BROADMARK

Market Update

December 1, 2019

Stocks continued to rise during November, spurred by earnings coming in higher than reduced estimates, hopes of renewed trade talks with China and continued low interest rates. The percentage of stocks in the S&P 500 Index that have a higher yield than the 10-Year U.S. Treasury Note is still over 50% but has declined with the recent rally and increase in interest rates.[1] While the scales still seem to be tipped in favor of equities, the market has gotten somewhat overbought as the result of the recent market advance. In addition, investor optimism has increased, although it is still below the higher levels reached earlier in the year. Momentum was strong during the month and we saw renewed strength in several of the market's lagging areas, including the small cap stock sector.

We raised our market exposure early in the month by adding exposure to small cap stocks due to their improving relative strength. The portfolio also currently has a diversified exposure to the large cap and technology sectors. In order to raise exposure further, we would need to see additional evidence that the broad market is participating in the market advance. New all-time highs on the Russell 2000 Index, the Dow Jones Transportation Average and international stocks would be evidence that broader market participation is happening. On the other hand, if investor sentiment were to get too bullish (negative from a contrary point of view) and we were to continue to see lagging broader market participation, we would move to a more defensive posture.

We believe current events and news reports will likely continue to buffet the market during December. The House of Representatives continues to pursue its impeachment inquiries and trade talks with China are still uncertain. Developments on the news front could affect the market—both positively and negatively—along with the usual year-end crosscurrents. We are comfortable with our current increased market exposure but remain flexible to adjust market exposure in light of new developments.

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

1. **Valuation:** The S&P 500 median price-earnings ratio has risen to 23.8x in recent months but remains below its 15-year high of 26.8x reached in January 2018.[1] Given the historically low level of interest rates and the U.S. Federal Reserve's (Fed's) more dovish stance, valuations now appear to be more reasonable when adjusted for interest rates.

2. **Monetary factors and credit conditions**: Interest rates rose modestly during November. The 10-Year U.S. Treasury Note yield rose above 1.90% in the first few weeks of the month but then ended the month at 1.78%.[2] Current low interest rates and the Fed's most recent interest rate cut have provided a bullish monetary background for stocks. Our indicator of the 26-week rate of change of the Moody's Baa bond yield reached bullish territory in November. This type of rapid decline in rates also occurred at the stock market bottoms of 2009 and 2016 and reflects the current positive monetary background.

3. **Sentiment:** In November, the market's move to new highs in the major market averages produced more bullishness among investors (negative from a contrary point of view). This rise in bullishness is a negative development and could potentially signal a near-term market correction. However, investor sentiment has not yet risen to the optimistic levels reached earlier in the year.

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4. **Momentum:** Both our intermediate- and long-term measures of breadth and volume remain positive. Lagging sectors began to participate in the market's rise in November, which is a positive sign. The percentage of stocks in the New York Stock Exchange that are above their 10- and 30-week moving averages has now risen around 65%—near the highest levels of the year—which is also a positive development.

[1] *Source: Ned Davis Research. November 30, 2019*
[2] *Source: U.S. Department of Treasury. November 30, 2019*