



MarketDesk  
Research

# Sector Investing

## Focusing on the Key Drivers of Risk

MarketDesk Research | September 17, 2020

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## Today's Main Focus

1. What are the drivers of risk and return when sector investing?
2. How to monitor these inputs as they rotate in importance?

## Table of Contents

- MarketDesk Research (MDR) Current Sector Ratings
- Historical Performance of MDR's Ratings
- Drivers of Risk & Return
- Stock Picking vs Sector Allocation
- Earnings Importance & Volatility
- MDR's Sector Research Process
  - 6 Charts We Monitor Monthly
  - First Level Drivers
  - Second Level Drivers

# About MarketDesk Research

- MarketDesk Research is on the Interactive Brokers Research Portal (\$150/month Subscription)
- MDR is an independent research firm providing **Strategic Ratings** across U.S. sectors, factors, credit and international regions as well as **Tactical Idea Generation** across industries, countries, and themes.
- Email [info@MarketDeskResearch.com](mailto:info@MarketDeskResearch.com) for a free 3-week research trial

## Strategic Ratings

MDR's longer-term strategic recommendations. Strategic positions may not necessarily be consistent with our "Tactical Opportunities."

- Long-Term Research, Rooted in Common Sense
- Time Horizon: 12-18 months
- Low Turnover
- Monthly Updates

U.S. Sectors

U.S. Factors

International  
EM vs DM

U.S. Credit

## Tactical Opportunities

Investment ideas independent of our asset allocation model. We monitor the tactical investment recommendation until the position is closed.

- Focus on Risk-Adjusted Performance
- Off the Beaten Path & Often Contrarian
- Time horizon: 3-12 months
- New ideas published weekly

U.S. Industries

Countries / Regions

Global Themes

Macro  
Rates / Commodities

Technical Ideas

# MarketDesk Research Sector Ratings

**MarketDesk Sector Ratings:** The goal of sector ratings and the following analysis is to simplify sector investing by focusing on the key drivers of risk and return. Below is a summary of our allocation views for the next 12 months. Up / down arrows indicate a positive (▲) or negative (▼) change in view since the prior monthly report.

● Underweight (UW) ● Neutral (N) ● Overweight (OW)

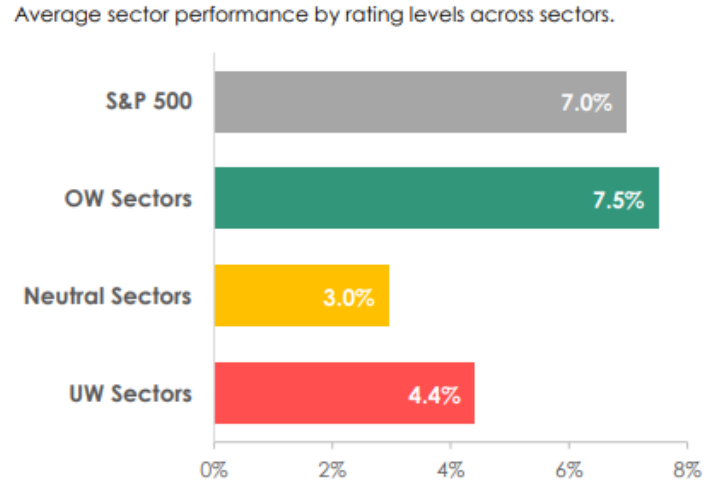
| Sector                    | Allocation View |    |   |    | Beta | Dividend Yield | Performance (%) |       |       | Asset Flows (%) |       |       | Rationale  |
|---------------------------|-----------------|----|---|----|------|----------------|-----------------|-------|-------|-----------------|-------|-------|--|
|                           | Chg             | UW | N | OW |      |                | 1M              | 6M    | 1Y    | 1M              | 6M    | 1Y    |  |
| <b>U.S. Sectors</b>       |                 |    |   |    |      |                |                 |       |       |                 |       |       |  |
| Comm Svcs                 |                 | ●  | ● | ●  | 0.87 | 0.88%          | 8.1             | 21.5  | 25.0  | 0.3             | 24.0  | 42.0  | Mixture of high growth Interactive Media & low beta Telecom; The "Stay at Home Sector"                                     |
| Tech                      |                 | ●  | ● | ●  | 1.07 | 0.97%          | 11.9            | 40.5  | 56.9  | 1.0             | 9.6   | 17.0  | Valuation composite +3std vs 5yr average (Fig 4); Technical setup is concerning (Figs 66-67), but stick with sector        |
| Health Care               |                 | ●  | ● | ●  | 0.83 | 1.49%          | 2.6             | 17.8  | 22.0  | -0.1            | 11.0  | 17.0  | Sector most likely to become "2020 election punching bag"; Strong blended EPS growth (Fig 20)                              |
| Cons Disc                 |                 | ●  | ● | ●  | 0.97 | 1.02%          | 9.6             | 30.2  | 26.8  | 2.3             | 0.3   | -5.5  | Amazon & online retailers driving the sector higher; Reliant on consumer demand; Second infection wave = Big risk          |
| Real Estate               |                 | ●  | ● | ●  | 1.12 | 3.80%          | 0.4             | -4.8  | -8.0  | -0.2            | -11.0 | -6.9  | Investors overly pessimistic in our view; Technicals present an attractive set up (Figs 132-133)                           |
| Industrials               |                 | ●  | ● | ●  | 1.07 | 1.95%          | 8.5             | 7.4   | 4.7   | 4.6             | 9.8   | 5.7   | Faces low capacity utilization & disrupted supply chain as manufacturers start / stop / re-start production lines          |
| Utilities                 |                 | ●  | ● | ●  | 0.99 | 3.28%          | -2.6            | -3.2  | -2.2  | 5.4             | 8.6   | 16.0  | Prefer Utilities over Cons Stpls as defensive play; Technicals present an attractive set up (Figs 44-45); Attractive yield |
| Cons Stpls                | ▲               | ●  | ● | ●  | 0.76 | 2.47%          | 4.6             | 14.4  | 10.7  | -0.3            | -1.0  | -1.5  | Defensive position with S&P 500 at all-time high; Risk of underperformance in Fed stimulus rally                           |
| Energy                    | ▼               | ●  | ● | ●  | 1.35 | 6.23%          | -1.1            | -18.9 | -31.0 | -5.1            | 37.0  | 37.0  | Oil demand collapse leading to dwindling storage supply and plunging prices; Long road to recovery                         |
| Financials                |                 | ●  | ● | ●  | 1.23 | 2.44%          | 4.3             | -4.6  | -4.6  | 0.8             | -2.0  | -7.3  | Low interest rates & deteriorating credit quality priced in, but loan growth stalling is not in our view                   |
| Materials                 |                 | ●  | ● | ●  | 1.04 | 1.91%          | 4.4             | 20.6  | 13.2  | -0.7            | -10.0 | -23.0 | Gold & forest products carrying sector higher; Stimulus could lead to inflation & materials provide a hedge                |
| <b>U.S. Sector Groups</b> |                 |    |   |    |      |                |                 |       |       |                 |       |       |  |
| Cyclicals                 |                 | ●  | ● | ●  | 1.05 | 1.85%          | 6.7             | 15.8  | 16.3  | 1.2             | 2.9   | 3.0   | Limited upside in our view while the economy reopens & investors assess the economic damage                                |
| Defensive                 |                 | ●  | ● | ●  | 0.86 | 2.41%          | 1.5             | 9.7   | 10.2  | 1.7             | 6.1   | 10.0  | Be prepared to quickly rotate to defensives if case counts continue to increase  |

**Performance** is total return including dividends. **Beta** versus S&P 500 Index for past 6 months. **Asset Flows** use 5 largest ETFs for each category and divide total net flows by total beginning of period AUM. **MSCI USA Defensive Sectors** include Health Care, Consumer Staples, and Utilities. **MSCI USA Cyclical Sectors** include Information Technology, Industrials, Communication Services, Consumer Discretionary, Materials, Financials, and Real Estate. Note: Energy is currently removed from defensive sectors due to the sector's idiosyncratic risk drivers.

# Ratings performance (Since Initiation on 11/30/2019)

- MDR tracks the performance of active sector ratings over the past month and since inception
- Long/Short model has returned +17.6%
- Long Only model has returned +23.3%
- S&P 500 has returned +12.8%

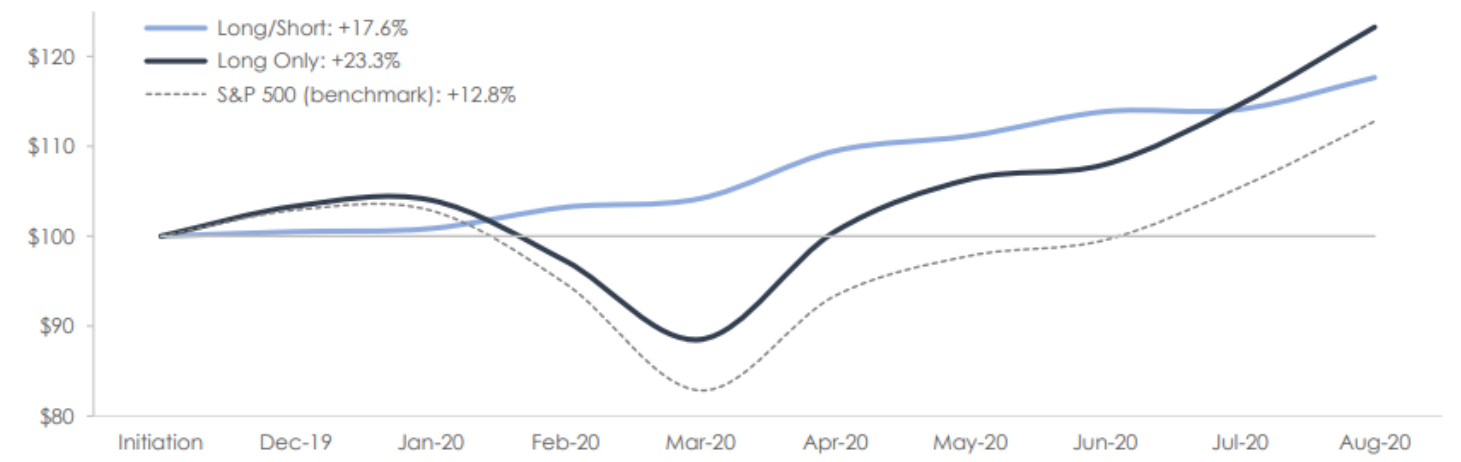
**Figure 1: Performance of MDR Ratings — August 2020**



Source: MarketDesk Research

**Figure 2: Model Portfolios Performance**

Based on equal weight total return data. Assumes long OW and short UW sectors. Returns do not include borrowing costs.



Source: MarketDesk Research. **Note:** MDR Sector Ratings began on 11/30/2019.

# Sector Performance Can Vary Drastically

Figure 3: U.S. Sector Total Returns

|         | September 2019      | October 2019        | November 2019        | December 2019        | January 2020         | February 2020        | March 2020            | April 2020          | May 2020            | June 2020           | July 2020           | August 2020         | YTD                   | 1-Year               |
|---------|---------------------|---------------------|----------------------|----------------------|----------------------|----------------------|-----------------------|---------------------|---------------------|---------------------|---------------------|---------------------|-----------------------|----------------------|
| Best ↑  | Financials<br>4.5%  | Health<br>5.1%      | Tech<br>5.4%         | Energy<br>6.0%       | Utilities<br>6.7%    | Comm Svcs<br>-5.6%   | Health<br>-3.9%       | Energy<br>30.8%     | Tech<br>7.2%        | Tech<br>6.9%        | Utilities<br>7.8%   | Tech<br>11.9%       | Tech<br>35.5%         | Tech<br>56.9%        |
|         | Utilities<br>4.2%   | Tech<br>3.9%        | Financials<br>5.1%   | Tech<br>4.3%         | Tech<br>4.0%         | Health<br>-6.6%      | Cons Stpls<br>-5.6%   | Cons Disc<br>18.9%  | Comm Svcs<br>6.9%   | Cons Disc<br>3.1%   | Comm Svcs<br>7.4%   | Cons Disc<br>9.6%   | Cons Disc<br>20.2%    | Cons Disc<br>26.8%   |
|         | Energy<br>4.0%      | Comm Svcs<br>3.0%   | Health<br>5.0%       | Health<br>3.5%       | Real Estate<br>1.2%  | Real Estate<br>-7.0% | Tech<br>-8.6%         | Materials<br>15.2%  | Materials<br>6.9%   | Real Estate<br>2.4% | Cons Disc<br>7.3%   | Industrials<br>8.5% | Comm Svcs<br>15.4%    | Comm Svcs<br>25.0%   |
|         | Materials<br>3.2%   | Financials<br>2.5%  | Industrials<br>4.5%  | Utilities<br>3.3%    | Comm Svcs<br>0.6%    | Tech<br>-7.3%        | Utilities<br>-10.1%   | Comm Svcs<br>14.4%  | Cons Disc<br>6.5%   | Materials<br>2.2%   | Materials<br>7.1%   | Comm Svcs<br>8.1%   | Health<br>7.1%        | Health<br>22.0%      |
|         | Industrials<br>3.0% | Industrials<br>1.1% | Comm Svcs<br>3.2%    | Materials<br>2.9%    | Cons Stpls<br>0.3%   | Cons Disc<br>-7.6%   | Materials<br>-14.1%   | Tech<br>13.7%       | Industrials<br>5.4% | Industrials<br>2.0% | Cons Stpls<br>6.9%  | Cons Stpls<br>4.6%  | Cons Stpls<br>5.3%    | Materials<br>13.2%   |
|         | Real Estate<br>1.9% | Real Estate<br>1.1% | Materials<br>3.2%    | Cons Disc<br>2.8%    | Cons Disc<br>-0.1%   | Cons Stpls<br>-8.2%  | Comm Svcs<br>-14.4%   | Health<br>12.6%     | Utilities<br>4.2%   | Comm Svcs<br>0.1%   | Tech<br>5.7%        | Materials<br>4.4%   | Materials<br>3.5%     | Cons Stpls<br>10.7%  |
|         | Cons Stpls<br>1.7%  | Cons Disc<br>0.1%   | Energy<br>1.6%       | Financials<br>2.6%   | Industrials<br>-0.4% | Materials<br>-8.5%   | Cons Disc<br>-15.0%   | Financials<br>9.5%  | Health<br>3.3%      | Cons Stpls<br>-0.2% | Health<br>5.5%      | Financials<br>4.3%  | Industrials<br>-3.6%  | Industrials<br>4.7%  |
|         | Tech<br>1.6%        | Materials<br>0.0%   | Cons Stpls<br>1.4%   | Cons Stpls<br>2.4%   | Financials<br>-2.7%  | Utilities<br>-9.9%   | Industrials<br>-18.7% | Real Estate<br>9.0% | Financials<br>2.7%  | Financials<br>-0.5% | Industrials<br>4.4% | Health<br>2.6%      | Utilities<br>-6.8%    | Utilities<br>-2.2%   |
|         | Cons Disc<br>1.3%   | Cons Stpls<br>-0.4% | Cons Disc<br>1.3%    | Comm Svcs<br>2.2%    | Health<br>-2.7%      | Industrials<br>-9.9% | Real Estate<br>-19.3% | Industrials<br>8.8% | Energy<br>2.0%      | Energy<br>-1.1%     | Financials<br>3.8%  | Real Estate<br>0.4% | Real Estate<br>-10.4% | Financials<br>-4.6%  |
|         | Health<br>-0.1%     | Utilities<br>-0.8%  | Real Estate<br>-1.3% | Real Estate<br>0.7%  | Materials<br>-6.2%   | Financials<br>-11.2% | Financials<br>-21.1%  | Cons Stpls<br>7.0%  | Real Estate<br>1.7% | Health<br>-2.4%     | Real Estate<br>3.6% | Energy<br>-1.1%     | Financials<br>-17.6%  | Real Estate<br>-8.0% |
| Worst ↓ | Comm Svcs<br>-0.3%  | Energy<br>-2.1%     | Utilities<br>-1.9%   | Industrials<br>-0.2% | Energy<br>-11.0%     | Energy<br>-15.3%     | Energy<br>-34.6%      | Utilities<br>3.3%   | Cons Stpls<br>1.7%  | Utilities<br>-4.7%  | Energy<br>-4.8%     | Utilities<br>-2.6%  | Energy<br>-38.8%      | Energy<br>-31.0%     |
|         | Cyclical<br>2.2%    | Cyclical<br>1.7%    | Cyclical<br>3.0%     | Defensive<br>3.1%    | Defensive<br>1.5%    | Cyclical<br>-8.2%    | Defensive<br>-6.5%    | Cyclical<br>12.8%   | Cyclical<br>5.3%    | Cyclical<br>2.3%    | Defensive<br>6.7%   | Cyclical<br>6.7%    | Cyclical<br>6.1%      | Cyclical<br>16.3%    |
|         | Defensive<br>2.0%   | Defensive<br>1.3%   | Defensive<br>1.5%    | Cyclical<br>2.2%     | Cyclical<br>-0.5%    | Defensive<br>-8.2%   | Cyclical<br>-15.9%    | Defensive<br>7.6%   | Defensive<br>3.1%   | Defensive<br>-2.4%  | Cyclical<br>5.6%    | Defensive<br>1.5%   | Defensive<br>1.9%     | Defensive<br>10.2%   |

MSCI USA Defensive Sectors include Health Care, Consumer Staples, and Utilities. MSCI USA Cyclical Sectors include Information Technology, Industrials, Communication Services, Consumer Discretionary, Materials, Financials, and Real Estate. Note: Energy is currently removed from defensive sectors due to the sector's idiosyncratic risk drivers.

# Sector Drivers of Risk & Return

## Unique Sector Drivers

- **Interest Rates** (Financials, Real Estate, Utilities)
- **Price of Oil** (Energy)
- **Price of Materials** like Copper & Steel (Materials)
- **Geopolitical** (Heavy Export Industries)
- **Gov't Regulation** (Health Care, Financials)

## Drivers Across All Sectors

- **Relative Earnings Power**
- **Relative Price Momentum**
- **Relative Valuations**
- **Investor Sentiment / Market Volatility**
- **Equity Factors** (Interest in Growth vs Value)

# Stock Picking vs Sector Allocation

- This analysis simplifies Sector Allocation into two investment regimes: stock selection and sector selection.
- The chart graphs the NTM P/E dispersion against performance intra-correlation for each sector. Both axes are standardized using z-scores based on month-end data vs the three-year moving average.
- The further a sector's value is from either axis, the stronger the implied investment regime.

Figure 14: Sector Valuation Dispersion & Performance Correlation



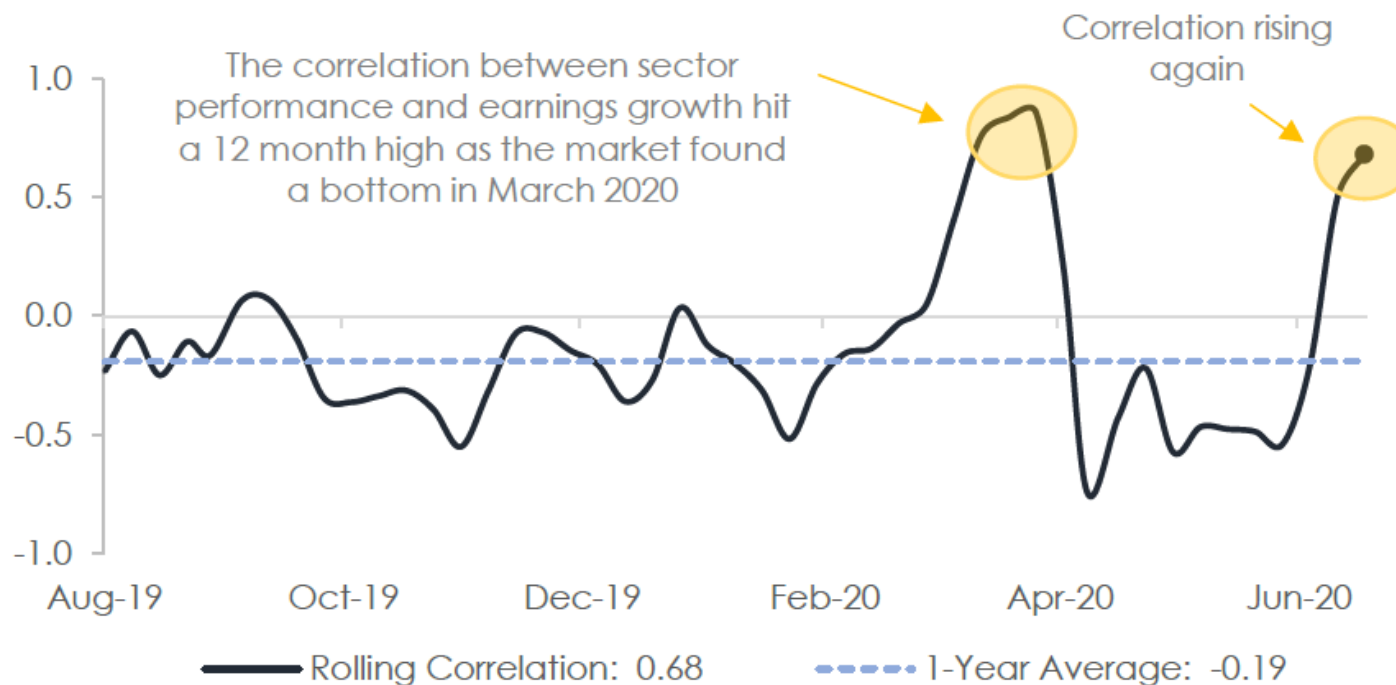
Source: MarketDesk Research. **MSCI USA Defensive Sectors** include Health Care, Consumer Staples, and Utilities. **MSCI USA Cyclical Sectors** include Information Technology, Industrials, Communication Services, Consumer Discretionary, Materials, Financials, and Real Estate. **Note:** Energy is currently removed from defensive sectors due to the sector's idiosyncratic risk drivers.



# Earnings Importance Indicator

- Charts the sector earnings importance indicator, which is measured as the rolling 3-month correlation between NTM EPS revisions and performance.
- A higher correlation indicates the performance trend is more directionally accurate based on EPS revisions.
- Earnings importance dropped in 2H2019 as the market rallied. As the pandemic took hold, earnings became more important in March. The indicator fell again as the market rallied, but surged again in June as investor focus turned back to earnings.

**Figure 21: Sector Earnings Importance Indicator**

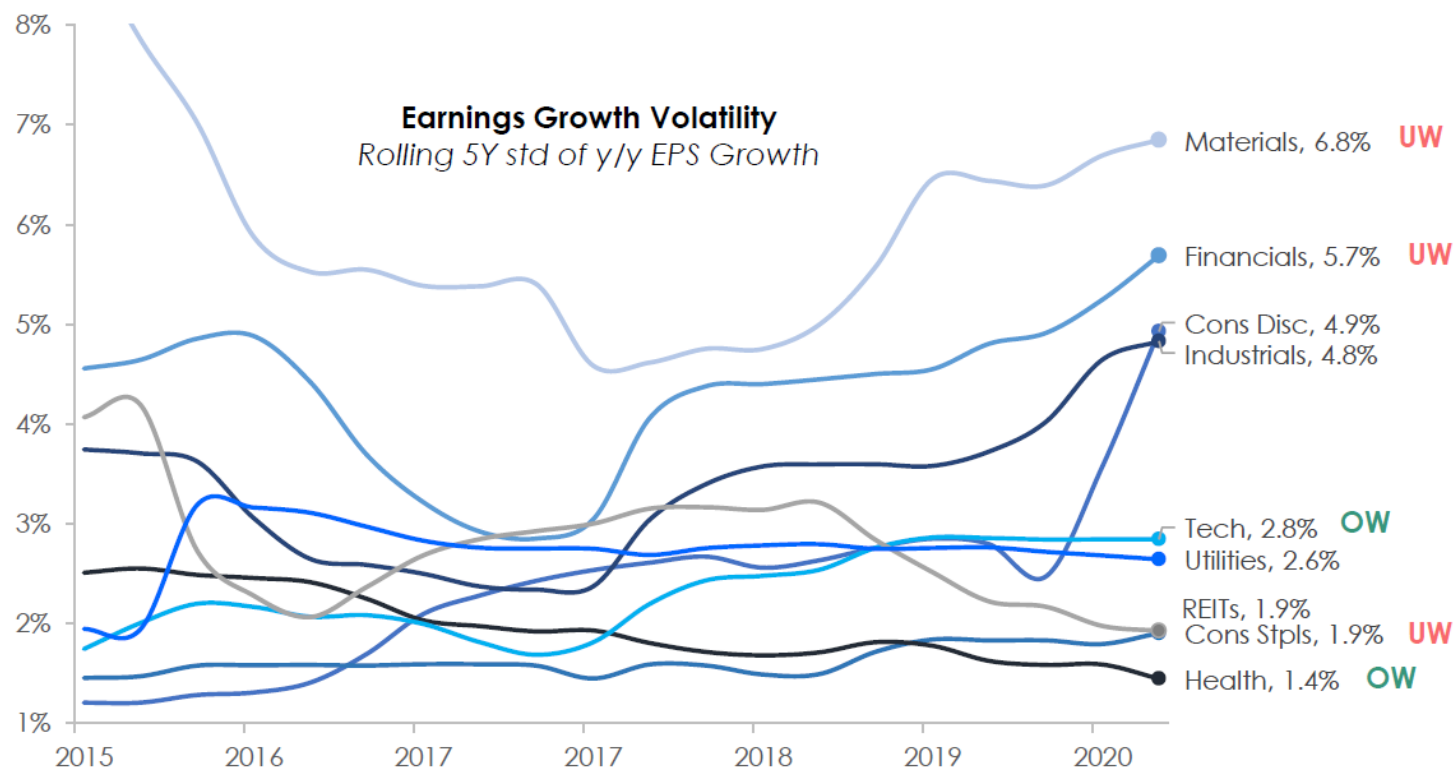


Source: MarketDesk Research

# Focus on Earnings Stability in Volatile Environment

- The graph to the right charts y/y EPS growth volatility across sectors over the past 5-years.
- EPS volatility is measured as the standard deviation, or amount of variation, in y/y EPS growth. A higher standard deviation indicates more EPS volatility and risk.
- Given the economic uncertainty, we prefer less volatile EPS growth. Tech (OW), health care (OW), and utilities (July 2020 N upgrade) exhibit less EPS volatility. In contrast, materials (UW), financials (UW), and industrials exhibit higher EPS volatility.

**FIGURE 7: Sector EPS Volatility - Consistency is Key**



Source: MarketDesk Research. **Note:** Quarterly Y/Y EPS growth based on LTM EPS at the sector level.

# MarketDesk Research Process

## First Level Drivers

- **Relative Earnings Growth**
  - Blended EPS Growth (Average of NTM & LTM)
- **Price Momentum**
  - Year over Year Sector Return
  - Year over Year Sector Return Relative to S&P 500
- **Sector Breadth**
  - % Outperforming S&P 500 LTM Returns
  - High / Low Index

## Second Level Drivers

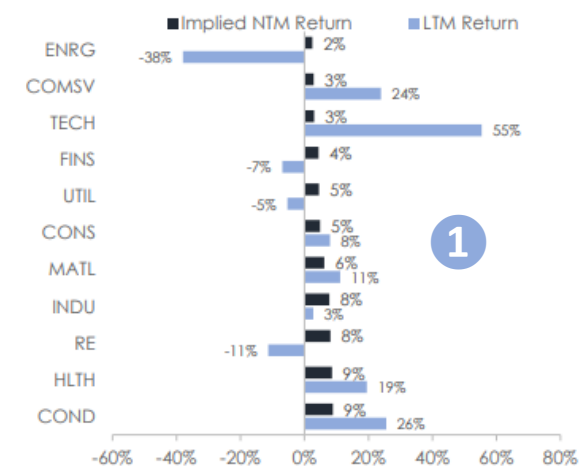
- **Relative Valuations**
  - NTM Price to Earnings Relative to S&P 500
  - Valuation Composite Relative to S&P 500
- **ETF Flows**
  - Near-term and Long-term Trends
- **Factor Drivers**
  - Largest factor driving industry performance (Value, Growth, Momentum, or Quality)

# Six Charts We Monitor Monthly

- 1 Implied NTM Returns
- 2 Technicals (% > 50dma)
- 3 EPS Revisions
- 4 Asset Flows vs Returns
- 5 Investor Positioning
- 6 Market Correlations

**Figure 8: LTM Returns & Implied NTM Returns**

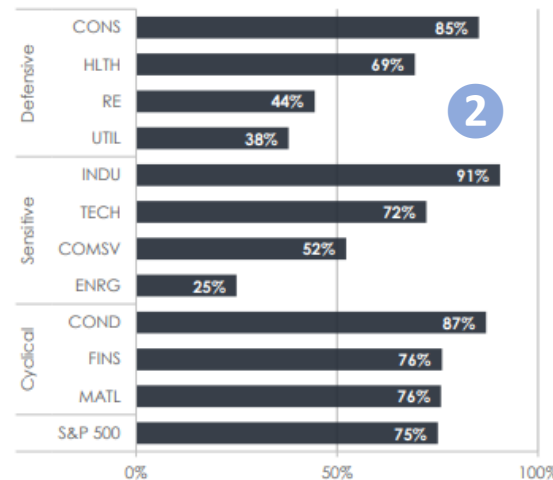
Providing a quantitative view into future sector performance, the implied NTM returns are based on regression analysis using weekly historical data since 2000.



Source: MarketDesk Research

**Figure 9: % of Index Above 50dma**

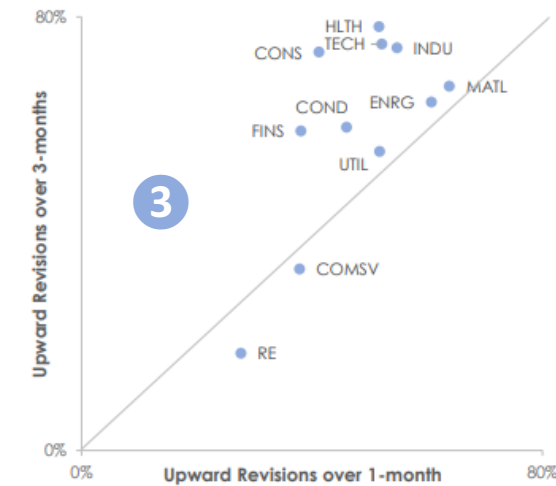
Short-term technical strength based on the percentage of companies within each sector above their 50-day moving average.



Source: MarketDesk Research

**Figure 10: % of Sector with Upward EPS Revisions**

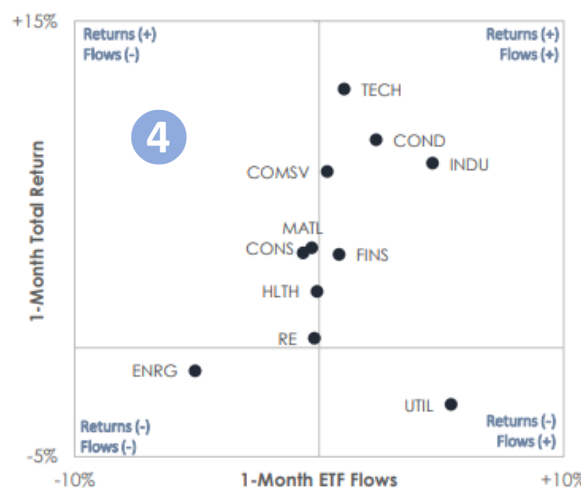
A look at the underlying breadth of upward earnings revisions across sectors over the past 1 and 3-months.



Source: MarketDesk Research

**Figure 11: 1-Month Asset Flows vs 1-Month Performance**

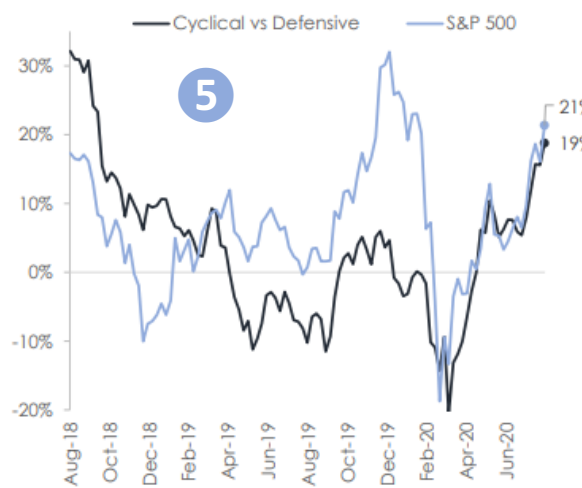
The scatter plot below highlights areas where investors are adding (or removing) capital based on recent returns.



Source: MarketDesk Research

**Figure 12: Cyclical vs Defensive Rolling LTM Returns**

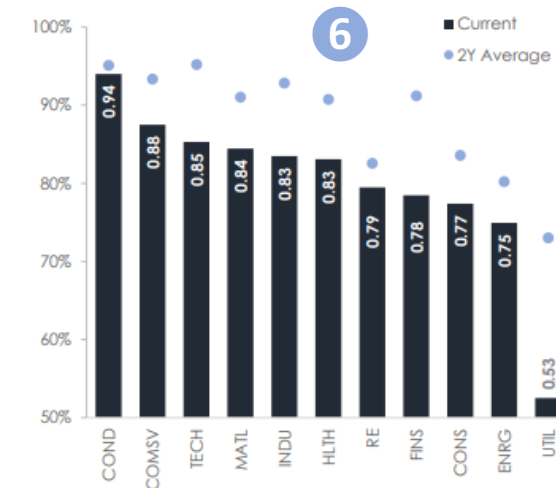
The relative performance between Cons Discretionary (Cyclical) and Cons Staples (Defensive) often leads the S&P 500.



Source: MarketDesk Research

**Figure 13: Sector Correlation with S&P 500**

The current correlation of each sector's daily movement to the S&P 500 vs its 2-year average level.



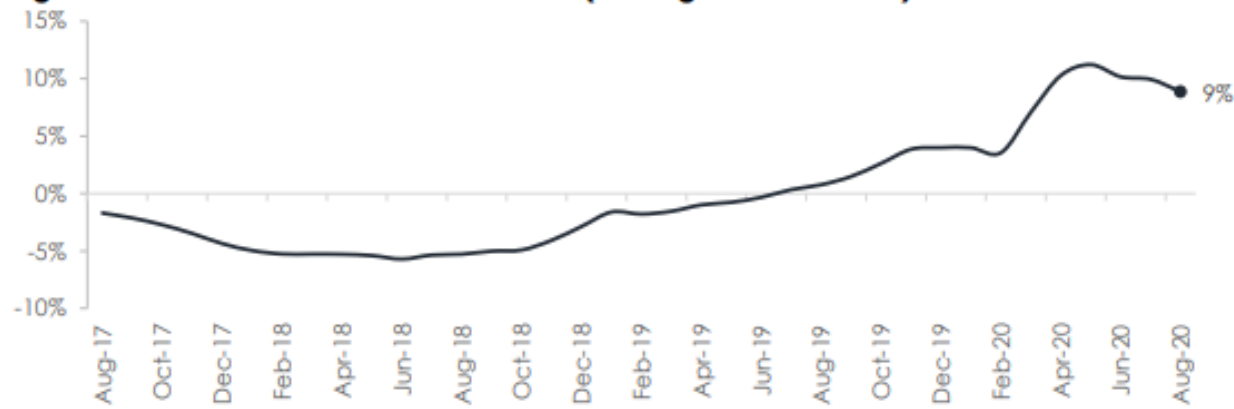
Source: MarketDesk Research

# Relative Earnings Growth

Our team focuses primarily on two areas of analysis for sector earnings:

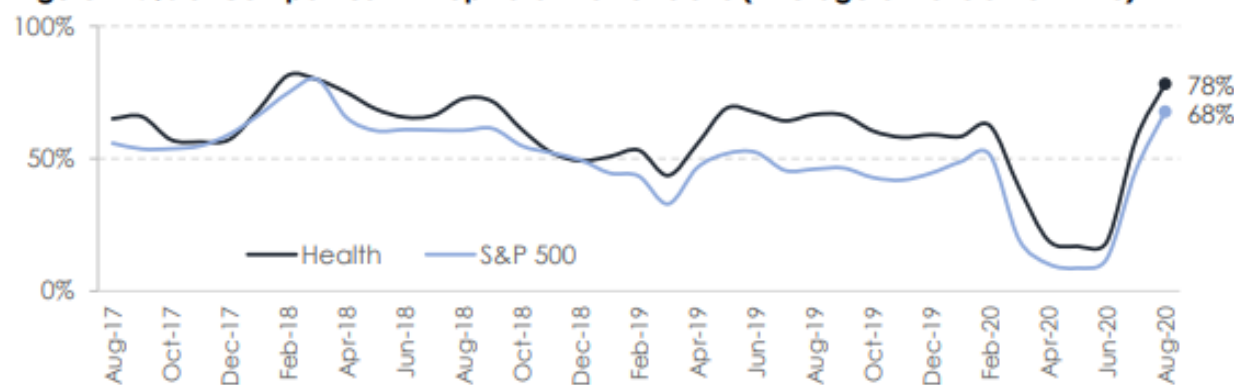
- **Relative EPS Growth vs S&P 500:** This analysis is based on blended average of LTM reported results and NTM consensus estimates. Blending these to data points (1) smooths out the results to more clearly identify the trend and (2) balances quantitative signals as some investors prefer to use historical results while others prefer to base signals on future estimates.
- **% of Companies with Upward EPS Revisions:** Our team views revisions (i.e. estimate changes from Wall Street analysts) as a leading indicator for sector health and earnings breadth. We pay attention to both the (1) direction of the trend and (2) the absolute revisions number vs the S&P 500.

**Figure 20: Blended EPS Growth vs S&P 500 (Average of NTM & LTM)**



Source: MarketDesk Research

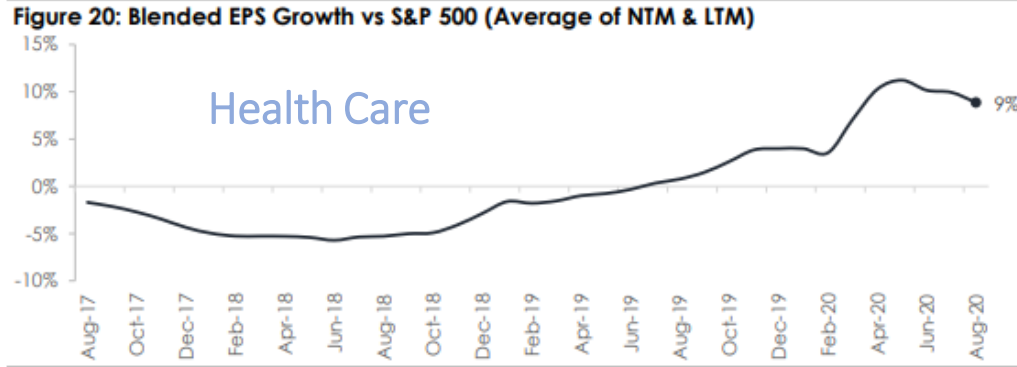
**Figure 21: % of Companies with Upward EPS Revisions (Average of 2020 & 2021 EPS)**



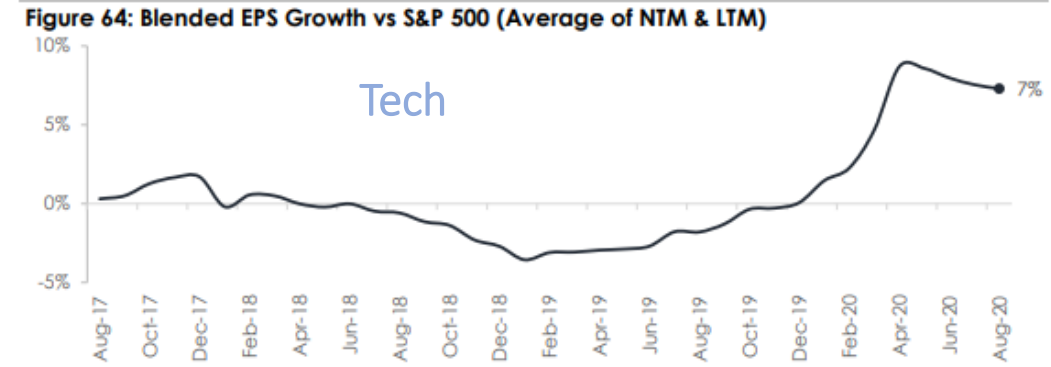
Source: MarketDesk Research

# Relative Earnings Growth – EPS Growth

Improving

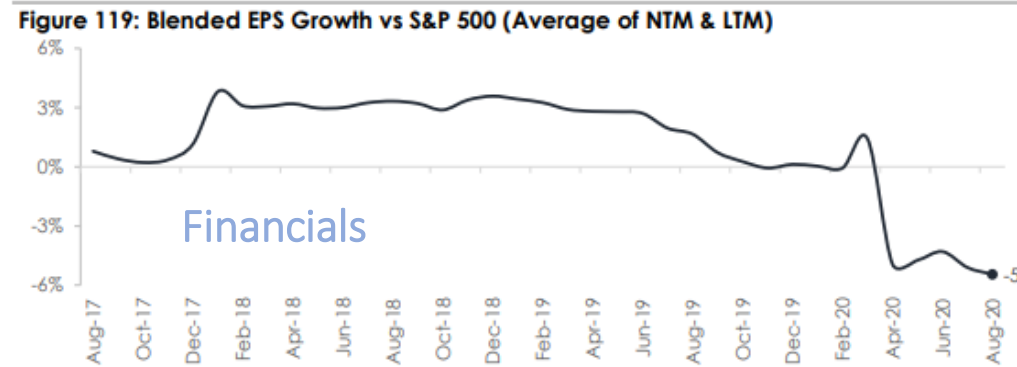


Source: MarketDesk Research

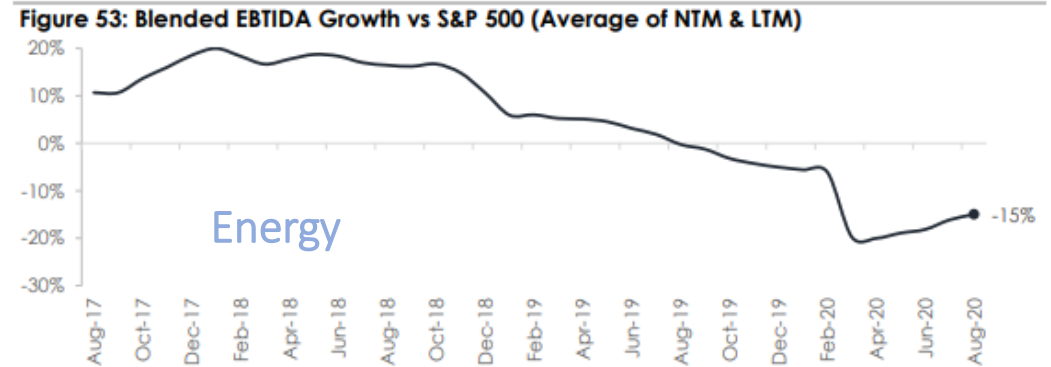


Source: MarketDesk Research

Deteriorating



Source: MarketDesk Research

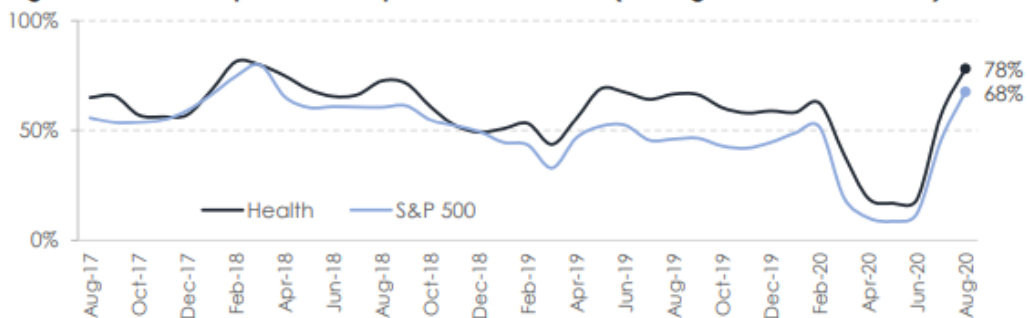


Source: MarketDesk Research

# Relative Earnings Growth – Revisions

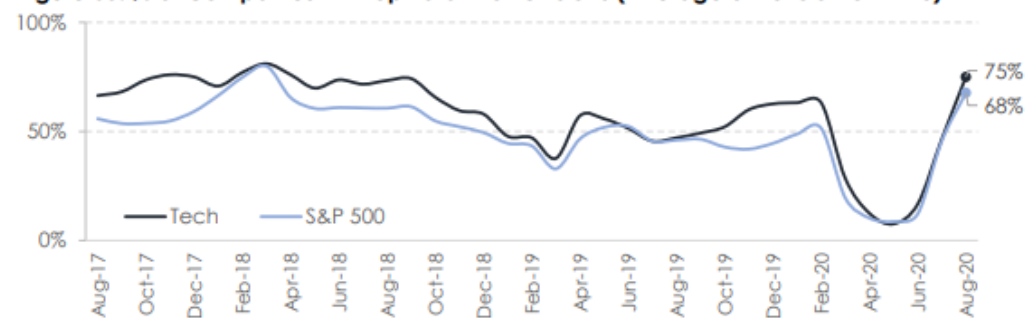
Improving

**Figure 21: % of Companies with Upward EPS Revisions (Average of 2020 & 2021 EPS)**



Source: MarketDesk Research

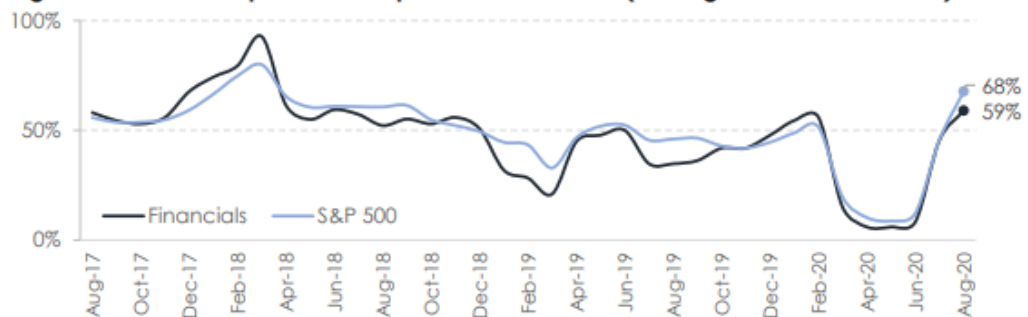
**Figure 65: % of Companies with Upward EPS Revisions (Average of 2020 & 2021 EPS)**



Source: MarketDesk Research

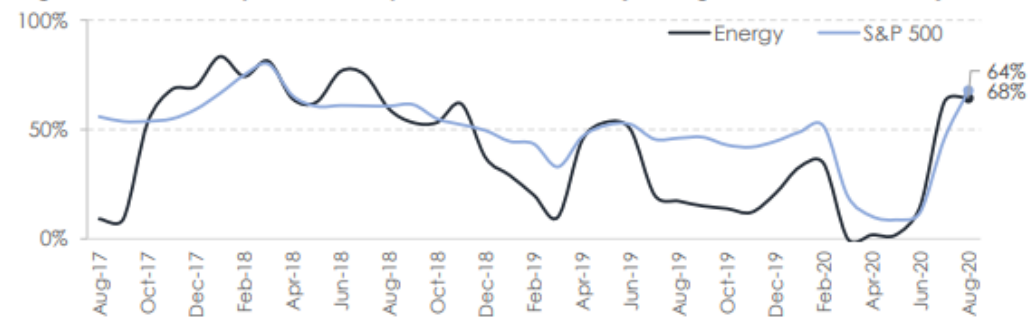
Deteriorating

**Figure 120: % of Companies with Upward EPS Revisions (Average of 2020 & 2021 EPS)**



Source: MarketDesk Research

**Figure 54: % of Companies with Upward EPS Revisions (Average of 2020 & 2021 EPS)**



Source: MarketDesk Research

# Price Momentum

Our team splits price momentum into absolute and relative year over year (Y/Y) returns. While we focus on Y/Y results for longer-term investing, you can also follow month-over-month or week-over-week returns for shorter investment horizons.

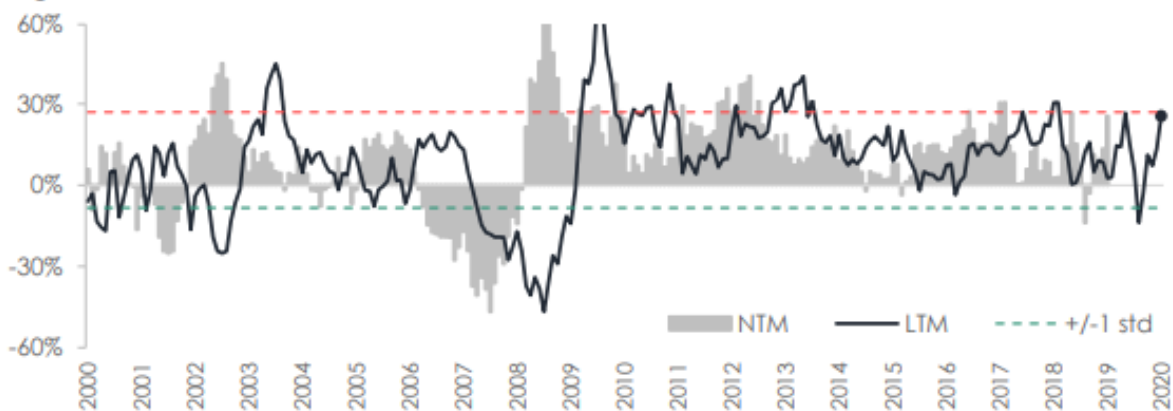
- **Multi Dimensional Analysis:**

- Y/Y returns are the perfect culmination of several areas of analysis: momentum, breadth, statistics, technicals, and reversion to the mean.
- While all investors have their preferred analysis method, Y/Y does a great job of averaging all of these indicators into a blended indicator.

- **Statistical Significance:**

- Our analysis includes standard deviation bands based on 15-years of data to highlight overbought and oversold areas.
- Between -1std and +1std accounts for expected returns ~68% of the time.
- Y/Y returns should rise over +1std less than 16% of the time. Therefore, when the Y/Y relative return reaches this point, there is a ~80-90% statistical probability it will sell off in the coming weeks.

**Figure 88: Y/Y Sector Returns**



Source: MarketDesk Research

**Figure 89: Y/Y Relative Sector Returns vs S&P 500**



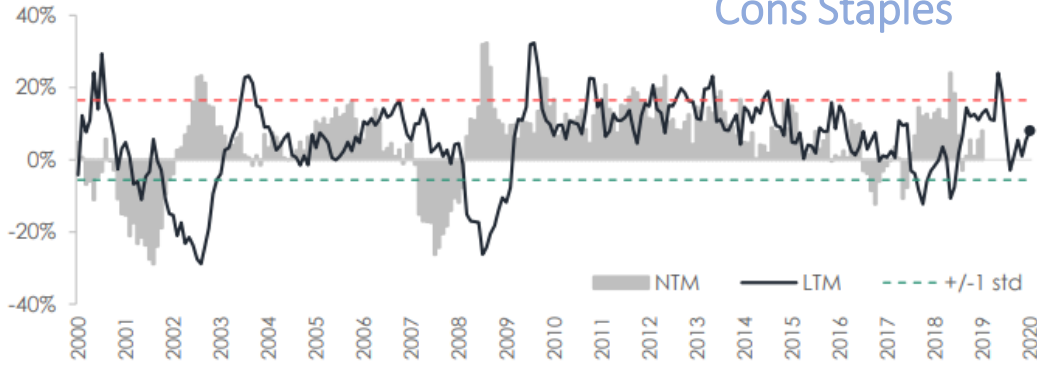
Source: MarketDesk Research



# Price Momentum – Statistical Upside

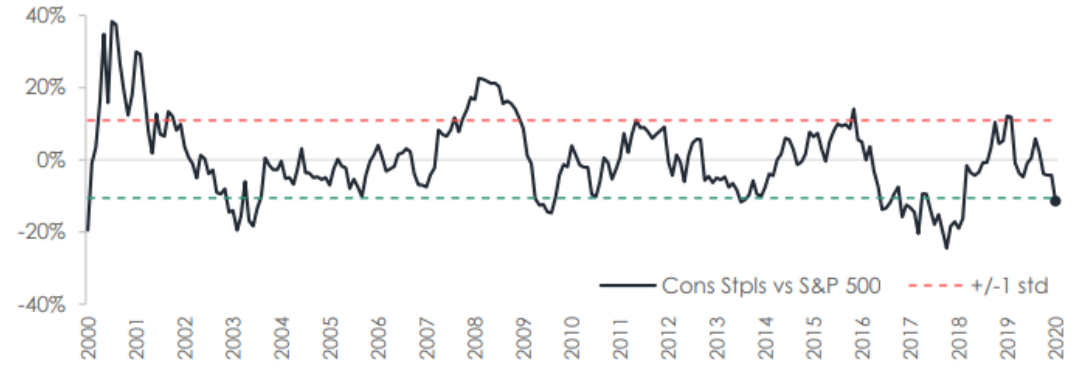
Sectors with Statistical Upside

**Figure 33: Y/Y Sector Returns**



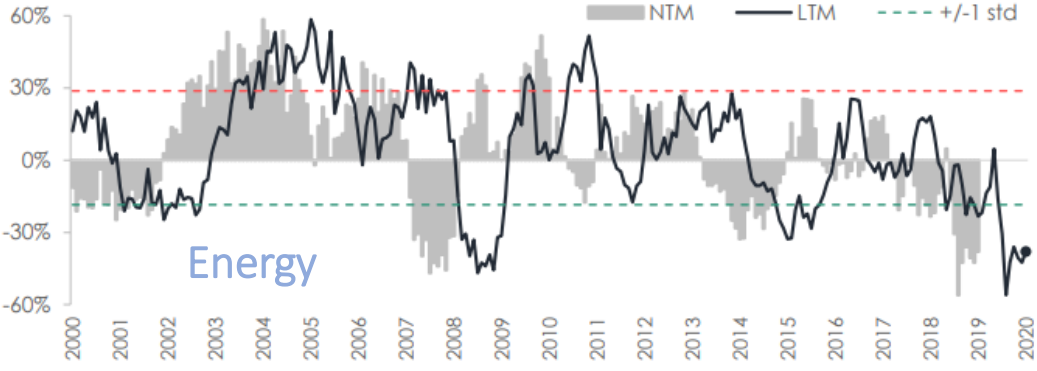
Source: MarketDesk Research

**Figure 34: Y/Y Relative Sector Returns vs S&P 500**



Source: MarketDesk Research

**Figure 55: Y/Y Sector Returns**



Source: MarketDesk Research

**Figure 56: Y/Y Relative Sector Returns vs S&P 500**

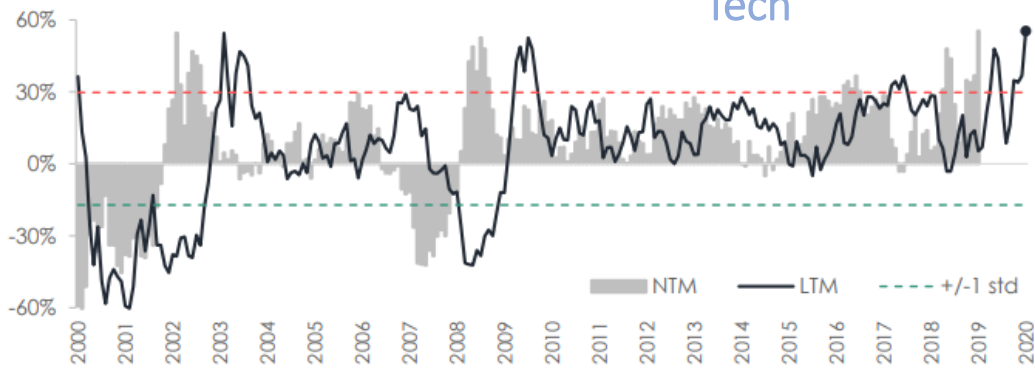


Source: MarketDesk Research

# Price Momentum – Statistical Downside

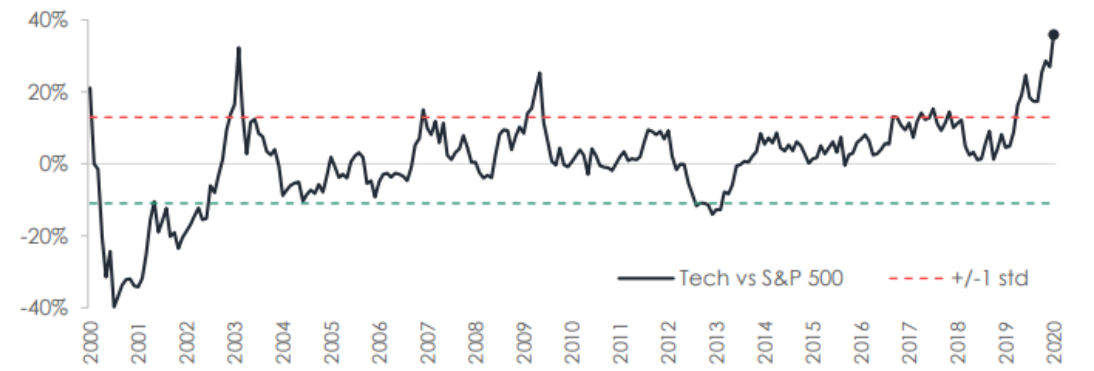
Sectors with Statistical Downside

Figure 66: Y/Y Sector Returns



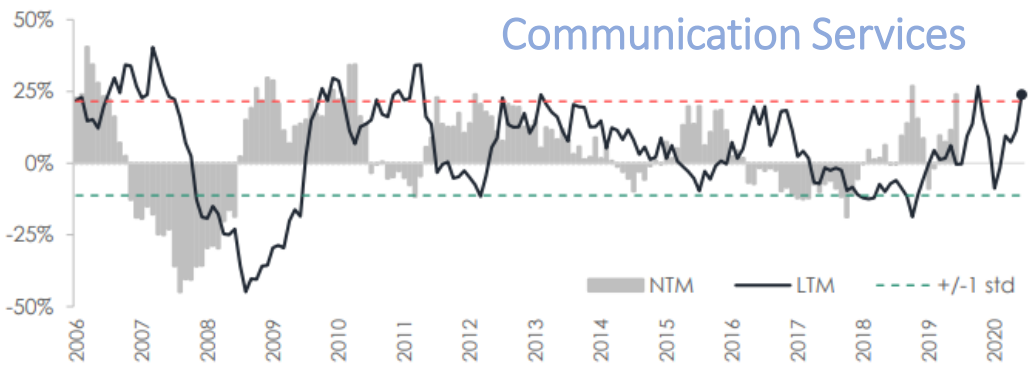
Source: MarketDesk Research

Figure 67: Y/Y Relative Sector Returns vs S&P 500



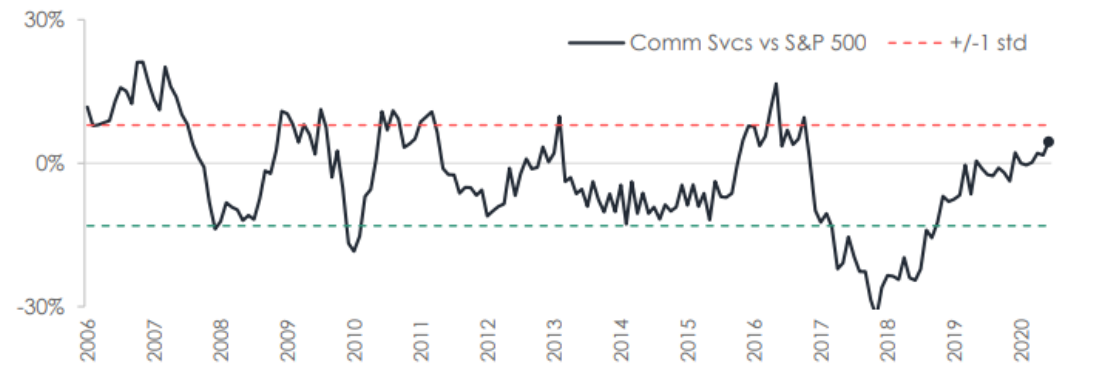
Source: MarketDesk Research

Figure 77: Y/Y Sector Returns



Source: MarketDesk Research

Figure 78: Y/Y Relative Sector Returns vs S&P 500



Source: MarketDesk Research

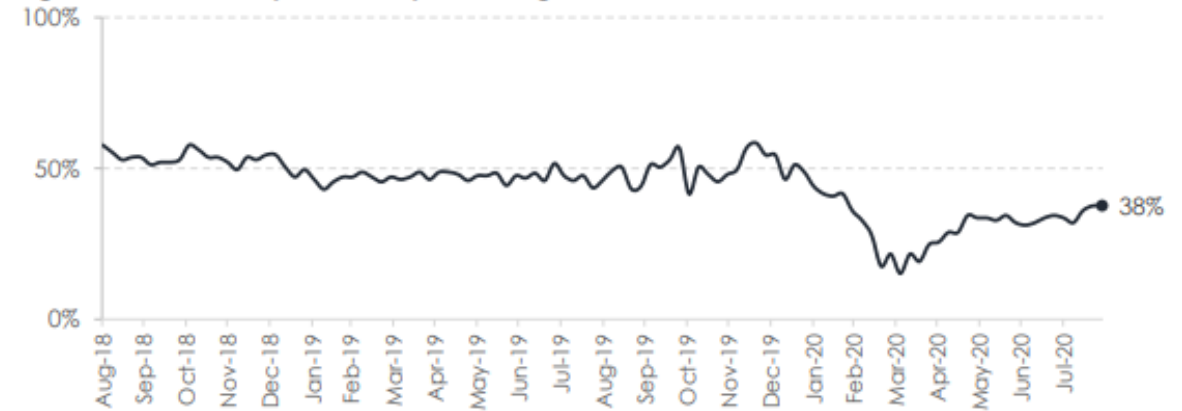
# Sector Breadth



Our team focuses primarily on two areas of analysis for sector breadth / strength:

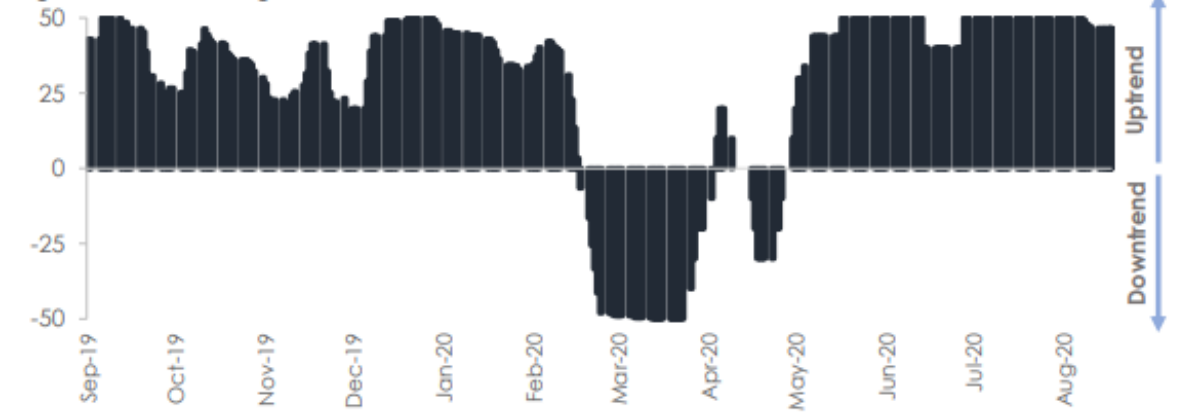
- **% of Companies Outperforming S&P 500 LTM Returns:**
  - Long-term breadth measure
  - Highlighting sectors seeing strong returns across industries and not just being driven by a select few names. We measure this as the last 12-month return vs the S&P 500 index.
  - Sectors with weak breadth can easily fall apart during market selloffs.
  
- **Sector High-Low Index:**
  - Near-term breadth measure
  - Splits sectors into two regimes: Uptrends & Downtrend
  - The H/L Index is calculated as the (% of sector with new 52-week highs vs % of the sector with new 52-week lows) - 50%.

**Figure 90: % of Companies Outperforming S&P 500 LTM Returns**



Source: MarketDesk Research

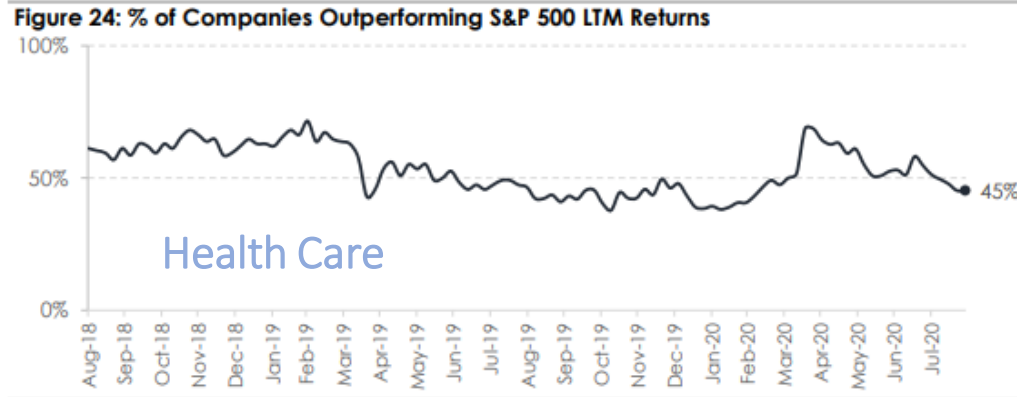
**Figure 91: Sector High-Low Index**



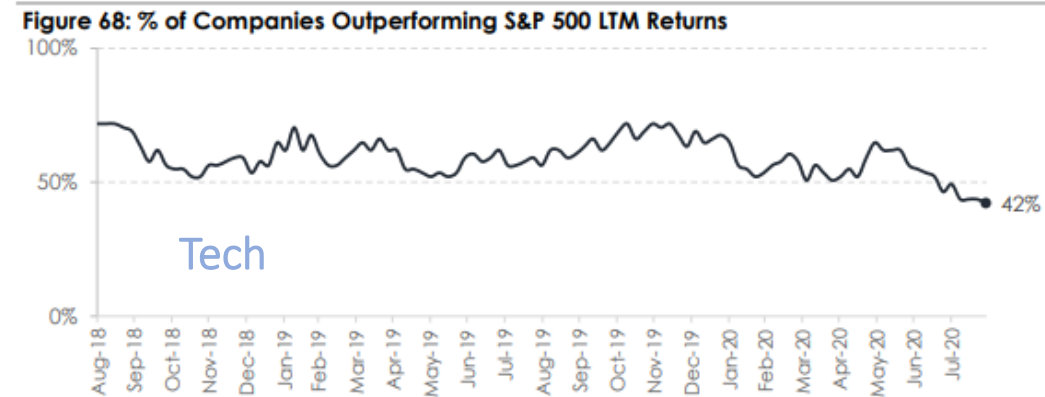
Source: MarketDesk Research.  $H/L\ Index = (\% \text{ of New } 52\text{wk Highs vs } \% \text{ of New } 52\text{wk Lows}) - 50\%$

# Sector Breadth – % Outperforming S&P 500

Improving

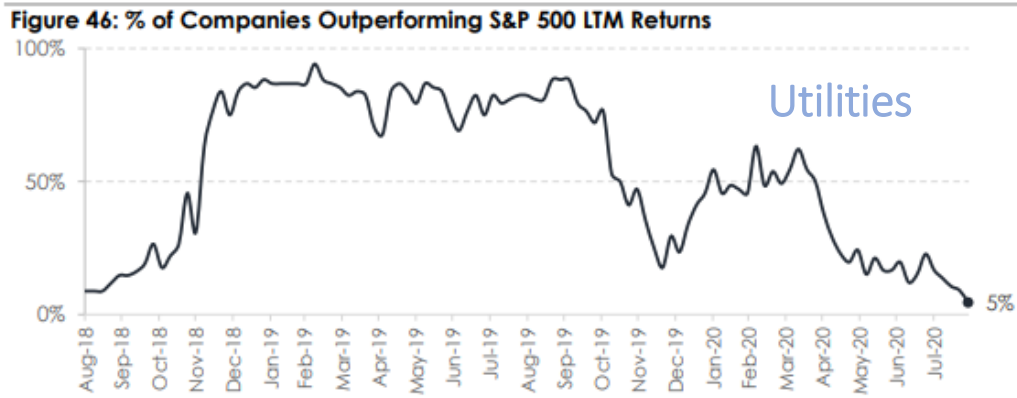


Source: MarketDesk Research

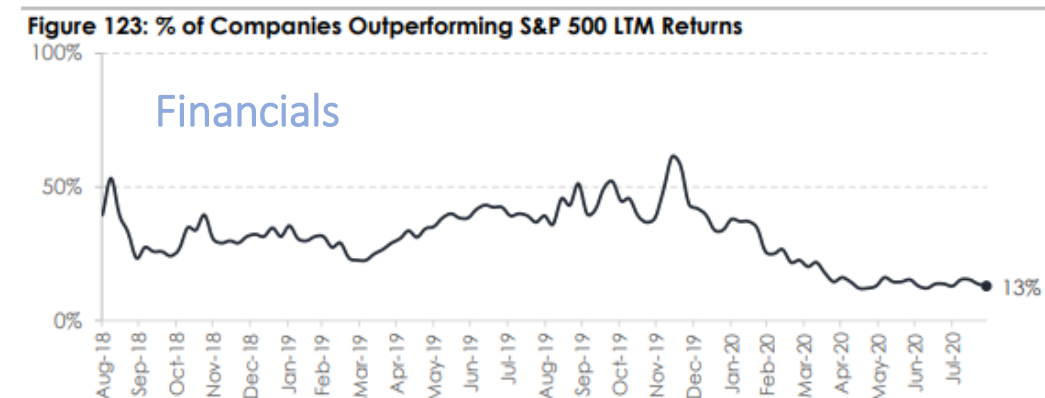


Source: MarketDesk Research

Deteriorating



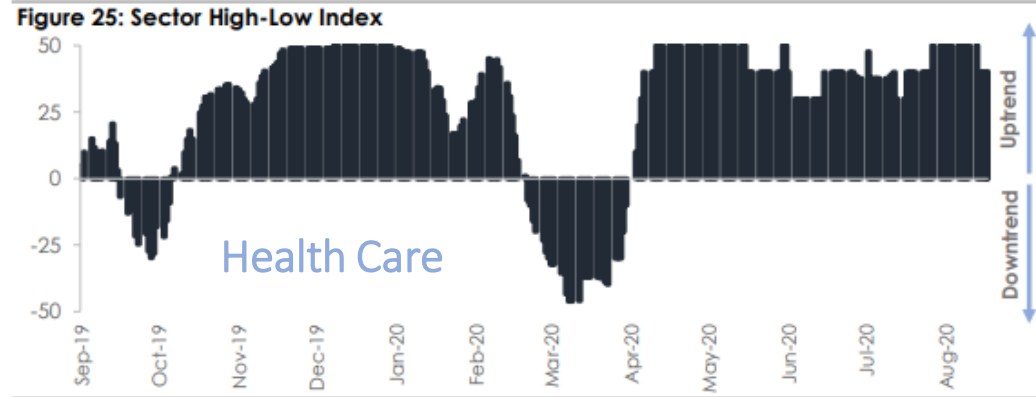
Source: MarketDesk Research



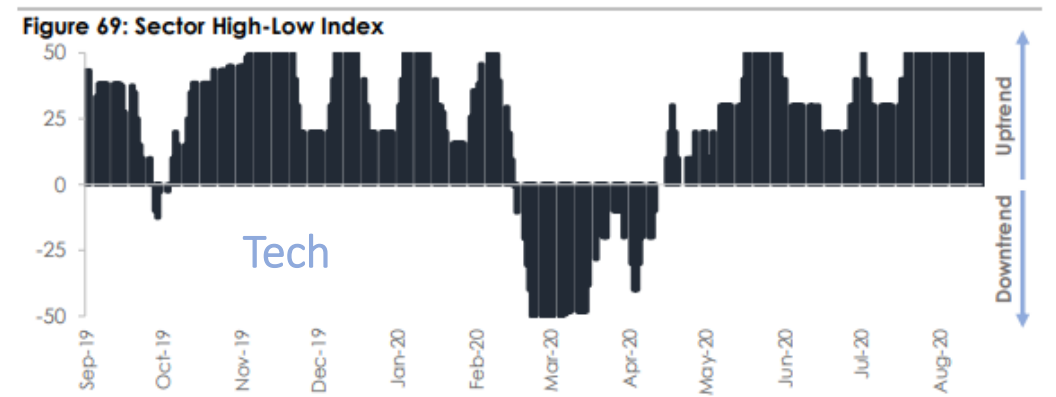
Source: MarketDesk Research

# Sector Breadth – High / Low Index

Improving

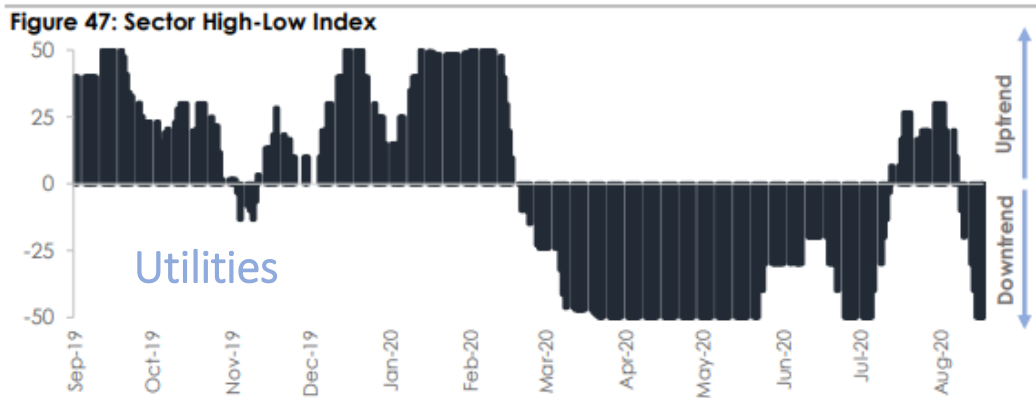


Source: MarketDesk Research. **H/L Index** = (% of New 52wk Highs vs % of New 52wk Lows)-(50%)

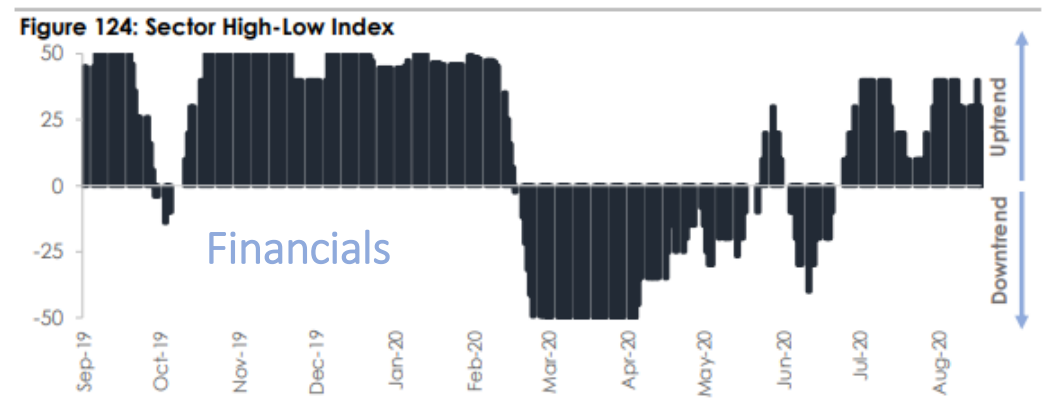


Source: MarketDesk Research. **H/L Index** = (% of New 52wk Highs vs % of New 52wk Lows)-(50%)

Deteriorating



Source: MarketDesk Research. **H/L Index** = (% of New 52wk Highs vs % of New 52wk Lows)-(50%)



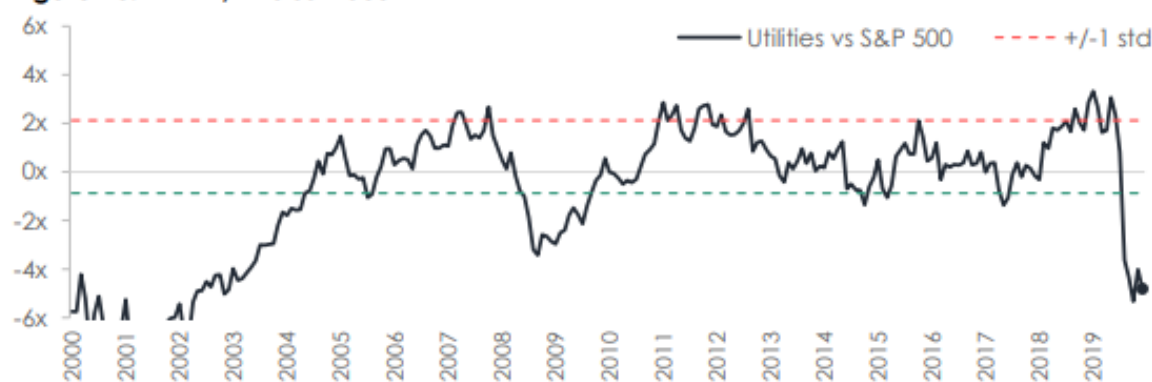
Source: MarketDesk Research. **H/L Index** = (% of New 52wk Highs vs % of New 52wk Lows)-(50%)

# Relative Valuation

Our team focuses primarily on two areas of analysis for relative valuation analysis:

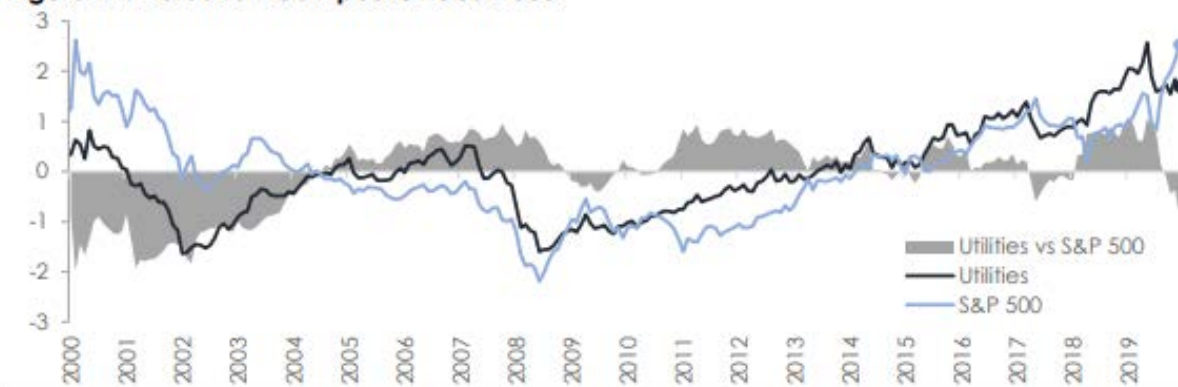
- **NTM P/E vs S&P 500:**
  - Based on next 12-month consensus EPS estimate, this tracks the differential between the sector's P/E and the S&P 500's P/E valuation
  - Standard deviation levels highlights when sectors are trading at a relative discount or premium vs the market
  - Helpful for historical context around past recessions (i.e. 2000 Tech Bubble and 2008-2010 Financial Crisis)
  
- **Valuation Composite vs S&P 500:**
  - Average Z-score of LTM P/E, NTM P/E, P/Book, EV/Sales, and EV/EBITDA.
  - Z-score is another term for standard deviation analysis. The left axis is -3std to +3std.
  - Combines several areas of valuation analysis to combine investor preferences

**Figure 40: NTM P/E vs S&P 500**



Source: MarketDesk Research. **Note:** 1 std = 10-year avg +/- 10-year standard deviation.

**Figure 41: Valuation Composite vs S&P 500**

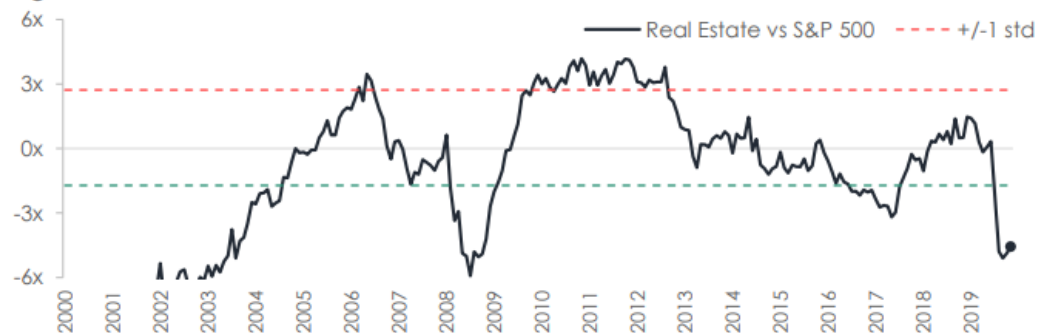


Source: MarketDesk Research. **Composite** is average Z-Score of LTM P/E, NTM P/E, P/B, EV/S, EV/EBITDA.

# Relative Valuation – Cheap

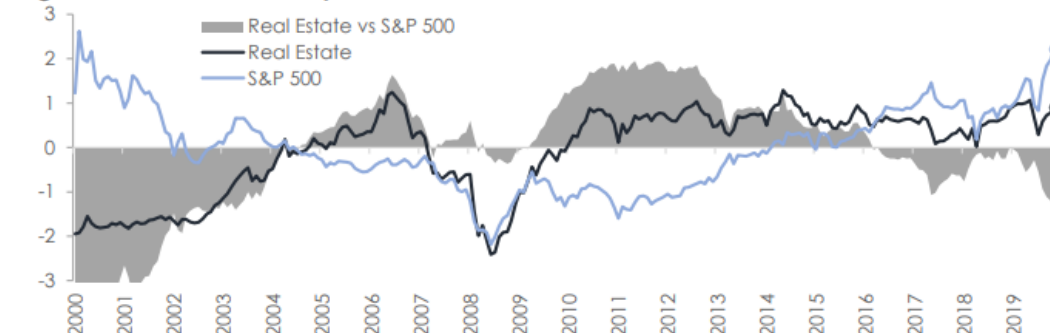
Cheap Sectors

**Figure 128: NTM P/E vs S&P 500**



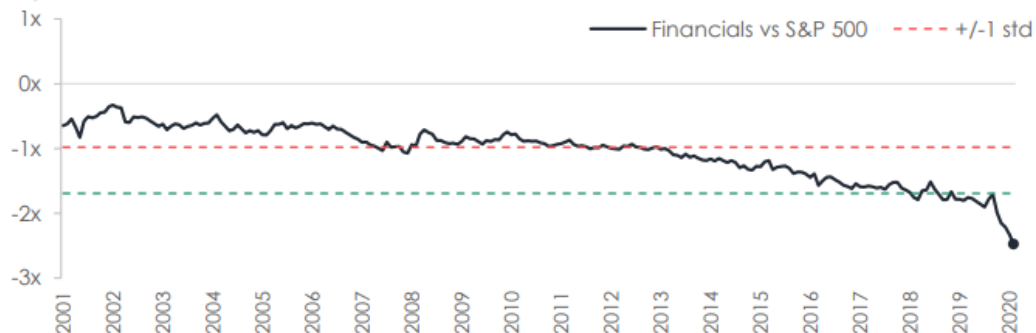
Source: MarketDesk Research. **Note:** 1 std = 10-year avg +/- 10-year standard deviation.

**Figure 129: Valuation Composite vs S&P 500**



Source: MarketDesk Research. **Composite** is average Z-Score of LTM P/E, NTM P/E, P/B, EV/S, EV/EBITDA.

**Figure 117: Price/Book Ratio vs S&P 500**



Source: MarketDesk Research. **Note:** 1 std = 10-year avg +/- 10-year standard deviation.

**Figure 118: Valuation Composite vs S&P 500**

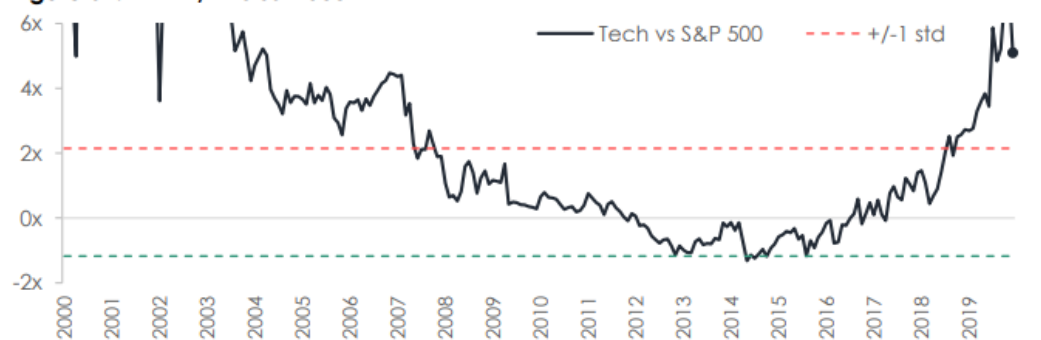


Source: MarketDesk Research. **Composite** is average Z-Score of LTM P/E, NTM P/E, P/B, EV/S, EV/EBITDA.

# Relative Valuation – Expensive

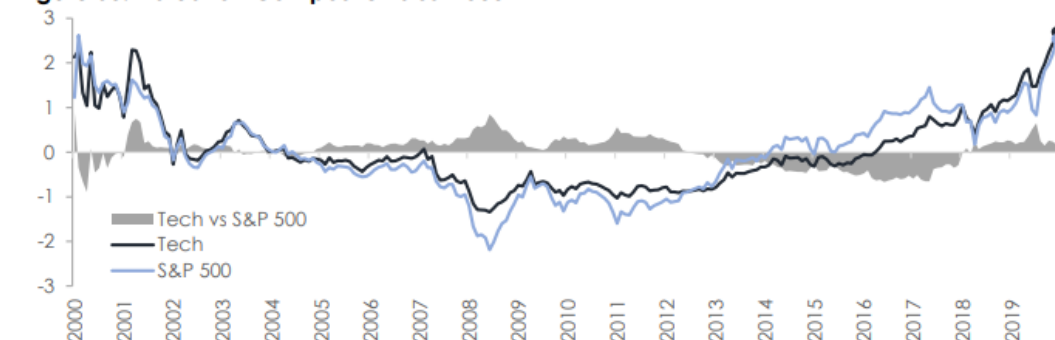
Expensive Sectors

**Figure 62: NTM P/E vs S&P 500**



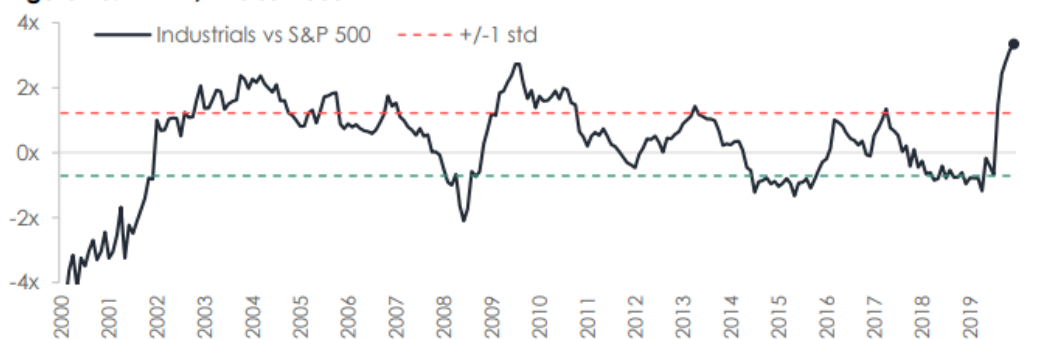
Source: MarketDesk Research. **Note:** 1 std = 10-year avg +/- 10-year standard deviation.

**Figure 63: Valuation Composite vs S&P 500**



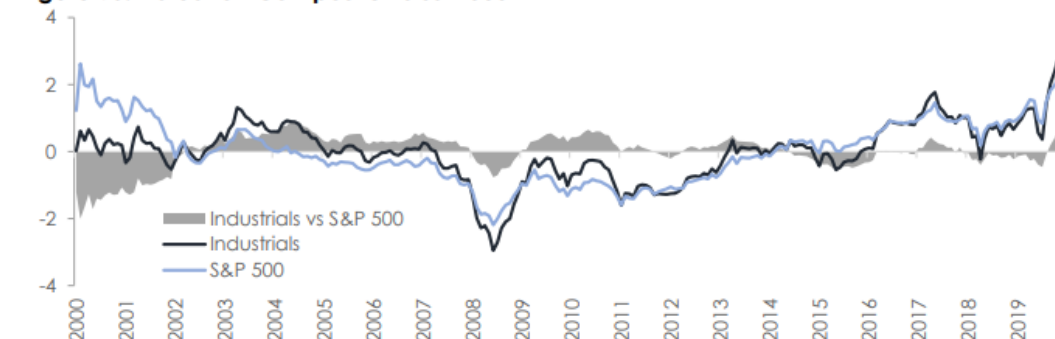
Source: MarketDesk Research. **Composite** is average Z-Score of LTM P/E, NTM P/E, P/B, EV/S, EV/EBITDA.

**Figure 95: NTM P/E vs S&P 500**



Source: MarketDesk Research. **Note:** 1 std = 10-year avg +/- 10-year standard deviation.

**Figure 96: Valuation Composite vs S&P 500**



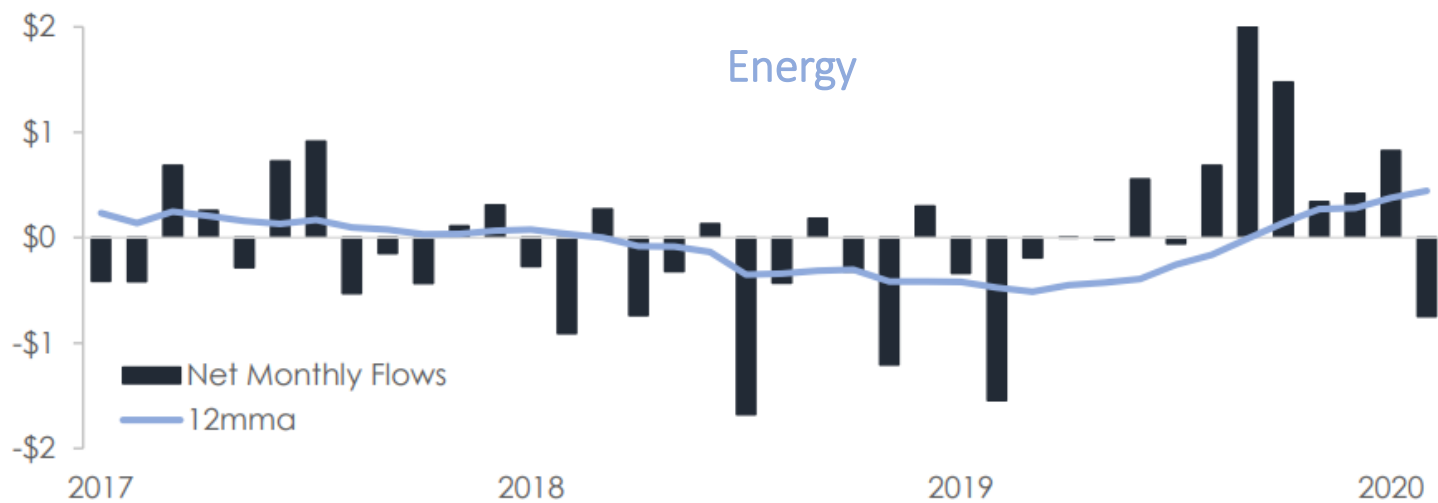
Source: MarketDesk Research. **Composite** is average Z-Score of LTM P/E, NTM P/E, P/B, EV/S, EV/EBITDA.



# ETF Flows

- ETF Flows track investors sentiment and highlight sectors that investors are keen to get future exposure to.
- While we consider ETF Flows to a secondary level indicator (not a great predictor of future performance) it is an important area of analysis to “round out” a sector’s story
- Sectors that are seeing negative performance and positive ETF flows offer contrarian opportunities to get exposure “beaten up” areas of the market. For example, while the relative earnings growth of Energy hasn’t recovered yet, investors have been consistently adding exposure to the sector since early 2019.

**Figure 59: Sector ETF Flows (\$ USD Billions)**

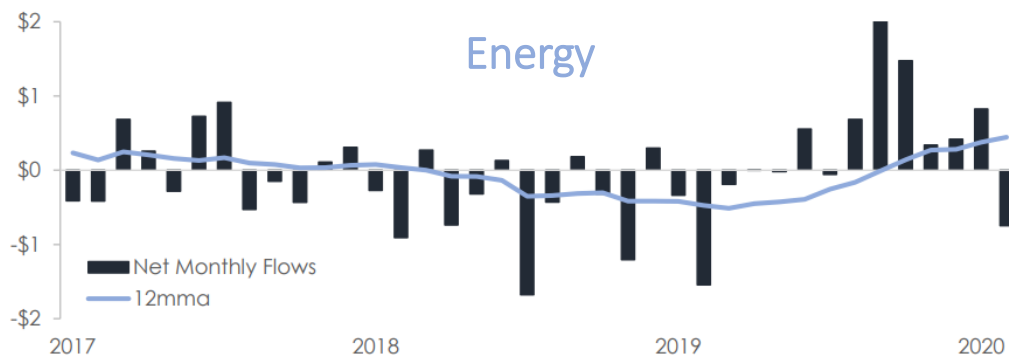


Source: MarketDesk Research. **ETF Flows** are based on 5 largest sector ETFs.

# ETF Flows (cont.)

Improving

**Figure 59: Sector ETF Flows (\$ USD Billions)**



Source: MarketDesk Research. **ETF Flows** are based on 5 largest sector ETFs.

**Figure 70: Sector ETF Flows (\$ USD Billions)**



Source: MarketDesk Research. **ETF Flows** are based on 5 largest sector ETFs.

Deteriorating

**Figure 114: Sector ETF Flows (\$ USD Billions)**



Source: MarketDesk Research. **ETF Flows** are based on 5 largest sector ETFs.

**Figure 136: Sector ETF Flows (\$ USD Billions)**

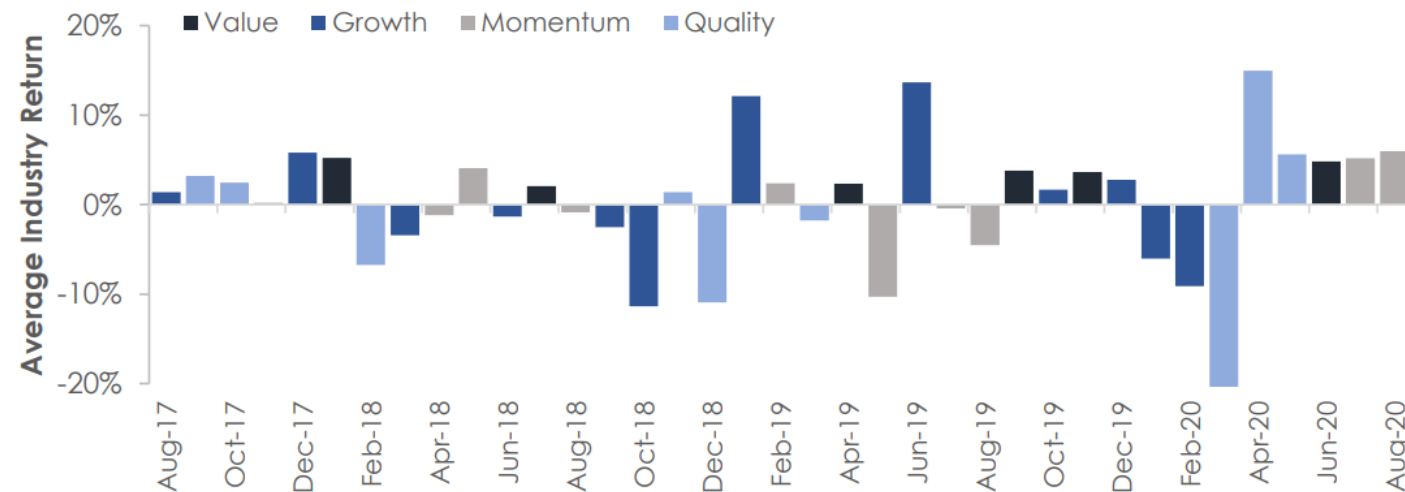


Source: MarketDesk Research. **ETF Flows** are based on 5 largest sector ETFs.

# Factor Drivers

- Our team tracks which factors are driving outperformance amongst the industries within each sector.
- Sectors seeing consistent factor drivers tend to experience sustained outperformance rather than sectors which see inconsistent factor outperformers.
- Investor sentiment can also be seen through the factor drivers of each sector:
  - **Bearish** = Quality & Value outperforming
  - **Bullish** = Momentum & Growth outperforming

**Figure 115: Largest Factor Driving Industry Performance Each Month**

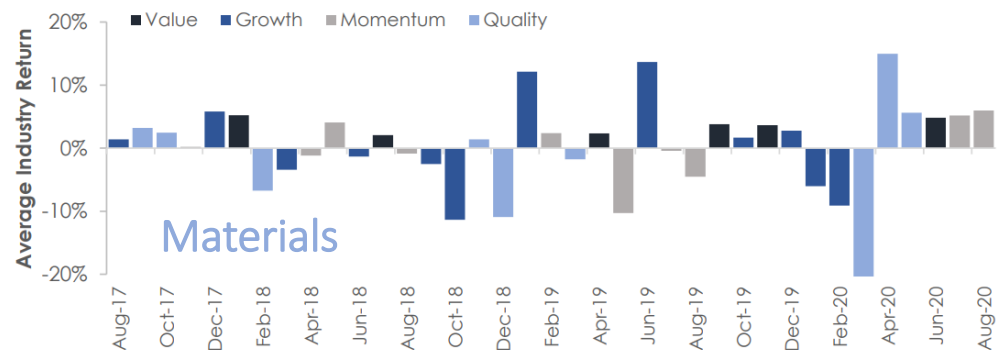


Source: MarketDesk Research. **Value** is based on NTM P/E. **Growth** is based on blended EPS growth (NTM & LTM). **Quality** is based on Profit Margin. **Momentum** is based on previous 3-month returns.

# Factor Drivers (cont.)

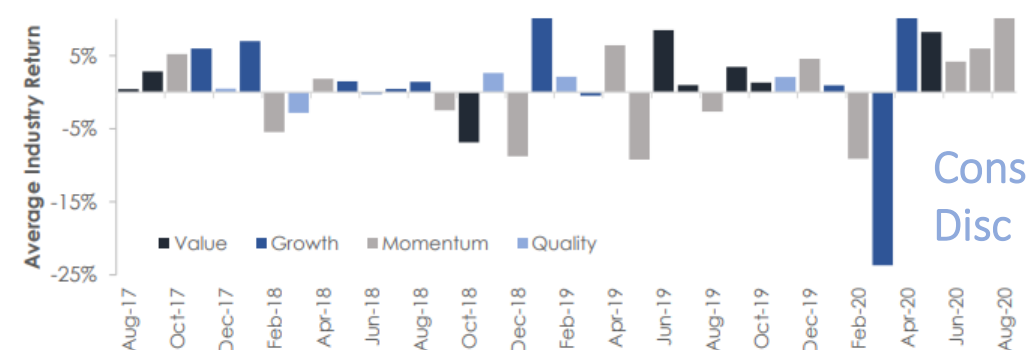
Improving

**Figure 115: Largest Factor Driving Industry Performance Each Month**



Source: MarketDesk Research. **Value** is based on NTM P/E. **Growth** is based on blended EPS growth (NTM & LTM). **Quality** is based on Profit Margin. **Momentum** is based on previous 3-month returns.

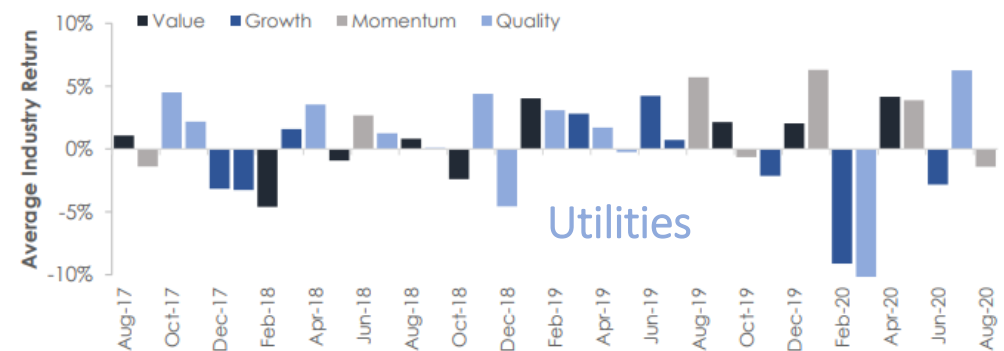
**Figure 93: Largest Factor Driving Industry Performance Each Month**



Source: MarketDesk Research. **Value** is based on NTM P/E. **Growth** is based on blended EPS growth (NTM & LTM). **Quality** is based on Profit Margin. **Momentum** is based on previous 3-month returns.

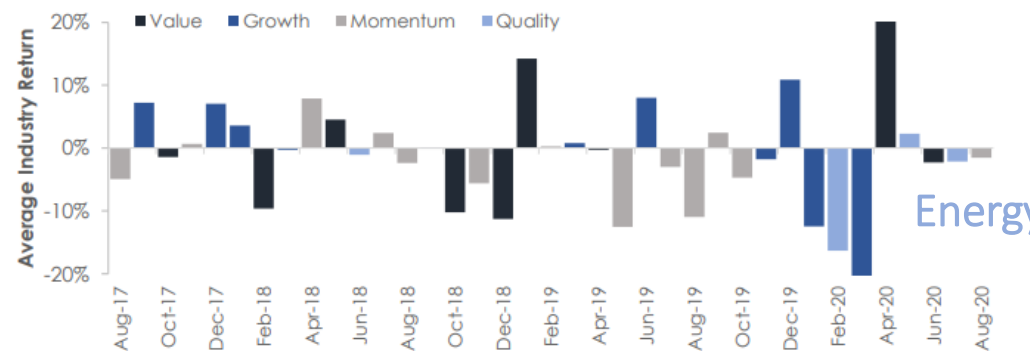
Deteriorating

**Figure 49: Largest Factor Driving Industry Performance Each Month**



Source: MarketDesk Research. **Value** is based on NTM P/E. **Growth** is based on blended EPS growth (NTM & LTM). **Quality** is based on Profit Margin. **Momentum** is based on previous 3-month returns.

**Figure 60: Largest Factor Driving Industry Performance Each Month**



Source: MarketDesk Research. **Value** is based on NTM P/E. **Growth** is based on blended EPS growth (NTM & LTM). **Quality** is based on Profit Margin. **Momentum** is based on previous 3-month returns.

# Key Takeaways

- Sector returns can vary drastically, allowing for outperformance
- Important to pay attention to current market environment (i.e. earnings power in COVID world)
- Each sector has unique drivers as well as common relative drivers
- Combined analysis (i.e. Blended Earnings Growth, Valuation Composite, Y/Y Returns) can account for multiple investor preferences and reduce the vulnerability of relying on just one area of analysis
- No one driver can predict future returns; Important to use several areas of analysis when investing in sectors



Questions?