



Market Outlook

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Highlights

Market Risk Index improved on the week but still entrenched in territory that suggests being fully-invested in equities isn't wise. The improvement this week was almost solely due to improvements in the Technical Indicators category inside our Psychology composite. That category is made up of a number of measures track internals, breadth, and short term momentum. All made notable improvements over the last week, and all rely mostly on "price" as their primary input. For most investors, including the talking heads, price is really all that matters, and it's enough to go all-in. Higher prices = good. Lower prices = bad. If we were solely talking heads and didn't have skin in the game, it's probably the best way to build a message to ensure that you only look dumb when the largest magnitude of people look both dumb (and poorer) alongside you.

Investor's chase price. How the economic backdrop was perceived changed the instant that the S&P 500 made a new high. Price does work, enough so that it's an input for us, but it's not enough to outweigh a body of evidence that suggests both the magnitude of the gains and the longevity of the gains, relying solely on a breakout in price, is highly uncertain. Prices are ultimately tethered to fundamentals and economic reality. That tether may be stretched to extremes through excitement or despair around a collective narrative – but only for a time.

Regarding price, on one hand, recognizing that higher prices beget higher prices is an admission that maybe someone knows something that you don't, that someone is smarter than you. It's an argument for not sticking your head in the sand and keeping some exposure. On the other hand, for an investor to fully give in to price is giving in to the herd, and in investing, the herd ends up getting slaughtered. From the moment of birth, your 2019 Thanksgiving Turkey's weight and wellbeing has followed a beautiful, fool-proof trend. Your Turkey's Index of well-being will continue to make all-time highs, until a few days before Thanksgiving. We digress.

Market Risk Index

Elevated

86.4%

Category Percentiles

Psychology - P6

92.8%

Monetary - M4

68.6%

Valuation - Extremely Overvalued

95.0%

Trend - Positive

0.8%

Biggest Psychology Influences

Technical Indicators	Positive
Leveraged Investments	Negative
Option Activity	Negative
Surveys	Negative

Biggest Monetary Influences

Falling Bond Yields	Positive
Yield Curve	Negative
Velocity	Negative

Valuation

7-10 Year Rtn Forecast	3.0%
10Yr Treas Yield (on 09/30)	1.7%

Price Trends

US Equities	Positive
Intl Equities	Positive
REITs	Positive
Broad Commodities	Positive

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.

As dramatic as the shift was for those technical indicators, the bulk of it was offset by a dramatic swing in Option Activity, which saw a big shift in favor of call-buying and enthusiasm. The ISEE Index, which measures only opening transactions in puts and calls saw a 14yr high in call option buying this week.

This feels like new, historic territory for both the bull market and policy. Valuations don't support a substantive argument for gains going forward. It's difficult to go all-in on a market where the only upside targets that we can point to rely on comparisons with the Tech bubble. That, and almost every long-leading gauge of market cycles that we track suggests that gains from an extension of the bull market here will be given back.

Case in point - a couple of weeks ago, we showed you an example of every yield curve RE-version over the last 50 years, a single factor among a stable of indicators that we use. The best bullish examples from 1967 and 1998, both of which showed that gains proved to be short lived extensions that preceded historic bear markets, both of which would see prices take over a decade from which to recover (if you were fully invested).

Would you rather feel the immediate pleasure of milking and timing those last 12-18 months of uncertain gains, or would you prefer to sidestep a decade of losses and have enough capital set aside to be able to profit when your favorite stocks go on sale? When given the choice between the short-term pain of looking dumb over the long-term ramifications of permanent impairment of capital, we choose to look dumb, every time. Markets have presented opportunities throughout history for the patient that were exponentially better in terms of both risk and reward than the short-term one that may be presenting itself today, an opportunity that appears to be largely based upon the price of an index of stocks making a new high.

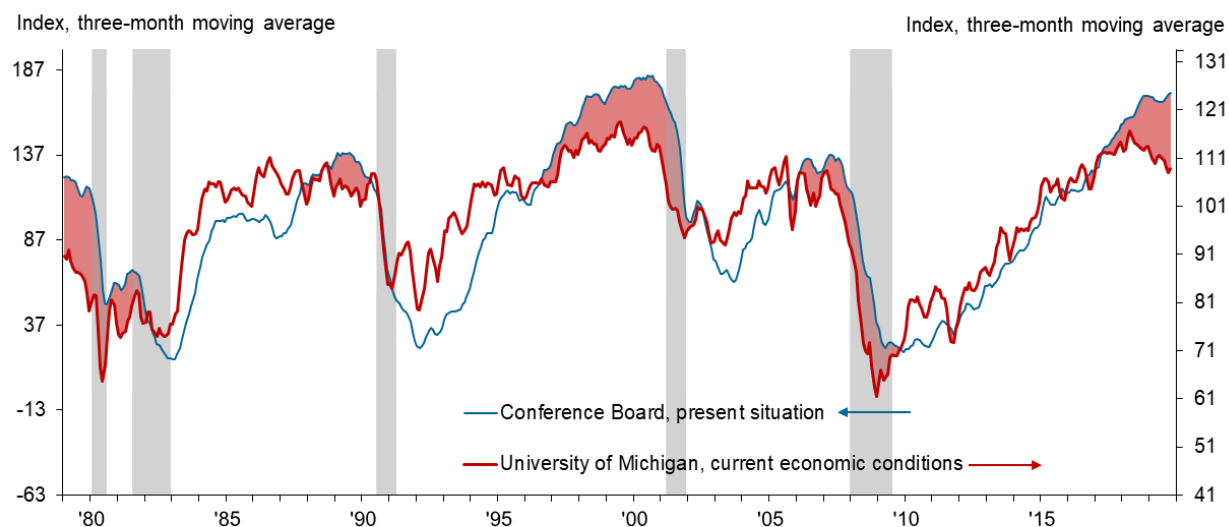
Charting Trends

We showed a chart a few weeks back that showed how the gap between the University of Michigan's Consumer Sentiment Index and The Conference Board's Consumer Confidence Index appeared to be both cyclical and predictive of recessions. The Dallas Fed had a [piece](#) this week that tried to explain or expound on it. Short version is that they implied that the Michigan survey focuses more on recent changes in conditions than does the Conference Board. Visually, the Michigan survey does appear to peak and roll over before the Conference Board's survey historically. We've included the charts from the piece below.

Chart – Gap Between Consumer Confidence Indices Widens Prior to Recessions

Chart 1

Conference Board Index Rose Above the University of Michigan Index Prior to Past Recessions



NOTES: Red shaded areas indicate the Conference Board measure exceeds the University of Michigan measure when scaled by a regression. Gray shaded areas indicate NBER recessions.

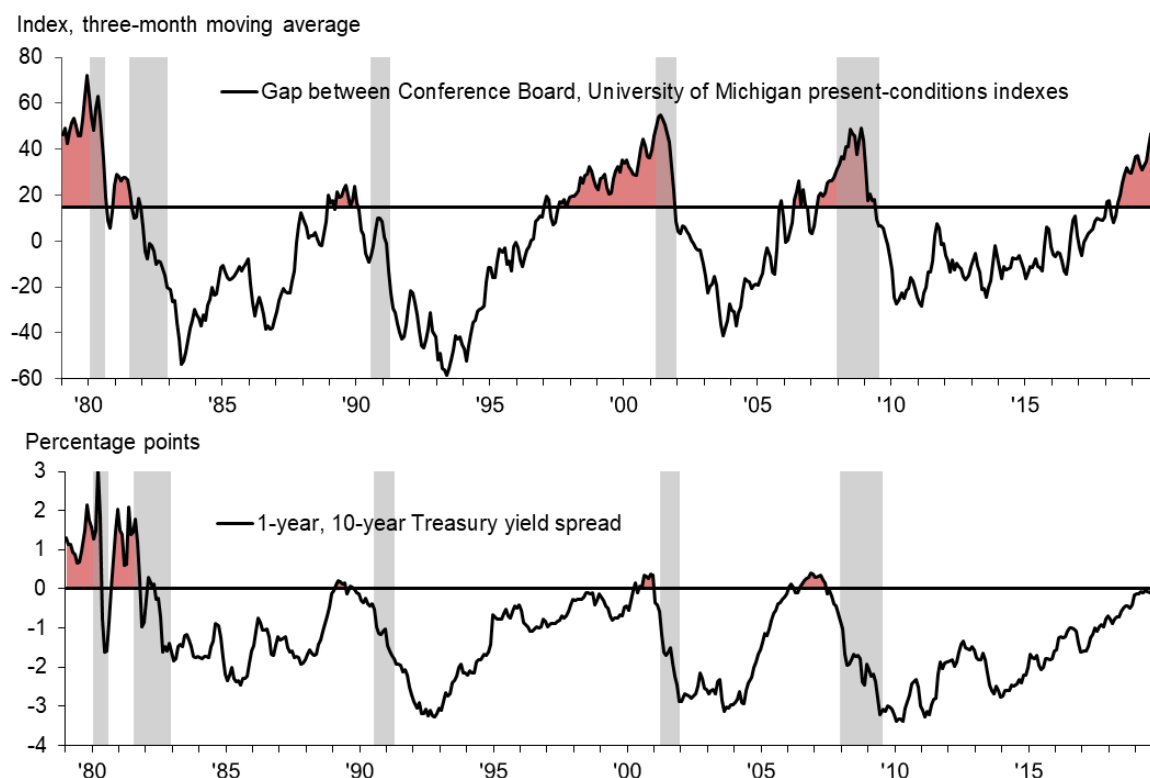
SOURCES: Haver Analytics; University of Michigan; Conference Board; National Bureau of Economic Research (NBER).

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Chart – The Gap is Highly Correlated to Yield Curve Inversions and the Economic Cycle

Chart 2

Timing Is Similar to Yield Curve Inversions Except in 1997



NOTES: The gap in the top panel is set with a regression (the same scale as Chart 1). Gray shaded areas indicate NBER recessions. Gap of 15 (top chart) was chosen to best depict the relationship between confidence measures and the yield spread.

SOURCES: Haver Analytics; University of Michigan; Conference Board; Federal Reserve Board; National Bureau of Economic Research (NBER).

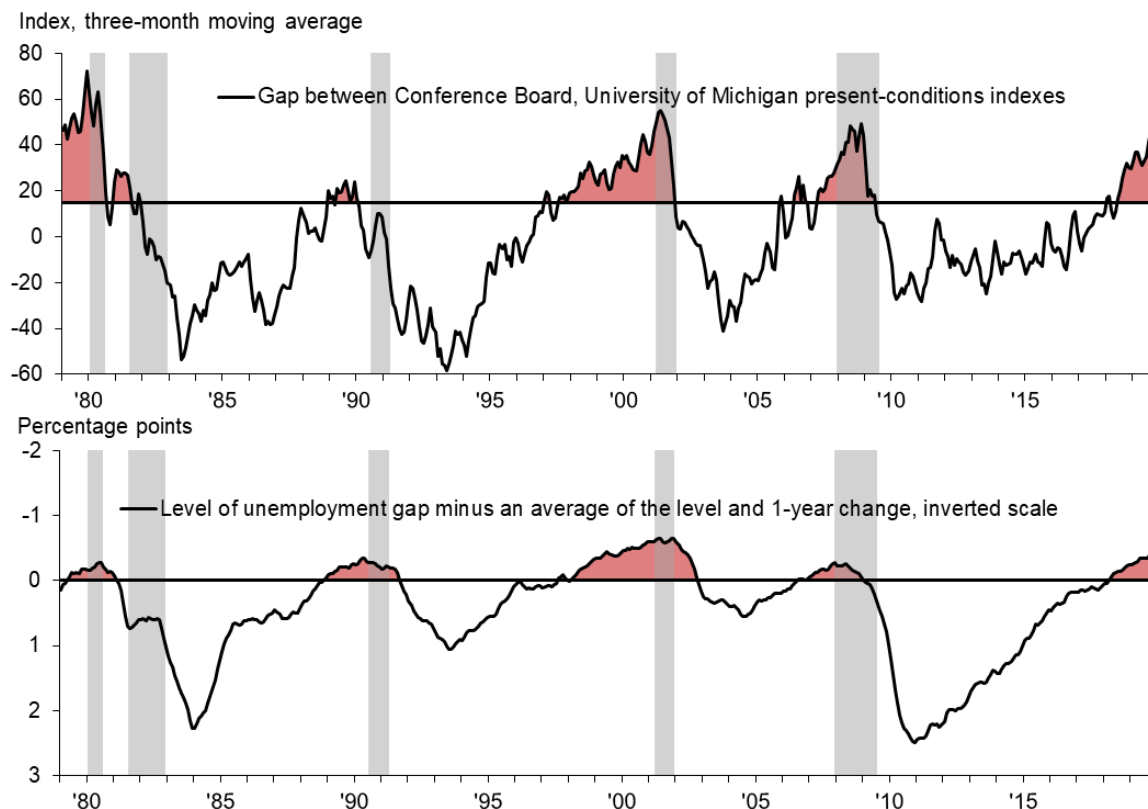
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Chart – Confidence Survey Gap vs Unemployment Gap

The gap in the consumer confidence surveys also correlates with periods where unemployment is running below its natural rate, i.e. when the economy is overheated.

Chart 3

Average of Level and Change in Unemployment Rate Gap Provides a Similar Signal



NOTES: The unemployment gap is defined as the unemployment rate minus its natural rate. Gray shaded areas indicate NBER recessions.
 SOURCES: Haver Analytics; University of Michigan; Conference Board; Federal Reserve Board; National Bureau of Economic Research (NBER); Congressional Budget Office.

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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.