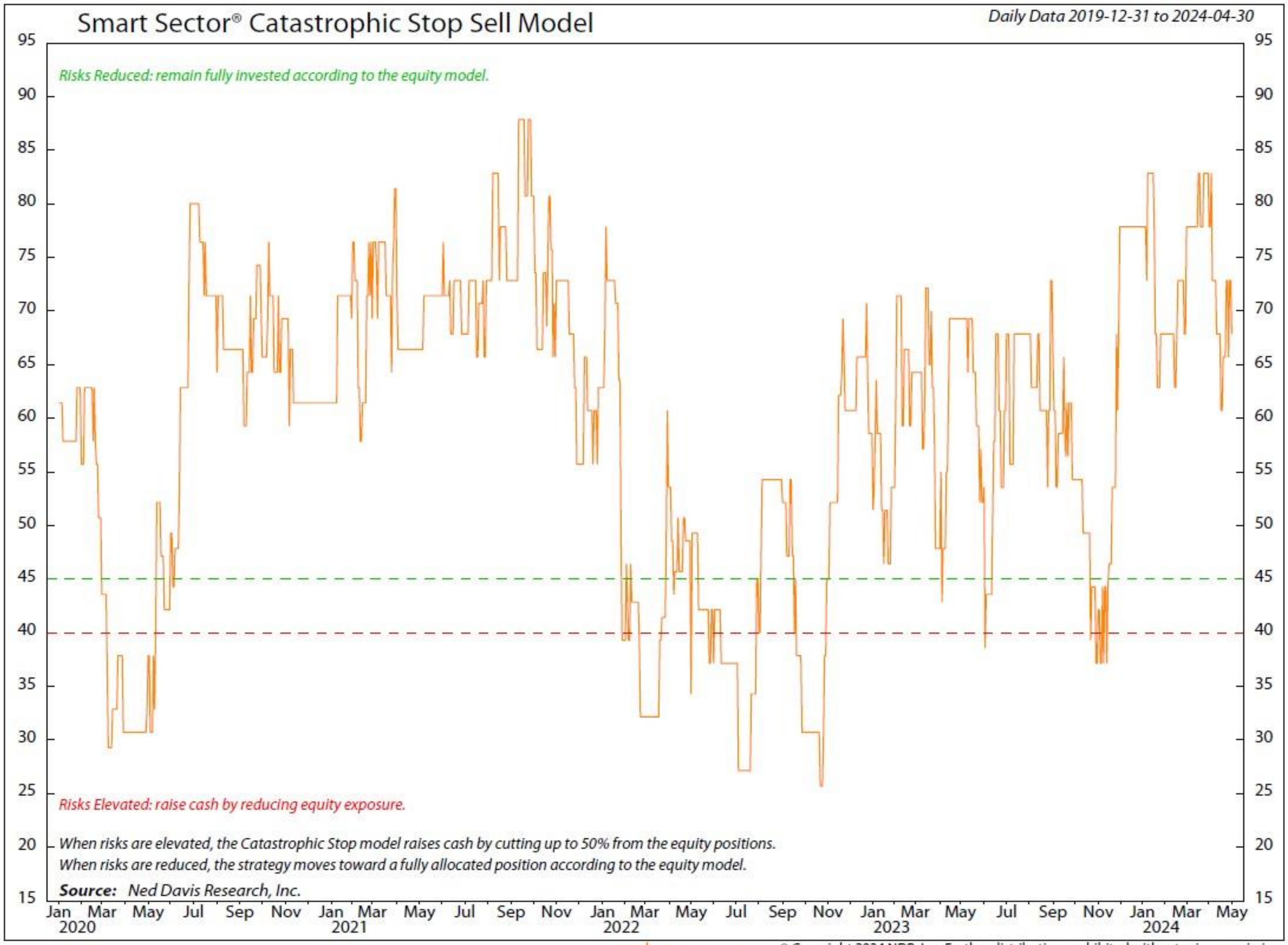
Smart Sector® Strategy

MAY 2024

Catastrophic Stop Update

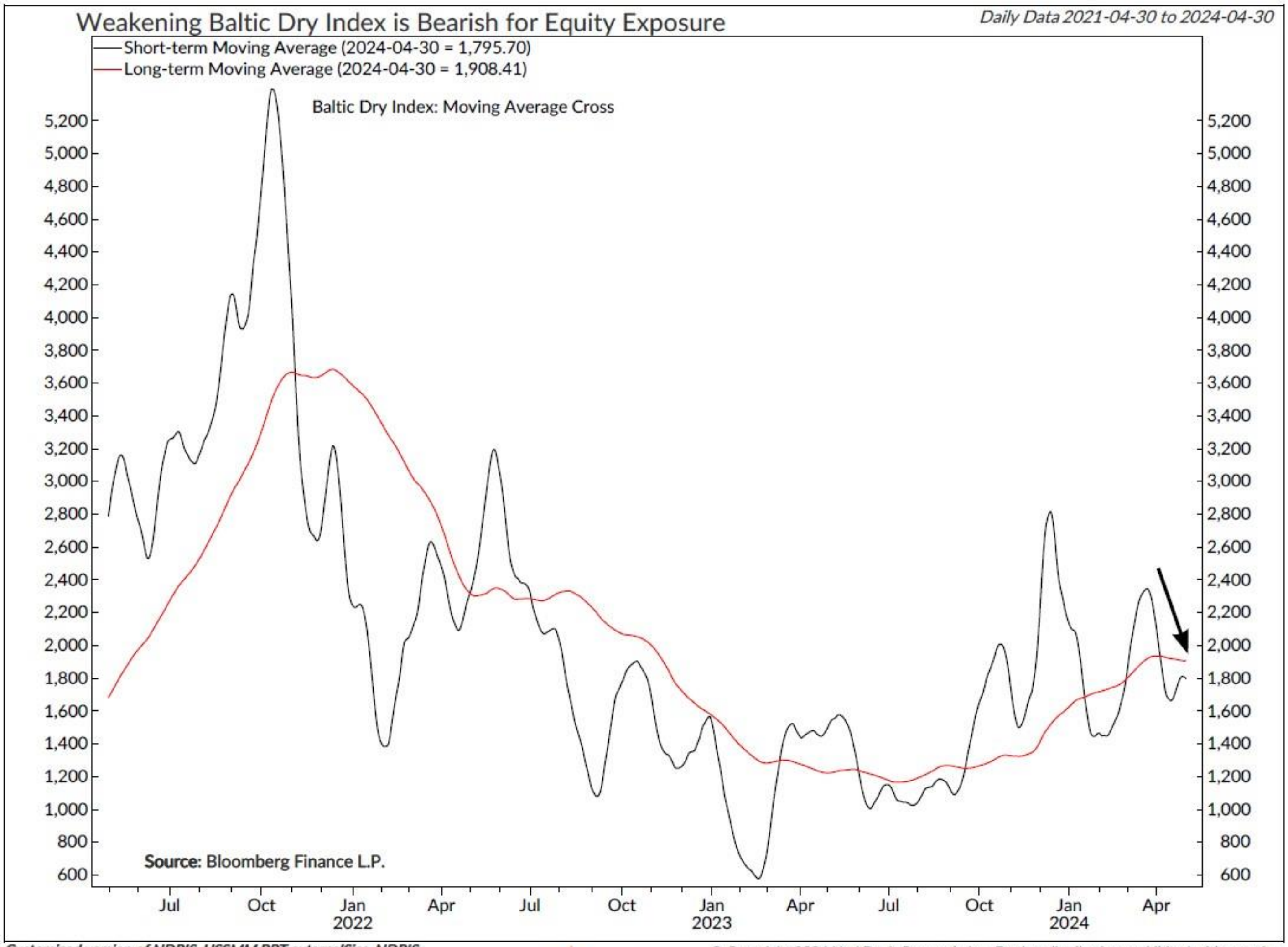
The NDR Catastrophic Stop Sell model combines time-tested, objective indicators designed to identify high risk periods for the equity market. The model (Figure 1) deteriorated during the month but entered May with a fully invested equity allocation recommendation.

Figure 1: Smart Sector Catastrophic Stop Sell Model



The bullish reading from the model is driven by strong internals. Five of the seven price-based measures—including relative strength, trend, and breadth—remain bullish. However, two external measures deteriorated. High-yield and Emerging Market bond breadth weakened to neutral, while the Baltic Dry Index (a measure of global trade) flashed bearish during the month (Figure 2). For now, the weight-of-the-evidence recommends a fully invested allocation to equity sectors according to the model.

Figure 2: Weakening Baltic Dry Index is Bearish for Equity Exposure



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U.S. Market Update

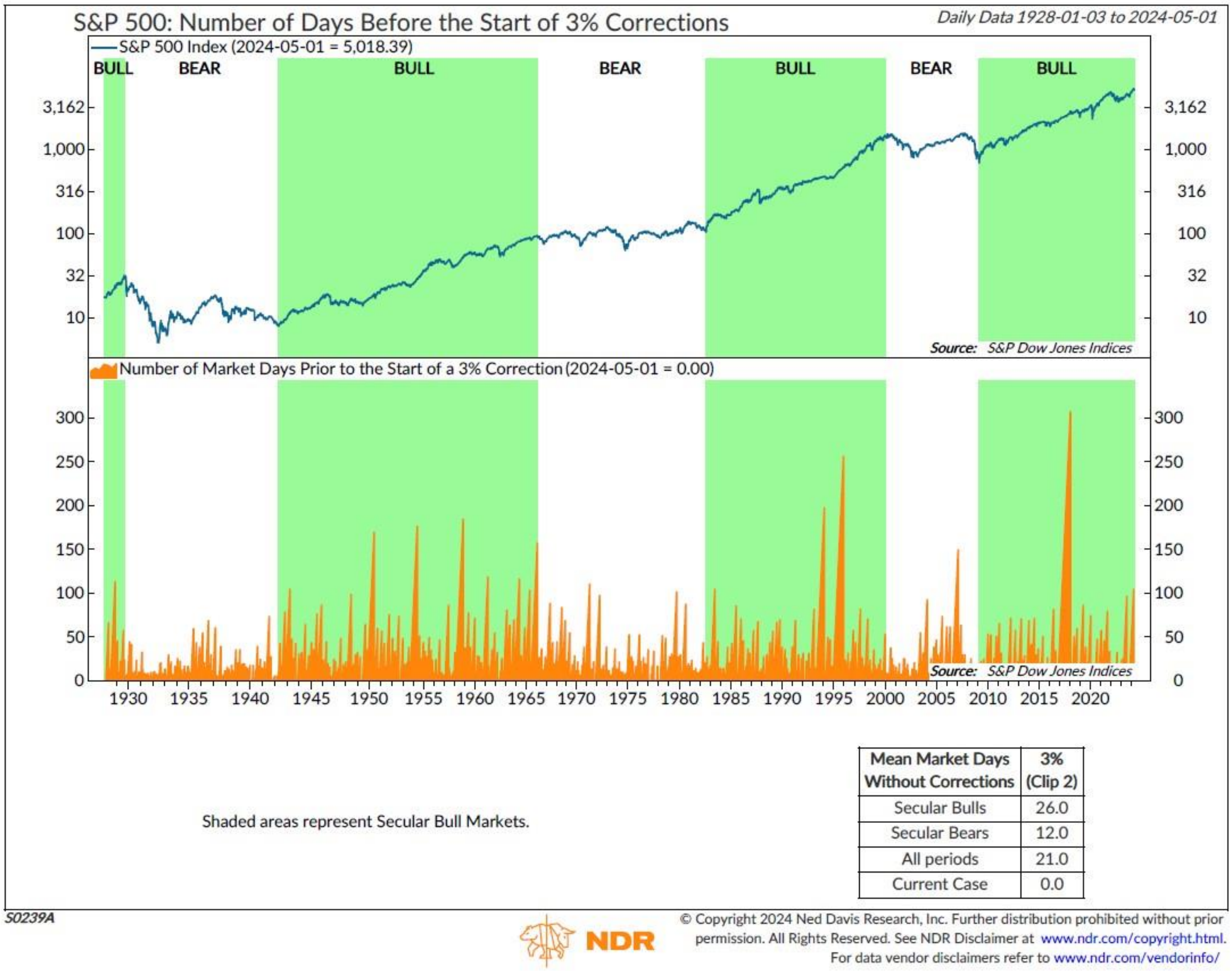
After a strong start to the year, the S&P 500 Total Return Index had a small correction in April, dropping about 4%. Breadth deteriorated sharply—10 of the 11 S&P 500 sectors posted negative returns for the month. Utilities was the standout with a 1.66% gain.

Since last fall, investors had been enjoying a period of historically low downside volatility. The S&P 500 Index had not endured a 3% correction since 10/27/2023, the longest stretch since the 308-day streak ending on 1/26/2018. Almost on cue, the S&P 500 dipped more than 3% by mid-April, ending the streak at 105 trading days (Figure 3). Stronger-than-expected jobs, manufacturing, CPI, and retail sales data suggest that inflation is sticky enough and economic growth is solid enough for the Fed to wait for more evidence before cutting its target rate. Both the two-year and 10-year Treasury yields hit five-month highs.

However, economic strength, earnings growth, and long-term momentum support the case for the long-term uptrend in equities to remain intact.

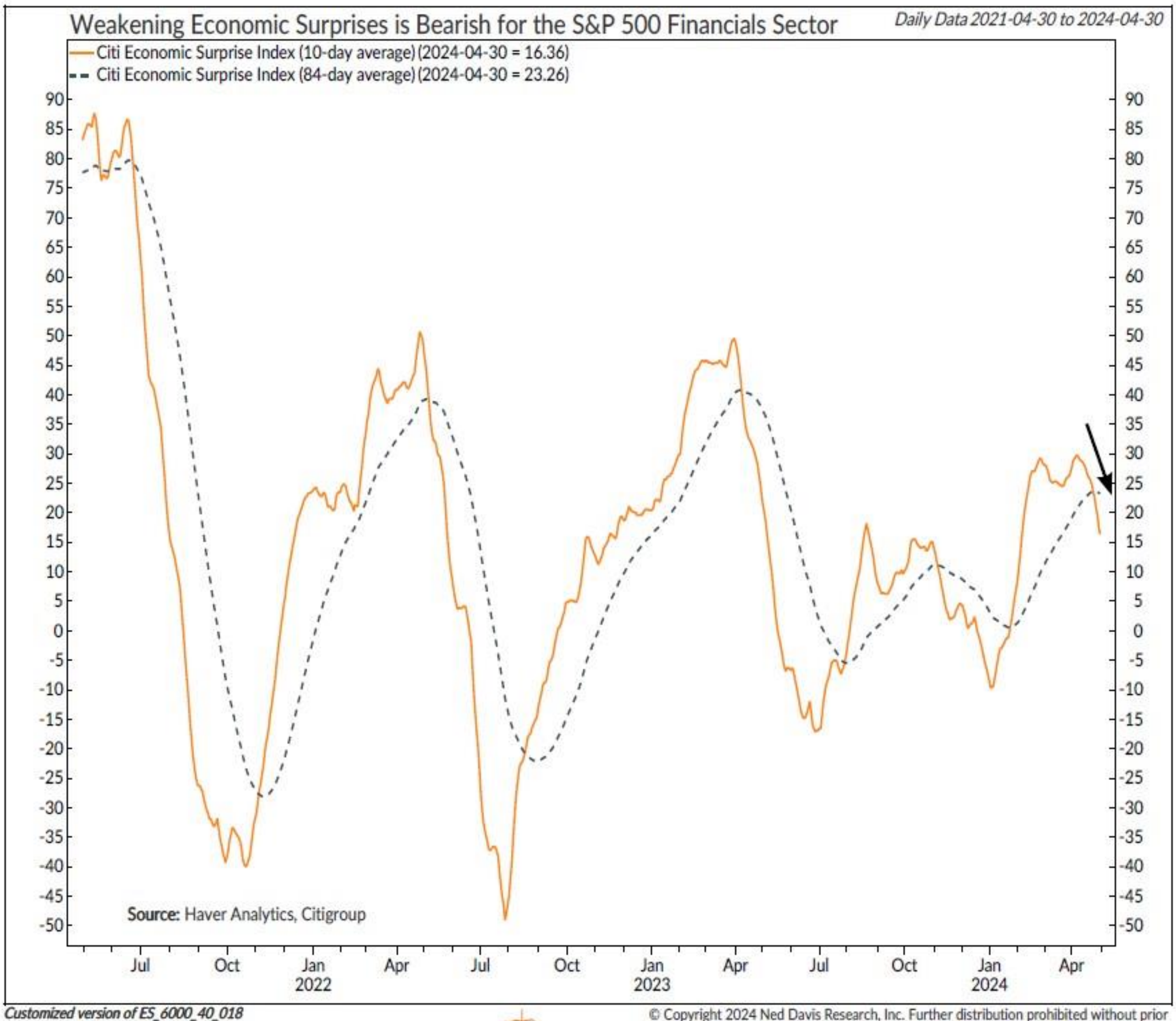
The sector model maintained mixed leadership this month. Entering May, Financials, Industrials, Consumer Staples, and Utilities are above benchmark weight. Energy, Real Estate, and Information Technology are neutral. Materials, Consumer Discretionary, Health Care, and Communication Services are below benchmark weight.

Figure 3: S&P 500: Number of Days Before the Start of 3% Corrections



Financials' allocation remained well above benchmark weight. On a fundamental basis, a strengthening U.S. Dollar Index, business credit conditions, and Financials' investment grade option-adjusted spreads remained bullish for the sector. However, during the month, weakening economic surprises (Figure 4) joined bearish signals from bank loan growth and the 10-2 yield curve. Technicals are positive—four of the six measures remained on bullish signals including sector momentum, trend, volatility, and relative drawdown.

Figure 4: Weakening Economic Surprises is Bearish for the S&P 500 Financials Sector

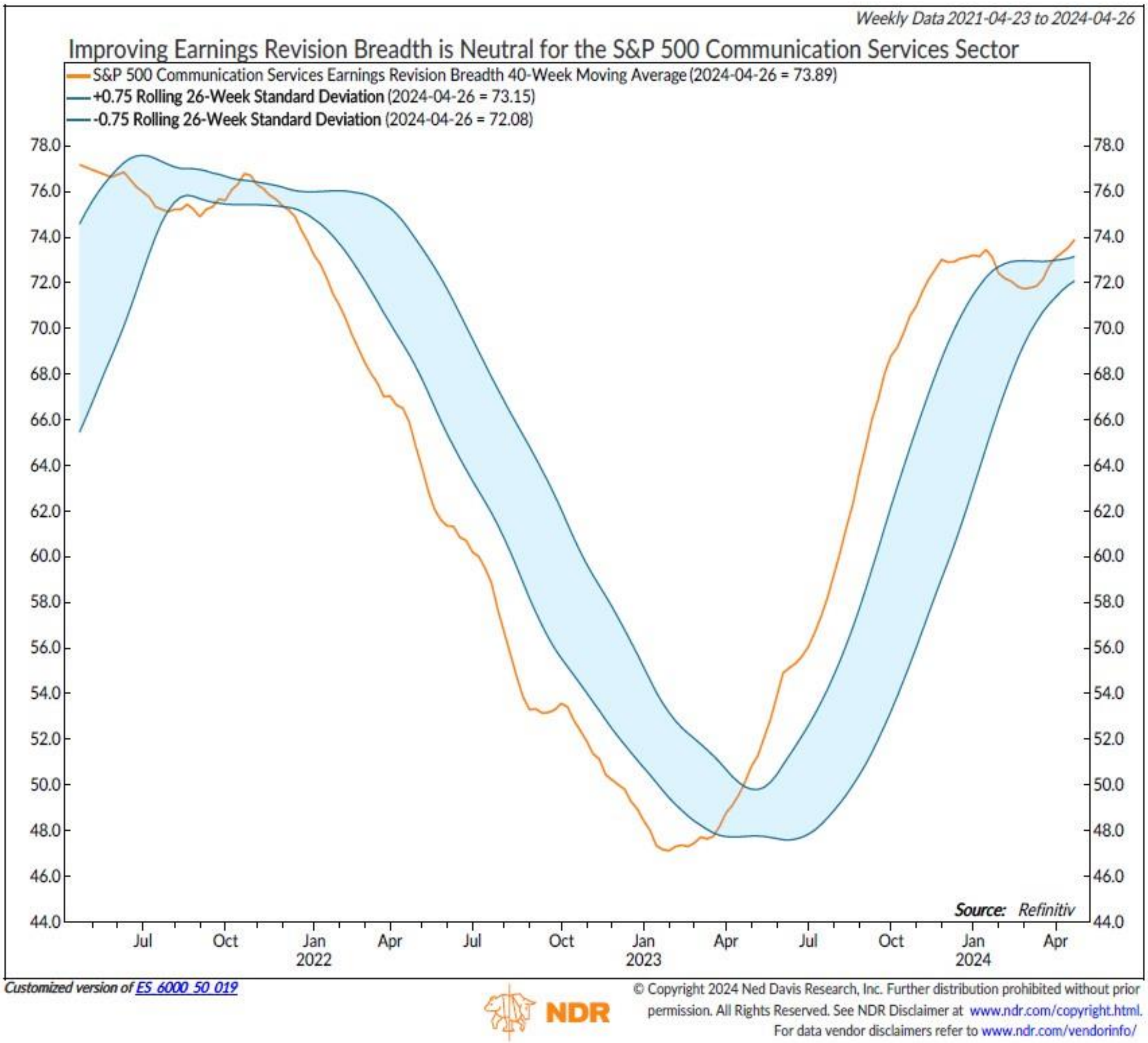


The Utilities sector's allocation is also above benchmark weight. On a fundamental basis, indicators are mixed—bullish signals from relative earnings yield, manufacturing PMI, and yields on Utilities investment grade bonds are offset by oil prices, the copper/gold ratio, and capacity utilization. However, all seven price-based measures are now bullish—a trend indicator flashed a bullish signal during the month (Figure 5).

Figure 5: Improving Trend is Bullish for the S&P 500 Utilities Sector

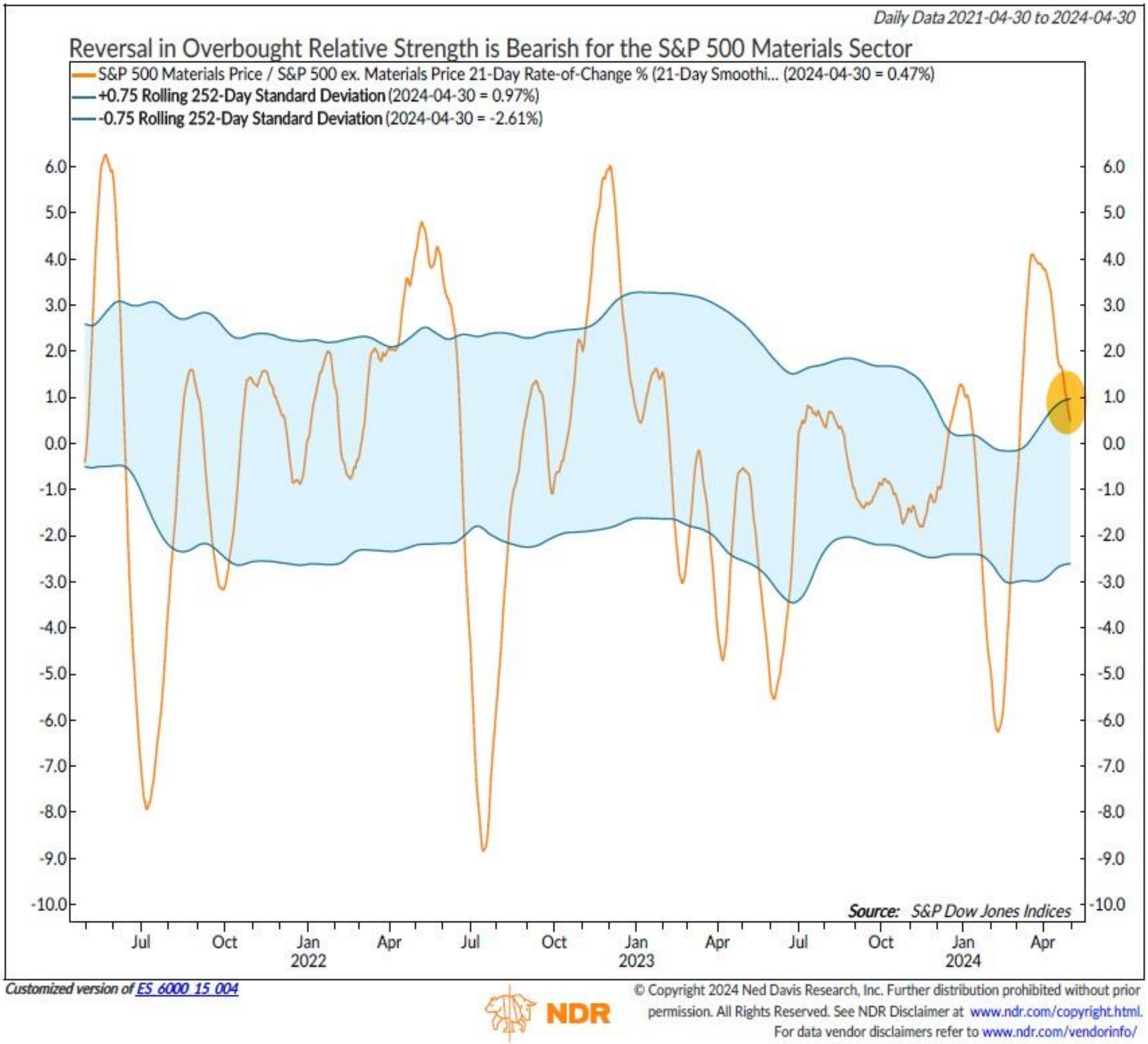
Communication Services' allocation remained below benchmark weight. On a fundamental basis, the 10-2 yield curve and sales growth trends remained bullish. However, relative valuation, option-adjusted spreads, and internet vs. retail sales trends remained bearish. One positive development occurred during the month—earnings revision breadth (Figure 6) improved to neutral. Technicals are weak—four of the six measures remained bearish for the sector.

Figure 6: Improving Earnings Revision Breadth is Neutral for the S&P 500 Communication Services Sector



The Materials sector's allocation remained below benchmark weight. On a fundamental basis, indicators lean bullish—during the month, the emerging/developed equity momentum indicator flashed a bullish signal, joining bullish readings from commodity prices (copper, silver, gold, and natural gas). However, technicals lean bearish—four of six measures are negative for the sector including an overbought/oversold indicator that moved bearish during the month (Figure 7).

Figure 7: Reversal in Overbought Relative Strength is Bearish for the S&P 500 Materials Sector



Summary

The sector model maintained mixed leadership this month. Entering May, Financials, Industrials, Consumer Staples, and Utilities are above benchmark weight. Energy, Real Estate, and Information Technology are neutral. Materials, Consumer Discretionary, Health Care, and Communication Services are below benchmark weight.

Strategy Description

- The Smart Sector® with Catastrophic Stop strategy combines two Ned Davis Research quantitative investment strategies: The NDR Sector Allocation and the NDR Catastrophic Stop.

The process is based on the weight of the evidence

- The fund begins by overweighting and underweighting the S&P 500 sectors based on Ned Davis Research's proprietary sector models.
- Each of the sector models utilizes sector-specific, weight-of-the-evidence composites of fundamental, economic, technical, and behavioral indicators to determine each sector's probability of outperforming the S&P 500.
- Sectors are weighted relative to benchmark weightings.

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 may be trimmed by up 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 will reverse toward being fully invested.

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