Investor Perspectives

By Mike Collopy, CFP®

January 2022

Key Observations

- Although the S&P 500 Index is only ~1% from all-time highs, the average stock is down 10% from 52-week highs and 18% from all-time highs.
- Valuations differ meaningfully among assets classes, creating mid- to long-term opportunities.
- Apple, Microsoft, Amazon, Alphabet and Tesla make up over 20% of the S&P 500 Index. They have a strong influence on the performance of the market.

S&P 500 Index Overview

The S&P 500 Index is the common benchmark to measure market performance. It is composed of 505 companies (*not 500 like you may have expected*). This index is market cap weighted, meaning larger companies make up a larger weighting of the index. For example, the performance of Apple is more impactful to the index than the performance of JP Morgan, since Apple's market cap is six times the size of JP Morgan. The index we call "the market" is not always illustrative of what is happening with many of the publicly traded companies in the US. While "the market" is near all-time highs, the average S&P 500 stock is down roughly 18% from all-time highs and 10% from 52-week highs. While the index looks healthy on the surface, there has been a breakdown within.

CHART 1	1-Day	1-Month	1-Year
S&P 500 Index Return	-0.26%	-4.48%	28.71%

**YCharts as of 12/31/2021*

The question becomes, is this weakness a concern or a buying opportunity? As shown in Chart 1, market returns were strong in 2021. In fact, it was the third year in a row where the S&P 500 Index has returned 18% or more. As we discussed on our recent Student of the Markets Webinar, when the S&P 500 Index has had three years of strong returns, the fourth year also provided strong returns.

Strong returns and valuations have investors considering the best path forward:

1. With three years of strong market returns, is this a good time to invest or stay invested?
2. Is the market too expensive to provide attractive returns?
3. Are there cheaper areas of the market?

Run of Returns

There have been several instances like the recent, where the markets have had several strong years in a row. As shown in the below chart, the fourth year was also a strong year. History would tell us that just because markets have had strong years, does not indicate that following years will be weaker. Rather the fourth year has been historically strong, from the three instances we have seen.

Other periods when U.S Stocks returned over 18% per year, for three consecutive years. *

Years	**1942**	**1943**	**1944**	**1945**
Returns	20%	26%	20%	36%

Years	**1949**	**1950**	**1951**	**1952**
Returns	19%	32%	24%	18%

Years	**1995**	**1996**	**1997**	**1998**	**1999**
Returns	38%	23%	33%	29%	21%

Years	**2019**	**2020**	**2021**	**2022**
Returns	32%	18%	29%	?

**Data from YCharts, as of 12/31/2021 and Morningstar as of 11/30/2021. U.S. stocks are represented by the S&P 500 TRIndex from 3/4/1957 to 11/30/2021 and the IA SBBIU.S. Lrg Stock TRUSD Index from 1/1/1926 to 3/4/1957.*

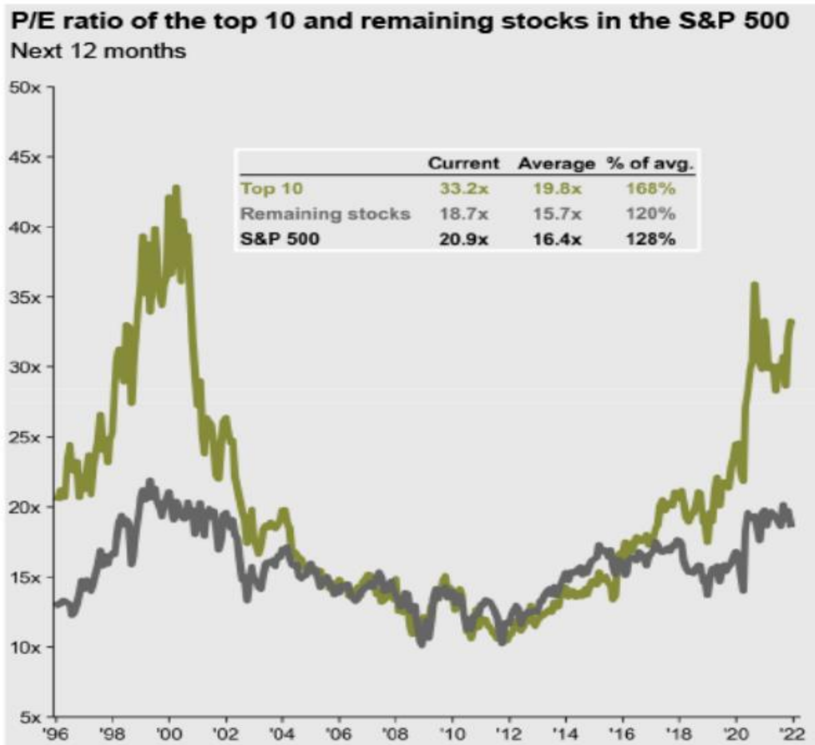
After remarkable 4-year returns (and not illustrated on this chart), the market was down approximately 11% in 1946 and 6% in 1953. Those losses seem minimal relative to the growth seen during those periods. Following five years of strong returns during the 1990s, the technology bubble occurred shortly after 1999, where the market had three years of negative returns.

When considering short-term returns, like what the markets will do next year, past performance has no indication of what to expect in the short run.

Valuations

Equity valuations are higher than their historical average, therefore, investors may believe they are unattractive. We can see in Chart 2, that valuations are elevated, but much of the elevation is due to the market's largest companies. When removing the top ten largest companies in the S&P 500 Index, the 12-month forward P/E ratio is 18.7x versus its normal average of 15.7x. Elevated, yes, but not to extreme levels.

We can also see that the top ten holdings in the S&P 500 Index had much higher valuations prior and during the technology bubble than they do now.

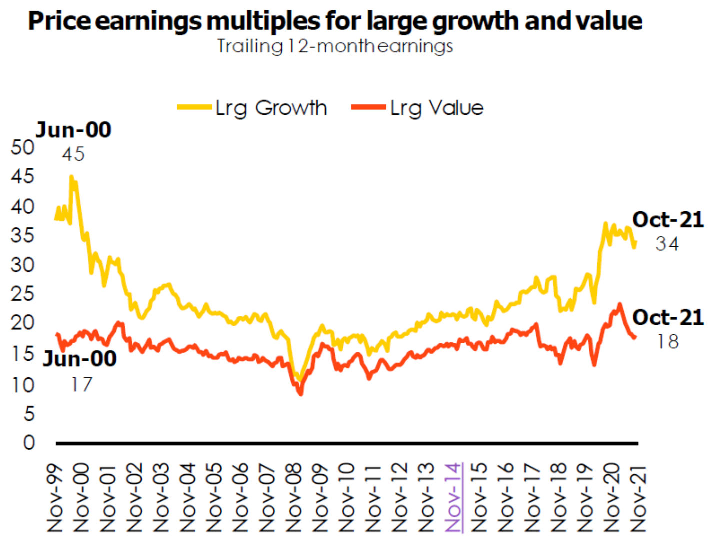


Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management

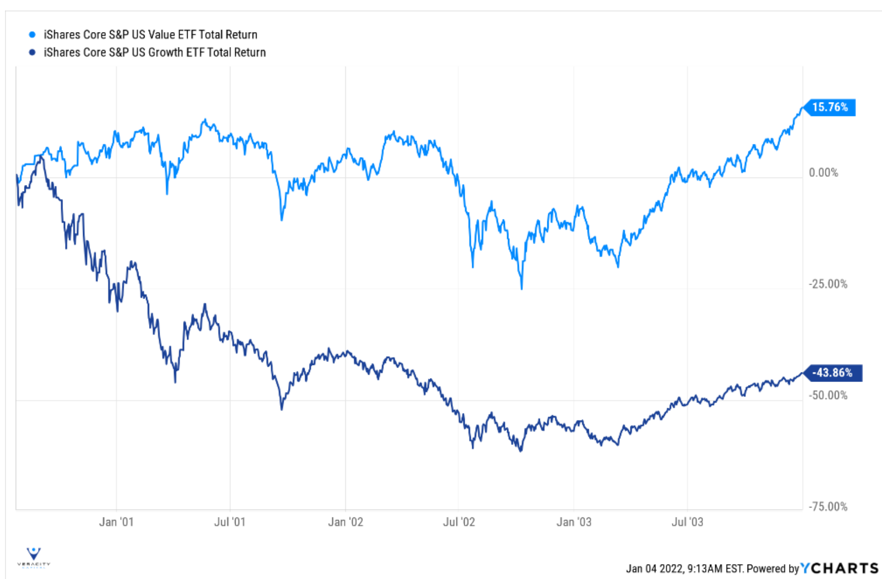
While we do not believe the markets are dangerously overvalued, investors looking for cheaper valuations may find attractive options within US value equities as well as developed international and emerging market assets classes.

Growth and Value

Using a different perspective to look at valuations, Growth and Value metrics are illustrated on Chart 3. The gap between Growth and Value is reaching levels last seen during the Technology Bubble. As shown on Chart 4, the three years following the technology bubble, Value outperformed Growth by almost 60%, returning 15.76%, while growth equities were down -43%. If a repeat of the technology bubble or valuations are a concern, diversification could help investors stay invested.



The below shows performance between US Growth and US Value Equities from 2000-2003. During that period, US Value equities outperformed US Growth Equities by approximately 60%.



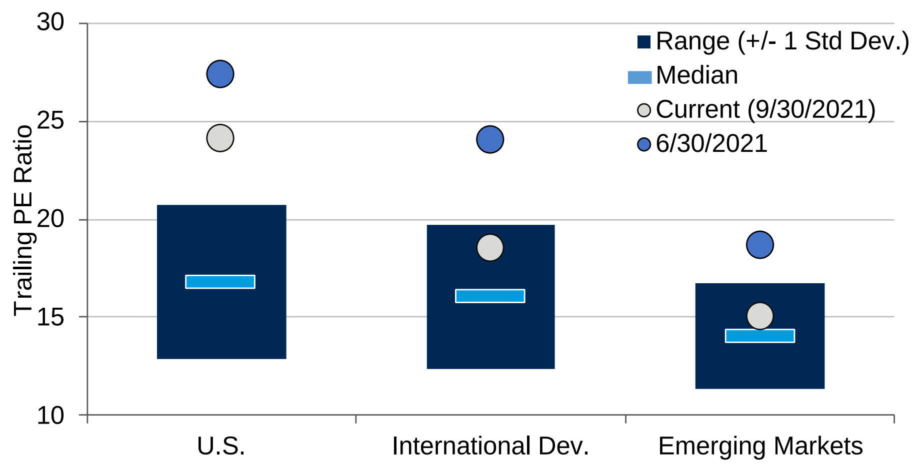
Developed International and EM Equities

To further the discussion on diversification, international equities look cheaper relative to US equities when compared to their historical averages. As shown below, Emerging Market Equities have a valuation that is consistent with their 15-year average. Developed International Equities are just slightly more expensive than their historical average.

Underperformance of International equities versus US equities has led investors to be underweight in the assets class. But from a valuation standpoint, these equity asset classes appear more attractive which warrants attention.

Equity Valuations (Trailing 15 Years)

While valuations remain somewhat elevated relative to historical norms, underlying company earnings have proven resilient, which has helped investors rationalize current price levels.



Source: FactSet, Standard & Poors, Thomson Reuters,
J.P. Morgan Asset Management Guide to the Markets - U.S. Data are as of June 30, 2021.

Purchasing Power and the End Game

Investing is an endeavor to increase the purchasing power of your wealth. This helps you achieve your goals. Too often we see investors swayed by a forecast or crystal ball depiction that leads to market timing and other bad behaviors.

It can be challenging to diversify into value and international equities, while technology stocks steal the show. Others may find it challenging to keep an allocation to technology when valuations seem stretched. But the data, history and several factors suggest that staying invested and diversified are the common principal that will help investors build wealth.

Build a plan that focuses on your goals. Follow that plan. Rebalance and adjust, as needed. This increases the probability of success over the long term.

For more information, please reach out to any of the professionals at Veracity Capital.

About Mike

Mike Collopy, CFP® is a financial advisor and Partner at Veracity Capital, LLC, a registered investment advisor firm founded on the premise of providing conflict-free financial and investment advice. With over a decade in the field, Mike strives to help clients achieve their goals, through investment management and financial planning. Mike's philosophy is that financial planning should drive investment decisions, as the true benchmark is a client's personal goals. Mike primarily works with clients who receive equity compensation through their employer, are planning to transition to retirement, or are already retired. To learn more about Mike, connect with him on LinkedIn.

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