CIO's outlook for continued outperformance of value company earnings is a key driver of their preference for value over growth. (UBS)

Lower rates should help growth stocks, right?

06 December 2022, 3:37 pm CET, written by UBS Editorial Team

As many observers have pointed out, over the last few years there has been a significant correlation between interest rates and the performance of growth stocks. When rates were falling in 2020 and near rock bottom levels in 2021, this was a nice tailwind for growth stocks.

As rates have skyrocketed this year, growth stock valuations have come under pressure. The logic is that the bulk of growth company cash flows are realized well into the future, so they have a longer "duration" than value stocks. In other words, the market views growth stocks as the zero-coupon bonds of the equity market.

But something seems to be shifting. Since 24 October, 10-year Treasury yields have fallen quite dramatically from 4.24% to 3.60% today. Yet, growth stocks have underperformed value stocks by over 4 percentage points. Materials and industrials have been the best performing sectors over this period. What's going on?

We think corporate profits are the answer. In the early stages of the recovery from COVID-19, growth company profits surged as companies raced to digitize their businesses and consumers flocked to e-commerce and video streaming. But over the last several months, many of these COVID-19 beneficiaries have suffered as spending shifted back to pre-pandemic activities. This is evident by looking at relative expected earnings trends between growth and value companies.

Our outlook for continued outperformance of value company earnings—despite potentially lower interest rates over the next year—is a key driver of our preference for value over growth.

Main contributors: David Lefkowitz, Nadia Lovell, Matthew Tormey

For more, see Lower rates should help growth stocks, right?, 6 December 2022.

Content is a product of the Chief Investment Office (CIO).

Important information

As a firm providing wealth management services to clients, UBS Financial Services, Inc is registered with the U.S. Securities and Exchange Commission (SEC) as an investment adviser and a broker-dealer, offering both investment advisory and brokerage services. Advisory services and brokerage services are separate and distinct, differ in material ways and are governed by different laws and separate contracts. It is important that you carefully read the agreements and disclosures UBS provides to you about the products or services offered. For more information, please visit our website at www.ubs.com/workingwithus.

© UBS 2021. All rights reserved. UBS Financial Services Inc. is a subsidiary of UBS AG. Member FINRA/SIPC.

There are two sources of UBS research. Reports from the first source, UBS CIO Global Wealth Management, are designed for individual investors and are produced by UBS Global Wealth Management (which includes UBS Financial Services Inc. and UBS International Inc.). The second research source is UBS Group Research, whose primary business focus is institutional investors. The two sources operate independently and may therefore have different recommendations. The various research content provided does not take into account the unique investment objectives, financial situation or particular needs of any specific individual investor. If you have any questions, please consult your Financial Advisor. UBS Financial Services Inc. is a subsidiary of UBS AG and an affiliate of UBS International Inc.