Market Outlook

By Mark T Dodson, CFA

Another Case of the FOMOs

Market Risk Index fell modestly for the third week in a row to 73%, just shy of the high drawdown zone for markets – led by another improvement in Monetary conditions.

The Monetary Composite moved back into the best third of readings, historically the most bullish zone for the stock market. Six of the eight categories in our Monetary Composite are bullish. Some are a result of categories signaling that we are in a recession, and some result from investor enthusiasm providing liquidity to markets as investors have grown less risk-averse in 2023. It's an unusual mix of conditions. It draws attention to the Fed, whose official position is that they aren't on board with easy money. Their official position is that they are taking liquidity out of the economy but are again back in a situation where liquidity is becoming more prevalent due to a reignition of animal spirits.

We have gone nearly nine months with an inverted yield curve, and our category that measures the Velocity of Money has not shown the slightest sign of a significant shift in risk aversion among households. Instead, it became one of the most bullish influences on our Monetary Composite this week. It remains an anomaly, as we seem to keep drastically underestimating how far $5 trillion in fiscal stimulus will take us, and for how long.

It sure looks like Households are still playing that game that Milton Friedman likened to monetary hot potato – in a futile attempt to spend cash printed by the government. According to Friedman, that game ultimately ends by pushing up prices on goods and services in the economy – but maybe he forgot to mention the prices of financial assets. For example, year-over-year growth in M2 and MZM continues to decline. That's not the Fed's doing – that's Households trying to spend their excess cash, and it's a stimulus. Our Monetary Composite says liquidity is running hotter than the Fed intends.

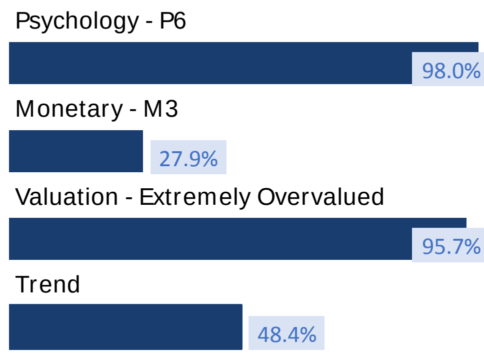
Meanwhile, the market's strength is carried on the back of a handful of stocks with trillion-dollar market capitalizations, and investors continue to bid them up in a bet that they will keep swallowing up world financial markets. It's a return to the playbook that led to fast money in 2021. The behavior has pushed Investor Psychology into the worst 2% of readings and Valuations

Market Risk Index

Rec Allocation 25% Underweight

73.0%

Category Percentiles



Largest Psychology Influences

Leveraged Investments	Negative
Option Activity	Negative
Technical Indicators	Negative
Flow of Funds	Negative

Largest Monetary Influences

Interest Rate Spreads (Yield Curve)	Negative
Lending & Leverage	Positive
Velocity of Money	Positive

Valuation

7-10 Year Equity Return Forecast	1.7%
10Yr US Treasury Yield	3.9%

Market Trends

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

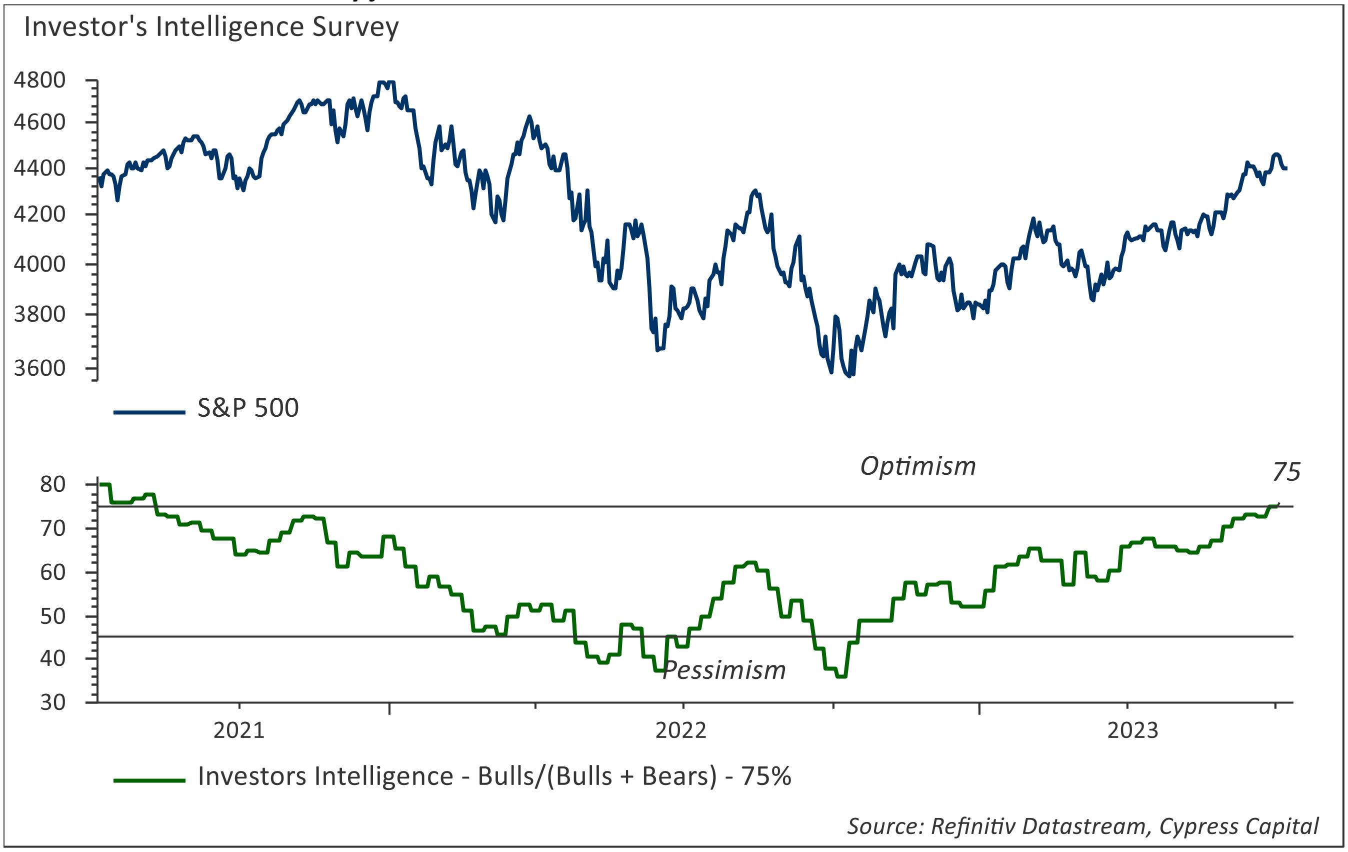
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

into the worst 5% of readings. That particular combination has historically been a precursor to market environments with nasty outcomes, so it stands in opposition to our take on Monetary Conditions.

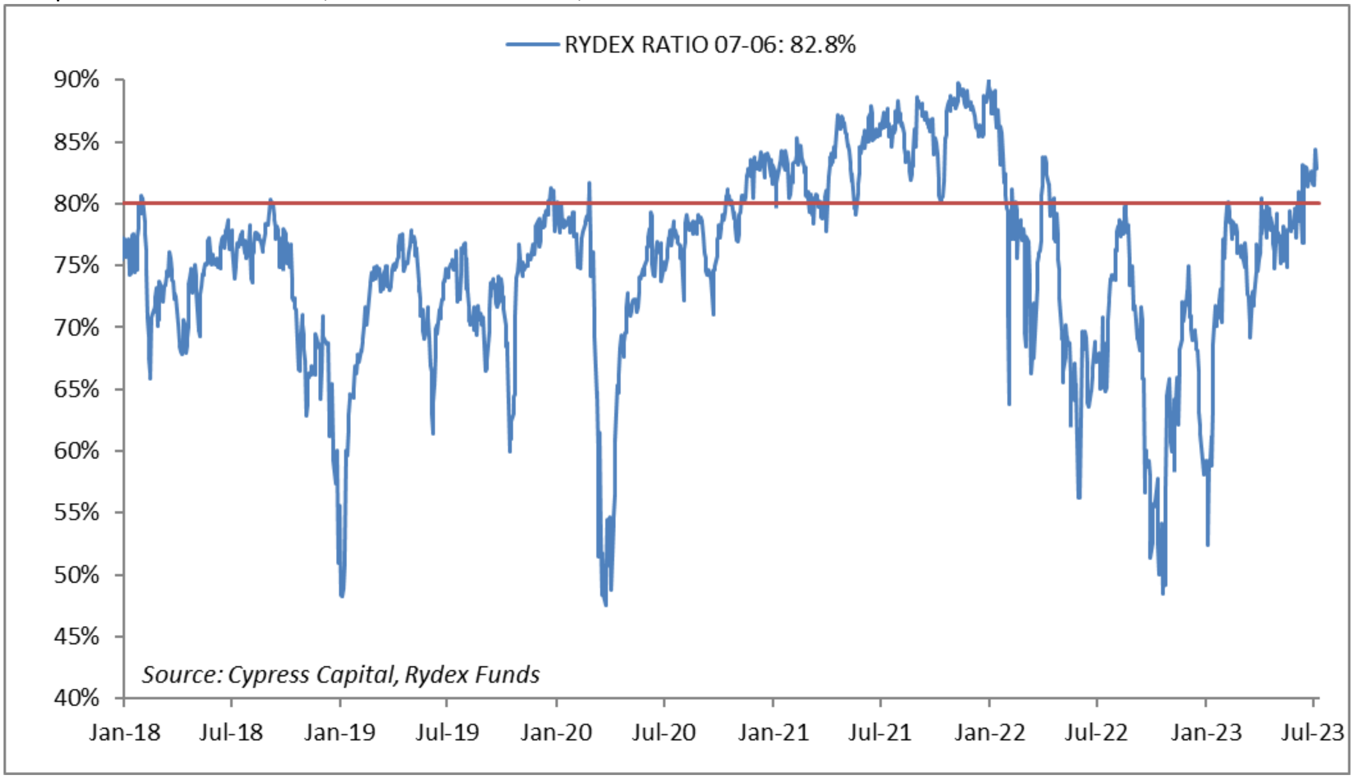
Without a clear message coming from our instrument panel, we continue to twiddle our thumbs, taking profits in stocks where we think Mr. Market is eager to pay us too much for our shares. We aren't willing to commit too much capital to equities, even though in theory this should be a young bull market with plenty of room (and time) to ramp higher. We are in the strangest of market times. If you are unphased and embracing this bull market, you must be a dyed-in-the-wool efficient market apologist, the purest of momentum traders, or you didn't pay attention during stock market history class and have another case of the FOMOs.

Charts of the Week

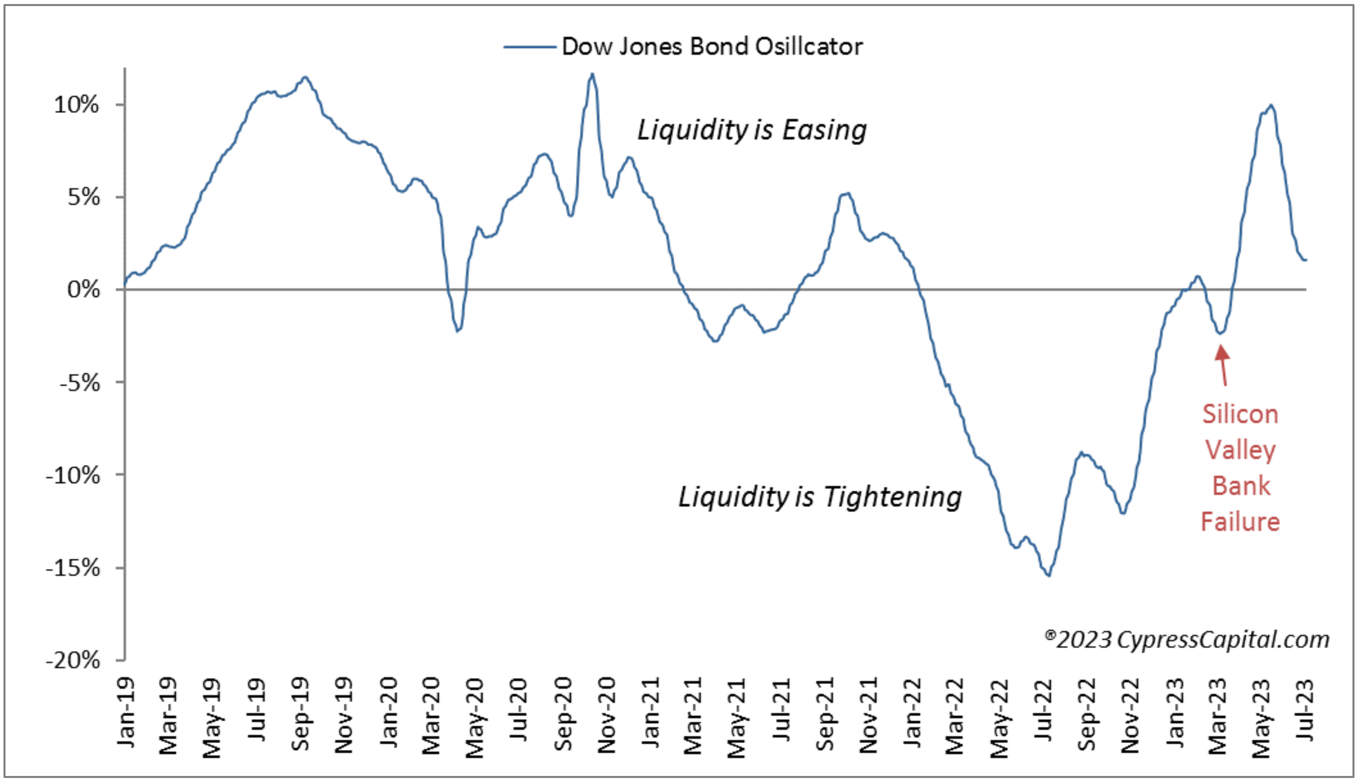
Investment Advisors officially joined individual investors in a return to bullish sentiment.



Rydex Ratio – the original measure of leveraged investor optimism – is within 5% of a new record.
The previous record is 90%, set on December 30, 2021.

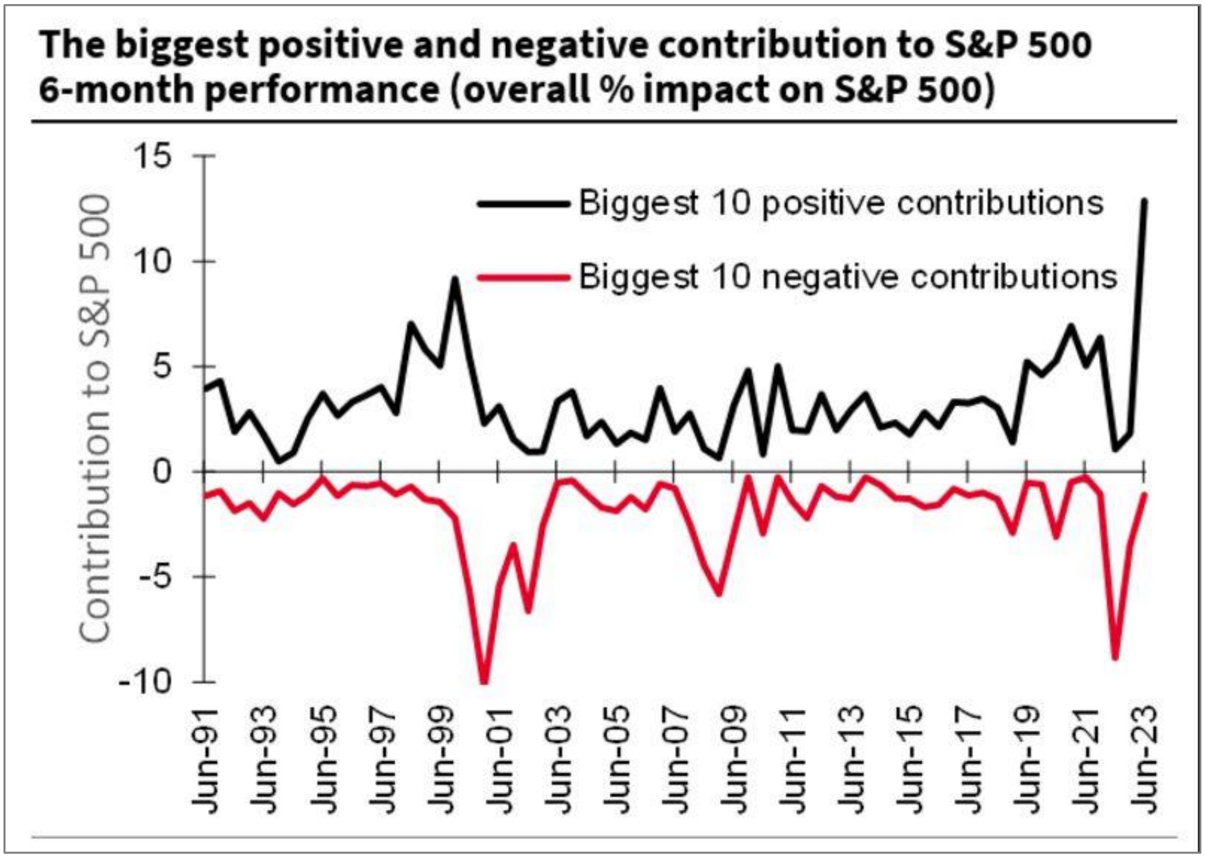


Bond Markets gave a bullish signal within days of the Silicon Valley Bank Failure.
We have hit peak liquidity, but bond markets are still easy.



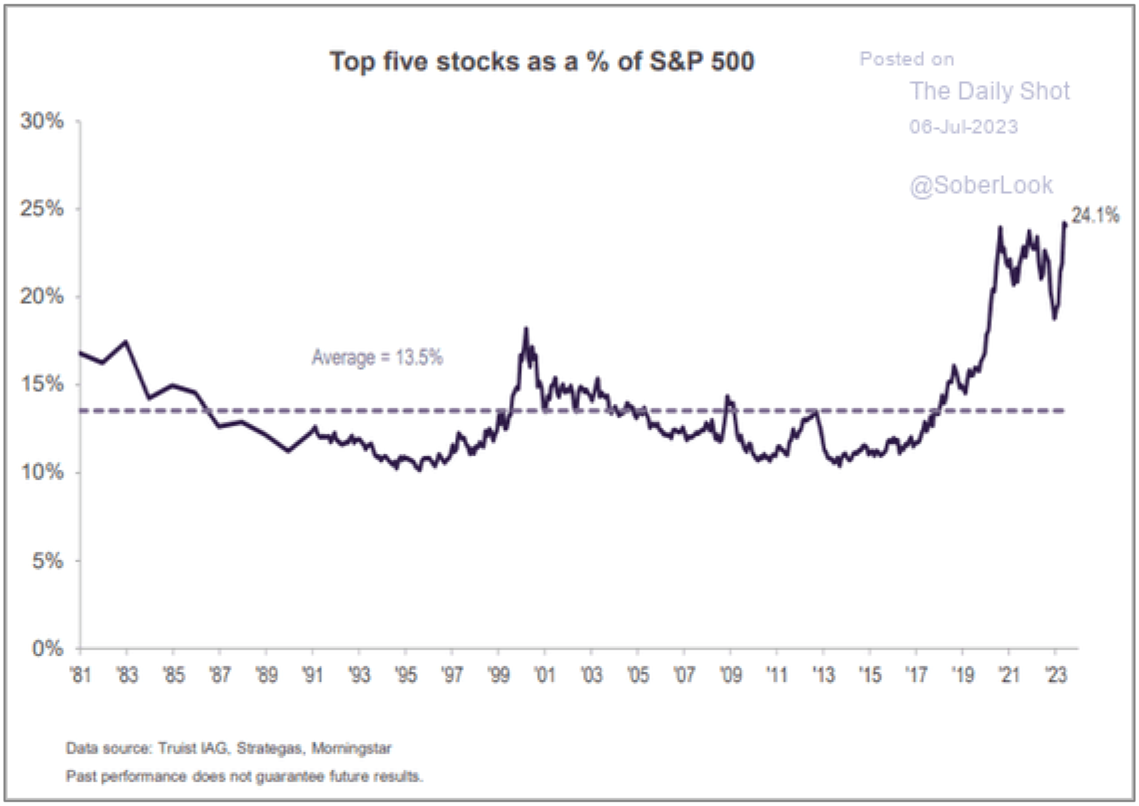
Narrowness to the Extreme

Ten Stocks have accounted for a double-digit rise in the S&P 500 in six months, blowing past the 2000 record.

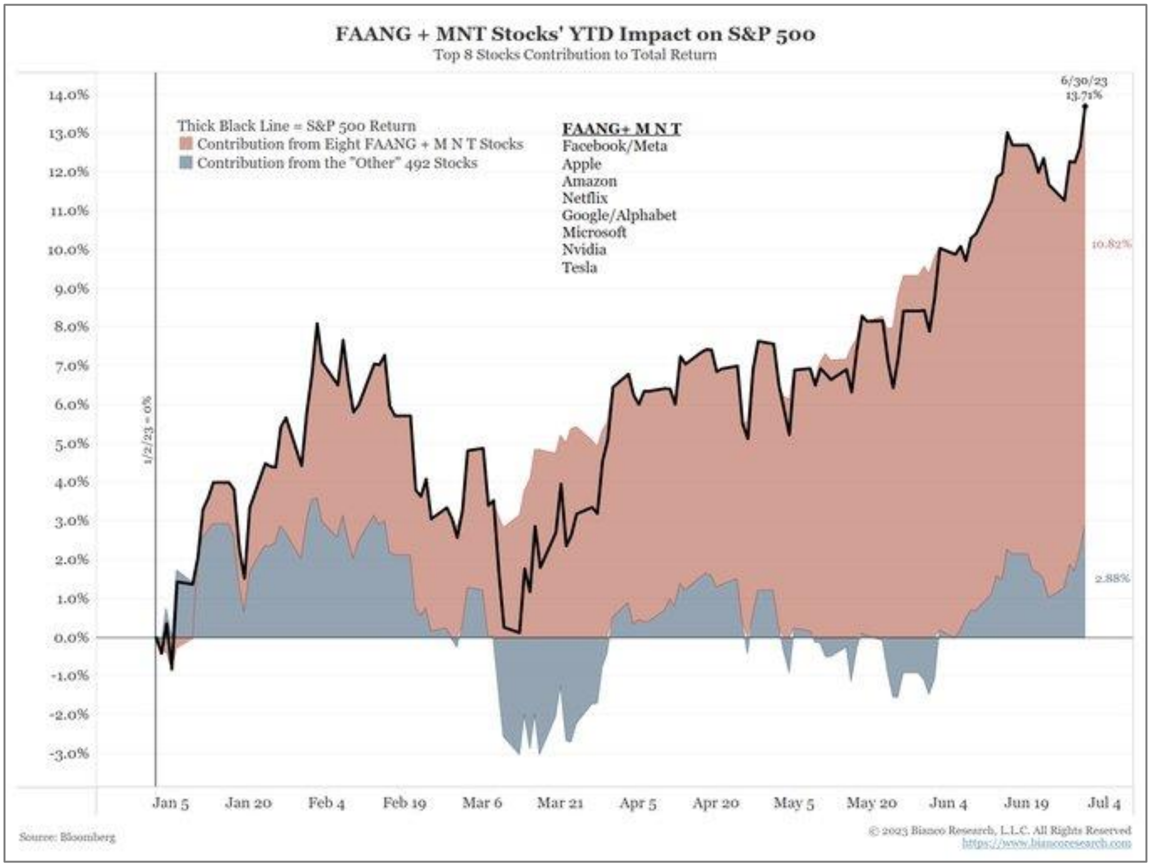


Source: Societe Generale, Bloomberg

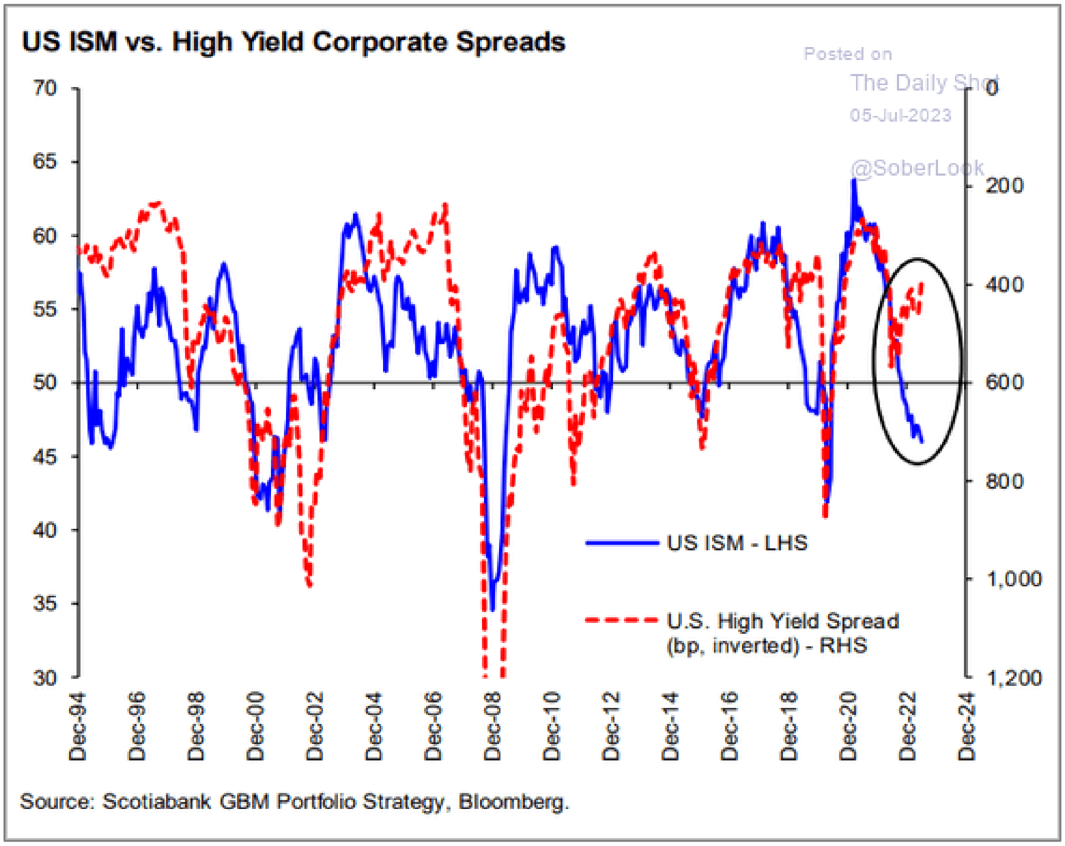
Largest five stocks make up nearly a quarter of the S&P 500



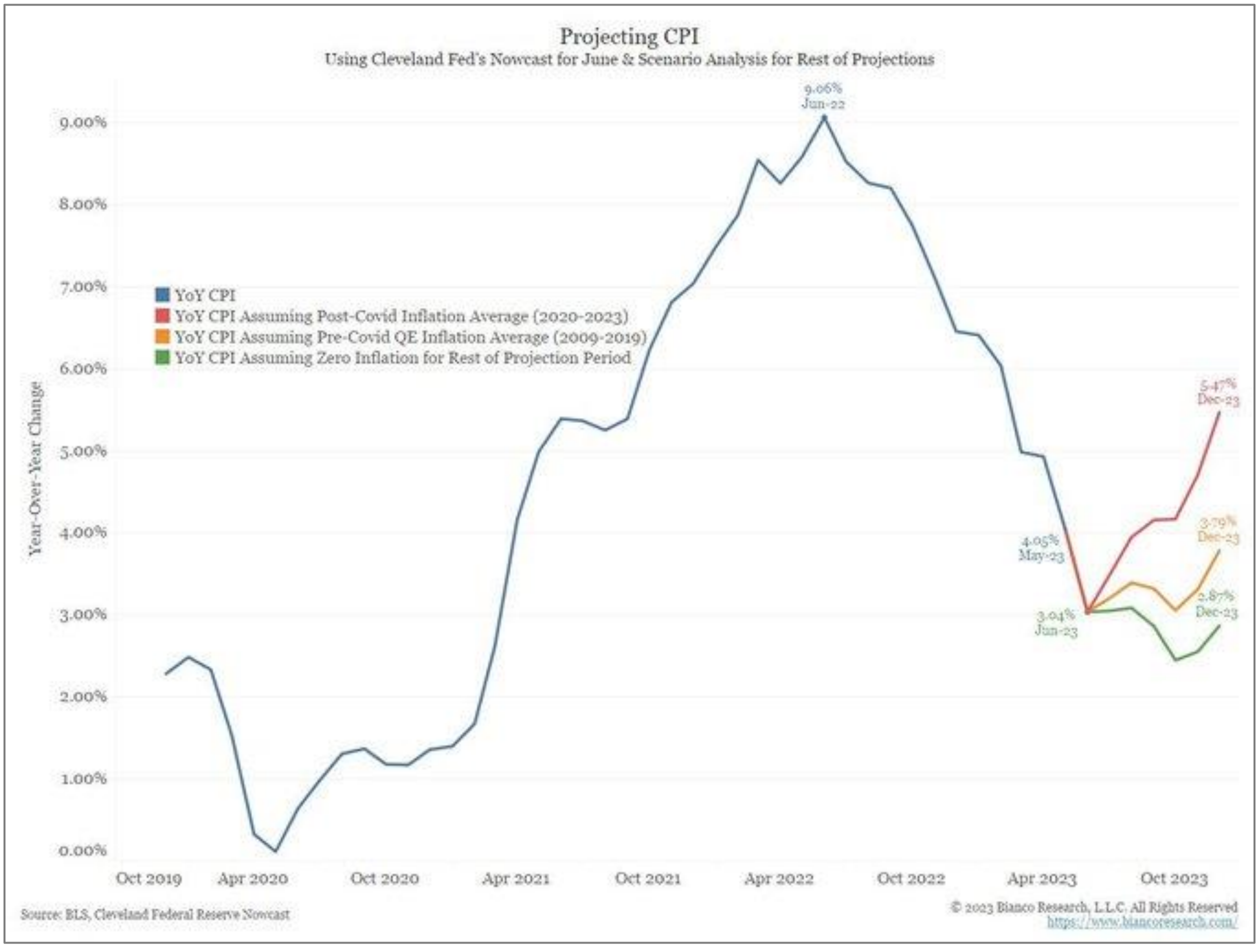
Eight stocks carried the S&P 500 for the first half of 2023!



Disconnect between the economy and the appetite for High Yield Bonds.



Rate of inflation appears set to move higher through year-end.



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.