

DECEMBER 2023

## Catastrophic Stop Update

The NDR Catastrophic Stop Sell model combines time-tested, objective indicators designed to identify high-risk periods for the equity market. On November 20, we increased equity exposure by 25% due to the model moving above 45% for two consecutive days, putting current equity exposure at 75%.

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.

Of the many thousands of indicators in its vast library, NDR's most popular indicator is its Daily Trading Sentiment Composite. This indicator composite consists of various measures of market sentiment, including surveys, asset holdings, volume, VIX, SKEW, and put/call ratios. It combines many individual indicators to represent the psychology of a broad array of

Figure 1: Smart Sector® Catastrophic Stop Sell Model

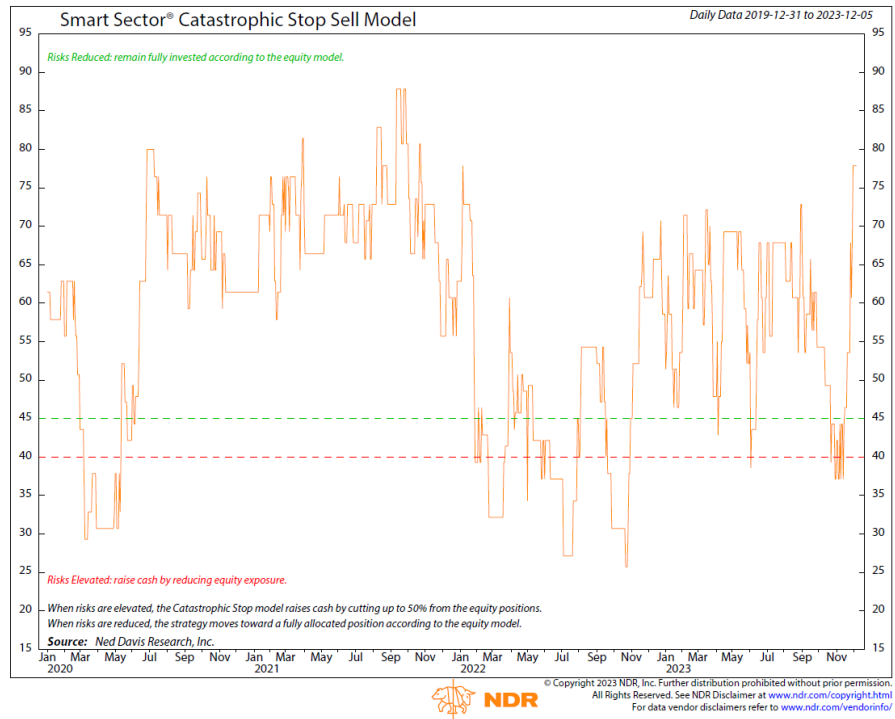
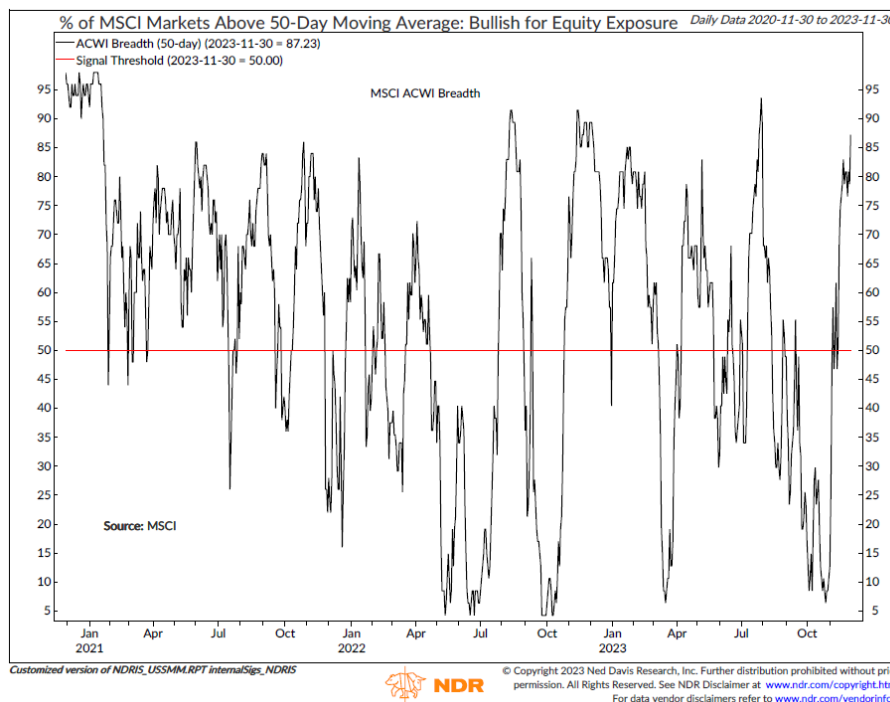


Figure 2: % of MSCI Markets Above 50-Day Moving Average: Bullish for Equity Exposure



investors to identify trading extremes that may be used for contra or hedging trades. Although the overall Catastrophic Stop model changed signals, recommending a fully invested equity position, the Daily Trading Sentiment Composite (an indicator in the Catastrophic Stop model) turned bearish due to near-term excessive optimism. Given the conflicting messaging of the Catastrophic Stop model increasing while the Daily Trading Sentiment Composite reflects near-term caution, we executed the November 20 signal by shifting 25% of the cash holding into equities. We are looking to redeploy the remaining 25% cash holding as sentiment eases or longer-term breadth thrust measures confirm the near-term signals.

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.

## Global Market Update

The ACWI ex. U.S. Total Return Index jumped over 900 basis points (bps) in December. It was the best month for the index since November 2022. Among the strongest-performing markets were Egypt, South Korea, Israel, Spain, and Sweden, while the largest underperformers included Hong Kong, Thailand, Singapore, Kuwait, and China.

The global economy stagnated in October, as the S&P Global Purchasing Managers' Index (PMI) global composite (services and manufacturing) fell to the lowest level since January and down significantly from its May peak. It was the fifth straight decline in the composite PMI, the worst streak since 2014, and matched the second longest on record. Successive decreases of this length occurred both during the 2001 and 2008 global recessions, raising concerns about the global economy. However, for now, the PMI is still comfortably above the 47.8

threshold typically associated with severe global recession, giving the current expansion the benefit of the doubt.

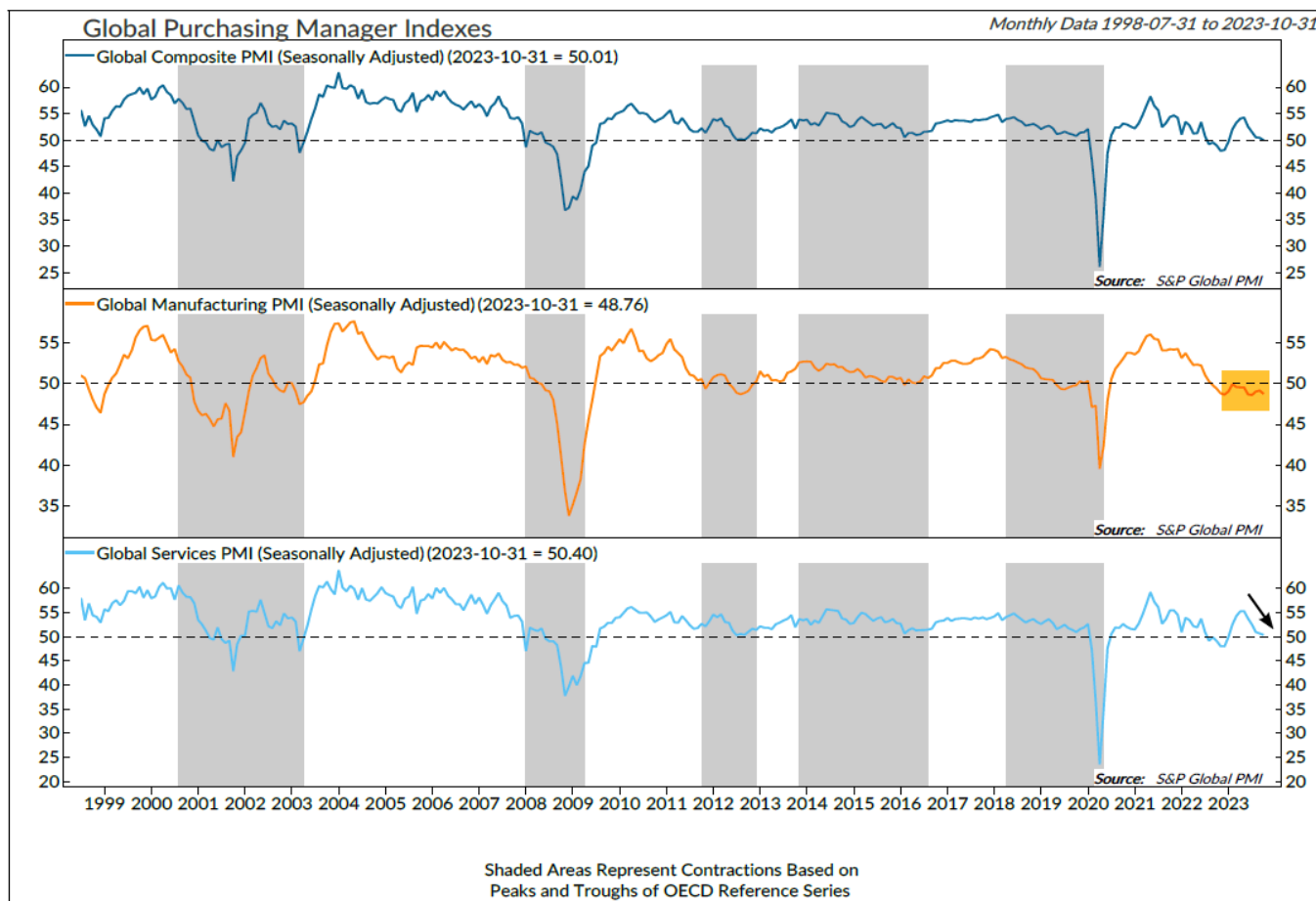
New orders contracted for a second month and at a slightly faster pace, while employment barely grew. The future output index slipped to its lowest level this year. The manufacturing sector contracted at a faster pace after showing signs of stabilization in the prior month, while services modestly grew.

Most of the slowdown since earlier this year has been due to Europe, which is seeing rising recession risk, and the cooling of the Chinese economy following a short-lived rebound earlier this year due to the end of its zero-COVID policy. The outlook now hinges on the U.S., the world's largest economy, where trends there appear to be slowing. The few bright spots continue to be in emerging markets outside of China, namely India and the Middle East.

Global price growth continued to moderate, as both the composite input and output price indexes fell to their lowest levels since Q4 2020. Price growth in the services sector continued to slow as the input and output price indexes fell to their lowest levels since early 2021. Even so, they are still well above pre-pandemic levels. Conversely, manufacturing prices remain in line with pre-pandemic norms but have begun to edge up in recent months as supply chain pressures normalize.

Entering December, the non-U.S. equity Core model overweighted Japan, Canada, Germany, and Switzerland. Australia and France are neutral, while the U.K. and China are underweight. The Explore model favored Brazil, India, Mexico, Poland, and Spain. All allocations are relative to the cash-adjusted benchmark.

Figure 3: Global Purchasing Manager Indexes



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## Core Allocations

Germany moved to the largest relative overweight allocation for December. Although Germany's Manufacturing PMI is in contractionary territory, it has risen from its lows. Most eurozone economic data has stabilized at low levels, indicating that if the region does slip into recession, it's likely to be mild. The European Central Bank is likely done hiking rates. The disinflation trend since the peak of 10.6% one year ago has been a necessary factor underpinning the bullish case for European equities. The market has started to reverse from an oversold condition as valuations are relatively attractive, with the cyclically adjusted price-to-earnings ratio trading below its long-term median (chart right).

Figure 4: MSCI Germany

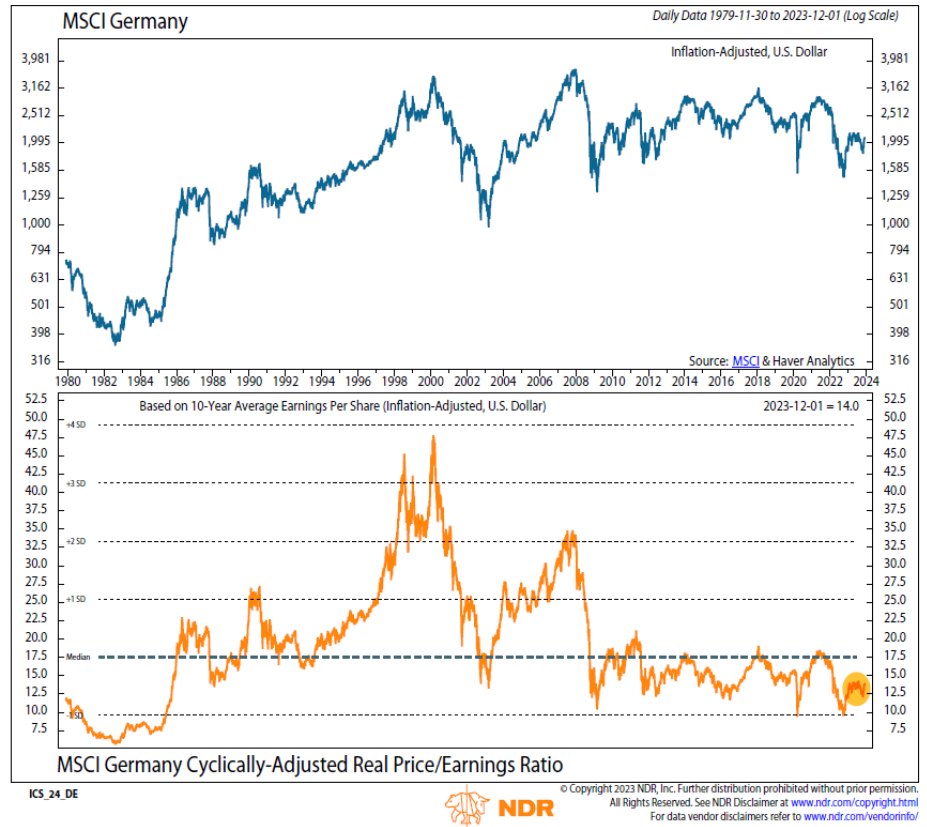
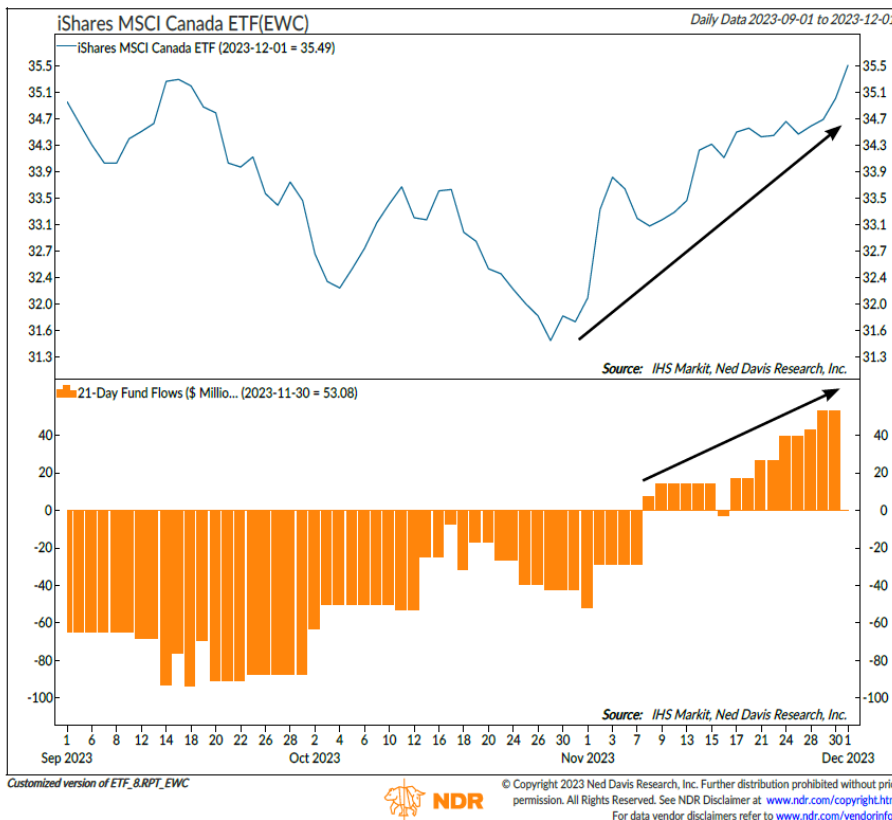


Figure 5: iShares MSCI Canada ETF (EWC)



Canada moved to an overweight allocation as the market reversed higher from an oversold condition, and ETF flows have been positive (chart left). Consumer prices rose at the slowest rate since June, a sign for the Bank of Canada that rates are now high enough to ease inflationary pressures. Relative economic, profitability, and valuation data have weakened but have not deteriorated enough to trigger a bearish signal.

Figure 6: United Kingdom Markit Manufacturing Purchasing Managers' Index (PMI)

The U.K. remained underweight for December. Sentiment has not reached an overly pessimistic condition, economic conditions remain weak, and the equity risk premium does not yet reflect a longer-term opportunity. The U.K.'s manufacturing PMI remains well below expansionary territory (chart right). Business and consumer confidence remain negative. None of the region's technical indicators are bullish.

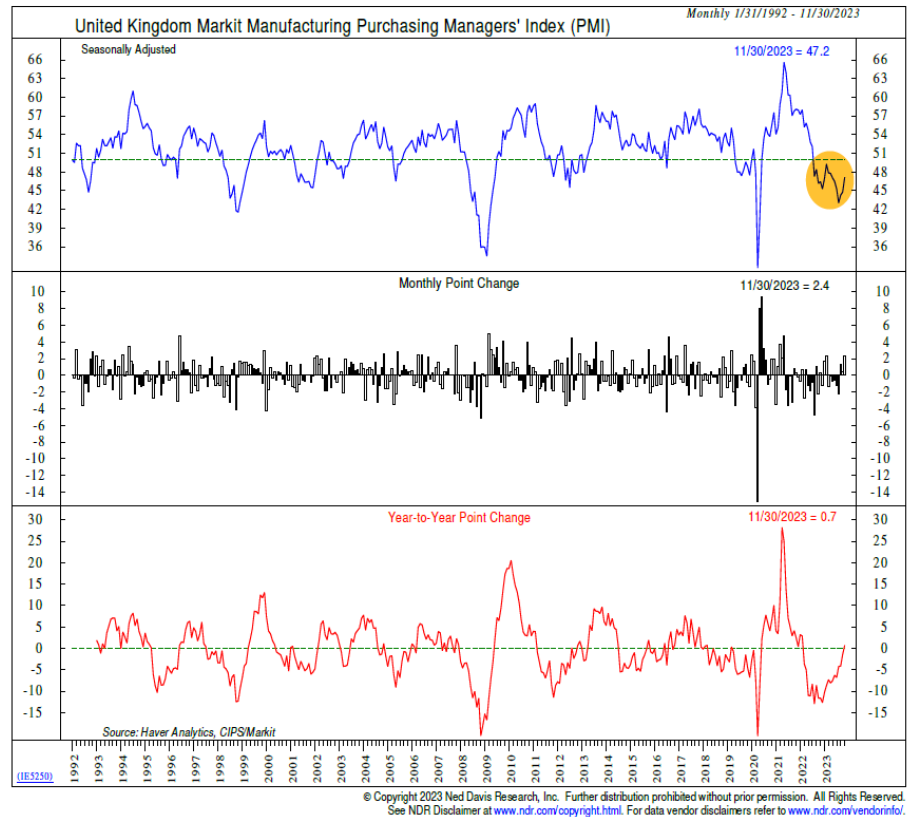
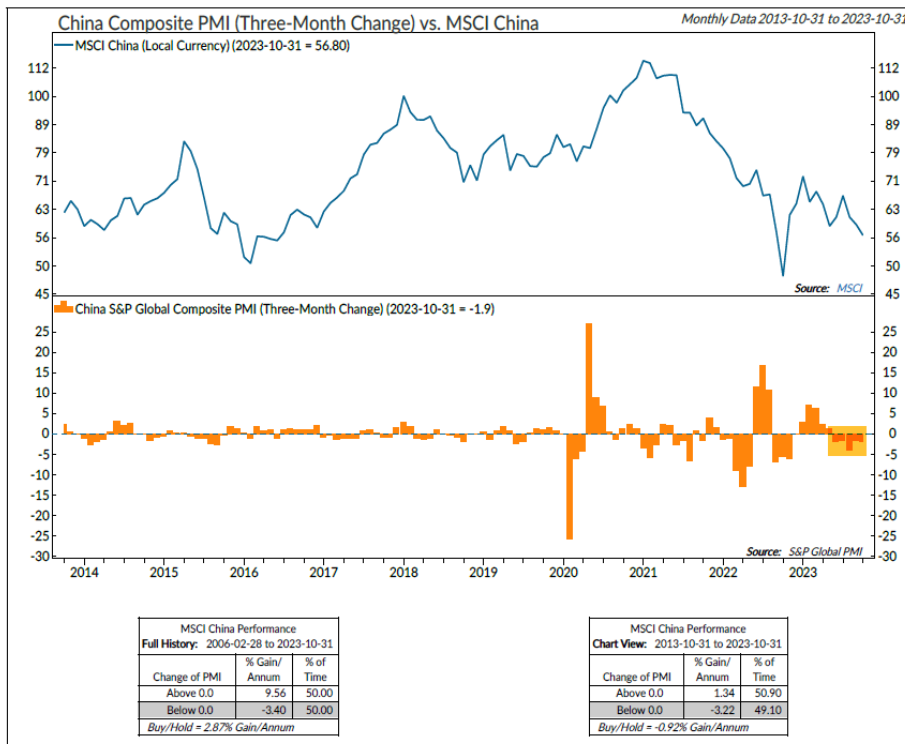


Figure 7: China Composite PMI (Three-Month Change) vs. MSCI China



China's allocation declined this month. Its Caixin Composite PMI fell 0.9 points to 50.0 in October, the lowest reading this year, indicating stagnation (chart left). The services sector grew at a snail's speed, while the manufacturing sector slipped back into modest contraction territory. Although a stream of targeted stimulus may alleviate fears of an economic hard landing, there is little evidence of a sizable rebound. Consumer and business sentiment remains depressed, the property market is in distress, and high debt, especially at the local government level, points to little appetite for any significant fiscal and monetary stimulus.

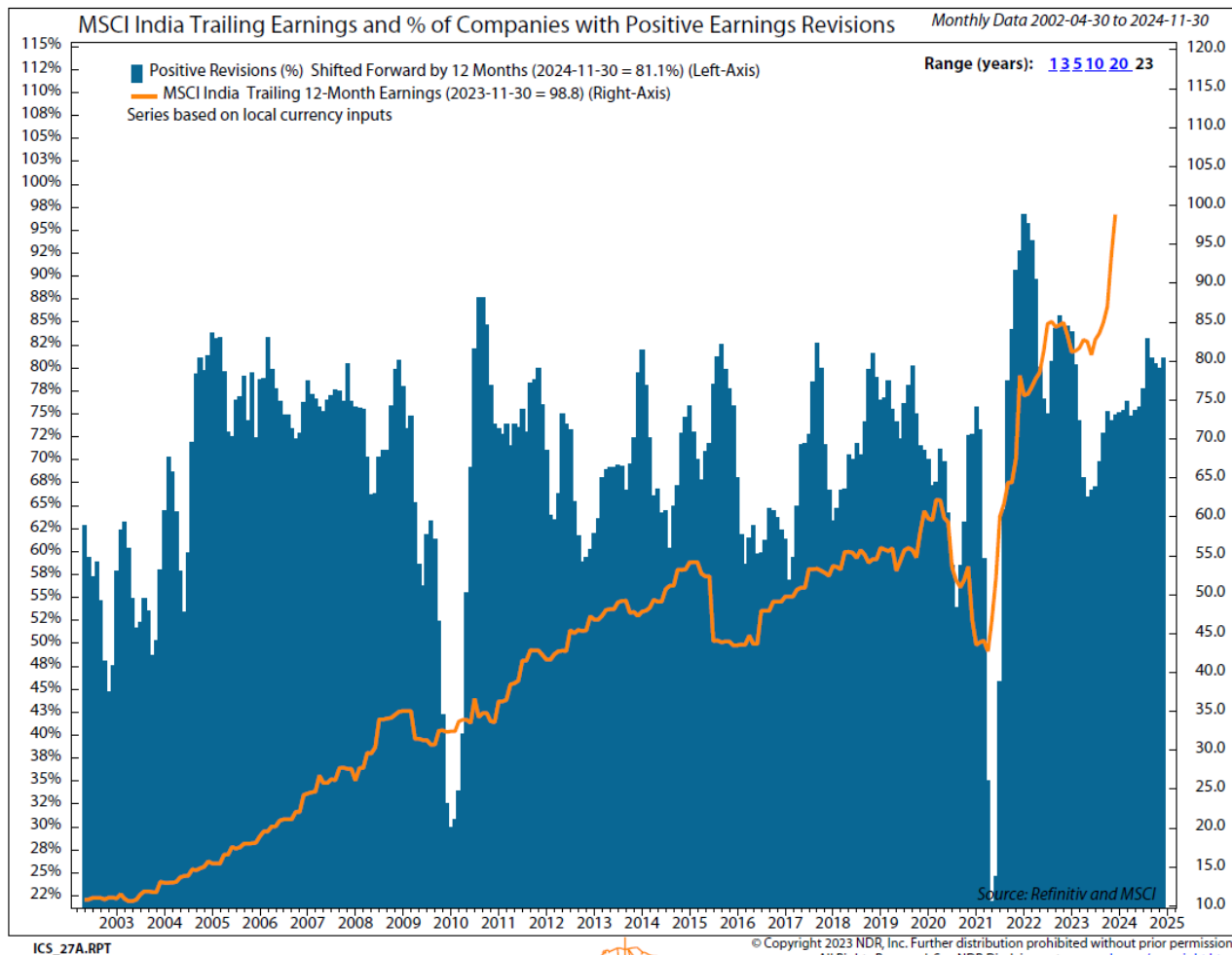
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## Explore Opportunities

Among the top-ranked Explore markets are Brazil, India, Mexico, Poland, and Spain:

- Brazil, India, Poland, and Spain have favorable price trends as their 50-day moving averages trade above their 200-day counterparts.
- Mexico is almost one standard deviation oversold, which may provide a near-term bounce opportunity.
- All have low market capitalization-to-GDP ratios, which typically indicate a favorable valuation.
- Brazil, Mexico, Poland, and Spain trade below their average cyclically adjusted price-to-earnings ratios.
- India's and Mexico's composite PMIs reside in the expansionary zone.
- Neither Mexico's nor India's Composite Leading Indicators are in contractionary territory.
- India has a double-digit one-year forward earnings growth estimate.
- Brazil and India (chart bottom) have over 75% of stocks with positive earnings revisions from analysts.

Figure 8: MSCI India Trailing Earnings and % of Companies with Positive Earnings Revisions



## Summary

Given the conflicting messaging of the Catastrophic Stop model increasing while the Daily Trading Sentiment Composite reflects near-term caution, we executed the November 20 signal by shifting 25% of the cash holding into equities. We are looking to redeploy the remaining 25% cash holding as sentiment eases or longer-

term breadth thrust measures confirm the near-term signals.

Entering December, the non-U.S. equity Core model overweighted Japan, Canada, Germany, and Switzerland. Australia and France are neutral, while the U.K. and China are underweight. The Explore model favored Brazil, India, Mexico, Poland, and

Spain. All allocations are relative to the cash-adjusted benchmark.

The models combine macro, fundamental, technical, and sentiment indicators to determine opportunities and identify 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 utilizes 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 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.

For more information, please contact us at:

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