Kensington Market Insights

November 14, 2024

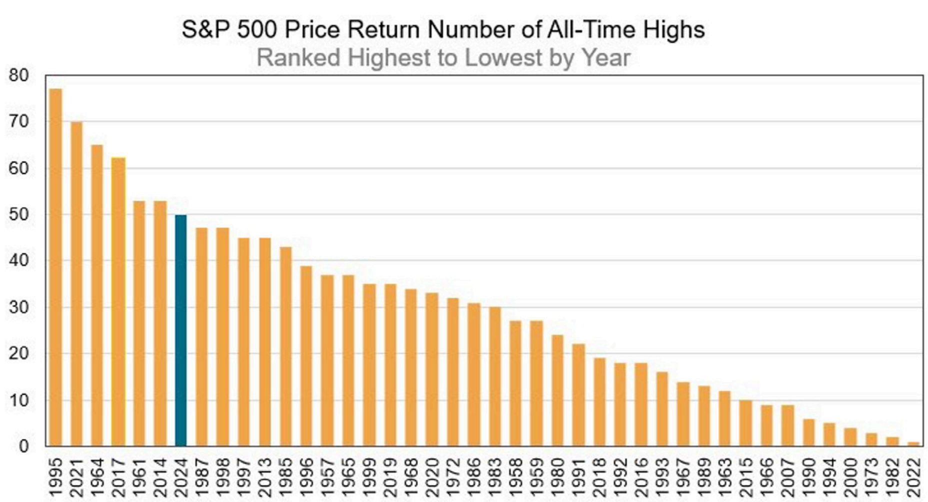
KENSINGTON Asset Management

Market Insights is a piece in which Kensington's Portfolio Management team will share interesting and thought-provoking charts that we believe provide insight into markets and the current investment landscape.

In the current market landscape, it's becoming increasingly clear that "everything is expensive." Elevated valuations across both US equity and fixed income markets underscore the need for caution and adaptability. Although this doesn't imply an imminent correction, it highlights the importance of vigilance and flexibility for investors navigating today's environment.

The Elevated Landscape of US Equity Markets

US equity markets continue to reach new highs, driven by strong performances in large-cap and technology stocks. The S&P 500, for example, has hit a record high 50 times this year, making 2024 one of the most record-setting years since the index's inception (see chart below).



Source: S&P Dow Jones Indices. Data as of Nov. 8, 2024.
Chart is provided for illustrative purposes only.
Past performance is no guarantee of future results.

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About Kensington

Kensington Asset Management specializes in data-driven, quantitative investment solutions spanning across the global investment landscape. Our focus is to help provide investors with confidence through quantitative analytics, by attempting to participate in rising markets, while taking steps to help avoid exposure during times of market decline or volatility. Kensington Asset Management was founded by Bruce P. DeLaurentis, a quantitative pioneer with over 40 years of trading experience through numerous market cycles.

Investment Philosophy

Kensington believes that the best way to generate steady, above average positive returns is to employ an investment methodology that has the potential to recognize and measure consistent and repeating behavioral patterns in the financial markets. With that goal in mind, Kensington has developed clearly defined quantitative decision models that strive to minimize subjectivity in this decision-making process. The overarching goal is to capture sufficient returns in positive market conditions, while protecting capital, with rigorous mitigation during down markets.

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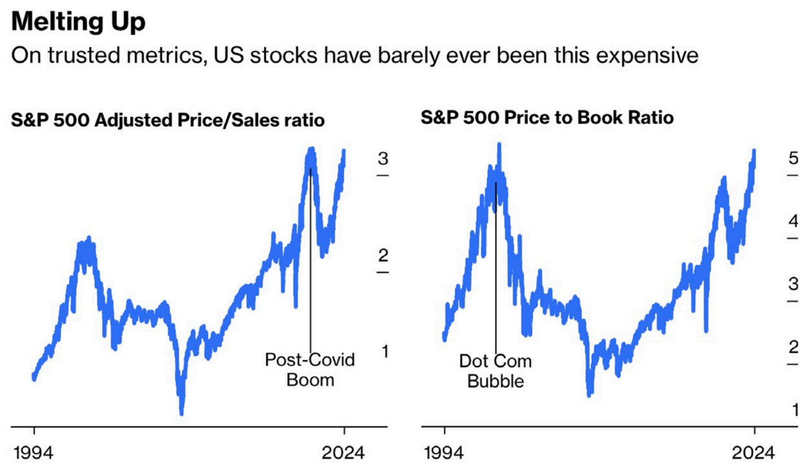
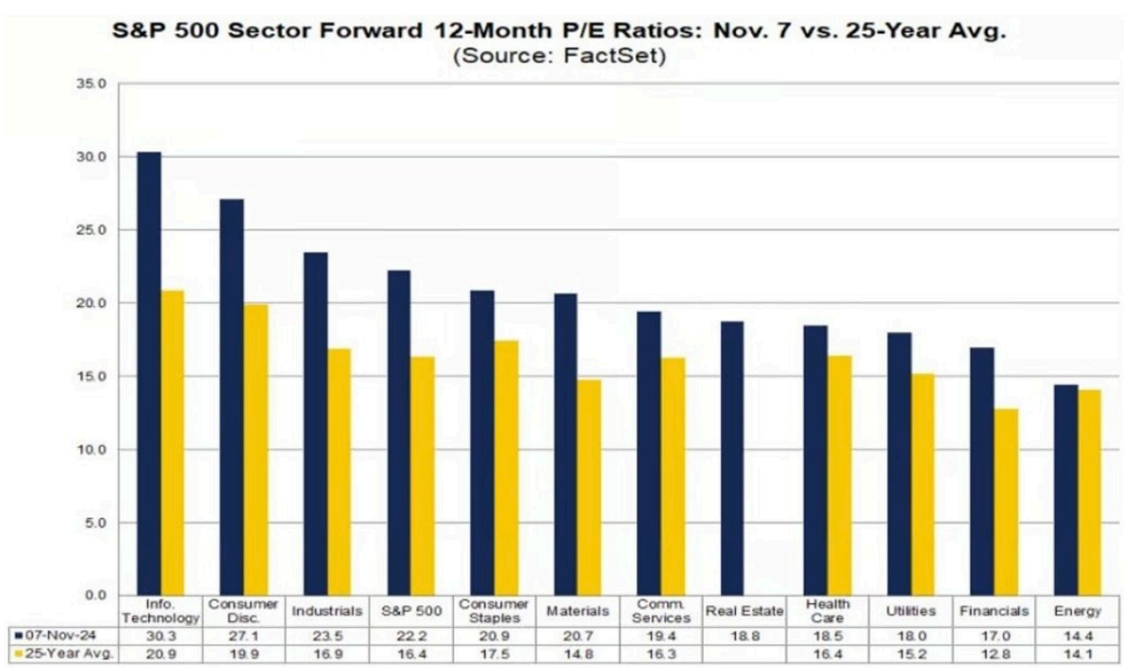
This trend raises questions about sustainability, especially as valuation metrics show stocks are expensive relative to historical norms (chart below). On a price-to-sales basis, the market is near levels last seen during the post-COVID surge in 2021. Similarly, the price-to-book ratio is approaching levels not seen since the dot-com bubble. These indicators suggest valuations are stretched, potentially limiting further upside without substantial earnings growth.



Source: Bloomberg as of September 30, 2024

While much of the run-up in S&P 500 valuations can be attributed to specific sectors—particularly Information Technology—the broader reality is that 10 out of 11 sectors are trading at multiples exceeding their 25-year averages. The aggregate P/E ratio for the S&P 500 stands at 22.2, well above the historical average of 16 (see chart below).



	Info. Technology	Consumer Disc.	Industrials	S&P 500	Consumer Staples	Materials	Comm. Services	Real Estate	Health Care	Utilities	Financials	Energy
07-Nov-24	30.3	27.1	23.5	22.2	20.9	20.7	19.4	18.8	18.5	18.0	17.0	14.4
25-Year Avg.	20.9	19.9	16.9	16.4	17.5	14.8	16.3		16.4	15.2	12.8	14.1

Source: FactSet as of November 8, 2024

Fixed Income Markets: Low Spreads Highlight Broad-Based Expensiveness

The fixed income market also reflects expensive valuations across both high-yield and investment-grade bonds, signaling a low-risk premium for investors. As shown in the chart below, high-yield spreads are at their lowest levels in 17 years, meaning investors receive minimal compensation for taking on higher credit risk. This compression typically signals optimism in the economic outlook but also heightens the risk if economic conditions weaken.

Source: Bloomberg as of November 12, 2024

Investment-grade bond spreads have similarly dropped to levels not seen since 1997. The low spreads across both high-yield and investment-grade sectors indicate a challenging environment for bond investors, who are paying high prices relative to historical averages. When both high and low-risk bonds offer reduced spreads, the fixed income market as a whole appears "expensive," providing limited compensation for risk.

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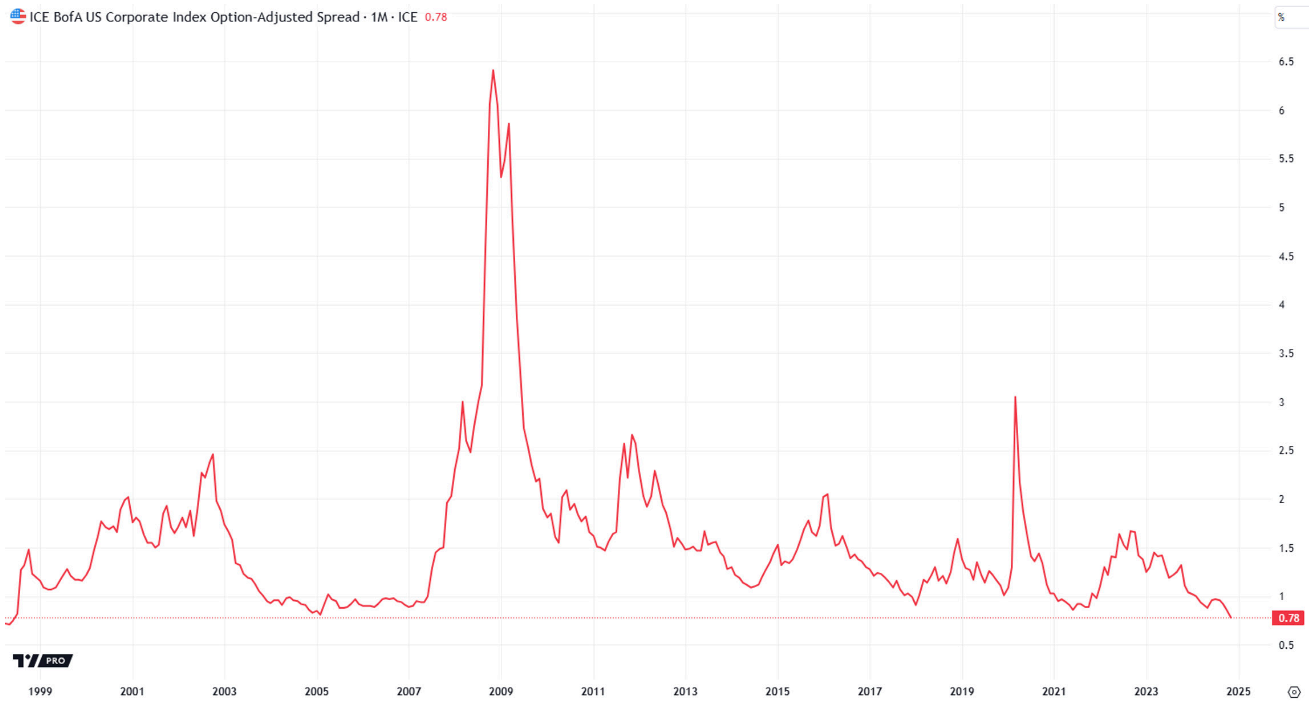

Source: Trading View as of November 12, 2024

Although 10-year Treasury yields have recently risen (4.43% as of November 11, 2024), this does not necessarily counter the narrative of expensiveness; rather, it reflects an atypical relationship in today's market. While high Treasury yields may offer some return potential if there's a retracement, they underscore the elevated prices investors are paying across the board. This makes it crucial for investors to approach the bond market cautiously, as current valuations provide little buffer in the event of economic downturns or credit stress.

Considering the Other Side: Market Momentum as a Buffer

While current valuations indicate caution, recent insights from Doug Ramsey at the **Leuthold Group** offer a counterpoint: strong market momentum could serve as a temporary "inoculation" for the economy. The S&P 500's rare nine-week winning streak in late 2023, combined with a trailing 12-month gain of 36%, places it in an elite historical category associated with continued economic expansion. Over the past 100 years, no recession has followed a trailing 12-month gain above 35%, suggesting that robust market performance may provide short-term economic stability (chart on next page).

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S&P 500 Performance After Gaining More Than 35% In The Last 12 Months*

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Date	S&P 500 12-Mo. Gain	S&P 500 Forward Performance 1-Mo %	3-Mo %	6-Mo %	12-Mo %	Business Cycle Peak In Next 12 Mos.?
March 30, 1928	37.3	3.2	0.3	11.7	33.5	No
April 30, 1933	42.7	15.9	19.6	7.7	25.7	No
October 31, 1935	41.4	3.9	14.8	10.5	38.1	No
March 31, 1943	44.6	0.1	6.6	4.3	3.8	No
January 31, 1946	37.9	-6.9	1.0	-3.3	-15.7	No
September 30, 1954	38.4	-1.9	11.4	13.2	35.2	No
December 31, 1958	38.1	0.4	0.4	5.9	8.5	No
June 30, 1971	37.1	-4.1	-1.4	2.4	7.5	No
March 31, 1983	36.6	7.5	9.9	8.6	4.1	No
September 30, 1987	39.1	-21.8	-23.2	-19.6	-15.5	No
January 30, 1996	35.2	0.7	2.9	0.6	23.6	No
July 31, 1997	49.1	-5.7	-4.2	2.7	17.4	No
August 31, 1999	37.9	-2.9	5.2	3.5	14.9	No
February 27, 2004	36.1	-1.6	-2.1	-3.6	5.1	No
February 26, 2010	50.3	5.9	-1.4	-5.0	20.2	No
March 31, 2021	53.7	5.2	8.2	8.4	14.0	No
October 31, 2024	36.0	?	?	?	?	?
Average	41.0	-0.1	3.0	3.0	13.8	No peaks within next 12 months.
Avg., All Periods	8.4	0.7	2.0	4.1	8.4	

*12-month gain must have been below 35% for each of the previous 12 months.

Source: Leuthold Group as of November 6, 2024

Additionally, market breadth remains strong, with the NYSE Advance/Decline Line recently reaching an all-time high. Over the past 70 years, only two bull market peaks (in 1980 and 1987) occurred when the S&P 500's trailing one-year gain exceeded 30%. Unlike those periods, however, today's strong breadth suggests broad participation and liquidity support (see chart).

Breadth & Momentum At S&P 500 Bull Market Highs

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Date of S&P 500 High	S&P 500 1-Yr. % Chg. At High	Wks. Since Peak In NYSE A/D Line
August 2, 1956	15.6	20
December 12, 1961	27.8	30
February 9, 1966	7.8	40
November 29, 1968	14.7	69
January 11, 1973	16.0	35
September 21, 1976	26.8	0
November 28, 1980	31.6	116
August 25, 1987	35.9	22
July 16, 1990	11.0	49
March 24, 2000	20.4	102
October 9, 2007	15.9	18
February 19, 2020	21.8	0
January 3, 2022	29.6	8
November 6, 2024	*35.8*	*3*
Average (ex. 2024)	**20.8**	**47.8**
Median (ex. 2024)	**18.6**	**37.7**

Source: Leuthold Group as of November 6, 2024

Conclusion: Navigating an Expensive but Resilient Market

Today's market presents a complex picture: valuations across equities and fixed income are undeniably high, suggesting a limited margin for error and heightened sensitivity to economic shifts. At the same time, recent market momentum offers a counterbalance to this caution. Historically, powerful rallies like the current one in the S&P 500 have often supported economic resilience in the short term, with strong 12-month gains coinciding with continued economic expansion rather than recession.

In this dual environment, investors are best served by a flexible approach. While high valuations warrant caution, the market's momentum may provide a stabilizing force. Staying adaptable allows investors to manage risk amid high valuations while remaining open to the possibility that strong momentum might extend the economic cycle. This combination of caution and flexibility can help navigate the opportunities and risks in today's expensive yet resilient market.

Forward-looking statements are based on management's then current views and assumptions and, as a result, are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. This market insight is for informational purposes only and should not be construed as a solicitation to buy or sell, or to invest in any investment product or strategy. Investing involves risk including loss of principal.