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Elston Insights

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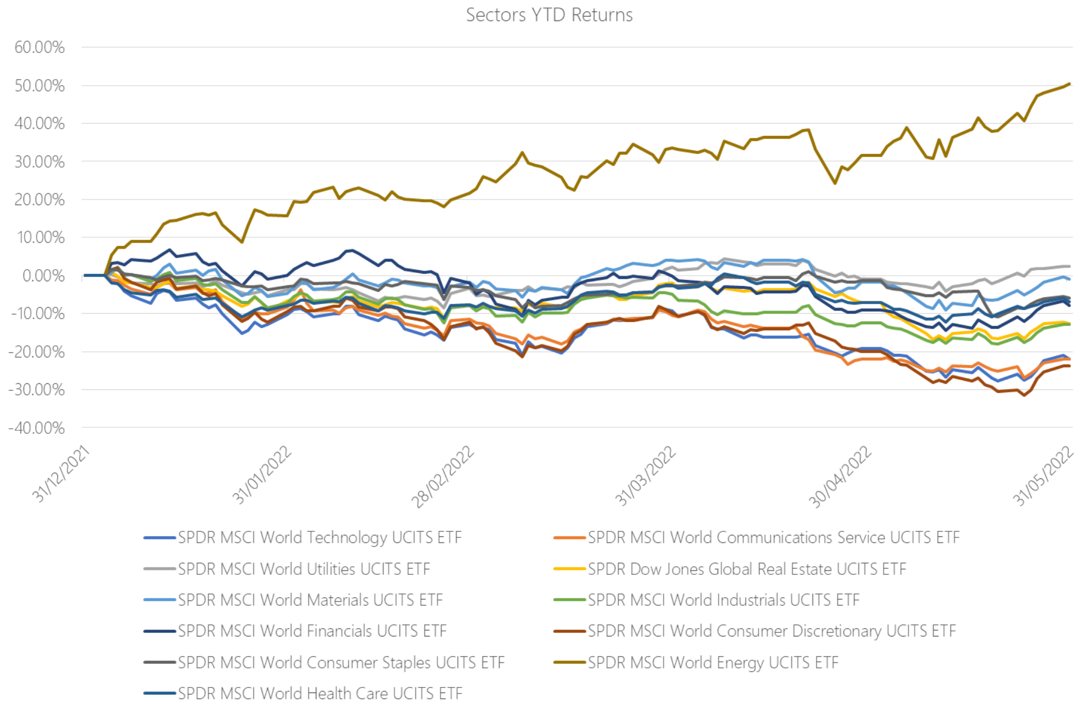
Sector role reversal: pandemic winners, today's losers

- Pandemic winners are suffering a fall from grace
- Inflation risk is re-rating frothily valued sectors
- Market uncertainty driving investors to dependable businesses

The uncertainty of the current market environment is prompting a pivot away from sectors that have served investors well, in many cases since the financial crisis but particularly during the Covid-19 pandemic. With inflation rampant, commodity prices spiralling, supply chains choked and the much relied-on 'Fed Put' (whereby central banks rescue markets by flooding them with liquidity) a thing of the past, investors are rotating away from Technology and Real Estate and into traditionally "boring", but dependable sectors like Industrials, Materials and Energy.

The economic restart in the wake of the pandemic was a driver for inflation and the outbreak of war in Ukraine has only served to exacerbate this. The consequences have been binary: as commodity prices spiral upwards, this benefits businesses in the Energy and Materials sectors, and penalises manufacturers in the Consumer Discretionary sector, for example.



Source: Elston research, Bloomberg data, as at 31-May-22, USD terms

The chart above shows the returns generated by each world equity sector since the start of the year.

The Energy sector is the runaway outperformer, alongside Materials, Healthcare and Utilities. The sanctions prompted by the war in Ukraine have wrought havoc in terms of global energy supply and recalibration is going to be slow and capital intensive. The many new facilities required to ensure energy security will give a likely boost to the Industrials sector, as will government defence spending. Materials as a sector is highly correlated with Industrials, supported by demand for metals and chemicals. For healthcare, the dynamics are less sensitive to prevailing market pressures than other sectors, but it is this defensive resilience that makes it attractive to investors. The impact of inflation is significantly less direct and demand is stable.

As the cost-of-living squeeze has an ever greater impact on populations worldwide, non-essential spending is weakening considerably, badly affecting the Consumer Discretionary sector. The most significant fall from grace, however, has been experienced by the Technology sector. Not only has demand for certain tech-enabled services waned since pandemic-related confinement came to an end, but investors are now increasingly focused on dependable businesses with reasonable valuations, reliable growth and real-time profitability.

Focusing on sector performance and capturing the themes that drive it can be of great benefit to investors, especially in such changeable economic and market conditions. Diversification is a key driver of returns and by gaining exposure to a whole sector rather than individual securities within it, risk can be reduced without necessarily undermining the scope for upside.

Marina Gardiner

Elston Consulting

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