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NED DAVIS RESEARCH

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Reassessing Energy after Middle East escalation

Risk premiums across the energy complex widened last week as investors reacted to the heightened geopolitical tensions following Israel's attack on Iran. WTI closed more than 7% higher last Friday, the biggest one-day advance for the U.S. benchmark since March 2022, following Russia's invasion of Ukraine.

Energy stocks also rallied, but to a lesser extent. While crude prices are roughly 12% higher since June 12, the S&P 500 Energy sector is up 2% versus a 1% decline for the S&P 500.

One explanation for the more muted response from Energy equities is that the market has become increasingly desensitized to headlines absent clear signs of supply disruption, particularly with regard to Iran energy infrastructure or through chokepoints like the strait of Hormuz. Another explanation is that investors see the combination of weakening global growth and OPEC spare capacity as likely capping the upside for the sector.

Reweighing the evidence

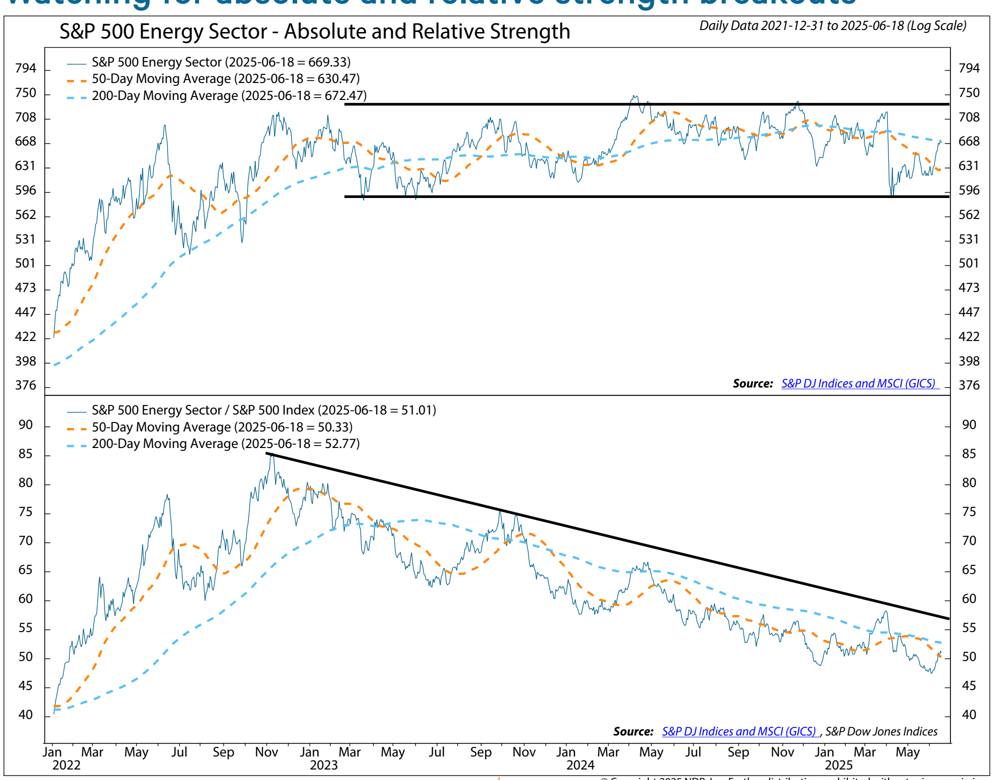
Crude short positioning by CTAs and hedge

Current Recommendations

Sector	Position	Recommended	Benchmark
Consumer Discretionary	Overweight	14%	10.6%
Communication Services	Marketweight	9%	9.2%
Consumer Staples	Marketweight	6%	6.5%
Financials	Marketweight	12%	12.6%
Health Care	Marketweight	12%	12.1%
Industrials	Marketweight	9%	8.5%
Real Estate	Marketweight	2%	2.3%
Technology	Marketweight	30%	30.1%
Utilities	Marketweight	3%	2.3%
Energy	Underweight	2%	3.7%
Materials	Underweight	1%	2.3%

Overweight Marketweight Underweight

Watching for absolute and relative strength breakouts



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Technical Update

The late April/early May rally triggered extremely high short-term technical readings that have been consistent with additional gains by the S&P 500. From here, look for intermediate-term breadth data to confirm. The percentage of stocks above their 50-day moving averages has exceeded 90% a median of 58 trading days after correction lows. June 20 is 49 trading days after the April 8 low, so we are in the window of when the indicator should fire. The current reading is 65%, so further broadening is needed. A failure for intermediate-term breadth to confirm does not mean the market will break the April lows, but a 90% reading would increase the chances of strong gains in the second half.

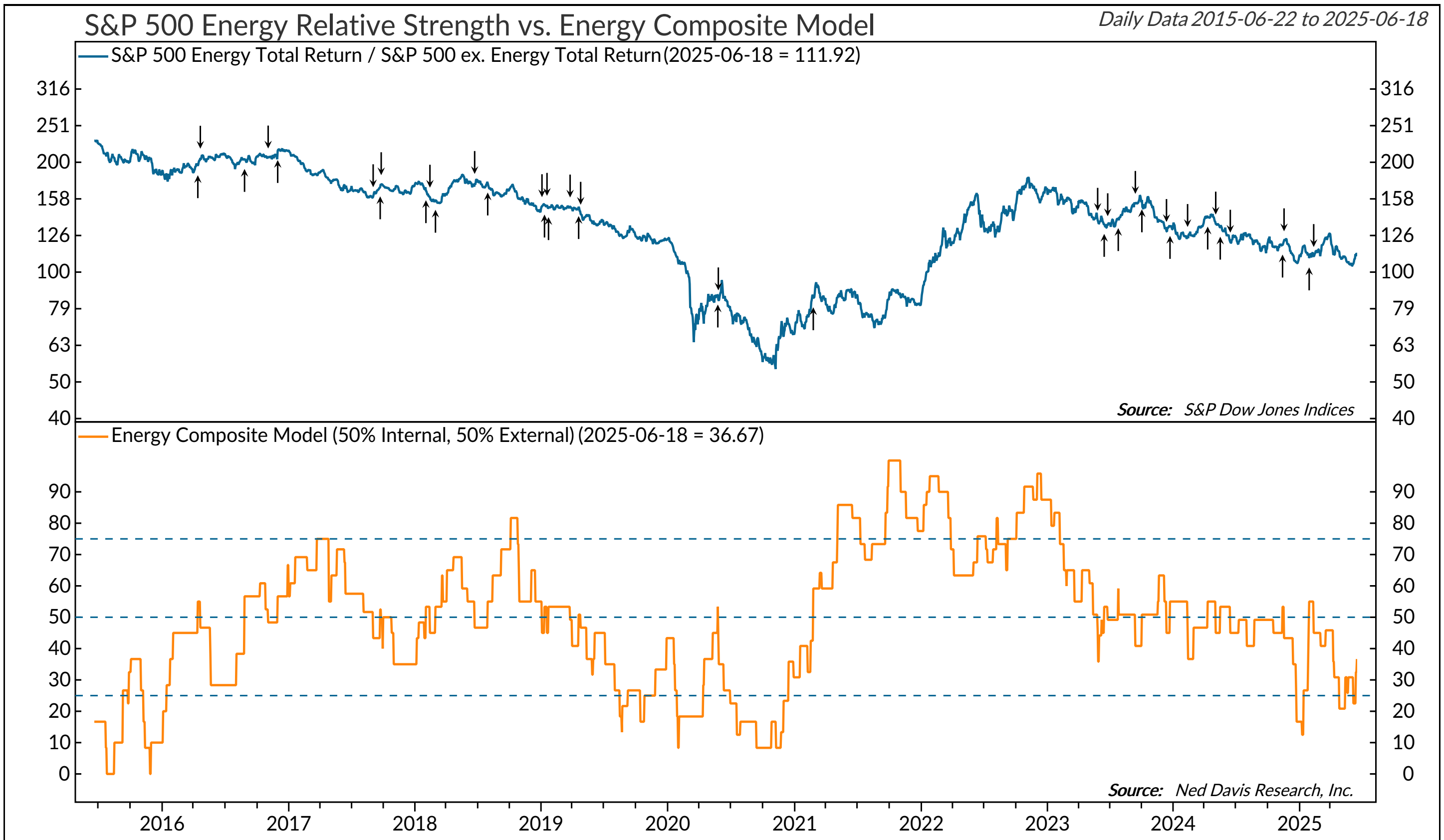
funds heading into Israel's attack was relatively low, suggesting short covering will not play a major factor to drive prices higher**. Absent an escalation, excess supply and demand growth concerns could reassert themselves and put downward pressure on oil prices.**

Importantly, Energy remains near the middle of its trading range going back to early 2023 (chart page 1, top clip). Relative to the S&P 500, the sector remains in its long-term downtrend (bottom clip). **If the sector can breakout, it would suggest something more sustainable than just another countertrend rally.**

While breakouts have yet to materialize, Energy has been the top performer since its June 4 relative strength low, and **there are signs that evidence may be beginning to turn more positive.** Declining Energy volatility turned the Energy Rolling 6-Month Volatility indicator in the sector model bullish on June 16 in the sector's internal (price-based) composite. Two of the sector's five internal composite indicators are now bullish.

However, any further near-term model improvement will likely come from Energy's external (non-price-based) composite, as the remaining bearish internal indicators are generally slower moving, designed to capture the longer-term relative movements often seen with Energy. Top candidates to turn bullish are the Crude Futures Sentiment and Median Cash Flow indicators.

Model continues to lean bearish on Energy



Energy / S&P 500 ex. Energy Performance
Full History: 1979-12-31 to 2025-06-18

Energy Composite Model is	% Gain/ Annum	% of Time
Above 75	25.77	10.57
Between 50 and 75	2.73	42.47
Between 25 and 50	-5.36	39.88
25 and Below	-34.23	7.08

Buy/Hold = -1.59% Gain/Annum

Energy / S&P 500 ex. Energy Performance
Chart View: 2015-06-22 to 2025-06-18

Energy Composite Model is	% Gain/ Annum	% of Time
Above 75	10.23	11.84
Between 50 and 75	-6.43	36.94
Between 25 and 50	0.42	37.30
25 and Below	-34.86	13.92

Buy/Hold = -6.86% Gain/Annum

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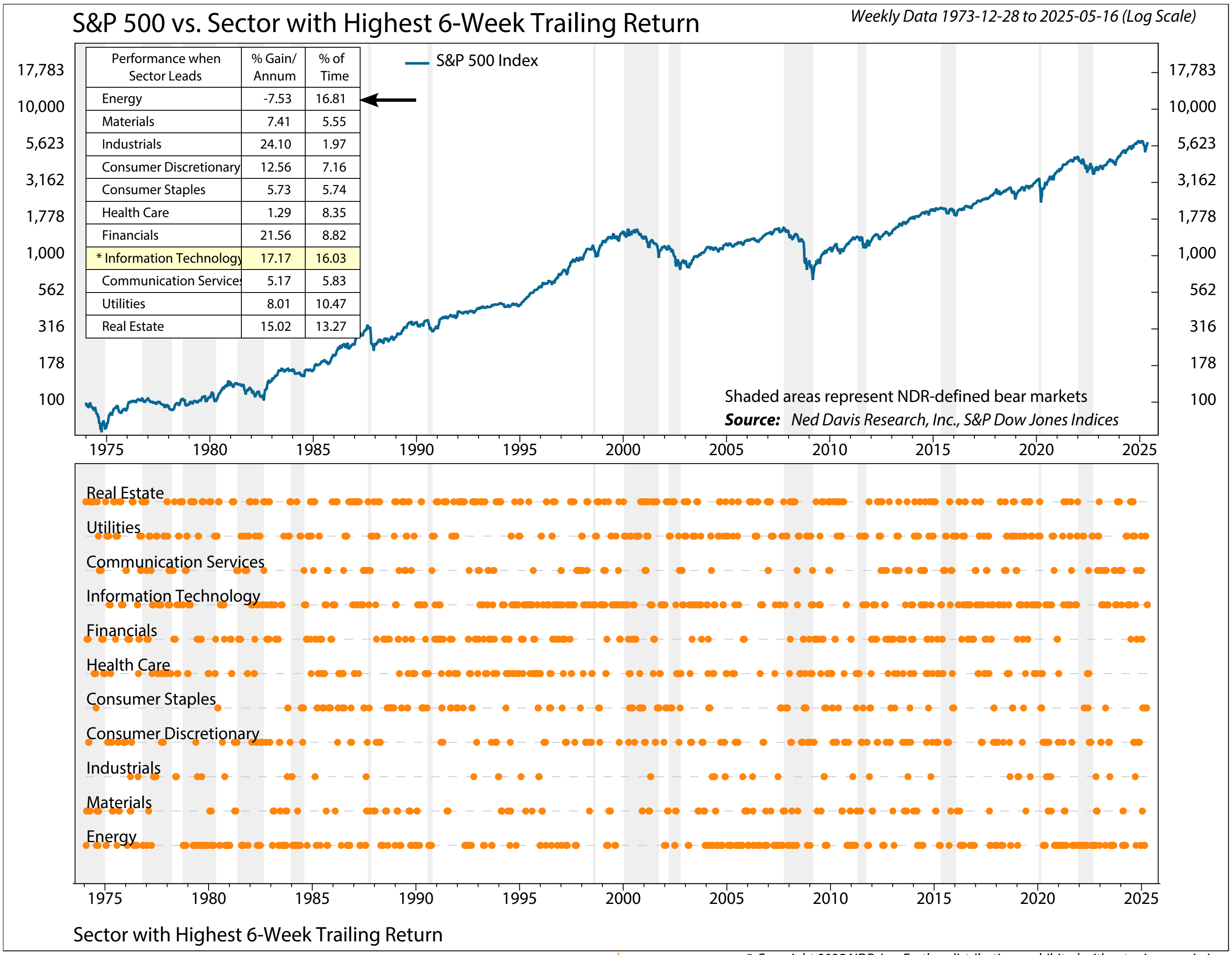
For now, the model **maintains its bearish stance on the sector (chart, page 2).** However, if another indicator turns bullish before month end, the sector model would likely close out its underweight of the sector at its July 1 update.

Market implications

The chart below shows how the S&P 500 has historically performed based on which sector has led over trailing six-week periods. Overall, returns have been positive regardless of which sector has led – with **Energy the lone exception.**

The results likely reflect Energy's tendency to rally alongside rising commodity prices, which can stoke inflation concerns, lead to a more hawkish Fed, and pressure corporate margins. Technology, the current leader, has been consistent with strong returns from the S&P 500. However, **persistent strength from Energy would be a bearish development for the longevity of the bull market.**

Continued Energy leadership would be bearish sign for stocks



Performance when Sector Leads	% Gain/ Annum	% of Time
Energy	-7.53	16.81
Materials	7.41	5.55
Industrials	24.10	1.97
Consumer Discretionary	12.56	7.16
Consumer Staples	5.73	5.74
Health Care	1.29	8.35
Financials	21.56	8.82
* Information Technology	17.17	16.03
Communication Services	5.17	5.83
Utilities	8.01	10.47
Real Estate	15.02	13.27

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NDR's sector team uses a quantitative sector model as the primary guide to deriving our recommendations. The model is designed to identify sectors and industries with the strongest fundamental (macro, economic, valuation, profitability) and technical price trends. Our team uses the model as the framework for our tactical shifts around longer-term fundamental themes. As a discipline, our recommendations are put on a "short leash" if they rank opposite the model's top and bottom quintiles, unless industry-specific influences can be shown to dominate.

Some sectors receive "over-," "market-," or "under-" weight recommendations, which means that the research firm recommends that more, the same, or less of the sector should be held in your portfolio than is held in the market.

Definitions

S&P 500 Index. A capitalization-weighted stock index of 500 of the largest and best known common stocks. The S&P 500 is one of the most quoted indexes, and is the often used as a benchmark for the stock market.
Alpha. The remaining portion of excess return after compensating for market risk.
Price-to-Earnings (P/E) Ratio. The price of a stock divided by its earnings. Also known as Price Multiple.
Price/Earnings to Growth (PEG) Ratio. A stock's price-to-earnings ratio divided by the growth rate of its earnings for a specified time period. The price/earnings to growth (PEG) ratio is used to determine a stock's value while taking the company's earnings growth into account, and is considered to provide a more complete picture than the P/E ratio.
Return on Equity (ROE). The amount of net income returned as a percentage of shareholder equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.
Basis Point. One hundredth of a percent. Used when describing change in yield. There are 100 basis points in 1%.
Price-to-Dividend. The price of a stock divided by the amount of dividends per share paid by the company each year. It is a measure of the return on investment for a stock.

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See the signals.™

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