A pivot to easing mode by the Federal Reserve (Fed) and progress in the trade war with China led to the best annual total return for the S&P 500® Index since 2013. For the year, the S&P 500® Index (including dividends) gained 31.5 percent while the NASDAQ Composite Index gained 36.7 percent and the Dow Jones Industrial Average added 25.3 percent. The gains in the market helped extend the longest bull market in post war history. Since the trough reach on March 9, 2009 through year-end, the S&P 500® Index has posted a total return of 498 percent or an outstanding average annualized return of nearly 18 percent.

Sector Snapshot

Gains were widespread with all eleven of the S&P sector groups posting double digit total returns. The technology sector, the largest weighting in the S&P 500® Index, gained 50.3 percent followed by communication services (32.7 percent) and financials (32.1 percent). The energy sector (11.8 percent) lagged on a relative basis for the second straight year due to weak earnings trends and volatility in oil prices.

A Cautious View Remains in Place

Despite the strong gains over the course of last year, Guggenheim continues to believe the bull market remains intact and further upside is likely in the year ahead. While a repeat of the strong 2019 performance is not likely, the macro environment should remain supportive of moderate gains. The Fed is expected to keep monetary policy stable over the course of the year, inflationary pressure is likely to remain muted, the rate of unemployment should remain near multi-decade lows, and modest gains in productivity should continue to bolster wages. The combination of low unemployment, rising wages and low interest rates should be supportive of consumption—the main driver of U.S. economic growth.

While earnings growth last year has been driven almost exclusively by the expansion in the market’s P/E multiple, which in turn, has raised concern that valuation levels are looking a bit elevated relative to underlying earnings growth. After very little earnings growth during 2019, earnings will need to become the key driver of forward returns.

—Q1 2020 Equity Market Outlook

Two Sector Categories

Based on how sectors react to different market environments and economic phases, Guggenheim divides sectors into two categories: **cyclical** and **defensive**.

**Cyclical**
- Consumer Discretionary
- Energy
- Financials
- Industrial
- Information Technology
- Materials
- Real Estate
These sectors are highly sensitive to business cycle peaks and troughs.

**Defensive**
- Consumer Staples
- Communication Services
- Health Care
- Utilities
These sectors provide services that consumers need regardless of business cycle and tend to be immune to the economic cycle.

Past performance does not guarantee future results.
Sector Review

Don’t Fight the Fed

After raising rates four times during 2018 and indicating more were likely in 2019, the Fed—citing muted inflation and uncertainty around global growth due to trade tensions—pivoted to easing mode and cut rates by three times over the course of the year. At the December Federal Open Market Committee (FOMC) meeting, the Fed released its updated Summary of Economic Projections with the so-called “dot-plot” suggesting the central bank is likely to hold rates steady over the course of this year. According to the December FOMC meeting minutes, Fed officials “regarded the current stance of monetary policy as likely to remain appropriate” as long as incoming reports affirmed their outlook. In addition, while not referring to it as quantitative easing, the Federal Reserve renewed its bond buying activity resulting in a renewed expansion of its balance sheet. After troughing at $3.76 trillion in late-August, the Fed’s balance sheet ended the year at $4.17 trillion, an annualized run rate of over 35 percent, but still below the peak of $4.5 trillion reached at the end of 2014.

Outside the U.S., the investment outlook continues to brighten for both the emerging markets and Europe. Both areas are showing signs of economic stability which should be further enhanced by progress on trade. Valuations are attractive on a relative basis and accommodative central bank policies should remain supportive of the markets. Potential Risks to Outlook: 2020 brings a Presidential election in early November, and while it is currently too early to handicap the outcome, the market could face a candidate who is perceived to be less investor friendly. While progress in the U.S./China trade talks has been moving forward, the issues are very complicated, and setbacks could become a headwind to the market. The Fed is expected to maintain a favorable interest rate policy. However, rising inflationary pressure or an acceleration in growth could lead to a more hawkish outlook. Lastly, further escalations in Middle East tensions, along with the potential for retaliation, could put upward pressure on the price of oil, which in turn could be a headwind for the U.S. consumer.

S&P 500 Index—Earnings Per Share

Source: Factset as of 1.17.2020. Past performance is not guarantee of future results. There is not guarantee that these trends and projections will continue or come to fruition and they are subject to change.
Health Care

Given the elevated premiums in growth and the low probability of significant economic expansion affecting the earnings profile of value, investing at this stage of the market cycle is slightly more nuanced. Guggenheim believes it is best to remain focused on secular growth, but investors should be cognizant of premium valuations. One sector that checks both boxes is healthcare. While almost all sectors are trading at a premium valuation against their 10-year averages, it is most appropriate to determine the valuation against the market. Currently, healthcare relative to the S&P 500 is trading at a 12 percent discount. This is down significantly from late 2018, in part to uncertainty resulting from 2020 election debates. Given healthcare's above-market forecasted revenue growth over the next two years and little expected immediate changes to the industry dynamics, investors should begin rewarding the sector with a higher multiple.

GICs Sector Review and Relative Strength Indicator as of December 31, 2019

Review recent sector performance and Relative Strength Indicator (RSI) highlights. The relative strength indicator can provide insight into sector performance and help identify trends. RSI measures the velocity of a security’s price movement to identify overbought and oversold conditions and is calculated from closing prices. Some investors use RSI indicators to recognize potential turning points for making entry/exit decisions. An RSI indicator falling below a value of 30 indicates an oversold condition, and a buy signal is usually triggered when the indicator crosses 30 from below. Similarly, an RSI value greater than 70 indicates an overbought condition. A sell signal is usually triggered when the indicator crosses 70 from above.

Even with the manufacturing sector exhibiting weakness, the consumer discretionary sector has remained resilient as a result of modest wage gains that have been supportive for consumers. Consumer spending upside is limited going forward, primarily due to negative headlines of U.S.-China trade discussions and the upcoming election.

* Most labor-intensive sector at risk from wage inflation.
Energy Valuation remains near undervalued levels and the sector is a strong late-cycle performer given its strong correlation to inflation. Conditions have improved for a more balanced market in 2020, and OPEC continues to act on production cuts to the market. Economic growth and more importantly demand trajectory will be the determinant factor.

- The energy sector (11.8 percent) lagged on a relative basis for the second straight year due to weak earnings trends and volatility in oil prices.

Financials As a result of a downward tilt in the Federal Reserve’s path of interest rate hikes, the outlook for financials has deteriorated. A substantial recovery in the global economy would be necessary to support yields and thus fundamentals. Fundamentals are not driven by the shape of the yield curve, but it does affect the valuation of financials.

- The 2-10 yield curve increased to 35 basis points at the end of 2019.

Industrials This sector is a beneficiary of sustained economic growth, increased capital expenditures, mergers & acquisitions and fiscal policy action. However, there’s been some evidence that capital expenditures have peaked and continue to slow. Valuation has corrected, but easing of trade tensions has favored the already discounted sector. Industrials, with its mega-cap conglomerates and low earnings risk, represents a less risky sector to play a recovery in the economy.

- Global manufacturing data has improved since bottoming in July, ending 2019 in expansion territory.
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Guggenheim Sector Insights

The sector’s sensitivity to economic growth and interest rates has declined as a result of lower volatility in earnings and sales. Given a flatter yield curve, volatility and economic growth uncertainty, secular growth profiles are more desirable. Valuation is becoming a concern, especially in software.

- Some components of technology are defensive—mature, cash-rich, cash-flow generating, dividend-paying, and high-margin.

Materials

Inflation has been subdued but could pick up in the latter stages of the economic recovery, given cycle-low unemployment, elevated consumer confidence, and signs of labor shortages and wage pressures; best hedge in periods of rising inflation.

- A weak global economic environment continues to weigh on the material demand, especially China, where the correlation between growth and materials performance is at its highest.

Real Estate

REITs have outperformed the S&P 500 for most of 2019 amid a sharp decline in long-term rates, solid fundamentals (real estate supply levels are health and occupancy levels near long-term average) and relatively stronger growth rate than the overall equity market. Given these favorable factors, along with being a safe haven because much of its cash flow is contractual via long-term leases, the “wall of capital” chasing yield will likely continue the way of REITs.

- REITs offer defensive characteristics amid an uncertain macro environment with stable earnings and high dividend yields, but are not immune to broader market weakness.
Rising economic uncertainty has acted as a tailwind for overall non-discretionary retail sales, and the export of U.S. consumer goods’ trajectory is positive, satisfying a growing middle class in the emerging markets. • From a pure defensive equity posture, the consumer staples sector is uniquely positioned with favorable fundamentals and a relatively cheaper valuation to other defensive equities.

Communication services exhibits attributes suitable for a volatile late market cycle. The sector has defensive qualities that would hold up well during higher volatile periods and significant market exposure with idiosyncratic growth business models that rely little on the trajectory of the economy. The sector’s sales growth is expected to outpace the S&P 500 index at 10%. • The sector is comprised of telecommunications, media, and high growth technology.

According to BCA Research, the S&P 500 index on average has had gains of 24.8% from ISM to SPX peak with energy (inflationary pressures), real estate (inflationary pressures), and health care (biotechnology performance) leading all sectors. In addition, following the peak of the market to the official beginning of the recession, the S&P 500 index exhibited losses of -11.6% on average with health care, consumer staples, and materials leading all sectors. • Currently, health care relative to the S&P 500 is trading at a 12 percent discount. This is down significantly from late 2018 in part to uncertainty resulting from 2020 election debates.

Given the attractiveness to yield-oriented investors, utilities have a sustained buyer in a low long-term yield environment. Valuation remains high and comparable earnings growth relative to the market and other defensive stocks should give investors pause from becoming bullish on the sector. • At the end of bull markets, momentum and long-term growth perform the best, giving way to defensive sectors.
S&P 500® GICs Sector Performance as of 12.31.2019

Source: Guggenheim Investments. Sector performance is represented by sub-indices of the S&P 500 Index that are classified as members of the related Global Industry Classification Standard (GICS) sector.

Past performance does not guarantee future results. Index performance is for illustrative purposes only and is not meant to represent any particular investment product. Returns do not reflect any management fees, transaction costs or expenses. The index is unmanaged and not available for direct investment.
Rydex Sector Mutual Funds

Guggenheim makes it convenient to implement a sector strategy with our wide selection of 18 Rydex sector mutual funds, many with a 20-year performance history. Rydex funds offer unlimited exchange privileges, with no holding periods or transaction fees, among equivalent share classes of Rydex funds, as well as transparency through daily holdings listed on our website.

For more information on sector strategies, visit GuggenheimInvestments.com or call 800 345 7999.

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- Rydex Leisure
- Rydex Precious Metals
- Rydex Real Estate
- Rydex Retailing
- Rydex Technology
- Rydex Transportation Fund
- Rydex Utilities


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