Market Outlook

By Mark T Dodson, CFA

Sharpest Yield Curve Inversion since 2000

Market Risk Index dropped to 69.3%. Additional deterioration by the Psychology Composite was offset by improvement to both the Monetary Composite and Market Trend. Market Trend is on the cusp of moving to Neutral as a result of the market rally off the October lows.

Despite Fed tightening, Monetary conditions have shown signs of easing since the CPI release. The yield on the 10Yr Treasury dropped, but not enough to trigger a buy signal from our Bond Momentum indicator. However, it was enough to drive the yield curve's slope to its most severe inversion since the start of the 2000 bear market. More than 70% of the different versions of the yield curve have inverted at this point, an undeniable recession warning coming from the bond market.

Within the Psychology Composite, the 15-day moving average of the equity put/call ratio climbed above 80%, one of a handful of indications we have been looking for before we'd even entertain the idea of the bear market being over.

At the same time, our favorite measure of market internals, the High Low Logic Index, is beginning to signal that the market rally may not be on solid footing. Renewed signs of a split market occurred last week, with the trigger of a minor warning from the NASDAQ version of the indicator, and the NYSE version of the indicator could do the same over the next couple of weeks. Bear market rallies in both the 2000-02 and 2008 bear markets halted on sell signals in the High Low Logic Index.

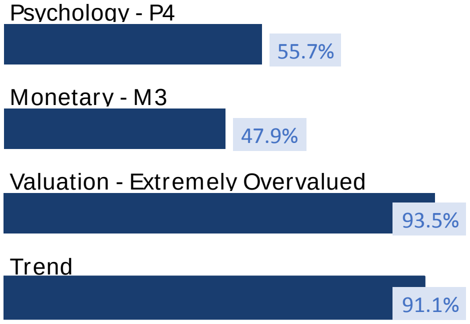
After the extreme fear readings set by the Psychology Composite in October, we have been comfortable letting equity allocations drift up in this seasonally strong period after a mid-term election year. We expect to lighten exposure on a sell signal from High Low Logic or signs that short-term sentiment is growing enthusiastic again.

Market Risk Index

Rec Allocation 25% Underweight

69.3%

Category Percentiles



Largest Psychology Influences

Surveys	Positive
Leveraged Investments	Negative
Fund Flows	Negative
Bank Sentiment	Negative

Largest Monetary Influences

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

Valuation

7-10 Year Equity Return Forecast	2.5%
10Yr US Treasury Yield	3.7%

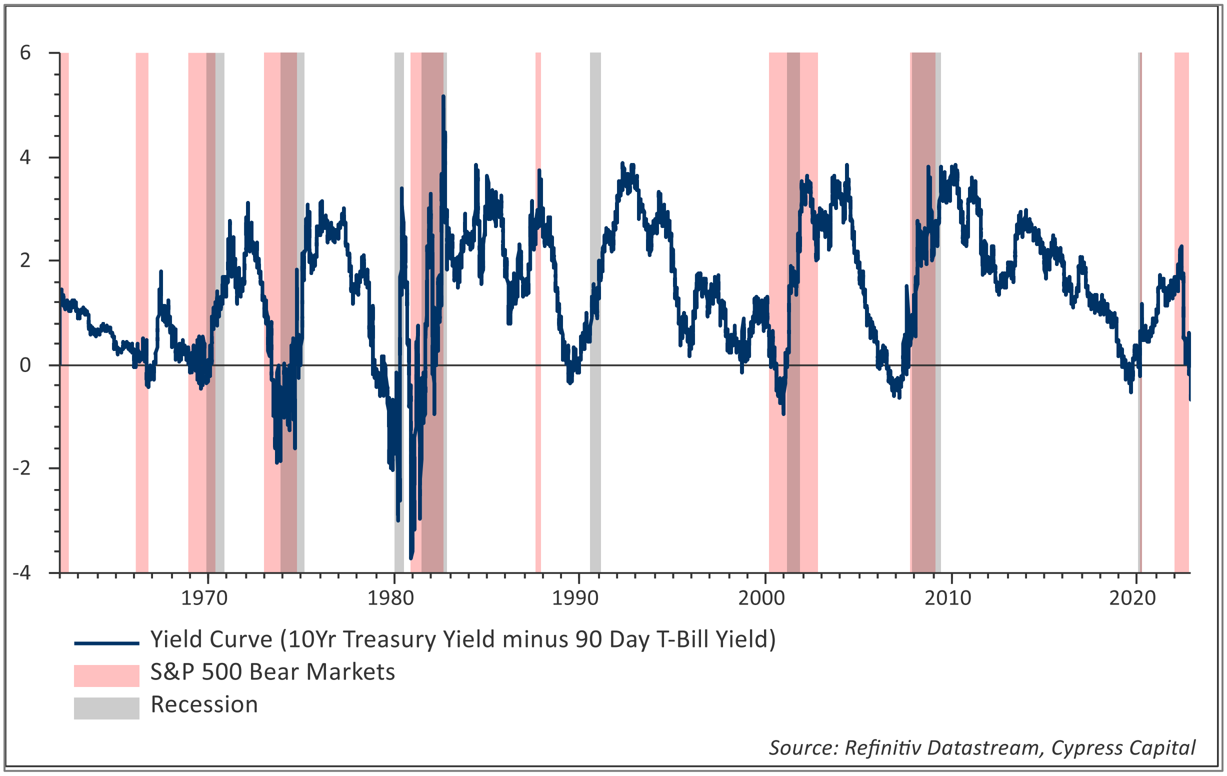
Market Trends

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

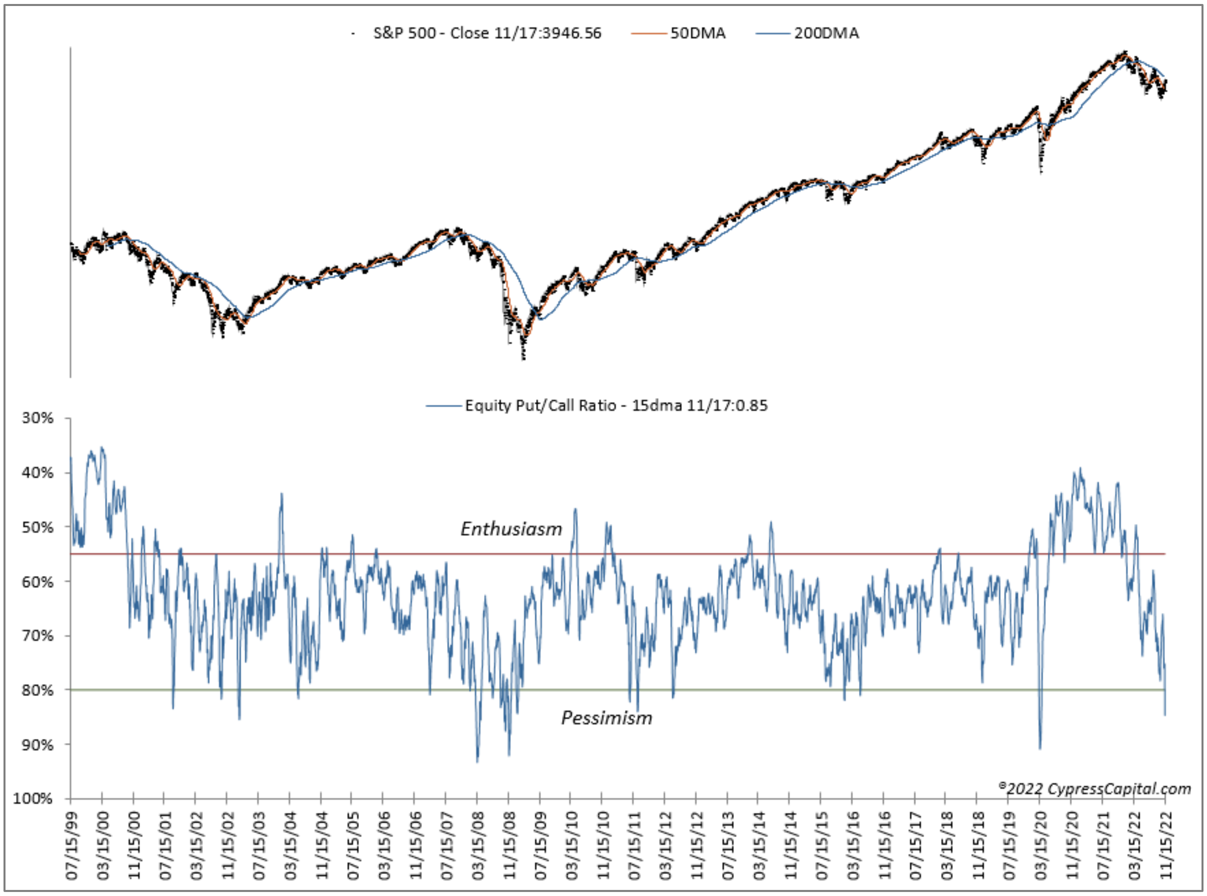
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

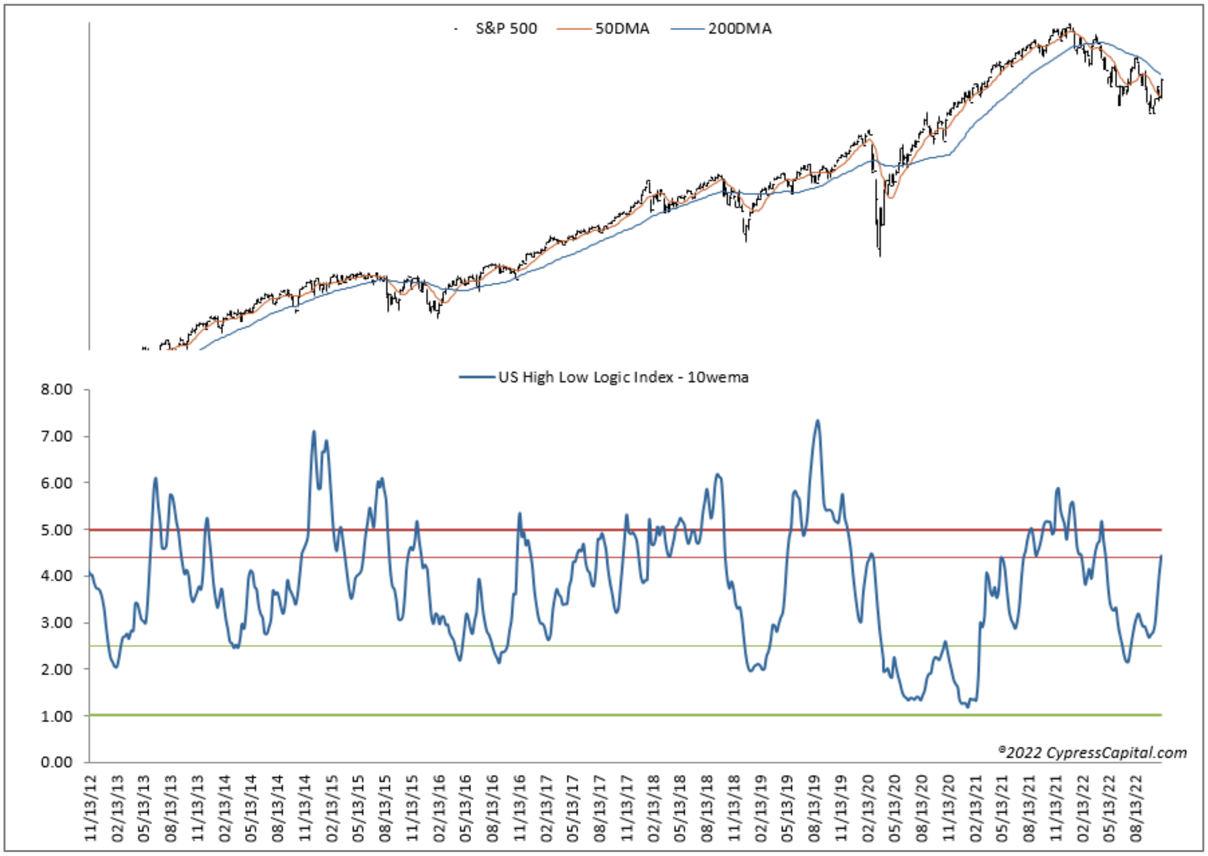
Falling yields on 10Yr Treasuries leads to the most significant yield curve inversion since 2000.



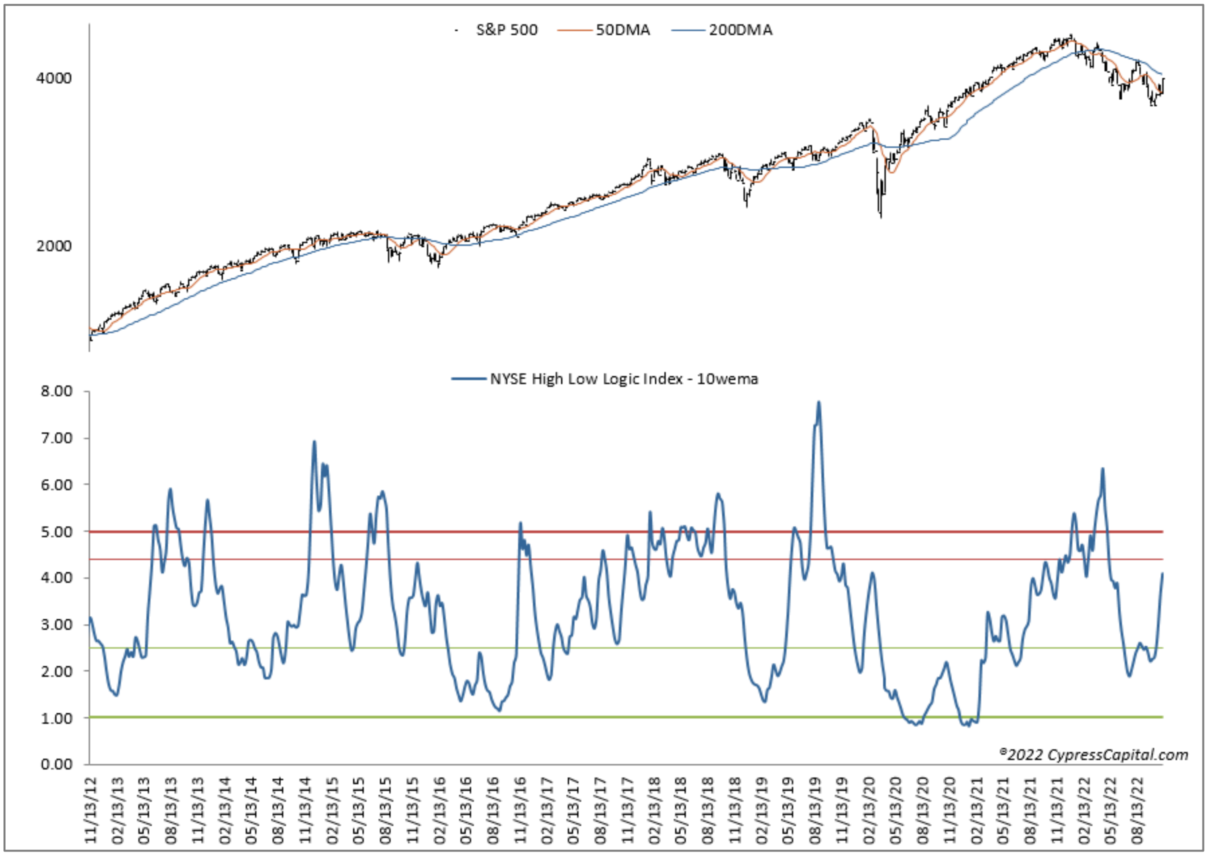
The Equity Put/Call Ratio is finally showing the first signs of capitulation.



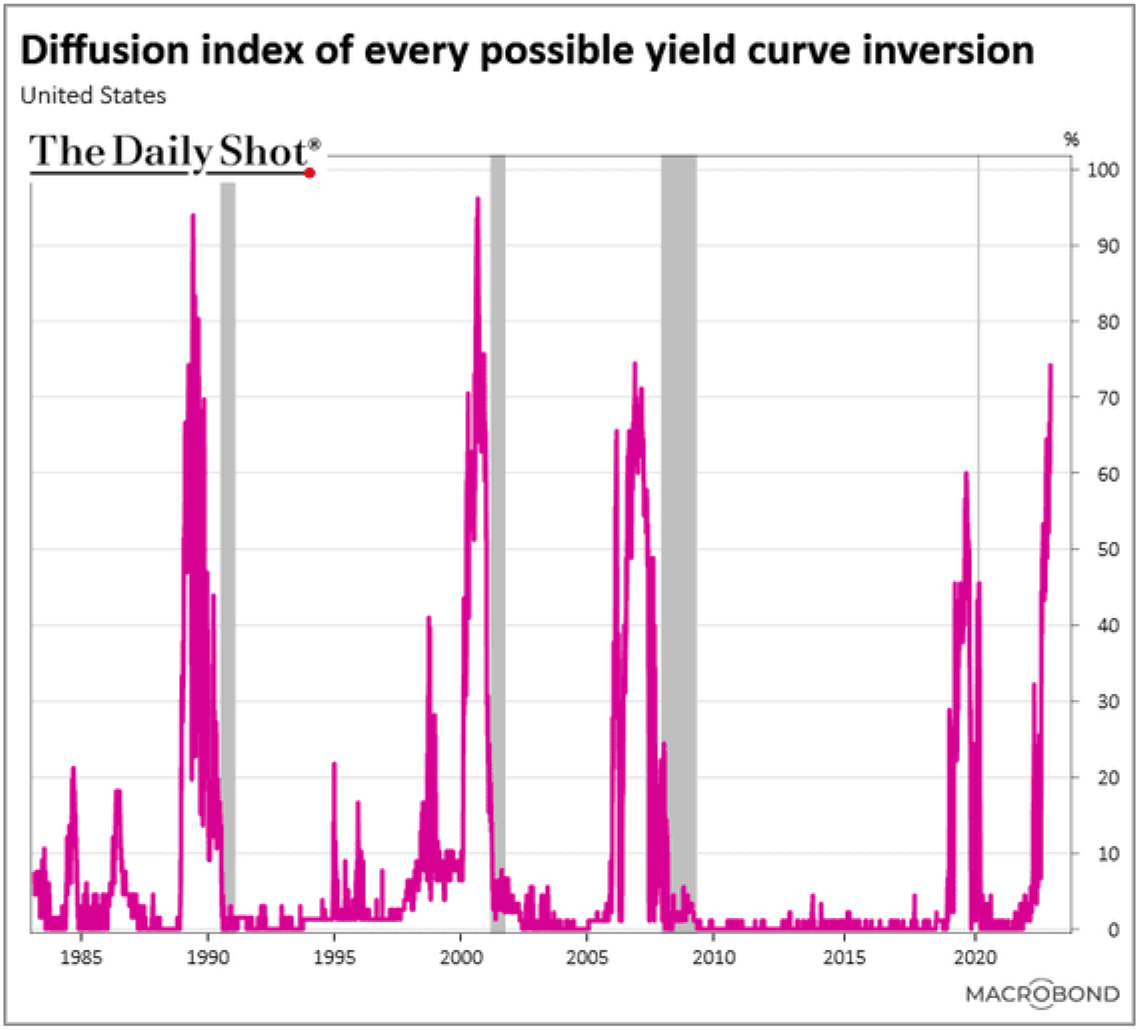
NASDAQ High Low Logic Index triggered a secondary warning last week.



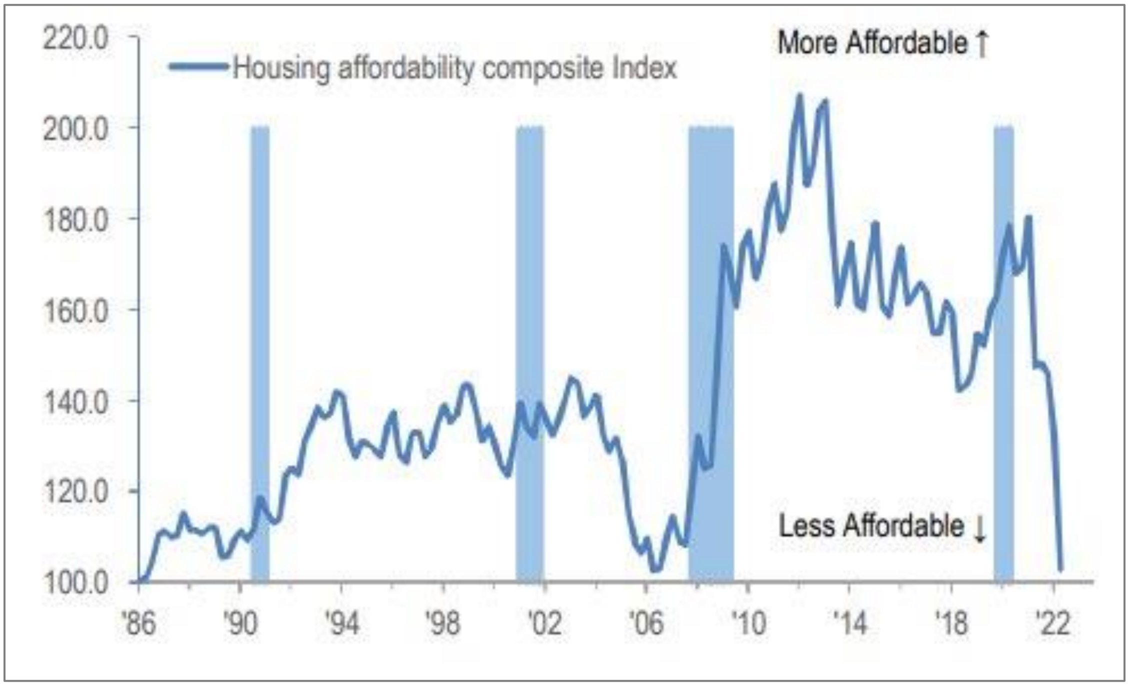
NYSE High Low Logic Index is rapidly deteriorating.



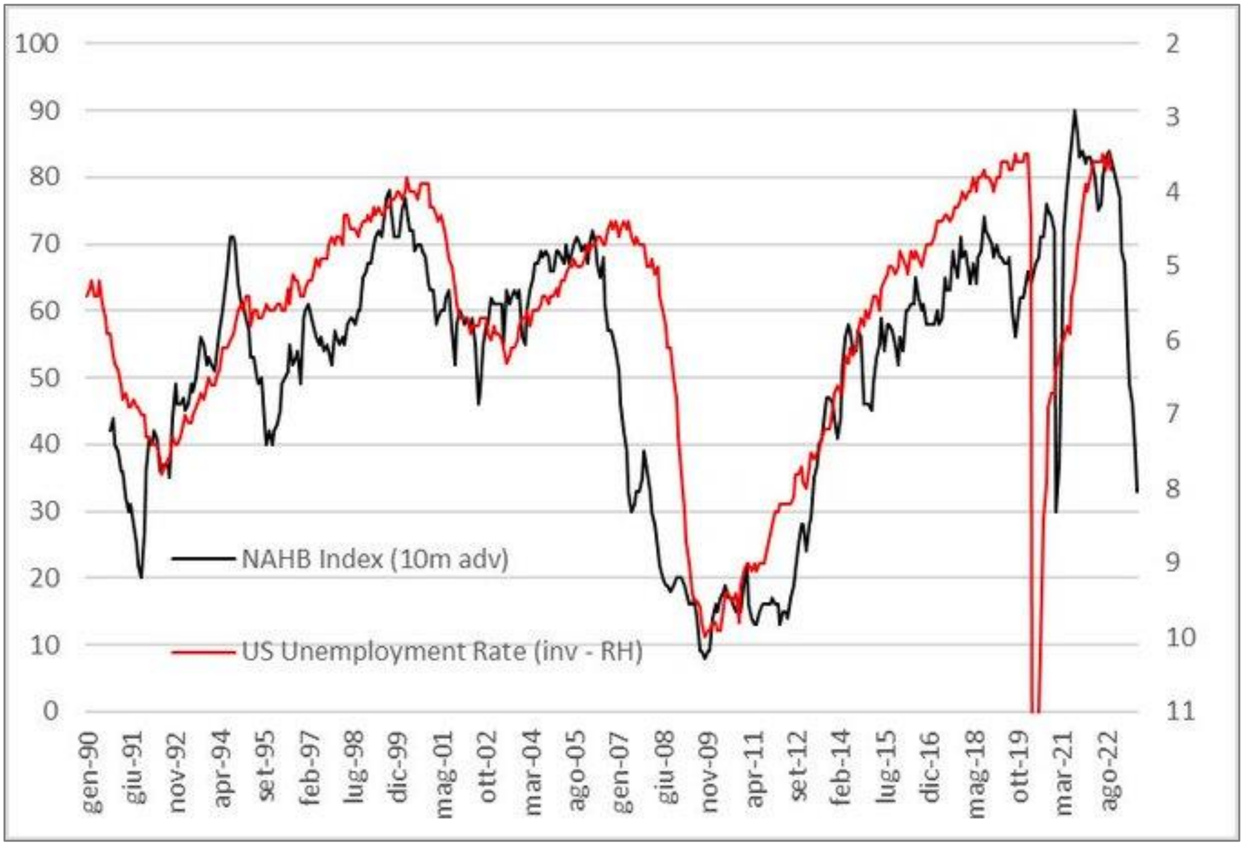
More than 70% of every possible yield curve combination has inverted.



Housing Affordability has fallen to the lowest level since 2006.



Falling Home Builder Sentiment implies much higher unemployment in 2023.



Consumers are tapping credit to make up for lost purchasing power.

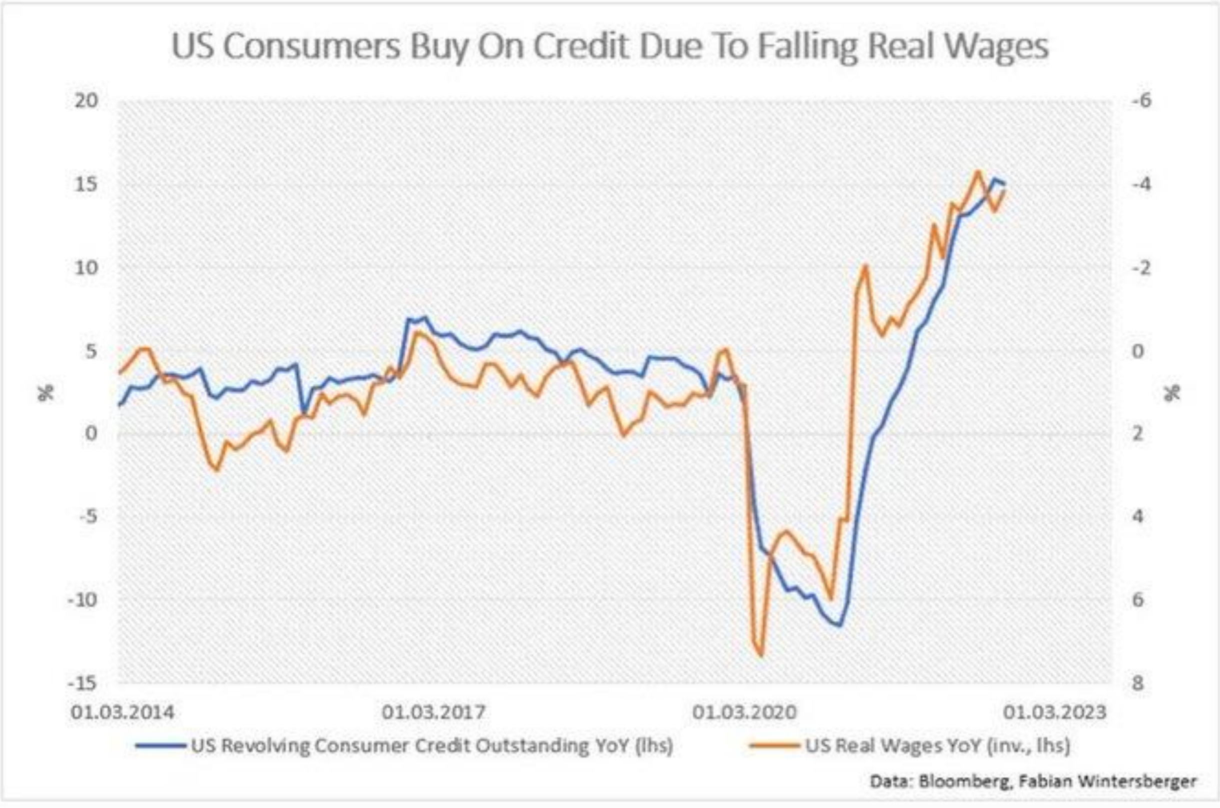
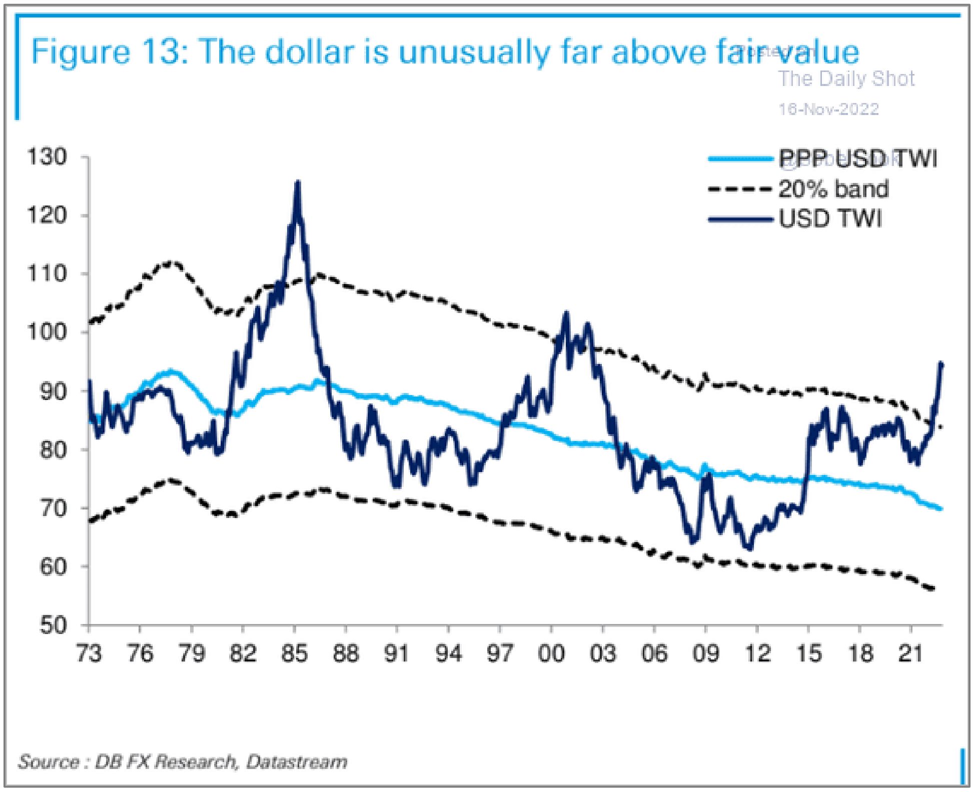


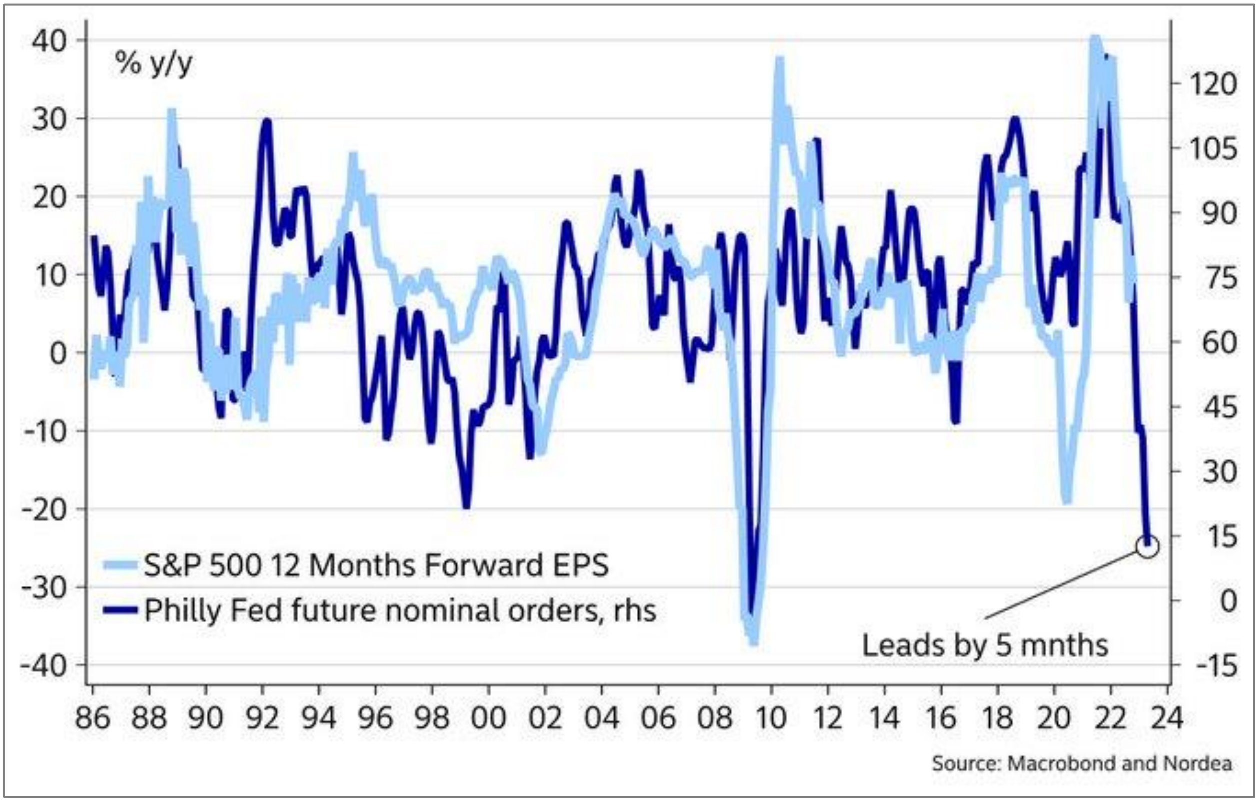
Abbildung 1: US Consumers Buy On Credit Due To Falling Real Wages; Fabian Wintersberger

The US Dollar is overvalued.

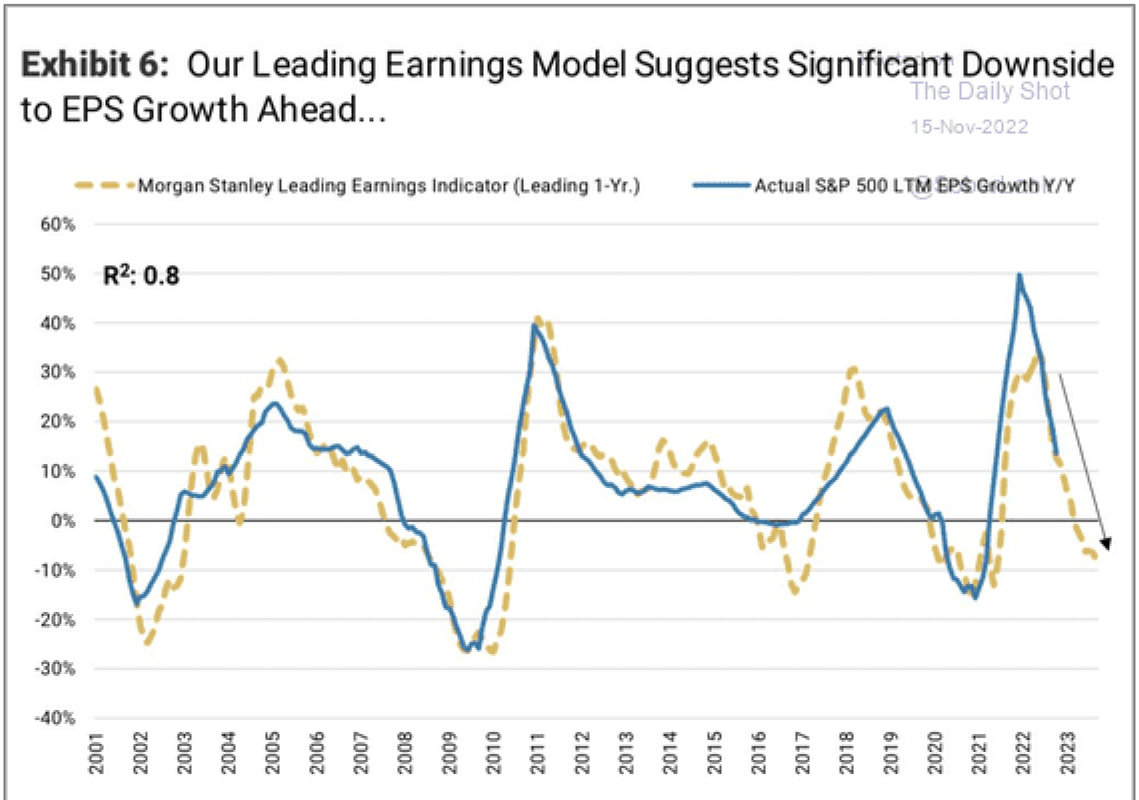


New momentum in Chinese credit growth should produce a move higher in the Euro.

A sharp drop in Philly Fed Orders means S&P 500 earnings are at risk.

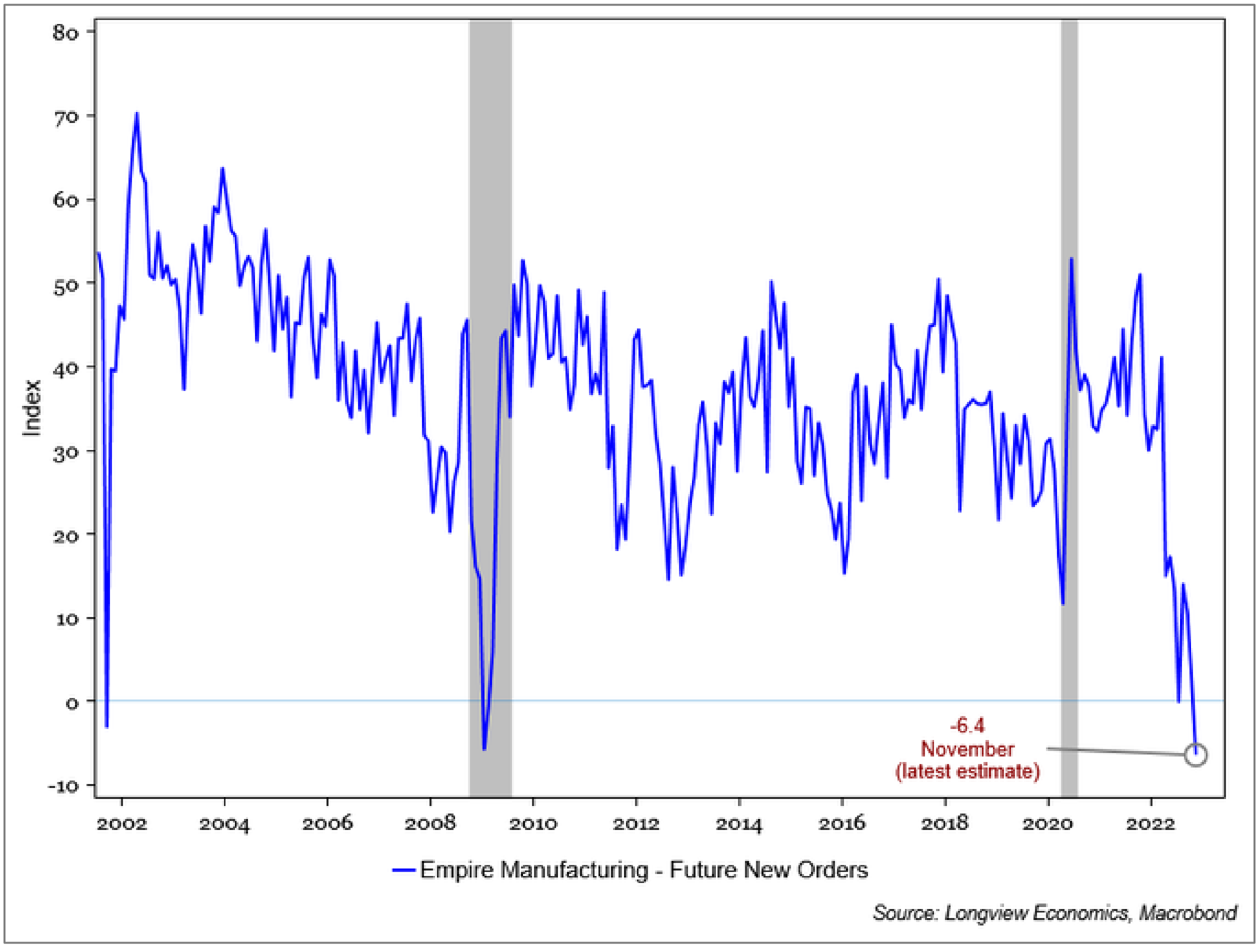


Morgan Stanley Leading Earnings Indicator suggests the same.



Source: FactSet, Bloomberg, Morgan Stanley Research; Note: Inputs: ISM Mfg. PMI, Conference Board Consumer Confidence, housing starts, credit spreads. Weightings float over time based on rolling correlation of a given factor versus EPS growth.

Empire Manufacturing New Orders Index looks recessionary.



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.