

Cash Flow and Carey



Robert Carey, CFA
Chief Market Strategist

8/10/23



This chart is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions or other expenses incurred when investing. Investors cannot invest directly in an index. The S&P 500 Index is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance. The respective S&P 500 Sector Indices are capitalization-weighted and comprised of S&P 500 constituents representing a specific sector.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

Defensive Sectors and Elevated Inflation

S&P 500 Defensive Sectors vs. S&P 500 Index: Total Returns

(YTD & Years In Which Trailing 12-Month CPI \geq 3.0%)

Year	CPI Rate	S&P 500	S&P 500 Health Care	S&P 500 Consumer Staples	S&P 500 Utilities
2023 (8/8)	3.0%	18.30%	0.16%	2.15%	-7.40%
2022	6.5%	-18.13%	-1.95%	-0.62%	1.56%
2021	7.0%	28.71%	26.13%	18.63%	17.67%
2011	3.0%	2.11%	12.73%	13.99%	19.91%
2007	4.1%	5.49%	7.15%	14.18%	19.38%
2005	3.4%	4.91%	6.46%	3.58%	16.84%
2004	3.3%	10.88%	1.68%	8.16%	24.28%
2000	3.4%	-9.10%	37.05%	16.78%	57.19%
1996	3.3%	22.96%	21.04%	25.90%	5.68%
1991	3.1%	30.47%	53.69%	41.66%	23.89%
1990	6.1%	-3.10%	17.29%	15.32%	-0.63%

Source: Bloomberg. CPI Rate for 2023 as of 6/30. **Past Performance is no guarantee of future results.**

View from the Observation Deck

For today's post, we looked back to 1990 and selected calendar years where inflation, as measured by the Consumer Price Index (CPI), rose by 3.0% or more on a trailing 12-month basis. We chose 3.0% as our baseline because the rate of change in the CPI averaged 3.0% from 1926-2022, according to data from the Bureau of Labor Statistics. Once we had our time frames, we selected three defensive sectors (Health Care, Consumer Staples, and Utilities) and compared their total returns to those of the S&P 500 Index.

The total returns for the three defensive sectors in today's table were higher than the total return for the S&P 500 Index in five of the eleven time frames presented (1990, 2000, 2007, 2011, and 2022).

Additionally, the S&P 500 Index outperformed all three of these defensive sectors in just two of the eleven periods presented in the table (year-to-date [YTD] thru 8/8 and 2021). As many investors likely know, because defensive sectors tend to be less cyclical, they may offer better performance than their counterparts during periods of heightened volatility. Today's table reveals that defensive sectors may offer better performance relative to their peers during periods of higher inflation as well.

From 12/29/89 - 8/8/23 (period captured in the table above), the average annualized total returns posted by the four equity indices in the table were as follows (best to worst): 11.62% (S&P 500 Health Care); 10.53% (S&P 500 Consumer Staples); 10.10% (S&P 500); and 7.96% (S&P 500 Utilities); according to data from Bloomberg.

Takeaway

As today's table reveals, the S&P 500 Index outperformed the Health Care, Consumer Staples, and Utilities sectors in just two of the eleven time frames presented (YTD thru 8/8/23 and in 2021). In our opinion, the YTD total returns for the defensive sectors are likely a reflection of a stunning retreat in the CPI over the past year. As of 6/30/23 the CPI stood at 3.0%, down sharply from its most recent high of 9.1% on 6/30/22. That said, investors will often use defensive sectors as a safe haven during times of increased volatility, as well as during periods of heightened inflation. From our vantage point, tighter monetary policy, declining corporate earnings, and increasing price pressures, among other metrics, could be an indication that heightened volatility is on the horizon.