Market Outlook

By Mark T Dodson, CFA

Investors are growing concerned but not capitulating.

Market Risk Index dropped 1.8% to 85.7% on modest improvements to all three of our counter-cyclical composites – Psychology, Monetary, and Valuation.

Monetary composite improvement was trivial. Even though our interest rates category is max negative and can deteriorate no further, it's worth pointing out that the Dow Jones Bond Oscillator shows bond market liquidity has tightened the most since the early 1980s. This signal of tighter liquidity will become more evident and appreciated by the public and work its way into the broader economy throughout the summer.

Our hopes for better news on the inflation front were dashed with the release of the ISM numbers this week. The ISM Price Index is too high for a constructive stock market environment. For over 70 years, ISM Price index readings above 75 have been associated with declining stock prices.

S&P 500 Price Performance & ISM Price Index	
Above 75	-2.9%
Between 50 and 75	8.4%
Less than 50	19.4%

Feb 1950 to Present

Stock market volatility is beginning to impact investor psychology again, in a good way. One welcome development was with corporate insiders, whose apathy we highlighted just last week gave way to signs of interest in buying stocks.

The Leveraged investments category made a substantial week-over-week improvement, causing it to fall from the top spot as the Largest Psychology Influence – a spot it has held for the last year. It's still a negative, but decidedly less so, as investors are beginning to rethink whether being levered on stocks is a great idea anymore. The speculative fever is breaking, slowly and begrudgingly.

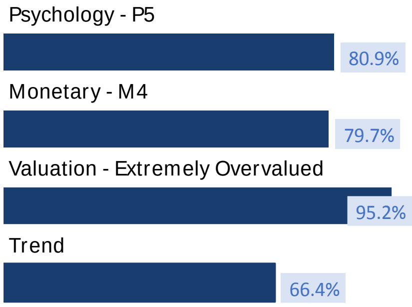
The Surveys category now tops the list as the largest influence on the Psychology composite. Both investment professionals and individual investors continue to respond to surveys with very bearish inclinations (bullish for markets), even though they have yet to position their portfolios to match their responses to said surveys

Market Risk Index

Rec Allocation 25% Underweight

85.7%

Category Percentiles



Largest Psychology Influences

Surveys	Positive
Technical Indicators	Positive
Option Activity	Positive
Leveraged Investments	Negative

Largest Monetary Influences

Inflation	Negative
Interest Rates	Negative
Exchange Rates	Positive

Valuation

7-10 Year Rtn Forecast	1.9%
10Yr US Treasury Yield	3.0%

Market Trends

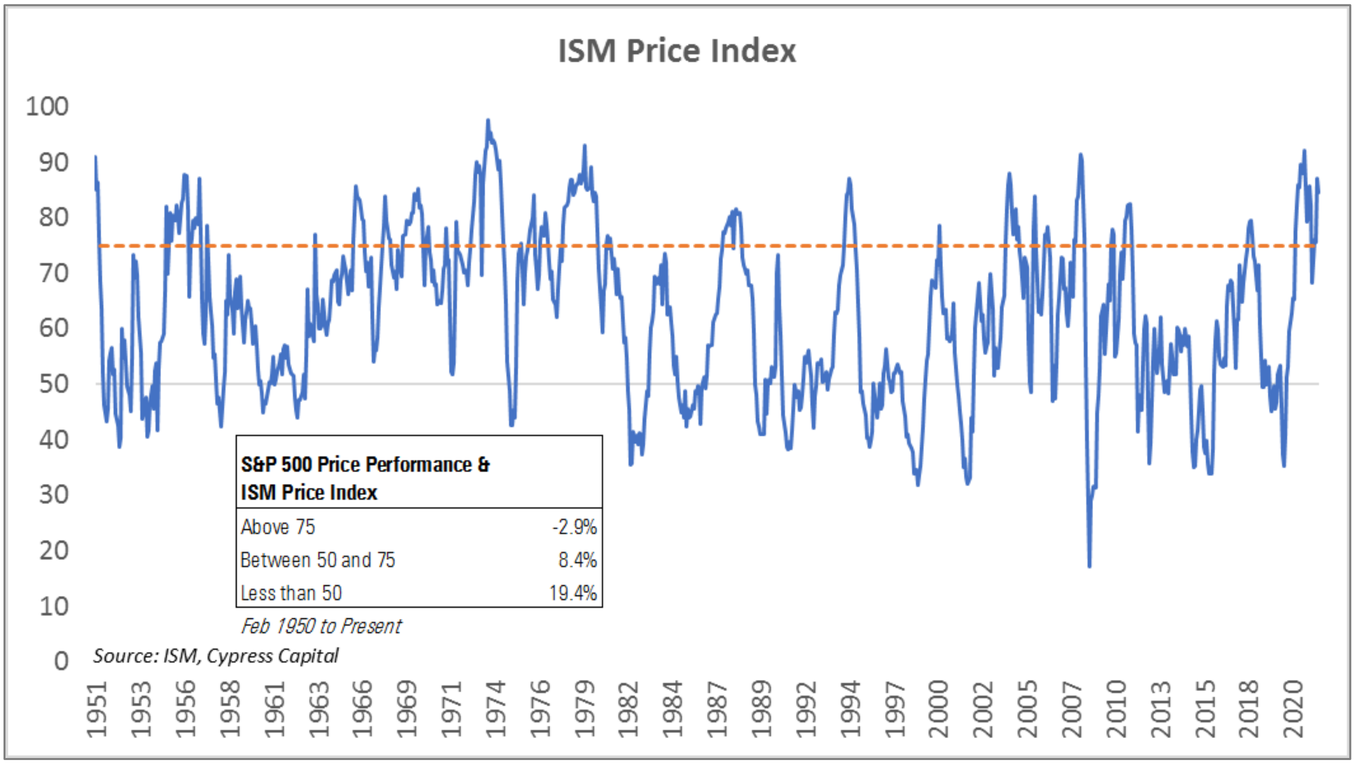
US Equities	Bullish Investment
Intl Equities	Bullish Investment
REITs	Bullish Investment
Broad Commodities	Bullish Investment

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.

Overall, Psychology shows investor apprehension but not capitulation, and broad market internals remain unhealthy. Consequently, equity allocation recommendations are unchanged.

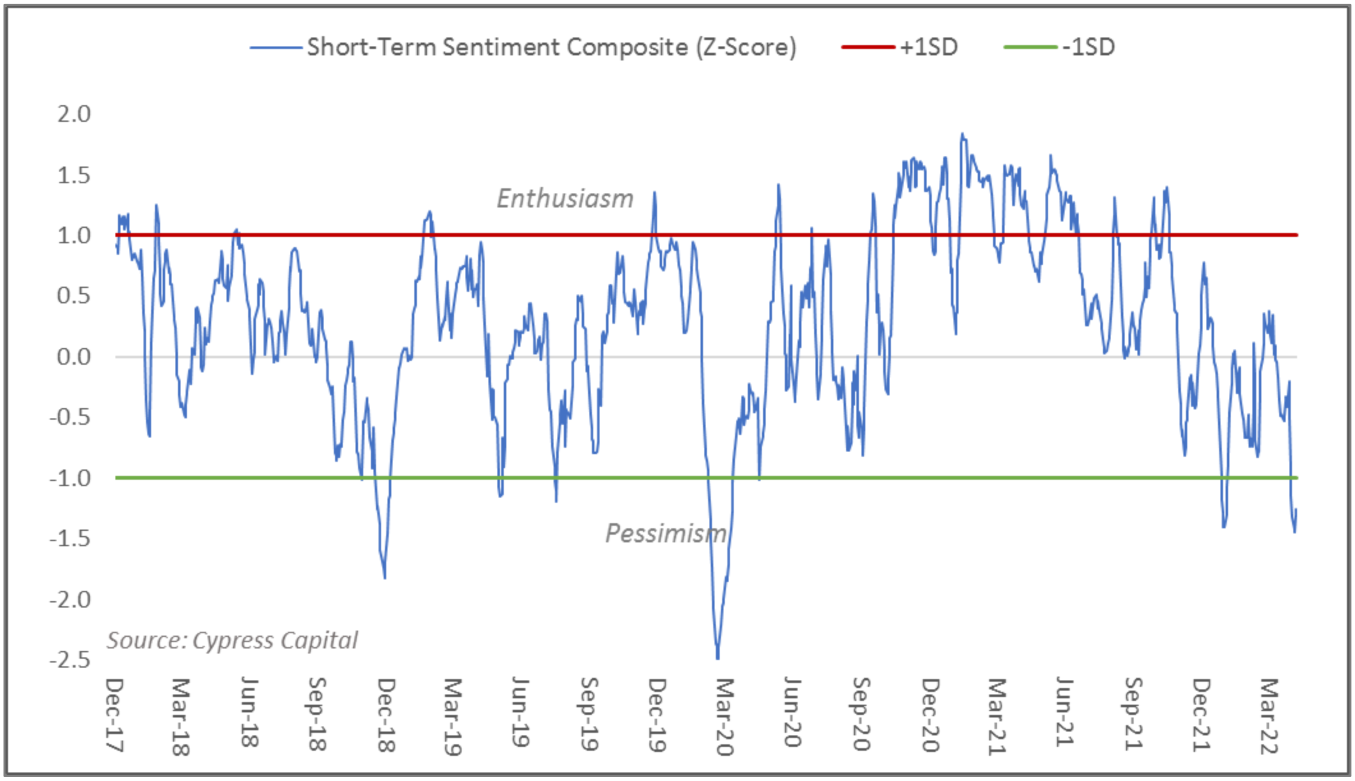
Charts of the Week

ISM Price Index – another reading above 75

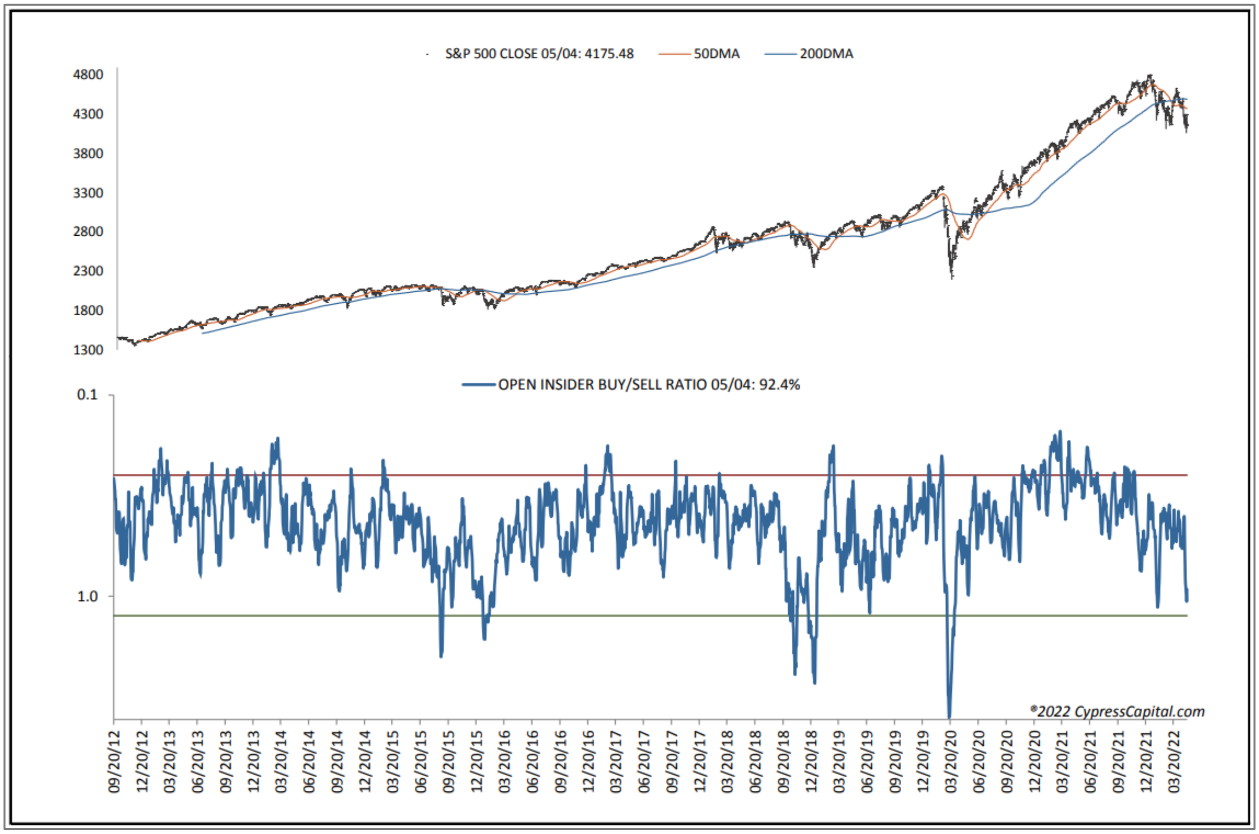


Short Term Sentiment Composite

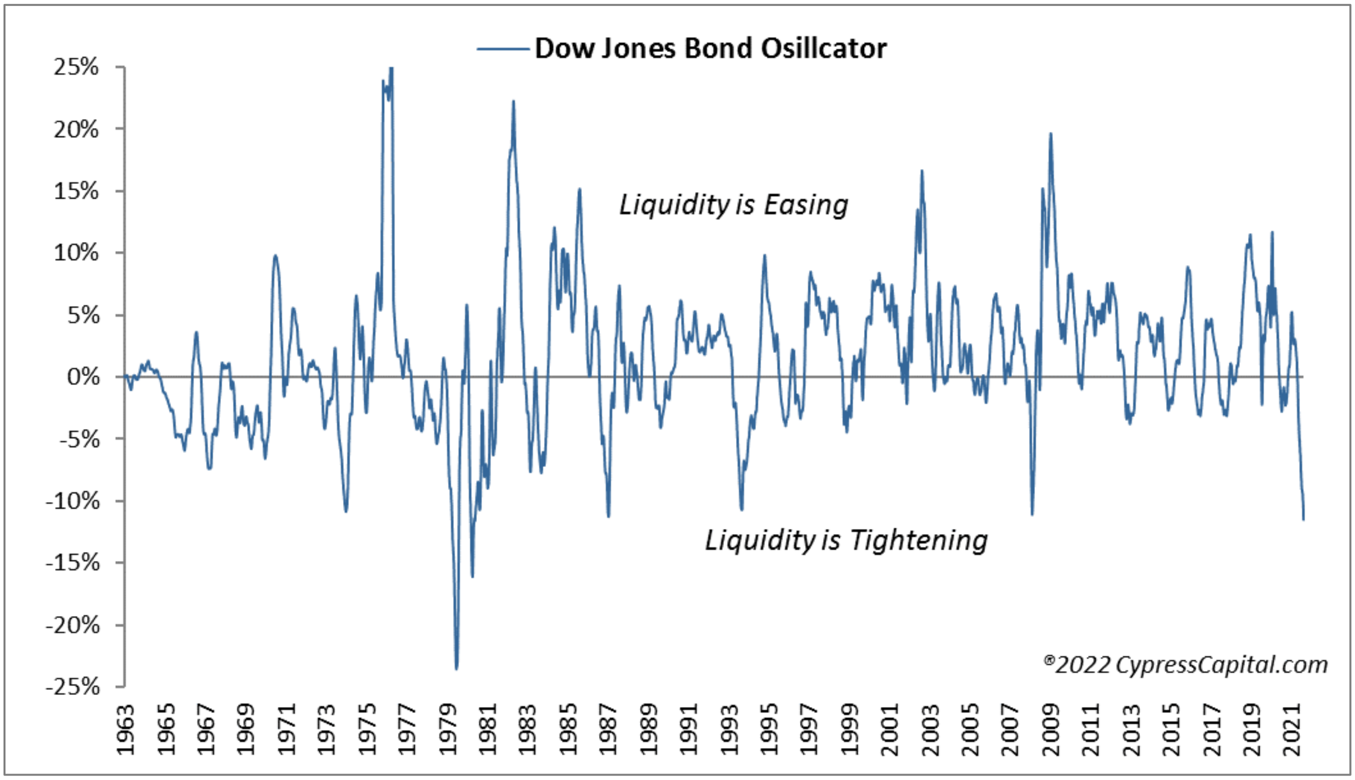
Short-term sentiment moved one standard deviation into pessimism for the second time this year. Healthy bull markets rally almost immediately after hitting this level. In bear markets, readings tend to cluster in pessimism.



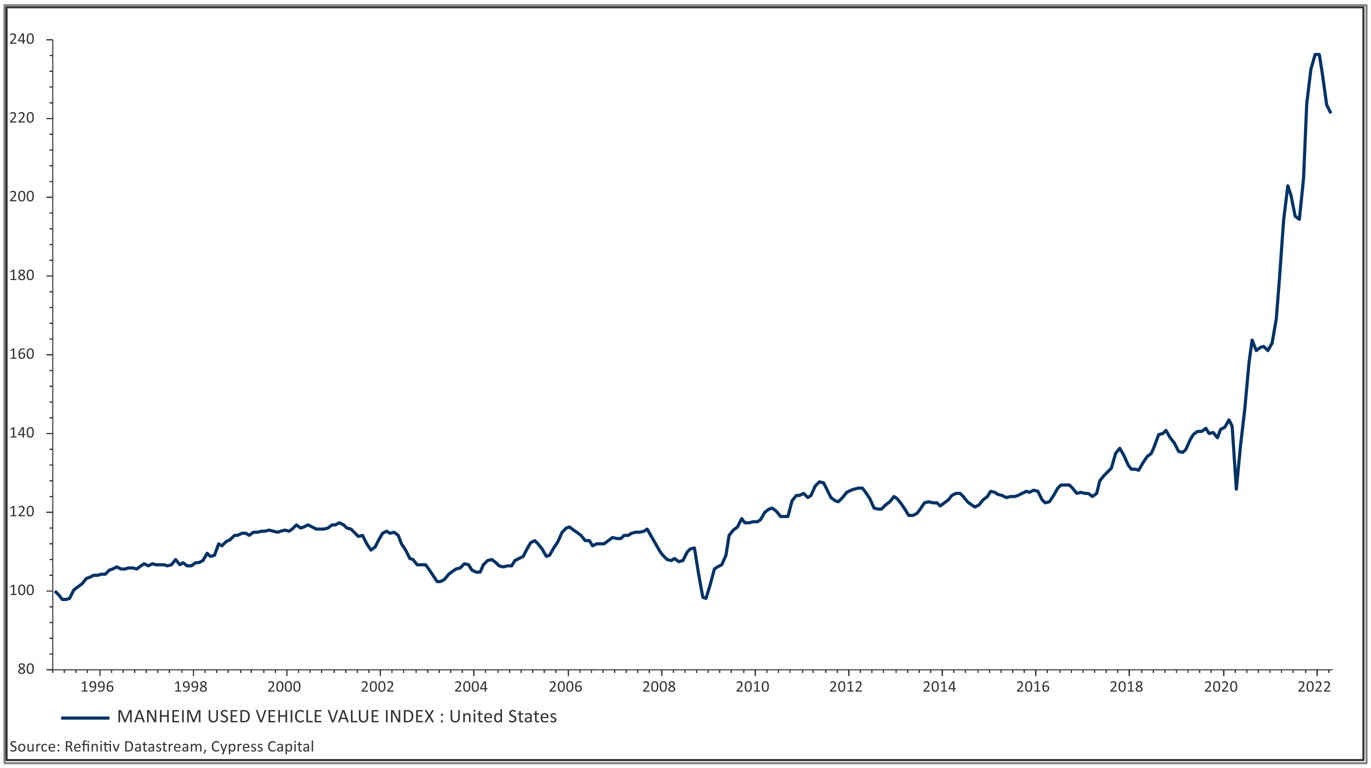
Corporate Insiders finally showed mild interest in their stocks this week.



Bond Market liquidity has tightened faster than anytime since the early 1980s.



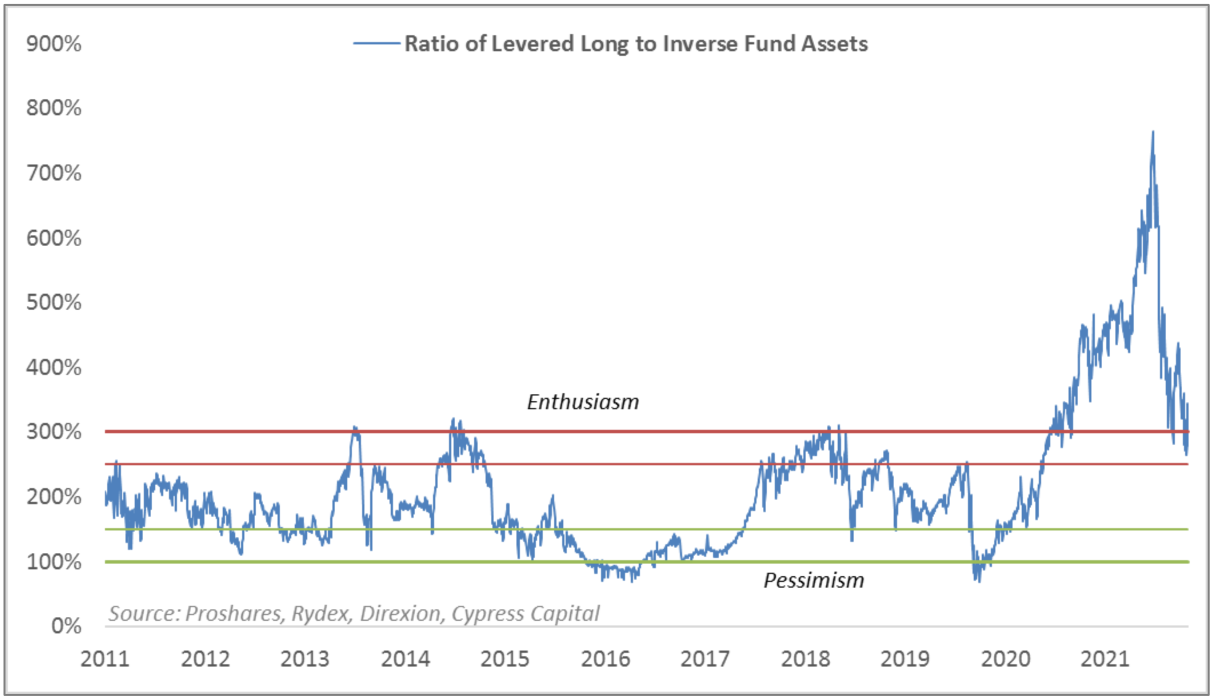
Manheim Used Vehicle Value Index – the price of used cars is finally peaking.



Real Yields on 10YR TIPs went positive for the first time since 2020.

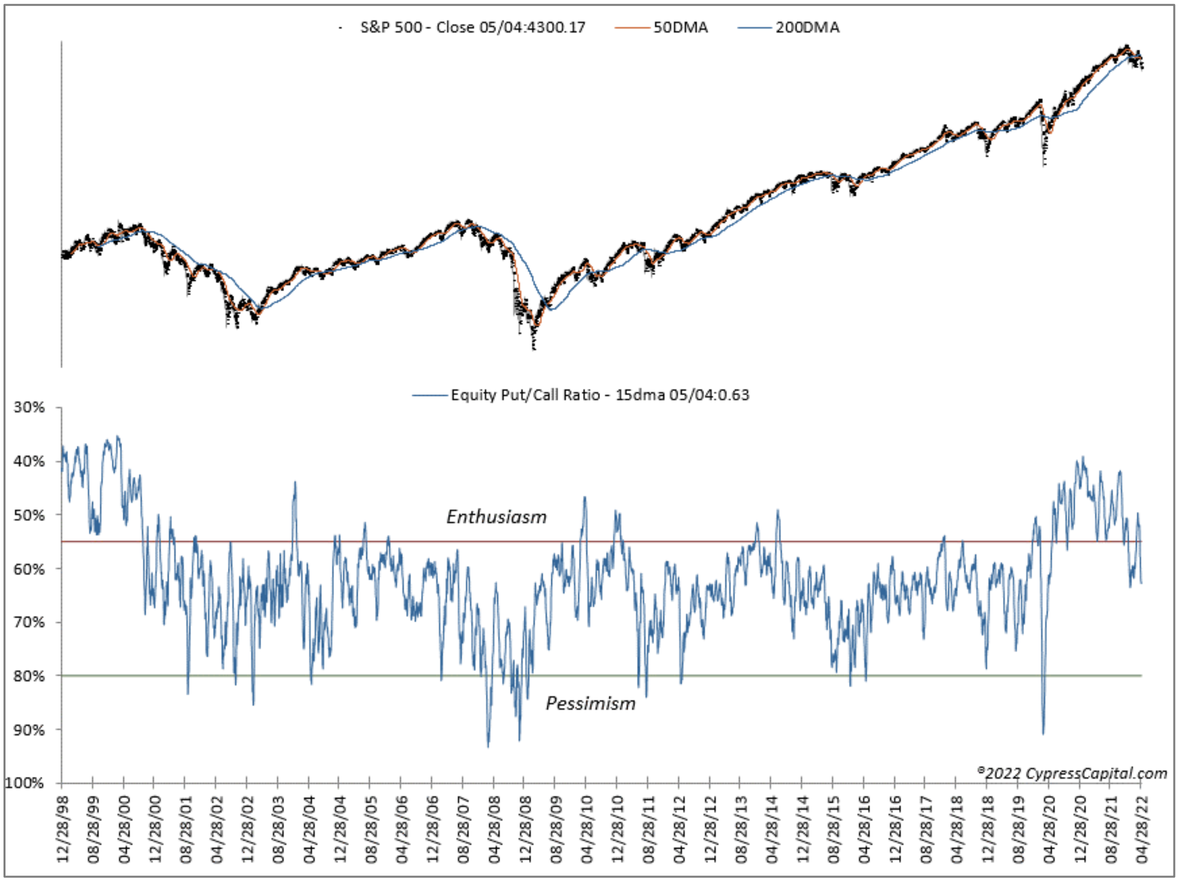
Ratio of Levered to Inverse Fund Assets

We will routinely include this chart, as it will yield the most conspicuous clue when the the first Federally funded stock market speculative era has ended.

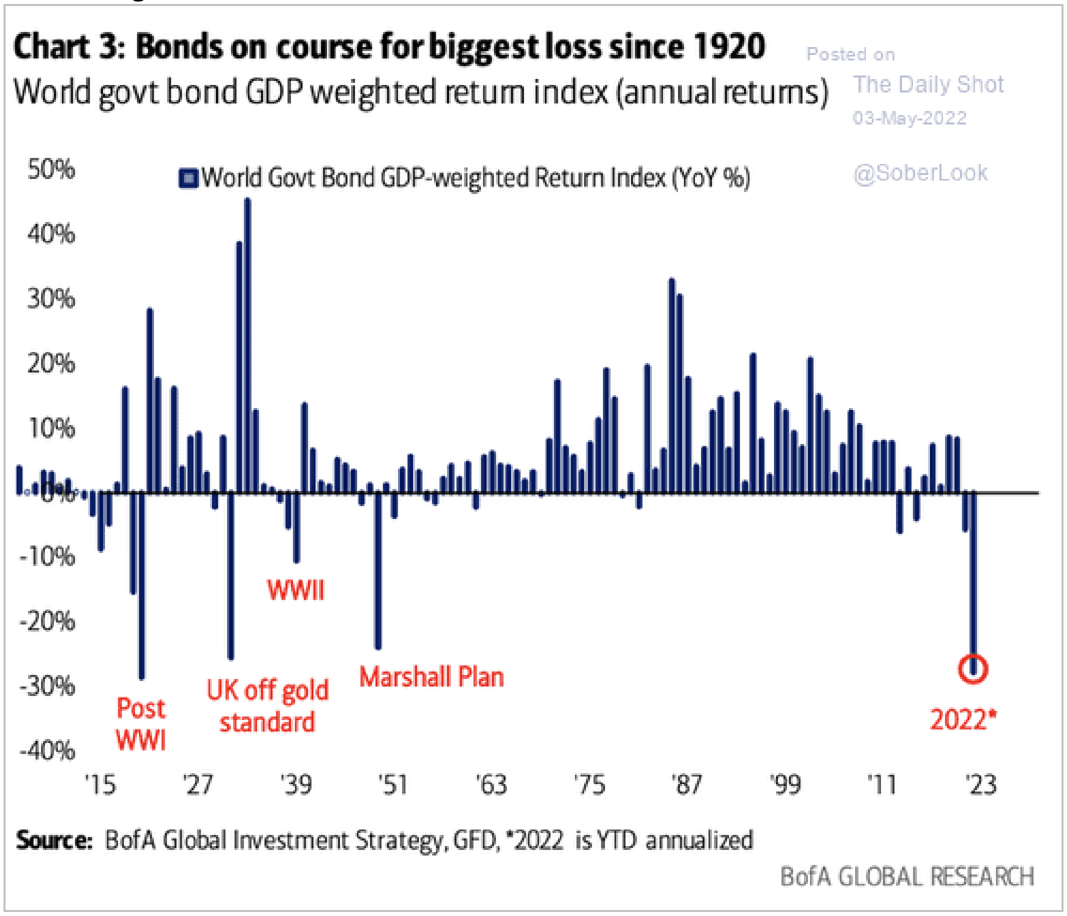


Equity Put/Call Ratio – 15 day moving average.

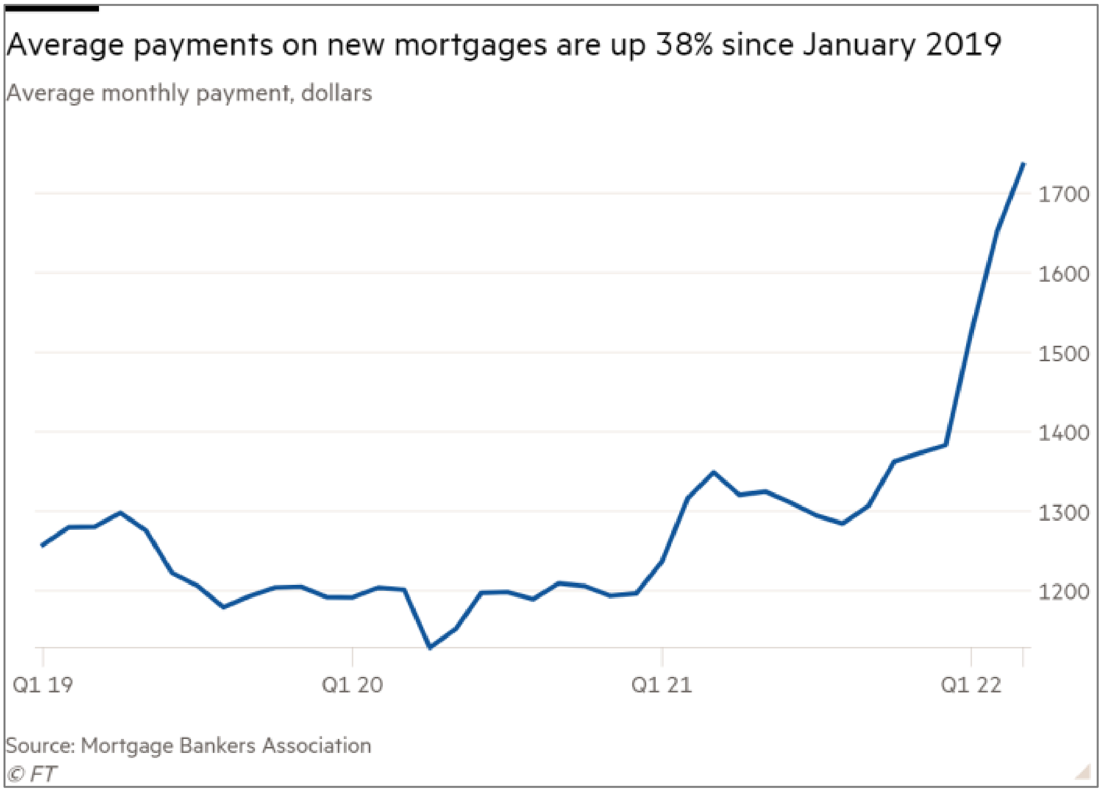
Ditto for this chart. Investors are growing leery of buying the dip, but this chart shows that investors are still clearly in the denial phase.



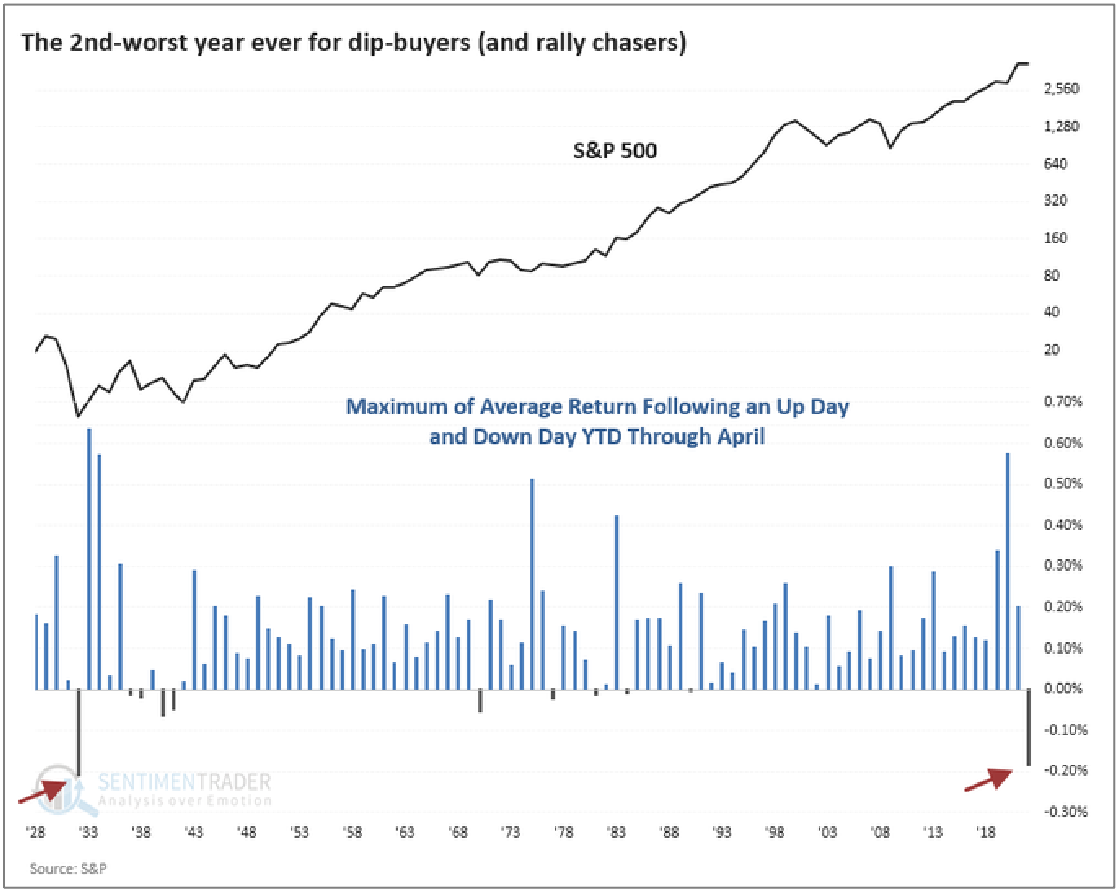
The worst global bear market in bonds since 1920.



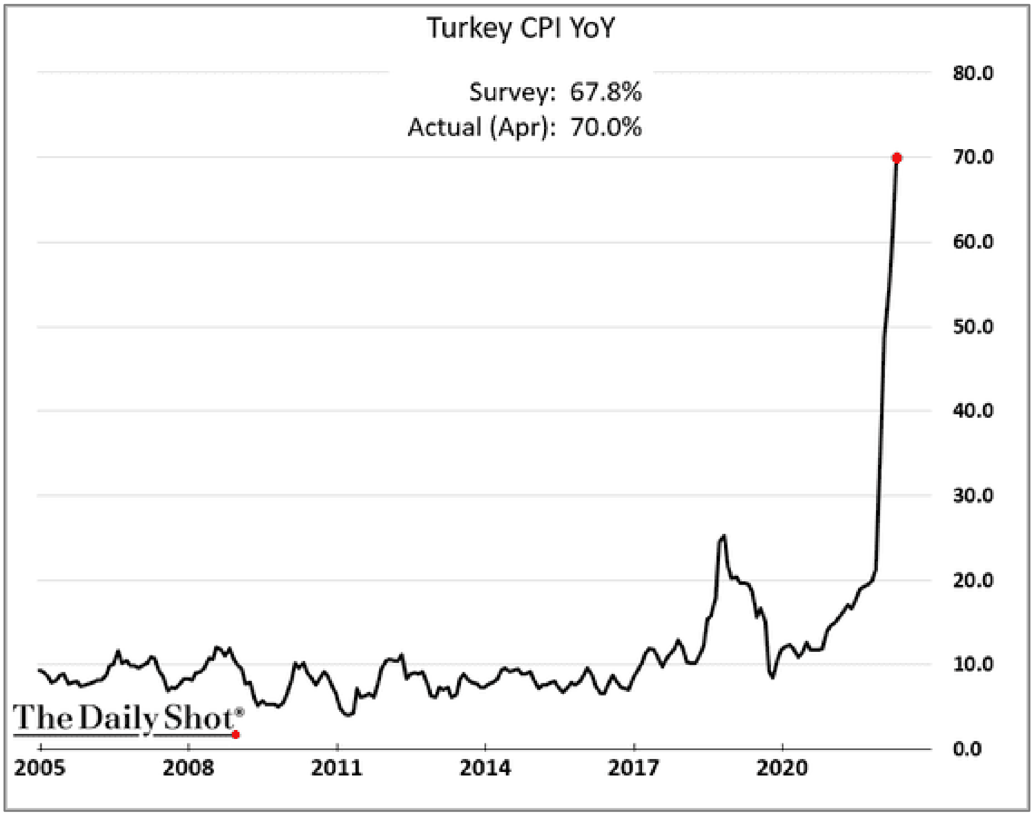
The average payment on a new mortgage has risen 38% since 2019.



2022 has squashed the simple strategy of always Buying the Dip.



Have you ever seen a turkey fly? Inflation in Turkey hits 70%.



Futures liquidity is drying up.

Exhibit 20: Top-of-book depth has fallen to levels typically associated with extreme volatility

10-day rolling median E-mini future bid-ask depth ($mm notional), based on 5-minute intraday snapshots

Source: Goldman Sachs Global Investment Research, Reuters

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.