



Market Outlook

By Mark T Dodson, CFA

NYSE High Low Logic Index gives a sell signal

Market Risk Index improved this week but remained above the 90th percentile. Improvements to the Psychology composite offset modest deterioration of the Monetary composite.

Investor psychology was set to see even more progress but was held back by another turn for the worse in stock market breadth. The NYSE High Low Logic Index triggered its first significant sell signal since the second half of 2019, joining the NASDAQ composite sell signal from November. Together, they are signaling a more broadly split market.

We have leaned more heavily on breadth measures that use new highs and lows over advance decline based indicators in recent years. The latter category of indicators have seen some of their efficacy wane – either because of decimalization, the embrace of indexing, or something else. We’ve attempted some data manipulations to adjust for decimalization with limited success.

Regardless, as we said of the NASDAQ High Low Logic Index when it triggered its sell signal, these two indicators aren’t perfect and subject to false signals, but when it comes to the number of indicators that exist that are timely and accurate at highlighting market peaks, these are two that should not be ignored.

Within the Monetary composite, the Interest Rates category worsened again due to a higher rate of change of investment-grade corporate bond yields relative to real GDP. Similarly, the Dow Jones Bond Oscillator moved into tightening territory. These are indications that market conditions are beginning to tighten and rising risk aversion.

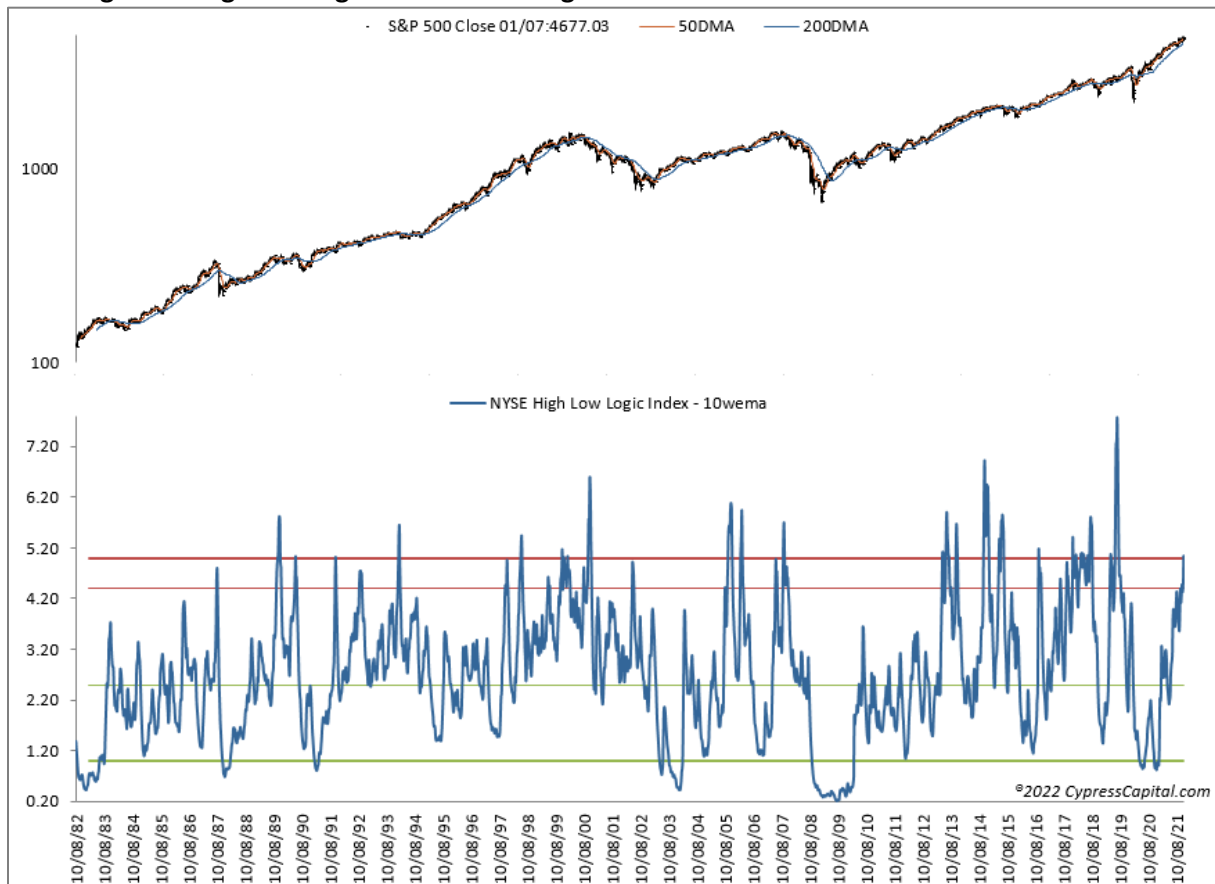
The Producer Price Index data was released this week, and the six-month rate of change has clearly peaked but is still north of 5%; consequently, the Inflation category is still at its maximum negative reading. How the Fed responds to rising market volatility (a prerequisite for breaking inflationary pressures) will likely determine whether inflation expectations become untethered.

JP Morgan CEO Jamie Dimon suggested¹ that we will see six or seven rate hikes, and the Fed Funds market is pricing in as many as four this year. While we agree that it is not good policy to have record negative yields while unemployment is under 4% and inflation is printing 7%, we have some doubts that we’ll even see those three or four hikes that the market expects. This Fed is likely to panic if and when equity markets do – anything to alleviate short-term pain. It’s the path of least resistance, and after a nearly 40-year history of disinflation, it will be all too easy to find excuses to dismiss inflationary pressures in an attempt to appease markets.

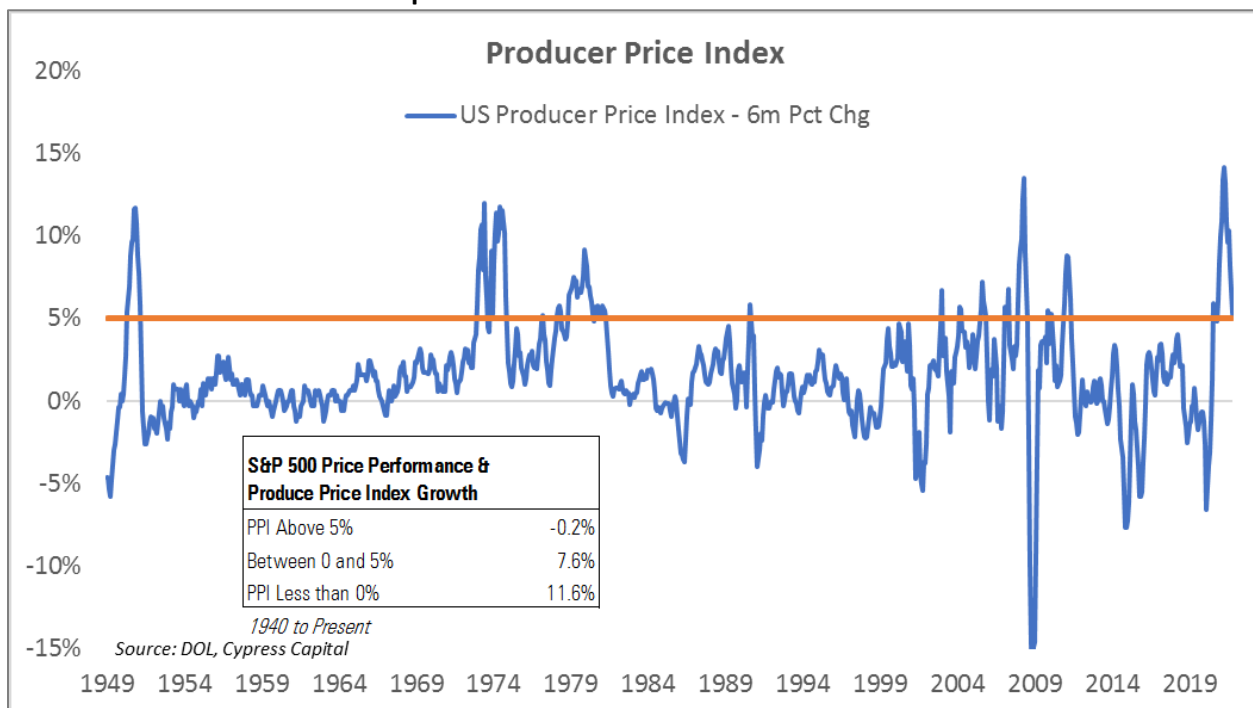


Charts of the Week

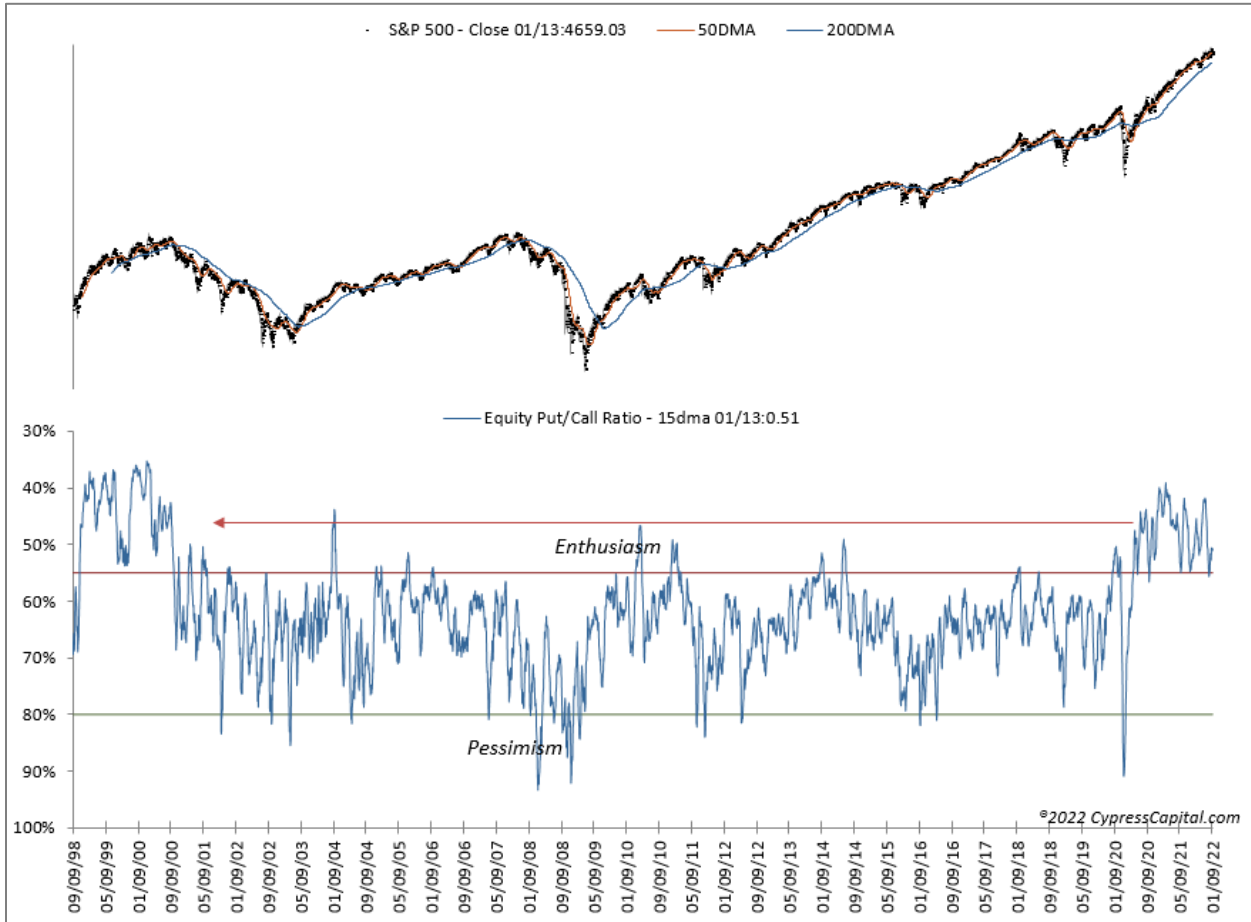
NYSE High Low Logic Index gives its first sell signal since the second half of 2019.



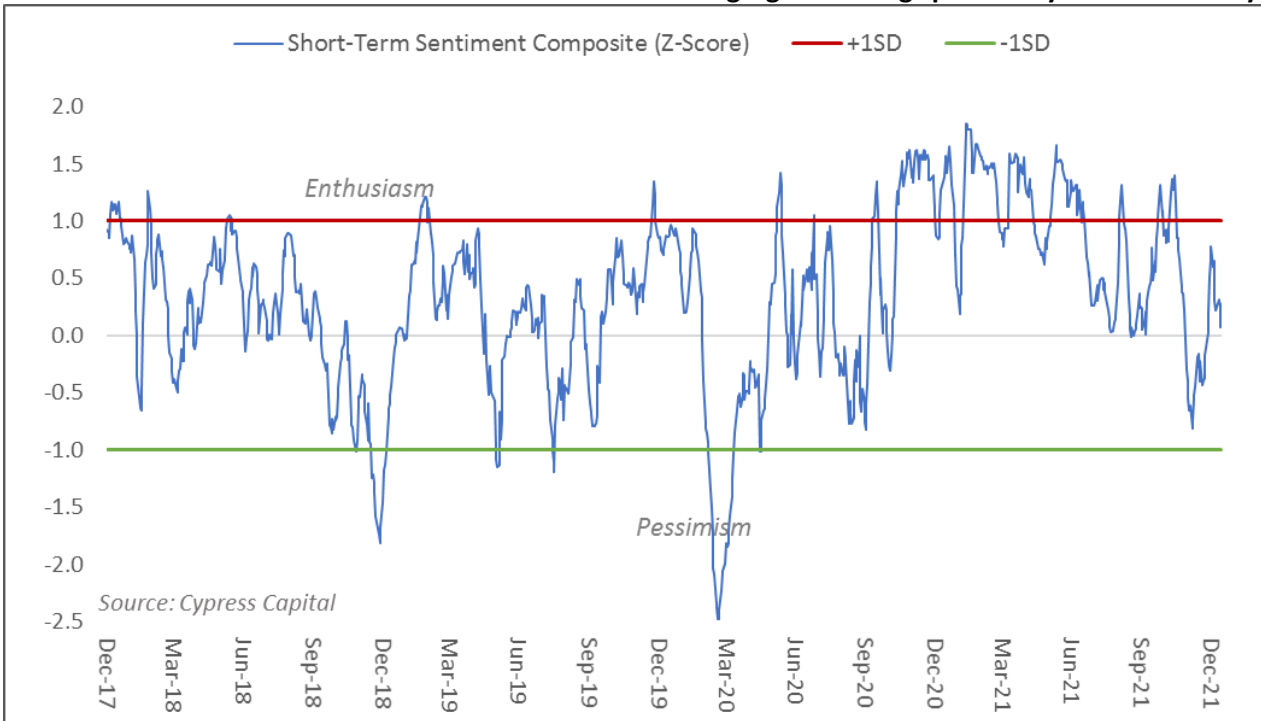
Produce Price Index inflation has peaked.



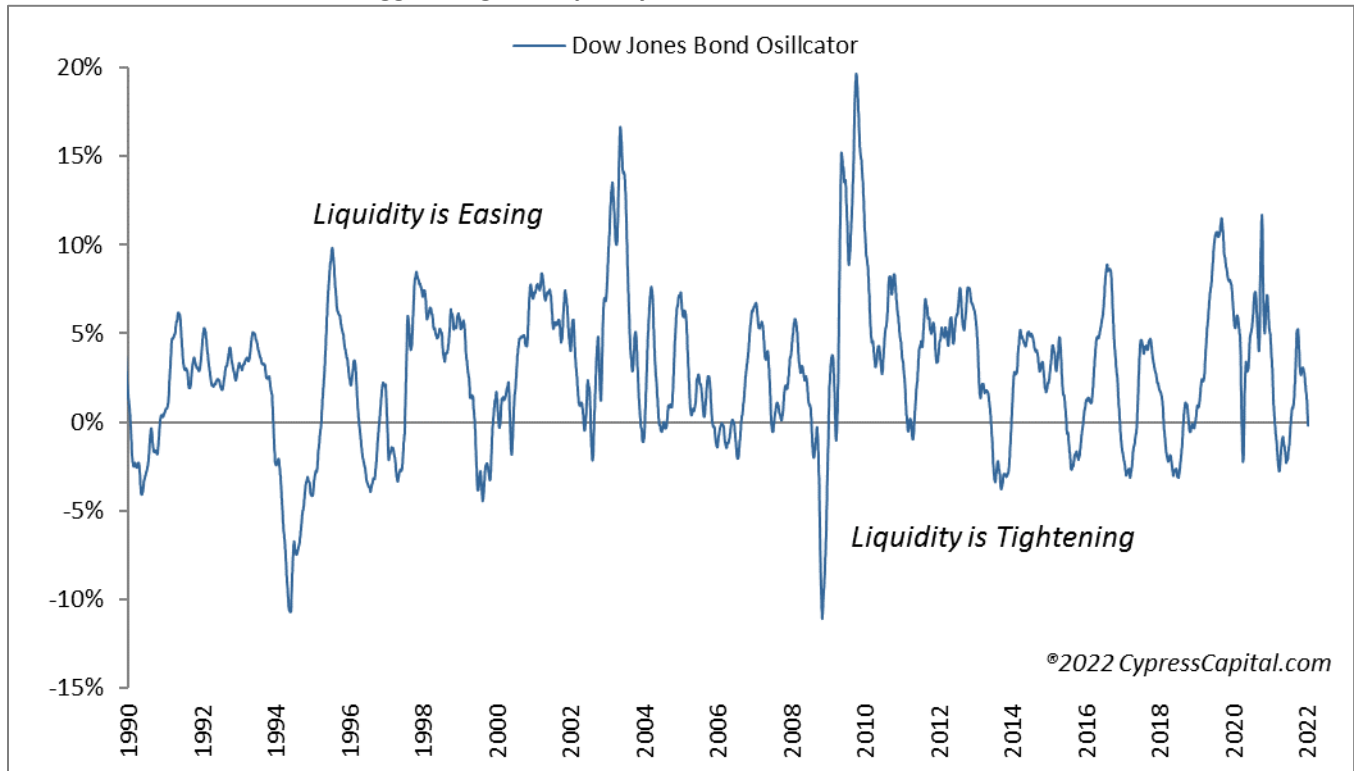
Equity Put/Call Ratio is still holding the Enthusiasm line, following the pattern of the late 90s.



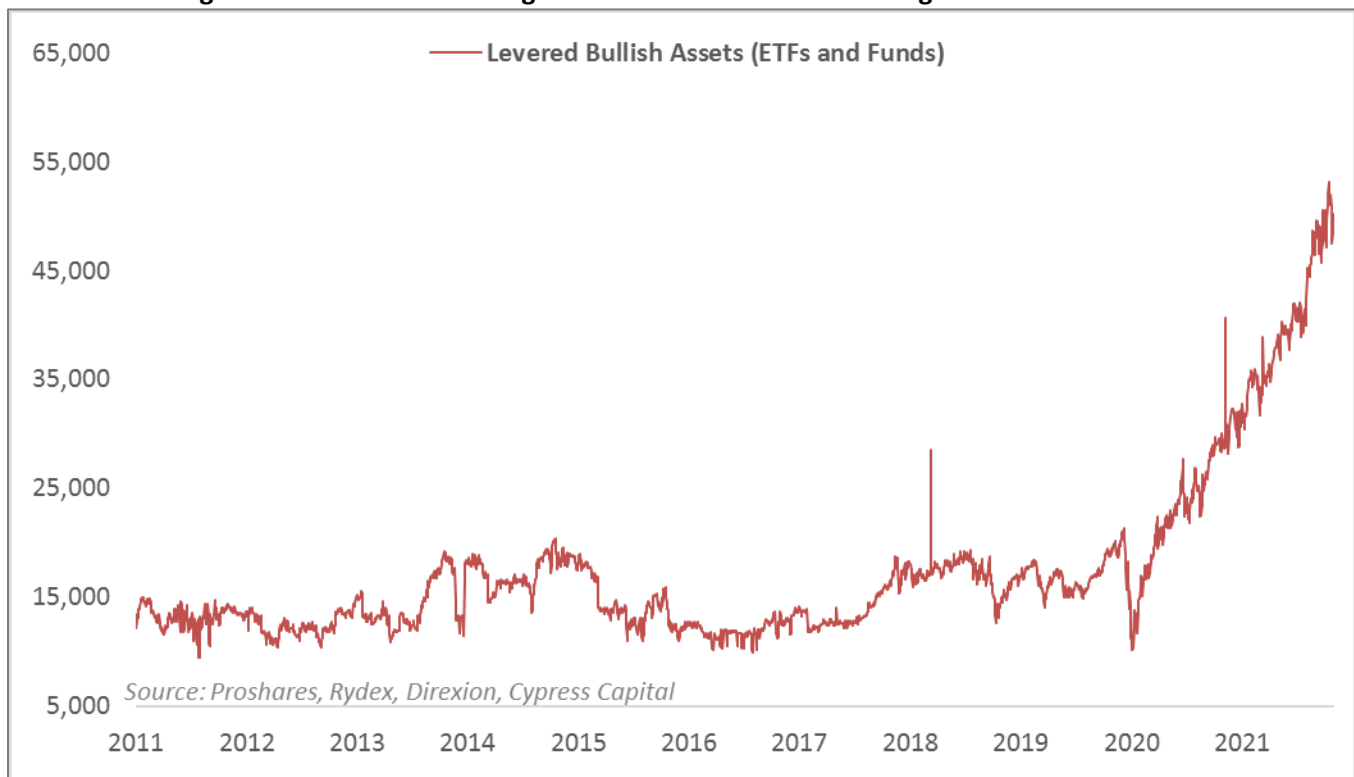
Short-Term Sentiment retreated to neutral but isn't showing signs of being spooked by recent volatility.



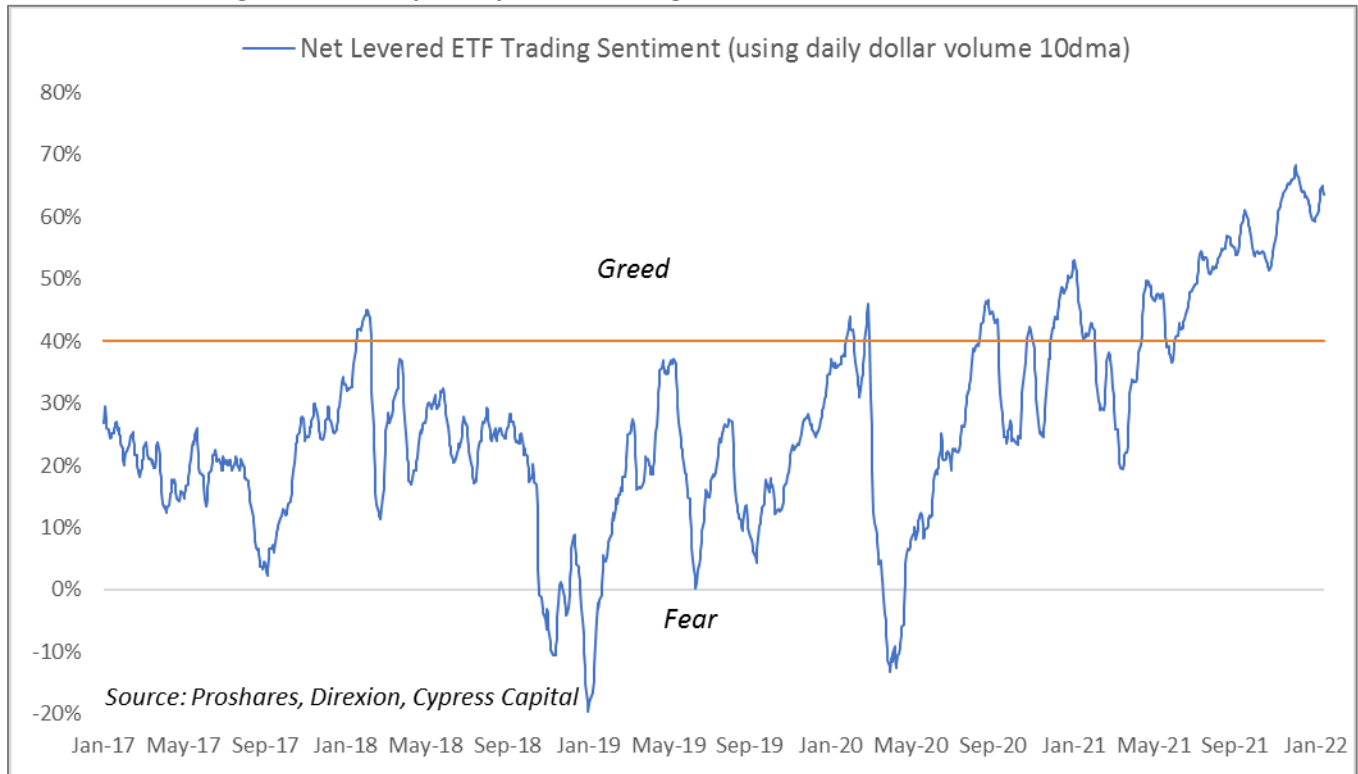
Down Jones Bond Oscillator suggests tighter liquidity conditions.



Assets in Leveraged ETFs have shown no signs of a break in their astonishing ascent.



Levered ETF Trading Sentiment is just shy of all-time highs.



Partisan Gap in Consumer Sentiment

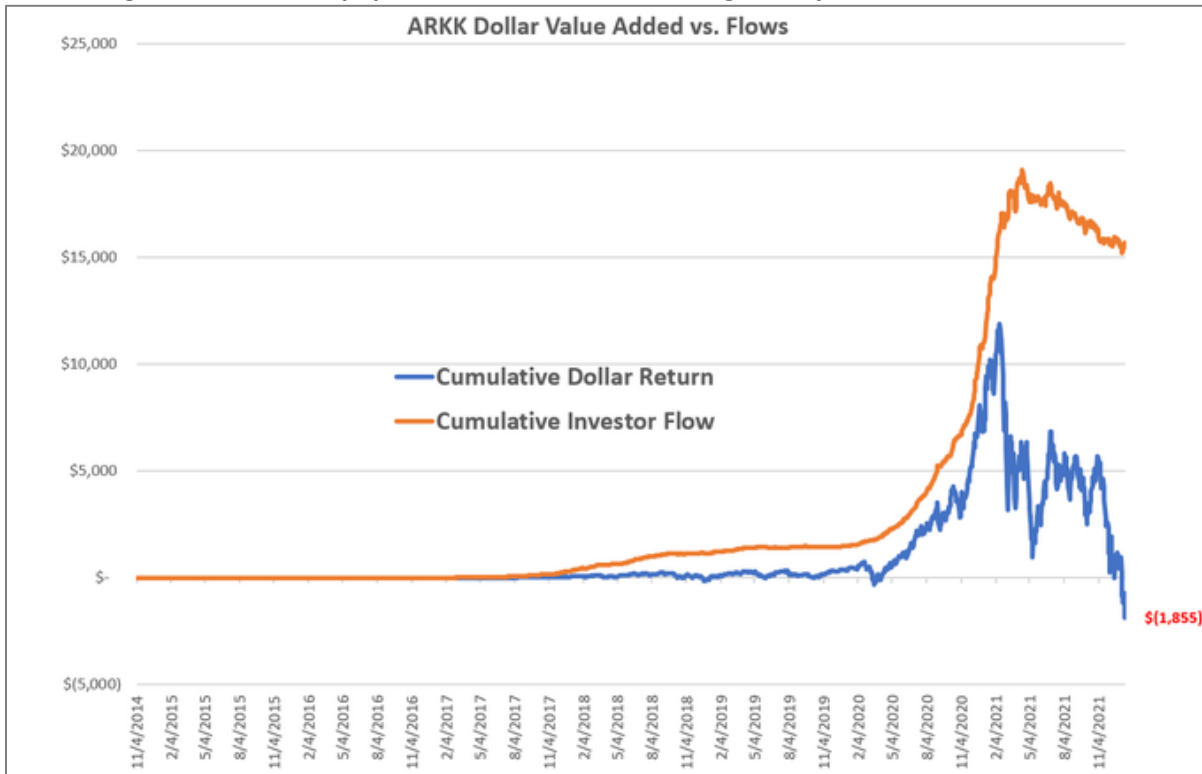
Consumer Sentiment has become a political enthusiasm survey. The average partisan gap doubled during Trump’s term and has remained there in Biden’s term.

Impact of Partisan Gap on Economic Expectations											
Index of Consumer Expectations	Economic News Heard	Year Ahead Outlook for Economy	Long Term Outlook for Economy	Assessment Economic Policies	Year Ahead Expectations						
					Personal Finances	Nominal Income	Real Income	Price Expectations	Unemployment Expectations	Interest Rate Expectations	
Partisan Gap (Democrat vs Republican)											
Bush	21.3	24	35	38	59	14	0.5	15	1.3	17	14
Obama	25.0	55	45	41	72	17	0.7	14	0.6	31	5
Trump	53.1	102	94	96	91	29	1.3	26	1.0	69	12
Biden	52.3	102	86	83	106	45	2.2	34	2.3	67	17
Income Gap (Top 20% vs Bottom 20%)											
Bush	10.3	29	0	28	17	15	3.0	42	1.3	4	24
Obama	10.4	8	10	20	6	13	1.8	34	1.1	12	3
Trump	11.3	6	19	17	23	11	2.2	46	0.9	10	1
Biden	11.9	8	21	29	6	1	1.8	33	0.9	23	9
Age Gap (35 or younger vs 65 or older)											
Bush	13.9	1	6	4	3	48	3.5	34	0.1	3	1
Obama	19.2	9	24	11	12	45	3.2	50	0.4	1	9
Trump	4.7	17	5	12	19	36	4.5	46	0.2	12	0
Biden	17.2	9	16	5	11	49	4.6	51	1.2	6	3
Memo: Absolute gap from the 5% to 95% of 528 time series observations											
1978-2021	46.3	96	97	59	71	35	4.5	34	5.4	59	83

Note: All variables are defined as “better minus worse plus 100” except for nominal income and price expectations which were defined as percentages. Table entries indicate the absolute value of the differences among the indicated subgroups within presidential administrations. Party affiliation was measured in fewer surveys in the Bush (4,526 cases) and Obama (11,860) administrations, and regularly for Trump (27,555) and Biden (6,648).

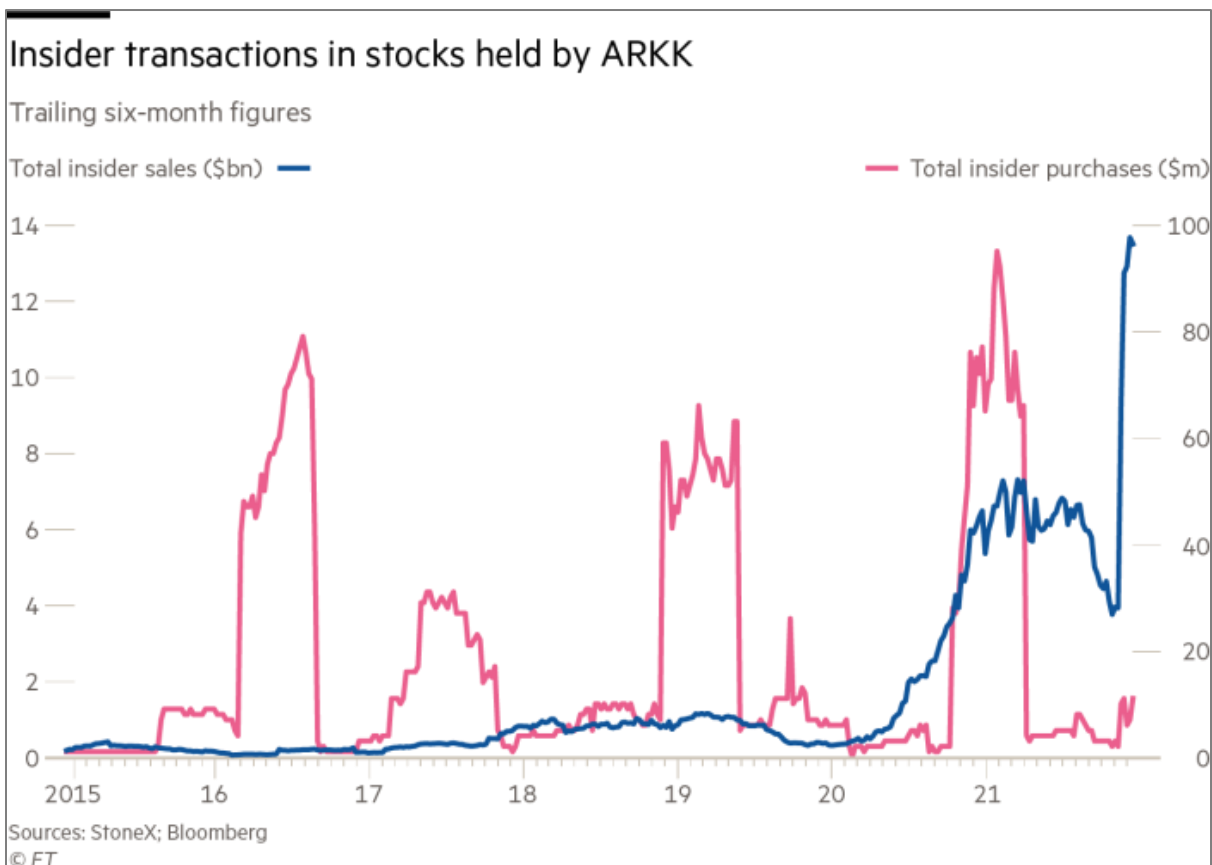
Source: Surveys of Consumers, University of Michigan

The average investor in the popular ARKK fund is now losing money.



Source: @Keubiko

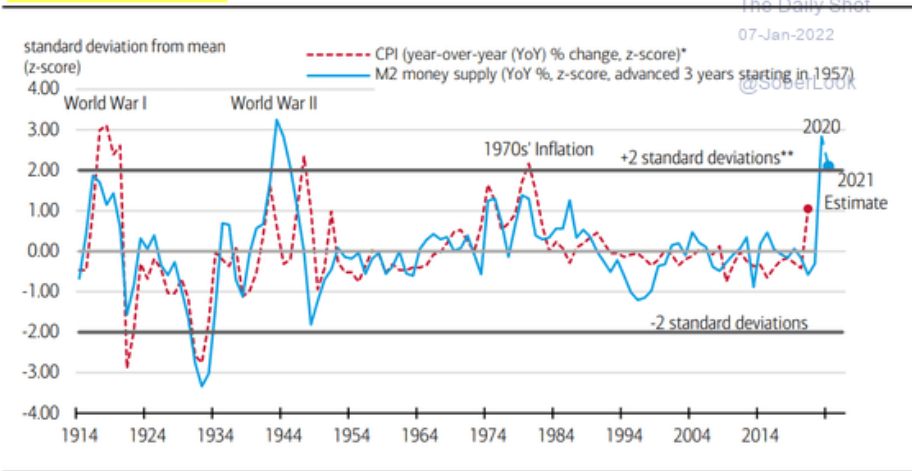
Meanwhile, corporate insiders in the stocks held by ARKK are selling shares at a rapid clip.



Sources: StoneX; Bloomberg
© FT

Average Money Supply Growth lead time implies peak inflation is still in the future.

Exhibit 1: Inflation Tends To Respond To Changes In Money Supply With A Lag Of Two to Three Years.

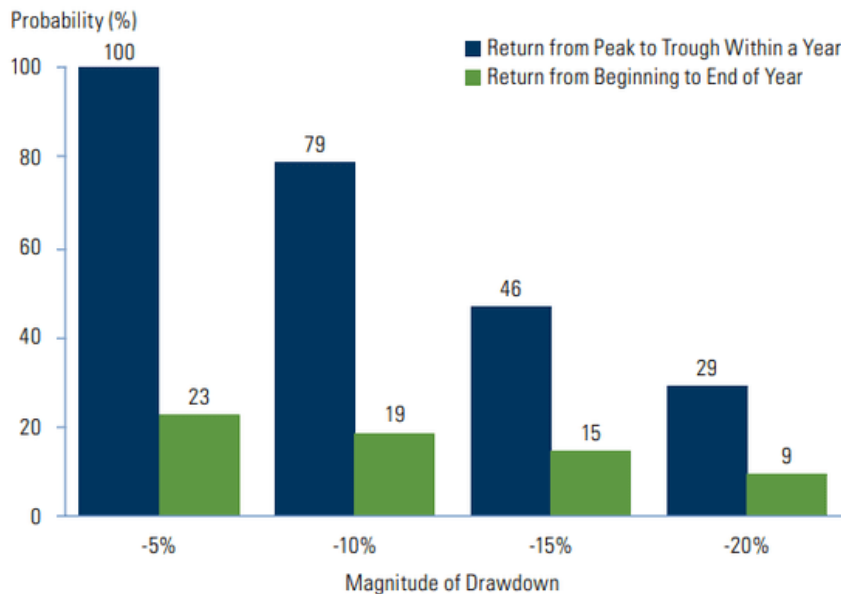


*Last data point shows the past six-month annualized rate for 2021. **Standard deviation is a measure that is used to quantify the amount of variation or dispersion of a set of data values. M2=a measure of money supply used by the various central banks. Z-score is a numerical measurement that describes a value's relationship to the mean of a group of values. Sources: Bureau of Labor Statistics; Fed Board/Haver Analytics. Data as of December 28, 2021.

High Valuations and One-Year Drawdown Probabilities

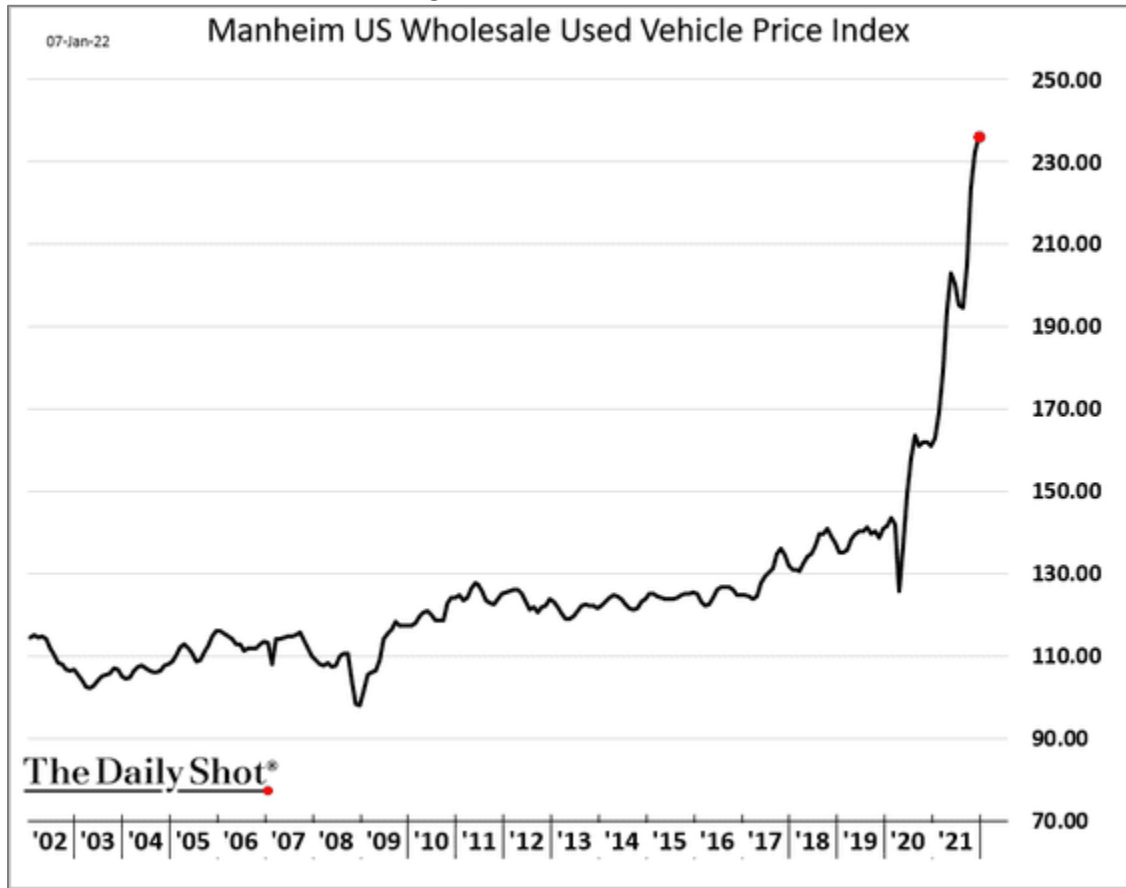
Exhibit 28: S&P 500 One-Year Drawdown Probability When Valuations Are High

The probability of a 5% correction at any point over the course of a year has been 100%.

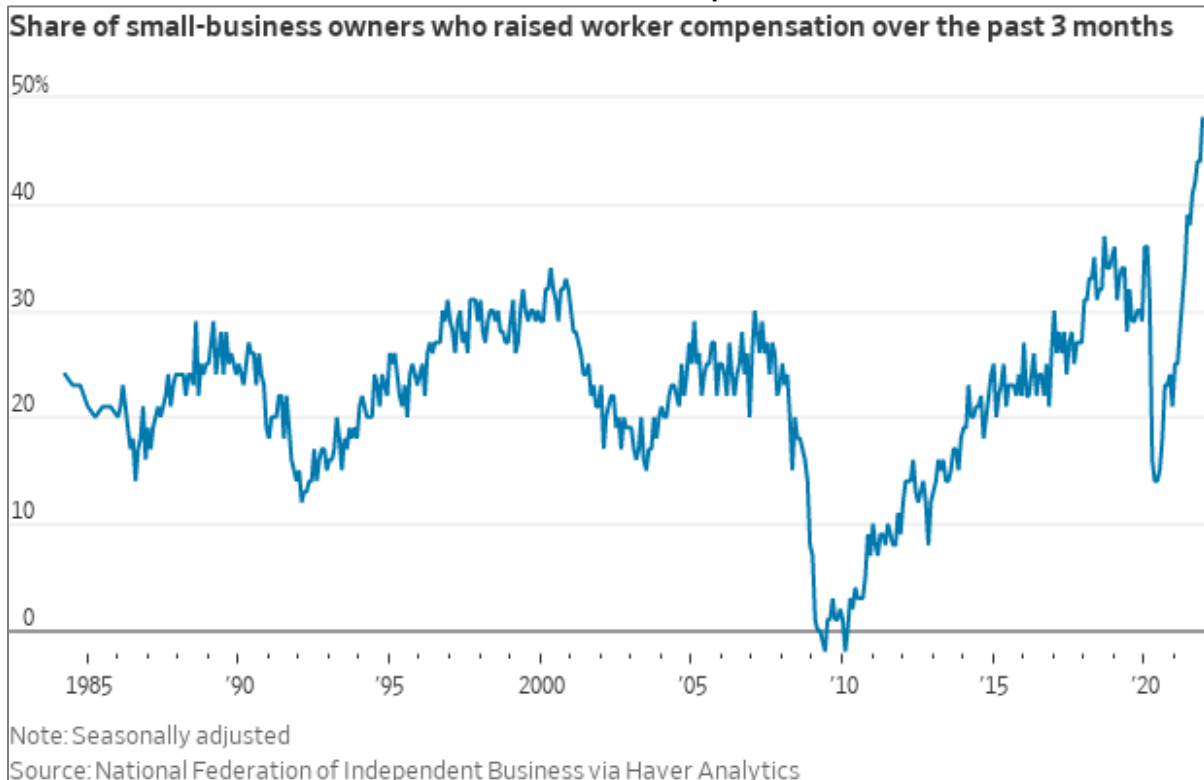


Data through December 31, 2021 - excluding 2017.
 Note: Conditional on US equity valuations being in the 9th or 10th deciles.
 Source: Investment Strategy Group, Bloomberg.

Used Car Prices set another new high.



Record share of small-business owners raised worker compensation.

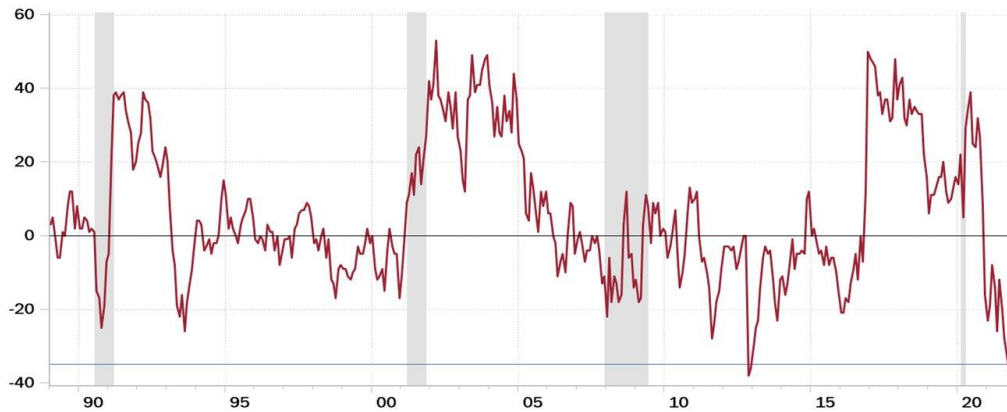


Source: WSJ

Small Businesses Confidence has fallen.

Share of Firms Expecting Economy to Improve

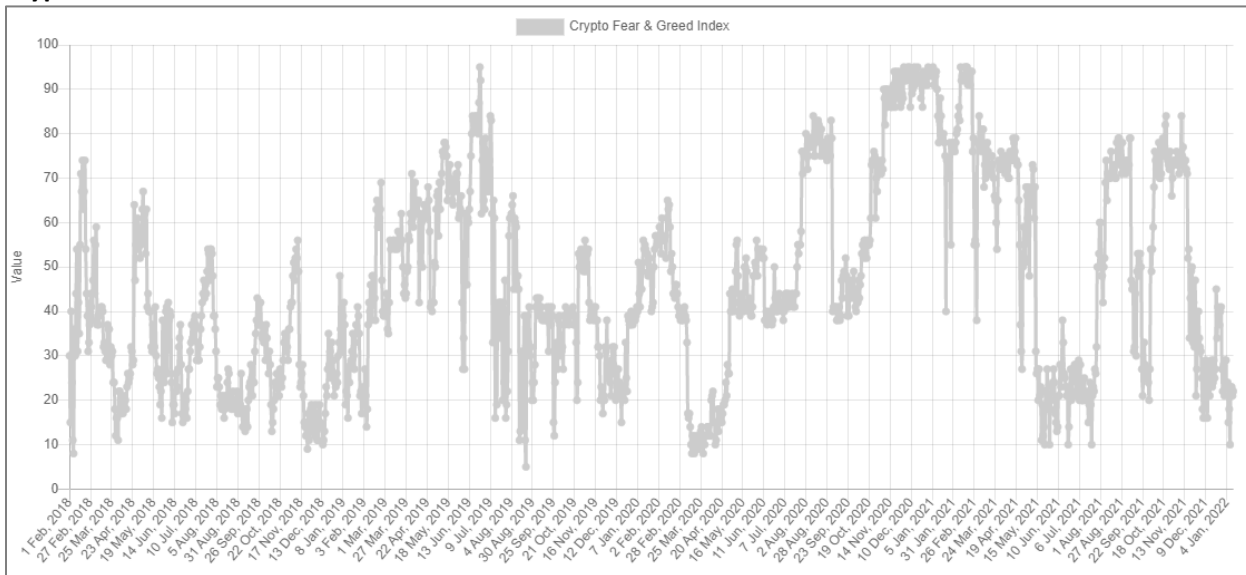
United States: NFIB Small Business Economic Trends
(percent)



Shading indicates recession

Source: Haver Analytics, Rosenberg Research

Crypto Fear & Greed Index hit extreme fear.

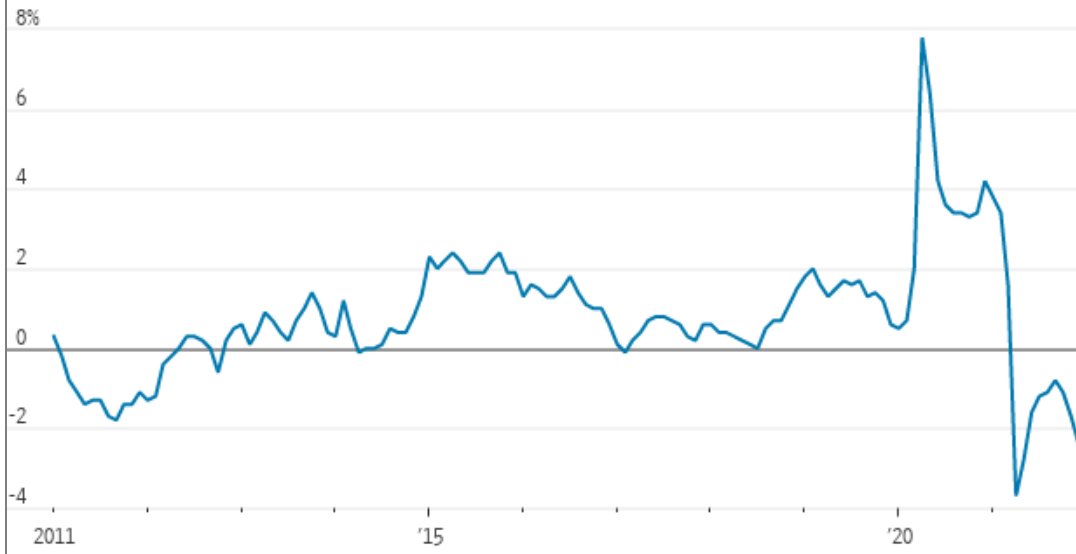


Source: Alternative.me

The initial inflation party has given way to a hangover as real wage growth turns negative.

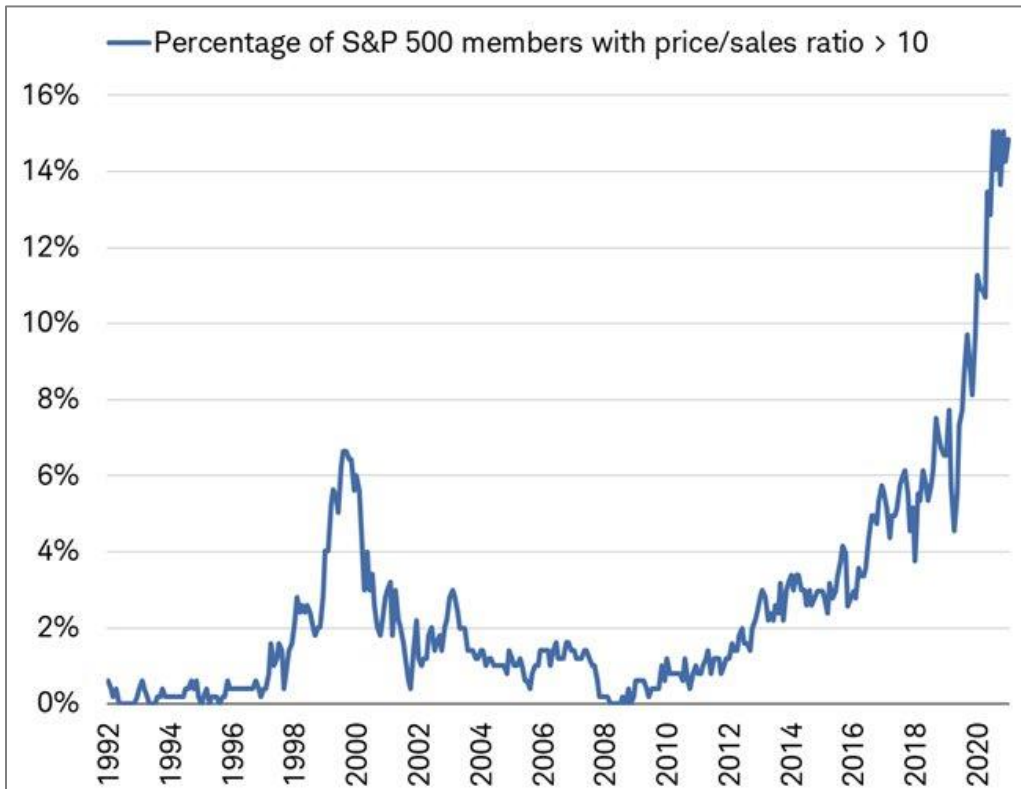
Nationwide, real hourly pay fell by 2.4% last month as rising prices outpaced wage increases.

U.S. inflation-adjusted average hourly earnings, 12-month change



Note: Seasonally adjusted
Source: Labor Department

Share of S&P 500 members with Price to Sales above 10 is more than twice the share achieved in 2000.



Source: Charles Schwab, Bloomberg, as of 12/31/2021.

Source: Liz Ann Sonders

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.

¹ <https://www.bloomberg.com/news/articles/2022-01-14/dimon-sees-as-many-as-seven-federal-reserve-rate-increases>