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Investment Institute

Market Commentary

Weekly perspective on current market sentiment | **January 31, 2024**

Scott Wren
Senior Global Market Strategist

Last week's S&P 500 Index: +1.1%

Sector swap

Key takeaways

- Over the past three months, the S&P Financials sector has dramatically outperformed the S&P Energy sector.
- The S&P 500 as a whole appears expensive, but we want to take advantage of select opportunities as they arise.

Over the past three months, the S&P Financials sector index has dramatically outperformed the S&P Energy sector index by slightly more than 24% (+22.57% vs. -1.52%)[1]. All that happened while the S&P 500 Index (SPX) rallied an eye-popping 17.7% through January 29. So, looking at the simple math and not taking dividends into account, the Financials sector nicely outperformed the SPX while the Energy sector meaningfully underperformed the index. The question we were asking as strategists, given the magnitude of the performance differential, was "Is there an opportunity here?"

Portfolio management is often a matter of trying to take advantage of perceived market mispricing to position investors in asset classes or sectors that look undervalued and/or trimming positions in asset classes or sectors that appear overvalued. One also must take into consideration the underlying forward economic outlook and where we think we are in the cycle. Certain sectors over many past cycles have tended to outperform or underperform the SPX at particular points in the economic cycle. Of course, no two cycles are exactly alike, but the way they evolve over time have often "rhymed."

In this particular instance, and looking at the performance of Financials versus Energy, we believe there is currently potential opportunity. In the Energy sector, oil prices tumbled from close to $94 per barrel this past September to the recent lows near $70. Energy stocks fell as the price of oil dropped, and the SPX rallied. Our analysis suggests the price of oil is unlikely to trade significantly below the recent lows as we believe there continues to be a shortage of crude oil on the global market relative to long-term demand. We see the price of oil rising into the $85 to $95 range by the end of this year. We would expect the Energy sector to outperform as a result over the next 6 – 18 months and now carry a favorable rating on the sector.

On the other side of the swap, the Financials sector has rallied strongly over the past three months and looks overvalued relative to our economic outlook. This sector has typically performed well when the economy has come out of a slowdown or recession. Our outlook calls for slow growth in at least the first half of this year. The Financial sector is likely to directly feel the effects of this slowdown through lower loan demand, falling consumer consumption, and fewer credit/deal underwriting opportunities. Our analysis suggests it is too early to get interested in Financials as the economy is in the early stages of the slowdown we expect. We downgraded the Financials sector to unfavorable as a result.

From a funds allocation standpoint, we favor investors trimming positions in Financials down to our recommended weighting and bring their Energy sector exposure up to our recommended favorable (overweight) weighting. The SPX as a whole appears expensive in our view, but we want to take advantage of select opportunities as they arise.

[1] All mentions of performance are from October 29, 2023 through January 29, 2024.

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Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. An investment that is concentrated in a specific sector or industry increases its vulnerability to any single economic, political or regulatory development affecting that sector or industry. This may result in greater price volatility.

Definitions

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

S&P 500 Energy Index comprises those companies included in the S&P 500 that are classified as members of the GICS® energy sector.

S&P 500 Financials Index comprises those companies included in the S&P 500 that are classified as members of the GICS® financials sector.

An index is unmanaged and not available for direct investment.

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