Smart Sector® International Strategy

SEPTEMBER 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 slightly from last month but entered September with a fully invested equity allocation recommendation.

Figure 1: Smart Sector® Catastrophic Stop Sell Model

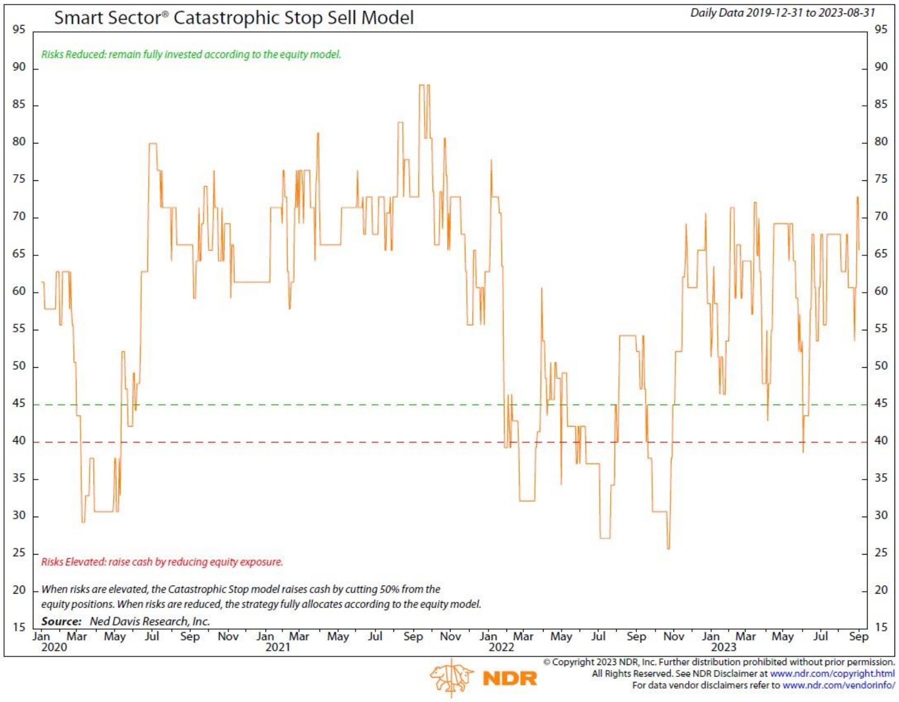
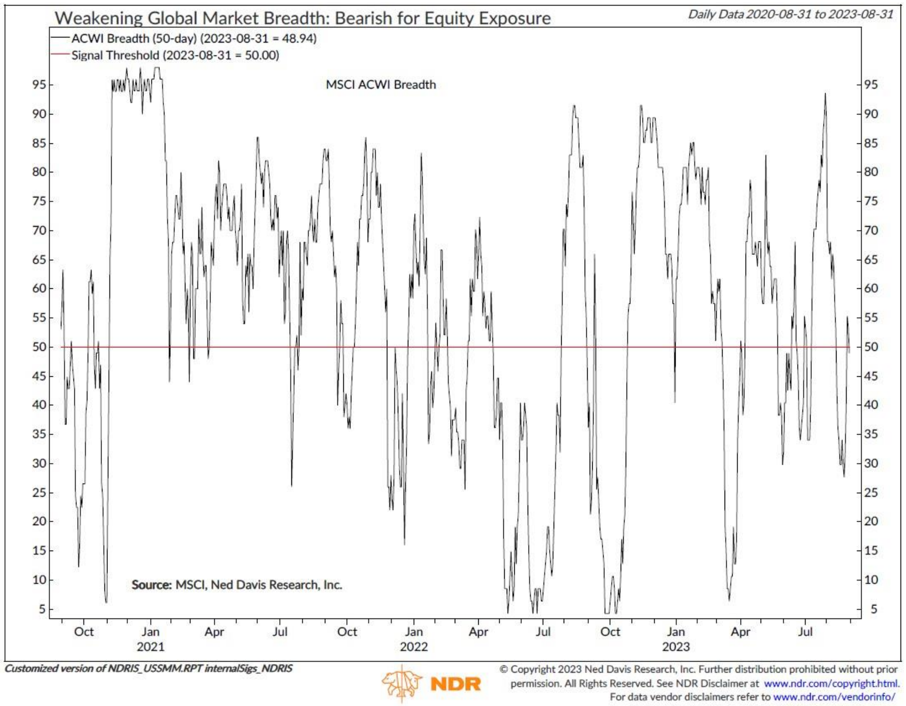


Figure 2: Weakening Global Market Breadth: Bearish for Equity Exposure



The model's overall bullish position is driven by four of the seven (price-based) measures that remain positive for stocks. However, global market breadth weakened during the month and flashed a sell signal (chart left). While external influences such as trade and market sentiment remained bearish and neutral, respectively, they're offset by bullish readings from high-yield and emerging market bond breadth, as well as high-yield option-adjusted spreads. For now, the weight of the evidence recommends a fully invested allocation to equity sectors according to the model.

Global Market Update

The ACWI ex. U.S. Total Return Index declined by almost 450 basis points (bps) in August. After gaining more than 400 bps for two consecutive months, the index suffered its largest monthly decline since last September. Among the strongest-performing markets were Egypt, Turkey, Hungary, and Denmark, while the largest underperformers included the Philippines, Singapore, Poland, South Africa, and Colombia.

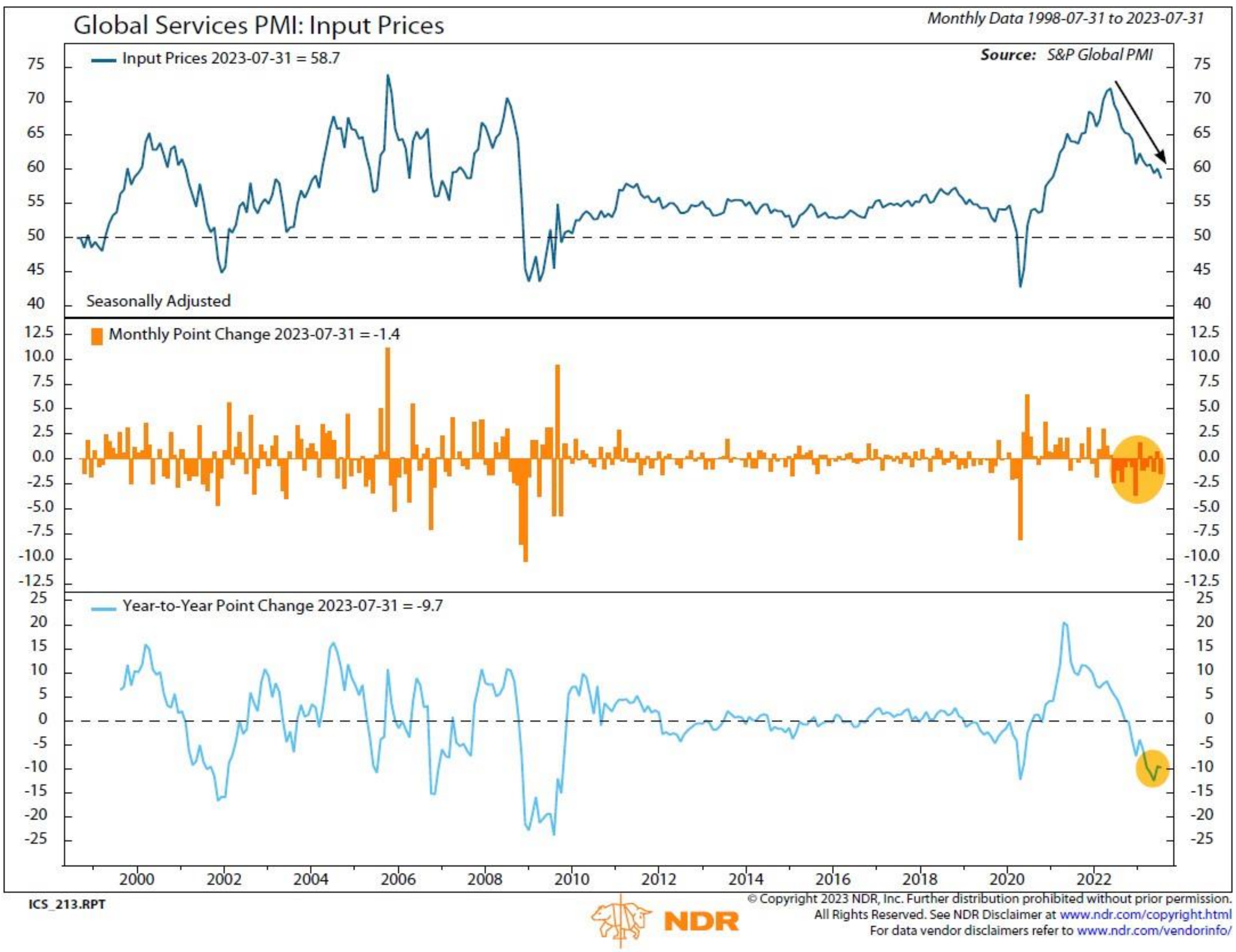
S&P Global Purchasing Managers' Index (PMI) data continues to signal a softening global economy. The global composite (services and manufacturing) PMI fell for a second straight month in July to its weakest reading since January. The continuous upside momentum from the first half of the year appears to be fading. Leading indicators within the PMI reports, such as new orders, backlogs, and future output, all point to weakening momentum in the coming months.

Continued adjustments to the pandemic-related imbalances have caused price pressures to ease considerably. The global composite input price index sank to a 33-month low in July (chart bottom). Although most of the price weakness has been in the manufacturing sector, services costs still grew at the slowest pace since December 2020.

However, the risk of global recession, which is historically associated with large equity bear markets, doesn't appear to be a near-term risk. The latest PMI reading marked the sixth straight month of global expansion after declining throughout most of the second half of last year. The composite is also well above the threshold that has historically been associated with global recession. Furthermore, many emerging markets outside of China have maintained resiliency and are contributing to some stabilization in the manufacturing PMI. Among developed economies, growth remains positive in Japan.

Entering September, the non-U.S. equity Core model overweighted Australia, Germany, Japan, and China while underweighting the U.K., Canada, France, and Switzerland. The Explore model favored Poland, Mexico, Peru, Spain, and India.

Figure 3: Global Services PMI: Input Prices



Core Allocations

Australia moved further overweight as its allocation increased for September. Australia was one of the top-performing markets in the ACWI toward the end of August. On a local currency basis, the MSCI Australia Index (local currency) is less than 5% from its all-time high. The trend is supported by improving upside participation. More than half of Australian companies are trading above their 200-day moving averages (chart right). The Reserve Bank of Australia kept its core interest rate steady, as unemployment rose to 3.7% last month.

Figure 4: Australia Percentage Stocks Trading Above 200-Day Moving Averages

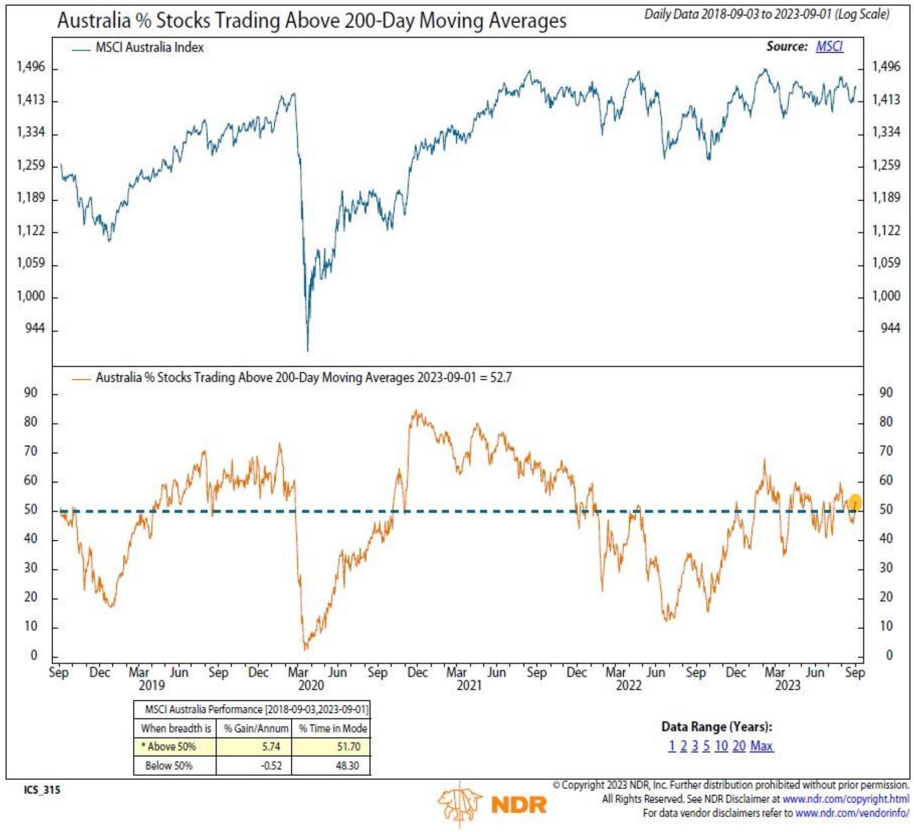
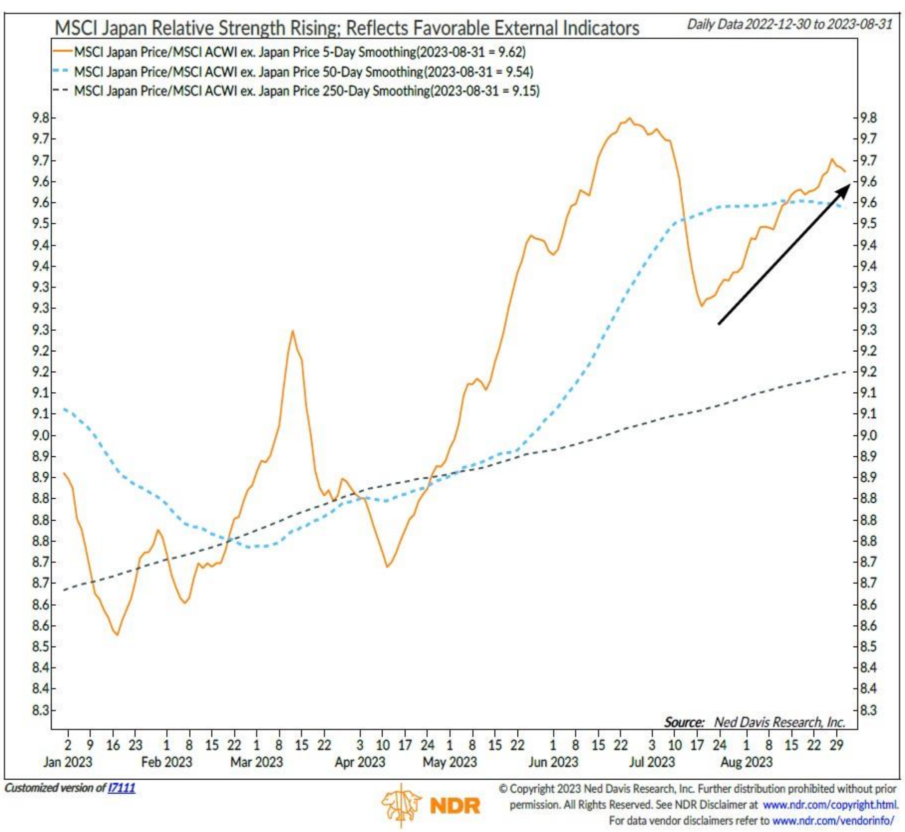


Figure 5: MSCI Japan Relative Strength Rising; Reflects Favorable External Indicators



Japan increased to overweight allocation for September. Most aggregate measures of economic activity point to continued but slower growth in the second half of the year. The flash composite PMI was at 52.6 in August, led by ongoing strength in the services sector. While the PMI is down from its peak earlier this year, it's higher than any other economy in the G7. Similarly, the Now-Casting Index of Economic Activity, while down from its peak in Q2, is still comfortably above its long-term average. A weaker yen has also helped boost demand for Japanese goods. Japan's relative strength to other markets continues to improve (chart left).

The U.K. remained below benchmark allocation. Only two of its indicators are bullish. The market is now oversold, which may drive a near-term bounce. 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. The composite PMI for August slipped into negative territory for the first time in seven months, as both services and manufacturing activity contracted. Similarly, the Now-Casting index of Economic Activity fell for a second straight month (chart right).

Figure 6: United Kingdom: Now-Casting Index of Economic Activity

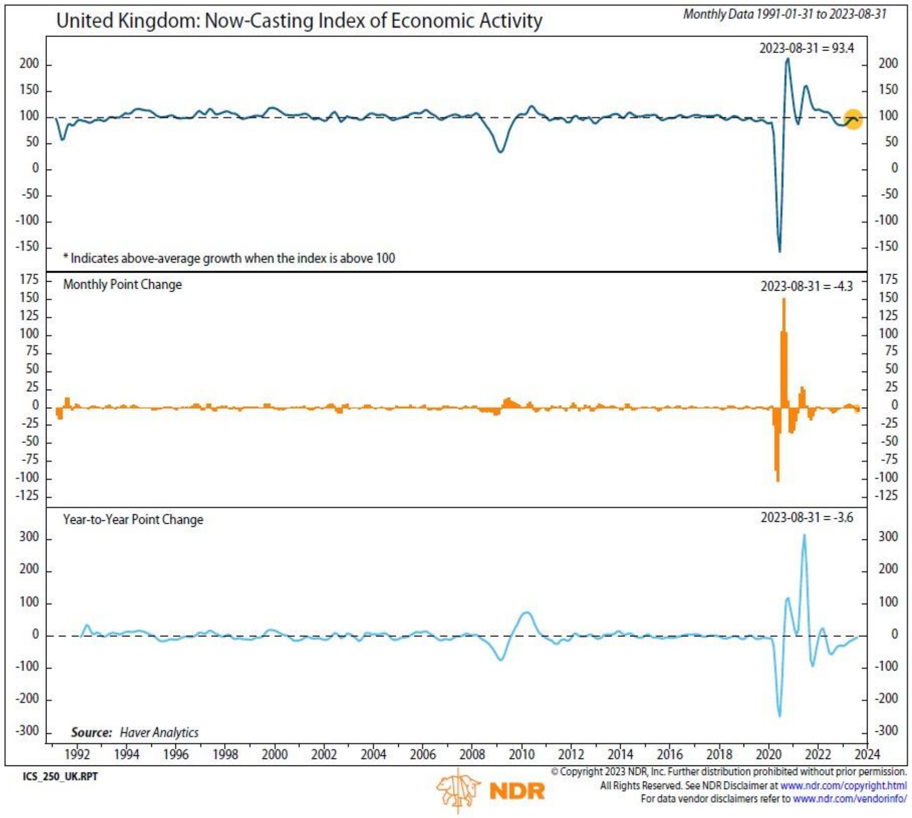
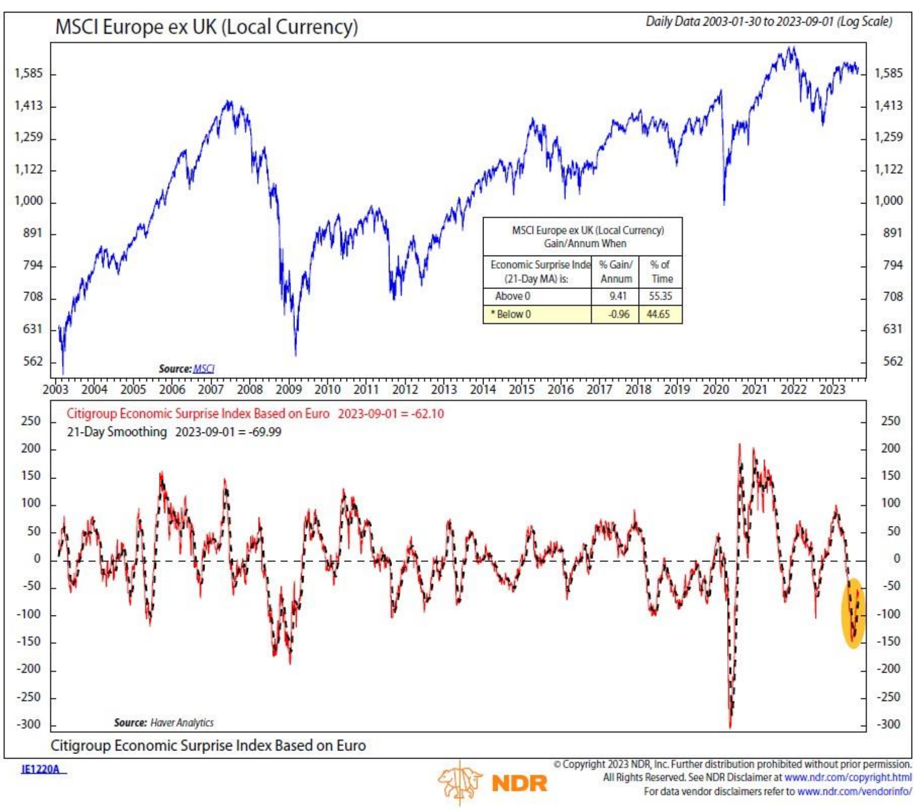


Figure 7: MSCI Europe ex UK (Local Currency)



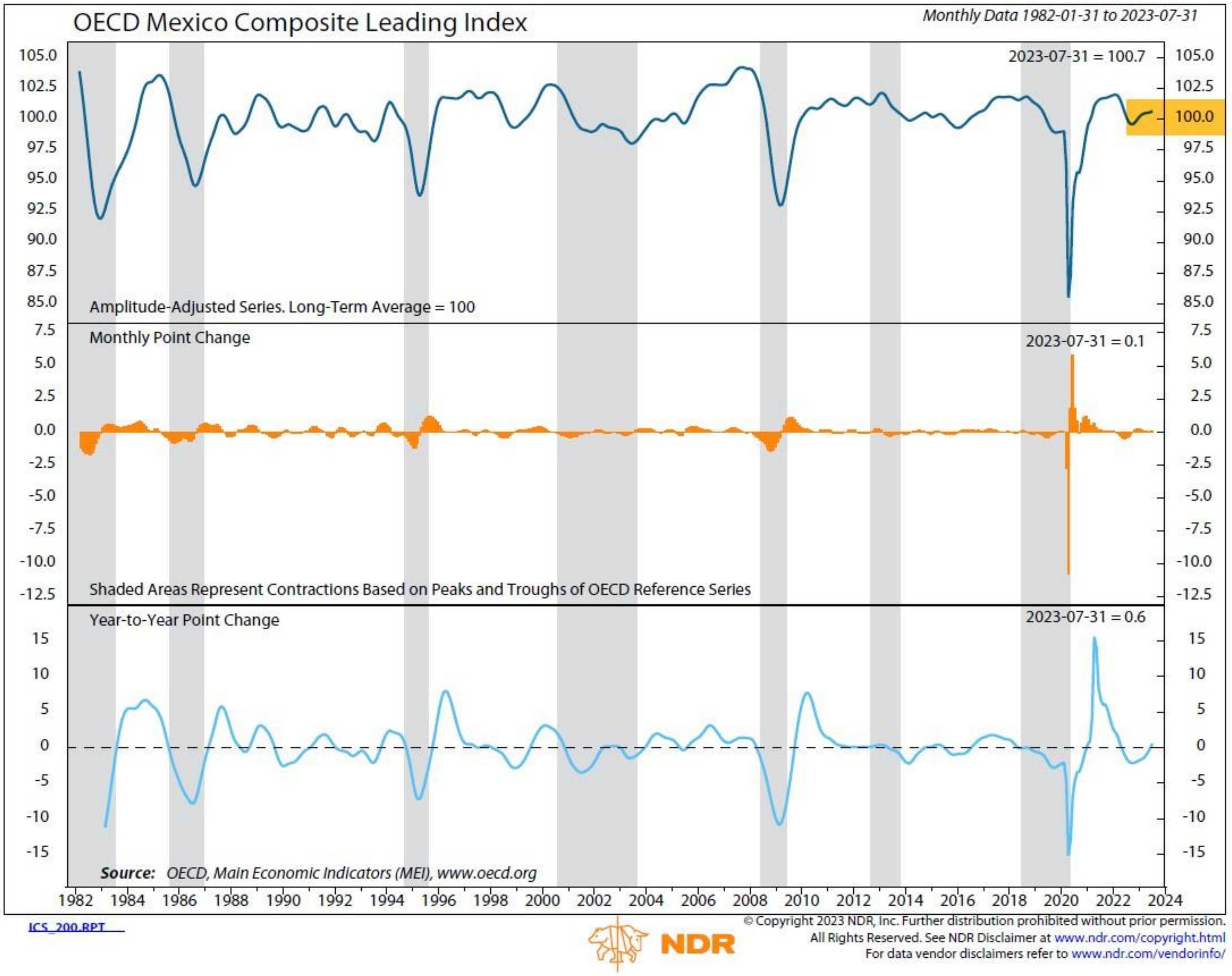
Both Switzerland and France maintained underweight positions. The continuation of high inflation and tighter monetary policy has taken its toll on the European economy. With potential growth in the eurozone quite low, it won't take much to put the economy into recession. The flash composite PMI for August fell to 47.0, its third straight month in contraction territory (i.e., below 50) and a 33-month low. The Ifo business climate index, an excellent leading indicator for the economy, fell to 85.7 in August, the lowest level since December. The Citigroup Economic Surprise Index has been trending around its lowest level since the beginning of the pandemic (chart left). The latest ECB Bank Lending Survey indicated further weakening conditions for bank lending.

Explore Opportunities

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

- Poland, Mexico, Peru, Spain, and India have favorable price trends as their 50-day moving averages trade above their 200-day counterparts.
- Within the last 21 days, Poland, Mexico, and Spain are more than one standard deviation oversold, which historically has provided a near-term bounce opportunity.
- Peru, Poland, and Mexico have low market capitalization-to-GDP ratios, which typically indicate a favorable valuation.
- Spain's composite PMI resides in the expansionary zone.
- Mexico is one of the few economies with a Composite Leading Indicator in expansionary territory (chart bottom).

Figure 8: OECD Mexico Composite Leading Index



Summary

The Catastrophic Stop model declined from last month, but it continues to recommend a fully invested allocation. Entering September, the non-U.S. equity Core model overweighted Australia, Germany, Japan, and China while underweighting the U.K., Canada, France, and Switzerland. The Explore model favored Poland, Mexico, Peru, Spain, and India. 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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