BROADMARK

Market Update

December 1, 2023

In November, the stock market continued its strong rebound from the late October lows and turned in its best month of performance in almost a year and a half. The S&P 500 Index gained 9.13%, the Dow Jones Industrial Average was up 9.15%, the NASDAQ-100 Index jumped 10.82% and the Russell 2000 Index gained 9.03%.[1] Global bonds also rallied and had their best month since 2008. Investors have been cheered by lower inflation numbers and anticipation that the Federal Reserve (Fed) may begin lowering rates as early as the first quarter of 2024. The yield on the 10-year U.S. Treasury Note fell from 4.77% at the beginning of the month to 4.37% at month-end.[2]

Both absolute equity valuations and valuations adjusted for inflation improved in recent months but have still not declined to historically fairly valued levels. While there is anticipation of a more accommodative Fed, monetary policy continues to be negative in our work until the Fed begins to lower interest rates. Investor sentiment became increasingly optimistic in November, which is also negative in our work. For example, JPMorgan's Treasury client survey, conducted weekly since 1991, found that the most active investors are as bullish as they've ever been and have increased their net long positions to 78%.[3] Also, the Hulbert Stock Newsletter Sentiment Index, which measures the average equity exposure among investment advisors, has now reached one of its most negative readings on record.[4] Reflecting the fundamental pillars of our investment process leaning negative, the investment team has remained in a defensive posture, taking advantage of relatively high short-term interest rates. At month-end, both the 1-month and 3-month U.S. Treasury Bill rates yielded in excess of 5.00%.[2]

The team's measures of volume and breadth momentum improved in November. Despite the negative position of the three fundamental pillars of our process, the team would raise exposure if our volume and breadth momentum models returned to positive territory. The team would continue its defensive posture if interest rates began to rise, credit spreads widened and if volume and breadth momentum models failed to improve from current levels.

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) rose to 24.4x last month after some improvement following the July highs. However, valuations are still above the 59.8-year average of 17.6x.[4] Valuations adjusted for inflation declined as well but they are still in elevated territory. From a longer-term perspective, 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 ended the month with a 4.37% yield, down from 4.77% at the beginning of the month. As has been the case during most of the year, credit spreads remained narrow. We would note that while credit spreads have narrowed near their lowest levels of the year, indicating no signs of significant credit problems, the high-yield ratio (high-yield corporate bonds divided by 10-year Treasurys) is now nearing readings of excessive optimism, which has historically been negative from a contrary point of view.[4]

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Sentiment: Both our daily and intermediate measures of investor sentiment have shown greater optimism, which is negative from a contrary point of view. The Hulbert Stock Newsletter Sentiment Index, which measures the average equity exposure among investment advisors, has now reached one of its most negative readings on record.[4] While optimistic investor sentiment can stay elevated for a time, our investor sentiment models indicate that we may be headed for extremes in these measures, which often precede a stock market pullback.

Momentum: The team's measures of momentum have improved. Volume and breadth models have lagged the market's rally primarily because seven stocks in the S&P 500 have accounted for over 90% of the index's gain this year. Historically, this high concentration has only occurred in 1972 (the Nifty Fifty era), the late 1970s (oil and energy stocks) and the 2000 dot-com bubble. In fact, the seven largest companies in the S&P 500 now comprise 29% of the index, a historical record.[5] Following these periods of concentration, leadership stocks showed sharp declines that led the rest of the market lower. Nonetheless, we do not predict—we adapt. Our watchword is "Don't fight the tape." Upside volume is now marginally above downside volume and breadth is improving.[4] If momentum continues to improve, we may raise market exposure based upon the improvement in these momentum models.

[1] *Source: Bloomberg. November 30, 2023*
[2] *Source: U.S. Department of Treasury. November 30, 2023*
[3] *Source: Bloomberg. November 28, 2023*
[4] *Source: Ned Davis Research. November 30, 2023*
[5] *Source: Ned Davis Research. November 24, 2023*

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