Market Strategy
by STRATEGAS A BAIRD COMPANY

BAIRD
Private Wealth Management

U.S. Equity Sector Allocation

April 25, 2024

5 CHANGES AMID BROADENING LEADERSHIP AND ECONOMIC RESILIENCY

In the throes of Covid, we adopted four "prerequisites" for a broad economic recovery: 1) the virus has been cleared; 2) inflation is back to levels acceptable to policymakers and investor/consumers; 3) stock valuations have been level-set; and 4) organic drivers of growth can bring capital in from corporations and investors (making the recovery sustainable). Since that time, the market has enjoyed a policy-induced, Tech-led advance, but inflation is still sticky and stock valuations are at the upper end of their historical range. The economy has been resilient despite these factors and now that corporations have largely digested higher interest rates, economic optimism hinges less on the Federal Reserve's policy decisions and more on the back of corporate investment. Still, macro risks abound and the areas of strength today may not closely track with other risk-on cycles of recent memory – the changes below reflect an intact, but rotational, cyclical bull market.

Materials: Industrial metals are breaking out and a trend change is underway. The trends for Copper and Gold specifically are higher. Improving commodities prices could prove an important tailwind for next-12-months free cash flow for the broader Materials sector. **We are upgrading our recommended allocation to Materials to Overweight from Neutral.**

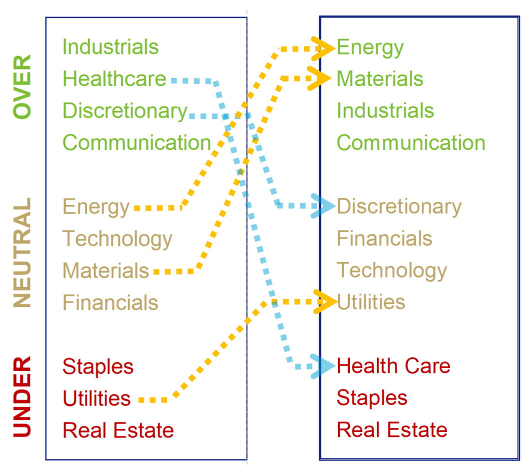
Utilities: Utilities has had a troubled performance profile against rising interest rates but has recently found its footing. he market is getting more defensive with both Utilities and rates moving higher. The combination of relative performance improving and internal trends getting better has our attention. The percentage of stocks in an uptrend is improving as the sector corrects—an important internal development that should be monitored closely. **We are upgrading Utilities to Neutral from Underweight.**

Energy: Despite recent price action, Crude has held a generally upward trajectory in recent months. The sector could see volatility in the near-term if oil cannot reapproach and hold $90. Longer-term, however, equilibrium between geopolitical conflict, supply/demand dynamics, and inflation appears to favor the sector. A higher average year-to-date price of WTI crude could buoy sector profits and free cash flow. It's important to watch evolving geopolitical situations. **We are upgrading Energy to Overweight from Neutral.**

Consumer Discretionary: Consumer shares rarely work in concert with Energy. The Strategas "Common Man CPI," which measures inflation in goods and services that the average person must purchase, continues to outpace both Headline CPI and wages. Consumers are feeling the pinch with wages trailing prices. For now, the uptrend in Discretionary shares relative to Staples remains intact, but how the ratio responds to oversold conditions will be important information on the cyclical tone of the market. **We are downgrading Consumer Discretionary to Neutral from Overweight.**

Health Care: The opportunity cost to own shares is high as profit margins fall and we move further into an election year in which neither candidate is particularly "good" for the sector. Long-term relative performance for Health Care has persistently struggled despite being in a bottom decile historically. Given its inconsistency, the opportunity cost is too high to remain overweight. **We are downgrading Health Care to Underweight from Overweight.**

Strategas Recommended Allocations
(for U.S. Equities)



2 sectors moved to a lower-weighted allocation and 3 sectors moved higher (since Dec. 2023). Sectors are listed as over-, neutral-, or under-weight relative to the S&P 500.

Strategas Sector Allocation – Changes – April 25, 2024

Strategas U.S. Recommended Sector Allocation Summary

	Sector	Rationale	Risks
Overweight	Energy	Equilibrium between geopolitical conflict, supply/demand dynamics, and inflation appearing to favor the sector. Despite price action in April, Crude has held a generally upward trajectory towards $90 over the start of 2024. Rolling 1-year Energy sector ETF flows are responding to historically depressed levels and there's ample room before the trade is crowded.	If oil can't re-approach and hold $90, volatility is likely. M&A has challenged the idea that capital stewardship is a top priority. Input costs and wage inflation have risen. A global recession would hurt demand. Non-OPEC supply growth has compensated for cuts. OPEC+ cuts come into question later this year as the U.S. and other non-OPEC producers take share. Heavyweights Exxon and Chevron create concentration risk for the sector.
	Materials	Commodity strength would be an asset for profits and relative performance. Copper and Gold are in defined uptrends, though consolidation is needed in the short-term. Debt-maturity wall not an issue despite rising cost of capital.	Smaller sub-industry weightings are outperforming larger ones (chemicals remain an area of concern). A recession would hamper economic activity and a stronger US dollar would hurt global revenue. Longer-term, deglobalization trends could raise costs and inhibit supply chains. 2024 EPS estimate behind most sectors.
	Industrials	Industrials provide exposure to cyclical reacceleration in pockets of the economy. The sector sits at the center of "deglobalization," which will have broad implications as long-held operating conventions are reoriented. Both near-shoring and re-shoring initiatives will continue to be a tailwind. Our SLIM Survey indicates manufacturing expansion.	Cost growth in many segments remains higher than nominal activity levels. Manufacturing slowing from an economic downturn would weigh on all corners of the sector.
	Communications	Shares could see a boost from ad-spending in a presidential election year. Sector bellwethers completed cost-cutting measures in 2022. Sector estimated to have strongest 2024 EPS growth. We think streaming & content could do well if there's a slowdown (as consumers scale back other activities outside the home).	Price increases for at-home content continue, while ad-laden subscription tiers are being introduced. Streaming options could be the cheaper alternative to events such as concerts, sports, and movie theaters, but there might be a point at which consumers' wallets feel the pressure. Media, Broadcasting, and Publishing wage inflation continues to surge--presenting a threat to margins.
Neutral	Discretionary	The recent correction in the Discretionary vs. Staples ratio and our elevated Common Man CPI measure both highlight the stress consumers are under. The response of the Discretionary-Staples measure to oversold conditions will be critical. Student loan cut is planned for July 1, US oil production is at record highs to keep prices low (though gas prices are likely to rise over the summer), and the CFPB is limiting credit card late fees to help consumers. From a sector standpoint, it's rare to see Discretionary and Energy work in tandem for an extended period.	If stimulus doesn't materialize, the consumer could be on borrowed time. The sector is heavily influenced by Amazon and Tesla. More broadly, a slowing economy (or recession) would hamper consumer spending. Moreover, consumers' savings cushion from the pandemic appears to be depleted as interest costs sink and student debt repayments return.
	Financials	We are Neutral weight given the number of stocks entering uptrends while the sector's earnings weight exceeds its market cap weight in the index--which could lead to share appreciation. Equal weight, banks and regional banks are getting better, while data and exchanges are growing their influence in the sector. Credit availability is slowing as banks' willingness to lend decreases and the sector tightens lending standards. Financials are notably punching above their market cap weight within the index and that could lead to share price appreciation.	Capital market activity continues to drag through the upcoming quarters. Pressure remains from tighter financial conditions globally and the potential for higher capital requirements and regulation. Stress in sector credit could emerge.
	Technology	Market weight exposure feels adequate considering the sector's outsized influence on the index. AI emerging as a durable long-term target for capital. Sector bellwethers are no longer Growth darlings but are capable of leadership due to cash generation capabilities. Given extreme absolute and relative price momentum, Tech is not in a position for a timely entry.	Concentration risk remains a consistent theme. Pure Growth could struggle in an operating environment of higher interest rates and elevated inflation, but Technology worked before the era of quantitative easing, so outperformance could persist. The sector appears to be at risk of more vanity projects as AI trends continue.
	Utilities	The sector's dividend yield is facing competition from the fixed income asset class. The sector does have some defensive hedge properties in the wake of a recession, but also faces fundamental struggles like volatile natural gas prices and rising leverage. Utilities are outpacing Transports at present, but it will be important to gauge how the ratio responds to oversold conditions.	A recession could give a bid to the sector. A sharp decline in yields could enhance the yield-attractiveness of the sector. Higher interest rates could begin to weigh on the sector and hinder price action.
Underweight	Health Care	Relative performance is scoring in the bottom 10% of historical data back to the 1970s, but the sector has failed to capitalize on this oversold condition for an extended period, creating a high opportunity cost to stay long. As we move further into the election year, neither candidate is particularly "good" for the sector. NTM EBIT margins are falling precipitously. The sector would likely lag in a protracted cyclical upswing. Higher-for-longer rates are a headwind for Biotech.	The sector could capitalize on the bottom decile relative performance condition and mount an extended period of relative leadership. Secular growth characteristics of the sector could attract investors during a cyclical slowdown.
	Staples	Persistent underperformance relative to Discretionary and the broader market. Sector has defensive attributes and a record of outperforming in the early stages of a slowdown, but the consumer seems undeterred by well known headwinds such as higher interest rates and tighter lending standards. With interest rates above the sector's dividend yield, there are reasonable income alternatives.	Consumer behavior and confidence can turn quickly if the job environment worsens, which could lead to a pare-back in spending. A growth slowdown or a spike in "risk-off" price action could boost shares.
	Real Estate	We are underweight given persistent ambiguity re: commercial real estate valuations, jagged growth opportunities and general sector weakness. Return to pre-pandemic office attendance has been uneven, impacting commercial property valuations. Leverage ratios deteriorating. Sector has struggled to mount bulk outperformance.	A fall in yields could make interest/dividend income from Real Estate attractive. Industry "Buy" ratings are very low despite impressive net income revisions. Sentiment is extremely negative. Low bar for office REITs to outperform depressed expectations. Internally, the percentage of stocks in an uptrend has been improving.

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