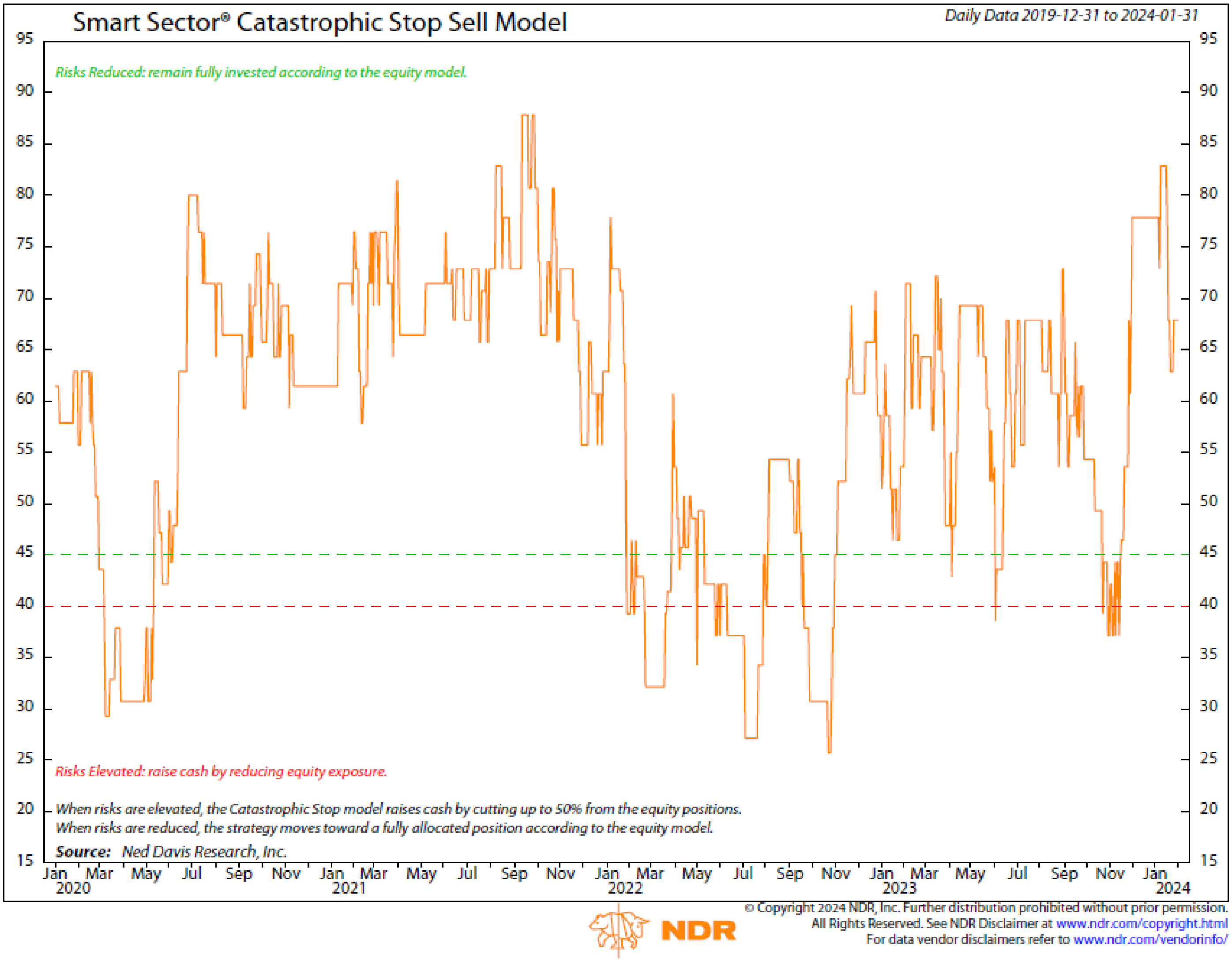
Smart Sector®
International Strategy

FEBRUARY 2024

Catastrophic Stop Update

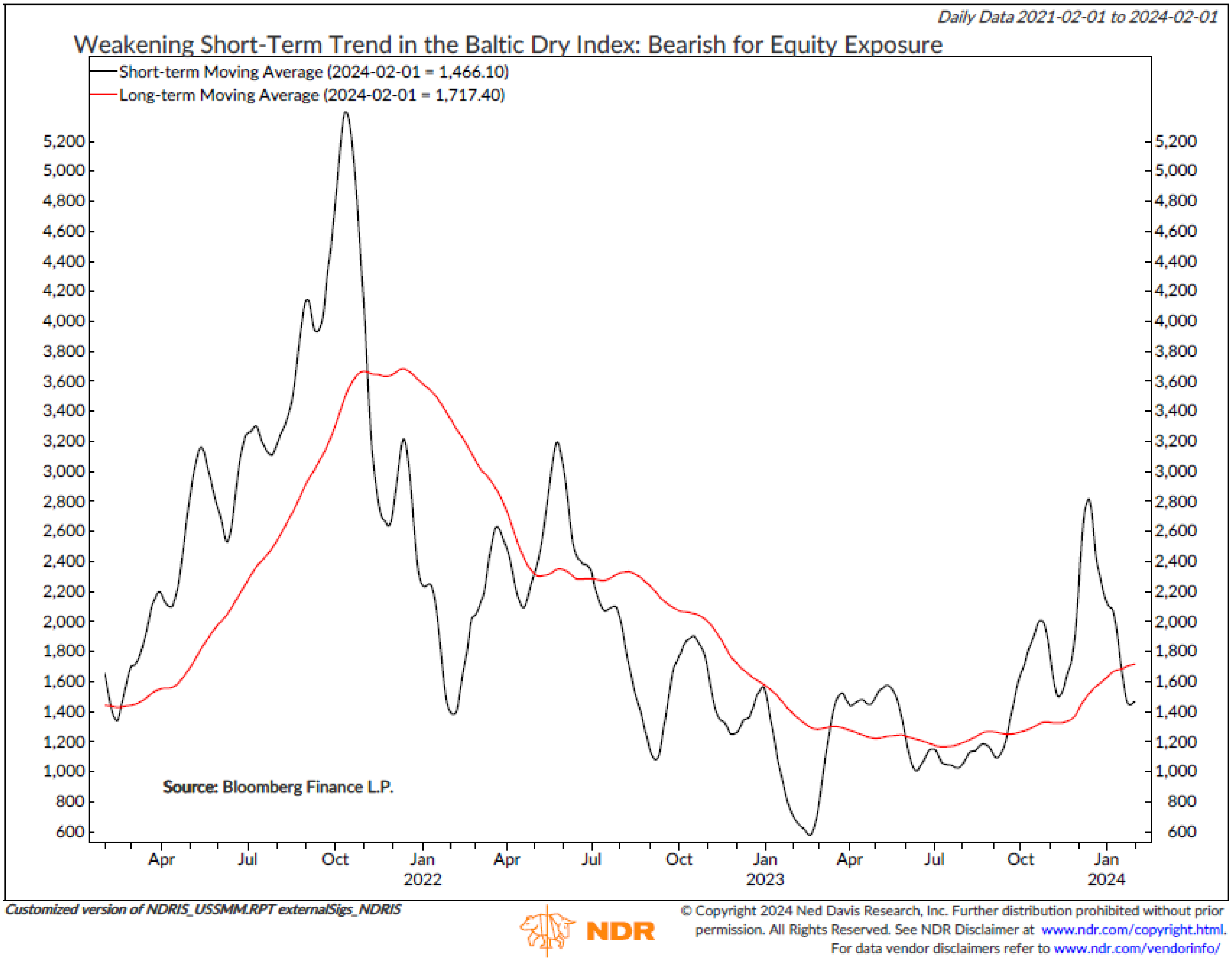
The NDR Catastrophic Stop Sell model combines time-tested, objective indicators designed to identify high-risk periods for the equity market. The model (Figure 1) weakened during the month but entered February with a fully invested equity allocation recommendation.

Figure 1: Smart Sector® Catastrophic Stop Sell 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, external measures are more mixed. While option-adjusted spreads and high-yield and emerging market breadth are bullish, the short-term trend in global trade—as measured by the Baltic Dry Index—became bearish during the month (Figure 2). Furthermore, investor sentiment remains excessively optimistic, which is bearish for stocks. For now, the weight of the evidence recommends a fully invested allocation to equity sectors according to the model.

Figure 2: Weakening Short-Term Trend in the Baltic Dry Index: Bearish for Equity Exposure



Global Market Update

The ACWI ex. U.S. Total Return Index declined by almost 100 basis points (bps) in January. The index has fallen for four of the last six months. Among the strongest-performing markets were Turkey, Egypt, Kuwait, Netherlands, and Greece, while the largest underperformers included Chile, China, South Korea, Hong Kong, and Portugal.

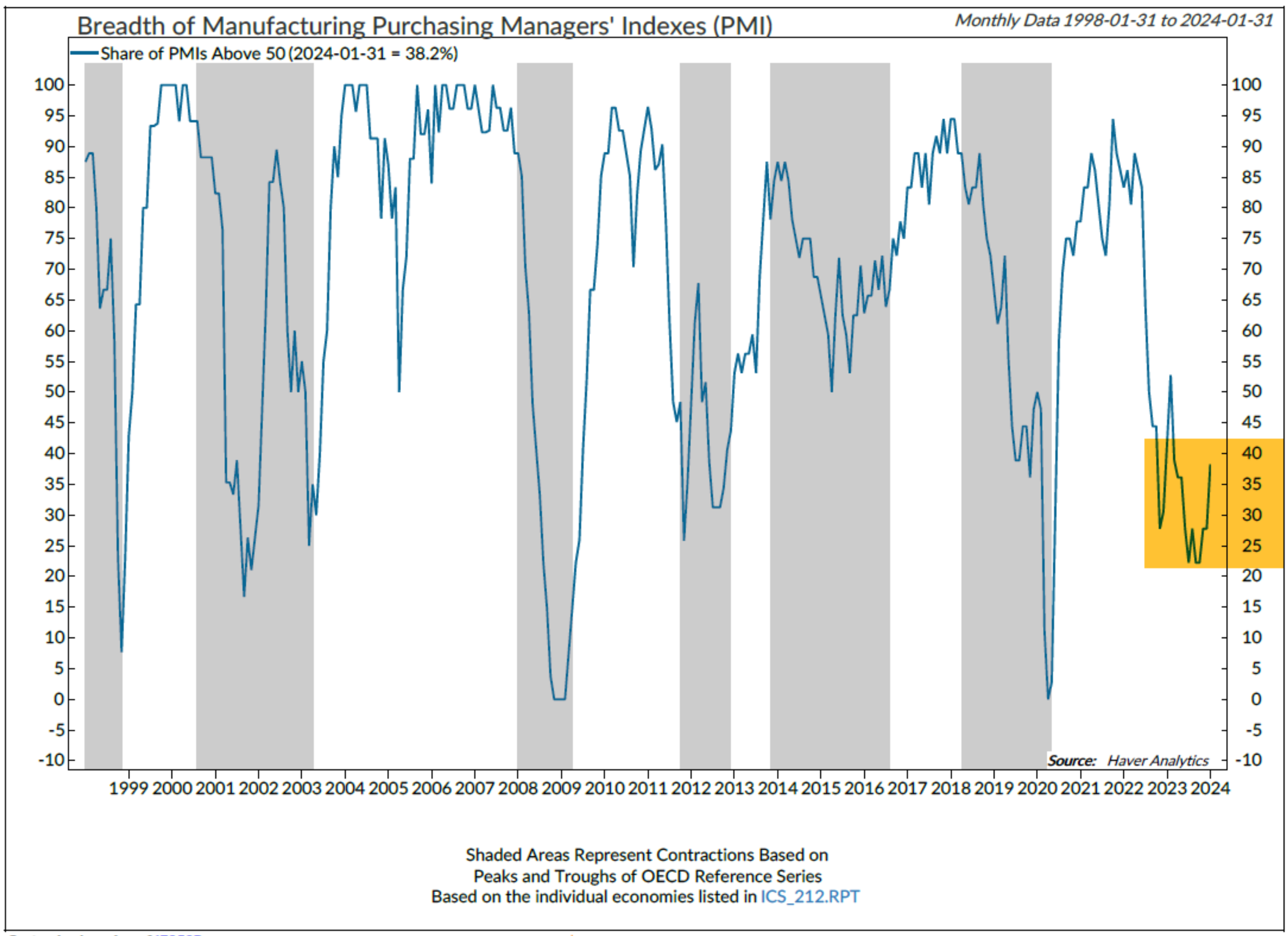
The global economy ended 2023 showing signs of resiliency, exhibiting a modest expansion, according to the S&P Global Purchasing Managers' Index (PMI). It was the second straight month of growth, following stagnation in October, and the highest reading since July. Leading indicators, such as overall new orders and the future output index, rose to their highest levels in six months, indicating continued strength in the near term.

However, the current pace of global economic expansion is much slower than it was earlier in 2023. The PMI peaked in May and is still well below its long-term average. Downside risks abound, including the delayed impact of tight monetary policy, sticky inflation, less fiscal support, and abundant geopolitical risk. The global expansion also lacks broad participation across economies. The services sector is expanding, but manufacturing continues to sputter. Many economies, with greater concentration in Europe, still show contracting services and manufacturing activity (Figure 3). This supports an outlook for slower economic growth but no recession. The lack of a recession would be critical for investors since the largest bear markets typically occur during economic contractions.

Global input prices accelerated in December, while output price growth was little changed. Both indexes, while down from last year, made little headway in the second half of the year and remain above pre-pandemic levels. Sticky prices continue to present challenges to central banks regarding monetary policy.

Entering February, the non-U.S. equity Core model overweighted Canada and Germany. Japan was neutral, while the U.K., China, France, Australia, and Switzerland were underweight. The Explore model favored Brazil, Peru, Spain, Poland, and the Philippines.

Figure 3: Breadth of Manufacturing Purchasing Managers' Indexes (PMI)



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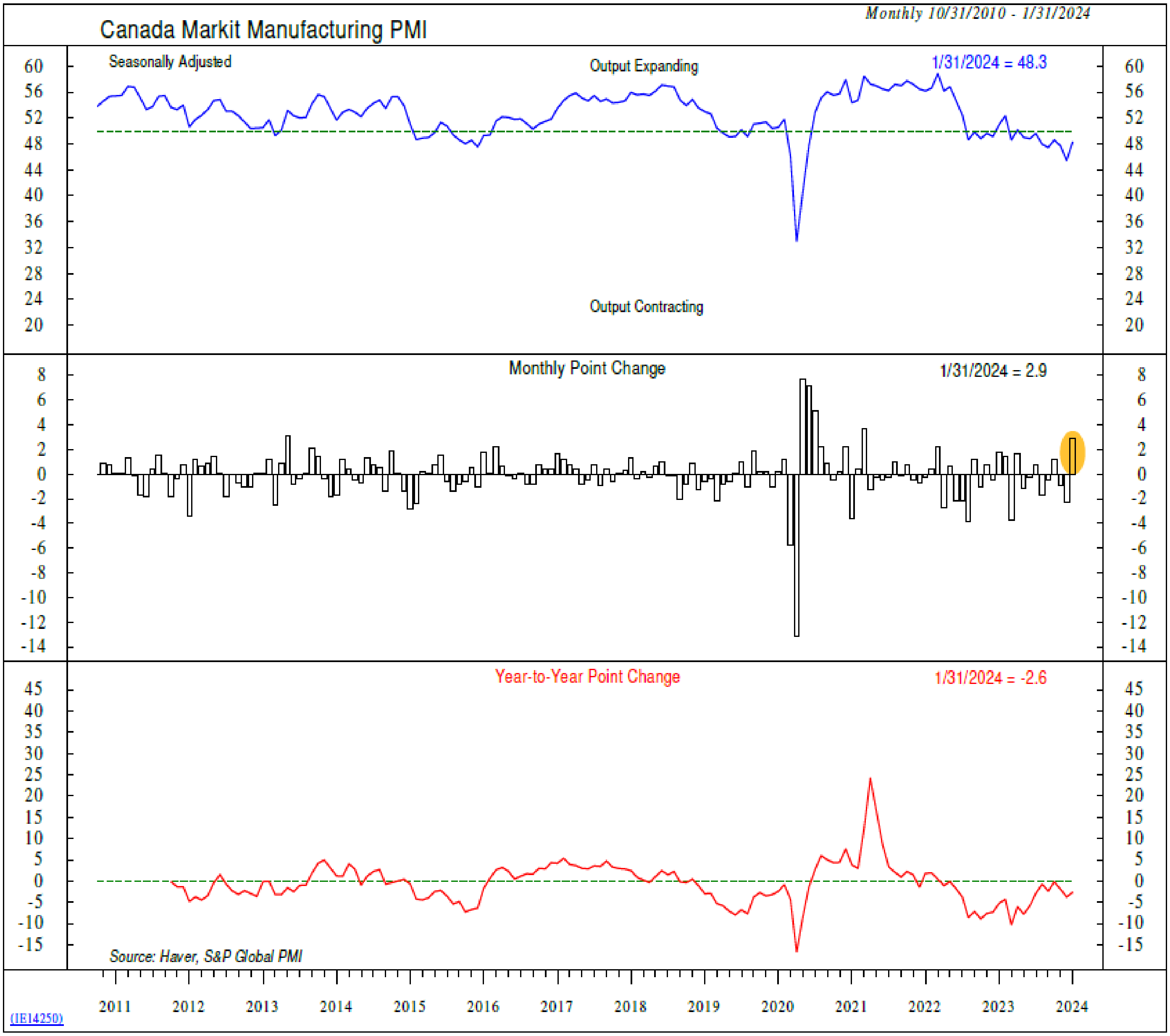
Core Allocations

Canada maintained the largest relative overweight allocation as the market's trend continues to move higher with strengthening long-term breadth. The Canadian economy is likely to have bounced higher during the final quarter of 2023 as manufacturing and trade rebounded. Canada produced one of the largest month-over-month gains in the manufacturing PMI for January (Figure 4).

The Bank of Canada held its policy rate steady for a fourth consecutive meeting and stated that it won't need to increase it again if the economy performs in line with its forecasts.

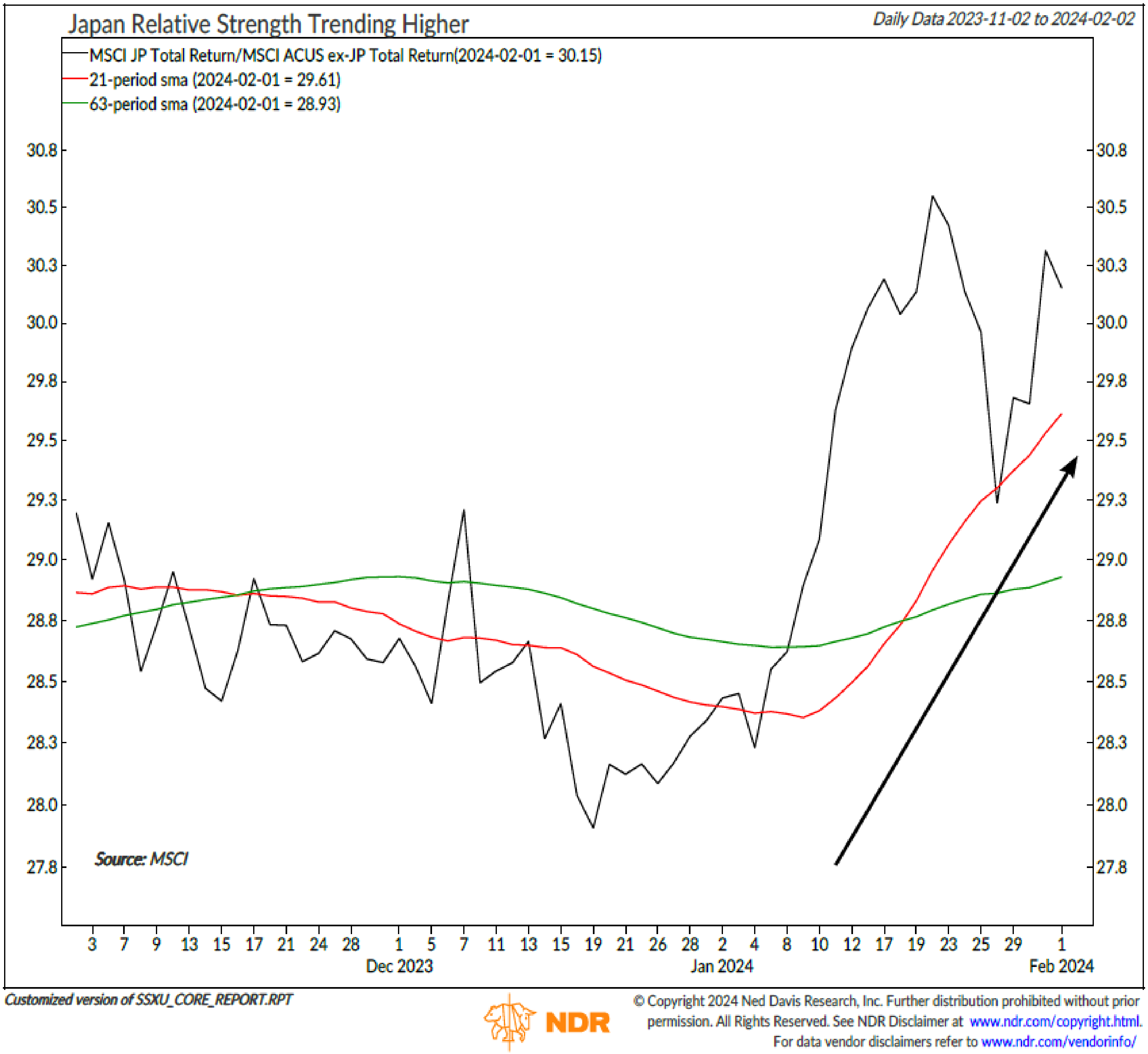
Figure 4: Canada Markit Manufacturing PMI



Japan's allocation is neutral, though is our largest weighting due to its weight in the ACWX index. Models show that measures of trend (Figure 5) and breadth remain positive.

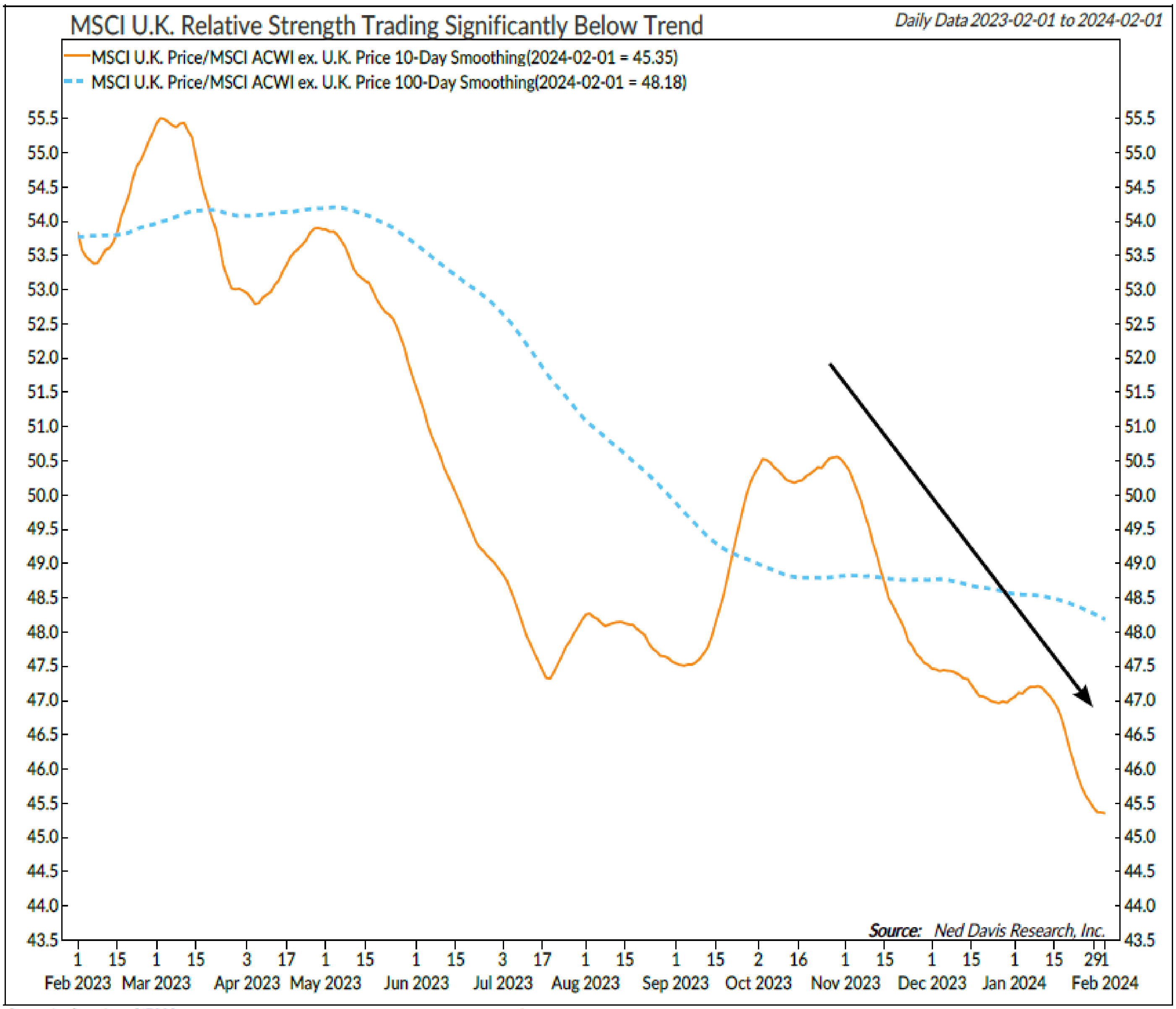
The Japanese government unveiled a $113 billion stimulus package in November consisting of tax cuts and subsidies to low-income households dealing with higher inflation. Also, another year of constructive wage negotiations increases the possibility of Japan getting out of its deflationary spiral, which may allow the Bank of Japan to normalize monetary policy.

Figure 5: Japan Relative Strength Trending Higher



The U.K. remained underweight for this month. Economic trends are still lackluster. Real GDP growth was flat in Q3, with data since then suggesting continued stagnation. High interest rates, inflation eating into consumer purchasing power, ebbing labor market trends, and the structural downside associated with Brexit continue to serve as a drag on the economy. However, Bank of England (BoE) Governor Andrew Bailey recently noted that the BoE may lag the Federal Reserve and the European Central Bank (ECB) in cutting rates. The market recognizes these risks as equities remain in a downtrend (Figure 6) with weak breadth. None of the region's technical indicators are bullish.

Figure 6: MSCI U.K. Relative Strength Trading Significantly Below Trend

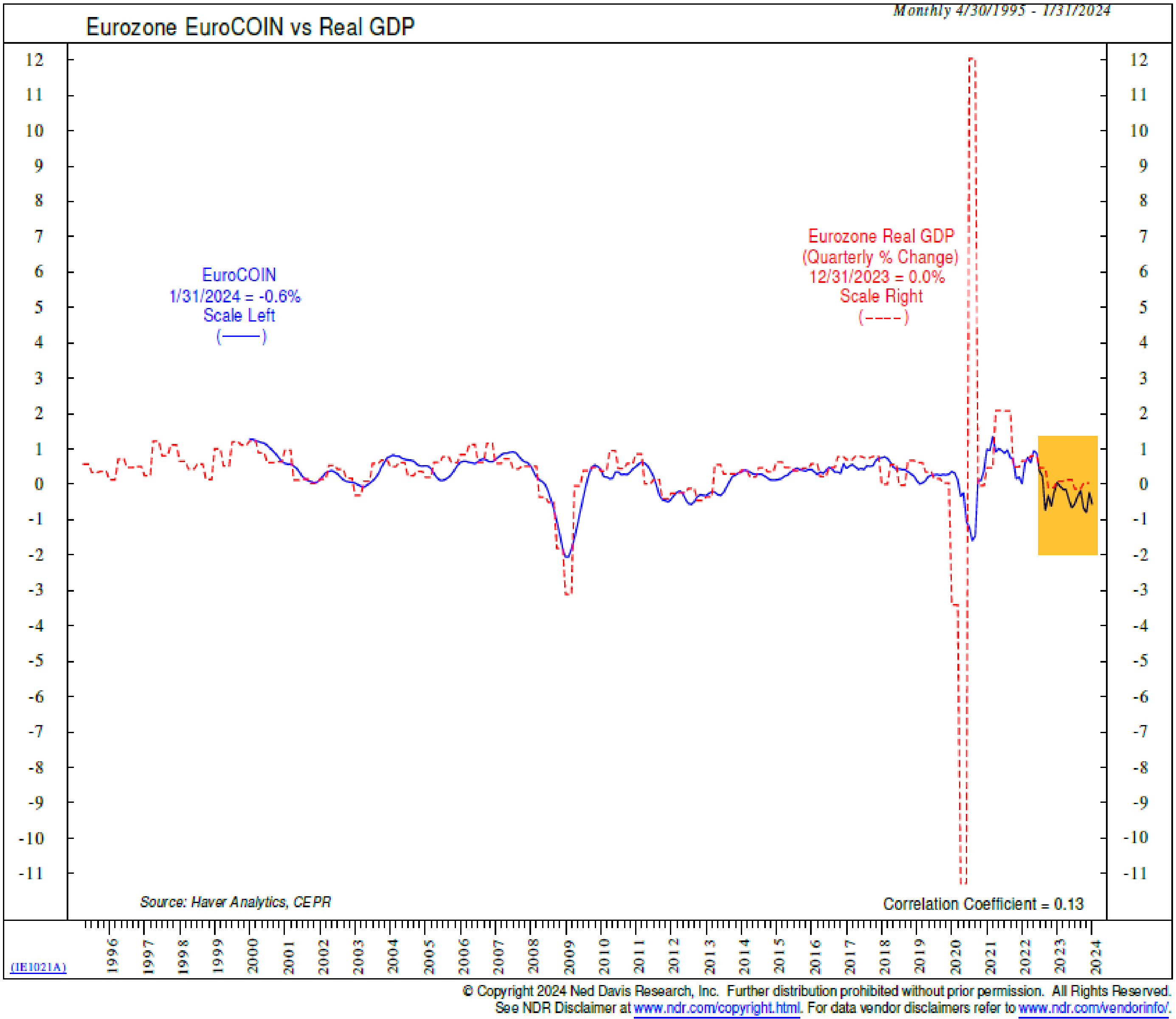


France and Switzerland maintained underweight positions for February due to macro and fundamental weaknesses. The outlook has deteriorated as inflation remains elevated and the ECB's most aggressive tightening cycle on record works its way into the economy.

Monthly GDP proxies remain at levels consistent with economic decline. The Now-Casting Index of Economic Activity, with a reading of 89.3 for January, is well below its long-term average of 100. Moreover, the EuroCOIN, which aims to estimate quarterly GDP, declined 0.6% last month (Figure 7).

Similarly, the composite PMI for the eurozone held in contraction territory for an eighth straight month in January, a condition also historically associated with declines in real GDP. The manufacturing sector has been doing poorly for some time, while the more services-heavy economies in the region have held up better. But even there, there has been weakness in recent months.

Figure 7: Eurozone EuroCOIN vs Real GDP



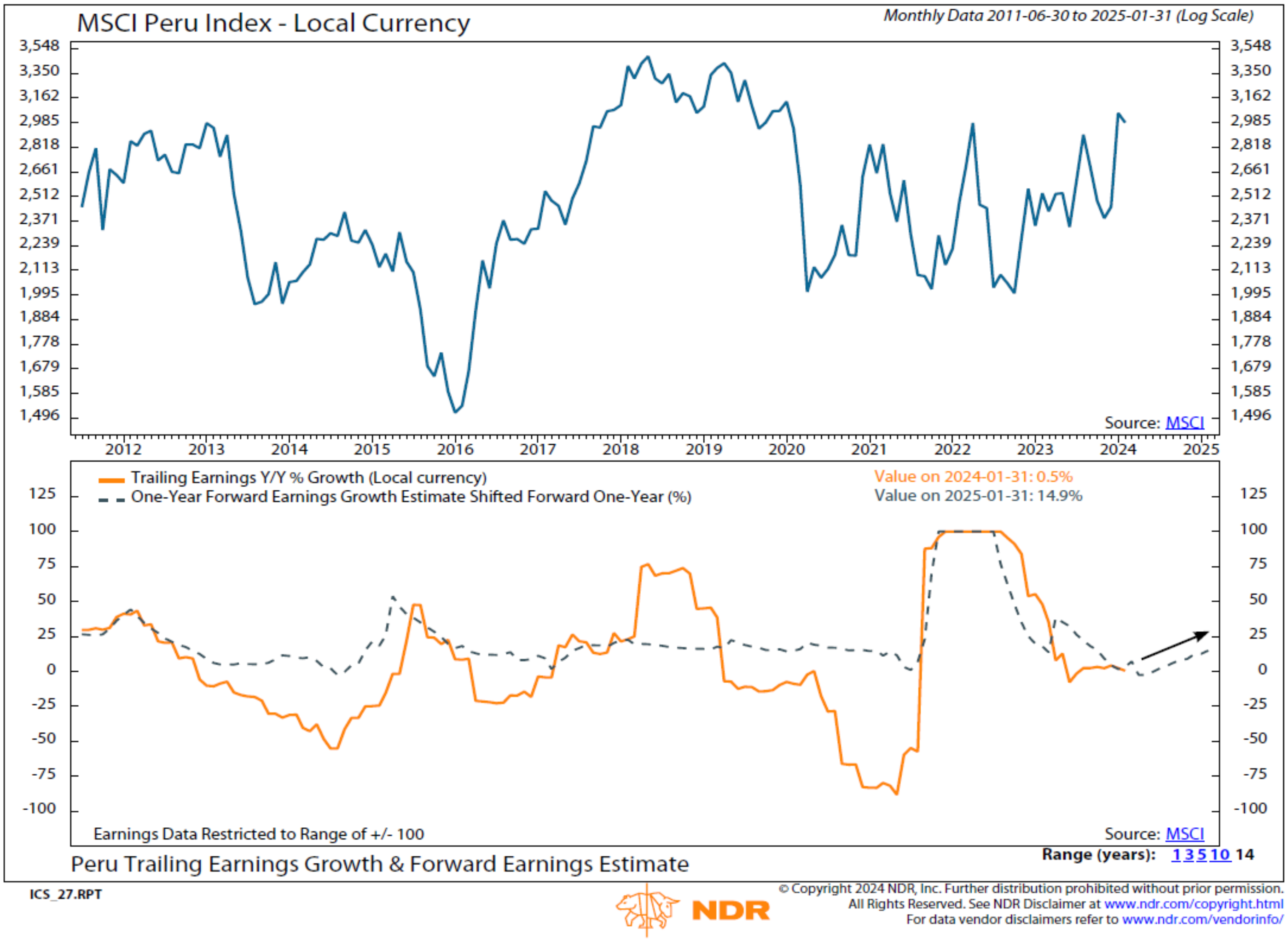
Explore Opportunities

Among the top-ranked Explore markets are Brazil, Peru, Spain, Poland, and the Philippines.

- All markets have favorable price trends as their 50-day moving averages trade above their 200-day counterparts.
- Brazil, Peru, and Spain are one standard deviation oversold. Such oversold conditions may provide a near-term bounce opportunity.
- All markets have low market capitalization-to-GDP ratios, which typically indicates a favorable valuation.
- Poland and Spain have two of the largest relative valuation spreads between their respective earnings yields and 10-year government bond yields.
- All markets trade below their average cyclically adjusted price-to-earnings ratios.

- Peru has a double-digit one-year forward earnings growth estimate (Figure 8).
- All markets have over 50% of stocks with positive earnings revisions from analysts.
- Spain and the Philippines have two of the five strongest year-over-year earnings growth readings.

Figure 8: MSCI Peru Index – Local Currency



Summary

Entering February, the non-U.S. equity Core model overweighted Canada and Germany. Japan was neutral, while the U.K., China, France, Australia, and Switzerland were underweight. The Explore model favored Brazil, Peru, Spain, Poland, and the Philippines.

The models combine macro, fundamental, technical, and sentiment indicators to identify opportunities and risks in an objective, weight-of-the-evidence approach

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 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 U.S. 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 will reverse toward being fully invested.

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