Smart Sector® Strategy

JANUARY 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 (chart right) remained steady during the month and entered January with a fully invested equity allocation recommendation.

Figure 1: Smart Sector® Catastrophic Stop Sell Model

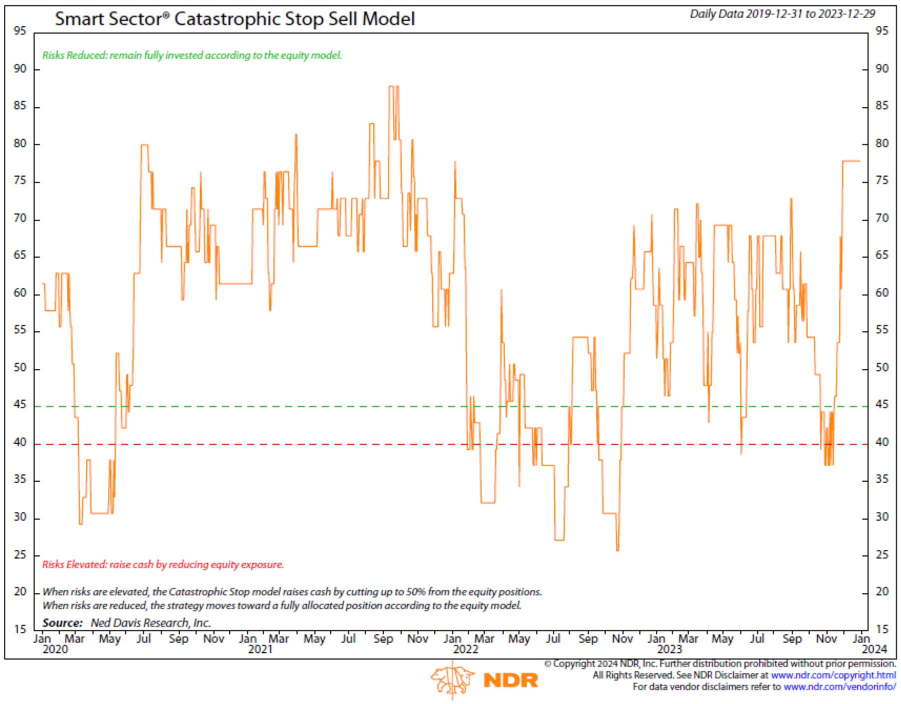
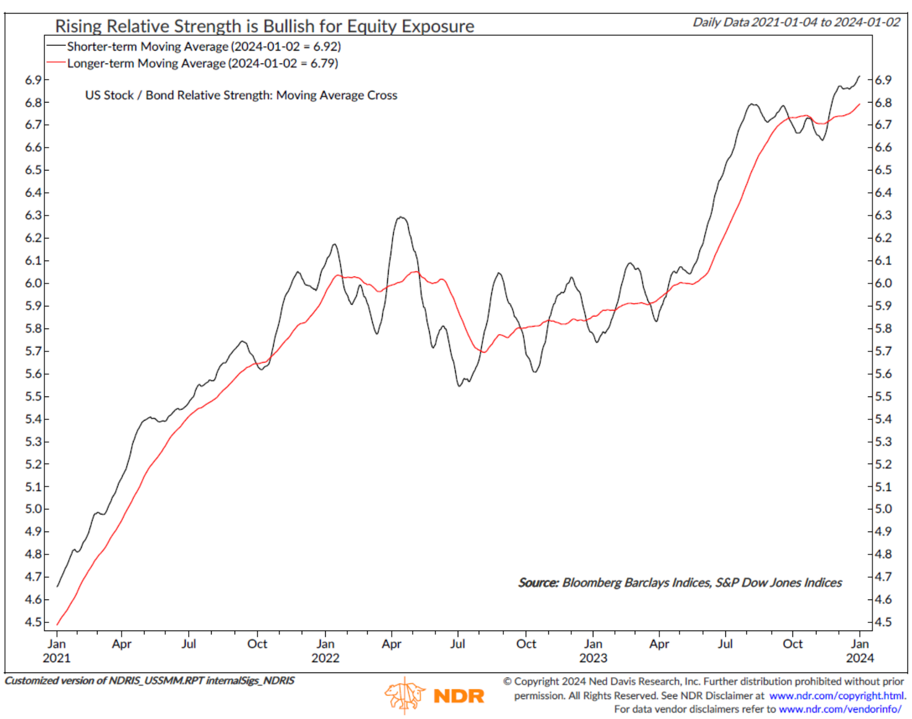


Figure 2: Rising Relative Strength is Bullish for Equity Exposure



The bullish reading from the model is driven by strong externals and internals. Five of the seven price-based measures remain bullish, including relative strength (chart left). With a strong market rally off the October lows, investor sentiment remains excessively optimistic, so we will keep an eye on this measure. For now, the weight of the evidence recommends a fully invested allocation to equity sectors according to the model.

U.S. Market Update

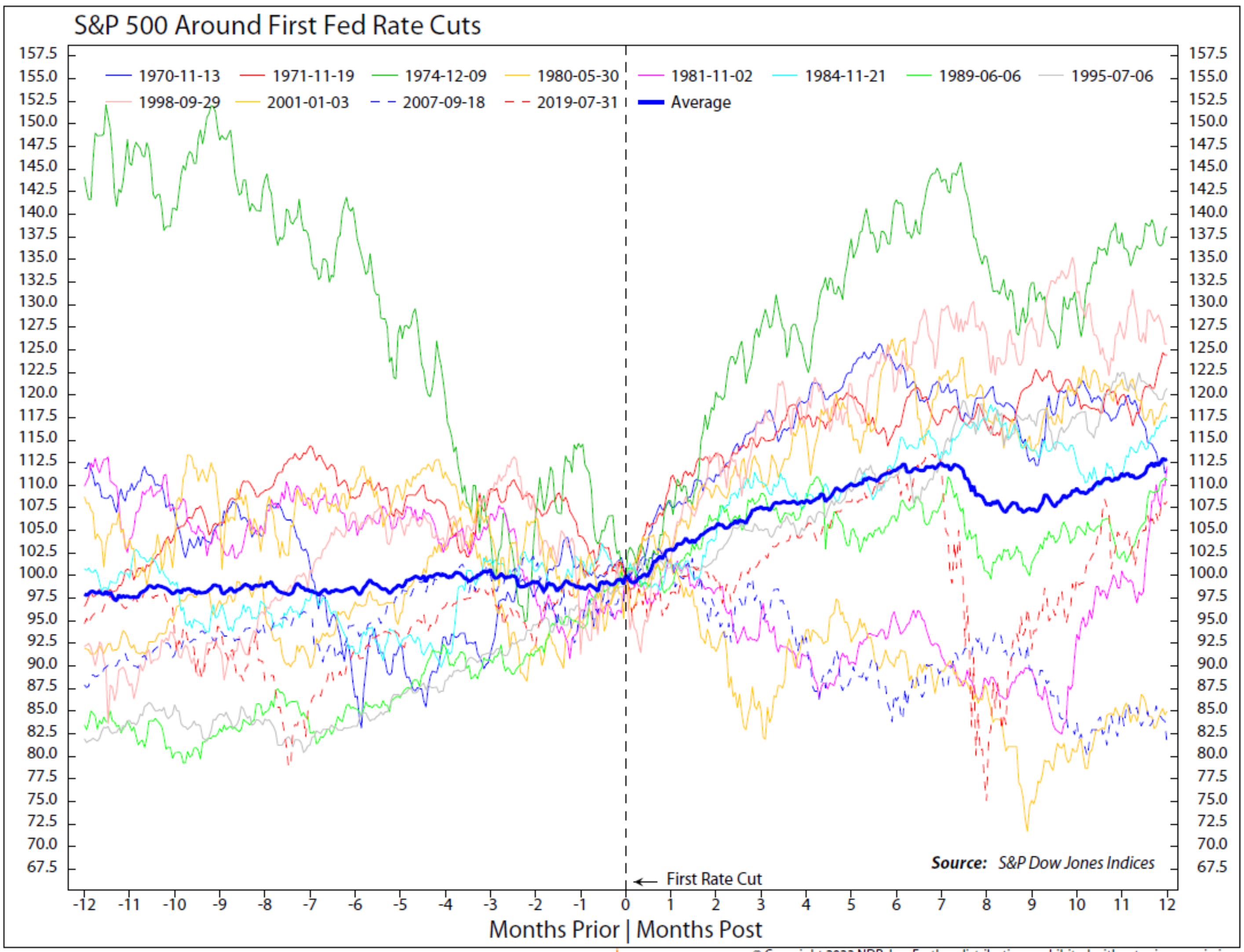
The S&P 500 Total Return Index finished 2023 with a bang, gaining about 4.5% and pushing the yearly return to about 26%! Breadth remained strong, with 10 of 11 S&P 500 sectors posting positive price gains for the month—only Energy was down modestly.

The 10-year Treasury yield continued to decline and helped drive strong returns from Real Estate, Industrials, Consumer Discretionary, and Financials. The 10-year Treasury yield, which had risen above 5% in October, dropped to less than 4% last month. Ten-year Treasury yields have always fallen in the 2-3 months before the first rate cut going back to 1970. The market is expecting a rate cut in March. Historically, after first rate cuts, yields tend to stabilize.

The S&P 500 has never rallied more than 11% in the three months leading up to the first Fed rate cut. On average, performance has been pretty flat. But after the rate cut, stocks tend to rally for 6-7 months with a mean gain of roughly 12% (chart below).

Entering January, the sector model is overweight Energy, Real Estate, Utilities, and Consumer Discretionary. Materials and Financials are underweight. Information Technology, Communication Services, Consumer Staples, and Health Care are market weight.

Figure 3: S&P 500 Around First Fed Rate Cuts



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Consumer Discretionary is 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. All six price-based measures remained bullish during the month, including short-term trend (chart right).

Figure 4: S&P 500 Consumer Discretionary Sector's Short-Term Trend is Bullish

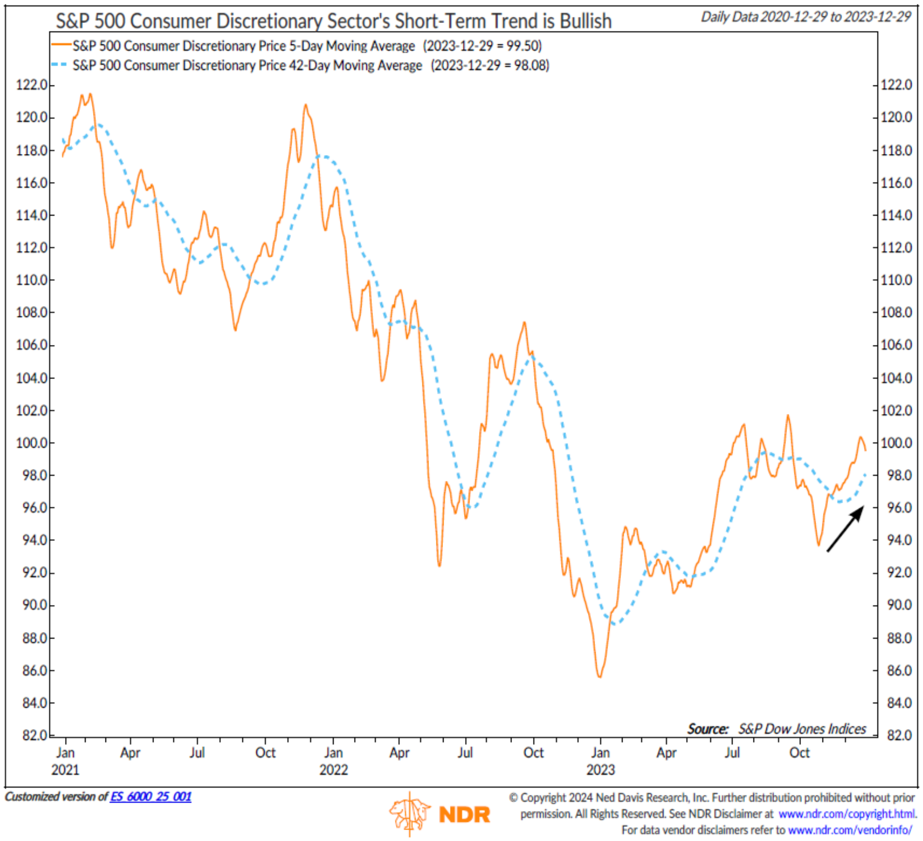
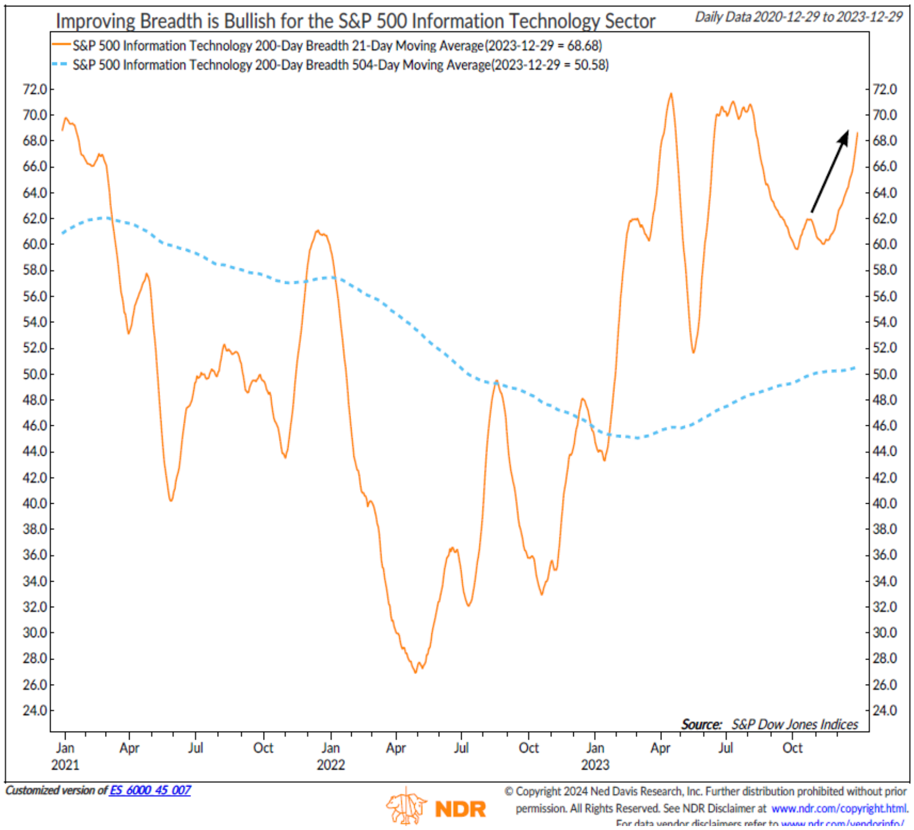


Figure 5: Improving Breadth is Bullish for the S&P 500 Information Technology Sector



The Information Technology sector's allocation remains neutral. On a fundamental basis, while valuation, inflation expectations, and short interest remain headwinds for the sector, earnings revision breadth and Emerging Asia equity performance are bullish. Technicals are confirming, as an overbought/oversold indicator moved from bearish to neutral during the month. And four of the five internal (price-based) indicators remain bullish, including improving breadth (chart left).

Communication Services' allocation dropped sharply and was downgraded from overweight to neutral. On a fundamental basis, indicators are mixed. The yield curve, sales growth trends, and earnings revision breadth remain bullish. However, widening option-adjusted spreads moved bearish for the sector during the month (chart right). This was confirmed by two price-based indicators moving from bullish to bearish.

Figure 6: Widening Spreads is Bearish for the S&P 500 Communication Services Sector

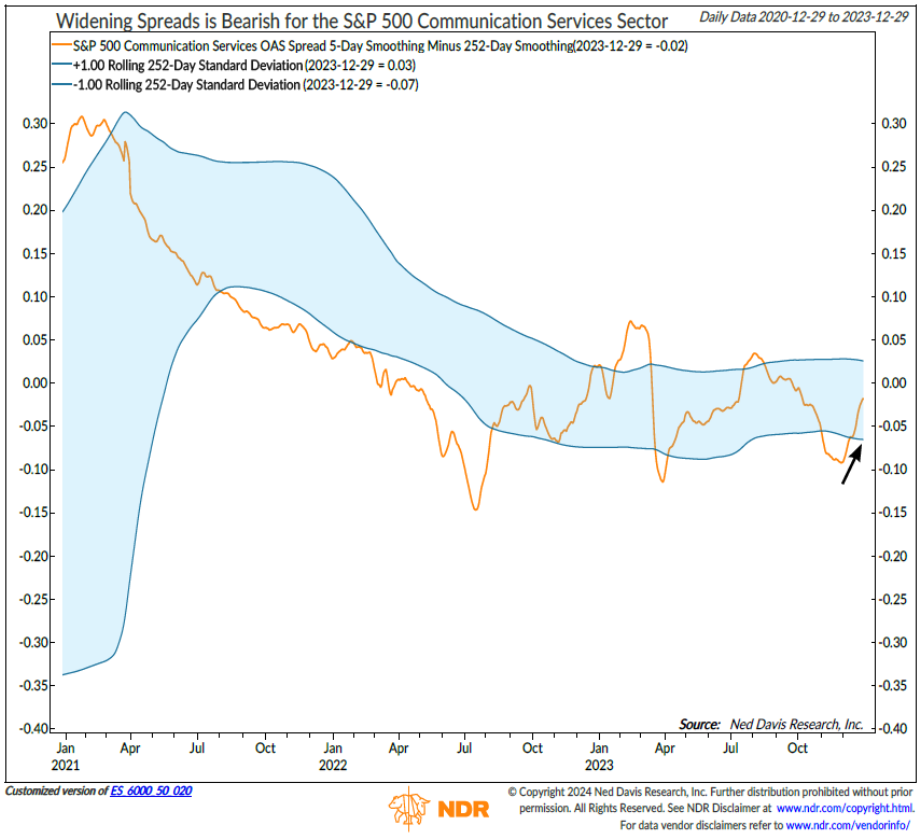
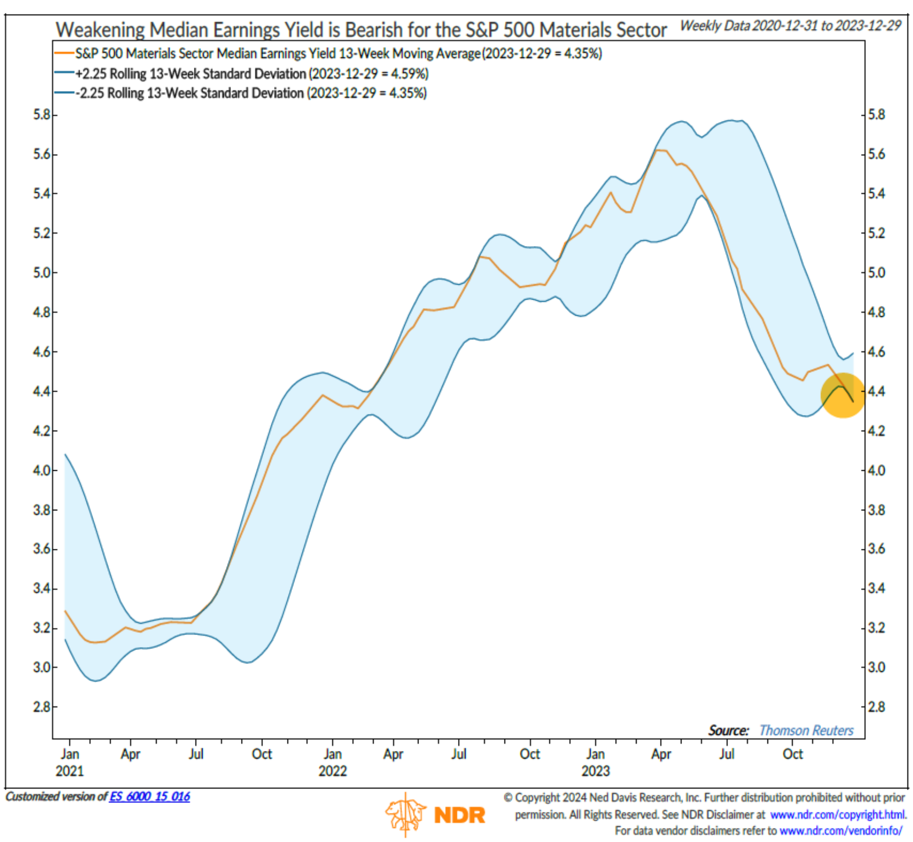


Figure 7: Weakening Median Earnings Yield is Bearish for the S&P 500 Materials Sector



The Materials sector's allocation dropped and was downgraded to underweight. Price-based measures are mixed. On a fundamental basis, five of the eight indicators are now bearish—earnings yield (chart left) and emerging vs. developed equity momentum moved negative for the sector during the month.

Summary

The sector model remained with a cyclical bias during the month, but there were several changes. Entering January, the sector model is overweight Energy, Real Estate, Utilities, and Consumer Discretionary. Materials and Financials are underweight. Information Technology, Communication Services, Consumer Staples, and Health Care are market weight.

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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