Donoghue Forlines

Markets in Motion™

August 9, 2021

Macro… From Great to Good

For some time, our view is that the economy is accelerating from the "Covid-sized" hole created in 2020. As economies re-opened and activity began to surge, this view has now become consensus among investors, according to the Bank of America Fund Manager Survey (Chart 1).

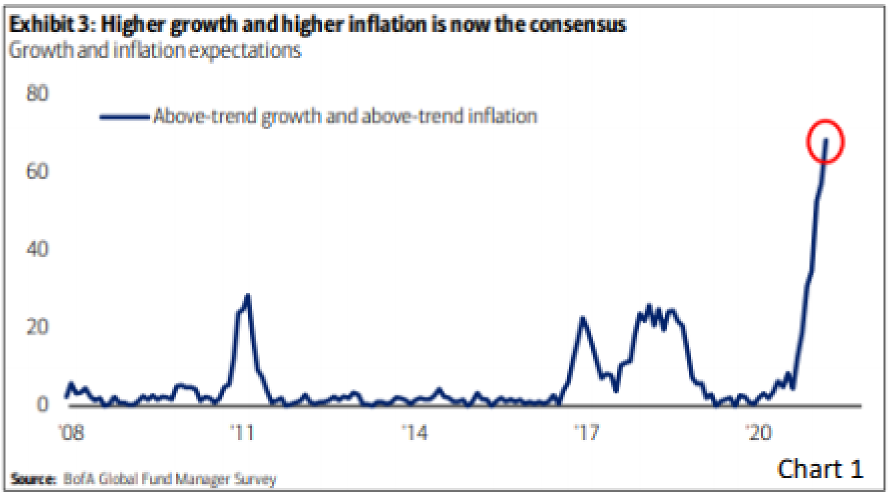


Chart 1

But as the tailwind from stimulus fades and the vaccination campaign winds down, economic momentum has likely peaked with expectations. Historically, a slowdown in growth has been associated with lower overall equity returns. But this is expected: the next leg of the rally in risk assets will not have the strength of the past year. However, we believe there are reasons to expect this "slowdown" to be relatively benign and remain overweight risk assets (especially certain pockets).

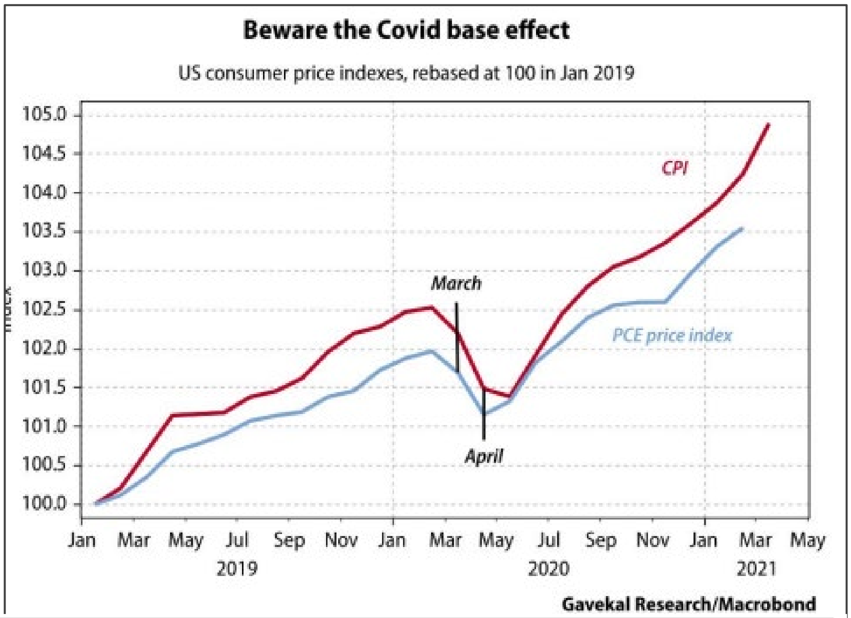
First, US growth is slowing from exceptionally strong levels and will remain above-trend. The golden rule of investing is to stay bullish on risk assets unless one think's there is a recession around the corner (Chart 2). In our view, growth is highly unlikely to turn contractionary anytime soon.

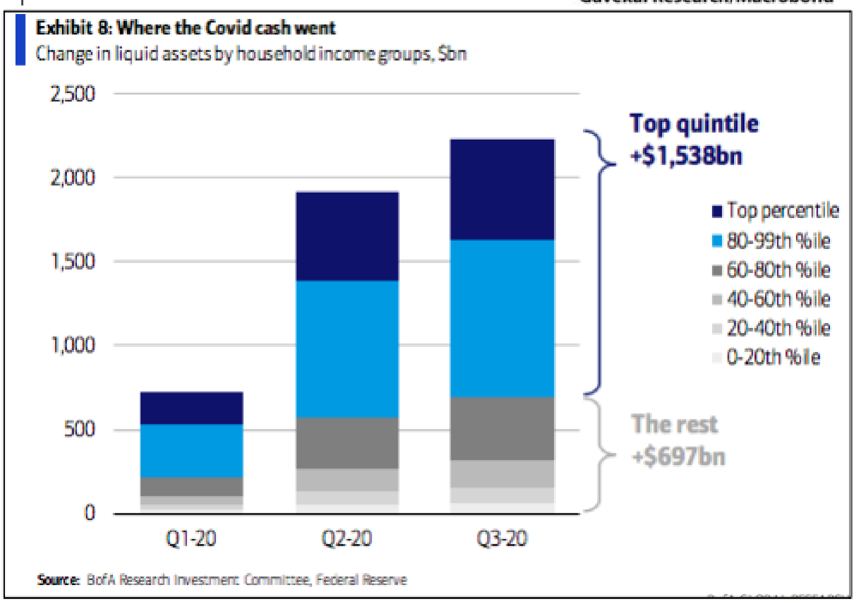
Chart 2

Much Ado About Inflation

Concerns about higher than expected inflation have weighed on investors over the first half of the year. In our last Quarterly Commentary, we discussed our view that structurally higher inflation is not a near term risk. This quarter, we'd like to elaborate further on that view and add nuance because we believe that the data will continue to be a bit noisy.

First, US consumer price inflation is trending up. But this is not surprising … expansionary factors like fast money supply growth (stimulus) and stronger demand (reopening) are driving up prices. However, base effects are a big part of the story. Inflation plunged during last spring's lockdowns, resulting in a significant base effect over the last several months. Now with investor inflation expectations at/near all-time highs, we believe these current inflationary dynamics are already priced into markets. For example, the 10-year treasury yield is down over 50 bps in the face of "blowout" CPI reports over the last couple months. And reflation assets that had been outperforming since September, have cooled down since May.





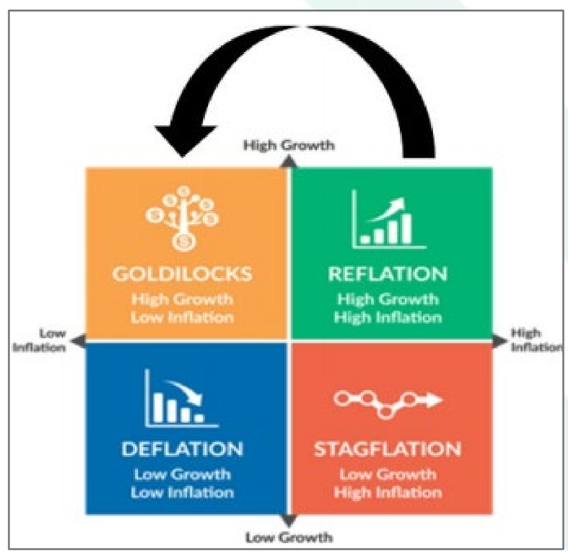
Moreover, a transitory pickup in inflation is a policy goal of the Federal Reserve. We believe the real risk to markets would be a more hawkish central bank. But we do not expect data over the next few months will make them flinch and future moves will continue to be dictated by labor market dynamics (which are a long way from normalization).

Finally, after a transitory pickup in inflation, we believe structural deflationary trends will reassert themselves. Technology continues to produce more (and better) goods & services at a lower cost while suppressing workers' wages at the same time. Globalization and free trade (global and domestic) allows bigger labor pools to be utilized, leading to the production of more goods at a lower cost. And the pandemic accelerated structural low-end job losses and already plunging global birth rates.

While structural deflation will continue to ease cost pressures, we believe that the biggest deterrent to near term inflation will be the dynamics of Pandemic stimulus. Inflation bulls point to the >$2T extra cash in household accounts from post-Covid stimulus. But we believe this data is skewed, because despite narratives, ~70% of this cash has gone to the top 20%, which is always the group least likely to spend. Therefore, much of the extra cash will be saved and not unleashed into the economy. That's why a savings glut on the balance sheets of already-wealthy households is unlikely to boost inflation in a sustained way.

With no structurally higher inflation, the Fed can afford to sustain exceptionally easy monetary policy, which should keep growth above-trend and continue to support equity valuations. And if inflation fears recede, the economic environment will begin to change from a period of reflation to goldilocks.

This would trigger rotations from cyclical/value exposures back into quality/growth exposures. The fuel for this rotation will come from one-sided positioning into the inflation trade. Tech funds have seen their largest outflows since December 2018, another short-term bottom for the sector. We have an overweight to stocks with these characteristics within our portfolios. In this environment, bonds will likely remain rangebound over a tactical timeframe. However, we will continue to avoid allocations to bonds, as they provide very little asymmetric risk. Therefore, we remain overweight stocks and credit, with a focus on quality/growth factors.



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 June 30, 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 June 4th, 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 June 4th, the portfolio was reconstituted and rebalanced.

See important disclosures on the final page.

Donoghue Forlines Treasury Portfolio

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

The Donoghue Forlines Treasury Portfolio began the second quarter bullishly invested in long term US Treasuries. In early-April the portfolio's technical signals triggered a shift into intermediate-term US Treasuries. The DF Treasury Portfolio was our best performing strategy in 2020 and has received wide recognition from peers within the industry for its strong performance and risk mitigation. In particular, the strategy was awarded a PSN Top Guns distinction by Informa Financial Intelligence's PSN manager database, North America's longest running database of investment managers. The award is a 3 Star Top Gun rating for our Donoghue Forlines Treasury SMA, meaning the Treasury SMA had one of the top ten returns for the three-year period in its respective universe.

We continue to suggest that this strategy should not be utilized as a standalone solution, but rather should be blended with other solutions to provide a potential hedge in risk-off market environments.

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: 3% in cash, 80% in fixed income, 11% in equities, and 6% in alternatives.

Target Allocations: *(55%) in Donoghue Forlines Tactical Income Fund; (31%) in Donoghue Forlines Risk Managed Allocation Fund; (12%) in Trim Tabs Donoghue Forlines Tactical High Yield ETF; and 2% Cash.

Donoghue Forlines Dividend & Yield Portfolio

The DF Dividend and Yield Portfolio's allocations at quarter end are as follows: 3% in cash, 47% in fixed income, 45% in equities, 5% in alternatives.

Target Allocations: Donoghue Forlines Tactical Income Fund (34%); Donoghue Forlines Tactical Allocation Fund (34%); Donoghue Forlines Risk Managed Income Fund (15%); Donoghue Forlines Dividend Fund (12%); Donoghue Forlines Momentum Fund (3%); and 2% Cash.

Donoghue Forlines Growth & Income Portfolio

The DF Growth and Income Portfolio's allocations at quarter end are as follows: 3% in cash, 24% in fixed income, 70% in equities, and 3% in alternatives.

Target Allocations: Donoghue Forlines Tactical Allocation Fund (48%); Donoghue Forlines Momentum Fund (21%); Donoghue Forlines Risk Managed Income Fund (5%); Donoghue Forlines Tactical Income Fund (10%); Donoghue Forlines Dividend Fund (15%); and 2% Cash.

IMPORTANT RISK INFORMATION