Cypress CAPITAL

Market Outlook

By Mark T Dodson, CFA

Investor Psychology is finally throwing a lifeline to bulls.

Market Risk Index dropped to 51.7% on significant improvements to both the Psychology and Monetary composites. Valuations also edged out of the worst decile of readings for the first time since April 2020. Unlike April 2020, there is a more credible investment option in Treasury Bonds, taking away the popular "There is No Alternative" narrative.

The Psychology Composite has improved to the best quintile of readings, which historically has meant good short to intermediate investment opportunities in the stock market. The composite is stingy, so these are good readings. In this case, it's coming in the middle of October, right as the favorable Mid-term November to April window is upon us. For a short-term setup, it looks almost too good to be true.

We could make a modest tactical increase in our equity allocation over the coming weeks due to this good reading on the Psychology composite, but it's ultimately the bearish shift in Trend that is keeping us from increasing equity allocations more aggressively here.

Getting Psychology to move from the best 20% to the best 10% of possible readings may prove more difficult. Improvement in some of our favorite indicators for signaling the all-clear at the ends of bear markets continues to remain elusive – to our financial benefit. A market rally here, as strong as it might be during a seasonably favorable period, will likely fall short of ending the bear market.

As market watchers obsess over the idea of the Fed pivot, the Fed's series of sharp interest rate hikes over a brief period have yet to fully work their way through the economy. The damage that they have wrought will not become apparent for several months.

Market Risk Index

Rec Allocation 25% Underweight

51.7%

Category Percentiles

Psychology - P2: 15.2%

Monetary - M4: 55.9%

Valuation - Overvalued: 89.6%

Trend: 93.8%

Largest Psychology Influences

Surveys	Positive
Volatility	Positive
Option Activity	Positive
Flow of Funds	Negative

Largest Monetary Influences

Interest Rates	Negative
Exchange Rates	Positive
Interest Rate Spreads (Yield Curve)	Negative

Valuation

7-10 Year Equity Return Forecast	3.6%
10Yr US Treasury Yield	3.9%

Market Trends

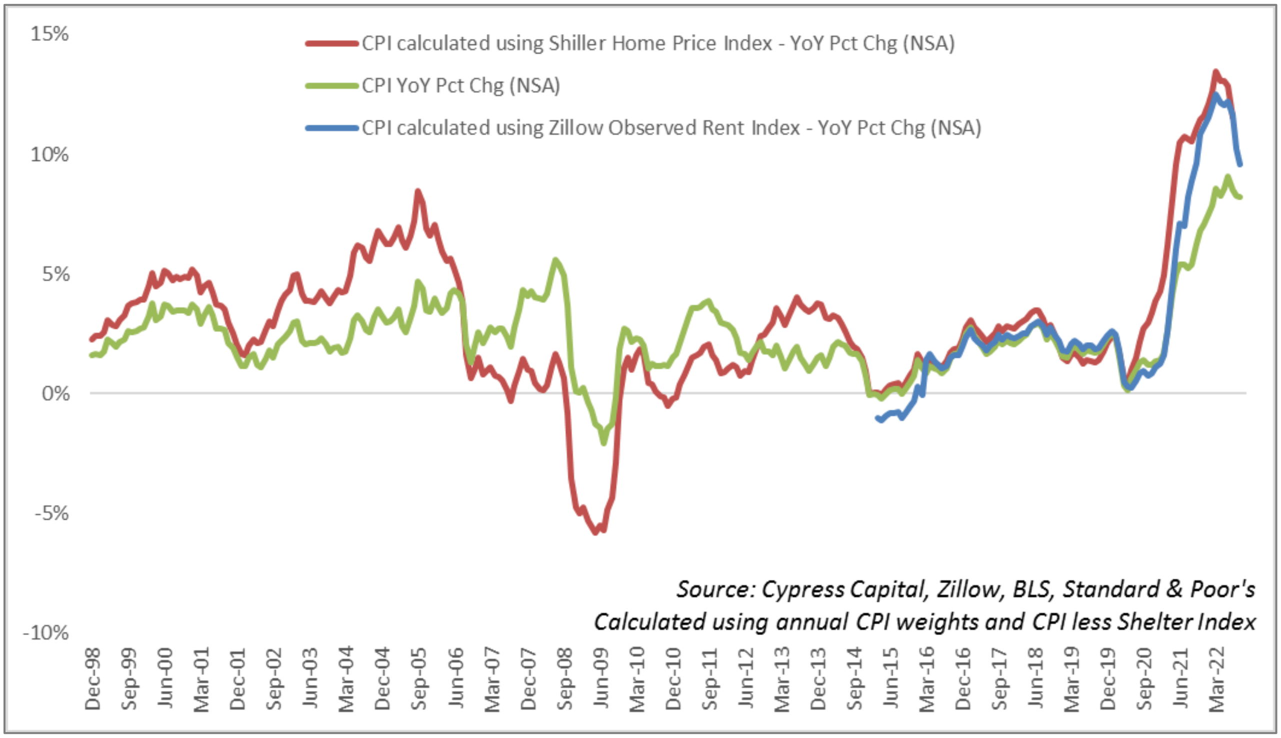
US Equities	Bearish Trade
Intl Equities	Bearish Trade
REITs	Bearish Trade
Broad Commodities	Bullish Investment

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.

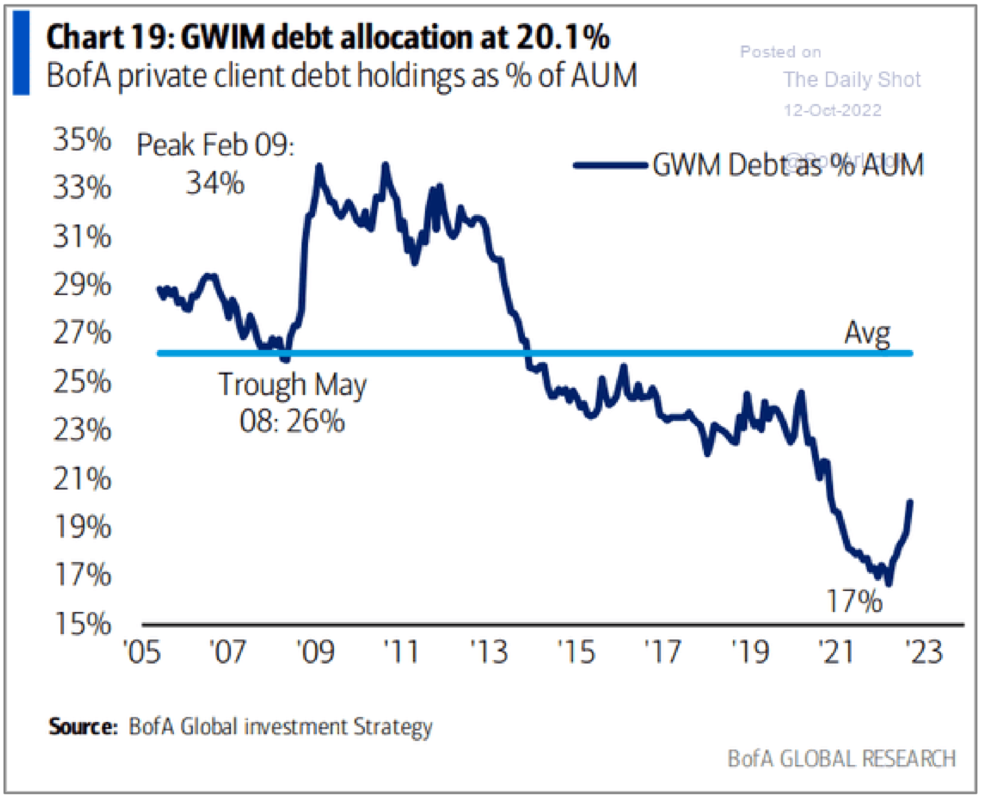
Charts of the Week

What does inflation look like when you use the Shiller Home Price Index and Zillow Rent Index?

The Shiller Home Price Index and the Zillow Observed Rent Index lead the CPI's measures of shelter expenses by several months. It's a common complaint. We took the CPI and substituted those measures in place of the CPI's Shelter components to see what difference it would make. A March inflation peak becomes becomes much more apparent, but the inflation overshoot becomes much more pronounced as well.



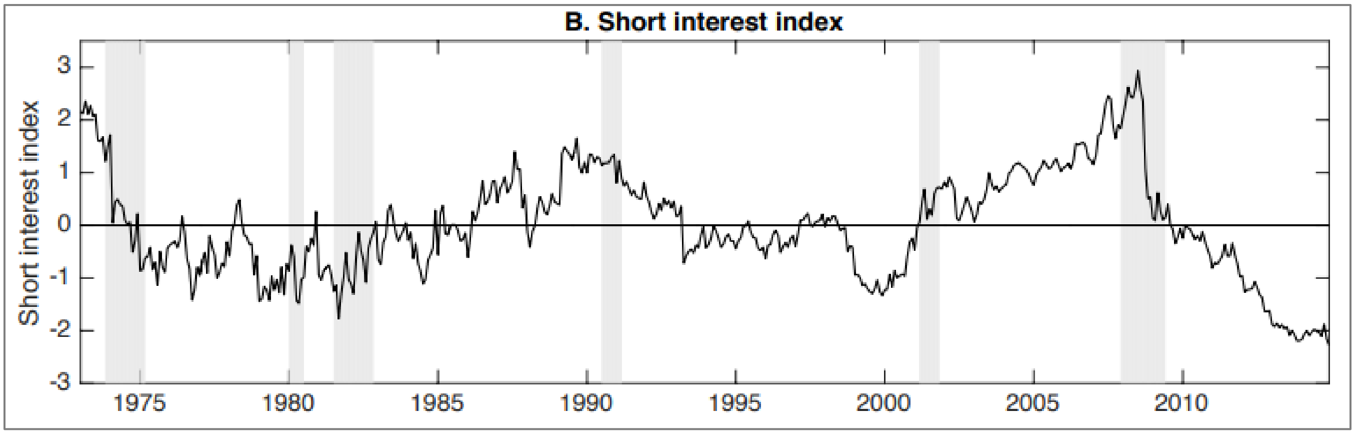
Early signs that investors are starting to increase bond allocations.



Short-Interest has risen to 1.5 standard deviations above its long-term trend.
Contary to popular belief about short interest and short squeezes, shorts are smart money.

Source: Mark Hulbert

Longer-Term Chart of Short Interest

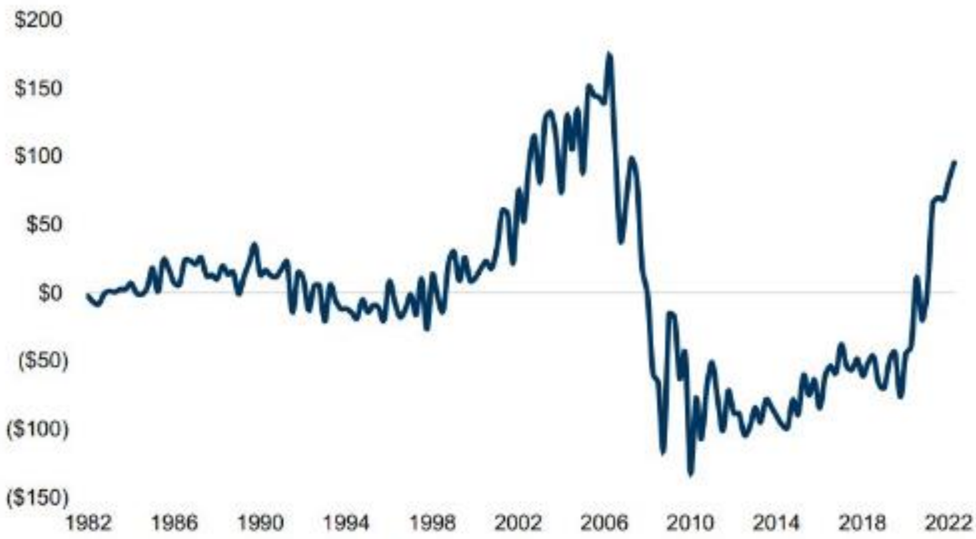


Source: Short Interest and Aggregate Stock Returns

Homeowner’s are pulling money from their homes at the fastest pace since the Housing Bubble.

Exhibit 14: Households are Withdrawing Home Equity at the Highest Rate Since 2007

$bn



Mortgage equity withdrawal (MEW) measured as the difference between total borrowing in home mortgages and the implied total amount of financing needed for residential construction

Source: Federal Reserve Board, Federal Housing Finance Agency, Goldman Sachs Global Investment Research

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.