# Market Strategy Weekly

April 26, 2024

Strategegas Research Analyst Thomas DiFazio stops by to talk through a handful of the firm's recent sector allocation changes: upgrades to Energy, Materials, and Utilities, and downgrades to Consumer Discretionary and Health Care.

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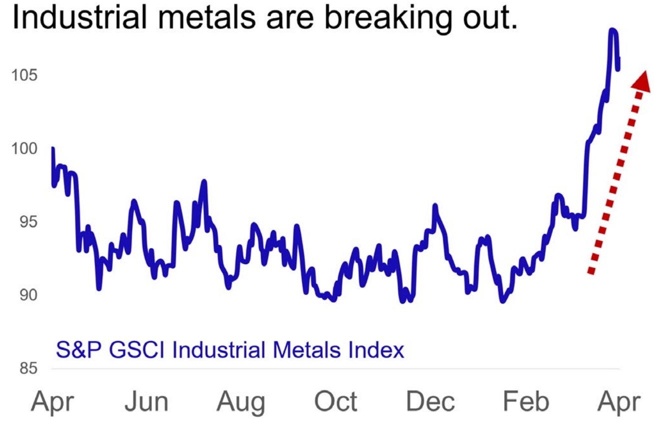
## COMMODITY SECTORS UPGRADED | UTILITIES PERCOLATING | CONSUMER DOWNGRADE

**ROSS MAYFIELD:** Let's talk sector allocation. Could you discuss the two recent upgrades you made to a pair of cyclical areas?

**THOMAS DIFAZIO:** Yes, we upgraded both Energy and Materials to Overweight. Starting with Materials, we believe that there is a big trend change underway in the industrial metal space. Looking at Copper and Gold, the trends are higher. It would not be surprising to see consolidation after such impressive runs, but we ultimately think the bias for these metals is higher. And from a fundamental perspective, improving commodity prices are good for overall sector free cash flow. With Energy, crude oil prices are on an upward trajectory, albeit with some volatility. That comes with higher free cash flow and higher profits. The other important consideration is that the trade is not crowded. If you look at Energy sector ETF flows on a rolling one-year basis, there's ample room for them to move higher before the trade gets crowded, and that helps provide an entry point for Energy.

Industrial metals are breaking out.




**ROSS:** Now, you also upgraded a traditionally defensive sector in Utilities. How does that fit into the larger outlook?

**THOMAS:** With Utilities, we're just trying to appreciate the nuanced improvement going on under the hood. Looking at the equal weight construction of the sector, we see early signs of relative leadership. It's hardly full-throated, but the percent of stocks in an uptrend has been moving higher at a time when rates aren't doing the sector any favors. Put it all together and you're seeing improvement both internally and on a surface level, and we think that should be recognized.

**ROSS:** And then ending on a down note, could you discuss the two downgrades you made as part of the overall update?

**THOMAS:** First, Consumer Discretionary. It's rare to see that sector work well in conjunction with Energy, and we think the Energy sector has upside potential. From a fundamental perspective, our Strategas Common Man CPI, which looks at inflation for "must have" products and services, is treading higher than overall inflation and wage growth. This hints at pressure on the consumer that we don't think the market is properly appreciating. From a price perspective, we're watching the Consumer Discretionary vs. Consumer Staples (equal weighted) relationship, an important cyclical barometer for us. Discretionary has underperformed recently, but if it responds strongly from here, that would be an encouraging sign that cyclicality still permeates the marketplace. If not, we may need to ask a couple more serious questions about cyclicals vs. defensives.

We also downgraded Health Care, primarily because it's a high opportunity cost right now to be Overweight. Health Care is in the bottom decile of relative performance historically, and we've yet to see any spark of leadership coming out of that weakness. We don't believe the sector deserves a deep loyalty when we could put money to work elsewhere, especially when you consider that neither presidential candidate is particularly "good" for that sector anyway.

## IMPORTANT DISCLOSURES

This conversation is lightly edited and consolidated from an interview located at www.youtube.com/@BairdTV.

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