



# Market Outlook

By Mark T Dodson, CFA

## Don't become insensitive to a speculative environment.

Market Risk Index edged a smidgeon higher, as both the Monetary and Psychology composite risk scores increased slightly.

Technical indicators moved back into one of the worst detractors for Psychology. Still, there is no silver bullet to point to suggesting breadth has deteriorated enough to be on high alert. Key indices in our dashboard have stopped making highs alongside cap-weighted indices, and the NASDAQ High Low Logic Index continues to edge toward a major sell signal, but most measures of breadth have fallen short of giving technicians any reason to sound an alarm.

Inflation will continue to be a stumbling block for monetary conditions well into the fall, barring a sharp stock market reset. Inflation is having a remarkable impact on the mood of consumers, judging by the University of Michigan's Consumer Sentiment Survey. It's dramatic enough that if we were politicians, we'd be sweating the upcoming mid-term elections.

The Producer Price Index, one of the best inflation metrics in terms of stock market impact, hit another high, leading us to believe that we hit peak corporate earnings optimism during this quarter. CPI and PPI are behaving in a way that implies profit margin pressure for corporations. Unfortunately, as high as confidence is in the Fed and the Fed put, any market friction that comes now will not be the kind that Fed liquidity can help, as inflation is running well too hot. This is not the post-GFC recovery.

Many of the indicators that we highlight weekly might be best referred to as timing tools – quantitative voodoo built on the shoulders of a lot of shrewd investors. But, ultimately, we use them to help us adhere to a valuation discipline. A discipline that is good at measuring risk, but more often than not, terrible at timing. Valuation is the framework that gives us that margin of safety – protecting capital from permanent impairment – even though she can lead us through the wilderness for a time.

Margin of safety is driven by the price that we pay for financial assets that generate cashflows. It determines the rate of return that we earn on those investments, and that figure is not relative. It's absolute. The margin of safety in this environment is the thinnest that we have ever seen, so it helps to not focus too long and hard on the shorter-term timing tools, particularly when there is no clear-cut short-term signal coming from those tools. Instead of the fear of missing out, we desire to fear growing numb to the short-term resilience of a highly speculative environment.

### Market Risk Index

Rec Allocation 25% Underweight

**82.5%**

### Category Percentiles

Psychology - P6

98.2%

Monetary - M4

50.7%

Valuation - Extremely Overvalued

100.0%

Trend

0.0%

### Largest Psychology Influences

Levered Investments	Negative
Surveys	Negative
Technical	Negative
Consumer Confidence	Negative

### Largest Monetary Influences

Inflation	Negative
Velocity	Positive
Exchange Rates	Positive

### Valuation

7-10 Year Rtn Forecast	-0.3%
10Yr Treas Yield (on 08/12)	1.4%

### Market Trends

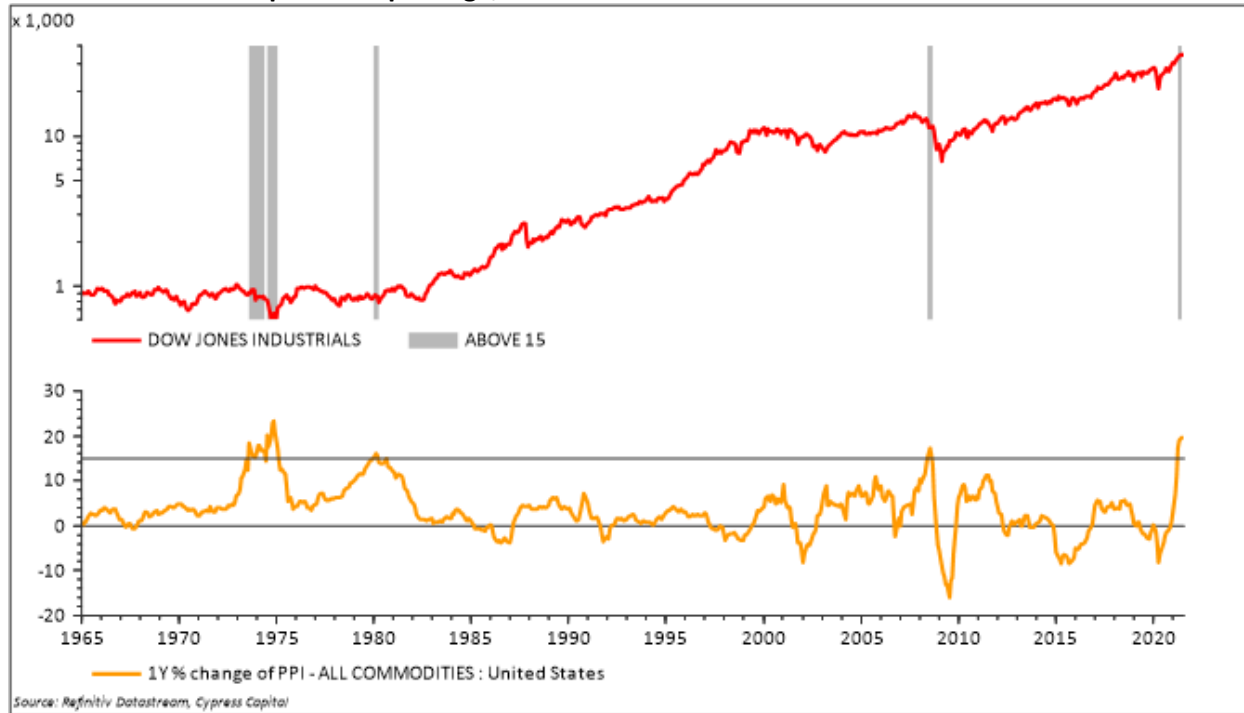
USEquities	Bullish Investment
Intl Equities	Bullish Investment
REITs	Bullish Investment
Broad Commodities	Bullish Investment

Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets.

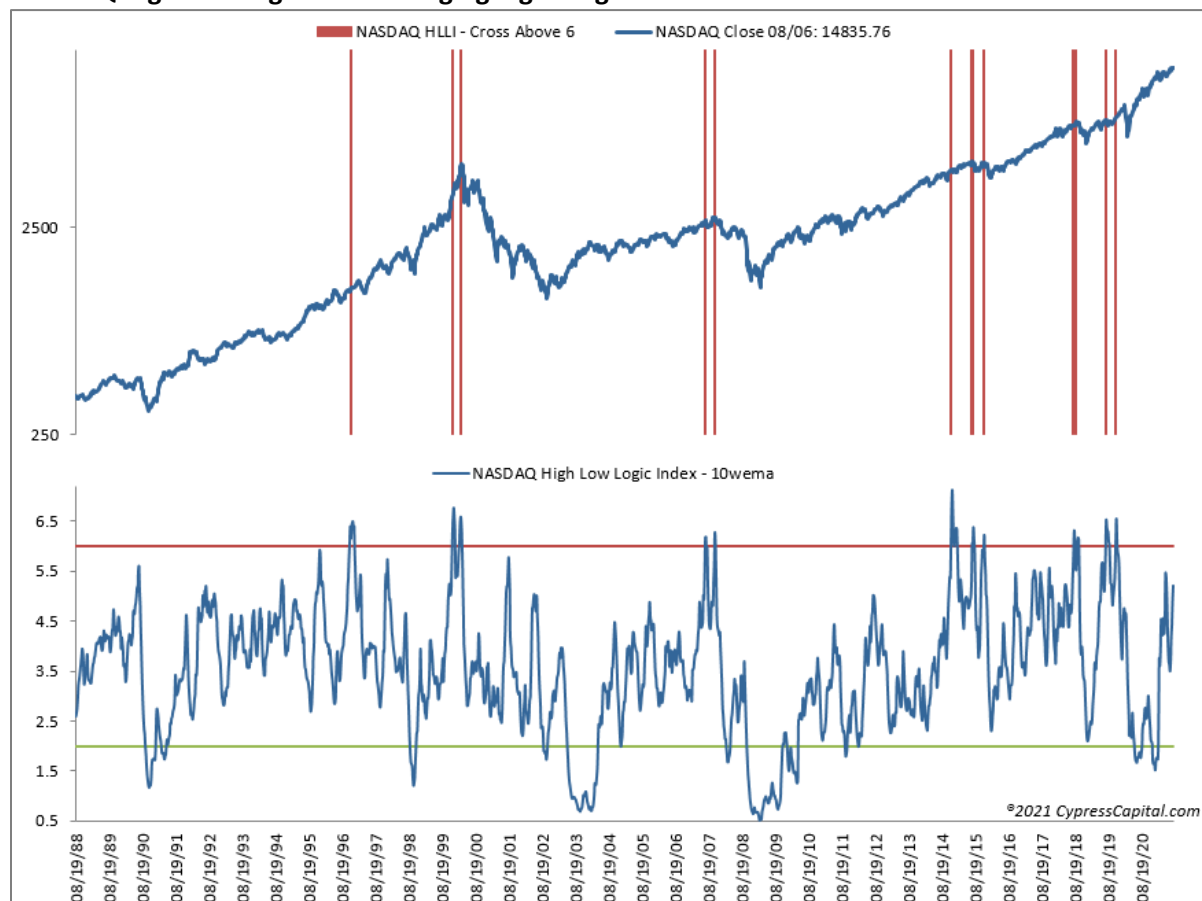
Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

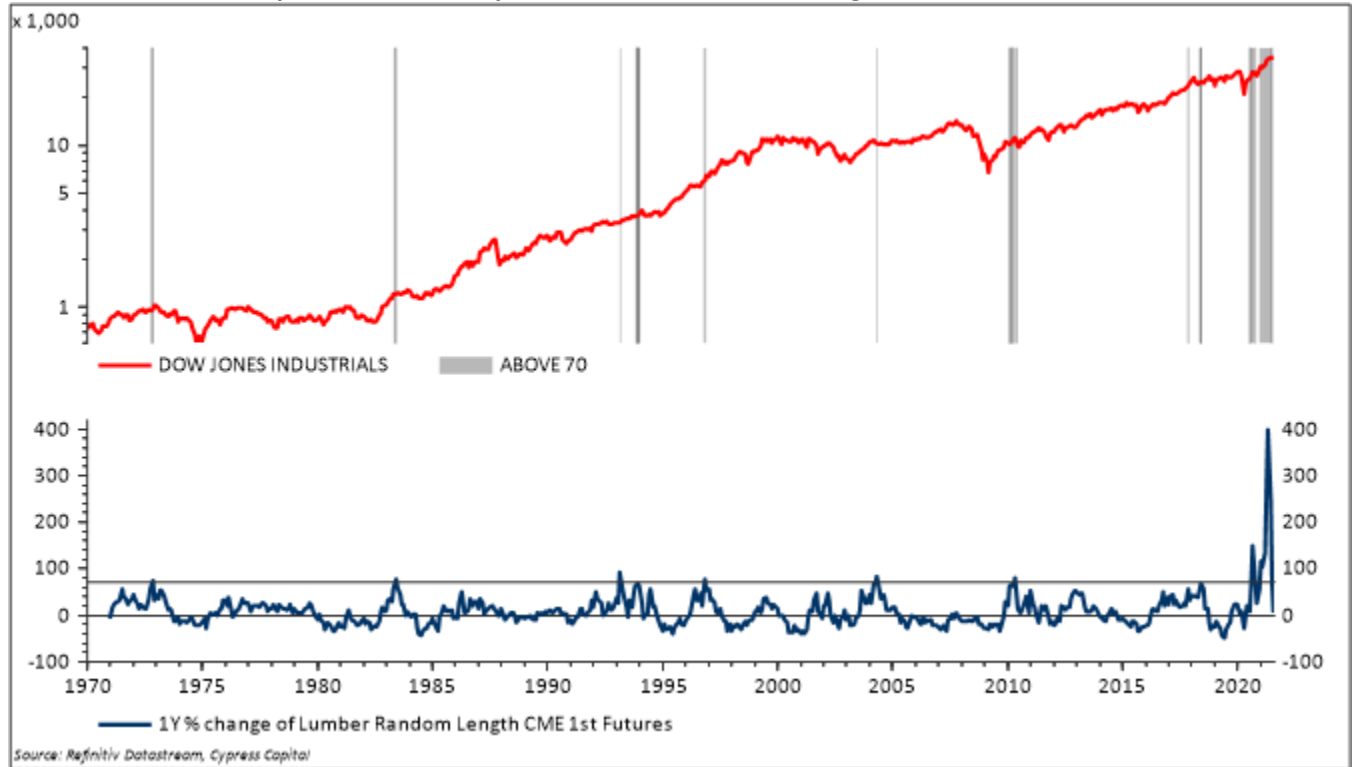
PPI Inflation is like Papa Bear’s porridge, too hot.



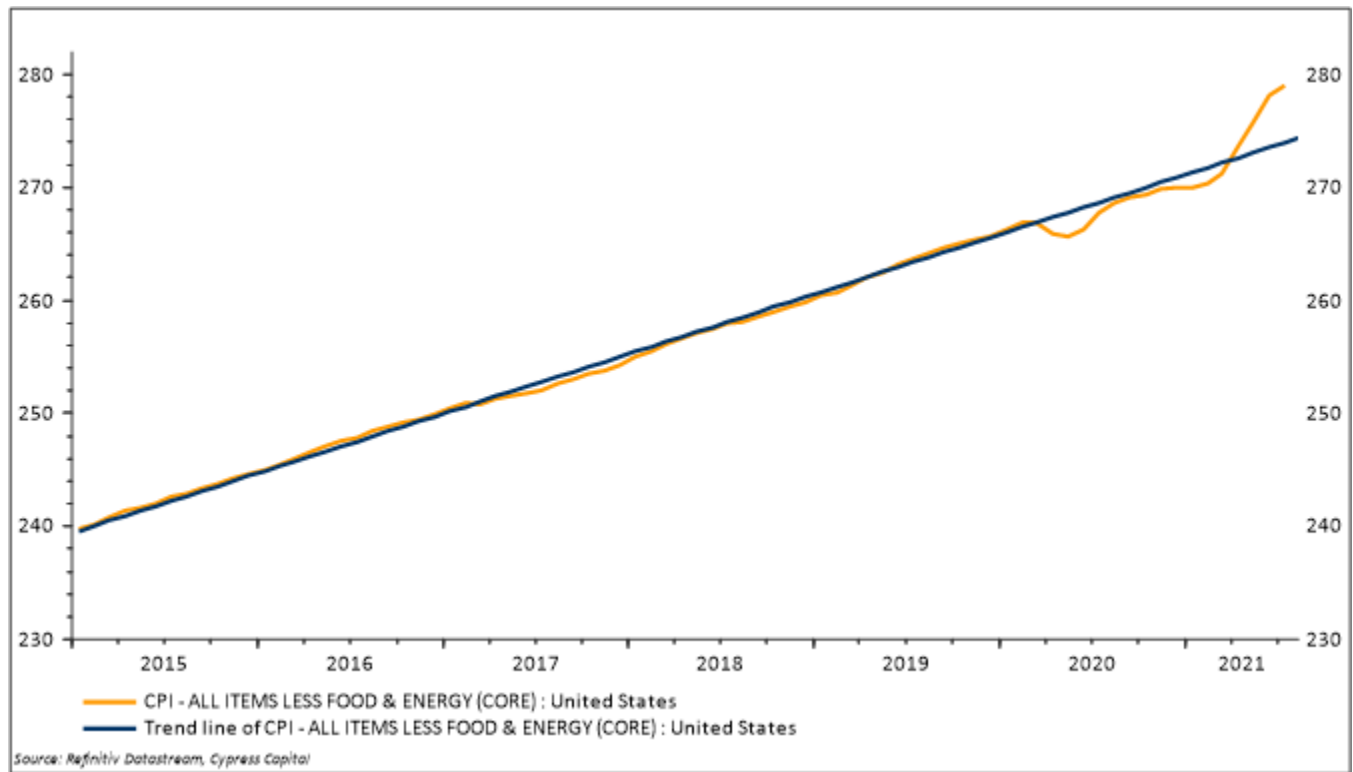
NASDAQ High Low Logic Index is edging higher again.



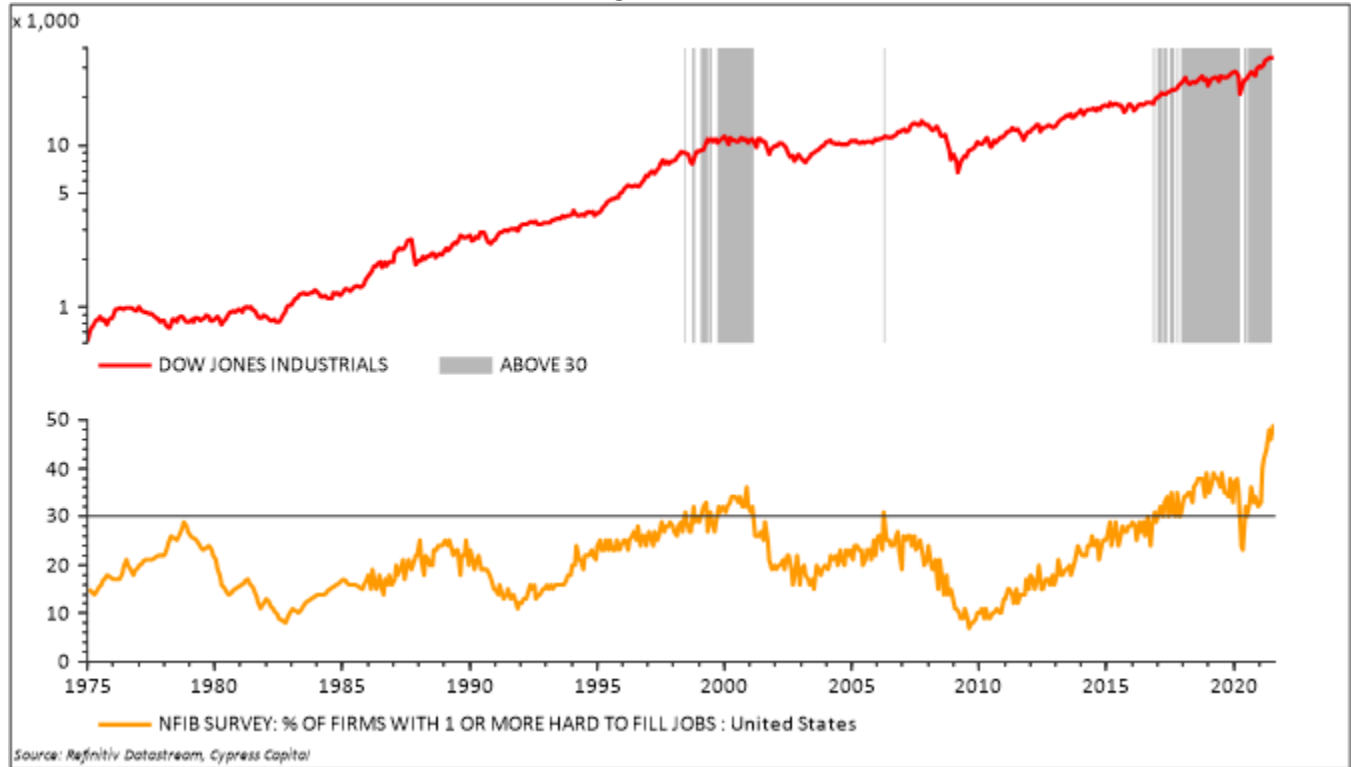
The ascent and subsequent crash in the price of Lumber is like nothing we have seen in our lifetimes.



Core CPI has broken above a trend that has been intact since the 1980s.



**Small Business has never had a harder time finding workers.**



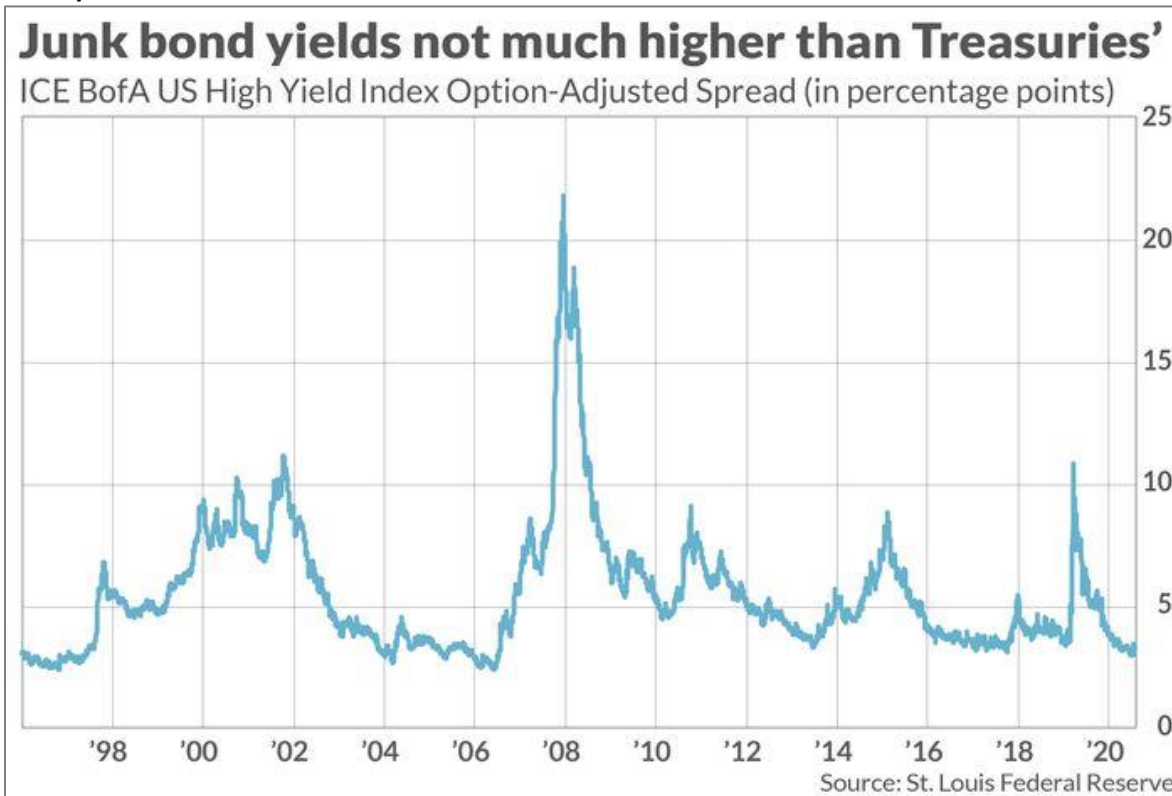
**Inflation is impacting consumer sentiment in a way that we haven't witnessed in a generation.**



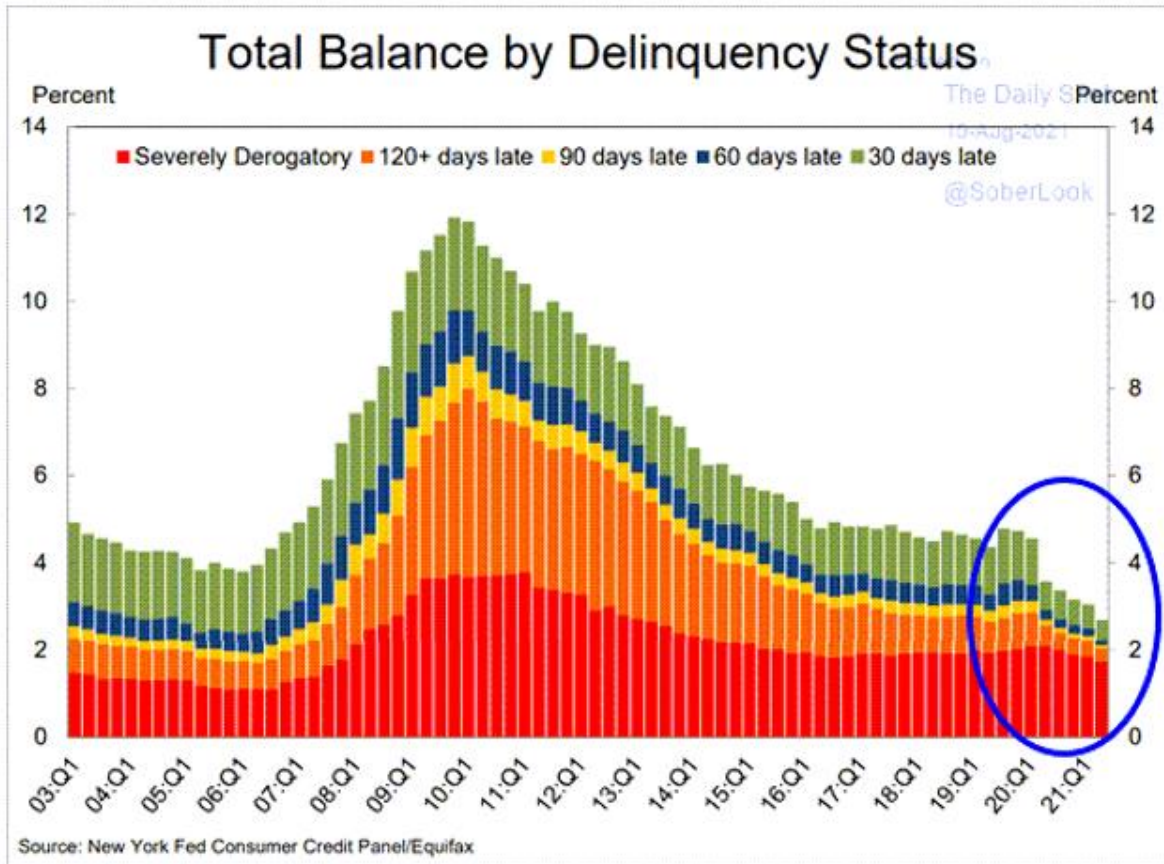
Emerging market relative strength is approaching the point that China entered the WTO.



Junk spreads are the thinnest since 2006.



Times are good, and inflation makes debt cheaper. No one is behind on their payments.



Hedge funds are crowding into the same names.

Figure 13: Level of Exp to Top 50 Crowded Longs Eclipses 40% of Total Long Exp for the First Time Since 2010

Client Long Exp to Top 50 Names as % of Total Long Exposure (N. America)



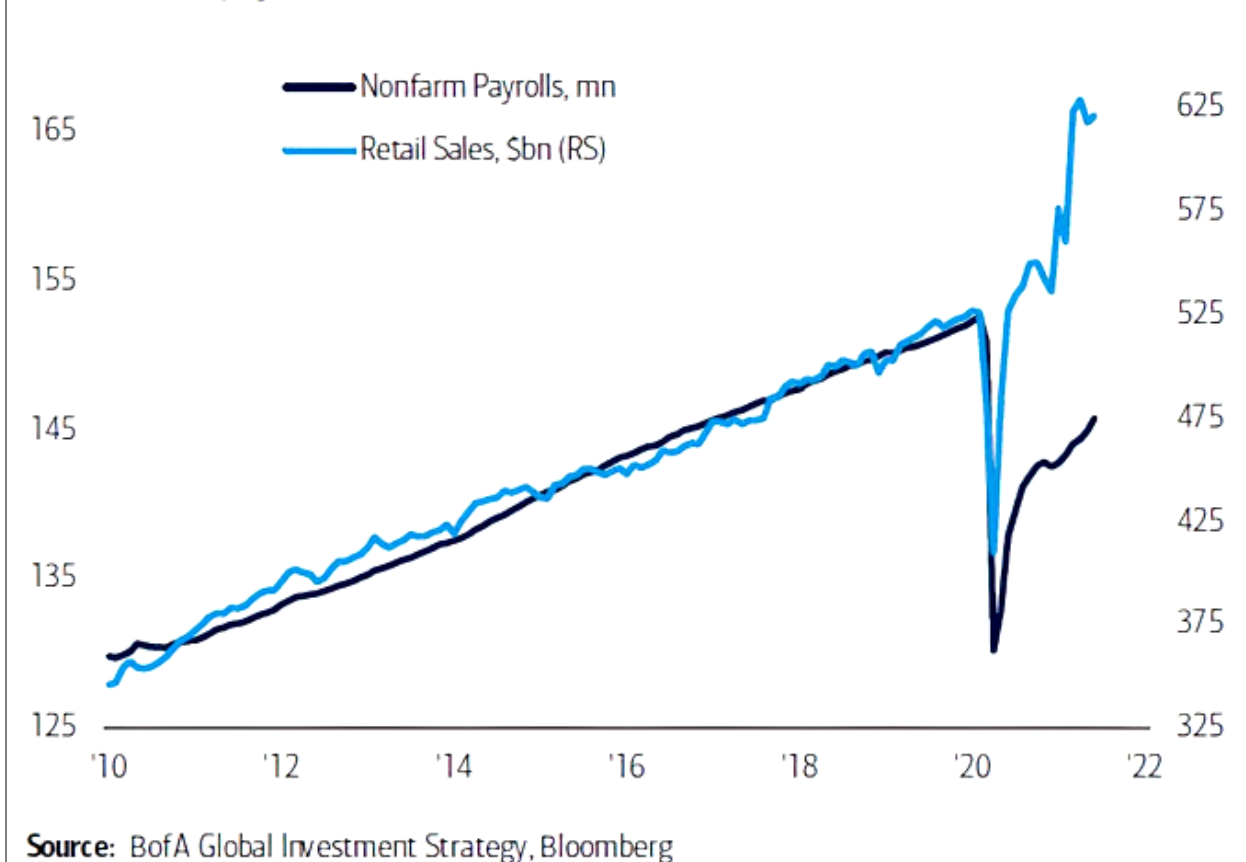
Source: Bloomberg, Morgan Stanley Prime Brokerage, data as of Jul 30, 2021

Trading has become a national past-time.



The gap in this chart does a great job in explaining inflation pressures.

**Chart 5: Payrolls 7mn below pre-Covid levels vs. retail sales 18% above**  
US nonfarm payrolls vs retail sales



The Cash Flow Yield on the stock market is close to breaking below the 2000 Lows.

## Cash Flow as a Percent of Market Cap Near New Low

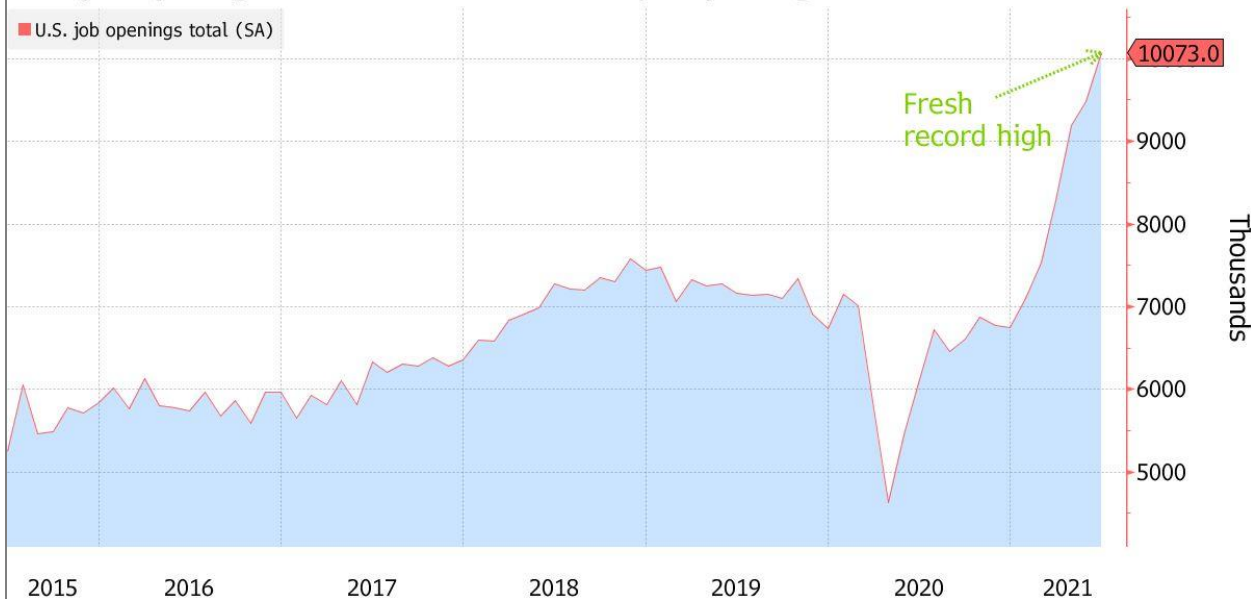


Source: Bloomberg as of Aug. 4, 2021

The number of job openings hit a new record, breaking above 10 million.

## More Vacancies

**U.S. job openings hit a new record in June, surpassing 10 million**



Source: Bureau of Labor Statistics



## 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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