Market Outlook

By Mark T Dodson, CFA

Boomers vs Robinhoodies

Smart Money/Dumb Money gives way to Young vs Old

The psychology composite moved 8% higher to 64%, pushing the Market Risk Index to 73.4%, just shy of the 75th percentile that approximates the point for markets that are growing vulnerable to significant drawdowns. Broadly, psychology isn't euphoric, but it has crossed the threshold where fear of losing money is giving way to the fear of missing out.

Volatility dropped out of the top spot for biggest tailwind for markets, as VIX and VXO have dropped to levels that denote the period of investor panic has subsided, but not low enough to suggest the good days are back again. The surveys category has assumed the top spot to replace vol as the largest sentiment tailwind for markets. Despite the bullishness of gurus inside the Investor's Intelligence survey creeping higher, the AAII survey of investor sentiment keeps registering high levels of market anxiety among individual investors, or at least among the baby boomer investors that it measures.

Robinhoodies (investors who use the free trading app Robinhood) are a different matter. If you are a student of markets, you have to be fascinated by the juxtaposition going on between generations of investors, as it appears to be in politics as well. Seasoned boomers, burned by two bear markets and a housing bubble, aren't enthusiastic about this market.

Meanwhile, the same Millennials that were caricatured as living unemployed in their parents' basements during the first half of the secular stagnation cycle are now said to be again in their basements, but this time on Covid quarantine, trading options and stocks. There are headlines about legendary investors like Warren Buffett and Carl Icahn liquidating full positions in troubled stocks, while those same stocks are making the Robinhood lists of most popular long holdings. In 2020, smart and dumb money is being perceived as young vs old more than professional vs non-professional.

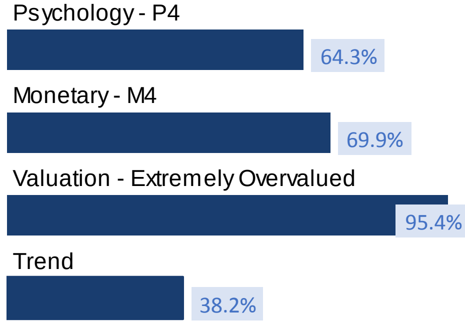
We aren't yet measuring the activity of Robinhood investors within our psychology composite, but our options category is picking up on some of this excitement for the stock market. Option activity continues to push into extremes and is the largest detractor inside psychology, with 7 of the 11 indicators inside the composite now pegged at maximum euphoria scores. Equity put/call, OEX put/call, and total put/call ratios are all crossing their red line thresholds.

Market Risk Index

Neutral

73.4%

Category Percentiles



Largest Psychology Influences

Surveys	Positive
Volatility	Positive
Leveraged Investments	Negative
Option Activity	Negative

Largest Monetary Influences

Monetary Aggregates	Negative
Yield Curve	Negative
Velocity	Negative

Valuation

7-10 Year Rtn Forecast	2.2%
10Yr Treas Yield (on 05/28)	0.7%

Price Trends

US Equities	Positive
Intl Equities	Negative
REITs	Negative
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.

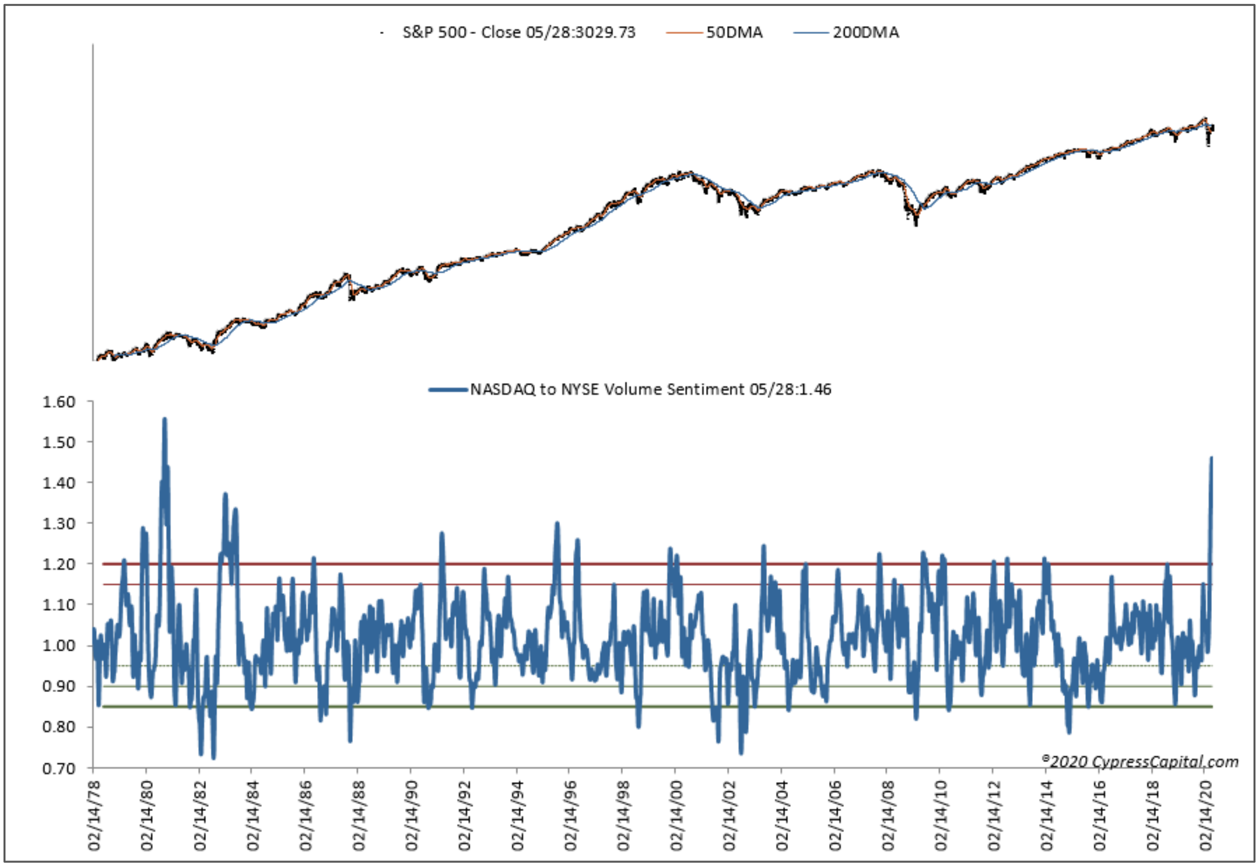
Consumer Confidence was released this week, and the range of survey questions have all improved enough to move that category back to neutral from negative. We have cautioned already that there hasn't been a bear market or recession to end in 50 years with confidence bottoming out here. We also concede that there hasn't been a rapid and massive combination of fiscal and monetary stimulus like this outside of World Wars either. Maybe you can bend the laws of human nature if you throw enough money at them.

As dramatic and newsworthy that Fed action has been, our monetary composite has been the most stable and the least volatile part of our four-factor framework over the last few months. The yield curve has shifted little off the March lows, and thus far the Fed's actions continue to be balanced out by higher demand for money and dollars. The dollar is stable. We are as equally encouraged and discouraged by Fed officials both dismissing the pursual of negative interest rate policy and also flirting with the idea of yield curve control, which we prefer to call Euro-Japan Lite Policy.

Valuation worsened again on higher prices and weaker fundamentals – driving our seven indicator valuation composite up to the 95th percentile. This is not as high as in January 2018 or February 2020, but too close for comfort for a new bull market. Prices have already rallied so much that even a full recovery of sales and earnings to pre-Covid levels are already discounted. We'll use the 20% rally from the bottom rule to operate under the assumption that March 23rd marked the bear market's low. With the Fed flirting with the idea of yield curve control and valuation not providing enough room for a bull market to stretch its legs, this bull should be short-lived by historical standards.

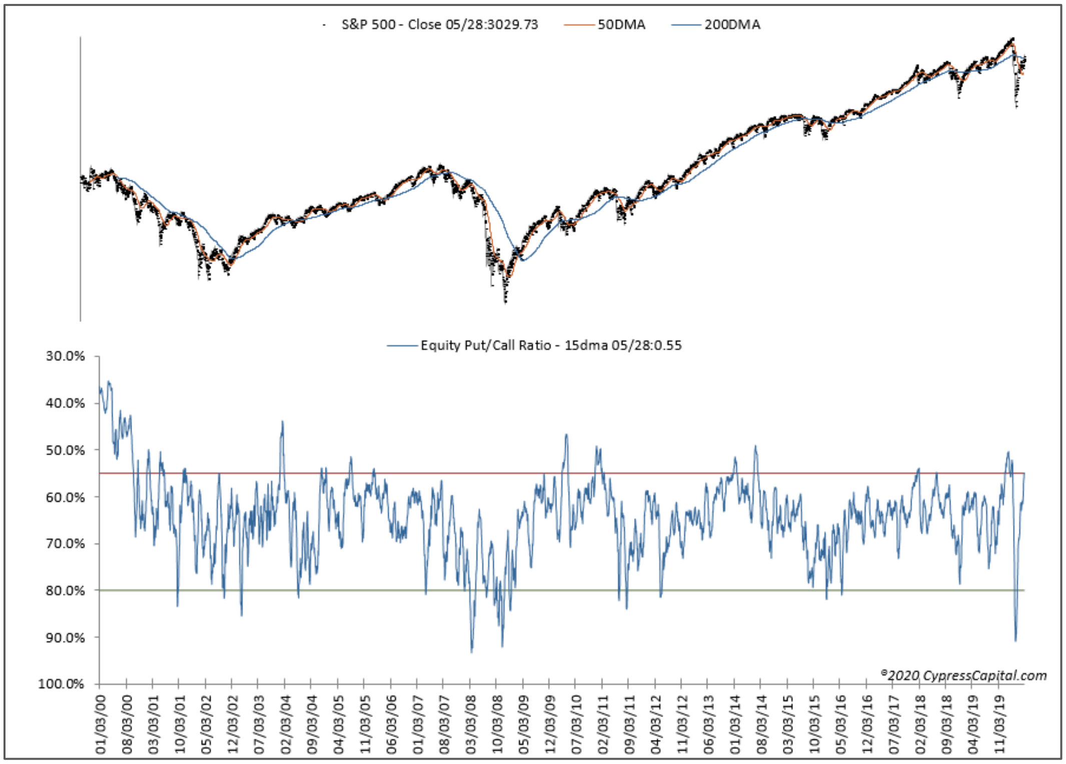
NASDAQ to NYSE Volume Sentiment

Our NASDAQ to NYSE Volume sentiment indicator appears determined to challenge the 1980 record. This chart is a sign of all the dislocations occurring within equity markets. Growth versus Value, young versus old, FAAAM stocks versus the world.



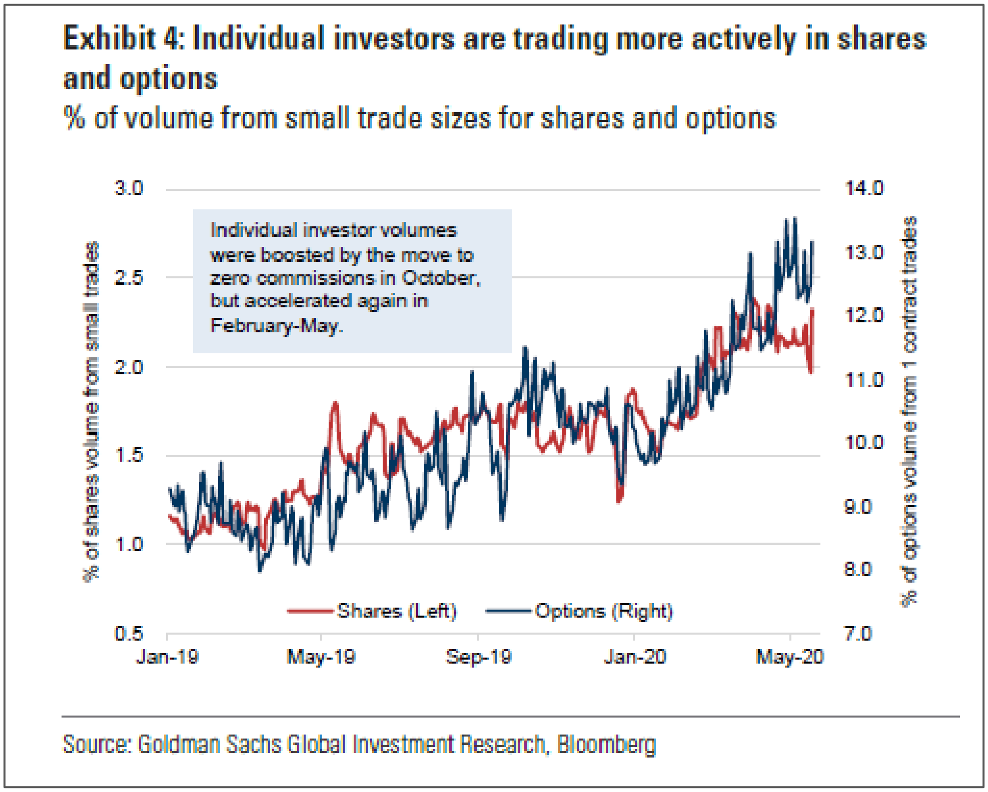
Spike in Equity Call Option Activity

Very low equity put/call readings like this week have come near the ends of euphoric markets, at the ends of bear market rallies, and have also marked the first signs that a new powerful bull market is underway. In the short term, all tend to lead to short term weakness, where you get clues about which scenario you are facing.



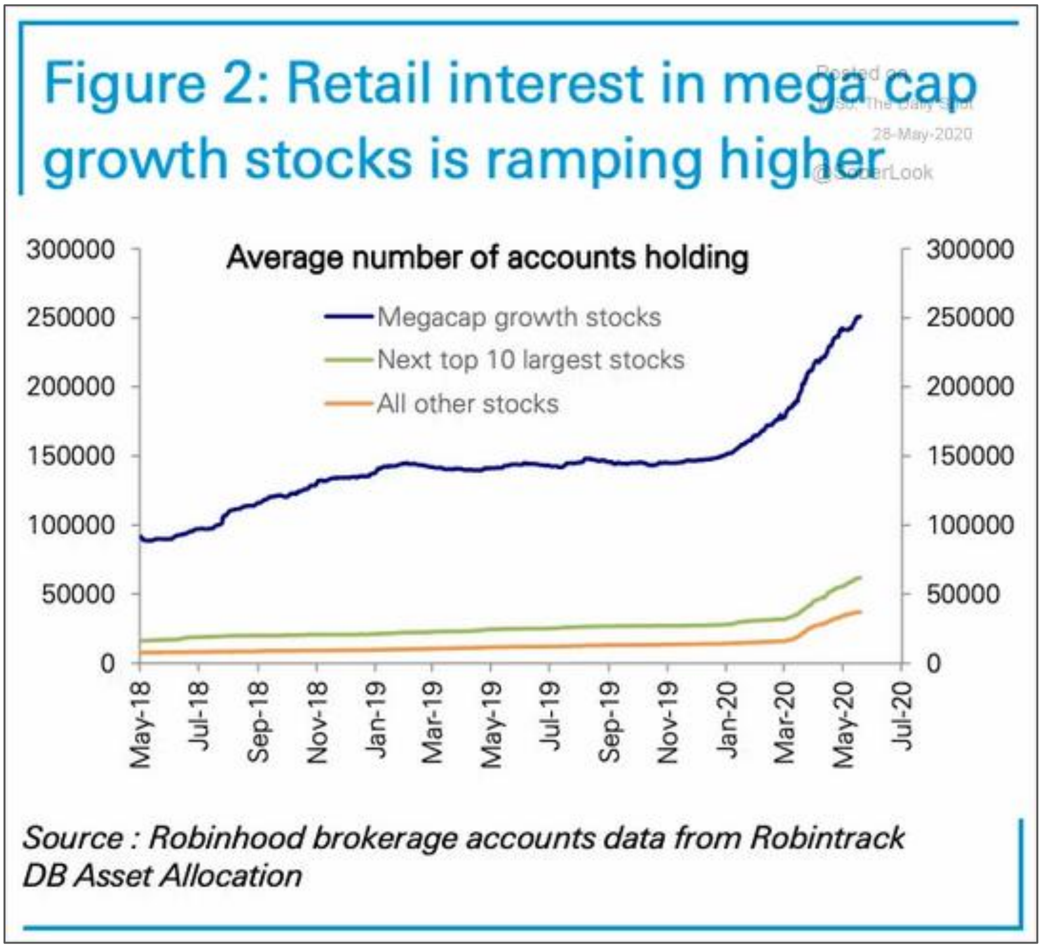
Individual Investor Surge in Stock and Option Volume

The Bloomberg article headline with this chart was “Bored Day Traders Locked at Home Are Now Obsessed With Options.”



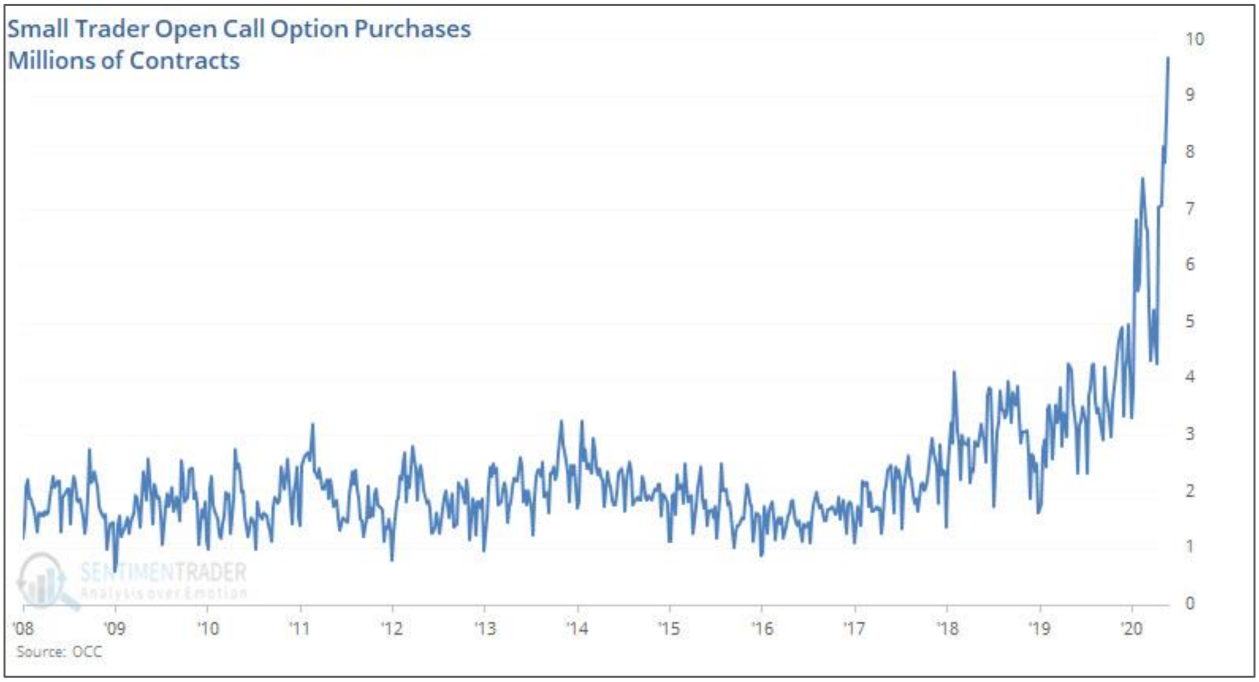
Source: Bloomberg

Robinhoodies Like The Big, Popular Stocks



Source: WSJ

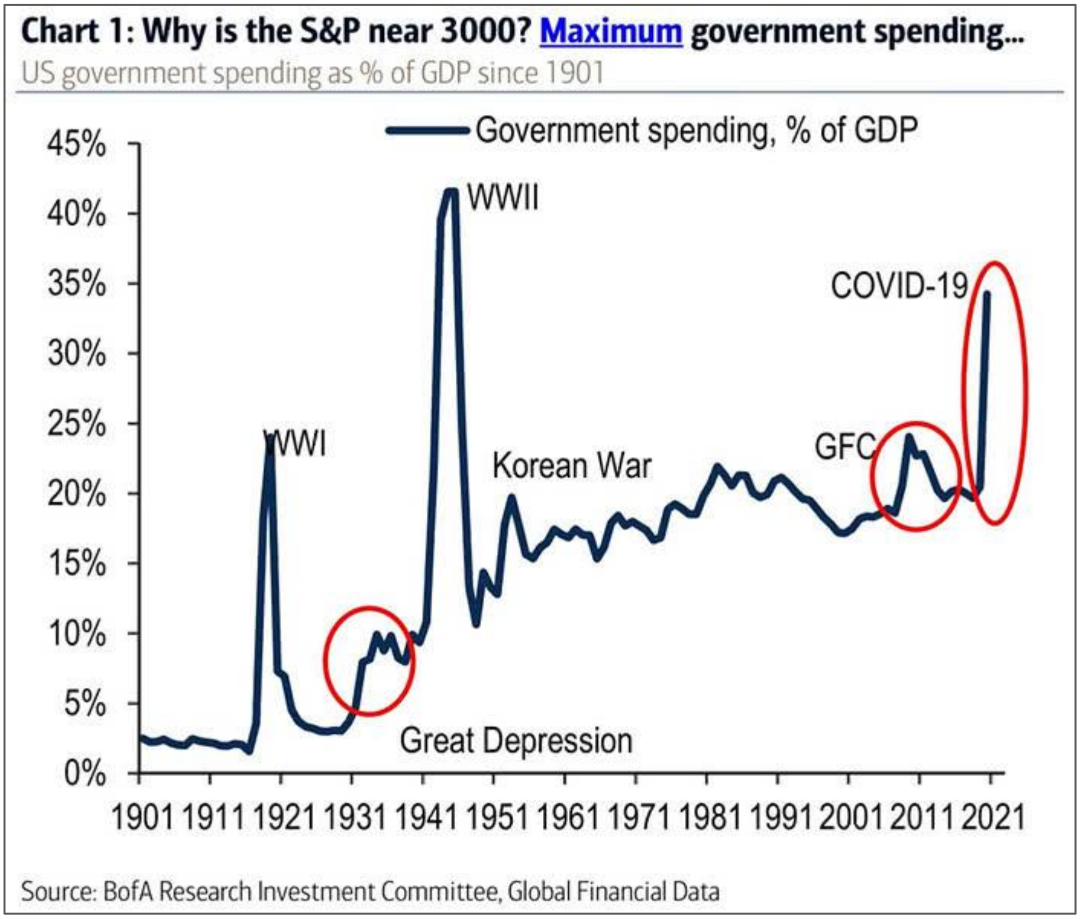
And, Robinhoodies Like Options



Source: SentimentTrader

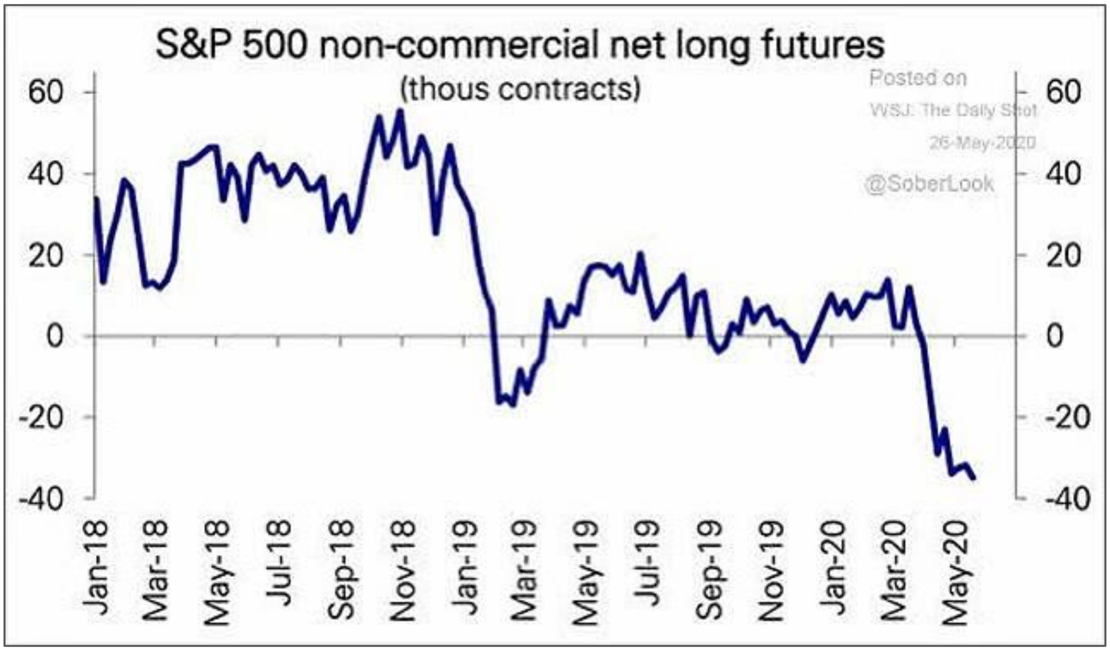
World War-Esque Spike in Government Stimulus

Largest spike in government spending since WWII. If you throw enough money at a problem, can it break the laws of economic gravity and human nature? We are going to find out.



Futures Positioning Still Too Bearish

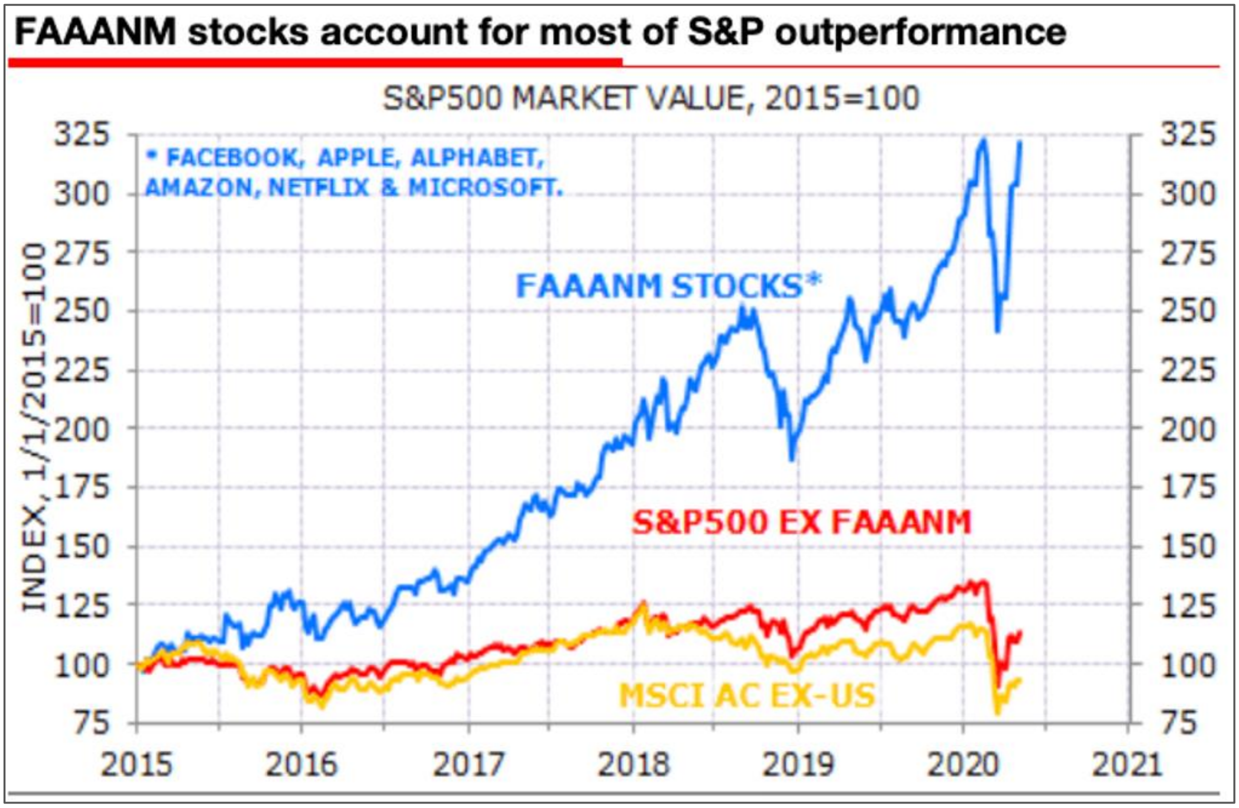
Futures positioning isn't a perfect indication of investor sentiment, but it has stayed stubbornly short throughout the market rally. Futures investors haven't bought in yet.



Source: WSJ

Equities – The Lost Decade...

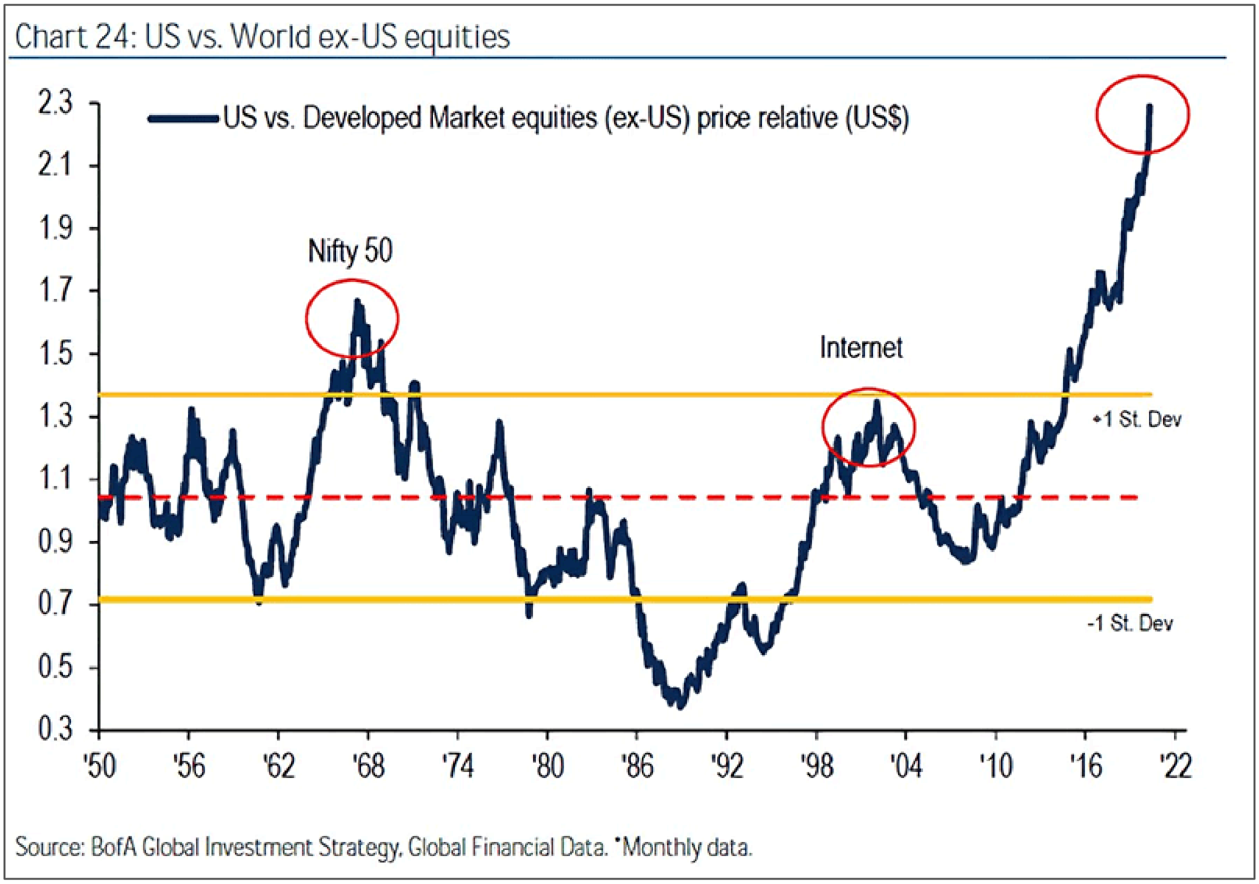
These charts blew us away. For everything but the FAAAM, FAANG, FAAANM, it looks like a lost decade for equity prices.



Source: Gerard Minack, Downunder Daily

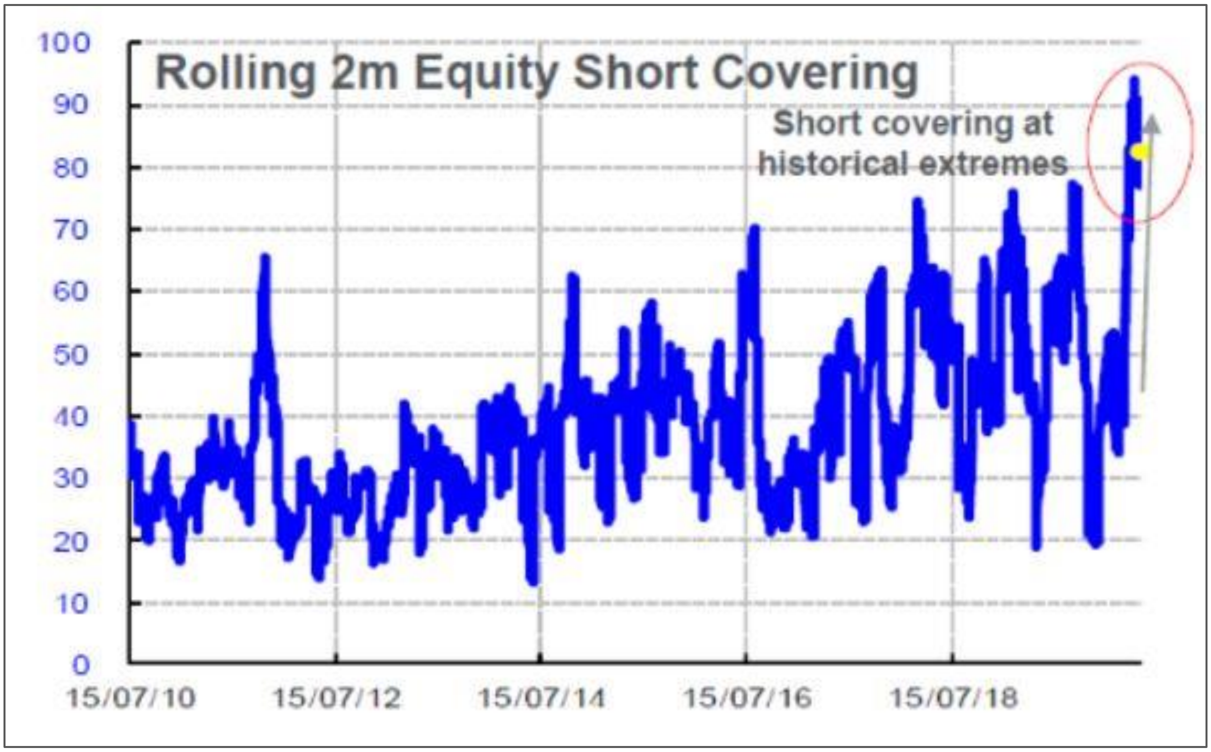
US versus International Relative Performance

This looks different. The outperformance has gone further than anyone could have predicted.



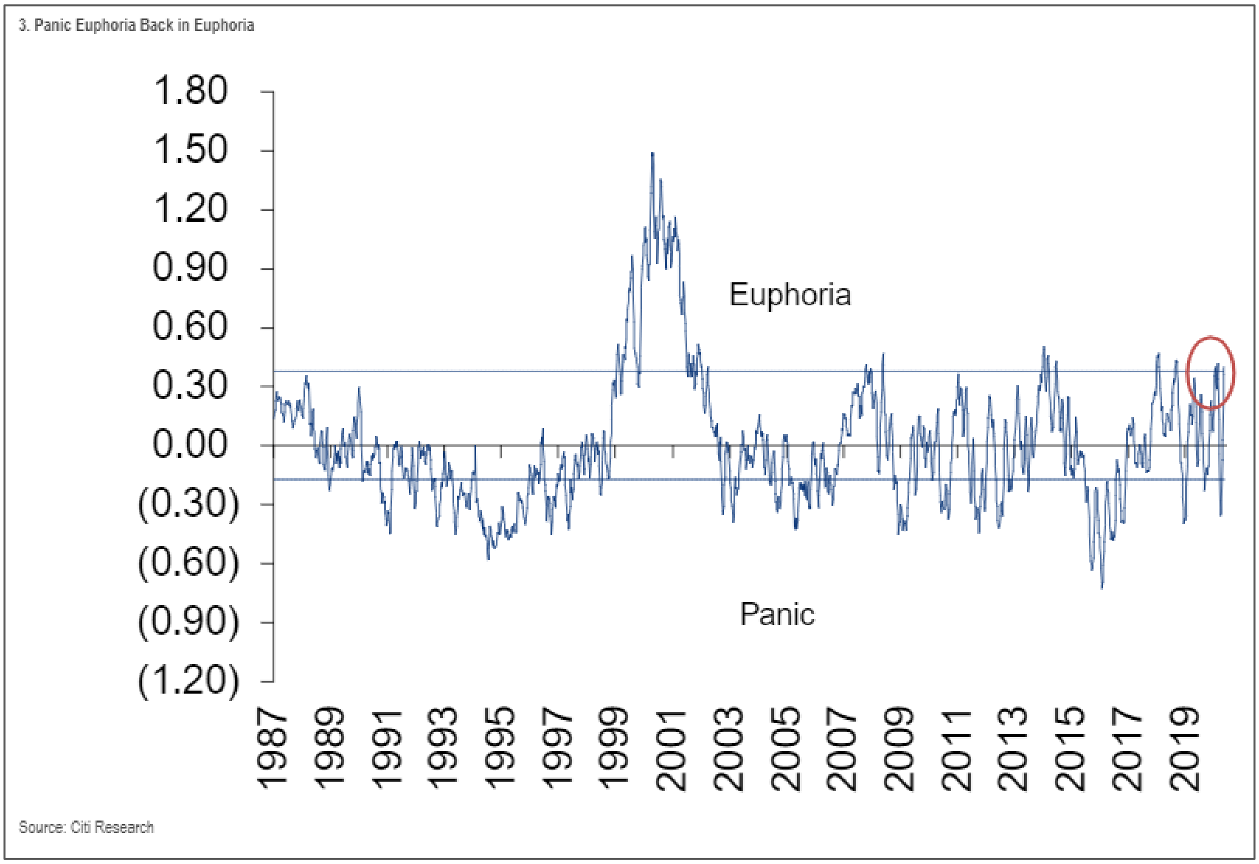
Short Covering Rally

The sharp rally from the market bottom has led, or coincided with, a historic short-covering rally.



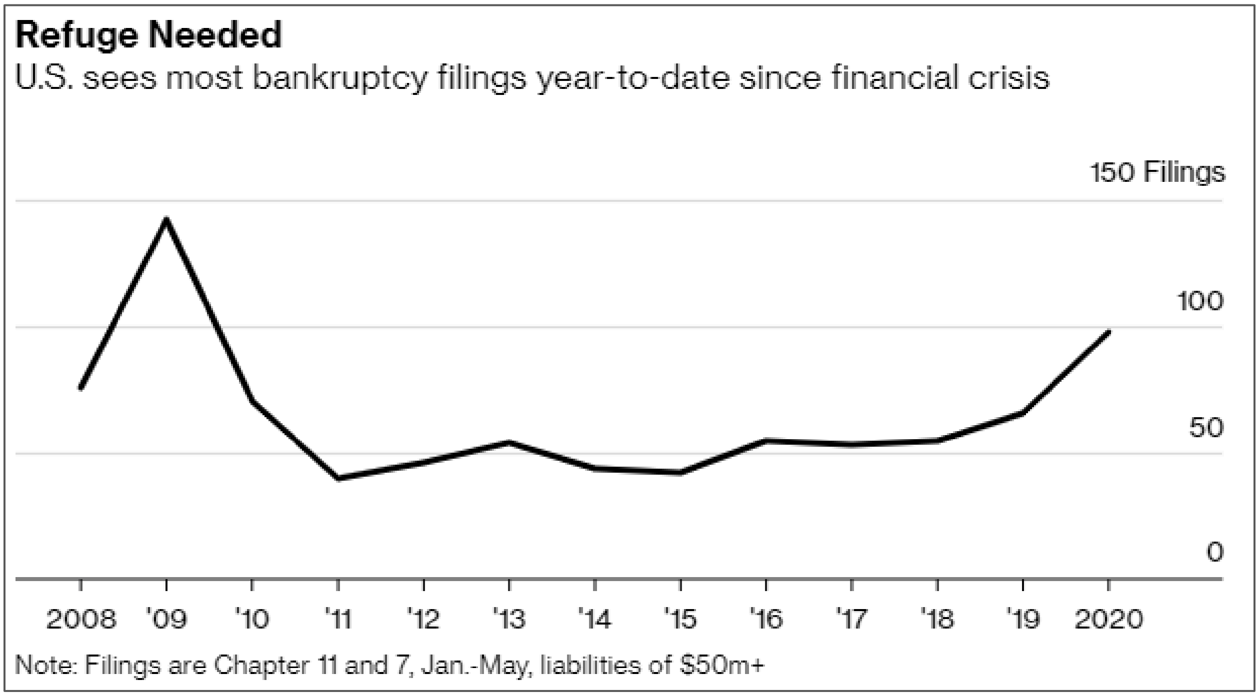
Source: Bloomberg

Citigroup Panic/Euphoria Model is back to Euphoria



Source: Citigroup, Bloomberg

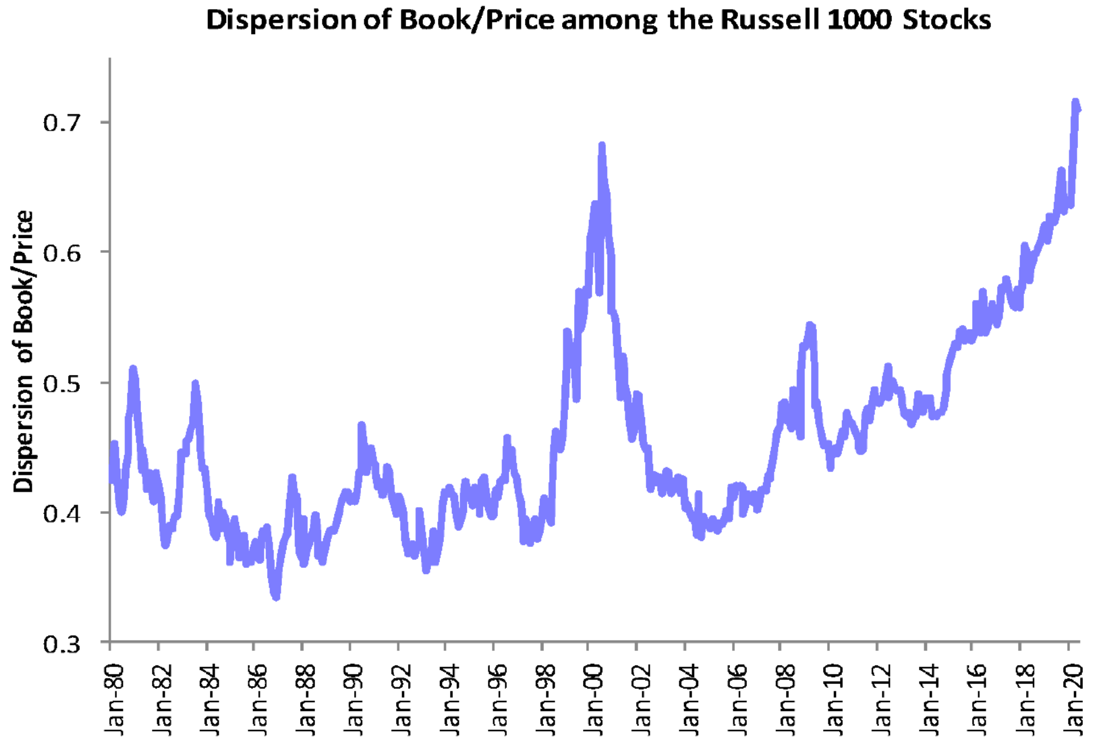
Most YTD Bankruptcy Filings since GFC



Bloomberg

Value has Never Been Cheaper Relative to Growth

Fig. 1: Valuation Gap Is at Extreme Level



Note: Shows the median absolute deviation in the book/price of Russell 1000 stocks, normalized by the median level of book/price among these stocks. Period is from January 1980 through beginning of May 2020.
Source: Compustat, Russell, Instinet analysis

Source: Bloomberg

Value has never underperformed growth like this either

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.