THINK STRATEGICALLY:

The Great Rotation, Is Your Stock Portfolio Ready?

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As the great market rotation continues, have you asked yourself, "Is my portfolio ready?"

For this reason, we must discuss three distinct strategies designed to provide some context to help you navigate the opportunities.

Each strategy goes from low to high risk and somewhere in between.

– Begin adding exchange traded funds (ETFs) that track equal-weight indexes: For example, let's use the S&P 500, which is one of our favorite stock benchmarks. Today, technology stocks constitute 37 percent of the index, whereas from 2001 to 2018, they comprised 18-20 percent. With so many investors using ETFs, if you are not very keen on what type of ETF you are invested in, you could be over-invested in tech stocks and under-invested in other sectors, including cyclical. This is a low-risk strategy.

– Building "The Barbell Portfolio": Some investors have been using a barbell approach, in which the investors split their portfolios into two extremes, for example, stocks that benefited from COVID's spread and those stocks that are part of the recovery process.

Or by choosing companies that can perform well in either of the two market extremes, this is a moderate risk strategy.

– Investing only in Recovery Stocks: While some of these stocks, such as the BEACH stocks—bookings, entertainment, airlines, cruise lines and hotels—were hammered during the pandemic, the conventional wisdom is that most will rise, but others could fail. The key is to choose prudently. However, if this high-risk strategy suits you, an excellent exercise to get your feet wet is to analyze the top 20 cyclical stocks in the S&P 500 with the best prospects.

Week in Markets: The Great Stock Rotation and its Impact in October

Historical market data reveals that the month of October is often marked by volatility and pullbacks; however, this October, the opposite occurred. The U.S. stock markets delivered one of the best months of 2021. Three of the four indices we follow had corrections during September, with the Nasdaq Composite falling 5.31 percent, only to deliver a superb 7.27 percent return in October. More robust than expected corporate earnings have driven these results.

We must note that 56 percent of the S&P 500 constituents have reported their third-quarter earnings, and 82 percent of them have reported better than estimated earnings.

It is safe to say that opportunities guide the great stock rotation in the growth and value sectors. However, not all companies have delivered better than expected earnings; such was the case for two of the highest-profile members of the Nasdaq Composite, Amazon and Apple. Apple revenues rose 29 percent and net income 61.79 percent, these are hardly bad results, but it cost it losing the title of the world's most valuable company to Microsoft. Also, Amazon issued a warning about severe staffing shortages and the rising costs of maintaining its complex supply chain running at full speed; because of this matter, Amazon saw its net income drop by 50 percent.

We have not seen a single company—not even SMEs or ones like Amazon—that has not said labor issues had become the No. 1 constraint for growth during the third quarter and going into the fourth quarter.

Another critical aspect to consider as we look at the great rotation is the infamous "fear gauge," known as the VIX Index, which measures overall market volatility. The latest reading came in at 16.53, down from 16.98 the previous market day and down from 40.28 one year ago. The Vix saw a 2.65 percent decline from the previous day and 58.96 percent from one year ago.

The Market Rotation and its Driving Forces

From our vantage point, we see three components that are in action, even as labor shortages and global supply chain disruptions are the norm. We detail the factors that drove the solid October results:

1. The World is in reopening mode: Following the delta variant's surge and all the U.S. efforts to control it, as well as most global economies', the world is registering lower numbers for the time being. The surge proved to be positive in that it drove more people to get vaccinated. The following are the top seven places with the most vaccines administered:

– Spain: 79.83 percent
– China: 74.12 percent
– Puerto Rico: 73.45 percent
– Italy: 71.32 percent
– France: 67.88 percent
– United Kingdom: 66.93 percent
– United States: 57.09 percent.

Now that the vaccines have been approved for children 5-11 years old, we await to see how the numbers rise.

1. Better than Forecasted Earnings: With 82 percent of the S&P 500 companies that have reported so far exceeding expectations, there is a positive tone that allows investor sentiment to improve; while we await 44 percent of the S&P 500 constituents to report, we project that overall third-quarter earnings growth has increased a solid 36 percent year-over-year, and 8 percent above the projected growth.

The tone is mainly positive when such a broad range of companies hit it out of the park. However, as mentioned earlier, there will be some high-profile misses such as Apple and Amazon and others as the logistics of labor shortages and supply chain disruptions get sorted out. The silver lining is that we see demand rising even as prices increase.

2. The Build Back Better Act: President Biden circulated an outline of tax and spending provisions that he and Democratic leaders on Capitol Hill have agreed to as part of the pending budget reconciliation bill.

If passed, it can create millions of jobs to alleviate the labor shortage pressures and set the United States on course to meet its clean energy ambitions. The $1.75 trillion social spending plan includes these areas:

– Child Care and Preschool: $400 million
– Home Care: $150 million
– Child Tax and Earned Income Tax Credits: $200 million
– Clean Energy and Climate Investments: $555 million
– ACA Credits, Including in Uncovered States: $130 million
– Medicare (hearing aids): $35 million
– Housing: $150 million
– Higher Ed and Workforce: $40 million
– Equity & Other Investments: $90 million

The listed provisions remain subject to negotiations with the likelihood of additions as well as eliminations.

How does the United States pay for these? Let us look at the $1.995 trillion in new taxes:

– 15 percent Corporate Minimum Tax: $325 million
– Stock Buybacks Tax: $125 million
– Corporate International Reform: $350 million
– Adjusted gross income (AGI) Surcharge on the Top 0.02 percent: $230 million
– Close Medicare Tax Loophole for Wealthy: $250 million
– Limit Business Losses for the Wealthy: $170 million
– IRS Investments to Close the Tax Gap: $400 million
– Prescription Drugs (Repeal Rebate Rule): $145 million

While not all in the Democratic Party have endorsed the proposal, most policymakers are driving to get the bill passed in the weeks ahead, along with a vote on the House's $1.2 trillion infrastructure package. Much more to come.

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Monthly Market Close Comparison	10/29/21	10/1/21	Return	YTD
Dow Jones Industrial Average	35,819.56	34,326.46	4.35%	16.57%
Standard & Poor's 500	4,605.38	4,357.04	5.70%	21.00%
Nasdaq Composite	15,498.39	14,566.70	6.40%	17.08%
Birling Puerto Rico Stock Index	2,944.78	2,924.13	0.71%	47.14%
U.S. Treasury 10-Year Note	1.55%	1.48%	4.73%	0.60%
U.S. Treasury 2-Year Note	0.48%	0.27%	77.78%	0.63%