Smart Sector® International Strategy

MAY 2023

Catastrophic Stop Update

The NDR Catastrophic Sell Stop model combines time-tested, objective indicators designed to identify high-risk periods for the equity market. The model (chart at right) improved from last month and entered May with a fully invested equity allocation recommendation.

Figure 1: Smart Sector® Catastrophic Stop Sell Model

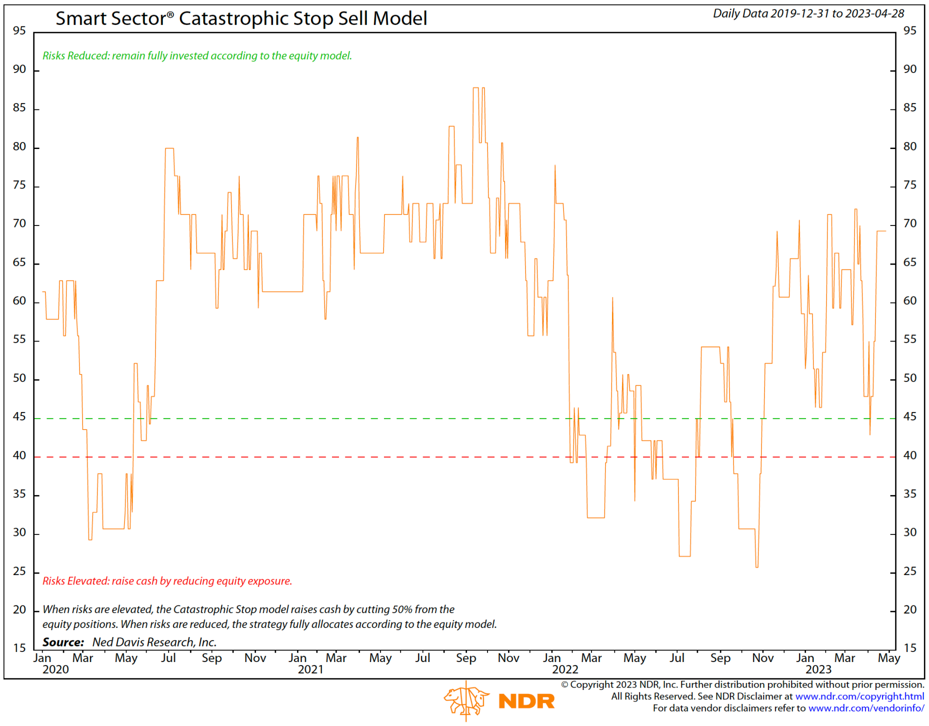
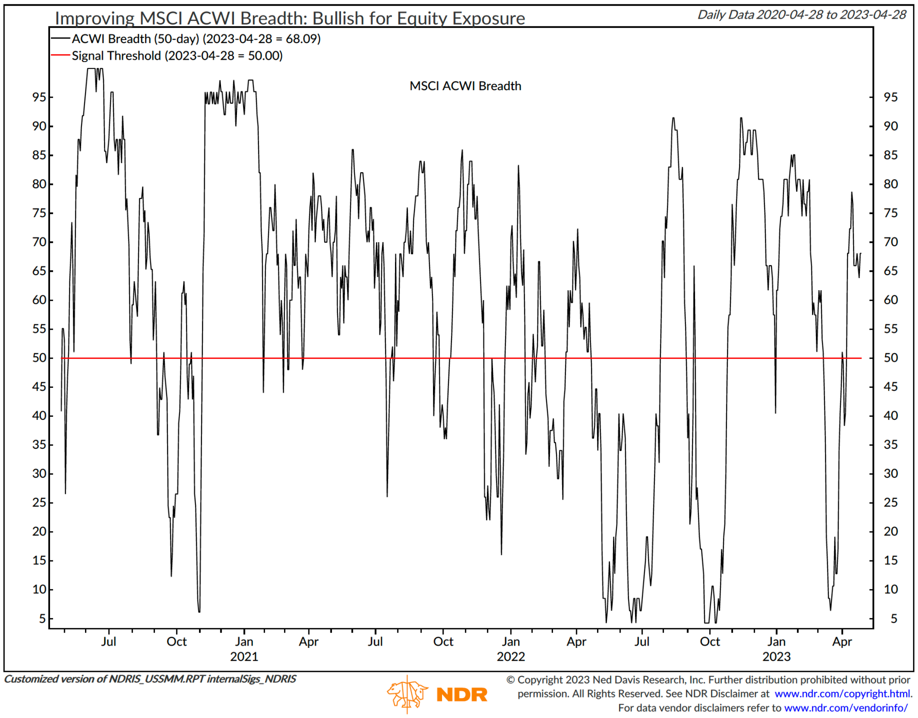


Figure 2: Improving MSCI ACWI Breadth: Bullish for Equity Exposure



The model improvement was mostly driven by stronger technicals—stock/bond relative strength, global stock market breadth (chart at left), and stock market short-term trend all improved to bullish levels during the month. In terms of external influences, the breadth for High Yield and Emerging Market bonds and global trade (as measured by the Baltic Dry Index) remains bullish, while high-yield option-adjusted spreads remain bearish.

If stock volume demand outpaces supply and spreads narrow, then it could indicate that the rally could be sustained. Conversely, if the stock market weakens in the near term and investors return to fears of a recession, the stock market rally could be short-lived.

Global Market Update

The ACWI ex. U.S. Total Return Index increased by over 180 basis points in April. The index has risen by more than 175 bps for five of the last seven months. Among the strongest-performing markets were Poland, United Arab Emirates, Hungary, Saudi Arabia, and Colombia, while the largest underperformers included China, Turkey, Thailand, Netherlands, and Taiwan.

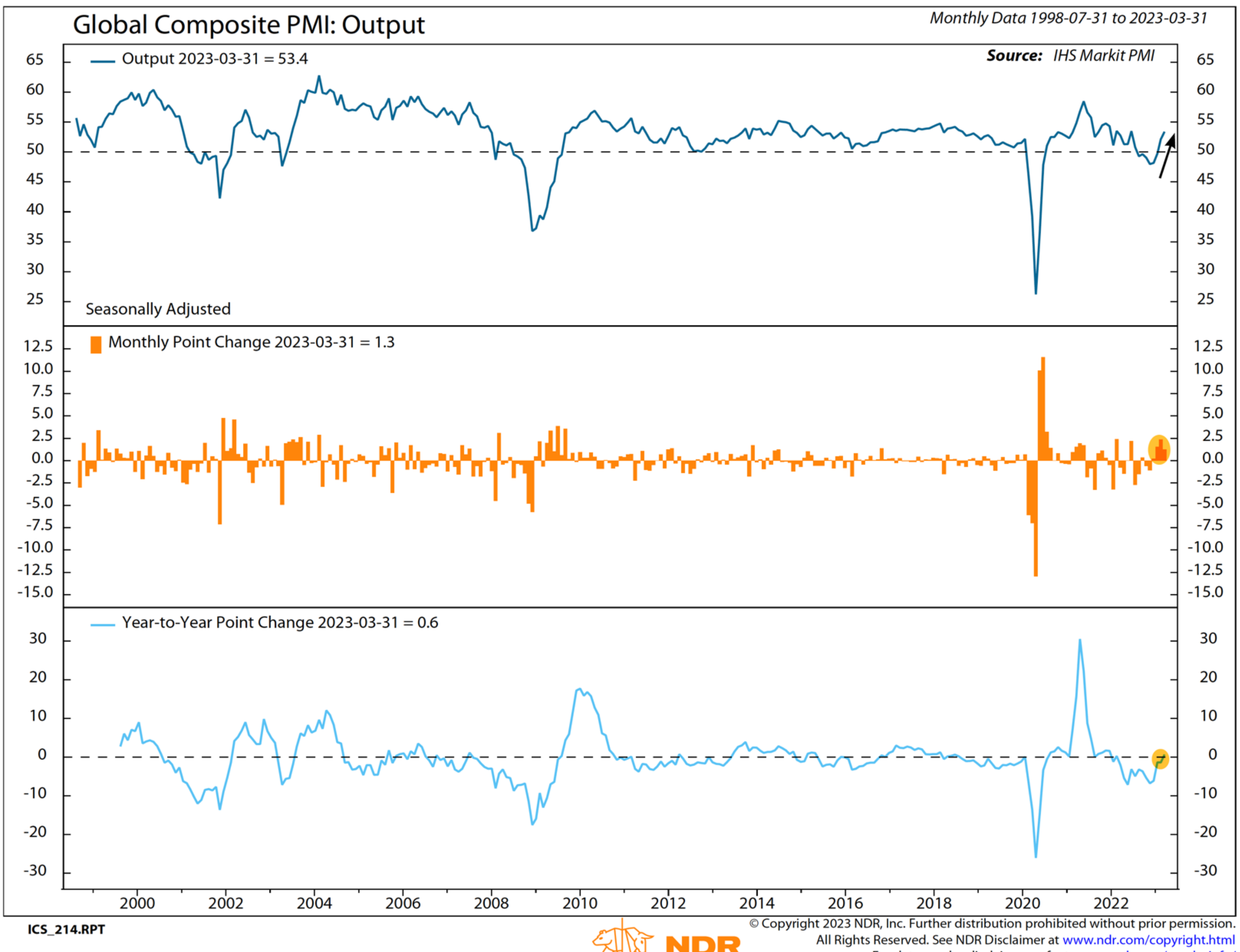
The global economy continued to accelerate through March, according to the S&P Global Purchasing Managers' Index (PMI) readings. The global composite PMI jumped to its highest level in nine months (chart at bottom). The reading marked the fourth straight increase in the PMI and the second straight month of expansion. When the global economy has been accelerating, it's historically been associated with outperformance in global equities.

Unfortunately, the global economic outlook reflected some cracks under the surface. Although services sector growth remained broad and healthy, the manufacturing PMI slipped back into contraction territory, while breadth in the sector weakened significantly. Moreover, the composite future output index ticked down for the first time in five months. While it remains elevated, it suggests that global growth may peak in the first half of the year.

History suggests that the past year's tight monetary policy will continue to limit the upside in the global economy in the coming months. The March banking crisis provides another overhang to the global economy, as it will likely be associated with tighter credit conditions over the near term. Moreover, stubbornly high inflation, especially in the services sector, may keep central banks tighter for longer, increasing the risk of recession, possibly in late 2023 or early 2024.

Entering May, the non-U.S. equity Core model overweighted France, Germany, and Switzerland while underweighting Australia, Japan, and China. Canada and U.K. are market-weight. The Explore model favored the Netherlands, Mexico, Singapore, South Korea, the Philippines, and Spain.

Figure 3: Global PMI: Output



Core Allocations

France's allocation continues to be above benchmark weighting. The market generated a new all-time high toward the end of April (chart at right). All of France's indicators in this model are bullish. The trend is positive as the market trades above its 50- and 200-day moving averages, and breadth has strongly improved. The strengthening technical indicators reflect macroeconomic and fundamental improvement. France's services PMI remains in expansionary territory. Earnings growth continues to be positive on a year-over-year basis.

Figure 4: MSCI France Price Return Index (in local currency)

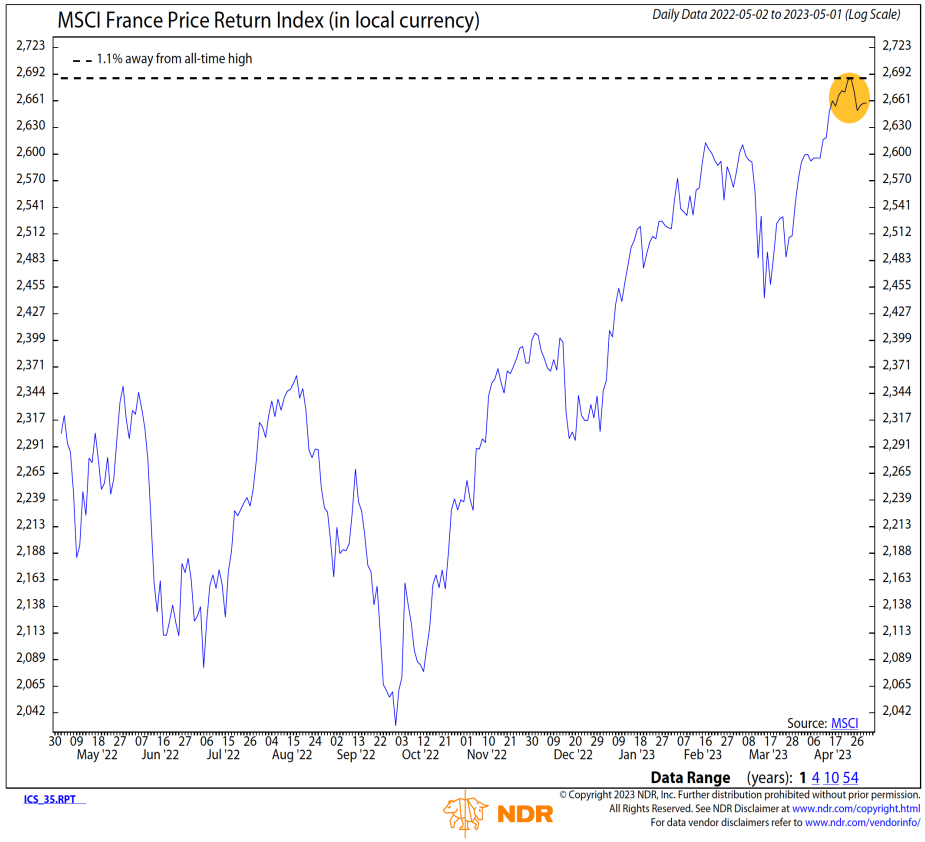
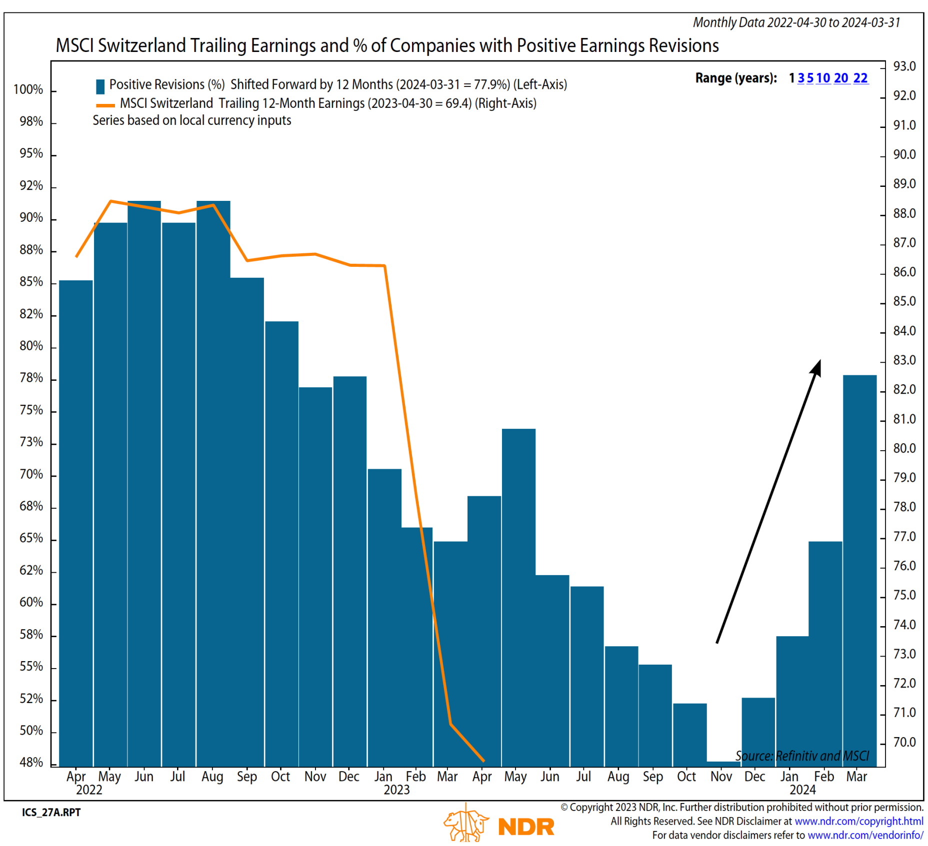


Figure 5: MSCI Switzerland Trailing Earnings and % of Companies with Positive Earnings Revisions



Switzerland's allocation continues to be above benchmark weighting. One-year forward earnings estimates have been increasing (chart at left), as UBS's takeover of Credit Suisse likely reduced financial disruptions. The Swiss National Bank is expected to end its tightening cycle in June, which should reduce monetary headwinds. Technical indicators reflect the improving macro-outlook as trend, momentum, and breadth indicators are bullish.

Japan fell further underweight. Although near-term earnings growth has improved and monetary policy remains easy, there are risks. The market's trend reversed lower on extremely optimistic sentiment and a weakening manufacturing outlook in China (chart at right), which tends to lead Japanese economic activity.

Figure 6: China PMI Trends to Lead Japan: Currently Trending Lower

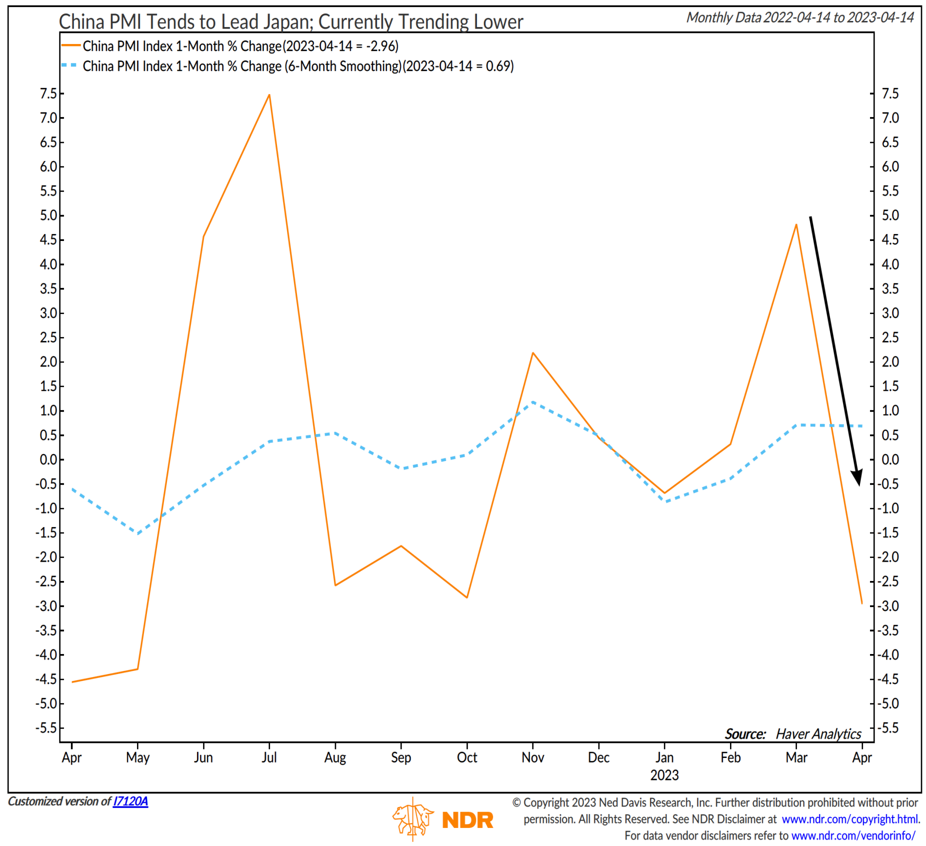
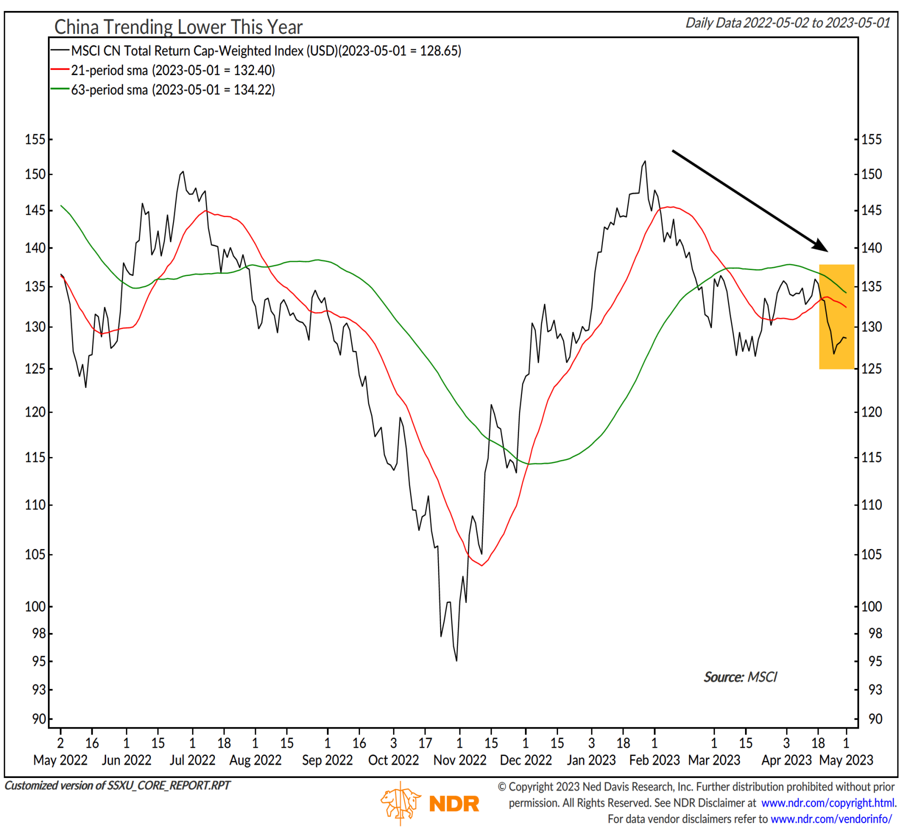


Figure 7: China Trending Lower This Year



China continues to receive below benchmark allocation. China's economy rapidly accelerated due to the end of zero COVID. The official composite PMI jumped to its best level since data began in 2017. The acceleration, however, was led entirely by the services sector, as manufacturing nearly ground to a halt. Services growth is likely to ease as the year progresses as pent-up demand from the lockdowns is satisfied. With manufacturing lagging, this suggests that China's growth for this year will mostly be front-loaded. The market's relative strength, absolute price trend (chart at left), and momentum all reflect expected headwinds. Emerging Market high-yield credit spreads have widened, showing concerns in the fixed-income market.

Explore Opportunities

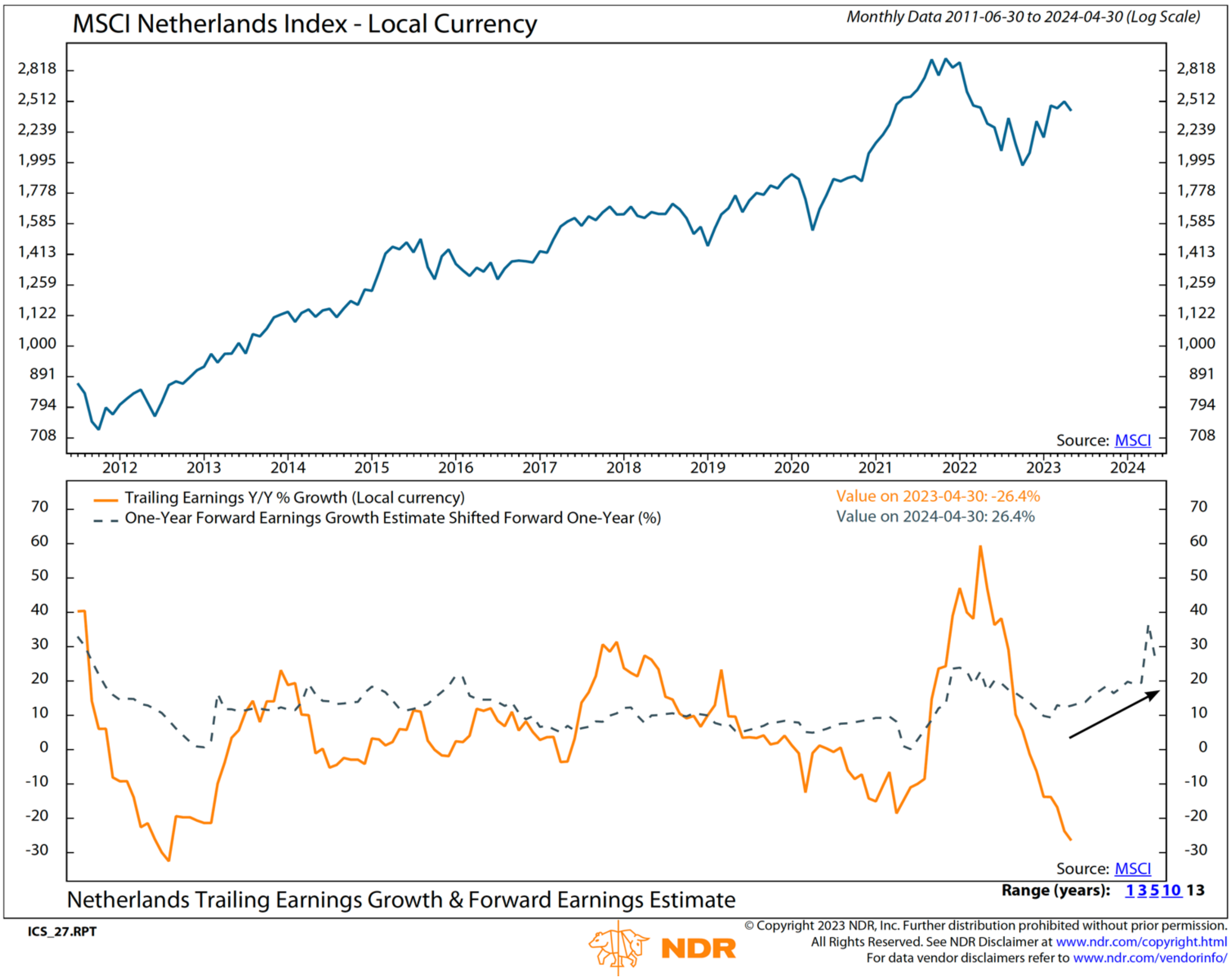
To select smaller markets, the fund uses a multi-factor technical ranking system to choose the top markets. Among the top-ranked Explore markets are the Netherlands, Mexico, Singapore, South Korea, the Philippines, and Spain:

- Singapore, Netherlands, South Korea, Mexico, Spain, and Turkey have favorable price trends as their 50-day moving averages trade above their 200-day moving averages.
- Over the last five days, Singapore has been more than one standard deviation oversold, which historically has provided a near-term bounce opportunity.
- South Korea and Singapore possess cyclically adjusted price-to-earnings ratios (long-term valuation metrics) trading below their historical medians.
- Singapore and Netherlands (chart at bottom) have double-digit one-year forward earnings growth estimates.

Mexico and the Netherlands are supported by positive earnings revisions. Over the past three months, the percentages of increasing estimates (for the current fiscal year) are 81.1% and 85.7%, respectively.

The forward P/Es for our Explore holdings are Netherlands (17.3x), Mexico (12.4x), Singapore (12.2x), South Korea (14.1x), Philippines (13.8x), and Spain (10.3x). All are below the U.S. forward P/E of 18.4x. (Using MSCI Country Indexes.)

Figure 8: MSCI Netherlands Index – Local Currency



Summary

The Catastrophic Stop model remains with a fully invested Core and Explore allocation entering May.

The non-U.S. equity Core model overweighted France, Germany, and Switzerland while underweighting Australia, Japan, and China. Canada and U.K. are market-weight. The Explore model favored the Netherlands, Mexico, Singapore, South Korea, the Philippines, and Spain.

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

Smart Sector® Strategy

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 is trimmed 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 immediately moves back to fully invested.

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