Bond yields across the globe rose to a 15-year high in mid-August, climbing to their highest level since the 2007–2008 financial crisis. A primary driver of the rise in yields was the release of the July Federal Reserve (Fed) minutes, which indicated that significant inflation risk could merit further rate hikes. Mortgage rates topped 7%, their highest level in 21 years.[1] Investors were also concerned by the economic slowdown in China, particularly in the housing and property sectors. All these factors pushed the market averages lower for the month. The S&P 500 Index closed the month with a -1.59% loss, the Dow Jones Industrial Average was down -2.01% and the NASDAQ-100 Index lost -1.50%.[1] The Russell 2000 Index was weaker than the large cap indexes and fell -5.01%, while the S&P 500 Equal Weight Index lost -3.16%.[1]

Equity valuations remained above their historical average. Adjusted for inflation, valuations have improved due to the decline in the Consumer Price Index. Nonetheless, both absolute and inflation-adjusted valuations remained elevated. Monetary policy continued to be negative as the Fed maintains its fight to bring inflation to the 2% level as interest rates rose to their highest levels of the year. Several of the investment team's measures of investor sentiment rose into negative territory last month but are now backing off into the neutral range.

The team's volume and breadth models deteriorated during the month and the team reduced market exposure. The team also tilted the composition of the portfolio to the equal-weighted S&P 500 Index rather than the cap-weighted index to gain a broader exposure to the market less influenced by the larger tech stocks. The resulting more defensive exposure and increase in cash allowed the portfolio to take advantage of the rise in Treasury bill rates. At month-end, the 3-month U.S. Treasury Bill was yielding in excess of 5.50%.[2]
The team would lower exposure further if interest rates continued to rise, credit spreads widened and if the team's volume and breadth momentum models deteriorated. The team would raise exposure if interest rates declined, investor sentiment again grew pessimistic and if the team's volume and breadth momentum models showed improvement.

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

Valuation: The S&P 500 median price-earnings (P/E) ratio (using trailing 12-month earnings) fell to 24.8x last month after reaching the highest level in a year in July. Valuations are still 40% above the 59.5-year average of 17.6x.[3] Much of the rise in valuations this year has come from an expansion of P/E multiples rather than from increases in underlying earnings or profits. From a longer-term perspective, therefore, it appears that equity valuations have further to decline to more fairly valued levels during this cycle.

Monetary factors and credit conditions: The 10-year U.S. Treasury Note yield rose to a high of 4.34% before settling back to 4.09% at the end of the month, up only slightly from 4.05%. As has been the case during most of the year, however, credit spreads remain narrow. In fact, credit spreads have now narrowed to their lowest level of the year, indicating continued healthy credit markets [3] despite the Fed's tightening posture and the rise in interest rates.

Continued next page
Disclosure next page

Sentiment: Investor sentiment has backed off from the more extreme optimistic levels reached at the end of July, which were negative from a contrary point of view. The team's intermediate- and short-term measures of sentiment have now declined into neutral territory after rising to their highest levels since the market peak in January 2022.[4]

Momentum: The team's measures of volume and breadth deteriorated in August. Ned Davis Research's "Big Mo" Multi-Cap Tape Composite, which measures breadth within the S&P 500 industry groups, fell into neutral territory.[5] Up volume (demand) remains above down volume (supply), which is positive, although this spread narrowed in August.[4] These measures of volume and breadth, while still positive, could indicate potential market risk if they were to deteriorate further.

[1] *Source: Bloomberg. August 31, 2023*
[2] *Source: U.S. Department of Treasury. August 31, 2023*
[3] *Source: Ned Davis Research. August 31, 2023*
[4] *Source: Ned Davis Research. August 29, 2023*
[5] *Source: Ned Davis Research. August 25, 2023*

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

©2023 Broadmark Asset Management LLC. All rights reserved.

All other registered trademarks or copyrights are the property of their respective organizations.