Market Outlook

By Mark T Dodson, CFA

Bank Sentiment Pushes Psychology into Worst 5 Percent of Readings

Market Risk Index climbed to 85.4, the highest level since March 12th. Our psychology composite has pushed into the worst five percent of readings on a worsening of the Bank Sentiment category. The Senior Loan survey revealed that banks have further tightened lending standards, and the sentiment of bankers is approaching the worst levels from the 2008 global financial crisis. These indicators may arguably be a better fit for our monetary composite, because the durations and correlations move look more like our basket of monetary indicators. Instead, we have treated it as a smart money indicator within the psychology composite. With the release of the survey this week, the category is at its maximum negative score with all six questions that we track still growing more negative while in recessionary territory.

In one sense, Consumer Confidence and Bank Sentiment have swapped places. The euphoric readings in January and February of this year were being hurt by historically high Consumer Confidence, while Bank Sentiment was in good shape. Now, Consumer Confidence has shifted to neutral while Bank Sentiment is flashing red.

Enthusiasm for leverage in way of options and levered ETFs has shown little sign of retreat, and our NASDAQ to NYSE Volume sentiment indicator not only reversed, but it moved to new all time highs this week, beating the previous 40 year record from 1980.

Only two categories are helping psychology to any degree, the still elevated levels of volatility for small cap stocks, and the Technical Indicators category, where there was enough improvement in breadth to move the category to a positive.

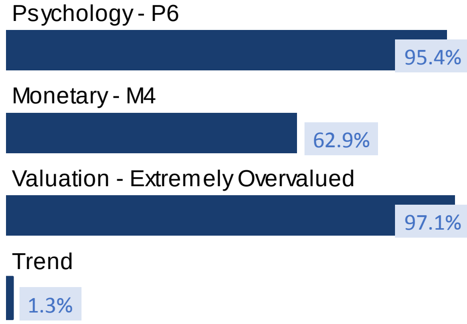
Monetary conditions improved, and all of it is a result of an acceleration in falling corporate bond and municipal bond yields. Investment grade yields have fallen to the level of dividend yields on stocks, making an argument that this could be the most aggressive yield seeking environment ever. Meanwhile, the volatility of day to day changes in the yield curve look artificial, like the Fed is already practicing yield curve control, whether it is official policy or not. As we've seen with these kinds of extreme policies in Europe and Japan, it hasn't been good for the Financials in the US either.

Market Risk Index

Elevated

85.4%

Category Percentiles



Largest Psychology Influences

Volatility	Positive
Fund Flows	Negative
Option	Negative
Leveraged Investments	Negative

Largest Monetary Influences

Falling Yields	Positive
Monetary Aggregates & Velocity	Negative
Yield Curve	Negative

Valuation

7-10 Year Rtn Forecast	1.6%
10Yr Treas Yield (on 08/04)	0.6%

Market Trends

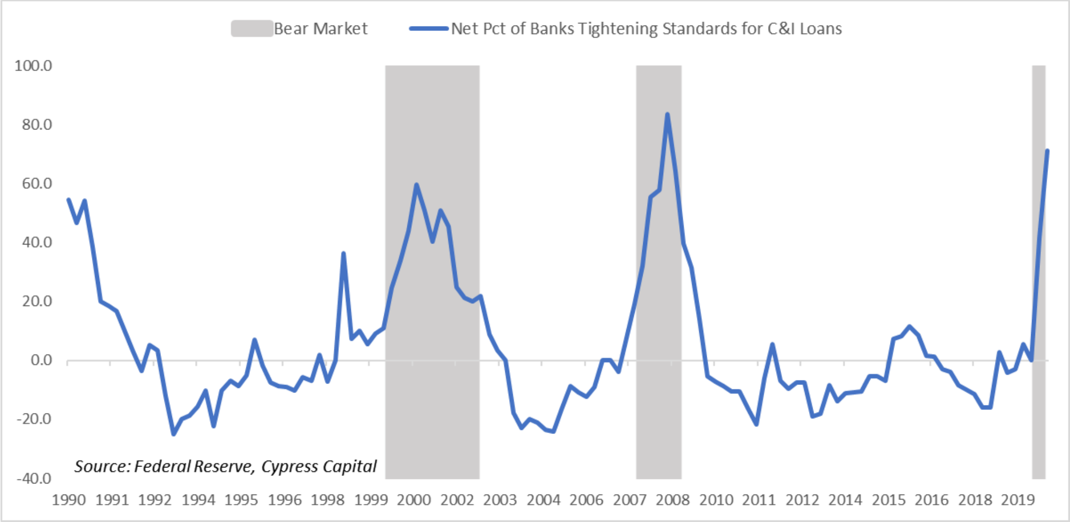
US Equities	Bullish
Intl Equities	Bullish
REITs	Neutral
Broad Commodities	Bullish

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.

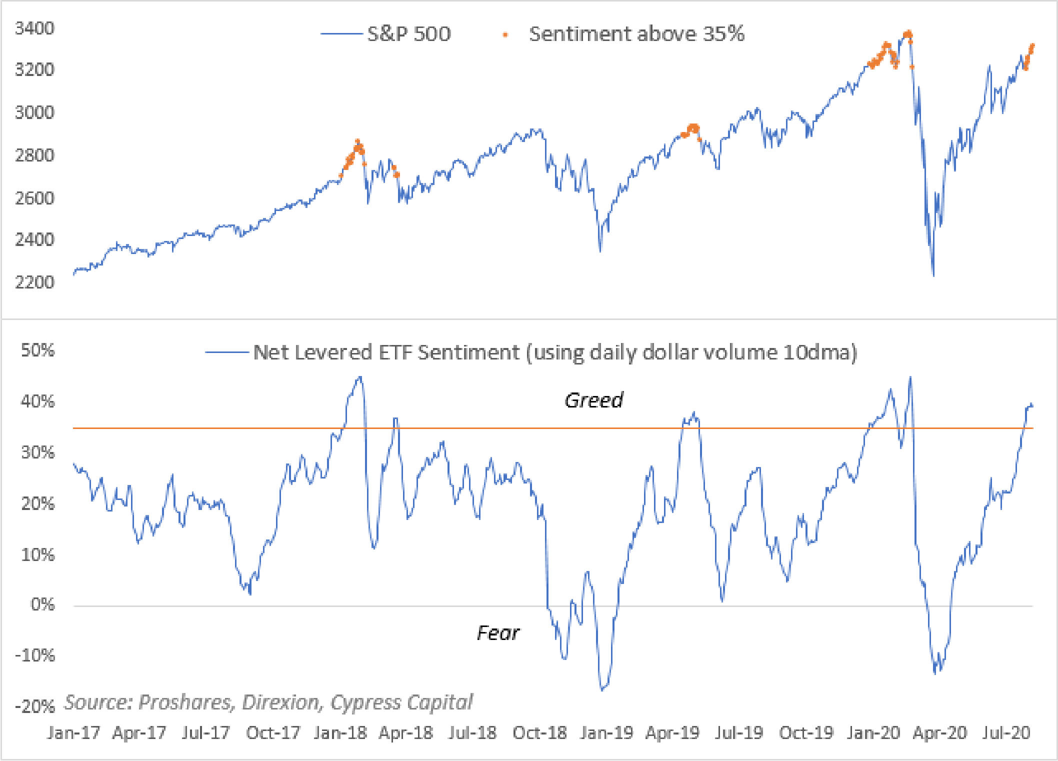
An unintended side effect of the government stimulus and Fed interventions, as well as the summer surge in Coronavirus cases, has been a sharp decline in the dollar. It's a fly in the ointment for the Fed – you'll notice that the rate of change in their balance sheet and monetary base rolled over as soon as declines in the dollar began to accelerate. As we mentioned last week, record low TIPs yields, higher prices in gold, silver, and even Bitcoin all look like a market that is working toward pricing in some form of stagflation.

Valuations continue to push higher, and for the first time ever, Valueline's Median Estimated PE and the cap-weighted 12 month forward PE on the S&P 500 climbed above 22X simultaneously. Our regression based forecast for equity returns fell into negative territory again, making even a Treasury yield of half a percent look attractive for long term investors. The last three times this forecast has fallen below the Treasury yield, it has spelled shorter term trouble for equities.

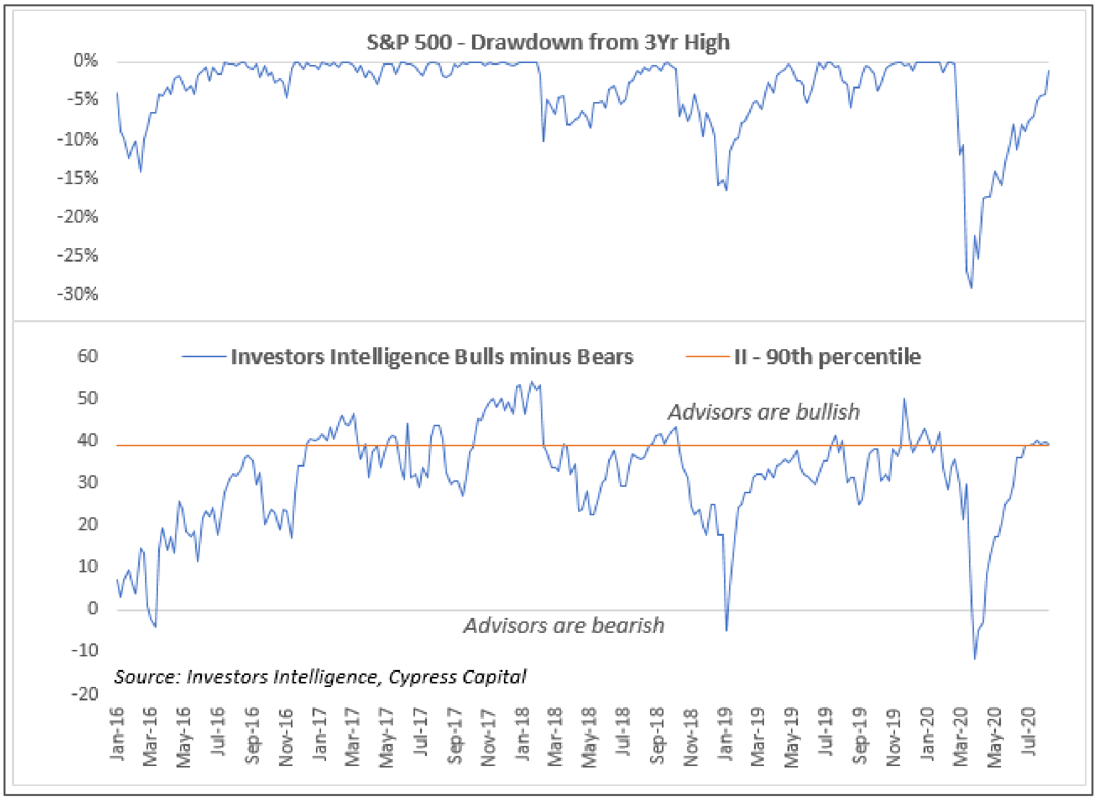
Banks continued to tighten lending standards this quarter



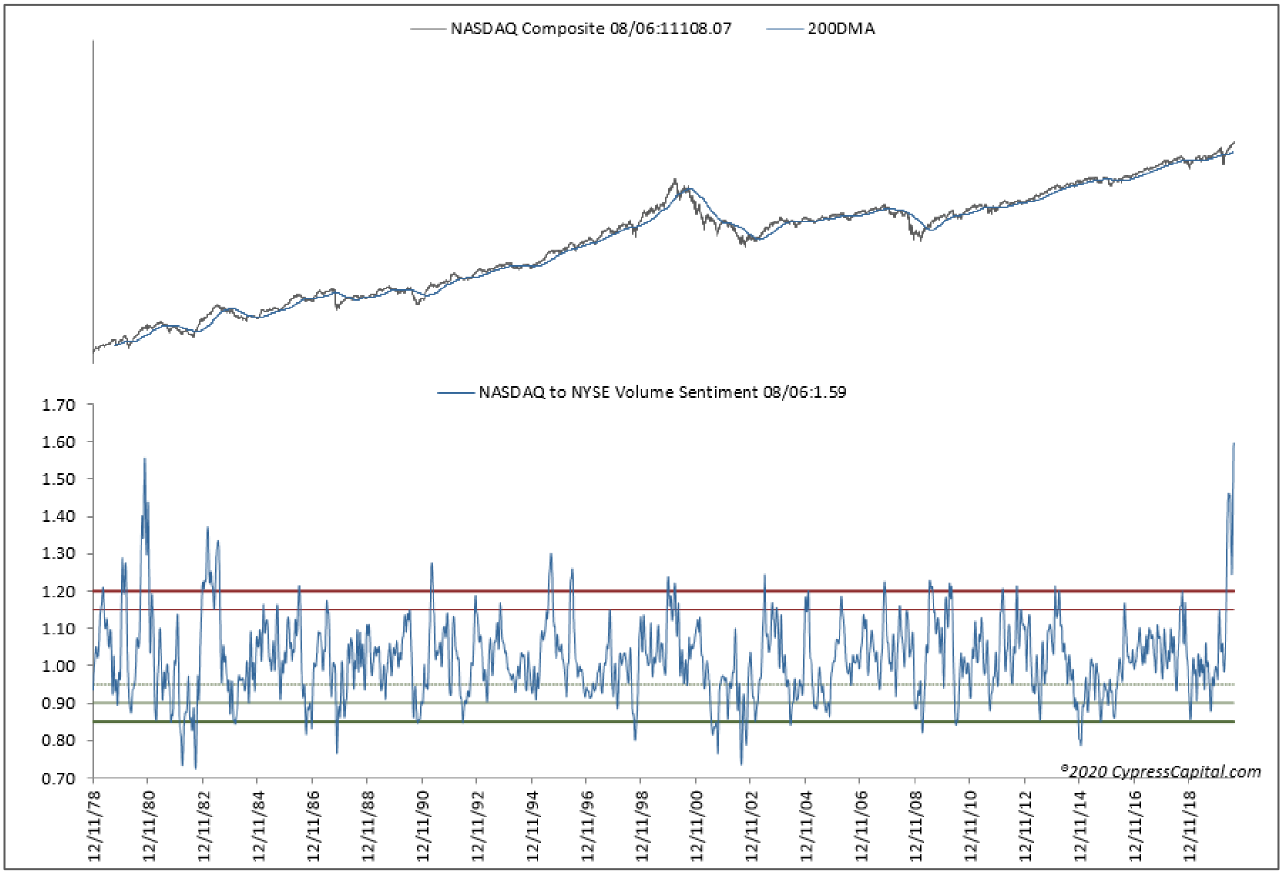
The sentiment of Leveraged and Inverse ETF investors climbed further into greed territory.



Investors Intelligence bullishness in the 90th percentile

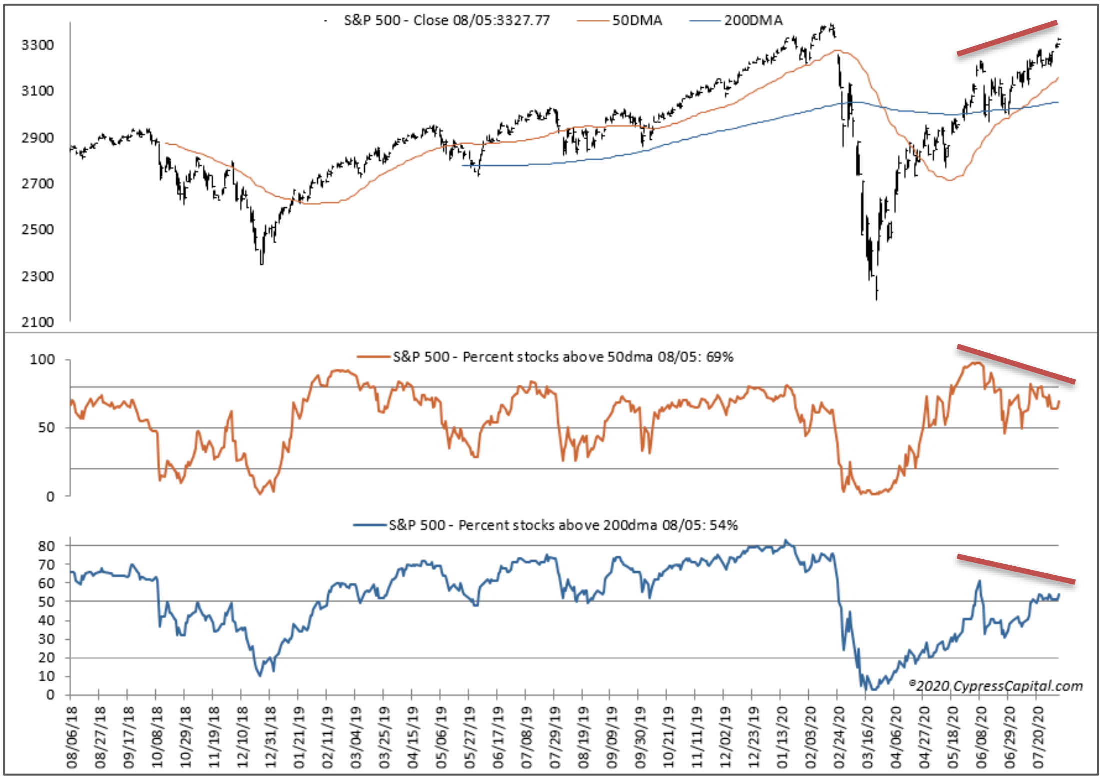


NASDAQ TO NYSE Volume Sentiment hits new all-time high



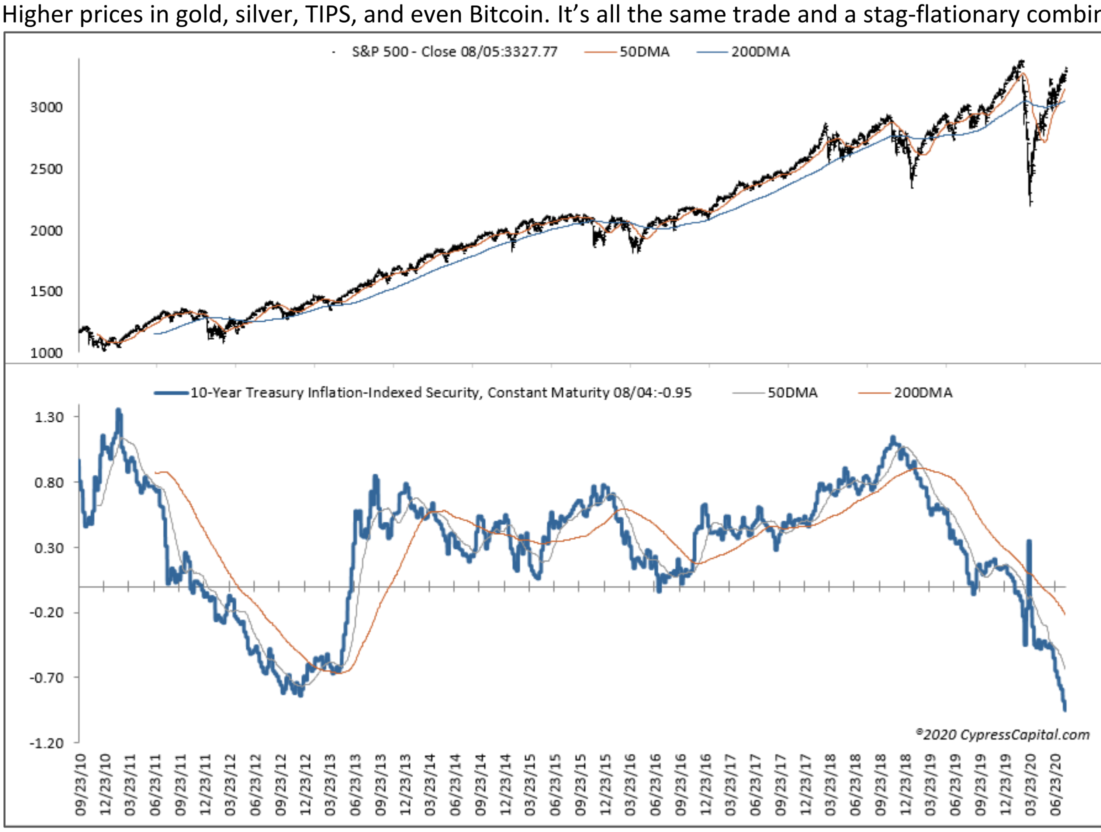
Percent of S&P 500 stocks above 200 day moving averages

This measure of breadth has solidly held the 50% line in the sand for multiple weeks, but it also hasn't shown signs of going higher than the June 8th high like the broader equity market.



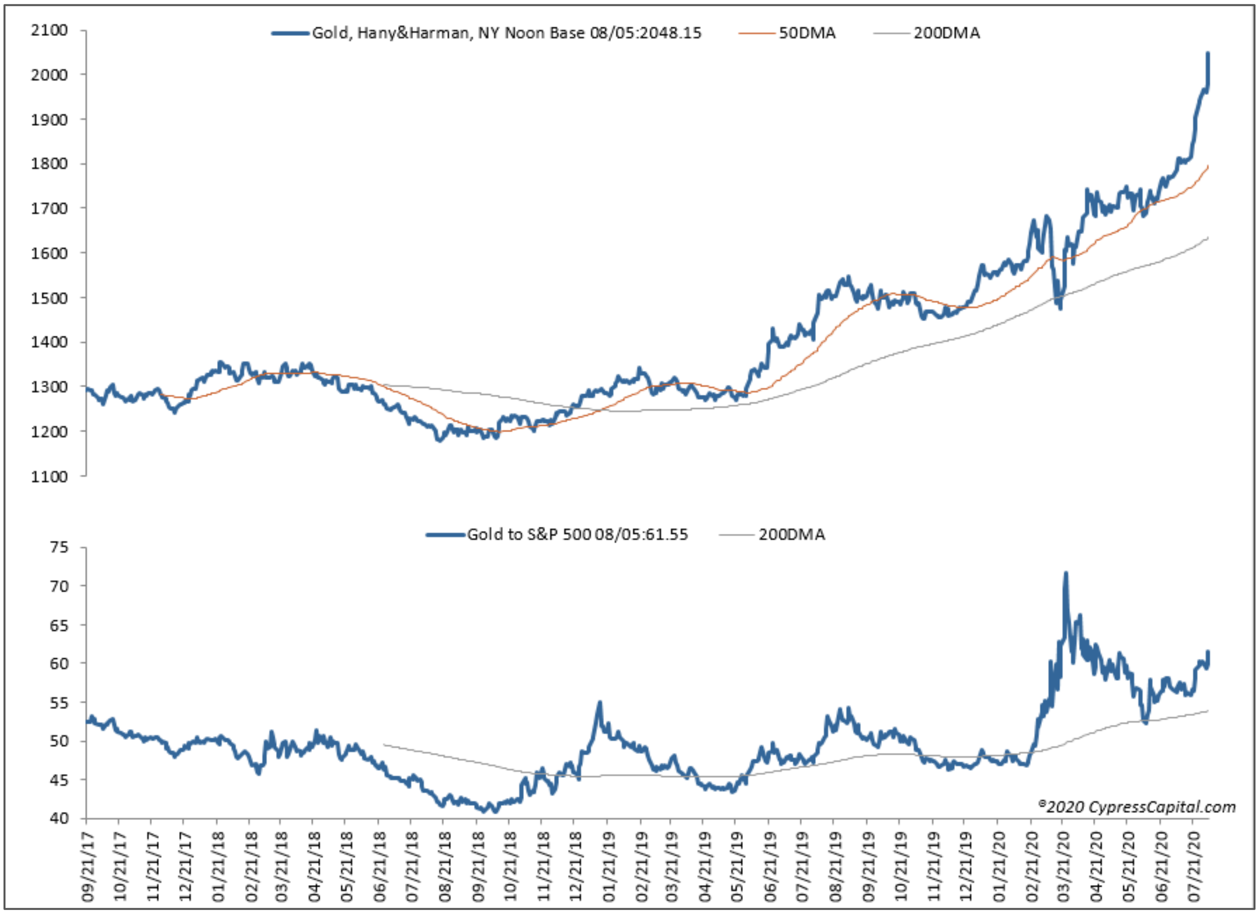
TIPS yields continue to set record lows

Higher prices in gold, silver, TIPS, and even Bitcoin. It's all the same trade and a stag-flationary combination of price moves.



Gold goes vertical

Consequently, flows going into both gold funds and TIPs funds are setting records.



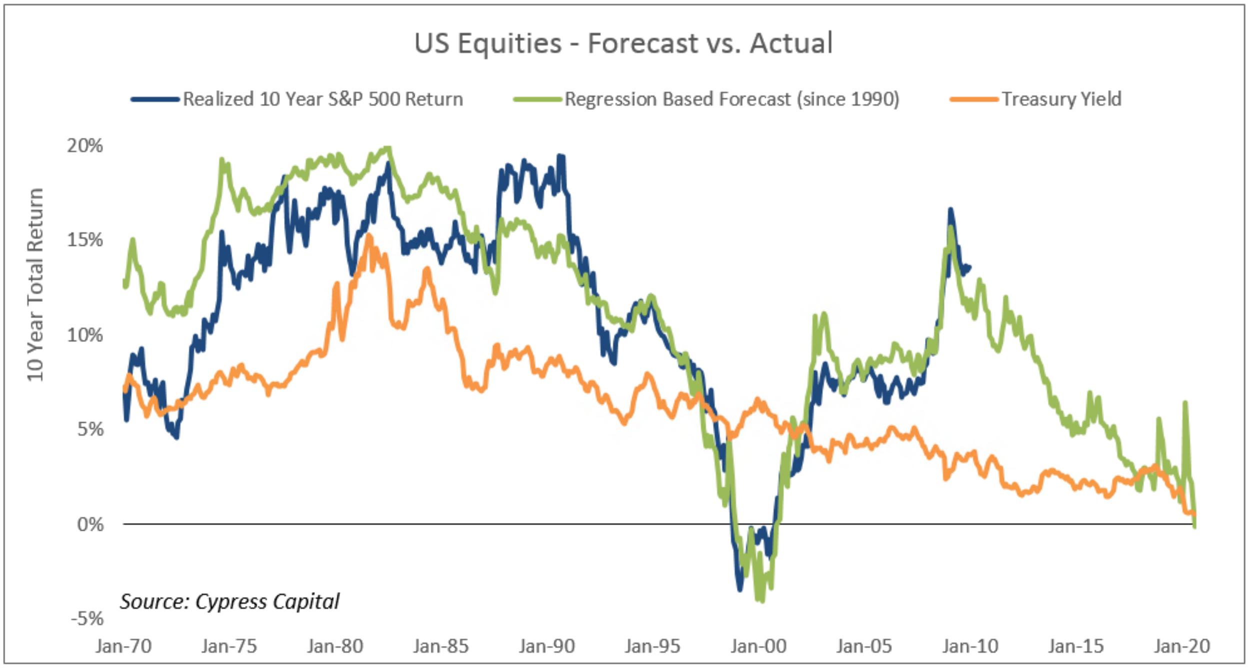
Gold Valuations

This interesting model of gold valuations treats the metal like it is a "zero-coupon 20-year Treasury inflation-protected security." It suggests gold is overvalued, but it can remain that way for a long time.

Source: Bloomberg, John Authers

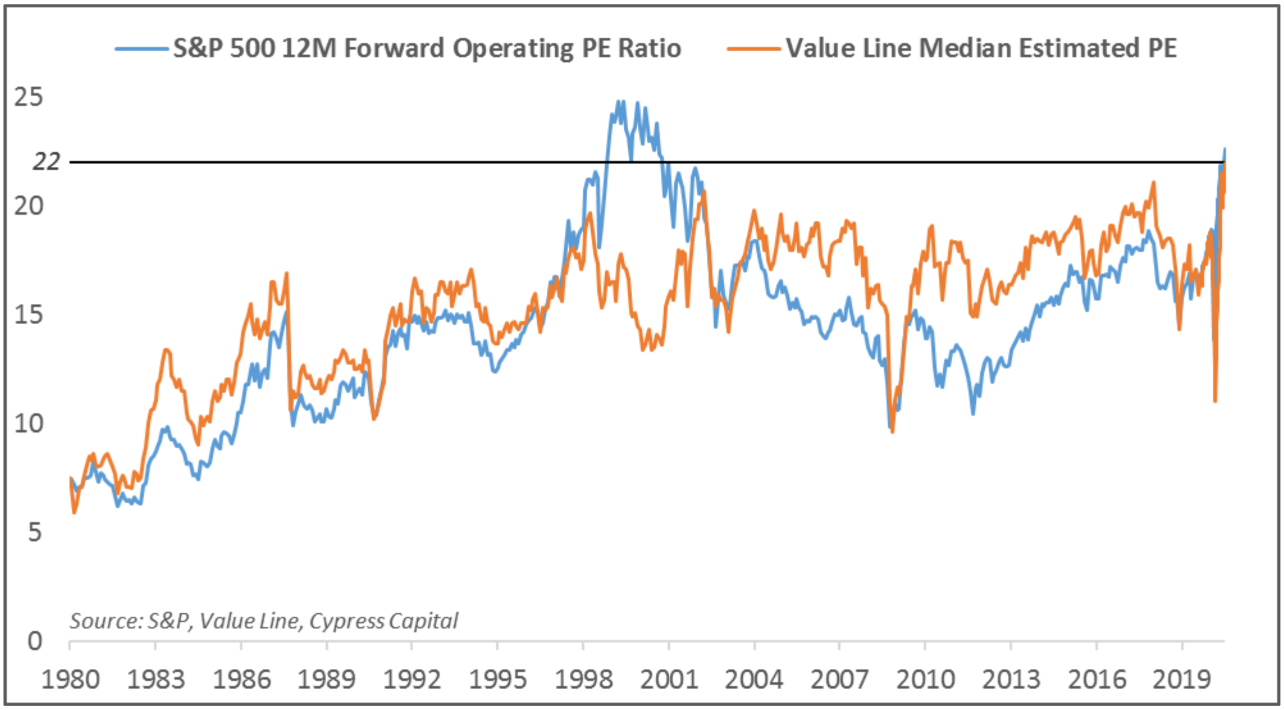
Valuations push equity return forecast back into negative territory

This is the fourth time in three years that this valuation driven forecast has fallen below Treasury yields. All three of those proved to be rare occasions where valuation showed some merit in short-term market timing. The last three instances were January 2018, September 2018, and February 2020.

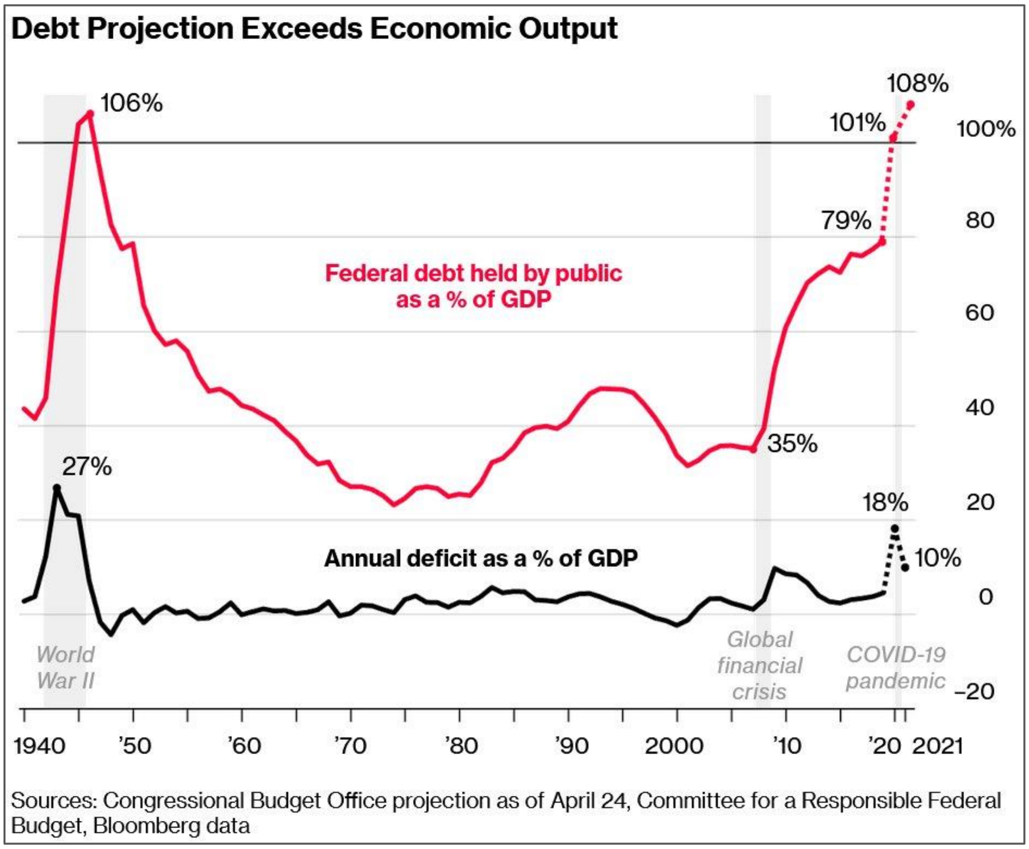


A Valuation First

For the first time, both the 12M forward PE ratio on the S&P 500 and Value Line's Median Estimated PE are trading above 22x at the same time. This is a record high level for the median PE.



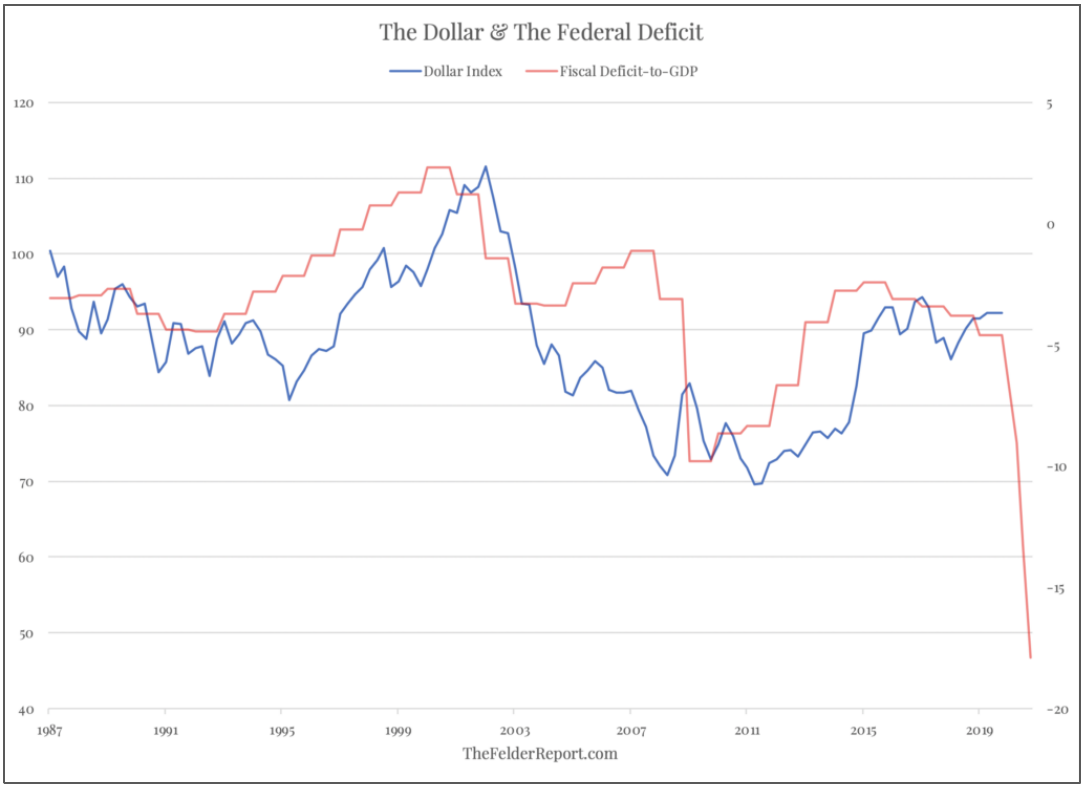
Federal Debt is set to exceed World War II era levels



Source: Liz Ann Sonders

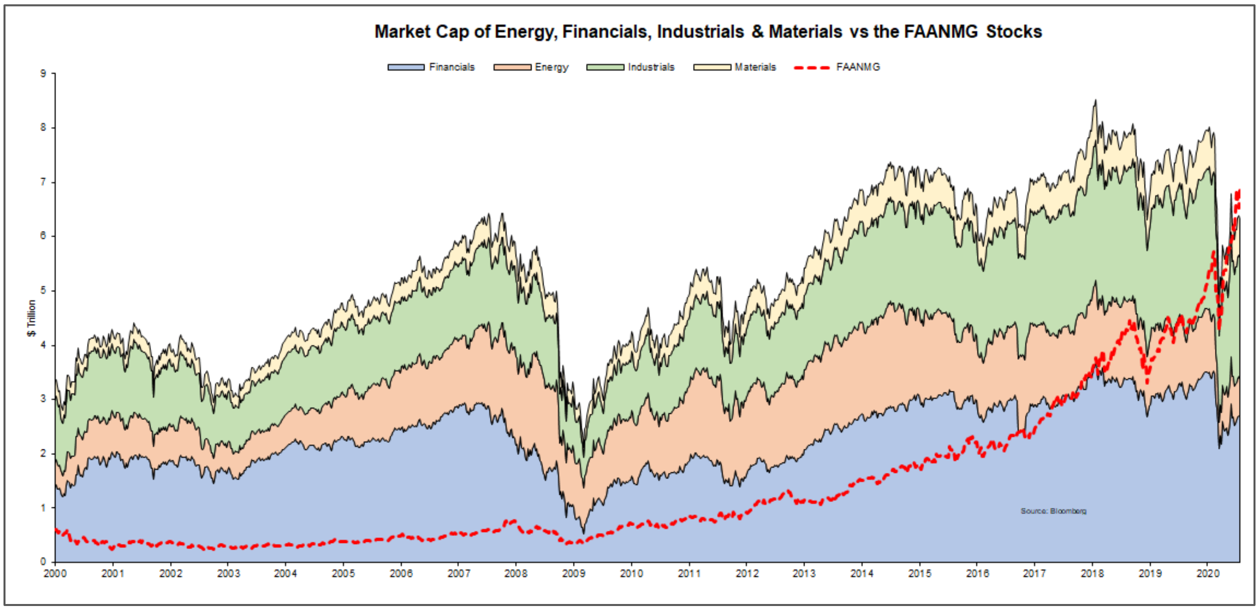
...And those higher deficits imply a falling dollar.

Commodities, emerging markets, and TIPs all do well in a falling dollar environment.



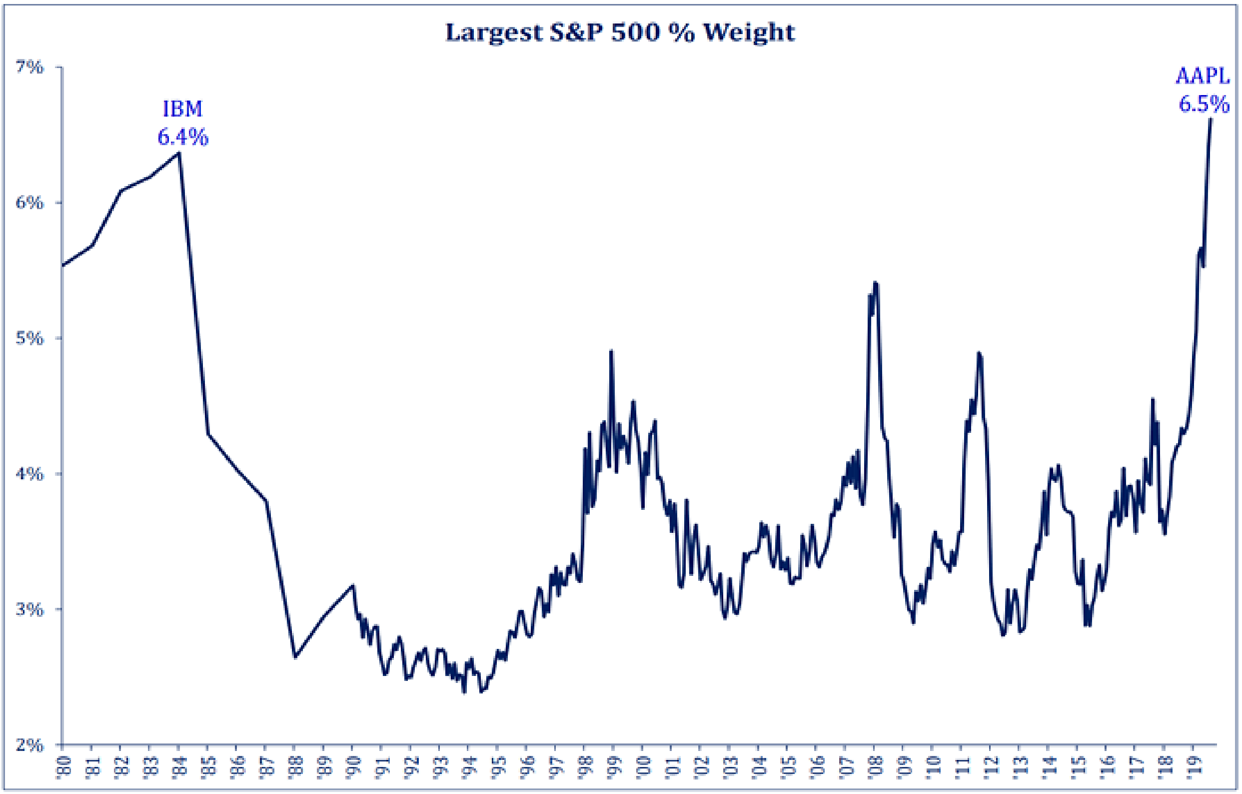
Source: TheFelderReport

Market Cap of FAANMG surpasses Energy, Financials, Industrials & Materials sectors combined



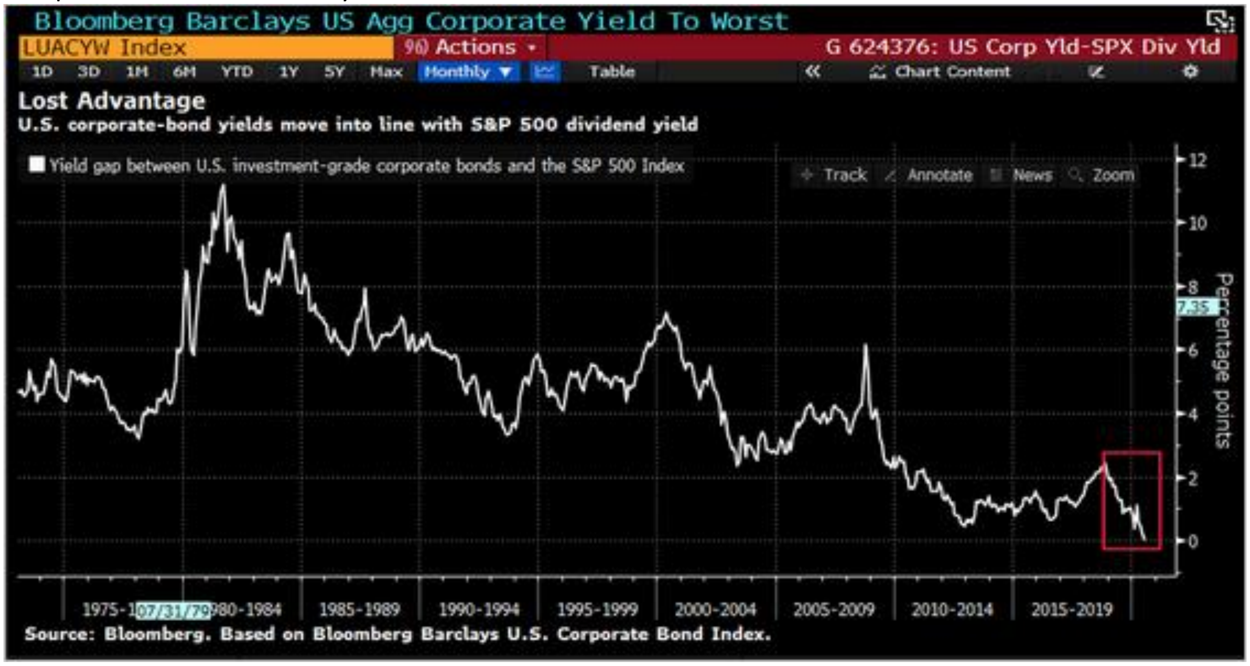
Source: Vincent Deluard

Apple beat IBM's nearly 40 year record for the largest single holding in the S&P 500



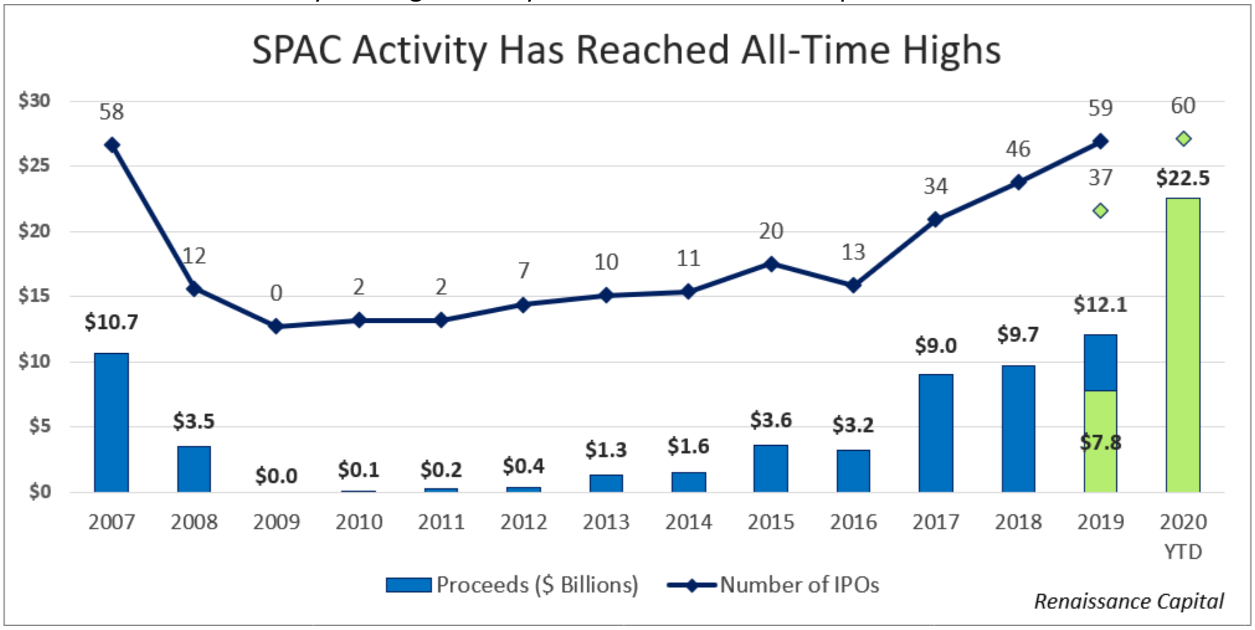
Source: Strategas Research Partners, Isabelnet

Investment Grade corporate bond yields now match the S&P 500 dividend yield
The Fed "put" on corporate bonds has driven yields down to new lows – so low that the yields are now comparable to the dividend yield on the S&P 500.

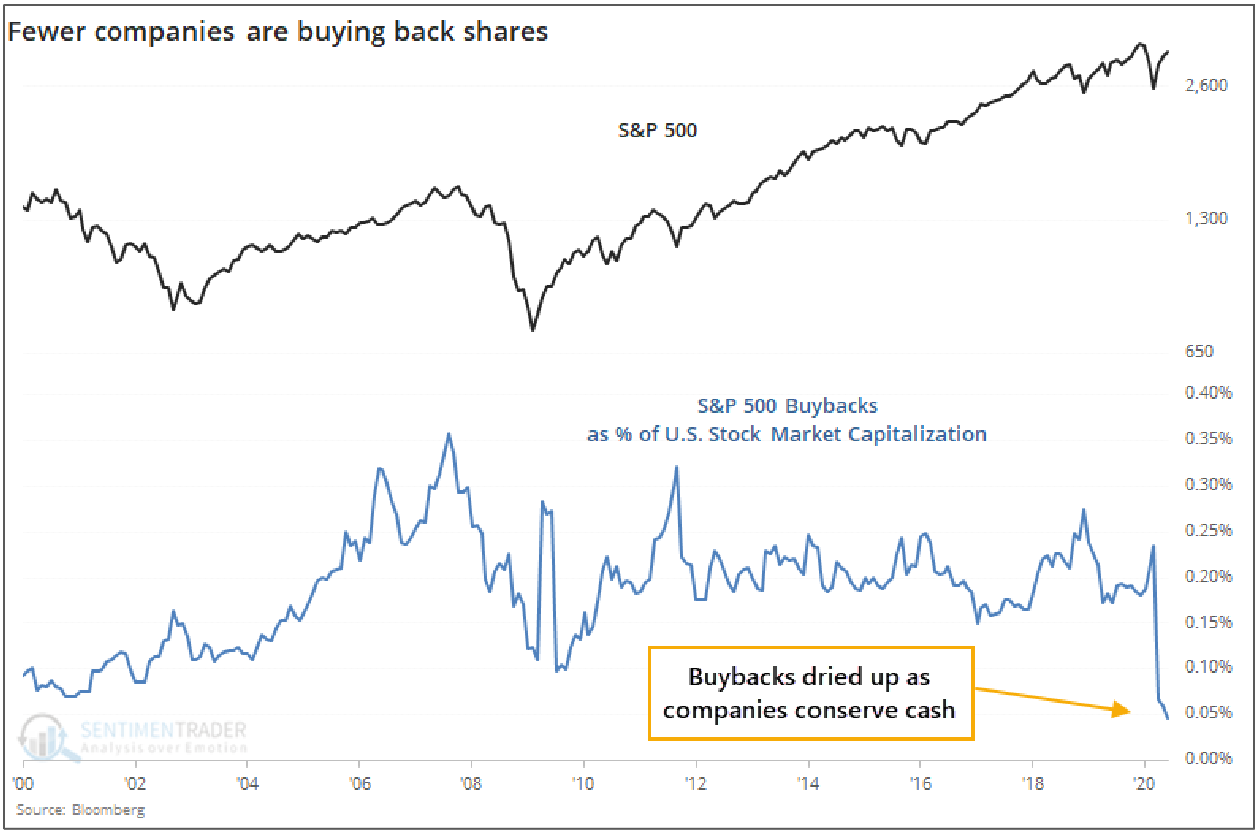


Source: Bloomberg

Record SPAC Activity
A record amount of money is being raised by these "blank check" companies.

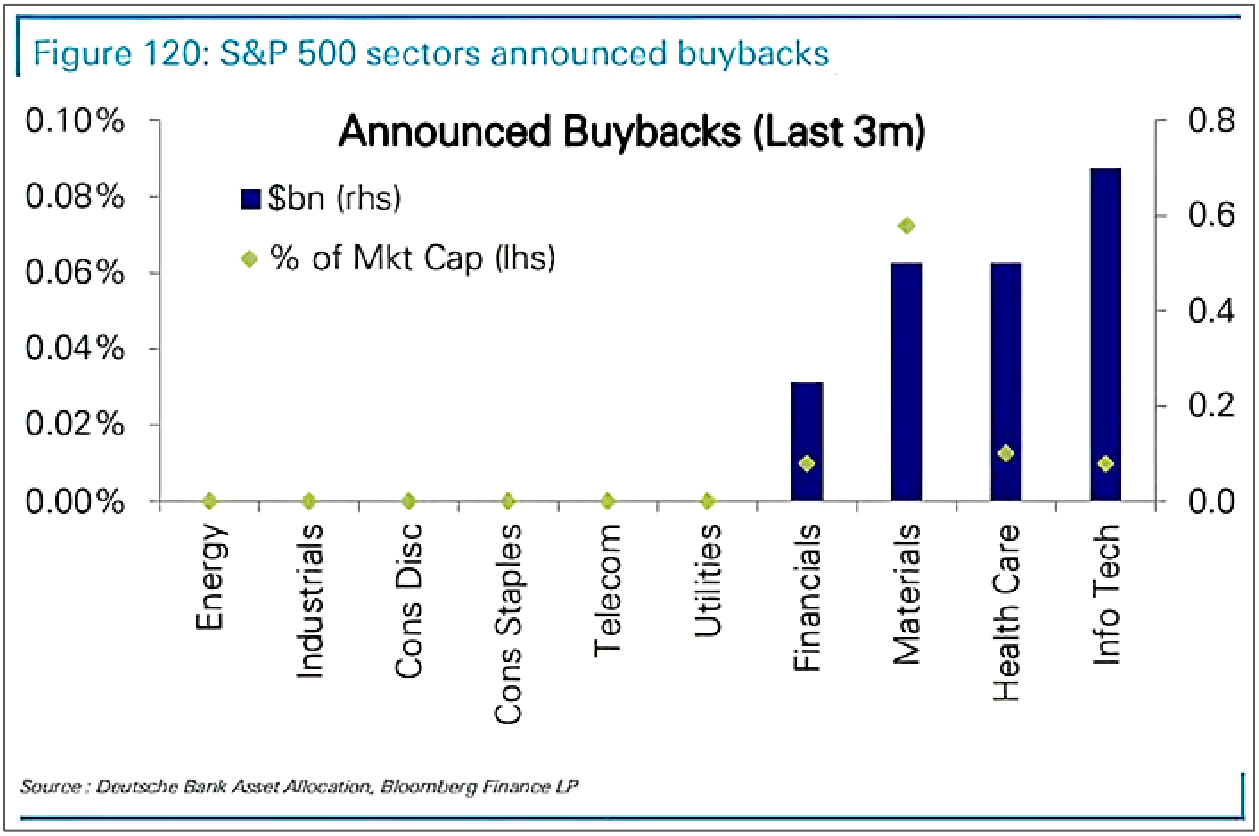


Buyback Activity has largely dried up



Source: SentimenTrader

...with the notable exception of the Tech sector.



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.