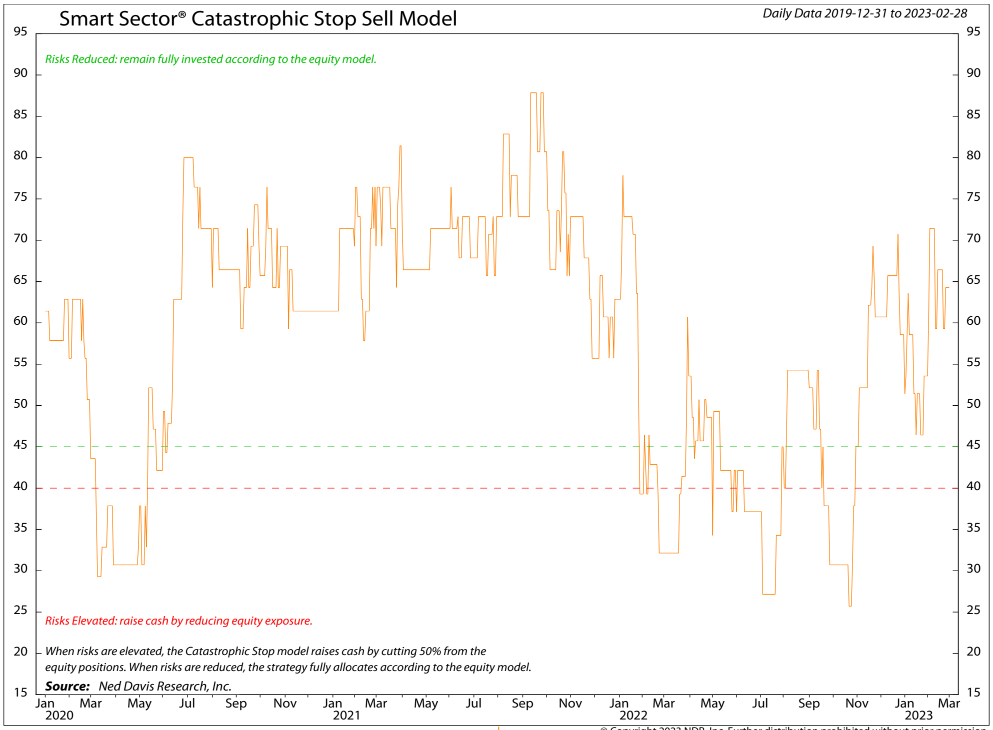
Smart Sector® International Strategy

MARCH 2023

Catastrophic Stop Update

The NDR Catastrophic Sell Stop model combines time-tested, objective indicators designed to identify high risk periods for the equity market. The model (chart right) improved into March and remained with a fully invested equity allocation recommendation.



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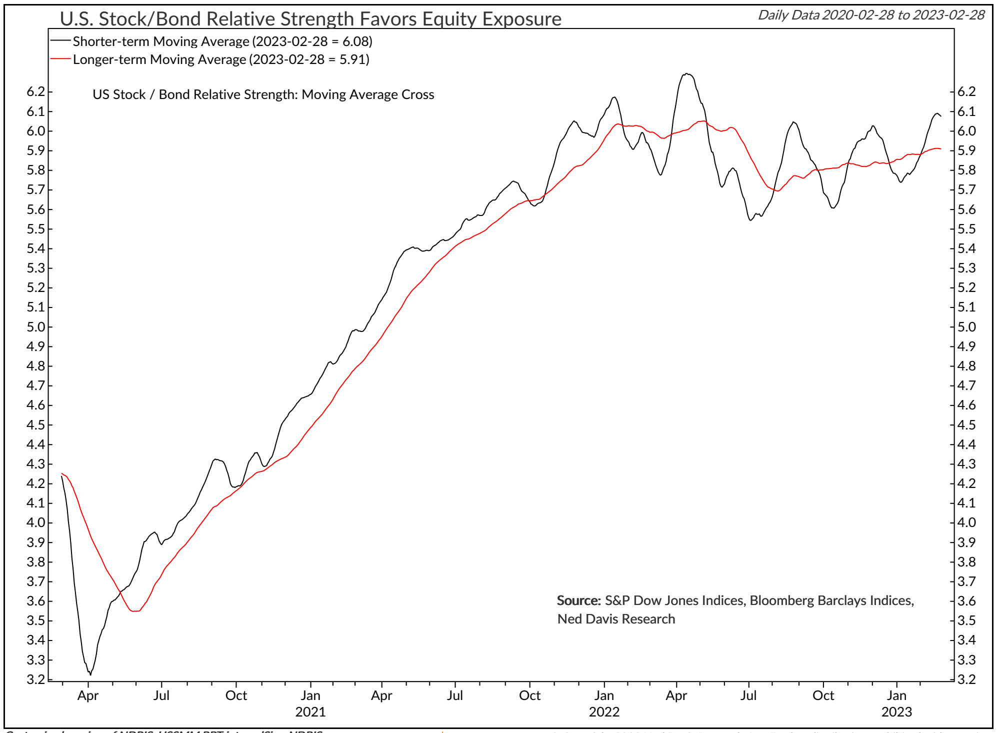

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Stronger breadth and relative strength drove the model improvement. On February 2, a breadth thrust signal (10-day advances vs. 10-day declines) flashed bullish and the stock/bond relative strength's short-term moving average rose above its long-term moving average (chart left). In terms of external influences, improvement in short-term stock market sentiment was offset by deterioration in high yield and Emerging Market bond breadth.

If stock volume demand outpaces supply and global shipping rates improve, then it could indicate the rally could be sustained. Conversely, if the stock market weakens in the near-term and investors return to fears of a recession, the stock market rally could be short-lived.

Global Market Update

The ACWI ex. U.S. Total Return Index declined by almost 350 basis points in February. It was the index's worst month since September. Among the strongest performing markets were Czech Republic, Greece, Turkey, Egypt, and Austria, while the largest underperformers included Colombia, China, Thailand, Brazil, and South Africa.

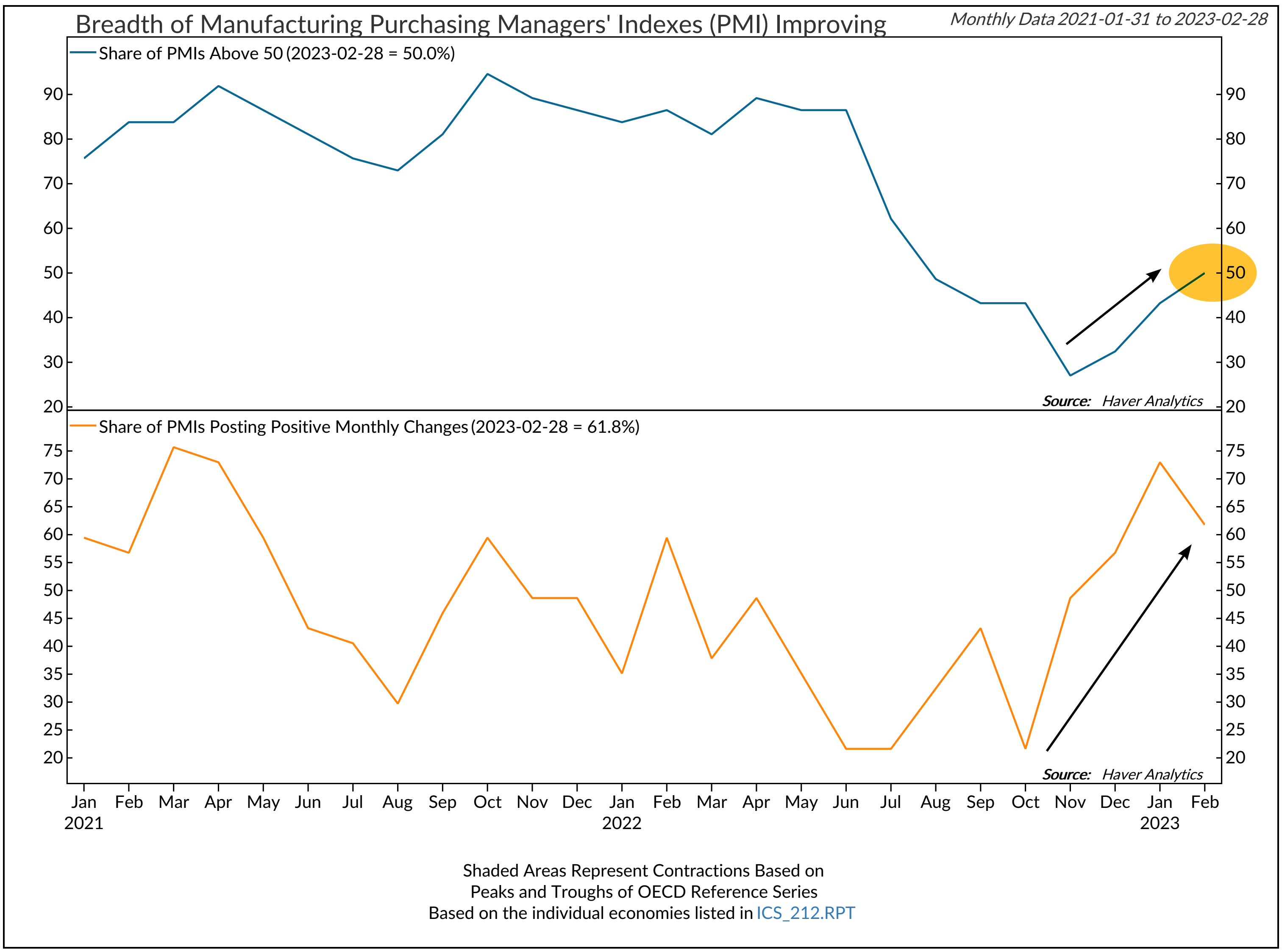
The global economy showed signs of stabilization at the start of the year, according to the latest S&P Global Purchasing Managers' Index (PMI) readings. The global composite PMI increased 1.6 points in January, its largest gain in seven months, to a six-month high.

Contrary to the prior month's global PMI, which increased slightly on a month-to-month basis but showed other areas of weakness, the latest global data were broadly positive, as both the manufacturing (chart at bottom) and services indexes rose. Moreover, the composite indexes for new orders (including export orders), employment, and backlogs all increased, indicating improving global demand.

Conditions are likely to pick up, as the future output index jumped at one of its fastest paces on record and to its highest level since April. China's reopening, due to the end of the zero-COVID policy, explained much of the rebound. But the improving trend occurred elsewhere, albeit to a lesser degree, as the global composite PMI ex-China also increased.

But the global economic outlook is not without risk. The latest composite reading is historically consistent with just 0.5% real Gross Domestic Product (GDP) growth. Moreover, history suggests that the past year's tight monetary policy will continue to negatively impact the global economy for at least the next six months, while a pick-up in input cost pressures may keep central banks tighter for longer, prolonging the headwinds from central banks.

Entering March, the non-U.S. equity Core model overweighted France, Australia, and Switzerland, while underweighting Japan, the U.K., Canada, China, and Germany. The Explore model favored Chile, Mexico, Netherlands, New Zealand, and Thailand.



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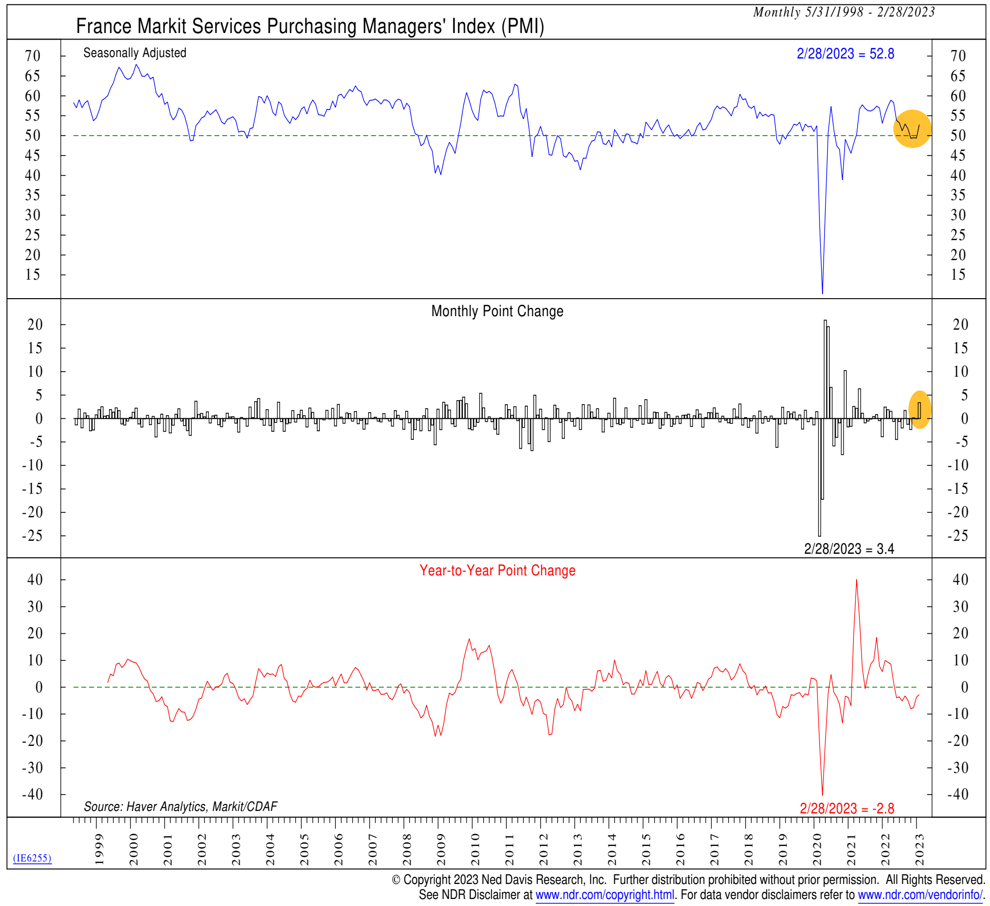
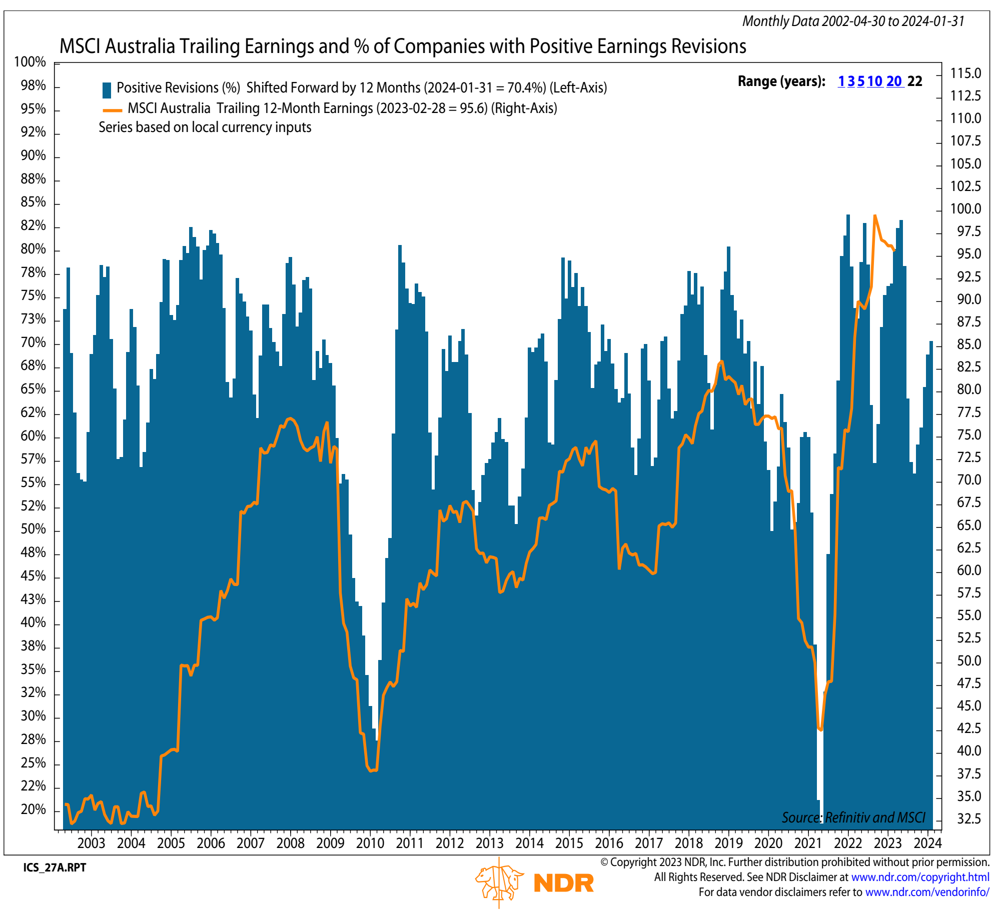
Core Allocations

France's allocation continues to be above benchmark weighting. The market has rallied to near its all-time high. The trend is positive as the market trades above its 50- and 200-day moving averages. The strengthening technicals reflect macroeconomic and fundamental improvement. France's services PMI crossed into expansionary territory this month (chart at right). Earnings growth remains positive on a year-over-year basis.



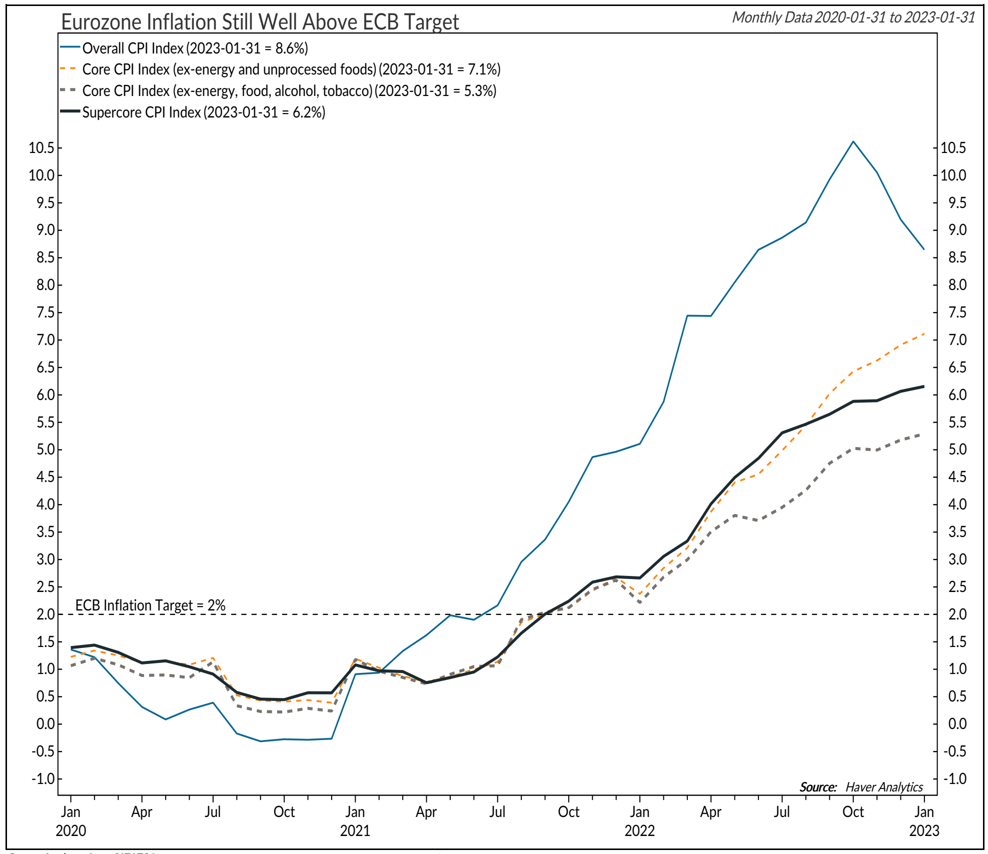


Australia is overweight for March as its earnings revisions are among the strongest in the world (chart at left). More than 70% of companies have positive revisions. Australia is likely to get an economic boost from China's reopening. Prior to the COVID pandemic, China was Australia's leading visitor market with Australia receiving 1.4 million visitors from China, which contributed $12.4 billion in visitor spend[1]. The market's cyclically adjusted price-to-earnings ratio is in the second cheapest quintile, which has historically provided a favorable reward-to-risk ratio. Australia's intermediate-term trend resides above its long-term trend and the market has risen near its all-time high.

[1]https://www.travelweekly.com.au/article/tourism-australia-to-entice-chinese-travellers-through-new-campaign/

Germany declined to underweight status. The eurozone composite PMI was in negative territory throughout the second half of last year, a condition consistent with recession. Manufacturing has been hit harder than the services sector due to higher energy prices and COVID-related disruptions in China. The biggest threat continues to be energy, as Russia will no longer be the primary supplier of energy for the region anytime in the foreseeable future.

Headline CPI peaked in October at 10.6%, and as of January, has fallen to 8.5%. If the warmer weather continues, along with more favorable base effects, the impact of energy on CPI will continue to wane. However, core inflation held at 5.2% in January, the highest for the region since data began in 1990, indicating second-round effects from the higher energy and food costs (chart at right). Although the easing in the headline CPI is encouraging, it's still over four times greater than the ECB's target of 2%. Higher inflation coupled with the resiliency of the economy, may push the ECB to be more aggressive, creating risks to the growth outlook.



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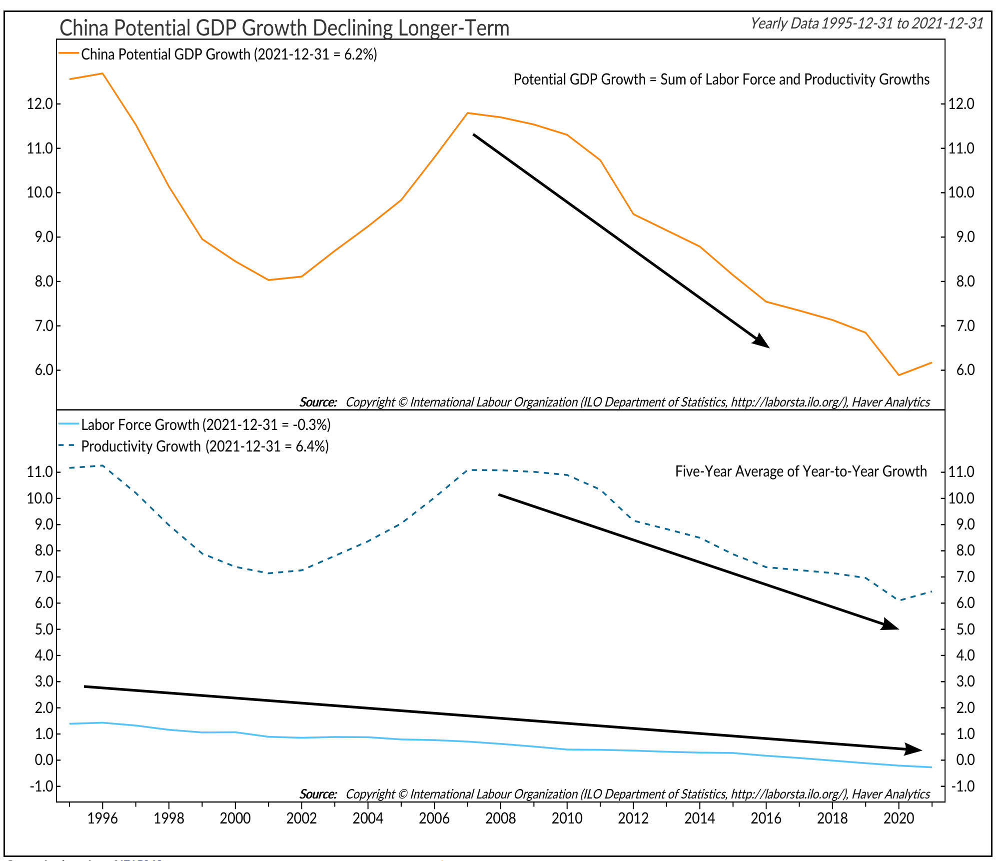
China fell to the most underweight market. The recent removal of the zero-COVID policy is bound to unleash some economic might. But the reopening will be bumpy, as it was forced and premature due to a lack of preparedness on the vaccine and healthcare front. Consumer-related data for December showed that households voluntarily disengaged from the economy amid fears of illness.



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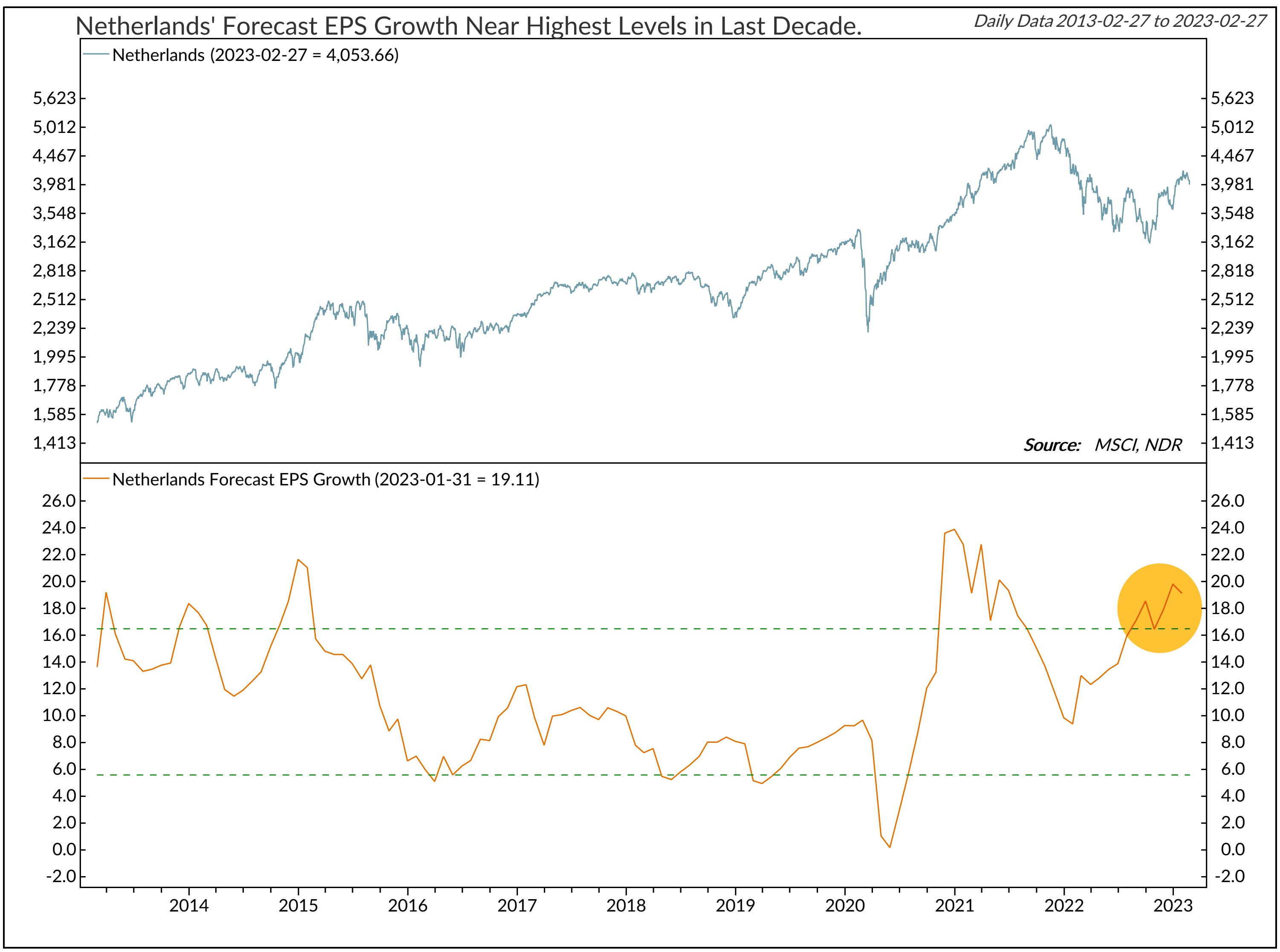
Explore Opportunities

Among the top ranked Explore markets are Chile, Mexico, Netherlands, New Zealand, and Thailand:

- Mexico, Netherlands, New Zealand, and Thailand have favorable price trends as their 50-day moving averages trade above their 200-day moving averages.
- Over the last 5 days, Thailand is more than one standard deviation oversold, which historically has provided a near-term bounce opportunity.
- Chile, Mexico, and New Zealand have low market capitalization-to-GDP ratios, which typically indicates a favorable valuation.
- Chile, Mexico, and Thailand possess cyclically adjusted price-to-earnings ratios (long-term valuation metrics) trading below their historical medians.
- Mexico is one of the few economies with a Composite Leading Indicator reading in expansionary territory.
- New Zealand and Thailand have elevated manufacturing PMIs, which are in the expansionary zone.
- Netherland's forecasted earnings growth is near the highest levels over the last decade (chart at bottom).

Summary

The Catastrophic Stop model recommended a fully invested position according to the Core and Explore allocation models. The Core model overweighted France, Australia, and Switzerland, while underweighting Japan, the U.K., Canada, China, and Germany. The Explore model favored Chile, Mexico, Netherlands, New Zealand, and Thailand. The models combine macro, fundamental, technical, and sentiment indicators to determine opportunities and identify risks in an objective, weight-of-the-evidence approach.



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Smart Sector® International Strategy

Strategy description

- The Smart Sector® International strategy combines three Ned Davis Research quantitative investment strategies: The Core International, Explore International, and the NDR Catastrophic Stop.

The process is based on the weight of the evidence

Core Allocation

- The fund begins by overweighting and underweighting the largest non-U.S. equity markets based on Ned Davis Research's proprietary models.

- Each of the models utilize market-specific, weight-of-the-evidence composites of fundamental, economic, technical, and behavioral indicators to determine each area's probability of outperforming the ACWI ex. U.S. Markets are weighted accordingly relative to benchmark weightings.

Explore Allocation

- To select smaller markets, the fund uses a multi-factor technical ranking system to choose the top markets. The markets with the highest rankings split the non-Core model allocation equally.

When market risks become extraordinarily high — reduce your portfolio risk

- The model remains fully invested unless the Ned Davis Research Catastrophic Sell Stop (CSS) model is triggered, whereupon the equity-invested position is trimmed to 50%.

- The NDR Catastrophic Sell Stop model combines time-tested, objective indicators designed to identify periods of high risk for the global equity market. The model uses price-based, breadth, deviation from trend, fundamental, economic, interest rate, behavioral and volatility-based indicator composites.

When market risks return to normal — put your money back to work

- When the NDR CSS model moves back to bullish levels, indicating lower risk, the strategy immediately moves back to fully invested.

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