Market Outlook

By Mark T Dodson, CFA

Is the Plateau Permanent or Transitory?

Market Risk Index dropped on an improved monetary composite score. For the third week in a row, our psychology and valuation composites are pegged at the 100th percentile.

No significant developments occurred under the surface, so it was a quiet week for the model. As measured by the factors within our model, the current environment is a combination of record valuations and sentiment in the face of some historic inflation pressure. Thus far, investors have shown only minor concerns about inflation, so one can conclude that the market consensus mostly believes the “inflation is transitory” narrative.

Some of the severe excesses within investor sentiment continue to pull back. Still, nothing is close to registering anxiety on behalf of investors outside of our de-trended put/call ratios, which we have already discussed in recent weeks. Pure equity put/call ratios are still beyond the 90th percentile in favor of calls over puts.

Looking at price charts of GME and AMC this week gives an excellent analog of investor sentiment. Right as the price on one or the other fades, there’s another resurgence in speculative behavior. However, any price downturns thus far in 2021 are still well above what most would have considered reasonable valuations for either of those businesses outside of this easy money euphoric environment. Instead, they represent a crowd playing a speculative zero-sum game – both stocks could just as easily be the names of new cryptocurrencies. The phenomenon of speculators jumping from financial asset to financial asset continues like a game of whack-a-mole. Similarly, we haven’t seen any signs of a broad retreat within our psychology composite.

Valuations and psychology remain on a plateau, but the question to answer is whether it’s a *permanently higher* plateau. Belief in the permanence of that plateau hinges on faith in the efficacy of government bureaucrats and politicians. History leans the other way. From Jeremy Grantham in a Financial Times interview this week,

It isn’t...difficult to identify a badly overpriced market. It is extremely easy in retrospect and it is easy in real time. If you graph them, they look like Himalayan peaks coming out of the plateau. The psychological problems are huge, but the intellectual problems are a piece of cake...it is statistically simple to identity a two-sigma price move...and all of them went back to where they came from, all of them, every one.

Market Risk Index

Rec Allocation 25% Underweight

86.7%

Category Percentiles

Psychology - P6: 100.0%

Monetary - M4: 57.1%

Valuation - Extremely Overvalued: 100.0%

Trend: 0.6%

Largest Psychology Influences

Levered Investments	Negative
Flow of Funds	Negative
Volatility	Negative
Technicals	Negative

Largest Monetary Influences

Inflation	Negative
Interest Rates	Negative
Velocity	Positive

Valuation

7-10 Year Rtn Forecast	-0.3%
10Yr Treas Yield (on 05/25)	1.6%

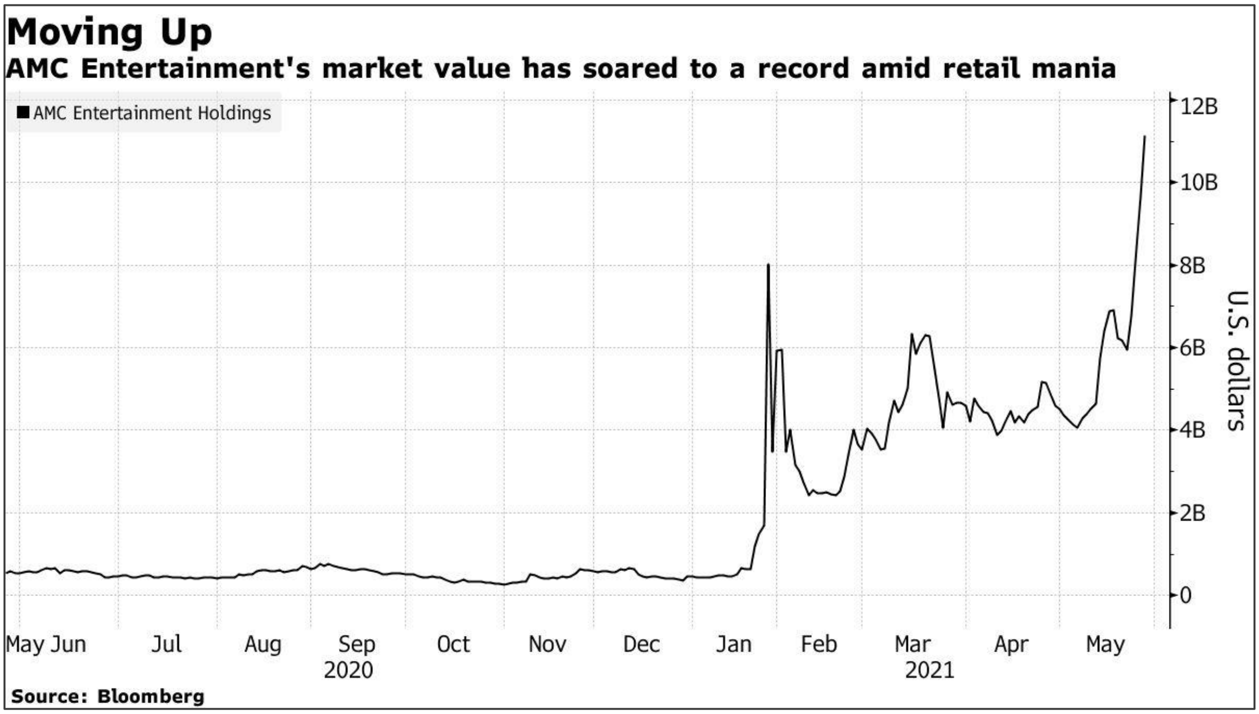
Market Trends

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

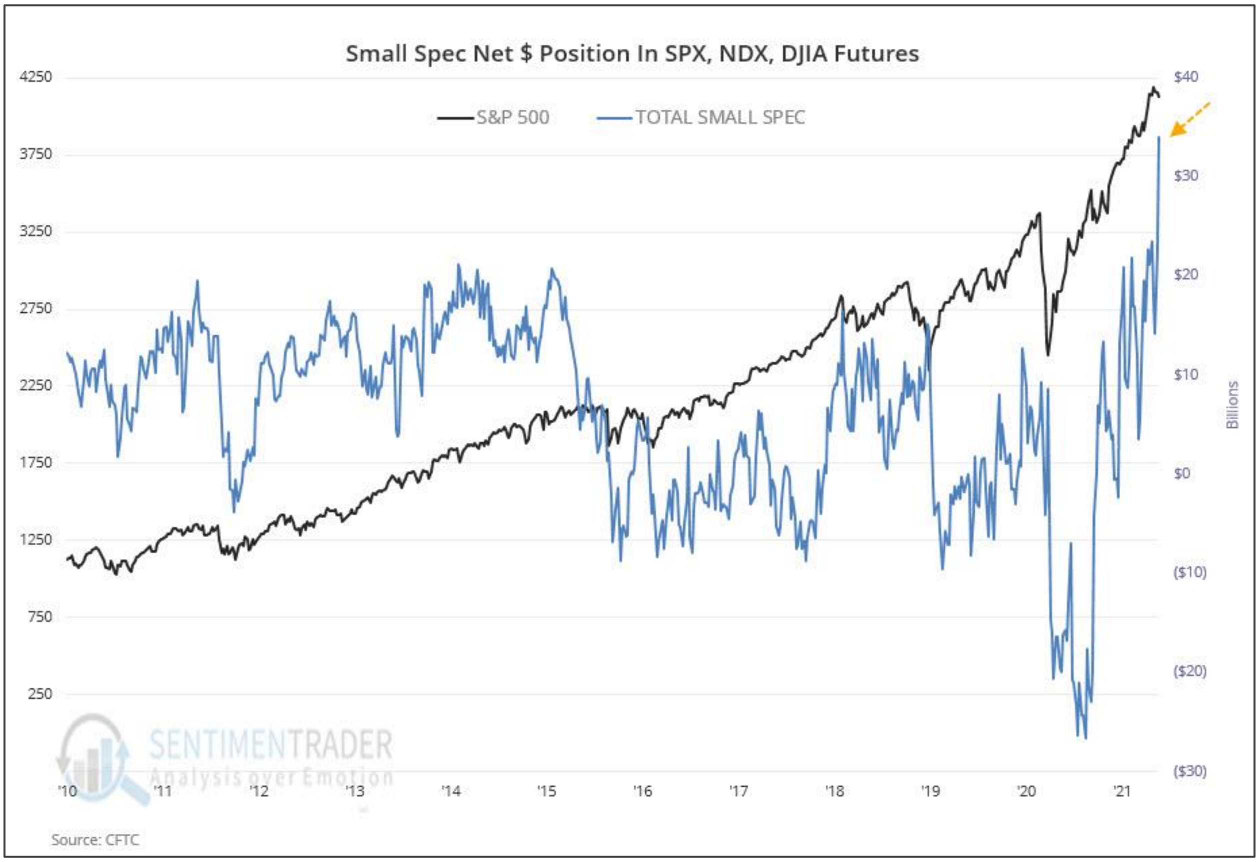
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

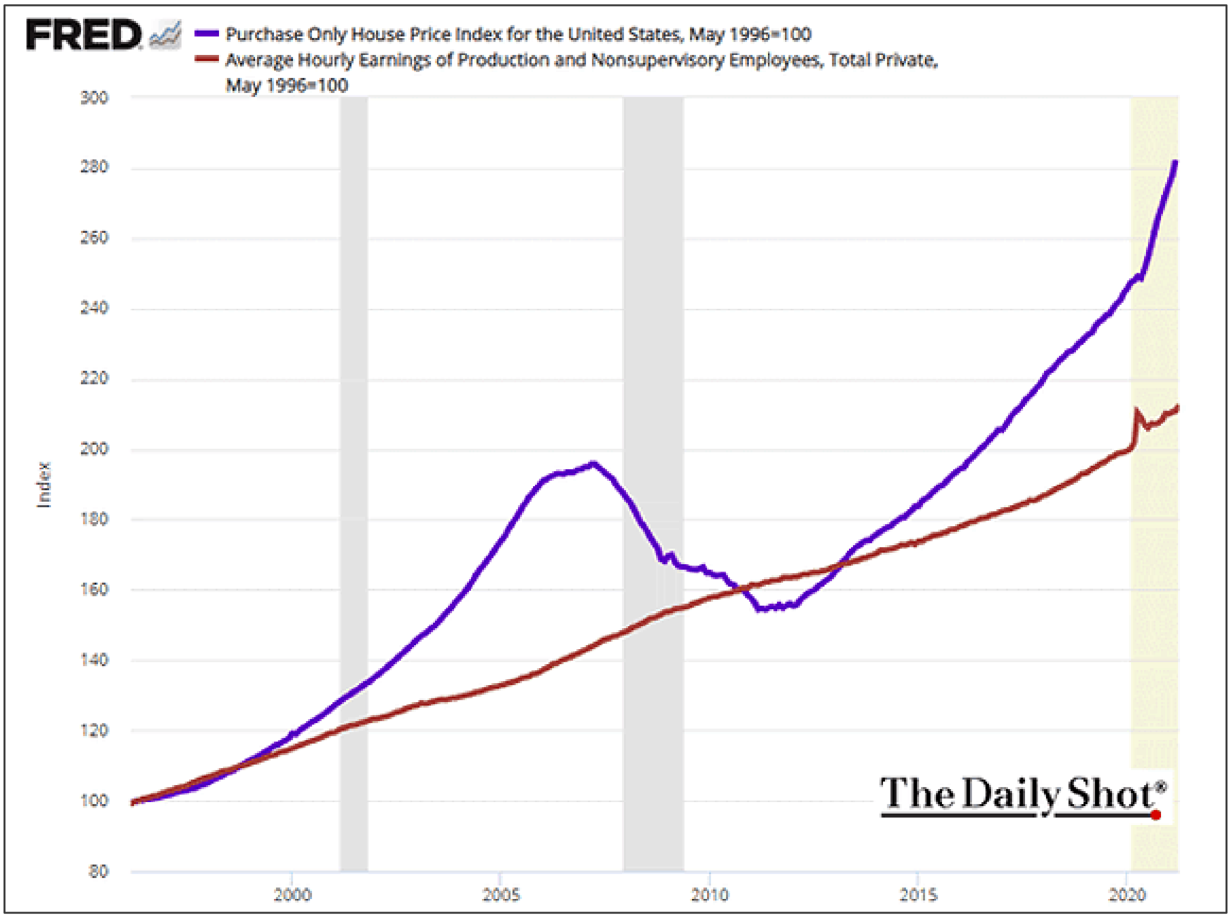
AMC Entertainment is back in the speculative spotlight, reaching another record high market value.



Small Speculators have gone record long equity futures.



The gap between Home Prices and Avg Hourly earnings has widened sharply.

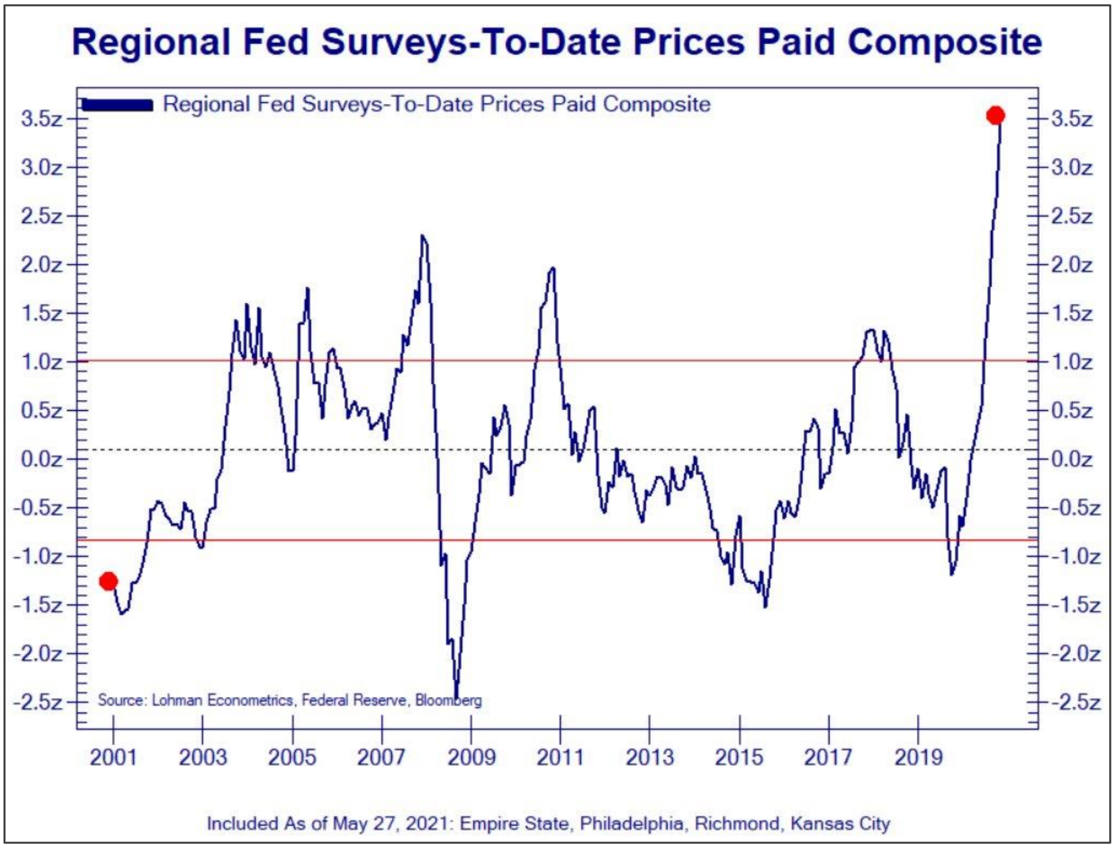


Higher home prices have led to a record one-month decrease in consumers planning to purchase a home.

All time high for Peter Lynch's Rule of 20 Valuation

All-time-low in real earnings and dividend yield for stocks

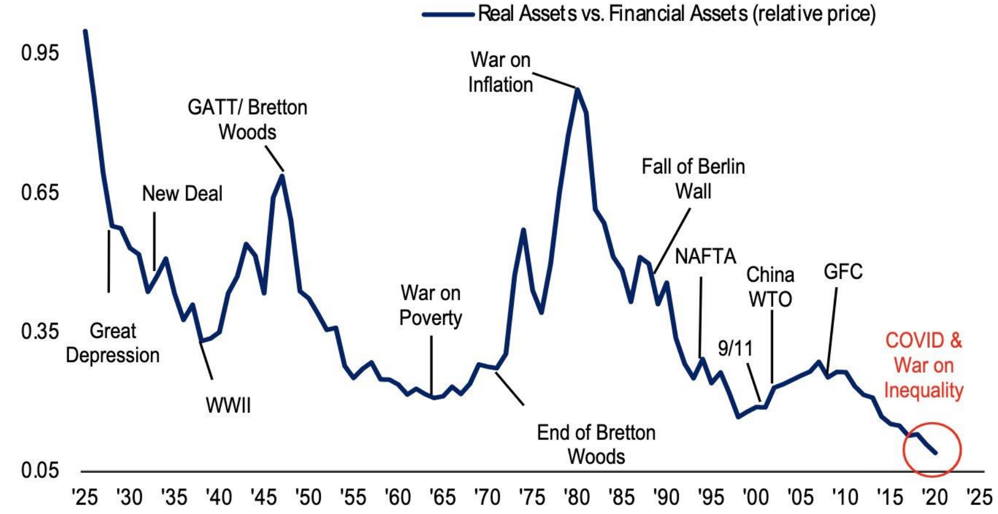
3.5 Standard Deviation move in the Regional Fed Surveys-To-Date Prices Paid Composite



Is it time for a real assets outperformance cycle?

Exhibit 1: All-time lows...real assets relative to financial assets since 1925

Real assets (Commodities, Real Estate, Collectibles) vs. Financial Assets (Large Cap Stocks, Long-term Govt Bonds) since 1925

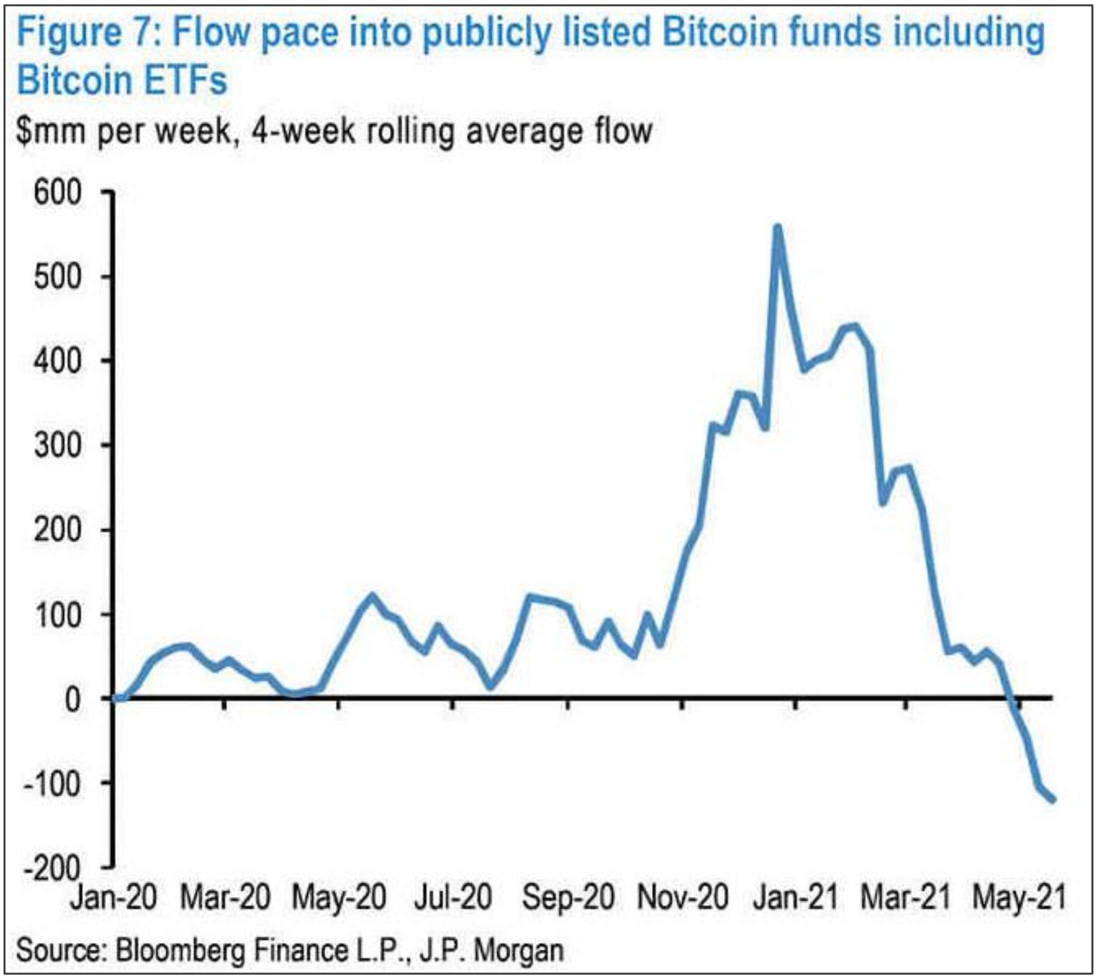


Source: BofA Global Investment Strategy, Global Financial Data, Bloomberg, USDA, Savills, Shiller, ONS, Spaenjers, Historic Auto Group.

Note: Real Assets (Commodities, Real Estate, Collectibles) vs. Financial Assets (Large Cap Stocks, Long-term Govt. Bonds)

BofA GLOBAL RESEARCH

Bitcoin outflows are accelerating



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.