Market Outlook

By Mark T Dodson, CFA

Consumers are confident but not positive.

A significant drop in the Market Risk Index has taken it closer to the edge of the 80th percentile. The monetary composite dropped sharply down to the 50th percentile. It's an unusual mix with good scores in the exchange rate category, with strong terms of trade readings and solid readings from the velocity category. Holding it all back is the inflation category, which is as damaging as it can be, ranking right up there with some of the worst scores from the 1970s.

No such nuance exists with psychology and valuations, which still signal near-record enthusiasm and record-high valuations, keeping MRI in elevated drawdown risk territory despite the monetary composite signaling firmer neutral readings.

Psychology didn't budge, other than some jockeying for position by the individual categories. The influence of the Consumer Confidence category moved up to become the second-worst detractor. The growing gap between the Conference Board's Consumer Confidence Index and University of Michigan's Consumer Sentiment survey has become abnormally large. So large that it has only been wider on one occasion, over 50 years ago in November 1968. We highlighted this spread a couple of years ago, before the pandemic when it initially began to widen. It boils down to the nature of how these two popular surveys frame their questions. More important is that it tends to signal overheating environments, where inflation influences consumers' moods before influencing markets.

Also worth pointing out this week – a buy signal in our de-trended version of the equity put/call ratio. Absolute levels of put/call ratios still show lots of call-option speculation, but to see the de-trended 3 minus 39-week moving average equity put/call ratio signal a buy on the same week the market was making a new all-time high came as a surprise. We couldn't remember it happening before. But, it has – a single occurrence on July 1, 1998.

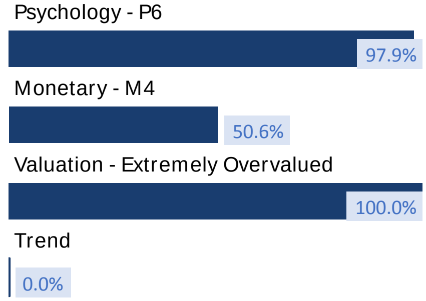
In that case, instead of a short-term buy signal, it highlighted an early shift toward risk aversion by speculators that preceded the failure of Long-Term Capital Management. The market ultimately bottomed in October 1998, and the era of moral hazard was born.

Market Risk Index

Rec Allocation 25% Underweight

82.2%

Category Percentiles



Largest Psychology Influences

Levered Investments	Negative
Consumer Confidence	Negative
Surveys	Negative
Option Activity	Negative

Largest Monetary Influences

Inflation	Negative
Velocity	Positive
Exchange Rates	Positive

Valuation

7-10 Year Rtn Forecast	-0.6%
10Yr Treas Yield (on 08/04)	1.2%

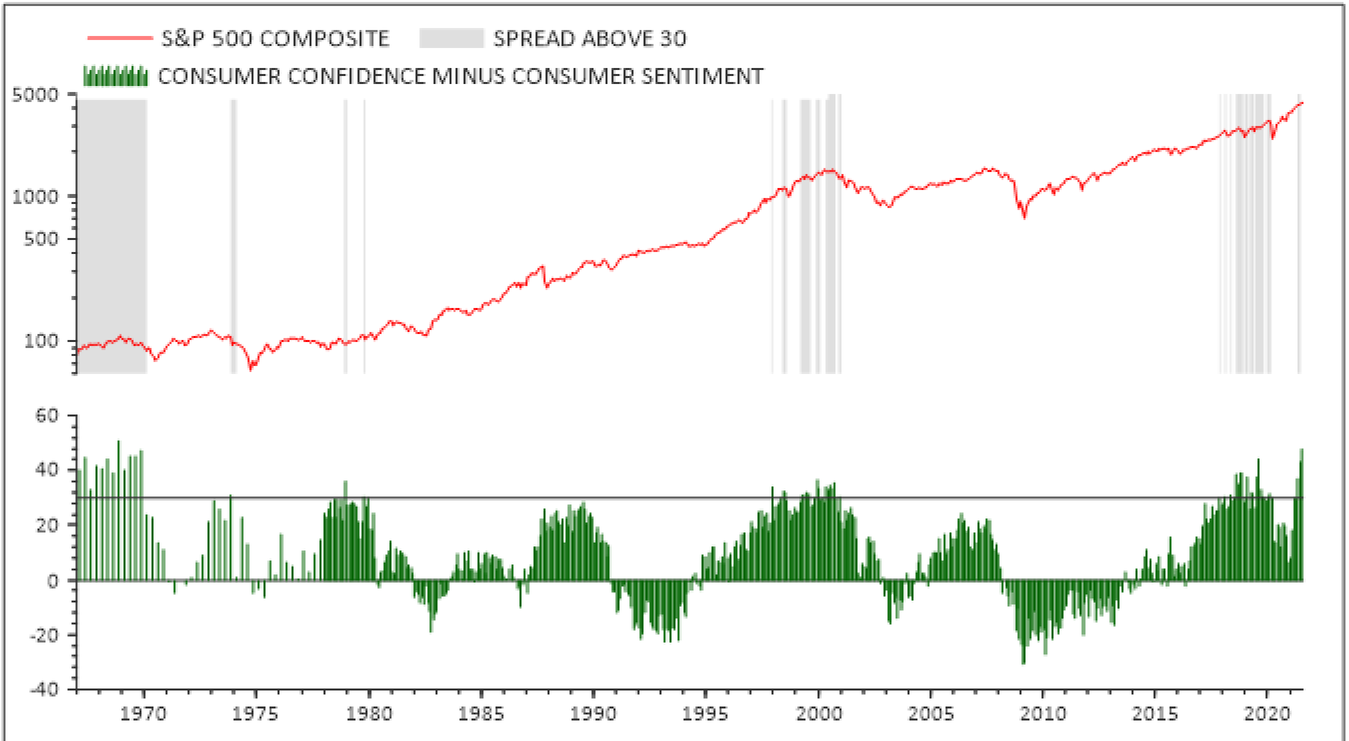
Market Trends

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.

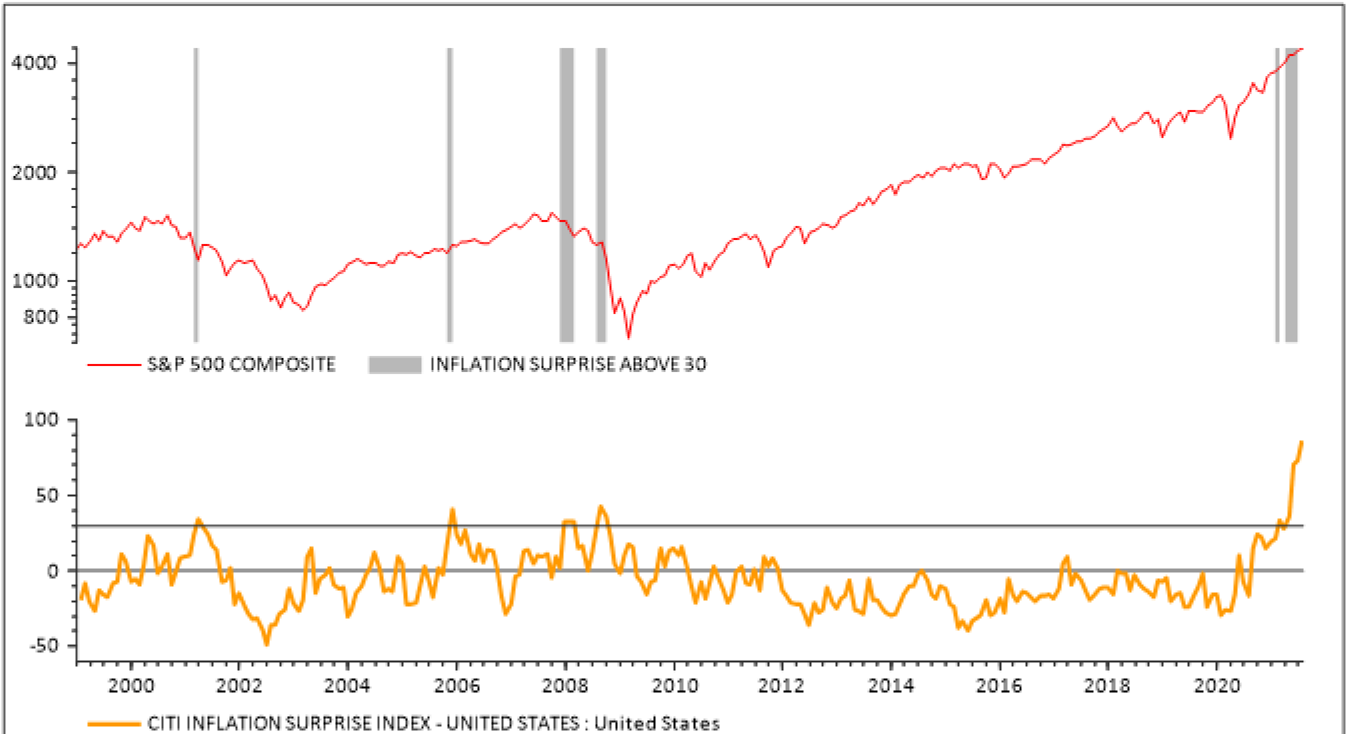
Charts of the Week

Widest spread between Consumer Confidence and Consumer Sentiment since 1968.



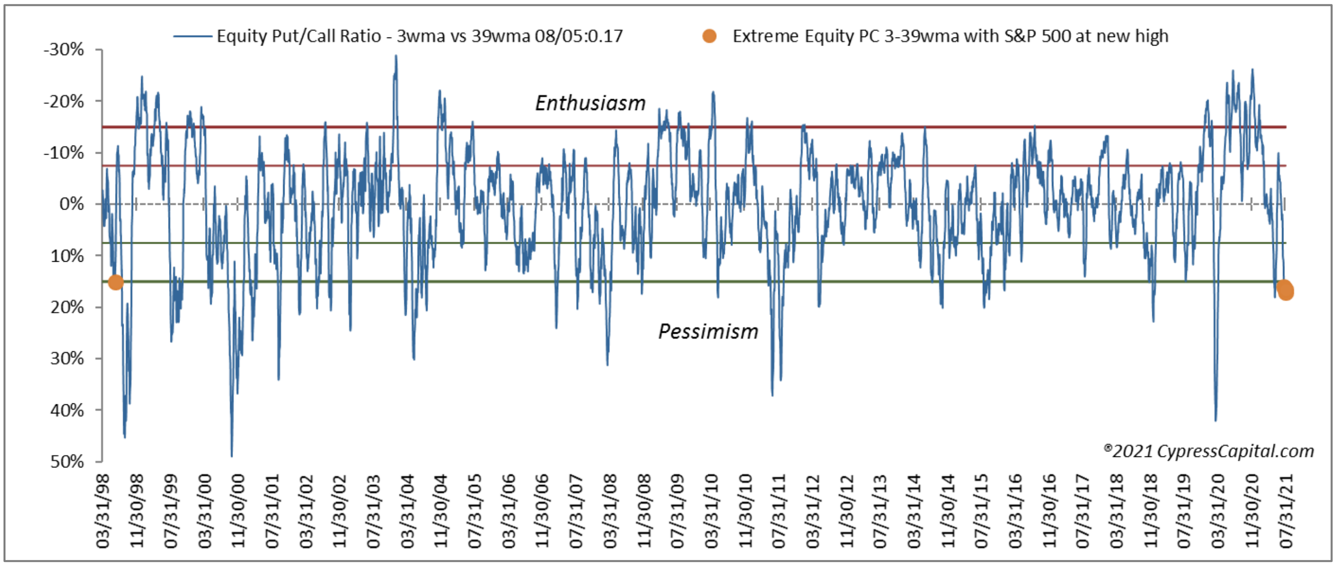
Source: Refinitiv Datastream, Cypress Capital

Citi Inflation Surprise Index made another new all-time high.

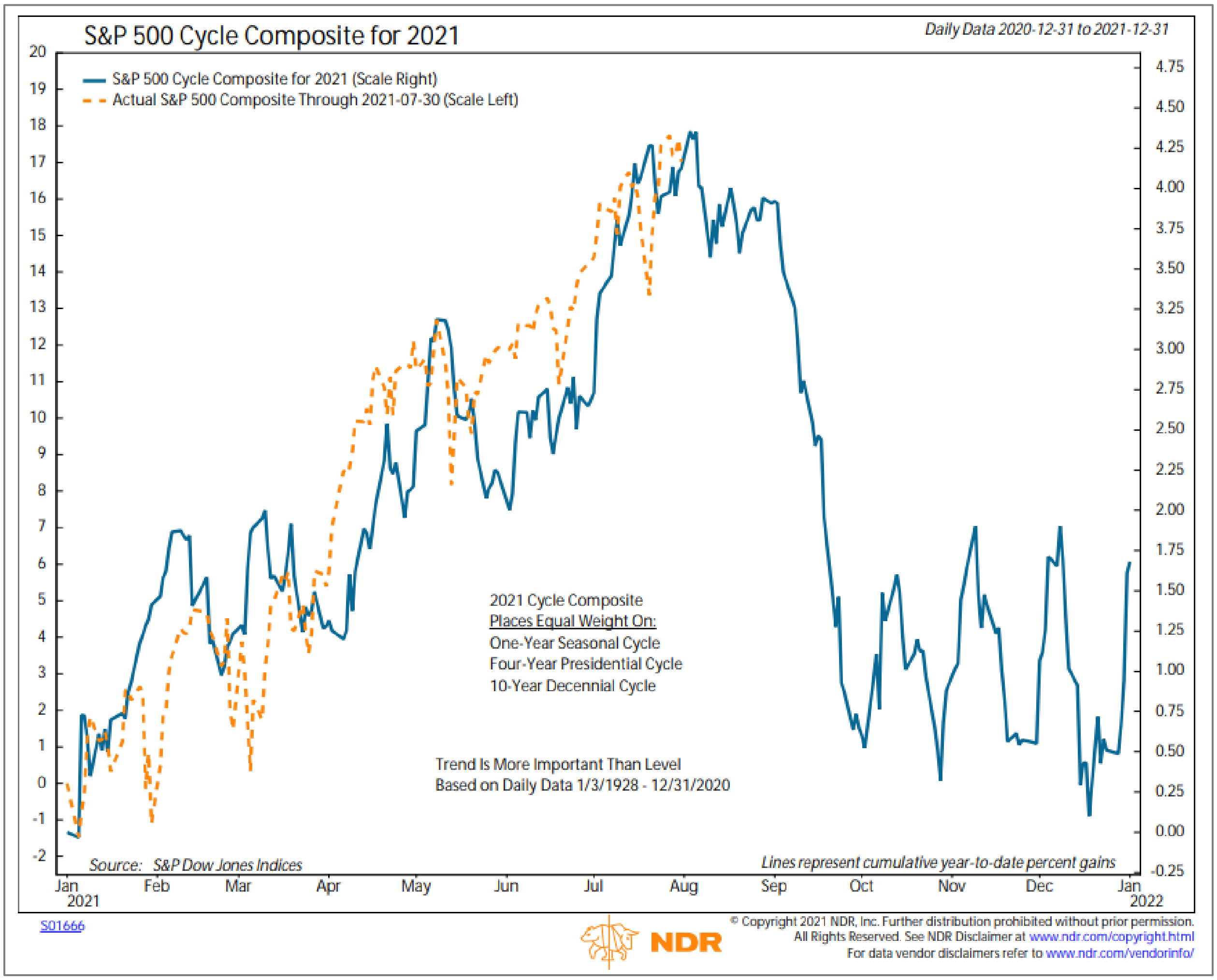


Source: Refinitiv Datastream, Cypress Capital

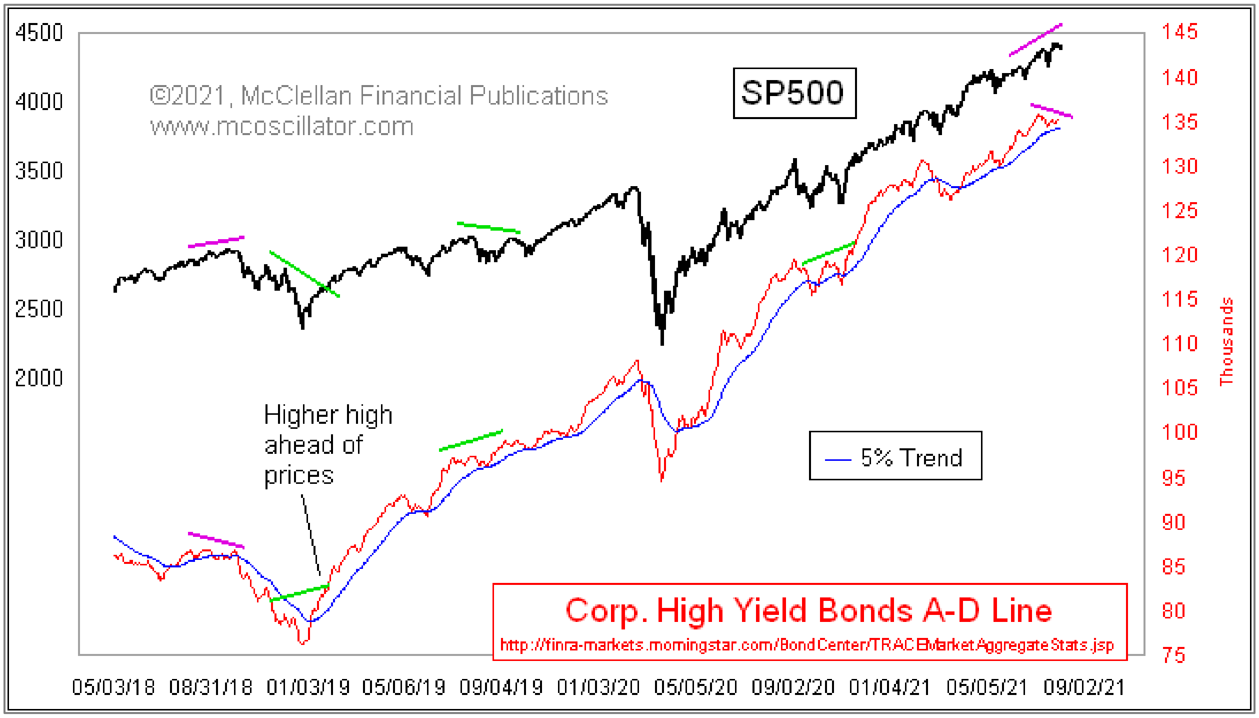
De-Trended Equity Put/Call ratio (3-39wma) gave a buy signal the same week the S&P made a high.
That's only happened one other time, July 1, 1998, before the October 1998 correction.



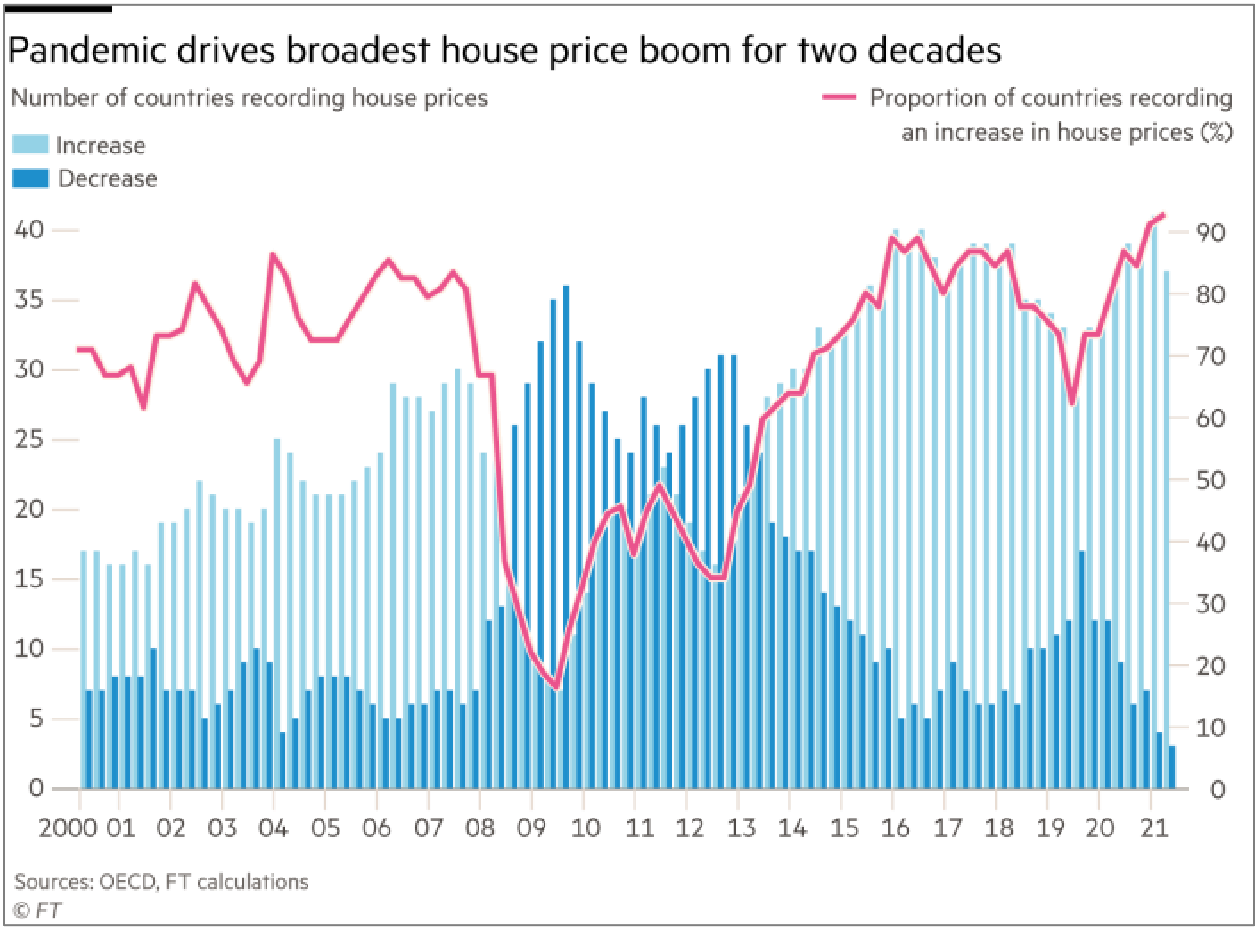
Stock market seasonality tends to peak in August.



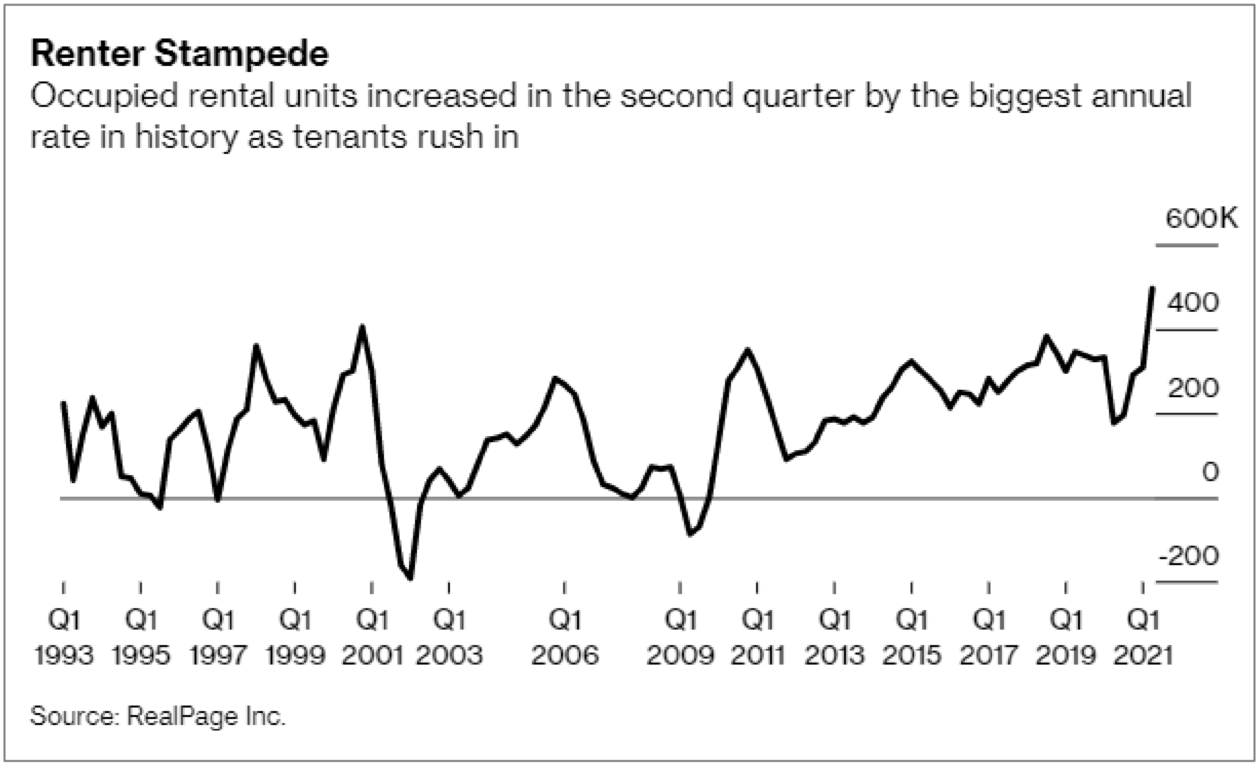
The high Yield Advance/Decline line is showing signs of divergence. (That's not the case with stocks.)



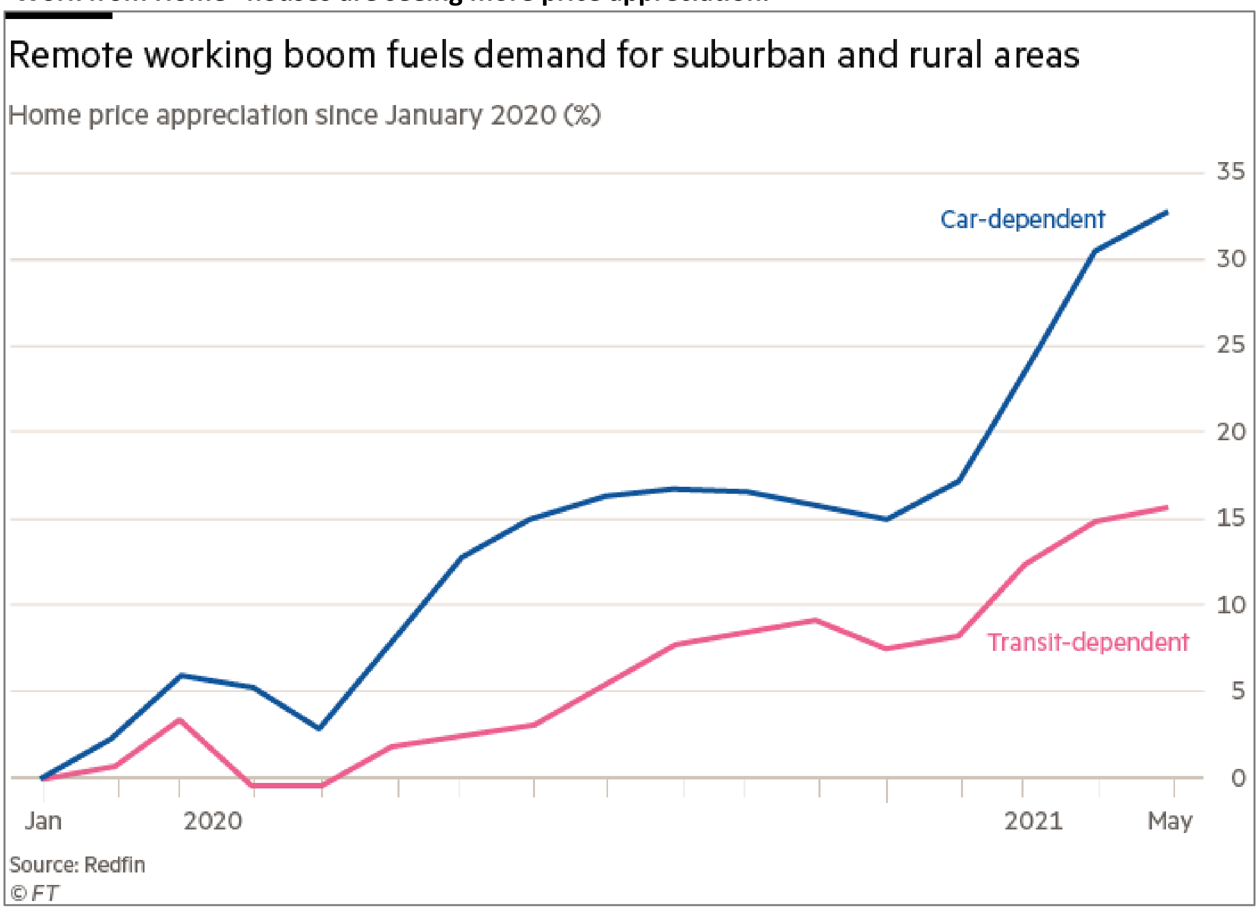
The stimulus-driven housing price boom is global – the biggest boom in at least 20 years.



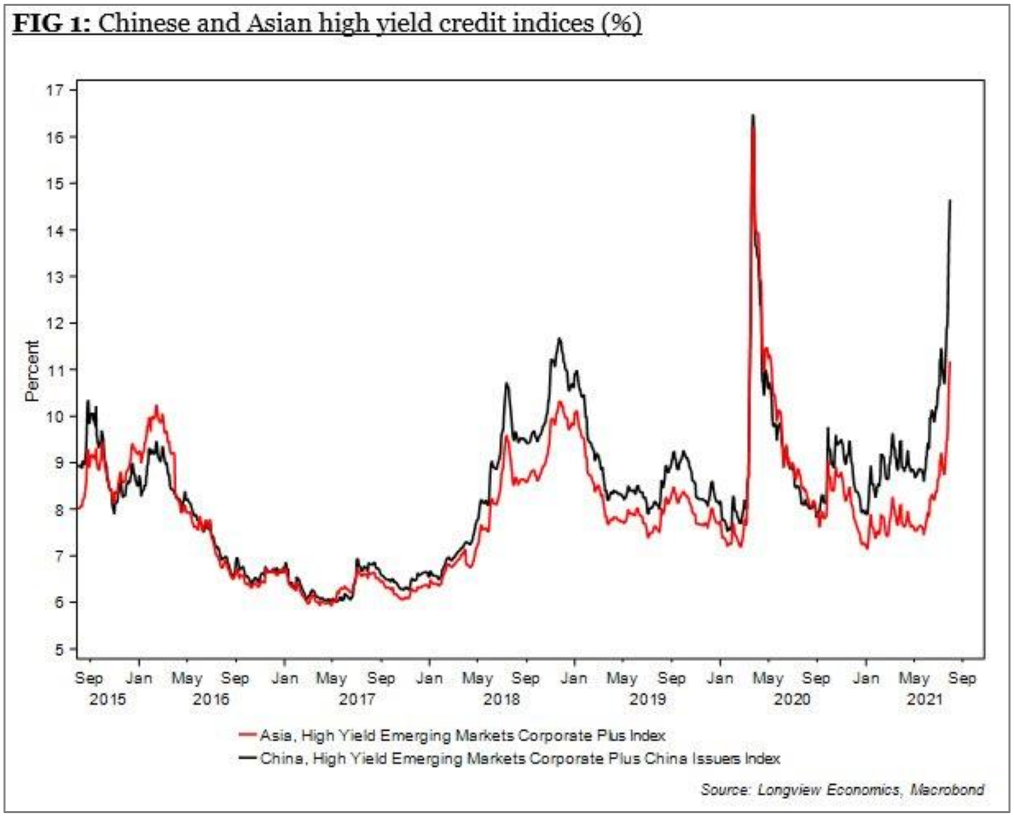
The biggest increase in occupied rental units in history occurred during Q2 2021.



"Work from Home" houses are seeing more price appreciation.



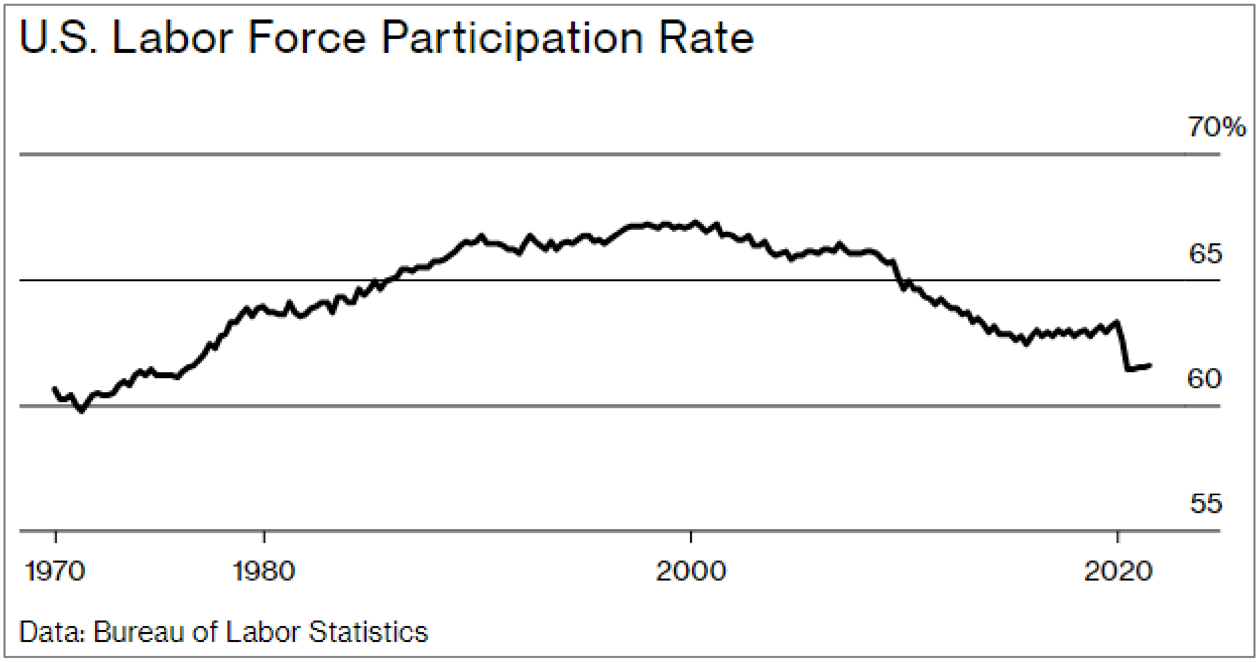
Credit spreads are tightening in China.



100 Yrs of Commodities to Stocks suggests a significant opportunity for real assets.

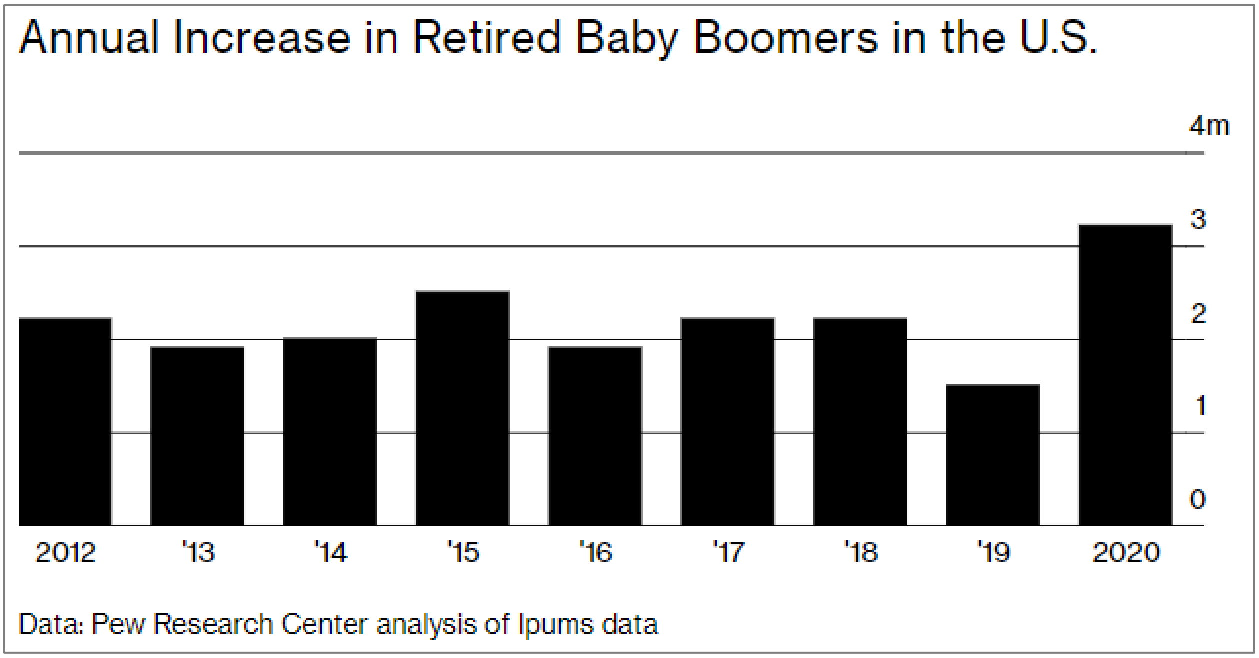
Source: The Felder Report

Explaining Inflation Surprises – Labor Force Participation dropped sharply during the pandemic.



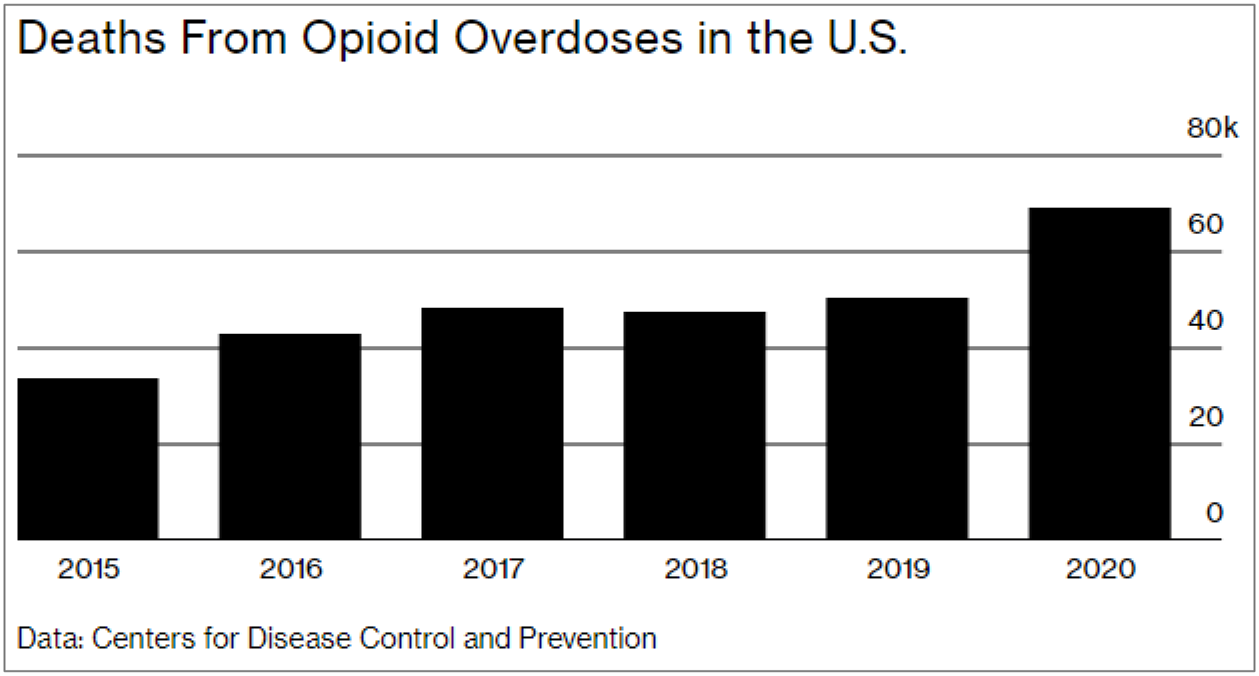
Source: Bloomberg

Explaining Inflation Surprises – A record number of Baby Boomers decided to retire during the pandemic.



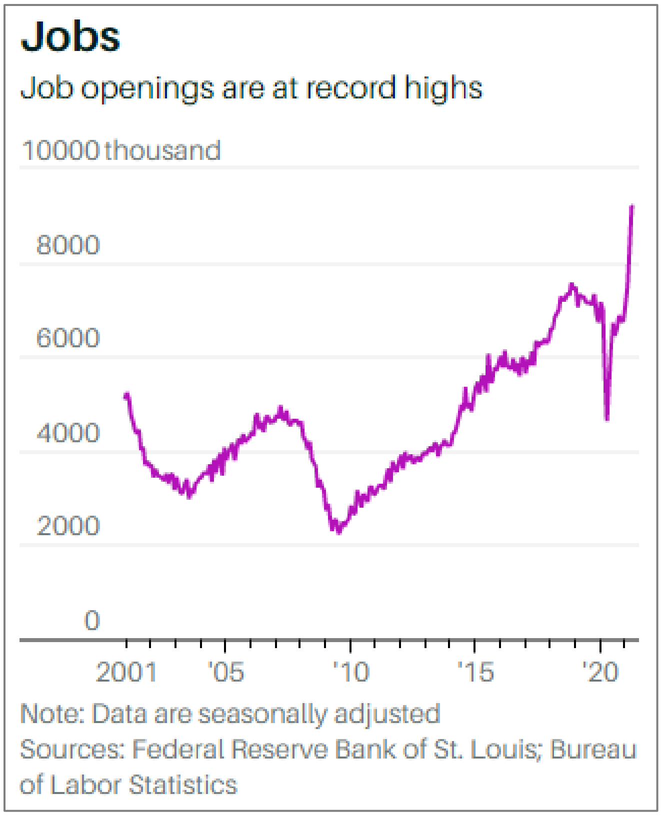
Source: Bloomberg

Explaining Inflation Surprises – Opioid deaths surged during the pandemic.

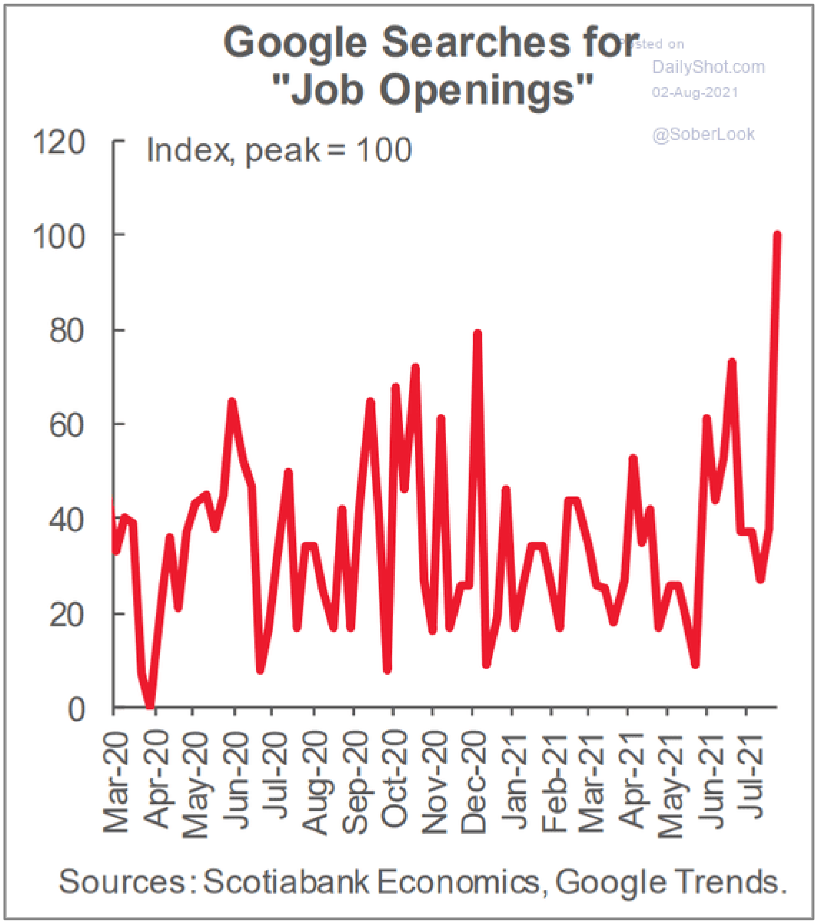


Source: Bloomberg

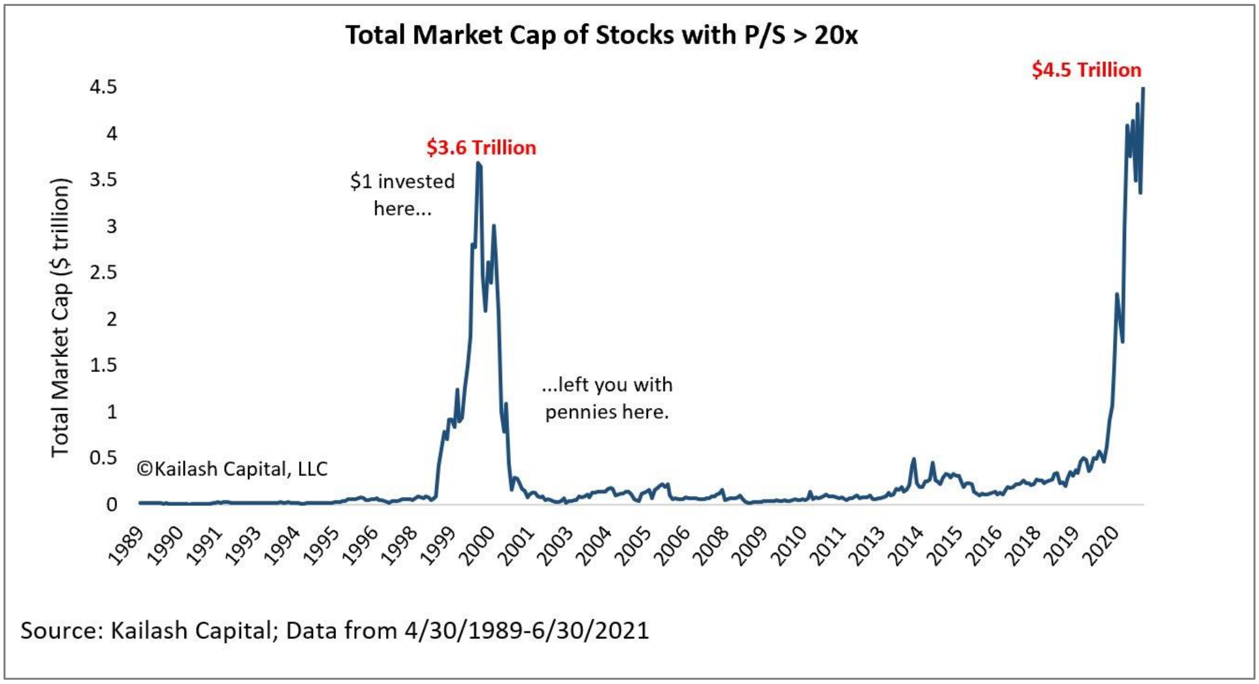
Employers searching for workers and employees quitting jobs are at record highs.



People have started searching for job openings as a wave of unemployment benefits is set to expire.



The total market cap of stocks with extreme valuations breaks the dot-com era record.



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.

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