



Market Outlook

By Mark T Dodson, CFA

The average investor isn't positioned for Recession

Market Risk Index was little changed and closed the week at 72.5%. The Psychology Composite risk score peaked internally but has stubbornly resisted falling out of the worst quintile of readings.

A higher than expected Consumer Confidence reading on Tuesday didn't help in that department. Consumer Confidence and our favorite bits of data within that release are consistent with the condition of the inverted yield curve and paint a picture of an economy before the onset of a recession.

The Federal Reserve's Financial Accounts of the United States report was also released this month. It showed investors remain over-exposed to equities, putting us squarely in the denial phase of the bear market. The forward returns implied from the current positioning are nearly identical to the equity return forecast from our valuation composite. Stocks have only corrected in line with bonds, and despite a bear market, they are even now priced to return a little less than Treasuries. There has been no overshoot nor a steep enough decline to eliminate the drawdown risk that valuations imply today.

We will take the next week off, barring some unusual stock market action or major shifts within our asset allocation model. Investor Psychology and fractured stock market action will be our key short-term concerns as we move into the new year. And as 2023 unfolds, the yield curve has us expecting a recession. However, unlike the average investor, we are positioned for it.

We look forward to Mr. Market providing us with opportunities in 2023 to earn respectable returns on our capital.

Market Risk Index

Rec Allocation 25% Underweight

72.5%

Category Percentiles

Psychology - P5



Monetary - M3



Valuation - Extremely Overvalued



Trend



Largest Psychology Influences

Leveraged Indextments	Negative
Technical Indicators	Negative
Surveys	Positive
Option Activity	Positive

Largest Monetary Influences

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

Valuation

7-10 Year Equity Return Forecast	2.9%
10Yr US Treasury Yield	3.7%

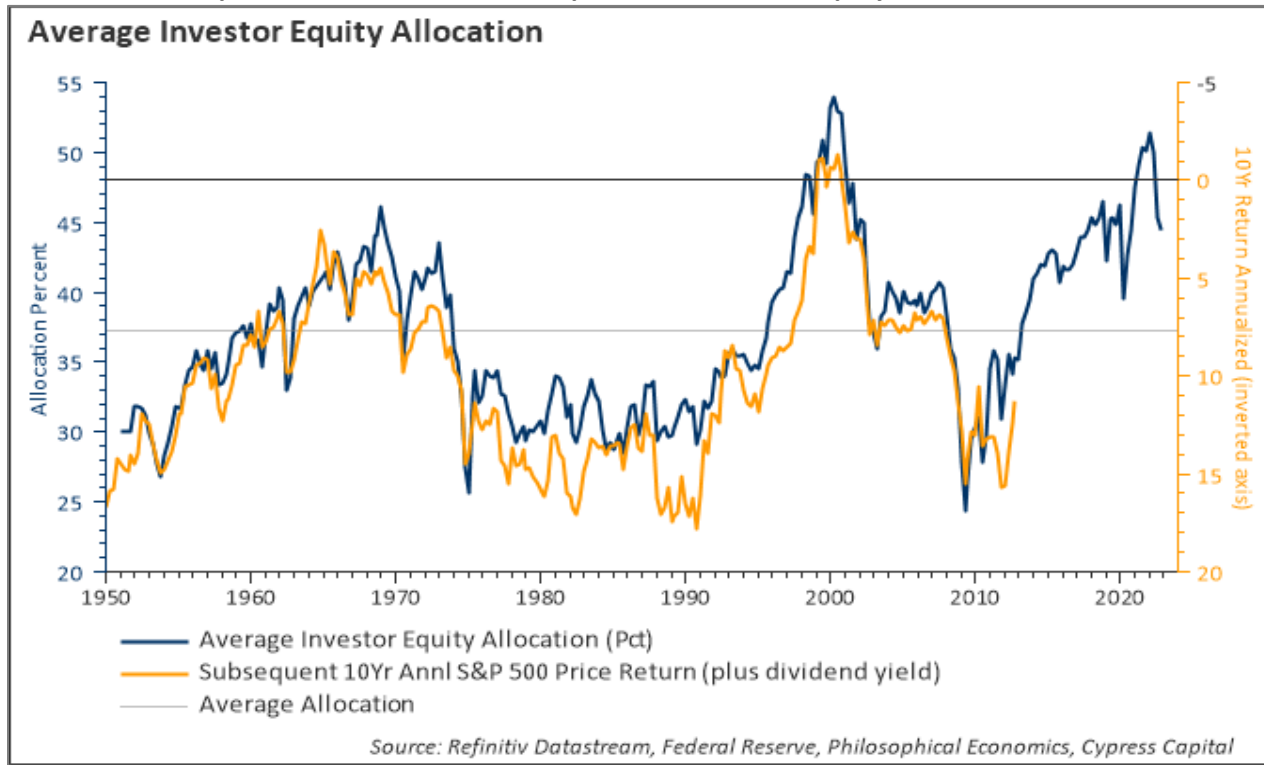
Market Trends

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

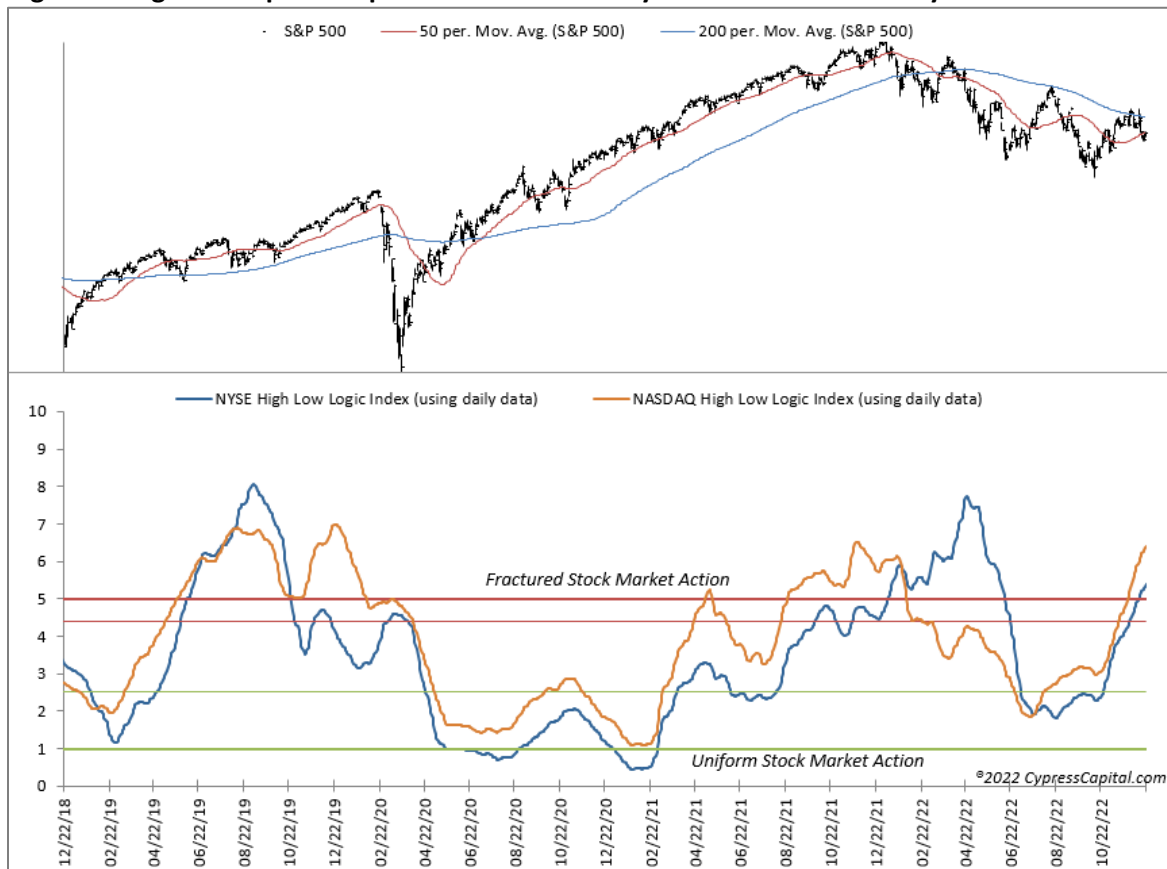
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

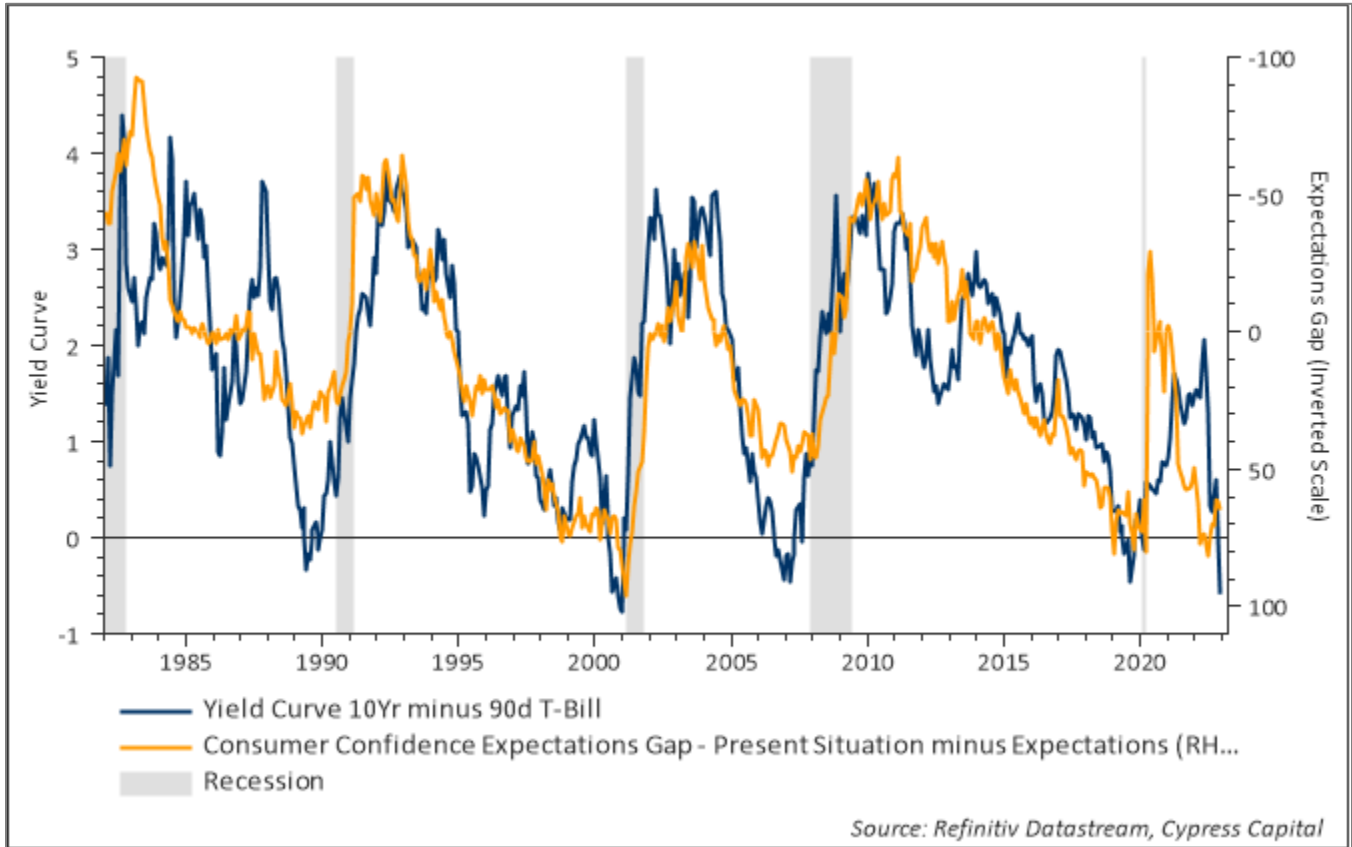
Investors are not positioned for recession. Despite a bear market, equity allocations are well above average.



High Low Logic Index paints a picture of an unhealthy stock market internally.

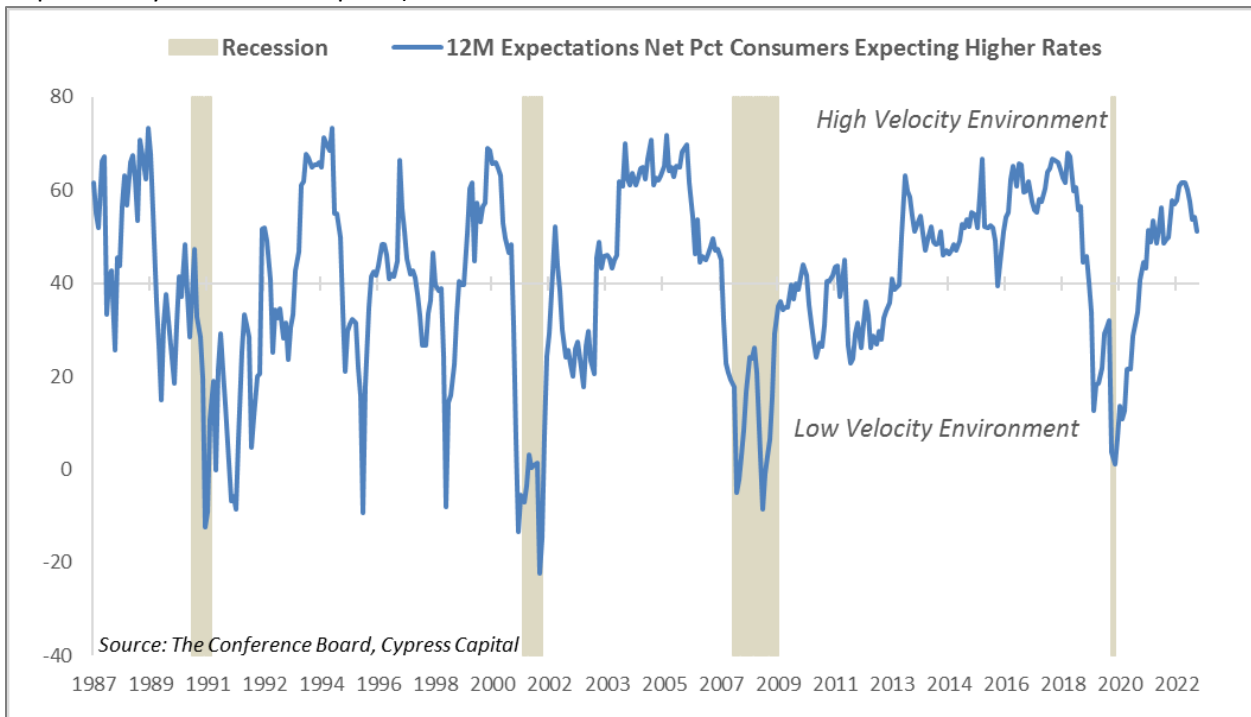


The Expectations Gap and Yield Curve are back in sync – both giving recession warnings.

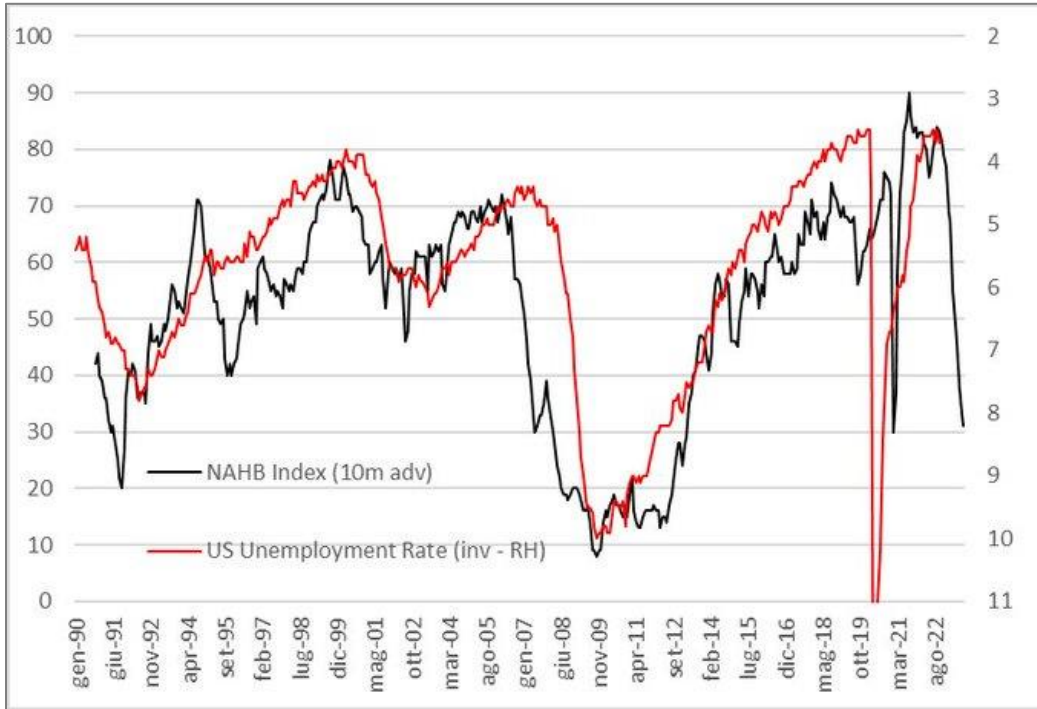


Consumer Expectations for interest rates have peaked.

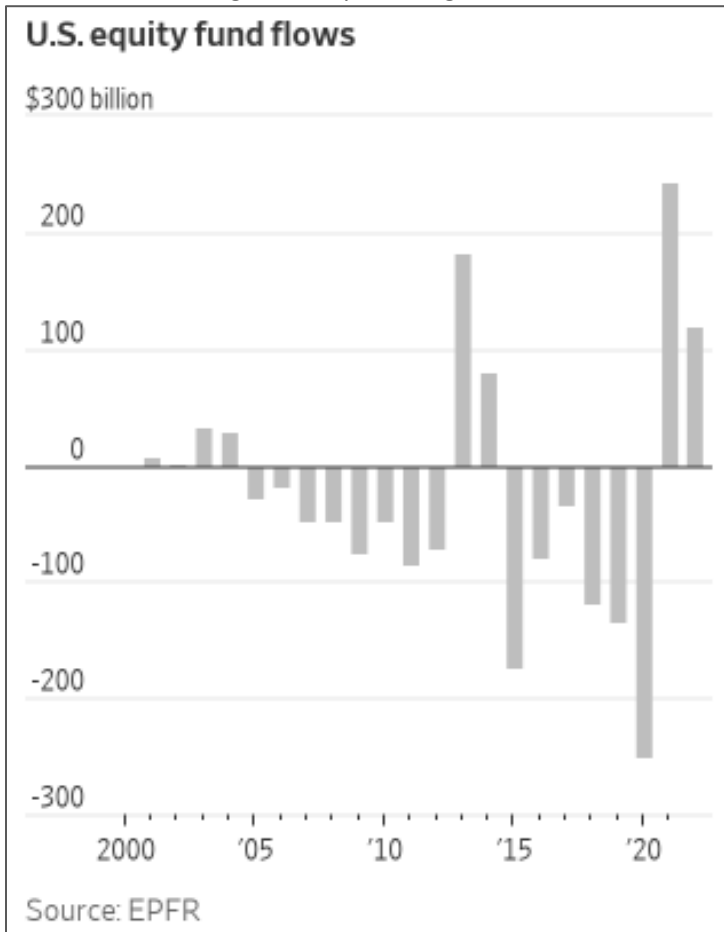
The corresponding increase in money demand that coincides with recession remains elusive. (That’s when the slope of the yield curve steepens.)



Sentiment in the Housing Market implies higher unemployment in 2023.



Equity Fund Flows have remained positive despite the bear market.
 Investors have bought the dips throughout 2022.

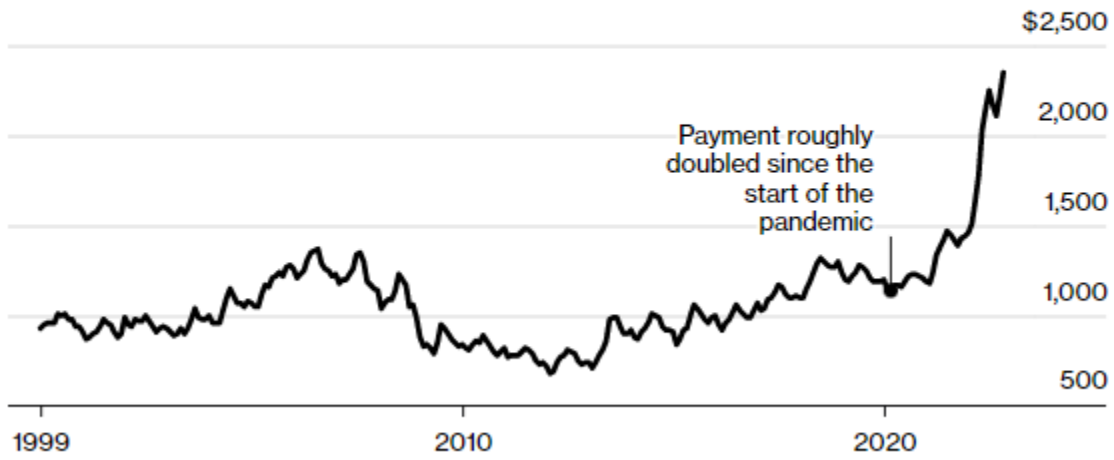


Source: EPFR

The monthly mortgage payment to purchase a home has doubled since the onset of the pandemic.

Home Costs Double

Monthly mortgage payment on a median-priced US house with a 10% down payment and 30-year mortgage rate



Source: Mortgage Bankers Association, National Association of Realtors, Bloomberg calculations

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.