ASK THE **ADVISERS**

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Time to Adjust Portfolios?

In 2021, U.S. stocks notched a third straight year of gains. From 2019-2021, the S&P 500 has more than doubled (up 100.4%), its highest 3-year return since 1997- 1999. However, it was the growth stocks that were responsible for most of the gains.

The Vanguard Growth Fund (VUG) gained 138.24% during those three years while the Vanguard Value ETF(VTV) gained only 48.66%. During COVID-19 when people were staying at home the traditional value stocks were impacted negatively. Conversely, many growth stocks, which are dominated by technology companies, benefited from the pandemic and the innovative technologies that thrived when people stayed at home.

Additionally, when the pandemic started, the Federal Reserve printed trillions of dollars - and cut rates even further - to help prop up the economy which served as an additional tailwind for growth stocks. Valuation of growth stocks is based more on distant future cashflows. Lower interest rates result in a higher present value of those future cash flows. However, the Fed has indicated that it will raise rates by March.

Despite Omicron, people are returning to work and traveling, and the expectation is that this trend will continue. Because of this, many of the “stay at home” growth stocks like Peloton (PTON) and Zoom (ZM) have given back much of their pandemic gains. Additionally, since inflation has been higher (hitting 7% in December), the Federal Reserve is widely expected to raise rates 3 or 4 times in 2022.

Through the first half of January, the 10- year treasury has risen from 1.52% to 1.78%. As expected, growth stocks have reacted poorly to that. For the first two weeks of the year, the growth-oriented Nasdaq-100 was down over 5% while the Vanguard Value Index was up 1.8%.

If the 10-year treasury rises to 2.5% over the next year as many analysts expect, it could be a rough time for growth stocks. Since the S&P 500 is overweighted towards growth companies, the index will likely perform poorly if growth stocks finally underperform. If your portfolio has become overweight in growth and tech stocks, it may be time to rebalance.