After the S&P 500 Index's 10.55% jump in the first quarter, which was the 11th highest gain for a quarter since WWII, positive momentum carried the market upward in the second quarter (Q2).[1] The S&P 500 posted a gain of 4.28% in Q2, and the S&P 500's year-to-date 2024 gain of 15.29% was the second strongest election year gain since 1944.[1] Stock market history tells us that when the first half of an election year is positive, this momentum often carries into the end of the year, although the data also shows volatility often increases as well.[1] In this uncertain election year fraught with geopolitical risks, the investment team will be keeping a close eye on our momentum models, which are currently indicating some negative divergences. Nonetheless, the team continues to maintain a net long position in its Tactical Growth strategy in deference to the market's positive momentum.

The technology sector continued to lead the way in July with the Nasdaq-100 Index up 6.27%.[1] Small cap stocks continued to lag, with the Russell 2000 Index down -0.93% for the month.[1] The S&P 500 gained 3.59% in July, and the more defensive Dow Jones Industrial Average was up 1.23%.[1]

Equity valuations are still elevated by historical standards. When we adjust for inflation using the Consumer Price Index (CPI), valuations have climbed to their highest level in two years.[2] Nonetheless, both absolute and relative valuations are still below the extremes reached at the 2000, 2009 and 2022 market highs, particularly when we adjust for the long-term upward cyclical bias in price-earnings (P/E) multiples.[2] Given the market's positive momentum and continued earnings trends, valuations may have some room to expand but are still in the top quintile of historical valuations.

Interest rates declined in June but ticked up at the end of the month. The 10-year U.S. Treasury Note closed the month with a 4.36% yield, which is down from the 4.51% yield at the end of May, amid signs that inflation is moderating.[3] Credit spreads remain narrow. While the yield curve remains inverted, which is a negative long-term indicator, monetary policy and credit conditions are more neutral now, provided that the Federal Reserve's (Fed's) "higher for longer" policy does not have a major negative impact on consumer spending and economic activity. Investor sentiment is negative, with our intermediate-term investor sentiment model near its most optimistic levels of the year, which is negative from a contrary point of view.

While the market's momentum remains compelling, the team is seeing a divergence between our breadth model and the market. Our breadth model has made lower lows despite the stock market reaching new highs. Our volume models have also recently begun to show the same divergences. The team has diversified the portfolio due to relative strength in some more defensive sectors. The portfolio is now invested in the cap-weighted and equal-weighted S&P 500 indexes as well as the health care, utilities and communication services sectors. The team would raise exposure if our volume and breadth momentum models continued to improve and potential volume and breadth momentum divergences were resolved to the upside. The team would decrease exposure if interest rates rose, credit spreads widened and if volume and breadth momentum models weakened.

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

Valuation: When we adjust the S&P 500's median P/E ratio for inflation, valuations are still at their highest level in two years. Nonetheless, both absolute and relative valuations are below the extremes reached in 2000, 2009 and 2022. Indeed, when we adjust P/E multiples for their long-term upward secular trend, valuations appear far more reasonable. While this gives P/E multiples room to expand, valuations are in the top quintile historically and remain high by historical standards.

Monetary factors and credit conditions: The 10-year U.S. Treasury Note ended the month with a 4.36% yield, down from 4.51% at the end of May. Narrow credit spreads tell us that credit and financial conditions remain reasonably healthy. On the other hand, the narrow credit spreads indicate strong economic activity, which is a headwind in the fight against inflation and makes it more difficult for the Fed to cut interest rates. The Fed's "higher for longer" policy on interest rates, coupled with an inverted yield curve, could have a negative effect on consumer spending and economic activity. *Sentiment:* Both our daily and intermediate sentiment measures show elevated optimism, which is negative from a contrary point of view. In particular, our intermediate sentiment model has remained in negative territory for a month.

Momentum: The team's measures of momentum continued in positive territory in June. However, our breadth model has not risen in line with the new highs in the major market averages. Our up-down volume momentum model has also recently failed to make a new high along with the market averages. We will be keeping an eye on these divergences. If these divergences continue, they could indicate some future market weakness to correct this imbalance, particularly if volatility increases prior to the November election.

[1] *Source: Bloomberg, June 31, 2024*
[2] *Source: U.S. Department of the Treasury, June 31, 2024*
[2] *Source: Ned Davis Research, June 31, 2024*