Market Outlook

By Mark T Dodson, CFA

Fastest Margin Debt Growth Since 2000

Market Risk Index improved to the 95th percentile. The interest rates category of the Monetary composite was the reason, specifically a resumption in the decline of municipal bond yields. Yet, the inflation category is keeping the monetary composite risk score elevated, and we've shared some of that evidence over recent weeks. Our inflation category historically tends to lead CPI numbers, so we will likely see even higher CPI prints over the summer. More importantly, it often leads to underperforming market environments until the pressure on prices fades. This is a grand, new experiment in stimulus – both monetary and fiscal. There will be unintended consequences and risks.

We should mention that even with this inflationary evidence, a recent pause in the inflation trade has been hard to miss. Treasury yields have recently stopped their steady march higher, as have some broad commodity indices and emerging markets, particularly Chinese equities.

Within the psychology composite, breadth looked exceptional this week. The percentage of S&P 500 stocks trading above their 50 and 200 day moving averages rarely gets this high. It means the market is overbought, but it's also so strong that it implies any near-term retreat from current euphoric sentiment suggests a market correction instead of a bear market. We call it resetting the bear market clock.

We prefer to see strong breadth in markets with less than euphoric sentiment. Breadth often peaks in markets with this much enthusiasm, and we have it in spades. Levered ETF and mutual fund sentiment set a new all-time record this week. This ramp in leverage is distinct from others in that it's a broad, uniform bet in 2021 – on Tech, on small caps, on mid and large caps. It's just flat-out leveraged speculation on all kinds of stuff going higher.

Margin debt was also released for March, and it's growing at more than 70% year over year, the highest growth rate since the February 2000 dot-com era peak. Going back to the 1920s, surges in margin debt growth with extreme valuations like this have only come in the most euphoric market environments.

Market Risk Index

Rec Allocation 25% Underweight

95.0%

Category Percentiles

Psychology - P6: 99.5%

Monetary - M5: 82.8%

Valuation - Extremely Overvalued: 99.9%

Trend: 0.3%

Largest Psychology Influences

Levered Investments	Negative
Option Activity	Negative
Fund Flows	Negative
Surveys	Negative

Largest Monetary Influences

Inflation	Negative
Interest Rates	Negative
Monetary Aggregates	Negative

Valuation

7-10 Year Rtn Forecast	-0.1%
10Yr Treas Yield (on 04/14)	1.6%

Market Trends

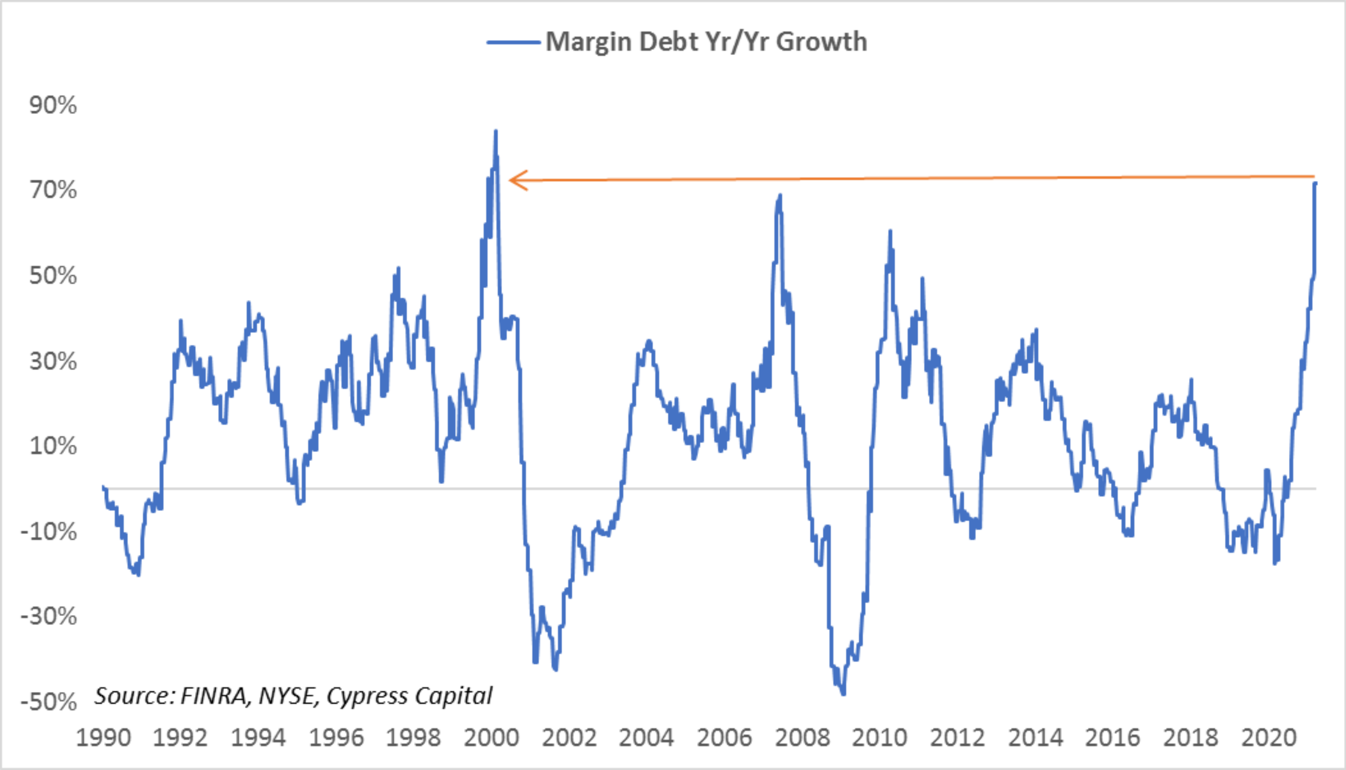
US Equities	Bullish Investment
Intl Equities	Bullish Investment
REITs	Bullish Trade
Broad Commodities	Bullish Trade

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.

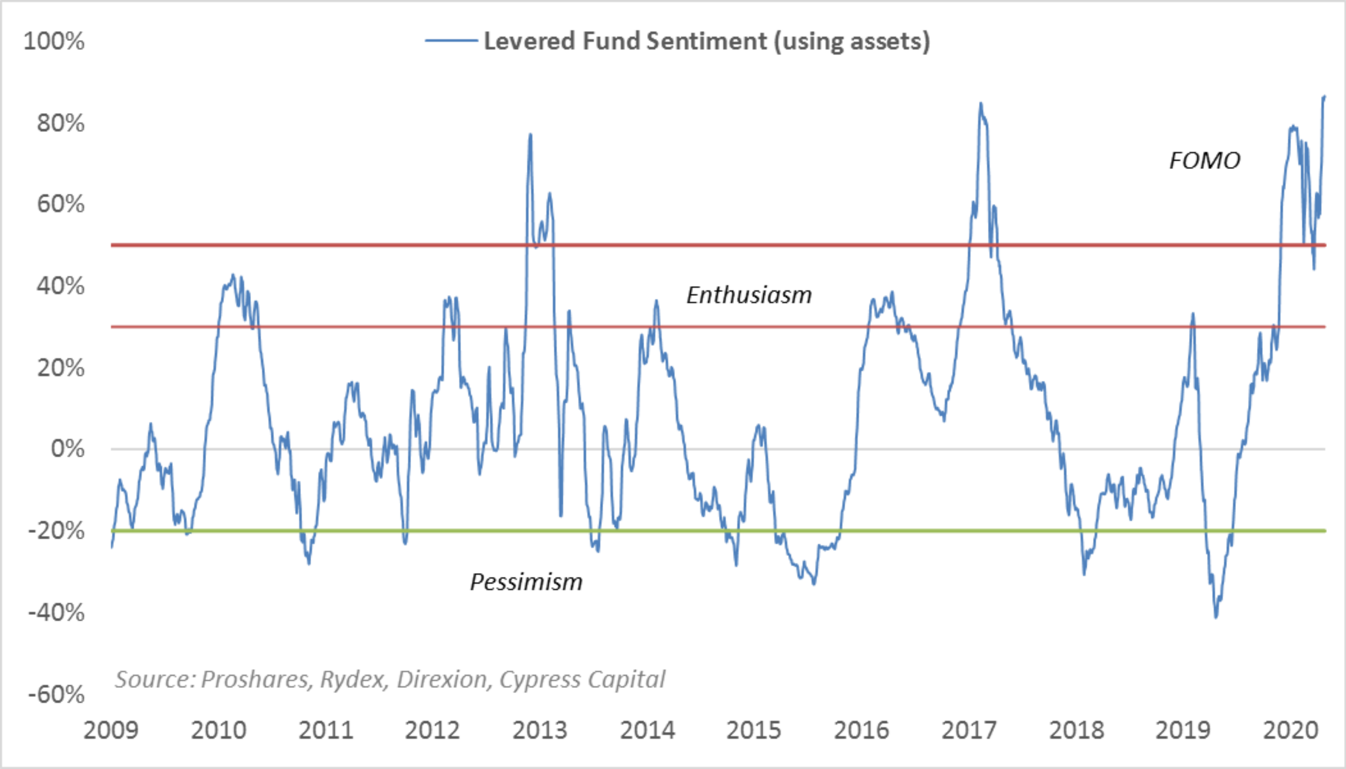
CNBC published a story this week of a New Jersey deli with $35,000 in sales that trades on the pink sheets with a market cap that has ballooned to $100 million – another anecdote of acute froth. The crowd is bold and confident, and we wouldn't be inclined to chase anything here. Markets are priced with maximum confidence in the bureaucrats' abilities to plan a perfect recovery.

Charts of the Week

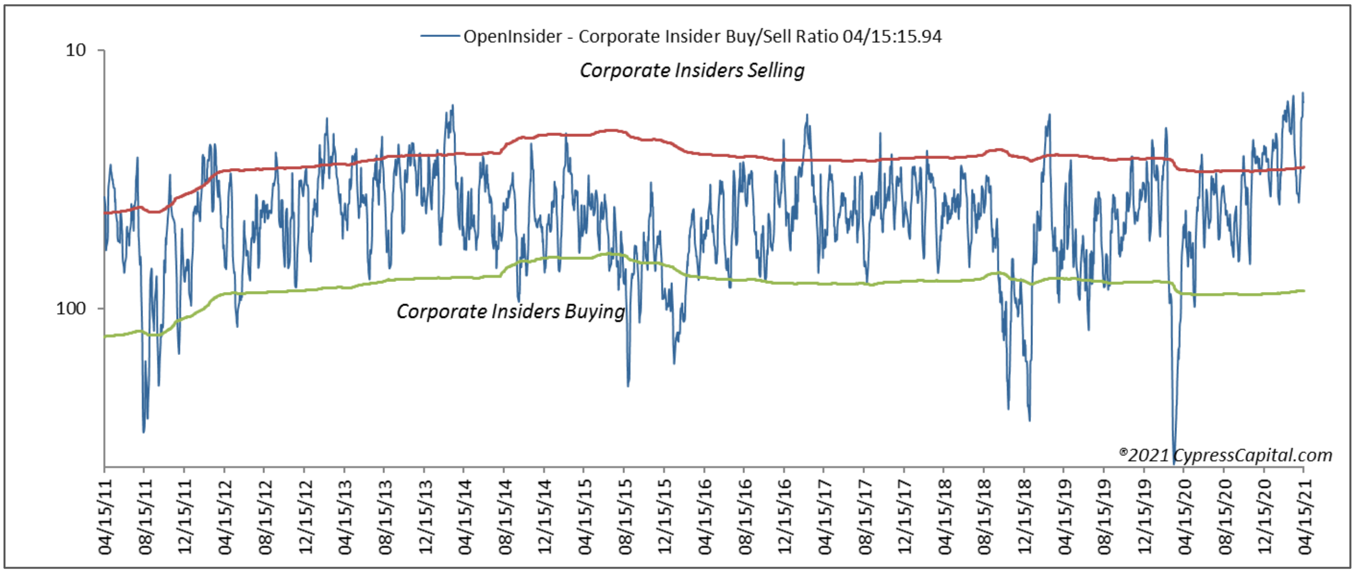
Margin Debt Growth is the highest since February 2000.



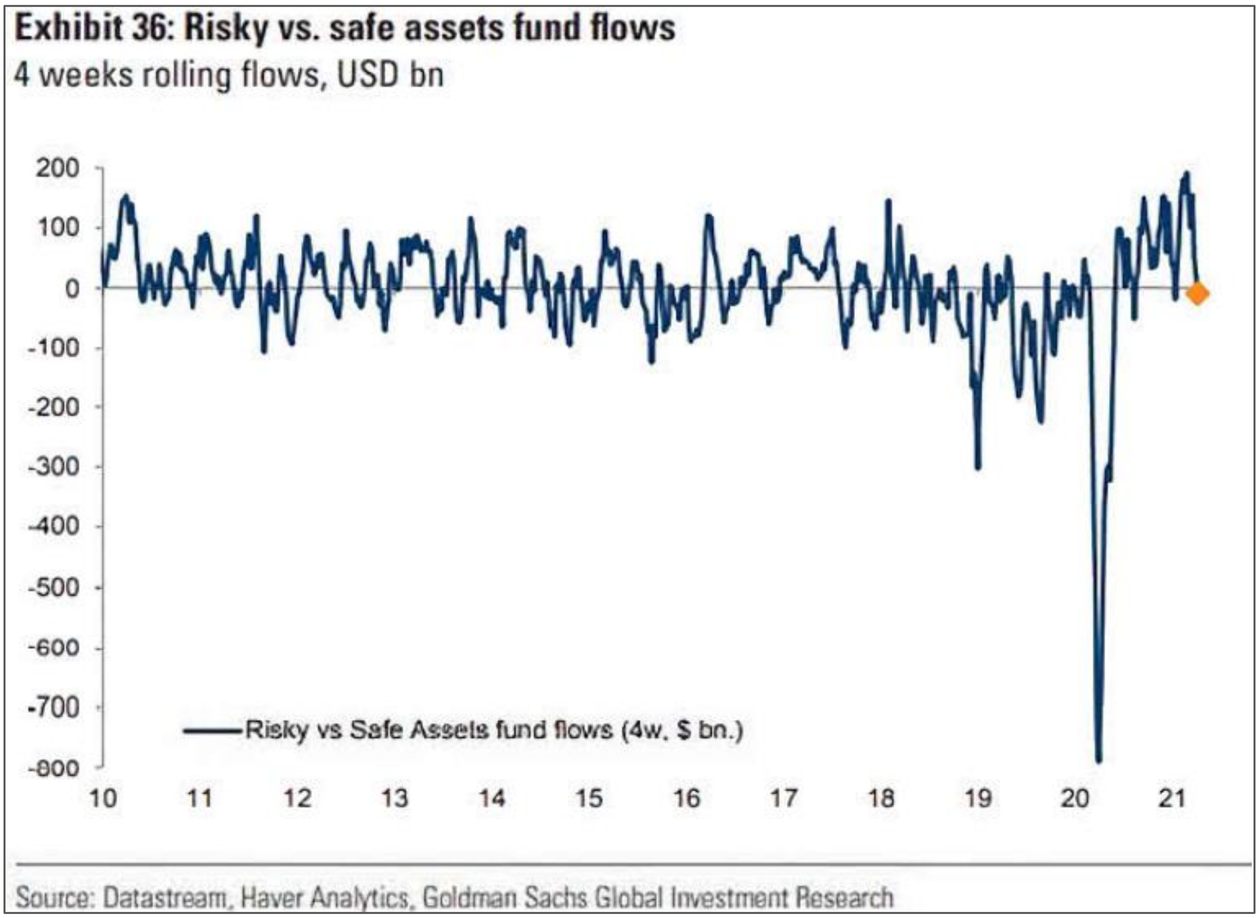
Levered Fund Sentiment set another new record this week.



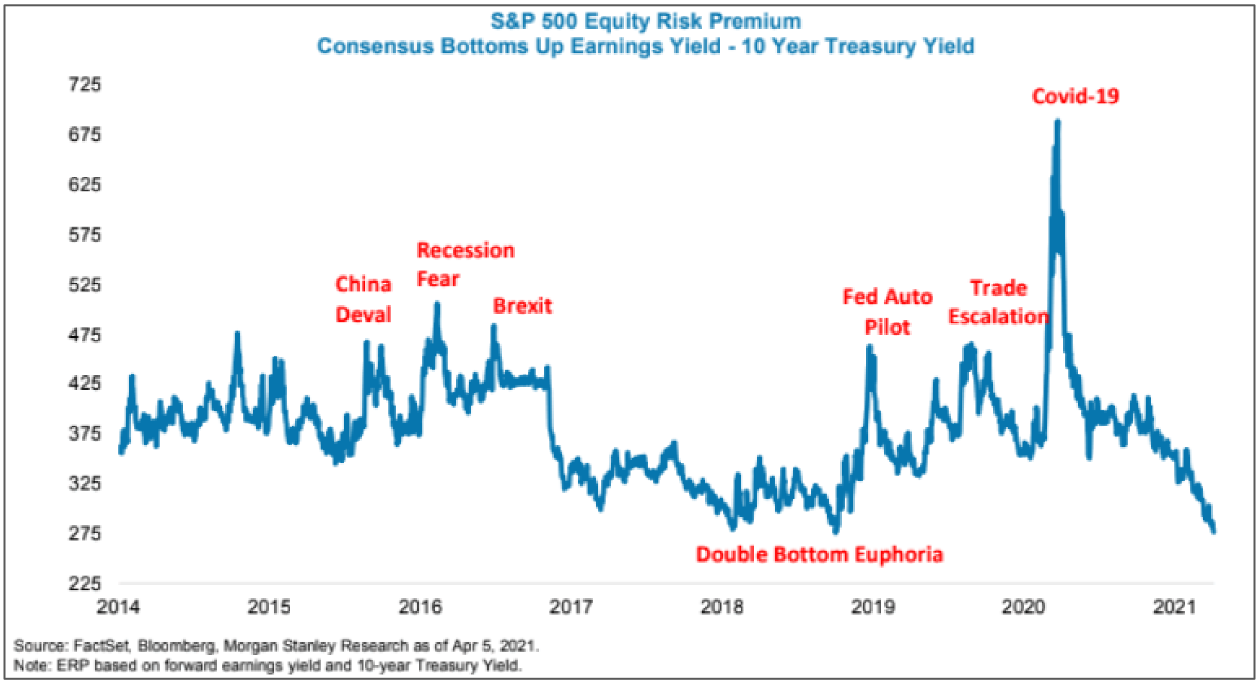
It was a record week for smart money Corporate Insider selling as well.



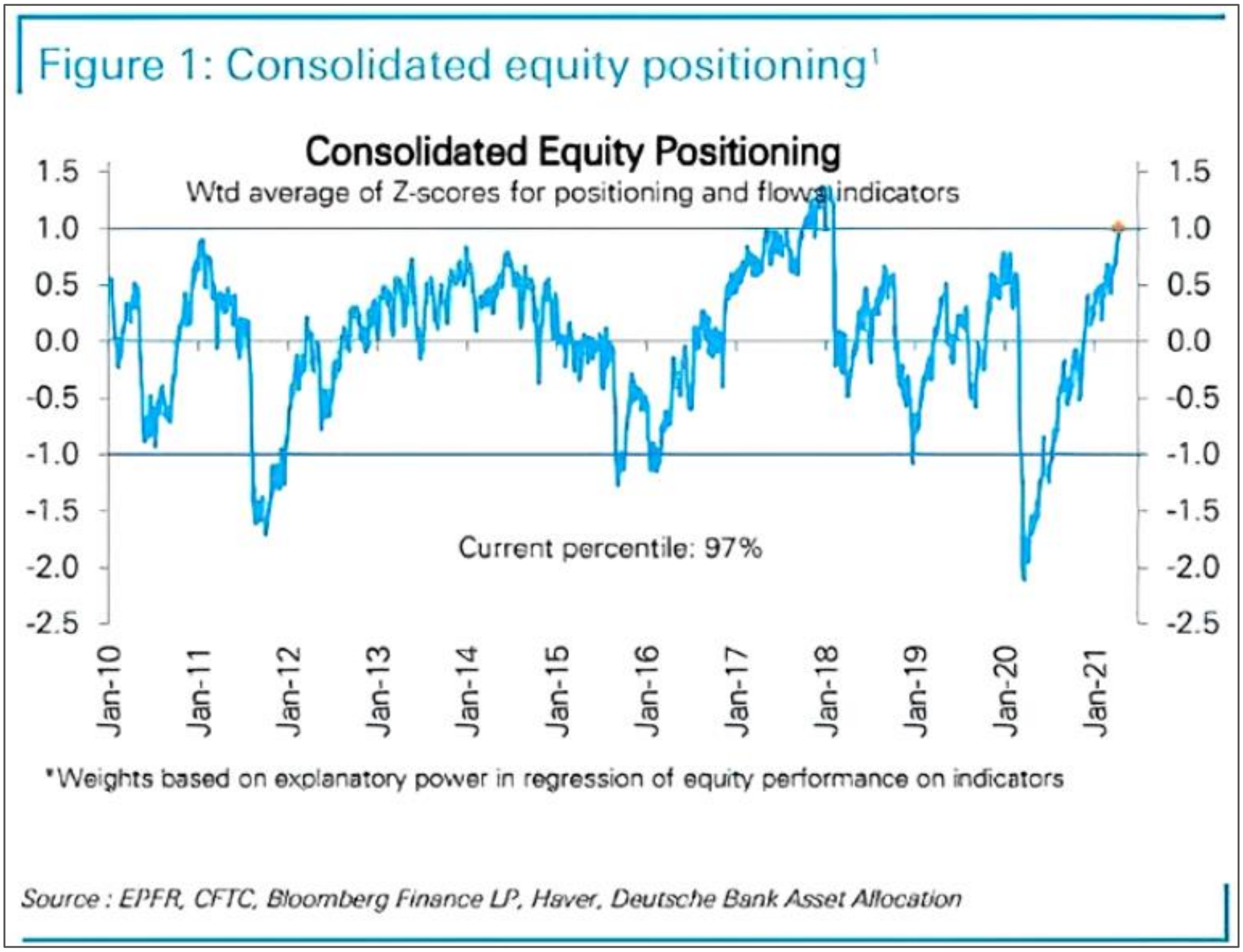
Sudden reversal in flows back toward safe assets.



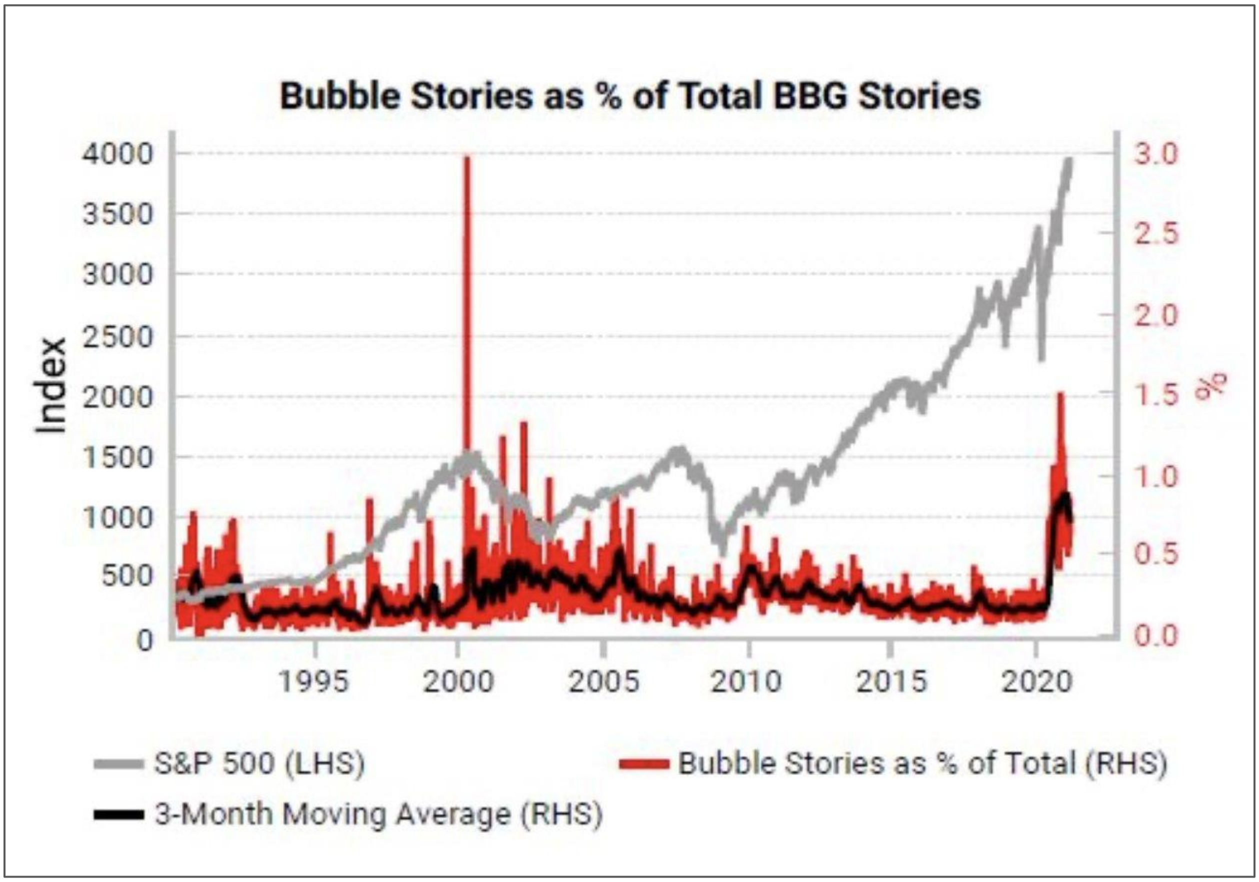
Equity Risk Premium near all-time lows.



Consolidated Equity positioning is at extremes.



Big spike in the number of Bubble Stories.



Source: Variant Perception, Jesse Felder

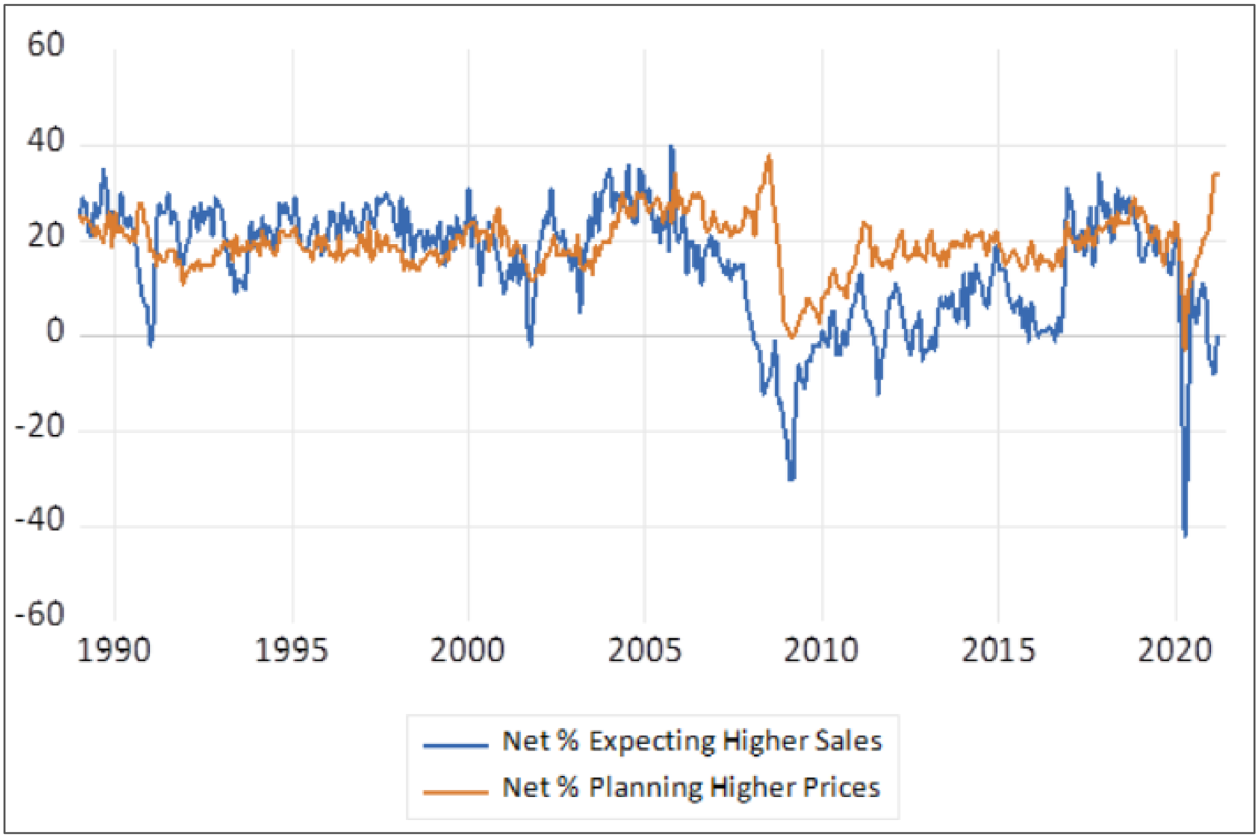
The stimulus has led to one of the most pronounced short-term spikes in retail sales we have ever seen.

Source: Bespoke

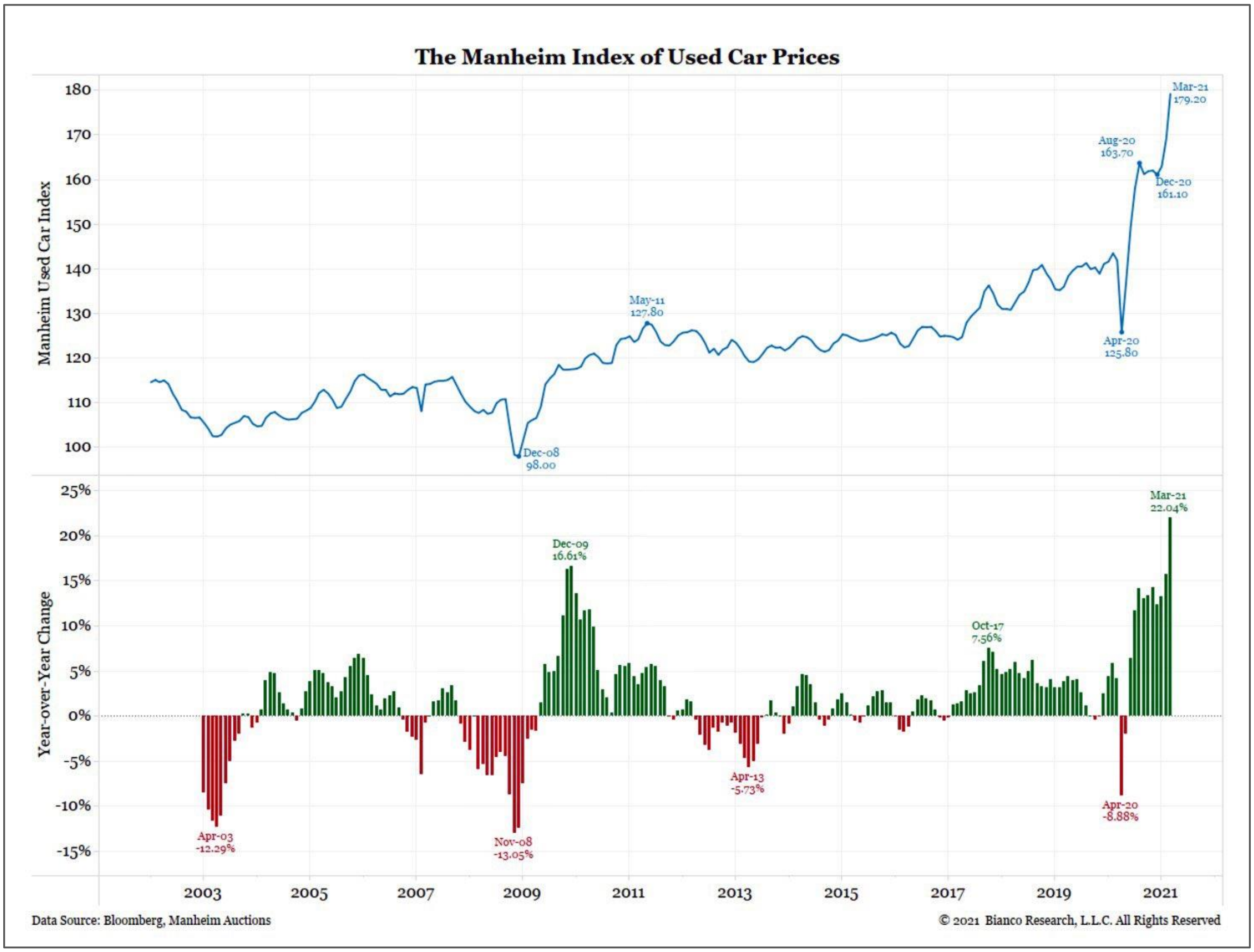
Employers are having to pay more to lure workers back.

Source: Bloomberg

Small Businesses appear to be expecting a profit margin squeeze.



Record spike in Used Car Prices



Source: Bianco Research

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.