NDR
NED DAVIS RESEARCH

Dynamic Allocation Strategy

NOVEMBER 2023

Macro/Market Update

The global economy saw its momentum slow again in September, according to the S&P Global Purchasing Managers' Index (PMI) data. The global composite (services and manufacturing) PMI fell for a fourth straight month to its weakest reading since January. The delayed impact of tighter global monetary policy and continued price stickiness pose risks to the global outlook. Historically, slowing global economic momentum has been associated with less upside in global equities.

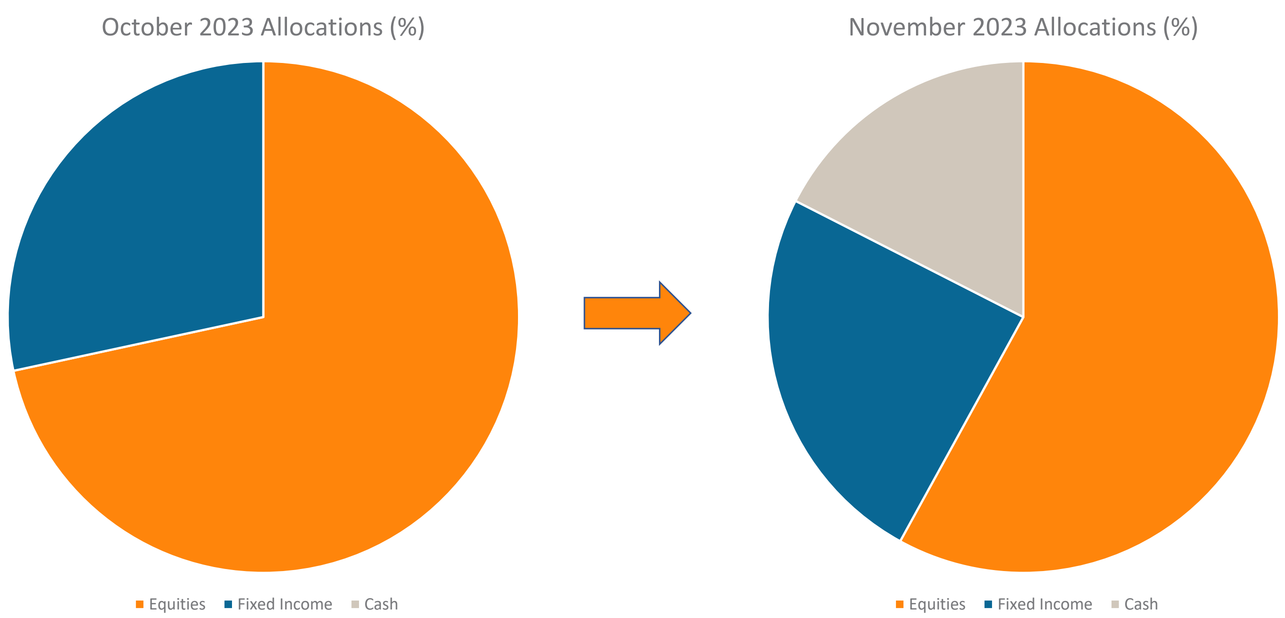
Manufacturing continues to shrink modestly, but it is showing some signs of stabilization. Both output and new orders shrank at a slower pace, while future output expectations picked up. Supplier delivery times also contracted at a slower pace, suggesting further normalization in global supply chains. But the global bullwhip slipped deeper into negative territory, as the inventories index rose faster than new orders. Despite some stabilization at the aggregate level, breadth weakened to concerning levels. The share of economies with expanding manufacturing sectors ticked down to 24% in September.

Services growth has slowed significantly compared to the first half of the year, as the post-pandemic spending rebound dissipates. New orders shrank for the first time this year, while the future output index also ticked down to its lowest level this year.

The strongest growth is being observed among a select group of emerging markets, led by India and Middle Eastern economies (benefiting from higher oil prices). The world's two largest economies, the U.S. and China, continue to see positive, but slowing growth. Much of Europe continues to contract, according to the PMIs, indicating increased risk of recession.

During October, the MSCI All Country World Index (ACWI) underperformed the Bloomberg Barclays Global Aggregate Bond Index by over 100 basis points (bps) for a third-straight month. Such a string of relative equity weakness last occurred during the first quarter of 2020. It was the fourth month this year where

Asset Allocation Summary



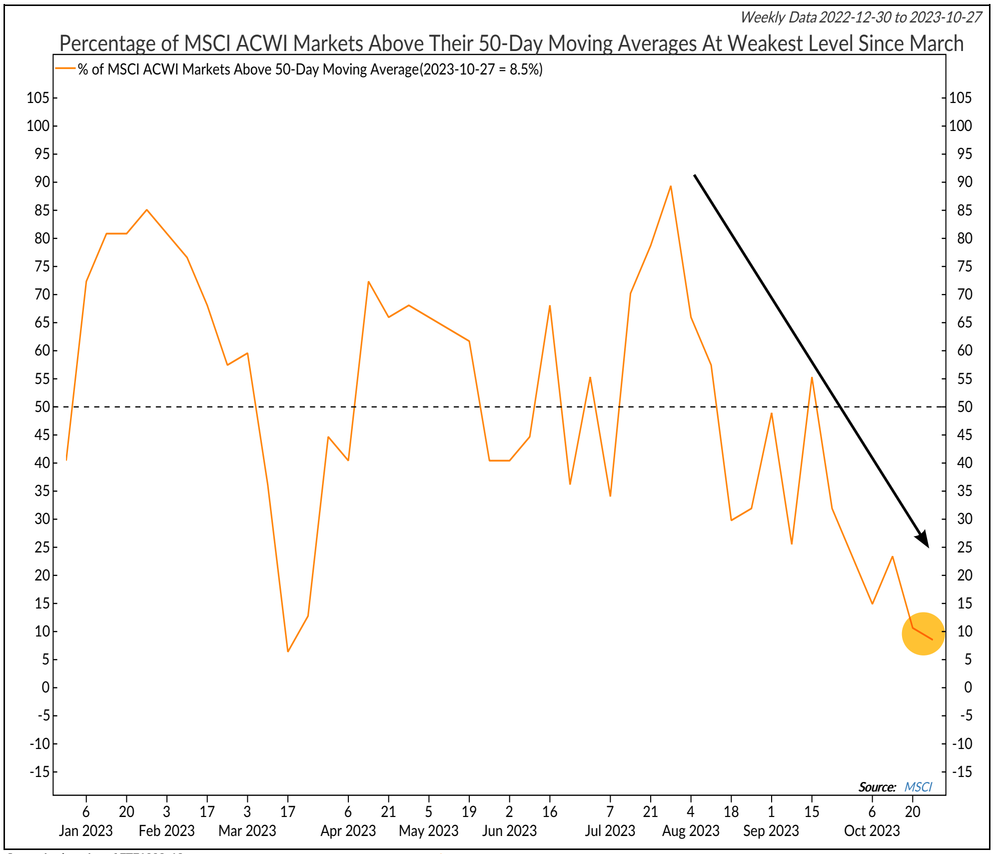
* See Equity Allocation Summary for how the equity allocation is distributed
** See Fixed Income Allocation Summary for how the fixed income allocation is distributed

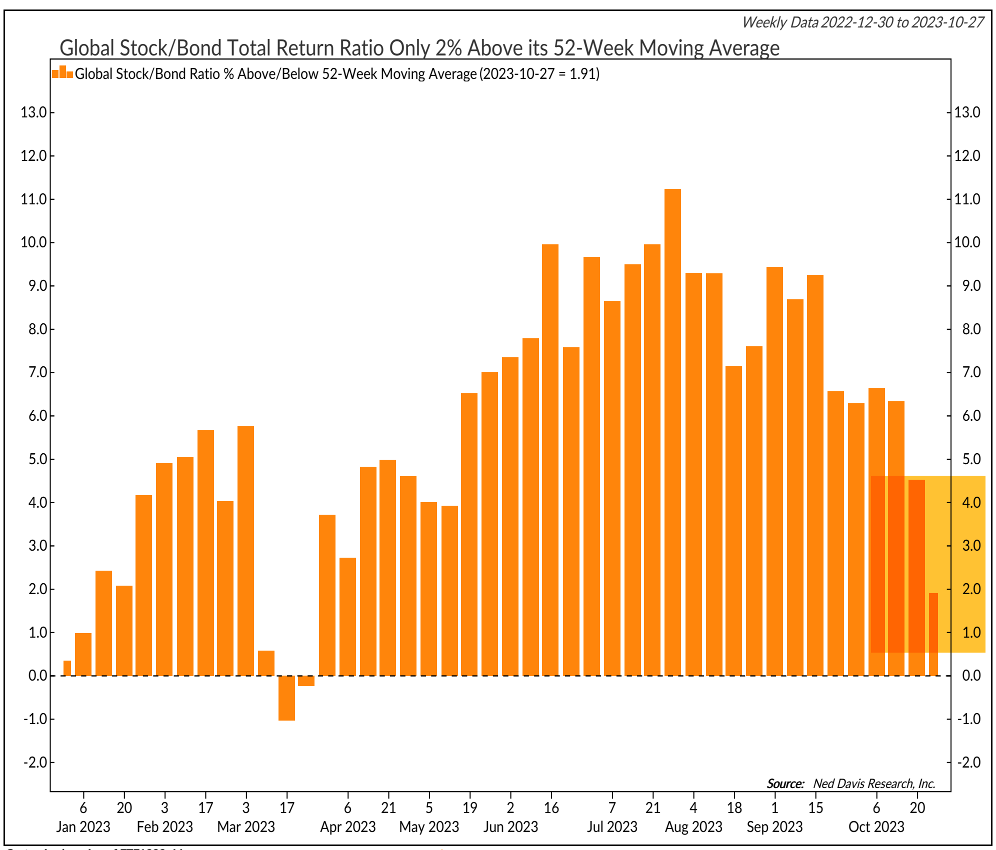
global bonds outpaced stocks. The rising interest rate induced sell-off has produced a near-term oversold condition, along with pessimistic sentiment for equities.

The equity allocation declined to slightly below benchmark weighting. The indicators are split between stocks and bonds.

Global equity market breadth has significantly weakened. The percentage of global equity markets trading above their 50-day moving averages has experienced significant volatility in 2023. After jumping to almost 90% at the end of July, the percentage of markets above their intermediate trends declined to less than 10% at the end of October (chart right).

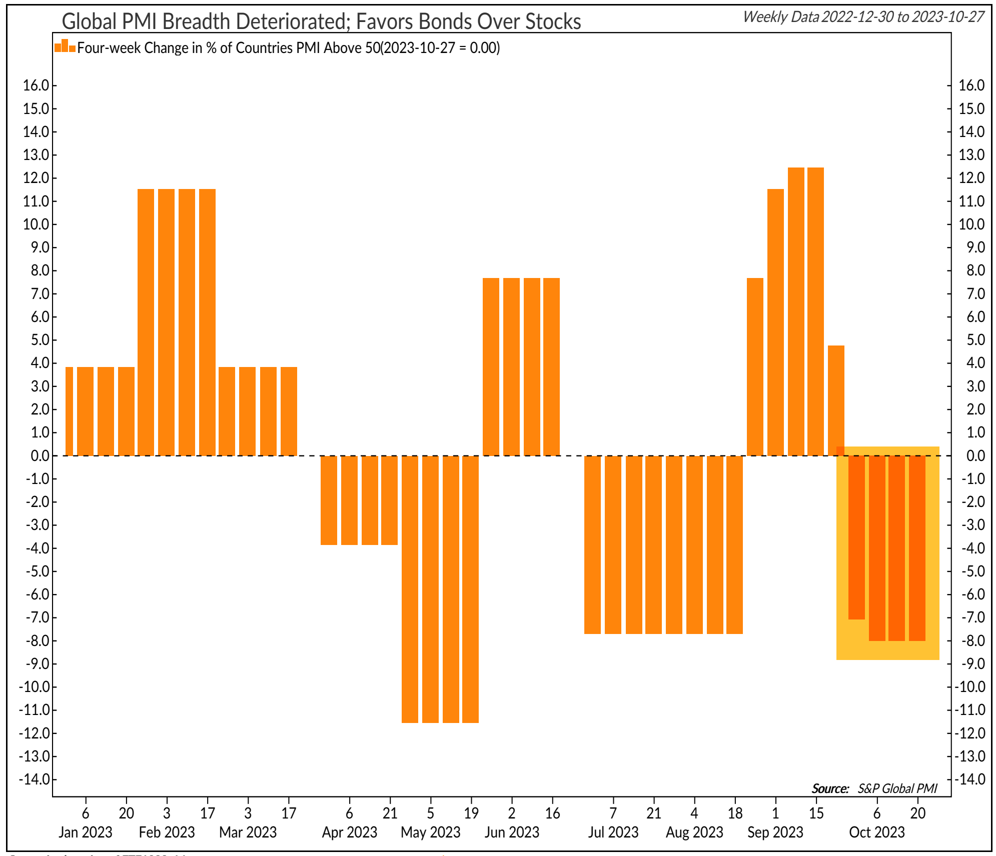
This indicator describes the underlying health of global equities, since it tracks the number of markets participating on the upside. Elevated breadth is important because if many stocks rally, even if a few run into trouble, enough stocks remain in uptrends that they can support the popular averages.

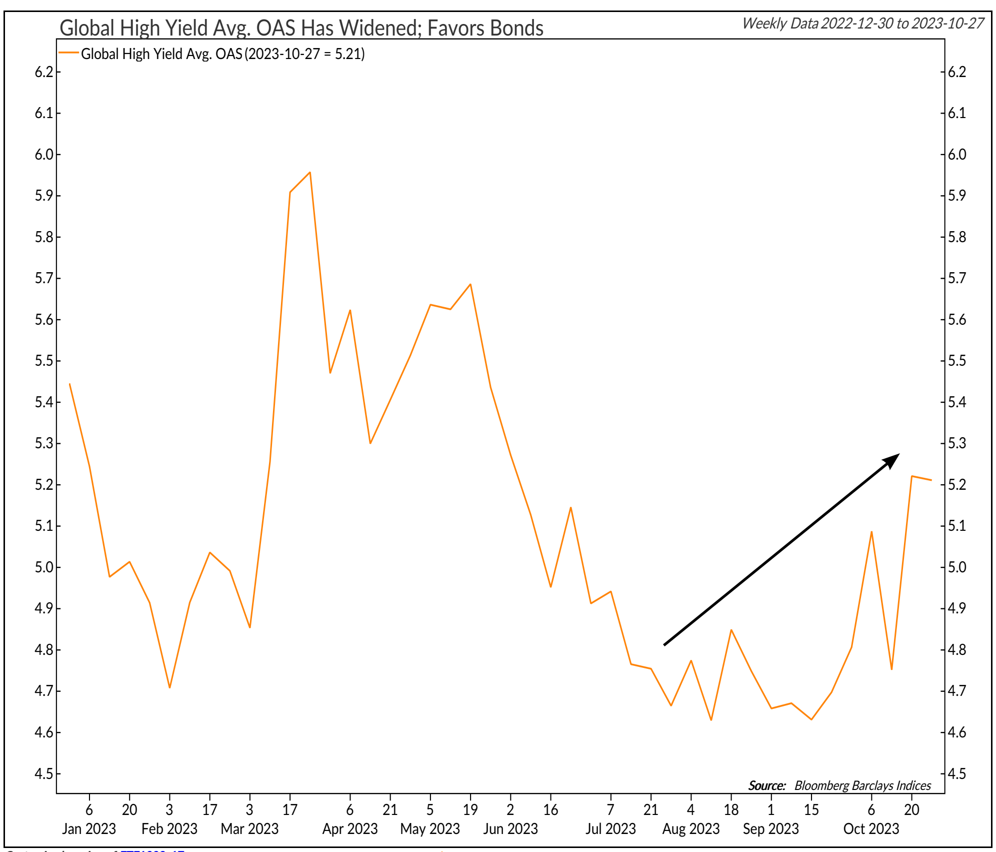




The stock/bond relative strength indicator, which receives the greatest weighting in the model, compares the stock/bond ratio to its 52-week moving average. The stock/bond ratio has fallen to less than 2% above its one-year moving average. The spread between the relative strength ratio and its trend is at its lowest level since the end of March (chart left). Although weakened, the trend still favors stocks over bonds.

Two macroeconomic measures turned bearish on stocks. 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). The PMI is based on a survey sent to executives regarding their outlook on areas such as inventories, production, and employment. A change greater than zero favors stocks, while a change less than zero supports bonds. Equities typically underperform fixed income when the economic outlook worsens. This economic momentum breadth indicator (chart right) declined as Brazil and Ireland dropped below 50.

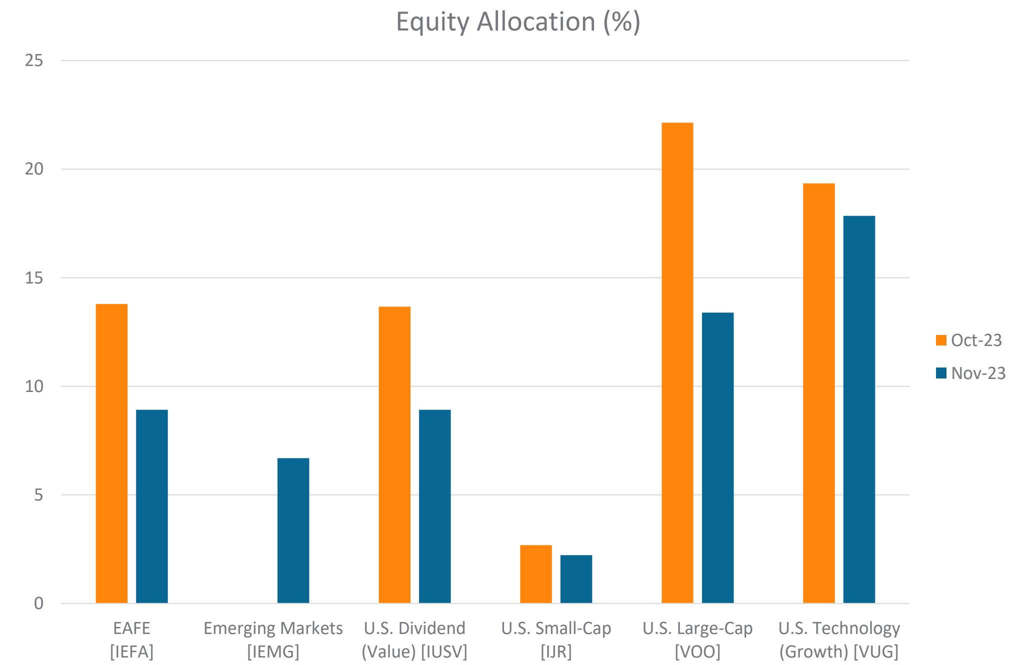


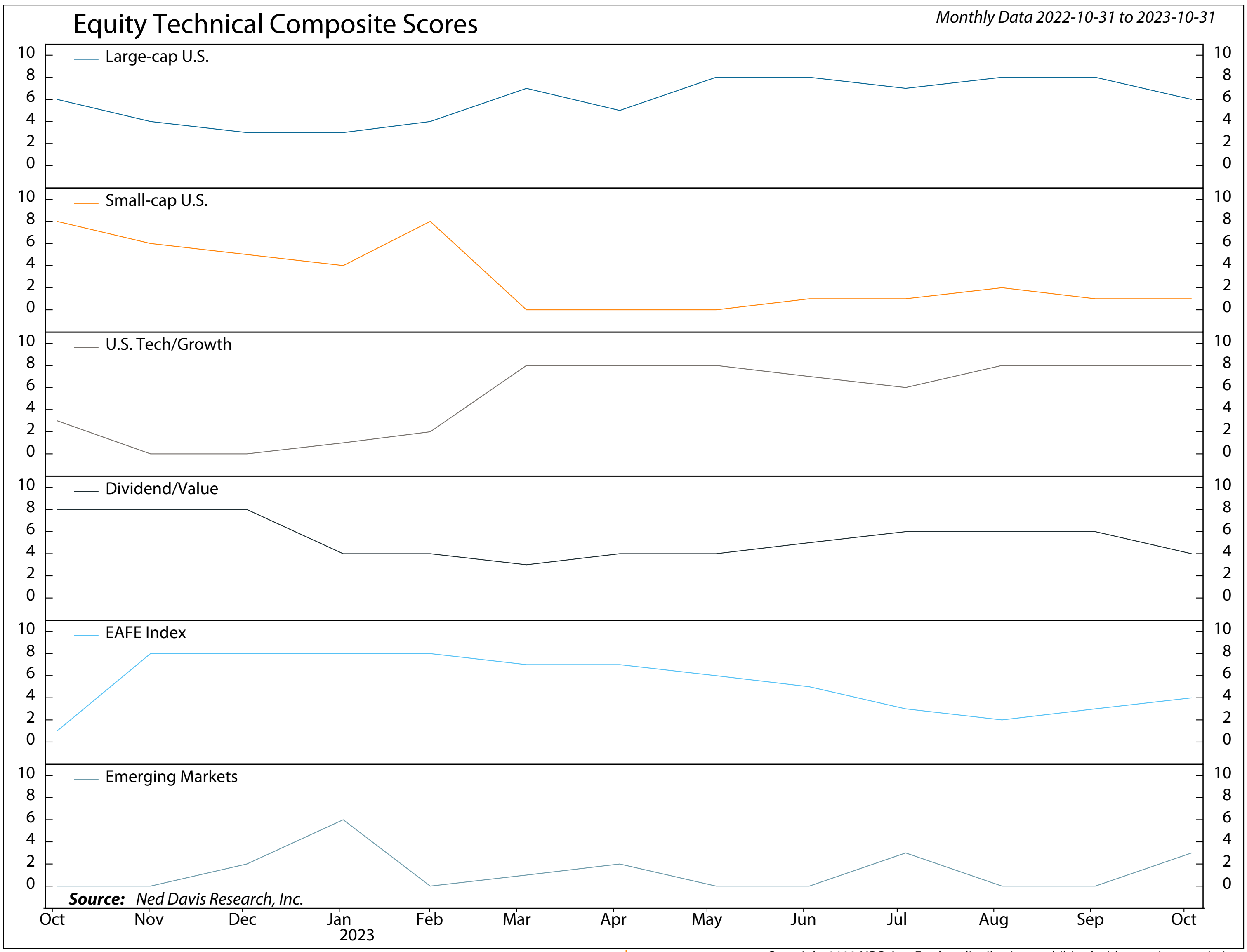


Global high yield OAS has risen by almost 60 basis points (bps) since mid-September (chart left), which reflects less risk appetite and favors bonds over stocks. However, this is not as severe as earlier this year when spreads jumped 125 bps during the regional banking problems.

Equity Allocation Summary

All six equity areas declined by more than 100 bps in October. It was the third straight month of such negative returns, which has not happened in more than ten years. Down more than 700 bps, U.S. small-caps plummeted over 500 bps for a second consecutive month. U.S. Large-Caps and Growth are the only two areas to receive more than 10% allocation for November (chart right).





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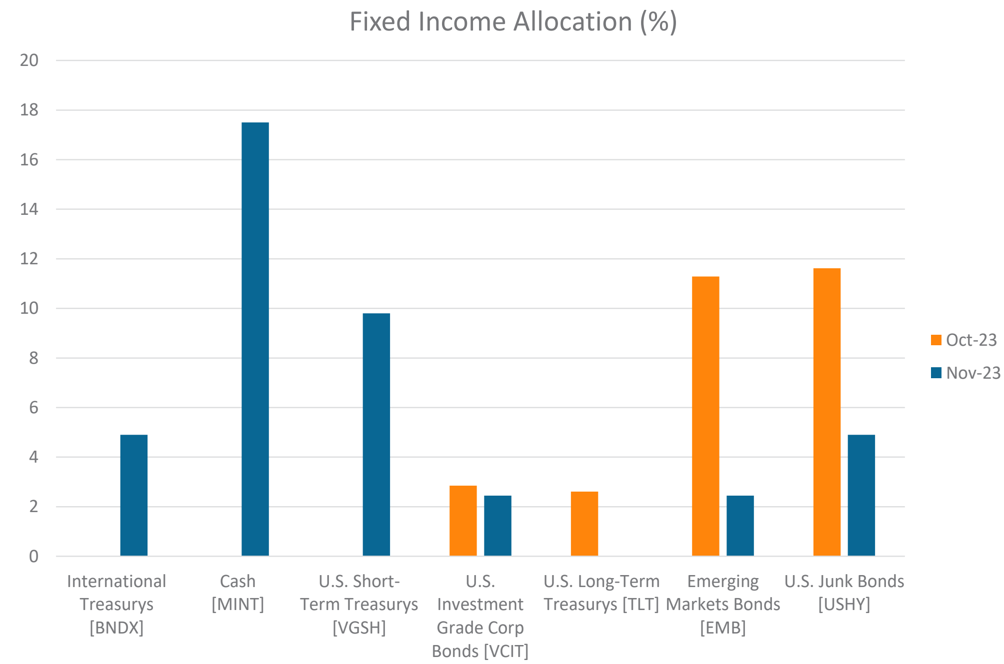
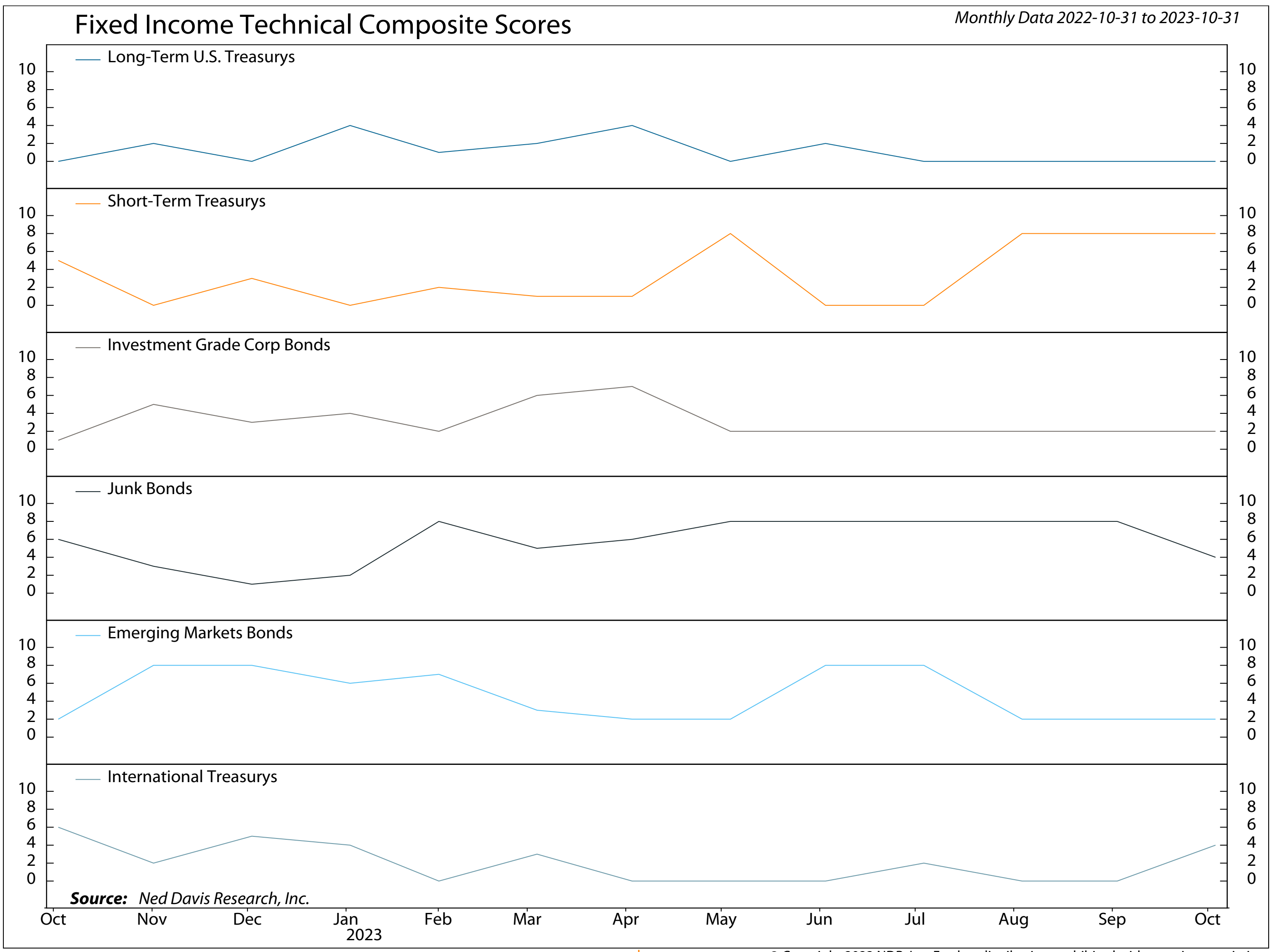
Fixed Income Allocation Summary

Only short-term Treasurys were higher during October. U.S. long-term Treasurys (TLT) continued its rout, as it declined more than 500 bps. TLT has not produced a positive monthly return since June and has declined more than 100 bps during 17 of the last 23 months. Emerging Market bonds, U.S. Investment Grade Corporates, and U.S. High Yield all fell more than 90 bps. Cash and U.S. short-term Treasurys were the only areas to receive more than 9% allocation for November (chart right).





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