Fixed Income Allocation Strategy

NDR
NED DAVIS RESEARCH

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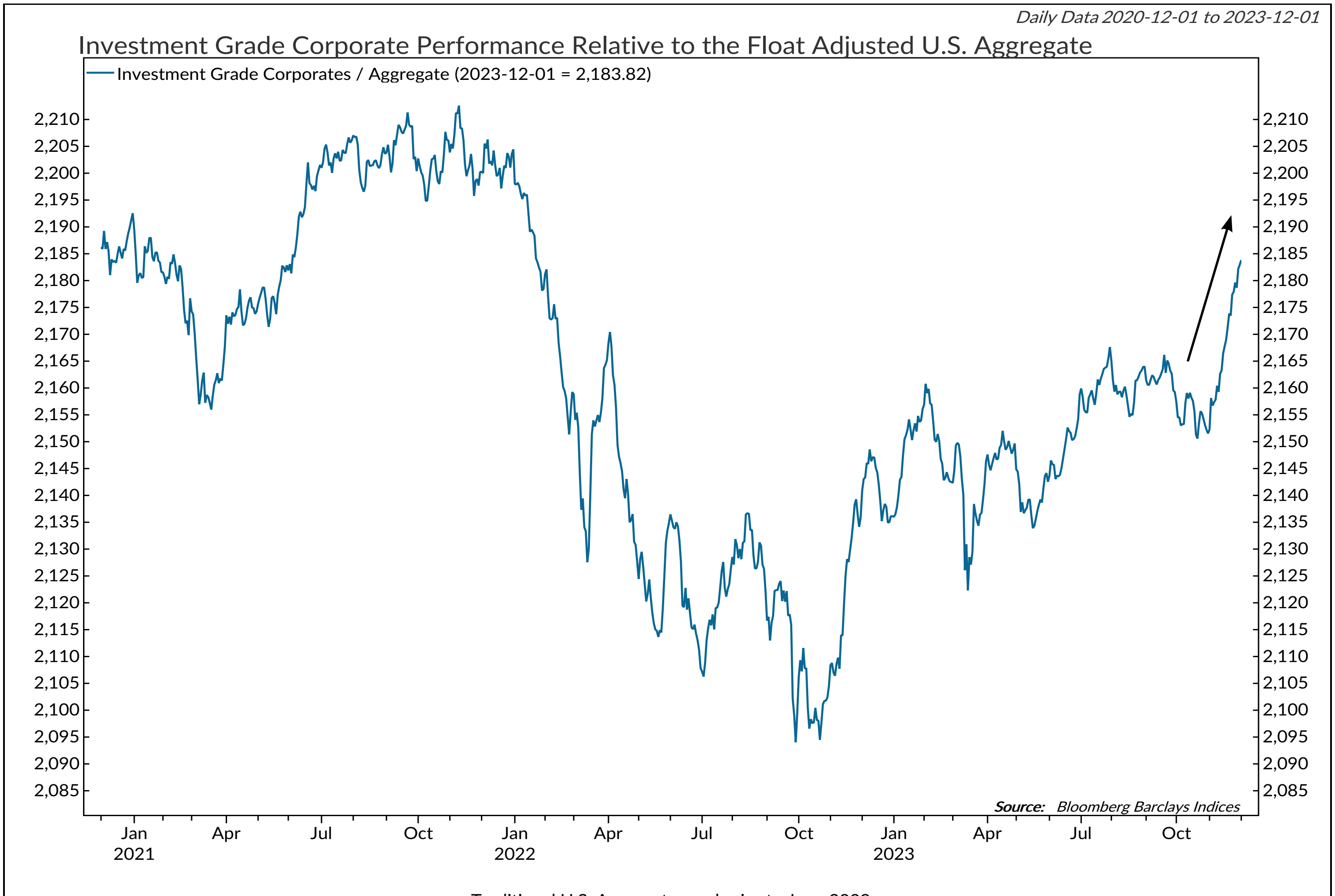
Fixed Income Market Update

After being down for six months in a row, the Bloomberg Barclays U.S. Aggregate Bond Total Return Index rebounded and gained 4.5% in November. Breadth improved sharply—all nine fixed income sectors we track had positive returns in November—U.S. Long-Term Treasurys rebounded nearly 10%!

After 10-year yields topped 5.00% and became good values, yields have sharply reversed on slowing growth, cooling inflation, and a Fed that is finished hiking rates. Historically, bonds have performed well after the last rate hike and the Fed has maintained a tightening bias. Additionally, our Bond Enhancement Model flashed a buy signal. As a result, we increased our recommended bond duration. Long-term support can be found from 5.00% to 5.25%. Intermediate-term resistance is around 4.00%.

Investors have moved back into riskier assets—Investment Grade Corporate (chart below), High-Yield, Mortgage-Backed Securities, and Emerging Market bonds all rallied sharply during the month.

Entering December, the fixed income allocation strategy shifted to risk-on leadership. The model is overweight Emerging Market bonds, U.S. High Yield, U.S. Investment Grade Corporate, and U.S. Mortgage-Backed Securities. The model is underweight U.S. Floating Rate Notes, U.S. Long-Term Treasurys, U.S. Treasury Inflation-Protected Securities, and International Investment Grade.



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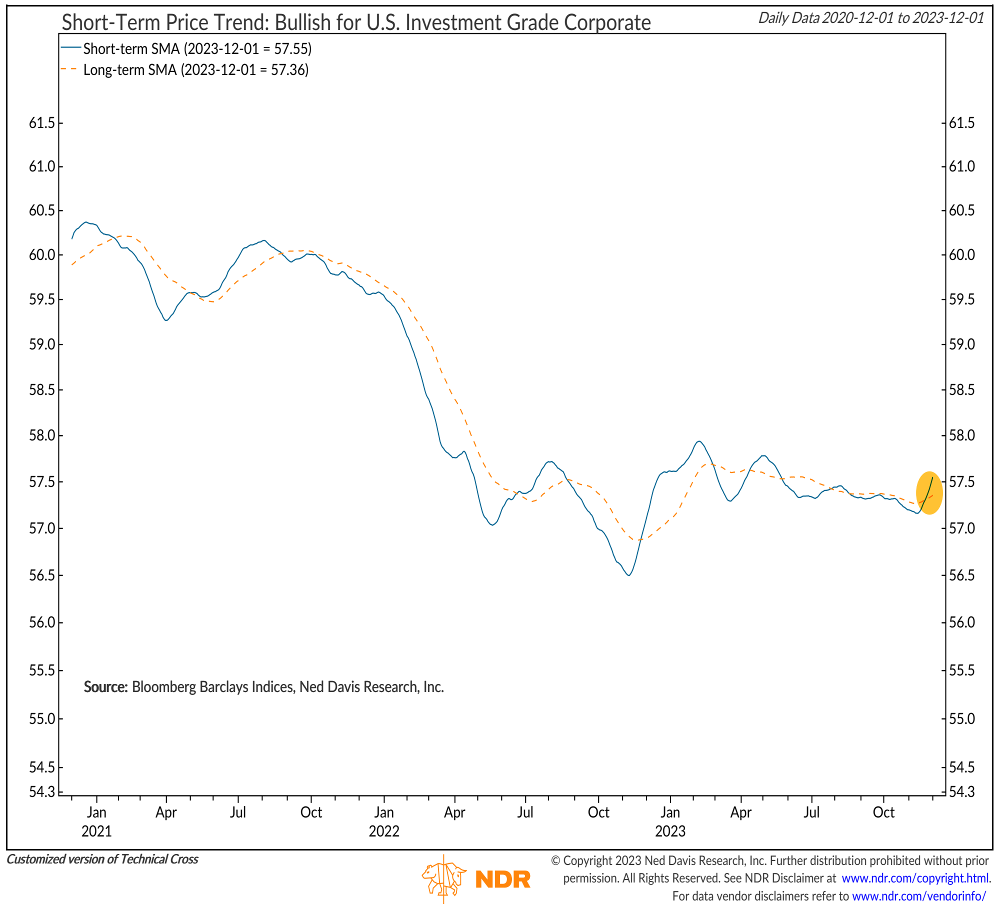
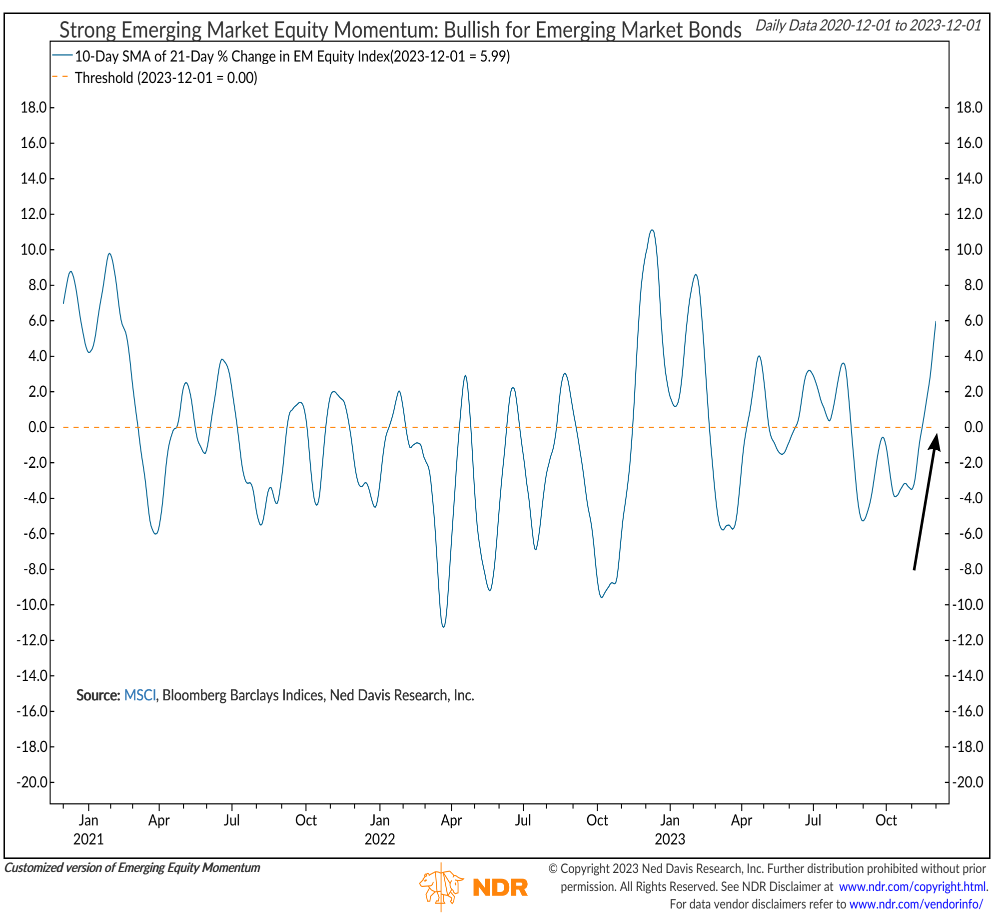
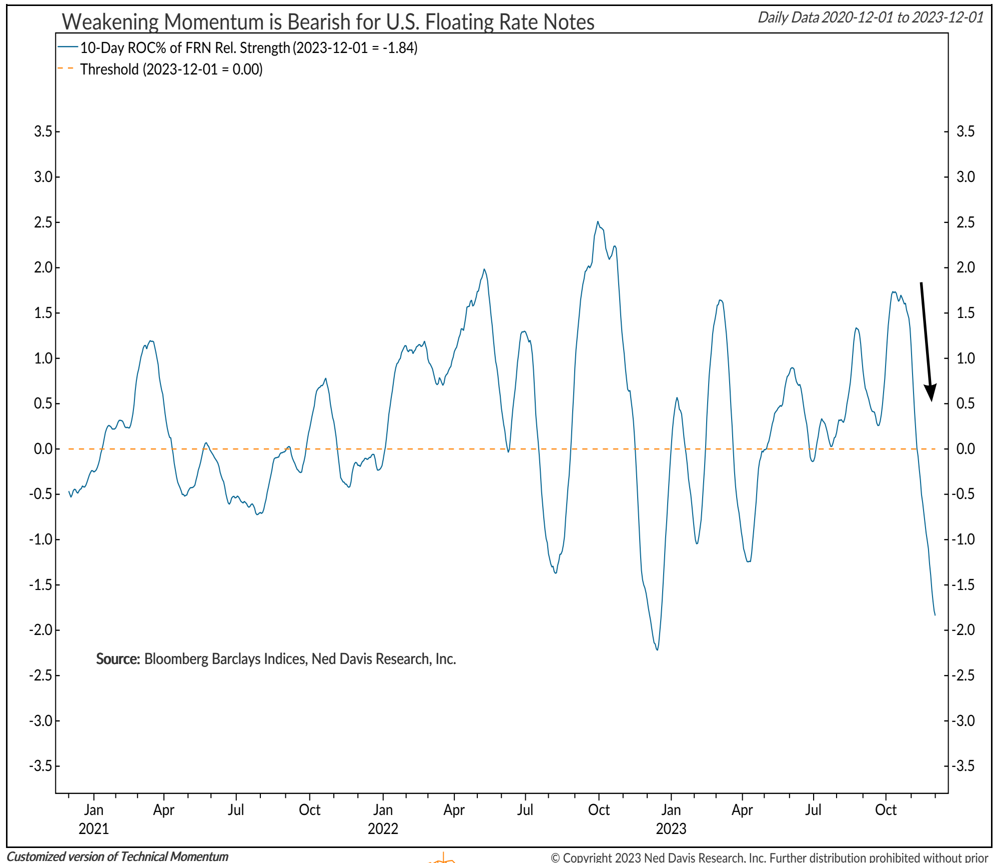
U.S. Investment Grade Corporate bond's allocation rose significantly and is now the largest overweight position. While bond volatility and the U.S. dollar are bearish for the sector, four of the six indicators are bullish including a price trend indicator that flashed positive during the month (chart right).

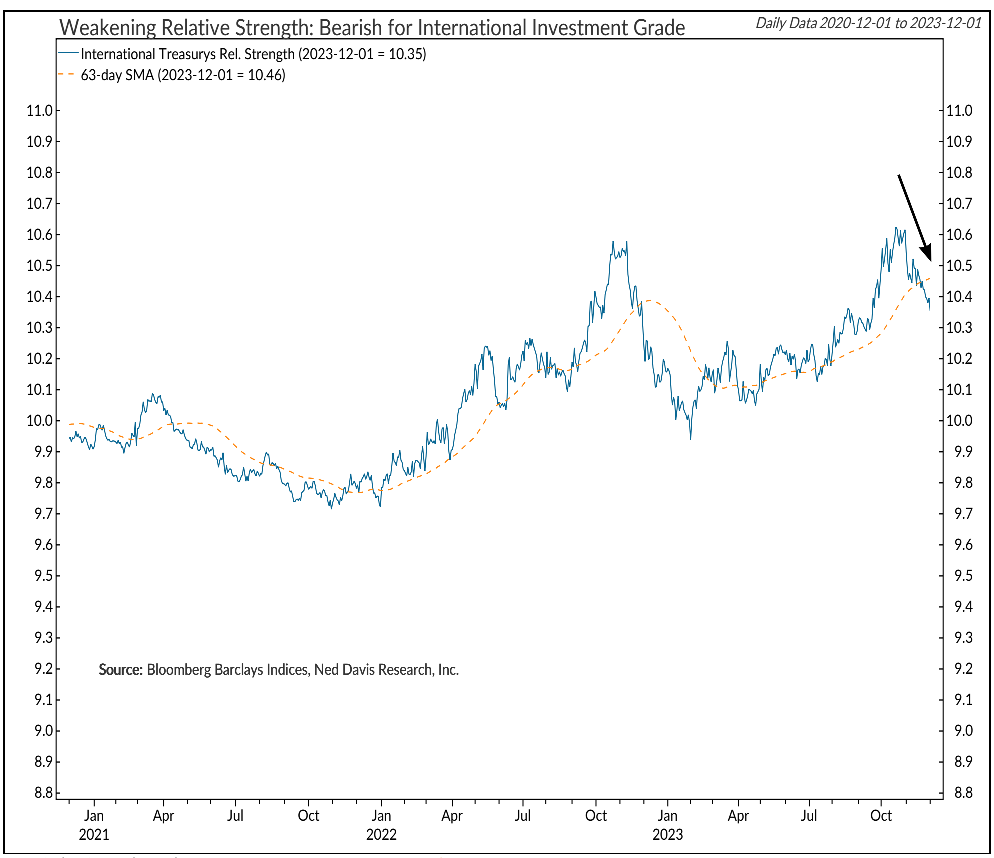




Emerging Market bonds rallied by over 6% in November. The model's allocation rose sharply and the sector was upgraded to overweight. Four of five indicators are now bullish for the sector. A weakening U.S. Dollar and positive momentum in Emerging Market equities (chart left) was confirmed by improving technicals.

U.S. Floating Rate Notes' allocation dropped significantly and is now the largest underweight position. Floating rate notes typically outperform when rates are rising. With the sharp drop in rates in November, the sector underperformed significantly. All five indicators are now bearish for the sector including short-term momentum (chart right).





International Investment Grade bonds' allocation dropped sharply and was downgraded to underweight. Narrowing global option-adjusted spreads joined U.S. swaps at neutral. Two price-based measures including relative strength trends (chart left) flashed bearish, along with equity volatility.

Summary

Entering December, the fixed income allocation strategy favors risk-on leadership. The model is overweight Emerging Market bonds, U.S. High Yield, U.S. Investment Grade Corporate, and U.S. Mortgage-Backed Securities. The model is underweight U.S. Floating Rate Notes, U.S. Long-Term Treasurys, U.S. Treasury Inflation-Protected Securities, and International Investment Grade.

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