Day Hagan Asset Management

NDR Ned Davis Research

Smart Sector® Strategy

JULY 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) improved from last month and entered July with a fully invested equity allocation recommendation.

Figure 1: Smart Sector® Catastrophic Stop Sell Model

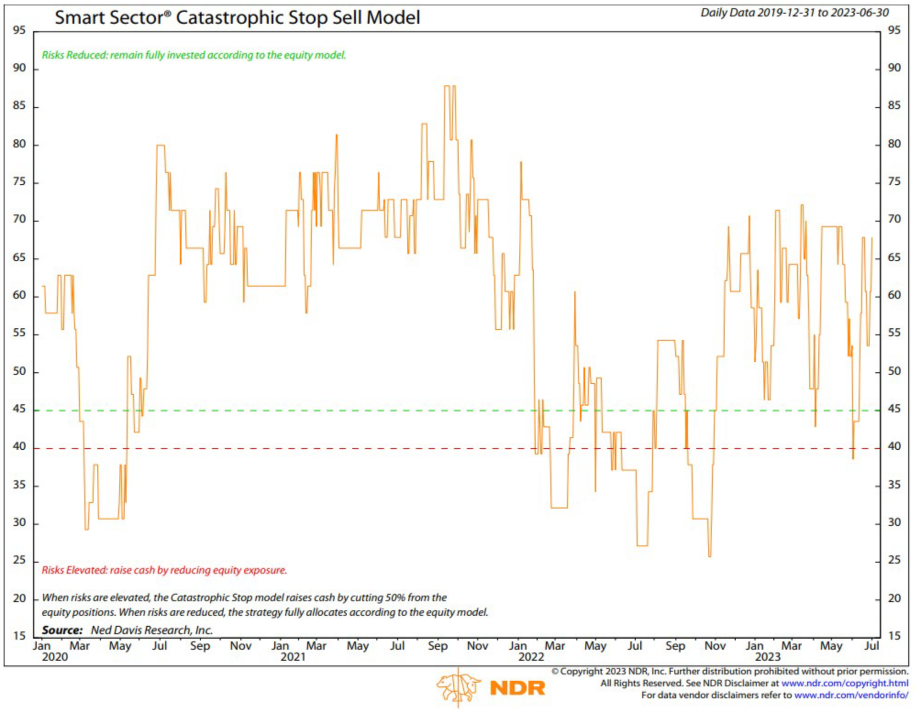


Figure 2: NDR Volume Demand Outpacing NDR Volume Supply: Bullish for Equity Exposure

The model improvement was driven by two internal (price-based) measures that moved bullish during the month—stronger global stock market breadth and stock volume demand outpacing supply (chart left). While external influences such as trade and market sentiment moved bearish during the month, it was partly offset by a bullish reading from high-yield and emerging market bond breadth. Some of these indicators will need to improve if the stock market rally is going to continue deep into the second half of the year.

U.S. Market Update

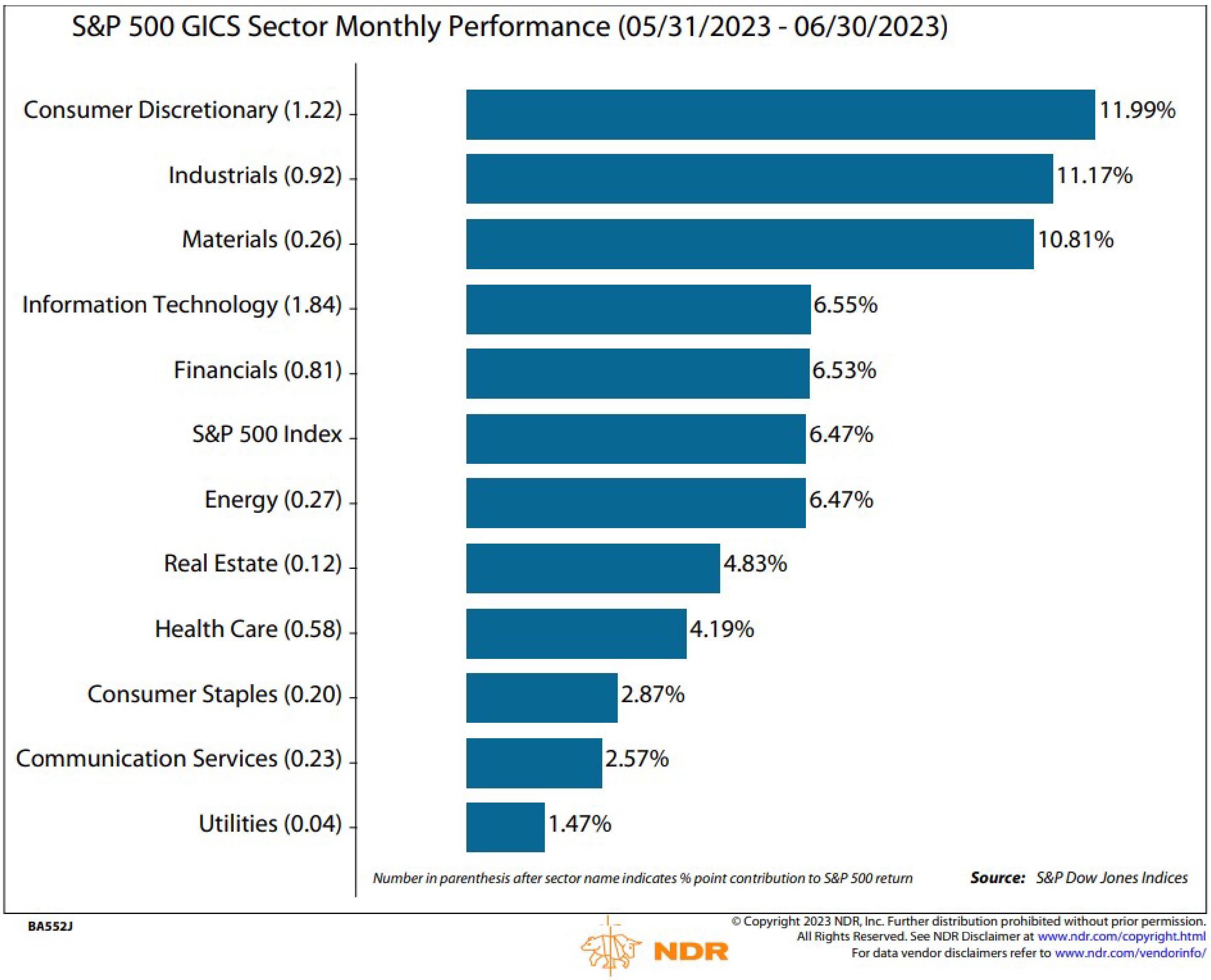
The S&P 500 gained for a fourth month in a row, closing out the second quarter with an impressive return of over 6.5%. Breadth improved significantly—all 11 S&P 500 sectors registered positive returns in the month of June. Performance was led by cyclical sectors—Consumer Discretionary, Industrials, and Materials—all three posted double-digit returns (chart below).

This has been the most lopsided start to a bull market on record. Technology was responsible for over half of the initial 20% gain from the October low, the highest contribution for a single sector on record. Adding in the contributions from Consumer Discretionary and Communication Services, the three Growth sectors combined to make up nearly three-quarters of the gains from the bottom. The recent breadth improvement has not been accompanied by a decisive rotation in leadership, at least not yet.

The broad sector trends that began at the beginning of the year remain intact, with cyclical Growth sectors outperforming cyclical Value sectors, cyclical Value sectors outperforming defensive sectors, and cyclical Growth sectors outperforming defensive sectors. Several factors, including a continued slowdown in growth and inflation, rising levels of optimism, Fed policy, and valuations, could contribute to a leadership rotation in the 2H.

The sector model began to shift toward a mix of cyclical and defensive leadership during the month. Entering July, the sector model is overweight cyclical sectors such as Information Technology, Consumer Discretionary, and Industrials, as well as defensive sectors like Health Care and Utilities. Energy, Communication Services, Materials, and Real Estate moved to marketweight. The Financials and Consumer Staples sectors remain underweight.

Figure 3: S&P 500 GICS Sector Monthly Performance (05/31/2023 -06/30/2023)



Allocation to the Information Technology sector dropped over 300 basis points in June, but it remains the largest portfolio position. After being the best-performing sector in May, Tech gains moderated in June and were more in line with benchmark returns. Three of the five external (macro-based) indicators—sales yield, inflation expectations, and earnings revision breadth—continue to be bearish. The only change for the month in the sector's five internal (price-based) indicators was an overbought/oversold indicator which moved bearish (chart right).

Figure 4: Long-Term Overbought Indicator: Bearish for S&P 500 Information Technology Sector

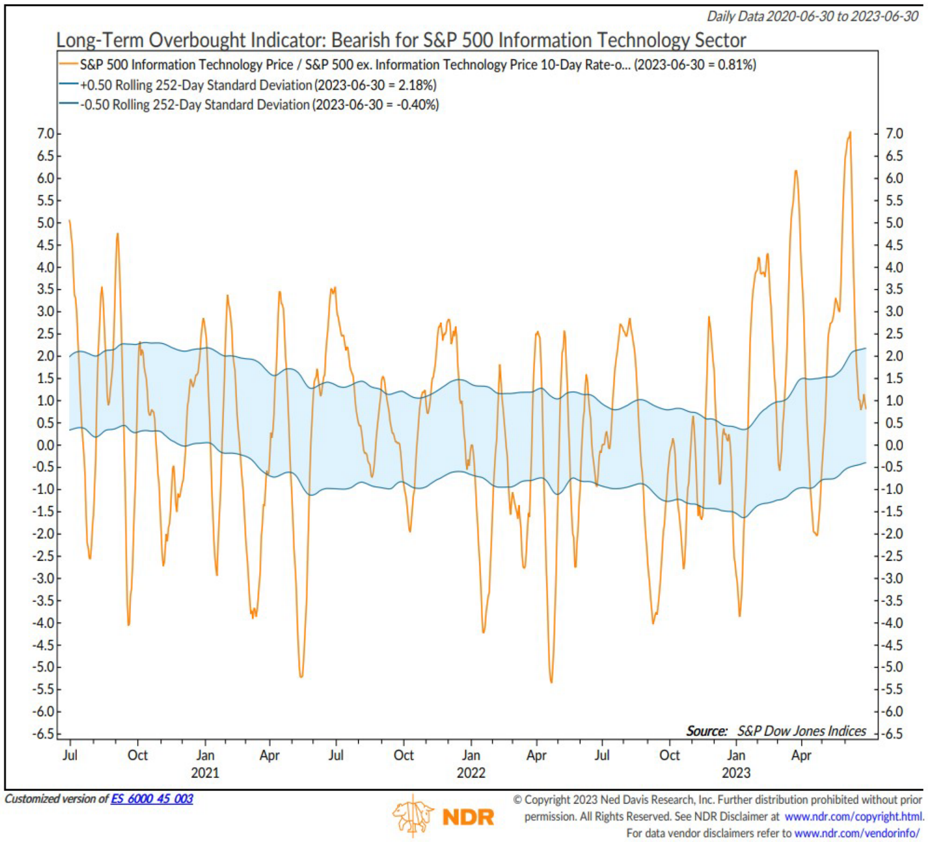
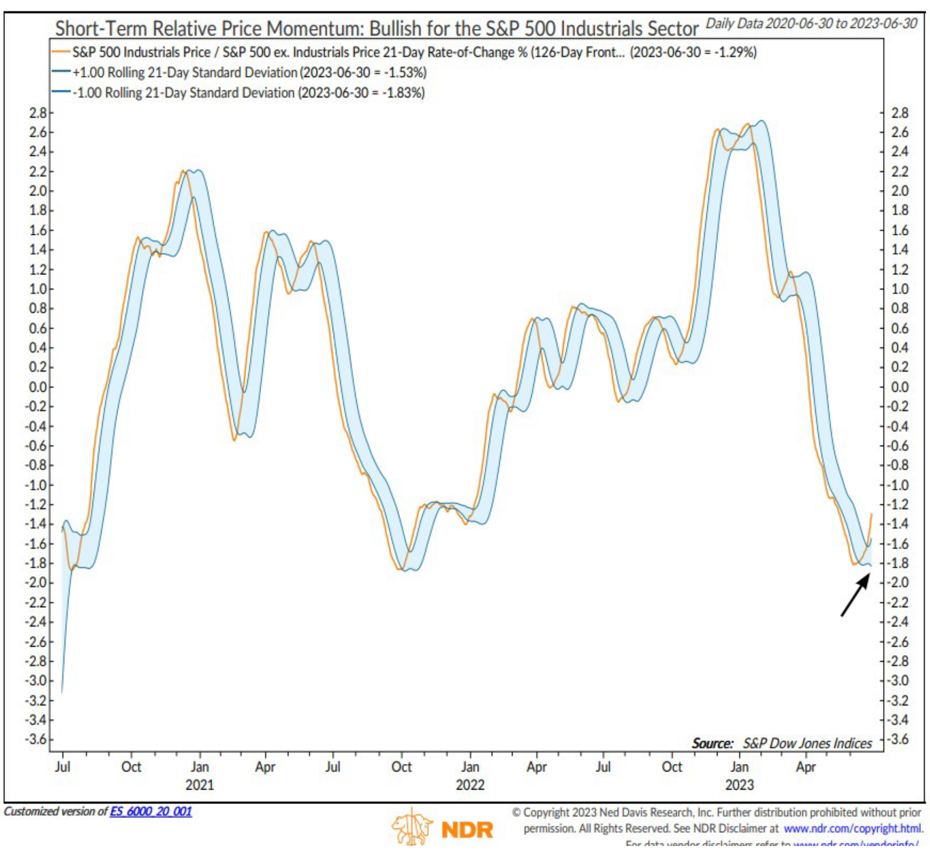


Figure 5: Short-Term Relative Price Momentum: Bullish for the S&P 500 Industries Sector



Allocation to the Industrials sector rose in June, moving it from a marketweight to an overweight position. On a fundamental basis, there were no changes in the month—valuation remains mixed; oil prices, industrial pro-duction, and the U.S. dollar remain bullish; and commodity prices and consumer confidence remain bearish. Two of the six technical measures moved bullish for the sector, including short-term relative price momentum (chart left).

Consumer Staples' allocation dropped over 250 basis points in June and is now the largest underweight position (relative to the benchmark). Although the sector was up over 2.5% in June, it still underperformed the S&P 500 benchmark. On a fundamental basis, credit conditions and economic surprises remain bullish for the sector. However, the majority of external measures are bearish, an example being the cyclical credit to food spread moved bearish in June (chart right). This was confirmed by further weakening technicals, as a relative price trend measure moved bearish during the month.

Figure 6: Cyclical Credit to Food Spread: Bearish for S&P 500 Consumer Staples

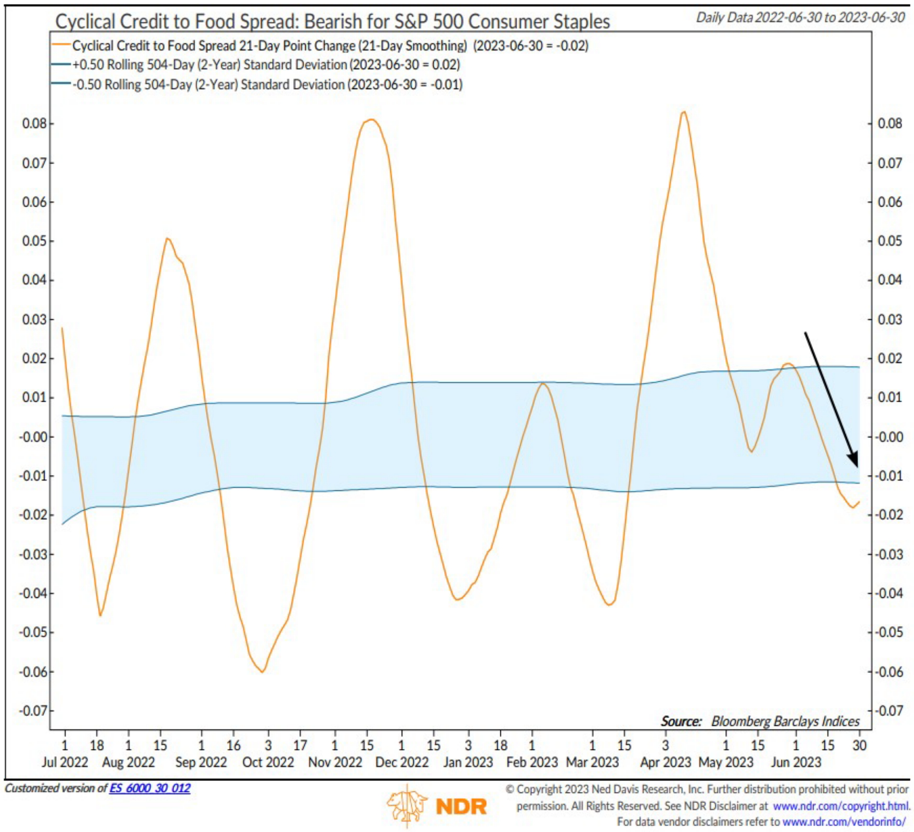
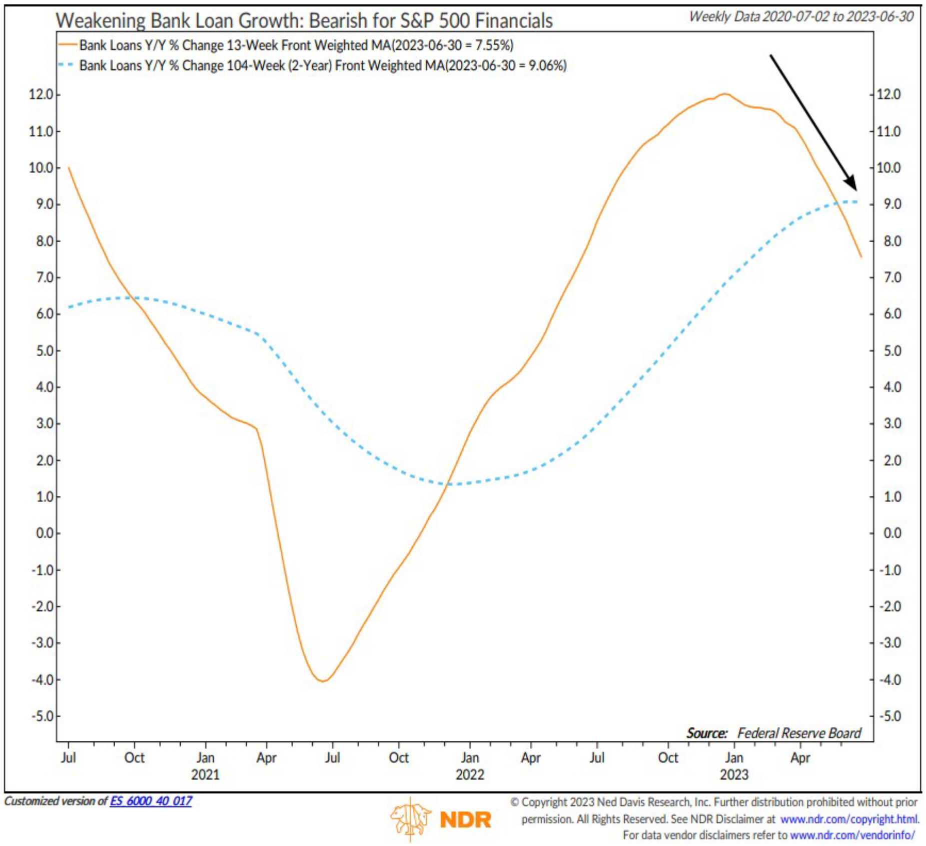


Figure 7: Weakening Bank Loan Growth: Bearish for S&P 500 Financials



The Financials sector's allocation rose in June but remains at an underweight position. On a fundamental basis, the majority of external indicators are now bearish, with weakening bank loan growth joining several other indicators during the month of June (chart left). This was partly offset by the sector's price trend and lower volatility, both of which moved bullish in June.

Summary

The sector model shifted toward mixed leadership during the month. Entering July, the sector model is overweight Information Technology, Consumer Discretionary, Industrials, Health Care, and Utilities. Energy, Communication Services, Materials, and Real Estate moved to marketweight. The Financials and Consumer Staples sectors remain underweight. The sector model uses sector-specific indicators to determine opportunities and identify risks in an objective, weight-of-the-evidence approach.

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Smart Sector® Strategy

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 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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