Market Strategy
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Strategas Head of Macro and Technical Research Chris Verrone takes stock of the equity market. He describes why the current environment is so disorienting, what the implications are, and where he has the highest conviction as of today.

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A DISORIENTING MARKET | STICKING WITH THE "AVERAGE" STOCK

ROSS MAYFIELD: You've recently used the word "disorienting" to describe this market. Could you elaborate on that a bit?

CHRIS VERRONE: I think "disorienting" is appropriate to describe the market here. For instance, it's been a very good rally since mid-October, but at the same time the yield curve has actually only gotten more inverted over that period (see chart). So, on one hand, we've had a good rally and it's even largely been driven by cyclical sectors (Financials, Industrials, etc.). This is an important distinction from the rally that we saw in July, which was very much led by defensive sectors**. We like that improved tone out of stocks. But I think our optimism has to be tempered by what the reality of a deeply inverted curve means.** It's difficult to find an example where, from an inversion of this depth, the economy didn't suffer major slowdown in the near-term. Historically, when the curve is this inverted, it's rare to see a market rally much more than 15-20%. And our current rally is starting to approach that level.

One other disorienting feature of this market is all of these rumors about reopening in China and the potential for that to send commodities higher. And yet, crude oil really hasn't responded and is actually about to make a one-month low. Chinese high yield bonds haven't really responded to that optimism either. So, I think it's our job as analysts to always try and identify when the market action is pushing back against the consensus narrative, and I think there's two examples of that right now.

ROSS: On the flip side of the "disorienting market" you described, what is a theme or call that you do have high conviction in?

CHRIS: I would go back to the theme that's been dominant in our thinking over the last 18 months: the idea that as investors right now, we have to be different than the index (i.e., the market-cap weighted indexes like the S&P 500). In the S&P, five stocks comprise something like 20-25% of the total weight, and we think they are the weakest parts of the market (i.e., the large cap Tech and Growth names). On the other side of that, the "average" stock is actually getting better. That's a theme that's been durable in our thinking over the last 18 months, and I don't see a ton of evidence that it's really changing.

And then we go back to kind of the bigger picture: What has driven this migration away from the big weights and toward the average stock? I think it's the change in the price of money (i.e., higher interest rates). Low rates were such a tailwind for Tech for so much of the last decade. That's certainly less so the case right now, and even with bond yields off their recent highs, the fact that Tech hasn't rallied in a meaningful way as an outperformer reflects that this is still a very different environment for them to operate in. So, we're using this rally to lighten Growth/Tech exposure and add to the average stock (e.g., Financials, Industrials, Materials). They're not big weights, but it's where the strength has really been coming from here.

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