

Shifting Sector Views

We recently introduced our Addepar Investor Sentiment Index (ISI) (methodology found [here](#)), which uses portfolio-level transaction data to gauge investor sentiment. Additionally, in our December [Research Note](#), we introduced sector ISI as an invaluable tool to gain further insight into how U/HNW investors traded the major shifts in the economy and financial markets brought about by the pandemic.

Over the past year (January 2020–January 2021), U/HNW investors have generally been more bullish on higher-performing sectors. At the extremes, sentiment on the consumer cyclical sector was most bullish and most bearish on the energy sector.

More recently in the month of January 2021, U/HNW investors' views have now shifted to become more bullish on laggard sectors, which have finally begun to catch up to the broader market.

- Though largely bearish through most of last year, energy shifted from being the most negative sector ISI to the highest one in January. The energy ISI has become highly correlated with oil prices as U/HNW investors have begun taking a more tactical view.
- Bucking the trend, investors remain bullish on consumer cyclicals, primarily reflecting a positive view on Amazon. Since the start of the pandemic, Amazon's ISI has been running at double its long-term historical average.
- Sentiment on the technology sector has been counterintuitive and remains bearish. This is mostly due to U/HNW investor views on Apple. In fact, investors have only been bullish on Apple and the overall sector when searching for value after periods of broad market sell-offs. This includes following the Q4:2018 and March 2020 sell-offs.

U/HNW investors more optimistic on higher-performing sectors

As described in our previous [Research Note](#), over the course of 2020 dispersion across sectors has been the highest in two decades (see appendix). For this reason, we believe that providing perspective on sector sentiment is particularly relevant. In this article, we apply the ISI methodology to sectors¹ and look into how sector ISI relates to sector performance. Additionally, we begin to provide insight into the main drivers of sentiment for a few of the most noteworthy sectors by examining stock-level ISI. In subsequent analyses, we will more formally assess sentiment in detail across each of the sectors.

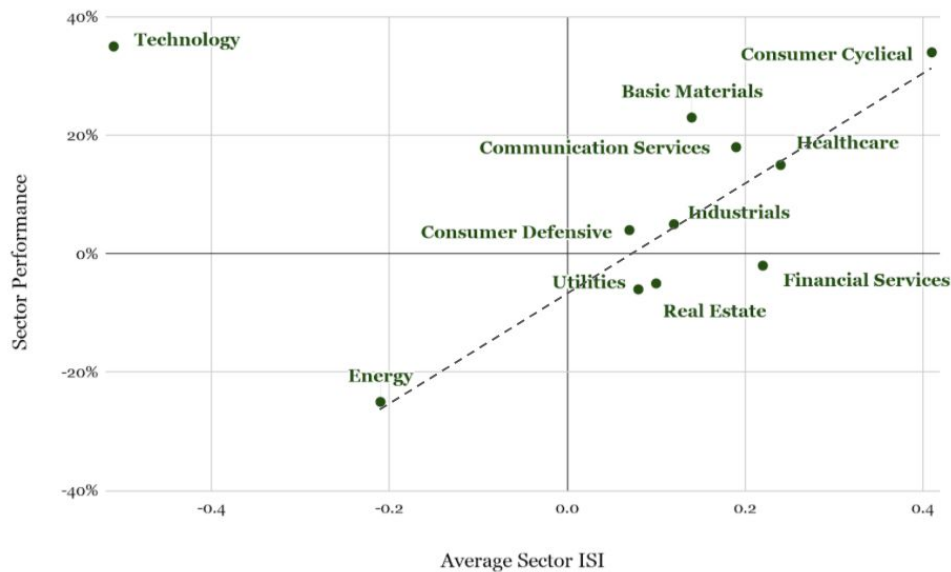
Figure 1 shows a scatter plot over the previous year of the average weekly sector ISI along the x-axis and the respective sector performance along the y-axis. The timeframe is of particular interest because it roughly measures sector sentiment and performance from the pre-pandemic market peak in 2020 through the present. With the exception of the technology sector (which we will cover in more detail below), U/HNW investors have on average been more optimistic about sectors that have been higher performers. Said differently, we see that the average sector sentiment is very positively correlated with sector return over the sample period from March 2020. A simple regression analysis (excluding technology) estimates a beta of .92 with an $R^2 = .73$.

Since performance was generally positive over the previous year, most of the sector scatter plots appear in the upper right quadrant. Energy stands out with both very negative returns and negative sentiment (lower-left quadrant). In the middle, utilities, real estate, and consumer defensive sectors had low sentiment scores and low absolute returns. The financial services sector had moderate sentiment with negligible returns.

¹ ISI sectors based on Morningstar sector classification. Sector performance based on S&P 500 indices.

Figure 1: Average Weekly Sector ISI vs. Total Sector Return

January 29, 2020–January 29, 2021



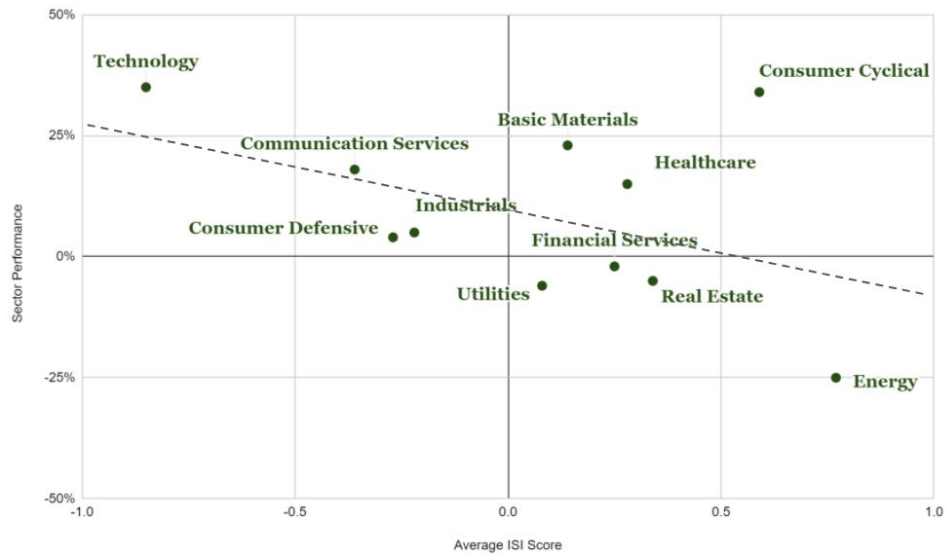
Source: Addepar Analysis, S&P Global

U/HNW investors are buying the laggards

Figure 2 shows a scatter plot of the average weekly sector ISI for January 2021 relative to sector performance over the previous year. While U/HNW investors have generally been more bullish on the strong-performing sectors over the past year, more recently sentiment has shifted in favor of sectors that have underperformed in the pandemic. A regression analysis reveals a moderately negative correlation between recent sector sentiment and the previous year's performance with a -0.18 beta and a $R^2 = .22$.

The biggest shift was in the energy sector, where sentiment scores moved from the most bearish in the previous year to the most bullish in January (from -0.2 to 0.8). The consumer cyclical sector is an exception, with virtually an immovable ISI score despite having a very high return year over year.

Figure 2: Jan 2021 Average Weekly Sector ISI vs. Previous Year Total Sector Return



Source: Addepar Analysis

We now drill down a little deeper into technology, energy, and the consumer cyclical sectors to better understand the behavior we see in each one.

Bearish views on Apple drive technology sentiment

In figure 3, we look at the top 10 most-traded tech stocks in the technology ISI data set. Because investors often invest on a market cap-weighted basis, we also include these figures to evaluate the relative importance of each stock. In a concentrated industry such as technology, Apple and Microsoft share more than half of the total sector market cap, and therefore sentiment in these two stocks will drive much of the overall sector-level sentiment. Apple has the most bearish score and the largest weight, and therefore we can attribute most of the sector-level sentiment to this one stock.

Figure 3: 10 Most-Traded Tech Stocks Average Sentiment

January 2020–January 2021

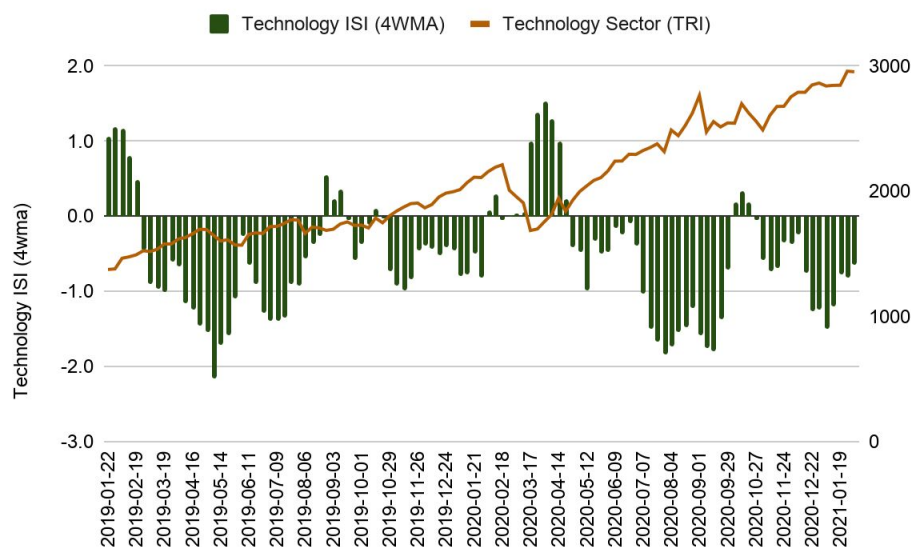
Top 10 Traded Stocks	Average ISI Previous 1 Year	Percentage Market Cap
Apple	-0.6	26%
Microsoft	0.2	20%
Nvidia	0.4	4%
Intel	-0.5	3%
Adobe	0.4	3%
Cisco	-0.4	2%
Qualcomm	0.2	2%
Oracle	-0.4	2%
Salesforce	0.4	2%
IBM	0.0	1%

Source: Addepar Analysis

Interestingly, negative sentiment in this sector—and on Apple specifically (figure 4)—has been relatively consistent for some time despite the relatively outsized returns. The only time there is any significant positive sentiment is in January 2019 when analysts saw value opportunities following the Q4 2108 sell-off, and again during the post-pandemic sell-off in March 2020.

Figure 4: Technology Sector ISI (4wma) vs. Total Return Index

January 22, 2019–February 2, 2020



Source: Addepar, S&P Global, Morningstar

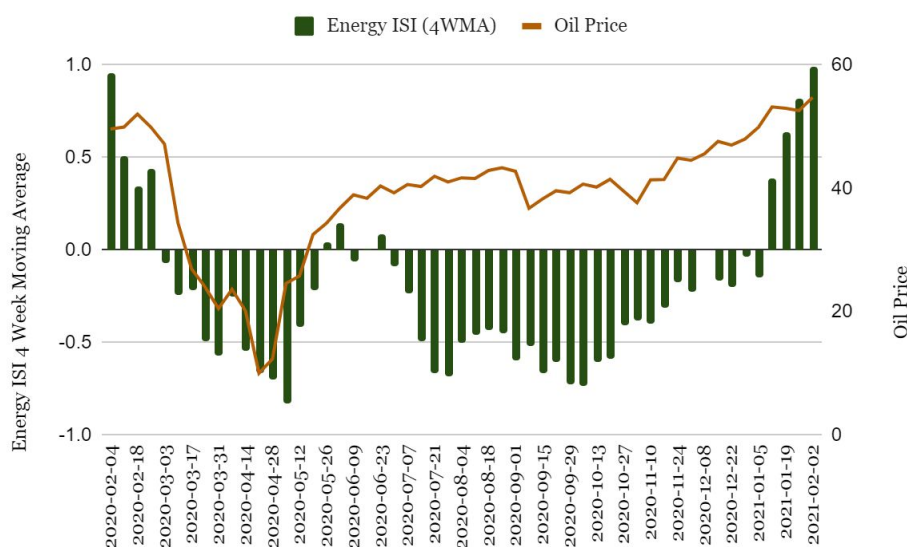
Energy sector sentiment recently linked to oil prices

The energy sector has seen a significant shift from very bearish to very bullish sentiment. As shown in figure 5, the energy sector ISI was bullish at the beginning of 2020. When oil prices (and energy more broadly) plummeted, sentiment for energy turned bearish. Even though for many investors (and the S&P 500), the allocation to the energy sector was small, as oil prices crashed and medium-term demand became stunted, investors continued to reduce their allocations through the end of October. However when oil prices rebounded in November, our energy ISI continued to grow more bullish.

The relationship between the energy ISI and oil prices has been relatively strong over the last year with a correlation of .6 whereas the previous year there was no correlation. The energy sector can behave both like the broader equity market (i.e. has a beta) and like its underlying energy commodities. More mechanically when energy prices increase (or decrease), incremental revenue largely falls to the bottom line because the cost of extraction stays relatively fixed. So perhaps when correlations of the energy ISI rise, we are seeing investors respond to their specific views on this sector and underlying energy commodities, rather than to the broader equity markets. In conversations with our clients, they report being bullish tactically, but interestingly, are also structurally increasing their allocations to this sector as a hedge against rising inflation expectations.

Figure 5: Energy Sector ISI (4WMA) vs. Oil Price

February 4, 2020–February 2, 2021



Source: Addepar, S&P Global, Morningstar

Amazon drives consumer cyclical ISI

Per figure 6, Amazon is the primary driver of the consumer cyclical ISI. With both a large market capitalization and a relatively large ISI, Amazon provides the vast majority of this signal.

Figure 6: 10 Most Traded Consumer Cyclical Stocks Average Sentiment

January 2020–January 2021

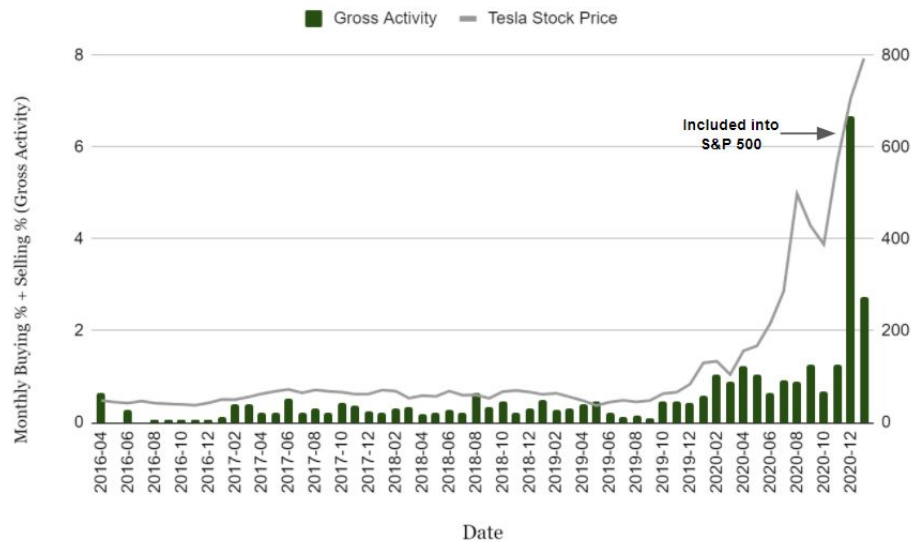
Top 10 Traded Stocks	Average ISI Previous 1 Year	Percentage Market Cap
Amazon	1.1	19%
Alibaba	-0.1	8%
Home Depot	0.1	3%
Nike	0.0	3%
McDonalds	-0.1	2%
Starbucks	0.3	1%
TJX	-0.2	1%
General Motors	0.0	1%
Ford	0.0	0%
Loews	-0.1	0%

Source: Addepar Analysis

Surprisingly, Tesla doesn't appear in the top 10 most-traded stocks. In fact, it has become a highly traded stock only after its inclusion in the S&P 500. Per figure 7, gross trading activity (% of portfolios buying plus % of portfolios selling) increased as the stock price for Tesla began its meteoric ascent. Then in December of 2020—the month of Tesla's inclusion in the index—gross activity increased by 4x. Note that the methodology only includes individual stocks and doesn't apply look-through to ETFs and mutual funds, which might otherwise lead to this effect.

Figure 7: Tesla Activity and Stock Price

April 2016 –January 2021

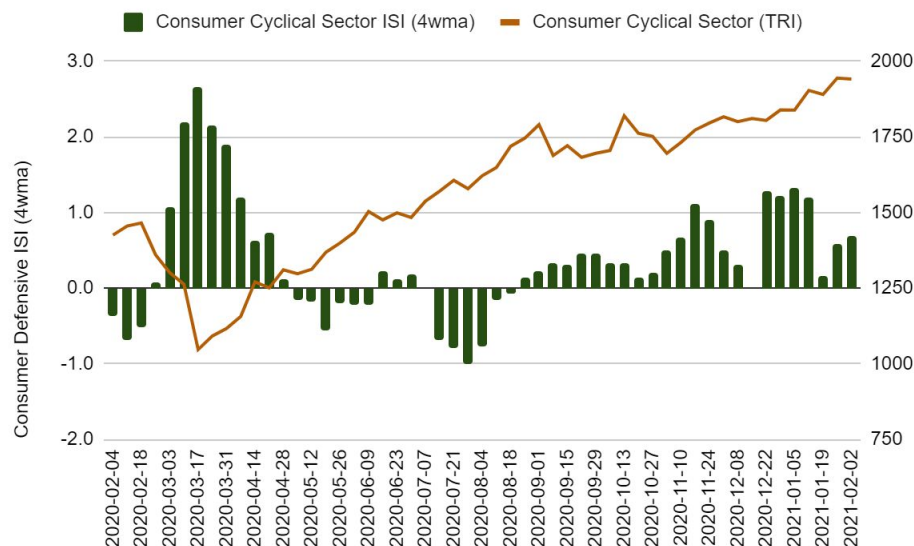


Source: Addepar, S&P Global

By the start of March 2020 (figure 8), consumer cyclicals went from being neutral to very bullish in the ISI. Investors foresaw the importance of companies such as Amazon during the pandemic. While overall sentiment remained modestly neutral through the end of the summer, consumer cyclicals sentiment turned positive, perhaps signalling a belief in long-term changes to consumer behavior.

Figure 8: Consumer Cyclical Sector ISI (4wma) vs. Total Return Index

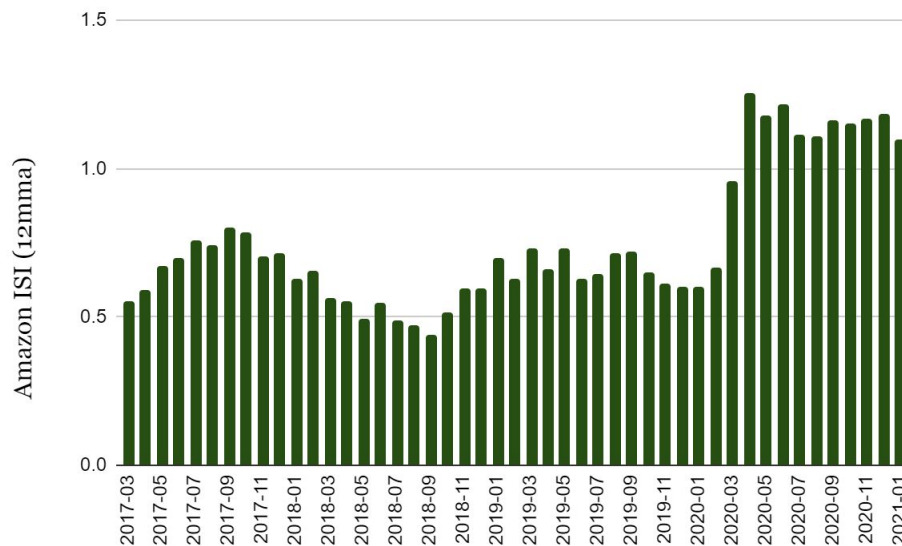
February 4, 2020–February 2, 2021



Looking at Amazon's rolling 12-month average ISI (figure 9), it increases in March 2020 and remains approximately double its previous level throughout the year.

Figure 9: Amazon ISI (12mma)

March 2017–January 2021



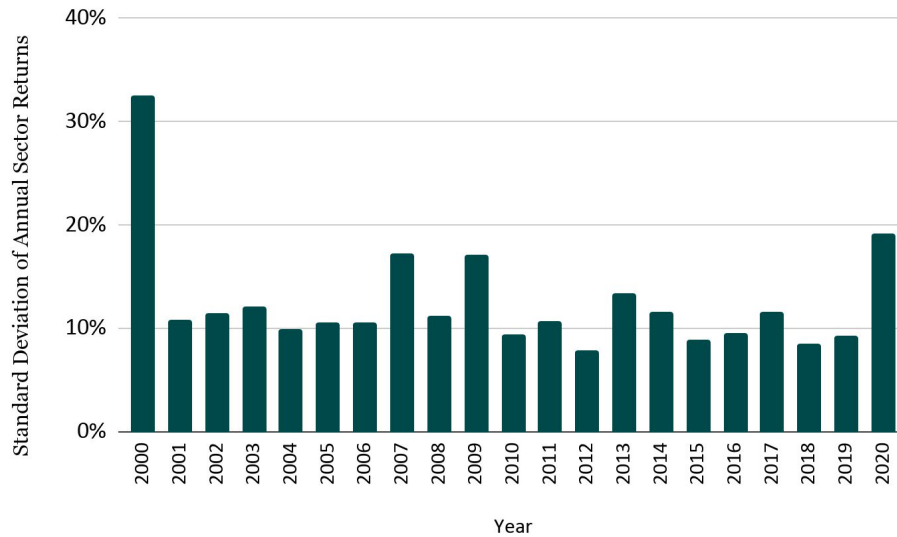
Source: Addepar

Stay tuned

We will continue to develop analytics that provide additional value to our clients through the aggregated and anonymized investment data on our platform. We'll also continue to post the monthly ISI index, our key observations and periodic research notes on our website.

Appendix

Figure 10: Standard Deviation of Annual Sector Returns
2000–2020



Source: S&P Global, Addepar Analysis

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