October 18, 2021

The seasonal market weakness that has historically dogged investors in September put a damper on the third quarter rally. As we head into the final quarter of the year, there are a mounting number of headwinds (or narratives) threatening to slow the recovery from the pandemic recession. Stagflation, delta variant, energy shortages, US debt crisis, Evergrande crisis, Fed tightening … to name a few. Faced with this catalogue of woes, the stock market setbacks in September are hardly surprising. But with major indices only ~5% off their September all-time highs, is the worst still to come? In a "post peak growth" environment, it is important to monitor the risks for signs that it is time to reduce risk exposure.

A New Covid Wave

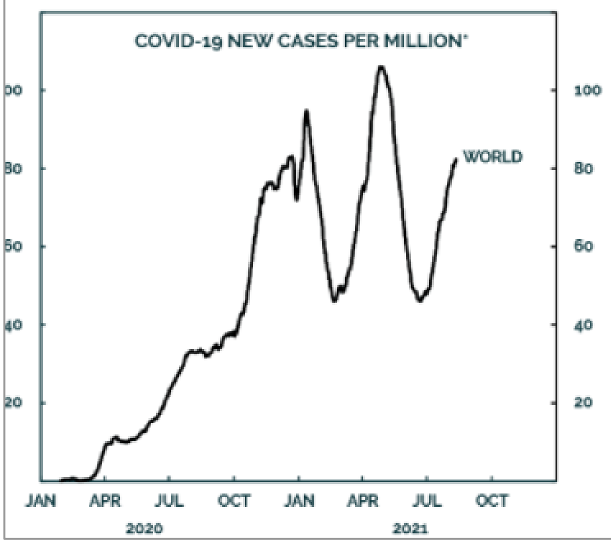


Chart 1

New Covid Variants

It's been a year and a half since the emergence of Covid in the United States, but its impact on asset markets remains. The Delta variant continues to roll through the US and other countries. (Chart 1). While the new strain does not seem to be any more deadly, it is a lot more contagious. CDC estimates suggest 40% more contagious than the original strain. While still vulnerable to the Delta variant, the symptoms of vaccinated individuals tend to be mild and non-life threatening.

The risk is likely not the delta variant but if a new variant emerges which is: 1) highly contagious; 2) vaccine resistant; and 3) as or more lethal than the original strain.

However, the current suite of vaccines confers substantial protection and if a vaccine-resistant strain does emerge, it is likely the vaccine producers could adjust to keep the virus at bay. And to some extent, firms and households have learned to transact through the pandemic. It would be highly unlikely we could drop to the level of economic activity in April 2020 again. As such, we only consider Covid to be a modest risk to financial markets … but not one we're willing to ignore.

Tighter Monetary Policy

The latest angst in equity markets is the Fed preparing to taper asset purchases. Several Fed governors and regional presidents made media appearances over the last few weeks, each one presenting a timeline that sets up a tapering announcement before the end of this year. Nevertheless, we don't expect the tapering announcement to move markets all that much.

In theory, monetary policy should mostly affect asset prices through interest rates, and not through central bank balance sheets, or other liquidity factors, unless these also move interest rates. Therefore, changes in the Fed's balance sheet management should have relatively little effect on equity prices if investors believe that the Fed will keep interest rates unchanged for at least another year (and we don't expect them to rise any time soon). This theory was tested in the 2013 "taper tantrum." Equity markets dipped by only 6% in the month after Ben Bernanke announced the Fed's 2013 taper and fully recovered within three weeks. The bull market then enjoyed a largely uninterrupted run for the next two and a half years, while the Fed reduced its bond purchases. It was only after the Fed raised the fed funds rate from 0.25% to 0.5% in December 2015 that the S&P 500 experienced a meaningful correction of -10.5%. Therefore, we don't put a high risk on tighter monetary policy but we'll monitor closely to see when the facts change.

Glass Half Bull

While no one can rule out more downside in the days ahead, we believe most risks are either already discounted, exaggerated, transient or irrelevant to equity prices. And broadly speaking (NYSE Composite Index), while it may not feel like it, most stocks have gone nowhere for the past 5 months. (Chart 2).

Chart 2

And as we've highlighted in the past with other market narratives, the business cycle is by far the most important driver of equity returns over intermediate-term horizons. (Chart 3). So where are we in the business cycle?

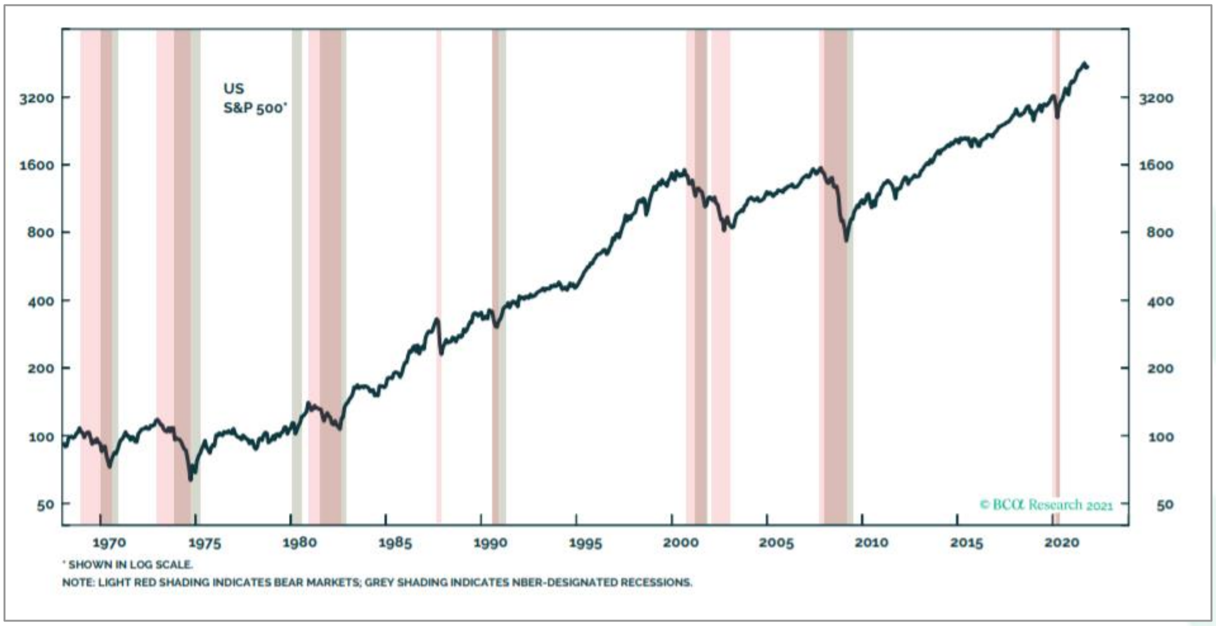
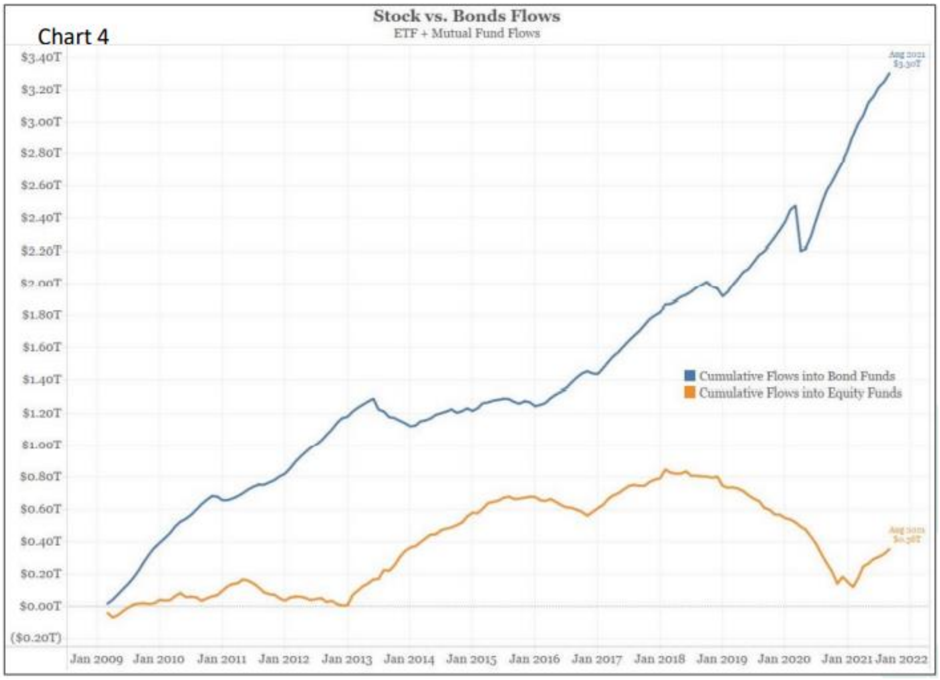


Chart 3

We believe global growth has peaked, but at very high levels. Progress on the vaccination campaign, along with continued accommodative monetary and fiscal policies, should keep growth above trend and recession risks at bay for the foreseeable future. This means there is a strong chance stocks and other risk assets continue to make new highs as recession risks remain low.

Therefore, our portfolios remain overweight stocks or in bullish postures. As previously noted, the risk-reward profile for equities is not as appealing as it was last year, but the TINA theme (There is no alternative to equities) will continue to resonate with investors.

After all, money flows to where its treated best. We believe this rotation from bonds to stocks is just beginning to play out. (Chart 4).



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 September 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 September 8th, 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 September 8th, the portfolio was reconstituted and rebalanced.

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, 85% in fixed income, 7% in equities, and 5% 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, 56% in fixed income, 35% in equities, 6% in alternatives.

Target Allocations: Donoghue Forlines Tactical Income Fund (44%); Donoghue Forlines Tactical Allocation Fund (24%); Donoghue Forlines Risk Managed Income Fund (15%); Donoghue Forlines Dividend Fund (11%); 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, 29% in fixed income, 65% in equities, and 3% in alternatives.

Target Allocations: Donoghue Forlines Tactical Allocation Fund (43%); Donoghue Forlines Momentum Fund (21%); Donoghue Forlines Risk Managed Income Fund (5%); Donoghue Forlines Tactical Income Fund (15%); Donoghue Forlines Dividend Fund (15%); and 2% Cash.

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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The investment descriptions and other information contained in this Markets in Motion are based on data calculated by Donoghue Forlines LLC (Donoghue Forlines) and other sources including Morningstar Direct. This summary does not constitute an offer to sell or a solicitation of an offer to buy any securities and may not be relied upon in connection with any offer or sale of securities. This report should be read in conjunction with Donoghue Forlines' Form ADV Part 2A and Client Service Agreement, all of which should be requested and carefully reviewed prior to investing.

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.

The S&P 500 Index is a market capitalization weighted index of 500 widely held stocks often used as a proxy for the stock market. Standard and Poor's chooses the member companies based on market size, liquidity, and industry group representation. Included are stocks of industrial, financial, utility, and transportation companies.

The S&P 500 Value Index measures the performance of value stocks drawn from the S&P 500 index. The complete market capitalization of S&P 500 index is divided into growth and value segments by using three factors: sales growth, the ratio of earnings change to price, and momentum. The index is market capitalization weighted.

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.

Donoghue Forlines LLC is a registered investment advisor with the United States Securities and Exchange Commission in accordance with the Investment Advisors Act of 1940.