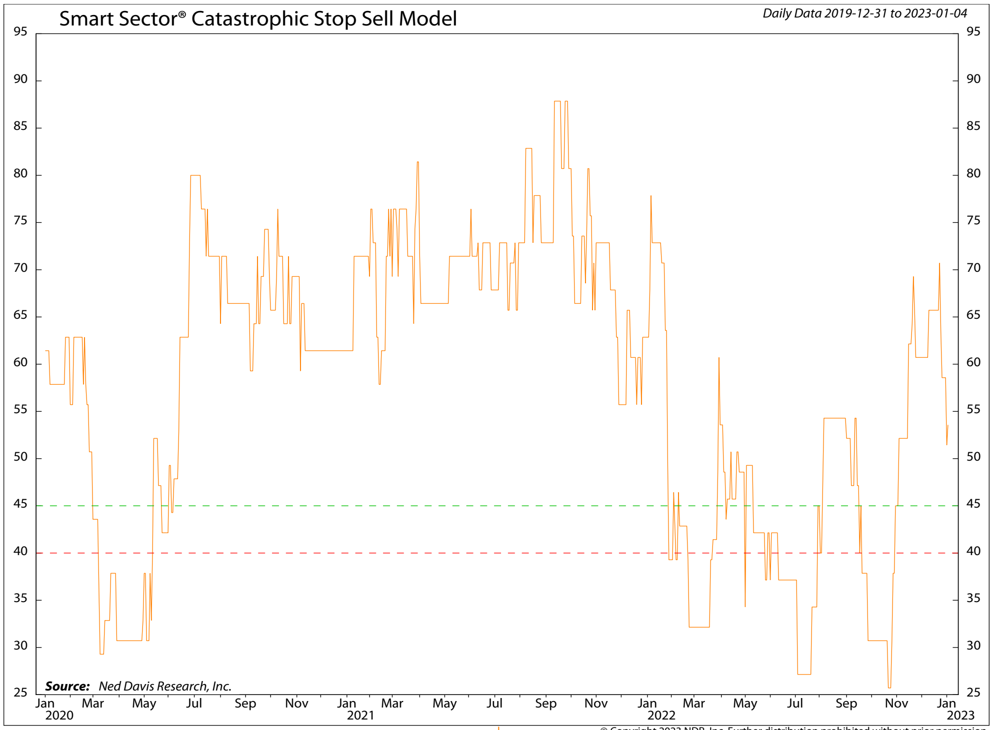
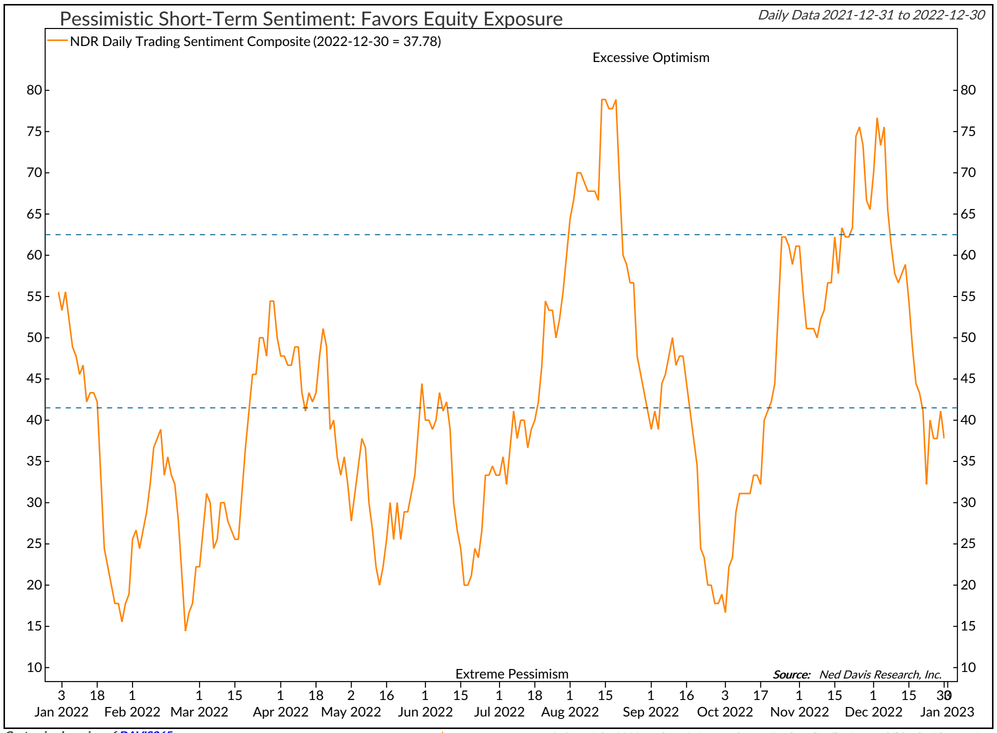
Smart Sector® International Strategy

JANUARY 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 at right) deteriorated in December but remains with a fully invested equity allocation recommendation.





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Weaker price-based measures were to blame, moving the internal composite reading to its lowest level since October 2022. The stock/bond relative strength ratio rolled over and only 40% of global equity markets traded above their intermediate-term trends. In terms of external influences, high yield and Emerging Market bond breadth weakened, which was partly offset by short-term pessimistic stock market sentiment (chart at left).

If the near-term market weakness continues, additional technical indicators should roll over and trigger another bearish signal. Conversely, if volume demand outpaces supply and global shipping rates improve, then it could indicate a new rally might transpire in early 2023.

Global Market Update

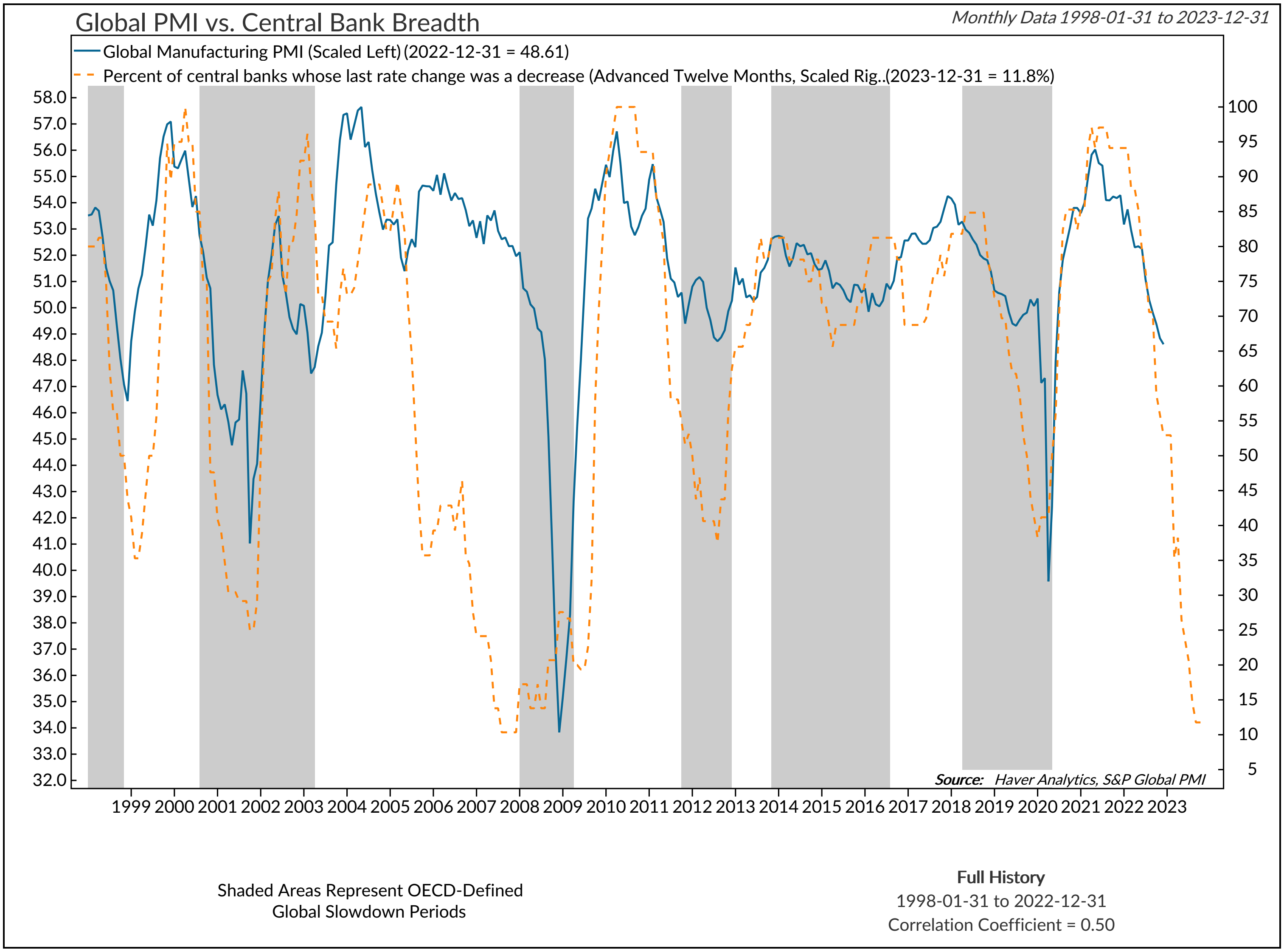
After rising during October and November, the ACWI ex. U.S. Total Return Index declined by more than 70 basis points in December. Among the strongest performing markets were Hong Kong, Turkey, Colombia, and Poland, while the largest underperformers included Qatar, Peru, Mexico, and the United Arab Emirates.

The global economy contracted for a fourth-straight month in November, according to the S&P Global Purchasing Managers' Index (PMI). The global composite (services and manufacturing) PMI reflects the deepest contraction since June 2020. At its current level, the composite PMI is historically consistent with a 0.9% decrease in global annual real Gross Domestic Product (GDP) growth.

Most of the downside risks that plagued the global economy in 2022 will likely continue in 2023, but from a much lower starting point. Global savings have been depleted, while labor markets are starting to show signs of slowing. Moreover, given the lagged impact of monetary policy on the economy (chart at bottom), the indicators, many of which are already on the cusp of levels associated with global recession, are likely to worsen in the coming months.

However, one major positive is that price pressures continue to deteriorate. Both the global composite input and outprice indexes fell to their lowest since February 2021. Even so, the indexes (especially input prices) remain well above their pre-COVID levels.

Entering December, the non-U.S. equity Core model overweighted China, France, and Switzerland, while underweighting Japan, Germany, the U.K., and Canada. The Explore model favored Spain, Italy, Mexico, Peru, and New Zealand.



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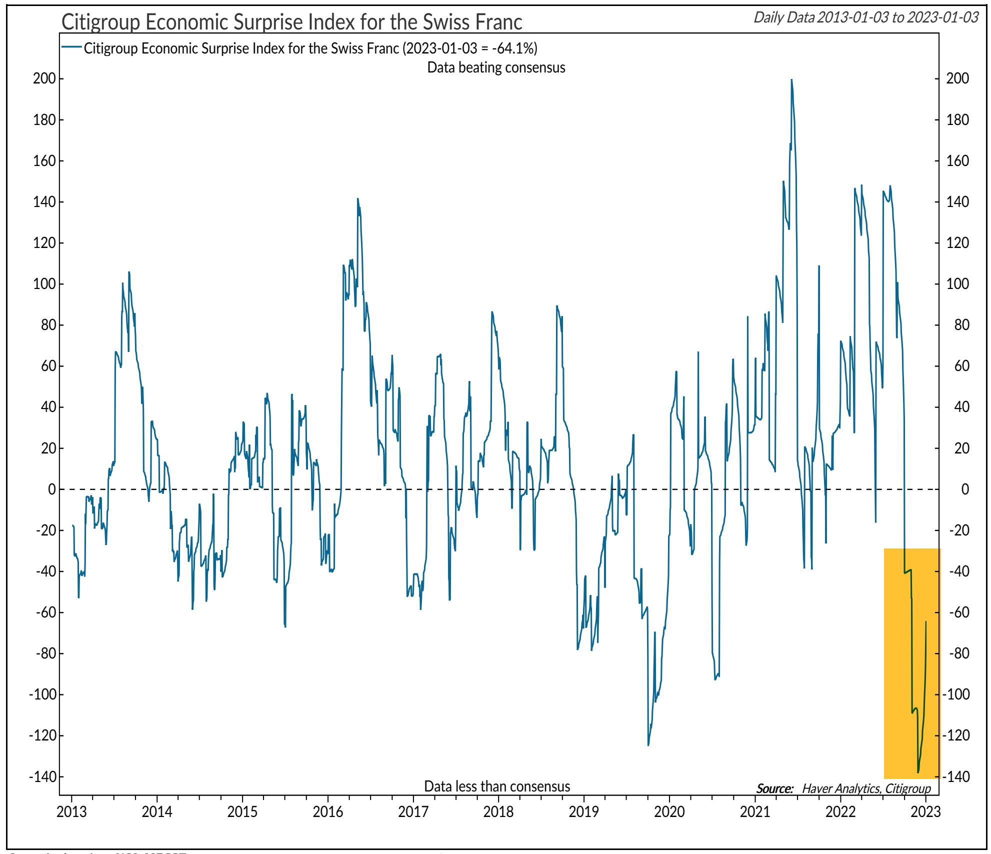
Core Allocations

Switzerland remains above benchmark allocation this month. It had the largest one-month increase across the Citigroup Economic Surprise indices as the economy's reading rebounded from a ten-year low (chart at right). Switzerland had the third highest manufacturing PMI, which also increased last month. Relative valuations continue to favor equities and the cyclically adjusted price-to-earnings ratio is in its second-cheapest quintile. The technical indicators improved to reflect this opportunity as trend, momentum, and breadth measures produced positive readings on the market.



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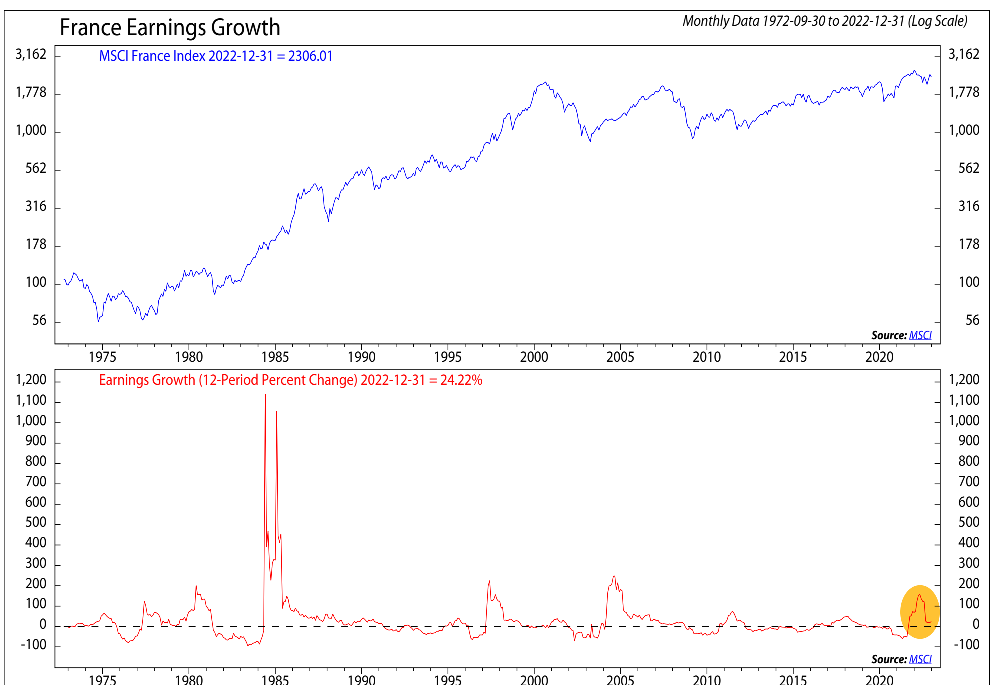
France's allocation continues to be above benchmark weighting. Although its manufacturing PMI resides in contractionary territory, France's reading has risen over the last month and quarter. It is just below the key threshold of 50. Earnings growth remains positive on a year-over-year basis (chart at left). The trend has improved as the market trades above its 50- and 200-day moving averages.



Full History Statistics

Analysis Dates: 1972-09-30 to 2022-12-31		
Performance when Change in Earnings Growth:	% Gain/ Annum	% of Time
* Positive	6.74	60.38
Negative	5.56	39.62

Chart View Statistics

Analysis Dates: 1972-09-30 to 2022-12-31		
Performance when Change in Earnings Growth:	% Gain/ Annum	% of Time
* Positive	6.74	60.38
Negative	5.56	39.62

Data Range (years):
1 2 3 5 10 20 **Max**

Rate-of-Change Periods :
3 12 36 60

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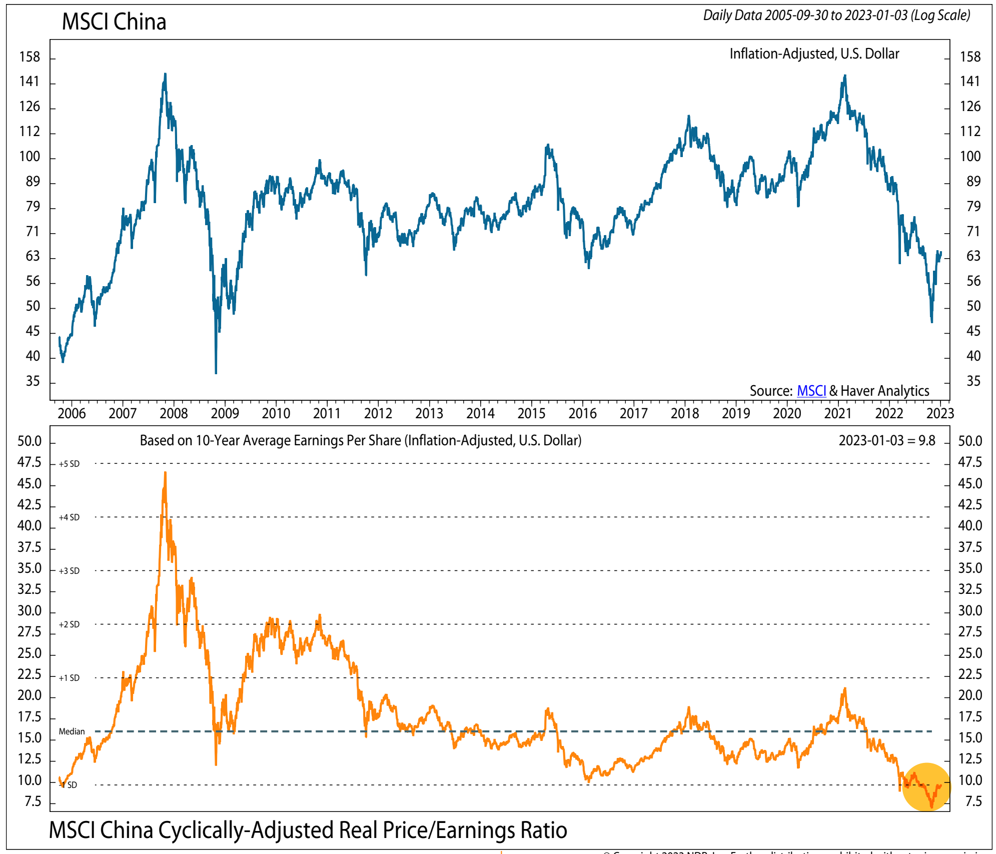
China's allocation improved to above benchmark weighting. China's market surged following the easing of its zero-COVID policy. Among the 47 ACWI components, the China index has been the strongest performer, up over 30% since October. However, China's economy presents the greatest uncertainty to the global outlook in 2023. Given the abrupt and premature nature of the economic reopening, large swaths of the population could choose to disengage from the economy given the rising risk of infection and death. Also, other elements of the economy, such as external demand and real estate remain fragile. Valuations may already reflect the risk as China's cyclically adjusted price-to-earnings ratio is one standard deviation below its historical tendency (chart at right).



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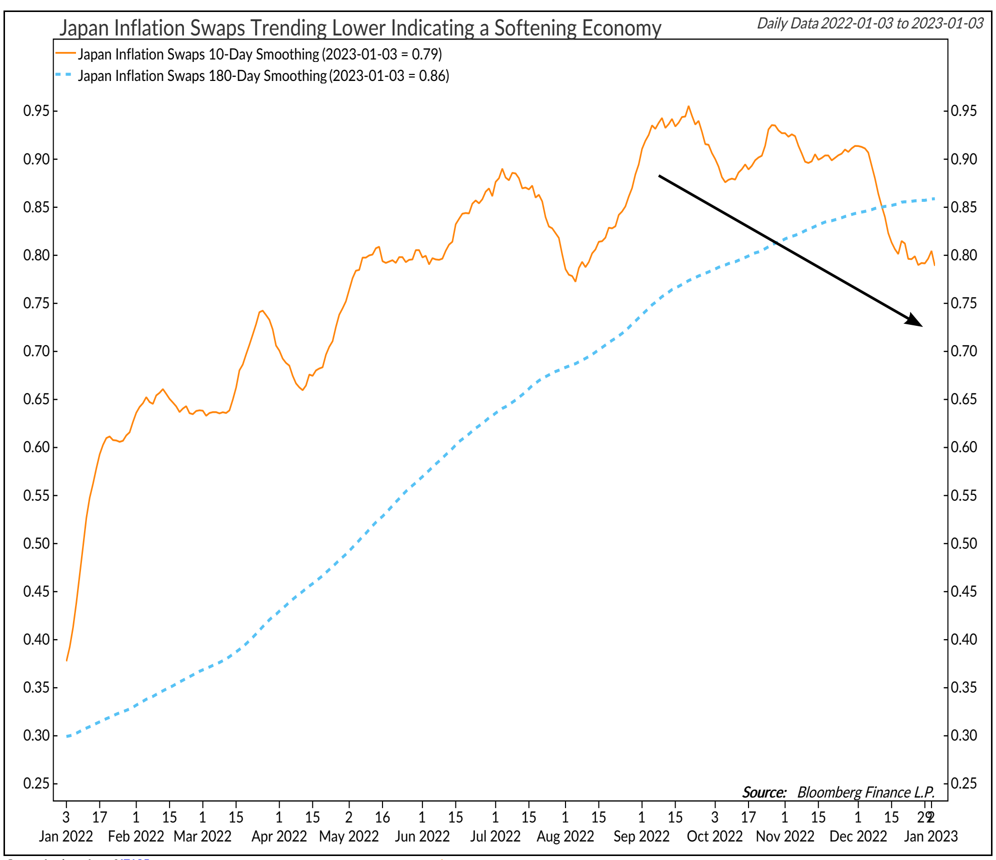

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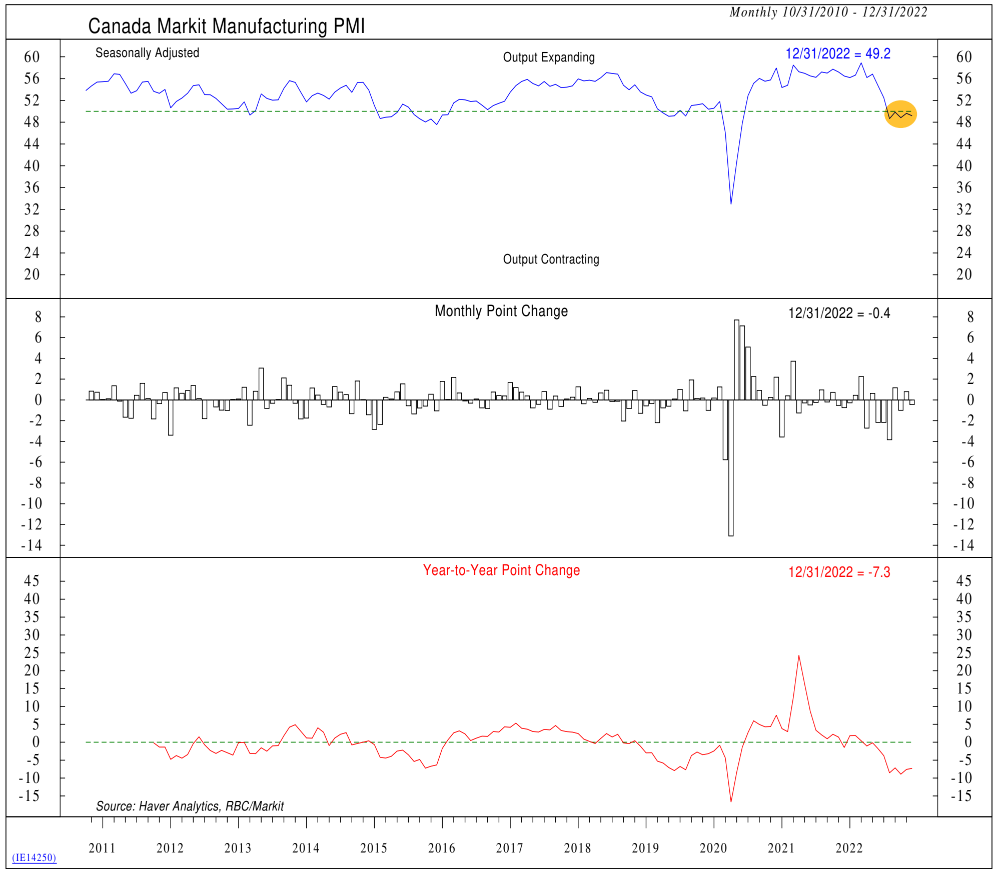
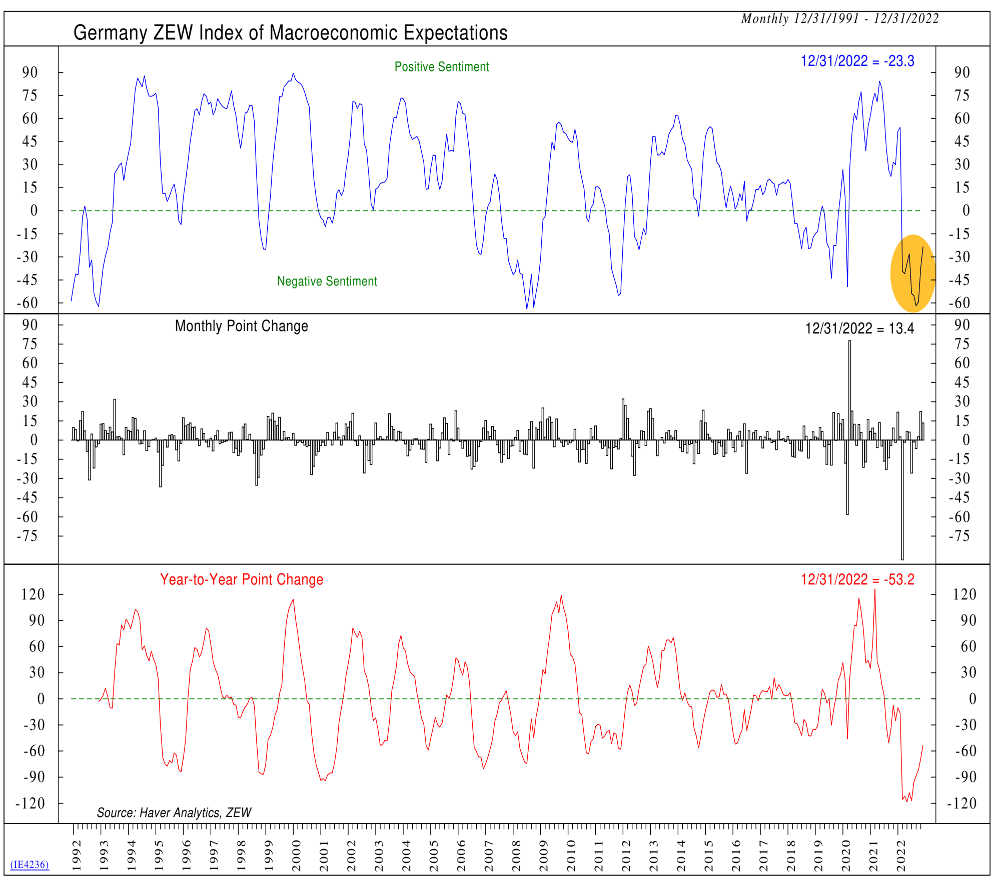
Japan fell to significantly below benchmark allocation. Weak trend, breadth, and momentum indicators reflect challenged near-term earnings growth, unattractive valuations, sentiment reversing from optimistic conditions, and economic activity softening, as evidenced by falling inflation swaps (chart at left).

Canada was one of the worst-performing developed markets in December as it declined almost 5%. The market plummeted to underweight status due to a weakening trend, expensive valuations, and deteriorating economic data. The country's market capitalization-to-GDP ratio is among the highest across global markets. The economy's manufacturing PMI resides in contractionary territory, and it declined last month (chart at right).





Germany's allocation rose, but the market is still below benchmark allocation. The relative trend has fallen due to weak economic activity, low consumer confidence, and negative economic sentiment (chart at left).

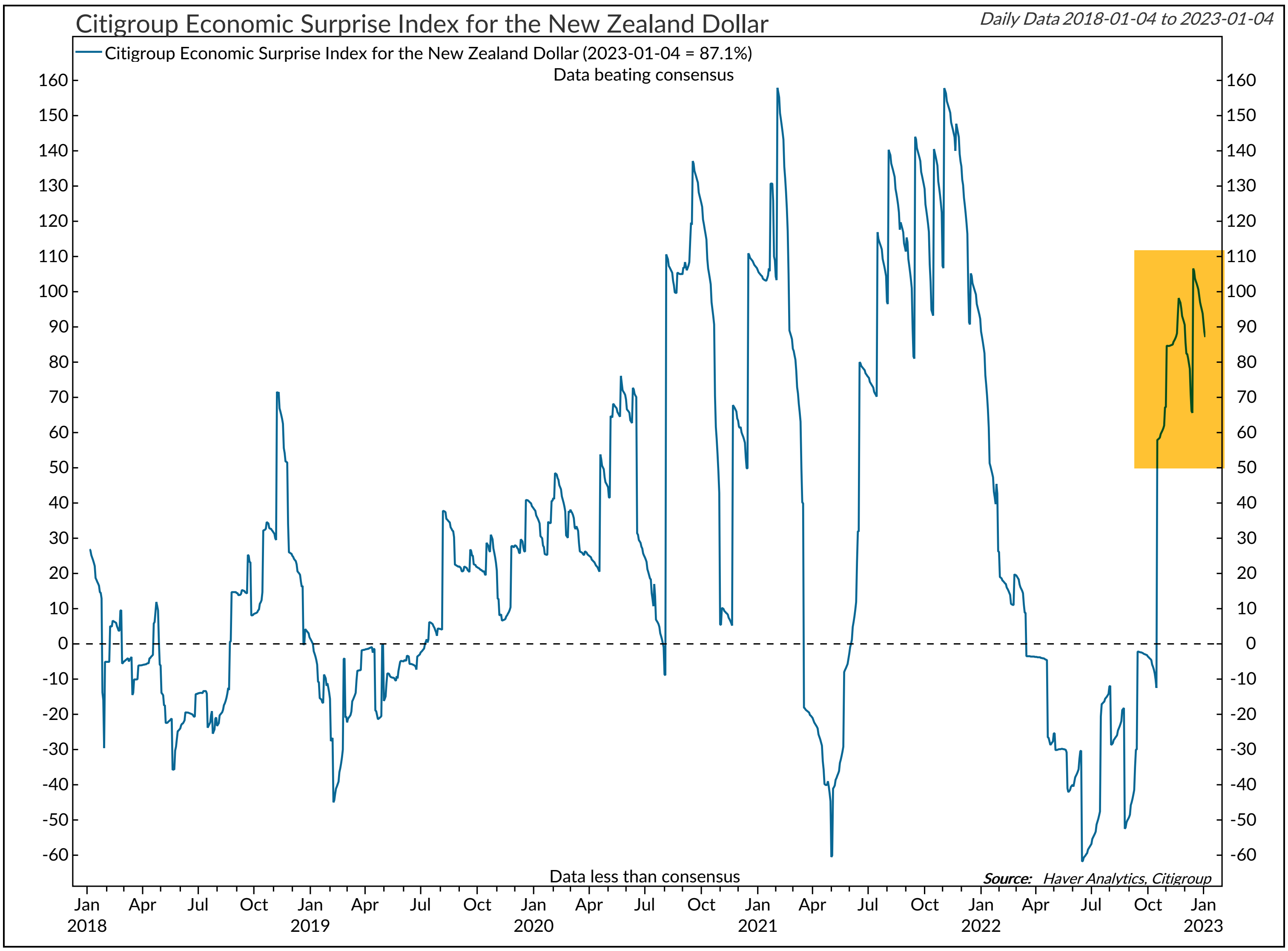
Explore Opportunities

The top-ranked smaller markets are Peru, Mexico, Spain, Italy, and New Zealand.

- Peru, Mexico, New Zealand, Italy, and Spain have favorable near-term trends as their 50-day moving averages trade above their 200-day moving averages.
- Over the last ten days, Mexico is more than one standard deviation oversold, which historically has provided a near-term bounce opportunity.
- Peru, Mexico, New Zealand, Italy, and Spain have low market capitalization-to-GDP ratios, which typically indicates a favorable valuation opportunity.
- New Zealand currently has the highest Citigroup Economic Surprise Index reading (chart at bottom) and largest percentage of positive earnings revisions across global markets.
- Mexico is one of the few economies with Composite Leading Indicator and PMI readings in expansionary territory.

Summary

At the start of January, the Catastrophic Stop model recommended a fully invested position according to the Core and Explore international allocation models. The Core model overweighted France, Switzerland, and China while underweighting Germany, Canada, the U.K., and Japan. The Explore model favored Peru, Mexico, Spain, Italy, and New Zealand. The international 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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DAY HAGAN ASSET MANAGEMENT

NDR NED DAVIS RESEARCH

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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