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NED DAVIS RESEARCH

Dynamic Allocation Strategy

AUGUST 2022

Macro/Market Update

Global economic growth accelerated in June, as the global composite Purchasing Managers' aIndex (PMI) jumped 2.2 points to 53.5. It was the highest level this year and in line with the index's long-term average. Moreover, the latest reading is historically consistent with a robust 3.3% annual real Gross Domestic Product (GDP) growth rate.

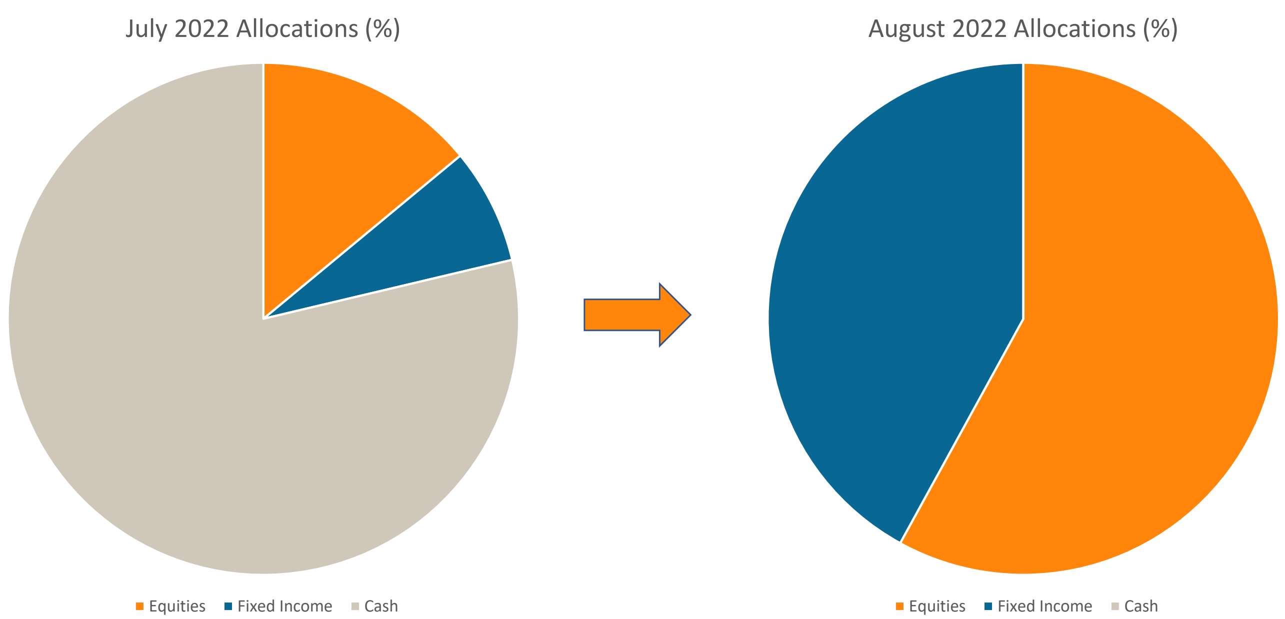
However, the latest data were distorted by a surge in China's PMI, which has rebounded markedly after easing its COVID stringency measures. Excluding China, the global PMI fell for a third straight month to 53.1. This is not necessarily a bad reading and by no means does it point to an imminent severe recession.

Once the effect of the China rebound abates, it will be difficult for global growth to further accelerate amid high inflation, waning excess savings, superfluous inventories, and tighter monetary policy in most parts of the world. Forward looking indicators confirm this, as both the new orders and future output indexes fell to their lowest points since mid-2020.

The good news was that supplier delivery times slowed at a much slower pace, with the index rising to its highest level since November 2020. This points to fewer supply chain disruptions, which should lead to easing global inflation trends in the near-term.

During July, the MSCI All Country World Index (ACWI) outperformed the Bloomberg Barclays Global Aggregate Bond Index by over 450 basis points (bps). It was the largest spread between stocks and bonds since March. Global stocks have trailed bonds for four of the first six months in 2022. If the current economic slowdown turns out to be moderate, there's a good chance that investors will consider the current valuations to be reasonable, rallying on expectations of earnings growth improvement in 2023.

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 model deployed cash to both equities and fixed income this month.
- The equity allocation is slightly below 60%, while the fixed income allocation is more than 40%.
- After having an all-time high allocation last month, cash received no weighting for August.
- The global stock/bond relative strength and global equity market breadth (chart, below) indicators turned bullish on equities.
- Entering this week, more than 70% of global equity markets were trading above their 50-day moving averages, the highest weekly reading since January.
- Three of the six top-level indicators support equities over fixed income (table, below).
- The technicals favor equities, while the macro indicators support fixed income.

Top Level Factors

Indicator	Current Signal (Red = New Signal)	Comment
Equities/Fixed Income Relative Strength (indicator receives a heavier weighting)	Favors Equities	This indicator now favors equities. Although the relative strength ratio rose above its one-year moving average, it is less than 1% above its long-term trend.
Global Equity Market Breadth	Favors Equities	This indicator now favors equities. Entering the week, more than 70% of global equity markets traded above their 50-day moving averages, the highest reading since January.
OECD Leading Indicator	Favors Fixed Income	The four-week change in the OECD Composite Leading Indicator (CLI) declined for a ninth straight month. The drop accelerated at its fastest rate since 2020.
PMI Breadth Factor	Favors Fixed Income	The four-week change in economies with expanding manufacturing industries declined as the PMIs from many European economies and South Korea now reflect contracting activity.
Baltic Exchange Dry Index	Favors Fixed Income	Entering this month, the Baltic Dry index (BDI) was more than 23% below its 13-week moving average. It was the widest gap between the BDI and its intermediate-term trend since early February.
Central Bank Policy	Favors Equities	To favor fixed income, this indicator requires a significant drop in global short-term rates.

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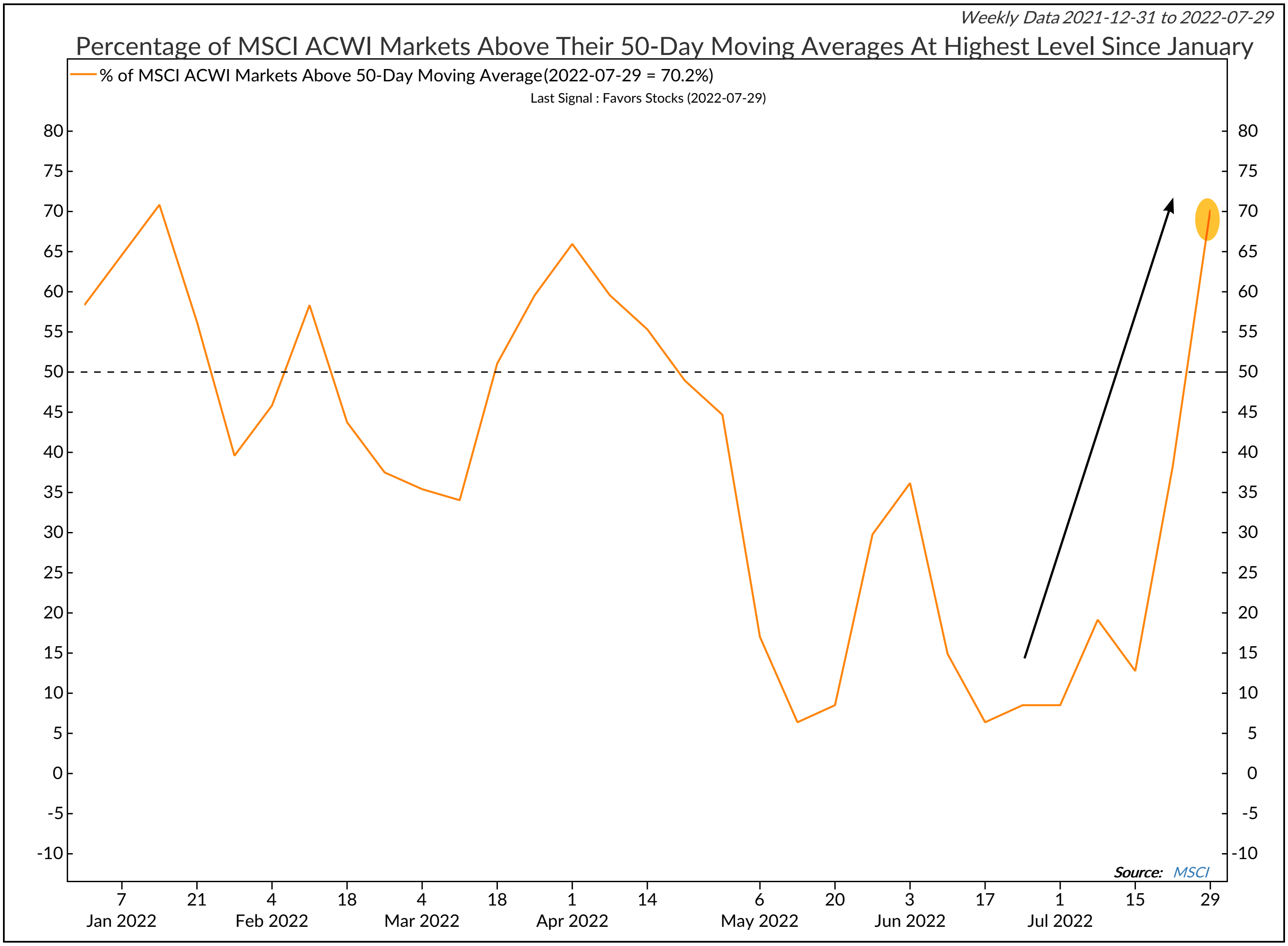

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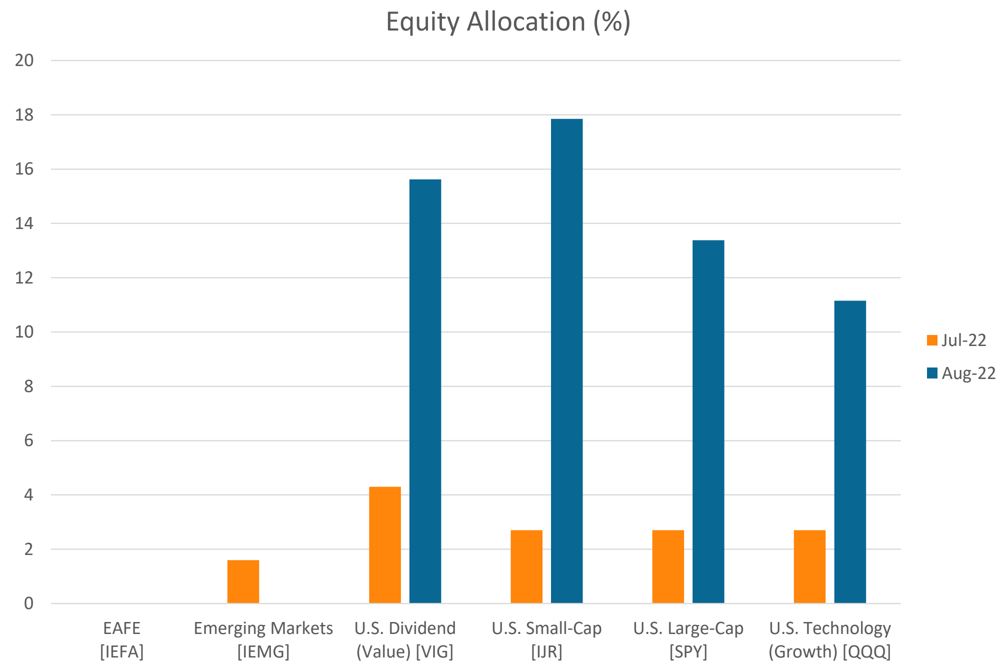
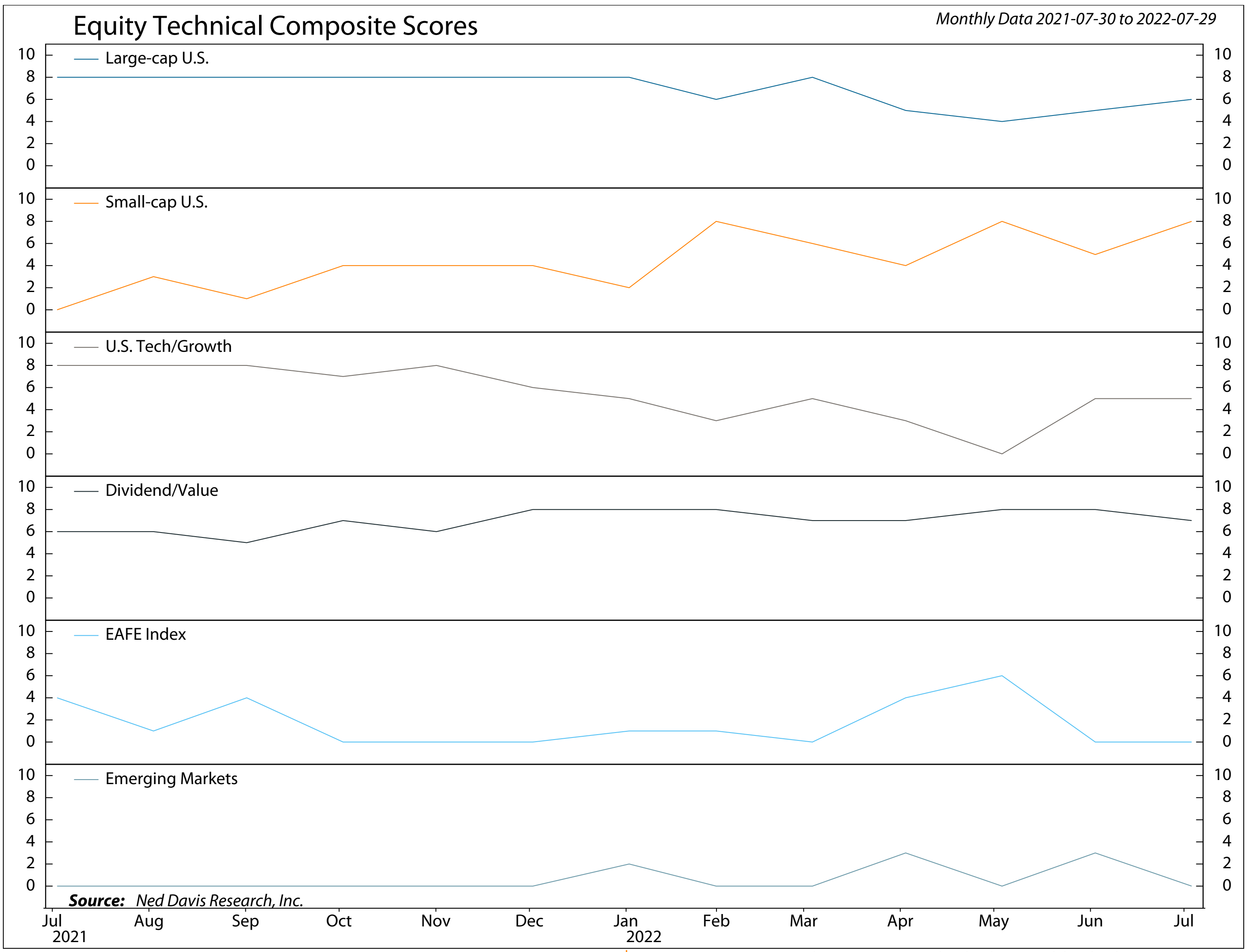
Equity Allocation Summary

After each declining by more than 500 basis points (bps) during June, none of the six equity areas fell during July. U.S. Growth [Technology] (QQQ) soared by more than 12%, which broke a three-month losing streak. U.S. Large Caps (SPY) and U.S. Small Caps (IJR) each gained more than 900 bps. U.S. Value [Dividends] (VIG) and Europe, Australasia, and the Far East [EAFE] (IEFA) both increased by over 500 bps. It was the best monthly gain for SPY, IJR, QQQ, and IEFA since 2020. VIG, SPY, QQQ, and IJR each received more than 10% allocation for August (image at bottom).





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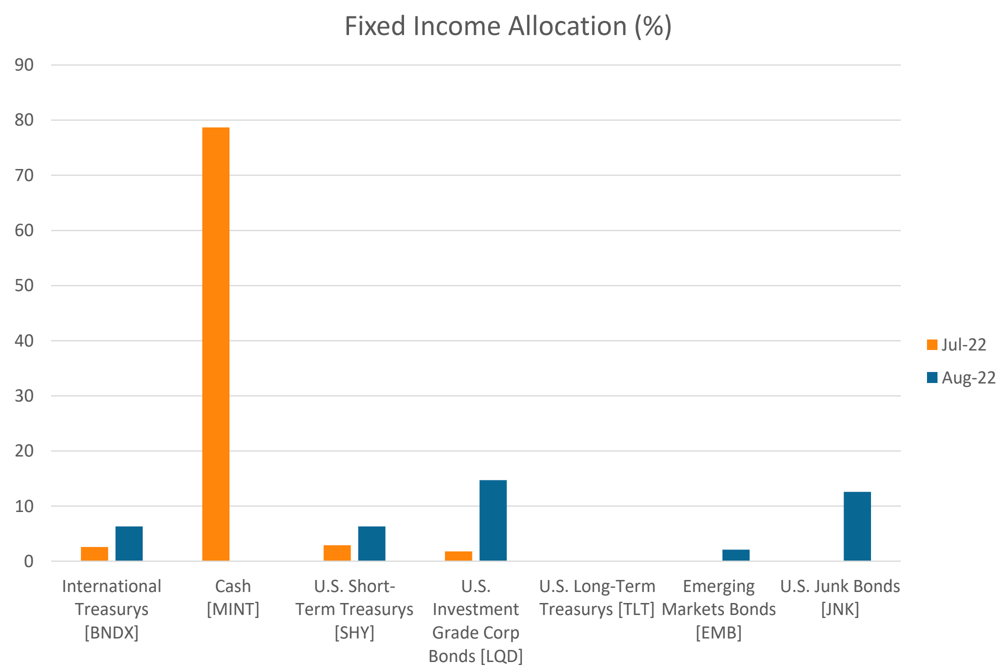
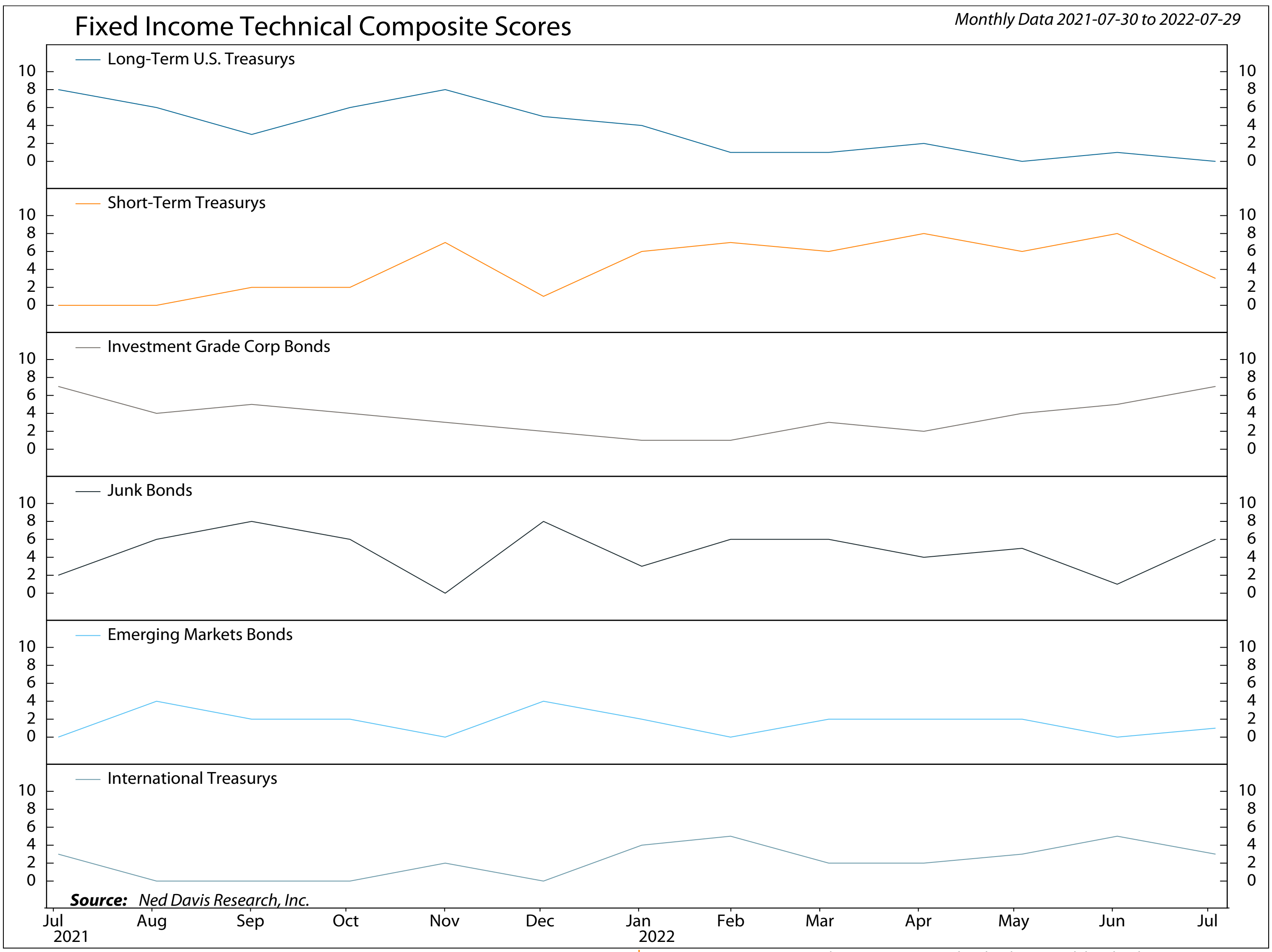
Fixed Income Allocation Summary

Performance within fixed income continued to follow its equity counterpart, as none of the fixed income segments declined last month. U.S. High Yield (JNK) had its best month since October 2011, as it jumped by more than 600 bps. Emerging Market bonds (EMB), International Investment Grade (BNDX), and U.S. Investment Grade (LQD) each rose over 300 bps. It was the best month in the history of BNDX. U.S. Long-Term Treasurys (TLT) broke a seven-month losing streak as it gained more than 200 bps. LQD and JNK each received more than 10% allocation for August (image at bottom).





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