Market Outlook

By Mark T Dodson, CFA

Is it over?

Market Risk Index doesn't think so. Although MRI had a hefty 5% drop to 80.2% this week, it is well above levels that give an all-clear for investors wanting to increase equity allocations early within an unfolding bear market.

Monetary conditions improved, aided by the Inflation category, which fell from the top spot as the most significant negative Monetary influence. The rate of change in the CRB Raw Industrials Spot index has slowed dramatically. CRB doesn't carry the heaviest weight in the Inflation category, but it's often the first to signal inflation pressures are subsiding, even if it can have uncomfortably long lead times. Unfortunately, the Producer Price index didn't confirm it, which also leads CPI, but does so in a more timely manner. PPI still isn't showing signs of a clear CPI peak, and the current inflation rate in producer prices is not favorable for stock market investors.

Valuations are steadily improving, but not at the same pace as bond valuations. We have gone from a -0.4% expected return in Feb 2021, when enthusiasm peaked, to a 2.2% expected return on stocks at this week's low. That's a significant improvement, but it's remarkably shy of the 3% return one can earn on a 10Yr Treasury. If a 3% return on Treasuries doesn't make you drool in an 8% CPI inflation environment, then current stock market valuations shouldn't either. Using rules of thumb, like how far we have fallen from a stock market peak, aren't sufficient in gauging the risk-reward present in equities.

Investor psychology made a significant week-over-week improvement, with daily point totals inside our composite matching levels not seen since February 2020. In the past, it's been enough to signal the end of the 1998 stock market correction, the 1990 bear market, or the onset of powerful bear market rallies, like the one after 9-11. It's also been a signal that the worst of the bear market was yet to come like right before the worst parts of the bear markets in 1973-74, 2008, or before the shortest ever recorded bear market in 2020.

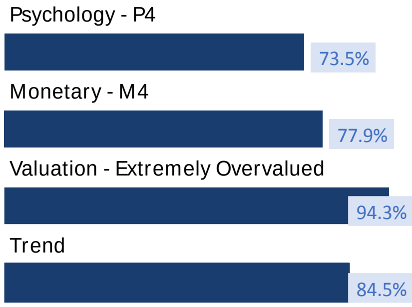
If you are looking for a layup to put on risk for a long-term investment, this week didn't give it to you. If you are looking for more subjective metrics, like a possible panic move by Jerome Powell, we didn't get that either. Financial conditions haven't tightened to even the point where he's had previous pivots in both 2018 and 2020 – pivots we'd add that occurred where the current inflation rate was even a factor worth consideration. The level of inflation now is the kind that relegates central bankers to the hall of shame. Credit spreads also haven't widened to the point that has made Powell panic, and we've yet to see a single indication that the job

Market Risk Index

Rec Allocation 25% Underweight

80.2%

Category Percentiles



Largest Psychology Influences

Surveys	Positive
Volatility	Positive
Option Activity	Positive
Leveraged Investments	Negative

Largest Monetary Influences

Interest Rates	Negative
Inflation	Negative
Exchange Rates	Positive

Valuation

7-10 Year Rtn Forecast	2.2%
10Yr US Treasury Yield	3.0%

Market Trends

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

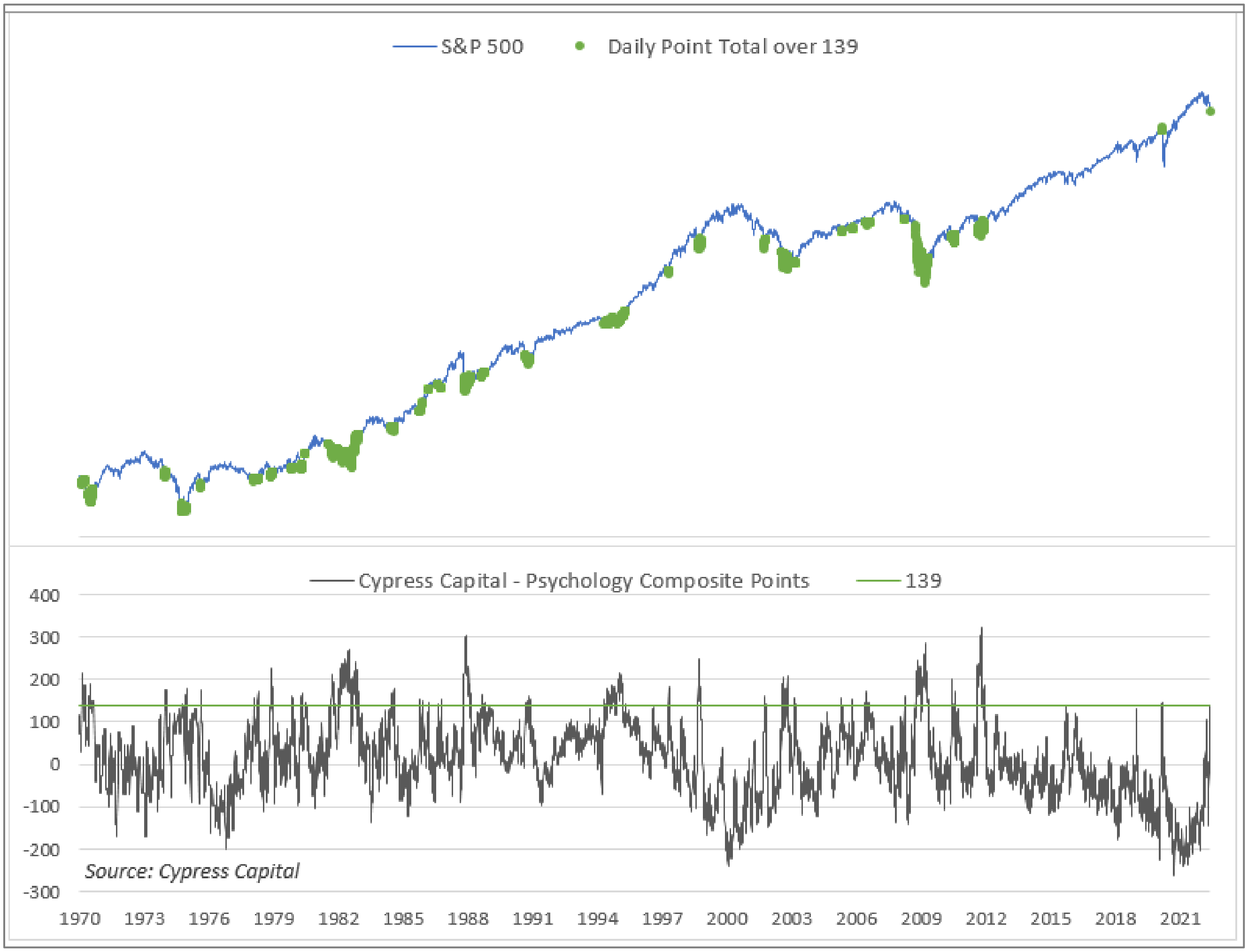
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

market has softened. Nothing happened this week that will make Jerome Powell take his new Paul Volcker poster off the wall.

Robust bull markets require a solid monetary foundation, valuations so compelling that it's undeniable that investors have abandoned equities, and a positive market trend - indicating that all the forced-panic selling is in the rearview mirror. Unfortunately, we don't have this combination today. At best, we have conditions in place for a speculative bear market rally.

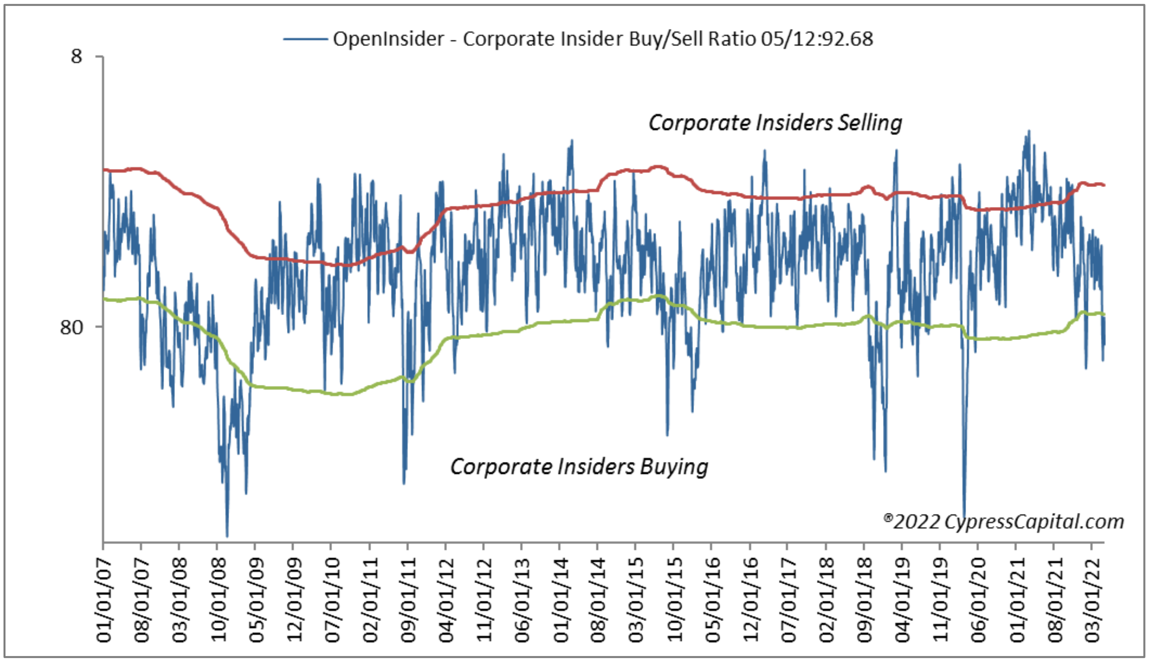
Charts of the Week

Cypress Psychology Composite Daily Point Total
Best daily reading on investor psychology since February 2020.



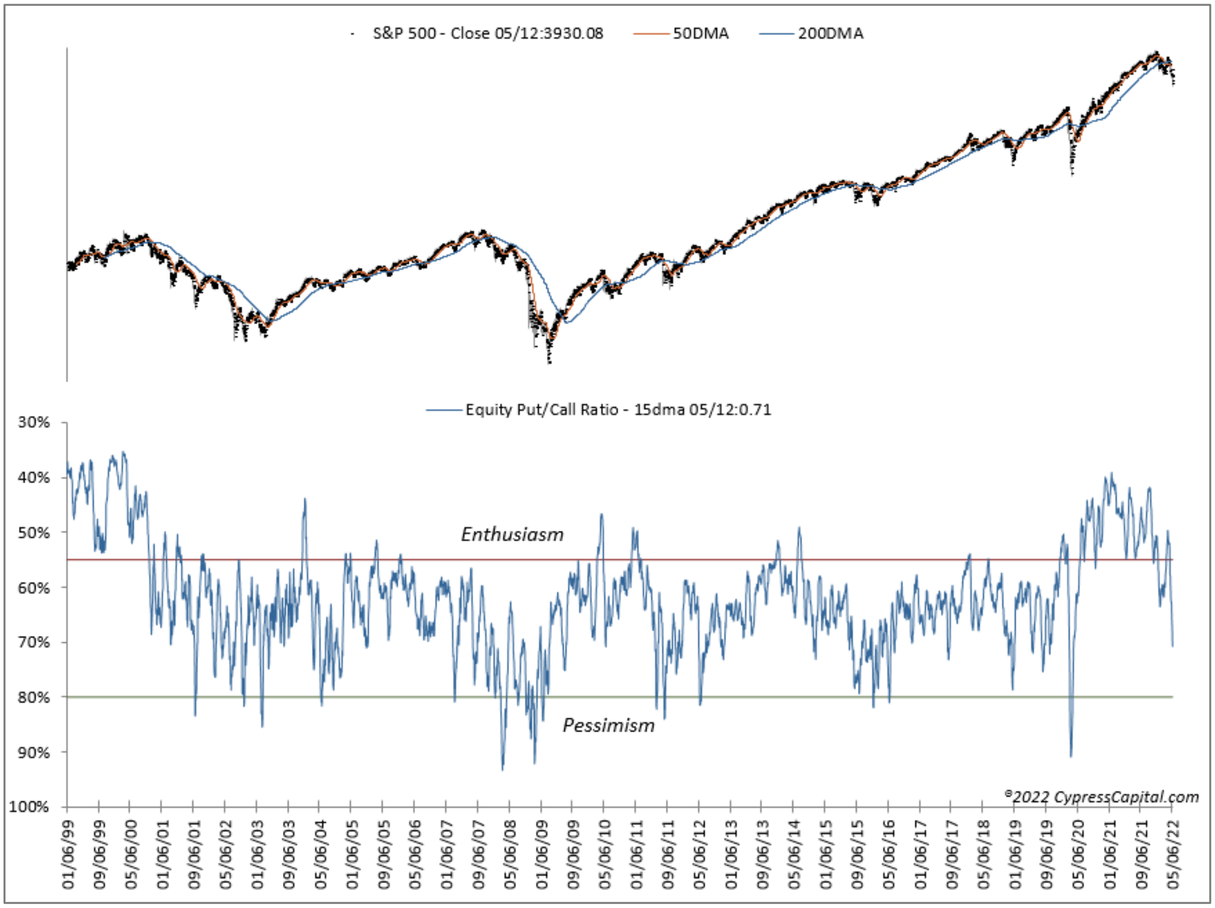
OpenInsider – Corporate Insider Stock Market Sentiment

Corporate insiders are buying, which is good, but there is little conviction. Compare today's buying with the worst part of the Covid selloff, 2008, or even the Q4 2018 stock market panic.



Equity Put/Call Ratio - 15-day moving average

The nail still hasn't been driven into the coffin of the Covid-crypto speculative era.



Enthusiasm for Levered ETFs and Mutual Funds

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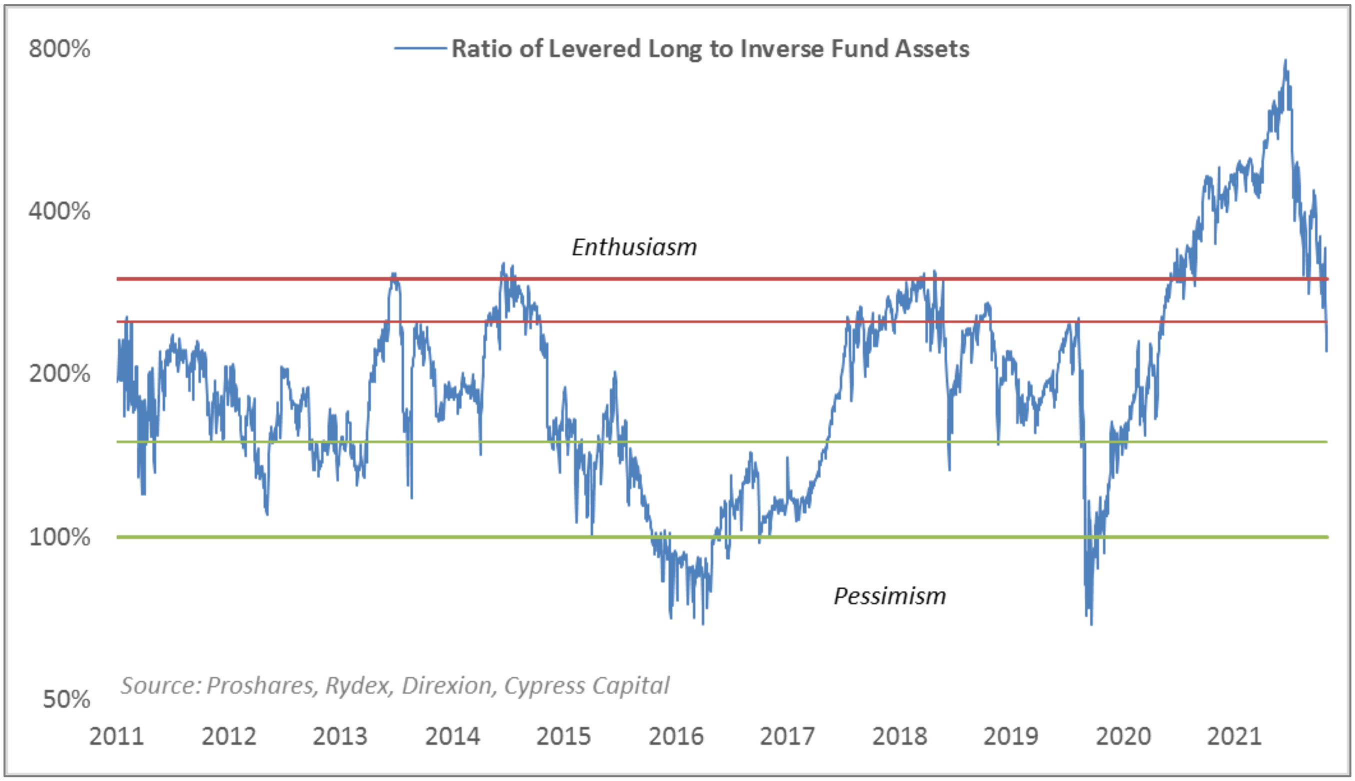
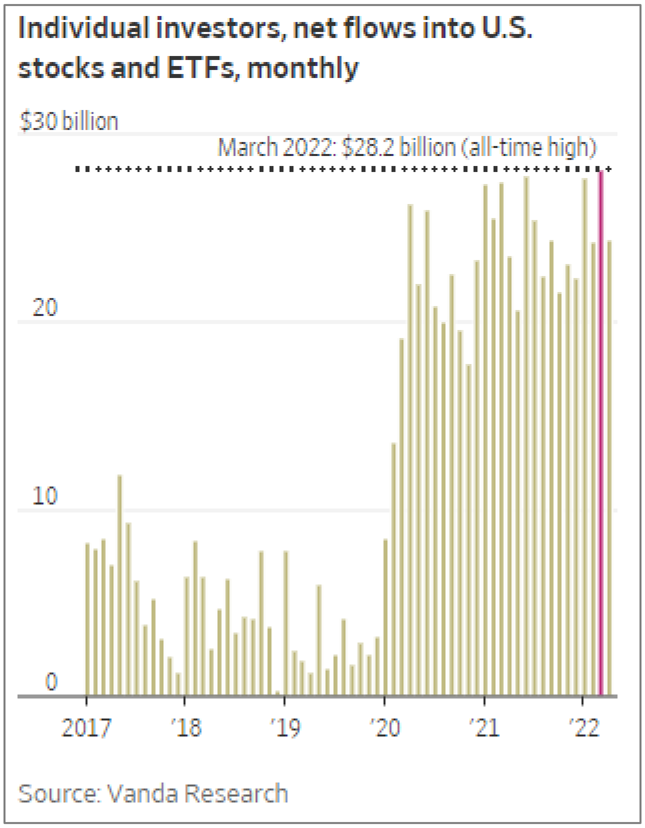
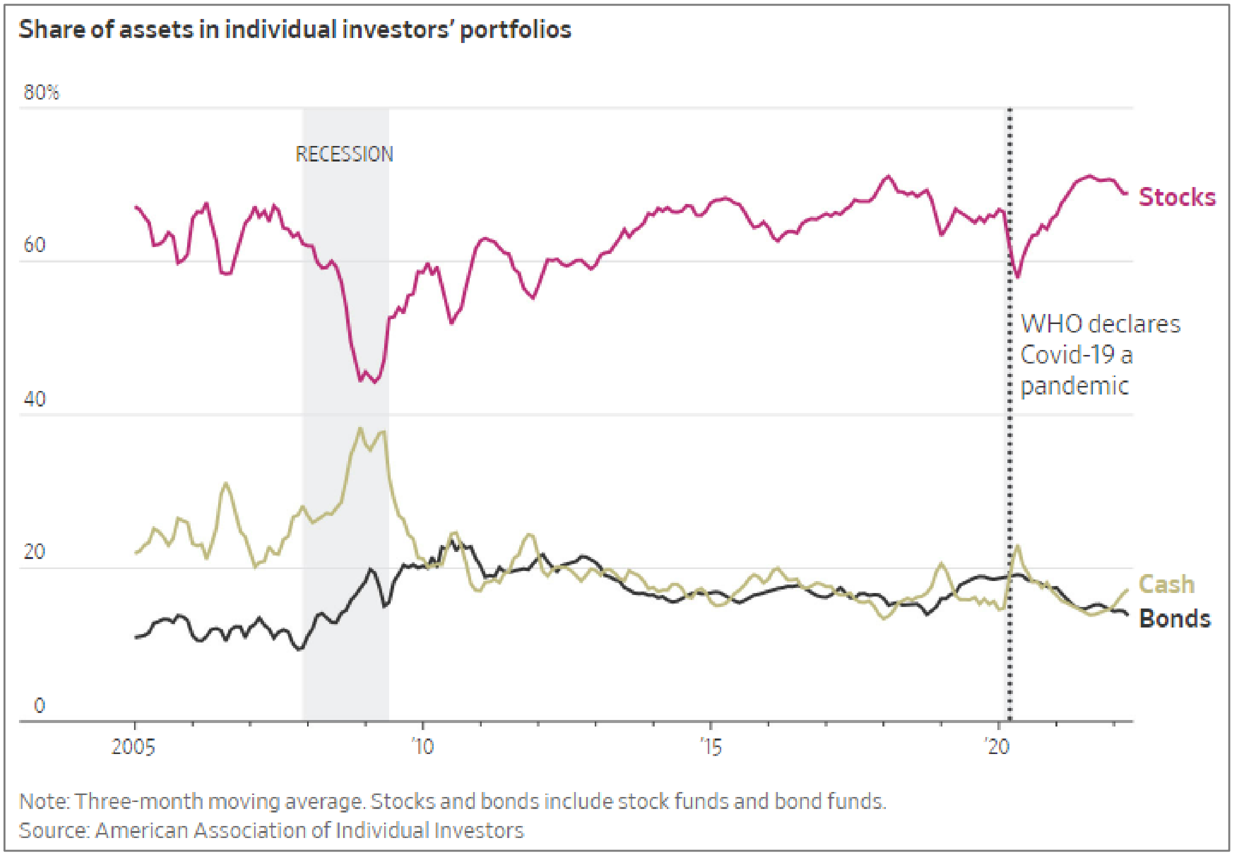


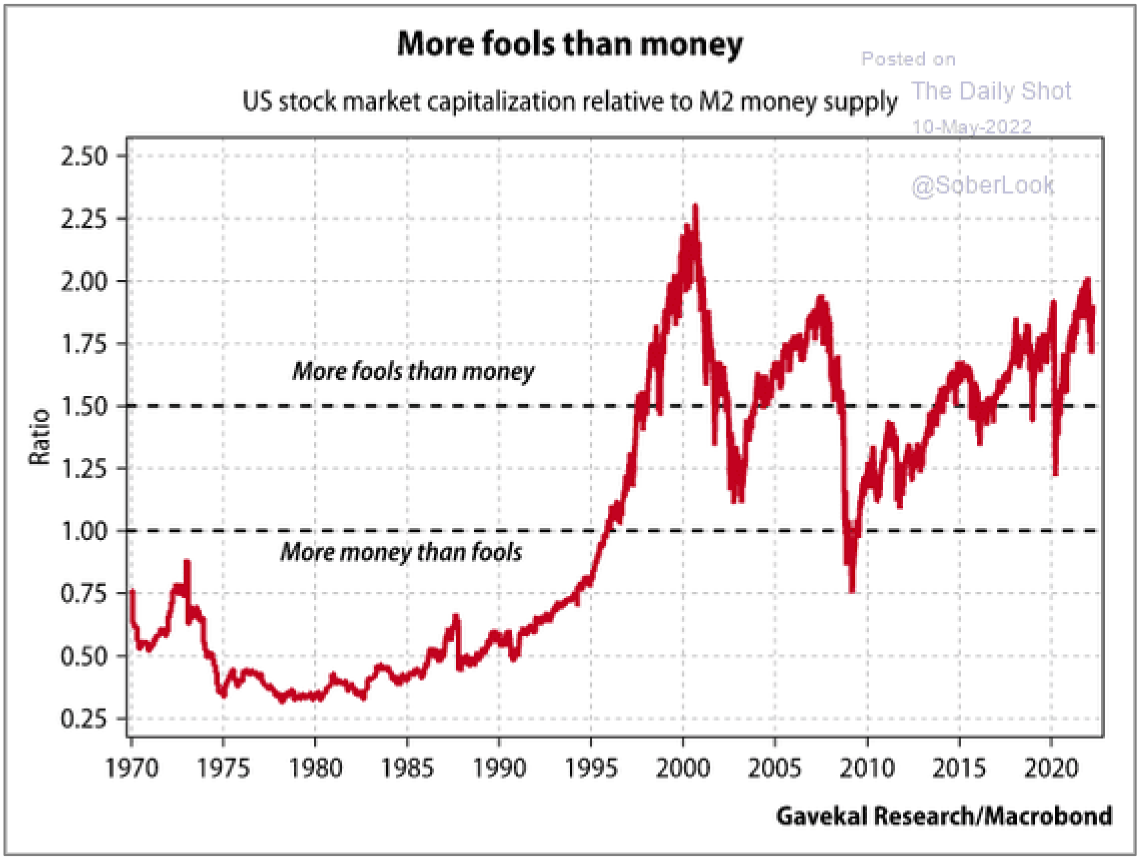
ETF inflows show no signs of a a big break in the government funded Covid stock market speculative era.



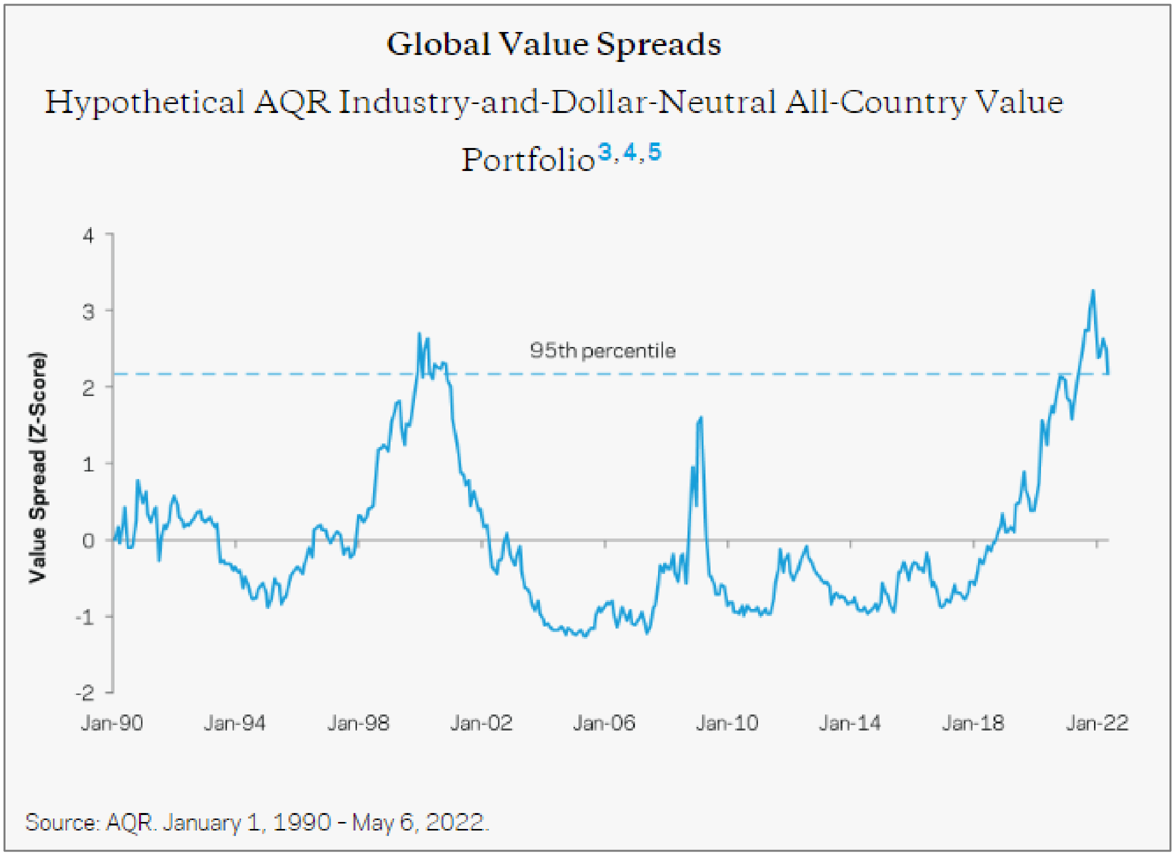
Investor Allocations are still stock heavy.



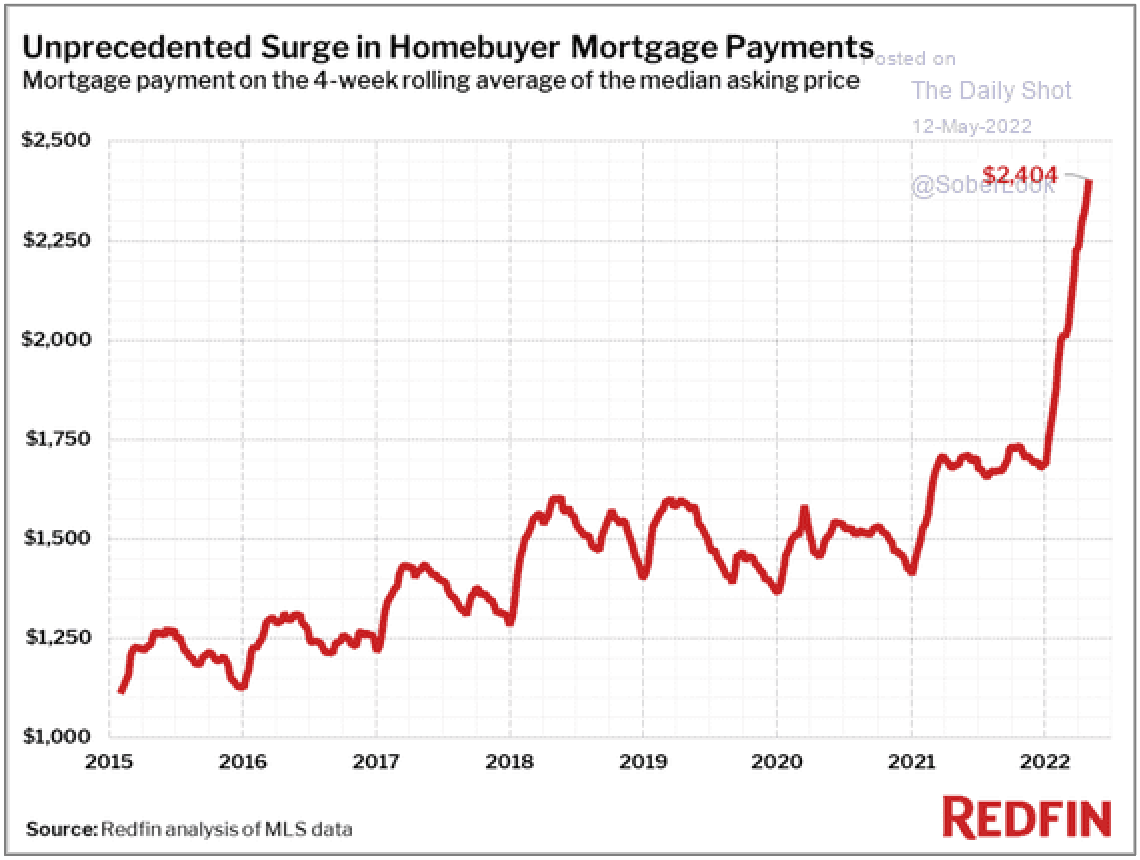
The velocity of Financial Assets is running too hot (More fools than money)



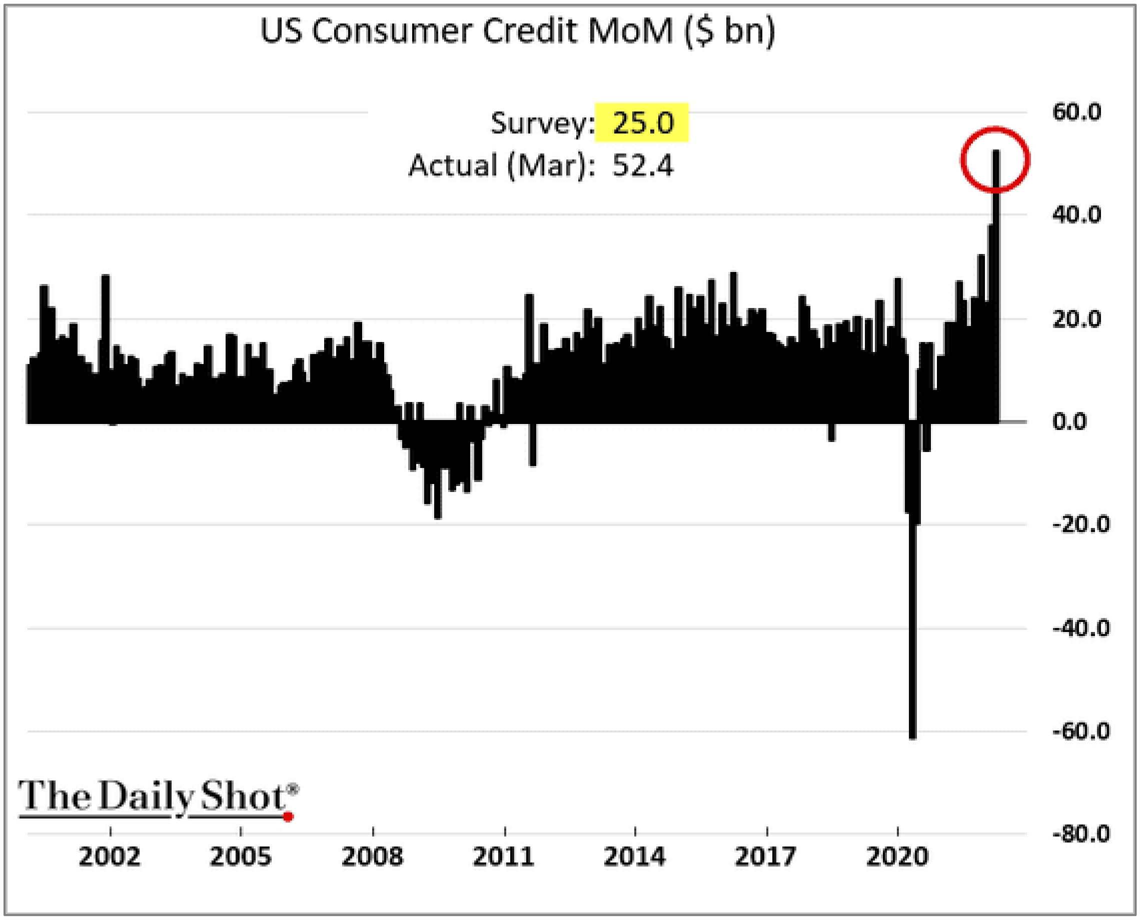
Value stocks still look attractive on a relative basis.



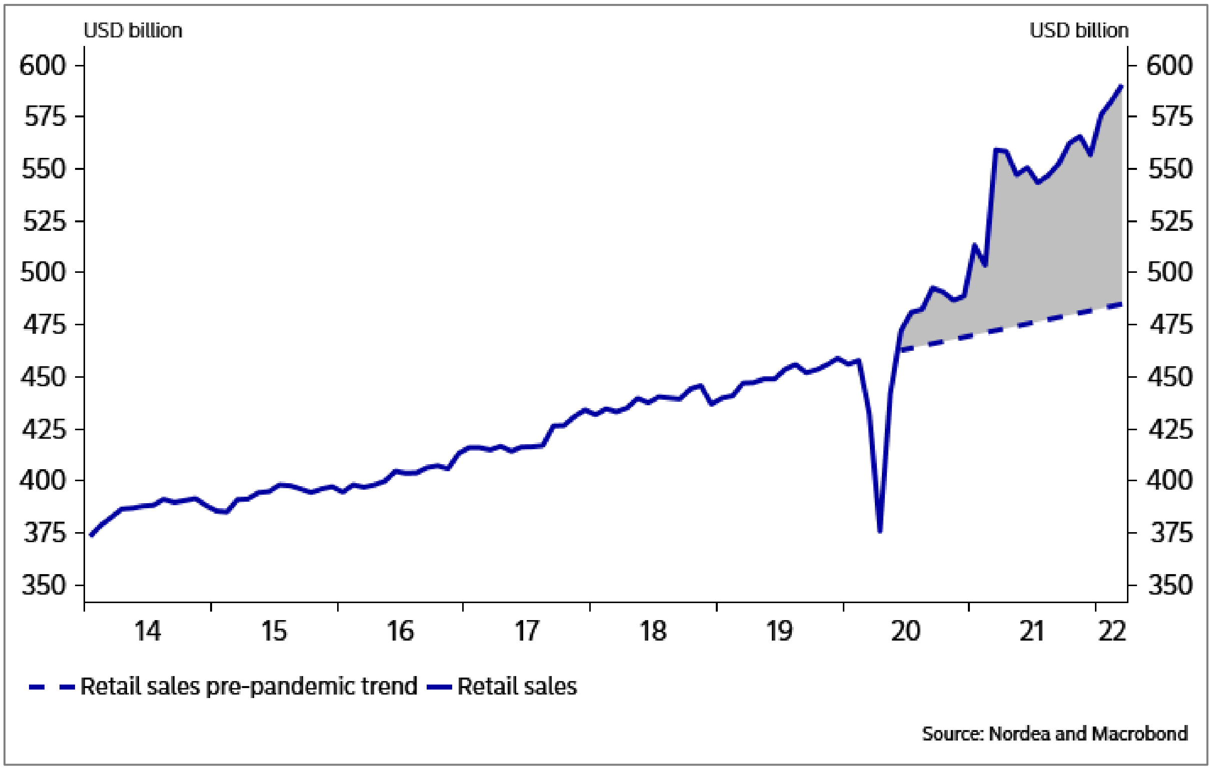
Higher mortgage rates and higher real estate create a record surge in mortgage payments in 2022.



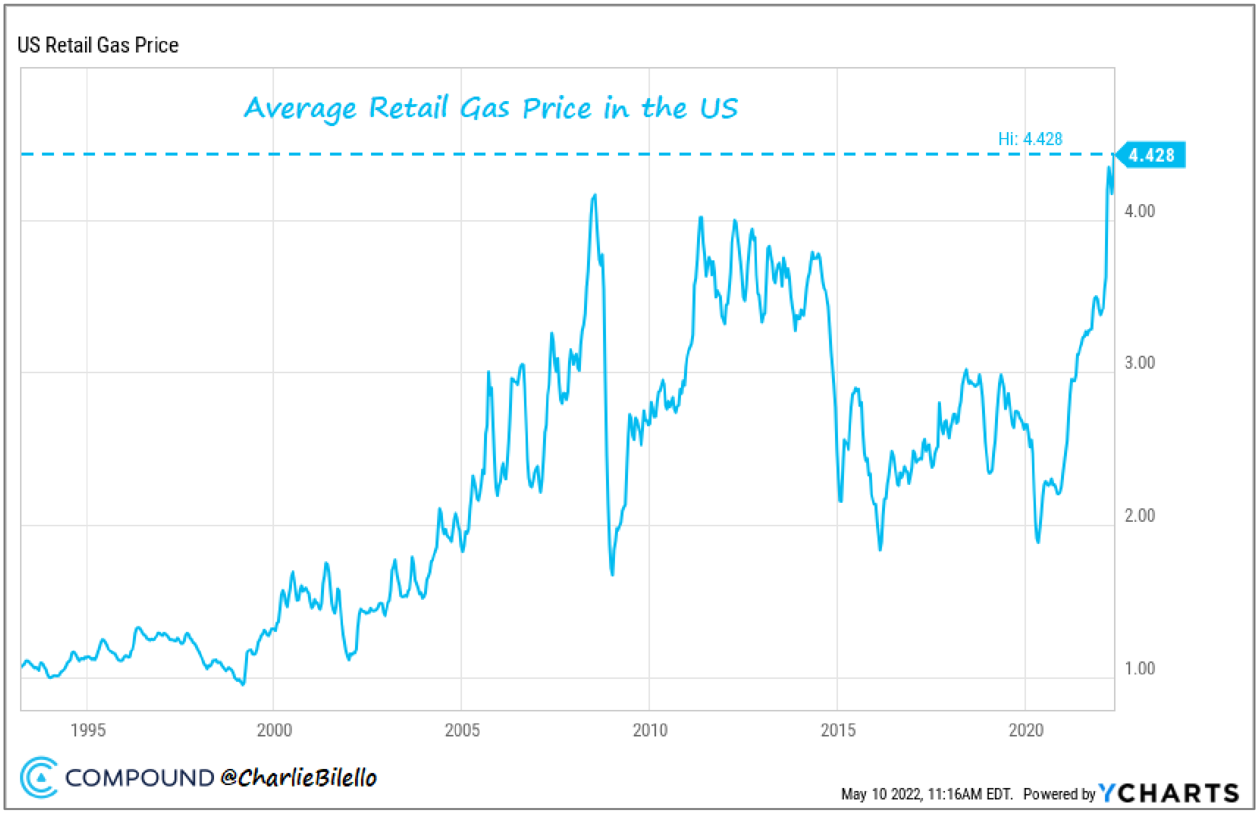
Inflationary pressures and a decline in real wages appear to be causing a boom in consumer borrowing.



Retail Sales are running well above the pre-pandemic trend.



Gas prices hit a new high.



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.