Level Set: Sector Thoughts and a Too Early Recovery Playbook

We were asked several times this week about the sell-off in the market, when the market could bottom, and what might work in a recovery. As we wrote last week, we really want to get bullish, because nothing is better than being a contrarian bull now that seemingly everyone is cautious again. However, we think it is just too early given what we see as a higher probability of downward than upward earnings revisions during April, and the overwhelming number of data points indicating the US consumer is slowing. Moreover, it doesn't appear investors are buying stocks on their recent misses. For instance, Nike (Ticker: NKE) reported earnings this week, with top-line revenue down 16% year-over-year. The stock fell sharply, indicating disappointing news was not all discounted in the price.

Thoughts on recent price action:

1. **We continue to like Healthcare:** it has worked because it is defensive and has above average estimate achievability, but we think it could continue to work in an up tape if we get some productivity proof cases in the coming quarters.
2. Energy: We are recommending a market-weight, but it is noteworthy that Energy has been the best performing sector so far this year. Historically, a growth scare would have likely triggered fears of a demand slowdown, yet that hasn't been the case this time. Only 8 times in the last 141 quarters has Energy beaten Consumer Discretionary by more than 20% in a quarter — and we are on pace for this quarter-to-date. Oil prices are modestly down quarter-to-date, despite Energy stocks broadly working. Hence, this sector is the one area of the market that seems to contradict the notion that lower revisions are not being penalized, which for now leads us to believe that owning some Energy stocks is prudent. **Healthcare and Energy are the top two performing sectors year-to-date, and historically they are strange bedfellows, as they were the top two performing sectors in the same quarter only once before, in Q4 of 1995.**
3. **We recommend an underweight in Consumer Discretionary.** The sector has been the worst performing year-to-date, with 17 stocks down more than 10% quarter-to-date, and eight stocks down more than 19%, including Deckers Outdoor (Ticker: DECK) down 42%, Tesla (Ticker; TSLA) down 38.4%, Norwegian Cruise (Ticker: NCLH) down 20.7%, Chipotle Mexican Grill (Ticker: CMG) down 19.5%, and Ulta Beauty (Ticker: ULTA) down 19.4%. If we go back to 1989, Energy has been the best performing sector in 24 of the last 141 quarters. **But, in only 2 of those quarters was Energy the best performing sector while Consumer Discretionary was also the worst performing (Q3 2007 and Q4 of 2022). The Consumer is slowing, and there are lots of bad companies that are in trouble.**
4. **Technology:** We have been recommending a Market-Weight in Technology, and an Underweight in the Mag 7 since early February (*Level Set: Sell Some Mag 7*). Several investors have asked us what we think is most likely to work in a market recovery. While we continue to think a strong near-term rally is unlikely, we did analyze the US equity market returns for the 3-month periods following the last twenty S&P500 pull-backs of 10% or more. On average, the lowest quality quartile "Junk" works best, up 26.4% on average for the quarter following a market pullback. On the contrary, the highest quality quartile of stocks averages 19%. Small and micro. cap stocks average 22.9% and 22.6% performance respectively, while mega cap. stocks typically advance 16.1%. The question then is, when and how much low quality stocks should an investor buy? The challenge is that many of the previous upturns that drove the lower quality / small-cap. performance were accompanied by incremental government stimulus and easy monetary policy. We are less convinced that will be the case in 2025, as

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Trump's policies are generally to reduce government spending, and the Fed "put" doesn't appear to be very close to today's price level.

Small Cap Junk Works Best in a Recovery

Average Performance Following Worst 20 S&P500 Downturns Since 1999 By Cohort	
Cohort	Performance
Junk	26.4%
Small Cap	22.9%
Micro. Cap	22.6%
Growth	22.4%
Value	22.3%
Low Quality	20.9%
Mid-Cap.	20.7%
"Neither" Growth Nor Value	20.1%
Mid-Quality	19.7%
High-Quality	19.0%
Large Cap.	18.3%
Mega Cap.	16.1%

Source: Trivariate Research, LP

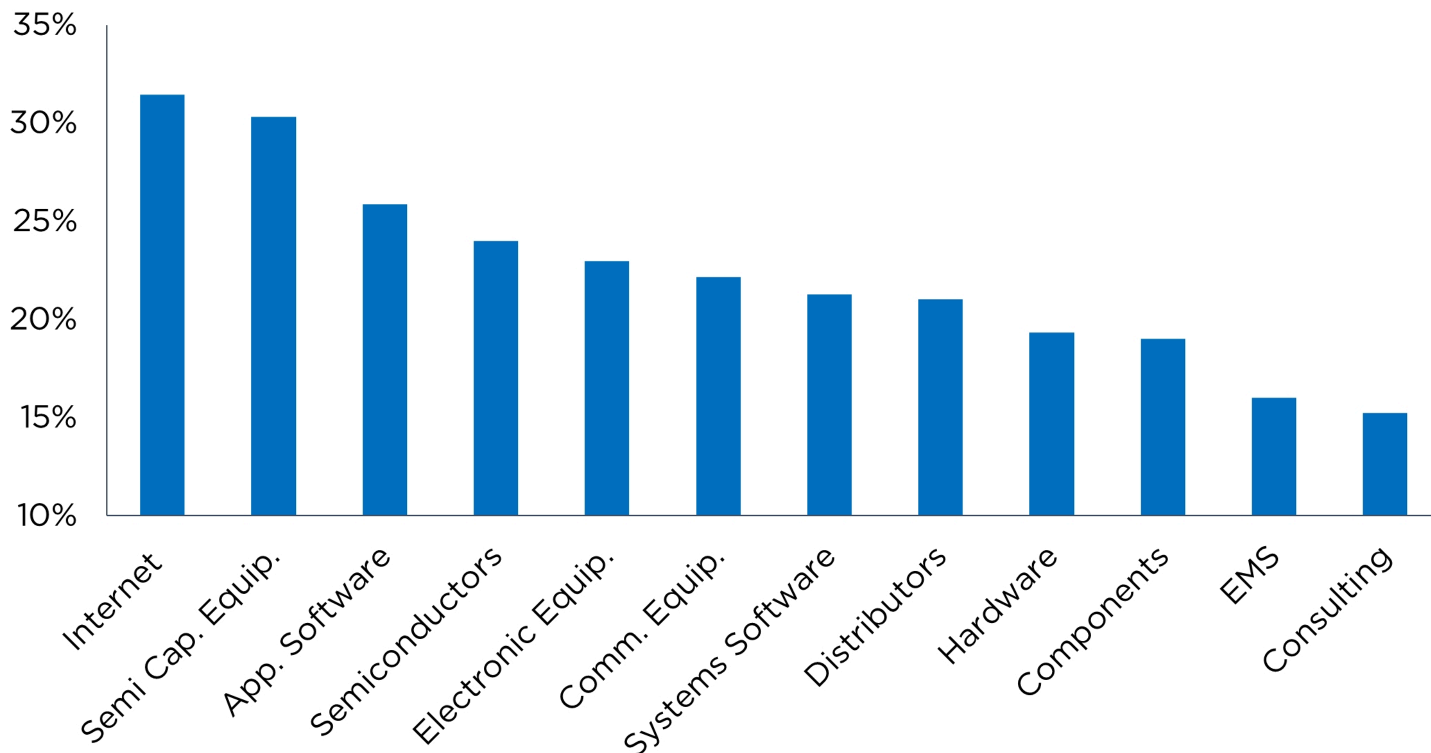
At the sector level, one point is quite clear. Technology stocks work in recoveries. In fact, in 19 of the 20 recoveries Technology worked, with the TMT bubble unwind of 2000 the only exception. On average, Technology was the best performing sector in the three-month periods following the worst market sell-offs in the last 25 years (see below). It isn't surprising that Consumer Staples and Utilities lag, given their defensive nature. Following this analysis, our "prior" guess was confirmed — **the market likely can't work in a recovery without Technology stocks participating.**

Technology Works Best in a Recovery

Average Performance Following Worst 20 S&P500 Downturns Since 1999 By Sector	
Sector	Performance
Information Technology	27.4%
Energy	24.4%
Consumer Discretionary	24.2%
Materials	23.6%
Communication Services	22.3%
Health Care	22.1%
Industrials	21.5%
Real Estate	20.6%
Financials	18.9%
Consumer Staples	13.6%
Utilities	13.3%

Source: Trivariate Research, LP

Within Technology, the best performing sub-industries over the 3-month periods following drawdowns are Internet, Semi. Cap. Equipment, and Application Software (see below). The worst are IT Consulting, and Electronic Manufacturing Services (EMS). We could see the case for buying some Semi Cap. Equipment stocks today.



Source: Trivariate Research, LP

CONCLUSION

When we finally get more clarity on tariffs, and are able to focus on pro-growth initiatives, such as lower taxes, and some proof cases for margin expansion from AI-induced productivity, we can certainly see the market 10-15% higher a year from now. In that scenario, most investors expect that in the early stages of such a market recovery lower quality and smaller stocks will work. But, when uncertainty reigns, those stocks fail miserably. So, the constant debate after a market retreat is which lower quality stocks to own. We could see the argument for moving "down" market from high-quality growth, to owning some mid-cap stocks, particularly those that are forecasted to have accelerating revenue. The current quantitatively derived screen is below. Given it seems like adding a little of lower quality is a way to tip-toe into a market that is selling off but may rebound, we highlight mid-quality stocks where the consensus expects revenue to accelerate below.

Mid-Quality Stocks With Forecasted Accelearing Revenue
As of March 21st, 2025

Ticker	Name	Industry	Market Cap. (US $ Bil.)
CSGP	CoStar Group, Inc.	Real Estate Management & Development	32.41
FSLR	First Solar, Inc.	Semiconductors & Semiconductor Equipment	13.75
CHWY	Chewy, Inc.	Specialty Retail	13.21
RBC	RBC Bearings Incorporated	Machinery	10.43
EPAM	EPAM Systems, Inc.	IT Services	9.80
TECH	Bio-Techne Corporation	Life Sciences Tools & Services	9.54
PLNT	Planet Fitness, Inc.	Hotels, Restaurants & Leisure	8.46
FN	Fabrinet	Electronic Equipment, Instruments & Components	7.96
CRDO	Credo Technology Group Holding Ltd	Semiconductors & Semiconductor Equipment	7.89
CCCS	CCC Intelligent Solutions Holdings Inc.	Software	5.95
GKOS	Glaukos Corporation	Health Care Equipment & Supplies	5.69

Source: Trivariate Research, LP

Important Disclosures

Analyst Certification

The analysts, Adam Parker, Maxwell Arnold, Chang Ge, Colin Cooney and Ryan McGovern, responsible for the preparation of this research report certifies that: all the views expressed in this research report accurately reflect the research analyst's personal views.

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