DAY HAGAN PRIVATE WEALTH

MARKET UPDATE

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September 29, 2023

MARKET UPDATE

SUMMARY

Interest rates are rising, and decreasing liquidity in the markets continues to put pressure on the economy. However, the recent market pullback and low current investor equity exposure are presenting the opportunity for a rally in the fourth quarter.

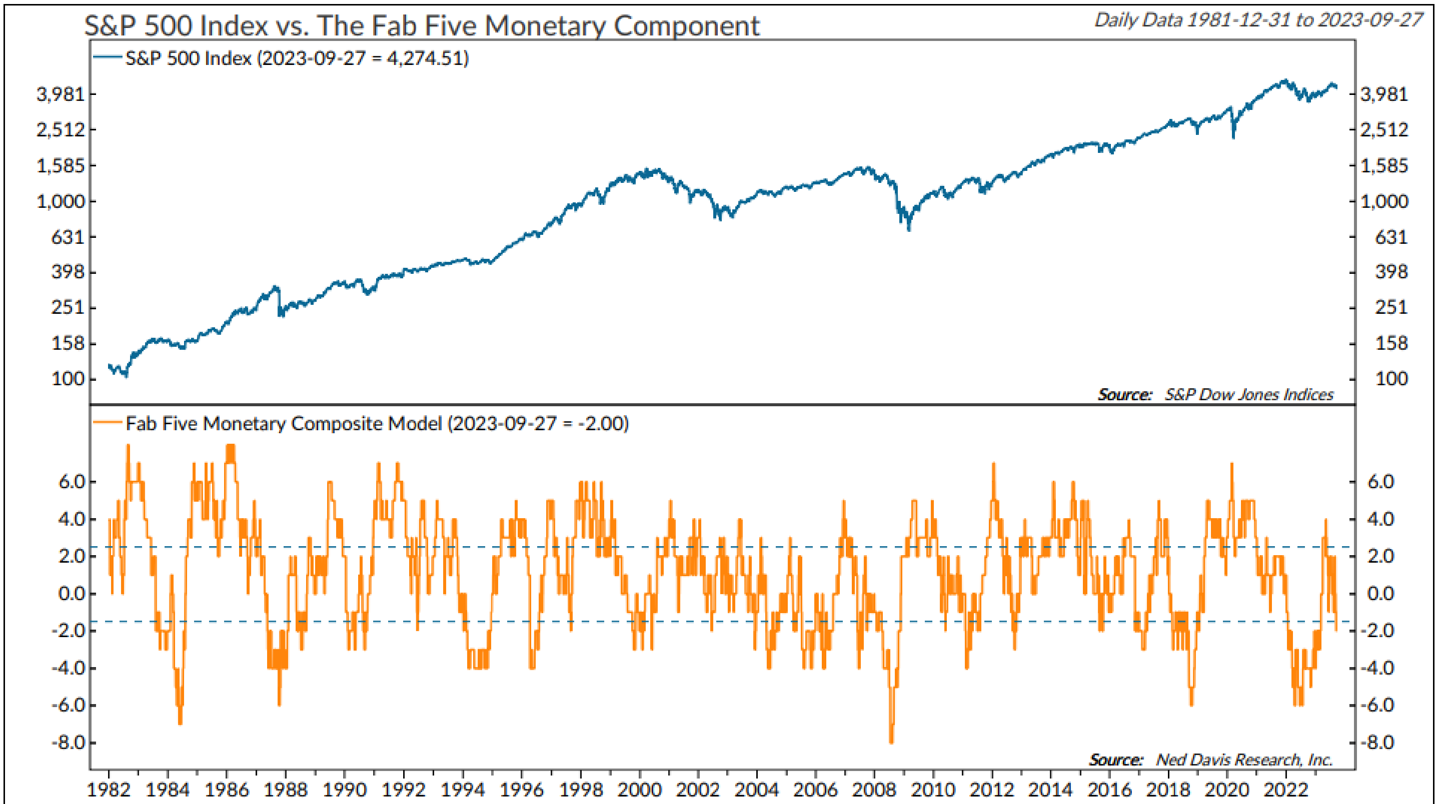
BROAD MARKET PERFORMANCE (AS OF 9/27/2023)

	YTD Performance	Trailing 1-Year Performance
SPY (SPDR S&P 500 ETF)	12.65%	19.11%
DIA (SPDR DJIA ETF)	2.77%	17.47%
QQQ (Nasdaq 100 ETF)	33.92%	30.23%
TLT (20+ Year US Treasury ETF)	-9.28%	-9.68%
AGG (US Aggregate Bond ETF)	-1.23%	1.18%

Source: Morningstar

MACROECONOMIC VIEW

Back in May, we wrote about how money supply growth and banks' willingness to lend were getting worse and were likely to impact consumer sentiment negatively. As expected, those factors continue to work their way through the economy and have now caused the NDR Fab Five Monetary Component model to turn negative. The model evaluates a broad range of indicators that measure monetary liquidity, fixed income, and commodities markets to determine whether the macro environment is conducive to higher stock prices.



Model	Model Reading (As of 2023-09-27)	Model	Model Reading (As of 2023-09-27)
S876	NEUTRAL	S875A	BEARISH
S835	NEUTRAL	S950	BEARISH
S955	BEARISH	S970	NEUTRAL
DAVIS168	BULLISH	DAVIS194A	NEUTRAL

S&P 500 Index Performance **Full History:** 1981-12-31 to 2023-09-27		
Fab Five Monetary Component is	% Gain/ Annum	% of Time
Above 2.5	21.33	34.32
-1.5 - 2.5	8.24	45.48
Below -1.5	-8.22	20.20
Buy/Hold = 8.88% Gain/Annum		

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Figure 1: The Fab Five Monetary Component

The Fed's stance of increasing their policy rate has rippled through the credit markets, and we are seeing rates reach levels not seen in over ten years. For example, the 10-year U.S. Treasury is now yielding roughly 4.6%, which was last seen back in 2007.

Figure 2: 10-Year Treasury Note Rate

The drastic increase in yields has wiped out years of gains for many fixed income investors. The total return for the Vanguard Total Bond Market ETF (BND) over the past seven years is now -1.10% and has averaged -5.27% *per year* over the past three years. Long-duration U.S. Treasury bonds have fared even worse, with the PIMCO 25+ year U.S. Treasury ETF (ZROZ) now down over -62% from its peak in early 2020. That has brought the 5-year price return for that ETF down to -5.91% per year! Treasury bonds have not been the safe haven everyone expected, illustrating our view that diversified portfolios, distributed among several asset classes, make sense.

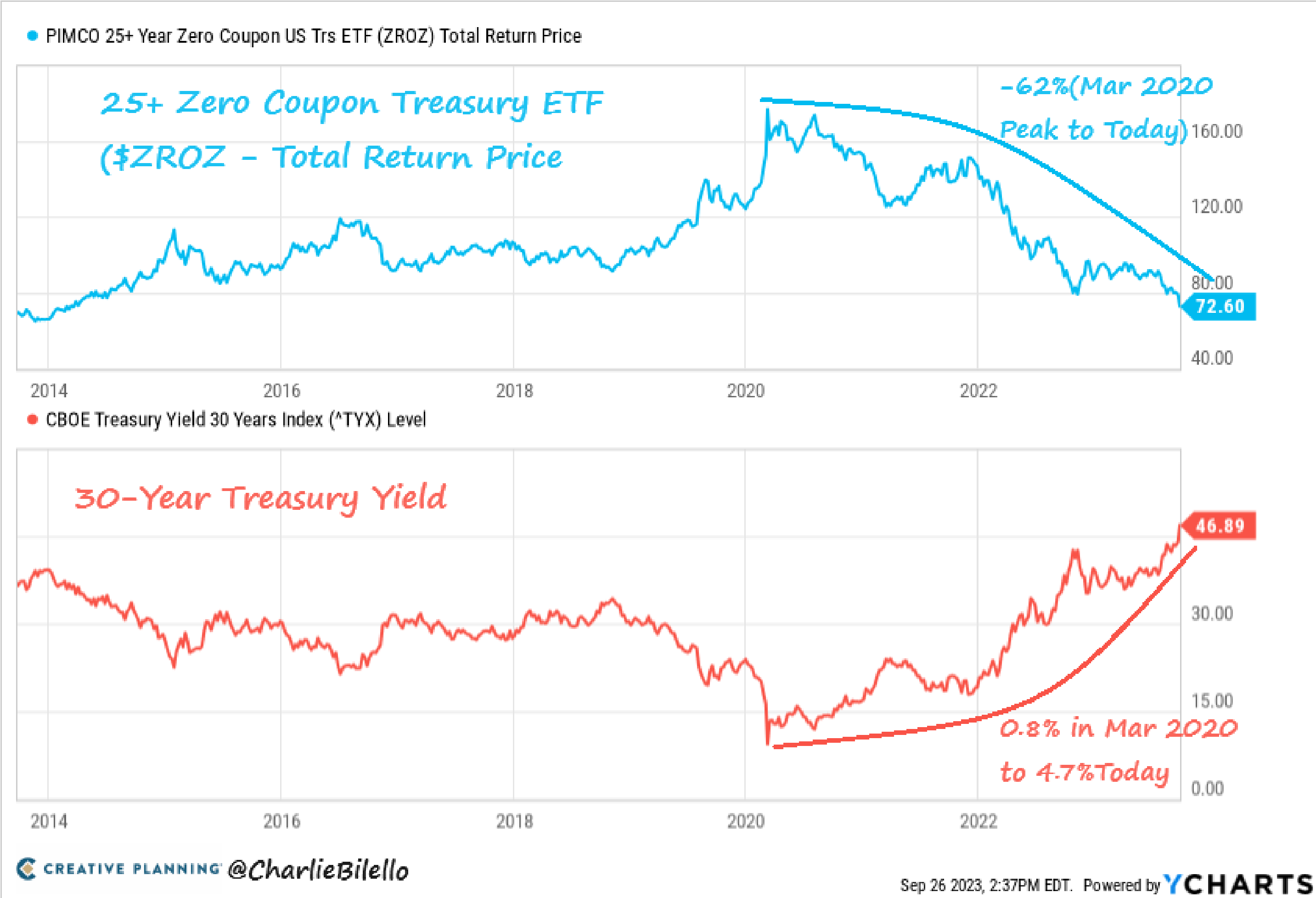


Figure 3: ZROZ Total Return versus 30-Year U.S. Treasury Yield

Another byproduct of the Fed's interest rate policy has been a drastic increase in mortgage rates. Over the past two years, the average 30-year fixed rate has gone from just over 3% to around 7.5% today. Consequently, housing affordability has reached historic lows, with the median U.S. housing payment spiking to well over 40% of median income.

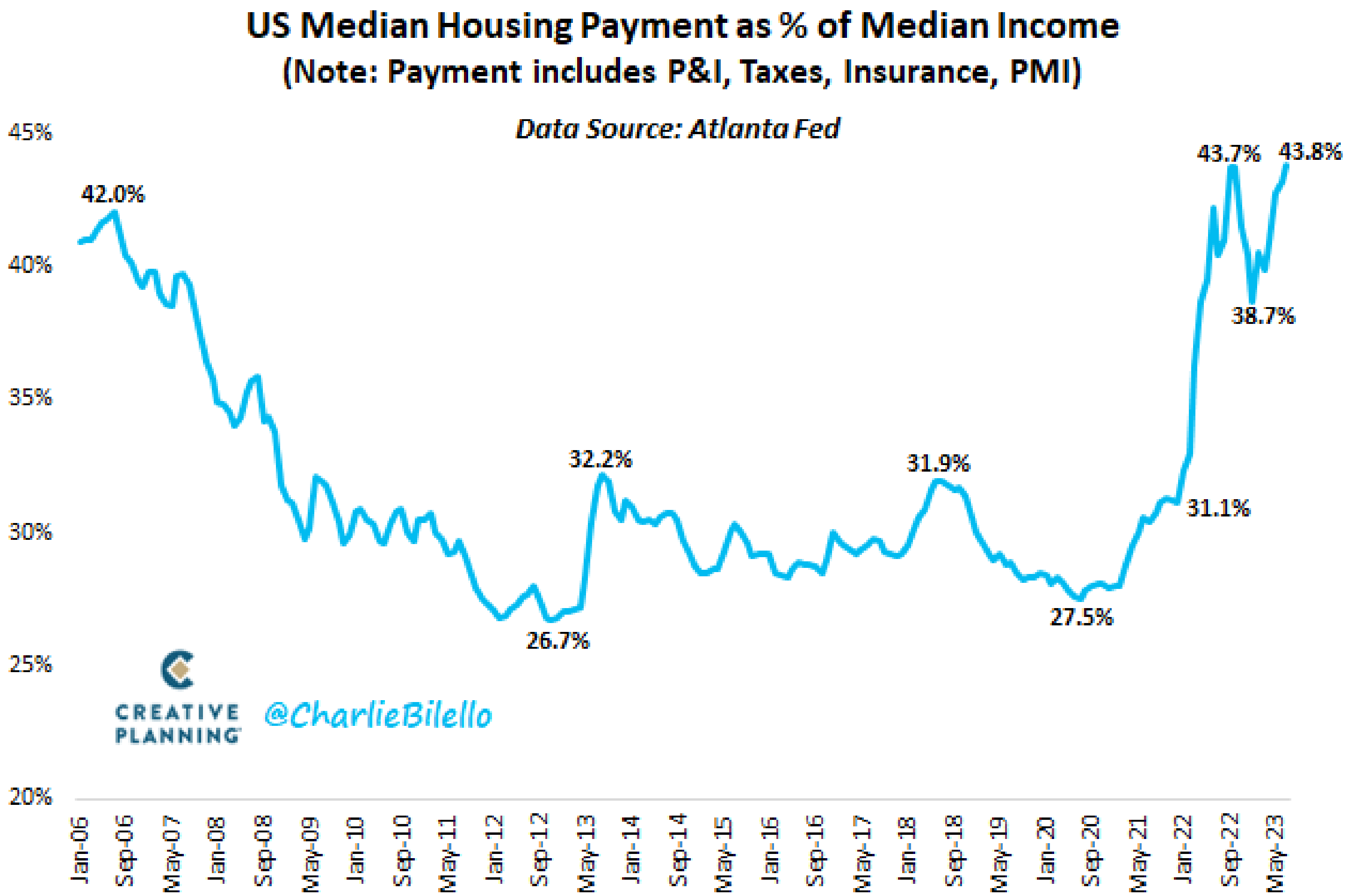
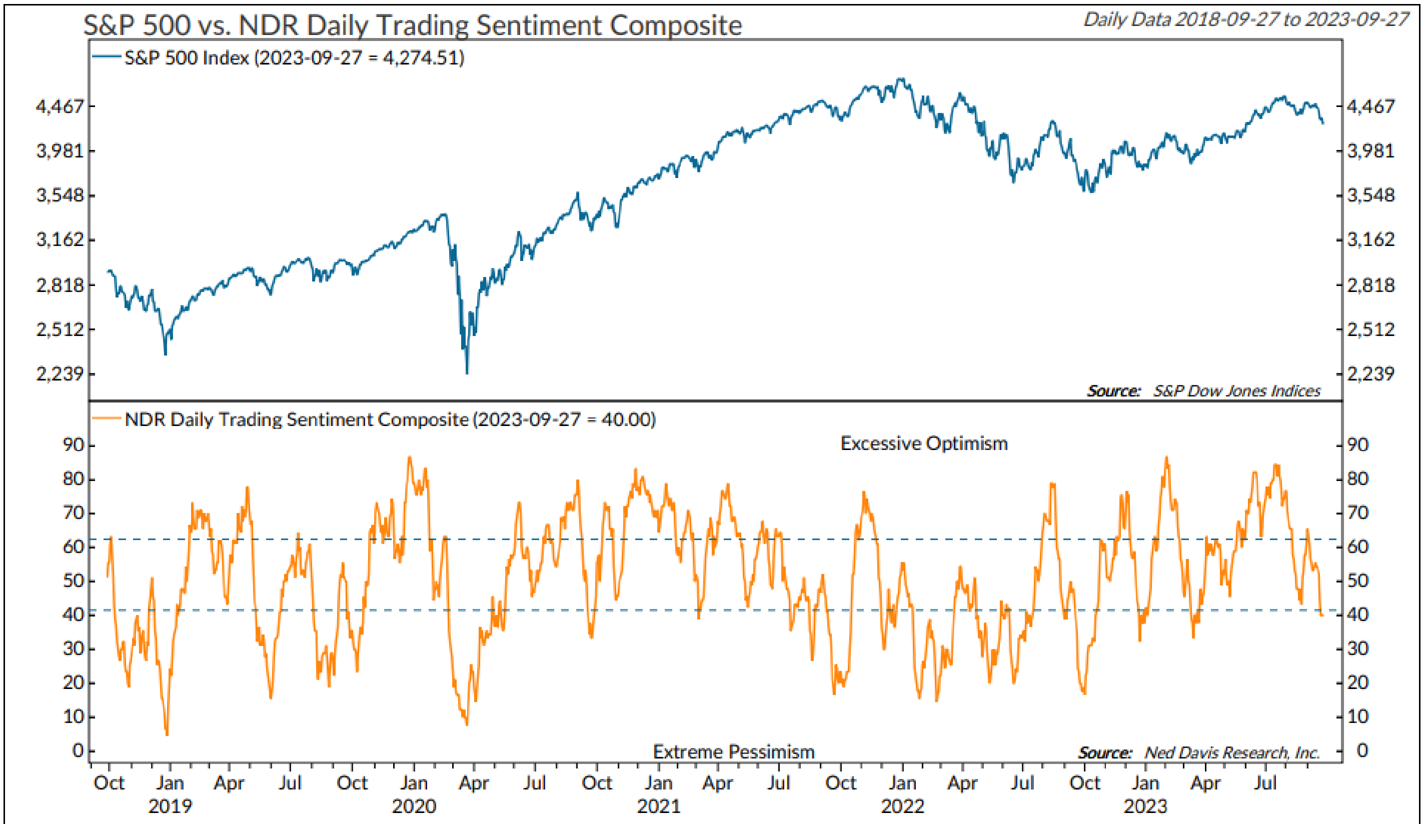


Figure 4: U.S. Median Housing Payment as % of Median Income

Interestingly enough, the decrease in bond prices (increase in interest rates) has been somewhat orderly, and credit spreads have remained fairly stable as they stay below or at their historical norms. Credit spreads, in our opinion, are a good indicator of stress levels within the credit markets. We typically see spreads increase dramatically during times of extreme duress, but they are not showing any signs currently.

TECHNICALS/SENTIMENT

Equities have sold off from their July highs, with the S&P 500 (SPY) down about -6.75% and the Nasdaq 100 (QQQ) down roughly -8.23%. This was the second pullback of more than -5% this year, with the previous period occurring between February and March. After that pullback (also largely a function of rising rates), equities (SPY) rebounded more than +15%. The current pullback has caused the NDR Daily Trading Sentiment Composite to move into the “Extreme Pessimism” zone, albeit barely. We use this model to discern the near-term headwinds or tailwinds for the U.S. equity markets. With the model now showing Excessive Pessimism, we see fewer headwinds.



S&P 500 Index Performance **Full History:** 1994-12-30 to 2023-09-27		
NDR Daily Sentiment Composite is	% Gain/ Annum	% of Time
Above 62.5	-6.40	28.65
41.5 - 62.5	7.57	44.18
Below 41.5	26.69	27.17
Buy/Hold = 8.06% Gain/Annum		

S&P 500 Index Performance **Chart View:** 2018-09-27 to 2023-09-27		
NDR Daily Sentiment Composite is	% Gain/ Annum	% of Time
Above 62.5	4.53	30.61
41.5 - 62.5	12.92	38.83
Below 41.5	5.33	30.56
Buy/Hold = 7.96% Gain/Annum		

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Figure 5: NDR Daily Trading Sentiment Composite

Another measure of sentiment is hedge fund positioning. Currently, based on futures holdings, hedge funds are decidedly bearish, with the ratio of short to long positions at stretched levels. In other words, hedge funds, overall, are net short. Historically, this is a positive development. When they close out their short positions, either to lock in profits or as a stop-loss, this creates buying demand, which can drive equities higher.

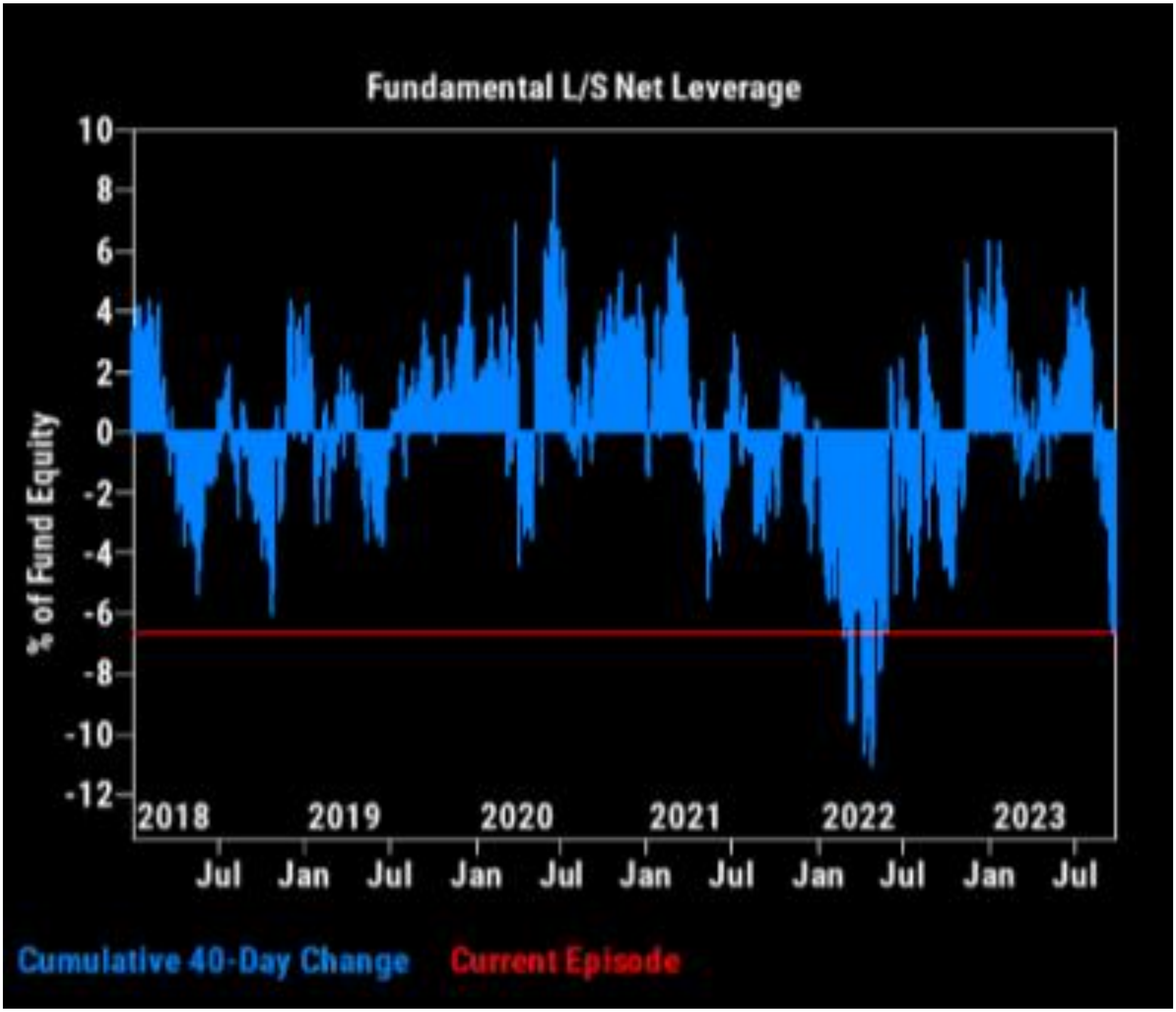

Figure 6: Hedge Fund Fundaments Long/Short Net Leverage

Even with the recent pullback, the S&P 500 is up roughly +12.65%. The gains have been created mostly by the seven largest stocks in the index, as they are up about +81% YTD, with the equal-weighted S&P 500 roughly flat. The divergence between the “Super 7” and the rest of the market illustrates just how narrow the market has been this year.

Figure 7: S&P 500 Index versus the Magnificent 7 Index and S&P 500 Equal Weighted Index

This has caused the valuation of the S&P 500 index as a whole to be skewed higher, as multiples are quite rich for the handful of mega-cap stocks that have rallied this year. Importantly, however, there are many stocks that aren't one of the favored few and are now exhibiting interesting valuation opportunities. We continue to focus our Day Hagan Smart Value portfolio holdings on those prospects. (Please give us a call if you would like to discuss the portfolio in more detail.)

This type of market dynamic (just a handful of stocks driving broad index returns) can create performance anxiety for a lot of managers who are underperforming relative to their S&P 500 index benchmark. This underperformance has historically created demand as they try to catch up with the benchmark before year-end. Although the economic and monetary environments are less than favorable, the current pessimism evidenced by retail and institutional investors alike, along with FOMO ("fear of missing out") from managers who are underperforming their benchmarks, could be setting the markets up for a bullish fourth quarter this year. As always, we will follow the message of our models. They are keeping us bullish for now, but should they turn bearish, we will be quick to decrease risk across your portfolios.

Have a great week,

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—Written 9.28.2023

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