Market Outlook

By Mark T Dodson, CFA

The Confident Consumer is Back

Market Risk Index fell below 90% this week to 88.9%. While still elevated, it has dropped enough that any shakeup of investor psychology will increase our recommended equity allocation. We need some shift away from the current euphoric sentiment.

Again, it was the monetary composite that caused all of the movement in MRI, and the Velocity category is firmly in positive territory now. The Fed has shown no signs of taking their foot off the pedal, even though we see clear signs that money demand is beginning to slow. It's that particular combination that causes our velocity readings to improve. We've never seen anything quite like this, a Fed with a foot firmly on the gas leaning into the wealth effect despite clear signs of speculative excess and building inflation pressures. It's a big bet on the word "transitory." It looks nothing like any other early economic recovery, despite its young age.

Case in point – the Conference Board data was released this week, and Consumer Confidence is back in the 80th percentile of readings. That's what you see when you are years into a recovery, not within 12 months of an economic trough. The Present Situation Index and (what we call) the Job Confidence index also surged close to the pre-2020 highs. Outside of the last cycle, you have to look at the late 60s and the late 90s to match these readings. It was right before inflation expectations lost their moorings for more than a decade in the former. In the latter, it was the most expensive stock market in US history. One was stagflationary, and the other more deflationary. In 2021, we have echoes and analogs to both of those periods.

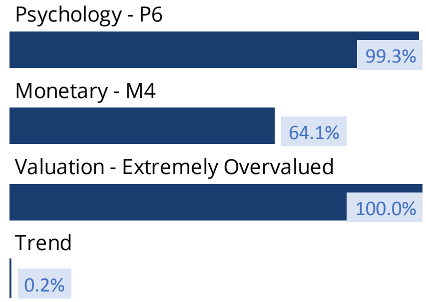
We're fans of the folks at Stock Trader's Almanac, who have popularized many calendar-based stock market anomalies. With April drawing to a close, the dreaded Sell in May period is upon us, as returns between May to October are significantly lower than the November to April returns. We learned long ago the phenomenon is best viewed through the lens of the presidential election cycle. It's the May to October in a mid-term election year (next year) that has the fangs when it comes to Sell in May. This one, in a post-election year, is decent historically.

Market Risk Index

Rec Allocation 25% Underweight

88.9%

Category Percentiles



Largest Psychology Influences	
Levered Investments	Negative
Surveys	Negative
Fund Flows	Negative
Option Activity	Negative

Largest Monetary Influences	
Inflation	Negative
Velocity	Positive
Monetary Aggregates	Negative

Valuation	
7-10 Year Rtn Forecast	-0.7%
10Yr Treas Yield (on 04/28)	1.6%

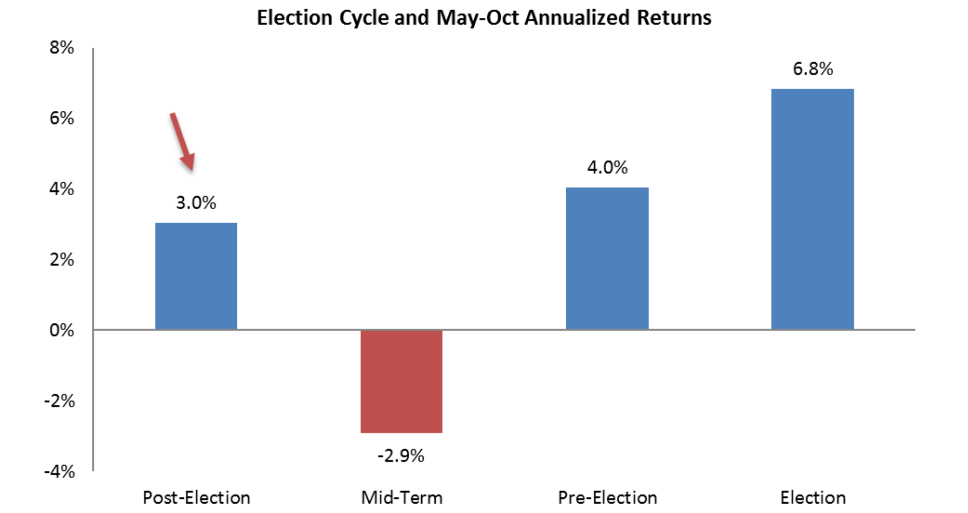
Market Trends	
US Equities	Bullish Investment
Intl Equities	Bullish Investment
REITs	Bullish Investment
Broad Commodities	Bullish Trade

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.

It's not the calendar that gives us pause. It's the previously unfathomable, record concurrent extremes in both investor psychology and valuation. Too many things have to go right to generate equity returns that are a premium over Treasury yields, even if valuations have entered a new era that marks a permanently high plateau. Regardless, so far, it's been the wrong short-term move to fade the record euphoria and valuations and a good lesson on why it's not a good idea behaviorally to be an all or none investor.

Charts of the Week

Post-Election Sell in May returns are below average, but not terrible.



S&P 500 price only returns since 1930, Source: Cypress Capital

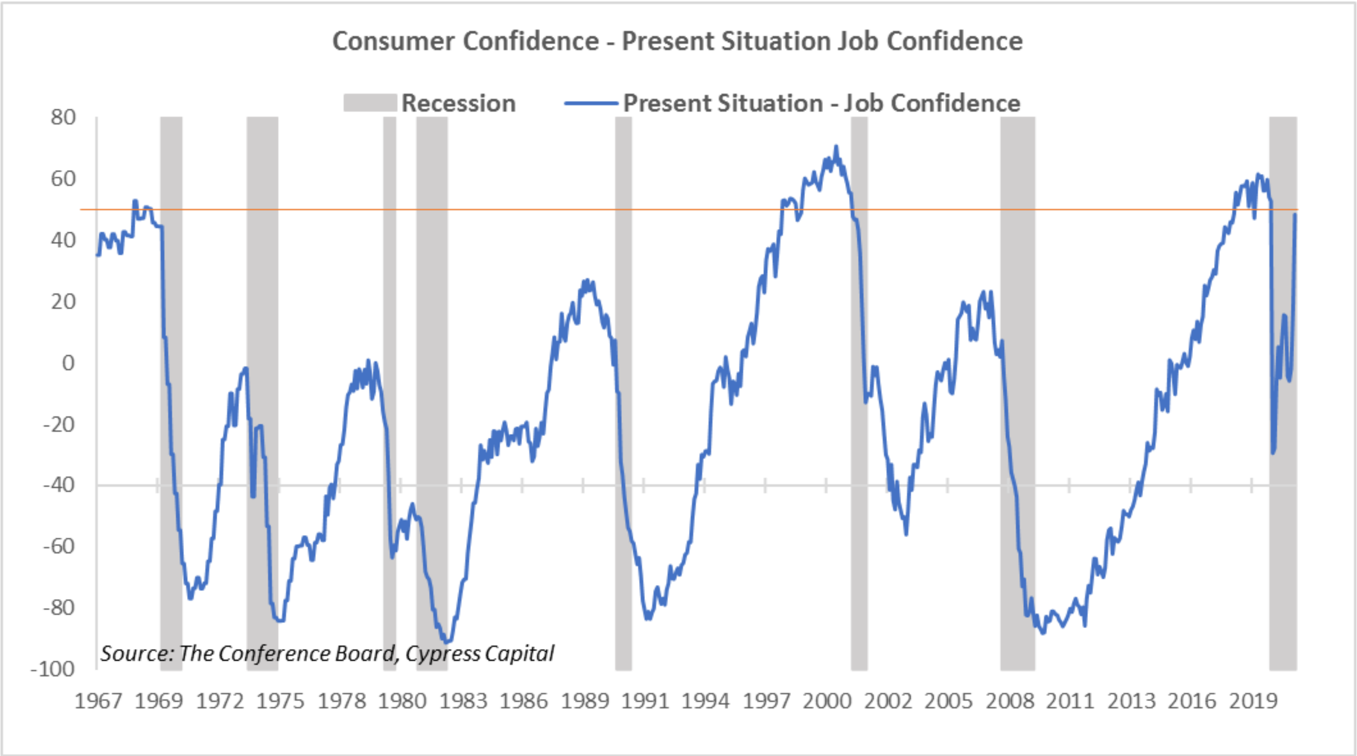
Table: Sell in May and the Presidential Election Cycle

Election Cycle & May-October Returns

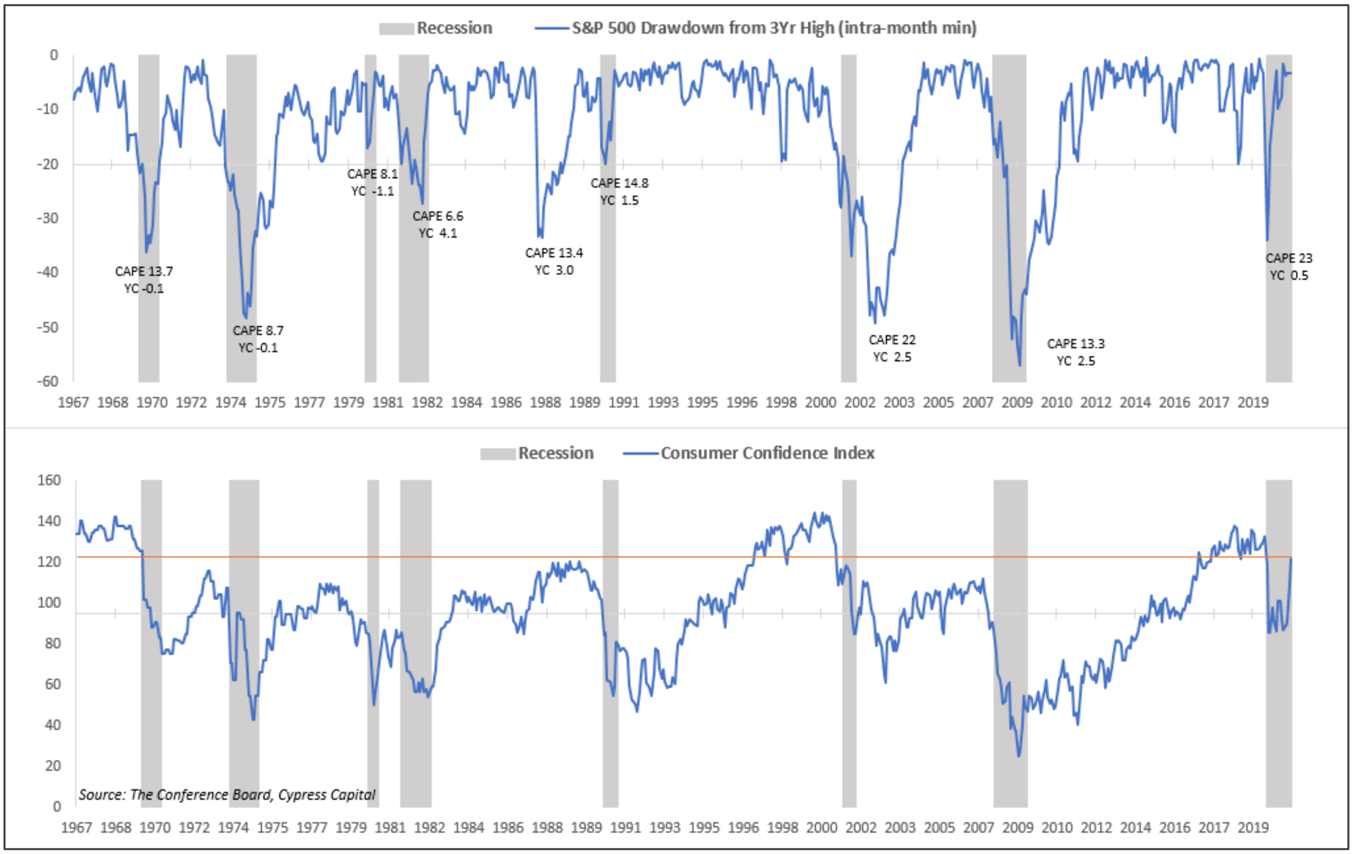
Period	Post-Election	Mid-Term	Pre-Election	Election
1929-1932		-32.0%	-30.2%	19.4%
1933-1936	7.7%	-15.8%	34.3%	25.0%
1937-1940	-24.8%	35.8%	17.5%	-9.1%
1941-1944	2.0%	23.0%	2.8%	7.7%
1945-1948	12.2%	-20.9%	5.8%	6.8%
1949-1952	8.8%	8.1%	2.3%	5.1%
1953-1956	-0.3%	12.1%	11.5%	-5.8%
1957-1960	-10.2%	18.2%	-0.1%	-1.8%
1961-1964	5.1%	-13.4%	6.0%	6.8%
1965-1968	3.7%	-11.9%	-0.8%	6.1%
1969-1972	-6.3%	2.1%	-9.4%	3.6%
1973-1976	1.2%	-18.2%	2.0%	1.2%
1977-1980	-6.2%	-3.8%	0.1%	19.9%
1981-1984	-8.3%	14.8%	-0.5%	3.8%
1985-1988	5.6%	3.6%	-12.7%	6.8%
1989-1992	9.9%	-8.1%	4.6%	0.9%
1993-1996	6.3%	4.7%	13.0%	7.8%
1997-2000	14.1%	-1.2%	2.1%	-1.6%
2001-2004	-15.2%	-17.7%	14.6%	2.1%
2005-2008	4.3%	5.1%	4.5%	-30.1%
2009-2012	18.7%	-0.3%	-8.1%	1.0%
2013-2016	10.0%	7.1%	-0.3%	2.9%
2017-2020	8.0%	2.4%	3.1%	12.3%
Mean	**2.1%**	**-0.3%**	**2.7%**	**4.0%**
Median	**4.7%**	**2.1%**	**2.3%**	**3.8%**
Geo Mean (Annl)	**3.0%**	**-2.9%**	**4.0%**	**6.8%**
Std Dev.	**10.3%**	**15.7%**	**12.1%**	**10.8%**
C.V (SD/Mean)	**4.9**	**(58.7)**	**4.5**	**2.7**
Pct Positive	**68%**	**52%**	**65%**	**78%**

S&P Price Only since 1930 *Source: Cypress Capital*

Consumer Confidence in the Job Market is approaching all-time-highs again.

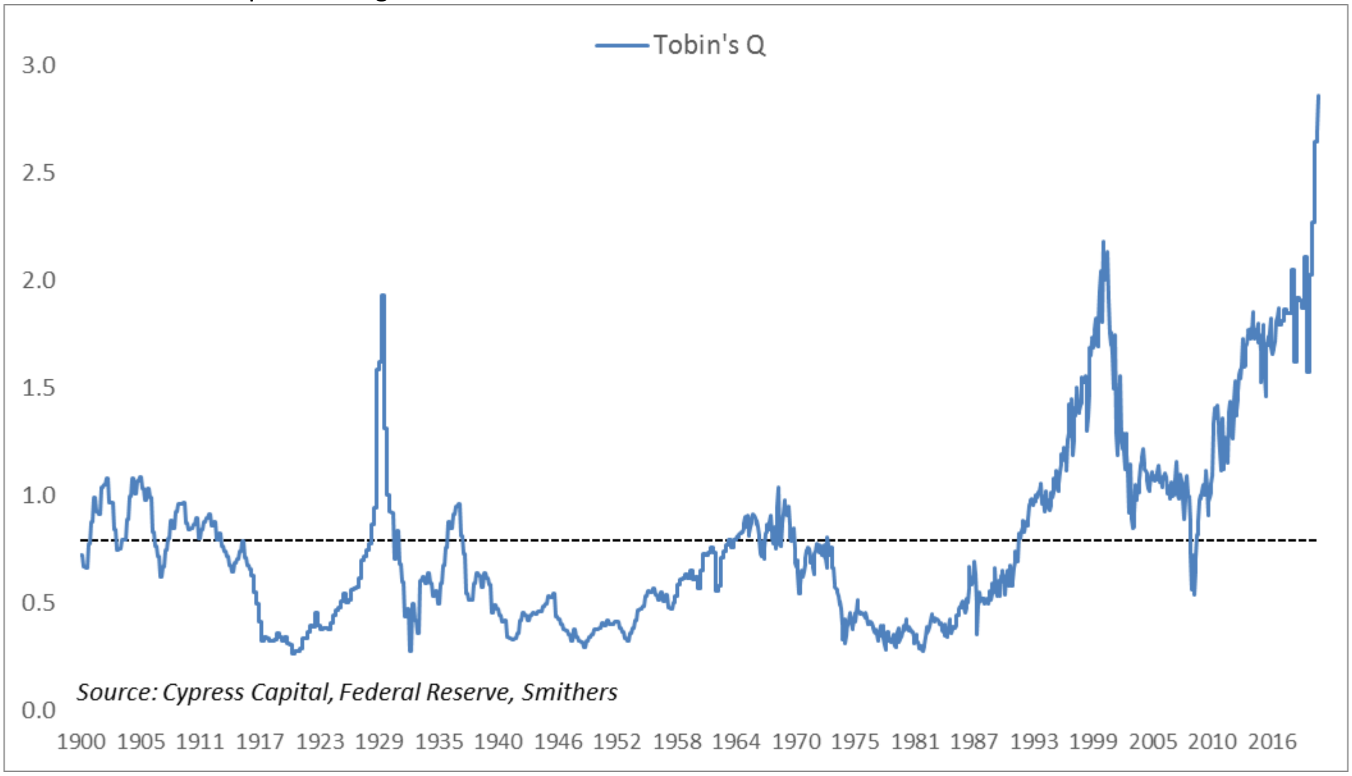


Consumer Confidence has never rebounded this much so soon after an economic trough.

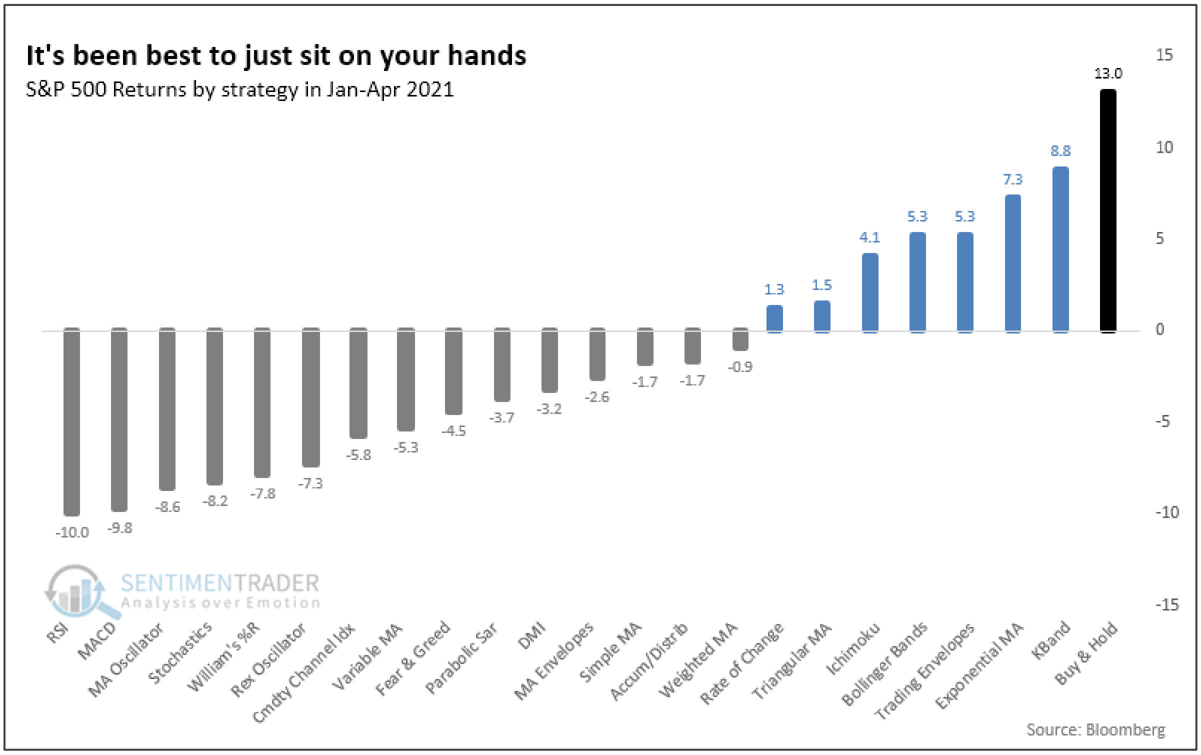


Tobin's Q has reached escape velocity.

Tobin's Q is one of the metrics within our valuation composite. If you aren't familiar, it measures the ratio of the market value of equities to the replacement cost of the assets. It became more popular for market watchers on the publishing of Valuing Wall Street in 2000, when Andrew Smithers warned of a bear market for stocks. Q has climbed more than 250% above its long-term average, more than 100% above its average since 1995, and more than 30% above the peak during the dot-com bubble.

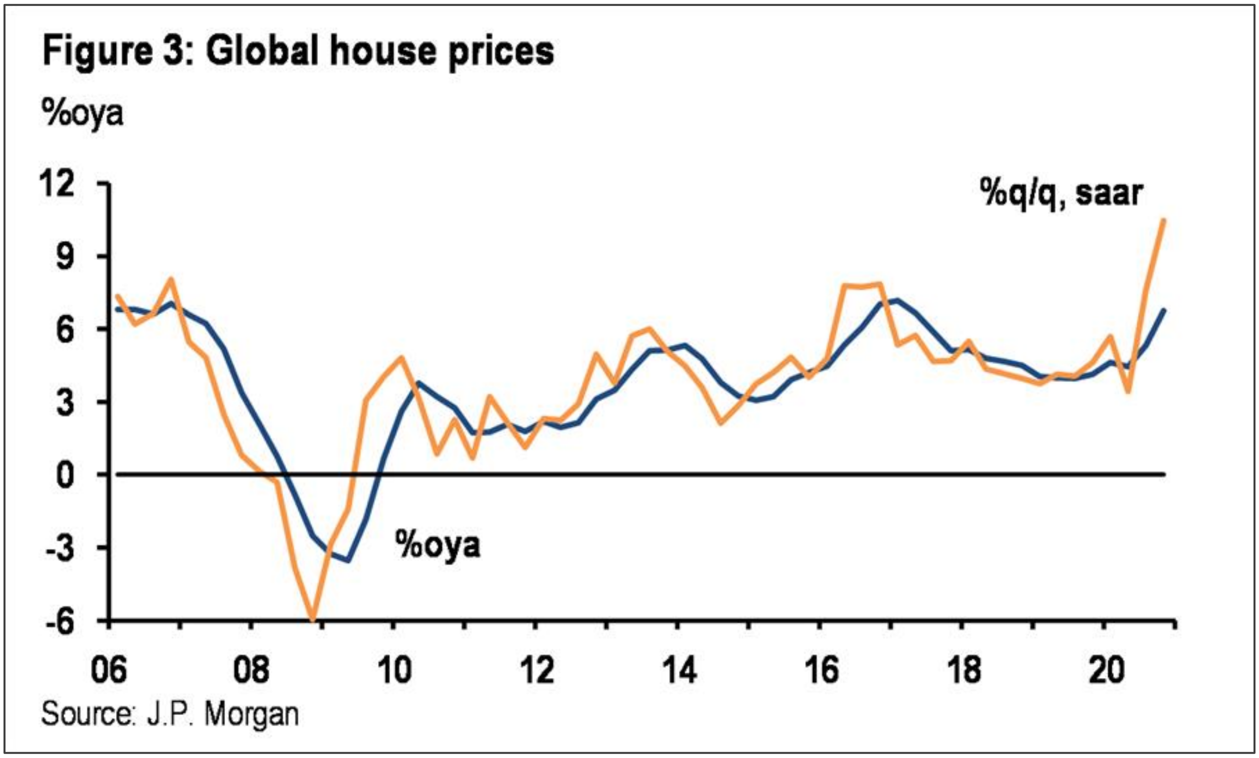


Passive Buy and Hold has beaten Technical Analysis in 2021.



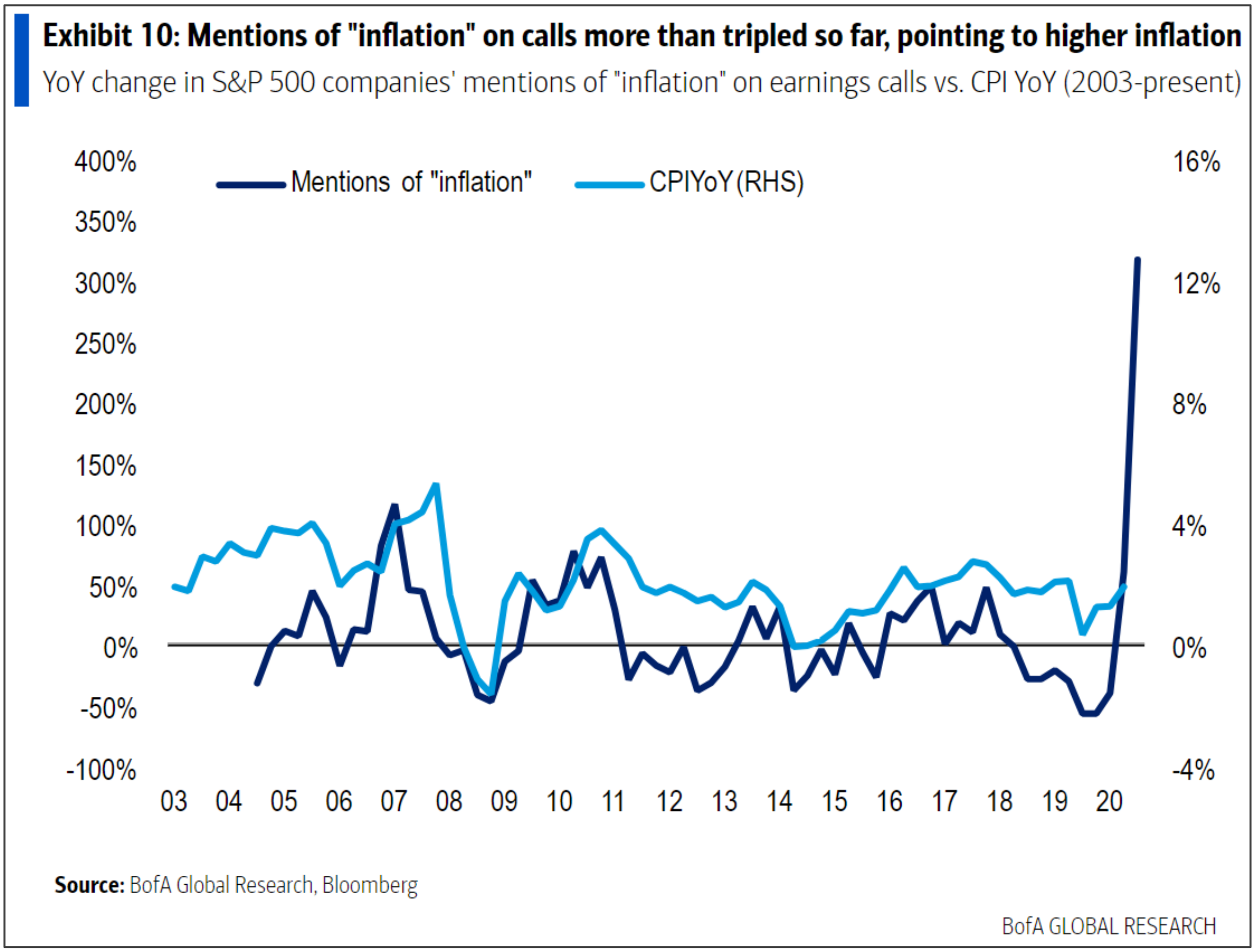
Gain on Existing Home Sales Price broke the record set during the housing bubble.

Stimulus is pushing up the prices of homes globally, so it's not just a demographic phenomenon in the US.

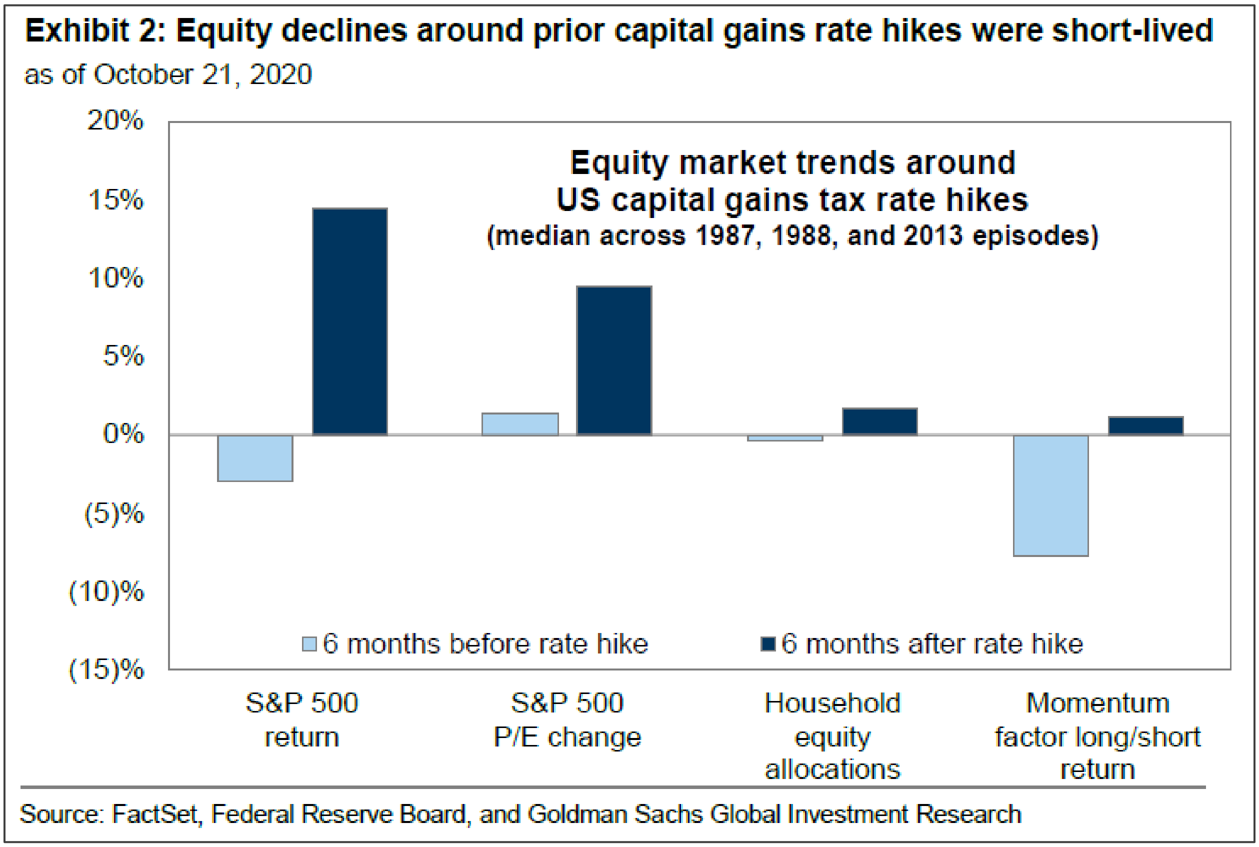


Inflation Expectations are at 2008 levels, when Goldman Sachs released the infamous $200 oil price target.

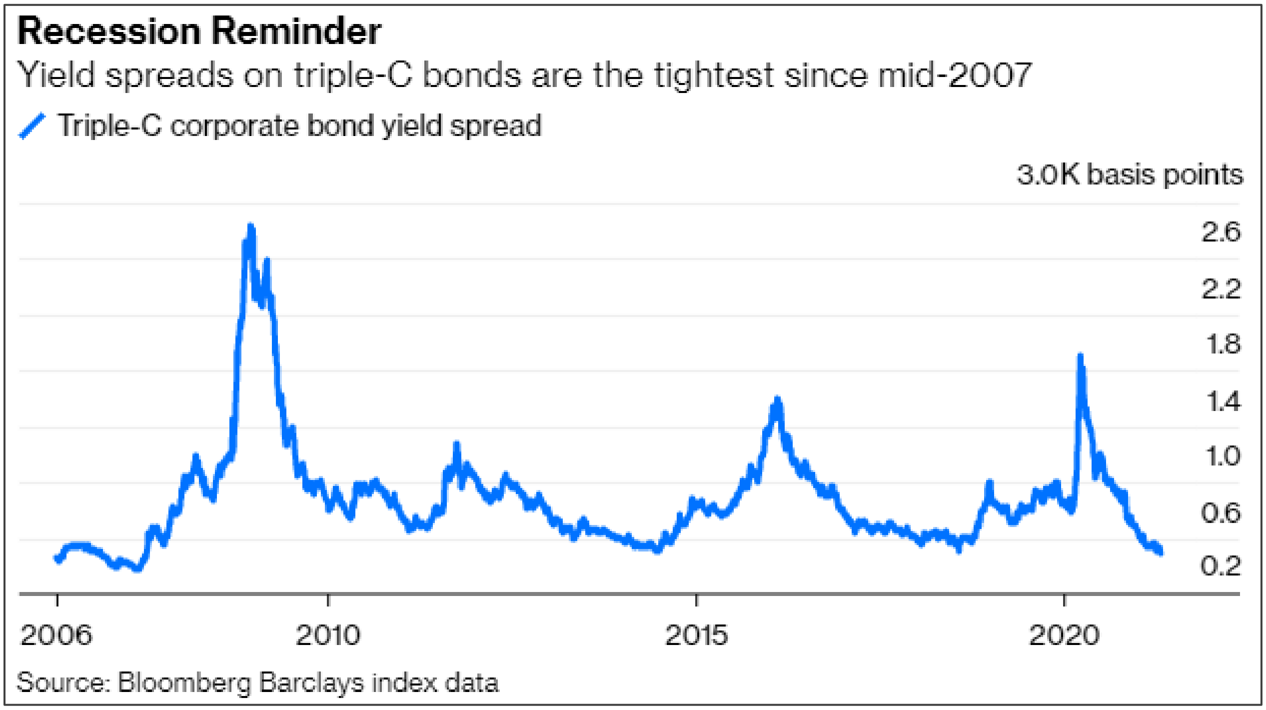
Mentions of "inflation" on earnings calls have more than tripled this year.



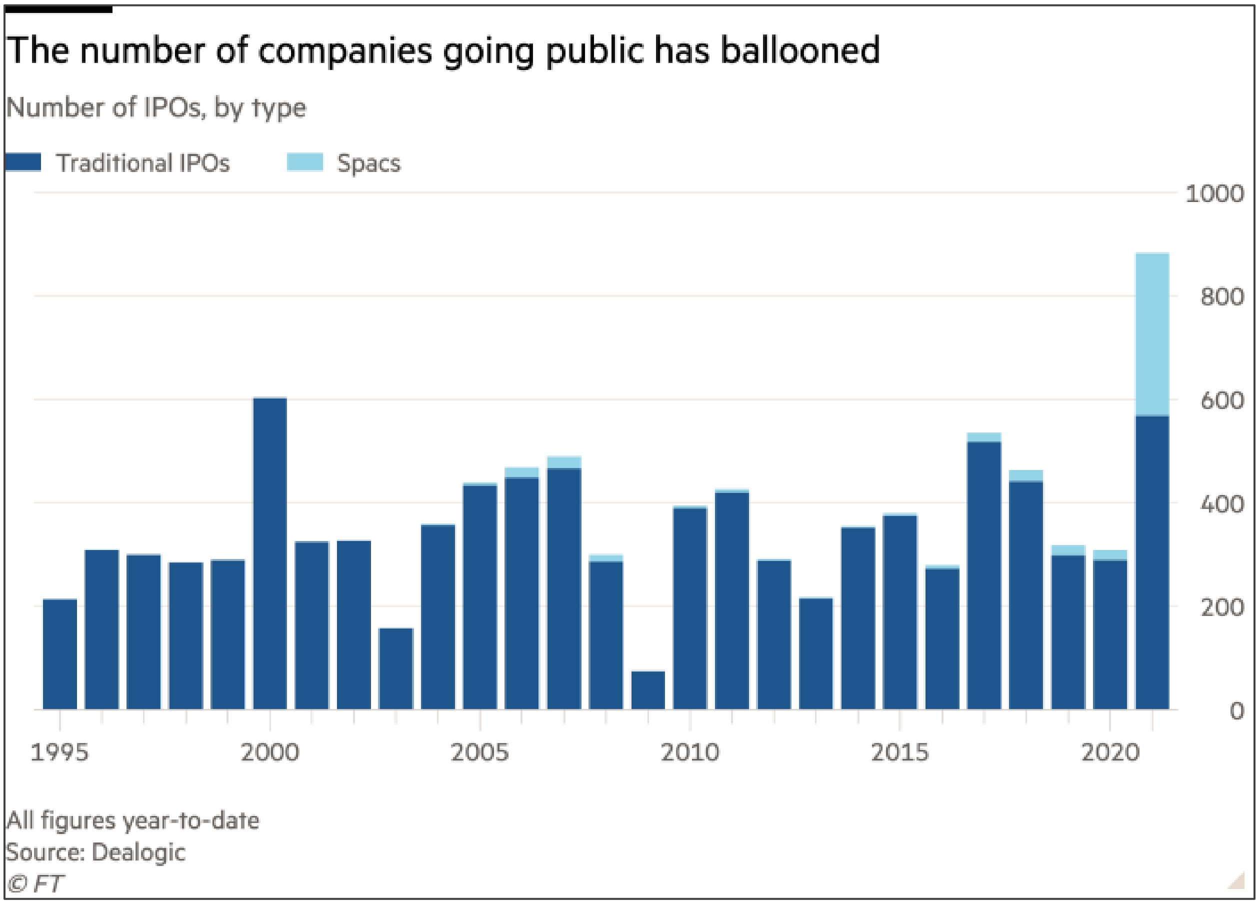
Investors tend to sell stocks before cap gains taxes go up, then repurchase them after the law goes into effect.



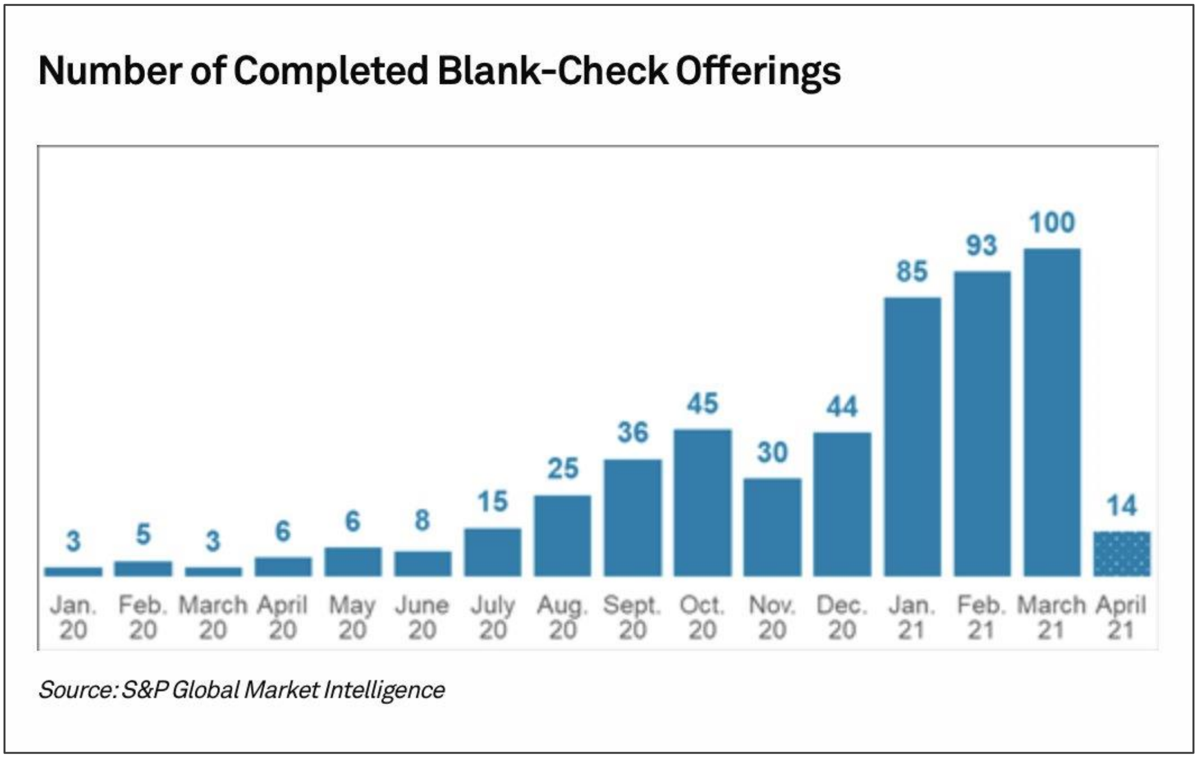
Reaching for yield – pricing high yield bonds like its 2007.



The number of IPOs has ballooned.



But, the market for SPACs has softened.



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.