NDR Global Allocation Strategy

NDR
NED DAVIS RESEARCH

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Macro/Market Update

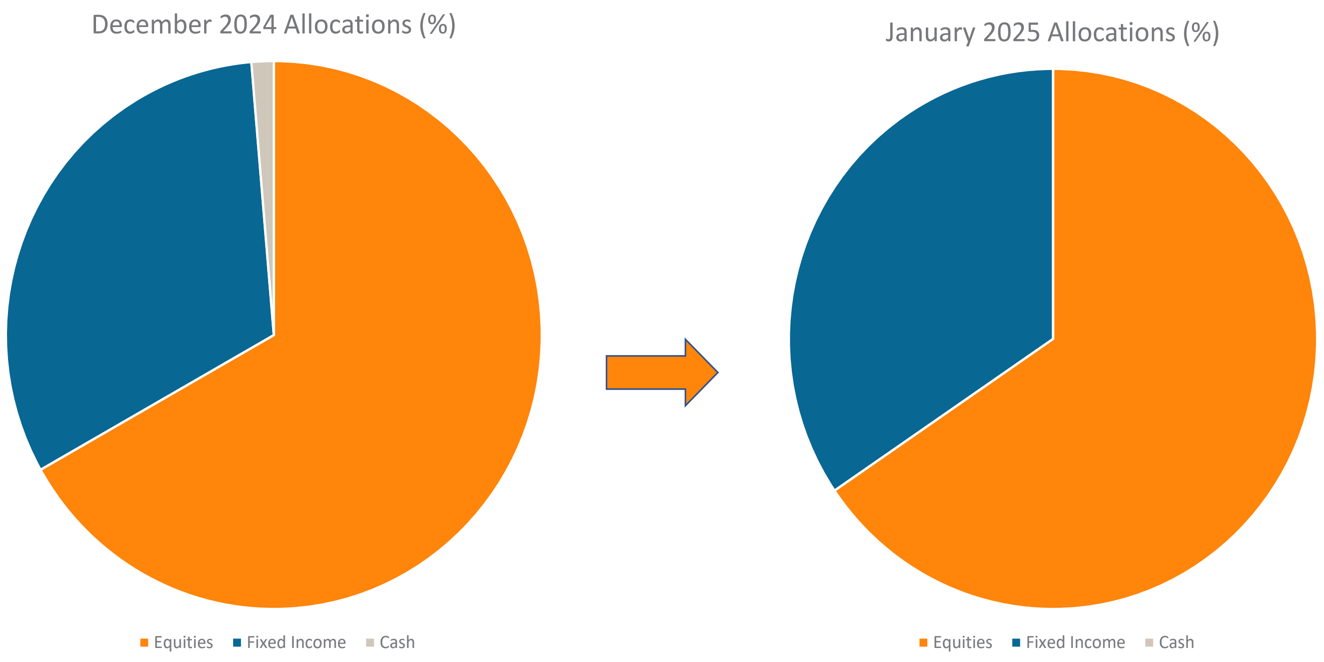
Global economic momentum saw continued growth in November, as the global composite (services and manufacturing) Purchasing Managers' Index (PMI) has risen for three of the last four months. The PMI resides well above levels associated with global recession, as the economy has reasserted itself to the upside.

Leading indicators within the report point to further improvement at the aggregate level. Both the new orders index and the future output index rose to their highest levels in six months. While services have continued to lead the expansion, which has the been the case for over two years, we see burgeoning signs of a turning point in global manufacturing based on leading indicators within the report.

The global economy appears positioned for an ongoing expansion, as easier global monetary policy, positive real wage growth, and increased fiscal support from some of the world's largest economies provide compelling evidence for this trend. However, there are potential downside risks emanating from the geopolitical sphere, most notably the risk of higher tariffs from the U.S. and an ensuing trade war.

During December, the MSCI All Country World Index (ACWI) underperformed the Bloomberg Barclays U.S. Aggregate Bond Index by almost 70 basis points (bps). Stocks have outpaced bonds for eleven of the last fourteen months. Easing central banks, accommodative fiscal policy, receding inflation, and lacking recessionary evidence continue to support the equity cyclical bull market.

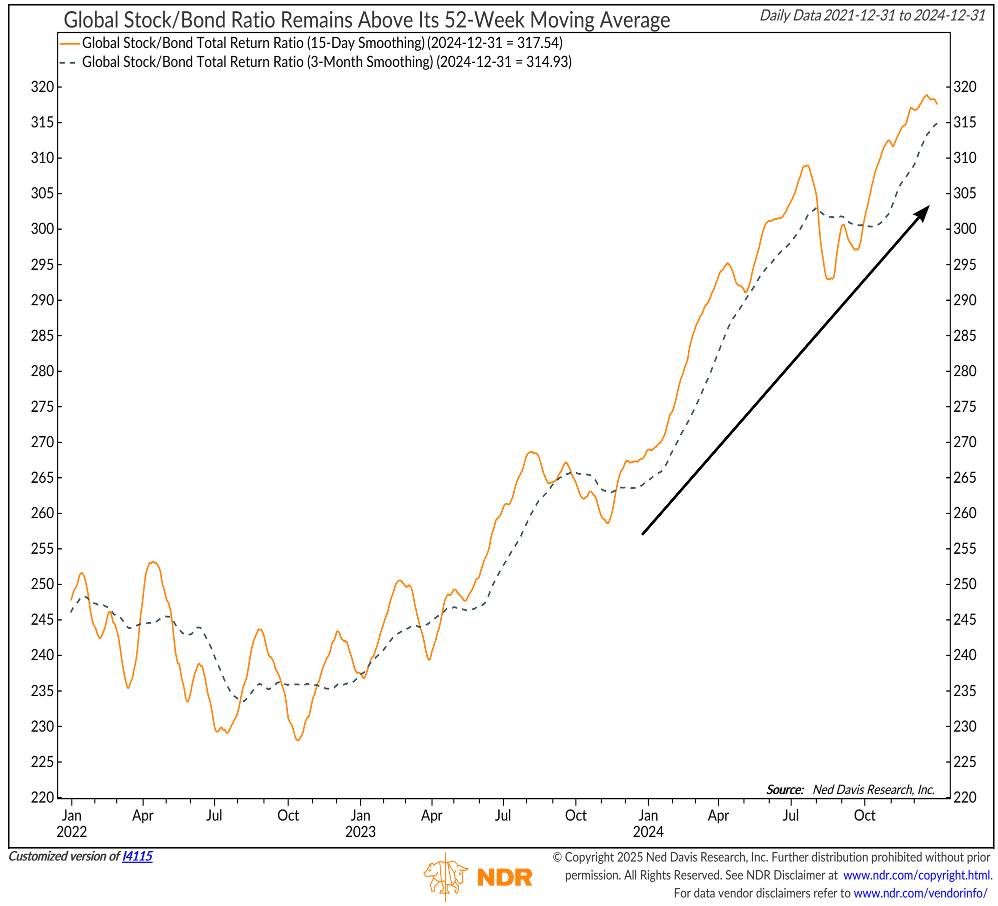
Asset Allocation Summary

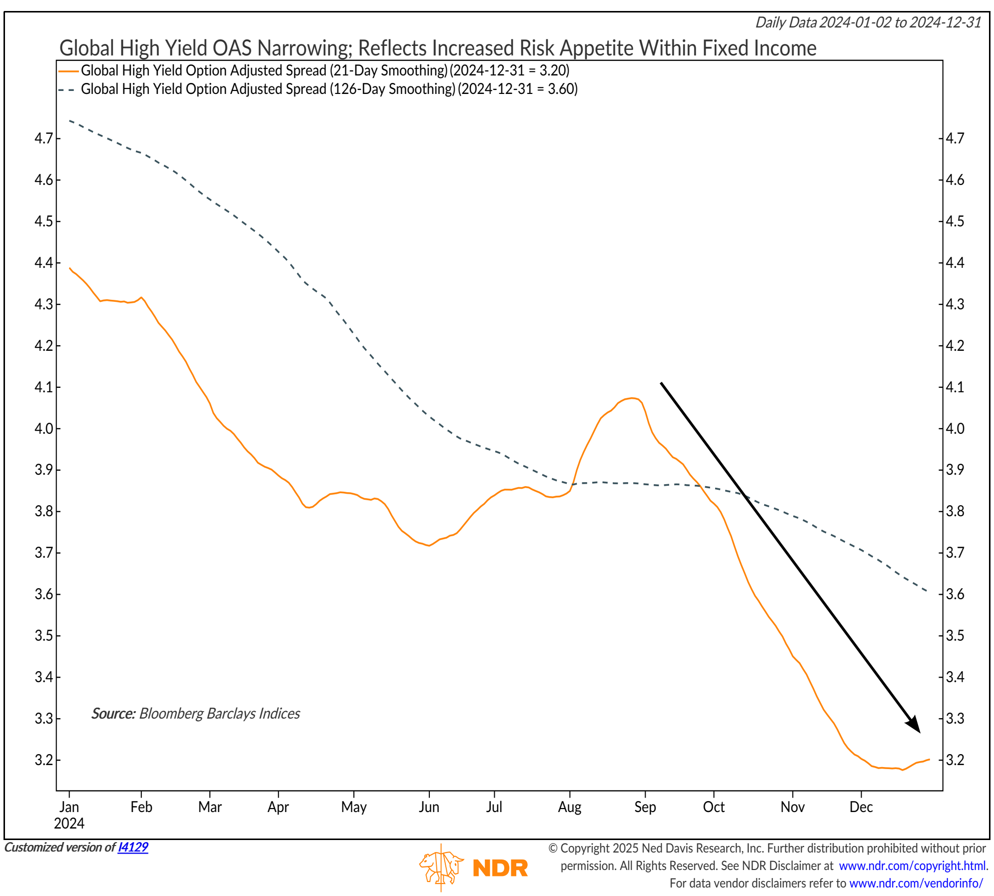


* See Equity Allocation Summary for how the equity allocation is distributed

The model's equity exposure remains above benchmark allocation, as fixed income is underweight.

The price-based indicators (internals) are split between equities and fixed income. Price momentum and trend (chart right) measures support an above-average equity weighting, while breadth and volatility indicators favor fixed income.



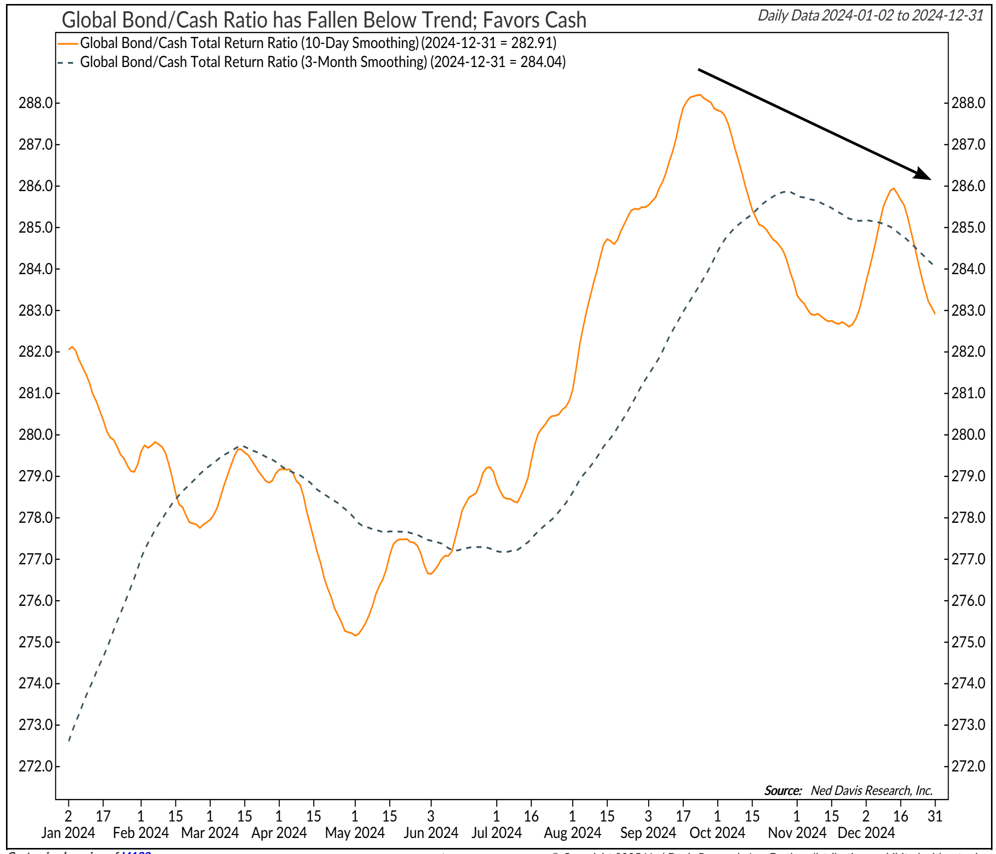


The macroeconomic, fundamental, and sentiment (external) indicators strongly favor equities over fixed income. Earnings growth is positive, defensive sectors are not leading, economic sentiment is improving, recession odds are low, and global high yield option-adjusted spreads (OAS) are narrowing (chart left).

Global high yield OAS has moved significantly lower since experiencing large volatility in August. During the beginning of August, OAS jumped almost 50 bps. Since then, OAS has reversed by over 100 bps, indicating improved risk appetite by fixed income investors.

Within the bond/cash decision, the technical measures are split between fixed income and cash. However, the trend is bearish on bonds relative to cash (chart right).

Following the trend is important as it can help to keep you on the right side of major market moves. The trend also can reduce behavioral biases. Ned Davis has said that following the trend is important because “the degree of unprofitable anxiety in an investor’s life corresponds directly to the amount of time one spends dwelling on how an investment should be acting rather than the way it actually is acting.”



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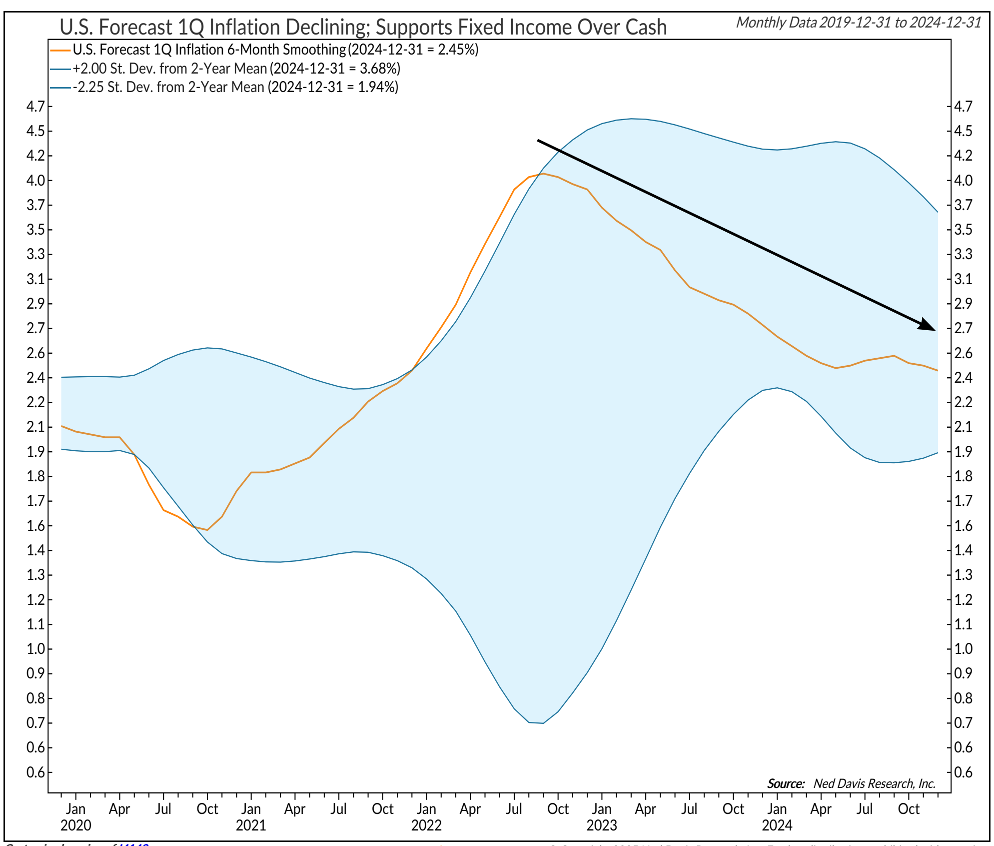

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All but one of the external indicators support bonds over cash. Both U.S. and global yields are falling, as expected inflation continues to trend lower (chart left). Disinflation allows global central bank to ease monetary policy. Falling interest rates benefit bonds, as rates and bonds prices are inversely related.

Equity Region Update

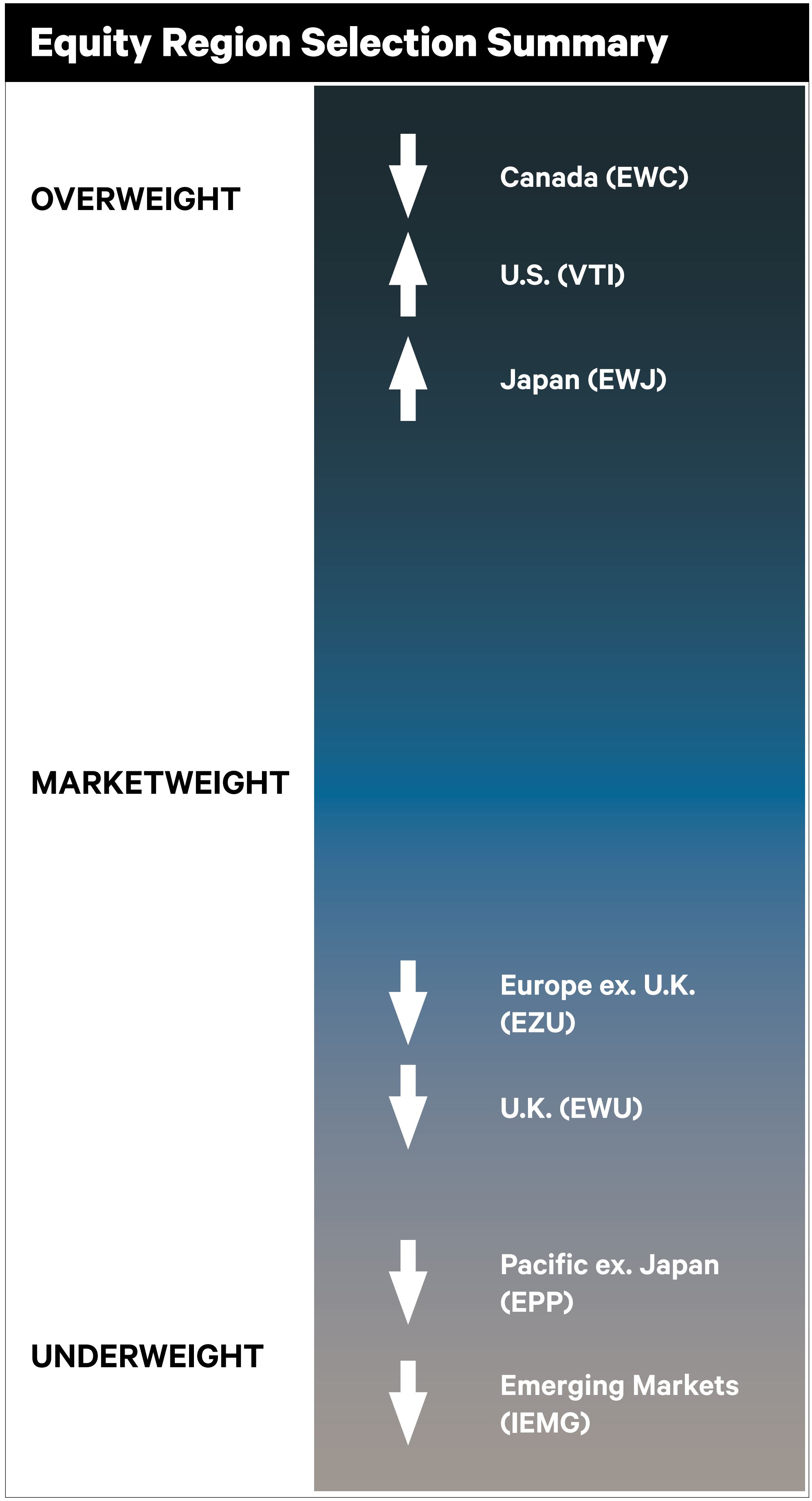
All equity regions declined during December, which has occurred for two of the last three months.

Emerging Markets and Japan both fell by less than 35 bps. EM and Japan have declined for three of the last four months.

The U.S., U.K., and Europe ex. U.K. dropped by less than 300 bps. It was only the third monthly decline for the U.S. in the last fourteen months. Europe ex. U.K. is in a three-month losing streak.

Canada and Pacific ex. Japan plummeted over 560 bps. It was Canada's worst monthly decline since September 2022. Pacific ex. Japan has fallen more than 560 bps for two of the last three months.

This month the model has overweight positions on Canada, the U.S., and Japan while holding below benchmark allocations for Emerging Markets, Pacific ex. Japan, Europe ex. U.K., and the U.K.

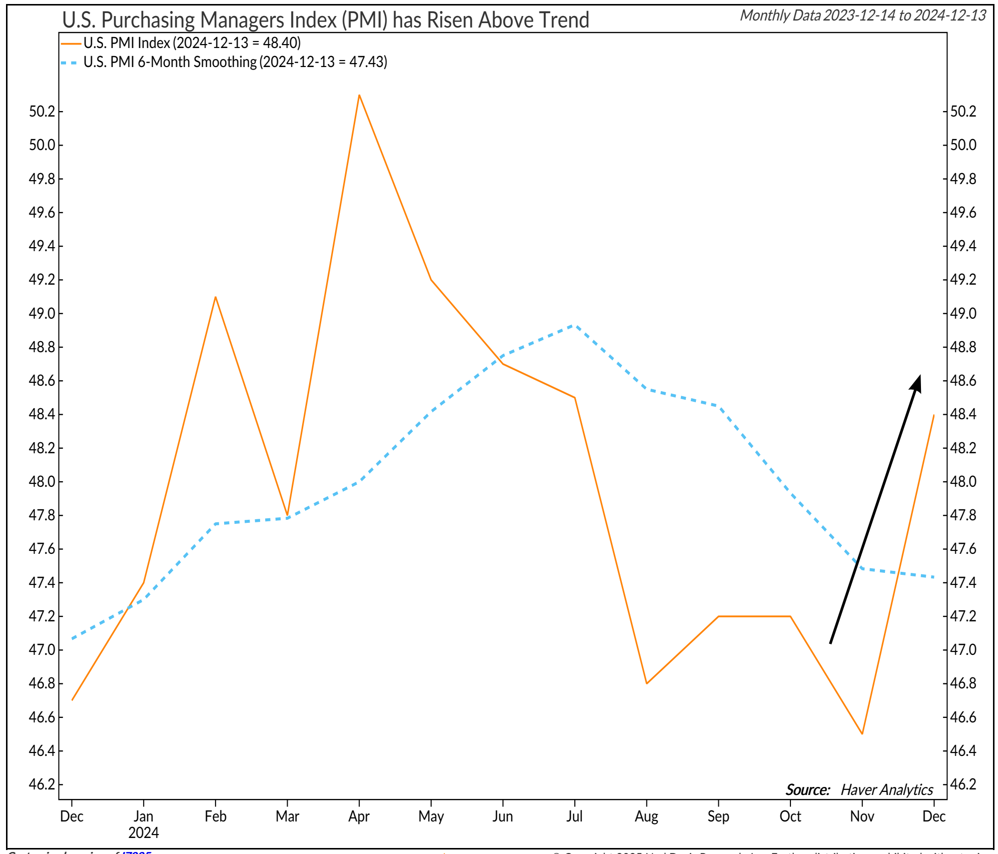


Arrow indicates direction in which region's weight (as a percentage of benchmark allocation) moved from last month (up = weight increased, down = weight decreased).

Equity Region Selection Summary

The U.S. maintained its overweight allocation this month. ETF asset levels are growing relative to other regions, economic sentiment (chart right) and relative valuations are favorable, and business credit conditions are positive. Trend, momentum, and breadth indicators are bullish and support the overweight position.

Initial claims for unemployment insurance dropped at the end of December to the lowest level in eight months. Continuing claims in the previous week fell to the fewest in three months, while the insured jobless rate dipped back down. The readings of all three indicators are close to pre-pandemic levels as labor market conditions have normalized from the pandemic extremes and labor demand remains healthy.



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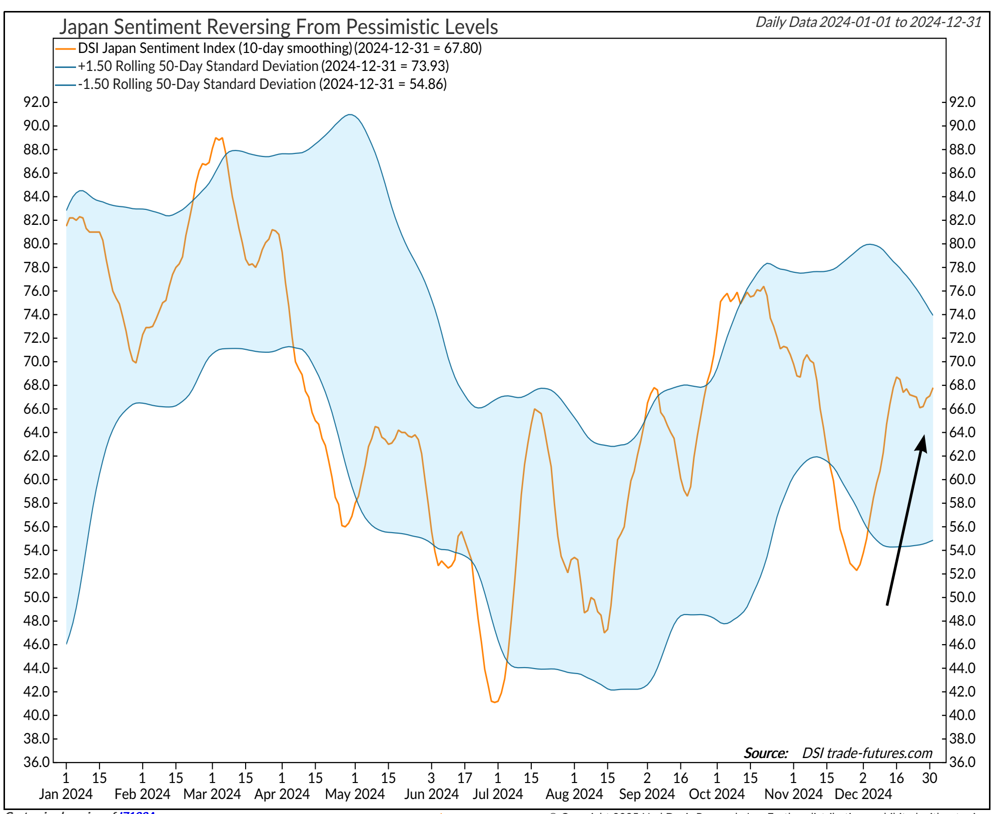

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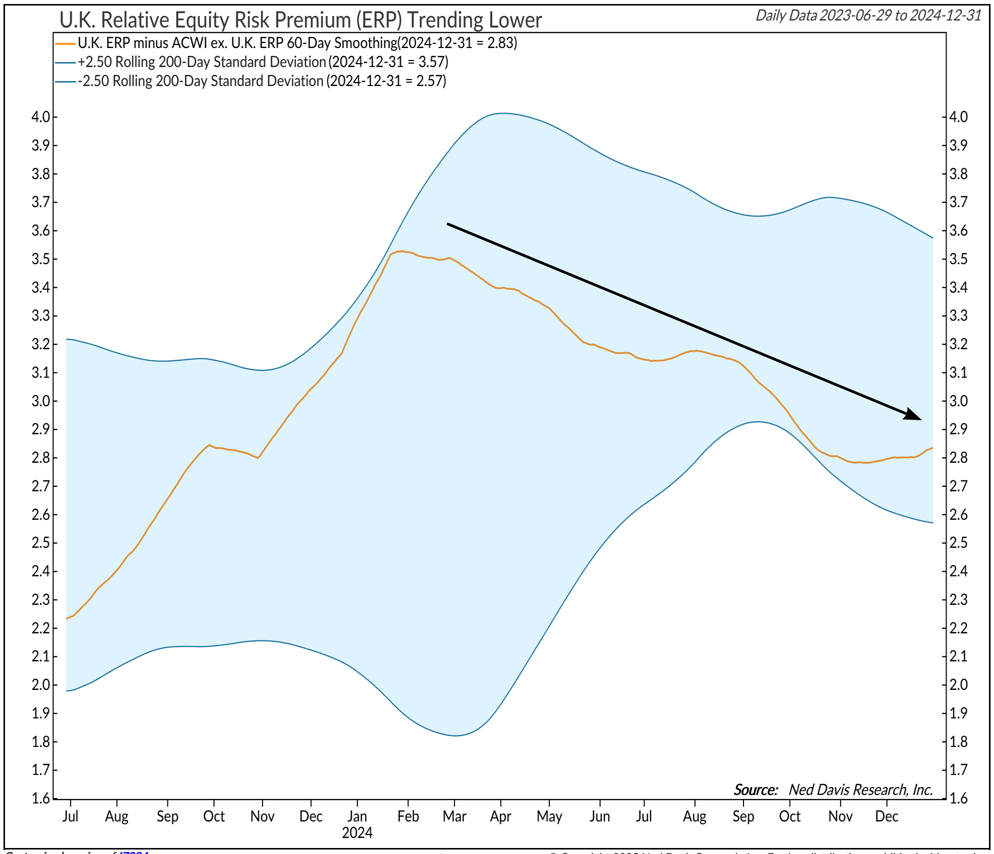
Japan improved to an overweight allocation. Trend, momentum, and breadth measures are positive as sentiment is reversing from a pessmistic condition (chart left).

The Japanese consumer appears to be on solid footing, as retail sales rose over three times more than expectations in November. Moreover, the unemployment rate remained low.

The services sector of Japan's economy has also been shining brighter. The cyclical picture among Japanese businesses was positive in the fourth quarter, according to the latest Tankan survey. Non-manufacturing sector sentiment has been the strongest since the early 1990s, with almost all major sub-sectors breaking out to new highs.

The U.K. remains with an underweight allocation. Only one technical indicator is bullish, as the market is near-term oversold. Trend and breadth measures are bearish. More external indicators are bearish over bullish. Relative valuations are unfavorable, the yield curve reflects weakening conditions, and the equity risk premium is unattractive (chart right).

U.K. retail sales volumes rose less-than-expected in November, adding to other soft data in the fourth quarter. Discretionary items such as clothing and footwear took a hit, suggesting consumers remain cautious. Sentiment remains in the doldrums as consumers await contractionary fiscal policies.



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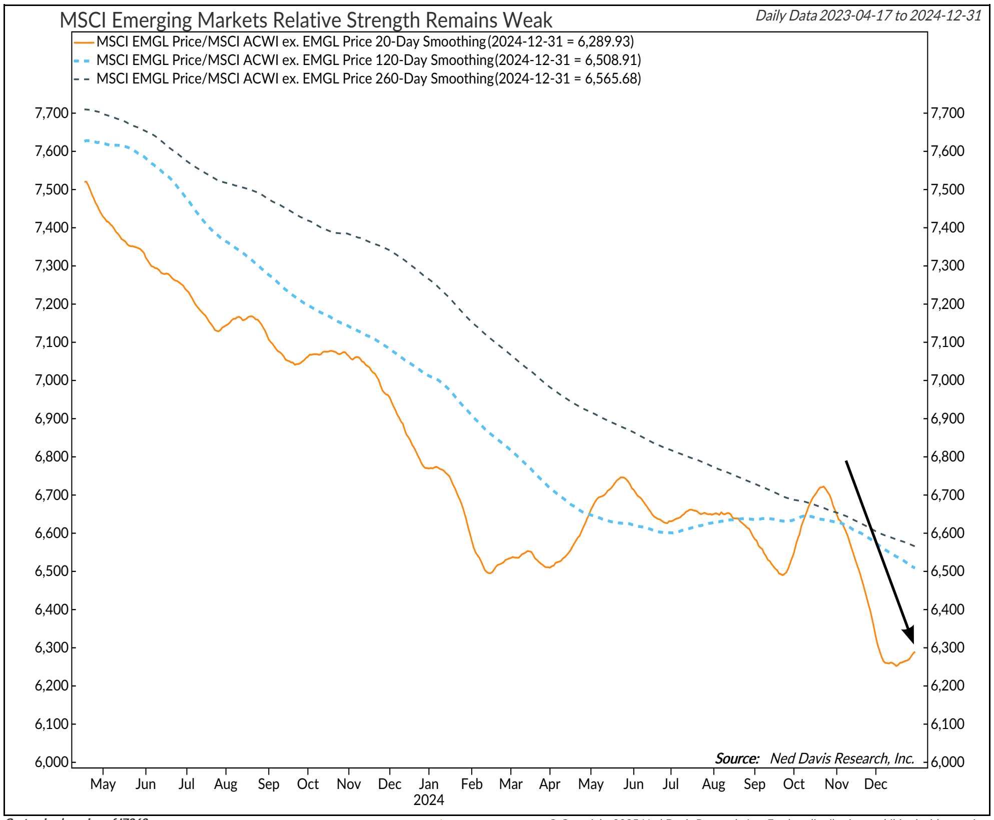

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Emerging Markets' allocation plummeted to significantly below benchmark allocation. None of the region's technical and external indicators are bullish. Weak trend (chart left), breadth, and momentum measures reflect widening high yield credit spreads, weakening economic sentiment, and declining EM ETF asset levels.

China constitutes almost 30% of the EM index. China retail sales disappointed significantly, its weakest pace in three months. Sales of discretionary items, such as apparel, cosmetics, and phones, were abysmal. Weak demand among consumers has been a consistent cause of stagnation in inflation.

Summary

The global asset allocation framework maintained an overweight equity exposure this month. Within the global equity decision, Canada, the U.S., and Japan were overweight, while the model held below benchmark allocations for Emerging Markets, Pacific ex. Japan, Europe ex. U.K., and the U.K.

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