Market Strategy by STRATEGAS A BAIRD COMPANY

BAIRD Private Wealth Management

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Strategas Technical Strategist Todd Sohn walks us through how his team determines whether a market pullback is healthy or concerning, how he gauges the state of the consumer, and what his team's flow research suggests about investor positioning.

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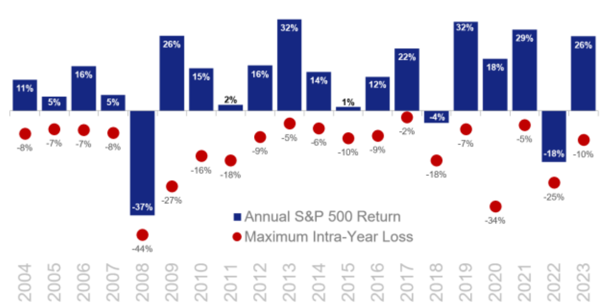
ROSS MAYFIELD: How do you view the April volatility? What do you look for to determine the severity of any given pullback?

TODD SOHN: For context, the average year sees a drawdown of about 14%, and we only hit 5.5% during the April correction. Well short of the historical threshold, and just something to keep in mind in case there's further volatility during the election season. But the most important clues about a selloff's severity come on any resumption of the trend higher. I get worried when the market rally gets narrower—say, the S&P 500 starts to go on and make new highs, but with less individual stocks accompanying that move. From October to March, we had an expanding new high list that helped fuel the momentum in stocks. **Durable bull markets are built on broad participation, so we want to see evidence of that participation going forward.**

Corrections are common (even in strong years)



Source: FactSet

We also look at credit spreads. High yield spreads (how much a junk bond yields over a Treasury bond) remain very narrow. That's good. Then I'm watching Consumer Staples vs. Discretionary closely for a read on risk appetite. The more cyclical Discretionary sector has paused versus the more defensive Staples. That's okay for now, but it's on our radar going forward.

ROSS: Sticking to the that last bit, what are you watching to determine the overall health of the consumer and consumer sectors?

TODD: So, we're aware that some big bulwark Consumer names have fallen quite a bit here. I am curious to see if that bleeds into small-cap stocks—some of the small-cap restaurants have actually been very strong. I would also keep an eye on what's going on abroad. European automobile names have paused recently, and the luxury goods names are trying to get a foothold again (especially as China shows signs of life). And then, Japanese consumer and auto names have had a great run. Ultimately, to get a good read on things **we're watching smaller stocks in the U.S. and we're also watching the Discretionary vs. Staples ratio for the international picture** (with an eye on the possibility that cyclicality is being relocated geographically, but not being extinguished overall).

ROSS: What is your ETF flow work telling you about investor sentiment and positioning right now?

TODD: Flows into stock market ETFs were ~$18 billion in April, which is meaningfully lower than recent months. I think it's consistent with the shakeout in the market last month, as well as some money being shifted towards tax payments. If one thing stands out, it is the aggressive flows to Tech-related ETFs. That's worked this year, but when the herd starts to position a little too aggressively in one part of the market, I get concerned. We're also seeing cracks in the performance of Tech vs. the rest of the market. On the other hand, when you look at flows to more cyclical sectors such as Energy, Industrials, and Materials, they've been negative since the Fed pause began last July. So, if you're looking for a less crowded space with some leadership and improvements in trend, I would take a look at the more cyclical areas, especially if there's a deeper pullback this summer.

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