Market Outlook

By Mark T Dodson, CFA

Monetary Conditions continue to improve

No such luck for either Psychology or Valuation

Market Risk Index improved to 83.9% on another significant shift in our Monetary composite.

With the yield curve moving to neutral, it's allowing near record low real corporate bond and municipal bond yields to use brunt of their positive implications toward improving the monetary score. Monetary is right in the 50th percentile, a Goldilocks reading from the composite. None of the readings are what we'd call long-lasting powerful credit cycle readings, so it's a fragile Goldilocks reading.

The shift toward an improving investor psychology composite that began as the market started to correct came to a halt. Put/Call indicators reversed and started to move back in favor of calls, although, they are well off the levels from the peaks in August. There are improvements at the margins, but still a lot of excess, and the composite didn't budge.

Measures of market internals that rely on price, like the percent of stocks trading above their 200 day moving averages rebounded to healthier levels this week, but other measures of breadth, like the McClellan Summation and Breadth Thrust indicators are still negative having started their deterioration before the broad market peaked.

We updated two monthly data points this week - fund flows and consumer confidence. Consumers expectations for a rebound in both jobs and income prospects over the next six months are still near record highs. This is reasonable if your impression is that the Covid is the only economic concern and a temporary one. If your framework for viewing markets and the economy includes the aggregate level debt and condition of the credit cycle, it looks like too much optimism. On the fund flows side, equity outflows continue, while mutual fund cash levels are at record lows.

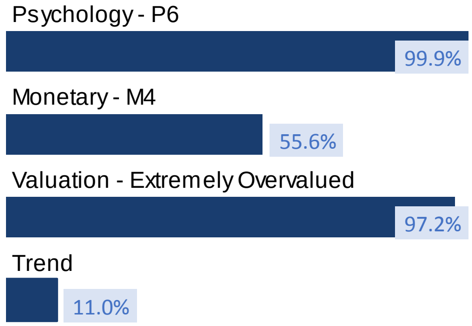
As our monetary composite continues to improve, it will take less of an improvement for psychology and valuations from those August extremes to get us to recommend an increase in equity exposure. Considering how little improvement we have seen from either psychology or valuation thus far, those itching to see us increase recommended equity exposure can view that as a positive development.

Market Risk Index

Elevated

83.9%

Category Percentiles



Largest Psychology Influences

Flow of Funds	Negative
Fund Flows	Negative
Option Activity	Negative
Levered Investments	Negative

Largest Monetary Influences

Interest Rates	Positive
Monetary Aggregates	Negative
Velocity	Negative

Valuation

7-10 Year Rtn Forecast	1.6%
#VALUE!	#VALUE!

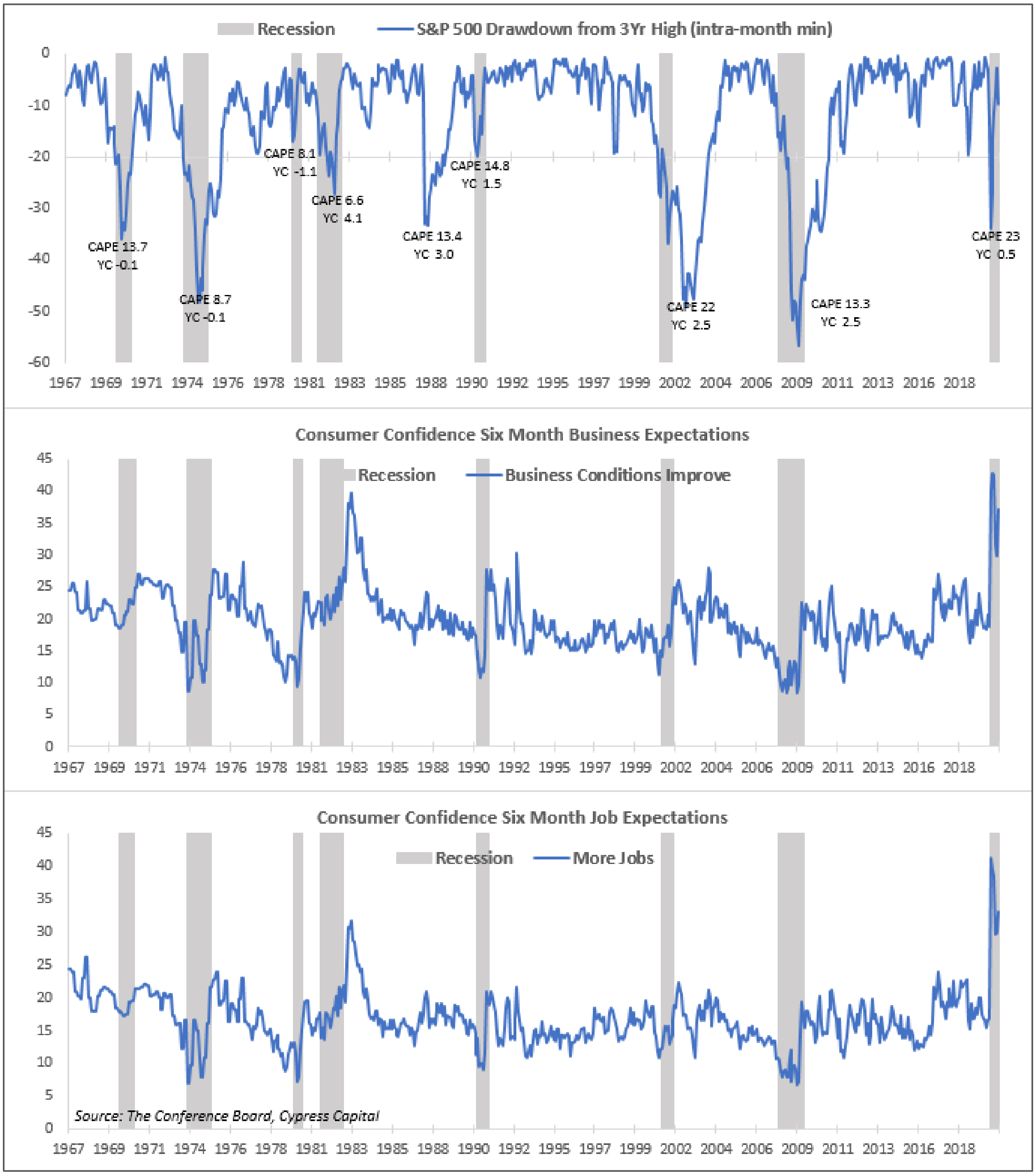
Market Trends

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

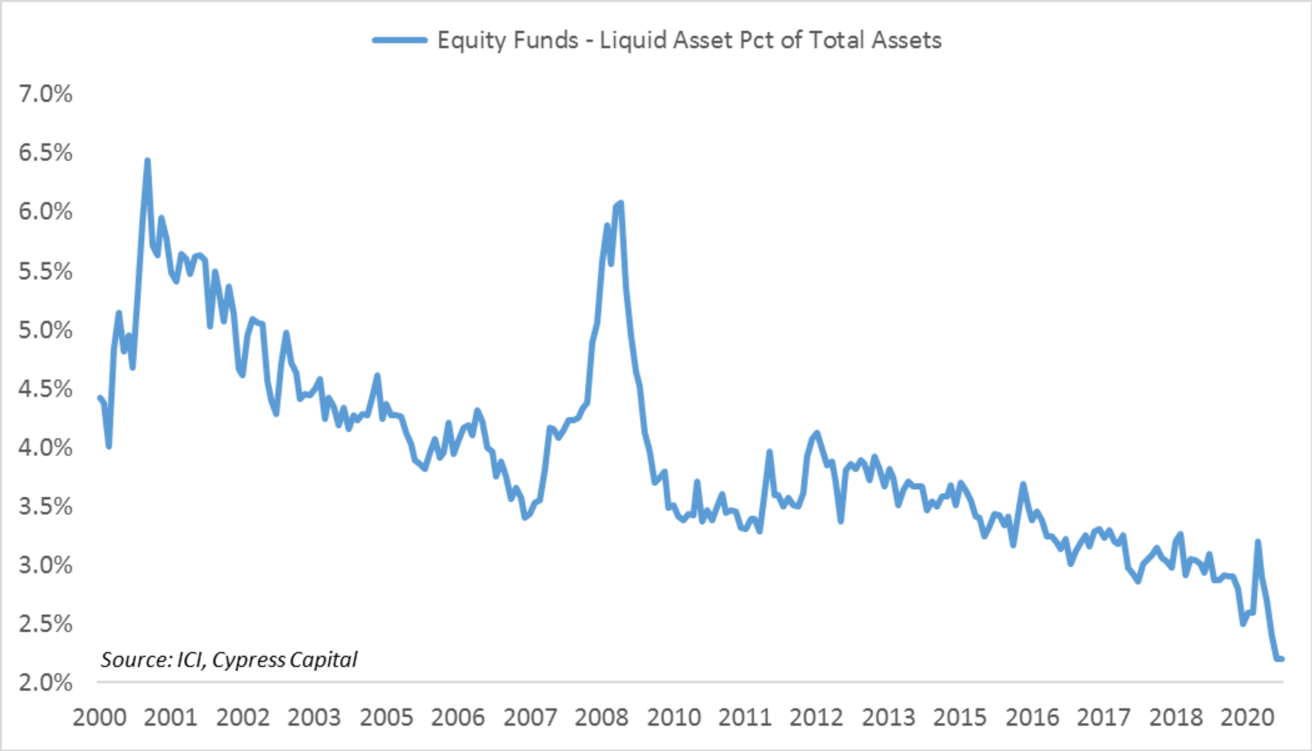
Consumer Confidence – Expectations for Improved Business Conditions and Job Market

Consumers expectations, the more forward looking component of the Consumer Confidence Index, rebounded last month and are near record highs. If the recession is purely a function of coronavirus, it makes sense. Viewed from the lens of the credit cycle, it looks like expectations are too high.



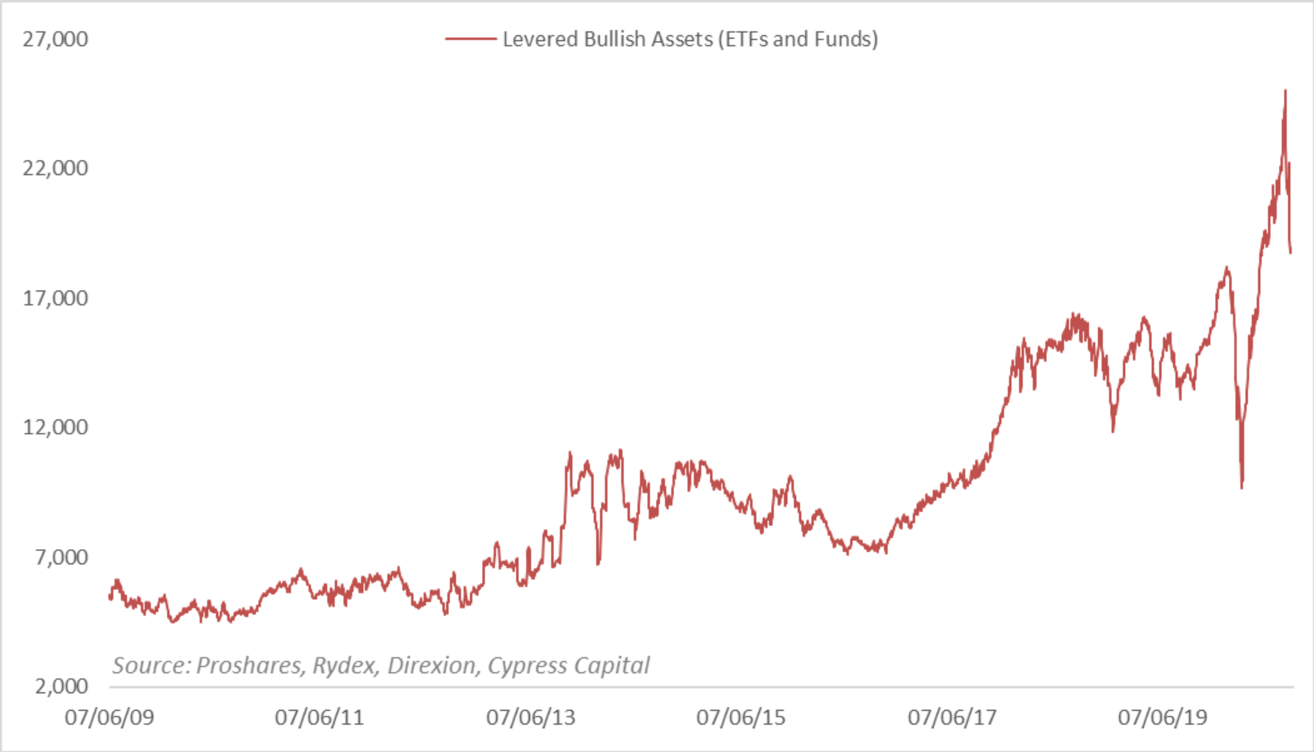
Mutual Fund Cash Levels at Record Lows

Equity outflows continued, and fund managers continue to push the assets that remain into risk assets. It's part 0% interest rates and part fear of lagging a benchmark in this environment dominated by large cap-weighted Tech stocks.

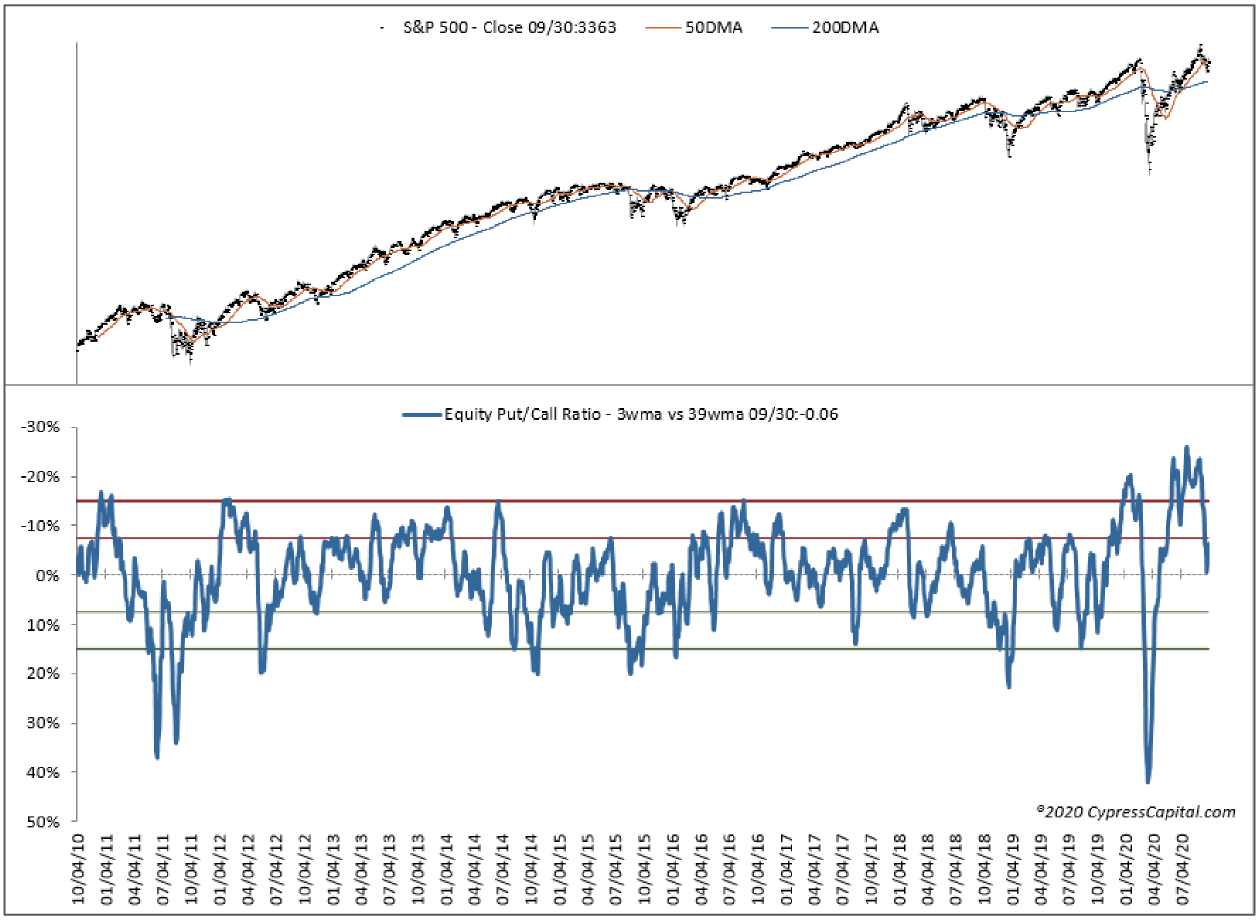


Assets in Leveraged ETFs and Funds

In August and September, assets in levered ETFs and funds surpassed the February peak by more than 50% before beginning to retreat within the last week.

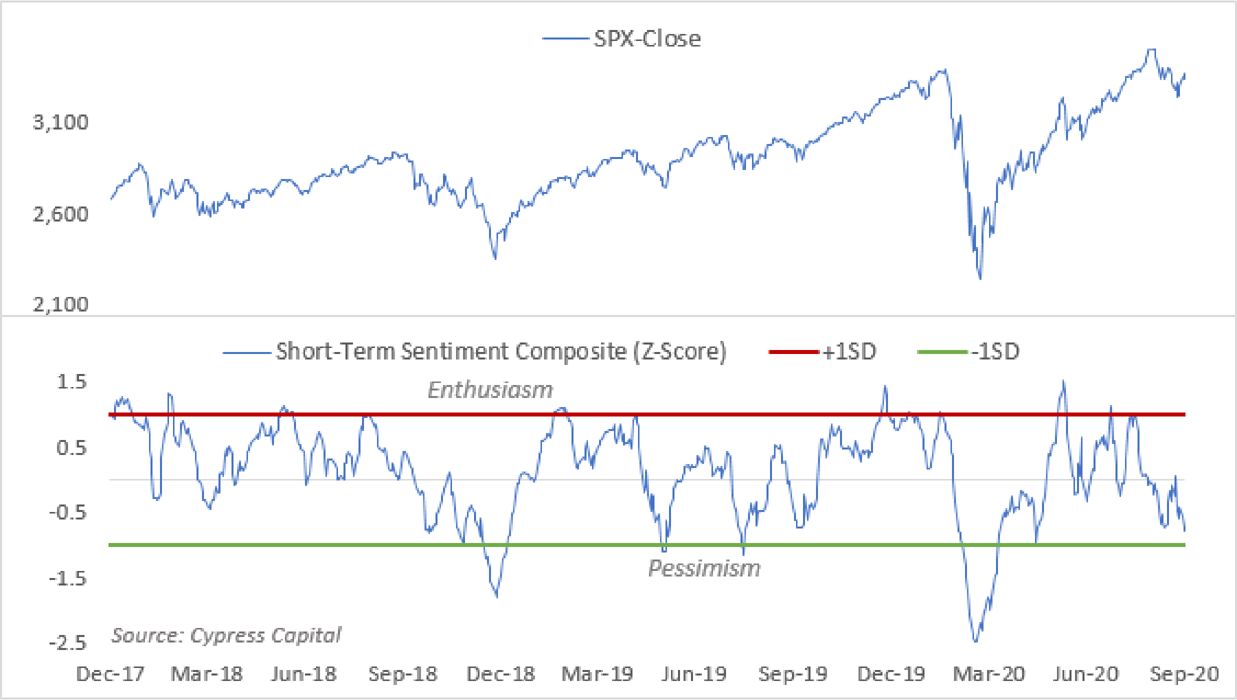


Equity Put/Call (3wma – 39wma) improved and then quickly reversed before registering positive readings.



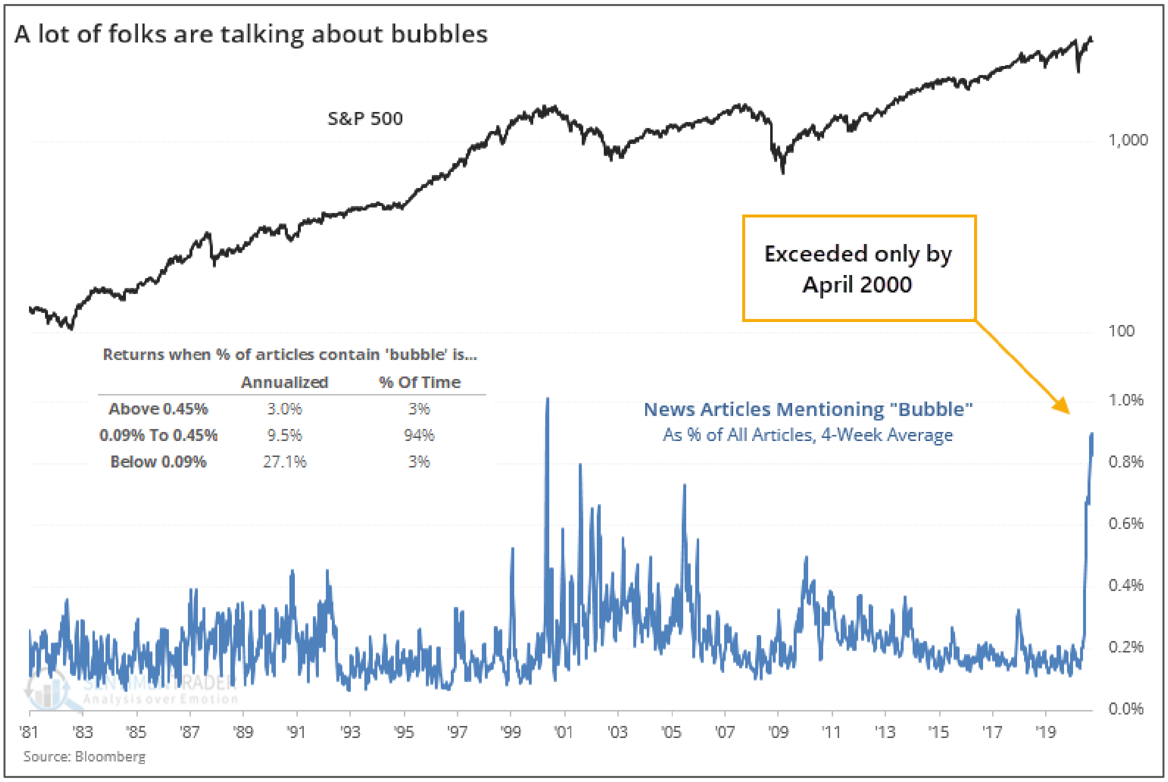
Short-Term Sentiment Composite

Edging closer to one-stand deviation of pessimism from our shortest term psychology indicators.



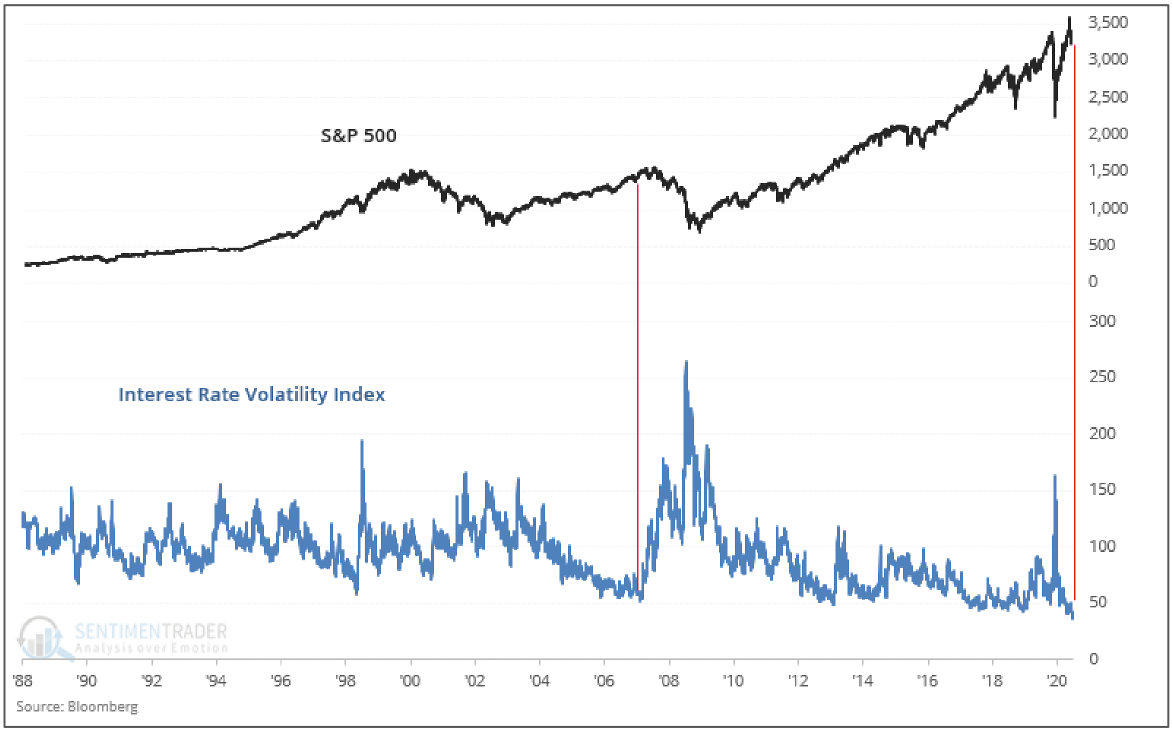
Bubble Headlines

We have often heard pundits argue that you cannot have an asset bubble when it is so widely recognized and discussed. Jason Goepfert has debunked that idea with a single chart. Investors (and the media) can recognize bubbles in real-time, as they did 2000 – or in 2005 with the housing bubble. The hard part is avoiding being sucked into one, because of the appeal of easy riches.



Source: SentimenTrader.com

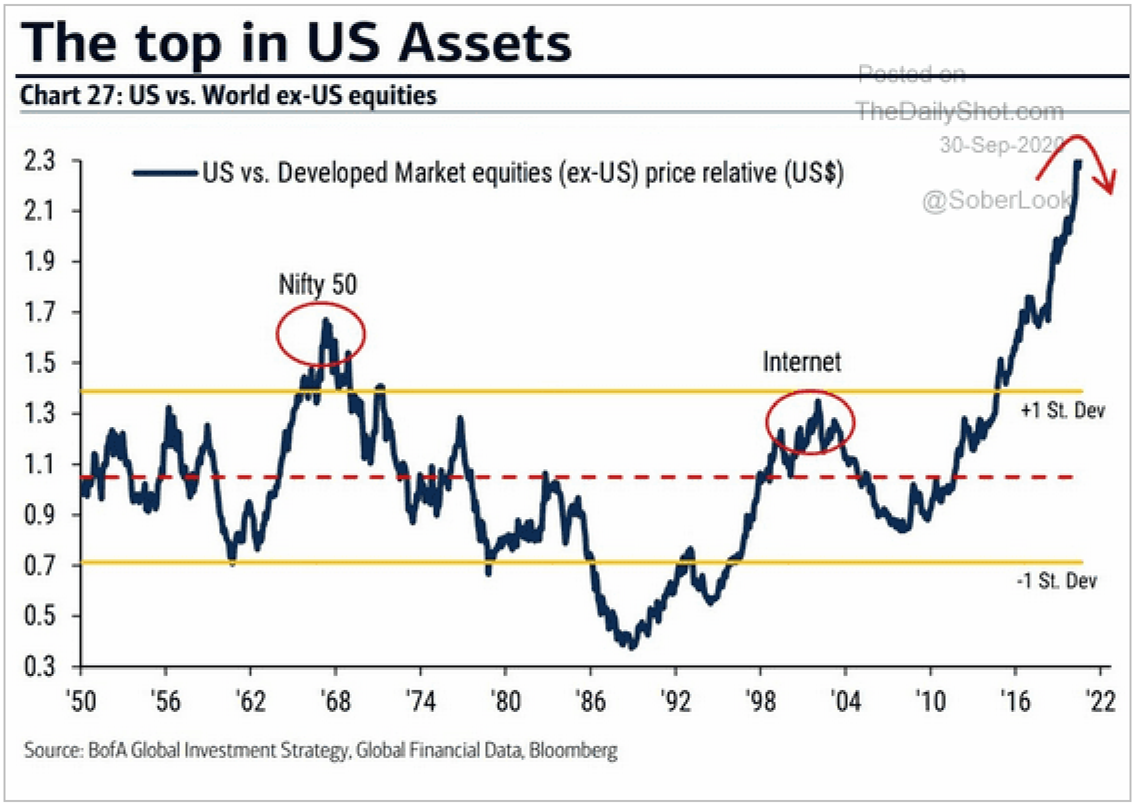
Interest Rate Volatility fell to the lowest since 2007



Source: SentimenTrader.com

US versus International equity prices

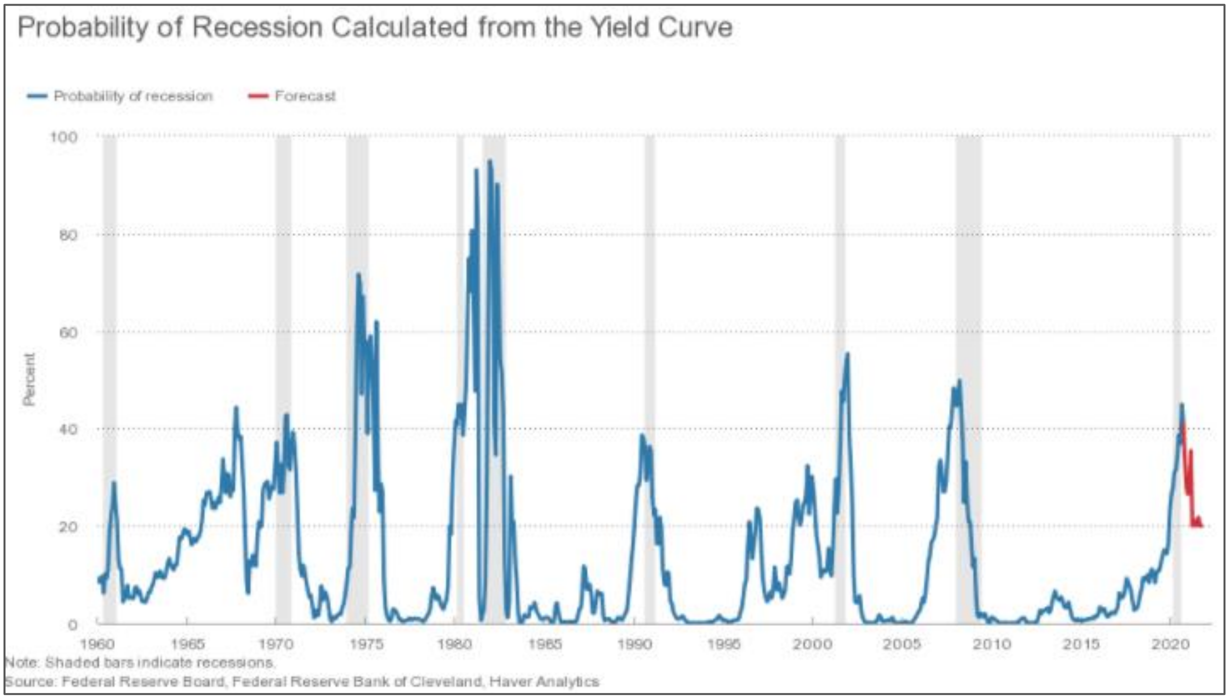
The relative strength of US equities over international equities has surpassed any other period in over 70 years.



Source: DailyShot, BofA, Jesse Felder

Yield Curve and Recession Probability

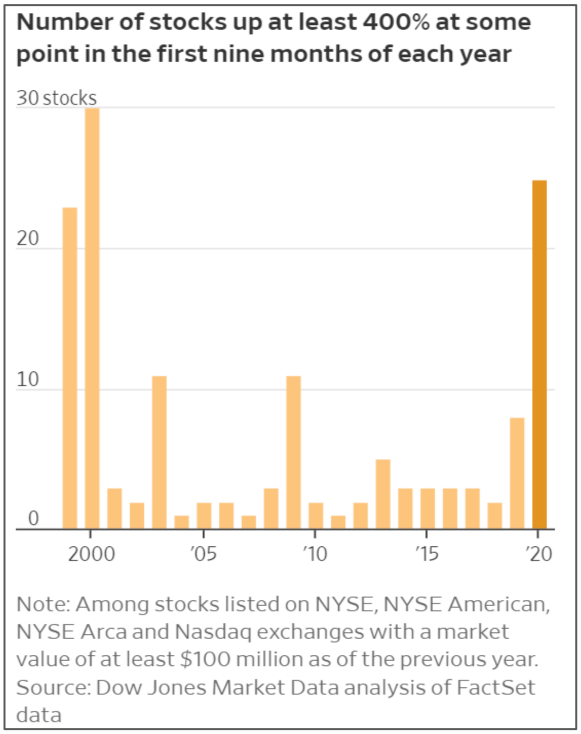
We don't use the yield curve in a probit model for recession forecasting in this way, because our primary concern is a bear market not a recession, but this shows how recession probabilities have been falling, as our monetary composite has been improving. Same input, different illustration.



Source: Isabelnet

Number of stocks up at least 400%

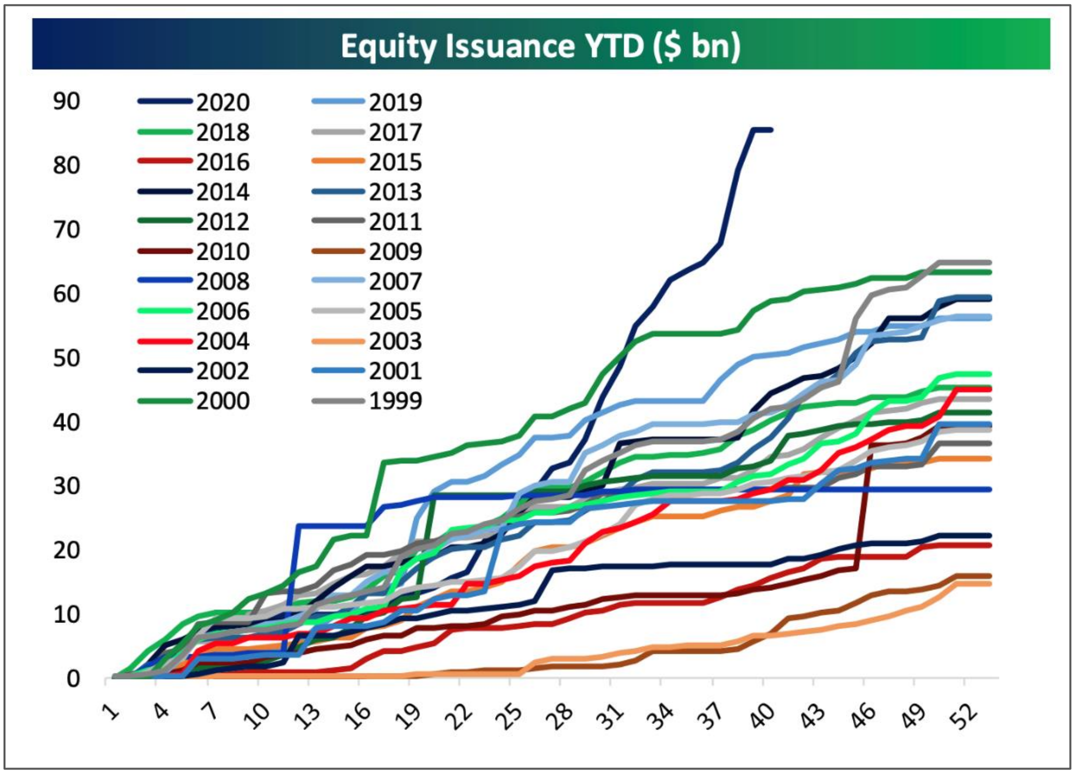
More stocks have climbed 400% this year than any time since the year 2000.



Source: WSJ

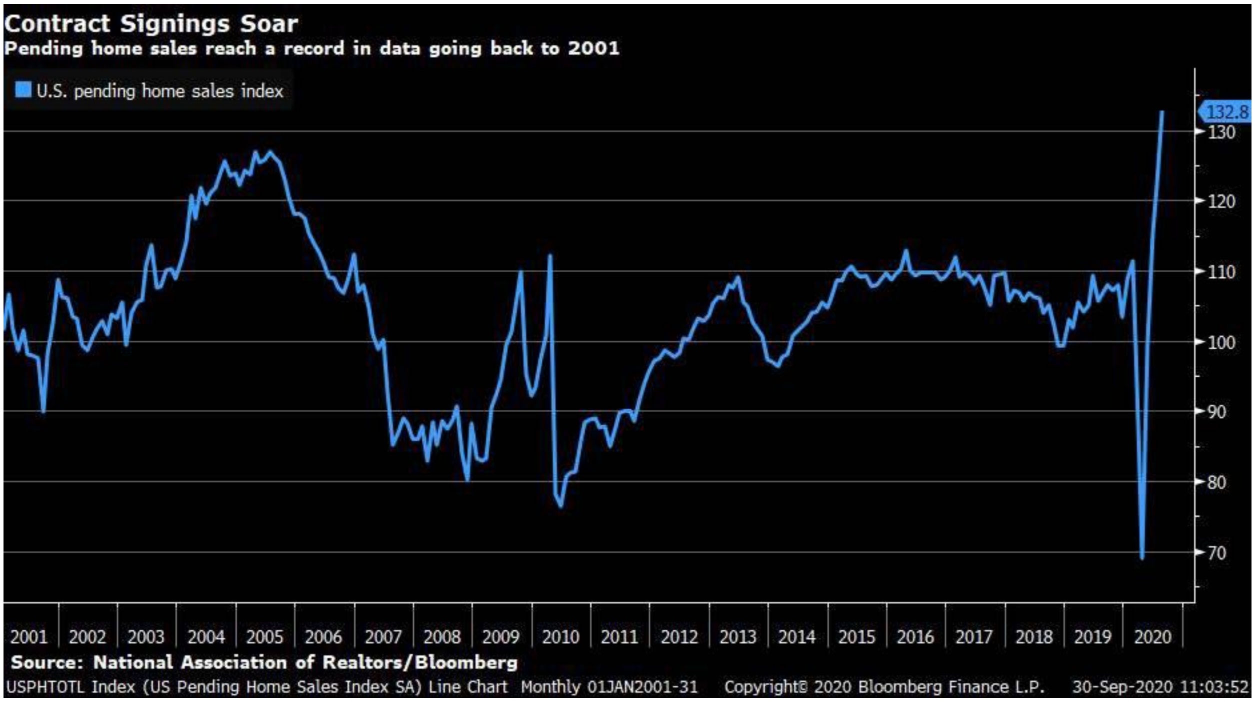
YTD Equity Issuance is the highest in 20 years

Corporations issue equity in hot markets like 2000 and in markets like 08/09 where capital is needed to shore up an impaired balance sheet. In a tip of the hat to the K-shaped recovery narrative, 2020 is a combination of both.



Source: Bespoke, Bloomberg

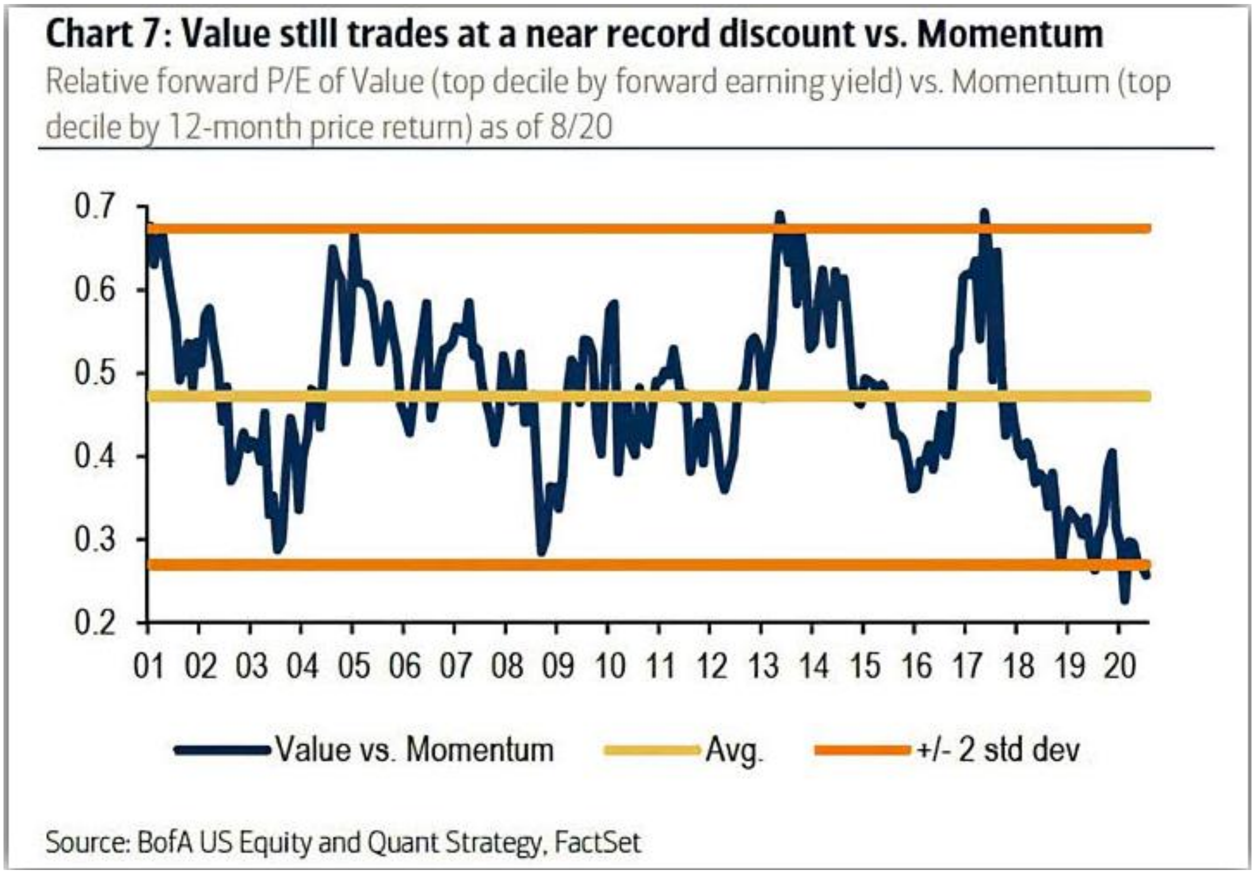
Pending Home Sales hit a record high, surpassing the 2005 housing peak.



Source: Bloomberg, Liz Ann Sonders

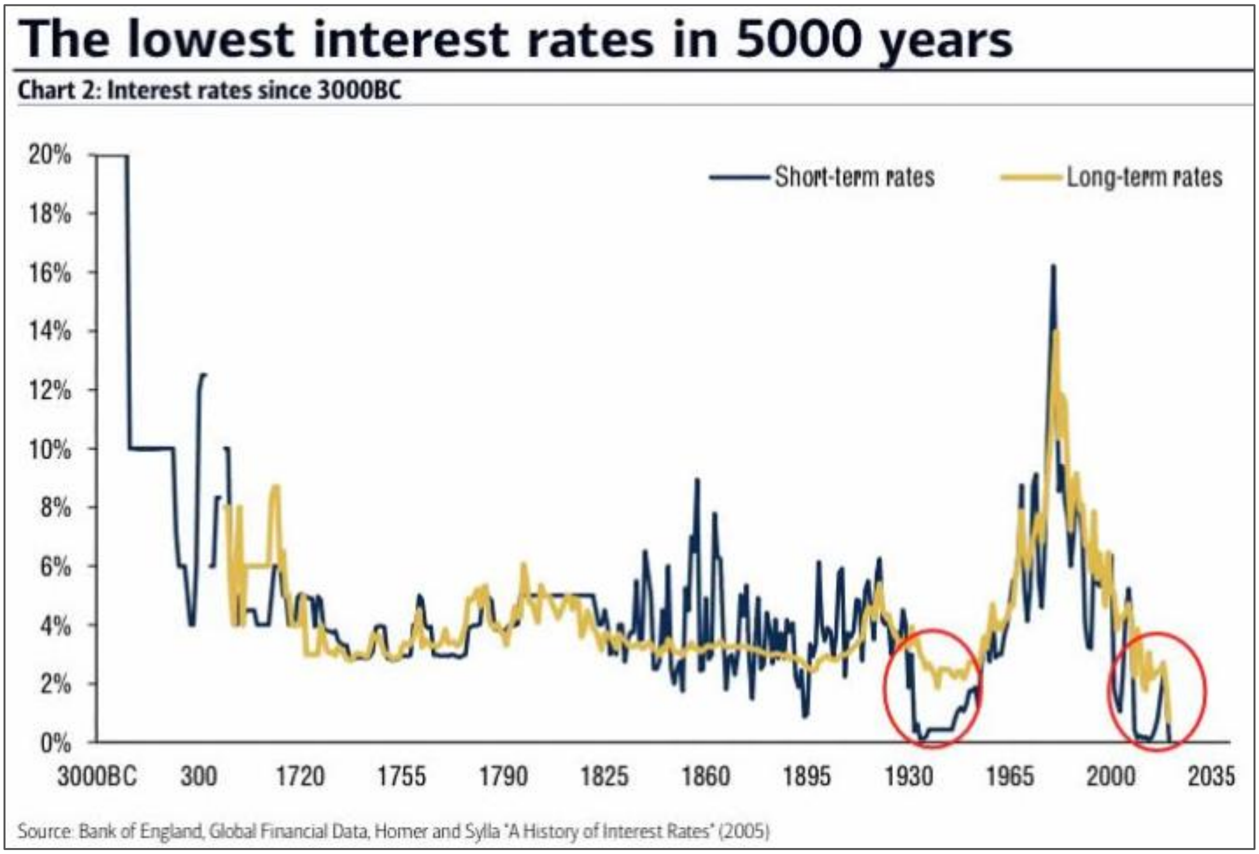
Value versus Momentum relative valuations

Value has traded at a 2 standard deviation discount to Momentum for much of the last two years.



Source: BofA, Isabelnet

The lowest interest rates since 3000 BC?



Source: Isabelnet

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.