Cypress CAPITAL

Market Outlook

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Summary

The Market Risk Index dropped again slightly this week on further improvement to investor psychology but remains stuck in elevated risk territory.

While the investor psychology score is a long way from the impressive readings from in January, the daily readings from the underlying indicators have finally moved into positive territory this week. That's the first step toward improvement in the overall score. Improvements to some individual indicators - put/call ratios, the level of bearishness from the AAII survey, and up volume ratios this week – have been substantial. The AAII survey has now put together four weeks in a row of elevated bearish readings, the kind of levels that would lead a market watcher to believe a tradeable rally is afoot, and there's enough there to suggest an early summer rally.

We usually see improvments like this and grow more optimistic, but with a backdrop of long-leading sentiment indicators at or close to all-time highs, a yield curve that has grown more inverted, negative monetary base growth, and excessive valuation, it remains difficult to get constructive or make aggressive shifts solely based upon short term sentiment indicators. It's why the our model hasn't made much headway overall.

For example, the AAII survey produced similar kinds of bearish readings late in 2007 with a comparable backdrop which led to a tradable short-term rally, but it was in the context of the start of both a recession and a bear market. It was a rally that in hindsight looked imprudent upon which to place a large bet, and the AAII sentiment readings turned out to be early recession warnings. The survey was determined to be so good at forecasting recessions that the Conference Board ended up adding the survey to it's basket of Leading Economic Indicators.

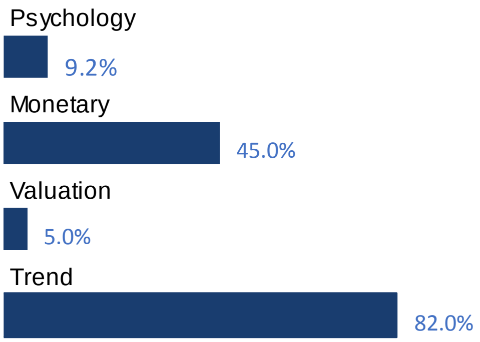
At the same time, the High-Low Logic Index has triggered another minor sell signal in the last week, and maybe more than any other measure of market internals over the last 18-24 months, it has been smart to take heed of what has been occuring in new highs and lows over what has occurred with any of the advance decline based statistics.

Market Risk Index

Elevated

78.2%

Category Percentiles



Biggest Psychology Influences

Option Activity	Positive
Surveys	Positive
Leveraged Investments	Negative
Consumer Confidence	Negative

Biggest Monetary Influences

Change in Interest Rates	Positive
Yield Curve	Negative
Velocity	Negative

Valuation

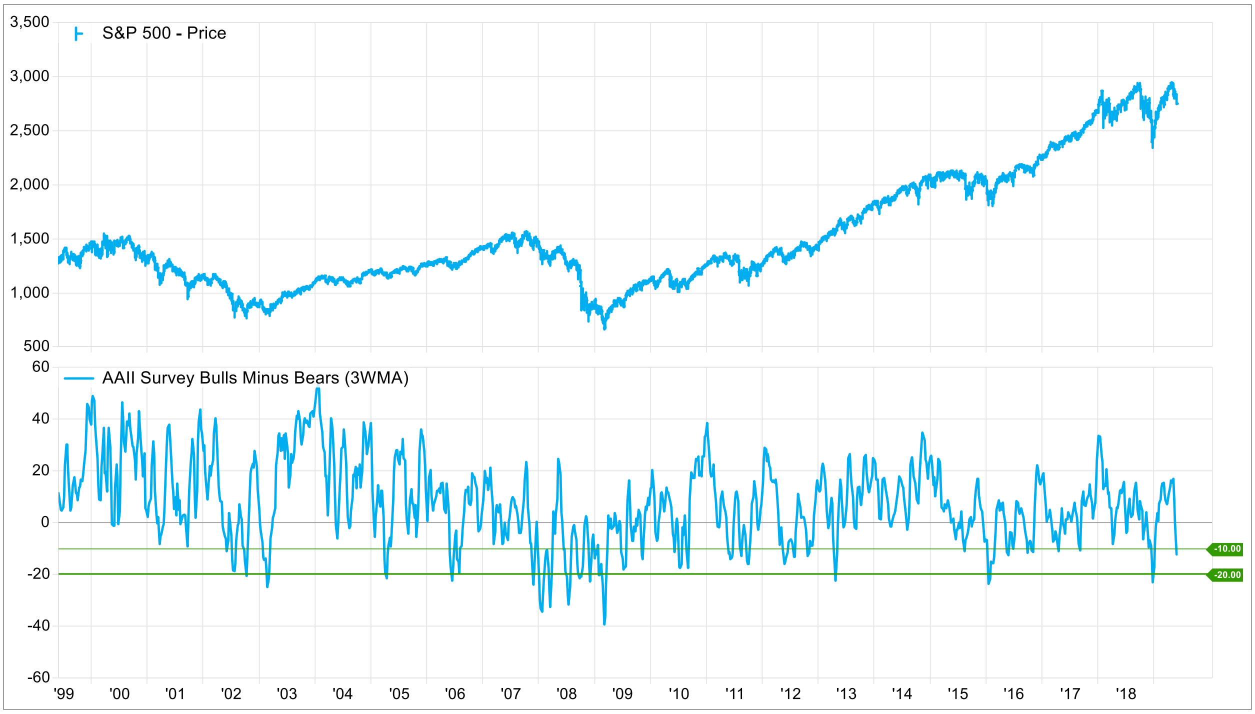
7-10 Year Rtn Forecast	3.2%
10Yr Treas Yield (on 4/30)	2.5%

Correction headlines have focused on a brewing trade war with the assumption that a resolution there would be a bullish event. While we have been impressed with how well markets and the economy have been able to shake off the escalation in trade war headlines, the trade spat itself has an assymetric payoff. The gains from a resolution are likely short term in nature, while market history tells us that the negative outcomes of trade wars have been both more probable and larger in magnitude.

Tariffs are also ineffective and moving the needle on the trade deficit. Take a look at a chart of the Reminibi, and how each tariff announcement has been met with a drop in the level of the Chinese currency, largely offsetting the tariffs, excluding any retaliation. If a tariff is designed to artificially increase the price of a foreign good, but the currency used to price that foreign good drops, it neuters the effect of the tariff. In the meantime, friction, uncertainty, and and the likelihood of slower growth increase. The public nature of politicians trying to save face to avoid appearing weak causes a tit for tat that ends up harming all involved. That's not to say that one side cannot win, but investors win by avoiding the fallout.

The current backdrop is one that bear market risk has been growing, and the catalyst that leads to a broad shift toward risk aversion usually becomes self-evident only with hindsight. The trade war may end up being a catalyst, but it won't be the cause. The cause is too much animal spirits and the excessive risk taking that goes along with it. In a few short years, the economic narrative has gone from discussing secular stagnation where Fed intervention and quantitative easing was considered ineffective to an environment that discusses the idea of a Fed put again with prominent arguments being put forth that recessions are largely improbable to impossible because of unprecedented monetary intervention. That's end of cycle talk, and it occurred in both 2000 and 2007. There are enough cross-currents and evidence out there that investors should acknowledge that there's a reasonable chance that the bull market is over, and that a better opportunity will present itself for above average returns for smart and patient investors who are holding back their risk allocations.

Chart – AAII Survey Readings Hitting Key Correction Levels



Source: AAII, Factset

Chart – High Low Logic Index Minor Sell Signal

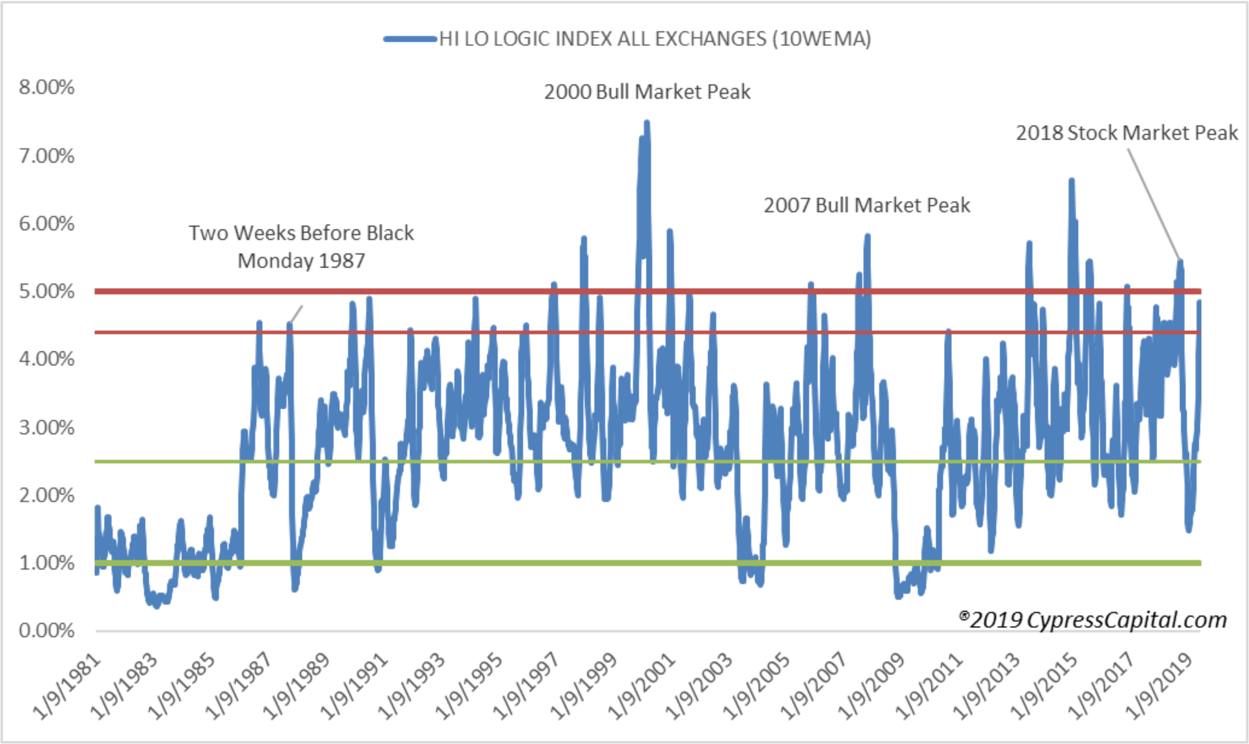


Chart – Yield Curve moves firmly into inverted territory

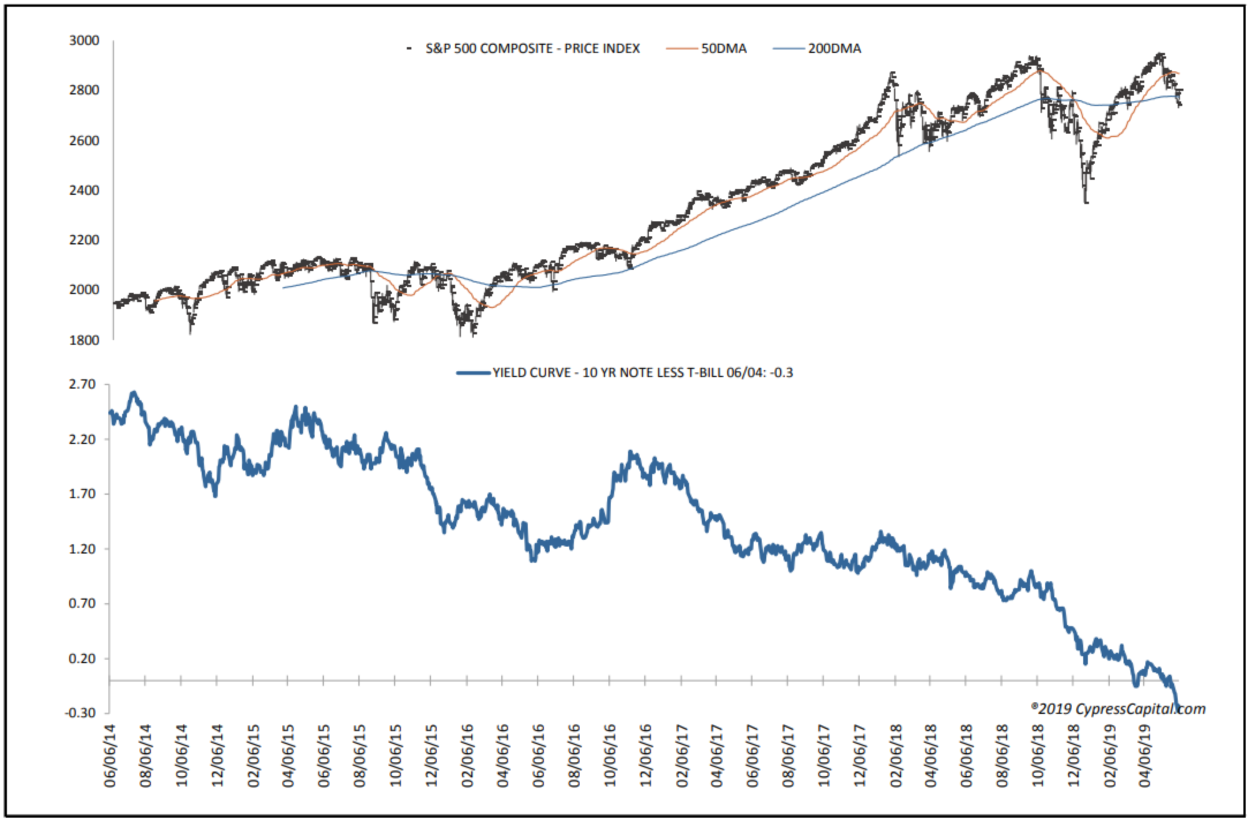
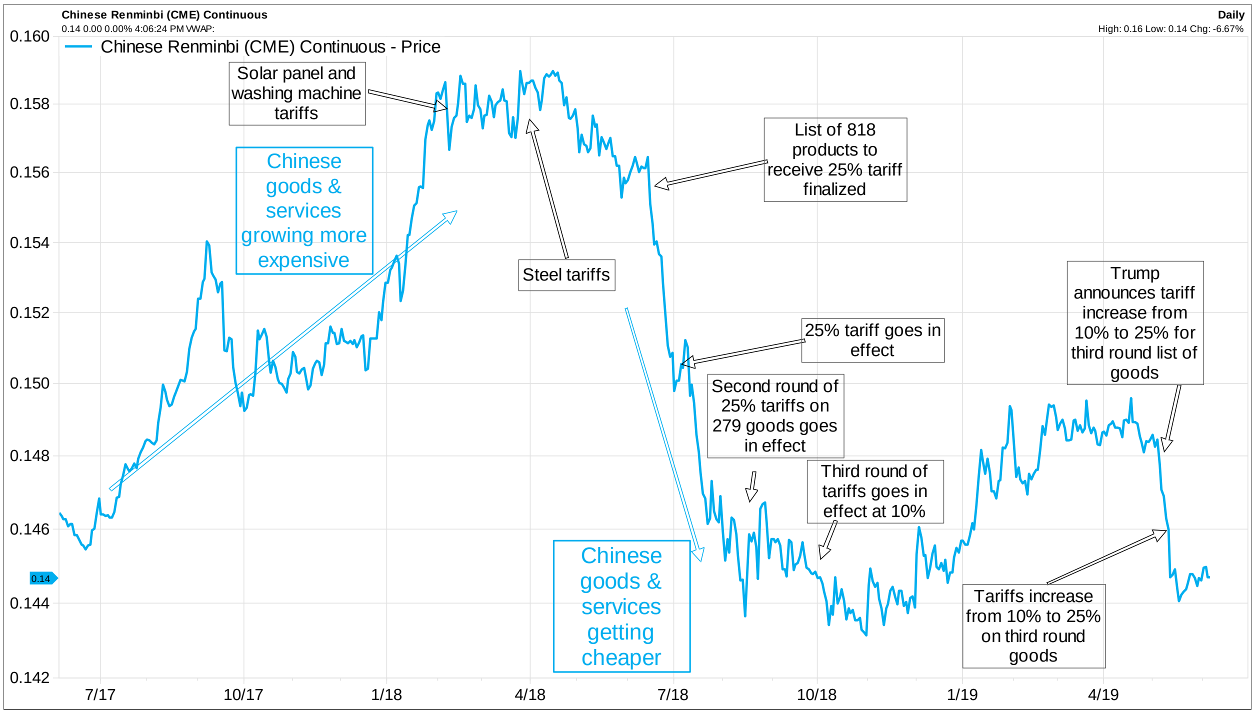


Chart – Chinese Renminbi: Tariffs getting offset by Chinese goods getting cheaper



Source: Factset