Market Outlook

By Mark T Dodson, CFA

Banks are starting to tighten the purse strings.

Market Risk Index increased by a whopping 15.1% to 69.3%. All three of the counter-cyclical components of our asset allocation model worsened. Still, the Psychology composite's rapid one-week unwind was the most pronounced, as market strength quickly assuaged investor anxieties. It has the hallmarks of the Denial phase of a bear market rally.

The most noteworthy development inside the Psychology Composite came from the Bank Sentiment category, as it shifted to become a bearish influence with the release of the Senior Loan Bank Survey this week. Banks are beginning to tighten credit for the first time since the pandemic. Bank Sentiment has been confirming what the yield curve has been implying for several months. All of it combined suggests recession and a high probability that the bear market is not over.

On the breadth front, our NYSE Overbought/Oversold Indicator breached the 50% threshold, indicating considerable buying interest. The 100% level on that indicator is the real bear-killer, but that level of buying interest is rare and doesn't occur at the end of every bear market. The 50% threshold is a good compromise. It's a level that has heralded the starts of new bull markets, but it's also a level that has marked the point where several bear market rallies have started to falter – which makes it useful for our purposes either way. This leaves three more of our four horsemen left to ring the new bull market bell, none of which have triggered.

The bottom line...bear markets traditionally experience capitulation, and none of the conditions we look for as indications of capitulation have occurred. Additionally, none of the conditions required for economic recovery or a new credit cycle are in place – quite the opposite – monetary and economic conditions are worsening. Banks are tightening credit. The yield curve is inverting, and the Fed is still raising rates.

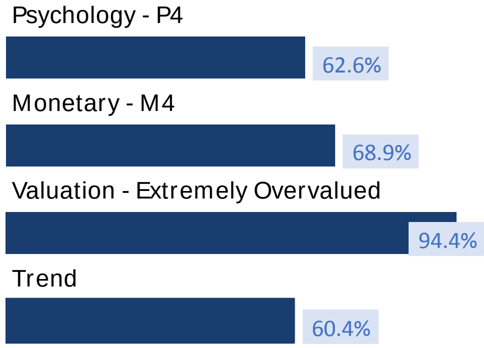
Finally, ignoring those fundamentals and assuming another bull market only requires a re-ignition of animal spirits. In this case, only one of four breadth signals that have heralded the start of every bull market in the last sixty years has been triggered. The weight of the evidence still recommends that a defensive posture makes sense for investors.

Market Risk Index

Rec Allocation 15% Underweight

69.3%

Category Percentiles



Largest Psychology Influences	
Leveraged Investments	Negative
Volatility	Negative
Surveys	Positive
Flow of Funds	Negative

Largest Monetary Influences	
Interest Rates	Negative
Inflation	Negative
Lending & Leverage	Negative

Valuation	
7-10 Year Rtn Forecast	2.1%
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

Chart – Banks have started tightening access to credit.

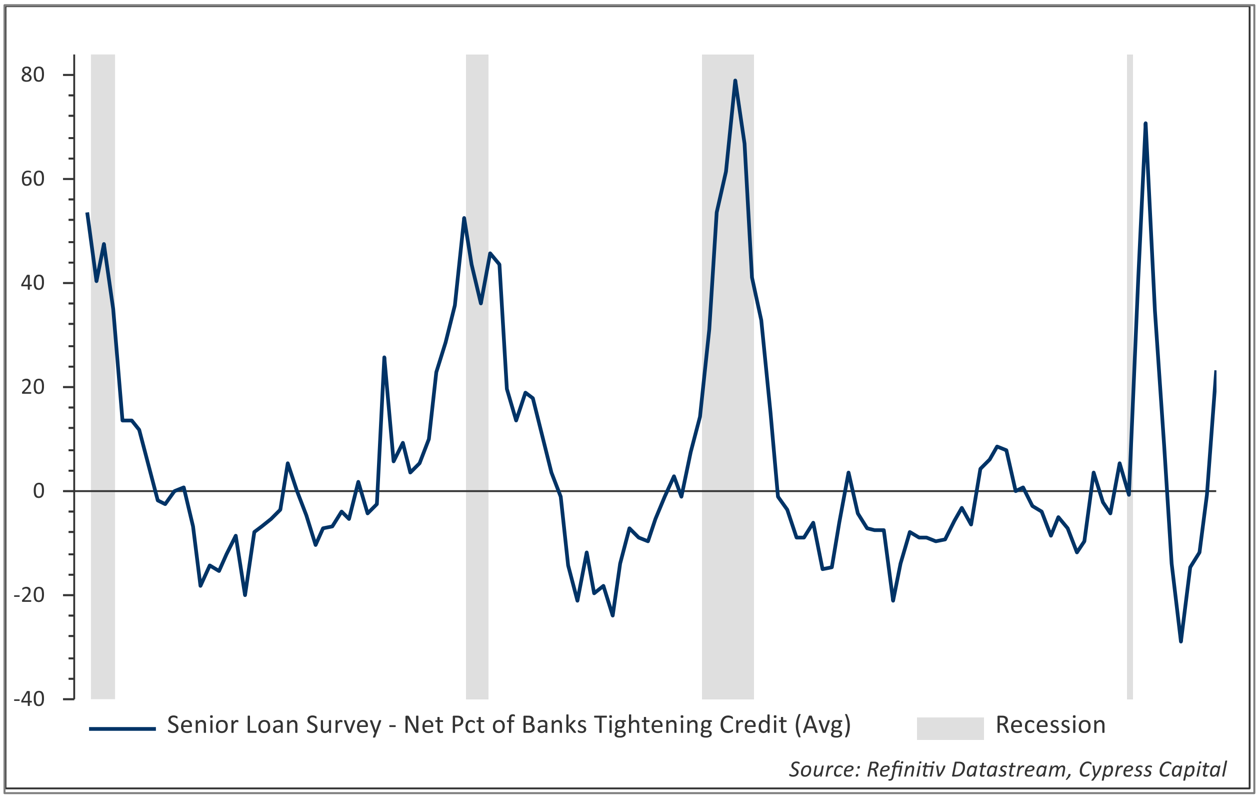
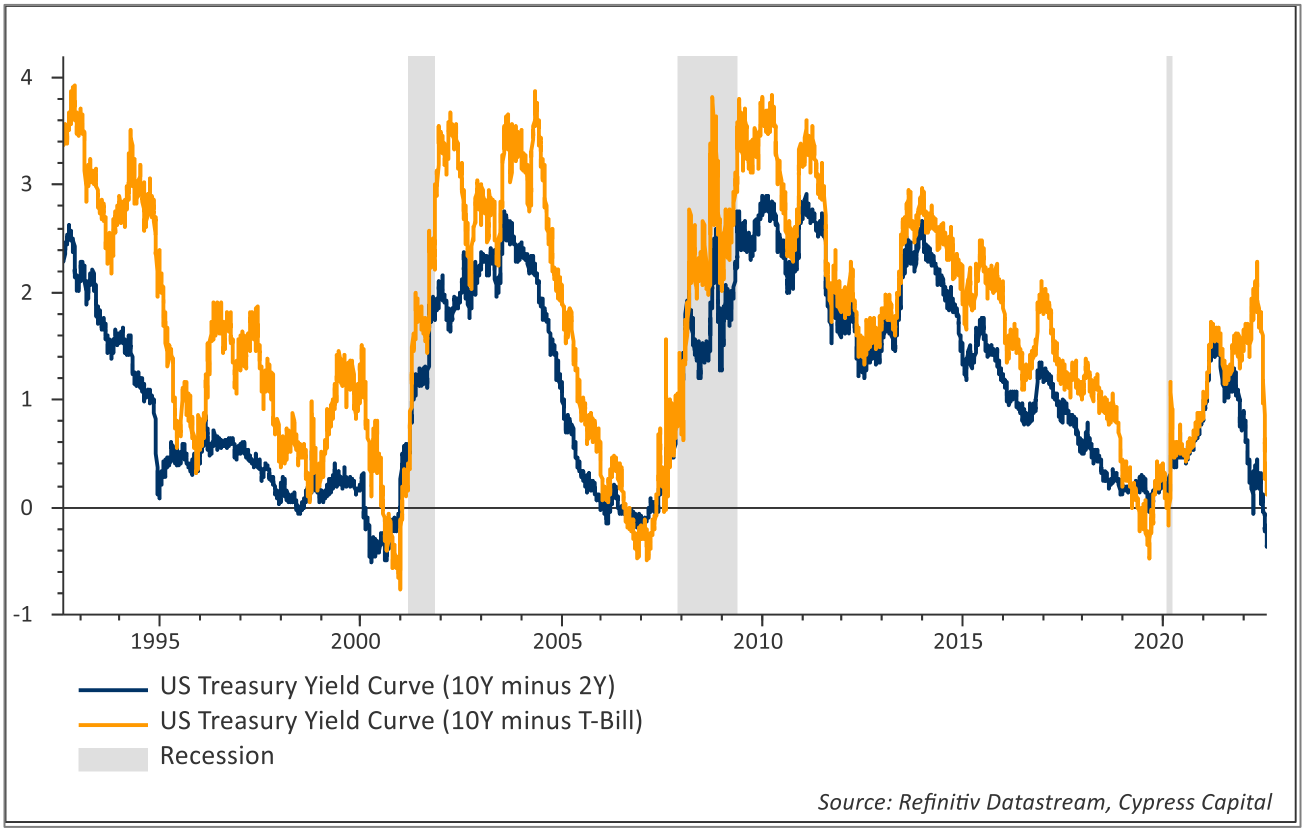
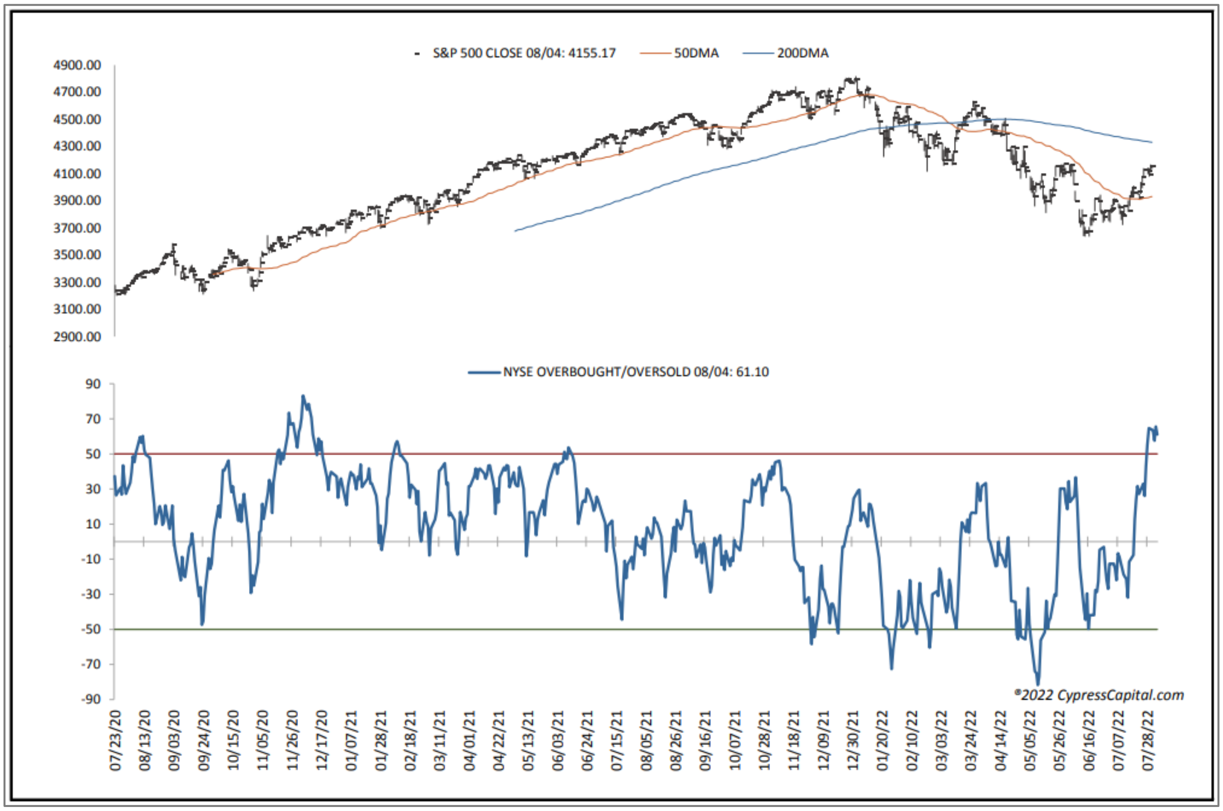


Chart – Investors are looking for market bottoms just as the yield curve has given clear economic warnings.

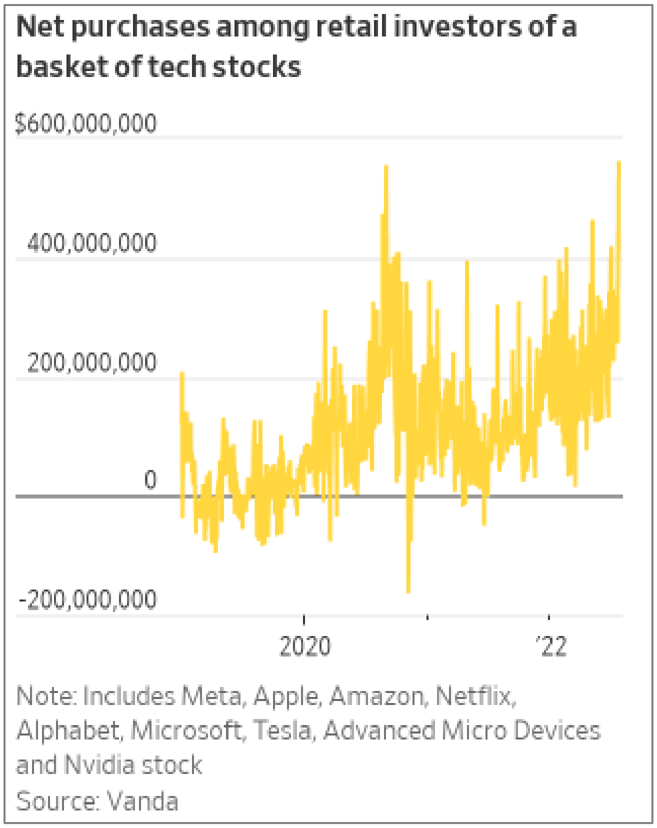


NYSE Overbought/Oversold Indicator crosses above 50.

Bear market rallies tend to falter after crossing this threshold. Those that don't waver often lead to the three other breadth thresholds we look for in heralding the starts of new bull markets.



Signs of Bear Market Denial? Retail investor purchases of popular Tech stocks surged to a record.



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.