Cypress CAPITAL

Market Outlook

By Mark T Dodson, CFA

2020 - The Dot-Com Era's Easy Money Cousin

Market Risk Index increased modestly to 86.2% on a move by the valuation composite back into the worst 1% of historical readings. Psychology and monetary conditions deteriorated slightly as well.

It's difficult for our Psychology percentile rankings to frame the kinds of extremes that we are seeing now, because it's at 99.4% and can only go to 100%. Moving another 0.6% isn't going to have a material impact on MRI, or an emotional impact on you. However, each week, we see more levels and records that are challenging the most speculative eras in modern financial market history. The examples this week - the average first day pop in IPOs for the month of December is nearly 100%, a double. The last time that happened was February 2000.

Also this week, small money option traders made up more of the total call option volume than ever before – well beyond the 2000 record. The call option volume is so pronounced that the equity put/call ratio has become a must-see daily chart for us, mainly to see if the readings are going to be able to push below the dot-com era lows. Each day it edges closer. Rydex Ratio and assets chasing levered ETFs are hitting record highs on a daily basis. For the Rydex Ratio, it's become so pronounced that we are relying more and more on our de-trended version of the indicator.

The same holds for valuations. Each week for the last several weeks, we update our valuation composite curious to see if our equity return forecasts managed to break below the previous dot-com era records, and they too edge closer and closer. Hallmarks of euphoria are all around, but they appear to go on ignored. We've rationalized the environment because of a couple of simple arguments – there is no alternative to stocks, and the Covid economic recovery has only just started.

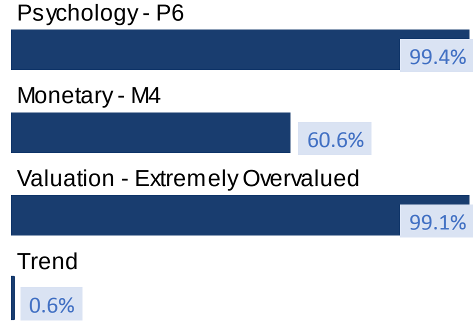
There are differences from the dot-com era that we think are noteworthy. There is no Alan Greenspan this time around preaching about the dangers of irrational exuberance and tightening monetary policy. Instead, we have a Fed that flat out not only ignores it, but encourages it, in

Market Risk Index

Elevated

86.2%

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	1.0%
10Yr Treas Yield (on 12/09)	1.0%

Market Trends

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

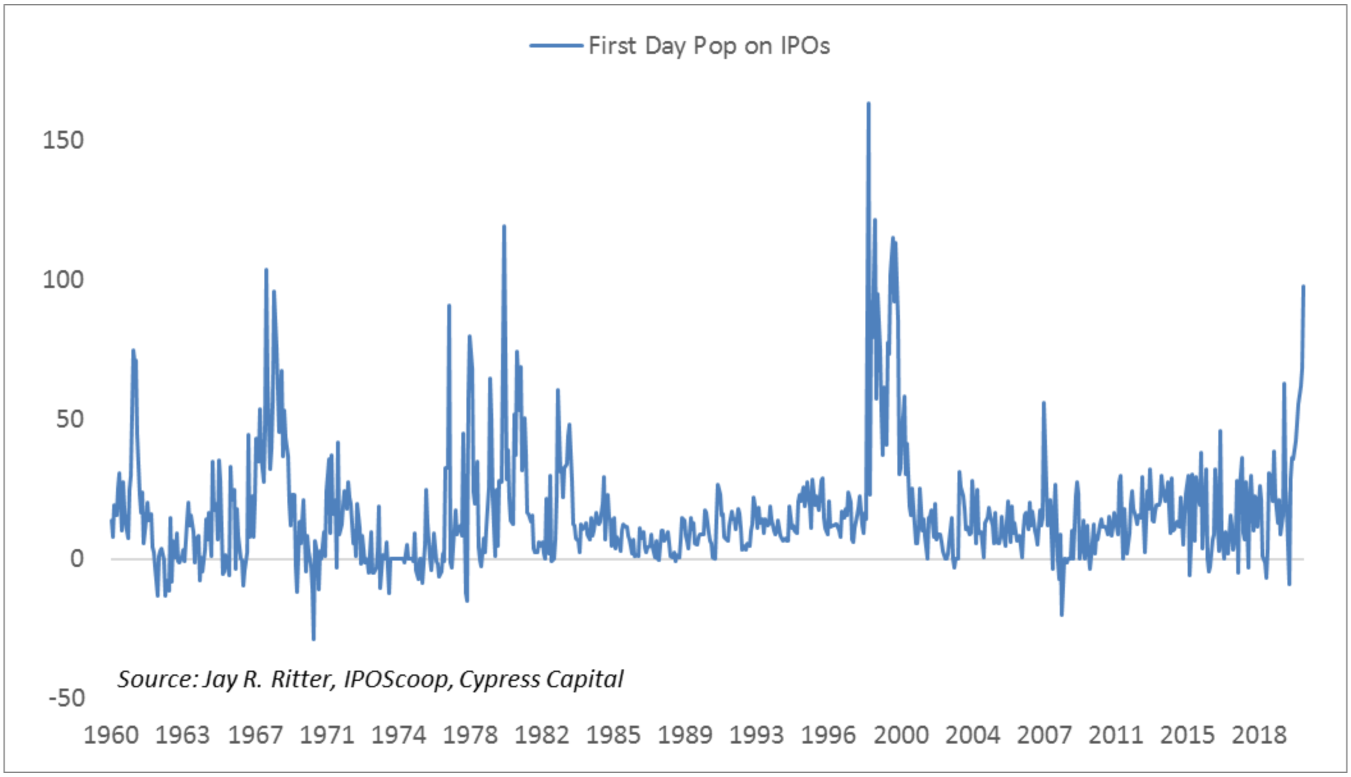
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

hopes that a souped up version of wealth effect can push us beyond the point where the vaccinations begin. There's also another distinct difference between now and the dot-com era. The breadth of the advance that we have seen since the announcement of the vaccine is also one for the history books. It's the kind of breadth where more stock market highs follow, so you can't bury your head in the sand. You have to play the game, even if it's not a clean one. Keep your brass knuckles handy.

Charts of the Week

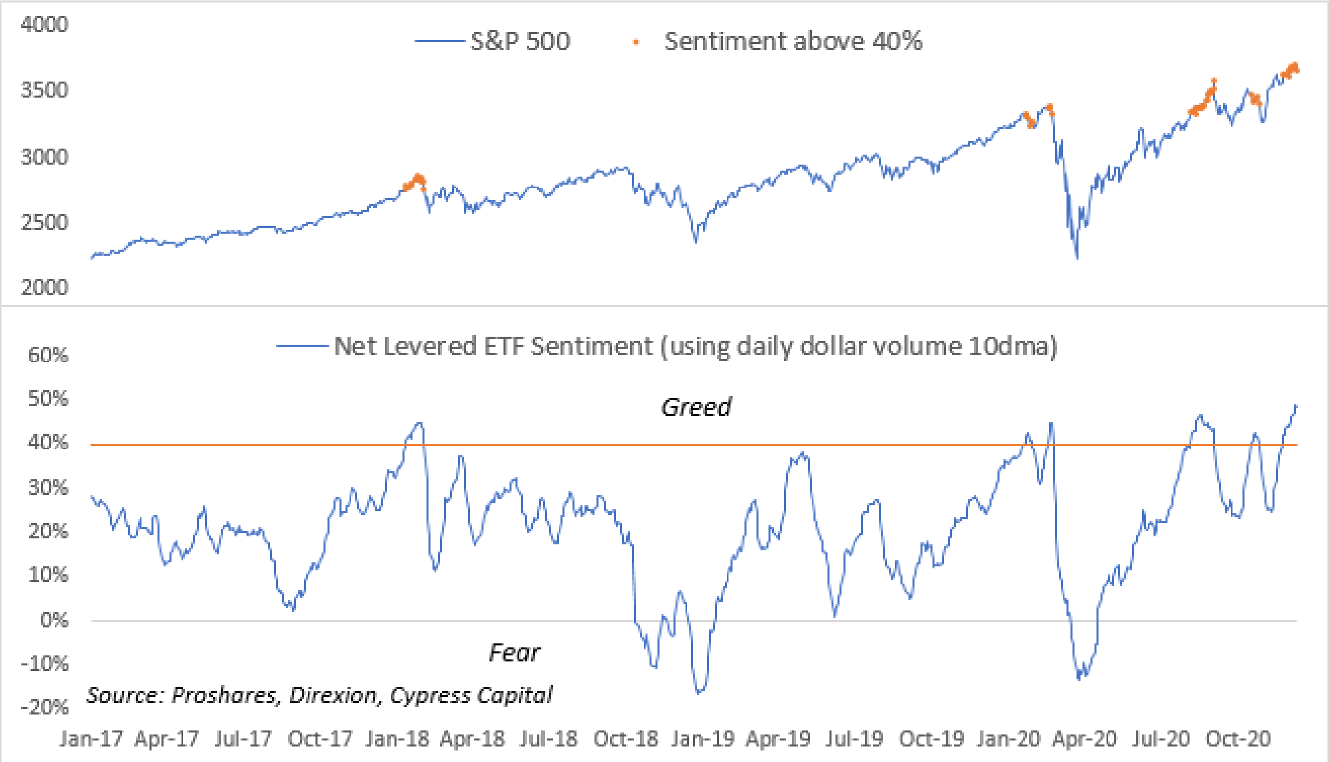
First day Pop in IPOs

This indicator is inside our composite of psychology indicators, but it's not one we share often, because the kinds of speculative environments this indicator highlights only come around once every 20-30 years. We're in one now.



Levered ETF Speculation

Volume in levered ETFs has broken to new highs and surpassed all the highs set during the Trump presidency. We are firmly in greed territory before the NBER has even declared the recession to be officially over.



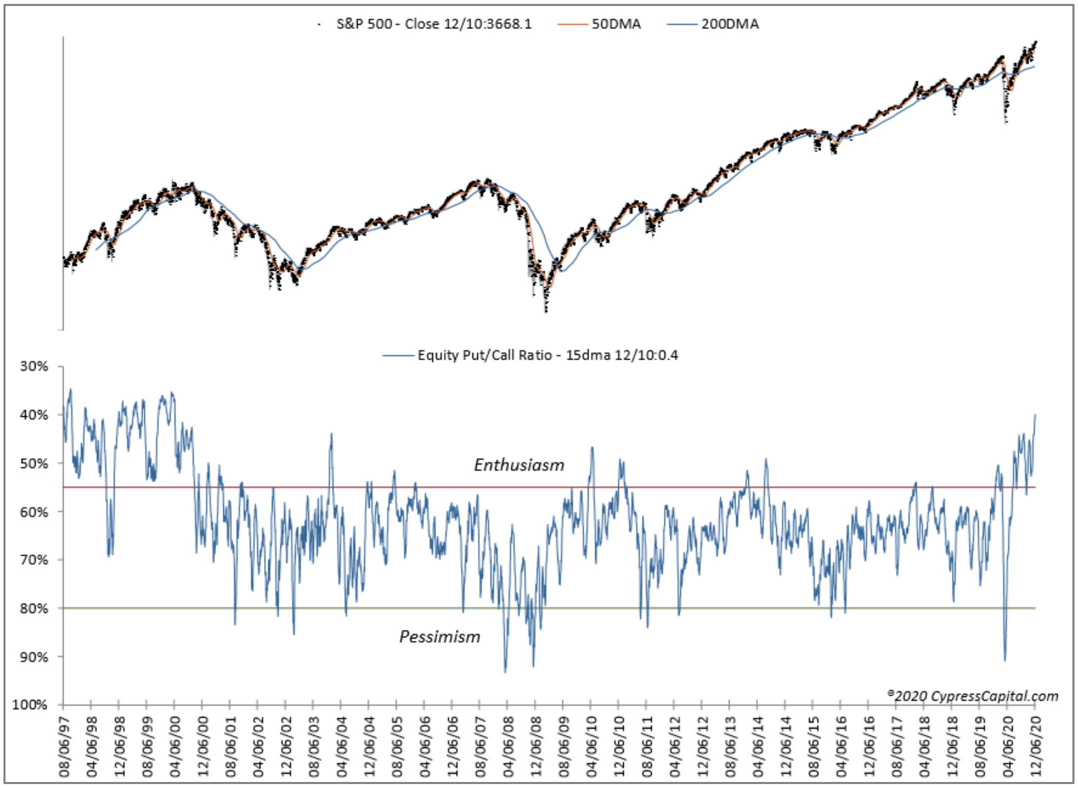
Psychology Table

We don't share this table often, but the readings in our Psychology composite are pervasive in its signal that we are in an environment of irrational exuberance. Only two categories are bucking that trend – Technical Indicators, which is positive because it's picking up on some very solid breadth signals. The other is Consumer Confidence, which is neutral and is a symptom of the K-shaped economic recovery. Fed stimulus has been heavy-handed and unbalanced in determining whose boats get lifted in the rising tide, and it's biased toward the yachts over the bass boats.

Category	Total Points	Condition
Bank Sentiment	-18.0	Negative
Flow Of Funds	-20.0	Negative
Fund Flows	-26.0	Negative
Insider Sentiment	-15.0	Negative
Leveraged Investments	-67.0	Negative
Option Activity	-52.0	Negative
Surveys	-38.4	Negative
Consumer Confidence	-2.0	Neutral
Technical Indicators	21.0	Positive
Trading Data	-10.0	Negative
Volatility	-10.0	Negative
Total Model Points	**-237.4**	

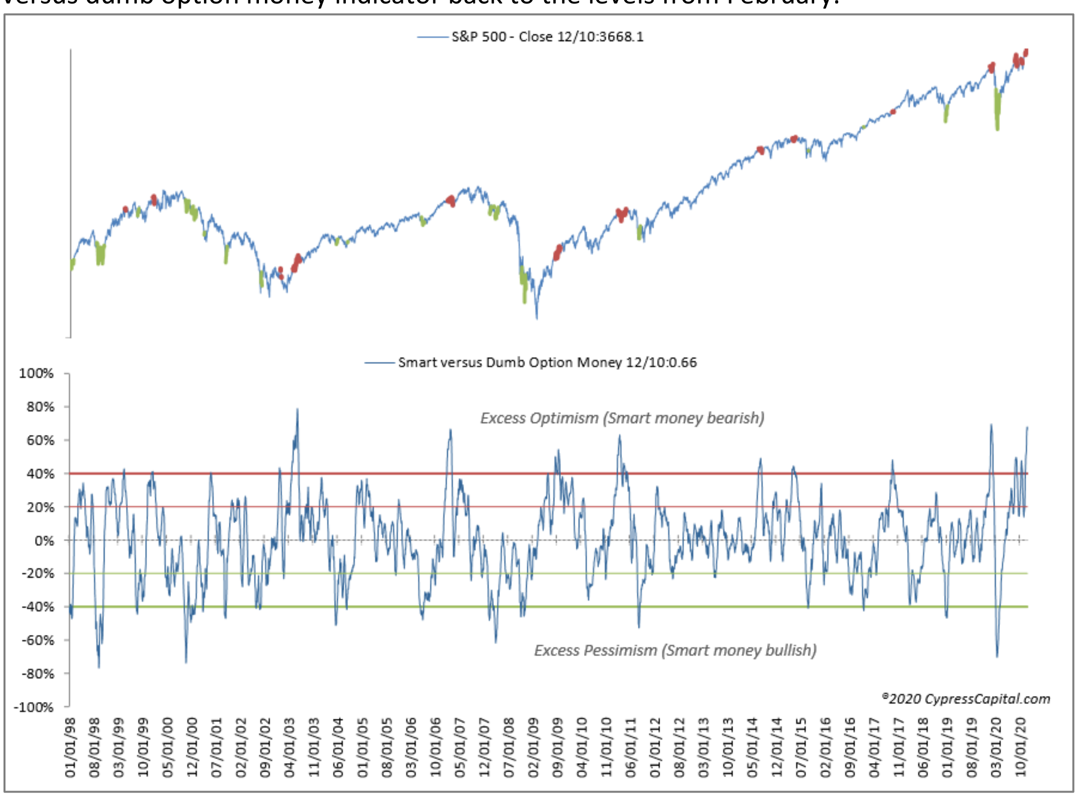
Equity Put/Call Ratio

We've gone beyond the levels of speculation that we saw in August and September – very close to registering readings that we haven't seen since March 2000.



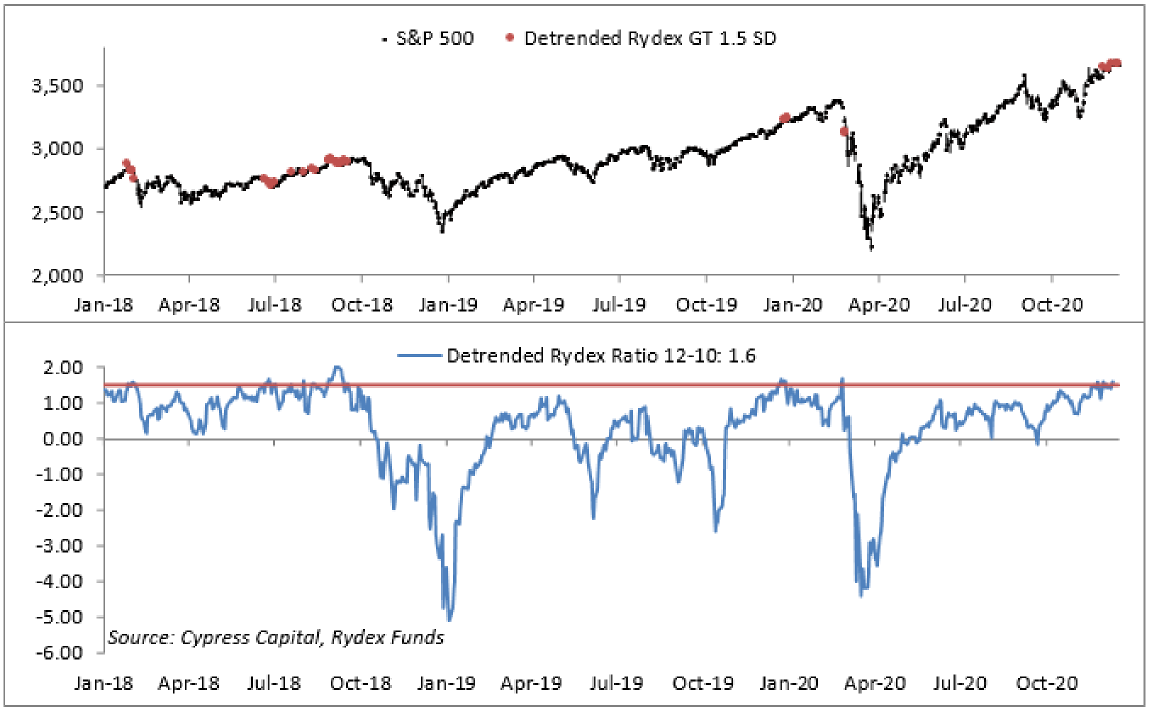
Smart versus Dumb Option Money

While call buying is rampant, hedging activity by smart money option traders is increasing, pushing our smart versus dumb option money indicator back to the levels from February.



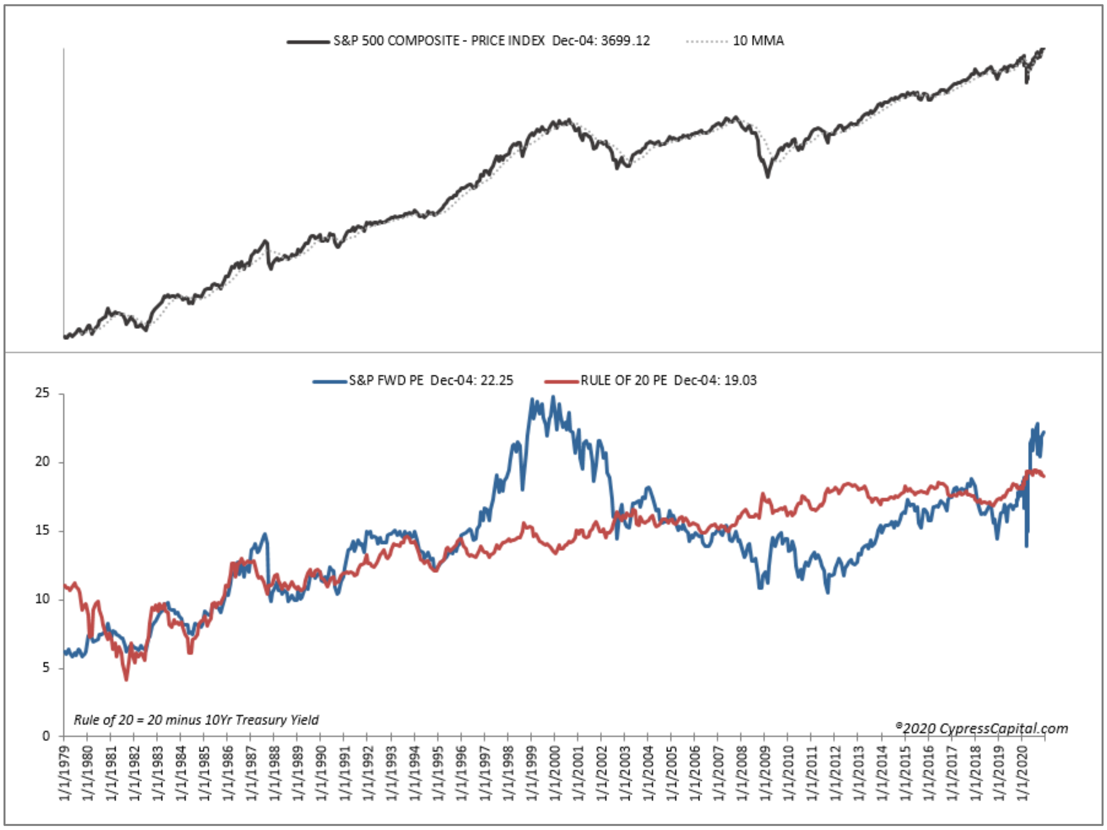
De-Trended Rydex Ratio

Rydex Ratio broke to new highs this week, and our de-trended version of the indicator has climbed to 1.6 standard deviations above average.



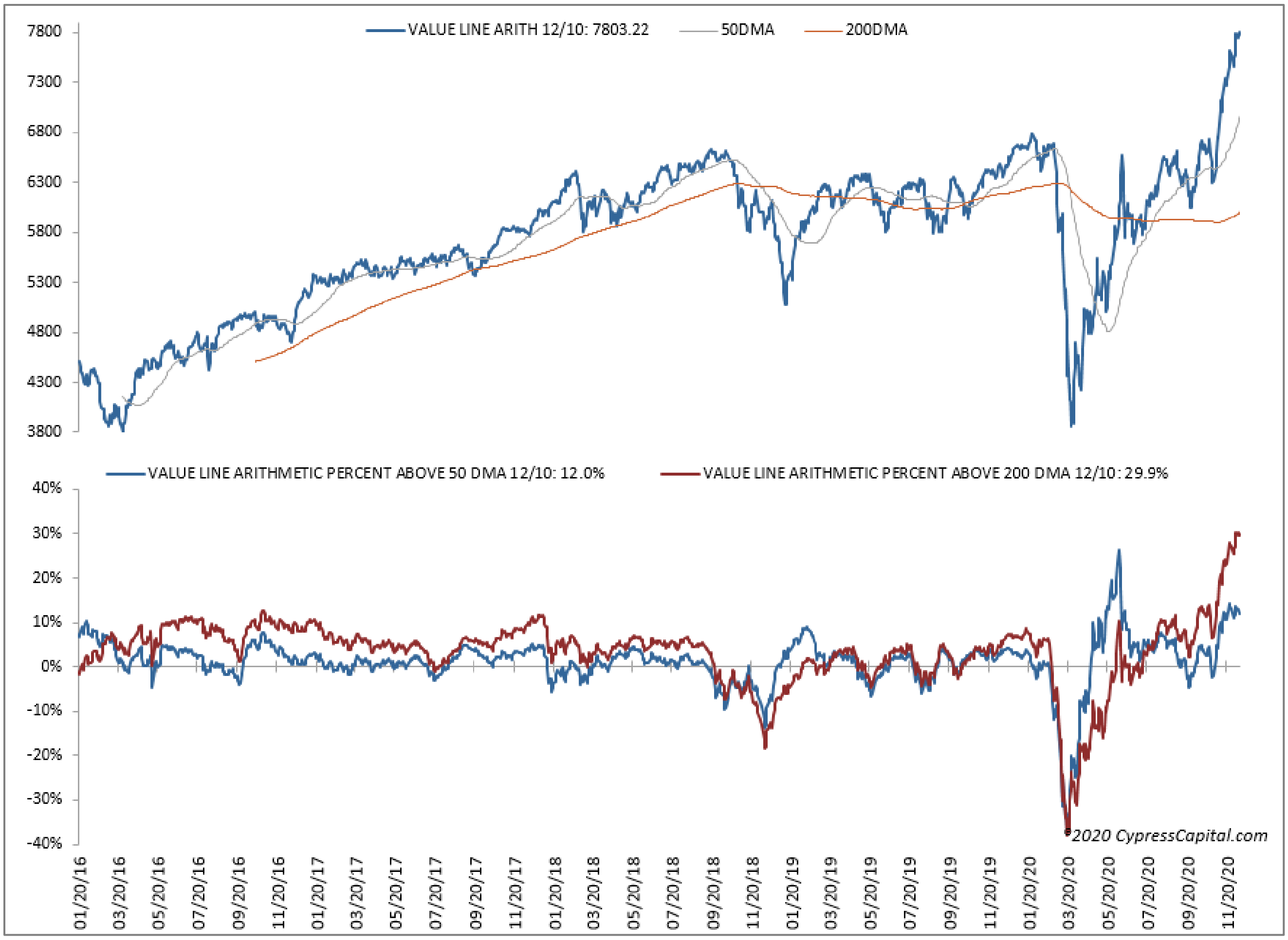
Valuation - Rule of Twenty

This simple, but reasonably discerning, gauge of valuation subtracts the Treasury yield from 20 to suggest a PE ratio for equity markets. The current forward PE has broken above the Rule of 20 like it's 2000. There is an obvious limit to this humble model...20 minus 0...is 20.

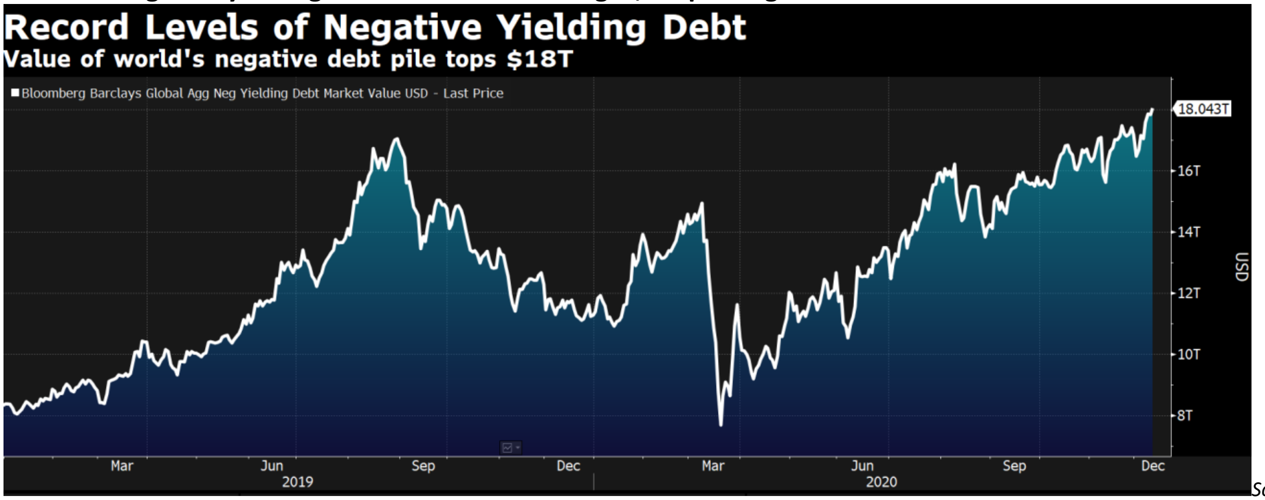


Valueline Arithmetic Index

The Valueline Arithmetic index has broken out well above its 2018 highs. The average stock may be over-priced, as can be seen from the Valueline Median Appreciation Potential chart that we shared last week, but we also aren't keen on ignoring this important signal. When the "average" stock breaks out like this, it mean there was a lot of breadth behind a stock market advance.



Value of Negative yielding debt breaks to new highs, surpassing $18 Trillion

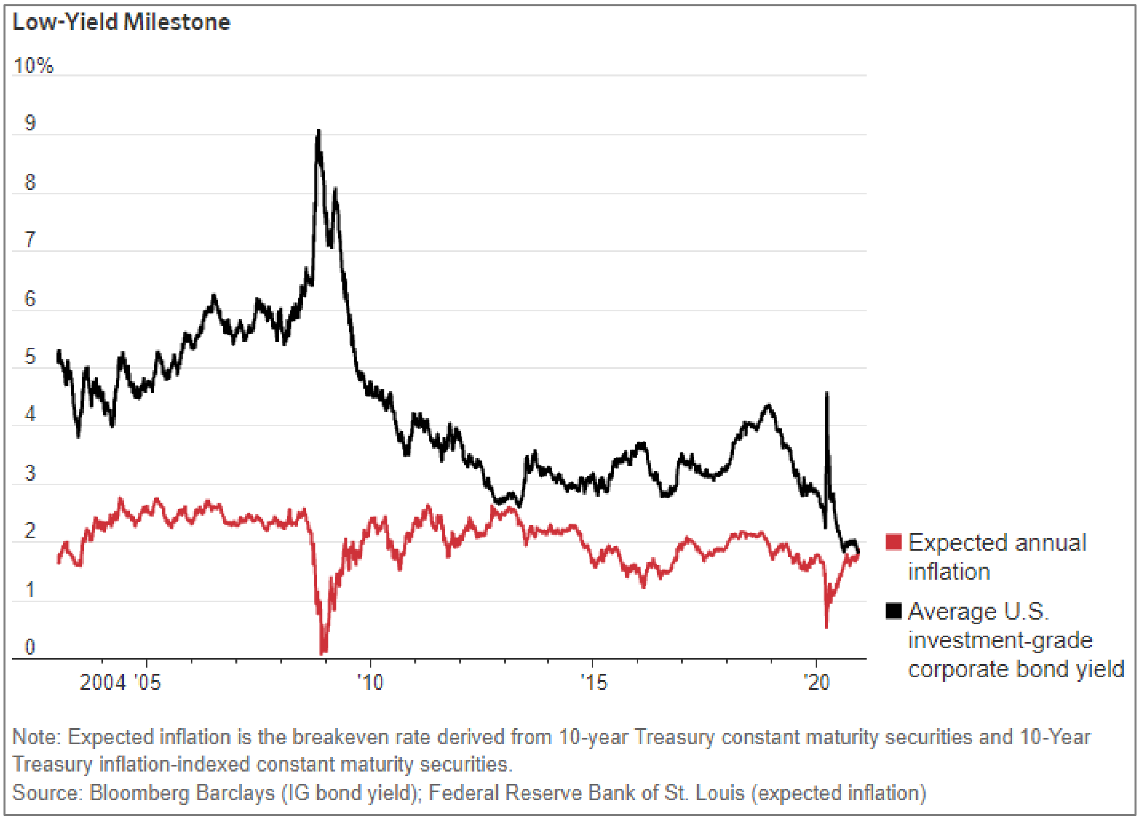


Source:

Source: Christophe Barraud

Corporate bond yields have fallen below the level of inflation

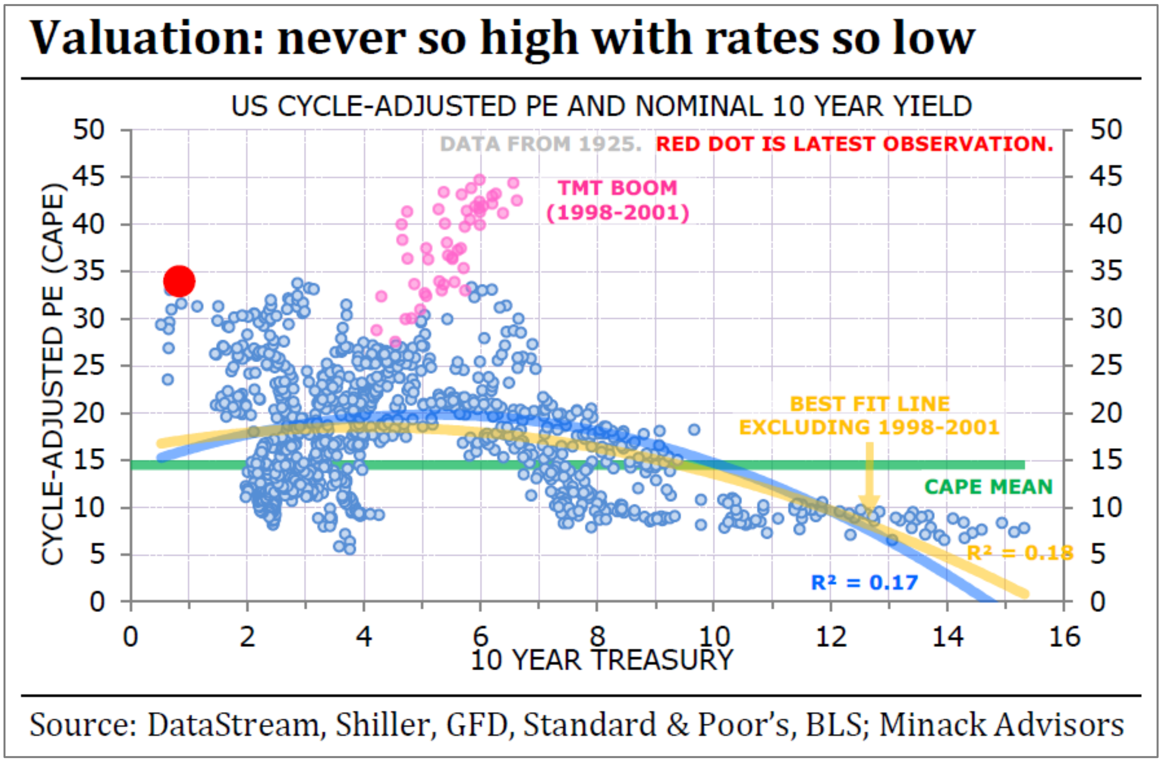
Financial repression at its finest. Fed intervention has made the lender the slave to the borrower.



Source: WSJ

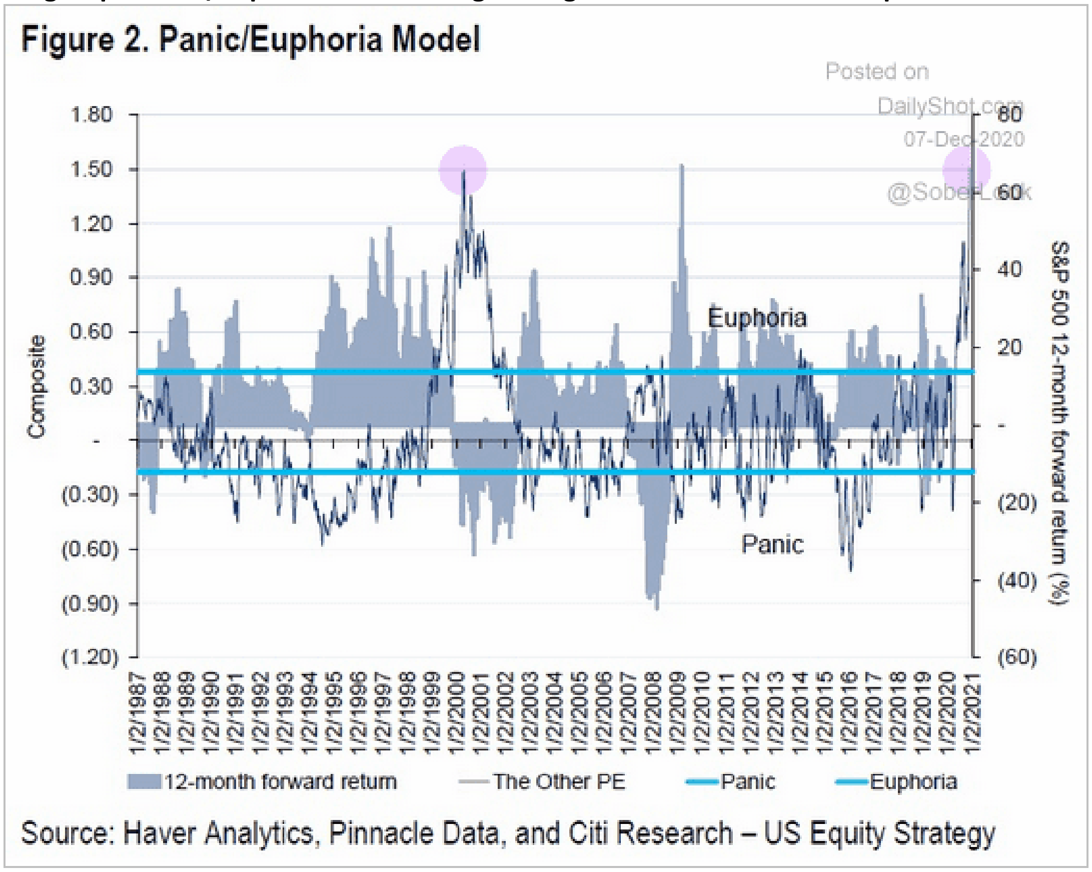
Relative valuations

Valuations have never been higher, given the super low level of interest rates.



Source: Jahn Authers

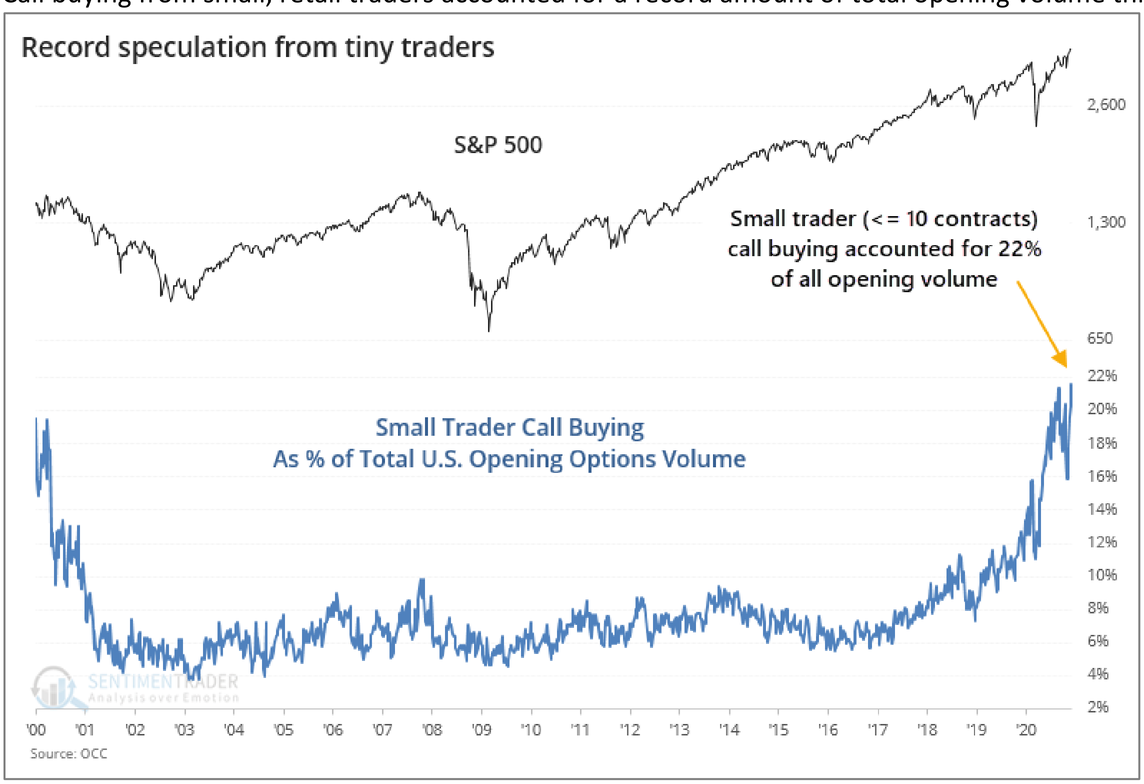
Citigroup's Panic/Euphoria Model is registering Dot-Com Era levels of Euphoria



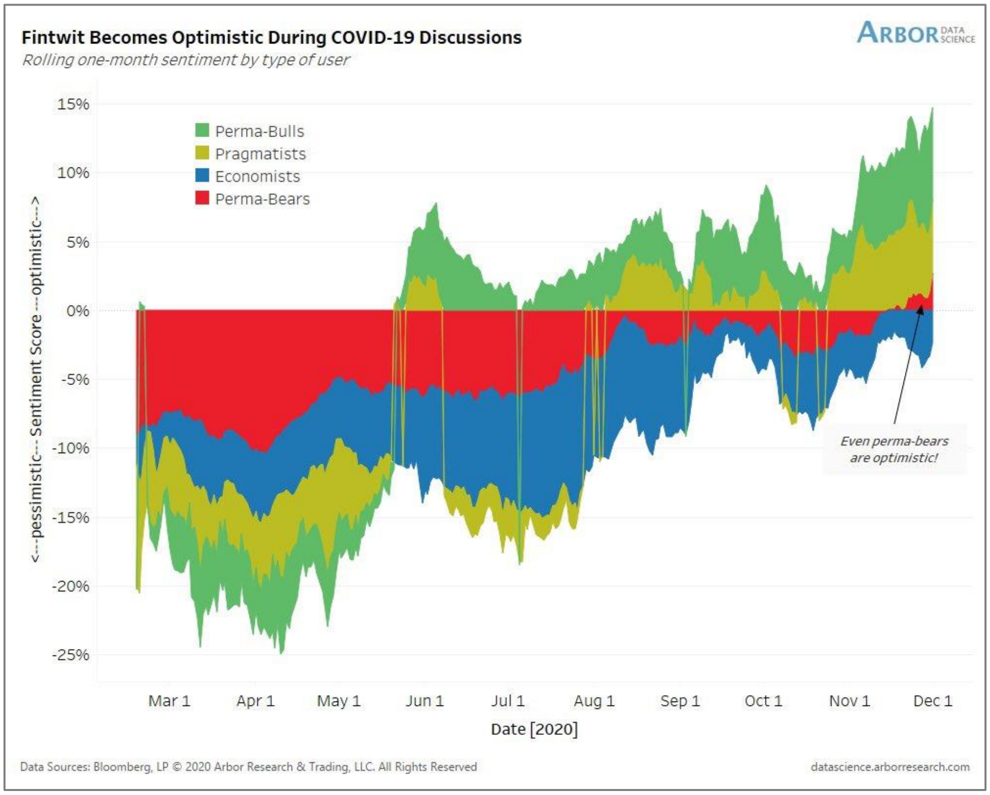
Source: DailyShot

Tiny Trader Record Speculation

Call buying from small, retail traders accounted for a record amount of total opening volume this week.



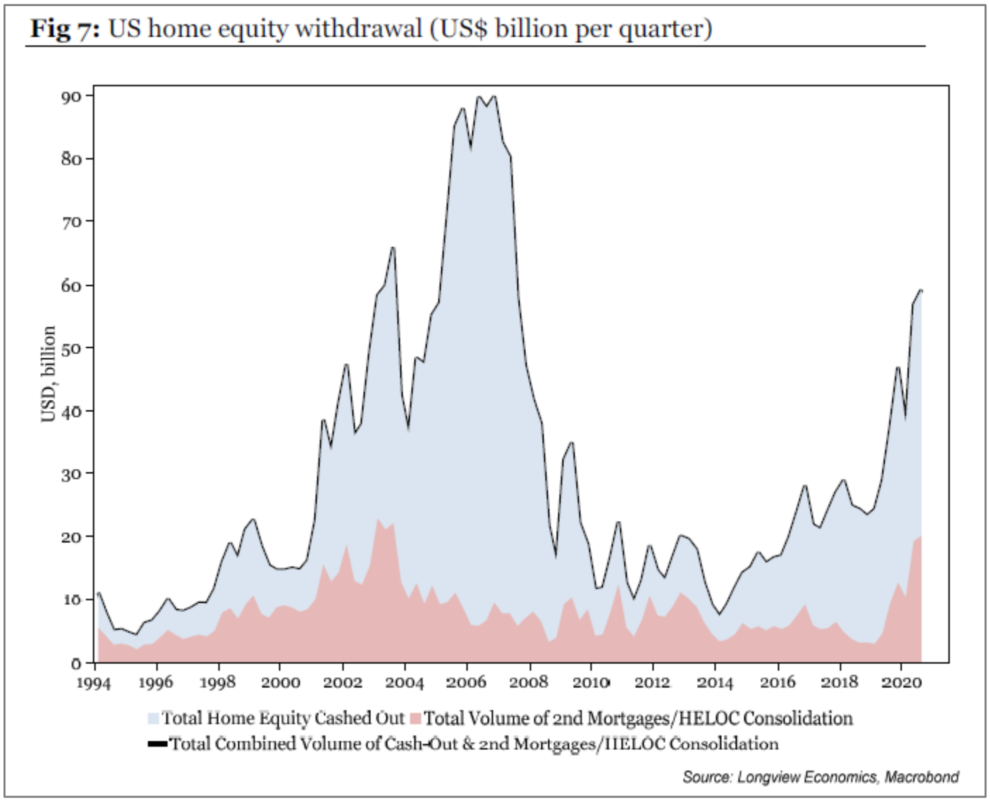
Fin-twit gets bullish – even the perma-bears



Source: Liz Ann Sonders

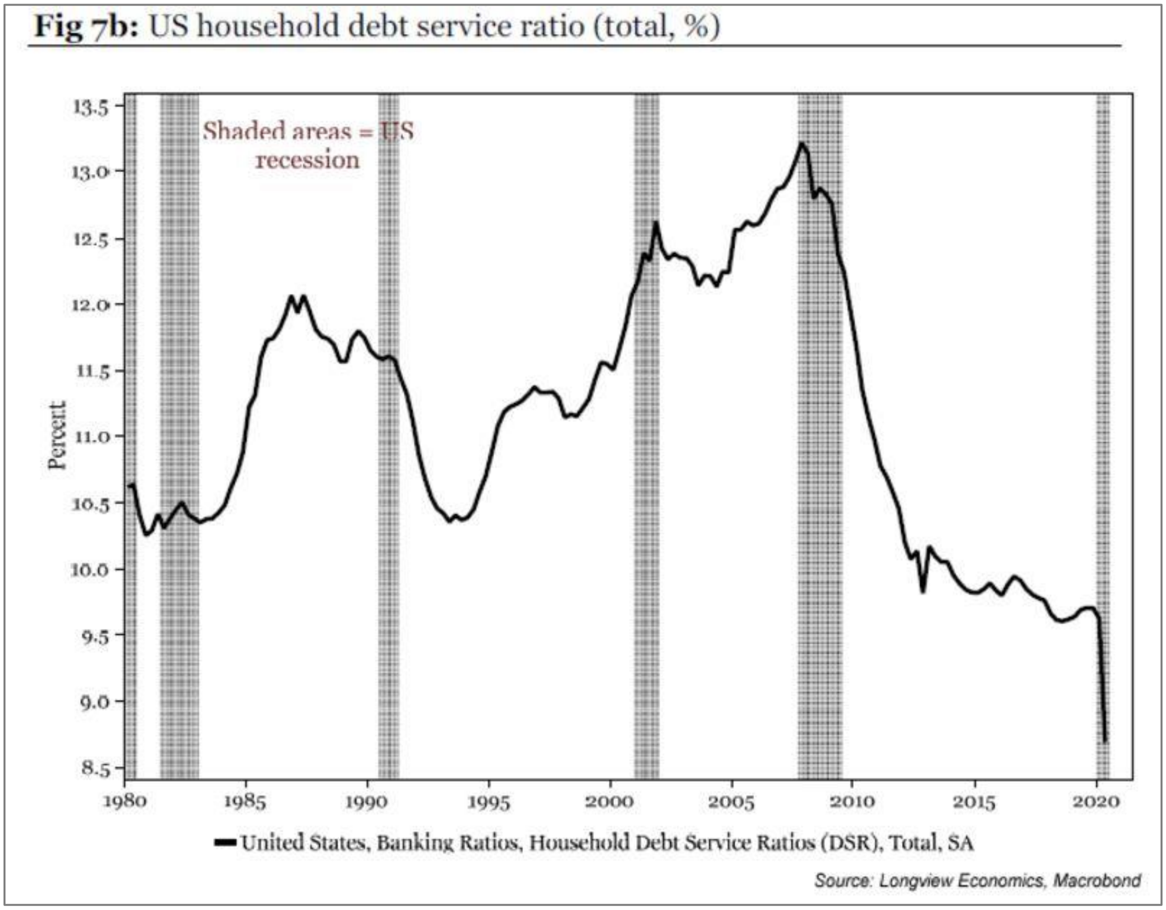
Home Equity Withdrawals

If the dot-com era comparisons weren't enough, homeowners are starting to withdraw equity like it's the housing bubble again.



Source: John Authers

The really good news for households – Debt service payments have fallen to record lows!



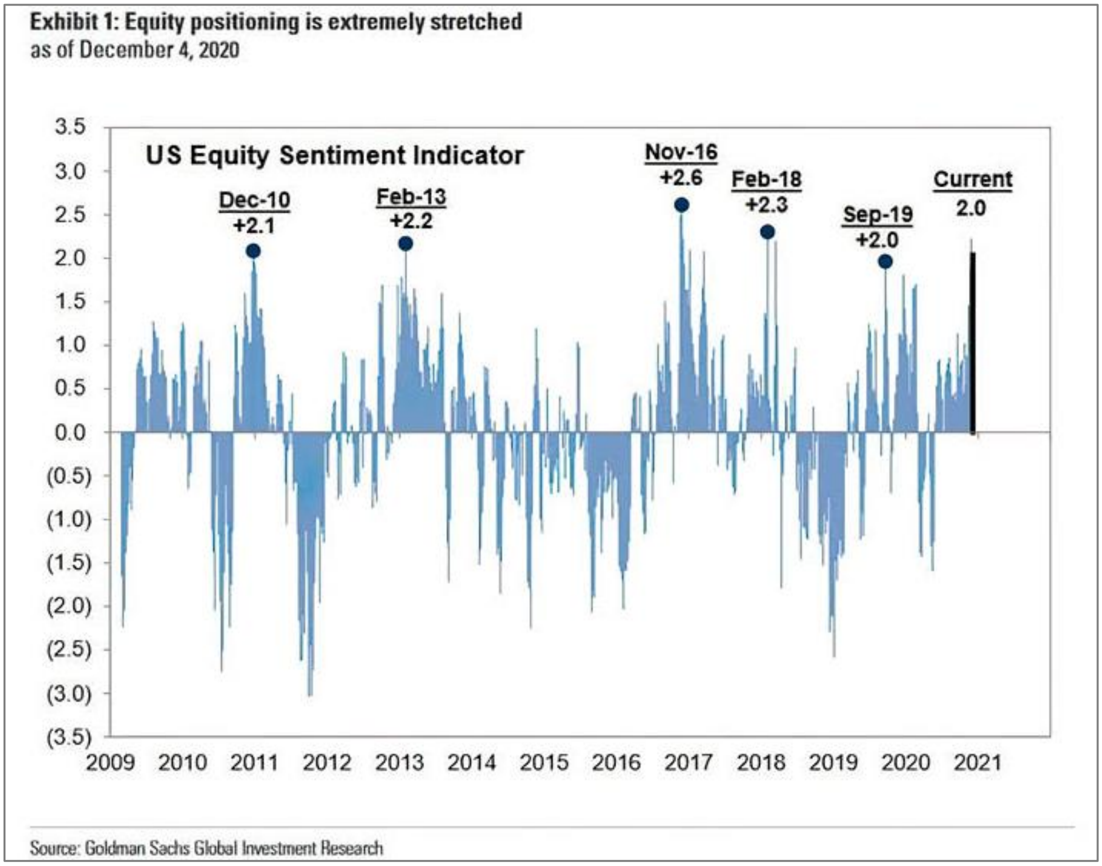
Source: John Authers

The good news for US Corporations

Corporate debt levels might be at record highs, but so are the levels of corporate cash.

Source: Authers

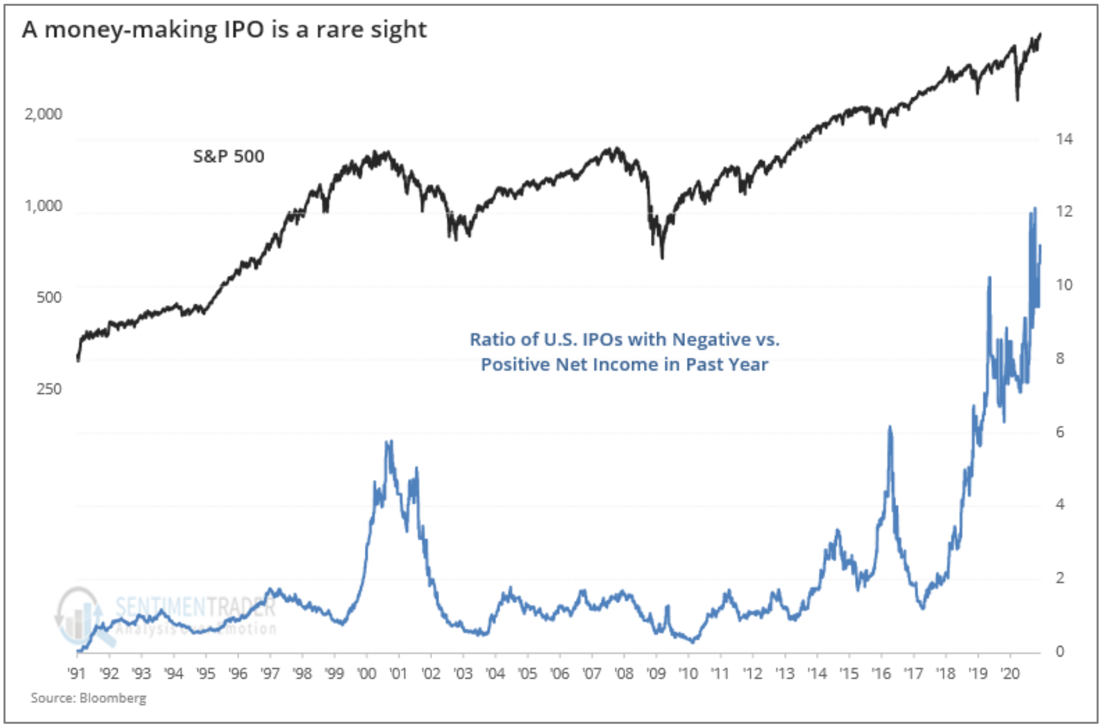
US Equity positioning is hitting an extreme.



Source: Goldman Sachs, Isabelnet

Money-losing IPOs

The first day pop of IPOs may not have exceeded the 2000 peak but the ratio of negative net-income to positive net-income IPOs has put the dot-com era in the rear view mirror.



Source: SentimenTrader

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.