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NED DAVIS RESEARCH

Dynamic Allocation Strategy

MARCH 2023

Macro/Market Update

The global economy showed signs of stabilization at the start of the year, according to the latest S&P Global Purchasing Managers' Index (PMI) readings. The global composite PMI increased 1.6 points in January, its largest gain in seven months, to a six-month high.

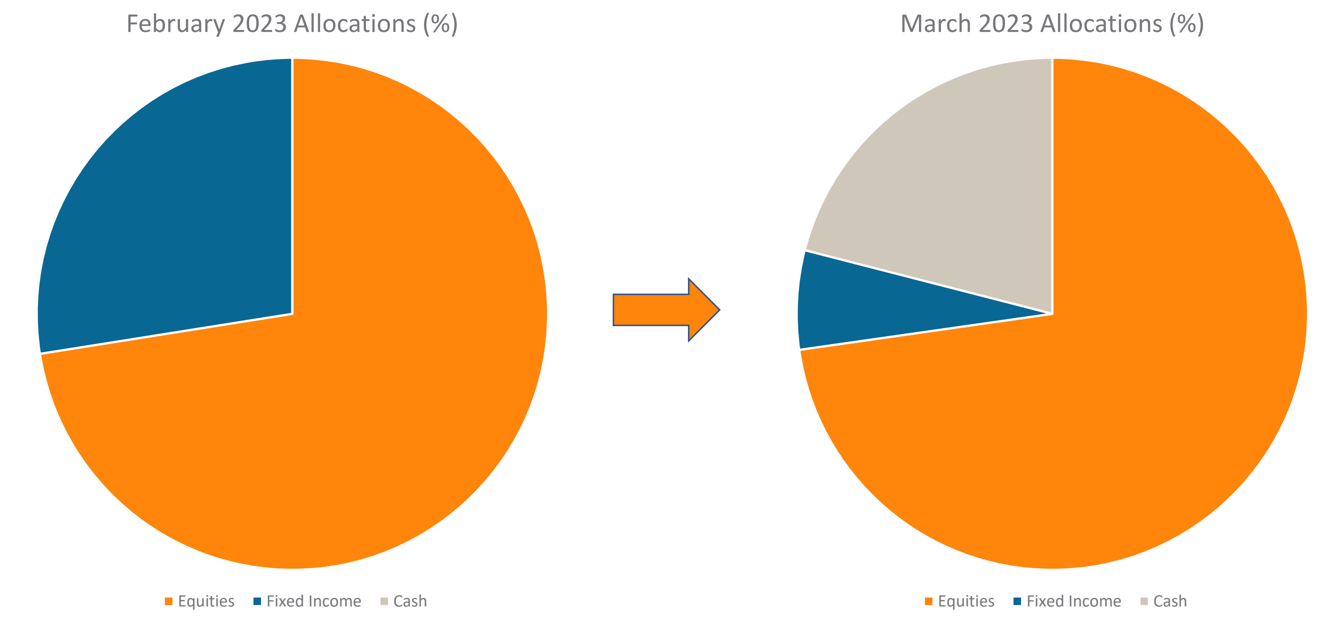
Contrary to the prior month's global PMI, which increased slightly on a month-to-month basis but showed other areas of weakness, the latest global data were broadly positive, as both the manufacturing and services indexes rose. Moreover, the composite indexes for new orders (including export orders), employment, and backlogs all increased, indicating improving global demand.

Conditions are likely to pick up, as the future output index jumped at one of its fastest paces on record and to its highest level since April. China's reopening, due to the end of the zero-COVID policy, explained much of the rebound. But the improving trend occurred elsewhere, albeit to a lesser degree, as the global composite PMI ex-China also increased.

But the global economic outlook is not without risk. The latest composite reading is historically consistent with just 0.5% real Gross Domestic Product (GDP) growth. 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, while a pick-up in input cost pressures may keep central banks tighter for longer, prolonging the headwinds from central banks.

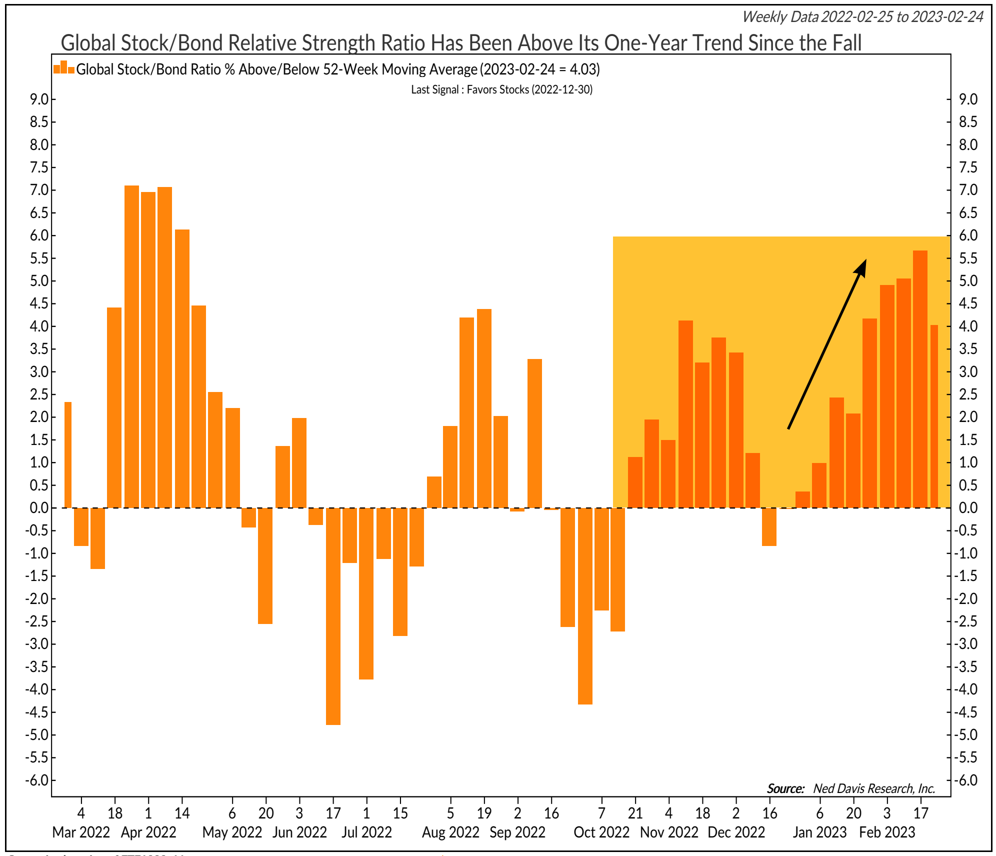
During February, the MSCI All Country World Index (ACWI) outperformed the Bloomberg Barclays Global Aggregate Bond Index by over 40 basis points (bps). Global stocks have outpaced bonds for six of the last eight months. However, on an absolute basis, stocks felt pressure during the month due to excessively optimistic sentiment and rising interest rates. The good news is that both economic and earnings growth have been improving from weak levels, which has resulted in very few stocks making new lows. Currently, the weight of the trend evidence leans bullish.

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 equity allocation remained above benchmark allocation for March, as two-thirds of the top-level indicators favor equities over fixed income. 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. During February, the spread between the relative strength ratio and its one-year trend reached the highest level in almost one year (chart at right). Currently, the trend is the equity market's friend.



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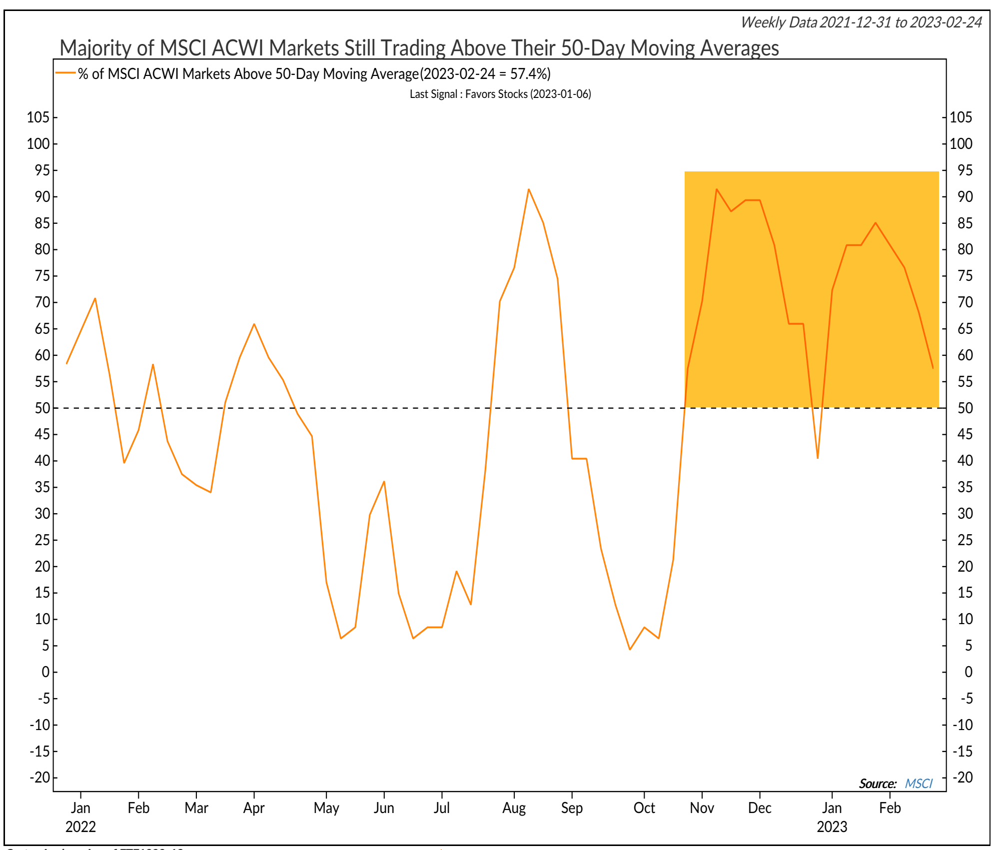

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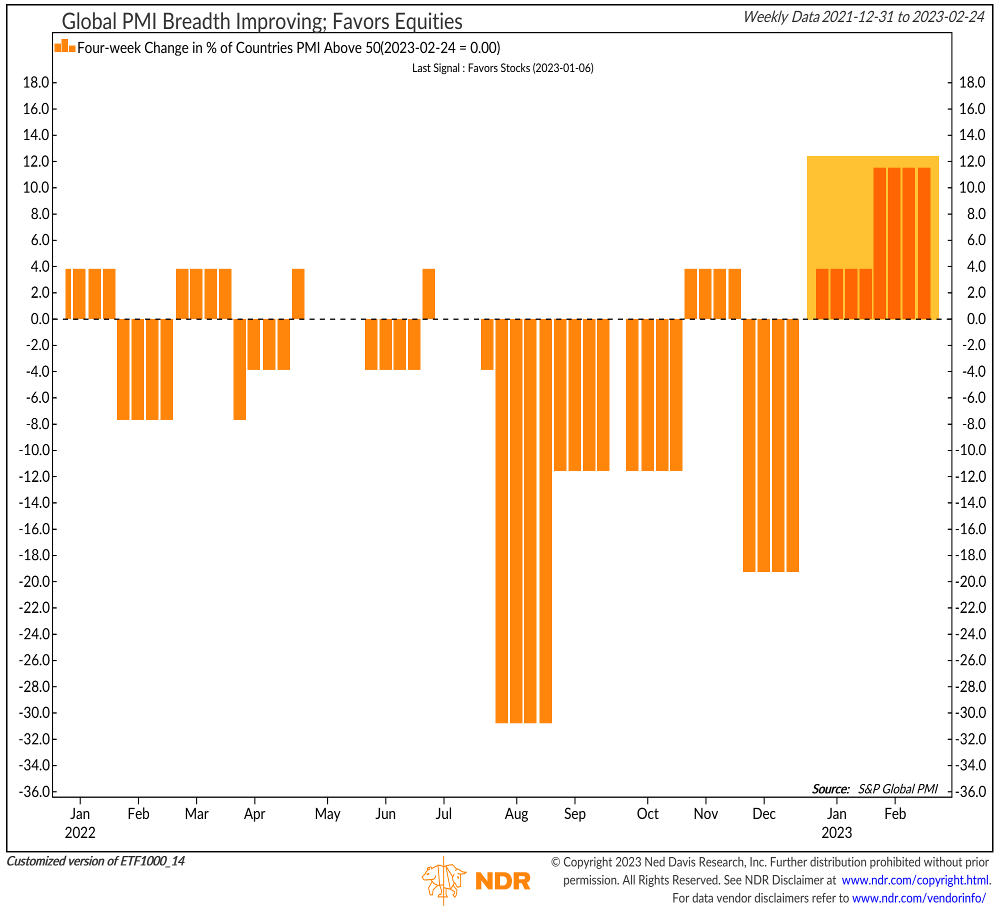
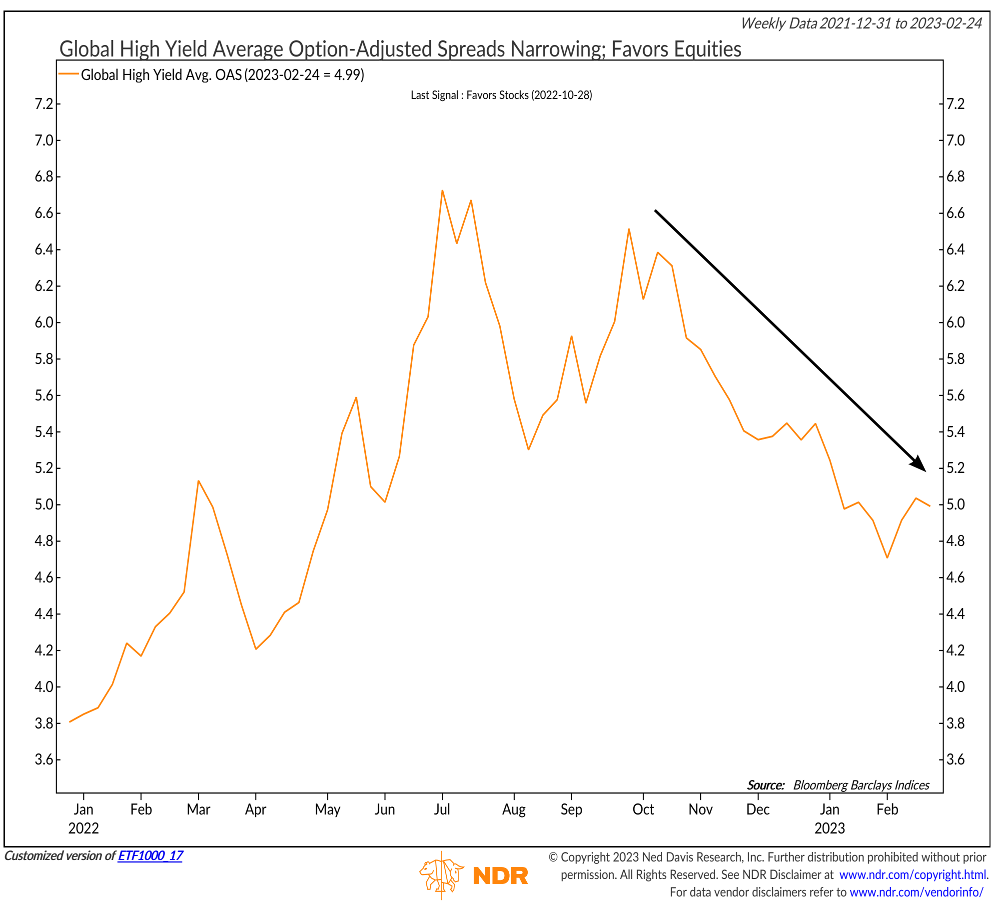
The global equity breadth indicator calculates the percentage of global equity markets trading above their 50-day moving average. Although the percentage declined from 85% in January to 57% last week, most global markets continue to trade above their intermediate-term trends (chart at left). The equity market uptrend is still supported by broad upside participation globally.

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 right) continues to improve as multiple European economies (France, Italy, Ireland) rose above 50.

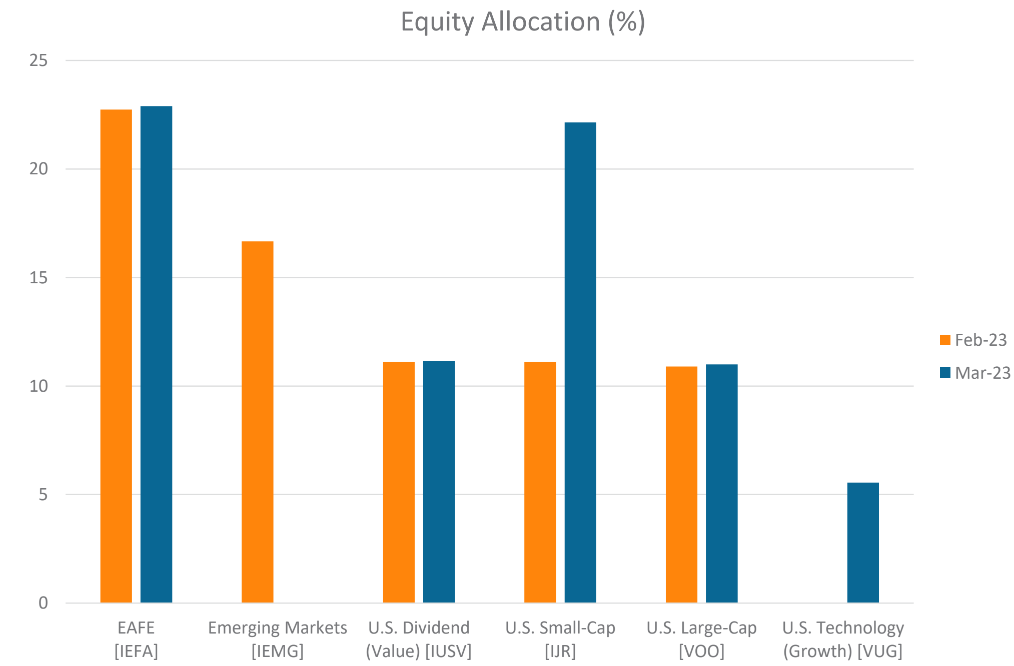


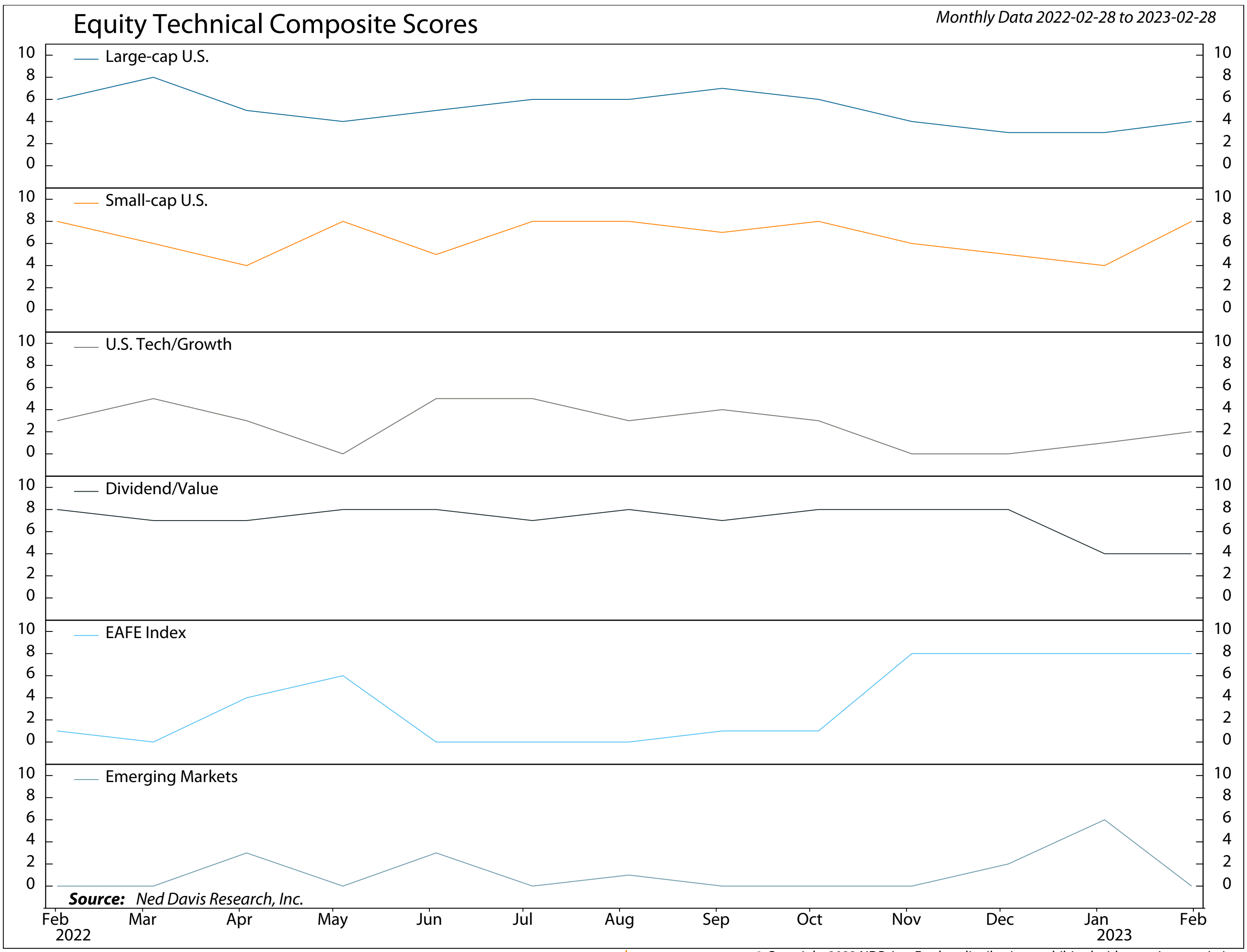


Global high yield option-adjusted spreads (OAS) continue to favor equities (chart at left). Global high yield OAS narrowed over 150 bps since late-September. This OAS indicator measures risk appetite within the fixed income market. With global high yield OAS narrowing, bond investors are not demanding higher yields for taking on more risk, as they are not as concerned with default at this time.

Equity Allocation Summary

During February, all equity areas declined. Non-U.S. equity areas were the weakest performers, as they had their worst monthly returns since September. Emerging Markets (IEMG) plummeted over 690 basis points (bps), while non-U.S. Developed (IEFA) dropped over 300 bps. U.S. Value (IUSV), U.S. Small-Caps (IJR), U.S. Large-Caps (VOO), and IEFA each received more than 10% allocation for March (chart at right) due to their technical composite scores (chart at bottom).





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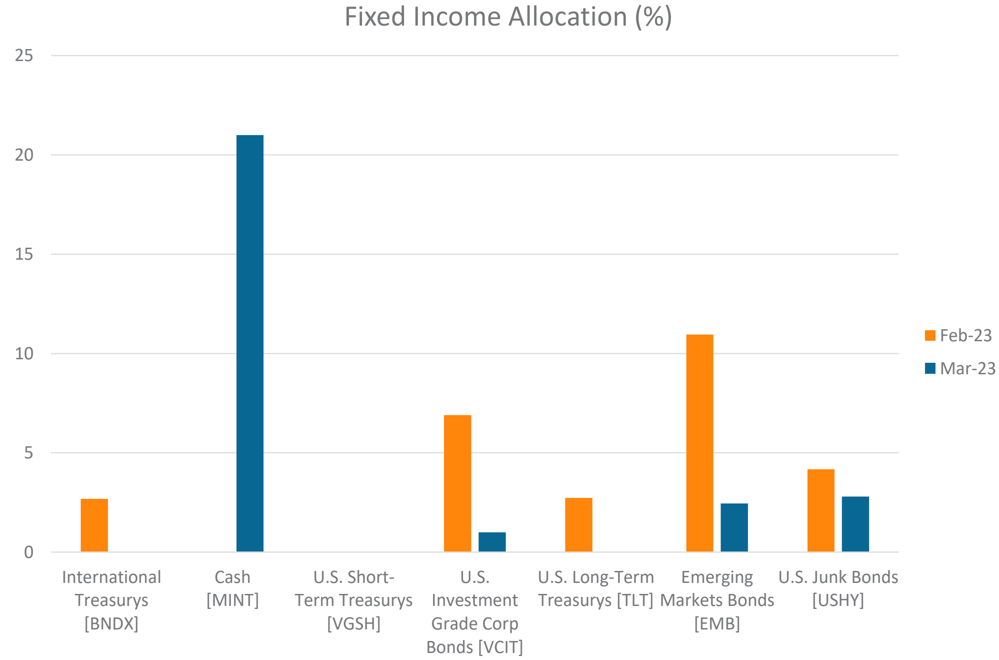
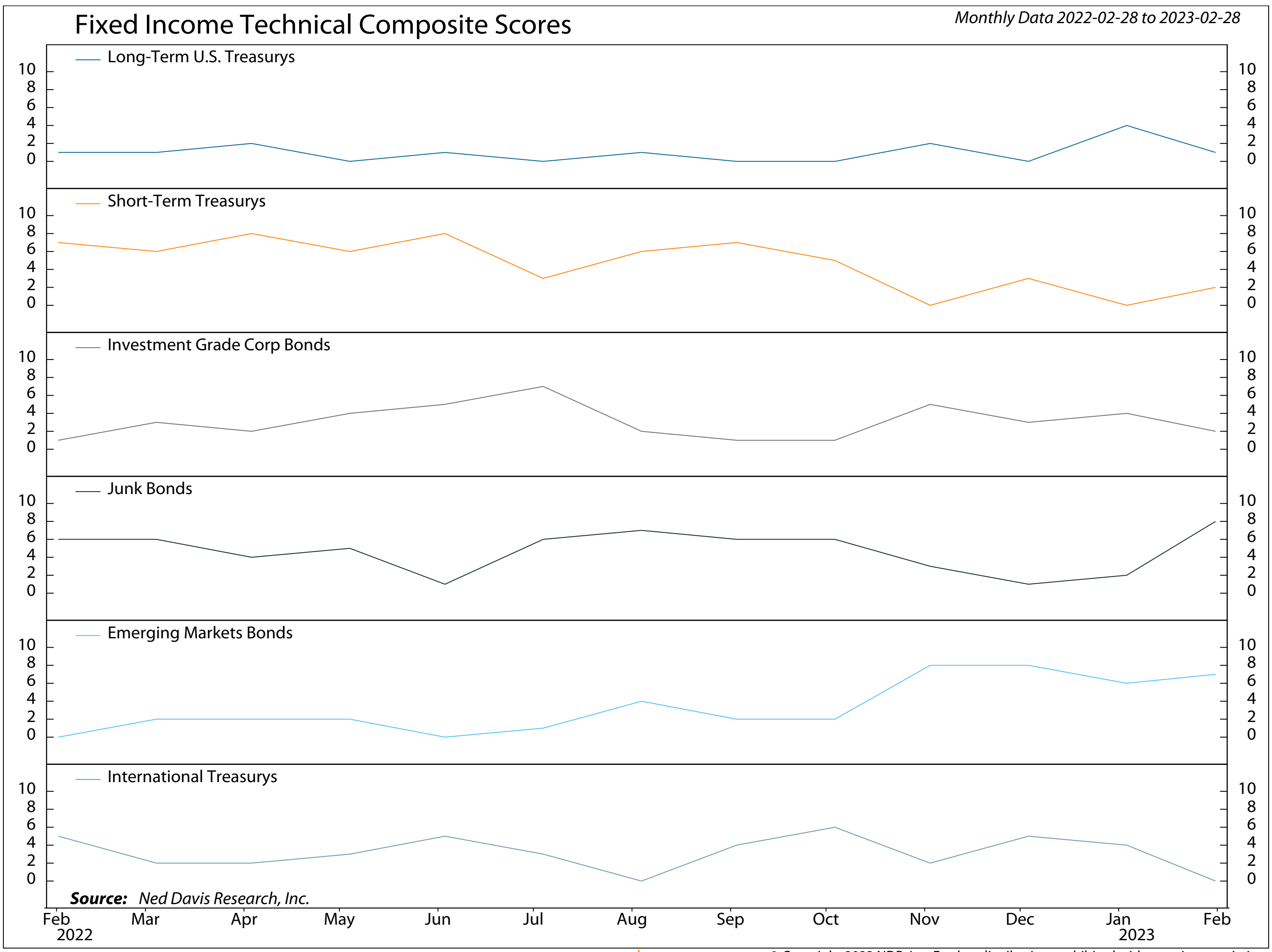
Fixed Income Allocation Summary

All fixed income areas dropped last month. U.S. Long-Term Treasurys (TLT) declined over 485 bps. Emerging Market bonds (EMB), U.S. Investment Grade (VCIT), U.S. High Yield (USHY), and U.S. Short-Term Treasurys (VGSH) suffered their worst monthly performance since September. Only cash received at least 5% allocation for March (chart at right).





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