Market Outlook

By Mark T Dodson, CFA

Velocity is accelerating in a bear market for the first time since 1974.

Market Risk Index fell to 87.5% on improvements in the Psychology Composite. While still in the worst decile of readings, stock market volatility since Powell's Jackson Hole speech has led to a peak in the Psychology Composite risk score. The Surveys category saw the most significant shift, enough to make it the most positive influence on the composite, a place it held when the market bottomed early in the summer.

For those keeping a close eye on Market Trend, the rally during this holiday-shortened week has held off the shift to Bearish Trend; however, the shift to a bearish regime is still highly probable over coming weeks.

Monetary conditions improved modestly, but the overriding message from the composite is that any investor who is too bullish with equity positioning here is fighting the Fed. Our heaviest weighted indicator, the yield curve, has yet to bear the full brunt of its force down on the composite as a result of its recent inversion. Investors appear to be in a pollyannish fog about what has to happen to the unemployment rate and economic output to bring inflation back down to the 2% that had become our norm for decades.

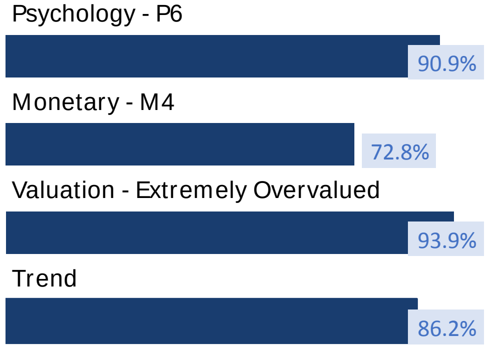
Something that struck us this week in reviewing the indicators is how the Velocity category of our Monetary composite is still accelerating. The traditional economic definition of velocity is the number of times the average dollar gets spent per year – how loose or tight we are with our wallets. Our version is loosely related to that idea but different in that we aren't concerned about the broad economy as much as we are about the value of financial assets. We calculate a handful of velocity indicators integrating the concept of that traditional definition with some ideas we borrowed from the economist Art Laffer several years ago to give us more tools to help forecast bear markets.

Market Risk Index

Rec Allocation 20% Underweight

87.5%

Category Percentiles



Largest Psychology Influences

Surveys	Positive
Flow of Funds	Negative
Volatility	Negative
Leveraged Investments	Negative

Largest Monetary Influences

Interest Rates	Negative
Exchange Rates	Positive
Inflation	Negative

Valuation

7-10 Year Equity Return Forecast	2.3%
10Yr US Treasury Yield	3.3%

Market Trends

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

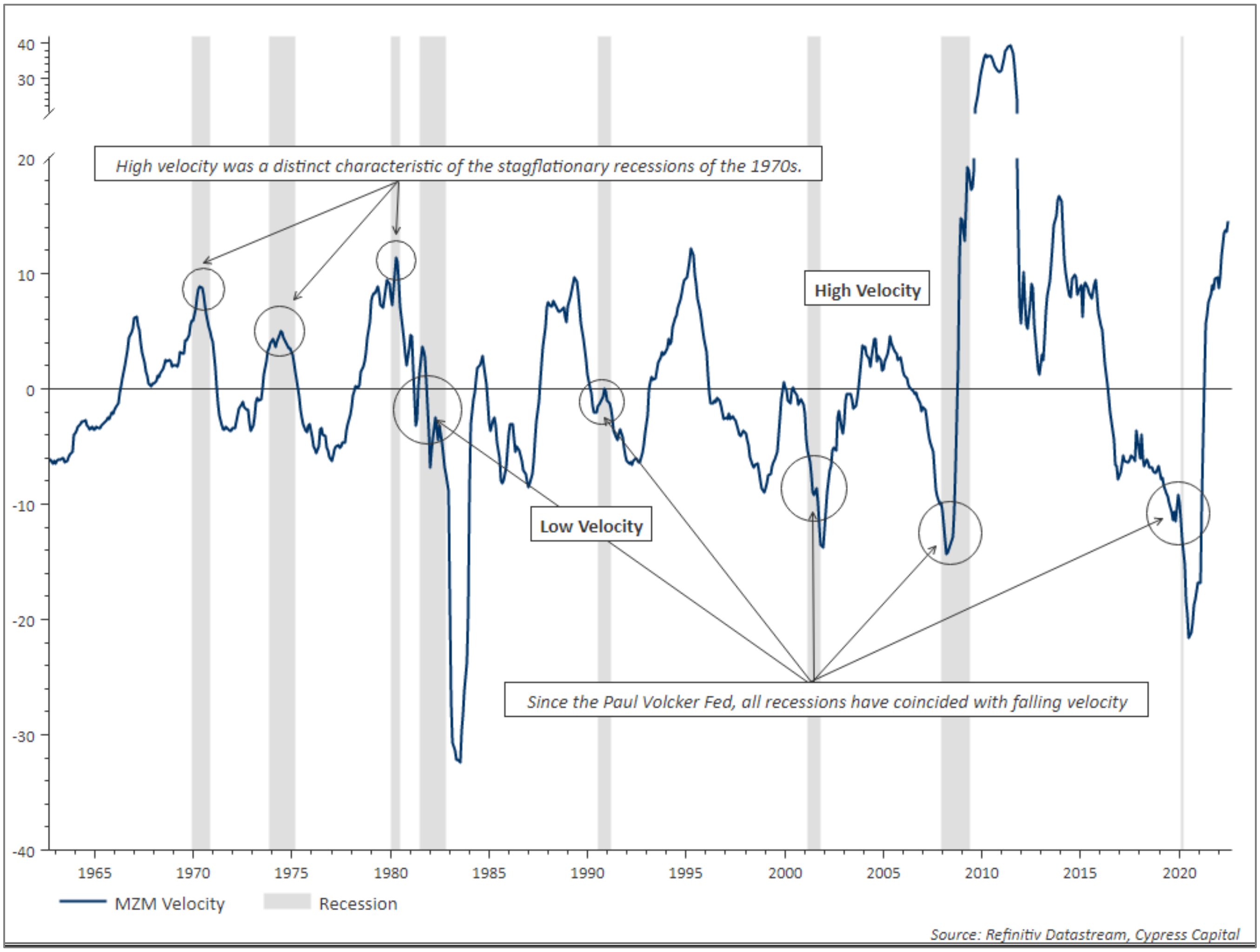
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

And...this is the first bear market since 1974 that inflation hasn't coincided with falling velocity (our velocity, not the traditional kind). For every credit cycle since 1980, velocity peaked and began declining well before inflation peaked and the economy entered recession. It was a hallmark of the disinflationary era of the post-Paul Volcker Fed. The only instances where peaks coincided with peaks in inflation and bear markets occurred during the stagflationary recessions of the 1970s. In our minds, any Fed pivot that would come before velocity is declining would mean we haven't killed off high inflation, only weakened it temporarily.

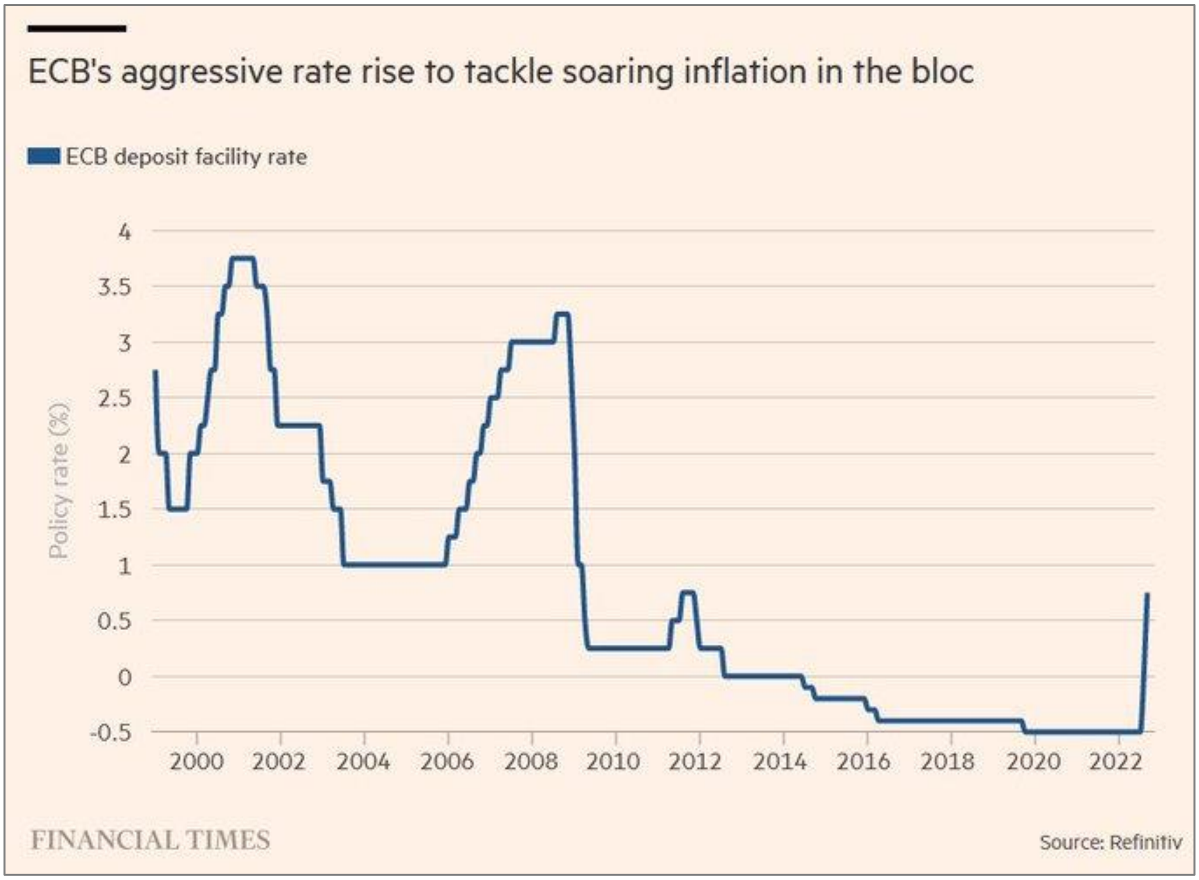
Valuations drew the short end of the straw again this week with little to report on that front. Improvements to valuations have been minimal - despite a bear market. Should the current 2022 lows hold and mark the start of a new bull market, it would be the most expensively priced bear market bottom in US history...by a long shot.

Charts of the Week

Velocity is still accelerating inside a bear market for the first time since 1974.



Europe going positive yields - ECB joins the inflation fight with a 75 basis point interest rate hike.



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.