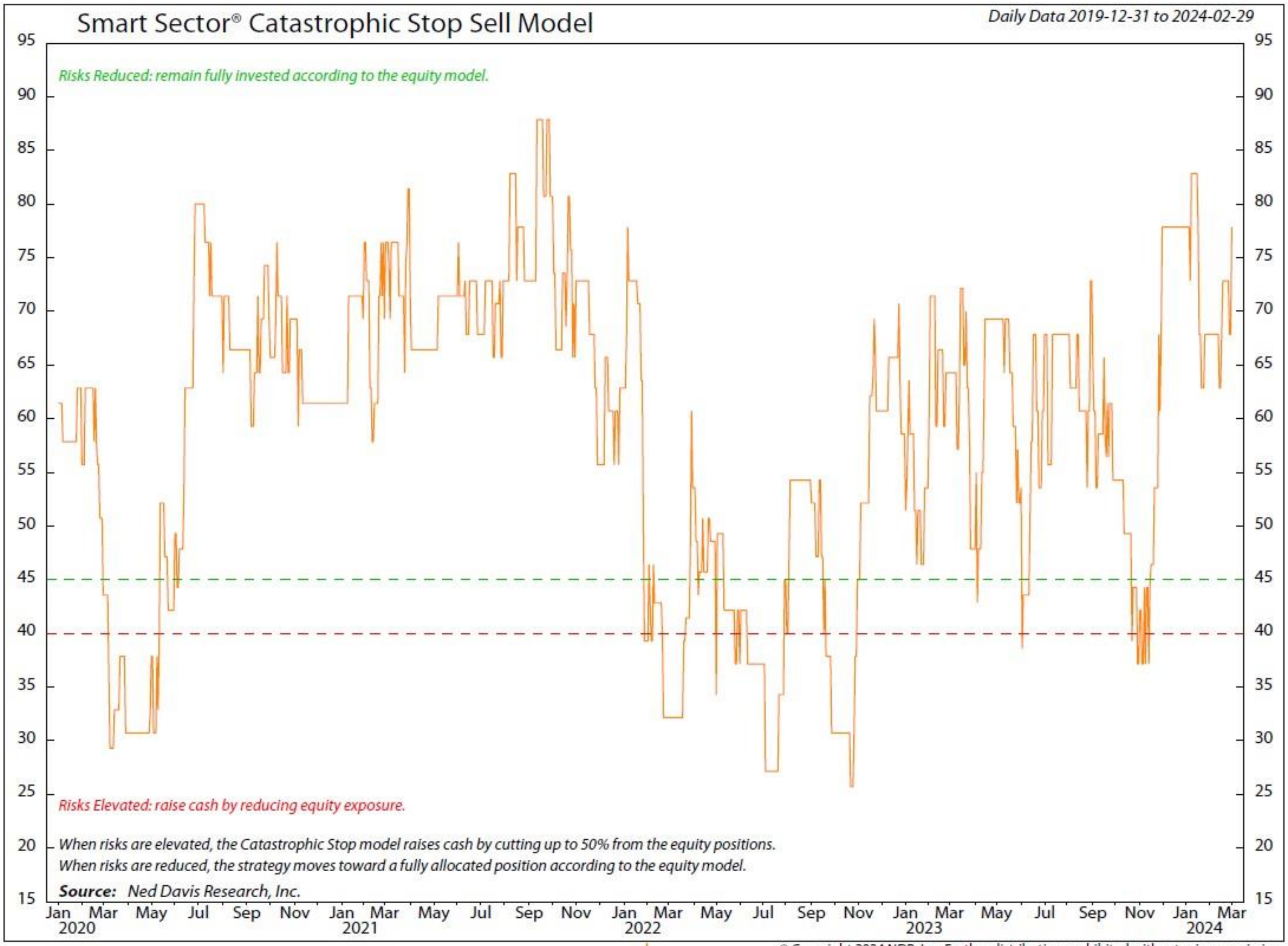
Smart Sector® Strategy

MARCH 2024

Catastrophic Stop Update

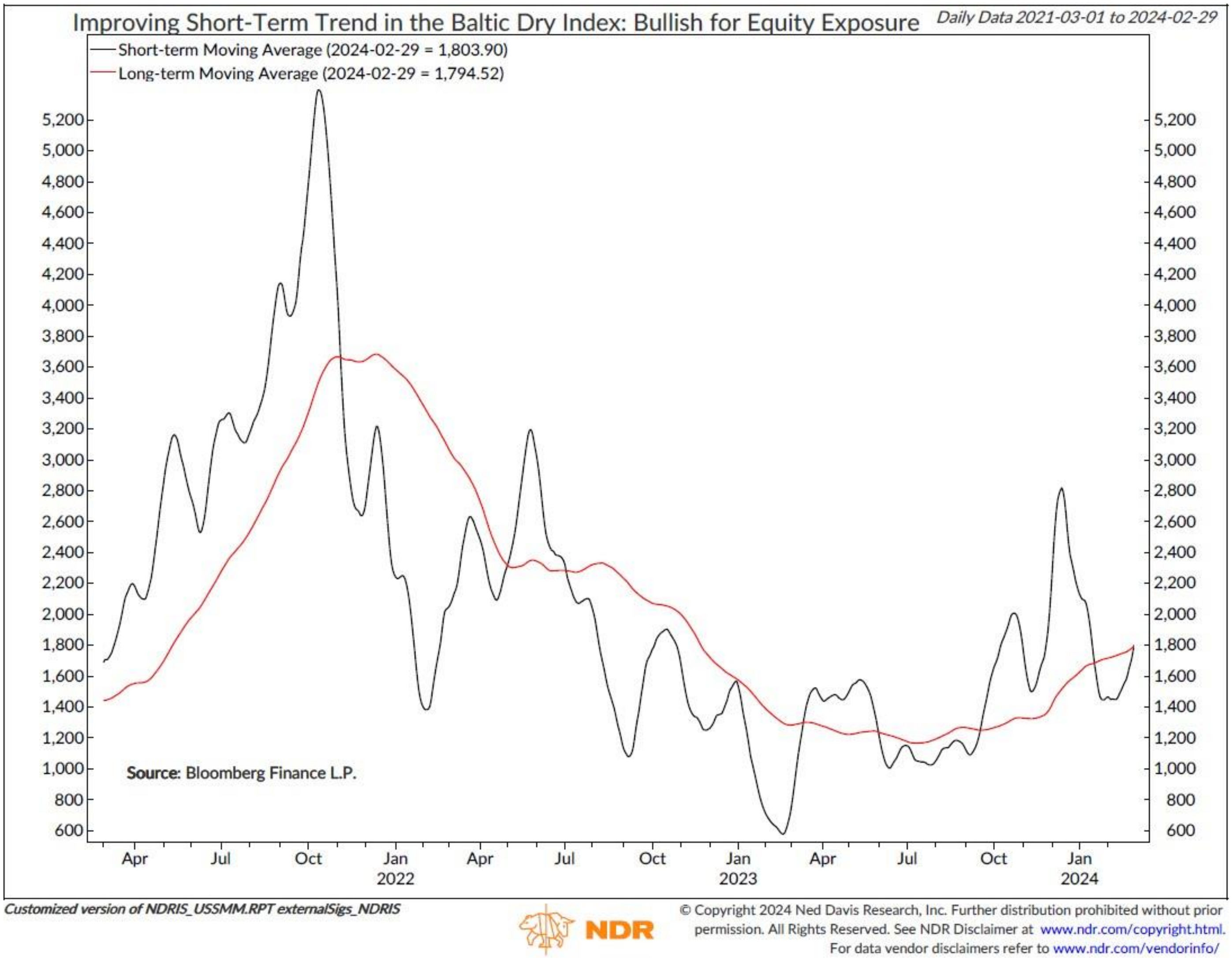
The NDR Catastrophic Stop Sell model combines time-tested, objective indicators designed to identify high-risk periods for the equity market. The model (Figure 1 below) improved during the month and entered March with a recommendation for fully invested equity allocation.

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. External measures improved. The short-term trend in global trade—as measured by the Baltic Dry Index—flashed a bullish signal during the month (Figure 2, below), joining bullish readings from option-adjusted spreads and high-yield and emerging market breadth. 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: Improving Short-Term Trend in the Baltic Dry Index: Bullish for Equity Exposure



U.S. Market Update

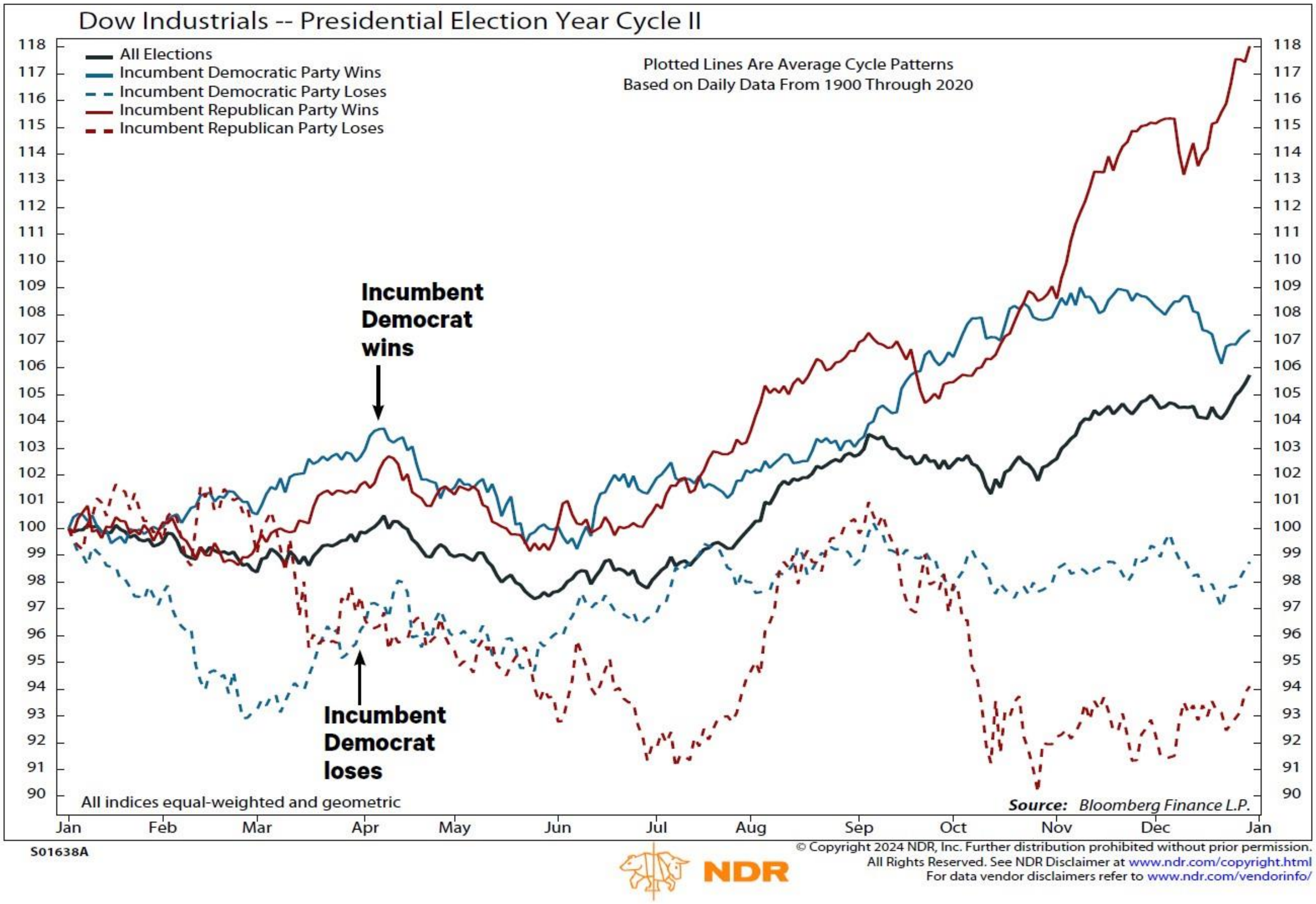
The S&P 500 Total Return Index continued its positive momentum into February with a gain of about 5.3%. Breadth improved significantly—all 11 S&P 500 sectors posted positive price gains for the month. Several of the "Magnificent Seven" (Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta Platforms, and Tesla) continued their strong gains, which led to Consumer Discretionary, Communication Services, and Information Technology outperforming the broad market during the month. Other cyclical sectors like Industrials and Materials also outperformed.

A strong start to the year for stocks has tended to foreshadow an incumbent victory in U.S. presidential elections, especially for Democrats. Many factors determine an incumbent's reelection bid, including perceived policy effectiveness and international events.

When an incumbent Democrat has gone on to win, the DJIA has risen a median of 2.6% in the first two months of the year versus a 6.2% decline when an incumbent Democrat has lost (Figure 3 below).

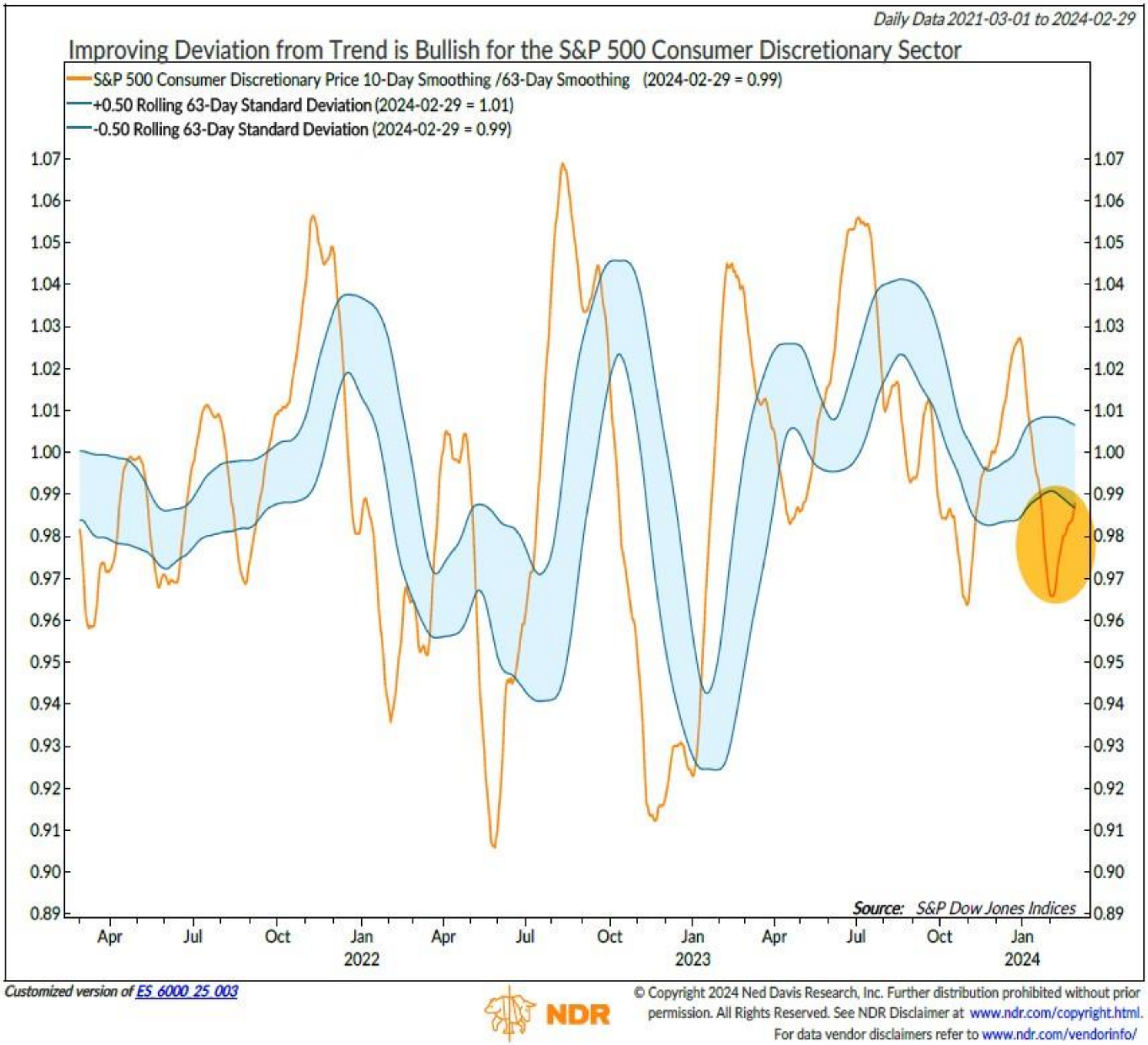
Leadership has been more defensive in the run-up to presidential elections. However, for now, the sector model remained with a cyclical bias during the month. Entering March, Information Technology and Financials are overweight. Industrials, Health Care, Consumer Discretionary, Consumer Staples, Energy, and Real Estate are neutral. Materials, Communication Services, and Utilities are underweight.

Figure 3: Dow Industrials – Presidential Election Year Cycle II



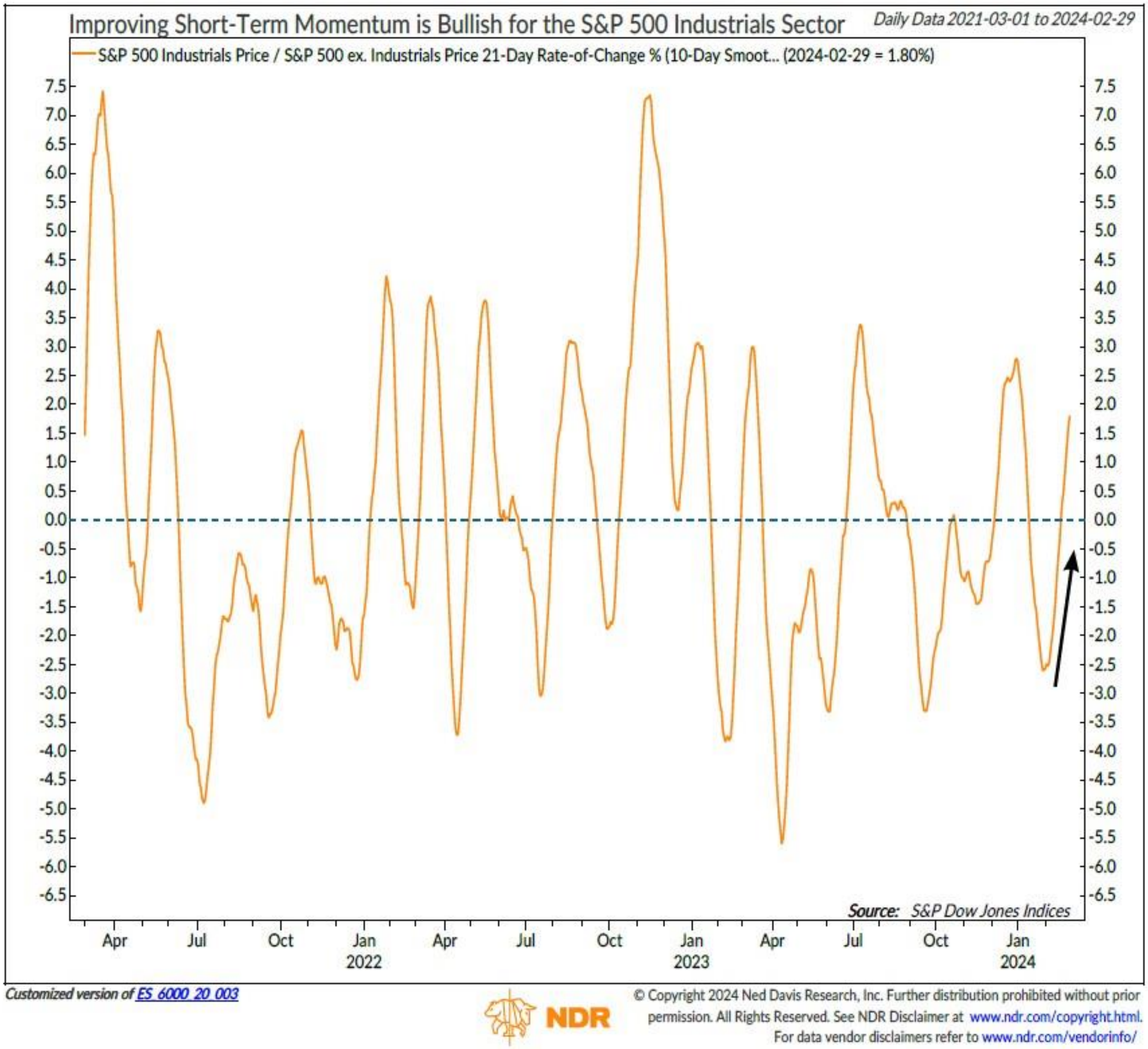
The Consumer Discretionary sector's composite model improved on the back of strong February gains from Amazon (+13.9%) and Tesla (7.8%), which helped drive another bullish signal from one of the price-based indicators—deviation from trend (Figure 4, below). However, internals are still mixed, with only three of the six on bullish signals. On a fundamental basis, the weight of the evidence remains positive, with four of the six measures on bullish signals.

Figure 4: Improving Deviation from Trend is Bullish for the S&P 500 Consumer Discretionary Sector.



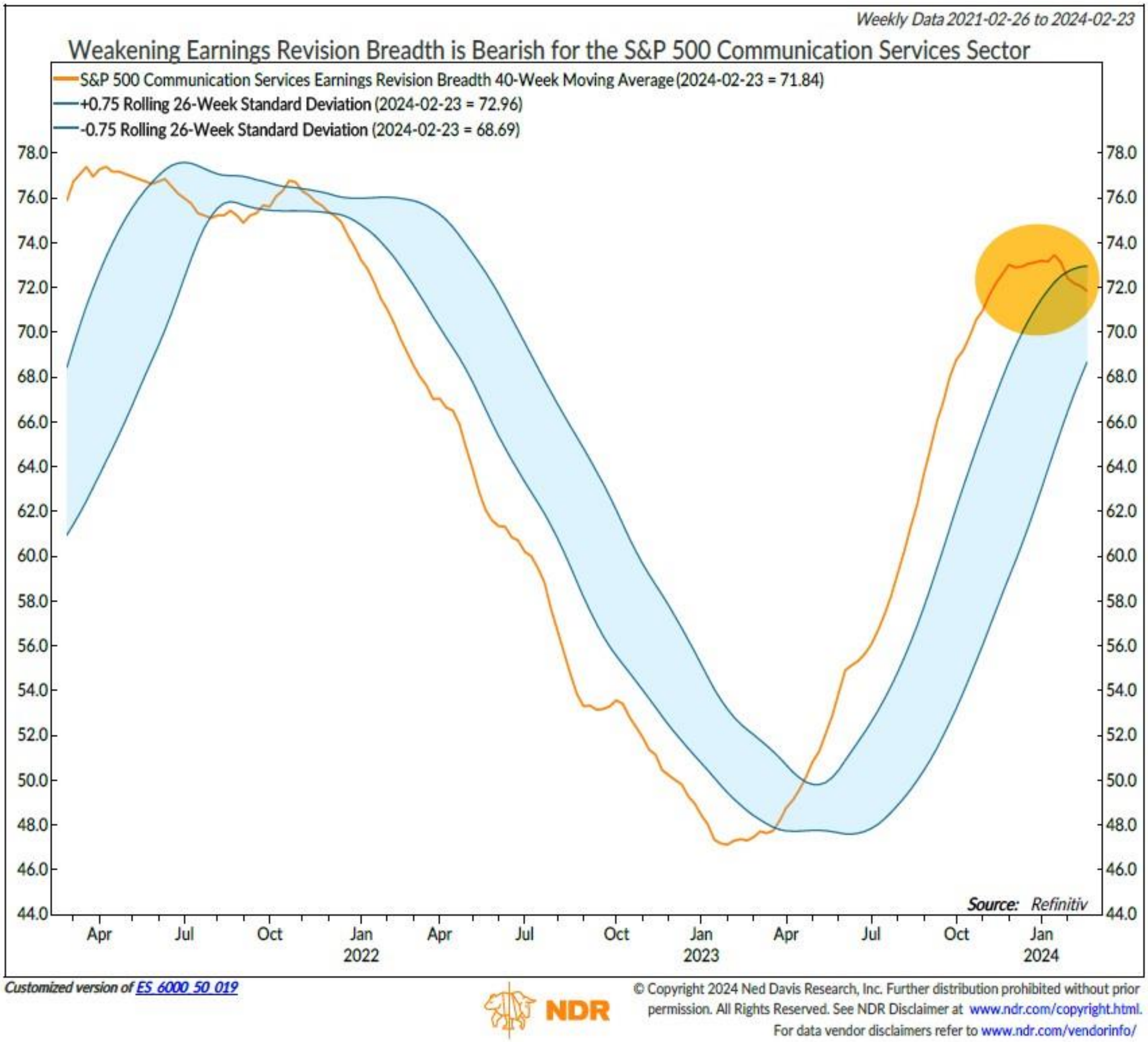
The Industrials sector's allocation improved sharply, upgrading it to neutral from a significant underweight. On a fundamental basis, indicators remain mixed, including valuation measures. While the U.S. dollar remains a tailwind, commodities and industrial production are neutral, and crude oil futures prices and consumer confidence are bearish. However, internals improved with three more price-based measures flashing bullish signals during the month, including 3-month volatility and two short-term momentum indicators (Figure 5 below).

Figure 5: Improving Short-Term Momentum is Bullish for the S&P 500 Industrials Sector



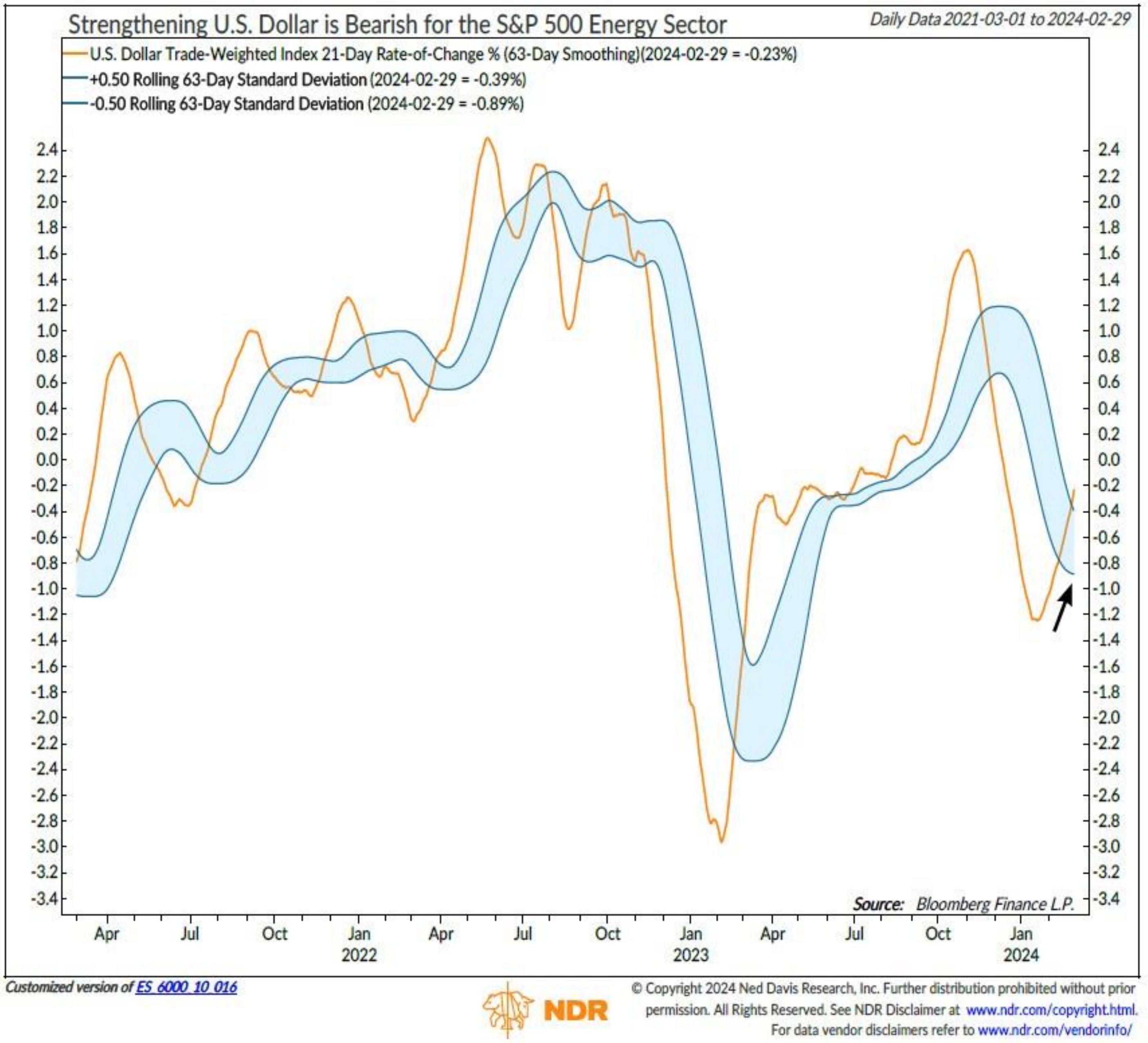
The Communication Services sector allocation deteriorated sharply, dropping to an underweight from overweight. On a fundamental basis, indicators evaluating the 10-2 yield curve and sales growth trends remained bullish. However, earnings revision breadth flashed a bearish signal (Figure 6, below), joining other negative readings from relative valuation, option-adjusted spreads, and internet vs. retail sales trends. This was confirmed by weakening technicals, with both an overbought/oversold indicator and deviation from trend measure that moved bearish during the month.

Figure 6: Weakening Earnings Revision Breadth is
Bearish for the S&P 500 Communication Services Sector



The Energy sector's allocation dropped during the month, moving it to neutral from overweight. On a fundamental basis, a strengthening U.S. Dollar Index indicator flashed a bearish signal during the month (Figure 7, below), joining negative signals from crude futures sentiment, valuation, and oil supply measures. Technicals confirmed with three of five measures now negative for the sector, with a 6-month volatility indicator turning bearish during the previous month.

Figure 7: Strengthening U.S. Dollar is Bearish for the S&P 500 Energy Sector



Summary

The sector model remained with a cyclical bias during the month. Entering March, Information Technology and Financials are overweight. Industrials, Health Care, Consumer Discretionary, Consumer Staples, Energy, and Real Estate are neutral. Materials, Communication Services, and Utilities are underweight.

The sector model uses sector-specific indicators to identify opportunities and risks in an objective, weight-of-the-evidence approach. **NDR Strategists contributing to this publication: Brian Sanborn, CFA, Ed Clissold, CFA, Rob Anderson, CFA, Thanh Nguyen, CFA, Tim Hayes, CMT, Joe Kalish**

Strategy Description

- The Smart Sector® with Catastrophic Stop strategy combines two Ned Davis Research quantitative investment strategies: The NDR Sector Allocation and the NDR Catastrophic Stop.

The process is based on the weight of the evidence

- The fund begins by overweighting and underweighting the S&P 500 sectors based on Ned Davis Research's proprietary sector models.
- Each of the sector models utilizes sector-specific, weight-of-the-evidence composites of fundamental, economic, technical, and behavioral indicators to determine each sector's probability of outperforming the S&P 500.
- Sectors are weighted relative to benchmark weightings.

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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