Market Outlook

By Mark T Dodson, CFA

Valuation joins Psychology in the 100 Percentile Club

Market Risk Index moved up to 93.9, on another jump in the Monetary Composite reading. MRI has breached the peak reached in January and February of 2020.

Monetary conditions worsened on another decrease in points coming from the interest rates category. Monetary conditions are better now than they were in early 2020, but psychology and valuations are notably worse. Both have hit the 100% threshold and can worsen no further, although further deterioration to valuations still has implications for more severe drawdown risk. For the valuation composite, it was the first week in the 100th percentile club, meaning it's a new high watermark for valuation, taking the title from the 1999-2000 period.

This week was full of stories about GameStop, short squeezes, Robinhood, and politicians up in arms about the rights of speculators. It made for a long, but interesting week. It's still a narrative on repeat – another surge in speculative behavior, with a different security in focus and a slightly different story that has been ongoing since the Fed unleashed the Kraken last spring. There are parallels with the dot-com era, but it's different from the original series. It's the Kobra Kai version of the dot-com bubble.

Our psychology composite has been stuck in the 100th percentile for three straight weeks. The equity put/call ratio (15dma) hit the lowest levels since April 2000 and is now a rounding error away from breaking the record set back at the height of the dot-com bubble, over 20 years ago. We are seeing some signs that the fever might break for a while, as our short-term sentiment composite and the results of sentiment surveys this week managed to break below their most speculative readings.

The model's recommendation to increase cash last week proved timely, and a price correction will likely coincide with a recommendation to increase equity allocations. The risk of a substantial drawdown is high, but economic, fiscal, and (most important for our model) price momentum are still voting in favor of the bull market, so our model will not recommend any additional decreases to equity allocations. In spite of the market's weakness this week, there have been no signs of upset from the bond market or the dollar, meaning it has more hallmarks of a correction and a short-term episode of higher volatility. It looks like an environment where large hedge funds are taking down gross exposure, but not panicking en masse.

Market Risk Index

Rec Allocation 25% Underweight

93.9%

Category Percentiles

Category	Percentile
Psychology - P6	100.0%
Monetary - M4	77.8%
Valuation - Extremely Overvalued	100.0%
Trend	1.6%

Largest Psychology Influences

Levered Investments	Negative
Option Activity	Negative
Surveys	Negative
Fund Flows	Negative

Largest Monetary Influences

Velocity	Negative
Monetary Aggregates	Negative
Lending and Leverage	Negative

Valuation

7-10 Year Rtn Forecast	0.0%
10Yr Treas Yield (on 01/27)	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.

Quote of the Week

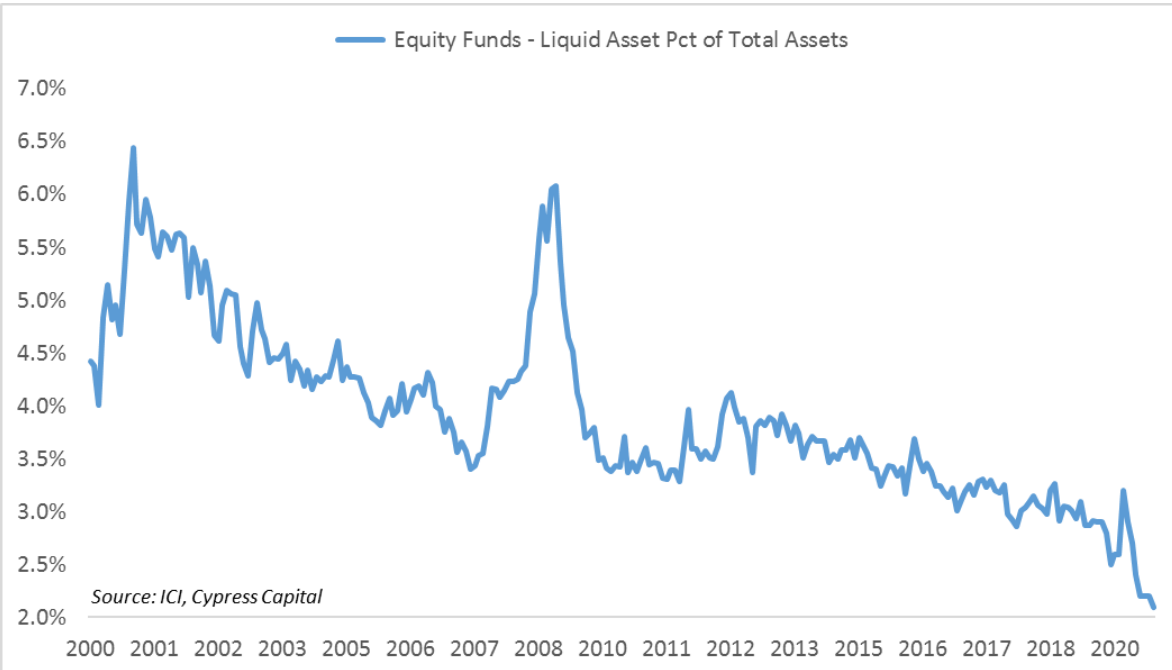
"I think the big takeaway is, fundamentals do not apply to retail traders...It's all about sentiment. The only reason why Tesla is worth what it is...is because people believe in that company."

- Noah Williams, a 36-year-old Atlanta resident, after earning close to $150,000 cash from GameStop options in the last two weeks.

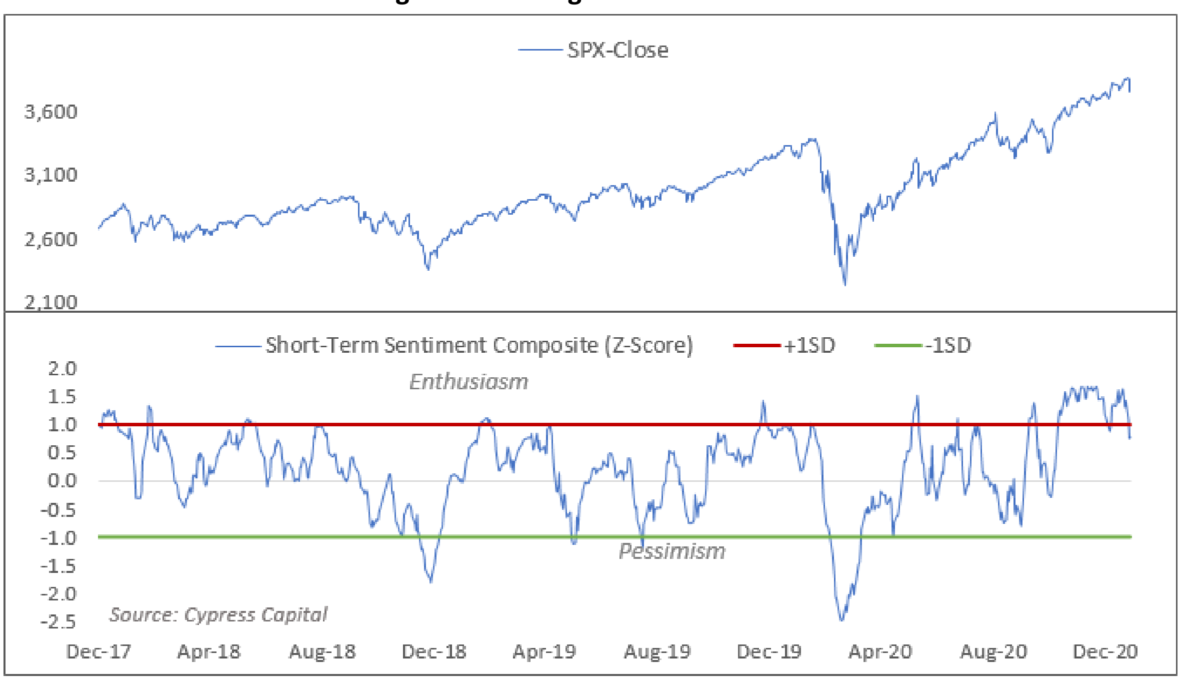
Source: Wall Street Journal

Charts of the Week

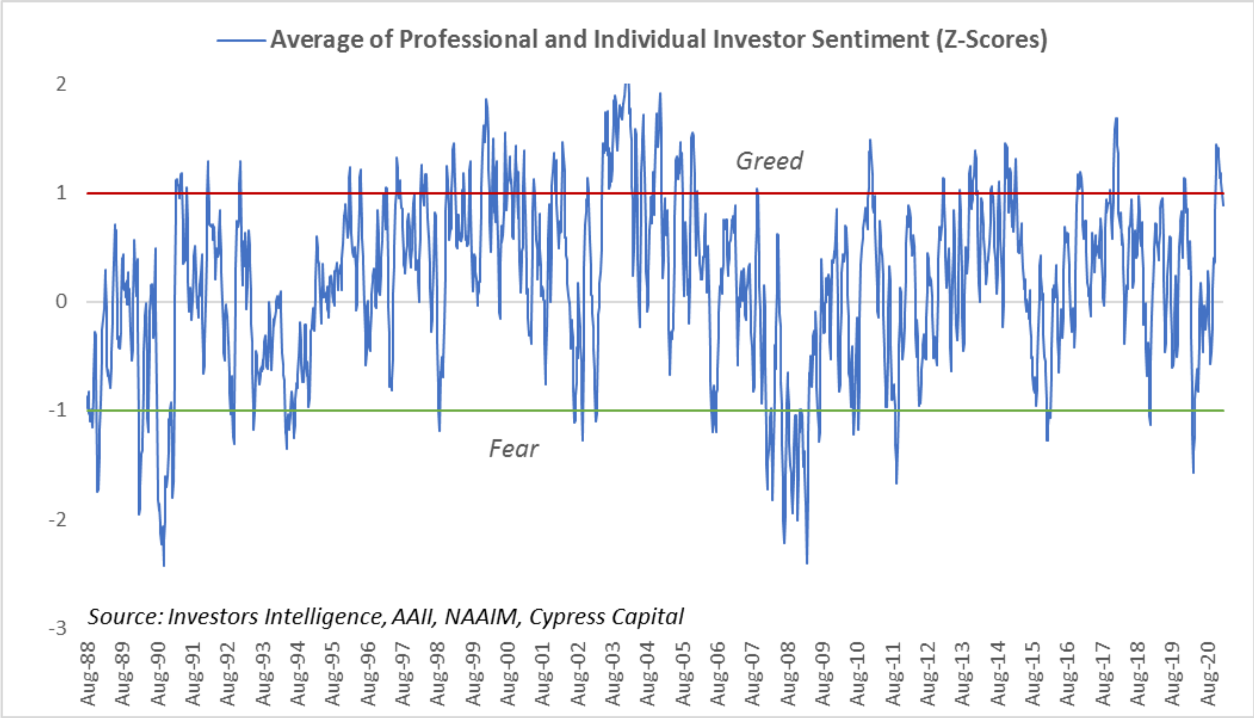
Mutual Fund Cash Levels set a new record low.



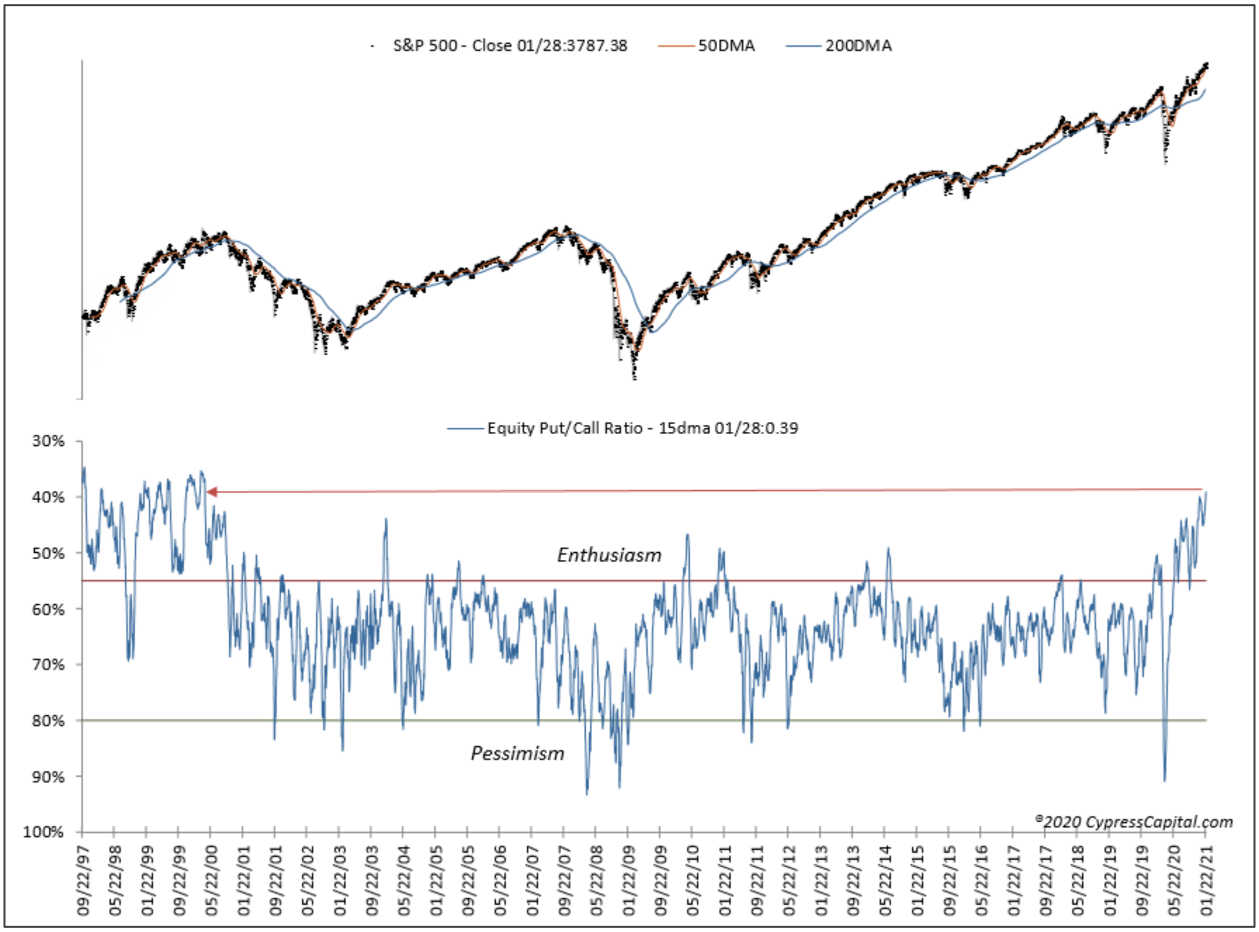
Short-Term sentiment showed signs of breaking this week.



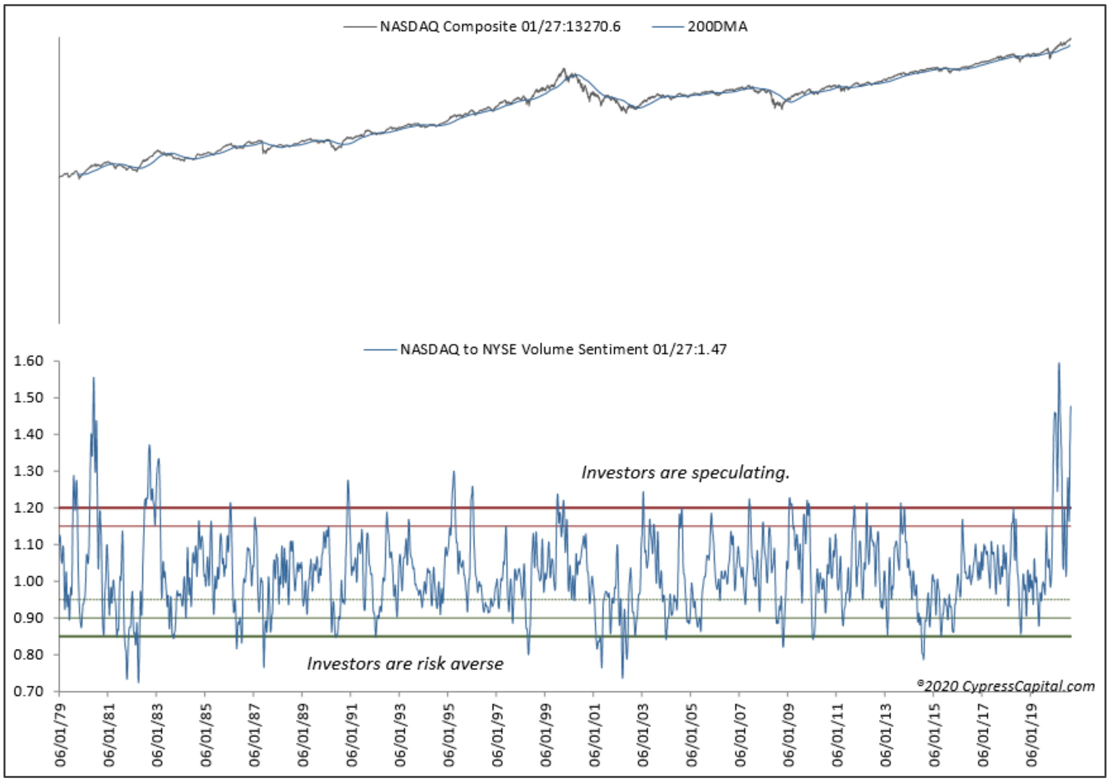
Surveys of Investment Professionals and Individuals have started to show a break in sentiment as well.



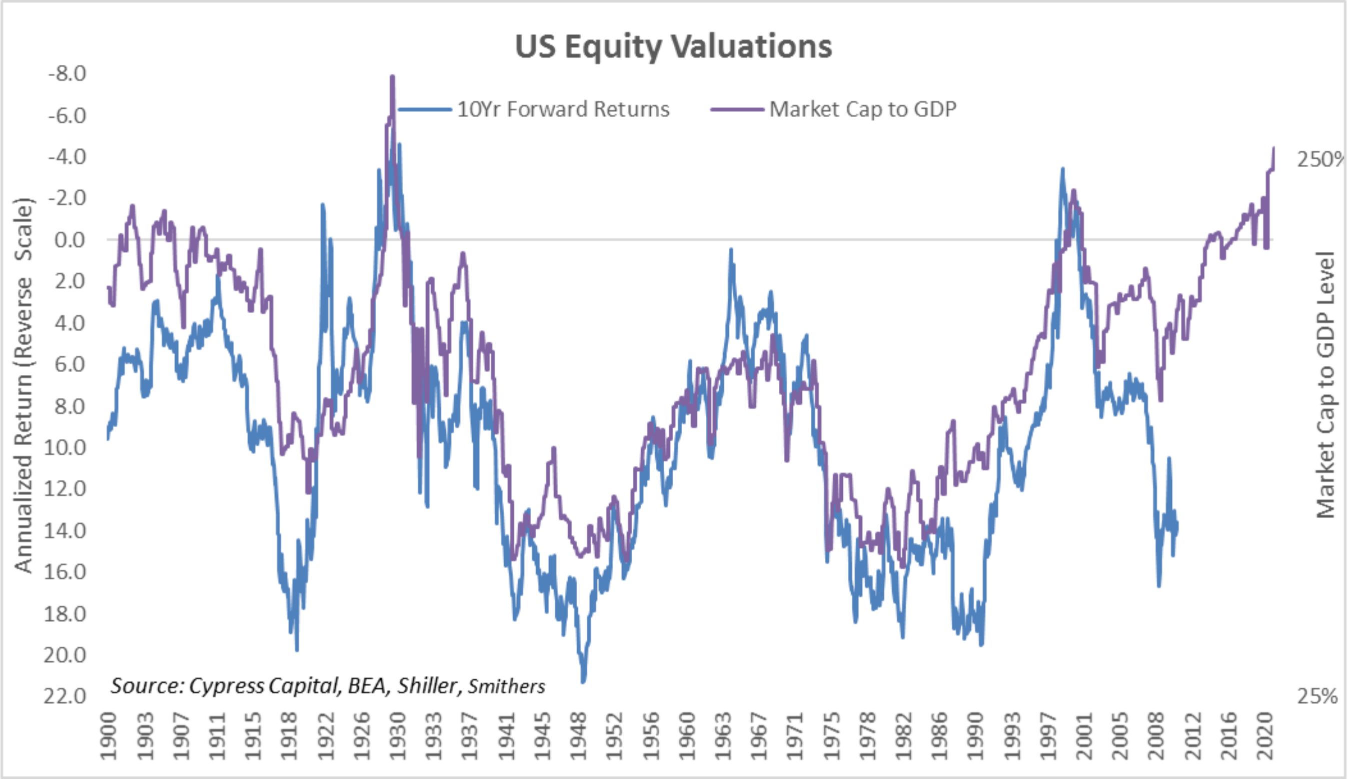
Equity Put/Call Ratio is at the lowest level since April 2000 and close to setting a new all-time record low.



NASDAQ to NYSE Volume edged even closer to a new all-time speculative high.

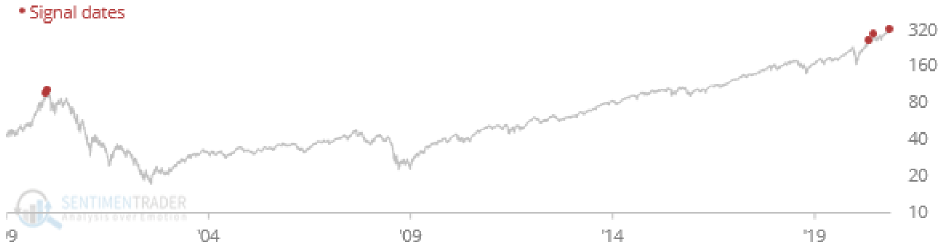


Market Cap to GDP has surpassed the 1999 period – next stop the levels from 1929.



Sharp intra-day price reversals in the NASDAQ are similar to 2000.

QQQ after 0.5% round-trip at 52-week high (2000-2020)

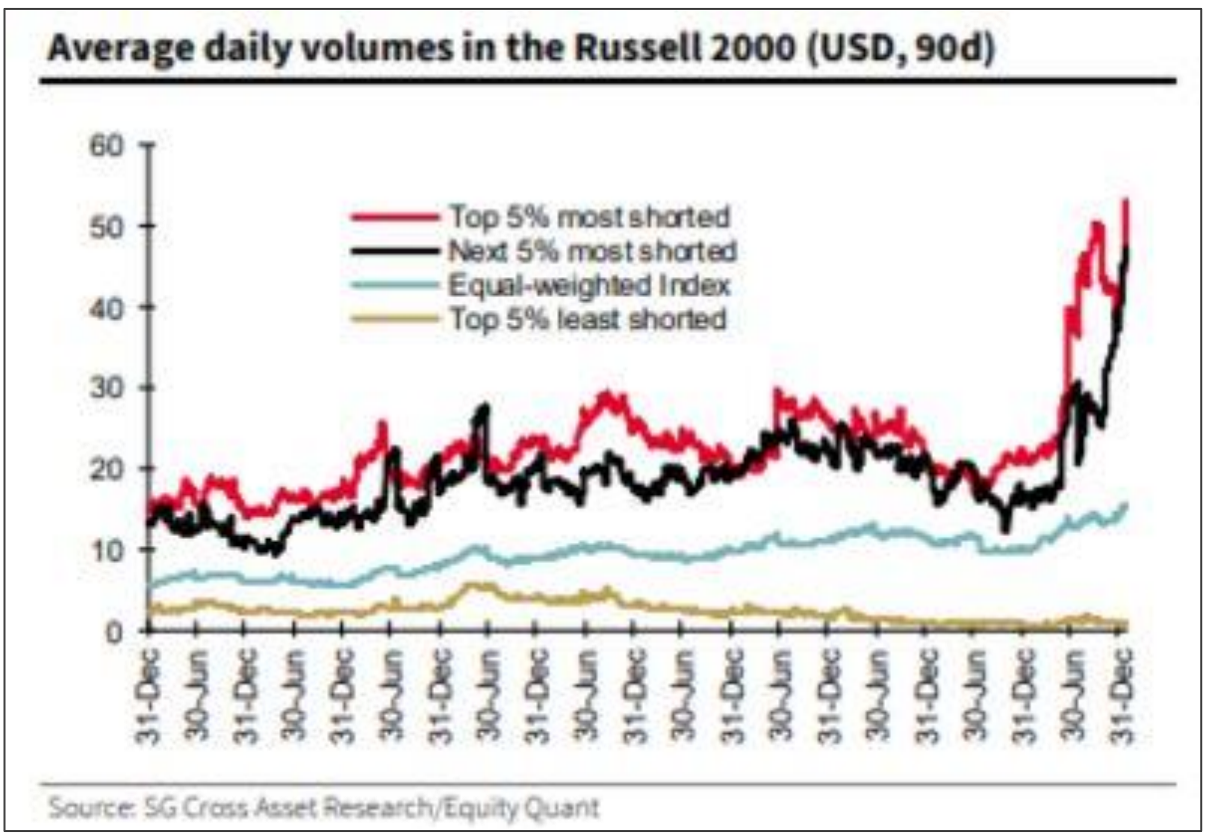


Signals (4)	1 Day	3 Days	1 Week	2 Weeks	1 Month	2 Months	3 Months
2000-03-06	-1.5	2.7	-0.4	-3.8	-8.9	-20.2	-16.2
2000-03-24	0.2	-6.4	-6.9	-9.3	-23.0	-32.4	-22.2
2020-07-09	0.7	-0.7	-1.2	-1.6	3.5	3.0	6.9
2020-09-02	-5.1	-10.8	-10.0	-10.7	-9.3	-10.7	0.5
2021-01-25							
Median	**-0.7**	**-3.6**	**-4.0**	**-6.6**	**-9.1**	**-15.5**	**-7.8**
% Positive	**50%**	**25%**	**0%**	**0%**	**25%**	**25%**	**50%**
Avg Risk	-0.8	-4.0	-5.1	-9.5	-10.8	-20.4	-22.9
Avg Reward	0.1	0.4	0.4	1.0	2.5	2.7	2.8
% Big Drop	50	50	50	75	75	75	75
% Big Rise	0	25	0	0	0	25	25
Z-Score	-0.6	-1.2	-1.8	-3.2	-1.9	-2.3	-1.6

© SENTIMENTRADER Numbers are % return after signal

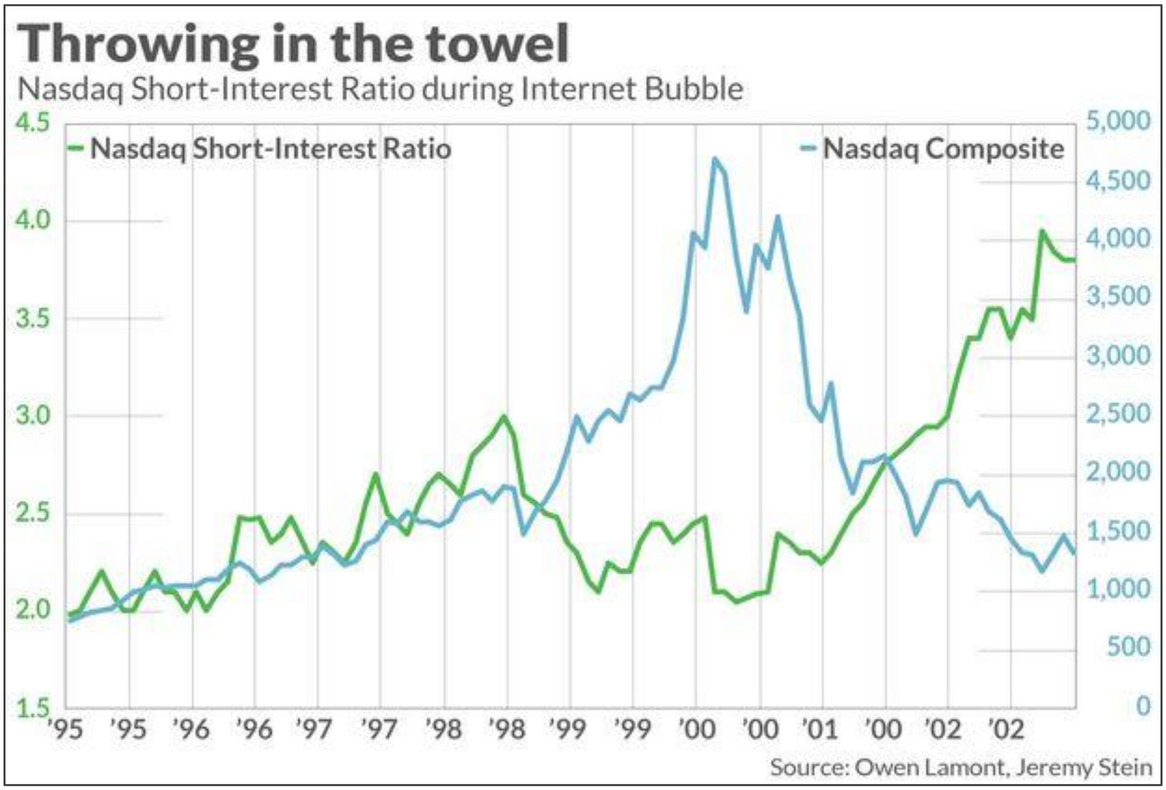
Source: SentimenTrader

The most shorted stocks are seeing the strongest rallies.



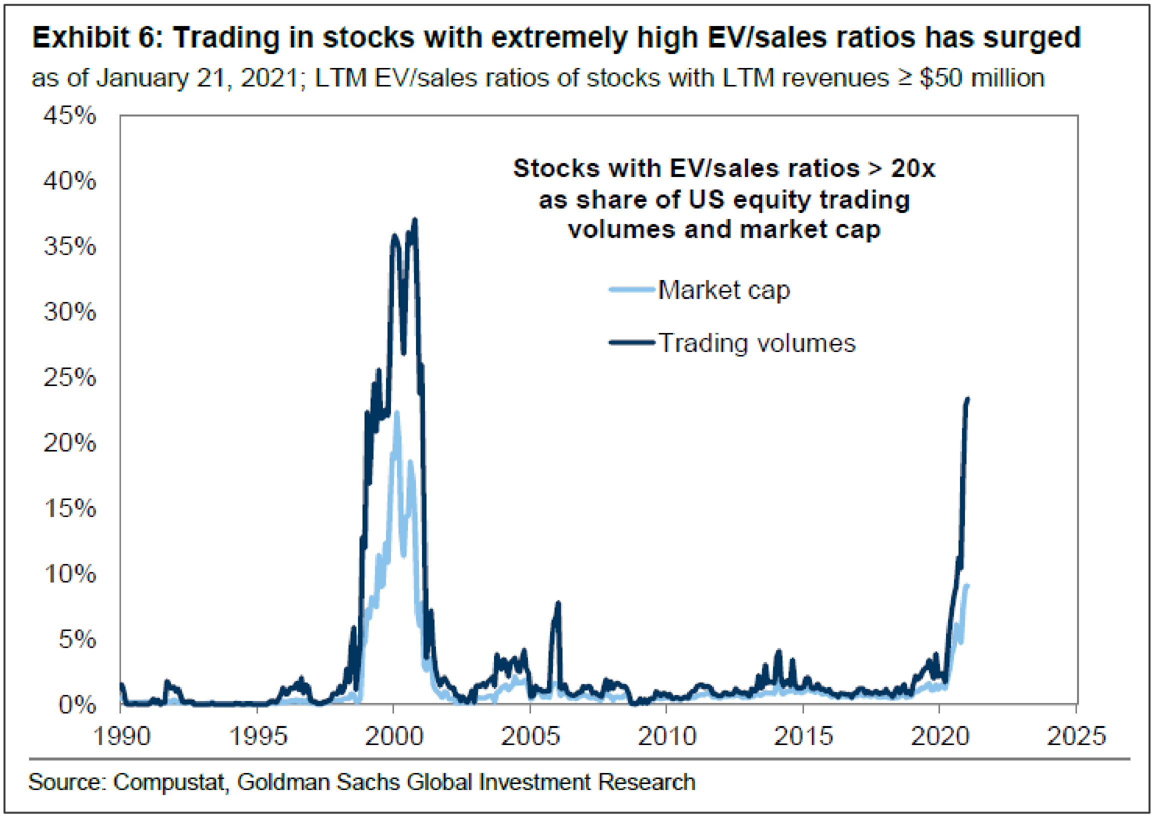
Source: Bloomberg

Shorts threw in the towel during the Internet Bubble too.



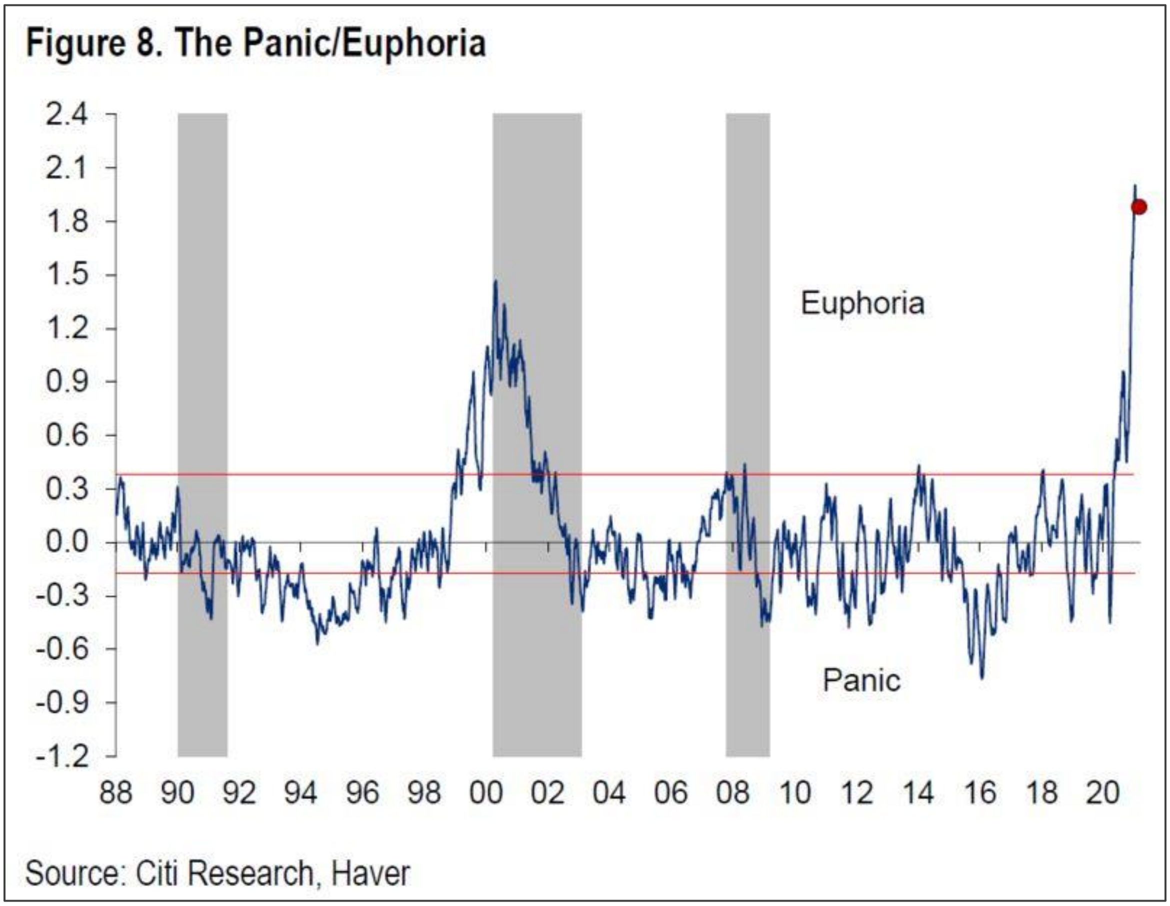
Source: MarketWatch

Swelling trading volumes and market caps of the most expensive stocks imply a frothy market.



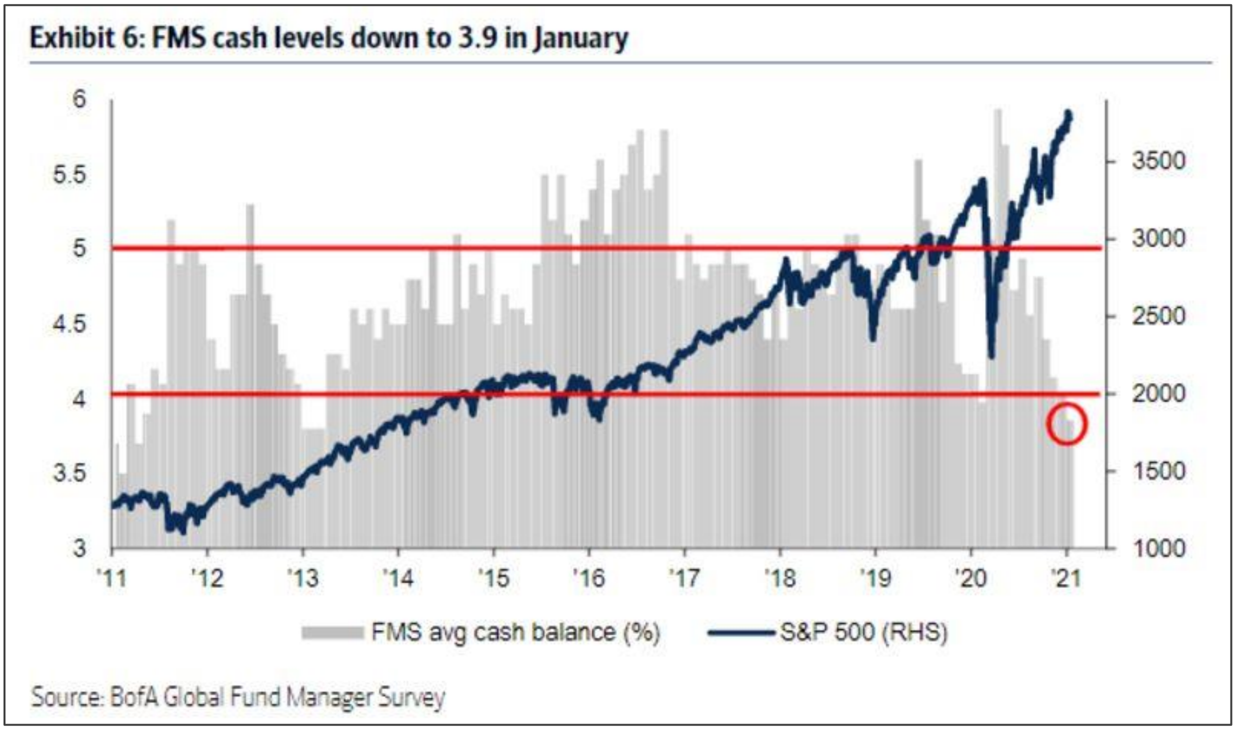
Source: Bloomberg

Citigroup's Panic/Euphoria Indicator



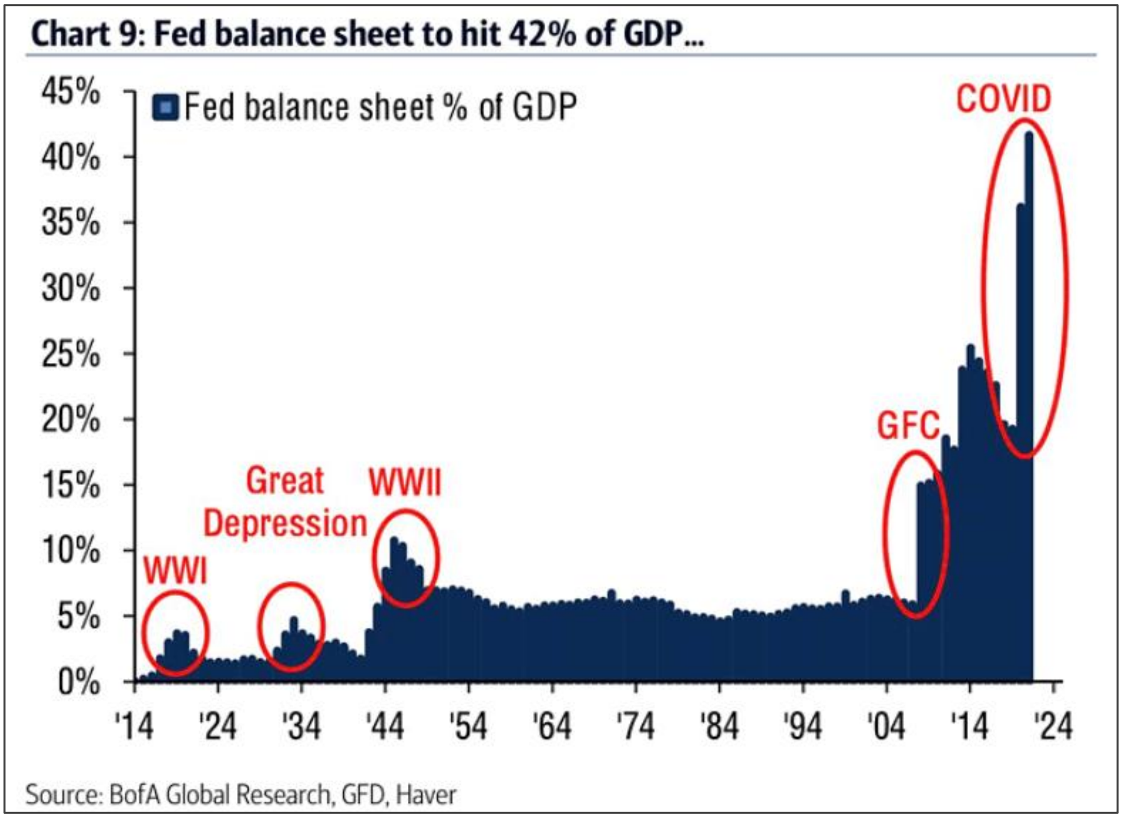
Source: Bloomberg

BofA's Fund Manager Survey shows cash levels below 4%, a sell signal for the indicator.



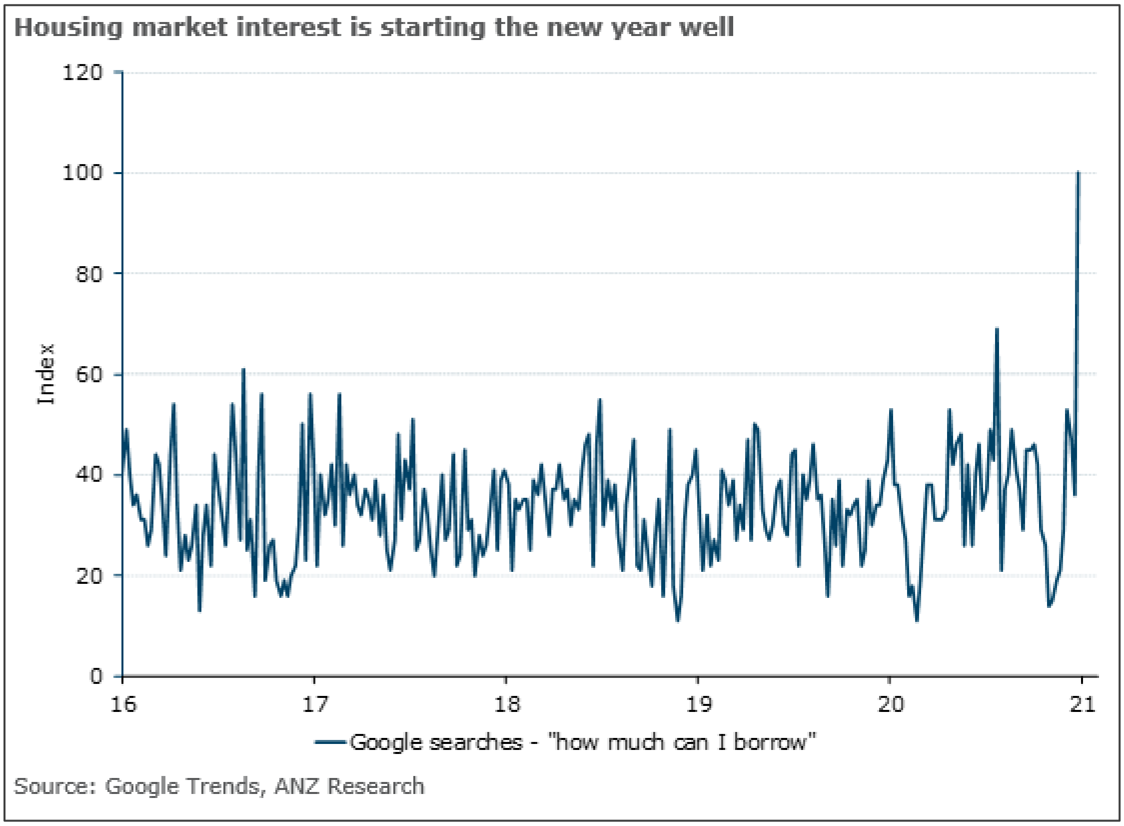
Source: Bloomberg

Where is the ceiling on the Fed's balance sheet?



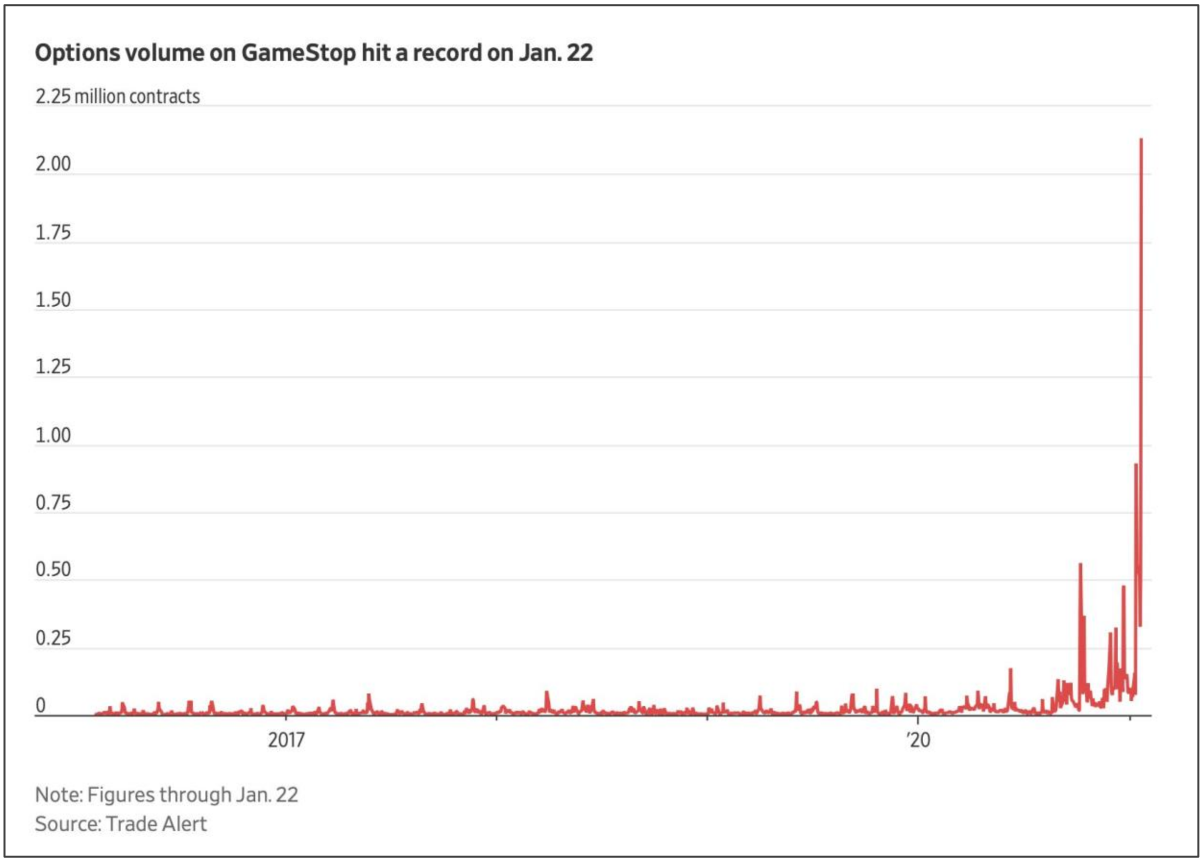
Source: Isabelnet

Households are eager to borrow money.



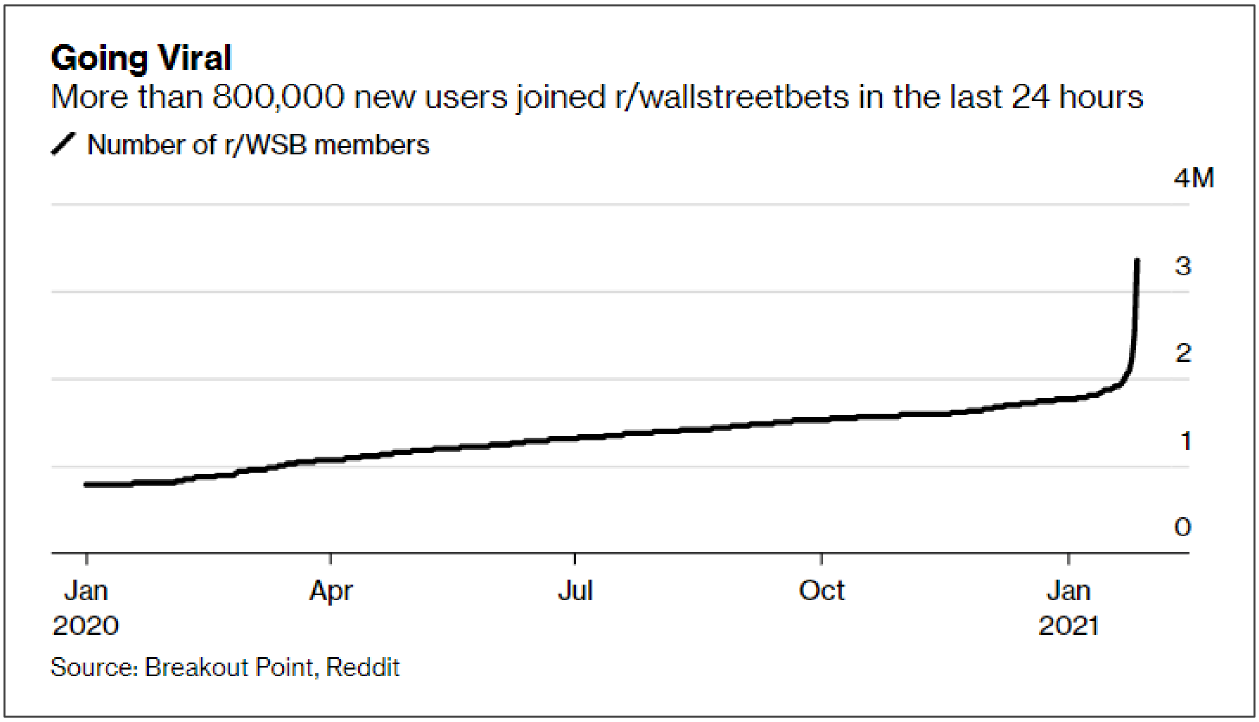
Source: ANZ Research, David Scutt

GameStop Options volume. It's still in the bubbly, options driven feedback loop of higher prices. It will break.



Source: WSJ

After GameStop's week, everyone wants to see what's going on in Reddit's wallstreetbets channel.

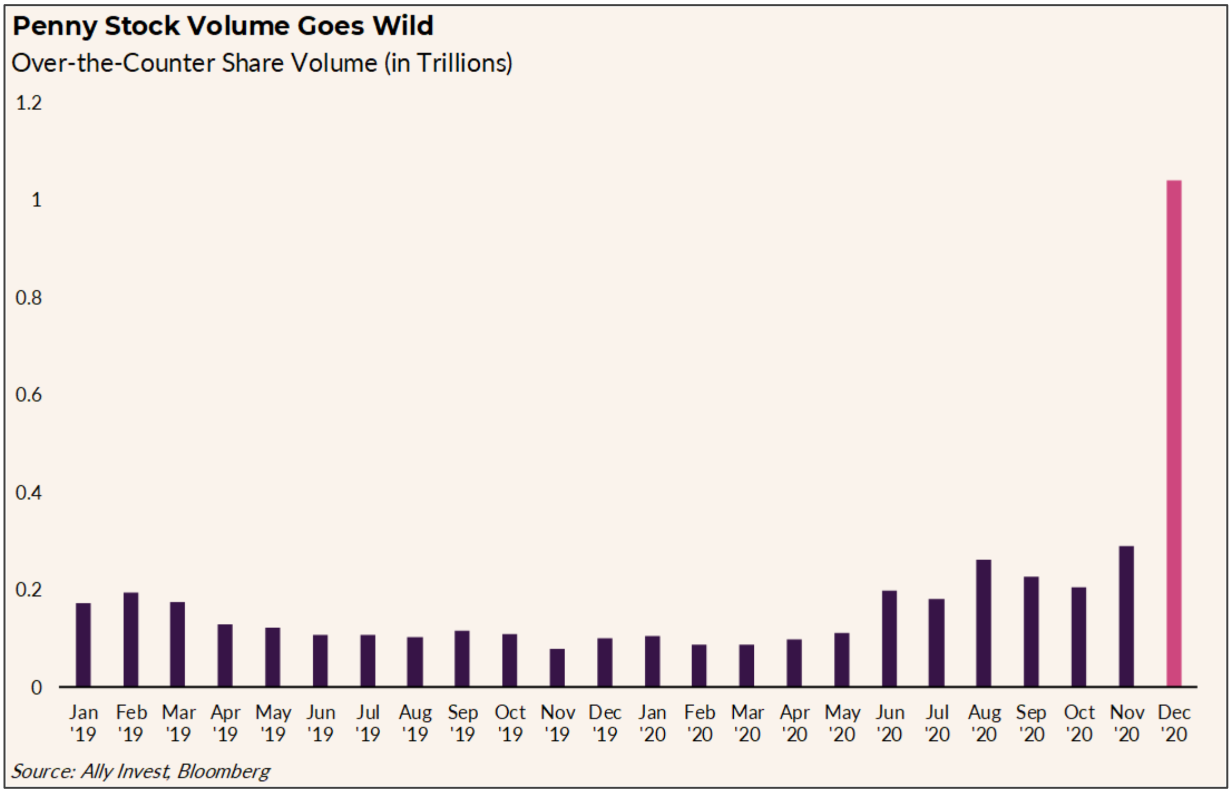


Source: Bloomberg, Christophe Barraud

Record inflows into global equities.

Source: ZeroHedge

Penny Stock Volume is booming.



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.