Market Outlook

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Stagflation is official, according to ISM

Market Risk Index increased to 37.6% on deterioration in the Psychology composite - offset by a modest improvement in Monetary conditions.

The Psychology composite weakened enough to move out of the best 20% of readings. Investment Surveys remain primary support for the bullish market readings coming from sentiment. Outside of this category, it's more of a mixed bag. Broad investor capitulation or market internals suggesting a bear market bottom didn't appear in the first week of July 2022.

In a significant sign of a coming peak in the rate of CPI inflation, the six-month rate of change on the CRB Raw Industrials index turned negative. Although the lead times on CRB Raw Industrials prices to peak readings in the rate of inflation are not stable enough to give a prediction, it's concrete evidence that monetary tightening is working its way into the economy.

Meanwhile, the ISM survey was released this week. We pay most attention to the Price Index and the New Orders Index. ISM New Orders Index indicated the first month of economic contraction since March 2020. The ISM Price Index has peaked, but readings in June were still above 75. We call periods where contractions in ISM New Orders (below 50) coincide with expansions in the ISM Price Index (above 50) inflationary busts, and inflationary bust periods are historically associated with weak stock market returns.

ISM is signaling Inflationary Bust

ISM Quadrant	Annualized Return	Freq	Avg 12M Fwd
Deflationary Boom	13.4%	12.4%	14.7%
Inflationary Boom	5.8%	64.8%	8.4%
Inflationary Bust	0.1%	12.9%	3.4%
Deflationary Bust	25.0%	9.9%	15.8%

S&P 500 annualized price returns since 1950

Additionally, this period is unique because ISM Price Index readings are still sky-high. In 70+ years, ISM Price Index readings above 75 combined with contractionary readings in ISM New Orders Index

Market Risk Index

Rec Allocation 15% Underweight

37.6%

Category Percentiles

Psychology - P3: 22.6%

Monetary - M4: 65.0%

Valuation - Extremely Overvalued: 93.9%

Trend: 86.7%

Largest Psychology Influences

Surveys	Positive
Corporate Insider Sentiment	Positive
Flow of Funds	Negative
Option Activity	Negative

Largest Monetary Influences

Interest Rates	Negative
Exchange Rates	Positive
Inflation	Negative

Valuation

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

Market Trends

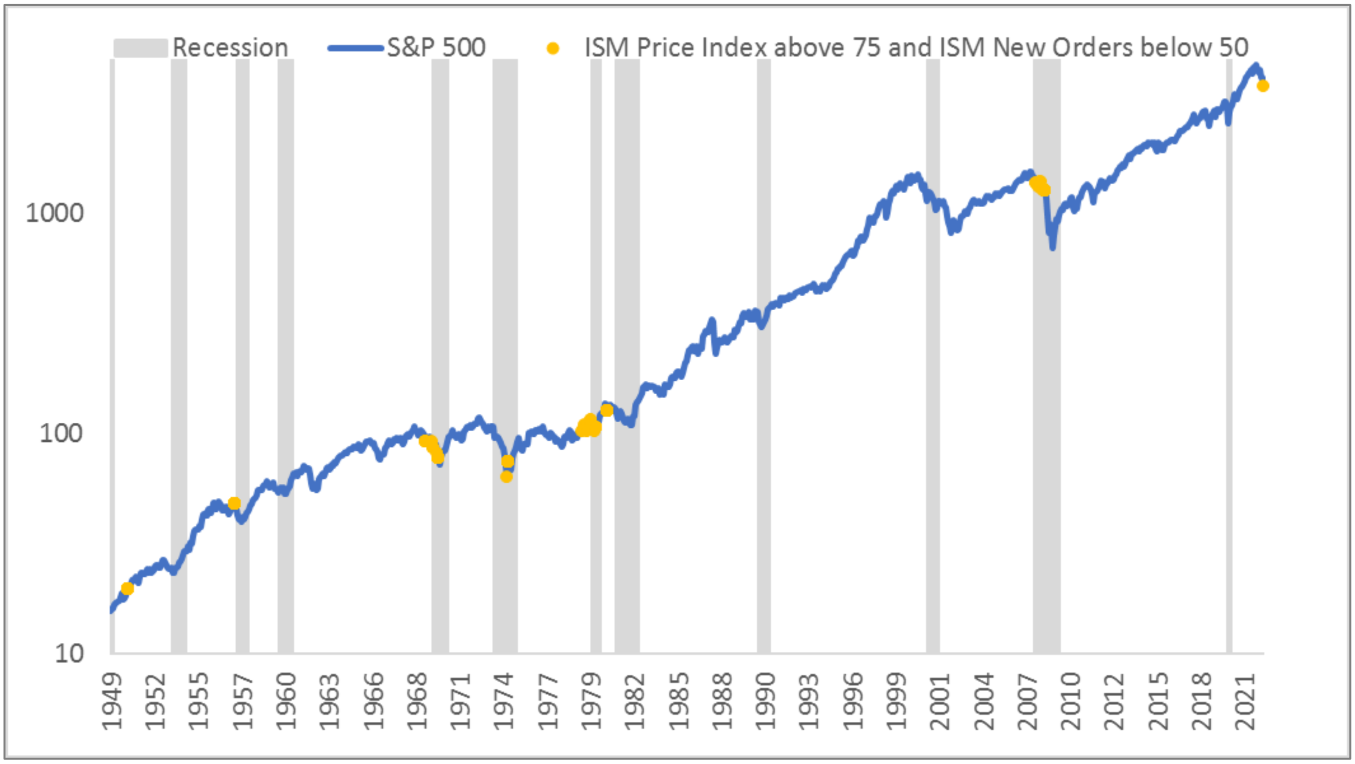
US Equities	Bullish Investment
Intl Equities	Bearish Trade
REITs	Bearish Trade
Broad Commodities	Bullish Investment

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.

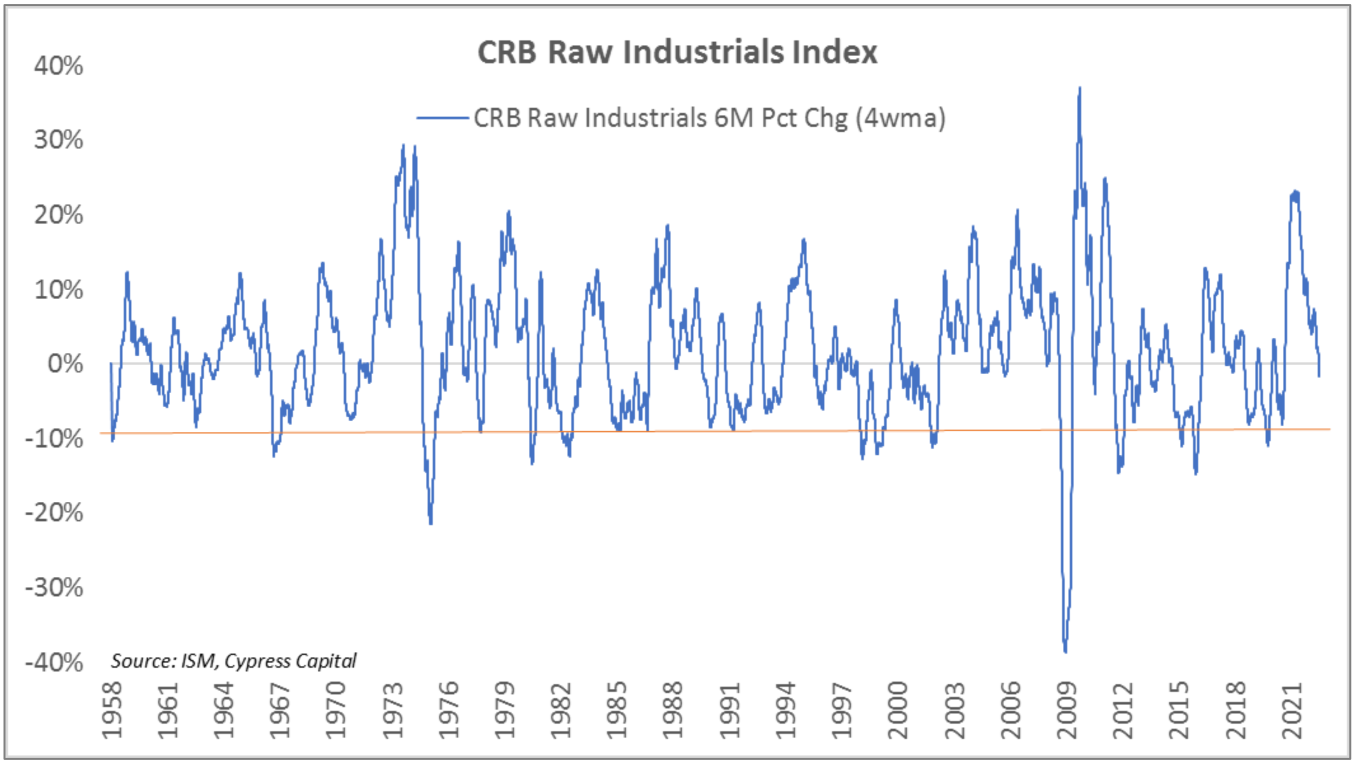
(below 50) have only occurred eight times. Seven of those eight occurrences were either during or right before the onset of a recession. Confidence in central bankers and their ability to engineer a soft-landing is too high.

Charts of the Week

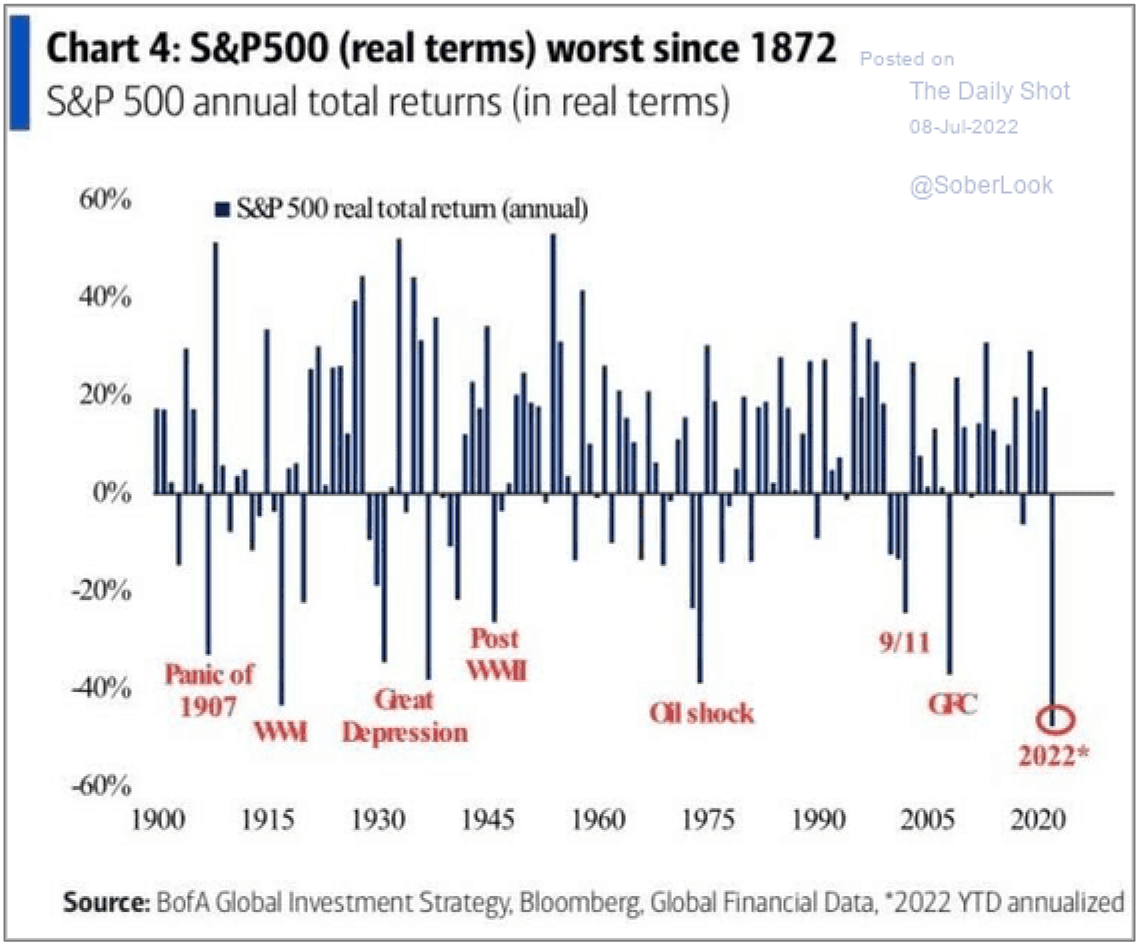
Ultra-high ISM Price Index readings and contraction in ISM New Orders rarely occurs outside of a recession.



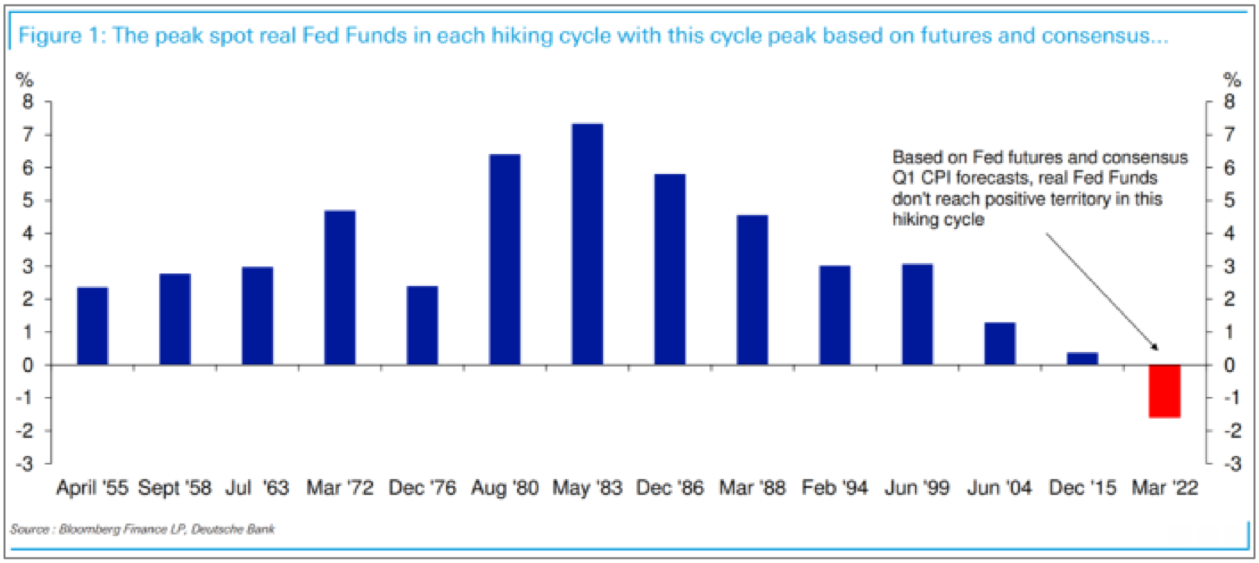
CRB Raw Industrials – an index of some of the most economically sensitive commodity prices is now declining.



Worst inflation-adjusted start to a year in the stock market since 1872.

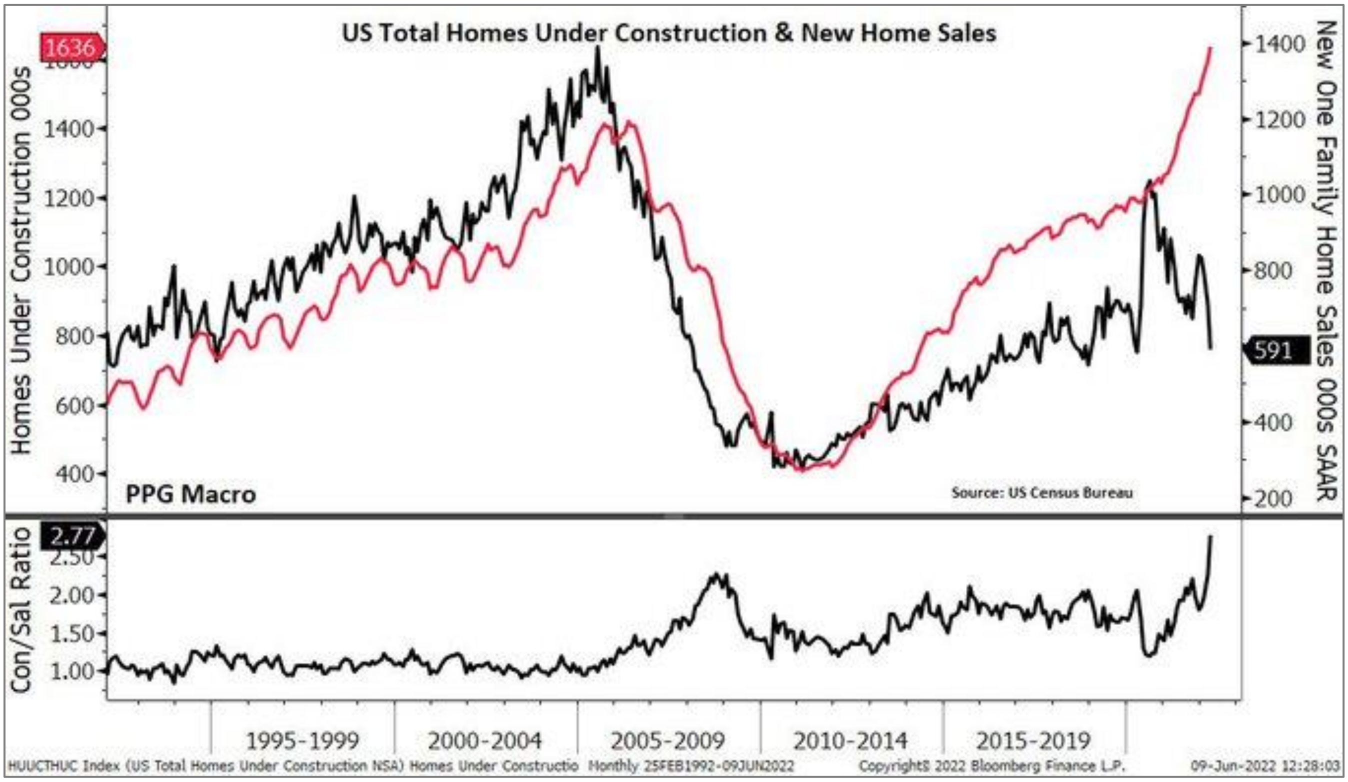


Either the bond market is too complacent, or they think the Fed will blink.
Fed futures pricing in negative real rates at the end of the hiking cycle. That's never happened before.



Housing Affordability is as bad as it was during the Housing Bubble.

Record Gap between Total Homes Under Construction and New Home Sales



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.