Market Outlook

By Mark T Dodson, CFA

Party On, Retail

Market Risk Index climbed to 96.3%, another small increase that marks 13 consecutive weeks of uninterrupted increases. The monetary composite and valuations drove MRI higher this week.

For the monetary composite, the rate of change of the falling dollar joined the status of the inflation and interest rate categories to help push up the Monetary risk score. The bond market's inflation expectations climbed to the highest levels since 2008, so it seems that we have finally found the quantity of money required to throw at the economy to get inflation expectations to break higher. The trends and mix of readings within the monetary composite continue to favor value stocks.

The psychology composite hasn't moved, but there were signs of shifts in sentiment, although most were offsetting. Retail investor enthusiasm waxed, while investment professional bullishness waned. Volume into levered ETFs relative to inverse ETFs dropped, while the level of assets chasing levered small and mid-cap ETFs rocketed higher. Overall, there's been no break in animal spirits for months. With stimulus checks in the mail, it's difficult to envision anything other than more speculation in the short-term from retail investors. Retail trading market impact has burgeoned in the last 15 months to become as influential as hedge funds and mutual funds.

The strong wall of breadth readings that we saw at the beginning of 2021 has begun to show cracks, not ominous but noteworthy. As a result of the monster surge in value stocks over growth stocks, a large number of individual issues are beginning to register new highs and new lows at the same time. Consequently, the NASDAQ's High Low Logic Index shot up to the highest level since before the pandemic began and will move even higher when we update it over the weekend. Notably, neither the NASDAQ nor the broad Advance-Decline line joined the S&P 500 in making a new high this week. None of it is yet a red flag – only a pale shade of yellow.

In the meantime, enjoy the party without overindulging. Valuations matter – slowly, and then all at once. There is no level of chicanery and animal spirit inducing voodoo that can break the iron laws of valuation. Right now, they don't seem to matter, until they do.

Market Risk Index

Rec Allocation 25% Underweight

96.3%

Category Percentiles

Psychology - P6: 99.7%

Monetary - M5: 88.2%

Valuation - Extremely Overvalued: 99.6%

Trend: 0.7%

Largest Psychology Influences

Levered Investments	Negative
Volatility	Negative
Option Activity	Negative
Fund Flows	Negative

Largest Monetary Influences

Velocity	Negative
Interest Rates	Negative
Inflation	Negative

Valuation

7-10 Year Rtn Forecast	0.3%
10Yr Treas Yield (on 03/09)	1.6%

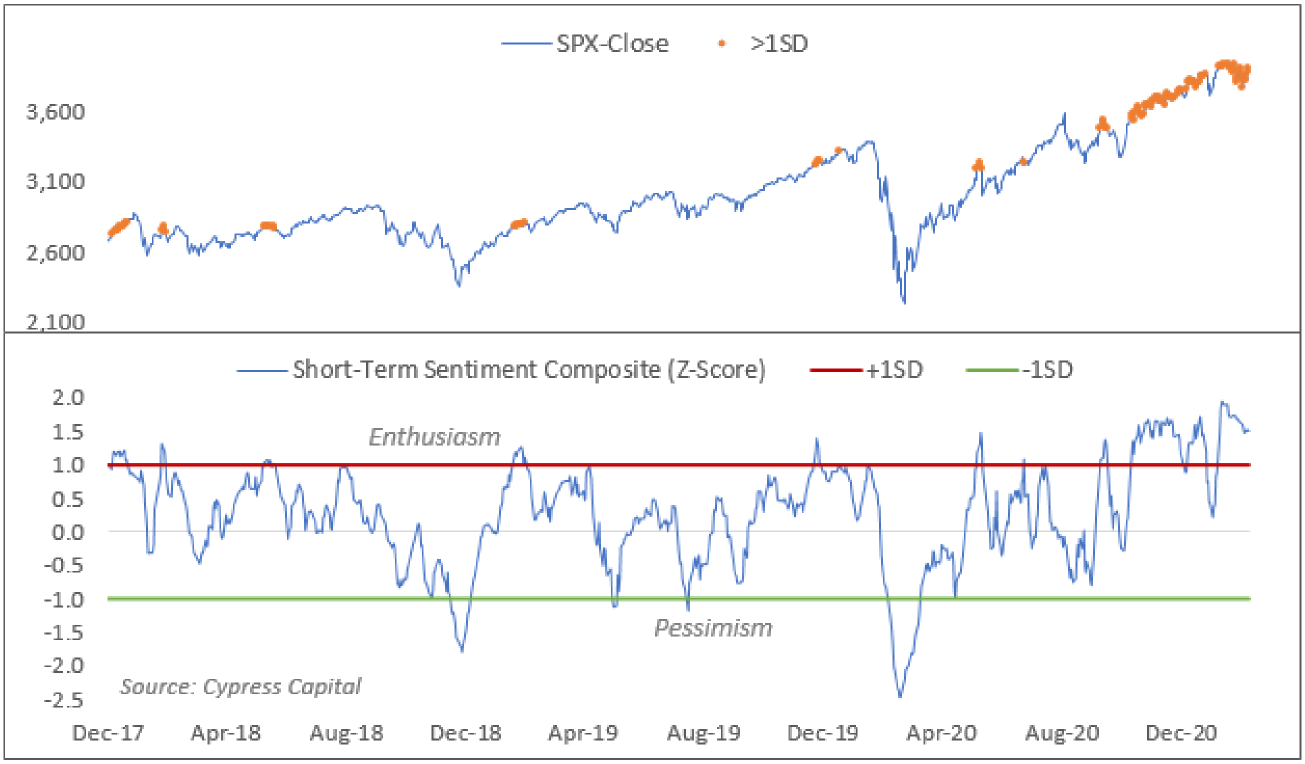
Market Trends

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

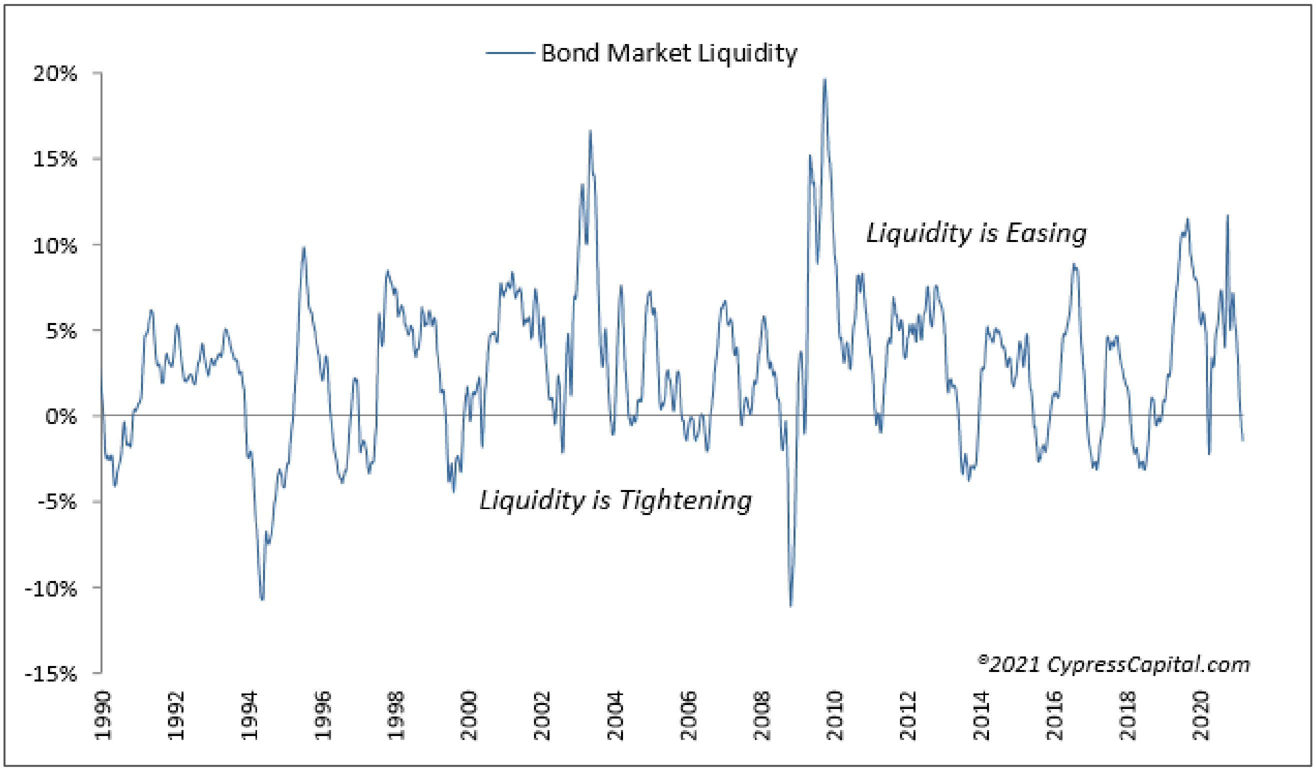
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

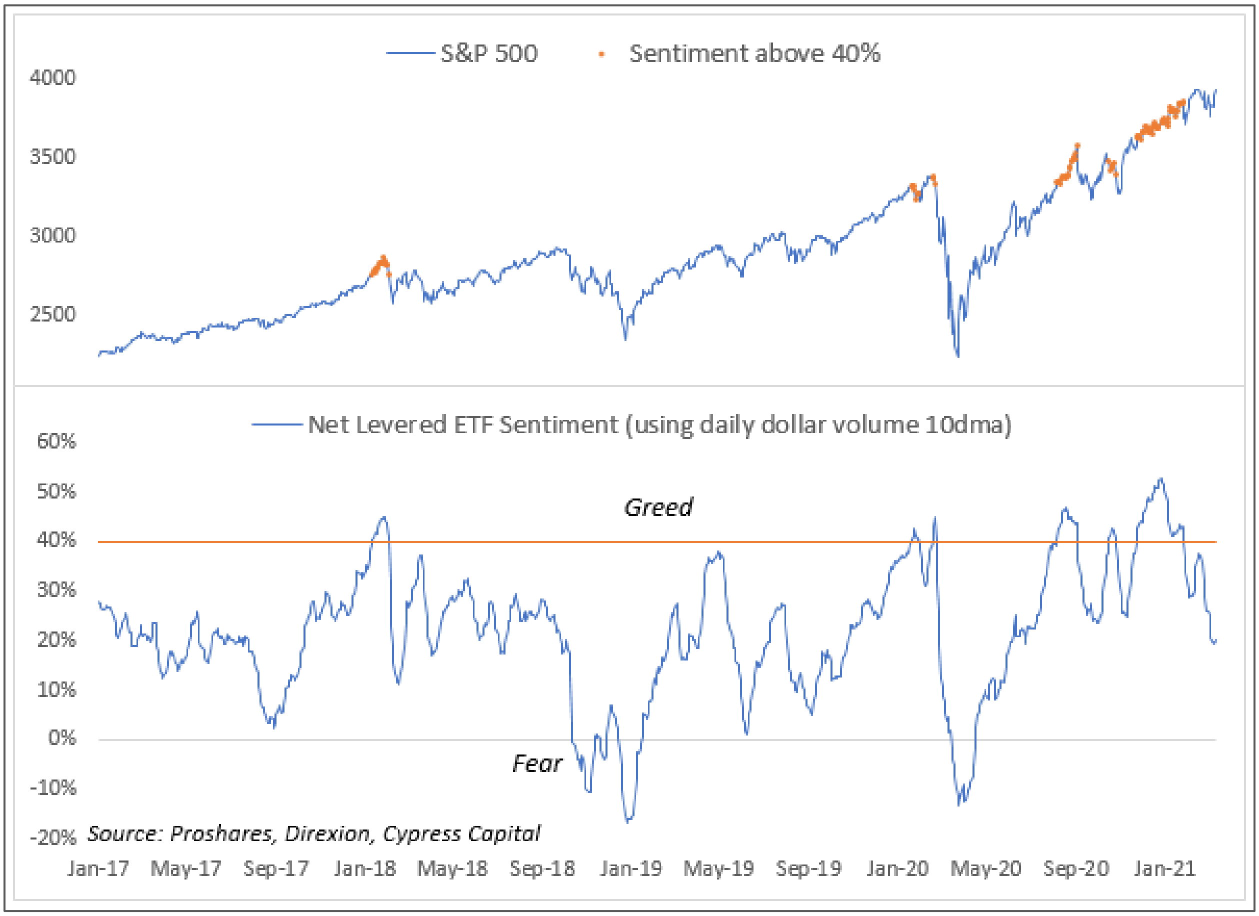
Short-Term Sentiment Composite
Insiders have not stopped selling. Aggressive trading using leverage and options hasn't come in enough, and investors are still enthusiastic.



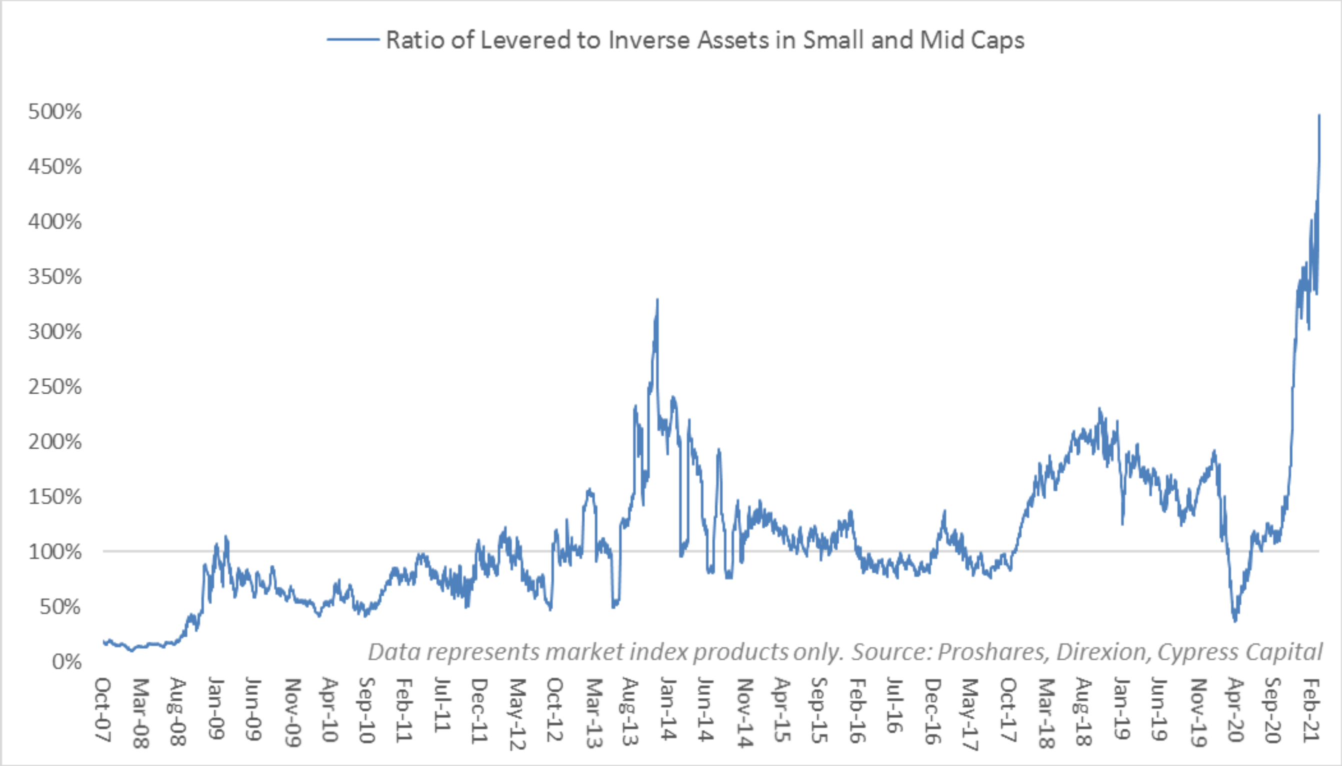
Bond Market Liquidity has started tightening.



Net Levered ETF Volume is starting to cool off.

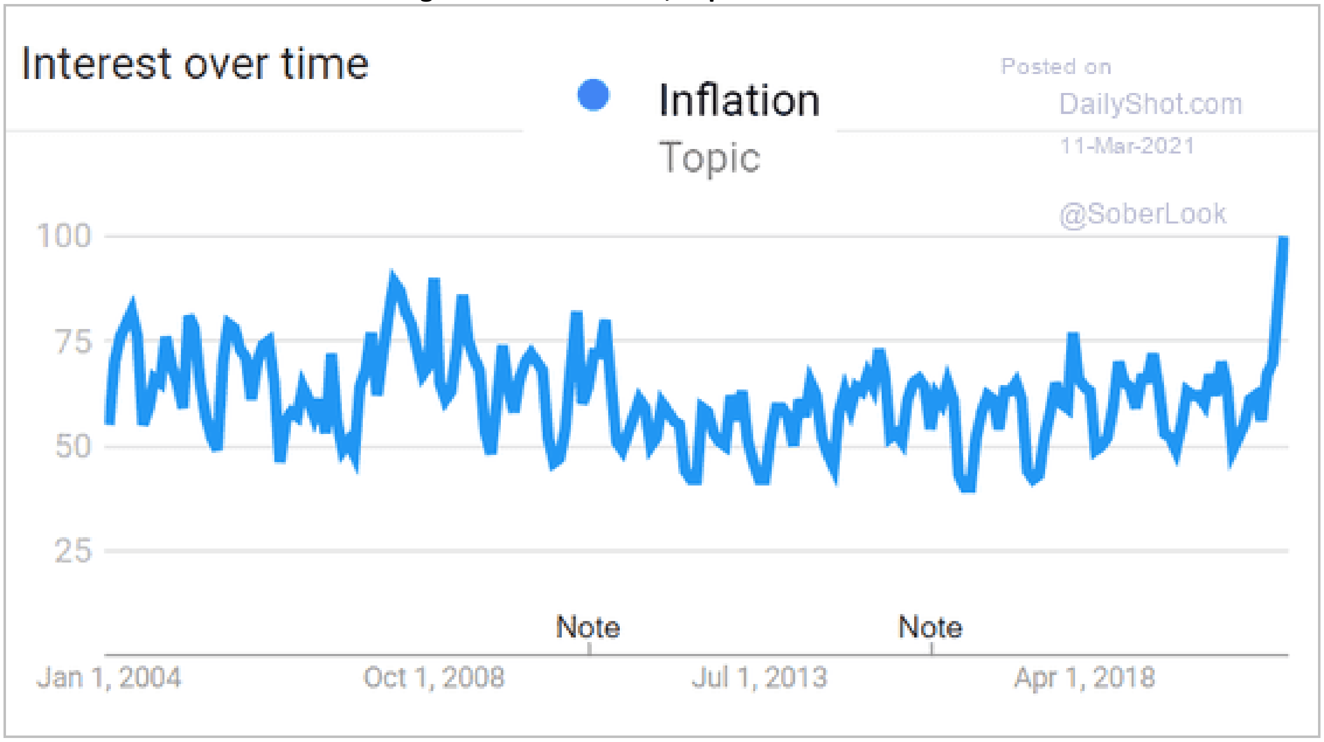


But...assets parked in levered ETFs are not. Small & Mid-Cap levered bets outnumber inverse ones by 5 to 1.

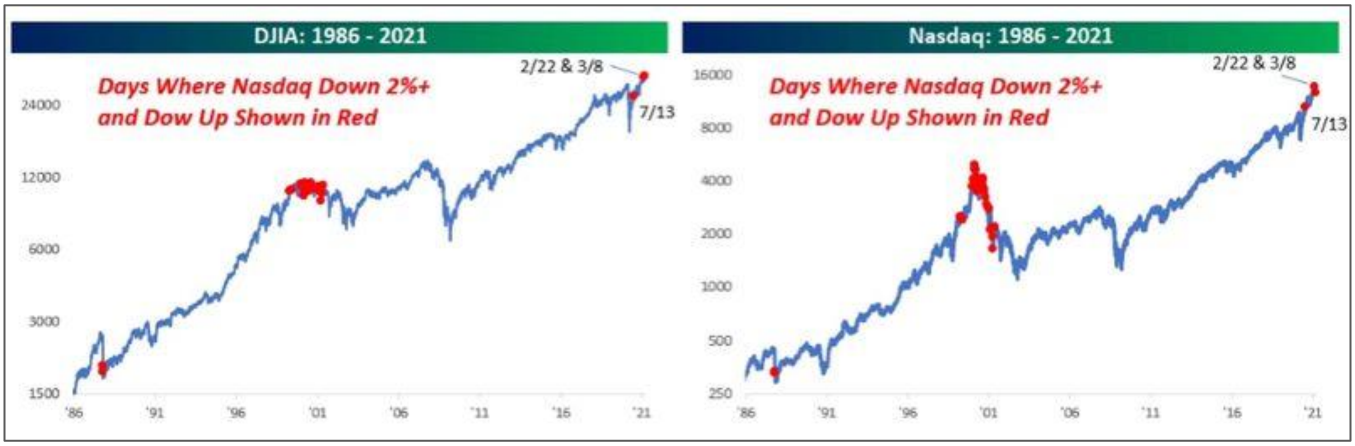


Speculators are record short the US dollar.

Inflation search Interest is breaking out. With inflation, expectations matter.

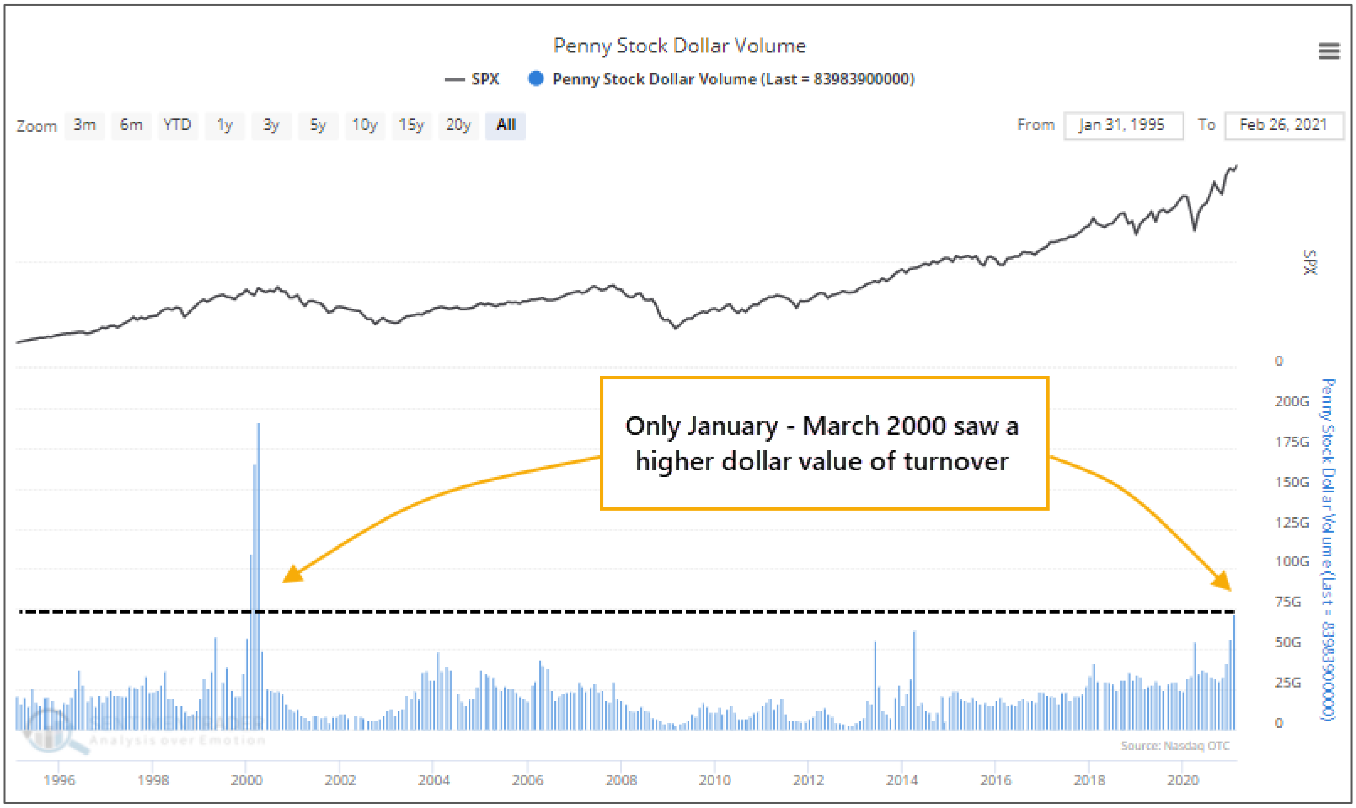


Most significant NASDAQ and Dow divergence since the dot com era.



Source: Bespoke

Largest surge in Penny stock dollar volume since Jan-Mar 2000.

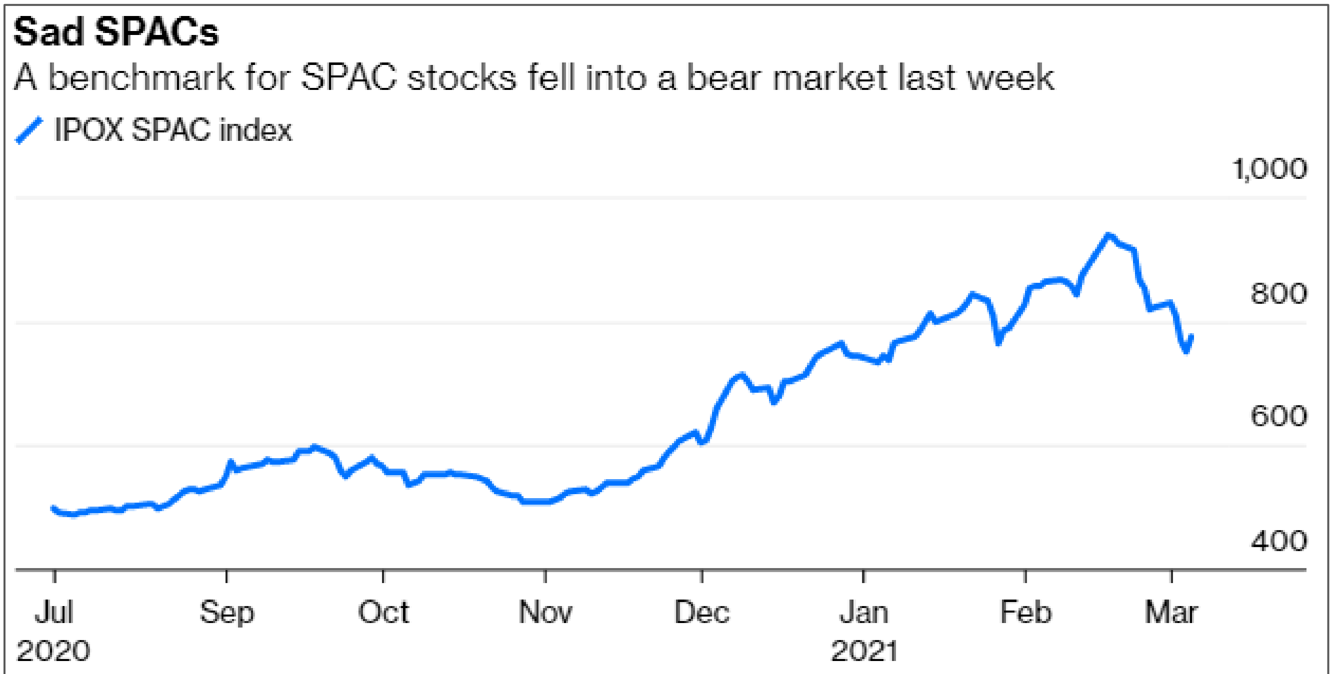


Source: SentimenTrader

Value stocks are cheap on a relative basis.

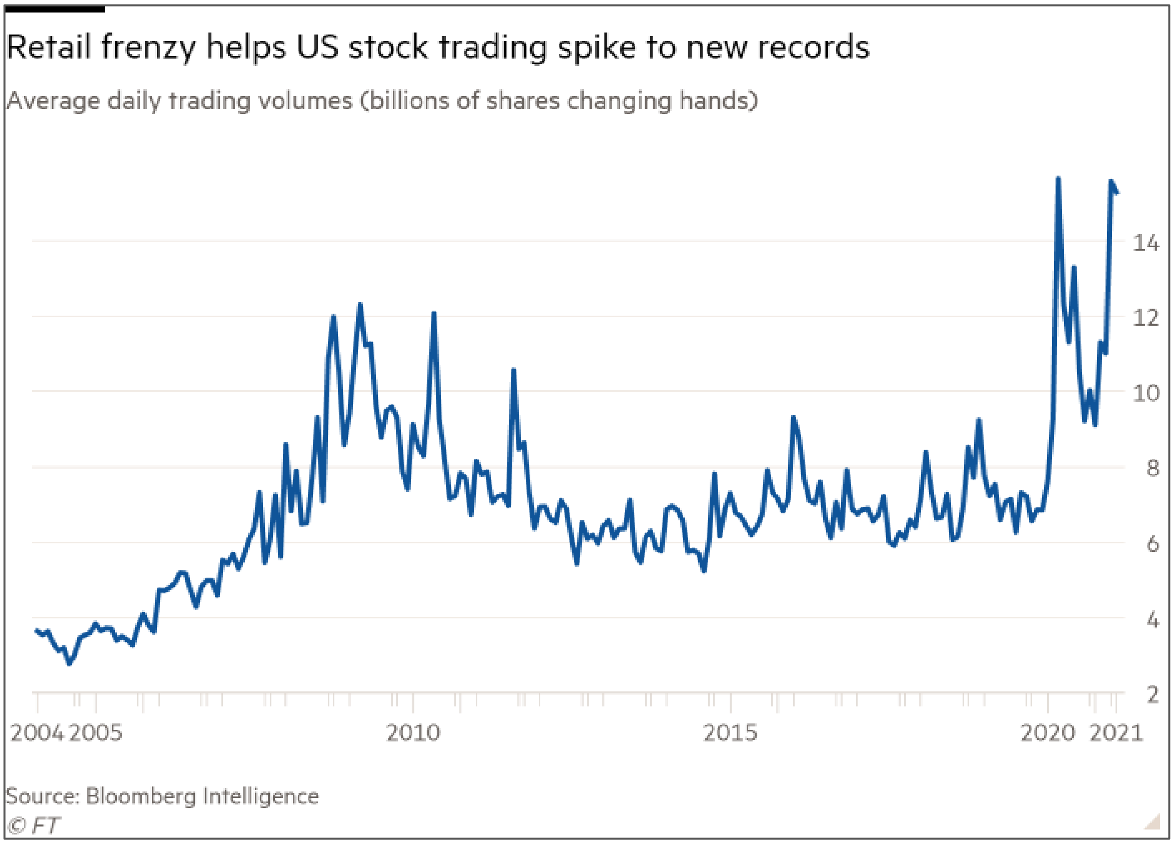
Source: AQR, XpressFeed. Using the HML (devil) B/P value spread. Please see the Appendix for more details on the construction. For illustrative purposes only and not representative of a portfolio AQR currently manages. Hypothetical data has inherent limitations, some of which are disclosed in the Appendix.

SPACs fell into bear market territory.

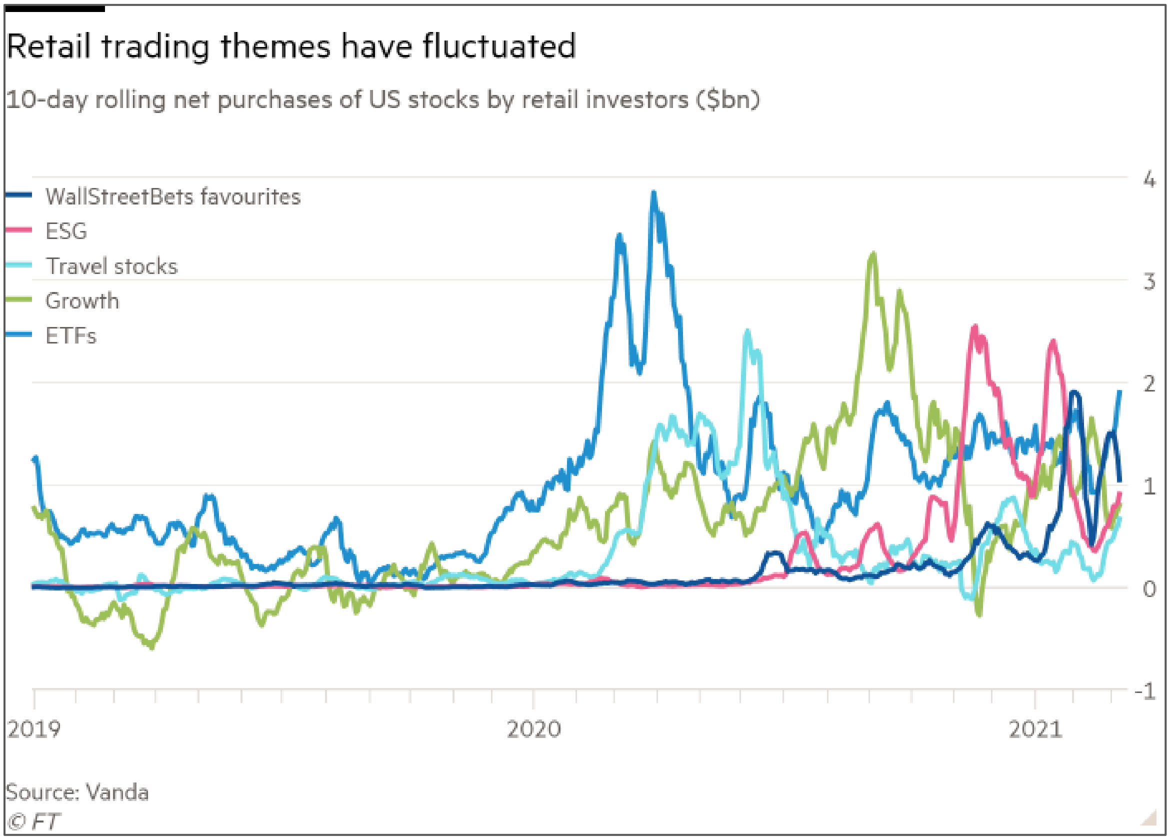


Source: Bloomberg, IPOX

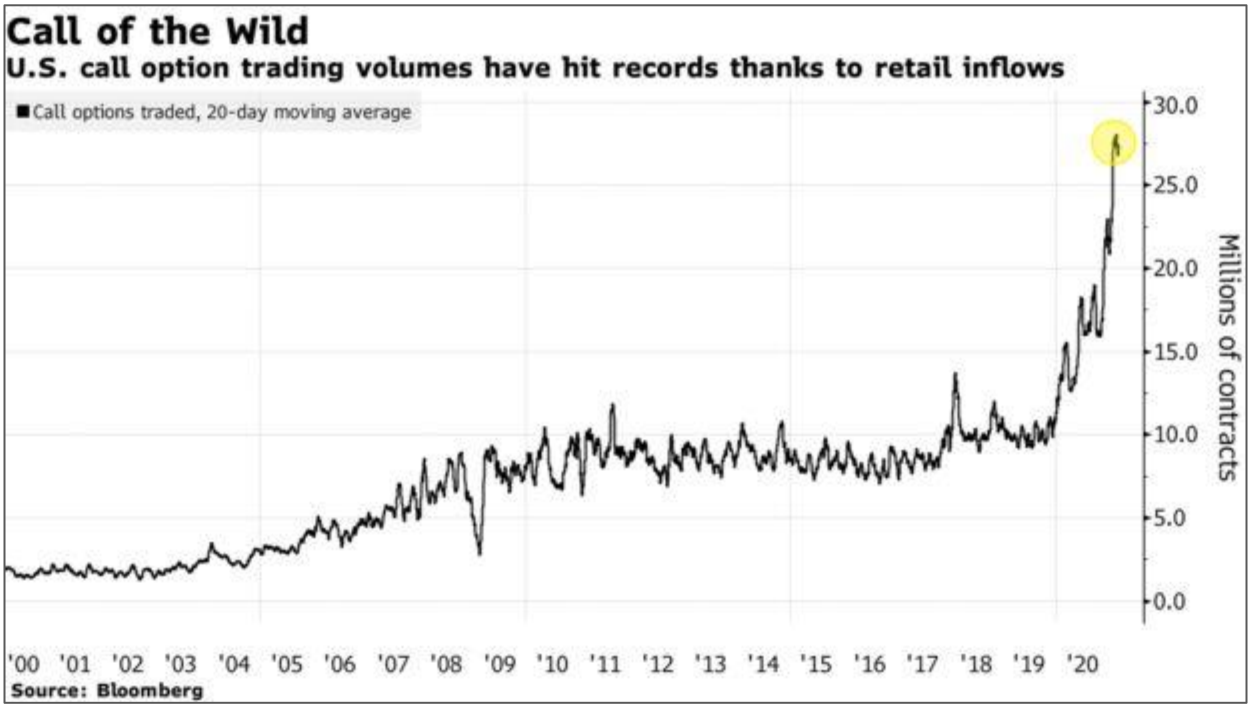
Retail trading Frenzy



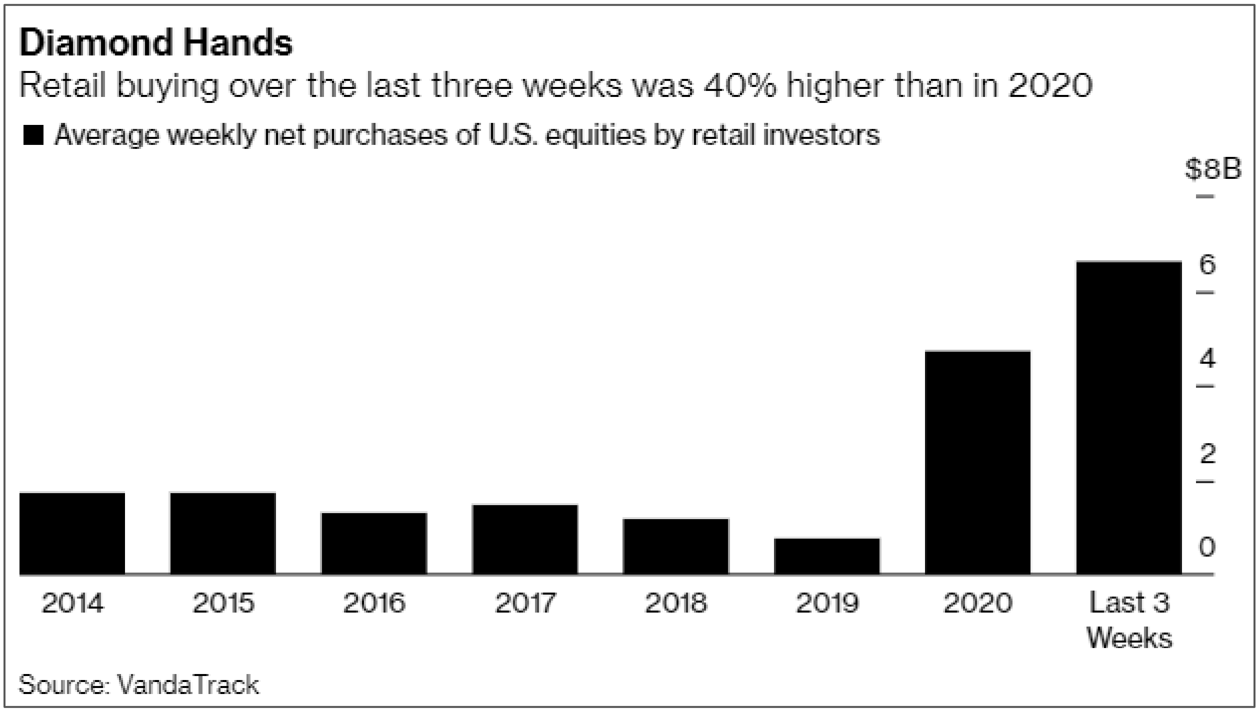
Retail traders are stampeding from theme to theme.



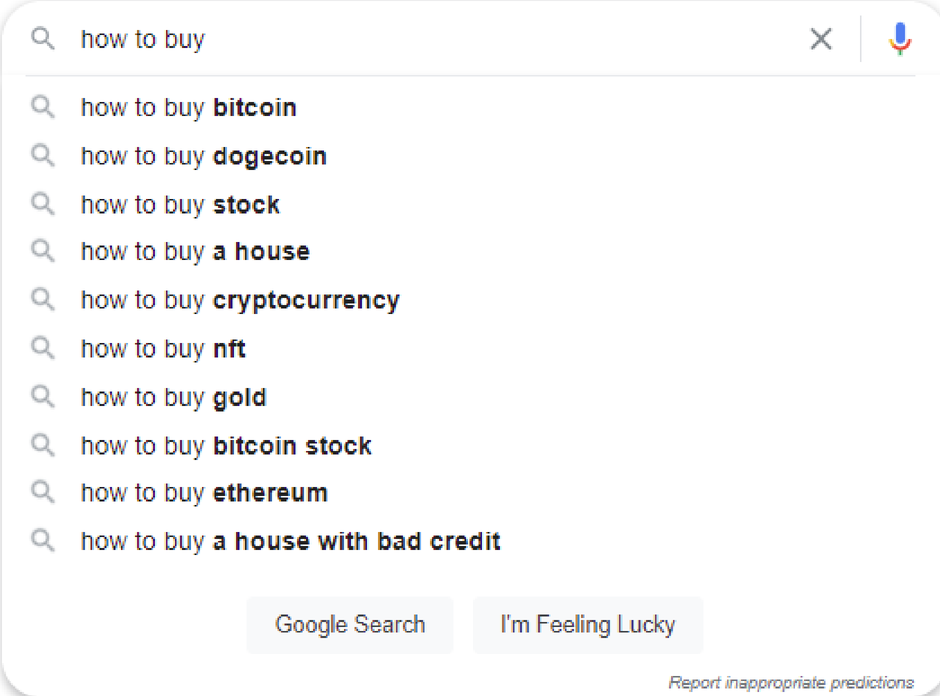
More call option records from retail trading.



Retail can't get enough stonks.

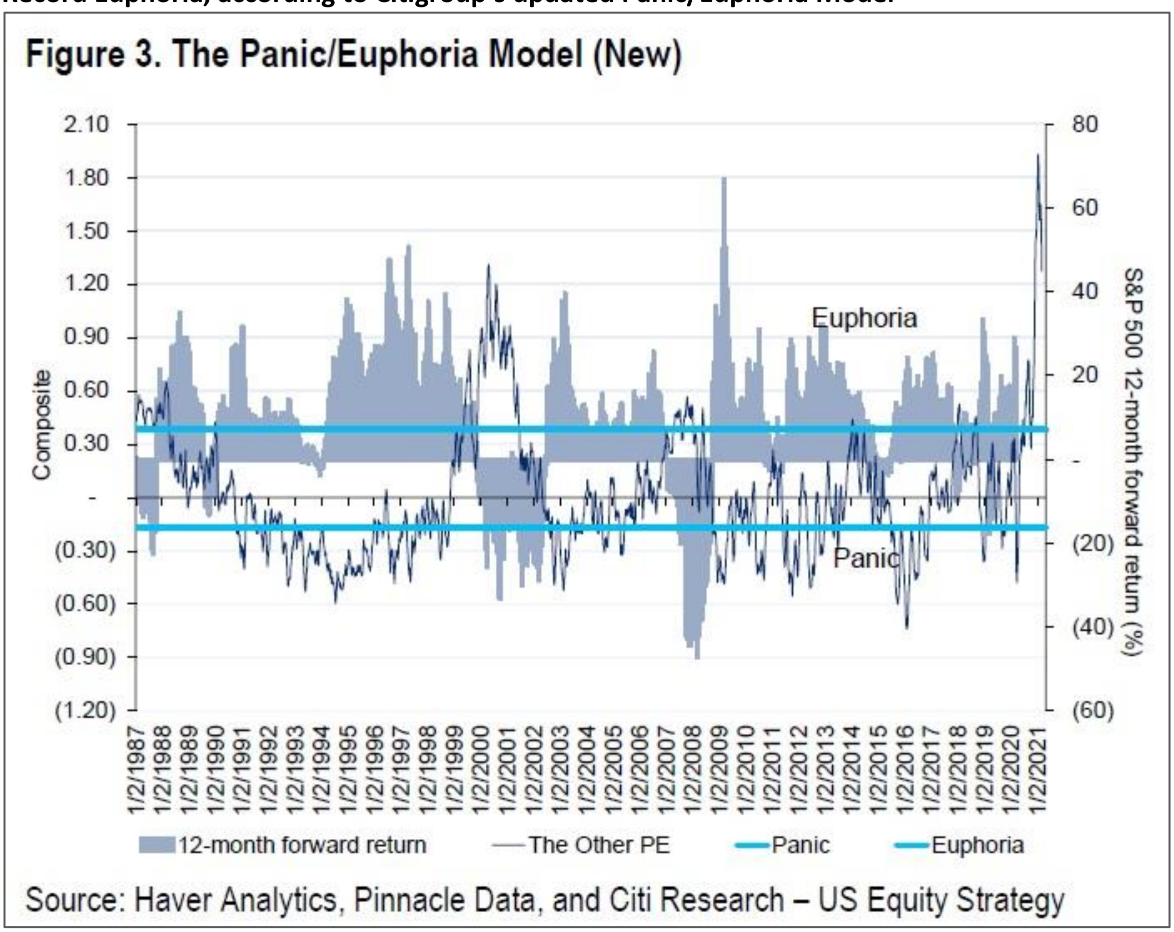


Google's algo knows what retail wants to buy.



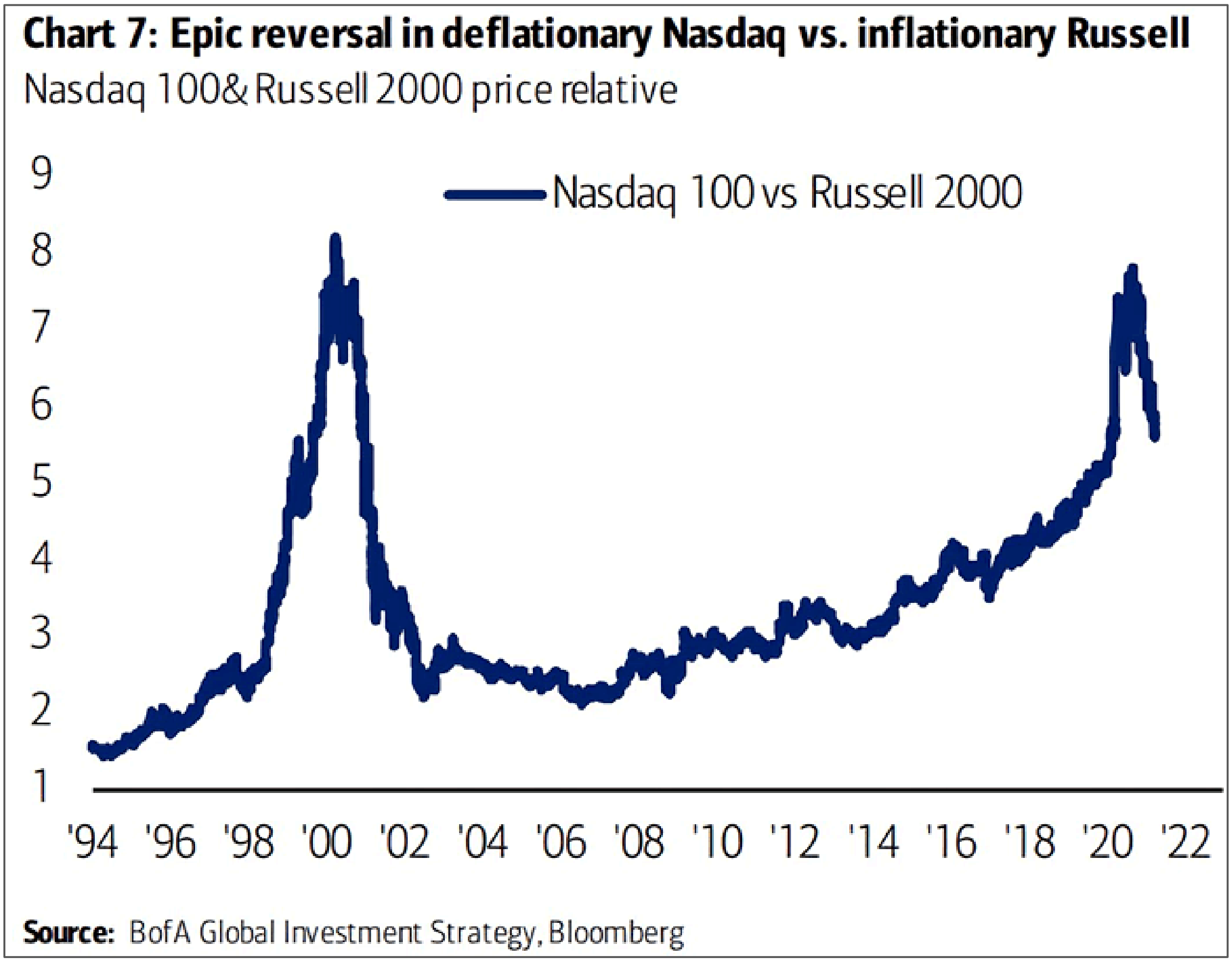
H/T David Scutt

Record Euphoria, according to Citigroup's updated Panic/Euphoria Model

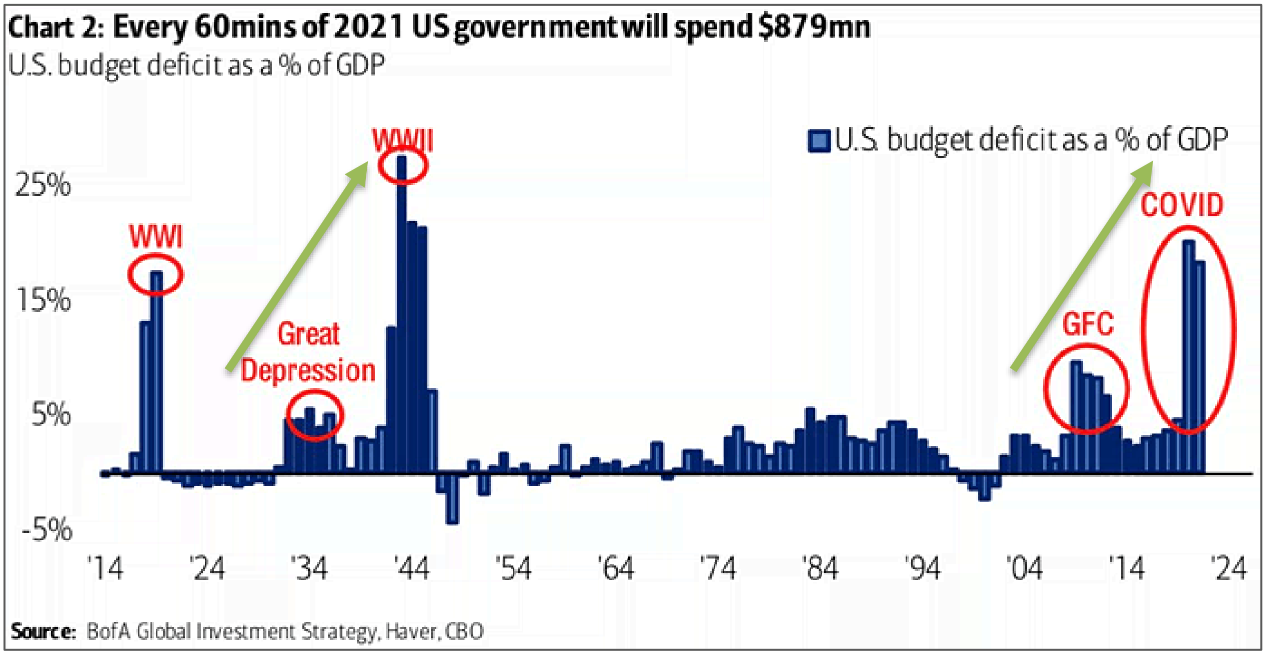


Source: David Scutt

NASDAQ 100 to Russell 2000 – most volatile reversal since 2000.



US Deficit: The second surge in federal spending from WWII broke the Great Depression deflationary cycle. The spending pattern looks similar today.



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.

Contact us for more information.