

The S&P 500 Index notched its fifth consecutive month of gains in March with most major averages crossing new all-time high closing levels. The S&P 500 was up 3.22%, while the Dow Jones Industrial Average gained 2.21%. The market's breadth broadened in March with the S&P 500 Equal Weight Index jumping 4.46% and the Russell 2000 Index up 3.58%.<sup>1</sup> The NASDAQ 100 Index trailed the other averages for the first time in a while but was still up 1.23%.<sup>1</sup>

The market's gains were fueled by the latest remarks from the Federal Reserve (Fed) that maintained central bankers' rate-cutting timeline for this year. While the Fed has indicated that it intends to cut rates this year, commodity and gold prices have ticked up in the last month, and the Personal Consumption Expenditures (PCE) price index, a measure of inflation closely watched by the Fed, ticked higher for the first time in six months. However, the core PCE inflation index—which excludes volatile food and energy costs—was lower than the previous month and within expectations. While there is still a risk that the Fed keeps rates higher for longer, most investors continue to focus on the Fed cutting rates in the coming months.

Investor sentiment has become more optimistic, which is negative from a contrary point of view. Both of the investment team's daily and intermediate-term sentiment measures are in negative territory. Equity valuations have also continued to rise. The median price-earnings (P/E) ratio on the S&P 500 has now risen to 26.5x, its highest level in over a year.<sup>2</sup> The largest 10 stocks in the S&P 500 are overextended by historical standards, while the bottom 490 stocks have also risen into overvalued territory.<sup>3</sup> Nonetheless, our models of volume and breadth momentum have continued to be positive, and the team has raised market exposure incrementally since the beginning of the year.

The team would raise exposure further if our volume and breadth momentum models showed more improvement. The team would decrease exposure if interest rates continued to rise, credit spreads widened and if volume and breadth momentum models once again 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) ticked higher during the month to 26.5x. Valuations are still above the 60.1-year average of 17.6x. Taking a bit more granular look at equity valuations, the median P/E of the largest 10 stocks in the S&P 500 is now 2.6 standard deviations above its long-term mean. The bottom 490 stocks in the S&P 500 are 1.8 standard deviations above their long-term mean. From a longer-term perspective, it would appear that equity valuations are high by historical standards.

Monetary factors and credit conditions: 10-year U.S. Treasury Note ended the month with a 4.25% yield, only modestly up from 4.19% at the beginning of the month. Narrow credit spreads tell us that credit and financial conditions remain healthy. While the yield curve remains inverted and the Fed has not yet begun to cut rates, stable interest rates and narrow credit spreads, coupled with expectations that the Fed will cut rates in coming months, are increasingly positive for the monetary and credit environment.

Sentiment: Both our daily and intermediate measures of investor sentiment have risen into negative territory. While these measures can remain elevated for a time, they are now at levels that suggest the possibility of a market pullback from current levels.

*Momentum:* The team’s measures of momentum remained positive in March. Our model, which monitors market breadth, has bounced back into positive territory after a sharp dip at the end of 2023. Upside volume also strengthened in March.

<sup>1</sup> Source: Bloomberg, as of March 31, 2024

<sup>2</sup> Source: Ned Davis Research, March 31, 2024

<sup>3</sup> Source: Ned Davis Research, February 29, 2024

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