Market Outlook

By Mark T Dodson, CFA

Investor Psychology drives MRI higher

Market Risk Index moved up to 73.6% after our Psychology Composite made a sharp U-turn, worsening by 4.8%. Equity market strength and any reignition of animal spirits will continue to be met with more hawkish Fed language until inflation shows clear signs of receding.

The Psychology composite deterioration resulted from a combination of the bullish (for the stock market) Survey category readings easing over recent weeks as well as worsening in the Volatility and Technical Indicators categories. Volatility is too high for aggressive traders who trade the market's trend and not high enough for those who want to place a big bet on mean reversion – it's a volatility minefield.

The Technical Indicators category also worsened as market internals softened. The NYSE High Low Logic Index moved more decisively into its sell signal, indicating unhealthy market action. New lows are prevalent, but the new highs responsible for elevated High Low Logic readings are occurring in Energy and Utilities sectors. Energy stocks are unlikely to continue their orbit-defying ascent when the stock market ultimately capitulates – that ultimate anxiety-producing moment that investment professionals refer to as "correlations going to one." The silver lining for Technicals/Internals is that the ARMS Index has reached levels that suggest at least a short-term reprieve from this week's steady selling pressure.

The six-month rate of change in Producer Prices made a new cycle high, further cementing the inflation-related stock market warnings coming from our Monetary composite.

A more immediate concern for monetary conditions – intra-month Bond Momentum readings shifted negative for both 10Yr and 30Yr Treasuries, changing our intermediate-term tactical outlook for Treasuries. Consequently, this marks a short-term failure for the previous Bond Momentum buy signal of a magnitude that hasn't occurred since the 1970s.

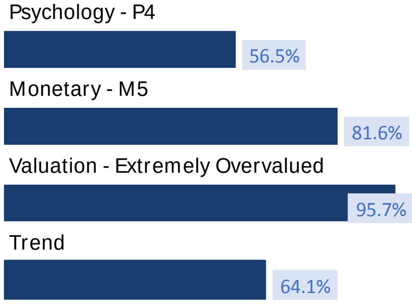
If you recall our hedgy language when bond momentum gave a bullish signal for Treasuries late last year, it was also the first time since using the indicator that we didn't allocate aggressively to longer-term Treasuries on said signal. Instead, we went light on both the allocation and the duration, mainly because real yields (after inflation)

Market Risk Index

Rec Allocation 25% Underweight

73.6%

Category Percentiles



Largest Psychology Influences

Leveraged Investments	Negative
Flow of Funds	Negative
Volatility	Negative
Technical Indicators	Negative

Largest Monetary Influences

Inflation	Negative
Interest Rates	Negative
Exchange Rates	Positive

Valuation

7-10 Year Rtn Forecast	1.6%
10Yr US Treasury Yield	2.7%

Market Trends

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

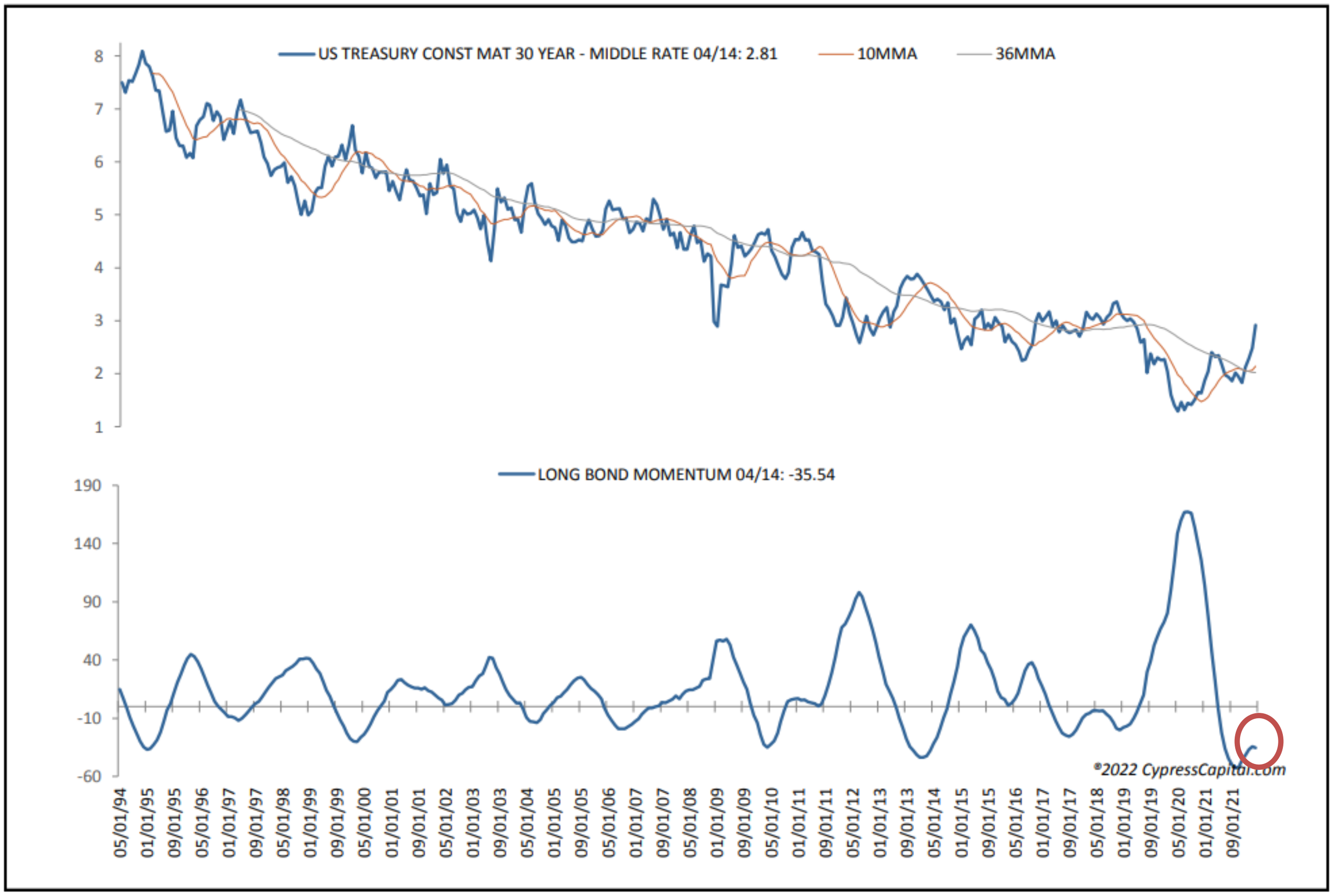
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

were hitting record lows, making the fundamental backdrop for this particular buy signal a riskier one to embrace.

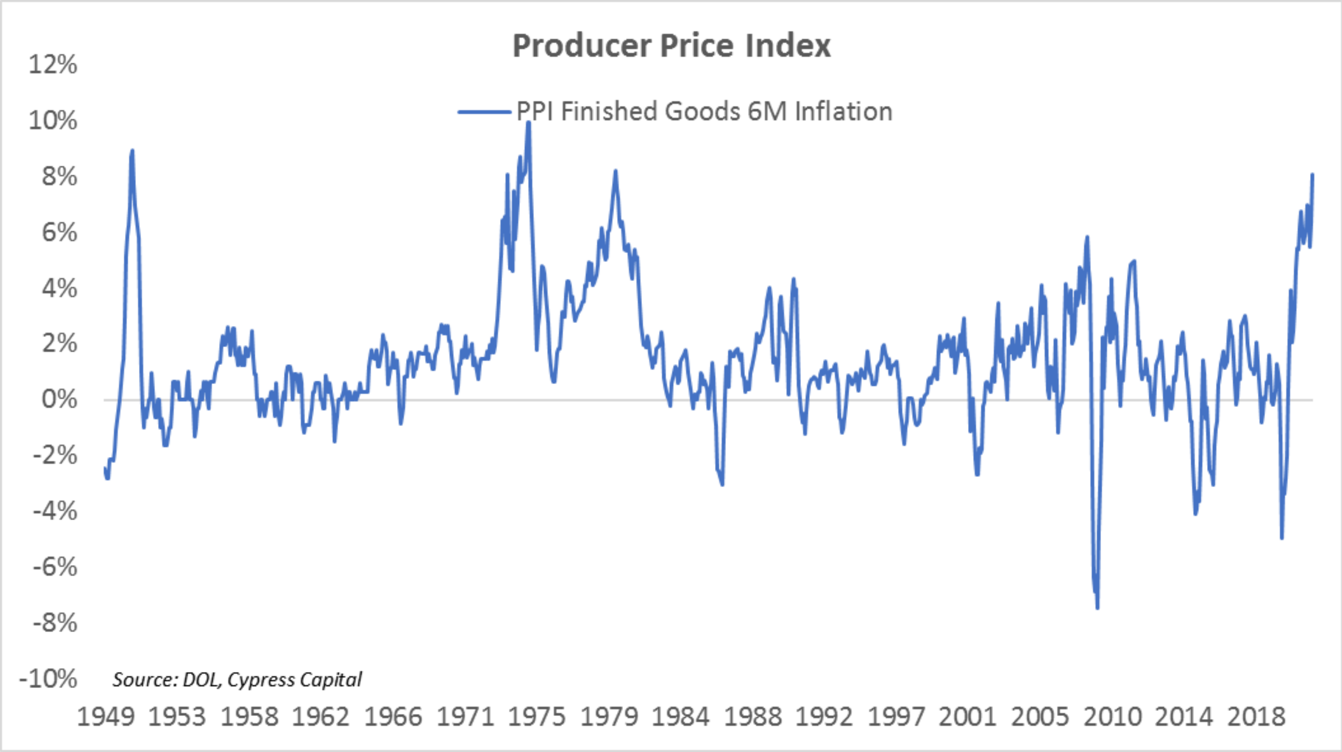
Nonetheless, Treasuries are severely oversold, and futures positioning indicates sentiment has shifted to a bearish extreme, which encourages being patient with our investment decisions over the coming weeks. With Treasury volatility so high, Bond Momentum could easily whipsaw back to bullish, so we aren't uneasy about our current positioning. Holding even a modest amount of intermediate to longer duration Treasuries serves as a hedge on the Fed and how it responds to this inflationary moment. Is this Fed going to be dovish like the Arthur Burns Fed, or is this Fed made in the mold of the more hawkish Paul Volcker? Is it more like 1970 or 1980? That remains to be seen.

Charts of the Week

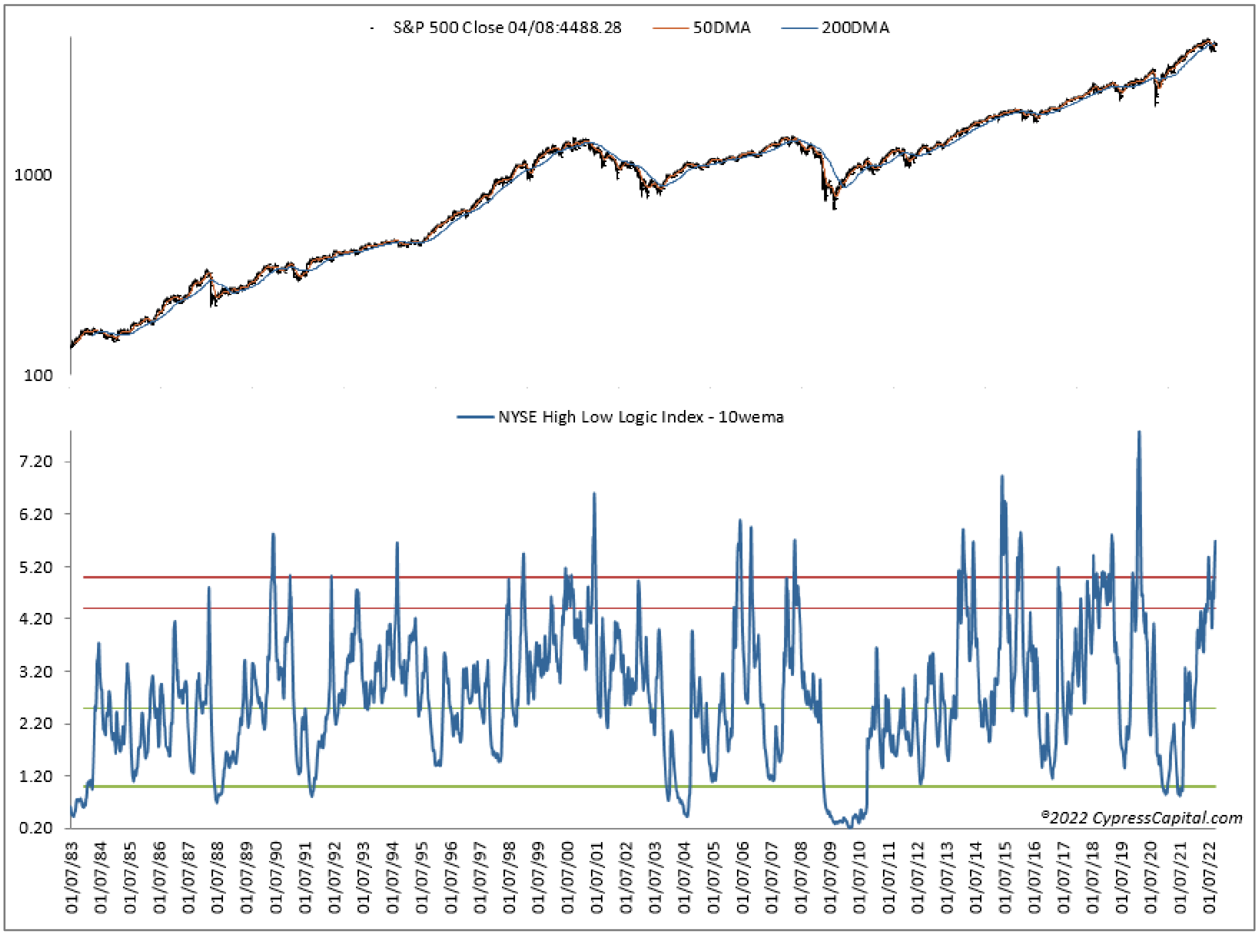
Bond Momentum gives intra-month sell signal for 30Yr Treasuries.
Given the high volatility in fixed income markets, Bond Momentum will be highly sensitive to any fall in yields.



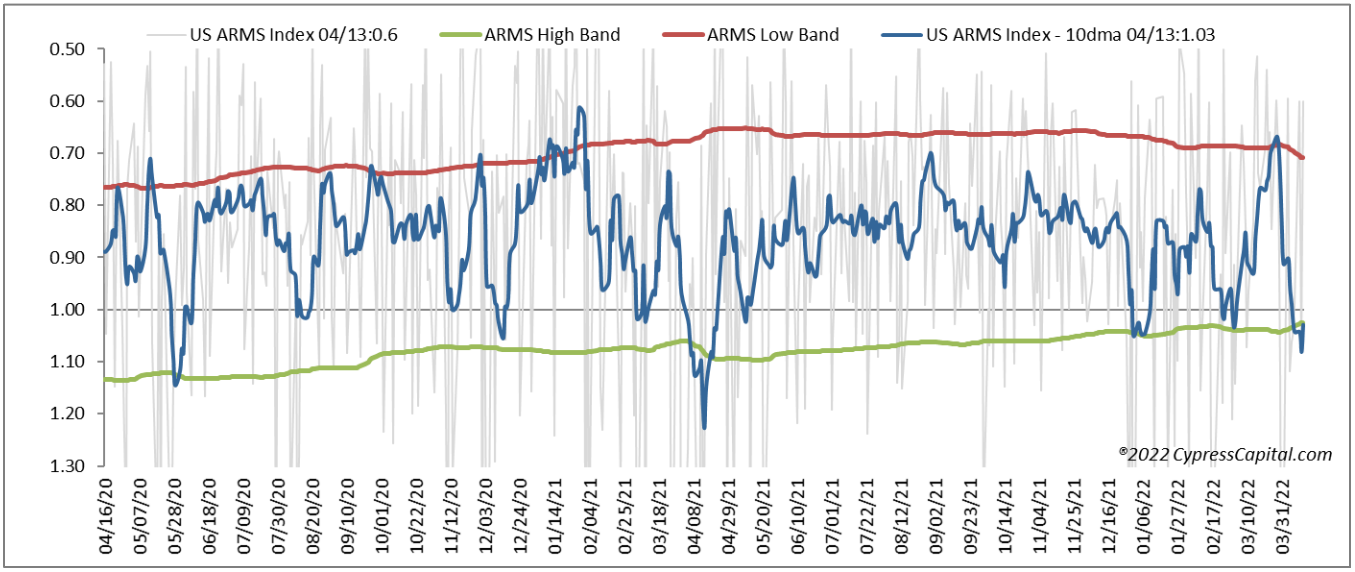
Producer Price Index for finished goods surged to the highest level since 1974.



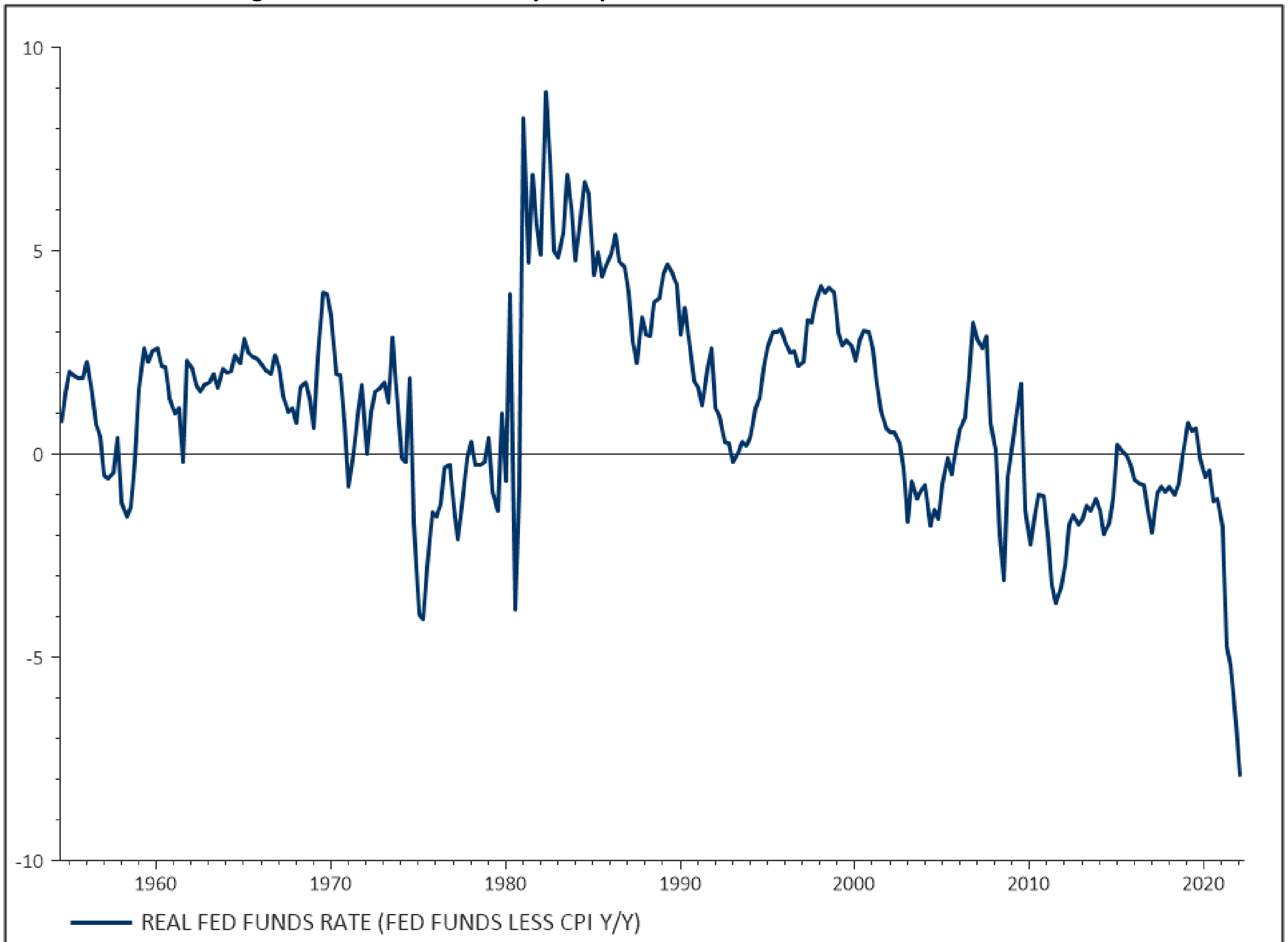
NYSE High Low Logic Index reached the highest level since the start of the bull market.



ARMS Index – short term selling pressure is hitting an extreme.

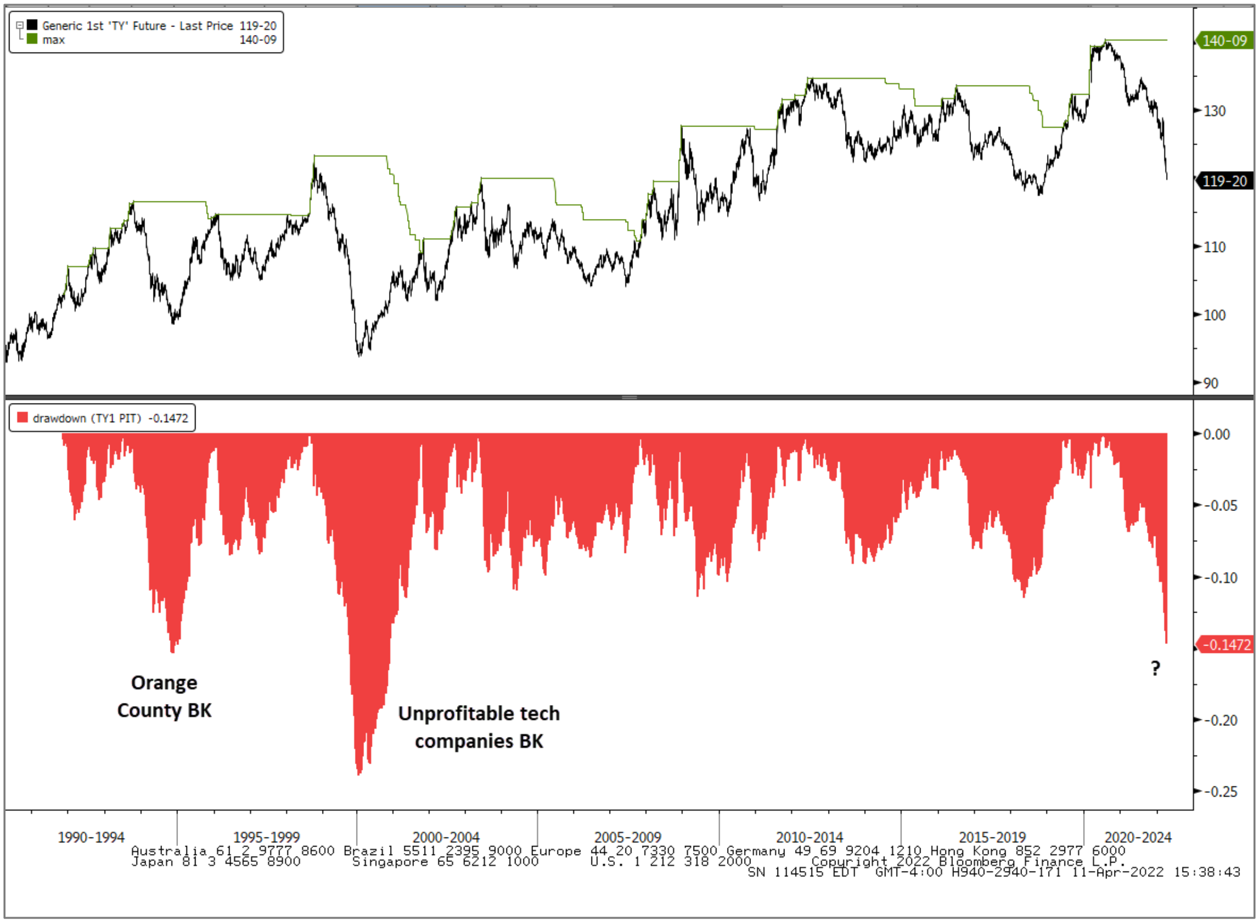


Failure at the Fed - Highest CPI inflation in 40 years pushes the real Funds Rate to record lows.



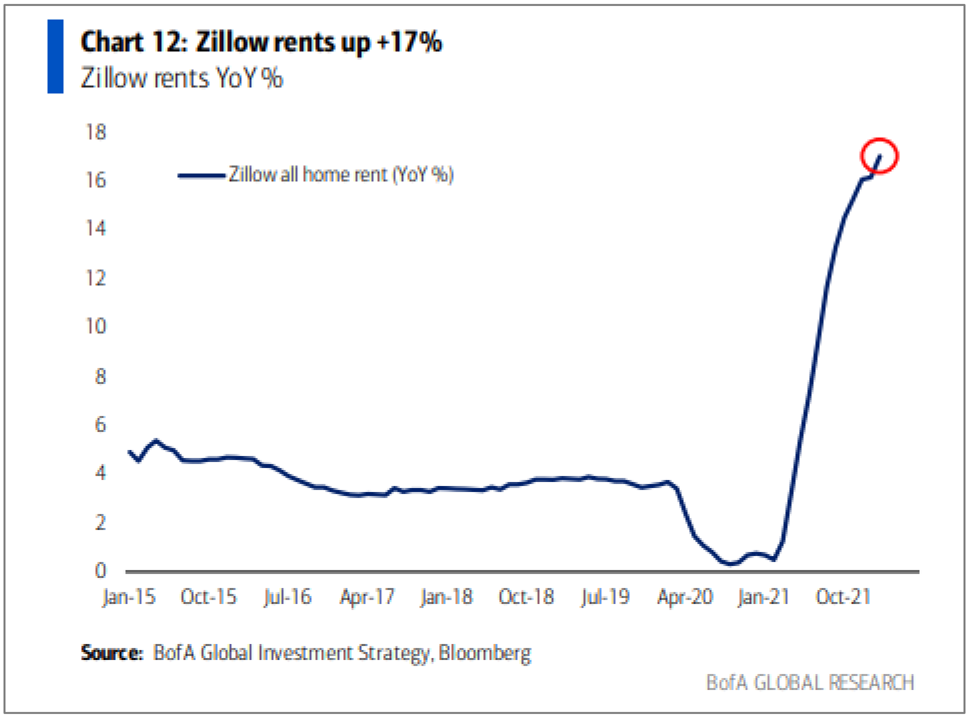
Source: Refinitiv Datastream, Cypress Capital

The drawdown in fixed income has been sharp enough to lead to headline grabbing financial distress.



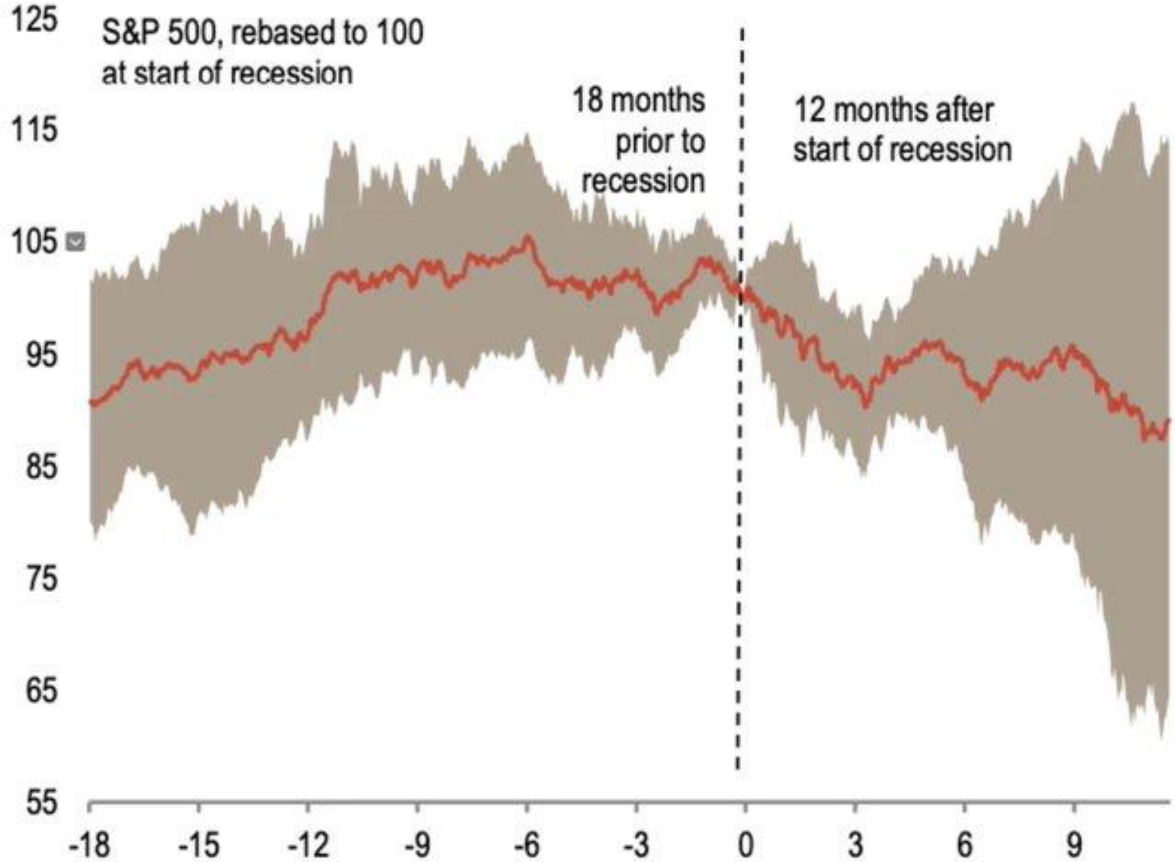
Source: SentimenTrader

Rent inflation has yet to peak.



Stock market tends to peak around six months before recession.

Figure 52: In the past, the S&P has made gains up until 6 months before the start of a recession



Source: Refinitiv, Credit Suisse research

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.