Cypress CAPITAL

Market Outlook

By Mark T Dodson, CFA

The Yield Curve officially becomes a headwind for markets.

Market Risk Index moved up to 54.2% on a substantial shift in the Psychology Composite, as investor psychology has quickly shifted away from its most bullish readings on recent stock market strength.

Monetary Conditions made a noteworthy shift this week, as the yield curve officially moved from neutral to negative. Despite World War fighting sums of fiscal and monetary stimulus in 2020 and 2021, the yield curve never grew steep enough to drive a full, healthy credit cycle. Instead, we got record amounts of speculation in financial assets and inflation reminiscent of the 1970s. Covid stimulus only proved to re-arouse animal spirits and exacerbate excesses that had built up due to a decade of quantitative easing.

For a new bull market to begin with the yield curve in its current state, while the Fed is still tightening nonetheless, would be the stock market analog to breaking one of Newton's Laws of Physics. The yield curve will likely prove a headwind for markets beyond 2022. The good news is that inflation pressures are set to ease, as the yield curve is a highly reliable leading indicator of inflation. The bad news is that it means recession (the 2qtrs of negative GDP growth rule of thumb indicates we are already in one) and additional bear market losses.

Still, the stock market put in a strong performance this week. So, let's imagine for a moment that yield curves, inflation, and valuations don't matter. Looking purely through the technician's lens of stock market internals and breadth, none of our four horsemen of stock market internals have signaled the end of the current bear market.

Bottom line - we will continue to treat stock market rallies as opportunities to reduce equity exposure in anticipation of another leg down in the ongoing bear market.

Market Risk Index

Rec Allocation 15% Underweight

54.2%

Category Percentiles

Psychology - P3: 41.3%

Monetary - M4: 67.8%

Valuation - Extremely Overvalued: 94.0%

Trend: 78.6%

Largest Psychology Influences

Surveys	Positive
Leveraged Investments	Negative
Volatility	Negative
Trading Data	Positive

Largest Monetary Influences

Interest Rates	Negative
Inflation	Negative
Interest Rate Spreads	Negative

Valuation

7-10 Year Rtn Forecast	2.3%
10Yr US Treasury Yield	2.8%

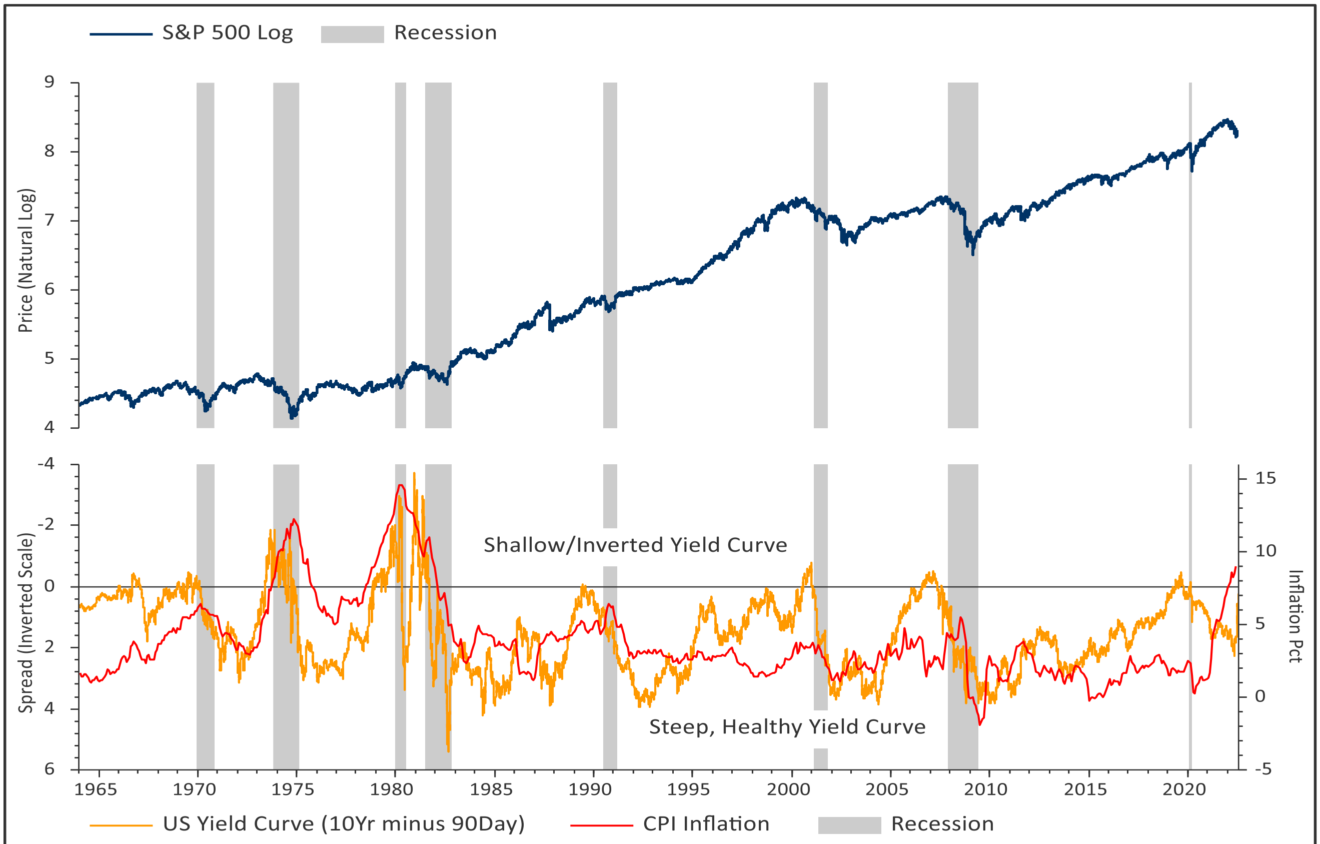
Market Trends

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

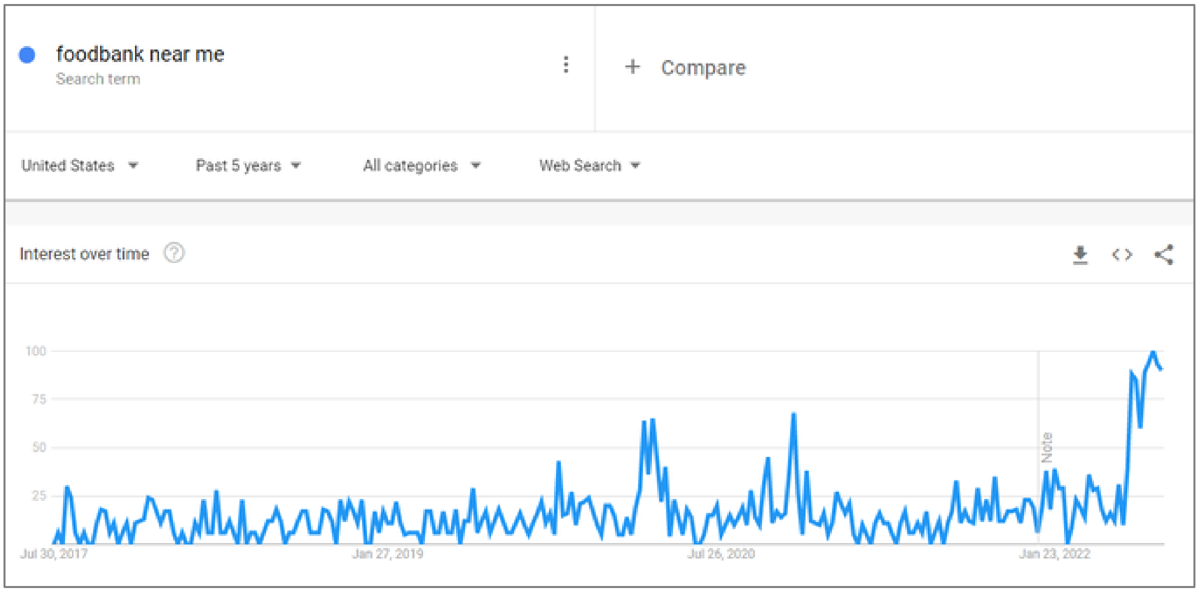
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

Yield Curve (our favorite version) went from Neutral to Negative this week.
We added inflation (the red line) to the chart to highlight its reliability as a leading indicator of turning points in the inflation rate.



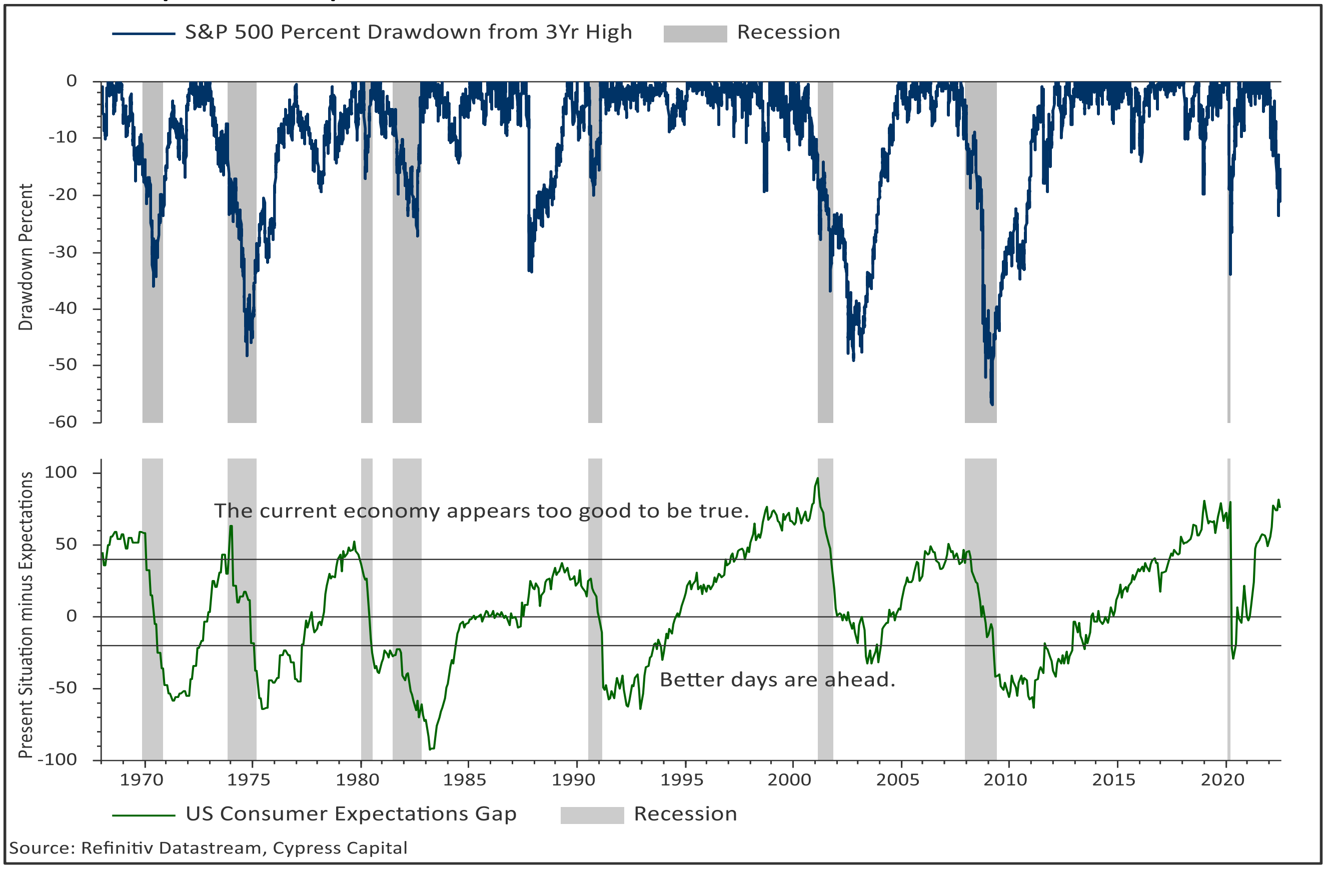
Shame on Central Bankers and Politicians – Google searches for Foodbanks surge.
There are real-world consequences for gambling on whether inflation is transitory and getting enamored with ideas like Modern Monetary Theory.



Source: Peter Atwater

Real Food Prices set a record high. High food prices mean geopolitical instability.

Consumer Expectations Gap isn't consistent with new bull market narratives.



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.