# Smart Sector® International Strategy

AUGUST 2023

## Catastrophic Stop Update

The NDR Catastrophic Stop Sell model combines time-tested, objective indicators designed to identify high-risk periods for the equity market. The model (chart right) was unchanged from last month and entered August with a fully invested equity allocation recommendation.

Figure 1: Smart Sector® Catastrophic Stop Sell Model

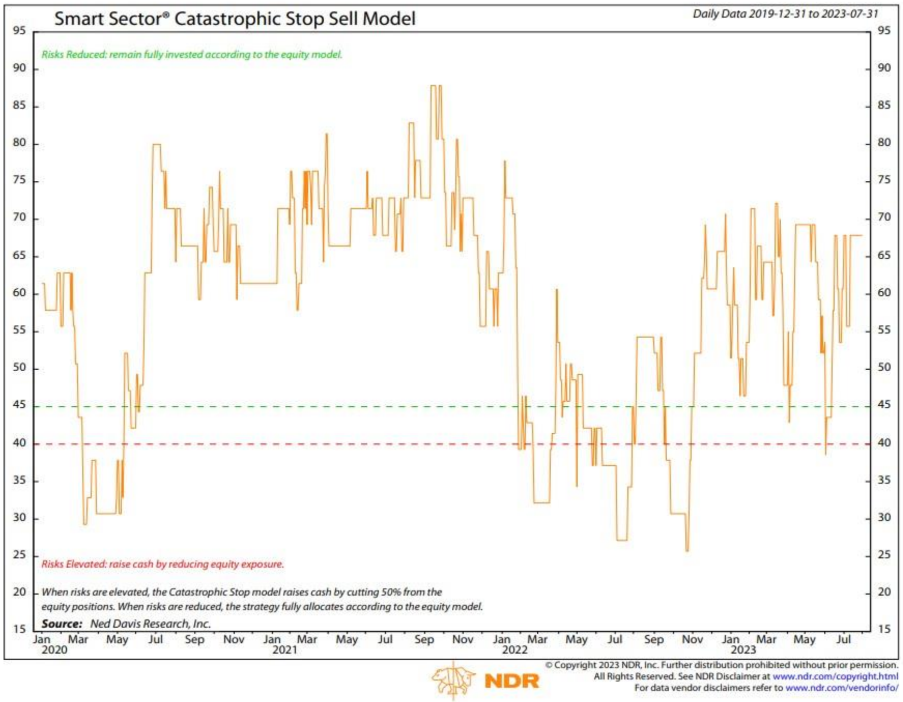
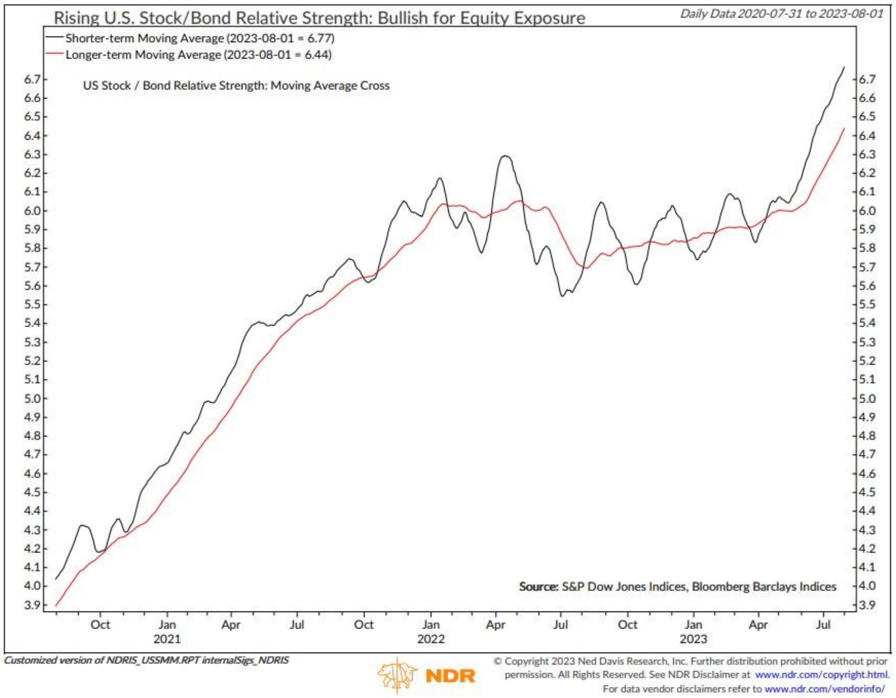



Figure 2: Rising U.S. Stock/Bond Relative Strength: Bullish for Equity Exposure.




The model's steadiness is driven by five (of seven) internal (price-based) measures that remain bullish, including rising stock/bond relative strength (chart left). While external influences such as trade and market sentiment remained bearish, they're offset by bullish readings from high-yield and emerging market bond breadth, as well as high-yield option-adjusted spreads. For now, the weight of the evidence recommends a fully invested allocation to equities according to the model.

# Global Market Update

The ACWI ex. U.S. Total Return Index increased over 409 basis points (bps) in July. The index gained more than 400 bps for a second consecutive month, which last occurred in late 2020. Among the strongest-performing markets were Turkey, Colombia, South Africa, Peru, and China, while the largest underperformers included Egypt, Portugal, Finland, Taiwan, and Denmark.

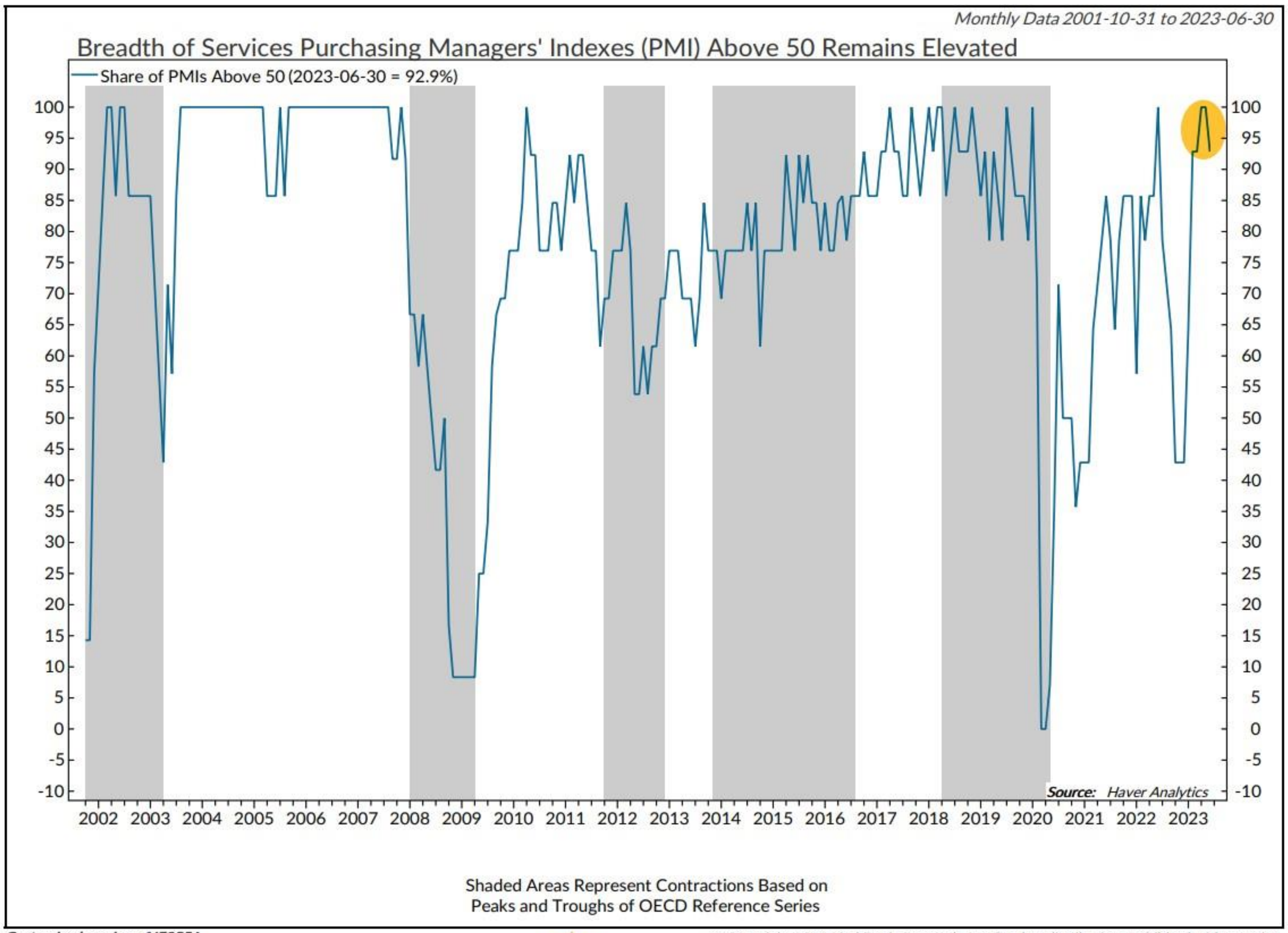
Global economic momentum eased in June, according to the latest S&P Global Purchasing Managers' Index (PMI) readings. The combined services and manufacturing global PMI declined. It was the first deceleration in growth since November and the weakest reading in four months. Even so, the global PMI remains 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 (chart bottom), 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 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.

Entering August, the non-U.S. equity Core model overweighted Australia, Germany, Canada, and China, while underweighting the U.K., Japan, France, and Switzerland. The Explore model favored Chile, India, South Korea, Sweden, and Taiwan.

**Figure 3:** Breadth of Services Purchasing Managers' Indexes (PMI) Above 50 Remains Elevated



## Core Allocations

China continues to be overweight. Although slowing, both the official and Caixin composite PMIs stayed firmly in growth territory as of their latest readings for June. Engagement in the economy via measures of passenger traffic and subway usage remains high and at pre-pandemic levels.

Also, industrial activity has stabilized. Annual industrial production growth accelerated to 4.4% in June from a 3.3% pace in the prior month. The absolute trend has recently broken out higher after declining for most of the year (chart right).

Figure 4: MSCI China Absolute Trend Has Started To Move Higher

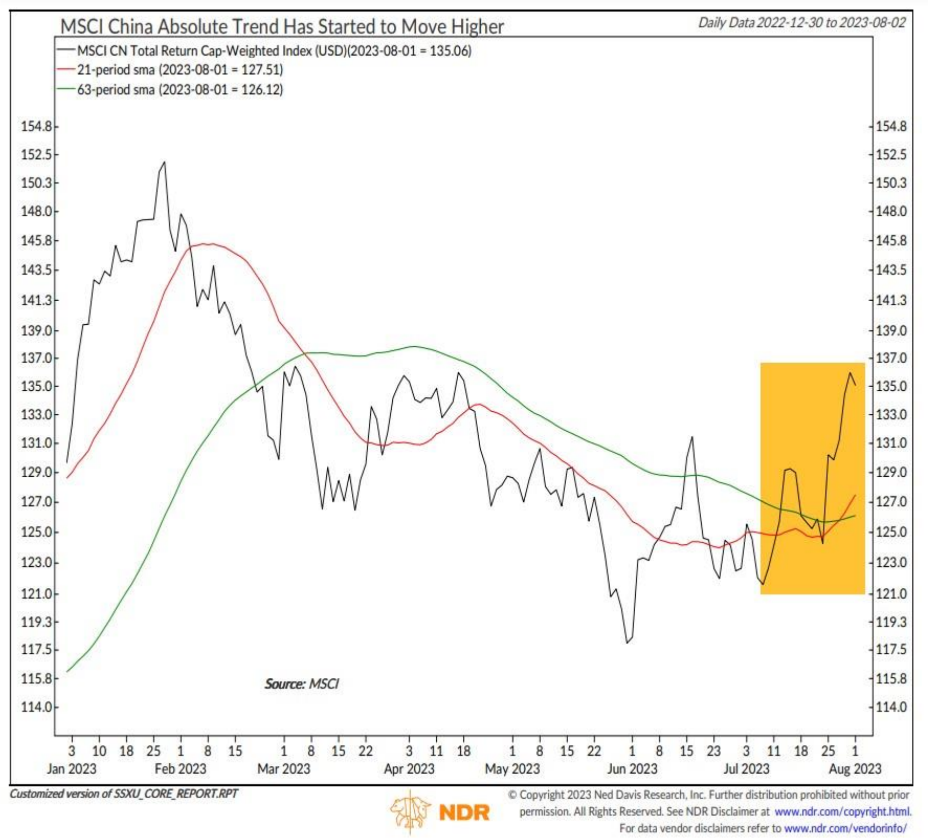
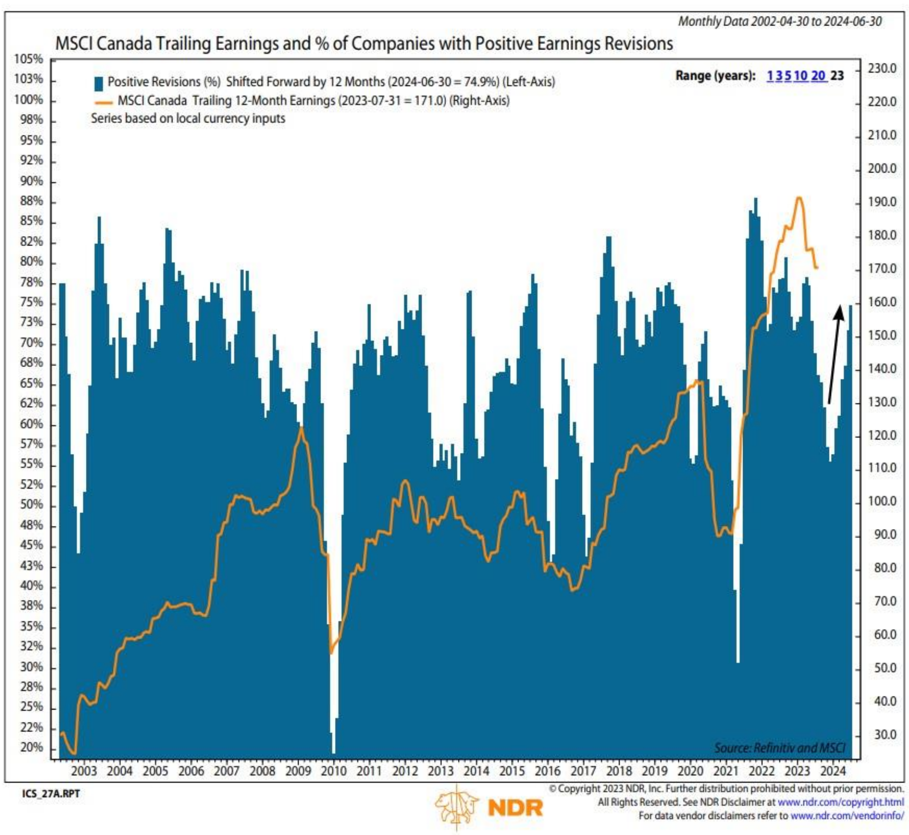



Figure 5: MSCI Canada Trailing Earnings and % of Companies with Positive Earnings Revisions




Canada continues to have above benchmark allocation. Earnings revisions jumped as analysts have become more optimistic about the individual companies (chart left). Inflation slowed to within the central bank's control range for the first time since March 2021. This has led to positive technical improvement, as the absolute trend and breadth indicators are bullish.

France and Switzerland are both underweight as recession risks within Europe are rising. The flash PMIs for July are signaling a poor start to the third quarter. The composite PMI signaled contraction for a second straight month. The Ifo business climate survey, an excellent leading indicator for the economy, fell to its lowest level this year. The Citigroup Economic Surprise Index (chart right) is at its lowest level since the beginning of the pandemic.

Figure 6: MSCI Europe ex UK (Local Currency)

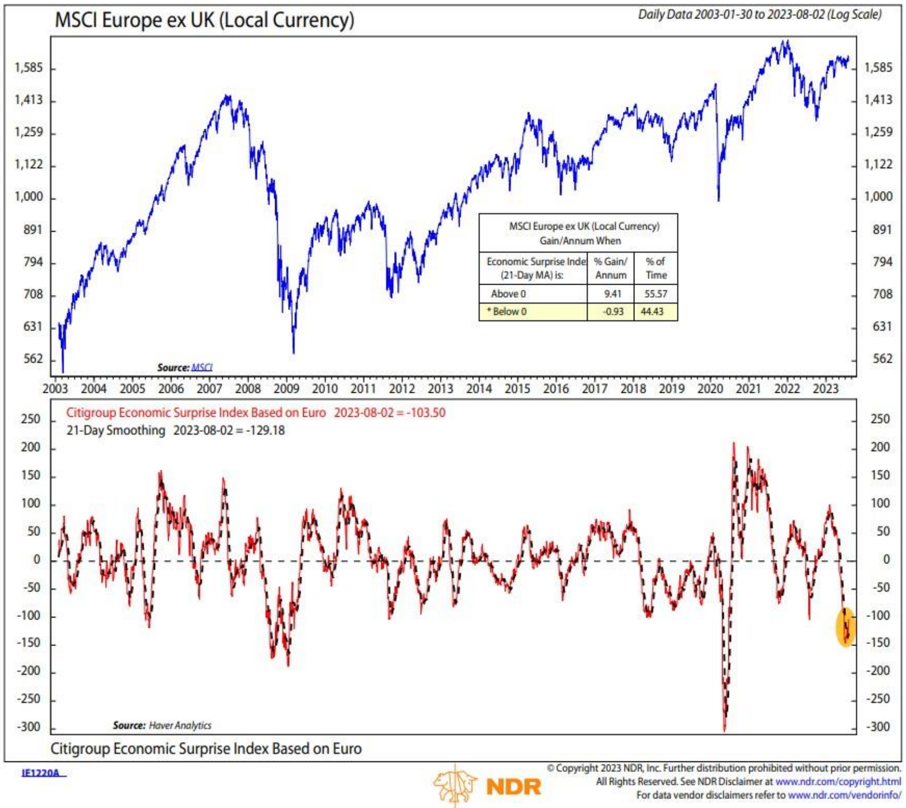
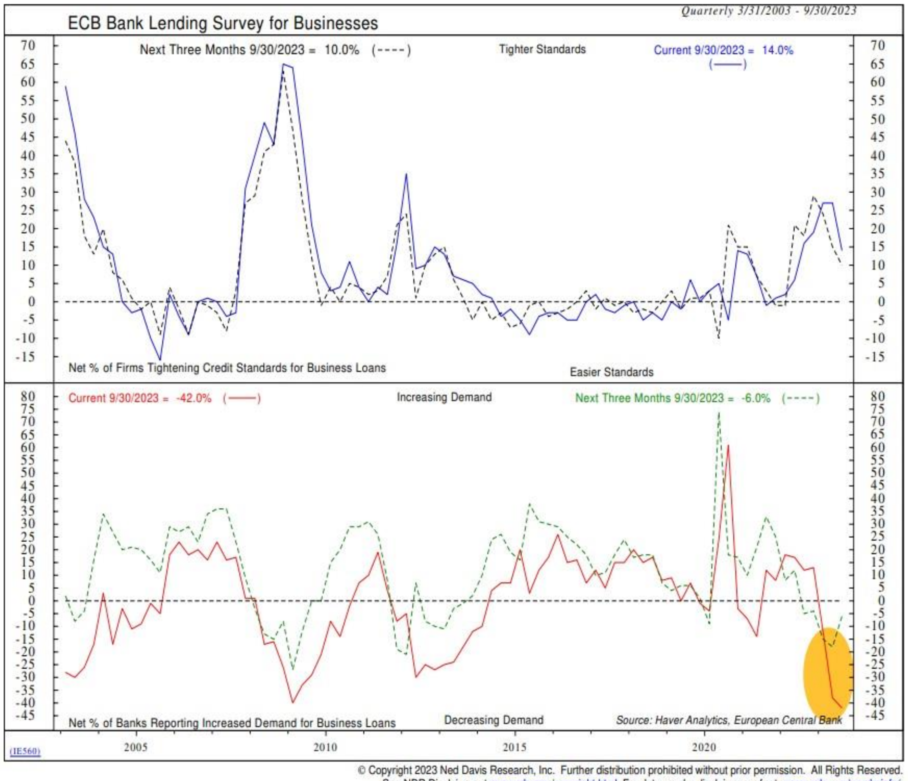



Figure 7: ECB Bank Lending Survey for Businesses



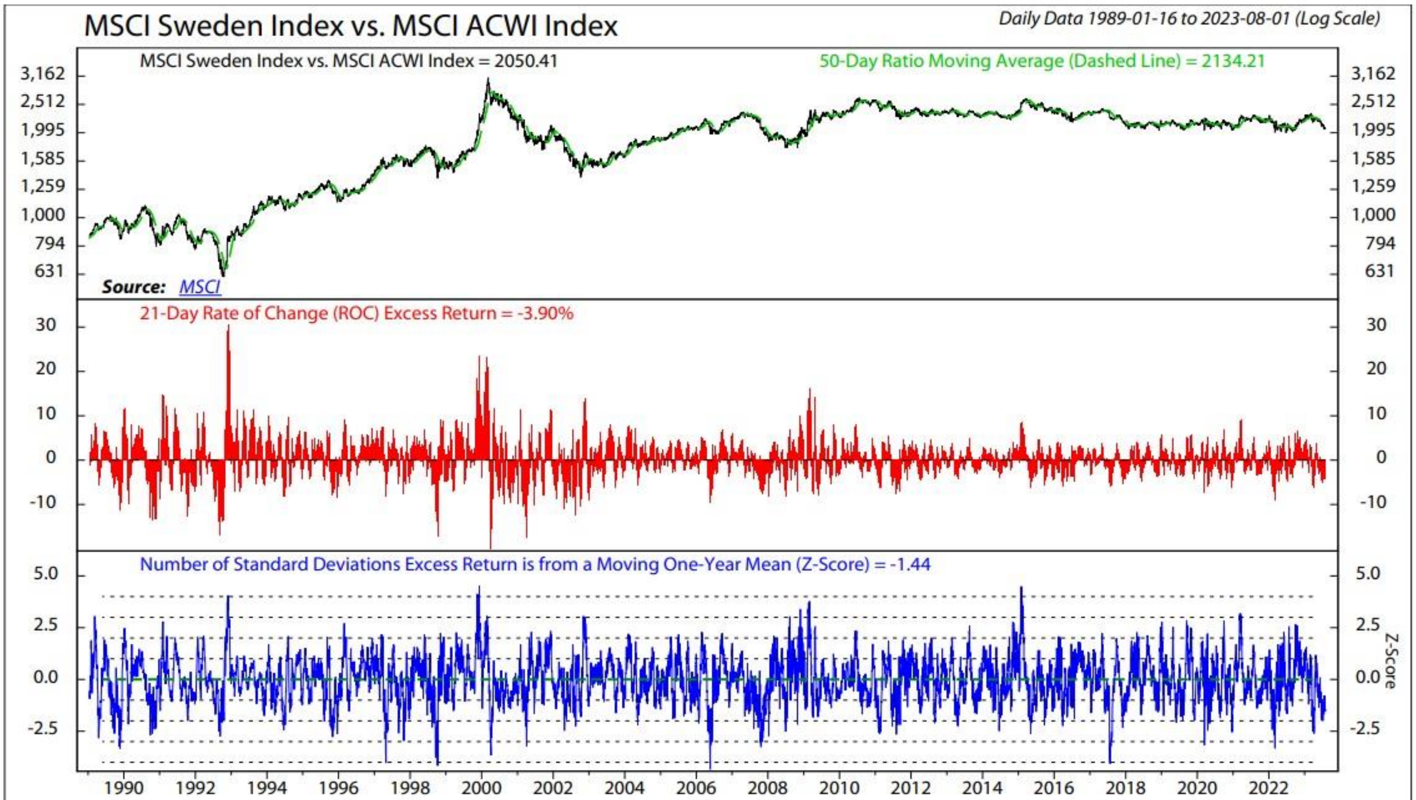

The latest European Central Bank (ECB) Bank Lending Survey indicated further weakening conditions for bank lending. Demand continued to plunge across all loan types at a pace not seen since the European sovereign debt crisis, reflecting the effect of higher interest rates and the slowing economy. Notably, the demand for business loans fell to the lowest since data began in 2003 (chart left).

## Explore Opportunities

Among the top-ranked Explore markets are Chile, India, South Korea, Sweden, and Taiwan:

- India, South Korea, Sweden, and Taiwan have favorable price trends as their 50-day moving averages trade above their 200-day counterparts.
- Over the last 21 days, Sweden is more than one standard deviation oversold, which historically has provided a near-term bounce opportunity (chart bottom).
- Chile and India have low market capitalization-to-GDP ratios, which typically indicate a favorable valuation.
- India has one of the largest composite PMI readings.
- India, South Korea, and Sweden have double-digit one-year forward earnings growth estimates.
- India, South Korea, and Sweden have over 75% of stocks with positive earnings revisions from analysts.

**Figure 8:** MSCI Sweden Index vs. MSCI ACWI Index




| Analysis Dates: 1989-01-16 to 2023-08-01 | | |
|---|---|---|
| Relative Performance when Excess Return is: | % Gain/ Annum | % of Time |
| At Least 1 SD Above Mean | -12.80 | 16.39 |
| Within 1 SD of Mean | -2.34 | 66.08 |
| * At Least 1 SD Below Mean | 43.39 | 17.53 |

| Average Relative Percentage Gain After Z-Score of 21-Day ROC First Crosses: | | | |
|---|---|---|---|
| Days Later | Above 1 | Below -1 | All Periods |
| 5 | -0.22 | 0.48 | 0.07 |
| 10 | -0.16 | 0.40 | 0.13 |
| 21 | 0.18 | 0.58 | 0.28 |



## Summary

The Catastrophic Stop model improved from last month, as it continues to recommend a fully invested allocation. Entering August, the non-U.S. equity Core model overweighted Australia, Germany, Canada, and China, while underweighting the U.K., Japan, France, and Switzerland. The Explore model favored Chile, India, South Korea, Sweden, and Taiwan.

The models combine macro, fundamental, technical, and sentiment indicators to determine opportunities and identify risks in an objective, weight-of-the-evidence approach.

## Strategy Description

- The Smart Sector® International strategy combines three Ned Davis Research quantitative investment strategies: The Core International, Explore International, and the NDR Catastrophic Stop.

## The process is based on the weight of the evidence

### Core Allocation

- The fund begins by overweighting and underweighting the largest non-U.S. equity markets based on Ned Davis Research's proprietary models.
- Each of the models utilize market-specific, weight-of-the-evidence composites of fundamental, economic, technical, and behavioral indicators to determine each area's probability of outperforming the ACWI ex. U.S. Markets are weighted accordingly relative to benchmark weightings.

### Explore Allocation

- To select smaller markets, the fund uses a multi-factor technical ranking system to choose the top markets. The markets with the highest rankings split the non-Core model allocation equally.

## When market risks become extraordinarily high — reduce your portfolio risk

- The model remains fully invested *unless the Ned Davis Research Catastrophic Sell Stop (CSS) model is triggered,* whereupon the equity-invested position is trimmed to 50%.

- The NDR Catastrophic Sell Stop model combines time-tested, objective indicators designed to identify periods of high risk for the broad U.S. equity market. The model uses price-based, breadth, deviation from trend, fundamental, economic, interest rate, behavioral and volatility-based indicator composites.

## When market risks return to normal — put your money back to work

- When the NDR CSS model moves back to bullish levels, indicating lower risk, the strategy immediately moves back to fully invested.

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