GLOBAL FOCUS CAPITAL LLC
INSIGHT THAT MATTERS

# From Bear Market to Sector Rotation - Its' All a Bit Confusing Now!

This year has been a rollercoaster for global equity investors. From the weak start to the year to the recovery in early March it has left investors with more questions than answers. Are we in a bear market? Are we just pausing until global growth resumes?

Lots of questions and few answers, but maybe we can distill some useful information from the recent price action of global equity markets. In a world where the headlines revolve around broad market indices such as the S&P 500, Nikkei 225 or MSCI Emerging Markets much is left unexplored. In this note we look at the technical characteristics of our global equity sample for clues as to what may be going on behind the scenes.

Our global equity sample is composed of 13,000 securities in 46 markets ranging in market capitalization from Apple at $565 billion to $200 million. To gain insight into the inner workings of global equity markets we classify each stock into one of six technical stages based on their price behavior over the last 200 trading days. Readers unfamiliar with our Technical Stage Model can refer to our post describing the methodology "***Getting All Technical*** **".**

As mentioned before each stock in our sample is classified into one of six buckets. The idea is that the average stock moves clockwise and cycles through the various technical stages.

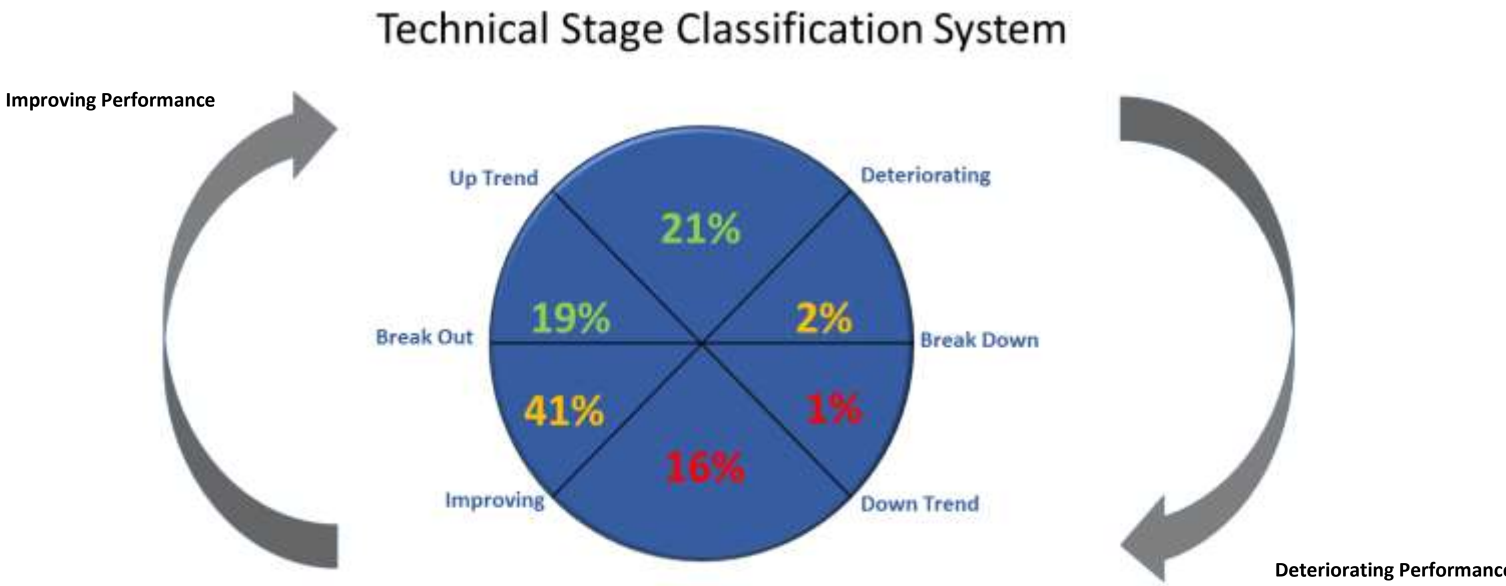
## Where do we stand today?

The classification proportions as of March 25 reflect a global equity market lacking direction but one that has recovered significantly in the last few weeks.

In clearly defined trending markets you expect to see a proportion of stocks usually exceeding 60% in either the Up Trend Stage (in a Bull Market) or in the Down Trend Stage (in a Bear Market).

What we are seeing today is neither a bull or bear market given the low percentage of stocks classified in the extremes (21% in an Up Trend, 16% in a Down Trend).

Rather what we observe is a very large number of stocks currently classified in the Improving Stage – 41% of our global equity sample. These are stocks whose price action is in the early process of potentially recovering to a more sustained uptrend (Break Out and Up Trend Stages), but they are historically almost as likely to fall down again into the Down Trend Stage. We associate this technical stage with significant investor indecision.




## How much has the technical picture changed?

Quite a bit especially if you go to the beginning of last year. At the end of 2014 there was roughly an equal split between Up and Down Trend stocks (29%) but as global equity markets ramped up in Q1 the proportion of Up Trend stocks jumped to 45%. Investors were generally upbeat and market volatility had remained subdued and below historical norms.

| DATE | UP TREND | DETERIORATING | BREAK DOWN | DOWN TREND | IMPROVING | BREAK OUT |
|---|---|---|---|---|---|---|
| Mar-16 | 21.0% | 2.4% | 1.2% | 15.6% | 41.2% | 18.5% |
| Dec-15 | 24.0% | 8.6% | 4.9% | 38.0% | 15.4% | 9.1% |
| Sep-15 | 10.6% | 12.4% | 11.3% | 55.4% | 7.7% | 2.5% |
| Jun-15 | 28.8% | 30.8% | 10.5% | 23.6% | 3.4% | 2.9% |
| Mar-15 | 45.0% | 9.3% | 4.4% | 20.7% | 12.2% | 8.5% |
| Dec-14 | 29.7% | 15.4% | 7.4% | 29.6% | 11.7% | 6.1% |

Things started changing in the spring and summer months culminating with a pretty severe downdraft in global equity markets. August was a particularly nasty market with the MSCI All Country index down nearly 7%. Losses compounded in September with a further -3.5% return.

By the end of Q3 55% of our global equity sample was classified in the Down Trend Stage. It sure started looking like the early stages of a Bear Market but the fundamentals remained murky.

The implosion of the energy markets was highly destabilizing along with slowing global growth and the realization that the Fed was committed to raising rates. Similar to the last real spike up in investor risk aversion during mid- 2011 capital market volatility rose dramatically creating much uncertainty for investors.

A seesaw pattern was established in the autumn with a big recovery in October (up 7.8%) leading to a drop by the end of December 2015 in the proportion of stocks classified in the Down Trend Stage to 38%. Maybe a Bear Market had been avoided for now.

The technical picture worsened again in January 2016 as global equity markets suffered wide ranging losses. By the end of the month over 60% of companies in our sample were classified in the Down Trend category. It sure felt like "*it's deja vu all over again*" as Yogi Berra once said.

Investors started hunkering down for a Bear Market but as the market often does the next couple of months brought about a recovery especially in segments of the global markets that investors had long given up on. Resource-oriented sectors and countries started out-performing. The signs of an imminent Bear Market had become a bit fuzzier.

The technical picture became more consistent with an environment of investor indecision as the proportion of stocks in the Improving Stage jumped up to over 40% - fear gave way to quiet hope, but maybe something else was happening behind the scenes.

## Could all of this market drama and indecision be related to a rotation toward unloved sectors?

The recovery of negative sentiment sectors and countries has taken most investors by surprise. Outflows from EM equities and commodities had been accelerating and only the brave were left behind with significant exposures to these maligned equity groups.

Maybe the correction in resource-oriented groups had gone too far or put another way maybe the trade had become over-crowded.

| CHANGE FROM ONE YEAR AGO | UP TREND | DETERIORATING | BREAK DOWN | DOWN TREND | IMPROVING | BREAK OUT |
|---|---|---|---|---|---|---|
| Commercial Services | -18.2% | -7.5% | -2.4% | -2.3% | 21.7% | 8.6% |
| Communications | -10.2% | -9.1% | -6.2% | -10.0% | 28.1% | 7.4% |
| Consumer Durables | -29.6% | -6.6% | -1.6% | -1.1% | 28.2% | 10.7% |
| Consumer Non-Durables | -14.0% | -4.9% | -2.7% | -3.7% | 16.8% | 8.5% |
| Consumer Services | -18.8% | -7.7% | -5.2% | -2.4% | 22.1% | 11.9% |
| Distribution Services | -20.6% | -5.2% | -4.0% | -12.1% | 26.8% | 15.1% |
| Electronic Technology | -30.1% | -6.9% | -1.9% | -4.4% | 33.5% | 9.7% |
| Energy Minerals | -4.9% | -0.7% | -2.3% | -31.3% | 27.5% | 11.7% |
| Finance | -18.4% | -10.4% | -3.9% | -7.2% | 27.7% | 12.4% |
| Health Services | -28.8% | -2.9% | -4.8% | 10.7% | 17.4% | 8.5% |
| Health Technology | -40.3% | -5.4% | -3.0% | 17.7% | 29.6% | 1.4% |
| Industrial Services | -13.2% | -5.2% | -1.7% | -19.9% | 29.1% | 10.8% |
| Non-Energy Minerals | -13.1% | -5.9% | -3.6% | -24.6% | 30.1% | 16.9% |
| Process Industries | -35.3% | -5.9% | -2.9% | -2.6% | 36.2% | 10.6% |
| Producer Manufacturing | -36.7% | -3.5% | -2.0% | -3.3% | 36.4% | 9.1% |
| Retail Trade | -22.5% | -7.9% | -2.4% | -3.5% | 28.6% | 7.8% |
| Technology Services | -26.4% | -5.6% | -3.4% | 2.7% | 24.6% | 8.1% |
| Transportation | -24.8% | -9.4% | -4.7% | -9.3% | 35.1% | 12.9% |
| Utilities | -2.0% | -14.0% | -6.8% | -9.0% | 24.1% | 7.7% |

Compared to a year ago the global sector picture has changed dramatically. The table shows the change in the proportion of stocks classified in each of the six technical stages from a year ago.

We observe a strong rotation away from growth oriented sectors to out of favor groups currently suffering from weak fundamentals and multi-year under-performance.

Let's take a look at stocks currently classified in the Up Trend Stage. All economic sectors have a smaller proportion of stocks in this technical phase reflecting poor overall global equity market performance over the last year, but the greatest proportional increases have occurred in growth segments such as Health Care Technology. The smallest proportional changes have occurred in out of favor sectors such as Utilities, Energy, Telecom and Minerals.

What about stocks classified in the Down Trend Stage? The largest increase is seen in the Health Care Technology and Service area. The largest decrease has occurred within the Energy and Mineral sectors. Not surprisingly these numbers confirm the directional movement that has occurred in the last year away from higher growth to out of favor sectors.

However, **the strongest message coming out of our analysis of the technical picture of global equity markets is one of indecision**. Over 40% of stocks are in the Improving Stage at the moment. We have seen a very significant jump in the proportion of companies in this technical stage across all global sectors.

While historically one would expect these stocks to keep on moving up higher to the Break Out Stage there is also a non-trivial probability of regressing to the Down Turn Stage hence our characterization of the Improving Stage as indecisive.

**What do we make of all of this indecision?** We are currently experiencing a trendless equity market with significant sector rotation complicating the picture. It is still unclear to us whether this sector rotation has legs or whether it is simply a reaction to potentially over-sold conditions.

The fundamentals of profitable growth, cash generation and associated valuation comprising our sector approach do not yet point to a sustained rebound for resource-oriented sectors.

Many of these downtrodden sectors are being noticed because of the year to date out-performance but we do not view short-term measures of momentum as indicative of a rebound in business fundamentals. We view the current market drama as more of a reflection of a low economic growth environment and a preference for principal protection. Getting used to a low return environment will take time!

Sincerely,

**Eric J. Weigel**

***Managing Partner and Founder of Global Focus Capital LLC***

Feel free to contact us at Global Focus Capital LLC (mailto:eweigel@gf-cap.com or visit our website at http://gf-cap.com to find out more about our asset management strategies, consulting solutions and research subscriptions.