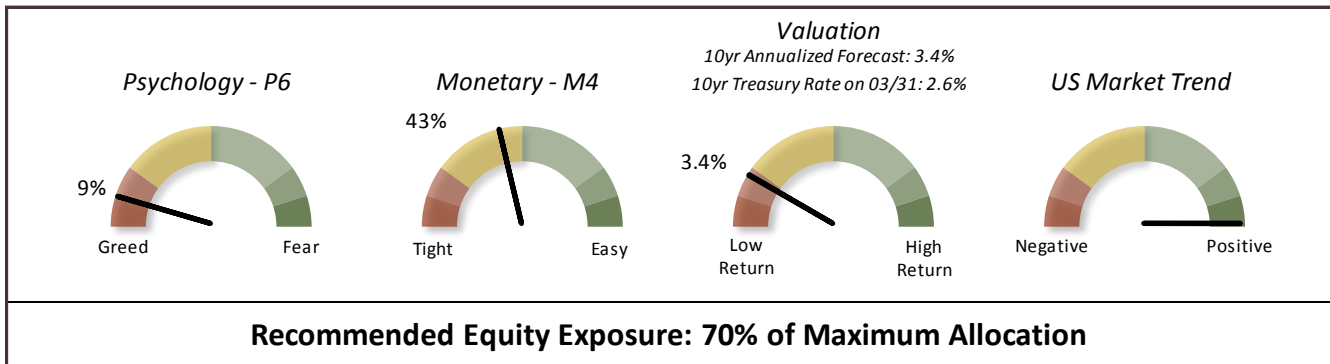




Cypress Market Outlook

By Mark T Dodson, CFA



Market Trend Analyzers

- Domestic Equities
- International Equities
- Real Estate
- Commodities

Phase

- Investment Phase: 70% Invested
- Trading Phase: Short Term Trend Positive
- Investment Phase: All Trends Positive
- 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	●

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	Neutral	○
Technical Indicators	Positive	●
Trading Data	Positive	●
Volatility	Positive	●

Valuation

Components	Level
10Yr Annl Equity Return Forecast	3.4%
10Yr Treasury Note Yield	2.6%
5Yr Annl Valueline App Potential Forecast	6.2%

The S&P 500 and NASDAQ have hit new highs and with it, our psychology composite has breached the 10% level, meaning the worst 10% of possible readings and its lowest readings since October 2018 and a round-trip from the sentiment that we saw in late December. Monetary improved again modestly, making the market risk index largely unchanged for the week and still in cautious territory. Sentiment and valuations are going to make it difficult to move the needle to one where we would recommend an aggressive posture. Valuations, while unlikely to breach the dot com highs, have firmly cemented the mantle as the second worst period of over-valuation for US equities.

New highs tend to beget new highs, and the post-Christmas Eve rally continues to show a lot of similarity to the rally off the 1998 correction lows. FAANG stocks have resurged, as technology stocks did in 1999. Fewer stocks hit highs along with indices, and several indices have some distance to make up to breach new highs. This too is like the 1999 rally, but the 2019 version looks a little healthier in this regard.

The areas in psychology that are positive, Technicals, Trading Data, and Volatility, reflect this recent positive momentum in markets. Higher prices and low volatility often produce more of the same in the short run. The momentum isn't without its warts in this case. The McClellan Oscillator, an internal measure of the market's momentum, is still negative, which is unusual. There were more stocks making new lows than highs early this week. Ongoing battles between stocks making new lows and new highs, while a broad index is making new highs (or new lows) is not ideal either.

The indicators weighing down psychology are the ones that we would call long cycle sentiment indicators – those are the indicators which correlate with valuation and credit cycle indicators like the yield curve. Those have stubbornly maintained extremes since early 2017, and the only similar stretch was in the late 90s. We've already highlighted the similarities in the dotcom period and today with FANG. If you dig deeper; however, the narrative revolves more around the political story this time around. Gallup has shown from surveys that consumer confidence has been breaking mostly along party lines. It seems that everything has become political.

Narratives and stories drive animal spirits and in turn bets on financial assets. Sentiment and valuation don't make judgements about narratives. Instead, they answer the question of whether a narrative has become so popular that you are overcrowding into an asset. Whether your story is right or wrong comes second to whether you pay too much for the asset. Price matters more.