US

Smoke on the Water...Fire Under the Surface

Notwithstanding developments in the Iran conflict, there are important leadership shifts still at play within the equity market, which emphasize the importance of diversification.

March 4, 2026•Liz Ann Sonders•Kevin Gordon

Key takeaways

- Despite relatively flat, low-volatility headline indexes, market internals show widening dispersion, falling correlations, and broadening participation.
- Equal-weighted indexes, small caps, and international equities are outperforming cap-weighted benchmarks, echoing past periods when heavy Tech concentration constrained index-level gains and increased vulnerability beneath the surface.
- Iran-related geopolitical risk has boosted Energy leadership and volatility, while elevated stock- and sector-level swings reinforce the importance of diversification, rebalancing, and fundamentals-driven, active decision-making.

The tectonic plates of artificial intelligence (AI)—and more recently, the U.S./Israel war with Iran—are not simply shifting the prospects for markets and the economy. They are reshaping the fault lines of equity market leadership, with some of the most important trends occurring under the surface of the capitalization-weighted indexes.

Importantly, these shifts are not linear. We can't think of either the "AI trade" or the "Iran trade" as singular. They represent layered evolutions and are forcing faster reassessments of growth trajectories and the durability of leadership trends.

Resilience?

Even in the immediate aftermath of last weekend's news of the military strikes on Iran by the United States and Israel, the broad equity market continues to show signs of resilience. The market's internals tell a more complicated story, about which we've been writing for many months. Both the S&P 500 Equal Weight Index and Russell 2000 Index of small-cap stocks are handily outperforming the capitalization-weighted S&P 500, up +7% relative to 0.5% for the S&P 500. International stocks continue to outperform the S&P 500 this year: +7% and +13% for the MSCI EAFE (developed markets) and MSCI EM (emerging markets) indexes, respectively.

Shown below are several visuals that go on my (Liz Ann's) X feed every morning. The first looks at the four major equity indexes and a series of columns highlighting maximum drawdowns—both at the index and sub-index levels. At the index level, the S&P 500 is +1% year-to-date and the Nasdaq has a small -2% loss. As shown in the first table's third column, the S&P 500 and Nasdaq have only suffered mild maximum drawdowns year-to-date: -3% and -6%, respectively. More dramatic are the average member drawdowns: -12% for the S&P 500 and -26% for the Nasdaq year-to-date.

Average member maximum drawdowns have been deeper than at the index level

Major indexes and maximum drawdowns

Index	Index YTD return	Index maximum drawdown from YTD high	Average member maximum drawdown from YTD high
S&P 500	1%	-3%	-12%
Nasdaq	-2%	-6%	-26%
Russell 2000	7%	-5%	-19%
Dow Jones	2%	-3%	-10%

Disclosures

Source: Charles Schwab, Bloomberg, as of 3/2/2026.

Some members were excluded from year-to-date return columns given additions to indices made after January 2026. Table represents price performance. Indexes are unmanaged, do not incur management fees, costs and expenses and cannot be invested in directly. **Past performance is no guarantee of future results.**

Next, we can look at the percentage of S&P 500 stocks outperforming the index itself over various rolling time periods. Only about 20% of the index's constituents have outperformed the index itself over the past year, but that has jumped to about 60% over the past couple of months. This broadening of participation suggests rotation rather than retreat. In other words, capital is moving within the market, not exiting it.

The percentage of S&P 500 constituents outperforming the index has broadened

% of S&P 500 members outperforming S&P 500 Index over the past year

1 month	2 months	3 months	4 months	5 months	6 months	1 year
58%	60%	46%	37%	25%	23%	21%

Source:

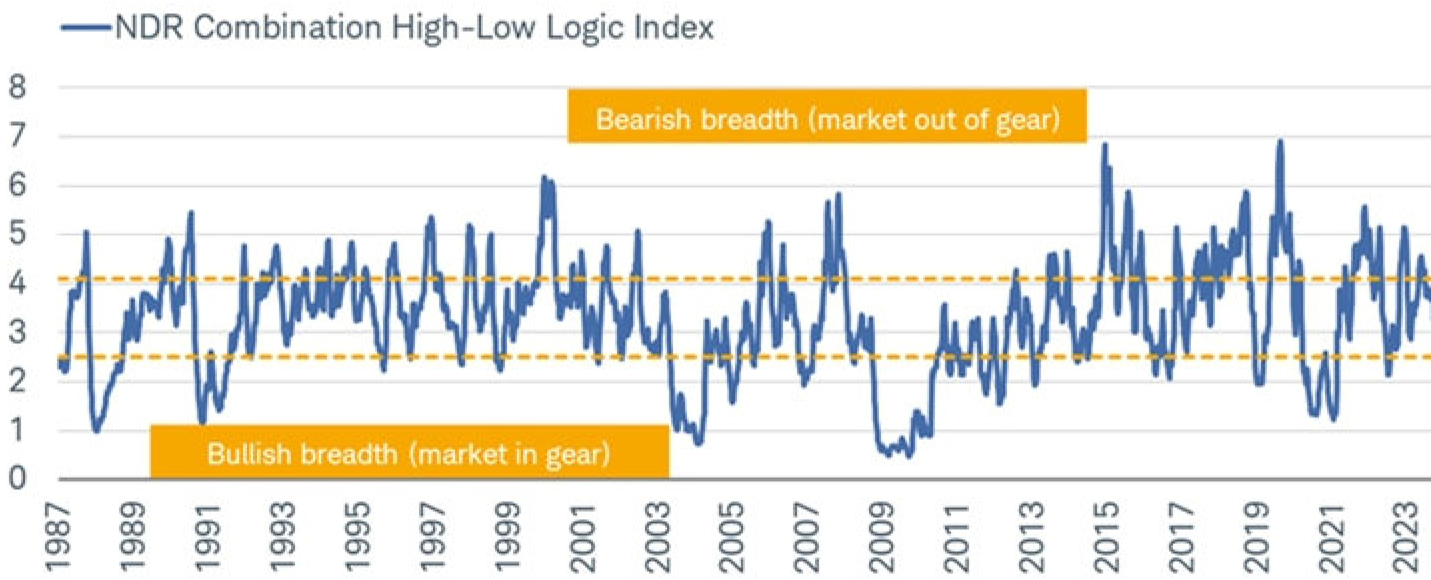
Source: Charles Schwab, Bloomberg, as of 3/2/2026. Indexes are unmanaged, do not incur management fees, costs and expenses and cannot be invested in directly. **Past performance is no guarantee of future results.**

At the same time, dispersion has increased, with a historically large percentage of stocks experiencing moves of at least plus or minus 20% so far this year. In other words, low index volatility has not translated into low stock-level volatility. Correlations have fallen and performance gaps have widened, creating a more selective environment in which stock picking matters more and passive concentration carries different risks than it did during the prior mega-cap tech-heavy leadership cycle.

The NDR Combination High-Low Logic Index, shown below, reinforces this theme. Elevated readings indicate a market that is "out of gear," with meaningful numbers of stocks making new highs and new lows simultaneously. The original formula, created by Norm Fosback, focused on the New York Stock Exchange (NYSE) and applied a 10-week exponential moving average (EMA). NDR's version combines stocks that trade on the NYSE, AMEX, and Nasdaq, but still applies the 10-week EMA.

That kind of internal divergence does not necessarily signal imminent weakness, but it does reflect a lack of synchronized momentum beneath the surface. Historically, such conditions tend to precede either a pickup in volatility or a more decisive leadership handoff.

Market out of gear



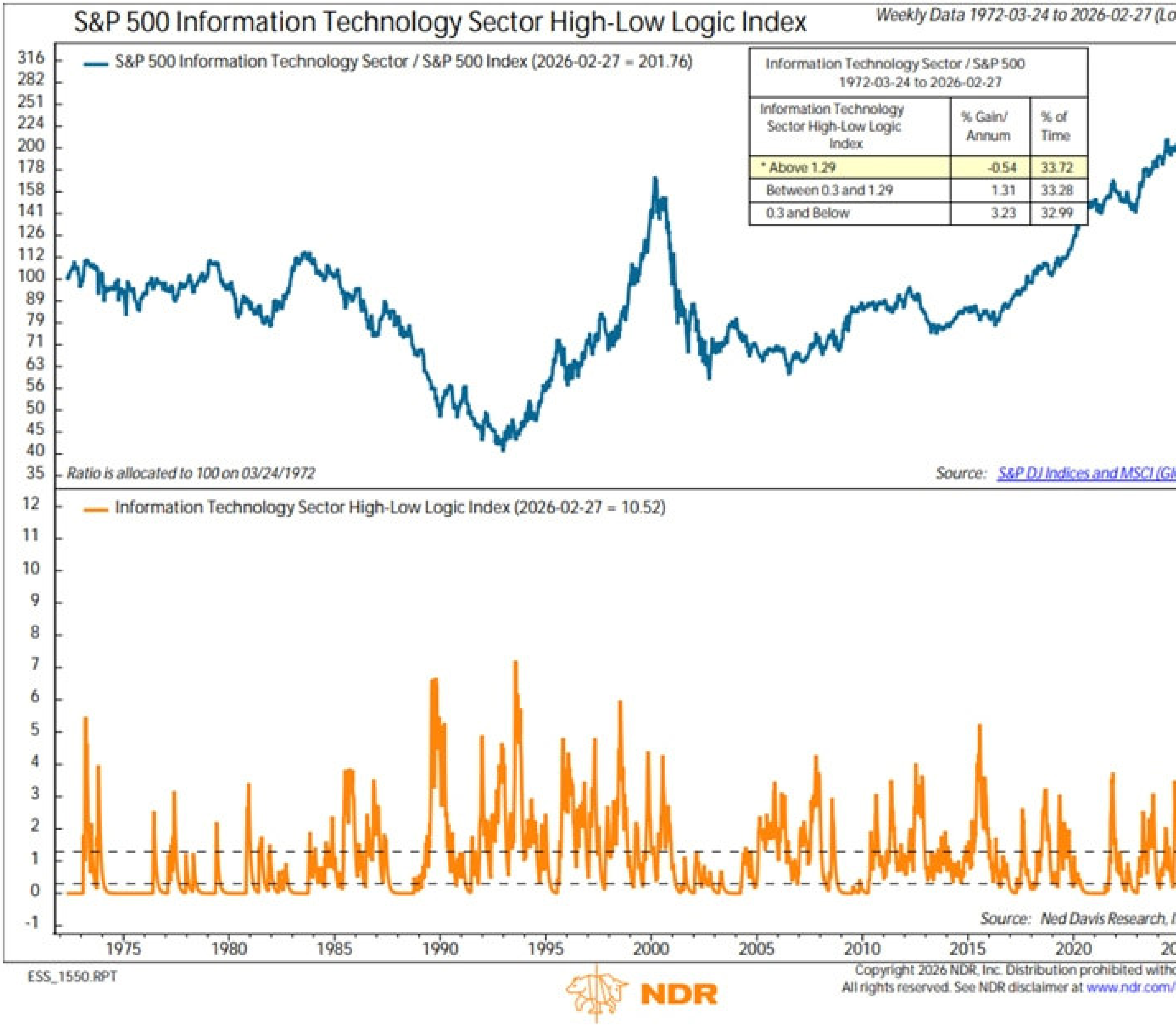
High-Low Logic Index	S&P 500 annualized performance (1/2/1987 - 2/27/2026)
Above 4.1	-2.7%
2.5 - 4.1	9.8%
Below 2.5	22.3%

Source:

Source: Charles Schwab, ©Copyright 2026 Ned Davis Research, Inc. Further distribution prohibited without prior permission. All Rights Reserved. See NDR Disclaimer at www.ndr.com/copyright.html, as of 2/27/2026. NDR Combination High-Low Logic Index is an indicator developed by analyst Norman Fosback and expanded on by NDR for the purpose of gauging whether market conditions are in gear and therefore bullish, or out-of-gear and therefore bearish. When many stocks are making new highs at the same time that many stocks are making new lows, the index reading is high, indicating a divergent market. When very few stocks are diverging from the prevailing trend, the index reading is low, a reflection of confirmation. Indexes are unmanaged, do not incur management fees, costs and expenses and cannot be invested in directly. Dividends and interest are assumed to have been reinvested, and the example does not reflect the effects of taxes or fees which would cause performance to be lower. **Past performance is no guarantee of future results.**

Even more extreme is the High-Low Logic Index for the S&P 500 Technology sector. The index went parabolic in the midst of the extreme selloff in the software stocks that accompanied the disruption caused by AI. Alongside the carnage in the software stocks was a surge in Tech industries like Hardware and Semiconductors. That spread has led to a recent record-high reading for this version of the High-Low Logic Index.

Tech sector way out of gear



Source: Charles Schwab, ©Copyright 2026 Ned Davis Research, Inc.
Further distribution prohibited without prior permission. All Rights Reserved. See NDR Disclaimer at www.ndr.com/copyright.html, as of 2/27/2026. Data in top pane rebased to 100 at 3/24/1972. An index number is a figure reflecting price or quantity compared with a base value. The base value always has an index number of 100. The index number is then expressed as 100 times the ratio to the base value. High-Low Logic Index is an indicator developed by analyst Norman Fosback and expanded on by NDR for the purpose of gauging whether market conditions are in gear and therefore bullish, or out-of-gear and therefore bearish. When many stocks are making new highs at the same time that many stocks are making new lows, the index reading is high, indicating a divergent market. When very few stocks are diverging from the prevailing trend, the index reading is low, a reflection of confirmation. Indexes are unmanaged, do not incur management fees, costs and expenses and cannot be invested in directly. **Past performance is no guarantee of future results.**

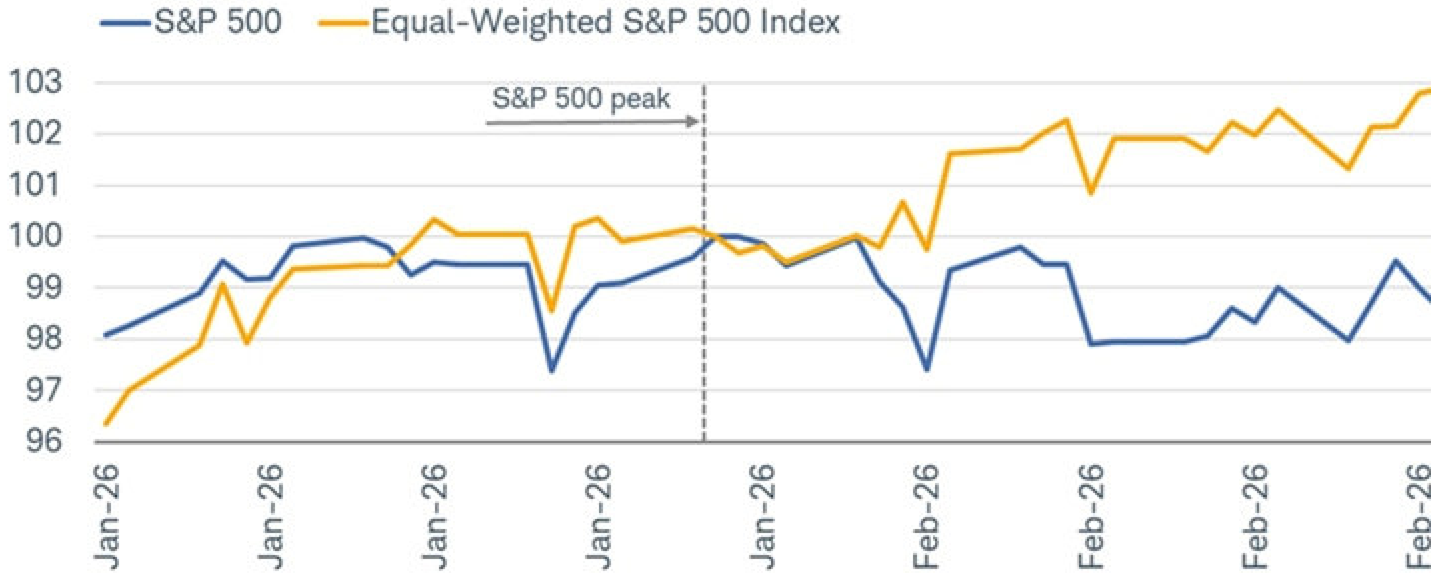
A focus on the Tech sector also warrants a comment on market concentration and a brief look back to the late 1990s, during which we saw many of the metrics discussed reach extreme levels—of course, due to the hype around the dot-com boom. Given the rotation at play today, with Tech taking a back seat and the rest of the market outperforming, it's worth keeping in mind that as that dynamic unfolded from 1999 to 2000, the equal-weighted S&P 500 outperformed the cap-weighted S&P 500 meaningfully. In fact, as you can see in the chart below, in the first year of the cap-weighted S&P 500's (blue line) bear market, the equal-weighted S&P 500 had a positive return. Of course, it eventually caught down, but for a solid year, it provided relative safety.

Tech's outsized influence

Source: Charles Schwab, Bloomberg, 1/1/2000 to 3/30/2001.
Data rebased to 100 at 3/27/2000. An index number is a figure reflecting price or quantity compared with a base value. The base value always has an index number of 100. The index number is then expressed as 100 times the ratio to the base value. Indexes are unmanaged, do not incur management fees, costs and expenses and cannot be invested in directly. **Past performance does not guarantee future results.**

Of course, no two periods are the same and we don't mean this to come off as any kind of forecast or exact repeat of 2000. If anything, it's a reminder that given Tech's weight in the S&P 500, any persistent downward pressure for the sector can be powerful enough to halt the broader index's advance (we saw this as recently as 2022). Arguably, that has happened so far this year, with the cap-weighted S&P 500 only up slightly but the equal-weighted version already outperforming by a few percentage points.

Equal weight, not performance



Source: Charles Schwab, Bloomberg, as of 3/2/2026. Data rebased to 100 at 1/27/2026.
An index number is a figure reflecting price or quantity compared with a base value. The base value always has an index number of 100. The index number is then expressed as 100 times the ratio to the base value. Indexes are unmanaged, do not incur management fees, costs and expenses and cannot be invested in directly. **Past performance does not guarantee future results.**

Zooming out

Despite a rocky start to the year, it's clear that investors haven't shied away from the market. As shown in the chart below, the average daily equity market turnover has hit a new cycle high, which is a function of elevated retail trader involvement.

Retail traders' influence

Source: Charles Schwab, Bloomberg, as of 2/27/2026.

Equity market turnover is a measure of the trading activity within a stock market.

Sector performance so far this year underscores the leadership transitions, as shown below in our "sector quilt." Technology's dominance has softened over the past several months (contributing to the Nasdaq's relative underperformance). Meanwhile, broader participation—including by cyclicals and select defensives—has improved, while Energy has benefited from geopolitical crosscurrents/conflicts. The leadership baton is moving rather than disappearing.

Sector swingers

Schwab Asset Class Quilt®

1/2/26	1/9/26	1/16/26	1/23/26	1/30/26	2/6/26	2/13/26	2/20/26	2/27/26
Energy 2.1%	Cons. Discr. 5.8%	Real Estate 4.1%	Energy 3.1%	Comm. Serv. 4.2%	Cons. Staples 6.0%	Utilities 7.1%	Comm. Serv. 2.3%	Utilities 2.9%
Industrials 1.9%	Materials 4.8%	Cons. Staples 3.7%	Materials 2.6%	Energy 3.9%	Industrials 4.7%	Real Estate 3.9%	Cons. Discr. 1.7%	Cons. Staples 2.7%
Materials 1.5%	Industrials 2.5%	Industrials 3.0%	Comm. Serv. 1.1%	Utilities 1.7%	Energy 4.3%	Materials 3.7%	Industrials 1.7%	Health Care 2.1%
Utilities 1.2%	Comm. Serv. 2.4%	Energy 2.4%	Health Care 1.1%	Cons. Staples 0.8%	Materials 3.5%	Energy 1.7%	Financials 1.5%	Energy 2.0%
Health Care 0.4%	Energy 2.1%	Utilities 2.1%	Cons. Staples 0.9%	Industrials 0.7%	Health Care 1.9%	Cons. Staples 1.4%	Info. Tech. 1.5%	Materials 1.3%
Financials 0.2%	Cons. Staples 2.1%	Materials 0.7%	Cons. Discr. 0.7%	Real Estate 0.7%	Real Estate 1.5%	Industrials 0.6%	S&P 500 1.1%	Real Estate 0.7%
S&P 500 0.2%	S&P 500 1.6%	S&P 500 -0.4%	S&P 500 -0.4%	Financials 0.7%	Financials 1.5%	Health Care -0.1%	Energy 0.5%	Comm. Serv. 0.5%
Real Estate 0.1%	Financials 1.4%	Info. Tech. -0.6%	Info. Tech. -0.8%	S&P 500 0.3%	Utilities 0.2%	S&P 500 -1.4%	Real Estate 0.0%	Industrials -0.1%
Info. Tech. 0.0%	Health Care 1.1%	Health Care -1.1%	Industrials -1.6%	Info. Tech. -0.4%	S&P 500 -0.1%	Info. Tech. -2.0%	Materials -0.3%	S&P 500 -0.4%
Cons. Staples -0.2%	Real Estate 0.4%	Comm. Serv. -1.5%	Utilities -2.0%	Materials -1.2%	Info. Tech. -1.4%	Cons. Discr. -2.1%	Utilities -0.5%	Cons. Discr. -0.5%
Comm. Serv. -0.4%	Info. Tech. 0.0%	Cons. Discr. -2.0%	Real Estate -2.4%	Cons. Discr. -1.4%	Comm. Serv. -4.4%	Comm. Serv. -3.5%	Health Care -0.6%	Financials -2.0%
Cons. Discr. -1.1%	Utilities -1.6%	Financials -2.3%	Financials -2.5%	Health Care -1.7%	Cons. Discr. -4.6%	Financials -4.8%	Cons. Staples -2.3%	Info. Tech. -2.2%

Source: Charles Schwab, Bloomberg, as of 2/27/2026.

Sector performance is represented by price returns of the following 11 Global Industry Classification Standard (GICS®) sector indices: Consumer Discretionary Sector, Consumer Staples Sector, Energy Sector, Financials Sector, Health Care Sector, Industrials Sector, Information Technology Sector, Materials Sector, Real Estate Sector, Communication Services Sector, and Utilities Sector. Returns of the broad market are represented by the S&P 500. Indexes are unmanaged, do not incur management fees, costs and expenses and cannot be invested in directly. **Past performance is no guarantee of future results.**

Notwithstanding Energy's leadership among sectors, sector volatility within the S&P 500 has been higher than usual. This volatility and higher dispersion/rotation reflect elevated single-stock and sector moves compared with recent years, even as the overall index has been deceptively calm. How do investors navigate this? Diversification and periodic rebalancing (managing position sizing) are key, but so is a focus on fundamentals and earnings trends. Shifts in earnings outlooks and economic drivers suggest a focus that's more on factor-based analysis than monolithic sector biases and can help identify sustainable potential winners (and help avoid overly reactive trades).

Implications

In light of the military conflict in/around Iran, trends in Energy's leadership are important for the broader market as well as the economy. Sustained high energy prices would contribute to an ongoing tightening of financial conditions. That would push up headline inflation, squeeze consumers and corporate margins, and complicate central bank policy. At the same time, ongoing geopolitical stress could trigger flights to perceived safety into Treasuries and/or the U.S. dollar, raising risk premiums and possibly weighing on equities. These channels are often how geopolitical risk is translated into tighter liquidity and more fragile market conditions.

This is not a market unraveling, nor is it one in full-throated risk-on mode. It is a market redistributing opportunity, easing concentration risk, and widening dispersion. The calm at the index level masks an active internal rotation that argues for discipline, diversification, selectivity, and a focus on breadth under the surface rather than just benchmark performance.