



Market Outlook

By Mark T Dodson, CFA

Sharp drop in MRI

Market Risk Index dropped by more than 14% to 66%, the best MRI reading since May 2020. It came on the heels of a 20% Psychology composite improvement to 53.4%, as market anxieties are growing more pervasive. An increase in our recommended equity allocation could come as early as next week.

While the Psychology improvement isn't enough to signal capitulation, there's enough to drive a bear market rally. Several catalysts could quickly spark such a rally, including any signs that the inflation rate has peaked or any good news on the Ukraine war front. Comparing today's Psychology composite progress with the dot-com speculative era, psychology has improved almost precisely to the point that marked the start of the post-9/11 bear market rally.

However, we don't believe this bear market will be in the rear view mirror without more classic signs of capitulation. Some examples of this – the equity put/call ratio surpassing 80%, VIX moving above 40, more conviction from corporate insiders buying their stock, and a High Low Logic Index that signals market internals are moving in gear again. If the Fed is using the wealth effect as a tool to reign in inflation, this will be required to get the job done. Consequently, it's also likely to cause a recession. While our primary concern is front-running bear markets, we cannot find a historical example of inflation being tamed after running this hot without a coinciding recession.

Market Risk Index

Rec Allocation 25% Underweight

66.0%

Category Percentiles

Psychology - P4



Monetary - M4



Valuation - Extremely Overvalued



Trend



Largest Psychology Influences

Surveys	Positive
Volatility	Positive
Flow of Funds	Negative
Bank Sentiment	Positive

Largest Monetary Influences

Interest Rates	Negative
Inflation	Negative
Exchange Rates	Positive

Valuation

7-10 Year Rtn Forecast	2.4%
10Yr US Treasury Yield	3.0%

Market Trends

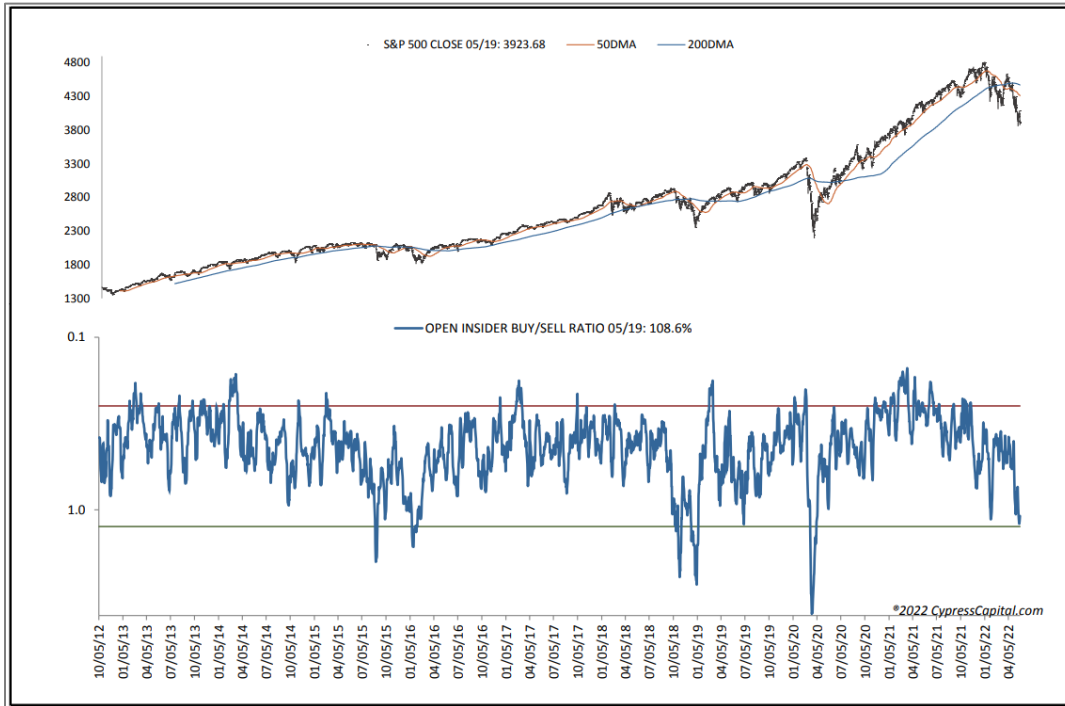
US Equities	Bullish Investment
Intl Equities	Bullish Investment
REITs	Bullish Investment
Broad Commodities	Bullish Investment

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.

Charts of the Week

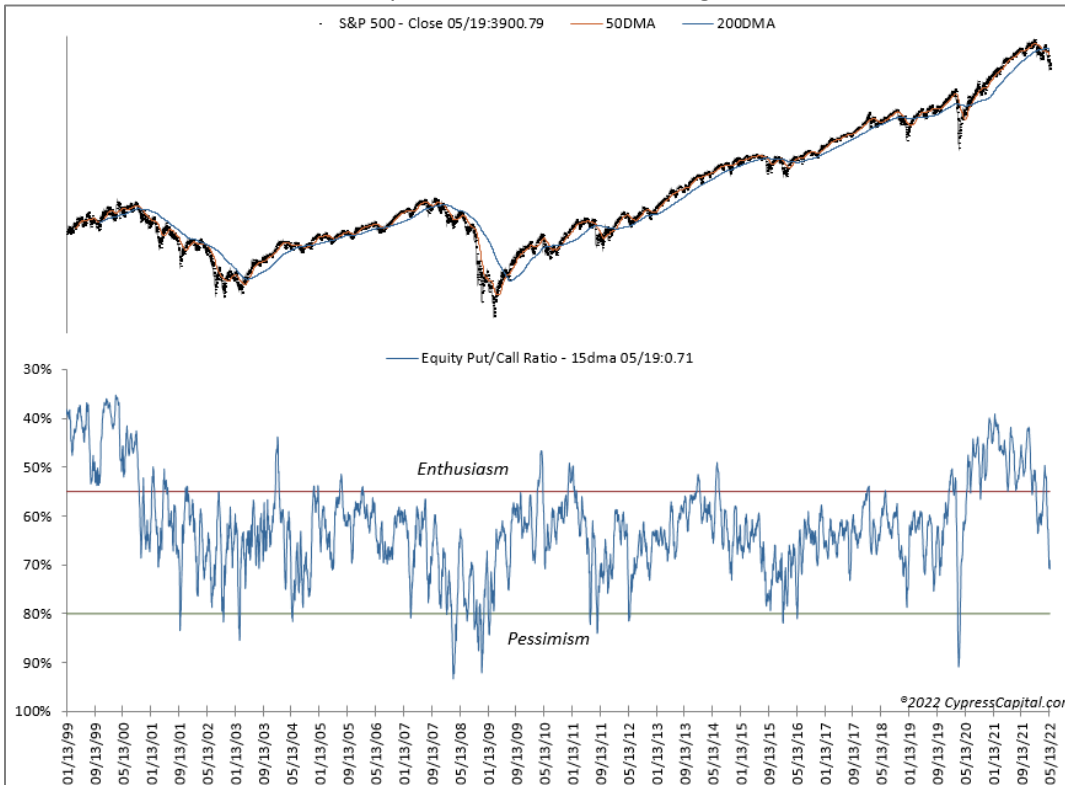
Corporate Insider Buy/Sell Ratio

Corporate Insiders bought a little more stock, but not to the extent that has signaled the end of every significant correction in the last decade.



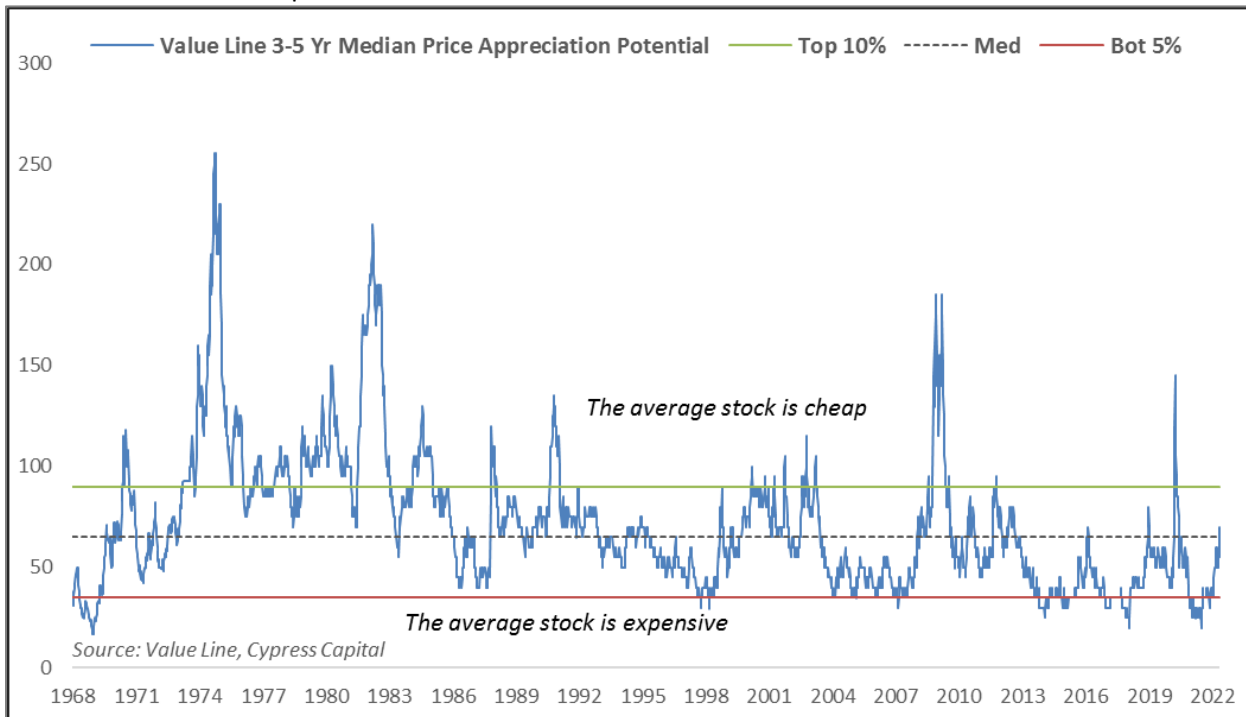
Equity Put/Call Ratio (15dma)

We believe that we'll see equity put/call readings above 80% before the bear market ends, a clear sign that the 2020-21 fever for stock market speculation has been wrung out of markets.



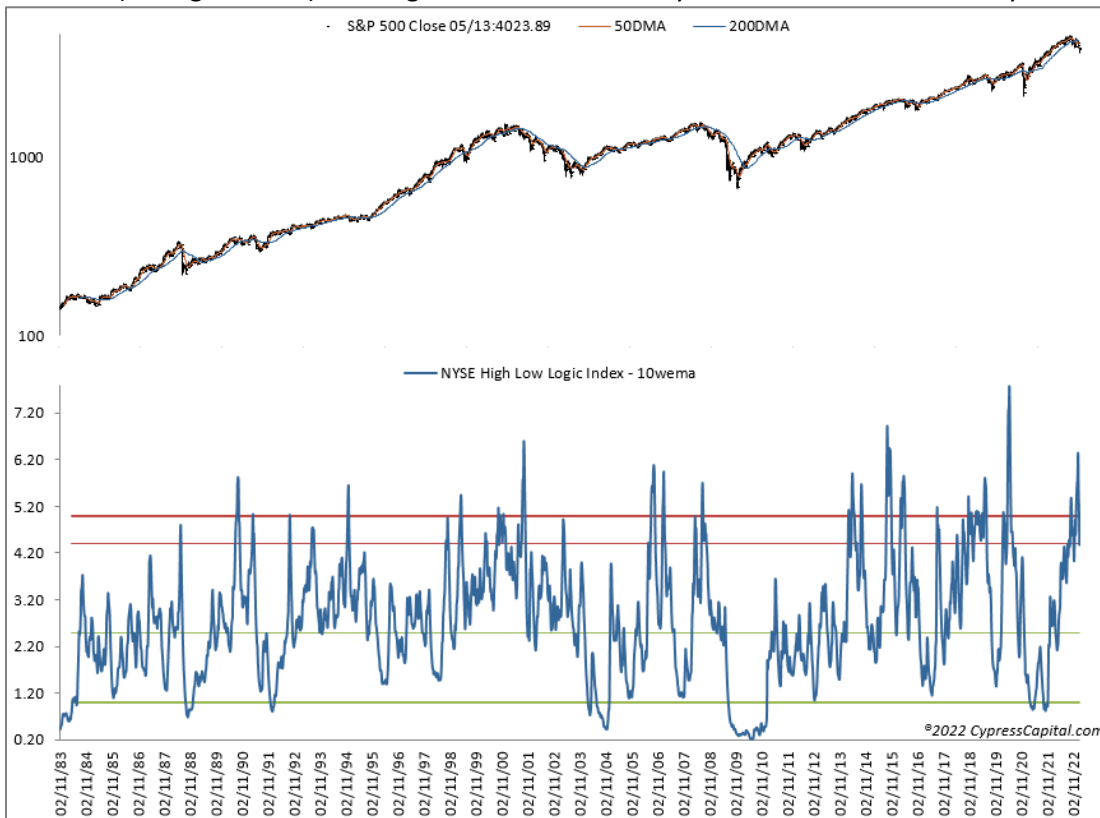
Valueline Median Appreciation Potential

The average stock is now fairly valued. We'll be looking to add tactical exposure to small and mid-cap stocks with some additional improvement.



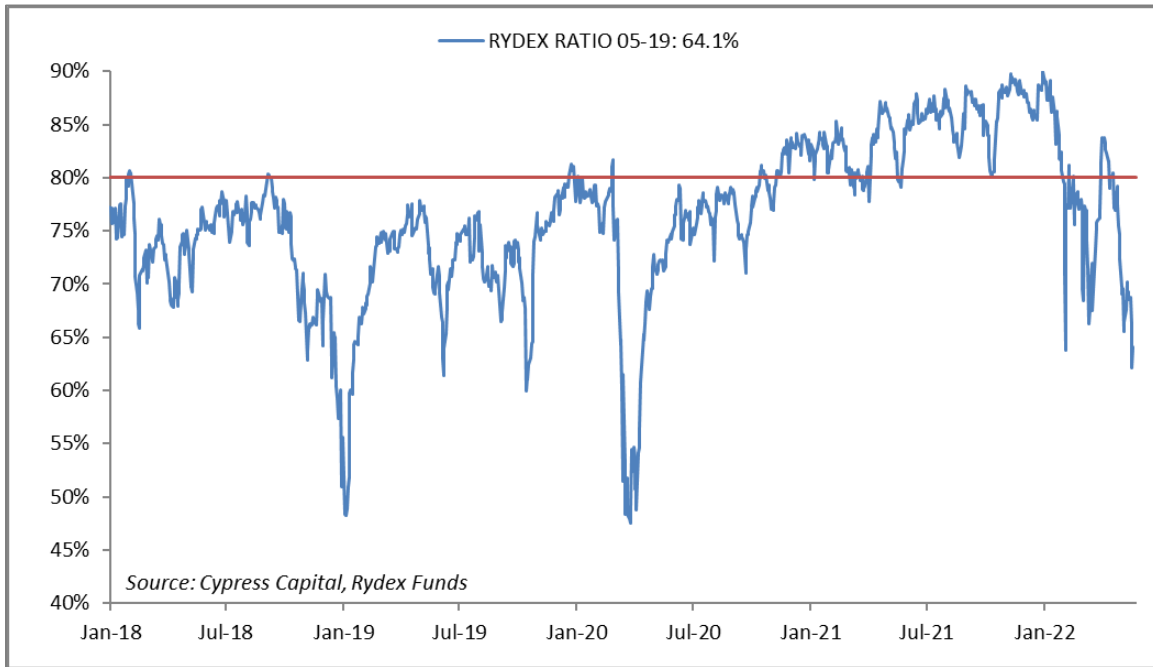
NYSE High Low Logic Index

This measure of market internals signaled the start of this bear market, and the most bullish readings on this indicator (thick green line) have signaled the end of every bear market in the last 39 years.



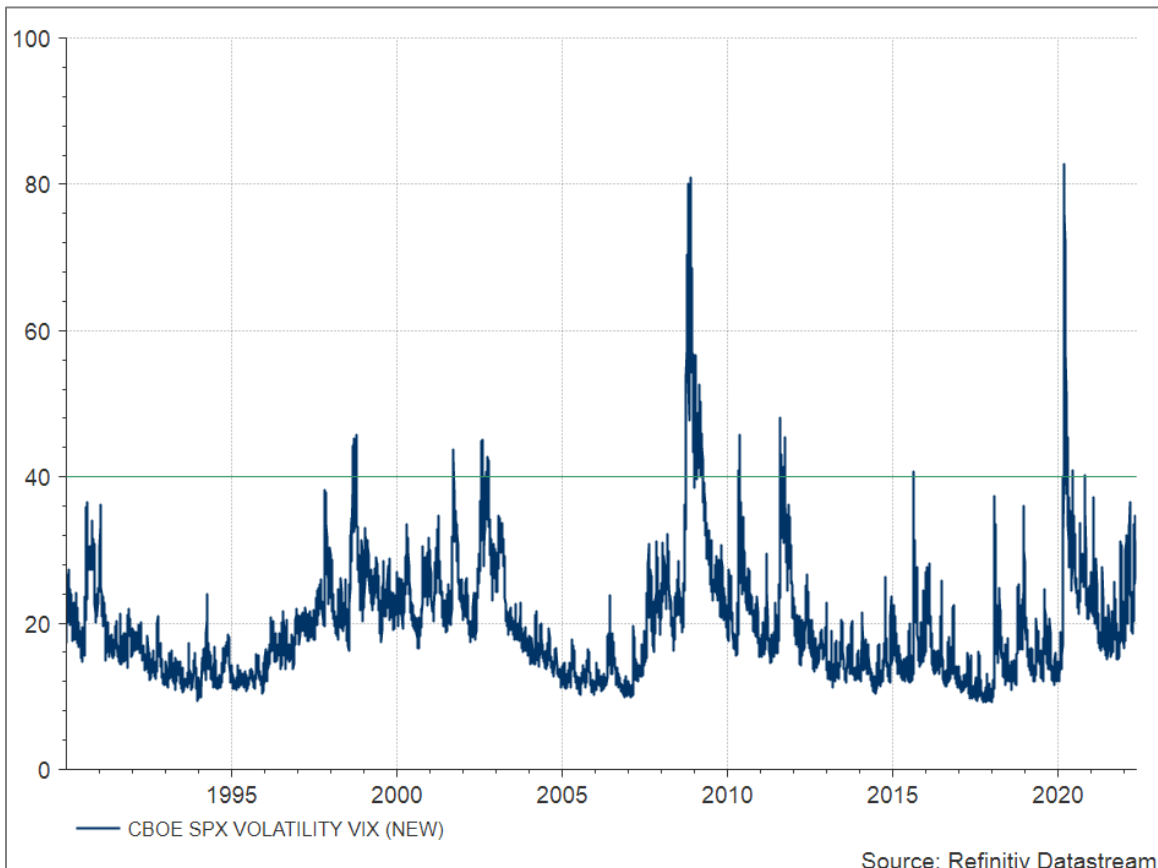
Rydex Ratio

A lower low in Rydex indicates that investors continue to shed leverage; however, current levels on Rydex are not as low as Powell Pivot or the Covid Pandemic market bottoms.



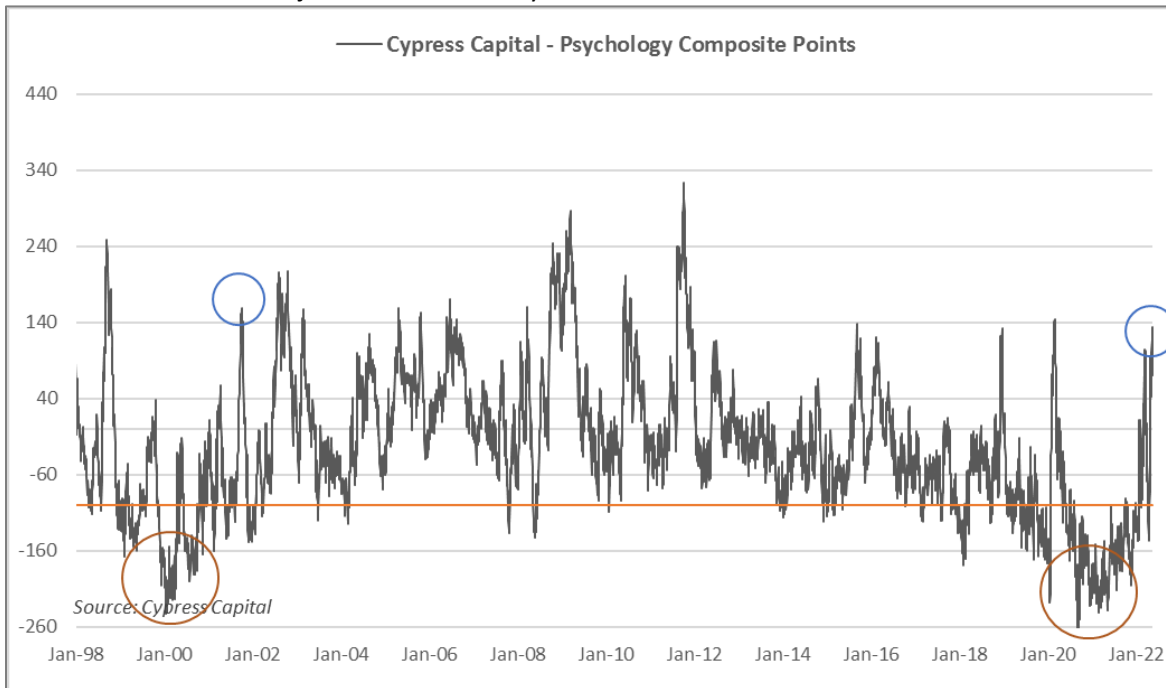
Bear markets end when VIX climbs above 40.

Thus far, VIX has oscillated between 20 and 35, a minefield for traders.



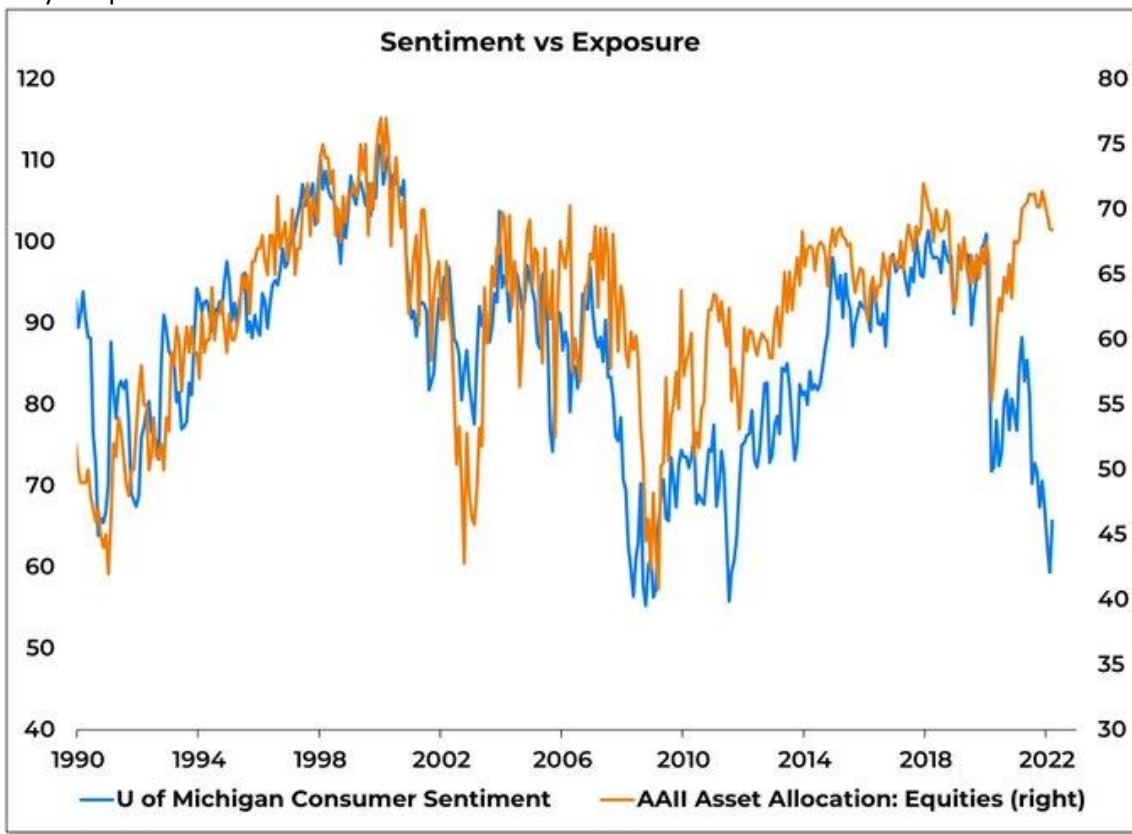
Psychology Composite Points

Using the dot-com era as an analog, our psychology composite has improved to the levels seen after 9/11, which marked the start of a major bear market rally.



Sentiment versus Exposure

A great chart that illustrates a point that we have highlighted in recent weeks with charts of the AAI surveys, but we like this one better. A clear disconnect exists between current survey responses from investors and how they are positioned.



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.

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