Cypress CAPITAL

Market Outlook

By Mark T Dodson, CFA

PPI is flying too high.

Market Risk Index was unable to move under 90%, a threshold breached near the start of the year and associated with an poor risk-reward set up for investing too heavily in risk assets.

Psychology improved modestly. The Investors Intelligence survey showed advisors are growing more bearish. While not at the threshold that marks significant market bottoms, it's good enough to help move the needle further on the Surveys category of the Psychology composite, nudging that risk score a bit lower for the week.

A higher Monetary composite risk score offset psychology's improvements. Anxiety around markets is building as liquidity is growing tighter. Investor angst can create short-term trading opportunities, but the best risk-reward setups come when liquidity improves as investors grow risk-averse – in other words, seeing better scores for both the Monetary and Psychology composites at the same time.

Unfortunately, this week's Producer Price Index release didn't help the Monetary composite. The six-month rate of Producer Price inflation has rolled over, but the inflation rate is still north of five percent. That's associated with falling stock prices.

S&P 500 Price Performance & PPI Inflation	
PPI Above 5%	-2.3%
Between 0 and 5%	8.5%
PPI Less than 0%	4.3%

Jan 1930 to Present

The same goes for ISM released earlier in the month – the ISM New Orders index is slowing faster than the ISM Price index, which edges the economy closer to what can be described as an inflationary bust, also associated with falling stock prices. Given the level of inflation, markets still have too much confidence in the ability of the Federal Reserve to solve the problem. Alleviating inflation pressure without hitting stock prices or economic growth is a bit like fitting the proverbial camel through the eye of a needle – both take divine intervention.

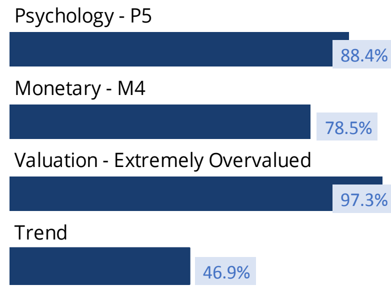
High inflation can also tie the Fed's hands in market panics – a fly in the ointment for those who take excessive risks by relying on the Fed put. For example, inflation made navigating the housing crisis in 2008 considerably more difficult. PPI continued accelerating in 2008 and didn't peak until July at 13.5%, well after it was clear that the economy was in recession.

Market Risk Index

Rec Allocation 25% Underweight

90.3%

Category Percentiles



Largest Psychology Influences

Levered Investments	Negative
Volatility	Negative
Surveys	Positive
Flow of Funds	Negative

Largest Monetary Influences

Inflation	Negative
Velocity	Positive
Interest Rates	Negative

Valuation

7-10 Year Rtn Forecast	0.9%
10Yr US Treasury Yield	2.0%

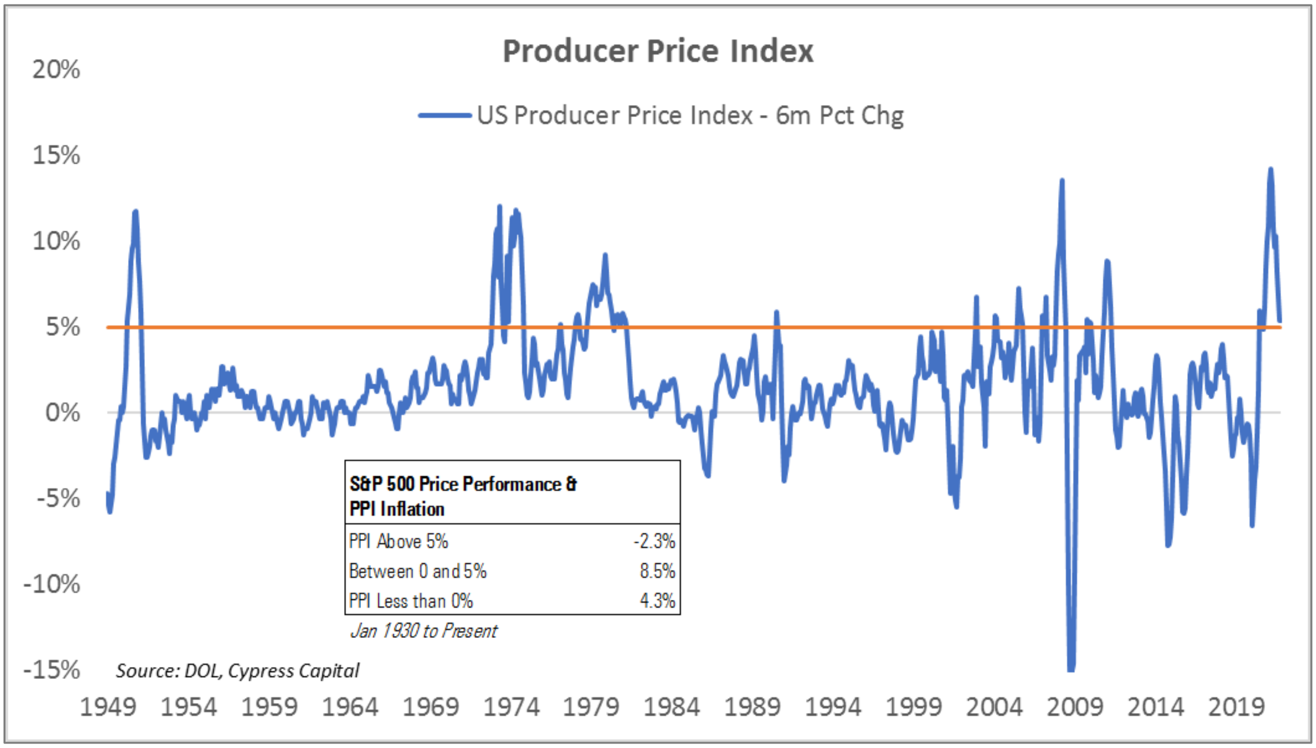
Market Trends

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

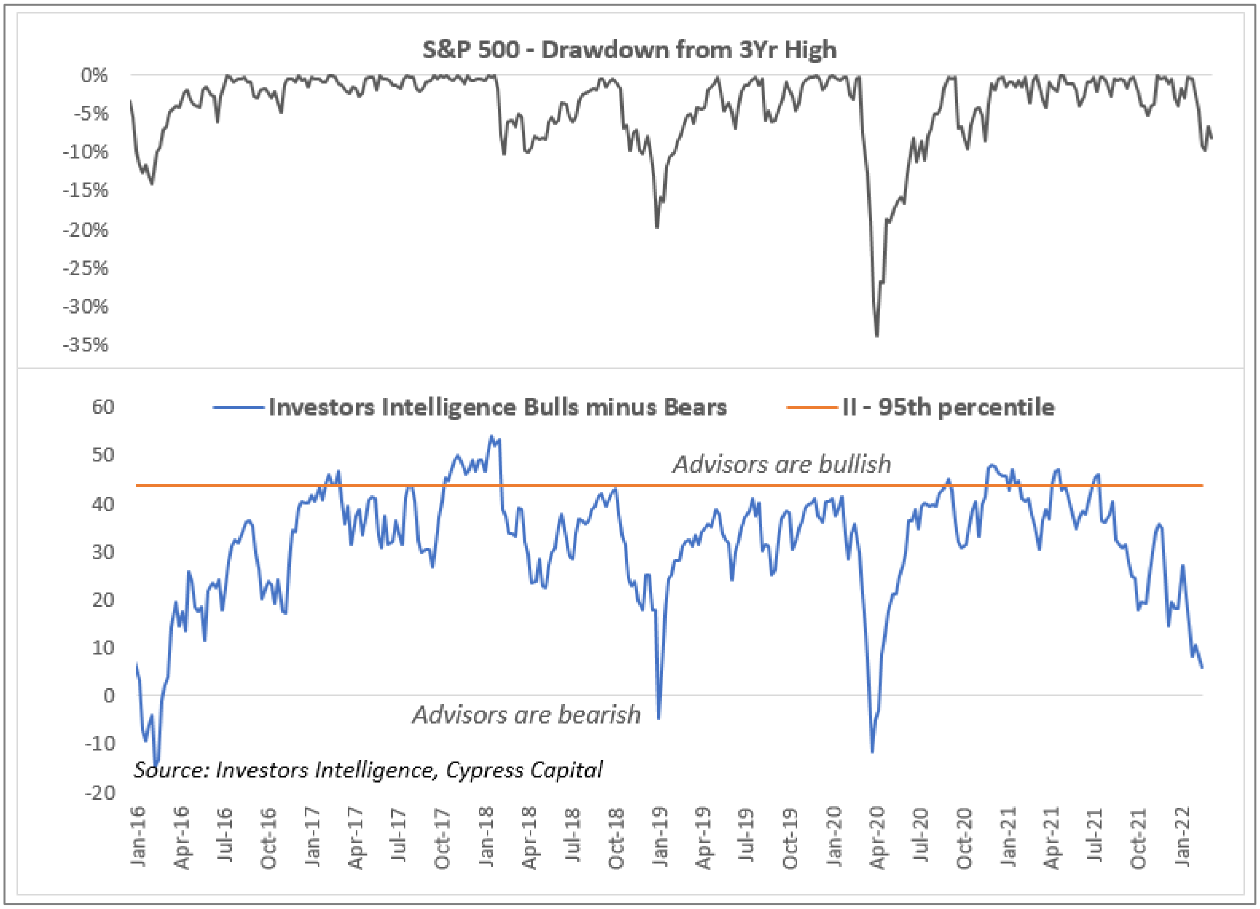
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

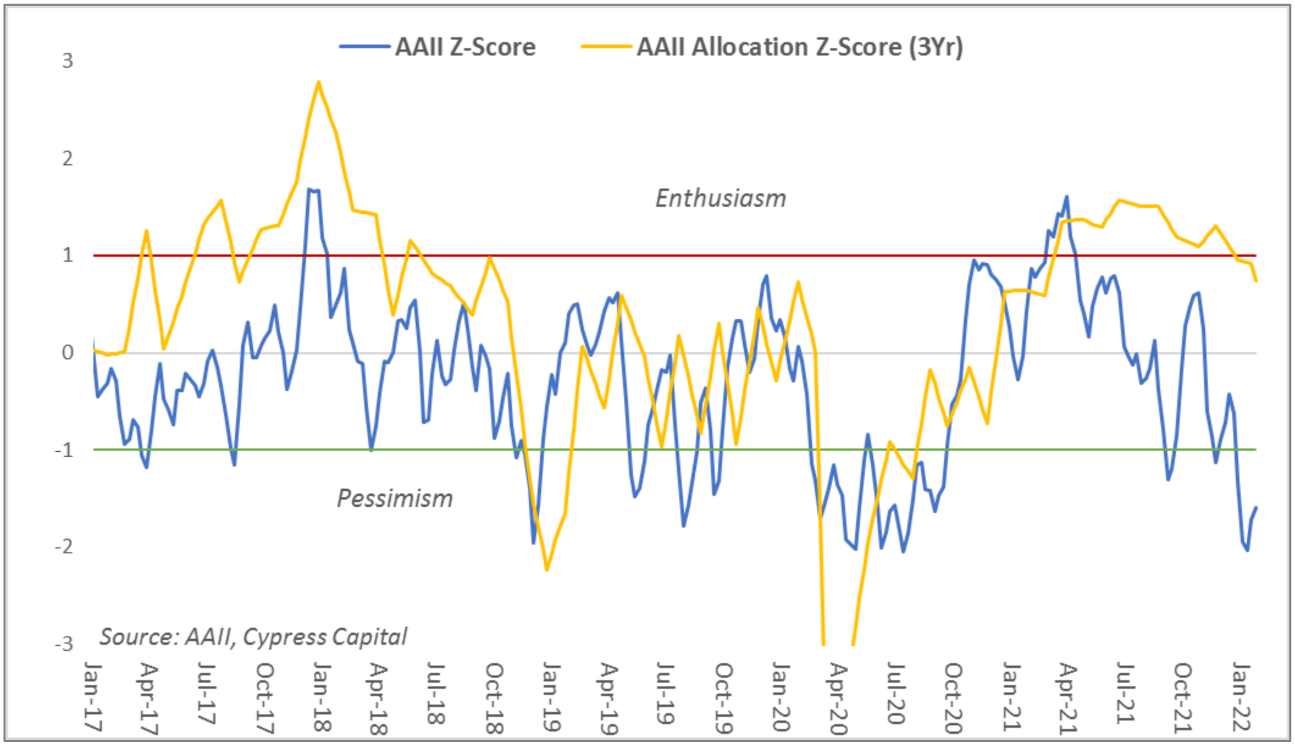
Produce Price Index – Six month rate of change has peaked.



Investor's Intelligence improved, helping the Psychology composite.

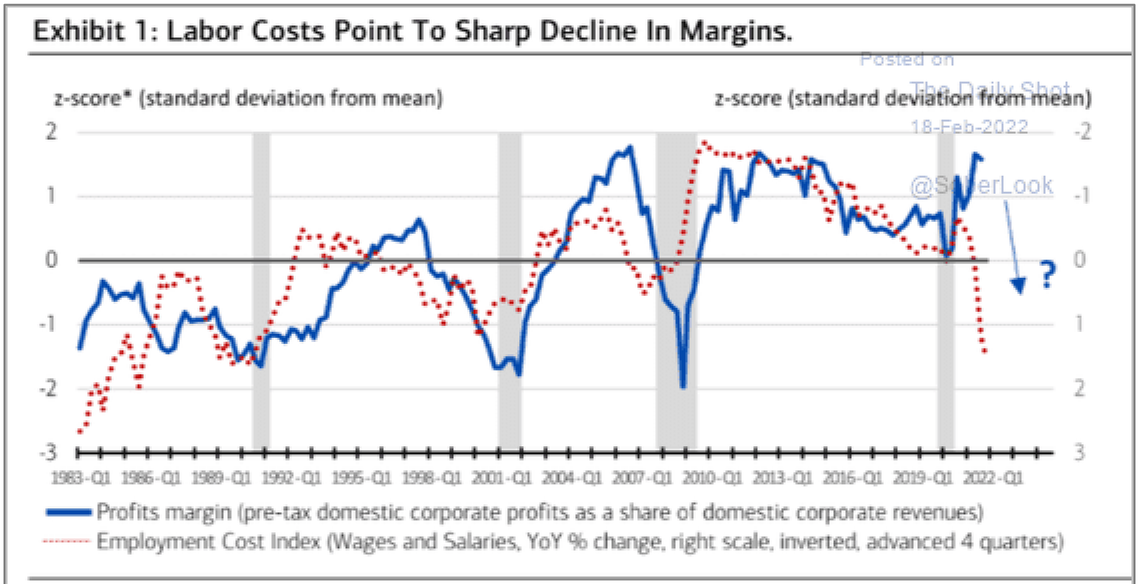


AAII members are not walking the talk. There's a wide gap between risk allocations and survey responses.



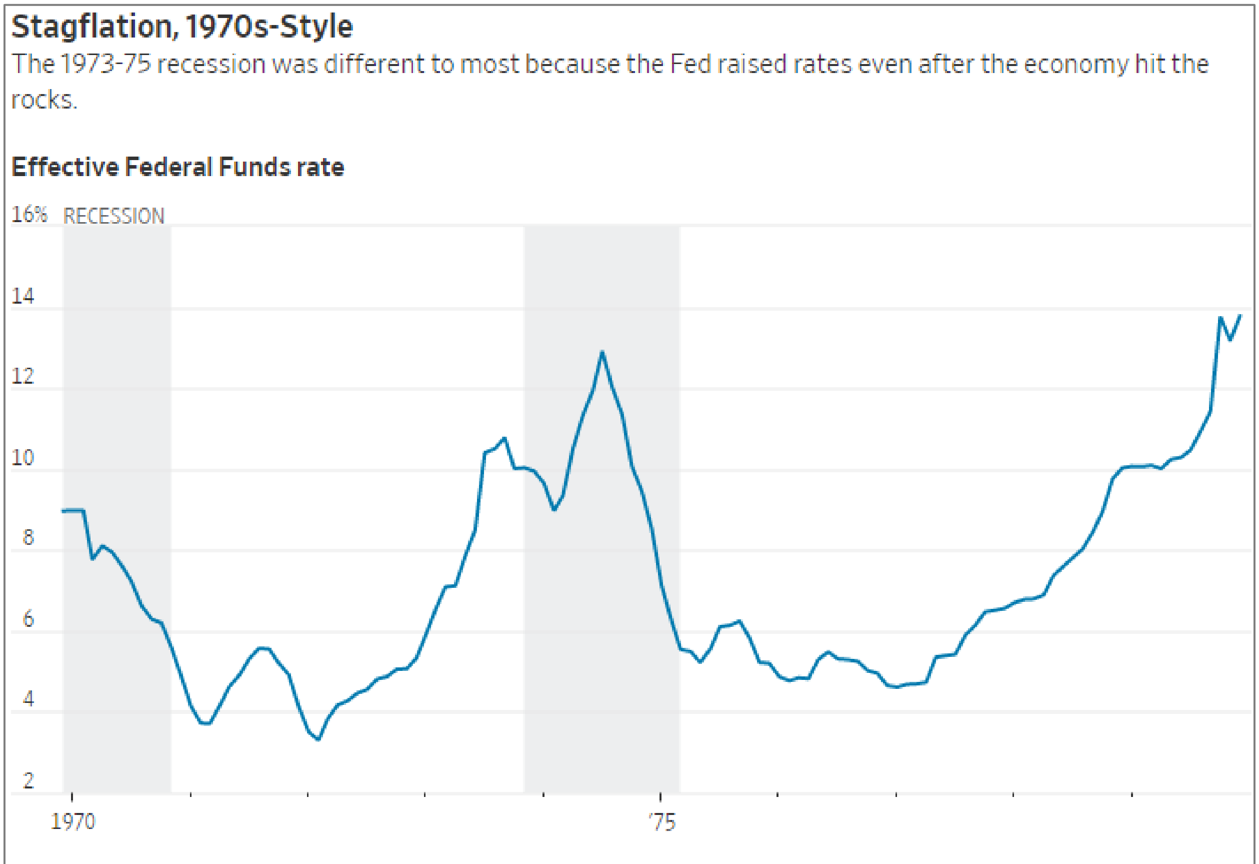
Household's have a record allocation to equities.

Higher Labor costs should put pressure on margins.



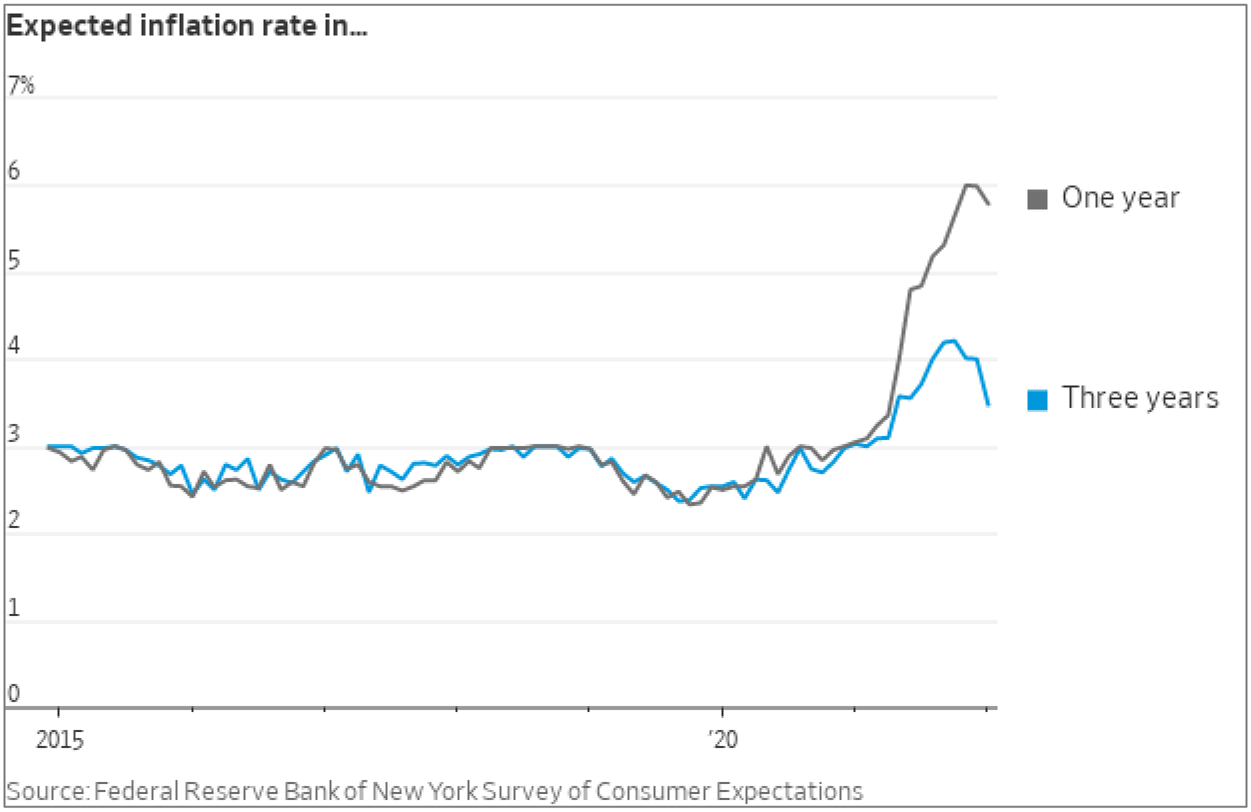
*z-score is the number of standard deviations by which the value of a raw score is above or below the mean value of what is being observed or measured. Gray shaded area represents recessions. Sources: Bureau of Economic Analysis; Bureau of Economic Analytics/Haver Analytics. Chief Investment Office. Data as of February 10, 2022.

Fed was forced to continue to tighten during the 1973-75 recession because of inflation.

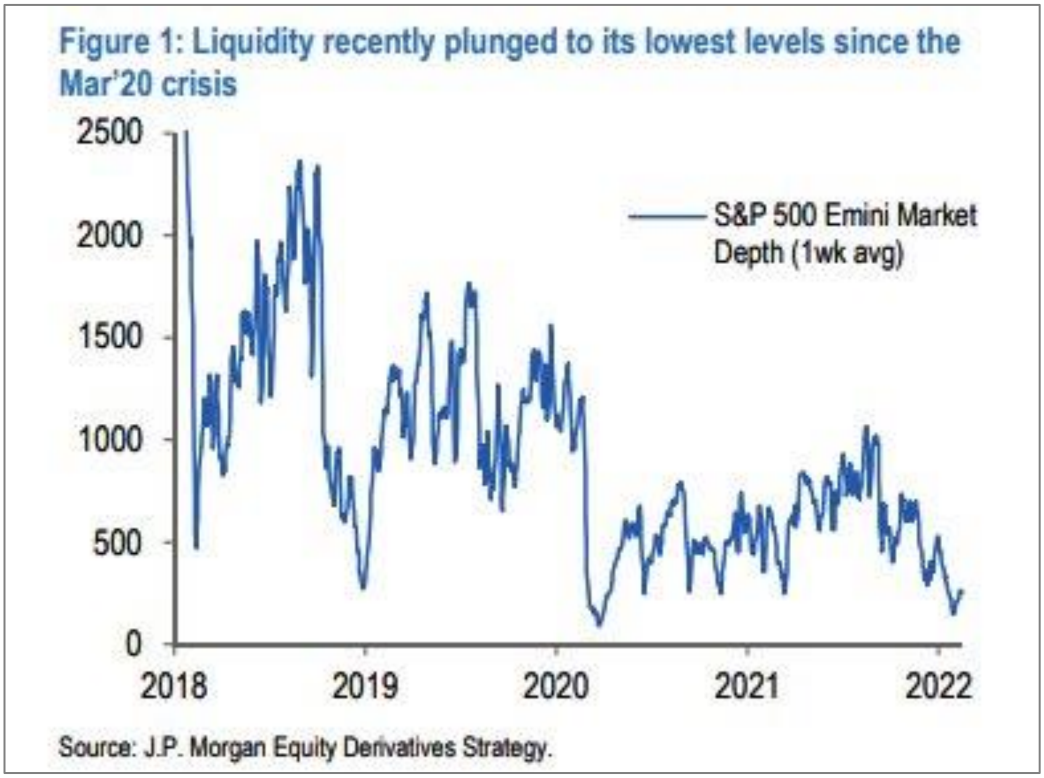


Source: Federal Reserve Bank of St. Louis

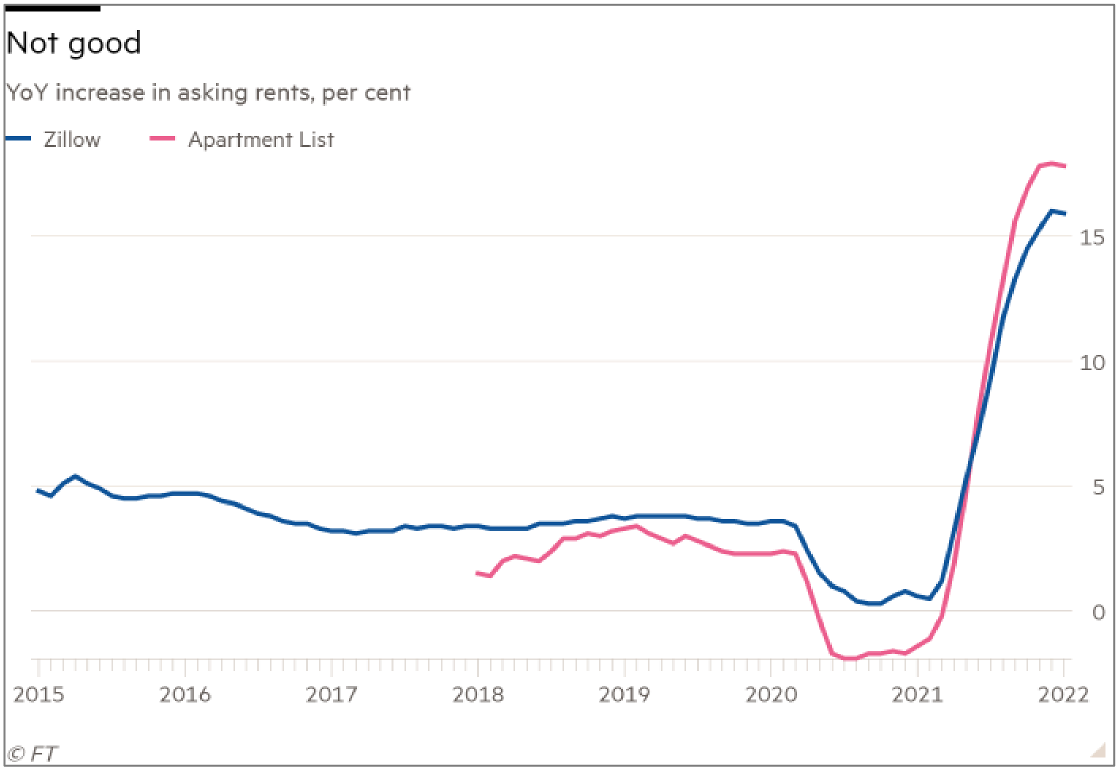
Inflation expectations appear to be peaking.



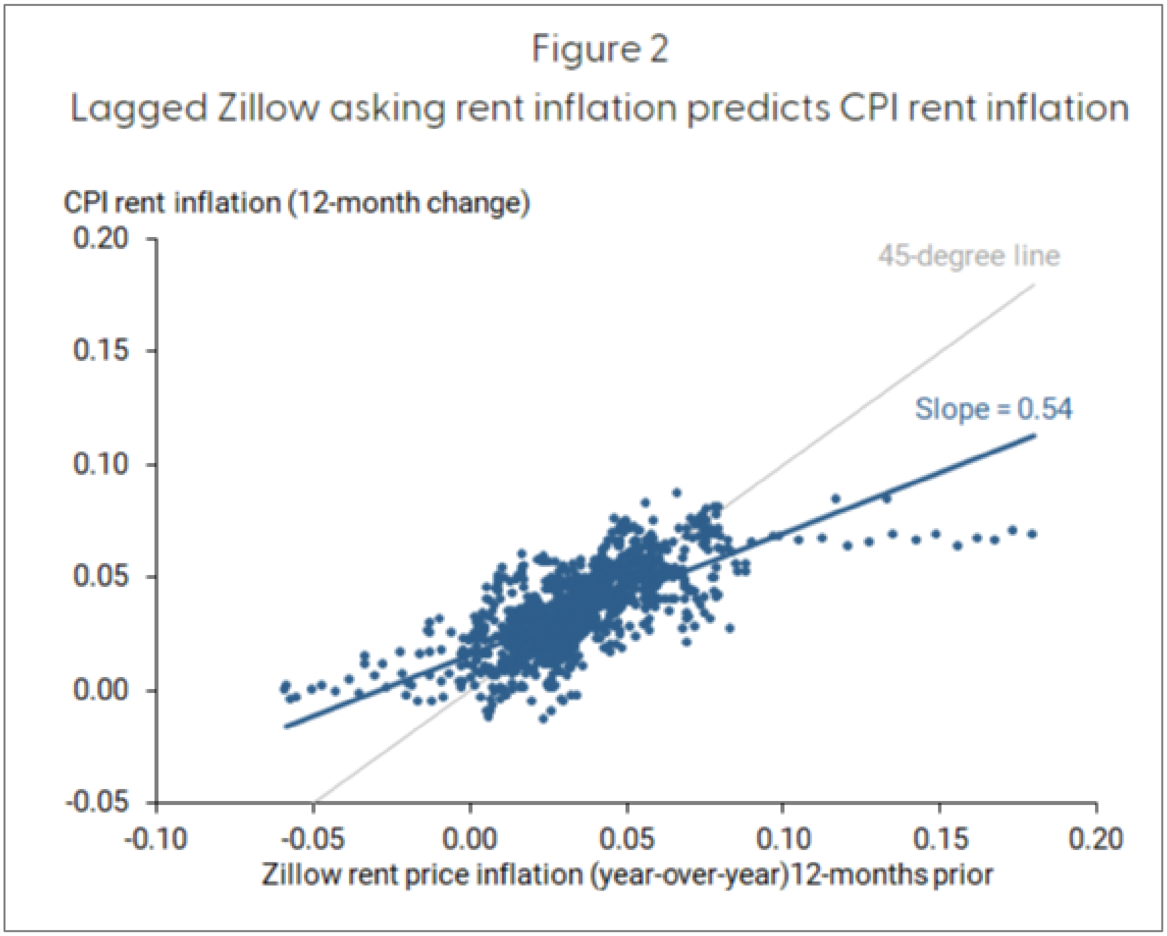
Liquidity in S&P500 futures has been drying up.



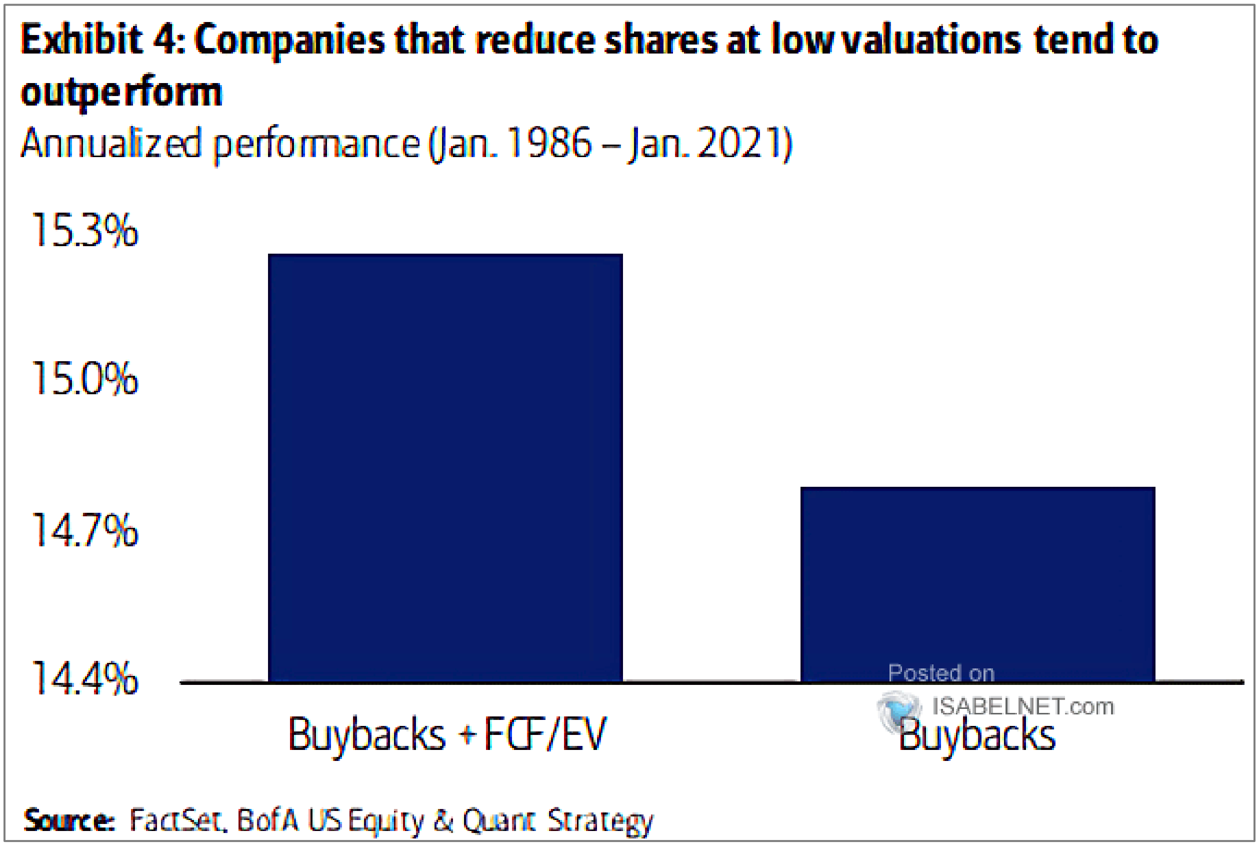
High rent inflation on Zillow...



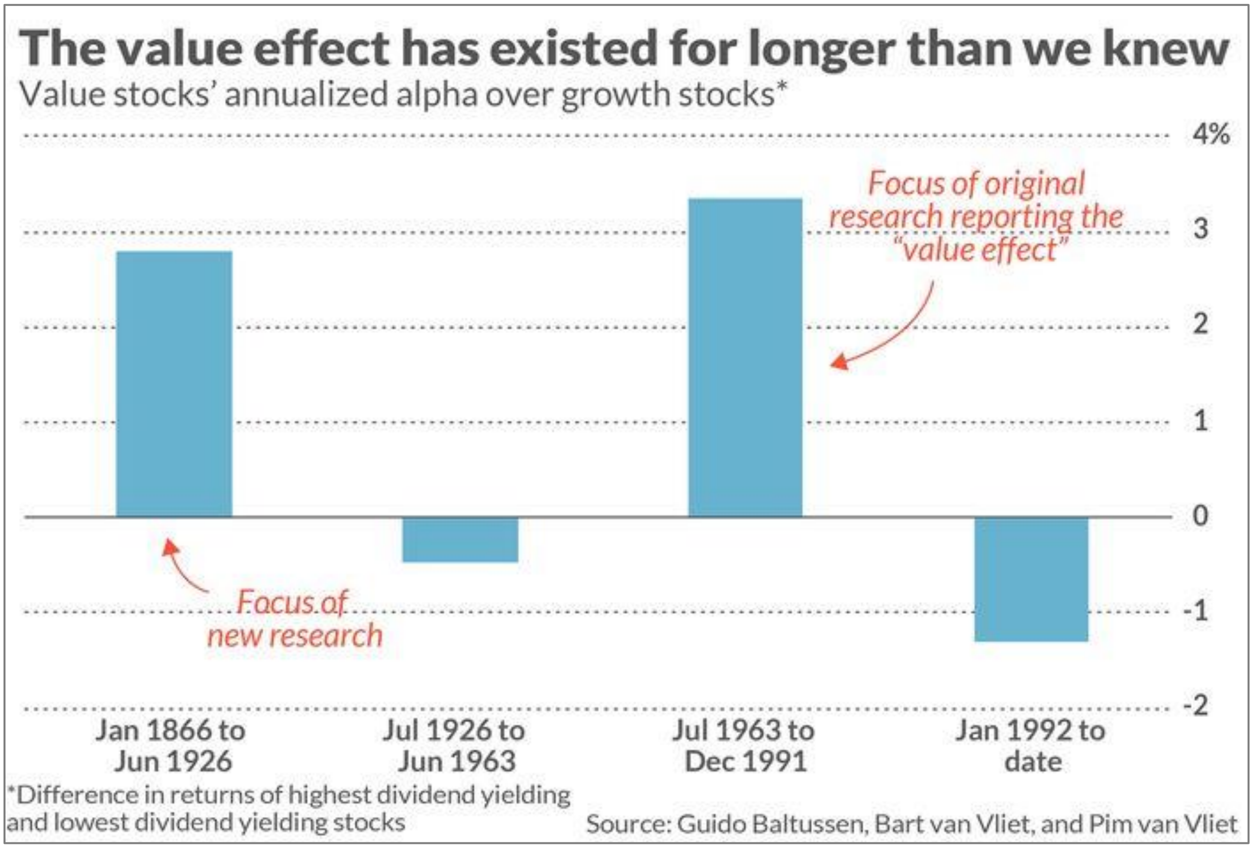
...will show up in CPI over the next year.



Smart corporations buyback stock when the valuation is attractive.

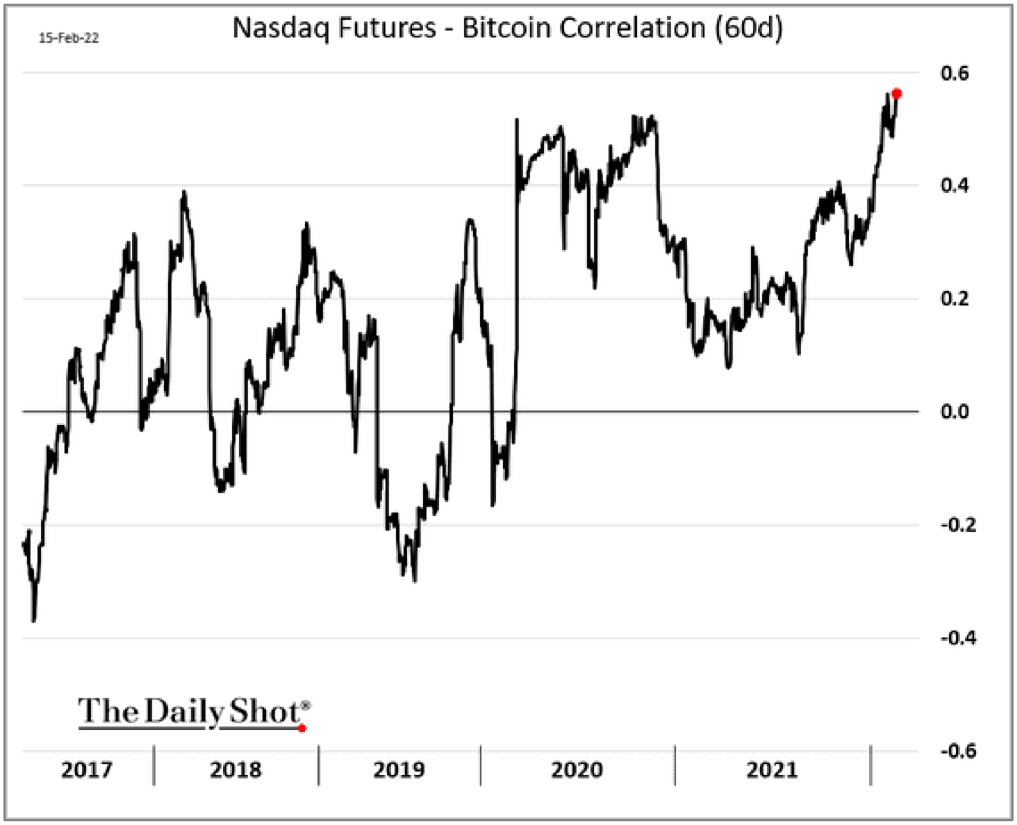


Expanded study on Value shows that the factor has worked much longer than we knew.

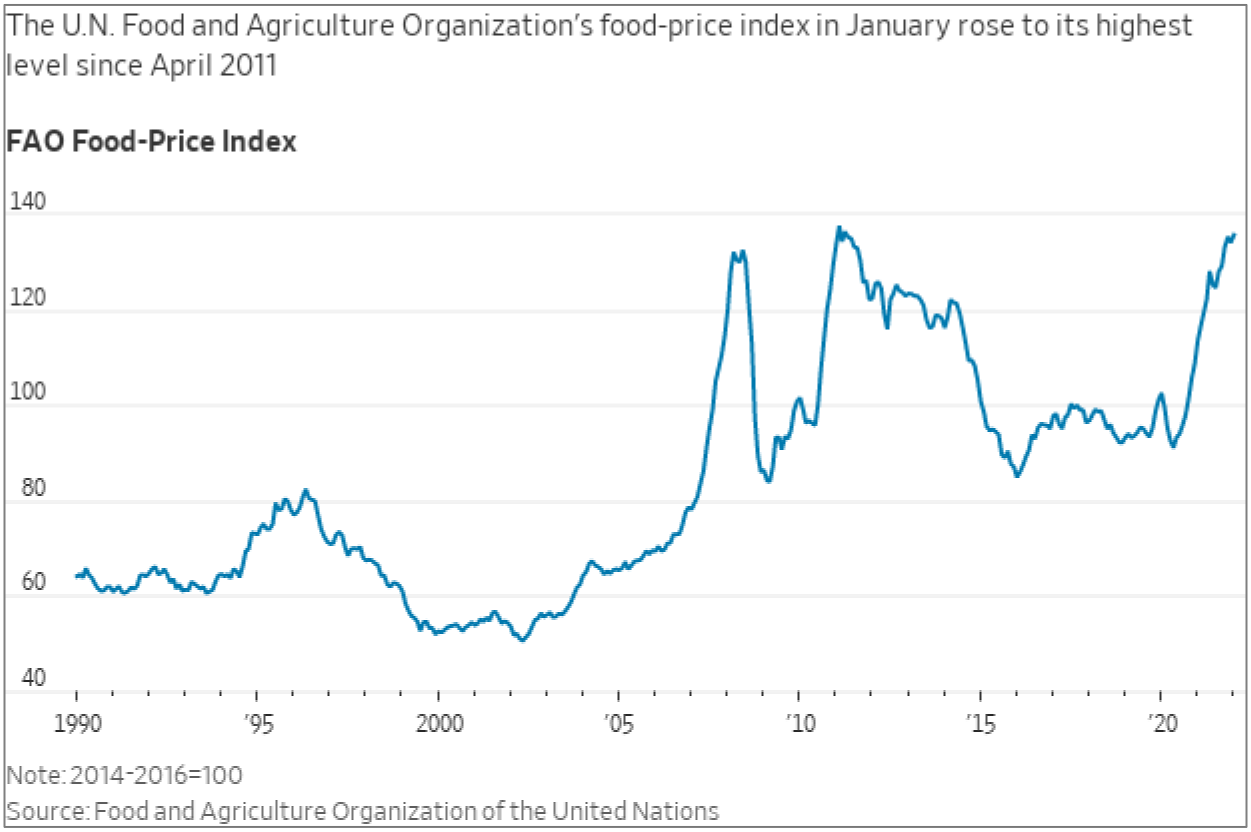


Source: Mark Hulbert

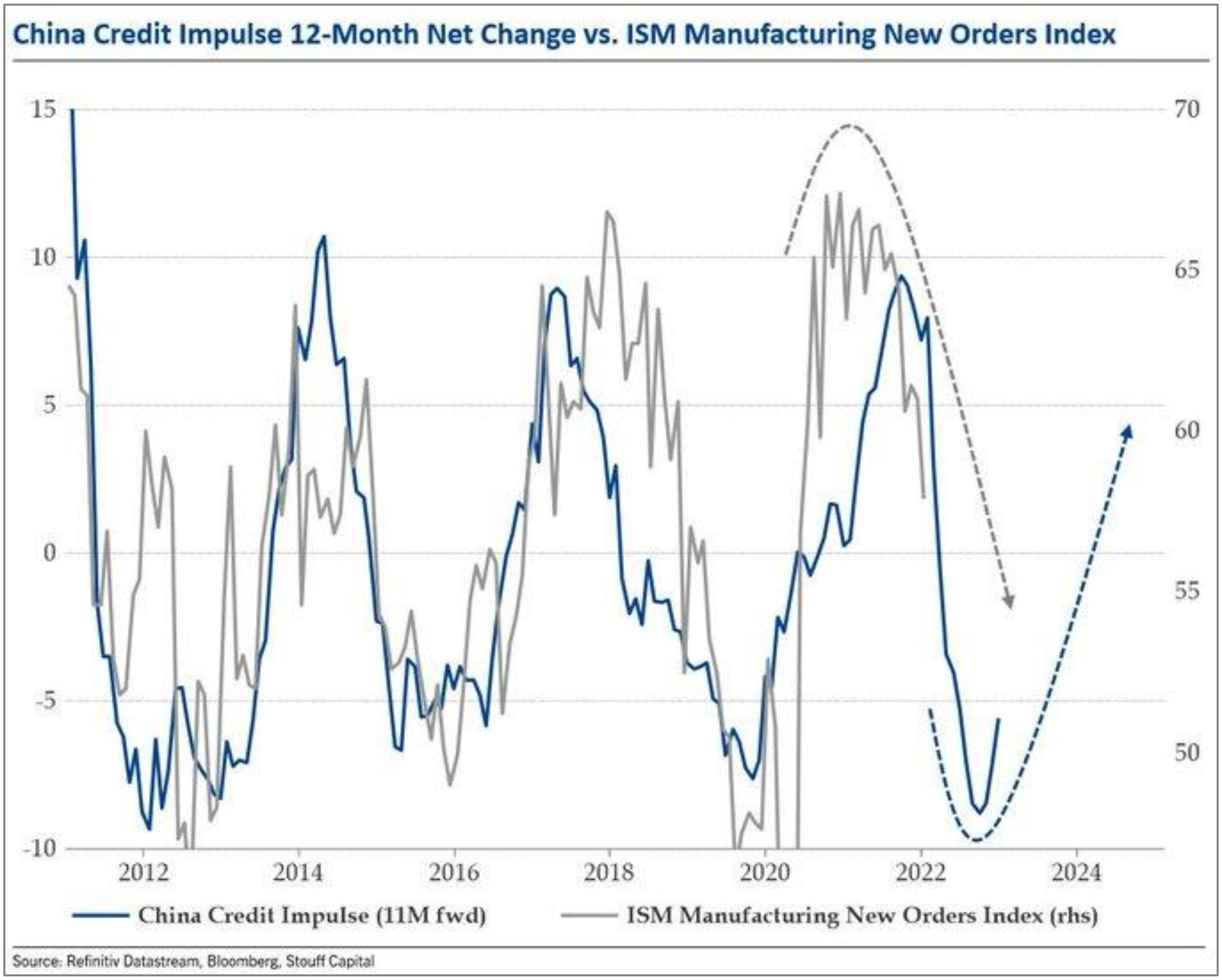
Nasdaq and Bitcoin correlation is on the rise.



Food prices are reaching levels that give rise to geopolitical tensions.



Liquidity in China may be easing right as it is growing tighter in the US.



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 porfolio 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.

Contact us for more information.