Cypress CAPITAL

Market Outlook

By Mark T Dodson, CFA

Speculators are down but not out.

Market Risk Index fell to 81.9% on another noteworthy improvement in the Psychology score, which was again more than enough to offset further deterioration in the Monetary composite. However, valuation improvements have been marginal and remain in the worst decile of readings.

This week marks the end of the Fed's pandemic-prompted round of asset purchases – the third time we've gone to that well since 2008. Jerome Powell's version of QE blew the others out of the water. He went big, with asset purchases that nearly monetized every single check that Trump and Biden sent to us in the last two years in the name of fighting a Covid recession and an MMT experiment gone wrong. Outside of the potential for the psychological impact of knowing the Fed is unplugging the money printer, it will take several months for the cessation of QE-Covid to register in our Monetary composite in a way that indicates less liquidity for the economy.

No matter, without a single increase in rates, our Monetary composite has moved from the 50th percentile in October to knocking on the door of the 80% percentile. This shift in the direction of tight money all resulted from simply the prospect of the Fed removing the punch bowl and, more recently, Putin's gamble to invade Ukraine. Still, inflation remains problem number one for the Fed. Do most of us lack appreciation for what it takes to break inflation when it's hitting 40-year highs without breaking something else in the process? Very likely. This is unfamiliar territory for this generation of investors who have morphed the maxim, Don't fight the Fed, into the Fed will fight to ensure we never lose any money on our investments.

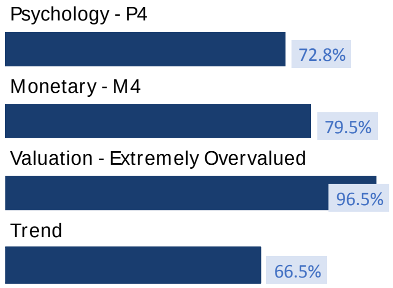
Headlines have become fertile ground for crushing animal spirits, but the shift to the fear that creates opportunities for patient investors hasn't become pervasive within our Psychology composite. Only two categories, Surveys and Volatility, are giving extreme readings that are bullish for markets and responsible for recent MRI improvements. Both categories have a great history of showing their ability to highlight short-term buying opportunities, exceptional in their ability to highlight periods to redeploy capital within a bull market. Unfortunately, they also have a history of highlighting very short-term opportunities within bear markets that investors quickly come to regret in the next leg down.

Market Risk Index

Rec Allocation 25% Underweight

81.9%

Category Percentiles



Largest Psychology Influences

Surveys	Positive
Volatility	Positive
Leveraged Investments	Negative
Flow of Funds	Negative

Largest Monetary Influences

Inflation	Negative
Interest Rates	Negative
Exchange Rates	Positive

Valuation

7-10 Year Rtn Forecast	1.4%
10Yr US Treasury Yield	1.9%

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.

Thus, the need for a basket of indicators that both complement and confirm each other. When your primary concern is your capital at risk instead of relative performance to a benchmark, it's mandatory. It's the only way to ensure you are looking at a bona fide high reward per unit of risk opportunity for aggressive investment in equities.

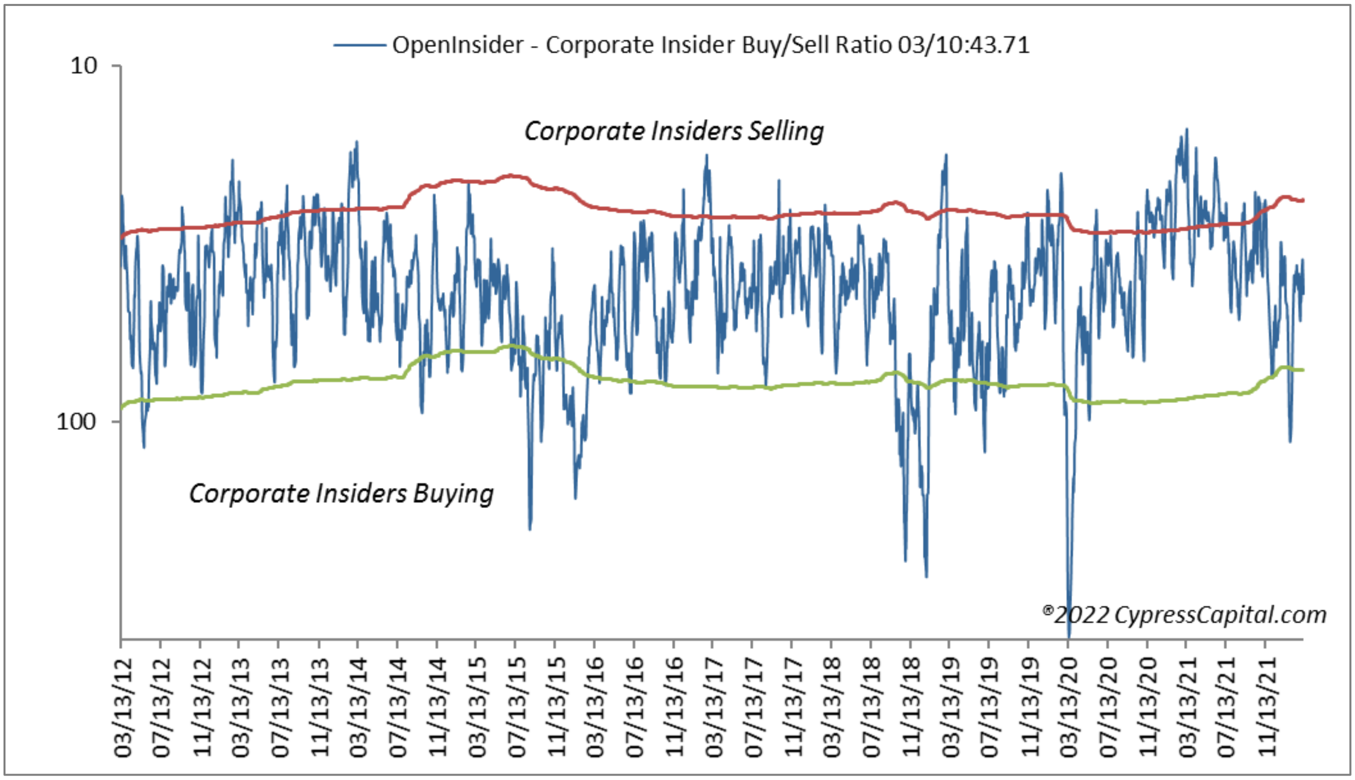
Case in point – corporate insider sentiment is neutral. Despite substantial market volatility and declines in individual stocks over the last two weeks, there has been an apparent apathy on behalf of corporate insiders for buying their stock. We don't like that.

Another example is the appetite for risk-taking in levered and inverse ETFs. When we de-trend it or look at daily dollar volume, Levered ETF sentiment is moving into fear zones that provide good buy the dip opportunities in a bull market, similar to what we described for survey readings. However, on an absolute basis, the ratio of assets in leveraged ETFs to inverse assets is more than 3 to 1 - well above anything outside of this Covid-stimulus fueled speculative period.

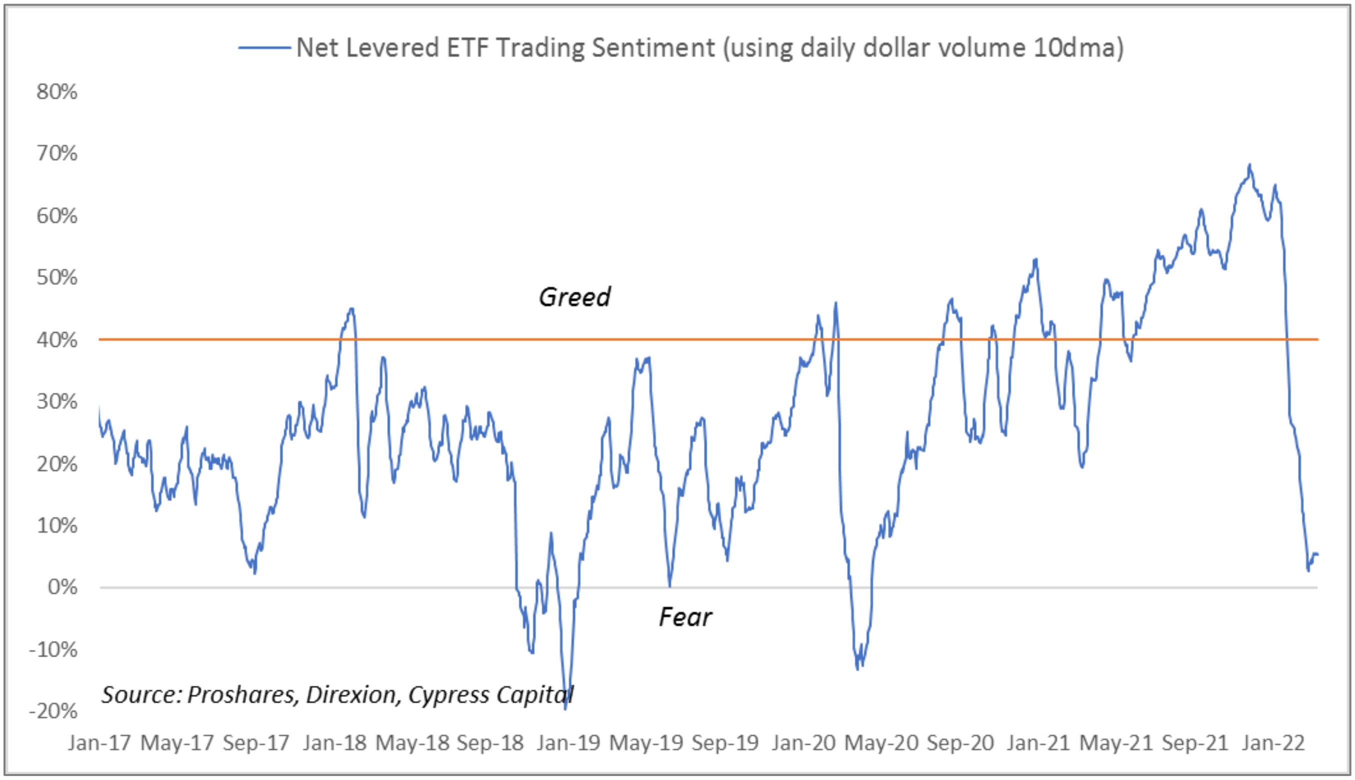
Similarly, our de-trended put/call ratios are in fear zones, but the raw equity put-call ratio (15-day moving average) is not showing a break in the speculative spirit. Kathy Wood's ARKK fund, the poster child for Covid-era excess, is down nearly 50% from its highs but still seeing inflows as investors continue to buy the dip. Speculators are down but not out.

Charts of the Week

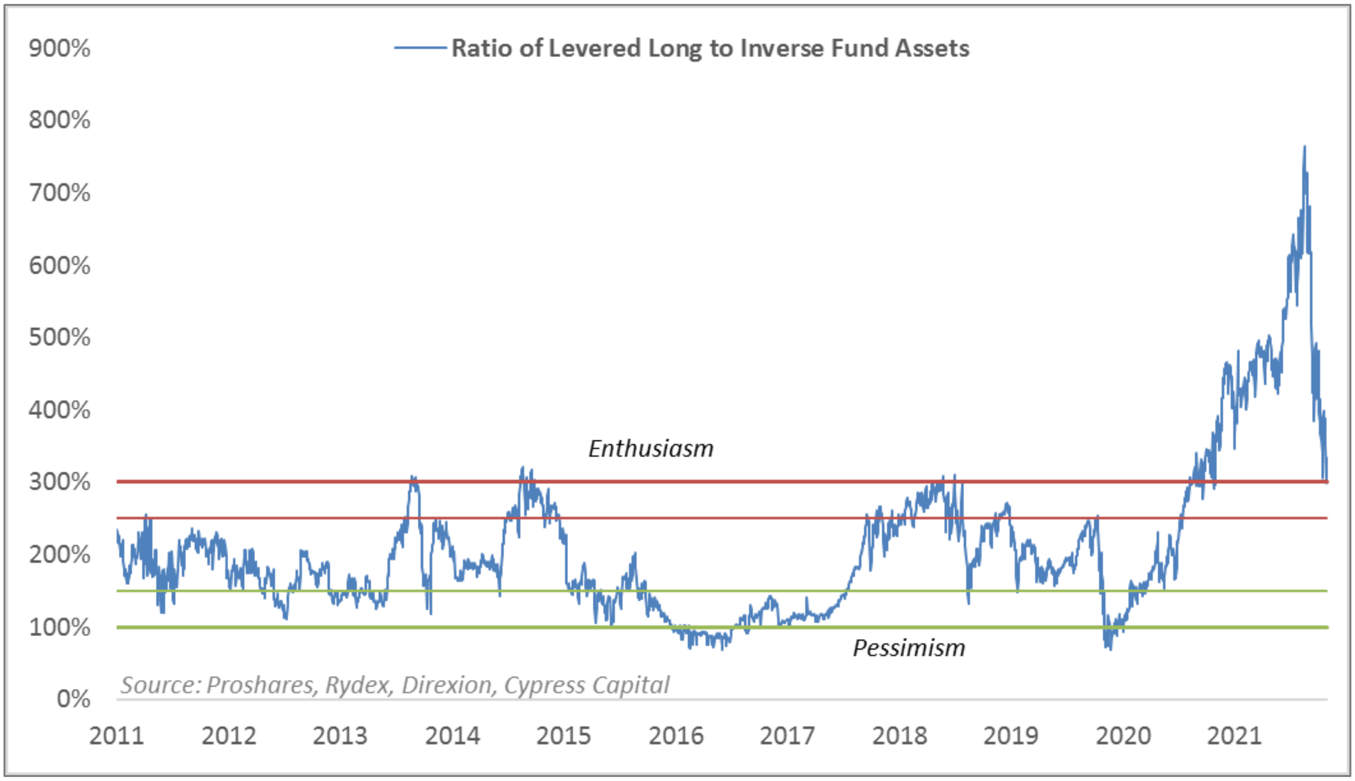
Corporate Insiders haven't shown much enthusiasm for buying the dip.



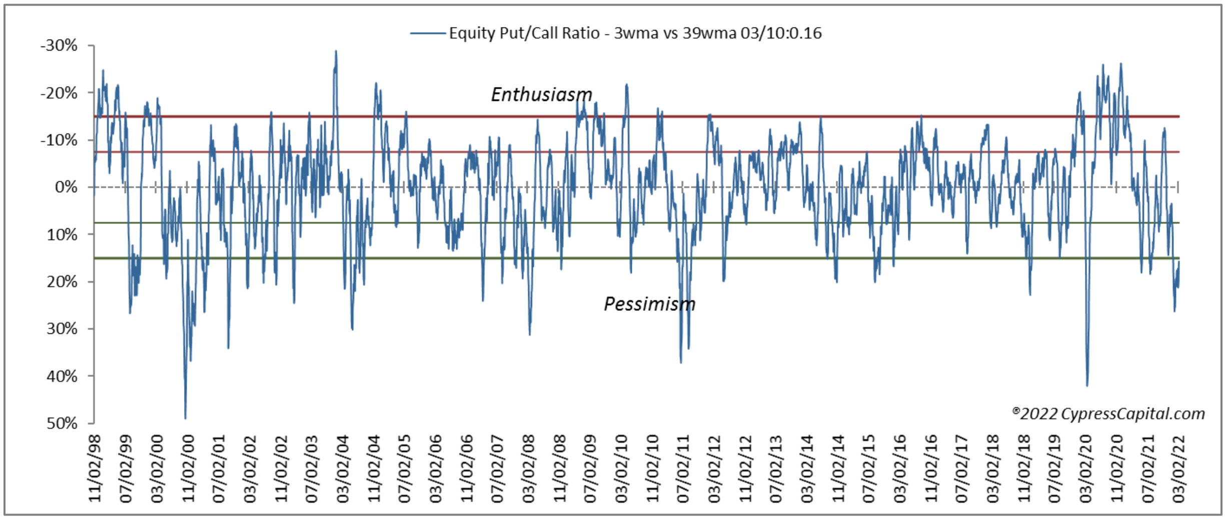
Net Levered daily dollar volume has improved to the best condition since the March 2020 decline…



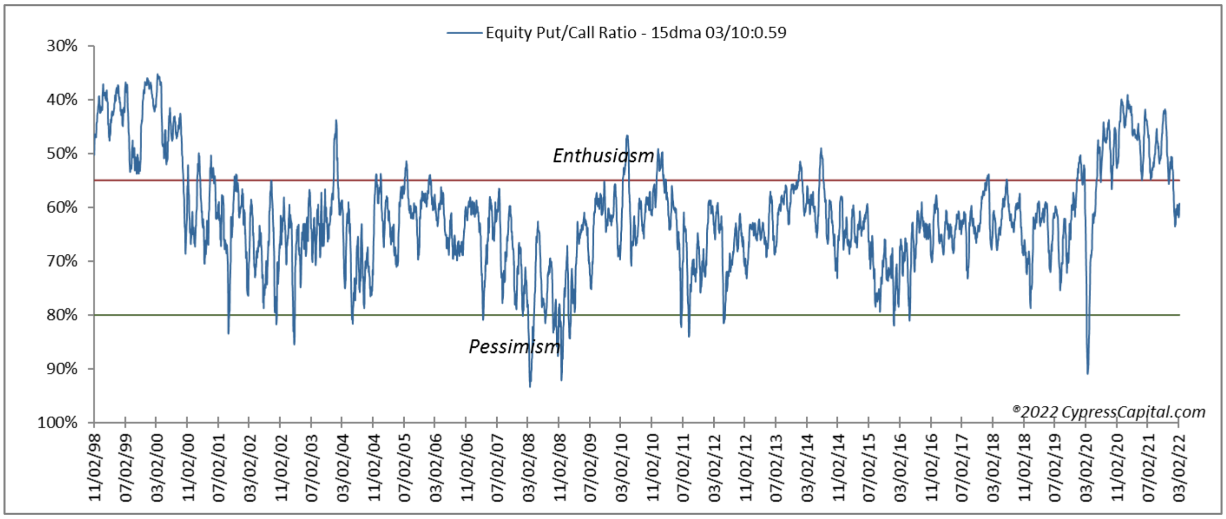
But, the assets in Levered Long ETFs in relation to Inverse assets is still in super-speculation territory.



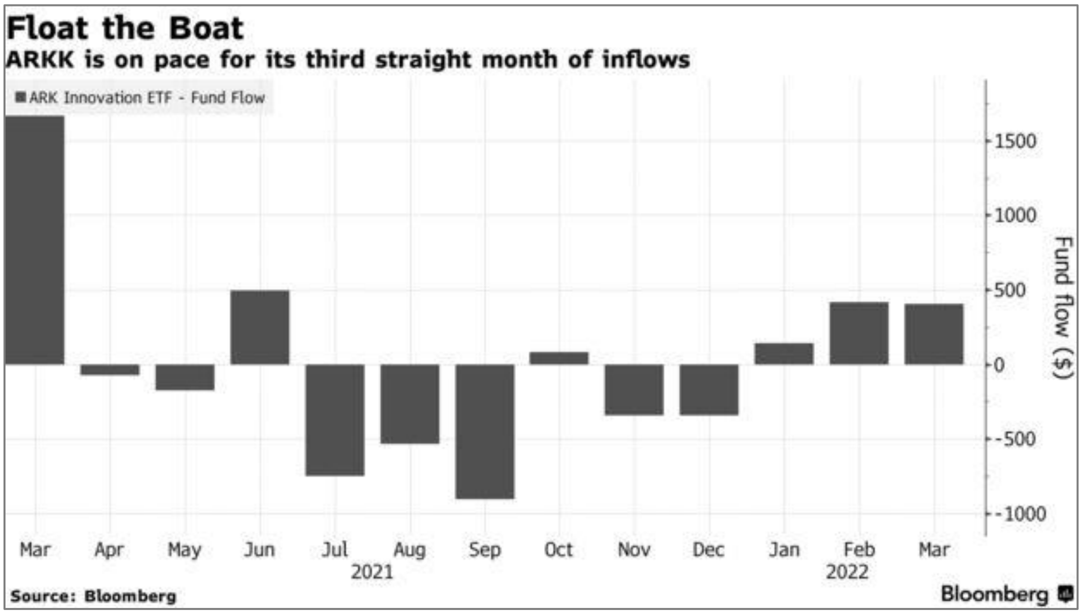
When the recent trend is removed, the Equity Put/Call ratio is hitting extremes...



But, when we look at the raw Equity Put/Call ratio, it shows speculators are still hanging on.



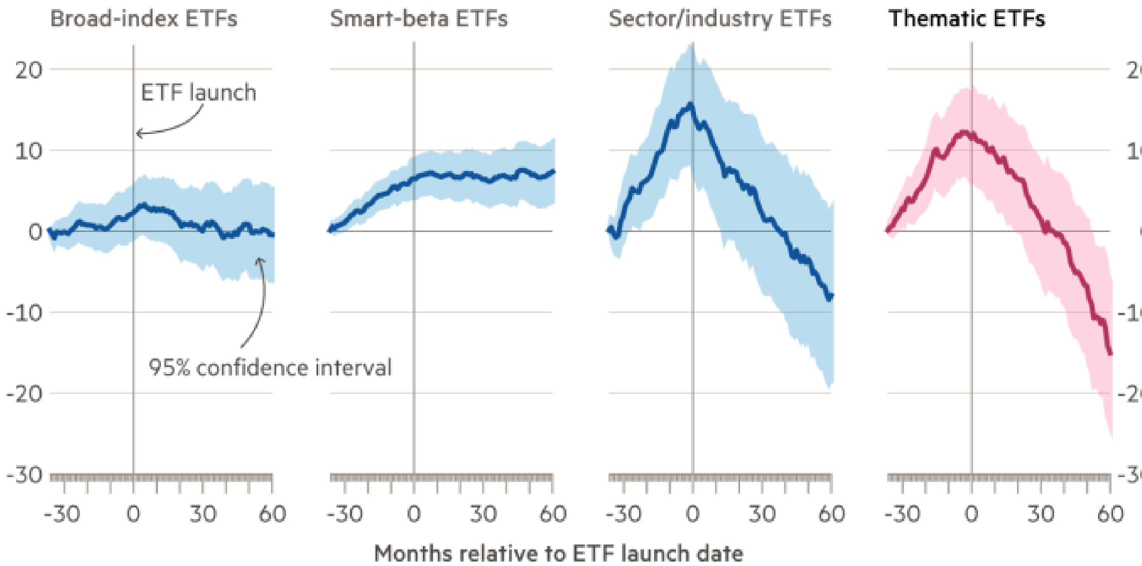
Three months in a row of inflows into ARKK.



When a theme becomes popular, it's often peaking.

Thematic ETFs on average have missed the peak of their theme

Cumulative risk-adjusted return of underlying indices (%)*

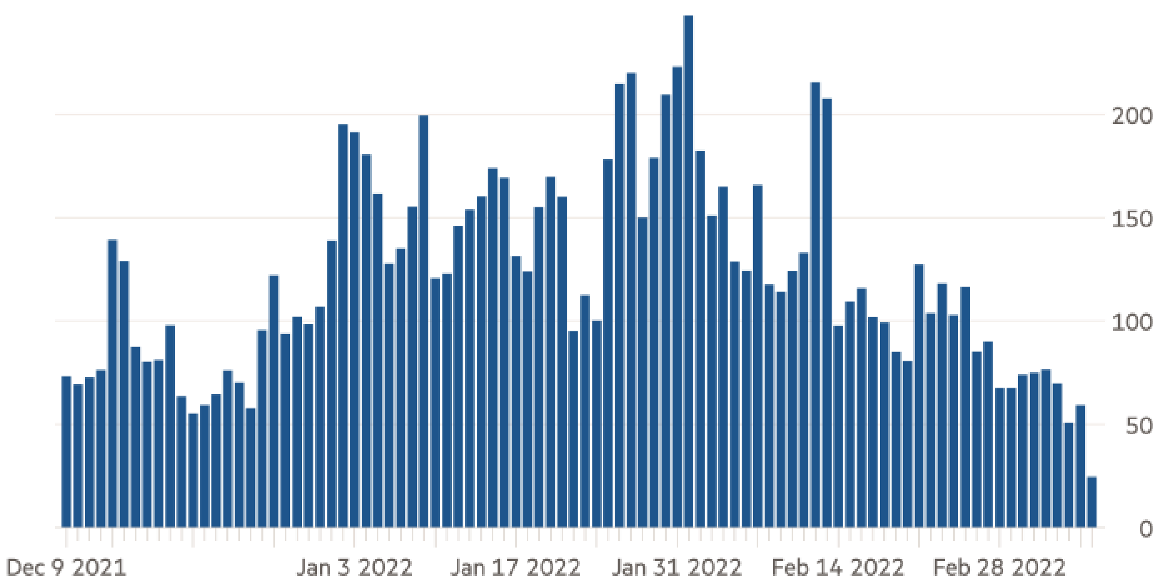


* Based on Fama-French-Carhart four-factor model (FFC-4) alpha US equity ETFs 1993-2019
Source: Ben-David, Franzoni, Kim, Moussawi (Competition for attention in the ETF space, Feb 15 2022)
© FT

Fervor for NFTs is waning as trading volumes on the biggest marketplace for NFTs plummets.

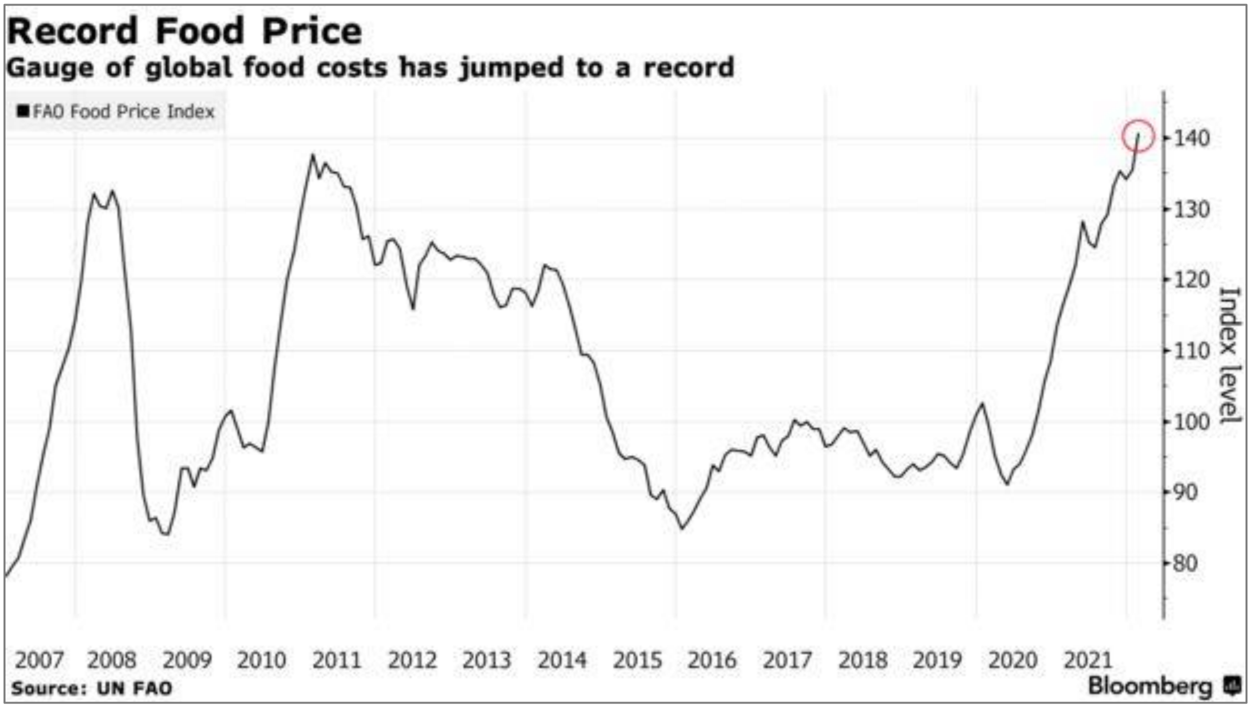
Trading on OpenSea in decline

Daily volume ($mn)

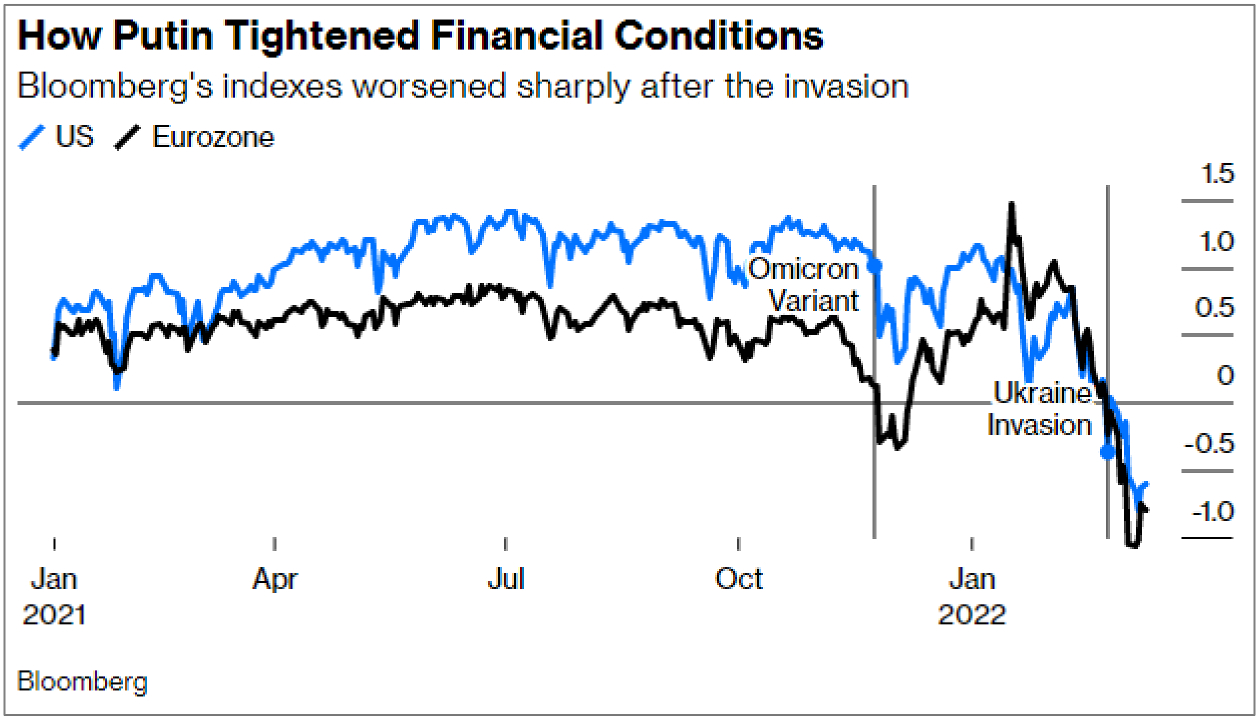


Source: Richard Chen/Dune Analytics
© FT

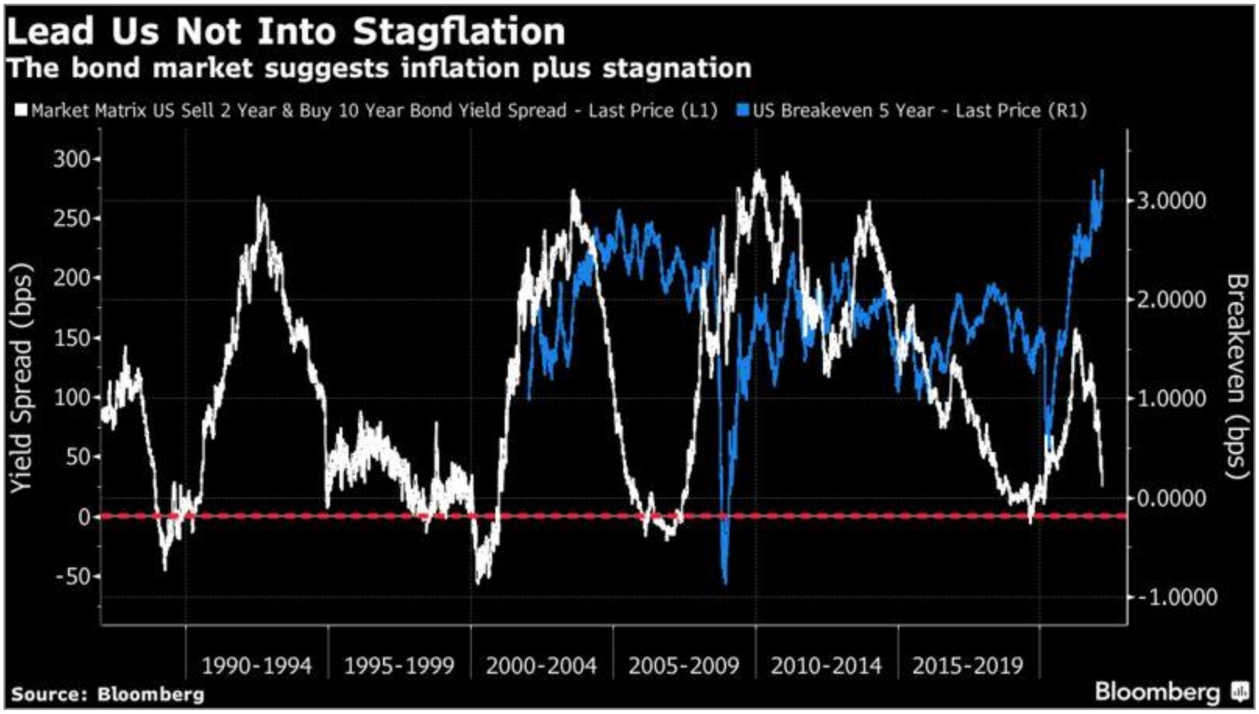
Global food prices set a new record, surpassing the increases that led to the Arab Spring.



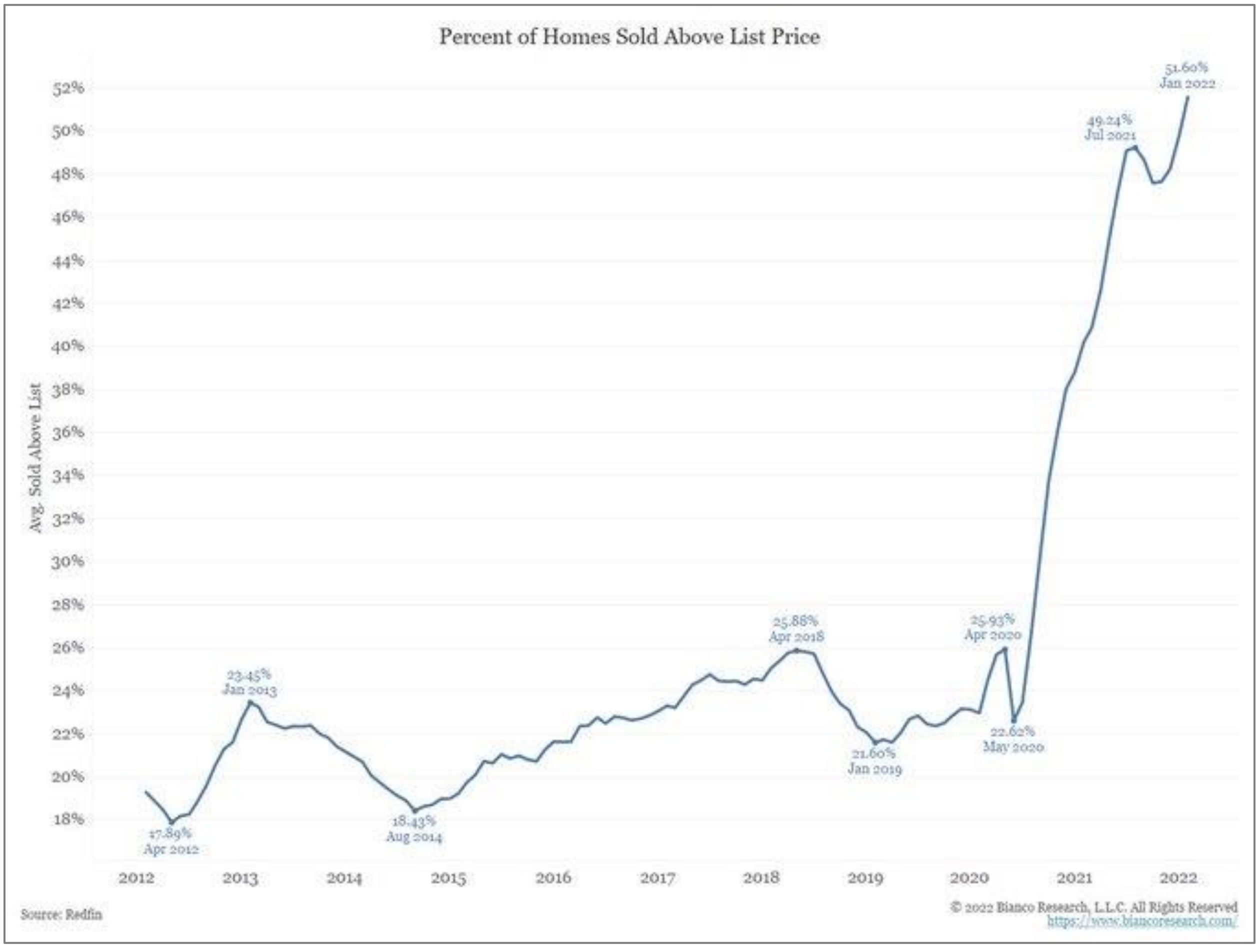
Ukraine invasion has tightened financial conditions further.



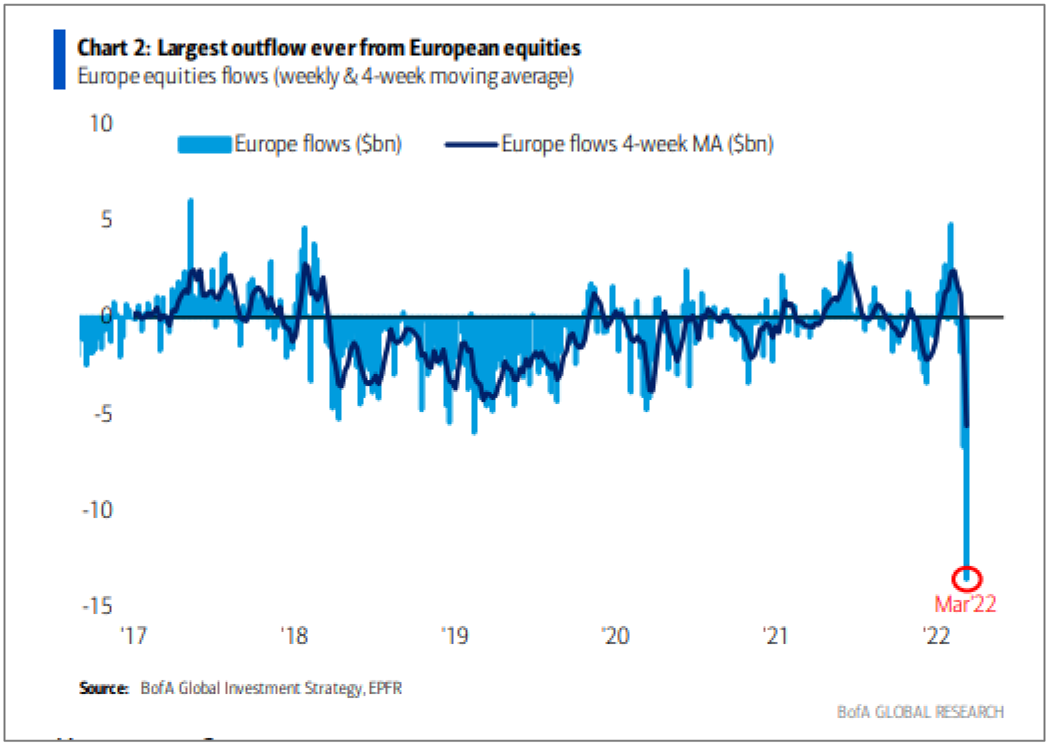
Stagflation – yield curve suggests slower growth while Breakevens pricing in higher inflation.



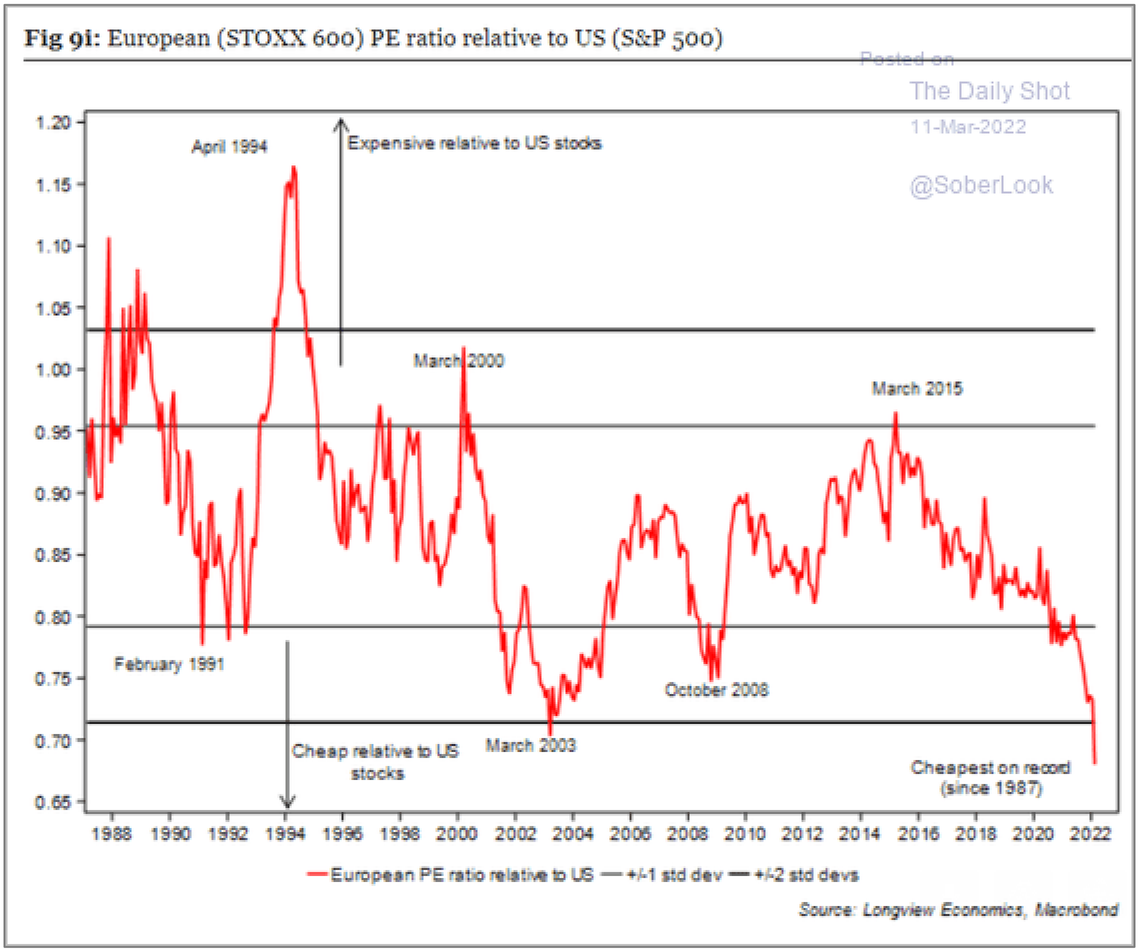
More than 50% of homes sold above list price in January.



Record outflow from European equities



No coincidence - relative valuations in Europe are the cheapest 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.

Contact us for more information.