



July 25th, 2019

Cheap cyclicals may be a warning sign

With the slowdown in the US corporate profit cycle showing few signs of an imminent reversal, we continue to emphasize high quality and stable earnings over cyclicality within our portfolios. These positions have become very contrarian because investors believe defensive sectors have become expensive while cyclical sectors are cheap. But comparing the valuations between cyclical and defensive industries comes with some complications. For cyclical stocks, valuations tend to be elevated when profits are bottoming (when you should be buying them) and cheap when profits are peaking (when you should be selling them). Take a look at the P/E multiples for Machinery stocks (a deep cyclical industry) during the last cycle. They became consistently “cheap” (trading below their long-term median P/E) throughout 2005-2008 and only started screening “expensive” (trading above their long-term median) after the stock market bottomed in the spring of 2009.

US Machinery consensus EPS and P/E ratio 2001 - 2010



Source: Richard Bernstein Advisors LLC, Bloomberg

We analyzed the valuation and subsequent performance of defensive sectors going into the last three bear markets. With the exception of the Tech bubble — when Info Tech traded at a P/E of 60x, Telecom traded at 34x and everything else traded at a discount— **defensive sectors have almost always traded at a premium going into bear markets, yet they have consistently outperformed during the subsequent bear markets.** History suggests, therefore, that the market’s present valuation of cyclicals may be a warning signal rather than an opportunity.

Relative valuations and performance (vs S&P 500®) of defensive sectors during bear markets

Sector	Jul '90 - Oct '90		Mar '00 - Oct '02		Oct '07 - Mar '09		Current
	Starting P/E Premium/Discount	Relative Bear Market Performance	Starting P/E Premium/Discount	Relative Bear Market Performance	Starting P/E Premium/Discount	Relative Bear Market Performance	P/E Premium/Discount
Cons. Staples	+17%	+6ppt	-42%	+78ppt	+12%	+27ppt	+14%
Health Care	+34%	+6ppt	-3%	+43ppt	+4%	+17ppt	-11%
Utilities	-23%	+18ppt	-49%	+4ppt	+4%	+12ppt	+9%

Source: Richard Bernstein Advisors LLC, Bloomberg

Dan Suzuki, CFA
Portfolio Strategist

Please feel free to call your regional portfolio specialist with any questions:

Phone: 212 692 4088

Email: marketing@rbadvisors.com

For more information About Dan Suzuki, please click [here](#).

Recent & Related articles:

[Madonna, hair bands and protectionism](#)

[A long December](#)

[Why is corporate profit growth slowing?](#)

[Look forward, not backward](#)

[S&P 500® for the long run?](#)

[Sometimes defense is the best offense](#)

[Health Care for All](#)

[Time to hang up your CAPE?](#)

[Protectionism, profits and positioning](#)

Dan Suzuki is registered with Foreside Fund Services, LLC which is not affiliated with Richard Bernstein Advisors LLC or its affiliates.

Nothing contained herein constitutes tax, legal, insurance or investment advice, or the recommendation of or an offer to sell, or the solicitation of an offer to buy or invest in any investment product, vehicle, service or instrument. Such an offer or solicitation may only be made by delivery to a prospective investor of formal offering materials, including subscription or account documents or forms, which include detailed discussions of the terms of the respective product, vehicle, service or instrument, including the principal risk factors that might impact such a purchase or investment, and which should be reviewed carefully by any such investor before making the decision to invest. RBA information may include statements concerning financial market trends and/or individual stocks, and are based on current market conditions, which will fluctuate and may be superseded by subsequent market events or for other reasons. Historic market trends are not reliable indicators of actual future market behavior or future performance of any particular investment which may differ materially, and should not be relied upon as such. The investment strategy and broad themes discussed herein may be unsuitable for investors depending on their specific investment objectives and financial situation. Information contained in the material has been obtained from sources believed to be reliable, but not guaranteed. You should note that the materials are provided "as is" without any express or implied warranties. **Past performance is not a guarantee of future results.** All investments involve a degree of risk, including the risk of loss. No part of RBA's materials may be reproduced in any form, or referred to in any other publication, without express written permission from RBA. Links to appearances and articles by Richard Bernstein, whether in the press, on television or otherwise, are provided for informational purposes only and in no way should be considered a recommendation of any particular investment product, vehicle, service or instrument or the rendering of investment advice, which must always be evaluated by a prospective investor in consultation with his or her own financial adviser and in light of his or her own circumstances, including the investor's investment horizon, appetite for risk, and ability to withstand a potential loss of some or all of an investment's value. Investing is subject to market risks. Investors acknowledge and accept the

potential loss of some or all of an investment's value. Views represented are subject to change at the sole discretion of Richard Bernstein Advisors LLC. Richard Bernstein Advisors LLC does not undertake to advise you of any changes in the views expressed herein.