Chart-in-Focus

April 2023

Are Markets Getting Defensive? Sector Rotations Tell A Story

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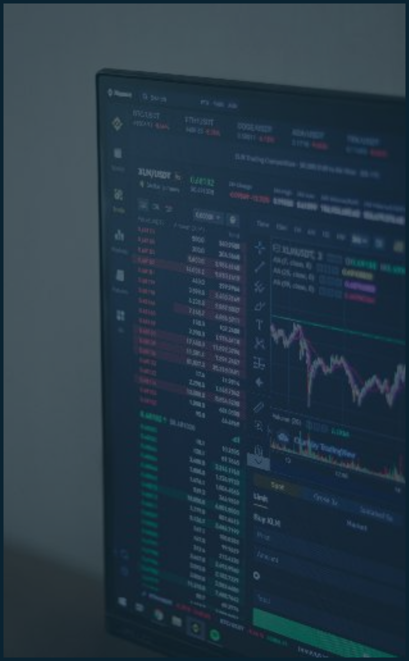

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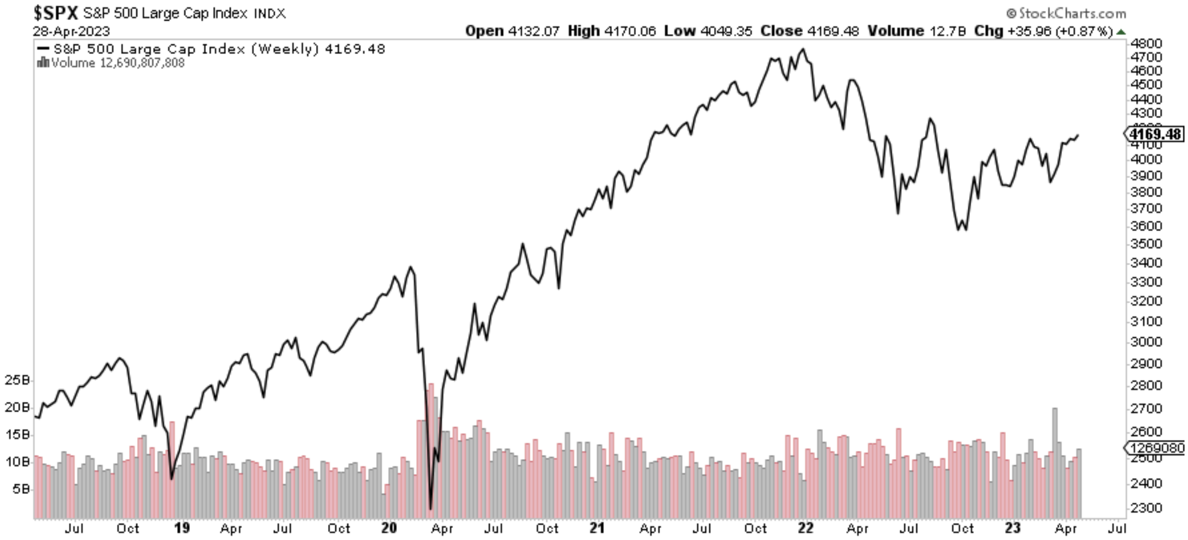
Chart-in-Focus: Are Markets Getting Defensive? Sector Rotations Tell A Story

We are late in publishing the April 2023 edition of Chart-in-Focus; we waited for the month to end as we wanted to take a look at the sector rotation as a whole and not at a particular stock given the important juncture the Indices are placed at.

The markets have had an excellent run over the past couple of weeks. The equities have been on a roll; what performed badly last year is playing excellent catchup. Take for example these three key US Indices; DJIA, NASDAQ, and SPX.

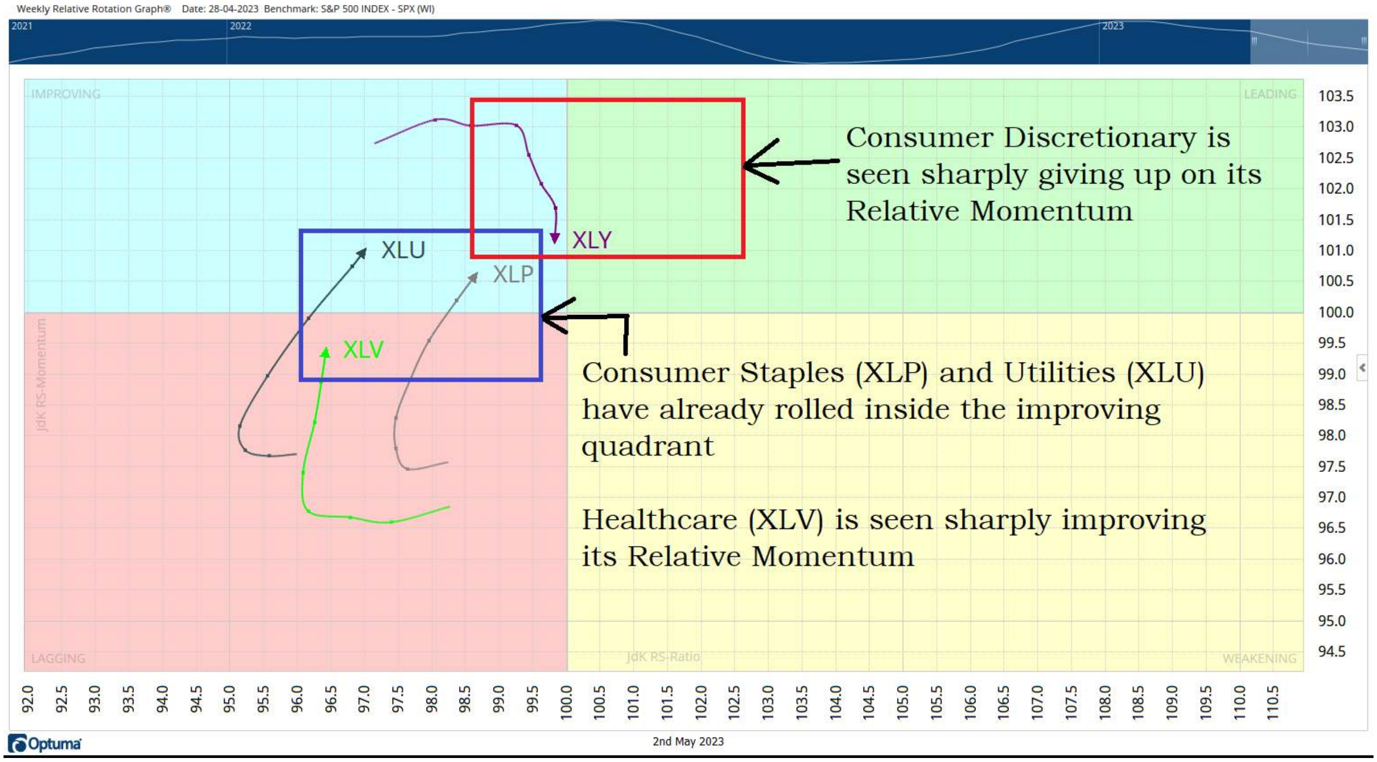
If we take a look at Year-to-Date (YTD) performance, the reading confirms the above interpretation. NASDAQ has been the best performing index returning a positive of 17.71%, SPX and DJIA returned 9.03% and 2.90% respectively. While the structure of the chart remains buoyant, the VIX, the volatility gauge, has been consistently falling.

Basically, the VIX and the SPX share an inverse relationship. VIX is an index that measures the expected volatility of the US stock market based on options prices. It shows how much investors are willing to pay for protection against market fluctuations in the next 30 days. It is calculated by using real-time SPX option prices. The VIX and the SPX usually have an inverse relationship, meaning that when the SPX goes up, the VIX goes down and vice versa. This is because the VIX reflects the level of fear in the market. When the market is rising, there is less fear and when the market is falling, there is more fear. **The persistently low levels of the VIX are often associated with important market tops; as of week ending April 28th, VIX had violated 2022 lows and was seen within striking distance of 2021 lows.**



The chart shown above is the SPX in the upper frame; it is seen buoyantly poised. However, it stares at important resistance zone of 4150-4200 levels and at the same time, the VIX (shown in the lower pane) has dropped to one of the lowest levels seen in the recent past. The VIX has violated the 2022 lows and is now within the striking distance of its 2022 lows.

A look on this month's Chart-in-Focus - RRG which shows sector rotation that hints at the markets getting cautious look and getting defensive over the coming days.

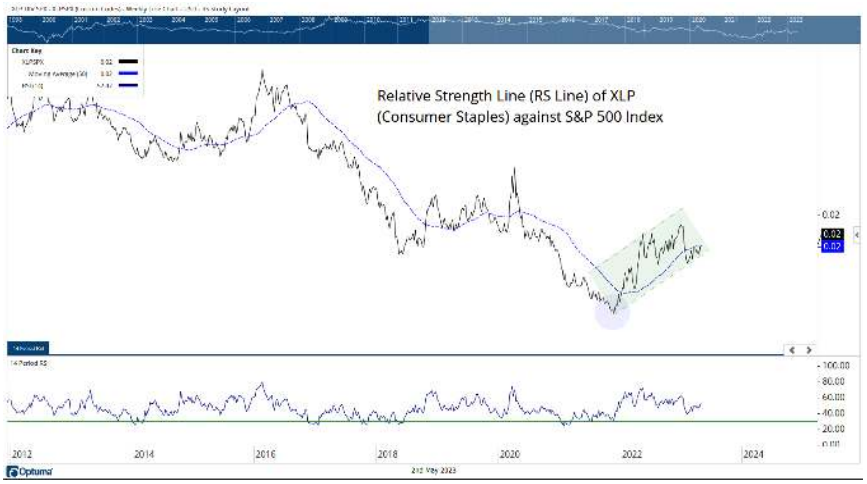


The Relative Rotation Graph (RRG) shown above clearly shows the sector rotation in favor of the defensives.

One of the indicators of a potential market correction is when the defensive sectors start outperforming the cyclical sectors. Defensive sectors are those that provide essential goods and services that people need regardless of the economic conditions, such as Consumer Staples, Utilities and Health Care. Cyclical sectors are those that depend on consumer spending and confidence, such as Consumer Discretionary. According to the Global Industry Classification Standard (GICS), these sectors have different characteristics and performance patterns over various investment horizons. When Consumer Staples, Utilities and Health Care sector start outperforming Consumer Discretionary sector, it may signal that investors are becoming more cautious and risk-averse, and are shifting their portfolios to more stable and resilient companies.

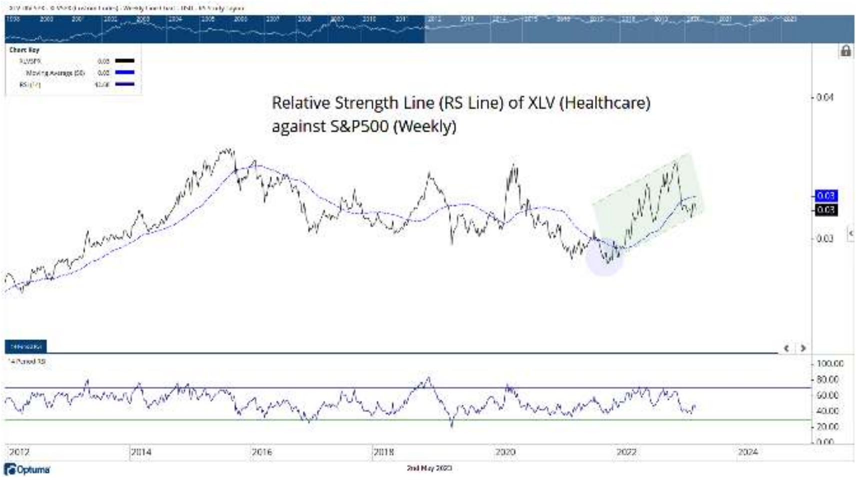
> It is evident from the above RRG that money is moving in favor of the defensive sectors. XLU - SPDR Utilities Selector Fund ETF, XLP - SPDR Consumer Staples Select Sector Fund ETF, and XLV - SPDR Healthcare Select Sector Fund ETF are seen sharply improving their relative performance against the broader S&P 500 Index. On the other hand, XLY -- SPDR Consumer Discretionary Select Sector Fund ETF is giving up on its relative momentum.

The above reading is also reflected in the Relative Strength Line (RS Line) of these sectors when compared against the broader S&P500 Index



Looking at the RSLines of XLU, XLP, and XLV below, it gets quite evident that they have recently found a bottom for themselves and are looking to each higher. This holds true for all the three defensive sectors, XLU (Utilities), XLP (Consumer Staples) and XLV (Healthcare).

A look at the XLY (Consumer Discretionary) shows that the RS line is declining and the sector is giving up on its relative performance against the benchmark S&P 500 index.



In summary, the SPX is staring at a potential resistance zone of 4150-4200 levels. A breakout above this may trigger a new rally but as of now, this zone poses stiff resistance. Further to this, VIX is plummeting nearly every day and it is at one of its lowest levels seen in recent times. This complecency of the market participants leaves the market vulnerable to sharp profit-taking bouts. This cautious is now evident with this recent shift in sector performance which suggests that investors are becoming more cautious and defensive in their portfolio allocation. The outperformance of Utilities, Consumer Staples and Healthcare indicates that these sectors are seen as more resilient and stable in the face of market uncertainty and current technical setup. On the other hand, the underperformance of Consumer Discretionary reflects the weakening consumer confidence and spending power amid the economic slowdown and inflationary pressures.

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