NDR Global Allocation Strategy

NDR
NED DAVIS RESEARCH

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Macro/Market Update

The global economic lull from the second half of 2023 is abating at the start of 2024. The global composite (services and manufacturing) S&P Global Purchasing Managers' Index (PMI) rose for a third straight month in January to an eight-month high. This suggests minimal near-term recession risk. However, the global composite is still well below its long-term average, indicating historically slower growth.

Leading indicators were constructive. The new orders index showed its strongest expansion in seven months. The future output index also jumped to its best level since June, led by both the manufacturing and services sectors.

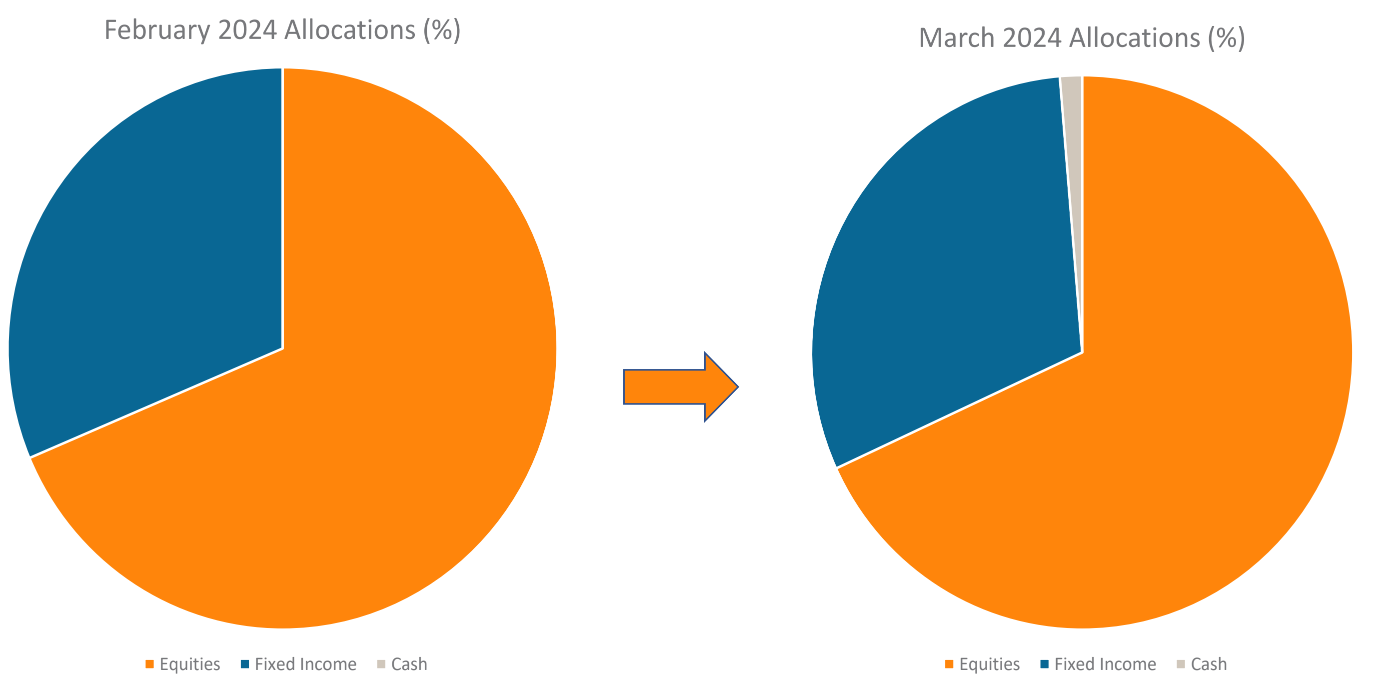
Manufacturing, which has been an economic laggard for some time, pulled out of contraction territory for the first time in 17 months. Meanwhile, services, the largest chunk of the economy, remains strong. Breadth in both sectors picked up, indicating that the expansion is broadening.

Global supply chain pressures picked up due in part to disruptions in the Suez and Panama Canals, but prices have so far been little affected. The global composite output price index fell to its lowest level since October 2020.

During February, the MSCI All Country World Index (ACWI) outperformed the Bloomberg Barclays U.S. Aggregate Bond Index by over 500 basis points (bps), the largest spread since June. Stocks have outpaced bonds for ten of the last 14 months.

The drivers pushing the equity market to new highs continue to persist. Those include increasing recognition that global inflation has given way to disinflation, relief that a global recession has been averted, encouragement from earnings that continue to beat expectations at a rising rate, and expectations that the Federal Reserve and several other central banks will be cutting interest rates.

Asset Allocation Summary

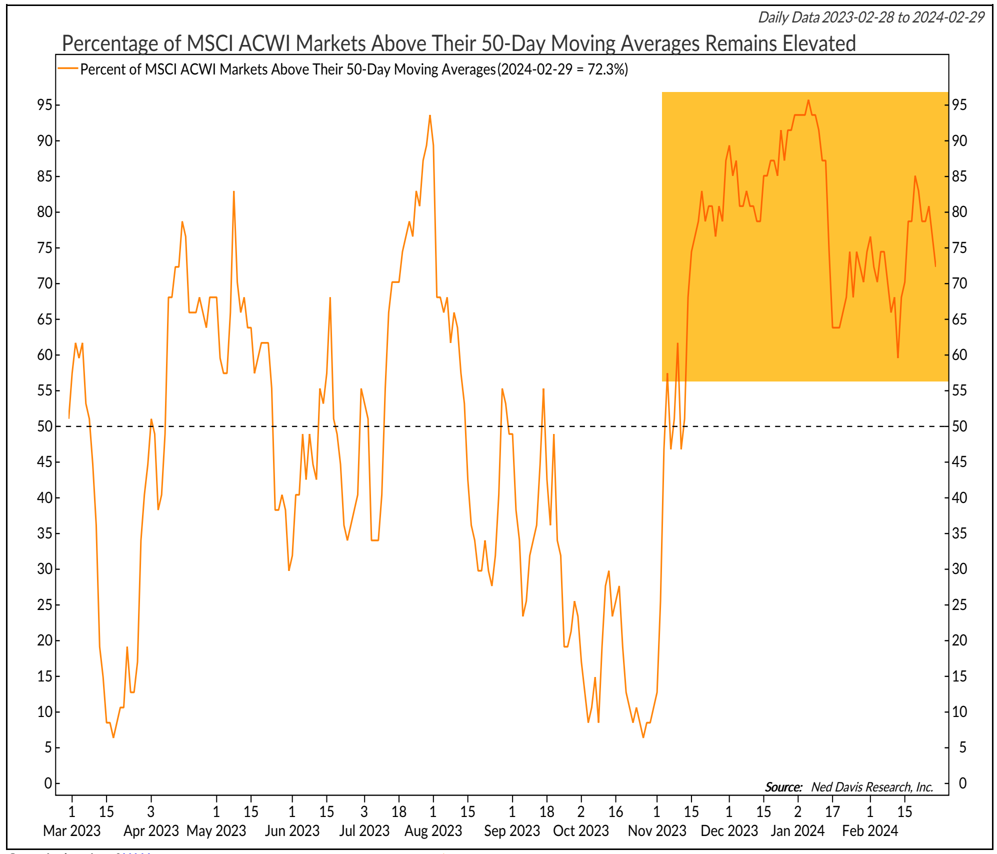


* See Equity Allocation Summary for how the equity allocation is distributed

The model's equity exposure remains above benchmark allocation for March. Following the strong market rally after the late-October correction lows, the price-based indicators (internals) turned bullish on equities. Trend, breadth (chart right), and risk measures continue to support an above average equity weighting. None of the internal indicators are bearish on stocks.

The improvement in trend was supported by widening breadth as the percentage of global equity markets trading above their 50-day moving averages rose by more than ten percentage points since mid-February. Over 70% of global equity markets traded above their intermediate-term moving averages (chart right).

This indicator describes the underlying health of global equities, since it tracks the number of markets participating on the upside. Elevated breadth is important because if many stocks rally, even if a few run into trouble, enough stocks remain in uptrends that they can support the popular averages.



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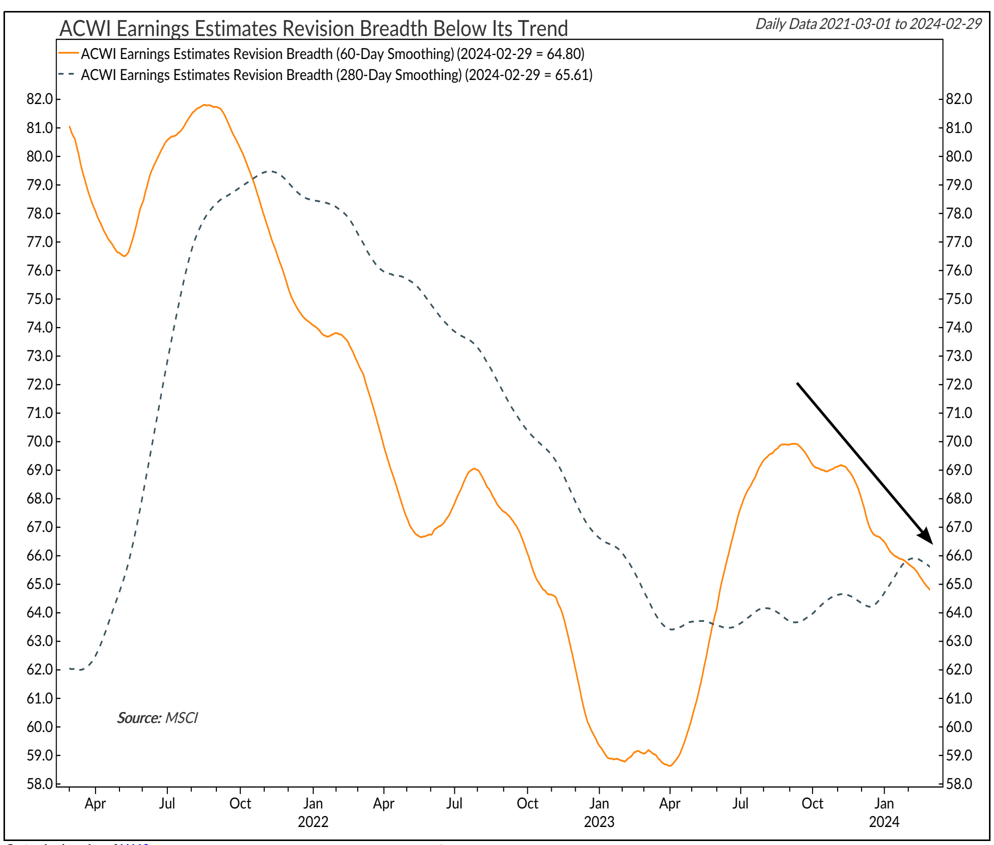
The macroeconomic, fundamental, and sentiment (external) indicators slightly favor fixed income over equities. Economic sentiment remains negative, trailing earnings growth breadth is weak, earnings expectations have rolled over (chart left), and investor sentiment is overly optimistic.



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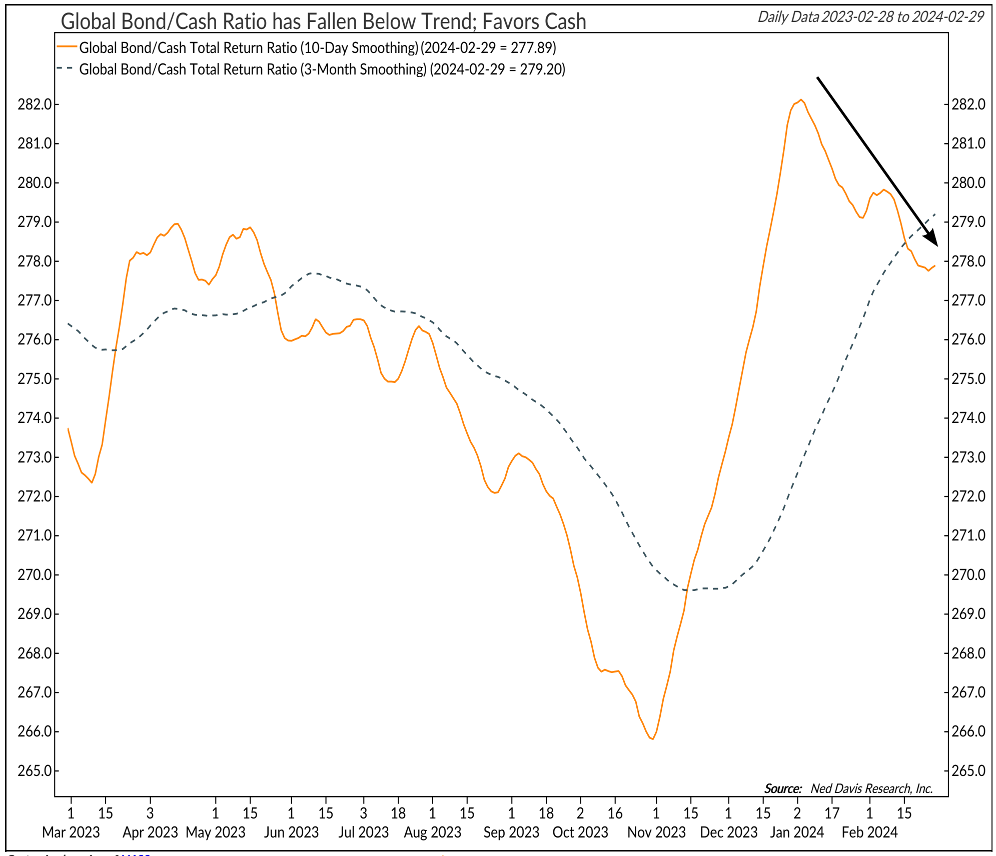
Within the bond/cash decision, the technical measures weakened and now favor cash over fixed income. On absolute basis, bonds are now below trend (chart right).

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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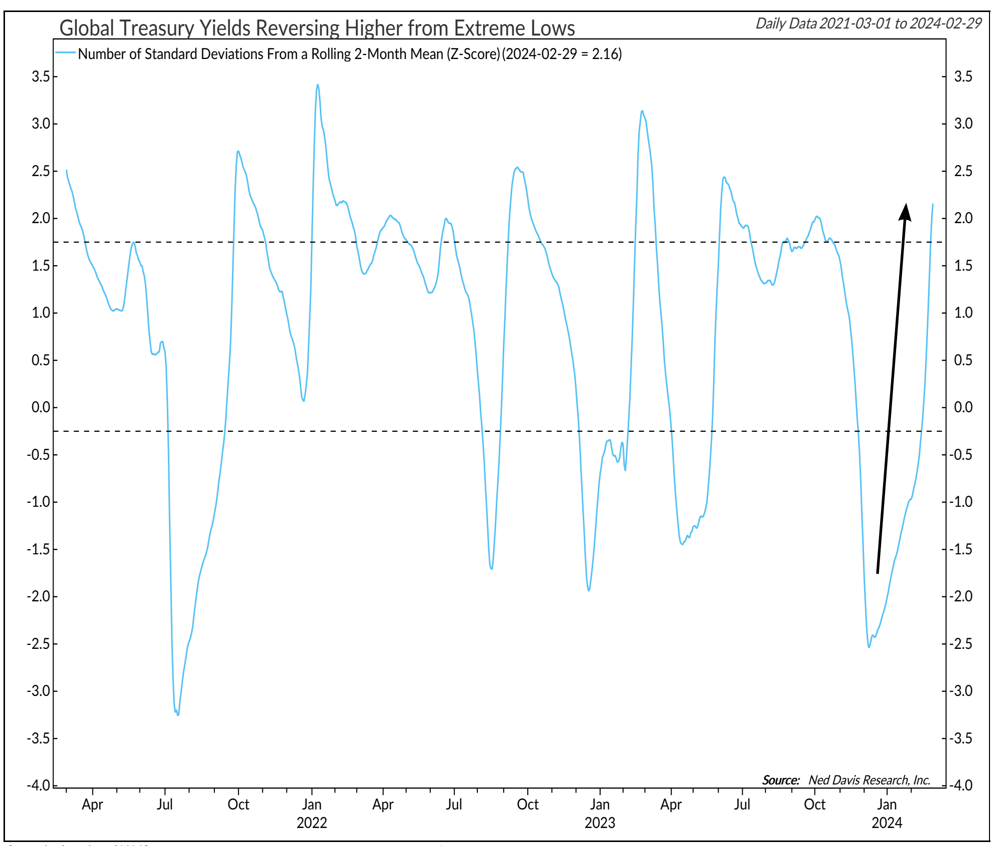

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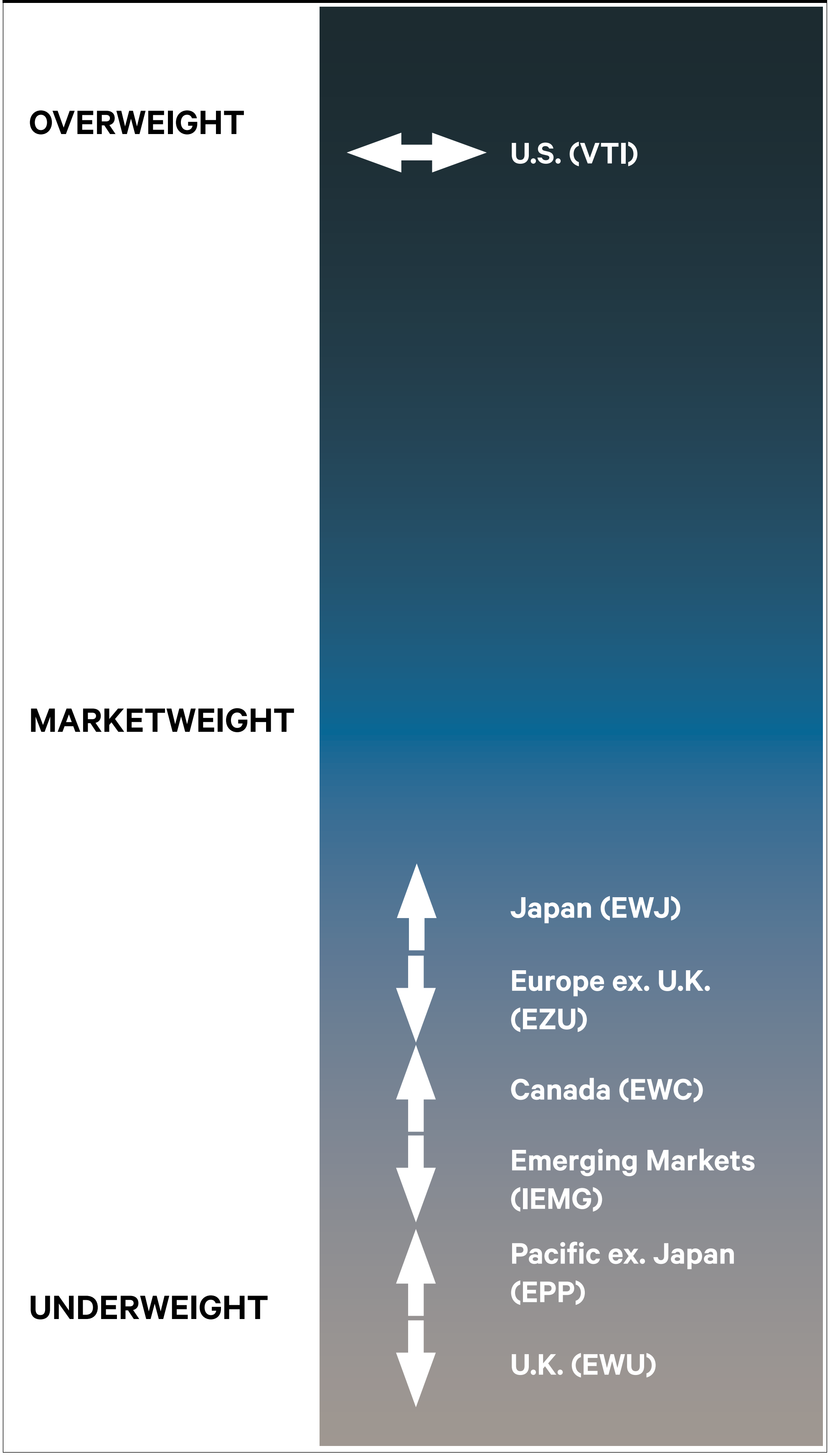
The external indicators are split between bonds and cash. Global yields have been reversing higher from extreme lows not seen since mid-2021 (chart left).

Equity Region Update

The U.S. and Emerging Markets both jumped more than 400 bps in February. Europe ex. U.K. and Japan increased more than 200 bps. The U.S., Europe ex. U.K., and Japan have risen for four straight months. The model has an overweight position on the U.S., while holding below benchmark allocations for Japan, Pacific ex. Japan, Emerging Markets, Canada, Europe ex. U.K., and the U.K.

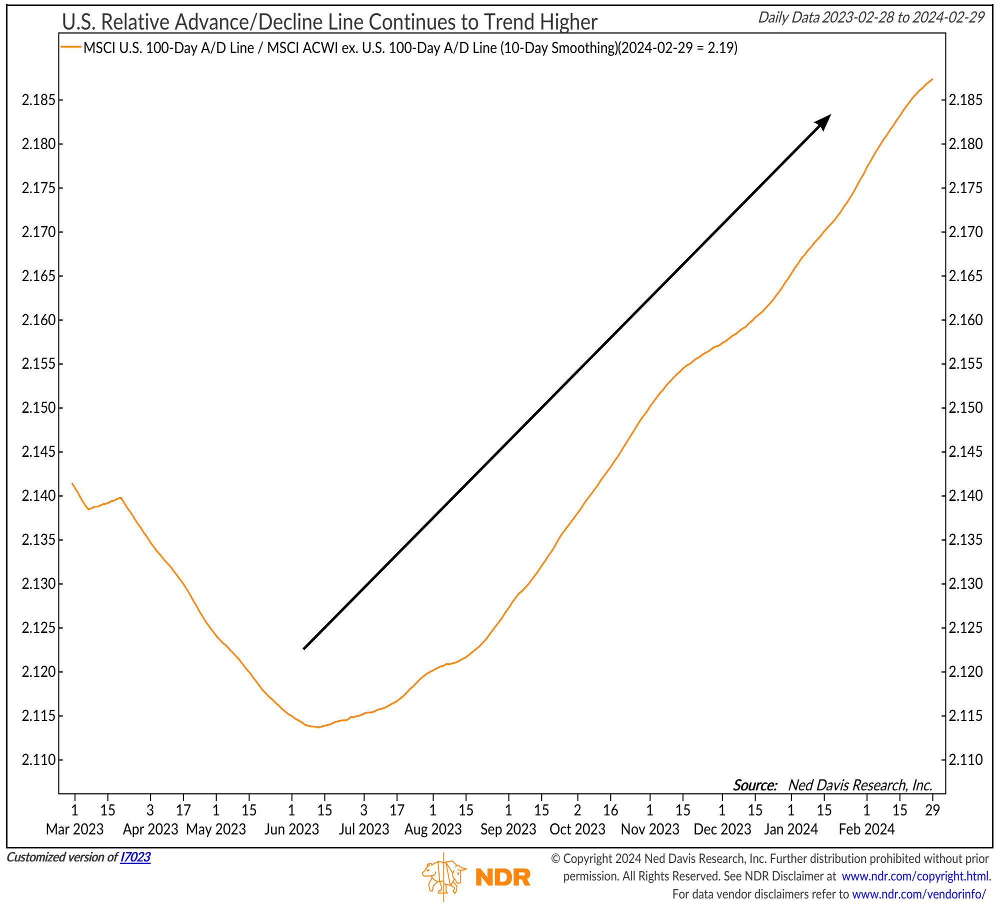
Equity Region Selection Summary

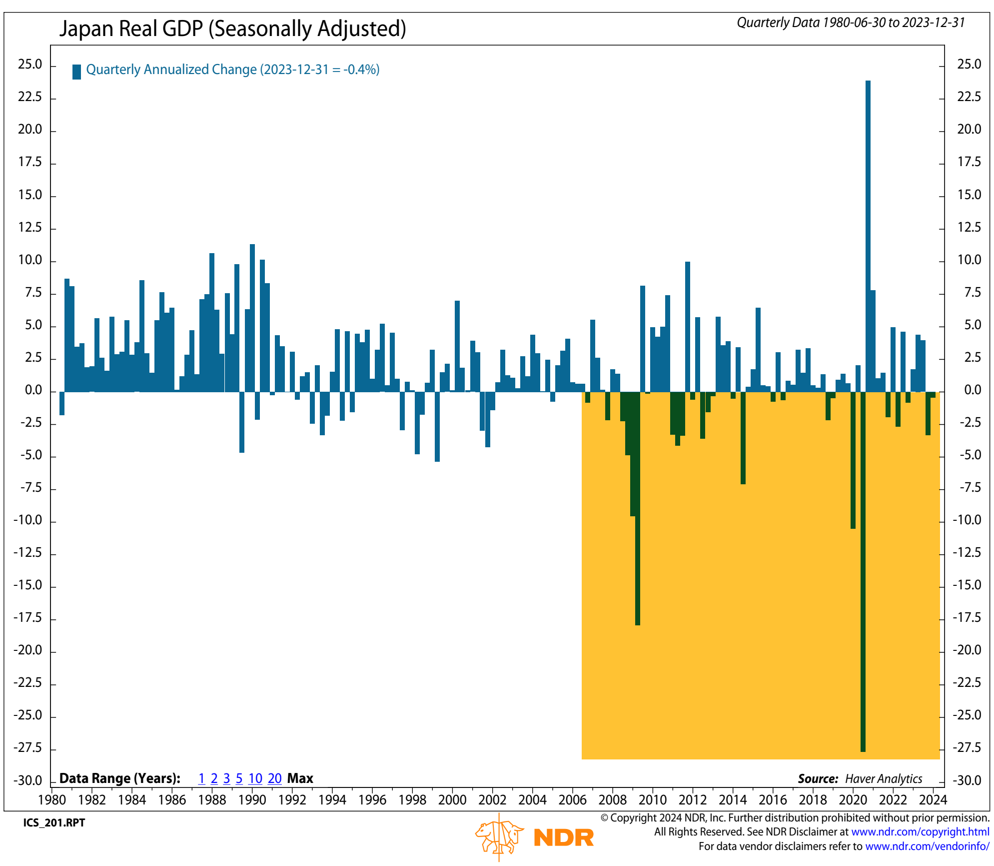


Arrow indicates direction in which region's weight (as a percentage of benchmark allocation) moved from last month (up = weight increased, down = weight decreased).

The U.S. market possesses the only overweight allocation this month. Breadth (chart right) and momentum remain positive as all external indicators are bullish on the market. Market sentiment is reversing from extreme pessimism, relative asset levels are growing, the U.S. Dollar is improving, the economic outlook is strengthening, and business credit conditions remain favorable.

Low unemployment, real wage growth, and positive stock market and housing wealth effects continue to drive consumer spending growth. Both households and businesses have termed out their debt, leaving them less vulnerable to high interest rates. The risk of recession remains low (for now).





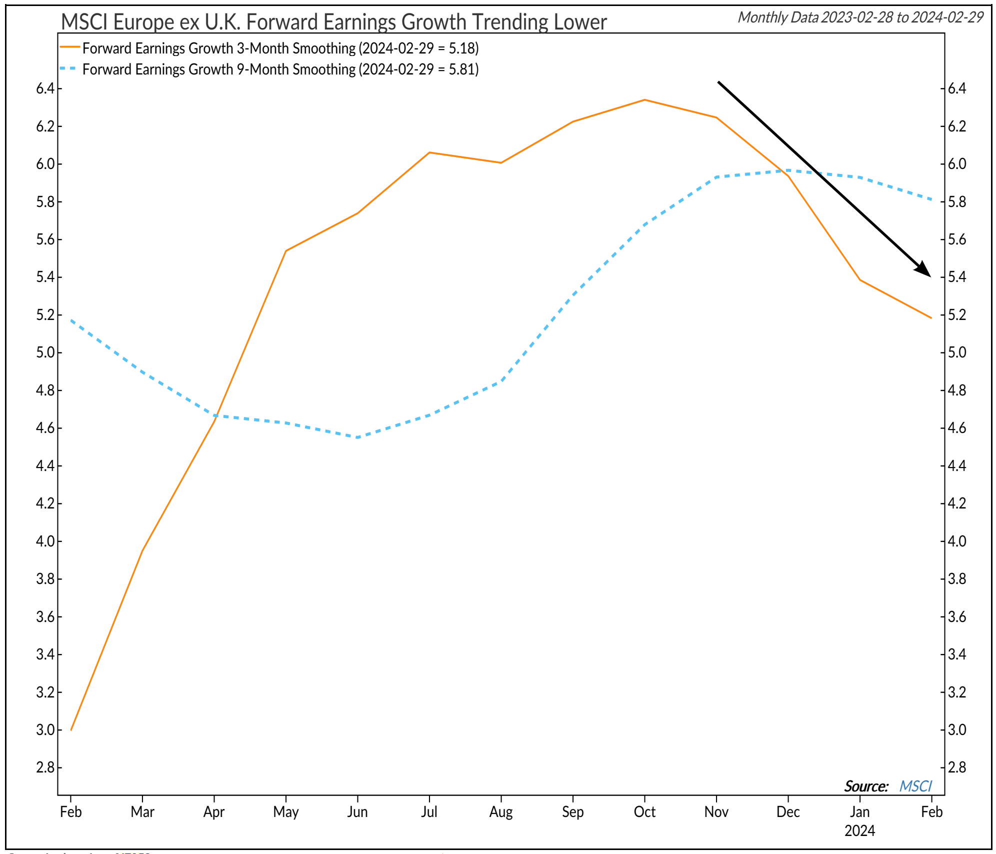
Japan's allocation improved, but it remains slightly below benchmark weighting. Almost all technical indicators favor the market. However, most external indicators (including relative valuations and inflation swaps) are negative on the region.

Japan's real GDP contracted an annualized 0.4% in Q4, following a 1.1% decline in Q3, which puts the economy into recession. However, Japan's economy contracts quite often. In fact, in 17 of the past 18 years Japan's economy has contracted at least one quarter per year (chart left). Japanese equities haven't always responded negatively to recession, with historically very mixed performance around economic downturns.

Europe ex. U.K. remains underweight this month due to technical, macro, and fundamental weakness. The outlook has deteriorated as inflation remains elevated and the European Central Bank's (ECB) most aggressive tightening cycle on record works its way into the economy.

Forward earnings expectations reflect the challenging environment as they remain in a downtrend (chart right). Last quarter, less than 60% of companies beat earnings estimates. Most internal indicators are bearish.

The U.K. remains significantly underweight for March. Economic trends are still lackluster, as NDR's U.K. Economic Timing is declining (chart left). High interest rates, inflation eating into consumer purchasing power, ebbing labor market trends, and the structural downside associated with Brexit continue to serve as a drag on the economy. The fundamental outlook is also unfavorable. Less than 55% of companies had positive one-year forward earnings revisions during February.



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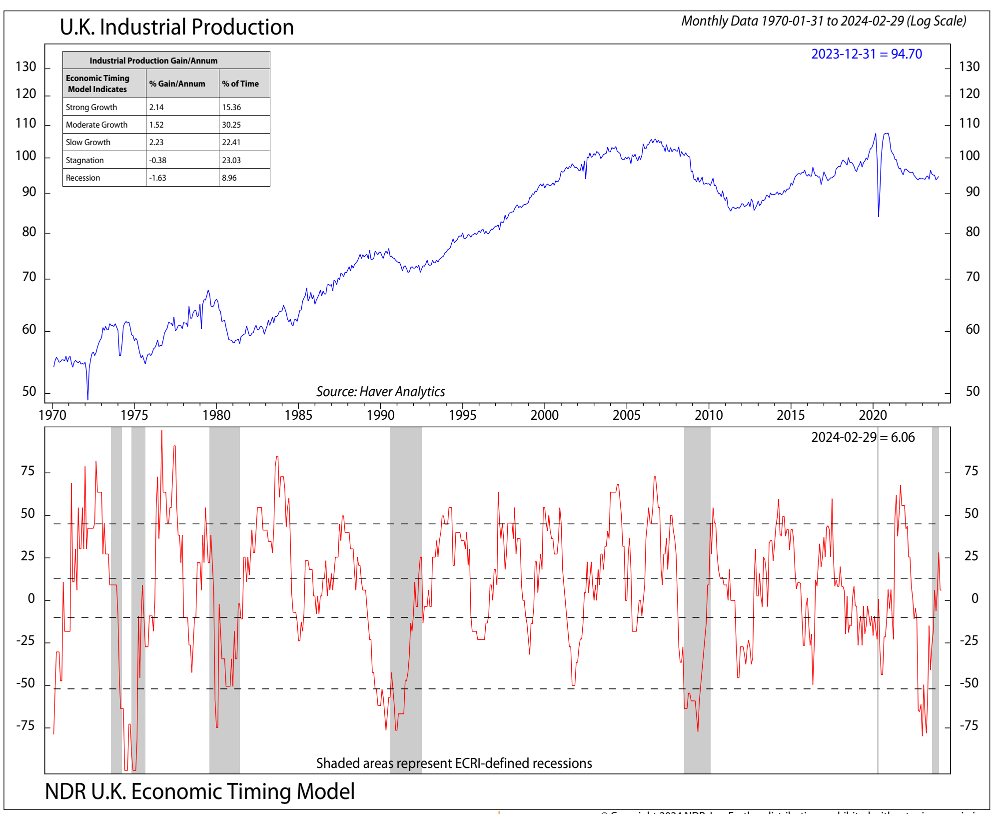

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The market recognizes these risks as equites remain in a downtrend with weak breadth. None of the region's technical indicators are bullish.

Summary

The global asset allocation framework maintained an overweight equity exposure this month. Within the global equity decision, the U.S. received above benchmark allocation, while Japan, Pacific ex. Japan, Emerging Markets, Canada, Europe ex. U.K., and the U.K. are underweight. The global allocation framework uses objective, asset class and region-specific indicators to determine opportunities and identify risks.

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