SECTOR VS. MARKET TIMING

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Thus far, 2024 has been positive for US equities, with the S&P 500 ([SPX]) up roughly 5% year-to-date (through 2/14), however, concerns about an uptick in inflation and what that means for the direction of monetary policy have recently reemerge. Even if the market were to reverse course and finish the year in the red, there will almost certainly be areas of strength, as we typically see wide dispersion between the best-performing and worst-performing sectors based on market fluctuations. Throughout our study, from 1993 through 2023, the S&P 500 posted a negative calendar year return six times, but there were only two years – 2002 & 2008 – in which all of the Dow Jones sector indices finished the year in the red. In 2022, when the S&P was down nearly 20%, the Dow Jones US Oil & Gas Index ([.DJUSET]) was up more than 60%.

The Sector vs. Market Timing study can be a useful tool both for coaching clients to stay the course in a turbulent market, like the one we found ourselves in 2022 and for explaining intra-market dispersion and the value of relative strength strategies generally.

Dispersion refers to the performance difference between the best and worst-performing assets and quantifies the opportunity available to tactical strategies. Relative strength-based strategies tend to offer excess return over their benchmarks more readily when the dispersion between the best and worst performers is very wide. The reason for this is straightforward - the more divergence that exists between the best and worst performers, the more potential value can be added by owning good-performing assets and avoiding the bad performers. When there is more dispersion, there is more potential for a tactical decision to produce a meaningful result. On the other hand, such strategies will tend to suffer or at least become muted when the dispersion is narrow. Taken to an extreme, if all investment possibilities were up the same amount each month and each year, tactical management would have no opportunity to add value via rotation. From 1993 through 2022, the calendar year dispersion between the best- and worst-performing broad DJ sector indices have ranged from a low of just over 25% in 2012 to a high of nearly 97% in 1999 and 2022, with an average of just over 45.5% In most years the sector dispersion has been greater than the total return of the S&P 500, meaning that there was potentially more to be gained from sector allocation than from deciding between the S&P and cash, as our study further illustrates.

Our study tracks the return of four hypothetical investors over 30 years, from 1993 through 2023, the first investor who we'll dub, "Mr. Buy and Hold" simply buys the S&P 500 Index and rides it up and down, making no movements at all in the portfolio. "Mr. Perfect Market Timer", our second investor, is assumed to be clairvoyant and is only invested during months in which the S&P 500 Index is up. In 2008, for example, this investor would have only been invested in April, May, August, and December, as those were the only positive months that year. In our view, this is about as "perfect" as any "market timer" could ever hope to be, and thus we feel this quantifies well as the best-case scenario for market timing.

Our last two investors are both sector investors, one of whom, "Ms. Perfect Sector", knows each and every year what the best-performing sector will be for that year, and invests 100% of her portfolio in just that one sector. The fourth investor, "Mr. Worst Sector", is an unfortunate fellow, who perhaps just follows a favorite magazine cover and is on the wrong side of things every year. He manages to invest only in the single worst-performing sector.

As you might imagine, each of the investors has seen dramatically different results over the years from their initial investments of $10,000 back in 1993. At the end of 2023, Mr. Buy and Hold had a portfolio value of about $200,000 while Mr. Perfect Market Timer had a portfolio value of nearly $28 million. Ms. Perfect Sector saw her portfolio swell to $93 million, all while poor Mr. Worst Sector's portfolio was worth only $268! Yes, you read that right - $268 from the starting point of $10,000.

So, it's easy, right? All you have to do is invest in the best-performing sector each year and simply walk away. Unfortunately, it is not that easy, nor are we advocating that you try to pick the best-performing sector and put all your eggs in one basket; rather, this is simply a powerful illustration of just how important incorporating a sector rotation plan can be into your overall portfolio strategy. It can also be an eye-opener for clients in that the magnitude of buying the best sectors is even greater than that of being able to perfectly time the overall market.

We have numerous tools and indicators on our website that help guide you in the right sector direction from guided ETF models to DALI to sector bullish percent indicators. The premade DWA Group Matrix is a favorite of the analysts to keep an eye on each week. This RS matrix was the first one created at DWA many years ago, and it is comprised of all 40 of our DWA sectors, along with the S&P 500 Equal-Weighted Index (SPXEWI). Each sector is represented by a DWA Equal-Weighted Sector Index, which is constructed with roughly 20 to 25 names from each group. The RS matrix concept summarizes a big arm-wrestling match between all 40 of these DWA sector indexes. Those sectors at the top of the matrix possess superior relative strength compared to the others on the list. Typically, you then want to focus your attention on those sectors toward the top of the matrix, while underweighting those found at the bottom.

Looking at the group matrix today, we see that the building index ([DWABUIL]) ranks at the top, with steel ([DWASTEE]), non-air transport ([DWATRAN]), software ([DWASOFT]) and insurance ([DWAINSU]) rounding out the top five. On the other end of the spectrum, we see precious metals ([DWAPREC]), utilities ([DWAUTI]), media ([DWAMEDI]), real estate ([DWAREAL]), and telephone ([DWATELE]) near the bottom.

Technology has been one of the strongest areas of the market over the last year the broad technology sector currently sits atop the DALI domestic equity sector rankings followed by industrials, so software, building, and non-air transports near the top of the matrix is another sign that these are areas we should focus on.

Total Return Table

Year End	Buy & Hold S&P 500	Perfect Market Timing S&P 500	Buying the Best Performing Sector	Buying the Worst Performing Sector
Beginning Value	**$10,000**	**$10,000**	**$10,000**	**$10,000**
1993	$11,008	$11,524	$12,416	$9,520
1994	$11,153	$13,685	$15,332	$8,358
1995	$15,344	$18,895	$23,724	$9,875
1996	$18,867	$24,798	$32,349	$9,880
1997	$25,162	$37,797	$48,180	$11,022
1998	$32,353	$58,429	$82,050	$10,111
1999	$39,161	$79,737	$150,709	$8,778
2000	$35,595	$95,733	$235,218	$5,243
2001	$31,364	$119,040	$241,457	$3,757
2002	$24,433	$143,232	$230,008	$2,305
2003	$31,441	$194,221	$347,404	$2,474
2004	$34,863	$229,746	$460,069	$2,517
2005	$36,575	$263,115	$616,890	$2,417
2006	$42,352	$313,702	$844,083	$2,583
2007	$44,679	$372,261	$1,138,153	$2,127
2008	$28,149	$405,438	$878,595	$1,046
2009	$35,598	$638,512	$1,454,138	$1,149
2010	$40,960	$915,321	$1,915,529	$1,201
2011	$41,825	$1,116,070	$2,282,378	$1,024
2012	$48,519	$1,418,592	$2,895,217	$1,042
2013	$64,233	$1,960,390	$4,116,170	$1,190
2014	$73,026	$2,335,128	$5,272,420	$1,079
2015	$74,036	$2,803,768	$5,620,655	$841
2016	$82,891	$3,368,914	$7,096,639	$821
2017	$100,986	$4,059,269	$9,742,976	$808
2018	$96,563	$4,933,011	$10,351,912	$655
2019	$126,970	$6,831,808	$15,266,289	$723
2020	$150,333	$10,658,751	$22,489,977	$483
2021	$193,494	$15,197,700	$34,733,521	$441
2022	$158,452	$19,685,093	$56,355,137	$289
2023	**$200,109**	**$27,774,233**	**$93,025,425**	**$268**
Average Annualized Return	**10.14%**	**29.13%**	**34.26%**	**-11.01%**

Source: Market Performance based on S&P 500; Sector performance based upon Dow Jones sectors

DWA Group Matrix (2/14/2024)

RANK	TICKER	NAME	BUYS	X'S	TOTAL	TECH ATTRIBUTE/ SCORE
1	DWABUIL	Dorsey Wright Building Index	40	39	79	5.00 ↑
2	DWASTEE	Dorsey Wright Steel Index	39	29 ↓	68	5.00 ↑
3	DWATRAN	Dorsey Wright Transport Non Air	36	29	65	3.00 ↑
4	DWASOFT	Dorsey Wright Software Index	31	38 ↑	69	5.00 ↑
5	DWAINSU	Dorsey Wright Insurance Index	31	26	57	1.00 ↑
6	DWAMACH	Dorsey Wright Machine and Tools Index	30	22	52	5.00 ↑
7	DWASEMI	Dorsey Wright Semiconductor Index	29	36	65	3.00 ↑
8	DWAPROT	Dorsey Wright Protect/Safety Index	29	34	63	3.00 ↑
9	DWAOIL	Dorsey Wright Oil Index	29 ↓	3	32	3.00 ↓
10	DWAELEC	DWA Electronics Sector	27	23 ↑	50	3.00 ↑
11	DWAAERO	DWA Aerospace Index	27	20	47	3.00 ↑
12	DWAOILS	Dorsey Wright Oil Service Index	27 ↓	2	29	5.00 ↑
13	DWAAUTO	DWA Autos & Parts Index	26	15	41	3.00 ↓
14	DWACOMP	Dorsey Wright Computer Index	25	34	59	3.00 ↓
15	DWATEXT	Dorsey Wright Textile Index	25 ↑	33	58	3.00 ↑
16	DWABUSI	Dorsey Wright Business Products Index	25	27	52	3.00 ↑

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