



Market Outlook

By Mark T Dodson, CFA

Making Policymakers Sweat

Psychology and Valuation bumped up to their max 100th percentile ceilings again, but an improved monetary composite more than offset it. Market Risk Index dropped by a percent to 88.2.

Our monetary composite appears to be aiming to move toward the 50th percentile. We have positive velocity and a Fed with the foot on the gas pedal, combined with our inflation indicators in the red and a yield curve that is neither too steep nor shallow. It's a balancing act.

Still, there was more leading inflation evidence coming this week that isn't good news for monetary conditions. The Producer Price Index moved even higher and hasn't shown signs of rolling over yet with growth at 10.7% over the last six months – it's in the worst 5% of readings on PPI. As we've repeated for several weeks, markets tend to struggle and grow more volatile when price increases are running hot. PPI growth above 5% is associated with market returns of -0.2% annualized. PPI growth above 10% is associated with market returns of -9.5% annualized.

The inflationary readings are more than base effects due to the covid recession. It is legitimate inflationary pressure, as monetary and fiscal stimulus caused an outsized impact on demand while the supply of both labor and goods is constrained. Given the recent ISM and PPI readings, CPI readings will continue to come in hot, ensuring that inflation will be part of the stock market narrative for several months. With rent moratoriums going away, the rental equivalent inputs for housing within CPI will begin some of the sharp inflation occurring in the housing market. There is a psychology behind inflation expectations, so the risk is that it not only shifts higher but becomes un-moored in the process. In the meantime, it's going to make policymakers sweat. Corrections in financial asset prices can alleviate the pressure, so it doesn't require a recession.

There are anecdotal headlines that some of the speculative retail fervor is softening. Retail trading volumes at Schwab and Robinhood are fading. The noticeable break in the market's most speculative areas like SPACs, Tech stocks, and cryptocurrencies may be taking the shine off the ideas of easy money and fast riches. The popular ARK fund, which reminds us of the Janus Twenty and Munder Net funds from the late 90s, has stumbled and has been forced to sell its names as prices slide to cover recent outflows.

Market Risk Index

Rec Allocation 25% Underweight

88.2%

Category Percentiles

Psychology - P6



Monetary - M4



Valuation - Extremely Overvalued



Trend



Largest Psychology Influences

Levered Investments	Negative
Surveys	Negative
Volatility	Negative
Option Activity	Negative

Largest Monetary Influences

Inflation	Negative
Velocity	Positive
Interest Rates	Negative

Valuation

7-10 Year Rtn Forecast	-0.6%
10Yr Treas Yield (on 05/11)	1.6%

Market Trends

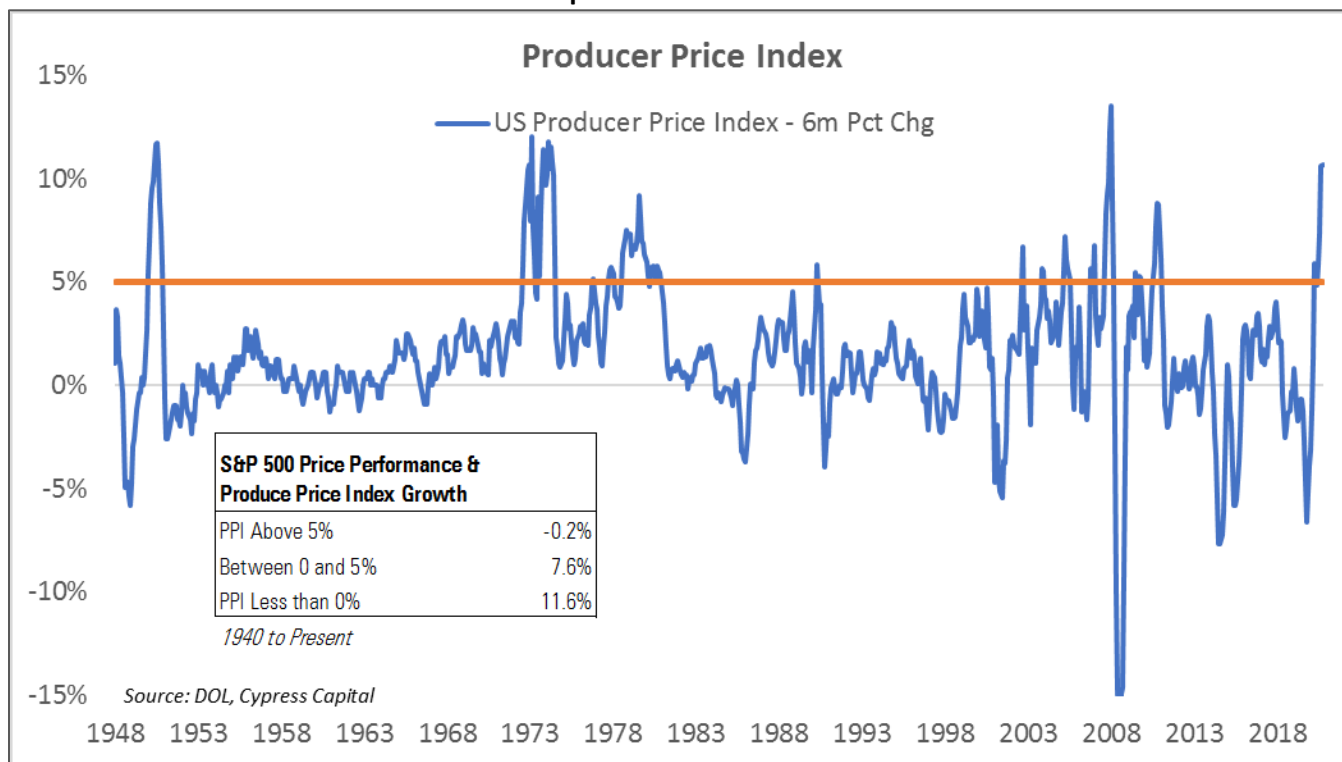
USEquities	Bullish Investment
Intl Equities	Bullish Investment
REITs	Bullish Investment
Broad Commodities	Bullish Investment

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.

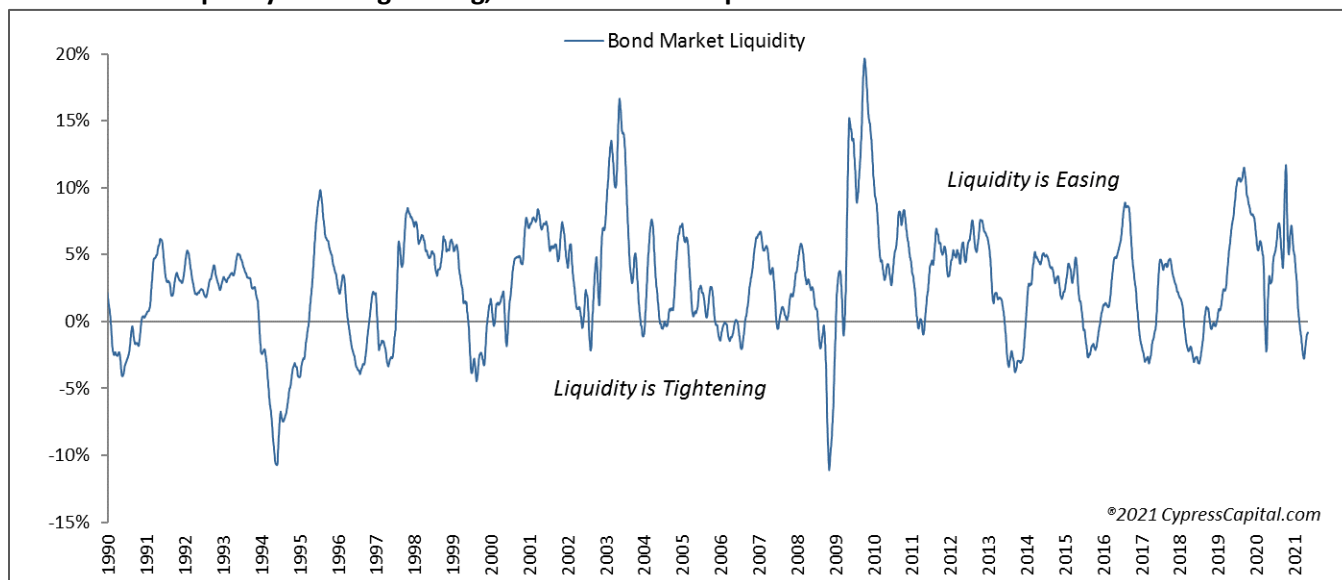
However, other than some oversold technical readings, none of this has translated into objective indications of investor fear within our psychology composite. The market has rallied right on the same modest oversold reading levels that we have seen since January. There is one notable exception – our de-trended version of the equity put/call ratio is back in the green. But, it's a consequence of speculative activity in call options hitting such extremes over the last six months. The absolute level of equity put volume relative to call volume is still in euphoria territory.

Charts of the Week

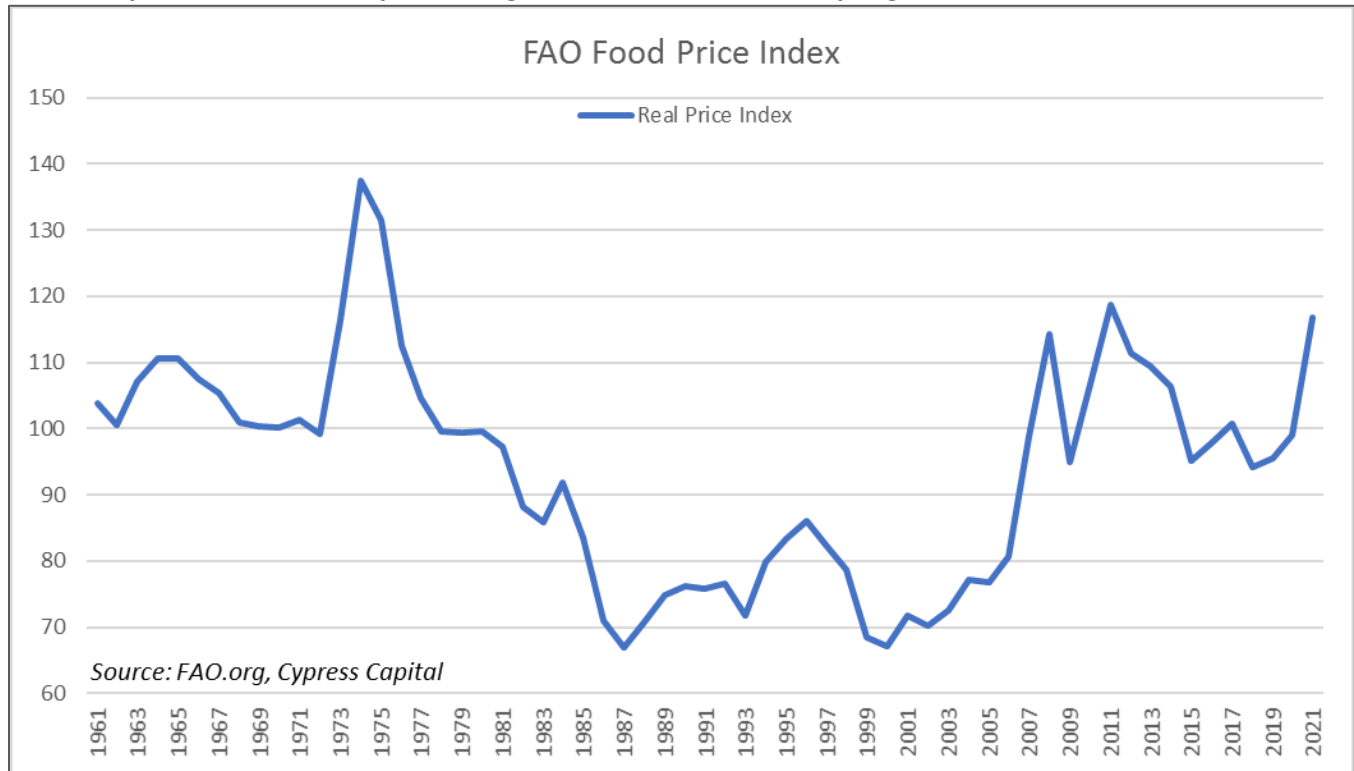
Producer Price Index inflation accelerated in April.



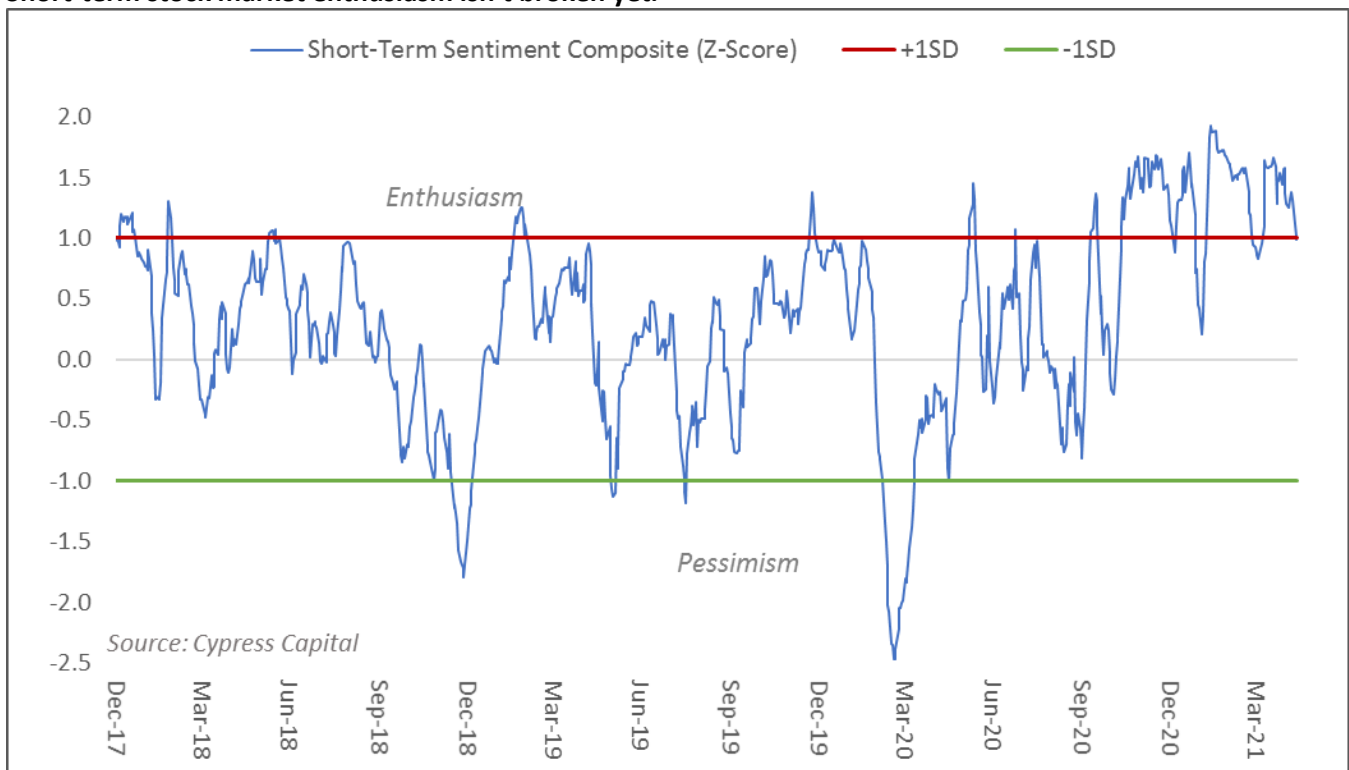
Bond Market Liquidity is still tightening, but it has turned up.



Real food prices have moved up to the highest level since the Arab Spring.

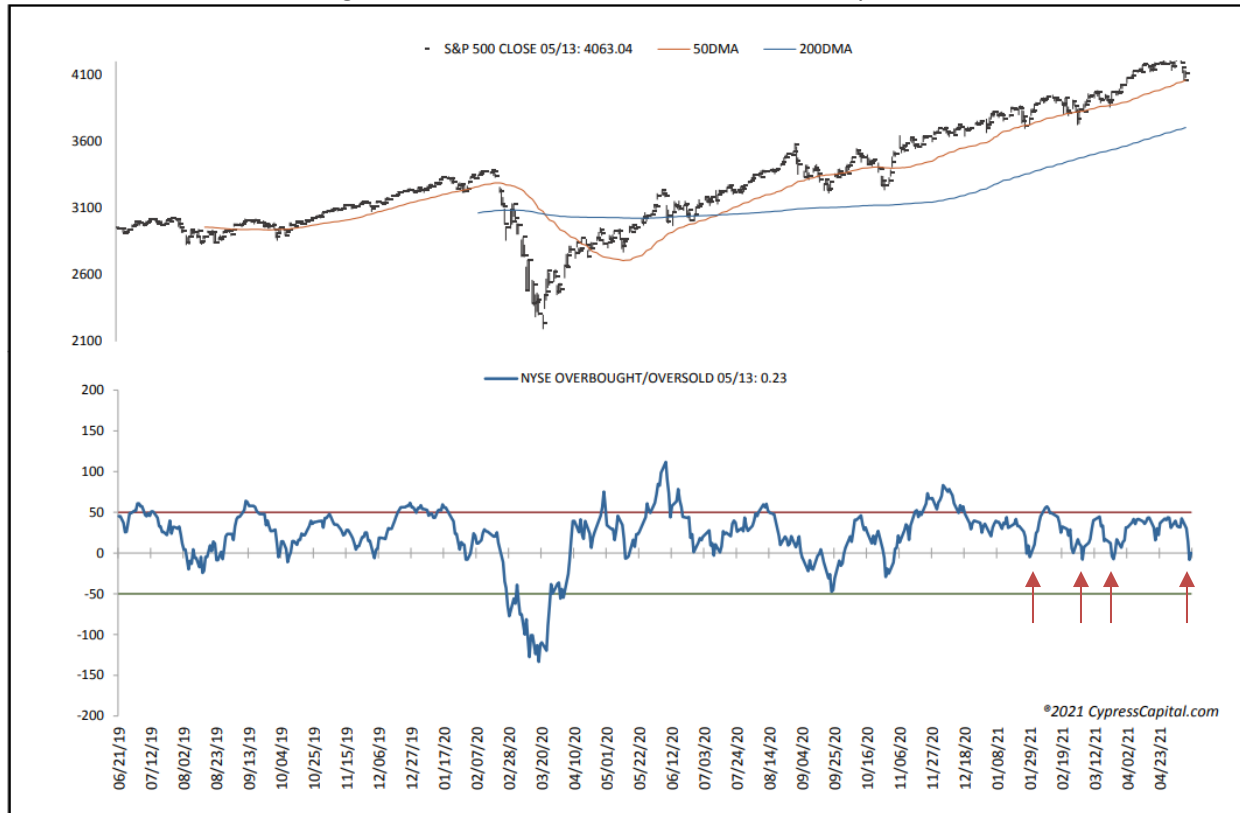


Short-term stock market enthusiasm isn't broken yet.

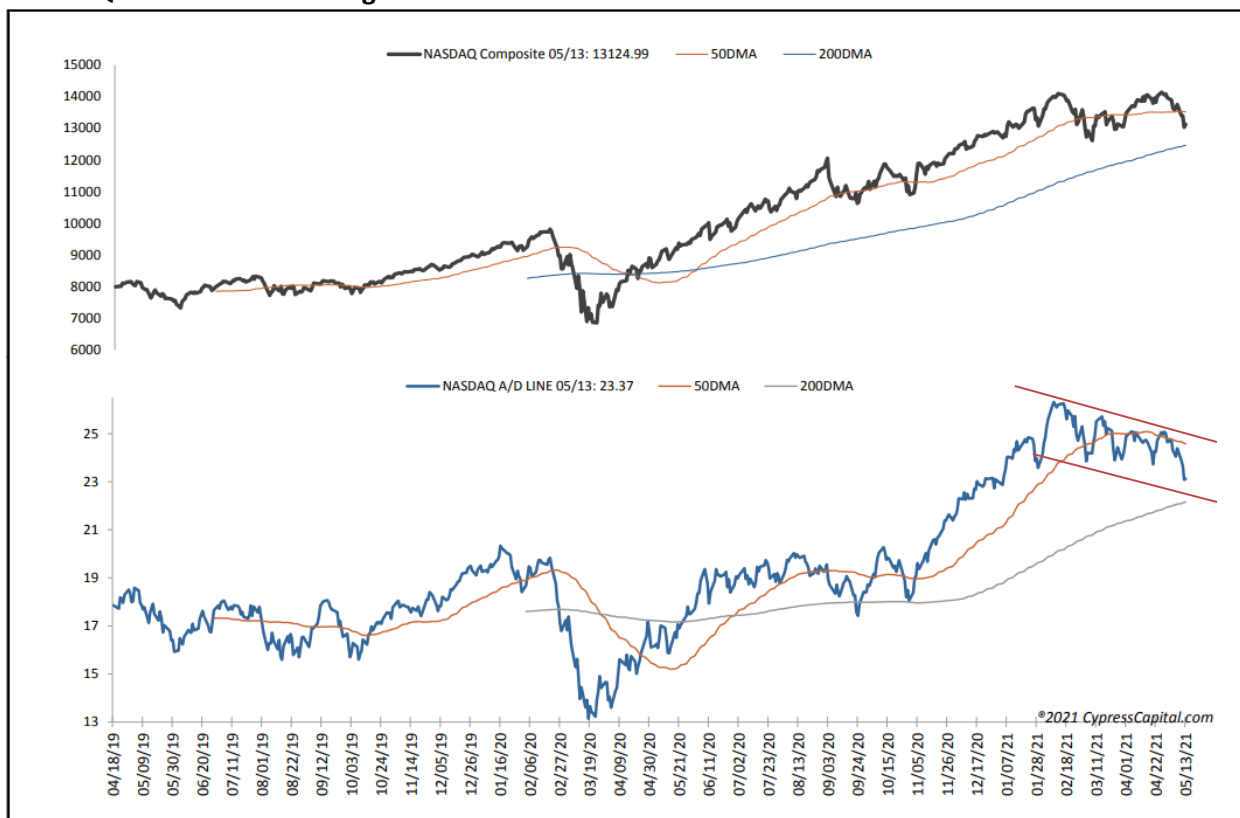


NYSE Overbought/Oversold has gone negative for the fourth time since January.

The market rallied to new highs the first three times almost immediately.

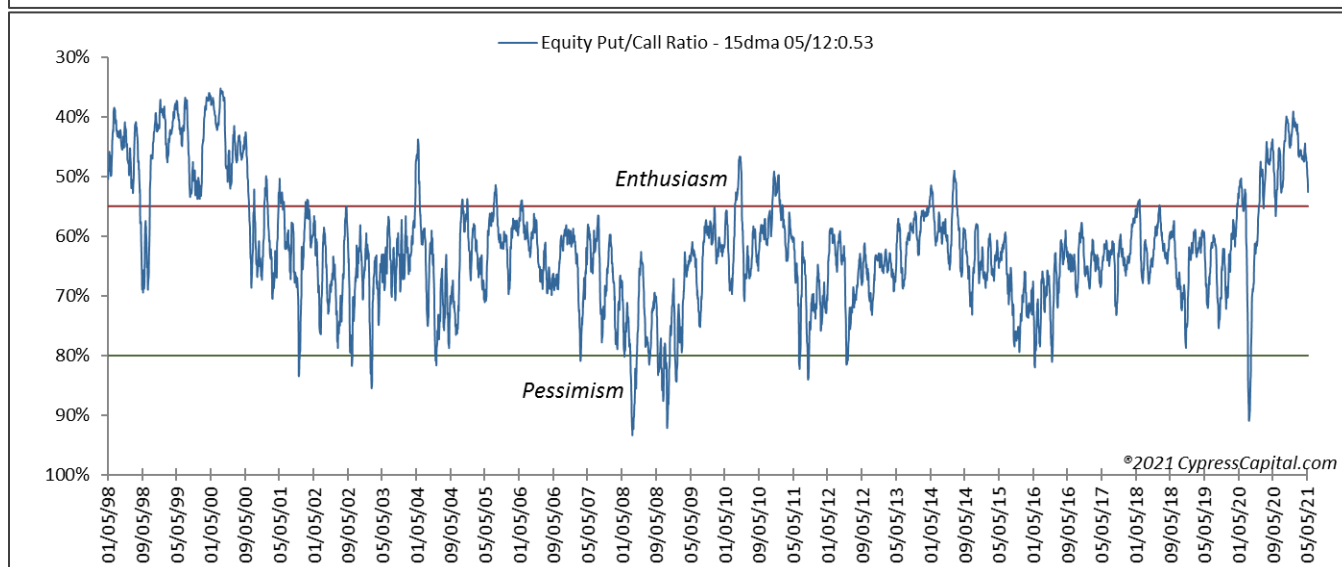
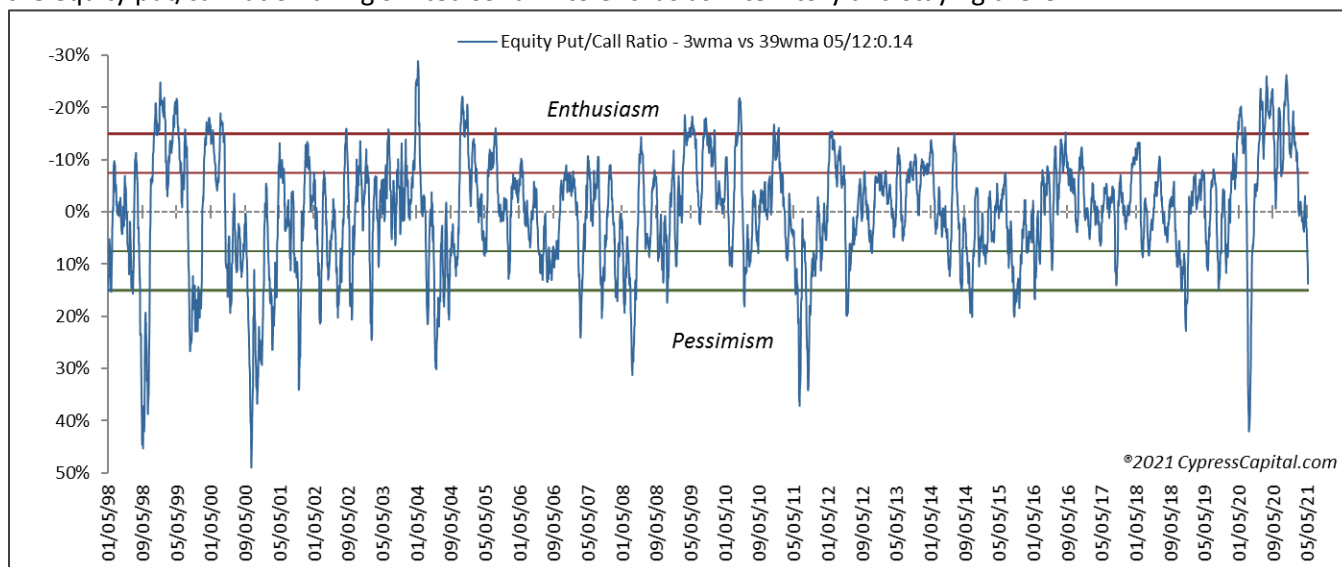


NASDAQ Breadth is worsening.



Equity Put/Call Ratio

The de-trended equity put/call ratio is hitting the best reading since March 2020, but it's primarily a function of the equity put/call ratio having shifted so far into enthusiasm territory and staying there.



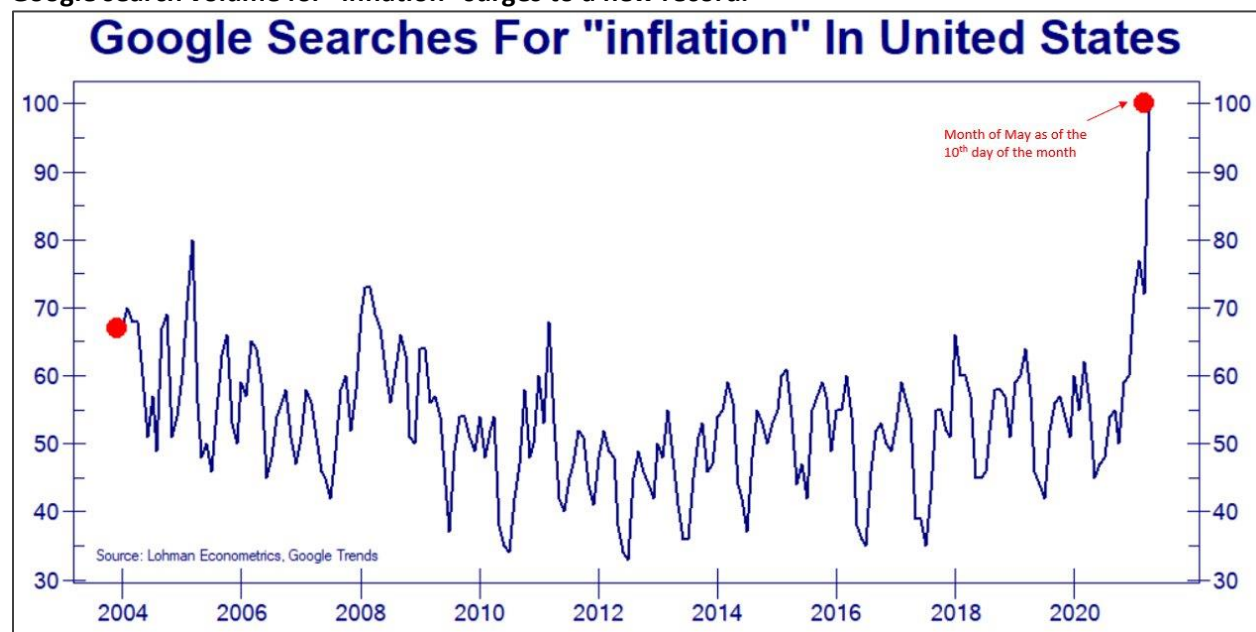
Small businesses have never had a more challenging time filling positions.

The Employment Bottleneck

Small businesses say they have never found jobs harder to fill



Google search volume for "inflation" surges to a new record.



Record price increase in single-family homes.**Prices On Fire**

Annual single-family home price increase hits record pace in first quarter



Source: National Association of Realtors

Cardboard box supplies are getting thin.**Containerboard—used to make cardboard boxes—at record low weeks of supply**

—Fibre Box Association Containerboard Plants Weeks Supply



Data represents the industry total for weeks of inventory based on shipments of corrugated products in millions of square feet, as reported in the Fibre Box Association Statistical Bulletin.
 Source: Charles Schwab, Bloomberg data as of 5/7/2021.

Source: Jeff Kleintop

College tuition inflation is the lowest on record.

Colleges Are Losing Their Pricing Power

US tuition fee inflation is the lowest since records started in 1978

US CPI College Tuition & Fees (%)



Bloomberg

The hottest retail areas of the market have weakened considerably from their 2021 peaks.

Investors pull back from frothier corners of stock market

Performance of Goldman Sachs custom indices (%)

Non-profitable tech

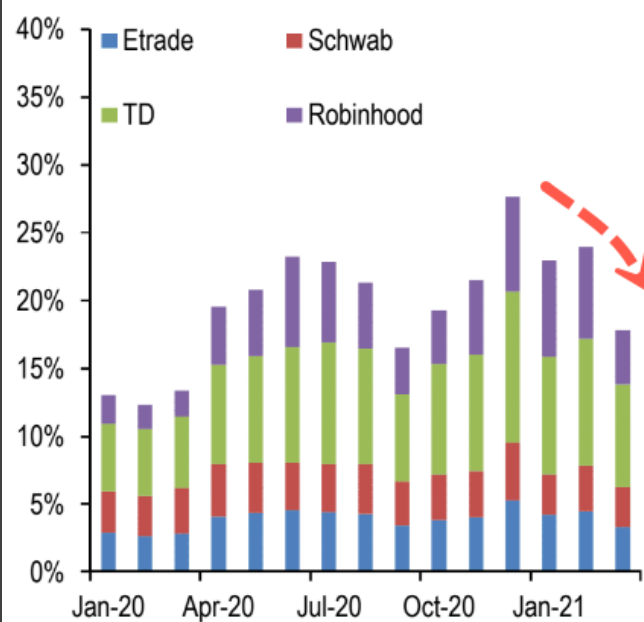
Liquid IPOs

Bitcoin sensitive stocks



Source: Goldman Sachs

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Retail trading volume is softening.**Figure 1: Source Flow by Retail Brokerage Firm as % of total US equity trading volume**

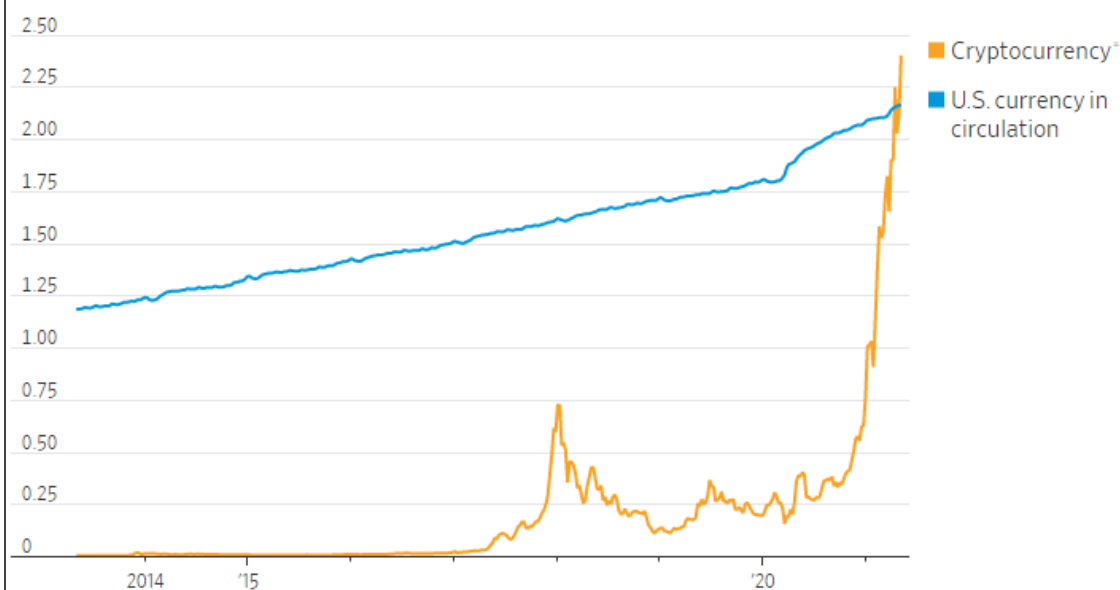
Source: Company filing - SEC 606 disclosure, J.P. Morgan.

Source: Alastair Williamson

Growth in Crypto-currency money supply is starting to look worse than Quantitative Easing.**Digital Greenbacks**

Weekly value of U.S. currency vs. cryptocurrency

\$2.75 trillion

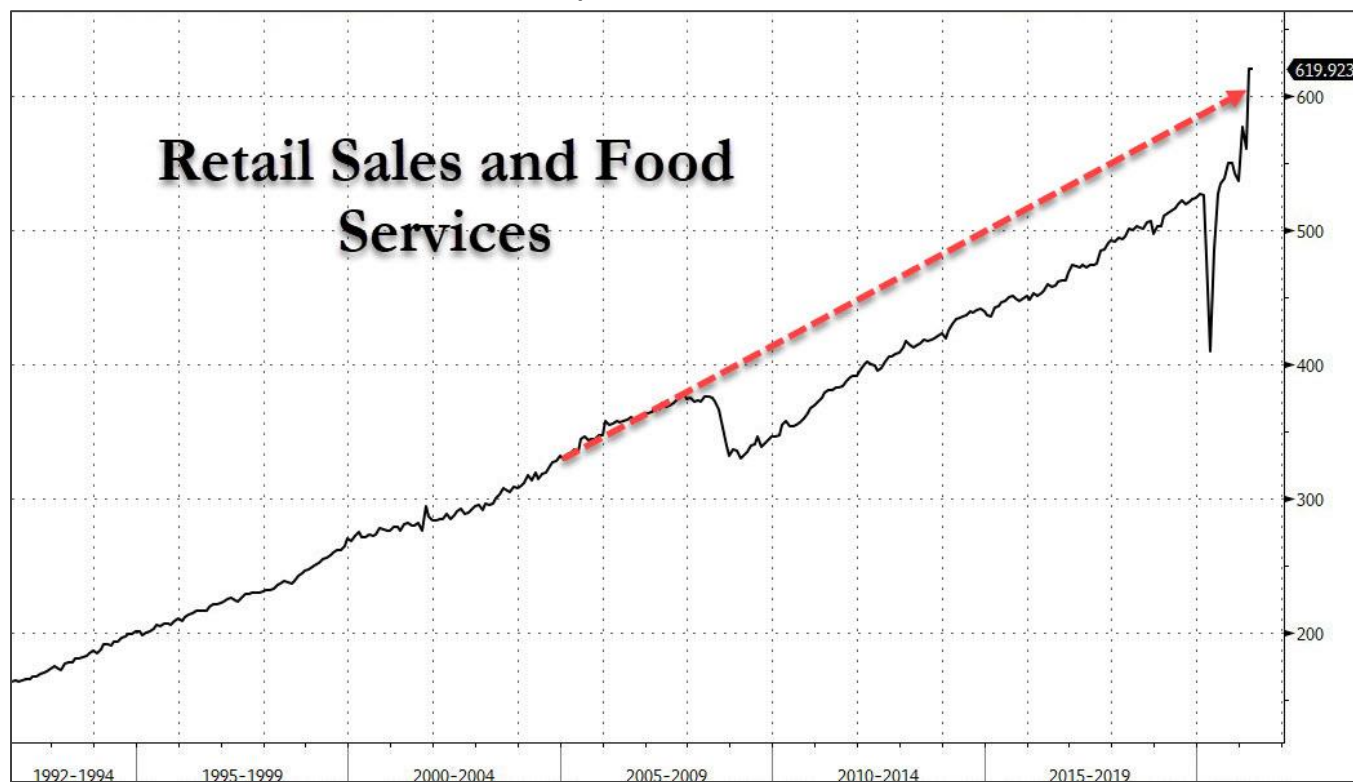


*Total market value of the 300 largest cryptocurrency assets

Sources: CoinDesk (cryptocurrency); Federal Reserve Bank of St. Louis (currency)

Source: WSJ

Stimulus has taken retail sales above even the pre-GFC trend.



Source: ZeroHedge

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.