Strategic Sector Selector
A summer postponed?

The rally in global equities narrowed further in Q2 2024, and there were signs of softening economic growth having an impact. Mega-cap technology stocks led the equity market moderately higher, while there were signs that disinflationary trends have resumed. We expect global growth to stay lower than average in the near term (although we think recession is a tail risk), and we assume that a recovery will start towards late 2024 or early 2025. We think equity markets may struggle for direction after strong returns year-to-date, although we do not expect the market expansion to end. With that in mind, we reduce our allocation to cyclical sectors slightly by downgrading industrial goods & services and consumer products & services (both to Underweight). Therefore, we keep the balance of defensives and cyclicals within our model sector allocation. At the same time, we upgrade utilities to Neutral as we expect the sector to benefit from lower interest rates.

Changes in allocations:

- Upgrades: utilities (UW to N)
- Downgrades: industrial goods & services (OW to UW), consumer products & services (N to UW)

Most favoured	Least favoured
US retailers	US automobiles & parts
European healthcare	European travel & leisure

Sectors where we expect the best returns:

- Retailers: well-diversified sector, exposure to growth factor and potential rebound in consumer spending
- Food, beverage and tobacco: hedge against market volatility, exposure to growth factor
- Healthcare: attractive valuations, decent dividend yield, potential beneficiary of lower interest rates

Figure 1 – Global sectors valuation matrix
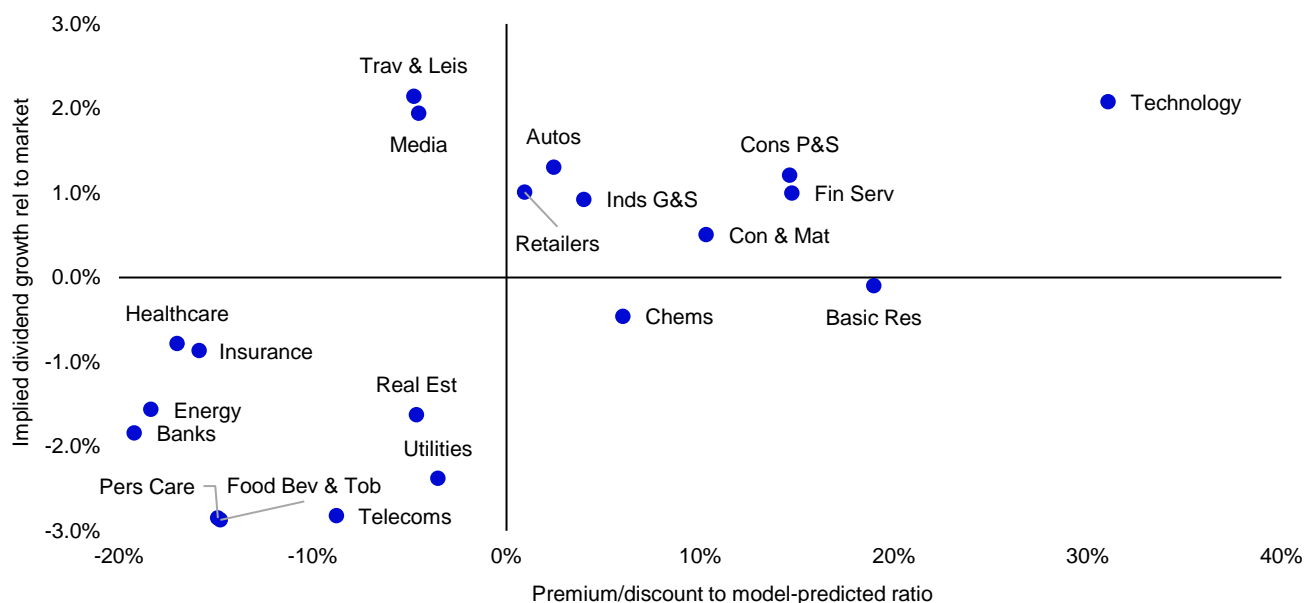
Notes: Data as of 30 June 2024. On the horizontal axis, we show how far a sector's valuation is above/below that implied by our multiple regression model (dividend yield relative to market). The vertical axis shows the perpetual real growth in dividends required to justify current prices relative to that implied for the market. We consider the sectors in the top right quadrant expensive on both measures, and those in the bottom left are considered cheap. See appendices for methodology and disclaimers.
Source: LSEG Datastream and Invesco Global Market Strategy Office

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Summary and conclusions

Since the last time
After a short pull-back at the start of Q2 2024, global equities found their footing, although total returns were more subdued than in the preceding two quarters: the MSCI All-Country World index returned 3.5% in Q2 2024 in local currency terms. In our view, this was largely driven by signs of softening, albeit still positive growth. Market leadership narrowed further, mostly to mega-caps in the technology sector reinforcing the dominance of price momentum.

Figure 2 – 3m Global sector returns relative to market in USD
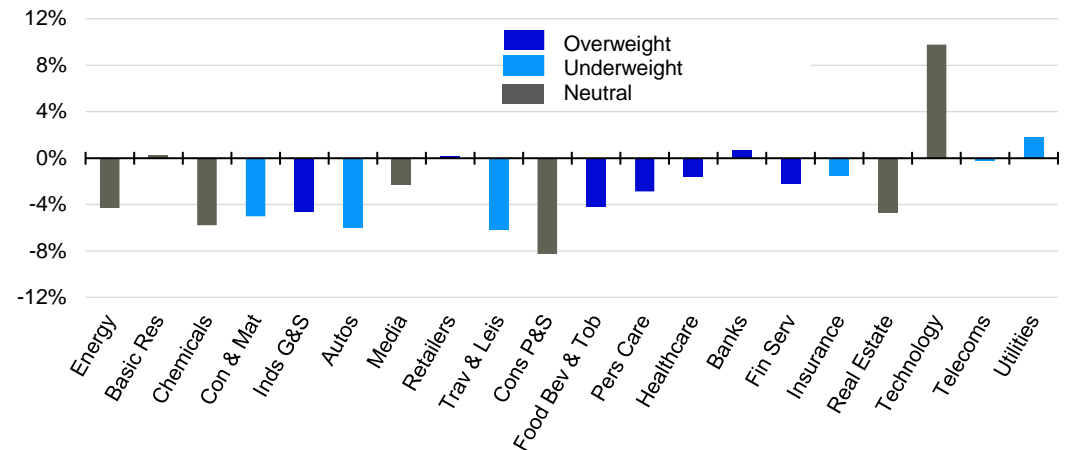
Notes: See appendices for methodology and disclaimers. Returns shown between 31 March 2024 and 30 June 2024. Colours indicate allocations in period considered. **Past performance is not a guarantee of future results.** Source: LSEG Datastream and Invesco Global Market Strategy Office

As **Figure 2** demonstrates, only a handful of sectors outperformed the market with the technology sector towering above all. We were Overweight two of the outperformers (retailers and banks), and we were Underweight only one them (utilities). We can also draw some comfort from the fact that most of the rest of our Overweights did not heavily underperform (for example healthcare, financial services and personal care, drug & grocery stores), though we were Underweight three of the five worst performers (travel & leisure, automobiles & parts and construction & materials).

Asset allocation backdrop
We think the global economy is still decelerating, bringing short-term risk for the more cyclical assets, especially after recent strong performance. We think politics may bring volatility and the global economy remains fragile, with stronger growth in some areas balanced by a weakening in the US. However, more than 25 central banks have cut rates in 2024 (though not the Fed), which raises hopes about eventual recovery.

Perhaps the single most important forecast is that most central banks will continue cutting rates and that the Fed and the BOE will join them (see **Figure 3**). We think that by mid-2025, major Western central banks will have cut rates by 100-150 basis points (from peak levels). We think a lot of this is already priced into the long end of yield curves, so that downside in 10-year yields will be limited. Hence, we believe that yield curve steepening will largely be the result of falling short rates, though we are more attracted to long duration assets than we were three months ago.

Within our Model Asset Allocation (published on 16 June 2024), we boosted government bonds and real estate. **Government bonds** have underperformed recently and yields have risen (and government bonds usually outperform equities when yield curves steepen). We went from an Underweight 22% to an Overweight 27% (Neutral is 25%).

We balanced the defensive boost to government bonds by adding to the riskier **real estate** asset class, taking it to the maximum 8% allocation. It's not that we ignore the

problems, but we think a lot of bad news is in the price (when looking at REIT yields) and suspect the sector will benefit from falling interest rates.

We reduced listed credit categories, both investment grade (IG) and high yield (HY). We are concerned that **HY** is pricing in a lot of good news about the economic cycle and few of the risks. We continue to expect spreads to widen and default rates to rise (though only towards cyclical norms) and our 12-month projected returns are lower than they were. Hence, we went from an Underweight 3% to Zero. Though performing less well than HY, we note that **IG** spreads have narrowed and we expect a slight rewidening. We reduced the allocation to a still Overweight 12%.

No changes were made to the cash or bank loan allocations, both of which remained Overweight. **Cash** continues to offer reasonable rates, especially considering its diversification profile. **Bank loans** also offer a higher return than most assets (in our opinion), with volatility similar to that of IG.

At the other end of the risk spectrum, we maintained the maximum allocation to **commodities**. Despite good performance over recent months, we think there is scope for further upside, especially as economies recover into 2025. As for **equities**, we stuck to an Underweight 35% (Neutral is 45%). The problem continues to be a US market that we think is expensive (in a slowing economy). We prefer other markets and favour China, EM and the Eurozone.

Regionally, we are Overweight European and EM assets. We maintained the partial hedge out of US dollar into Japanese yen, believing the latter will rally as the BOJ normalises.

Figure 3 – Market forecasts		
	Current (30/06/24)	**Forecast 12-month**
Central Bank Rates		
US	5.50	4.25
Eurozone	3.75	3.00
China	3.45	3.40
Japan	0.10	0.50
UK	5.25	4.00
10y Bond Yields		
US	4.37	4.10
Eurozone	2.46	2.50
China	2.21	2.25
Japan	1.03	1.20
UK	4.17	4.00
Exchange Rates/US$		
EUR/USD	1.07	1.15
USD/CNY	7.27	7.00
USD/JPY	160.86	130.00
GBP/USD	1.26	1.30
USD/CHF	0.90	0.85
Equity Indices		
S&P 500	5460	5175
Euro Stoxx 50	4894	5130
FTSE A50	12078	13700
Nikkei 225	39583	40500
FTSE 100	8164	8275
Commodities (US$)		
Brent/barrel	87	85
Gold/ounce	2326	2200
Copper/tonne	9456	10000

Notes: There is no guarantee that these views will come to pass. See Appendices for definitions, methodology and disclaimers. See The Big Picture for a full explanation.
Source: LSEG Datastream and Invesco Global Market Strategy Office

Changes to model sector allocations
Global equity market leadership narrowed even further in Q2 2024 with continued upward momentum resting on the shoulders of the technology sector. Without a broadening of the rally, we would not expect quarterly returns to match the pace of Q4 2023 and Q1 2024. Will heightened expectations finally catch up with the technology sector? Can equities move higher when economic growth slows? How will markets navigate the approaching US election and the start of monetary loosening by the Fed?

After the uptick in the winter, inflation has resumed its decline in most countries. After the 25 basis point (bps) rate cut of the European Central Bank, the Bank of England and Fed remained almost the last holdouts in keeping rates steady. Interestingly, unlike in Q1 2024, there was little movement in rate futures in Q2 with both central banks expected to start loosening in Q3. Recent data releases suggest that economic growth may have slowed in the US, although relatively high wage growth seems to make central bankers uncomfortable, for example in the UK. However, the labour market looks increasingly like an outlier and it may just be a matter of time before it resynchronises with weaker survey data, for example.

Equities may not be perturbed too much if this turns out to be a mild deceleration, although high valuations could become more difficult to justify. The technology sector may be able to "bridge" this period if the AI-boosted capex cycle remains intact, but we are struggling to find other sectors with such countercyclical buffers (apart from defensives). Nevertheless, even a period of slower growth may be enough to alleviate lingering concerns about inflation, which we expect to remain in the "comfort zone" of within on percentage point of central bank targets in the next 12 months in most major economies. If our base case turns out to be correct, and the global economy reaccelerates after a short period of weakness, equities may start to anticipate the upturn even as early as this quarter. We think the US presidential election could lead to a rise in volatility, but absent major downside surprises in growth, or adverse events perhaps driven by geopolitics, the current market cycle should remain intact.

What does this mean for our sector allocations? The technology sector may have kept headline returns positive, but when we look deeper, there are signs that investors may be getting more concerned about growth. This would explain the outperformance of utilities and the relatively strong returns by telecommunications and healthcare. Also, without the hefty outperformance of the technology sector, returns in Q2 2024 would have been negative. In our view, with the US presidential election looming in the autumn, and with most indicators suggesting the current slowdown may have further to run, an allocation to defensive sectors is appropriate to balance out our exposure to cyclicals. We think at this stage, markets may wait for economic fundamentals to catch up to expectations, or the start of Fed policy easing. Consequently, we do not think a comprehensive reshuffle is required and therefore make only minor changes.

We downgrade **industrial goods & services** from Overweight to **Underweight**. In our view, the sector may find it difficult to outperform as the global economy cools, while it looks slightly overvalued on our multiple regression model, indicating that any potential upturn in growth may be priced in including increased defence spending. The sector is one of the most diversified through its exposures to aerospace & defence, payment systems, vehicle manufacturers and logistics providers, but most of those look to be highly exposed to a downturn in the global economy.

We also reduce our allocation to **consumer products & services** to **Underweight** from **Neutral**. We think luxury groups will continue to struggle if consumer spending growth slows. The sector also has the second highest premium compared to the relative dividend yield implied by our multiple regression model, some of which may be justified by its relative resilience and diversification benefits (which we value). However, we are concerned that its high valuations may present a risk if the global economy slows more than we currently expect, while it tends to underperform in the mid-cycle stage of the equity market cycle.

Utilities have struggled to outperform in the cyclical upturn since Q4 2022. However, we think that market volatility may increase in the short term as we head into the autumn, driven by political uncertainty and slowing economic momentum. The sector's valuations look undemanding on both of our models and lower interest rates may start reducing the burden of high gearing. At the same time, since we do not expect a deep downturn, we would like to keep our exposure to defensives limited, especially if equity markets start anticipating a reacceleration in growth in Q3 2024. Therefore, we upgrade the sector only one notch to **Neutral** from Underweight.

The best and worst of the rest
One consequence of a higher risk of conflict near major energy exporting regions (both Ukraine and the Middle East) is that the price of oil and gas could remain near current levels supporting the revenues and margins of the **energy** sector. Based on our macroeconomic outlook, weaker demand, plentiful supply and discounts offered by major producers could balance the upward pressure on pricing driven by geopolitical risk, thus we maintain our **Neutral** allocation.

Basic resources may have underperformed year-to-date, but that was not enough to pull valuations to levels we would consider attractive. We think the sector may be boosted by a reaccelerating global economy, which we expect to start towards late 2024 or early 2025. However, we prefer to keep our **Neutral** allocation until we either see a more comprehensive de-rating versus our multiple regression model, or evidence emerges that the global economy has turned a corner (and China can maintain its current pace of growth, as it remains a major driver of demand for industrial metals).

Chemicals could be boosted by higher product prices, but we think it may struggle to outperform in the current economic environment, because its input costs have remained high. Although we expect a turnaround in industrial production in the next 12 months, we think it may be too early to upgrade the sector as it trades at a slight premium to the relative dividend yield implied by our multiple regression model. We maintain our **Neutral** allocation.

Although house prices seem to be stabilising and real wage growth is positive, relatively high mortgage rates may hinder the **construction & materials** sector. We are also concerned that higher costs of labour and materials will put pressure on profit margins. The sector also looks overvalued on our multiple regression model and its implied dividend growth rate is above that of the market. The sector may have defied expectations in 2023 mostly driven by demand for newbuilds in the US and the boost to investment from the IRA and CHIPS acts, but we believe its valuations reflect a lot of good news even after underperforming year-to-date, and therefore we stay **Underweight**.

Despite underperforming in the last 12 months, **automobiles & parts** remains one of the most overvalued sectors versus the relative dividend yield implied by our multiple regression model. We also consider the sector an early-cyclical, thus we are struggling to foresee any significant upside potential if we are in the mid-cycle phase for equity markets. In our view, the main driving forces behind its previous surge – namely the fall in inflation rates and a rebound after the drawdown in 2022 – will provide less support in the next 12 months. We stay **Underweight**.

We also keep our **Neutral** allocation to **media**. After strong relative returns recently, we think there may be less scope for further outperformance, especially after significant multiple expansion. As it stands, valuations are broadly in line with what we consider "fair value" based on our multiple regression model. Both EBITDA and net margins have risen, which has been one of the main driving forces behind the sector's outperformance, in our view, and we think further improvement will be difficult to achieve.

At the same time, we maintain exposure to the growth factor through **retailers**, which could be useful if the Fed starts cutting rates. The sector's relative dividend yield may be

at a slight premium to that implied by our multiple regression model, but it is a diversified sector, which we think will provide resilience during any market weakness. Sector earnings may also be supported if inflation falls further, and real wage growth remains positive. We maintain our **Overweight** allocation.

After the post-COVID-19 "great reopening" drove a surge in bookings, relative returns in **travel & leisure** finally succumbed to the twin threats of high oil prices and falling disposable incomes, and we think it is appropriate to keep our **Underweight** allocation. We believe the many headwinds the sector faces are proving too much: labour costs have risen, fuel costs could remain high, and demand may soften as economies slow and higher costs eat further into disposable incomes as excess savings are depleted. Nevertheless, there may be regional differences in returns if Asian tourists continue travelling in greater numbers, offset by weakness in the US and Europe.

At this stage of the cycle, assuming our interest rate expectations are proven correct, we believe that defensive growth offers an attractive way to hedge against equity market volatility and an inflation and economic growth undershoot. Therefore, we stay **Overweight** both **food, beverage & tobacco** and **personal care, drug & grocery stores**. Following their underperformance year-to-date, their valuations look attractive, well below the relative dividend yield implied by our multiple regression model. At the same time, both sectors have an implied perpetual dividend growth rate under 1%, which we think is appealing (out of three sectors altogether, all of which are defensives).

We find **healthcare** attractive for similar reasons and believe it makes sense to keep our **Overweight** allocation. As a defensive sector, it underperformed slightly so far in 2024 as markets favoured the technology sector. The sector's valuations look attractive on implied dividend growth, while it has the largest discount to the relative dividend yield implied by our multiple regression model. We also think that falling interest rates could boost its relative returns in the next 12 months.

At the same time, we think the probability of major issues in the banking sector will be lower if monetary policy becomes less restrictive, especially if the global economy avoids a recession. We also expect a steepening yield curve, which coincided with outperformance in the past, especially in the US and UK. Valuations look attractive both compared to the relative dividend yield implied by our multiple regression model and versus historical norms. Of course, we cannot sound the all-clear that the risk stemming from higher interest rates has passed (for example via lending risk to the real estate sector), but valuations suggest that at least some of that is priced in, in our view. We stay **Overweight banks**.

Based on our assumption that we remain in the mid-cycle phase of the equity market cycle, we expect financials to outperform. We are also encouraged by early signs of a turnaround in capital raising and mergers & acquisitions activity, which bodes well for **financial services**. As long as the market expansion continues and the interest rate cycle turns, we think their relatively rich valuation will not be a cause for concern. We stay **Overweight**.

By contrast, hopes for any potential outperformance by **insurance** could be fading if government bond yields continue to fall, while rising premiums may be close to levels that could restrict demand and profit growth. Valuations look supportive on our models, but we think that will not be enough to counteract fading support from macroeconomic factors, which may not have been fully priced even after slight underperformance in Q2 2024. Thus, we maintain our **Underweight** allocation.

At the same time, we keep our **Neutral** allocation to **real estate**. Perhaps a forthcoming turn in the monetary policy cycle could boost sentiment towards the sector, but with fewer rate cuts on the horizon (based on market pricing) we think the prospects for outperformance could fade. Gradual easing in financing costs imply only gradual improvement in sector returns, in our view. At the same time, valuations are close to what we would consider "fair value" based on our multiple regression model.

The biggest decision we face every quarter concerns the largest sector (based on market cap): **technology**. Its outperformance year-to-date was mostly driven by sentiment (multiple expansion – see **Figure 14**), which we find increasingly difficult to justify. We remain positive about the sector's long-term growth potential, which we think will continue to benefit from increasing investment and boosted by the focus on generative artificial intelligence. We also value its high margins and solid cash generation. Valuations have risen and the sector has the largest premium to the relative dividend yield implied by our multiple regression model, which makes it vulnerable to any turnaround in sentiment, in our view. We keep our allocation at **Neutral** for now.

Our base case of a continuing rise in equities (after a period of consolidation in the near term) implies limited allocation to defensives, thus we keep our **Underweight** allocation to **telecommunications**. We assume that an economic recovery will start towards the end of 2024, which equity markets may start anticipating in H2. We would expect defensive sectors, such as telecommunications, to underperform in that environment. Although the sector trades at a discount compared to the relative dividend yield implied by our multiple regression model, it has no obvious advantage in valuations compared to consumer staples, while it may not be boosted as much by either a rebound in consumer spending or a reduction in interest rates.
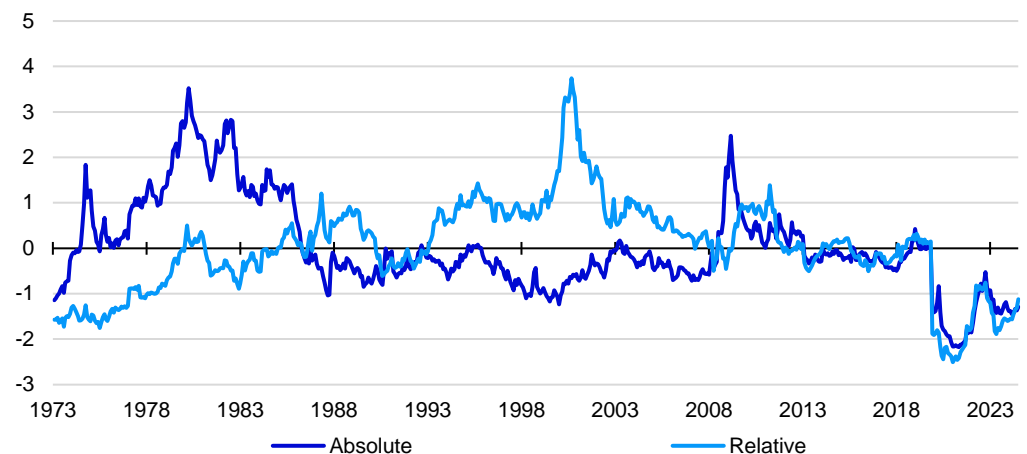
Sector in focus: Consumer products & services

Some sectors lend themselves to easy categorisation. Are they defensive or cyclical? Are they growth or value? The main drivers of their returns may also be relatively simple to pinpoint (for example energy). Then there are those that leave us a little more perplexed. Consumer products & services is a prime example. It has a sense of subsectors patched together without an overarching theme, which makes it diverse and diversified. It is not overshadowed by a dominant stock (the top ten account for less than 47% of market capitalisation as of 30 June 2024) and has a long tail of relatively small constituents. Interestingly, this diversification makes it well-placed to outperform during bear markets.

We think that is most probably due to a significant exposure to industries that are less sensitive to the economic cycle, for example consumer services (education, funeral parlours, storage facilities, vending and catering services etc), certain household goods, computer games and even luxury items. We would expect this to make the sector relatively resilient during a period of consolidation in equity markets. However, if equities continue their path through what we consider a mid-cycle environment, consumer products & services may struggle to outperform based on historical patterns.

As ever, there are multiple moving parts when trying to determine how consumer products & services will fare in the next 12 months. As long as global economic growth remains positive, their revenue growth should remain strong. However, we have seen signs of the economic cycle softening, while the sector's high exposure to the Chinese economy (where most of the demand growth comes from for luxury goods, for example) resulted in weak returns year-to-date as consumer spending growth languished. Although we think a global recession remains a tail risk, sector outperformance in past bear markets (which a global recession could trigger) suggest consumer products & services may act as a hedge when uncertainty increases.

Figure 4 – Global consumer products & services dividend yields versus historical averages (z-scores)

Notes: Data as of 30 June 2024. **Past performance is no guarantee of future results.** We use monthly data based on the 12-month trailing dividend yield on the Datastream World Consumer Products & Services Index and the Datastream World Total Market Index. Relative dividend yields are calculated by dividing the yield on the consumer products & services index by the yield on the total market index. Z-scores are calculated by dividing the difference to the long-term average since 2 January 1973 by the standard deviation of respective dividend yields.
Source: LSEG Datastream and Invesco Global Market Strategy Office

However, despite underperforming year-to-date, sector valuations look rich, in our view. When it comes to sector allocations, we start by comparing the relative dividend yield implied by our multiple regression model to what the sector trades at. This suggests that the sector is overvalued versus what our model implies (**Figure 12**). We then cross-check that using our perpetual dividend growth model, which shows that dividends would have to grow by a real 5% per year into perpetuity for the sector to generate the hurdle rate of return, well-above that of the market at 3.7% and suggesting it is relatively expensive (**Figure 13**).

Comparing other valuation metrics to their own respective historical averages paints a similar picture. All main metrics (price/earnings, dividend yield, price/book, price/cash flow as shown in **Figure 25**) suggest consumer products & services are overvalued in absolute terms and, apart from its P/E ratio, all are at a premium of over one standard deviation versus historical norms. However, relative valuations look more mixed: a similar dislocation with, for example relative dividend yields at 1.1 standard deviations below its historical average (see **Figure 4**), while relative P/E ratios are close to historical norms. Apart from the 1970s, dividend yields have not been at these levels outside the period during and after the COVID-19 pandemic (although sector reallocations in 2019 may have muddied the picture somewhat).

We think the future direction of sector dividend yields will depend largely on the fate of luxury goods providers, home construction and cosmetics, which account for about 60% of dividends paid within consumer products & services. Although recent weakness in luxury goods may be attributable to a slowdown in demand growth from EM economies (most of all, China), it may be just as cyclical as the other two industry groups: the "aspiring middle classes" provide a significant proportion of demand. So, for sector valuations to fall to levels closer to historical norms, either dividends would have to rise, or prices would have to fall. Unless the global economy reaccelerates, we do not foresee a significant rise in dividends paid, or the sector's payout ratio to increase (from the current 34% to a historical average of 40-50%).

Figure 5 – Global consumer products & services forward earnings growth vs total returns since 1988
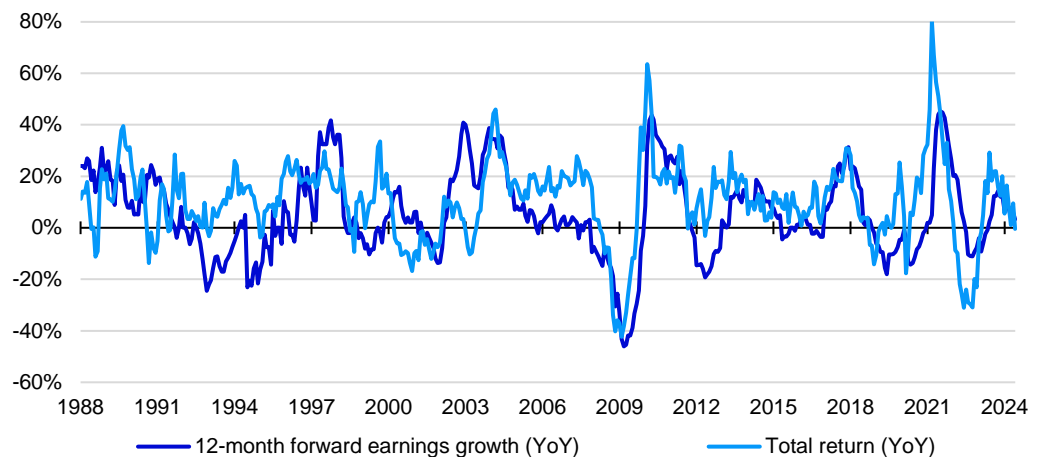
Notes: Data as of 30 June 2024. **Past performance is not a guarantee of future results.** The data shown in the chart is monthly starting in February 1988. The index used to represent global consumer products & services is the Datastream Consumer Products & Services World index in US dollars. We use IBES consensus 12-month forward EPS and calculate year-on-year change to represent earnings growth.
Source: LSEG Datastream and Invesco Global Market Strategy Office

In our view, it is more likely that the sector will continue underperforming. First, dividend growth is below average, and it may struggle to gain traction until consumer spending recovers. Although we expect economic growth to reaccelerate towards the end of 2024 or early 2025, dividend growth may only follow with a lag, when corporates are confident that it will be sustainable. Also, as **Figure 5** shows, 12-month forward earnings forecasts have been trending down recently with analysts expecting around 3% growth (as of 30 June 2024).

Where does all that leave us? In theory, consumer products & services is a sector that should provide diversification, especially when markets soften. However, with decreasing demand for the products of its biggest dividend payers, dividend growth may not improve much in the next 12 months. At the same time, sentiment could remain depressed, which will potentially constrain returns. If we are correct and equity markets remain in the mid-cycle stage, high sector valuations and historical patterns support a downgrade to Underweight.

Figure 6 – Model allocations for Global sectors

	Neutral	Invesco	Preferred Region
Energy	**6.6%**	**Neutral**	**EM**
Basic Materials	**3.8%**	**Neutral**	**Japan**
Basic Resources	2.3%	Neutral	Japan
Chemicals	1.5%	Neutral	US
Industrials	**12.7%**	**Underweight ↓**	**US**
Construction & Materials	1.7%	Underweight	US
Industrial Goods & Services	11.0%	Underweight ↓	US
Consumer Discretionary	**13.9%**	**Underweight ↓**	**US**
Automobiles & Parts	2.4%	Underweight	Europe
Media	1.1%	Neutral	Japan
Retailers	5.2%	Overweight	US
Travel & Leisure	1.9%	Underweight	EM
Consumer Products & Services	3.3%	Underweight ↓	Japan
Consumer Staples	**5.2%**	**Overweight**	**US**
Food, Beverage & Tobacco	3.3%	Overweight	US
Personal Care, Drug & Grocery Stores	1.9%	Overweight	Europe
Healthcare	**9.2%**	**Overweight**	**US**
Financials	**15.4%**	**Overweight**	**US**
Banks	7.4%	Overweight	Europe
Financial Services	5.1%	Overweight	US
Insurance	2.9%	Underweight	US
Real Estate	**2.6%**	**Neutral**	**Japan**
Technology	**24.0%**	**Neutral**	**EM**
Telecommunications	**3.3%**	**Underweight**	**US**
Utilities	**3.2%**	**Neutral ↑**	**US**

Notes: Arrows indicate latest changes in allocations versus the previous edition. See appendices for methodology and disclaimers.
Source: LSEG Datastream and Invesco Global Market Strategy Office

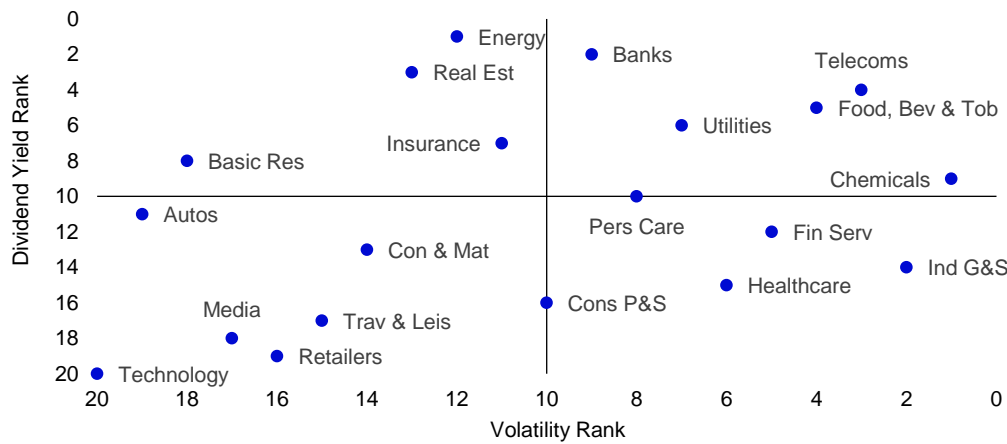**Figure 7 – Economic cycle and main sector allocation decisions**
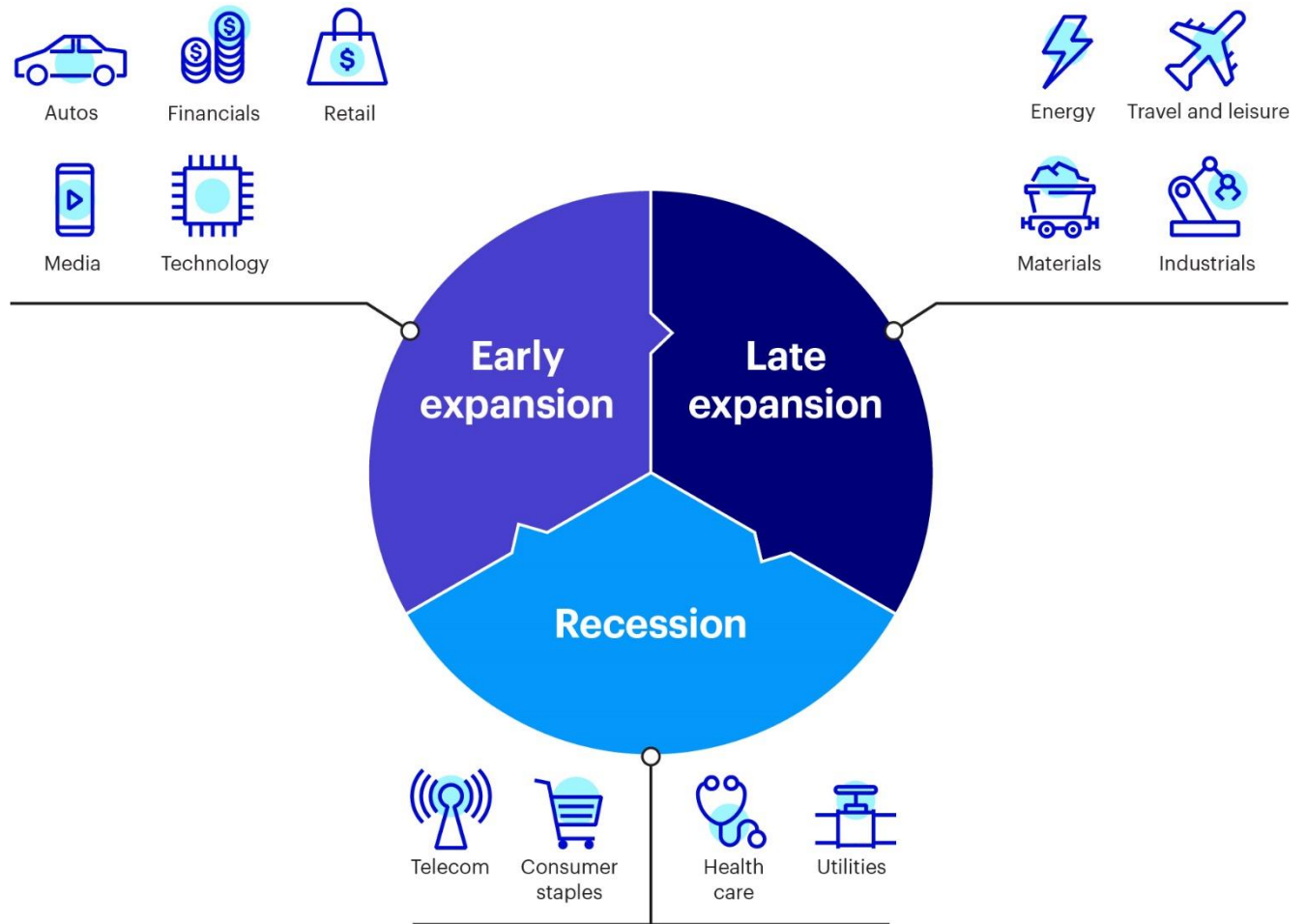
Note: The chart shows our opinion about which sectors tend to perform best at which stage of the economic cycle, based on our analysis of previous cycles.
Source: Invesco Global Market Strategy Office

Systematic strategy – Global

**Figure 8 – Global sectors ranked by volatility and dividend yield**

- A purely systematic approach would favour sectors in the top right corner: telecoms, food, beverage & tobacco and utilities.
- The approach would avoid sectors in the bottom left, such as technology, retailers or media.

Figure 9 – Global sector volatility of daily returns (using standard deviation in the past 3 months)
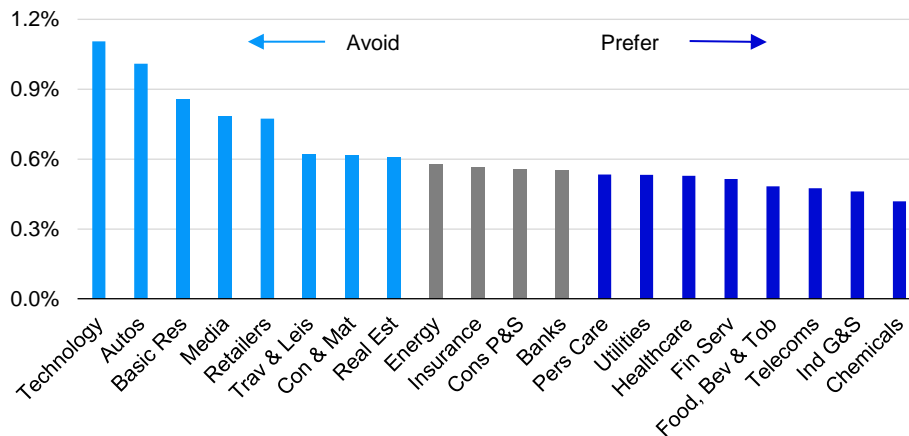
- The daily returns of technology, autos and basic resources were the most volatile in the past 3 months.
- Chemicals, industrials goods & services and telecoms were the least volatile.

**Figure 10 – Global sector dividend yield (12-month trailing)**
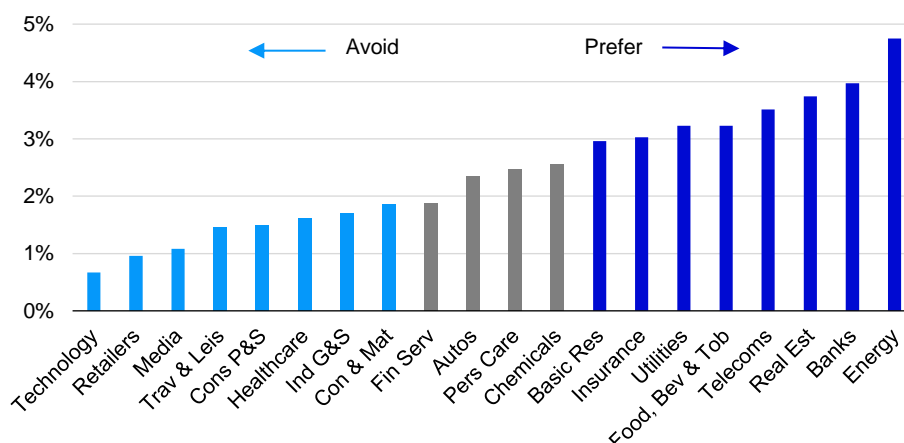
- Energy, banks and real estate look the cheapest based on their dividend yield.
- The lowest yielding sectors include technology, retailers and media.

Notes: In Figure 6, we rank sectors on the vertical axis by their current 12-month trailing dividend yields. On the horizontal axis, the sectors are ranked by the 3-month standard deviation of their daily returns. See appendices for methodology and disclaimers. Any reference to a ranking, a rating or an award provides no guarantee for future performance results and is not constant over time.
Source: LSEG Datastream and Invesco Global Market Strategy Office

Valuations – Global

Figure 11 – Global sectors valuation matrix
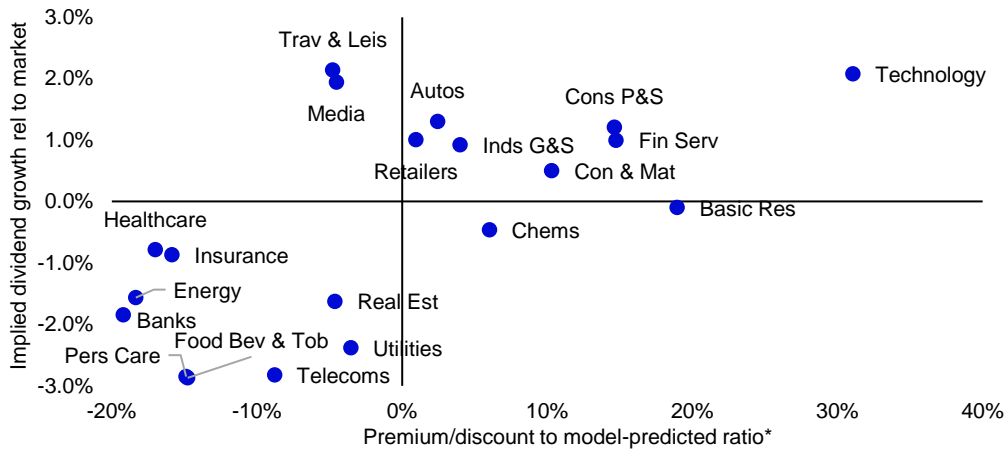
- Sectors in the top right corner look overvalued on both measures, while those in the bottom left appear undervalued
- This approach would avoid, for example, tech, consumer P&S and financial services.
- Banks, personal care and energy look better value

Figure 12 – Premium/discount to model-predicted ratio*
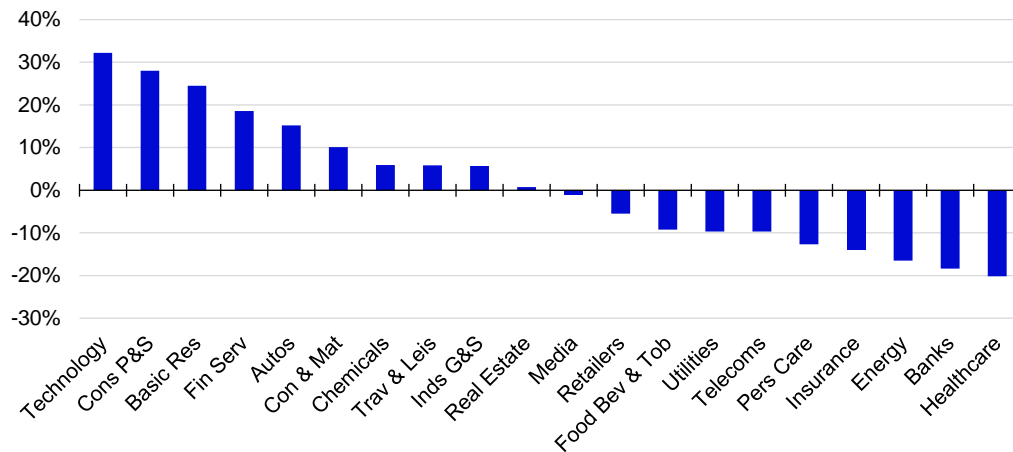
- Technology, consumer products & services and basic resources look the most overvalued versus our model
- Healthcare, banks and energy seem the most undervalued versus our model-predicted ratios

Figure 13 – Global implied perpetual real dividend growth
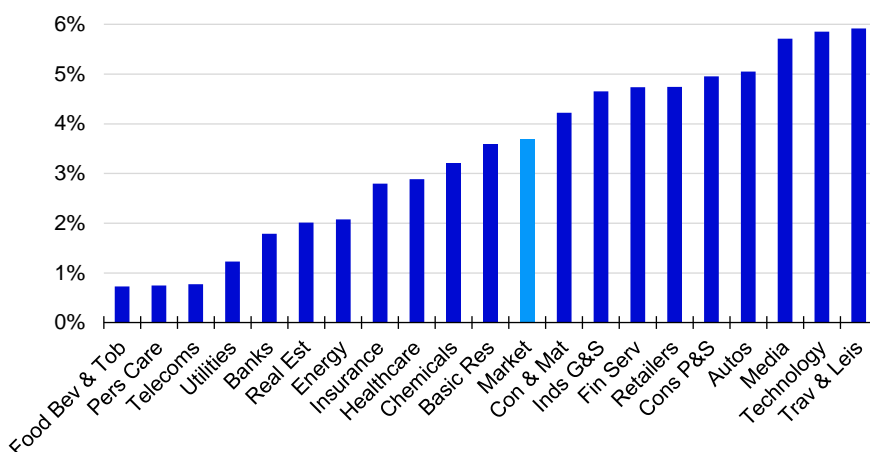
- Shows the future real growth required to justify current prices
- Travel & leisure, technology, and media appear priced for over 5% real growth in dividends (expensive)
- Only three defensive sectors seem priced for sub-1% growth (cheap)

Notes: *% above/below using dividend yield. See appendices for methodology and disclaimers.
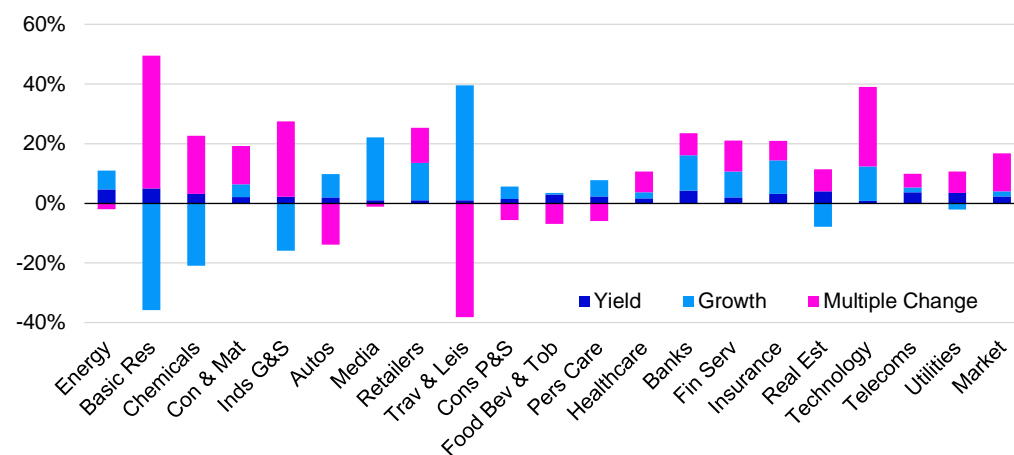Source: LSEG Datastream and Invesco Global Market Strategy Office

Decomposed returns – Global

Figure 14 – Global year-to-date total returns decomposed (annualised)
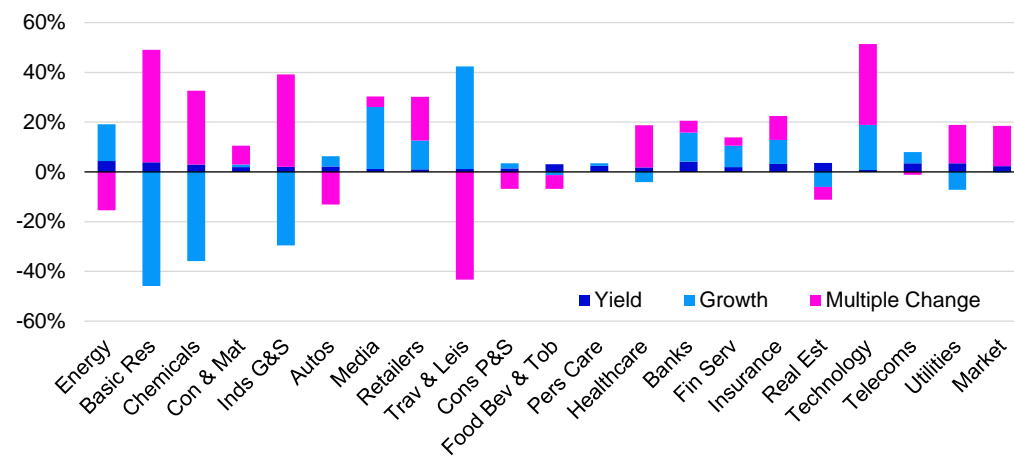
- Only two sectors had both negative growth and multiple contraction: food, beverage & tobacco and real estate.
- Two sectors had over 10% dividend growth: travel & leisure and media.

Figure 15 – Global rolling 12-month total returns decomposed

- All sectors had positive total returns, except autos and food, beverage & tobacco.
- Four sectors had a yield above 4%: energy, basic resources, banks and real estate.

Figure 16 – Global overall total returns decomposed (annualised, since 1973)
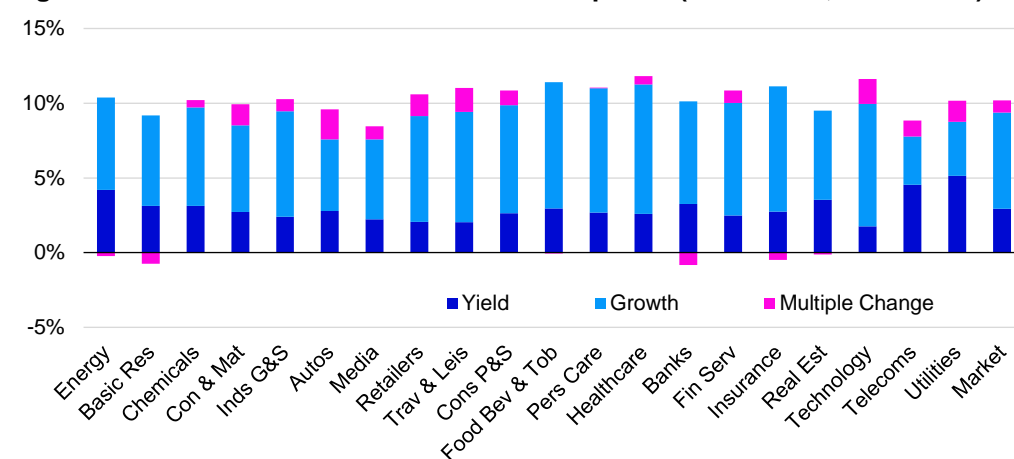
- Growth and yield drive long-term returns
- Growth is the most important, except for telcos and utilities
- Six sectors suffered from a multiple-related performance drag: energy, basic resources, food & bev, banks, insurance and real estate

Notes: See appendices for methodology and disclaimers. Past performance is not a guarantee of future results.
Source: LSEG Datastream and Invesco Global Market Strategy Office

Appendices

Appendix 1: Coefficients for variables used in multiple regression model

Figure 17 – Regression coefficients of Global defensive sectors

	Food, Bev & Tobacco	Personal Care	Health Care	Telecoms	Utilities	Market
Real Oil		-0.19			0.40	
Real Copper		0.01	0.00	0.02	-0.01	
Consumer Confidence	0.00		0.00	0.00	0.00	-0.01
Manufacturing Confidence		0.01	0.01	0.01		
IP		0.54	1.09		2.51	-5.13
10y Yield			1.61	-5.76	10.72	-11.34
CPI	4.00	1.15	-2.79	-1.77	-7.62	3.78
Net Debt/EBITDA		0.07	-0.04	0.11		
ROE	-2.34	-1.11	0.94	0.93	-4.74	

Notes: IP = industrial production. CPI = consumer price index. EBITDA = earnings before interest, taxes, depreciation and amortization. ROE = return on equity. Bev = beverage. Only showing coefficients that have a statistically significant relationship with valuations at the 0.05 level. We use the dividend yield relative to market as our dependent variable. See the Methodology in Appendix 6 for more details. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 18 – Regression coefficients of Global resource-related and industrial sectors

	Energy	Basic Resources	Chemicals	Construction & Materials	Industrial G&S	Market
Real Oil	-1.91	-0.94				
Real Copper	0.01	-0.01	0.00	-0.01	0.00	
Consumer Confidence	0.01	0.01	0.01	0.00		-0.01
Manufacturing Confidence		-0.02	-0.01	-0.01	-0.01	
IP	-2.12		-0.85	1.29	0.23	-5.13
10y Yield		-7.92		2.10	0.54	-11.34
CPI	12.39	29.91	7.72	6.77	0.92	3.78
Net Debt/EBITDA	-0.15	-0.13	0.05	0.26		
ROE	-3.26	-2.58	-1.59	-0.82		

Notes: IP = industrial production. CPI = consumer price index. EBITDA = earnings before interest, taxes, depreciation and amortization. ROE = return on equity. G&S = goods & services. Only showing coefficients that have a statistically significant relationship with valuations at the 0.05 level. We use the dividend yield relative to market as our dependent variable. See the Methodology in Appendix 6 for more details. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 19 – Regression coefficients of Global consumer discretionary and technology sectors

	Autos & Parts	Media	Retail	Travel & Leisure	Cons P&S	Tech	Market
Real Oil	1.04		0.24	0.50	0.97	0.41	
Real Copper	-0.01		0.00	0.00	-0.01		
Consumer Confidence	0.01	0.00	0.00	0.00	0.00	0.00	-0.01
Manufacturing Confidence			0.00	0.00		0.01	
IP	-3.23		0.97	-0.44	0.65	-1.69	-5.13
10y Yield	3.62	6.40	2.35	-1.09	4.96	-1.86	-11.34
CPI		-5.77	-4.51	-3.23	-4.07	-2.80	3.78
Net Debt/EBITDA	-0.06	0.04	0.23		-0.24	0.09	
ROE		1.40		0.60	-2.44	0.52	

Notes: IP = industrial production. CPI = consumer price index. EBITDA = earnings before interest, taxes, depreciation and amortization. ROE = return on equity. Cons = consumer. P&S = products & services. Only showing coefficients that have a statistically significant relationship with valuations at the 0.05 level. We use the dividend yield relative to market as our dependent variable. See the Methodology in Appendix 6 for more details. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 20 – Regression coefficients of Global financial sectors

	Banks	Financial Services	Insurance	Real Estate	Market
Real Oil	0.34		-0.48	0.56	
Real Copper	-0.01	-0.01	0.01	-0.02	
Consumer Confidence	0.01	0.00	0.00	0.01	-0.01
Manufacturing Confidence	-0.01	-0.02		-0.03	
IP	-2.66	1.75		3.73	-5.13
10y Yield	-8.64		-5.69	2.64	-11.34
CPI	6.23		9.88		3.78
ROE	4.19	0.65	-1.13	-3.62	

Notes: IP = industrial production. CPI = consumer price index. EBITDA = earnings before interest, taxes, depreciation and amortization. ROE = return on equity. Only showing coefficients that have a statistically significant relationship with valuations at the 0.05 level. We use the dividend yield relative to market as our dependent variable. See the Methodology in Appendix 6 for more details. Source: LSEG Datastream and Invesco Global Market Strategy Office
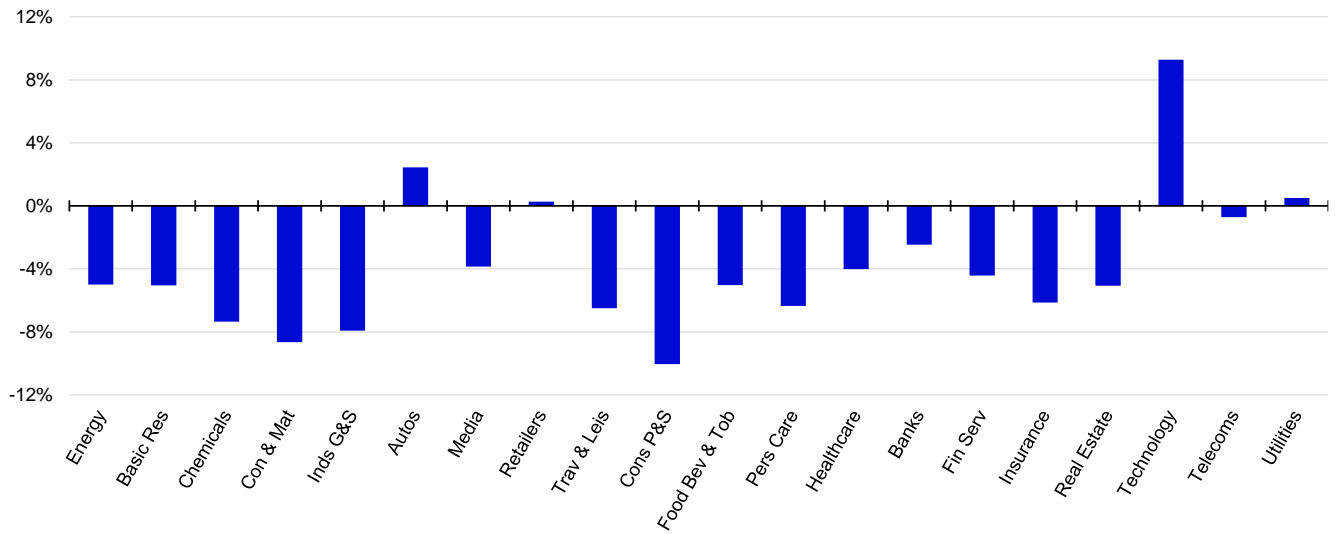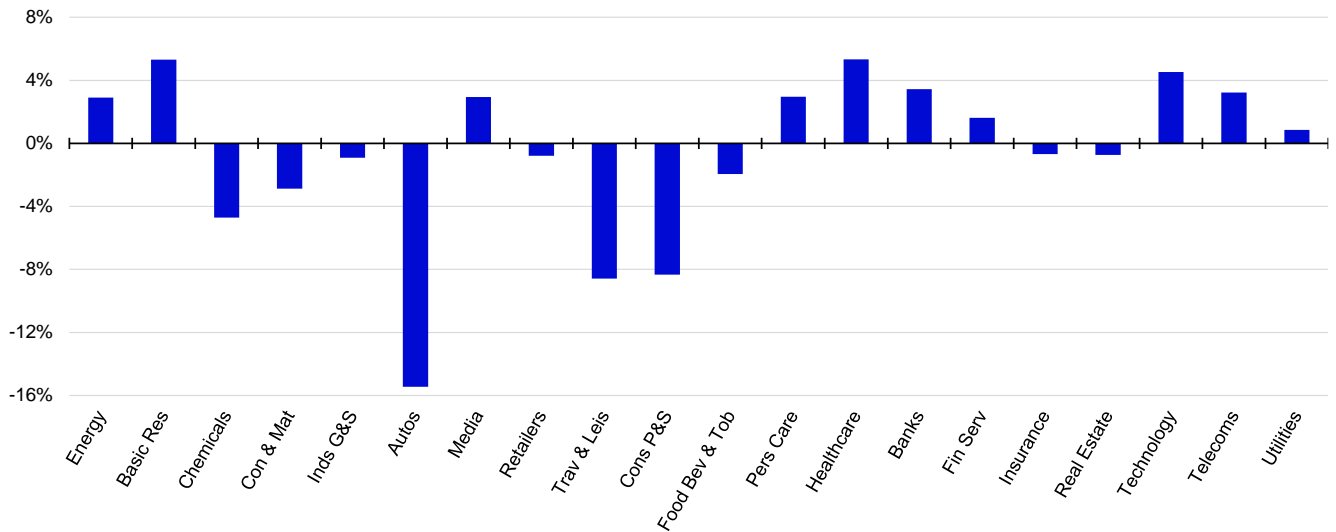
Appendix 2: Sector returns by region

Figure 21 – 3m US sector returns relative to market

Notes: See appendices for methodology and disclaimers. Returns shown between 31 March 2024 and 30 June 2024. **Past performance is not a guarantee of future results.** Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 22 – 3m European sector returns relative to market

Notes: See appendices for methodology and disclaimers. Returns shown between 31 March 2024 and 30 June 2024. **Past performance is not a guarantee of future results.** Source: LSEG Datastream and Invesco Global Market Strategy Office

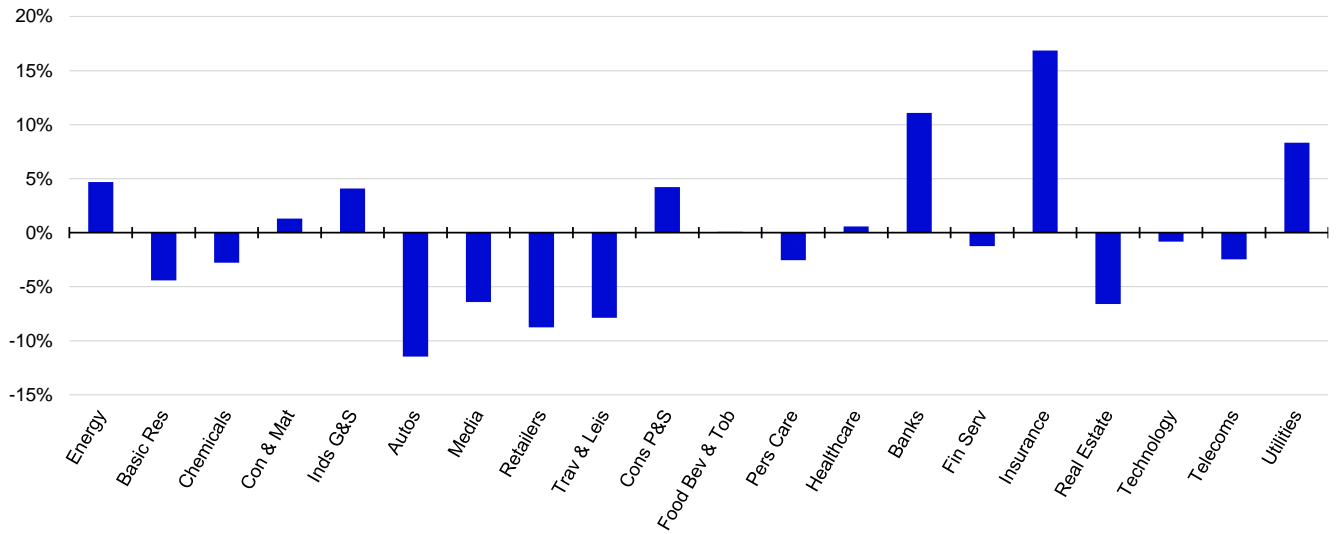**Figure 23 – 3m Japanese sector returns relative to market**

Notes: See appendices for methodology and disclaimers. Returns shown between 31 March 2024 and 30 June 2024. **Past performance is not a guarantee of future results.** Source: LSEG Datastream and Invesco Global Market Strategy Office

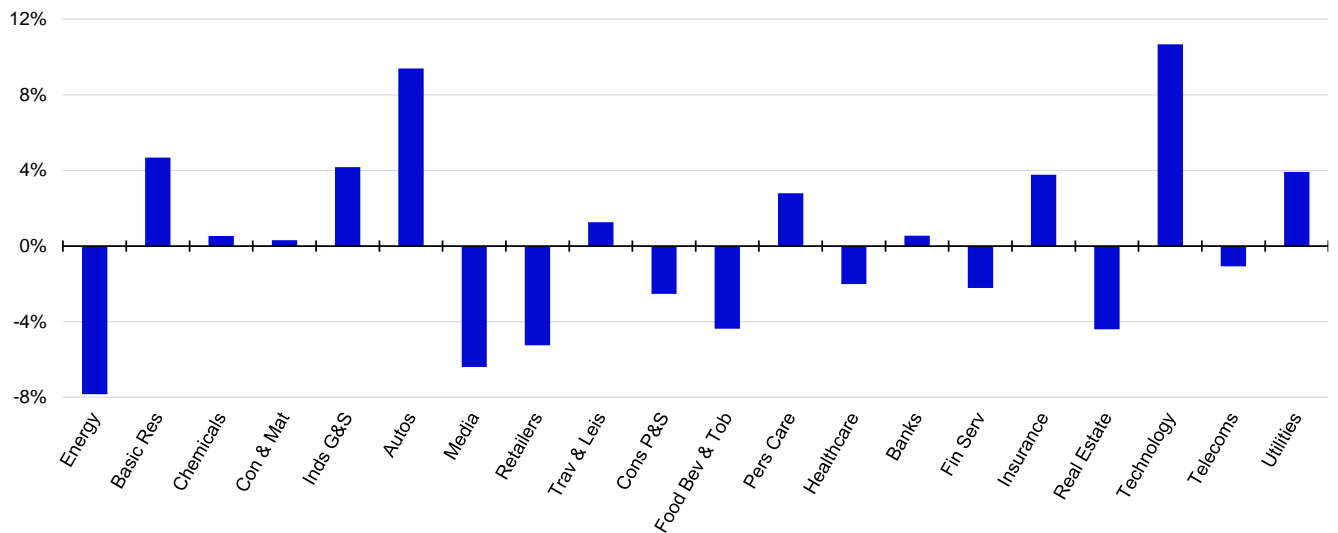**Figure 24 – 3m Emerging Market sector returns relative to market**

Notes: See appendices for methodology and disclaimers. Returns shown between 31 March 2024 and 30 June 2024. **Past performance is not a guarantee of future results.** Source: LSEG Datastream and Invesco Global Market Strategy Office

Appendix 3: Valuations tables

Figure 25 – Global absolute valuations

	Price/Earnings			Dividend Yield			Price/Book Value			Price/Cash Flow		
	Now	**Avg**	**Now vs Avg***	**Now**	**Avg**	**Now vs Avg***	**Now**	**Avg**	**Now vs Avg***	**Now**	**Avg**	**Now vs Avg***
Energy	**12.3**	**14.5**	**-0.3**	**4.8**	**3.9**	**0.8**	**1.5**	**1.8**	**-0.5**	**6.8**	**6.3**	**0.3**
Basic Materials	**21.1**	**16.6**	**0.9**	**2.8**	**2.8**	**0.0**	**1.9**	**1.8**	**0.2**	**9.4**	**7.4**	**1.2**
Basic Resources	18.6	16.8	0.3	3.0	2.9	0.1	1.7	1.7	0.1	8.3	7.2	0.5
Chemicals	26.4	17.1	1.8	2.6	2.9	-0.4	2.1	2.0	0.4	11.9	7.9	2.4
Industrials	**21.8**	**18.2**	**0.8**	**1.7**	**2.3**	**-0.8**	**3.0**	**2.2**	**1.8**	**12.8**	**9.2**	**2.0**
Construction & Mat.	20.0	16.7	0.8	1.9	2.5	-1.0	2.4	1.7	1.6	11.5	9.1	1.0
Industrial G&S	22.2	18.7	0.7	1.7	2.2	-0.7	3.1	2.3	1.7	13.0	9.2	2.0
Consumer Disc.	**20.9**	**18.8**	**0.4**	**1.4**	**2.2**	**-1.0**	**3.4**	**2.2**	**2.3**	**11.2**	**8.6**	**1.4**
Automobiles & Parts	11.1	15.0	-0.5	2.3	2.6	-0.2	1.4	1.5	-0.2	6.1	5.5	0.5
Media	31.4	21.8	1.2	1.1	2.1	-1.2	2.7	2.4	0.5	11.7	9.6	0.5
Retailers	30.2	21.6	1.3	1.0	1.8	-1.1	6.3	3.3	2.7	15.7	13.2	0.8
Travel & Leisure	18.9	23.3	-0.4	1.5	1.8	-0.5	5.8	2.7	3.2	10.0	9.4	0.2
Consumer Prod & Serv	23.3	19.4	0.8	1.5	2.4	-1.3	3.7	2.3	2.0	14.3	11.0	1.3
Consumer Staples	**21.0**	**16.9**	**0.8**	**3.0**	**2.5**	**0.4**	**3.0**	**2.8**	**0.3**	**11.7**	**10.9**	**0.3**
Food, Bev & Tobacco	20.3	18.4	0.4	3.2	2.7	0.6	2.8	2.7	0.2	11.9	11.1	0.3
Personal Care	22.5	20.5	0.4	2.5	2.4	0.1	3.5	3.0	0.5	11.4	10.5	0.4
Healthcare	**33.7**	**20.4**	**2.3**	**1.6**	**2.3**	**-0.9**	**4.4**	**3.4**	**0.9**	**18.8**	**12.9**	**1.6**
Financials	**12.2**	**15.5**	**-0.7**	**3.1**	**2.7**	**0.5**	**1.0**	**1.4**	**-0.9**	**7.4**	**5.8**	**1.2**
Banks	9.8	14.2	-0.9	4.0	3.0	1.1	1.1	1.3	-0.6	6.0	6.3	-0.2
Financial Services	17.1	18.2	-0.2	1.9	2.3	-0.6	0.7	1.4	-1.3	14.9	9.2	2.6
Insurance	13.9	15.9	-0.4	3.0	2.5	0.7	1.8	1.7	0.2	5.9	3.8	2.1
Real Estate	**23.5**	**19.2**	**0.7**	**3.7**	**3.3**	**0.6**	**1.2**	**1.4**	**-0.6**	**14.1**	**13.7**	**0.1**
Technology	**37.6**	**24.4**	**1.3**	**0.7**	**1.6**	**-0.9**	**8.7**	**3.3**	**4.1**	**26.6**	**12.0**	**3.3**
Telecommunications	**18.3**	**17.3**	**0.1**	**3.5**	**4.3**	**-0.4**	**1.9**	**2.6**	**-0.6**	**5.6**	**6.1**	**-0.2**
Utilities	**18.0**	**14.6**	**0.9**	**3.3**	**4.8**	**-0.8**	**1.9**	**1.6**	**0.9**	**7.9**	**5.7**	**1.5**
Market	**20.6**	**17.2**	**0.7**	**2.1**	**2.7**	**-0.7**	**2.3**	**2.0**	**0.7**	**11.5**	**7.9**	**2.1**

Notes: *in standard deviations from historical average. Mat. = materials. G&S = goods & services. Disc. = discretionary. Prod & Serv = products & services. Bev = beverage. Data starts on 1st January 1973 for price/earnings and dividend yield and 1st January 1980 for price/book and price/cash flow. See appendices for methodology and disclaimers.
Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 26 – Global cyclically-adjusted valuations

	Price/Earnings			Dividend Yield			Price/Book Value			Price/Cash Flow		
	Now	Avg	Now vs Avg*	Now	Avg	Now vs Avg*	Now	Avg	Now vs Avg*	Now	Avg	Now vs Avg*
Energy	**16.3**	**18.6**	**-0.3**	**3.8**	**2.9**	**0.9**	**1.6**	**2.6**	**-0.8**	**7.2**	**8.6**	**-0.5**
Basic Materials	**18.4**	**23.0**	**-0.6**	**2.6**	**1.9**	**1.3**	**1.9**	**2.4**	**-0.6**	**8.8**	**9.8**	**-0.4**
Basic Resources	17.8	21.3	-0.4	2.7	2.2	0.8	1.8	2.2	-0.4	8.2	9.3	-0.3
Chemicals	19.3	24.2	-1.0	2.5	1.9	1.2	2.1	2.7	-1.2	9.9	10.8	-0.5
Industrials	**26.6**	**26.5**	**0.0**	**1.4**	**1.5**	**-0.1**	**3.3**	**3.1**	**0.5**	**14.7**	**12.8**	**0.8**
Construction & Mat.	25.2	23.9	0.1	1.6	1.9	-0.5	2.5	2.2	0.4	13.5	11.7	0.5
Industrial G&S	26.8	27.3	-0.1	1.4	1.4	0.0	3.5	3.1	0.7	14.9	12.7	1.1
Consumer Disc.	**27.5**	**27.0**	**0.1**	**1.2**	**1.4**	**-0.7**	**3.5**	**3.0**	**1.2**	**13.7**	**11.8**	**1.0**
Automobiles & Parts	15.4	18.9	-0.8	1.8	1.7	0.1	1.5	2.0	-1.3	7.0	6.7	0.2
Media	27.5	29.9	-0.3	1.1	1.4	-0.8	3.2	3.3	0.0	14.0	13.1	0.3
Retailers	41.8	32.3	1.5	0.8	1.1	-1.1	7.0	4.7	2.3	21.8	19.7	0.5
Travel & Leisure	25.2	33.8	-0.9	1.3	1.2	0.4	4.2	3.6	0.6	12.7	13.1	-0.2
Consumer Prod & Serv	28.2	28.6	-0.1	1.4	1.6	-0.6	4.1	3.1	1.6	16.5	15.6	0.4
Consumer Staples	**20.4**	**22.5**	**-0.5**	**2.4**	**1.7**	**1.9**	**3.3**	**3.8**	**-0.9**	**13.4**	**14.6**	**-0.6**
Food, Bev & Tobacco	23.0	28.1	-1.1	2.5	1.6	2.1	3.2	4.1	-2.0	13.9	16.3	-1.4
Personal Care	25.2	31.4	-0.9	2.1	1.5	1.5	3.7	4.6	-1.1	12.7	16.1	-1.3
Healthcare	**35.4**	**31.6**	**0.6**	**1.3**	**1.4**	**-0.4**	**5.2**	**5.2**	**0.0**	**20.6**	**19.6**	**0.3**
Financials	**16.6**	**23.1**	**-0.6**	**2.3**	**2.0**	**0.4**	**1.2**	**1.9**	**-1.1**	**7.9**	**7.4**	**0.4**
Banks	13.2	20.5	-0.8	3.0	2.3	0.6	1.2	1.7	-0.9	6.8	7.9	-0.5
Financial Services	23.2	29.1	-0.4	1.4	1.5	-0.2	1.0	1.9	-1.4	15.5	11.6	1.6
Insurance	19.2	23.6	-0.5	2.1	1.7	0.7	1.9	2.4	-0.6	5.1	4.9	0.2
Real Estate	**13.7**	**26.0**	**-0.9**	**3.9**	**2.6**	**1.5**	**1.2**	**1.7**	**-1.2**	**13.2**	**16.9**	**-1.0**
Technology	**57.7**	**39.2**	**0.9**	**0.5**	**0.9**	**-0.9**	**11.1**	**5.1**	**2.3**	**36.1**	**19.4**	**1.8**
Telecommunications	**16.1**	**22.7**	**-0.7**	**3.7**	**3.1**	**0.6**	**2.0**	**3.3**	**-1.0**	**5.4**	**7.6**	**-0.8**
Utilities	**20.3**	**18.6**	**0.4**	**3.0**	**3.5**	**-0.5**	**1.9**	**2.0**	**-0.2**	**8.0**	**7.0**	**0.8**
Market	**25.1**	**24.7**	**0.1**	**1.7**	**1.8**	**-0.2**	**2.6**	**2.8**	**-0.2**	**12.7**	**10.7**	**1.1**

Notes: *in standard deviations from historical average. Mat. = materials. G&S = goods & services. Disc. = discretionary. Prod & Serv = products & services. Bev = beverage. Data starts on 1st January 1983 for price/earnings and dividend yield and 1st January 1990 for price/book and price/cash flow. See appendices for methodology and disclaimers.
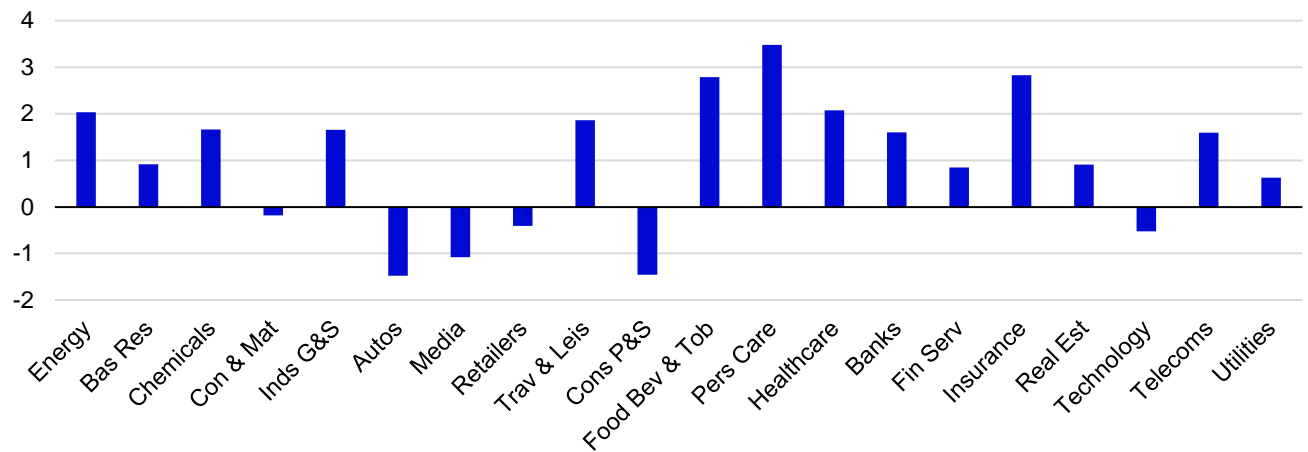Source: LSEG Datastream and Invesco Global Market Strategy Office

Appendix 4: Sector valuations by region

Figure 27 – Global dividend yields relative to market (z-score)
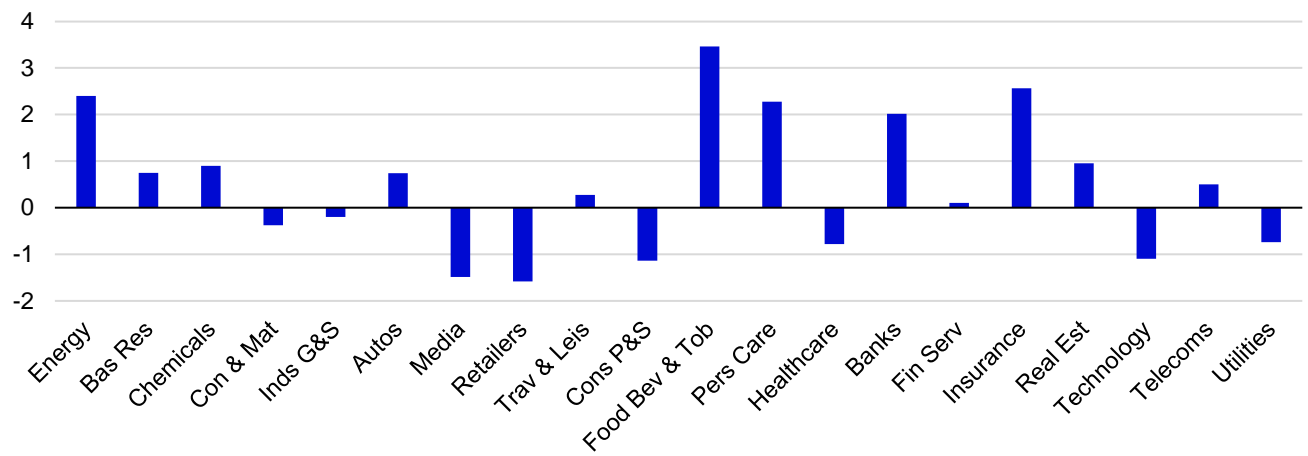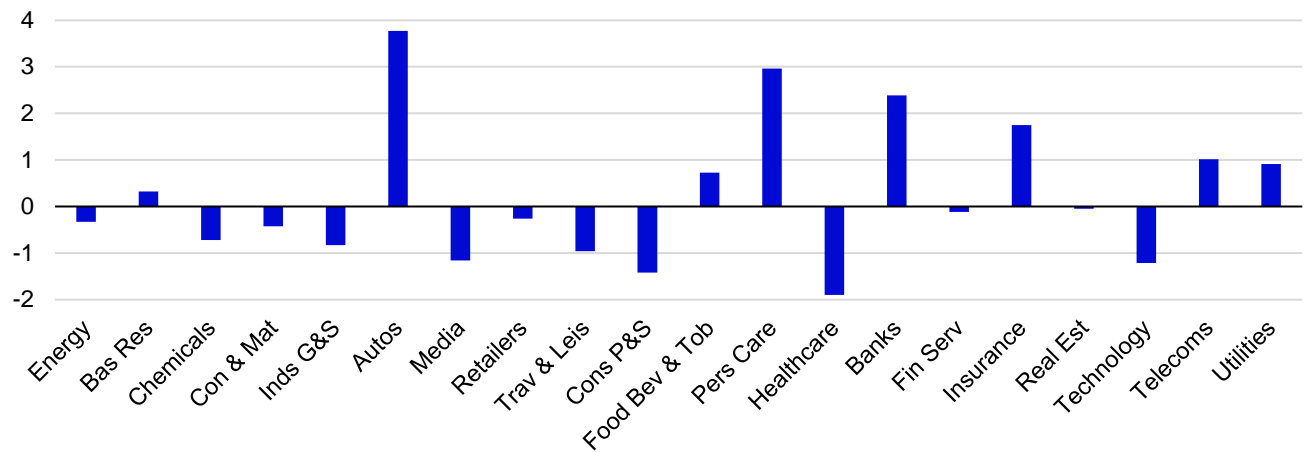

Notes: Data as of 30 June 2024. See appendices for methodology and disclaimers.
Source: LSEG Datastream and Invesco Global Market Strategy Office

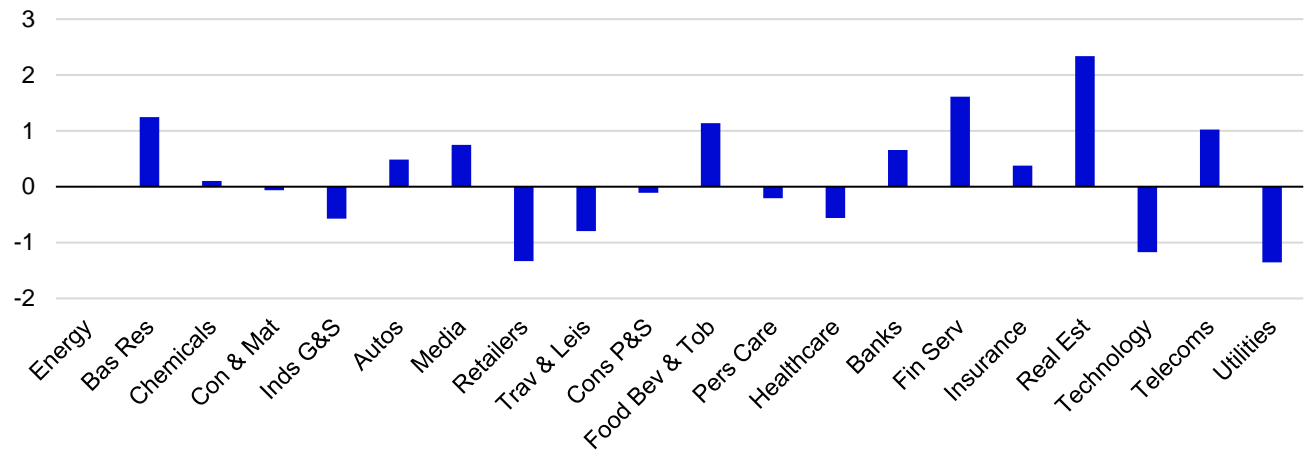**Figure 28 – US dividend yields relative to local benchmark (z-score)**

Notes: Data as of 30 June 2024. See appendices for methodology and disclaimers. The local benchmark is the Datastream US Total Market Index. Source: LSEG Datastream and Invesco Global Market Strategy Office

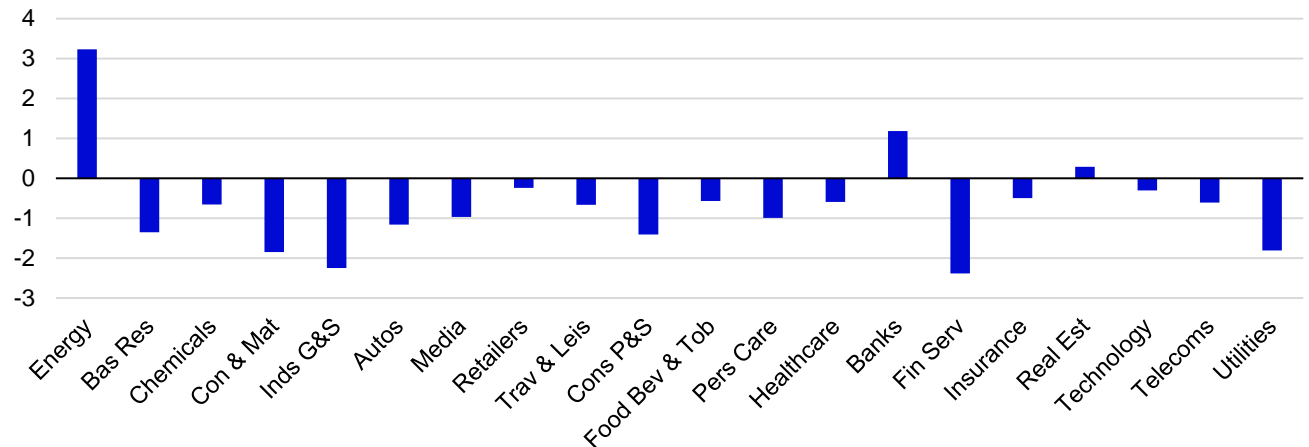**Figure 29 – Europe dividend yields relative to local benchmark (z-score)**

Notes: Data as of 30 June 2024. See appendices for methodology and disclaimers. The local benchmark is the Datastream Europe Ex-Emerging Total Market Index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 30 – Japan dividend yields relative to local benchmark (z-score)

Notes: Data as of 30 June 2024. See appendices for methodology and disclaimers. The local benchmark is the Datastream Japan Total Market Index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 31 – Emerging markets dividend yields relative to local benchmark (z-score)

Notes: Data as of 30 June 2024. See appendices for methodology and disclaimers. The local benchmark is the Datastream Emerging Markets Total Market Index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Appendix 4: Performance tables

Figure 32 – Global equity sector total returns relative to market

Data as at 28/06/2024	Global				
	3m	YTD	12m	5y*	10y*
Energy	**-4.3**	**-6.8**	**-7.1**	**-4.6**	**-6.6**
Basic Materials	**-2.3**	**-8.4**	**-7.7**	**-0.5**	**-1.5**
Basic Resources	0.3	-7.1	-3.4	2.6	-0.8
Chemicals	-5.8	-10.1	-13.4	-4.5	-3.0
Industrials	**-4.7**	**-4.0**	**-3.6**	**-1.2**	**-0.3**
Construction & Materials	-5.0	-3.6	2.2	0.7	-1.5
Industrial Goods & Services	-4.6	-4.1	-4.4	-1.5	0.0
Consumer Discretionary	**-4.1**	**-3.7**	**-6.7**	**-2.5**	**-0.8**
Automobiles & Parts	-6.0	-11.5	-17.3	1.2	-2.5
Media	-2.3	5.5	3.3	-4.9	-2.5
Retailers	0.1	5.5	7.1	-0.6	1.6
Travel & Leisure	-6.1	-8.7	-13.4	-7.1	-3.5
Consumer Products & Services	-8.2	-9.9	-14.8	-2.4	-0.1
Consumer Staples	**-3.7**	**-9.0**	**-16.2**	**-6.1**	**-3.5**
Food, Beverage & Tobacco	-4.2	-10.1	-17.8	-6.4	-3.9
Personal Care, Drug & Grocery Stores	-2.9	-6.8	-13.2	-5.8	-3.0
Healthcare	**-1.6**	**-1.7**	**-5.0**	**-0.7**	**0.6**
Financials	**-0.7**	**0.3**	**5.3**	**-1.2**	**-0.8**
Banks	0.7	1.2	6.7	-2.4	-2.6
Financial Services	-2.2	-2.0	4.0	0.7	1.6
Insurance	-1.5	2.0	4.1	-0.7	0.5
Real Estate	**-4.7**	**-11.9**	**-12.0**	**-9.6**	**-4.7**
Technology	**9.8**	**15.2**	**19.1**	**11.9**	**10.0**
Telecommunications	**-0.2**	**-5.3**	**-6.5**	**-5.0**	**-4.5**
Utilities	**1.8**	**-3.1**	**-7.2**	**-3.0**	**-2.1**

Notes: *showing annualised returns. Returns shown are for Datastream sector indices versus the total market index. **Past performance is no guarantee of future results.** Source: LSEG Datastream and Invesco Global Market Strategy Office

Appendix 5: Methodology

Multiple regression analysis
We have run a multiple regression analysis to examine how macroeconomic factors influence sector valuations. We have used the dividend yield relative to market as the dependent variable and have run the regressions with the following independent variables:

Monthly series since 31/01/1991:
- **1-year change in:** industrial production, consumer price index
- **The level of:** real oil price (US CPI adjusted), real copper price (US CPI adjusted), consumer confidence index, manufacturing confidence index, 10-year benchmark government bond yield, net debt/EBITDA (only for non-financial sectors), return on equity

We calculate a global measure of industrial production growth, consumer price index growth, consumer confidence, manufacturing confidence and government bond yields using data from four regions or countries representing 65% of global Gross Domestic Product: United States, Europe, Japan and China. The global measures are weighted averages using Datastream global index market capitalisations as weights.

This analysis shows us which independent variables have a statistically significant relationship with sector valuation ratios. In addition, the regression coefficients tell us how much each independent variable influences those ratios. Finally, we use those coefficients to calculate what the valuation ratios should be, based on the model, and compare them to currently observed valuations. In theory, this allows us to determine whether a sector is undervalued or overvalued based on the macroeconomic factors we have used.

Sector classification
We use the Industry Classification Benchmark (ICB).

Leverage and profitability ratios
We calculate Net Debt/EBITDA from sector and market level aggregates supplied by LSEG Datastream. They define Net Debt as Total Debt minus Cash, where Cash represents Cash & Due from Banks for Banks, Cash for Insurance companies and Cash & Short Term Investments for all other industries. We tend to exclude Financials from Net Debt/EBITDA comparisons for it is difficult to distinguish debt they sell as a product and debt they incur during the operation of the business. In addition, LSEG Datastream define EBITDA – Earnings before Interest, Taxes and Depreciation – as the earnings of a company before interest expense, income taxes and depreciation. It is calculated by taking the pre-tax income and adding back interest expense on debt and depreciation, depletion and amortisation and subtracting interest capitalised.

Decomposed returns
We break down total returns into 3 components to examine what has driven sector performance year-to-date, in the last 12 months and for the whole history of the index. "Yield" shows the income investors received from dividends paid during the period concerned. "Growth" shows the rate of dividend growth, calculated using the percentage change in dividend per share (DPS) values for the sector indices. DPS is calculated as dividend yield times the price index. "Multiple Change" refers to the change in dividend yield between the two periods indicated, plus the change in dividend yield times dividend growth. We use it to measure investor expectations and sentiment regarding the sectors.

Implied perpetual growth models
A valuation cross-check is sought by calculating the perpetual real growth in dividends required to justify current prices. This then allows an evaluation of whether those implied growth rates are realistic.

We use a simple perpetual growth model to calculate implied growth. If Price = Dividend/(Discount Factor - Growth), then Growth = Discount Factor – Dividend Yield. The Discount Factor is equal to Risk Free Rate + (Beta x Market Risk Premium). Everything is expressed in real terms to eliminate the distorting influence of inflation, the output being growth in real terms. The important ingredients are derived as follows:

- The risk-free rate is an equity market capitalisation weighted average of US, UK, Eurozone, Japanese and Chinese 10-year real yields.
- Sector betas are calculated using five years of weekly price movements relative to the global market index.
- The risk premium is derived from US equity and treasury market returns since 1871.
- The dividend yield for each sector is the 12-month trailing yield calculated by Datastream.

Sector allocations
We start by considering where the equity markets are in their respective economic cycles, which determines whether cyclical or defensive sectors are more likely to outperform. Our preferred measure of cyclical sensitivity is beta. Sector betas are calculated using five years of weekly price movements relative to the local market index.

Next, we refine our decisions by looking at how sector yields relative to the market relate to the ratio calculated by our multiple regression model and how much dividend growth is implied in current trailing 12-month dividend yields relative to market.

Finally, we rank sectors by their recent volatility, using the standard deviation of daily returns for the three months before our cut-off date. After that we rank sectors by their 12-month trailing dividend yield. Based on our thematic report about sector strategies, Sector strategies: Control your volatility, combining these approaches provided the best cost-adjusted and risk-adjusted returns in the US, and was among the best in cost-adjusted returns in Europe.

An investment decision is the result of balancing a range of factors and the weightings applied to those factors can vary across time and sectors. "Overweight" suggests that we prefer to hold more of the given sector than suggested by the market capitalisation-weighted "neutral" position. "Underweight" suggests we prefer to hold less of the given sector than suggested by the market capitalisation-weighted "neutral" position. "Neutral" suggests a holding in line with the market capitalisation-weighted benchmark.

Preferred regions
We measure sector valuations relative to their respective local benchmarks in the United States, Europe, Japan and Emerging Markets. We calculate a z-score comparing the latest relative dividend yield to its historical average, which gives us a standardised way to measure how far valuations are from those averages in each region. Our normal preference would be for the cheapest region based on this measure, but we also take into account thematic and other fundamental considerations.

Appendix 6: Abbreviations

Changes in allocations on the front page: OW = Overweight, N = Neutral, UW = Underweight

Sector name abbreviations:

Autos = Automobiles & parts
Basic Res = Basic Resources
Chem = Chemicals
Con & Mat = Construction & Materials
Cons P&S = Consumer Products & Services
Fin Serv = Financial Services
Food, Bev & Tob = Food, Beverage & Tobacco
Ind G&S = Industrial Goods & Services
Pers Care = Personal Care, Drug & Grocery Stores
Pers & Hh Gds = Personal & Household Goods
Real Est = Real Estate
Tech = Technology
Telecoms = Telecommunications
Trav & Leis = Travel & Leisure

Appendix 7: Definitions of data and benchmarks

Sources: we source data from LSEG Datastream unless otherwise indicated.

Government bonds (Figure 3): Current values use LSEG Datastream benchmark 10-year yields for the US, Eurozone, Japan and the UK and the Thomson Reuters China benchmark 10-year yield for China.

Value sectors: stocks or sectors that have low price/book value or price/earnings multiples or high dividend yields. Some of these stocks or sectors may generally trade at a discount compared to the market if investors expect their earnings or dividends to grow at a slower pace than the market. Examples of such sectors are utilities, telecommunications, banks and oil & gas.

Growth sectors: stocks or sectors that have high price/book or price/earnings multiples or low dividend yields, because investors expect them to have high earnings or dividend growth. Examples of these sectors are technology, healthcare and food & beverage.

Defensive sectors: stocks or sectors that have business models that investors consider to be relatively stable throughout the business cycle. We refer to the following sectors as defensive: food & beverage, personal & household goods, healthcare, telecommunications and utilities.

Cyclical sectors: stocks or sectors that have business models that investors consider to be sensitive to the economic cycle. We refer to the following sectors as cyclical: oil & gas, basic resources, chemicals, construction & materials, industrial goods & services, automobiles & parts, media, retail, travel & leisure, banks, financial services, insurance, real estate and technology.

Growth factor: a subset of the S&P 500 in the US and the Stoxx 600 index in Europe and includes stocks in the top third based on both their 5-year sales per share trend and their internal growth rate (the product of the 5-year average return on equity and the retention ratio).

Low volatility factor: a subset of the S&P 500 in the US and the Stoxx 600 index in Europe and includes stocks in the bottom quintile based on the standard deviation of their daily returns in the previous three months.

Price momentum factor: a subset of the S&P 500 in the US and the Stoxx 600 index in Europe and includes stocks in the top quintile based on their performance in the previous 12 months.

Quality factor: a subset of the S&P 500 in the US and the Stoxx 600 index in Europe and includes stocks in the top third based on both their return on invested capital and their EBIT to EV ratio (earnings before interest and taxes to enterprise value).

Size factor: a subset of the S&P 500 in the US and the Stoxx 600 index in Europe and includes stocks in the bottom quintile based on their market value in US dollars for the US and euros for Europe.

Value factor: a subset of the S&P 500 in the US and the Stoxx 600 index in Europe and includes stocks in the bottom quintile based on their price to book value ratios.

Data as of 30 June 2024 unless stated otherwise. This publication is updated quarterly.

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