Dynamic Allocation Strategy

FEBRUARY 2023

Macro/Market Update

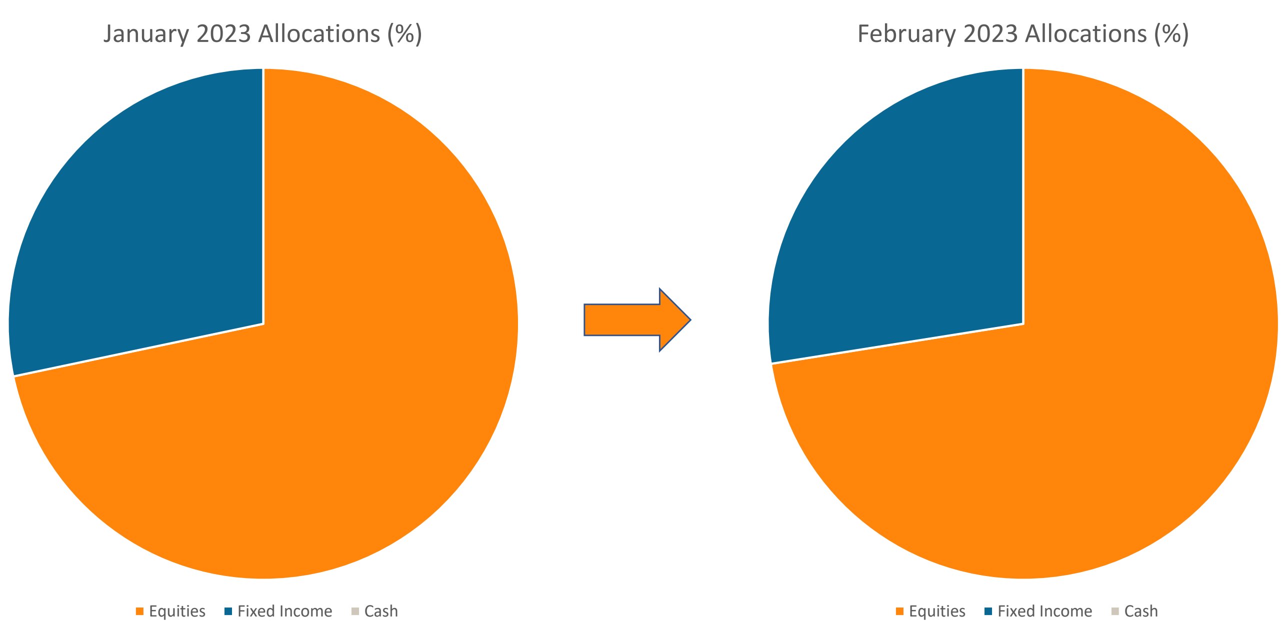
The global economy ended 2022 on a weak note, according to the latest global S&P Global Purchasing Managers' Index (PMI). The global composite PMI was little changed in December, edging up 0.2 points to 48.2. This marked the fifth straight month of contraction and the second-lowest reading since the initial COVID lockdowns in 2020. Both the services and manufacturing sectors registered declines in tandem for the fourth straight month, a condition also last observed in early 2020. The latest level in the composite is historically consistent with a 0.4% contraction in global real Gross Domestic Product (GDP) growth

The near-term economic outlook is murky. Although global output contracted at a slightly slower pace, overall new orders shrank at the fastest pace since May 2020. Moreover, history suggests that the past year's tight monetary policy will continue to negatively impact the global economy for at least the next six months. The future output index (gauges expectations over the next year) improved, but it remained at historically low levels, suggesting some caution about the outlook.

However, there may be some tentative signs of stabilization ahead. The global bullwhip, a measure of new orders relative to inventories, ticked up for a second straight month, as businesses continued to pare back the massive inventory accumulated in late 2021/early 2022. Also, global supply chain pressures continued to ease, with the supplier delivery index rising to its highest level since January 2020.

During January, the MSCI All Country World Index (ACWI) outperformed the Bloomberg Barclays Global Aggregate Bond Index by over 390 basis points (bps). It was the largest performance spread for stocks over bonds in January since 2019. The equity comeback of the past three months has been broadening out globally, with the U.S. market now participating to a greater extent and the performance of risk-on proxies becoming more decisive relative to the performance of risk-off proxies. Since the 2022 extremes in sentiment and

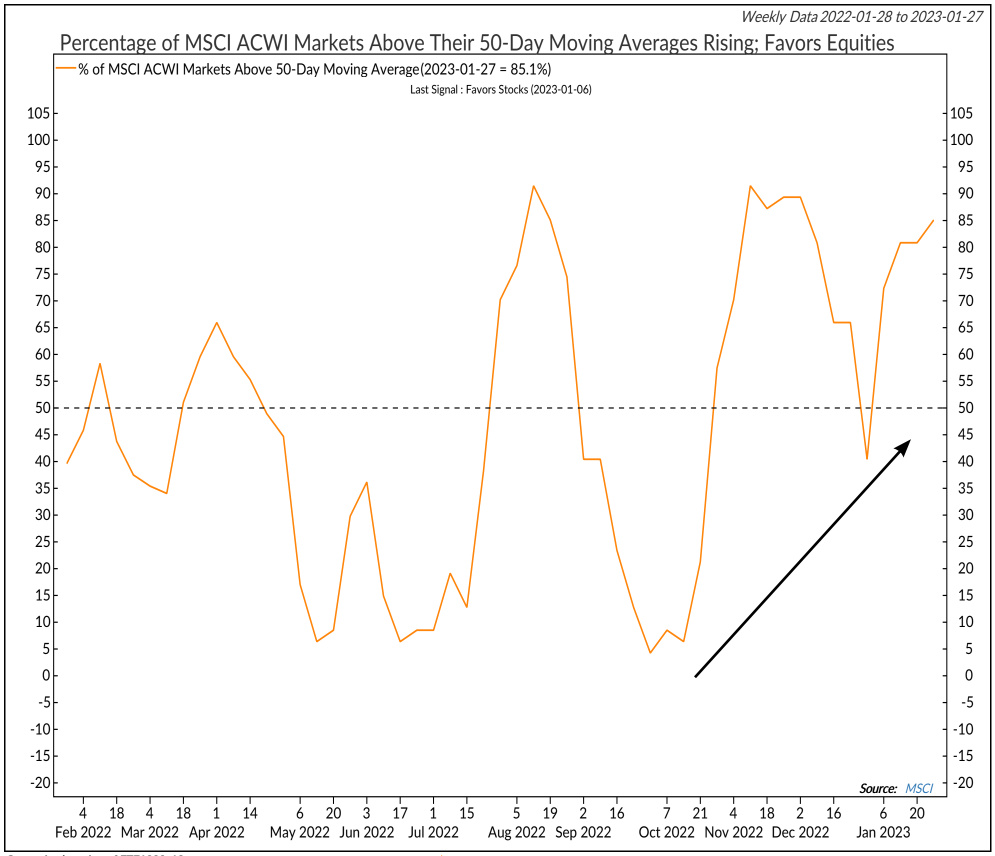
Asset Allocation Summary



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

valuation data, reflecting the highest levels of pessimism since 2020, the markets have been responding to signs that last year's expectations for economic weakness, stagflation and earnings deterioration have become less likely.

The equity allocation remained above benchmark allocation for February as two-thirds of the top-level indicators favored equities over fixed income. More global equity markets are trending higher, which supports an overweight equity allocation. In December, only 40% of global equity markets traded above their 50-day moving averages. During January that number improved to 85% (chart at right). When more markets are in uptrends, the global equity market is less susceptible to larger declines. Historically, greater equity market upside participation has favored stocks relative to bonds.



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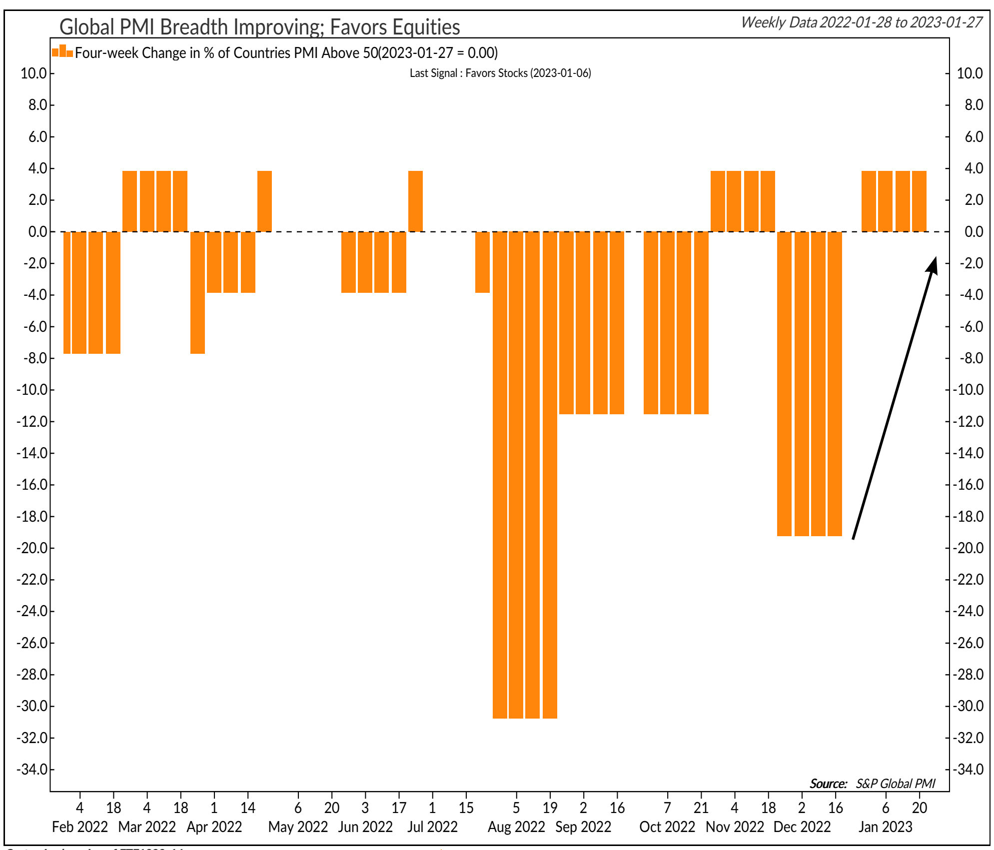

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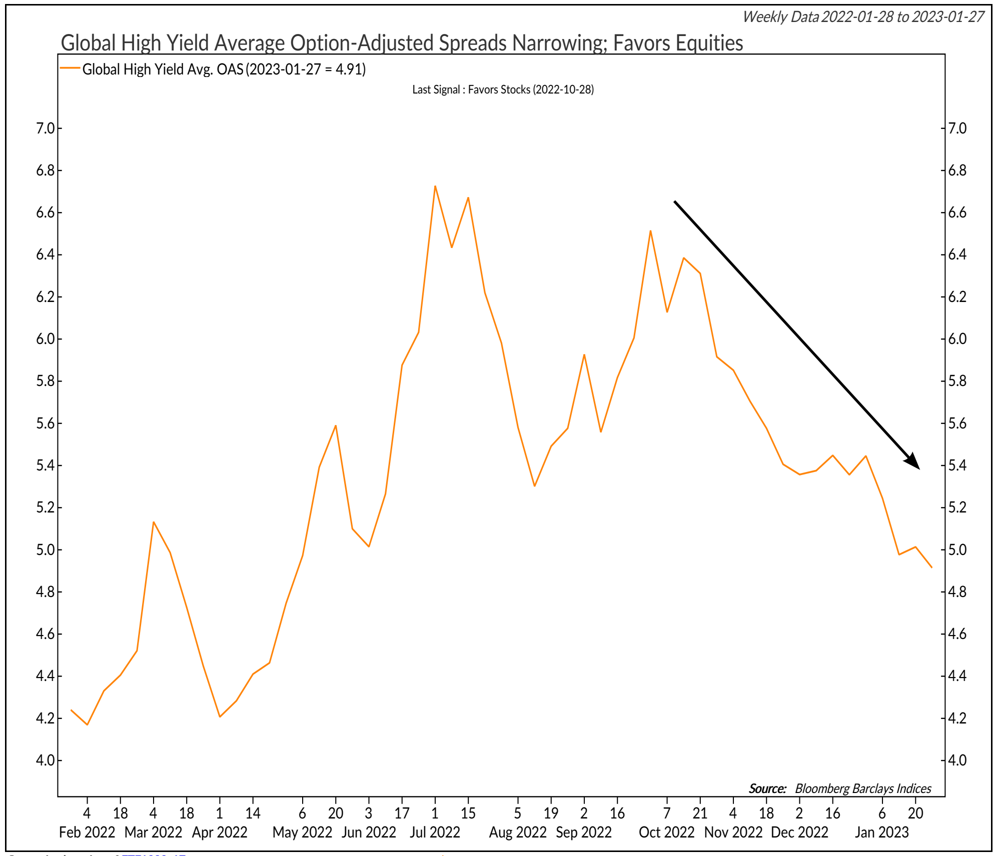
The Purchasing Managers' Index (PMI) breadth indicator measures the four-week point change of the percentage of economies with a PMI greater than 50 (expanding activity). A change greater than zero favors stocks, while a change less than zero supports bonds. Equities typically outperform fixed income when there is widening improvement in the economic outlook. This economic momentum breadth indicator (chart at left) improved this month as Denmark's reading rose above 50.

Although it did not change signals this month, the global high yield option-adjusted spread (OAS) indicator continues to favor equities (chart at right). Global high yield OAS has narrowed over 150 bps since late-September. 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.



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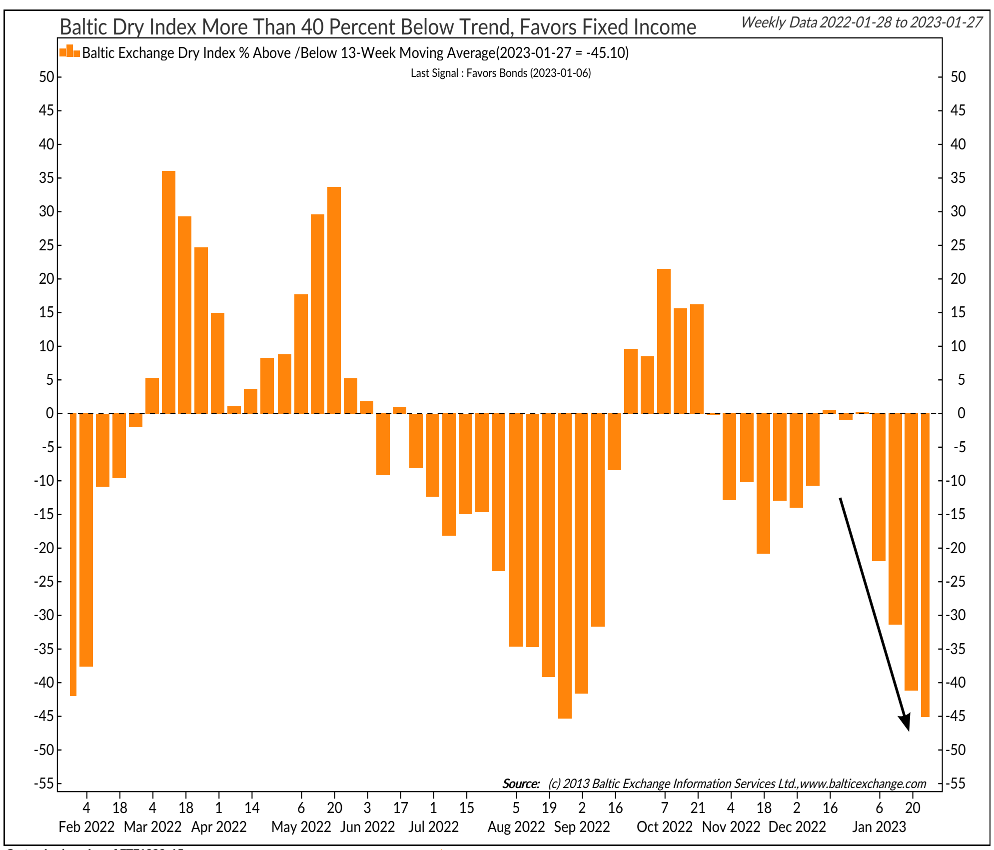

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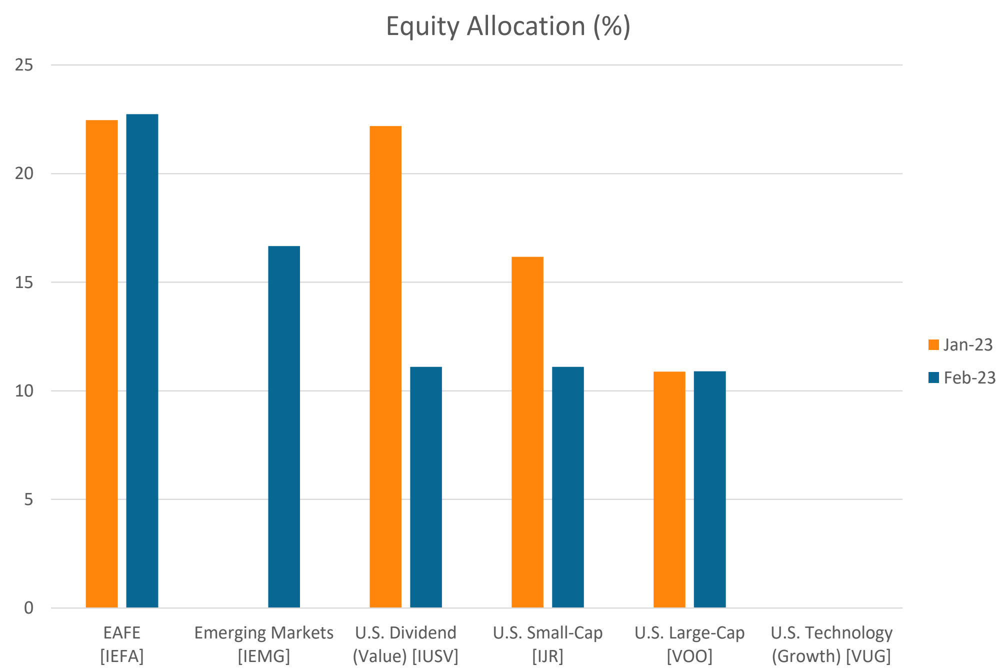
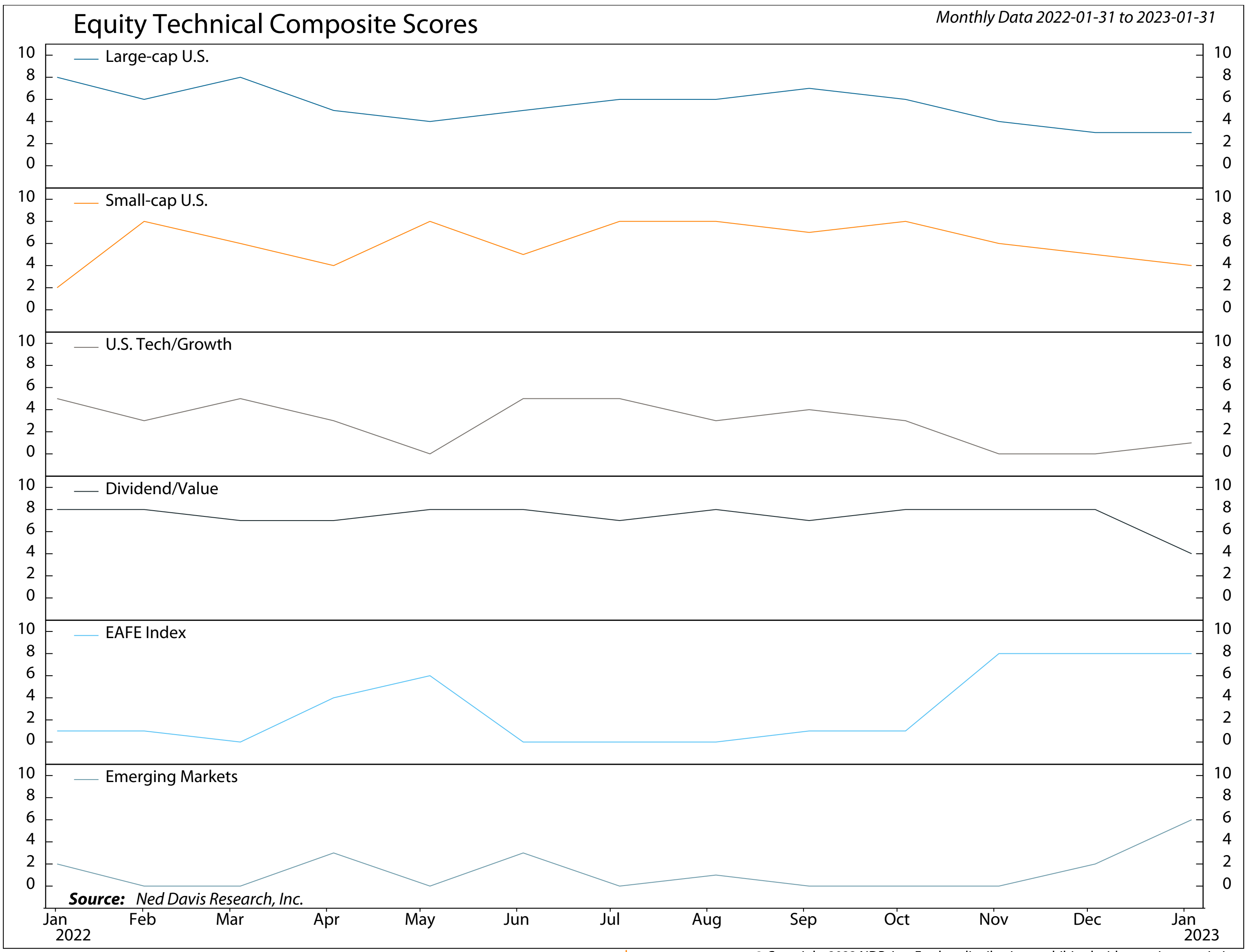
Not all indicator changes favored stocks. The Baltic Dry Index (BDI) indicators compares global shipping rates relative to their 13-week moving average. Entering this week, the Baltic Dry index (BDI) was more than 45% below its 13-week moving average, the largest gap since August (chart at left). Such a deficit typically indicates global economic weakness, which favors fixed income over equities.

Equity Allocation Summary

During January all equity areas jumped over 600 basis points (bps). U.S. Small Caps (IJR) and U.S. Growth (VUG) soared over 950 bps. It was the best monthly return for VUG since July. International Developed (IEFA) and Emerging Markets (IEMG) increased more than 8%. U.S. Value (IUSV), IEFA, IEMG, VOO, and IJR each received more than 10% allocation for February (chart at top) due to their technical composite scores (chart at bottom).





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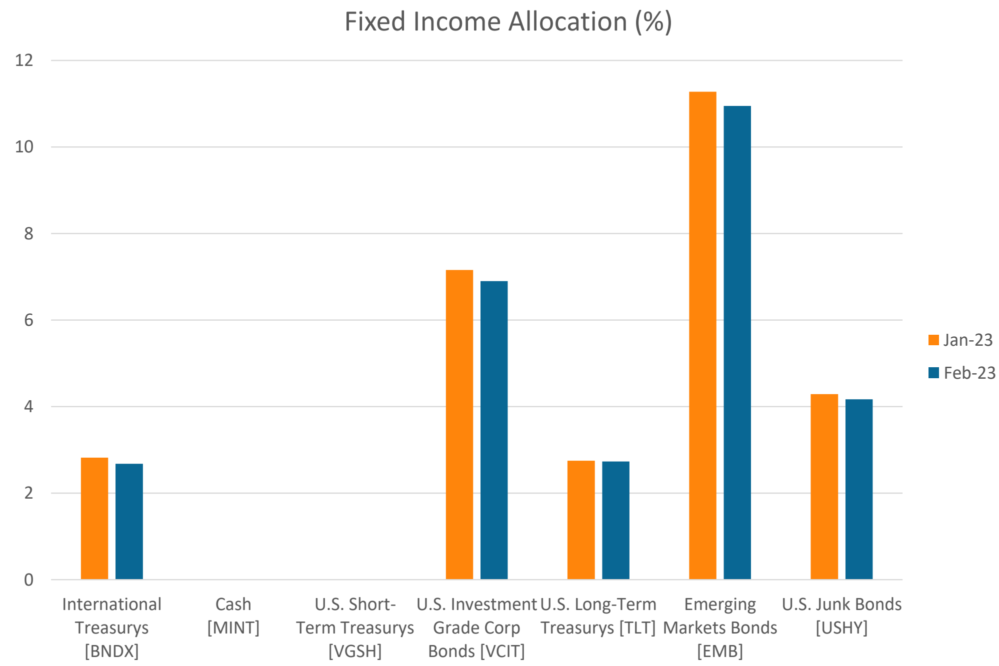
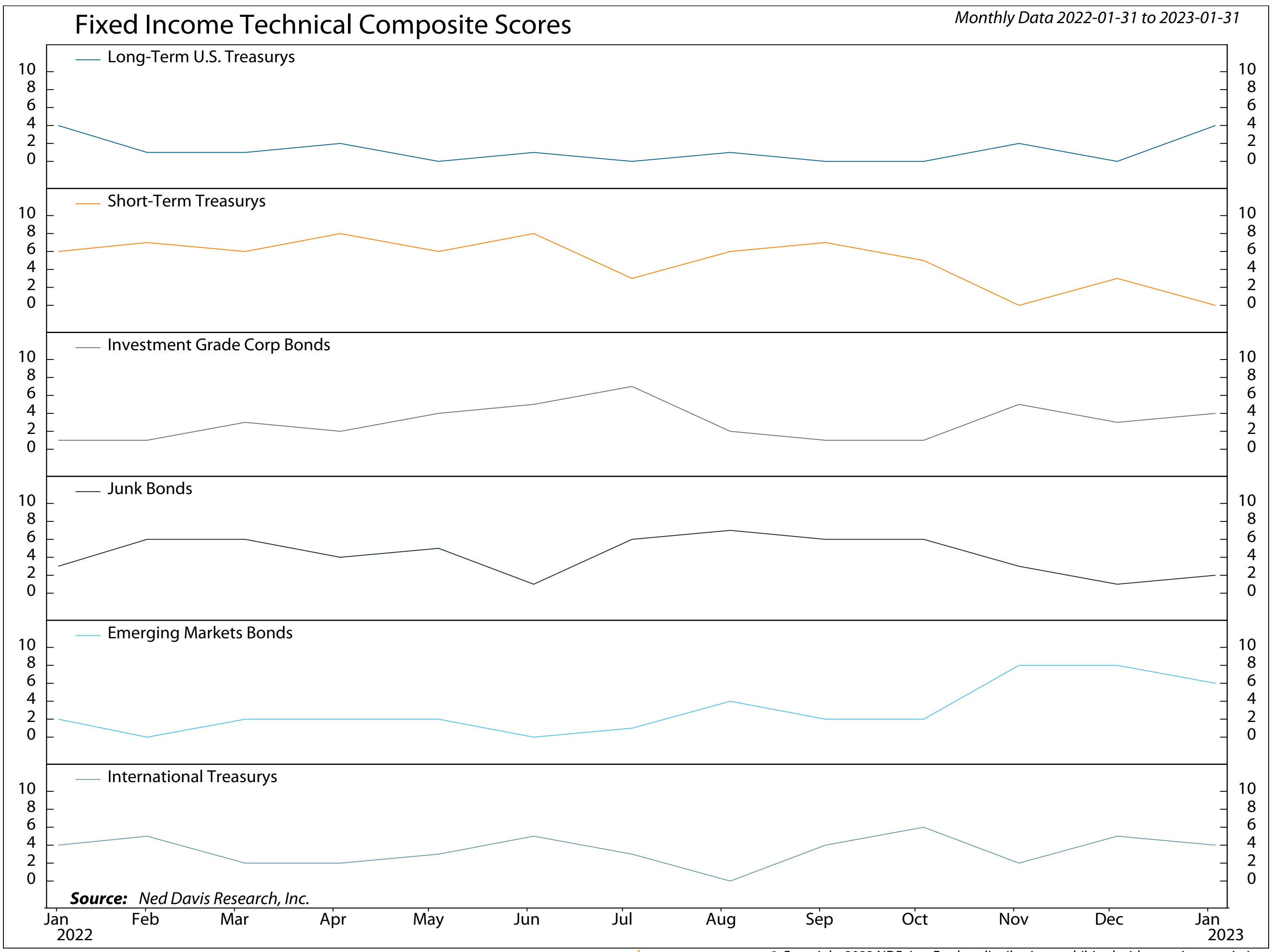
Fixed Income Allocation Summary

All fixed income areas gained during January. U.S. Long-Term Treasurys (TLT) had its best month since January 2020 as it jumped more than 700 bps. Emerging Market bonds (EMB), U.S. High Yield (USHY), and U.S. Investment Grade (VCIT) all gained over 300 bps. EMB and VCIT received over 5% allocation for February (chart at top) due to their technical composite scores (chart at bottom).





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