Market Outlook

By Mark T Dodson, CFA

AAII Survey signals investor pessimism

Market Risk Index fell to 78.1% this week. Both psychology and valuation improved modestly – enough to offset the increase in the Monetary composite risk score.

The Surveys category shifted to positive, helping the Psychology composite. It's the first category to grow more bullish for markets since the stock market softened. Investment professionals have grown neutral on markets, while individual investors have grown pessimistic, as the net bullish sentiment from the AAII Investor Sentiment survey fell to one standard deviation below its average reading. Those AAII survey takers can be skittish. The steady stream of inflation and debt ceiling headlines, a modest pullback for markets, and likely some politics has impacted their stock market mood. The short-term market timing for AAII readings in pessimism territory has generally been good the last few years, particularly when other indicators continue to signal too much enthusiasm. The allocations of those AAII members, however, remain equity-heavy.

The AAII survey is also a member of our Short-Term Sentiment composite (our pruning and planting guide), but the improvement wasn't enough to push the Short-Term Sentiment composite any deeper into pessimism territory than it had reached the prior week. The areas where stock market speculation have consistently set records in 2021, like options markets and levered ETF and mutual fund trading, have not receded from euphoria.

Stock market breadth continues its steady deterioration - advance-decline lines, the number of stocks making highs and lows, percentage of stocks trading in uptrends all continue to soften. None have given oversold readings either. It's worth noting that the combined Hindenburg and Titanic Syndrome sell signals from August have been prescient in signaling the soft patch in equities in 2021.

The source of the weaker Monetary composite was the Interest Rates category. Since September, Baa Corporate bond yields have crept up enough to turn a bullish reading for equity markets into a neutral one. However, Muni yields and Aaa Corporate bond yields have maximum bullish scores, so the category still scores bullish overall. As longer-maturity Treasury yields have started creeping back up, it's a decent time to highlight that our Long Bond Momentum indicator (a fan favorite) never gave a buy signal on the previous rally in prices of 10 and 30Yr Treasuries.

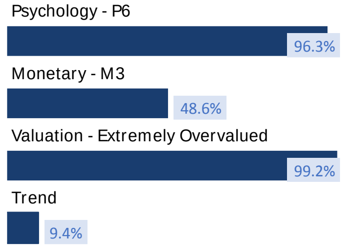
With valuations well out of the realm of reasonable, a big improvement in MRI (enough to make a significant increase in equity allocations) will require a retreat in inflation pressures, more progress with investor sentiment, or both.

Market Risk Index

Rec Allocation 25% Underweight

78.1%

Category Percentiles



Largest Psychology Influences	
Levered Investments	Negative
Surveys	Positive
Fund Flows	Negative
Option Activity	Negative

Largest Monetary Influences	
Inflation	Negative
Velocity	Positive
Interest Rates	Positive

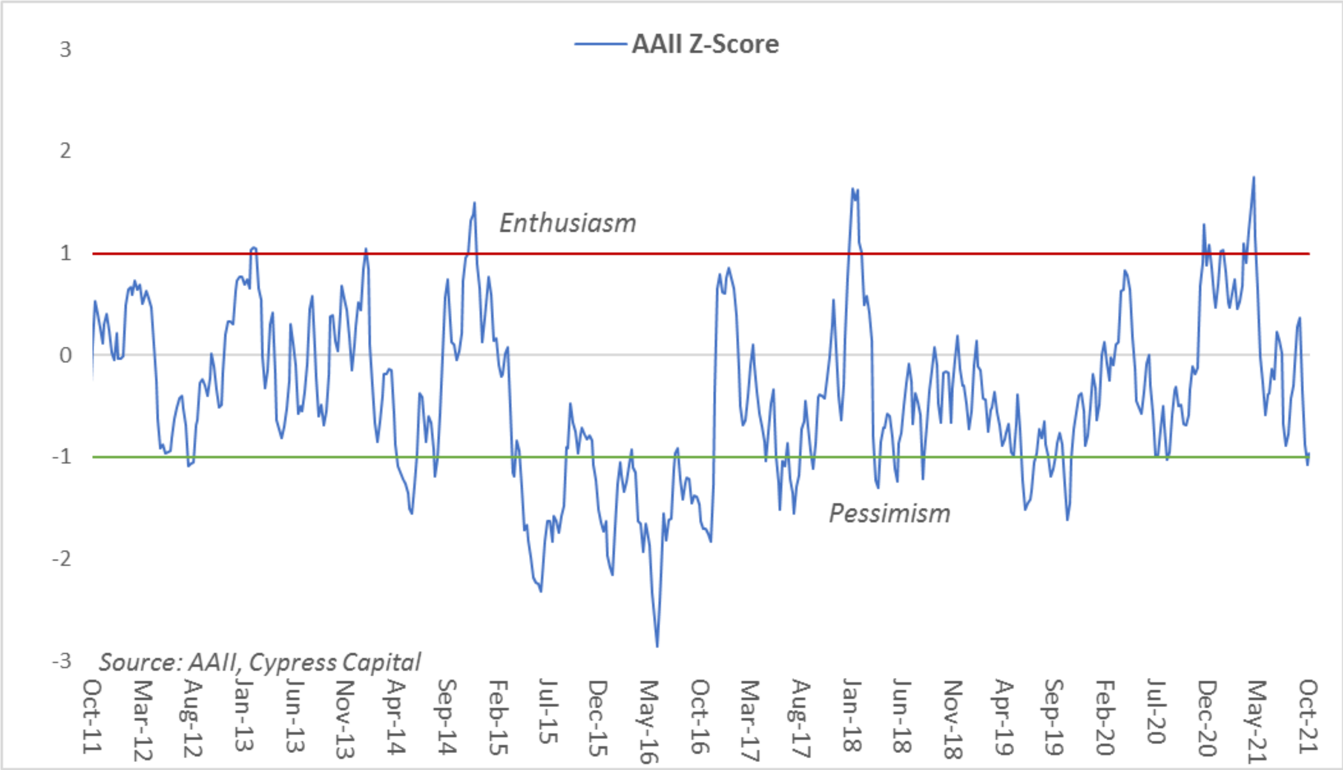
Valuation	
7-10 Year Rtn Forecast	0.3%
10Yr Treas Yield (on 10/06)	1.3%

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.

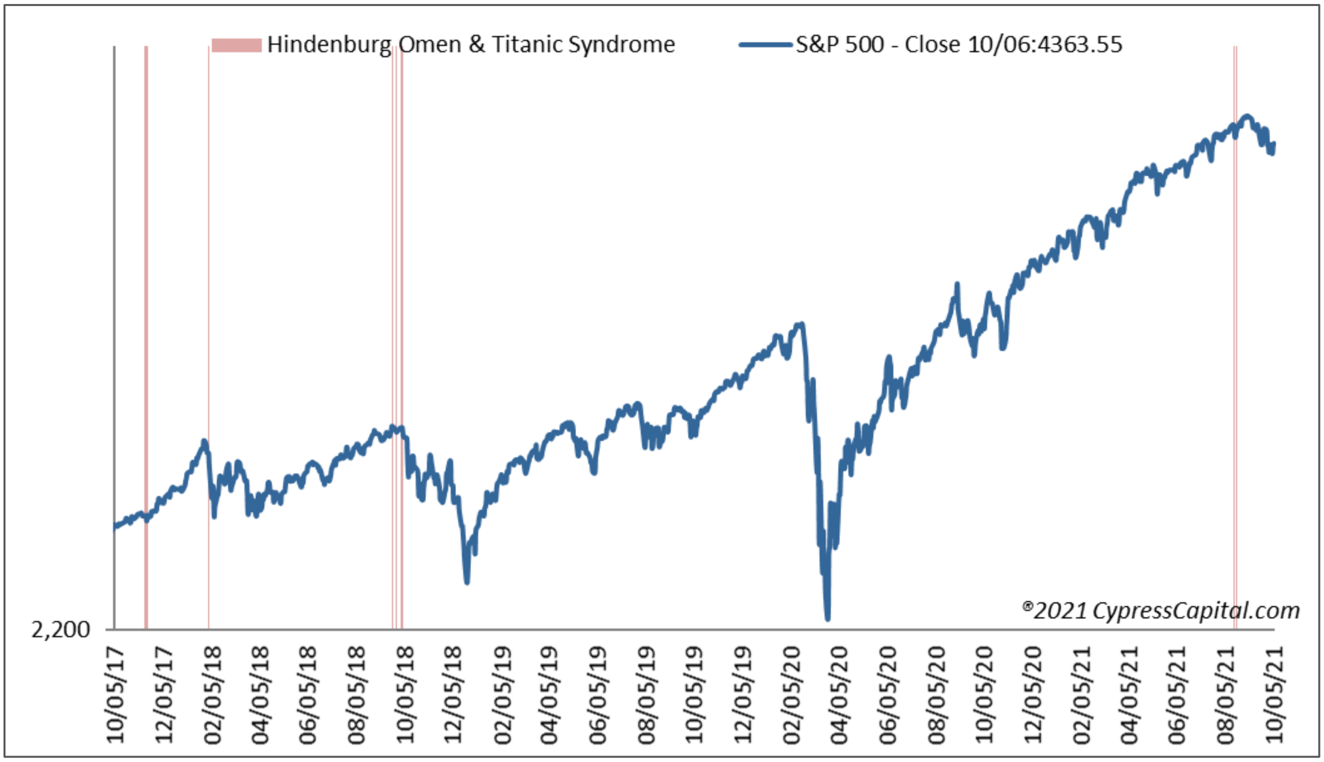
Charts of the Week

AAII Sentiment Survey signals Pessimism for the first time since the summer of 2020.

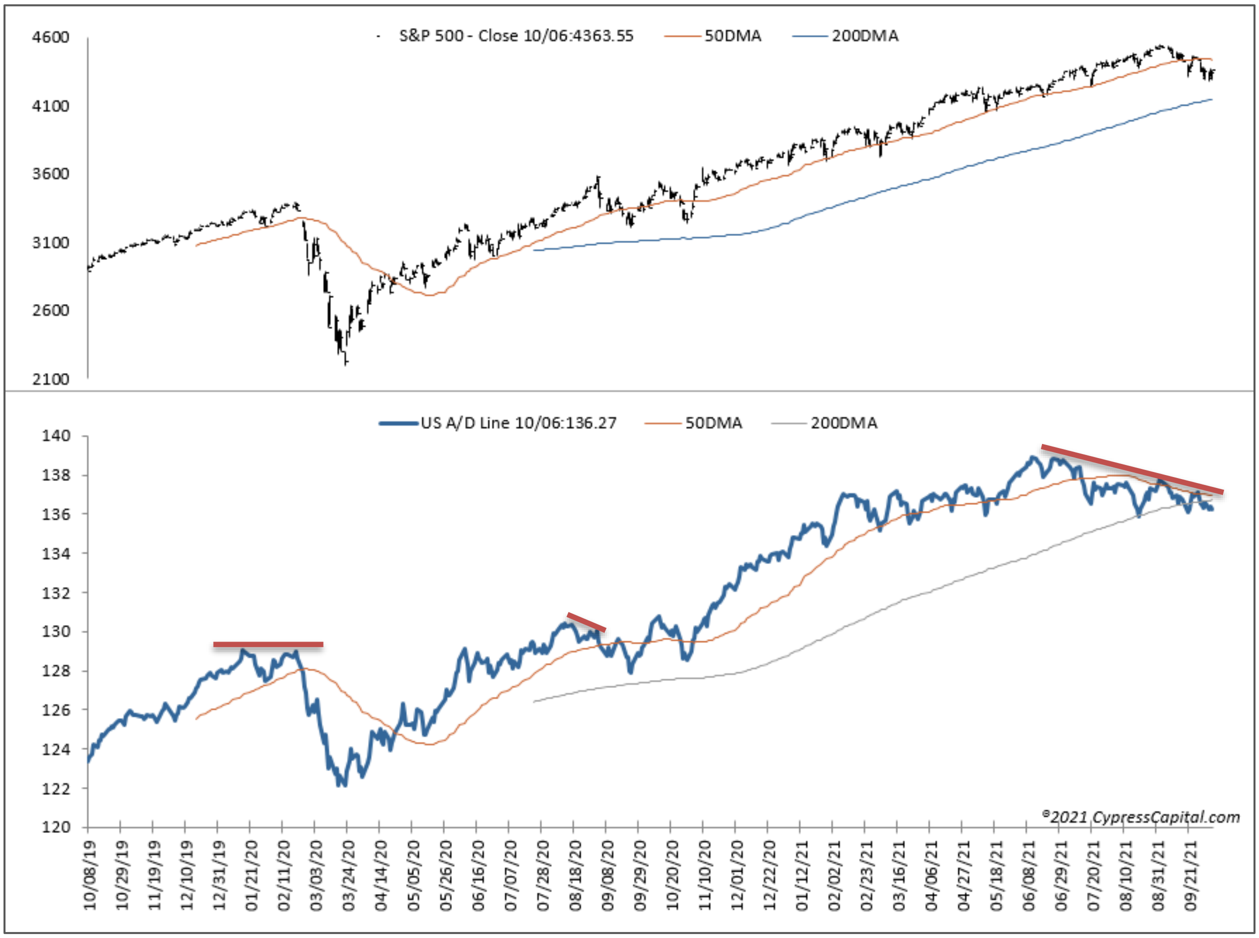


Combined Hindenburg & Titanic Syndromes Signals

The union of the Hindenburg Omen and Titanic Syndrome signals cuts down on a lot of false positives. The dual sell signals from mid-August were the first since September 2018 and were prescient in highlighting the first real bout of stock market weakness in 2021.

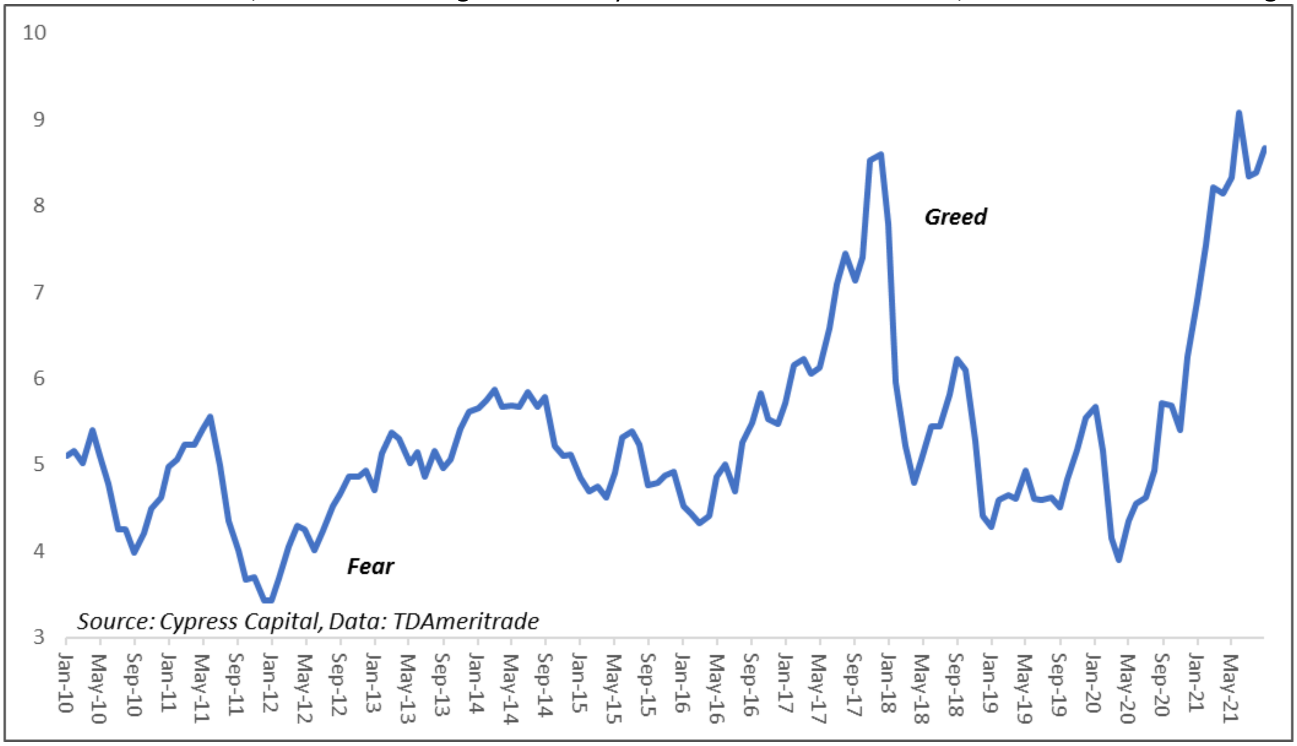


The Advance/Decline Line continues to soften and hasn't confirmed stock market highs since June.

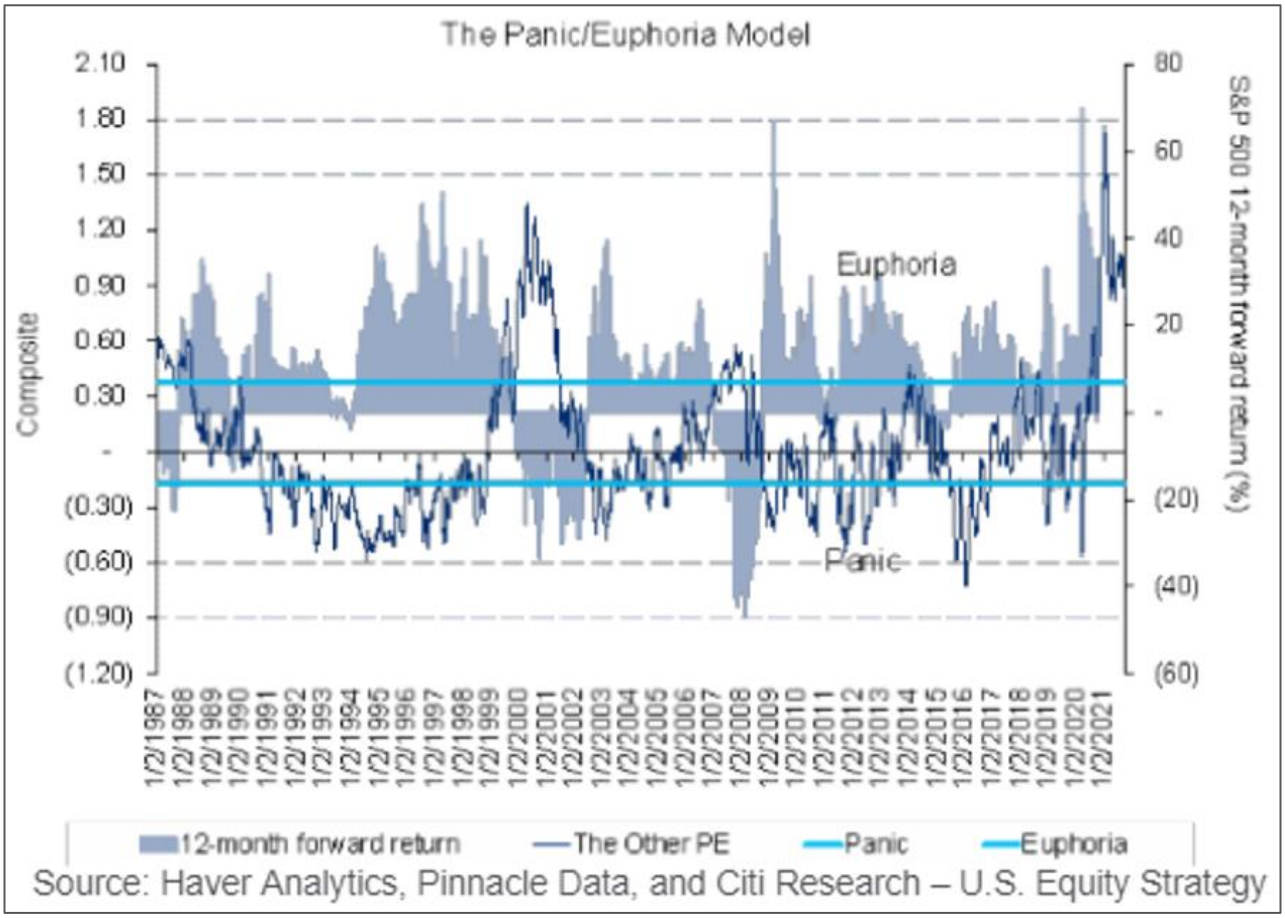


Investor Movement Index

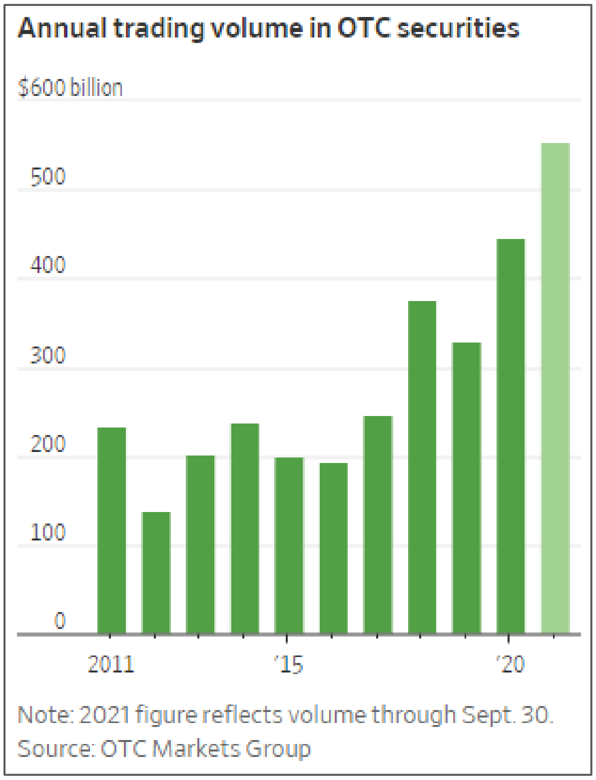
TD Ameritrade's IMX, based on holdings and activity of their 11 million accounts, is still close to all-time highs.



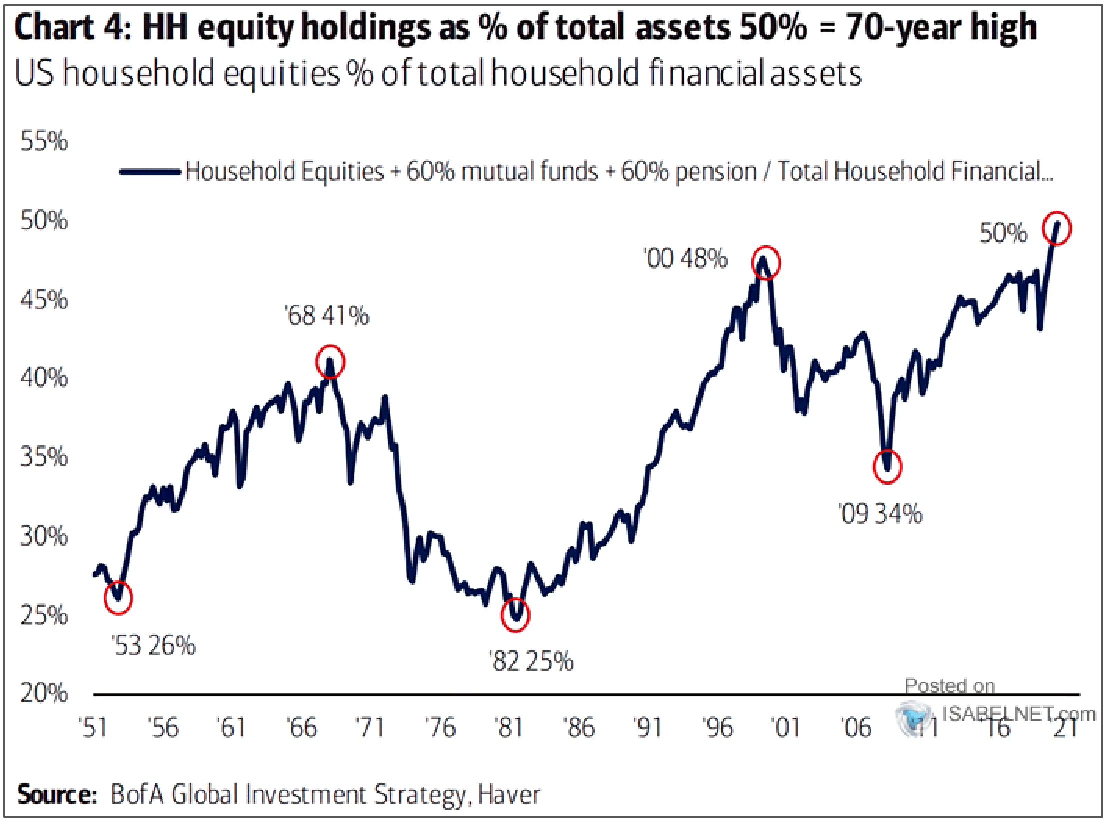
Citigroup's Panic/Euphoria Model is off its record highs but still firmly in Euphoria territory.



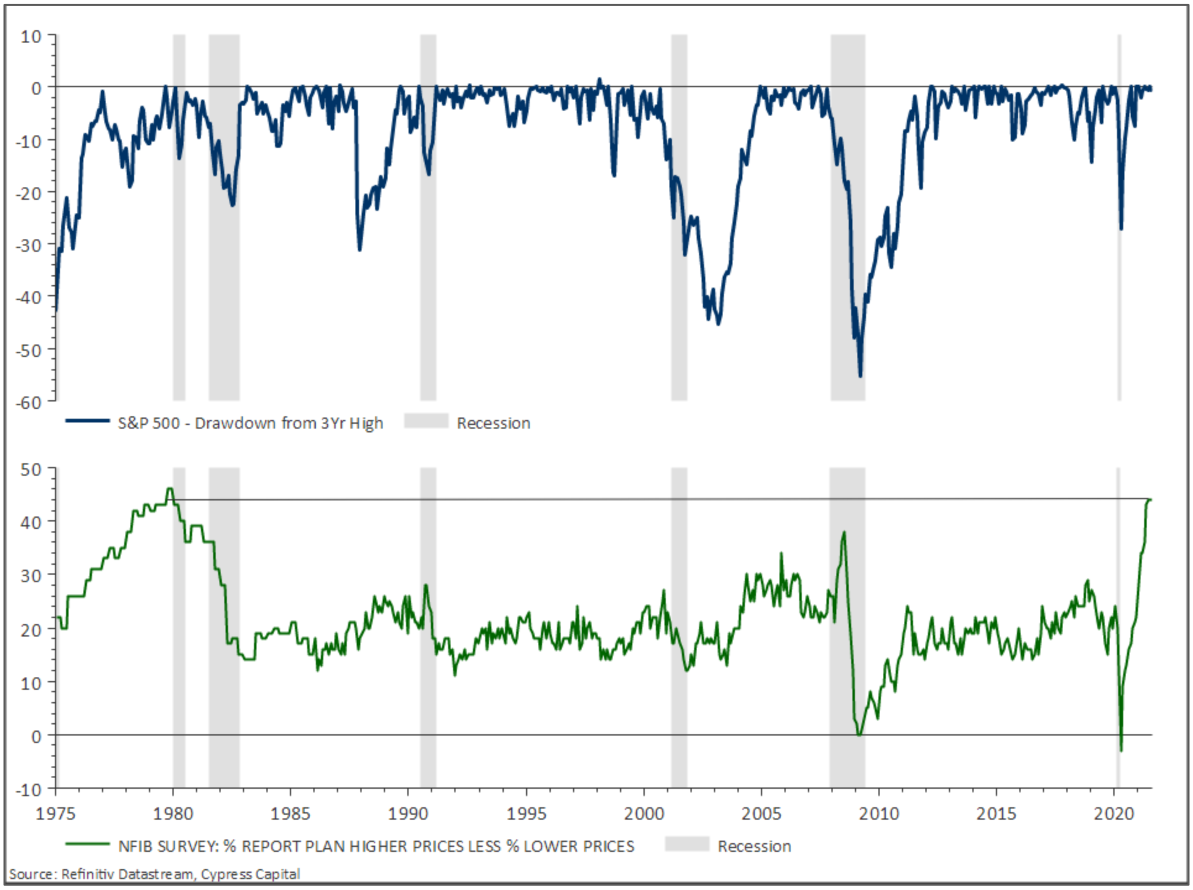
Trading in Over the Counter Stocks, a traditional sign of excess speculation, is beating the record set in 2020.



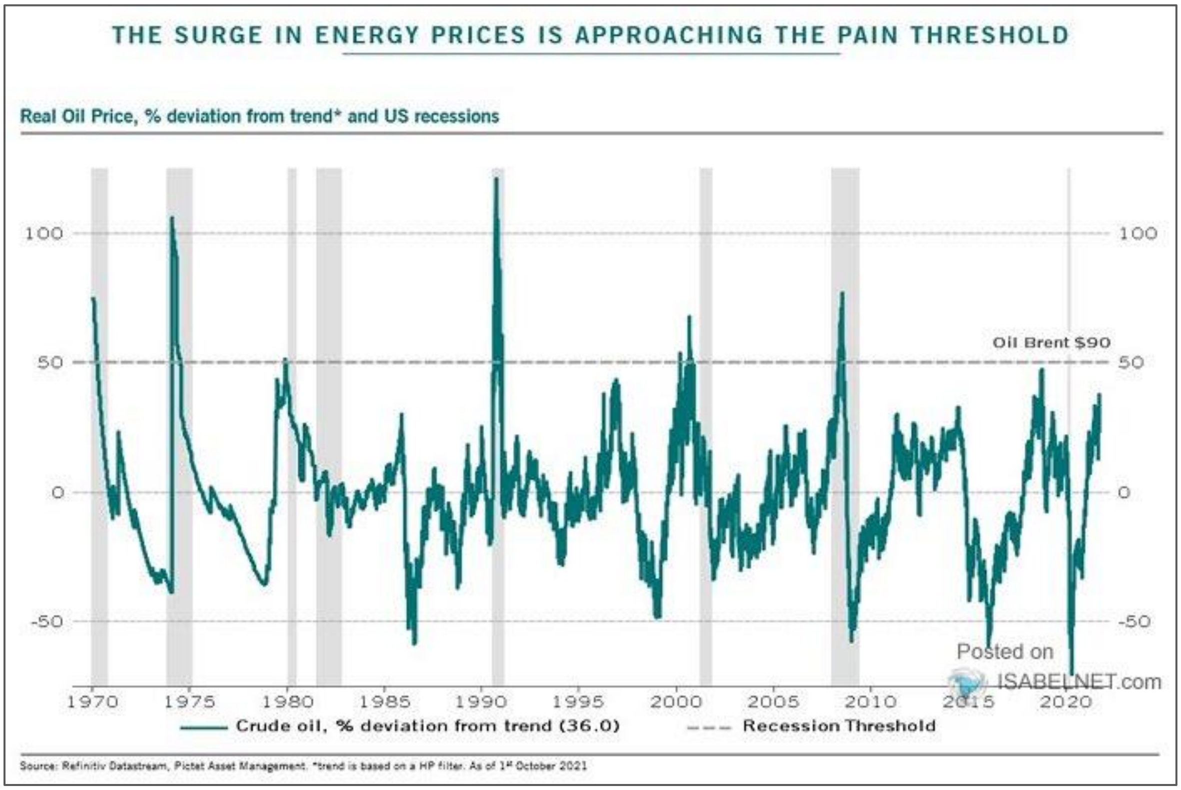
Household Equity Holdings are at a 70-year high.



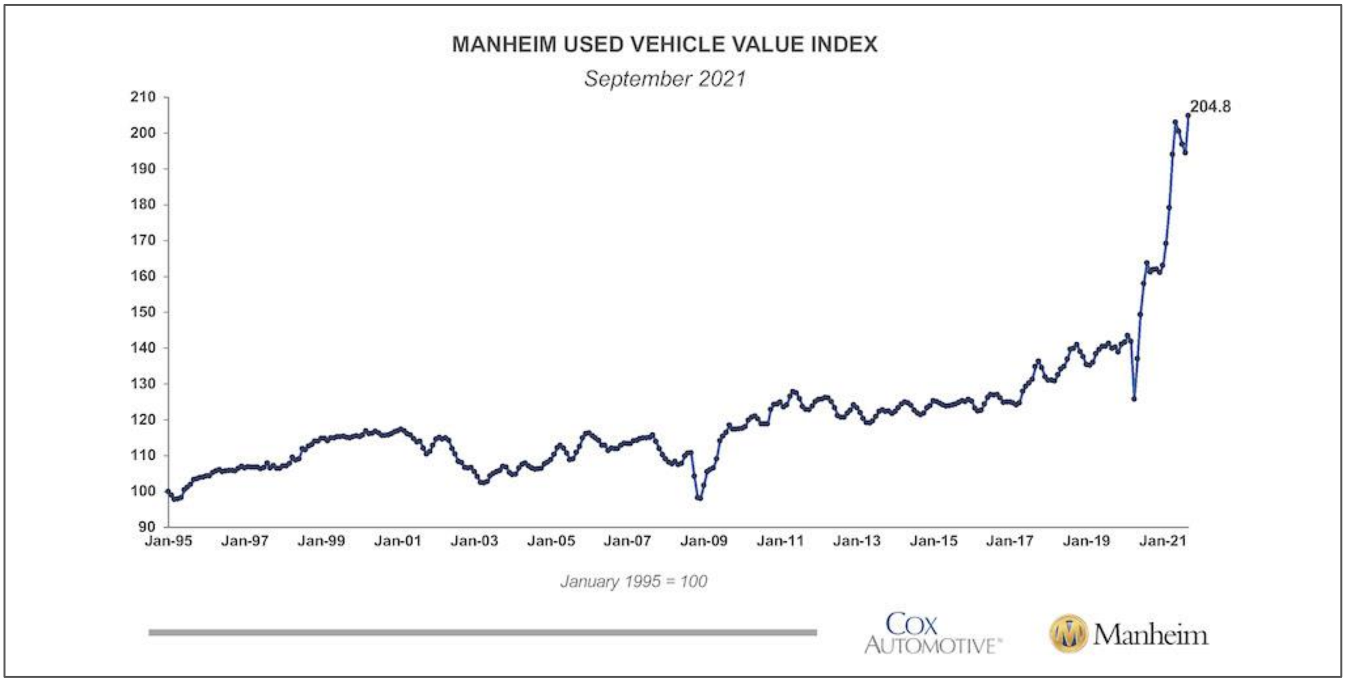
Small businesses are raising prices like it's 1979.



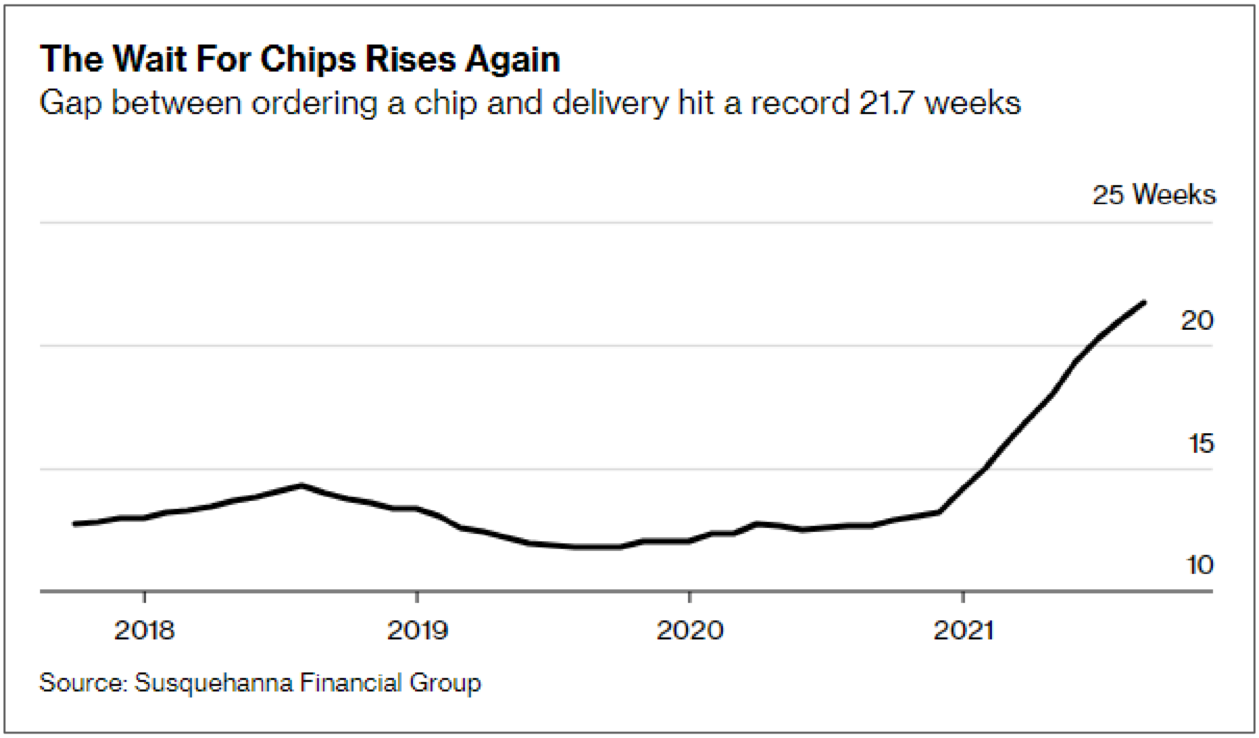
History of periods when oil price shocks become recessionary.



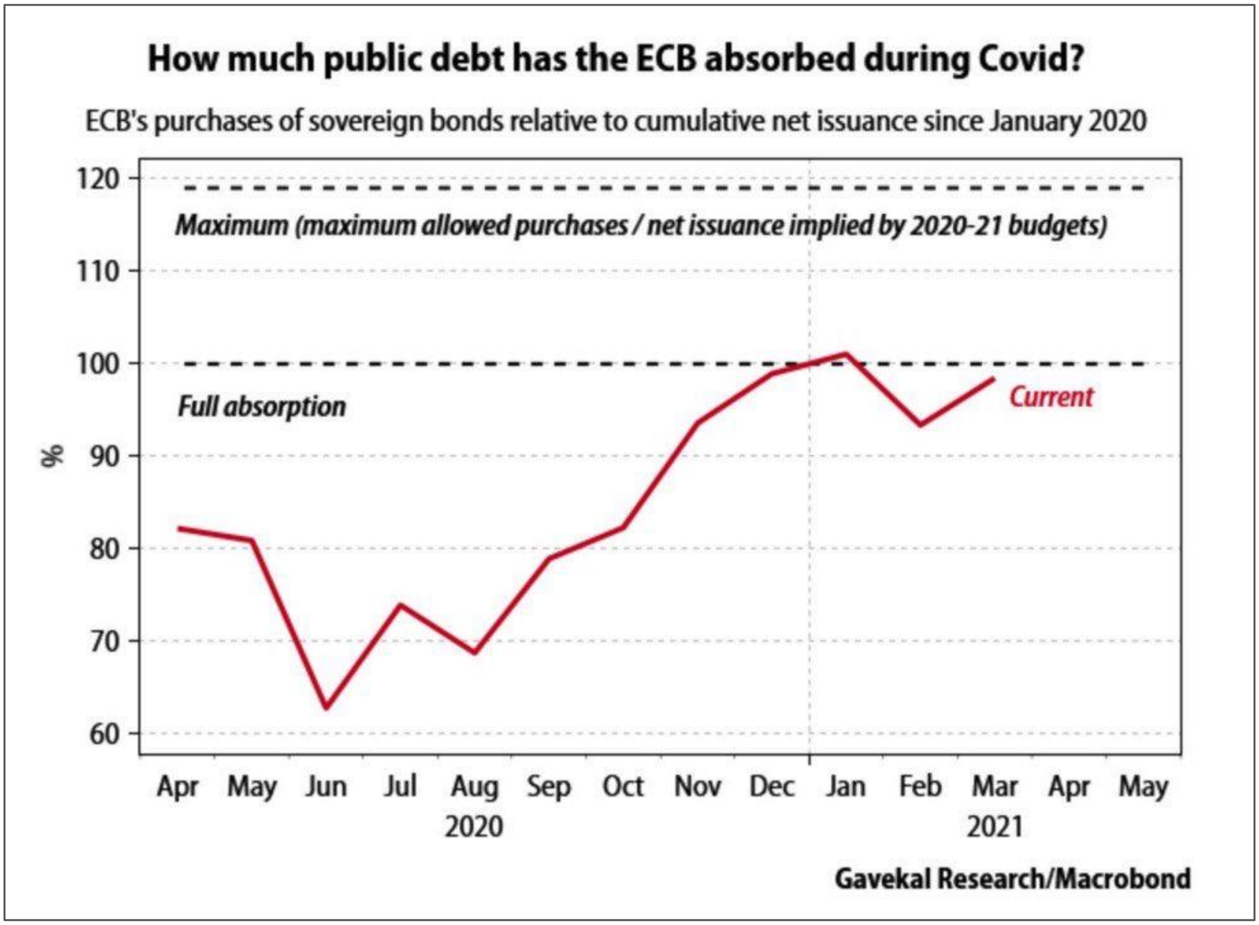
Used Car values set another record.



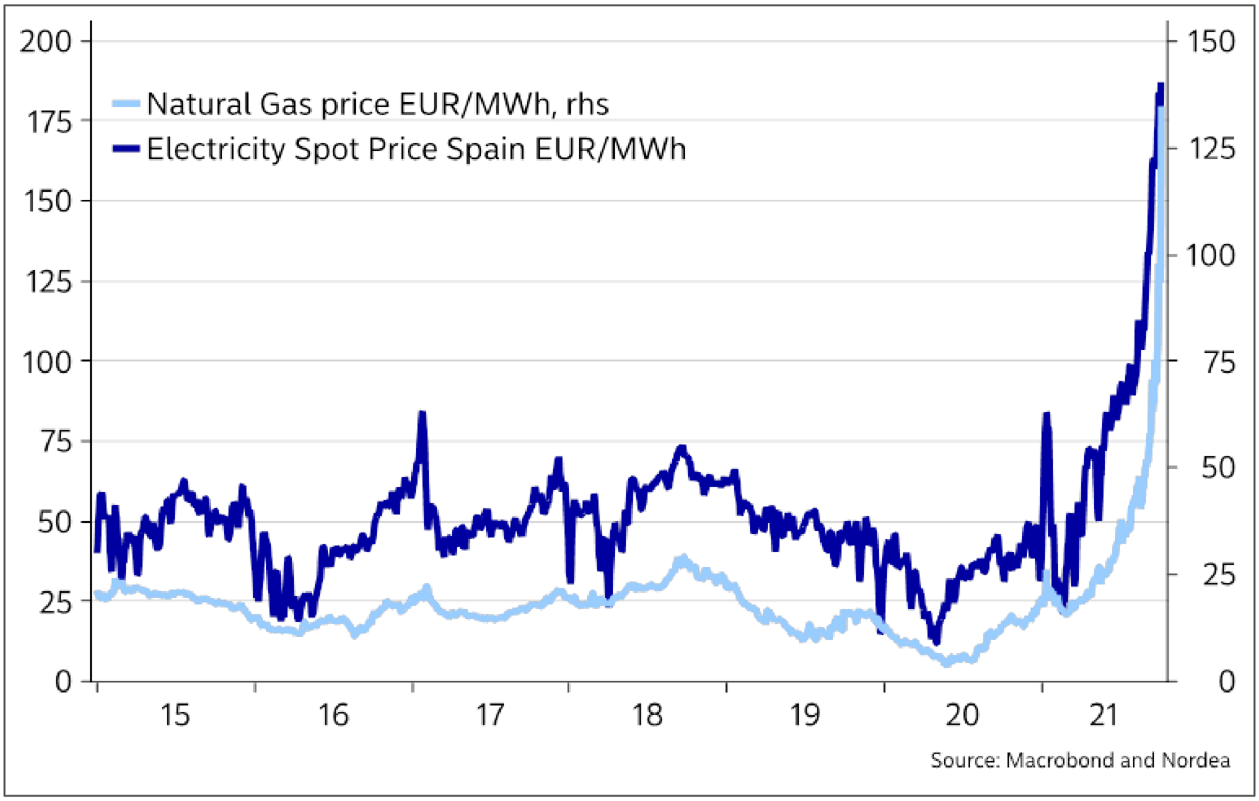
Semiconductor delivery delays set another record.



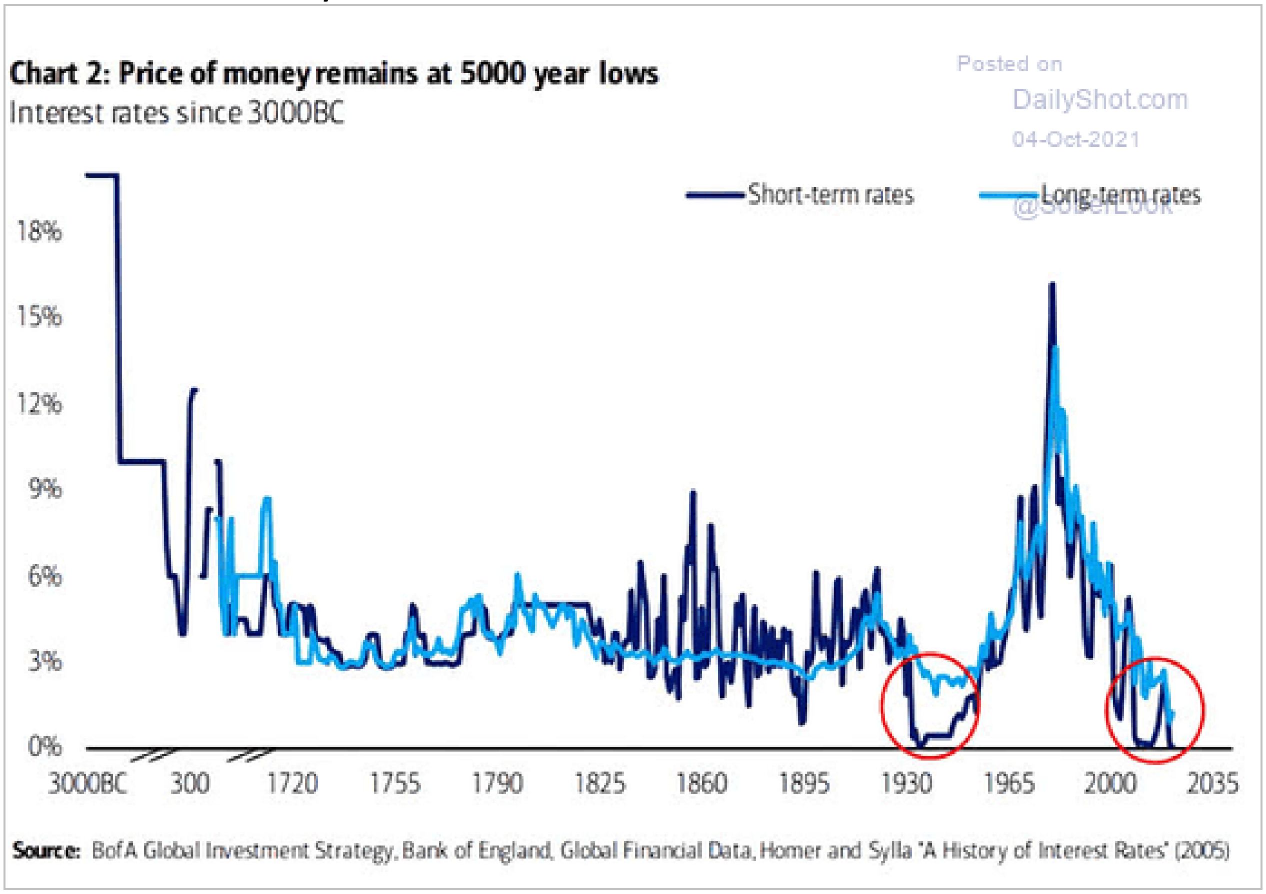
European Debt Monetization - ECB has purchased nearly all the net sovereign debt issued in 2021.



A surge in Natural gas and electricity prices in Europe

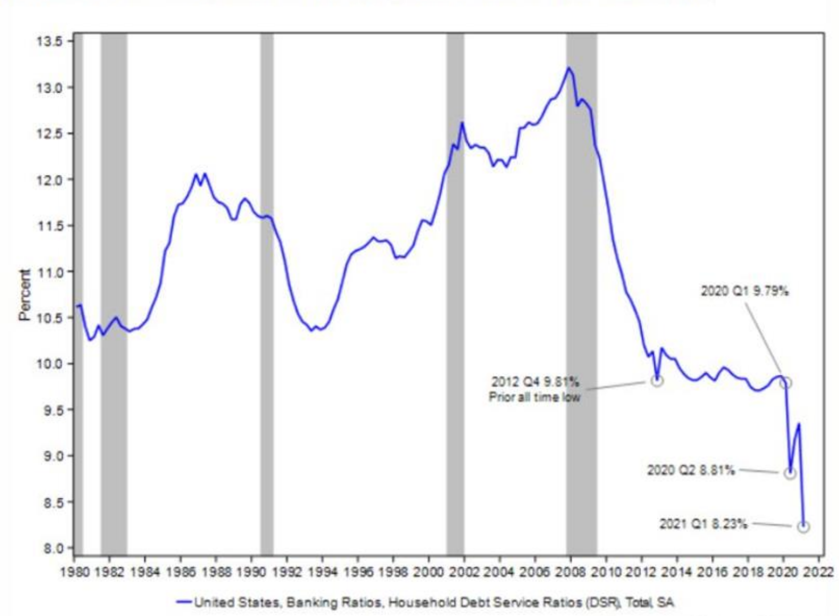


Interest rates are at 5000-year lows.



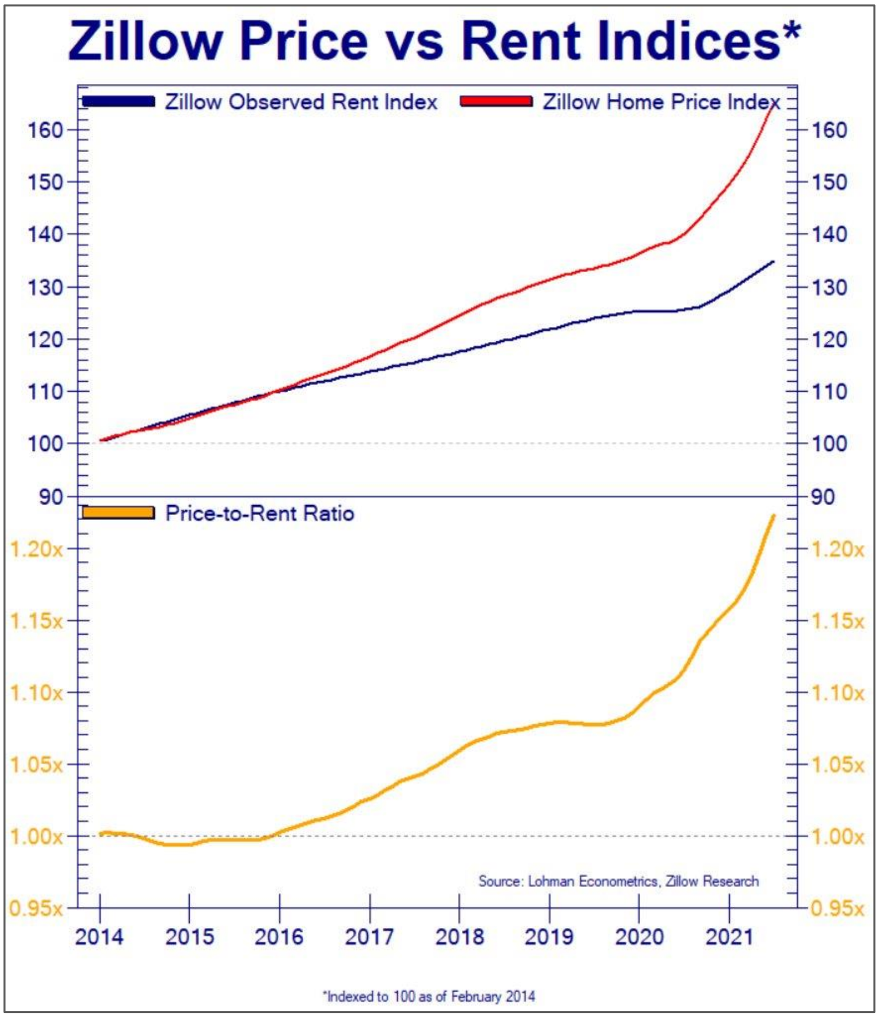
US Household debt service ratio is at all-time lows.

FIG 6: US household debt service ratio, shown with US recession bands



Source: Longview Economics, Macrobond

Zillow home price to rent index hits a new high.



The “relative valuation” of growth and value is beyond the 90s Tech Bubble.

Quantitative Easing is making the Treasury market less liquid.

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.

for more information.