

Can The Rotation Continue? The Fed, Current Trends & Historical Performance

Chairman Powell's acknowledged in his testimony to Congress on July 10 that cooling inflation and labor market might necessitate interest rate cuts sooner than anticipated. This was followed by historic moves in the equity market. From 10JULY through Monday's close the S&P 500 is down 3%, this amount is negligibly newsworthy, especially given the change in the Presidential election landscape. However, as mentioned in previous posts, [Which Way Did The Market Go?](#), [The New Trend Rotation Not Just For Small Caps](#), and [The Election's Impact On The Market](#) there is an underlying trend developing in the market. The **Nasdaq 100 fell 7.8%** over this period, while small cap stocks, represented by the **Russell 2000 gained 9%**. The rotation from big tech has been broader, the table illustrates the performance of the sectors of the S&P 500 through Monday's close.

Sector	YTD Until Rotation	Since Rotation
IT	23.5%	-9.4%
Communications	20.8%	-3.8%
Financials	11.5%	3.4%
Utilities	9.7%	2.9%
Staples	7.5%	1.4%
HealthCare	7.3%	2.5%
Discretionary	7.1%	-3.0%
Industrials	7.0%	3.4%
Energy	6.6%	2.3%
Materials	3.4%	3.5%
Real Estate	-3.5%	6.0%
Russell 2000	1.3%	9.0%
Nasdaq 100	22.8%	-7.8%
S&P 500	18.1%	-3.0%

On Wednesday, the Federal Reserve will announce interest rate policy. The market is waiting to see if Powell's Congressional testimony is matched by either Fed action or strong language in the accompanying monetary policy statement. Interest rate futures do not imply a move in rates tomorrow, so the focus of the market will be on the Fed's statement and projections. A bias towards lower rates, with confidence of waning inflation and labor market slack should continue the current trend of small caps performing better than the rest of the market. If the Fed has the inclination to procrastinate and wait for more data, the current outperformance of the Russell 2000 should subside.

The data on the table is as of Monday's close, and some of the indexes are approaching a 10% move. Analyzing daily data from Feb 2001 until January 2023 and averaging the performance over random five-year intervals there are some interesting statistics to keep in mind. The Nasdaq 100, on sell offs of at least 10%, average down 16.5%, and the move happens over 41 trading sessions. The Russell 2000 on moves higher by at least 10%, average gains are 29.7% and the cycle lasts for 139 trading sessions.

While the absolute movement of the indexes in relation to one another is historic, as reported by other news agencies. The rationale behind the moves are common arguments that always drive the market. The expectation that the current move will continue in the same pace and manner (Nasdaq down, Russell up) is unlikely as the historic correlation between the indexes is 70% (current overperformance is 16.8% as of Monday's close). Markets tend to mean revert, and the most likely manifestation of the continuation of the trend is that the Russell 2000 outperforms on higher prices.

Contact Triathlon Partners LLC for further discussion on the topic. Please see the next page for disclosures. The Nasdaq 100 is down 1.47% and Russell 2000 is up .28% as of posting, these figures aren't included in the above calculations.



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