Cypress CAPITAL

Market Outlook

By Mark T Dodson, CFA

Only Speculators can be bagholders

Psychology improved by 3.5% but was offset by some deterioration in the Monetary Composite, leaving the Market Risk Index above 75% for the fifth week in a row. While we were skeptical of the potential the stock market had to rally beyond the seasonably strong November to April period, the model knew better. MRI didn't cross above the 75% level, which delineates higher-risk markets, until the last week of July, when enthusiasm for AI and soft-landing news was peaking.

The Options and Surveys categories are routinely the first two areas of investor sentiment to shift before any others as market volatility increases – this market pullback has been no different. The Surveys category reversed from bearish to neutral, but the Options Category did all the heavy lifting inside Psychology this week. Options markets have showcased almost a complete 180 in sentiment from a month ago, with the category now the sole bullish influence on the composite as the stock market pullback sent both stock prices and call option volume lower along with it.

Still, there are signs of excess sentiment in options markets left to be wrung out. The dual phenomenon of both zero days to expiration options and retail trading making up the majority of options volume makes it evident that we have not turned the page on the bipartisan government-funded speculative stupor that was the 2020-2021 stock market environment.

The NYSE Overbought/Oversold indicator crossed below the negative 50 threshold during the week, a solid oversold reading that tends to pinpoint good times to buy in bull markets. S&P 500 returns over the next three months have averaged 7.3% since 1965 when hitting that level, compared with an average S&P three-month price return of 2.1% over the entire period – not too shabby. That said, when our Psychology Composite is in the worst decile of readings, as it is now, that three-month average return falls to -0.7%. In other words, aggressively buying oversold markets with fundamental backdrops like this one still qualifies as picking up nickels in front of manhole cover behavior.

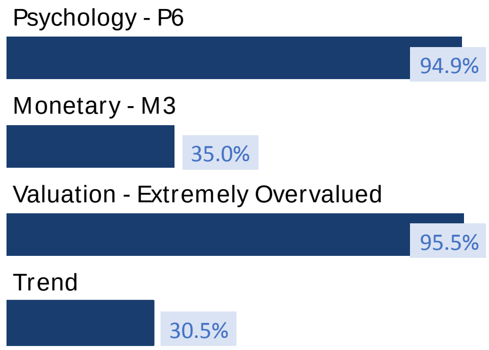
The weight of the evidence always rules the day, regardless of whether individual indicators are hitting extremes while others are not. When we feel emotions welling up to the surface in our decision-making or get too wrapped up in popular narratives or the

Market Risk Index

Rec Allocation 25% Underweight

75.3%

Category Percentiles



Largest Psychology Influences

Leveraged Investments	Negative
Option Activity	Positive
Bank Sentiment	Negative
Flow of Funds	Negative

Largest Monetary Influences

Interest Rate Spreads (Yield Curve)	Negative
Lending and Leverage	Positive
Inflation	Positive

Valuation

7-10 Year Equity Return Forecast	1.8%
10Yr US Treasury Yield	4.2%

Market Trends

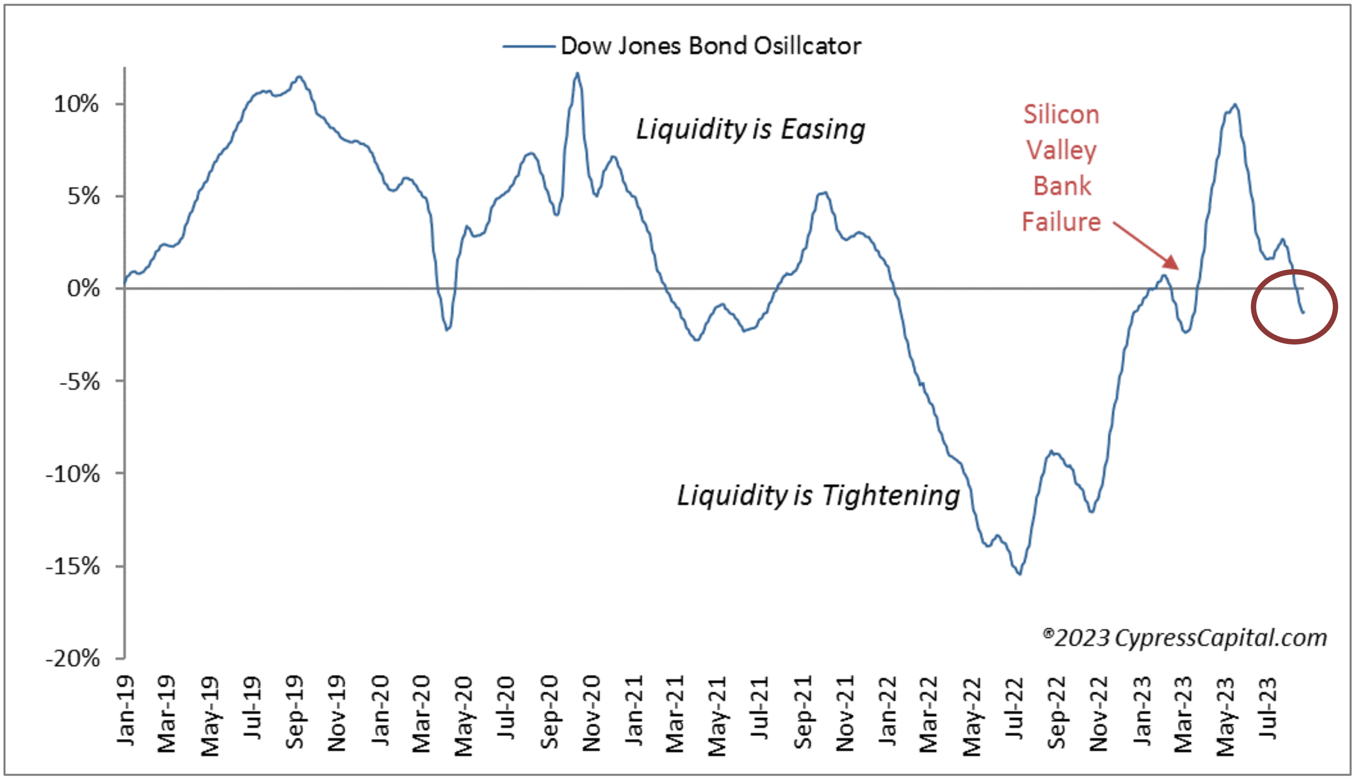
US Equities	Bullish Trade
Intl Equities	Neutral Trade
REITs	Bearish Trade
Broad Commodities	Bullish Trade

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.

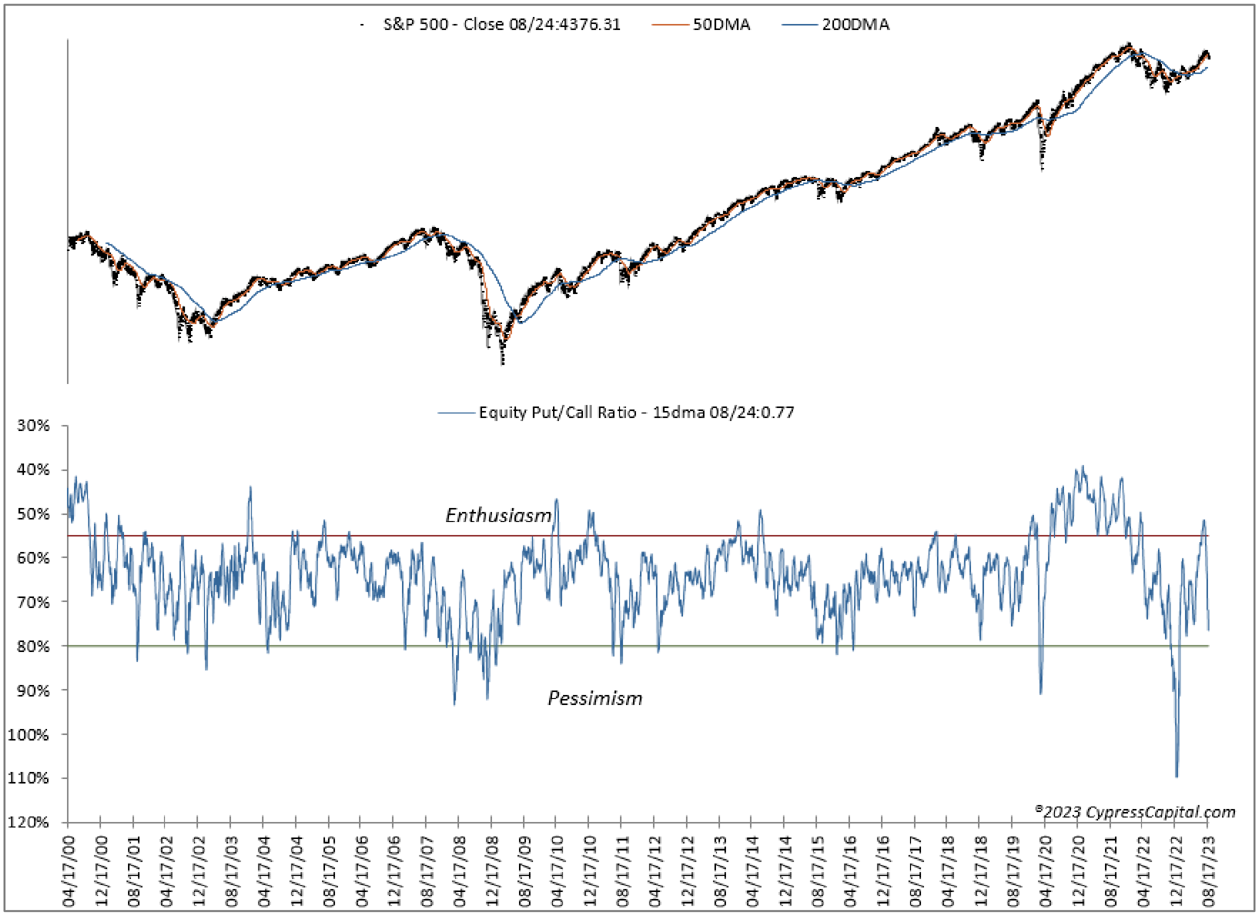
idea of making the perfect call, we have always tried to use Ben Graham's thinking on investing versus speculation as our plumb line. It's the philosophy that keeps us from making decisions we may regret. If you are buying an asset solely with the hopes of selling it to someone else at a higher price without any regard to the valuation of the asset, it's speculation. Buying an asset because it generates cash and that asset is priced with a margin of safety is an investment. You may occasionally walk around with an egg on your face as you watch a neighbor score some easy money, but you won't ever be the bagholder in a game of greater fool theory.

Charts of the Week

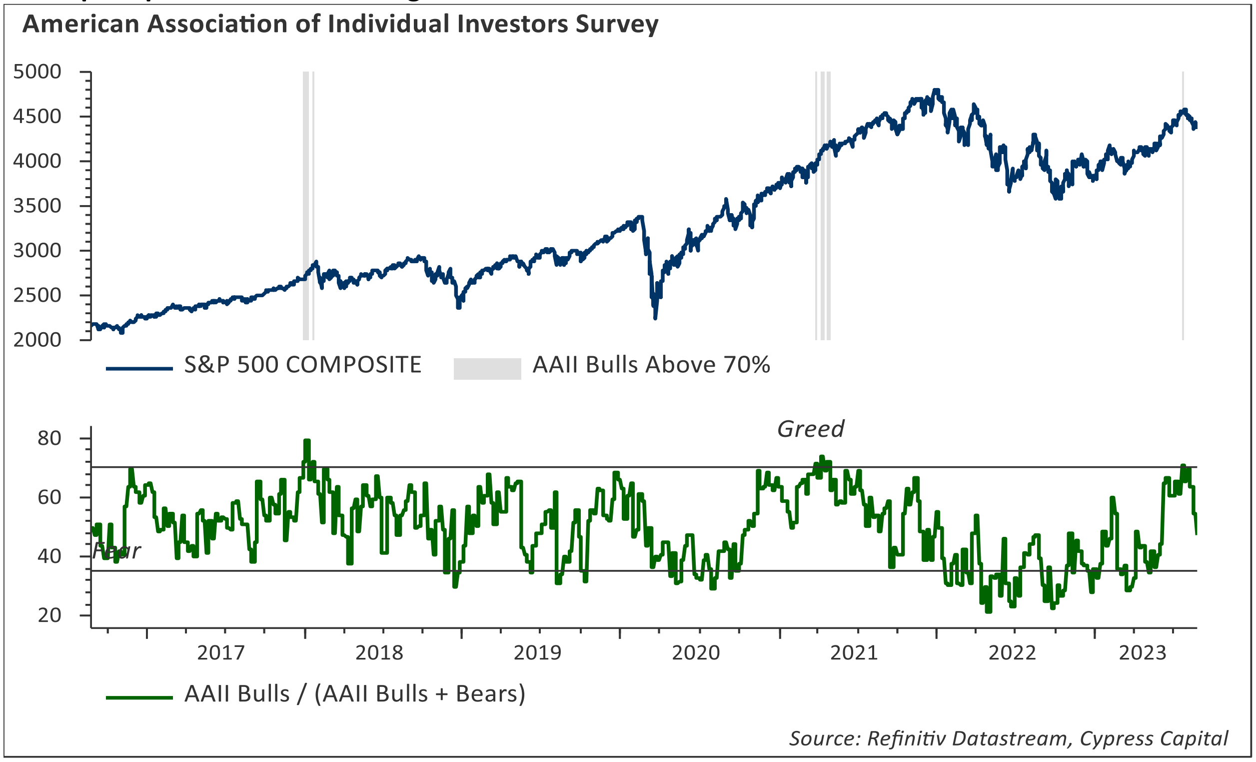
Bond Markets have only grown tighter in August.



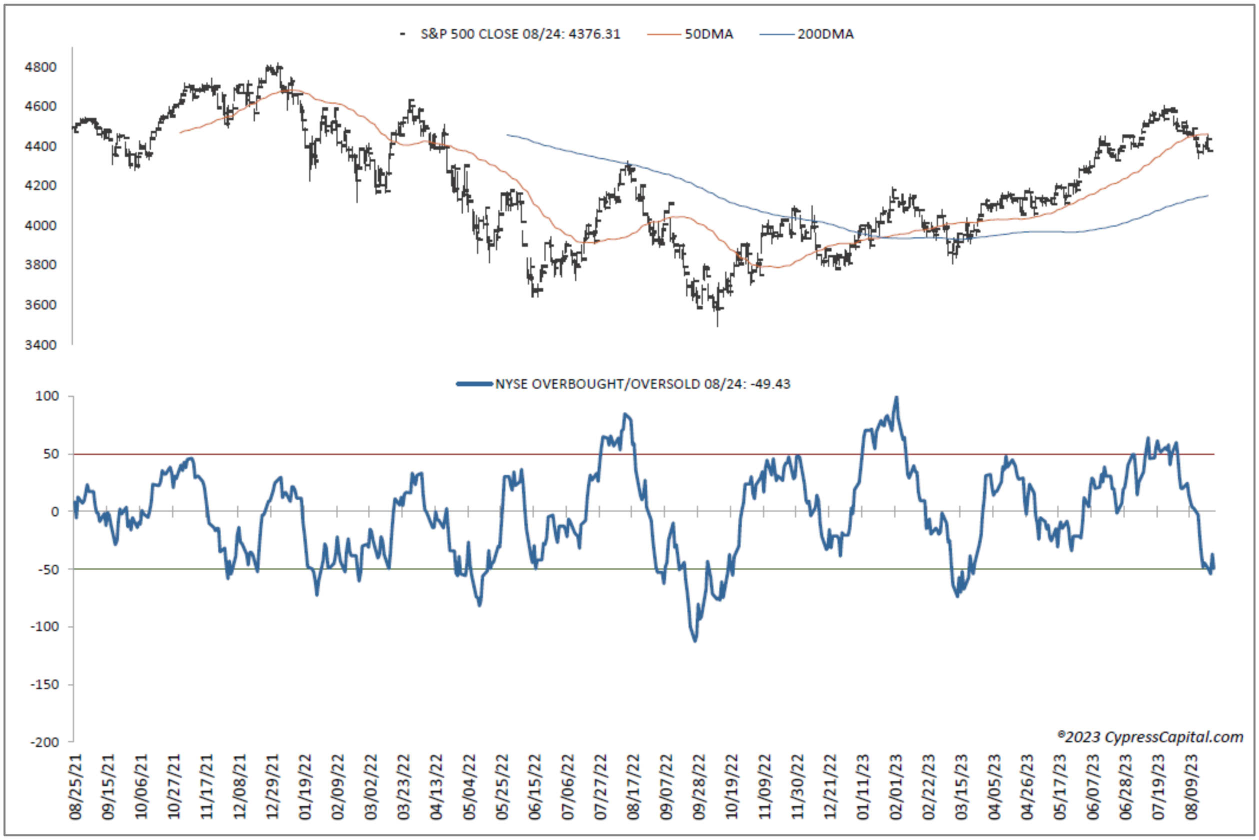
Equity Put/Call Ratio made a U-turn away from speculative behavior this week.



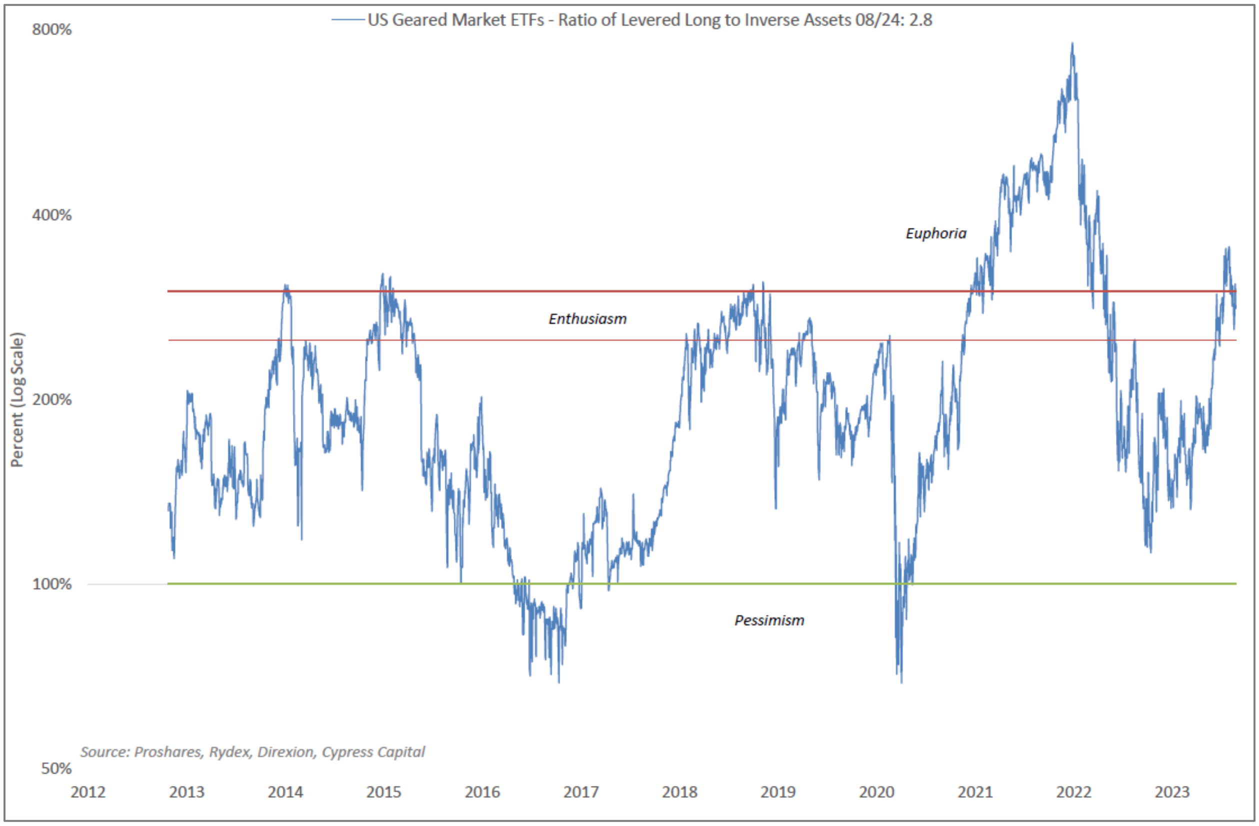
A sharp drop in bullishness among individual investors.



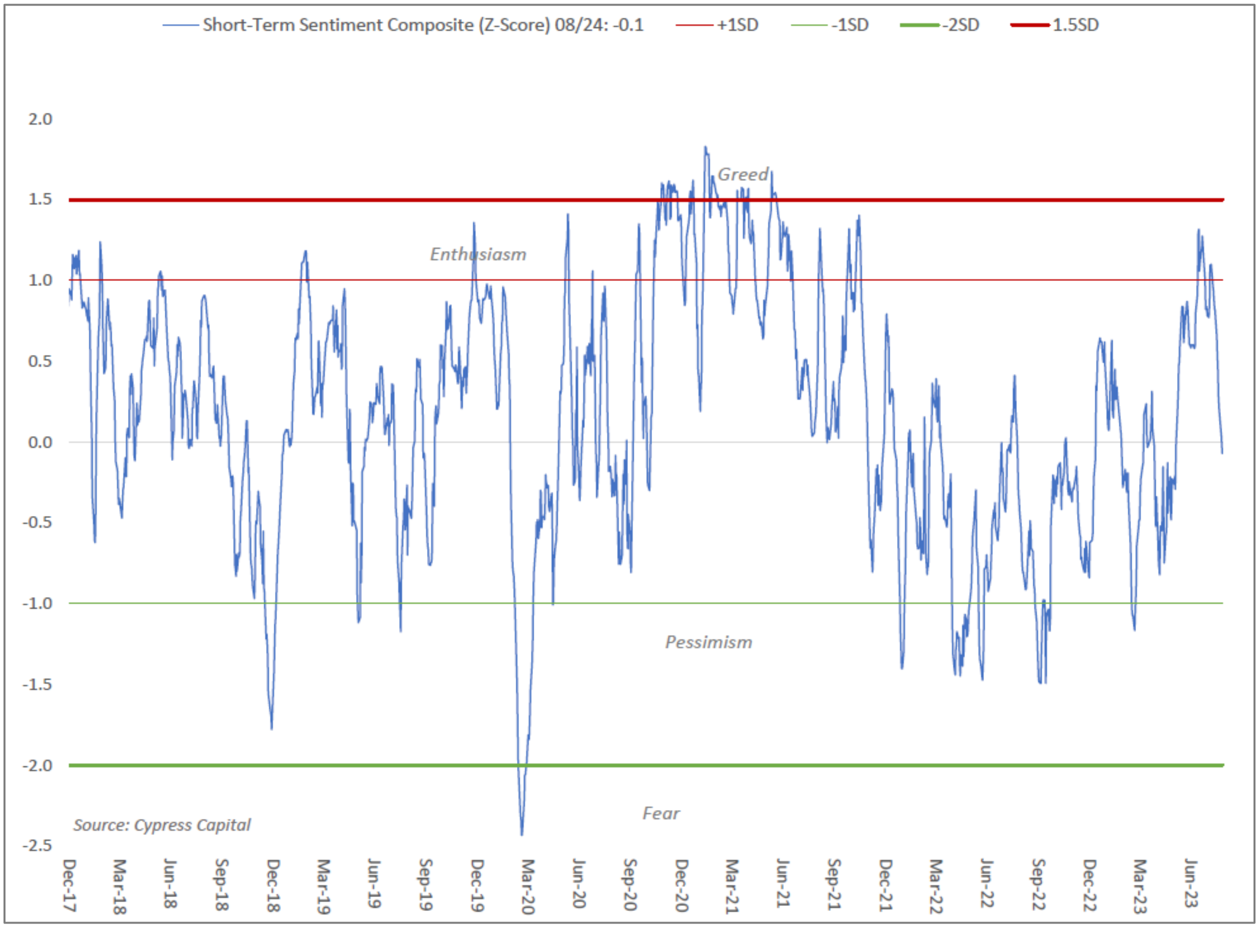
The Stock Market is officially oversold.



Leveraged Fund investors haven't been shaken out of bullish positioning.



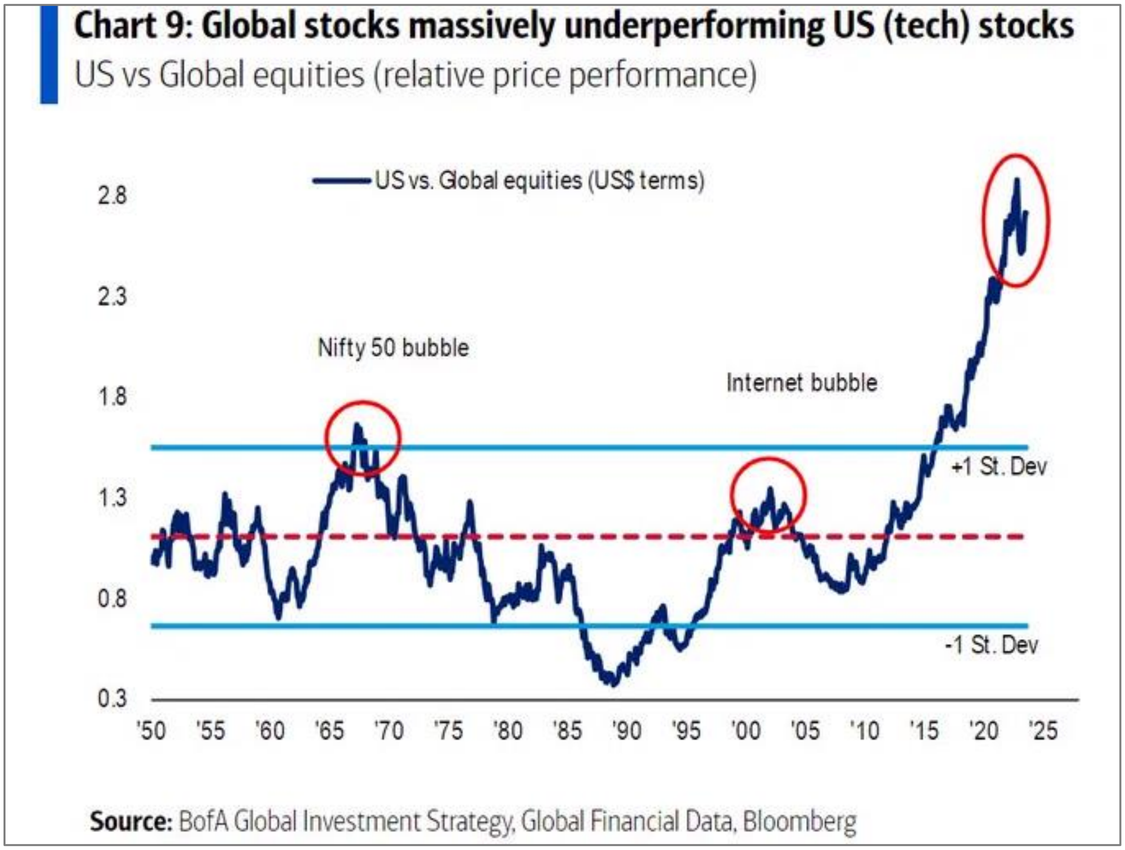
Short-Term Sentiment Composite crossed the fear/greed threshold but isn't signaling fear.



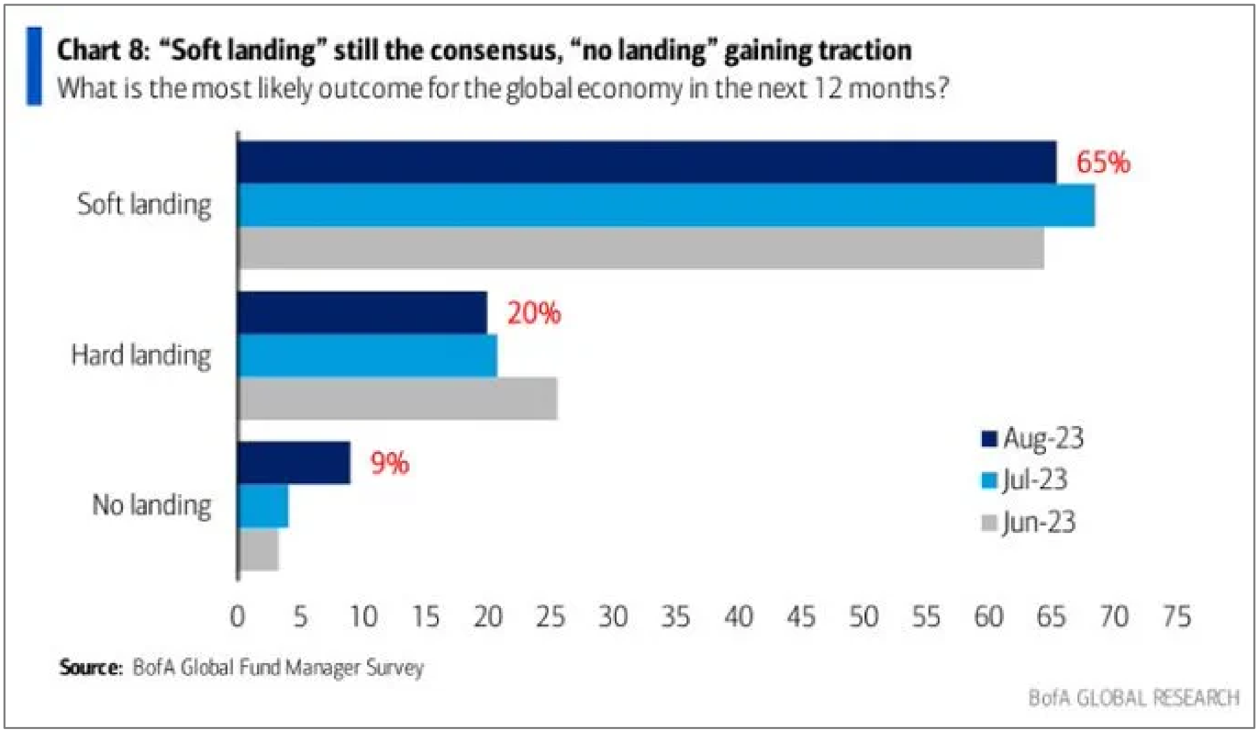
Yields on 30-year TIPs crossed above 2% for the first time since 2011.

The summer of 2023 stock market FOMO was American FOMO.

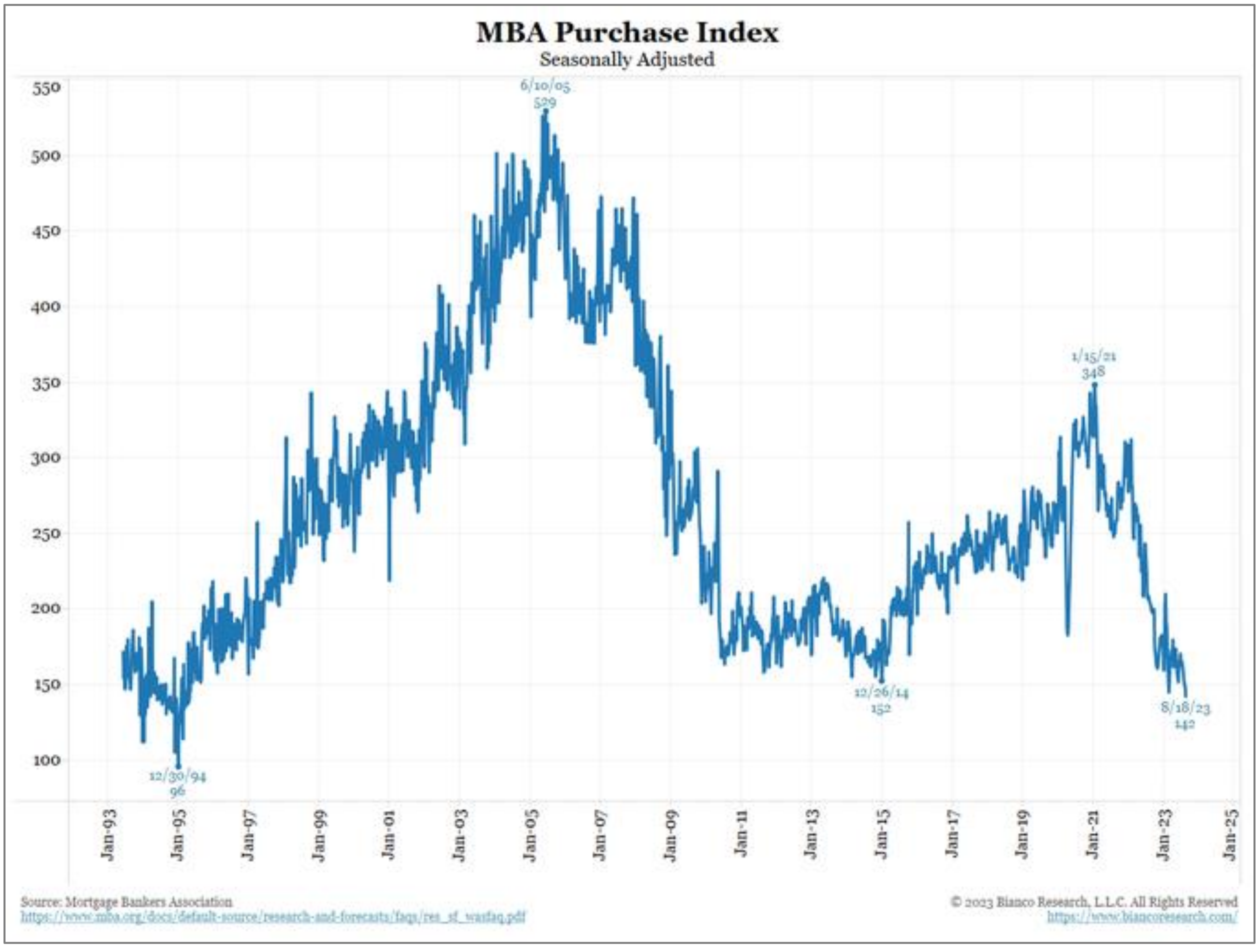
For Tech Stocks, it hasn't just been the summer – it's been a decade.



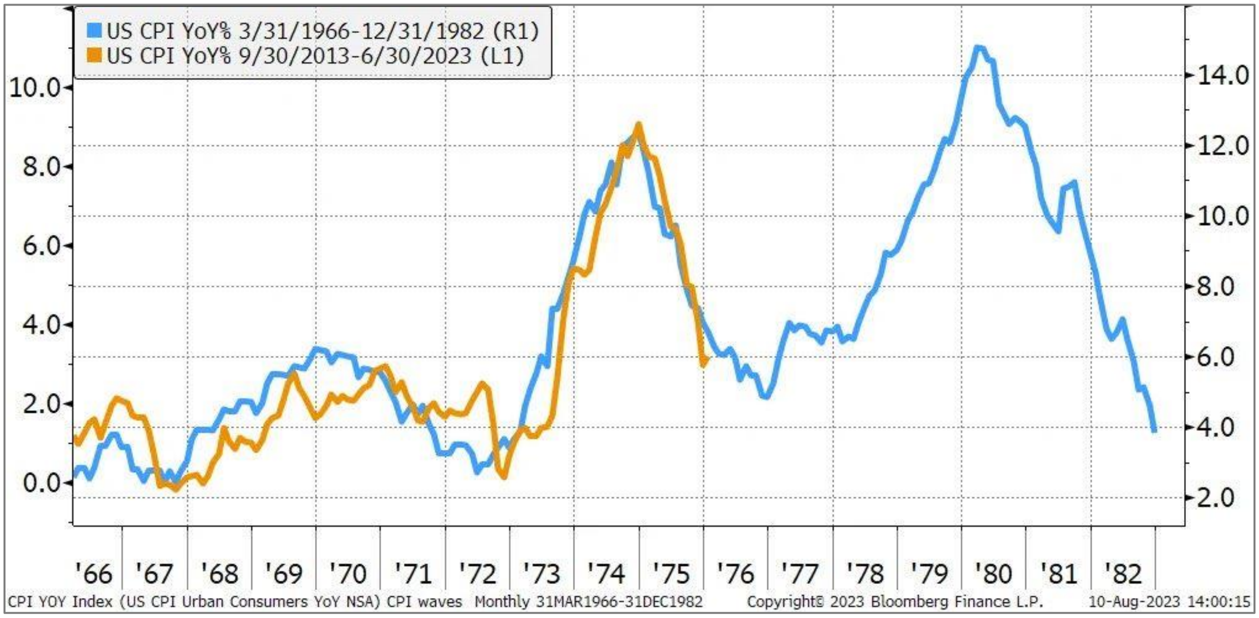
Soft-Landing is the consensus opinion.



Mortgage Applications for home purchases have fallen to the lowest level in over 25 years.

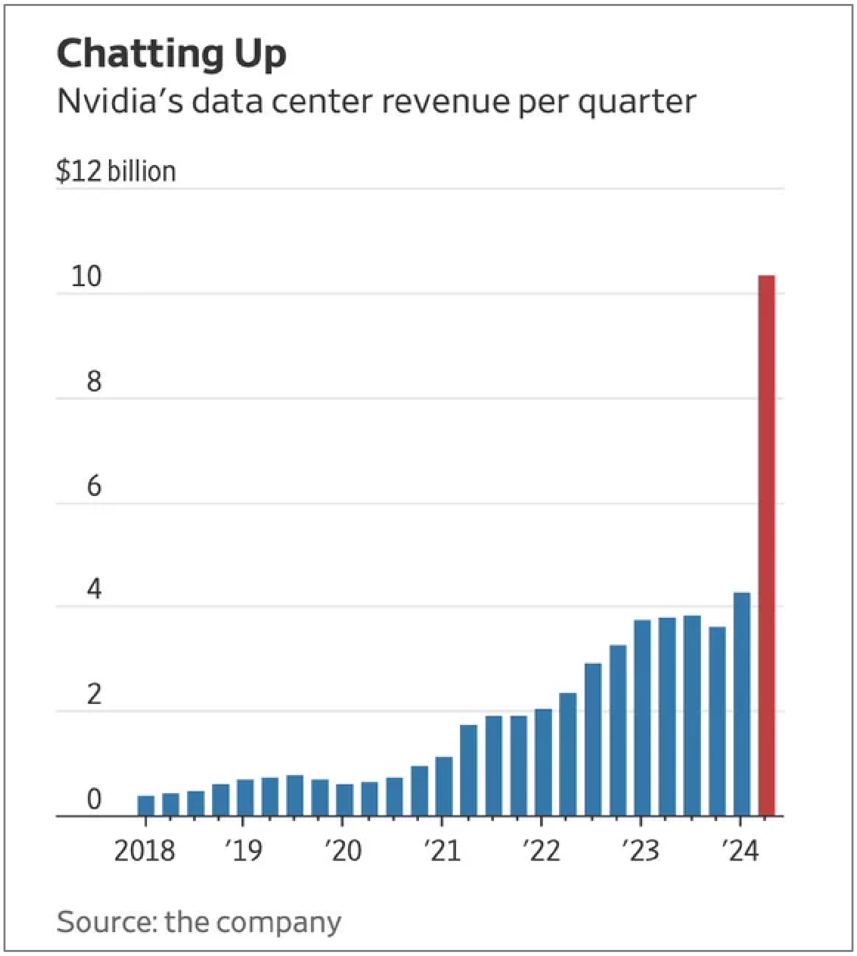


1970s Inflation Analog



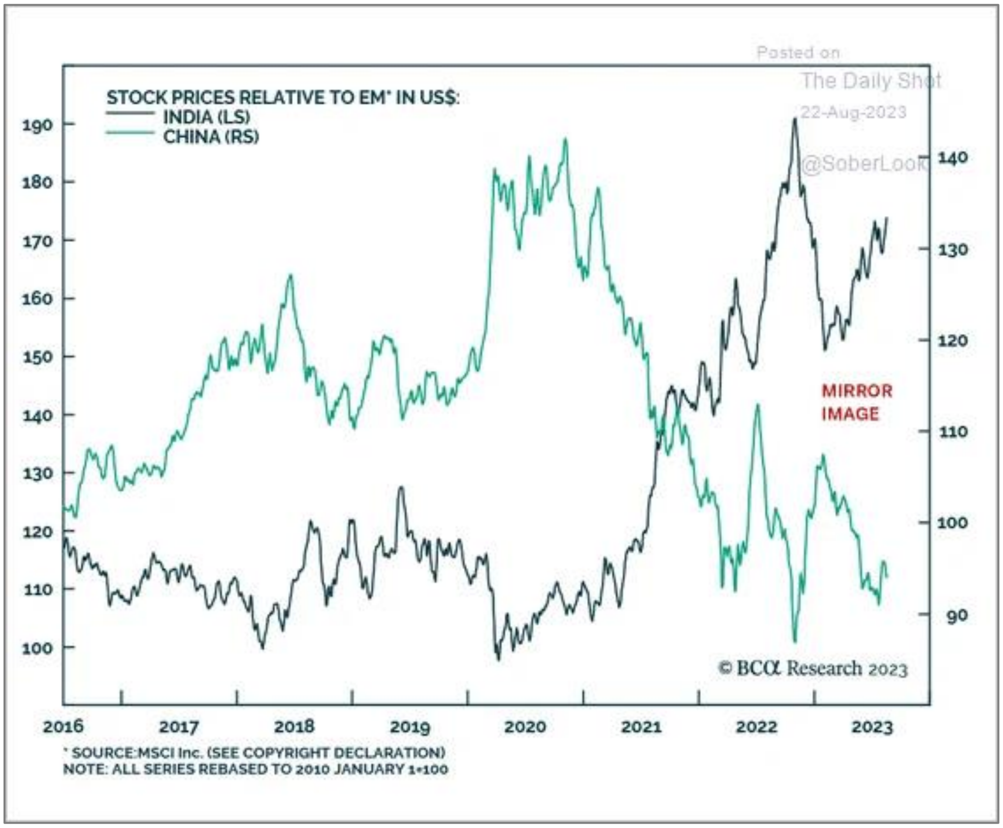
Source: Larry Summers

Nvidia's recent quarter was beyond impressive.

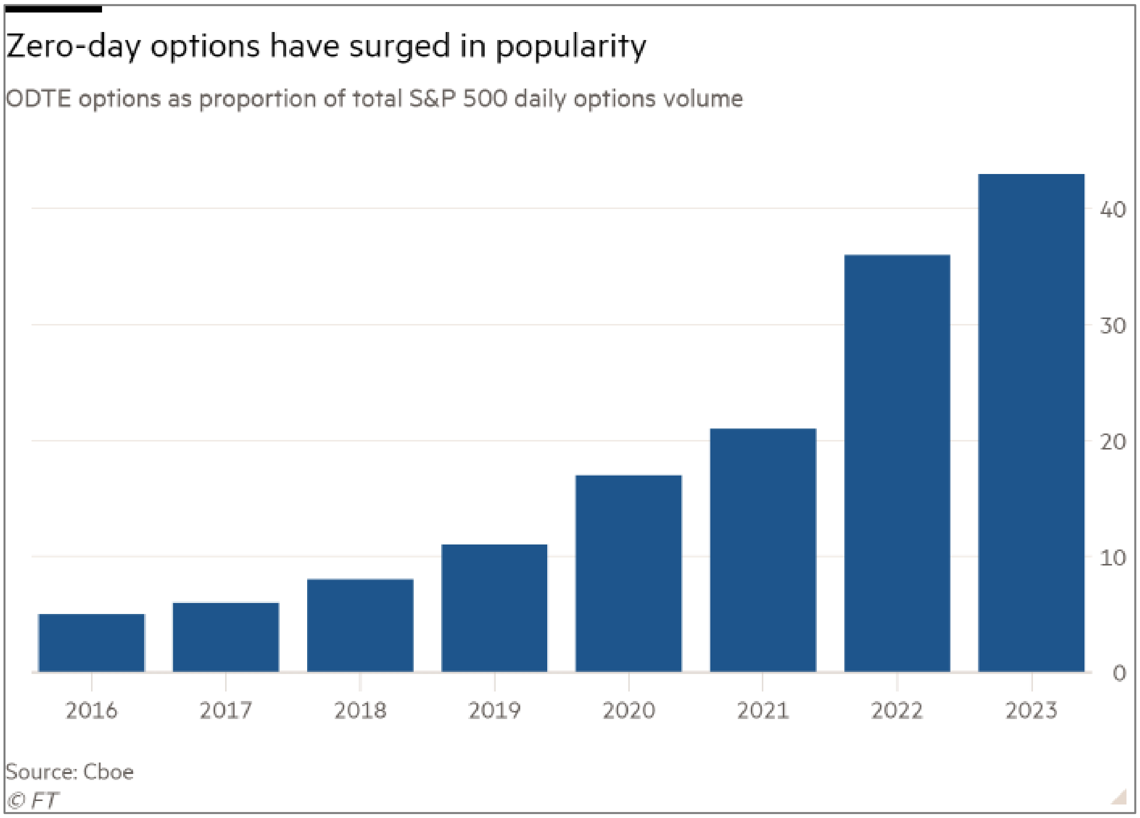


China is stocking up on semiconductors ahead of Western export restrictions.

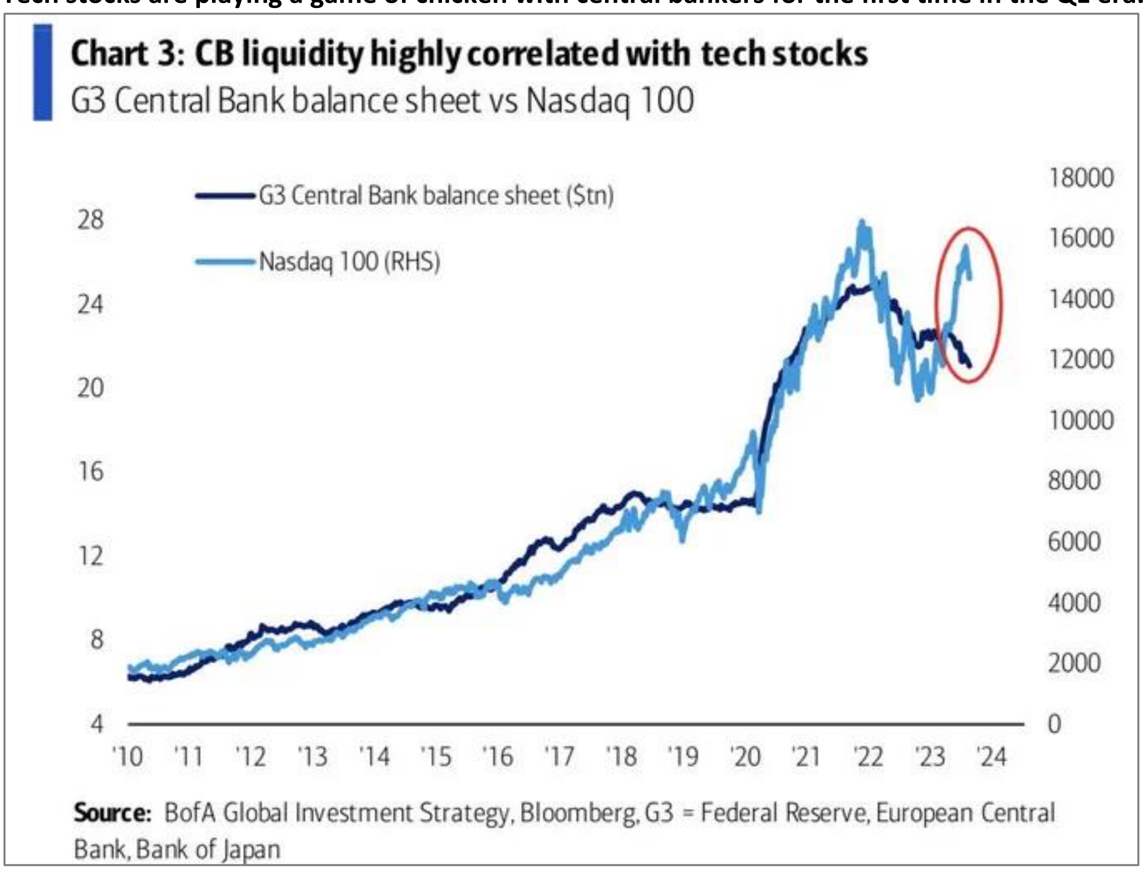
Has India become the post-Covid China?



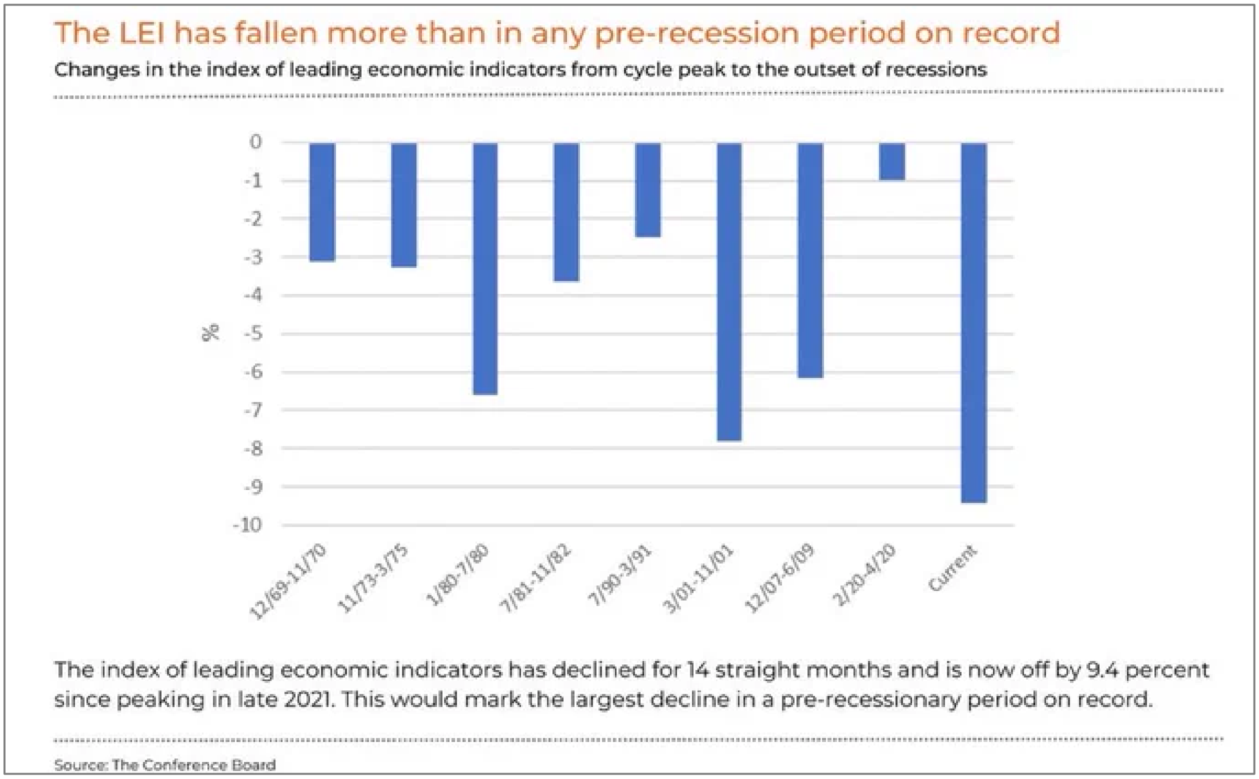
Trading in options expiring the next day makes up more than 40% of S&P 500 daily options volume. They made up less than five percent six years ago.



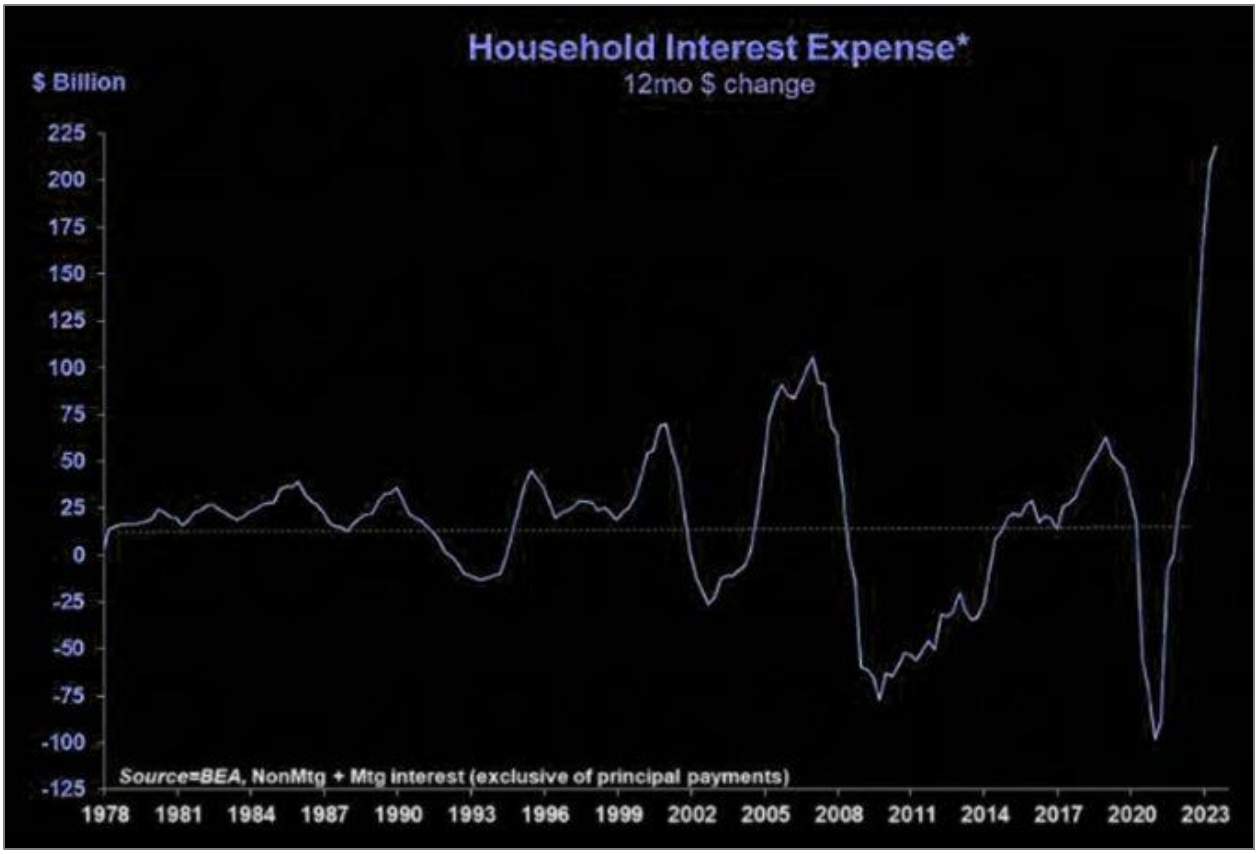
Tech stocks are playing a game of chicken with central bankers for the first time in the QE era.



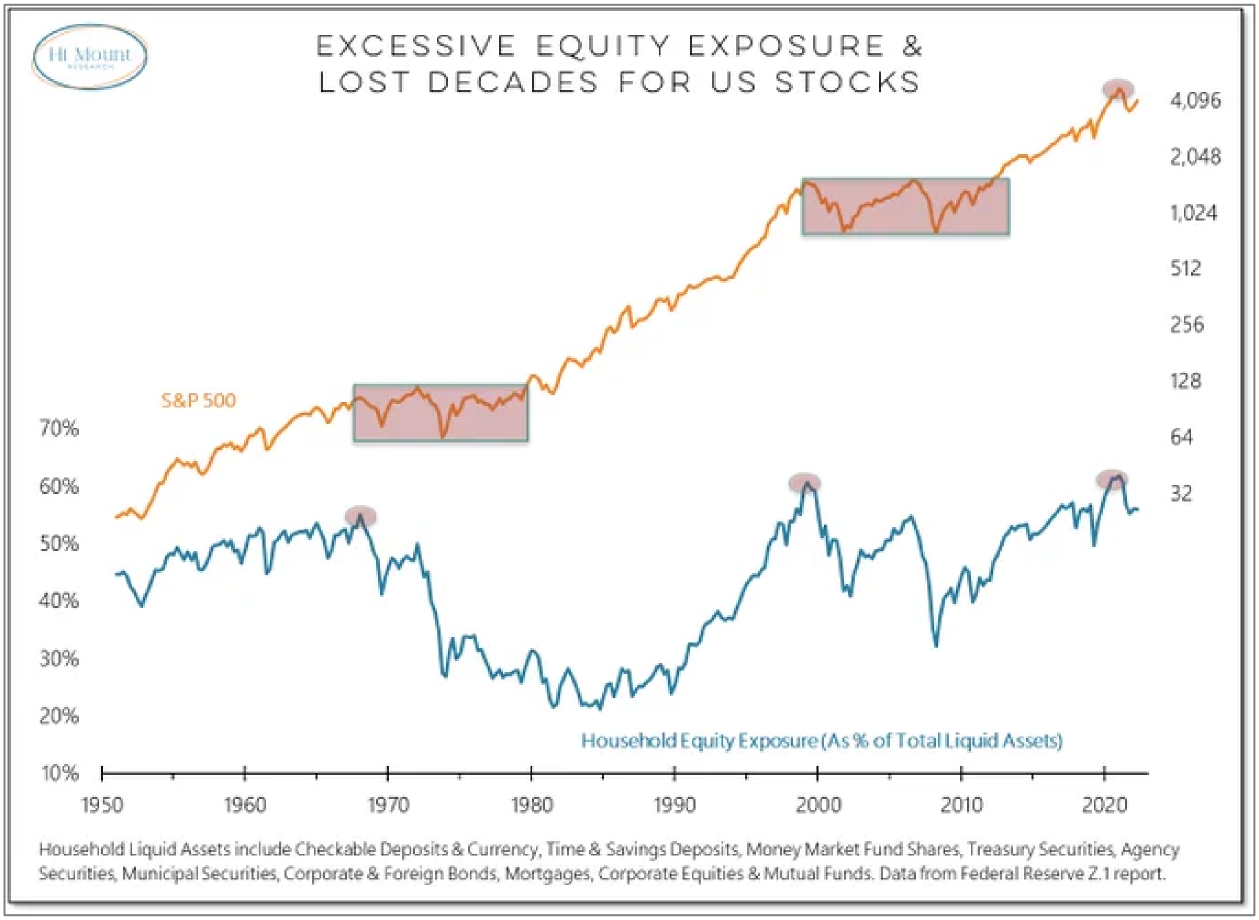
Leading Economic Indicators have fallen more than in any pre-recession period on record.



Household Interest Expense is surging.



Investors don't appear to rebalance their portfolios, but this chart strongly advocates it.



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.