# Market Outlook

By Mark T Dodson, CFA

## The Battle of Wits has Begun!

Market Risk Index increased to 68.9%. In a reversal of recent trends, the Monetary Composite risk score drove MRI higher, while Psychology improved. Both Psychology and Valuations remain in the worst decile of readings, while Monetary Conditions have edged out of the best 20% of readings.

The most notable development within Psychology Composite this week is a sell signal coming from US High Low Logic Index. The US version of the index combines the weekly high and low figures on the NYSE, NASDAQ, and original AMEX exchanges. The NYSE appears poised to do the same over the coming weeks – signs of a bifurcated market coming too early for a new bull market.

The 2023 respite for MRI (readings below 75%) was a result of Monetary Conditions that grew bullish – stemming from a dramatic improvement in the inflation picture and what looked like a boost in market liquidity in the wake of the failure of Silicon Valley Bank. Still, front and center on our Monetary Composite dashboard has been a Check Engine light with a Yield Curve Error code. This inversion is the most severe of our careers, but it's not the first one to be dismissed by pundits in our careers. Yield curve dismissal has happened every single time – 2023 proving no exception as a prominent article in the WSJ this week was another one to cast doubt on both the efficacy and rationale for why the yield curve has inverted this time.

Meanwhile, the Leading Economic Indicators in April declined for the 13th month in a row, and the current year-over-year decline in LEI has never occurred outside of a recession already deemed ongoing by the NBER in hindsight. The warnings are so glaring in their certainty, yet the average household's equity positioning remains significantly elevated by historical standards.

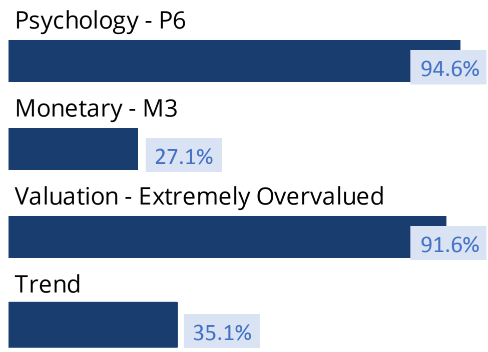
The warnings are so pronounced that some pundits have started speaking of the LEI and yield curve as if they are sentiment indicators, that they are reasons to be bullish because their economic warnings are symptoms of too much fear. It reminds us of the Battle of Wits scene from the movie Princess Pride, where Vizzini expounds for several minutes with a lesson in game theory on which glass of wine contains the poison. Westley ultimately wins the Battle of Wits in Princess Bride, because he has taken small doses of the poison for years to build up immunity. He won because his play in the game was only an illusion.

### Market Risk Index

Rec Allocation 25% Underweight

**68.9%**

### Category Percentiles




#### Largest Psychology Influences

| | |
|---|---|
| Leveraged Investments | Negative |
| Surveys | Positive |
| Consumer Confidence | Negative |
| Bank Sentiment | Negative |

#### Largest Monetary Influences

| | |
|---|---|
| Interest Rate Spreads (Yield Curve) | Negative |
| Inflation | Positive |
| Lending & Leverage | Positive |

#### Valuation

| | |
|---|---|
| 7-10 Year Equity Return Forecast | 3.0% |
| 10Yr US Treasury Yield | 3.5% |

#### Market Trends

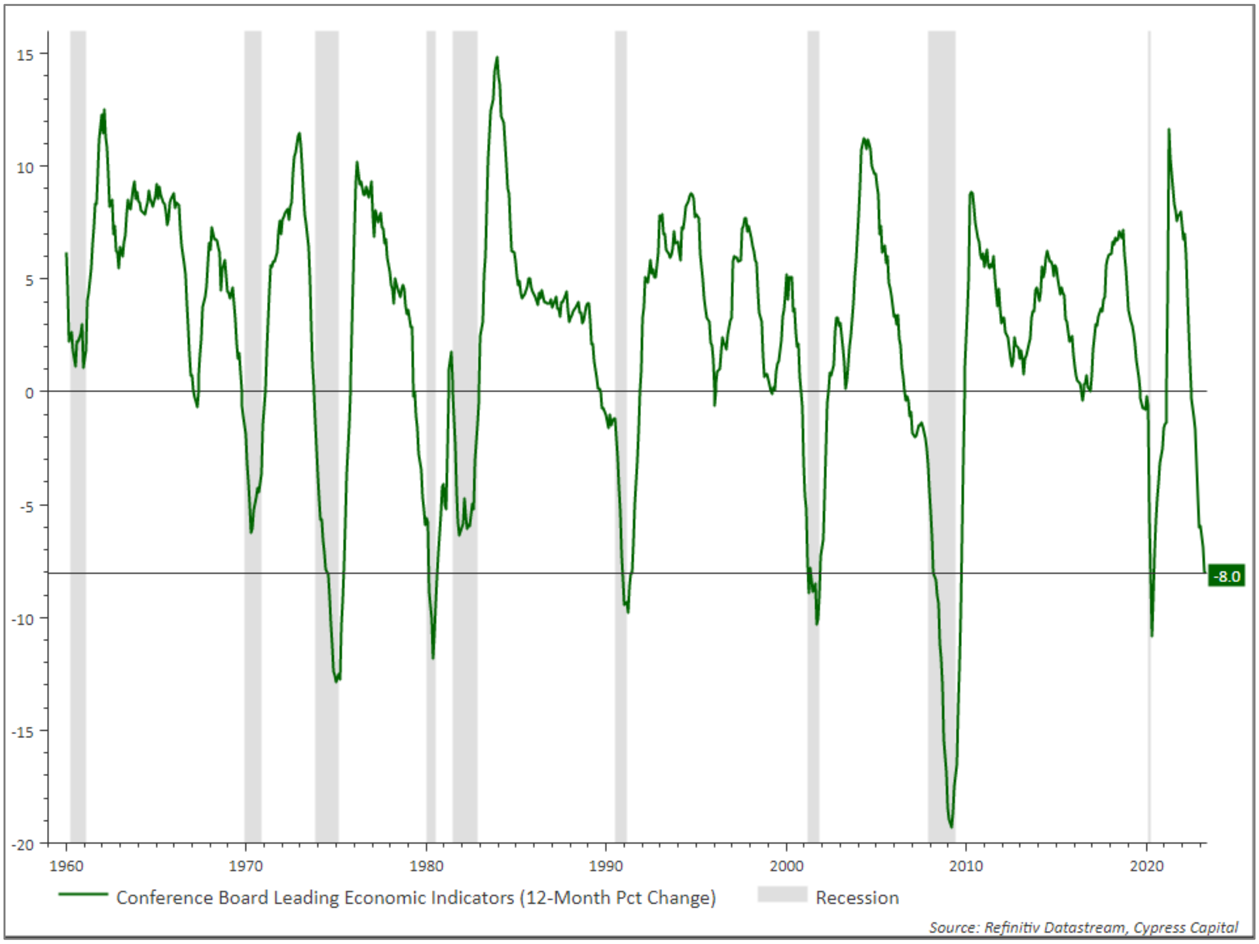
| | |
|---|---|
| US Equities | Bullish Trade |
| Intl Equities | Bullish Trade |
| REITs | Bearish Trade |
| Broad Commodities | Bearish Trade |

*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.*

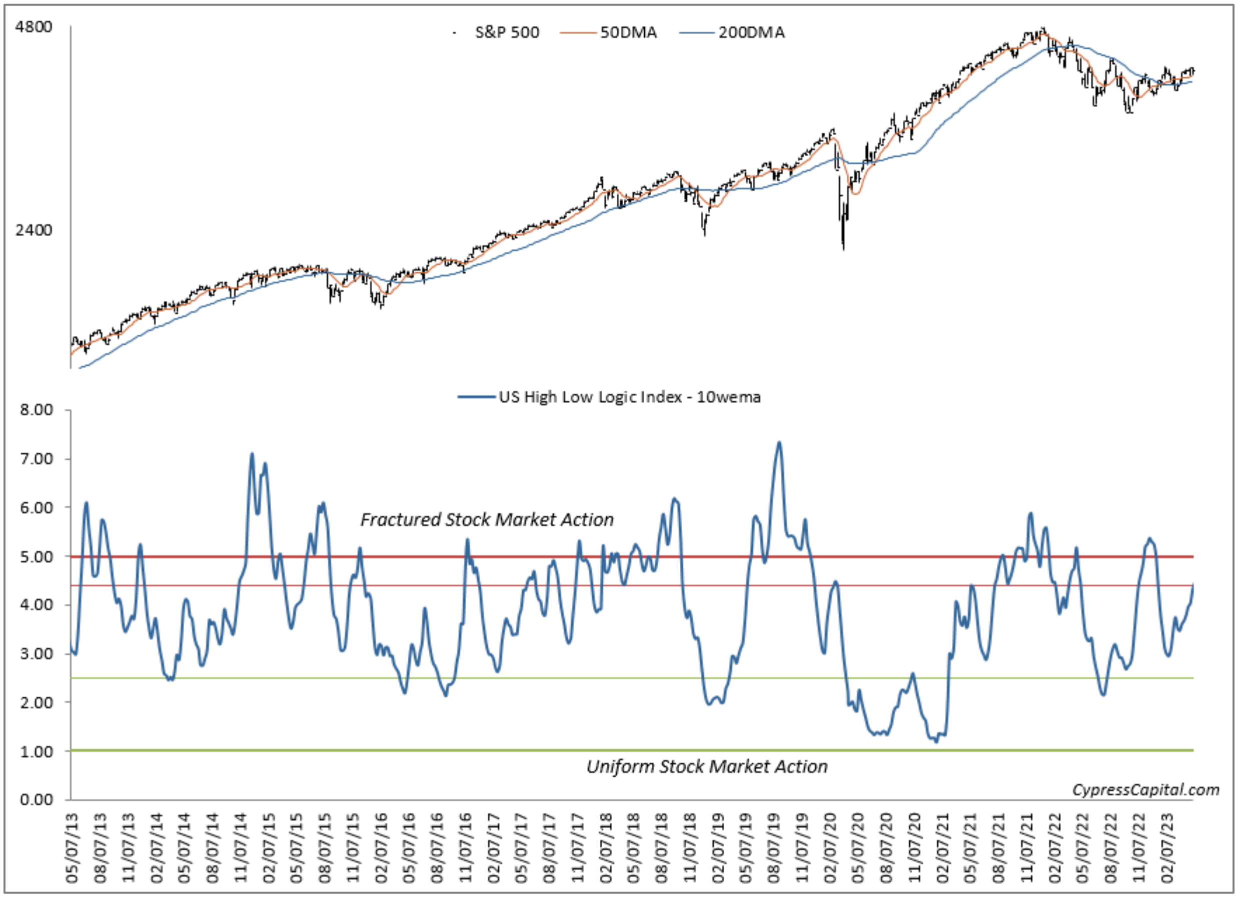
Avoiding the game theory involved in the Battle of Wits in investing is a simple endeavor, thanks to the wisdom of Ben Graham, who said, *"In the short run, the market is a voting machine, but in the long run, it is a weighing machine."* We have taken small doses of the poison for years in acknowledging the voting machine aspect in markets. However, we are absolute in our resolve to protect our hard-earned capital by ensuring our process is built around a weighing machine – using a weight of the evidence approach. Stock market opportunities are self-evident and absolute when it comes to valuations, and the opportunity is often the richest when you are least willing or able to seize it.

## Charts of the Week

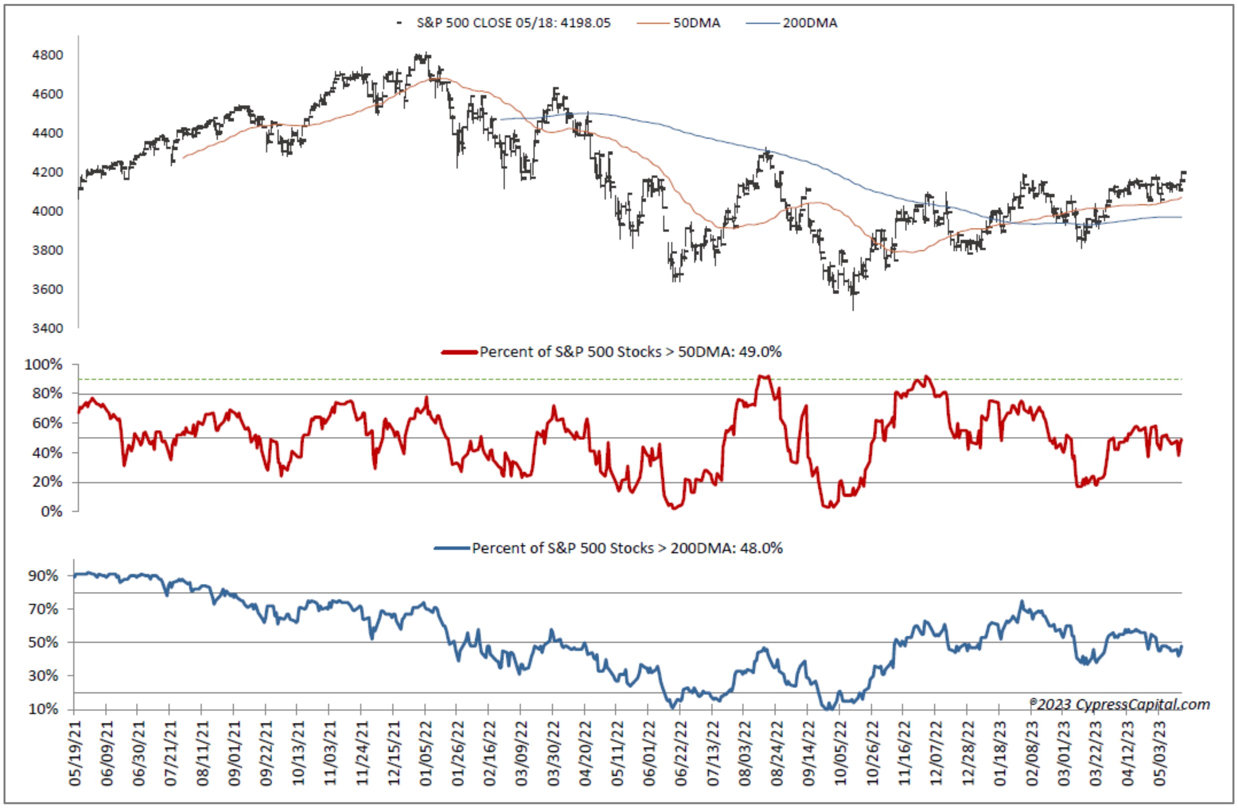
**Leading Economic Indicators have declined 13 months in a row and never this far outside of a recession.**



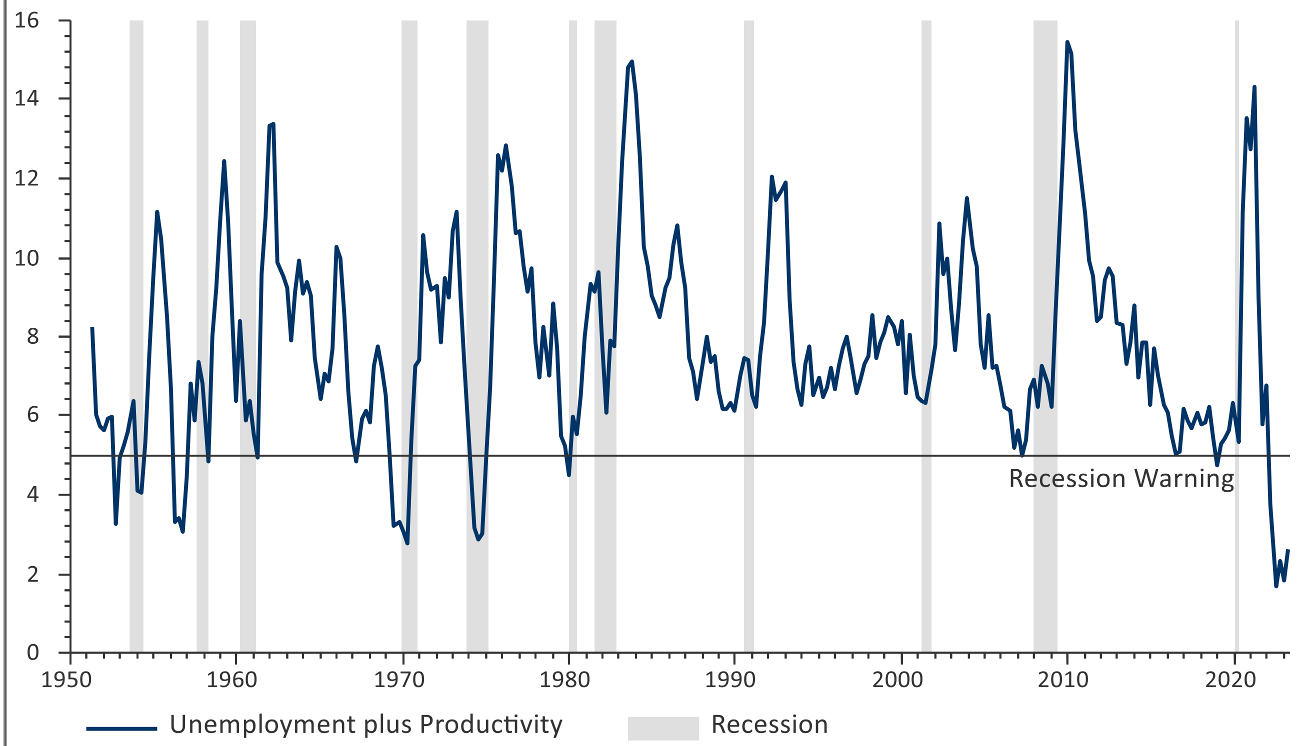
**US High Low Logix Index flashes a warning of fractured stock market action.**




**Amidst an S&P 500 rally, less than half the stocks are above their 50 and 200-day moving averages.**

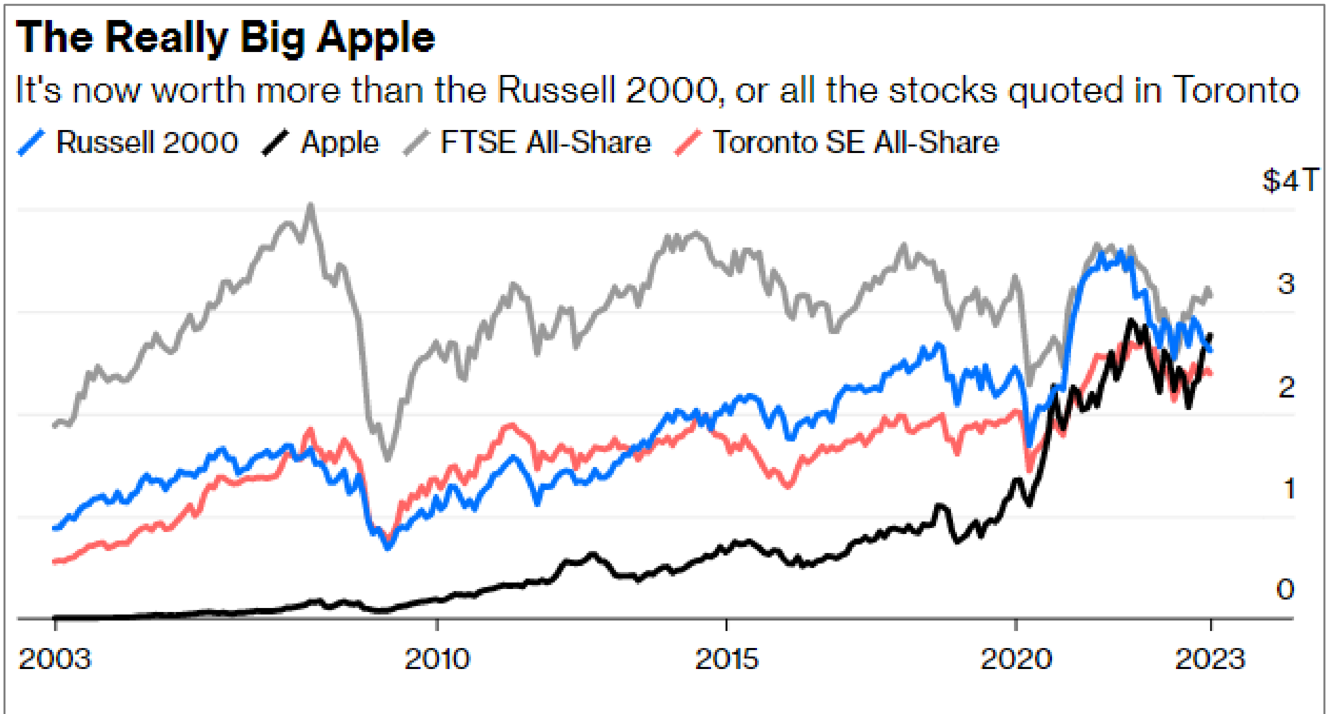


**Late-Cycle Complacency is at record levels.**
We are fans of this indicator, created by the smart folks at Leuthold Investment Group, which is based on the sum of the unemployment rate and productivity. Both tend to trough coincidentally, and it's so intuitive! When would you be least productive on your job – when unemployment is low or high?




*Source: Refinitiv Datastream, Cypress Capital*

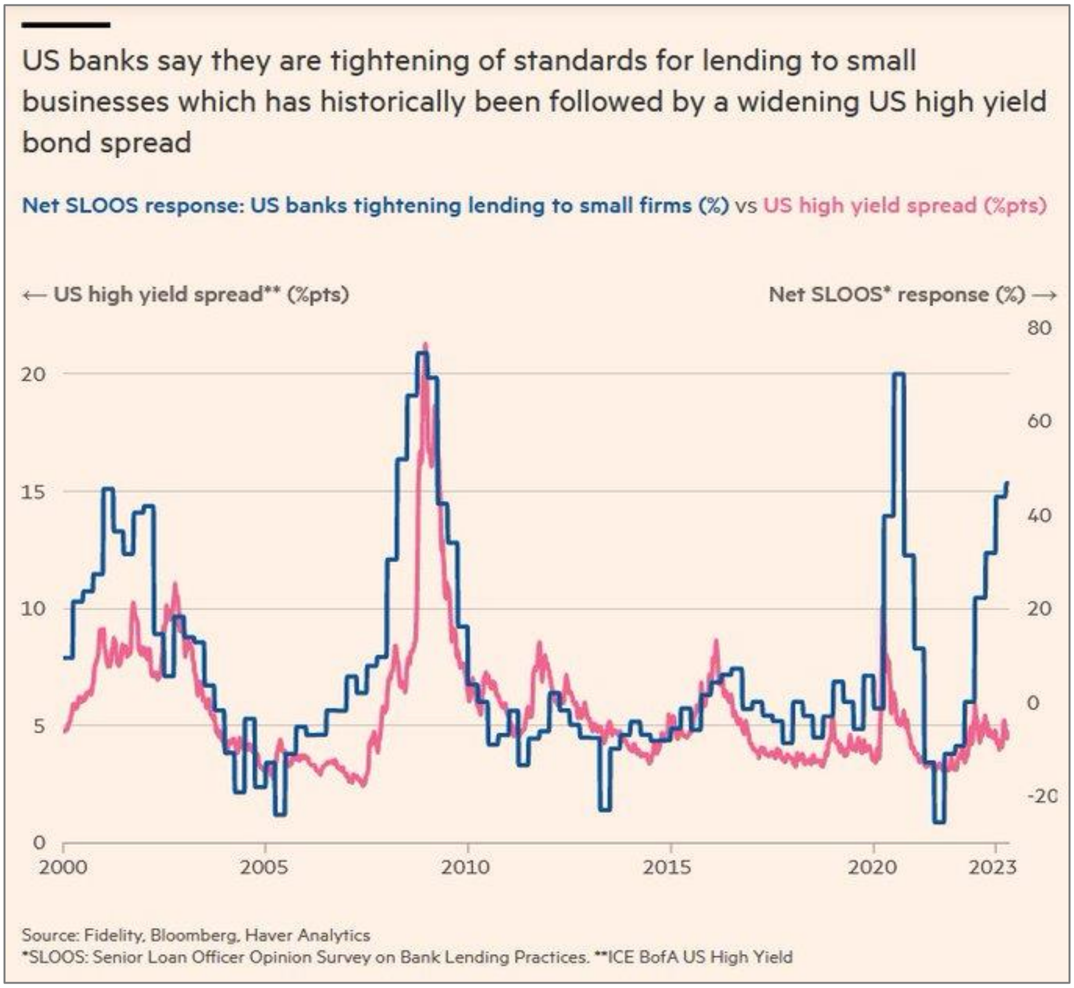
**Apple is worth more than all the small cap companies combined!**



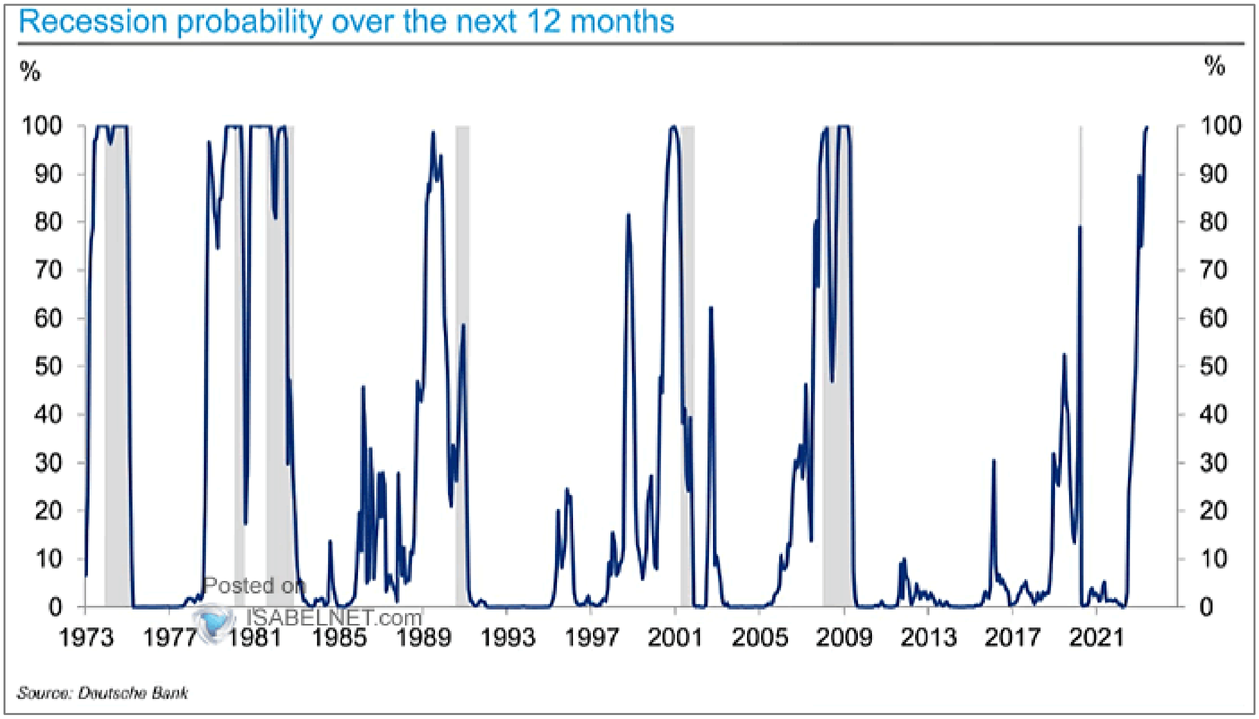

Source: Bloomberg

**Bank Tightening usually leads Earnings Growth**

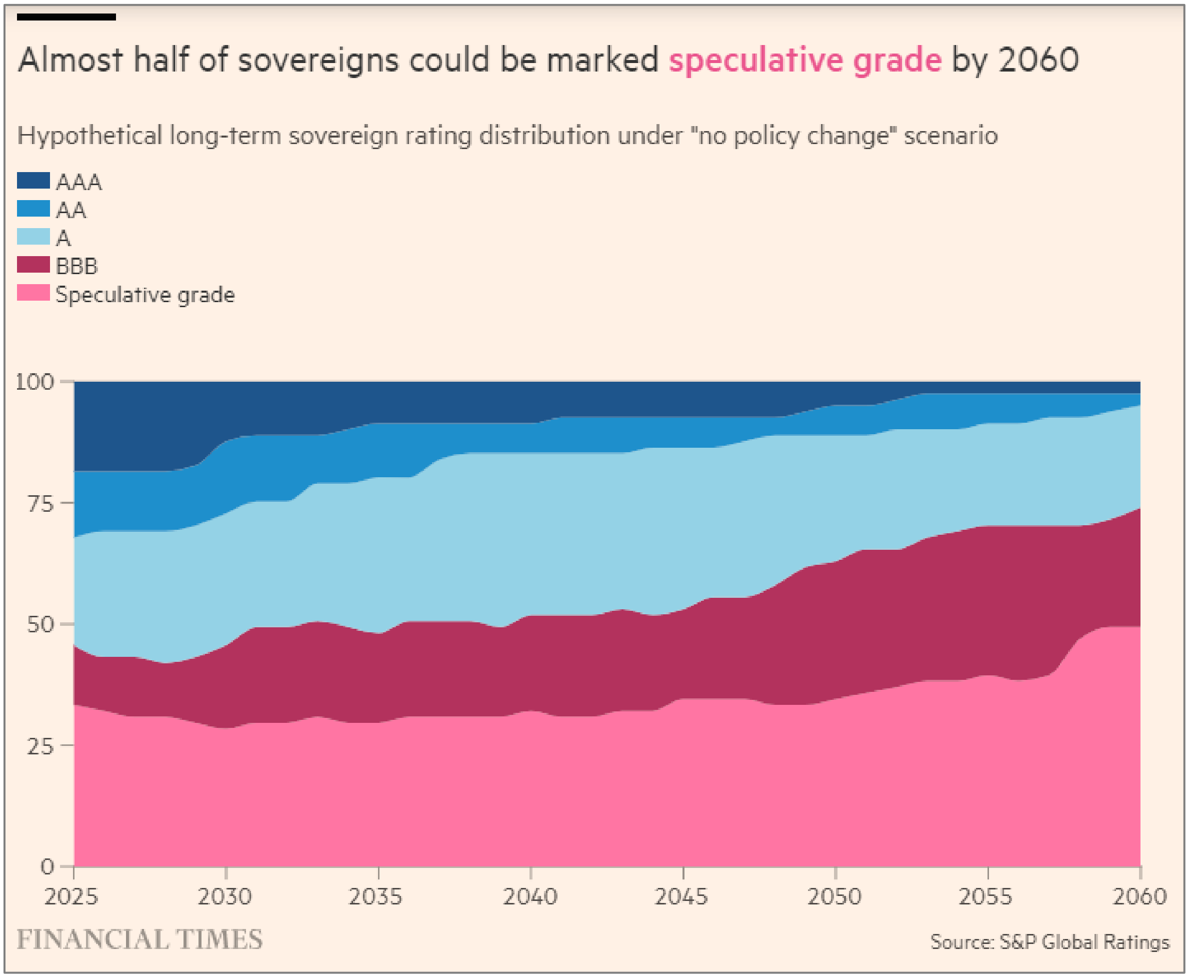

**Bank Tightening also usually leads High Yield Bond Spreads.**



**Irony - if Deutsche Bank had actually looked at its Recession Probability Model, it would have saved the stock.**



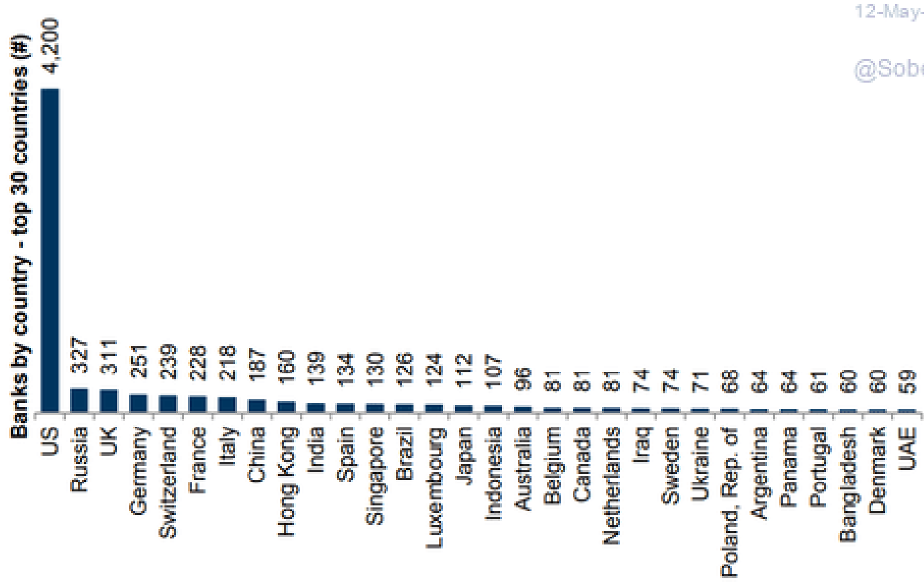

**Global gov't spending on auto-pilot puts the average sovereign debt rating on a path to speculative grade.**



**Are there too many banks in the United States?**

**Exhibit 28: There are multiples of the number of commercial banks in the US than any other country…**

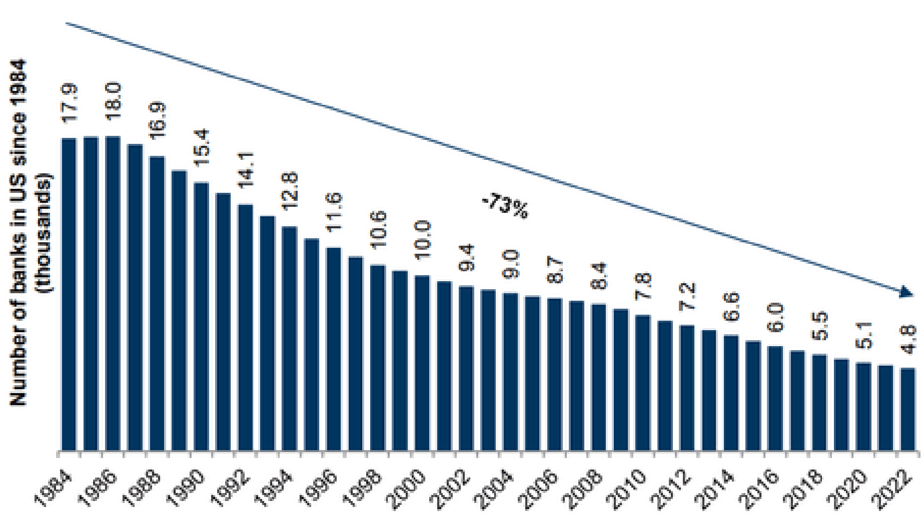





Note: includes commercial banks, data are as of 2021, ex. Russia, which is as of 2023.

Source: IMF, Goldman Sachs Global Investment Research

**Exhibit 29: …despite the number of US banks down by ~75% over the past ~40 years**




Note: all FDIC-regulated banks

Source: FDIC, 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.