



Relative Strength: A Key Consideration for Outperformance

Trading is easy, all you need to do is buy the shares that are moving higher, from the bottom left to the top right of the chart.

That's how you make money right? Well, YES and NO.

The argument for trend following is valid as it rests on the basis that prices can go further than we think and that market participants act as part of a herd with the fear of missing out a.k.a. FOMO, being a key driver.

Do these trends always persist? No.

Sometimes prices retrace moderately or consolidate in a sideways range, before continuing its trend higher. The counterargument is that despite strength and high momentum, the share could make a complete bearish reversal, turning from excessively bullish to bearish, in what the market refers to as a V-shaped reversal. In both cases, when reviewing the bull and bear case, it is the role of the analyst to make a judgement and assess the probability for either a continuation of the trailing move higher, or a reversal which may lead to a decline in prices.

Track, Trounce or Trail?

For the active trader and investor, a variety of choices are available.

Do they buy an index tracker to perform in line with the broader market? That may a good choice when markets are trending up and volatility is low, however what happens when markets lack a directional bias or are under selling pressure?

How does the trader identify instruments that have the ability to outperform the broader market, thereby generating alpha to reflect benefit of an active management approach?

Within Technical Analysis, the concept of Relative Strength (RS) plays a key role in not only identifying potential outperformers but also to identify areas of the market that could become serial laggards over a certain period.



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Take for example Naspers. In May 2021, our research identified that NPN was in the early stages of starting to underperform the JSE Top 40 Index (Equally Weighted).

Using the relative ratio chart (comparing NPN vs the index), the monthly chart shows the price breaching a multi-year upward channel while the 14-month RSI lost its horizontal support. At the time NPN traded at a price of R3020, while it has, over the subsequent period, declined by more than 50% at its recent lows. While not being a direct idea to short/sell NPN, the relative ratio chart provided the analyst or PM with a perspective on the portfolio percentage that may have needed to be allocated to NPN at the time. The ratio itself suggested an underweight allocation within a portfolio.

Monthly Chart: NPN vs JSE Top 40 Equally Weighted during May 2021



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More broadly, an analysis of the Equally Weighted chart of the JSE Top 40 versus the market cap weighted chart suggested a broad-based bid for South African equities i.e. money flowing out of Naspers into other Top 40 constituents. Since May 2021, we have indeed seen a broad-base bid for S. African shares. This is referred to as an increase in breadth.

Monthly Chart of JSE Top 40 Equally Weighted relative to JSE Market Cap Weighted during May 2021



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Moving to the sector level, an expanded view of the Telecommunications sector that suggested an overweight versus the broader market. Also in May of 2021, the sector cleared a multi-year downward channel suggesting investors continue to buy MTN and VOD, these being the sector leaders. Since, we have seen both counters outperform the market by a wide margin.

Monthly Chart of Telecoms Relative to All Share Index during May 2021

INTERMARKET ANALYSIS: JSE Telecommunications Index vs JSE All Share Index | Long Term Shift - Sitting Between Equal to Overweight vs All Share Index

- On a relative basis, and from a sector allocation perspective, the relative ratio chart of the JSE Telecommunications Sector versus the JSE All Share Index suggests that long term investors are possibly shifting from an underweight to equal weight and overweight positions versus the benchmark.
- Technical evidence of this is provided by the break of the channel extending back to October 2014.
- We also note the break of the downward trend line extending back to the peak of November 2007 (a positive development).



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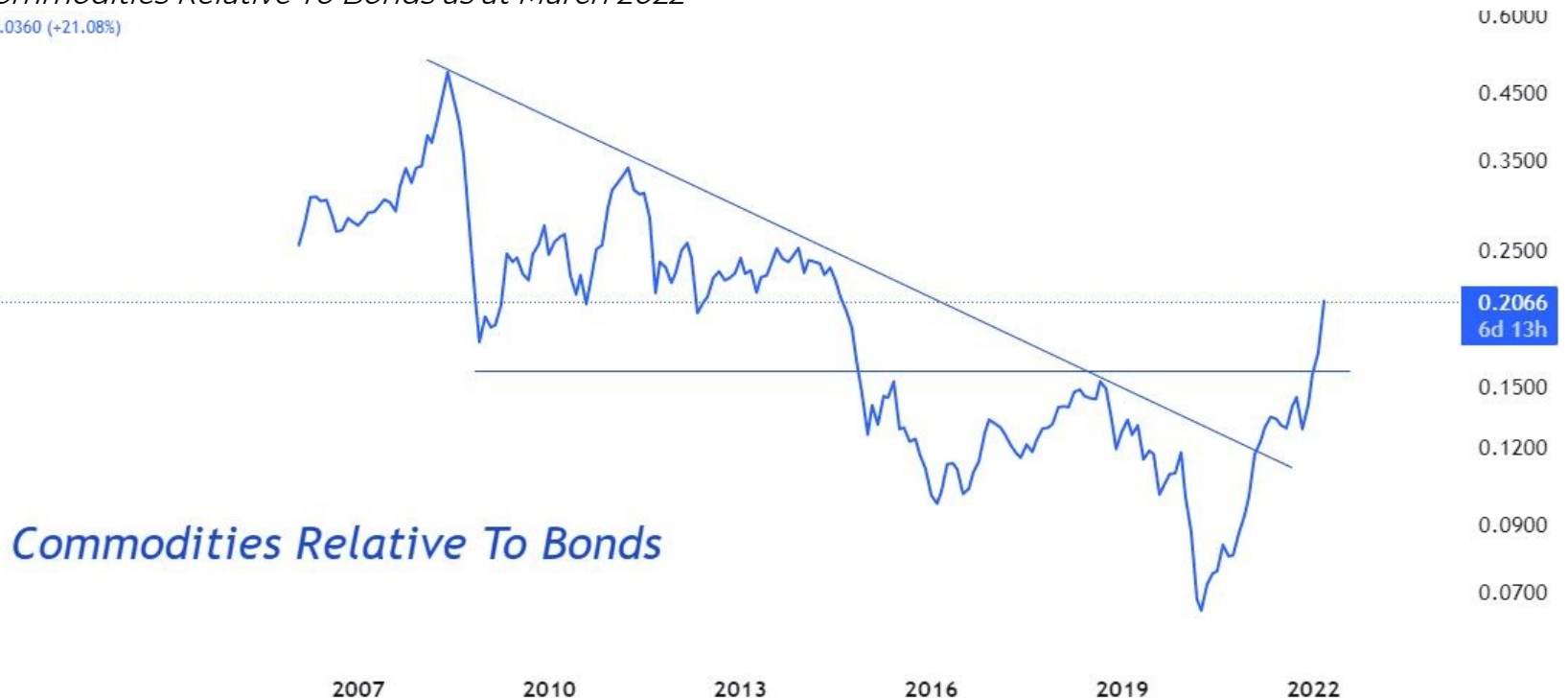
Cross-Asset

While the above examples focused on equities, traders (and investors) do not have to remain limited to a single asset class. In fact, comparing bonds to stocks to commodities to currencies provides market participants with a wealth of information for decision-making and serves as a firm basis for idea generation.

Let's say large fund is deciding on its allocation between bonds and commodities. Among other factors, the relative ratio chart saw commodities being deserved of a larger allocation relative to bonds. On the monthly chart, a breach of the downward trend line extending back to the 2008 peak suggested the potential for commodities to outperform bonds on a relative basis.

Monthly Chart: Commodities Relative To Bonds as at March 2022

DBC/TLT, 1M, AMEX 0.2066 +0.0360 (+21.08%)



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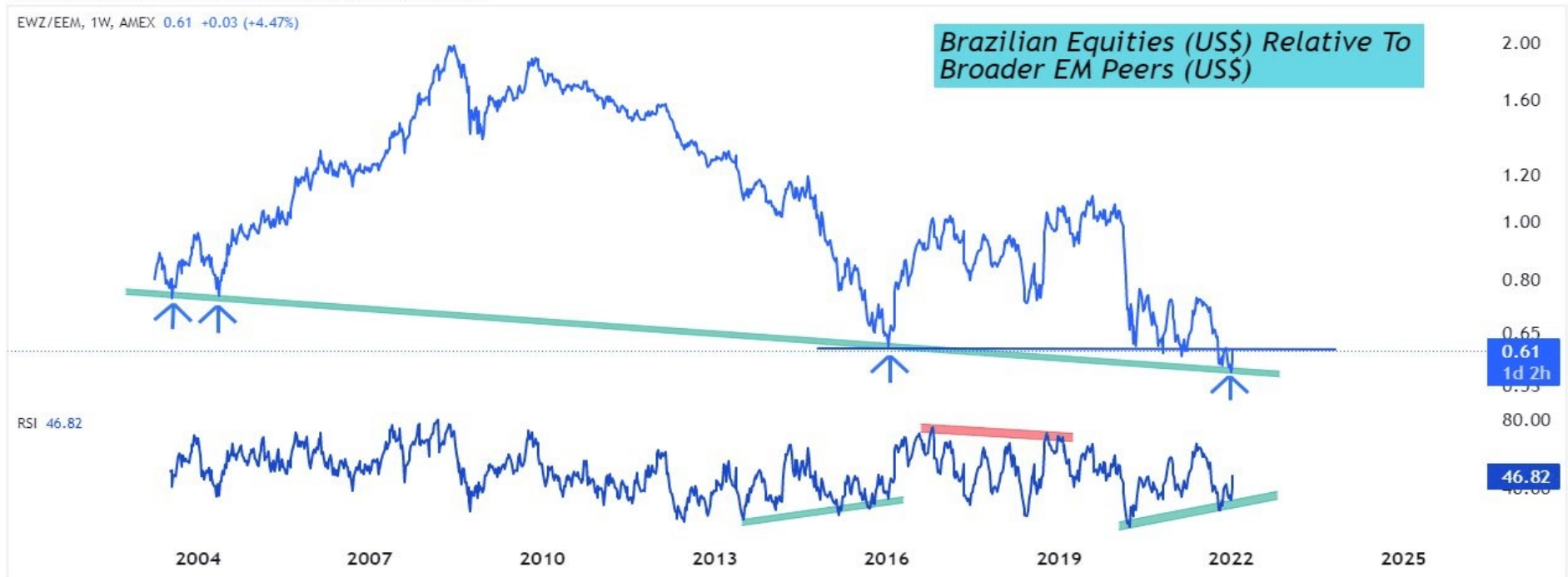
Geographical Allocation

The value of relative strength also shows up for the investor with a global view. Some investors would say that Q1 2022 has felt like a bear market however if one identified the technical signals, then performance is all relative.

Take for example outperformance of Brazilian equities in the first quarter of 2022. On 20 January, our technical perspective of the weekly chart showed the EWZ ETF (Brazilian equities in USD) developing a bottom relative to its broader EM peers (EEM ETF).

Weekly Chart of EWZ vs EEM ETFs during January 2022

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As at 25-March-2022, Brazilian equities have outperformed both the All-Country World Equity Index as well as its EM peer group. On an absolute basis, EWZ ETF traded at its best level since August 2021 while printing a 2-year high versus its emerging market peers.

Relative ratios have unlimited breadth in terms of scope. Other popular ratios include:

- **Copper vs Gold:** Shows demand for copper (economic growth etc.) relative to gold (safe-haven, inflation bid etc.)
- **Small Caps vs Large Caps:** Shows demand for small caps relative to large caps.
- **Investment Grade vs Sub-Investment Grade:** Shows the level of risk investors are willing to take in the credit market. It also speaks to the increase or reduction risk appetite, which is also an indicator for equities.
- **Financials vs Technology:** Sector vs Sector
- **Dirty Energy vs Clean Energy: Sector vs Sector**



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JSE Financials Relative to JSE Resources: On 1 March we identified an opportunity for a relative switch out of resources into financials, as at Tuesday, the pair was higher by 31%.

Satrix Financials Portfolio has been in a downward trend vs **Satrix Resources** - now trading between 2 and 2.5 standard deviations it's 200-daperiod linear regression channel. Possible switch out of Resource back into Financials on a relative basis?



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Bottom Line:

At Unum Capital, we view application of technical analysis as a risk management tool, rather than a predictive tool. While most of our research encompasses direct trade ideas i.e. buy or sell, as well as key levels for major markets, the identification of Relative Strength (RS) plays a key role for the investor within their capital allocation process. Making use of it comes down to one question. When it comes to relative performance, would you like your portfolio to trounce, track or trail the market? Relative Strength helps to manage this risk.

For more information on how to go about this, get in touch with us today.

Lester Davids

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