



# Market Outlook

By Mark T Dodson, CFA

## Unreasonable Investor Expectations

Market Risk Index climbed back into the worst decile of readings to 90.4%, mainly on a jump in the risk score from our Monetary composite. There were more poor readings from the inflation category, as the ISM Price index broke through the 2008 peak and hit the highest level since 1979. There was also a deterioration of the growth rates of Monetary Aggregates from positive to neutral. We're not ones for conspiracy theories, but we've had to start calculating our own MZM figures after the Fed discontinued that series earlier this year. Discontinuing MZM came a few months after they stopped publishing weekly figures on monetary base as well.

Money is coming out of the aggregates to chase financial assets, in a case of recovery FOMO, looking for yield and returns in a dwindling pool of opportunities. You can see it when you look at real yields on junk bonds going into negative territory for the first time. You can see it when private equity assigned billion-dollar valuations to more companies in just the second quarter than they did all last year, also a record. You can also see it in unreasonable, extreme equity return expectations.

Natixis 2021 [survey](#) of global investors revealed that US investors' expectations of stock market returns have climbed to a staggering 17.5% above inflation – expectations that are so lofty that they are difficult to believe. Before the era of Natixis, Gallup would conduct a monthly poll of US investors for their nominal equity return expectations. The highest value ever recorded in their poll was 16.2% in January 2000, at the height of the dot com bubble. Note that Gallup's poll was a nominal return expectation – before inflation. Equities have historically returned 6-7% above inflation.

The short-term weakness in markets early in the week didn't do anything to crush the speculative spirit. Instead, like every minor setback in 2021, it became an opportunity to reload and emboldened speculators to press bets harder. The Rydex Ratio and assets in levered ETFs made new all-time highs this week. Assets in levered ETFs are more than 300% higher than they were in the March lows and have nearly doubled from Jan/Feb 2020 peak. The post-pandemic era is one where leveraging up on the slightest weakness, with the implicit blessing of the Fed, has been the golden rule.

The newly forming technical concerns that we highlighted a couple of weeks ago have not gone away, as the daily reports of new highs in the S&P 500 no longer means the same for other key indices on our breadth dashboard. However, it hasn't translated into a bifurcation in the number of stocks making new highs and lows, so it still qualifies as a minor technical setback at this point.

### Market Risk Index

Rec Allocation 25% Underweight

**90.4%**

### Category Percentiles

Psychology - P6

97.9%

Monetary - M4

67.2%

Valuation - Extremely Overvalued

100.0%

Trend

0.1%

### Largest Psychology Influences

Levered Investments	Negative
Surveys	Negative
Option Activity	Negative
Fund Flows	Negative

### Largest Monetary Influences

Inflation	Negative
Velocity	Positive
Interest Rates (rate of change)	Negative

### Valuation

7-10 Year Rtn Forecast	-1.4%
10Yr Treas Yield (on 07/05)	1.4%

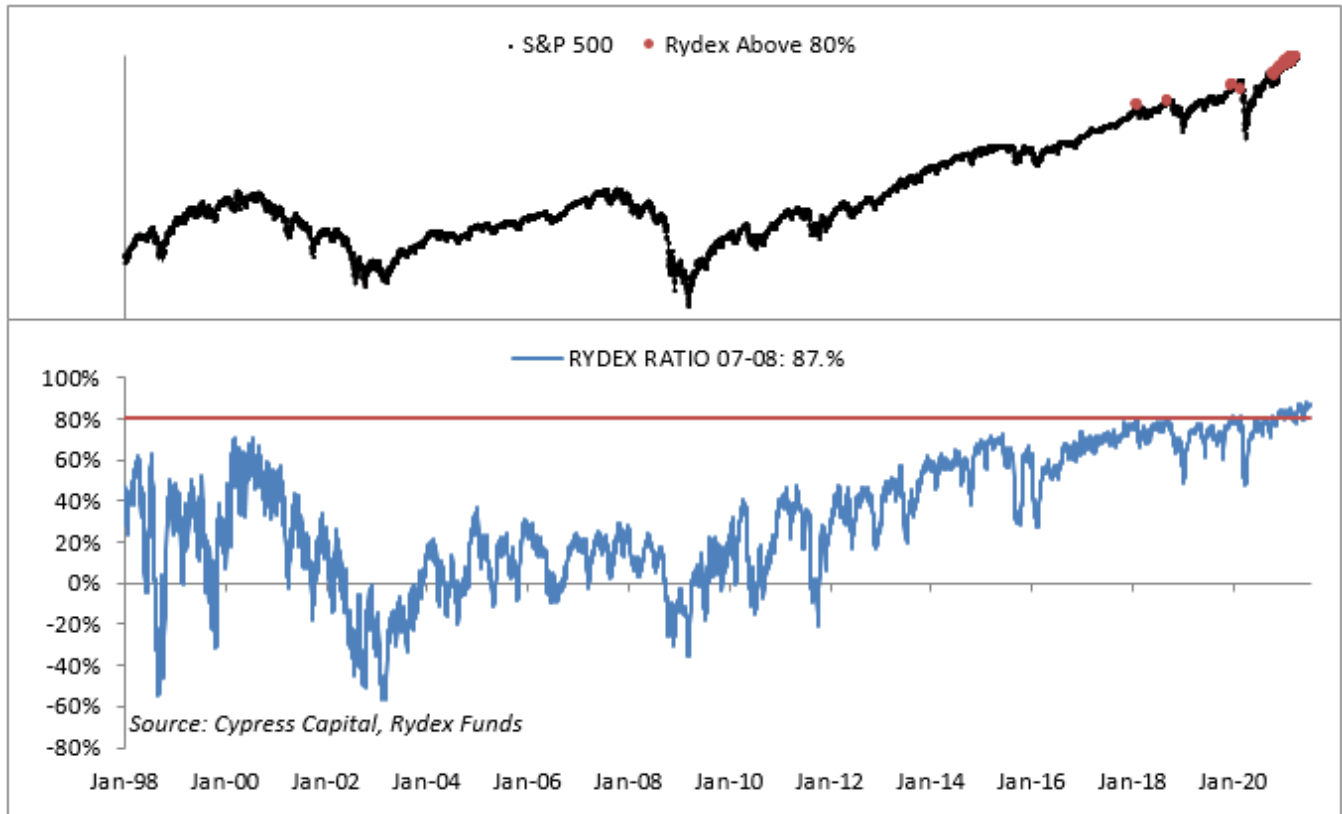
### Market Trends

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

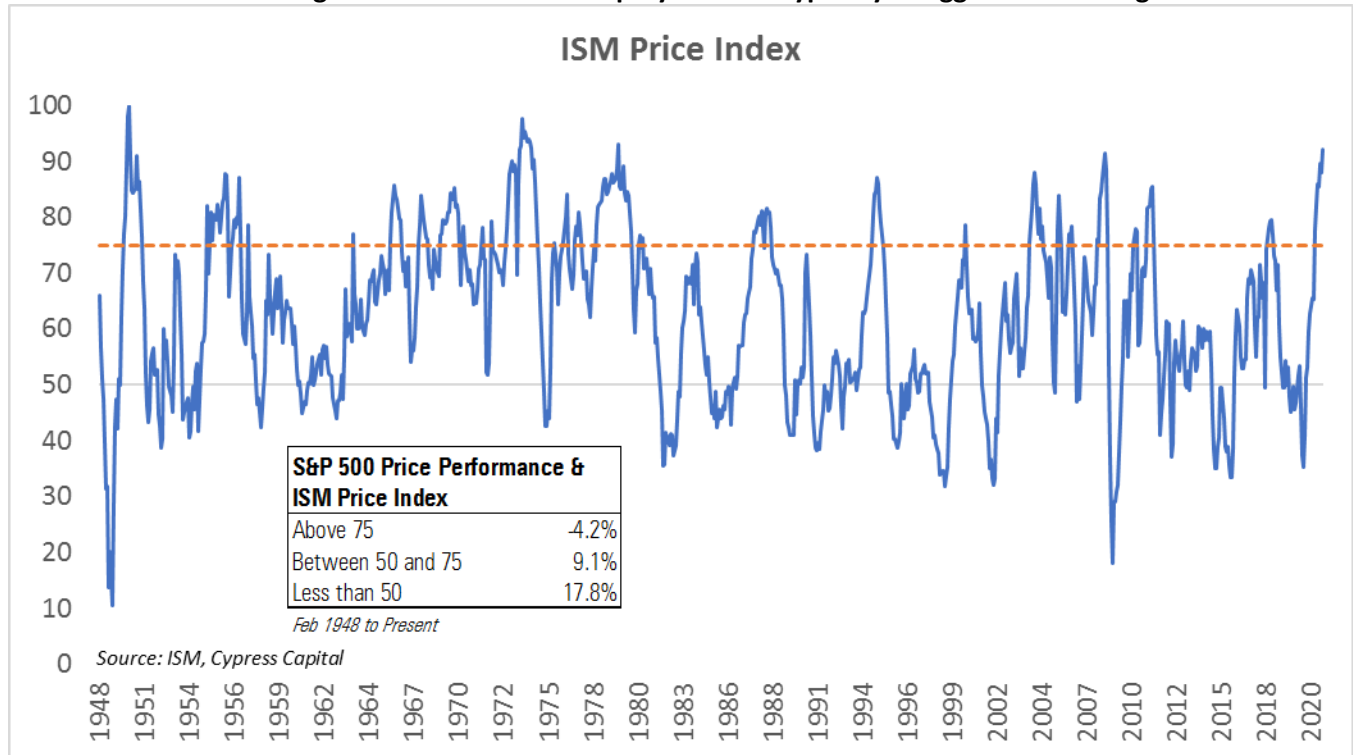
*Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.*

Charts of the Week

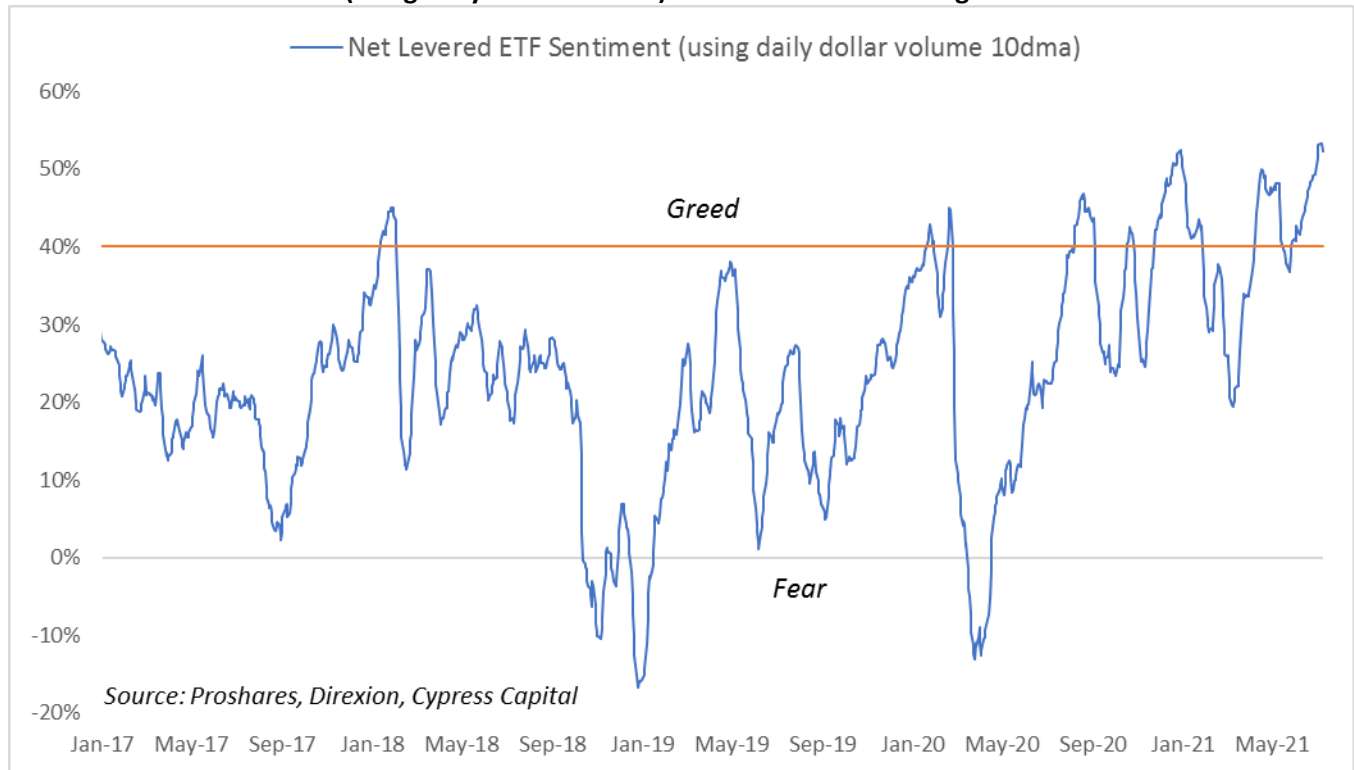
Rydex Ratio (net assets in levered mutual funds) made a new all-time-high.



ISM Price Index hit the highest level since 1979. Equity markets typically struggle with readings above 75.

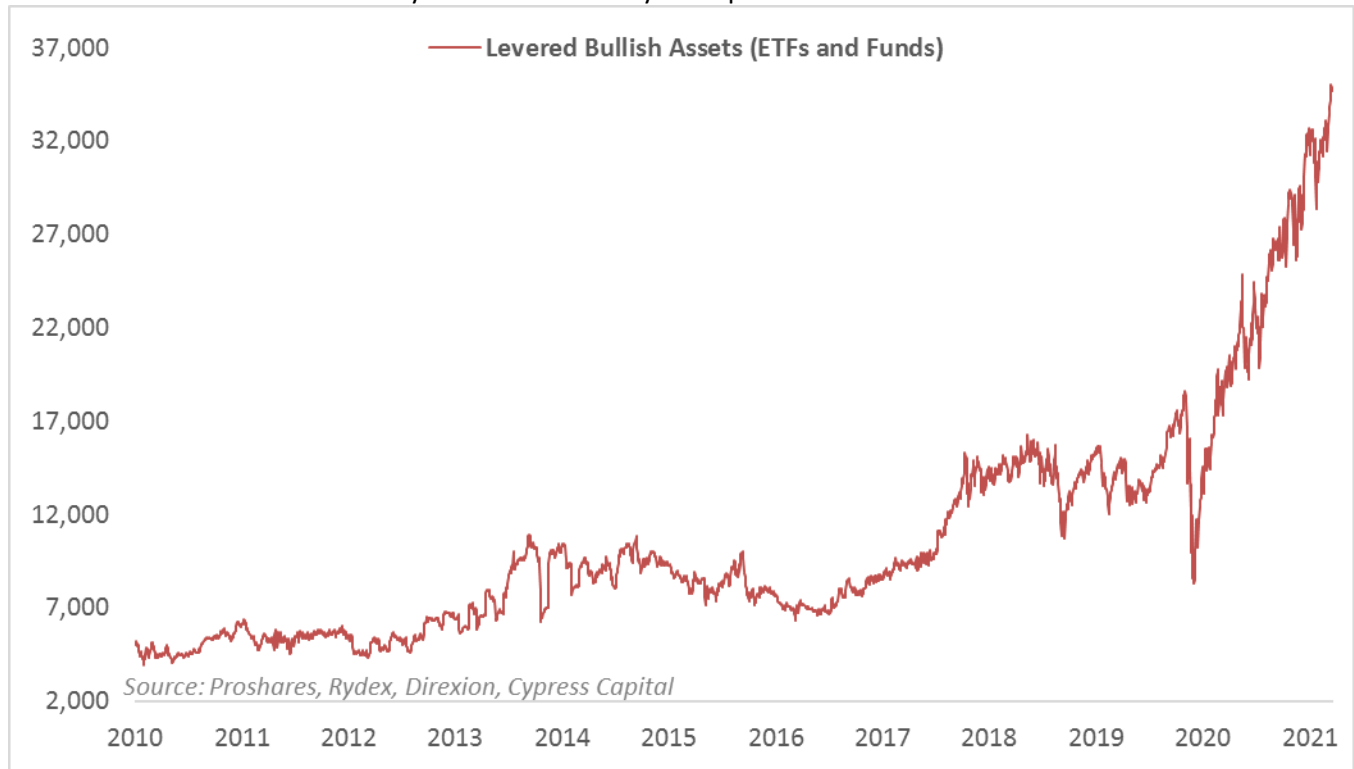


**Net Levered ETF Sentiment (using daily dollar volume) made a new all-time-high.**

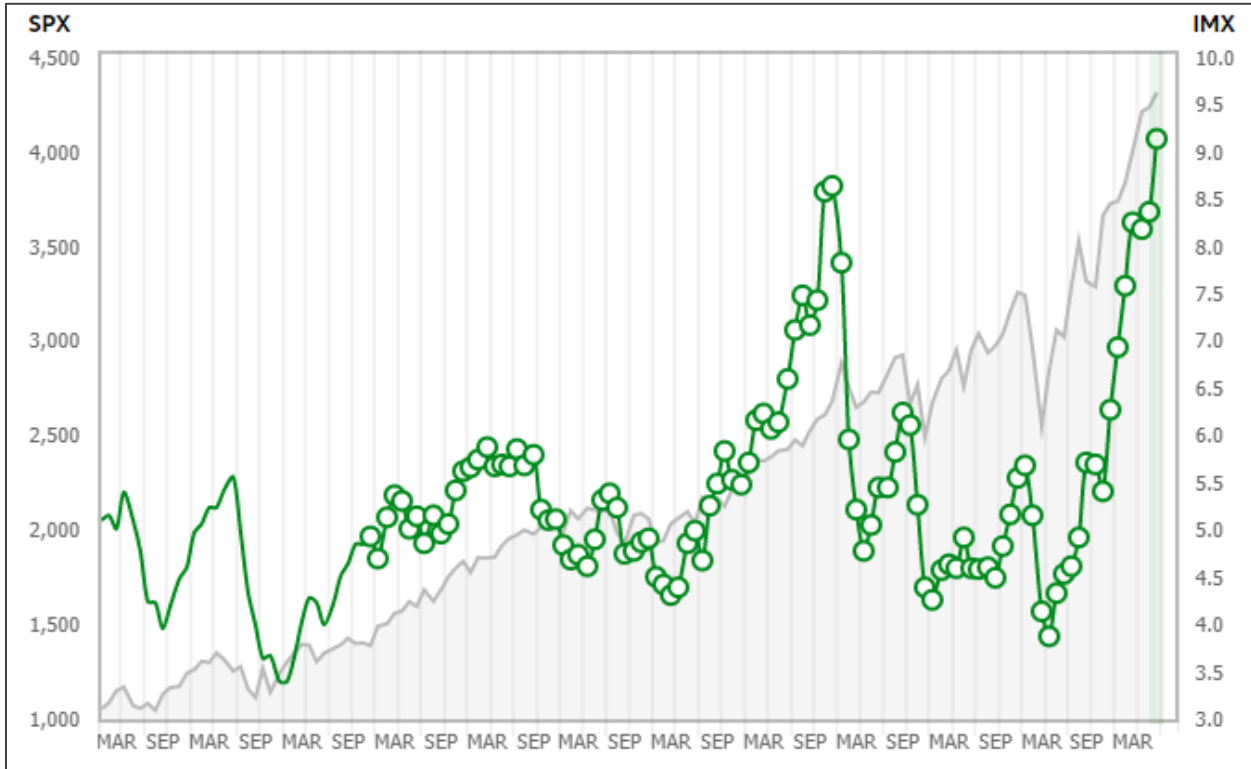


**Assets in Levered ETFs and Funds made a new all-time-high.**

Assets in levered ETFs and funds have increased by more than 300% from the March 2020 lows and have nearly doubled from what was an already extended February 2020 peak.

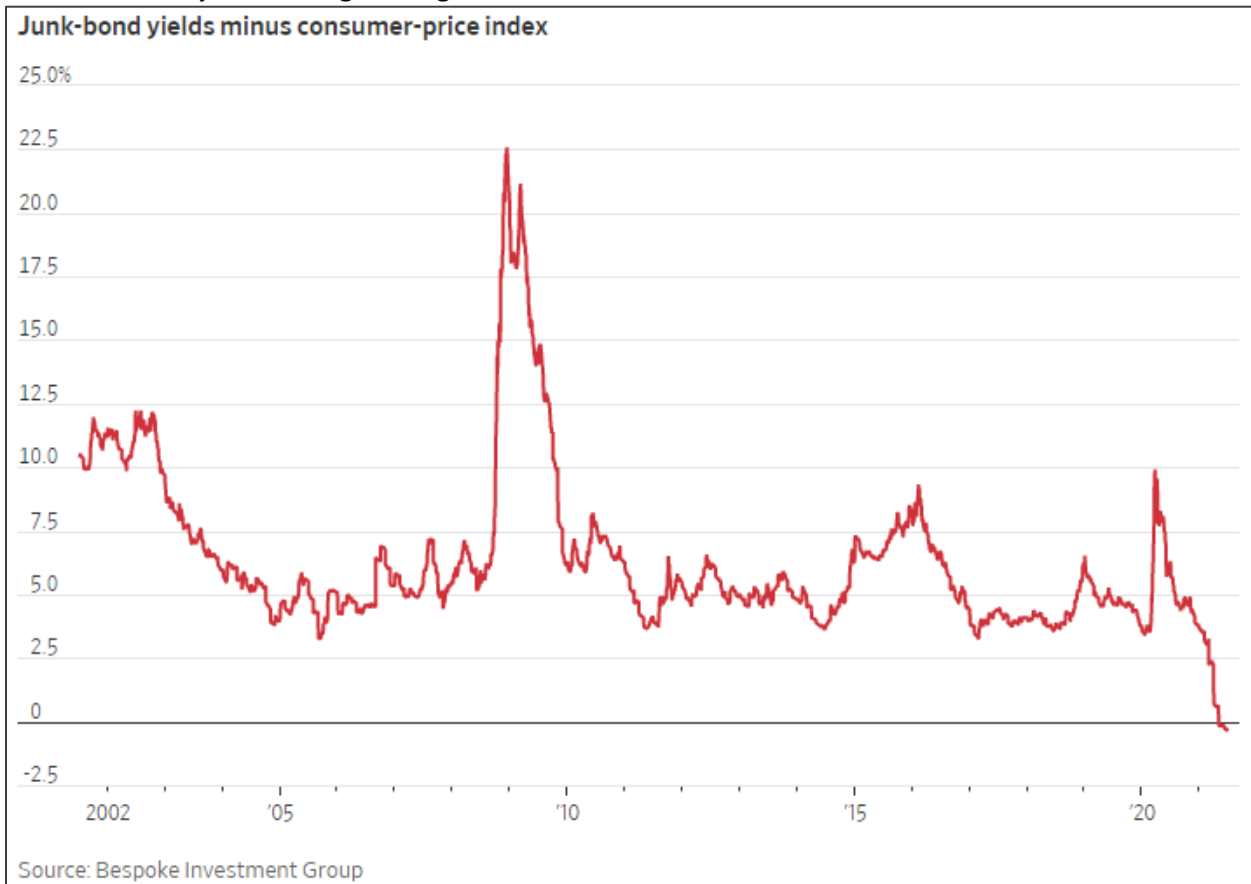


**Investor Movement Index (a gauge of investor sentiment toward the stock market) made a new all-time-high.**



Source: TD Ameritrade

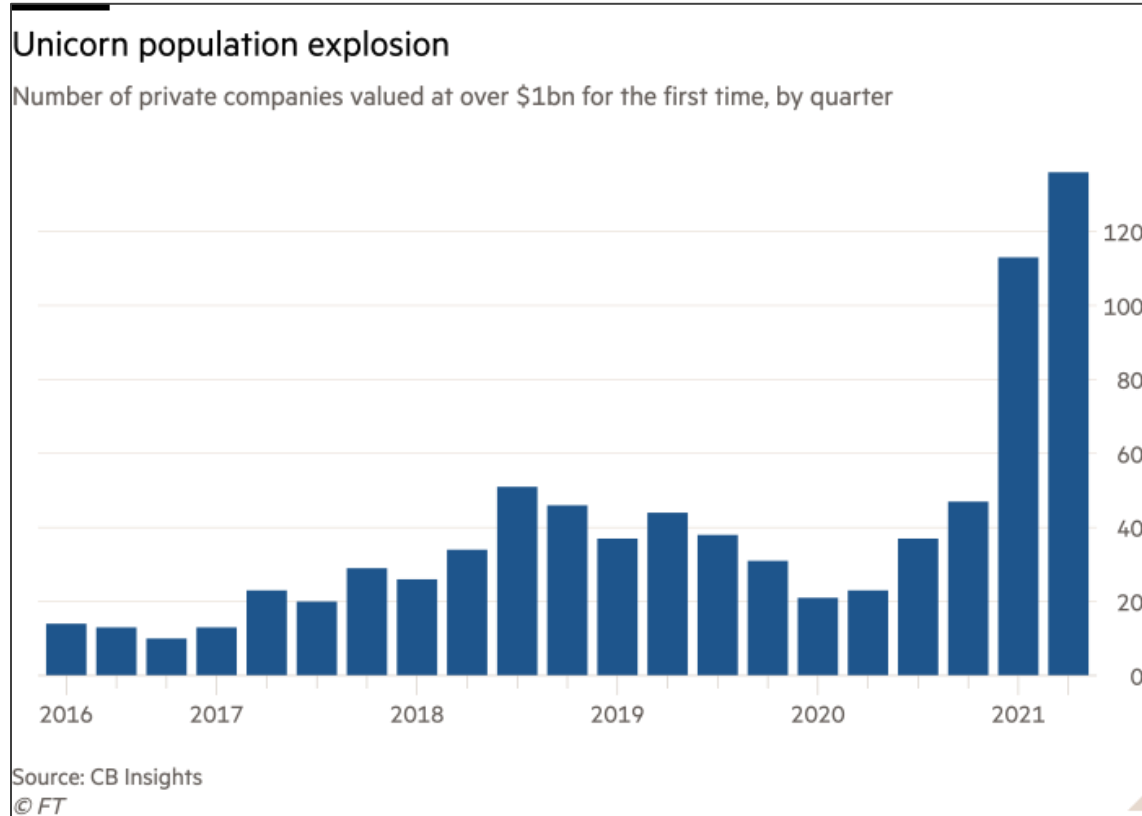
**Real Junk-bond yields have gone negative for the first time ever.**



Source: Bespoke Investment Group

Source: WSJ

**Record number of Unicorn valuations in Q2 2021.**

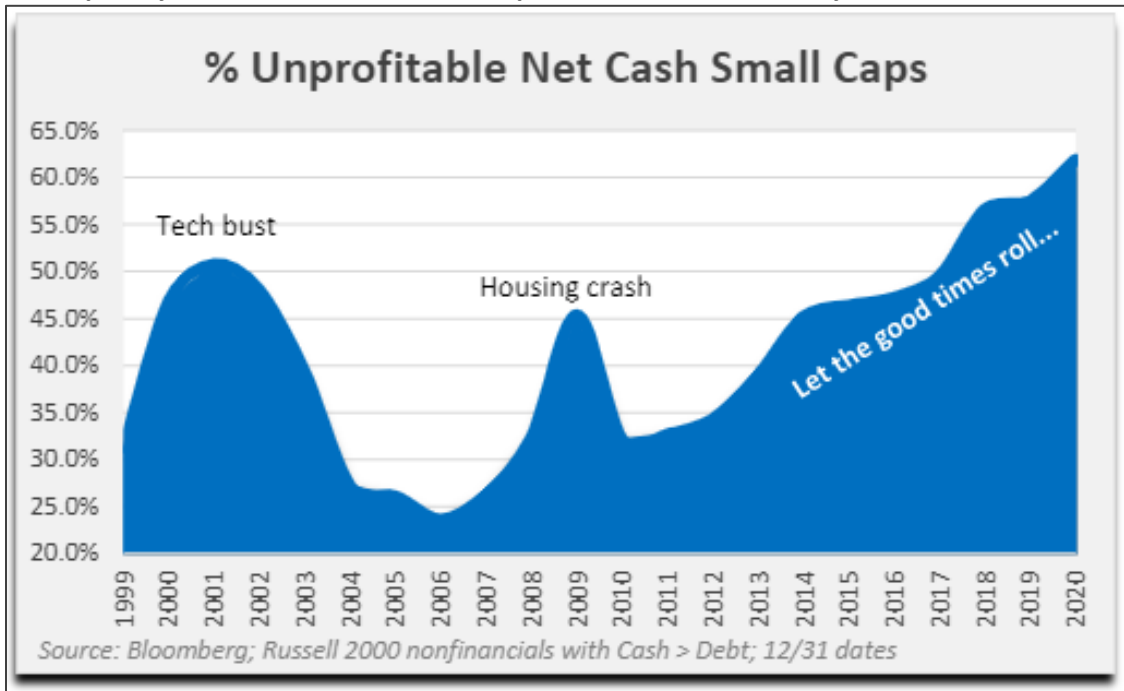


Source: FT

**Corporate bankruptcies normally spike in recessions. Instead, they are near record lows.**



Consequently, the number of Zombie companies continues its steady ascent.



Source: Palm Valley Capital

Falling yields have pushed the funded status of pension funds to the best position since 2007.

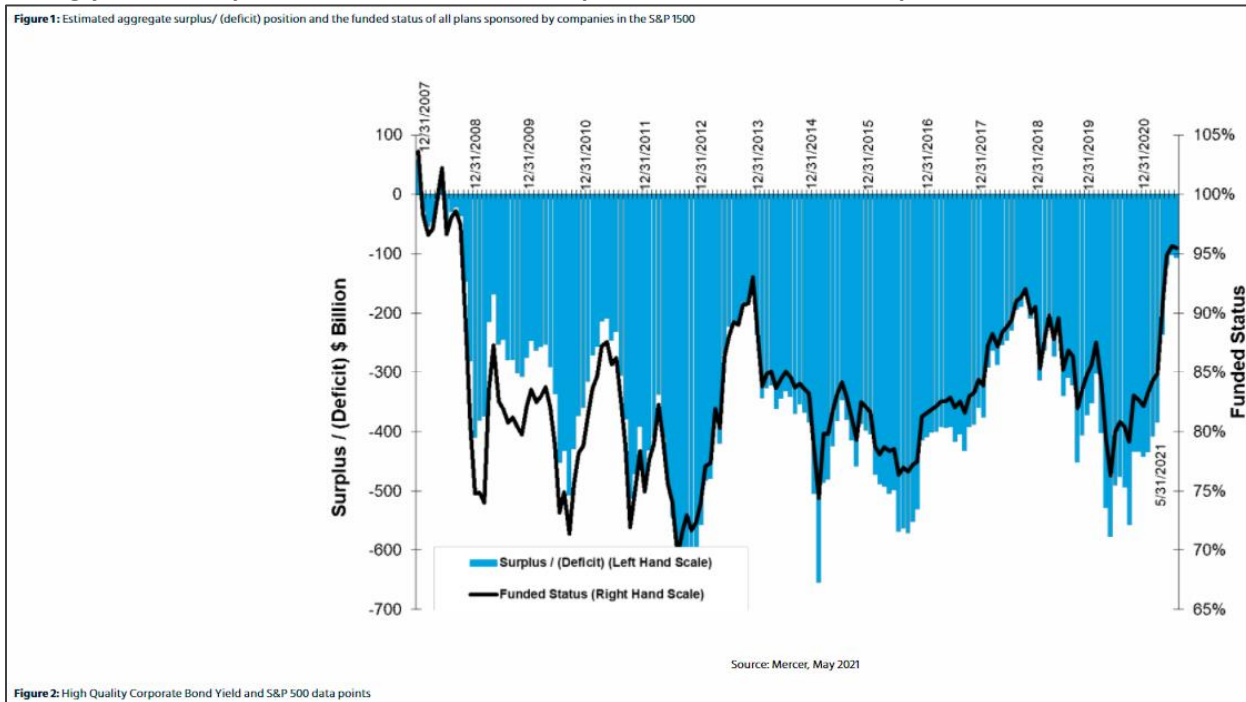


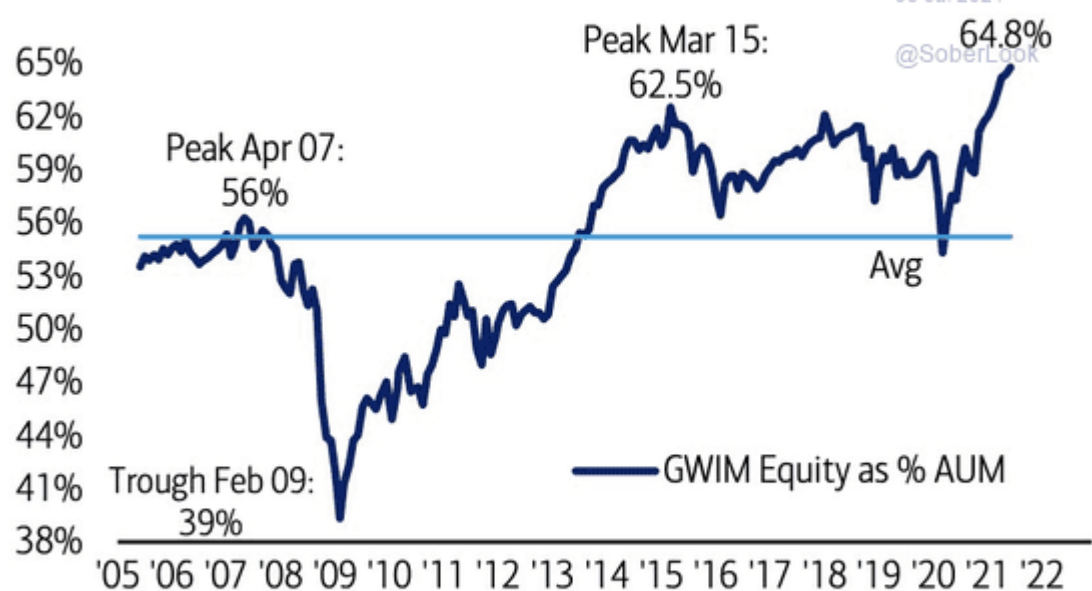
Figure 2: High Quality Corporate Bond Yield and S&P 500 data points

Source: Bloomberg

BofA client equity weightings hit a new record.

**Chart 19: GWIM equity allocation at record 64.8%**

BofA private client equity holdings as % of AUM



Source: BofA Global investment Strategy

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The Beta of their largest holdings is the highest ever as well.

**Chart 23: GWIM top 10 stocks at highs for 1-year SPX beta**

1-year S&P 500 beta for top 10 stocks held by BofA private clients

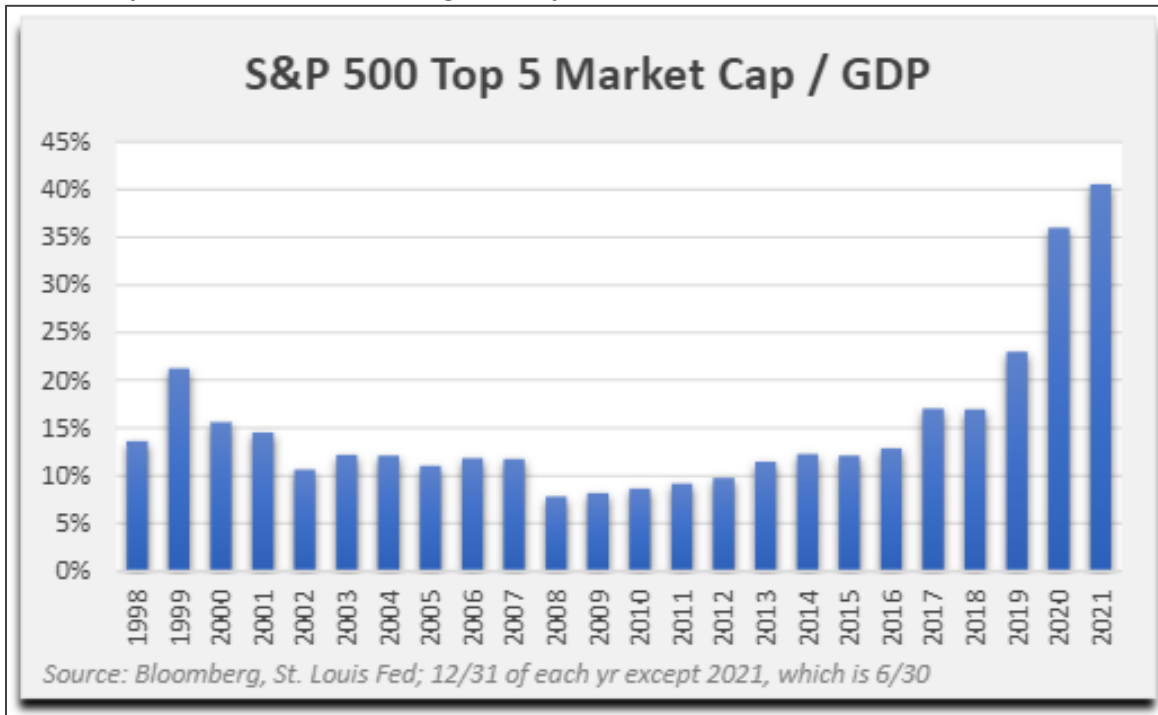


Source: BofA Global investment Strategy

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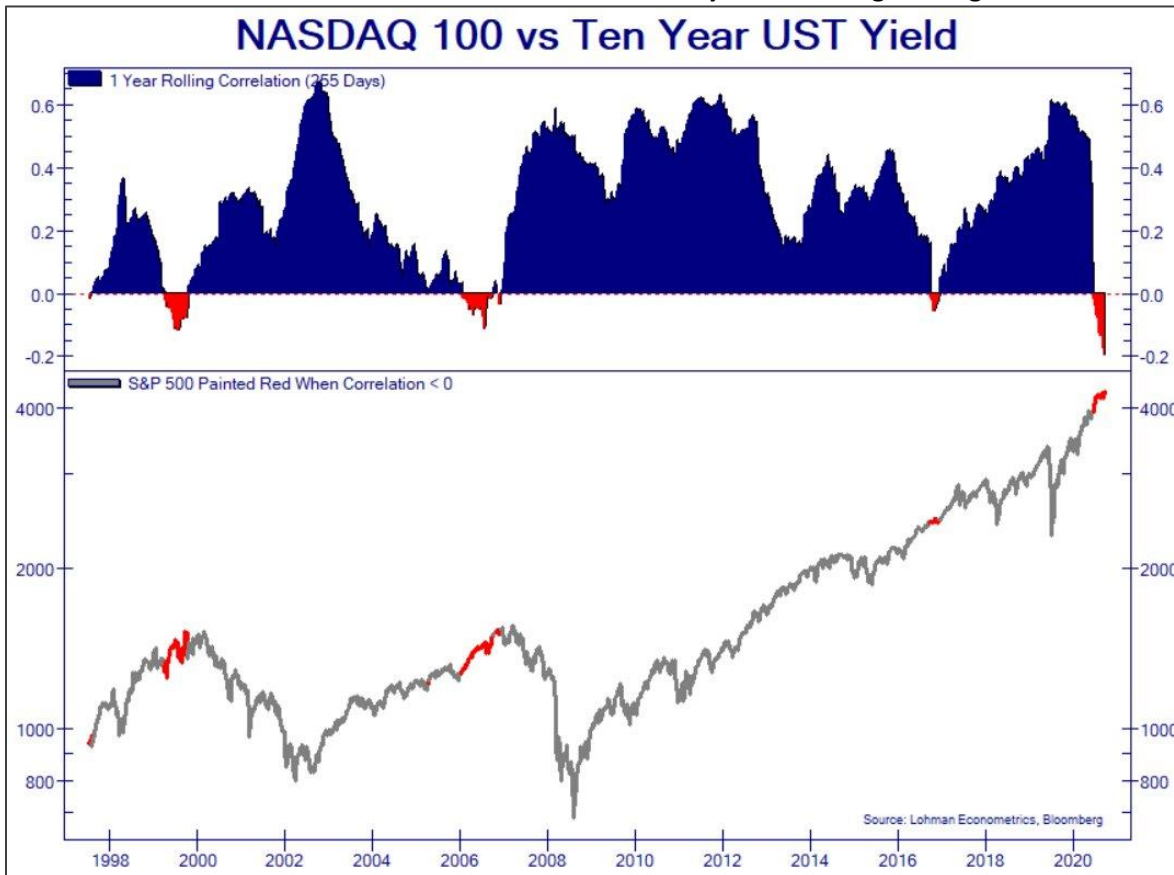


Market Cap of the S&P 500's five largest companies has climbed to more than 40% of US GDP.



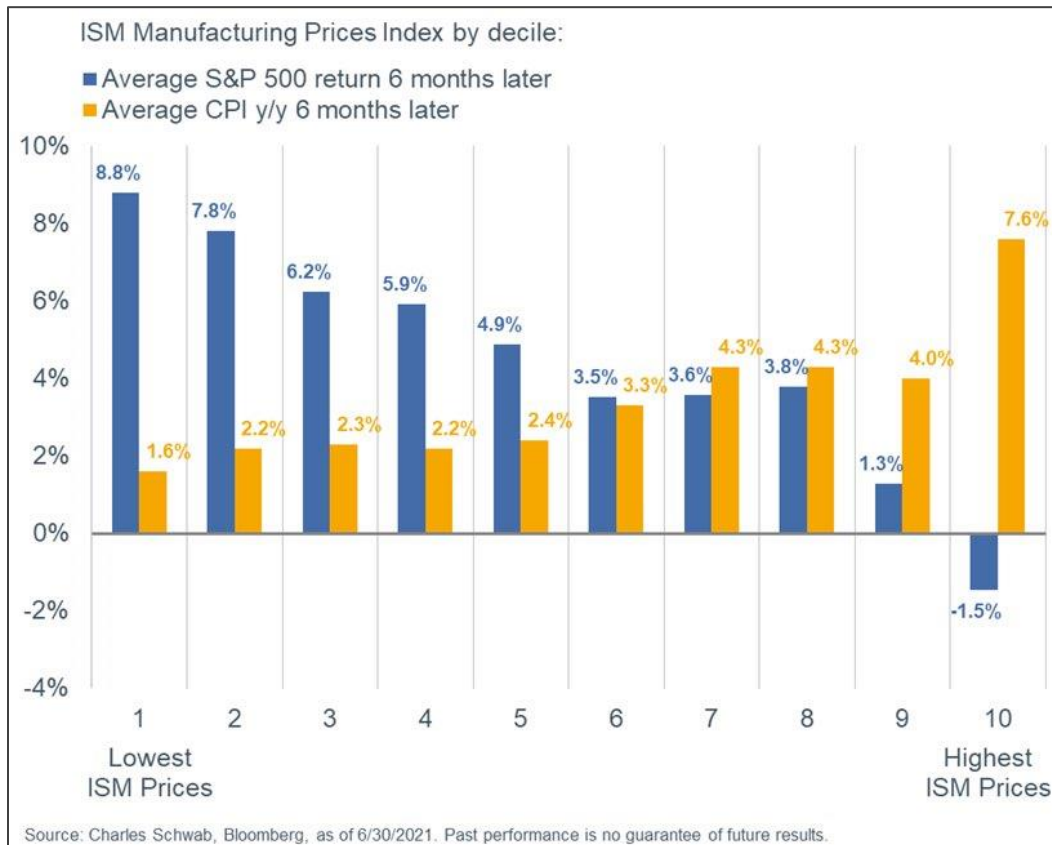
Source: Palm Valley Capital

When correlations on the NASDAQ 100 and 10 Yr. Treasury Yields have gone negative...

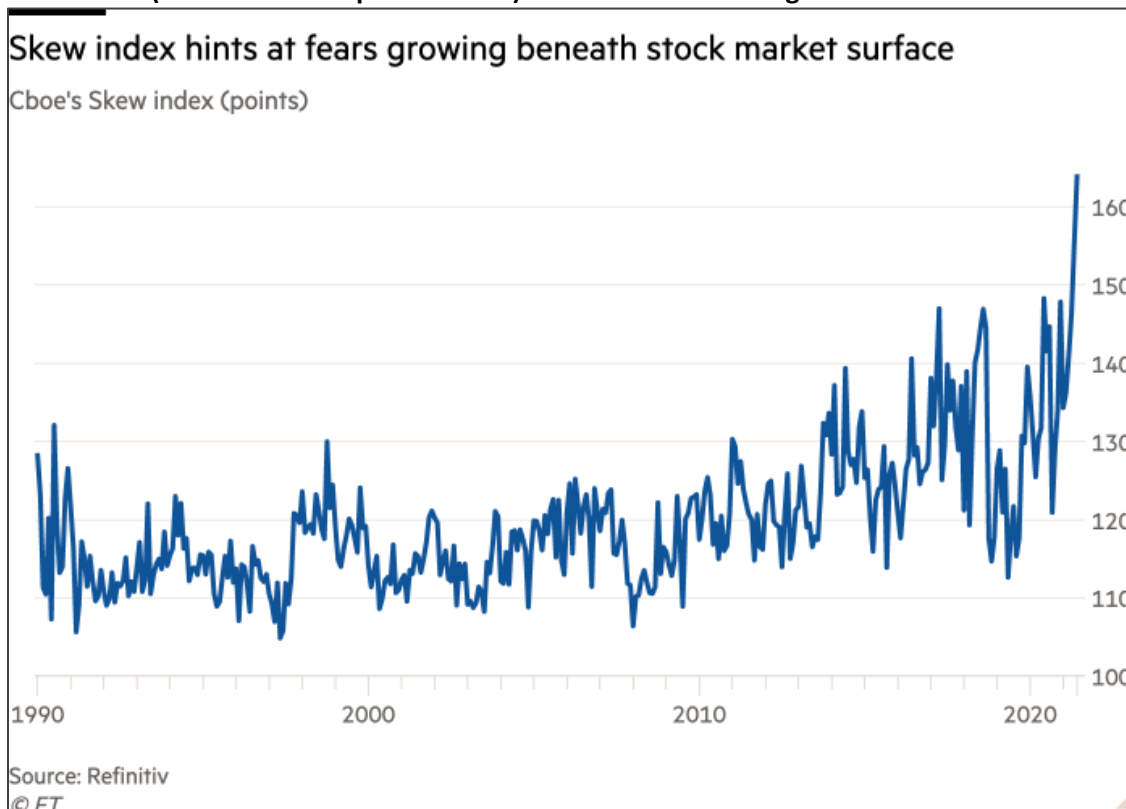




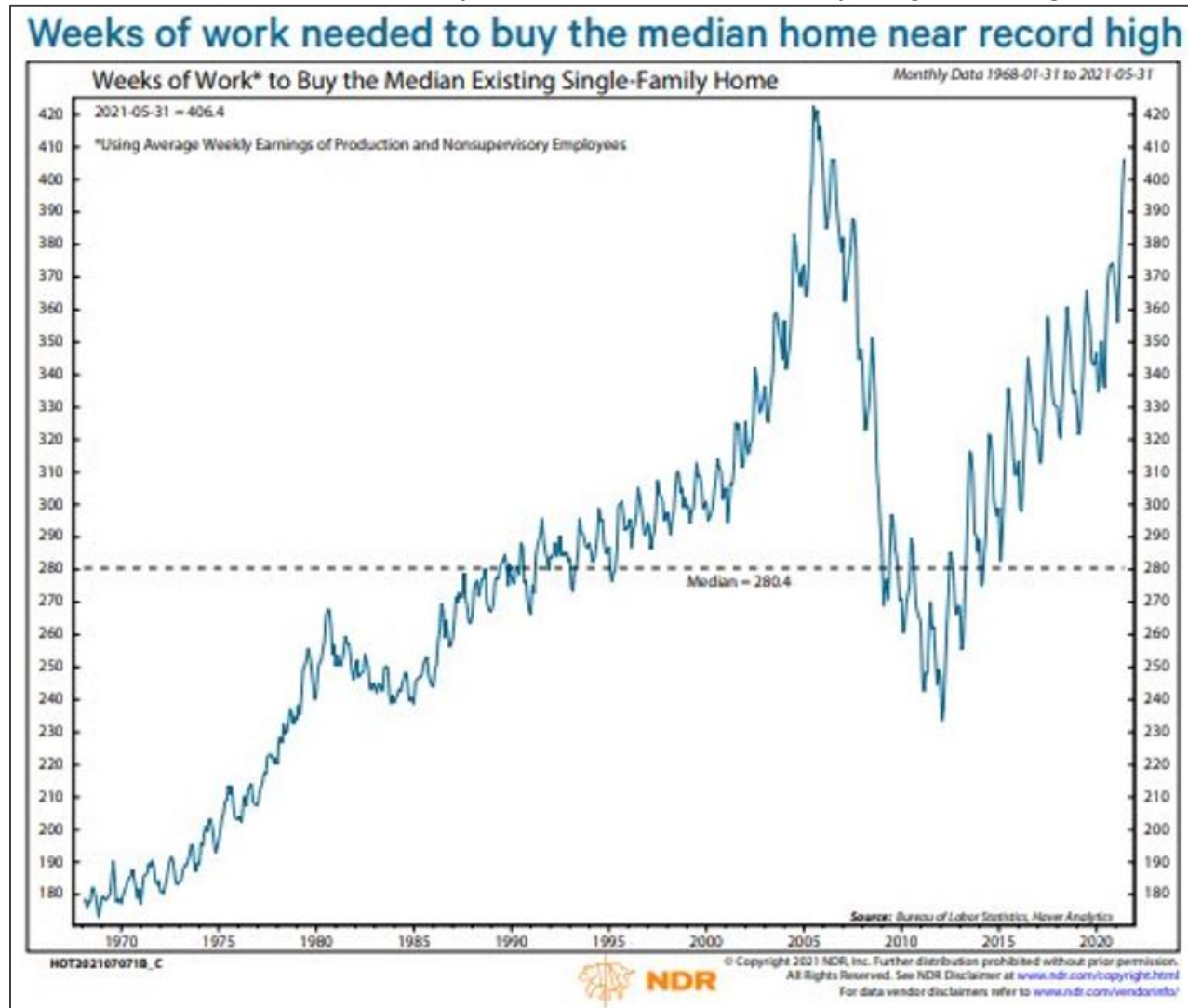
**High ISM Price Index implies higher CPI inflation and a lower stock market over the next six months.**



**Skew Index (a measure of implied tail risk) hits a new all-time-high.**



Number of weeks of work needed to buy the median home is close to surpassing the housing bubble record.

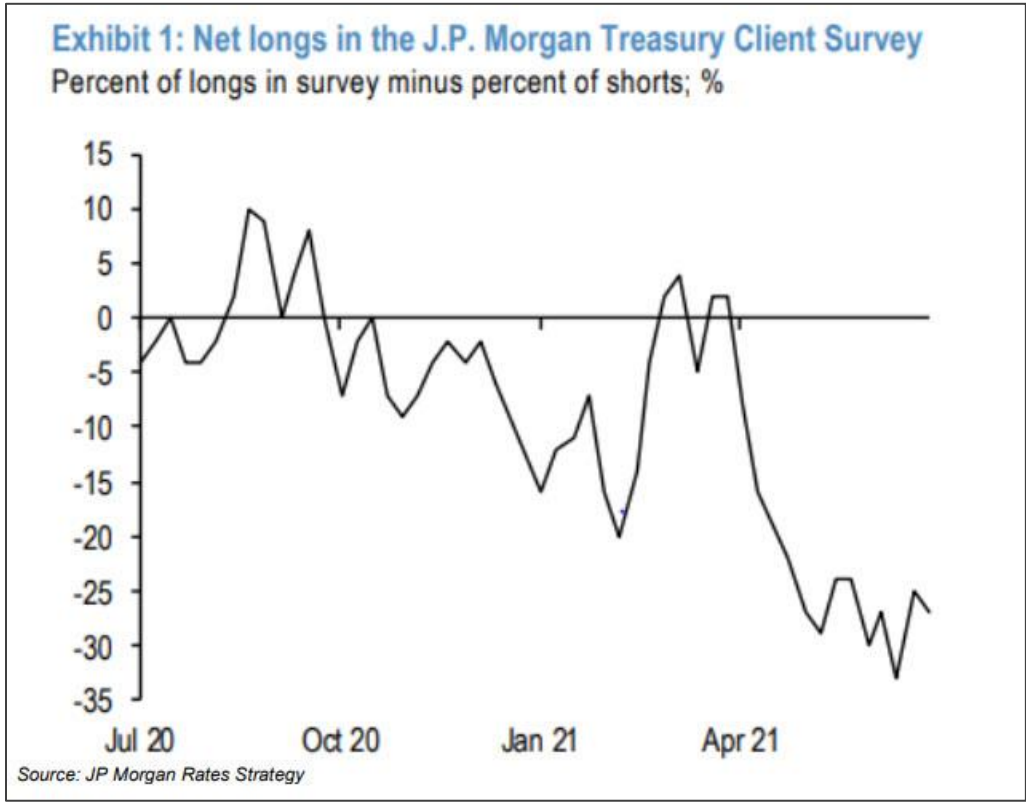


Source: NDR, M. Arouet

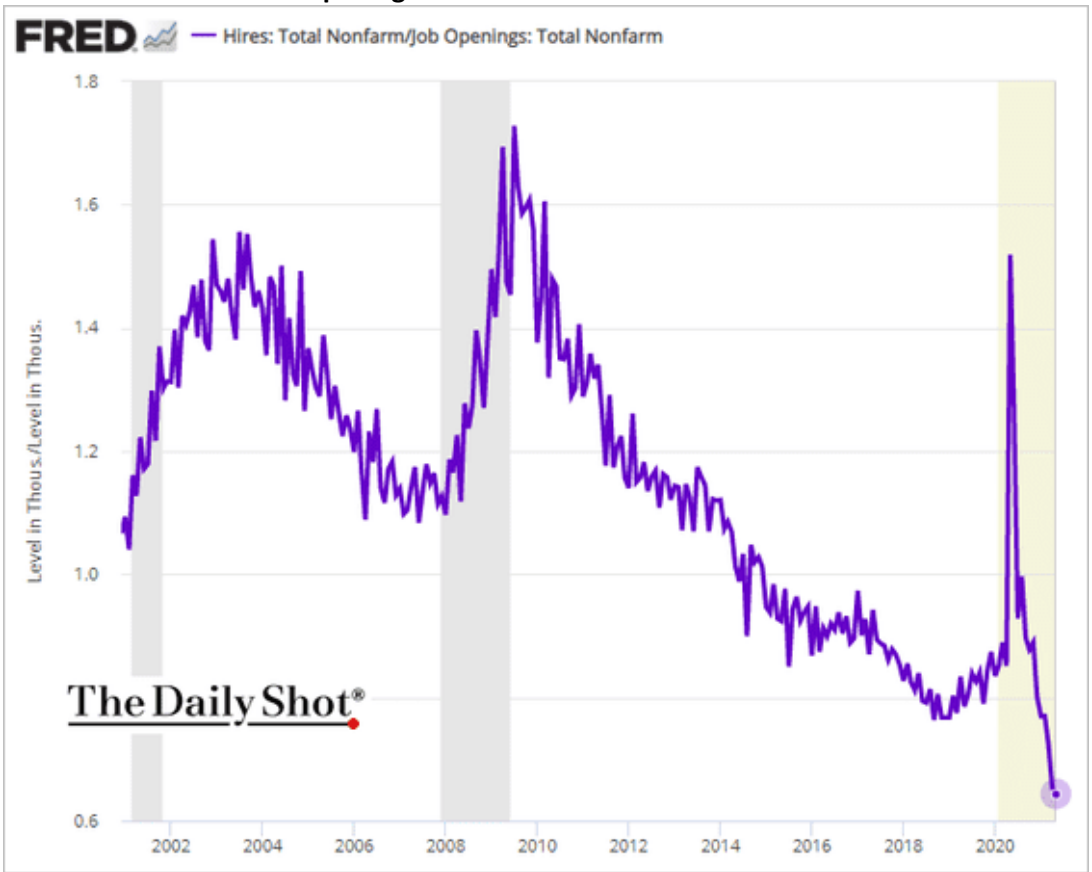
Real home prices are surging globally.



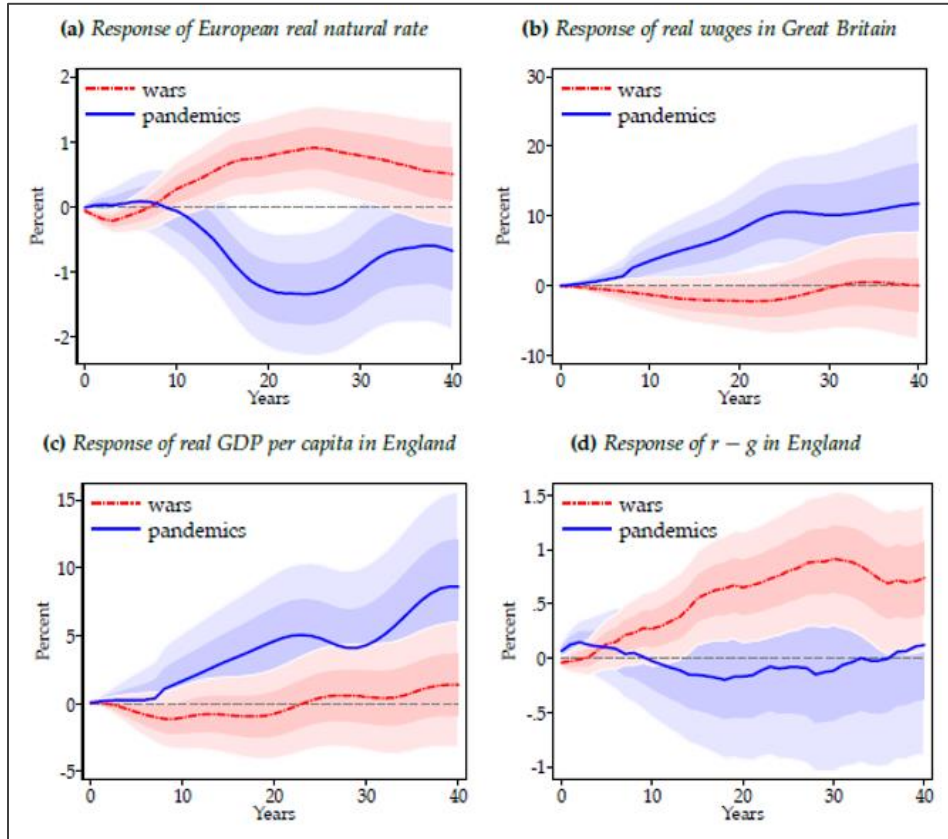
Inflation may suggest higher Treasury yields, but positioning implies that the pain trade is lower yields.



Ratio of Job Hires to Job Openings falls to a record low.



**History suggests that post pandemic periods are better for Labor than Capital.**



Source: San Francisco Fed, John Authers

**Gallup survey of Life Evaluations of US Adults hit an all-time-high.**



## 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.