Cypress CAPITAL

Market Outlook

By Mark T Dodson, CFA

Banks loosen the purse strings

Market Risk Index fell to 87.9 on slight improvement in the Psychology composite but mostly on further progress in the Monetary composite. Interest rates have softened enough to move the Interest Rates category from Negative back to Neutral.

Although a resumption in falling yields was a boost to one part of the Monetary composite, it has also produced a clear shallowing of the yield curve. The rollover in the slope of the yield curve has been so stark that it looks as if it has peaked for the cycle, and this turn often marks an informal measure of the halfway point of a credit cycle. The yield curve never achieved what we would call a robust slope, supporting the argument that this economic recovery (after the shortest recession on record) is a continuation of the previous credit cycle, not a new one.

Bank Sentiment helped the Psychology composite, as banks' attitudes have turned on a dime over the last quarter. Banks are as enthusiastic about lending as they were when the GDP growth cycle peaked in 2018. However, the improvement was offset by additional deterioration in market technicals.

Tuesday's strong market reversal had substantial thrust behind it, with 9 to 1 up volume on the NYSE. Still, it was not enough to keep the Technical Indicators category from becoming one of the four largest detractors within the Psychology composite this week. New highs on the cap-weighted S&P 500 are not trickling down to stocks broadly – a divergence that has been growing since May.

Short-term sentiment has finally broken out of Enthusiasm territory, but there are no indications that any investors have come close to throwing in any towels. Enthusiasm has waned, but not much. If anything, that sharp reversal early in the week followed by headlines of new highs in cap-weighted indices by the end of the week could quickly reinforce and ignite animal spirits again.

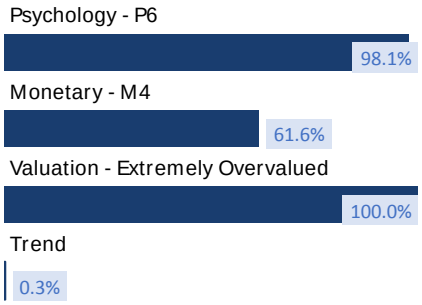
Let's put these short-term developments in perspective by noting that another week has passed with the valuation composite stuck at the 100th percentile, highlighting that none of our concerns about the margin of safety offered by equities in this environment have been alleviated.

Market Risk Index

Rec Allocation 25% Underweight

87.9%

Category Percentiles



Largest Psychology Influences

Levered Investments	Negative
Surveys	Negative
Option Activity	Negative
Technical Indicators	Negative

Largest Monetary Influences

Inflation	Negative
Velocity	Positive
Exchange Rates	Positive

Valuation

7-10 Year Rtn Forecast	-0.6%
10Yr Treas Yield (on 07/22)	1.3%

Market Trends

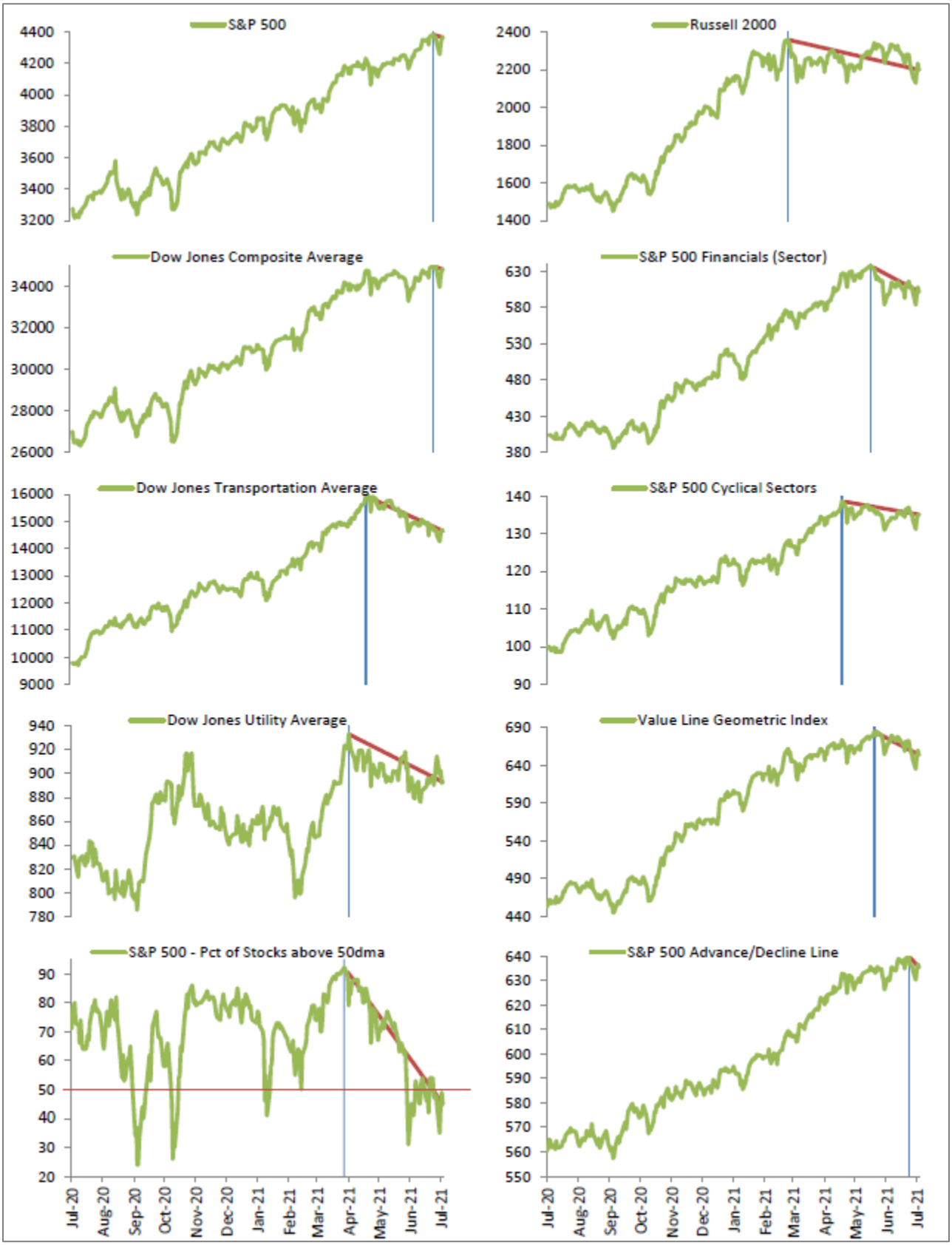
US Equities	Bullish Investment
Intl Equities	Bullish Investment
REITs	Bullish Investment
Broad Commodities	Bullish Investment

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

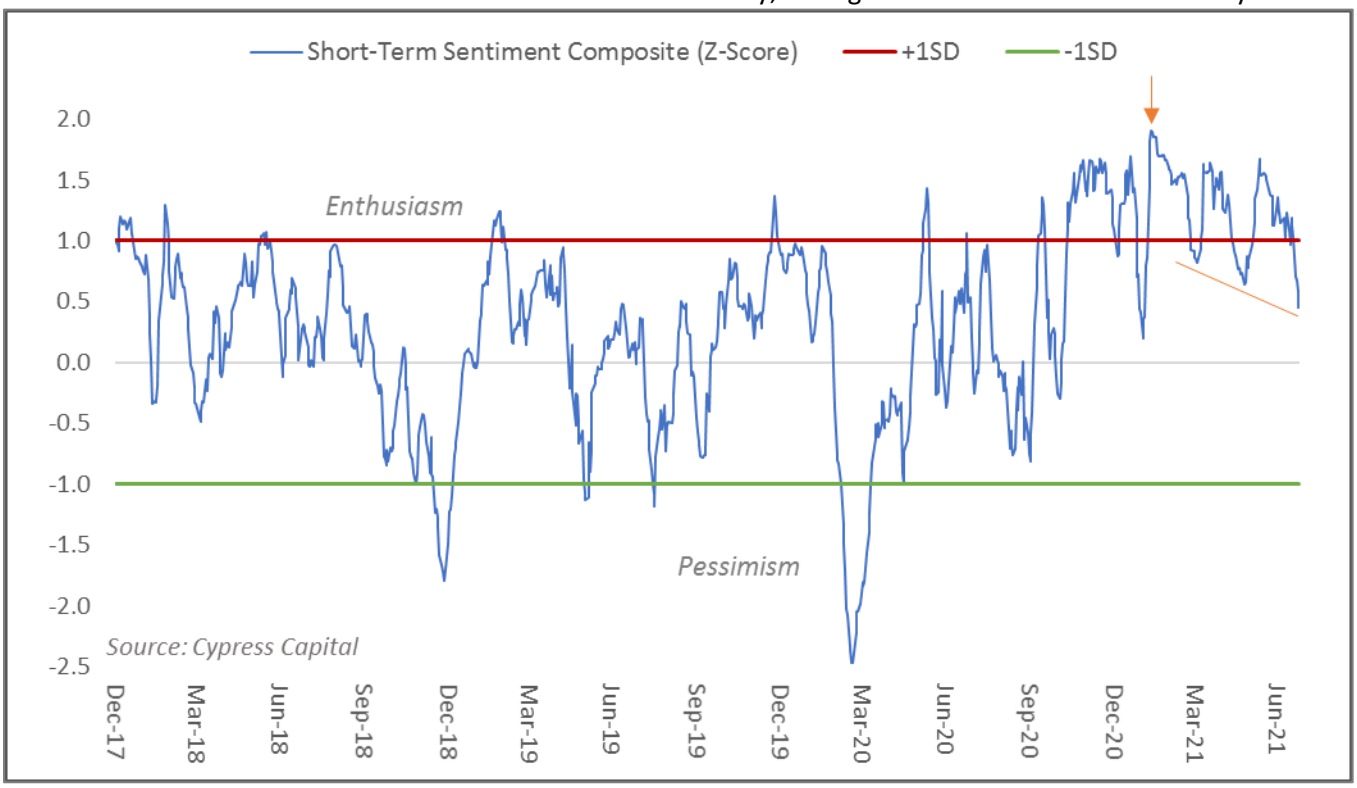
Stock Market Breadth Dashboard

The reopening trade ended in the spring, and breadth divergences persist.

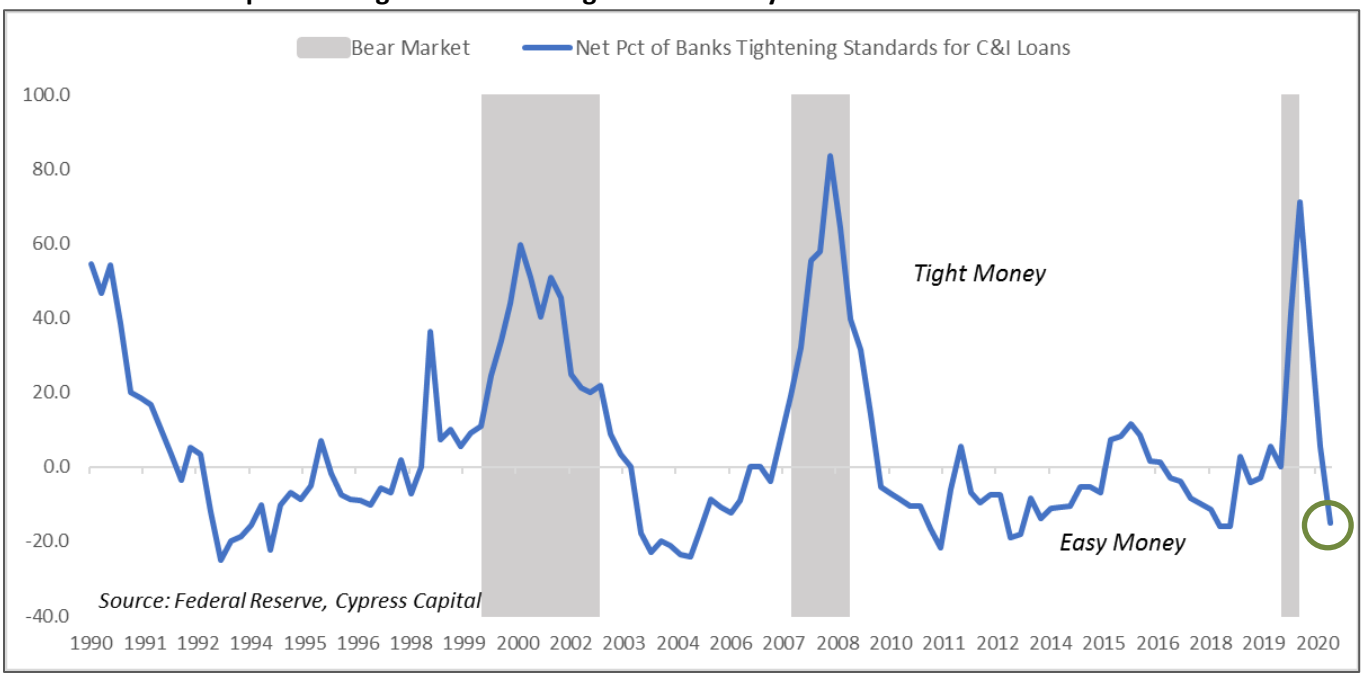


Short Term Sentiment Composite

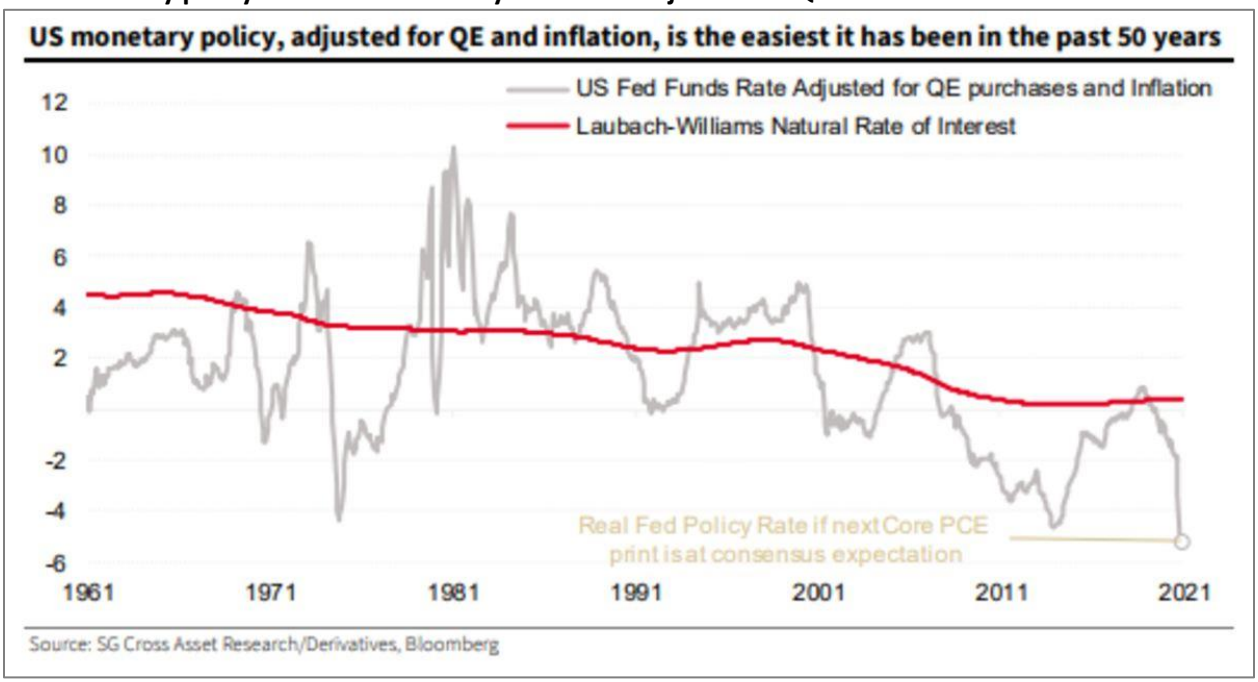
Short-term investor sentiment broke out of enthusiasm territory, hitting the lowest levels since February.



Banks loosened the purse strings and are looking to lend money.

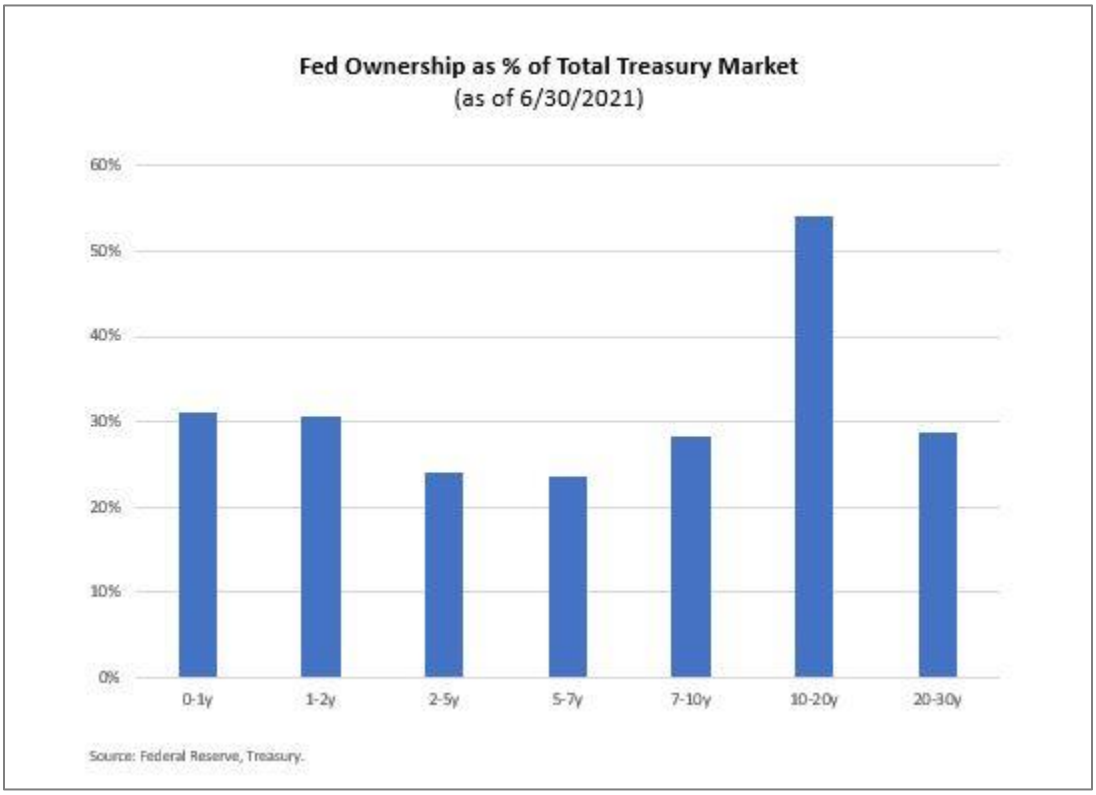


U.S. monetary policy is the easiest in 50 years when adjusted for QE and inflation.



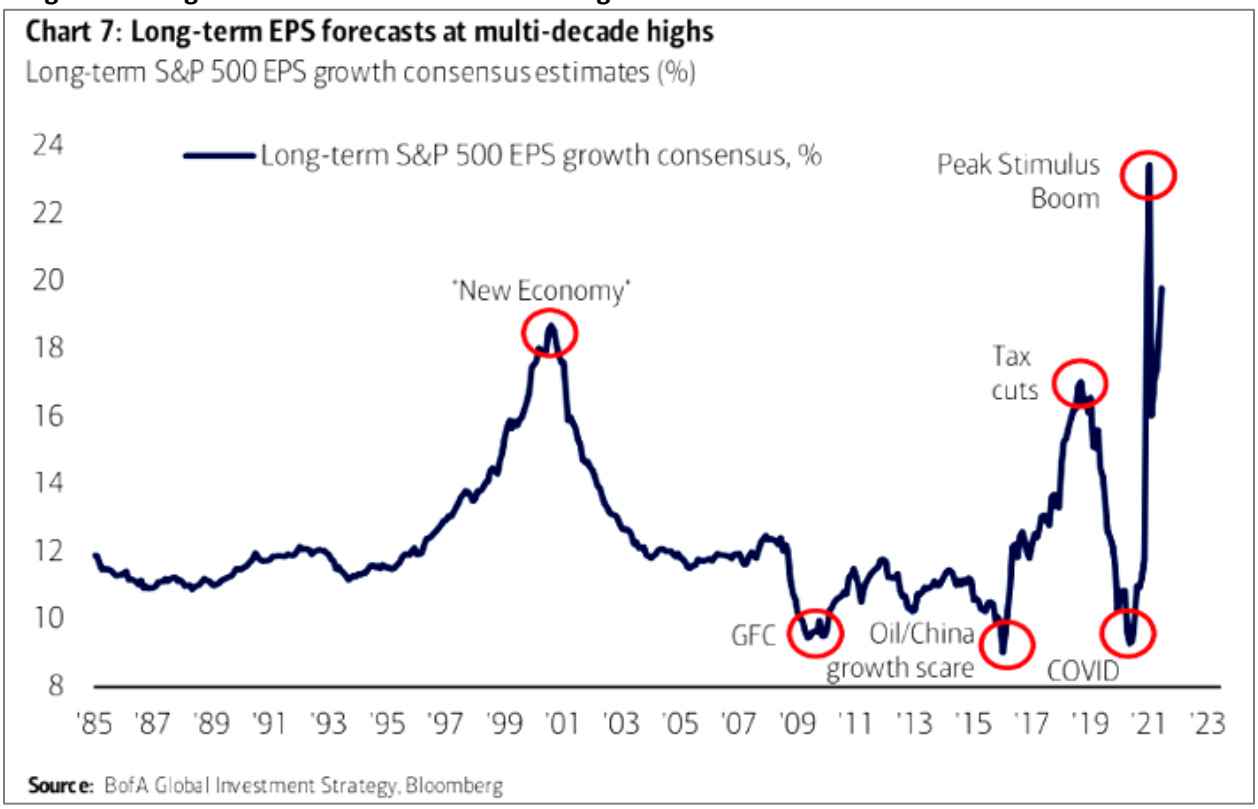
Source: Bloomberg

The Fed owns more than half of 10-20Yr Treasuries.



Source: Richard Bernstein Advisors

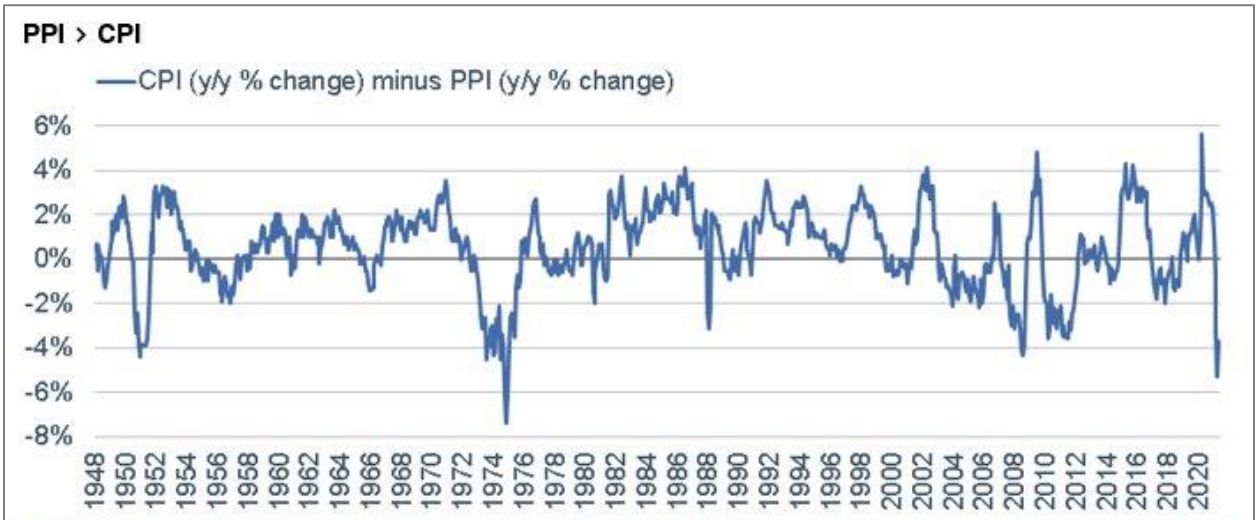
Long-term EPS growth forecasts are at all-time highs.



Source: BofA, Isabelnet

Stock market returns soften when PPI inflation is running well above CPI inflation.

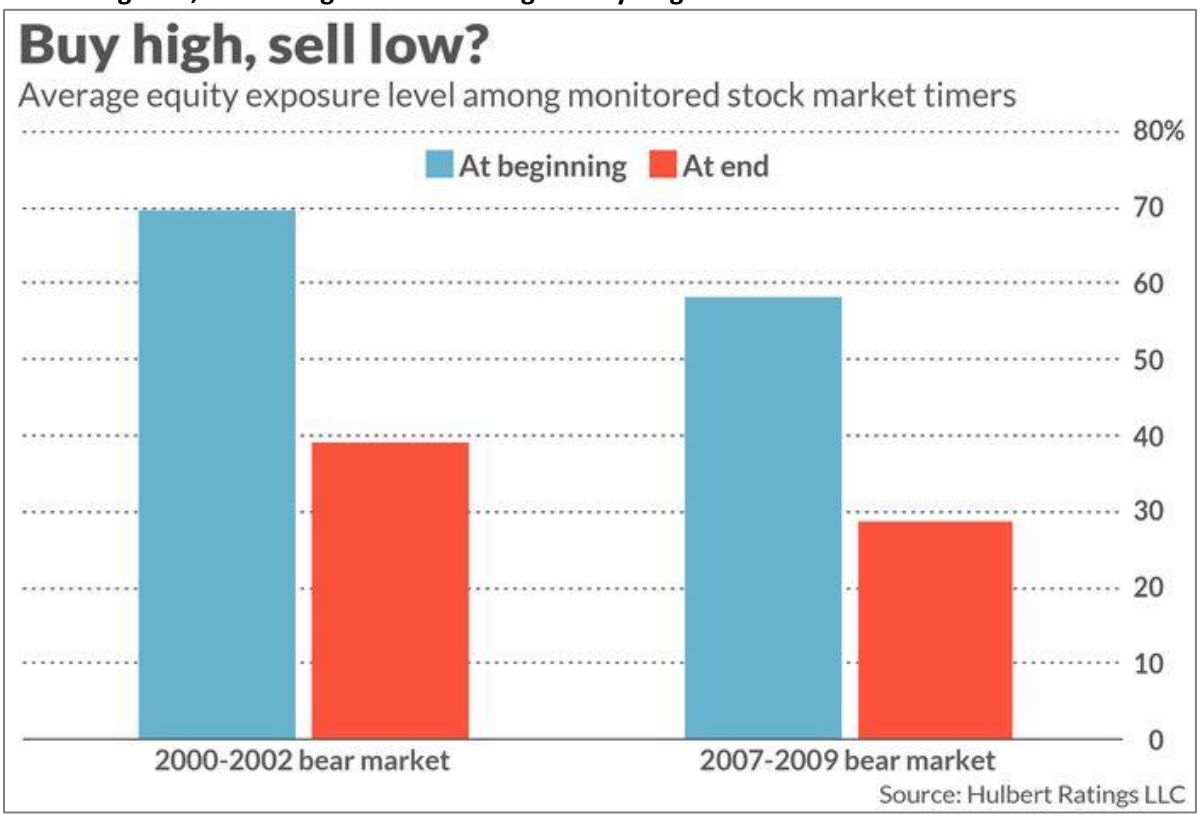
When producer prices are climbing faster than consumer prices, profit margins come under pressure.



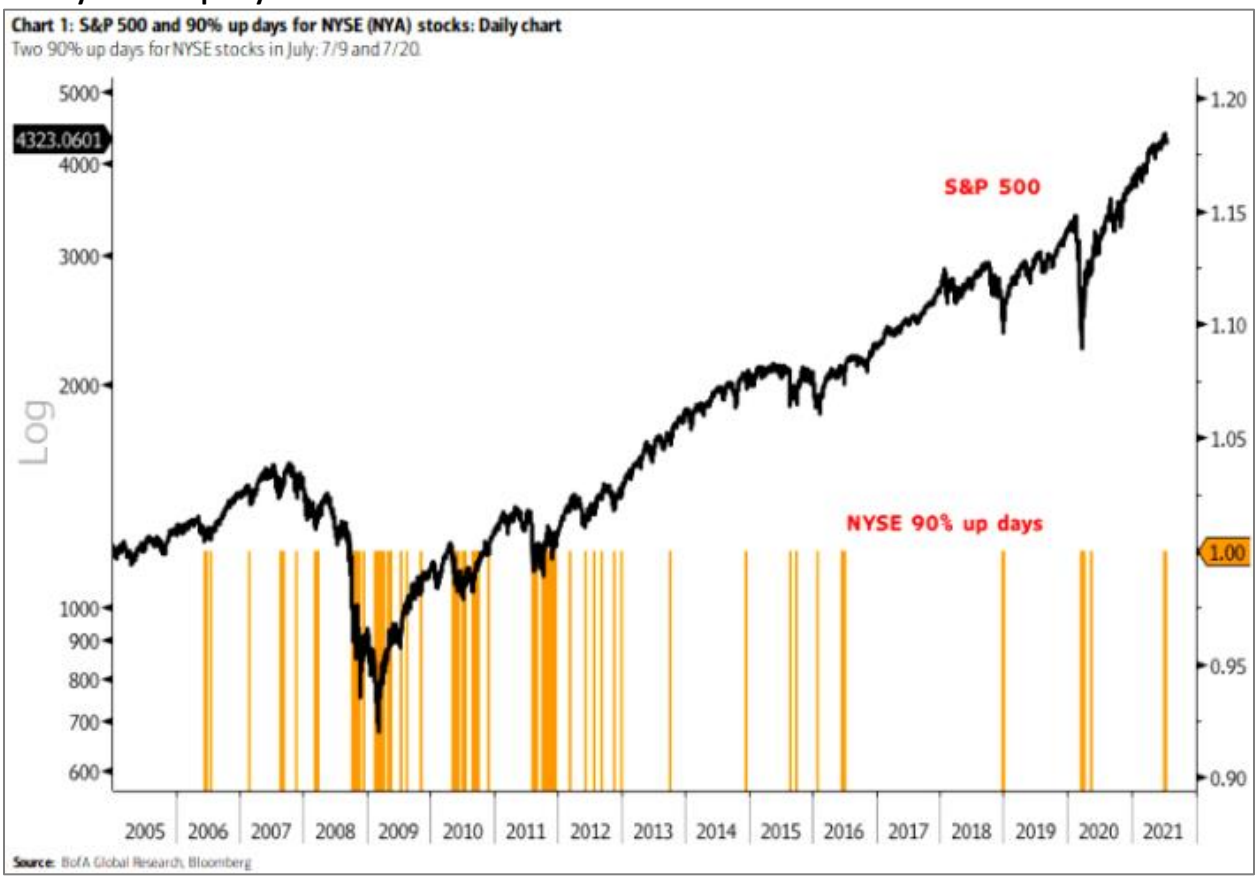
S&P 500 performance (1/31/1948-6/30/2021)	Negative spread (PPI > CPI)	No spread, 0% (PPI = CPI)	Positive spread (PPI < CPI)
Forward 6-month	2.3%	4.8%	5.6%
Forward 1-year	4.3%	9.5%	11.6%

Source: Charles Schwab, Bloomberg, Bureau of Labor Statistics, as of 6/30/2021. Indexes are unmanaged, do not incur management fees, costs and expenses and cannot be invested in directly. Past performance is no guarantee of future results.

For the big calls, the average stock market guru buys high and sells low.

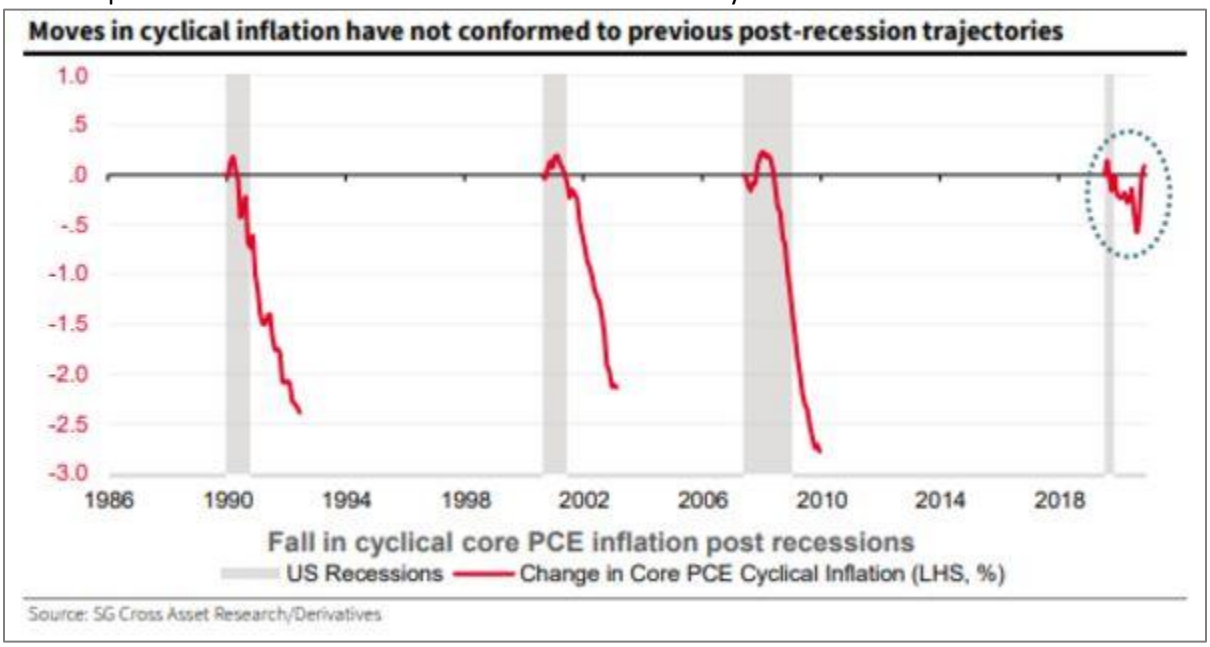


History of 90% up days on the NYSE.

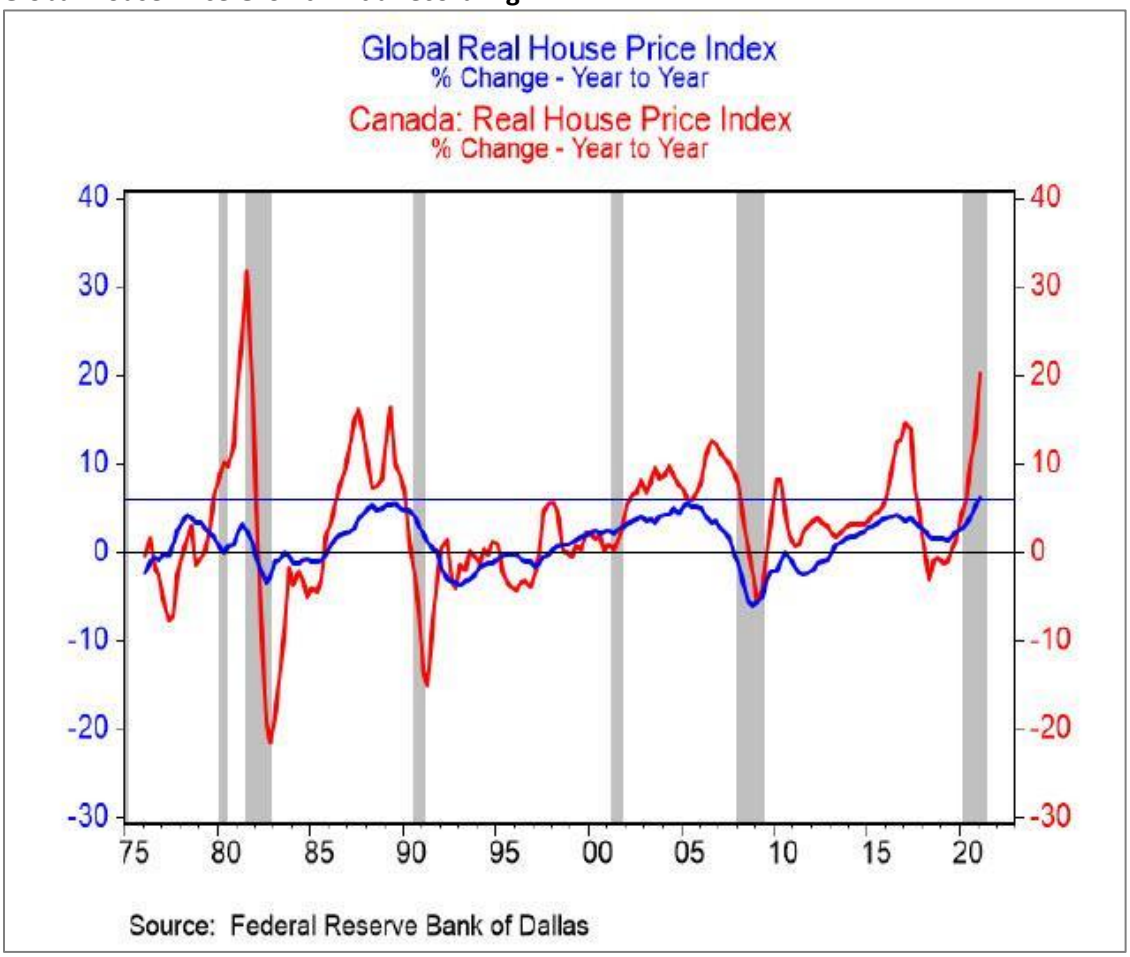


The inflation trajectory of this recovery hasn't been typical.

Inflation pressure tends to soften well into economic recovery – not so this time.

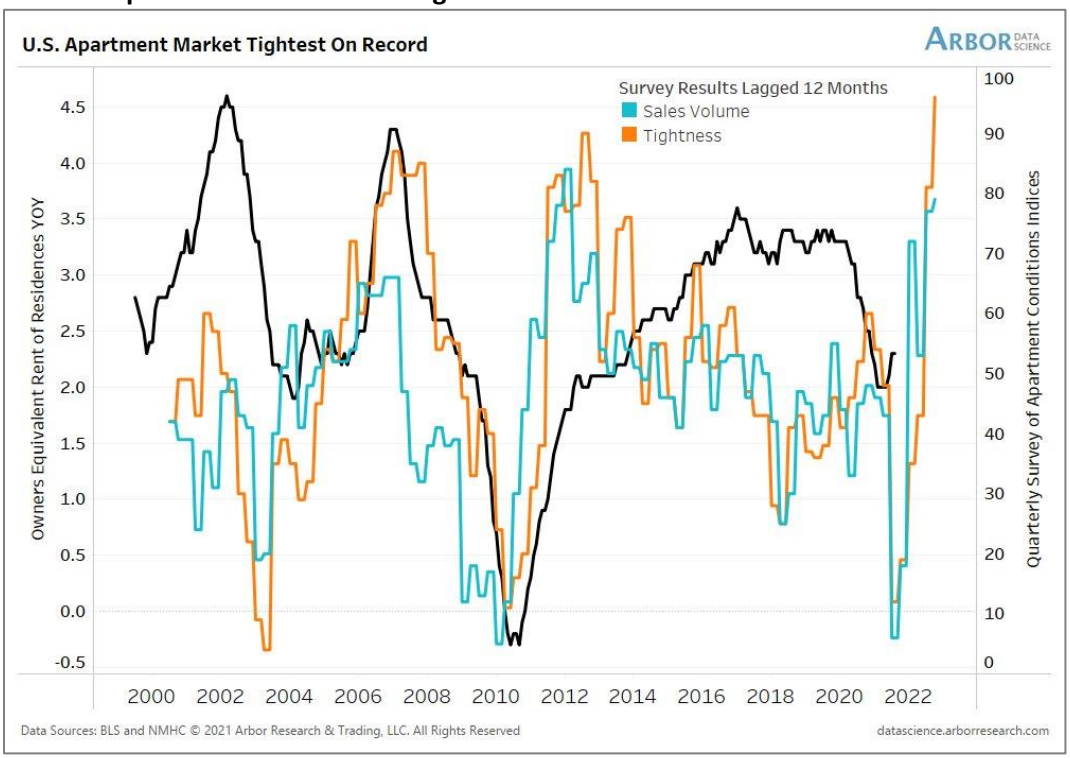


Global House Price Growth hit a record high.

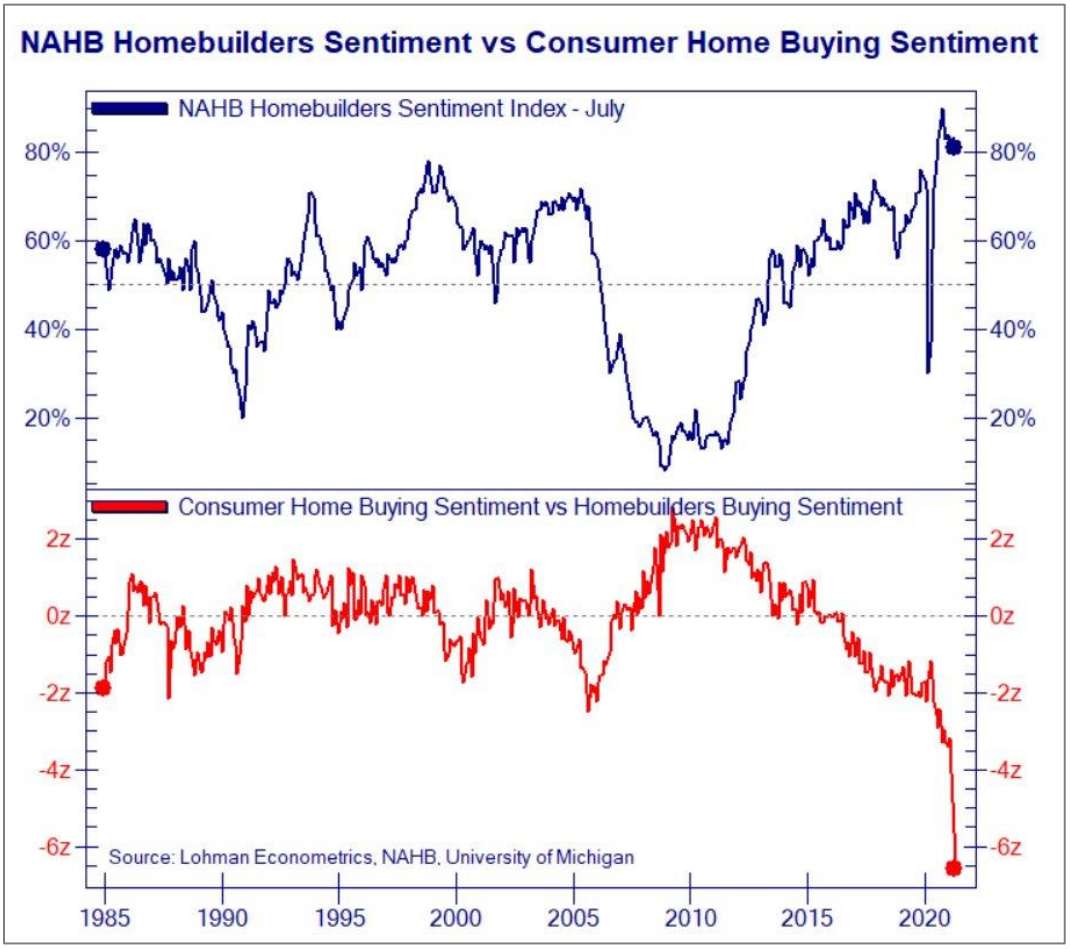


Source: ZeroHedge

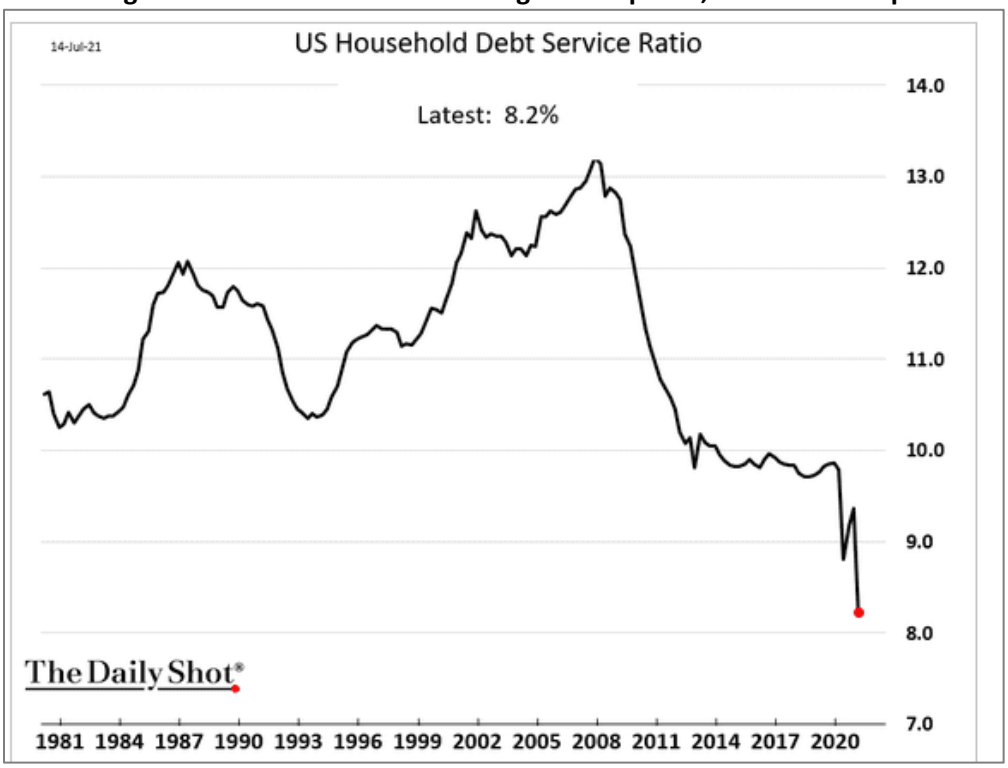
The U.S. Apartment market is the tightest it has ever been.



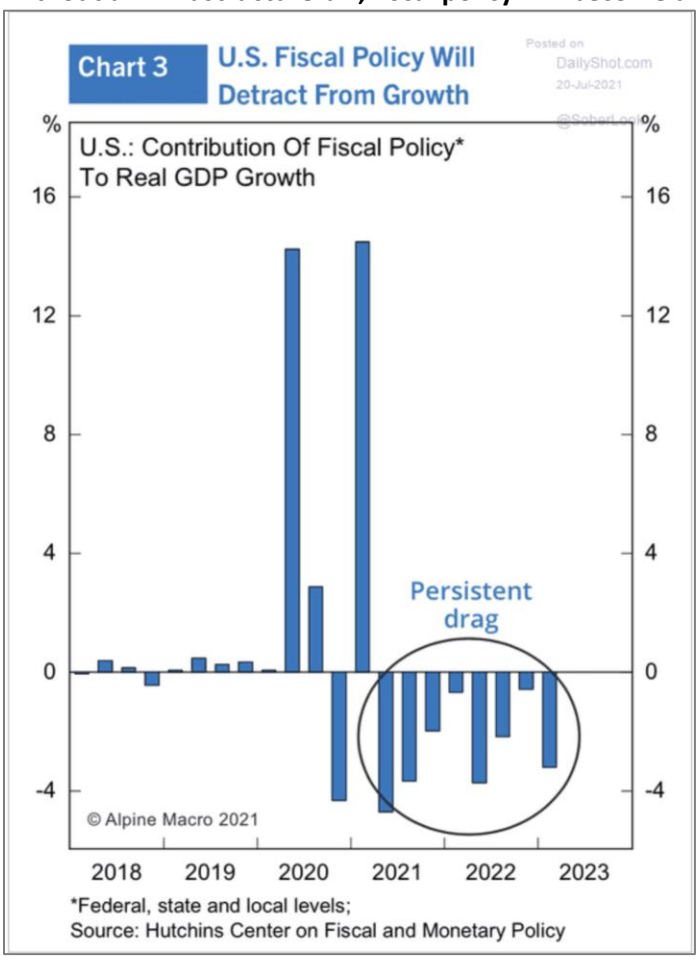
The sentiment spread between Homebuilders and Consumers is the widest ever.



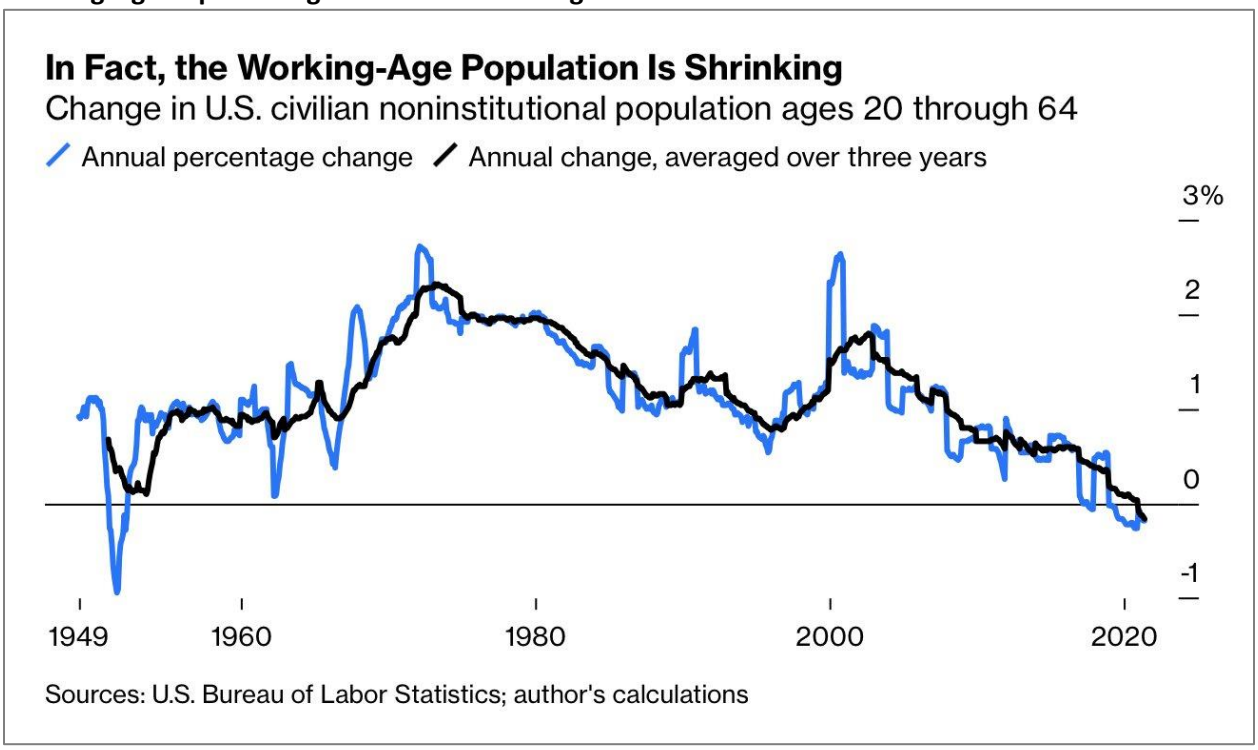
Even though consumers have soured on high home prices, their financial position looks solid.



Without an infrastructure bill, fiscal policy will become a drag on economic growth over coming quarters.



Working-Age Population growth has turned negative.



Source: Bloomberg

Labor is growing confident – employers have to offer more to get workers to accept a job.

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.

U.S. 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.

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