Stocks rebounded strongly in June with the S&P 500 Index recording its best June in over 80 years. The S&P 500 and the Dow Jones Industrial Average both reached all-time highs and most major market averages were up 5% or more during the month. In July, this economic expansion will become the longest in history (since 1857), surpassing the 120-month expansion from 1991-2001.[1]

Investors became more optimistic in June as President Trump and China's President Xi Jinping made progress on trade talks at the Osaka G20 summit. Also, while the U.S. Federal Reserve (Fed) did not lower interest rates at its June meeting, Fed Chair Jerome Powell indicated the Fed's willingness to be more accommodative, laying the groundwork for possible future easing. This indication was a big catalyst for the stock market advance and it also spurred a rally in bonds as interest rates declined to their lowest levels since 2016. The decline in interest rates has been a global phenomenon. For instance, the interest rate on France's 10-year note has now fallen into negative territory for the first time ever.[2] Additionally, over $10 trillion of global debt securities now have negative yields.[3]

Equity valuations in the U.S. are still below their overvalued readings of a year ago and, when adjusted for the low level of interest rates, valuations appear to be reasonable at current levels. Investor sentiment turned pessimistic (positive from a contrary point of view) in May but rebounded with the June stock market rally. However, investor sentiment is still in neutral territory and has not reached its previous negative levels.[4] Importantly, individual investors are skeptical about the market's advance, which is a positive sign from a contrary point of view.

Momentum strengthened in June. Our intermediate-term volume/breadth-based momentum model turned positive during the month. Our long-term model, which stayed positive through the May decline, also began to rise again. Accordingly, we raised our market exposure in large cap stocks and the technology sector. In addition, we added some exposure to gold as the result of good relative strength and a breakout to new highs going back several years.

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

1. **Valuation:** The S&P 500 median price-earnings ratio now stands at 20.9, well below its 15-year high of 26.8 reached in January 2018. Given the low level of interest rates and the Fed's more dovish stance, valuations now appear to be reasonable when adjusted for interest rates.[4]

2. **Monetary factors and credit conditions**: Interest rates fell significantly in June. The 10-year U.S. Treasury note declined below the 2% mark during the month and closed June at 2.00%, its lowest level since 2016.[5] The bond market signaled that it expects the Fed to cut interest rates in coming months.

   From a long-term perspective, however, we continue to be concerned that sections of the yield curve have inverted. The yield on the 10-year U.S. Treasury note has now fallen below the federal funds rate. This is the first time this has happened since the 2008-09 financial crisis.[6] On the other hand, an interest rate cut by the Fed would likely steepen the yield curve and lift this indicator out of negative territory.

   If the inverted yield curve and low interest rates are indicating that there is more trouble brewing in the economy than is now evident, these potential problems will likely begin to show up in a widening of credit spreads. Currently, however, credit spreads remain in neutral territory and do not yet indicate economic dislocations.[7]

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3. **Sentiment:** After an uptick in pessimism (positive from a contrary point of view) in May, the June rally produced more optimistic investor sentiment. However, the individual investor as represented by the American Association of Individual Investors (AAII) investor sentiment poll indicates that most individual investors are still showing a good deal of skepticism about the market —which is a positive sign.[4] We would look for individual investors to return to higher optimism prior to a significant market decline.

4. **Momentum:** Our intermediate-term volume/breadth momentum model returned to positive in June. The longer-term momentum model remained positive during both May and June, reflecting the good up volume and breadth that we saw on the early 2019 rally. With the intermediate-term model confirming the strength in the longer-term model, we raised our market exposure during June.

   One potential negative in the momentum picture are signs of lagging broader market participation. Neither the Russell 2000 Index nor the Dow Jones Transportation Average have reached new highs alongside the other major averages this year. These groups could well catch up with the market in coming months but continued strength in large cap stocks without participation in the rest of the market would create negative divergences.[7]

[1] *Source: CFRA Research. July 1, 2019*
[2] *Source: Investing.com. July 1, 2019*
[3] *Source: Bloomberg. March 25, 2019*
[4] *Source: Ned Davis Research. May 31, 2019*
[5] *Source: U.S. Department of Commerce. July 1, 2019*
[6] *Source: Ned Davis Research. April 30, 2019*
[7] *Source: Ned Davis Research. June 25, 2019*

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