Stock prices surged in November with the Dow Jones Industrial Average (DJIA) rising above 30,000 for the first time in history. Both the DJIA and the S&P 500 Index recorded new all-time highs. The DJIA posted a gain of 12.14% and the S&P 500 posted a gain of 10.95% for the month.[1] While market leadership for most of the year has been led by technology and social communications stocks, stock market breadth broadened in November with many lagging sectors rallying. Small cap stocks, as represented by the Russell 2000 Index, which have trailed the other averages for two years, surged 18.42% in November to an all-time high.[1]

Investors were encouraged by good news surrounding the potential introduction of a coronavirus vaccine. Several companies reported that their vaccines had been over 90% effective in test trials. In addition, the General Services Administration acknowledged President-elect Joe Biden as the winner of the 2020 election, which reduced investor uncertainty regarding the outcome. This acknowledgment allowed the Biden team access to government agencies, officials and intelligence briefings. Finally, former U.S. Federal Reserve (Fed) Chair Janet Yellen was named as the new incoming U.S. Treasury secretary, a move seen as signaling a closer relationship between the Fed and the Treasury and the possibility for further stimulus to support the economy.

Equity valuations remained elevated but low interest rates continued to make stocks attractive. An accommodative monetary policy and narrowing credit spreads were a big positive for the market. The investment team's volume and breadth measures of momentum strengthened, which is also a positive development. A short-term negative factor offsetting this generally positive outlook, however, is that investor sentiment reached very optimistic levels in November, which is negative from a contrary point of view. The team's investor sentiment indicators showed a rise in bullish sentiment among individual investors and a surge in flows into equity exchange-traded funds (ETFs). In addition, the market approached overbought levels. Therefore, we believe some type of short-term correction can be expected although the long-term outlook is still constructive.

The investment team raised market exposure in early November by boosting its position in large cap stocks and the Tactical Growth portfolio had exposure to the technology, value, health care, consumer discretionary, materials and industrials sectors. The team would raise market exposure further if investor sentiment returns to less optimistic levels provided that the team's volume and breadth models remain positive. The team would become more defensive if there is a rise in the team's rate of change models for interest rates or if the volume and breadth momentum models were to deteriorate.

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

Valuation: While it is normal for equity valuations to rise as earnings decline during a recession and recovery period, price-earnings ratios have now climbed to their highest level in almost 20 years.[2] Nonetheless, 65% of all stocks in the S&P 500 still have a dividend yield higher than the 10-year U.S. Treasury Note.[2] Thus, despite the absolute overvaluation of equities by historical standards, the low level of interest rates has made stocks more attractive when compared to their competition from the fixed-income sector. The danger to equity valuations from here would be if interest rates were to rise rapidly, causing a reassessment in the investment merits of stocks versus bonds.

Monetary factors and credit conditions: Interest rates remained stable during November. The 10-year U.S. Treasury Note closed the month with an 0.84% yield, down slightly from 0.88% at the beginning of the month.[3] While yields are now at their highest level since March 2020, this stabilization in interest rates is positive. In addition, credit spreads have narrowed over the last month. A negative factor for the market would be if interest rates were to rise rapidly or if credit spreads were to widen.[4]

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Sentiment: Investor sentiment got more optimistic (negative from a contrary point of view) as the market rose to new highs during November. The NDR Daily Trading Sentiment Composite climbed to its most negative level since its February highs.[4] In addition, flows into equity ETFs surged in November to their highest levels in over 10 years.[5] A short-term pullback from current levels would be natural, given this level of elevated investor optimism.

Momentum: Momentum improved during November. The team's measure of upside versus downside volume climbed to a new recovery high[4] and the market's breadth improved. As the market approaches overbought levels some type of short-term correction would be normal. However, the longer-term volume and breadth momentum models remain positive.

1 *Source: Bloomberg. November 30, 2020*
2 *Source: Ned Davis Research. November 30, 2020*
3 *Source: U.S. Department of Treasury. November 30, 2020*
4 *Source: Ned Davis Research. December 1, 2020*
5 *Source: Ned Davis Research. November 27, 2020*

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