Day Hagan Asset Management

NDR Ned Davis Research

Smart Sector® Fixed Income Strategy

DECEMBER 2023

Risk Management Update

The risk management model (chart right) seeks to reduce exposure to fixed-income sectors most sensitive to equity drawdowns. The risk management model improved during the month and entered December recommending an increase in exposure to areas most sensitive to equity markets: U.S. High Yield, Emerging Markets, U.S. Investment Grade, and Floating Rate Notes. At the time, we noted that many of our shorter-term measures of sentiment and overbought conditions had moved to levels denoting excess risk for the near term. Those models and indicators have not yet pulled back, indicating that the market is still consolidating in advance of the next trend, whether it is a resumption of the upside or a reversal lower. We will redeploy the remaining cash holding as sentiment eases or longer-term breadth thrust measures confirm the near-term signals.

Figure 1: Smart Sector® Fixed Income Risk Management Model

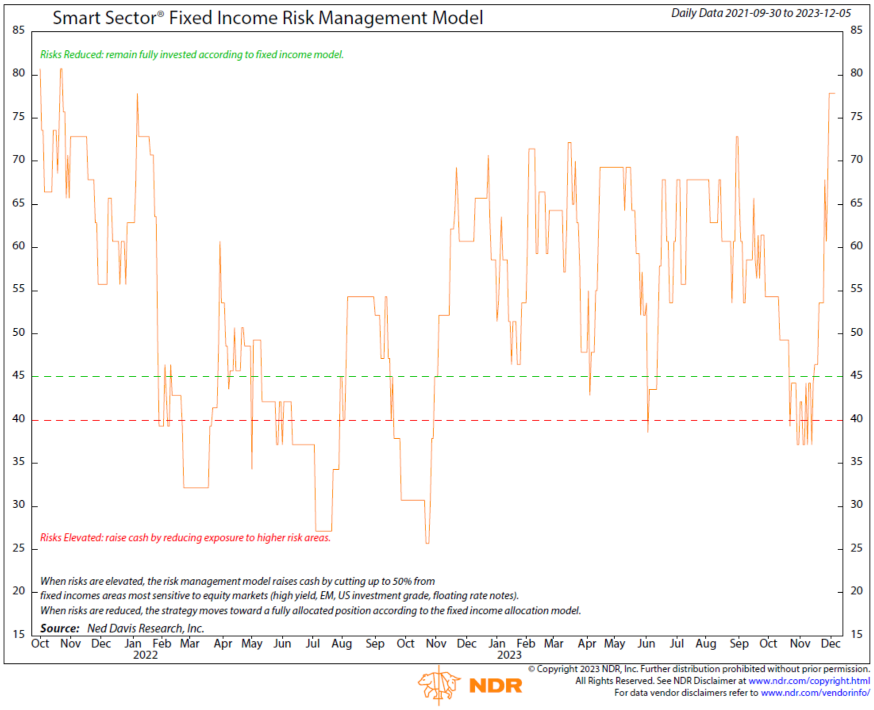
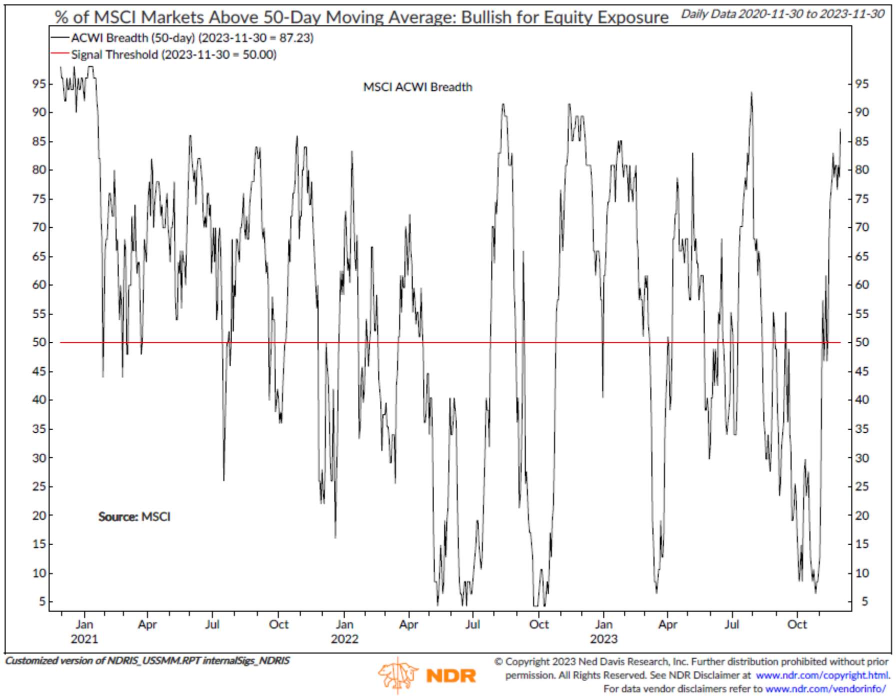


Figure 2: % of MSCI Markets Above 50-Day Moving Average: Bullish for Equity Exposure



The improvement in the model was purely driven by better technicals—five of the seven price-based measures are now bullish, including breadth rising to its highest level since July (chart left). Investor sentiment is now excessively optimistic, so we will keep an eye on these measures.

Fixed Income Market Update

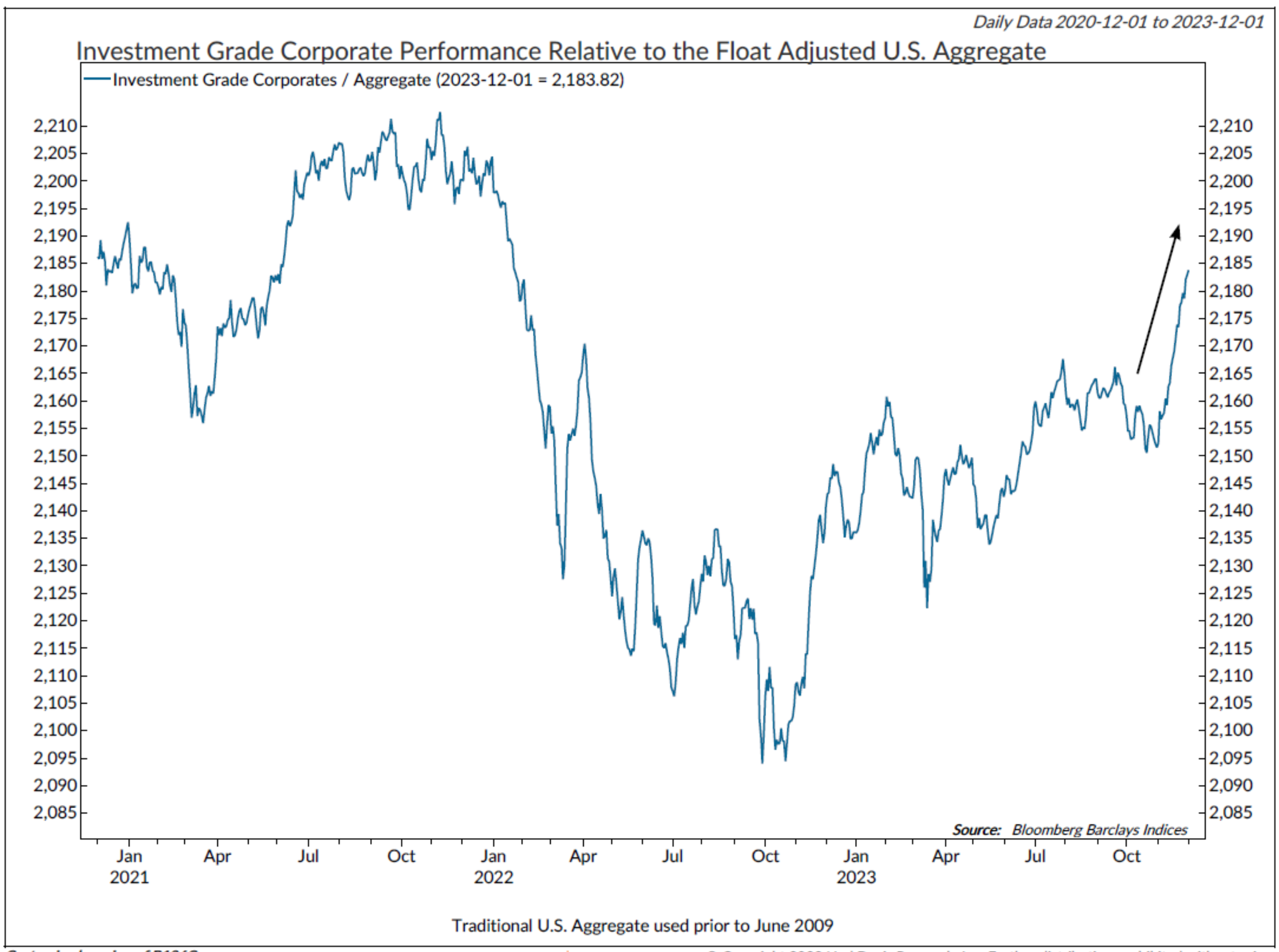
After being down for six months in a row, the Bloomberg Barclays U.S. Aggregate Bond Total Return Index rebounded and gained 4.5% in November. Breadth improved sharply—all nine fixed-income sectors we track had positive returns in November—U.S. Long-Term Treasurys rebounded nearly 10%.

After 10-year yields topped 5.00% and became good values, yields have sharply reversed on slowing growth, cooling inflation, and a Fed that is viewed as finished hiking rates. Historically, bonds have performed well after the last rate hike and the Fed has maintained a tightening bias. Additionally, our Bond Enhancement Model flashed a buy signal. As a result, we increased our recommended bond duration. Long-term support can be found from 5.00% to 5.25%. Intermediate-term resistance is around 4.00%.

Investors have moved back into riskier assets—Investment Grade Corporate (chart below), High-Yield, Mortgage-Backed Securities, and Emerging Market bonds all rallied sharply during the month.

Entering December, the fixed income allocation strategy shifted to risk-on leadership. The model is relatively overweight: U.S. High-Yield, Long-Term Treasurys, Short-Term TIPS, U.S. Investment Grade Corporates, International Investment Grade, and Emerging Market Bonds. The model is relatively underweight in U.S. Mortgage-Backed Securities and U.S. Investment-Grade Corporations. All allocations are relative to the cash-adjusted benchmark, Core U.S. Aggregate Bonds.

Figure 3: Investment Grade Corporate Performance Relative to the Float Adjusted U.S. Aggregate



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The U.S. Investment-Grade corporate bond allocation held steady. While bond volatility and the U.S. dollar are bearish for the sector, four of the six indicators are bullish, including a price trend indicator that flashed positive during the month (chart right).

Figure 4: Short-Term Price Trend: Bullish for U.S. Investment Grade Corporate

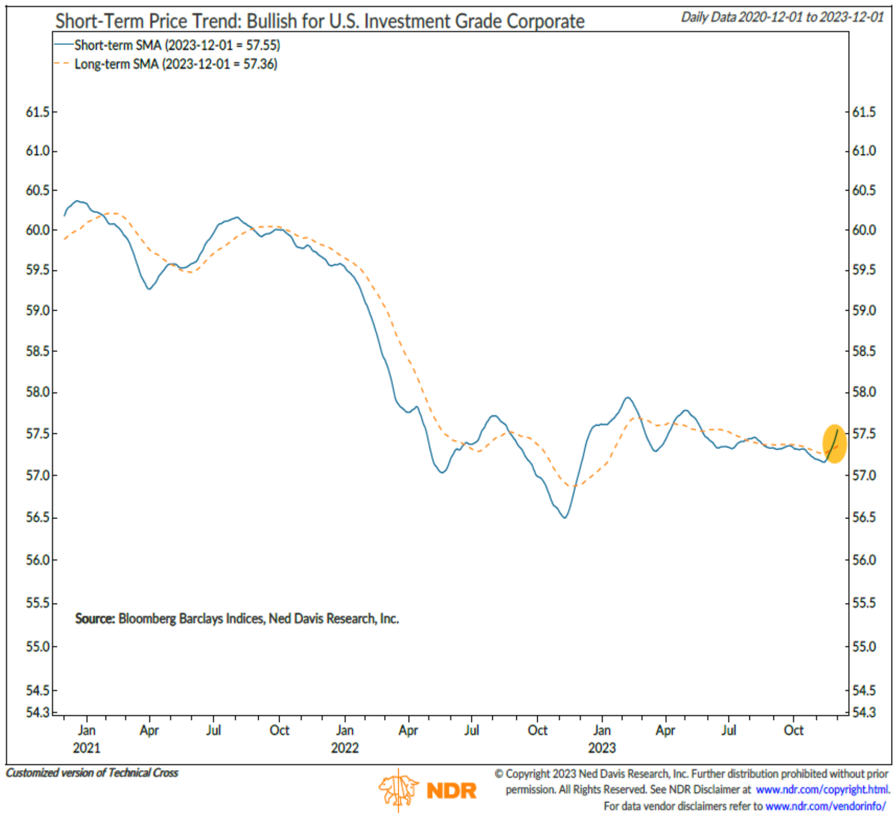
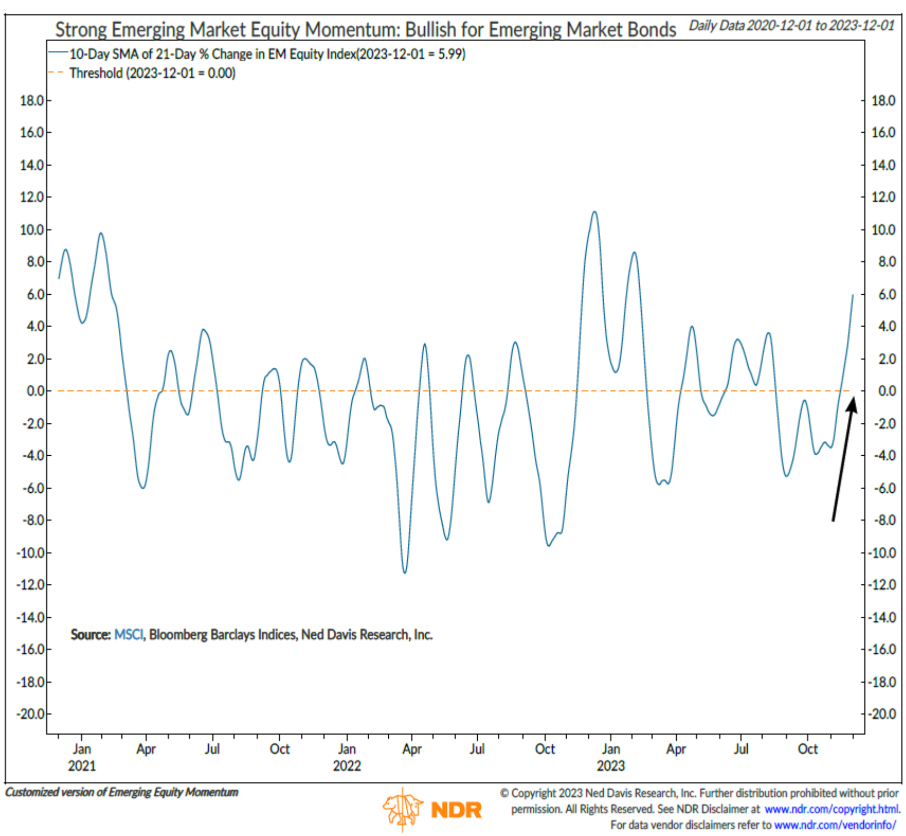


Figure 5: Strong Emerging Market Equity Momentum: Bullish for Emerging Market Bonds



Emerging Market bonds rallied by over 6% in November. The model's allocation increased, and the sector was upgraded to overweight. Four of five indicators are now bullish for the sector. A weakening U.S. Dollar and positive momentum in Emerging Market equities (chart left) were confirmed by improving technicals.

U.S. Floating Rate Notes' allocation remains minor. Floating rate notes typically outperform when rates are rising. With the sharp drop in rates in November, the sector underperformed significantly. All five indicators are now bearish for the sector, including short-term momentum (chart right).

Figure 6: Weakening Momentum is Bearish for U.S. Floating Rate Notes

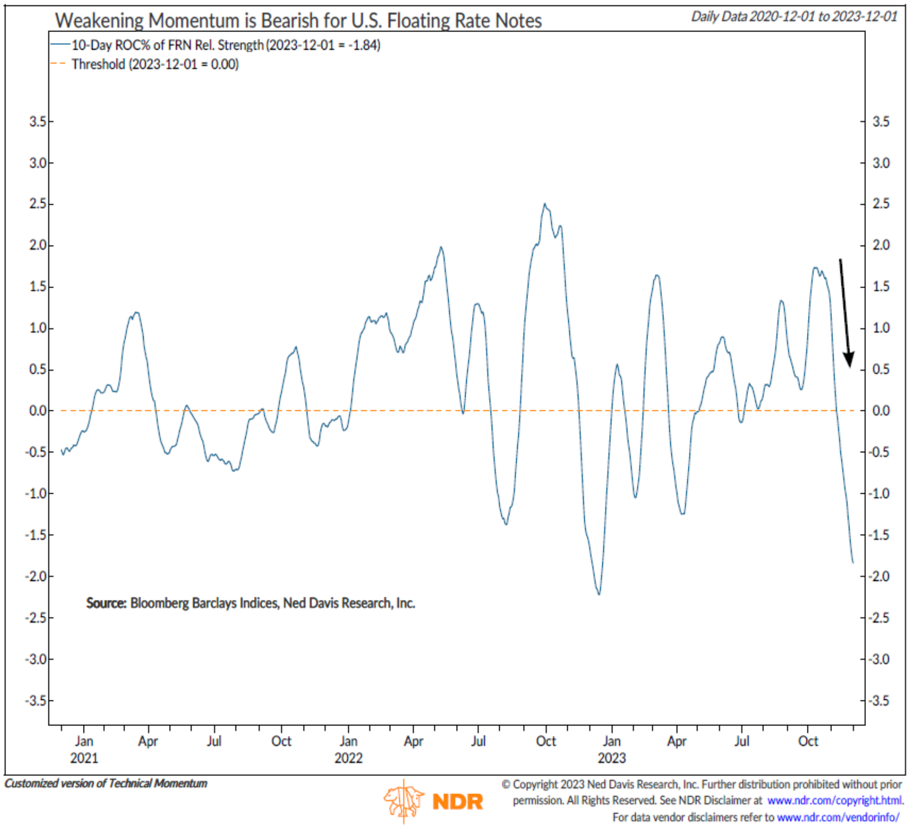
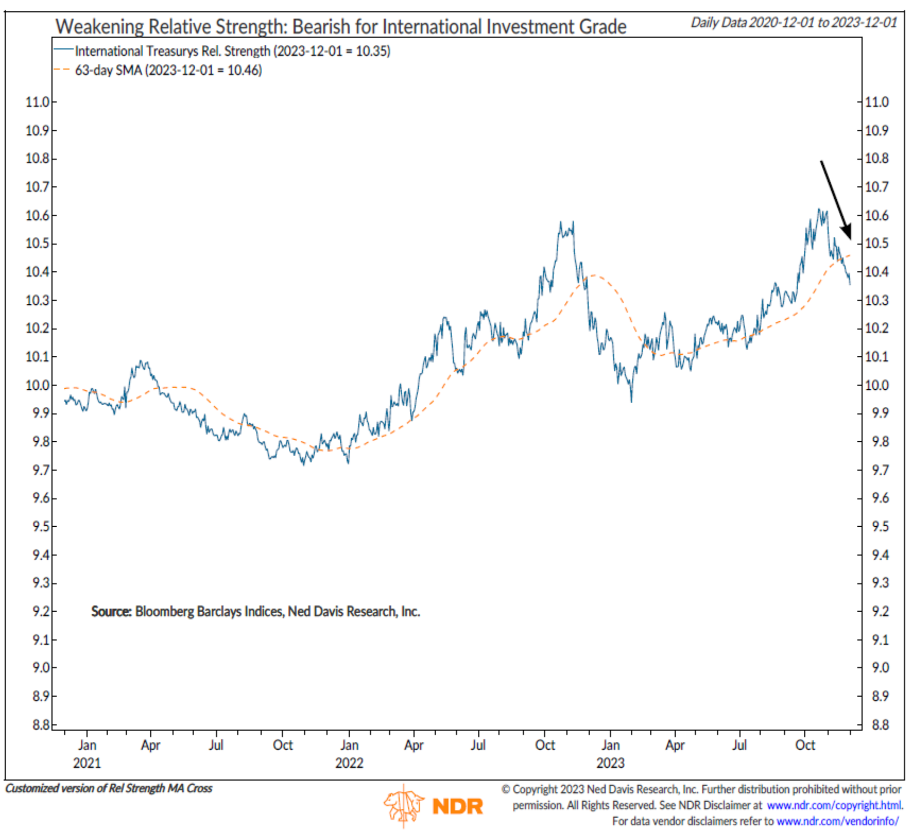


Figure 7: Weakening Relative Strength: Bearish for International Investment Grade



International Investment Grade bonds' allocation dropped sharply. Narrowing global option-adjusted spreads joined U.S. swaps at neutral. Two price-based measures, including relative strength trends (chart left), flashed bearish, along with equity volatility.

Summary

Entering December, the fixed income allocation strategy shifted to risk-on leadership. The model is relatively overweight: U.S. High-Yield, Long-Term Treasurys, Short-Term TIPS, U.S. Investment Grade Corporates, International Investment Grade, and Emerging Market Bonds. The model is relatively underweight in U.S. Mortgage-Backed Securities and U.S. Investment-Grade Corporations. All allocations are relative to the cash-adjusted benchmark, Barclays U.S. Aggregate Bond Index.

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Smart Sector® Fixed Income Strategy

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 utilizes 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 that 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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