NDR
NED DAVIS RESEARCH

Fixed Income Allocation Strategy

JUNE 2023

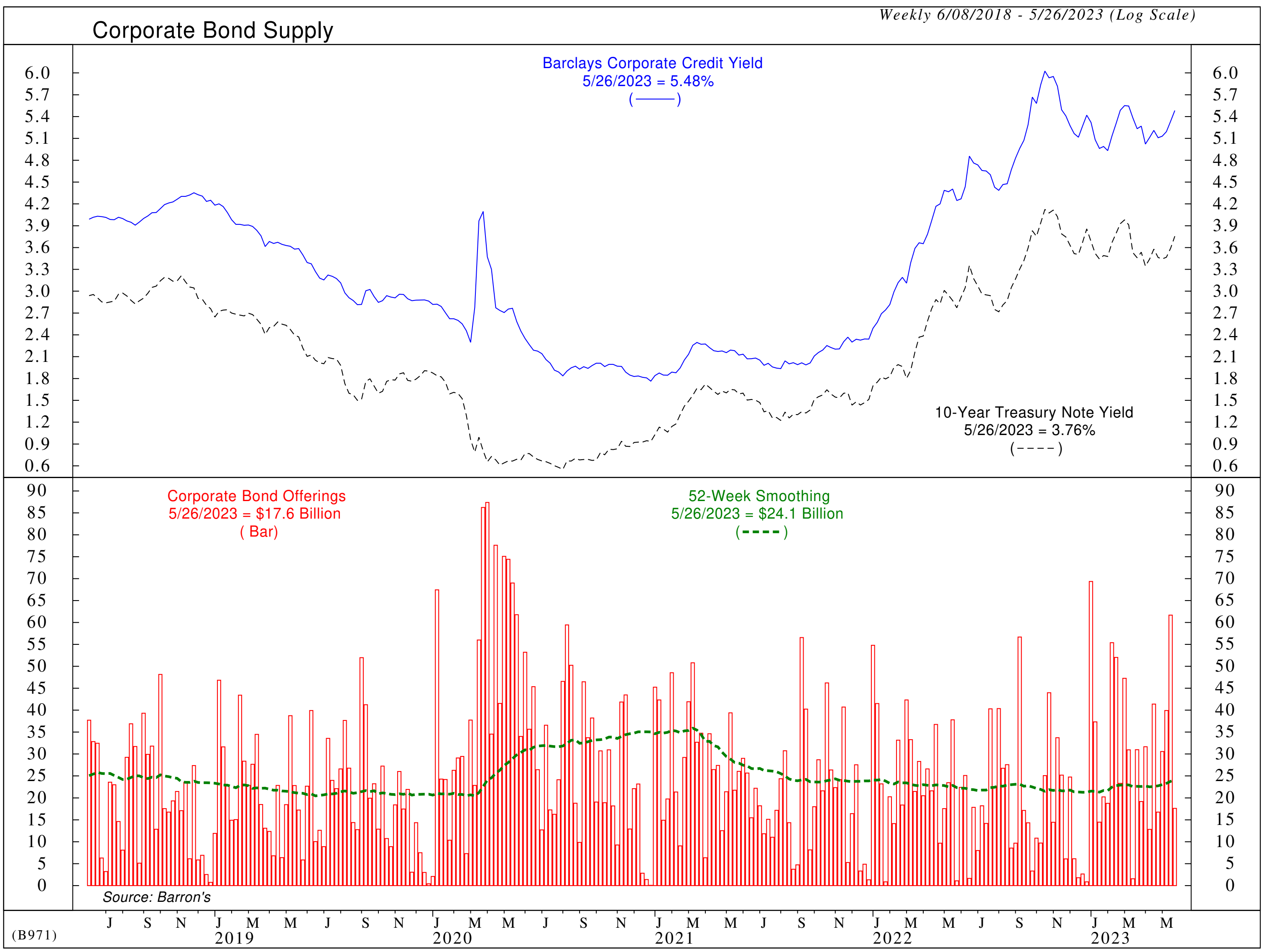
Fixed Income Market Update

The Bloomberg Barclays U.S. Aggregate Bond Total Return Index declined about 1% in May. Returns have been positive for five of the past 12 months. Breadth has been weak—six of the nine fixed income sectors we track had negative returns in May.

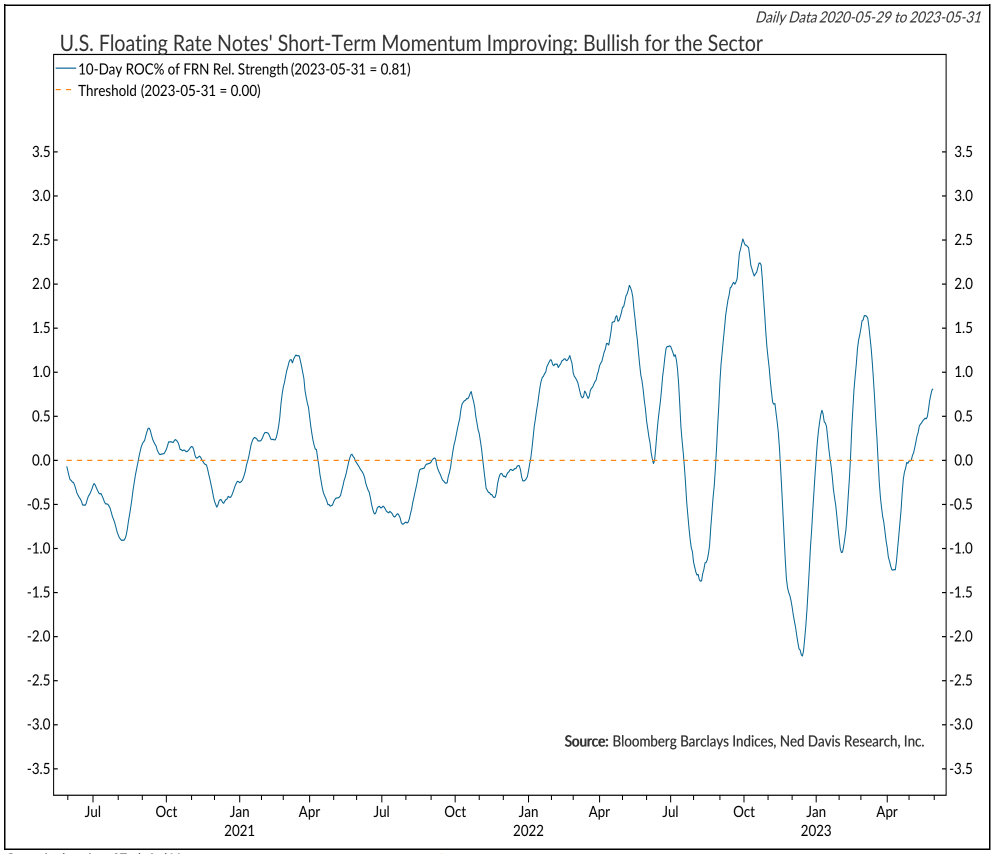
While 10-year yields have been in a trading range since last Fall (chart below, top clip), in the month of May, yields had a significant backup. There were several factors that contributed to the rise, including the debt ceiling, Fed speakers, and supply (bottom clip). The rise in the 10-year yield was a contributing factor to whipsawing fixed income sector leadership.

The bond market is oversold and near short-term support levels. But rising European yields could continue to put upward pressure on Treasurys. Turmoil in the banking sector, tighter credit, and a potential recession later in the year or early next year could lead to a yield breakdown.

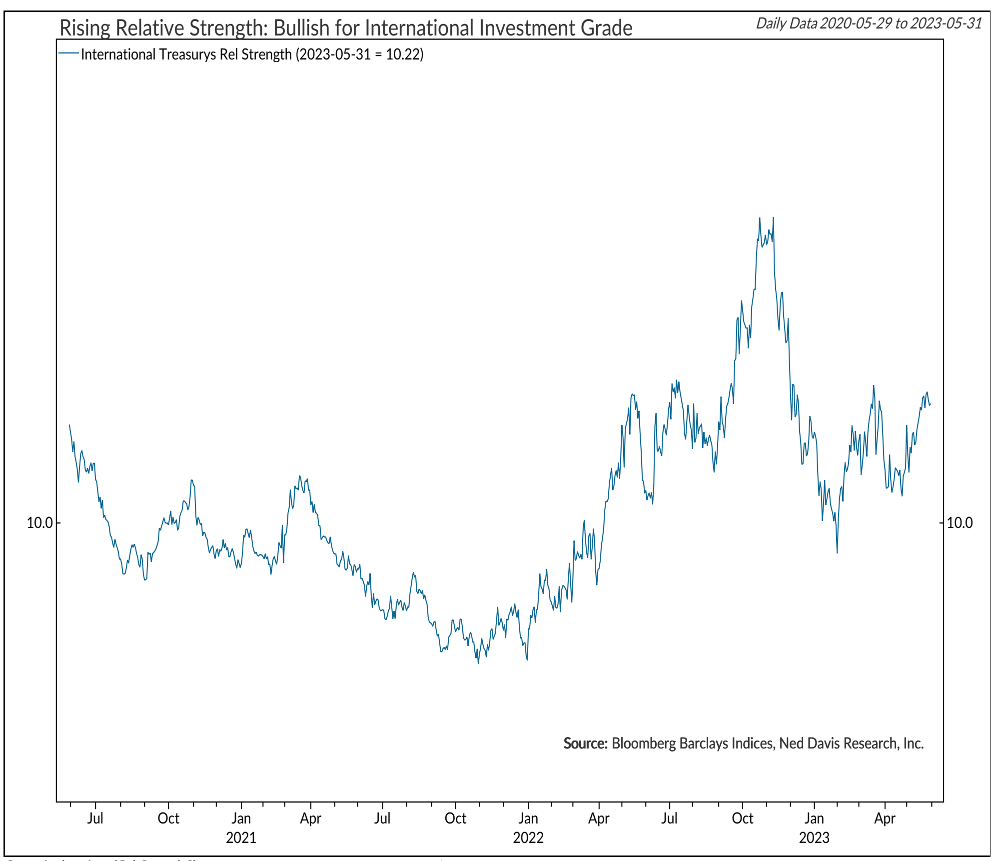
Entering June, the fixed income allocation strategy is overweight Floating Rate Notes, International Investment Grade, and U.S. Long-Term Treasurys and underweight Emerging Market Bonds, U.S. High-Yield Bonds, U.S. Treasury Inflation-Protected Securities, and U.S. Mortgage-Backed Securities.



Floating Rate Notes' allocation jumped over 1000 basis points and is now the largest overweight position. Floating rate notes typically outperform during a rising rate environment—yields have recently been in a trading range. Four of five indicators improved this past month, as improving spreads was confirmed by bullish short-term trend and momentum (chart right).



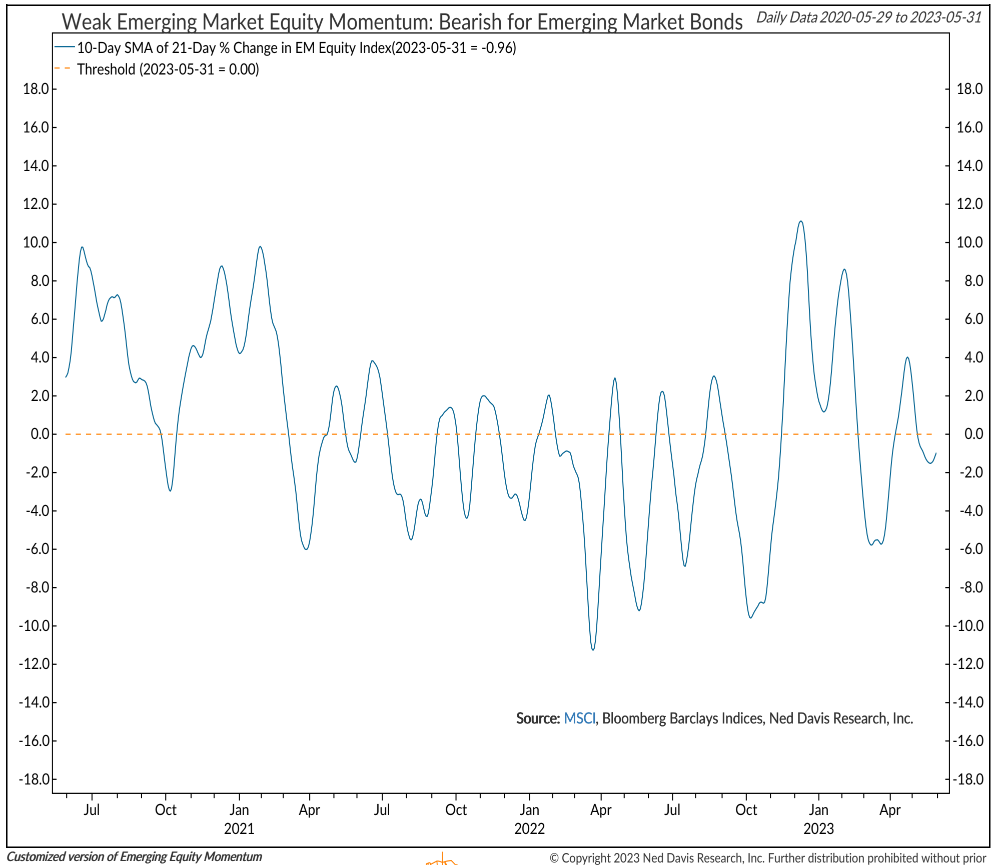
Customized version of Technical Momentum

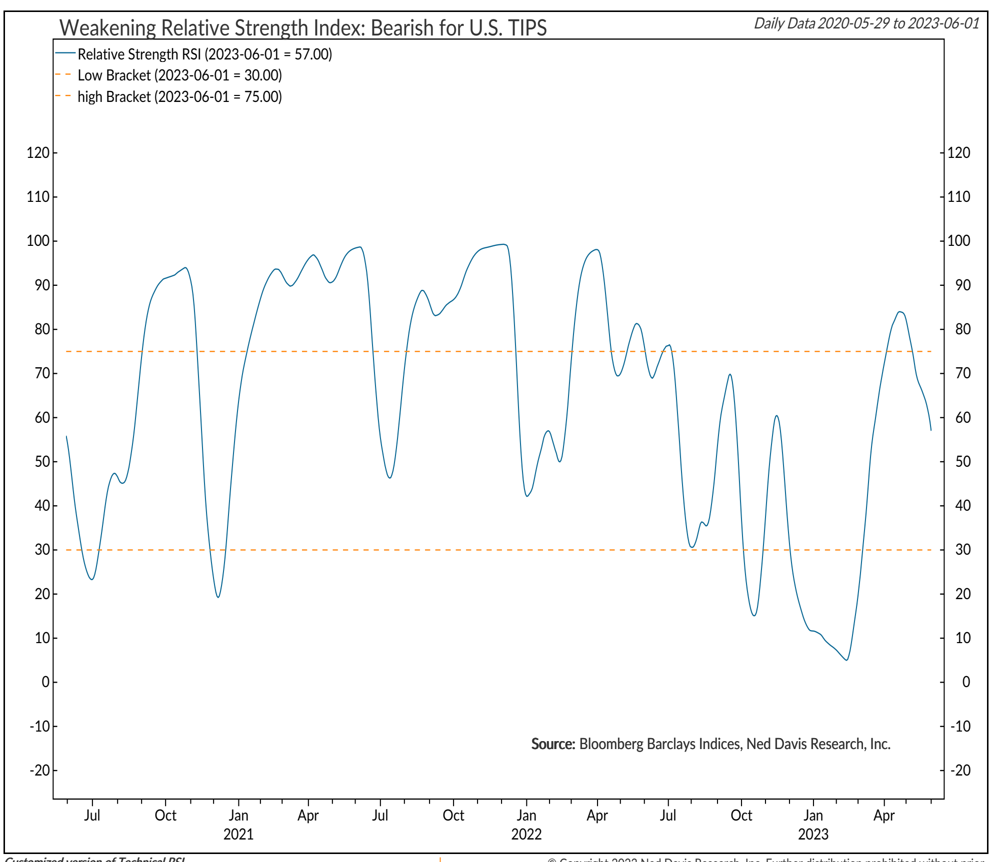


Customized version of Rel. Strength Slope

International Investment Grade bonds' allocation improved from a significant underweight to an overweight position. While external indicators such as high-yield returns vs. inflation and U.S. swaps remained neutral for the sector, two of the three technical measures flipped from bearish to bullish for the sector, including international investment grade bond relative strength trends (chart left).

Emerging Market bonds' allocation sank sharply in May, moving it from the largest overweight to a significant underweight position. Due to its size, China has a significant influence on Emerging Markets (EM). While China's economic recovery remains intact, momentum is fading. As a result, EM equities (chart right) and EM currencies weakened during the month, both of which are now bearish for EM bonds.





U.S. Treasury Inflation Protected Securities' (TIPS) allocation also dropped sharply in May, moving it from a slight overweight to the largest underweight position. TIPS tend to outperform when inflation is high. We have passed the peak in inflation—inflation expectations have dropped which is bearish for TIPS. This has been confirmed by two relative strength trend indicators (chart left), both of which moved bearish during the month.

Summary

Entering June, the fixed income allocation model is overweight Floating Rate Notes, International Investment Grade, and U.S. Long-Term Treasurys while Emerging Market Bonds, U.S. High-Yield Bonds, U.S. Treasury Inflation-Protected Securities, and U.S. Mortgage-Backed Securities are underweight.

Ned Davis Research Disclaimer:

The data and analysis contained within are provided "as is" and without warranty of any kind, either expressed or implied. The information is based on data believed to be reliable, but it is not guaranteed. NDR DISCLAIMS ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY, SUITABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. All performance measures do not reflect tax consequences, execution, commissions, and other trading costs, and as such investors should consult their tax advisors before making investment decisions, as well as realize that the past performance and results of the model are not a guarantee of future results. The Fixed Income Allocation Strategy is not intended to be the primary basis for investment decisions and the usage of the model does not address the suitability of any particular investment for any particular investor.

Using any graph, chart, formula, model, or other device to assist in deciding which securities to trade or when to trade them presents many difficulties and their effectiveness has significant limitations, including that prior patterns may not repeat themselves continuously or on any particular occasion. In addition, market participants using such devices can impact the market in a way that changes the effectiveness of such devices. NDR believes no individual graph, chart, formula, model, or other device should be used as the sole basis for any investment decision and suggests that all market participants consider differing viewpoints and use a weight of the evidence approach that fits their investment needs.