Market Update

March 1, 2024

The S&P 500 Index notched its 14th record close in the first two months of 2024. The good news is that the market's breadth broadened in February, with small-cap stocks coming to life. The Russell 2000 Index led the major market averages, jumping 5.65%.[1] The NASDAQ-100 Index was up 5.41% and the S&P 500 gained 5.34%.[1] The Dow Jones Industrial Average rose 2.50%, but utilities continued to trail the major averages with the Dow Jones Utility Average slipping -0.69%.[1]

A continued strong economy has moderated hopes of multiple interest rate cuts by the Federal Reserve (Fed). The 10-year U.S. Treasury Note yield climbed from 3.87% at the beginning of the month to 4.25% at the end of the month, its highest level since December 2023.[2] Despite the backup in rates, however, credit spreads remain narrow and do not indicate tighter credit conditions as of now.

Volume and breadth momentum models improved in February and the investment team raised market exposure. While both absolute equity valuations and valuations adjusted for inflation remain above their historically fairly valued levels, they are well below their 2021 highs, and so there is room for expansion from current levels. Monetary policy remains negative-to-neutral until there is a clear indication that the Fed is going to lower rates. Indeed, with the continuing strength in the economy, the Fed may keep rates a bit higher for a bit longer. Perhaps the most important change in our pillars recently has been that investor sentiment has become increasingly optimistic, which is a negative in our work. Both our intermediate- and short-term measures of investor sentiment are in negative territory, indicating the possibility of some type of market pullback from current levels.

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 price-earnings (P/E) ratio (using trailing 12-month earnings) ticked higher during the month to 26.5x. Valuations are still above the 60-year average of 17.6x. While these levels are elevated as compared to historic norms, they are still below the 34.0x reading of early 2021 and could retest these highs if earnings continue to be strong. Nonetheless, from a longer-term perspective, it appears that equity valuations have further to decline to reach more fairly valued levels during this cycle.

Monetary factors and credit conditions: The 10-year U.S. Treasury Note ended the month with a 4.25% yield, up from 3.87% at the beginning of the month.2 This backup in rates reflected disappointment that the Fed may not cut rates as quickly as some investors had hoped. Narrow credit spreads, however, tell us that credit and financial conditions remain healthy.

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<u>Sentiment:</u> 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 some type of market pullback from current levels.

<u>Momentum:</u> The team's measures of momentum improved in February. Our model, which monitors market breadth, has bounced back into positive territory after a sharp dip at the end of 2023. Upside volume has risen above downside volume, although upside volume has not been as strong as breadth. We would like to see an increase in upside volume versus downside volume to raise market exposure further.

[1] *Source: Bloomberg, as of February 29, 2024*
[2] *Source: U.S. Department of the Treasury, February 29, 2024*