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MARKETS

Tech Stocks Are Back in the Market's Driver's Seat

Behind the shift are expectations that inflation will eventually fall and the Fed will pare back the pace of interest-rate increases

By Pia Singh Follow *and Hardika Singh* Follow

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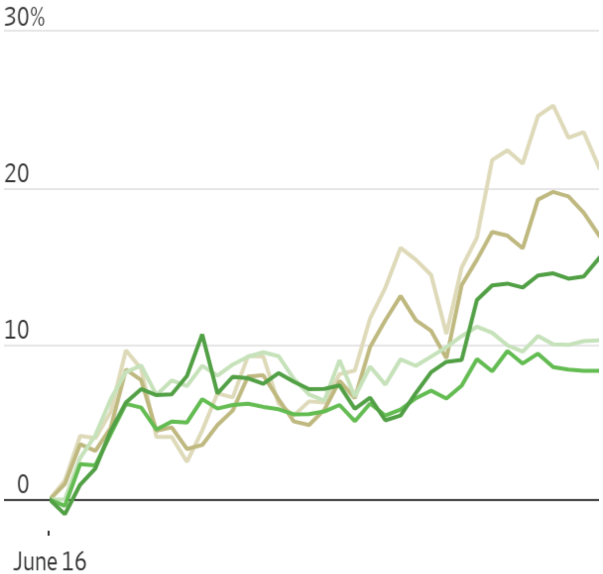
Some familiar stocks have reclaimed their place at the top of the market's leaderboard.

The technology and consumer discretionary segments of the S&P 500 have propelled the broader market's rally from its 2022 low in mid-June. That marks a reversal from much of the year when investors took shelter in utilities, consumer staples and healthcare stocks.

Defensive sectors versus tech and consumer discretionary since June 16

- Utilities
- Consumer staples
- Healthcare
- Information technology
- Consumer discretionary



Note: Data through Aug. 9.
Source: FactSet

The tech and consumer discretionary groups—home to the likes of Apple Inc., Microsoft Corp., Amazon.com Inc. and Tesla Inc.—have climbed 17% and 22%, respectively, since June 16, outperforming the three defensive groups. The index itself has risen 12%, trimming its losses for the year to 14%.

Behind the U-turn? Expectations that inflation will eventually fall and the Federal Reserve will pare back its aggressive pace of interest-rate increases. Friday's employment report suggested the U.S. economy isn't cooling as quickly as feared, with both job growth and wage gains topping estimates. Plus, a bounce is typical after a particularly punishing stretch in markets.

"Recession fears have been kicked down the road," said Eric Wightman, senior wealth adviser and partner at Maryland-based XML Financial Group. Mr. Wightman trimmed his exposure to staples and healthcare stocks in July, rotating into tech stocks.

Data Wednesday showed U.S. inflation eased slightly in July but remained near a 40-year-high. Consumer prices rose 8.5% from a year earlier last month, compared with 9.1% annual growth in June. Fed officials have said they want to see inflation ease meaningfully before taking their foot off the pedal on rate increases.

U.S. stock futures surged after the inflation data. Futures for the tech-heavy Nasdaq-100 rose 2.2% in premarket trading, futures tied to the S&P 500 added 1.6% and contracts for the Dow Jones Industrial Average gained 1.1%.

The rotation in the stock market coincides with a steady decline in government bond yields. The yield on the benchmark 10-year Treasury note touched an 11-year high of 3.482% on June 14. Lower yields have relieved some of the pressure on tech stocks, which are valued on their future cash flows.

The yield on the benchmark 10-year U.S. Treasury note fell to 2.692% from 2.797% on Tuesday, according to Tradeweb. Yields fall as prices rise.

Apple and Amazon have both climbed more than 25% in the past seven weeks, reasserting their dominance after helping to propel the market's rally for more than a decade.

Index performance

Source: FactSet

As the stock market slumped to start the year, investors piled into defensive stocks because consumers typically give priority to spending on utility bills, household goods and medical expenses ahead of discretionary items during a recession.

Their hefty dividends yields were another draw. The utilities sector offers a 2.97% yield, followed by consumer staples at 2.58% and healthcare at 1.66%. The yield on the index as a whole is 1.61%

Now, the haven rally is coming under pressure. The worst-performing decile of stocks in Russell 1000—which tracks the largest 1,000 public companies—from the first half of the year are up more than 32% in recent weeks. The stocks that held up the best, in contrast, have risen less than 3%, according to Bespoke Investment Group.

Mr. Wightman trimmed his positions last month in companies related to consumer goods, snacks and beverages, pharmaceuticals, and healthcare and insurance.

He boosted stakes in tech stalwarts, among others. He pointed to their lower valuations, the stability of their business and the allure of higher future cash flow. He hasn't bought shares of speculative growth companies, he added.

Likewise, Chris Zaccarelli, chief investment officer for Independent Advisor Alliance, said his firm is staying clear of utility and consumer-staple stocks. It has boosted its stake in small and midcap tech companies in the past month after cutting its exposure in late 2021 when it believed some were too expensive or risky to own.

"If we do have a recession, they're [staples and utilities] unlikely to gain much more from here because they're already so expensive," Mr. Zaccarelli said. "If it turns out we don't have a recession, I think they have much further to fall."

The S&P 500 utilities sector traded recently at 20.47 times its projected earnings over the next 12 months, according to FactSet, while consumer staples traded at 20.82 times earnings. That is above the average multiples of 17.25 and 19.10, respectively, over the past 10 years.

Of course, some investors haven't been swayed by the recent rebound in tech stocks. Sandi Bragar, chief client officer at wealth management firm Aspiriant, said her firm has shed much of its holdings in tech and other growth stocks over the past five years. Instead, she said they have invested in small-cap companies and value stocks in emerging markets.

"We think that the stock market as a whole, but especially growth stocks, in the U.S. primarily, but also outside, are just too overvalued at this point still," Ms. Bragar said.

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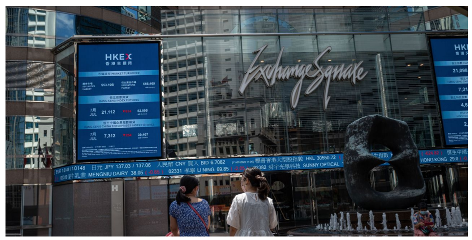

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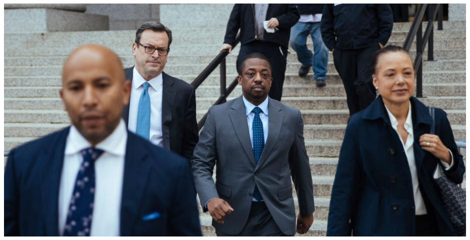

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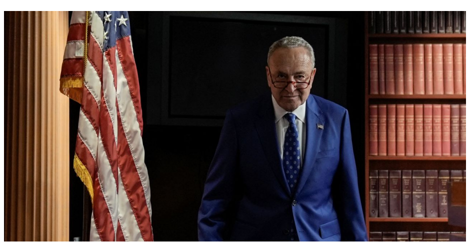

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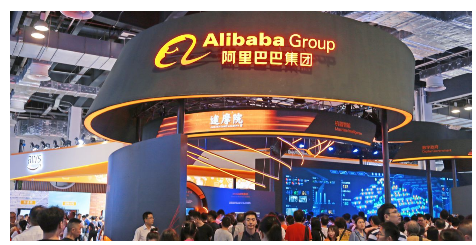

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