Market Outlook

By Mark T Dodson, CFA

Bond Vigilantes attempt to make the Fed Model relevant again.

Market Risk Index improved to 68.4%. Psychology and Monetary conditions improved, with Psychology doing the heavy lifting.

Notwithstanding the one-week improvement, psychology remains in the worst quintile of readings. The Options category is the only indication that investors have grown anxious about the stock market again. Leveraged fund investors bought the dip and took their leverage back to euphoric levels, and we also saw an uptick in insider selling this week. If it's fear or a wall of worry that you are looking for from sentiment, we don't have it.

This move in interest rates has been impressive. Every key interest rate that we measure a rate of change on within our Monetary Composite is red-lined and registering max negative. Environments where rates are rising in conjunction like this are often problematic for equities. They can be challenging for politicians too – Ed Yardeni coined the term bond vigilantes long ago to describe the corrective discipline bond markets can enforce on politicians and investors who are out too far over their skis.

The rise in yields on the 10-year Treasury has been pronounced enough that yields crossed above the earnings yield (TTM) on the S&P 500 for the first time since 2002. That comparison, known as The Fed Model (also coined by Ed Yardeni), had been made irrelevant after 20 years of Federal Reserve escalation of interventions aimed at propping up markets and the wealth effect. Money goes where it's treated best. First, it was cash, and now bonds are treating money better today than stocks.

Market Risk Index

Rec Allocation 25% Underweight

68.4%

Category Percentiles

Psychology - P5: 86.8%

Monetary - M3: 33.7%

Valuation - Extremely Overvalued: 95.3%

Trend: 24.7%

Largest Psychology Influences

Leveraged Investments	Negative
Option Activity	Positive
Bank Sentiment	Negative
Technical Indicators	Positive

Largest Monetary Influences

Interest Rate Spreads (Yield Curve)	Negative
Interest Rates	Negative
Lending & Leverage	Positive

Valuation

7-10 Year Equity Return Forecast	2.0%
10Yr US Treasury Yield	4.7%

Market Trends

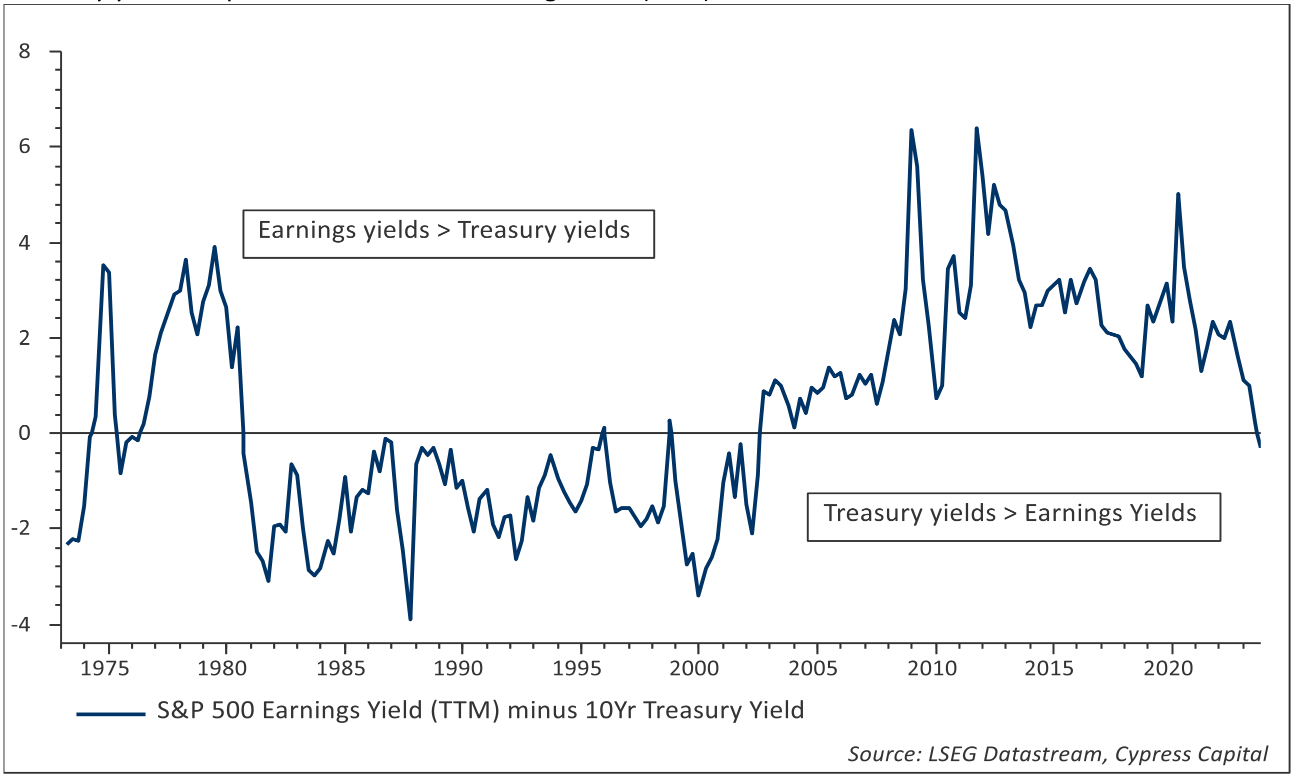
US Equities	Bullish Trade
Intl Equities	Bearish Trade
REITs	Bearish Trade
Broad Commodities	Neutral Trade

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

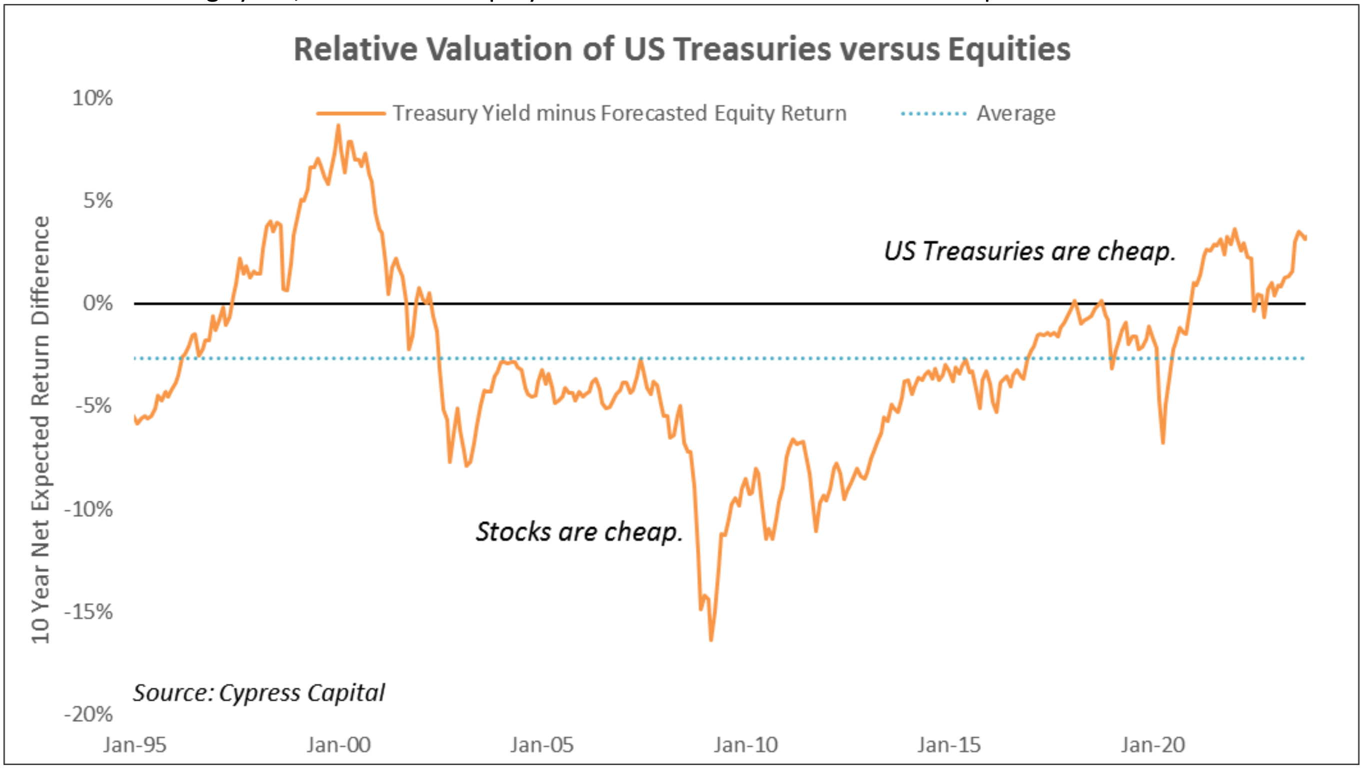
Is the Fed Model back?

Treasury yields surpassed the S&P 500 Earnings Yield (TTM) for the first time since 2002.



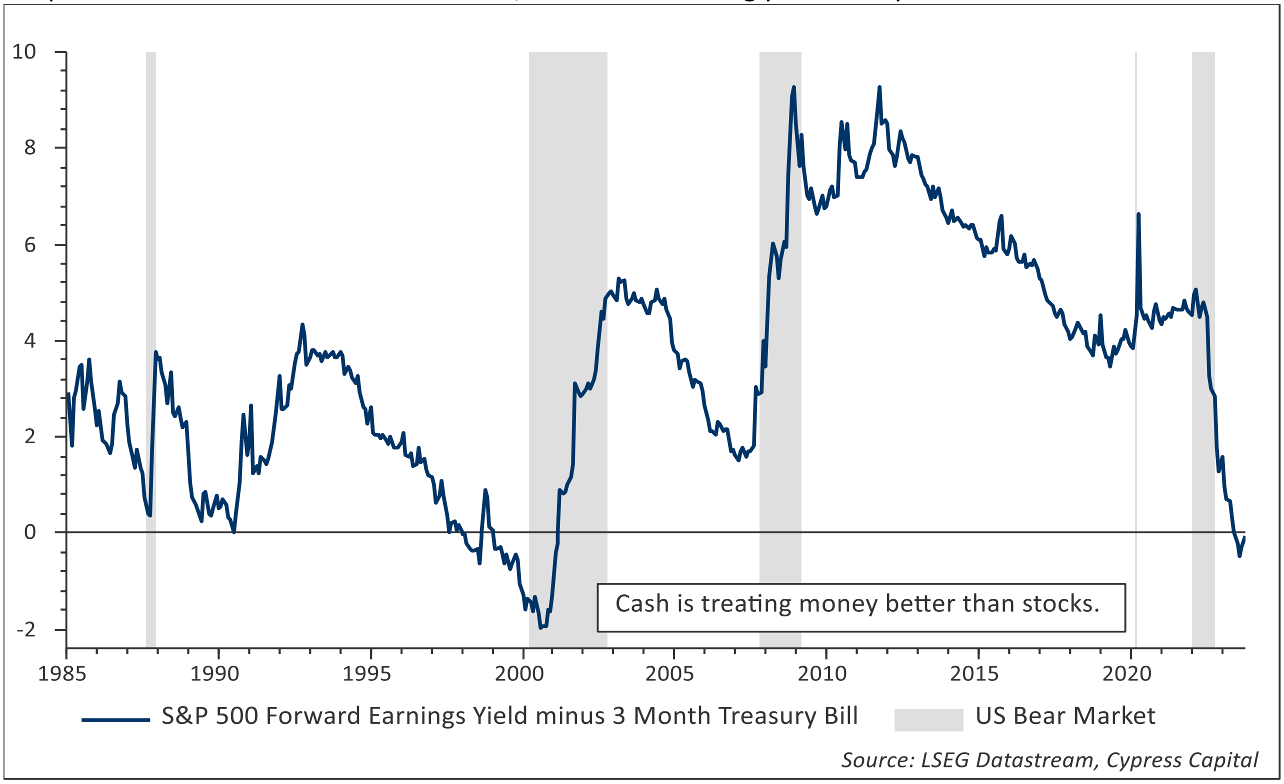
Stocks are as expensive relative to bonds as they were at the 2021 bull market peak.

Instead of earnings yield, this uses the equity return forecast of our Valuation composite.

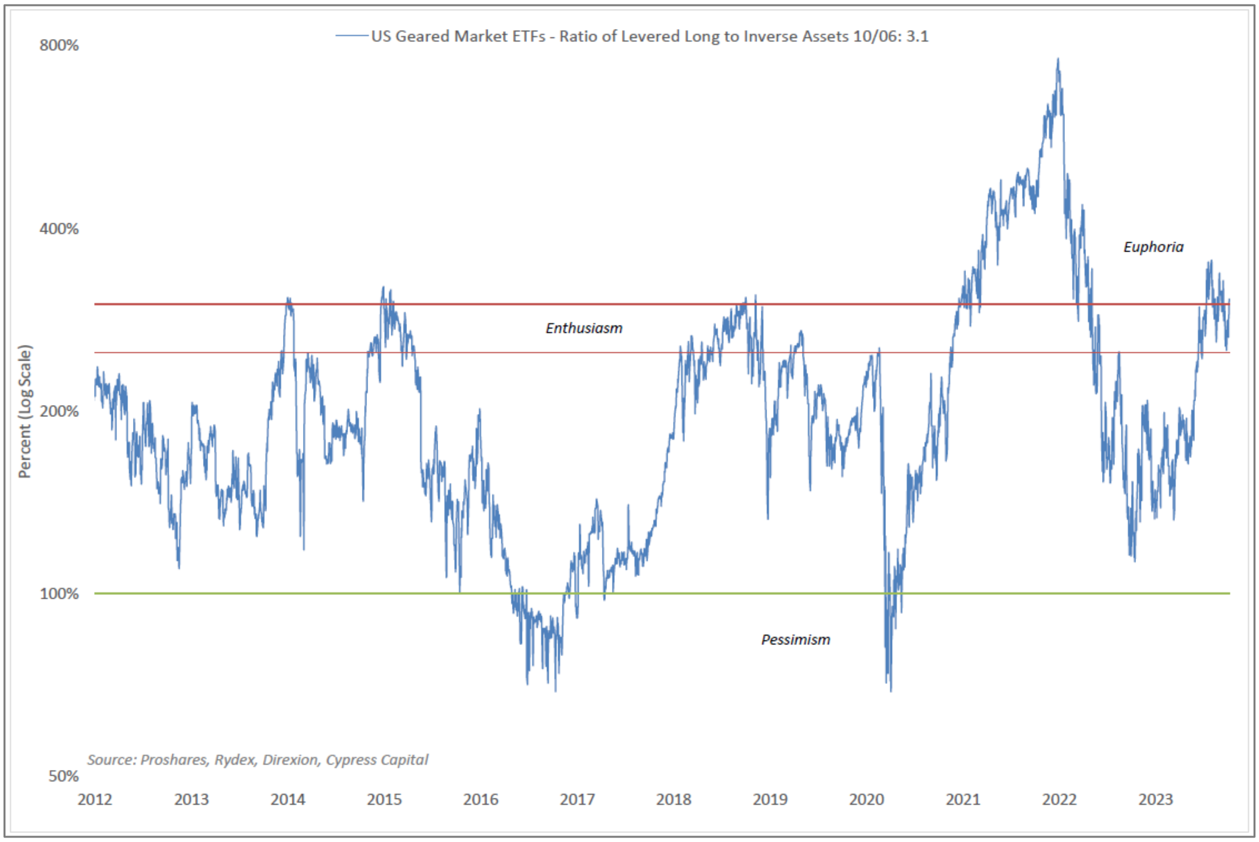


Treasury Bill yields are higher than the S&P 500 Forward Earnings Yield.

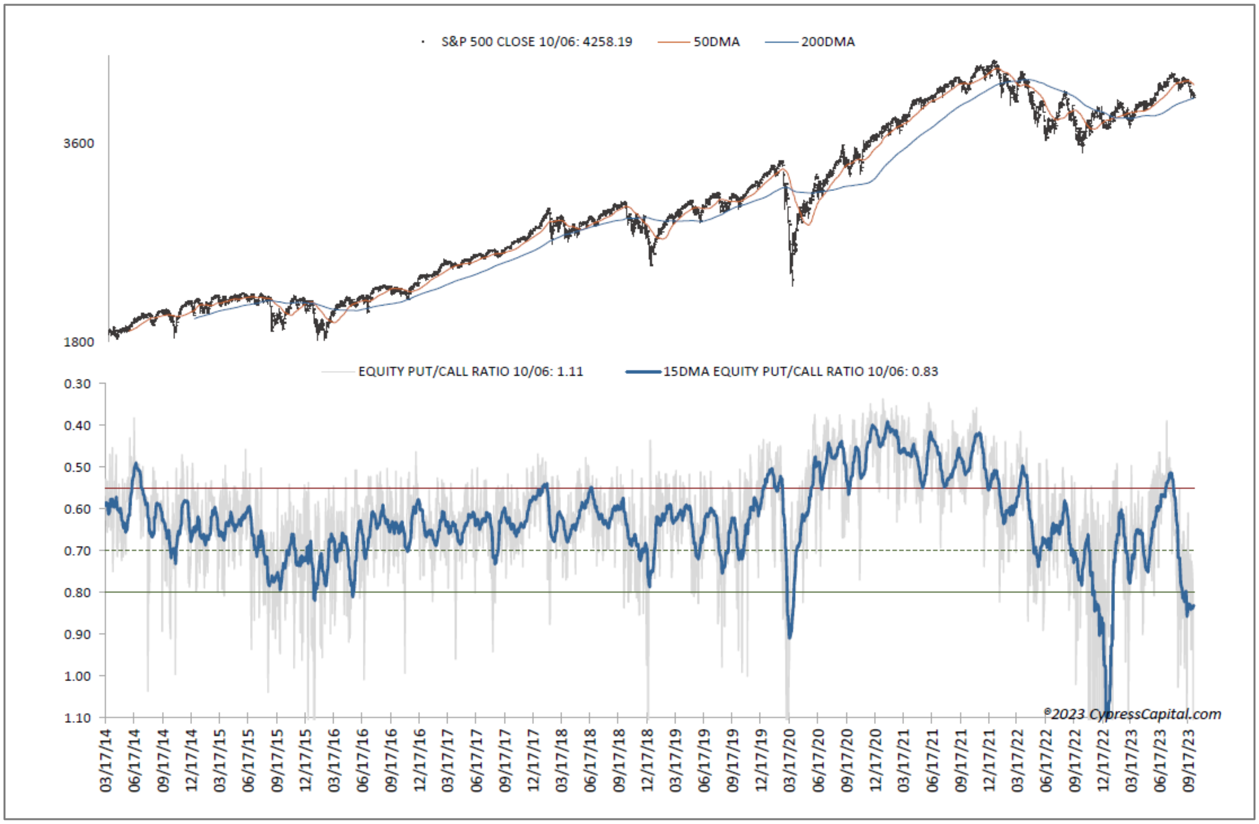
Despite the recent stock market correction, cash is still treating your money better.



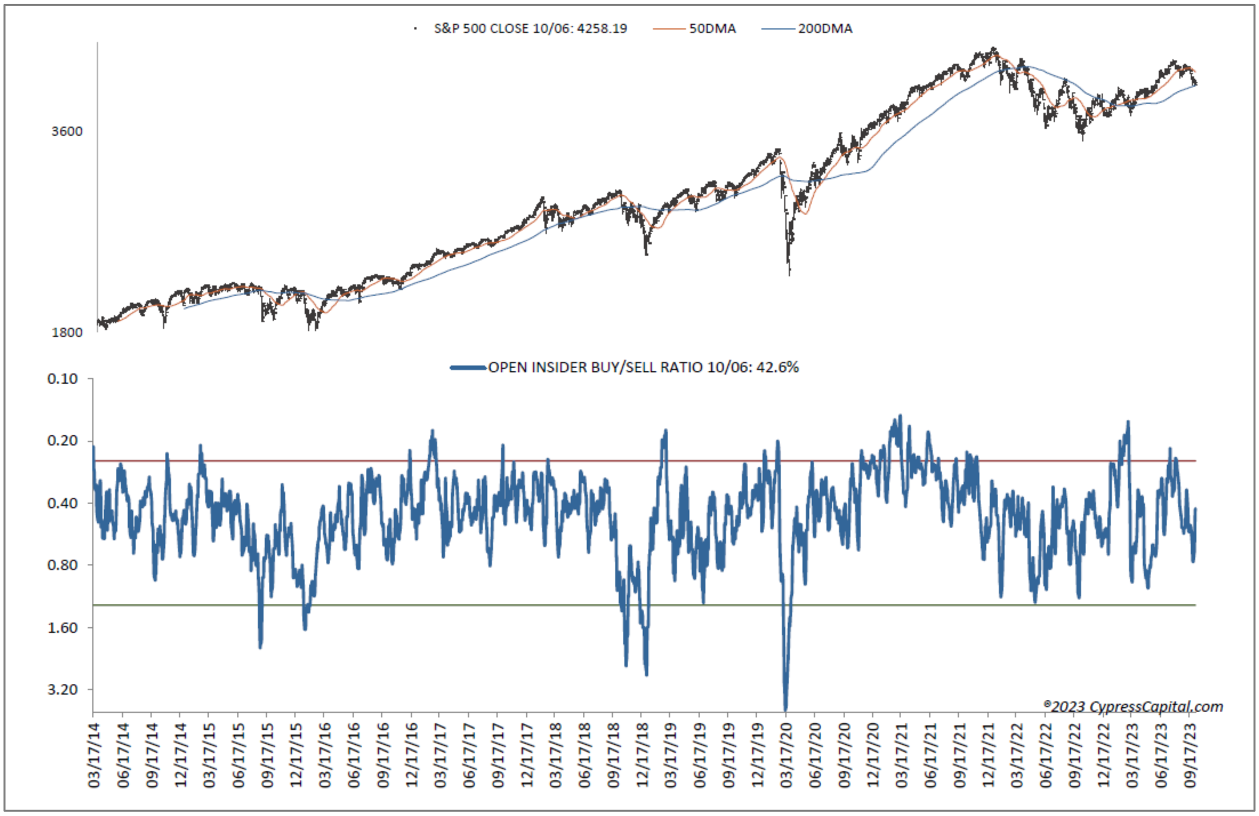
Leveraged Investors' sentiment pushed back into Euphoria.



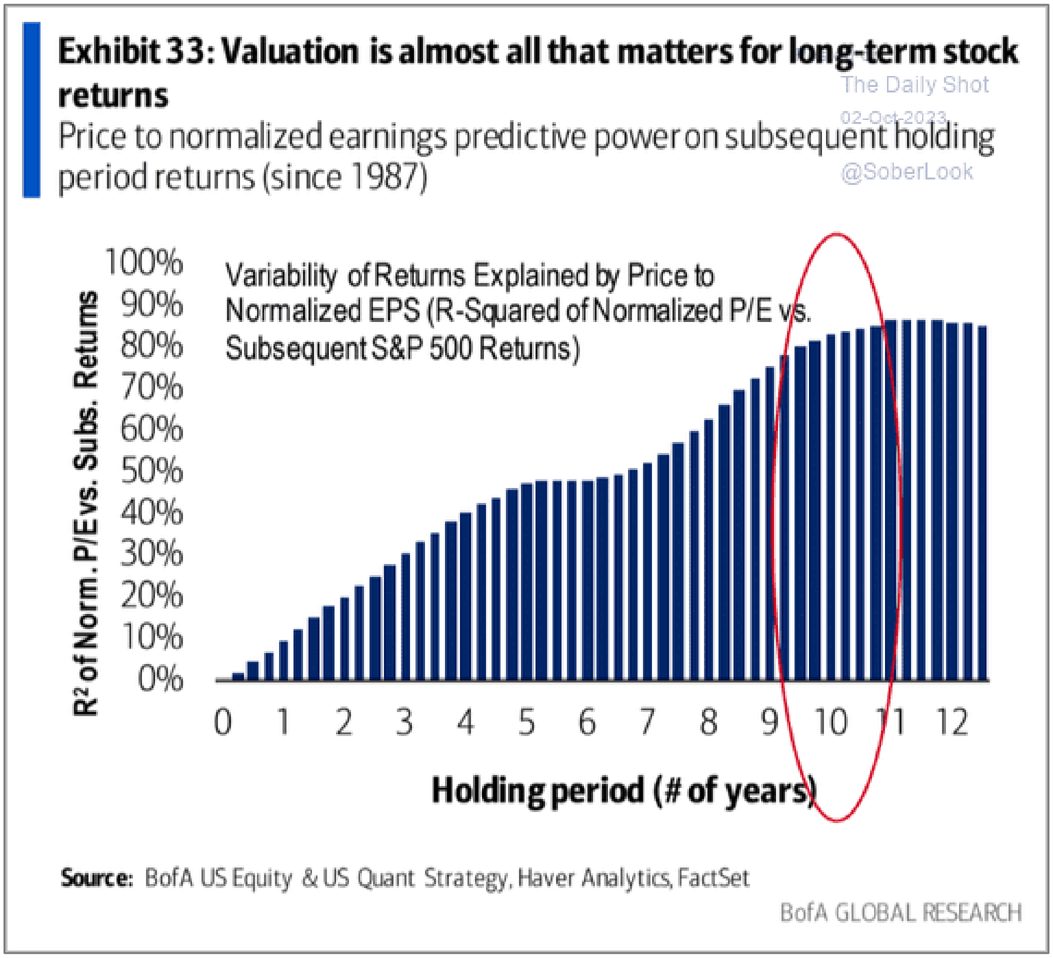
Put/Call Ratios are the lone set of investor psychology signaling a wall of worry.



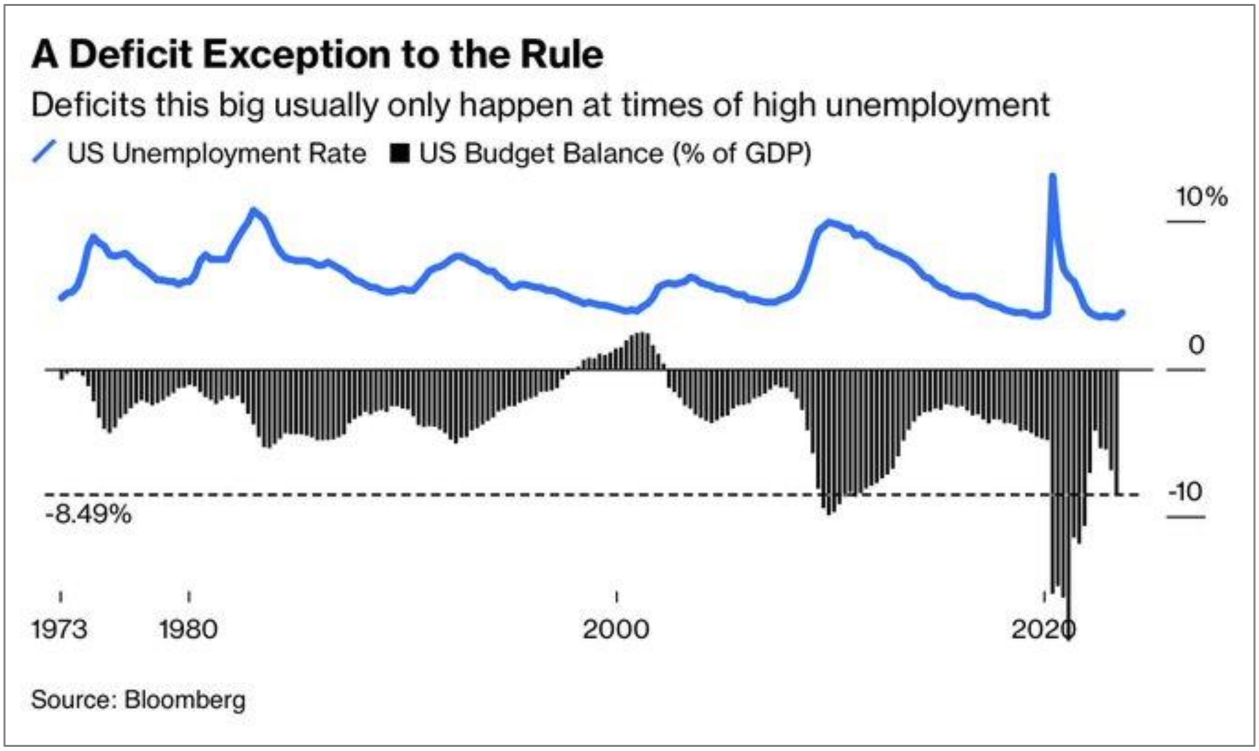
Corporate Insider selling ticked up in a volatile stock market week.



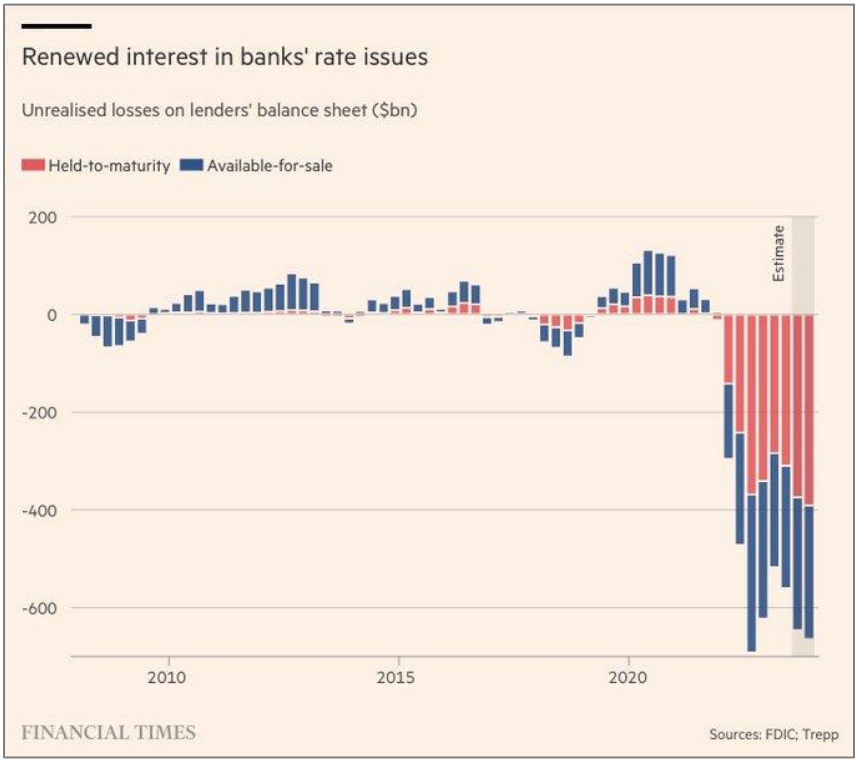
Valuation matters in the long-run.



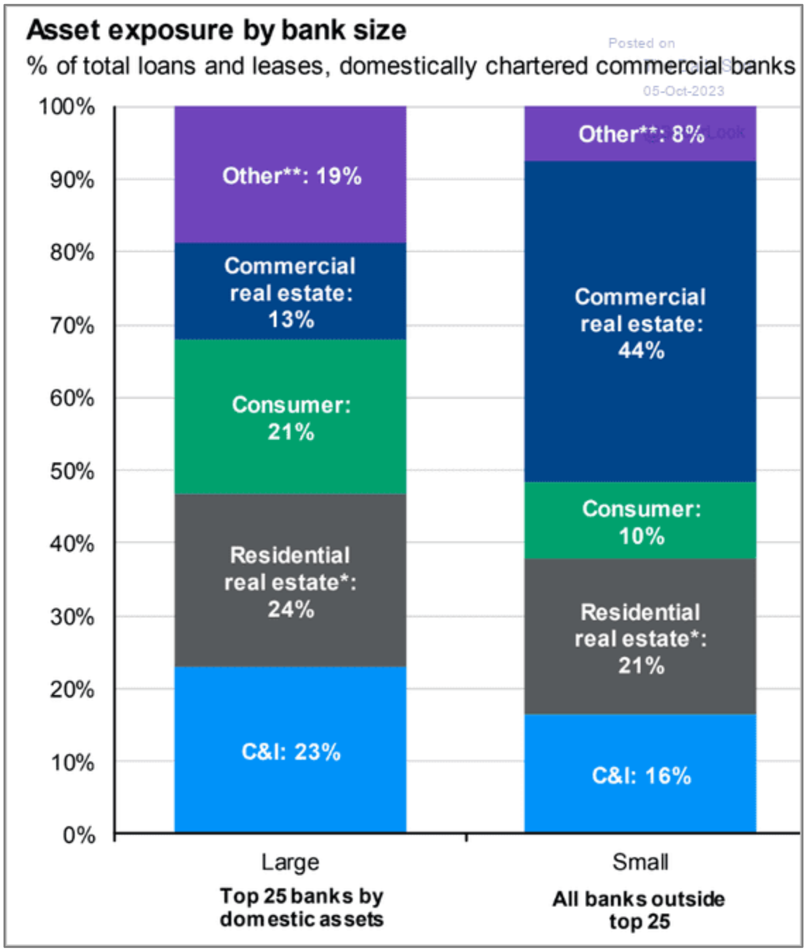
The government is running an 8% budget deficit in an economy with full employment.



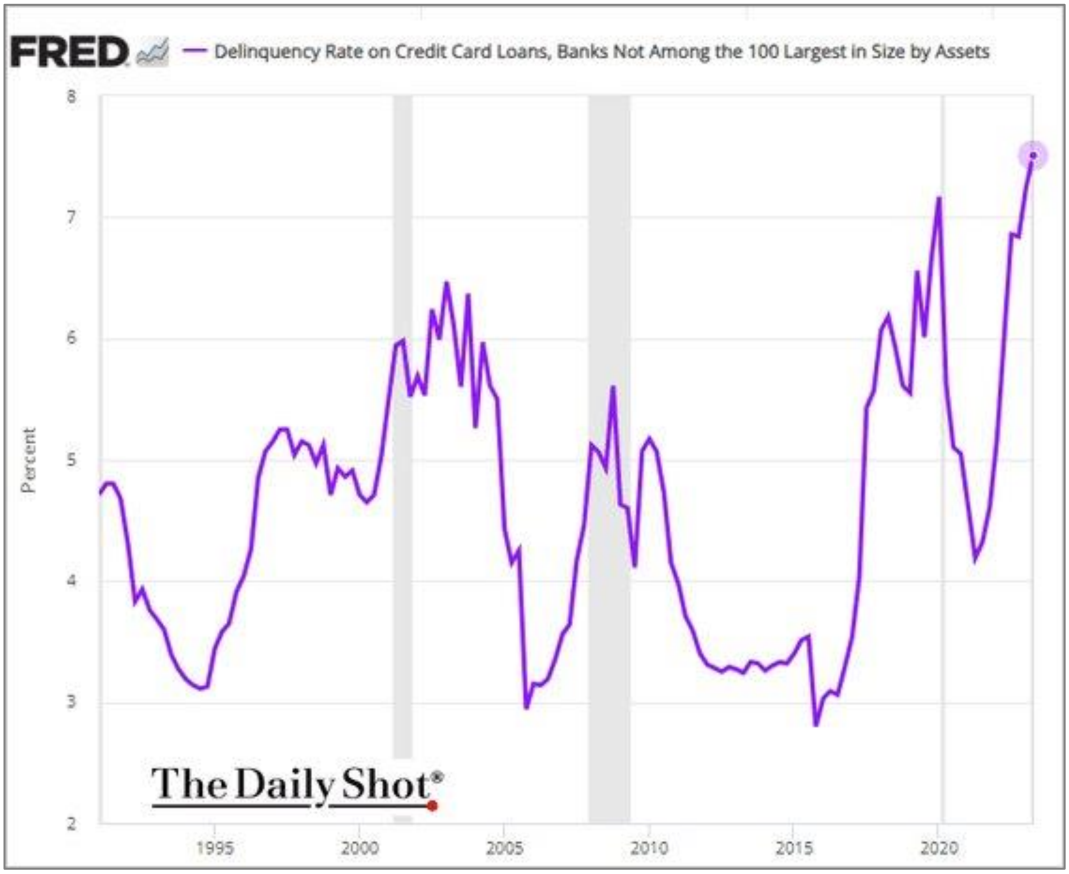
Unrealized losses at banks have worsened since the spring.



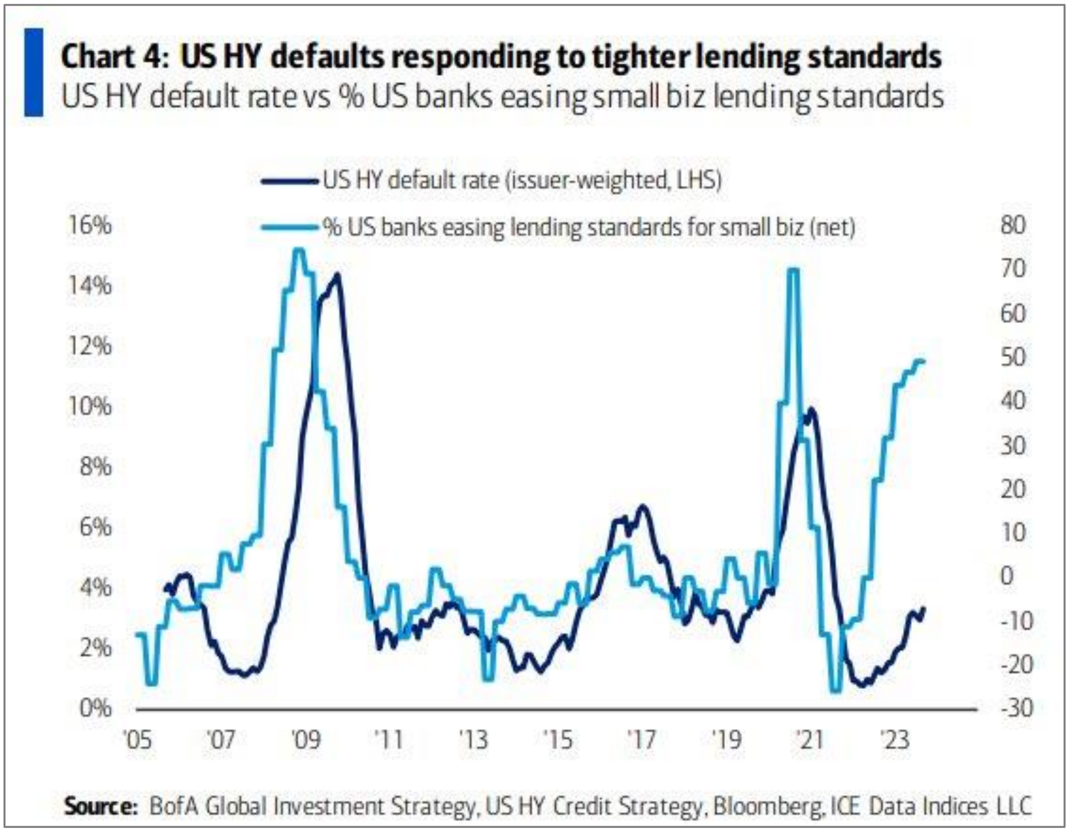
Small banks highly exposed to Commercial Real Estate.



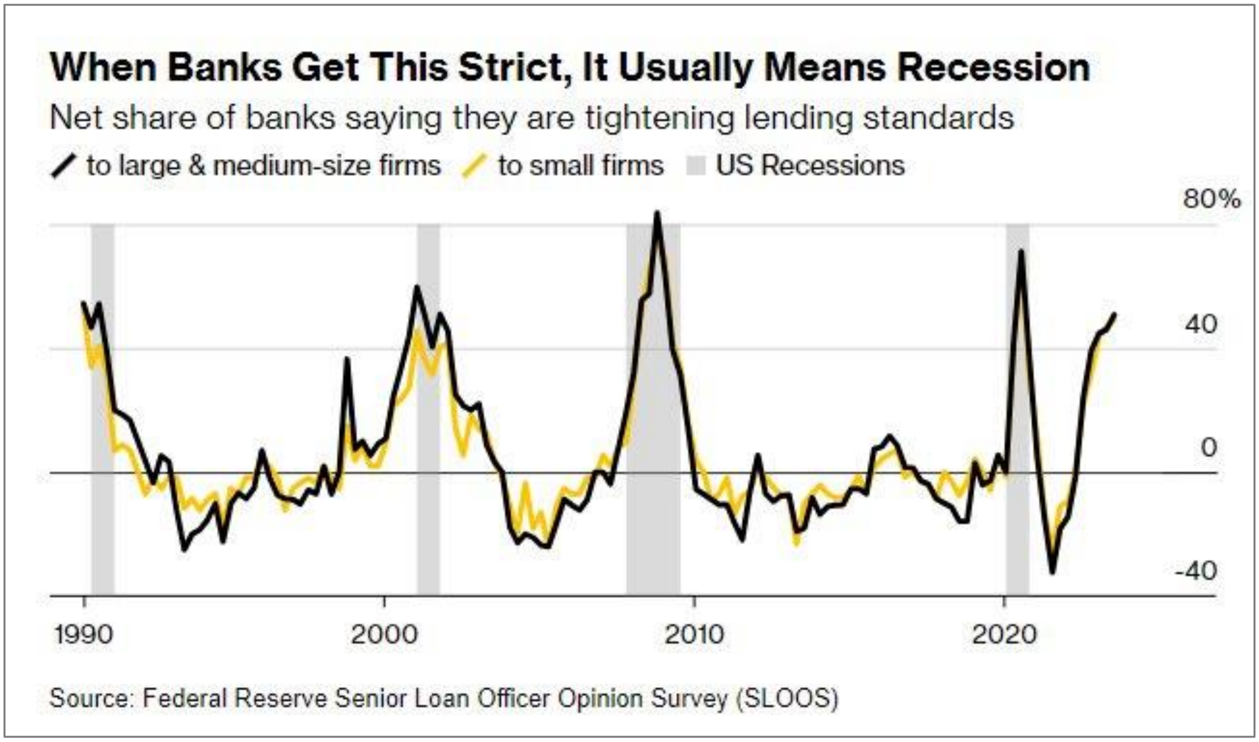
Credit Card Delinquencies set a new high.



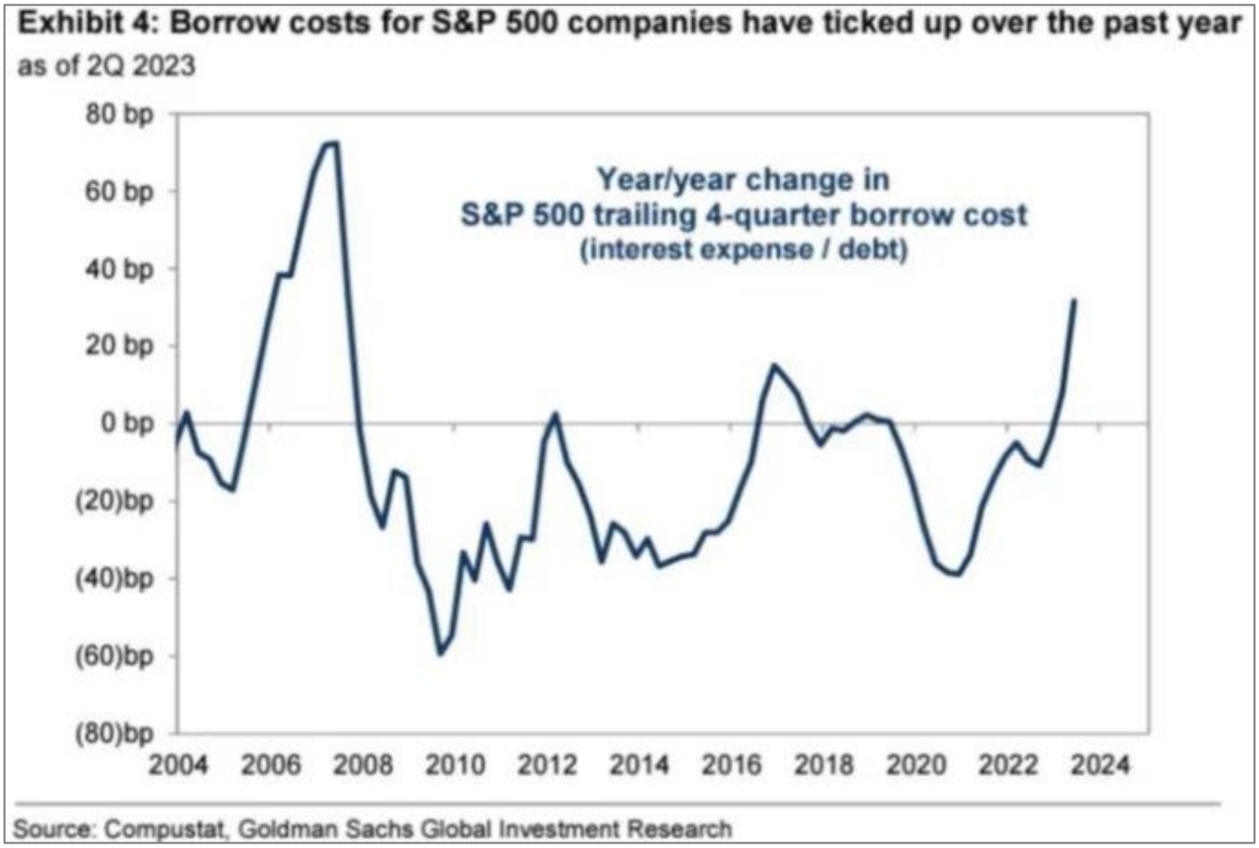
Expect to see higher default rates on High Yield debt.



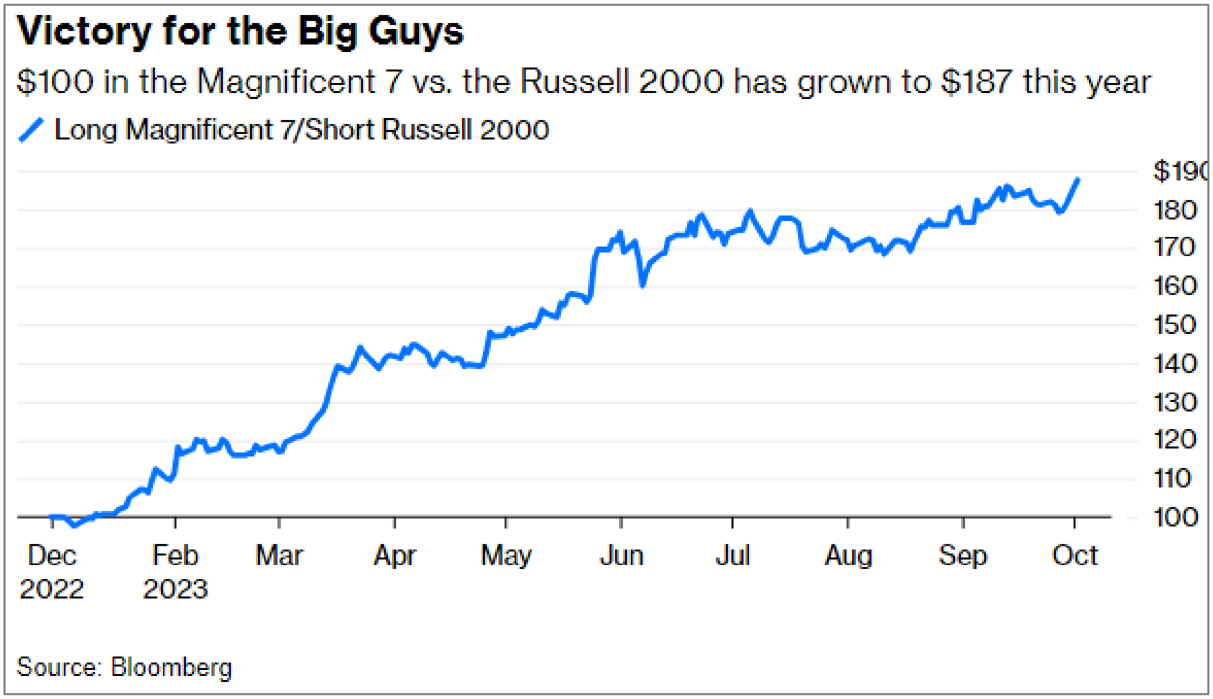
Tight banks signal recession.



Borrowing costs for S&P 500 companies is ticking up.



Going long the Magnificent 7 and short the Russell 2000 in 2023 has returned more than 85%.



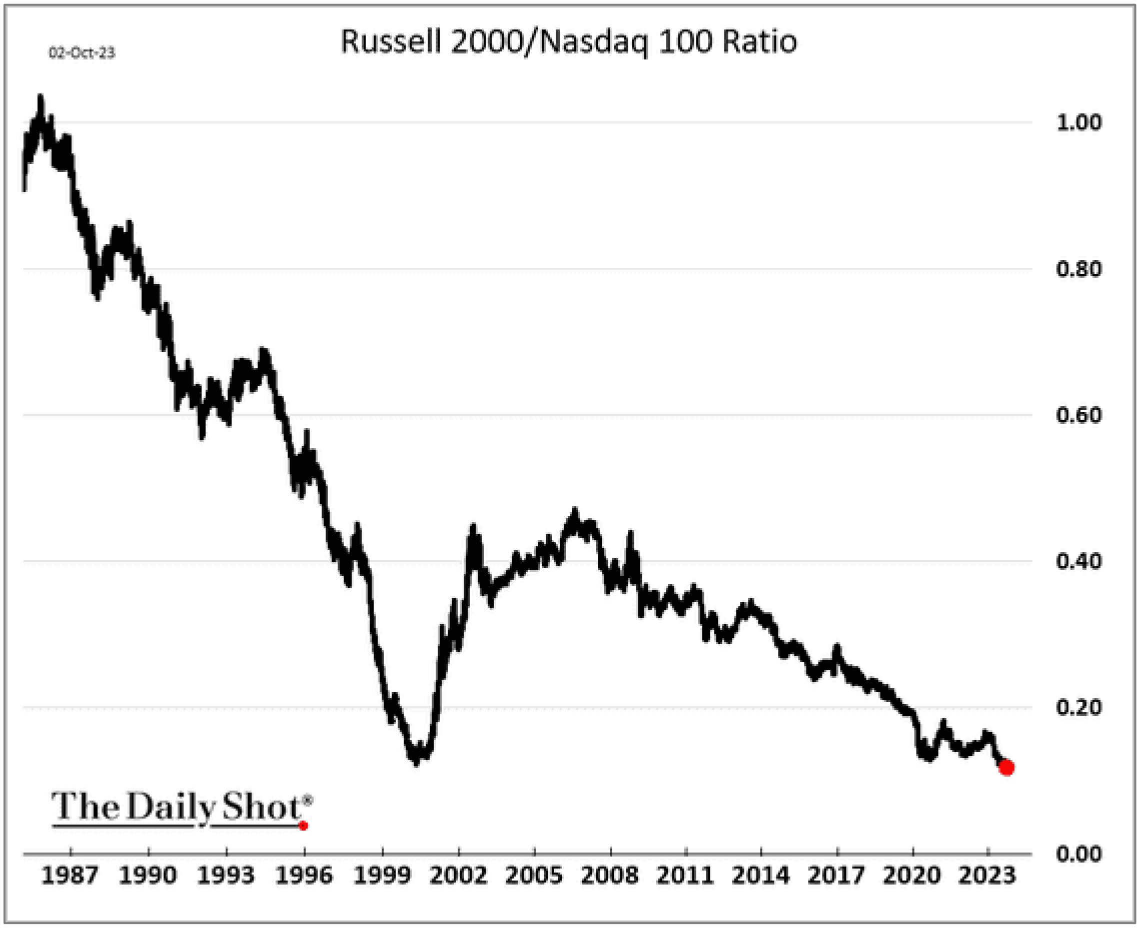
2023 is setting a record for top-heavy performance in the cap-weighted S&P 500.

Annual S&P 500 Contribution of 10 Largest Weights During Positive Performance Years

Year	Top 10 as % of Total	S&P 500 % Perf.
2023 YTD	**96.5%**	**11.7%**
2007	78.7%	3.5%
2020	58.9%	16.3%
1999	54.5%	19.5%
2021	45.0%	26.9%
1998	36.8%	26.7%
1996	33.9%	20.3%
2017	33.3%	19.4%
2019	32.8%	28.9%
1991	28.6%	26.3%
2006	27.6%	13.6%
2016	26.6%	9.5%
2003	23.6%	26.4%
1995	22.3%	34.1%
2014	22.2%	11.4%
2004	21.1%	9.0%
2005	20.5%	3.0%
2010	19.6%	12.8%
2012	19.2%	13.4%
1997	19.1%	31.0%
2013	17.6%	29.6%
2009	15.5%	23.5%
1992	14.9%	4.5%
1993	12.2%	7.1%

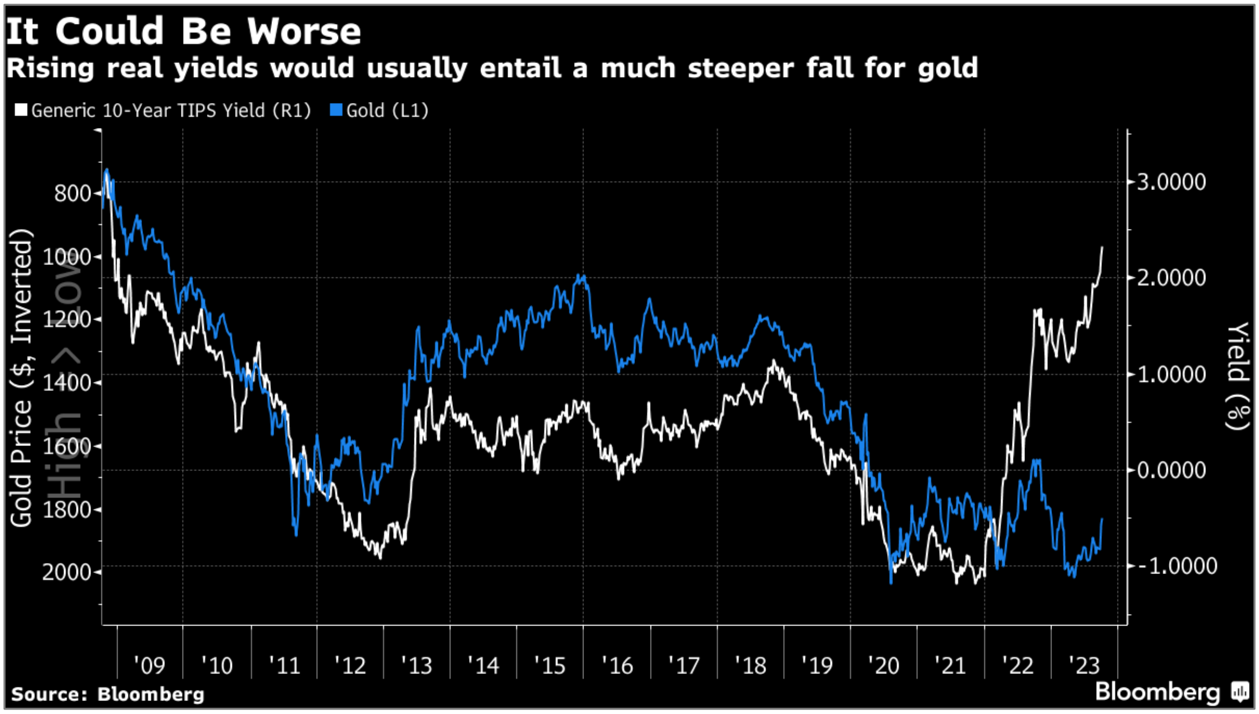
Source: @jessefelder, @nateGeraci, @Todd_Sohn

Relative under-performance of Russell 2000 versus the NASDAQ 100 is hitting the dot-com levels.



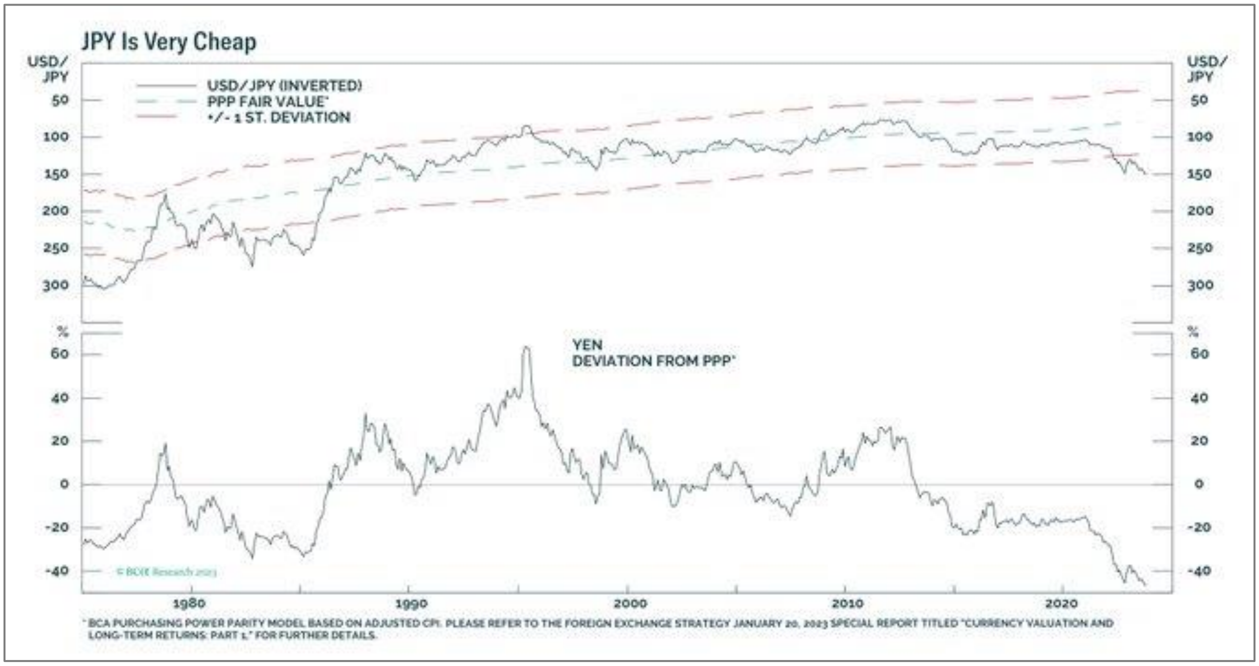
Largest Seven stocks make up more of the stock market than at the peak of the dot-com bubble.

Gold is faring better than TIPS suggest they should.

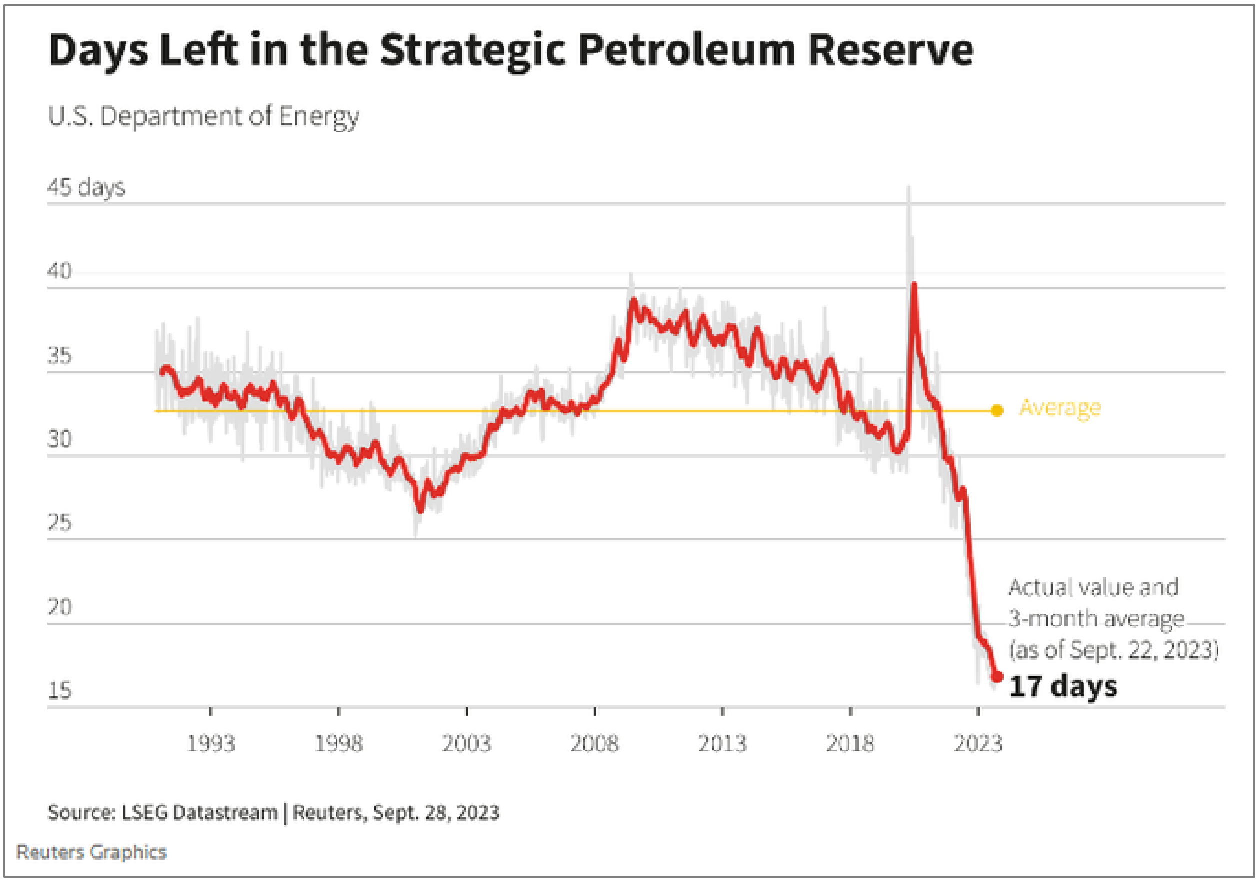


US has built homes at a slower pace than the rest of the world.

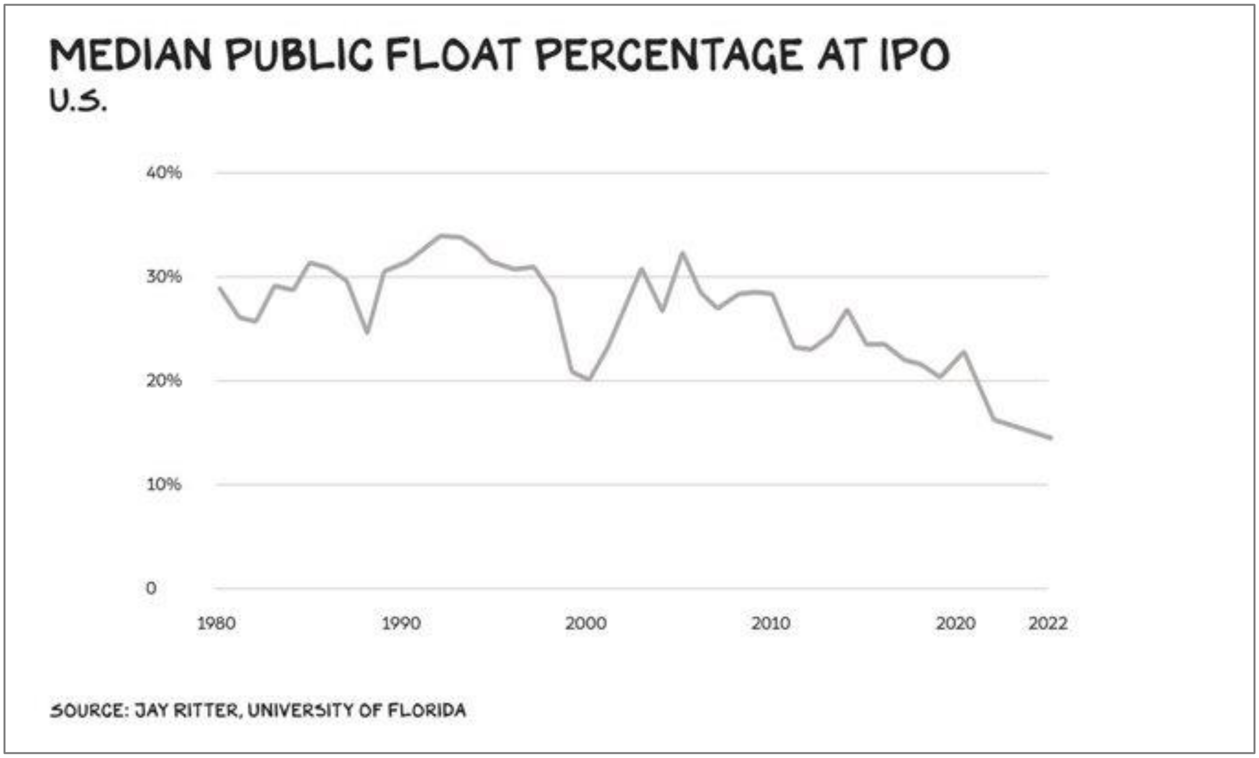
The Japanese Yen hasn't been this cheap in more than 45 years.



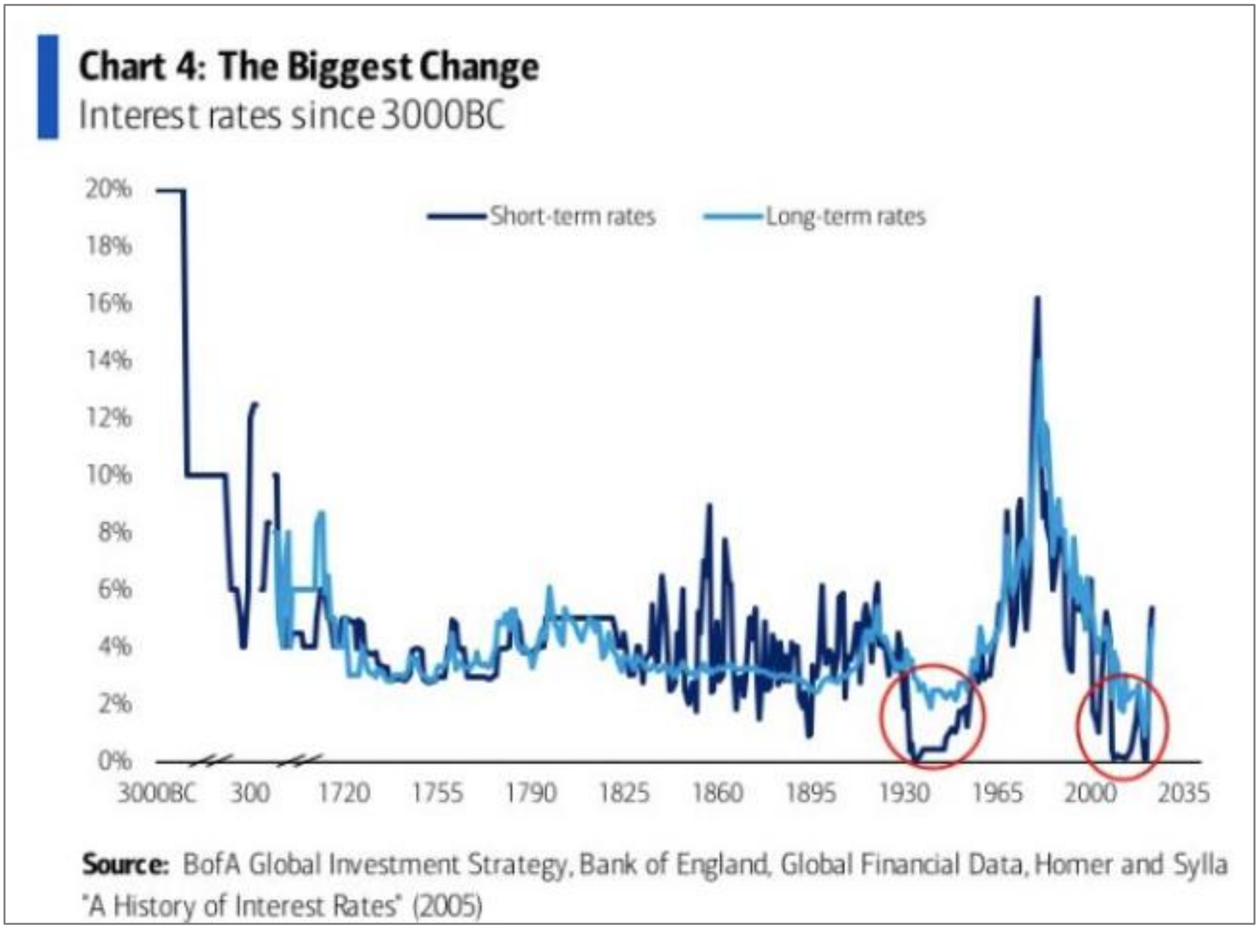
Lowest Strategic Petroleum Reserve inventory in over 30 years.



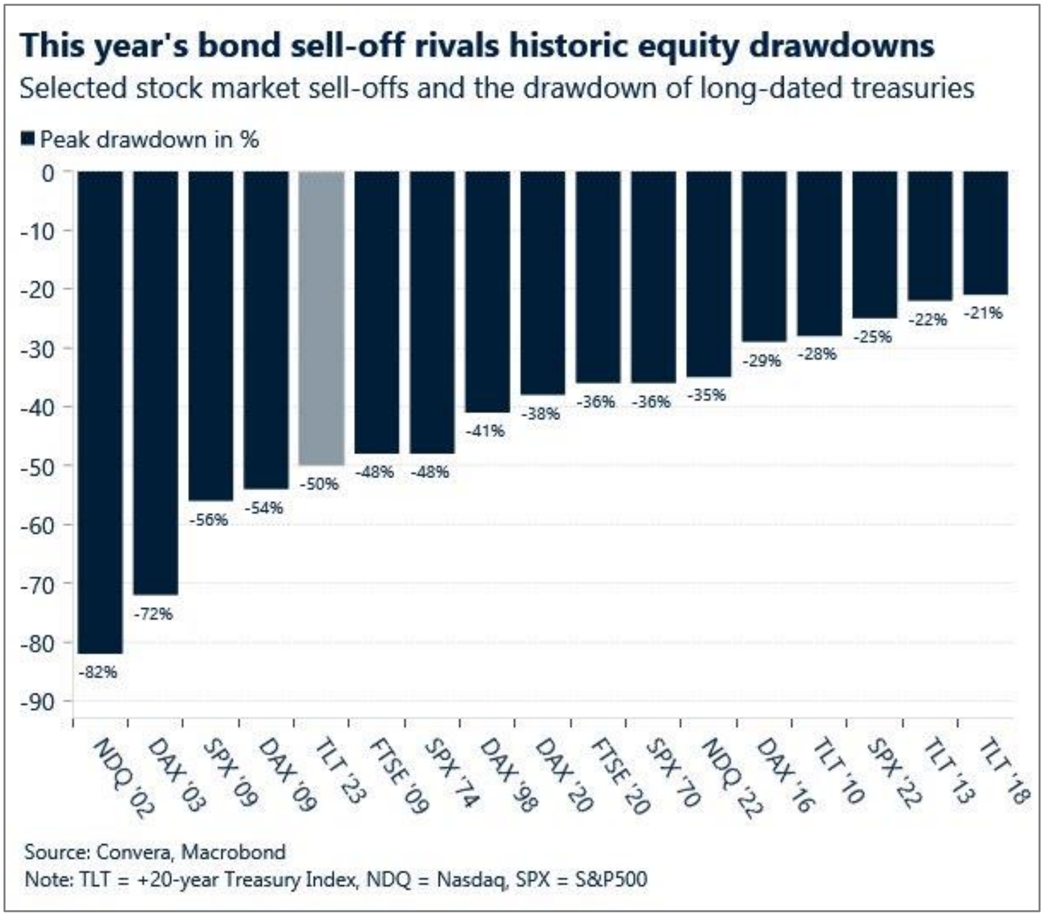
Float percentage from IPOs is at record lows.



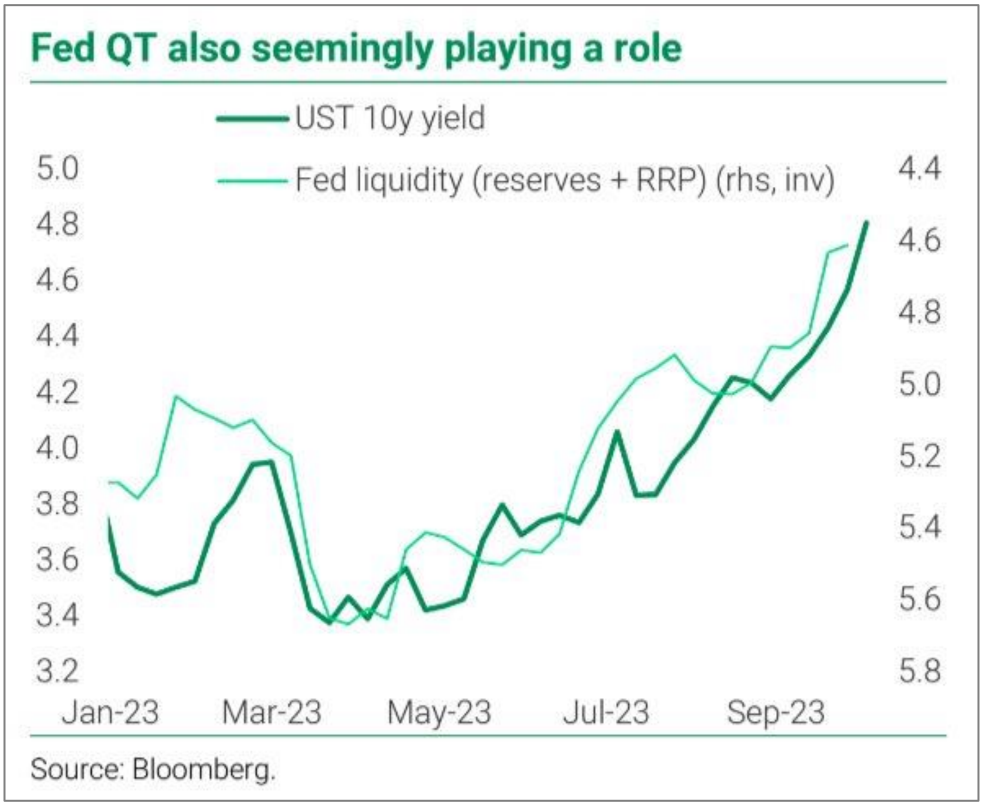
Hope you locked in your mortgage when rates were at 5,000 year lows.



The drawdown in Long-Dated Treasuries has been worse than the 1974 stock bear market.



Does Quantitative Tightening explain some of the recent rise in rates?



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.