Sabrient Systems

Sector Detector

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As visibility improves, investor focus can return to America's dynamism

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Overview

As we close out H1 2025, markets seem eager to press higher on optimism about imminent fiscal stimulus and monetary policy support during H2—plus perhaps a "peace dividend" thrown in. Of course, investors at home and abroad know that President Trump will pull out all stops to demonstrate meaningful successes in raising organic economic growth and jobs creation, fostering an affordable and reliable energy supply for an electricity-hungry future, and leveraging trade negotiations to open up overseas markets while shrinking the debt/GDP and deficit/GDP ratios over the next 12 months. Otherwise, he risks a catastrophic loss in the mid-term congressional elections—which means his political opponents will be impeding him every step of the way in an effort to make that loss happen.

I had been expecting elevated volatility during H1 as the economy faced a gauntlet of challenges before surging to new highs in H2, but sanguine retail investors (with a healthy dose of FOMO) have been too eager to wait it out. Instead, they bought the April dip and never looked back, seemingly confident that my optimistic scenario would play out. And then the momentum-driven algos jumped in, followed by the institutional money. The Invesco S&P 500 High Beta ETF (SPHB) is up nearly 50% since the "Liberation Day" selloff, reflecting major risk-on behavior. Foreign capital is returning as well after a brief period of rebalancing, hedging, and "tariff paralysis."

But, with lingering macro uncertainties and valuations seemingly "priced for perfection," caution is warranted. Inflation and jobs metrics have been softening, in spite of what the headline numbers and MSM might suggest, as I discuss in greater depth in today's post. The current inflation trend, as illustrated by the rolling 3-month annualized month-over-month (MoM) metrics rather than looking back 12 months to last year's price index, shows Personal Consumption Expenditures (PCE) and Consumer Price Index (CPI) falling to just +1.08% and +1.01%, respectively. And regarding jobs growth, if you look under the hood of last week's reports, private sector hiring has been quite weak, with the headline numbers bolstered by government hiring (at the state and local level, while federal jobs shrink) and government-supported sectors, like healthcare and education.

Of course, some of this reluctance to hire can be chalked up to the lack of clarity around trade deals, tariffs, inflation, the One Big Beautiful Bill Act (OBBBA), and Fed policy, but much of this is clearing up. For example, now that the OBBBA has been signed into law, we know the new rules on tax rates, subsidies, and incentives. Moreover, the trade deals are gradually coming to fruition. However, the FOMC might continue to lay low in "watch and wait" mode to see how the economy and inflation respond rather than cut rates, which leaves Fed policy intentions murky.

I discuss both inflation and jobs in greater depth in my full commentary below, and I again make the case that the FOMC should have a terminal/neutral fed funds rate 100 bps lower than today's 4.33% effective rate. Bond yields have normalized with the 10-year Treasury now around 4.40%, which is back to its levels last November to flatten the yield curve, and the 2-year is around 3.90%. Both rates are signaling to the FOMC they should cut, and in fact the Fed's own long-run estimate for the fed funds rate is 3.0%. The market needs lower interest rates in tandem with business-friendly fiscal policy, including a 5.0% 30-year mortgage rate and a weaker dollar, to support US and global economies, to allow other central banks to inject liquidity, to avert global recession and credit crisis, and to relieve indebted consumers and businesses.

As Real Investment Advice has opined, *"…if interest rates drop by just 1%, this could reduce [federal] spending by $500 billion annually, helping to ease fiscal pressures, [and] the coming strategic investments, workforce development, and sustainable energy policies could improve economic outcomes while resolving deficit concerns.*" I agree.

So, I believe the Fed remains behind the curve as it worries about tariffs and phantom inflation—which the FOMC sees as a lurking boogeyman, like frightened children lying wide-eyed awake in their beds at night, expecting it to pounce at any moment. But as I continually pound the table on, tariffs are actually *disinflationary* (in the absence of a commensurate and offsetting increase in income). And more broadly, I believe inflation has resumed its 40-year (1980-2020) secular downtrend, as I discuss in my market commentary below.

Famed investor, co-founder of PIMCO, and "Bond King" Bill Gross argues that the growing federal deficit, elevated bond supply, and a weak dollar likely will keep inflation above 2.5% and create headwinds for bonds. However, while we both like US equities (even at today's valuations, which I discuss in greater detail below), I see the outlook for bonds differently. Now that we have some clarity on the OBBBA and the debt ceiling, foreign investors and US consumers and businesses know much more about the rules they will be playing under.

Capital tends to flow to where it is most welcome and earns its highest returns, so I think the recent tide of foreign capital flight leaving the US will reverse, helping the dollar find a bottom and perhaps strengthen a bit, which based on historical correlations would suggest higher bond prices (lower yields, despite elevated issuance in the near term) and perhaps lower gold prices. However, without the de facto boost to global liquidity of a weakening dollar, the Fed will have to step up and provide that liquidity boost, such as by lowering interest rates and implementing "stealth QE" (such as through reduced bank reserve requirements) to encourage lending and boost velocity of money (M2V), which has recently stagnated.

Most any foreign investor will tell you there is no other place in the world to invest capital for the innovation and return on shareholder capital than the US, given our entrepreneurial culture, technological leadership in disruptive innovation, strong management and focus shareholder value, low interest-rate exposure, global scalability, wide protective moats, and our reliable and consistently strong earnings growth, free cash flow, margins, and return ratios, particularly among the dominant, cash flush. So, I continue to like US equities over international equities for the longer term (other than a simple mean-reversion trade).

Hindered by its quasi-socialist policies, Europe doesn't come close to the US in producing game-changing technologies, opportunities, and prosperity for itself and the world at large. In my view, it lacks our level of freedom, openness, dynamism, and incentive structures. And as for China's unique "capitalism with Chinese characteristics," although its authoritarian rule, homogenous society, and obedient culture helps ensure broad unity and focus on common goals, its system is still far inferior when it comes to freedom of thought, entrepreneurship, and innovation, in my view. Despite America's inequalities and inadequacies, there is no better country on earth for tolerance and opportunity for economic prosperity, and we continue to grow ever more diverse and inclusive—without government programs forcing it to be so.

Moreover, it's not just the Technology sector that is appealing to investors. As BlackRock wrote in their Q2 2025 Equity Market Outlook, *"Commentators will often cite the prevalence of a large number of Tech companies in the U.S. as the driver of U.S. equity dominance. But our analysis points to wider breadth in U.S. quality. Current return on tangible invested capital (ROTIC), a proxy for a company's ability to allocate capital for optimal profitability, is significantly higher in the U.S. than elsewhere in the world, suggesting quality exists not in pockets but across sectors."*

Indeed, rather than investing in the passive cap-weighted indexes dominated by Big Tech, investors may be better served by active stock selection that seeks to identify under-the-radar, undervalued, high-quality gems. This is what Sabrient seeks to do in our various portfolios, all of which provide exposure to Value, Quality, Growth, and Size factors and to both secular and cyclical growth trends. When I say, "high-quality company," I mean one that is displays a history of consistent, reliable, resilient, durable, and accelerating sales, earnings, and free cash flow growth, rising profit margins, a history of meeting/beating estimates, high capital efficiency and ROI, solid earnings quality, a strong balance sheet, low debt burden, competitive advantage, and a reasonable valuation compared to its peers and its own history.

These are the factors Sabrient employs in selecting our **Baker's Dozen, Forward Looking Value, Dividend, and Small Cap Growth** portfolios, which are packaged and distributed as UITs by First Trust Portfolios. (By the way, the new Q3 Baker's Dozen and Small Cap Growth portfolios are launching late next week, so these are the final several days to get into the Q2 portfolios launched in April—both of which are performing well versus their benchmarks so far.)

We also use many of those factors in our SectorCast ETF ranking model, and notably, our proprietary *Earnings Quality Rank (EQR)* is a key factor used in each of our portfolios, and it is also licensed to the actively managed **First Trust Long-Short ETF (FTLS)** as a quality prescreen. In fact, we have launched our next-generation **Sabrient Scorecards**, which are powerful digital tools that rank stocks and ETFs using our proprietary factors. You can learn more about them by visiting: http://HighPerformanceStockPortfolios.com.

In my full commentary below, I discuss in greater depth the trends in inflation, jobs, GDP, and stock valuations, as well as Sabrient's latest fundamental-based SectorCast quantitative rankings of the ten U.S. business sectors, current positioning of our sector rotation model, and several top-ranked ETF ideas. *As always, please email me your thoughts on this article, and feel free to contact me about speaking on any of these topics at your event!*

Market Commentary

The S&P 500 chart has been stair-stepping higher, surging and then consolidating in sideways fashion before surging again multiple times, displaying remarkable resilience to finish H1 with a flourish. And although the chart seems extremely overbought, the CBOE Volatility Index (VIX) remains tame, solidly below 20. Winners leading the stunning surge off the April selloff include companies expected to benefit from spending (both actual and projected) on new technologies, infrastructure, and defense. Not surprisingly, Big Tech—and other technology firms that can coattail with it—has been the clear leader of this rally for its positioning in the AI revolution and all the glory it is expected to bring (and is already doing), including enhanced productivity (which is disinflationary).

But you might be surprised to learn that the top-performing sector, both last week and YTD, has been the Basic Materials sector (IYM), driven by infrastructure spending, demand for precious and industrial metals, hedging against currency devaluation, renewable energy and electric vehicle demand, and a commodity "Supercycle" boosting prices for gold, silver, copper, platinum, palladium, steel, and aluminum.

Although the major indexes like the S&P 500 and Nasdaq 100 have hit new all-time highs, market breadth has not recovered in the same way, with about 42% of the S&P 500 companies trading bearishly below their 200-day moving average (although way down from 82% at the depths of the April selloff).

Small caps were expected to be major beneficiaries of Trump's America-First policies, but the small cap indexes have been conspicuously lagging, mainly due to their lower allocation to the Tech sector. However, for the past month they have certainly perked up, with the Russell 2000 finally recapturing its 200-day moving average. Indeed, small caps might be nearing breakout levels from a two-year base. If this fledgling expansion in market breadth continues in tandem with low VIX and collapsing high-yield credit spreads (which is largely small cap debt), it could combine to suggest improving investor confidence. Notably, the ICE BofA US High Yield Index Option-Adjusted Spread has fallen precipitously from 4.61 in April to 2.86 (as of 7/8) and back down to near its historic lows around 2.60 from earlier this year when optimism was at its peak.

Similarly, regional banks and transports have regained their 200-day moving averages. The Dow Jones Transportation Index (DJT) has been trailing the S&P 500 but has perked up over the past month. With the DJT considered a leading economic indicator, it is important to see it recover because Dow Theory posits that both the DJT and the Dow Jones Industrials Index (DJI) must confirm each other's direction to validate the trend, while a divergence between them suggests either no trend or a reversal of the stronger index's apparent trend. That divergence now appears to be closing.

Notably, Bob Diamond, CEO of Atlas Merchant Capital, sees fertile ground for M&A among regional banks, greatly shrinking the number of banks by perhaps 50-60% to increase ROE through cost synergies. High interest rates and high credit demand mean the environment for strong regional banks "has never been better," in his view. The SPDR S&P Regional Bank ETF (KRE) and iShares US Regional Banks ETF (IAT) are ways to invest in this space.

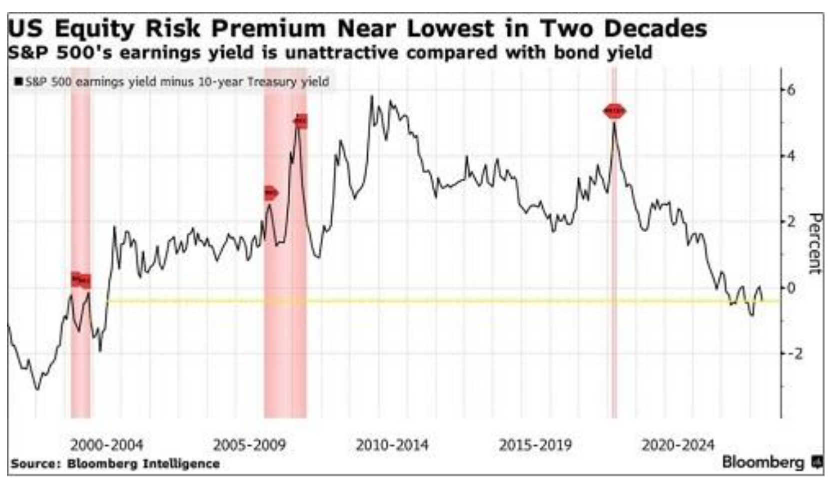
Equity valuations:

Valuations are usually driven by earnings, interest rates, and the equity risk premium (ERP), although they can be distorted by investor sentiment—driving multiple expansion (when optimistic) or multiple contraction (when pessimistic). Also, the growth rates for GDP, corporate earnings, wages, and stock prices tend not to stray too far apart since they are all closely linked to a strong economy. But if we look at the Buffett Indicator (ratio of total US market cap to GDP), it has risen to a record high of nearly 210%, and the US now accounts for nearly 50% of the world's equity market cap.

So, yes ,equity valuations are frothy once again, but if we remove the Big Tech concentration—which tend to enjoy high valuations given their juggernaut status, wide business moats, huge cash positions, and technological leadership in disruptive innovation, valuations are more reasonable. To illustrate, the forward P/E on cap-weighted Nasdaq 100 (QQQ)=29.4x and S&P 500 (SPY)=25.2x, but equal-weight Nasdaq 100 (QQQE)=26.7x and S&P 500 (RSP)=19.5x, while the S&P 400 midcap (MDY)=18.0x and S&P 600 small-cap (SPSM)=16.2x, as of 7/7. Still, these forward valuations are quite elevated compared to earlier in the year. In other words, stocks have risen on multiple expansion rather than expectations of stronger earnings growth.

Indeed, the Shiller 10-year Cyclically Adjusted Price-to-Earnings ratio (CAPE) has risen to 37.9x (versus a 1999 Internet Bubble high of 44.2x), which some would say puts the S&P 500 in mega-bubble territory. However, as I discussed in my January post, I don't put much validity in comparing the S&P 500 index P/Es through history because the makeup of the index has evolved so greatly. Today, the indexes are dominated by asset-light Tech companies with high margins, growth rates, and ROCE as opposed to the industrial conglomerates and oil companies of days past which were asset-heavy, slower growth, value-oriented, high dividend payers. In fact, there is a new version called the Current Constituents CAPE ("CC CAPE") that adjusts historical earnings for index additions and deletions, and as you might expect, it shows the index today is much less richly valued than during the Internet Bubble.

As for the ERP, it typically compares the expected returns for equities (as measured by the earnings yield, or inverse P/E) relative to a "risk-free" 10-year Treasury yield. PIMCO points out that the ERP has dwindled to below zero (i.e., the inverse of the S&P500 P/E of 25x equals 4%, which is less than the 10-year yield of around 4.4%), and this historically foreshadows significant market declines, including in 1987 and 2000. The chart below from Bloomberg illustrates the negative ERP. It is the lowest since the Internet Bubble burst over 20 years ago. A reversion back to a higher equity risk premium (which rewards the risk of owning equities versus risk-free fixed income securities) typically occurs



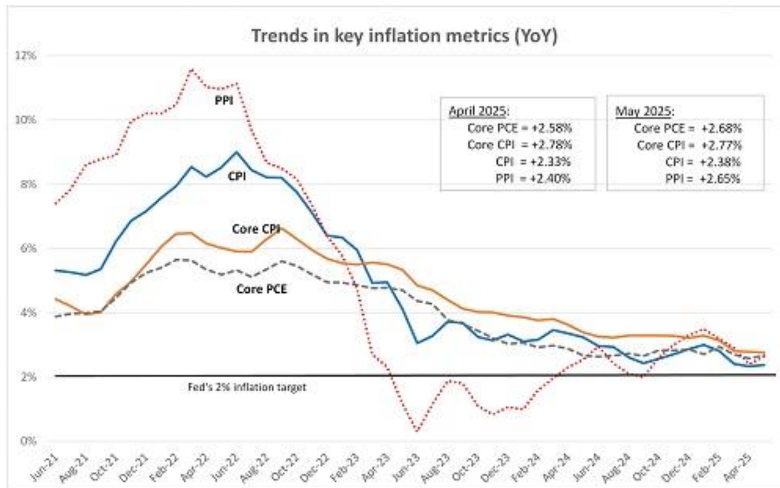
via a bond rally, an equity sell-off, or a combination of the two. According to Bloomberg, *"The S&P 500 has averaged a 12-month return of only 2.5% over the past three decades when the risk premium has stood around current levels."*

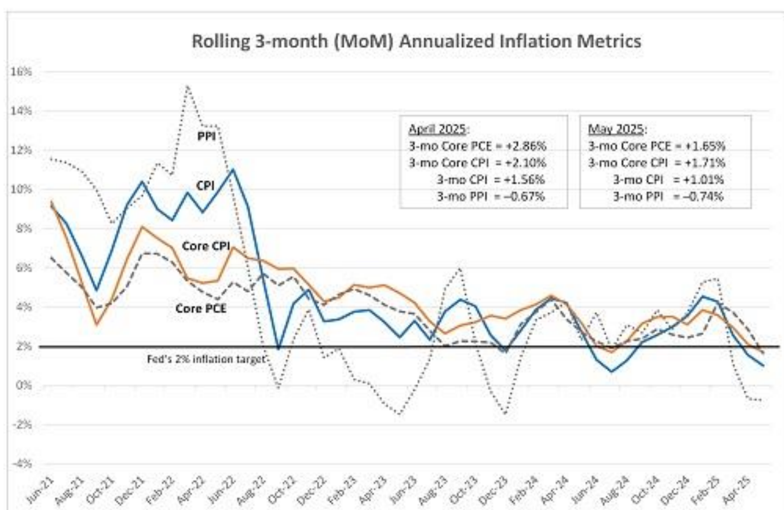
If we enhance the ERP by adding the S&P 500 dividend yield of 1.21% to the 4% earnings yield to create a total expected equity return, it equals about 5.2%. Subtract the 10-yr yield of 4.4% implies an ERP of 0.8%. This puts the ERP back to positive but still well below the 4-5% level historically considered an attractive risk premium, further emphasizing the relative attractiveness of bonds.

Of course, things are somewhat different today, as I have described in the past, regarding the differences in the financial health of Tech stocks, then versus now. For example, today's investment boom is structural rather than speculative, and the sources of AI infrastructure capital spending are dominated by the free cash flows of the Big Tech titans rather than VC and debt-financed spending (and investor "irrational exuberance") in the late 1990s in questionable dot-com companies (e.g., Pets.com), overinvestment in telecom infrastructure (e.g., Global Crossing and WorldCom), and addressing the Y2K scare.

We might have some companies today that are getting a bit "over their skis" in terms of valuations versus their timeline to adoption and profitability, such as those in quantum computing or small modular nuclear reactors, but they are not the dominant destinations for capital investment. Nevertheless, this all warrants some caution.

Julian Emanuel, chief equity and quantitative strategist at Evercore ISI, believes we are in the midst of a secular bull market (that began at the lows of October 2022), driven by the AI revolution (much like the Internet Revolution-driven bull market 30 years ago), but dealing with occasional (and brief) cyclical bear markets and "digestion phases" as valuations hit extremes. However, he also warns, *"This is the very beginning of a period of FOMO that happens in the late stages of every structural bull market—every single one."* Again, caution is warranted.





<u>Inflation, jobs, and consumer confidence</u>:

Inflation metrics continue to soften (as I have been insisting they would), May PCE was released on 6/27 further confirming the trend. The upper chart below compares the headline metrics for May CPI, PPI, Core CPI, and Core PCE, which are +2.38%, +2.65%, +2.77%, and +2.68% YoY, respectively. However, I prefer to focus on rolling 3-month (MoM) annualized rates (rather than the YoY numbers) for a better read of the *current inflation trend*, as shown in the lower chart. It shows 3-month annualized Core PCE fell to just +1.65% in May. while 3-month CPI annualized at just +1.01%, PPI at -0.74% (yes, negative), and Core CPI at +1.71%. Not shown is PCE which fell to just +1.08% in May. And lastly, the real-time blockchain-based Truflation (which historically presages CPI) is just +1.70% YoY, as of 7/8. As illustrated in the charts, inflation briefly ticked up after the Biden Administration's last-minute surge in federal spending in October-January, but now the disinflationary trend has resumed.

Moreover, as Brian Wesbury and the economic team at First Trust recently pointed out about the May reports, *"Notably, prices continue to fall in categories many expected to be impacted by tariffs, including apparel (-0.4) and new vehicles (-0.3%). We also like to follow "Supercore" inflation – a subset category of prices that excludes food, energy, other goods, and housing rents…[and] it appears the tide has finally turned for the category, with Supercore prices up at just a 0.1% annualized pace in the last three months, while the year-ago comparison has fallen from 4.1% in January to 2.8% in May."*

As I continually espouse, disruptive innovation is deflationary (increased productivity), China's economic woes are deflationary (cheaper goods, i.e., "dumping" in the face of weak domestic demand), and tariffs are deflationary (just like a tax, in the absence of a commensurate and offsetting rise in income). In addition, global liquidity growth has been modest, and global supply chain pressures are normal. According to the New York Fed's Global Supply Chain Pressure Index (GSCPI), June showed a z-score of 0.00, which means it is right at the long-run average. At the margin, supply chain pressures, including rising manufacturing, shipping, and oil prices, are inflationary, but if they spike dramatically, it becomes deflationary (again, like a tax) by weakening consumer demand, reducing discretionary spending, and compressing business margins.

Of note, Switzerland's inflation rate has gone negative, and its policy rate has returned to zero (ZIRP), while the EU recently cut for the 8th time to bring its policy rate down to 2.00%. But the Fed continues to sit on its hands, with the US effective fed funds rate remaining at 4.33%, which perpetuates its restrictive monetary policy of elevated *real* interest rates (good for savers but bad for borrowers in our highly indebted economy). Indeed, compared with other developed economies, the US has the highest policy rates in the world. The FRED chart below illustrates the real interest rate with the recent history of the difference between the effective fed funds rate and CPI.

Next week, 7/15-16, will reveal the June CPI and PPI reports, and then on 7/30 the FOMC policy announcement will be released. I fear the FOMC will decide to hold off on cuts at this month's meeting just to wait and see if private sector hiring and economic activity start ramping up now that the OBBBA has been signed into law (which has cleared up some of the paralyzing uncertainty) and any associated impact on inflation. The following meeting isn't until mid-September, seven weeks later. Fed funds futures now assign just 5% odds of a 25-bp cut on 7/30—which also coincides with the BEA's advance estimate of Q2 GDP and the Treasury Department's quarterly refunding issuance strategy (note: the OBBBA includes a $5 trillion debt ceiling lift). Looking further out, fed funds futures assign 66% chance of at least one 25-bp cut in September and 72% odds of at least 50 bps in cuts by year end.

There is obviously room for the Fed to cut—and I continue to advocate for a fed funds rate 100 bps lower (and 30-year mortgage rates closer to 5%). Treasury Secretary Bessent has intimated that the market (e.g., the 2-year yield) is signaling the need for Fed rate cuts, and if they don't start in July, it might require a larger cut (e.g., 50 bps) at the September meeting. Even some Fed governors, like Christoper Waller, have stated publicly, *"We've been on pause for 6 months to wait and see, and so far, the data has been fine…I think we've got room to bring it down…."*

In addition, economist Michael Howell of CrossBorder Capital believes we are facing an impending "debt maturity wall" such that the debt/liquidity ratio matters far more than debt/GDP. He has persuasively argued that *"public debt is expanding faster than private debt, fueled by welfare commitments and rising interest burdens…. [such that] the modern financial system [has become] a fragile, collateral-driven mechanism, and one that requires constant intervention [through proactive management] to avoid collapse."* Thus, he asserts that *"monetary policy must prioritize liquidity over inflation,"* whereas the Fed's current hands-off, higher-for-longer, reactionary approach risks causing a liquidity crunch.

Moving to the jobs front, although last week's BLS jobs report for June showed 147,000 new jobs, and the unemployment rate ticked down to 4.1%, private payrolls were up only 74,000 in June and were revised down by -16,000 for prior months, bringing the net gain to just 58,000 jobs. So, the BLS report showed that half of the June gain and upward revisions to prior months were from *government hiring*—notably driven by state and local rather than federal government (which saw 7,000 few jobs in June and 69,000 fewer since January, as the Trump Administration and DOGE shrink the size of our bloated bureaucracy).

This weakness in private-sector hiring was similar to what the June ADP Employment Report revealed with its loss of -33,000 jobs (the first decrease since March 2023), and the May ADP report was revised lower to 29,000 new jobs (from the previous 37,000). Moreover, there was a -0.3% decline in private-sector hours worked, and in the ISM Non-Manufacturing (Services) Index June report, the employment index fell to 47.2 from 50.7, reflecting the third month of contraction in the past 4 months.

Also, The Conference Board Consumer Confidence Index fell far below consensus expectations, inflation-adjusted consumer spending declined by -0.3% in May, and loan delinquency rates continue to climb (even as non-housing total debt declines), with credit card delinquencies at their highest level since Q1 2011—all of which suggest increasing financial strain on households, particularly among those with lower incomes.

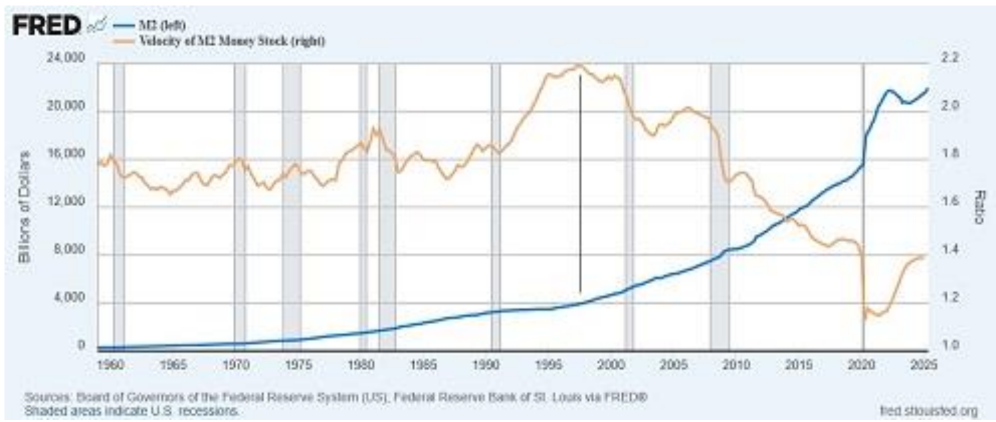
GDP growth expectations:

The latest Atlanta Fed GDPNow Forecast estimates the economy will post 2.6% growth for Q2 2025 (as of 7/3), down from the 4.6% estimate in early June. The first reading from the BEA will be released on 7/30. But in its dire forecast of a $2-3 trillion increase in the federal budget deficit over the next 10 years from the newly passed OBBBA, the Congressional Budget Office (CBO) assumes a 1.8-2.0% steady-state GDP growth rate. But if instead we can fuel stronger GDP growth (through fiscal stimulus like tax cuts and deregulation along with accommodative monetary policy) to 2.5% or more, it would cut the deficit and accelerate reduction in the debt/GDP ratio (which is more than 120% today) as the economy and resulting tax receipts growth faster than the debt, as I discussed in my June post. Indeed, Treasury Secretary Scott Bessent's 3-3-3 strategy targets 3% GDP growth and 3% deficit/GDP (a level last seen in 2016, versus 6.6% today), as well as an extra 3 million bbls/day in oil production (to bring oil price down to a target of $50/bbl).

As Real Investment Advice pointed out, *"…the CBO defaults to a long-run real GDP growth rate of about 1.8% to 2.0%—a figure derived from trend productivity and labor force growth, rather than cyclical or structural changes in the economy…This baked-in pessimism ignores potential upside scenarios such as demographic shifts, productivity surges due to technology [like imminent AI impacts], or policy-induced economic acceleration."*

In other words, the CBO doesn't consider the potential for above-trend GDP growth—given supportive fiscal and monetary policies as well as the rapid development and adoption of productivity-enhancing new technologies—that could more than offset the rise in debt, thus reducing both the deficit and the debt/GDP ratio. I would like to see the CBO produce a 3-point estimate comprising a base case scenario along with an optimistic case and a pessimistic case. Then, MSM and social media would have a broader range of outcomes to squawk about.

As a reminder, nominal GDP growth equals money supply growth plus the change in velocity of money. The chart below compares money supply (M2) versus velocity of money (M2V, which measures the number of transactions per dollar in a given unit of time). It shows that money supply grew at a steady rate until 1997 and then began to accelerate, but GDP was able to grow without a spike in inflation because M2V concurrently fell precipitously to prevent the economy from overheating. Next, a parabolic surge in M2 during the pandemic lockdowns was met with flat-then-rising M2V, which along with hobbled supply chains, caused demand to rise while supply was limited, and so inflation spiked. Then, during a brief pullback in M2, rising velocity kept the economy growing. And most recently, M2 has been growing while velocity has leveled off such that inflation has receded back to its previous deflationary trend. So, as long as the rate of M2 growth moves roughly in line with the real GDP growth rate, coupled with stable velocity of money, there should be no inflationary pressure.



Final comments:

GDP and jobs growth have been long over-reliant on government spending and its inefficient capital allocation compared with the "crowded out" private sector, which has proven much more adept at the job. Inflation briefly ticked up after a surge in federal spending in October-January, but now the disinflationary trend has resumed. After stocks pulled back on defensive investor sentiment from the uncertainty around trade wars and the budget bill, the S&P 500 and Nasdaq 100 have surged back to achieve new highs on renewed optimism as earnings growth forecasts have held up, inflation has retreated, the omnibus OBBBA budget reconciliation bill has been signed into law, AI applications continue to gain steam, and the Fed may soon cut rates.

Recall that inflation was in a 40-year secular downtrend from 1980 until the pandemic lockdowns of 2020. Globalization (comparative advantage), aging demographics, declining unionization, and productivity-enhancing disruptive technologies have been disinflationary/deflationary drivers. After the lockdowns caused a surge in global liquidity (higher demand) coupled with hobbled supply chains (lower supply), inflation naturally surged—and some observers believe that the sharp turn towards nationalism and deglobalization means inflation is here to stay, But I believe we are moving back to the previous disinflationary trend despite some strategic reshoring—for national security, redundancy of supply chains, and to address the growing wealth inequality—that will only slightly diminish the broader and disinflationary benefits of globalization, AI, blockchain, quantum computing, genomics, robotics, autonomous vehicles, low-and-zero-waste nuclear fission, and (someday) perpetual-energy nuclear fusion.

As Andrew Lees of MacroStrategy Partners has asserted, *"Trump's focus on energy is again about economic strength and security. All GDP is just a measure of energy being degraded, so the security of GDP depends on secure access to energy. U.S. primary energy consumption has gone nowhere over the past 25 years, falling 1.3% from 2000 through 2023 as manufacturing has been outsourced, paid for by the sale of U.S. assets. If the economy is to restructure productively, accumulating capital, energy consumption must start to increase. While it is widely recognized that the present system has been no good for the American middle class or working class, or society generally, it is now recognized that it also threatens U.S. security."*

And as my friend Eric Peters, CEO of One River Asset Management, recently opined, *"Trump is returning the world to its historical state, one governed by the law of the jungle. It's a world where those nations that can, will invest massively to build out critical infrastructure, secure, redundant. NATO's pledge to spend 5% of GDP annually is an early example. Infrastructure investing in this old world will boom. Monetary infrastructure will be rebuilt as well. The rise in gold is an early indicator that this process is underway. And crypto infrastructure, built to operate in a trustless environment without a central authority, is the future."*

Indeed, as Bob Dylan wrote way back in 1964, *"The times they are a-changin'."*

Latest Sector Rankings

Relative sector rankings are based on Sabrient's proprietary SectorCast model, which builds a composite profile of each of over 1,400 equity ETFs based on bottom-up aggregate scoring of the constituent stocks. The *Outlook Score* is a Growth at a Reasonable Price (GARP) model that employs a forward-looking, fundamentals-based multifactor algorithm considering forward valuation, historical and projected earnings growth, the dynamics of Wall Street analysts' consensus earnings estimates and recent revisions (up or down), quality and sustainability of reported earnings, and various return ratios. It helps us predict relative performance over the next 3-6 months.

In addition, SectorCast computes a *Bull Score* and *Bear Score* for each ETF based on recent price behavior of the constituent stocks on particularly strong and weak market days. A high Bull score indicates that stocks held by the ETF recently have tended toward relative outperformance when the market is strong, while a high Bear score indicates that stocks within the ETF have tended to hold up relatively well (i.e., safe havens) when the market is weak. Outlook score is forward-looking while Bull and Bear are backward-looking.

As a group, these three scores can be helpful for positioning a portfolio for a given set of anticipated market conditions. Of course, each ETF holds a unique portfolio of stocks and position weights, so the sectors represented will score differently depending upon which set of ETFs is used. We use the iShares that represent the ten major U.S. business sectors: Financials (IYF), Technology (IYW), Industrials (IYJ), Healthcare (IYH), Consumer Staples (IYK), Consumer Discretionary (IYC), Energy (IYE), Basic Materials (IYM), Telecommunications (IYZ), and Utilities (IDU). Whereas the Select Sector SPDRs only contain stocks from the S&P 500 large cap index, I prefer the iShares for their larger universe and broader diversity.

The table below shows the latest fundamentals-based Outlook rankings and my full sector rotation model:

The rankings display a slightly bullish bias this month given that cyclicals and secular growth sectors mostly dominate the top half of the rankings but with defensive sectors Utilities and Staples towards the bottom. However, only two sectors score above 50 in the Outlook score. Strongly bullish rankings would entail cyclical and economically sensitive sectors dominating the top half of the rankings with scores well above 50 and defensive sectors in the lower half.

Sabrient SectorCast Sector Rotation Strategy - As of 7/7/2025
Suggested Top 3 Sector ETFs for Bullish, Neutral, or Defensive Outlooks
Bullish/Neutral/Defensive bias based on SPY vs. 50/200 day moving averages; 30-90-day forward look

Sector	ETF	Outlook Score	Bull Score	Bear Score	Net Score: Neutral Bias	Net Score: Bullish Bias	Net Score: Defensive Bias
TECHNOLOGY	IYW	95	58	47	95	90.0	56.3
HEALTHCARE	IYH	55	37	51	55	39.9	53.3
FINANCIALS	IYF	47	54	52	47	67.2	53.4
INDUSTRIALS	IYJ	43	53	52	43	64.2	51.7
BASIC MATERIALS	IYM	43	45	54	43	50.1	58.6
TELECOMMUNICATIONS	IYZ	41	49	58	41	56.5	71.5
CONSUMER STAPLES	IYK	36	32	64	36	24.9	90.0
CONSUMER DISCRETIONARY	IYC	35	53	49	35	61.6	38.1
ENERGY	IYE	14	42	59	14	35.3	63.7
UTILITIES	IDU	13	33	64	13	19.1	80.4

Sabrient's ***Outlook Score*** employs a forward-looking fundamentals-based scoring algorithm to create a composite profile of the constituent stocks. ***Bull Score*** and ***Bear Score*** are based on price behavior of the underlying stocks on particularly strong and weak days over the prior 40 market days. High Bull indicates a tendency for relative strength in a strong market, and high Bear indicates a tendency for relative strength in a weak market (i.e., safe havens). High for all scores is 100, and higher is better.

Technology (dominated by the mega-cap Big Tech titans and AI-driven highflyers) remains at the top with a robust Outlook score of 95, despite having by far the highest forward P/E—a quite lofty 31.0x. However, because of its rising EPS growth estimate of 18.0%, the forward PEG (ratio of P/E to EPS growth) of 1.72 remains relatively modest compared with the other growth-oriented sectors. Tech also displays by far the highest return ratios and insider sentiment (open market buying), as well as solidly positive analyst revisions to earnings estimates.

Because many Tech stocks are riding secular growth trends (i.e., little cyclicality), no other sector comes close to the consistent sales growth, margins, operating leverage, and return on capital. And Tech not only benefits from its own product development and productivity gains, but those products help other companies with their product development, product delivery, and productivity—so Tech benefits by helping all sectors grow and prosper.

Rounding out the top 5 are Healthcare, Financials, Industrials, and Basic Materials. At the bottom of the rankings are Energy and Utilities.

Keep in mind, the Outlook Rank does not include timing, momentum, or relative strength factors, but rather reflects the consensus fundamental expectations at a given point in time for individual stocks, aggregated by sector.

Notably, our ETF rankings continue to display much stronger Outlook scores for the cap-weight indexes, like SPY and QQQ, over the equal-weight indexes, like RSP and QQQE, which reflects the higher quality of the mega cap companies that dominate the cap-weight indexes. You can learn more about our gaining access to our ETF Scorecards, which rank roughly 1500 ETFs, by visiting: http://highperformancestockportfolios.com

Sector Rotation Model and ETF Trading Ideas

Our rules-based Sector Rotation model, which appropriately weights Outlook, Bull, and Bear scores in accordance with the overall market's prevailing trend (bullish, neutral, or defensive), returned to a bullish bias in May when the SPY closed solidly above its 200-day moving average several days after previously eclipsing its 50-day. *(Note: In this model, we consider the bias to be bullish from a rules-based trend-following standpoint when SPY is above both its 50-day and 200-day simple moving averages, but neutral if it is between those SMAs while searching for direction, and defensive if below both SMAs.)* The SPY suffered a dreaded "death cross" during the April selloff when the 50-day average crossed down through the 200-day, but it just recently recovered, with the 50 crossing back above the 200.

As highlighted in the table above, the Sector Rotation model suggests holding **Technology (IYW), Financials (IYF), and Industrials (IYJ).** However, if you prefer a neutral stance, it suggests holding Technology, Healthcare (IYH), and Financials. Or, if you prefer to take a defensive stance due to overbought technicals and lofty valuations, it suggests holding Consumer Staples (IYK), Utilities (IDU), and Telecom (IYZ).

Here is an assortment of other interesting ETFs that are scoring well in our latest rankings: US Global GO Gold and Precious Metal Miners (GOAU), WisdomTree Efficient Gold Plus Gold Miners Strategy (GDMN), Sprott Active Gold & Silver Miners (GBUG), NestYield Visionary (EGGQ), NestYield Total Return Guard (EGGS), VanEck Junior Gold Miners (GDXJ), Amplify Video Game Leaders (GAMR), WealthTrust DBS Long Term Growth (WLTG), Invesco Next Gen Media and Gaming (GGME), SmartETFs Smart Transportation & Technology (MOTO), Touchstone Sands Capital US Select Growth (TSEL), Principal US Small Cap (PSC), Abacus FCF Innovation Leaders (ABOT), Janus Henderson Small/Mid Cap Growth Alpha (JSMD), AXS Esoterica NextG Economy (WUGI), ERShares Private-Public Crossover (XOVR), Invesco Biotech & Genome (PBE), iShares A.I. Innovation and Tech Active (BAI), Sarmaya Thematic (LENS), First Trust NASDAQ ABA Community Bank (QABA), First Trust Innovation Leaders (ILDR), Roundhill Generative AI & Technology (CHAT), and First Trust Bloomberg Artificial Intelligence (FAI), and AdvisorShares Restaurant (EATZ). All score in the top decile (90-100) of Outlook scores.

As always, I welcome your thoughts on this article! Please email me anytime. Any and all feedback is appreciated. Also, please let me know of your interest in any of Sabrient's new **indexes** for ETF investing, such as *High-Quality Growth* (similar to our Baker's Dozen model), *High-Quality Growth & Income*, *SMID-Cap Quality Plus Momentum*, *High-Quality Technology*, *High-Quality Energy*, *Quality Legacy & Green Energy*, or *Defensive Equity*.

IMPORTANT NOTE: I post this information periodically as a free look inside some of our institutional research and as a source of some trading ideas for your own further investigation. It is not intended to be traded directly as a rules-based strategy in a real money portfolio. I am simply showing what a sector rotation model might suggest if a given portfolio was due for a rebalance, and I do not update the information on a regular schedule or on technical triggers. There are many ways for a client to trade such a strategy, including monthly or quarterly rebalancing, perhaps with interim adjustments to the bullish/neutral/defensive bias when warranted, but not necessarily on the days that I happen to post this article. The enhanced strategy seeks higher returns by employing individual stocks (or stock options) that are also highly ranked, but this introduces greater risks and volatility. I do not track performance of the ideas mentioned here as a managed portfolio.

Disclosure: *At the time of this writing, of the securities mentioned, the author held positions in SPY, QQQ, KRE, FTLS, GOAU, and gold.*