NDR
NED DAVIS RESEARCH

Dynamic Allocation Strategy

AUGUST 2023

Macro/Market Update

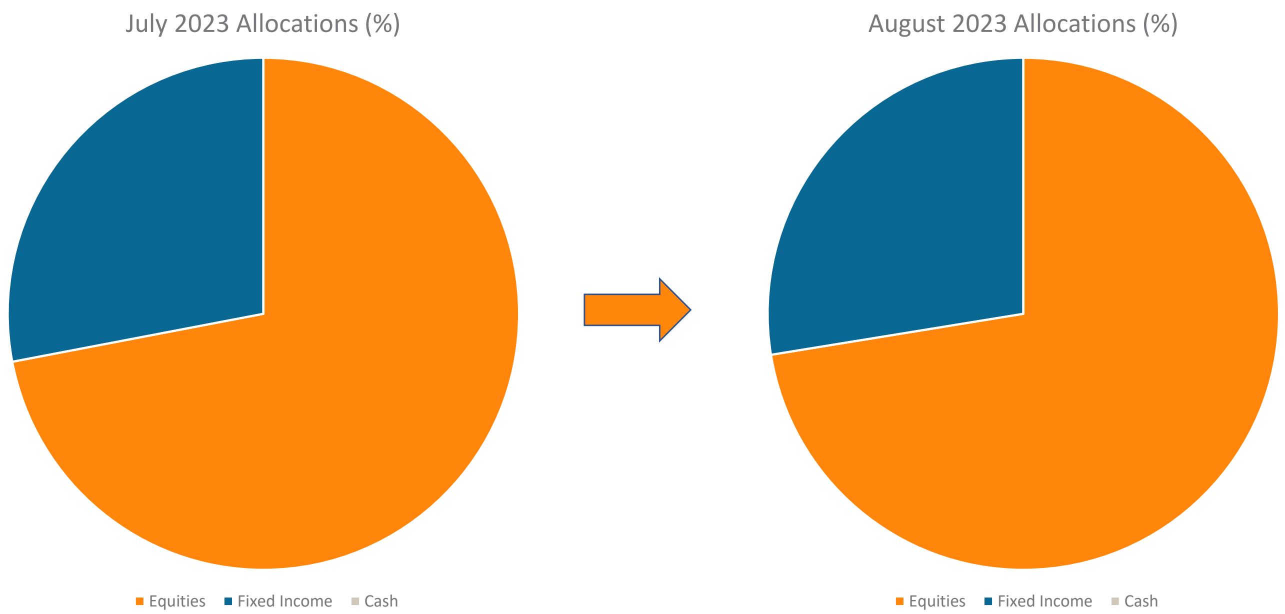
Global economic momentum eased in June, according to the latest S&P Global Purchasing Managers' Index (PMI) readings. The combined services and manufacturing global PMI declined. It was the first deceleration in growth since November and the weakest reading in four months. Even so, the global PMI remains firmly in expansion territory and well above the levels observed during global recessions. The future output index even ticked up further into positive territory in June.

Global growth has been almost entirely led by the services sector, which grew at a slower pace in June. Manufacturing continued to deteriorate, suggesting the global economy may be entering a manufacturing recession. However, the sector has also been a notable source of global disinflation.

Among countries and regions, growth has been holding up the strongest in emerging markets outside of China. On the other hand, the eurozone, which was the star earlier in the year, has seen momentum deteriorate in recent months. The second half of the year will be more challenging for the global economy amid tighter credit conditions, sticky services inflation, and easing Chinese economic growth.

During July, the MSCI All Country World Index (ACWI) outperformed the Bloomberg Barclays Global Aggregate Bond Index by almost 300 basis points (bps). Global stocks have outpaced bonds for eight of the last ten months. The combination of a better-than-expected global economy and increasing, positive revisions to earnings estimates have been bullish for equities.

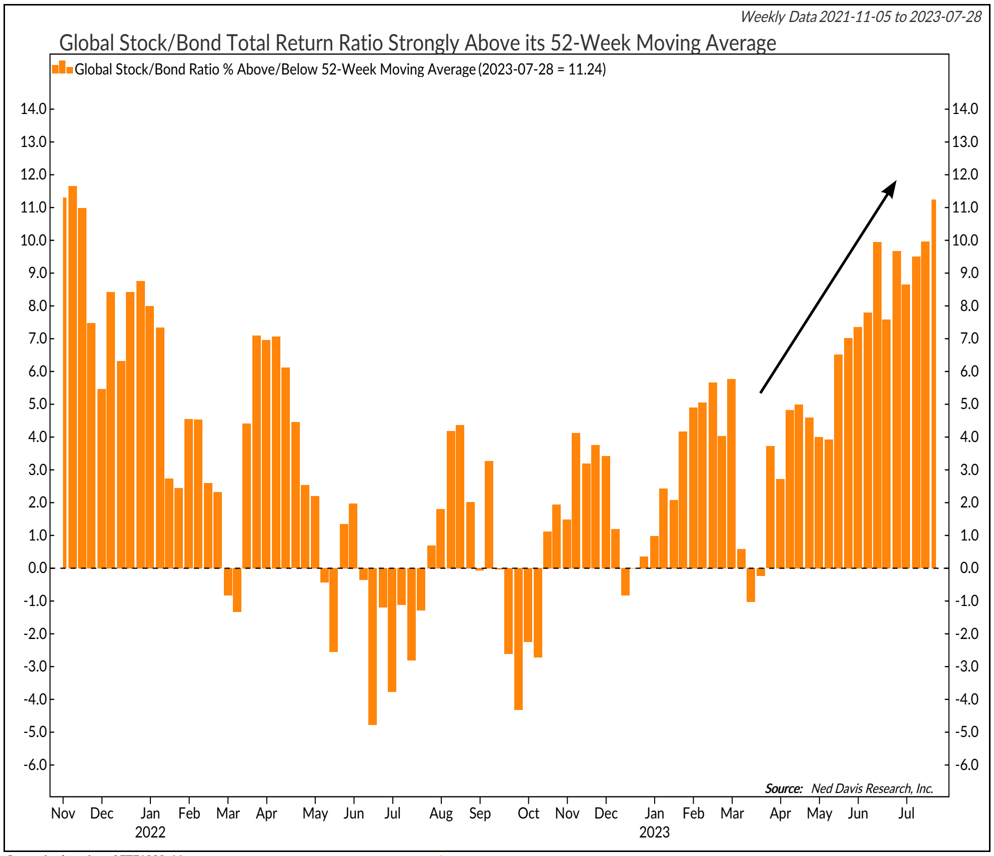
Asset Allocation Summary



* 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 weighting, as the model did not trade this month. 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 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 11% above its one-year moving average (chart at right), its highest spread since 2021. The trend continues to be equity's friend relative to fixed income.



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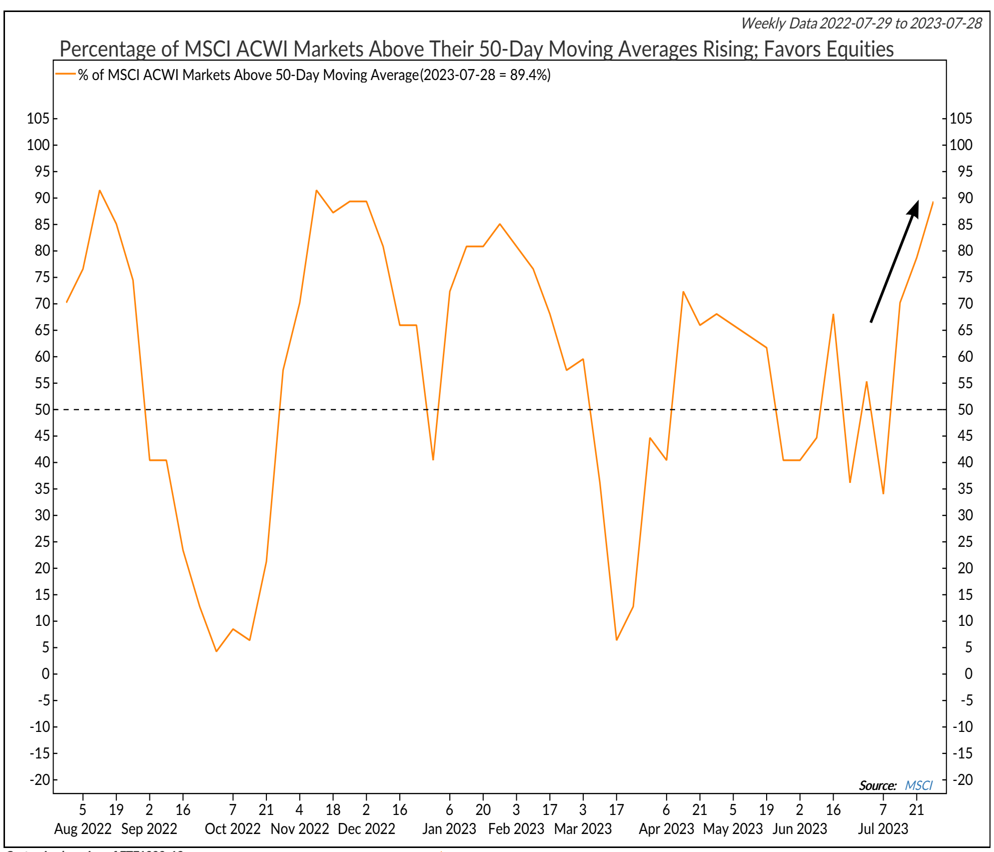

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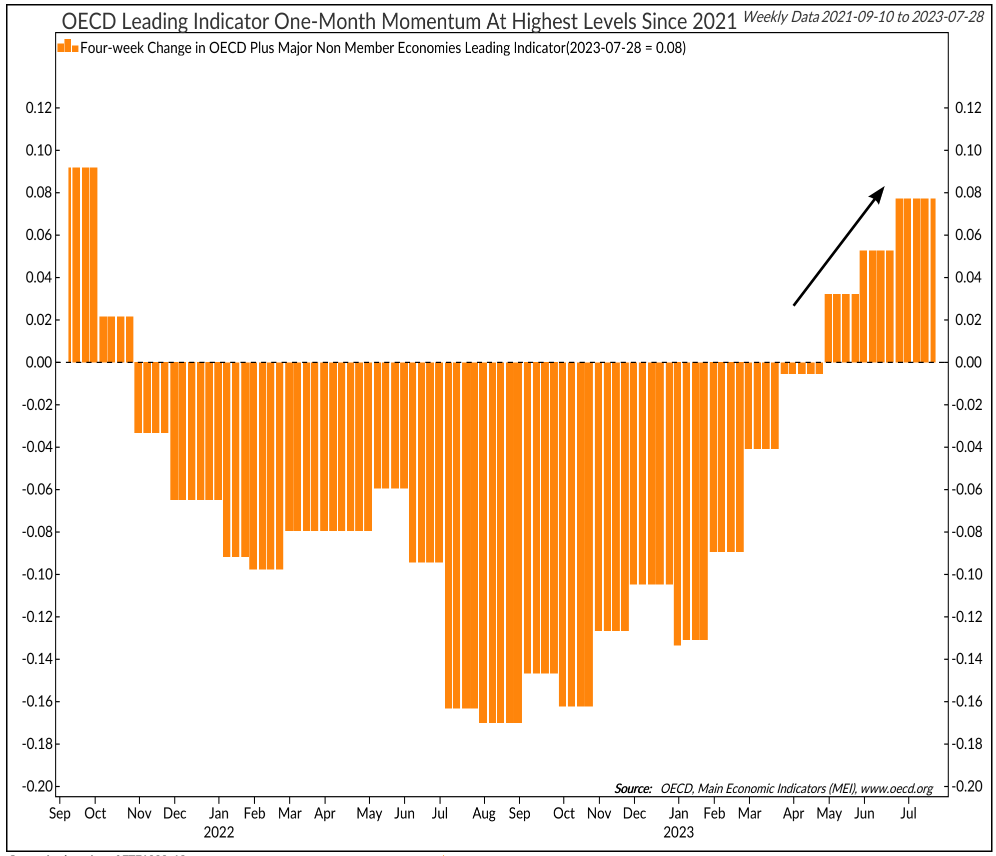
After experiencing significant signal volatility in 2023, the percentage of global equity markets trading above their 50-day moving averages has jumped to almost 90%, its highest level since November (chart at left).

It 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 one-month change in the Composite Leading Indicator (CLI) has increased for the past three months after declining for 18-consecutive months (chart at right). The monthly change in the CLI reached its highest level since September 2021.

The Organization for Economic Cooperation and Development (OECD) creates monthly CLIs for 35 economies to capture turning points in the growth cycle. Each CLI contains a wide range of indicators such as money supply, yield curve, building permits, consumer and business sentiment, share prices, and manufacturing production. Improvement in global economic momentum supports the equity trend.



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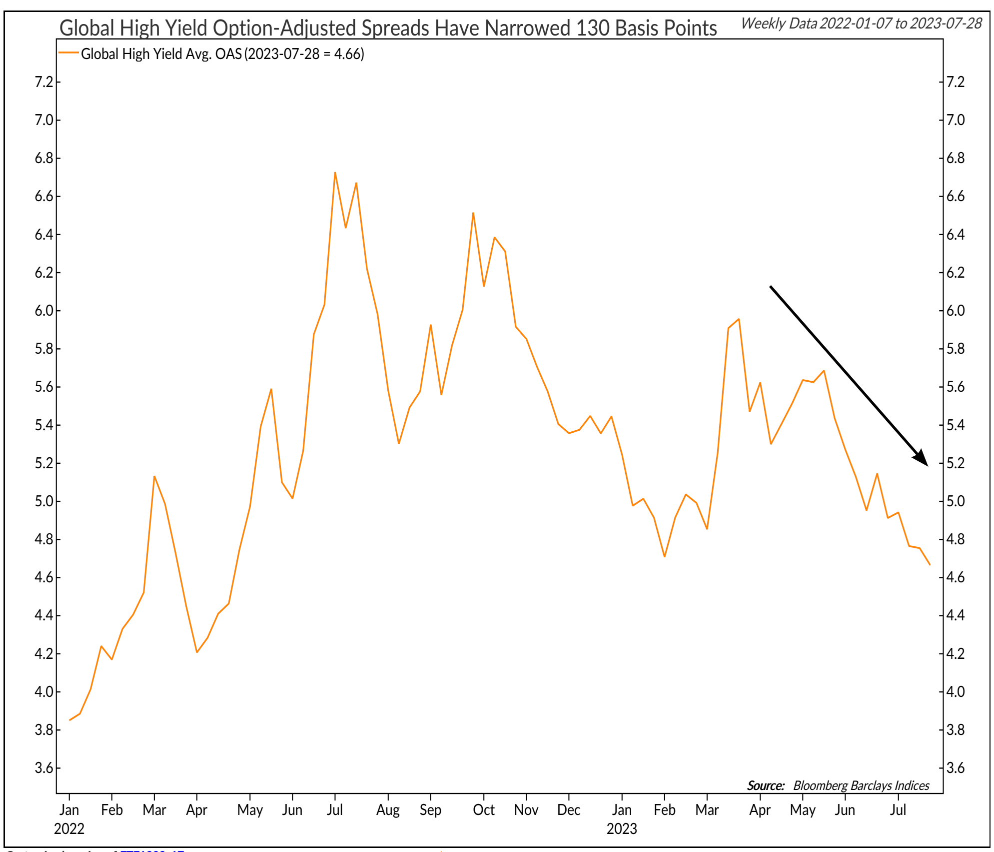

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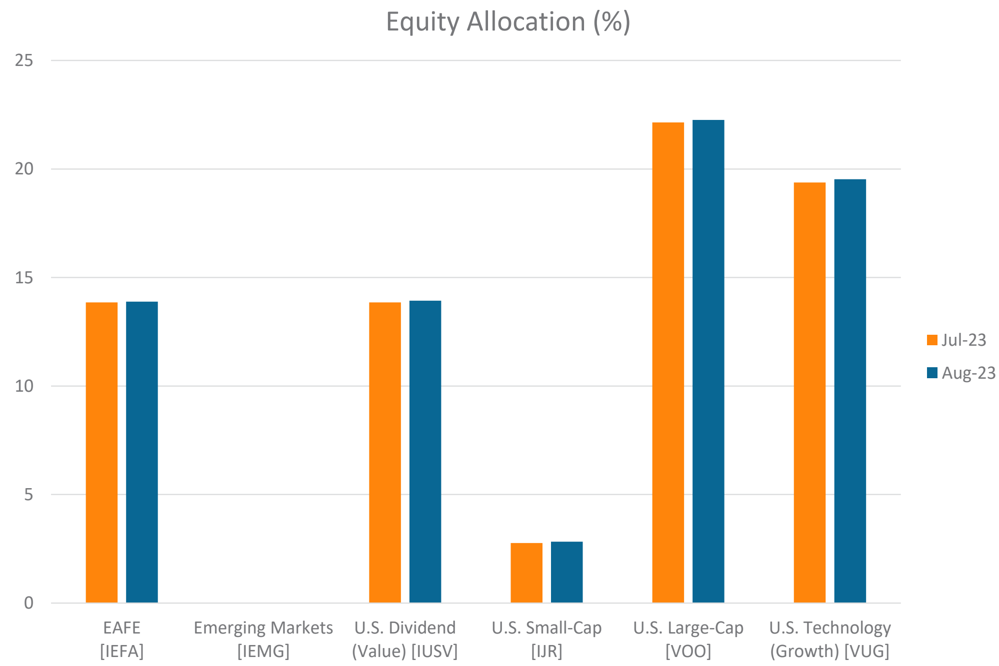
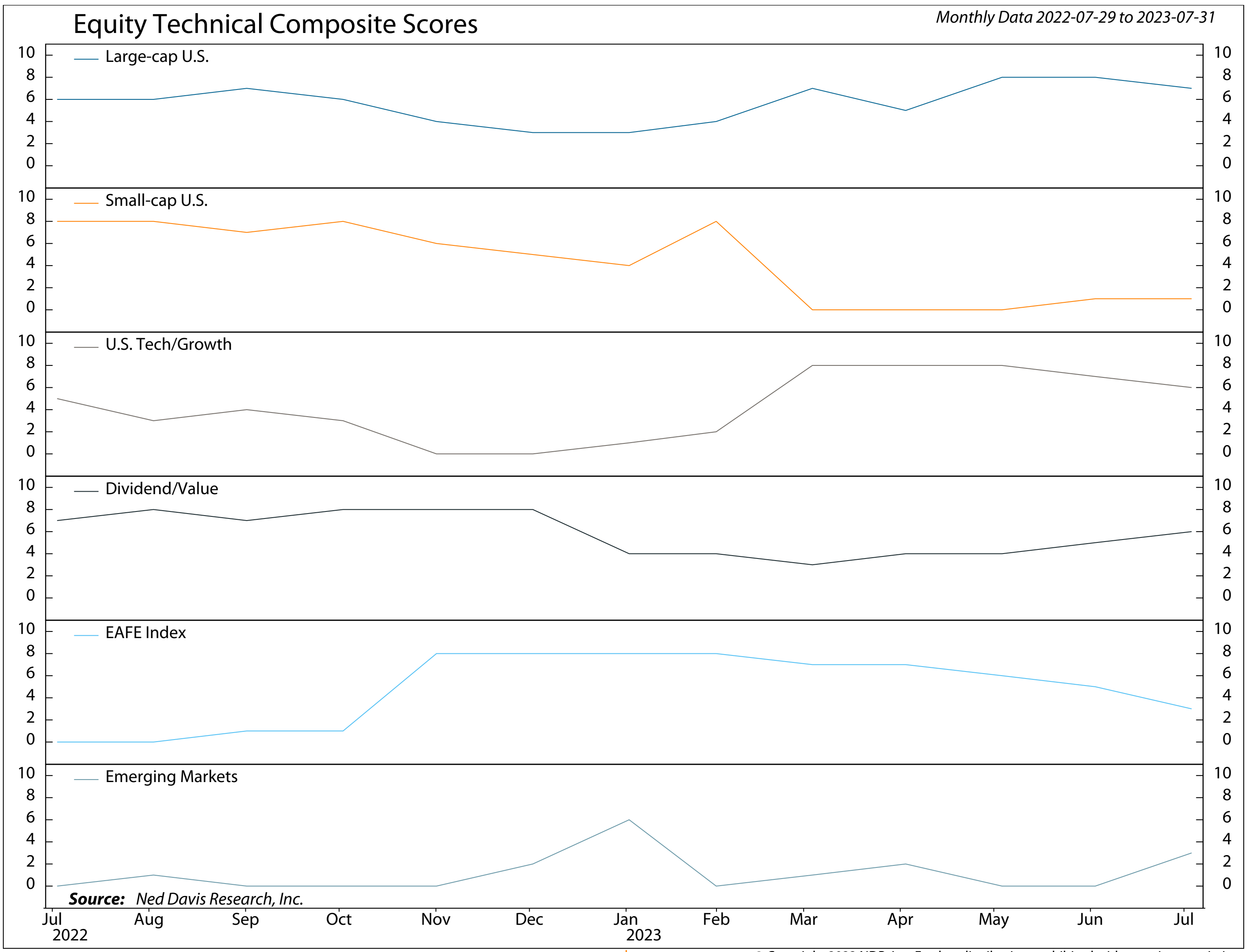
Global high yield option-adjusted spreads (OAS) widened by 125 basis points (bps) from early February until mid-March during the banking sector weakness. With global high yield OAS widening, bond investors demanded higher yields for taking on more risk.

However, since mid-March spreads have narrowed 130 bps to their lowest levels in over a year (chart at left). This indicates growing risk appetite, which favors equities over fixed income.

Equity Allocation Summary

For the second consecutive month, all six equity areas increased more than 300 basis points (bps). Emerging Markets (IEMG) had its best monthly return since January, as it gained over 595 bps. U.S. Small-Caps (IJR) jumped over 550 bps. IJR had its third positive month in 2023 and first consecutive positive monthly returns since last fall. After rising over 650 bps in June, U.S. Value (IUSV), U.S. Growth (VUG), and U.S. Large-Caps (VOO) produced strong returns in July. VUG and VOO received more than 15% allocation for August (image at bottom).





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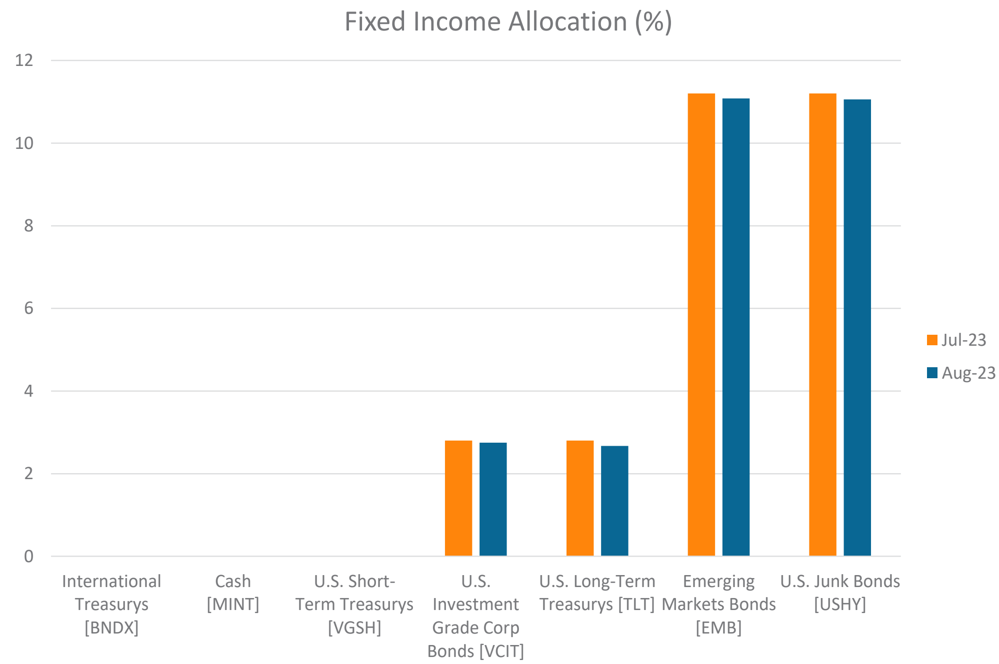
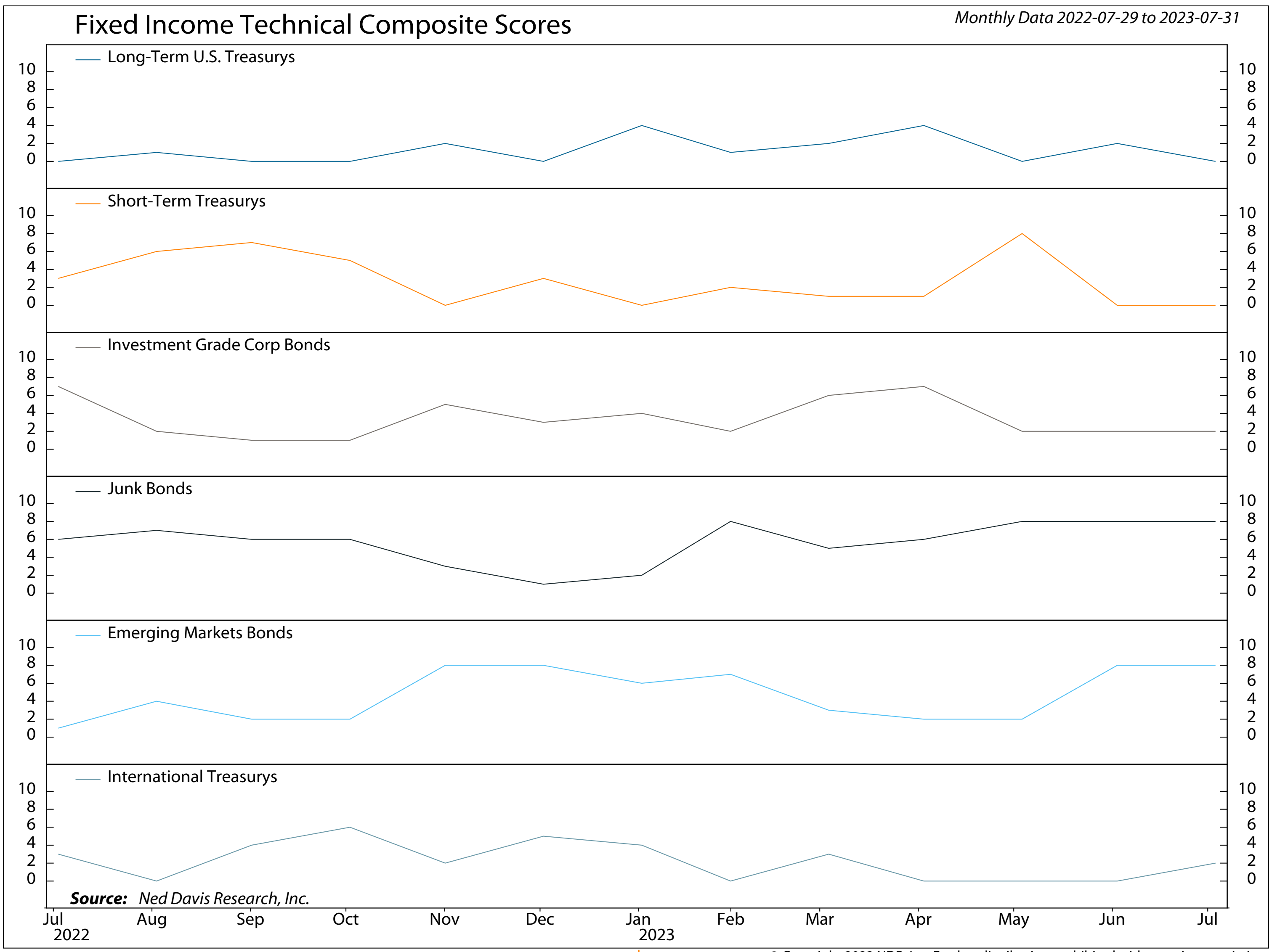
Fixed Income Allocation Summary

Only U.S. High Yield (USHY) and Emerging Markets (EMB) increased by more than 100 bps last month. Over that same period, U.S. Long-Term Treasurys (TLT) and International Investment Grade (BNDX) declined. TLT dropped over 250 bps for July. TLT has declined more than 250 bps for three of the last six months. BNDX's four-month winning streak ended. EMB and USHY both have over 10% allocation for August (image at bottom).





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