



Market Outlook

By Mark T Dodson, CFA

In 2021 - Be greedy when others are greedy

Market Risk Index continued its recent streak of modest improvements, falling to 78.8%, again due to some progress at the margins within the Monetary composite.

Moving monetary conditions beyond the neutral zone will take some help from the Inflation category, which can only occur if the consensus about transitory inflation is correct. Fortunately, we don't have to make that judgment. The indicators that we use only score negatively when readings reach levels associated with poor forward-looking stock market returns and higher volatility, which is still the case today. ISM numbers were released this week, and while the ISM Prices Paid Index appears to have peaked, it's too high for comfort. Sharp market corrections and a retreat in animal spirits are historically the most common way to alleviate inflation pressure.

Psychology and valuation remained locked in euphoric extremes, normal fare in 2021. The stock market's resilience and provision of easy gains managed to bolster some investors even more – pushing indicators within our Levered Investments category to new heights. The Rydex ratio and assets in levered ETFs set new records this week.

We were struck by the history of the Rydex ratio in particular as it set another new all-time high. While we have a de-trended version of the Rydex ratio, the original formula is an absolute measure of the zeal of speculative investors and their desire to swing for the fences - looking strictly at the total assets in those leveraged and inverse mutual funds.

Readings above 60% historically marked over-enthusiastic markets with too much bullishness, and the indicator would retreat into negative readings in poor market environments. As the Great Financial Crisis fell further into the rearview mirror, investors became emboldened from gradually increasing confidence in the Fed, quantitative easing, and a full embrace of the "There Is No Alternative" hypothesis. As a result, Rydex readings evolved to look more like a permanent levered bet – peak confidence in passive investing and "Buy & Hold." Readings above 60% became more common, and 80% marked the new sentiment extreme for speculators from 2018-2020. Net moves out of levered bets disappeared.

Since the flood of Covid liquidity and stimulus, it has entered a new regime of even higher readings. Readings have stayed above 80% for much of the year, as assets continue to flow into leveraged bets on a higher stock market. Every brief market dip provides speculators a perceived opportunity to add more leverage, turning Warren Buffett's mantra to be fearful when others are greedy on its head in a way that would make even Gordon Gekko blush. In 2021, it's to be greedy when others are greedy, or even simpler, be greedier.

Market Risk Index

Rec Allocation 25% Underweight

78.8%

Category Percentiles

Psychology - P6



Monetary - M3



Valuation - Extremely Overvalued



Trend



Largest Psychology Influences

Levered Investments	Negative
Option Activity	Negative
Technical Indicators	Negative
Consumer Confidence	Negative

Largest Monetary Influences

Inflation	Negative
Velocity	Positive
Interest Rates	Positive

Valuation

7-10 Year Rtn Forecast	-0.4%
10Yr Treas Yield (on 09/01)	1.3%

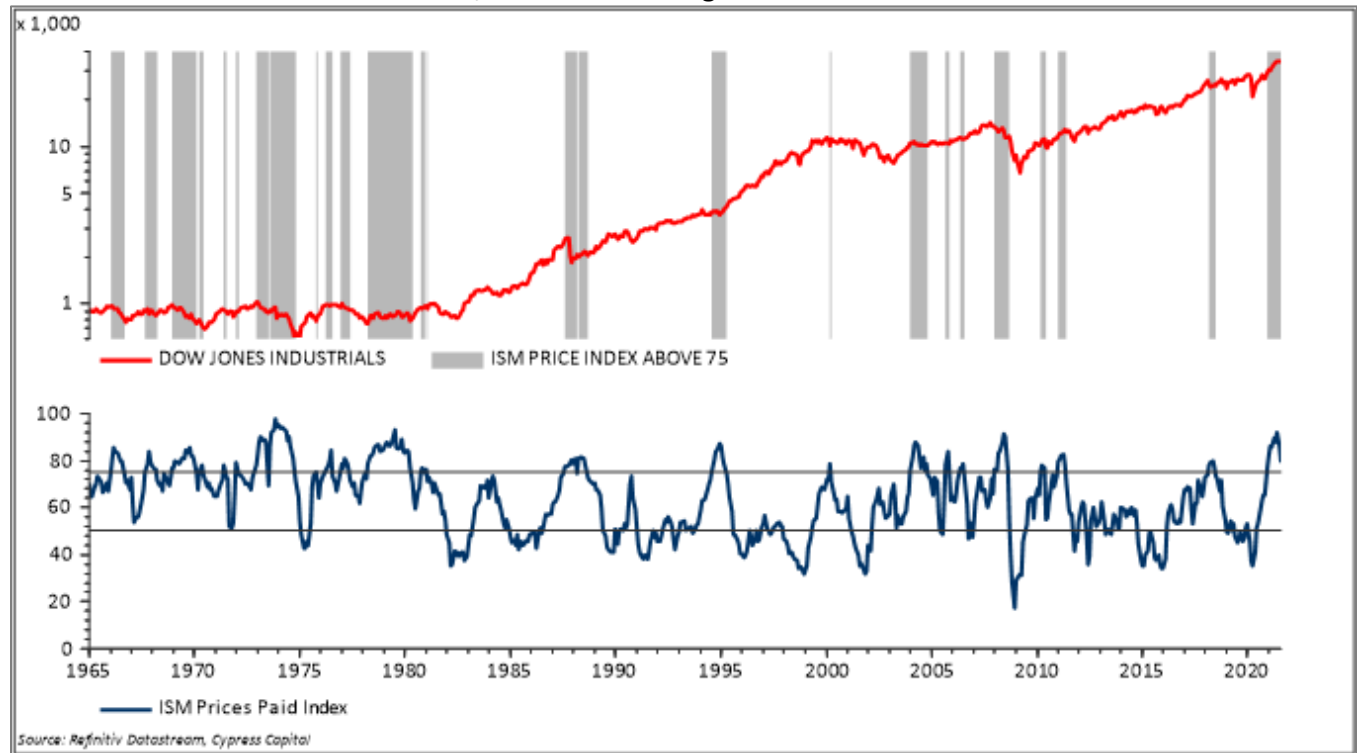
Market Trends

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

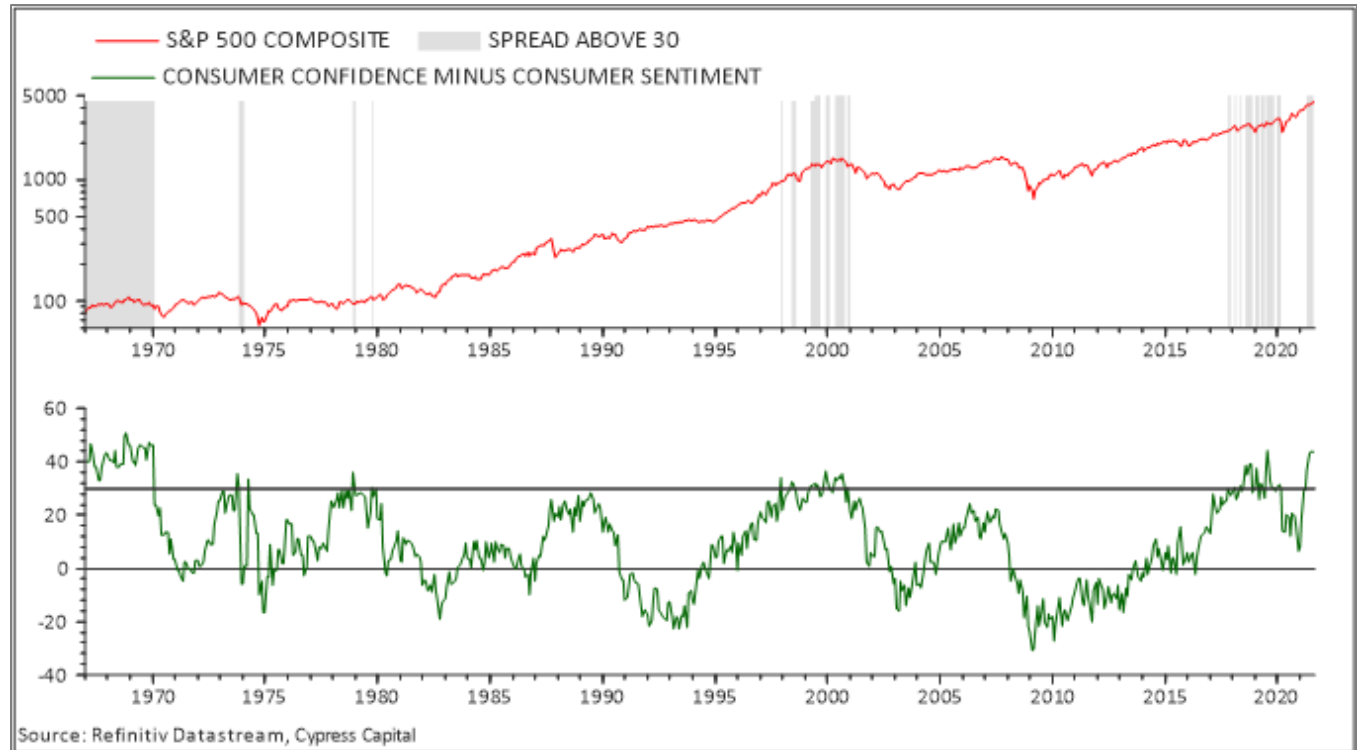
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

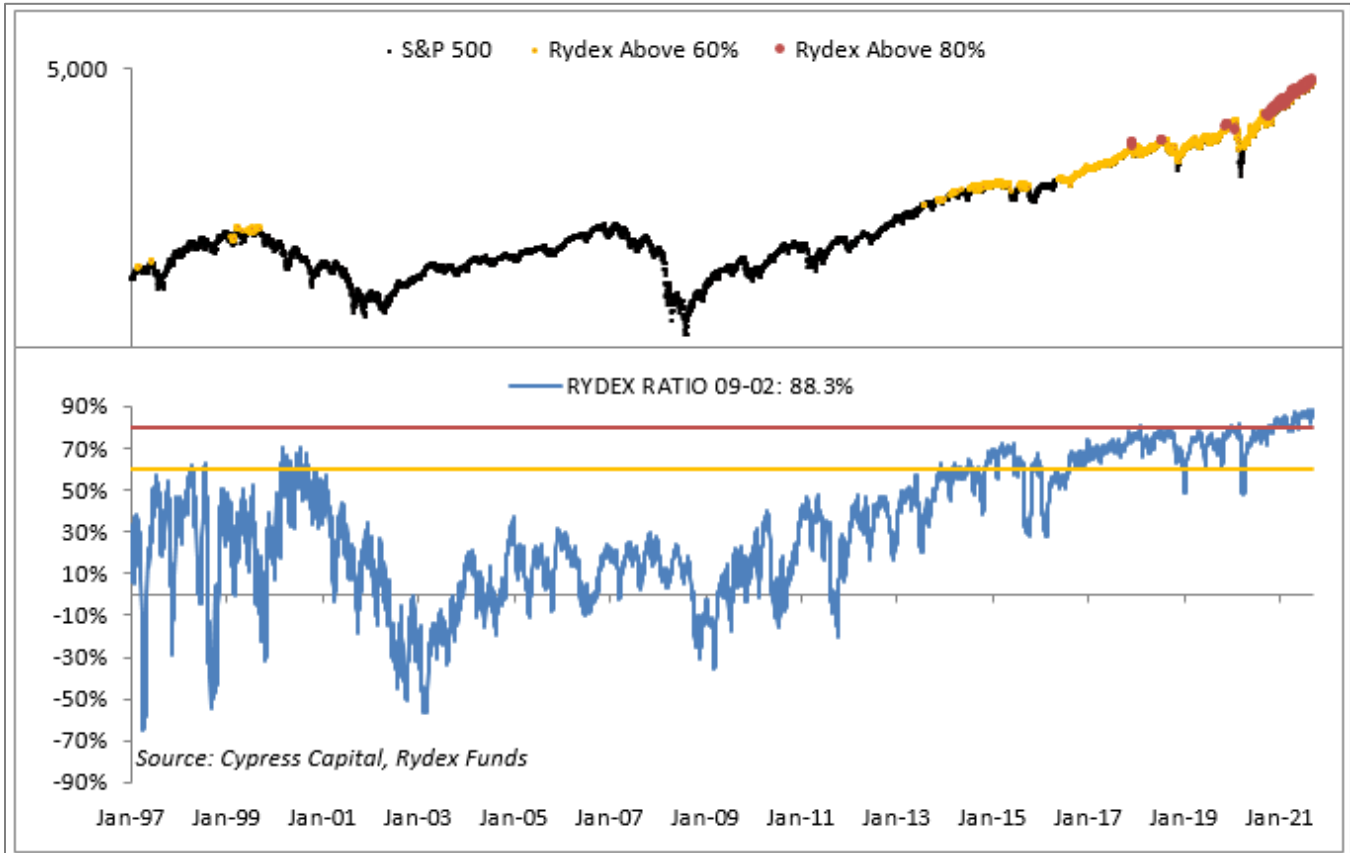
ISM Price Index rolled over this month, but it's still too high.



Spread between Conference Board and Michigan Consumer surveys giving a late cycle warning.

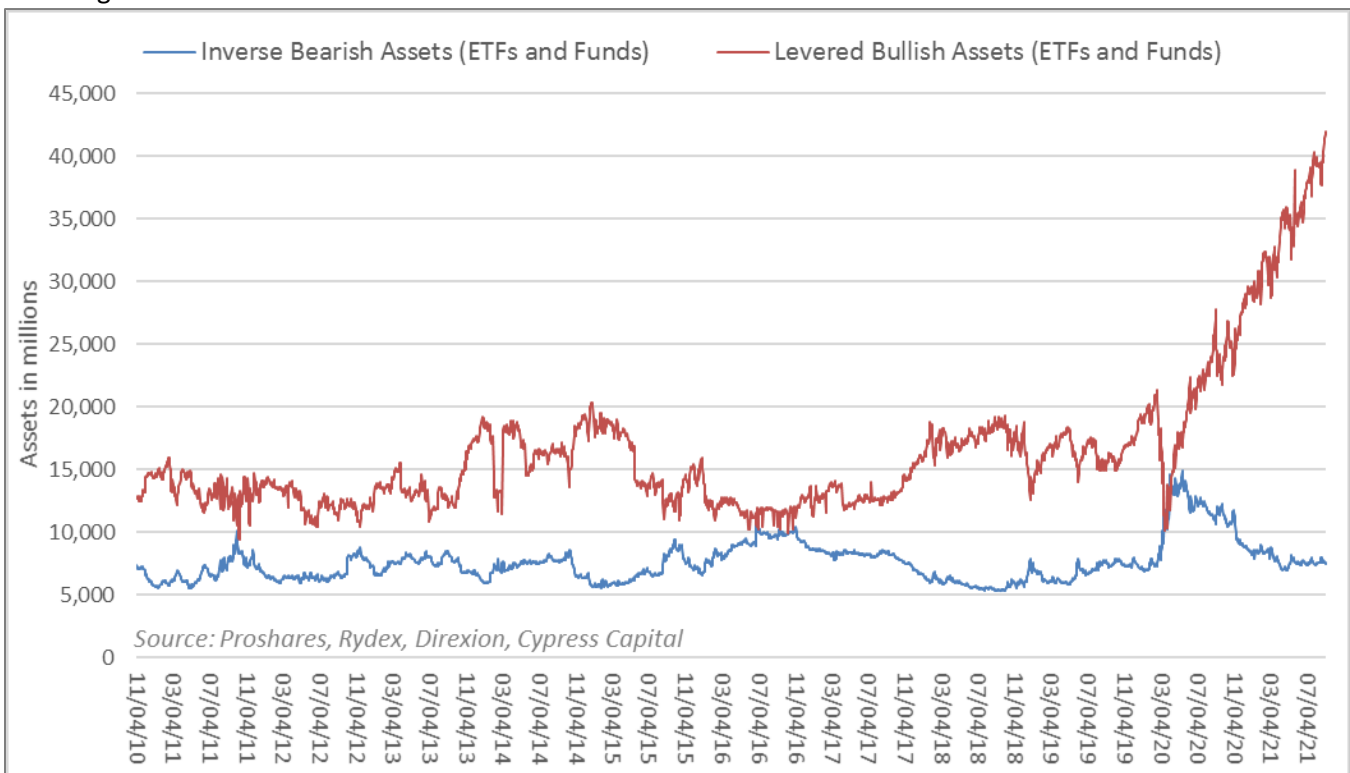


Another new Record for the Rydex Ratio. Readings above 80% have become commonplace in 2021.

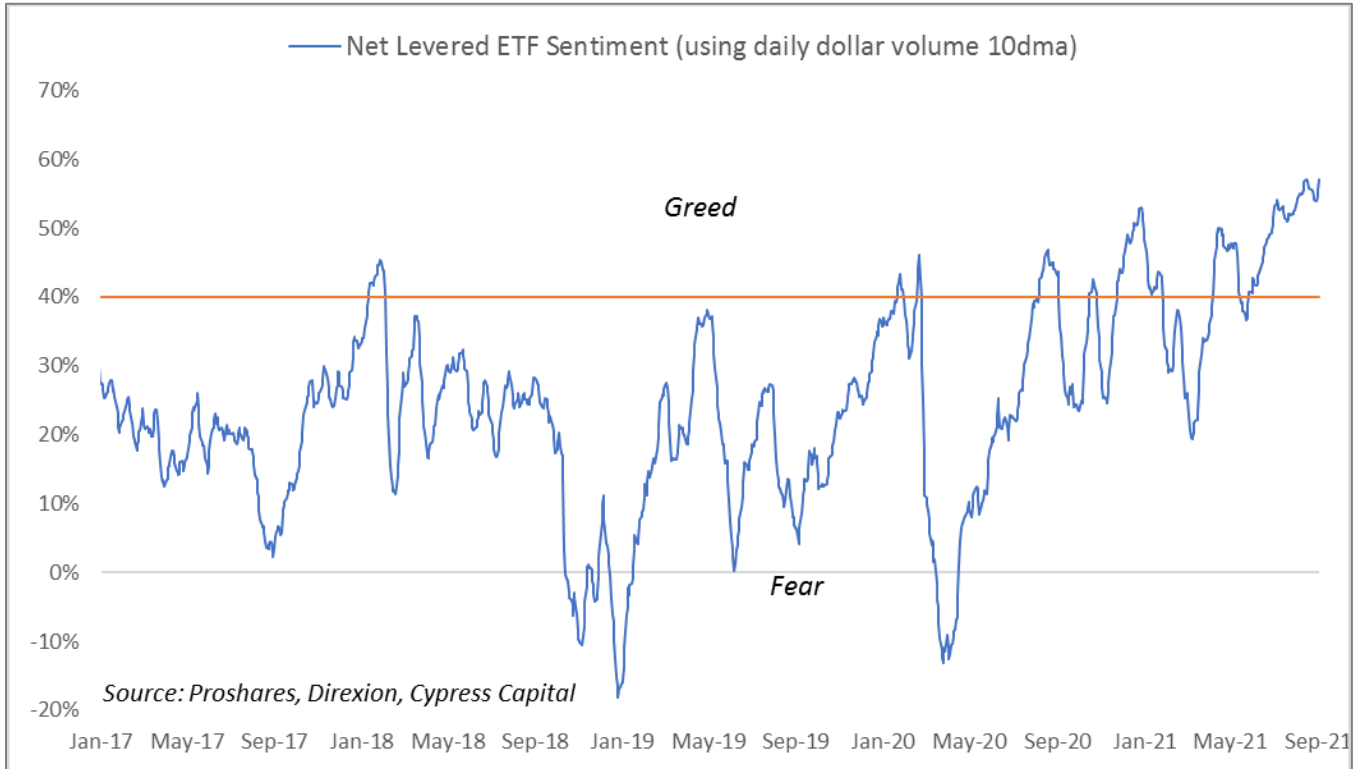


Another record in Levered Long assets

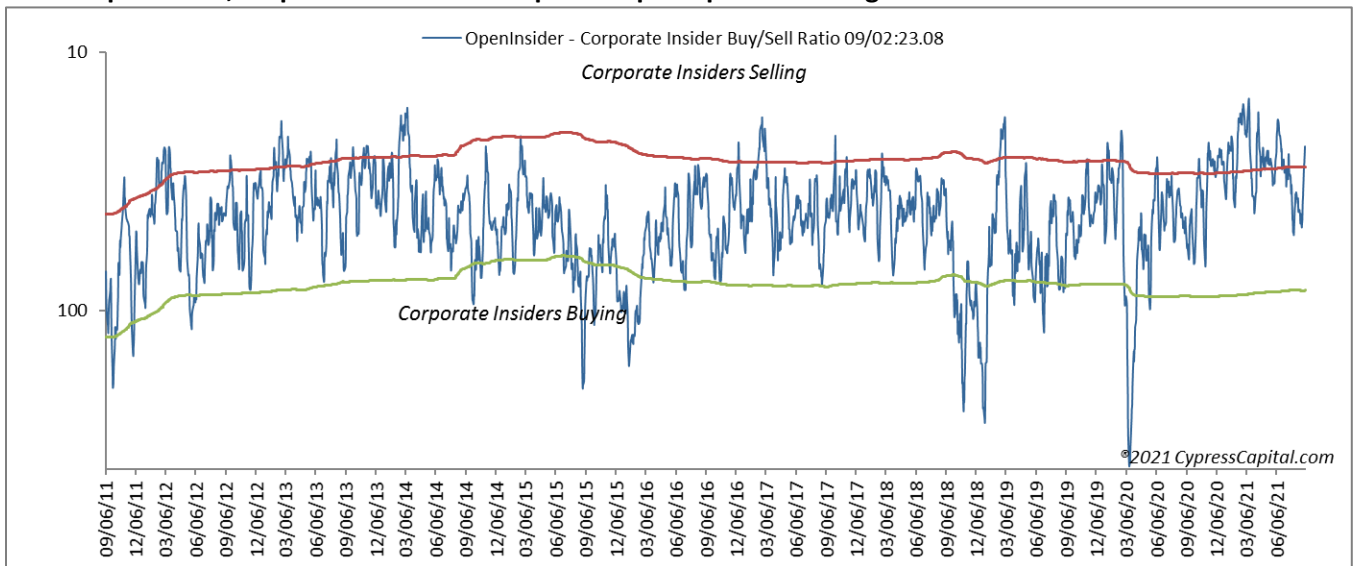
Both the level and growth trajectory in leveraged bets on the stock market have dwarfed anything we were used to seeing in these kinds of funds.



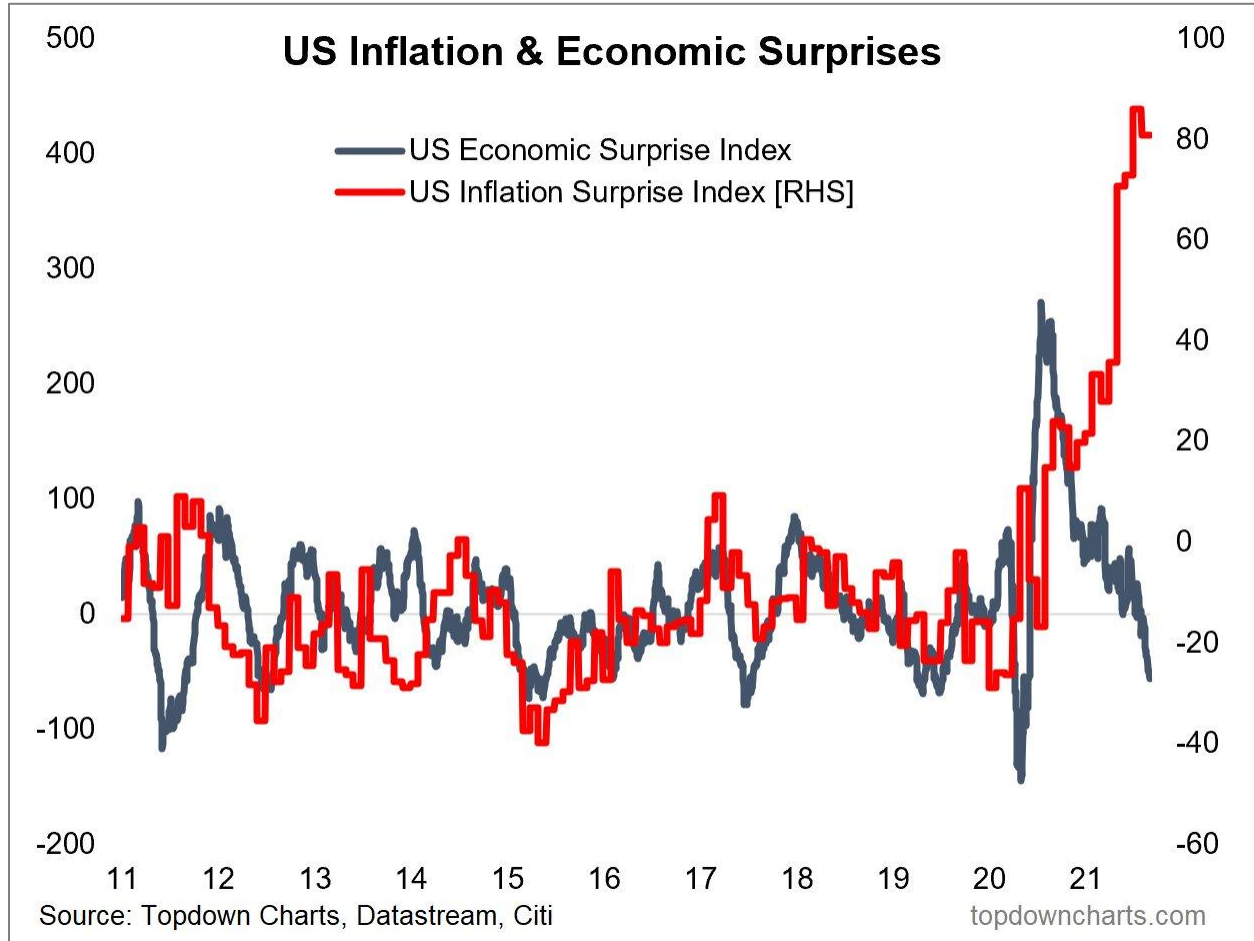
Levered ETF Sentiment, using daily dollar volume, climbed to a new all-time high.



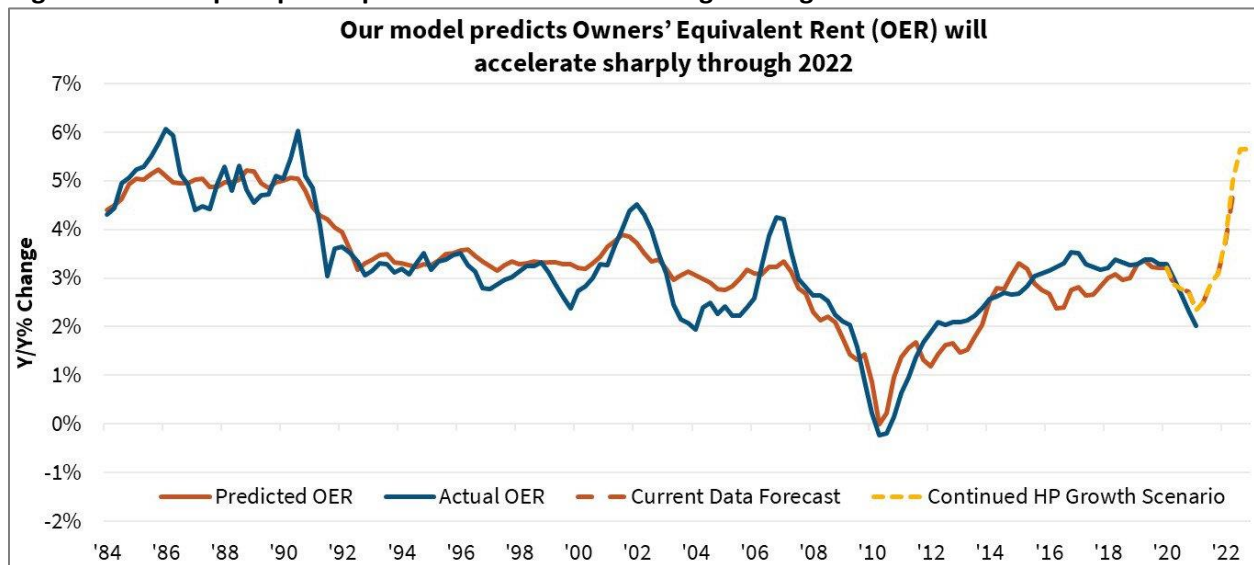
In a sharp reversal, corporate insiders have picked up the pace of selling shares.



Historic spread between Economic surprises and Inflation surprises



Higher rents will put upward pressure on inflation readings throughout 2022.

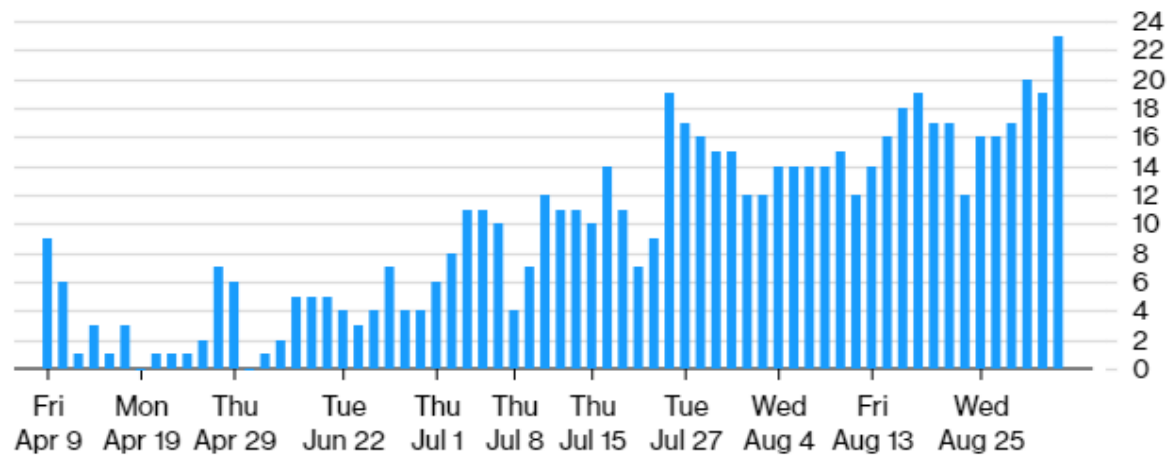


More evidence of bottlenecks at ports

Waiting for Savannah

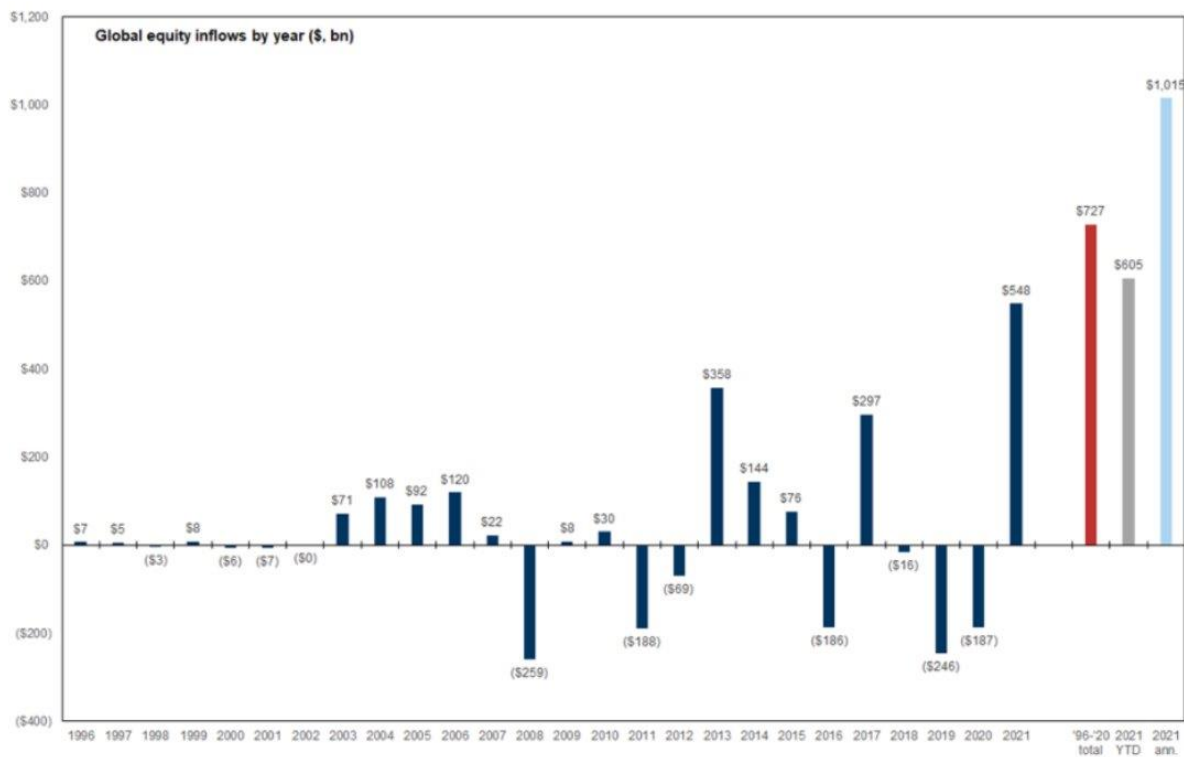
Container ships anchored off Savannah climb above 20 in late August

■ Containers waiting for port



Source: Bloomberg, IHS Markit, Genscape

A record year for global equity inflows



Source: Goldman Sachs Investment Research Division, Cormac Conners, as of 8/13/21. Past performance is not indicative of future returns.

A long Emerging opportunity?

Chart 13: EM stocks vs S&P500

EM stocks approaching 20-year lows vs S&P500



Source: BofA Global Investment Strategy, Bloomberg

Covid stimulus has led to a record decline in the poverty rate.

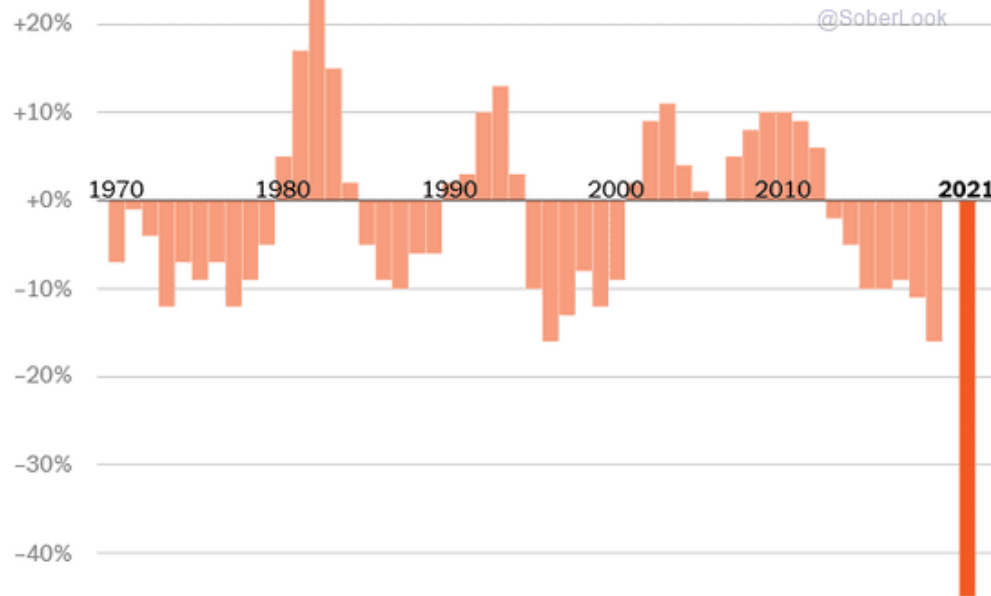
The Decline in Poverty Is Nearly Three Times the Previous Record

Three-year change in poverty rate

The Daily Shot

02-Sep-2021

@SoberLook



Note: The methodology used to calculate the historical poverty rates and the projected rate for 2021 are comparable but slightly different. Historical poverty rates follow the Census Bureau's Supplemental Poverty Measure. The 2021 data comes from a modified S.P.M. that uses different sources of income data and adjusts it to account for underreported income. Sources: Columbia University Center on Poverty and Social Policy (analysis of historical data); the Urban Institute (2021 data) By Alicia Parlapiano

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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