Dynamic Allocation Strategy

DECEMBER 2022

Macro/Market Update

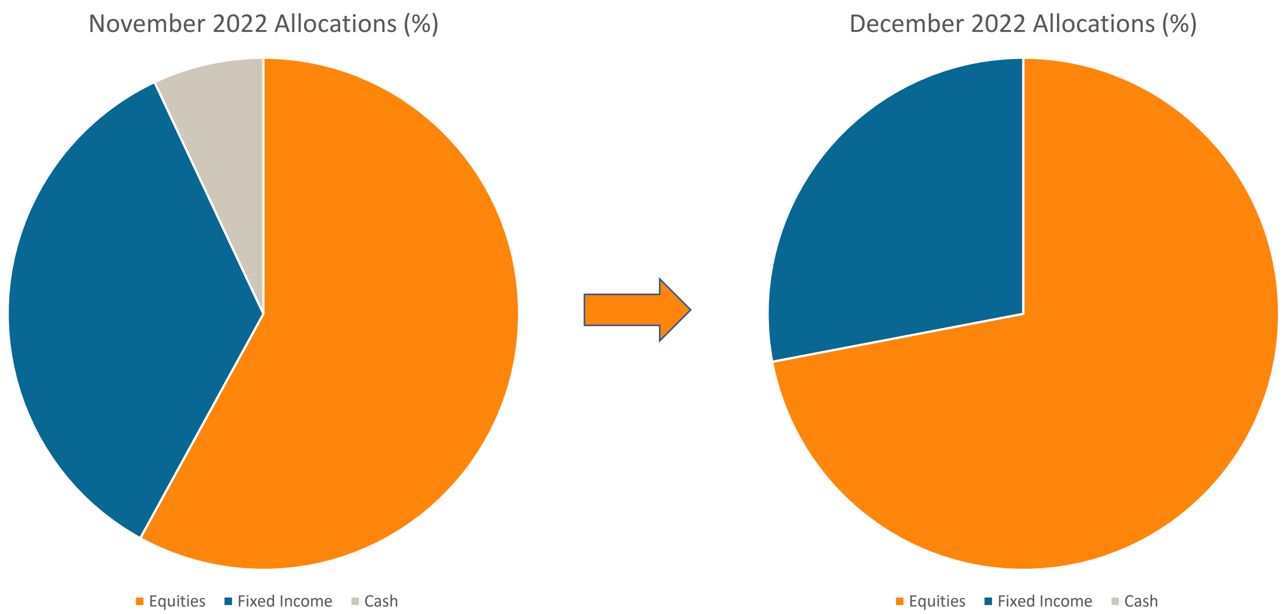
The global economy contracted for a third straight month in October, according to the latest S&P Global Purchasing Managers' Index (PMI). The global composite PMI declined to the lowest level since June 2020. Forward-looking indicators, including new orders and the future output index, point to deteriorating economic growth, increasing the possibility of a recession in 2023.

However, not all the economic data are negative. In line with the weakening global demand and easing supply chain issues, global price pressures continued to soften, suggesting lower global Consumer Price Index (CPI) inflation in the coming months.

Also, the Citigroup surprise indexes, which measure economic data relative to expectations, suggest that economists are too pessimistic. The economic surprise index for advanced economies has been in positive territory since September, indicating that economic data has, on balance, been surprising to the upside. This comes after a three-month streak of data consistently surprising to the downside. The positive surprises are broad-based, covering the U.S., eurozone, and the U.K. Global equities tend to outperform when the surprise index has been positive, as it is now. The index often bottoms ahead of major equity market bottoms and recession end (e.g., 2009 and 2020).

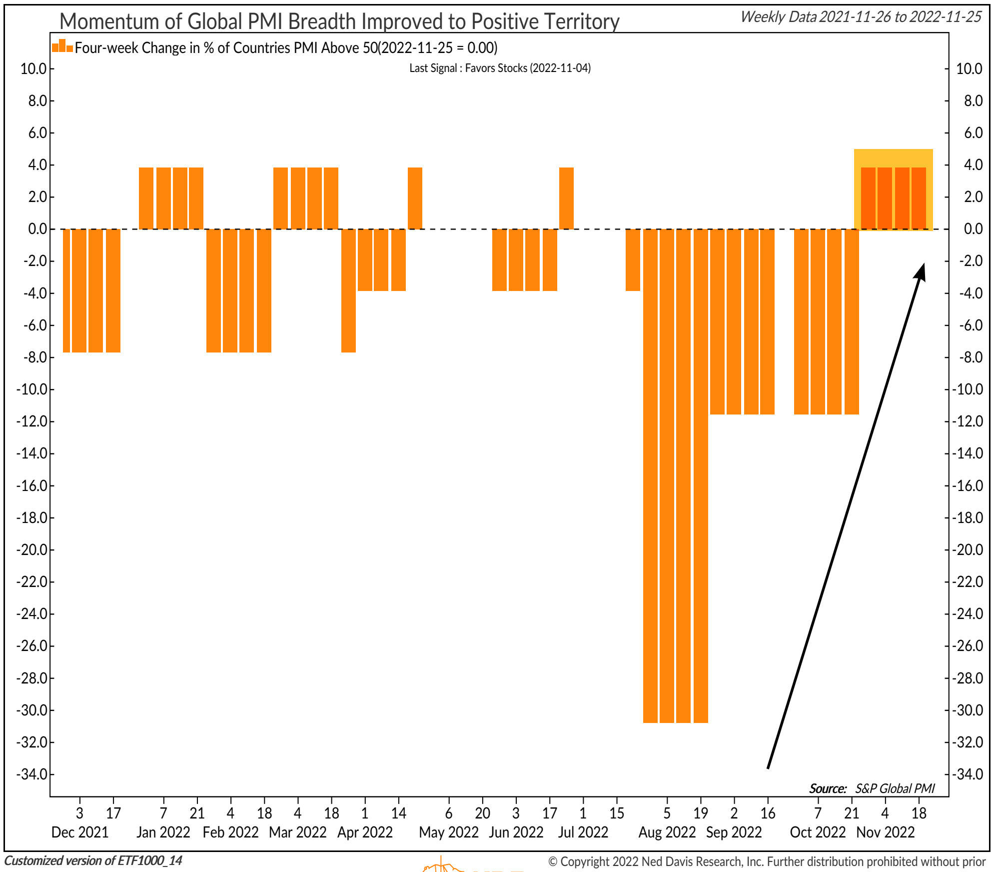
During November, the MSCI All Country World Index (ACWI) outperformed the Bloomberg Barclays Global Aggregate Bond Index by over 300 basis points (bps). Equities have seemingly regained their status as the preferred asset class, with bullish breadth and decisive outperformance. There has been a strong shift in Federal Reserve rate hike expectations, which helps explain the joint descent of bond yields and the U.S. dollar. This is attributable to increasing evidence that inflation is receding. All this evidence indicates that a bear market bottom may be behind us.

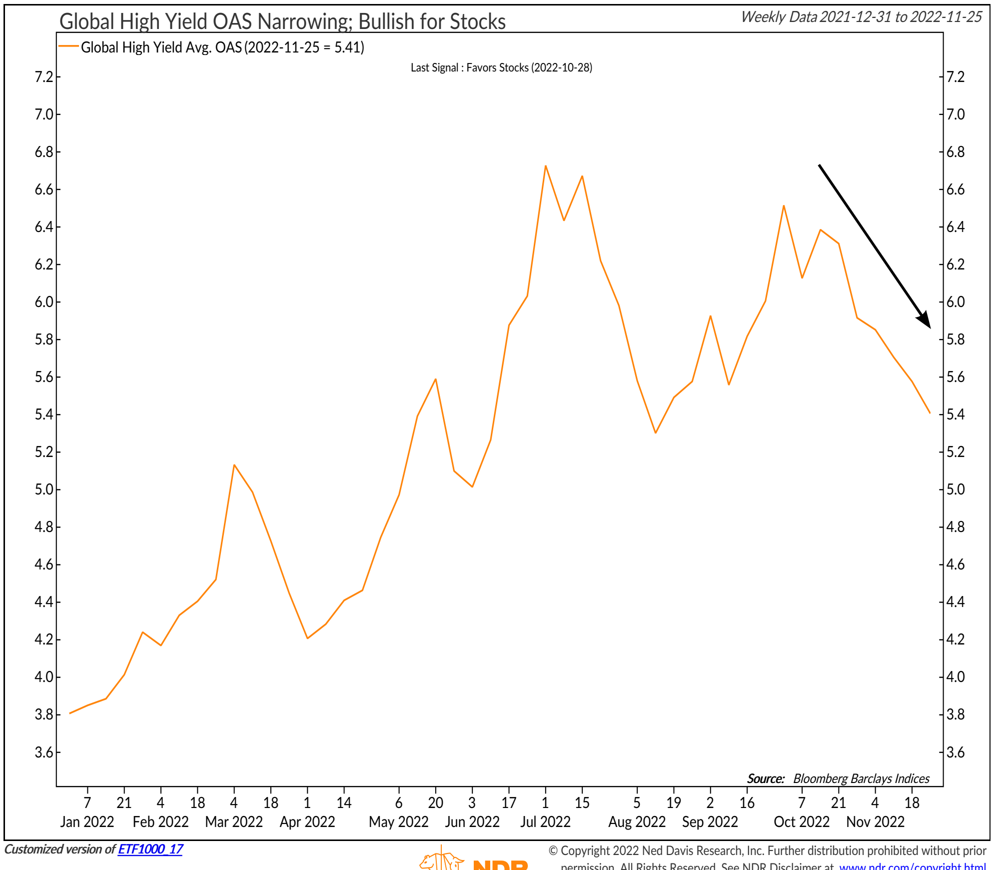
Asset Allocation Summary



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

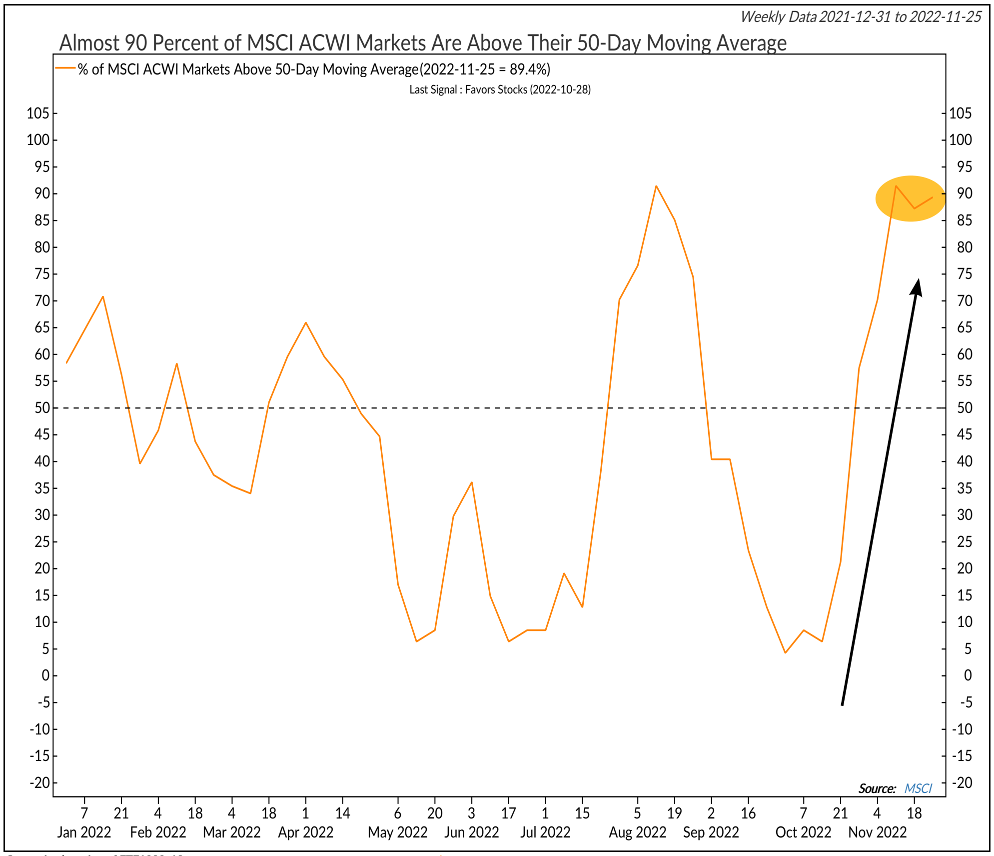
The equity allocation jumped to above benchmark allocation for December due to a new bullish signal from the PMI breadth indicator. The Purchasing Managers' Index (PMI) breadth indicator measures the four-week point change of the percentage of economies with a PMI greater than 50 (expanding activity). A change greater than zero favors stocks, while a change less than zero supports bonds. This economic momentum breadth indicator (chart at right) improved this month, as Denmark's and Hungary's PMIs rose above the expansionary threshold.





Global high yield option-adjusted spreads (OAS) also contributed to the equity allocation (chart at left). Since the high yield option adjusted spread can be considered a proxy for credit risk and financial stress, its decline suggests investors are becoming less worried about an economic disaster brought about by runaway inflation, ongoing central bank aggression, and soaring bond yields.

The technical indicators continue to reflect equity market improvement. The stock/bond relative strength ratio is almost 4% above its one-year moving average and almost 90% of global equity markets are trading above their 50-day moving averages, the highest reading since early August (chart at right).



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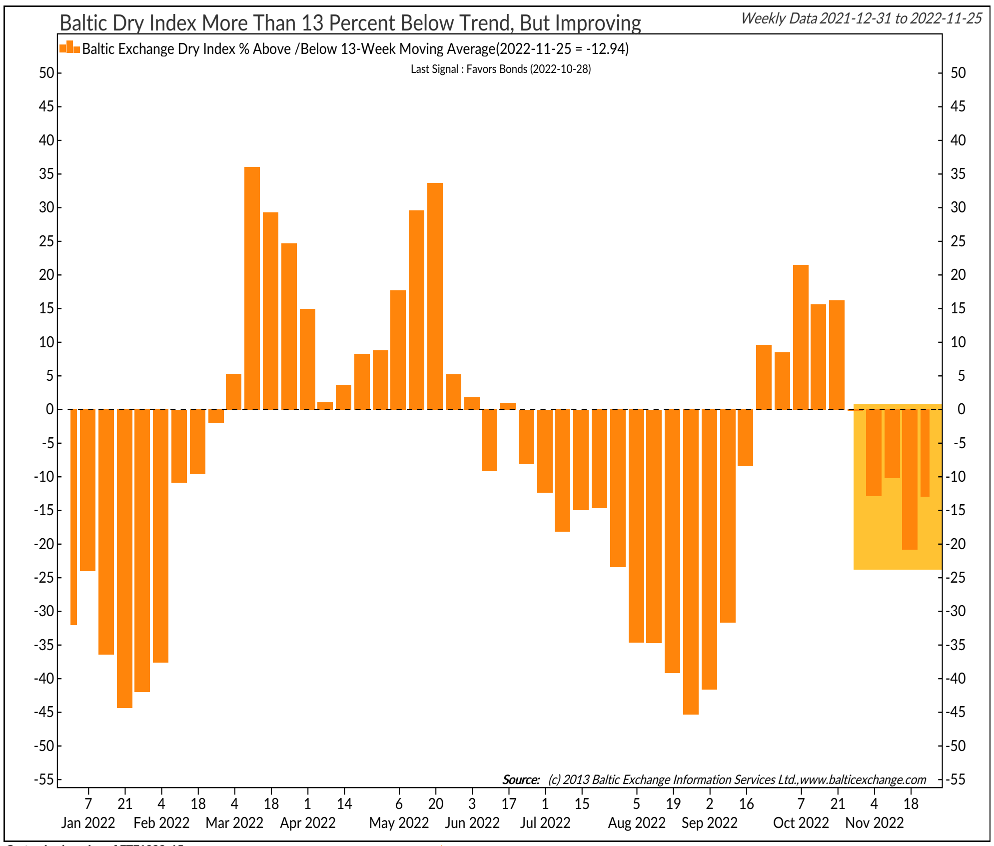

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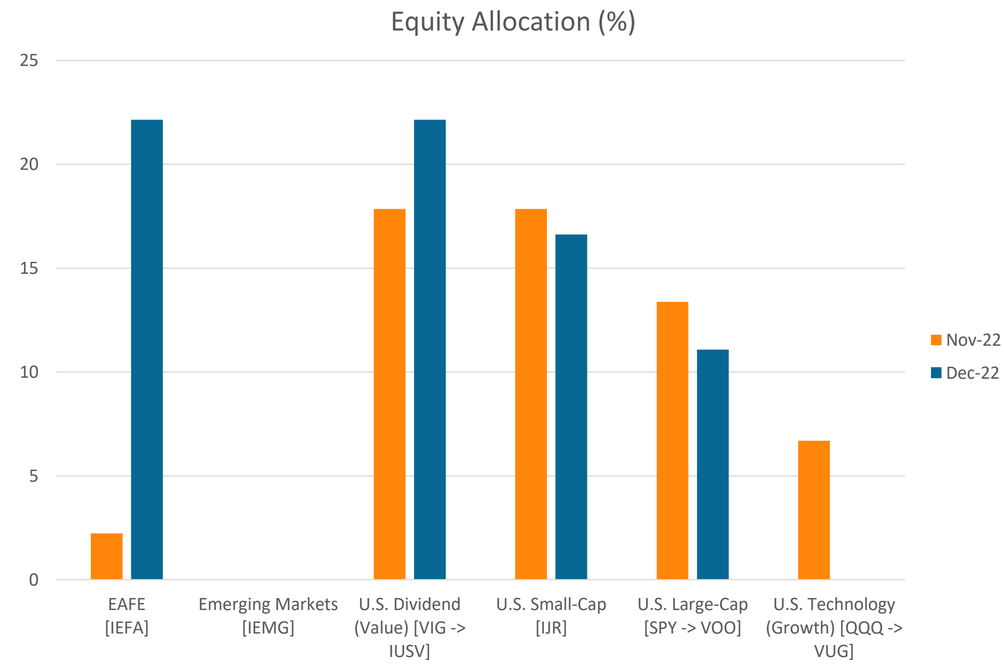
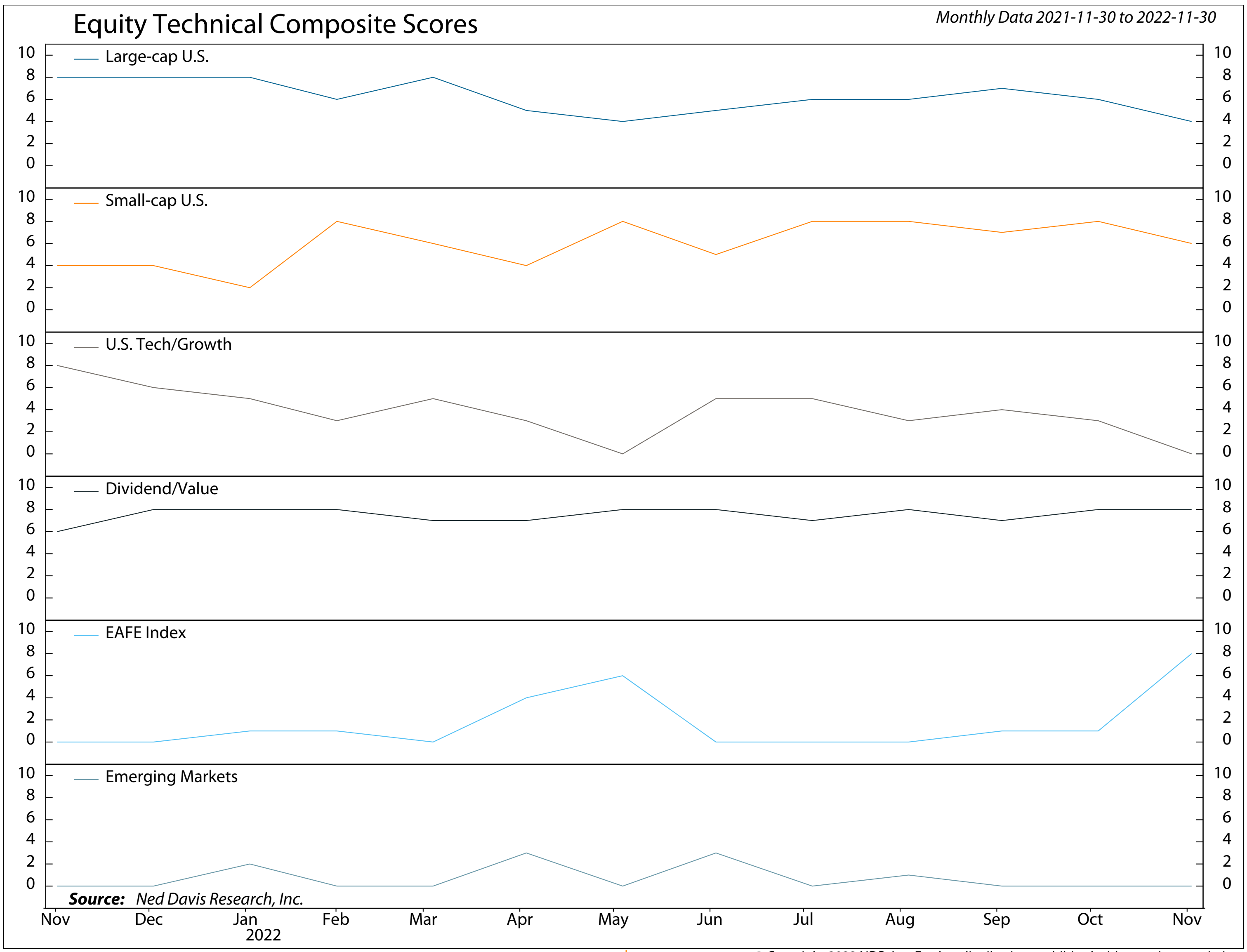
Both the Composite Leading indicator and global shipping rates indicators continue to favor fixed income. The Baltic Dry index (BDI) entered this month's update almost 13% below its 13-week moving average (chart at left). However, there has been improvement as the BDI was more than 20% below its intermediate-term trend in mid-November.

Equity Allocation Summary

All equity areas rose by at least 400 basis points (bps) during November. Emerging Markets (IEMG) and International Developed (IEFA) soared over 13% last month. It was the best month in IEMG's history. Within the U.S., Value (VIG) was the best performer as it has increased more than 600 bps. U.S. Value, U.S. Small-Caps (IJR), and International Developed all received more than 15% allocation for December due to their technical composite scores (image at bottom).





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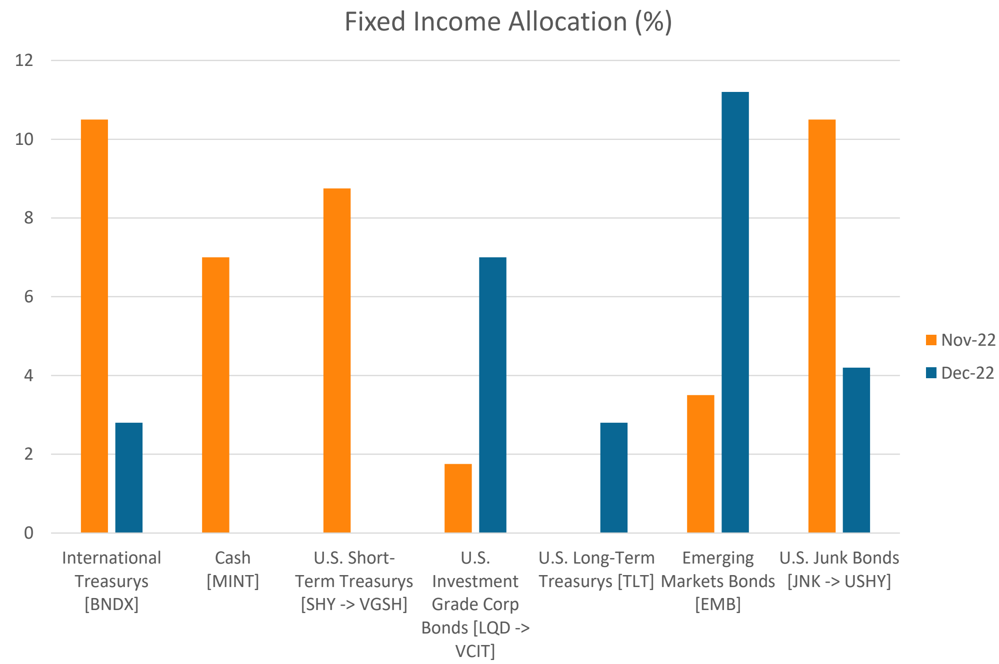
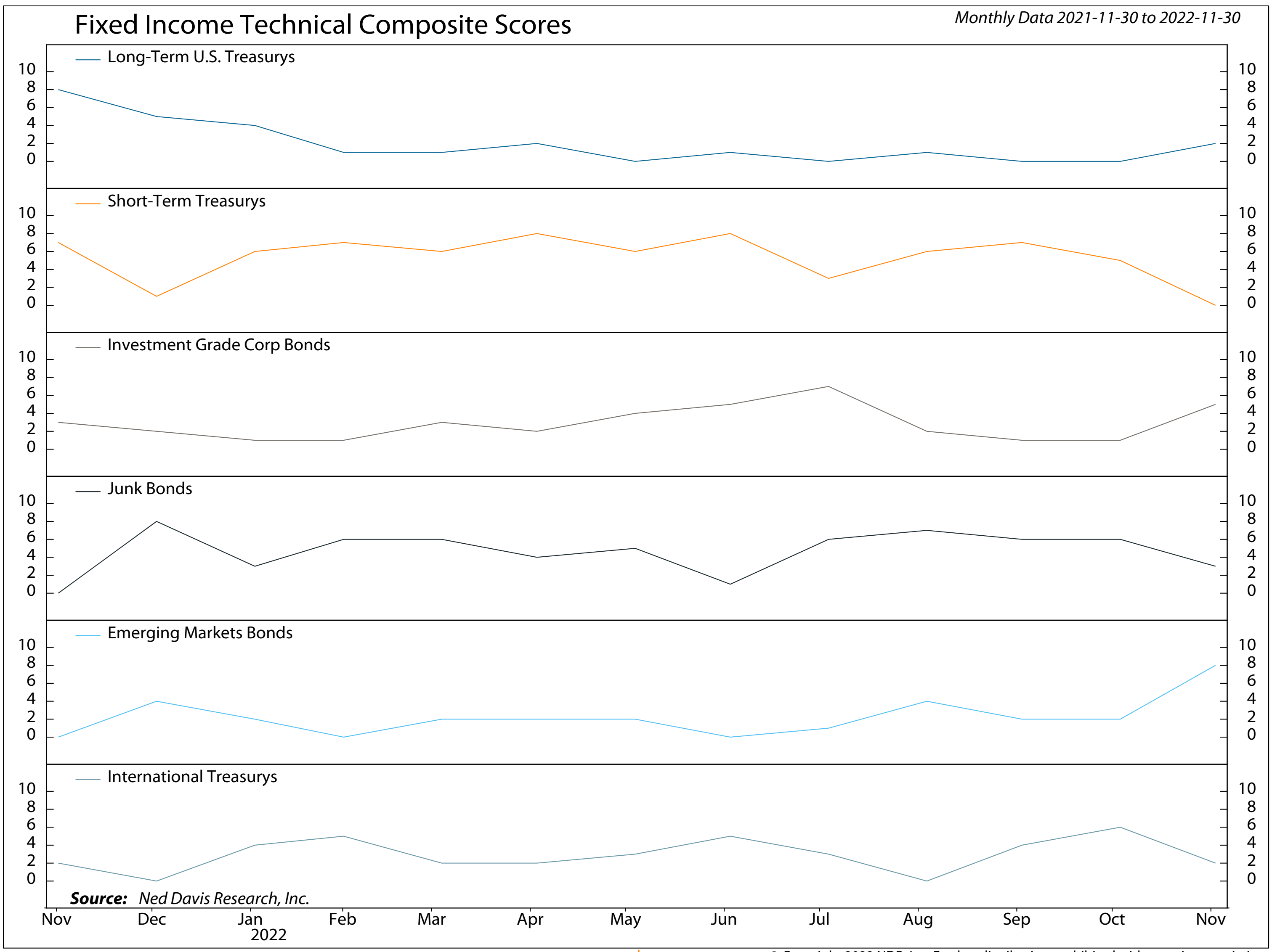
Fixed Income Allocation Summary

All fixed income areas rose during November. Emerging Markets (EMB), U.S. Long-Term Treasurys (TLT), and U.S. Investment Grade (LQD) each jumped more than 600 bps. It was the second-best month in both EMB's and LQD's histories. TLT has its best month since January 2020. Emerging Markets and U.S. Investment Grade both received more than 6% allocation for December due to their technical composite scores (image at bottom).





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