The S&P 500 is Not the Economy

December 2. 2022

One of the biggest misconceptions investors have is the notion that investment markets are directly tied to the health of the economy. In other words, these two subject matters should perfectly correlate.

Technology stocks make up nearly 24% of the S&P 500. And that number is probably understating things since many of the biggest companies aren't technically in the tech sector.

Amazon and Tesla are two of the biggest holdings in the consumer discretionary sector.

Facebook, Google and Netflix are in the communications sector.

Many of these companies are now such a part of our lives that it's difficult to classify them in just one sector, but you could make the case that technology stocks make up more like one-third of the S&P 500.

We're now seeing mass layoffs in these companies that are so embedded in our daily lives and such a big part of the stock market:

Meta Lays Off More Than 11,000 Employees

The parent of Facebook, Instagram and WhatsApp reduced its

TECH

Amazon reportedly plans to lay off about 10,000 employees starting this week

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Tech companies have laid off over 120,000 employees this year. Here's how their severance packages compare

BY PAOLO CONFINO
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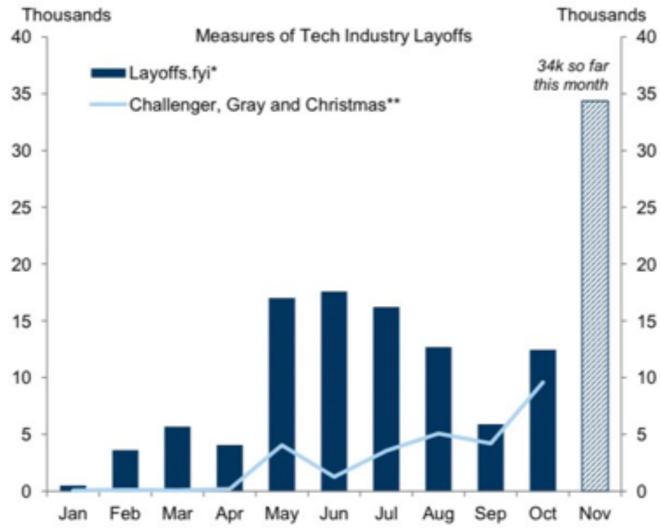
Elon Musk's Twitter lays off employees across the company

This seems like it must be worrisome for the rest of the economy…right?

I suppose we could be looking at a canary in the coal mine situation where this is the first domino to fall but the tech industry isn't nearly as important to the overall economy as it is to the stock market. In fact, Carl Quintanilla pointed out a research note from Goldman Sachs last week that put the tech layoffs into perspective.

Exhibit 1: Several High Profile Tech Companies Have Announced Layoffs in November



*Global **US-based companies only

Notable November Tech Layoff Announcements		
Company	**Date**	**Number of Layoffs**
Meta	9-Nov	11,000
Amazon	14-Nov	10,000
Twitter	4-Nov	3,700
Salesforce	7-Nov	1,000
Stripe	3-Nov	1,000
Redfin	9-Nov	862
Lyft	3-Nov	700
Opendoor	2-Nov	550
Sema4	14-Nov	500
Juul	10-Nov	400
Zendesk	7-Nov	350
Booking.com	1-Nov	226
Chime	2-Nov	156
AvantStay	9-Nov	144
Upstart	1-Nov	140
Coinbase	10-Nov	60
SoundHound	10-Nov	45
Total		**34k**

Source: layoffs.fyi, Challenger, Gray, & Christmas, Data compiled by Goldman Sachs Global Investment Research

Even in the unlikely scenario where every single worker in internet publishing, broadcasting and web search were all laid off immediately, the unemployment rate would rise by less than 0.3%. In fact, technology only makes up 2% or so of the entire U.S. labor force.

Part of this is because technology companies are more efficient. They don't need as many employees as a steel mill. But this mismatch also stems from the fact that the stock market is different than the economy in many ways. Check out this simplistic chart that shows the difference in composition between the S&P 500 and the U.S. economy in the form of earnings and economic growth:

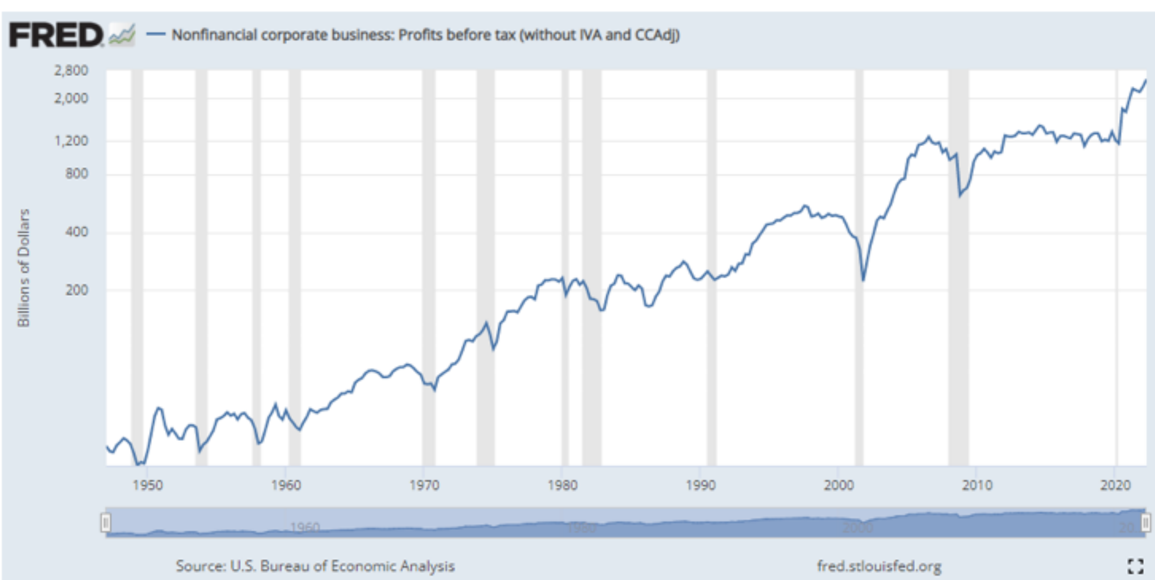
The S&P 500 is more about the manufacture and sale of goods. U.S. GDP is more about providing services.

The stock market is mostly corporations that make and sell things.

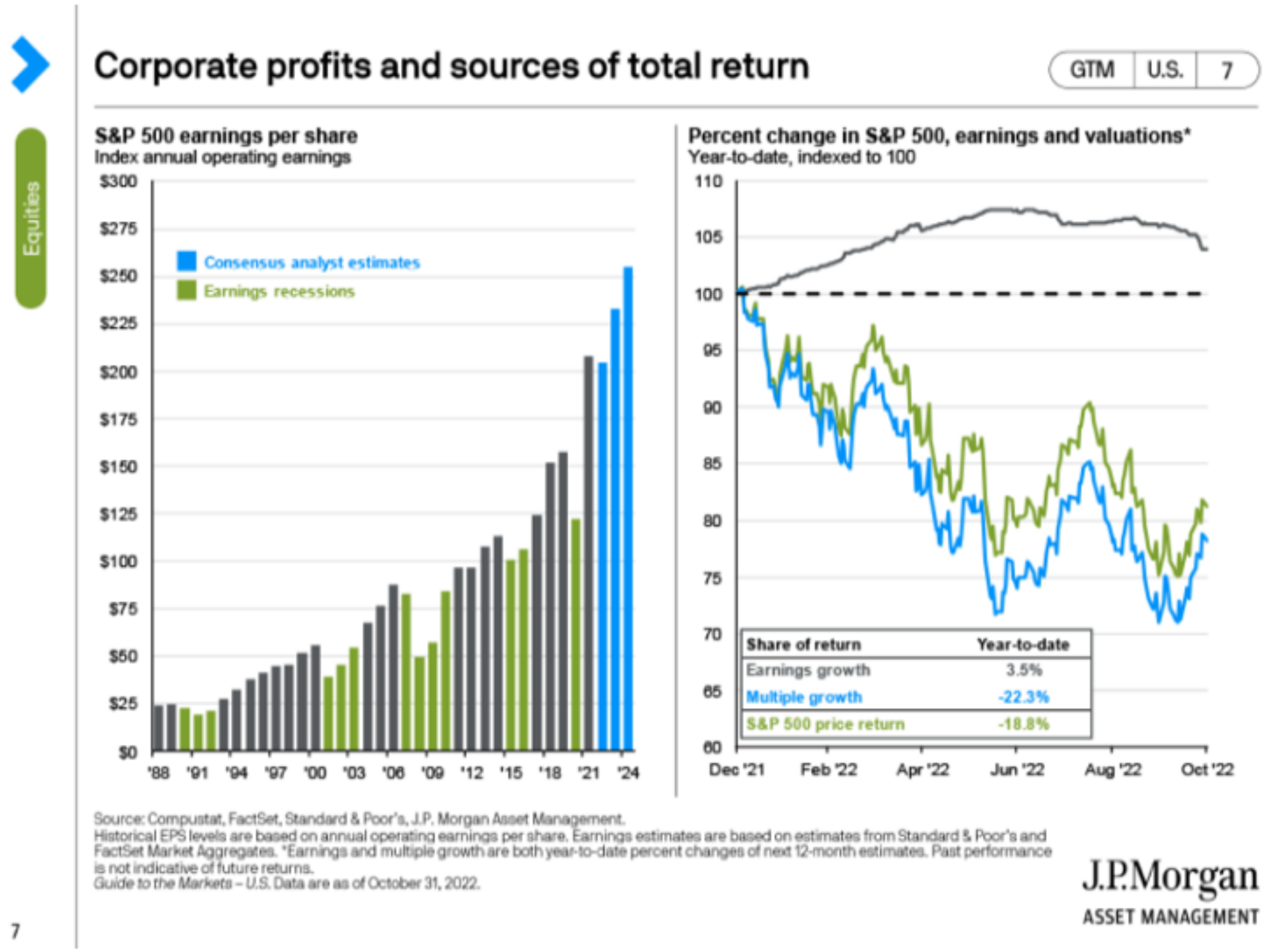
The economy is mostly the stuff we do with those things.

Most of the time the stock market and the economy are moving in the same direction, but they also diverge on occasion. The S&P 500 also receives roughly 40% of revenues from overseas. For tech stocks, that number is closer to 60%.

Profits for the broader economy continue to hit all-time highs:



The same is true for the stock market this year:



Unfortunately, investors aren't willing to pay as much for those profits this year because inflation and interest rates are higher. Sometimes investors pay a high multiple of corporate profits and sometimes they pay a low multiple.

The same is true of economic growth.

Below you can see the inflation-adjusted annual returns for the U.S. stock market compared to real GDP growth by decade:

Decade	Real Stock Returns	Real GDP Growth
1930s	2.6%	0.5%
1940s	7.2%	5.8%
1950s	14.3%	4.2%
1960s	5.3%	4.5%
1970s	0.7%	3.2%
1980s	9.1%	3.1%
1990s	14.5%	3.1%
2000s	-1.0%	1.9%
2010s	12.0%	2.2%

Sources: NYU, FRED

Economic growth was higher in the 1940s, but stock market returns were higher in the 1950s.

Real GDP growth was basically the same rate in the 1970s, 1980s and 1990s. Yet the stock market was awful in the 1970s and terrific in the 1980s and 1990s.

Growth has been subdued in each of the first two decades of this century. One of those decades experienced phenomenal stock market performance while the other was dreadful.

Sometimes the stock market takes its cues from the economy.

Sometimes the stock market decides to do its own thing.

I don't know what's going to happen with the economy in 2023. I wouldn't be surprised by continued growth or a recession. But even if you had a crystal ball that foretold which one of those scenarios was coming in the new year, it probably wouldn't help you predict what's going to happen to the stock market.