Perspectives

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# We've Come So Far, but Maybe It Was Too Fast

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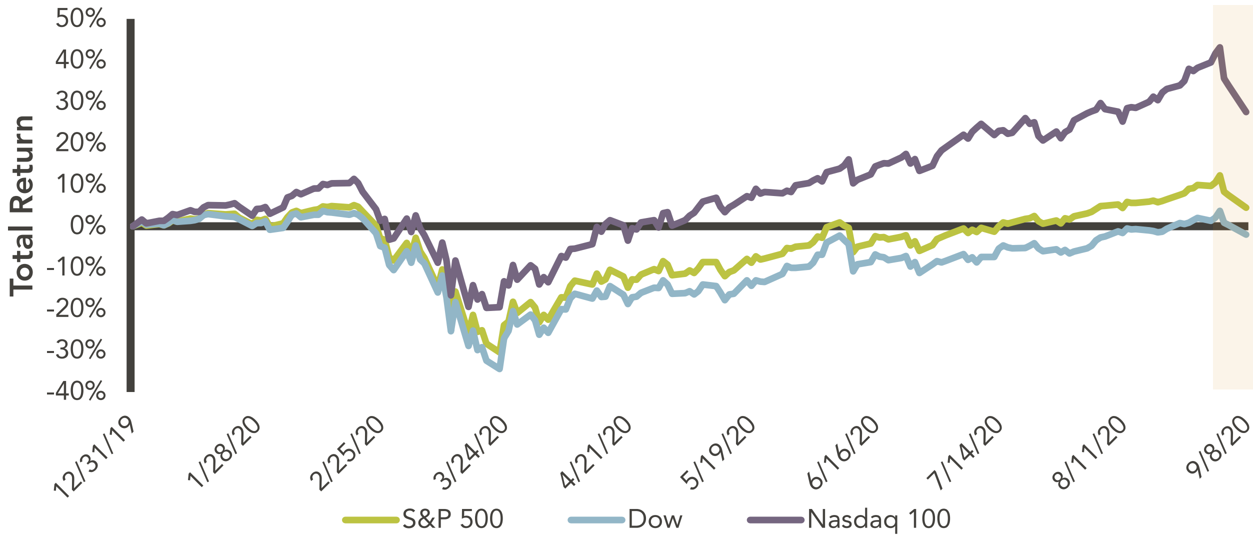
**It had been smooth sailing in equity markets since the first quarter's bear market. The S&P 500 index eclipsed the February 19th all-time high and in August the volatility index grazed lows not seen since the beginning of the year. However, over the past week, equity markets have been in turmoil with the S&P 500 falling nearly 7.0% and the NASDAQ 100 falling into correction territory, declining 10.9% in the last three trading days.[1] The turmoil has been concentrated in the most unlikely place: growth stocks.**

Growth stocks were relatively spared in the bear market. For example, the S&P 500 index troughed -33.8% in March while growth stocks as represented by the NASDAQ 100 index troughed at -28.0%. Since March, both indices have had strong performance driven by the largest stocks in each index (i.e., Apple, Microsoft, Amazon, Google, and Facebook). Year to date ending August 31st, 2020, the NASDAQ was up 39.6% while the S&P 500 was up 9.7%.

However, momentum or investor sentiment for growth stocks waned in early September. The main catalyst for the change in sentiment is the extremely strong performance from growth/technology-oriented stocks given their seeming immunity from the COVID-19 pandemic. Forward price-to-earnings valuations for the broad market are now in the top 1% of their historical averages, making it likely that there are some investors who are taking profits. This episode is similar to the market's 8.5% pullback in early 2018 when the forward 12-month P/E ratio reached 18 times; the current forward P/E is 27 times. Other catalysts include the recent reductions in COVID-19 infections which benefit a broader swath of non-tech companies as well as poor earnings/negative news for a few growth stocks. For instance, Tesla suffered its worst one-day loss ever (down 21%) as Standard & Poor's index committee declined to include Tesla in the S&P 500 index. Tech losses were further compounded as smaller companies like Slack, a workplace communication software company, reported earnings below expectations.

**Exhibit 1:** Performance Since the Trough




Source: Bloomberg as of September 8, 2020

The S&P 500 has been positive every month since March and is now up 50.2% since the trough.[1] It is no surprise that we are experiencing some negative pressure on equity prices. First, the late summer and early fall have historically been more volatile markets, as the S&P 500 is only positive 48% of the time in September. Additionally, the world is still finding ways to cope with the COVID-19 pandemic although a vaccine seems to be on the horizon. Lastly, the U.S. is less than 60 days from a presidential election where a shift to a new party may have notable economic implications. Overall, we expect a volatile market environment to continue for the remainder of the year, with the coronavirus and presidential election the most contentious issues over the next four months. We will continue to monitor market developments and share our views as news unfolds.

## NOTE

[1] Through market close September 8, 2020

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