Cypress CAPITAL

Market Outlook

By Mark T Dodson, CFA

Boomers get Bullish

Market Risk Index climbed to 85.7%. Psychology was unchanged, but the risk scores for monetary and valuation edged higher.

Boomers and Millennials finally agree on something – buy stocks. The vaccine news on Monday was enough to drive bullish sentiment on the AAII Investor survey above 50%. This is a survey mostly made up of the baby boomer cohort, and the spread between the bulls and bears on that survey is the highest since early 2018. That's when most risk assets peaked, that is until the new highs set this week for several indices. The high readings on that survey join the still elevated sentiment that we see in levered investments and equity call buying. Equity flows also surged in a big way this week as well, but we score that one as bullish for markets in the psychology composite.

Smart money corporate insiders weren't impressed with the vaccine news – they sold into the strength all week. Our corporate insider indicator not only hit warning levels, but Thursday was the single highest number of net insider sales transactions since November 2004. It was the fourth highest going back to 2003, which is as far back as OpenInsider has data.

One silver lining is breadth, where the percentage of stocks trading above their 200 day moving averages climbed above 80% for the first time since early this year. That's an overbought reading, but also a reading that suggests a healthy bull market, and it's coming in the seasonally strong period of the year.

On the monetary front, our bond momentum indicator sell signal for bonds in August has been spot-on. Even though we hedged a bit when informing you of the sell signal, yields continue to push higher. The move higher in yields has pushed the yield curve to its steepest slope since the recession began. It's still the shallowest sloping yield curve that we've seen coming out of a recession, and it needs to steepen further to help improve our monetary score. Steep yield curves precede strong recoveries.

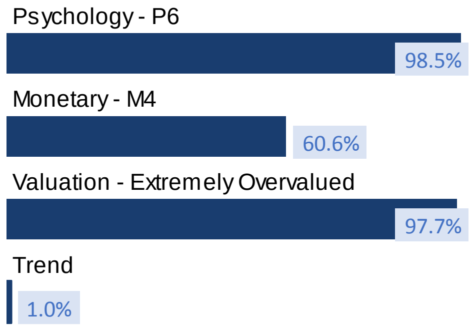
Regardless, the economy appears poised to enter a period where both growth and inflation will accelerate in 2021, and the market's vaccine response this week offered a big clue on what to expect as the recovery broadens. It looks like a change of leadership, with shocking, historic outperformance by value over momentum on Monday. Same goes for international equities, where Japanese equities were finally able to surpass their all-time highs from 30 years ago.

Market Risk Index

Elevated

85.7%

Category Percentiles



Largest Psychology Influences

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

Largest Monetary Influences

Interest Rates	Positive
Monetary Aggregates	Negative
Velocity	Negative

Valuation

7-10 Year Rtn Forecast	1.4%
10Yr Treas Yield (on 11/11)	1.0%

Market Trends

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

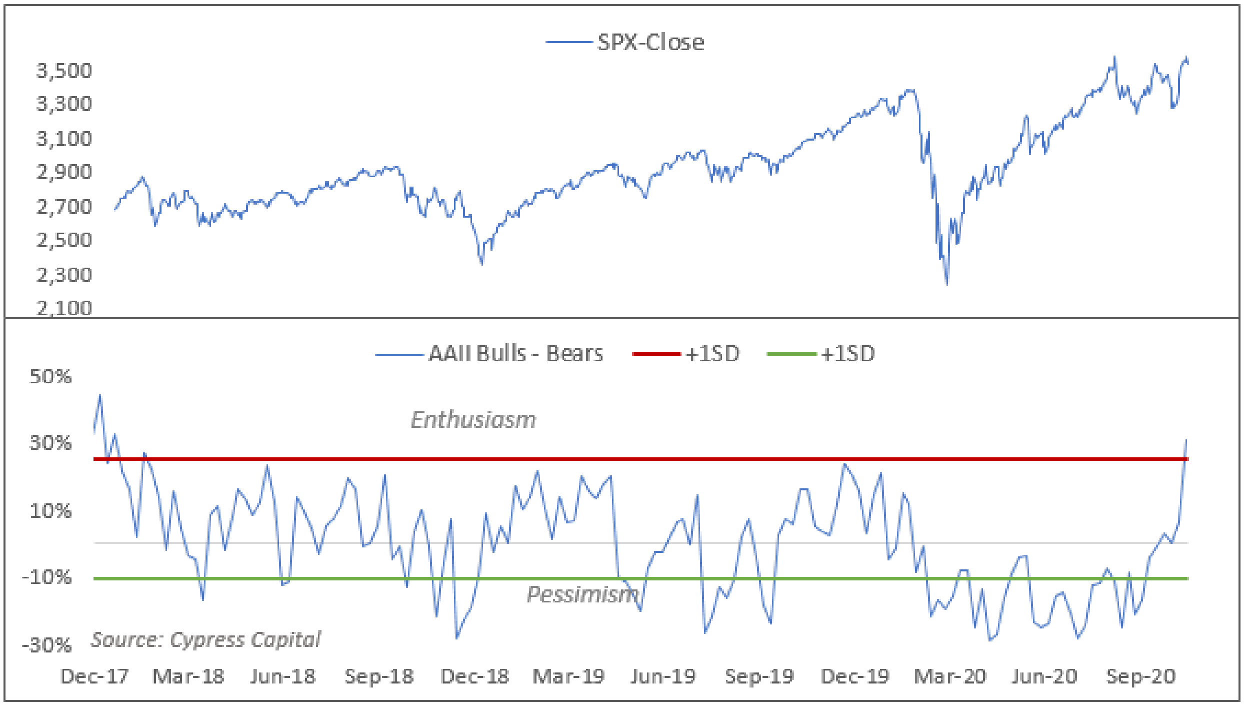
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

The conundrum for us is that recovery has already been fully discounted in broad market valuations, which are still pushing the biggest extremes since the dot com era, and it's also very rare to see a change in leadership without a market drawdown. However, if you were watching the market this week, you noticed that the NASDAQ 100 and popular FAAM stocks didn't make new highs alongside the broader market and were either down or underperformed on the strongest days. The army of quants wearing Patagonia vests have piled a lot of money into those momentum stocks, and also shorted the stocks that have suffered the economic impacts of Covid. It's rare to see crowded trades like this unwind without some volatility showing up in unexpected places.

There are a lot of crosscurrents, and the stars still haven't lined up in a way to recommend increasing equity exposure. We feel our own temptation to speculate growing, but the margin of safety isn't high enough for us to recommend getting giddy along with the crowd – still too much speculative fervor alongside high valuations. If you cannot resist, we'd recommend that it be in the unloved and left behind. With this likely to be the last major wave of Covid cases, human nature will be itching to spend some part of 2021 celebrating, with people, and in excess. The companies that stand the most to benefit are the ones struggling the most in 2020.

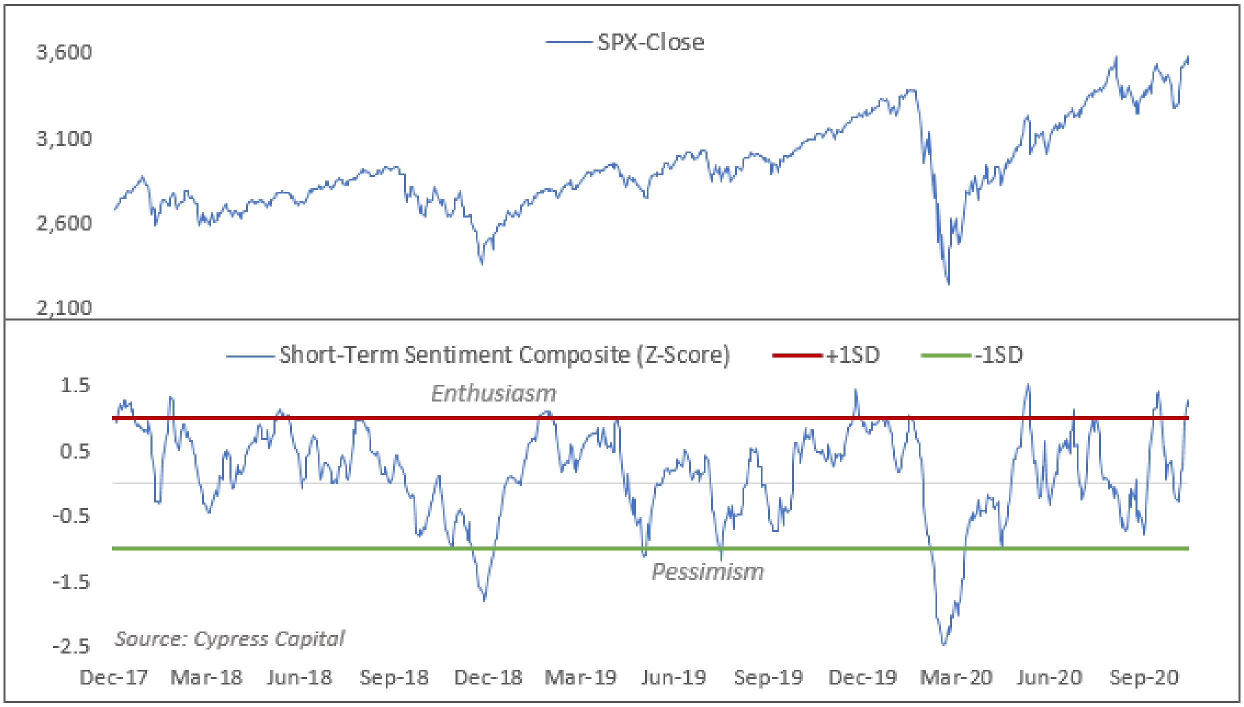
Charts of the Week

AAII Investor Sentiment
Older individual investors have been skeptical of the market for most of the last eight months. That changed this week in a big way, as those same investors grew as buoyant about market as they were in early 2018.



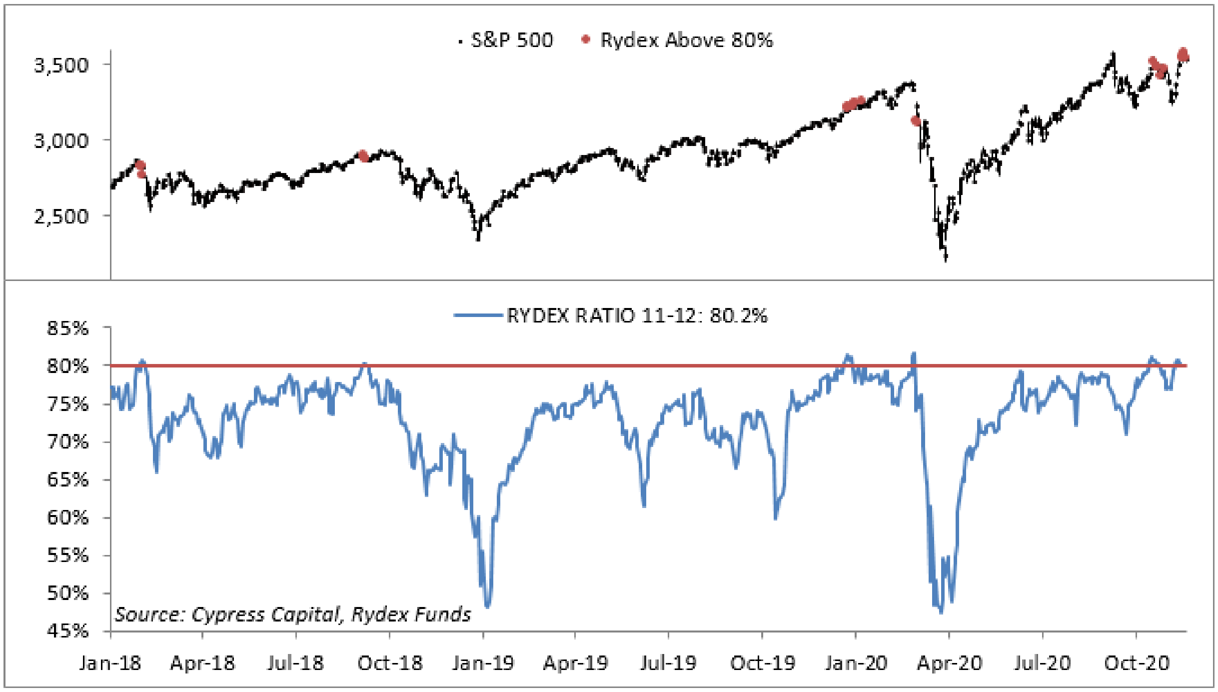
Short-Term Sentiment Composite

Short-term investor sentiment is enthusiastic as sentiment has again crossed back into enthusiasm territory.



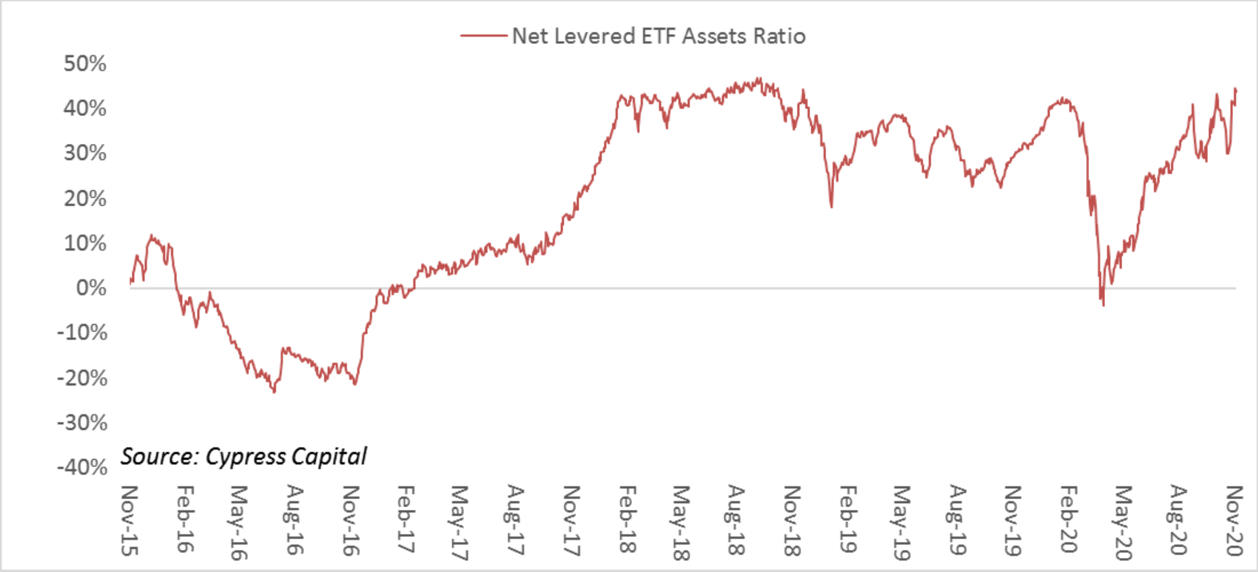
Rydex Ratio

The Rydex ratio of leveraged mutual fund investors has crossed back above the 80% threshold again, but it hasn't managed to take out the all-time speculative high reading from February.



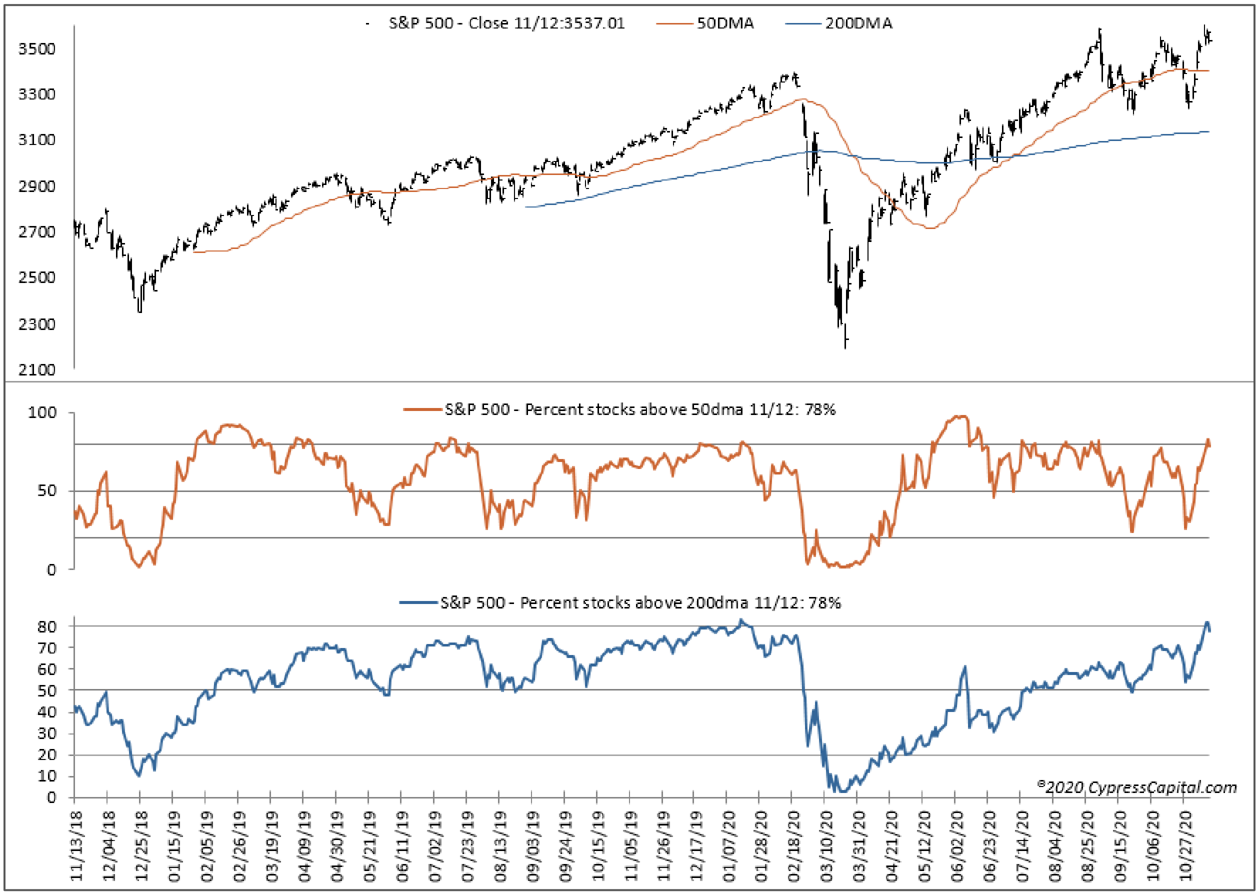
Net Levered ETF Assets

The assets chasing leveraged ETFs relative to inverse ETFs is close to taking out the speculative all-time high from September 2018.



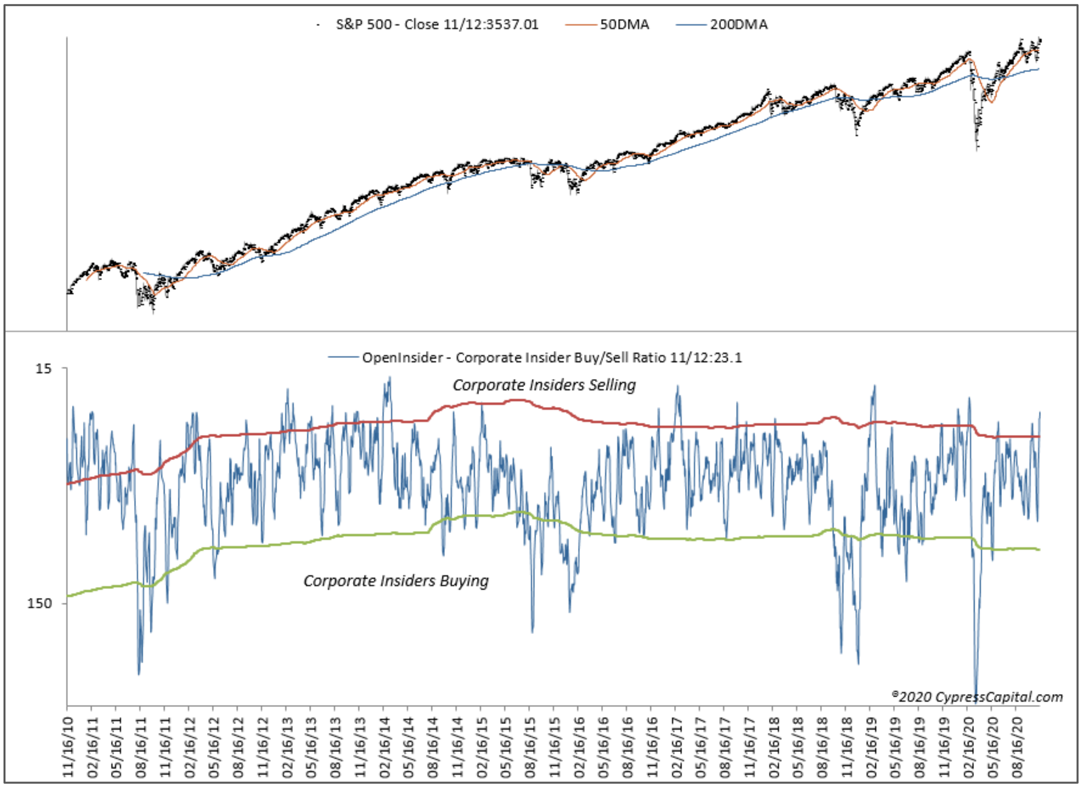
S&P 500 – Percent of stocks above 200dma

Crossing above the 80% threshold may mean the market is overbought, but it's also a bullish signal for a bull market, indicating a broad market move. We prefer to see it in an environment with better valuations and sentiment that is not so extreme. Notice that the market crossed this threshold in late January when both sentiment and valuations were excessive, and that bullish rule of thumb didn't hold true.



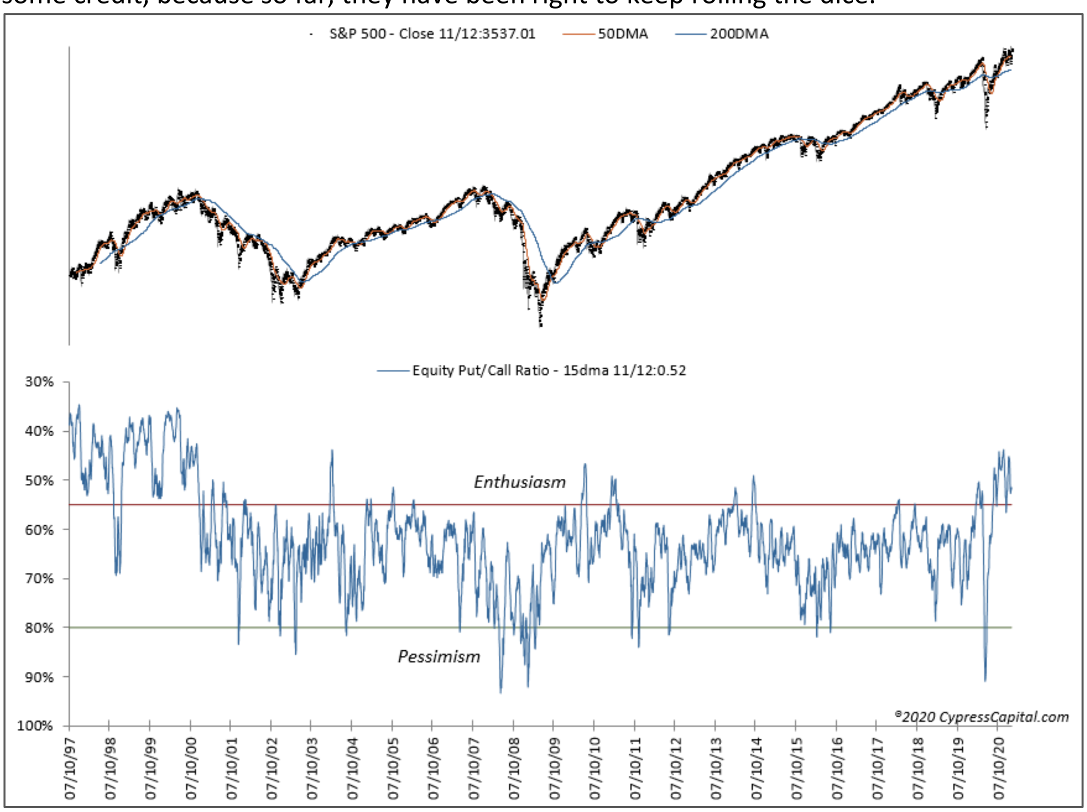
OpenInsider – Corporate Insider Buy to Sell Ratio

Corporate insider selling hit the highest level since the market peak in February 2020.



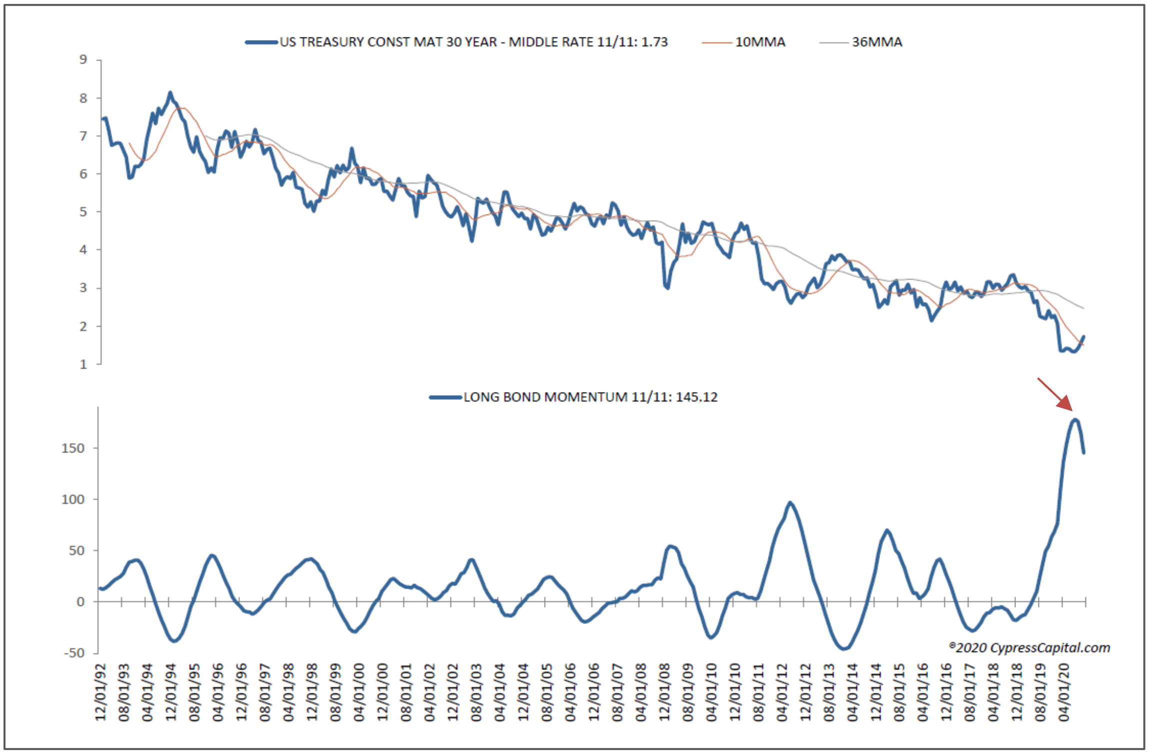
Equity Put/Call Ratio

No signs that the speculative euphoria that began in August has waned. We should give those option traders some credit, because so far, they have been right to keep rolling the dice.



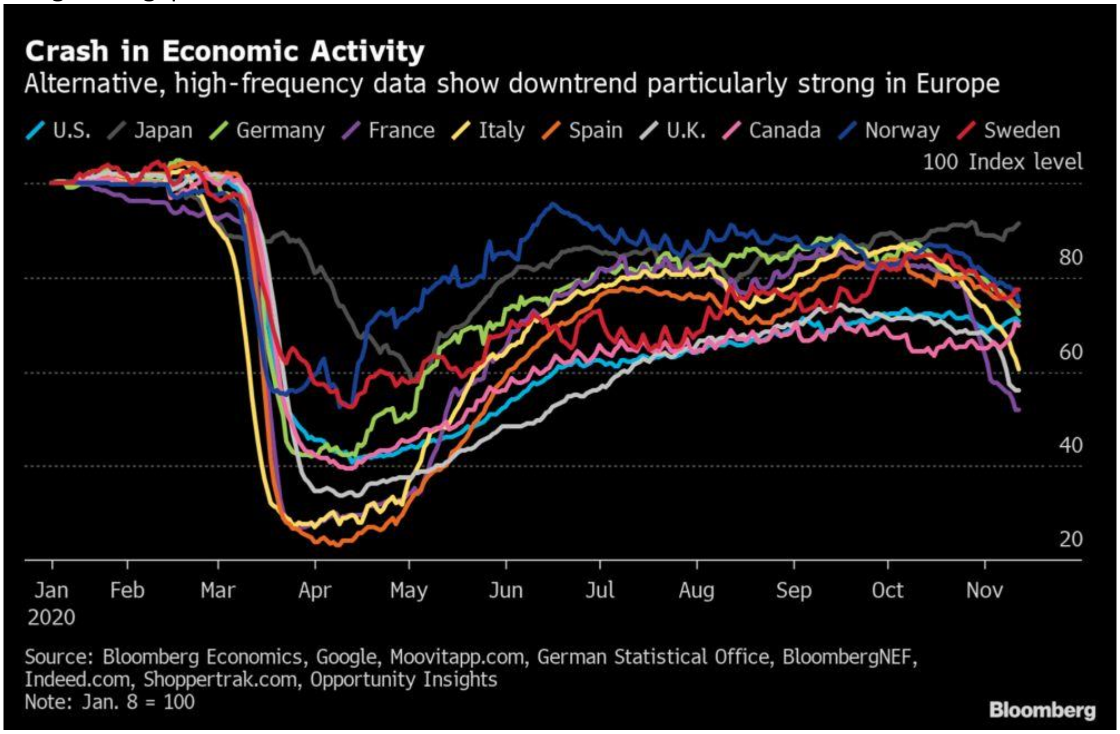
Bond Momentum

The roll-over in our long bond momentum indicator has gotten more pronounced this month. Yields are pushing higher, and the dollar continues to soften.



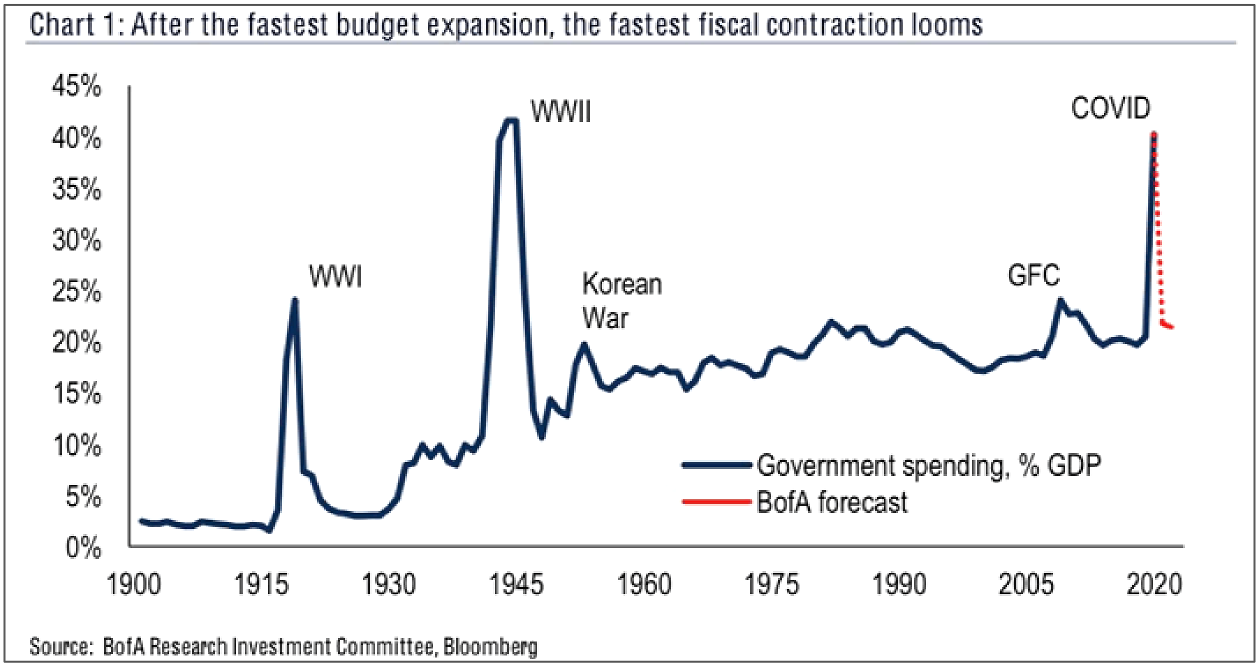
Global economic activity

In the short-term, this third wave in Covid cases is having an impact on economic activity. Stimulus would help bridge that gap.



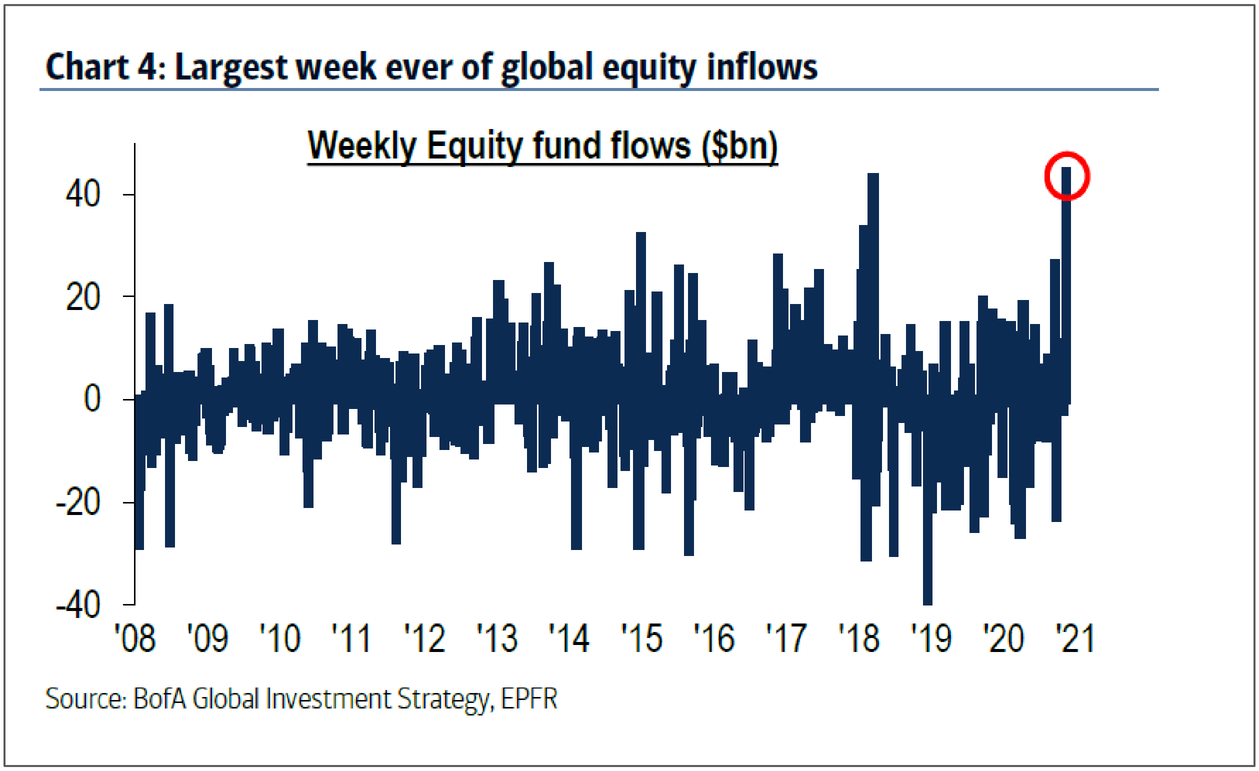
Fiscal Contraction

Sans another round of fiscal stimulus to get us through the last wave of the virus, the fastest fiscal contraction since post WWII looms.



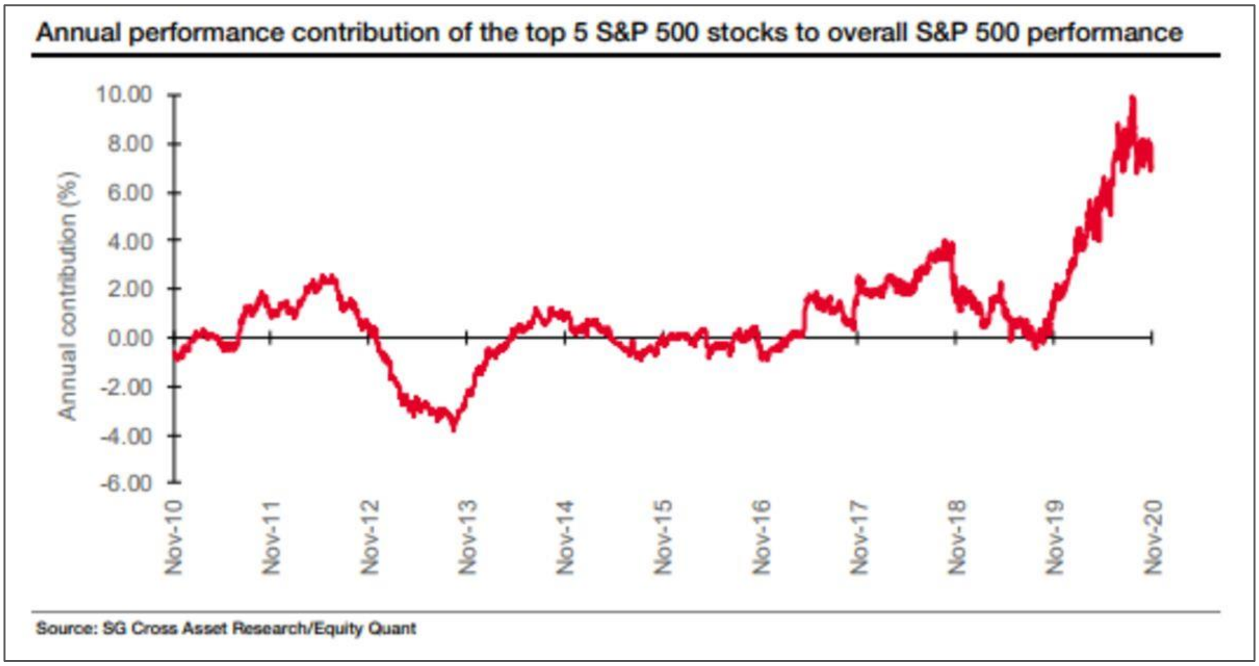
Source: Isabelnet

Surge in Equity inflows – surpasses the 2018 peak



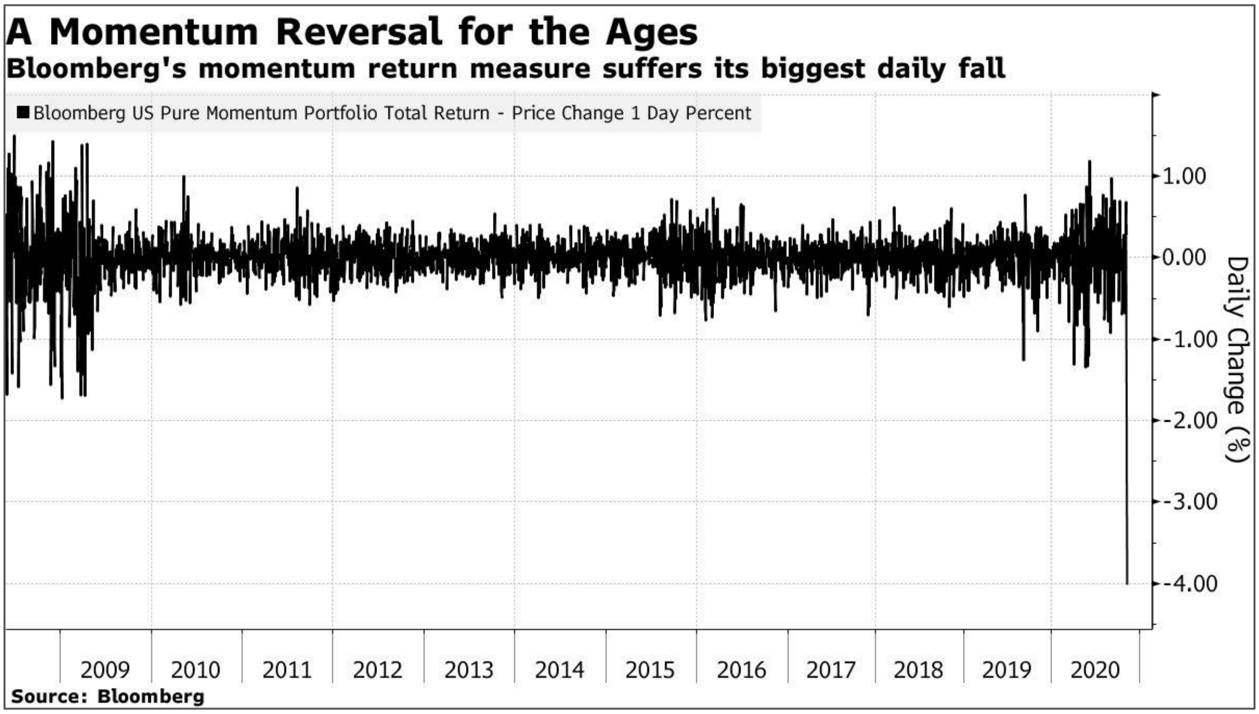
Source: Bloomberg

The largest five stocks have dominated the S&P 500 performance in an unprecedented way.



Source: Bloomberg

However, historic crack in that dominance became evident this week.

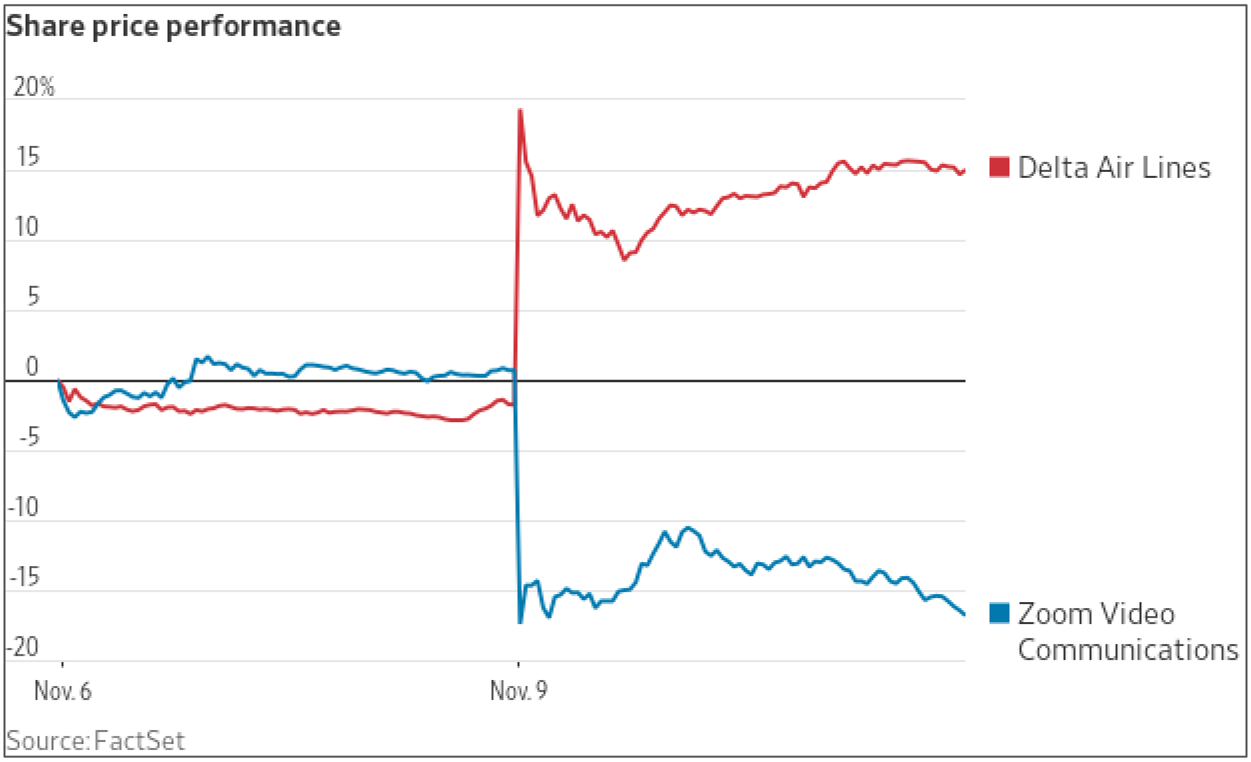


Source: Bloomberg

This week, FANG looked like the Patriots after losing Tom Brady.

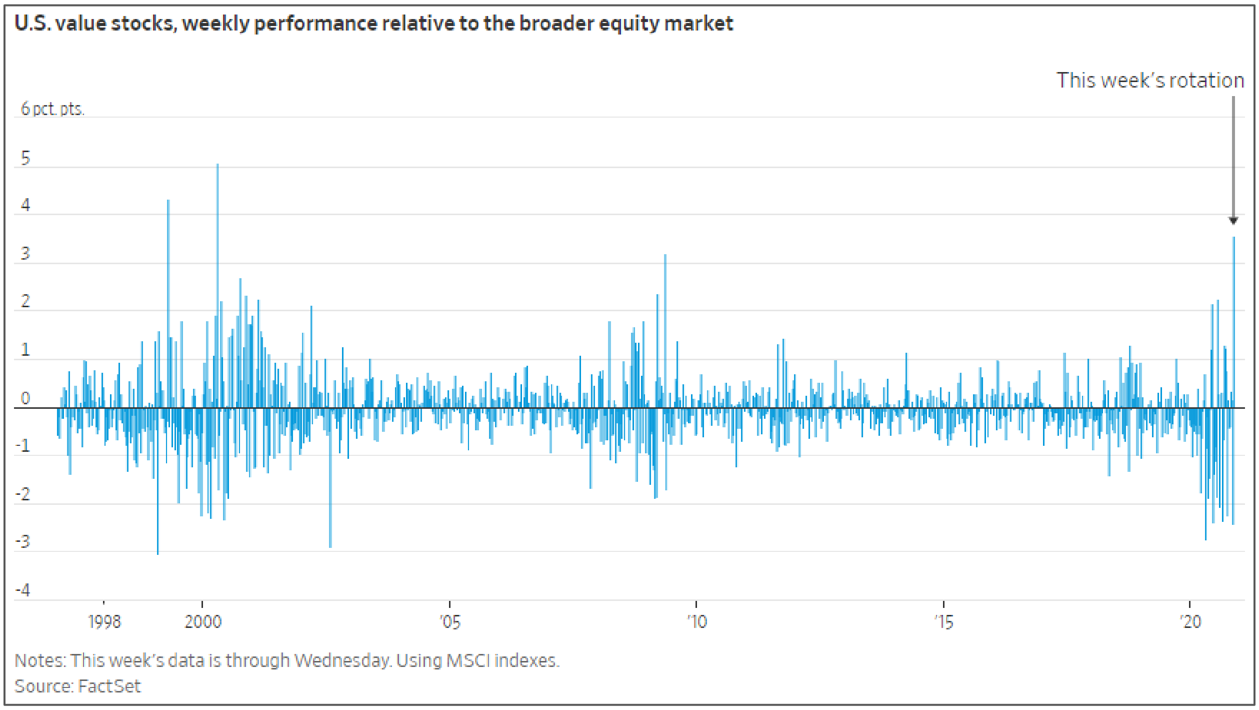
Source: Bloomberg

The Vaccine trade is an unwind of the Covid-trade.



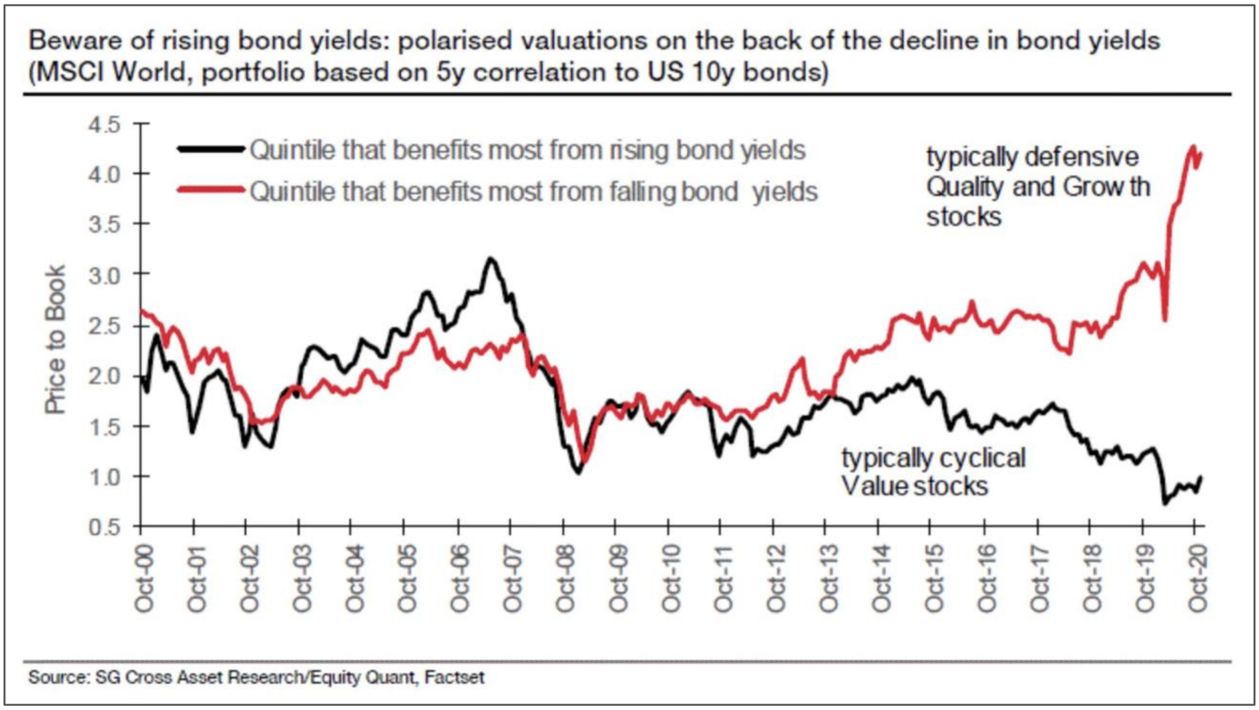
Source: Danielle Lacalle

Weekly outperformance of value this week is reminiscent of the dot-com era.



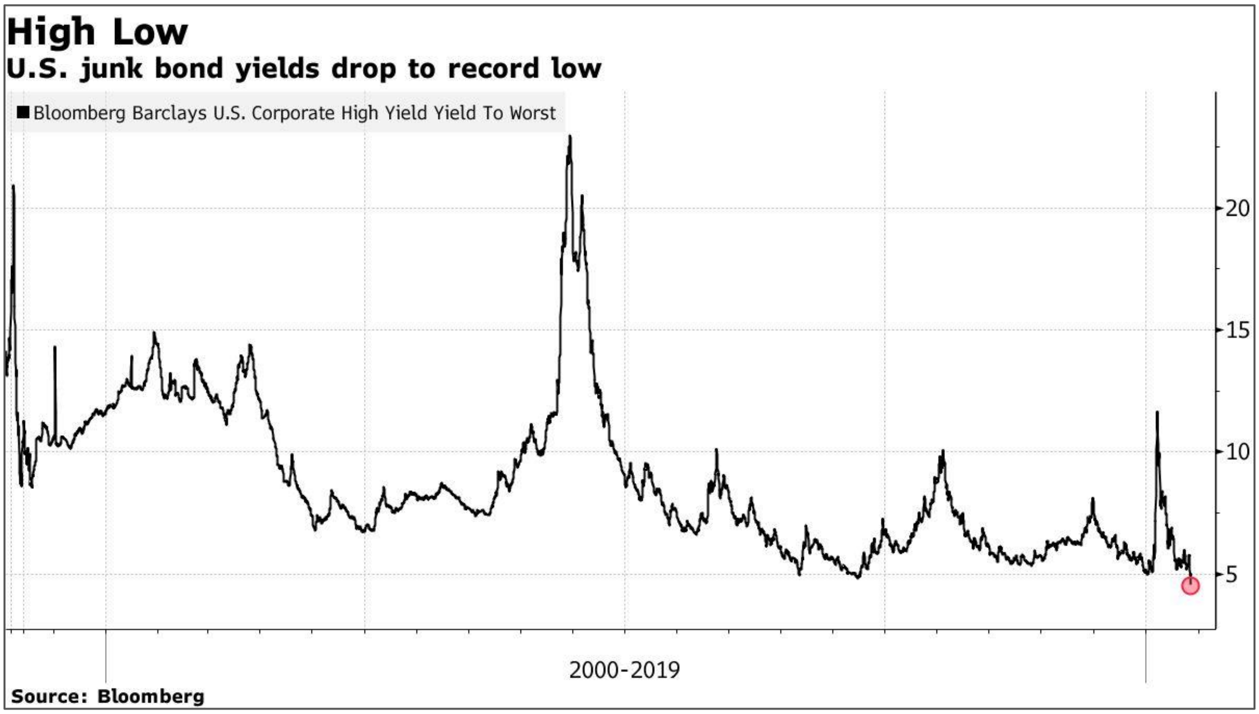
Source: WSJ

Value outperforms growth in environments with rising yields.



Source: Andrew Lapthorne

Junk bond yields hit record lows



Source: Bloomberg

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.