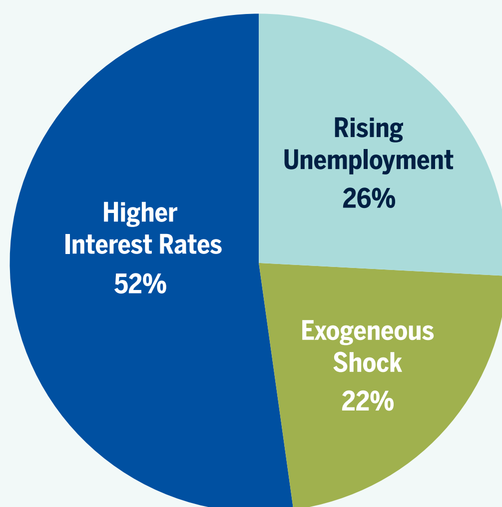
Why Stocks Fall

Since Alger's founding in 1964, there have been 27 S&P 500 index corrections of 10% or greater. During this time, data from Piper Sandler observed that each market correction had at least one of three main catalysts, 1) higher interest rates; 2) rising unemployment; or 3) a global (exogenous) shock. Are we due for a market correction and what could history tell us about the next one?

Causes for S&P 500 Corrections Greater than -10% Since 1964



Source: Piper Sandler, Standard and Poor's and Alger for the period 3/31/1964 through 3/31/2024.

- In the chart above, the majority of stock market corrections have historically been triggered by rising interest rates, averaging a 16% decline. Rising unemployment, though less frequent, often coincides with economic recessions and more severe corrections, with an average decline of 36%. Exogenous shocks—or those events outside the U.S. economy such as the Asian Financial Crisis and Euro Debt Crisis, are the rarest causes but have still led to significant corrections, averaging a 19% fall.
- During the 1970s and 1980s, higher interest rates contributed to all market downturns, although this did lead to higher unemployment. However, this pattern of higher interest rates shifted in the 1990s and 2000s due to a structural decline in rates and the adoption of zero interest rate policies after the Global Financial Crisis, making rate hikes less of a catalyst for market corrections. However, in the post-pandemic era, rising interest rates have become a considerable risk to equity markets, in our view.
- While the leading candidates for the next correction could be a continuation of higher-than-anticipated inflation or escalating conflicts in the Middle East, we believe the Federal Reserve remains on track to ease monetary policy, and of course, we hope that the current geopolitical conflicts do not spread. Should interest rates begin to decline, we believe this macroenvironment may help small cap growth stocks' relative performance, particularly given their lower valuations on price-to-earnings basis[1] and faster estimated earnings growth than large caps over the next few years[2] (see our note on Small Cap Sensitivity).

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[1] As of February 29, 2024, the S&P SmallCap 600 Growth Index was trading at a 22% discount to the S&P 500 Index on a P/E basis, despite historically trading at an 11% premium. The historical average was calculated from September 1998 through February 2024 on a monthly basis.

[2] As of 12/31/23, consensus cumulative EPS growth for the Russell 2000 Growth Index is estimated to grow 92% through 2026, while the S&P 500 is estimated to grow 43%.

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Earnings per share (EPS) is the portion of a company's earnings or profit allocated to each share of common stock.

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