Market Outlook

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The Unreported Covid Side Effect – Animal Spirits

Since our last Market Outlook prior to Thanksgiving week, Market Risk Index is at 86%, mostly unchanged. Improvements to the Monetary composite have offset higher risk scores from the valuation and psychology composites.

We've become desensitized seeing risk scores on psychology and valuation stuck in the top one or two percent of readings over the last couple of months. The animal spirits toward equity markets is becoming historic – the kind of market that you tell your grandchildren about. Frankly, it's speculative behavior that we didn't think we would see again, because of how closely it is coming to rival the dot-com era. Inside the psychology composite, readings on several indicators are topping the levels from August and September. Surveys, leverage, persistence in call option buying, insider selling, the speculation we are seeing in SPACs – speculative behavior is pervasive. The one positive component of the psychology composite is the category that measures breadth, which has been phenomenally good since the vaccine news. That's because everyone wants to own stocks – across the board. This is the most widely anticipated, plainly obvious to the crowd, economic recovery ever.

On the valuation front, dot-com era valuations are firmly in the crosshairs for almost all of our favorite valuation metrics. The Cyclically Adjusted PE Ratio, popularized by Robert Shiller, has surpassed the 1929 peak, and is only about 20-25% away from surpassing the dot-com era peak. Tesla is so expensive, that the addition of the stock to the S&P 500 may manage to push the 12 month Forward PE on the S&P 500 beyond the dot-com era record.

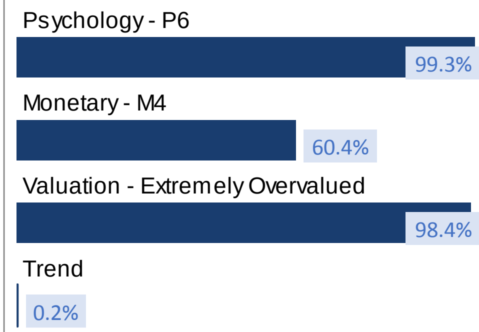
The monetary composite improved as a result of lower yields on credits and munis. Meanwhile, long duration Treasury yields still look sketchy, as does the US dollar, where declines have accelerated. Our long bond momentum gauge says to stay away from Treasuries, that both rising real yields and inflation are more of a threat in the short-term than deflation. At this point, we don't feel shy about saying that the Fed has overdone it and is using a perverse form of the wealth effect wedded to bubble pricing in financial

Market Risk Index

Elevated

86.0%

Category Percentiles



Largest Psychology Influences

Levered Investments	Negative
Option Activity	Negative
Surveys	Negative
Fund Flows	Negative

Largest Monetary Influences

Interest Rates	Positive
Monetary Aggregates	Negative
Velocity	Negative

Valuation

7-10 Year Rtn Forecast	1.2%
10Yr Treas Yield (on 12/03)	1.0%

Market Trends

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

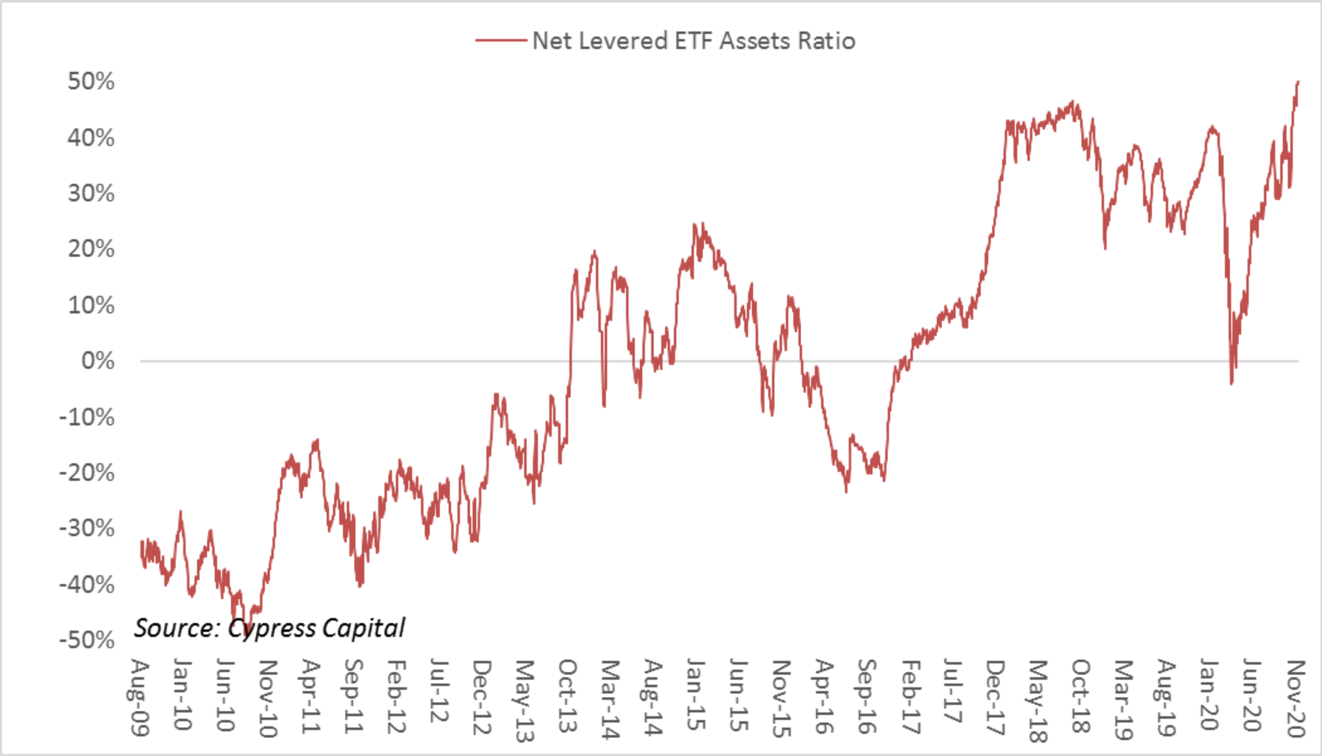
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

assets as the means to support the economy through the pandemic. The Fed doesn't make vaccines, so it made the only elixir in its book of financial alchemy – animal spirits. We were supporters of quantitative easing in the 2008 crisis, but yesterday's extraordinary measures have become today's ordinary tools. It's financial repression, and investors won't realize it until the music stops playing. We continue to play the game, but we play it with one eye glued to the margin of safety.

Charts of the Week

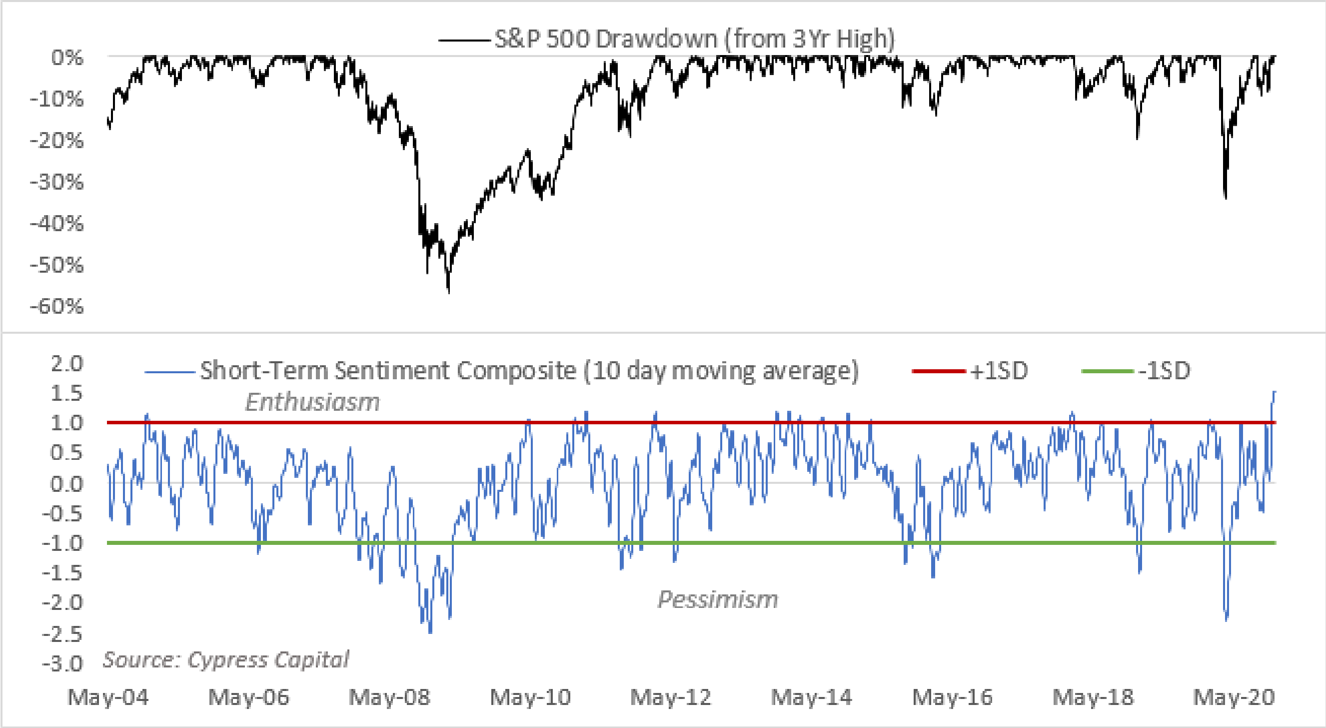
ETF Leverage hit all-time highs

The net speculative position of levered ETF traders hit all time highs this week. The dollar value of assets inside leveraged index ETF products has surged over 150% since the March lows and are 60% higher than they were at the February peak.



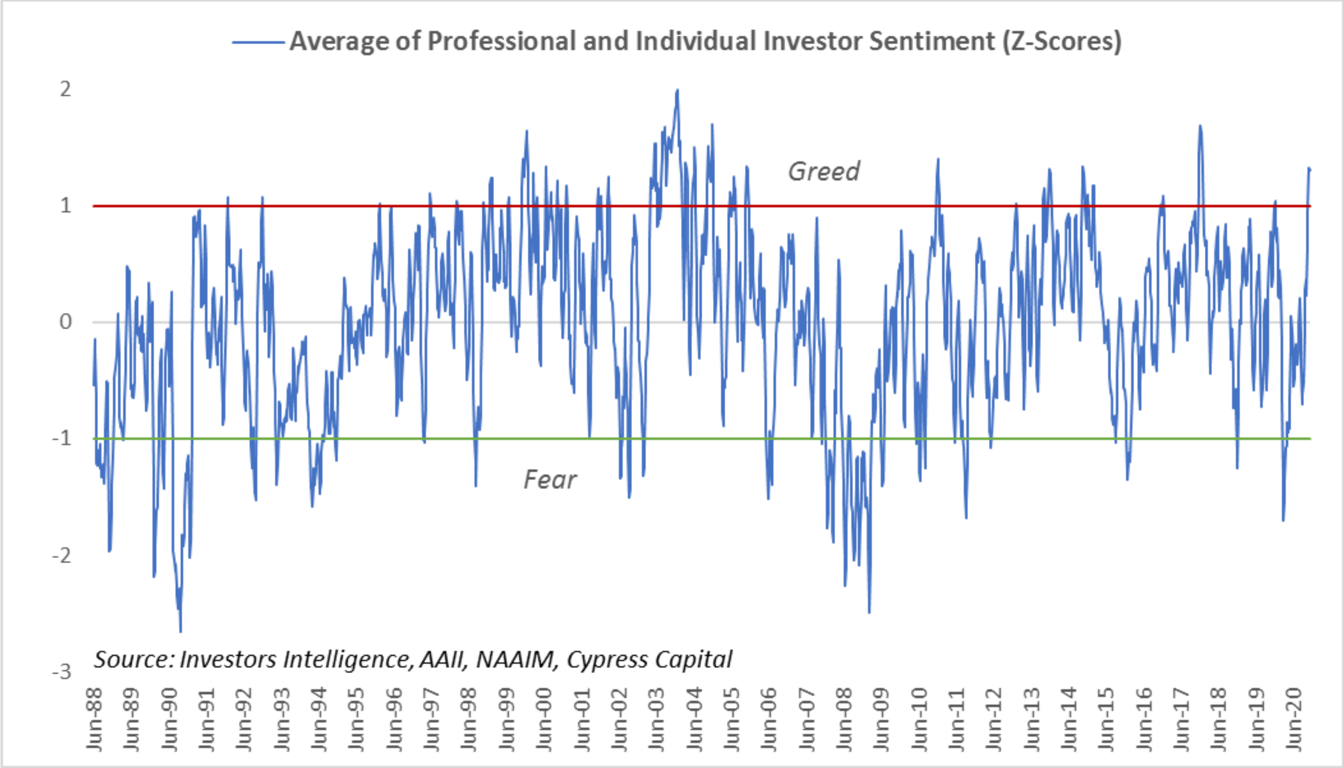
Short-Term Sentiment Composite

The 10 day moving average of our Short-Term Sentiment composite hit new all-time highs this week.

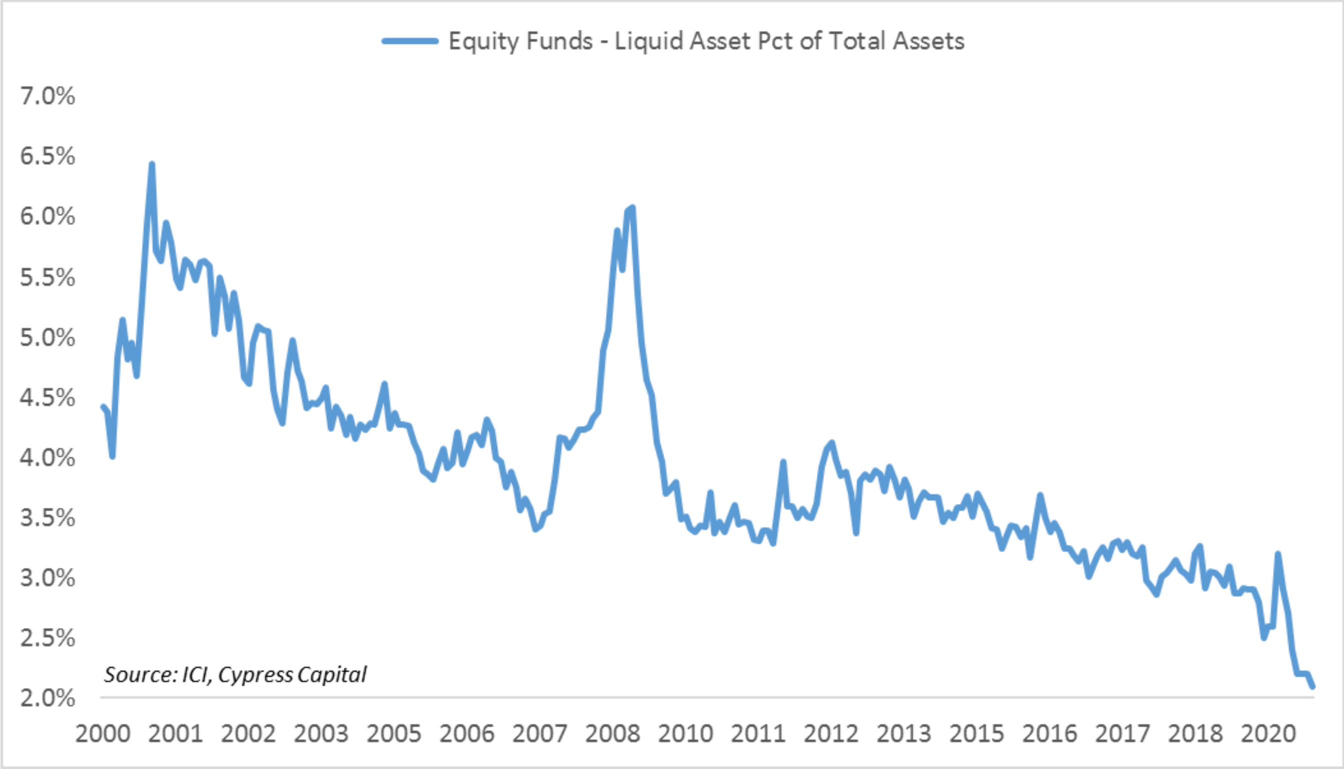


Investment Surveys are uniformly greedy.

Professionals and individuals are simultaneously bullish, nearly 1.5 standard deviations higher than normal, the highest since Jan 2018 when global equities peaked.

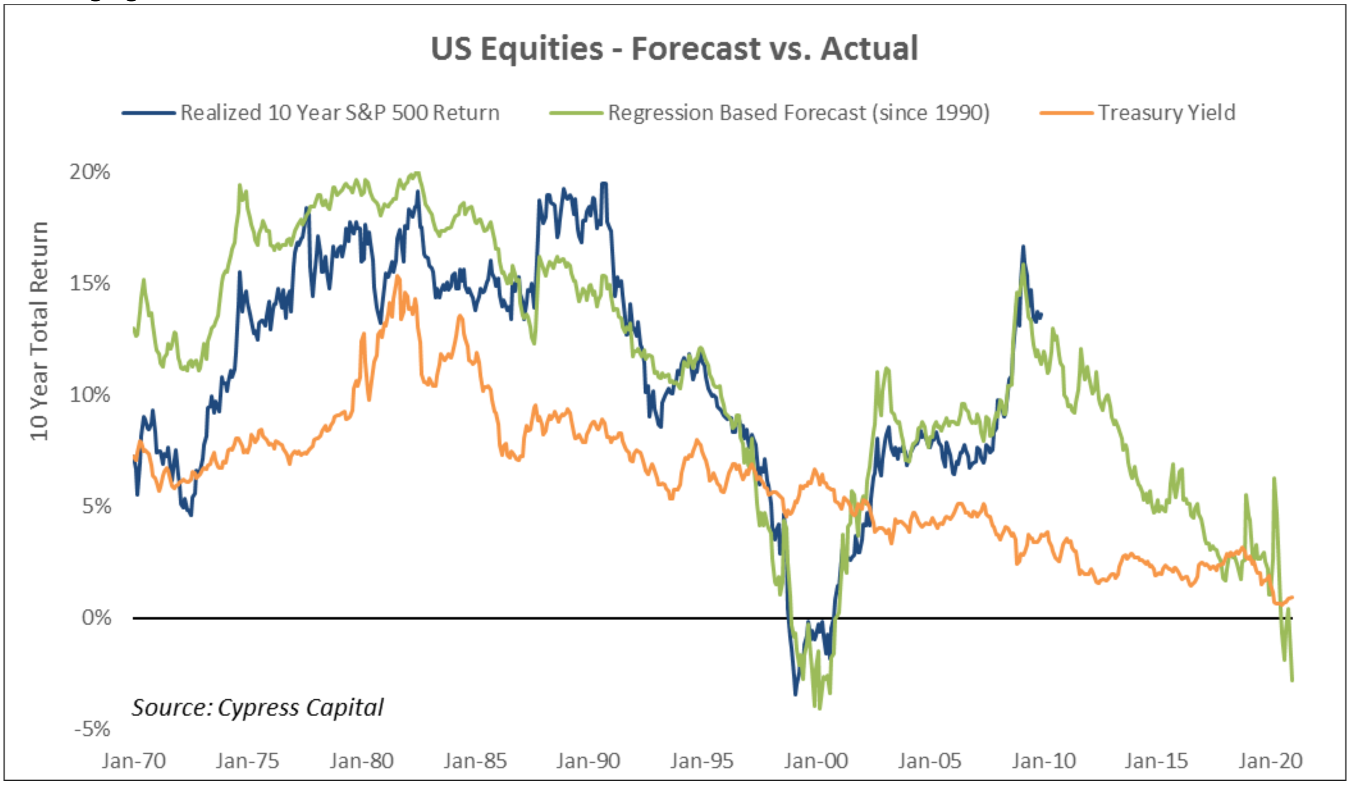


Cash is trash - cash holdings in Mutual Funds sank to all-time lows last month.



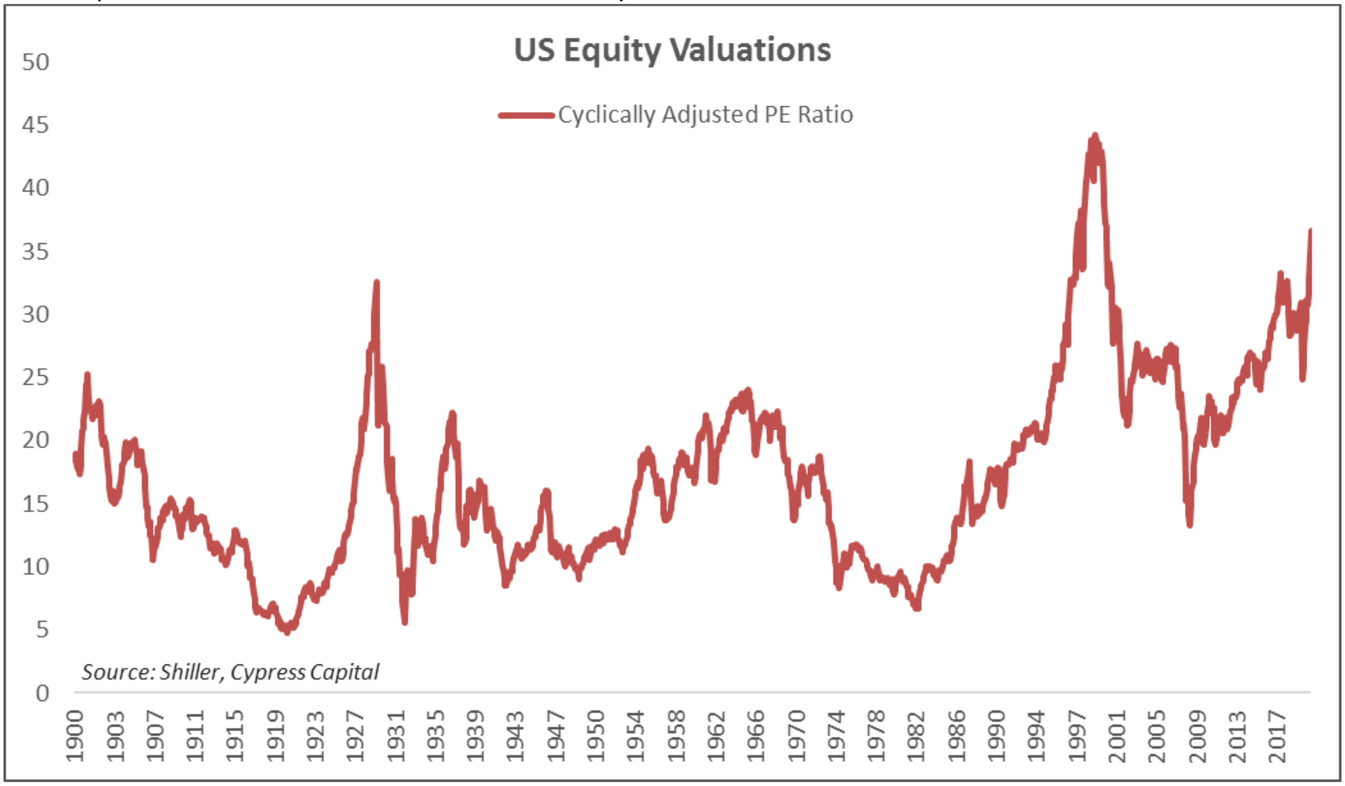
Valuations – Equity Return Forecast

The equity return forecast built upon a regression of our valuation composite against returns since 1990, the era where higher valuations have been more persistent, has fallen to new lows, and has also grown close to challenging the return forecast from the dot-com era.



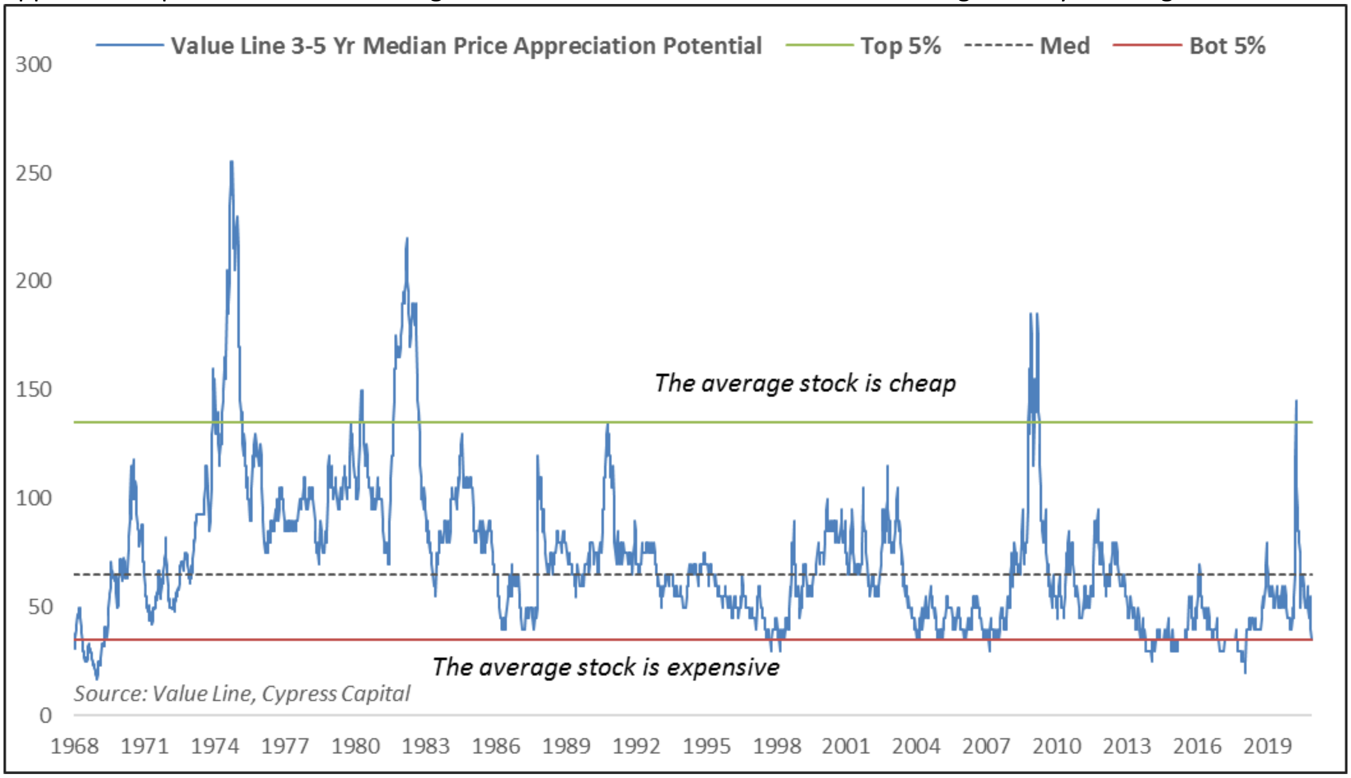
Valuations – CAPE Ratio

The Cyclical Adjusted PE Ratio on US stocks broke decisively beyond the levels that marked the 1929 stock market peak and have the dot-com era record firmly in the crosshairs.

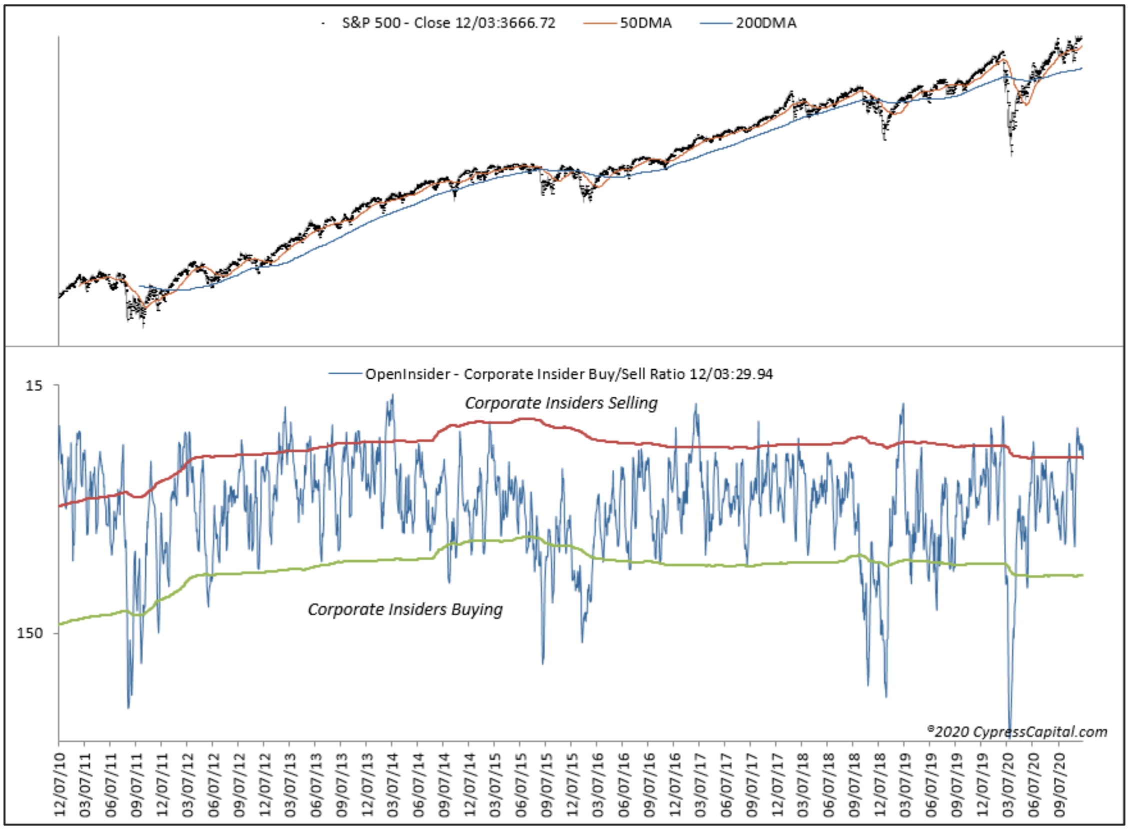


Value Line Median Appreciation Potential – the median stock has become expensive.

On March 22nd, the day before the market bottomed, we put out a note highlighting how attractive the average stock had become based on this indicator, one of our favorites. In a shift that normally takes years, the appreciation potential for the average stock has fallen to the worst 5% of readings. It only took eight months.

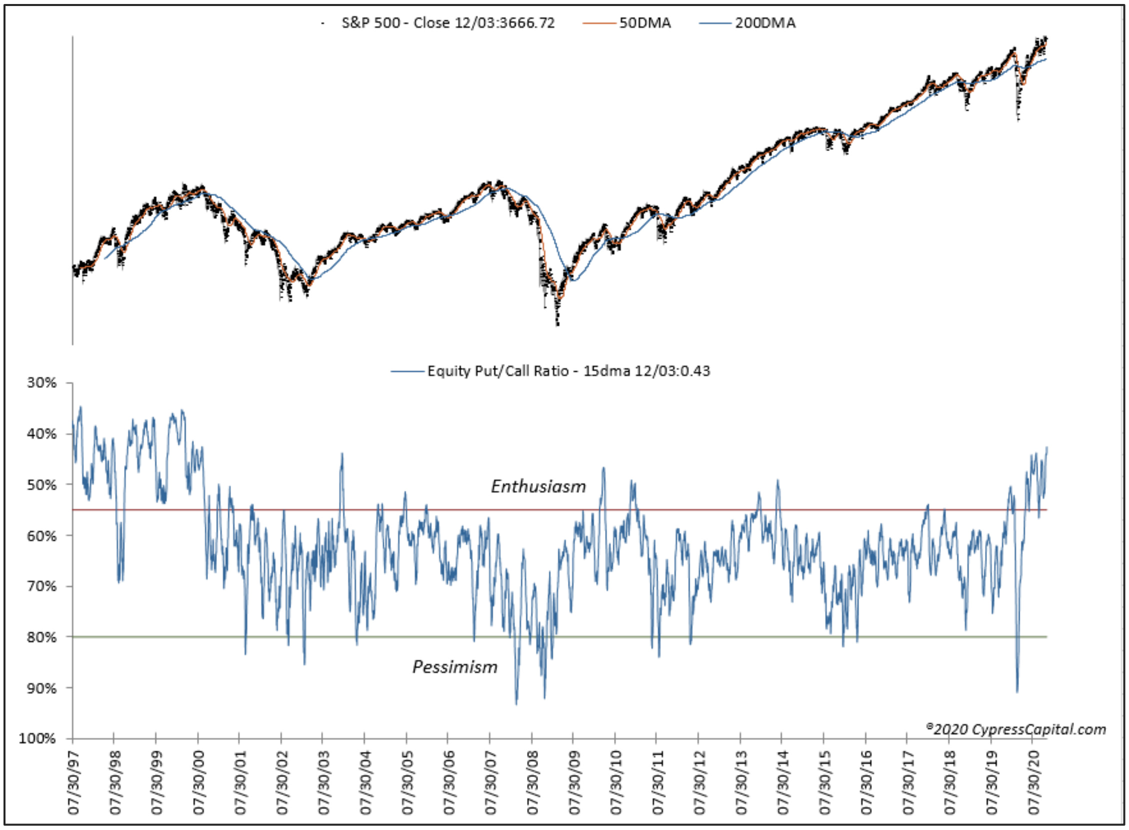


Corporate Insiders have persistently sold stock during this rally.

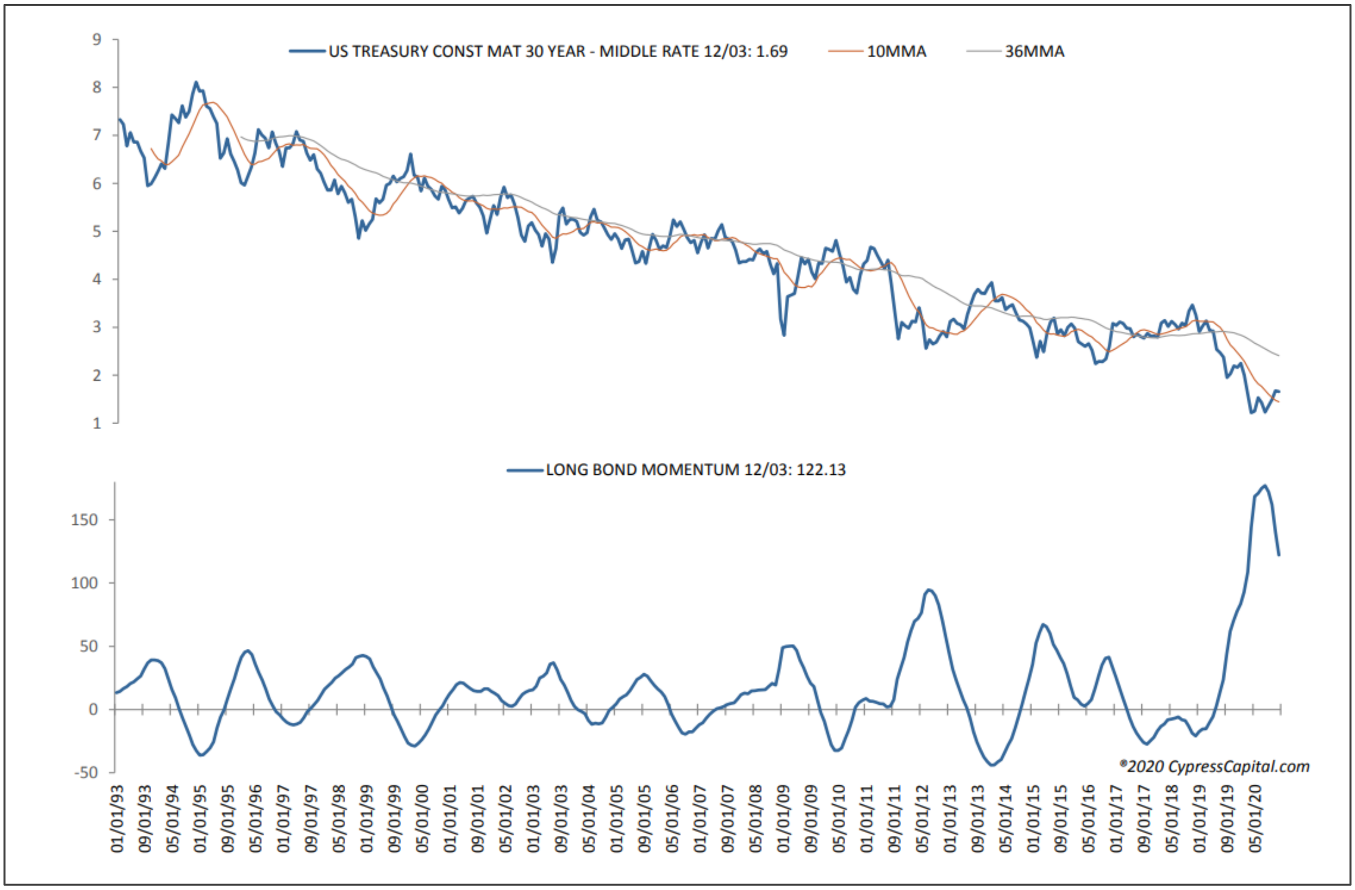


Equity Put/Call Ratio sets a new low.

Options speculation has accelerated beyond the levels from this summer and, like valuations, are close to challenging the speculative records set during the dot-com era.



Long Bond Momentum says stay away from long duration Treasuries.
Upward pressure on yields has been persistent since the August sell signal on bonds, and it has coincidentally served as a good sell signal for the dollar and gold as well.



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.