensive these days by most standard valuation measures. If you don’t like the current valuations, there is nothing wrong with buying bonds or a guaranteed investment certificate. Boring, yes, but effective if stocks – even solid, sensible stocks – hit a rough patch.