Cypress CAPITAL

Market Outlook

By Mark T Dodson, CFA

Are you playing Chess or Checkers?

What does the bull market have going for it?

1. Ample liquidity (partially a function of investor sentiment) and a Federal Reserve willing to overlook substantial inflation pressures and speculation. Liquidity is the mother's milk of bull markets.

2. Technicals - good breath and a solid trend sloping upward and to the right is also an argument that stacks up on the bullish side of the ledger. Stock market breadth can shift abruptly, and it has improved dramatically over recent weeks. Every index on our breadth dashboard, save one, has made new highs. The NYSE Advance-Decline is making highs. The percentage of stocks trading above key moving averages is healthy. The most prominent exception from breadth indicators happens to be one of our favorites – the NASDAQ High Low Logic Index. It had another uptick and is very close to breaching a critical bull market warning threshold.

3. The bull market also has seasonality as a tailwind. While not formally part of our process, we have always paid attention to the six-month (Sell in May) seasonality overlaid with the Presidential election cycle. It has been so persistent that it's hard to dismiss. The November to April period going into a mid-term election is generally a good one, while the May to October period in a mid-term year is the single worst six-month period when viewed from this framework. ...And, May is still more than five months away.

What should give bulls pause?

1. The Fundamentals. The economy is experiencing the most extreme inflation pressures in a generation, coming early into an economic recovery by a historic degree. Economists are doing mental gymnastics to identify reasons why it's transitory and ignore the obvious. The obvious - record amounts of fiscal and monetary stimulus that went straight into our bank accounts. We financed a World War, but there won't be any footage of tanks and troops storming beaches for Ken Burns to use in a PBS documentary. Granted, the market has ignored inflation pressure for months, but higher asset prices and the wealth effect will exacerbate inflation pressures, not alleviate them.

2. Dot-com-like investor sentiment. From SPACs to meme stocks to fly-by-night crypto-currencies, this environment has all the hallmarks of the frothiest of frothy stock markets. If you don't see it, your head is in the sand. Speculation is prevalent - using margin, options, leveraged funds, and the environment is rife with excessive short-term trading. A Bloomberg article argued this week that Macy's should embrace EVs and cryptos to take advantage of the lower cost of capital that comes from being favored by speculators – reminiscent of the late 60s embrace of all things "tronic" or the late 90s embrace of all things ".com." All the signposts of extreme speculation are there – and have been there persistently for over a year. That's part of what the government

Market Risk Index

Rec Allocation 25% Underweight

83.3%

Category Percentiles

Psychology - P6: 96.1%

Monetary - M4: 58.1%

Valuation - Extremely Overvalued: 100.0%

Trend: 0.0%

Largest Psychology Influences	
Levered Investments	Negative
Option Activity	Negative
Flow of Funds	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 11/03)	1.6%

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.

war stimulus financed – an army of speculators. They have been good soldiers in the Battle of Bitcoin, the Tesla Campaign, and no one will ever forget the heroism displayed in the Gamestop Offensive.

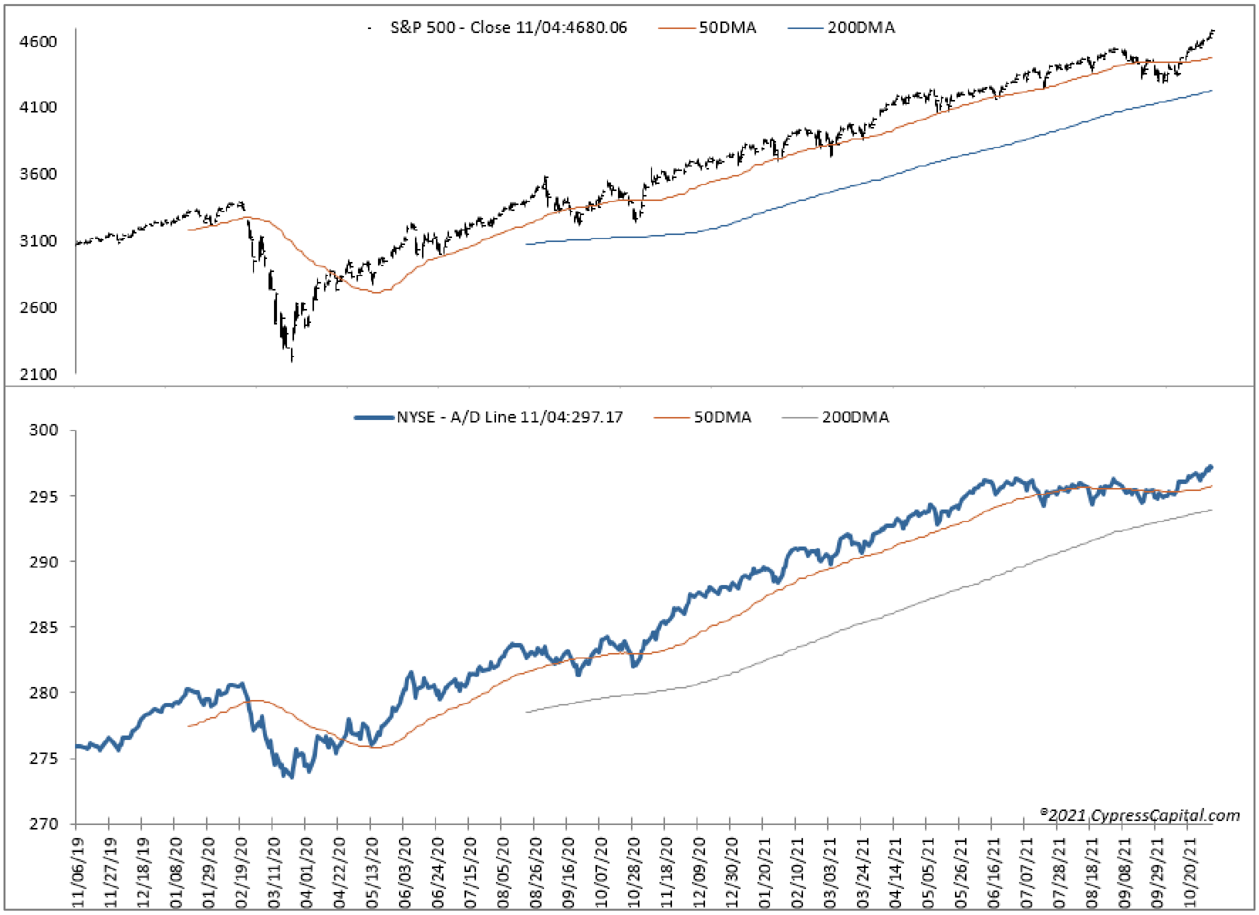
In the table to the right, you may notice that the Options category has moved up to the second spot in the list of heaviest influences on the Psychology composite. November has ushered in 2021's third surge of speculative call buying. We have never shaken out of the euphoric regime that has been the hallmark of 2021, and we are in the middle of another manic, speculative push. This behavior has no analog outside of the late 90s.

3. It's the most broadly overvalued stock market in US history. You have to come up with mental contortions and data gymnastics to argue otherwise. The absolute level of valuations is the most critical determinant of the probable return for equities and the drawdown risk present in equities at any given time. We would have been better off completely ignoring it in recent hindsight, but we learned long ago that in markets, risk comes at you fast. We also learned to regret our own mental gymnastics to find ways to ignore valuation's simple message. We have one life and one nest egg, and we will grow it prudently, using the tools at our disposal as objectively as possible, and it doesn't matter whether that means you want to read what we write or not.

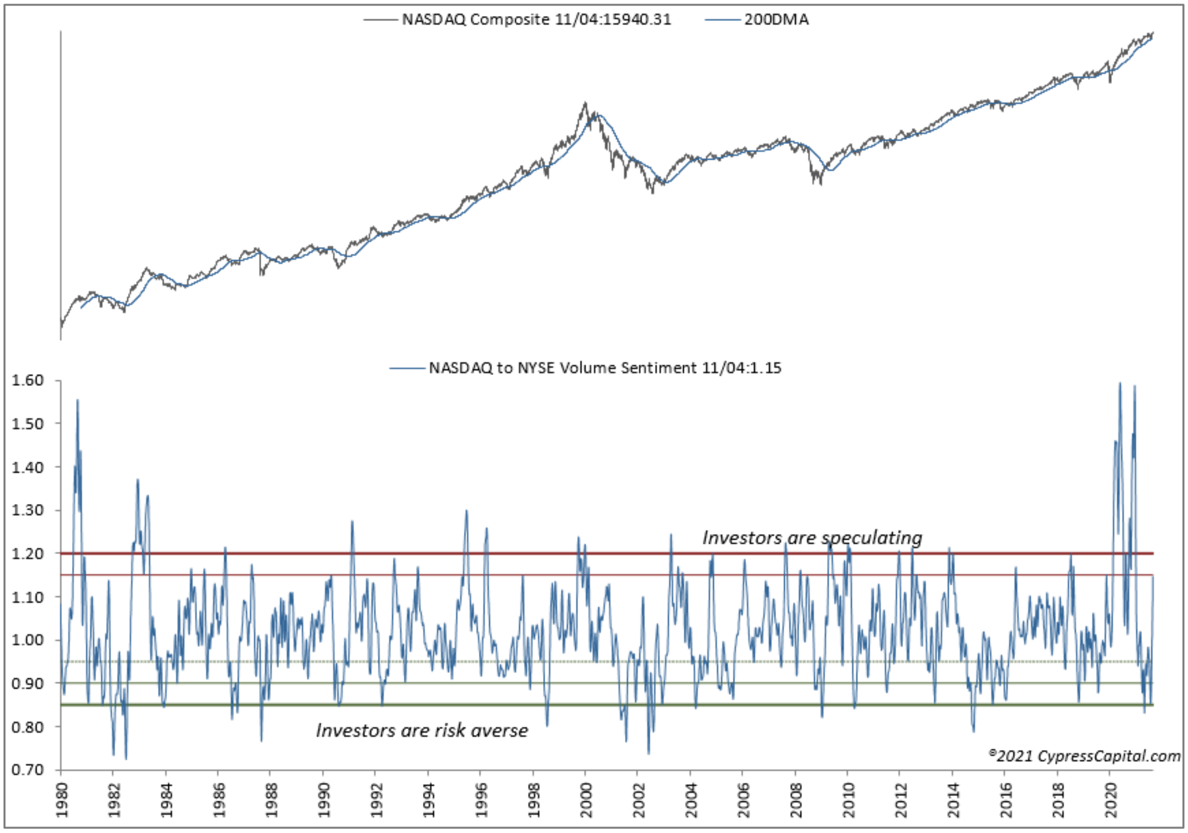
Valuations are chess - Technicals are checkers. Checkers is fun, but they don't make movies or Netflix series about people who play checkers. Therein lies the message from our Market Risk Index and this weight of the evidence approach. We respect the lecture coming from our Grandmaster chess champion, and as much as she might snub her nose at us, we are knee-deep in a low-stakes game of checkers right now.

Charts of the Week

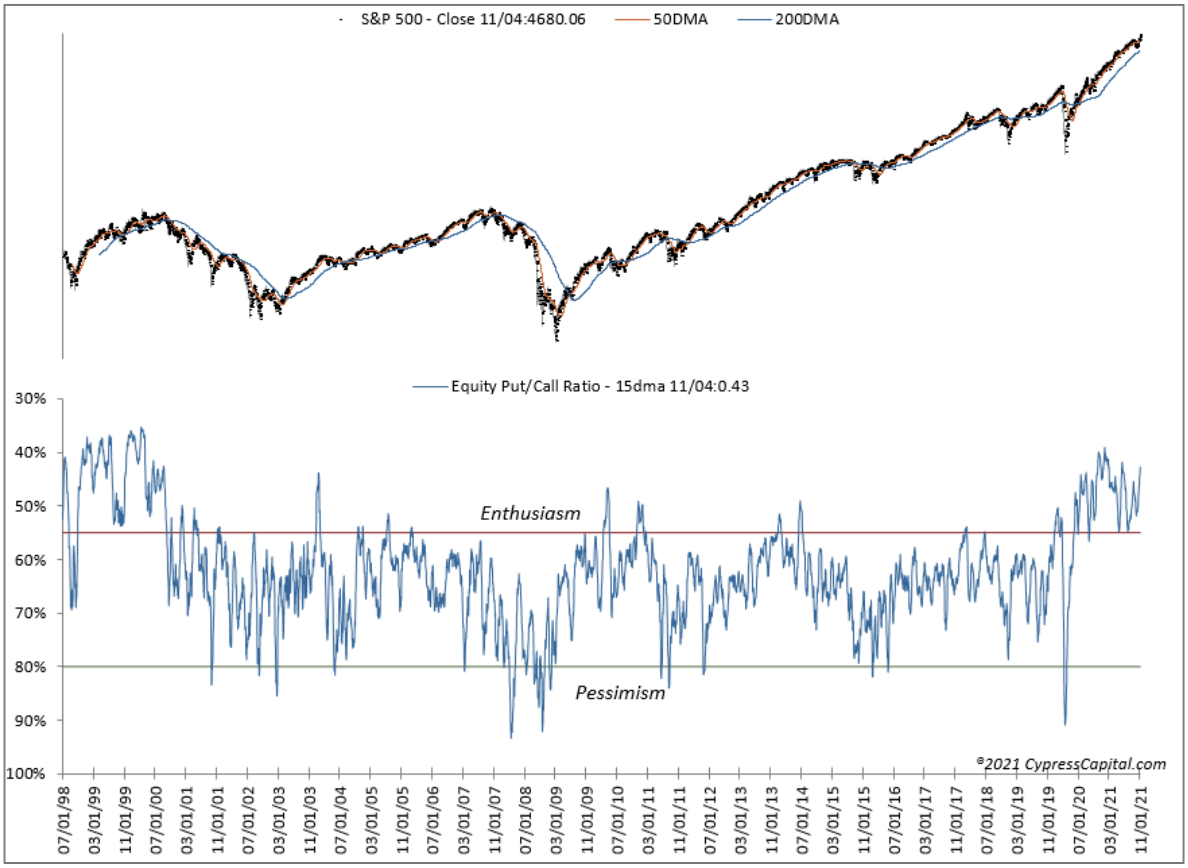
NYSE Advance/Decline line signaling all-clear.



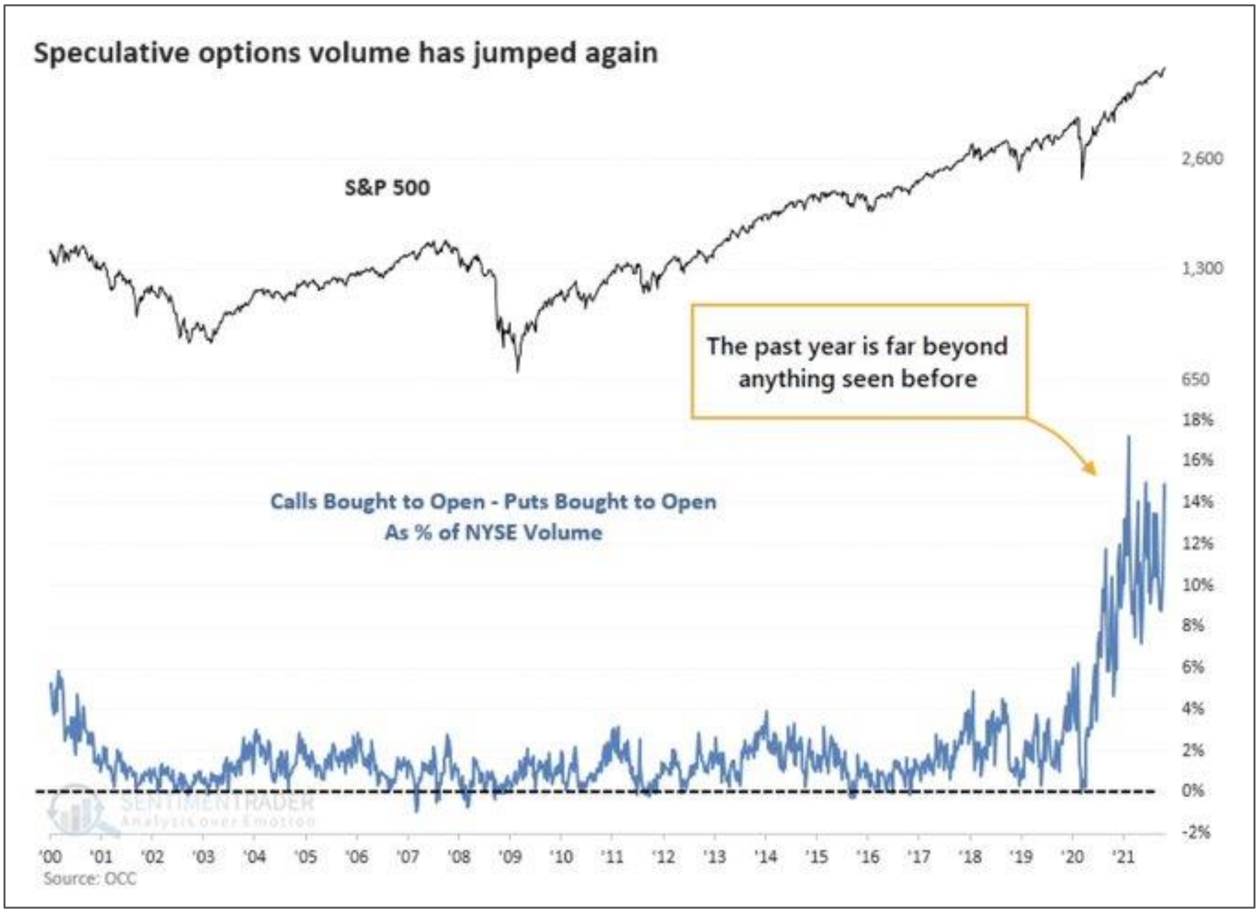
NASDAQ to NYSE Volume Sentiment is back in speculation territory.



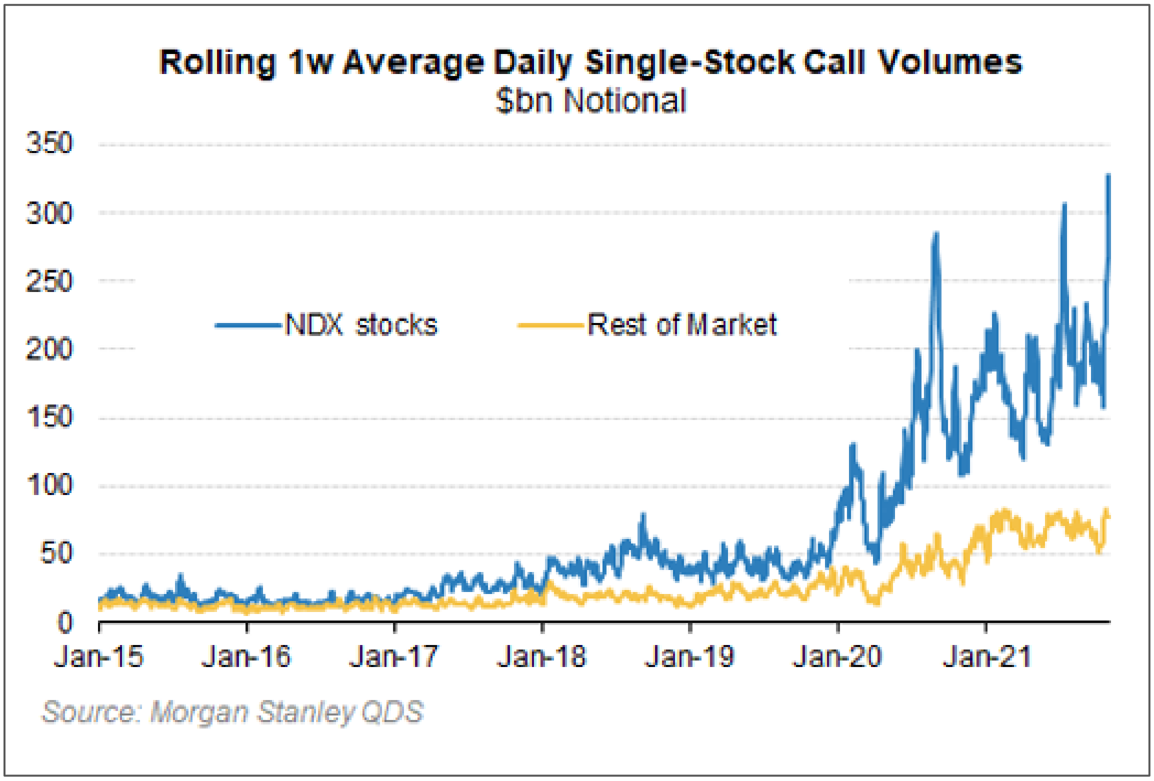
Equity Call Option buyers are making a run at the 2021 peak.



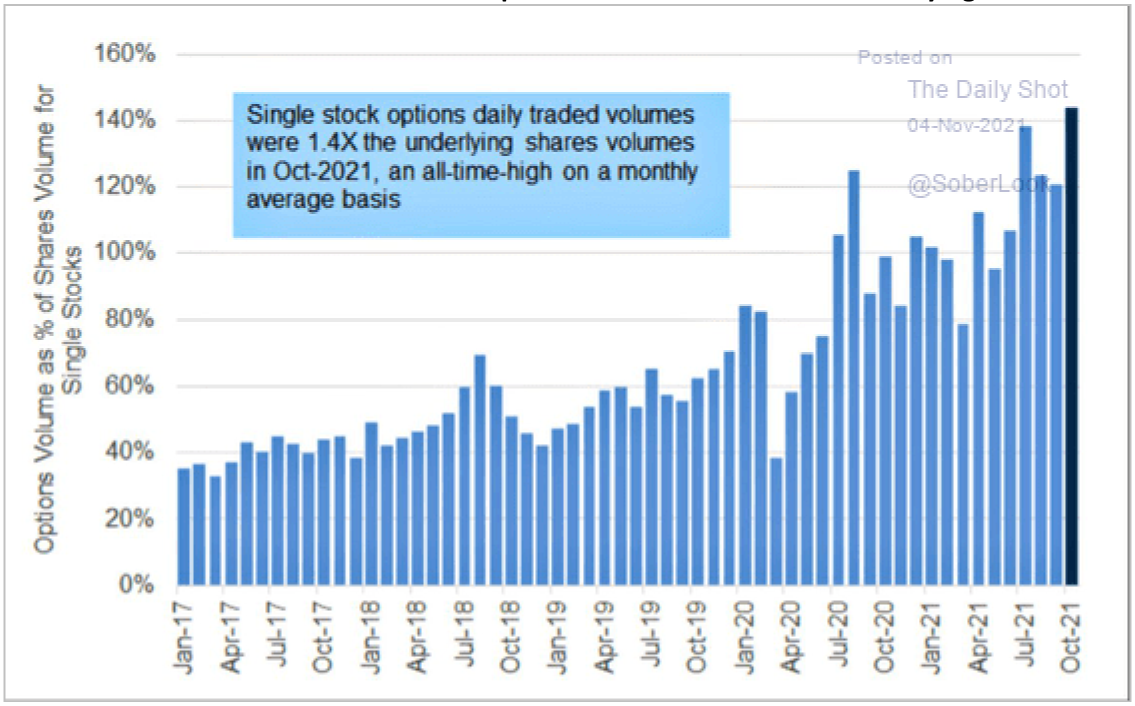
Speculative Options Volume entered a new era this year.



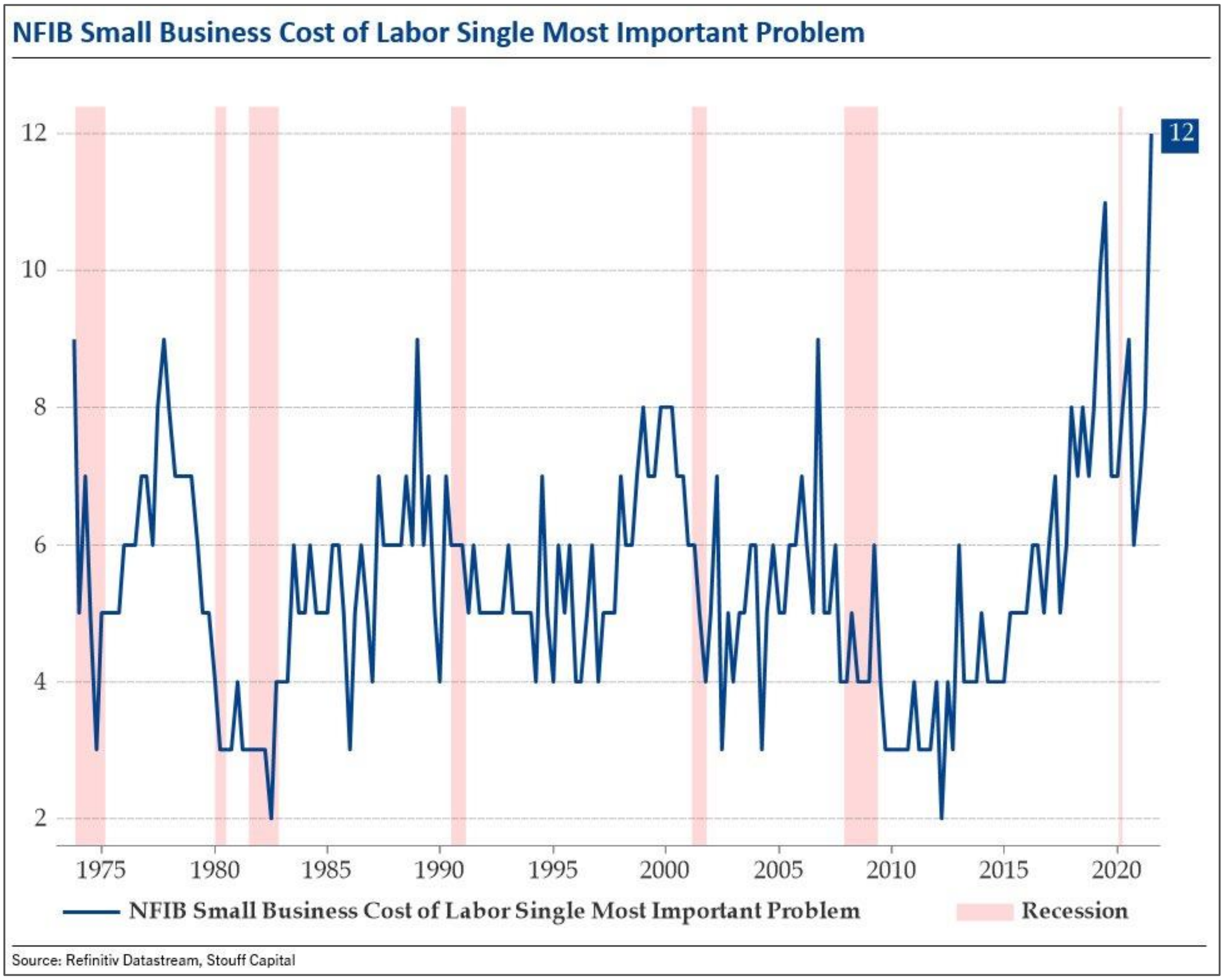
Record Notional Value of Single-Stock Call Volumes



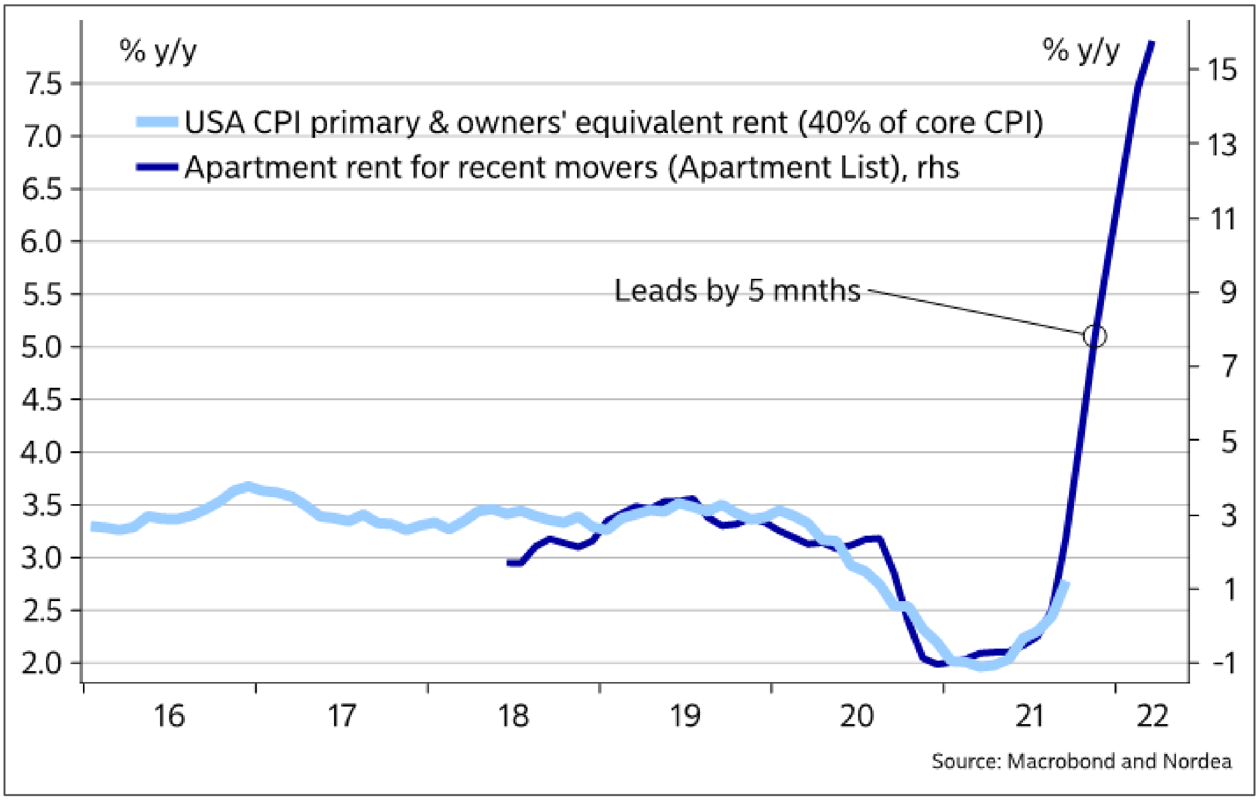
October set another all-time record for options volume in relation to underlying stock volume.



The cost of labor has never been a bigger problem for small businesses than it is right now.



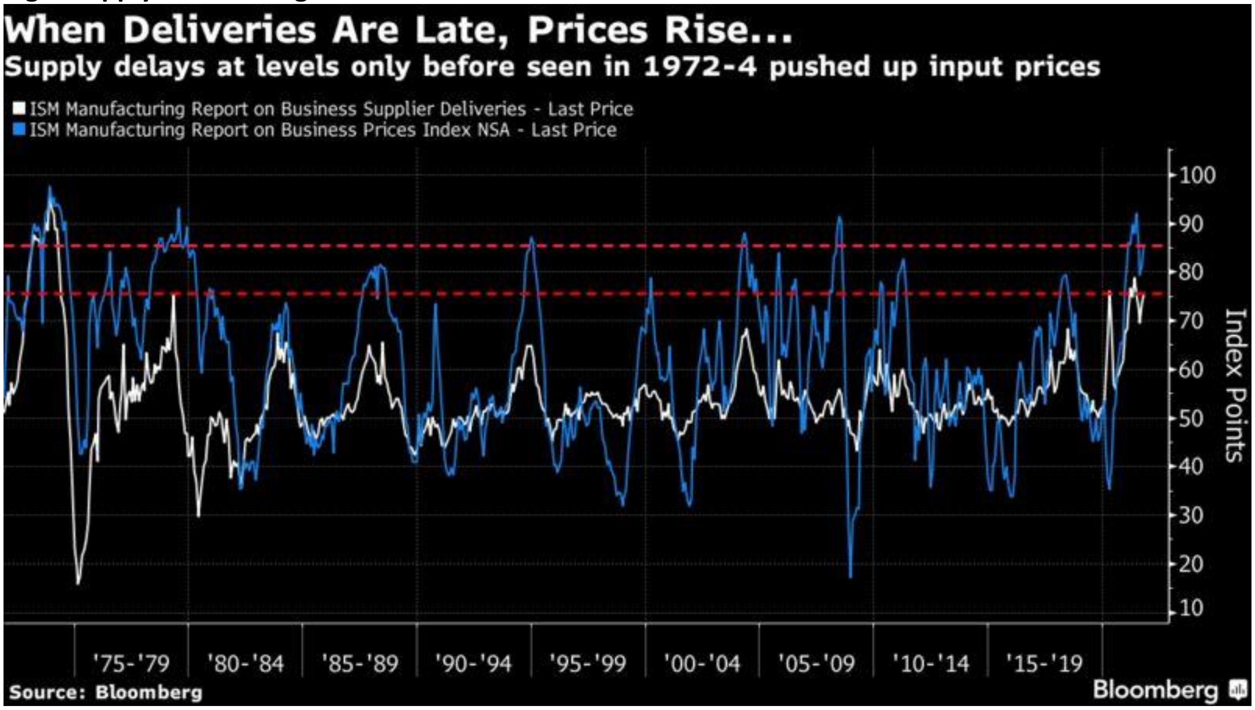
If this relationship holds, expect some revisions to the government CPI calculation methods in 2022.



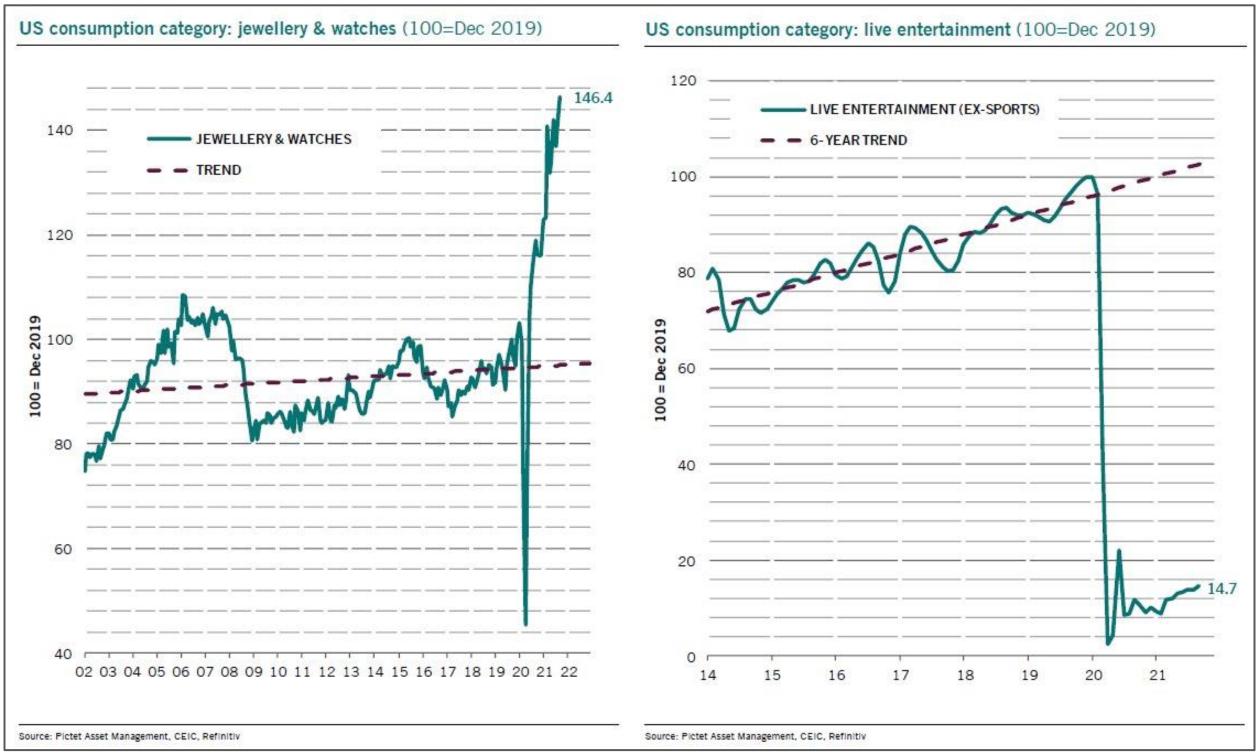
Cost of labor broke another government survey's record.

Supply Chains are a popular topic on earnings calls.

Tight Supply Chains = Higher Prices

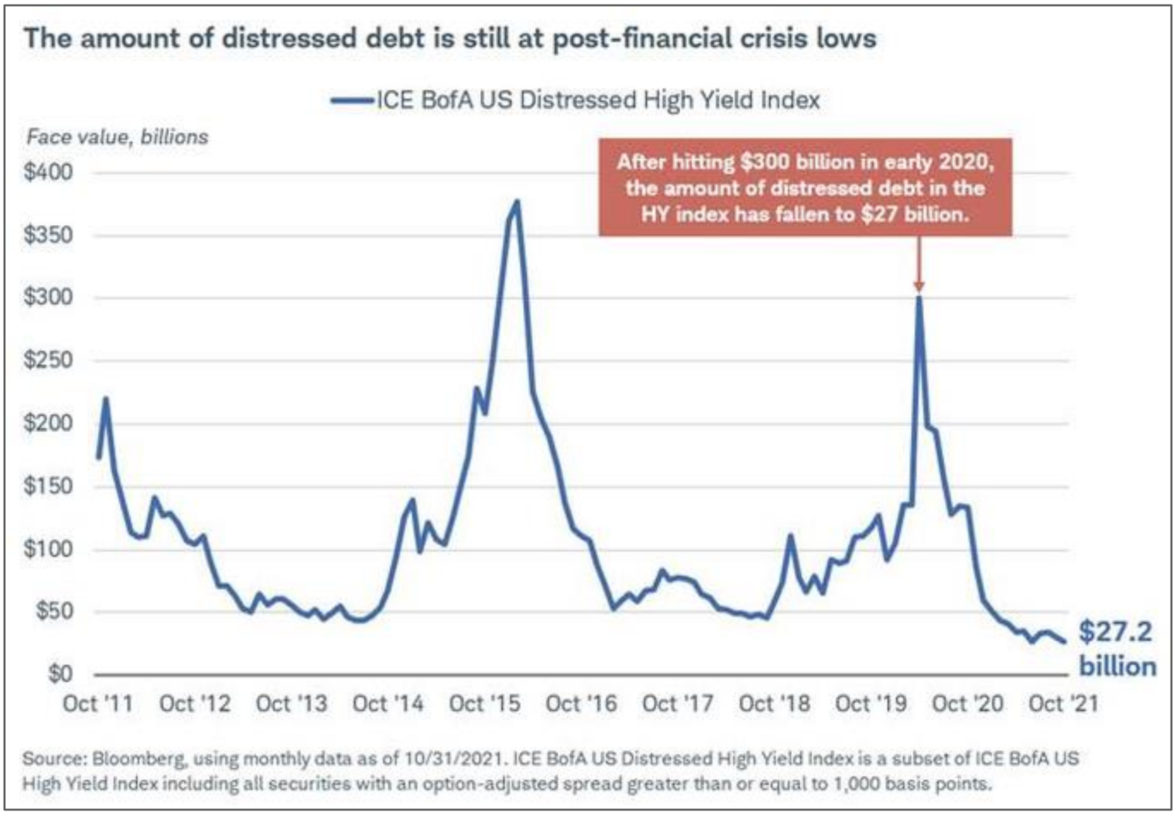


Some economists argue inflation pressures will alleviate when we shift from spending on goods to services.

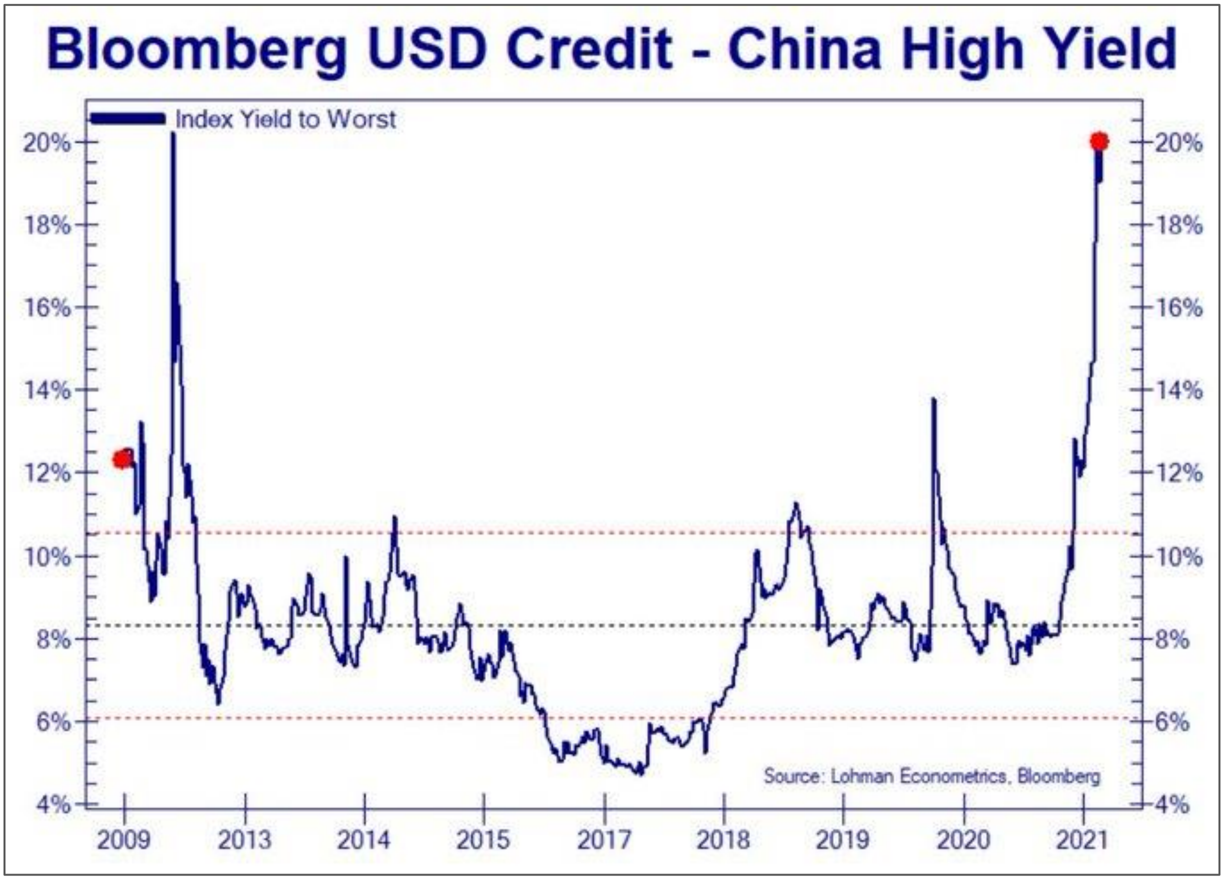


Meanwhile, the ISM Services index sets a new record.

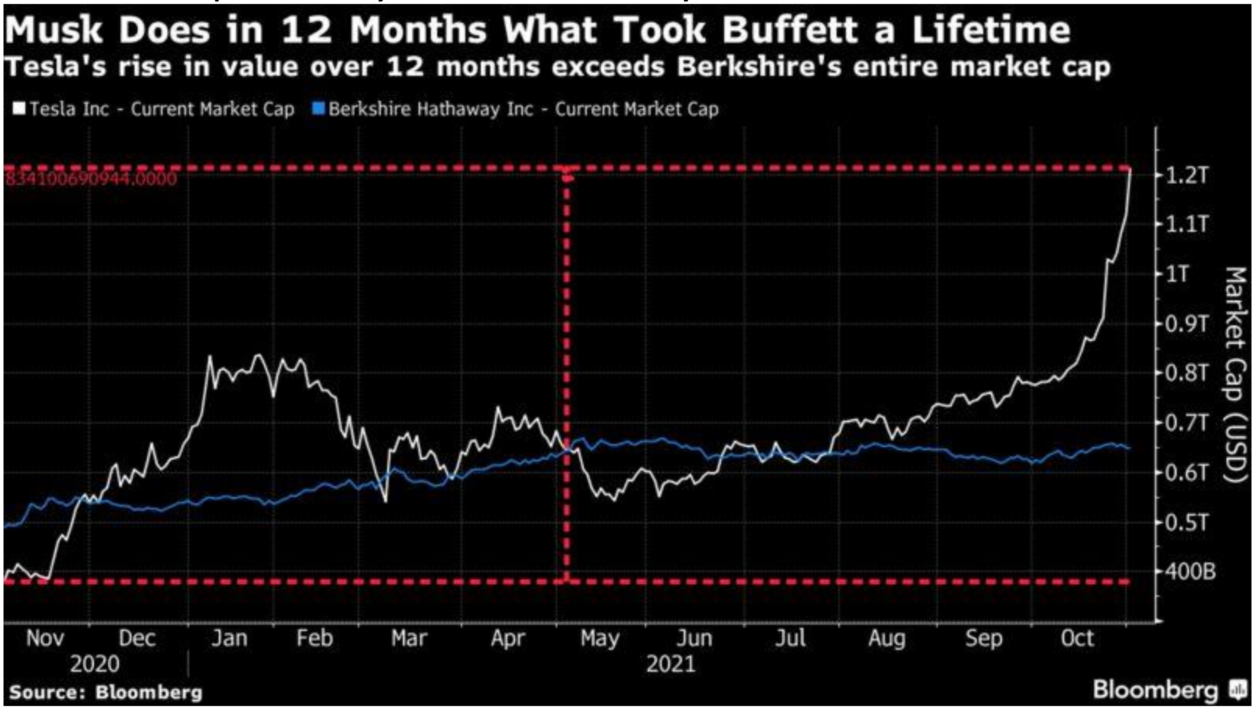
Amount of Distressed Debt in the US is near all-time lows.



Meanwhile, in China...



Tesla’s market cap increased by one Berskhire Hathaway over the last 12 months.



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.