DAY HAGAN
ASSET MANAGEMENT

NDR
NED DAVIS RESEARCH

Smart Sector® Strategy

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 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.

Figure 1: Smart Sector® Catastrophic Stop Sell Model

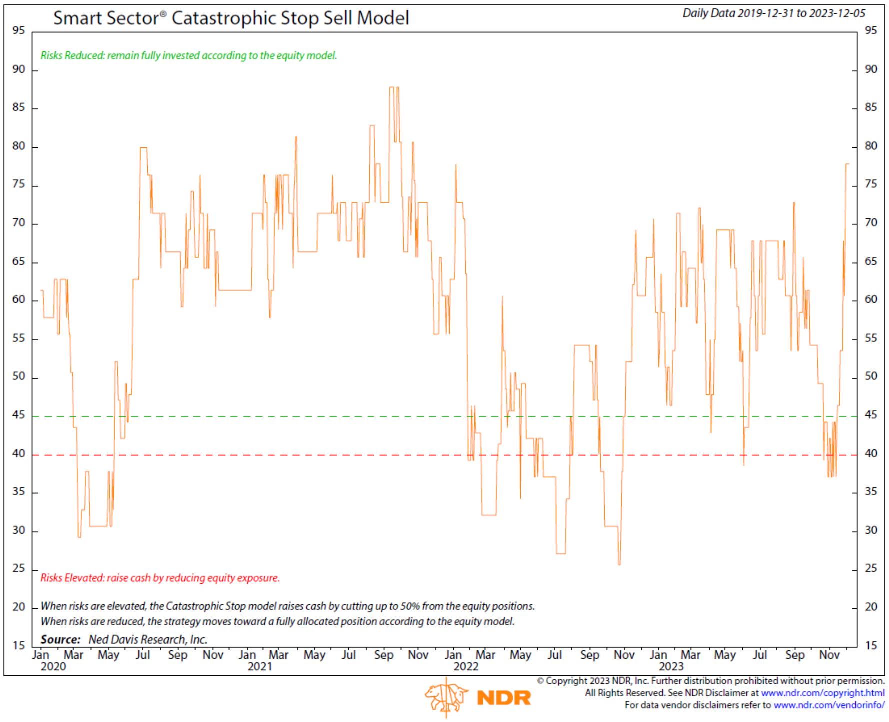
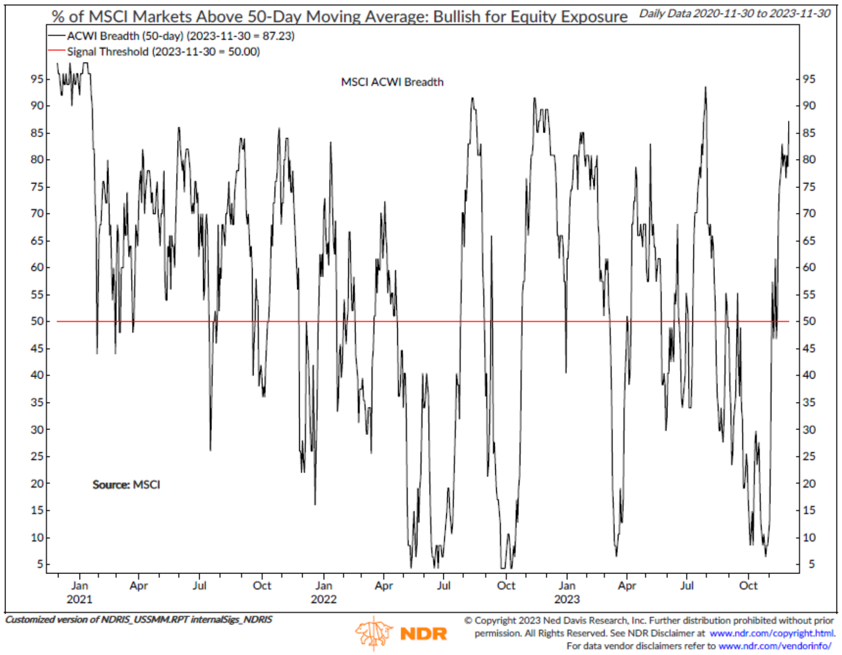


Figure 2: % of MSCI Markets Above 50-Day Moving Average: Bullish for Equity Exposure



U.S. Market Update

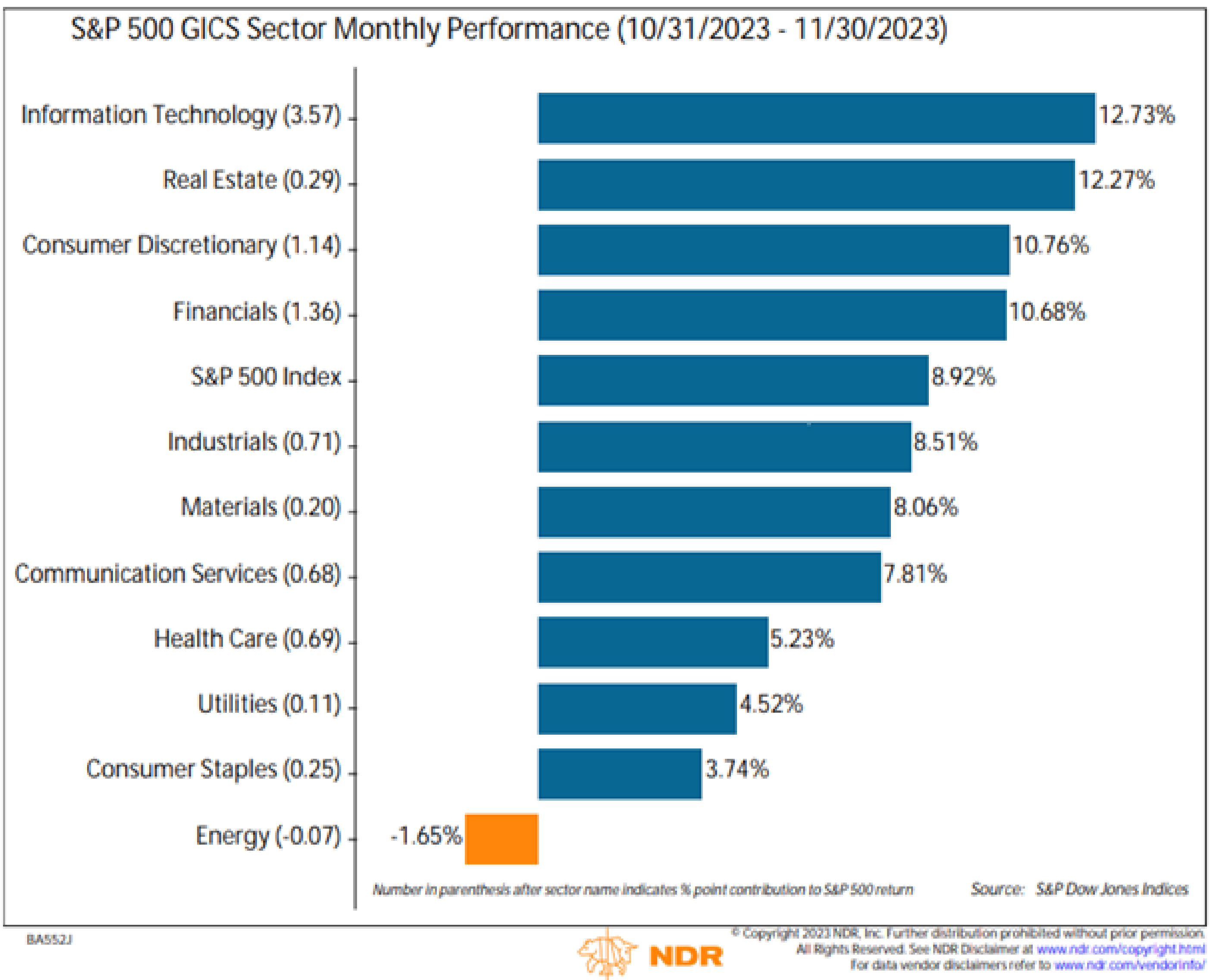
After declining for three months in a row, the S&P 500 Total Return Index rebounded sharply in November, gaining about 9%. Breadth improved—10 of the 11 S&P 500 sectors posted positive returns for the month—only Energy was down modestly. The 10-year Treasury yield declined and helped drive double-digit returns from sectors like Information Technology, Real Estate, Consumer Discretionary, and Financials (chart below).

The 10-year Treasury yield, which had spooked investors by rising above 5% in October, collapsed last month as the cooling inflation data rolled out, helping to boost sentiment for equities. Recent inflation and economic data could provide the Fed cover to end its tightening cycle, increasing the odds of a soft landing.

About half of all bear markets overlap with recessions, and half do not. Back-to-back non-recession bears are rare, but when they have occurred, they have been at least three years apart, so a soft landing would support the case for a continuation of the bull market. Macro risks heading into 2024 include the lagged effects of rate hikes, less fiscal stimulus, and tougher earnings comparisons.

The sector model moved to a more cyclical bias during the month. Entering December, the sector model is overweight: Materials, Communication Services, Energy, and Consumer Discretionary. The model is neutral on Consumer Staples, Information Technology, Real Estate, and Utilities. The model is underweight the Financials, Industrials, Health Care, and Utilities sectors. All allocations are relative to the cash-adjusted benchmark.

Figure 3: S&P 500 GICS Sector Monthly Performance (10/31/2023 -11/30/2023)



Consumer Discretionary's allocation increased, which upgraded it from an underweight to an overweight position. On a fundamental basis, valuation, consumer credit conditions, and housing starts remained bullish, while long-term rates, discretionary spending, and weak earnings surprises remained headwinds for the sector. However, the sector was oversold. All six price-based measures flipped bullish during the month, driving the internal composite to its highest level since July. Momentum, trend, and breadth (chart right) have all improved substantially.

Figure 4: Improving Intermediate-Term Breadth is Bullish for the S&P 5oo Consumer Discretionary Sector

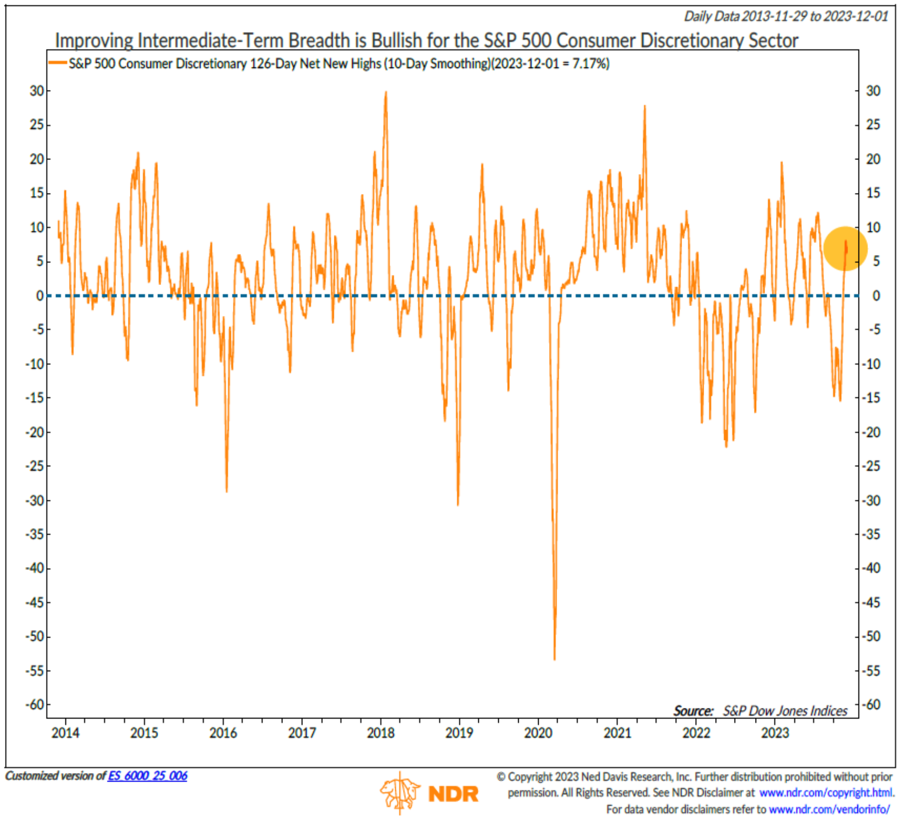
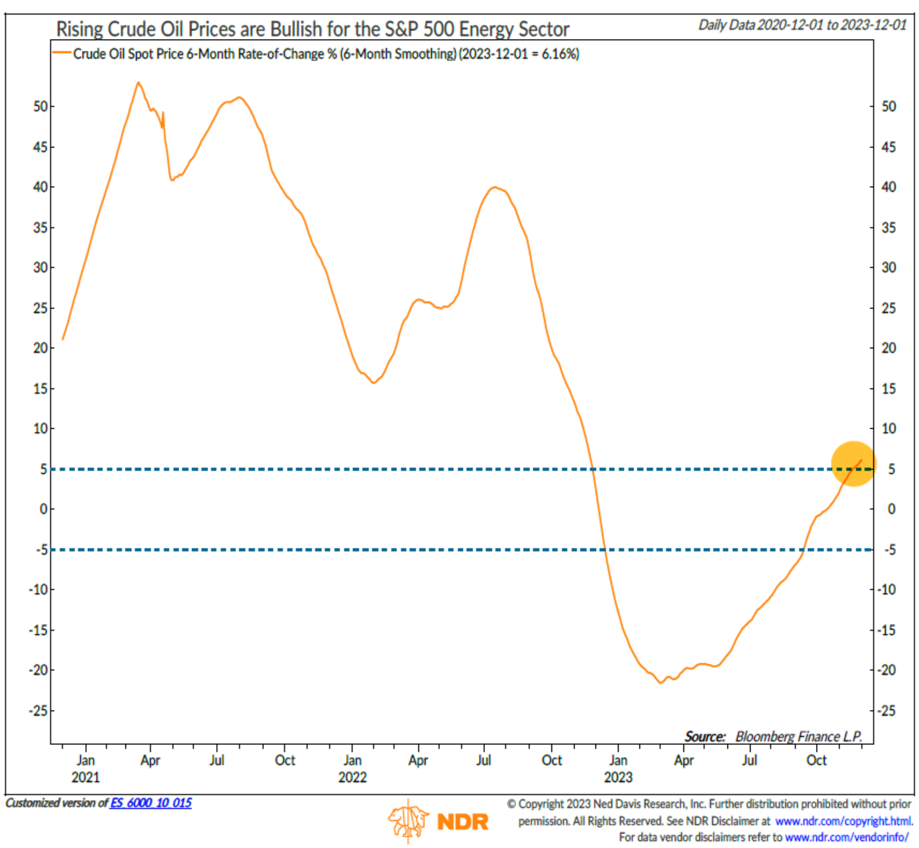


Figure 5: Rising Crude Oil Prices are Bullish for the S&P 500 Energy Sector



The Energy sector's allocation rose by over 75 basis points, boosting it to an overweight position. On a fundamental basis, while valuation and supply remain headwinds for the sector, oil price trends are now bullish (chart left) as the U.S. dollar has weakened. This was confirmed by technicals, as three of the five internal (price-based) indicators remain bullish.

The Utilities sector's allocation dropped and was downgraded to underweight. On a fundamental basis, indicators are mixed. Weak manufacturing, capacity utilization, and yields are partially offset by valuations and the copper/gold ratio, which are bullish for the sector. However, technicals weakened—four of the seven price-based measures are now negative, including price trends and relative breadth (chart right), which moved bearish during the month.

Figure 6: Weakening Relative Breadth is Bearish for the S&) 500 Utilities Sector

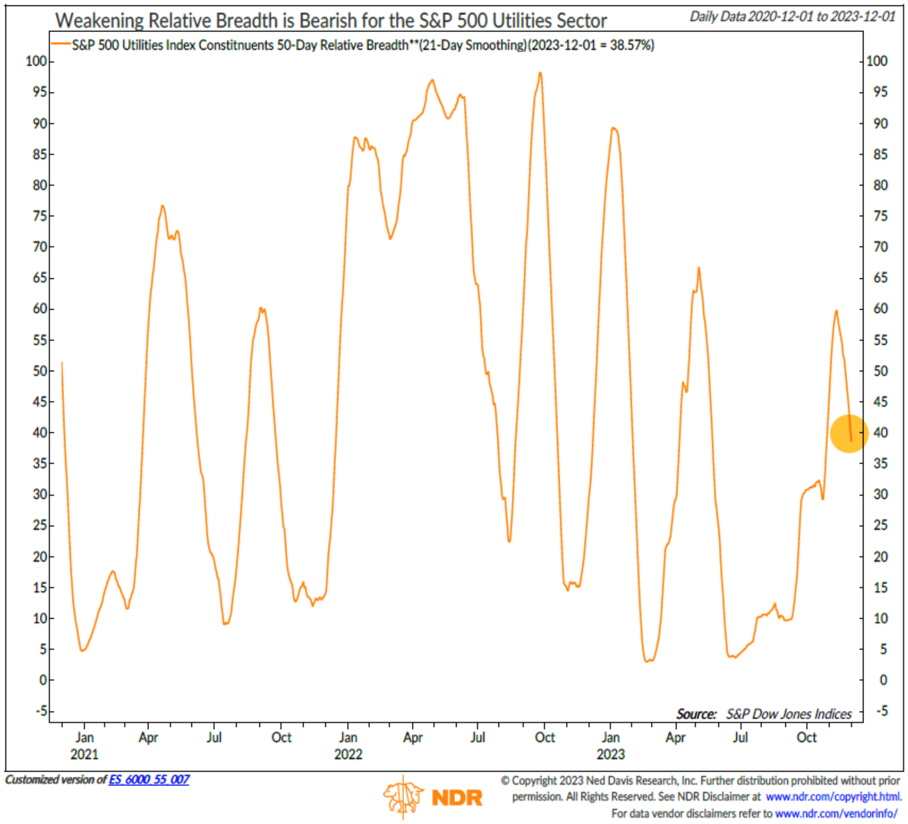
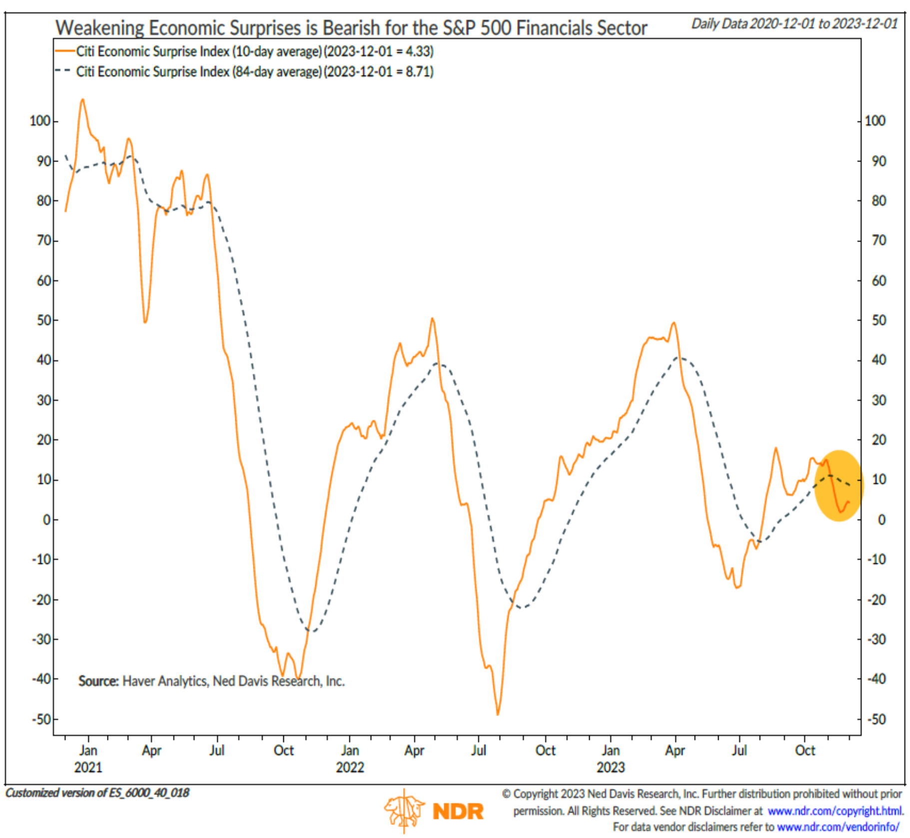


Figure 7: Weakening Economic Surprises is Bearish for the S&P 500 Financials Sector



The Financials sector's allocation declined and remained at underweight. On a fundamental basis, four of six indicators, including economic surprises (chart left), are now bearish for the sector. Four of the seven price-based measures are negative, including price momentum, trend, and short-term volatility.

Summary

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. We will deploy the remaining 25% cash holding as sentiment eases or longer-term breadth thrust measures confirm the near-term signals.

The sector model moved to a more cyclical bias during the month. Entering December, the sector model is overweight: Materials, Communication Services, Energy, and Consumer Discretionary. The model is neutral on Consumer Staples, Information Technology, Real Estate, and Utilities. The model is underweight the Financials, Industrials, Health Care, and Utilities sectors. All allocations are relative to the cash-adjusted benchmark. The sector model uses sector-specific indicators to determine opportunities and identify risks in an objective, weight-of-the-evidence approach.

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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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Using any graph, chart, formula, model, or other device to assist in deciding which securities to trade or when to trade them presents many difficulties and their effectiveness has significant limitations, including that prior patterns may not repeat themselves continuously or on any particular occasion. In addition, market participants using such devices can impact the market in a way that changes the effectiveness of such devices. NDR believes no individual graph, chart, formula, model, or other device should be used as the sole basis for any investment decision and suggests that all market participants consider differing viewpoints and use a weight of the evidence approach that fits their investment needs.

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There is no guarantee that any investment strategy will achieve its objectives, generate dividends or avoid losses.