Section (A) Sector Performance Review

Review sector performance relative to the broad market (SP500) and explain why; Include a two-week (for the two-week window reviewed) price chart of the SPDR sector ETF and SP500 (on the same chart)

Throughout my review period, both the S&P500 and the materials sector ETF (XLB) performed extremely well. As seen in both the graph and spreadsheet, the ETF outperformed the market by roughly 1.14% respectively, as shown by a 5.28% increase in the last two weeks. Much of this gain can be attributed to the extremely large dip in the market on the 16th of November, which happens to be the start date of my analysis. Most of this decline prior to my is due to talks of pessimism over the fiscal cliff. As noted before, the materials sector likes to follow closely with the S&P500 as a whole, given its cyclicality overall and dependency upon the outlook of the economy. Negotiation problems that regard reaching a deal over the fiscal cliff hit the market
hard. On November 19th, however, analysts and asset managers boasted of a prosperous economy and better negotiations of the fiscal cliff; which explains the large rise for both XLB and the market as a whole. Below is a diagram of the performance of XLB and the S&P500 over my review period.

Highlight noteworthy headline news from the sector (company-, industry-, or sector-level news)

Overall, the materials sector has been a pretty stable and boring sector over the past two weeks. Other than the fiscal cliff, nothing has happened to significantly shift the sector in the opposite direction of the market. This is pretty typical given XLB’s reliance upon market conditions. One thing that shifted the sector down was the CEO of Newmont Mining stepping down. As stated by Yahoo Finance, “Materials were the weakest sector on Monday (Dec. 3rd), led lower by Newmont Mining (NEM.N) after the company said its CEO resigned. Newmont's stock fell 3 percent to $45.69” (Yahoo Finance). Even though this came after my review period, I thought it was important to touch on. Whenever a CEO resigns, a re-evaluation is performed by analysts to further analyze the fundamentals of the company and the new CEO’s motives and goals in alignment with the current company’s structure. In this case, the sentiment demonstrated a few barriers that the new CEO will have to tackle before NEM is back on track. As noted by Reuters, “Goldberg will be faced with the task of reviving Newmont, where annual gold sales are down about 15 percent since 2006 and it has struggled with rising costs and falling output” (Reuters). The stock dropped roughly 4% since the company revealed its struggles and the CEO’s departure. The future of NEM looks bleak throughout the end of 2012.

Another small but important headline in the news is in regards to DuPont, the second largest company in the materials sector ETF. As noted in the Motley Fool, “DuPont (NYSE: DD)
was not so popular, losing more than 1.7% to lead the index lower. The company lost ground on the heels of disappointing manufacturing data that bodes poorly for the diversified materials company. The widely watched manufacturing index from the Institute for Supply Management unexpectedly fell to under 50% in November, showing a slowdown in activity (Motley Fool). Not only does this bode poorly for DD, it also demonstrates a negative sentiment over a large portion of the materials sector and the economy as a whole. Under concerns of this caliber, this definitely provides for somewhat negative sentiment over the materials sector in the near future. Due to the limited amount of headline news in the sector, I will be highlighting other important events in the other sections of this report.

Highlight the biggest (+) and the biggest (-) movers from the sector holdings during the review period. Are there notable reasons why the stocks had big moves (e.g., earnings surprises, etc)?

The largest holdings within the materials sector are Monsanto (MON), DuPont (DD), Freeport-McMoran (FCX), and Dow Chemical (DOW). As illustrated in the diagram below, three of the four largest holdings within XLB were the biggest moves. More specifically, DOW chemicals, Monsanto, Vulcan Materials and Freeport-McMoRan Copper and Gold have moved the most. Vulcan Materials has increased roughly 13.5%, DOW Chemical’s 9%, Monsanto 7.5% and Freeport-McMoRan roughly 6%. Please refer to the diagram below.

With three of these stocks being the largest in regards to holding percentage, it is only intuitive why XLB has outperformed the S&P500 from November 16th to November 30th. The majority of the volatility we see for FCX can be attributed to the somewhat subjective rise in demand for commodities, given the perceived safe-haven of gold if we go off the fiscal cliff. For Monsanto, this jump can be linked with their lawsuit that appears to be an easy win. The lawsuit was filed against another company in the sector, DuPont. This lawsuit will be covered
to a greater extent in the next section of my analysis. Lastly, Dow Chemicals also saw an incredible jump over this two-week period. Most of my research hints that this positive uptrend can be attributed to some recent upgrades by analysts. Many of the fundamentals that DOW possesses are extremely strong and given its intense cyclical nature, a prosperous economy will provide a very bullish environment for DOW to flourish in. These up-revisions were made on November 16th, the day we heard positive sentiment regarding the fiscal cliff. Lastly, we can look at the largest positive mover over this period, Vulcan Materials Company. VMC has been in negotiations with Martin Marietta Materials since last December. MLM has proposed a hostile acquisition (not takeover) of Vulcan Materials for $5 billion, which is 24-times EBITDA (Bloomberg). This gives VMC the highest acquisition multiple on record, and furthermore suggests the inexplicable value that MLM puts on the company. This has caused investors to go into a buying frenzy, boosting the stock nearly 14% over this review period.

It is important to note that my research began at the very bottom of a decline in the market, followed by a 4.14% increase from the market as a whole (S&P500). This can help put into perspective the uptrends we are seeing in the materials sector.

Highlight the largest two holdings from the sector and note any headline news on the companies.

We currently have no individual holdings within the materials sector; however, I will talk about the two largest holdings within the sector ETF. The two largest holdings in XLB are Monsanto Company (10.37 %) and DuPont (9.37%). Overall, the headline news regarding the entire sector has been minimal, with the exception of its two largest holdings. Both Monsanto and DuPont are currently in a lawsuit; against one another! According to Bloomberg, “DuPont has lied to a federal court and investors about its right to use Monsanto Co. seed technology as a central part of its defense in a patent lawsuit” (Bloomberg). As stated by Jude Richard Webber, “DuPont was combining Monsanto’s Roundup Ready soybeans with a second trait, while telling the court and public for years that it had such a right” (Bloomberg). Emails that were shared between executives in the company reveal this accusation. Judge Webber has gone to the lengths of making this case extremely well-known in regards to public relations. Additionally, “Webber will decide whether to uphold or increase the $1 billion award to Monsanto made in the patent case by a federal jury on August 1. He will also touch on whether or not Monsanto illegally extended its market dominance in genetically modified crops” (Bloomberg). This has been huge news for the sector, considering both companies make up roughly 20% of XLB overall. However, given this news, there hasn’t been a huge fluctuation in the ETF’s price, other than additional outlying market factors.
Comment on short-term outlook of the sector (including noteworthy upcoming events)

The short-term outlook of the sector is contingent upon the fiscal cliff. From a personal opinion, I believe the fiscal cliff will continue to be a problem up until the end of the year, making me bearish on the sector as a whole. As I’ve already mentioned numerous times, the materials sector is very cyclical, and therefore will adjust to the markets sentiment regarding the fiscal cliff. With 25 days left and no sort of agreement on behalf of both parties, it appears that the road is only going to get rockier for the market in regards to volatility. With a beta of 1.26, the sector as a whole will typically outperform or underperform the market, and with our current state of the economy, underperforming appears to be most likely given we jump off the fiscal cliff. I would like to note, however, that once an agreement is met or sentiment turns positive, the materials sector will likely be a great investment. The economy can be a great indication of whether or not we should or shouldn’t be interested in investing in this sector.

Section (C) Sector Recommendations

As mentioned in the previous section, I am rather bearish on the sector primarily because of the fiscal cliff that lies ahead. Each industry within the sector (paper and packaging, metals and mining, and chemicals) are all very cyclical. The underlying assumption we can pull from this is that they will all react extremely poorly given we go off the fiscal cliff and go into a small recession or they will perform well alongside the market. Given the ETF’s diversification across all industries within the sector, I believe that mitigating some of this cyclical risk through the ETF is best suited for the Cougar Investment Fund. I wouldn’t choose to sell out of the sector because XLB has provided for some diversification in the portfolio, something that is essential for all portfolios.

I have also decided to look into the three stock recommendations we have had in the sector so far this year. Below, you will find the graphs from each:

Freeport-McMoRan Copper and Gold (FCX) – 11/1/12
Sigma-Aldrich Corporation (SIAL) - 11/27/12

The Mosaic Company (MOS) – 10-16-12
Sources:


http://www.reuters.com/article/2012/12/03/newmontmining-ceo-idUSL4N09D3Q120121203

http://finance.yahoo.com/quotes/MON,DD,FCX,DOW,PX,NEM,ECL,PPG,LYB,APD/view/fv

http://finance.yahoo.com/q?s=xlb&ql=1

