viewpoint

MARSHALL & SULLIVAN

Marshall & Sullivan, Inc. / Registered Investment Advisor

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Rotation

In team sports, the best rarely rely on a single player to win games. If they did, the other team would quickly learn how to stop one player to win.

In baseball, teams use rotation schedules to give pitchers off days to recover. In hockey, managers use lines to allow players to skate as hard as they can and when they get warn out, an entire group of players come in to take their place. In football and basketball, player substitutions are used similarly. By rotating in fresh players, performance stays high and it makes it harder to know who will be the star of the game.

During the early years of the post-2008 financial crisis recovery, the market did not function like a team. If there was bad news in Europe, stocks around the world tend to fall, not simply European stocks. If a pharmaceutical stock missed on its earnings, not only did other pharmaceutical stocks fall, but almost every medical stock would pull back too.

This market action proved difficult for long-term investors as equity prices for a number of companies with strong fundamentals fell right alongside their weaker peers. Many investors became nervous and sold at the bottom. Some became frustrated and moved their equity holdings to index funds. Others moved to the side lines entirely.

As we move into the 8th year of a bull market, equities are beginning to act more like a well-managed sports team again with stocks rotating from one peak-performer to the next. Rather than rising and falling in waves, good companies with growing earnings are rewarded with solid price appreciation and when prices gets ahead of earnings, they are put on the "bench" to wait for earning to catch up. This is happening with sectors as well as individual stocks.

The financials and technology sectors are a good example of this. During the 4th quarter of 2016, financials were up over 21% while technology stocks were barely up 1%. During the first 5 months of 2017, financials were put on the "bench" with negligible appreciation while technology companies were up over 17%. Starting in June, financials took the lead again, while technology stocks were down over 2%.

Asset class rotation did not occur as rapidly as sector rotation. In 2012, most major asset classes moved in a wave, up anywhere from 16%-19%. For the next four years, US asset classes led the way – in 2013 it was small US companies; in 2014, US real estate assets performed best; in 2015, large US companies lead the way; and last year, small US companies outperformed.

With so many years of superior US asset performance, international assets became undervalued and it was only a matter of time before international asset classes would outperform. Thus, it should be of no surprise that US asset classes were "benched" in 2017 while nearly every major international asset class outperformed its US counterpart.

At Marshall & Sullivan, when a growing company (or asset class) in one of our portfolios gets ahead of itself, we put it on the "bench" either by waiting for earnings to catch up, trimming over-weighted positions, or selling out of entire positions – it all depends on the situation.

When a growing company that Marshall & Sullivan doesn't own is "benched" by the market, we often look to take advantage of the opportunity by adding it to our portfolios if it fits within our strict buy disciplines and we do not own a similar company.

For new funds added to client portfolios, we will continue to buy-up positions or asset classes that are on the "bench", knowing that as long as their earnings continue to grow, their turn to shine will come.

There are many times in the past when we have seen markets act this way. All of them have been in the middle of a bull market, not at the end of one. If the economies around the world continue to slowly grow, we think we could see this type of market for a number of years to come.

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