Cypress CAPITAL

Market Outlook

By Mark T Dodson, CFA

Sell in Mid-Term May

Market Risk Index climbed by 5.1% to 87.5%. Modest improvements to monetary conditions and valuations weren't enough to offset another substantial weekly bump in the Psychology composite risk score. Psychology has moved back into the worst 20% of readings, primarily due to internals and stock market volatility that has risen into zones indicative of a market not conducive to buying the dip. With Market Risk Index within the zone that indicates above-average drawdown risk, and still climbing, we aren't shifting away from our defensive posture.

Within Psychology, both the Options category and Levered funds broke below their most euphoric levels but remain elevated. Corporate insiders continue to snub their noses at sell-offs. The NYSE High Low Logic Index, one of our favorite indicators for market internals, moved even further into signaling a bifurcated, unhealthy market.

The most substantial indication of stock market anxiety is in the AAII Investor Survey, where 59.4% of the respondents were bearish this week. That's the highest level of bearishness since March 2009. The only other periods to register bearish readings above 59% occurred in 1990 and 2008. High AAII bearish readings are a contrarian bullish signal for stocks, but persistent bearish readings like we have seen thus far in 2022 are recession warnings. It is still not widely realized, but this particular investor survey is part of the Conference Board's Leading Economic indicators. The AAII survey and margin debt (discussed last week) are two of a handful of components inside the Leading Credit Index (LCI). The LCI replaced money supply growth in the Leading Economic Indicators when they revised it a decade or so ago. Many also don't realize that LEI was adjusted retroactively after it largely failed to warn of the 2008 recession until it was well underway.

Monetary conditions have stabilized, but they have stabilized within the worst 20% of readings. The message from our Monetary basket is clear. Inflation is a significant concern, and as we wrote several weeks ago, our ISM Growth quadrant model entered the inflationary bust quadrant at the end of March – the economic environment with the worst market returns. The Interest rates category shows that liquidity continues to tighten but not yet enough to break inflationary headwinds.

Market Risk Index

Rec Allocation 25% Underweight

87.5%

Category Percentiles

Psychology - P5	82.1%
Monetary - M5	81.1%
Valuation - Extremely Overvalued	95.7%
Trend	65.2%

Largest Psychology Influences

Leveraged Investments	Negative
Volatility	Negative
Surveys	Positive
Flow of Funds	Negative

Largest Monetary Influences

Inflation	Negative
Interest Rates	Negative
Exchange Rates	Positive

Valuation

7-10 Year Rtn Forecast	1.8%
10Yr US Treasury Yield	2.8%

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.

We'd be remiss if we didn't mention that the quadrennial *Sell in Mid-Term May* season is upon us. We have closely followed this anomaly for a long time, and it biases our view for 12 months every four years. Two of our favorite stock market anomalies, popularized by the Hirsch family in the Stock Trader's Almanac, are the Sell in May rules and the Presidential Election cycle.

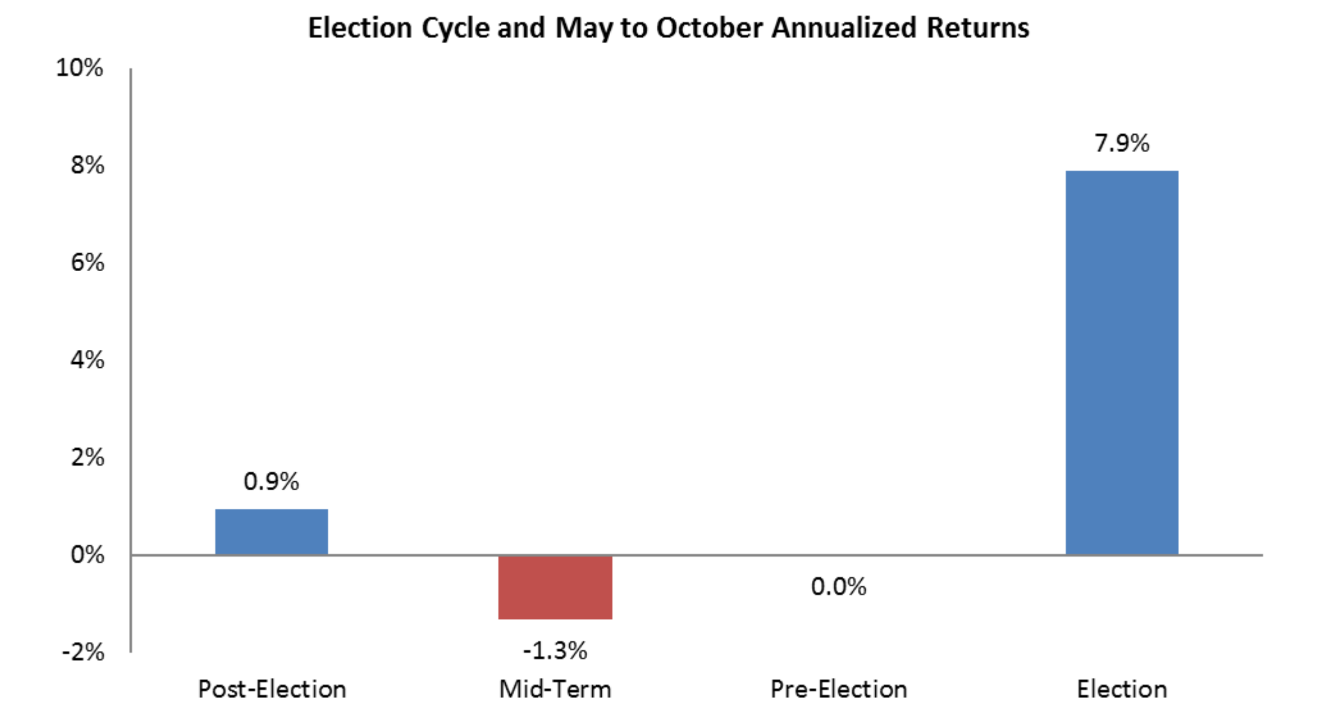
In the late 90s, we combined the two anomalies and noticed that most of their power hinges on a single 12-month period that begins in a mid-term election year, the point where the election cycle tends to bottom out. We have included an updated chart and table and extended the data beyond the post-WWII era to 1901, using price data on the Dow Jones Industrial Average. Since 1901, the May to October period in mid-term election years has an average annualized -1.3% average annualized return, the worst of the four years. (As an aside, the post-election and pre-election May to October period returns dropped markedly when we included the pre-WWII stock market data, but the May to October period in mid-term years was consistent in being the worst May to October period.)

The good news is that *Sell in Mid-Term May* gives way to *Remember Mid-Term November*, the November to April period in a mid-term election year. Historically, this has been a six-month land of milk and honey for the stock market. The average annualized price return for *Remember Mid-Term November* has been 21.1% since 1901, without a decline in 81 years. Buckle up, then giddy up!

In the meantime, we encourage readers to resist the urge to be aggressive buyers of these dips. We designed Market Risk Index to manage our own money - to weather every market environment. The tradeoff was that to avoid devastating kinds of losses markets can dish out, we knew it meant a considerable likelihood of missing out on some gains in frothy markets. As defensive investors, the risks we prefer to take in financial markets are positive asymmetric bets. We'll be more aggressive bulls when readings fall below 50% on MRI. When MRI readings fall below 25%, we'll be backing up the truck to buy stocks.

Charts of the Week

Sell in Mid-Term May



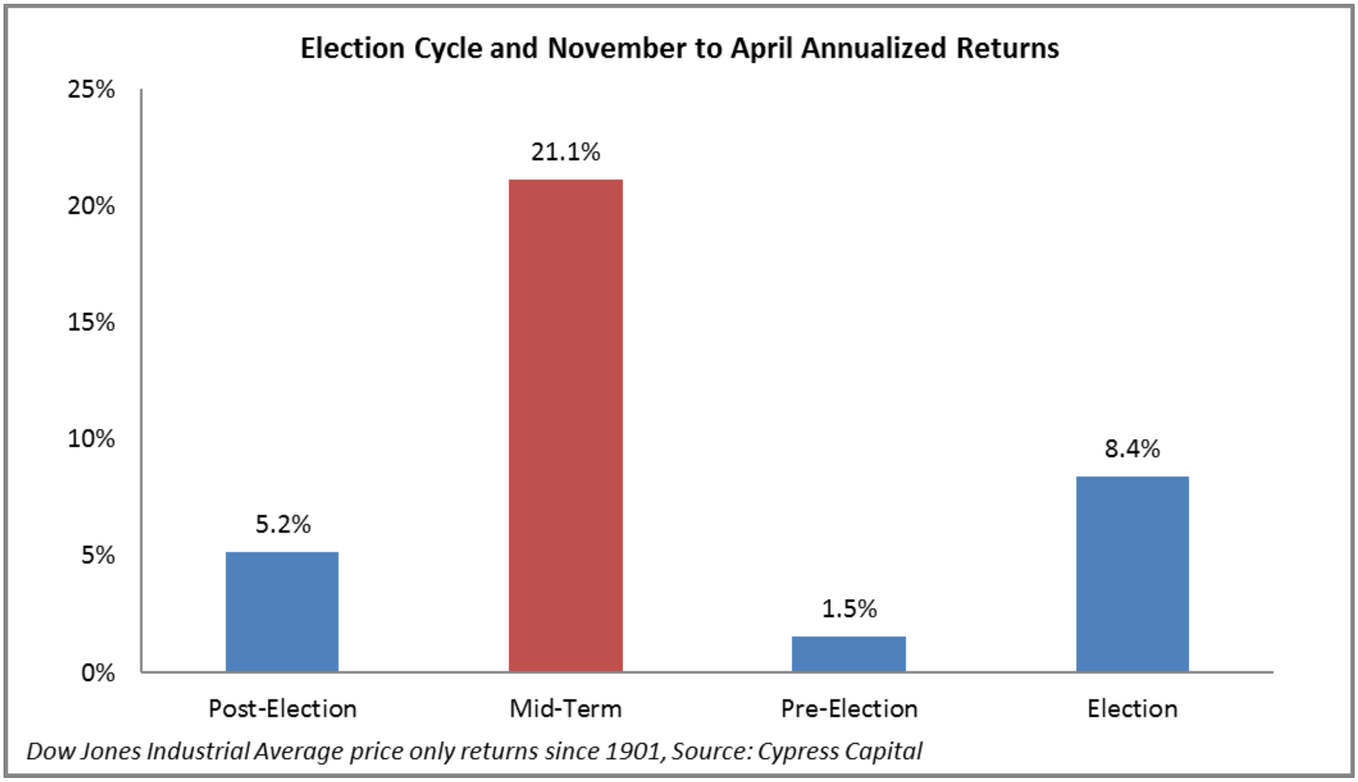
Dow Jones Industrial Average price only returns since 1901, Source: Cypress Capital

Table – Sell in Mid-Term May

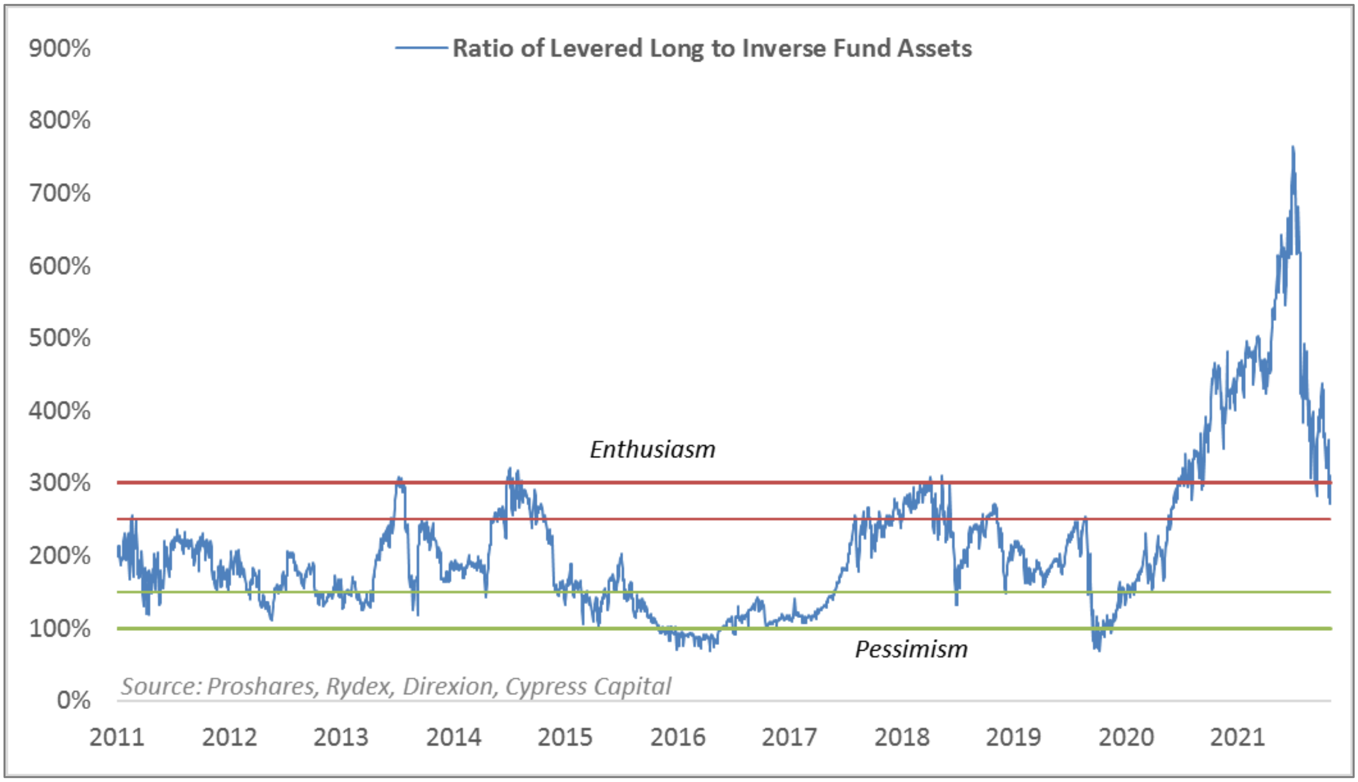
Election Cycle & May-October Returns				
Period	**Post-Election**	**Mid-Term**	**Pre-Election**	**Election**
1901-1904	-15.0%	-1.4%	-29.2%	29.1%
1905-1908	10.1%	2.6%	-31.6%	18.7%
1909-1912	12.2%	-1.7%	-9.4%	0.5%
1913-1916	-0.3%	-9.7%	32.8%	16.7%
1917-1920	-20.1%	10.3%	28.0%	-9.0%
1921-1924	-6.8%	4.5%	-10.0%	14.8%
1925-1928	29.7%	4.9%	10.4%	19.2%
1929-1932	-14.3%	-34.3%	-30.3%	10.3%
1933-1936	13.5%	-7.1%	27.7%	21.6%
1937-1940	-20.7%	36.3%	18.2%	-9.3%
1941-1944	2.0%	19.6%	2.1%	7.6%
1945-1948	12.8%	-18.2%	6.5%	4.5%
1949-1952	8.8%	5.0%	1.2%	4.5%
1953-1956	0.4%	10.3%	6.9%	-7.0%
1957-1960	-10.8%	19.2%	3.7%	-3.5%
1961-1964	3.7%	-11.4%	5.2%	7.7%
1965-1968	4.2%	-13.6%	-1.9%	4.4%
1969-1972	-9.9%	2.7%	-10.9%	0.1%
1973-1976	3.8%	-20.5%	1.8%	-3.2%
1977-1980	-11.7%	-5.4%	-4.6%	13.1%
1981-1984	-14.6%	16.9%	-0.1%	3.1%
1985-1988	9.2%	5.3%	-12.8%	5.7%
1989-1992	9.4%	-8.1%	6.3%	-3.2%
1993-1996	7.4%	6.2%	10.0%	8.3%
1997-2000	6.2%	-5.2%	-0.5%	2.2%
2001-2004	-15.5%	-15.6%	15.6%	-1.9%
2005-2008	2.4%	6.3%	6.6%	-27.3%
2009-2012	18.9%	1.0%	-6.7%	-0.9%
2013-2016	4.8%	4.9%	-1.0%	2.1%
2017-2020	11.6%	3.9%	1.7%	8.9%
2021-2024	5.7%			
Mean	**1.2%**	**0.3%**	**1.2%**	**4.6%**
Median	**3.8%**	**2.6%**	**1.7%**	**4.4%**
Geo Mean (Annl)	**0.9%**	**-1.3%**	**0.0%**	**7.9%**
Std Dev.	**12.2%**	**13.8%**	**15.4%**	**11.1%**
C.V (SD/Mean)	**10.2**	**53.0**	**12.9**	**2.4**
Pct Positive	**65%**	**57%**	**57%**	**70%**

Dow Jones Industrial Average Price Only since 1901 *Source: Cypress Capital*

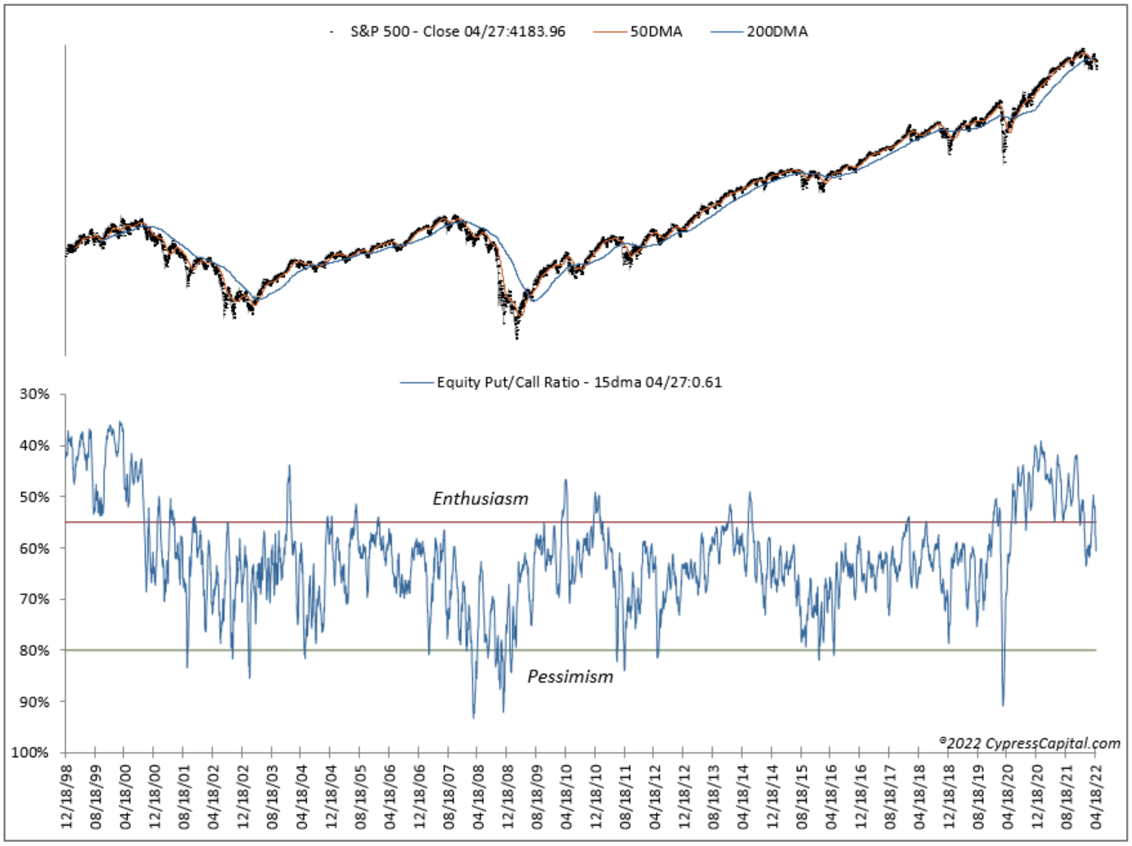
Remember Mid-Term November



Leveraged ETF and Fund Asset Sentiment is elevated but fell out of enthusiasm territory this week.

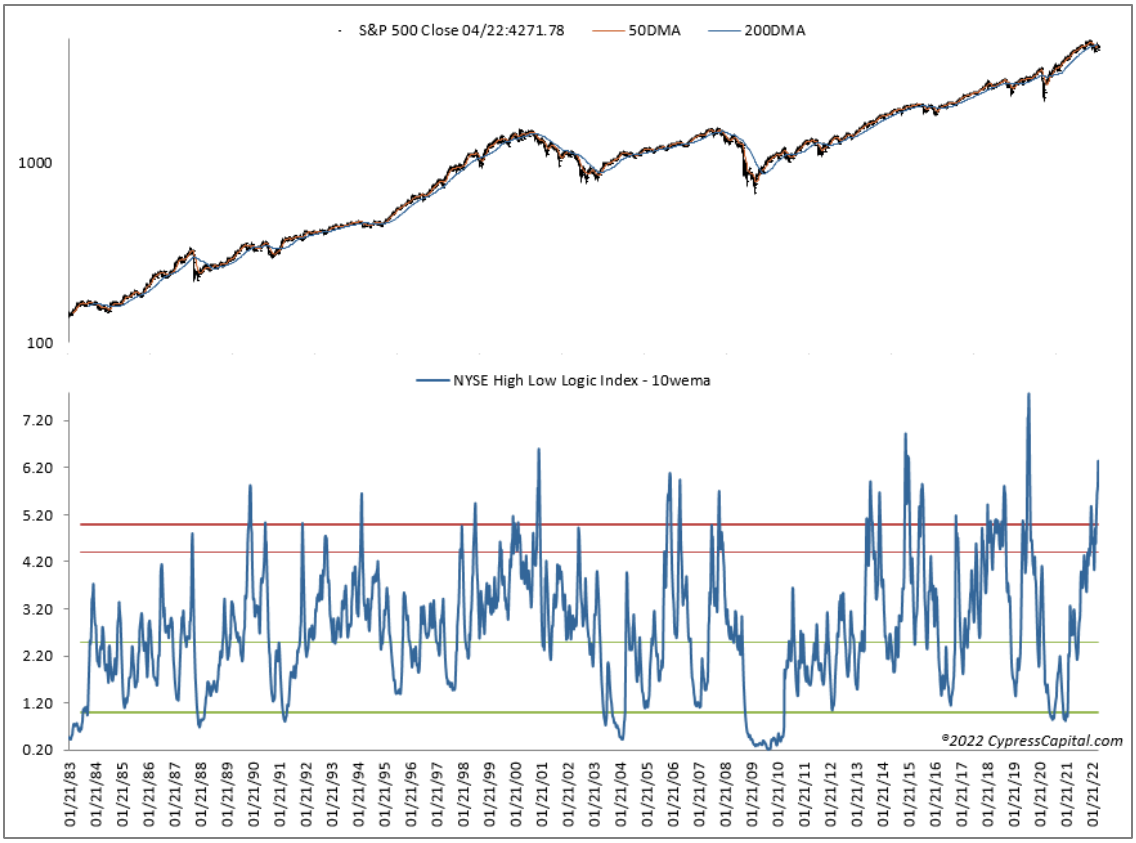


Equity Put/Call Ratio is showing similar behavior. No, but animal spirits are slowly breaking.



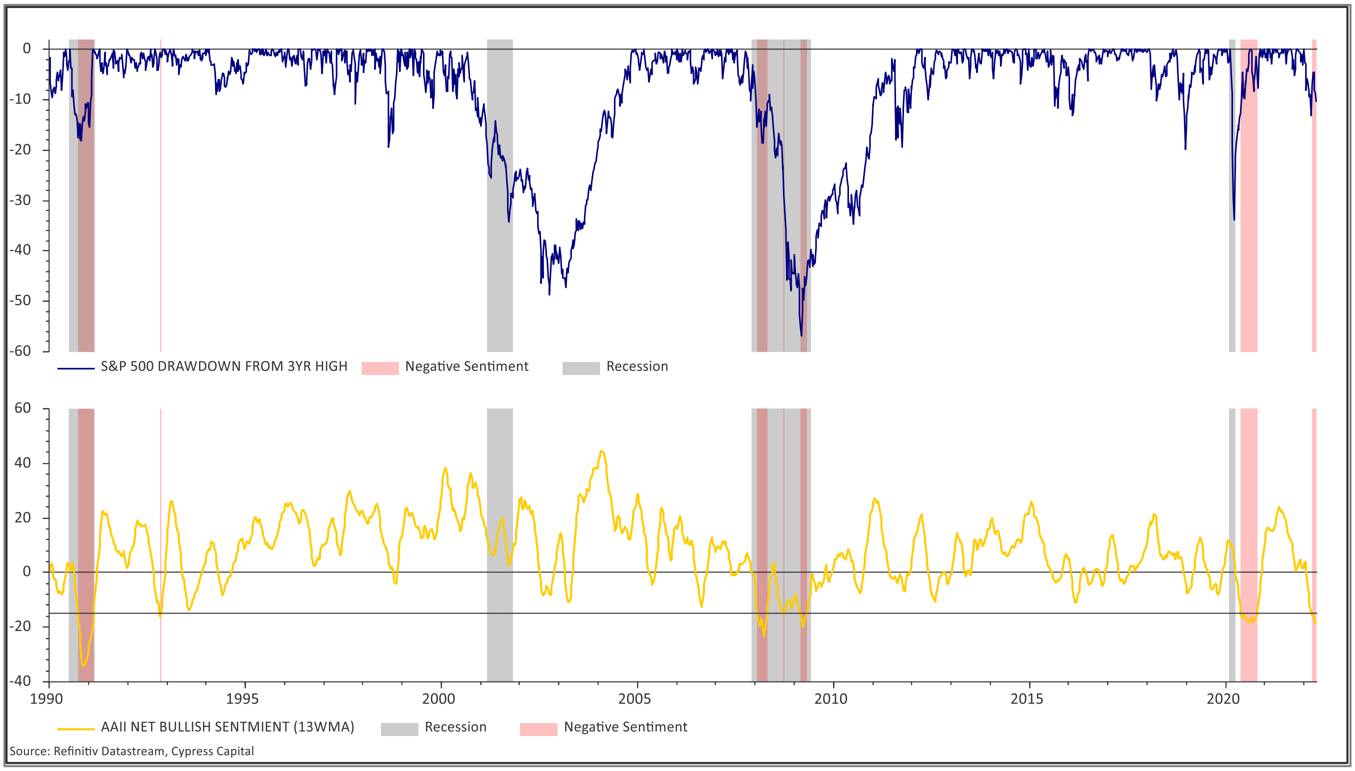
NYSE High Low Logic worsened – signaling unhealthy market internals

While the indicator has its share of false signals, it has also never failed to give a bear market warning before its onset.

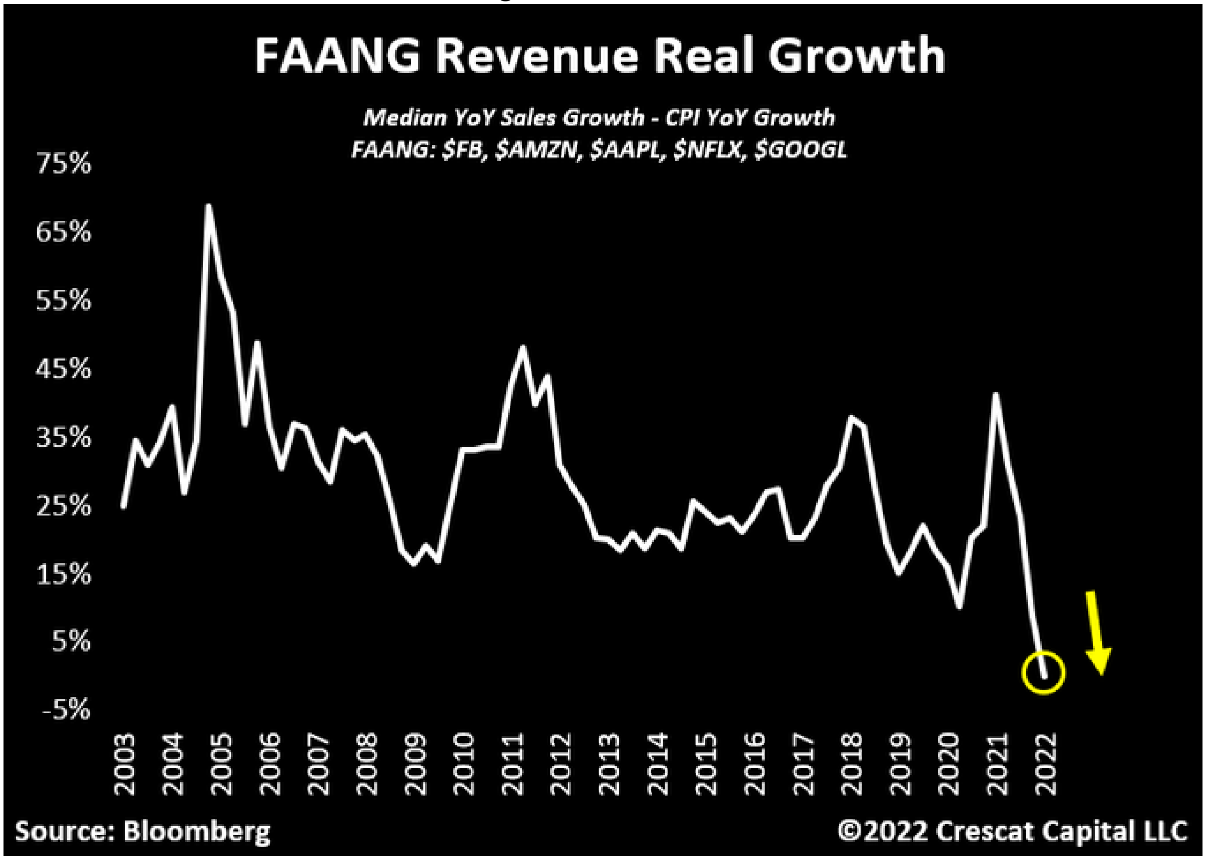


AAII Net Bullish Sentiment (using 13-week moving average)

Since the beginning of the survey, persistent and severe net bearish sentiment has coincided with economic recessions.



FAANG Stock Real Sales Growth Goes Negative



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.