BROADMARK

Market Update

April 1, 2017

The market advance that began following the November 2016 election ran into some headwinds in March 2017. The S&P 500 Index hit an all-time intraday high of 2,400.98 on March 1 and then turned downward, falling about 3% to its March low on March 27, before recovering to finish about flat for the month.

Since the U.S. presidential election, investors had anticipated that the Trump administration would enact measures that would help American business. However, with the failure of the administration's healthcare bill to come to a Congressional vote and increased inquiries into possible Russian interference in the U.S. election, investors became more cautious last month.

We noted previously that in February 2017, investor sentiment reached its most optimistic level in several years (negative from a contrary point of view). This optimism is one of the reasons that we reduced market exposure in our portfolios and were expecting a market correction. On the other hand, the major trend is still upward and we look for opportunities during the current market weakness to possibly increase market exposure provided that sentiment recycles and our momentum indicators stabilize.

Our assessment of the four pillars of our investment process is as follows:

1. **Valuation:** Valuation remains elevated by any measure. The median price-earnings ratio on the S&P 500 has now reached 24.2, its highest level since 2004. Rising U.S. interest rates will exacerbate high valuations for U.S. equities and further rises in interest rates would be negative for valuation levels.
2. **Monetary factors and credit conditions:** Last month, the Federal Reserve Board raised the fed funds rate for the third time in the last two years. The 10-year Treasury note rose from a July 2016 low of 1.35% to a high of 2.62% in mid-March 2017. Interest rates moderated in late March with the 10-year Treasury note ending the month at 2.40%. However, we have not yet seen credit spreads widen and the yield curve remains steep.
3. **Sentiment:** Investor sentiment reached its most optimistic level in several years in the first few months of 2017. This high degree of optimism is negative in our work and is another reason we became more defensive in our equity exposure prior to the recent market setback.
4. **Momentum:** We noted in our last commentary that there were some signs that the market's momentum was slowing. For example, the percentage of stocks above their 10- and 30-week moving averages did not confirm the new highs set in late February 2017. The current market correction is a positive step in the market getting back in gear. If our momentum models stabilize, we will look to possibly increase market exposure as our longer-term momentum models remain positive. If, however, the advance resumes with fewer and fewer stocks participating, that would be extremely negative and prompt us to become much more defensive.