Cypress CAPITAL

Market Outlook

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Inflation as a Fed Put Foil

Market Risk Index climbed another percent to 85.6%. Psychology held steady while Monetary conditions and Valuations worsened.

Improvements in our Short-Term Sentiment composite have fallen just shy of registering an extreme pessimism reading, but it's the first time it has fallen into pessimism territory in 2021. The improvement reflects a very oversold market as well as the start of some buying by corporate insiders. It would be unusual to see a selloff persist in December, but the one in 2018 permanently dispelled us of the notion of relying too heavily on that anomaly of the calendar.

Mending short-term sentiment has helped the Psychology composite, but those improvements were offset by deteriorating Technicals and volatility moving into a range that tends to be more bearish for markets in the short-term. Longer-term investor sentiment measures inside the composite will not budge without a more meaningful correction. The result is a Psychology composite that has not improved as much as we had hoped. Retail trading activity revealed that investors bought the recent dip in force, still following the same playbook that has worked for all of 2021. Unlike inflation, the improvements to investor sentiment are thus far proving to be transitory.

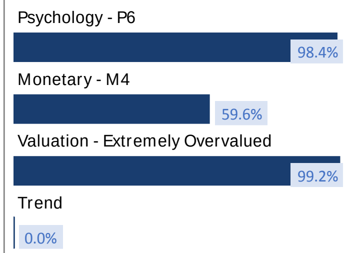
This week's big news was a 6.8% annual CPI inflation print, the highest since 1982. Unlike the CPI, the inflation category of our Monetary composite, made up of indicators that tend to lead CPI and equity markets, is showing signs of a peak. However, the category has not moved into a more neutral zone for equity markets. It's the response of policymakers that will determine whether a likely coming retreat in inflationary pressures also proves transitory. If policymakers and pundits in the past saw inflation lurking around every corner, we have grown conditioned to the absence of it. We have grown to disrespect inflation as much as we should, to our detriment.

Market Risk Index

Rec Allocation 25% Underweight

85.6%

Category Percentiles



Largest Psychology Influences

Levered Investments	Negative
Bank Sentiment	Positive
Option Activity	Negative
Flow of Funds	Negative

Largest Monetary Influences

Inflation	Negative
Velocity	Positive
Exchange Rates	Positive

Valuation

7-10 Year Rtn Forecast	0.2%
10Yr Treas Yield (on 12/08)	1.4%

Market Trends

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

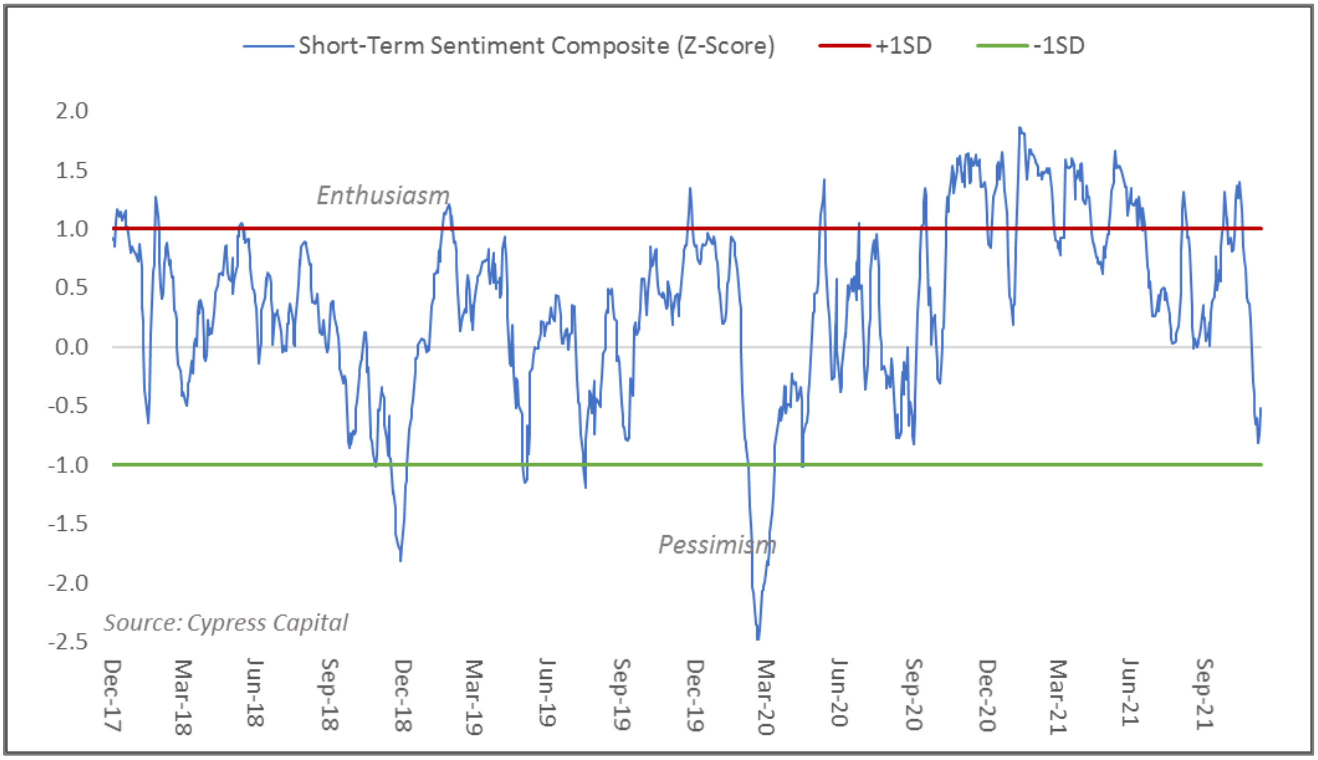
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

The disinflationary era was driven by productivity gains, an embrace of free trade, and immigration fueled population growth here at home. The fall of the Berlin Wall, the invention of the Internet, and China entering the WTO were critical events over the last 30+ years that proved to be massive disinflationary forces - each like stages of a disinflationary rocket, coincidentally making politicians and central bankers look more brilliant than they were.

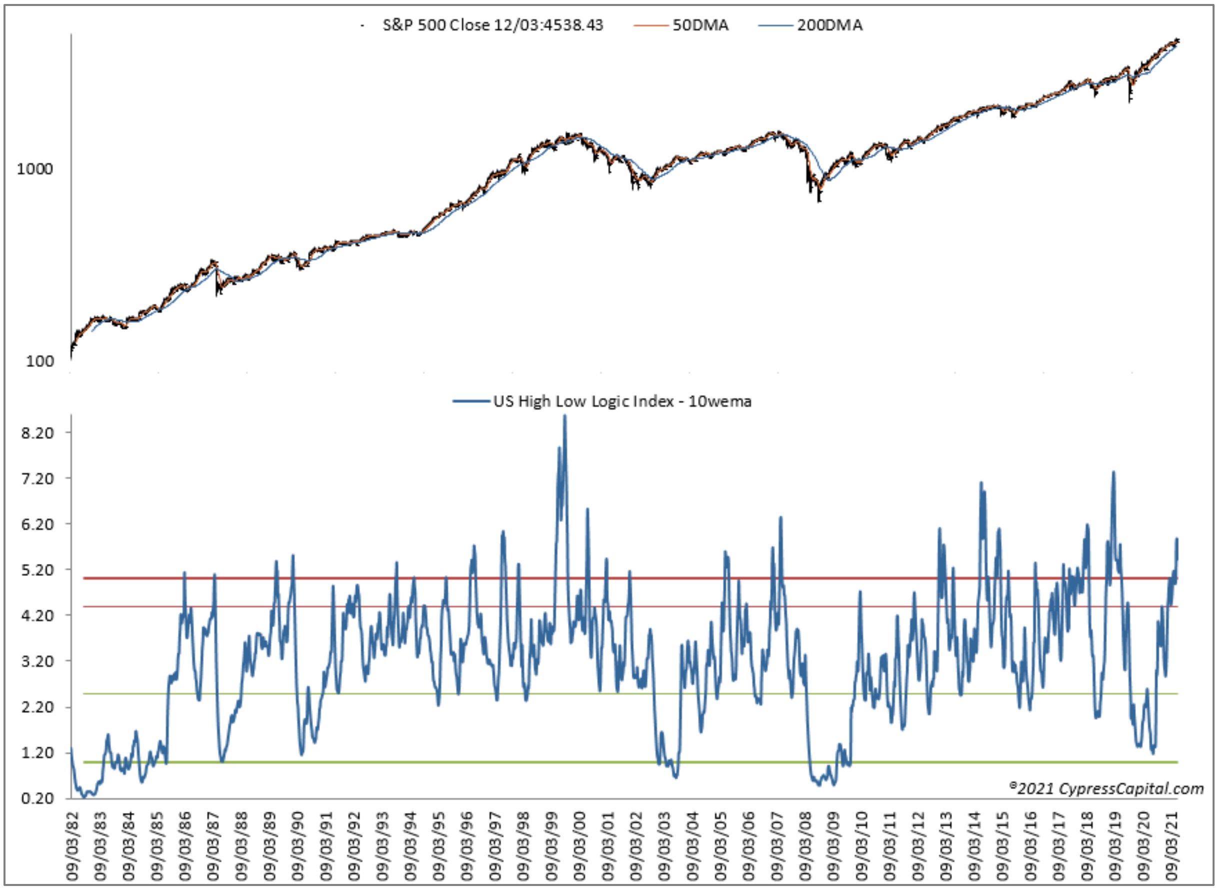
Now, the pendulum is swinging the other way. Labor markets are the tightest in a generation - free trade and immigration are out of favor – and just-in-time inventory management sounds risky. Still, Milton Friedman's axiom holds - inflation is always and everywhere a monetary phenomenon. Controlling inflation depends on how policymakers respond when the froth really comes out of this market. We've finally come to a point where the Fed put also puts gasoline on an inflationary fire. Policymakers faced a similar choice in the late sixties, who were coincidentally also conditioned by decades of disinflation, and in that era, they chose poorly.

Charts of the Week

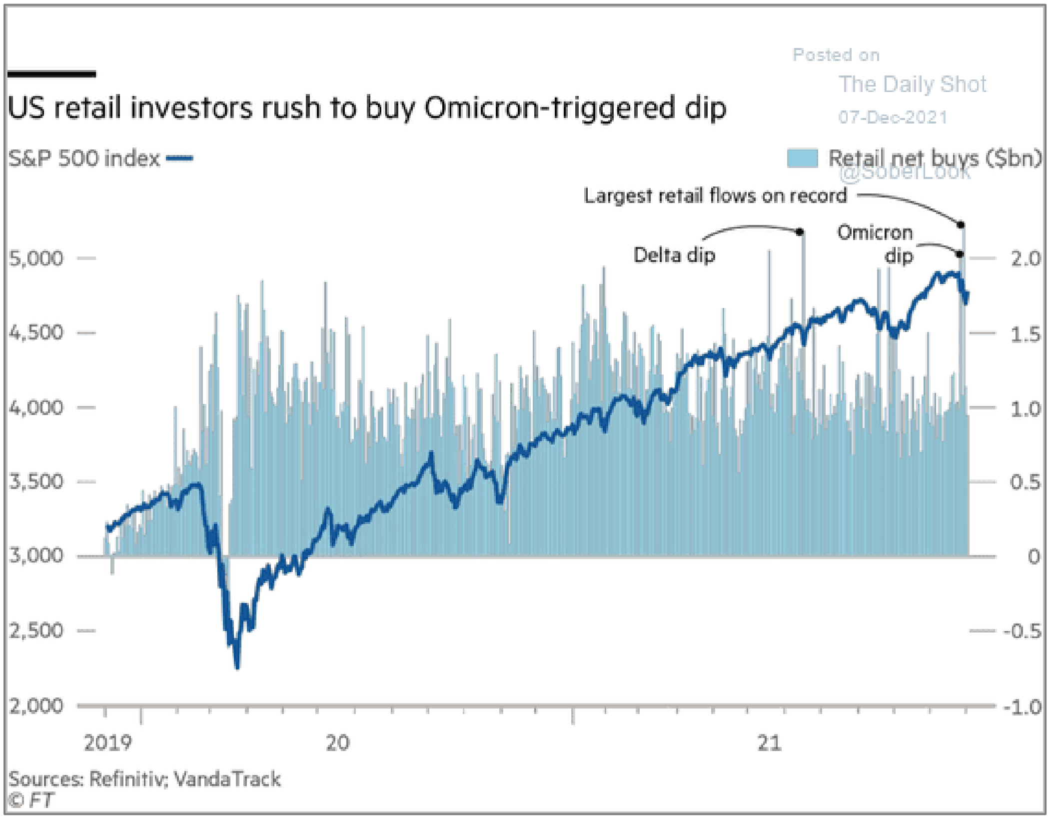
Short-Term Sentiment Composite improvement falls just shy of extreme pessimism.



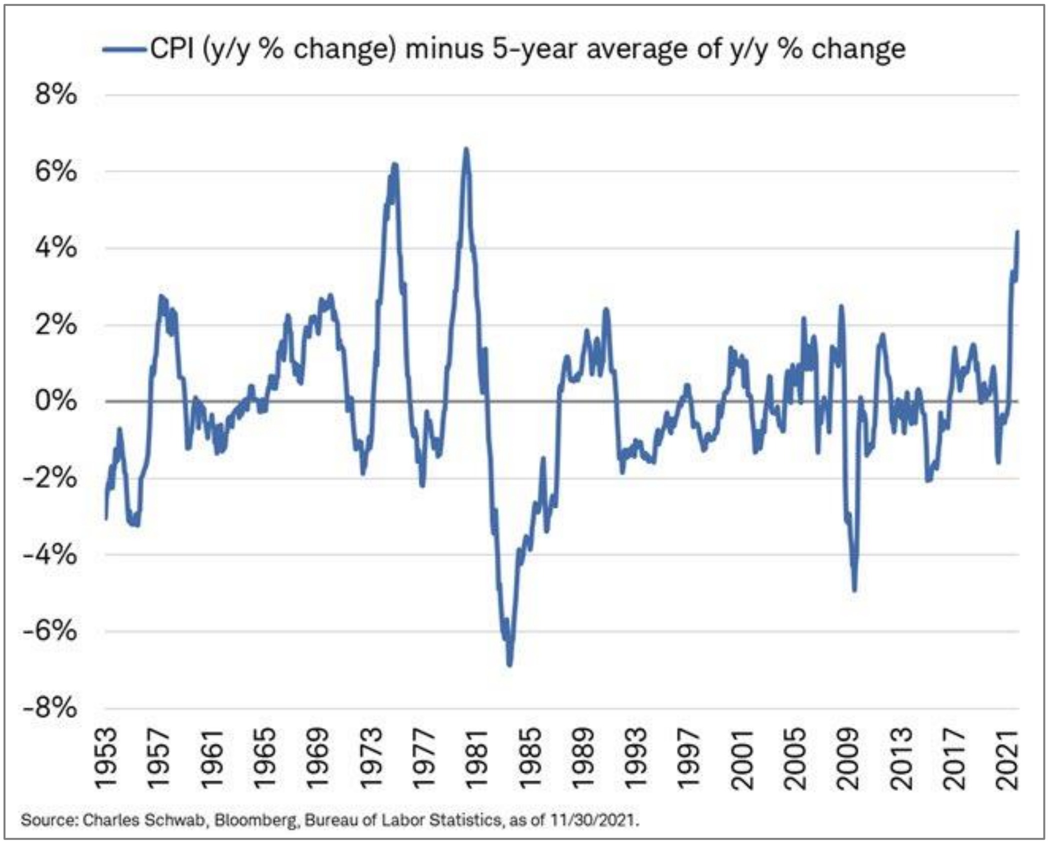
Meanwhile, the US High Low Logic Index is signaling a split market.



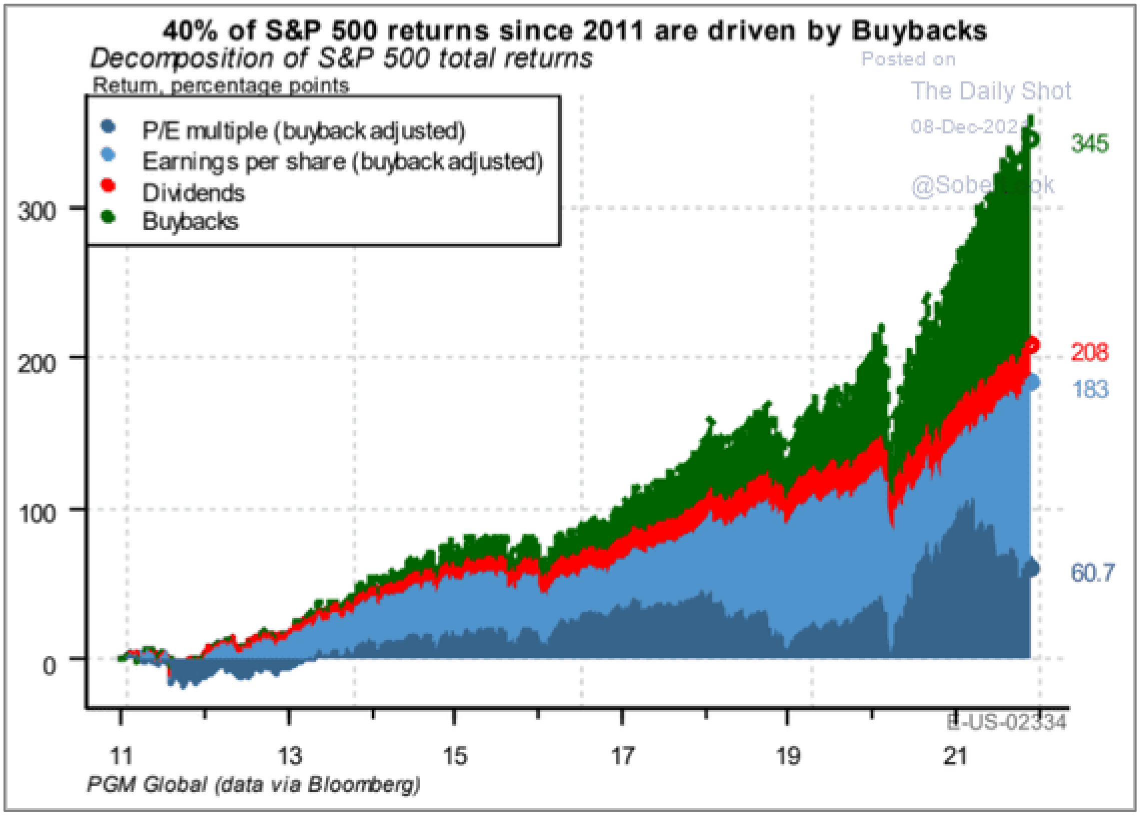
Dip-buying enthusiasm by retail investors set a new record.



Inflation hasn't been this far above trend in more than 40 years.



Buybacks have driven the bull market for more than a decade.



Fed Funds rate lags the Taylor Rule by the most on record.

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.