



Market Outlook

By Mark T Dodson, CFA

Market Risk Index falls below 90%

Psychology shows few signs of major improvement

Market Risk Index had some movement this week, falling to 87%, which is the first reading below 90% since late August. The improvement this week is all a monetary phenomenon, with monetary conditions firmly in neutral territory. Banks' restraint in lending is almost perfectly balanced by the Fed's lack of it. Neither psychology nor valuations have made big shifts as a result of the ongoing correction. The forward PE on the S&P 500, for example, has moved from 22.5x to 20.7x, and anything over 20x is a dot-com era level.

Other than a modest pullback in some of the surveys like Investor's Intelligence and NAAIM, the investor psychology risk score readings are still in rarified air. The current reading can get no worse, and it's become our new benchmark for extreme.

The market is more oversold than any time since March, but the sentiment indicators that have driven the psychology composite to break the year 2000 records have so far only pulled back from nosebleed levels to high levels. We'd like to see some signs that the speculative fervor in options markets has been reined in, and it has improved, but not much. In a surprise this week, we saw a pick-up in insider selling, not to dangerous levels, but it's unusual to see insiders selling when small and mid-cap stocks correct as strongly as they have over the course of September.

Markets are lamenting both the fading effects from the first round of stimulus and dimming prospects of a second round. Policymakers have had a laser focus on markets in 2020, running audibles on policy when asset prices get volatile. Instead of bond vigilantes, SPY or FAANG vigilantes have driven policy in 2020. Policymakers will blink, and it's likely to occur precisely when our psychology composite says that the euphoria from August has given way to a sharp shift toward fear.

Market Risk Index

Elevated

87.4%

Category Percentiles

Psychology - P6



Monetary - M4



Valuation - Extremely Overvalued



Trend



Largest Psychology Influences

Volatility	Negative
Flow of Funds	Negative
Levered Investments	Negative
Option Activity	Negative

Largest Monetary Influences

Interest Rates	Positive
Monetary Aggregates	Negative
Velocity	Negative

Valuation

7-10 Year Rtn Forecast	1.8%
10Yr Treas Yield (on 09/21)	0.7%

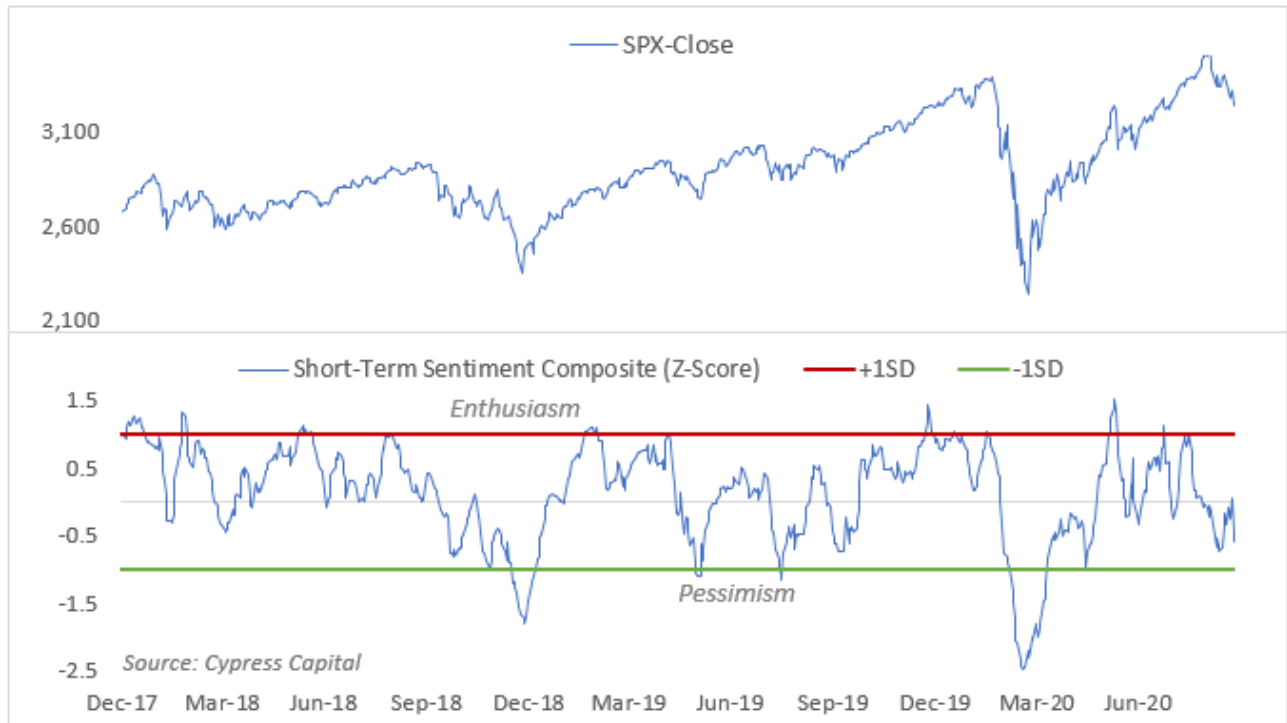
Market Trends

US Equities	Bullish Investment
Intl Equities	Bullish Trade
REITs	Neutral Trade
Broad Commodities	Bullish Trade

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.

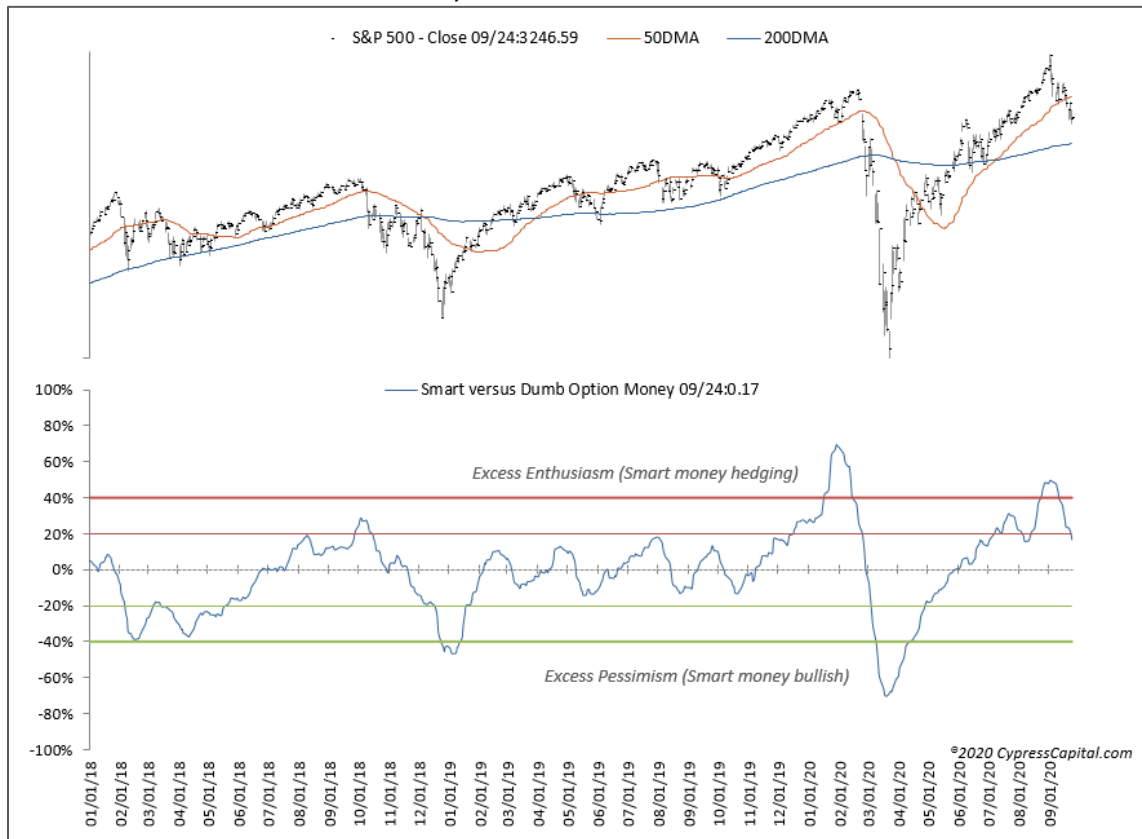
Short-Term Sentiment Composite

Faster moving short-term sentiment indicators reversed course again but are not displaying extreme pessimism.



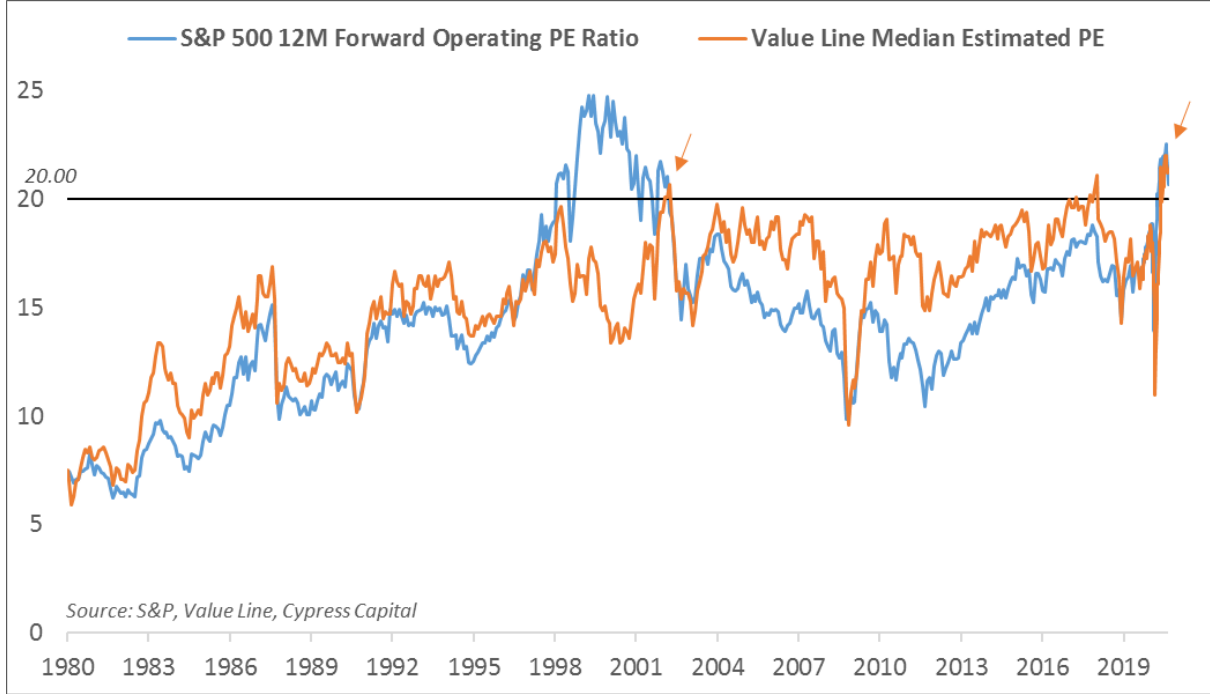
Smart versus Dumb Option Money

We've gone from nosebleed to just elevated readings on our smart vs dumb option money indicator. The indicator is still in enthusiasm territory.



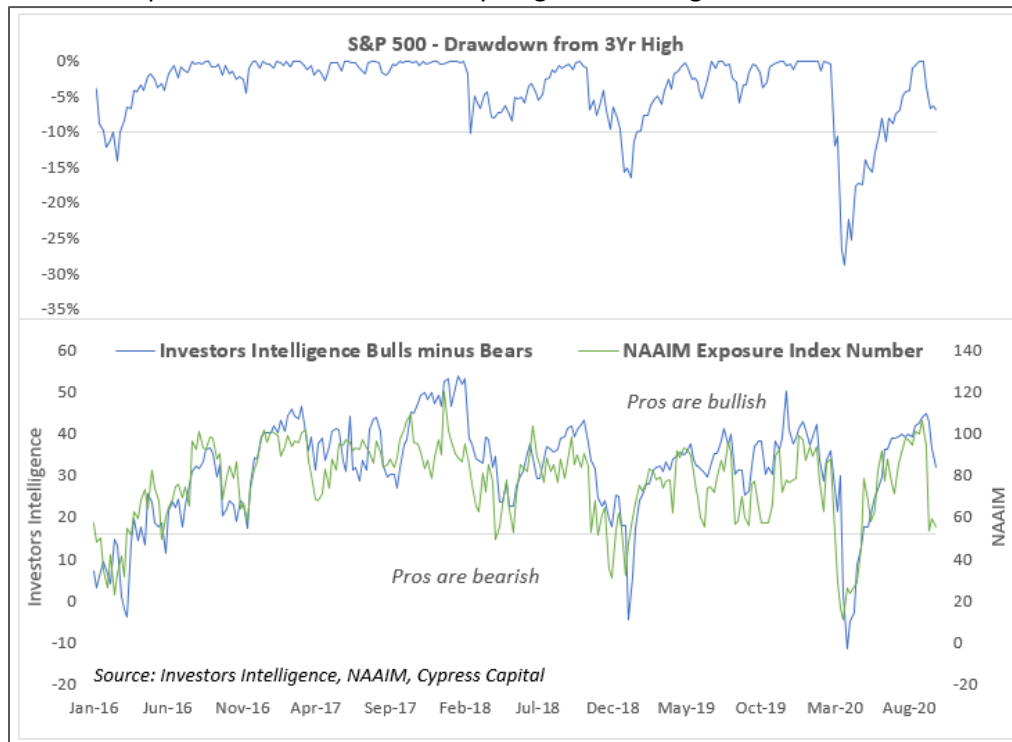
S&P 500 Forward PE vs Median Estimated PE

The market pullback has lowered the forward PE on the S&P 500 from 22.5x to 20.7x. Both the Median PE and cap-weighted PE are still above 20x. The only other precedent where both the cap-weighted market and median stock were trading above 20 times earnings was a few brief weeks in the spring of 2002. Investors had bid up valuations after the 2001 recession ended, but markets still had a lot of excess to work off from the 2000 stock market peak. It should serve as a stark warning to investors who ignore asset prices and spend too much time anticipating economic recovery.



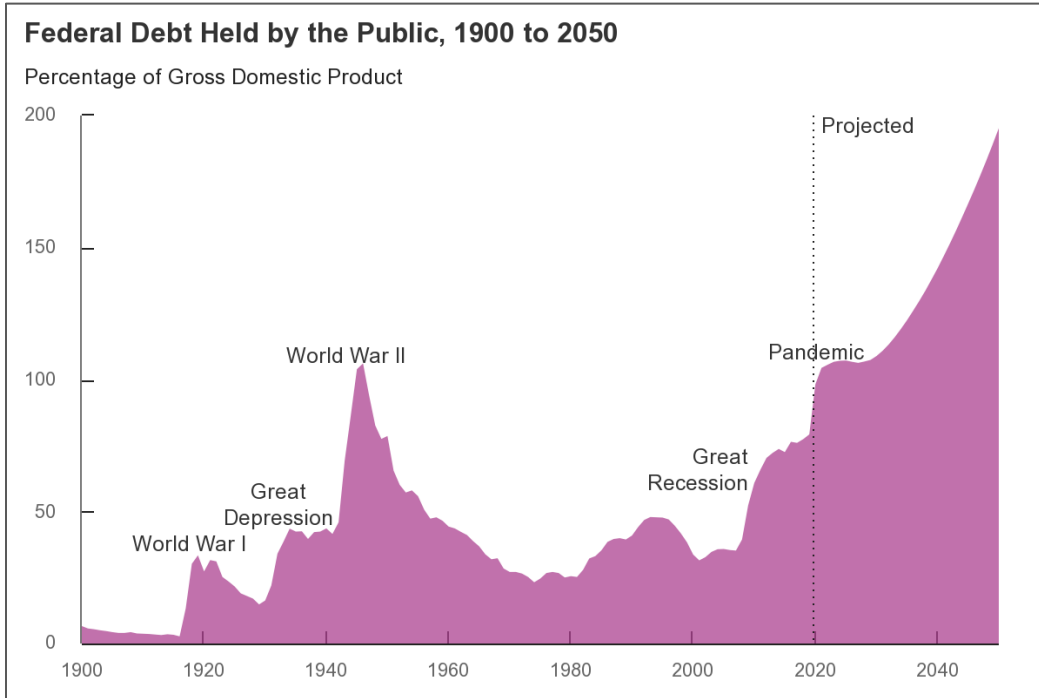
Surveys of Professionals

Investment professionals are in the early stages of a change of heart in their zeal for equities.



CBO Federal Debt Projections

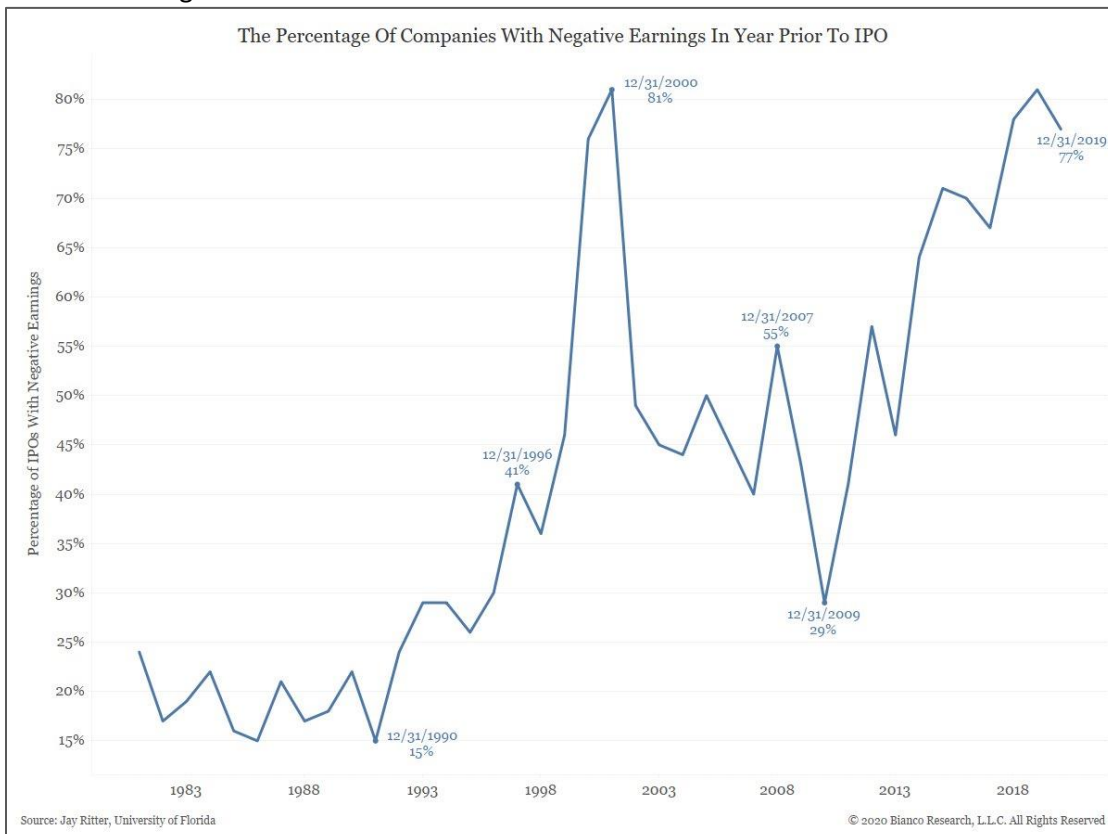
The pandemic has shifted CBO’s debt projections dramatically. It’s the MMT era whether we like it or not.



Source: Congressional Budget Office

IPOs with Negative Earnings

2018 fell just shy of the 2000 record for percentage of IPOs with negative earnings, but the percentage remained elevated through 2019.



Source: Jay Ritter, University of Florida

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Source: Bianco Research, Liz Ann Sonders

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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