Sector Insights

The setup heading into 2023 was that the lagged effect from the Federal Reserve's (Fed's) aggressive tightening of monetary policy would push the U.S. economy into a recession and, in turn, weigh on the stock market's overall performance. The market and the economy, however, had other plans, as economic growth remained resilient and the bellwether S&P 500 Index delivered a total return of 26.3 percent.[1] The S&P has now delivered positive performance in four of the last five years, with an annualized equivalent gain of 15.7 percent per year over that period.[2]

Driving the gains were the retreat in inflation and the stable jobs market. After peaking in June of 2022 at 9.1 percent, the consumer price index (CPI) fell to 3.4 percent during December of 2023.[3] Meanwhile, the jobs market remained strong with the unemployment rate ending the year at 3.7 percent.[4] The combination of falling inflation and a stable labor market shifted the conversation away from a pending recession to the possibility of a "soft landing."

Looking Ahead: Macro Fundamentals Remain Supportive

Looking ahead, Guggenheim still believes there is money to be made in the equity market as an environment of resilient economic growth, declining inflation, solid earnings, easing monetary policy, and lower long-term rates should continue to be a friendly environment for risk assets.

The economy is still chugging along, payrolls are still growing, the unemployment rate is low, inflation is moderating, the housing market is likely to improve with lower rates, and, importantly, the U.S. consumer continues to spend.

The outlook for earnings growth remains very favorable. The S&P 500 entered a three-quarter-long earnings recession in late 2022. That ended with third quarter 2023 results, marking the start of an

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Two Sector Categories

Based on how sectors react to different market environments and economic phases, Guggenheim divides sectors into two categories: **cyclical and defensive.**

Consumer Discretionary | Energy | Financials | Industrial | Information Technology | Materials | Real Estate
These sectors are highly sensitive to business cycle peaks and troughs.

Consumer Staples | Communication Services |Health Care | Utilities
These sectors provide services that consumers need regardless of business cycle and tend to be immune to the economic cycle.

Past performance does not guarantee future results.

earnings recovery, with forecasted quarterly earnings expected to reaccelerate throughout 2024. Full year expectations are also signaling a nice rebound in bottom line growth from the lackluster growth seen in 2023, with both 2024 & 2025 earnings expected to grow by 10.8 percent and 12.3 percent, respectively.[5] In a perfect world, all else being equal, market performance should closely track underlying EPS growth.

Improvement in the labor market could help push the Fed in a more dovish direction, potentially resulting in a more accommodative environment by year end.

Since 1928, presidential election years have often delivered favorable performance. There tends to be a seasonal pattern during election years, which often feature a lackluster start, followed by better performance through the summer months before turning cautious in the months ahead of the election (November 5th this year). Following the election, the market has often staged a relief rally with better performance into the year-end.

Cash on the sidelines remains at record levels. Money market mutual funds currently hold almost $5.965 trillion in cash.[6] Guggenheim believes a good chunk of that money will eventually find its way back into the market as clarity emerges on the economy, interest rates, and inflation. Historically it takes multiple rate cuts by the Fed for money to start flowing out of money market funds back into the equity markets. Based on current expectations for Fed cuts over the course of this year, the lagged impact could become the fuel for better performance in the second half of the year.

2024 Positioning

Understanding the components of economic growth and market trends are important building blocks when developing overarching views for equity positioning. Factors such as market cycles, price shocks, and innovation can influence drivers of economic growth through key components such as revenue growth, margin performance, and productivity. Similarly, external impacts from monetary and fiscal policy, asset and portfolio allocation positioning, seasonality, and valuation can further augment or limit how underlying fundamental performance flows through to equity price returns. Guggenheim will examine several themes, factor pairings, and sectors that we favor given the current market backdrop.

Looking back over the past three years, January has proved to be a pivotal month, with the start of the year essentially serving as the market lows in 2021 and 2023 and the top for equities in 2022. Turning to 2024, with pandemic-related uncertainty continuing to challenge market prognosticators—recall only a handful of firms called for positive market returns at the start of 2023, only to see the S&P 500 go on to deliver a total return of 26.3 percent—this uncertainty has resulted in a relatively wide range of projections for 2024, from a hard landing to a soft landing to no landing at all.

The S&P 500 has achieved positive total returns during 15 of the last 16 presidential election years that included an incumbent president or sitting vice president dating back to 1944, yielding an average total return of 13.98 percent in those years.[7]

With the S&P 500 starting the year under pressure after trading near all-time highs, we would not be surprised to see markets remain range-bound or show further signs of consolidation early in the year, particularly as the lagged effects of monetary policy and typical seasonality around the election (with stocks historically selling off around Super Tuesday) likely to weigh on returns. That said, as investors gain greater clarity around the size and frequency of potential rate cuts by the Fed, we tend to think 2024 will once again see January (or sometime slightly thereafter) be closer to the market bottom rather than the top, as stronger earnings growth (projected to be up double digits after negligible growth in 2023) and improved market breadth (approximately 85 percent of S&P 500 issues are trading above their 50-day average) should support steady equity returns as we move through the year.

Moreover, with inflationary pressures continuing to ease (core CPI excluding shelter is now at or near the Fed's 2 percent target on a 3-, 6-, and 12-month basis), this leaves us cautiously optimistic that inflation has been more transitory in nature and will likely be tamed without the need to tilt the economy into a significant recession. In addition, a tight labor market (which may be a factor behind the Fed's guarded stance) should show signs of cooling in 2024, with job openings falling to their lowest level in over two years and leading indicators like the quits rate now back to pre-pandemic levels. This in turn could help push the Fed in a more dovish direction, potentially resulting in a more accommodative environment by year end. Finally, with Bloomberg reporting that national elections are set to take place in countries that represent more than 40 percent of the world's population and roughly 80 percent of its stock market capitalization, incumbents will likely be incentivized to use available tools to keep their economies strong (recall the S&P 500 has achieved positive total returns during 15 of the last 16 presidential election years that included an incumbent president or sitting vice president dating back to 1944, yielding an average total return of 13.98 percent in those years[7]. As such, while we enter 2024 with a heighted degree of uncertainty, Guggenheim sees the potential for tactical opportunities to present themselves and would look to add to our equity exposure on material corrections as we move through the year.

Sector Snapshot

In 2023, nine of the 11 S&P sectors posted positive performance total returns, while two (Energy down -1.33% and Utilities down -7.08%) delivered negative returns. Information Technology (+57.84%), Communication Services (+55.80%) and Consumer Discretionary (+42.41%) had the largest returns for the year.

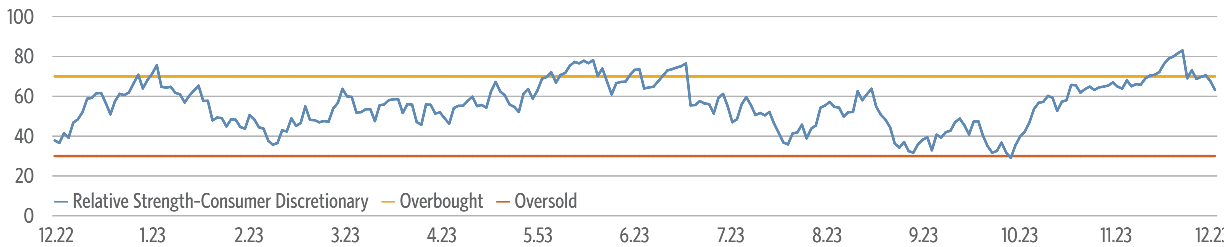
GICs Sector Review and Relative Strength Indicator as of December 31, 2023

Review recent sector performance and Relative Strength Indicator (RSI) highlights. The relative strength indicator can provide insight into sector performance and help identify trends. RSI measures the velocity of a security's price movement to identify overbought and oversold conditions and is calculated from closing prices. Some investors use RSI indicators to recognize potential turning points for making entry/exit decisions. An RSI indicator falling below a value of 30 indicates an oversold condition, and a buy signal is usually triggered when the indicator crosses 30 below. Similarly, an RSI value greater than 70 indicates an overbought condition. A sell signal is usually triggered when the indicator crosses 70 from above.

Cyclical

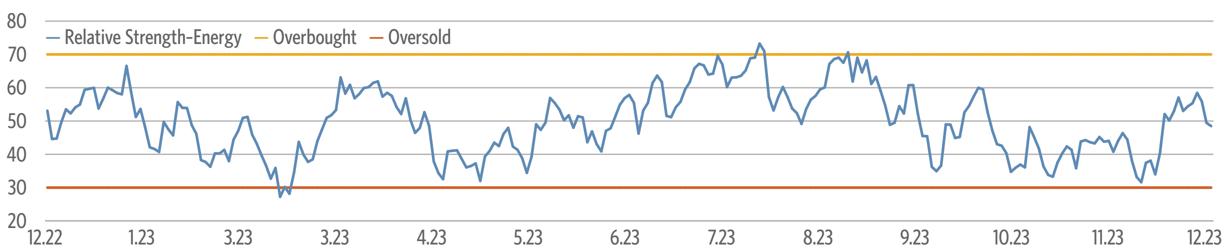
Consumer Discretionary

Performance-wise, the sector ended the year on a relatively high note. Overall, it displayed resilience and growth particularly in the auto industry, driven by robust electric vehicle sales and improved supply chain conditions. Expected interest rate cuts in 2024 will favor consumer spending in non-essential areas, however the prospect of a slowing growth trajectory and its impact on consumer confidence are potential sources of uncertainty. The outlook for the sector is cautiously optimistic, with some challenges to traditional retail and consumer durables from heightened e-commerce competition and shifting spending priorities towards services.



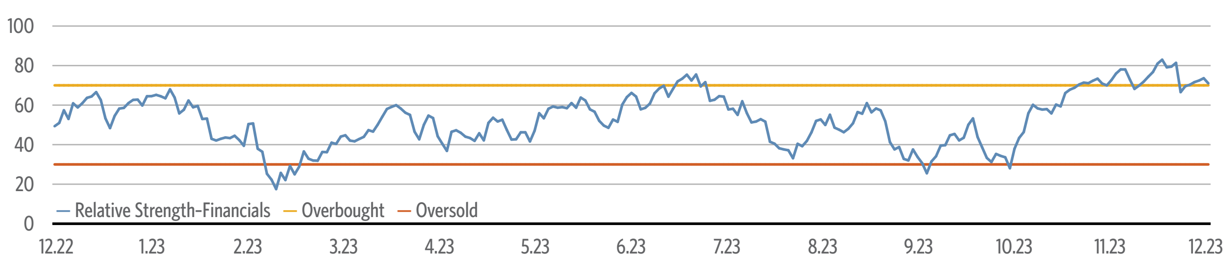
Energy

Energy was the worst-performing sector in December. Year-over-year (YoY), earnings and cash flow continued to be lower. Oil prices were on a downward path for most of the last two months of the year, especially after the disappearance of the early October geopolitical risk premium from the war in the Middle East. In 2024, prices are expected to remain relatively stable YoY, as OPEC+'s production curtailments and geopolitical factors might be partly offset by economic headwinds and a weaker demand outlook.



Financials

The Financials sector was one of the best performing since the equity market's near-term low at the end of October. The asset quality of banks remained strong, although commercial real estate began showing signs of stress. Loan growth, a key driver for the sector, has faced challenges due to tightening lending standards, but the normalization of the interest rate policy might be conducive to brighter months ahead. Activities like M&A and underwriting might only see a gradual recovery amidst broader economic uncertainties. The outlook is cautiously positive, with concerns from a mild recession and increased regulatory pressures as potential headwinds.



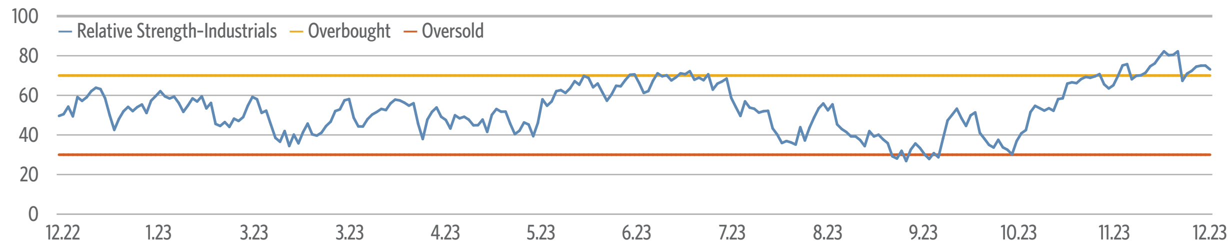
Sector performance is represented by sub-indices of the S&P 500 Index that are classified as members of the related Global Industry Classification Standard (GICS) sector.
Past performance does not guarantee future results. Source: Bloomberg 12.31.2023

GICs Sector Review and Relative Strength Indicator—Continued

Cyclical

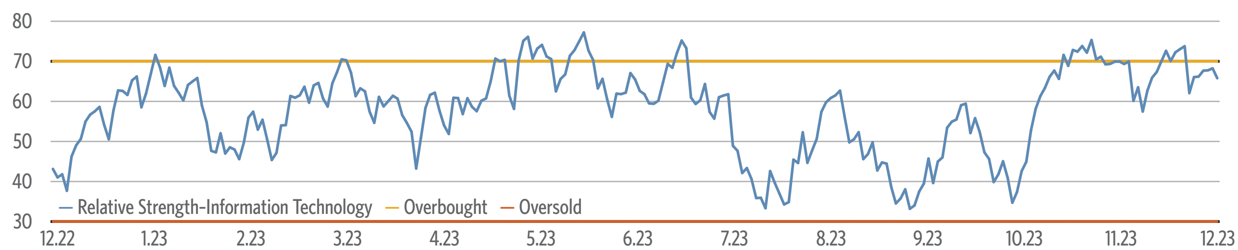
Industrials

Industrials performed well in the latter part of the year, especially driven by capital goods, and only partially offset by a weak showing from transportation. The bright, albeit minor, spot within the latter is passenger airlines, which benefitted from declining oil prices. Positives in the outlook are the easing of supply chain disruptions, increasing order levels for commercial aerospace and higher defense spending due to geopolitical uncertainty. Potential risks include weak freight environment amidst inventory destocking, as well as continued weakness in manufacturing PMI.



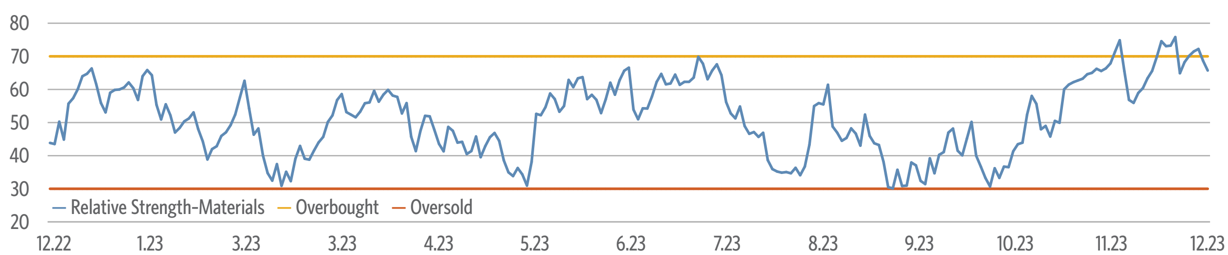
Information Technology

Despite underperforming in December, the sector did exceptionally well for the year. Secular trends remain intact, with continued enthusiasm around artificial intelligence leading to better prospects for profitability and cash flows. The expected start of the Federal Reserve's easing cycle, along with diminished risk of a significant recession, should be bullish for growth sectors. On the flipside, valuations at present looks stretched relative to fundamentals.



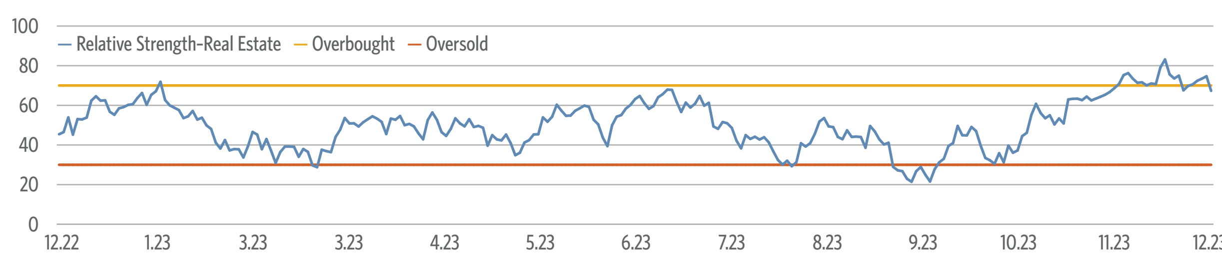
Materials

Materials had a weak year from a performance standpoint, driven for the most part by the chemicals industry. Going forward, while pricing momentum for construction materials companies can be expected to remain strong, prices for lithium and other specialty chemicals are expected to stay under pressure, driven by increased supply and lower demand. A cyclically sensitive sector, its fortunes in 2024 will be especially dependent on the resilience of economic growth.



Real Estate

After suffering the significant negative impact of the Fed's aggressive tightening over the past eighteen months, the Real Estate sector rebounded strongly over the past two months, as the yield on 10-Year Treasuries declined from its peak in October. Property-level fundamentals have remained fairly strong for most property types, with better-than-expected results for the most recent quarter, particularly from retail, hotel, data center, and telecom tower REITs. Solid operating parameters, along with favorable macro trends, can potentially lead to strong performance of the Real Estate sector in 2024.



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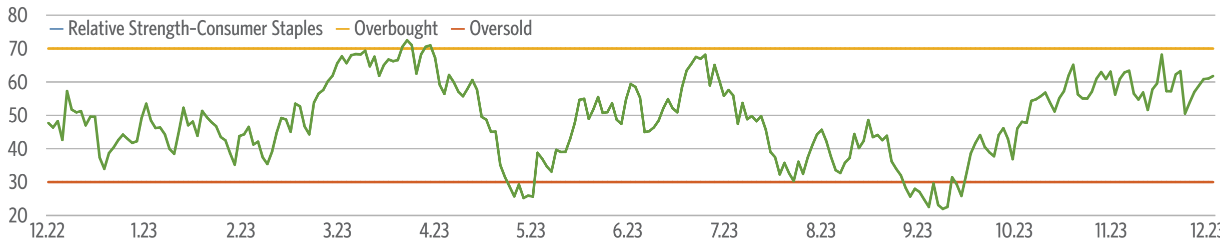
Past performance does not guarantee future results. Source: Bloomberg 12.31.2023

GICs Sector Review and Relative Strength Indicator—Continued

Defensive

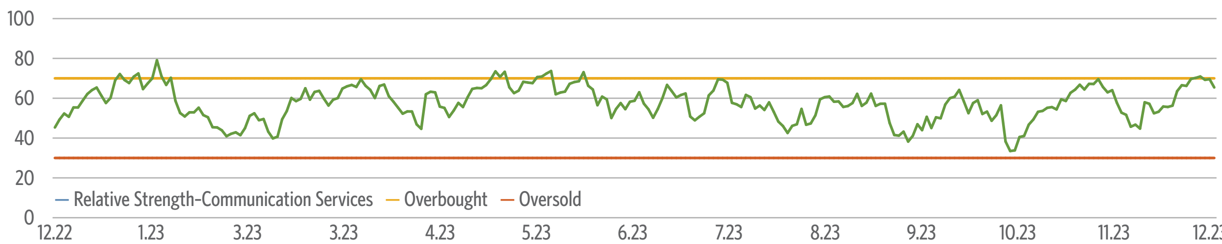
Consumer Staples

The sector was a significant underperformer for the year. As the economy kept surprising to the upside, the market tended to favor cyclicals over defensives. Consumers continue to be more price-sensitive, so volumes are still crucial to maintaining healthy topline growth. The sector's current attractive relative valuation is one potential positive for the outlook.



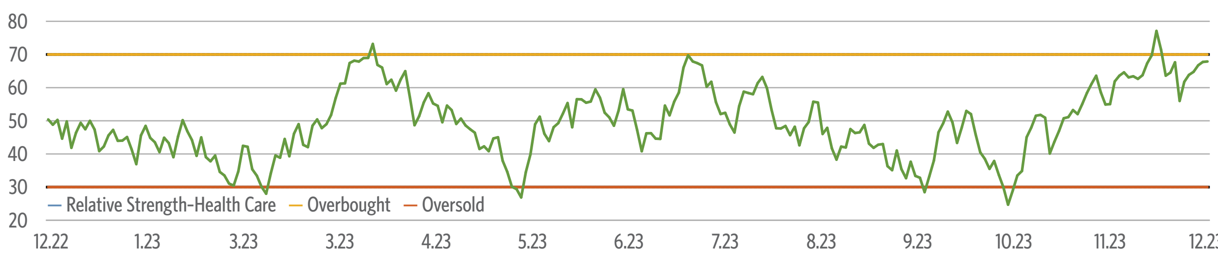
Communication Services

The outperformance of the sector's mega-caps was somewhat offset by weaker returns from telecom and entertainment industries towards the end of the year. Despite some headwinds from margin pressures, global advertising is expected to increase by seven percent in 2024, due to digital innovation and events such as the U.S. Presidential Election and the Summer Olympics. Valuations are more reasonable amongst the cyclical growth sectors, which might leave more room to benefit from the Fed's expected easing cycle over the course of the year.



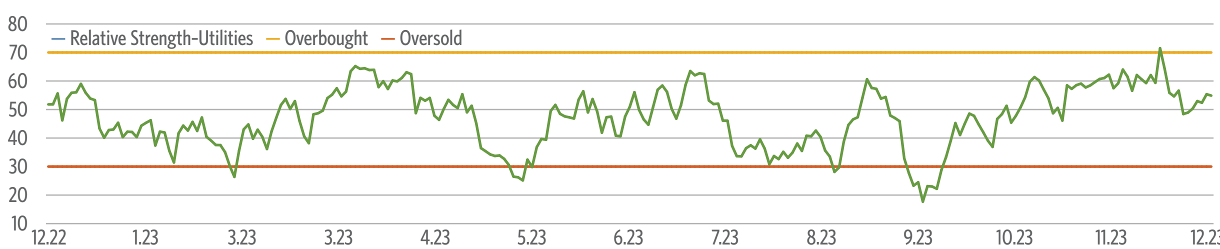
Health Care

The sector largely underperformed the broader market for the year, mostly driven by the pharmaceutical and health care providers & services industries. Sentiment remains bearish, as companies lowered guidance due to significant deterioration in the pharma/biotech end-market demand. The weak outlook is attributed to slower growth in bioprocessing and biotech funding, lower demand from China and a soft capital spending environment. The clinical development of GLP-1 anti-obesity drugs will be a closely watched theme due to their disruptive potential.



Utilities

Utilities were the worst performing sector in 2023. There were some positive contributors to median EPS from increased regulated rates and lower input cost due to reduced commodity prices, but interest expense and record-high debt-to-earnings ratio signal a deterioration in the sector's financial health. Valuations are relatively attractive but the still-negative spread between Utilities' dividend yield and 10-year Treasuries, as well as corporate bonds, continues to hurt the sector's appeal.



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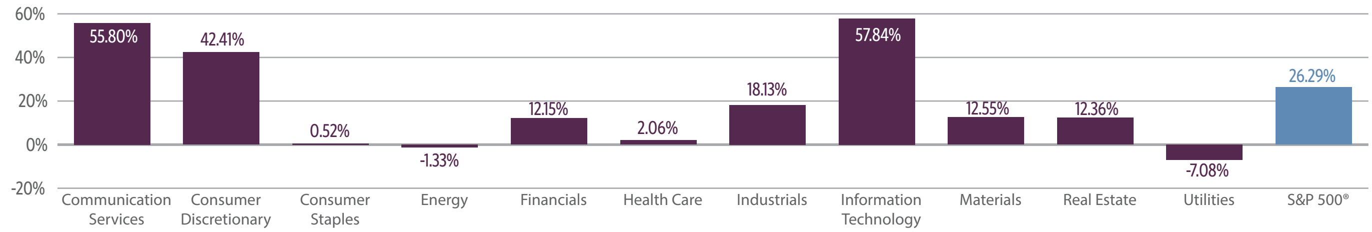
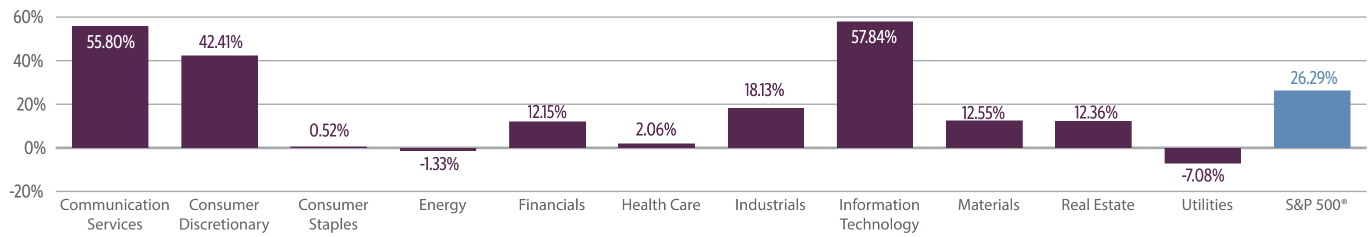
S&P 500 GICs Sector Performance as of 12.31.2023

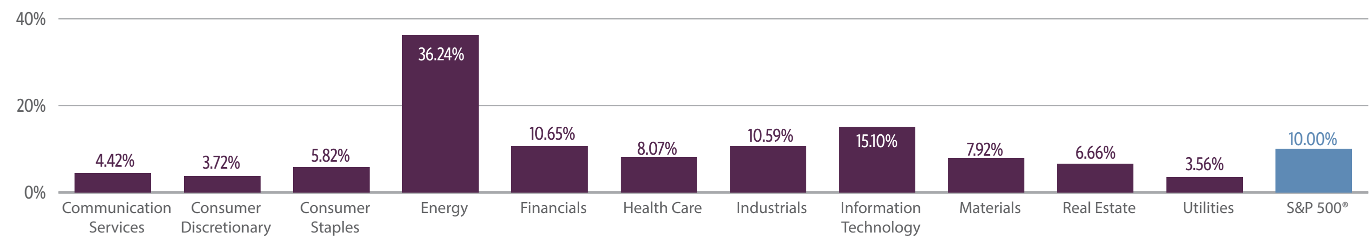
S&P 500 Index vs. Sector Index Performance—YTD



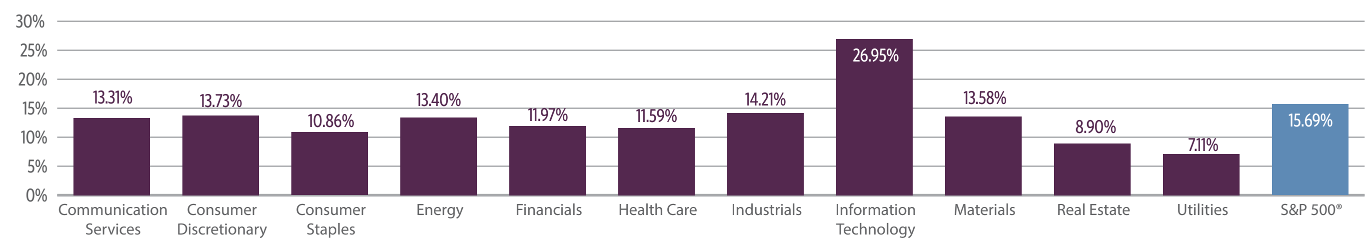
S&P 500 Index vs. Sector Index Performance—1-Year



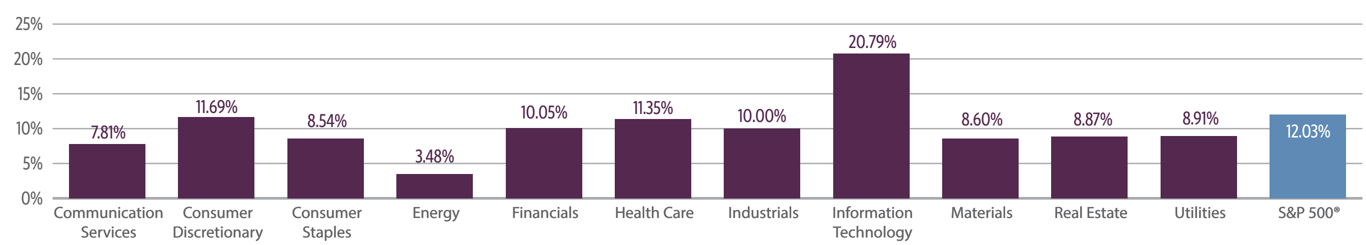
S&P 500 Index vs. Sector Index Performance—3-Year



S&P 500 Index vs. Sector Index Performance—5-Year



S&P 500 Index vs. Sector Index Performance—10-Year



Source: Guggenheim Investments. Sector performance is represented by sub-indices of the S&P 500 Index that are classified as members of the related Global Industry Classification Standard (GICS) sector.

Past performance does not guarantee future results. Index performance is for illustrative purposes only and is not meant to represent any particular investment product. Returns do not reflect any management fees, transaction costs or expenses. The index is unmanaged and not available for direct investment.

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Rydex Sector Funds

- Rydex Banking
- Rydex Basic Materials
- Rydex Biotechnology
- Rydex Communication Services
- Rydex Consumer Products
- Rydex Electronics
- Rydex Energy
- Rydex Energy Services
- Rydex Financial Services
- Rydex Health Care
- Rydex Internet
- Rydex Leisure
- Rydex Precious Metals
- Rydex Real Estate
- Rydex Retailing
- Rydex Technology
- Rydex Transportation Fund
- Rydex Utilities

For more information on sector strategies, visit GuggenheimInvestments.com or call 800 345 7999.

1-2, 5-6, Bloomberg, 12.29.2023. **3-4** Bloomberg, 12.31.2023. **7** Bloomberg, data from 1944 to 2020 elections.

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