



Market Outlook

By Mark T Dodson, CFA

Even Crazier...says Munger

Market Risk Index increased to 84.6%. Valuation improvements partially offset worsening Psychology and Monetary scores.

The Bond Momentum buy signal and NASDAQ High Low Logic market warning over recent weeks have been timely at heralding the start of the first correction for the Russell 2000 this year. It's a sharp correction for a large number of stocks – masked by a milder correction thus far in cap-weighted indices. Meanwhile, the Bond Momentum buy signal and position we initiated in longer duration Treasuries are currently working in our favor.

Investor sentiment is improving, even if not yet evident in the Psychology composite. Our Short-Term Sentiment composite is approaching pessimism, on severely oversold readings, a high VIX, and the start of a surge of corporate insider buying in beaten up small and mid-cap stocks. While it hasn't breached the pessimism threshold, it's the best reading for that composite since September 2020. Moreover, some individual equities are well off their highs and close to presenting an opportunity for entry, even if the broader market still has some big warts.

These short-term sentiment indicators were cherry-picked from our broader Psychology composite for their ability to highlight shorter-term pruning and planting opportunities. Within the Psychology composite, more speculation still needs wringing out of markets. Animal spirits are fresh off all-time highs, and enthusiasm for levered speculation has not been tamed. Charlie Munger, Warren Buffett's long-time right-hand man, called the current economic environment "even crazier than the dot-com era."ⁱ

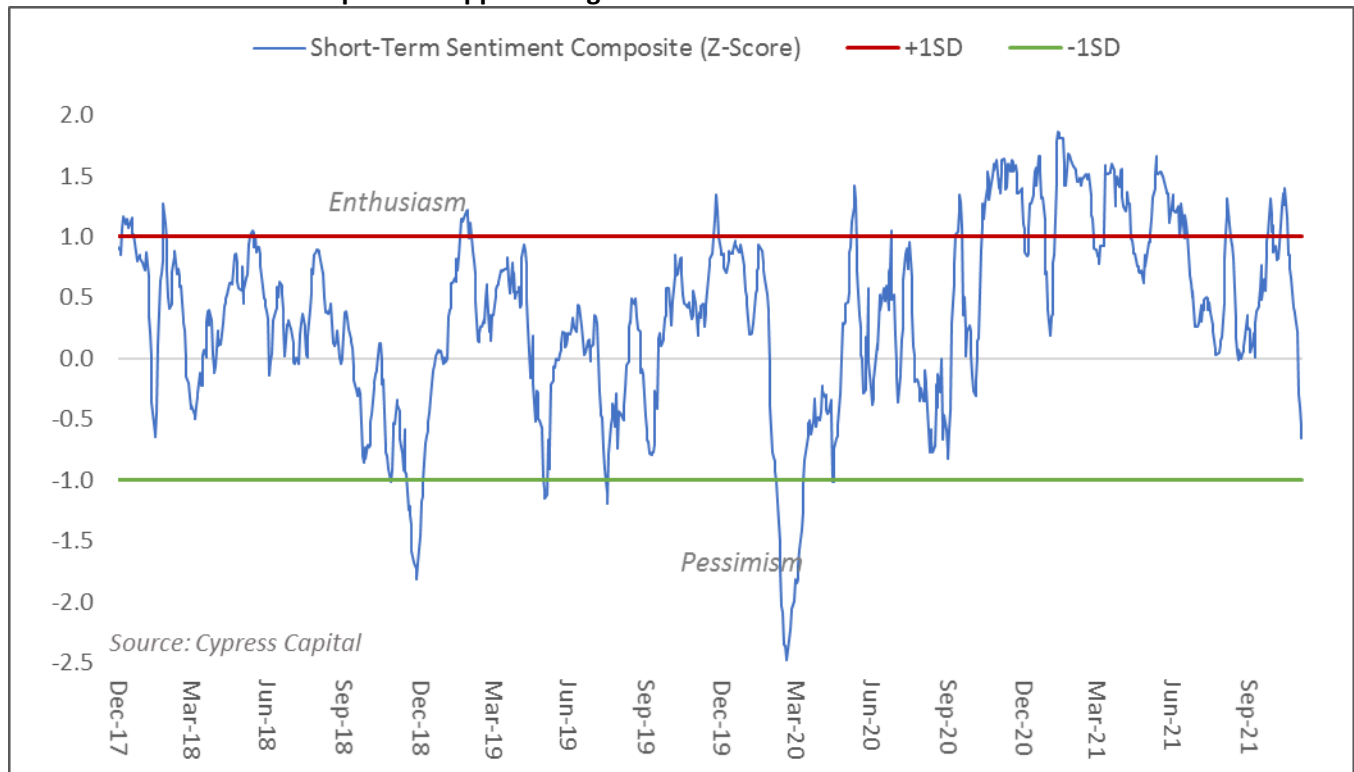
For investors, not speculators, concerned first and foremost about the margin of safety, buying technically oversold conditions in highly speculative environments can be precarious. Unwinding levered positions isn't gradual – it's all at once.

The same goes for the current inflationary backdrop, which is still throwing up red flags within our monetary composite. The task of policymakers to temper the inflation rate without causing a sharp retraction in asset prices or a recession is challenging. The last time our inflation category was similarly red-lined was in 2011, the correction that alleviated inflationary tension fell just shy of a bear market, and it came in a period where our valuation composite suggested that stocks were already undervalued.

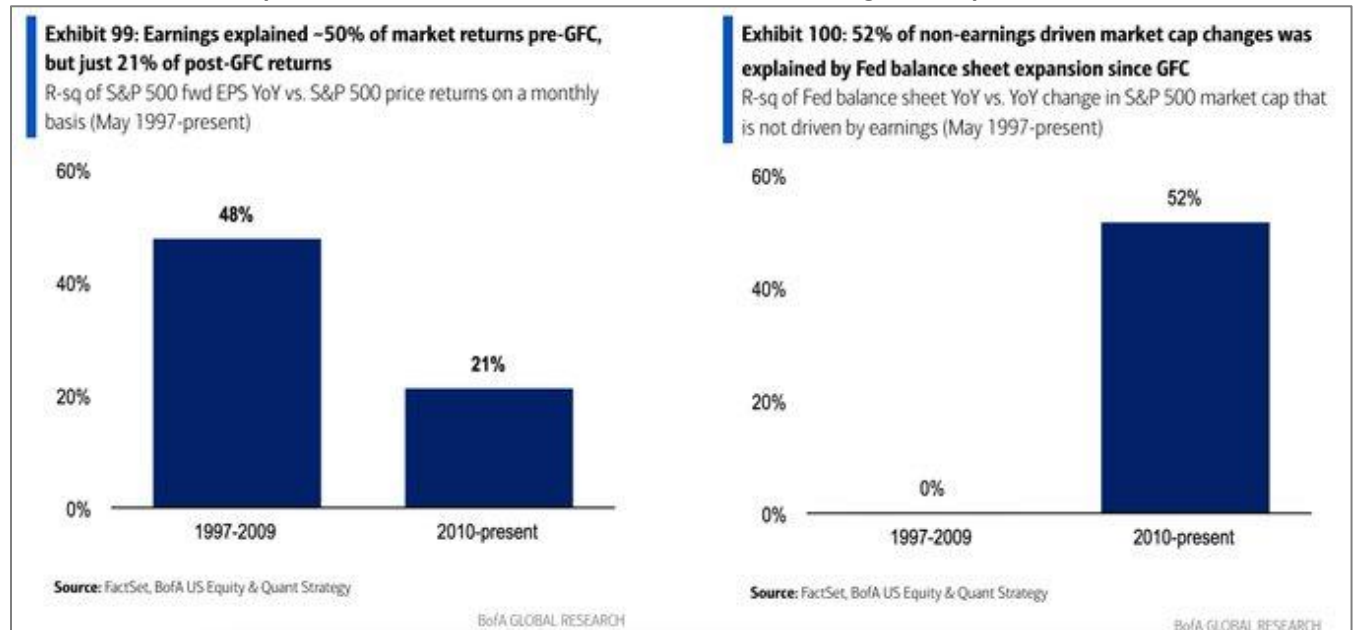


Charts of the Week

Short-Term Sentiment Composite is approaching Pessimism



Fed Balance sheet expansion has become more influential than earnings in the post-GFC environment.



Source: Robin Wigglesworth, BofA

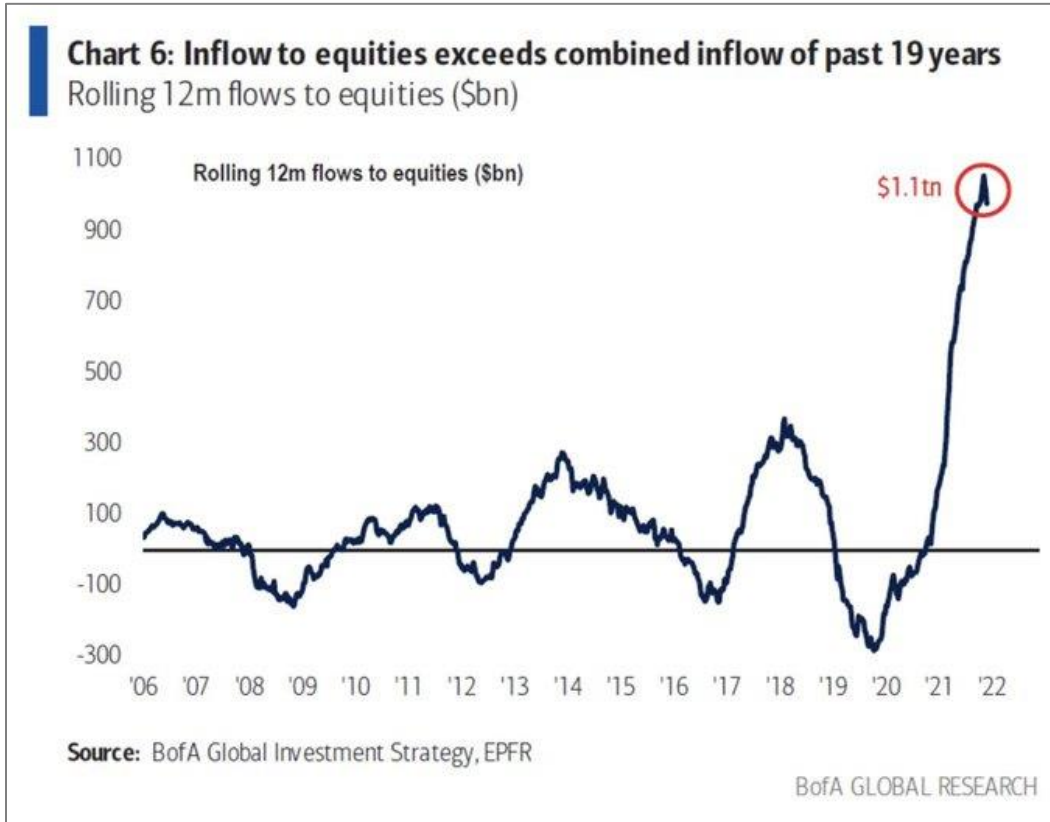
Private Equity deal volume is setting new records.



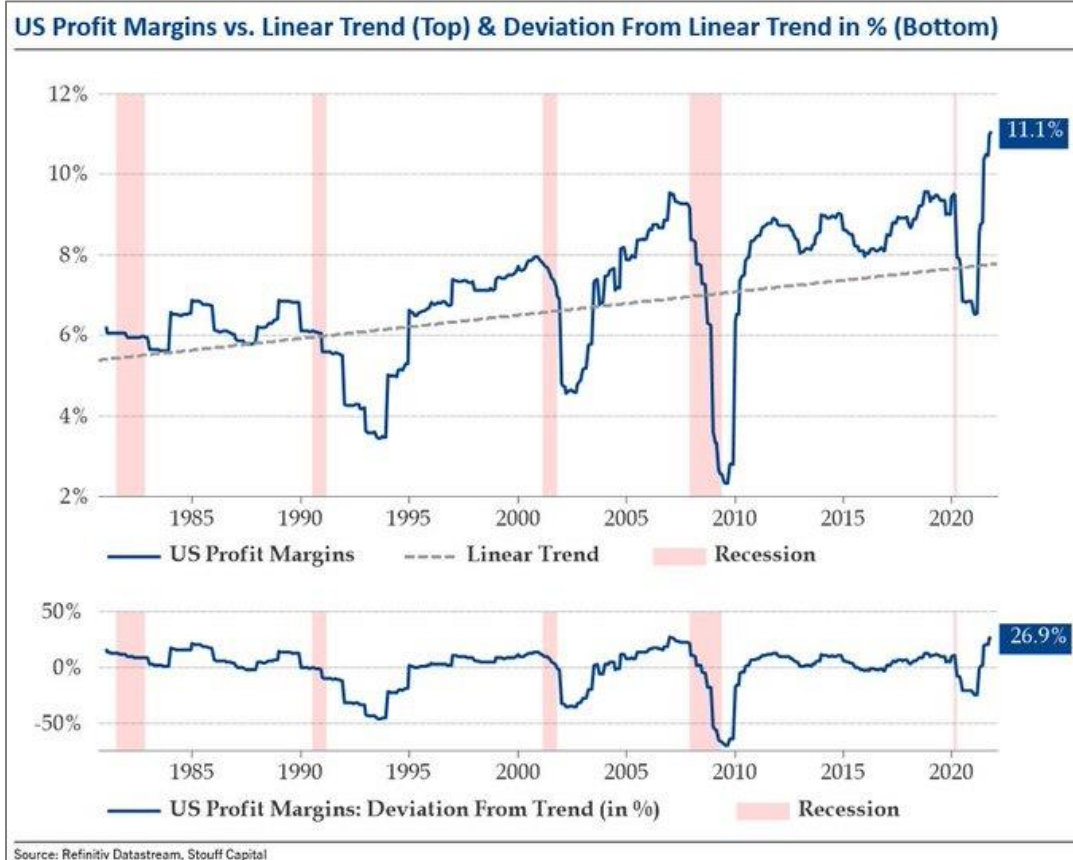
Net borrowing in US brokerage accounts is at all-time highs.



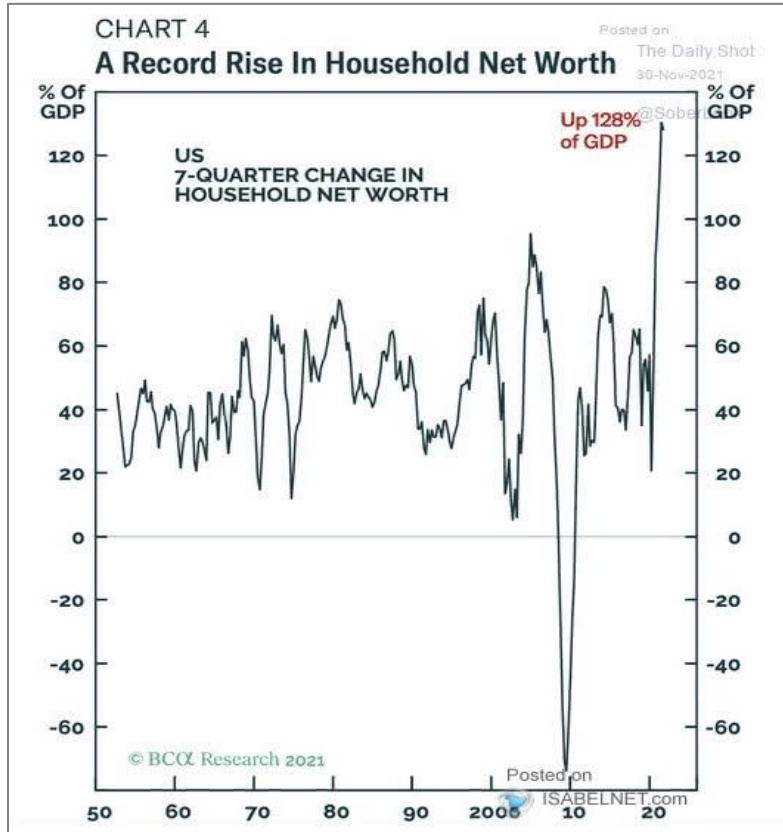
2021 Equity inflows exceed all of the last 19 years combined.



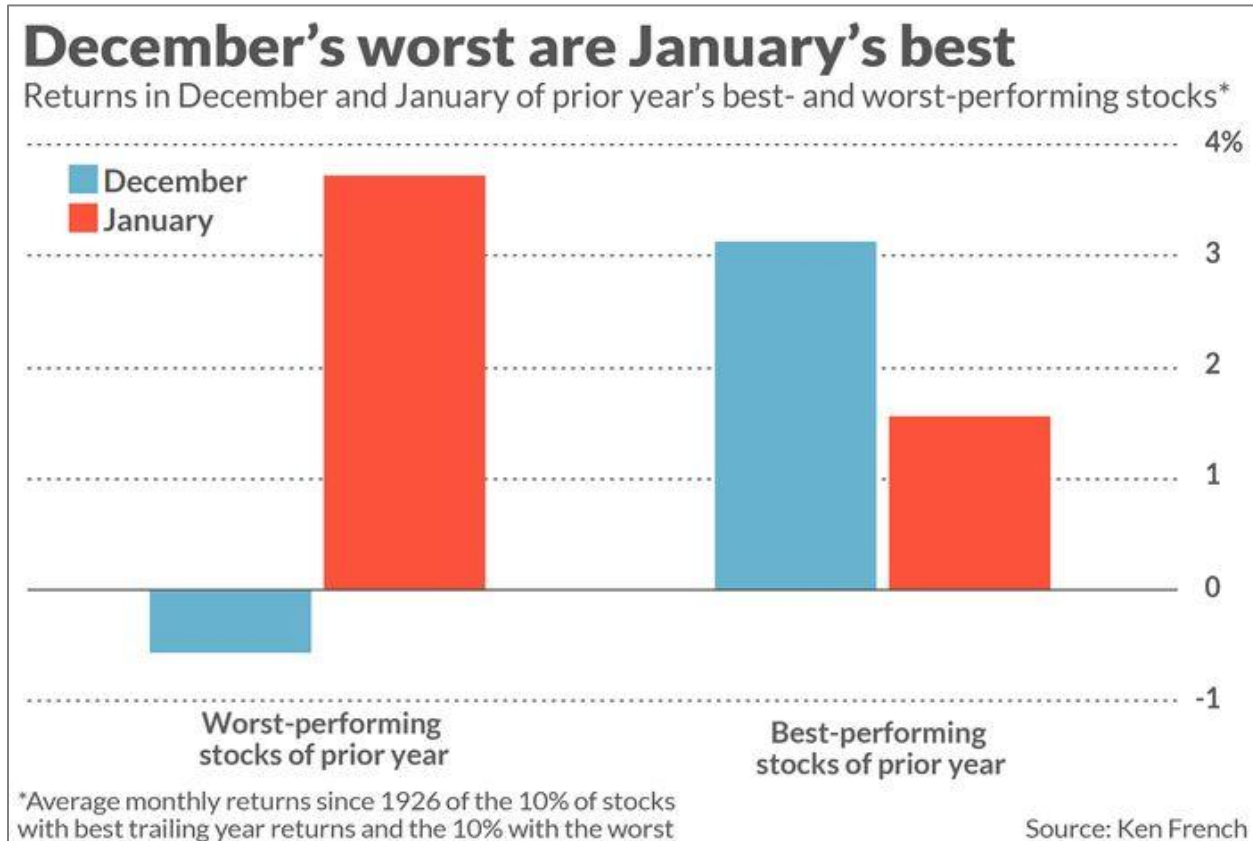
Government stimulus has pushed corporate profit margins well above trend.



Record increase in Household Net Worth



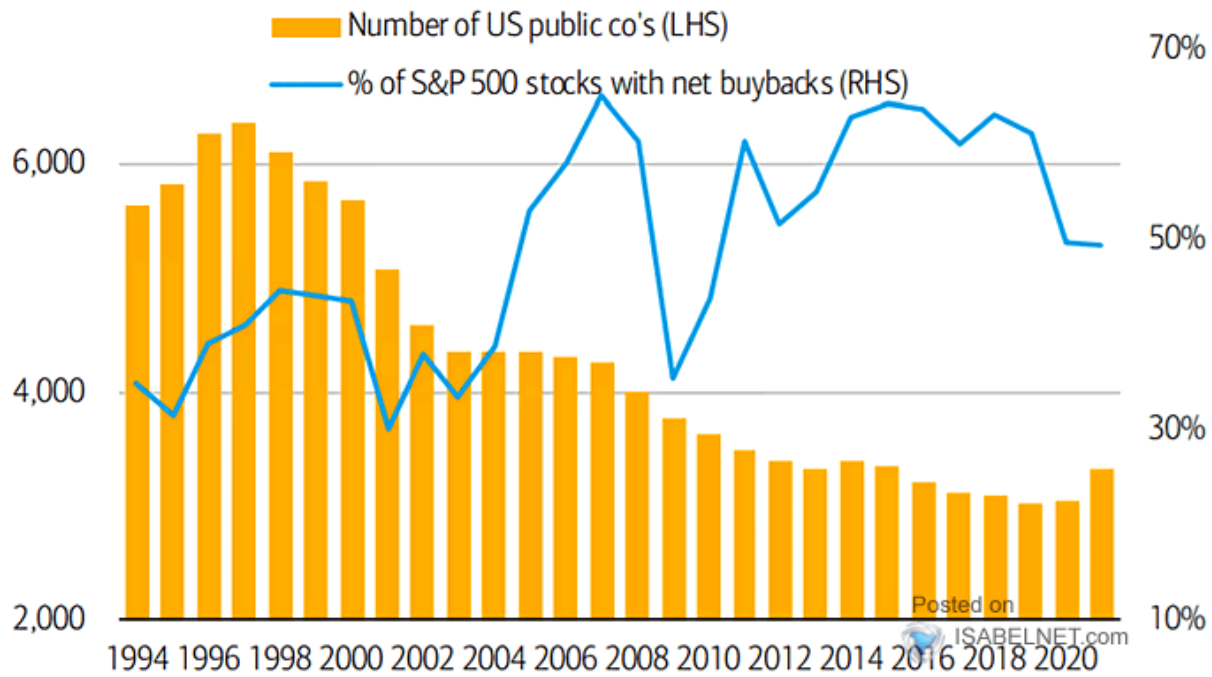
December's tax-loss selling creates January's best trades.



The number of public companies is on the rise, and % of S&P 500 stocks with net buybacks falls below 50%.

Exhibit 55: A pause in one of the most bullish themes for US stocks: shrinkage

Number of US public co's vs. the net percentage of share buybacks for the S&P 500

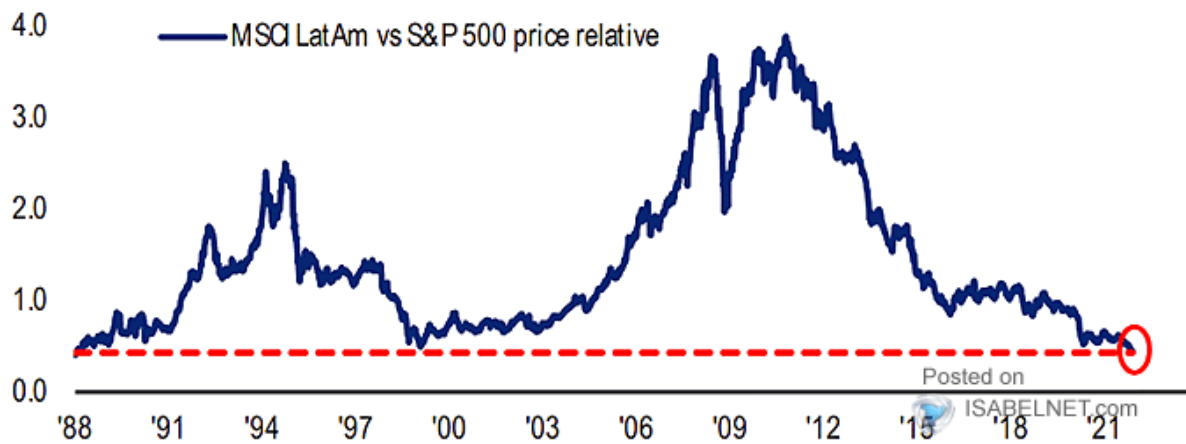


Source: BofA US Equity & US Quant Strategy, FactSet, Bloomberg

Latin American to US stock prices at the lowest level since 1988.

Chart 2: LatAm stocks at lowest level vs US stocks since 1988

LatAm stocks vs US stocks price relative



Source: BofA Global Investment Strategy, Bloomberg

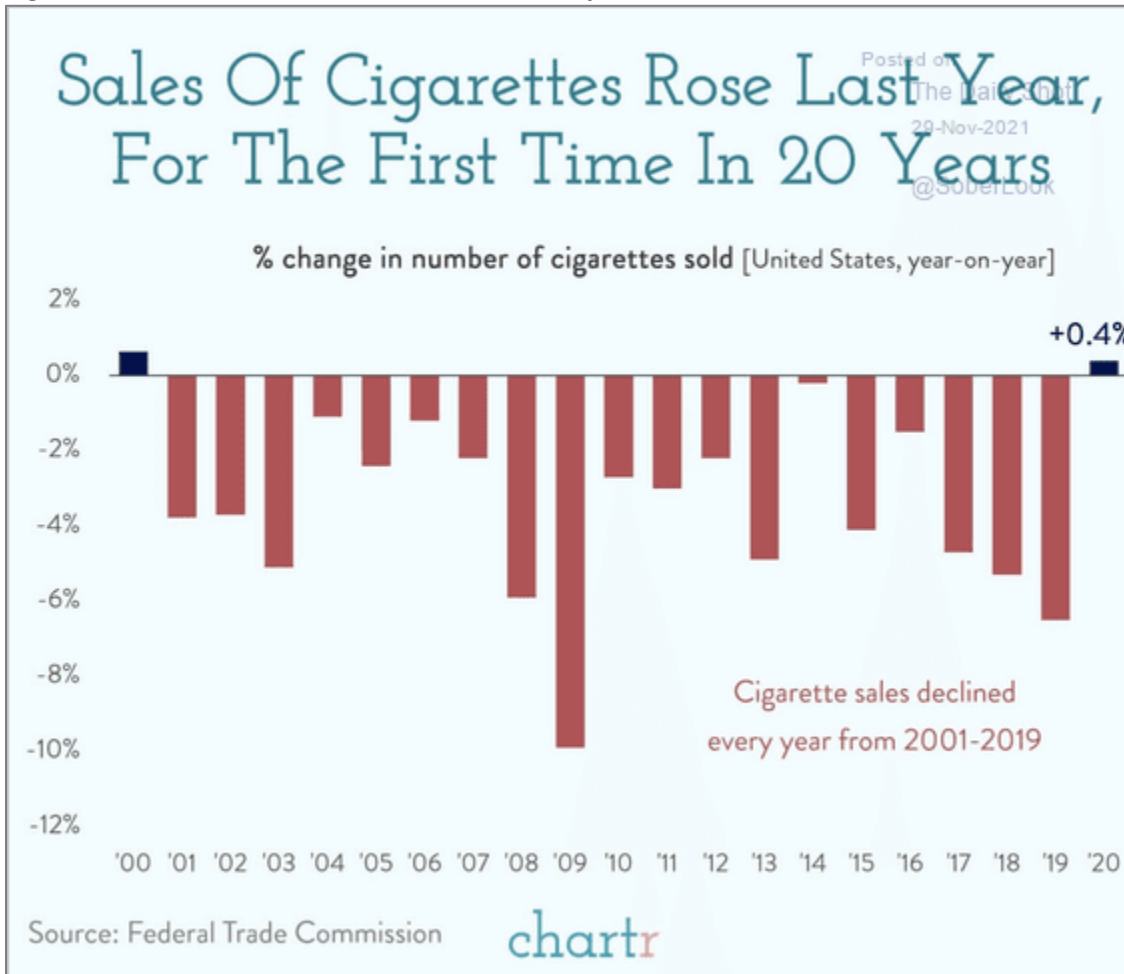
Emerging Market to US stock prices at the lowest level since 2002.



Percentage of stocks trading above 10x Price to Sales has peaked, but still well above dot-com era.



Cigarette sales increased for the first time in 20 years.



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.

ⁱ <https://www.bloomberg.com/news/articles/2021-12-03/berkshire-s-munger-says-now-is-even-crazier-than-dotcom-bust>