Dynamic Allocation Strategy

FEBRUARY 2020

Macro/Market Update

Prior to the impact of the coronavirus, recent global economic indicator readings suggested a bottom in downside economic momentum.

Easing trade tensions, as evidenced by the signing of a phase-one trade deal between the U.S. and China, and accommodative global monetary policy supported the recovery case.

The global manufacturing Purchasing Managers' Index (PMI) increased 0.3 points to 50.4 in January. It was the third straight month of expansion and the highest level since April 2019.

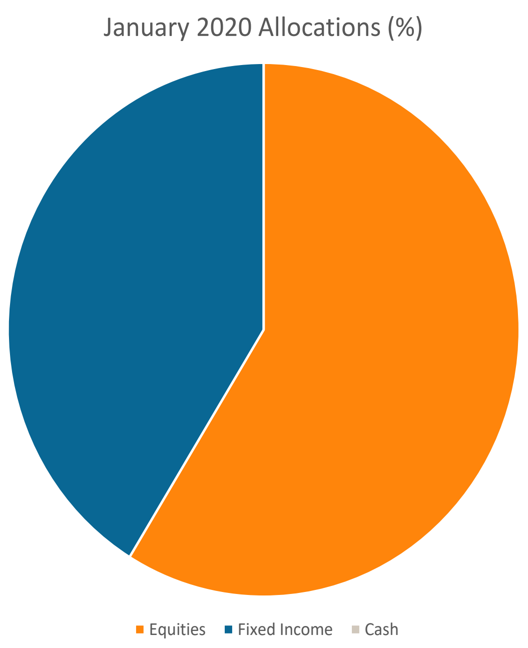
The unemployment rate in the OECD area is just 5.1%, the lowest since data began over 20 years ago. Countries such as the U.S., Germany, and Japan reported their lowest rates in decades.

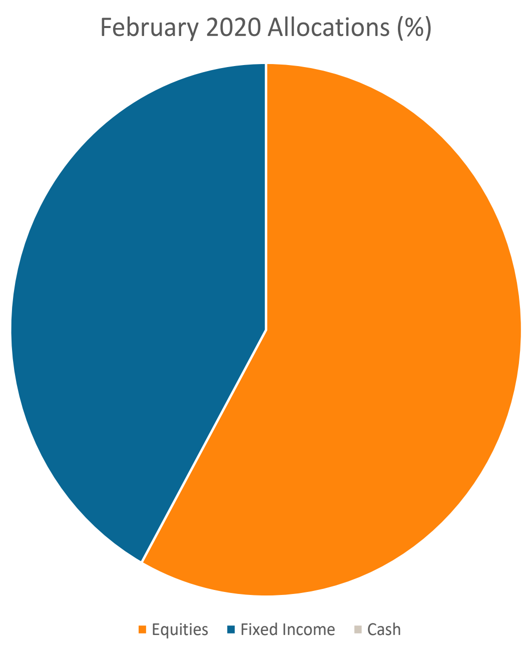
The global OECD Composite Leading Indicator (CLI) increased for a third straight month in November, following 22 months of decreases.

However, most of the economic indicators remain fragile, indicating that a return of risk could easily put the global economy back into peril.

During January, the MSCI All Country World Index (ACWI) underperformed the Barclays Global Aggregate Bond Index by more than 235 basis points (bps). Overly optimistic sentiment left equities vulnerable to a pullback, which the coronavirus outbreak served as the catalyst for. If interest rates continue to drop and volatility indices like the VIX continue to rise on renewed economic worries, then that will likely continue to send stock prices lower. If the VIX index reverses from a high and stock upside participation (breadth) improves, then the recent equity weakness could serve as an entry point into the long-term uptrend for stocks.

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

Asset Allocation Summary

- There were no position changes this month, as the turnover-reduction overlay threshold was not breached
- Equities and fixed income remain near their benchmark allocations at approximately 58% and 42%, respectively
- Cash continues to receive zero weight
- Four of the six top-level indicators favor equities over fixed income (table, below)
- The equities/fixed income relative strength continues to favor equities
- The global breadth indicator switched to favoring fixed income (chart, below). The combination of optimistic sentiment and the coronavirus scare triggered a sell-off that left only one-third of global equity markets above their 50-day moving average
- The OECD CLI now favors equities. The four-week change is at its highest level since late 2017
- The PMI breadth indicator favors equities as the share of countries reporting expanding manufacturing industries increased. This indicator has whipsawed over recent months
- The global shipping rates indicator continues to favor fixed income as trade uncertainty has weighed on global shipping rates
- The central bank policy indicator favors equities

Top Level Factors

Indicator	Current Signal (Red = New Signal)	Comment
Equities/Fixed Income Relative Strength (indicator receives a heavier weighting)	Favors Equities	The equities/fixed income relative strength ratio is still 4% above its one-year average. This is down from being almost 10% above mid-month.
Global Market Breadth	Favors Fixed Income	Only 1/3 of global markets are currently trading above their 50-day moving average. This is the lowest breadth reading since August
OECD Leading Indicator	Favors Equities	Latest OECD CLI reading showed a slight improvement from the previous month
PMI Breadth Factor	Favors Equities	The share of countries reporting expanding manufacturing industries improved by 8% over the past four weeks
Baltic Exchange Dry Index	Favors Fixed Income	Global shipping rates continue to come under pressure. The Baltic Dry Index finished the month 55% below its one-quarter average
Central Bank Policy	Favors Equities	Global short-term rates have started to decline, but a much larger drop is needed for a shift to fixed income

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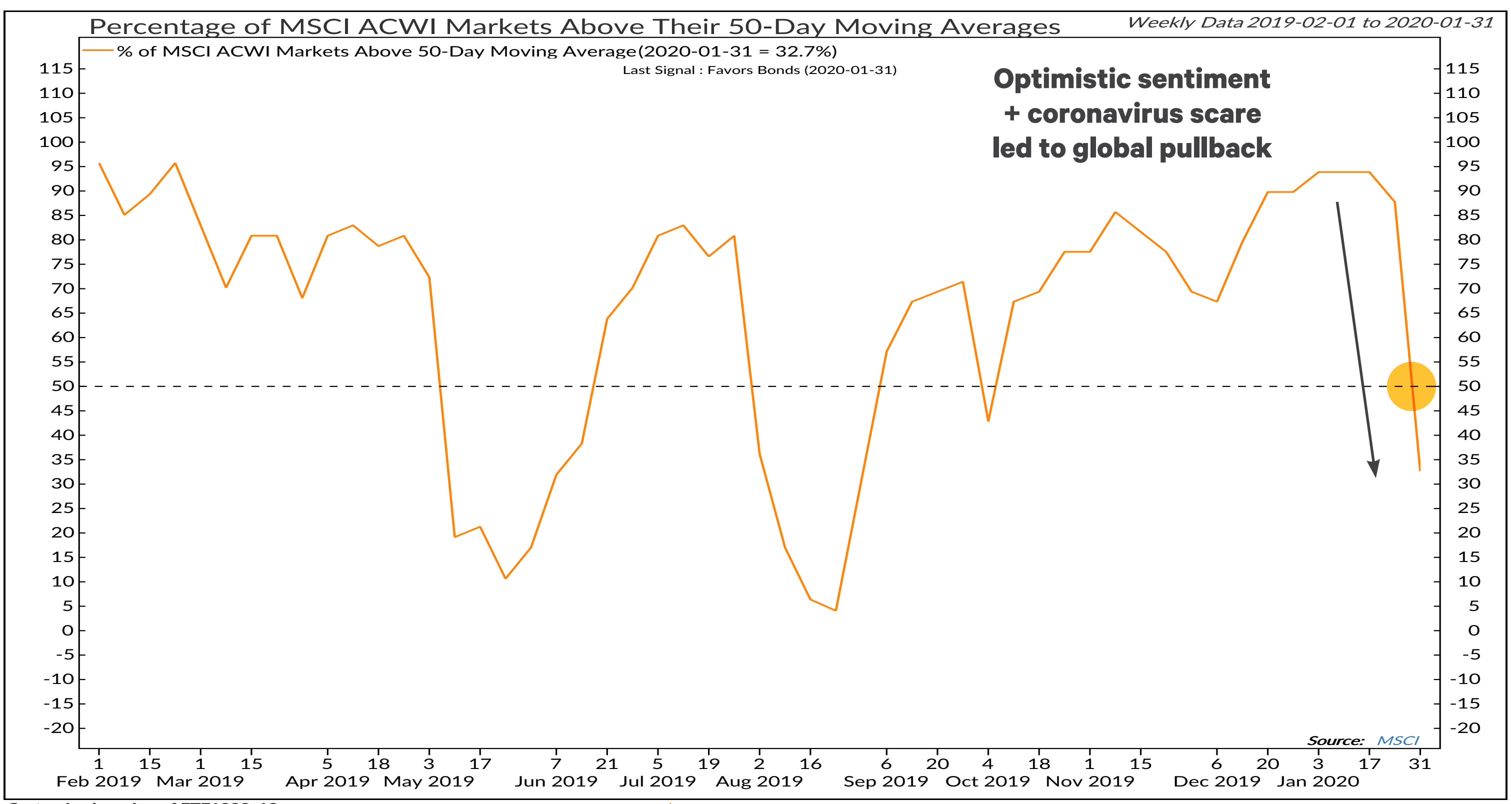

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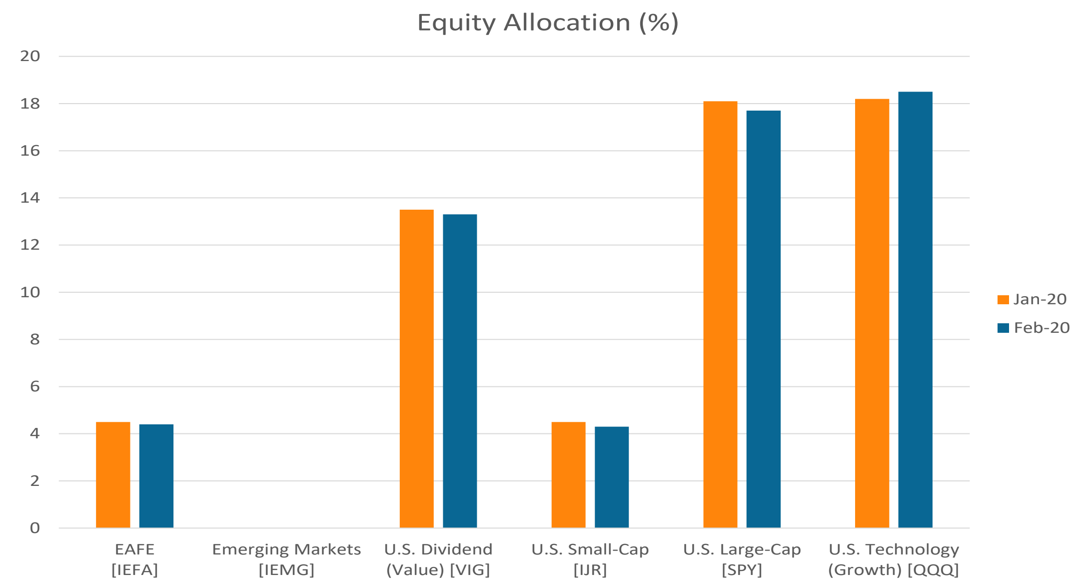
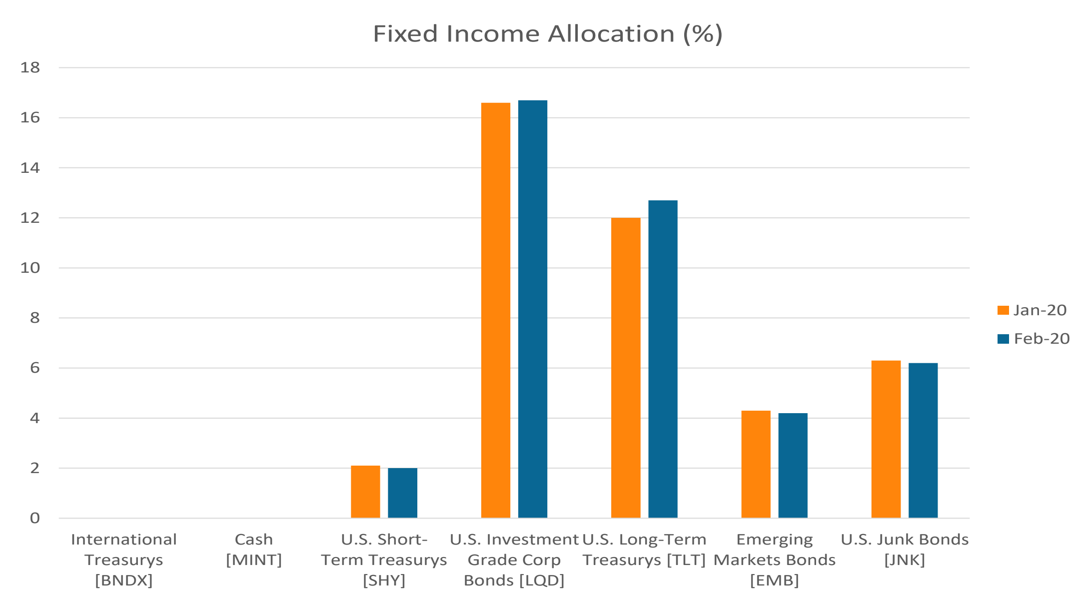
Equity Allocation Summary

U.S. Technology (Growth) [QQQ] demonstrated the strongest returns in January as it rose by more than 300 bps. It was the fourth-straight month where QQQ gained over 300 bps. U.S. Dividends (Value) [VIG] increased by 57 bps last month and has risen for eight consecutive months. U.S. Large Caps [SPY] declined by less than five bps in January, breaking a four-month winning streak. Europe, Australasia, and the Far East (EAFE) [IEFA] declined by more than 274 bps, the largest drop since May of last year. After rising by more than 200 bps for four-straight months, U.S. Small Caps [IJR] dropped by more than 400 bps. Emerging Markets [IEMG] fell by more than 589 bps in January after jumping more than 746 bps in December. There were no allocation changes this month.



Fixed Income Allocation Summary

U.S. Long-Term Treasurys [TLT] produced its largest gain since August as it increased by more than 769 bps last month. TLT had fallen for four-straight months. U.S. Investment Grade Corporate Bonds [LQD] gained over 244 bps in January and has risen for ten of the past eleven months. International Investment Grade Bonds [BNDX] broke a four-month losing streak as it gained over 189 bps. Emerging Markets Bonds [EMB] increased by 124 bps in January and has risen for two consecutive months. U.S. Short-Term Treasurys [SHY] increased by over 57 bps, while Cash [MINT] gained over 33 bps. It was the largest monthly increase for MINT in one year. U.S. High Yield [JNK] was the only sector to decline in January as it dropped by over 45 bps. There were no allocation changes this month.



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