The S&P 500 Index reached a new all-time high in August 2018. Markets were buoyed by continued improving economic fundamentals—a strengthening economy, historically low unemployment, a tax cut and strong corporate earnings. The U.S. economy grew at a 4.1% pace in the second quarter—the highest in four years.*

The market's new highs were confirmed by our breadth/volume momentum models. Additionally, our interest rate rate-of-change models have improved from negative to neutral with the stabilization in interest rates. Stable interest rates tend to be positive for the market. Accordingly, we increased our market exposure in August by adding to the large cap and technology sectors.

Nonetheless, our models continue to indicate that we are late in the market's cycle. Accordingly, we are closely watching our models of valuation, monetary policy and credit, sentiment and momentum for signs of change. We are ready to respond quickly to changes in these indicators.

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

1. **Valuation:** Rising earnings have brought valuations lower in recent months, which is positive in our models. The median price-earnings ratio has continued to decline and now stands at 23.8, below its 15-year high of 26.8 reached in January 2018. This ratio is still high by historical standards but on an improving trend.**

2. **Monetary factors and credit conditions**: Intermediate and long-term interest rates declined in August. The 10-year U.S. Treasury Note declined from 3.00% at the beginning of the month to 2.88% at the end of the month.*** The stabilization of interest rates has improved our rate-of-change models. In addition, credit spreads still remain relatively narrow. We note, however, that while longer-dated maturities stabilized during the month, short-term interest rates quietly ticked upward during August. The 13-week U.S. Treasury Bill rose to 2.08% during the month—its highest level since 2008.*** This rise in short-term rates reflects an improving economy and the fact that the annual rate of change of the Consumer Price Index (CPI) reached 2.9% as of the end of June 2018.****

   We believe a continued strong economy and higher inflation expectations are positive factors. A strong economy, however, may justify further Federal Reserve interest rate hikes and could conceivably lead to a further flattening or inversion of the yield curve as we near the end of 2018. These developments would be entirely consistent with the late stages of an economic cycle. We will be monitoring these developments closely.

3. **Sentiment:** Investor sentiment grew more optimistic as the market reached new highs in August and has remained elevated during the month. From a contrary point of view, this high degree of optimism is a potentially negative sign. The Hulbert Newsletter Stock Sentiment Index, compiled by Ned Davis Research (NDR), is a weekly survey of investor sentiment among stock market newsletter writers. This measure has now reached its most optimistic level (negative, from a contrary point of view) in five years. Optimistic investor sentiment has fueled the market's August advance. However, we will be closely monitoring all of our sentiment models since developing market tops are associated with high levels of optimism.

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4. **Momentum:** The market's new highs in August were confirmed by our breadth/volume momentum models. In addition, leadership groups such as technology have continued to set new highs as well, which is a positive sign for our models.

   Nonetheless, even as the market hit a new all-time high in August, less than 60% of all stocks are now above their 10- and 30-week moving averages, which is a potentially negative divergence that we will watch closely in coming months.

   With our continued exposure to large cap and technology stocks, we believe we are favorably positioned to participate in any further market strength. However, we are continuing to monitor these models closely to respond quickly to any future changes in momentum.

Source: Bloomberg. August 31, 2018
** *Source: Ned Davis Research. September 4, 2018*
*** *Source: Bloomberg. September 4, 2018*
****Source: Ned Davis Research. August 31, 2018*