Market Outlook

By Mark T Dodson, CFA

Higher yields impact Monetary Composite

Market Risk Index increased to 90.7%. A slight improvement to Investor Psychology was insufficient to offset another sizeable increase in the Monetary Composite risk score.

The Interest Rates category of the Monetary composite moved close to its maximum negative score due to high rates of change on every key interest rate that we follow, with the single exception of the 90-day US Treasury Bill. Still, it's rare to see our Monetary composite score weaken to this degree without a coinciding yield curve inversion. While the 2Yr Treasury yield spike has caused the 10Yr – 2Yr version of the curve to shallow, it is nowhere close to levels with recessionary implications.

The only bear market in the post-WWII era not preceded by an inverted yield curve was Black Monday 1987. However, our monetary score of the 1987 period was worse than today, with readings reaching the worst decile from July to October. The critical difference between this period and that being we have decidedly better velocity in this current period – thanks to the advent of quantitative easing.

Investor psychology has become a mix of sketchy market internals and investors who say they are nervous in surveys but are overexposed and over-levered when you look at their account statements. The NYSE High Low Logic index reading worsened from its sell signal two weeks ago, indicating a bad breadth market that has grown more split. Our Short-Term Sentiment composite is in retreat, but corrections like this tend not to end without at least a one standard deviation move into pessimism territory.

The AAII Sentiment Survey is signaling growing investor anxiety. As for how money is actually being invested, there has been only a minor retreat from the all-time highs in leveraged plays on the market – from options markets to levered ETFs to margin debt. Additionally, corporate insiders aren't buying this dip, while the army of Covid-era stimmy retail investors still are. In a recent Investing.com survey[i], 86% of individual investors who began investing last year plan to increase their stock holdings this year, and 84% of them expect stocks to rise.

We made no changes to allocations, and the model's current recommendation is a 25% underweighting to strategic weights for risk assets.

Market Risk Index

Rec Allocation 25% Underweight

90.7%

Category Percentiles

Psychology - P6: 94.2%

Monetary - M4: 72.8%

Valuation - Extremely Overvalued: 99.3%

Trend: 24.6%

Largest Psychology Influences

Levered Investments	Negative
Technical Indicators	Negative
Volatility	Negative
Option Activity	Positive

Largest Monetary Influences

Inflation	Negative
Interest Rates	Negative
Velocity	Positive

Valuation

7-10 Year Rtn Forecast	0.2%
10Yr US Treasury Yield	1.8%

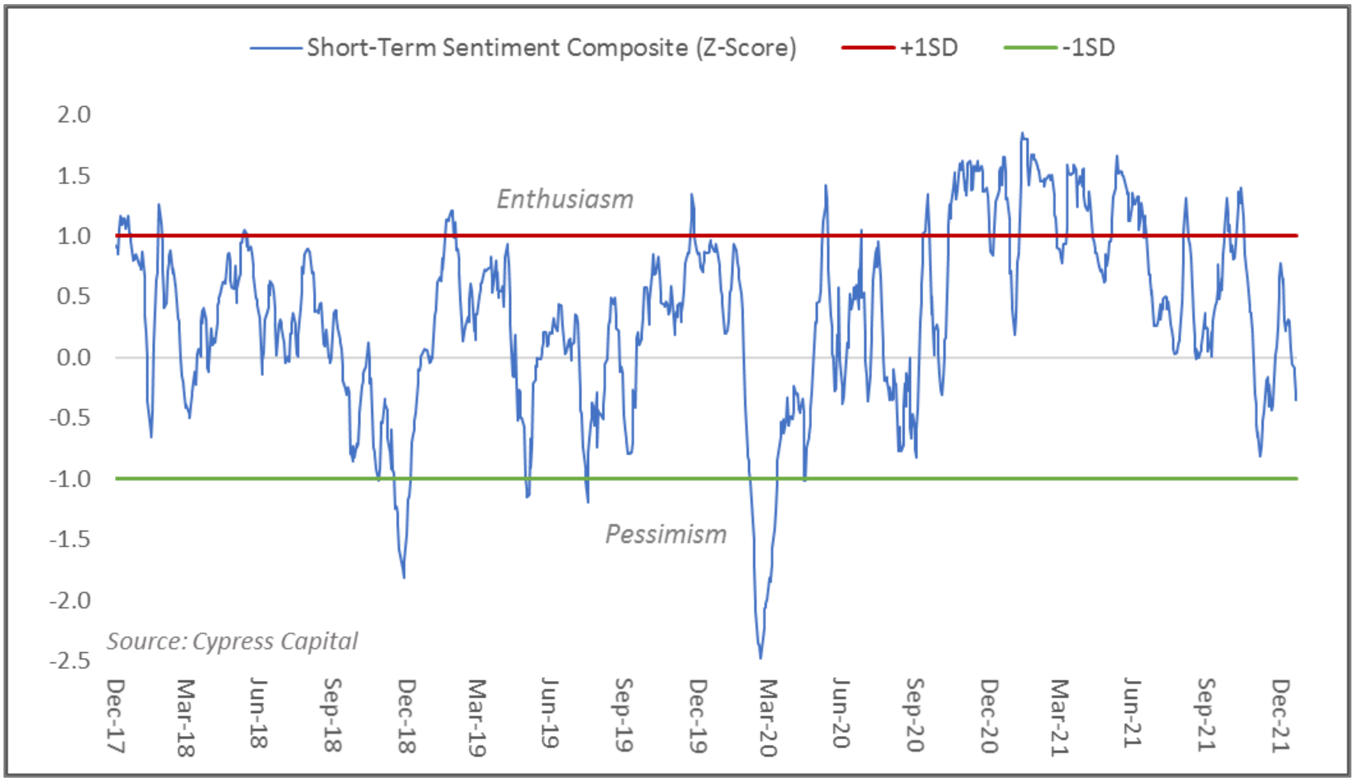
Market Trends

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

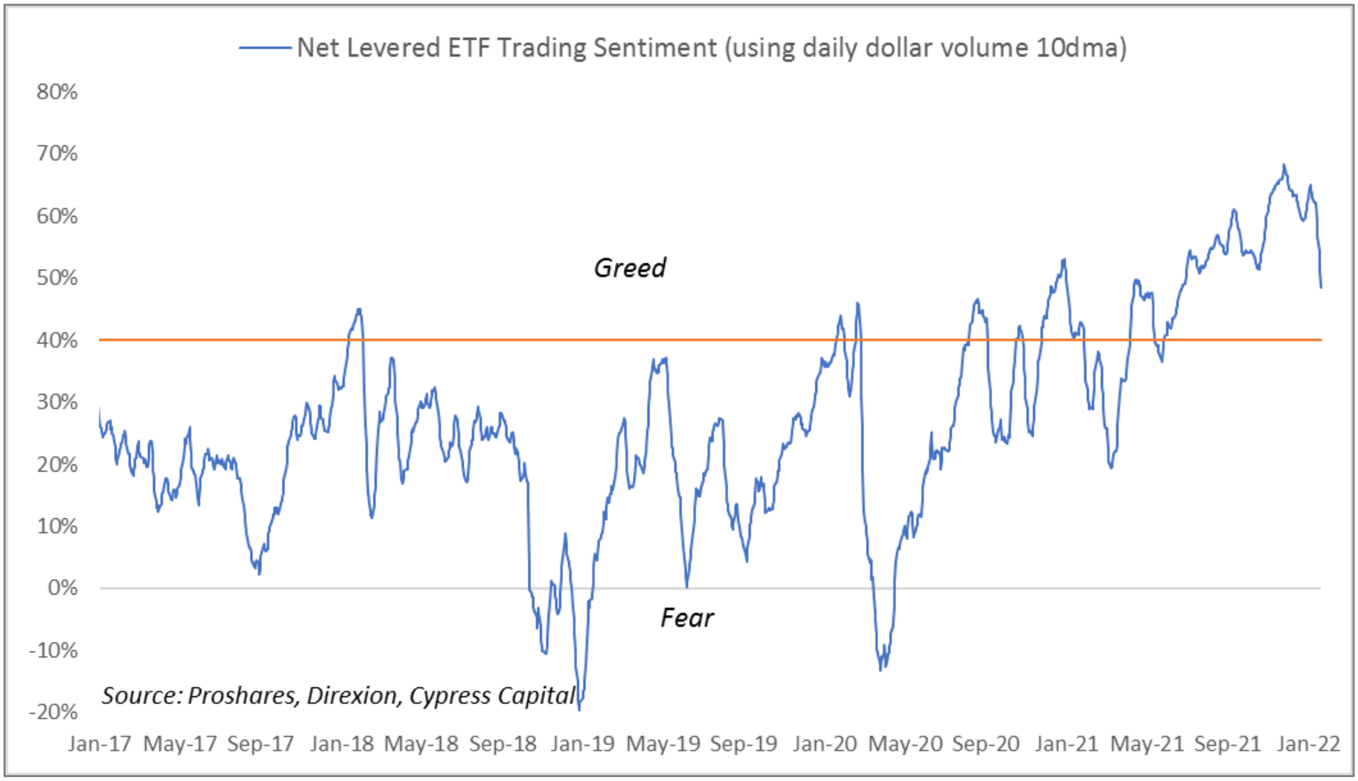
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

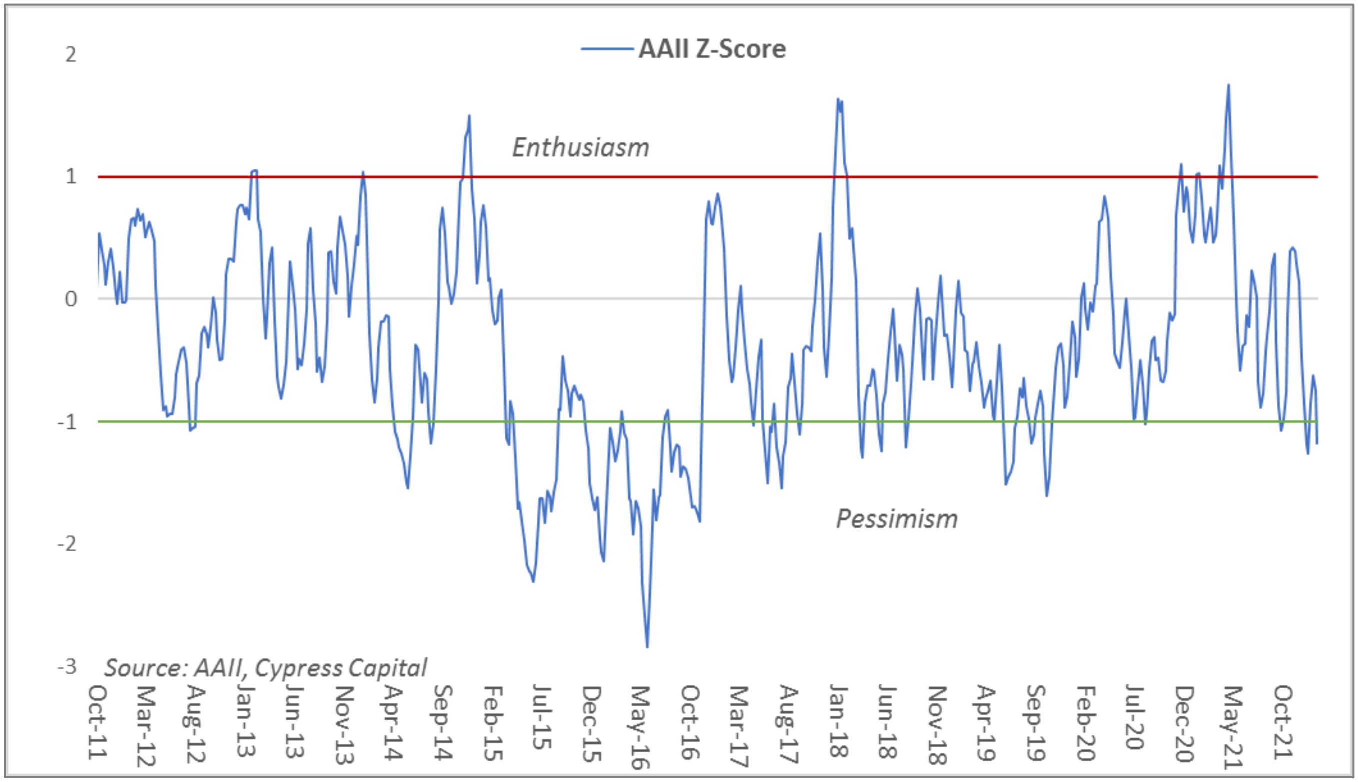
Short-Term Sentiment Composite – no wall of worry here



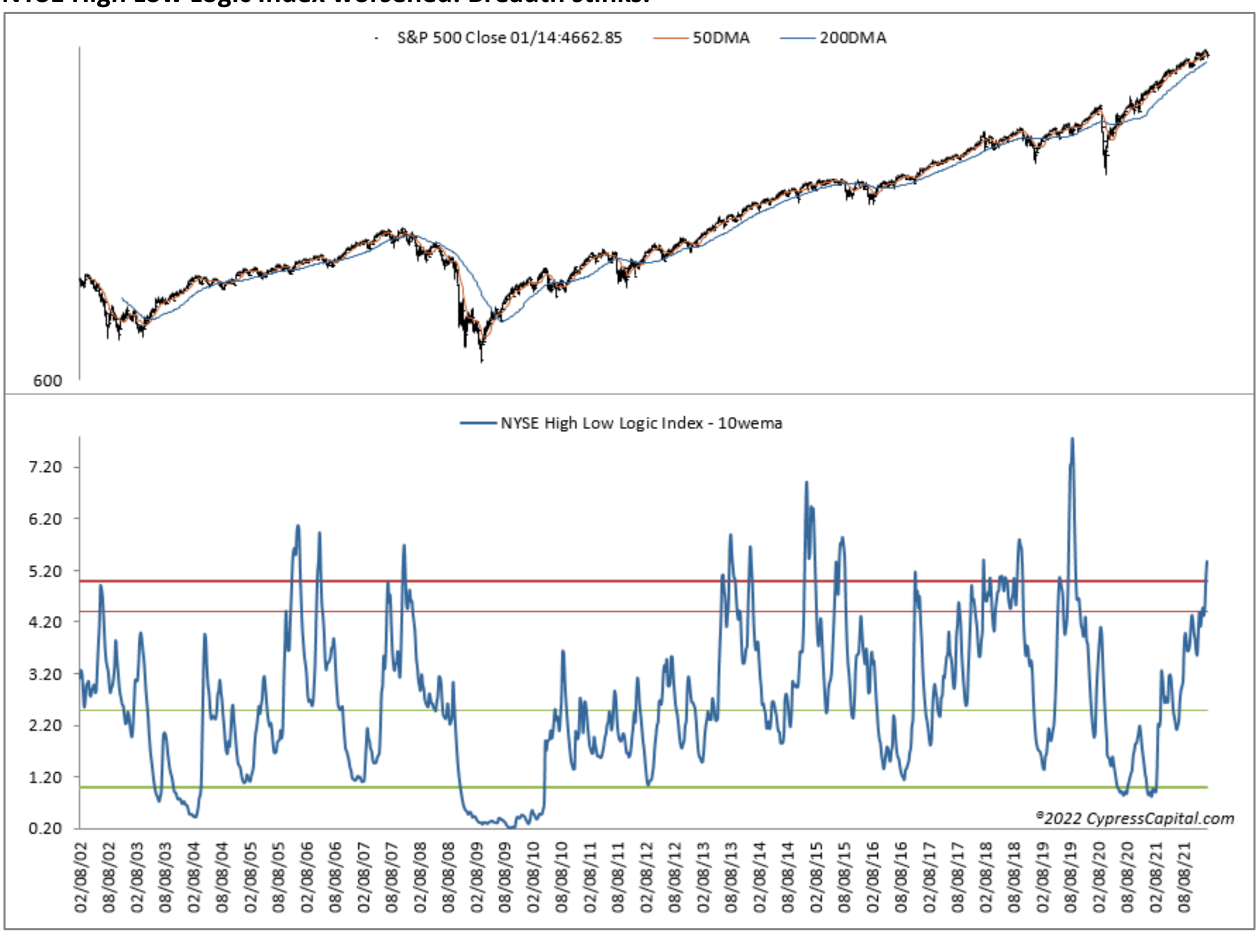
Levered ETF Trading Sentiment has taken a dive from the speculative peak in early January.



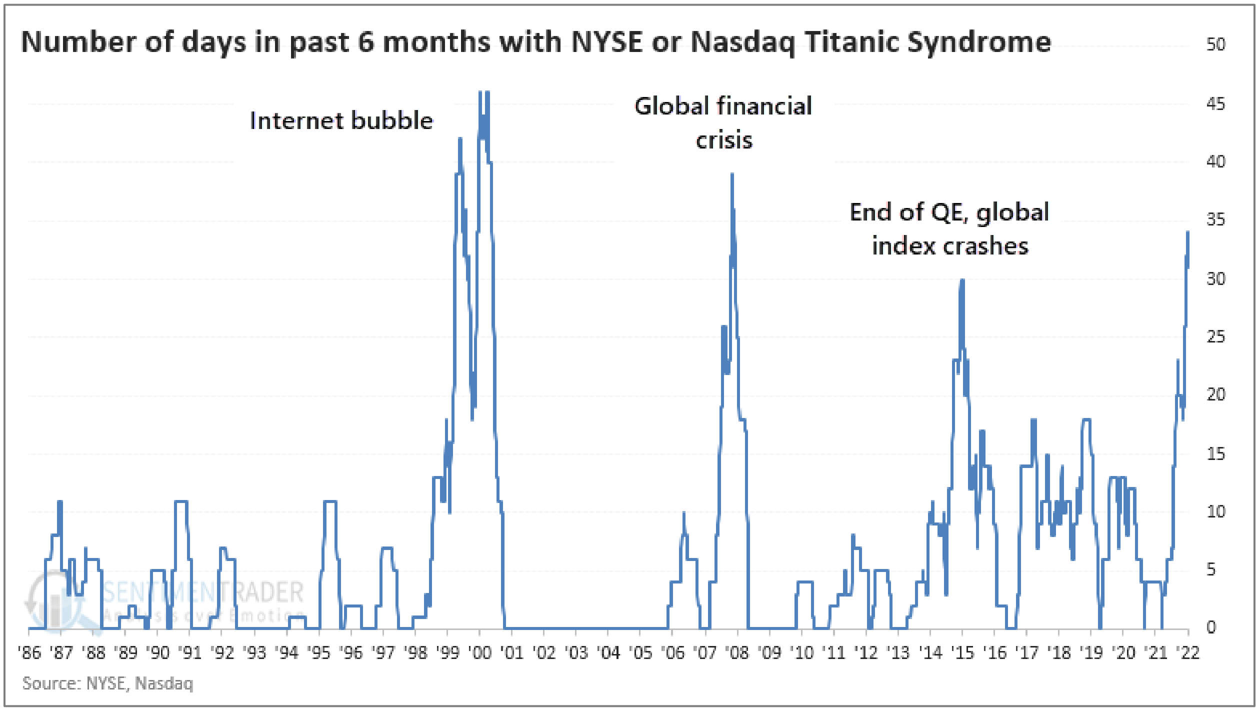
AAII Investor Survey crossed back into the Pessmism zone.



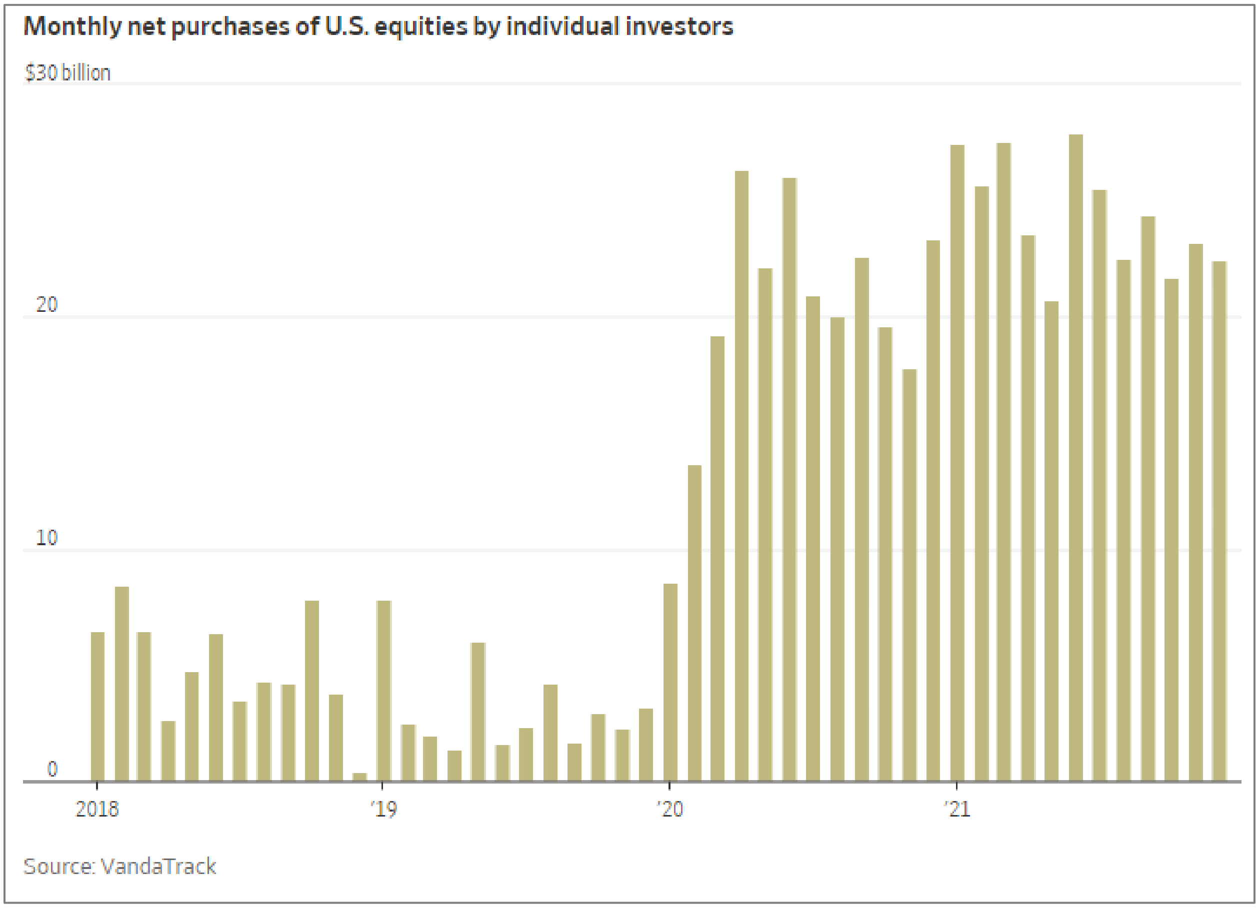
NYSE High Low Logic Index worsened. Breadth stinks.



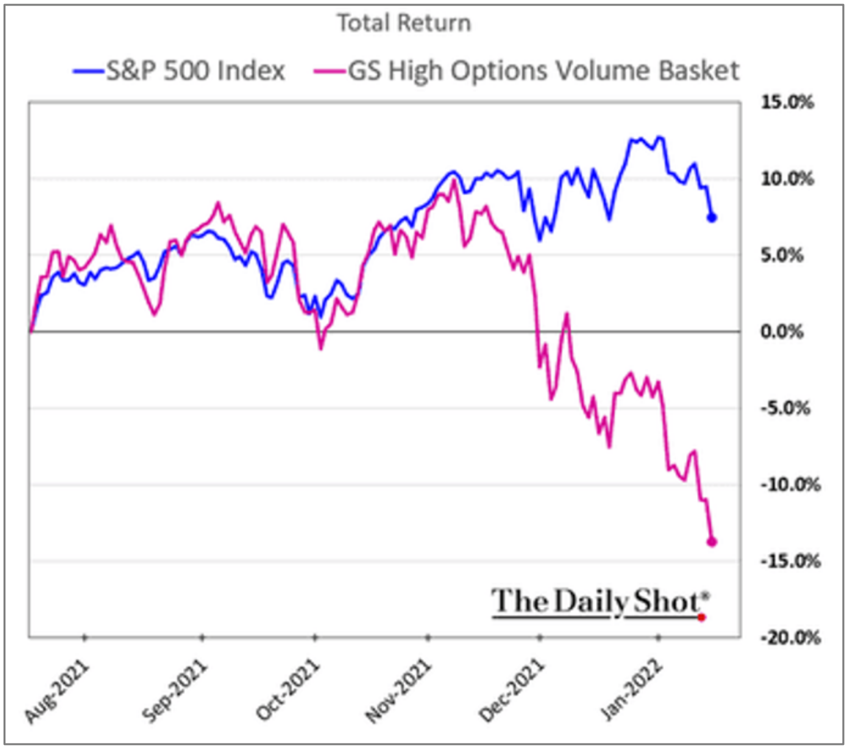
The largest cluster of NASDAQ Titanic Syndrome signals since 2007



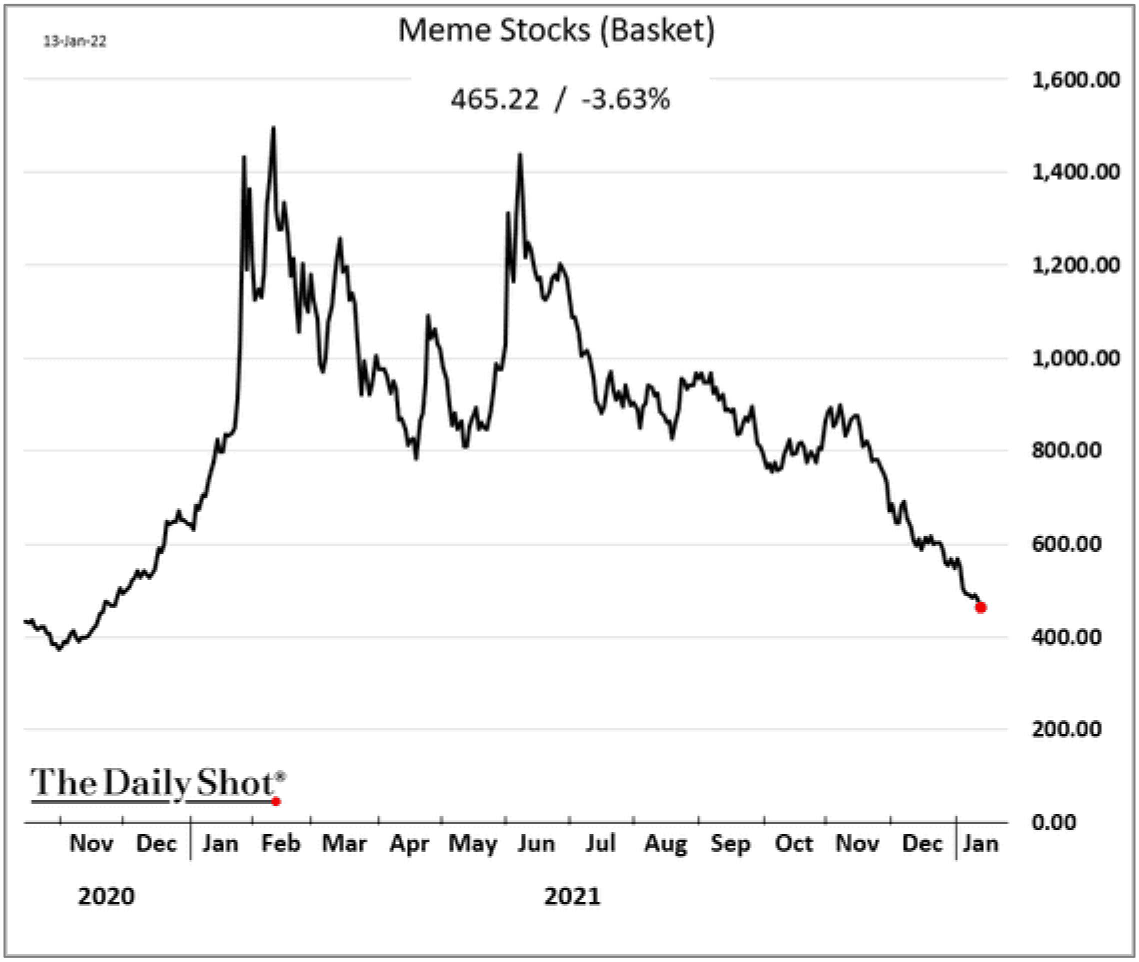
Covid-era retail investor equity buying persists.



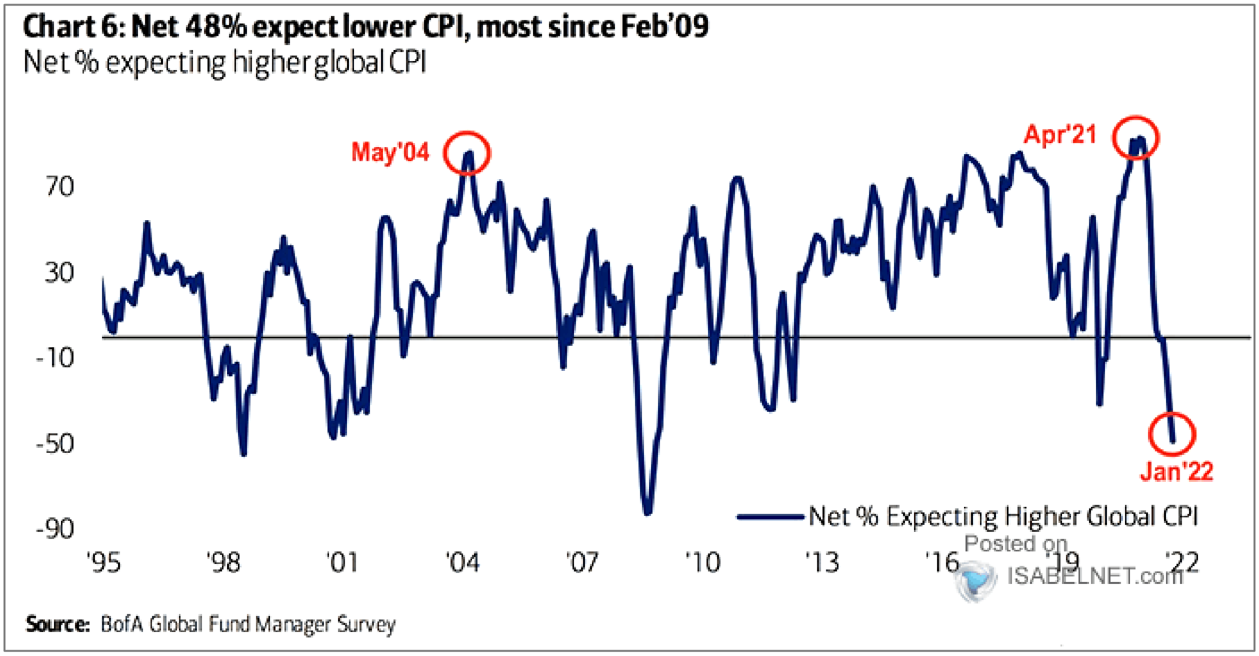
Retail traders favorite stocks are being hit the hardest.



Meme Stocks have fallen more than 65% from their highs.

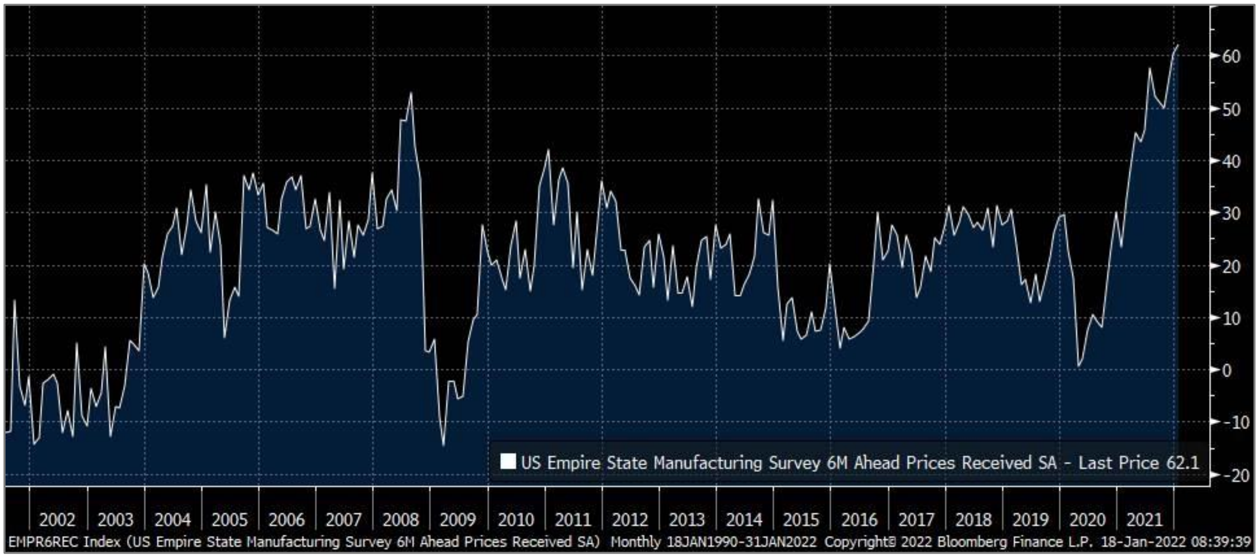


Majority of investors think inflation has peaked.



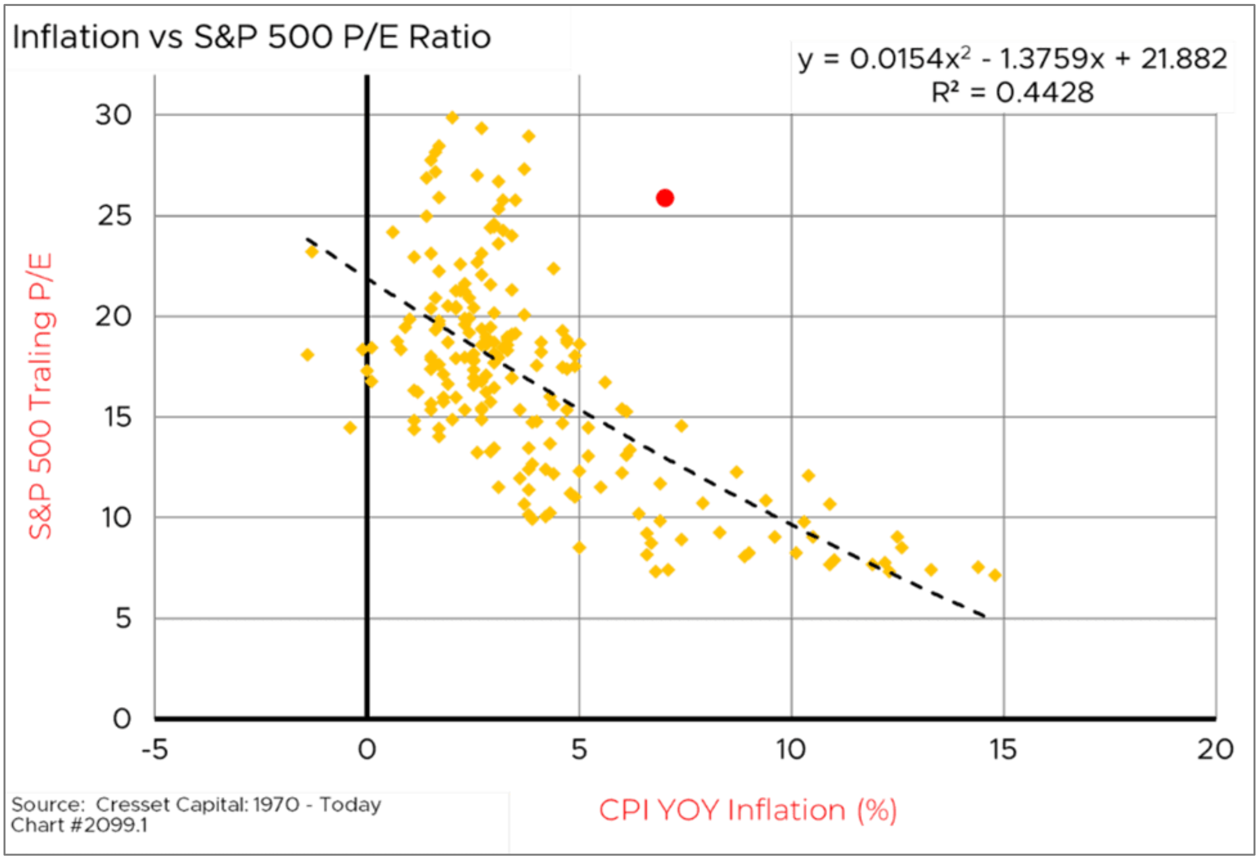
Yet, the number of waiting container ships set a new record.

And, Empire State Survey revealed an all-time record pricing forecast.

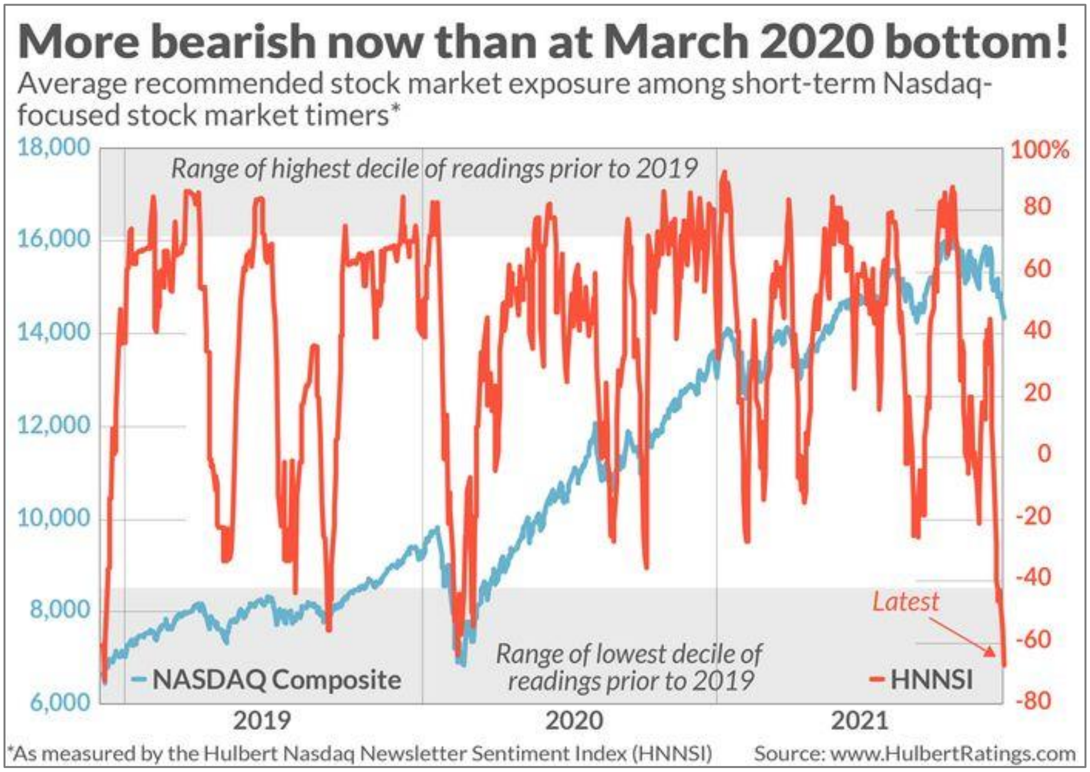


Source: Richard Bernstein Advisors

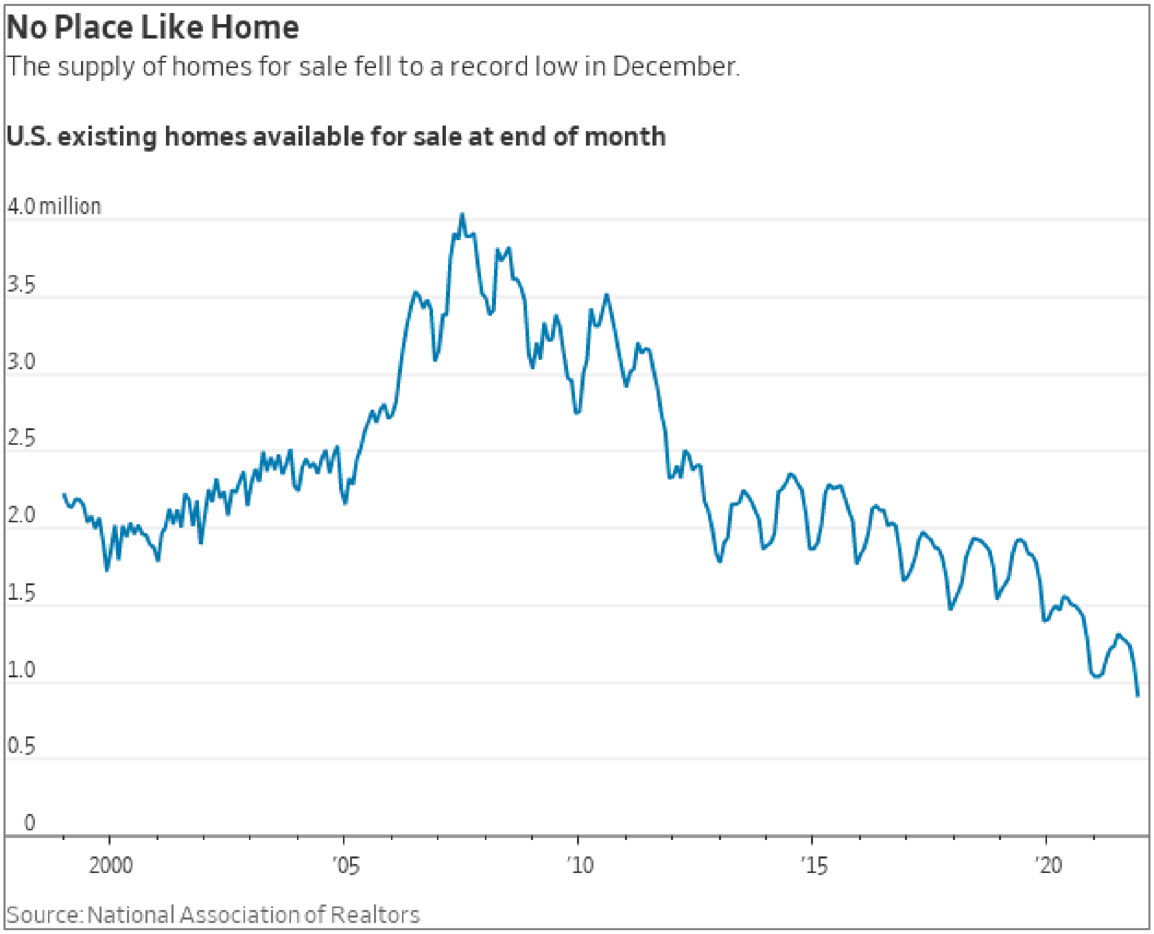
Most recent Valuation vs Inflation print is an outlier.



Hulbert Nasdaq Newsletter Sentiment is in the lowest decile of readings.

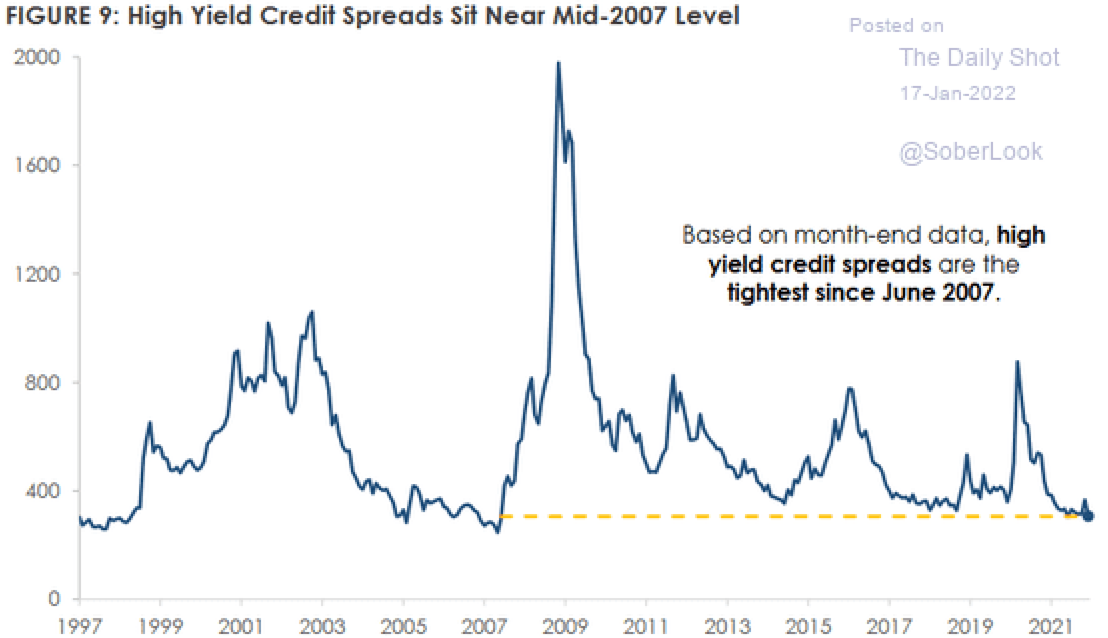


US inventory of existing homes for sale fell to a record low.



High Yield credit spreads are the tightest since 2007.

FIGURE 9: High Yield Credit Spreads Sit Near Mid-2007 Level



Source: MarketDesk. Data represents option adjusted spread of ICE BofA U.S. High Yield Index.

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.

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[i] https://www.cnbc.com/2022/01/19/most-of-last-years-new-investors-plan-to-buy-more-stocks-in-2022.html