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MARKET STRATEGY

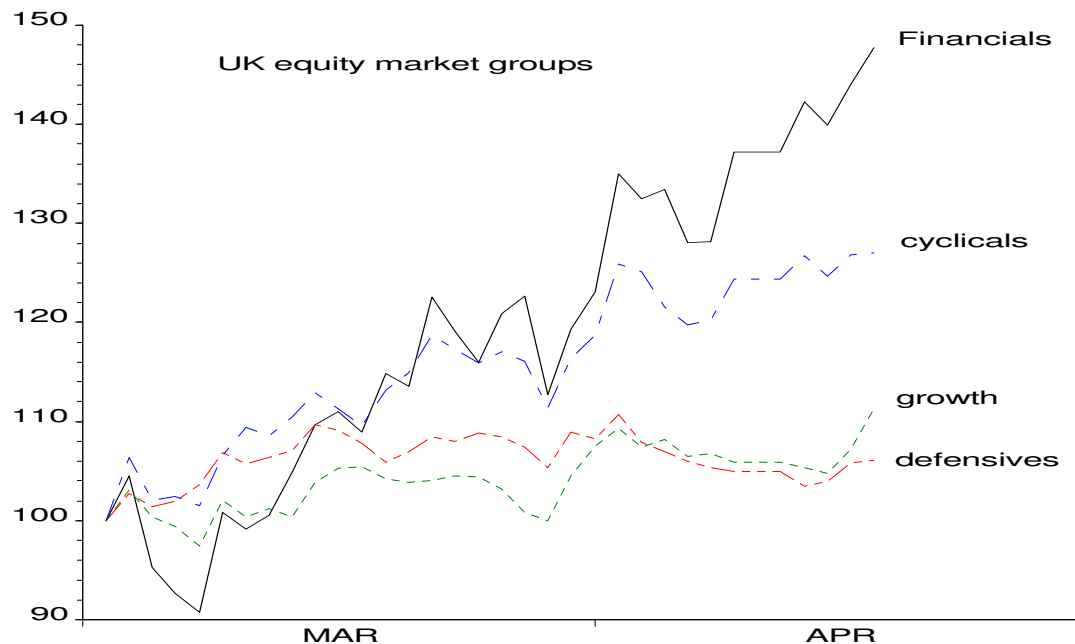
INVESTMENT RESEARCH

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Yesterday's sell-off – reaction to a spirited rebound.



Source: DATASTREAM

Up until yesterday's sell-off, the Financials had rebounded by nearly 50 percent from the UK equity market's low point early last month. The Banks alone were up by 60 percent and the Real Estate sector up by nearly 40 percent. A few cyclical sectors, notably Mining and the much smaller Autos & Parts and Industrial Engineering sectors, also rose sharply. All these sectors gained a lot in a short space of time. But then, having fallen to distressed levels, they had also lost a lot.

The FTSE 100 has now come up against an area of resistance that stretches from around 4100 up to around 4250. Also, the FTSE 250 and especially the FTSE Small Cap index are actually overbought. Interestingly, the FTSE 100 is not, owing no doubt to the representation of the defensives in the index. They were about half of the index in early March. They are a little less now - by our reckoning about 43 percent.

This makes us think that yesterday's sell-off is a reaction to the spirited rebound of the past weeks. Led by the Banks, the Financials have gone from one technical extreme to another - from being oversold to being overbought. So a period of cooling off may be required before the market is able to move ahead.

As for the defensives, given that their performance has greatly lagged in the rebound, there is still value here on top of reliable dividend growth. Electricity (Scottish & Southern, International Power) and Beverages (Diageo, SABMiller) are the preferred plays in the defensives. However, our recommendations on sector strategy have been moving progressively towards cyclicals on the view that, while it may lie some way down the road still, a sustainable recovery is coming. On cyclicals, our recommendations have focused most recently on the General Retailers (Marks & Spencer).

Our view then is that while the market may slip and slide further in reaction to the rebound since early March, we are really talking about a consolidation of the gains made since then and would treat this an opportunity to get up to the recommended sector weightings ([see Sector Strategy debrief – April 2009](#)).

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