Stocks ended 2019 with another strong gain, spurred by anticipation of "Phase One" of the trade deal with China and continued low interest rates. Momentum was strong during December and we've seen some evidence of renewed strength in several of the lagging areas. Nonetheless, the market's strong rally has produced a short-term overbought situation in our momentum models. Also, the market's strength produced a rise in optimistic investor sentiment (negative from a contrary point of view) and valuations have now risen to the highest level of the year.

Market exposure for the Tactical Growth strategy was diversified among the large cap, technology and small cap sectors of the market at the end of the year. All of these sectors have benefited from the market's recent strength. Nonetheless, we would expect to see some type of short-term market pullback as the new year begins due to the market's overbought status, a rise in bullish investor sentiment and higher valuations. We will be assessing the relative strength of these sectors to make any adjustments to our allocations as we enter 2020.

In order to raise exposure further, our momentum measures would need to show some relief in the overbought condition. We would also need to see decline in investor bullishness and better relative strength among the lagging sectors. Further strength in the Russell 2000 Index, Dow Jones Transportation Average and international stocks would be evidence of broader market participation. On the other hand, if investor sentiment continues to show elevated optimism, the market moves to higher valuations and the broader market lags the major market averages, we would move to a more defensive posture. While comfortable with our current market exposure, we are ready to adjust our sector exposure in order to focus on those sectors exhibiting the most relative strength.

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

1. **Valuation:** The S&P 500 median price-earnings (P/E) ratio rose to 24.4x in December — its highest level of the year.[1] The historically low level of interest rates and the more dovish stance from the U.S. Federal Reserve (Fed) have provided a positive environment for these higher valuations. However, while the median P/E ratio remains below its 15-year high of 26.8x reached in January 2018,[1] this indicator shows that the market has risen into overvalued territory on an absolute basis. Relative to the low levels of interest rates and inflation, the market is somewhat less overvalued. However, a rise in interest rates would be a negative factor for valuations.

2. **Monetary factors and credit conditions**: Interest rates rose modestly during December. The 10-year U.S. Treasury Note yield rose from 1.83% at the beginning of December to 1.92% at the end of the month.[2] The Fed's interest rate cuts during 2019 have provided a bullish monetary background for stocks. Our rate of change indicators also remain positive and have a way to go before they flash any warning signals. In addition, credit spreads continue to narrow. Until credit spreads widen or rates rise further or more rapidly, the monetary background remains favorable.

3. **Sentiment:** The market's move to new highs in December produced a significant increase in optimism among investors, which is negative from a contrary point of view. Our indicator of daily investor sentiment rose to its highest level in over a year during December. This rise in bullish investor sentiment could well signal a near-term market correction to bring sentiment back into more neutral territory.

Continued next page
Disclosure next page

4. **Momentum:** Both our intermediate- and long-term measures of breadth and volume remain positive. In addition, upside volume versus downside volume continues to improve and rose to its best level of the year during December. However, the late 2019 rise in stock prices has produced an overbought condition which, coupled with increased optimistic investor sentiment and higher valuations, could produce a short-term market consolidation as we enter the new year.

[1] *Source: Ned Davis Research. December 31, 2019*
[2] *Source: U.S. Department of Treasury. December 31, 2019*

Broadmark Asset Management LLC ("Broadmark") is a registered investment advisor. The views expressed contain certain forward-looking statements Broadmark believes these forward-looking statements to be reasonable, although they are forecasts and actual results may be meaningfully different. This material represents an assessment of the market at a particular time and is not a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding any particular security.
Prices, quotes and other statistics have been obtained from sources we believe to be reliable, but Broadmark cannot guarantee their accuracy or completeness. All expressions of opinion are subject to change without notice.

Indexes shown for illustrative purposes only. It is not possible to invest directly in an index.

The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for advisory clients, and the reader should not assume that investments in the securities identified and discussed were or will be profitable.

Not FDIC Insured | No Bank Guarantee | May Lose Value