Market Outlook

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Highlights

Market Risk Index changed little but inched closer to the breaching the worst readings of 2019 that we saw back in the spring. The overall level of MRI continues to support a cautious stance toward markets, leaving us doubtful about the sustainability of rallies based solely upon trade developments. Psychology managed to worsen by a small amount again this week, still in the worst decile of readings, with the fund flows category pulling points away. While it's often said that negative equity flows are a contrarian sign of anxiety among investors, coincidentally, it tends to be bad for markets. All else equal, the math works out better if you treat equity flows more like momentum indicators. If you want to avoid bear markets, it's generally better to treat negative equity flows with caution, like avoiding being trampled in a stampede.

The most notable improvement in the psychology composite was the AAII investor survey, which showed their members are again getting skittish about markets. It's a classic kind of contrary indicator and more short term in nature than equity flows. It has also been a very reliable indication of short term trading opportunities in markets for the last couple of years, and markets appear to be rallying on que. Meanwhile the monthly allocation survey that AAII recently released showed that these same investors are sitting with a heavy weighting in equities and very little in cash. If you combine the message of the three indicators - individuals are heavily overweight equities, growing nervous, and selling.

Still, this isn't a bull market that has relied on individual investors. It's relied on buybacks – that has been the single largest source of buying for US stocks and does help explain the continued strength of big cap US equities. Our composite for measuring price trends has both international equities and small cap US equities classified as being in cautious to negative trends – the price trend for the average stock in the US is also negative. One key difference among those asset classes is the prevalence of buybacks. The S&P 500 holds out, which is by and large what most of the investing public uses to judge stock market health, and buybacks have been a pillar of major price support for those big cap stocks. The difficult to

Market Risk Index

Elevated

85.9%

Category Percentiles

Psychology - P6

Monetary - M4

Valuation - Extremely Overvalued

Trend - Positive

Biggest Psychology Influences	
Trading Data	Positive
Leveraged Investments	Negative
Consumer Confidence	Negative
Investment Surveys	Negative

Biggest Monetary Influences	
Falling Bond Yields	Positive
Yield Curve	Negative
Velocity	Negative

Valuation	
7-10 Year Rtn Forecast	3.7%
10Yr Treas Yield (on 08/31)	1.7%

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.

answer question is how long it can persist and if the combined recent underperformance of the buyback index, rapidly falling CEO confidence, stretched balance sheets, and the stall in earnings growth will put a damper on buyback activity.

While the monetary composite has had very little movement over the last month, the conditions holding the composite back have not been moving in the bulls' favor. The persistence of the yield curve inversion isn't an argument in favor of the mid-cycle adjustment or extending a bull market. Mid cycle adjustments that avoid recession tend to be associated with brief periods of inversion. The same can said for monetary aggregates, whose growth rates continue to accelerate. We read a prominent strategist argue that the fall in the 10Yr Note yield and the acceleration of M2 growth showed that the Fed was on the ball and stimulating the economy. That only has the illusion of appearing true when an economy avoids recession, but that market action itself is more recessionary in nature. Long bond yields fall when growth is stalling, and M2 accelerates when risk aversion is on the rise.

Accelerating short term M2 growth and falling bond yields in an environment where valuations are elevated, and consumers are more confident than they have been in 20 years is an economy in a precarious position. Contrary to popular opinion, short term acceleration in monetary growth is instead a symptom of tighter money, confirmed by the announcement of the Fed having extend its temporary moves into the repo market and to resume expanding its balance sheet all the way into 2020. The Fed's worst enemy here is a break in elevated confidence, possible over the short to intermediate term but an impossible task overall.

Common late cycle developments like this that get lauded as an improvement in economic fundamentals and a rebuilt wall of worry instead are often – to paraphrase Warren Buffett – the first signs that the tide is rolling out to reveal who is skinny dipping. Please put on a pair of shorts.

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.

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