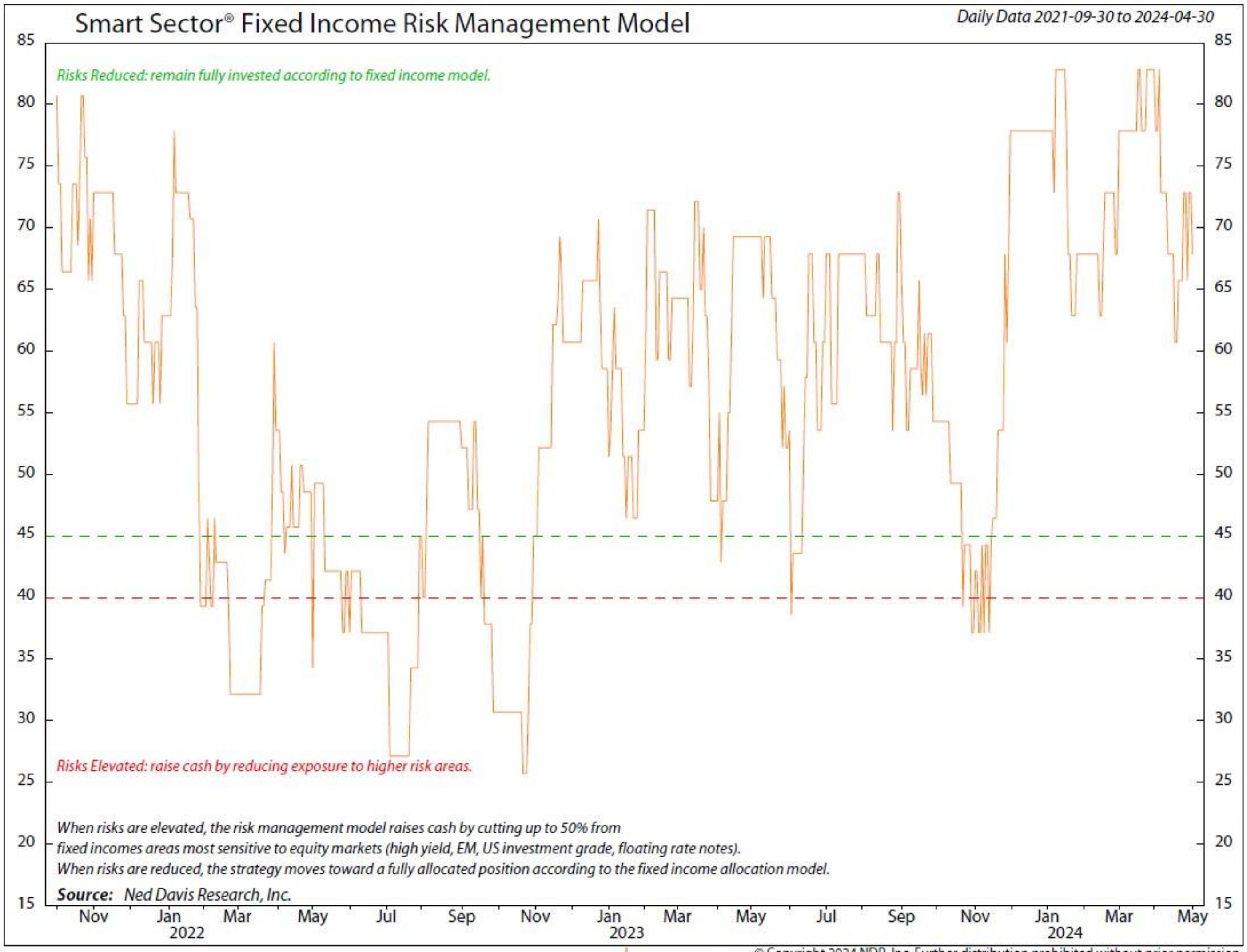
Smart Sector®
Fixed Income Strategy

MAY 2024

Risk Management Update

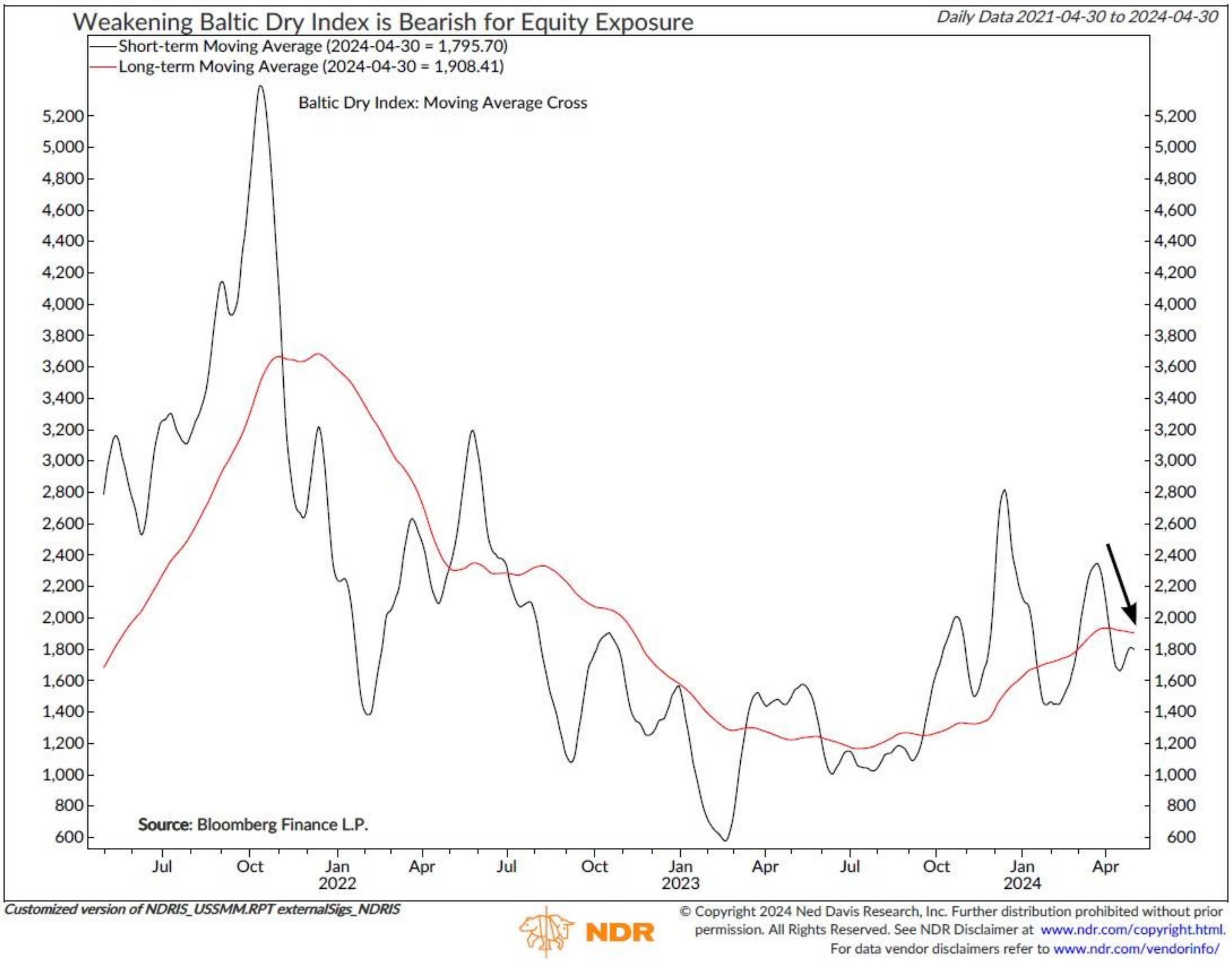
The risk management model (Figure 1) seeks to reduce exposure to fixed-income sectors most sensitive to equity drawdowns. The model deteriorated during the month but entered May recommending full model exposure to areas most sensitive to equity markets: U.S. High Yield, Emerging Markets, U.S. Investment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

Figure 1: Smart Sector® Fixed Income Risk Management Model



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. However, two external measures deteriorated. High-yield and Emerging Market bond breadth weakened to neutral, while the Baltic Dry Index (a measure of global trade) flashed bearish during the month (Figure 2). For now, the weight of the evidence recommends a fully invested allocation to fixed-income sectors according to the model.

Figure 2: Weakening Baltic Dry Index is Bearish for Equity Exposure



Fixed Income Market Update

The Bloomberg Barclays U.S. Aggregate Bond Total Return Index weakened in April with a return of about -2.5%. Breadth deteriorated sharply—seven of nine fixed-income sectors we track posted negative returns for the month. U.S. Long-Term Treasurys were the weakest at -6.4%, driving down the aggregate.

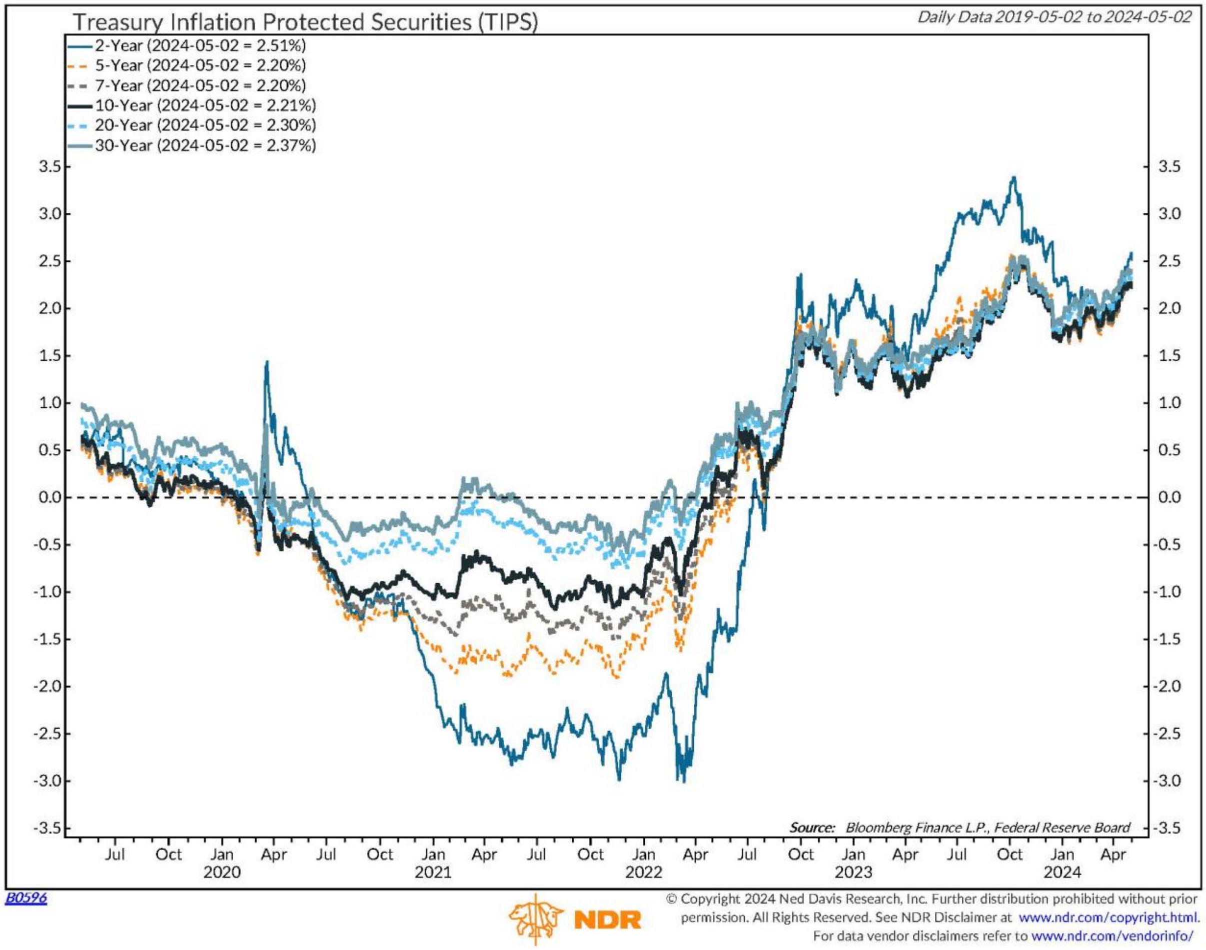
Due to sticky inflation and a robust jobs market, the FOMC kept the Fed funds target range at 5.25% to 5.50% for this month's sixth consecutive meeting. The Fed noted the "lack of further progress toward the Committee's 2% inflation objective." We believe that means fewer rate cuts this year than was expected in March.

The big debate in the market and the press is whether policy is restrictive. If you're the Fed and you look at the real policy rate, the answer is yes. Real rates from the TIPS market are at or near their

October cycle highs, leading to a higher cost of capital. In fact, the last time we saw real rates this high was during the GFC (Figure 3).

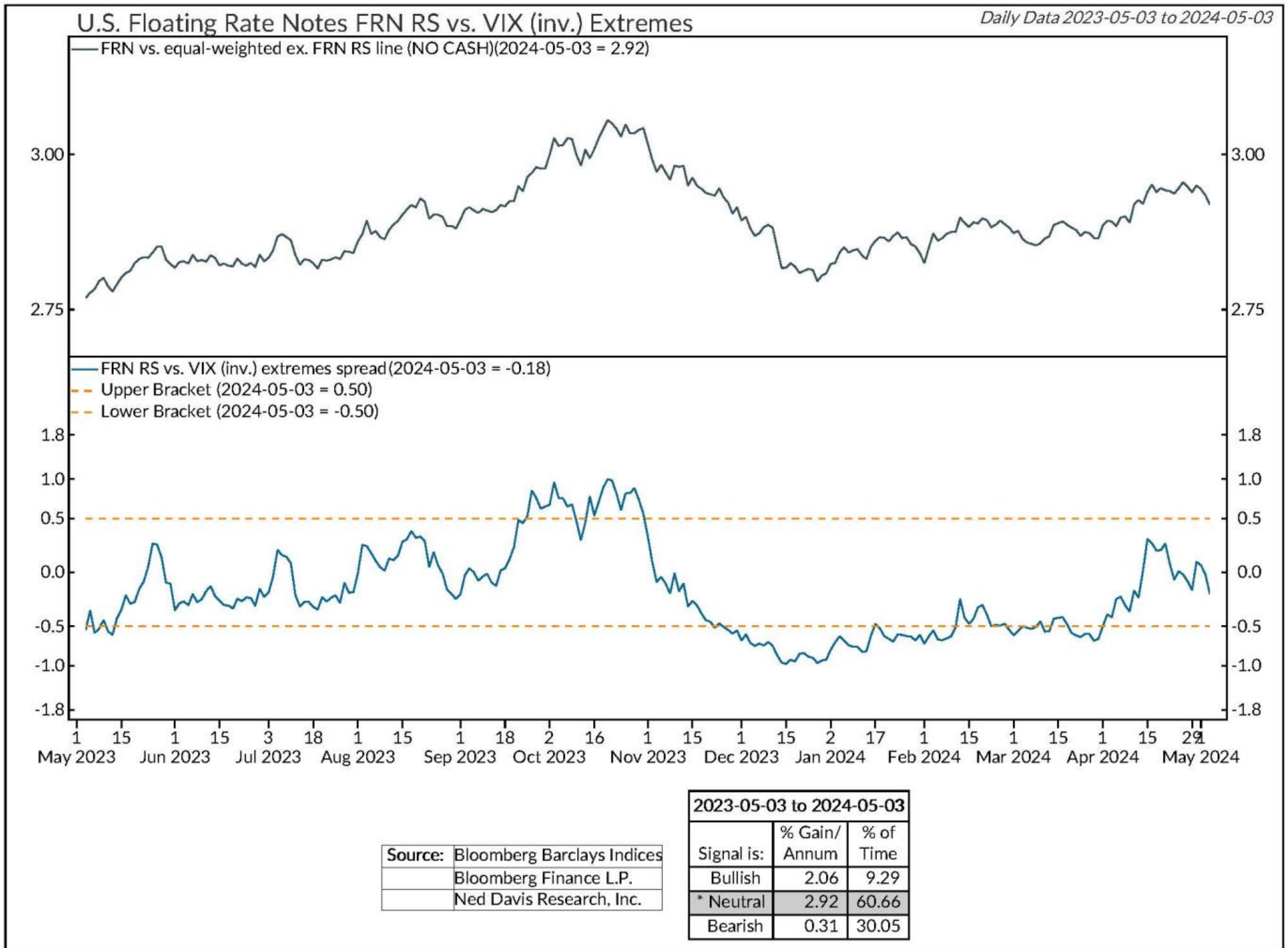
Entering May, the fixed income strategy's positioning is overweight Long-term Treasurys, U.S. High Yield, and International Investment Grade. U.S. Investment Grade Corporates are neutral. Floating Rate Notes, Emerging Market Bond, TIPS, and Mortgage-Backed Securities are underweighted relative to the benchmark.

Figure 3: Treasury Inflation Protected Securities (TIPS)



The U.S. Floating Rate Notes model improved with the recent uptick in rates. However, many of the indicators are now at levels that have historically coincided with overbought conditions. During the month, market volatility (as measured by the VIX) moved neutral for U.S. Floating Rate Notes (Figure 4). Technicals improved—the sector had new bullish signals from momentum and slope indicators. The sector is on watch for a potential increase in exposure.

Figure 4: U.S. Floating Rate Notes FRN RS vs. VIX (inv.) Extremes



Customized client version of FRN RS vs. VIX (inv.) Extremes

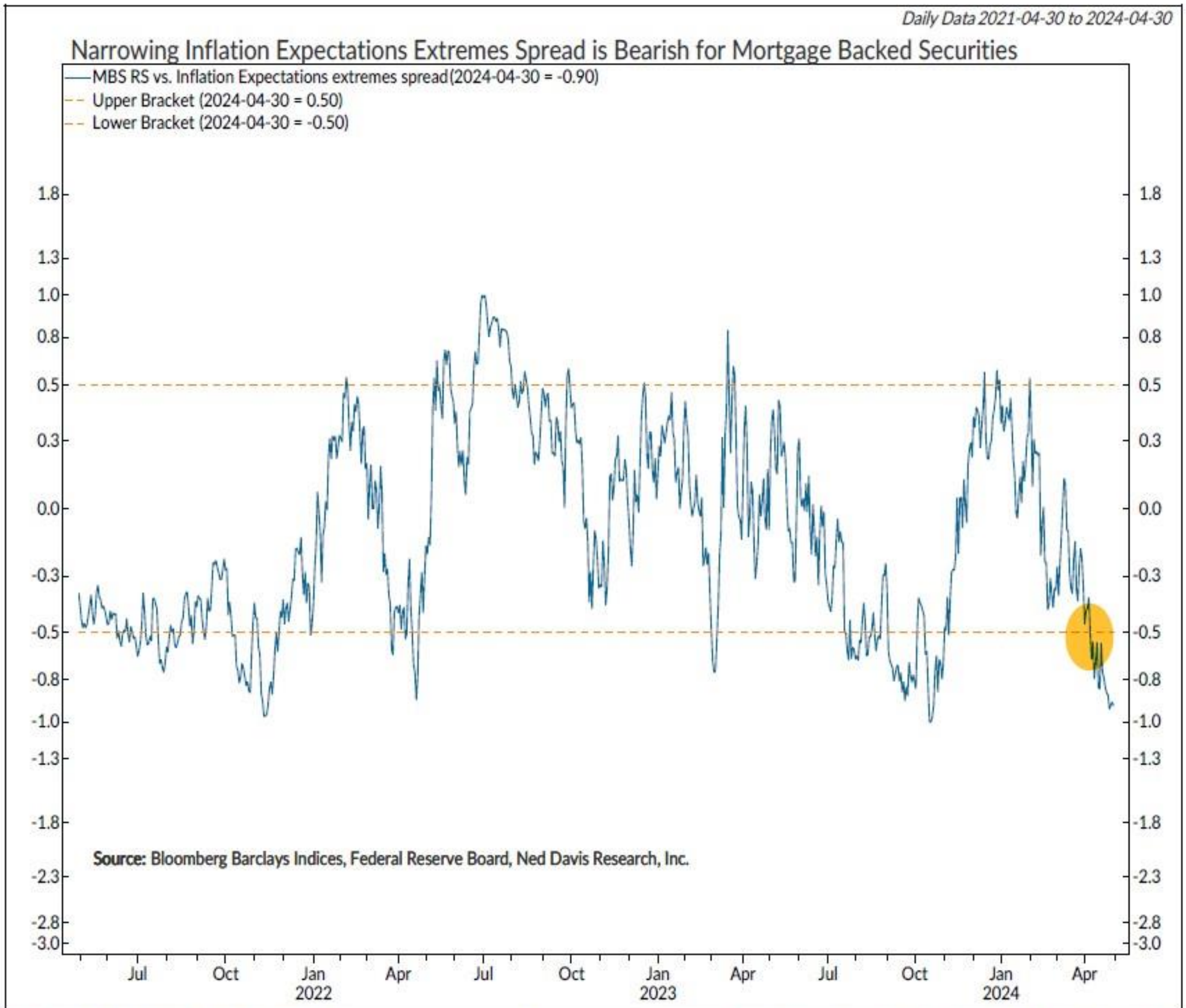
NDR

The International Investment Grade bond allocation improved sharply and was upgraded to overweight. Externals improved. Stock market volatility (as measured by the VIX) flashed bullish for the sector while widening spreads moved to neutral. Price-based measures are bullish—the short-term trend (Figure 5) improved to bullish during the month and joined a relative strength slope indicator.

Figure 5: Improving Trend is Bullish for International Investment Grade

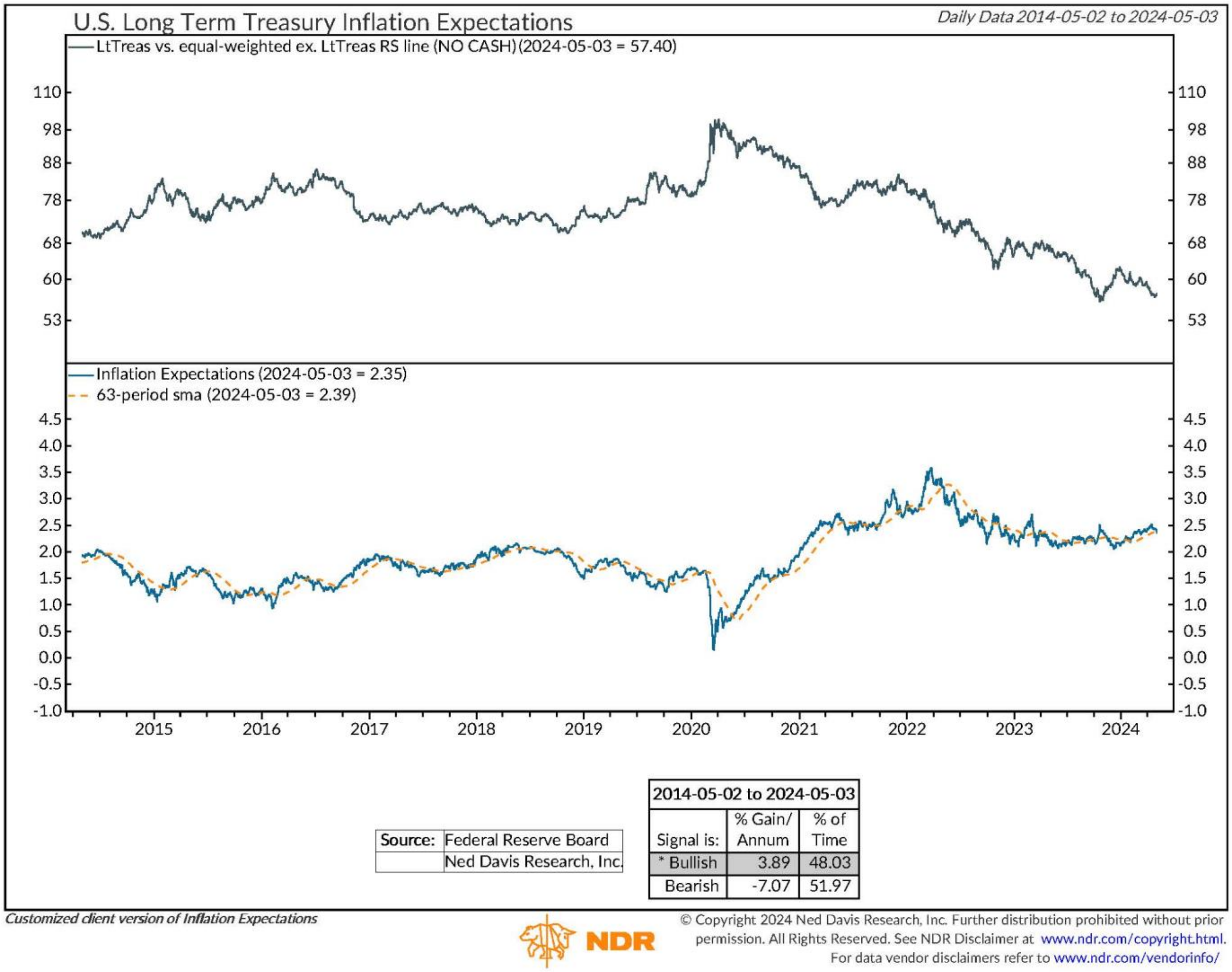
U.S. Mortgage-Backed Securities' allocation dropped sharply to underweight. On a fundamental basis, a bullish 10-year yield indicator was more than offset by bearish option-adjusted spreads and inflation expectations' extreme spreads (Figure 6), which moved negatively for the sector during the month. Technicals are confirming, as trend and relative strength measures remained bearish.

Figure 6: Narrowing Inflation Expectations Extremes Spread is Bearish for Mortgage Backed Securities



The allocation to U.S. Treasurys is now overweight. On a fundamental basis, last month's weaker equity trend was relatively positive for bonds. Notably, last month's bearish inflation expectations are reversing and several technical measures appear oversold (Figure 7).

Figure 7: U.S. Long Term Treasury Inflation Expectations



Summary

Entering May, the fixed income allocation strategy's positioning is overweight Long-term Treasurys, U.S. High Yield, and International Investment Grade. U.S. Investment Grade Corporates are neutral. Floating Rate Notes, Emerging Market Bond, TIPS, and Mortgage-Backed Securities are underweighted relative to the benchmark.

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.**

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.

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