# Market Outlook

By Mark T Dodson, CFA

## Psychology moves out of the worst decile of readings

Market Risk Index dropped below 70% this week as the Psychology composite moved outside the worst 10% of readings.

The improvement in investor psychology came from Option Activity, now the single largest positive (bullish) influence on Psychology. The readings from the equity put/call ratio are hitting levels we usually see after the market has had a 20% drawdown, making it unusual given the lack of severity of the decline. The extremes in January were also unusual, but they proved accurate. Still, it's the only category within Psychology that is a decisive tailwind for stock market bulls.

Options investors are aggressive, but they aren't the most aggressive investors we measure. The Leveraged Funds category holds that mantle and those investors haven't budged yet – they have diamond hands. Rydex Ratio is within a couple of percent of its July highs, and Leveraged ETF investors are back in the euphoria zone. Asset Manager/Institutional exposure net long exposure to equities using derivatives has barely retreated from the all-time high set on August 1st of this year.

The Consumer Confidence release for August was notable for the drop in consumers' confidence in the job market. Such a sharp drop, coming from such high levels, tends to occur before the onset of recession. We saw a clever use of the survey questions to create a Modified Sahm Rule (the original Sahm rule is a popular coincident recession indicator based on increases in the Unemployment Rate). We've included it below.

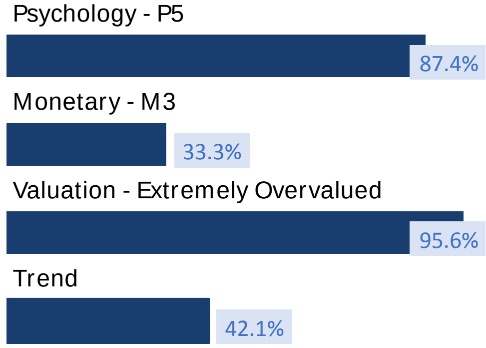
While we aren't changing our recommended equity exposure this week, we have started to shift exposure out of cap-weighted ETFs and into ETFs less focused on the Magnificent Seven stocks. The S&P 500 outperformed the Dow by a record amount in the first half of the year, and the average stock hasn't underperformed the S&P like this since 1998. Seeing this behavior less than a year into a bull market is an anomaly.

### Market Risk Index

Rec Allocation 25% Underweight

**68.7%**

### Category Percentiles




**Largest Psychology Influences**

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

**Largest Monetary Influences**

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

**Valuation**

| | |
|---|---|
| 7-10 Year Equity Return Forecast | 1.7% |
| 10Yr US Treasury Yield | 4.3% |

**Market Trends**

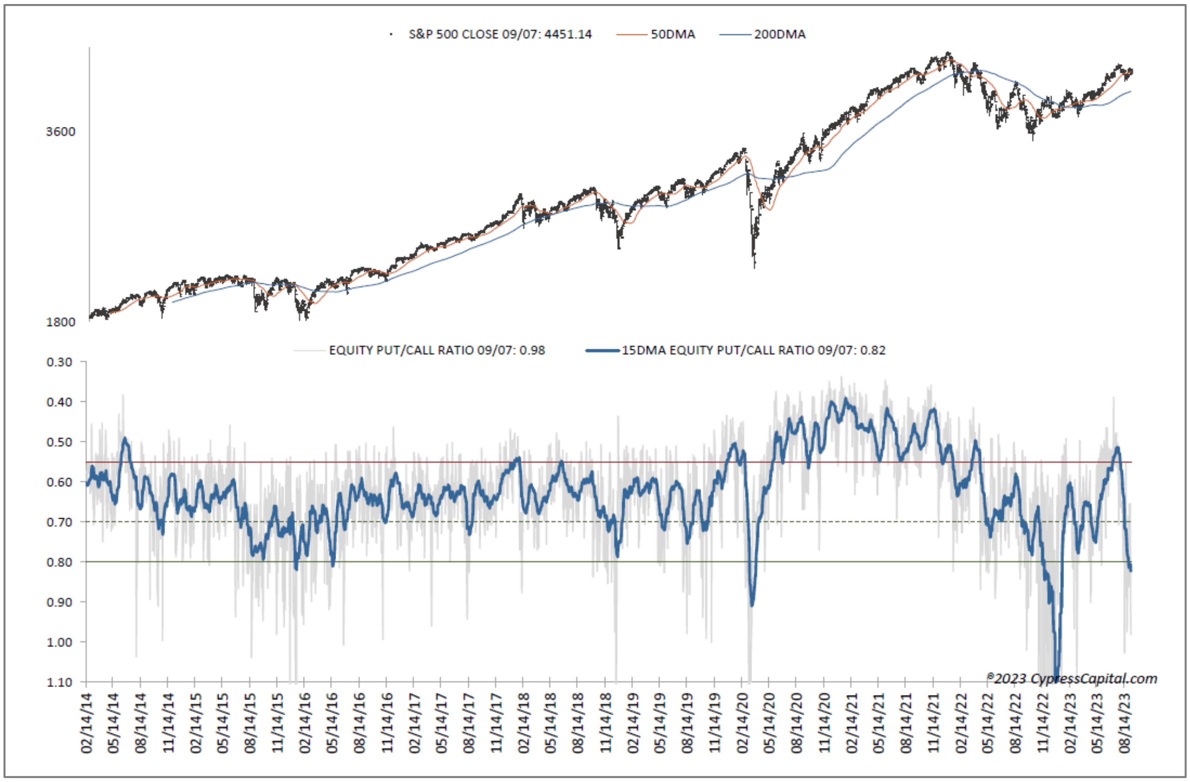
| | |
|---|---|
| US Equities | Bullish Trade |
| Intl Equities | Neutral Trade |
| REITs | Bearish Trade |
| Broad Commodities | Bullish Trade |

*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.*

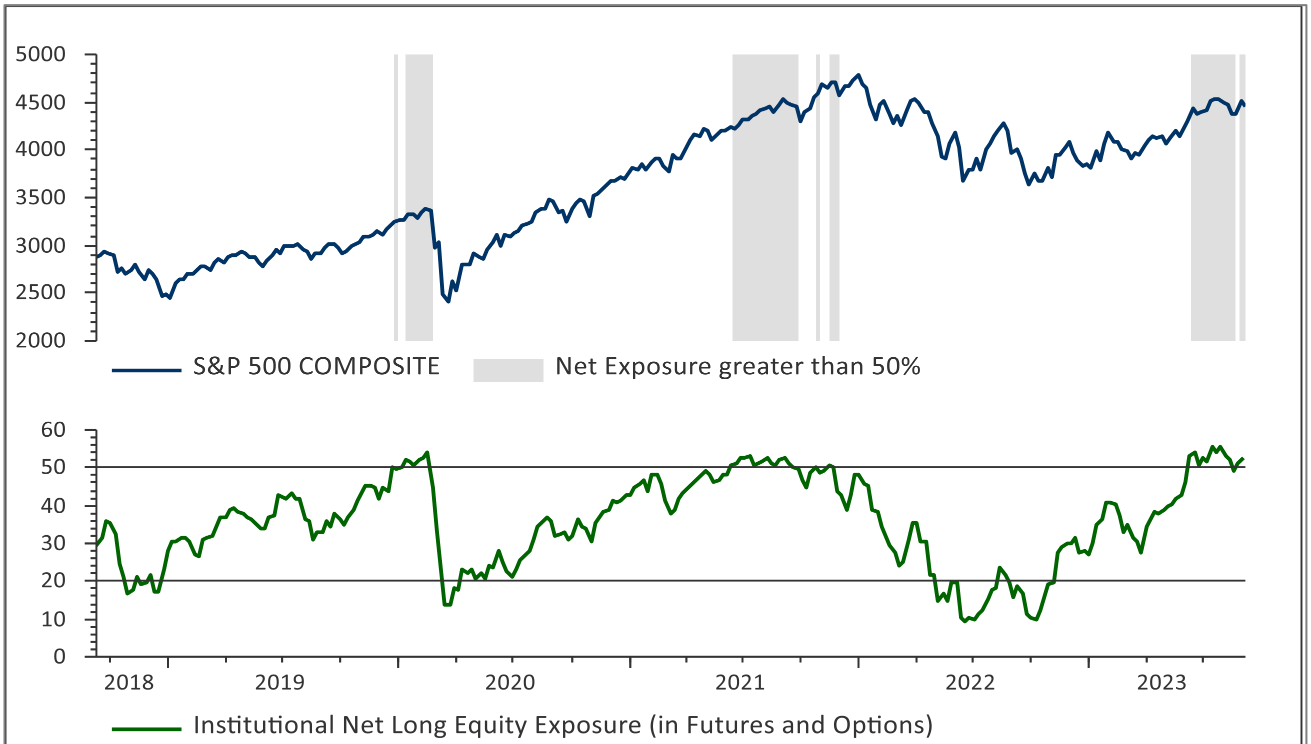
## Charts of the Week

**The Equity Put/Call Ratio is hitting levels on par with the Covid Panic decline.**

Sentiment readings in options markets have become unhinged since zero-days-to-expiration trading has become so popular in recent years.

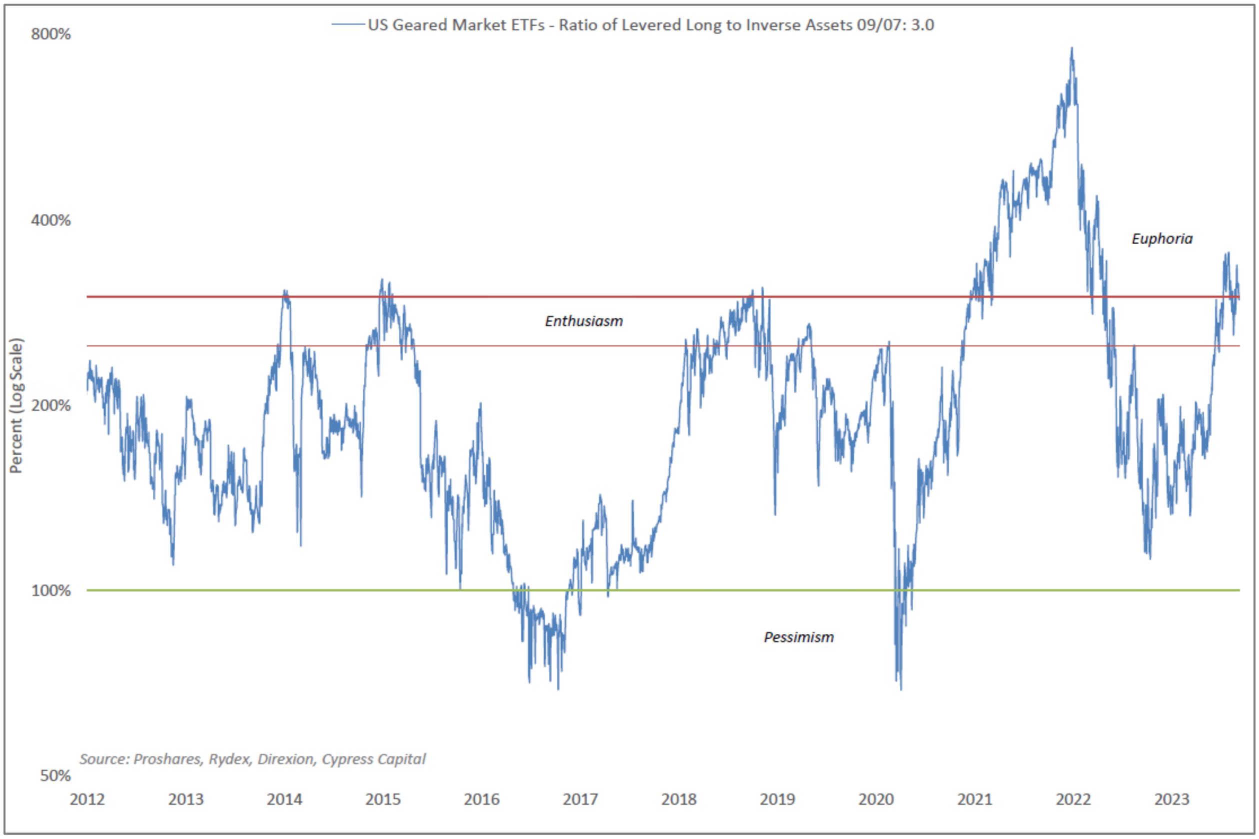



**Derivatives Exposure among Asset Managers and Institutional Managers remains elevated.**

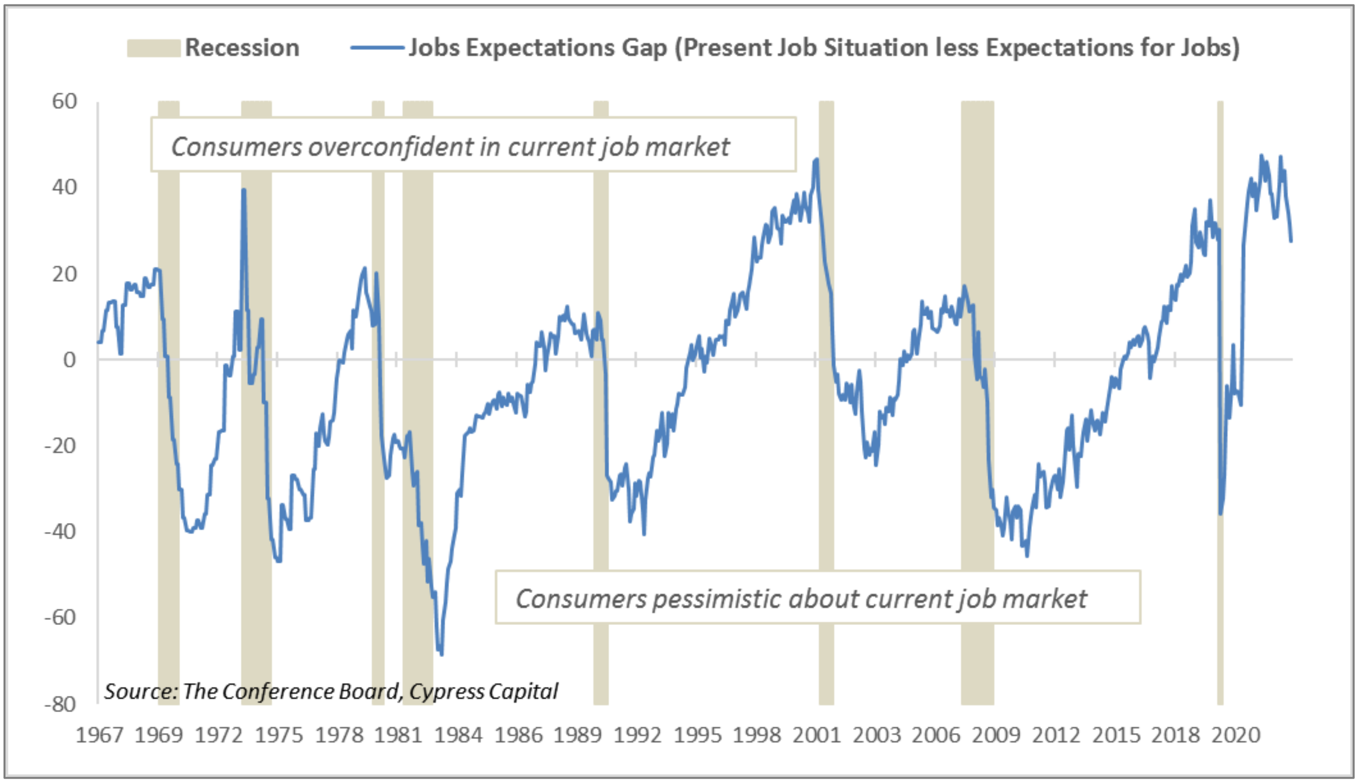


*Source: LSEG Datastream, Cypress Capital*

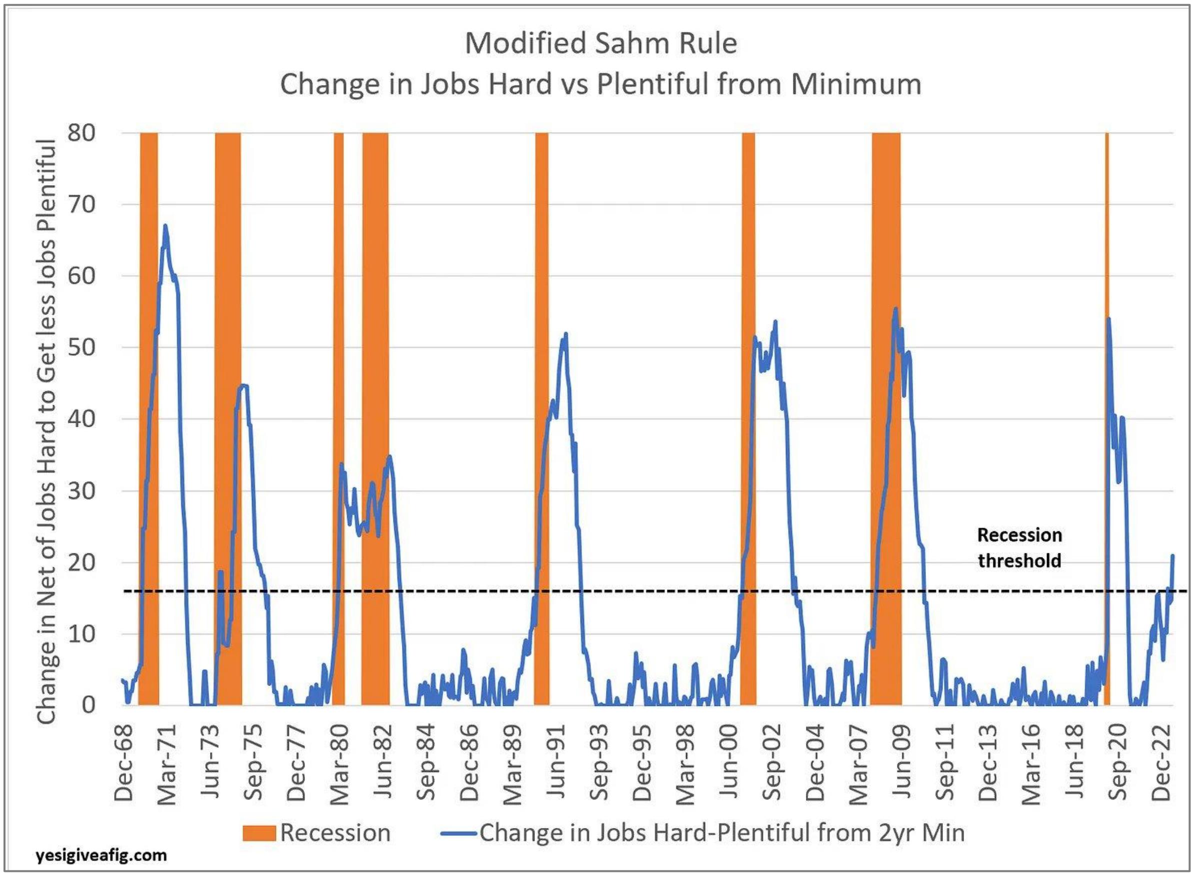
**Leveraged ETF Investors haven't been shaken out of aggressive leveraged long positioning.**



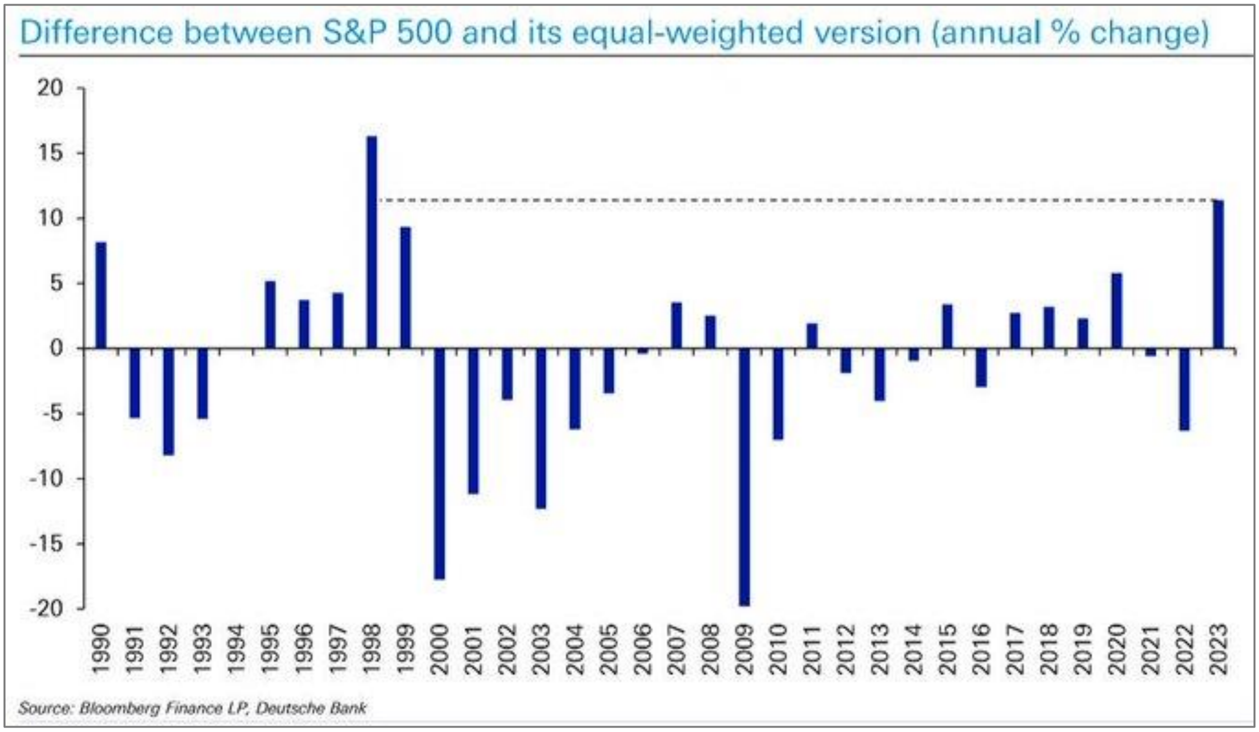

**A sharp drop in Consumer Confidence in the Job Market occurred in August.**
A drop that severe typically only occurs at the start of a recession.



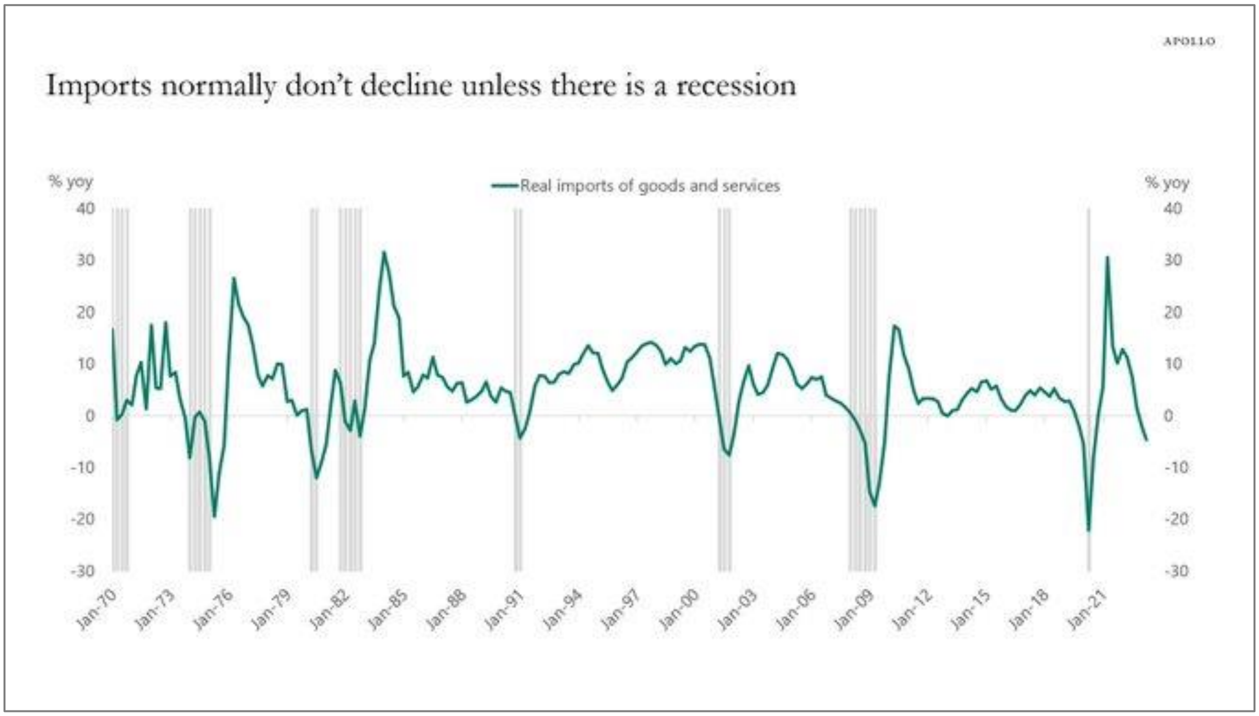
**Modified Sahm Rule (using the Consumer Confidence Survey) crosses the recession threshold.**
This is a clever use of the same job survey questions used to build the chart above. In case you aren't familiar, the original Sahm Rule measures the change in the unemployment rate from its recent minimum.



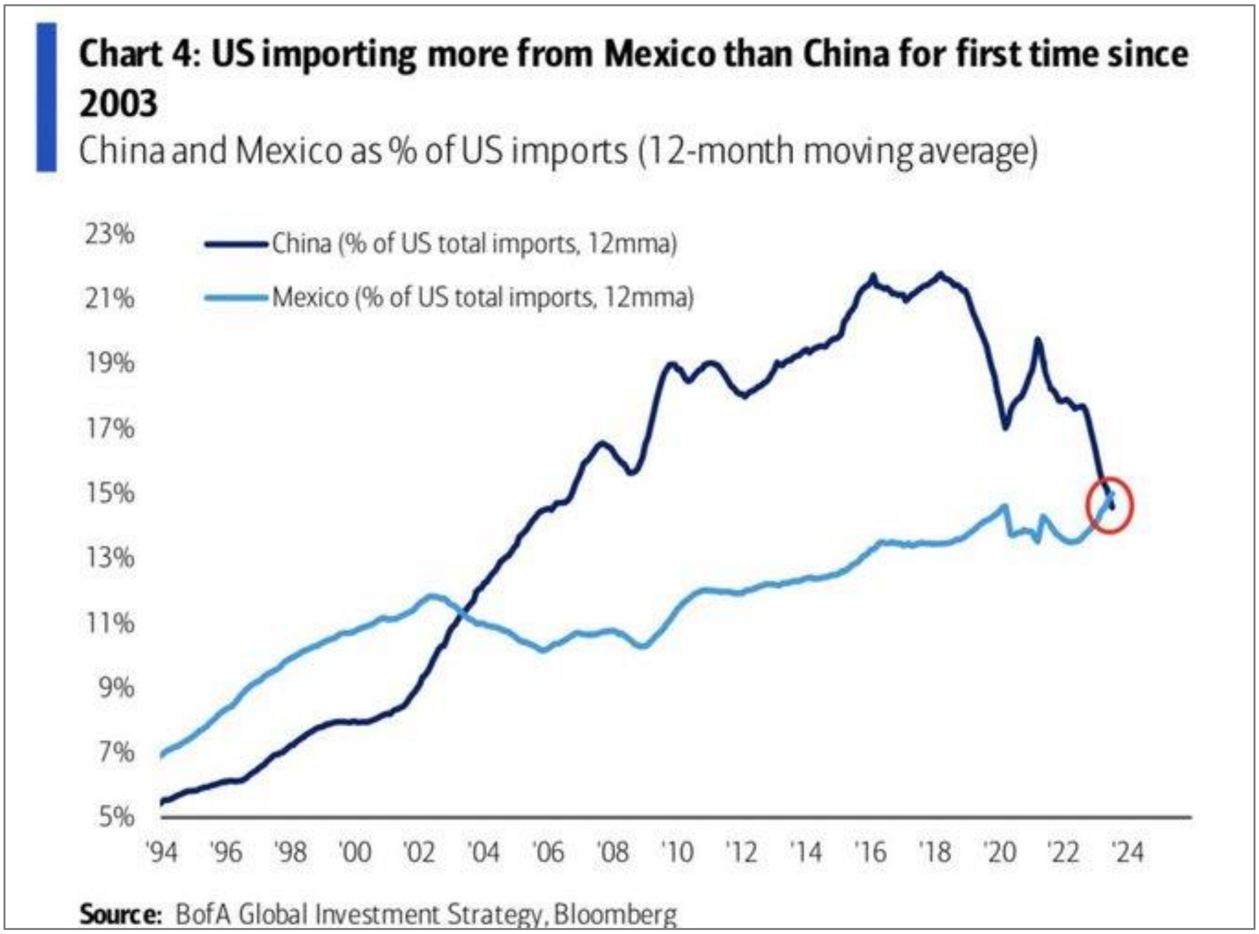

**Cap-weighted indices haven't outperformed equal-weighted indices by this much since 1998.**
That year also marked a significant bottom for small-cap stocks, particularly small-cap value stocks.



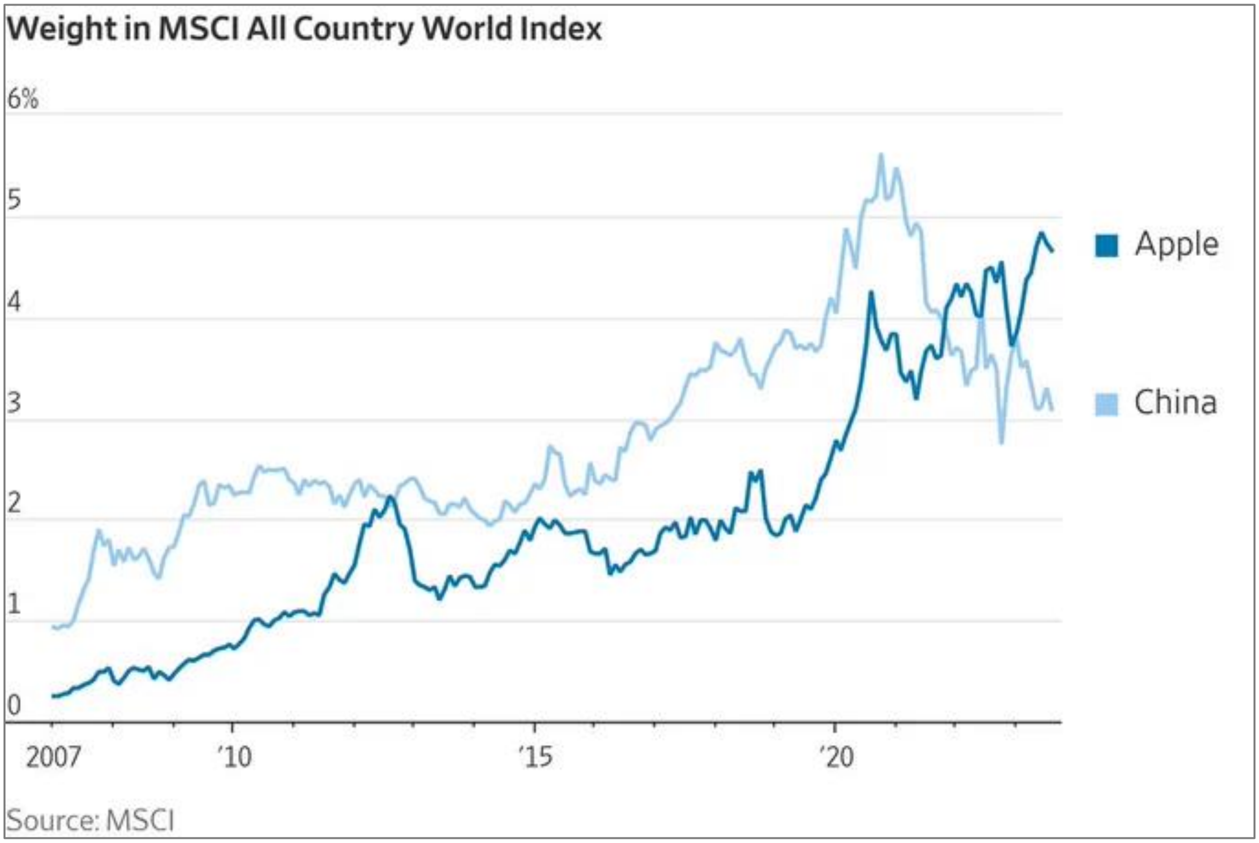
**The decline in imports looks recessionary.**
How much of it results from a shift away from globalization and trade from China?




**The US is importing more from Mexico than China since the early days of China's WTO entry.**

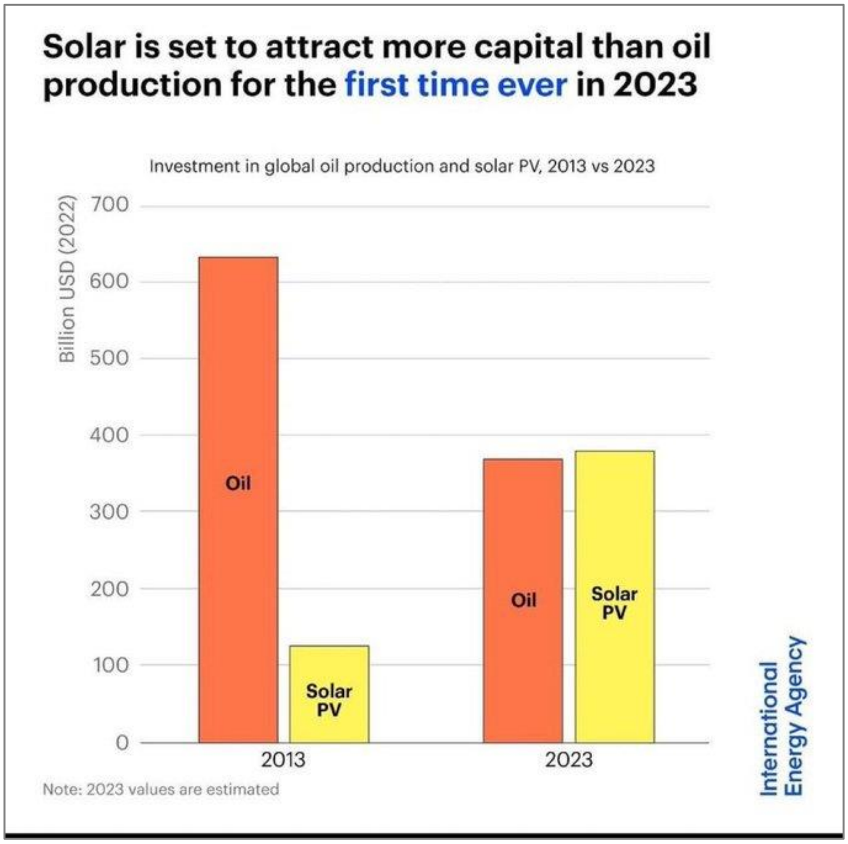


**Apple is worth more than all the companies in China.**

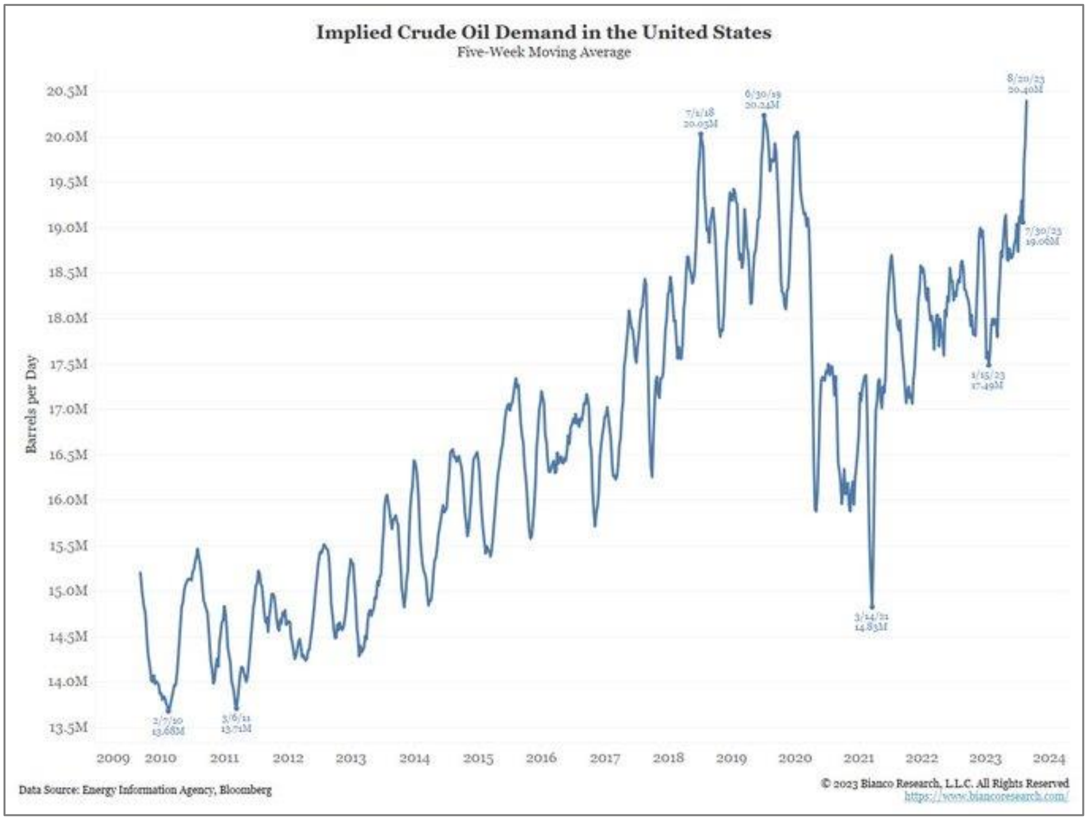



**A chart for the contrarians - negative articles about China hit a record high.**

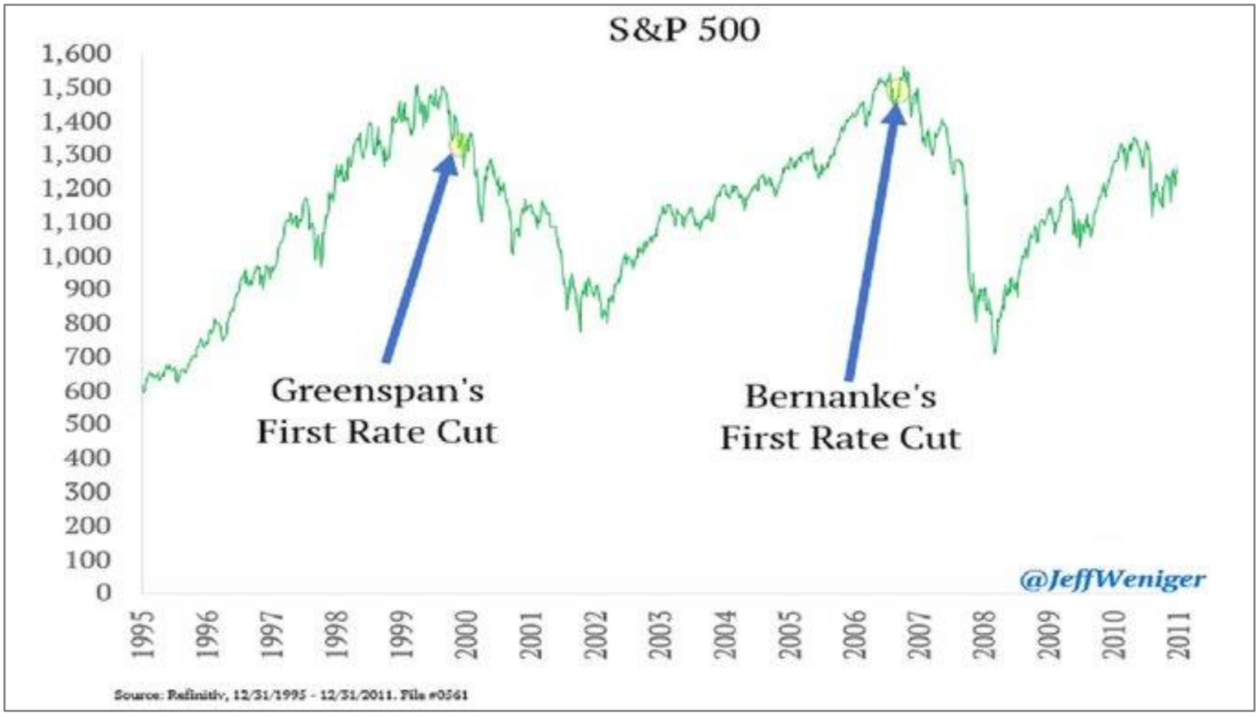
**Capital investment in solar is set to surpass oil for the first time ever.**



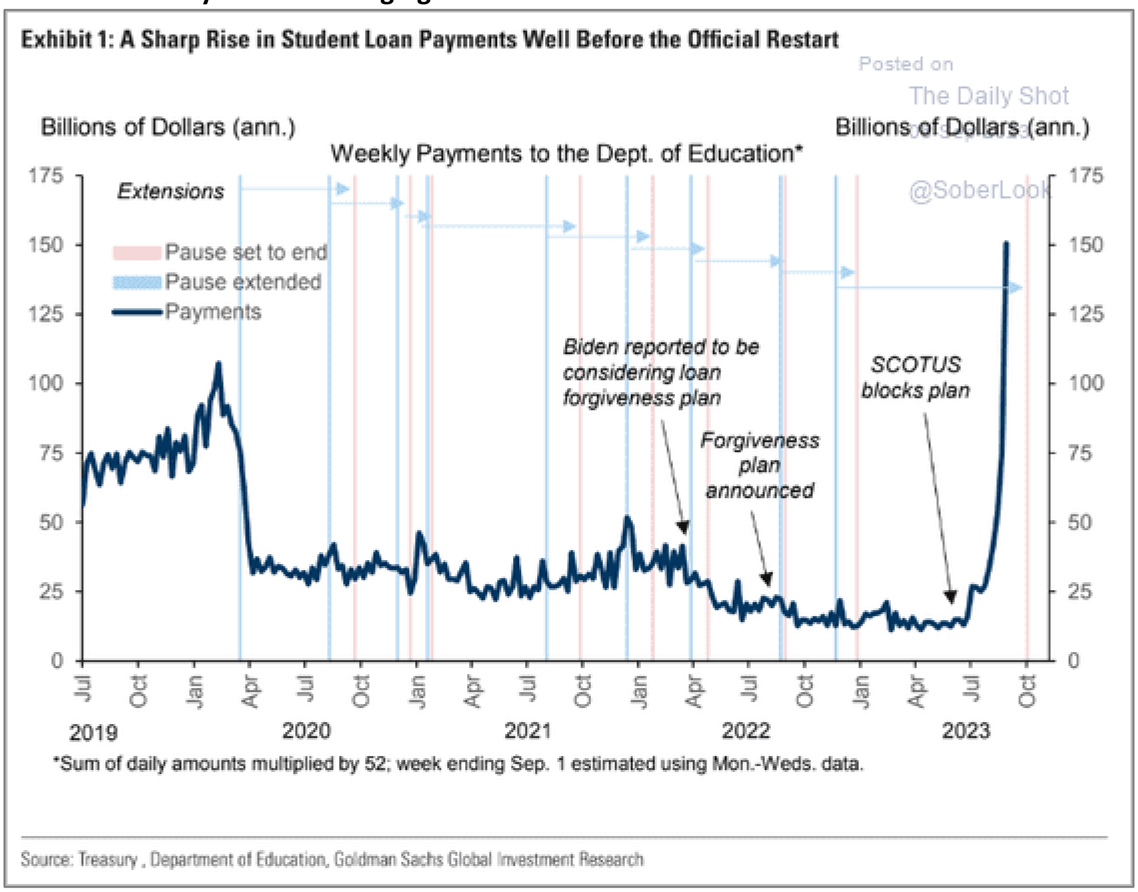

**Meanwhile, Demand for Crude Oil set a new high.**



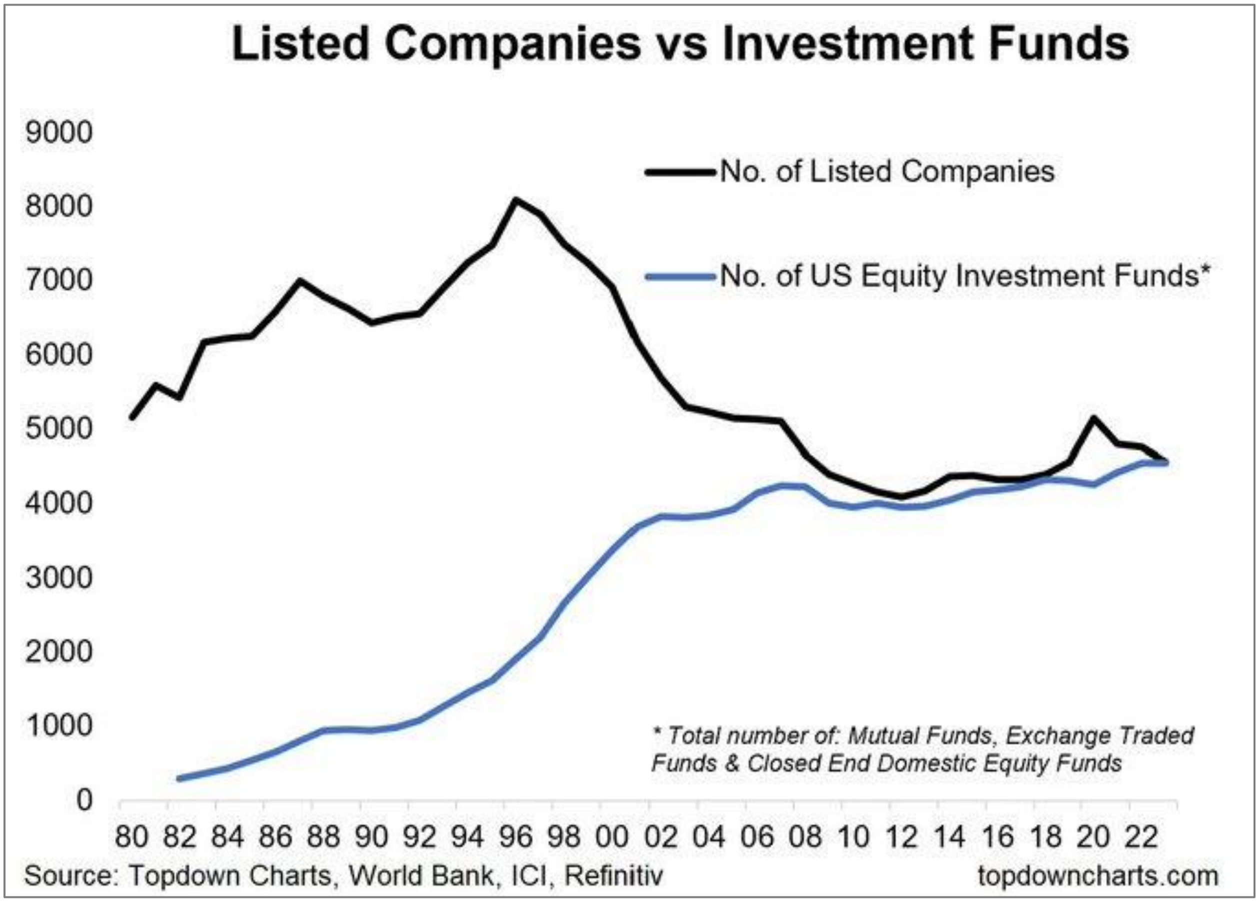
**Should bulls hope for higher rates for longer instead of rate cuts?**




**Student Loan Payments are surging ahead of the Official Restart**



**There are nearly as many investment funds as there are listed companies in the US.**



## 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.