

OCTOBER 2023

Macro/Market Update

The global economy saw momentum ease for a third straight month in August, according to the S&P Global Purchasing Managers' Index (PMI) data. The global composite (services and manufacturing) PMI fell for a third straight month to its weakest reading since January. Despite the moderating expansion, there isn't sufficient evidence to suggest that the global economy is entering a severe recession, which historically has been associated with the worst equity bear markets.

However, the risk of sustained moderate global slowdown is a real possibility amid diverging trends among the world's economies. Europe, which was a major source of rising momentum

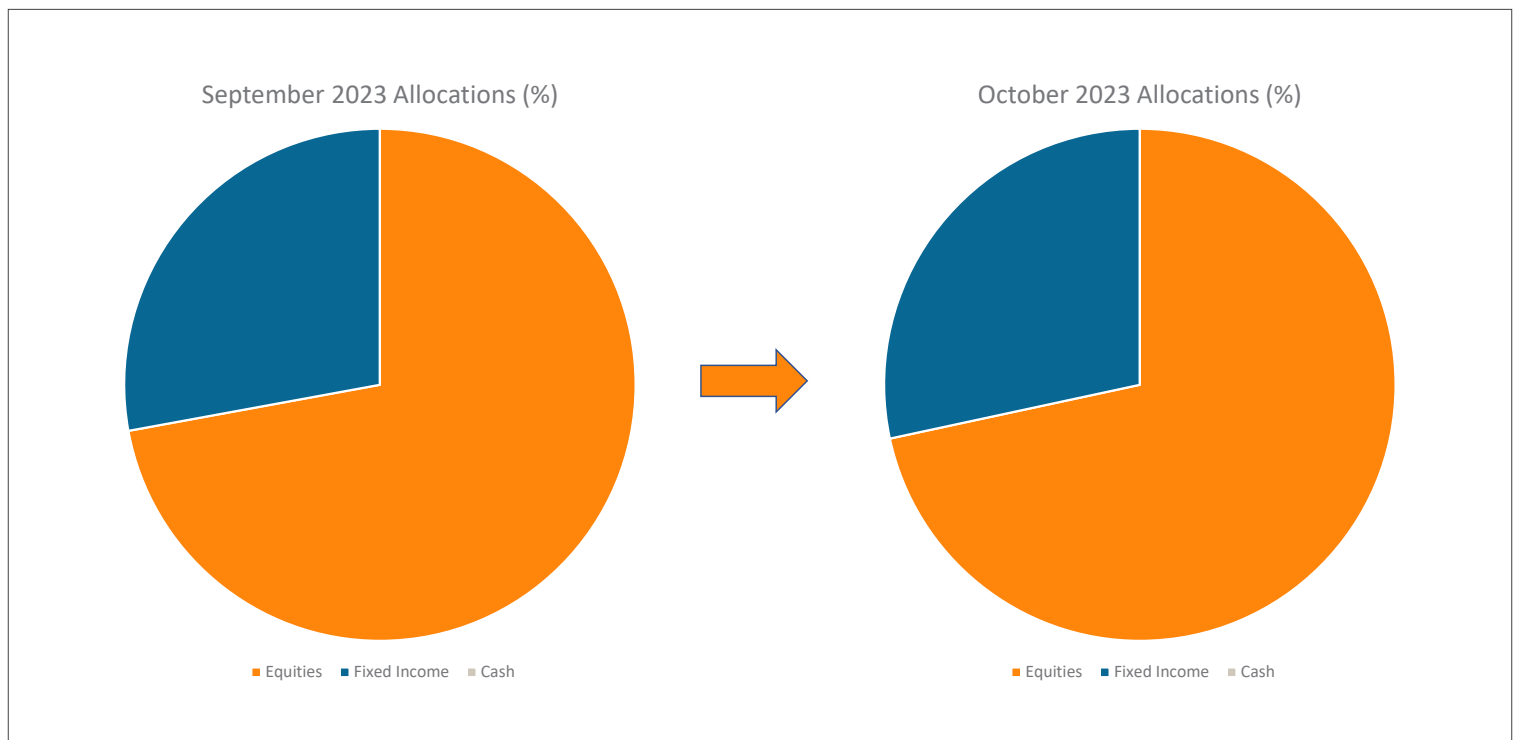
in the first half of the year, has seen activity ease markedly in recent months, and is even flirting with the prospect of recession. Trends in China and the U.S. remain positive, but not as much as the first half of the year, while Japan and several large emerging markets, such as India, continue to report robust activity.

Services growth has slowed significantly since peaking in May, while the manufacturing sector, which has been in the doldrums for a year, appears to be stabilizing. Although it was the 12th straight month of contraction, it was the first time in six months that manufacturing activity shrank at a slower pace, indicating some stabilization in the sector. Both output and new orders contracted at their slowest pace in three

months, while employment grew at its fastest pace in six months. The global bullwhip, which assesses the balance of new orders relative to inventories, moved up to its best level since March, with a rising share of economies contributing to the improvement.

During September, the MSCI All Country World Index (ACWI) underperformed the Bloomberg Barclays Global Aggregate Bond Index by over 115 basis points (bps). It was the first time since the beginning of 2022, where global stocks underperformed bonds by more than 100 bps for two consecutive months. Also, it was only the third month this year where global bonds outpaced stocks. Still, global stocks have outpaced bonds for eight of the last twelve months.

Asset Allocation Summary

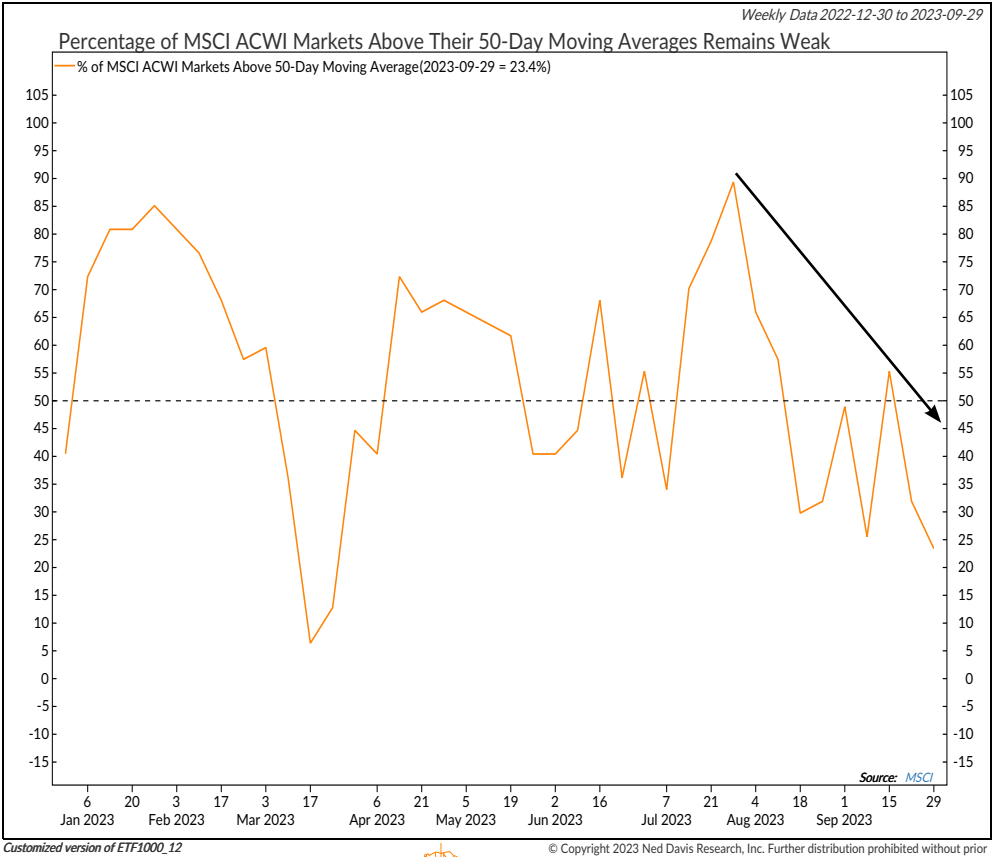
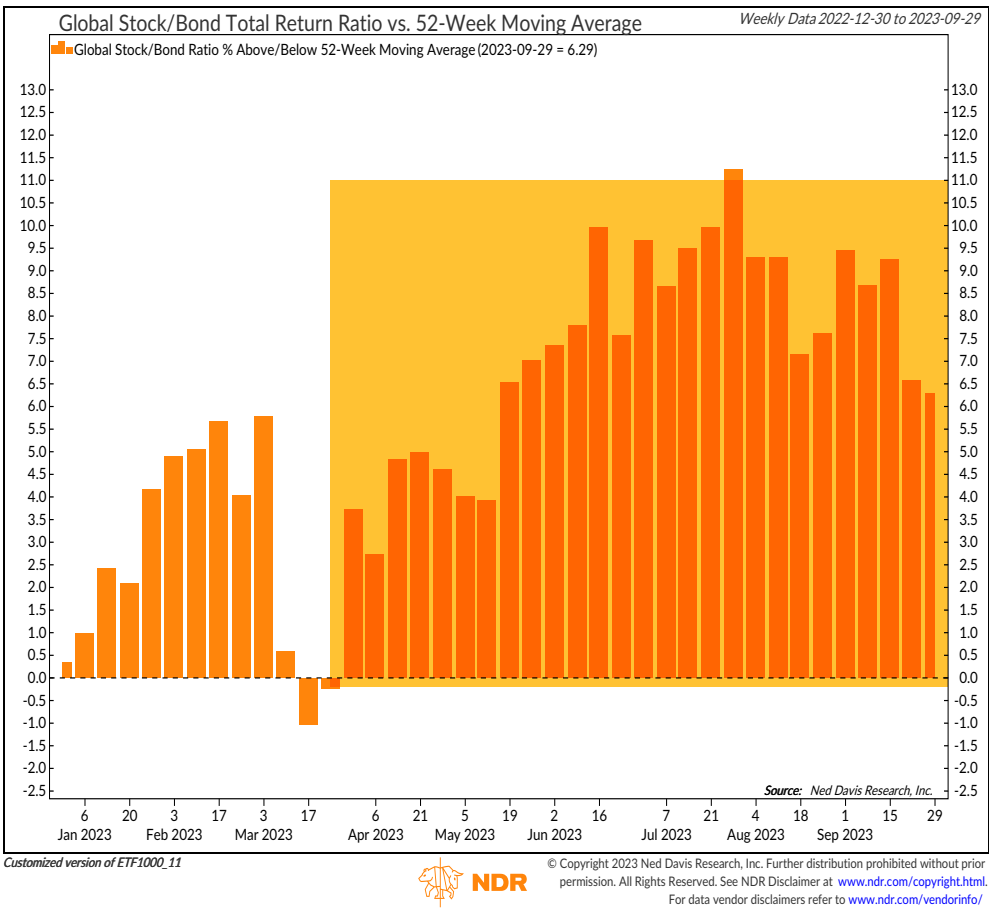


* See Equity Allocation Summary for how the equity allocation is distributed

** See Fixed Income Allocation Summary for how the fixed income allocation is distributed

The equity allocation remained above benchmark weighting, as the model did not trade this month. The model uses a turnover reduction mechanism, which reduces trading. The proposed allocations did not deviate enough from the existing weightings to warrant a model rebalance. The model has not changed positioning since the end of June. Such a stretch of low trading activity last occurred in 2021.

The stock/bond relative strength indicator, which receives the greatest weighting in the model, compares the stock/bond ratio to its 52-week moving average. The stock/bond ratio is more than 6.2% above its one-year moving average. The spread between the relative strength ratio and its trend has been positive since the end of March (chart right). The trend continues to be equity's friend relative to fixed income.

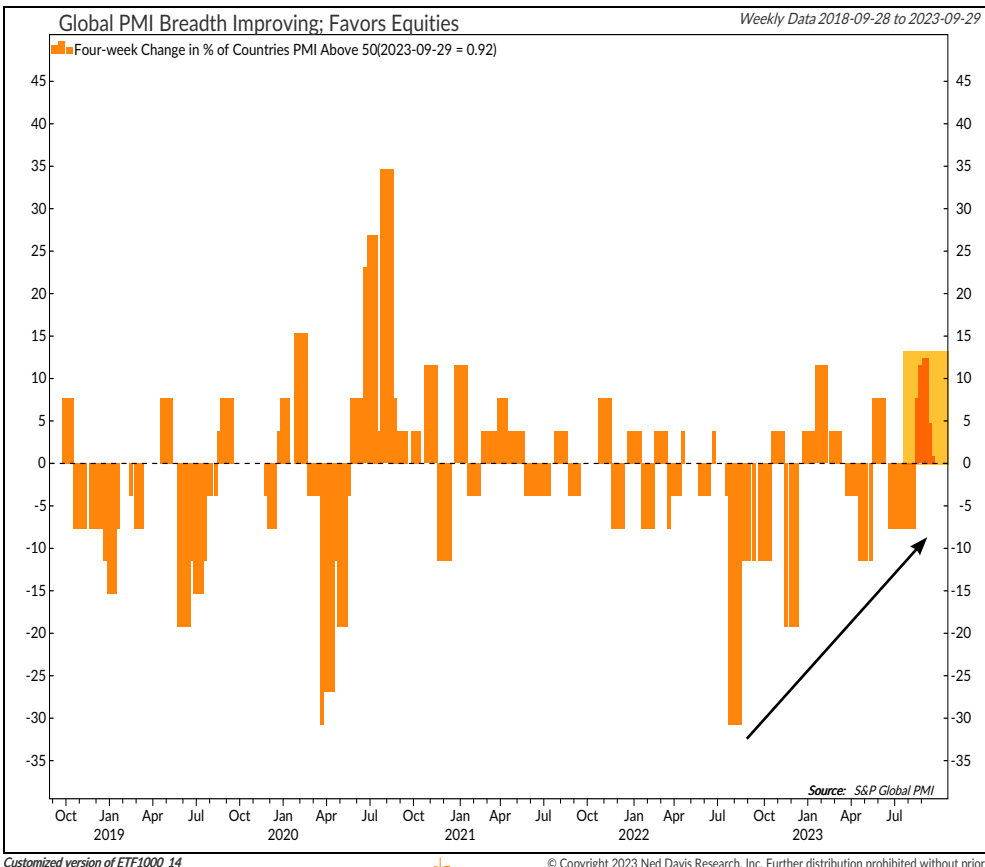


The percentage of global equity markets trading above their 50-day moving averages has experienced significant volatility in 2023. After jumping to almost 90% at the end of July, its highest level since November, the percentage of markets above their intermediate trends declined to less than 24% in September (chart left).

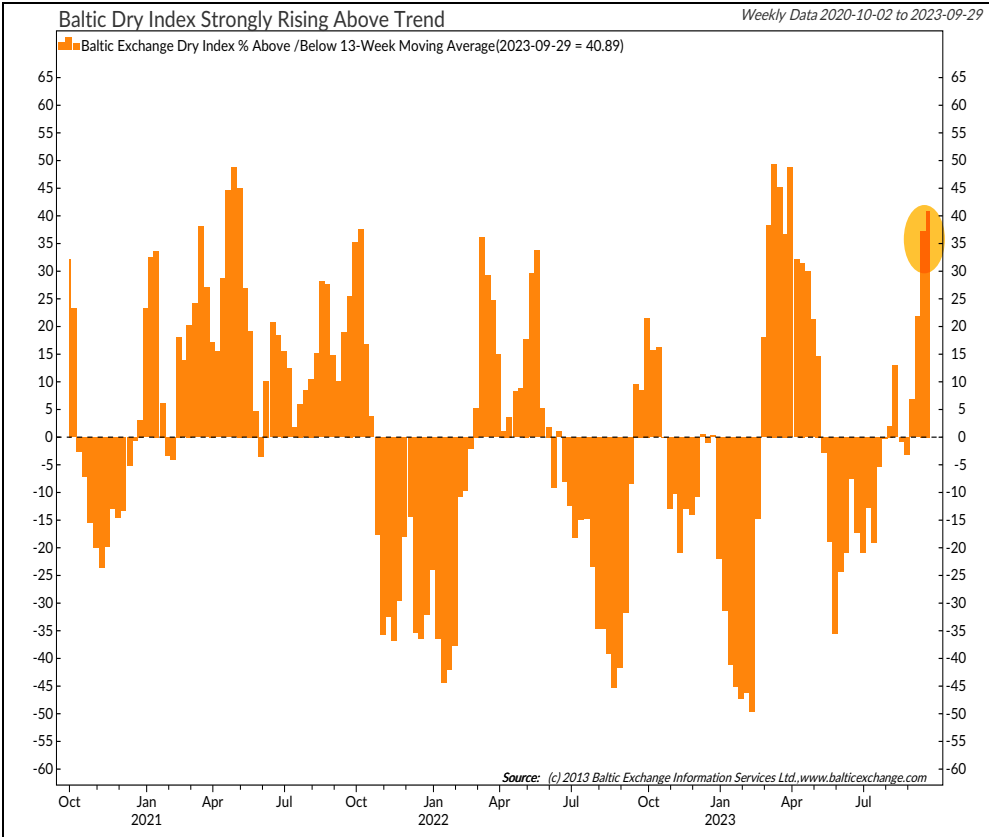
This indicator describes the underlying health of global equities, since it tracks the number of markets participating on the upside. Elevated breadth is important because if many stocks rally, even if a few run into trouble, enough stocks remain in uptrends that they can support the popular averages. Although declining upside participation is a risk, this could be a short-term move for this indicator due to the market pullback in what is still an uptrend.

Two macroeconomic measures turned bullish on stocks. The Purchasing Managers' Index (PMI) breadth indicator measures the four-week point change of the percentage of economies with a PMI greater than 50 (expanding activity). The PMI is based on a survey sent to executives regarding their outlook on areas such as inventories, production, and employment. A change greater than zero favors stocks, while a change less than zero supports bonds.

Equities typically outperform fixed income when there is widening improvement in the economic outlook. This economic momentum breadth indicator (chart right) improved to its highest level since the 2020 economic reopening as Brazil, China, and Ireland rose above 50.



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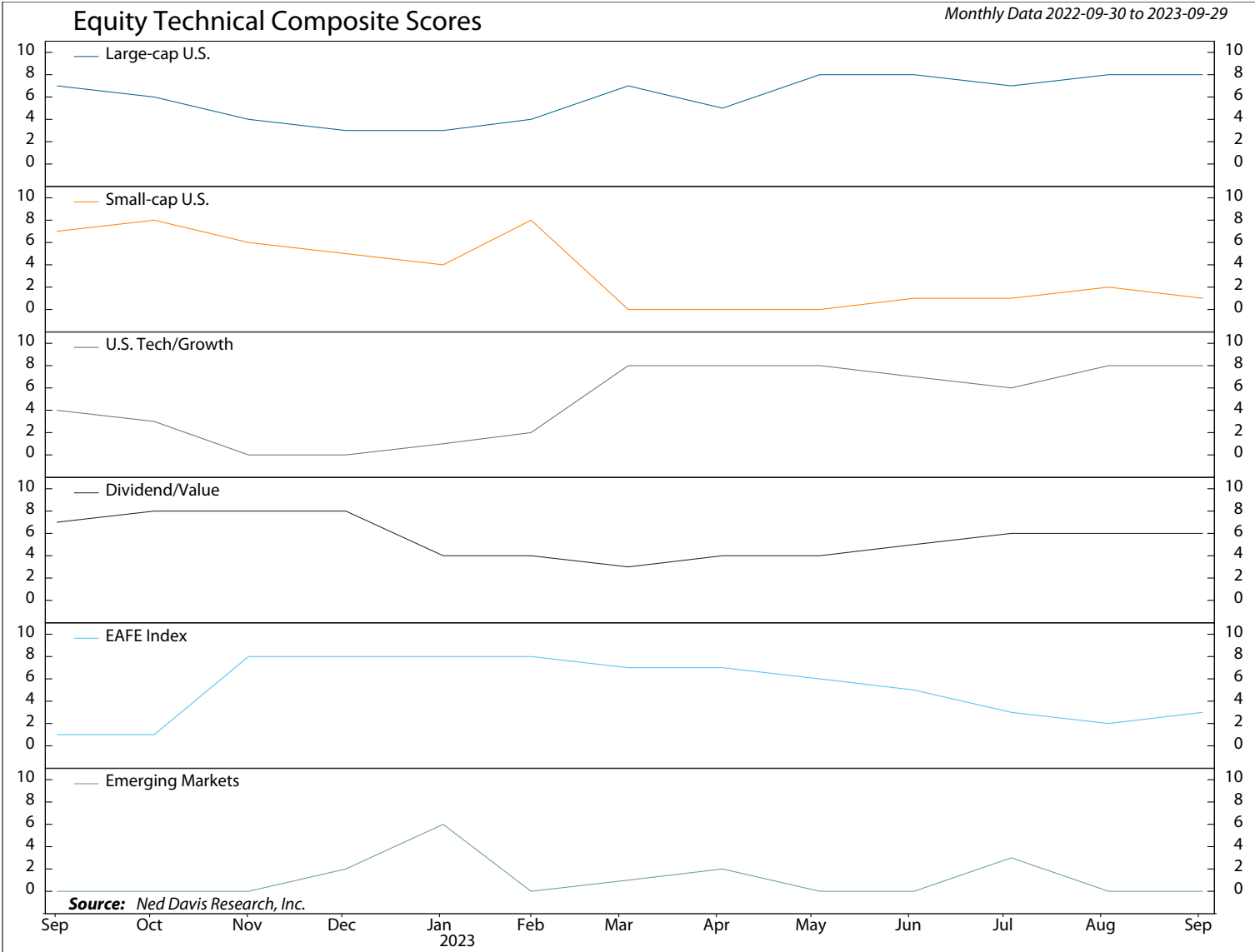
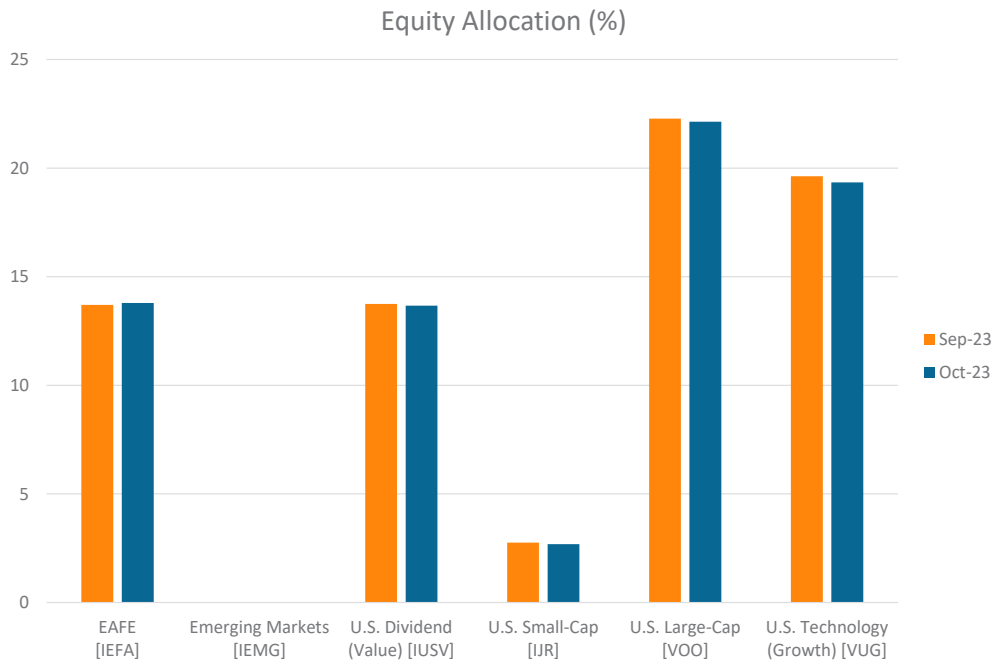
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The Baltic Dry Index (BDI) indicator turned bullish on stocks as it crossed above its 13-week moving average. The BDI is a proxy for the cost to transport items such as grain, metal, and energy materials. Rising trends in the BDI can signal improving economic activity, since growing levels may indicate greater demand for raw materials.

Global shipping rates' deviation from trend resided more than 49% below its 13-week moving average during February. Now, the BDI is more than 40% above its intermediate trend (chart left). This indicator has improved over recent weeks to a level that typically favors stocks over bonds.

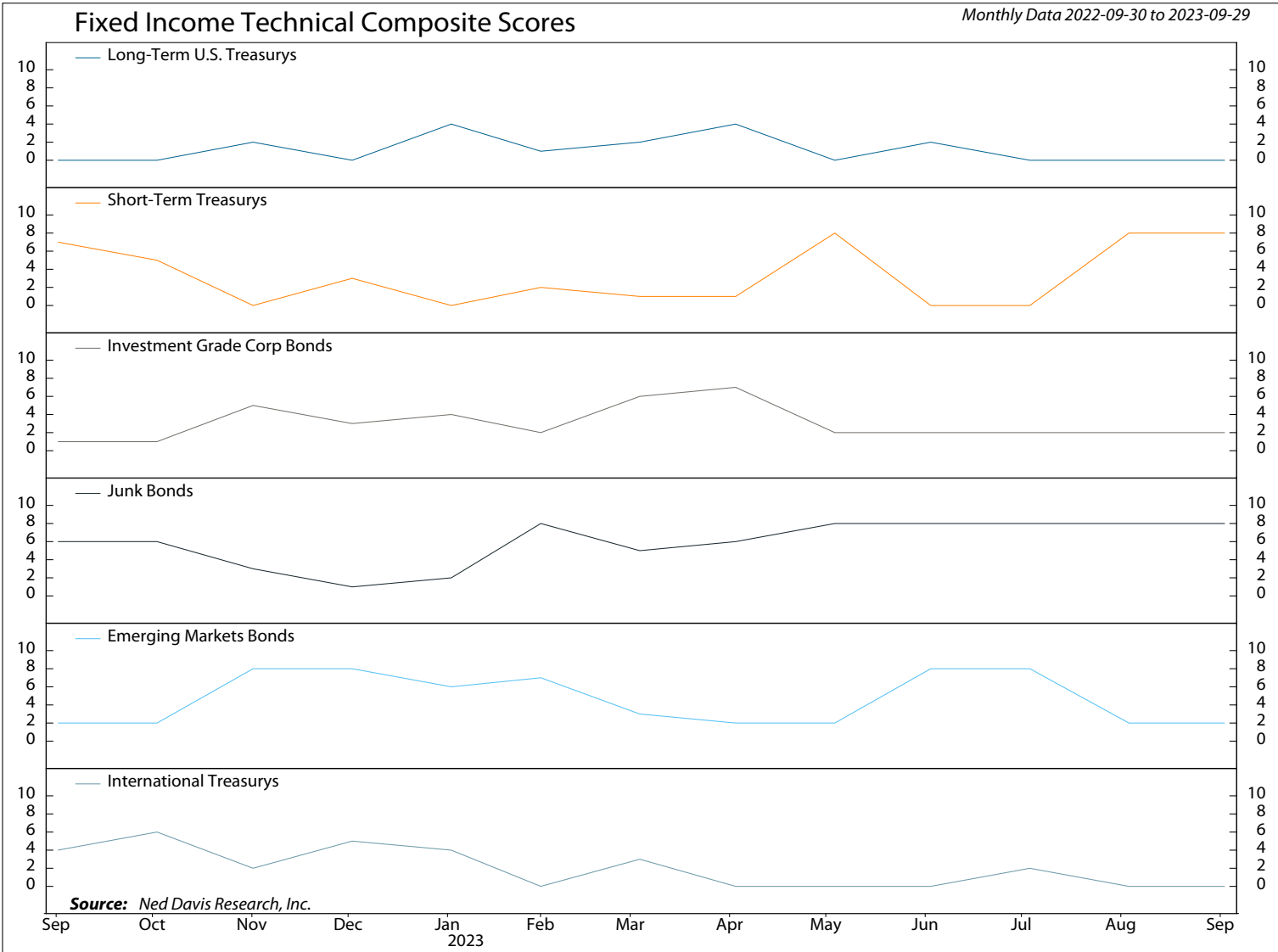
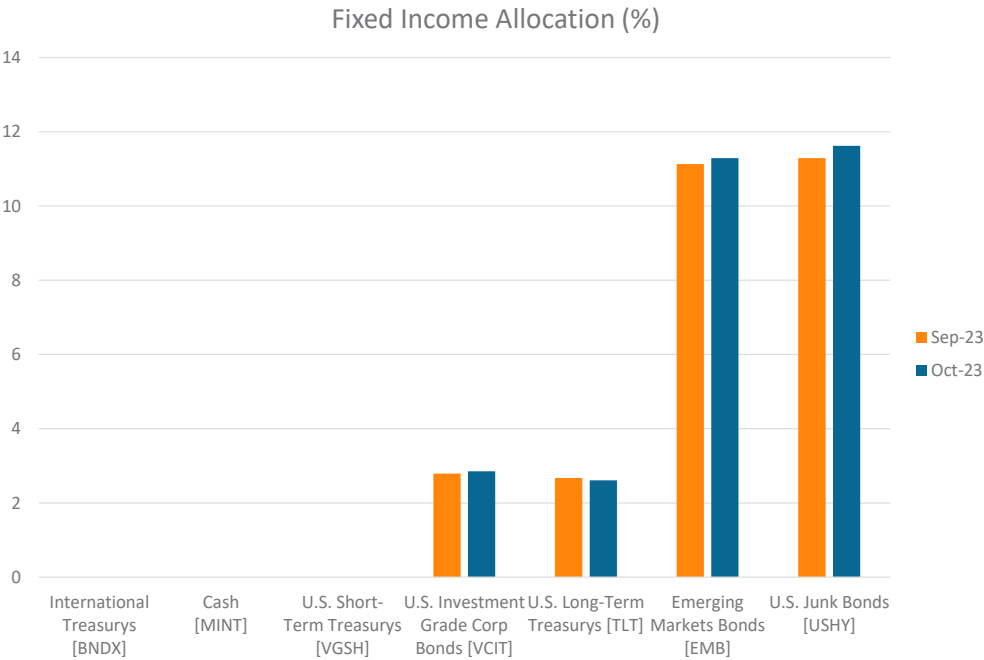
Equity Allocation Summary

During September, all six equity areas declined more than 299 basis points (bps). It was the second consecutive month where all equity areas declined, which last occurred in August and September of 2022. The U.S. suffered the largest declines, as large-caps, small-caps, Growth, and Value all dropped more than 450 bps. However, VUG and VOO each received more than 15% allocation for October (chart right).



Fixed Income Allocation Summary

All six fixed income areas declined last month. Only short-term Treasurys (VGSH) fell by less than 100 bps. Emerging Market (EM) bonds and U.S. Long-Term Treasurys suffered their largest monthly declines since September 2022. EM fell over 330 bps, while long-term Treasurys plummeted more than 790 bps. TLT has declined more than 250 bps during nine of the last 14 months! EMB and USHY both have over 10% allocation for October (chart right).



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Fixed Income Market Update

The Bloomberg Barclays U.S. Aggregate Bond Total Return Index was down for the fifth month in a row, dropping 2.5% in September. Breadth remained weak—seven of the nine fixed income sectors we track had negative returns in September—significant weakness in U.S. Treasuries again dragged down the Aggregate.

Sticky inflation, rising oil prices, and tight labor markets have been pushing yields higher all summer. Economic growth is likely to slow in Q4 and in 2024 (due to student loan repayments, strikes, etc.), labor markets should cool and get back into balance, and impacts from credit tightening should be increasingly felt.

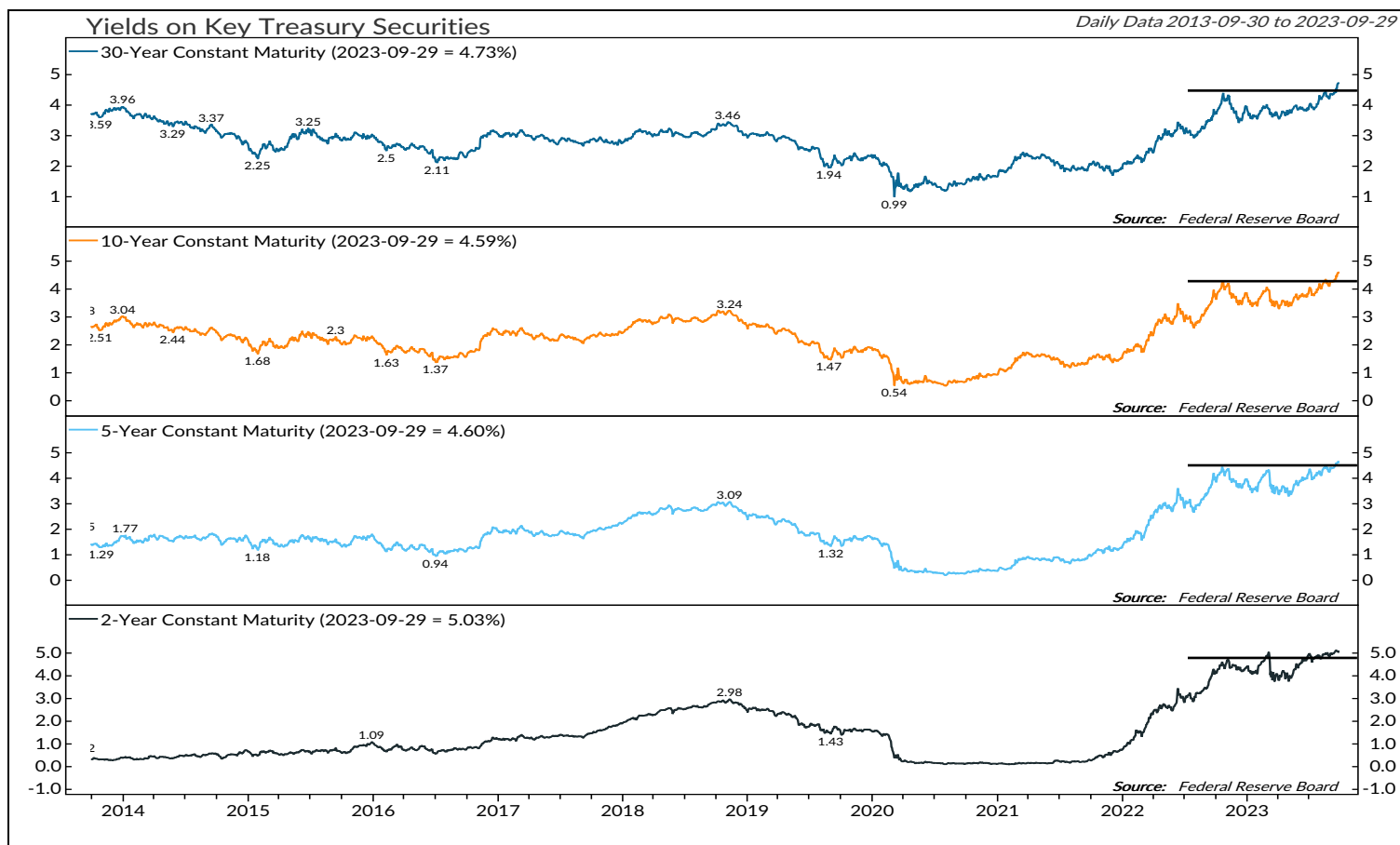
In September, the Fed surprised the markets by reaffirming its projection for another rate hike this year, and indicating two fewer rate cuts next year, even though inflation was revised lower for 2023. The Fed successfully communicated a “restrictive for longer” policy stance.

The Fed’s policy projections had two important implications. One, is the pricing in of higher rates in the front due to a higher terminal rate than the market had been expecting.

Two, is a steeper yield curve, since yields will be higher next year than previously thought. As a result, yields broke

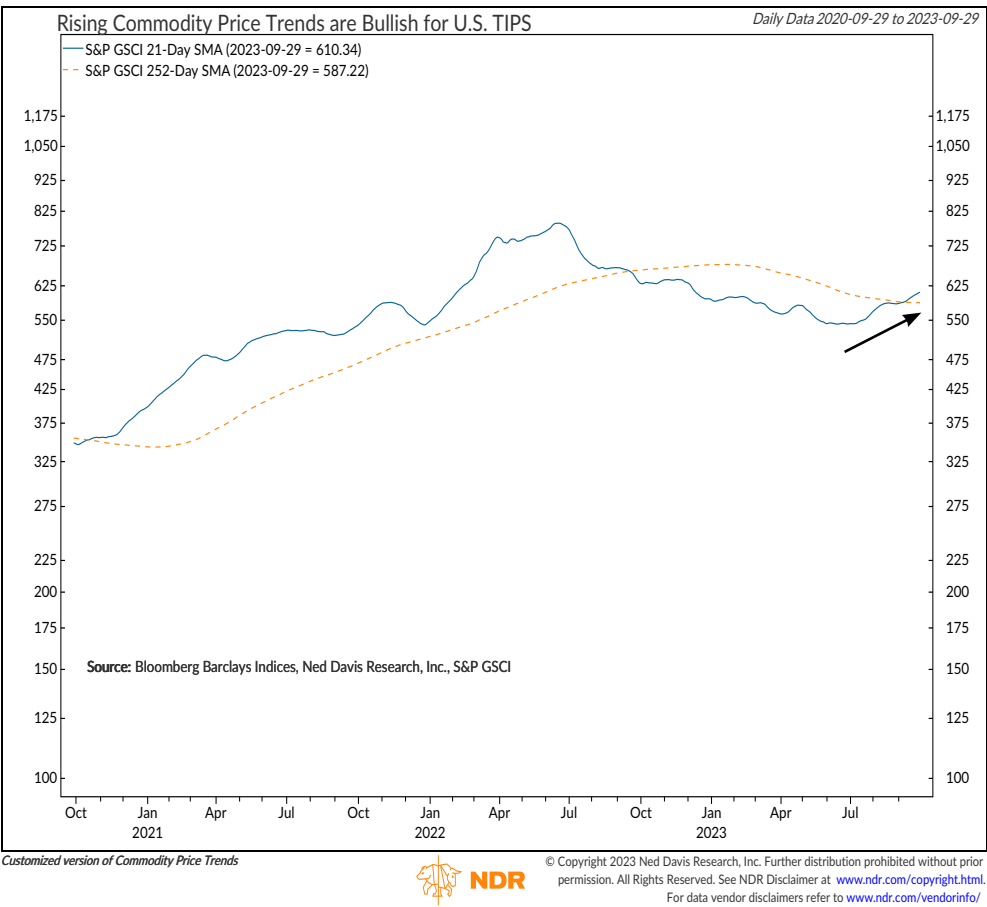
out across the curve and around the world (chart below), while yield curves steepened.

As a result, entering October, the fixed income allocation strategy rebalanced and favored mixed leadership. The model is overweight U.S. Floating Rate Notes, International Investment Grade, and U.S. Treasury Inflation-Protected Securities. U.S. High Yield and Emerging Market bonds were downgraded to marketweight. The model is underweight U.S. Investment Grade Corporate, U.S. Long-Term Treasuries, and U.S. Mortgage-Backed Securities.



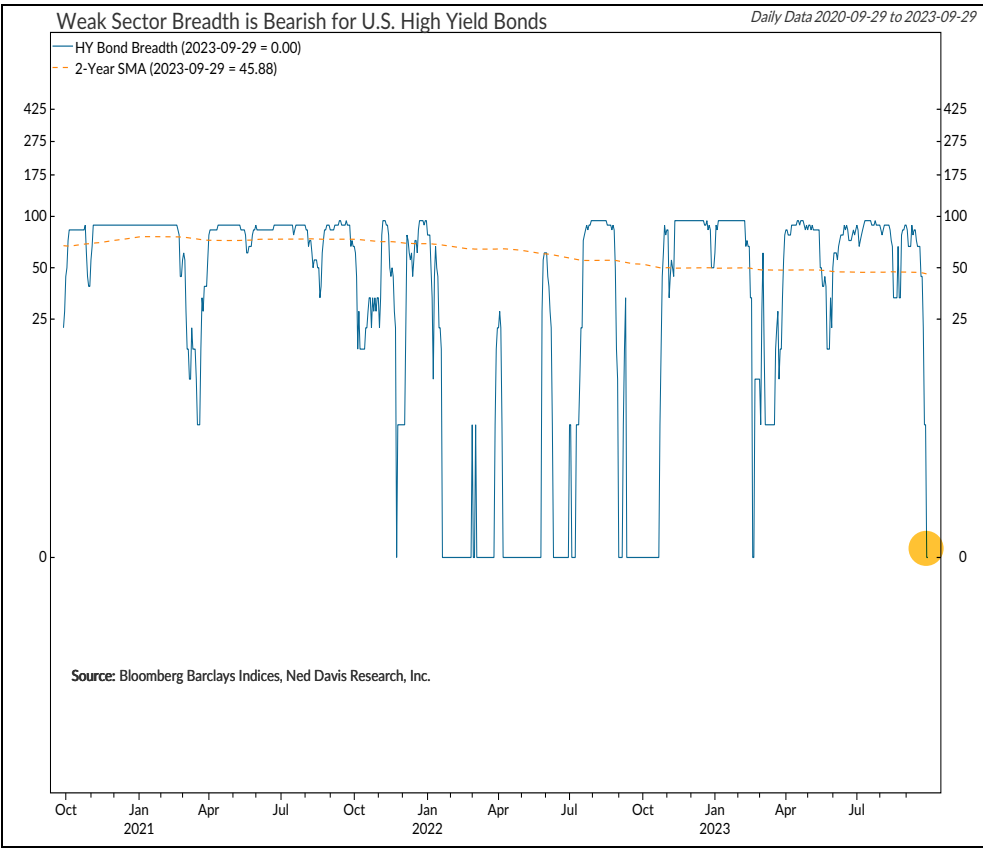
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U.S. Treasury Inflation-Protected Securities' (TIPS) allocation rose over 600 basis points in September, upgrading it from a significant underweight position to a modest overweight. Similar to U.S. Floating Rate Notes (which increased its overweight allocation by over 500 basis points), TIPS typically outperform when inflation is high (which then leads to higher interest rates). While inflation is down from its peak, there are still areas that are sticky. Commodity prices—led by energy—are rising and has provided a tailwind for the sector (chart right). This positive development was confirmed by two relative strength measures flashing bullish signals during the month.



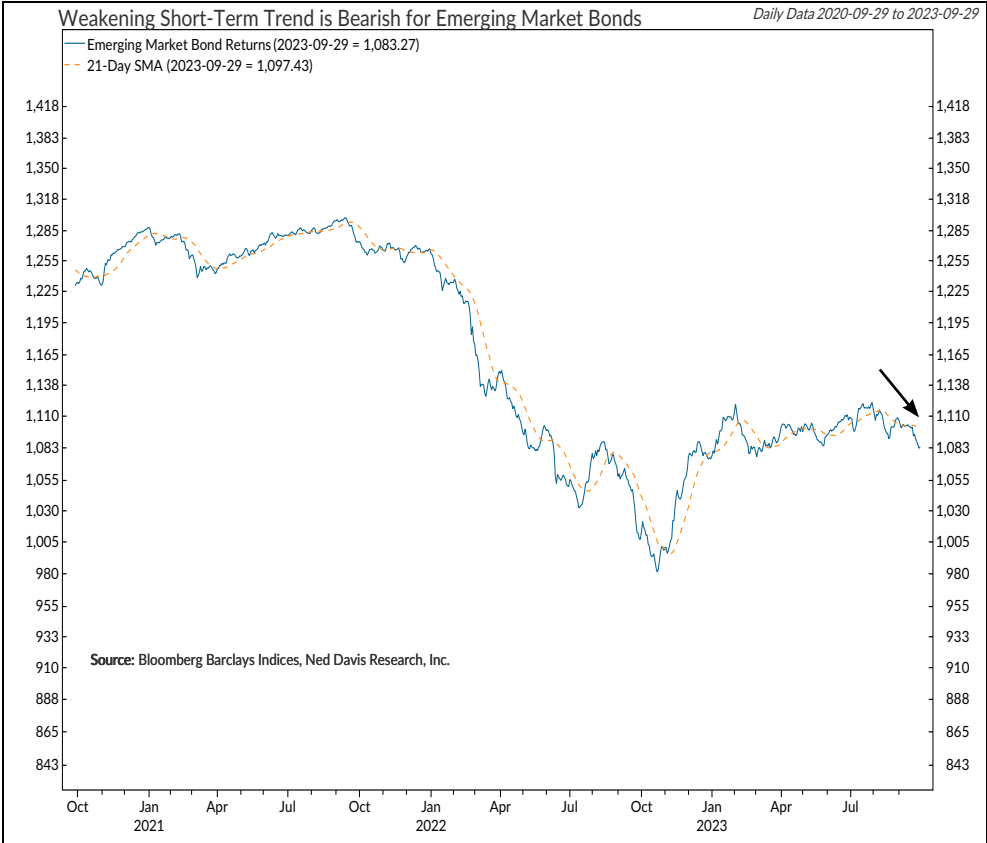
International Investment Grade bonds' allocation was up over 350 basis points in September, upgrading it to overweight. While global option-adjusted spreads and U.S. swaps remain neutral, equity volatility is bullish. This was confirmed by two bullish price-based measures including rising relative strength trends (chart left).

U.S. High Yield bonds' allocation dropped over 600 basis points in September, downgrading it from the largest overweight position to market-weight. Four of six indicators are now bearish, with two flipping negative during the month—absolute trend and breadth (chart right).



Customized version of High Yield Bond Sectors Breadth

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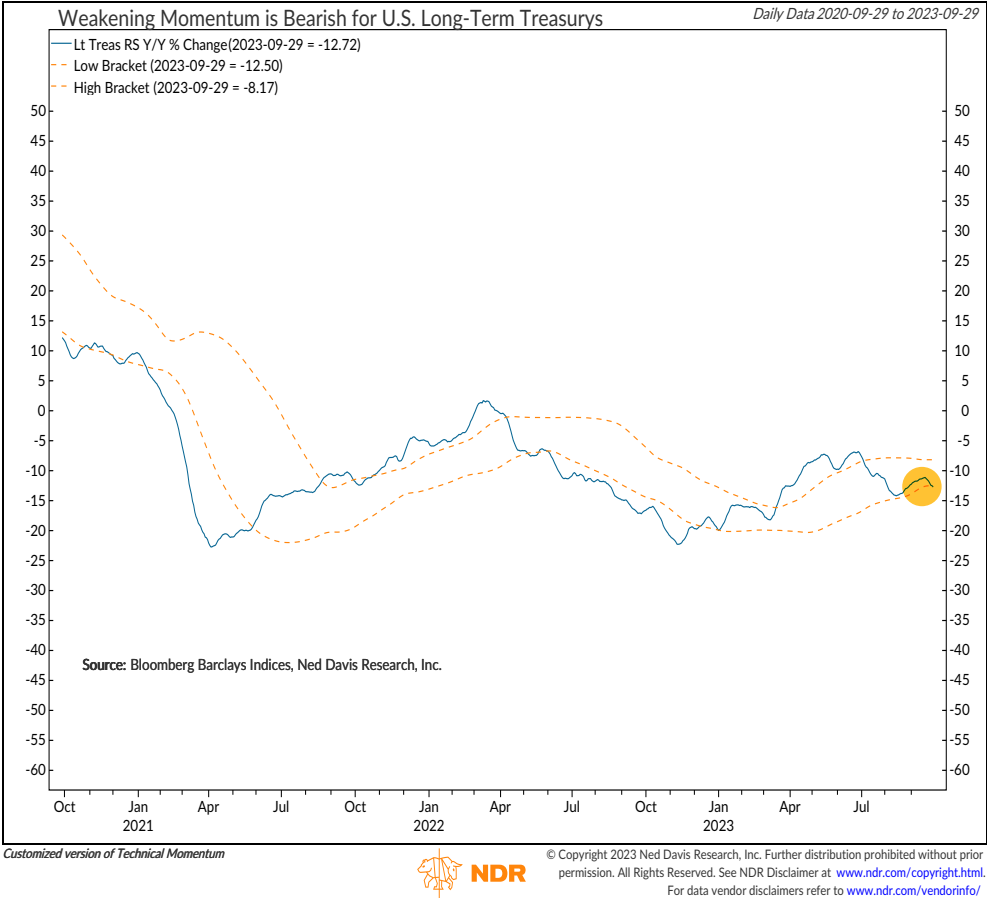
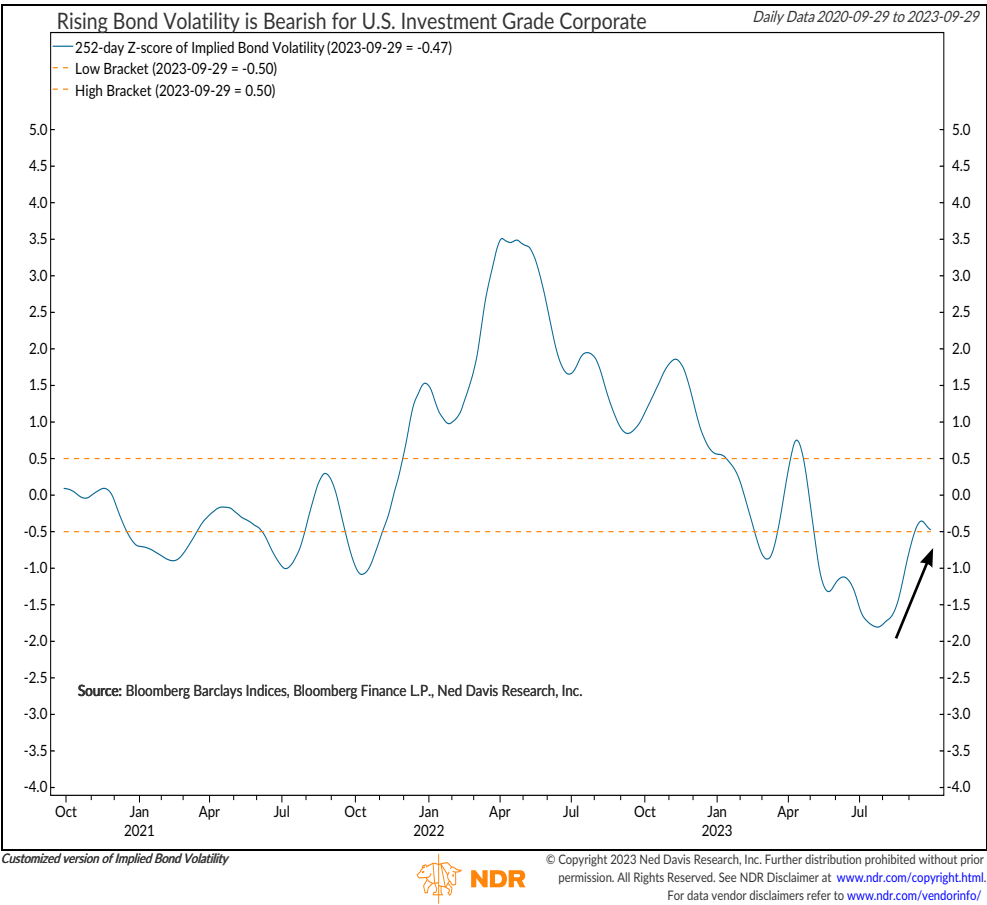


Customized version of Absolute MA Cross

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Emerging Market (EM) bonds' allocation dropped over 450 basis points in September, downgrading it from a significant overweight position to marketweight. On a fundamental basis, while rising commodity prices is bullish for Emerging Market bonds, weakness in emerging market equity momentum and currencies have been an offset. Technicals are mixed—relative strength remains bullish, but absolute trend moved to a bearish level for the sector during the month (chart left).

U.S. Investment Grade Corporate bonds' allocation dropped over 800 basis points in September, downgrading the sector from overweight to the largest underweight position. Four of the six indicators are now bearish. While the U.S. dollar index and a mean reversion measure remained bullish for the sector, spreads, credit default swaps, and a trend indicator are bearish offsets. Additionally, implied bond volatility rose to a bearish level for the sector during the month (chart right).



U.S. Long-Term Treasuries' allocation increased in September, but the sector remains underweight. While inflation expectations appear contained and have remained bullish for the sector since the Jackson Hole meeting, a few indicators changed during the month. The U.S. equity market trend, U.S. swaps, and sector momentum all flashed bearish signals during the month (chart left).

Summary

Entering October, the fixed income allocation strategy favors mixed leadership. The model is overweight U.S. Floating Rate Notes, International Investment Grade, and U.S. Treasury Inflation-Protected Securities. U.S. High Yield and Emerging Market bonds were downgraded to marketweight. The model is underweight U.S. Investment Grade Corporate, U.S. Long-Term Treasuries, and U.S. Mortgage-Backed Securities.

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OCTOBER 2023

Global Market Update

The ACWI ex. U.S. Total Return Index declined by over 310 basis points (bps) in September.

The index dropped more than 300 bps for two consecutive months for the first time since last August and September. Among the strongest performing markets were Egypt, United Arab Emirates, Turkey, Norway, and Philippines, while the largest underperformers included Poland, Ireland, Greece, Thailand, and Peru.

The global economy saw momentum ease for a third straight month in August, according to the S&P Global Purchasing Managers' Index (PMI) data. The global composite (services and manufacturing) PMI fell for a third straight month to its weakest reading since January. Despite the moderating expansion, there isn't sufficient evidence to suggest that the global economy is

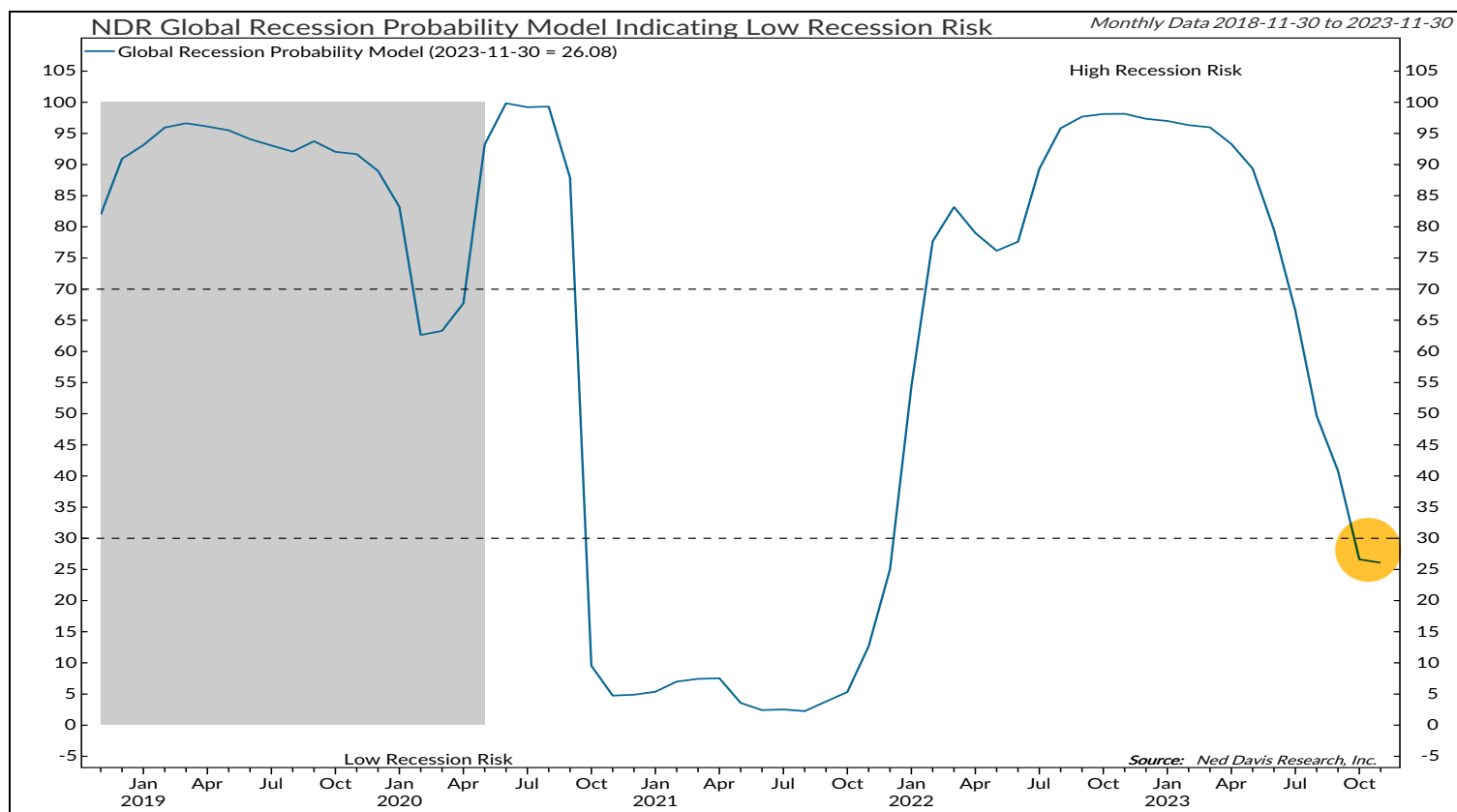
entering a severe recession (chart bottom), which historically has been associated with the worst equity bear markets.

However, the risk of sustained moderate global slowdown is a real possibility amid diverging trends among the world's economies. Europe, which was a major source of rising momentum in the first half of the year, has seen activity ease markedly in recent months, and is even flirting with the prospect of recession. Trends in China and the U.S. remain positive, but not as much as the first half of the year, while Japan and several large emerging markets, such as India, continue to report robust activity.

Services growth has slowed significantly since peaking in May, while the manufacturing sector, which has been in the doldrums for a year,

appears to be stabilizing. Although it was the 12th straight month of contraction, it was the first time in six months that manufacturing activity shrank at a slower pace, indicating some stabilization in the sector. Both output and new orders contracted at their slowest pace in three months, while employment grew at its fastest pace in six months. The global bullwhip, which assesses the balance of new orders relative to inventories, moved up to its best level since March, with a rising share of economies contributing to the improvement.

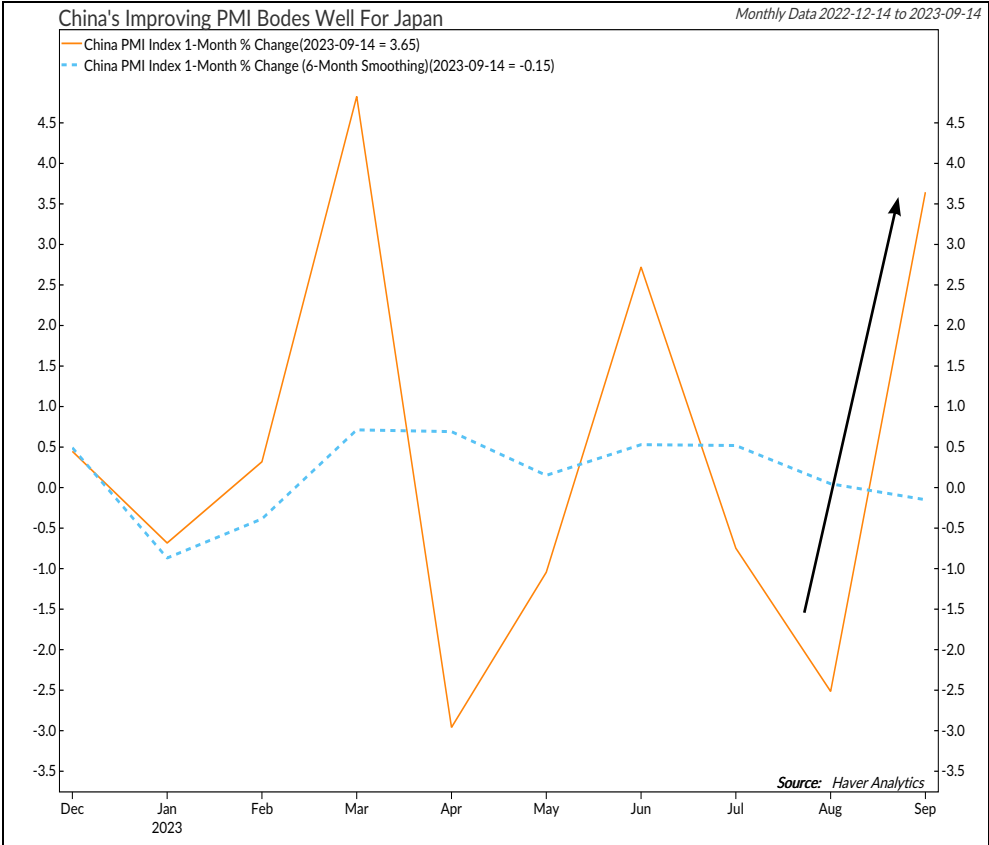
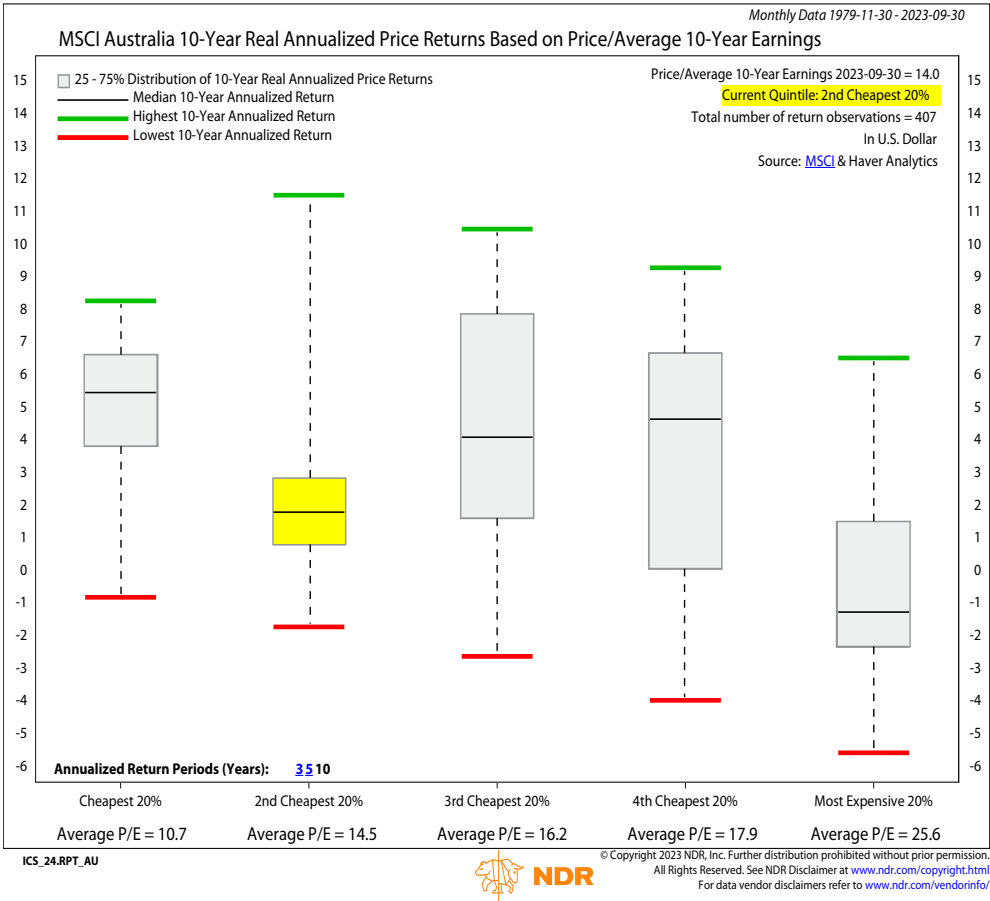
Entering October, the non-U.S. equity Core model overweighted Australia, Switzerland, Japan, and Canada, while underweighting the U.K., France, and Germany. The Explore model favored Brazil, India, Italy, Peru, and Poland.



Customized version of IE90

Core Allocations

Australia remains overweight for October. On a local currency basis, the MSCI Australia Index is less than 10% from its all-time high. The Reserve Bank of Australia recently kept its core interest rate steady, as it noted that its forecast is for “CPI inflation to continue to decline and to be back within the 2–3 percent target range in late 2025.” The market’s cyclically adjusted P/E ratio is giving a favorable reward-to-risk ratio (chart right) and relative valuations remain attractive.



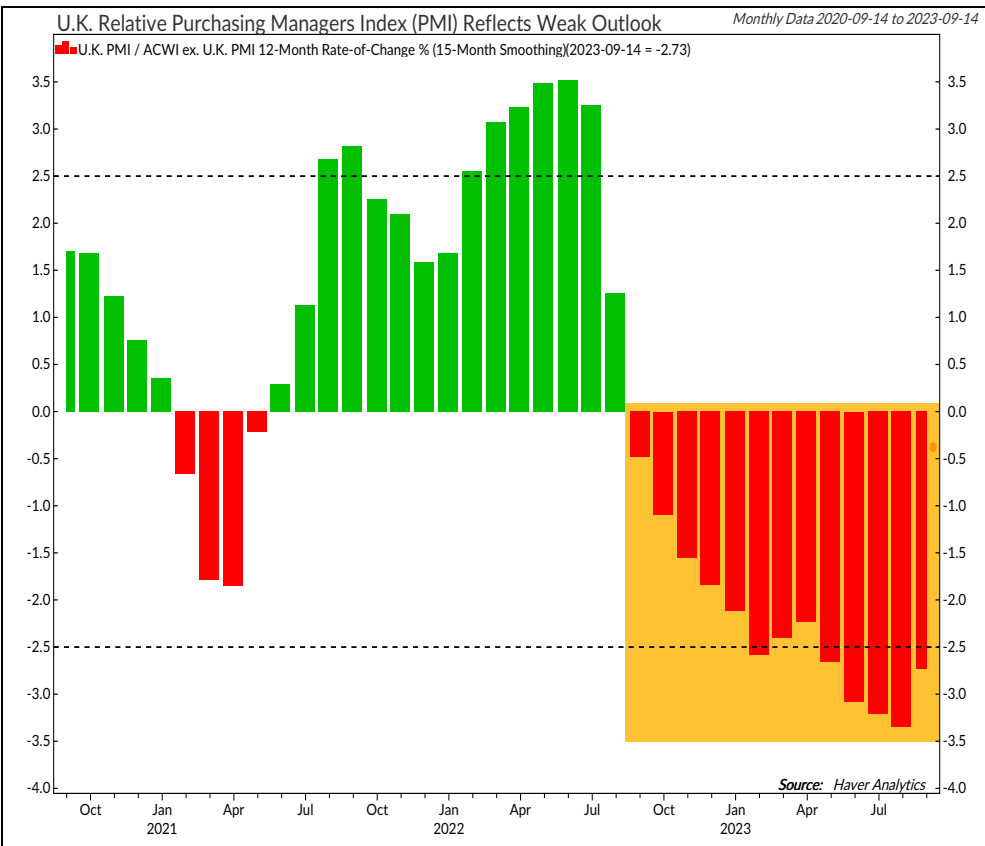
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Japan possesses the largest overweight allocation for October. Although external measures reflect headwinds, there are some areas showing an improving environment. Business confidence improved as the Tankan survey beat expectations. China PMI, which tends to be a leading indicator of Japan’s economy, rose this past month (chart left). Inflation swaps are confirming an optimistic economic outlook. The technical indicators reflect an improving outlook as trend and price momentum metrics are bullish.

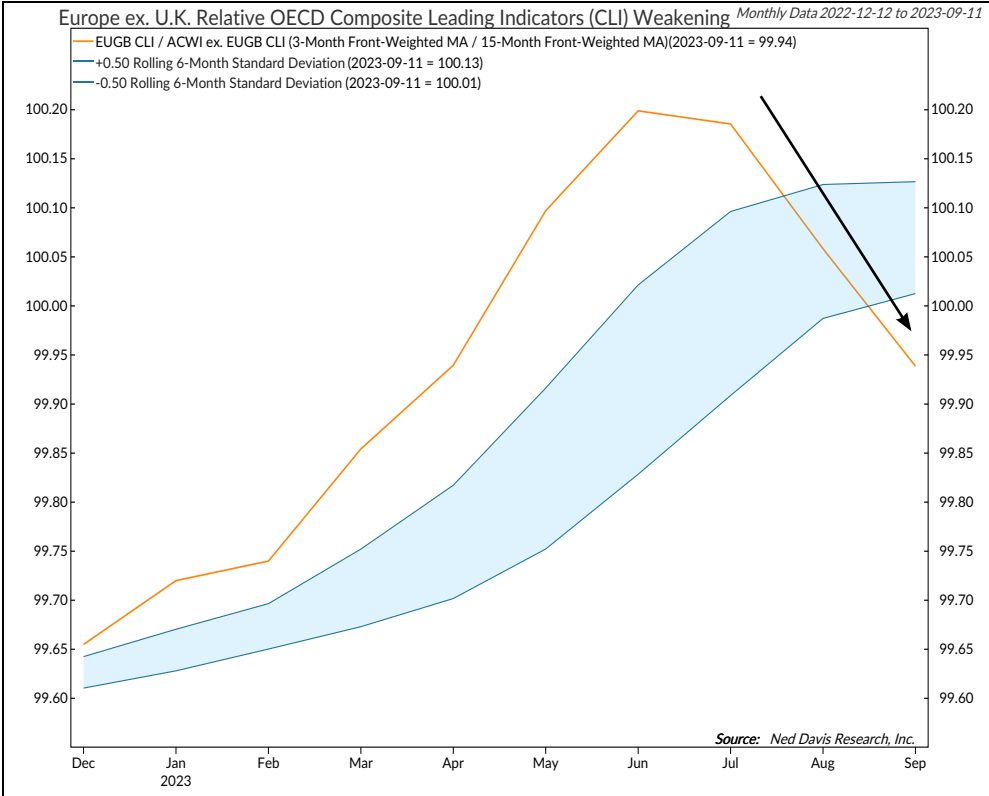
The U.K. remained below benchmark allocation. Only one of its indicators is bullish. Price-based indicators have deteriorated, which coincides with weaker economic data. Most aggregate measures of the economy point to stagnation, or even modest contraction, in the near-term. On a relative basis, leading economic indicators and economic sentiment (chart right) are both negative on the economy. Expensive relative valuations and an unattractive equity risk premium both indicate that the market still has downside risks.



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France maintained its underweight position. The continuation of high inflation and tighter monetary policy has taken its toll on the European economy. Economic conditions in Europe have gone from bad to worse. The eurozone composite PMI fell to 46.7 in August, the deepest contraction in nearly three years. The services sector contracted for the first time this year, while manufacturing continues to shrink markedly. The weak technical indicators confirm the headwinds depicted by the macro (chart left), valuation, and sentiment measures.

Explore Opportunities

Among the top ranked Explore markets are Brazil, India, Italy, Poland, and Peru:

- All have favorable price trends as their 50-day moving averages trade above their 200-day counterparts.
- Within the last 21 days, Peru and Poland are more than one standard deviation oversold, which historically has provided a near-term bounce opportunity.
- Brazil, India, Italy, Poland, and Peru have low market capitalization-to-GDP ratios,

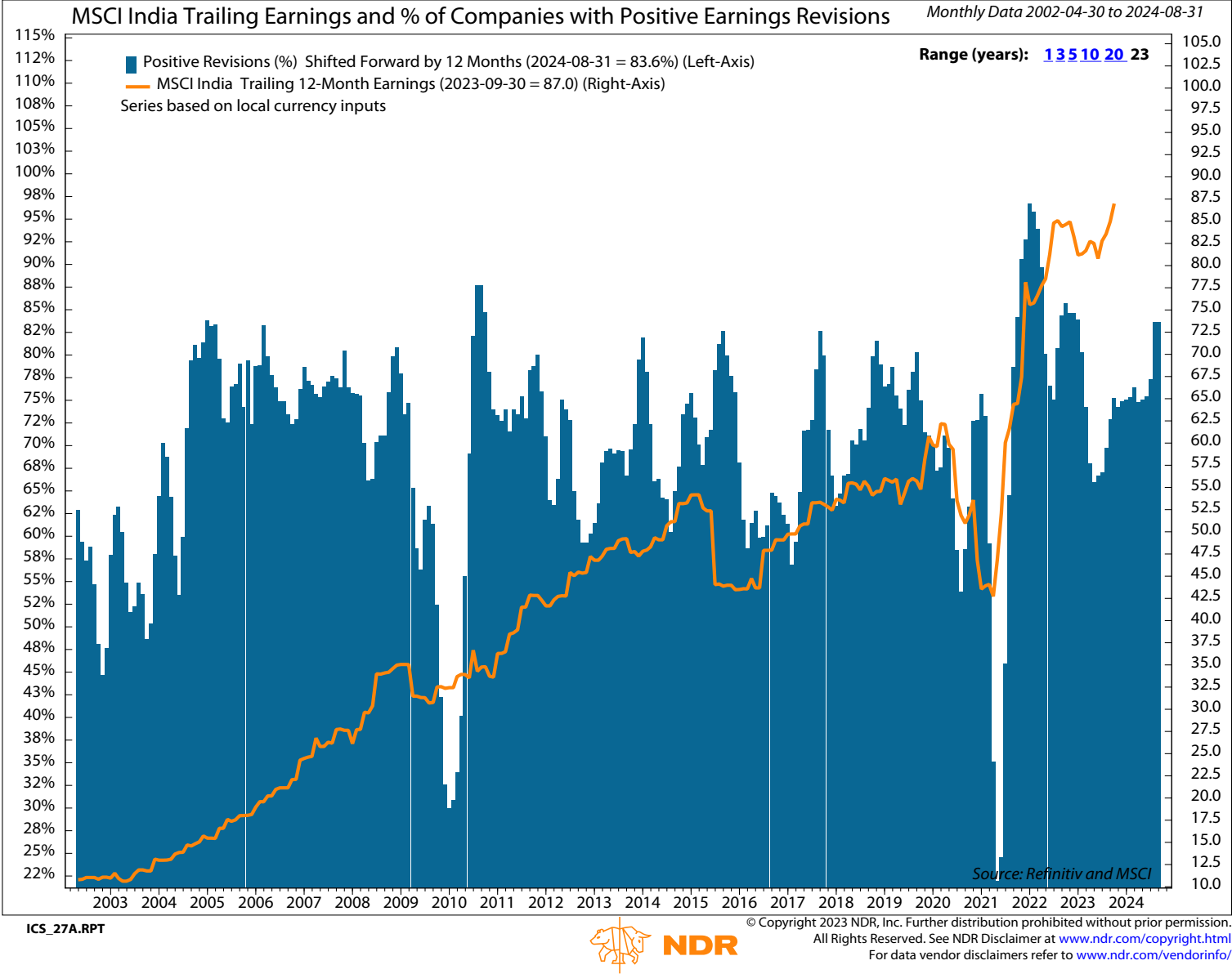
which typically indicates a favorable valuation.

- Brazil's and India's composite PMIs resides in the expansionary zone.
- Brazil is one of the few economies with a Composite Leading Indicator in expansionary territory.
- India has a double-digit one-year forward earnings growth estimate (chart bottom).
- Italy and India have over 80% of stocks with positive earnings revisions from analysts.

Summary

Entering October, the non-U.S. equity Core model overweighted Australia, Switzerland, Japan, and Canada, while underweighting the U.K., France, and Germany. The Explore model favored Brazil, India, Italy, Peru, and Poland.

The models combine macro, fundamental, technical, and sentiment indicators to determine opportunities and identify risks in an objective, weight-of-the-evidence approach.



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U.S. Market Update

For the second month in a row, the S&P 500 declined in September, dropping 4.8%. Breadth remained weak—10 of the 11 S&P 500 sectors posted negative returns for the month—Energy was the only sector with positive gains (chart below). Sectors inversely correlated to a rising 10-year yield—Real Estate, Tech, Consumer Discretionary, Utilities—underperformed the most.

The S&P 500 Index has fallen below previous support at the August 2022 highs. On the one hand, the pullback is coming during a seasonally weak time of the year, suggesting

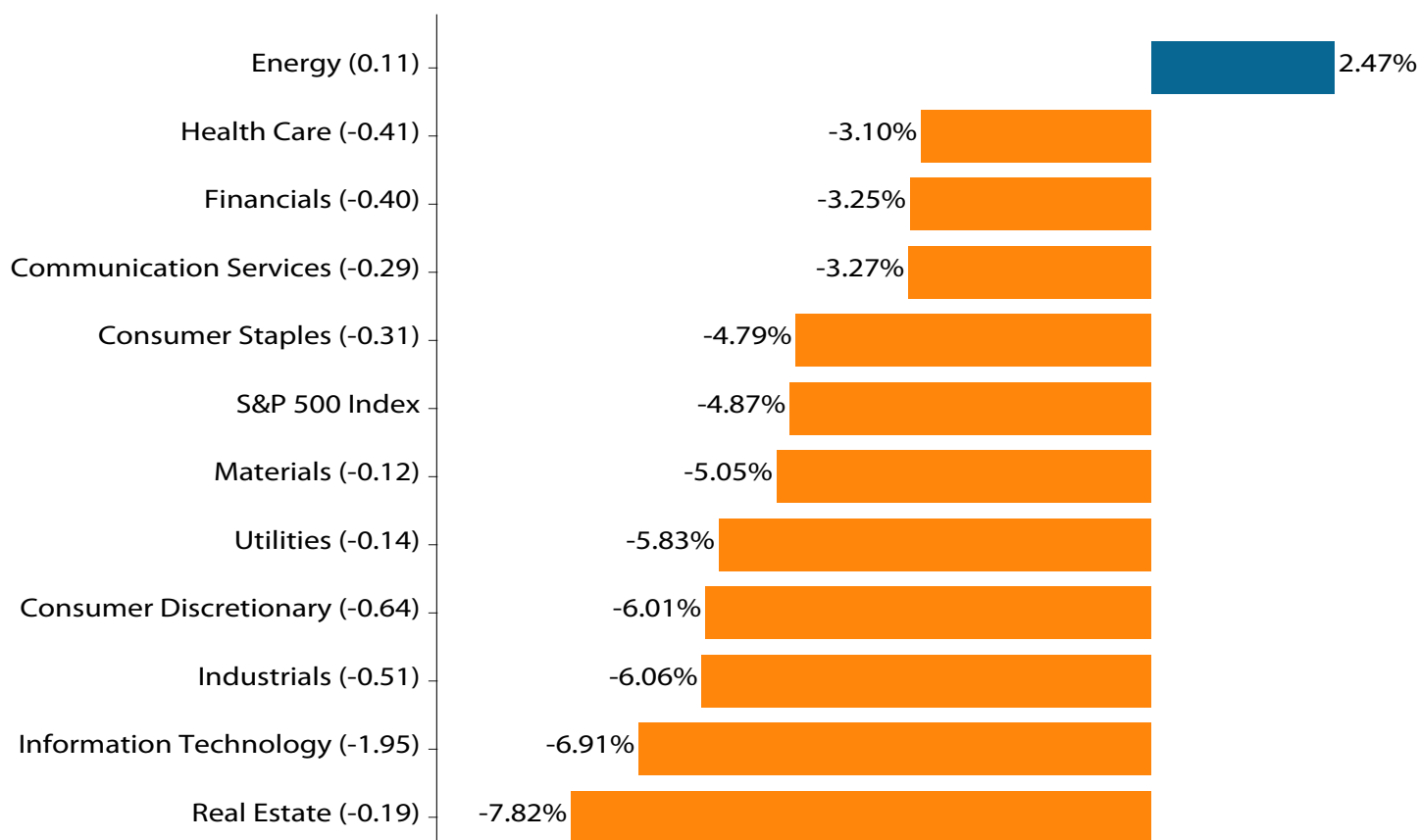
that the stage is being set for a year-end rally. On the other hand, the breakdown coincided with a breakout in bond yields across the Treasury curve. Investors may be belatedly taking the Fed's higher-for-longer rhetoric seriously just as economic data slows, arguing for more than a seasonal pause.

In reviewing our indicators, we came to three conclusions. First, technical damage has triggered negative signals from some trend and breadth indicators. Second, sentiment is approaching extremely pessimistic levels, suggesting that a year-end rally is not off the

table. Third, macro conditions and long-term technicals leave open the possibility that the market is going through a topping process that could carry into 2024.

The sector model remained with a mix of cyclical and defensive leadership during the month. Entering October, the sector model is overweight Information Technology, Communication Services, and Utilities. Health Care and Financials remained marketweight. Industrials and Energy joined Consumer Discretionary, Consumer Staples, Materials, and Real Estate at underweight.

S&P 500 GICS Sector Monthly Performance (08/31/2023 - 09/30/2023)

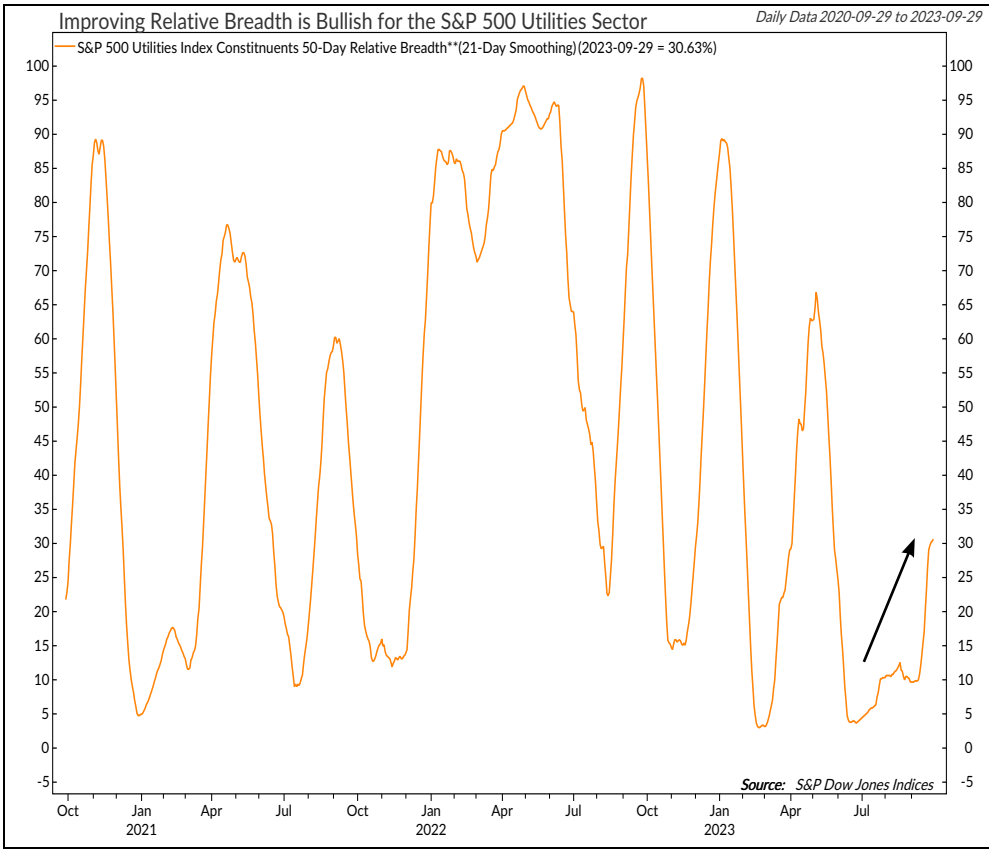


Number in parenthesis after sector name indicates % point contribution to S&P 500 return

Source: S&P Dow Jones Indices

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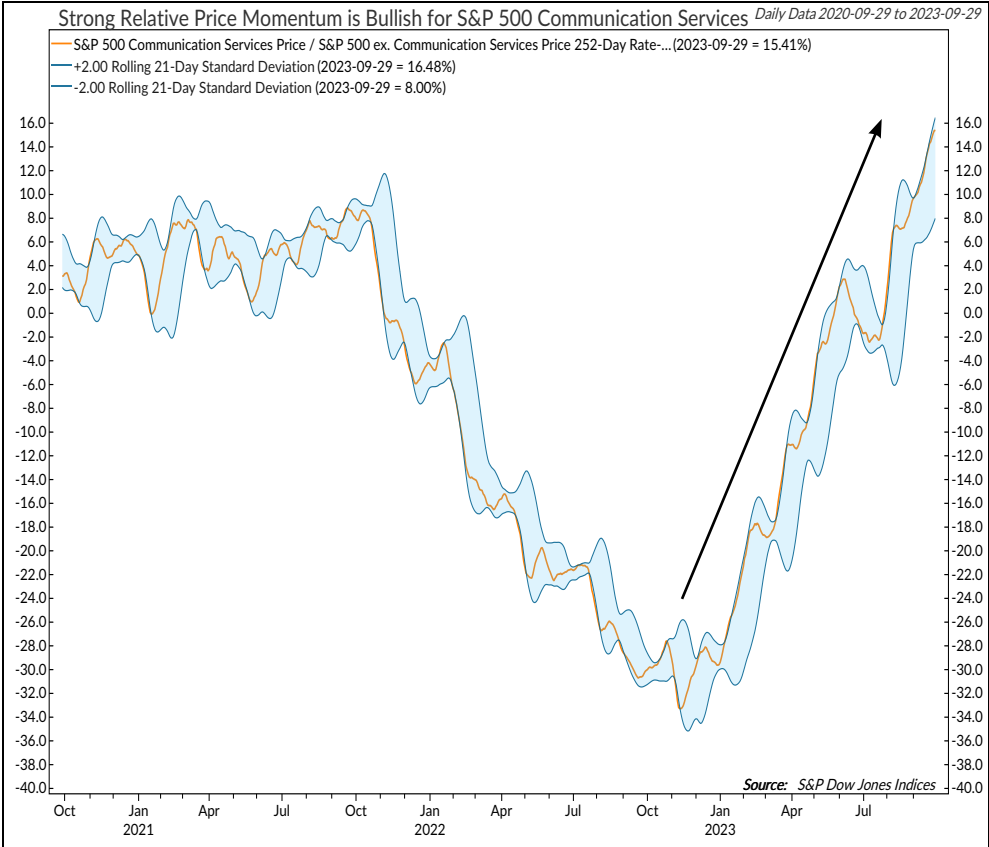
The Utilities sector's allocation rose by over 80 basis points in September and remains overweight. While the copper/gold ratio and manufacturing PMI are headwinds for the sector, rising oil prices, capacity utilization, valuation, and yields on investment grade utilities are bullish. Five of the seven internal (price-based) indicators are bullish—most recently, short-term breadth improved to a bullish level (chart right).



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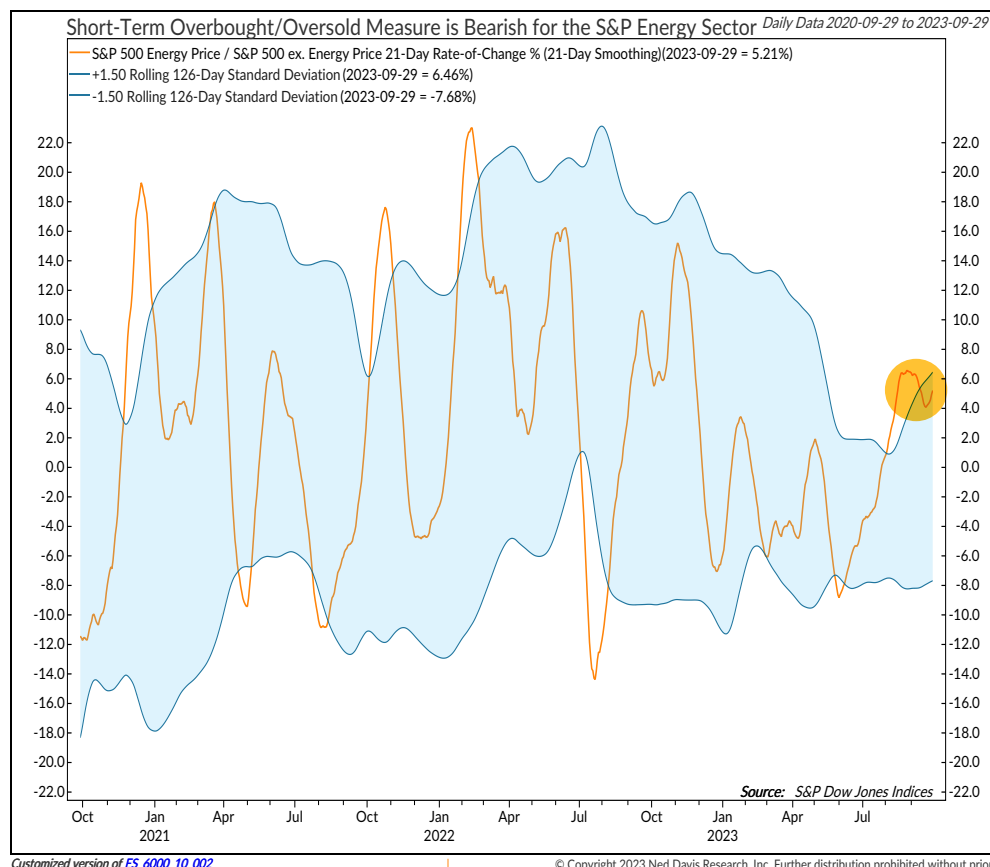
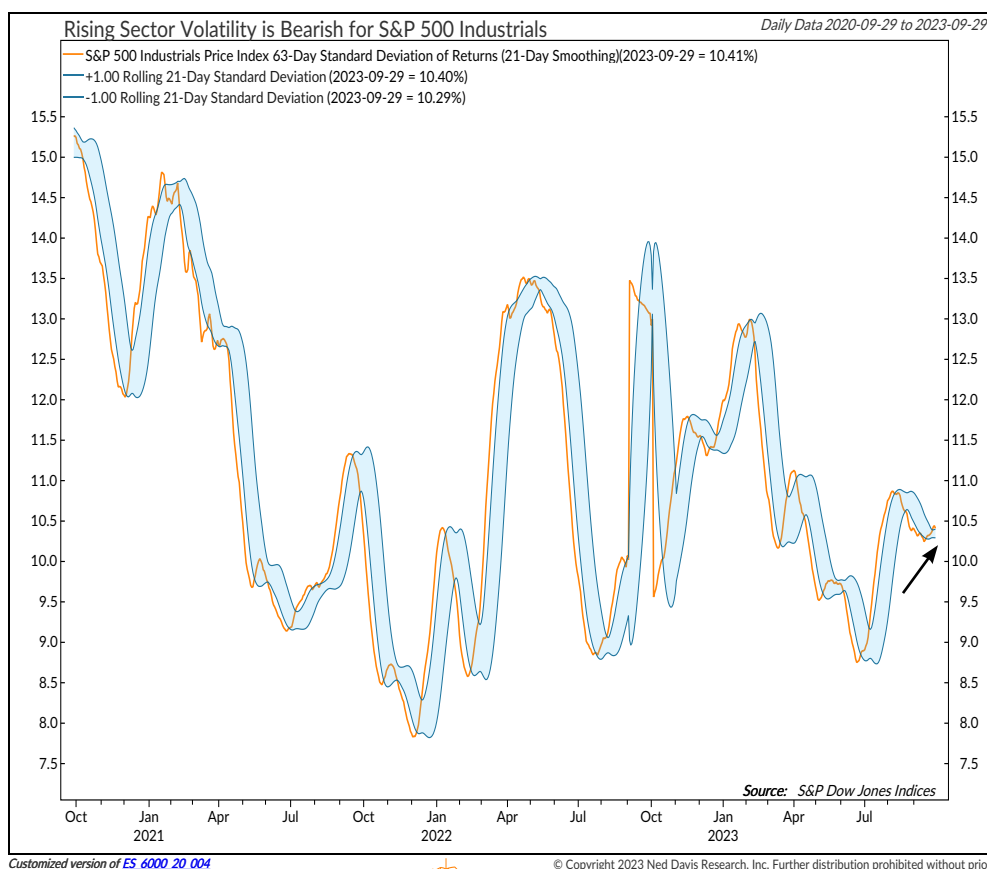
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The Communication Services sector's allocation rose by over 50 basis points and remained overweight. Among the "Elite Eight" stocks in the S&P 500, Alphabet has performed the best. The sector's Telecom- and Media-related companies have also performed better in Q3 after lagging the S&P 500 during the first half of the year. While the 10-2 yield curve remained bearish for the sector, a narrowing option-adjusted spread, valuation, and earnings revision breadth remained bullish. This was confirmed by internal (price-based) indicators, as five of six indicators remain bullish, including strong relative price momentum (chart left).

Industrials' allocation dropped over 50 basis points and was downgraded to underweight. On a fundamental basis, rising commodity prices moved bullish for the sector during the month. However, valuation, oil futures prices, and consumer confidence remain headwinds. This was confirmed by weakening technicals, as now four of the six price-based measures are bearish—sector volatility moved bearish for Industrials during the month (chart right).



The Energy sector's allocation dropped by over 25 basis points and was downgraded to underweight. On a fundamental basis, indicators are mixed. Crude futures sentiment and worldwide rig count are bullish, but are offset by crude spot prices, supply, and valuation which remain bearish. Technicals are also mixed. With a sharp rise in price over the past month, the Energy sector got short-term overbought, a bearish development (chart left).

Summary

Entering October, the sector model remained with a mix of cyclical and defensive leadership. The model is overweight Information Technology, Communication Services, and Utilities. Underweights include Industrials, Energy, Consumer Discretionary, Consumer Staples, Materials, and Real Estate. 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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