DAY HAGAN
ASSET MANAGEMENT

NDR
NED DAVIS RESEARCH

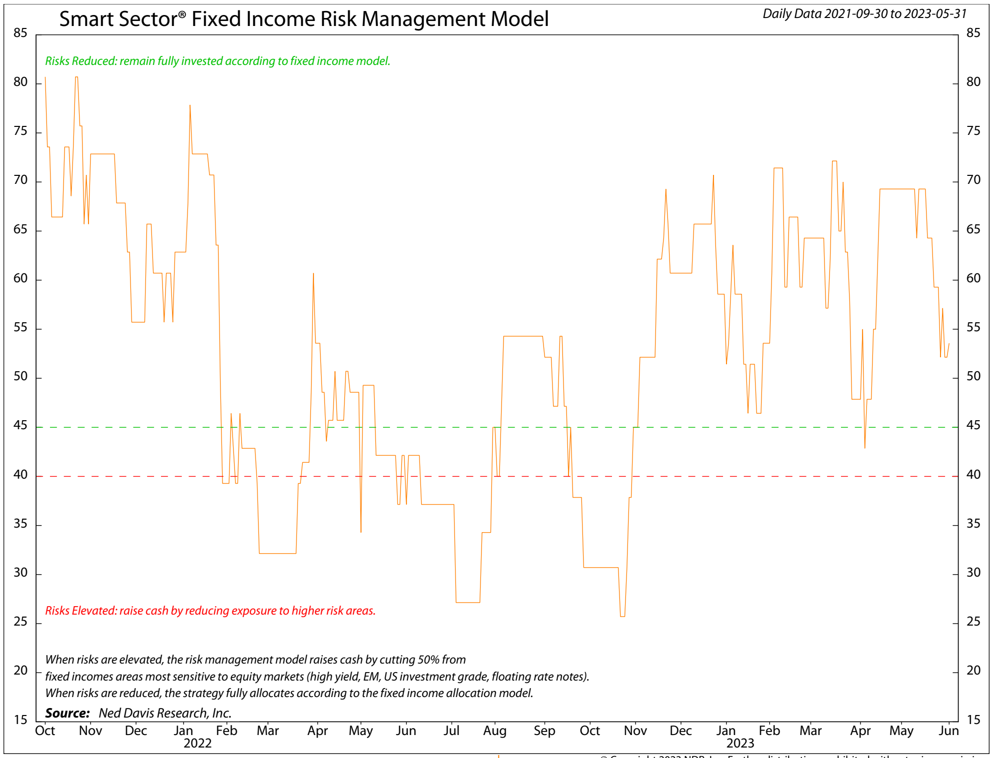
# Smart Sector® Fixed Income Strategy

JUNE 2023

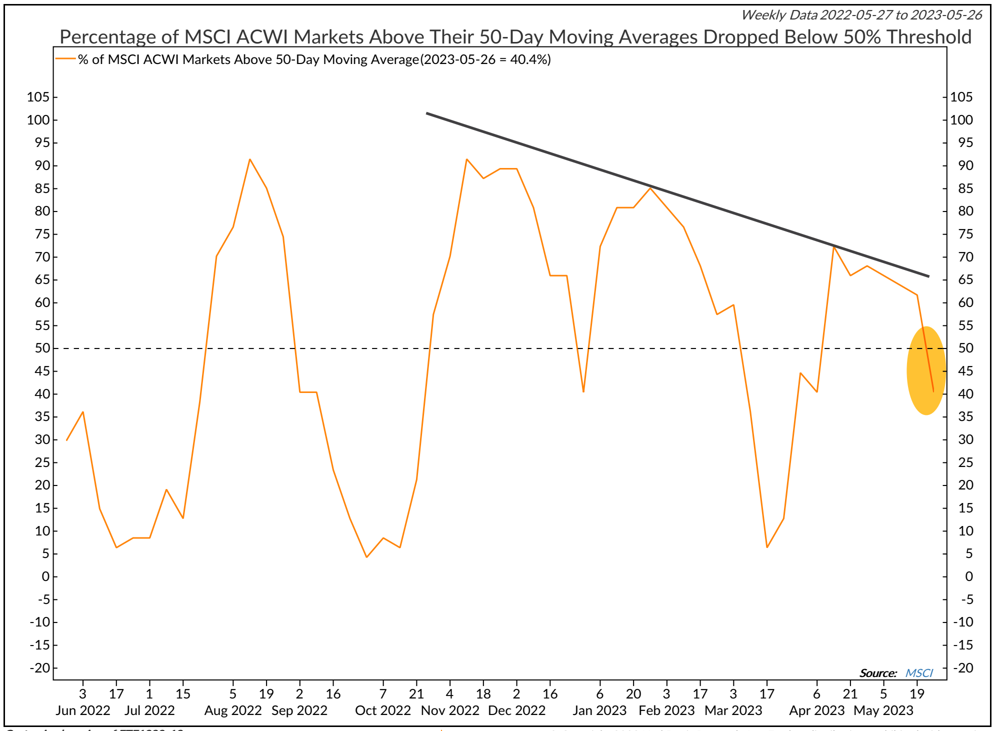
## Risk Management Update

The risk management model (chart at right) seeks to reduce exposure to fixed income sectors most sensitive to equity drawdowns (U.S. High Yield, Emerging Markets, U.S. Investment Grade, and Floating Rate Notes) during periods of market stress.

The model (chart at right) deteriorated from last month but entered June with a risk-on recommendation.






*Customized version of ETF1000_12*



The model deterioration was mostly driven by weaker breadth—global stock market breadth (chart at left) and breadth for High Yield and Emerging Market bonds both declined during the month. Additionally, stock volume supply continues to outpace demand, option-adjusted spreads remain wide, sentiment shows excessive optimism, and the Baltic Dry Index reflects weakening economic activity. Some of these indicators will need to improve if the market rally is going to continue deep into the second-half of the year. For now, the weight-of-the-evidence recommends a fully invested allocation to fixed income sectors according to the model.

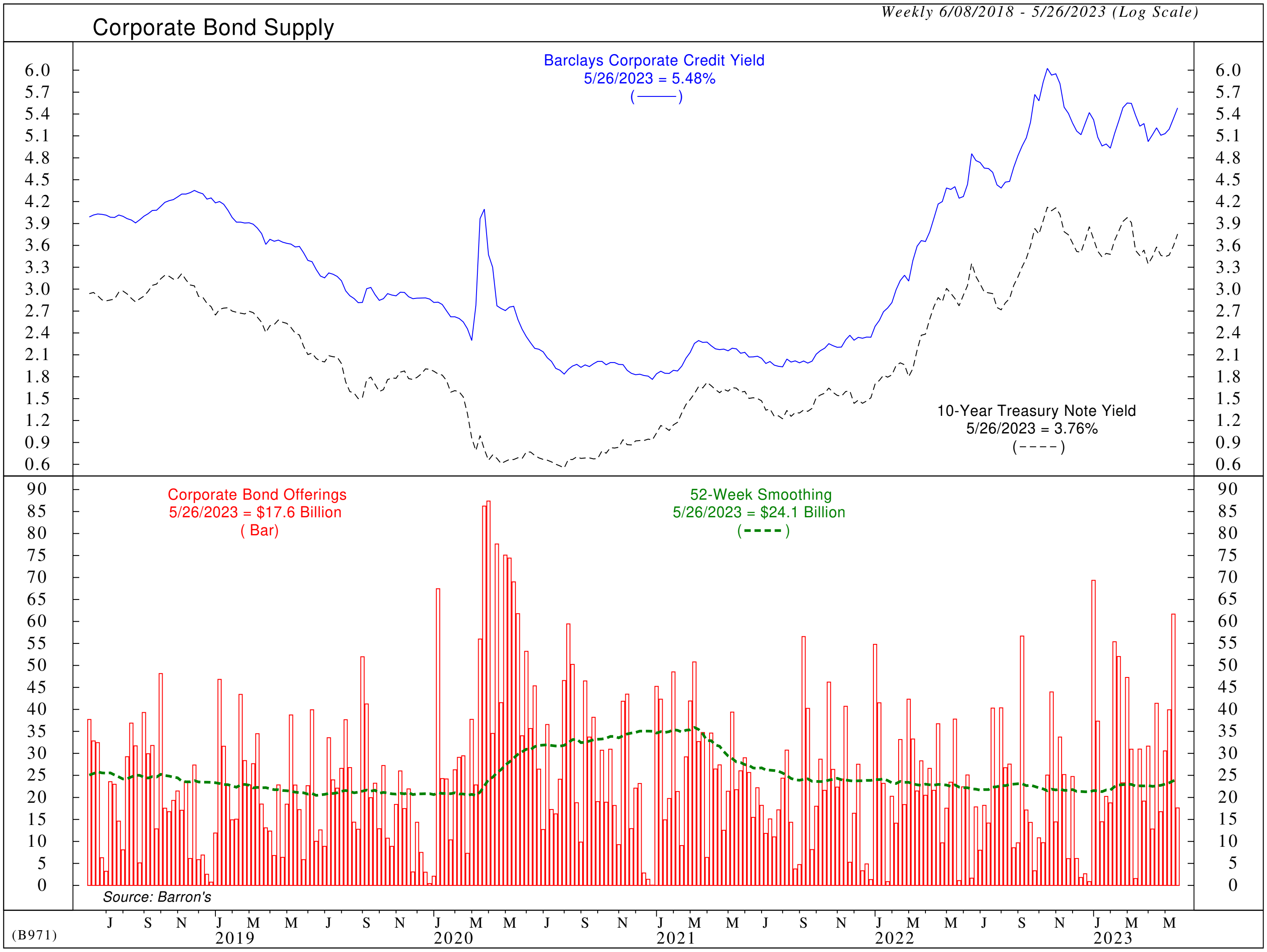
## Fixed Income Market Update

The Bloomberg Barclays U.S. Aggregate Bond Total Return Index declined about 1% in May. Returns have been positive for five of the past 12 months. Breadth has been weak—six of the nine fixed income sectors we track had negative returns in May.

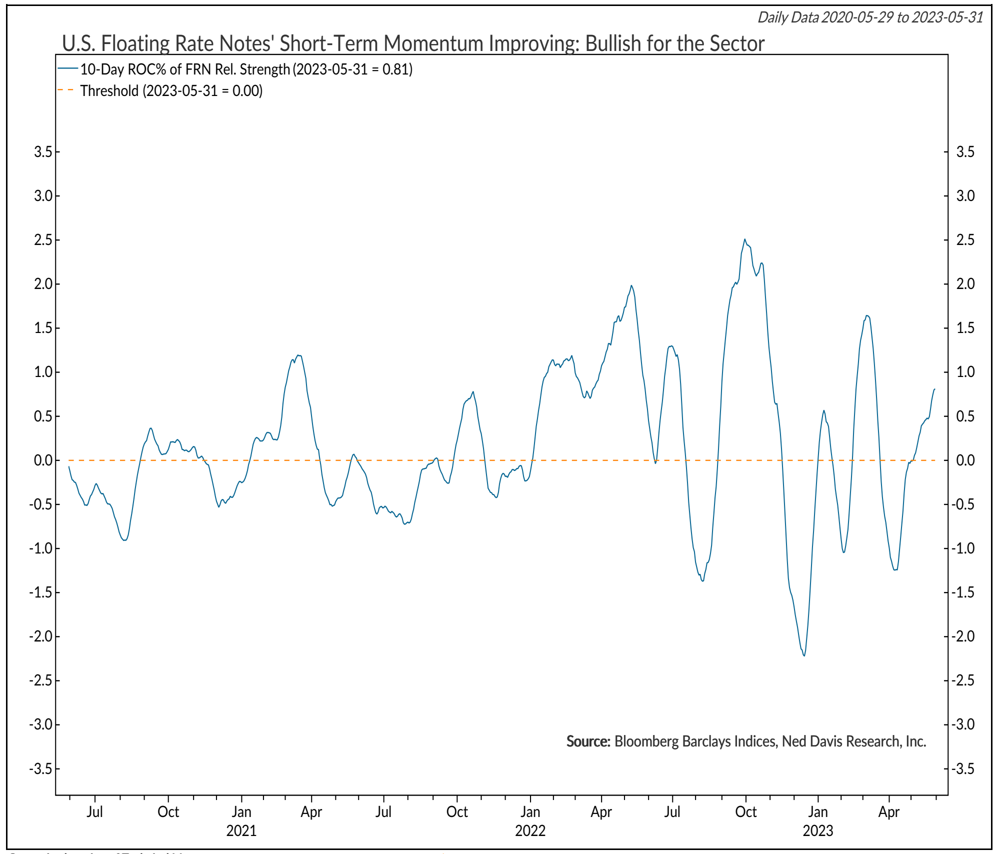
While 10-year yields have been in a trading range since last Fall (chart below, top clip), in the month of May, yields had a significant backup. There were several factors that contributed to the rise including the debt ceiling, Fed speakers, and supply (bottom clip). The rise in the 10-year yield was a contributing factor to whipsawing fixed income sector leadership.

The bond market is oversold and near short-term support levels. But rising European yields could continue to put upward pressure on Treasurys. Turmoil in the banking sector, tighter credit, and a potential recession later in the year or early next year could lead to a yield breakdown.

Entering June, the fixed income allocation strategy is overweight International Investment Grade, U.S. Mortgage Backed, Emerging Market Debt, and U.S. Long-Term Treasury. We are neutral on Short-Term Bonds. We are underweight Floating Rate Notes, U.S. Corporates, U.S. High Yield, and TIPS.

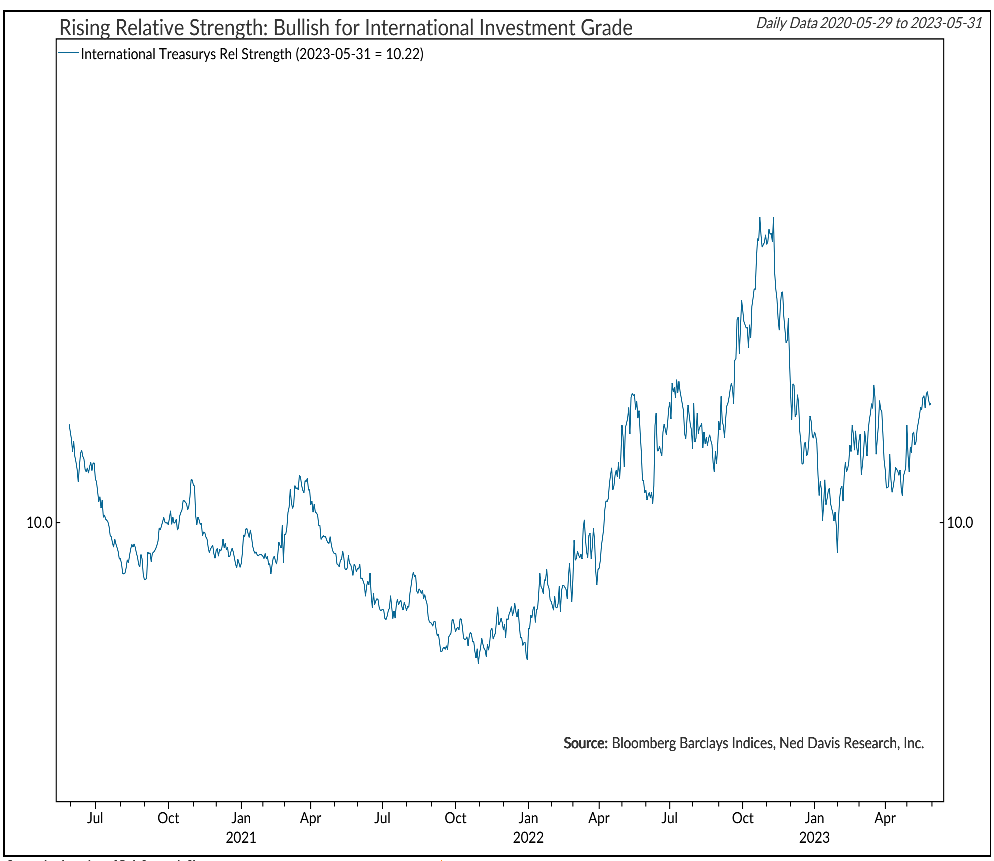


Floating Rate Notes' allocation is slightly underweight. Floating rate notes typically outperform during a rising rate environment —yields have recently been in a trading range. Four of five indicators improved this past month, as improving spreads was confirmed by bullish short-term trend and momentum (chart right).




*Customized version of Technical Momentum*



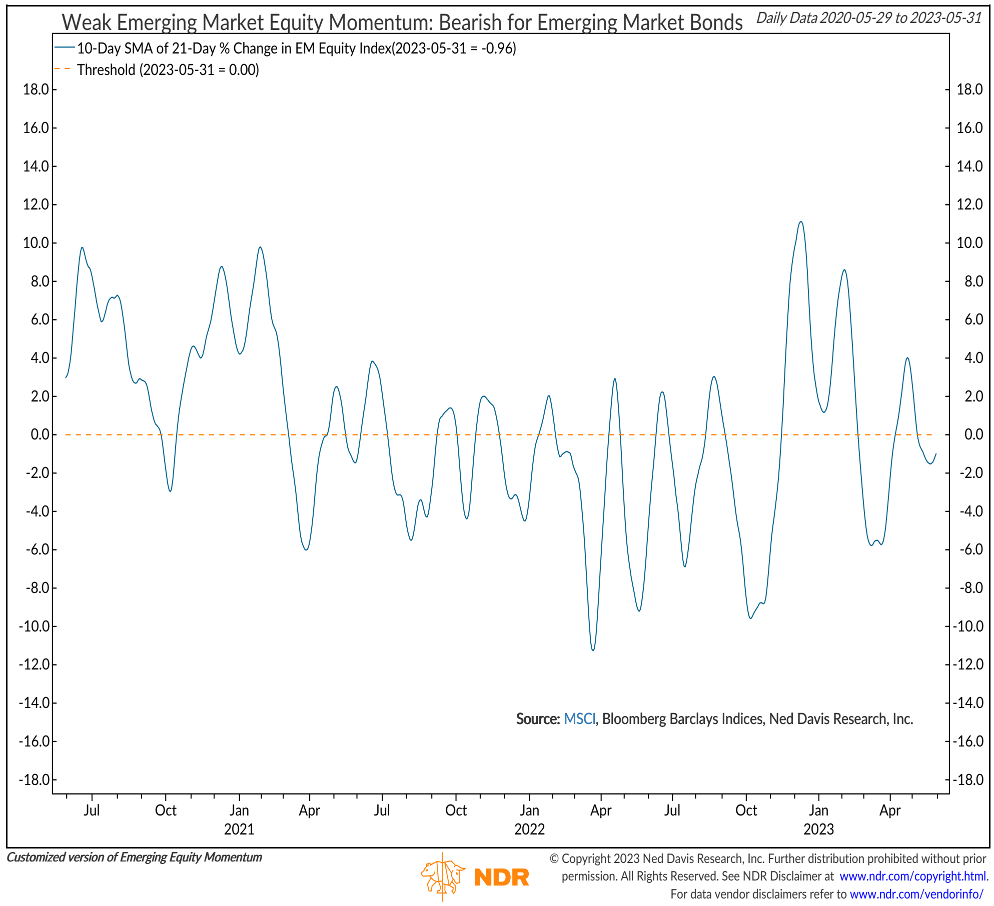


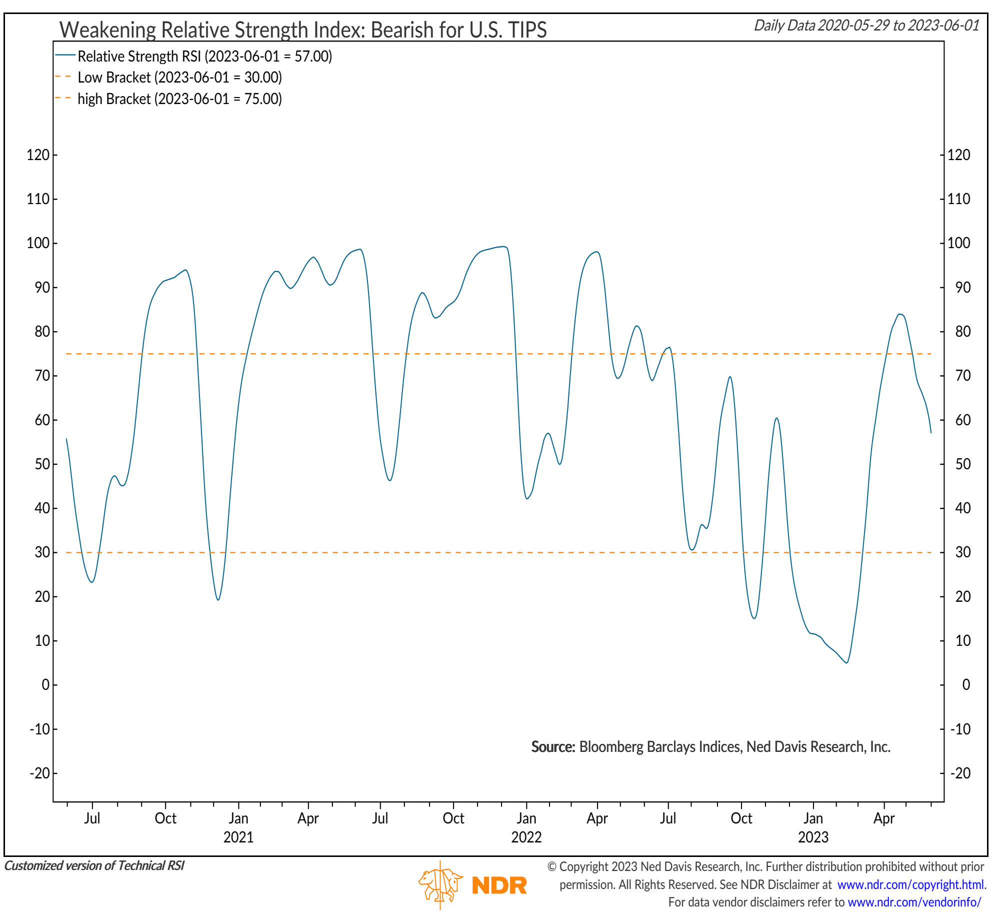

*Customized version of Rel. Strength Slope*



International Investment Grade bonds' allocation improved from a significant underweight to an overweight position. While external indicators such as high-yield returns vs. inflation and U.S. swaps remained neutral for the sector, two of the three technical measures flipped from bearish to bullish for the sector, including international investment grade bond relative strength trends (chart left).

Emerging Market bonds' allocation is slightly overweight based on the June model updates. Due to its size, China has a significant influence on Emerging Markets (EM). While China's economic recovery remains intact, momentum is fading. As a result, EM equities (chart right) and EM currencies weakened during the month, both of which are negative for EM bonds. We will reduce exposure if the models continue to deteriorate.




U.S. Treasury Inflation Protected Securities' (TIPS) allocation also dropped sharply for June, moving it from a slight overweight to the largest underweight position. TIPS tend to outperform when inflation is high. We have passed the peak in inflation—inflation expectations have dropped which is bearish for TIPS. This has been confirmed by two relative strength trend indicators (chart left), both of which moved bearish during the month.

## Summary

Entering June, the fixed income allocation strategy is overweight International Investment Grade, U.S. Mortgage Backed, Emerging Market Debt, and U.S. Long-Term Treasury. We are neutral on Short-Term Bonds. We are underweight Floating Rate Notes, U.S. Corporates, U.S. High Yield, and TIPS.

## 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 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) are trimmed by 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 immediately moves back to fully invested.

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