HOT TOPIC

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 tighter monetary policies by the Federal Reserve — intended to cool down 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 early 2022 when China's COVID-19 lockdowns dented the supply of goods, and Russia's invasion of Ukraine sent 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) to act aggressively to tame inflation. At the June meeting, the FOMC raised the benchmark federal funds rate by 0.75% (to a range of 1.50%–1.75%). This was the largest increase since 1994, and according to Fed Chair Jerome Powell, another 0.50% or 0.75% hike could follow in July.[6]

Rising interest rates push up bond yields, and the opportunity for higher returns from lower-risk bonds makes higher-risk stocks 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 in 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]

Tech stock gains drove the market to new heights, but when their share values began to fall, they dragged the broader 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]

Takeaways for Investors

Spreading investments among the 11 sectors of the S&P 500 is a way to diversify stock holdings. But over time, a stock portfolio that was once diversified can become overconcentrated in a sector that has outperformed. Tech sector stocks notched huge total returns of about 50% in 2019, 44% in 2020, and 35% 2021, so you may want to rebalance your portfolio if you find yourself overexposed to this highly volatile sector. (Rebalancing involves selling some investments in order to buy others. Selling investments in a taxable account could result in a tax liability.)[9]

Some market analysts view this year's price declines as a painful but overdue repricing of stocks with valuations that had grown excessive. The forward price-to-earnings (P/E) ratio of companies in the S&P 500 fell from 23.3 at the end of 2021 to 17.8 in May 2022, much closer to the 10-year average of 16.9.[10–11]

It could be a while before investors can better assess how the economy and corporate profits will 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.

It's not 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 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. 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 involves continuous investments in securities regardless of fluctuating prices, and it does not ensure a profit or prevent a loss. Consider your financial ability to continue making purchases during periods of low and high price levels.*

1) SIFMA, 2022
2) Yahoo! Finance, 2022
3) *The New York Times*, May 31, 2022
4, 7, 9–10) S&P Dow Jones Indices, 2022
5) U.S. Bureau of Labor Statistics, 2022
6) *The Wall Street Journal*, June 15, 2022
8) *The Wall Street Journal*, May 19, 2022
11) FactSet, 2022

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