Sectors for Economic Inflection Points

By **Nicholas Porter**
ASTOR INVESTMENT MANAGEMENT

Investors have long looked to sectors to add value within a portfolio, most notably looking for additional alpha during advancing markets. Sectors have also been used by investors seeking equity exposure but wanting to dial down risk during times of market stress. Additionally, certain sectors have long been utilized to add value in income portfolios. This piece expounds upon our research from 2018, which discussed some of the cyclical properties of the various GICS sectors, parsing the return data through an economic filter (astorim.com/which-sectors-are-defensive/).

The past year saw global macro data moderate in some segments like manufacturing. Equity markets ultimately had a very good year, taking back losses from Q4 2018 and then moving ahead as trade issues thawed in Q4 2019, monetary policy reversed course and global macro data trends stabilized. While investors weren't looking toward defensive sectors into year end, the economic expansion continues to age and investor's thoughts may turn to defensive sectors should an economic resurgence fail to materialize and the euphoria of 2019 begin to fade. But how have the defensive sectors actually performed when the economy falters?

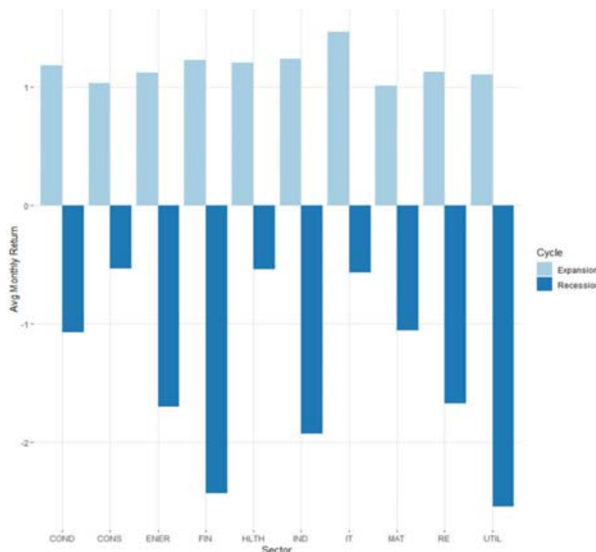
There is an obvious appeal in knowing how sectors of the economy perform in recessions and expansions. During recessions, investors could shift exposure into sectors that perform better than the market (i.e. defensive or anti-cyclical sectors), and underweight sectors that perform worse (pro-cyclical sectors), with the opposite process occurring during expansions.

Except for a few outliers, it looks like the street wisdom holds true. Our analysis lends some support to the existence of defensive sectors. As the chart shows, there is a much greater variation of sector returns when comparing expansions vs. recessions, with certain sectors faring better when the economy weakens. This empirical evidence lends credence to the idea of shifting portfolio allocations based on macro conditions.

Much of this reinforces what common sense tells us: stocks are not billiard balls which will always behave the same given the same force and angle of the shot. This emphasizes the first rule of portfolio construction: Diversification. It also highlights the potential we see in understanding the relationship between the top-down fundamentals underlying each economic sector's growth and corresponding asset valuation.

Astor's research has shown that sorting sectors through an economic lens generally shows more usefulness for allocating portfolios. As we come off a strong year of market returns, low interest rates and an aging economic cycle, understanding which areas are poised to add the most value can go a long way to improving a portfolio (upside and downside). Understanding the macro picture and which sectors are positioned to take advantage can really make a difference.

Cyclical Sector Returns



Sources: MCSI, Bloomberg, NBER, data 1995 through 2019

Nicholas Porter is a Research Associate and member of the Astor Investment Committee.
Learn more at **www.astorim.com**.

All information contained herein is for informational purposes only. This is not a solicitation to other investment advice or services in any state where to do so would be unlawful. Analysis and research are provided for informational purposes only, not for trading or investing purposes. All opinions expressed are as of the date of publication and subject to change. Astor and its affliates are not liable for the accuracy, usefulness or availability of any such information or liable for any trading or investing based on such information.

ASTOR
INVESTMENT MANAGEMENT
FUNDAMENTALLY DRIVEN.

Navigating Inflection Points in the Economic Cycle.

Astor specializes in risk-focused investment solutions for:

- Multi-Asset Allocation
- Unconstrained Income
- U.S. Sector Rotation

Mutual Funds | UMA | SMA

Our process is systematic, repeatable, and researched.

Utilizing current economic data and historical trend analysis, Astor seeks to identify the level of appropriate risk for the current environment. We offer tactical asset allocation strategies that seek to provide consistent, risk-managed portfolios for investors.

astorim.com

All information contained herein is for information purposes only. This is not a solicitation to offer investment advice or services in any state where to do so would be unlawful.