

Research Signals – Sector rotation model

Predicting relative performance across 10 European economic sectors

The sector rotation model combines economic, fundamental, momentum and sentiment factors to generate forecasts of sector performance.

Globalisation has increased the impact of macroeconomics on industry risk factors. As the performance of industry sectors are now more closely tied to the economic cycle, sector allocation is becoming more important to investment strategies. Stocks within the same sector are generally exposed to a common set of underlying drivers.

Markit's sector rotation model combines top-down and bottom-up signals to systematically score the relative attractiveness of 10 European economic sectors. It offers predictions of how sectors will perform against shifts in market movement and can be used as an overlay to stock selection strategies.

Actionable insight

Forecasts across 10 economic sectors in the form of 1, 0 and -1 ratings corresponding to outperform, neutral or underperform.

Predictive

Historical backtests indicate average returns of up to 7.84% over a 12 month holding period

Data sources

Uses Markit PMI, credit default swaps, and securities finance data for economic and sentiment insight.

History

Historical data available from January 1999

Customers

Asset managers

Hedge funds

More information

For more information on the products and services from Markit, please contact us at sales@markit.com or call one of our regional offices:

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Economic module (20%)

Uses sector level PMI data to identify relative sector performance. Sector-level data tracks the same variables as standard national PMI surveys, adding depth to the existing PMI coverage and allowing for identification of key growth sectors and associated drivers on a monthly basis.

The dataset contains information across a number of business metrics and focuses on output, new orders, output prices and backlogs of work, in addition to employment metrics.

Excludes Telecommunications, Utilities and Energy

Sentiment module (40%)

Intended to capture the overall market view of a sector using CDS, securities finance and ETF data for additional insight into sentiment. Sectors are ranked according to each factor and aggregated to determine the sentiment composite.

Momentum module (30%)

Calculates the rate of change of price, earnings or earnings estimates. Price momentum measures are constructed with basic security information – historical prices, returns and volumes. Factors look for positive trends in underlying measures. Sectors are ranked according to each factor and aggregated to determine the momentum composite.

Fundamentals module (10%)

Includes two key measures of fundamental value intended to capture the health of the underlying industries by looking at signals of overall sector strength. Return on assets and profit margin are used to determine each sector's fundamental attractiveness.

Sector rotation model: 3-month return spreads, Jan1999– Oct 2014

3 Month returns (%) Out of sample data

