Dynamic Allocation Strategy

NOVEMBER 2022

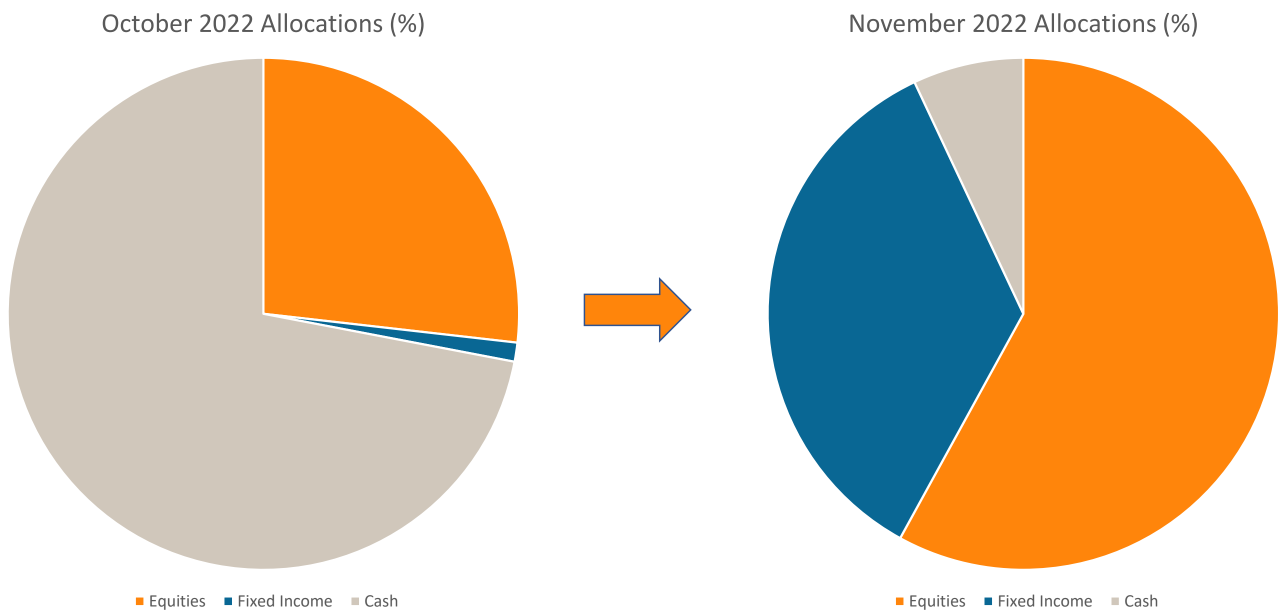
Macro/Market Update

Global economic risks have heightened amid persistently high inflation, much tighter monetary policy, the Russia/Ukraine war, and China's zero-COVID policy. The global economy contracted for a second consecutive month in September, according to the latest S&P global Purchasing Managers' Index (PMI). The global composite PMI was little changed at 49.7, the second straight reading below 50. Falling economic momentum as represented by the global composite, is historically consistent with weak global equity market performance.

With global inflation at multi-decade highs, most of the world's central banks have made it unequivocally clear that fighting inflation is their primary goal. A central bank pivot will come when there are clear signs that inflation has turned lower and there are some constructive signs that inflation pressures are easing.

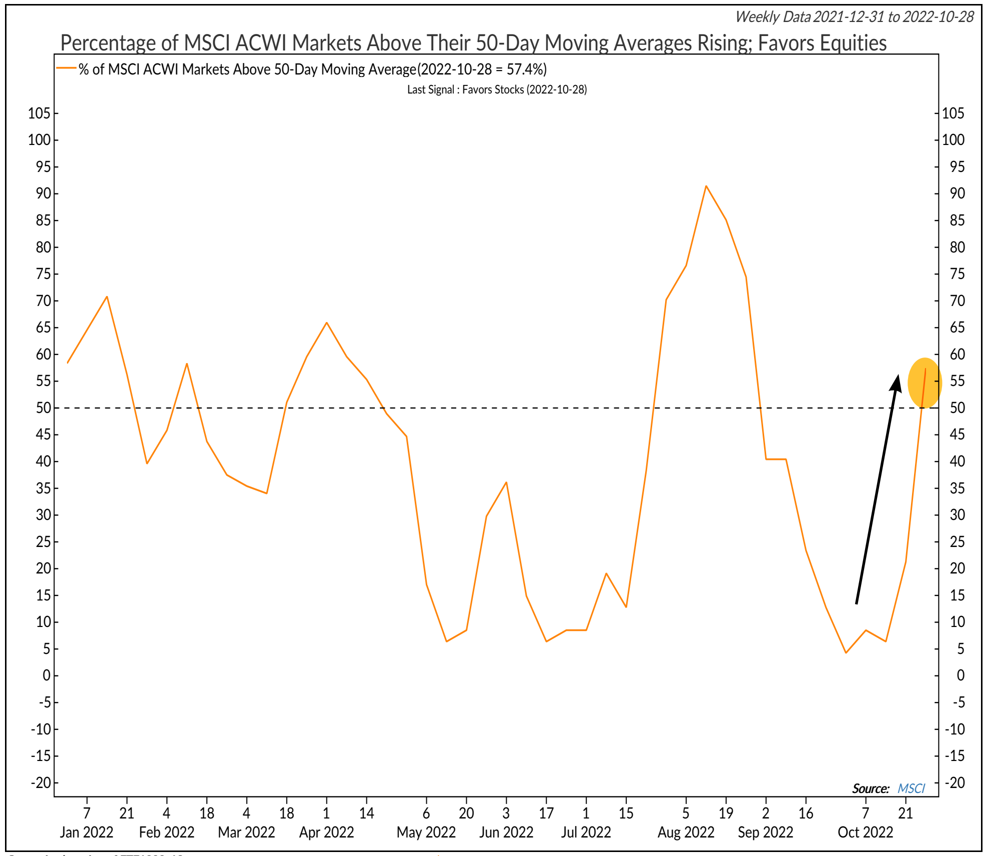
During October, the MSCI All Country World Index (ACWI) outperformed the Bloomberg Barclays Global Aggregate Bond Index by over 650 basis points (bps). Equity markets rose on hints that the Federal Reserve will soon downshift their rate hikes. Overtightening concerns noted by Vice Chair Brainard and rate hike downshifts by the Bank of Canada and the Reserve Bank of Australia gave the market hope for a slowing and eventual pause of the tightening cycle. Ultimately, a softening in labor market conditions and clear evidence that inflation is moving back down to 2% are required for the Fed to downshift.

Asset Allocation Summary



* See Equity Allocation Summary for how the equity allocation is distributed
** See Fixed Income Allocation Summary for how the fixed income allocation is distributed

The equity allocation jumped to slightly below benchmark allocation for November. The technical indicators reflect equity market improvement due to an expected Fed rate hike downshift, as the stock/bond relative strength ratio rose above its long-term average, and more than half of global equity markets traded above their intermediate-term moving averages (chart at right).



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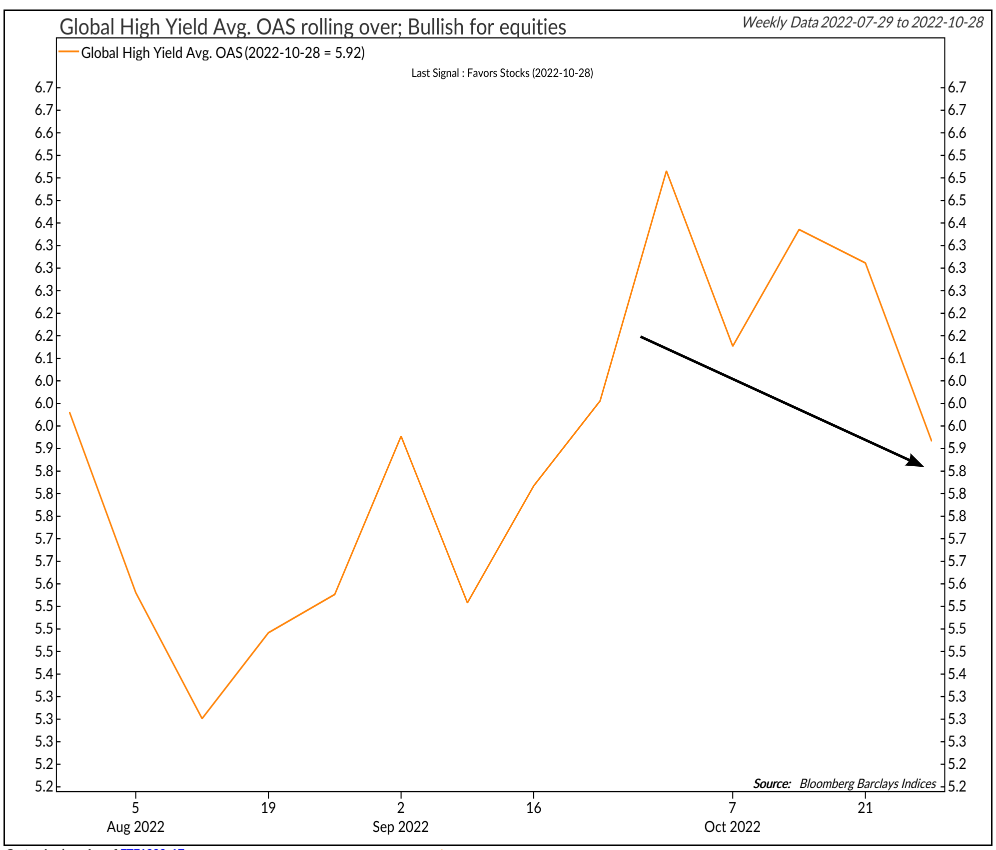

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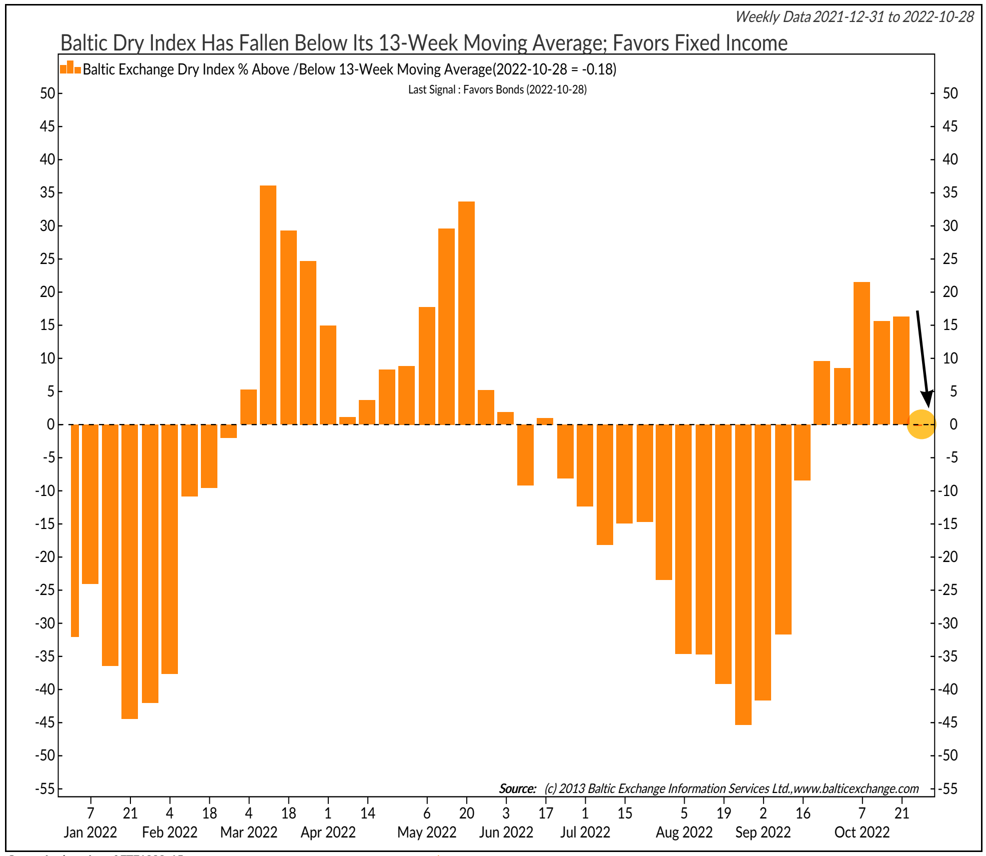
A new indicator tracking global high yield option-adjusted spreads (OAS) also contributed to the equity allocation (chart at left). This OAS indicator measures risk appetite within the fixed income market. With global high yield OAS narrowing, bond investors are not demanding higher yields for taking on more risk as they are not as concerned with default at this time.

Not all news was positive for equities. The global shipping rates indicator (chart at right), which turned bullish last month, deteriorated to a bearish reading. The Baltic Dry Index dropped more than 15.6% last week, its largest decline since early August, as the economy softened. However, the indicator is teetering on the threshold for turning bullish.



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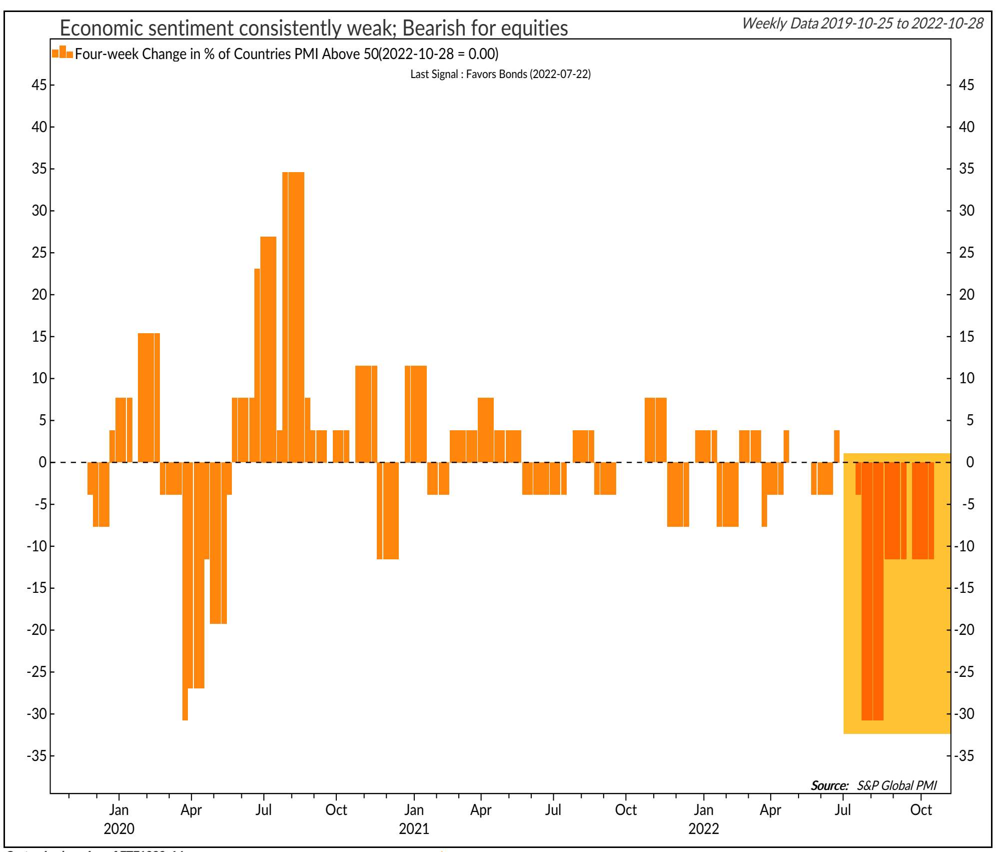

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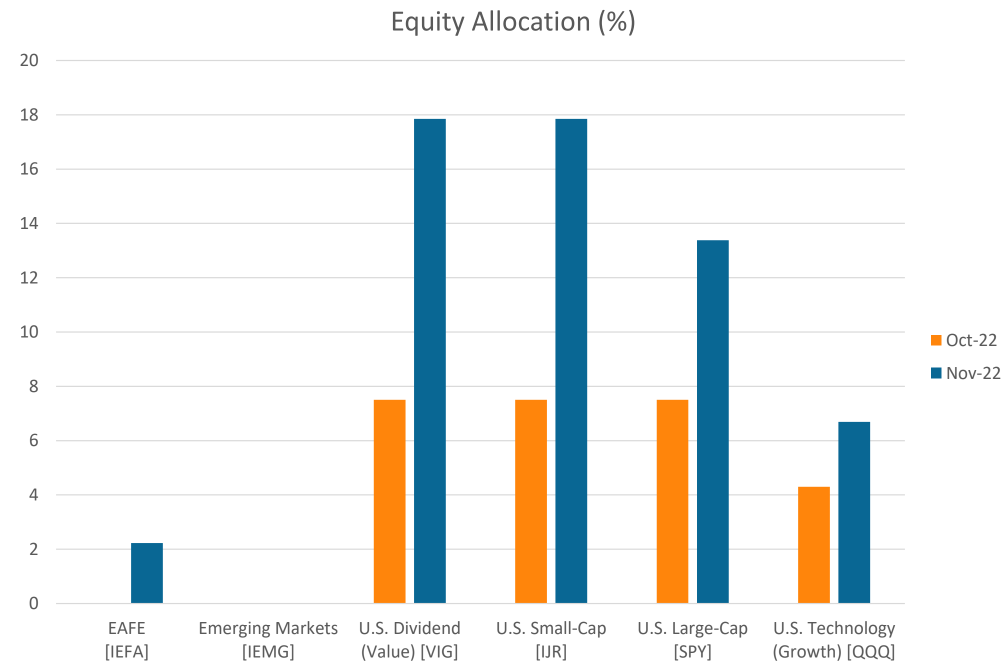
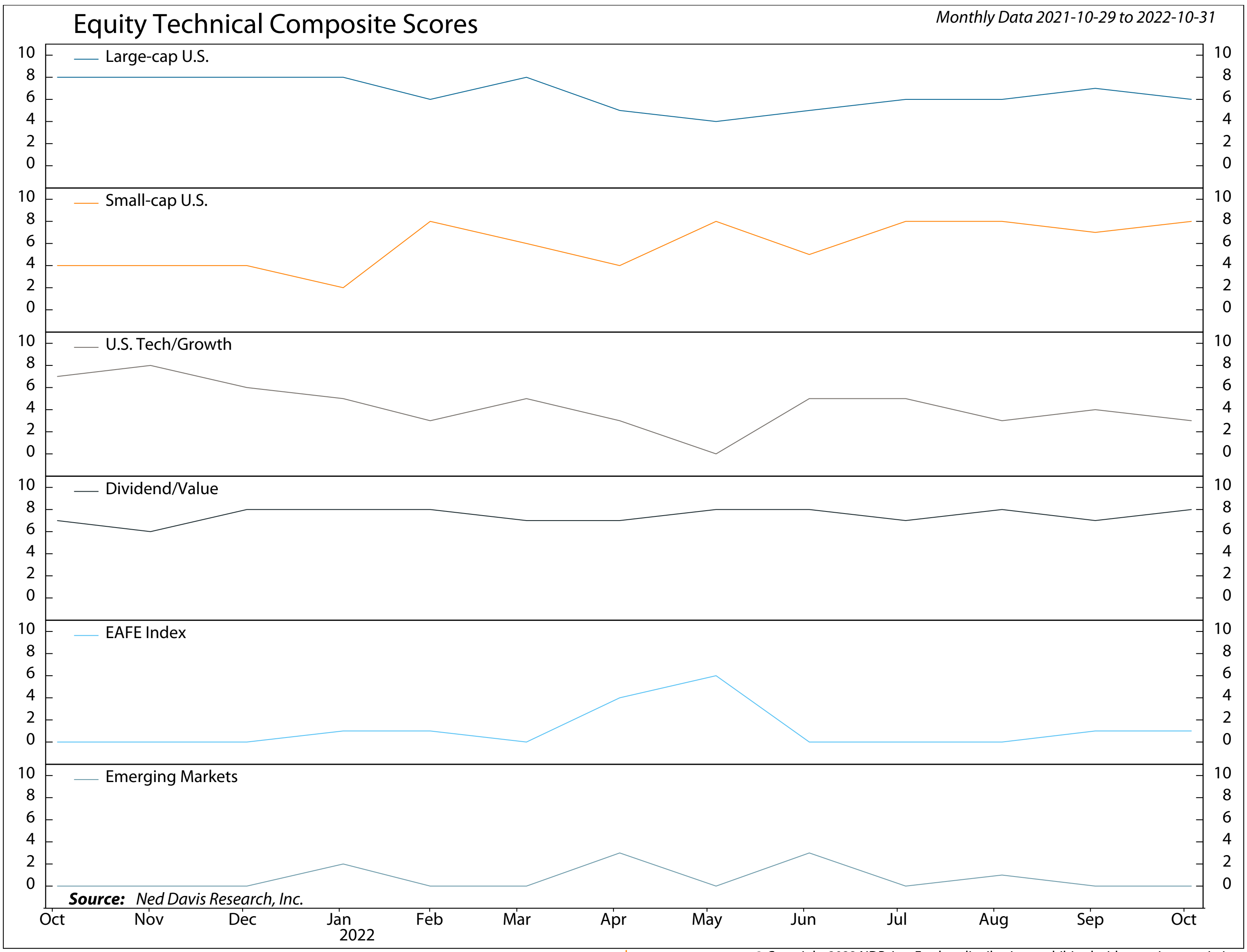
Global economic sentiment continues to be weak (chart at left). The consistent negativity across senior executives was last seen during the COVID-19 lockdowns in early 2020. The four-week change in economies with expanding manufacturing industries is negative as multiple European economies' PMI readings remain in contractionary territory.

Equity Allocation Summary

Except for Emerging Markets (IEMG), all equity areas rose by at least 400 basis points (bps) during October. IEMG declined over 100 bps, as China's zero-COVID policy has put a strain on its economy and market. IEMG received no allocation this month. U.S. Small Caps (IJR) and U.S. Value [Dividends] (VIG) increased over 990 bps, which were the best months for those segments since late 2020. VIG and IJR both received more than 17% allocation for November due to their technical composite scores (image at bottom).





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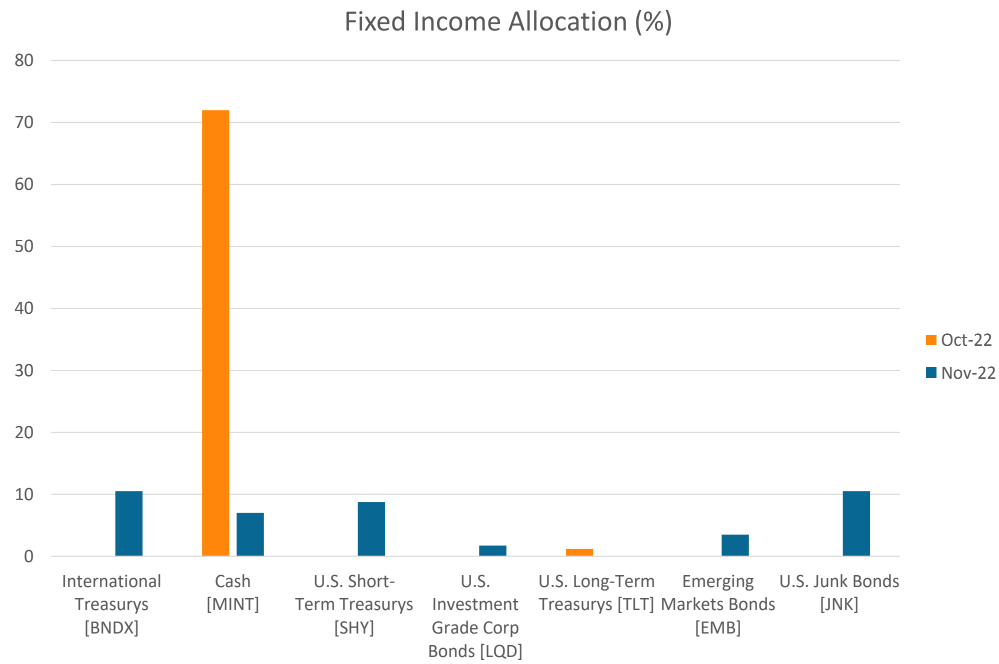
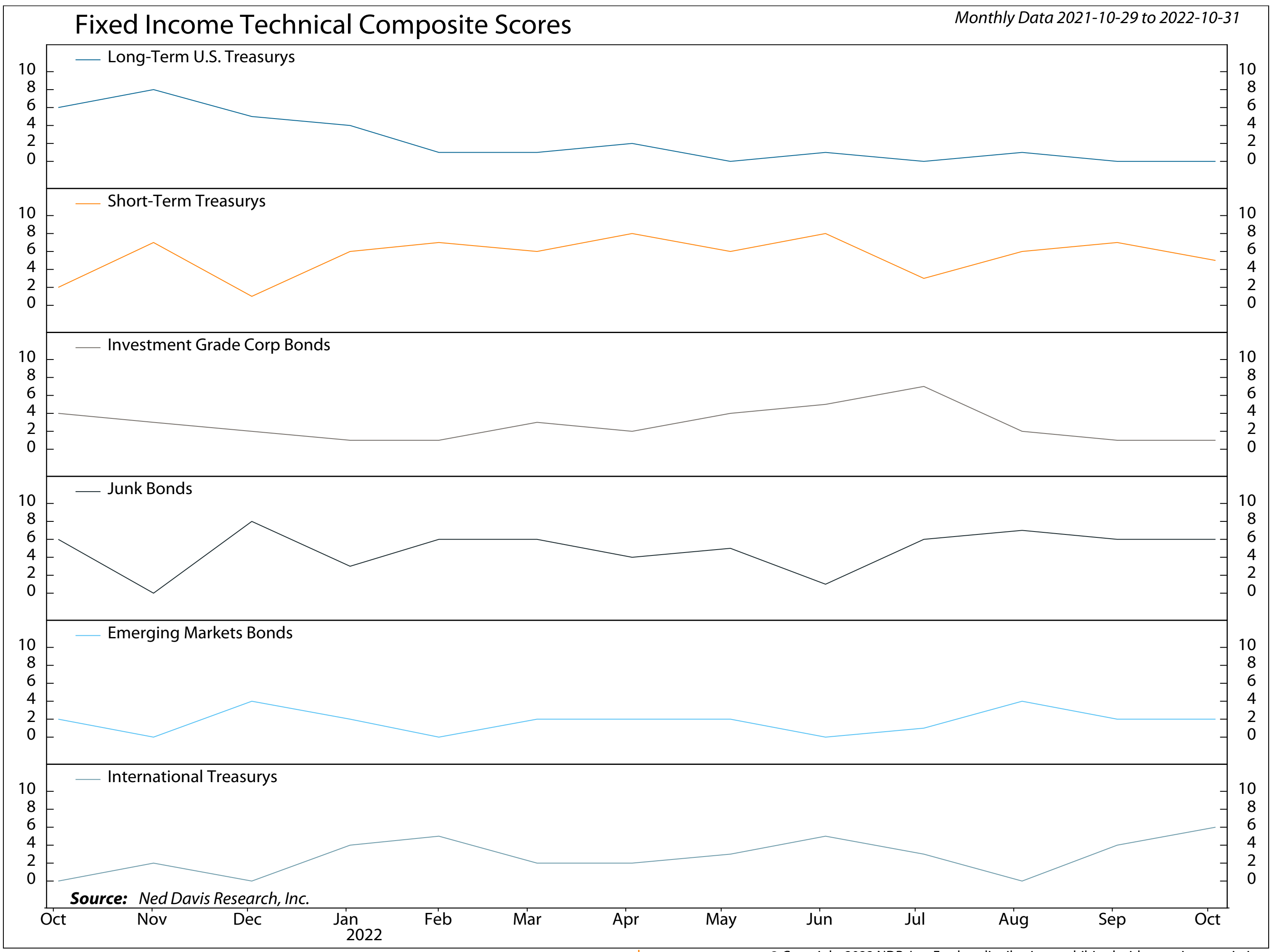
Fixed Income Allocation Summary

U.S. High Yield (JNK) and International Investment Grade (BNDX) were the only fixed income areas to produce positive returns during October. JNK is the only fixed income segment to have more than two positive monthly returns in 2022. U.S. Long-Term Treasurys (TLT) continues to plummet, as TLT dropped more than 500 bps last month. TLT has only risen one month this year. JNK and BNDX each received more than 10% allocation for November due to their technical composite scores (image at bottom).





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