Market Outlook

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Highlights

Market Risk Index climbed another 2% to 82.4 this week on further deterioration in investor psychology and monetary conditions. The peak for MRI this cycle was in early 2018 at 89.3 in early 2018, but that corresponded with the worst readings in our psychology composite for this bull cycle and was before the yield curve had inverted. This time, the move higher in the MRI Is coming after the completion of the Fed's tightening cycle, when the economy is more vulnerable to shocks in investor confidence and drawdown is more likely to cause a recession.

Investor psychology breached the worst 10% of readings since our last report. The peaks in January 2018, September 2018 and April 2019 were all preceded by bottom decile readings in our psychology composite. The bottom decile of psychology readings is notable, because it tends to mark the end of short-term rallies, particularly ones with waning breadth.

Under the surface of the current stock rally, the breadth and momentum definitely fit the label of waning breadth with negative McClellan readings and an unusual number of new lows occurring – both of which have led to a triggering of the Hindenburg Omen in the last week (name sounds worse than what it implies). In a continued echo of the tech bubble and a sign of waning breadth, small caps have continued to struggle on a relative basis more than any time since 1999 and have had prices challenging a declining 200 day moving average. With sentiment hitting extremes and a backdrop of questionable breadth, we wouldn't bet on continued short-term strength.

Market Risk Index

Elevated

82.4%

Category Percentiles

Psychology - P6

9.1%

Monetary - M4

37.3%

Valuation - Extremely Overvalued

5.4%

Trend - Positive

94.8%

Biggest Psychology Influences

Low Volatility	Positive
Leveraged Investments	Negative
Investment Surveys	Negative
Consumer Confidence	Negative

Biggest Monetary Influences

Falling Corporate Bond Yields	Positive
Yield Curve	Negative
Velocity	Negative

Valuation

7-10 Year Rtn Forecast	3.4%
10Yr Treas Yield (on 5/31)	2.1%

The monetary score dropped again this week modestly. The slope of our favorite measure of the yield curve has made initial attempts at turning positive for the first time this year. The response of the yield curve over coming months (and monetary aggregates) after the Fed cut this month will likely determine what kind of economic and stock market response to expect. A sharp steepening of the yield curve and continued increase to short term rates of change in monetary aggregates over the remainder of 2019 will mean the Fed's pre-emptive cut didn't shore up confidence, and we'd be staring at a recession and bear market.

Contrary to the consensus, the recent headlines that assets in money market funds are surging to multi-year highs are not ones that we want to read at this point in the market cycle. They aren't bullish signs that mean the Fed is getting easier. Instead, they are recession warnings as a result of a broad shift in consumer and investor

confidence. The best outcome for bulls is for any re-steepening of the yield curve to be very modest and the current backdrop of late cycle conditions to continue.

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