# Market Outlook

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## Highlights

Market Risk Index worsened from poorer readings in both the psychology and monetary composites and remains locked in defensive territory. The S&P 500 is poised to attempt a new high within the next week or so, but it won't be joined by most major indices outside of large cap US ones. As a result, it's grown less likely that psychology is going to improve substantially in the near term. Big cap US stocks have become more interest rate sensitive this cycle because of buybacks, and the sharp drop in yields has led to a gush of over $74 billion in corporate credit issued, the most ever in a week[i]. With the debt to equity of small cap stocks surpassing big caps for the first time, it's become difficult for small cap companies to keep that buyback pace. As wall of worry reconstructions go, the August correction mostly only managed to spook the old-timers who still fill out the AAII weekly sentiment survey.

The NYSE advance/decline line made a new high last Friday and again this week, a positive sign for breadth, but it's unusual given that both the High Low Logic index is on a sell signal and also given how poorly small cap stocks and the average stock have been performing. We looked at all instances where the High Low Logic Index (a measure of breadth that focuses on the number of stocks making highs and lows) was on a sell signal and the advance/decline line was making new highs. Over the last 35+ years, it occurred on 175 trading days, and over half of them occurred in the last 3 years and close to 90% of the instances have occurred during this cycle. Outside of this cycle, the only instances in nearly 40 years where the advance/decline line was making new highs while High Low Logic was giving breadth warnings was in 2006, the last time the yield curve inverted.

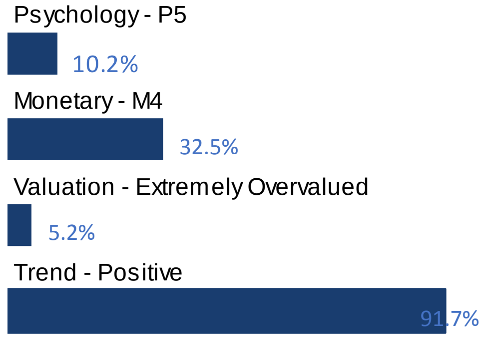
To see the S&P 500 and advance/decline line both making new highs while the High Low Logic Index is flashing a warning is even rarer still, occurring 65 times, and all of those have occurred in the last few years. Advance/decline stats still have value, even after decimalization made them less useful, but the wholesale takeover of passive investing (which now accounts for over half of investable assets) appears to be making advance/decline statistics less reliable than in the past as well. We have given the benefit of the doubt to High Low Logic, because it continues to give advance warning of corrections even with its occasional false signals. We've reached a point where signals from the advance decline line itself may need to be confirmed by other indicators.

### Market Risk Index

Elevated

**84.5%**

### Category Percentiles




**Biggest Psychology Influences**

| | |
|---|---|
| Surveys | Positive |
| Leveraged Investments | Negative |
| Consumer Confidence | Negative |
| Volatility | Negative |

**Biggest Monetary Influences**

| | |
|---|---|
| Falling Corporate Bond Yields | Positive |
| Yield Curve | Negative |
| Velocity | Negative |

**Valuation**

| | |
|---|---|
| 7-10 Year Rtn Forecast | 3.3% |
| 10Yr Treas Yield (on 7/31) | 2.1% |

**Price Trends**

| | |
|---|---|
| US Equities | Positive |
| Intl Equities | Negative |
| REITs | Positive |
| Broad Commodities | Negative |

*Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.*

Monetary conditions may continue to inch a little lower each week, but they are relatively stable here. Markets are pricing in a 100% chance of a Fed cut this month. On the economic front, there has been enough alarming data – from contraction in manufacturing to a rollover in University of Michigan's consumer confidence – that supports more aggressive cutting by the Fed if they choose. Instead, the resiliency of big cap US stocks will likely cause the Fed to be more conservative with their cut. The irony here is that the conservatism of corporations who continue to bid up stocks with buybacks as the least risky option for allocating extra capital, may end up creating a more challenging economic environment for corporations going forward – a twisted kind of feedback loop. If the Fed doesn't want to lower rates enough to make the yield curve positive sloping, markets can do it for them. Unfortunately, when markets do it, it often means recession.

**Chart – Advance/Decline Line New High says breath looks good**

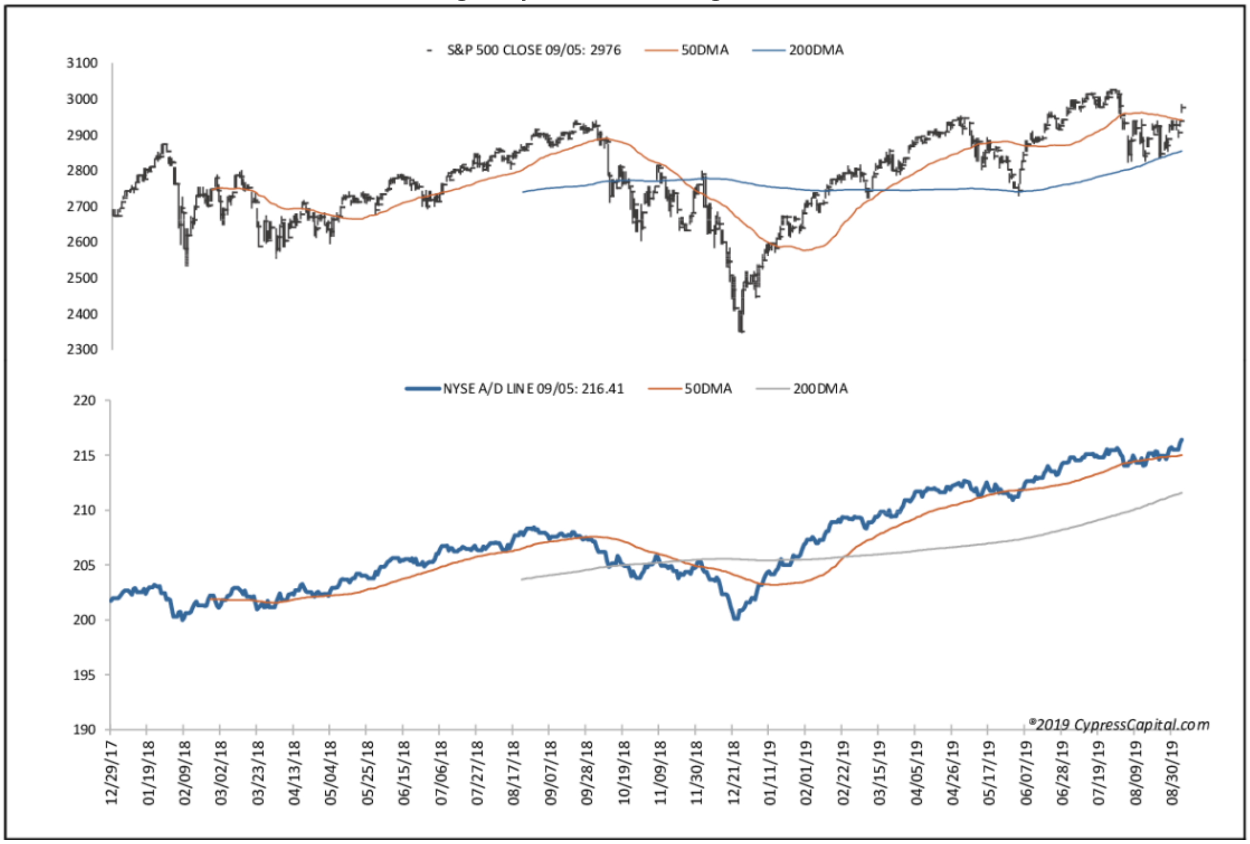


**Chart – Meanwhile, High Low Logic says breadth is historically bad**

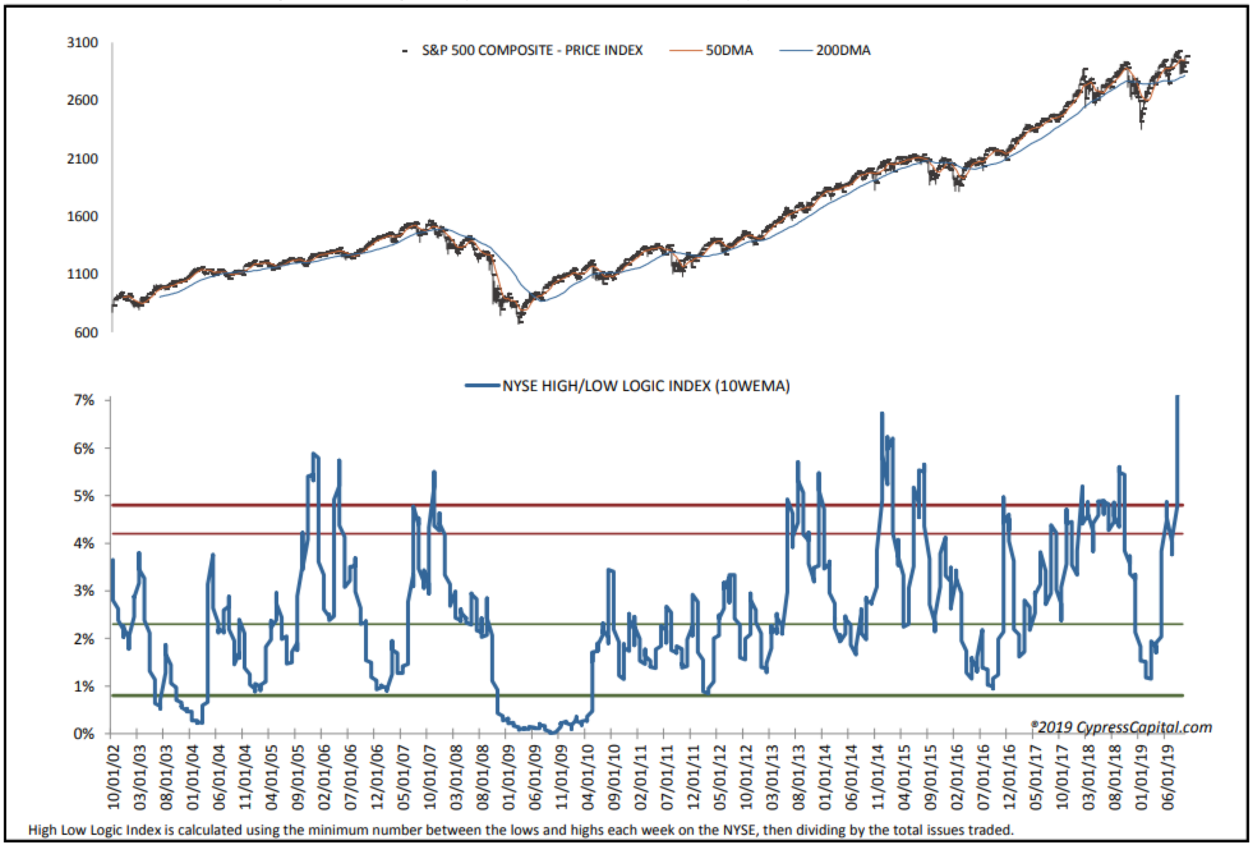
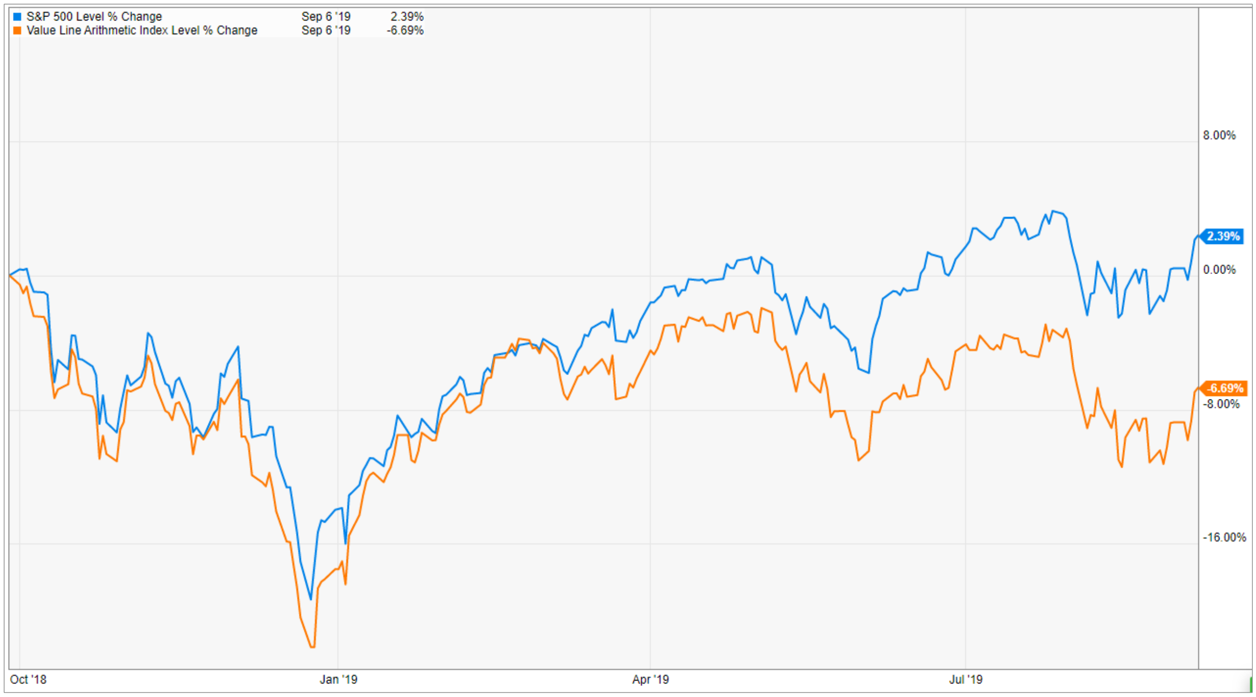



**Chart – Valueline Arithmetic Index versus S&P 500**

...and performance of the average stock continues to lag the broader market.




*Source: YCharts*

**Chart – AD Line New Highs during High Low Logic Sell Signals**

Is the combination of decimalization and the surge in passive investing making advance decline statistics less meaningful?

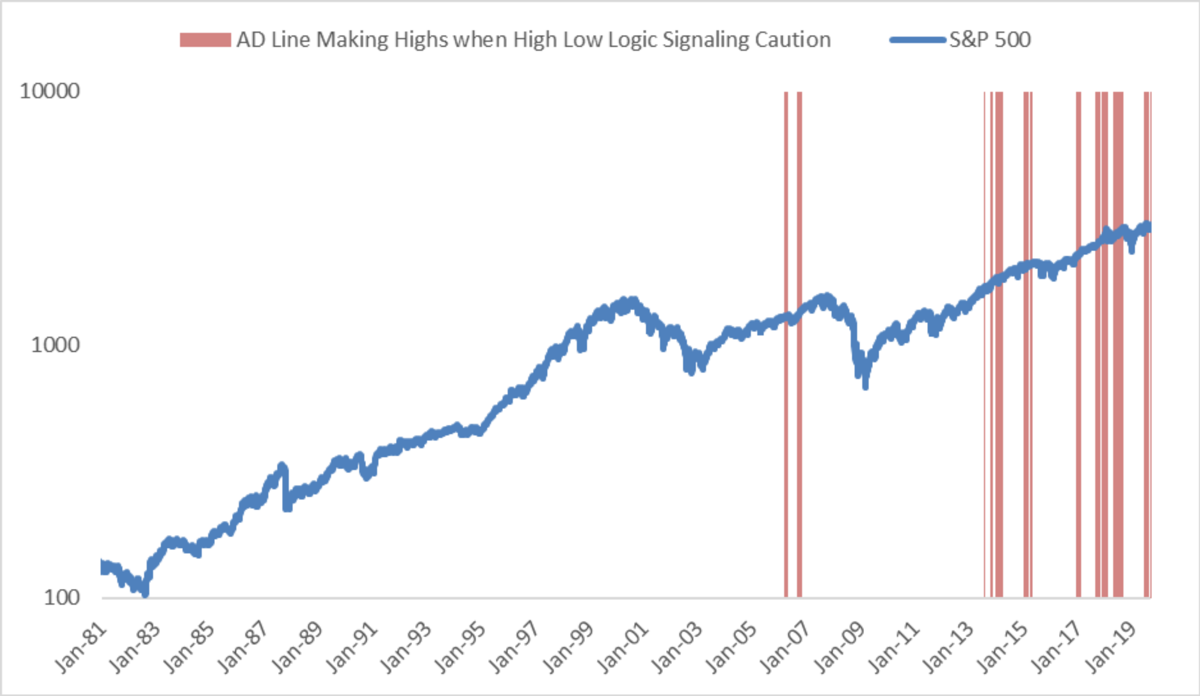
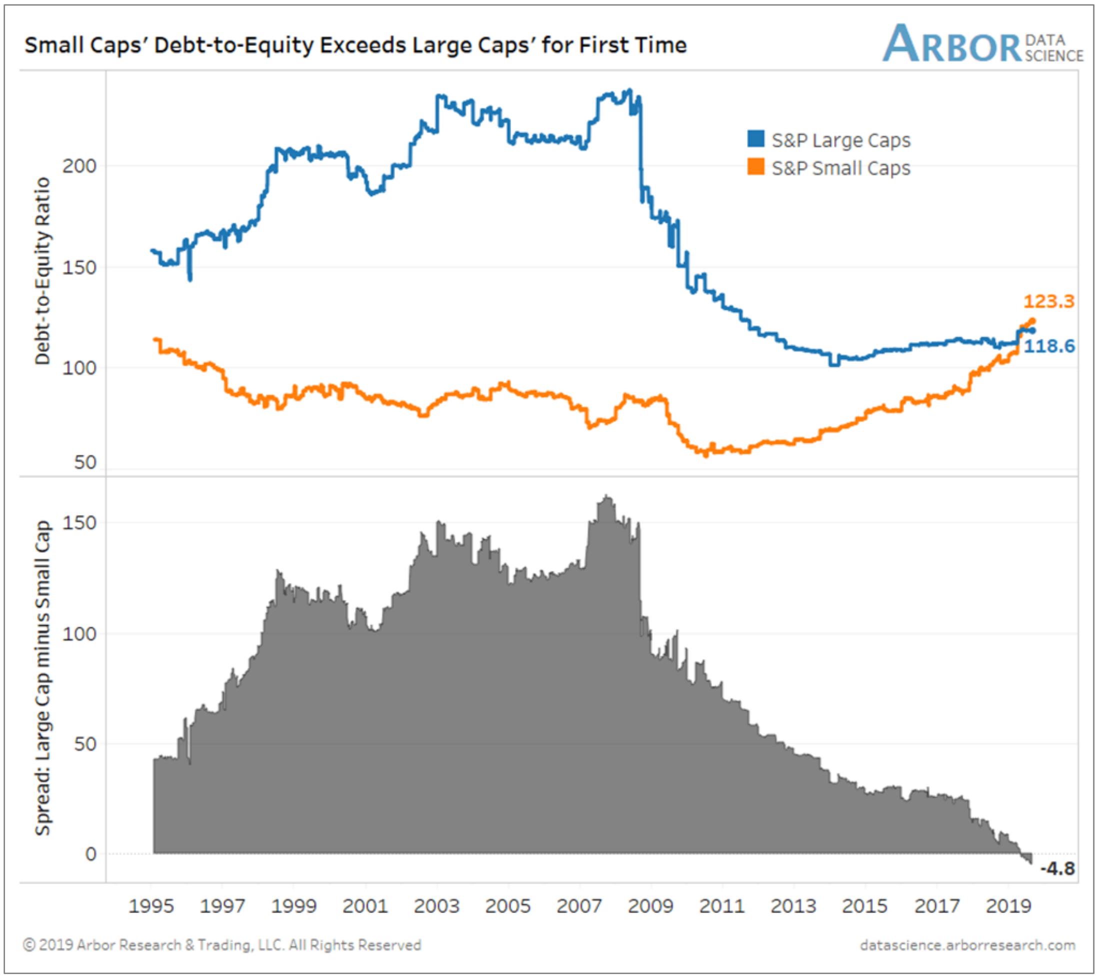



**Chart – Small Cap Debt-to-Equity Now Exceeds Large Caps**



## Asset Management – Portfolio Lineup

*The essence of investment management is the management of risks, not the management of returns.*
*– Benjamin Graham*

**Select Dividend** – Bottom up risk managed dividend portfolio of up to 40 stocks that can hold cash and fixed income when markets aren't presenting attractive individual equity opportunities. Portfolio built upon Cypress Capital's own metrics that measure dividend quality and safety. The portfolio is divided 75/25 into payers and growers. Payers are stocks with above average yields and a long-term history of paying dividends, where the dividend is perceived to be safe. Growers are companies with high total shareholder yields and perceived to be high quality, franchise companies. The portfolio is generally made up with familiar, household names.

**Global Allocation** – Multi-asset class portfolio that invests in low cost exchange traded funds across eight asset classes based upon the margin of safety offered by each asset class in an effort to avoid significant drawdowns.

**Strategic Income** – Disciplined, value biased income portfolio that practices patience in awaiting excellent risk reward opportunities in fixed income. Disciplined in its refusal to reach for yield and put capital at risk of permanent impairment.

**Asset Neutral** – Absolute return focused multi-asset class portfolio that allocates assets based upon the margin of safety offered in each asset class. Portfolio can go defensive and hold up to 100% cash in some environments.

**US Opportunity** – Concentrated value portfolio of up to 50 stocks that increases allocations to cash and fixed income when the margin of safety offered by equities is too narrow. Portfolio quantitatively buys the cheapest, highest quality stocks that it can find. Quantitative sell discipline sells individual holdings based on value and momentum factors.

Contact us for more information.

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[i] With 49 Deals in 30 Hours, U.S. Corporate Bond Market Ignites