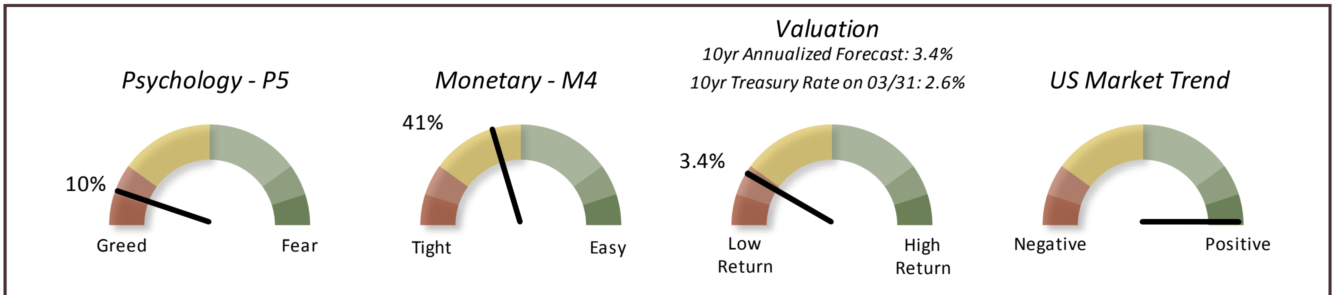
Cypress Market Outlook

By Mark T Dodson, CFA



Recommended Equity Exposure: 70% of Maximum Allocation

Market Trend Analyzers	Phase
Domestic Equities	*Investment Phase: 70% Invested*
International Equities	*Trading Phase: Short Term Trend Positive*
Real Estate	*Investment Phase: All Trends Positive*
Commodities	*Trading Phase: Short Term Trend Positive*

Monetary

Components	Condition
Exchange Rates	*Neutral*
GDP	*Positive*
Inflation	*Neutral*
Interest Rate Spreads	*Negative*
Interest Rates	*Positive*
Lending & Leverage	*Neutral*
Monetary Aggregates	*Neutral*
Velocity	*Negative*

Valuation

Components	Level
10Yr Annl Equity Return Forecast	3.4%
10Yr Treasury Note Yield	2.6%
5Yr Annl Valueline App Potential Forecast	6.1%

Psychology

Components	Condition
Bank Sentiment	*Negative*
Flow of Funds	*Neutral*
Fund Flows	*Neutral*
Insider Sentiment	*Neutral*
Leveraged Investments	*Negative*
Option Activity	*Negative*
Surveys	*Neutral*
Consumer Confidence	*Negative*
Technical Indicators	*Positive*
Trading Data	*Neutral*
Volatility	*Neutral*

The Market Risk Index fell under 80% this week, still in cautious territory, but this is the first time it has fallen under 80% since February. Both investor psychology and valuations worsened, but the improvement in monetary conditions were enough to offset it.

The decline in Treasury and Corporate bond yields that we have seen over the last six months has been enough to simulate what looks like a small round of monetary easing, and it's pushed our monetary composite up to the 40th percentile, which is just shy of neutral. Corporate bond yields, particularly their relationship to Price

Earnings ratios on stocks, have grown more important for measuring monetary conditions than was the case 30 years ago, as that spread is a big driver of corporate buybacks and the balance sheet arbitrage that corporations have embraced over the last two bull market cycles. It has been a quicker response kind of stimulus too, compared with the traditional role that the Fed & monetary policy have historically exerted over the capital investment cycle. It takes a couple clicks of a mouse to buy back stock and a lot longer to build a new widget factory.

Inflation pressures have also softened. For example, the Producer Price index, which we cited as a reason for caution last summer, has weakened considerably. Given that the nature of the fall in interest rates will be short lived and that the yield curve will begin weighing on markets over the course of the summer, this bounce in monetary readings will prove short-lived.

If the 1998 stock market analog continues to serve as guide, those challenges will begin showing up in breadth before they do in the broad cap-weighted indices. That may already be the case. The small cap Russell 2000 index is struggling to maintain its 200-day moving average and has recently made a lower high. In 1998-2000, small and mid-cap stocks were in an ongoing bear market well before tech stocks peaked in 2000. The silver lining was those same stocks also provided investors with an excellent opportunity just as the tech bubble was bursting.

As for investor psychology, it appears likely to push through the 10^{th} percentile and flirt with the poor readings that we saw at both market peaks last year. The Rydex Ratio is within 1-2 percent from taking out those euphoric peaks reached in early 2018.

Valuations have fallen to the 6^{th} percentile, which translates to a 10-year nominal return forecast for equities of 3.4%. Investors can buy 90-day T-Bills and earn 2.4%. If the spread between those two is an indication of a margin of safety, then piling into an asset with an infinite duration and a history of 20-50% declines to earn an extra percent return is an exercise in speculation not investing.

Company Purpose
To positively alter the course of others' lives.