Capital Market Review

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The Week Ending January 21, 2022

The risk-off sentiment continued last week as major market indices fell and the technology-dominate Nasdaq Index entered correction territory, defined as a 10% decline from its recent high. Market indexes have now declined three weeks in a row, with the S&P 500 Index falling 5.7%. Small cap and technology stocks fared worse, both falling more than 7.5% during the holiday-shortened week.

As the Federal Reserve discusses raising rates for the first time since rates were cut to zero at the onset of the pandemic, investors have been questioning the true valuation of some of the market's most expensive names. Technology stocks have been one of the hardest-hit sectors over the past three weeks, and these stocks have been the hottest sector since the market's March 2020 bottom as many benefited from the stay-at-home environment. Now the tide is turning, as investors question what the future looks like as the Fed rolls back pandemic-era stimulus.

When the Fed lowered rates and injected money into the economy, many market participants started buying everything as they viewed all stocks in similar business lines the same. The problem with that is just because a stock is publicly traded and included in an index does not means it's a good investment. Indexes contain unprofitable, speculative companies, many of which benefitted over the past 20 or so months; these companies have now become the primary drivers of the market's downturn to start the year. From September 30th through last week, unprofitable companies in the Nasdaq Index are down about 30% on average, while their profitable counterparts are only down about 1%.

Markets can become irrational at times. The current market decline is no different from a year ago when the meme stock craze began and sent many low-quality stocks well above a sustainable valuation; it's now just in the opposite direction. Markets are going through a repricing as they evaluate how we move from pandemic-induced easy policy to a rising rate environment. Companies and the economy are still growing, so using this time to rebalance portfolios and buy equities at a lower price can be beneficial for long-term success.

One of the reasons Allegheny has a long-term outlook utilizing active managers is for times like this. Just like we did not have FOMO (fear of missing out) during last year's meme stock rally, we are also not panicking when markets decline. We invest with active managers who are demonstrating the same mindset, and also those who own the quality Nasdaq companies that benefit portfolios, rather than the volatility-stimulating ones we often hear about on the news.

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