Cypress CAPITAL

Market Outlook

By Mark T Dodson, CFA

The Inflation Narrative isn't going away.

Market Risk Index climbed to 96.5% as the Monetary Composite crossed into the worst decile of readings. The economic cycle reset that we got on our monetary composite in 2020 was the weakest on record, beating out the 1970 recession, and appears to be part of the reason that we are seeing a much faster than normal deterioration.

The inflation category became the largest negative influence on the monetary composite this week, with the worst readings for the category since the summer of 2011. That environment was different in several ways, but it is similar in how it coincided with a period where our psychology composite was giving readings in the worst quintile. A severe market correction in the fall of 2011 alleviated the inflation pressures and reset the psychology composite back into the best 10% of readings.

The biggest news on the inflation front this week was the Philly Manufacturing Survey Prices Paid index, which climbed to the highest level in over 40 years. It's consistent with other readings like the ISM and the CRB Raw Industrials index, and all imply that will see higher prints in the rate of change in CPI over the coming months. We are seeing considerable upward pressure on prices after a recession where price levels were never permitted to reach levels that were consistent with previous economic troughs.

In that vein, since the bond momentum sell-signal last summer, the prices of long-duration Treasuries have experienced one of the sharpest drawdowns in over 40 years. It's another successful signal for one of our favorite indicators. Today, it is neither signaling that Treasuries are oversold, nor that a new buy signal is imminent.

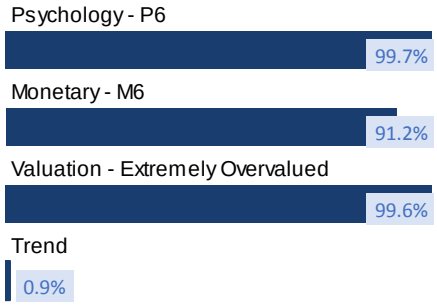
The fate of yields and inflation is a story that is not going away in the near term, and our monetary composite suggests it's a narrative that poses a drawdown risk for equity markets, even if it is "transitory." That's particularly the case when both valuations and sentiment are so rich and giddy.

Market Risk Index

Rec Allocation 25% Underweight

96.5%

Category Percentiles



Largest Psychology Influences

Levered Investments	Negative
Option Activity	Negative
Volatility	Negative
Fund Flows	Negative

Largest Monetary Influences

Inflation	Negative
Velocity	Negative
Interest Rates	Negative

Valuation

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

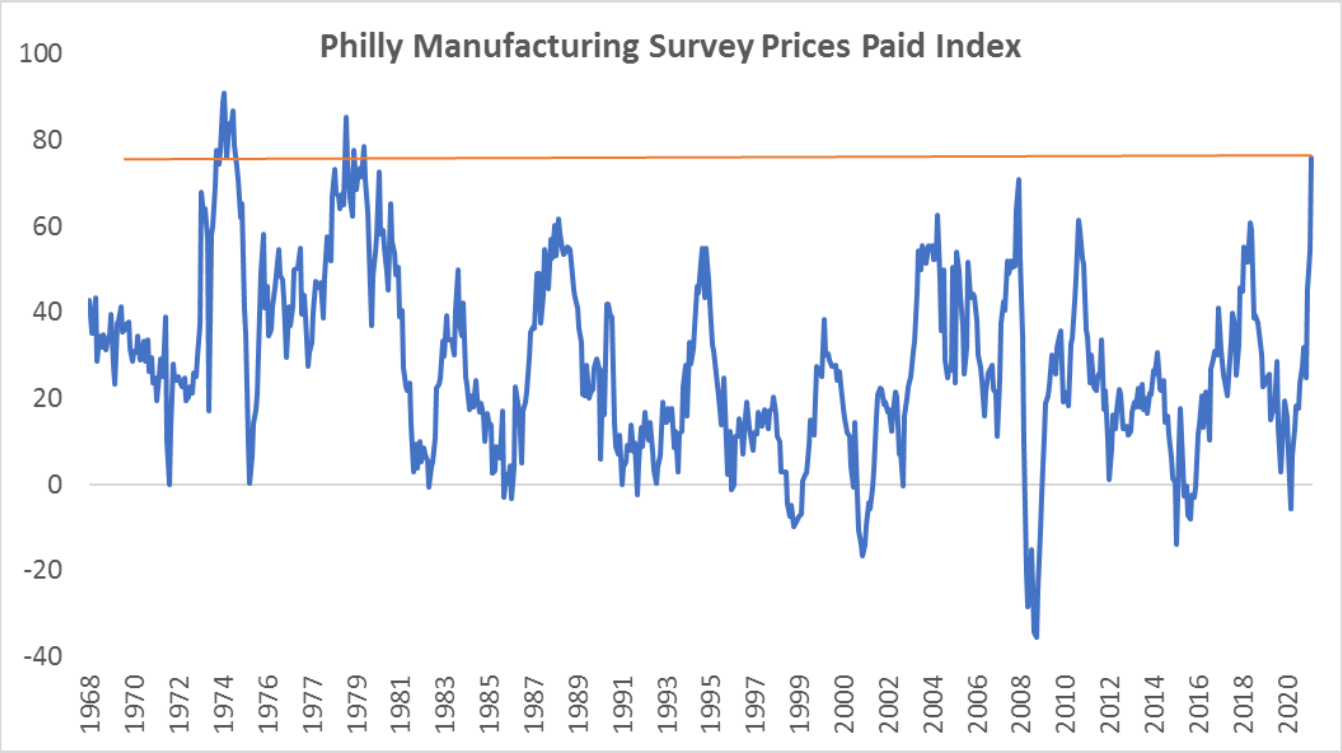
Market Trends

US Equities	Bullish Investment
Intl Equities	Bullish Investment
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.

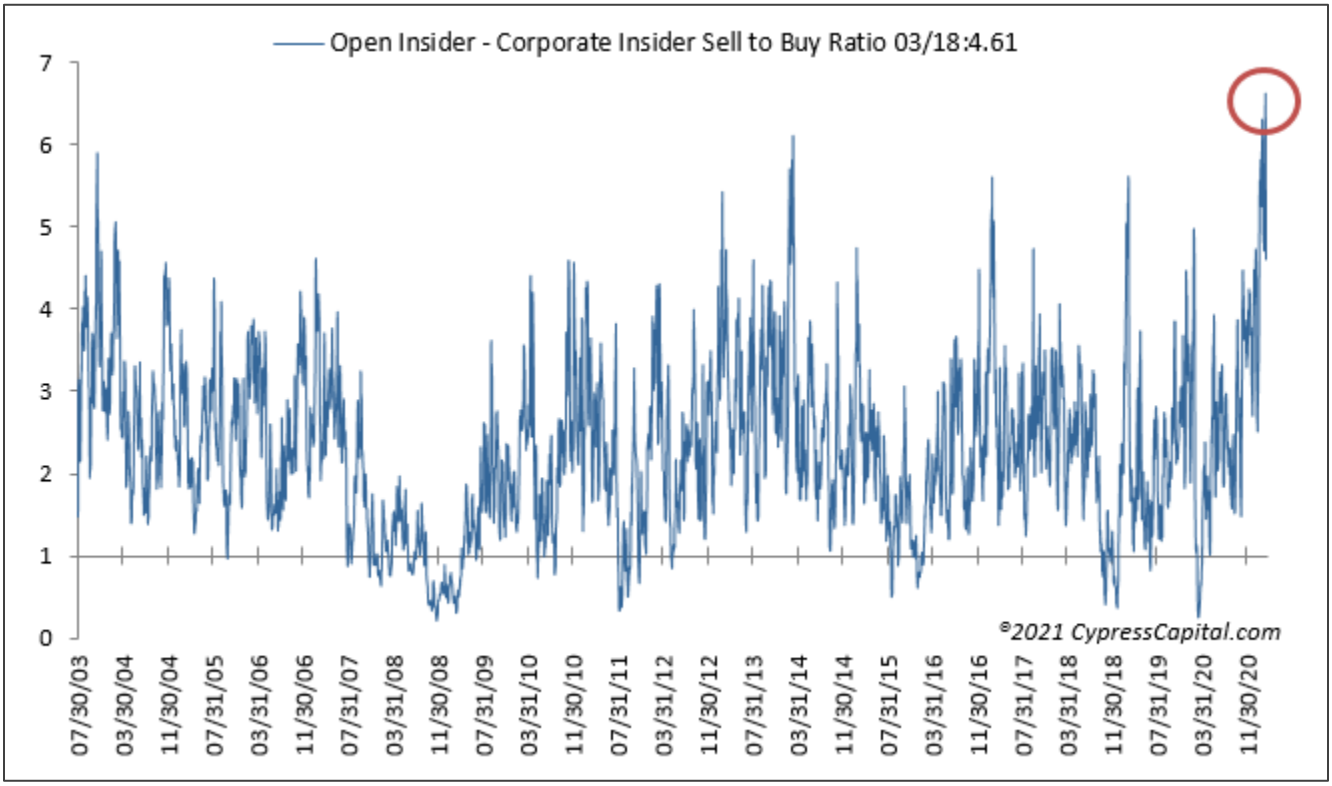
Charts of the Week

Philly Survey Prices Paid Index hit the highest level since 1980.



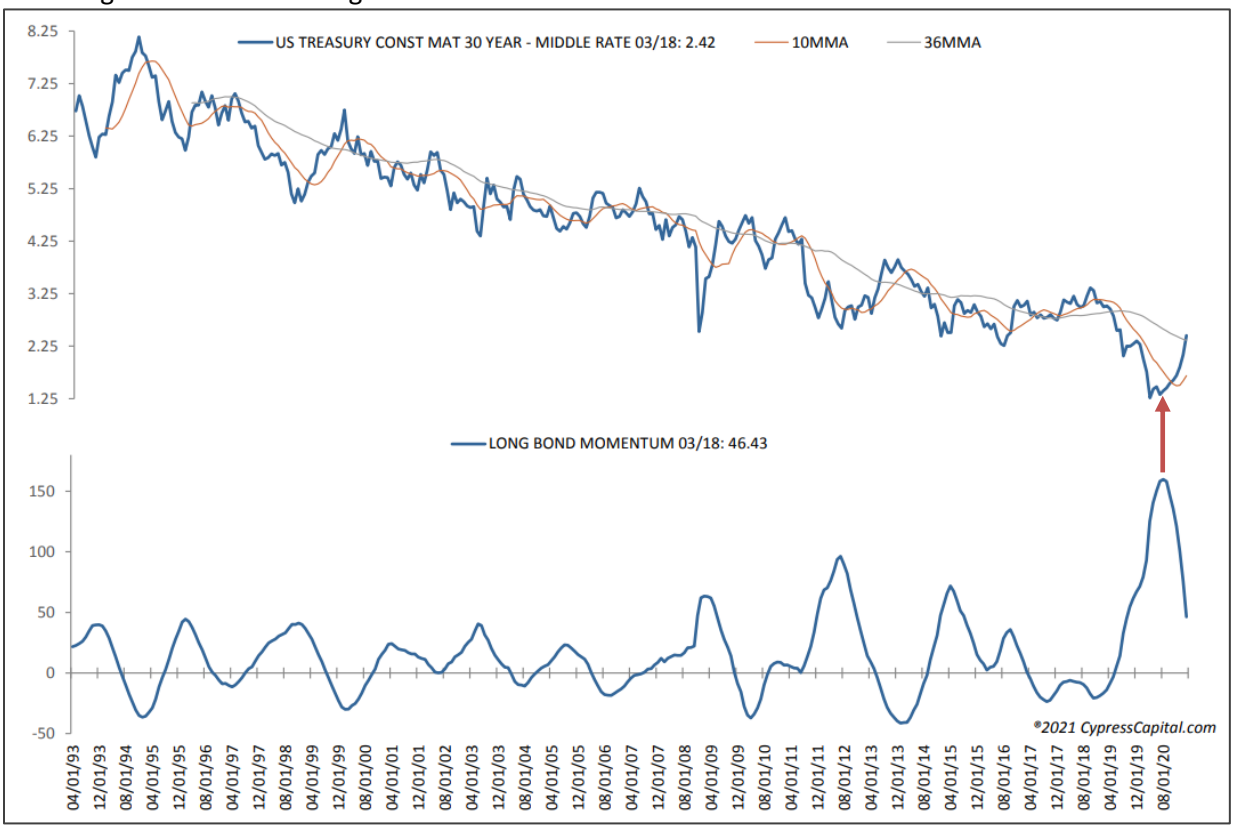
Source: Federal Reserve

Corporate Insiders set a new record in selling this week.

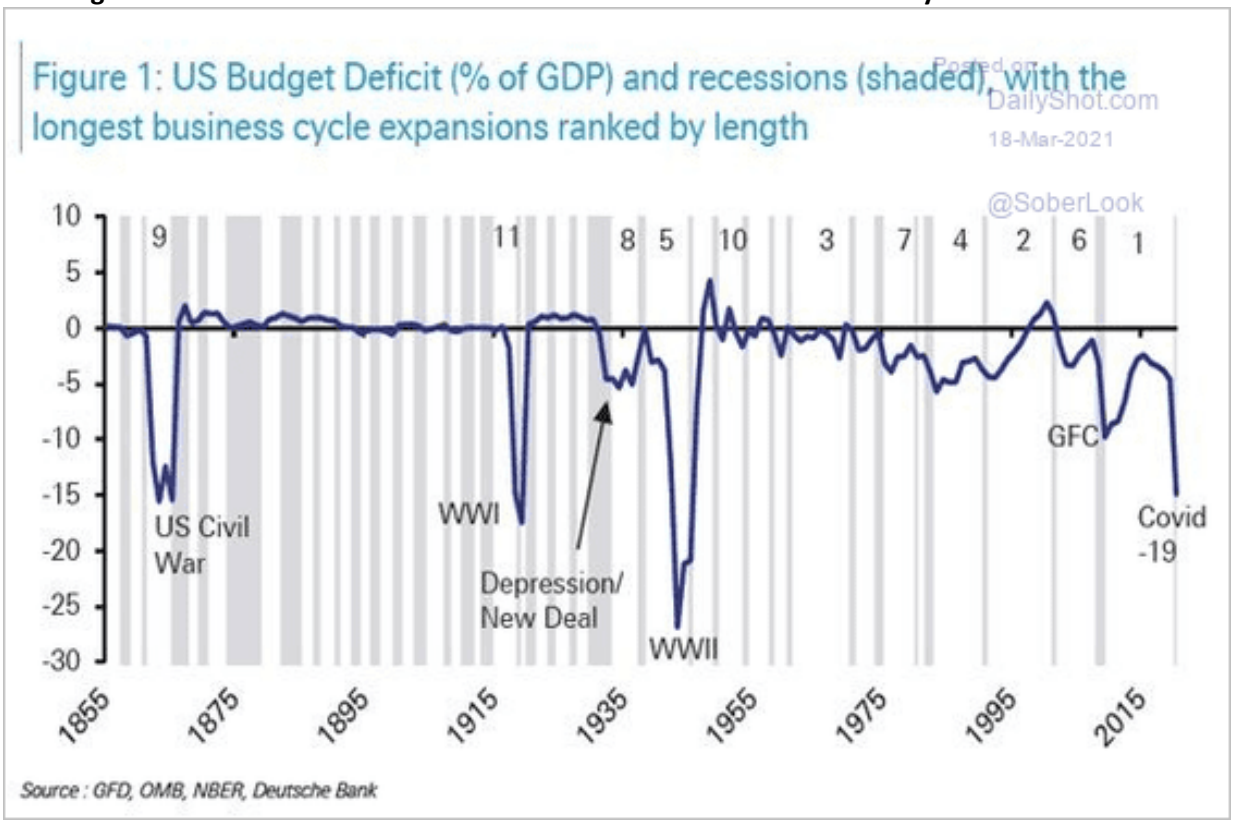


Bond Momentum Indicator

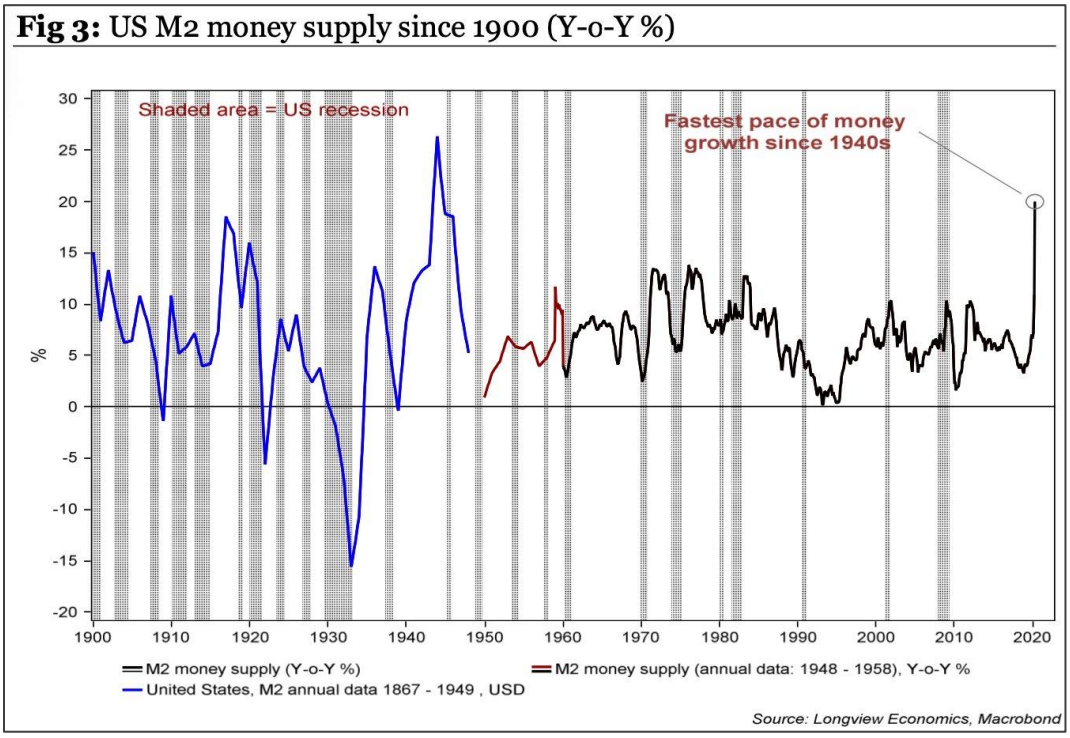
The sell signal from last summer was a successful one...no indication that bonds are oversold or that momentum is shifting back in favor of long-duration Treasuries.



US Budget Deficits since 1855 – we are in Civil War and World War I territory.

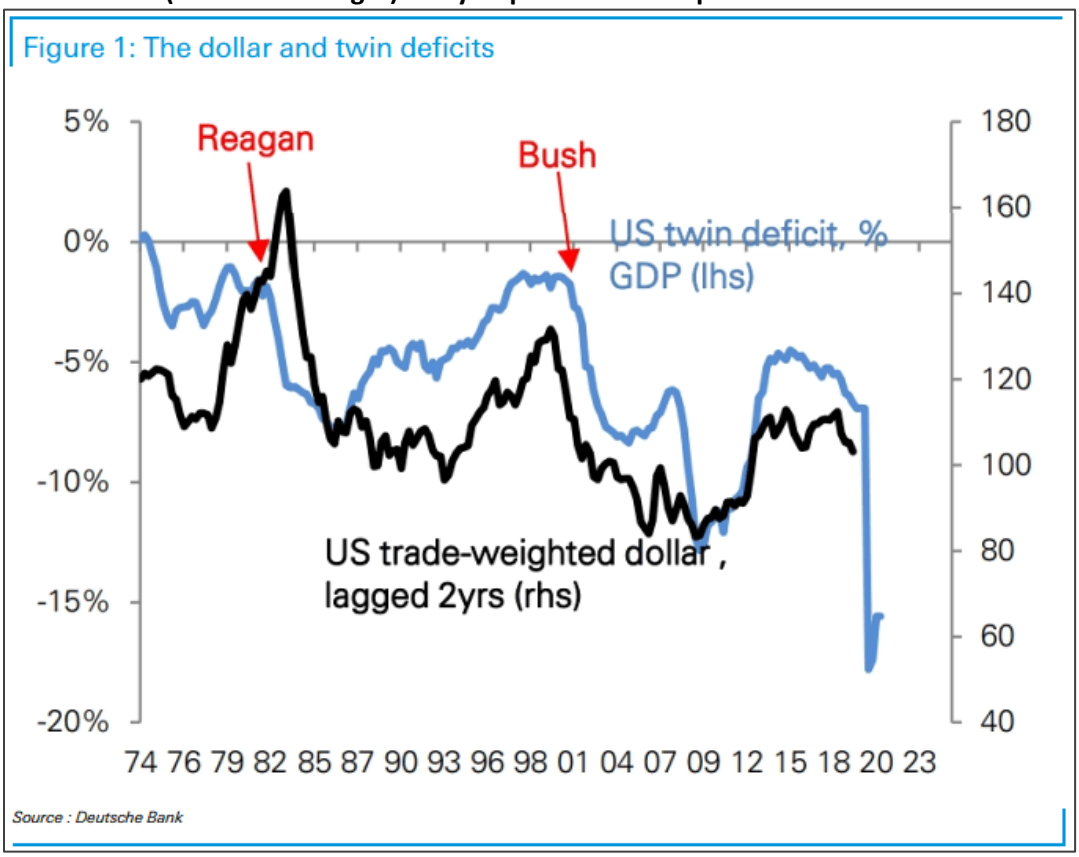


Money Supply Growth is on par with World War I as well.



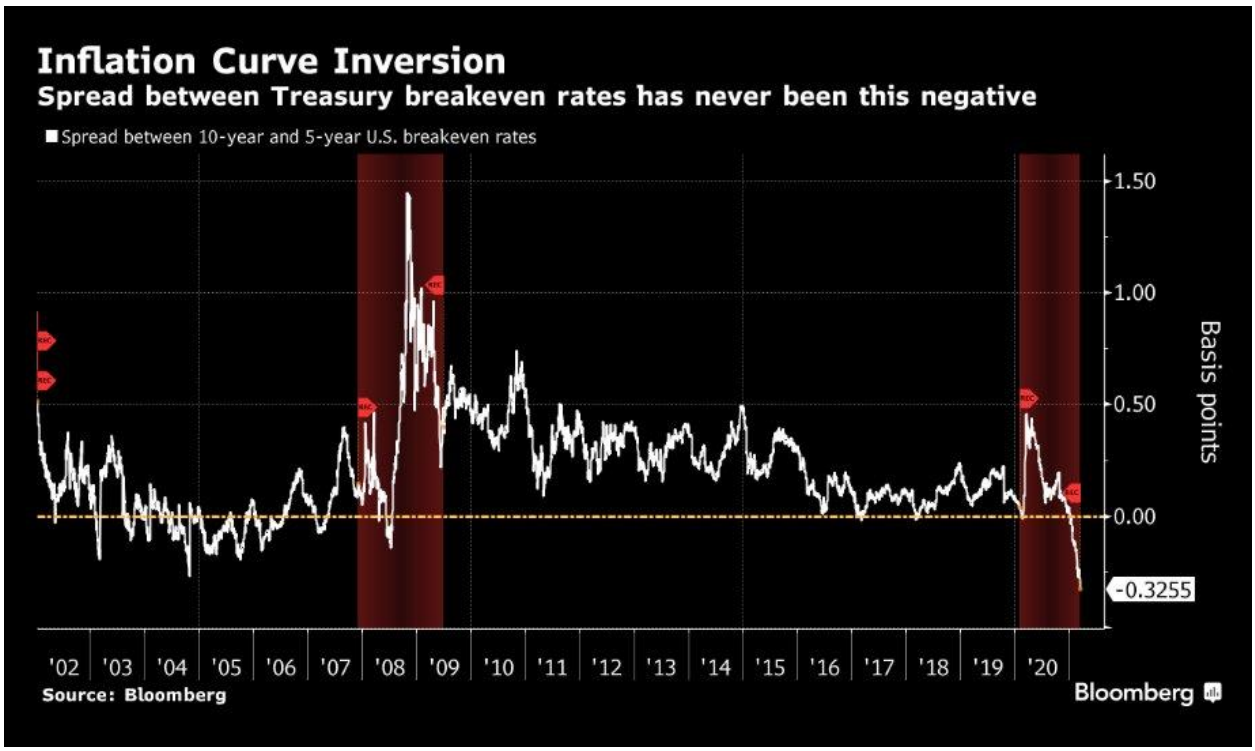
Source: Bloomberg

Twin Deficits (Trade and Budget) likely to put downward pressure on the dollar for the next couple of years.



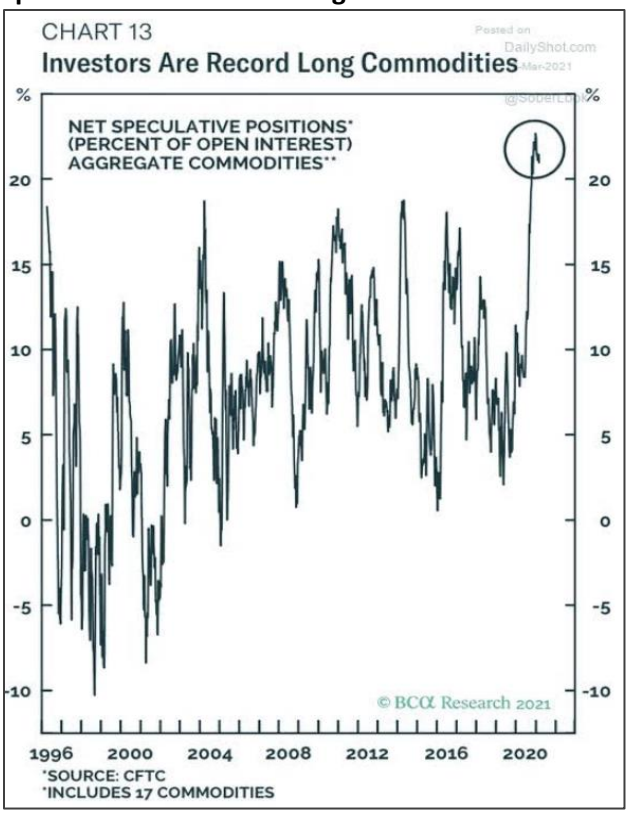
Breakeven Spreads

The bond market has never priced this big of a difference between inflation coming in 5 years relative to the next 10 years.

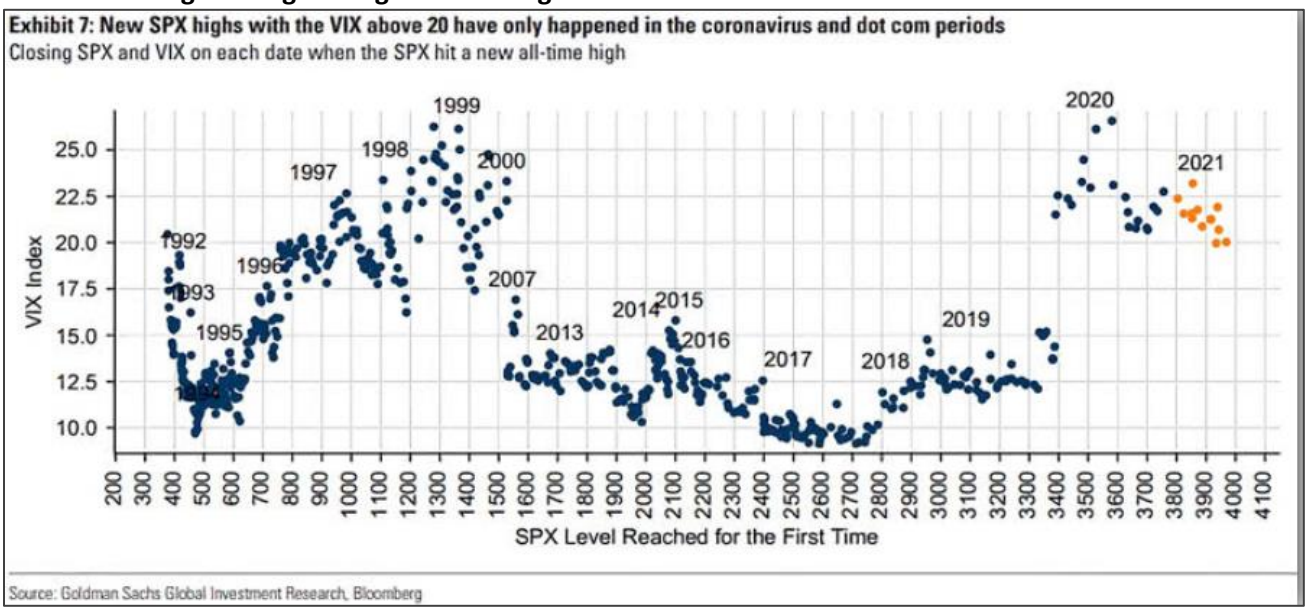


Barraud, Bloomberg

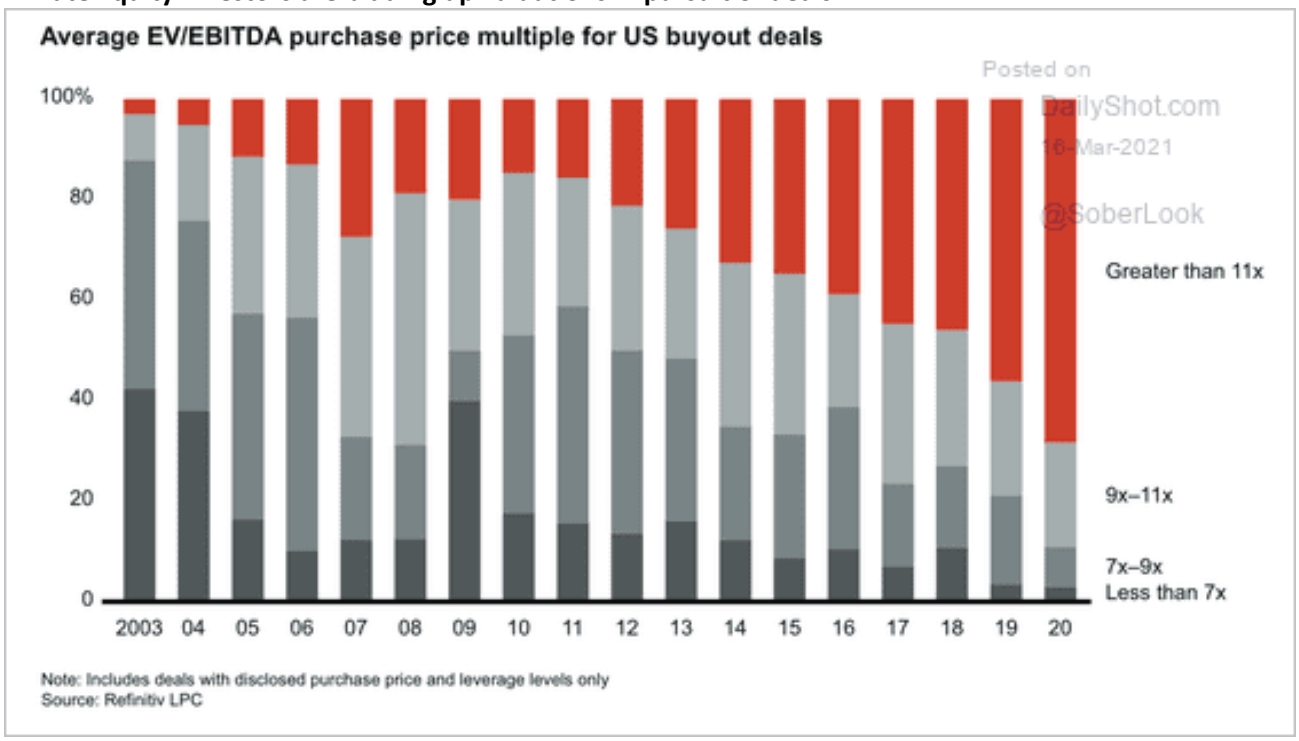
Speculators are Record Long Commodities.



New market highs alongside high VIX readings look similar to the dot com era.

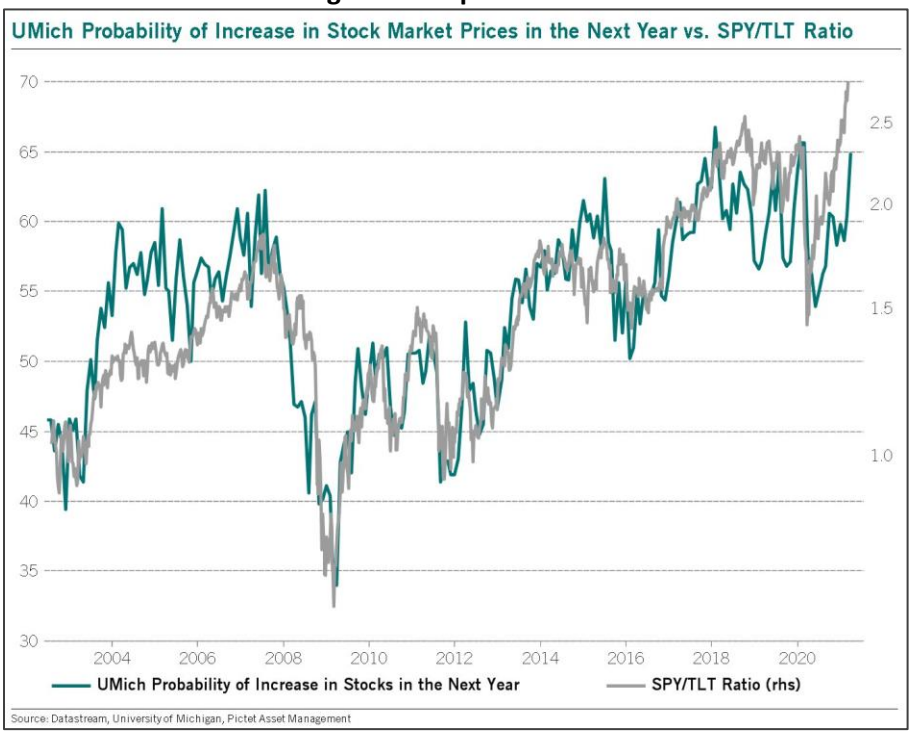


Private Equity investors are bidding up valuations in pursuit of deals.



Equity Allocation of US Households breaks a record.

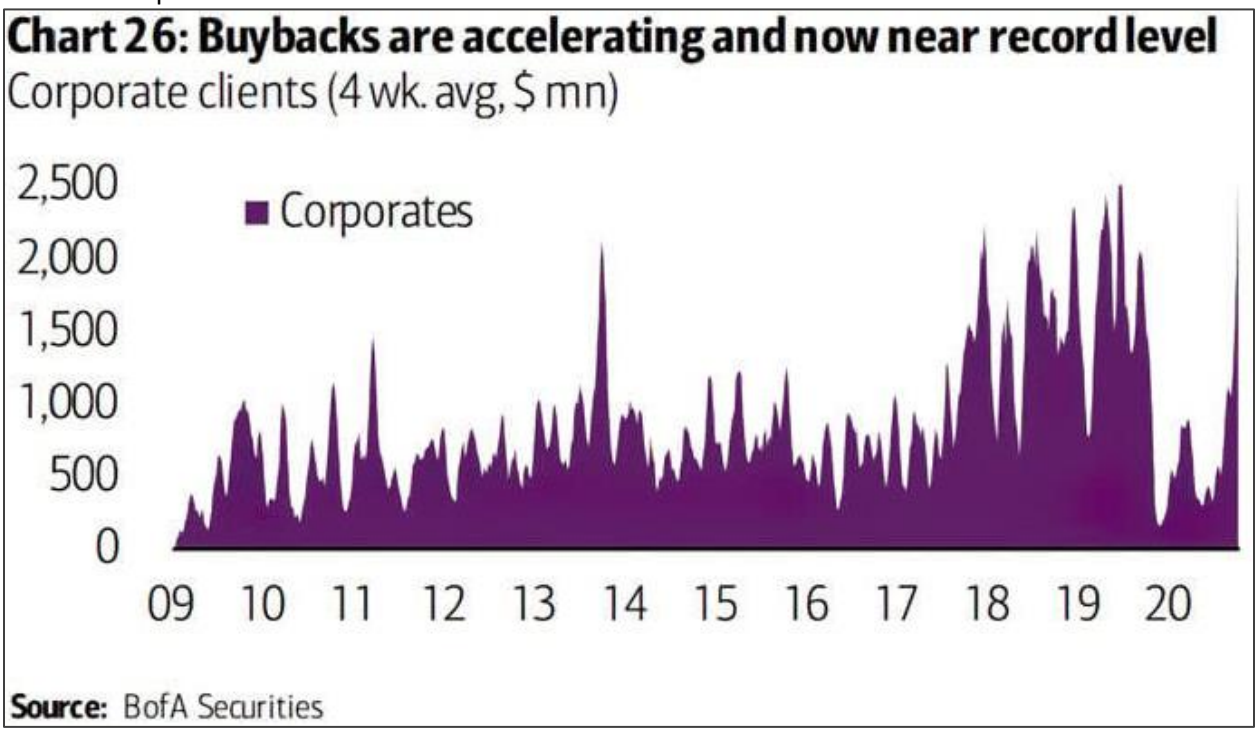
Consumer Confidence in higher stock prices is back to extremes.



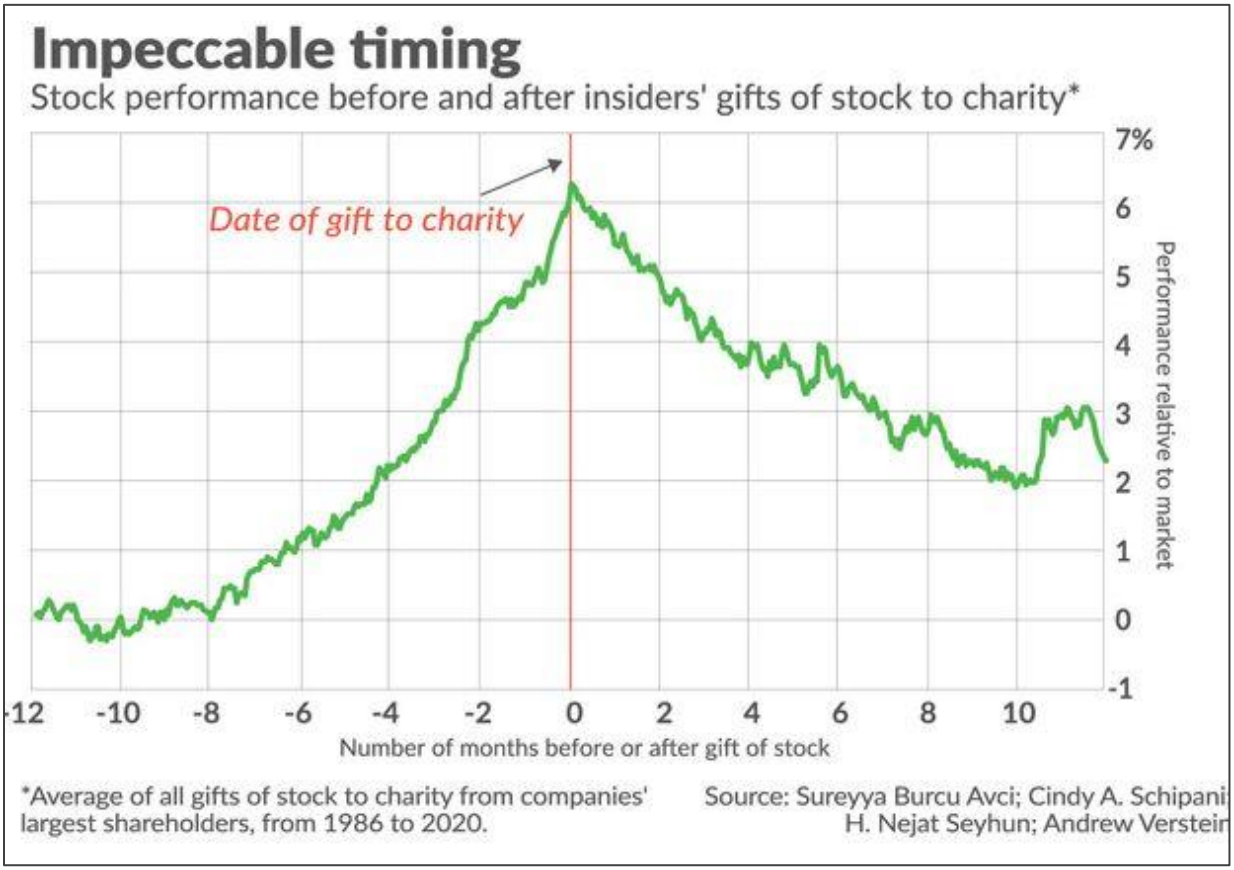
Fund Manager inflation expectations are at all-time highs.

Confidence in Economic Recovery is also at an all-time high.

Leave it to management...
...to make new records selling their own stock while simultaneously driving buybacks using corporate money back toward previous records.



A new indicator? Corporate Insider Gift Timing
The timing when corporate insiders gift stock to charity looks flawless.



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.

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