First Financial Investment & Retirement Center

Tech Sector Turmoil and the Bear Market

During the intensely volatile first 100 trading days of 2022, the stocks of companies in the S&P 500 index delivered their worst performance since 1970.[1] The S&P 500 continued to tumble, and the benchmark index descended into a bear market — typically defined as a sustained drop in stock prices of at least 20% — on June 13, 2022. When the market closed, the S&P 500 had dropped 21.8% from its January 3 peak, and the tech-heavy NASDAQ, already in bear territory, had plunged 32.7% from its November 19, 2021 peak.[2]

Some investors who are nervous about the future and their portfolios seem to have taken a defensive stance by selling riskier assets, including investments in growth-oriented technology stocks.

What's triggering market volatility?

Throughout 2021, U.S. businesses dealt with unpredictable demand shifts and supply shocks related to the pandemic, but near-zero interest rates and trillions of dollars in pandemic relief supported consumer spending, boosted economic growth, and drove record corporate profits. Companies in the S&P 500 posted profits in 2021 that were 70% higher than in 2020 and 33% higher than in 2019, which helped fuel a stock market total return of nearly 29%.[3-4]

But in the first months of 2022, investors began to worry that the anticipated tightening of monetary policies by the Federal Reserve — intended to cool off stubbornly high inflation — would stifle economic growth and cause a recession. Prices began rising in the spring of 2021 due to high demand, supply-chain issues, and a labor shortage that pushed up wages. Inflation picked up speed in the first quarter of 2022 when China's COVID-19 lockdowns impacted the supply of goods, and Russia's invasion of Ukraine sent already high global food and fuel prices through the roof. In May 2022, the Consumer Price Index rose at an annual rate of 8.6%, a 40-year high.[5]

The relentless acceleration of price increases puts pressure on the Federal Open Market Committee (FOMC), which meets on June 14 and 15, to act aggressively to tame inflation. At the beginning of May, the FOMC raised the benchmark federal funds rate by 0.5% (to a range of 0.75%–1.00%). This was the first half-percent increase since May 2000, and Fed projections suggest there will be more to come.[6]

Rising interest rates push bond yields upward, and the opportunity for higher returns from lower-risk bond investments makes higher-risk stock investments less attractive. Moreover, stock investors are buying a portion of a company's future cash flows, which become less valuable in an inflationary environment. Higher borrowing costs can also crimp consumers' spending power and cut into the profits of companies that rely on debt.

The downside of domination

Stocks tracked by the S&P Information Technology Sector Index, which fell 29.2% from a January 3 high, have been hit harder than the S&P 500 as a whole. Plus, like many benchmark indexes, the S&P 500 is weighted by market capitalization (the value of a company's outstanding shares). This gives the largest companies, most of which are in the tech sector, an outsized role in index performance. As of May 31, the information technology sector still accounted for 27.1% of the market cap of the S&P 500, compared with weightings of 14.4% for health care and 11.2% for financials, the next-largest sectors. Apple, Microsoft, Alphabet, and Amazon, respectively, are the four most-valuable companies in the index; Nvidia is ranked ninth and Meta has fallen to number 11.[7]

For the past several years, tech stock gains drove the market to new heights, but when their share values began to plunge, they dragged the broader stock indexes down with them. A *Wall Street Journal* analysis of market data through May 17 found that just eight of the largest U.S. companies — the six previously mentioned, plus Netflix and Tesla (in the consumer discretionary sector) — were responsible for an astounding 46% of the S&P 500's 2022 losses (on a total return basis).[8]

These well-known technology companies have grown into massive multinational businesses that have a major influence on everyday life. Some dominate their respective business spaces — social media, smartphones, online search and advertising, e-commerce, and cloud computing — enough to spark antitrust investigations and calls for stricter regulations in the United States and abroad. They also have plenty of cash on hand, which means they may be in better shape to withstand an economic slowdown than their smaller competitors.[9]

Takeaways for investors

Spreading investments among the 11 sectors of the S&P 500 is a common way to diversify stock holdings. But over time, a stock portfolio that was once diversified can become overconcentrated in a sector that has outperformed the broader market. Tech-sector stocks notched huge total returns of about 50% in 2019, 44% in 2020, and 35% in 2021, so you may want to look closely at the composition of your portfolio and consider rebalancing if you find yourself overexposed to this highly volatile sector. (Rebalancing involves selling some investments in order to buy others. Keep in mind that selling investments in a taxable account could result in a tax liability). [10]

If you feel shell-shocked after more than five months of market turbulence, try to regain some perspective. Some market analysts view recent price declines as a painful but long overdue repricing of stocks with valuations that had grown excessive, as well as a reality check brought on by waning growth expectations. The forward price-to-earnings (P/E) ratio of companies in the S&P 500 has fallen from 23.3 at the end of 2021 to 17.8 in May 2022, much closer to the 10-year average of 16.9.[11-12]

It could be a while before investors can better assess how the economy and corporate profits will ultimately fare against fast-rising inflation and higher borrowing costs — and the stock market is no fan of uncertainty. Disappointing economic data and company earnings reports could continue to spark volatility in the coming months.

It may not be easy to take troubling headlines in stride, but if you have a sufficiently diversified, all-weather investment strategy, sticking to it is often the wisest course of action. If you panic and flee the market during a downturn, you won't be in a position to benefit from upward swings on its better days. And if you continue investing regularly for a long-term goal such as retirement, a down market may be an opportunity to buy more shares at lower prices.

The return and principal value of stocks fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. Investments seeking a higher return tend to involve greater risk. Diversification is a method used to help manage risk. It does not guarantee a profit or protect against investment loss. The S&P 500 is an unmanaged group of securities that is considered representative of the U.S. stock market in general. The performance of an unmanaged index is not indicative of the performance of any specific investment. Individuals cannot invest directly in an index. Past performance is not a guarantee of future results. Actual results will vary. Dollar-cost averaging does not ensure a profit or prevent a loss. Such plans involve continuous investments in securities regardless of fluctuating prices. You should consider your financial ability to continue making purchases during periods of low and high price levels. However, this can be an effective way for investors to accumulate shares to help meet long-term goals.

Questions? Contact First Financial's Investment & Retirement Center by calling 732.312.1534. You can also email mary.laferriere@lpl.com or maureen.mcgreevy@lpl.com

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1) SIFMA, 2022

2) Yahoo! Finance, 2022

3) The New York Times, May 31, 2022

4, 7, 10-11) S&P Dow Jones Indices, 2022

5) U.S. Bureau of Labor Statistics, 2022

6) Federal Reserve, 2022

8) The Wall Street Journal, May 19, 2022

9) The New York Times, May 20, 2022

12) FactSet, 2022

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