Perpetual Equity Investment Company Limited

Perpetual knowledge bank series: market rotation

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Market rotation can take different forms but generally refers to the movement of investment capital from one equity class to another. This typically occurs when a sector, market capitalisation (size of listed company), region or style that had previously been flat or underperforming peers starts to gain momentum and becomes attractive to investors. Market rotation can be long term when it comes to general investment philosophy or short term in the case of a specific industry or sector. For example, investors may talk of the style rotation between growth and value stocks or sector rotation as money invested in companies from one industry moves to another as traders try to anticipate the next stage of the economic cycle.

An external incident is often the catalyst for a style rotation and the late 2020 / early 2021 shift to value and cyclical stocks is very much linked to the global recovery from the COVID pandemic. Specifically, it was the November announcement of effective vaccine roll outs that resulted in a dynamic change to the base case scenario of the market. Whereas investors had abandoned travel, tourism and hospitality stocks in favour of the so-called “stay-at-home” stocks or other “COVID winners” when the pandemic first hit, they have since moved to blue chip companies across mining, banking and healthcare. Broadly, the logic of the stock market is that a particular set of stocks usually move together, with investors switching accordingly – in this case from growth to value and defensive to cyclical stocks.

Rotation can therefore underpin investment strategy and even those investors who don't base their strategy on sector rotation should be aware of these cycles. However, it should be noted that even significant rotations (like growth to value) doesn't have to mean the collapse of the top growth stocks in an index. It could simply mean that large-cap growth or tech company expansion slows or consolidates while previously underperforming sectors catch up.