Cypress CAPITAL

Market Outlook

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Is the Yield Curve the G.O.A.T?

Market Risk Index fell modestly to 87.2% on improving Psychology and Valuations. The Investment Surveys and Option Activity categories have improved dramatically over the last two weeks, and the stock market is beginning to register its first oversold readings since the June lows.

Within the Surveys category, the AAII Sentiment Survey has experienced the most pervasive amounts of bearishness since the 2008 bear market. However, the AAII Allocation Survey of how those survey respondents are investing their money still doesn't match the 2008 mood, with equity allocations above their long-term average and well above every bear market bottom since the advent of the survey.

Investor's Intelligence survey also improved. Market gurus bought into the summer rally as a new bull market narrative, and bullishness spiked as a result. The double whammy of Powell's Jackson Hole speech and the poor CPI reading deflated some of that bullishness, but it's only led to a surge in neutral sentiment, meaning the gurus haven't given up hope yet.

Options markets are again a bullish influence on the Psychology composite. Still, since the bear market started, we've shown what we think it will take from options markets to register the kind of fear that mirrors the extreme euphoria that we saw in 2020 and 2021. Thus far, no dice.

The persistence of high inflation on the CPI release in the face of falling energy prices spooked investors this week. With the CRB Raw Industrials having peaked five months ago and the Producer Price Index making another attempt at a peak, we think CPI inflation will likely exhibit an undeniable peak in the coming months as well. But too many investors seem to equate a peak in the inflation rate as the rationale to resume aggressive risk-taking behavior.

To buy ourselves a peak in the rate of inflation, we had to fork over a down payment. That down payment was an inverted yield curve. And for the fourth time in my career, investors appear to be paying the yield curve much less respect than it deserves. They love to hate on it, but the yield curve is undeniably a winner. If financial markets were professional basketball, the yield curve is LeBron James.

Market Risk Index

Rec Allocation 20% Underweight

87.2%

Category Percentiles

Category	Percentile
Psychology - P6	90.4%
Monetary - M4	72.9%
Valuation - Extremely Overvalued	93.8%
Trend	84.7%

Largest Psychology Influences

Surveys	Positive
Option Activity	Positive
Leveraged Investments	Negative
Fund Flows	Negative

Largest Monetary Influences

Interest Rates	Negative
Exchange Rates	Positive
Inflation	Negative

Valuation

7-10 Year Equity Return Forecast	2.4%
10Yr US Treasury Yield	3.4%

Market Trends

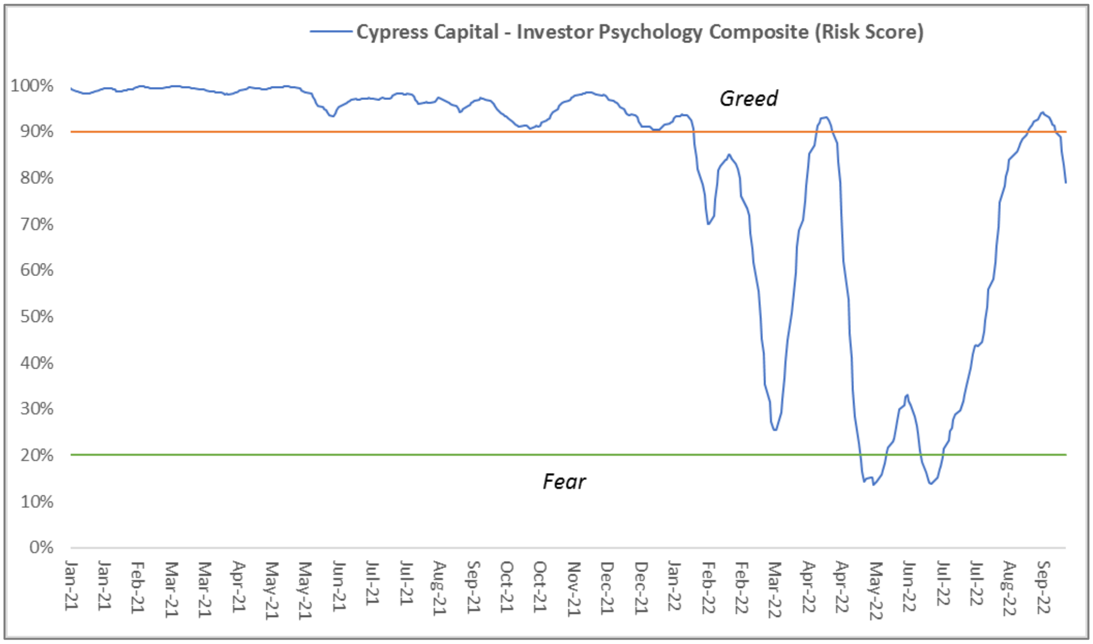
US Equities	Bullish Investment
Intl Equities	Bearish Trade
REITs	Neutral Trade
Broad Commodities	Bullish Investment

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.

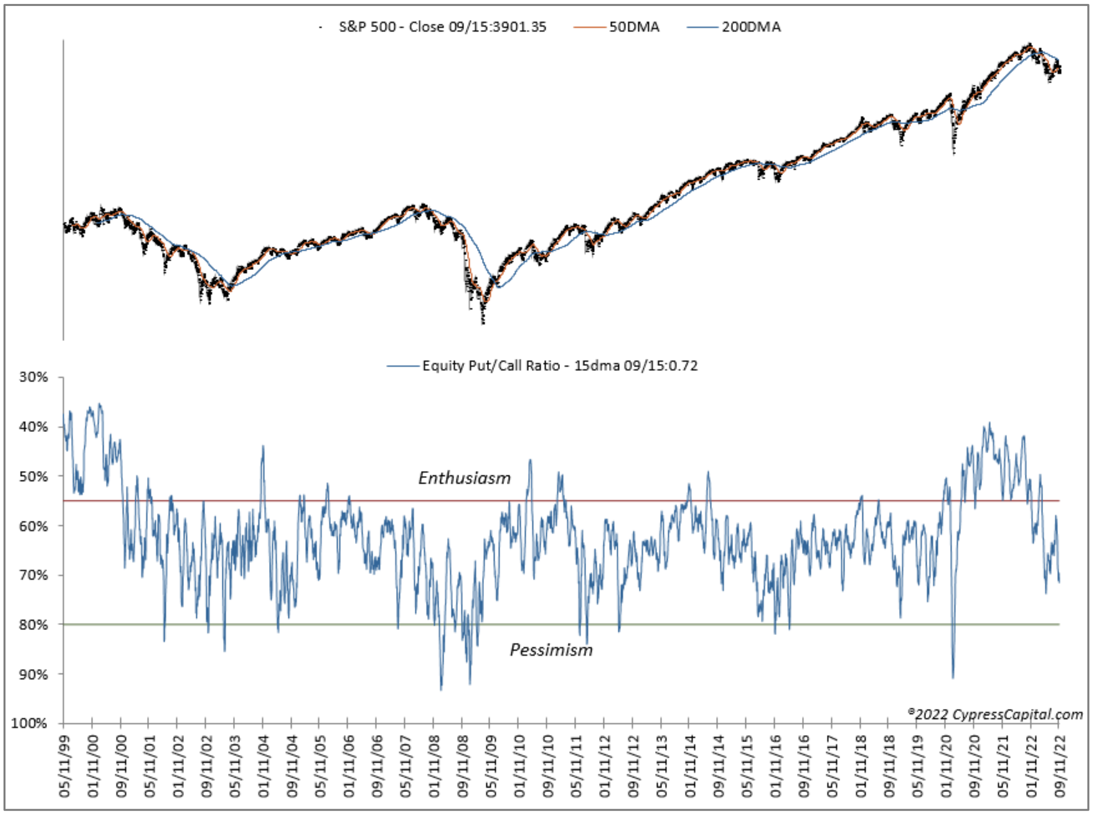
MRI has given no indication that the animal spirits from the Covid-era party of free money have given way to the kind of capitulation that is the hallmark of bear market bottoms. Should the stock market begin its traditional mid-term election year rally this November, the yield curve suggests that it will only serve as a pause on a bear market that will extend into 2023.

Charts of the Week

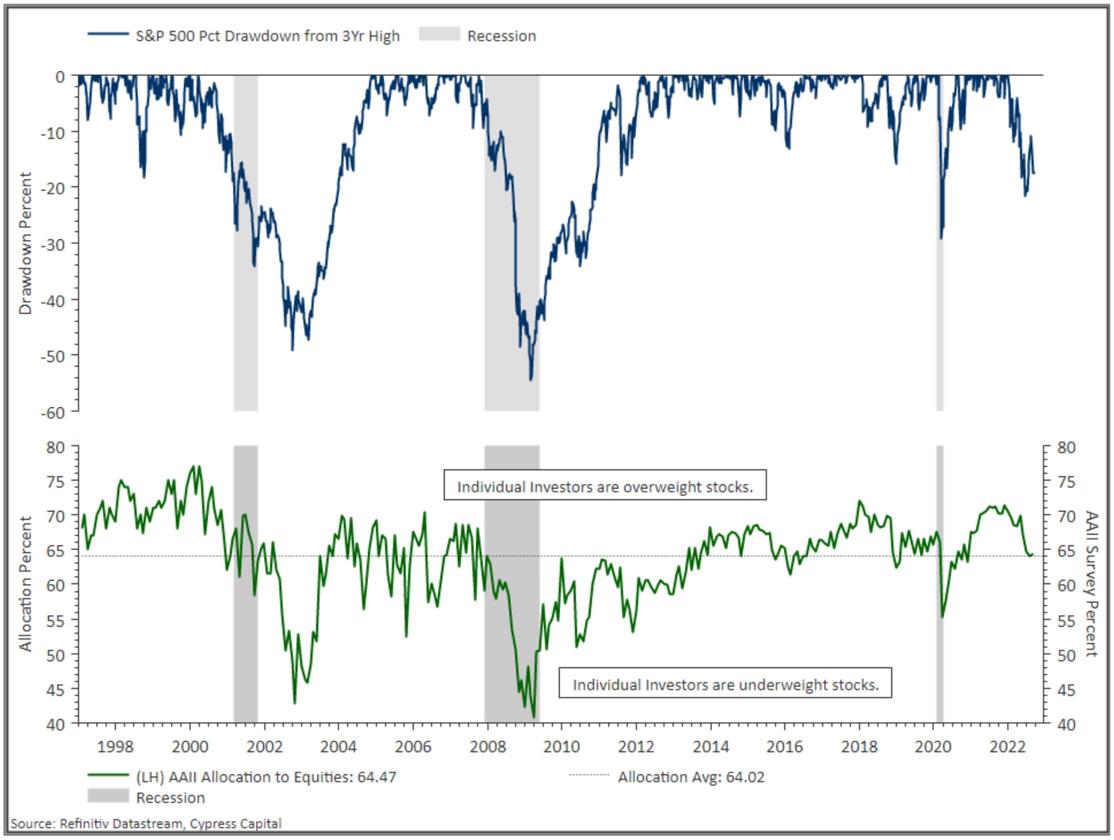
Psychology Composite – Greed has peaked for the second time in the bear market.



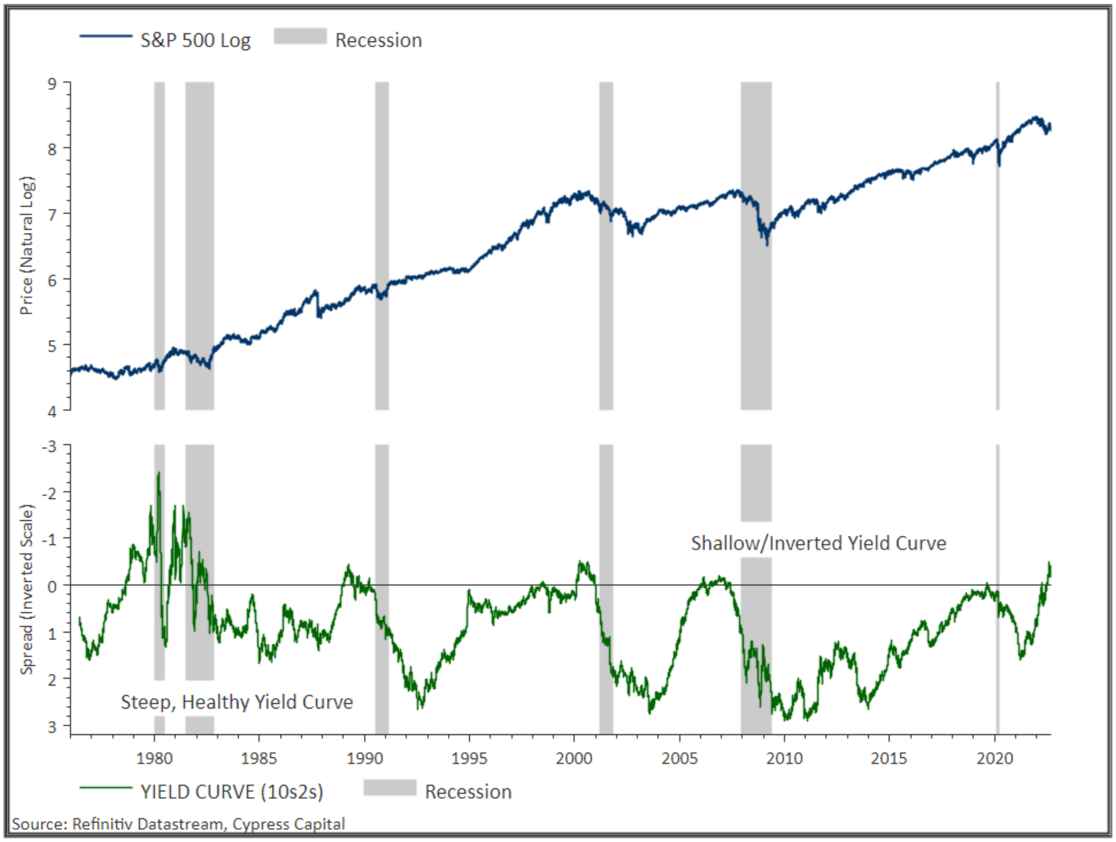
Equity Put/Call (15dma) is improving again, but capitulation is out of reach.



AAII Allocation Survey – Individual Investors are overweight equities.



You don't want to be under the rim when the Yield Curve goes in for the dunk.



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.