Investor concern that the Federal Reserve (Fed) might keep interest rates higher for longer snapped the market's 5-month winning streak in April. Small cap stocks were hit hardest with the Russell 2000 Index dropping 7.04%. The S&P 500 Index was down 4.08%, while the Dow Jones Industrial Average was off 4.92%.[1] The NASDAQ-100 Index declined 4.43%.[1]

While the Fed has continued to indicate that it intends to cut rates this year, commodity prices and gold have ticked up in the last month, and the Personal Consumption Expenditures (PCE) price index, a measure of inflation closely watched by the Fed, showed little sign that inflation is letting up, rising 2.7% in April as compared with the consensus estimate of 2.6%.[1] Interest rates reflected these persistent inflationary pressures with the 10-year U.S. Treasury Note yield rising to 4.69% from 4.20% at the end of March.[2]

Investor sentiment has declined from the optimistic levels of recent months, which is a positive development. Both the team's daily and intermediate sentiment models showed good improvement in April. Equity valuations declined slightly last month although the median price-earnings (P/E) ratio on the S&P 500 is still near its highest level in over a year. The market's weakness caused deterioration in the investment team's volume and breadth momentum models. As a result, we lowered exposure modestly but still retained a net long position.

We would raise exposure further if our volume and breadth momentum models showed improvement. We would decrease exposure if interest rates continued to rise, credit spreads widened and if volume and breadth momentum models weakened.

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

Valuation: The S&P 500 median P/E ratio (using trailing 12-month earnings) declined modestly in April, dropping to 25.6x from 26.5x in March. Valuations were still above the 60.2-year average of 17.6x. From a longer-term perspective, it appears that equity valuations are relatively high by historical standards. However, valuations are still below where they were during the 2000 dot-com bubble and 2020 coronavirus pandemic highs and could still rise from current levels.

Monetary factors and credit conditions: The 10-year U.S. Treasury Note ended the month with a 4.69% yield, up from 4.20% at the end of March. Despite this rise, tight credit spreads tell us that credit and financial conditions remain healthy. On the other hand, the narrow credit spreads indicate strong economic activity, which is a headwind in the fight against inflation and make it more difficult for the Fed to cut interest rates. A continued rise in interest rates, coupled with an inverted yield curve, would be negative for the monetary and credit picture.

Continued next page
Disclosure next page

BROADMARK

Market Update

May 1, 2024

<u>Sentiment:</u> Both our daily and intermediate sentiment measures improved considerably with the market's pullback in April. From a contrary point of view, investor sentiment is reaching positive territory.

<u>Momentum:</u> The team's measures of momentum deteriorated in April. Our breadth model weakened considerably while our measure of up and down volume also showed deterioration. The deterioration in momentum, coupled with rising interest rates, were two primary reasons for the reduction in exposure during April.

[1] *Source: Bloomberg, April 30, 2024*
[2] *Source: U.S. Department of the Treasury, April 30, 2024*