Financial Thesis - Bhavesh Bhagria

Current Status of the Market

From Mid November 2022 we have seen the markets bounce back a little from the year long steady decline that S&P500 and other indices have been experiencing for the majority of 2022. For the past 6 months, we have seen business sectors such as Basic Materials, Financials, Industrials and Healthcare have shown significant growth, indicating signs of recovery from a recession (that the western countries have been experiencing for the past year). Amid these positive developments, is the rising concern with the States' (and the other countries') business collaborations and dependency for manufacturing with China. Recent reports and news broadcasts have indicated that the labor market is tight in the USA because of the lack of labor to carry out work. According to the ISM reports the assembly plants are running at peak capacity, indicating that the sales of electronic components, mainly semiconductors, are going to be solid. The electronic components have had good amounts of bookings, but the reports also indicate that the semiconductors face the risk of not meeting the dates committed by manufacturers. The reality of lack of labor is also reflected in the recent BLS(unemployment reports) indicating the unemployment rate has been steady coming form december 2022 to March 2023 and to meet to demands of the market, there has been significant increase in the number of jobs created, not only in the private sectors such as leisure, hospitality, business services and healthcare, but also in the government sector. The significant rise of 25.2 percent for food and drinking places, and general merchandise of 4.5 percent, in one year, reflects the growth in the leisure and hospitality activities, explaining the increase in the number of jobs created in that sector. The rise of jobs in the business services sector is being reflected by the business decisions made by engineering companies. Earlier, the news anchor on CNBC was explaining that due to the tiff between western countries and china, and because of the chinese citizens preferring to manufacture and use the products made in the country, engineering companies are facing trouble with securing raw materials for production. Companies such as GM are planning to invest in their own raw materials mines, and/or make long-term contracts with other raw materials companies.

The recovery cycle is bad for real estate. For the past six months, the real estate sector has shown negative growth consistently, until recently showing a light of hope with positive growth for the past month. This state is also reflected in the recent home sales reports. The existing home sales have fallen for a straight 12th month, with construction spending showing an overall decline of 0.1 percent from December 2022. Private construction remaining unchanged and public construction experiencing a drop of 0.6 percent, this slowdown of housing construction has displayed concerns for a slowing economy. The new home sales with almost half a million units have a tentative plan for 7-8 months, showing promising growth in the real estate sector in the coming months.

3 Sectors to stay away from

Financials

The income of the financial services sectors, mainly Banks and insurance providers, whose primary income comes from interest payments. The data from daily treasury par yield rates showed that there has been a steady inverted yield curve, growing steeper and steeper, that directly means that banks will need to increase their interest rates. Also, as there are massive layoffs going on, people will need to resorts to their savings in the banks to make do with daily chores, and as people start to withdraw their money and restricting them from taking loans due to high interest rates and maybe delaying paying premium for their insurances, banks and insurance companies may face huge decline in their revenue, or maybe even report losses.

Real Estate

According to the macro reports, existing home sales fell for a 12th straight month in Jan. There's also a slowdown in housing construction, indicating concerns of a slowing economy. On top of that, the decline of stock prices of industrials and real estate goes hand in hand. Majority of the industries in the industrials sector provide raw materials and services and are used in real estate, such as lumber production, construction, manufactured housing, and cement and metal fabrication. During recession activity drops in this sector as companies tend to postpone expansion and produce fewer goods. According to macro reports the construction spending has also experienced a decline of an overall of 0.1 percent, with private construction virtually unchanged, and public construction being 0.6 percent low. But the construction spending is 5.7 percent above the January 2022 estimate. The reports also indicate that there are 439,000 new houses for sale, which are a tentative supply of 7.9 months. Amid large number of layoffs across the United States, and the Inverted Yield Curve increasing the interest rates of the banks, and the Industrials sector also limiting their production output, the construction of new houses and the sale of new houses will take a massive hit. (approx = 18% of GDP is related to the RE market)

Technology

According to the Monthly Retail Trade Report, the food and retail services were up by 3.0 %, the technology sector mainly consists of tangible products such as laptops and mobile phones, but limited to it, software development companies and consultancy companies provide SaaS services to other companies that include some of the technology sector companies as well. So we should not ignore the entire technology sector (because of recession and layoffs, people will refrain from buying products like televisions and phones, whose sales boost around the holiday season), and focus on companies that provide SaaS, mainly cybersecurity and fintech.

3 Sectors to have a greatest upside

For the past 6 months, the business sectors have been showing signs of expansion, and slowly moving to slow down. The previous 1-3 months performance has been showing signs of peak slowdown and heading to recession. So we need to focus on sectors that perform in slowdown and recession alike.

Which to focus on:

Consumer defensive (Staples) (Needs)
This sector contains sub-sector such as foods, groceries, tobacco, beverages (tea and coffee), hygiene and household items (shower gels toiletries), generating steady cash flows during strong economies. As there are layoffs on the horizon, and lack of jobs will mean lack of income and restricted spending by individuals, increase in the purchases of basic utilities such as food, groceries, and the other sub sectors are likely to increase. Also for food, food does include occasional outings with friends and family from time to time. According to the monthly retail trade report, the food services and drinking places were up by 25.2% compared to last year in January, and BLS reports say that approximately 128k jobs were added in the leisure and hospitality sector. Although there is a possibility that this can suffer in the coming months as leisure and hospitality does include hotel stays and travel (tourism) which will fall dramatically as recession and layoffs hit hard, but restaurant, fast food chains, alcoholic beverages and pub chains can expect an increase in their sales.

Communication Services
As during recession, sectors such as travel and tourism suffer because of people restricting their expenses, smaller entertainment sectors such as movies and OTT tend to boom. For example, how Netflix boomed in 2020 during covid as people were restricted to their homes, and gaming companies saw huge increase in sales. This also leads to increased usage of wireless and connectivity services such as carrier services (T-Mobile and others), internet service providers such as vodafone see increase due to their increased usage

Utilities
The Utilities sector comprises establishments engaged in the provision of the following utility services: electric power, natural gas, steam supply, water supply, and sewage removal. Due to the Russia-Ukraine war, Europe has been going through an energy crisis during a harsh winter. This has forced the EU to take necessary steps, and resort to other energy options such as natural gas, and for electricity, resort to other countries ’ businesses. As we approach a recession, and the war is showing no signs of ending, The of EU and the other western countries on international providers of energy will see a boost in the Utilities and in turn the energy sectors.

Other sectors that see positive growth during Recession are:
Energy
Healthcare