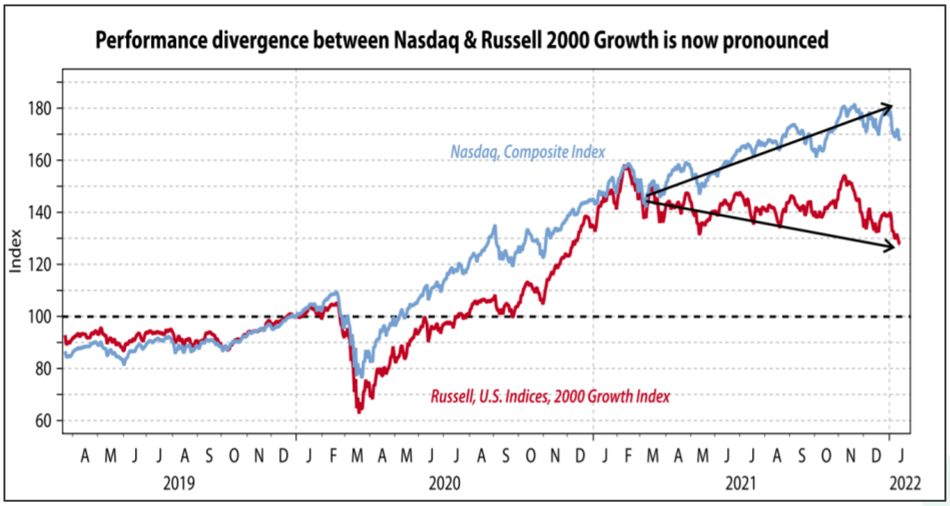
As January Goes, So Goes The Year?

Donoghue Forlines' 2022 Global Markets Outlook

We are only a few weeks into the year, but investors must hope the adage "as January goes, so goes the year" does not hold true for 2022. After all, at the recent lows, the S&P 500 was down almost 10%, while the Nasdaq 100 was down almost 15%. And behind this pullback, pain in the most speculative parts of the market is starting to add up. SPACS, meme stocks, unprofitable tech, and crypto have all struggled. Momentum seems to have turned…so, is there anything to like about risk markets?



Gavekal

Surging COVID cases, the FOMC's hawkish pivot, fiscal headwinds from Washington, extreme 2021 equity flows, and valuations are all legitimate concerns for investors, but the fact that we're all talking about them suggests they're already well known and mostly reflected in the market.

And selling the market based on headlines has never been a successful path to long-term outperformance.

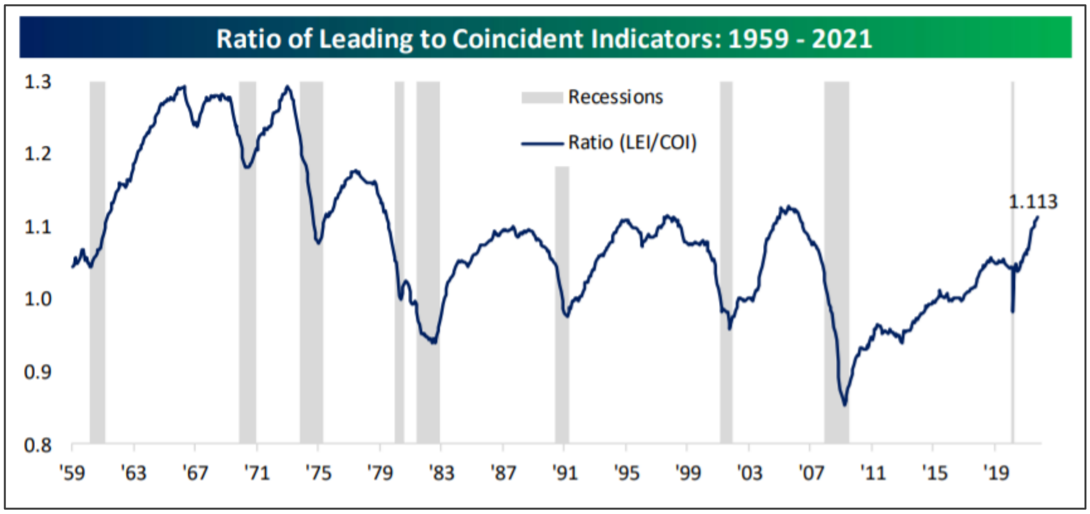
And we believe, despite higher volatility, there are several reasons to remain constructive towards risk assets for 2022.

So, let's throw away the headlines and review the current macro landscape and its implications on financial markets:

Growth

First, while growth will slow this year, we expect it will remain above trend. As we saw in 2021, average growth during economic expansions tends to be strongest early as pent-up demand leads to strong economic activity. While we believe we have reached "peak growth" for the cycle, at 20 months, the current expansion is still a baby. Post-WWII expansions have an average of 67 months, including three which have been longer than 100 months. It's highly unlikely for the economy to move back into a recession so early in an expansion, and two indicators we track closely - the ratio of leading to coincident indicators and the US treasury yield curve - indicate that the recovery remains on track.

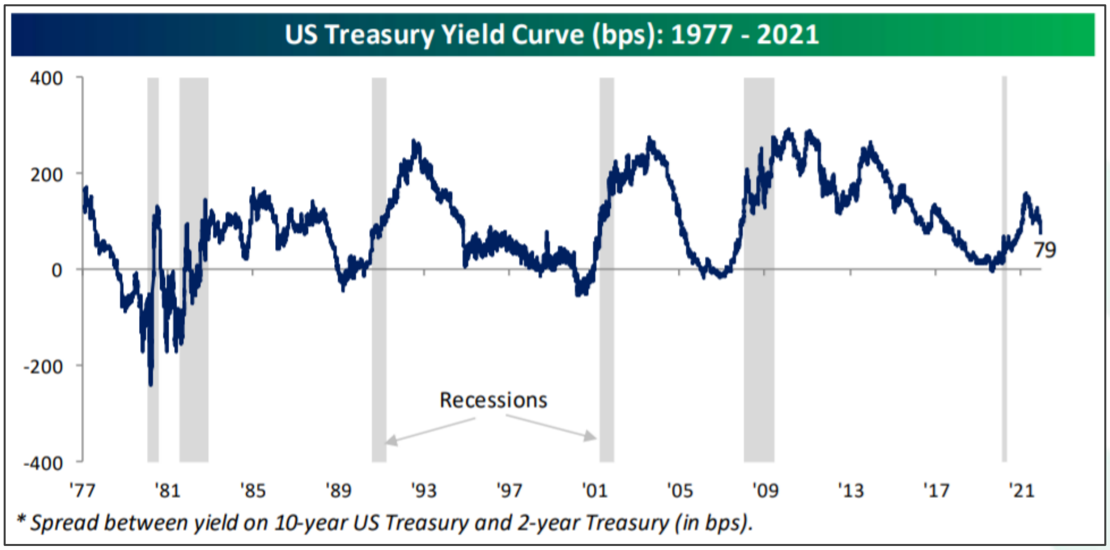
Leading indicators tend to always roll over well in advance of a recession. Now, the ratio is right at cycle highs indicating the health of the expansion remains sound.



Bespoke

One of the most reliable predictors of an impending recession is the US Treasury yield curve and specifically the spread between the 2-year and 10- year notes. Almost every inversion of yield curve has been followed by a recession, and no recession since at least the mid-1970s has occurred without an inversion of the yield curve beforehand.

While the curve has flattened substantially since March 2021, it still hasn't inverted, suggesting that outside of a major policy error by the Fed (or an exogenous shock), a recession starting in 2022 is unlikely.



Bespoke

We also discount the effect rising covid cases will have on the economy. Households and firms have learned to transact through covid over the last 2 years and the new Omicron variant appears to be less severe. We believe cases may have already peaked for the current wave.

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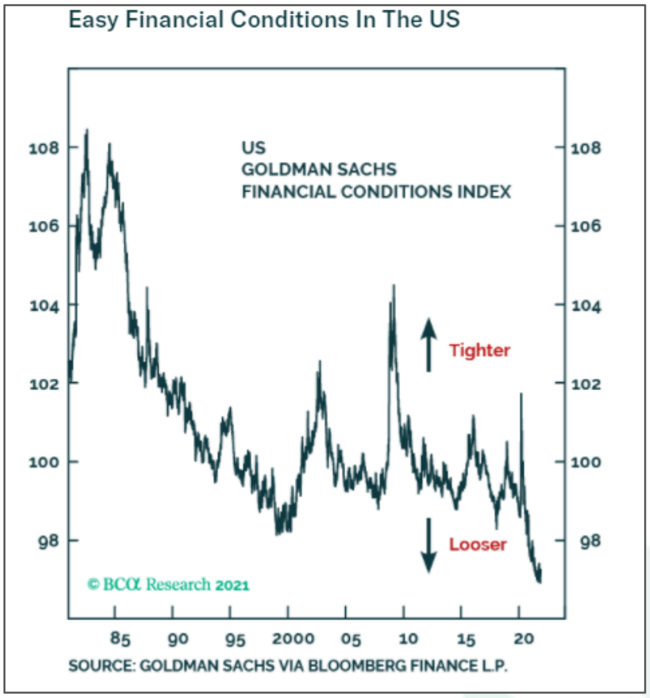
Inflation

Second, inflation is peaking, and in any case is not as bad as it looks. Inflation should dip over the next 6-to-9 months as the demand for goods moderates and supply-chain disruptions abate. When you strip out temporary distortions, inflation is not high by historical standards. The YoY inflation rates everyone is panicking about are misleading because they include large paybacks for the collapse in prices in the first year of the pandemic. If we look at two-year core rates that exclude energy and strip out Covid base effects, we find annualized US core PCE inflation is only 2.8%. Granted, even when the Covid reopening and energy effects drop out, inflation is unlikely to subside to the official 2% target rates. But after the shock of 7% headlines, inflation in the range of 3-4% in the US and even milder in other developed economies should be met with relief. On a longer timeline, inflation may continue to be structurally higher the next decade and investors will need to consider new diversifiers.

Policy

Finally, **we expect these growth and inflation dynamics will allow the Fed to not significantly tighten monetary policy in 2022**. While the Federal Reserve will expedite the tapering of asset purchases and will probably begin raising rates this summer, the Fed is unlikely to raise rates significantly. The respite from inflation next year will give the Fed some breathing space and a major tightening campaign is unlikely until mid-2023. The Fed has turned more hawkish, but the market has made a habit of over-estimating Fed moves. Reflective of this environment, real bond yields remain low and financial conditions remain easy. On the fiscal side, there will be much less stimulus, but with the dysfunction coming out of DC, tax hikes may also be less likely.



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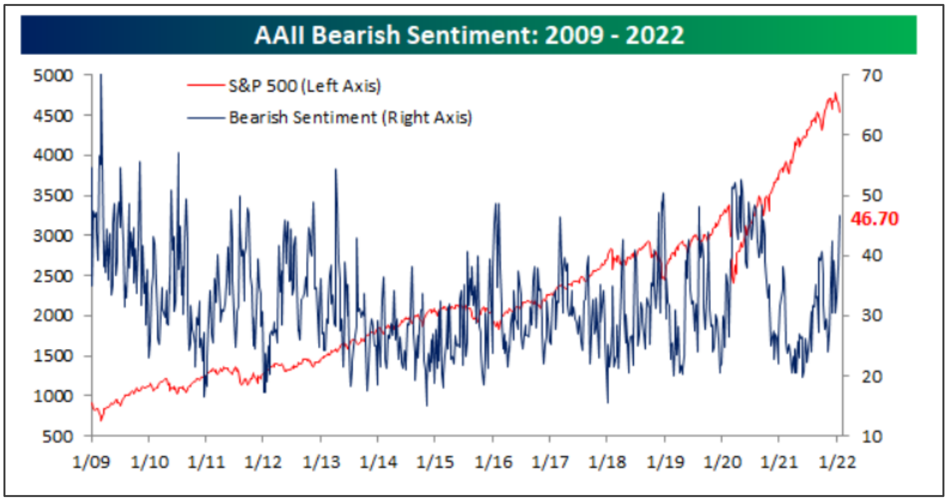
Financial Market Implications

Equities

Our golden rule of investing is simple: Don't bet against stocks unless you think that there is a recession around the corner, because equities and bear markets tend to overlap. Equity corrections can occur outside of recessionary periods. In fact, we are experiencing such a correction right now. Yet, with the percentage of bearish investors reaching the highest level in over 12 months in this week's American Association of Individual Investors survey, chances are that the correction will not last much longer. A sustained decline in stock prices requires a sustained decline in corporate earnings; the latter normally only happens during economic downturns.



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Equity valuations are still at lofty levels, but equities still look much more attractive than other asset classes. Don't expect the outsized returns of the past year and a half, but the bull market should continue. Our equity exposure remains focused on quality. We will look to opportunities internationally as the recovery broadens out.

Fixed Income

Opportunities in fixed income are limited. Treasury yields will continue to climb from historically low levels, but not fast enough to continue to stymie other risk assets. We remain underweight duration across all our portfolios and concentrate our exposure to high yield and floating rate markets for the current environment.

Alternatives

Diversification is not as simple as it used to be. Therefore, alternative assets have become an important part of our portfolios. We are allocated to quality real assets and believe they will be a crucial diversifier amid elevated long-term inflation. We'd expect to look for opportunities to increase our exposure to real assets in 2022.

Donoghue Forlines Portfolios

In today's interest rate environment, the 60/40 retirement rule is stuck in the past. Advisors are challenged to rethink foundational portfolio elements of investor portfolios – which means seeking out strategies that bolster the "core" going forward. With no cheap assets, tactical and unconstrained management is now more important than ever.

We continue to focus on the need to help craft easy-to-understand, longer-term narratives for Advisors and their Clients. Panicking and abandoning diversified investment strategies during volatility and market crashes/surges is a time-tested losing proposition.

Donoghue Forlines solutions are designed to be client-centric and deliver strong risk-adjusted return streams through both our rules-based, tactical strategies as well as our global macro, fundamentally driven tactical solutions. We aim to capture the majority of the upside but more importantly to avoid the majority of the downside.

We have continued to carefully assess exposure across all our portfolios over the past quarter, as per our risk management process. Our positioning is outlined in more depth below. We remain cautiously optimistic to the continuation of the recovery but recognize the possibility that the facts can change and will adapt.

We will stay vigilant with our goal of seeking strong risk-adjusted returns. Please visit our website at www.donoghueforlines.com for our latest information including Fact Sheets for the entire suite of products. Thank you for your confidence in Donoghue Forlines. Please let us know if you have any questions.

Regards,

Jeffrey R. Thompson
Chief Executive Officer
Portfolio Manager

The following reflects Donoghue Forlines' portfolios positioning as of December 31, 2021.

Donoghue Forlines Dividend Portfolio

Positioning: 100% allocated to large and mid-sized high yielding stocks with a diversified sector exposure and quality orientation.

During the quarter, the portfolio did not receive a technical trigger and remained 100% invested. On December 6th, the portfolio was reconstituted and rebalanced.

Donoghue Forlines Momentum Portfolio

Positioning: 100% invested in large and mid-sized stocks exhibiting strong short-term momentum with a diversified sector exposure.

During the quarter, the portfolio did not receive a technical trigger and remained 100% invested. On December 6th, the portfolio was reconstituted and rebalanced.

Donoghue Forlines Treasury Portfolio

Positioning: 100% invested in intermediate-term U.S. Treasury bonds via ETF exposure.

During the quarter, the portfolio did not receive a technical trigger and remained 100% invested in intermediate-term U.S. Treasury bonds.

BLENDED SOLUTIONS

The blended solutions combine the best ideas from our rules-based and global macro solutions into long-term investment solutions.

Donoghue Forlines Income Portfolio

The DF Income Portfolio's asset allocation at the quarter end is as follows: 4% in cash, 82% in fixed income, 8% in equities, and 6% in alternatives.

Target Allocations: Donoghue Forlines Tactical Income Fund (55.1%); Donoghue Forlines Risk Managed Allocation Fund (30.6%); Trim Tabs Donoghue Forlines Tactical High Yield ETF (12.3%); Cash (2.0%)

Donoghue Forlines Dividend & Yield Portfolio

The DF Dividend and Yield Portfolio’s allocations at quarter end are as follows: 4% in cash, 55% in fixed income, 33% in equities, 8% in alternatives.

Target Allocations: Donoghue Forlines Tactical Income Fund (44.3%); Donoghue Forlines Tactical Allocation Fund (24.3%); Donoghue Forlines Risk Managed Income Fund (14.7%); Donoghue Forlines Dividend Fund (11.7%); Donoghue Forlines Momentum Fund (3.0%); Cash (2.0%)

Donoghue Forlines Growth & Income Portfolio

The DF Growth and Income Portfolio’s allocations at quarter end are as follows: 4% in cash, 30% in fixed income, 58% in equities, and 8% in alternatives.

Target Allocations: Donoghue Forlines Tactical Allocation Fund (43.0%); Donoghue Forlines Momentum Fund (20.6%); Donoghue Forlines Risk Managed Income Fund (4.9%); Donoghue Forlines Tactical Income Fund (14.8%); Donoghue Forlines Dividend Fund (14.7%); Cash (2.0%)

IMPORTANT RISK INFORMATION

The views expressed are current as of the date of publication and are subject to change without notice. There can be no assurance that markets, sectors or regions will perform as expected. These views are not intended as investment, legal or tax advice. Investment advice should be customize3d to individual investors objectives and circumstances. Legal and tax advice should be sought from qualified attorneys and tax advisers as appropriate.

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There can be no assurance that the purchase of the securities in this portfolio will be profitable, either individually or in the aggregate, or that such purchases will be more profitable than alternative investments. Investment in any Portfolio, or any other investment or investment strategy involves risk, including the loss of principal; and there is no guarantee that investment in Donoghue Forlines' Portfolios or any other investment strategy will be profitable for a client's or prospective client's portfolio. Investments in Donoghue Forlines' Portfolios, or any other investment or investment strategy, are not deposits of a bank, savings, and loan or credit union; are not issued by, guaranteed by, or obligations of a bank, savings, and loan, or credit union; and are not insured or guaranteed by the FDIC, SIPC, NCUSIF or any other agency. The composite strategy provides diversified exposure to various asset classes such as equities, fixed income, and alternatives utilizing liquid exchange-traded products. Diversification does not guarantee a profit or protect against a loss.

Investors cannot invest directly in an index. Indexes are unmanaged. Index returns assume the reinvestment of distributions, but do not reflect the deduction of a management fee, transaction and custodial charges, or other expenses; the incurrence of which would reduce the indicated historical performance results. Economic factors, market conditions and investment strategies will affect the performance of any portfolio, and therefore there are no assurances that any portfolio will match or outperform any particular benchmark.

The Nasdaq Composite Index is the market capitalization-weighted index of over 3,000 common equities listed on the Nasdaq stock exchange.

The Russell 2000 Index refers is a stock market index that measures the performance of the 2,000 smaller companies included in the Russell 3000 Index. The Russell 2000 is is widely regarded as a bellwether of the U.S. economy because of its focus on smaller companies that focus on the U.S. market.

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