



Market Outlook

By Mark T Dodson, CFA

High Vol, Low Fear, and a Steeper Yield Curve

Market Risk Index climbed to 95.9%. The ongoing market correction has relieved the market’s overbought condition, but there has been little relief in short-term indications of investor sentiment outside of a sharp rise in volatility indices.

The Monetary Composite risk score increased, as the interest rates category became one of the top three detractors from the composite. While the interest rate levels are low, it’s the rate of change in rates that is putting stress on the monetary basket.

The yield curve crossed the minimum threshold for what we consider a more normally sloped curve. It will improve monetary conditions, but there is a lag built into our scoring. This one may be the most bizarre of the Yield Curve re-steepening events in history, and it’s breaking records. Stock prices, valuations, and inflation pressures have never been this high for an event considered an early economic recovery signal.

Looking at previous examples, 2021 breaks both the 2001 record for valuation and the 2008 record for ISM Price Index. But, both of those periods were early in a bear market that would pull down stock market valuations and the rate of inflation before recovery would begin.

Previous Yield Curve Re-Steepenings

Date	S&P Pct off 3Yr High	Price to		In a Bear Market
		Peak Earnings	ISM Price	
2021-Feb	-1%	26.6	82.1	No
2008-Feb	-15%	16.2	75.5	Yes
2001-Apr	-18%	21.6	48	Yes
1991-Jan	-10%	13.1	51.6	No
1982-Jul	-24%	7.1	40.8	Yes
1981-Nov	-13%	7.9	58.4	Yes
1980-May	-6%	7.0	70.8	No
1975-Jun	-23%	10.0	44	No
1971-Feb	-11%	16.3	64.6	No
1958-Feb	-18%	11.1	46.5	No
1943-Jan	-22%	6.1		No
Median	-15%	11.1	55	

Source: Cypress Capital

Market Risk Index
Rec Allocation 25% Underweight

95.9%

Category Percentiles

Psychology - P6

99.8%

Monetary - M5

86.2%

Valuation - Extremely Overvalued

99.7%

Trend

0.3%

Largest Psychology Influences

Levered Investments	Negative
Option Activity	Negative
Surveys	Negative
Flow of Funds	Negative

Largest Monetary Influences

Velocity	Negative
Interest Rates	Negative
Inflation	Negative

Valuation

7-10 Year Rtn Forecast	0.3%
10Yr Treas Yield (on 02/24)	1.4%

Market Trends

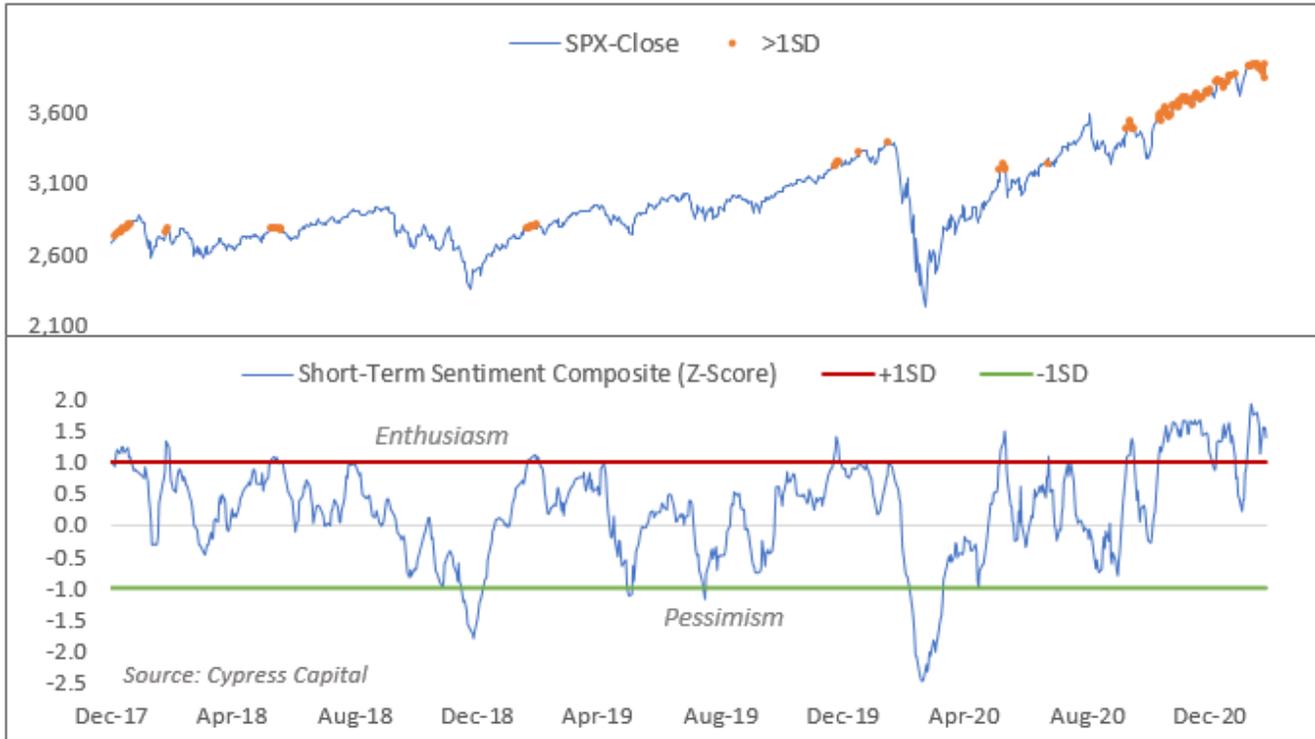
US Equities	Bullish Investment
Intl Equities	Bullish Trade
REITs	Bullish Trade
Broad Commodities	Bullish Trade

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.

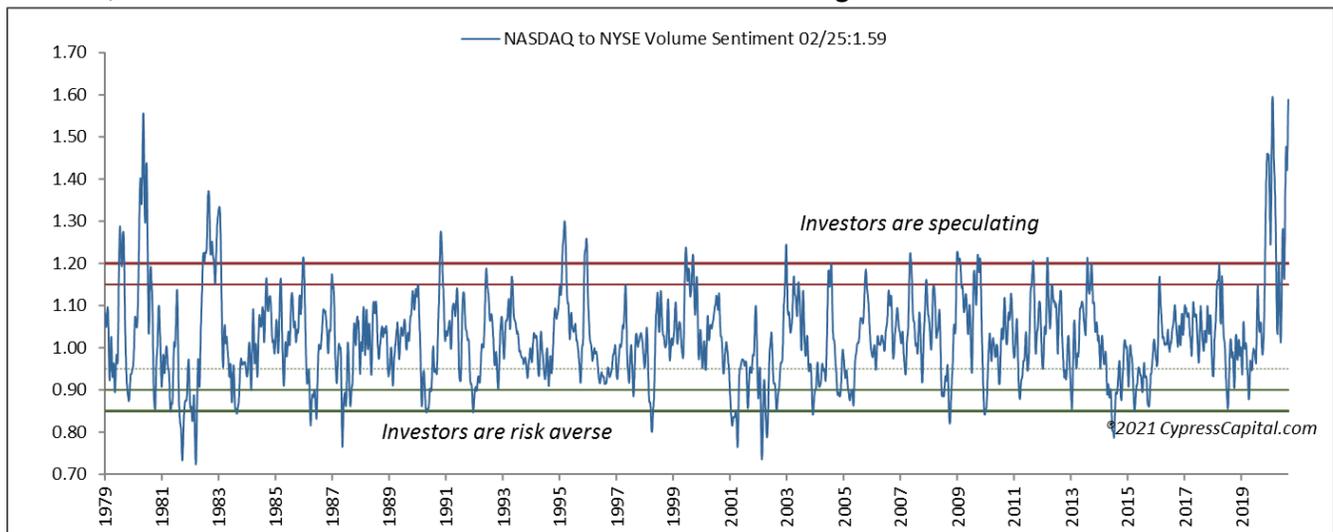
Charts of the Week

Short-Term Sentiment Composite

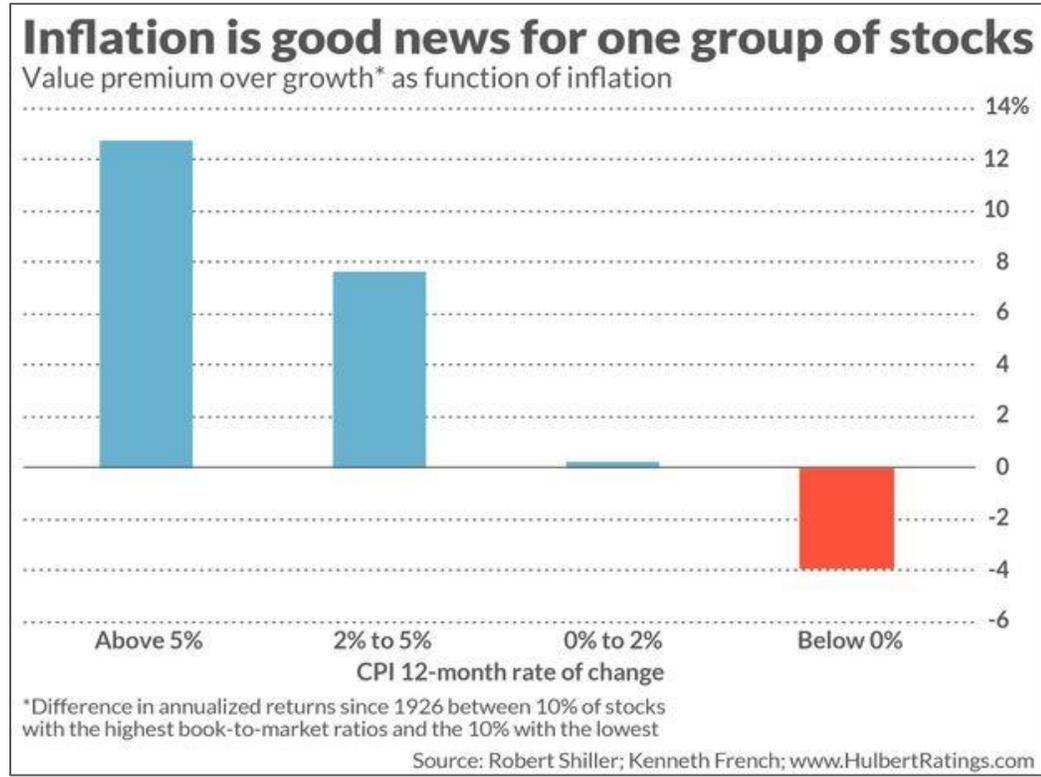
This basket of short-term, timely indications of investor sentiment did not budge from enthusiasm.



NASDAQ to NYSE Volume Sentiment matched its record from last August.

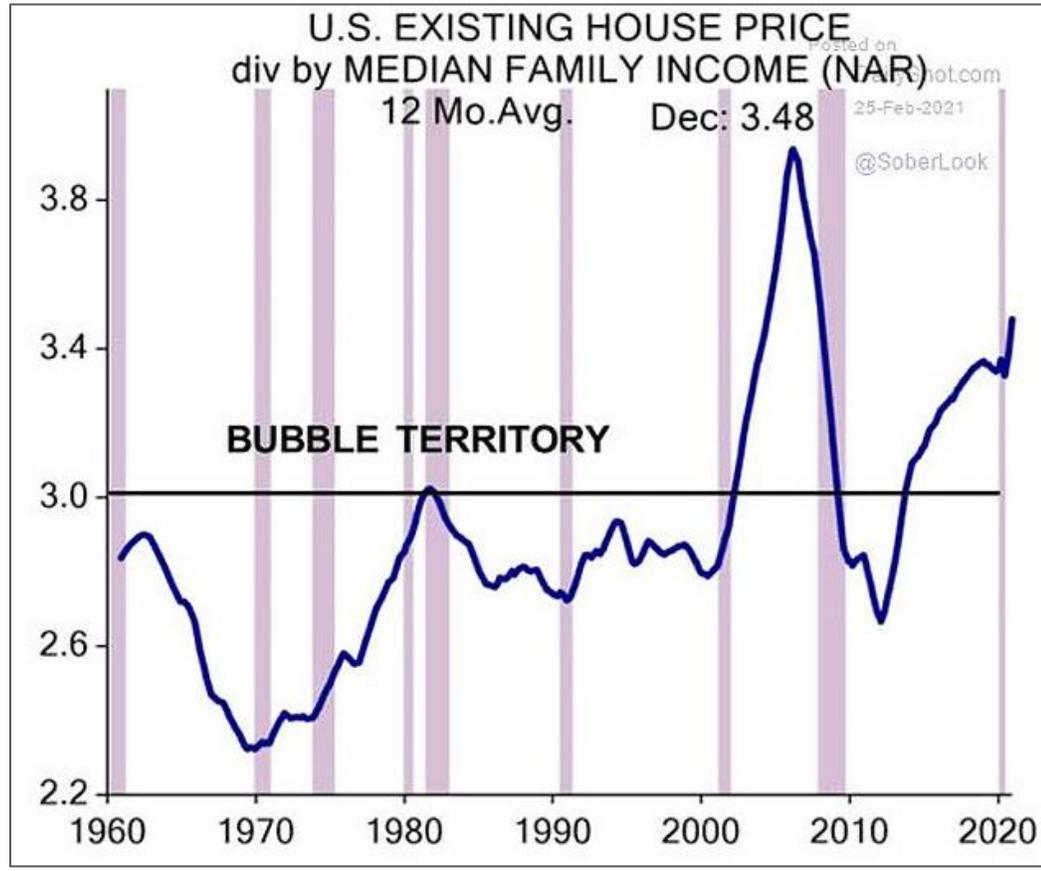


Inflation tends to be good for value stocks.



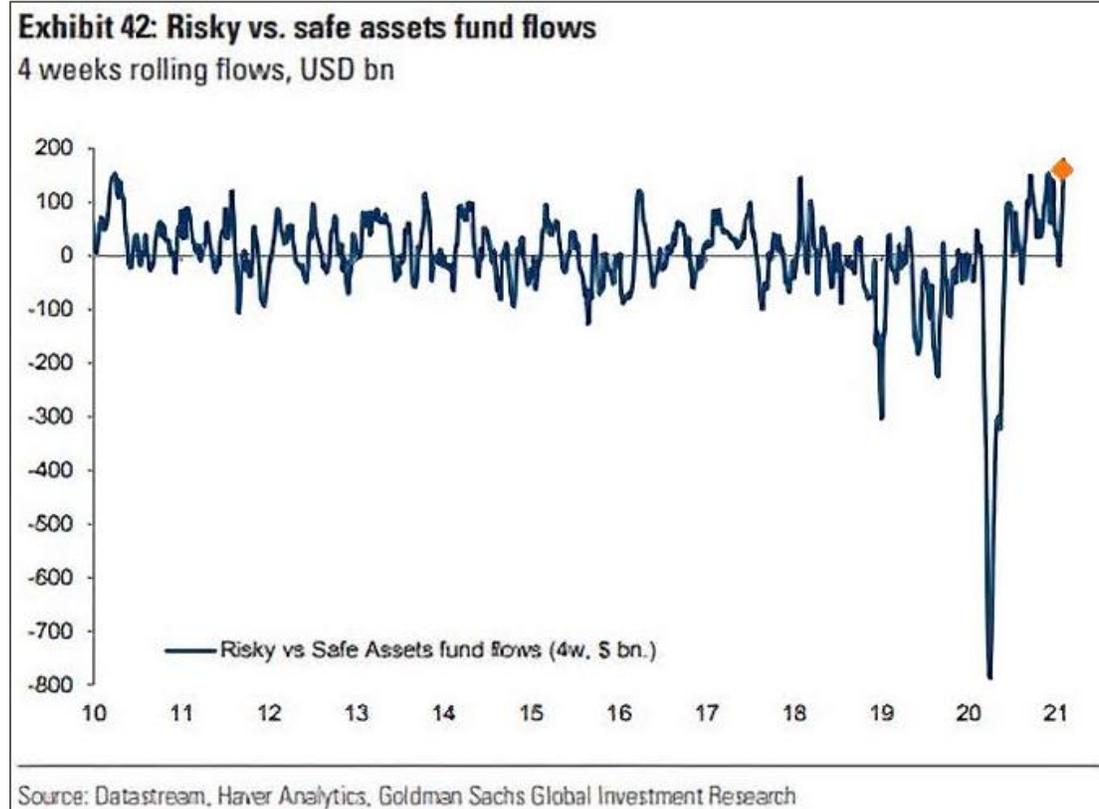
Source: Hulbert

Home Prices to Family Income are approaching the previous housing bubble record.



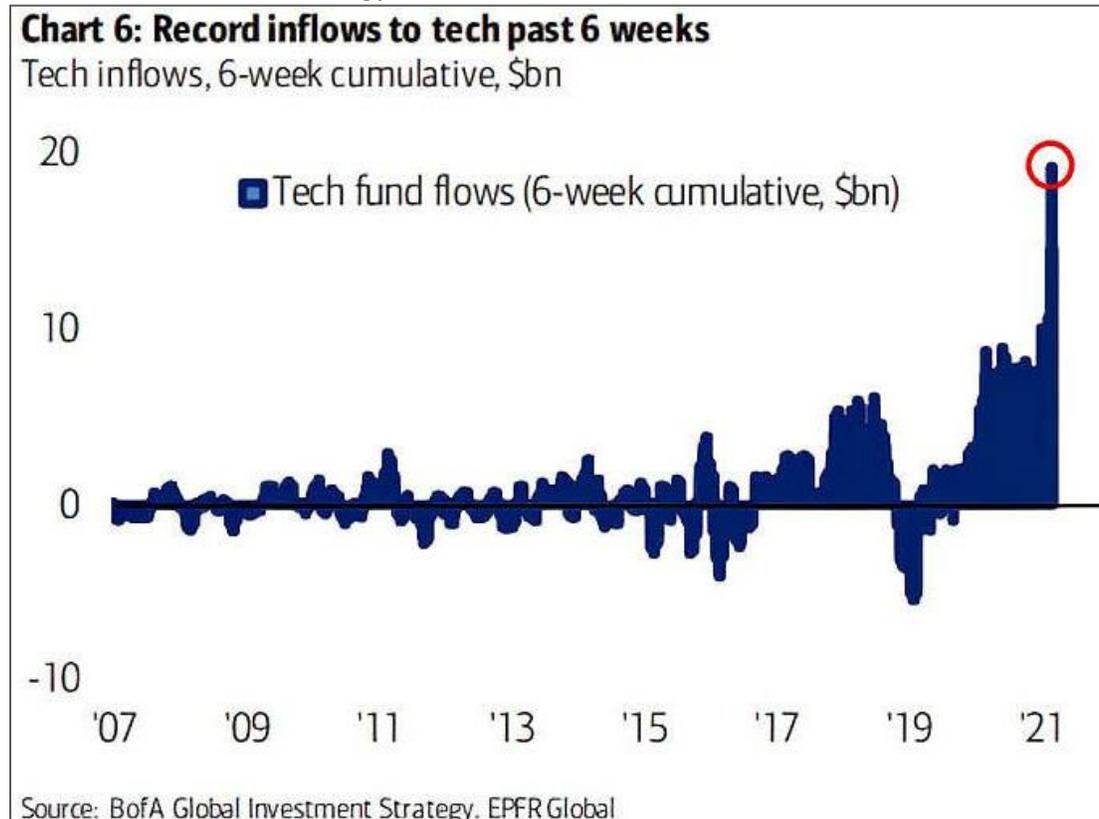
Source: TheDailyShot

Another record for Risky asset flows



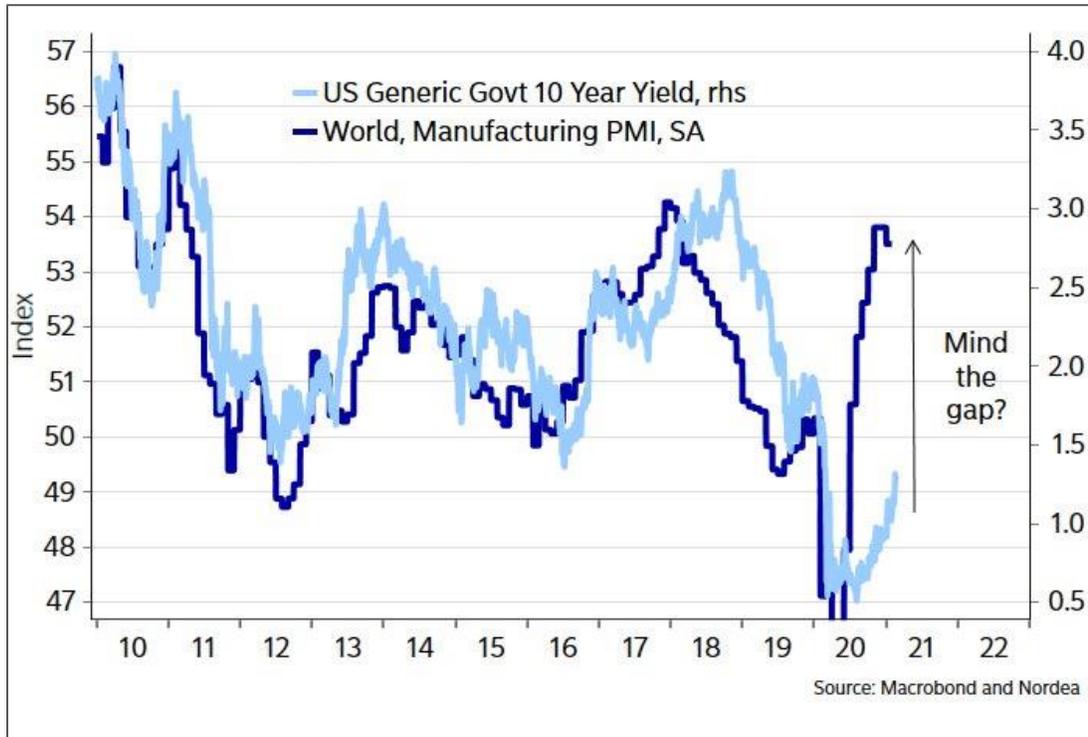
Source: Goldman Sachs, Isabelnet

Record inflows into Technology stocks

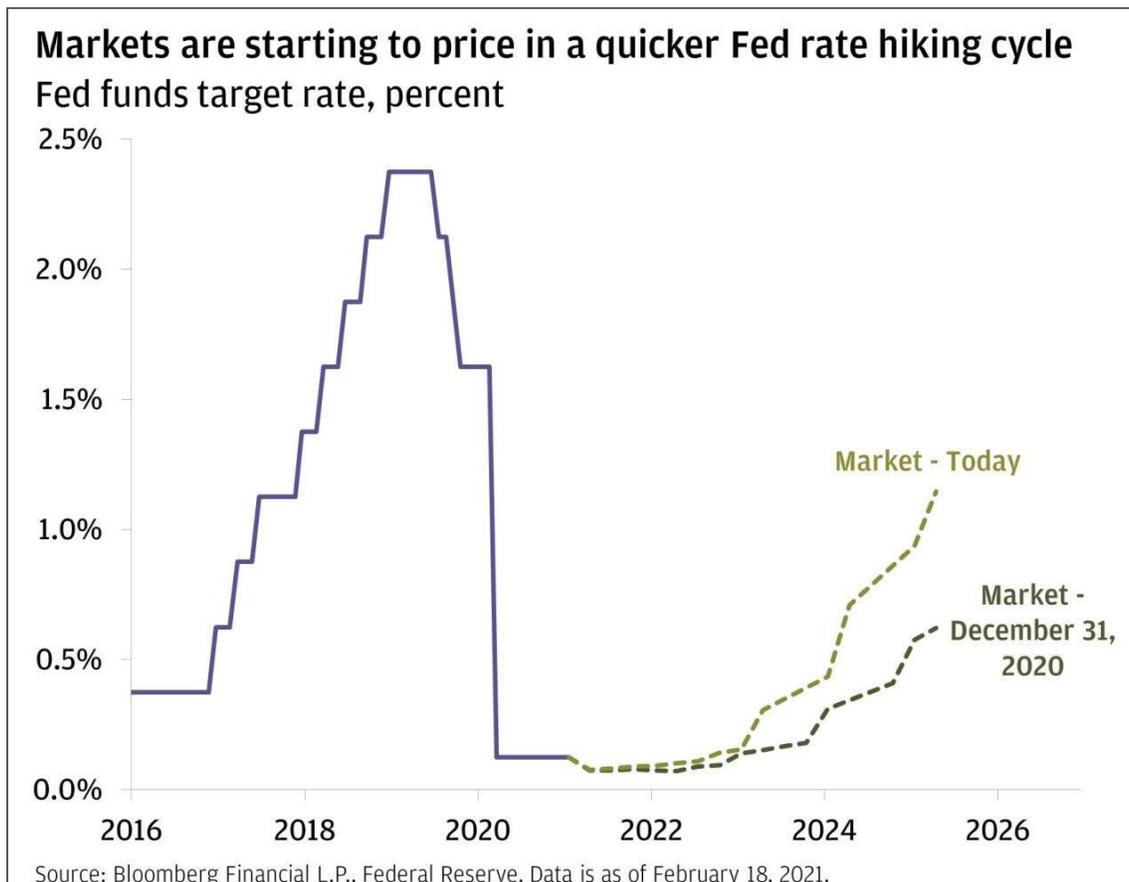


Source: BofA, Isabelnet

Manufacturing strength suggests higher yields from here.

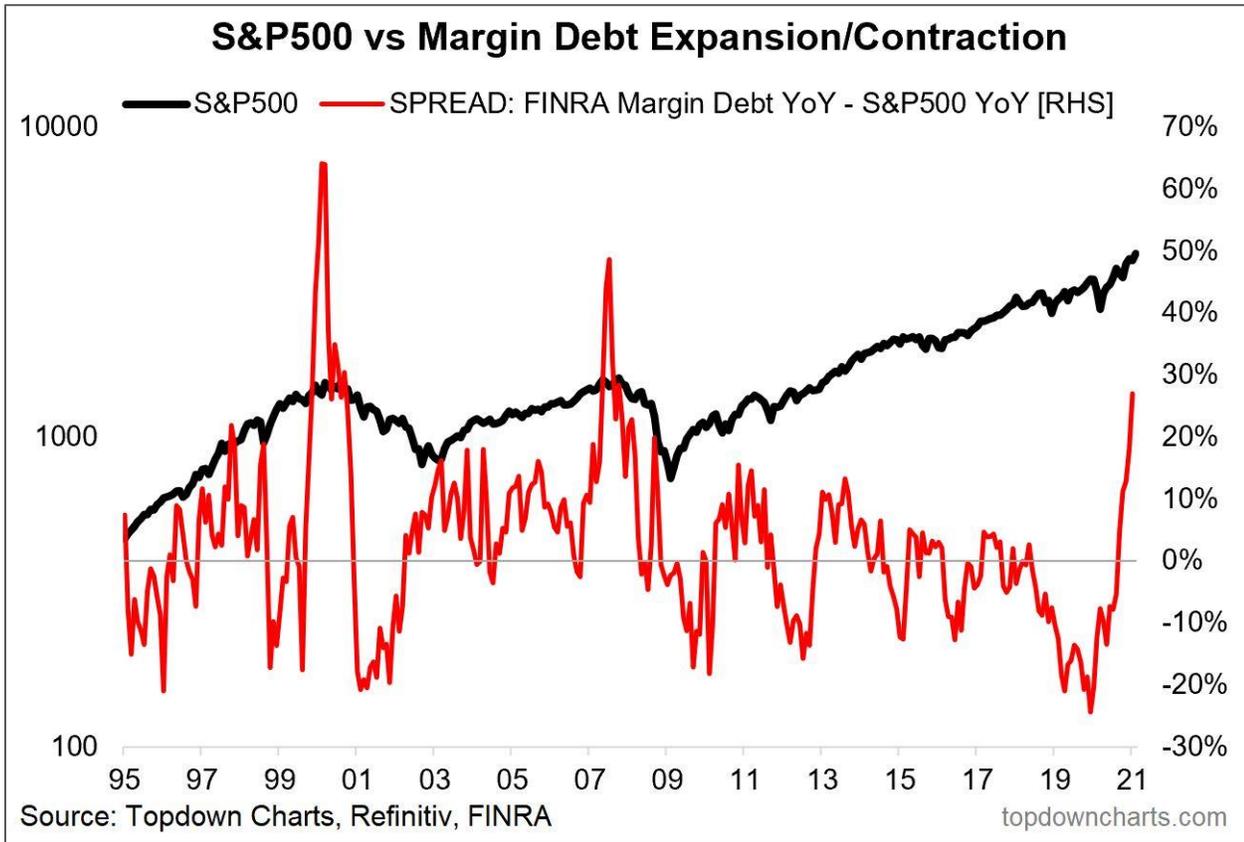


Markets are starting to price in Fed hikes sooner.



Source: Jeroen Blokland

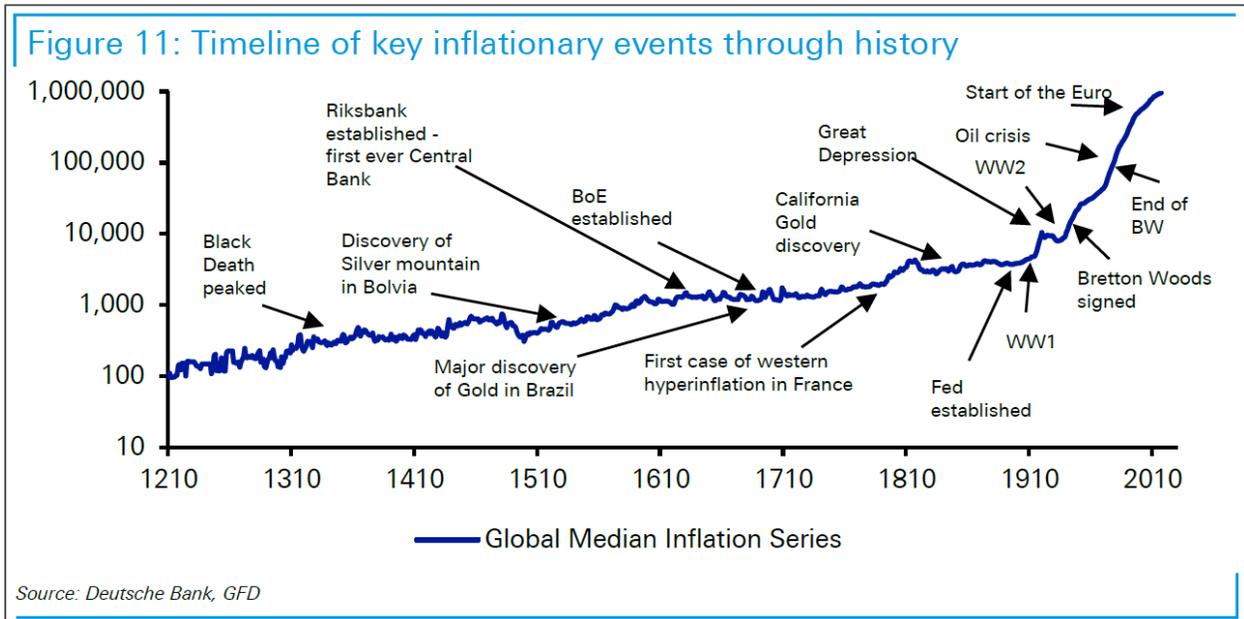
The largest relative increase in Margin Debt since late 2007.



Source: Topdown Charts

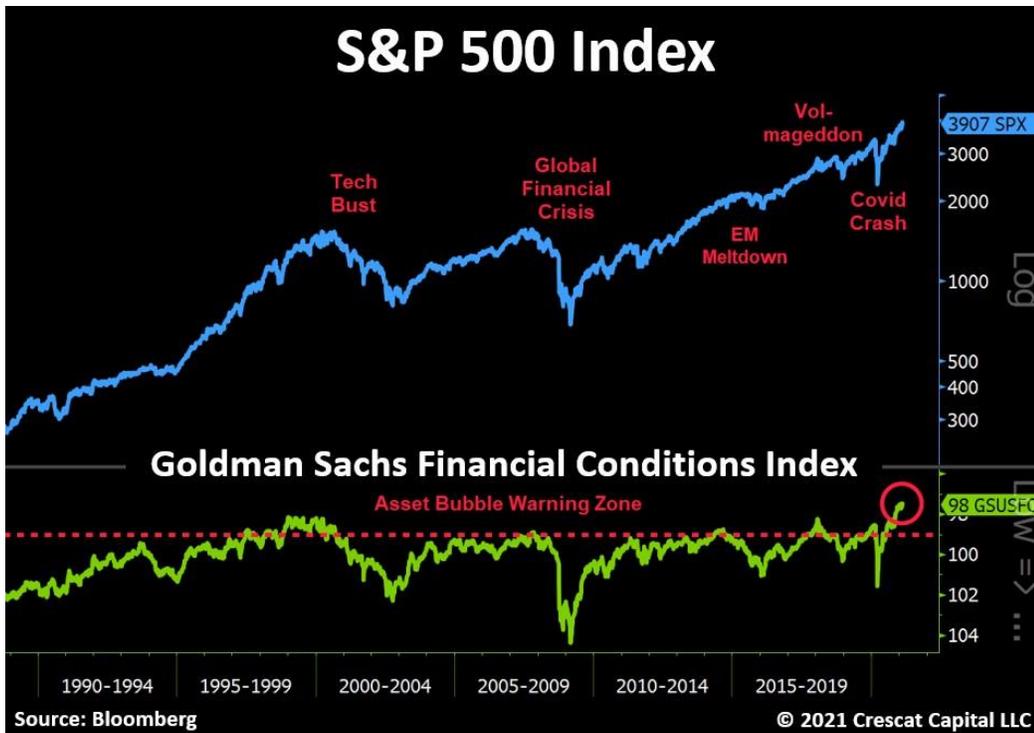
800 Years of Inflation

Notice the event that changed the slope of this line.



Source: Bloomberg, John Authers

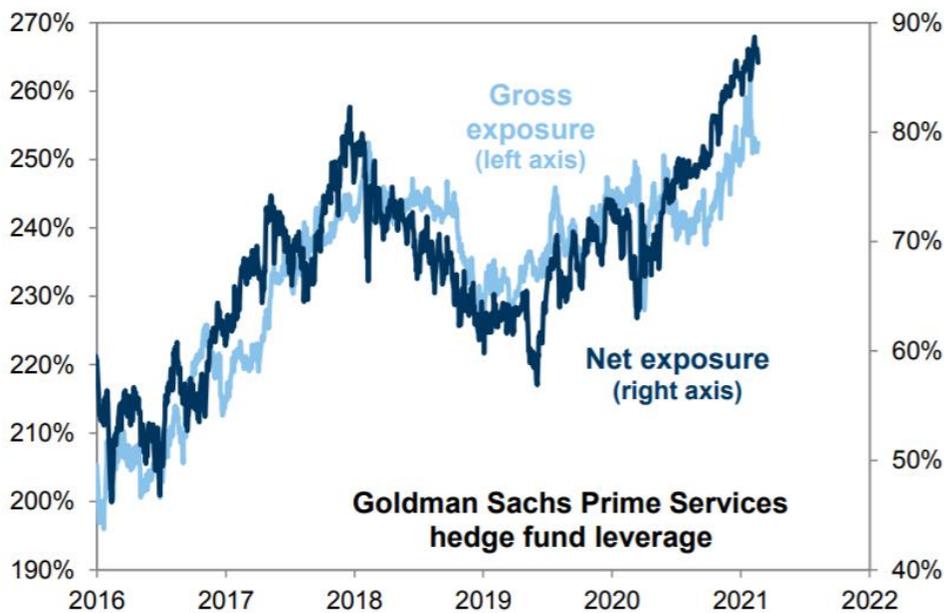
Goldman's Financial Conditions Index is overheating.



New highs in Hedge fund Gross Exposure

Exhibit 4: Hedge fund gross and net leverage

Aggregated data from Goldman Sachs Prime Services as of 18-Feb-21; should not be relied upon as a comprehensive view of the market

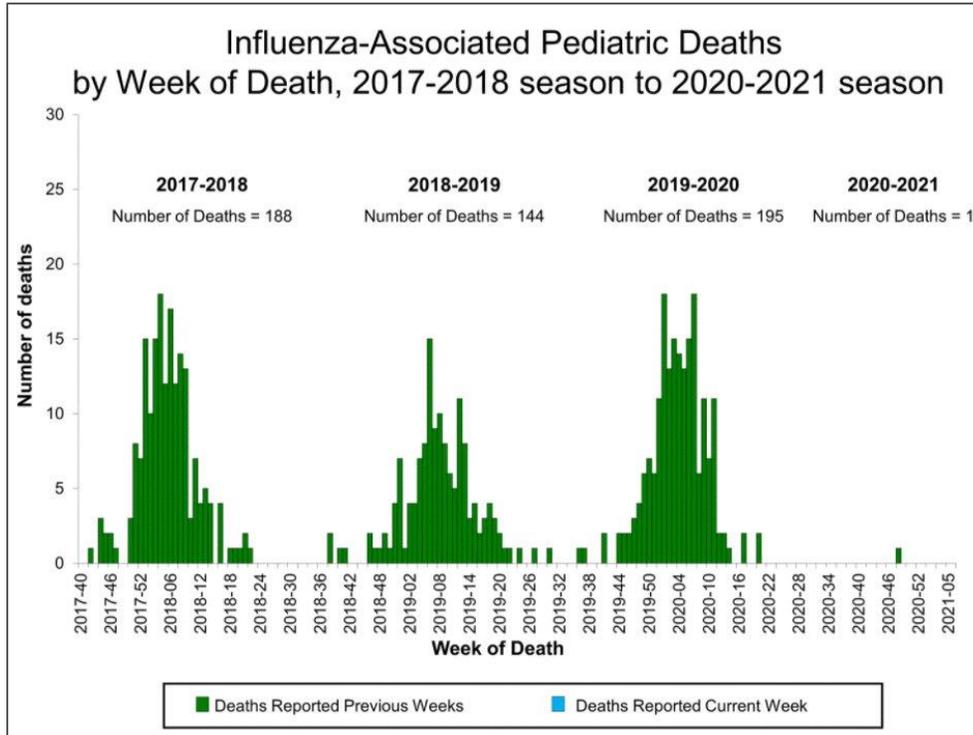


Source: Goldman Sachs Prime Services, Goldman Sachs Global Investment Research

Source: Goldman Sachs, Teddy Vallee

The silver lining of the pandemic – we killed the flu.

“In the 2019-20 season, there were 195 childhood deaths from the seasonal flu, one of the worst years on record. This year so far there has been one.” - Charlie Bilello

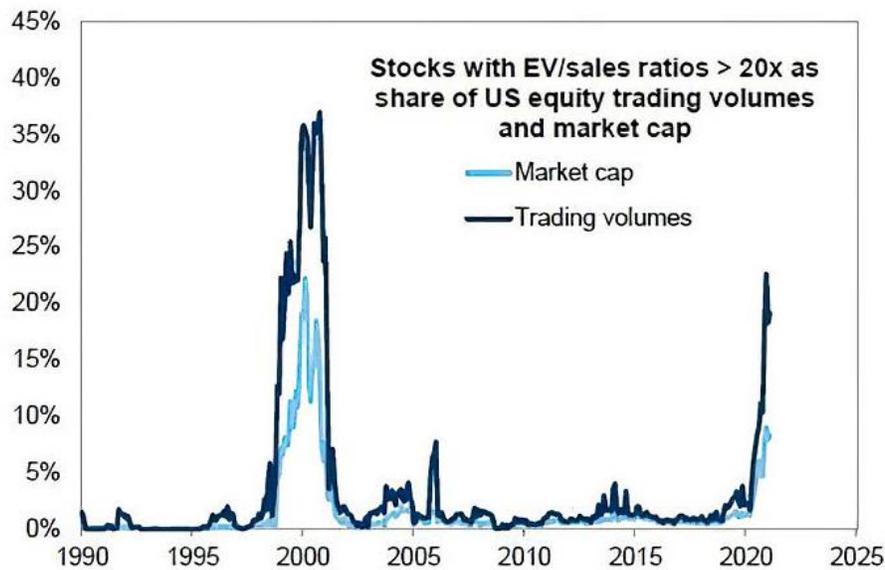


Source: CDC, Charlie Bilello

Speculation in high-valuation stocks is an echo of the 2000 era.

Exhibit 17: Market cap and trading activity in extremely high-valuation stocks

LTM EV/sales ratios of stocks with LTM revenues > \$50 million



Source: Compustat, Goldman Sachs Global Investment Research

Source: Goldman Sachs, Isabelnet

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. A portfolio built upon Cypress Capital's metrics that measure dividend quality and safety. The portfolio is divided 75/25 into payers and growers. Payers are stocks having above-average yields with 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 of 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 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. The 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.

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