BROADMARK

Market Update

June 1, 2023

Technology stocks drove solid gains in May, as several companies in the sector reported strong demand related to artificial intelligence. The Nasdaq-100 Index jumped +7.73% for the month, reaching its highest level in a year.[1] The index has now climbed +30.79% year to date, having retraced about half of its 2022 loss.[1] The technology surge has been a global phenomenon, with the top 20 tech companies in the world now accounting for 24.7% of the MSCI All Country World Index.[2] This percentage is above the extremes reached in recent years and is now rivaling the peak reached during the dot-com bubble in 2000. The S&P 500 Index was helped by its 28% weighting in the information technology sector but was weighed down by weakness in the general market and was only up +0.43% for the month.[1] The Dow Jones Industrial Average was the weakest major index, dropping -3.17%, and the Russell 2000 Index lost -0.93%.[1]

There is still lingering anxiety over persistently high inflation. Consumer spending has risen to its fastest pace since January, the job market continues to be tight and U.S. home prices rose in the most recent month after falling for seven months.[3] While the bond market was jittery over inflation and the pending debt ceiling resolution, the 10-year U.S. Treasury Note yield rose only modestly from 3.59% to 3.64%.[4]

Equity valuations remain above their historical average, both in absolute terms and relative to inflation. Monetary policy is negative as inflation remains stubbornly high. But credit spreads are narrow and do not indicate a deterioration in credit conditions. Investor sentiment turned more optimistic during the month (negative from a contrary point of view) and the team's daily sentiment model rose into negative territory. While the stock market's strength improved upward price momentum, the team's volume and breadth models continued to lag the market's price gains, which has produced negative divergences.

The strategy benefited from its modest exposure to large cap stocks during May. The strategy's high cash position was able to take advantage of high short-term interest rates as well. This cash position is now providing a competitive return with the 13-week U.S. Treasury Bill now yielding 5.52% as of month-end.[4] The team would raise exposure further if interest rates declined, investor sentiment became pessimistic and the team's volume and breadth momentum models showed more improvement. The team would lower exposure if interest rates rose, credit spreads widened, investor sentiment became overly optimistic and the team's volume and breadth momentum models once again deteriorated.

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

Valuation: The S&P 500 median price-earnings ratio (using trailing 12-month earnings) at 24.1x is well below its 2021 high of 34.0x but still above its 59.3-year median of 17.6x.[2] From a longer-term perspective, it would seem that equity valuations are still too high and have further to decline during the current cycle.

Monetary factors and credit conditions: Interest rates rose very modestly in May. The 10-year U.S. Treasury Note yield rose to 3.64% from 3.59%. Despite concerns over the banking system, credit spreads have remained stable, suggesting that the regional banking crisis has not spilled over into the general economy.[2] Federal Reserve officials have signaled that they may keep interest rates steady in June. If the May rate hike was the last of this cycle, since 1928 the stock market has been lower in the six- and 12-month periods more than half of the time after the final rate hike.

Continued next page
Disclosure next page

Sentiment: The NDR Daily Trading Sentiment Composite, which measures short-term investor sentiment, rose into negative territory during May and showed the most optimism in several months. The NDR Crowd Sentiment Poll, however, which measures intermediate-term sentiment, still showed a good amount of skepticism, which is positive from a contrary point of view.[5] Overall, investor sentiment remained neutral.

Momentum: The market's narrowing leadership has created negative divergences. For example, the largest 10 stocks in the S&P 500 have accounted for over 80% of this year's gains. The five largest stocks in the S&P 500 account for 24.7% of the index, a record high dating back to 1972. So far this year, the cap-weighted S&P 500 Index has risen +9.64% but the equal-weighted S&P 500 Index has increased only +0.21%. Further, the technology surge has been a global phenomenon. The top 20 tech companies in the world now account for 24.7% of the MSCI All Country World Index. This percentage has now risen above the recent 2020 and 2021 extremes and rivals the extreme reached during the dot-com bubble in 2000.[5]

The percentage of stocks outperforming the S&P 500 over a calendar year is at a record low.[6] Following such narrow market leadership, the stock market's return on average has been below its long-term norms one year later. The two worst periods came after two of the most notable periods of narrow leadership in Wall Street history: the Nifty 50 era of the early 1970s and the dot-com bubble in the late 1990s.

[1] *Source: Bloomberg. May 31, 2023*
[2] *Source: Ned Davis Research. May 31, 2023*
[3] *Source: Wall Street Journal. June 1, 2023*
[4] *Source: U.S. Department of Treasury. May 31, 2023*
[5] *Source: Ned Davis Research. May 26, 2023*
[6] *Source: Ned Davis Research. May 30, 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.