Market Outlook

By Mark T Dodson, CFA

Us Against the World

Market Risk Index remains in the high drawdown risk zone but managed to improve by 2.6 percent to 82.4%. The Psychology, Monetary, and Valuation composites improved modestly after a volatile week for risk assets.

While the Psychology Composite is still in the worst 5% of readings, headlines leading up to the failure of Silicon Valley Bank were enough to create a peak within the Psychology Composite, and the pendulum has started a move back toward fear. The most noticeable shift was in the Options Category, which is back to being the most positive influence on the Psychology Composite.

One indicator bucking that trend is the action from smart money corporate insiders, who continued to sell stocks. They ramped up to a level that is only a couple of tenths of a point away from matching their desire to sell stock in March 2021, when the Covid-stimulus driven bubble was at peak euphoria.

Also worth noting is that the Long Bond Momentum indicator is a couple of days shy from confirming a buy signal, joining the momentum on the 10Yr Treasury. Long Bond Momentum is the classic version of the indicator, and it's based on the Coppock momentum formula applied to the inverse of Treasury yields. It's an indicator we have used for over 20 years, largely with success, and it's one of our all-time favorite indicators. While positioning and sentiment from bond investors favor a bond market rally, real yields on nominal Treasuries do not present us with the best risk-reward opportunity. So, our embrace of this particular signal will not be as gung ho as it has been in the past. The 1970s were a period marked by fits and starts with Bond Momentum, and in that environment paying attention to real yields on bonds was good risk management.

We are particularly pleased with how the Psychology Composite has led us during the bear market, giving useful signals before the onset of market inflection points when most gurus and Wall Street sentiment composites were set on repeat that fear is rampant all the way down, ad-nauseam. We put a lot of man-hours and thought into building something that would help us guide the management of our wealth instead of our career risk, and it's paying off. We've ignored every head-fake and story of Fed pivots, breadth thrusts, and re-openings. You can't rely solely on technicals – you need

Market Risk Index

Rec Allocation 25% Underweight

82.4%

Category Percentiles

Psychology - P6: 95.3%

Monetary - M3: 48.8%

Valuation - Extremely Overvalued: 93.6%

Trend: 20.8%

Largest Psychology Influences

Leveraged Investments	Negative
Flow of Funds	Positive
Volatility	Negative
Consumer Confidence	Negative

Largest Monetary Influences

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

Valuation

7-10 Year Equity Return Forecast	2.5%
10Yr US Treasury Yield	3.9%

Market Trends

US Equities	Bullish Trade
Intl Equities	Bullish Trade
REITs	Bullish 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.

fundamentals, valuations, sentiment, and monetary conditions to be on your side – use the weight of all the evidence.

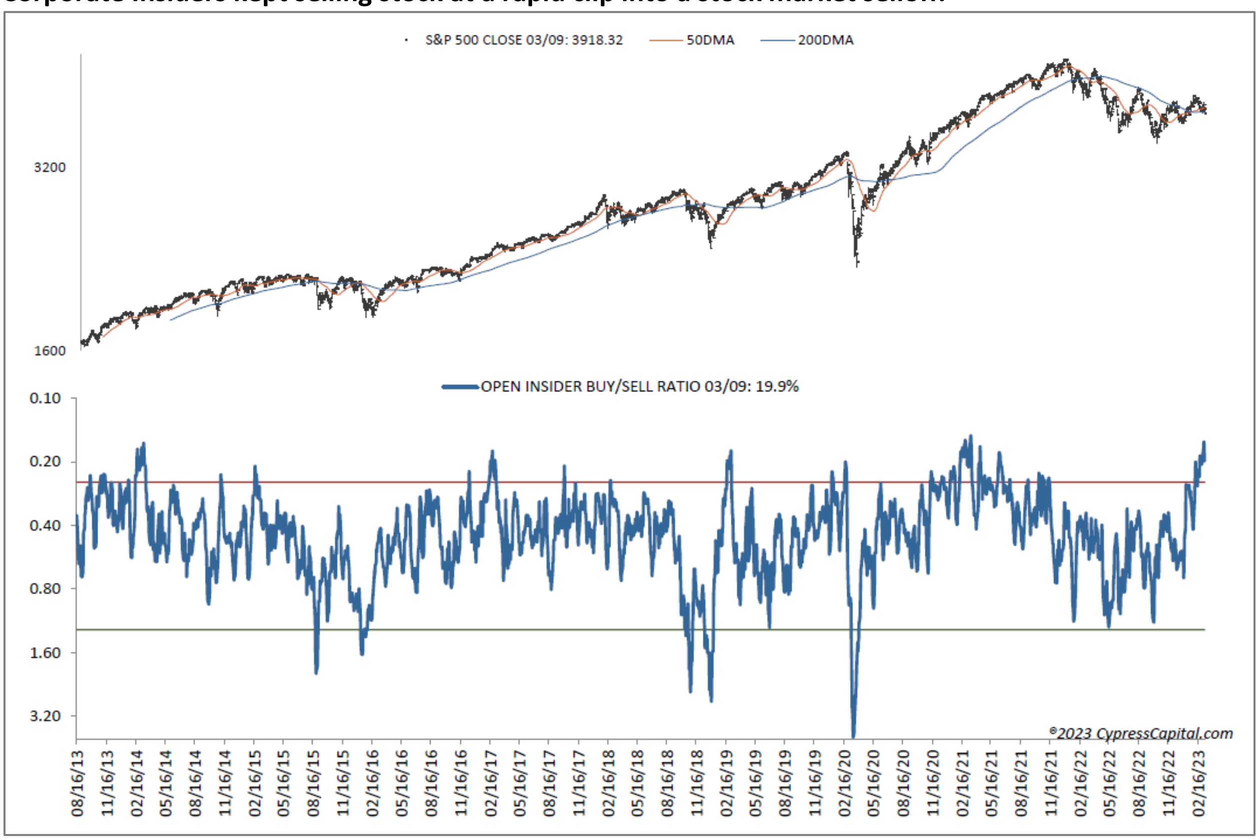
Speculation was rampant in 2021, to a degree that dwarfs the dot-com bubble and will only become evident to the masses in hindsight. We have seen Crypto scams from unassuming and honest-looking nerds and SPAC scams from slick-haired hucksters. We have witnessed big Tech soar to record valuations and froth in private equity as it is still today being offered as a low risk, levered sure thing. Some speculation entertained us – memorable ramps in a movie theater company and a used video game company stock described in the news as the little guy's fight against the big guy. We've witnessed an ETF named after Noah's boat rise to the straosphere, only to prove that it was anything but Noah's boat. We even saw an aspiring EV company roll its semi down a hill in an attempt to make it look like a cutting-edge innovator. There are enough stories there to keep Michael Lewis busy writing books for 15-20 years.

In a matter of months, we borrowed and printed, two presidents from both parties, enough money to fight a World War. Then we dropped it from a helicopter and told people to stay at home and spend it. The magnitude of drunken punch bowl antics our leaders engaged in has not sunk in – we're still in the stage of thinking we were smart enough to pull off those gains. If you've looked up your home value on Zillow in the last 24 months, please know that had nothing to do with your savvy for residential real estate.

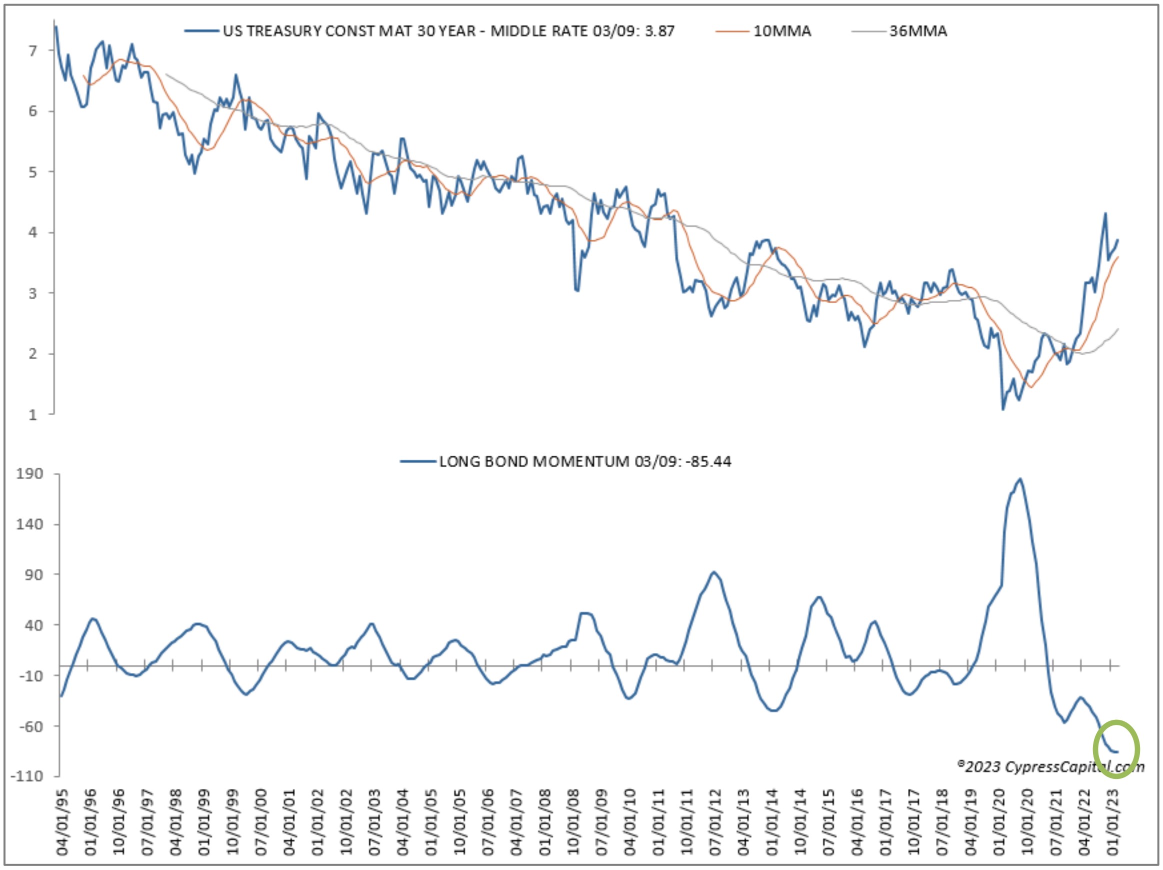
This is not the time to do anything rash, speculative, or excessive, whether bullish or bearish. It's a time to be measured, conservative, and patient with that dry powder on the sidelines. If you've followed this market alongside us, you aren't sweating this market – the rallies or the declines. We're taking care of our families. It's us against the world...and it looks like it's a world full of crazies.

Charts of the Week

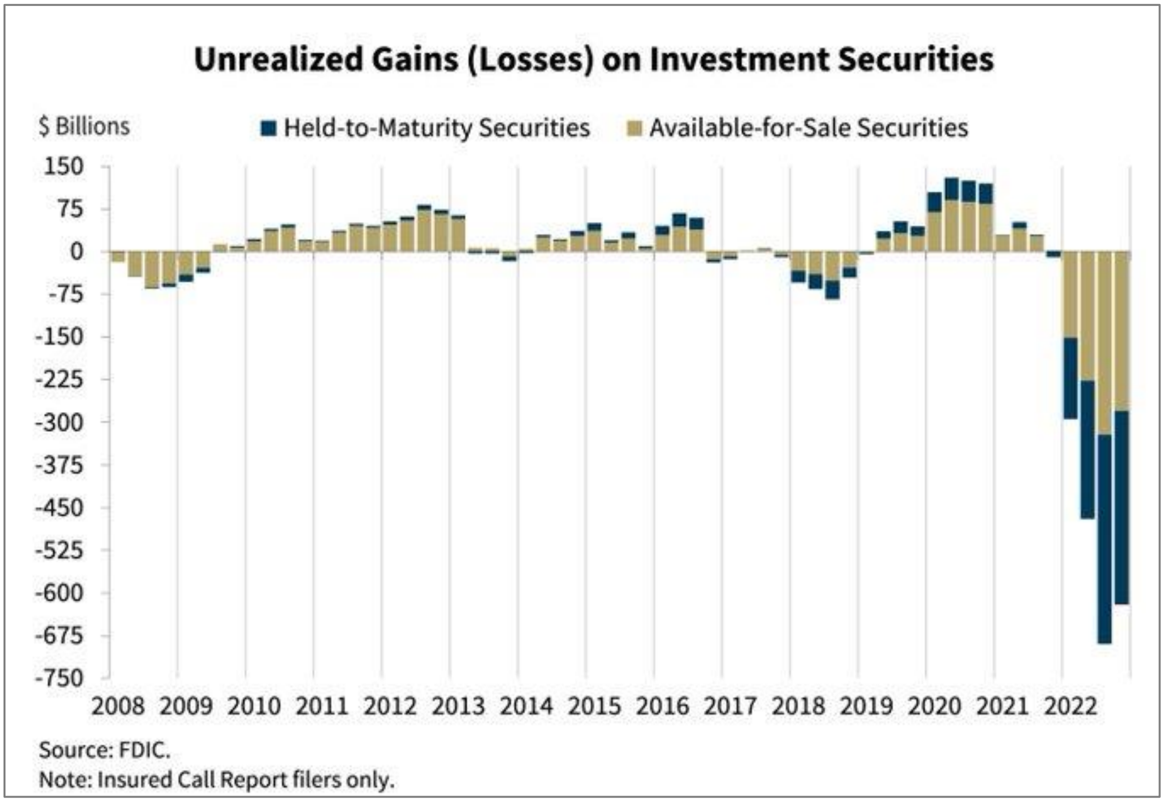
Corporate Insiders kept selling stock at a rapid clip into a stock market selloff.



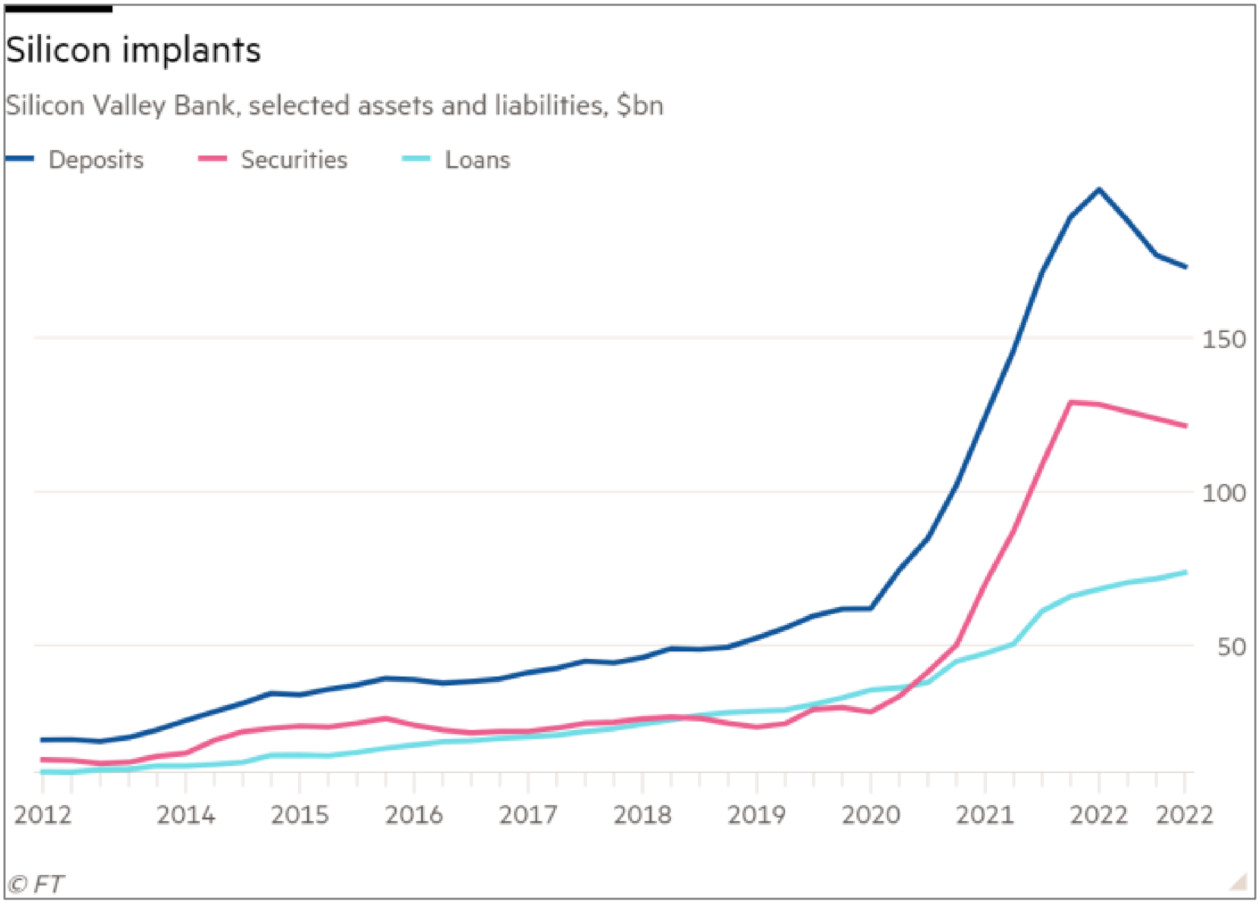
A Long Bond Momentum buy signal confirmation is likely next week.



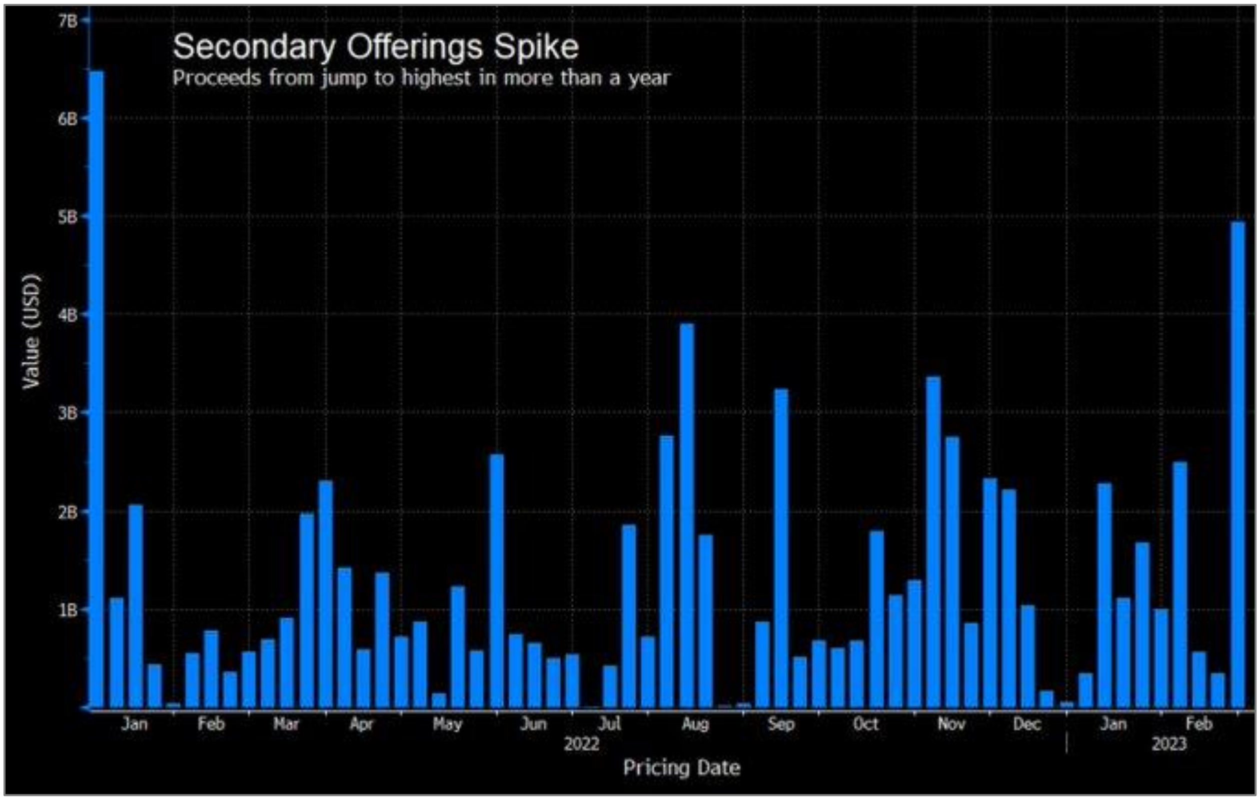
A rapid Fed tightening campaign has led to substantial unrealized losses on Bank Balance sheets.



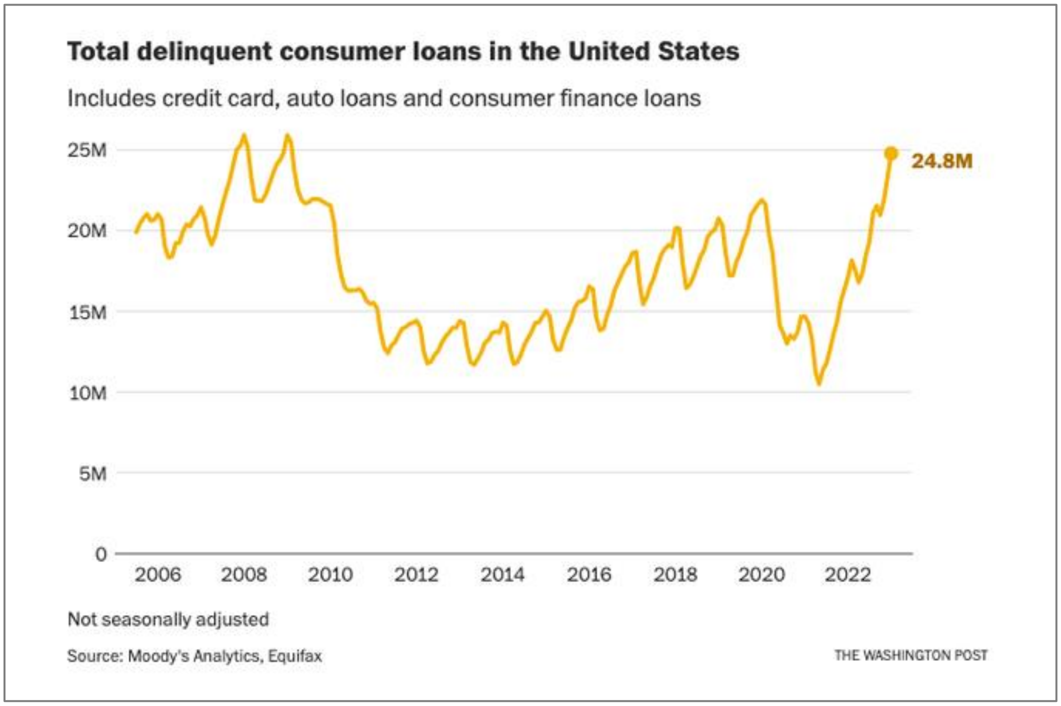
And, Silicon Valley Bank was especially sensitive to losses on its securities given declining deposits.



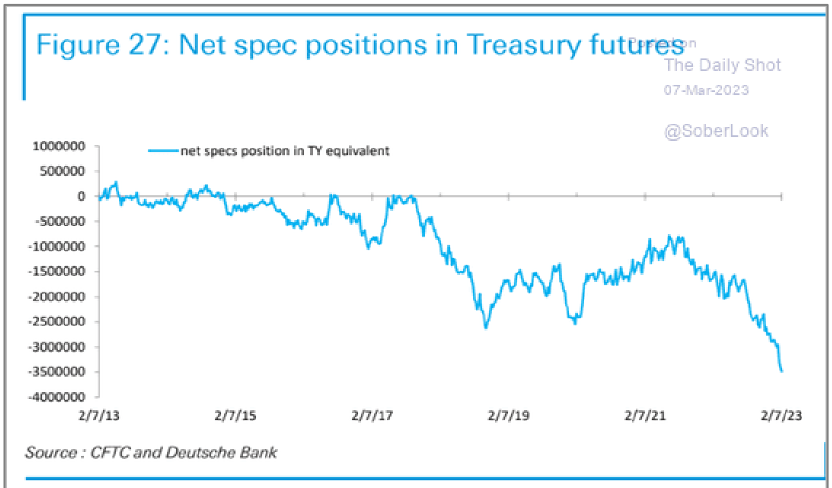
Companies have been scrambling to raise capital in March.

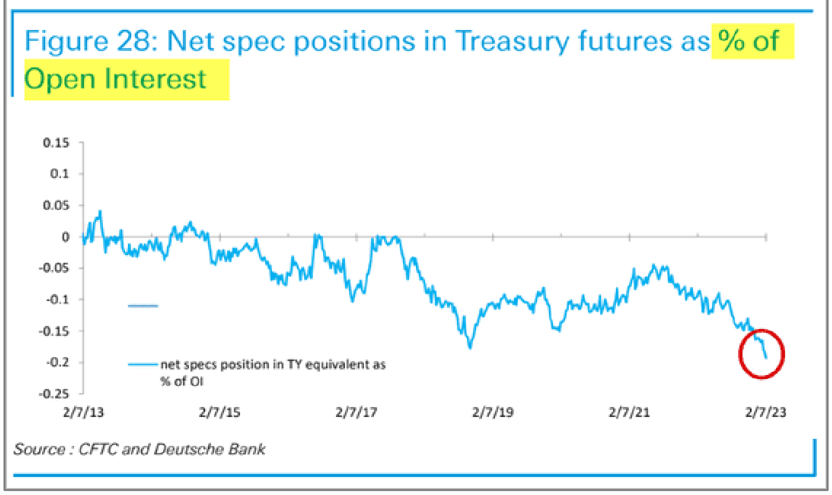


Consumer loan delinquencies are on the rise.

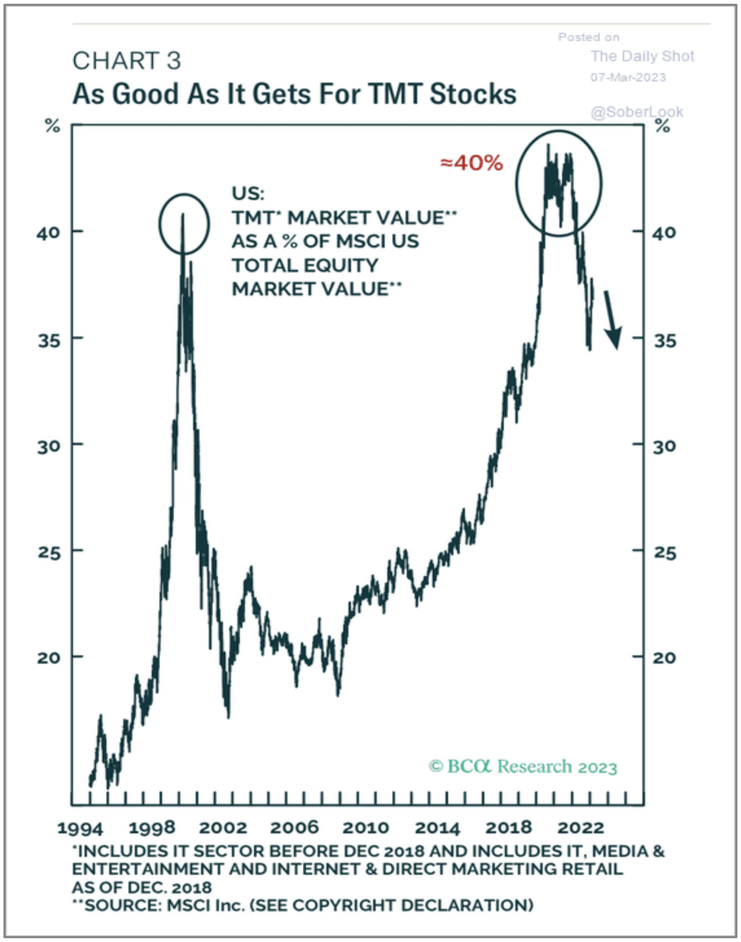


Futures speculators are short Treasuries.

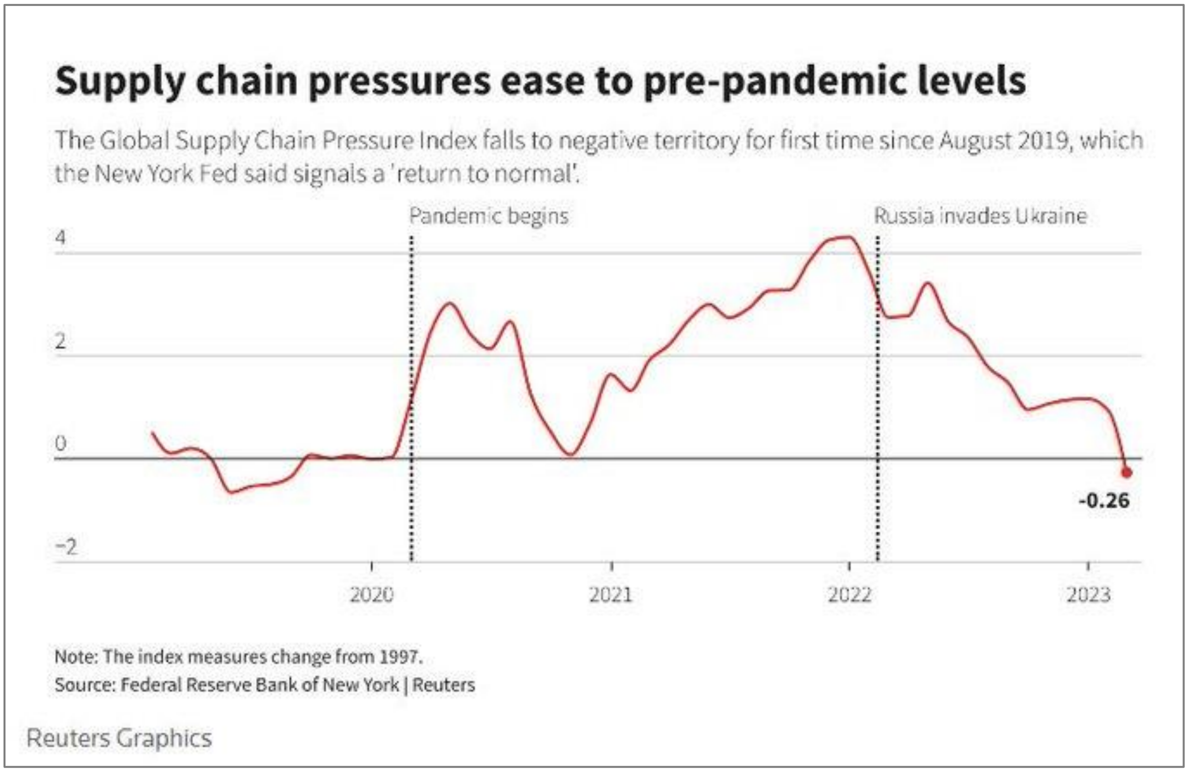




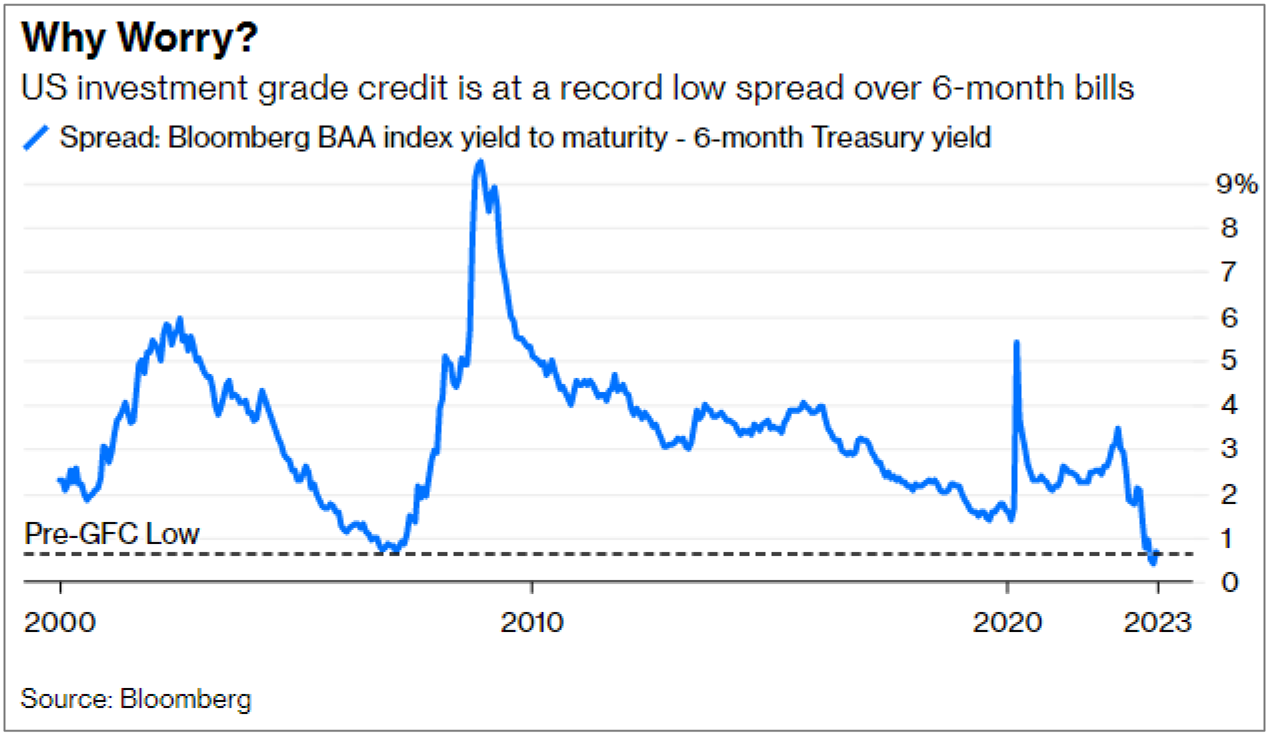
Tech, Media, and Telecom stocks are off the highs, but where will they settle?



Supply-chains are back to normal.



Record Low in Investment Grade Credit Spreads



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.