In December, the S&P 500 Index continued to reach for that elusive new all-time high, which remained less than 0.5% away at year-end. The Dow Jones Industrial Average (DJIA) and the NASDAQ-100 Index have already eclipsed prior highs, as have the S&P 500 Value, Industrials, and Information Technology groups. Health Care and Materials are just 6% shy of doing the same.[1] Receding inflation, a resilient economy and the prospect of lower interest rates in 2024 buoyed investors.

The NASDAQ-100 logged its largest yearly gain since 2020, surging 55.13% in 2023.[1] The DJIA recorded a record high, gaining 16.18% for the year.[1] The S&P 500, despite just missing its all-time high, gained an impressive 26.26% for 2023.[1] After lagging for the first half of the year, small cap stocks showed more strength in the last quarter of 2023, with the Russell 2000 Index gaining 16.88% for the year.[1] The one loser among the major market averages was the utility sector with the Dow Jones Utility Average Index down -5.29% in 2023.[1]

The broader market's gains were driven largely by the so-called Magnificent Seven companies: Apple, Microsoft, Alphabet, Amazon, NVIDIA, Meta Platforms and Tesla. They accounted for about two-thirds of the gain in the S&P 500 for the year.[2] In a sign of possible overexuberance, however, 97% of the 153 subindustries in the S&P Composite 1500 Index traded above their 50-day moving averages, while the 80% threshold implies the start of an overbought situation.[2] In addition, 90% of the stocks in the S&P 500 were above their 50-day averages.[2]

Both absolute equity valuations and valuations adjusted for inflation rose last month and have still not declined to historically fairly valued levels. While there is anticipation of a more accommodative Federal Reserve (Fed), monetary policy does not turn positive in our work until the Fed begins to lower interest rates. Both our measures of intermediate-term and daily sentiment show that investors are as optimistic as they have ever been, which is a negative in our work. 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.

The team has a modest net long position in its portfolios in deference to improved measures of volume and breadth momentum. Despite the negative position of the three fundamental pillars of our process, the team would raise exposure if our volume and breadth momentum models improved further. The team would lower market exposure if interest rates again began to rise, credit spreads widened and if volume and breadth momentum models deteriorated.

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 26.1x last month after improving following the July highs. Valuations are as high as they have been in several years and are still above the 59.8-year average of 17.6x.[4] Valuations adjusted for inflation also remain in overvalued territory. From a longer-term perspective, it appears that equity valuations have further to decline to reach more fairly valued levels during this cycle.

Continued next page
Disclosure next page

Monetary factors and credit conditions: The 10-year U.S. Treasury Note yield ended the month and the year with a yield of 3.88%, down from 4.22% at the beginning of the month and only slightly higher than the 3.79% yield at the beginning of 2023.[3] 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. 5

Sentiment: Both our daily and intermediate-term measures of investor sentiment have shown extreme optimism, which is negative from a contrary point of view.[6] While optimistic investor sentiment can stay elevated for a time, our investor sentiment models have now reached extremes, which often precede stock market pullbacks.

Momentum: The team's measures of momentum improved in December. 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 30% of the index, a historical record. Following these periods of concentration, leadership stocks showed sharp declines that led the rest of the market lower.[5] Nonetheless, we do not predict—we adapt. Our watchword is "Don't fight the tape." Upside volume is now above downside volume and is at its best levels in over a year. Breadth has improved significantly as well.[5] As a result, we have a modest net long position in our portfolios, and if momentum continues to improve, we may raise market exposure based upon the improvement in these models.

[1] *Source: Bloomberg. December 31,2023*
[2] *Source: Sam Stovall. CFRA Research. December 27, 2023*
[3] *Source: U.S. Department of Treasury. December 31, 2023*
[4] *Source: Ned Davis Research. December 31, 2023*
[5] *Source: Ned Davis Research. December 29, 2023*
[6] *Source: Ned Davis Research. December 26, 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.