Smart Sector® International Strategy

OCTOBER 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. The model (chart right) deteriorated from last month but entered October with a fully invested equity allocation recommendation.

Figure 1: Smart Sector® Catastrophic Stop Sell Model

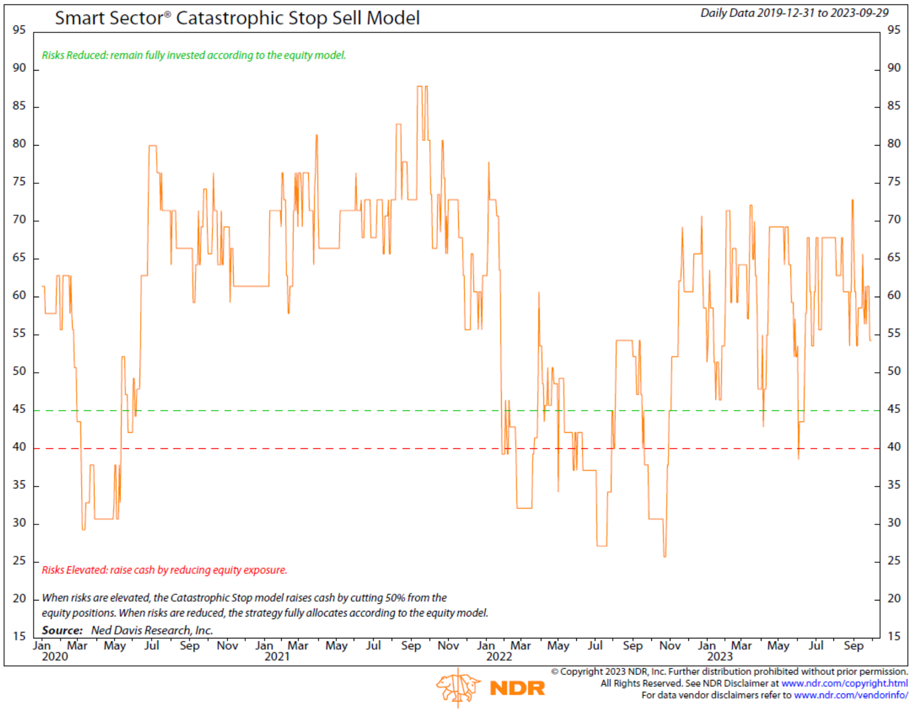


Figure 2: Volume Supply Exceeding Demand: Bearish for Equity Exposure

The model's overall reading is driven primarily by bullish external influences such as trade, market sentiment, and high-yield spreads. However, price-based measures have weakened during the month—three additional indicators flashed a sell signal including supply vs. demand (chart left). For now, the weight-of-the-evidence recommends a fully invested allocation to non-U.S. equity markets according to the model.

Global Market Update

The ACWI ex. U.S. Total Return Index declined by over 310 basis points (bps) in September. The index dropped more than 300 bps for two consecutive months for the first time since last August and September. Among the strongest-performing markets were Egypt, the United Arab Emirates, Turkey, Norway, and the Philippines, while the largest underperformers included Poland, Ireland, Greece, Thailand, and Peru.

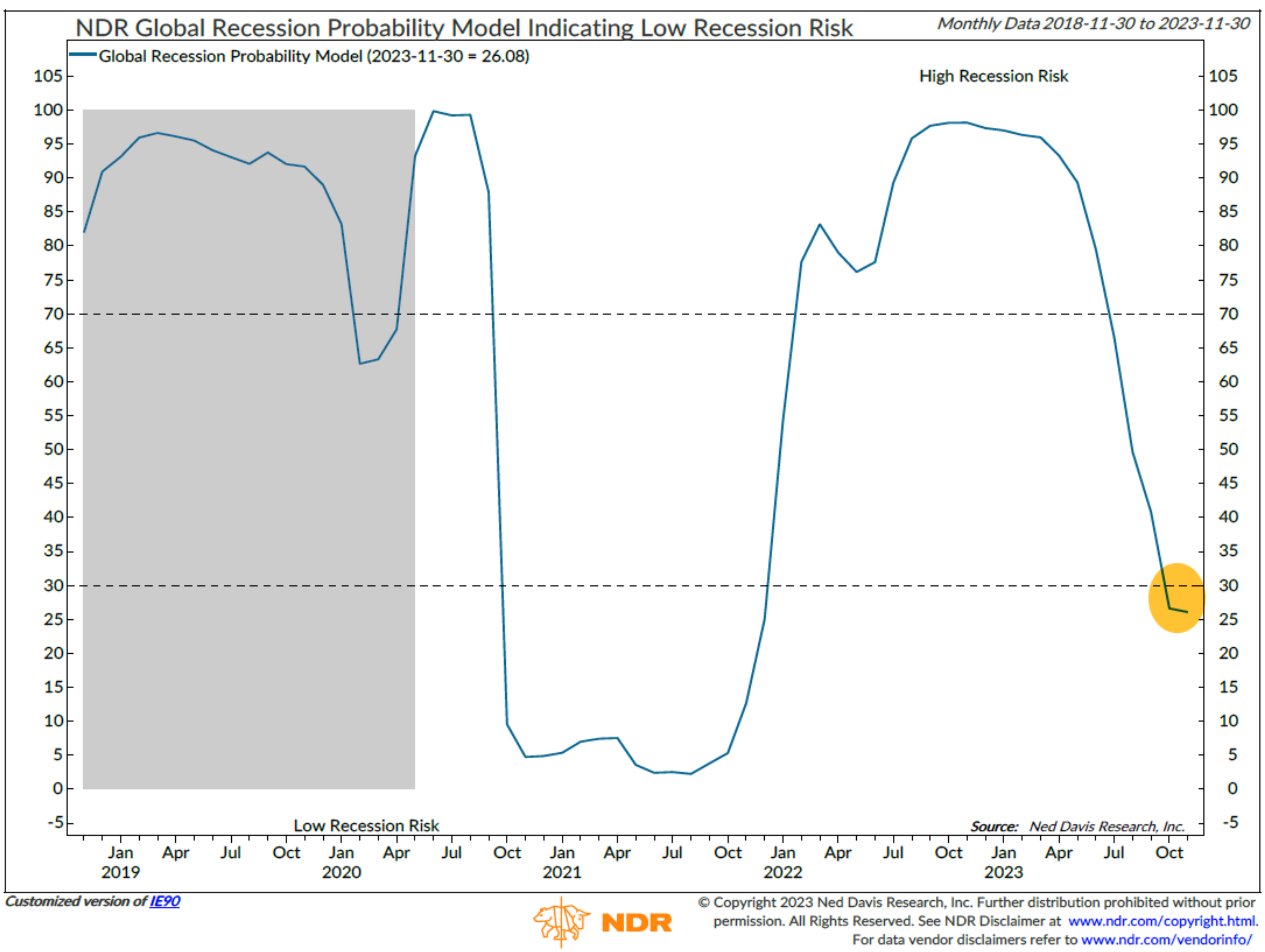
The global economy saw momentum ease for a third straight month in August, according to the S&P Global Purchasing Managers' Index (PMI) data. The global composite (services and manufacturing) PMI fell for a third straight month to its weakest reading since January. Despite the moderating expansion, there isn't sufficient evidence to suggest that the global economy is entering a severe recession (chart bottom), which historically has been associated with the worst equity bear markets.

However, the risk of sustained moderate global slowdown is a real possibility amid diverging trends among the world's economies. Europe, which was a major source of rising momentum in the first half of the year, has seen activity ease markedly in recent months and is even flirting with the prospect of recession. Trends in China and the U.S. remain positive, but not as much as the first half of the year, while Japan and several large emerging markets, such as India, continue to report robust activity.

Services growth has slowed significantly since peaking in May, while the manufacturing sector, which has been in the doldrums for a year, appears to be stabilizing. Although it was the 12th straight month of contraction, it was the first time in six months that manufacturing activity shrank at a slower pace, indicating some stabilization in the sector. Both output and new orders contracted at their slowest pace in three months, while employment grew at its fastest pace in six months. The global bullwhip, which assesses the balance of new orders relative to inventories, moved up to its best level since March, with a rising share of economies contributing to the improvement.

Entering October, the non-U.S. equity Core model overweighted Japan, was marketweight China, Canada, and Australia, and underweight the U.K., France, Switzerland, and Germany. The Explore model favored Brazil, India, Italy, Peru, and Poland.

Figure 3: NDR Global Recession Probability Model Indicating Low Recession Risk



Core Allocations

Australia's allocation was reduced and is now marketweight for October. On a local currency basis, the MSCI Australia Index is less than 10% from its all-time high. The Reserve Bank of Australia recently kept its core interest rate steady, as it noted that its forecast is for "CPI inflation to continue to decline and to be back within the 2–3 percent target range in late 2025." The market's cyclically adjusted P/E ratio is giving a favorable reward-to-risk ratio (chart right) and relative valuations remain attractive.

Figure 4: MSCI Australia 10-Year Real Annualized Price Returns Based on Price/Average 10-Year Earnings

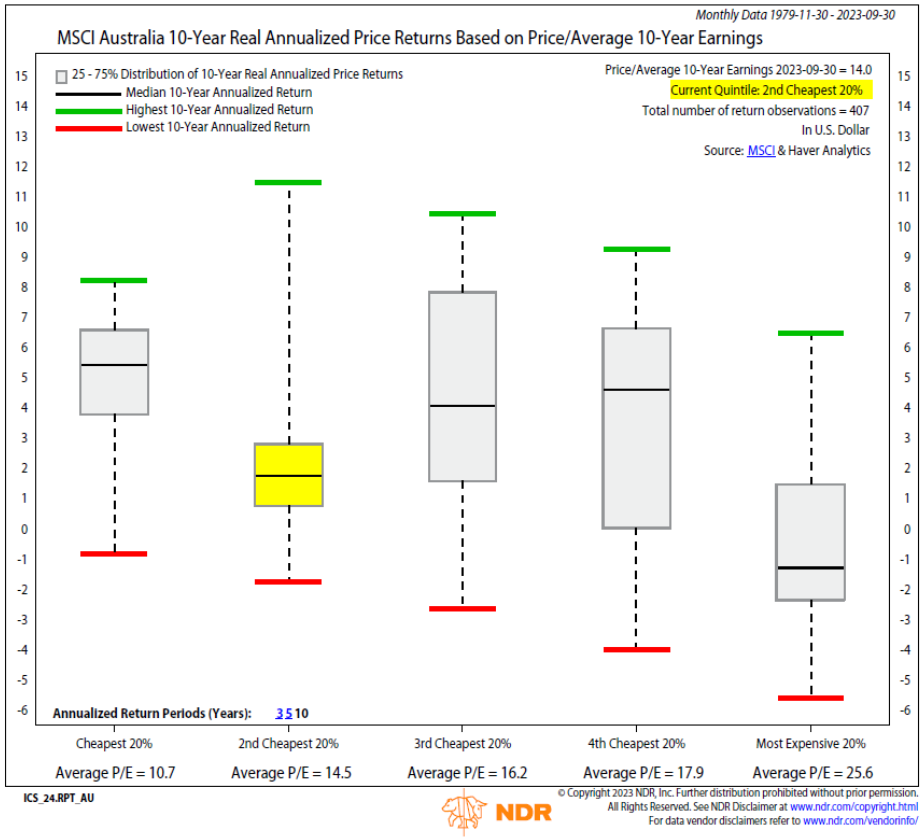
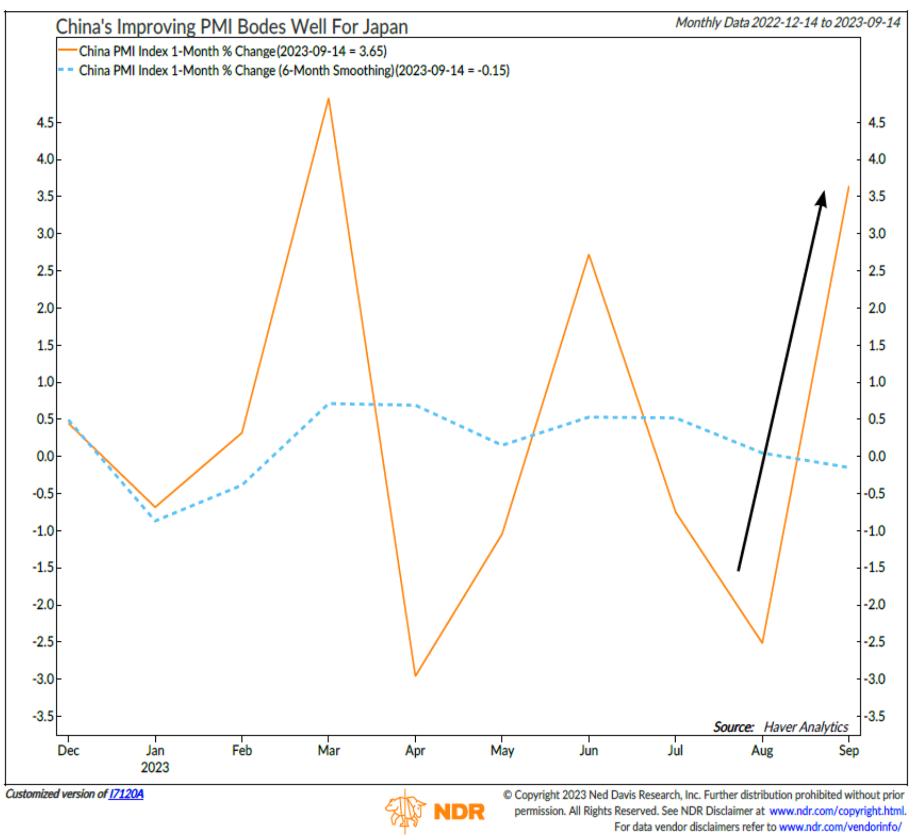
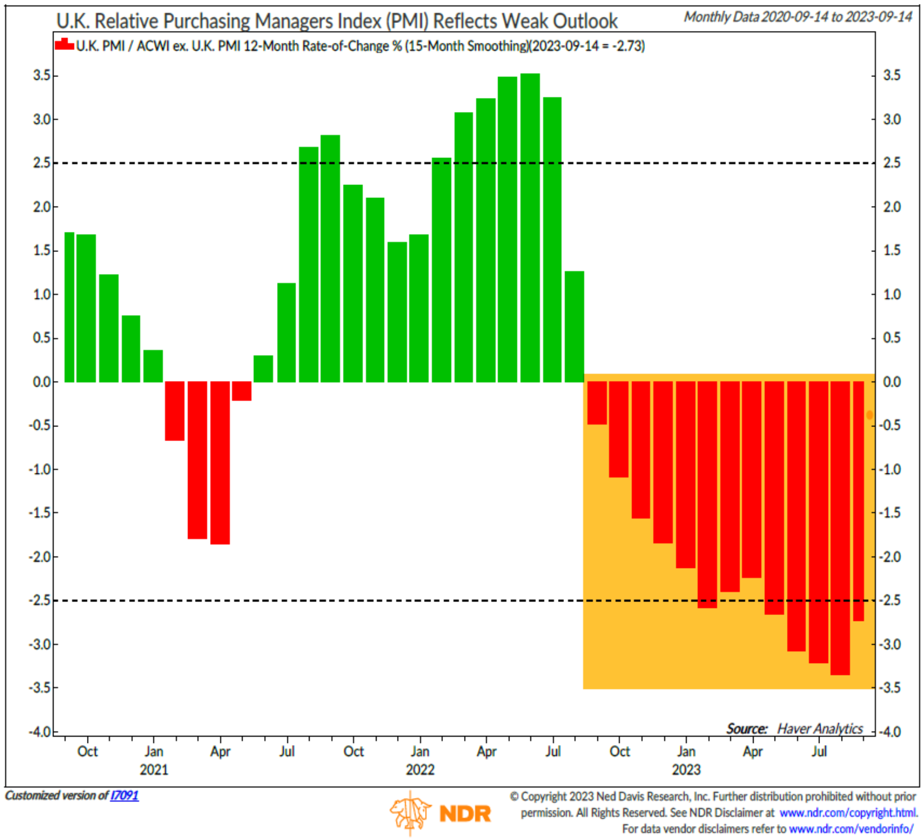


Figure 5: China's Improving PMI Bodes Well for Japan



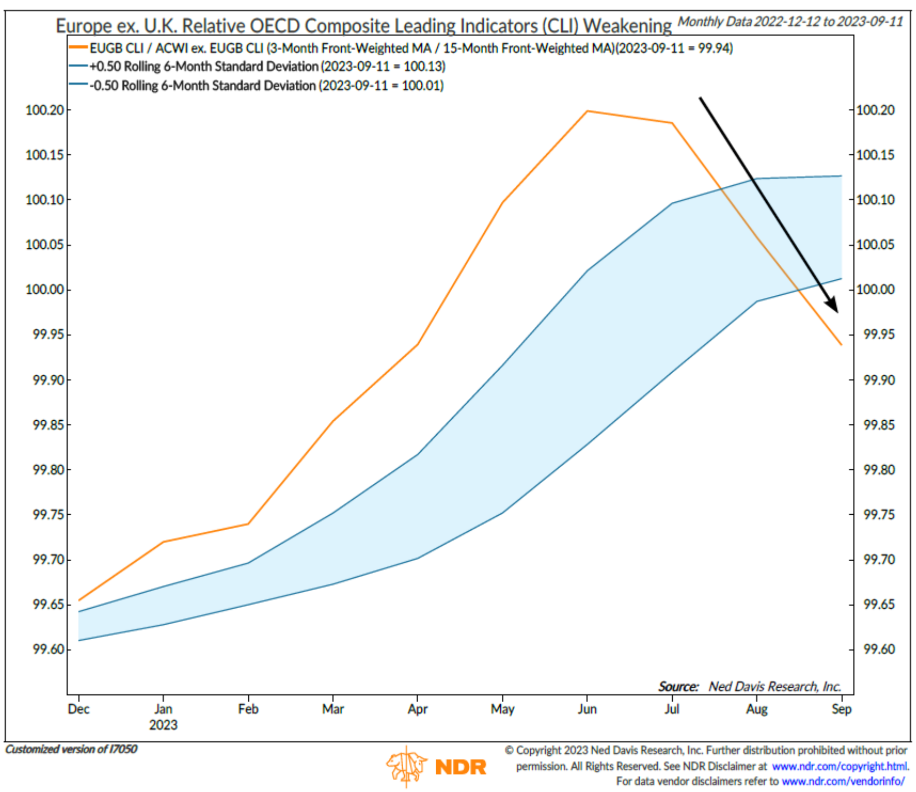
Japan possesses the largest overweight allocation for October. Although external measures reflect headwinds, there are some areas showing an improving environment. Business confidence improved as the Tankan survey beat expectations. China PMI, which tends to be a leading indicator of Japan's economy, rose this past month (chart left). Inflation swaps are confirming an optimistic economic outlook. The technical indicators reflect an improving outlook as trend and price momentum metrics are bullish.

Figure 6: U.K. Relative Purchasing Mangers Index (PMI) Reflects Weak Outlook



The U.K. remained below benchmark allocation. Only one of its indicators is bullish. Price-based indicators have deteriorated, which coincides with weaker economic data. Most aggregate measures of the economy point to stagnation, or even modest contraction, in the near-term. On a relative basis, leading economic indicators and economic sentiment (chart right) are both negative on the economy. Expensive relative valuations and an unattractive equity risk premium both indicate that the market still has downside risks.

Figure 7: Europe ex. U.K. Relative OECD Composite Leading Indicators (CLI) Weakening



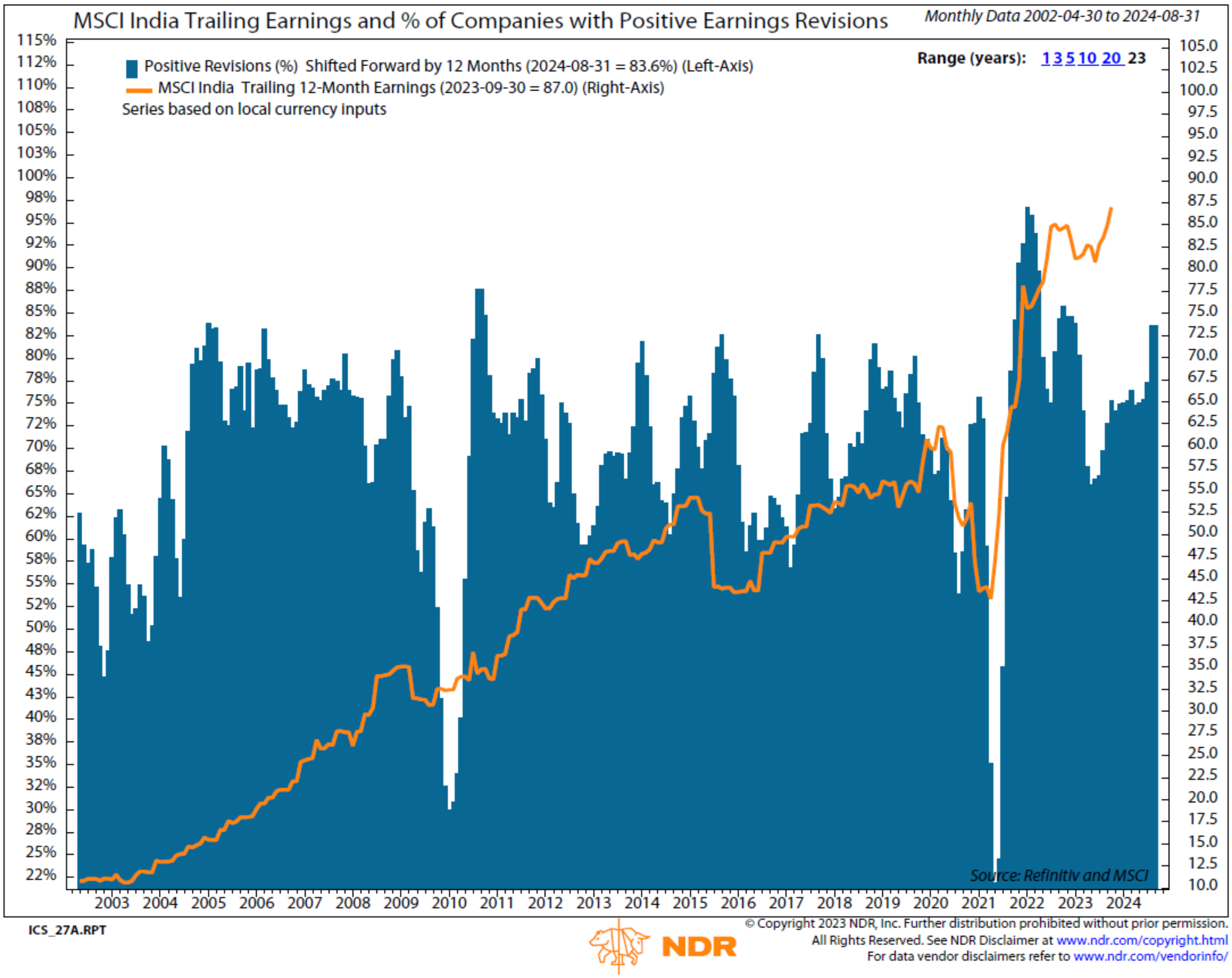
France maintained its underweight position. The continuation of high inflation and tighter monetary policy has taken its toll on the European economy. Economic conditions in Europe have gone from bad to worse. The eurozone composite PMI fell to 46.7 in August, the deepest contraction in nearly three years. The services sector contracted for the first time this year, while manufacturing continues to shrink markedly. The weak technical indicators confirm the headwinds depicted by the macro (chart left), valuation, and sentiment measures.

Explore Opportunities

Among the top ranked Explore markets are Brazil, India, Italy, Poland, and Peru:

- All have favorable price trends as their 50-day moving averages trade above their 200-day counterparts.
- Within the last 21 days, Peru and Poland are more than one standard deviation oversold, which historically has provided a near-term bounce opportunity.
- Brazil, India, Italy, Poland, and Peru have low market capitalization-to-GDP ratios, which typically indicates a favorable valuation.
- Brazil's and India's composite PMIs resides in the expansionary zone.
- Brazil is one of the few economies with a Composite Leading Indicator in expansionary territory.
- India has a double-digit one-year forward earnings growth estimate (chart bottom).
- Italy and India have over 80% of stocks with positive earnings revisions from analysts.

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



Summary

The Catastrophic Stop model declined from last month, but it continues to recommend a fully invested allocation.

Entering October, the non-U.S. equity Core model overweighted Japan, was marketweight China, Canada, and Australia, and underweight the U.K., France, Switzerland, and Germany. The Explore model favored Brazil, India, Italy, Peru, and Poland.

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 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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