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NED DAVIS RESEARCH

Dynamic Allocation Strategy

MAY 2023

Macro/Market Update

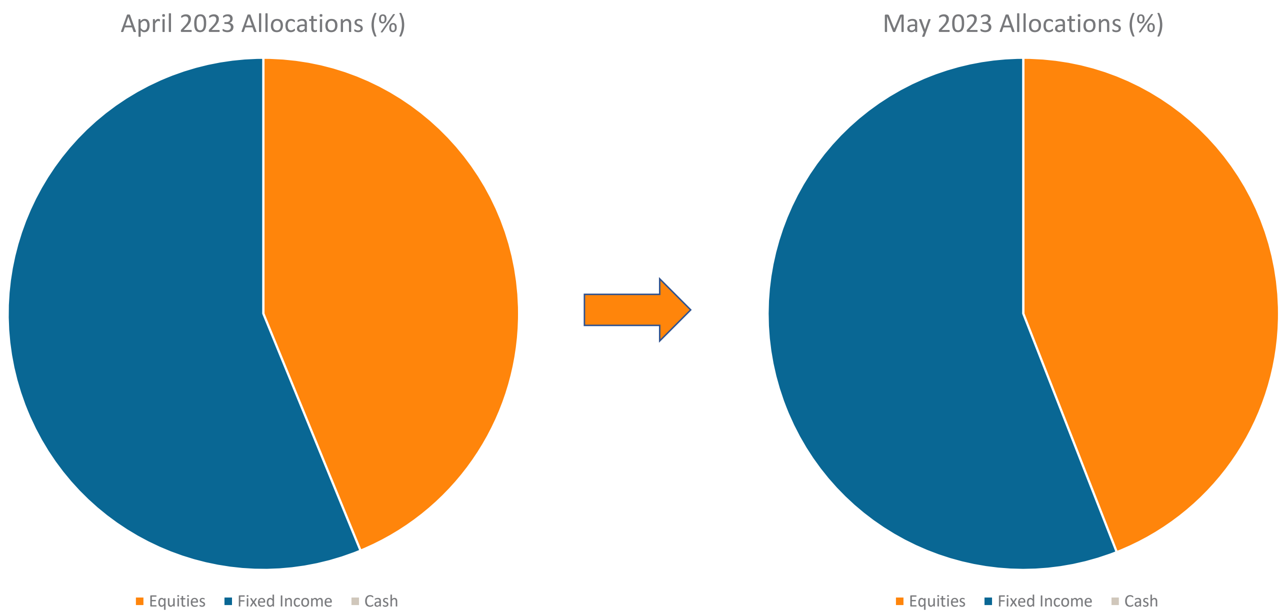
The global economy continued to accelerate through March, according to the S&P Global Purchasing Managers' Index (PMI) readings. The global composite PMI jumped to its highest level in nine months. The reading marked the fourth straight increase in the PMI and the second straight month of expansion. When the global economy has been accelerating, it's historically been associated with outperformance in global equities.

Unfortunately, the global economic outlook reflected some cracks under the surface. Although services sector growth remained broad and healthy, the manufacturing PMI slipped back into contraction territory, while breadth in the sector weakened significantly. Moreover, the composite future output index ticked down for the first time in five months. While it remains elevated, it suggests that global growth may peak in the first half of the year.

History suggests that the past year's tight monetary policy will continue to limit upside in the global economy in the coming months. The March banking crisis provides another overhang to the global economy, as it will likely be associated with tighter credit conditions over the near-term. Moreover, stubbornly high inflation especially in the services sector may keep central banks tighter for longer, increasing the risk of recession possibly in late 2023 or early 2024.

During April the MSCI All Country World Index (ACWI) outperformed the Bloomberg Barclays Global Aggregate Bond Index by more than 100 basis points (bps). Global stocks have outpaced bonds for five of the last seven months. Equity returns and bond yields have maintained an inverse correlation. Dropping bond yields have been a key influence behind the market's recovery. Accordingly, a renewed interest rate uptrend would be a major threat to the outlook.

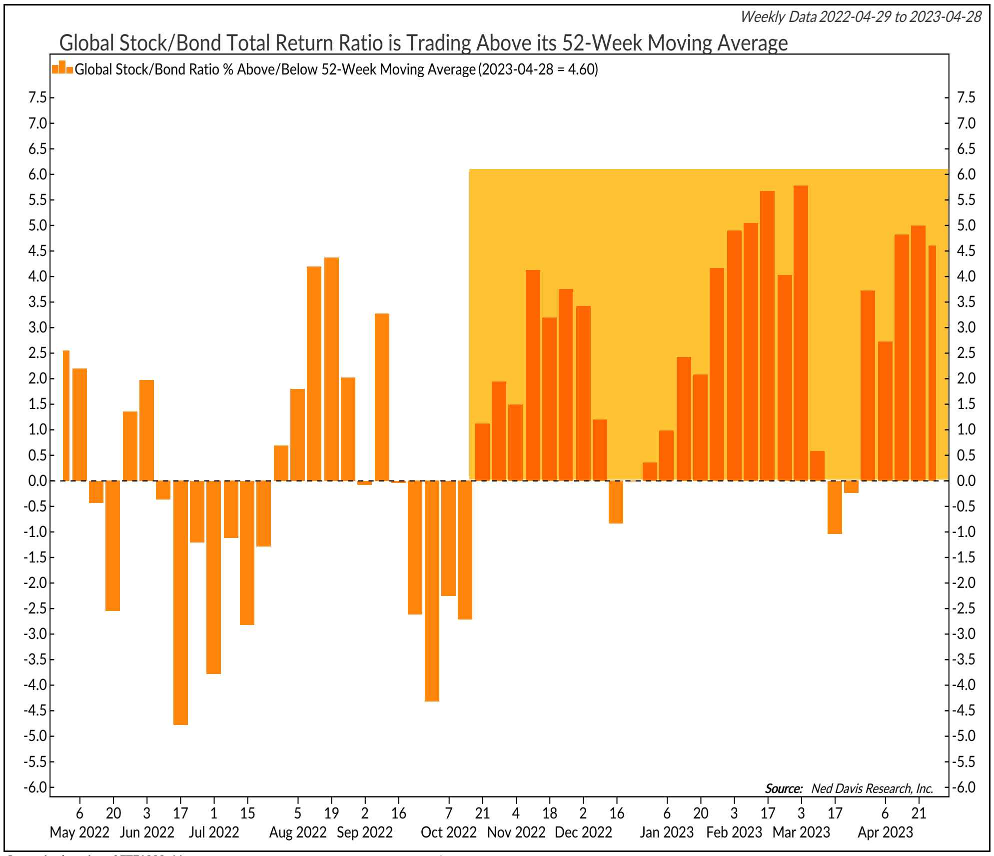
Asset Allocation Summary



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

Although there was indicator improvement this month, the allocations did not change. The model uses a turnover reduction mechanism, which reduces trading. The proposed allocations did not deviate enough from the existing weightings to warrant a model rebalance.

The technical measures reflect a positive outlook. 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 is more than 4.5% above its one-year moving average (chart at right).



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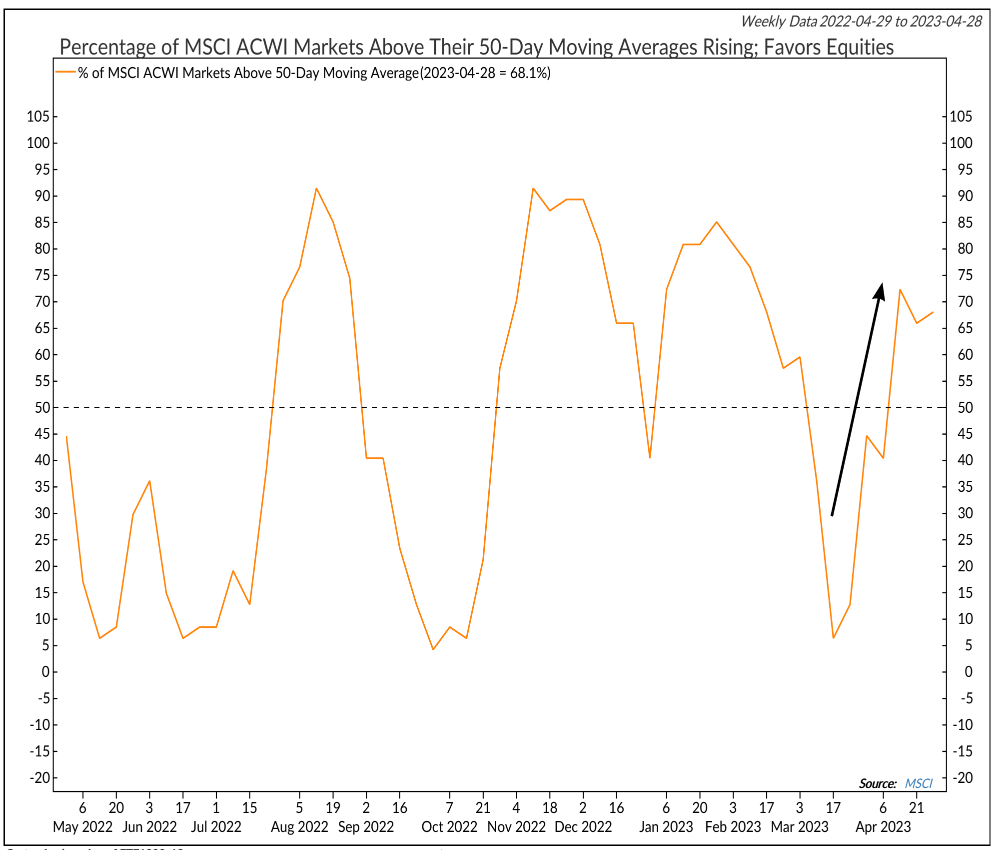

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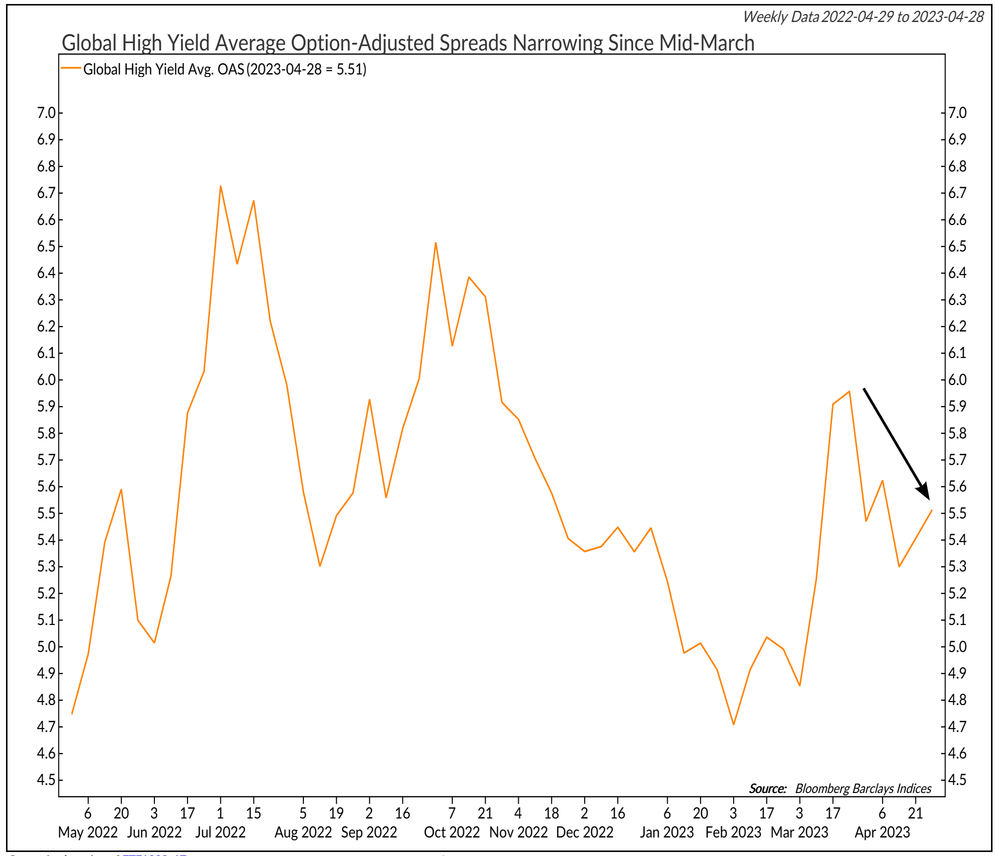
The global equity breadth indicator calculates the percentage of global equity markets trading above their 50-day moving average. This indicator recently has experienced significant volatility. The global equity market breadth indicator has produced bullish and bearish extremes over the last few months. At the end of January more than 85% of global equity markets traded above their 50-day moving average. By mid-March only 6% of equity markets met that criterion. The indicator improved to 68% at the end of May (chart at left).

Global high yield option-adjusted spreads (OAS) now favor equities (chart at right). Global high yield option-adjusted spreads widened by 125 basis points (bps) from early February until mid-March during the banking sector weakness, as bond investors demanded higher yields for taking on more risk. However, since mid-March spreads have narrowed over 65 bps.



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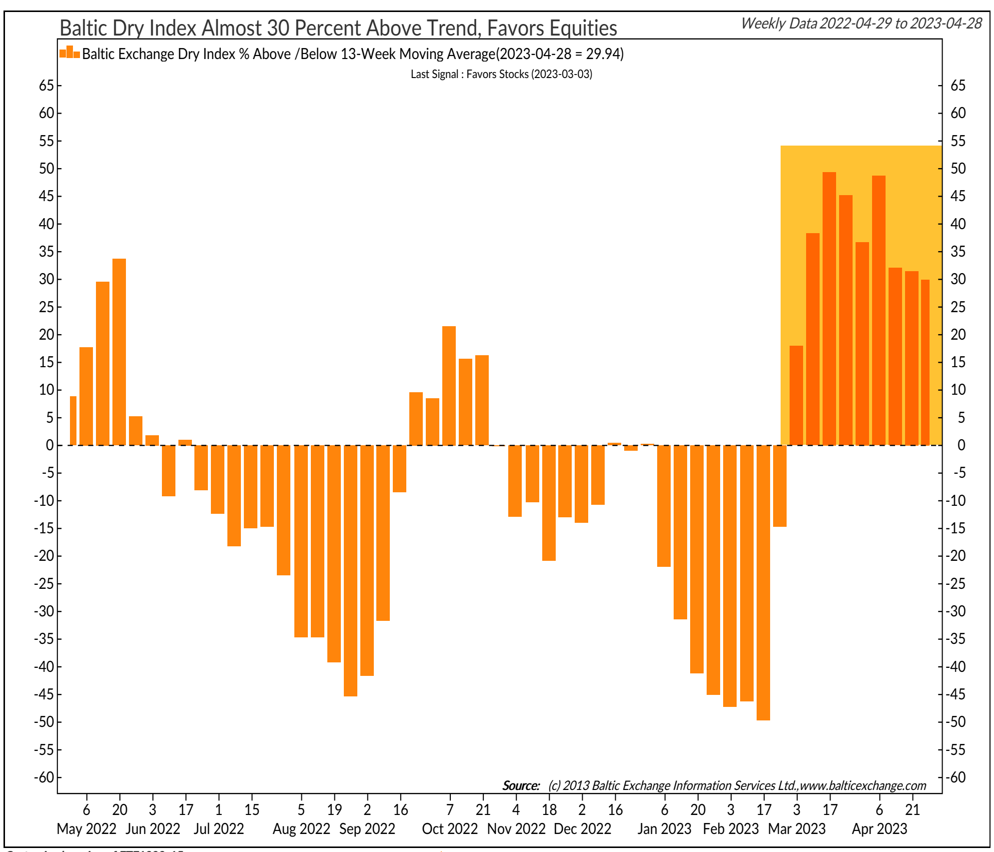

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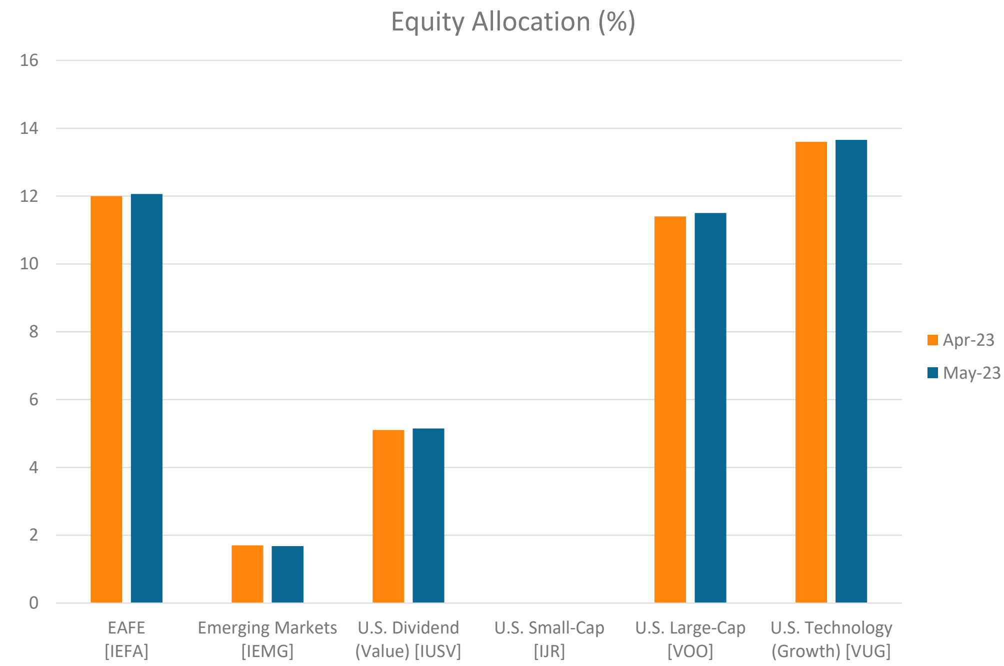
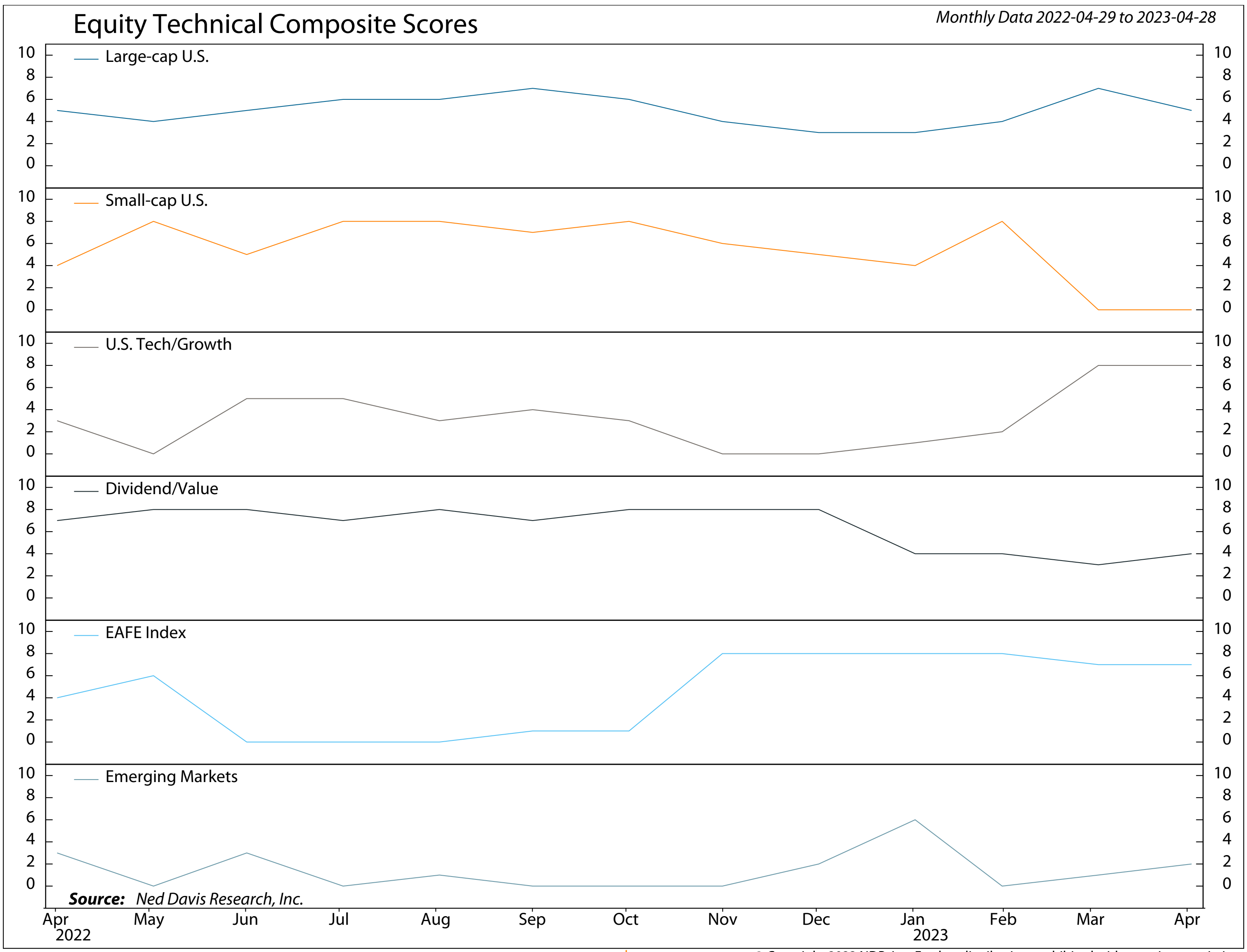
Global shipping rates continue to favor equities. This indicator compares the Baltic Dry Index (BDI) to its 13-week moving average. During February, the BDI was almost 50% below its 13-week moving average. By mid-March, the indicator jumped to its highest reading since the economic reopening during 2020. The BDI now resides at almost 30% above its intermediate trend (chart at left).

Equity Allocation Summary

During April, only U.S. Small Caps (IJR) and Emerging Markets (IEMG) declined. IJR has fallen by more than 100 bps for four of the last five months. U.S. Growth (VUG), International Developed (IEFA), U.S. Value (IUSV), and U.S. Large-Caps (VOO) each rose over 100 bps in April. VUG, VOO, and IEFA have increased by over 100 bps for five of the last seven months. VUG, IEFA, and VOO each received more than 10% allocation for May due to their technical composite scores.





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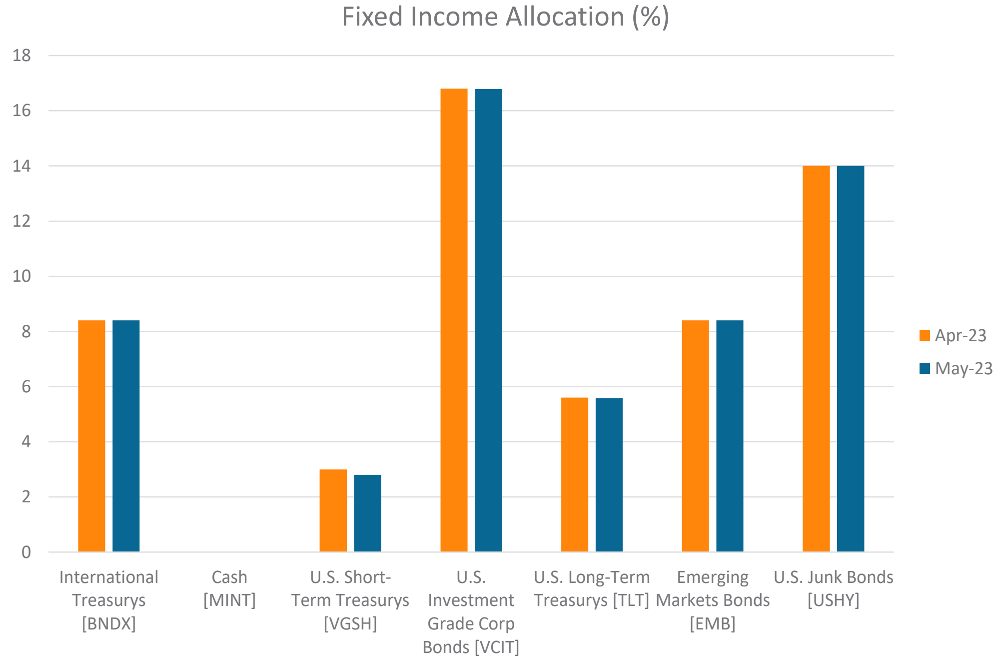
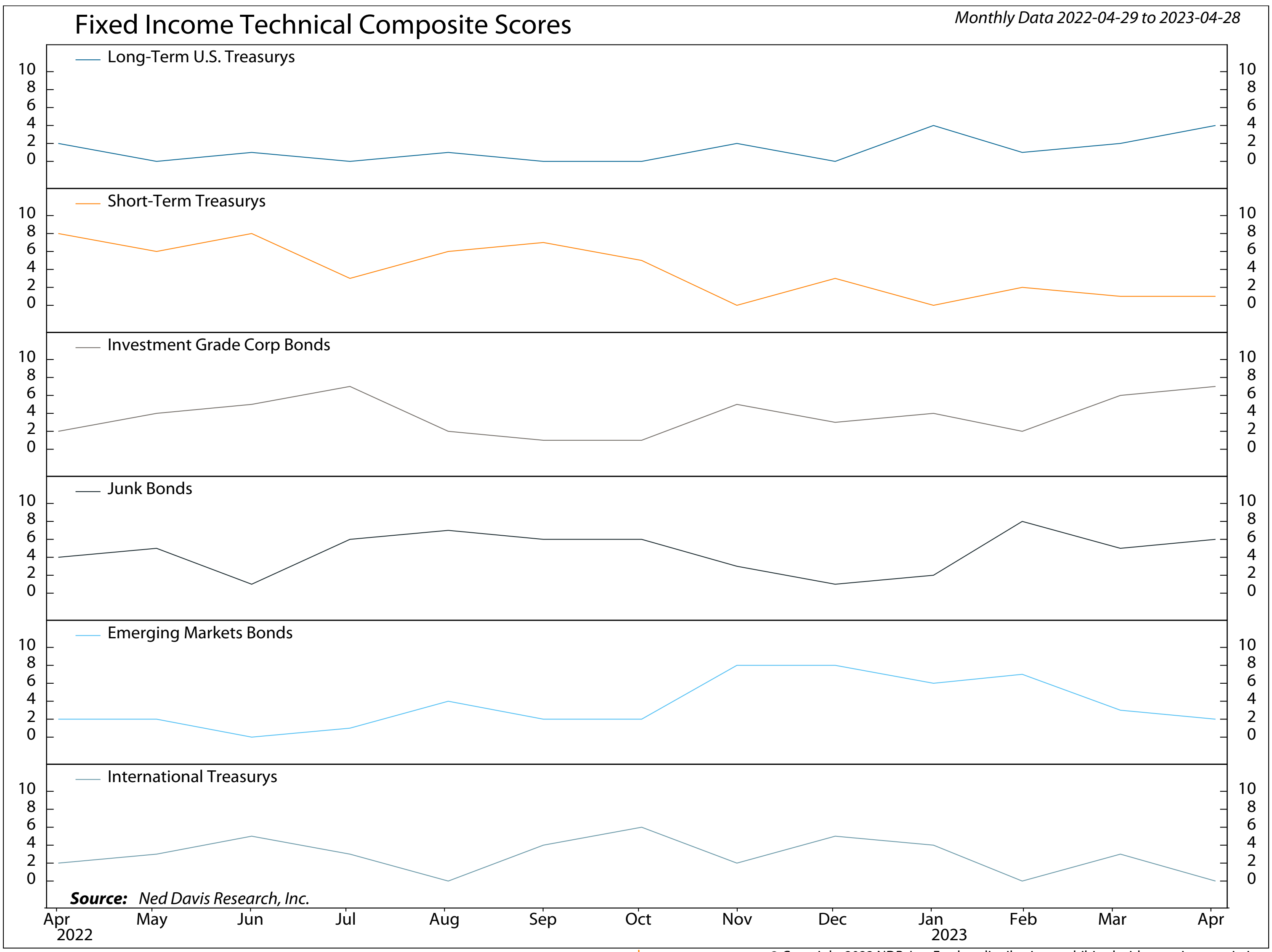
Fixed Income Allocation Summary

All fixed income areas increased by less than 100 bps during April. U.S. Investment Grade Corporates (VCIT) was the only area to rise by more than 50 bps. U.S. Long-Term Treasurys (TLT), U.S. Short-Term Treasurys (VGSH), U.S. High Yield (USHY), Emerging Markets (EMB), and International Investment Grade (BNDX) produced returns between 20-40 bps. VGSH is the only area to have risen for five of the last six months. VCIT and USHY received at least 10% allocation for May due to their technical composite scores.





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