DAY HAGAN
ASSET MANAGEMENT

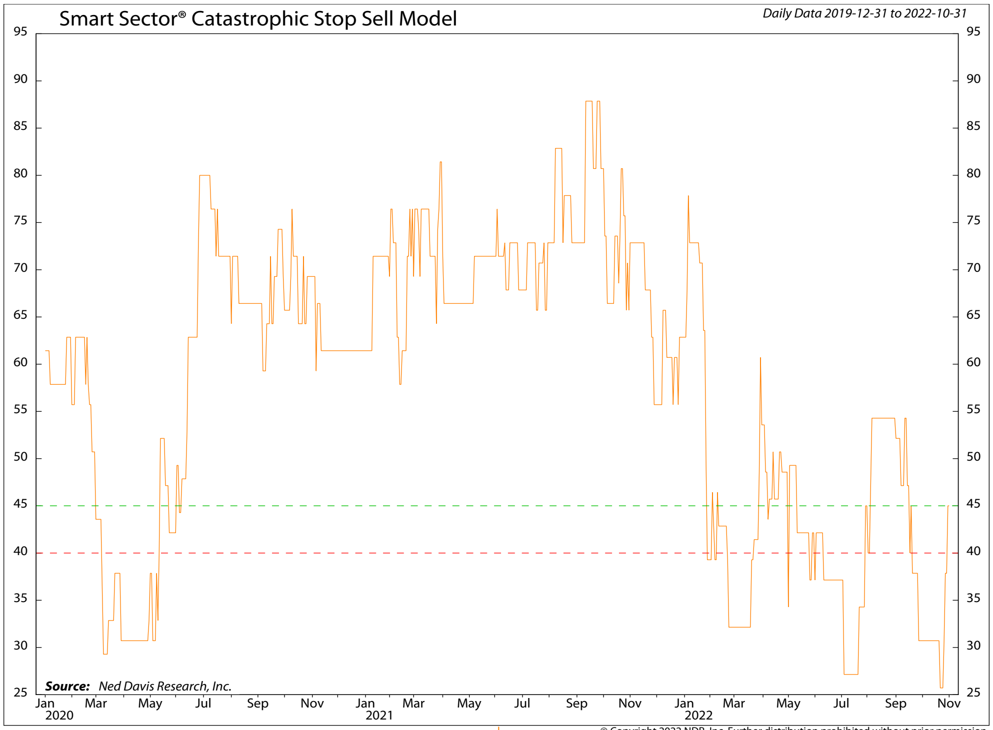
NDR
NED DAVIS RESEARCH

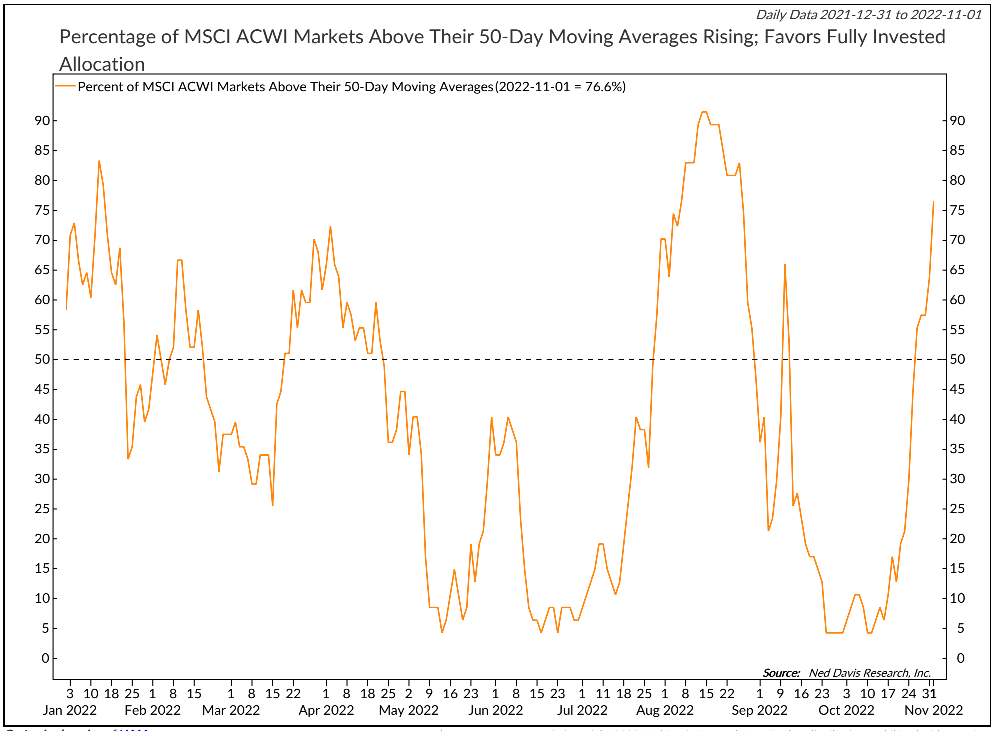
Smart Sector® Strategy

NOVEMBER 2022

Catastrophic Stop Update

The Catastrophic Stop model combines time-tested, objective indicators designed to identify periods of high risk for the broad U.S. equity market. The model (chart at right) entered November recommending a fully invested equity allocation, closing out its late-September stop-loss signal. The model improved on rising market performance, improving global equity market breadth (chart at left), and strengthening high yield and Emerging Market bond breadth. However, the fully invested signal is teetering on a bearish reading. If the near-term market strength is temporary, the shorter-term breadth indicators should roll over and trigger another bearish signal. Conversely, if the market trends upward, the stock/bond relative strength ratio moves higher, volume demand outpaces supply, global shipping rates improve, and high yield OAS narrows, then it could indicate that the rally may persist into the new year.





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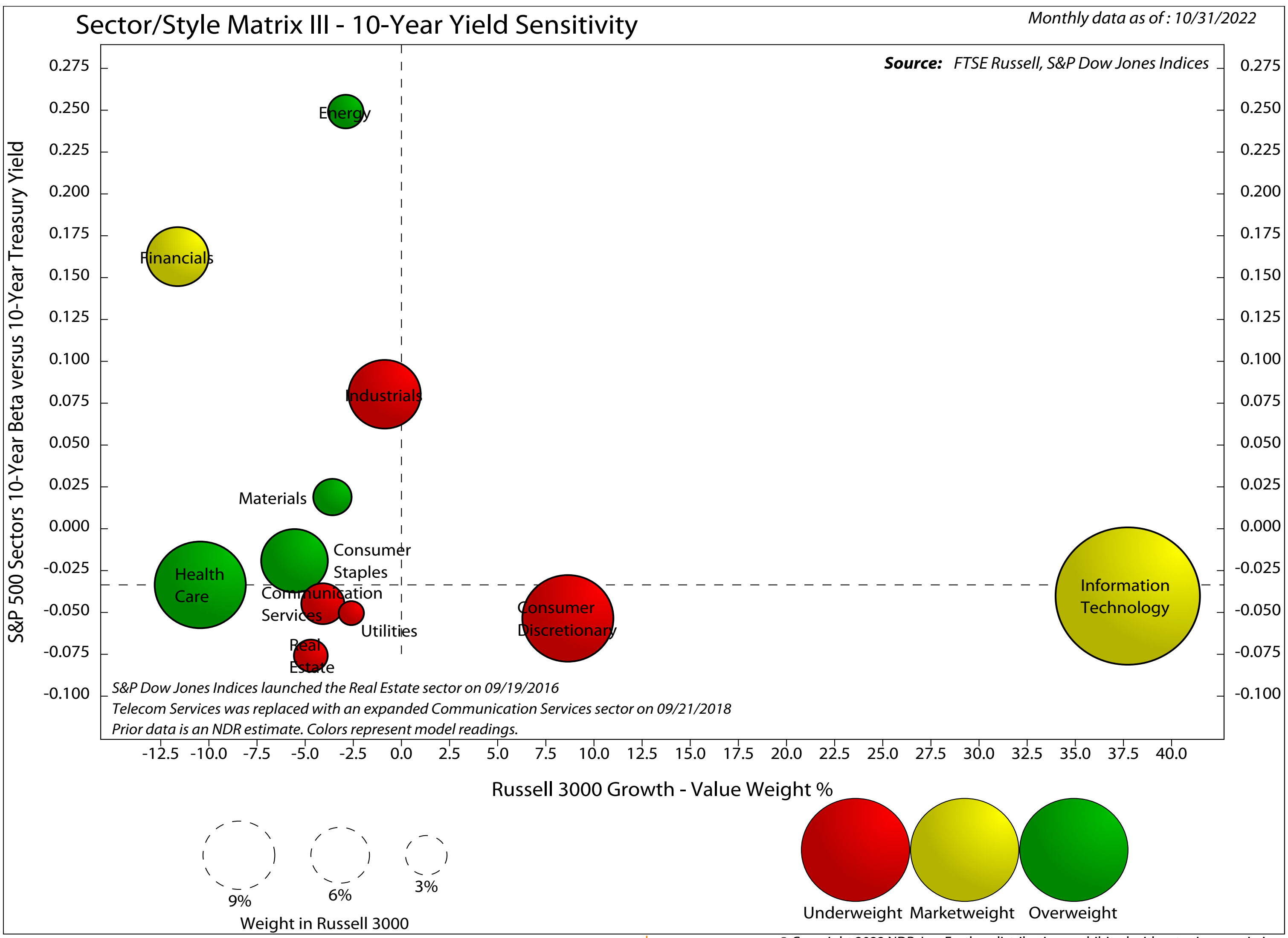
U.S. Market Update

The U.S. equity market rallied in October, as the S&P 500 Total Return Index rose by more than 800 basis points. It was the second-best monthly return for the S&P since late 2020. For historical perspective, the Dow Jones Industrial Average was up almost 14%. It was the index's best October going back to 1900, best monthly return since January 1976, and the 11th best monthly return going back to 1900.

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.

Although the market rallied on the hope of a slowing tightening cycle, sector leadership reflected the rising interest rate environment by favoring Value-oriented areas such as Energy, Industrials, and Financials. Over the last ten years, these three sectors have had the highest sensitivity to the 10-year yield (chart at bottom). Conversely, the sector laggards were Communication Services, Utilities, Real Estate, and Consumer Discretionary, which have had the largest inverse sensitivities to rates during the last decade. The 10-year yield ended October at its highest month-end reading since 2007.

Entering November, the sector model overweighted Value areas Energy and Materials, as well as defensive sectors Consumer Staples and Health Care (shown in green). Inverse rate sensitive areas such as Communication Services, Utilities, Consumer Discretionary, and Real Estate all entered the month below benchmark allocation (shown in red). Industrials was the one sector with rising rate sensitvity to enter the month significantly below benchmark weighting.



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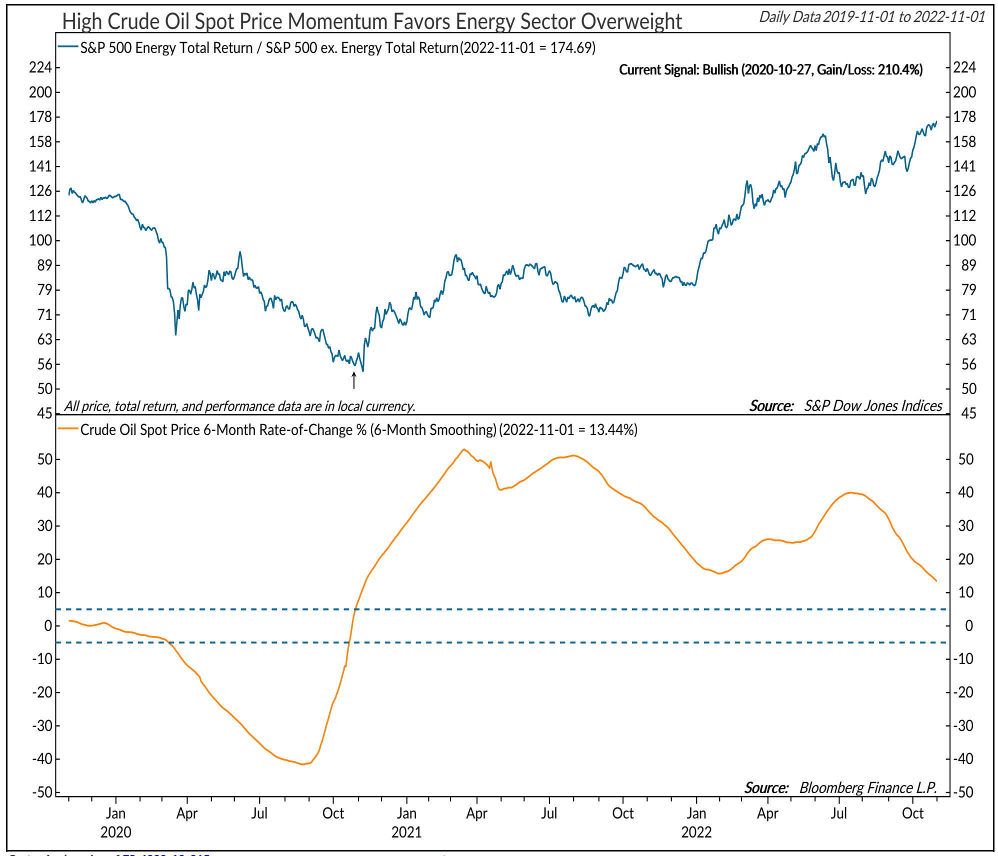
The Energy sector continues to be overweight. U.S. demand for petroleum products has yet to recover to pre-COVID levels. Even so, seasonally-adjusted inventories remain below pre-pandemic levels, indicating low supply relative to demand. That supply has included about 1 million barrels of oil per day from the U.S. Strategic Petroleum Reserve (SPR) stockpile. The SPR tap was set to shut off at the end of October, but the Biden administration has extended the releases by at least another month, albeit at only one-third the original rate. The SPR should become less of a bearish factor for oil going forward. Oil sentiment rising from an overly pessimistic condition, the U.S. Dollar momentum reversing lower, and favorable oil momentum (chart at right) are all tailwinds confirming the strong techincal readings.



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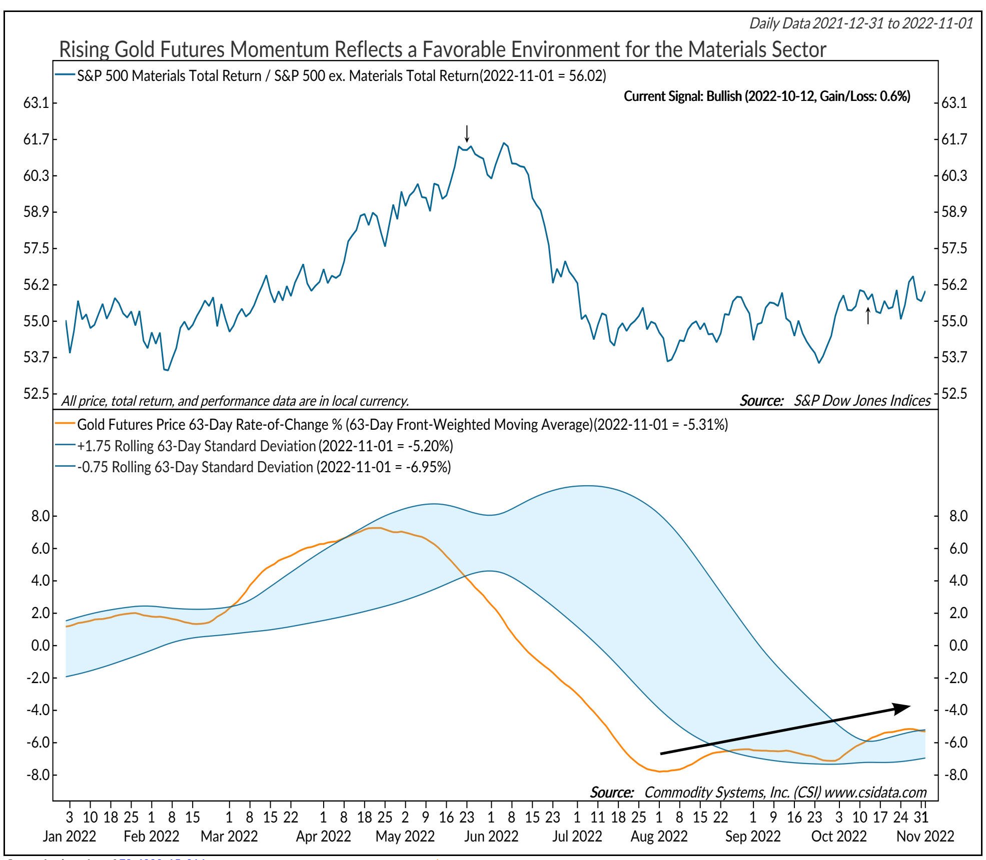

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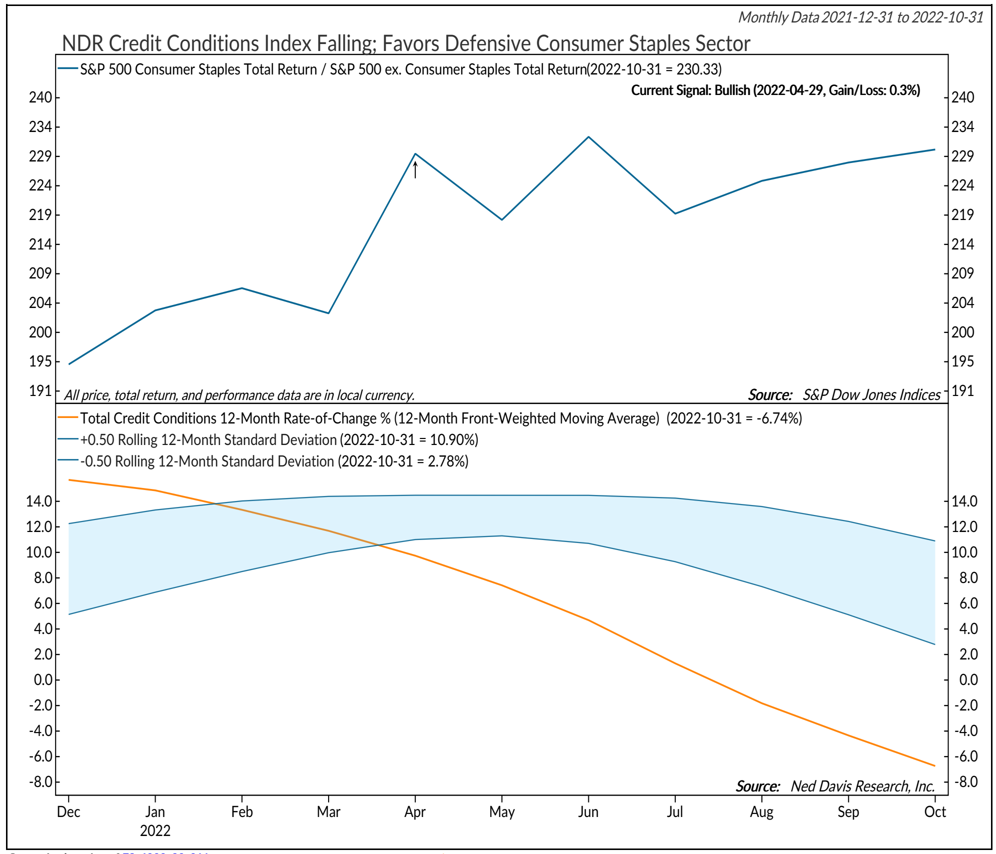
The Materials sector jumped to overweight as the U.S. Dollar momentum reversed lower and commodity prices moved higher. Rising gold momentum (chart at left) reflects the commodity tailwinds for the sector. Favorable valuations and upward earnings revisions have provided additional support, which has been confirmed via rising price trends, strong momentum, and reduced volatility.

Although its allocation declined, the Consumer Staples sector remains overweight. The sector is reversing from an overbought condition with weakening breadth. However, Staples still has a strong price trend and momentum. The macro environment also favors the sector as it typically outperforms as the economy weakens. Three-quarters of the yield curves NDR tracks (ranging from three months to 30 years) were inverted at the beginning of the month. NDR's Credit Conditions Index has fallen sharply from record levels of accommodation (chart at right). Such conditions historically favor the defensive Staples sector.



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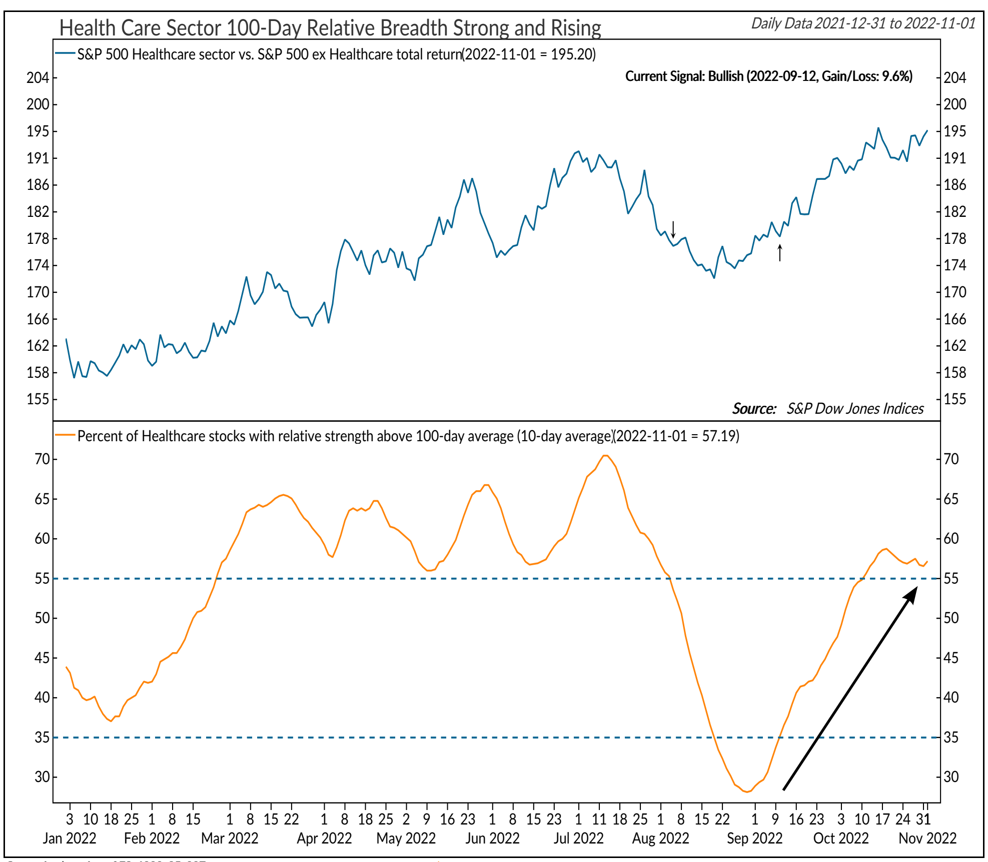

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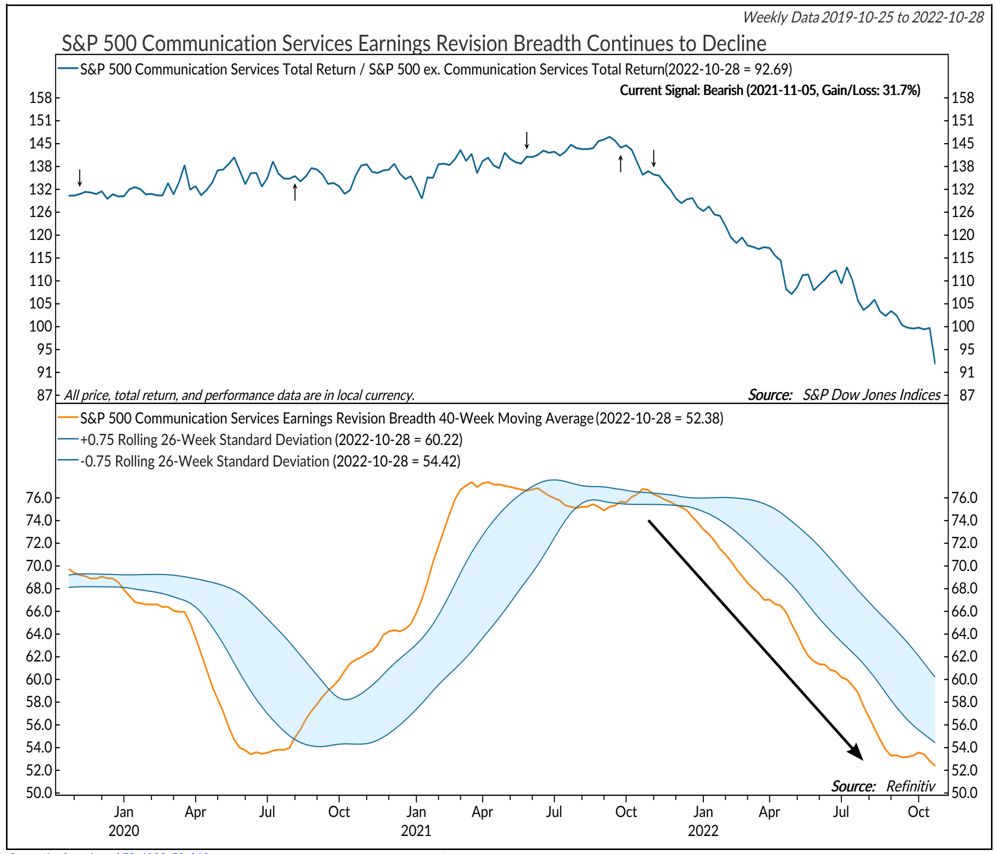
The Health Care sector's allocation declined, but it continues to have an above benchmark weighting. From a valuation standpoint, Health Care looks cheap on a relative basis based on most of the valuation metrics we track. Among metrics, we have found that the excess cyclically adjusted price-to-earnings (CAPE) yield has the best correlation with future long-term (10-year) returns, and Health Care has one of the highest. Further supporting the sector are the Biden administration's proposal to expand Affordable Care Act (ACA) subsidies and the sector's low beta is an asset in a bear market. The technical indicators firmly support a larger than average Health Care sector allocation. Trend, reversal, and breadth (chart at left) measures are all bullish.

Communication Services improved in allocation, but it remains below benchmark weighting. From the start of the year through October, the sector's three largest companies, Alphabet, Meta, and Disney all have declined more than 30%. In general, cyclical Growth sectors have had a tough year, as a combination of rising rates and an unwind of the 2020/2021 stay-at-home trade has weighed on the sectors. Antitrust suits have raised the level of uncertainty surrounding the sector. Subscriber growth for streaming services is becoming more difficult as competition rises. Widening OAS, falling earnings expectations (chart at right), and elevated relative valuations are headwinds for a sector with rising volatility and declining trends.



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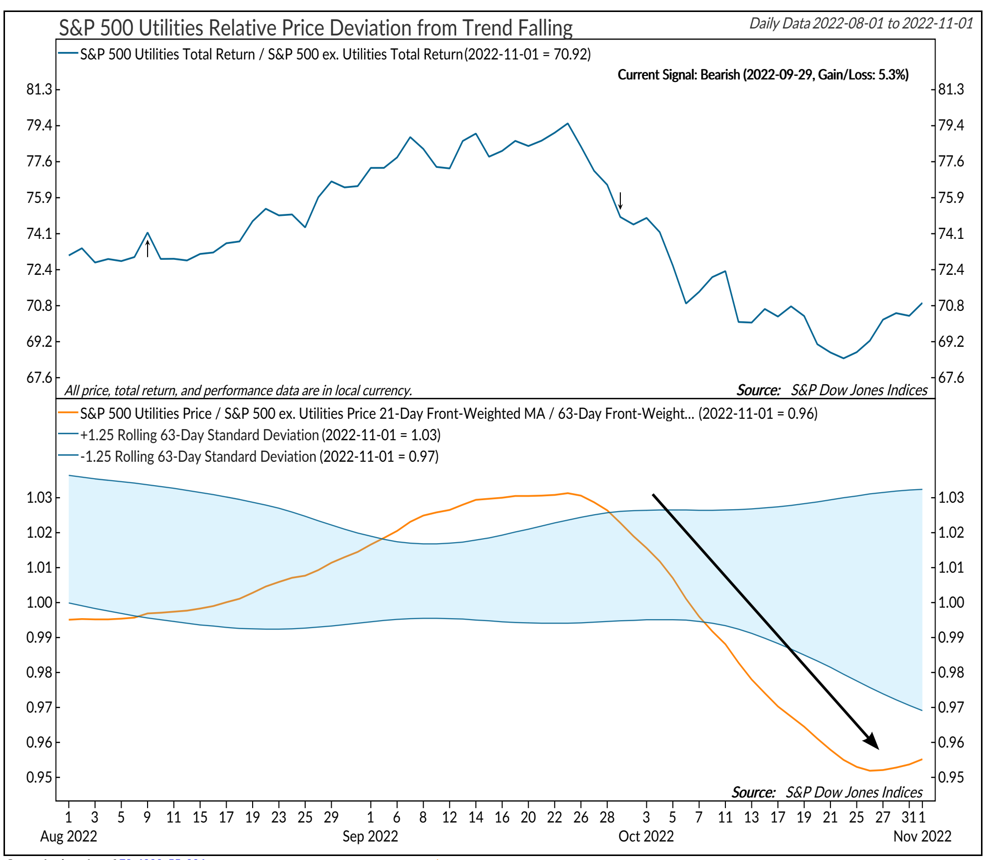

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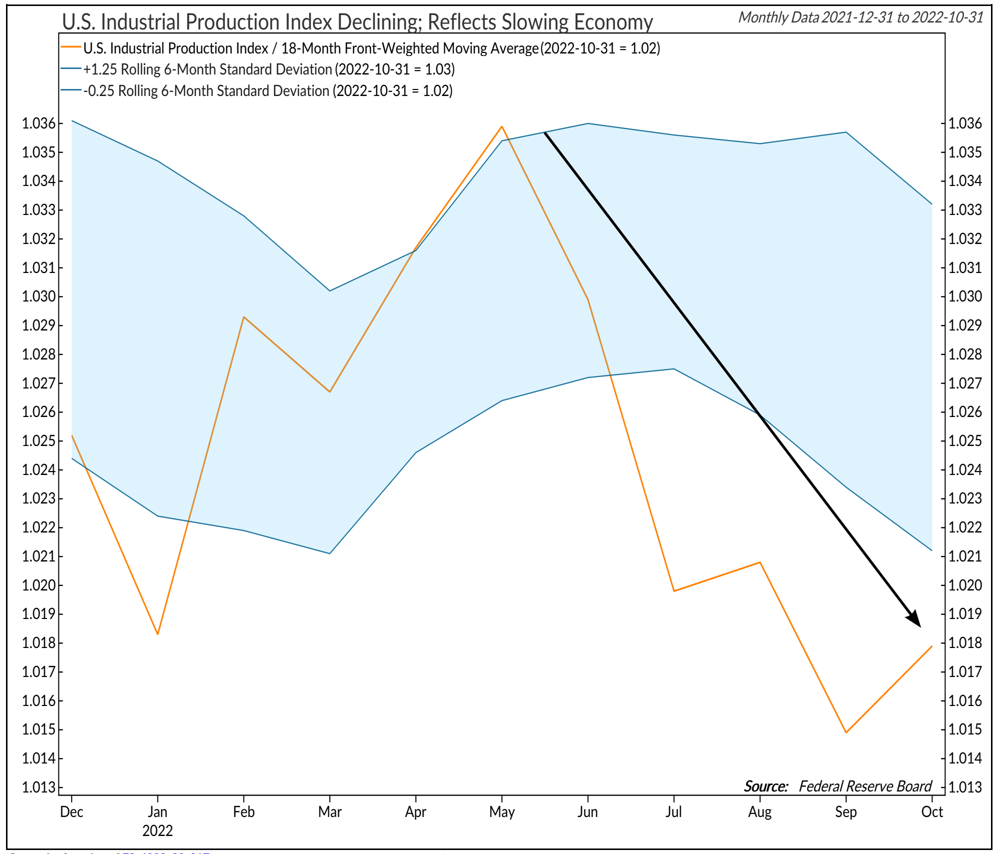
Utilities dropped from marketweight to underweight on technical deterioration as its trend is firmly lower (chart at left). Utilities is considered a bond proxy sector because a relatively large portion of its total return is derived from dividends. At 2.9%, the sector currently sports the third-highest dividend yield behind only Real Estate and Energy. While bond proxy correlations with yields are weaker than pre-COVID levels, they remain negative and have been trending lower throughout the year. The sector's net debt to cash flow ratio is at record high, but a large amount of capex is needed to shift to a more sustainable energy production mix.

Industrials increased in allocation, but it is still below benchmark weighting. In general, the most economically sensitive sectors have struggled as the Fed continued its tightening path that looks increasingly likely to end with a U.S. recession. The sector's valuations are expensive, which does not bode well as the economy slows as evidenced by weaker consumer confidence and falling industrial production (chart at right).



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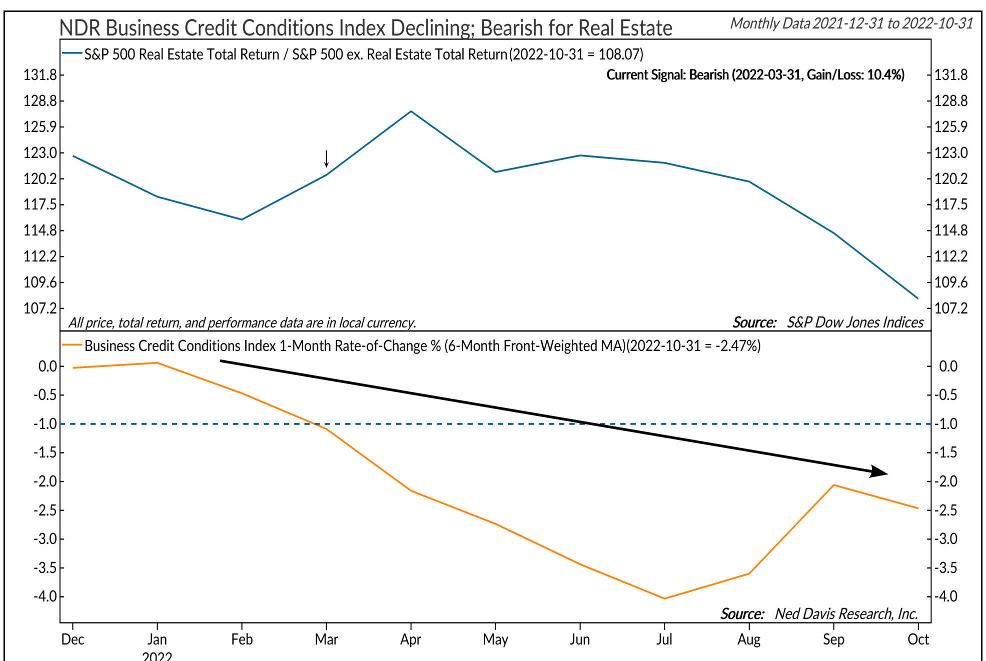

Bullish when the smoothed rate-of-change rises above 1%.

Bearish when the smoothed rate-of-change falls below -1%.

S&P 500 Real Estate Sector RS Performance
Full History: 2001-12-31 to 2022-10-31

Business Credit Conditions Index Indicator is	% Gain/ Annum	% of Time
Bullish	9.57	47.58
Bearish	-7.30	52.42

Buy/Hold = 0.37% Gain/Annum

S&P 500 Real Estate Sector RS Performance
Chart View: 2021-12-31 to 2022-10-31

Business Credit Conditions Index Indicator is	% Gain/ Annum	% of Time
Bullish	-1.68*	29.61
Bearish	-10.42*	70.39

Buy/Hold = -11.93% Gain/Annum

** Cases less than one year are not annualized*

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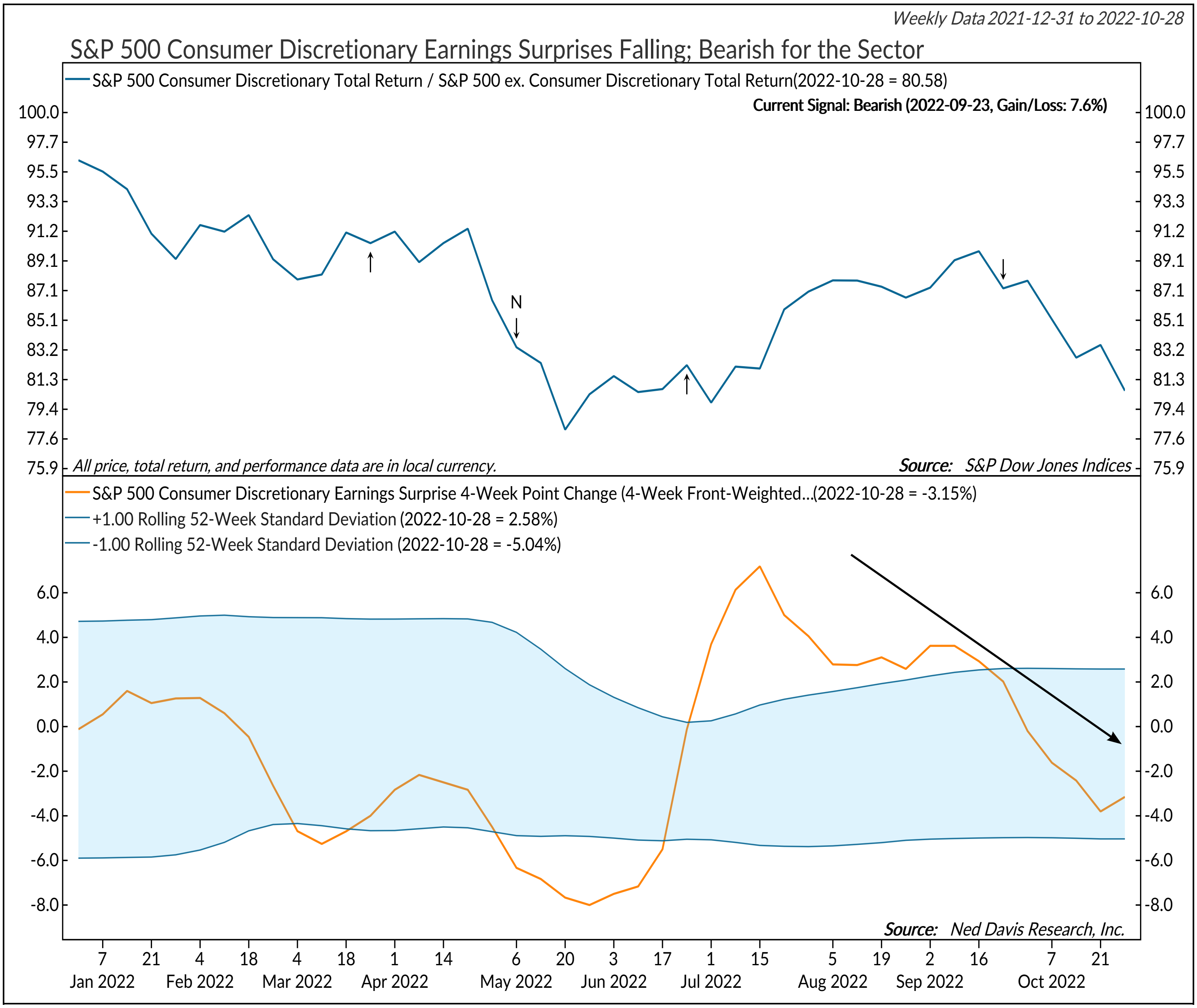
Real Estate's weighting declined to underweight status. The sector is now down almost 30% on the year, third worst among sectors. Real Estate is trading mostly below its pre-COVID levels, as ecommerce is challenging Retail REITs and work-from-home trends are pressuring Office REITs. The interest rate and economic environments also are headwinds for the sector. The -0.4 correlation with 10-year Treasury yield over the last year continues to be a drag. Business credit conditions have been rolling over (chart at left), which is bearish for Real Estate prospects.

The Consumer Discretionary sector plummeted to the most underweight sector. Rising interest rates have been a negative for durable good sales, including housing-related sub-industries, with Houseware & Specialties, Household Appliances, Home Furnishing Retail, and Home Furnishings all feeling the pressure. Housing weakness could be a drag on the sector as the Fed continues its aggressive policy to reduce inflation and consumer confidence is near record lows. The sector's earnings revisions ratio is among the lowest of all sectors, as earnings surprises have been reversing lower (chart at bottom).

Summary

The Catastrophic Stop model recommends a fully invested position according to the sector allocation model. The sector allocation strategy currently favors sectors most sensitive to rising interest rates or less economically sensitive, while reducing exposure to negatively interest rate sensitive sectors. Energy, Materials, Health Care, and Consumer Staples are overweight, while Utilities, Real Estate, Communication Services, Consumer Discretionary, and Industrials are underweight. 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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Smart Sector® Strategy

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 utilize 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 accordingly 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 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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