DAY HAGAN
ASSET MANAGEMENT

NDR
NED DAVIS RESEARCH

Smart Sector®
Fixed Income Strategy

MARCH 2024

Risk Management Update

The risk management model (Figure 1) seeks to reduce exposure to fixed-income sectors most sensitive to equity drawdowns. The risk management model improved during the month and entered March recommending full model exposure to areas most sensitive to equity markets: U.S. High Yield, Emerging Markets, U.S. Investment Grade, and Floating Rate Notes.

Figure 1: Smart Sector® Fixed Income Risk Management Model

Smart Sector® Fixed Income Risk Management Model

Daily Data 2021-09-30 to 2024-02-29

Risks Reduced: remain fully invested according to fixed income model.

Risks Elevated: raise cash by reducing exposure to higher risk areas.

When risks are elevated, the risk management model raises cash by cutting up to 50% from fixed incomes areas most sensitive to equity markets (high yield, EM, US investment grade, floating rate notes).
When risks are reduced, the strategy moves toward a fully allocated position according to the fixed income allocation model.

Source: Ned Davis Research, Inc.

Nov | Jan 2022 | Mar | May | Jul | Sep | Nov | Jan 2023 | Mar | May | Jul | Sep | Nov | Jan 2024 | Mar

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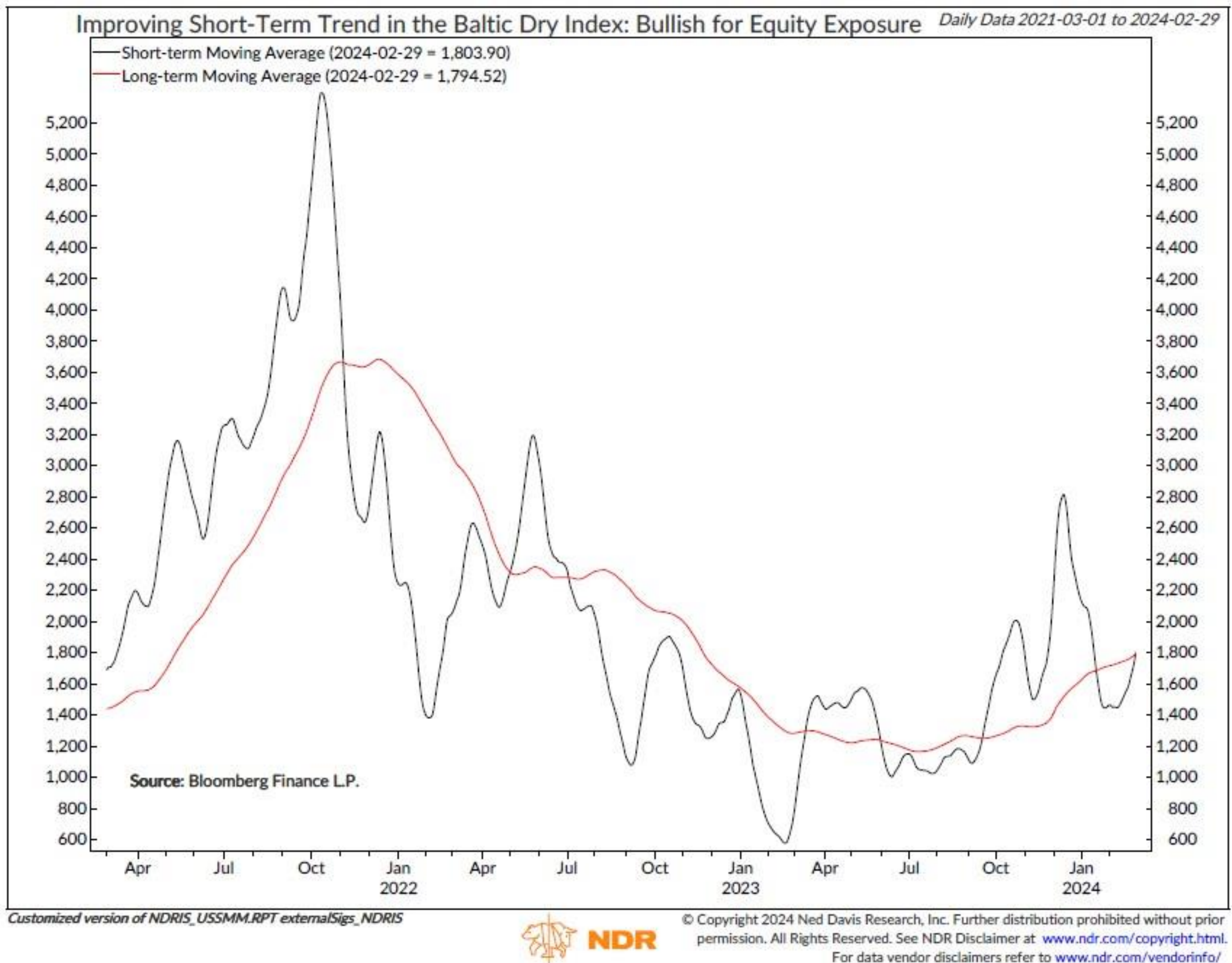
The bullish reading from the model is driven by strong internals. Five of the seven price-based measures—including relative strength, trend, and breadth—remain bullish. External measures also improved. The short-term trend in global trade—as measured by the Baltic Dry Index—flashed a bullish signal during the month (Figure 2), joining bullish readings from option-adjusted spreads and

high-yield and emerging market breadth. Investor sentiment remains excessively optimistic, which is bearish for stocks. For now, the weight-of-the-evidence recommends a fully invested allocation to fixed income sectors according to the model.

Figure 2: Improving Short-Term Trend in the Baltic Dry Index: Bullish for Equity Exposure



Fixed Income Market Update

After the strong performance by the Bloomberg Barclays U.S. Aggregate Bond Total Return Index at year-end 2023, the index dropped for the second consecutive month in 2024, down about -1.4% in February. Breadth remained weak—five of the nine fixed-income sectors we track had negative returns in February, with long-term Treasurys' performance the weakest.

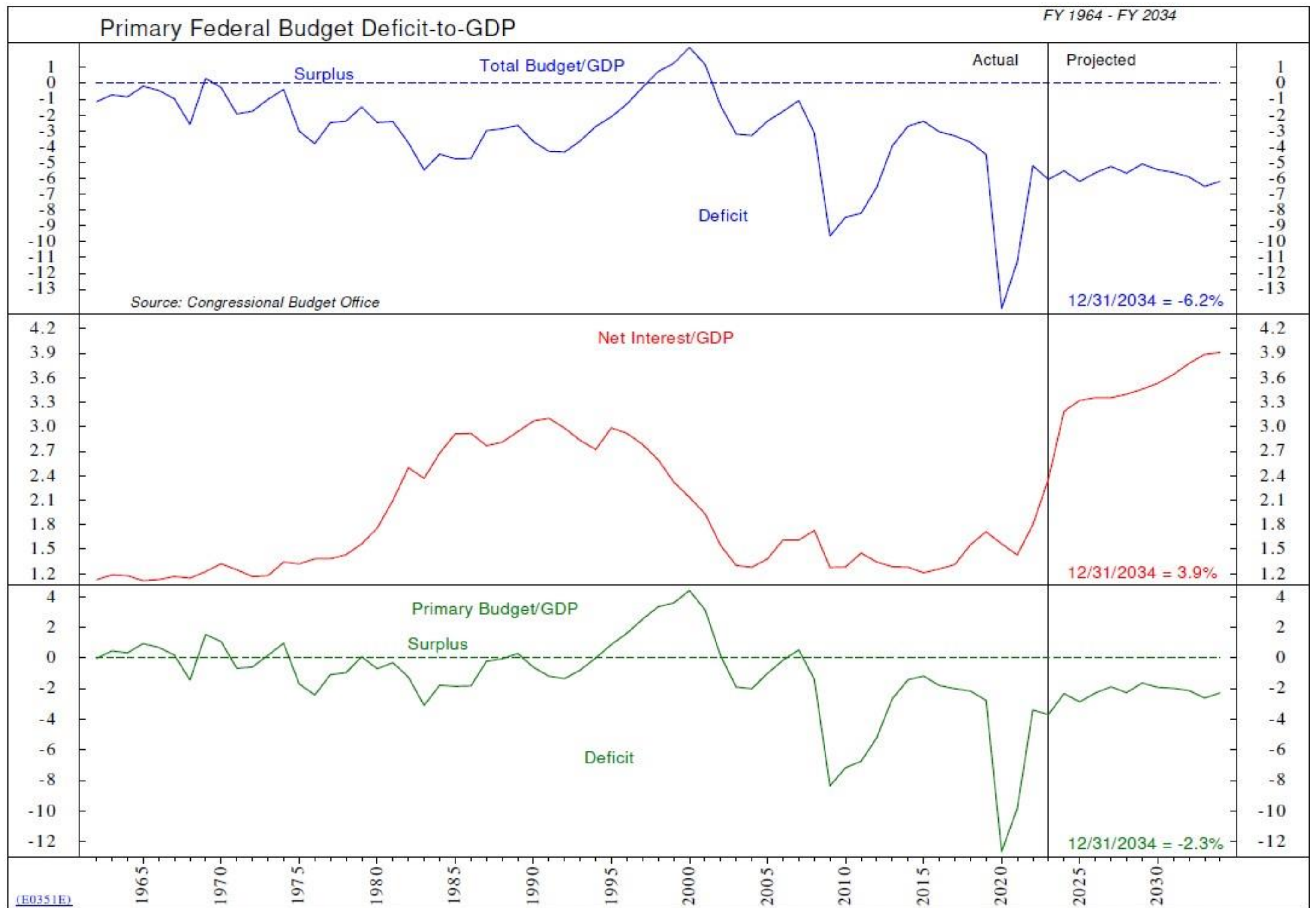
Most registered voters don't want a rematch between Trump and Biden, but that's likely what we will get. Their fiscal policy preferences are vastly different. Biden hasn't met a spending bill he doesn't like. The Trump tax cuts would expire at the end of 2025, and taxes would likely be raised on the wealthy under a Biden administration. Trump would extend the tax cuts. He would likely shy away from major infrastructure bills.

Despite these differences in policy approach, neither one seems interested in reducing the budget deficit (Figure 3). That should result in a higher term premium and higher interest rates, which could slow economic growth. Interest costs will continue to skyrocket, regardless of who occupies the White

House. The fastest-growing item in the federal budget, interest expense, will soon exceed our spending on defense, according to the CBO.

Entering March, the fixed income allocation strategy continued to favor risk-on leadership but did not rebalance. The model remains overweight (versus the AGG benchmark), U.S. Treasuries (allocated across short-, intermediate-, and long-duration), High Yield, and Emerging Market Bonds. The portfolio is marketweight TIPS and Mortgage-Backed Securities and underweight U.S. Floating Rate Notes, U.S. Investment Grade, International Investment Grade, and International Bonds.

Figure 3: Primary Federal Budget Deficit-to-GDP. Interest expense will ballon regardless of who wins.



U.S. High-Yield bonds remained overweight. Five of the six indicators remain bullish for the sector. However, during the month, stock market volatility (as measured by the VIX) moved bearish for high-yield bonds (Figure 4).

Figure 4: Rising Stock Market Volatility is Bearish for U.S. High Yield Bonds

Rising Stock Market Volatility is Bearish for U.S. High Yield Bonds

Daily Data 2021-02-26 to 2024-02-29

VIX 10-day SMA (2024-02-29 = 14.17)

VIX 63-day SMA (2024-02-29 = 13.34)

Source: Bloomberg Barclays Indices, Bloomberg Finance L.P., Ned Davis Research, Inc.

Apr Jul Oct Jan 2022 Apr Jul Oct Jan 2023 Apr Jul Oct Jan 2024

Customized version of VIX MACR

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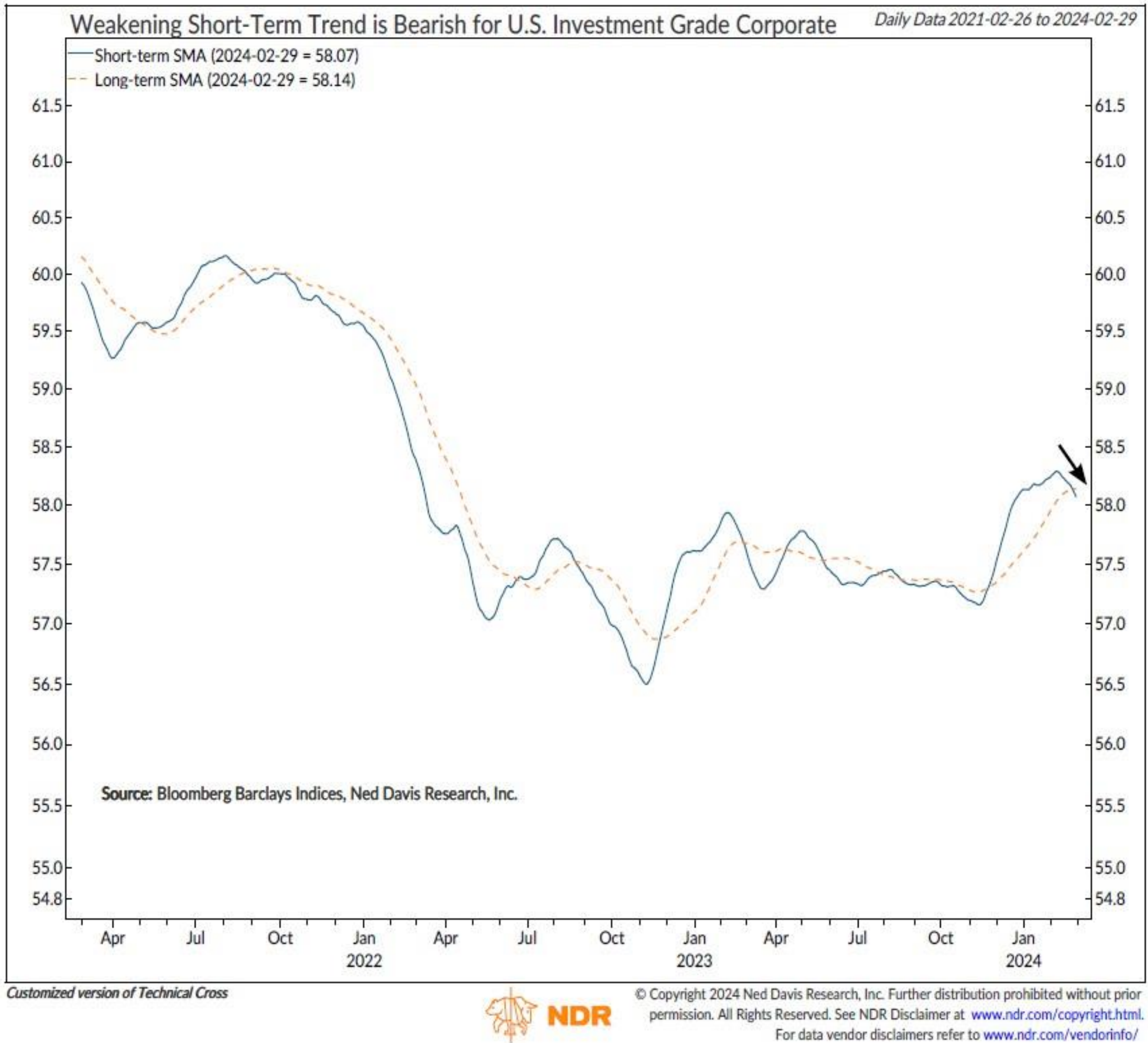
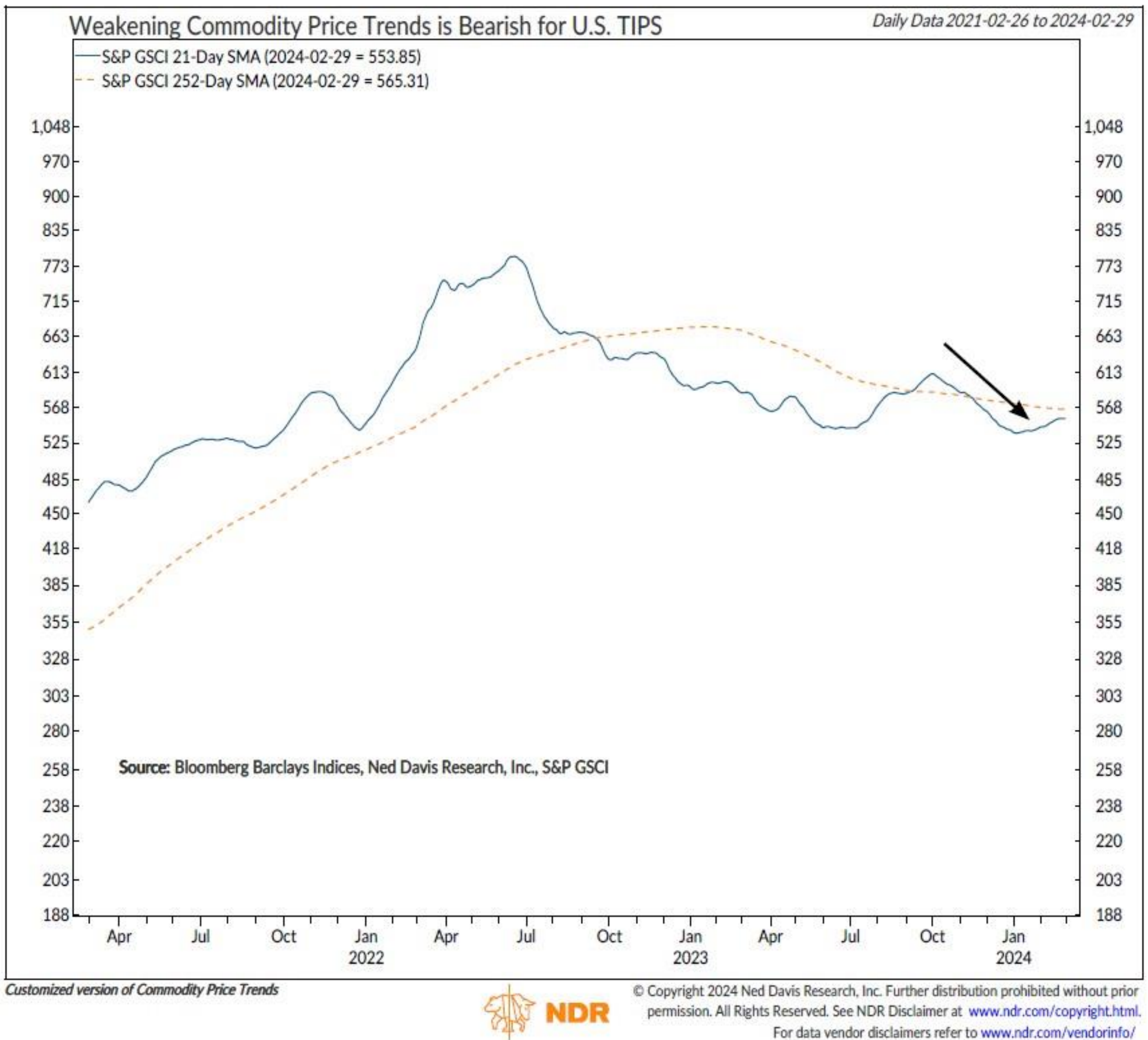
U.S. Investment Grade Corporate bond's allocation remained at neutral. Indicators are now mixed. On a fundamental basis, bond volatility and the U.S. Dollar Index are bullish but are offset by widening option-adjusted spreads and rising credit default swaps. Technical indicators picked up on recent weakness, as a short-term trend measure flashed a bearish signal during the month (Figure 5).

Figure 5: Weakening Short-Term Trend is Bearish for U.S. Investment Grade Corporate.



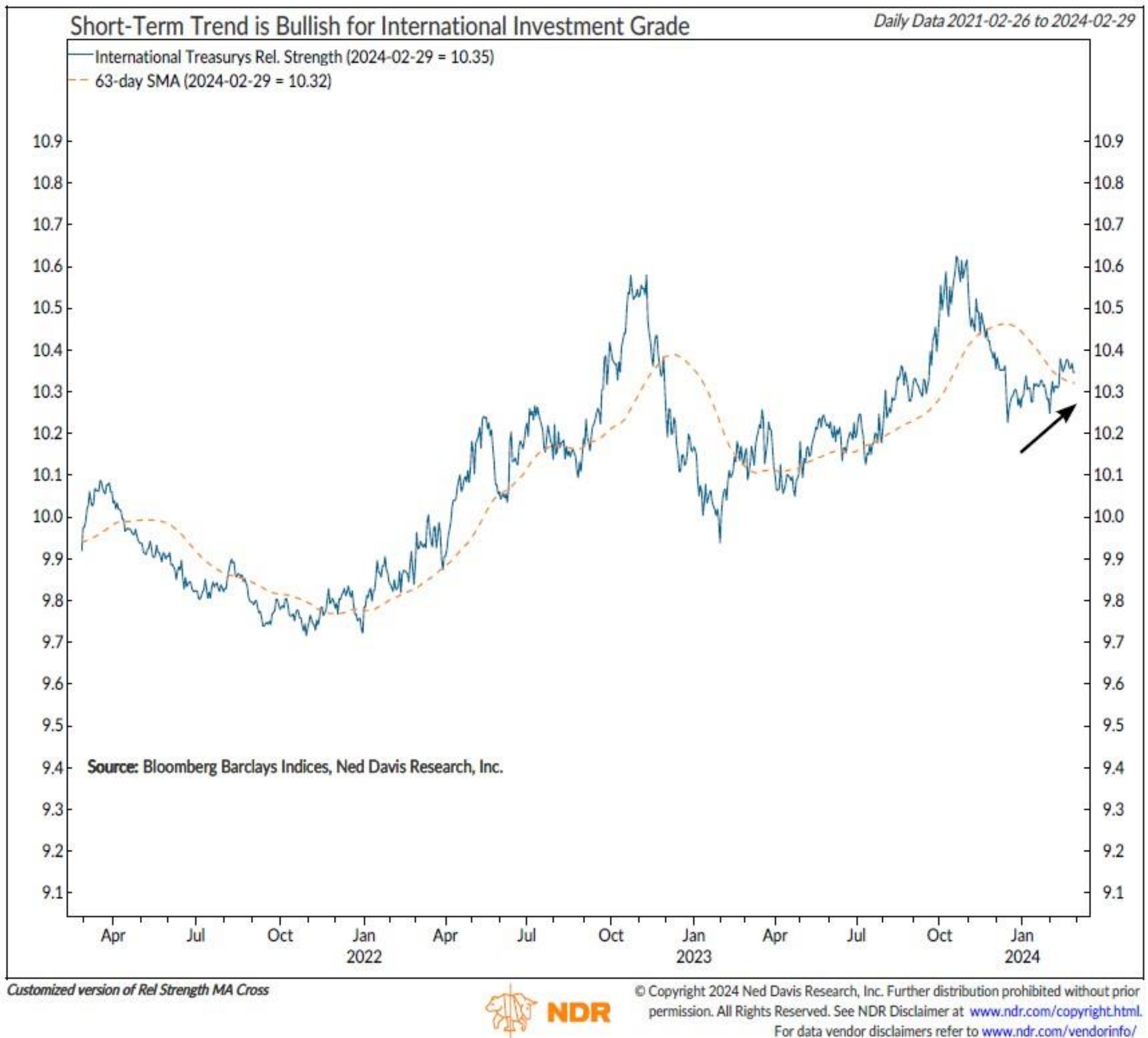
The U.S. Treasury Inflation-Protected Securities (TIPS) allocation is neutral. Commodity price trends (Figure 6) and high-yield option-adjusted spreads remain headwinds for TIPS. These bearish measures are confirmed by TIPS' weak technicals, including the relative strength index, the slope of its relative strength, and the short-term trend.

Figure 6: Weakening Commodity Price Trends is Bearish for U.S. TIPS



The allocation of International Investment-Grade bonds remained underweight. Rising inflation expectations are bearish for the sector but offset by rising stock market volatility. Price-based measures—rising relative strength and short-term trend (Figure 7)—improved during the month to bullish levels.

Figure 7: Short-Term Trend is Bullish for International Investment Grade.



Summary

The allocation of International Investment-Grade bonds remained underweight. Rising inflation expectations are bearish for the sector but offset by rising stock market volatility. Price-based measures—rising relative strength and short-term trend (Figure 7)—improved during the month to bullish levels.

This strategy utilizes measures of price, valuation, economic trends, monetary liquidity, and market sentiment to make **objective, unemotional, rational decisions about how much capital to place at risk, as well as where to place that capital.**

NDR Strategists contributing to this publication: Brian Sanborn, CFA, Ed Clissold, CFA, Rob Anderson, CFA, Thanh Nguyen, CFA, Tim Hayes, CMT, Joe Kalish

Strategy Description

- The Smart Sector® Fixed Income strategy combines two Ned Davis Research quantitative investment strategies: The NDR Fixed Income Allocation and the NDR Catastrophic Stop.

The process is based on the weight of the evidence

- The fund begins by overweighting and underweighting fixed income sectors based on Ned Davis Research's proprietary fixed income models..
- Each of the models utilize sector-specific, weight-of-the-evidence composites of fundamental, economic, technical, and behavioral indicators to determine each area's probability of outperforming the other categories.
- Sectors are weighted accordingly relative to an equal-weighted benchmark.

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 areas which underperform during periods of market stress (high yield, Emerging Markets, U.S. Investment Grade, and Floating Rate Notes) may be trimmed by up to 50%.
- The NDR Catastrophic Sell Stop model combines time-tested, objective indicators designed to identify periods of high risk for the broad financial markets. 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 will reverse toward being fully invested.

For more information, please contact us at:

Day Hagan Asset Management

1000 S. Tamiami Trl

Sarasota, FL 34236

Toll Free: (800) 594-7930

Office Phone: (941) 330-1702

Website: https://dayhagan.com/ or https://dhfunds.com/

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