DAY HAGAN
ASSET MANAGEMENT

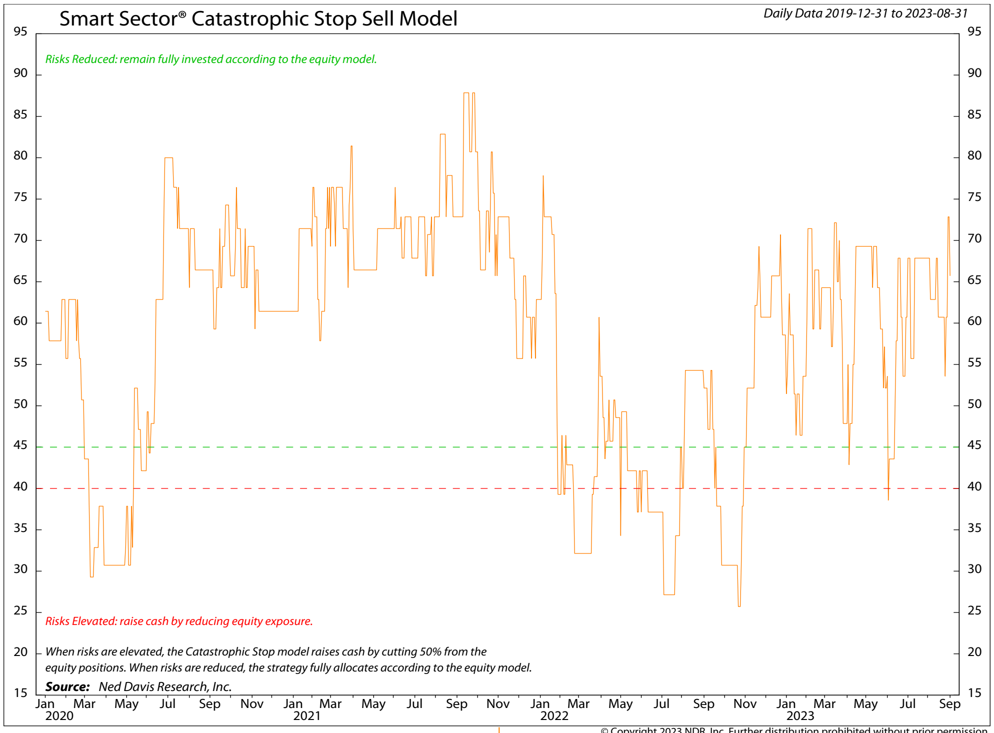
NDR
NED DAVIS RESEARCH

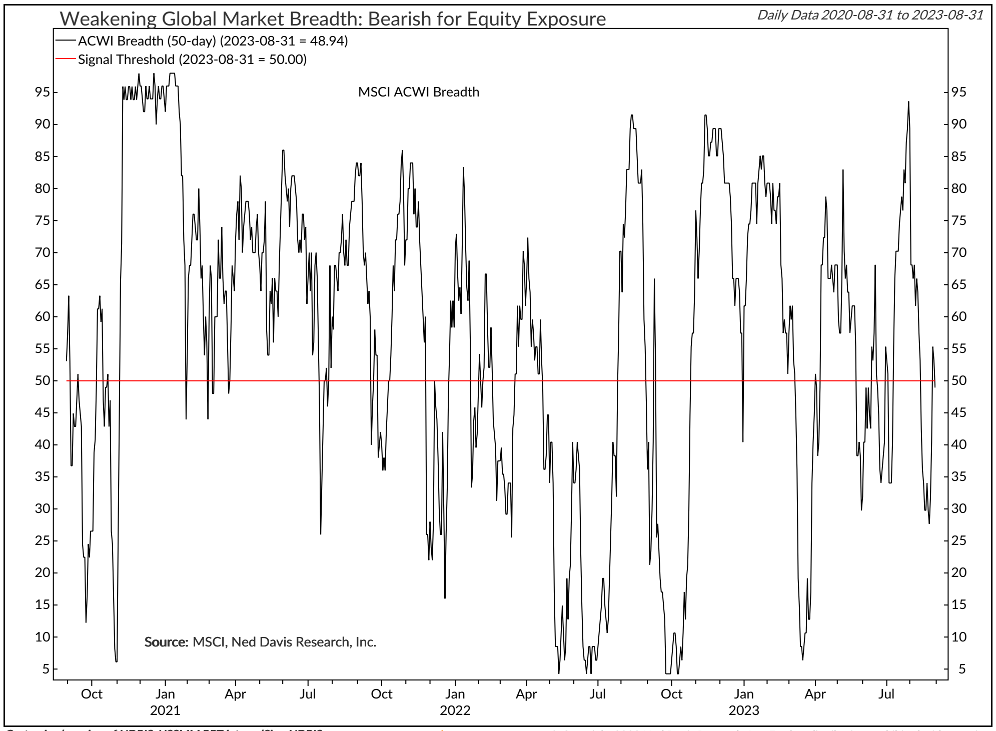
Smart Sector® Strategy

SEPTEMBER 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. The model (chart right) deteriorated slightly from last month but entered September with a fully invested equity allocation recommendation.





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The model's overall bullish position is driven by four of the seven (price-based) measures that remain positive for stocks. However, global market breadth weakened during the month and flashed a sell signal (chart left). While external influences such as trade and market sentiment remained bearish and neutral, respectively, they're offset by bullish readings from high-yield and emerging market bond breadth, as well as high-yield option-adjusted spreads. For now, the weight-of-the-evidence recommends a fully invested allocation to equity sectors according to the model.

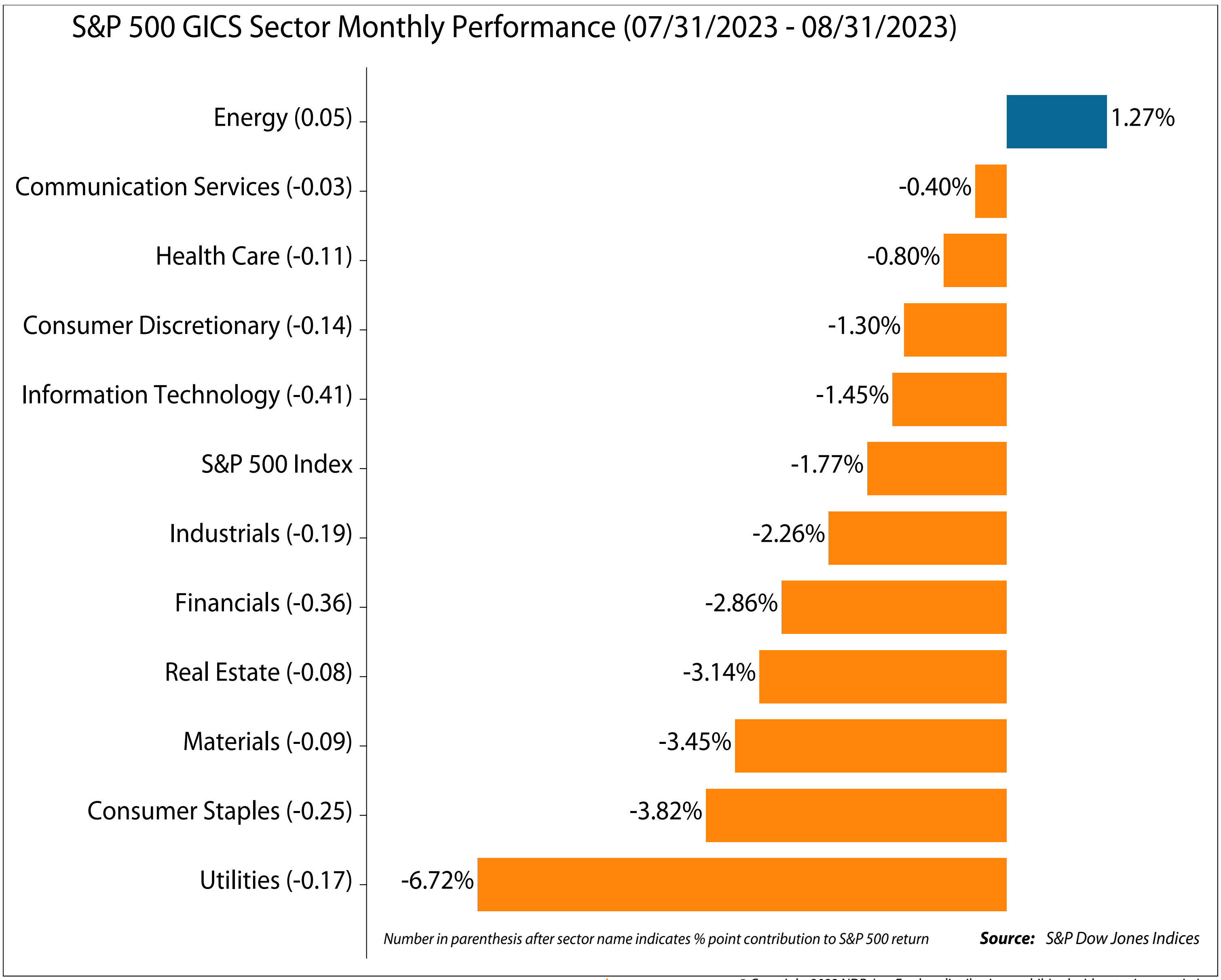
U.S. Market Update

The S&P 500 Total Return Index declined about 1.6% in August, breaking its five-month winning streak. Breadth weakened sharply—10 of the 11 S&P 500 sectors posted negative returns in the month of August. Cyclical Value sectors such as Financials, Materials, and Industrials reversed course in August and underperformed the broad market. Only Energy had positive gains (chart below).

The spike in bond yields coincided with the pullback in the S&P 500 Total Return Index after a two-month surge of 10%. However, the jump in yields has not been violent enough to derail the stock market, by historical standards. The risk of a policy mistake in late 2023 or early 2024 remains on the table.

The government has stepped on the gas in 2023 with one of the most expansionary policy years not associated with a recession on record. For the stock market to be choppy into the first half of next year—like the four-year presidential cycle suggests—government policy needs to be less expansionary. The potential for higher-for-longer monetary policy, the restart of student loan payments, a government shutdown, and lower COLA adjustments in 2024 could combine for a less friendly policy for financial markets.

The sector model remained with a mix of cyclical and defensive leadership during the month. Entering September, the sector model is overweight Information Technology, Communication Services, and Utilities. Health Care, Industrials, and Financials moved to marketweight, while Consumer Discretionary, Consumer Staples, Materials, and Real Estate are underweight.



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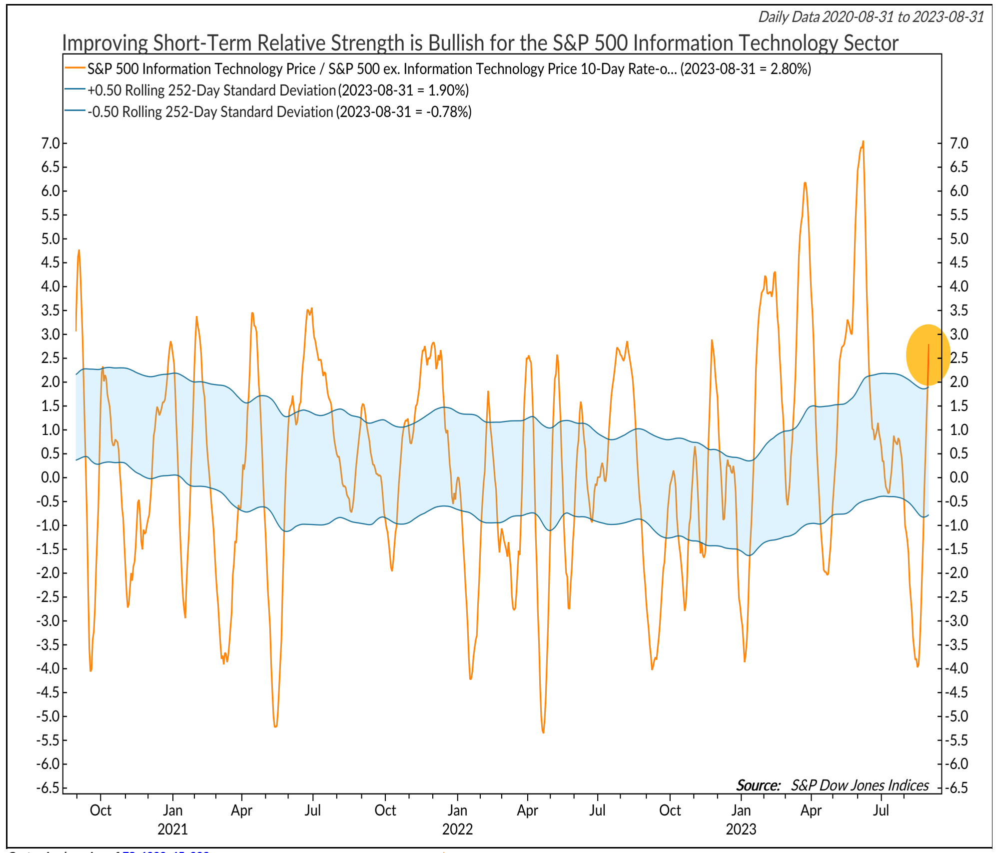
Allocation to the Information Technology sector rose by over 200 basis points in August, moving the sector to overweight. Tech gains have moderated over the past three months and have been more in line with benchmark returns. While sales yield and inflation expectations remain bearish for the sector, there are now three indicators that are bullish—earnings revision breadth flashed a positive signal during the month, but it could get whipsawed. Four of the five internal (price-based) indicators are bullish—weakness in intermediate-term net new highs was offset by improving short-term relative strength (chart right).



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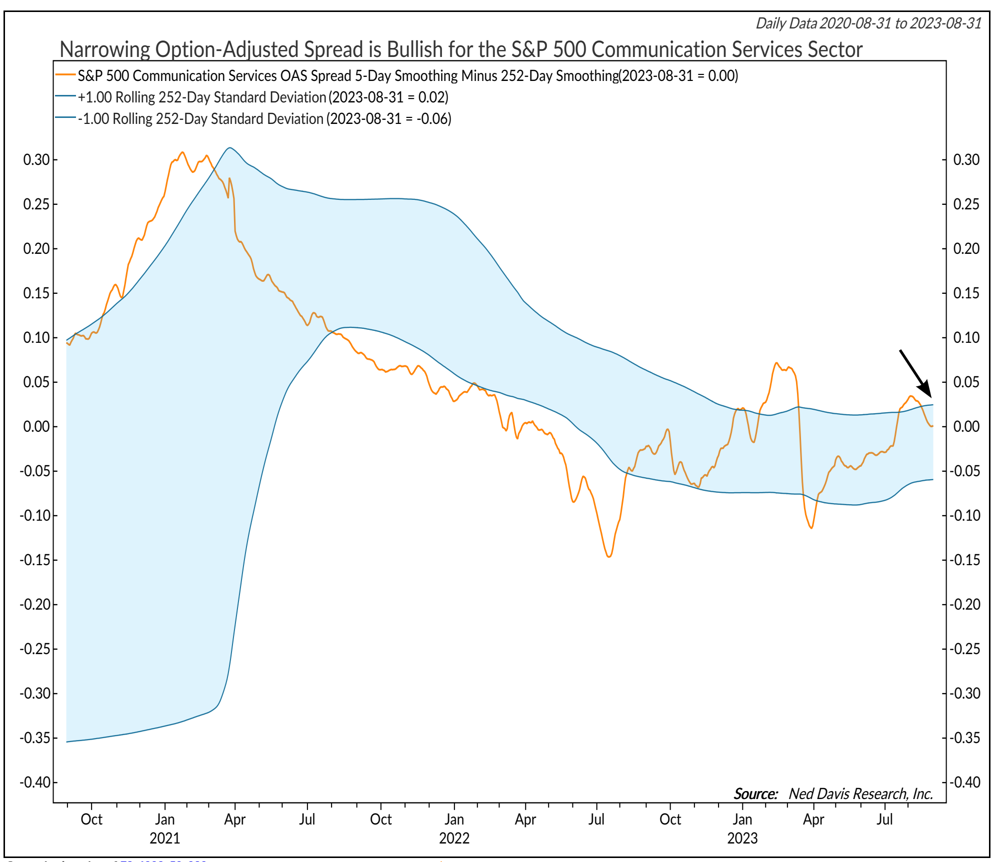

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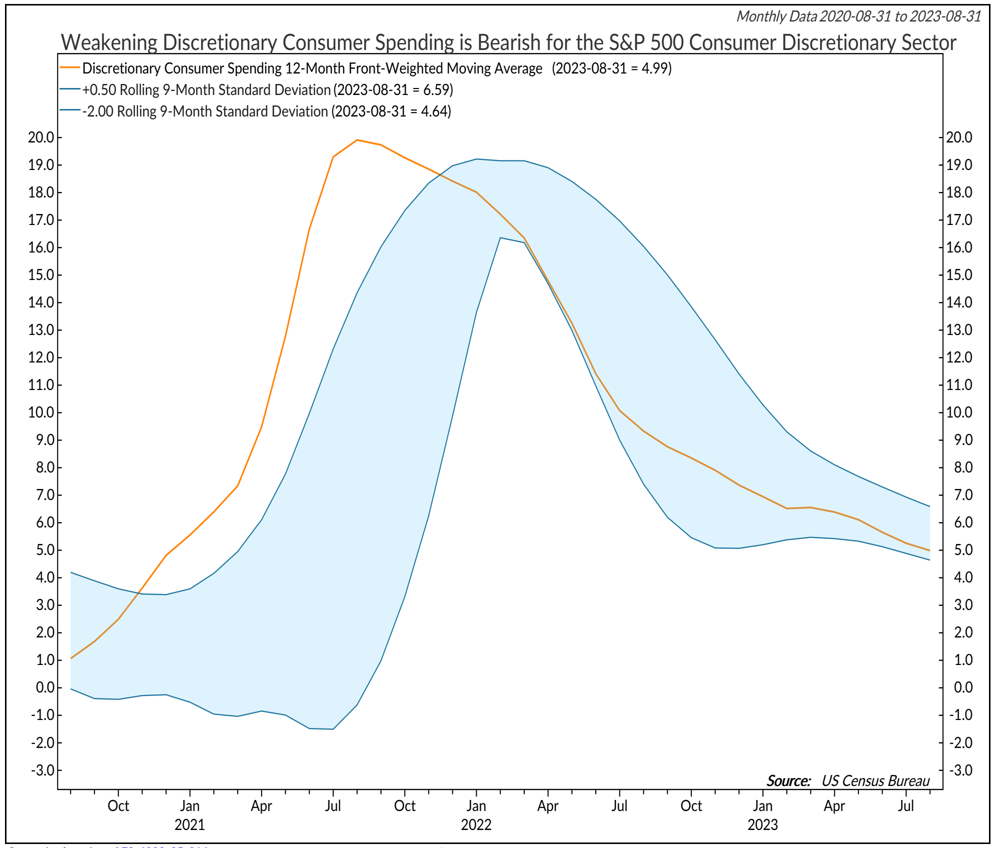
The Communication Services sector allocation rose by over 200 basis points and improved to overweight. On a fundamental basis, a narrowing option-adjusted spread (OAS) flashed bullish for the sector (chart left). This was confirmed by internal (price-based) indicators, as five of six indicators are now bullish, with the latest signal coming from an overbought/oversold measure.

The Consumer Discretionary sector's allocation dropped by over 500 basis points and was downgraded from overweight to the largest underweight position. On a fundamental basis, while housing starts improved to a bullish level, discretionary consumer spending continues to soften due to higher interest rates, which is bearish for the sector (chart right). This is confirmed by technicals—four measures moved bearish during the month.



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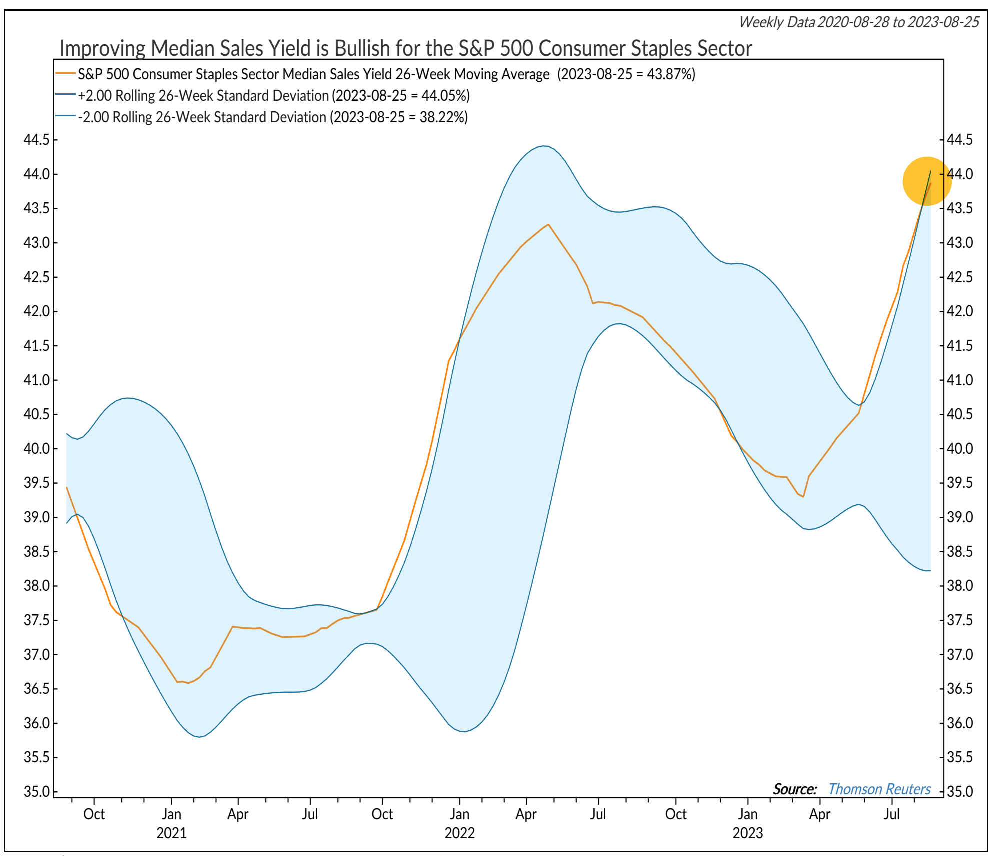

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Consumer Staples' allocation rose by over 200 basis points in August, but it remains an underweight position. It was the second worst-performing sector in August. On a fundamental basis, about half of the indicators are positive for the sector. Valuation (median sales yield, chart left) improved to a bullish level, joining credit conditions, consumer purchasing power, and economic surprises. However, most price-based measures remain bearish.

Summary

Sector leadership remained mixed during the month. Entering September, the sector model is overweight Information Technology, Communication Services, and Utilities. Health Care, Industrials, and Financials moved to marketweight, while Consumer Discretionary, Consumer Staples, Materials, and Real Estate 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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