Market Outlook

By Mark T Dodson, CFA

The Seven Month Old Baby Bull

The bull market turned seven months old today, a baby bull in duration terms, but ancient when your yardstick is animal spirits. Our quantitative measure of those animal spirits, MRI, increased this week as the monetary composite risk score edged higher.

Valuations and psychology improved by a rounding error. In spite of the inability to pass a stimulus bill and proximity to a presidential election, the market is holding up well, enough to surprise and embolden investors. The overbought condition from a little over a week ago has worked itself out, but investor sentiment continues to make movements toward those enthusiasm highs from August.

One key indicator within our psychology composite that has consistently argued in favor of the wall of worry since March has been the AAII weekly survey of their members. That changed this week as the bulls exceeded the bears for the first time since the stock market peak in February. That's a record stretch of time to go without a plurality of bulls, and it likely serves as decent indication that the short, but very deep Covid-recession has officially ended. That survey has become better for marking the starts and ends of recessions than as a broad gauge of the wall of worry.

Meanwhile, Investor's Intelligence crossed back into the top 10% of euphoria readings, closer to the levels from August. Rydex is still above the 80% level that we pointed out last week; volume chasing levered ETFs has red-lined again; and equity call options are still selling like it's Amazon Prime Day.

The bond momentum sell signal from August has been holding steady, and bond yields continue to behave like they are working up the nerve for a game of chicken with the Fed. Inflation pressures are building, for now, in part because it's the first recession that we've had in some time where the normal severe softening or decline in prices never came to be, as policymakers threw gasoline on a fire whose embers were still hot.

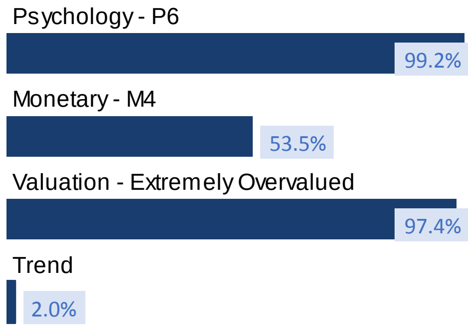
One sector that stands to benefit, but left for dead, is Energy. The sector should be worth at least a tactical bet as tax loss season begins to take unfold – the season for bottom feeding. We've read more than one story of prominent value funds throwing in the towel and deciding to return investor money in the last two weeks, which could be a signpost for the beginning of a turn.

Market Risk Index

Elevated

82.5%

Category Percentiles



Largest Psychology Influences

Levered Investments	Negative
Option Activity	Negative
Fund Flows	Negative
Bank Sentiment	Negative

Largest Monetary Influences

Velocity	Negative
Interest Rates	Positive
Monetary Aggregates	Negative

Valuation

7-10 Year Rtn Forecast	1.5%
10Yr Treas Yield (on 10/20)	0.8%

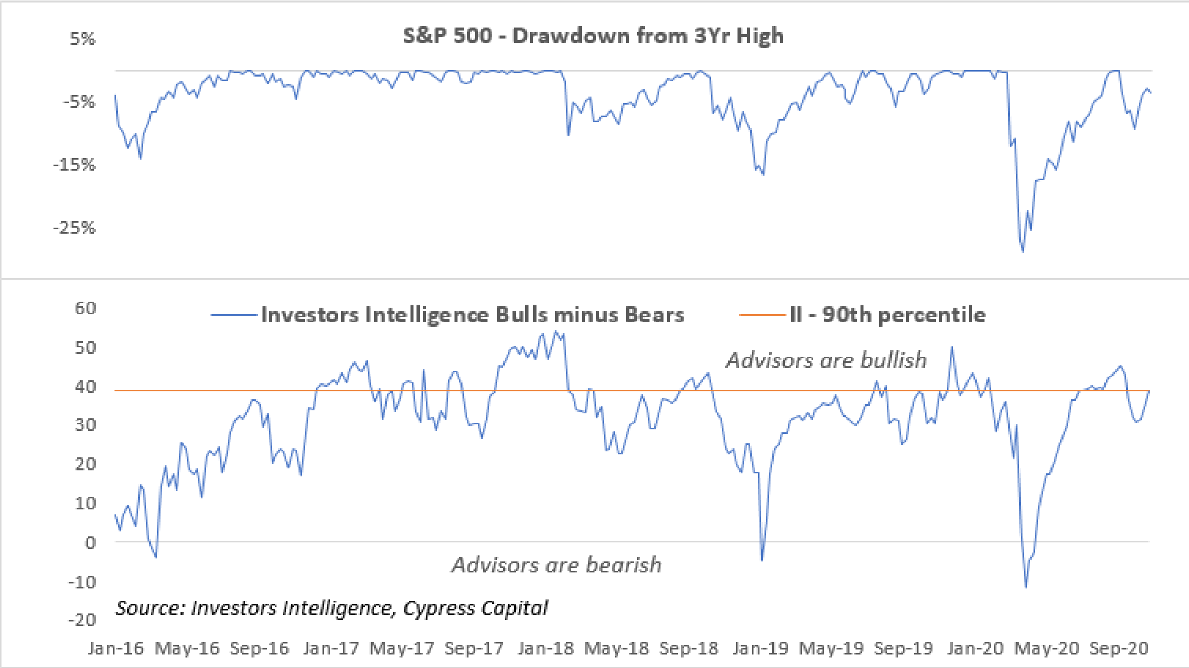
Market Trends

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.

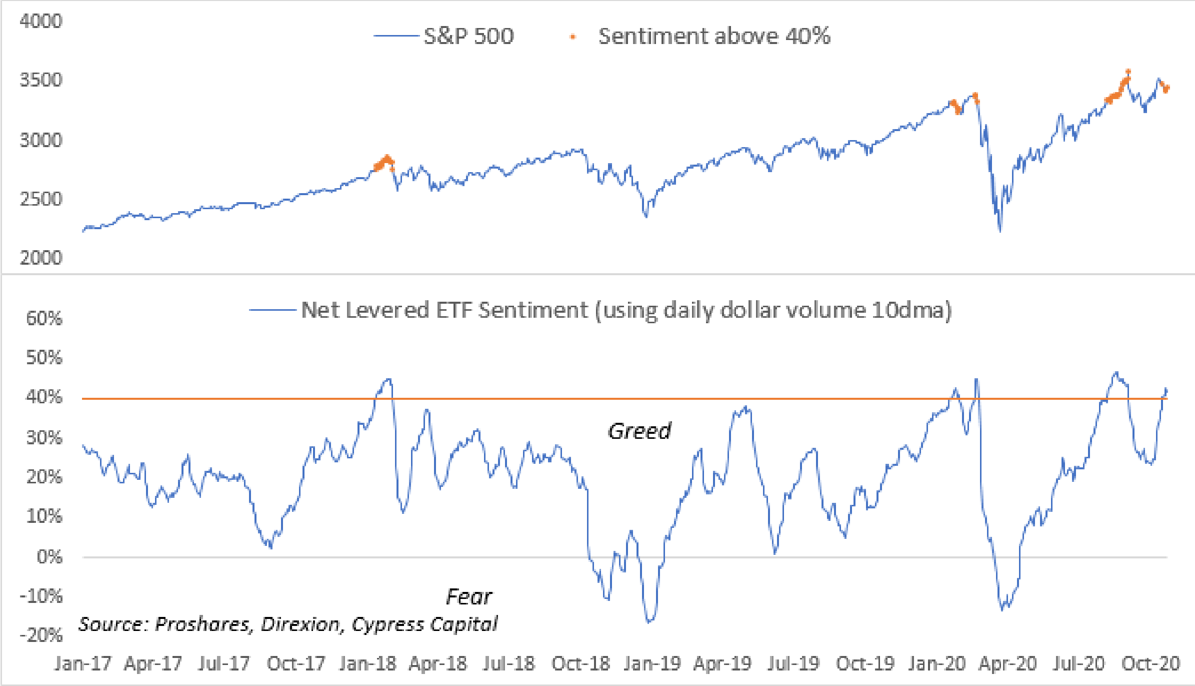
Seven months into the bull market – we have never seen asset prices recover and recapture old highs this fast. Seven months into the bull market – we have never seen valuations that were downright bubbly with record corporate leverage and broad signs of excess speculation & animal spirits. We've never seen our risk measures and complacency move this high, this fast. This bull market is like watching a 10-yr old kid pull out a Marlboro and ask for a light and watching everyone around you act like it's normal. Strange and fast times for financial markets. We should be wary of letting short-term stability in market prices lull us into complacency that this is a typical recovery.

Investors Intelligence moves back into the highest decile of readings

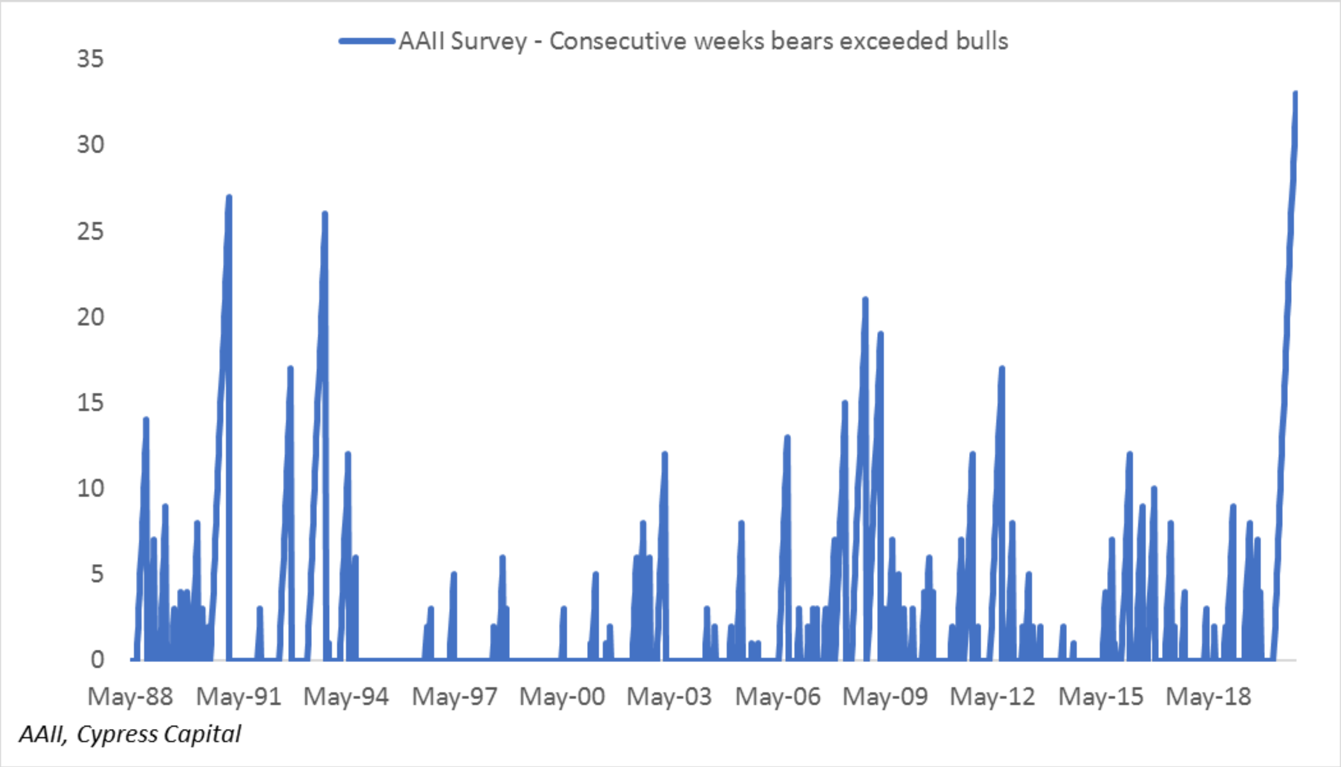


Levered ETF Sentiment

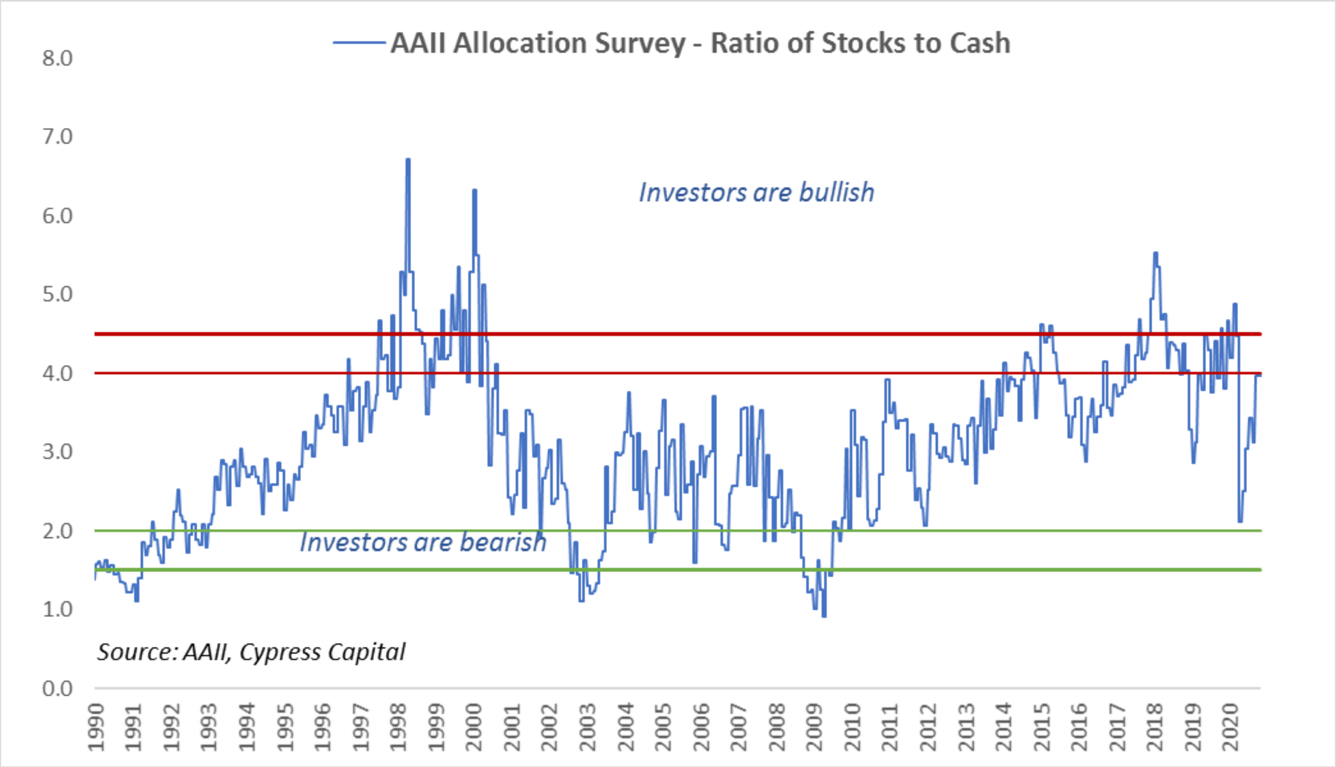
Sentiment among investors in levered ETFs has crossed back into extremes again, not unlike the quick double top earlier this year.



American Association of Individual Investors
Bulls finally beat out the bears in AAII's weekly survey for the first time in 33 weeks, a record period of time for the survey to see more bears than bulls. The first time that bulls surpassed bears after long periods has come before downturns and also before long, sustained up moves, so it provides little help in that regard.

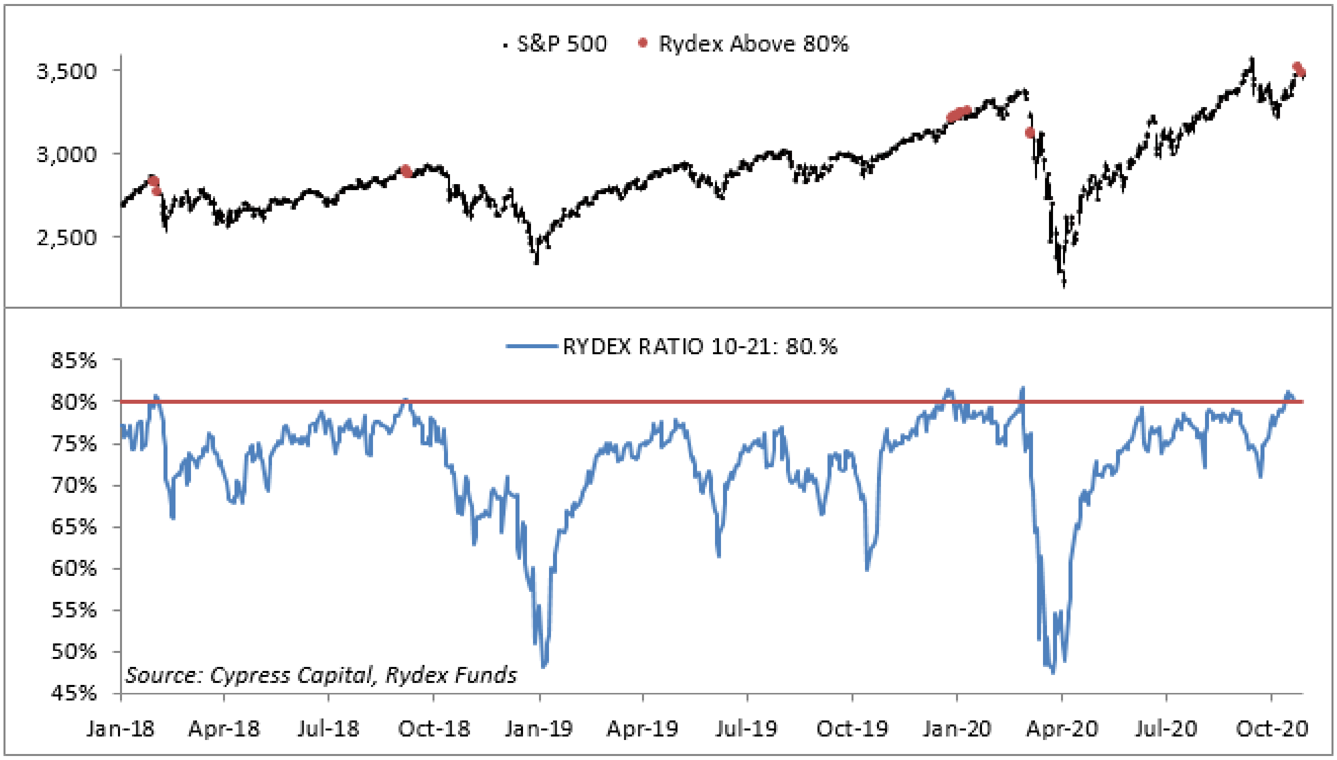


AAII Allocation Survey (Ratio of stocks to cash)
The allocation survey from AAII doesn't line up with the survey responses like it has in the past. Those same investors have a lot of equity exposure after having just completed a record period of reticence about markets.

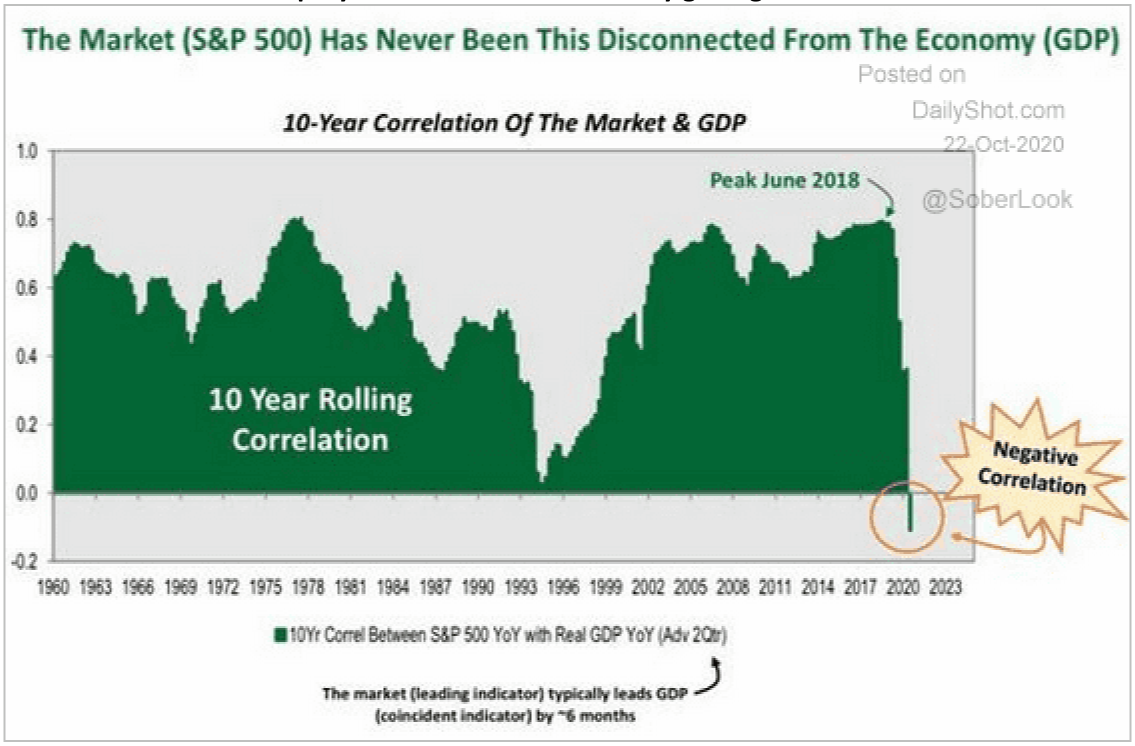


Rydex Ratio

Rydex was not able to beat the all-time high reading from February 2020 this week, but it held the 80% level.

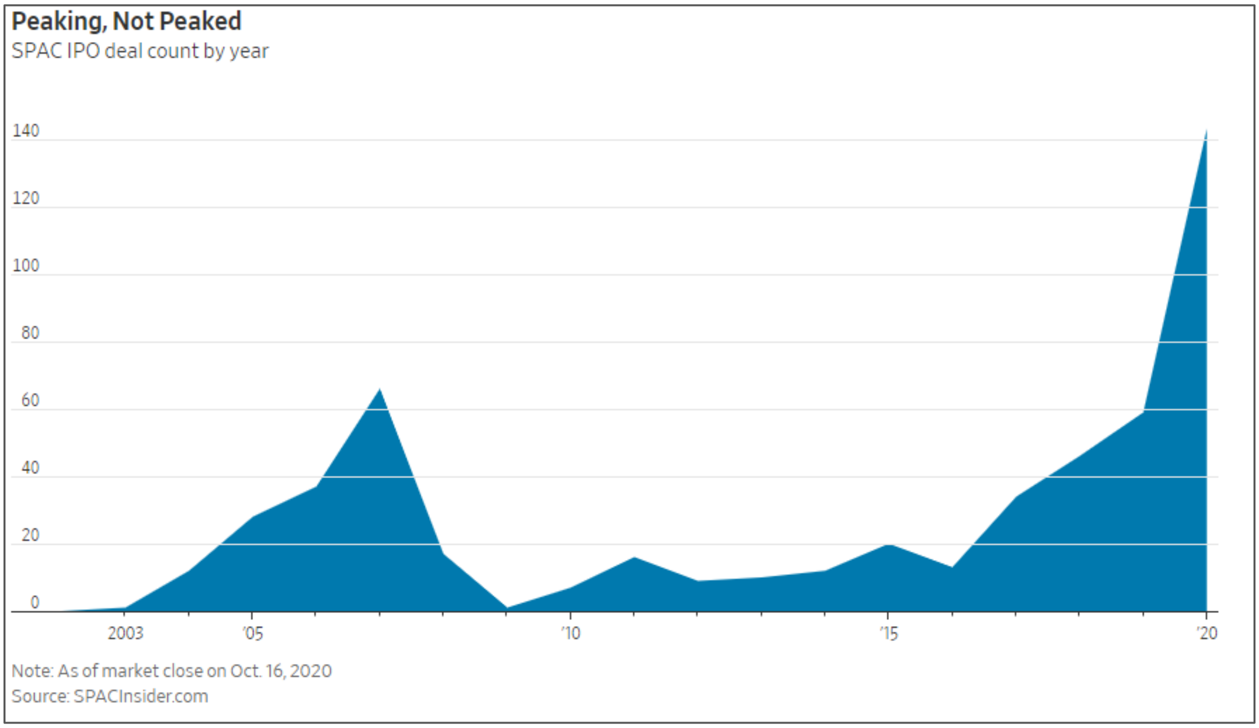


Correlations between equity markets and the economy go negative for the first time ever.



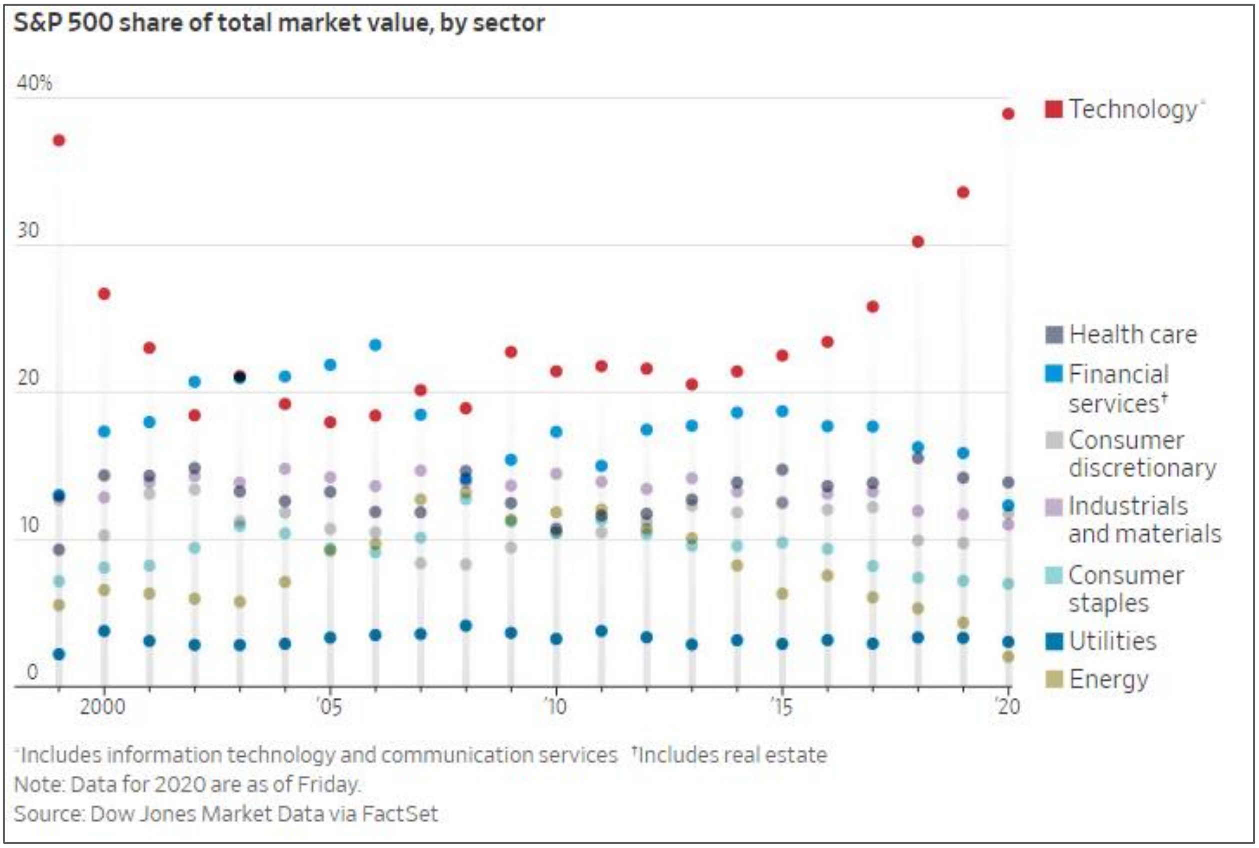
Source: DailyShot, Jesse Felder

SPACs – 2020's version of the Dot-Com IPO haven't peaked yet.



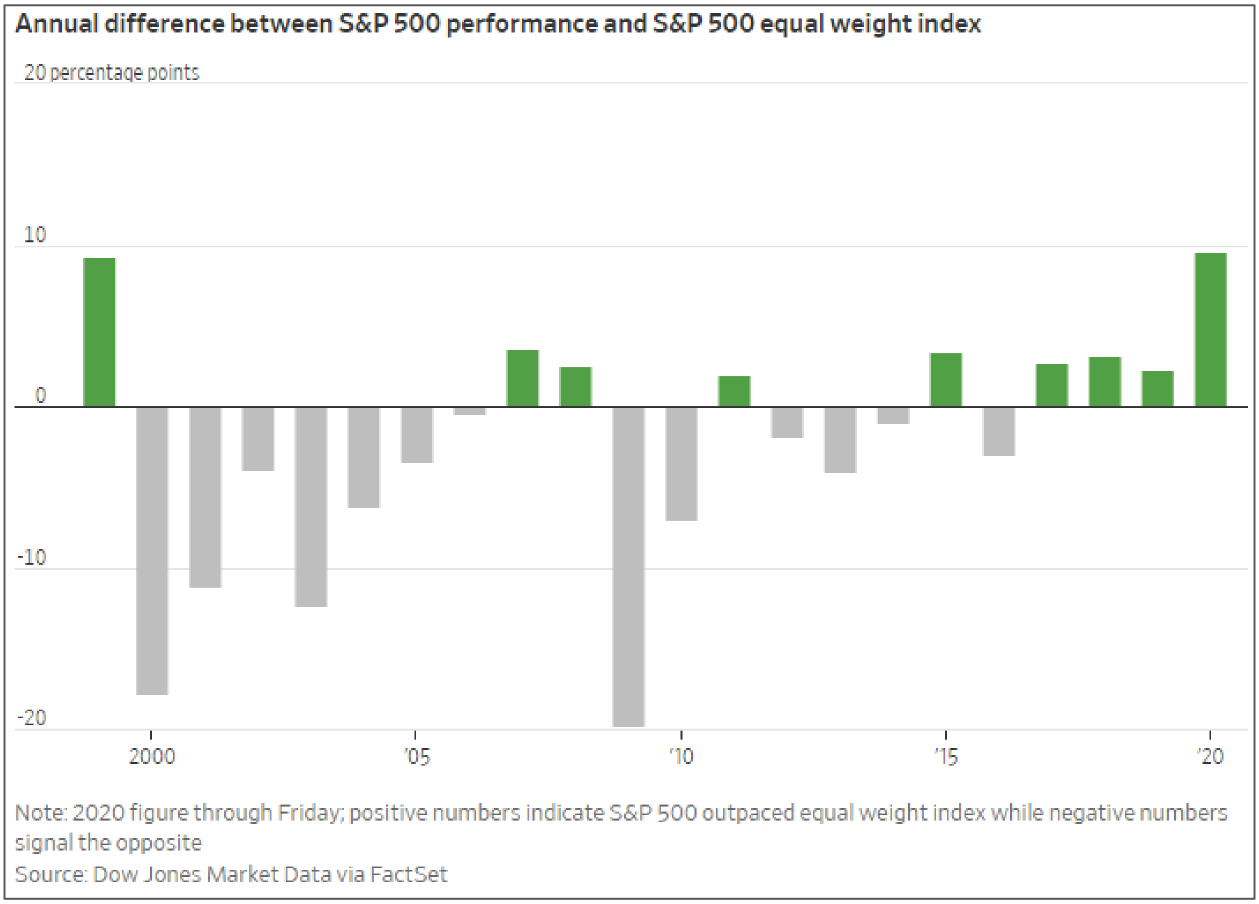
Source: WSJ

The Tech sector's S&P 500 market share surpasses 2000.



Source: WSJ

Widest gap between cap-weighted and equal-weighted S&P 500 performance since 1999.

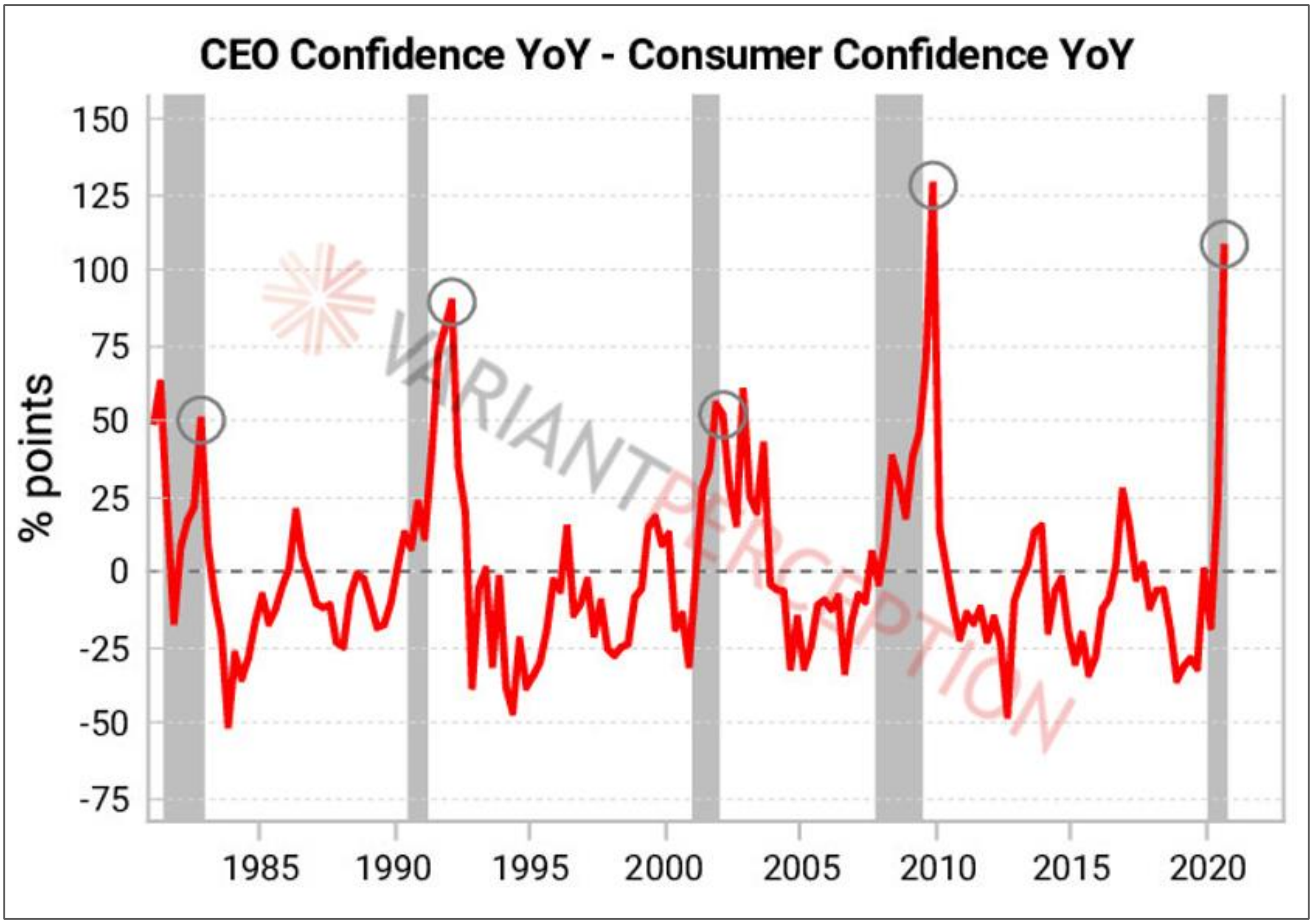


Source: WSJ

Market value of negative yielding debt approaching 2019 record.

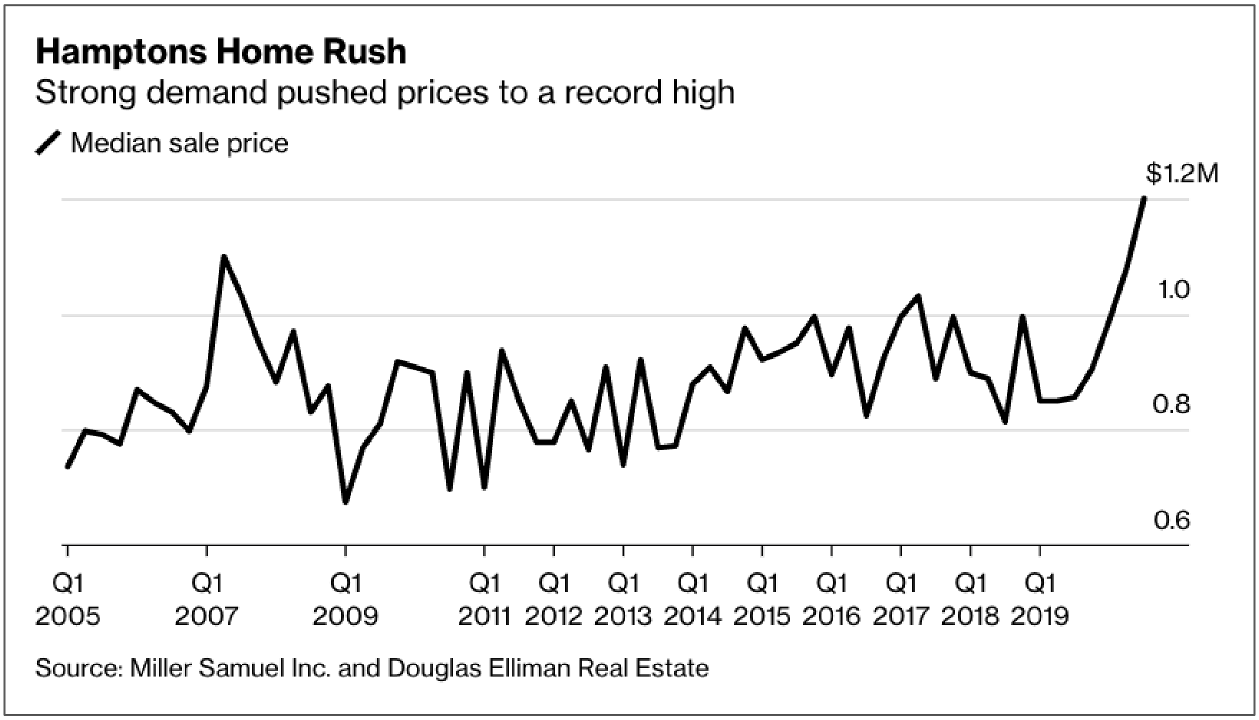
Source: Liz Ann Sonders

CEO versus Consumer Confidence signaling the recession's end.



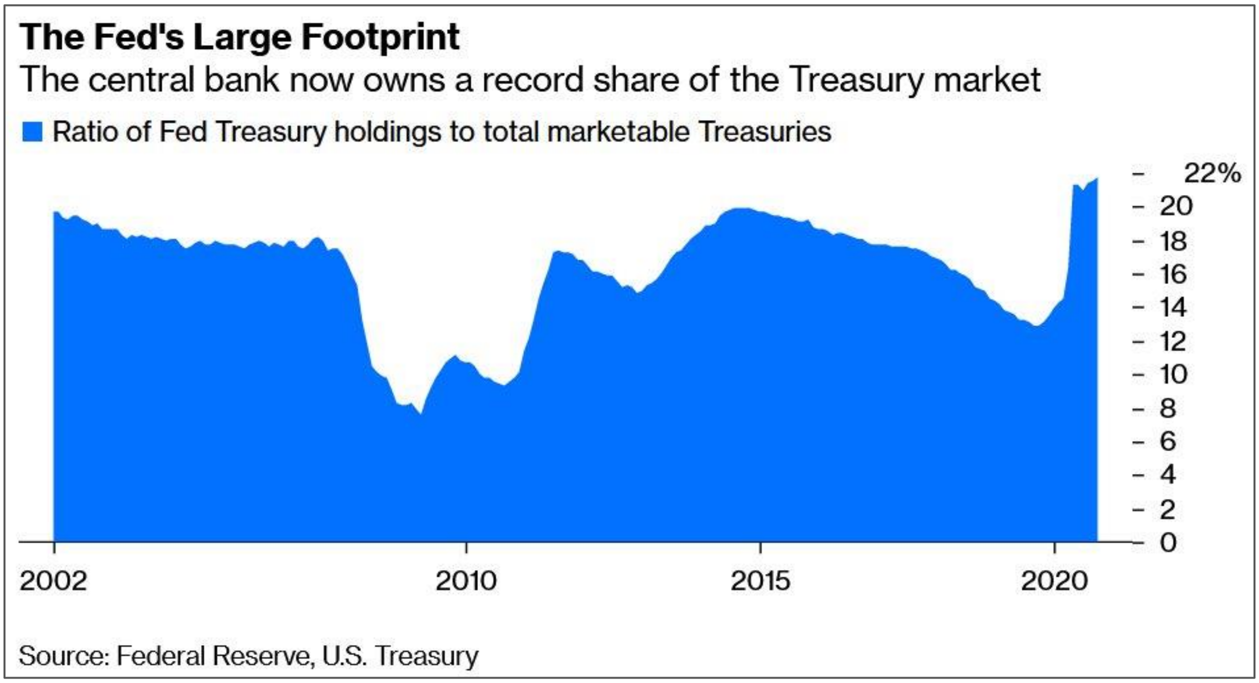
Source: Variant Perception Research

Median sales price of a home in the Hamptons goes parabolic.



Source: Bloomberg

Fed Record – the Fed now owns a record share of the US Treasury market.



Source: 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.

Contact us for more information.