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January Update: Market Corrects as Value Stocks Outperform

The stock market fell 5.3% in January, the worst start to a year since 2009. Concerns about interest rates, inflation, overvaluation, the pandemic, earnings reports, and a possible war in Ukraine all may have contributed to the decline. Perhaps most interestingly, the month saw an unusual dispersion in performance of different types of companies. Dividend paying stocks held up best, falling 1.0%. Value stocks were down 1.5%. Growth stocks fell 10%. Many of the most speculative equities fell 30% or more.

Performance dispersion is not unusual but when it is so extreme it is worth evaluating. Certainly, with the outperformance of growth stocks in recent years it would be expected that value stocks would have a period of outperformance. But in the current period there is more going on than that because there has also been significant dispersion within the growth stock world.

To understand what has been going on it is important to differentiate between traditional growth stocks and more speculative ones. Traditional growth stocks (think Apple, Facebook or Costco) have strong products, earnings and revenues and can be analyzed using the established tools of the security analyst. (Stocks in this category can be either small or large cap). Speculative growth stocks, on the other hand, lack the financial metrics which analysts prefer. While some of them will end up becoming great companies, their lack of traditional fundamental metrics makes them subject to becoming speculative vehicles or "concept stocks" whose prices may move substantially based on investor whims. (Think Tesla or Shopify.) These are the sorts of stocks which led the bubble up in 2020, and they are the ones which are now leading the decline. (Again, some of them will end up being great companies.)

Another interesting feature of this period is that the speculative bubble has crossed asset classes. To illustrate, note that in a month when speculative stocks fell, so did cryptocurrencies, meme stocks and SPACs. All of these have been favored by speculators in recent years.

While the underperformance of speculative stocks has been going on for a year, it has received more attention in recent weeks as the trend has accelerated, and the overall market has declined as well. Sometimes the acceleration of a trend which has been going on for a long time signals it is near its end, although that is not certain to us.

What does the future hold? The last time a bubble of this magnitude burst was the Tech Bubble early in this century. In that case it took three years for the excesses of the bubble to be shaken out. If we say we are one year into the shakeout then perhaps there would be two more years of underperformance ahead. But of course, it is not that simple. In the early 2000s, there was an earnings collapse of many of the leading tech companies. As Stanley Druckenmiller has pointed out, many of the leading tech companies during that period were involved in building out infrastructure for the internet and when that work was finished their growth came to a sudden halt. That may not be the case this time. If earnings for the current group of growth stocks meet expectations, it would be expected that the current underperformance would be shorter lived.

Please feel free to call us if you would like to discuss the market or any related topic.

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