Advisor Group
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MARKET ANALYSIS

Recent Market Pullback - Not a Bear Market

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January 2022

Name	Returns Since Jan. 3rd Record High (as of 1.24.2022)[1]
S&P 500 TR USD	-8.00
NASDAQ Composite TR USD	-12.48
DJ Industrial Average TR USD	-5.99
Russell 1000 Growth TR USD	-12.29
Russell 1000 Value TR USD	-3.87
Russell Mid Cap TR USD	-8.08
Russell 2000 TR USD	-10.50

On January 3rd, 2022, stocks hit a new record high potentially signaling to investors that the gains experienced in 2021 were going to be carried forward to 2022. However, the next day stocks reversed, and it has been a rough couple of weeks for the markets since. The Dow Jones Industrial Average and S&P 500 are on pace for their worst month since March 2020, when the market fell into turmoil amid the pandemic. The NASDAQ, meanwhile, is headed for its biggest one-month loss since October 2008.[1] As a result of the recent sell off, we have seen some indexes enter correction territory, which means that they are down -10% or more from their previous highs. While market volatility is unsettling, it is historically not unusual; On average, since 1980, markets have experienced four 5% pullbacks each year. Similarly, since 1980, the average year in the S&P 500 Index sees a 14% peak to trough correction.[2] Thus, it is important to remember that corrections are a normal part of investing and there are still plenty of reasons why stocks can push higher from here (i.e., a strong consumer and resilient corporate earnings).

Therefore, we would stress that this is not a time to panic, but a time to be confident in your long-term plan and potentially take advantage of the volatility by rebalancing your portfolios to parts of the market that have been hit the hardest. As recoveries from corrections have taken four months on average, staying invested in the market could be additive to portfolios, and leave investors better off in the long run. Lastly, we do not believe that we are entering a bear market. The selloff was triggered not by poor economic fundamentals, but rather a compounding of individual events that the market views as unfavorable.

What has sparked the selloff in the markets:

1. We're in the thick of fourth-quarter earnings season, with some 200 S&P 500 companies on deck to report this week and next. Investors have uncertainty about earnings growth; any lackluster earnings reports coupled with inflation running hot could hurt profit margins.
2. Geopolitics is front and center, with near-daily headlines suggesting escalating danger of an armed conflict in Ukraine.
3. The prospect of a Fed that is focused on fighting inflation by raising interest rates and reducing the size of its balance sheet has been tough for the market to digest.

High concentration has exaggerated the selloff:

The point of the Fed hiking rates is the one that deserves the most attention, as we believe it is the cause for the majority of the market volatility. Stocks have felt pain from this for two reasons:

- First, due to higher rates, the rate at which investors discount future cash flows is higher, which brings down the current valuation of companies.
- Second, higher rates usually mean slower economic and earnings growth in the future, which can hurt stock prices now.

Higher rates are of particular concern due to the makeup of the S&P 500 Index. The S&P 500 Index is a market cap weighted index, so it is dominated by the largest names in the market, which are the big technology companies (i.e., large cap growth stocks). Large caps have enjoyed almost two years of price/earnings (P/E) multiple expansion, and much of it has been deserved because of accelerated adoption of their platforms, exceptional earnings growth, and most importantly low interest rates.

Over the past two years, the top 5 names in the index (Apple, Amazon, Microsoft, Nvidia, Facebook) have had a significant impact on the S&P 500 Index's overall return.[3]

- In 2020, those top 5 names returned ~71% on average, responsible for approximately 62% of the indexes total return.
- In 2021, those top 5 names returned ~65% on average, responsible for approximately 31% of the indexes total return.

The top 5 names constitute close to 20% of the S&P 500 Index, and the technology sector makes up about 30% of the index, more than twice the size of the next largest sector.[1] Similarly, the NASDAQ has a 45% exposure to the technology sector.[1] Therefore, the success of the technology sector is closely tied to the success of the broader market. Just as these stocks can support markets on the way up, as we have seen this year, they can also exaggerate a sell off on the way down.

Our View:

Our view is that this is a normal market sell-off, especially amidst the removal of unprecedented monetary and fiscal stimulus and historically muted market volatility coming into 2022. Investors were spoiled in 2021, as the S&P 500 Index went 227 days without a 5% drop, the seventh-longest such streak on record. It is extremely rare for the market to enjoy such a period of relative calmness, as such lengthy stretches without a 5% pullback or better have occurred on only eight occasions in the history of S&P 500 index.[4] Similarly, stocks had not had a 10% correction since March 2020, and the S&P 500 has averaged exactly one 10% correction per year since 1950. Although the fear of the Federal Reserve hiking rates faster than expected remains, current economic data is solid and earnings growth, while lower, will remain resilient. Fed rate hikes by themselves do not mean the bull market is approaching an end. In fact, a year after the first hike in the previous eight hiking cycles saw the S&P 500 Index higher a year later every single time. While some of those returns were muted, by no means were they considered bear market events for investors. In closing, 2021 marked only the 10th time the S&P 500 has generated 3 straight years of positive double-digit returns in the last +90 years. The S&P was up 31.20% in 2019, 18.40% in 2020 and 28.71% in 2021.[1] Due to increased market volatility, we may not get a fourth year of double digit returns for the S&P 500, however, we believe that equities will continue to push modestly higher, returning between 8-10%.

Index Definitions

S&P 500: The S&P 500® is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

NASDAQ: The NASDAQ Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

Dow Jones Industrial Average: The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Russell Mid-Cap: Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index, which represent approximately 25% of the total market capitalization of the Russell 1000 Index.

Russell 2000: The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, representing approximately 8% of the Russell 3000 total market capitalization. The real-time value is calculated with a base value of 135.00 as
of December 31, 1986. The end-of-day value is calculated with a base value of 100.00 as of December 29, 1978.

Russell 1000 Growth: The Russell 1000® Growth Index measures the performance of the large cap growth segment of the US equity universe. It includes those Russell 1000 companies with relatively higher price-to-book ratios, higher I/B/E/S forecast medium term (2 year) growth and higher sales per share historical growth (5 years). The Russell 1000® Growth Index is constructed to provide a comprehensive and unbiased barometer for the large-cap growth segment. The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect growth characteristics.

Russell 1000 Value: The Russell 1000® Value Index measures the performance of the large cap value segment of the US equity universe. It includes those Russell 1000 companies with relatively lower price-to-book ratios, lower I/B/E/S forecast medium term (2 year) growth and lower sales per share historical growth (5 years). The Russell 1000® Value Index is constructed to provide a comprehensive and unbiased barometer for the large-cap value segment. The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect value characteristics

[1] Data Obtained from Morningstar Direct as of 1/24/2022

[2] https://www.chase.com/personal/investments/learning-and-insights/article/tmt-january-twenty-one-twenty-two

[3] https://www.cnbc.com/2022/01/13/op-ed-these-big-names-propelled-the-sp-500-in-2021-heres-whats-ahead-for-2022.html

[4] https://www.barrons.com/articles/stock-market-drop-51633037026