May 23, 2023

The Great Consolidation

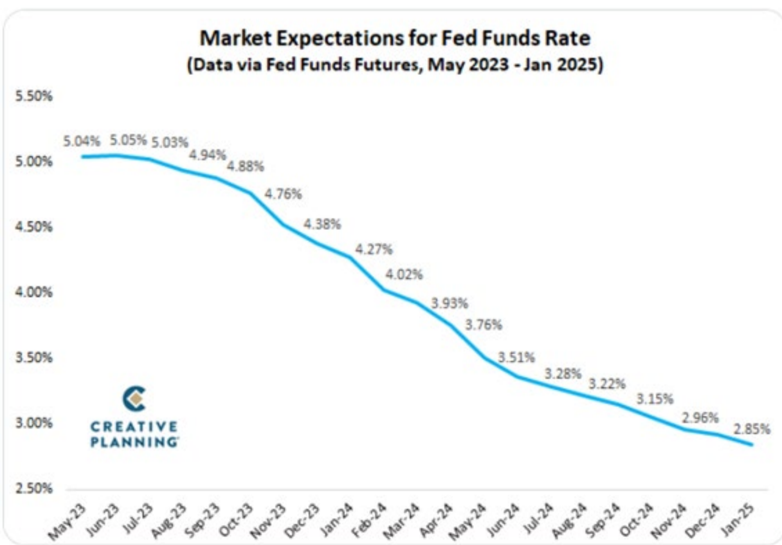
Over the past few weeks, equities have largely moved sideways. But it is not just the past few weeks that have been a wash. Zooming out on the S&P 500 shows that it is now trading at roughly the same level as it was in May of 2021 and May of 2022. In short, US equities have been consolidating over a shorter timeframe and a much longer timeframe… potentially setting up a large move. (Chart 1)

(Chart 1) Source: Bespoke Investment Group

So, this begs the question – what's next?

With the market going nowhere, it is not a shock that there are conflicting narratives.

The bullish one is rather simple – the Fed could be done raising interest rates. The Fed hiking cycle at least appears to be nearing its end… inflation is moderating, and growth has held up to this point. The market has begun to price in this "soft landing" scenario. Despite being at levels it was two years ago, it has broken a downtrend that started at the beginning of 2022 (see previous chart). Better yet, longer dated bond yields have stopped rising, and Fed fund rate futures are pricing cuts by the end of this year. (Chart 2).



(Chart 2) Source: Creative Planning; Charlie Billelo

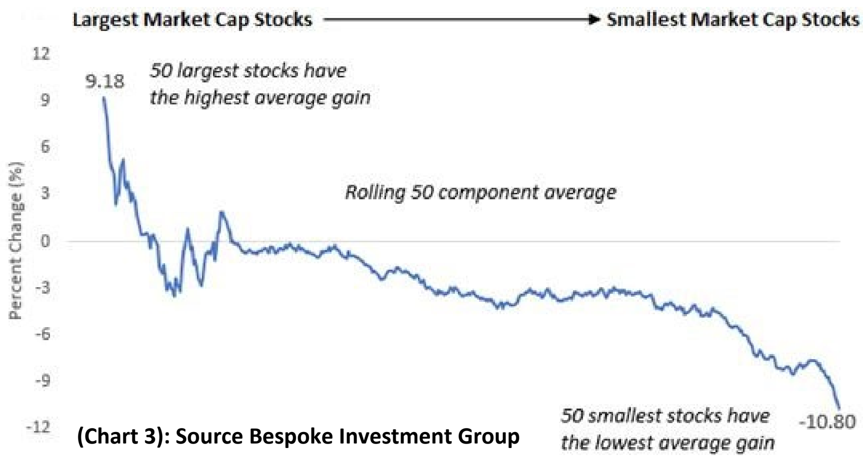
While the bullish narrative appears to be forming, and we suggested this scenario earlier in the year {Feb MIM}, we still believe there are highly plausible factors of the market facing strong downside risk.

Tighter Federal Reserve

The Fed has raised interest rates 500 basis points in a historically short timeframe. The effect of these hikes' filters through the economy with a lag. And the economy and financial system are already showing cracks. After SVB failure, the Fed injected $400B into the system. As it did this, the "liquidity stars" of the last bull market – META, APPL, MSFT, GOOGL, AMZN, NVDA, TSLA – all soared. Yet, the Fed has now actively withdrawn support and its balance sheet has shrunk by $230B in recent weeks. Even more, it's not a foregone conclusion interest rate policy has pivoted. A big risk could be hotter than expected inflation prints.

Lack of Breadth

Much of the YTD rally in the major indices has been narrow, confined to the monopolistic tech stocks (up ~61%) previously mentioned. These companies are trading at a 30x PE vs. 17x for the rest of the S&P. There are plenty of headwinds to these valuation multiples and while aberrations can continue for a while, it seems implausible the market can rely on this narrow a group of stocks for much longer. The equal weight S&P 500 index remains flat on the year and narrow rallies are rarely a sign of a healthy market. To illustrate, this chart (chart 3) shows the trailing three-month performance of S&P 500 components on a rolling 50-component basis starting with the 50 largest and moving all the way down to the smallest 50 stocks in the index. While the 50 companies with the largest market caps are up an average of 9.18%, the 50 companies with the smallest market caps are actually down an average of 10.8%.



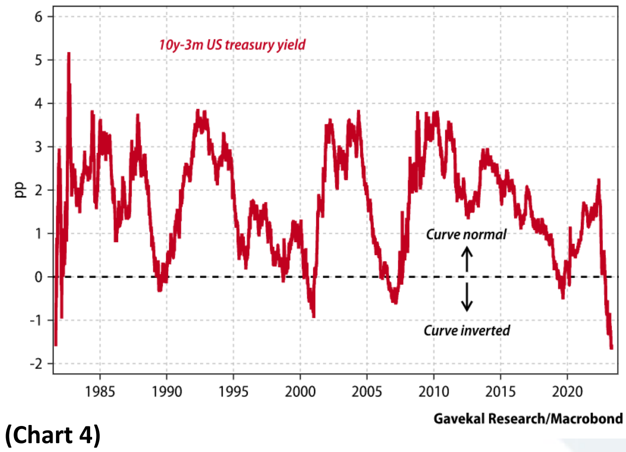
(Chart 3): Source Bespoke Investment Group

Debt Ceiling

While many believe that the impending debt ceiling crisis will be averted, if Republicans and Democrats fail to find a compromise solution, it is hard to see this not triggering a risk-off event.

Recession

Recession is the most important domino in all of asset allocation. Recession bells have been ringing for months now, but a combination of fiscal policy and labor market have prevented the 2022 bear market from causing a recession. However, with a deeply inverted yield curve (Chart 3), it is likely a question of when, not *If*, we enter a recession. 2023 will be defined by the economy and asset markets digesting the lagging effects of the Fed's aggressive monetary tightening.



(Chart 4)

Investment Implications

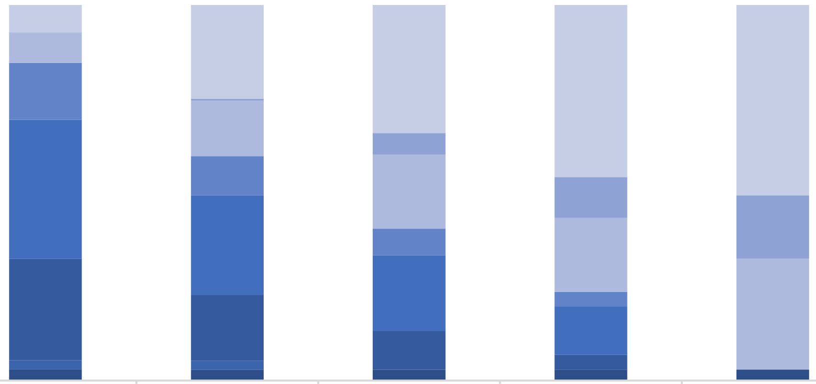
It would be very on brand for stocks to melt up into recession, right before a hard landing. For example, the S&P 500 rallied 11% in the two months after Beat Stearns collapsed in March of 2008. Currently, the S&P 500 is up 7% since the collapse of SVB.

We believe we could continue to see that same phenomenon, but ultimately, we will see more pain in the market and economy, especially before the Fed begins to cut rates. Therefore, our positioning remains relatively neutral, with an eye on downgrading risk assets in the near future. Before this bull market has a firm bottom, we will see more shocks to the system. Tactical management is more important than ever for client portfolios.

Recent Portfolio Changes

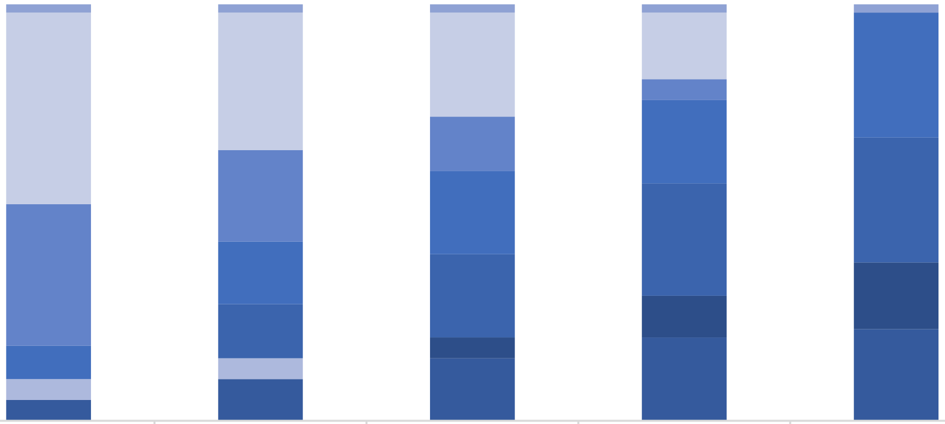
No changes this month.

Global Tactical Model Exposures as of 5/23/23



	GTI	GTC	GTA	GTG	GTE
US Equity	7.35%	24.94%	34.12%	45.82%	50.70%
Intl Equity	0.15%	0.54%	5.70%	10.86%	16.83%
Alt Equity	7.88%	14.78%	19.71%	19.71%	29.56%
High Yield	15.18%	10.41%	7.15%	3.90%	0.00%
Bank Loan	37.01%	26.55%	20.11%	12.87%	0.00%

Global Tactical Model Allocations as of 5/23/2023



	GTI	GTC	GTA	GTG	GTE
Cash	2.00%	2.00%	2.00%	2.00%	2.00%
FLOTX	46.00%	33.00%	25.00%	16.00%	0.00%
DFHY	34.00%	22.00%	13.00%	5.00%	0.00%
DFRA	8.00%	15.00%	20.00%	20.00%	30.00%
DFNV	0.00%	13.00%	20.00%	27.00%	30.00%
PWDIX	5.00%	5.00%	0.00%	0.00%	0.00%
TTAI	0.00%	0.00%	5.00%	10.00%	16.00%
TTAC	5.00%	10.00%	15.00%	20.00%	22.00%

You can get more information by calling (800) 642-4276 or by emailing AdvisorRelations@donoghueforlines.com.

Best regards,

John A. Forlines III

Chief Investment Officer

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The Donoghue Forlines Global Tactical Allocation Portfolio composite was created July 1, 2009. The Donoghue Forlines Global Tactical Income Portfolio composite was created August 1, 2014. The Donoghue Forlines Global Tactical Growth Portfolio composite was created April 1, 2016. The Donoghue Forlines Global Tactical Conservative Portfolio composite was created January 1, 2018. The Donoghue Forlines Global Tactical Equity Portfolio composite was created January 1, 2018.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Individual portfolio returns are calculated monthly in U.S. dollars. These returns represent investors domiciled primarily in the United States. Past performance is not indicative of future results. Performance reflects the re-investment of dividends and other earnings.

Regarding GTA, net returns are presented net of actual management fees and include the reinvestment of all income. Actual investment advisory fees incurred by clients may vary.

Beginning January 1, 2022, the 1% model fee was no longer assessed within the performance calculation as Donoghue Forlines no longer charges a model management fee on the portfolios listed below. The portfolios includes holdings on which Donoghue Forlines may receive management fees as the adviser and/or subadvisor or from separate revenue sharing agreements. Please see the prospectuses for additional disclosure.

Regarding GTI, GTC, GTG, and GTE, the investment management fee schedule for the composites is: Client Assets = All Assets; Annual Fee % = 0.00%. Actual investment advisory fees incurred may vary and should be confirmed with your financial advisor.

The Donoghue Forlines Global Tactical Allocation Benchmark is the HFRU Hedge Fund Composite. The Blended Benchmark Conservative is a benchmark comprised of 80% HFRU Hedge Fund Composite and 20% Bloomberg Barclays Global Aggregate, rebalanced monthly. The Blended Benchmark Growth is a benchmark comprised of 80% HFRU Hedge Fund Composite and 20% MSCI ACWI, rebalanced monthly. The Blended Benchmark Income is a benchmark comprised of 60% HFRU Hedge Fund Composite and 40% Bloomberg Barclays Global Aggregate, rebalanced monthly. The Blended Benchmark Equity is a benchmark comprised of 60% HFRU Hedge Fund Composite and 40% MSCI ACWI.

The MSCI ACWI Index is a free float adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The HFRU Hedge Fund Composite USD Index is designed to be representative of the overall composition of the UCITS-Compliant hedge fund universe. It is comprised of all eligible hedge fund strategies; including, but not limited to equity hedge, event driven, macro, and relative value arbitrage. The underlying constituents are equally weighted. The Bloomberg Barclays Global Aggregate Index is a flagship measure of global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.

Index performance results are unmanaged, do not reflect the deduction of transaction and custodial charges or a management fee, the incurrence of which would have the effect of decreasing indicated historical performance results. You cannot invest directly in an Index. Economic factors, market conditions and investment strategies will affect the performance of any portfolio, and there are no assurances that it will match or outperform any particular benchmark.

Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. For a compliant presentation and/or the firm's list of composite descriptions, please contact 800-642-4276 or info@donoghueforlines.com.

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