



Market Outlook

By Mark T Dodson, CFA

The Weight of the Evidence – Play Defense

Market Risk Index dropped by nearly 6% to 81.2%, on a sizeable improvement in the Psychology Composite. Investment surveys and trading in Options markets are registering market anxiety. The AAI survey saw a bearish response rate above 60% for the first time since March 2009. However, the divergence between how those respondents respond to the survey and how they are positioned in their portfolios has grown to the widest on record. That same group of investors are still overweight equities.

We have a handful of indicators that we have watched consistently throughout the bear market, either because they either signaled just how extreme the euphoria was in 2021 or because they gave accurate warnings before the onset of this bear market. None of them have given us any reason to grow more enthusiastic about making a significant shift away from our defensive posture.

Most noteworthy is that it's a foregone conclusion that the fourth component of our Asset Allocation model, Market Trend, has shifted from Investment to Trading Phase this week. It is a bearish shift in trend, but we call it Trading Phase because even within that bearish trend, we can have periods where the market setup is extremely bullish in the short term. What really changes is the duration of our expectations for investment in the stock market, which shortens. It's a tactic we use within bear markets to prevent us from pushing all of our chips into stocks too soon.

Annualized Returns during Market Trend Regimes	
Bullish Trend (Bullish Investment and Bullish Trade)	7.68%
Neutral Trade	2.40%
Bearish Trade	-8.65%
Average price return over entire period	5.49%

S&P 500 price-only returns since 1927

Being too early on investing in a bear market is not a concern today, as the counter-cyclical components of our model (Psychology, Monetary, and Valuation) don't give us any inkling that the bear market has entirely run its course.

However, the official shift to Trading Phase for Market Trend means that the tape's week-to-week movements could significantly affect MRI readings. The longer-term implication of all four asset

Market Risk Index

Rec Allocation 20% Underweight

81.2%

Category Percentiles

Psychology - P5



Monetary - M4



Valuation - Extremely Overvalued



Trend



Largest Psychology Influences

Surveys	Positive
Option Activity	Positive
Fund Flows	Negative
Leveraged Investments	Negative

Largest Monetary Influences

Interest Rates	Negative
Exchange Rates	Positive
Inflation	Negative

Valuation

7-10 Year Equity Return Forecast	2.7%
10Yr US Treasury Yield	3.6%

Market Trends

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

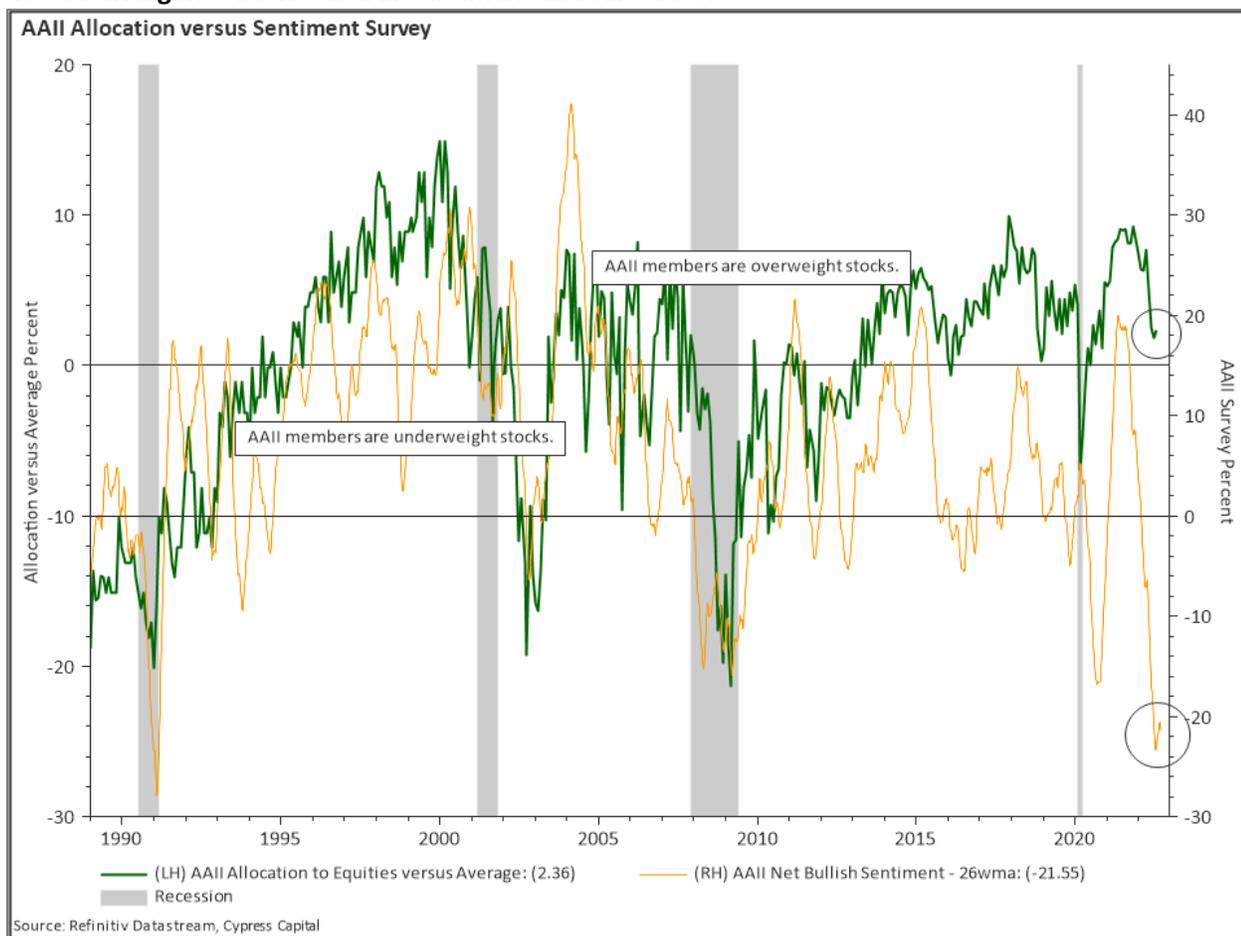
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

allocation model components signaling defense is that we are mentally preparing for a bear market that could persist into 2023.

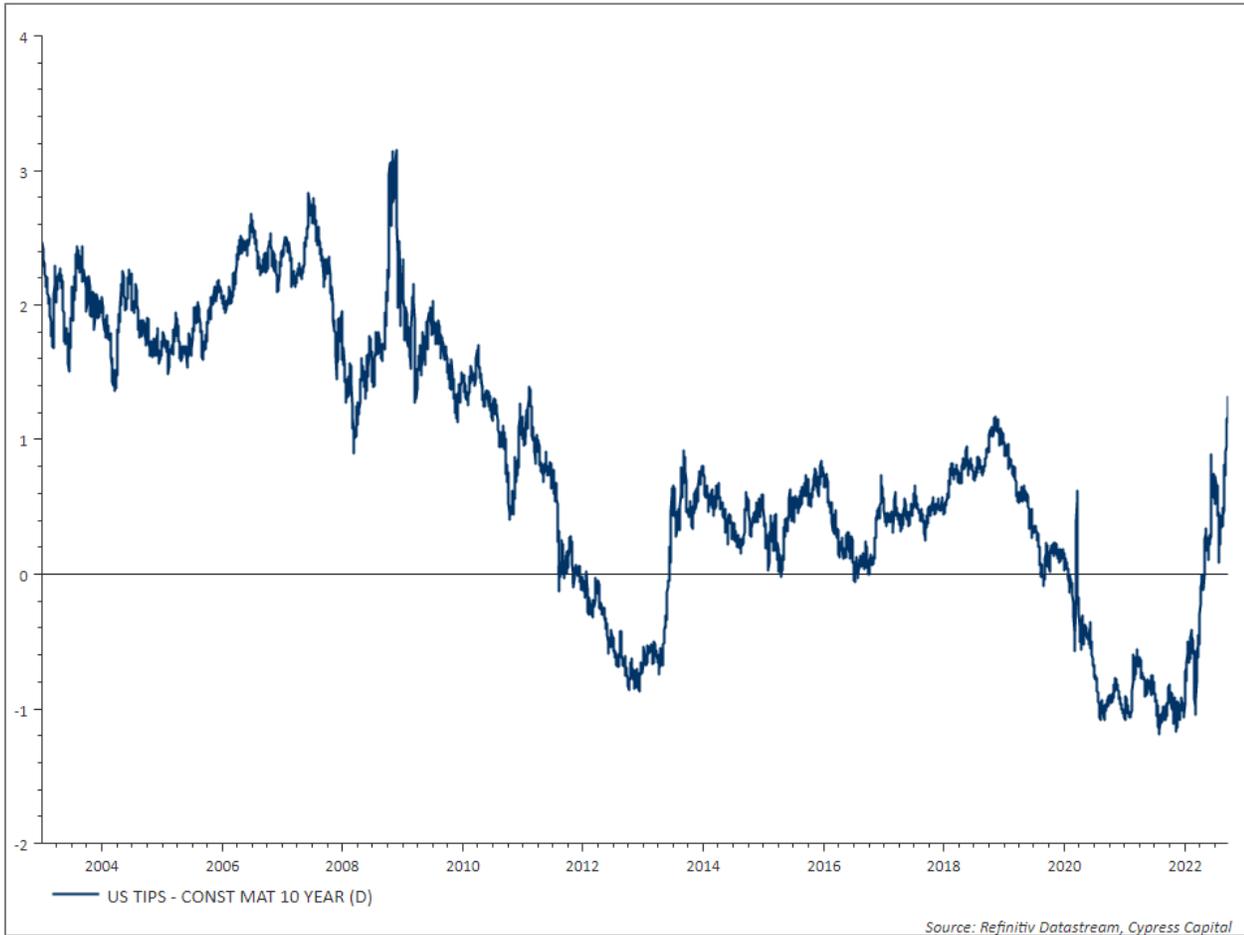
With a decent war chest on the sidelines, we also cannot help but feel optimistic at the opportunity to invest in markets when they provide us with a fat pitch – something with the potential to drive portfolio returns for several years with a high margin of safety. We hope for opportunities that boost returns well above the increase in inflation expectations that our central bankers and politicians have thrust upon us. But, we need to be patient, nimble, and avoid rash decisions.

Charts of the Week

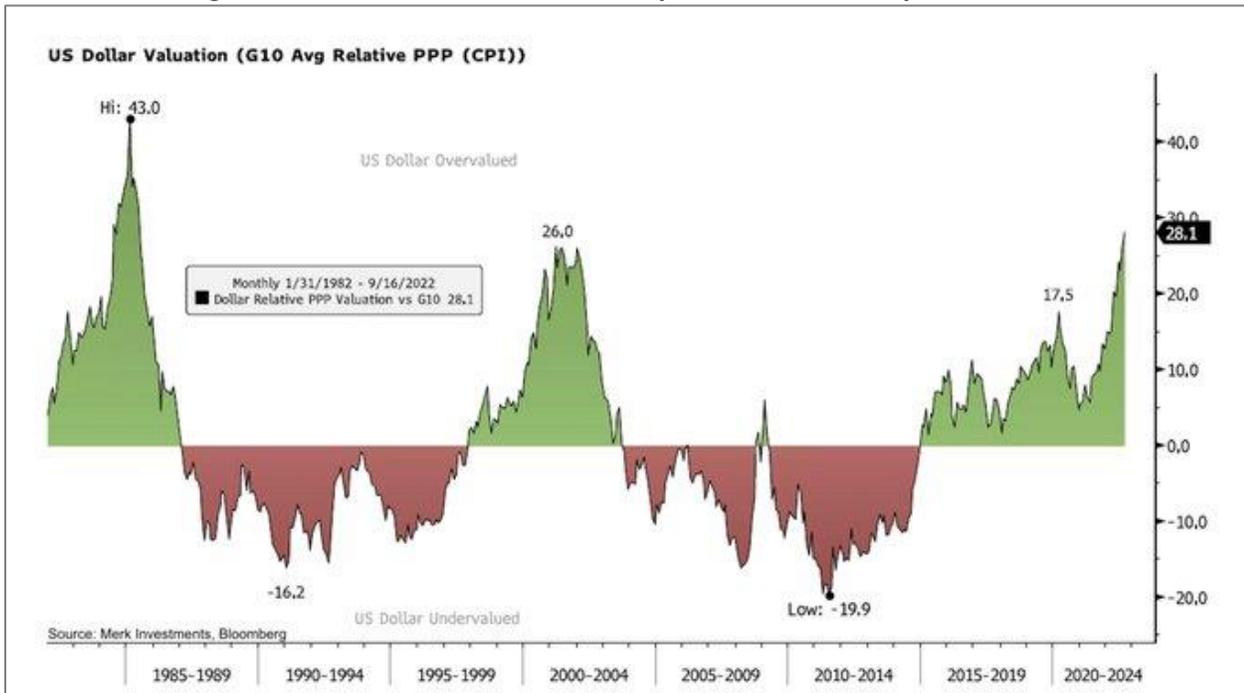
Record divergence between AAI Sentiment and Allocations



Yield on 10Yr TIPS hits the highest level since 2011.



The US dollar surge leaves it more overvalued than any time since the early 80s.



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.

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