

Sector trends for 2009

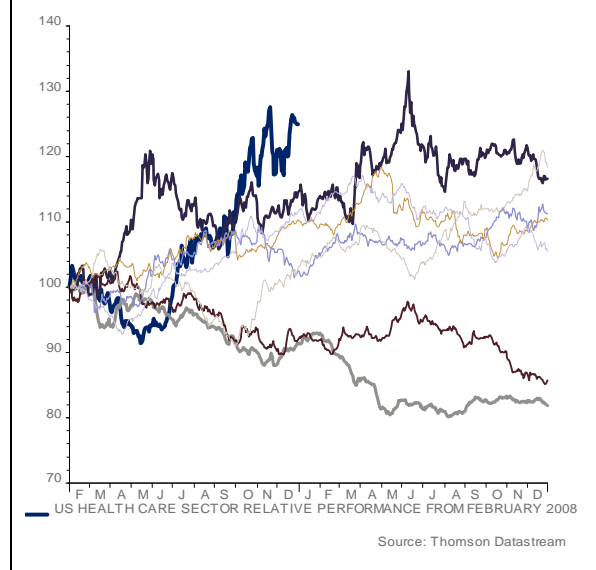
Looking forward into 2009, we have a positive view on equities in general. But which sectors of the market will do best in the recessionary economic and market environment we expect to extend through this period?

A review of previous recessionary periods indicates that health, consumer and financial-related sectors tend to perform better than more cyclical industrial and commodity-related sectors. Somewhat surprisingly, utilities also do poorly, perhaps because they have generally performed so strongly in the previous part of the cycle. Our latest review has used the US equity market, where Datastream provides sector data back to 1973 and we have information on the economic cycle as measured by the output gap.

Performance in 2008 has borne out many of the historical trends. But every cycle is unique and, this time, we have seen a sell-off of basic materials and financials after the bursting of the commodity and credit bubbles. The credit crunch has also highlighted balance sheet strength as a key factor in the current downturn. This has reduced the attractiveness of sectors outside the financial industry whose business models are reliant on high levels of debt, such as construction and utilities.

The length and scale of the financial crisis and recession means that performance during the current downturn has been extreme. Many defensive sectors have already outperformed strongly, as our example of health care shows. However, given the features of the current recession, scope for further outperformance remains.

US health care sector, relative performance from the start of recessionary periods since 1973 (from February 2008 in bold blue)



The recessionary part of the cycle is positive for equities overall, and 2009 will represent the (historically better) second half of the recessionary phase. Within the market, opportunities for outperformance should remain in the defensive consumer sectors. The emergency policies adopted by central banks – from interest rates close to zero to direct intervention – are designed to restore liquidity and, just as importantly, profitable functioning to financial markets, so the financial sector should contain some attractive opportunities. We would also look to some of the more cyclical industrial and technology sectors, where strong finances indicate an ability to weather the current financial storm and start to anticipate better trading conditions in 2010.

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