Market Outlook

By Mark T Dodson, CFA

Investors Bought the SVB Dip

Market Risk Index dropped to 77%, another improvement, but it remains in the zone that marks above-average drawdown risk for markets.

Monetary Conditions drove the drop in MRI this week, as Producer Price index inflation improved to the zone that has become neutral to bullish for equity markets historically. However, it's unusual for the fall into that zone to come while the yield curve was still inverted. It's occurred three of four times since 1965. One happened after a bear market low (that's your soft-landing case). The other three occurred when the market was still in an ongoing bull market but within months of the onset of a new bear market and recession (the hard landing cases). A surge in the value of the Fed's balance sheet almost surpassed the QT they have undertaken so far, but it's too early for that to impact the Monetary Composite score. The Long Bond Momentum buy signal was also confirmed this week, although we will be picky in initiating a position inside portfolios given current real yields.

Within the Psychology Composite, surveys moved back to being a bullish influence on Psychology. While the pace of selling didn't let off by corporate insiders, there was a substantial pickup in buying this week, enough to lead to a significant drop in the buy/sell ratio. From a cursory look, much of it appeared to be by regional bank insiders buying back their stock on the big sympathy drops in their stocks in the last week.

We were surprised that the Psychology Composite didn't improve more than it did until we looked at the market reaction immediately following the Silicon Valley Bank failure. There were massive inflows into SPY, the regional bank ETF, and the most substantial inflow into ARKK since its glory days in 2021. There is a Pavlovian-like response by investors to salivate at anything that remotely sounds like the possibility of the Fed ringing a bell. It has the hallmarks of denial more than capitulation. This behavior increases the odds that Powell doesn't come in dovish next week. The ingrained behavior to speculate (instead of invest) and persistent tightness in labor markets also make us more confident that another wave of inflation is in store for the US economy.

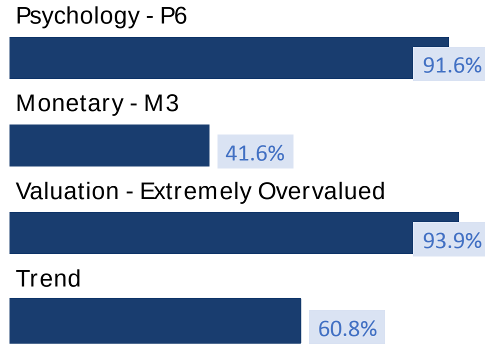
Valuation staying stuck in the worst decile of readings helps put speculative investor behavior into perspective. Investors are rushing to buy financial assets at elevated prices, fearing missing out on the

Market Risk Index

Rec Allocation 25% Underweight

77.0%

Category Percentiles



Largest Psychology Influences

Volatility	Negative
Leveraged Investments	Negative
Consumer Confidence	Negative
Option Activity	Positive

Largest Monetary Influences

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

Valuation

7-10 Year Equity Return Forecast	2.4%
10Yr US Treasury Yield	3.6%

Market Trends

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

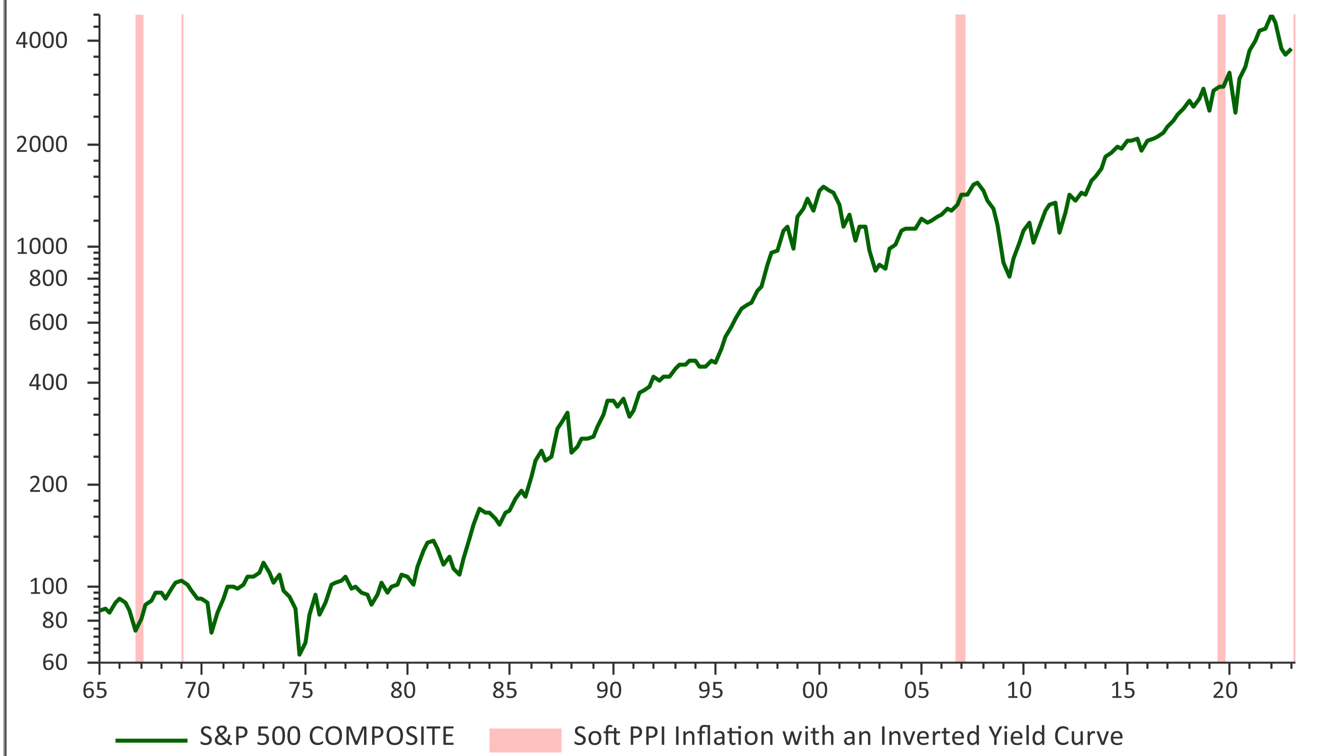
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

precise point of a Fed pivot. All of this behavior is Fed-trained. Speculators are ready to respond to how central bankers have taught them to behave over the last 15 years. What caused a bank run in 2023 is almost laughable compared to 2008. Silicon Valley Bank wasn't buying some esoteric securities with acronyms for names – their losses resulted from a reach for yield in long-duration US Treasuries. The bank's biggest mistake may have been believing the Fed when they said that inflation was transitory.

Charts of the Week

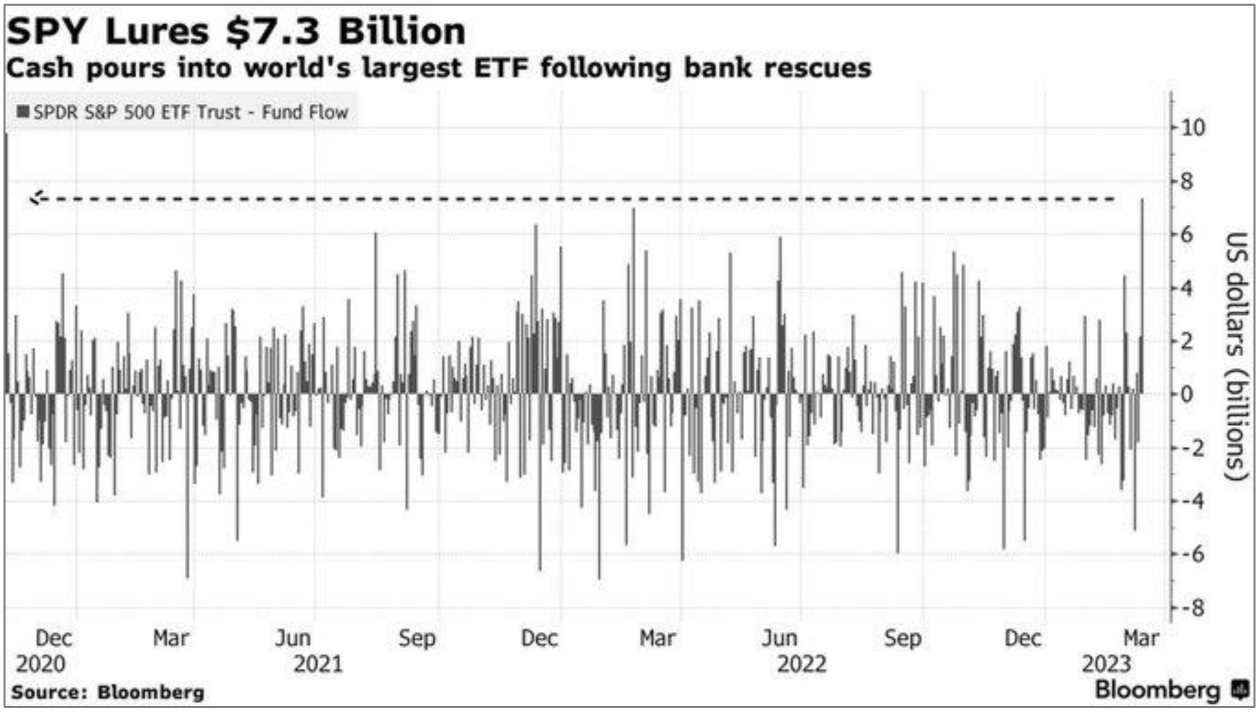
Soft PPI Inflation (less than 3%) and an Inverted Yield Curve

The combination has only occurred four other times. One happened at the end of a bear market. The other three occurred right before the onset of bear markets.

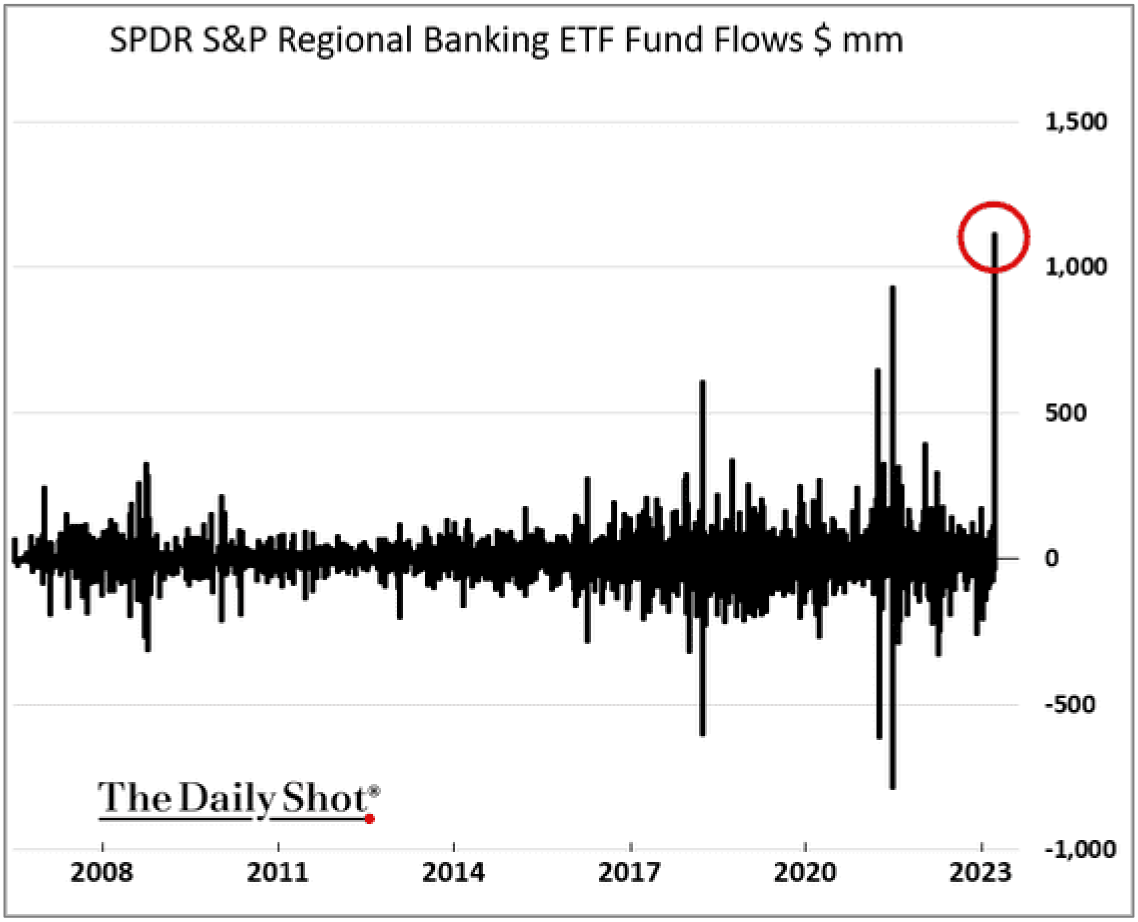


Source: Refinitiv Datastream, Cypress Capital

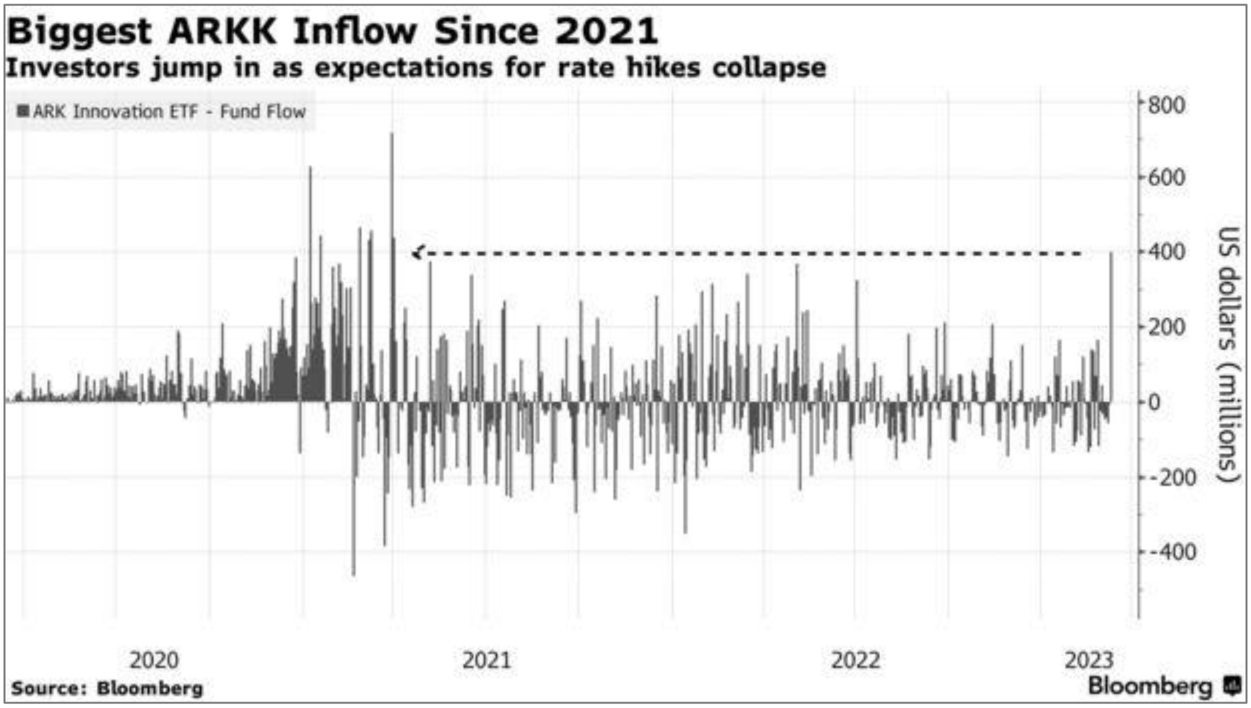
Massive flows went into the S&P 500 (SPY) this week.



Record inflows into the S&P Regional Banking ETF as well.

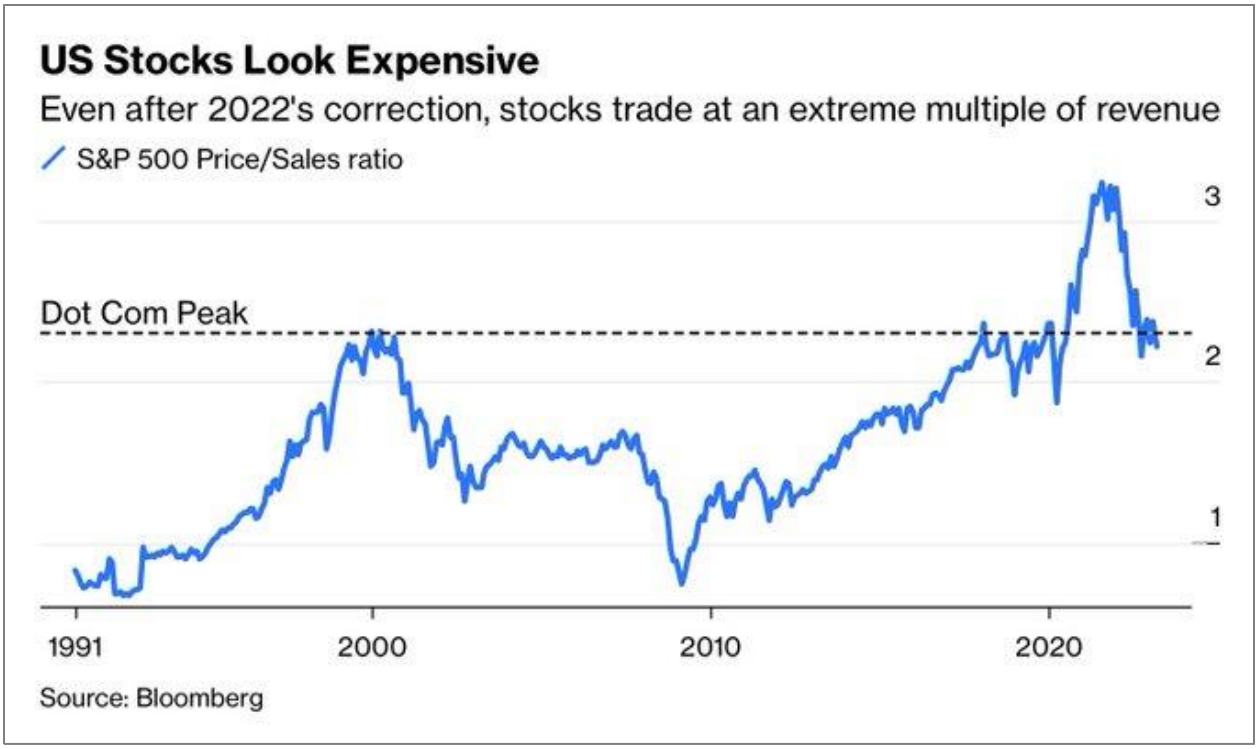


ARKK flows – the poster child of Covid-stimulus era excess – were a picture of nostalgia for euphoria.

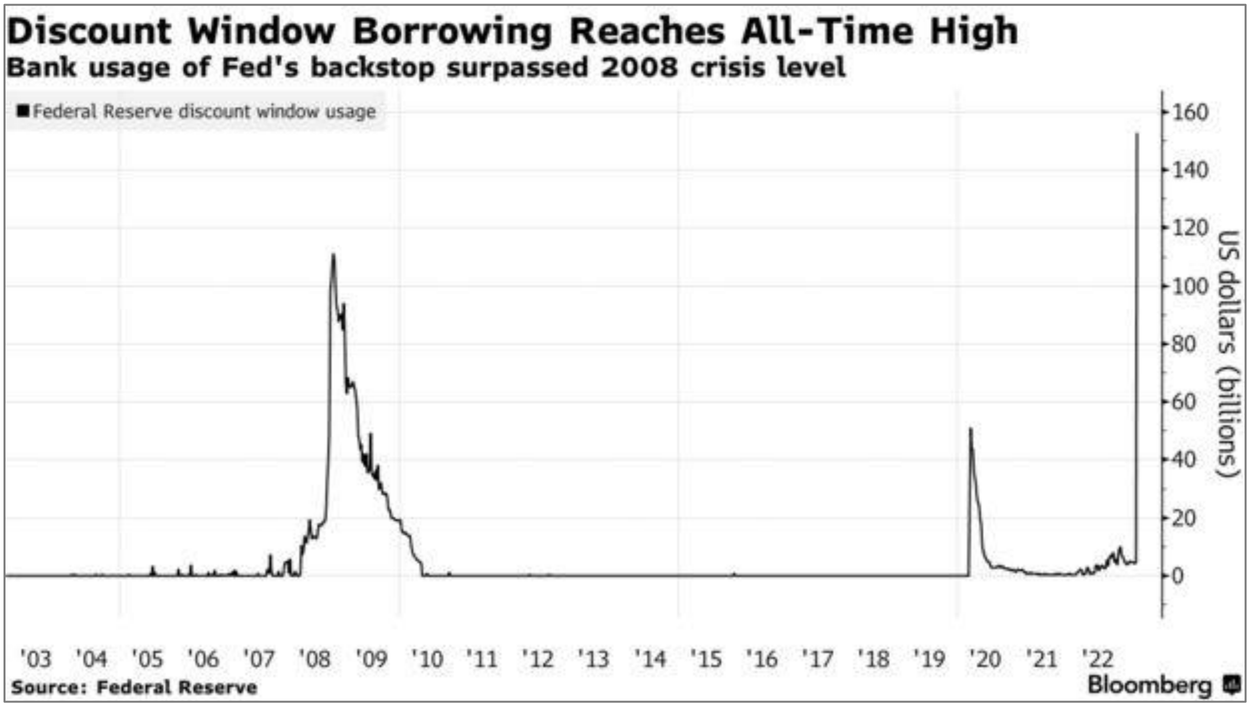


S&P 500 Price to Sales has retreated to the Dot Com Era Peak.

Subjectively, headlines of bank panics are ones that you'd associate with Buffett's adage to buy when there's "blood in the streets." However, valuations objectively say that's not the case.



Borrowing from the Fed's discount window reached an all-time high.



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.