Market Outlook

By Mark T Dodson, CFA

Colicky Bull Market Turns One

Market Risk Index dropped for the third week in a row, falling to 62.1%. Psychology is on the move, as the Investor Surveys Category has started to improve, joining the Options category as a more bullish influence on markets. Within the Options Category, the Total Put/Call Ratio hit the highest level since the 2020 bear market low.

Still, Psychology has a vast gulf to cross before it even intersects the threshold from greed to fear. Leveraged Investors are in a euphoric holding pattern, and corporate insiders haven't shown interest in buying the average stock despite a sharp sell-off in small-cap stocks.

The aggressive pursuit of leverage isn't coming solely from US Investors. As reported in the Financial Times this week, South Korean investors make up nearly a quarter of the assets in the Direxion Semiconductors 3x ETF. Regulators in South Korea were described as vowing *"to curb short-term speculation by retail investors, as their bets on tech stocks fuel fears of a market bubble."*

On the Market Trend front, the trend for Broad Commodities turned bearish, joining both International Equities and REITS. The Trend for US Equities remains Bullish Trade – solely on the strength of the Magnificent Seven stocks as they buoy the top-heavy market cap-weighted indices.

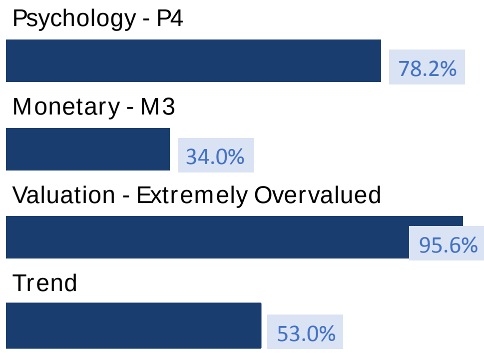
The bull market turned a year old this week, and she's a colicky baby bull. A year in, the strength of the Magnificent Seven stocks is nearly the only sign of a bull market. Small caps are down year-to-date. The yield curve is inverted, yields are breaking out to multi-year highs, and Treasury Bills are paying more than stocks. Technically, it's a bull, but it's nothing like the start of any bull market we have experienced. We believe history will likely remember this environment as an abnormally long reprieve within an ongoing bear market.

Market Risk Index

Rec Allocation 25% Underweight

62.1%

Category Percentiles



Largest Psychology Influences

Leveraged Investments	Negative
Bank Sentiment	Negative
Option Activity	Positive
Consumer Confidence	Negative

Largest Monetary Influences

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

Valuation

7-10 Year Equity Return Forecast	1.8%
10Yr US Treasury Yield	4.6%

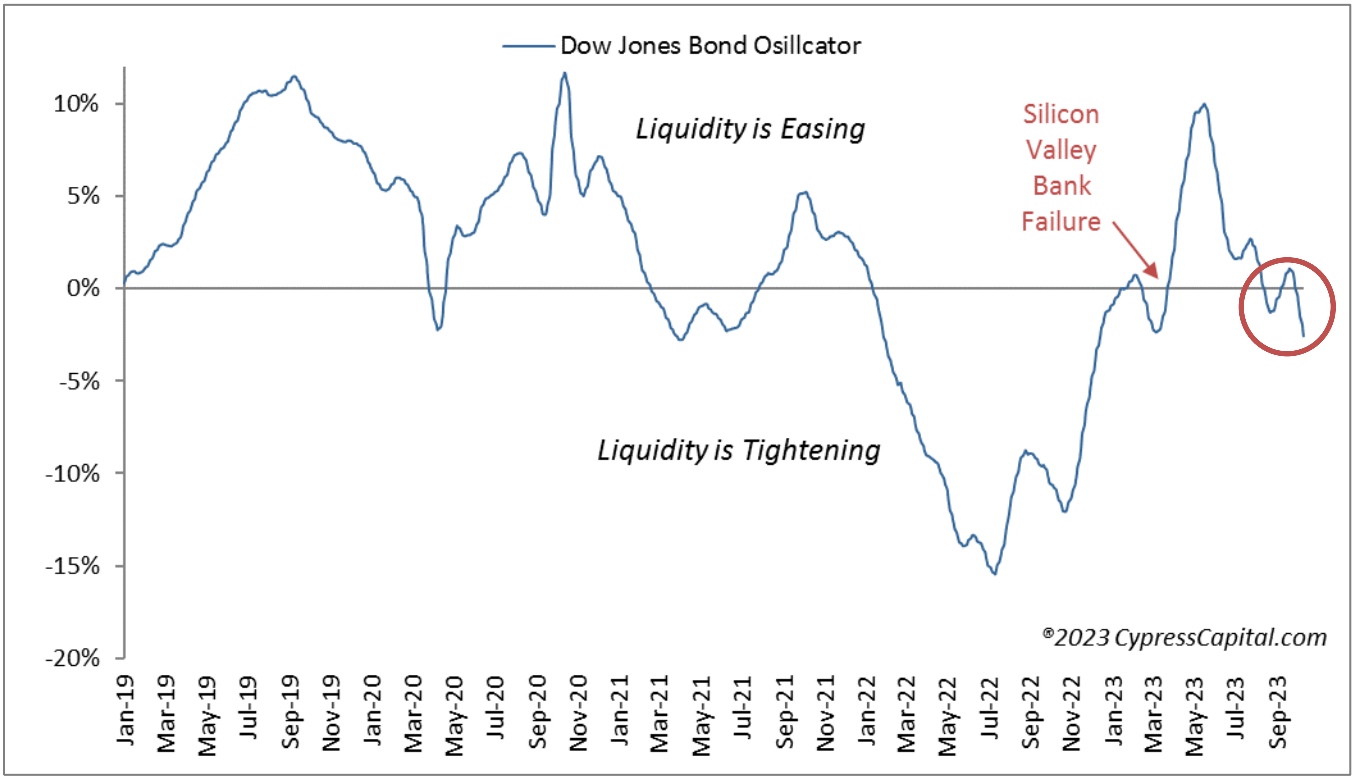
Market Trends

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

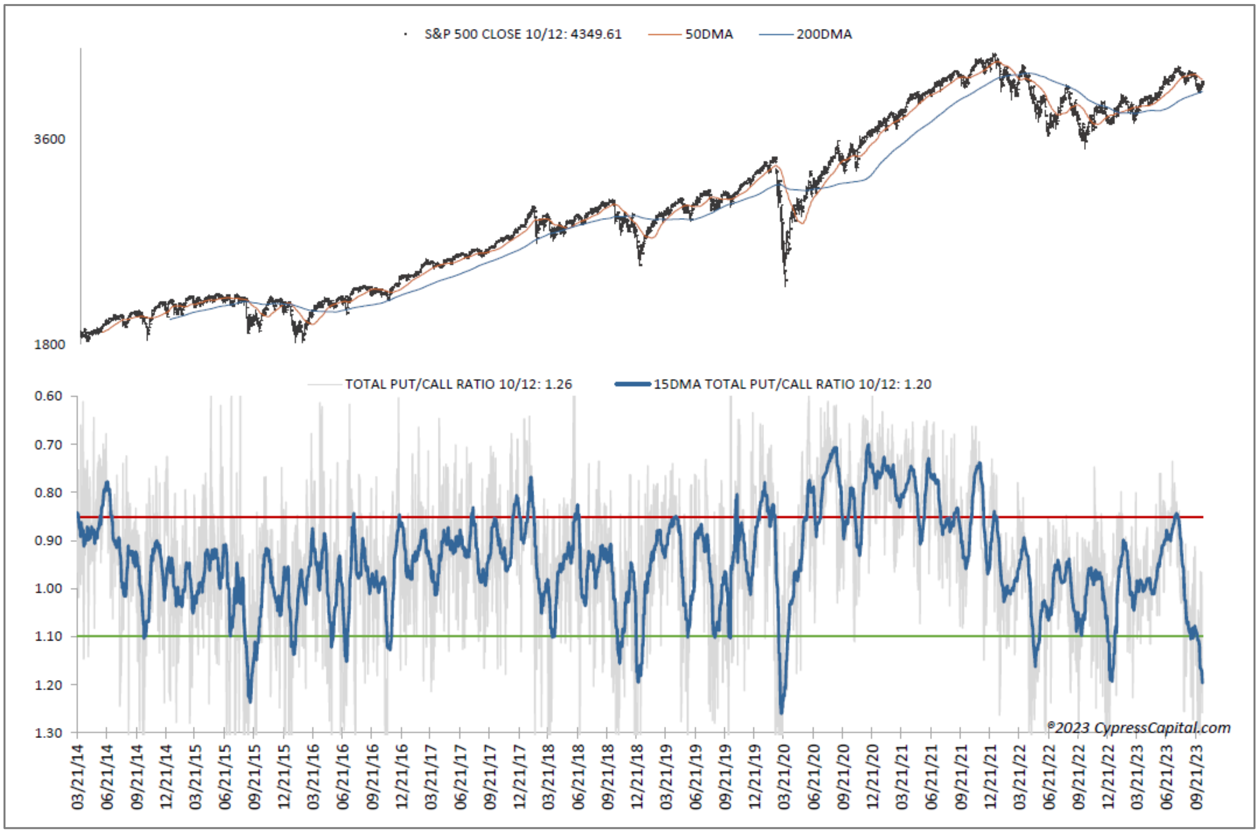
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

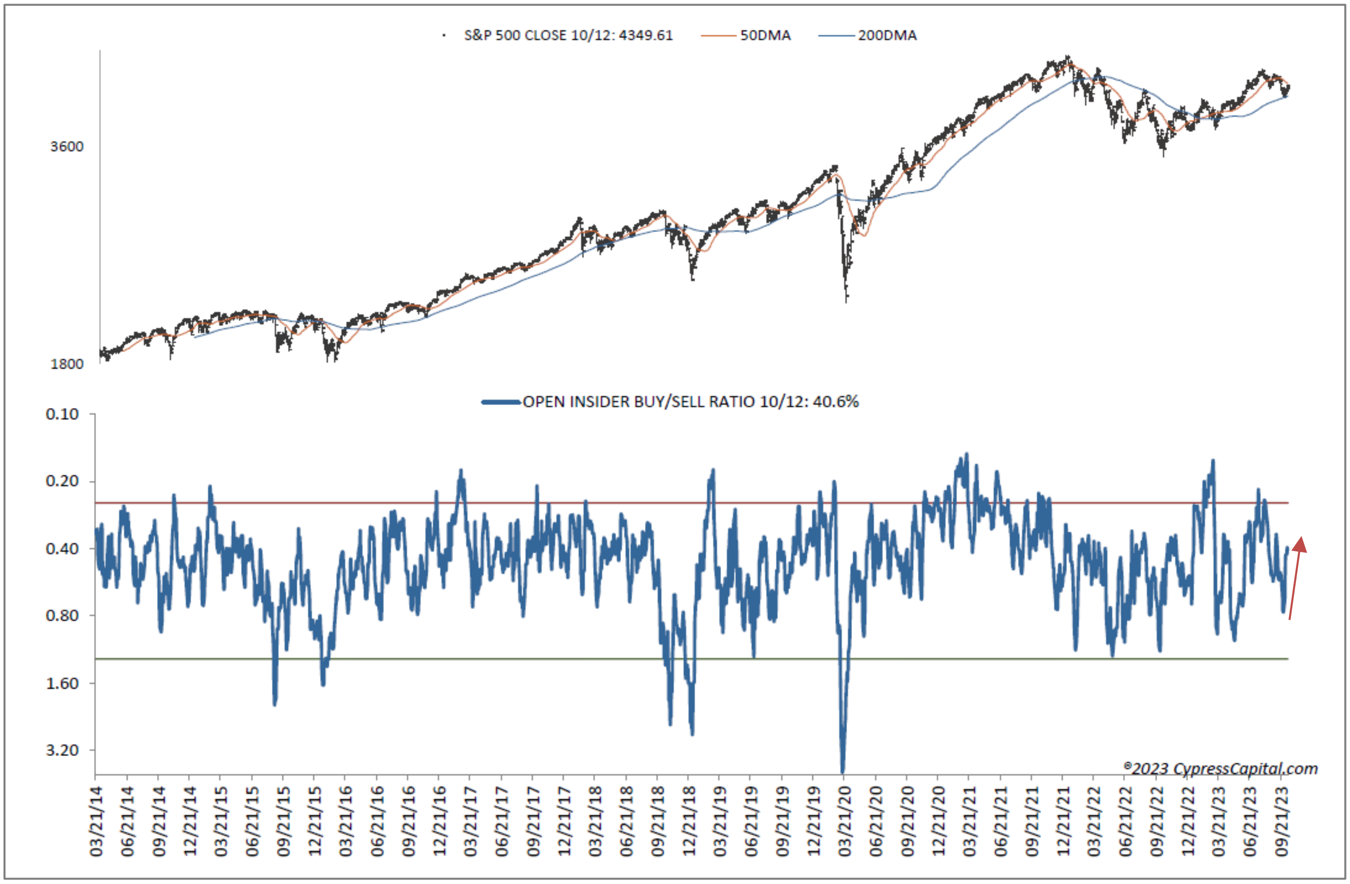
Bond Vigilantes are tightening the liquidity screws.



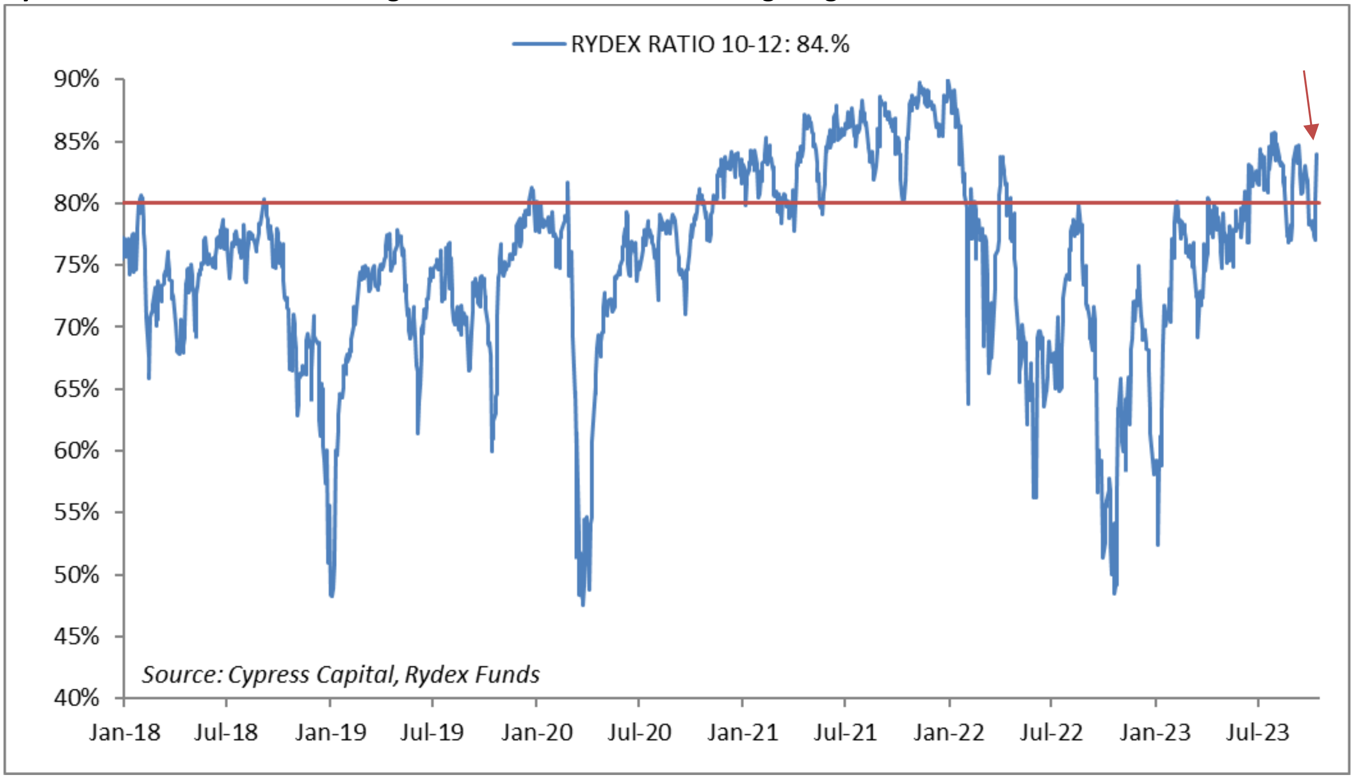
Total Put/Call Ratio indicates the most fear since the 2020 bear market.



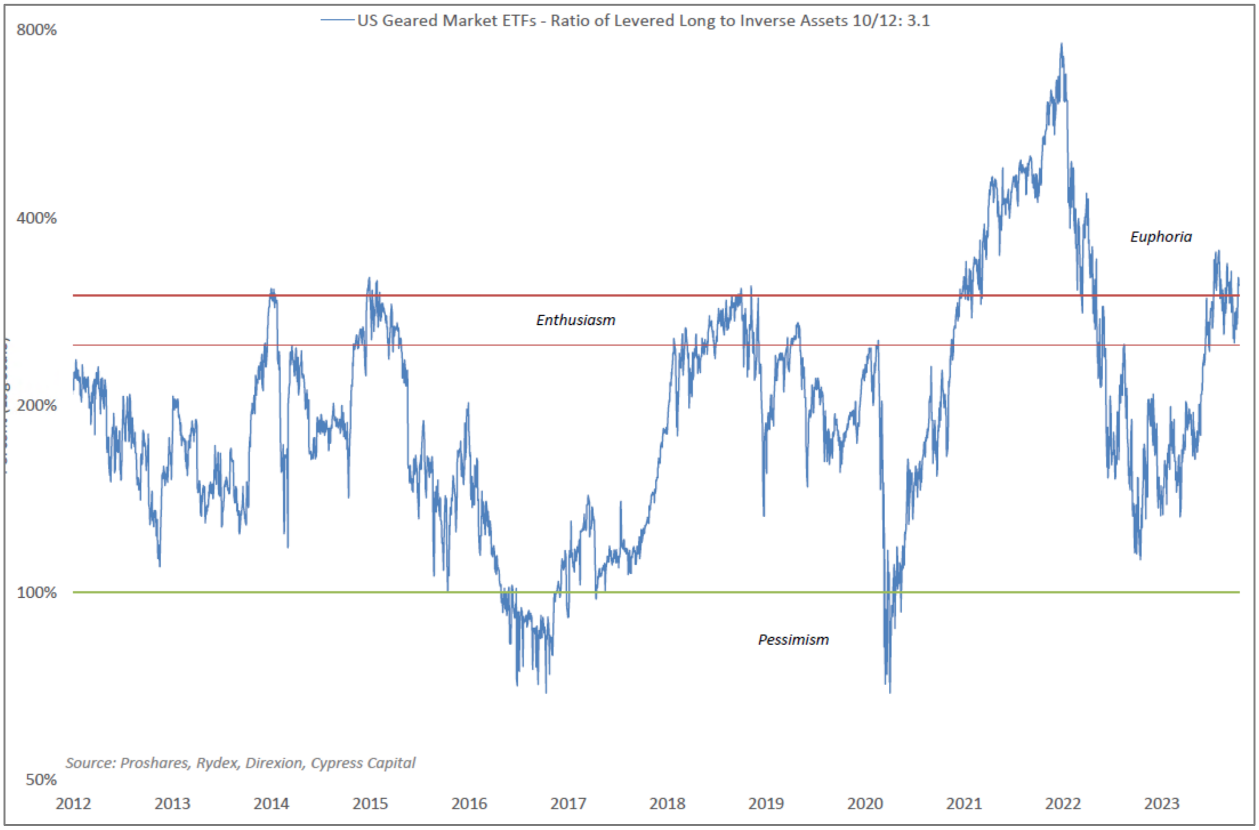
Corporate Insider selling increased again this week.



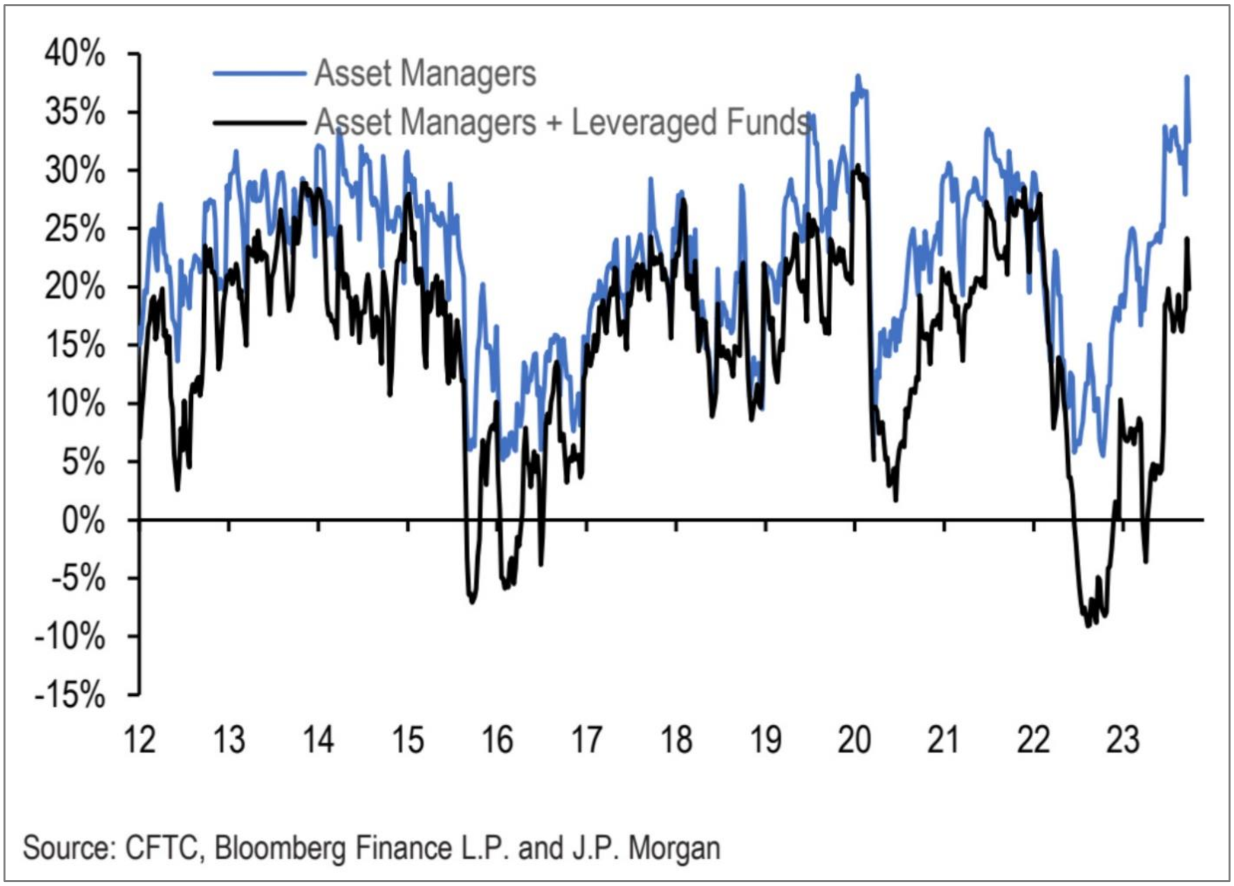
Rydex Ratio recovered – Leveraged investors aren't afraid of fighting the Fed.



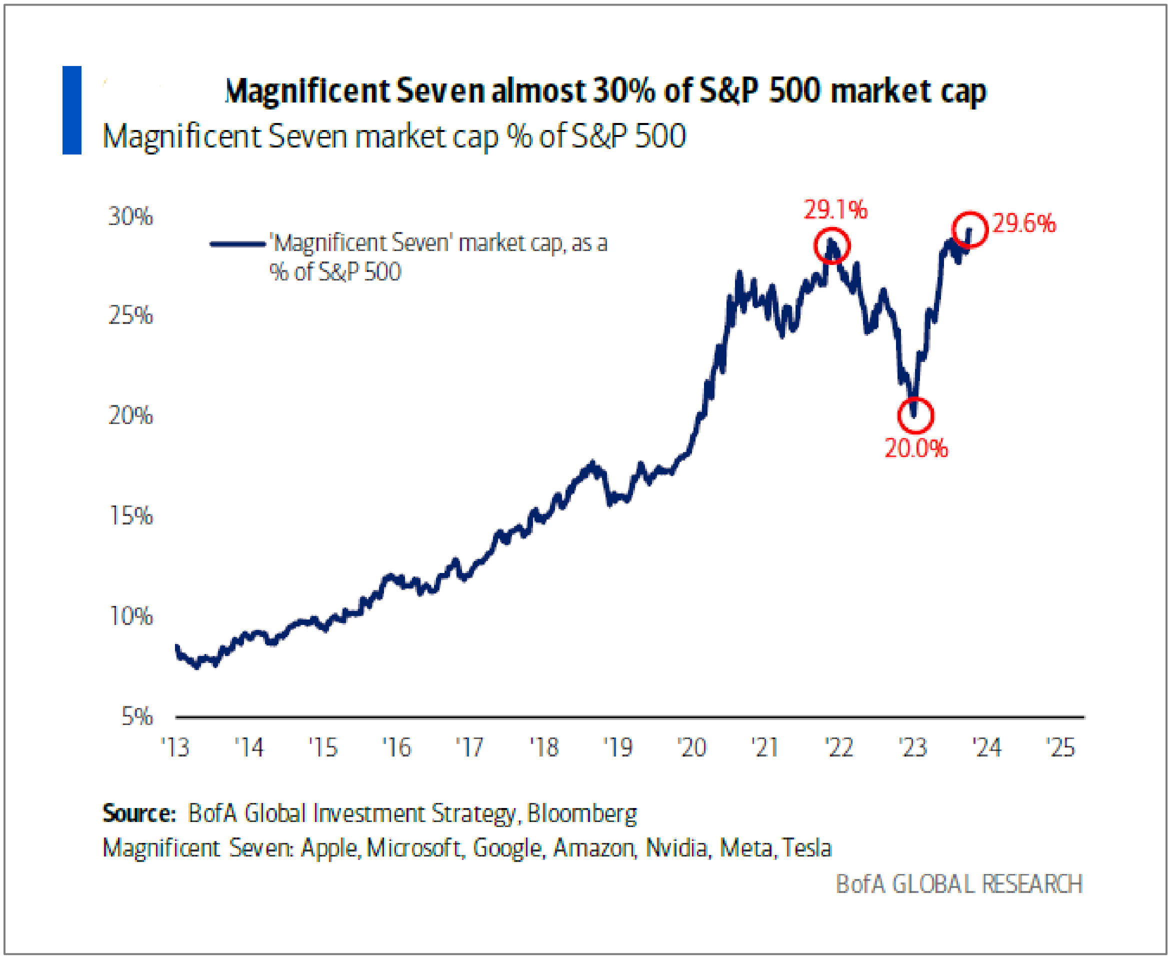
Similarly, Leveraged ETF investors have rebounded back into Euphoria.



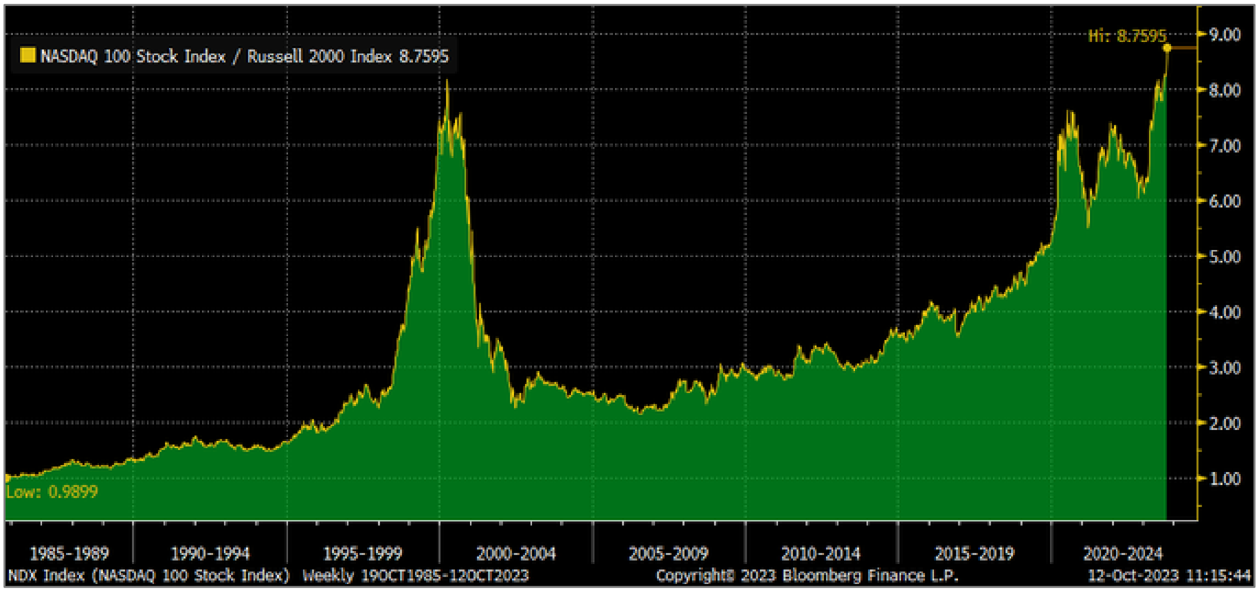
Net Equity Exposure among Asset Managers is near record highs.



Magnificent Seven weight in the S&P 500 at all-time highs.



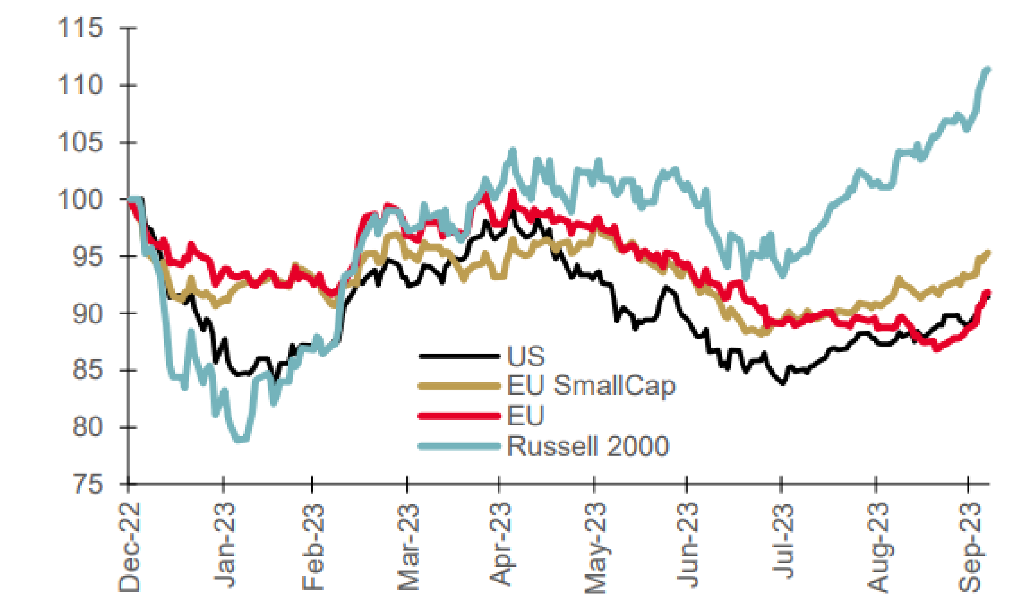
NASDAQ 100 to Russell 2000 relative performance is at all-time highs.



Strong is outperforming weak.

Stocks with solid financial positions have dramatically outperformed stocks with weak financial positions in the Russell 2000 since the start of the year.

Strong vs Weak starting to outperform (long vs short distance to default portfolios)



Source: SG Cross Asset Research/Quant Research, FactSet

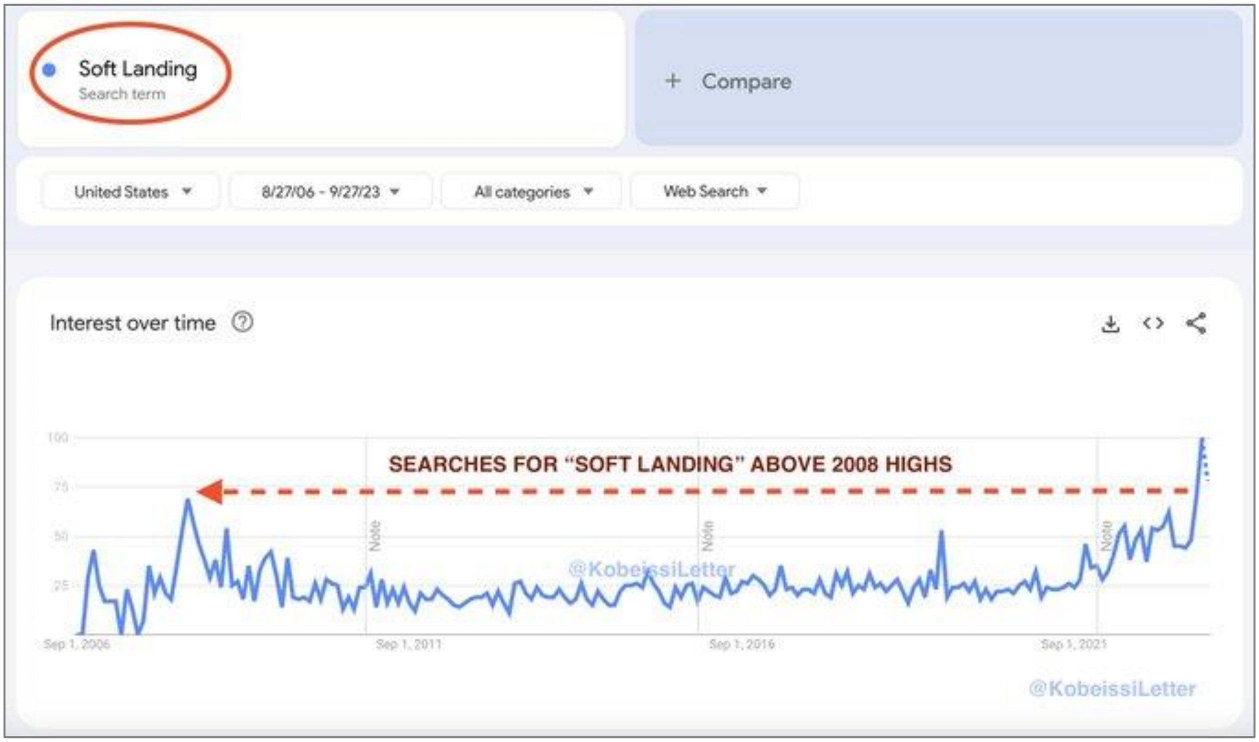
Small Cap Underperformance, like today, is a valid Recession Signal.

Recession chances based on Small Cap - Large Cap spread thru TDY #193

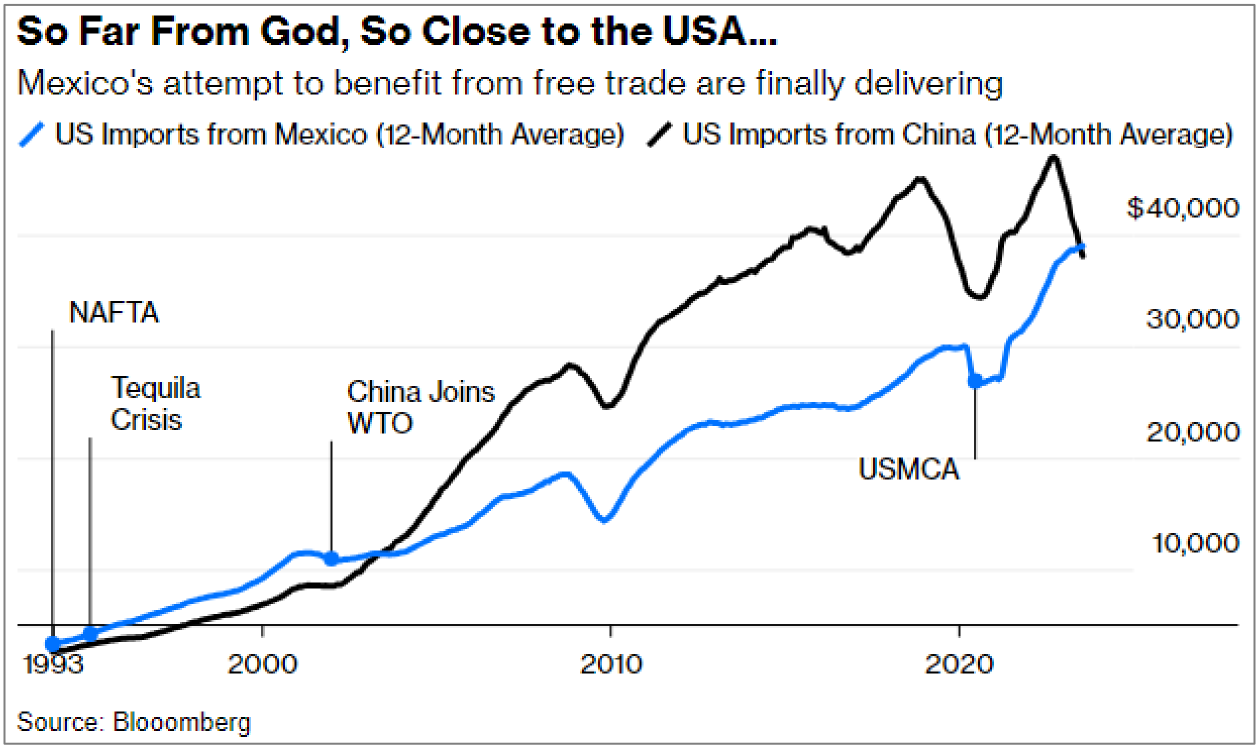
	Recession within...					
	3 Months	6 Months	9 Months	1 Year	2 Years	3 Years
	Years when Small Caps underperform by < -10%					
# of Signals	7	7	8	8	9	10
# Preceding Recession	14	14	14	14	14	14
% Preceeding Recession	50% ✓	50% ✓	57% ✓	57% ✓	64% ✓	71% ✓
	Years when Small Caps outperform by > +10%					
# of Signals	4	6	7	7	11	15
# Preceding Recession	25	25	25	25	25	25
% Preceeding Recession	16% ✗	24%	28%	28%	44%	60%
	All other years...					
# of Signals	11	13	15	16	24	31
# Preceding Recession	56	56	56	56	56	56
% Preceeding Recession	20%	23%	27%	29%	43%	55%

✓ Recession is more likely than random ✗ Recession is less likely than random

Searches for Soft Landing break the 2008 record.



China's loss has been Mexico's gain.



How oil has performed around Israeli-Palestinian conflicts since 2000

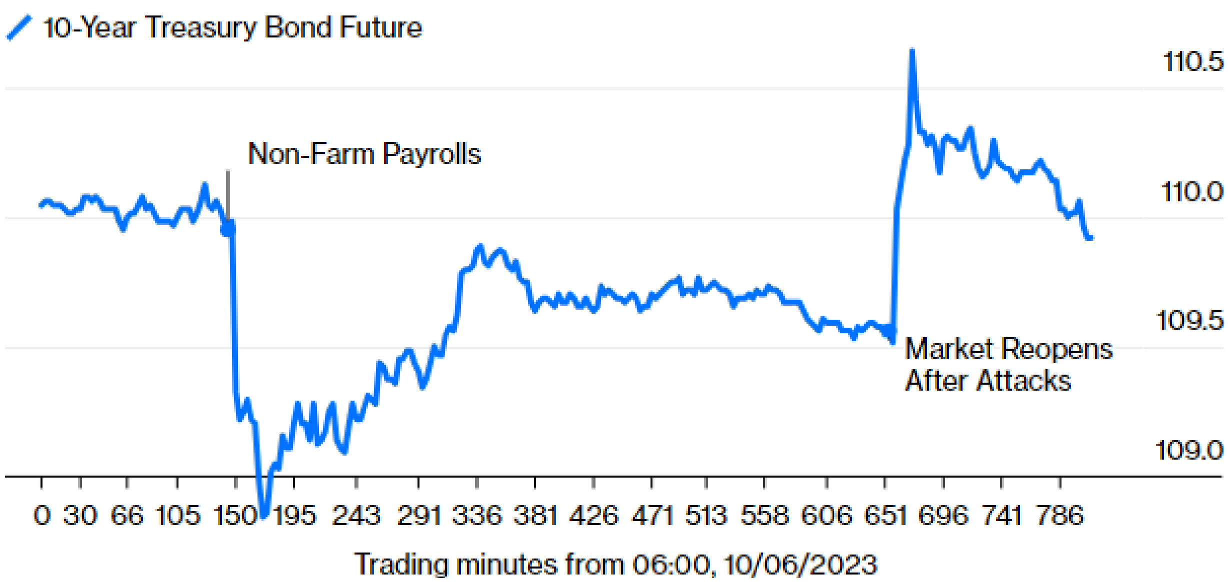
CHART 1 | Israeli-Palestinian Conflicts Have Had Limited Impact on Oil Prices

* INCLUDES THE CONFLICTS IN 2000, 2008, 2012, 2014, 2018 AND 2021. REBASED TO 100 AT START OF CONFLICT.
SOURCE: MACROBOND.

The robust jobs report and attack on Israel effect on Treasury bonds canceled each other out.

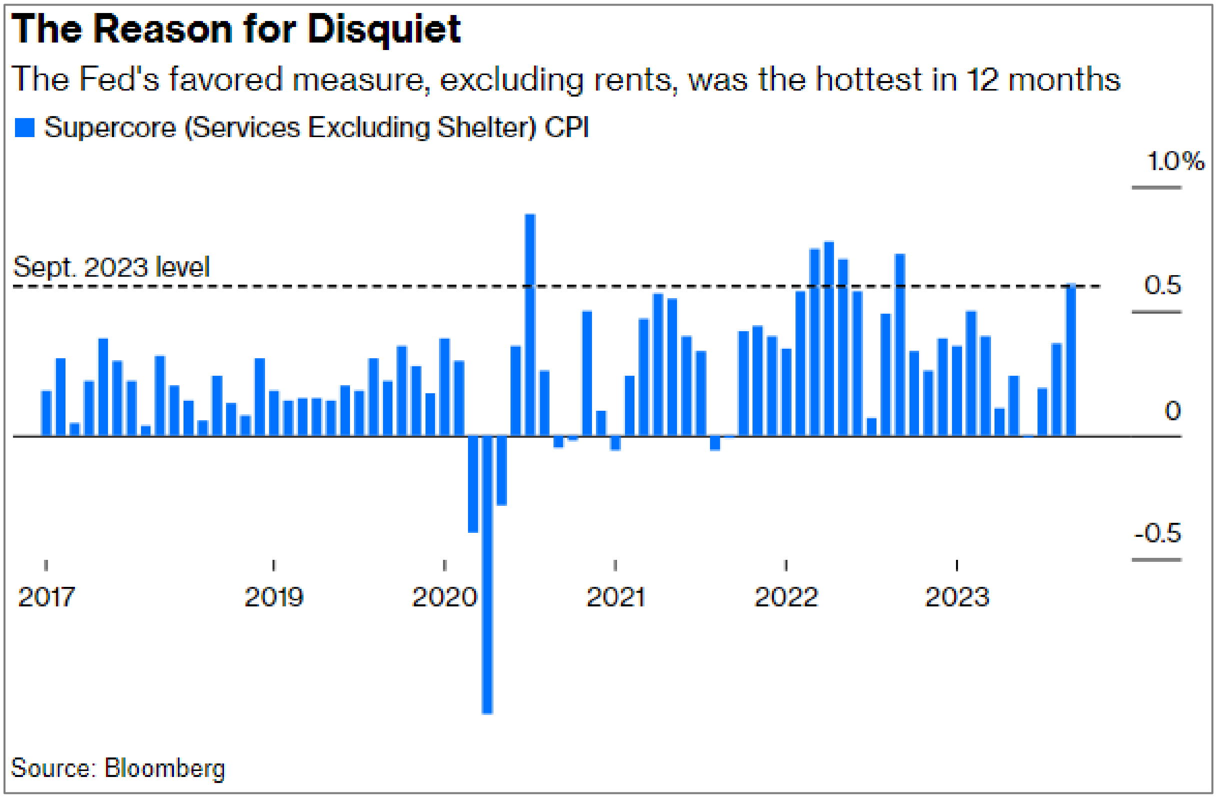
Another Day, Another Shock

Bond future prices show the two surprises canceled each other out

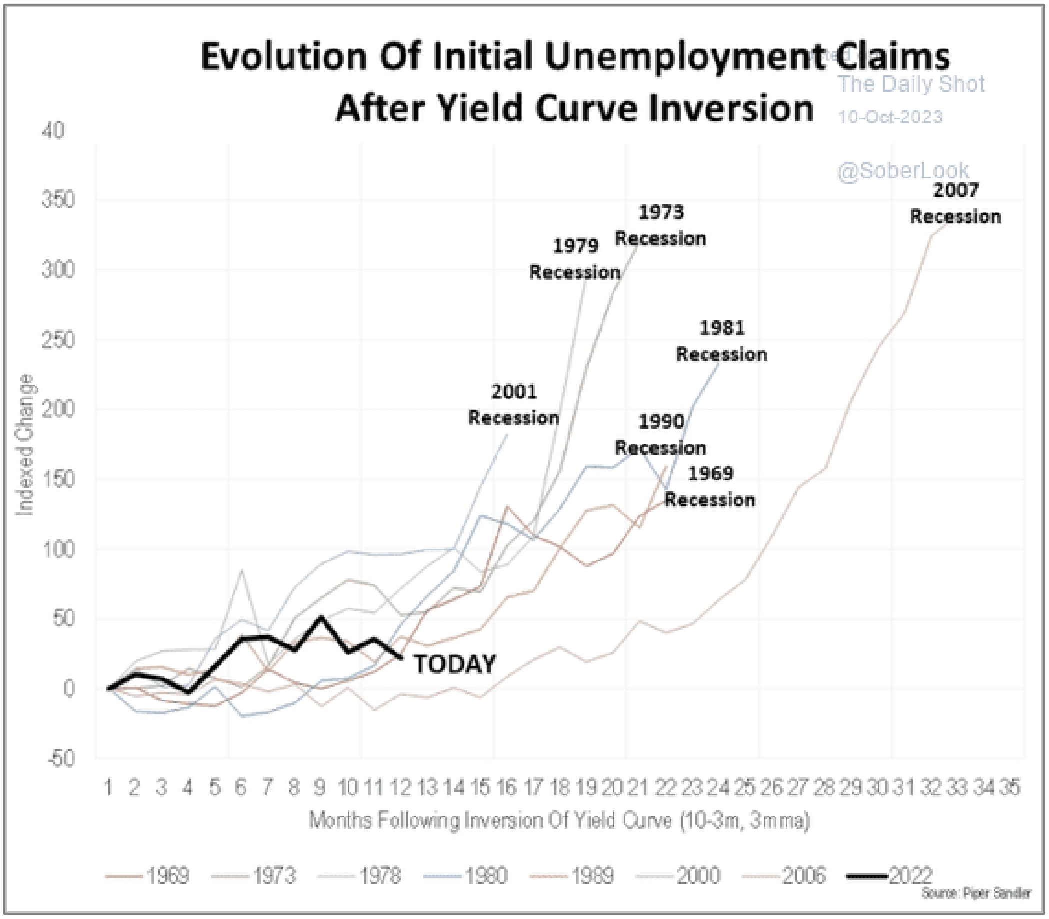


Source: Bloomberg

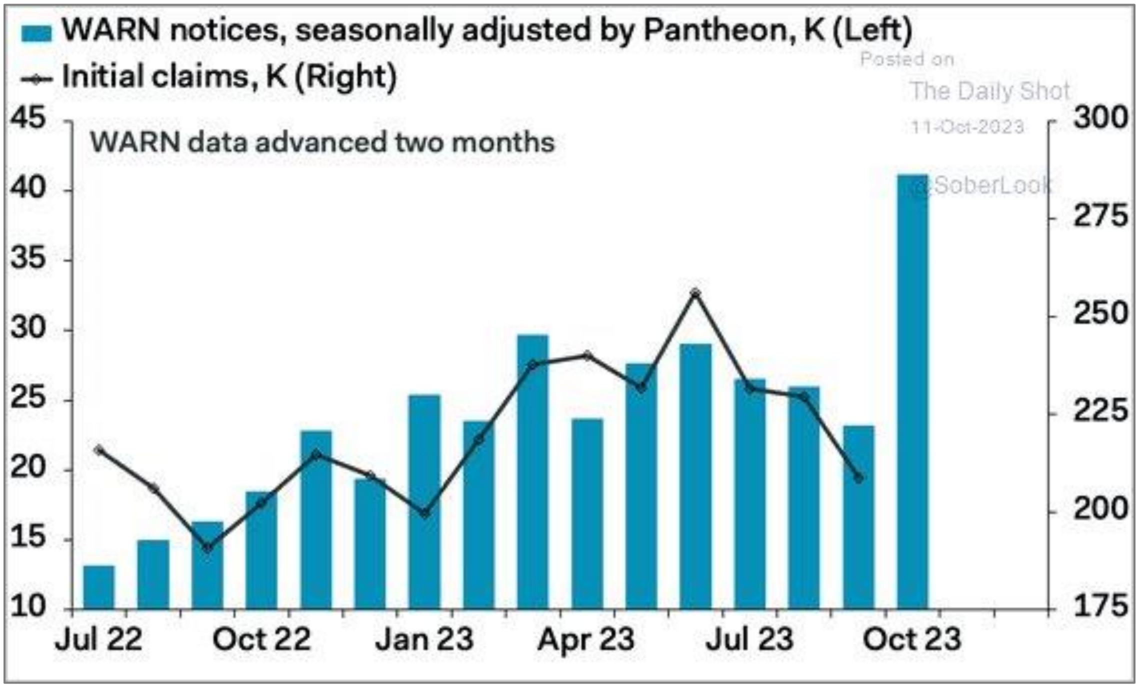
Fed's favored inflation measure is running the hottest in 12 months.



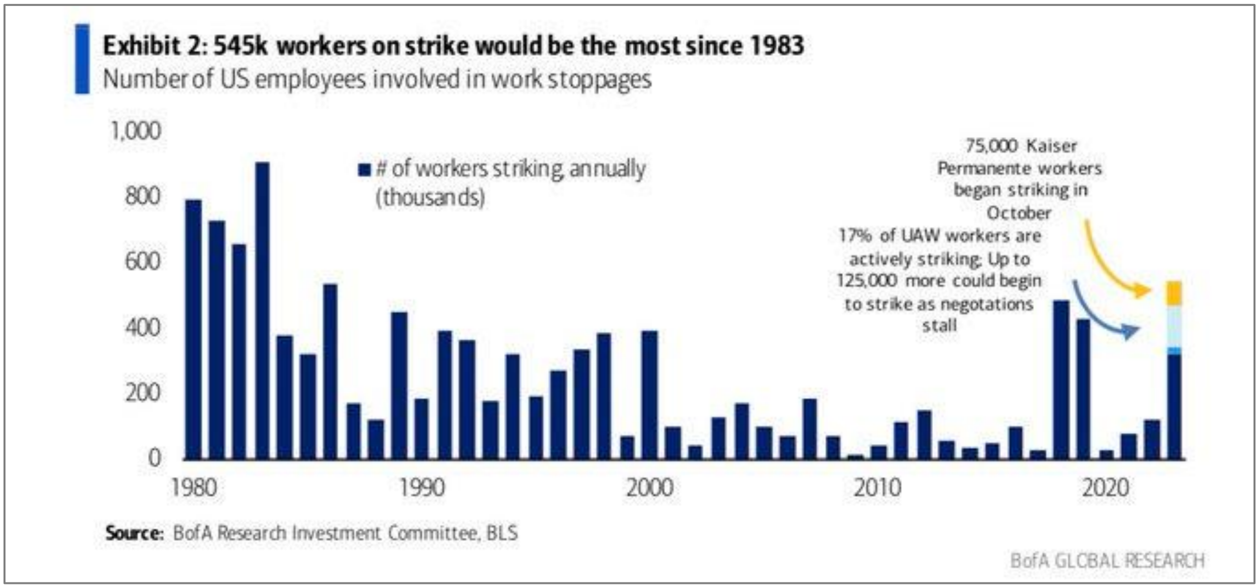
History of Yield Curve Inversions and Unemployment Claims



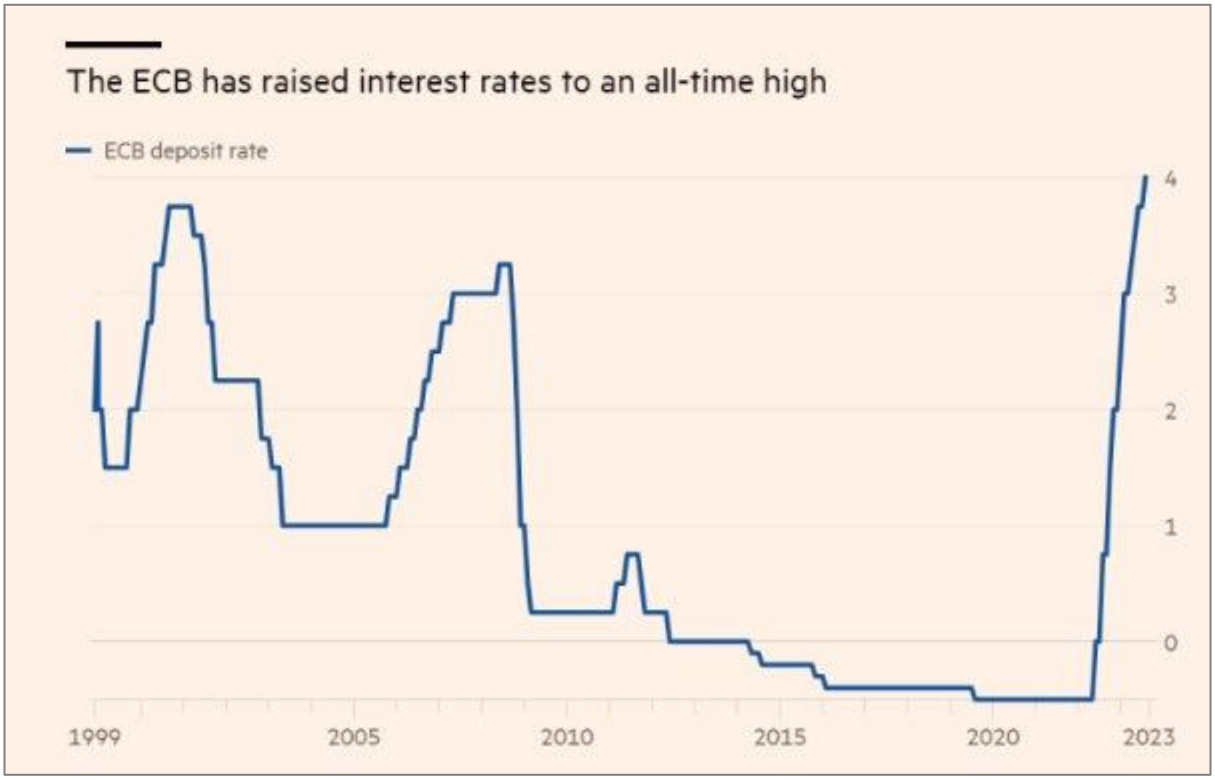
WARN notices suggest higher jobless claims are coming.



Number of workers on strike could approach the highest level since 1983.

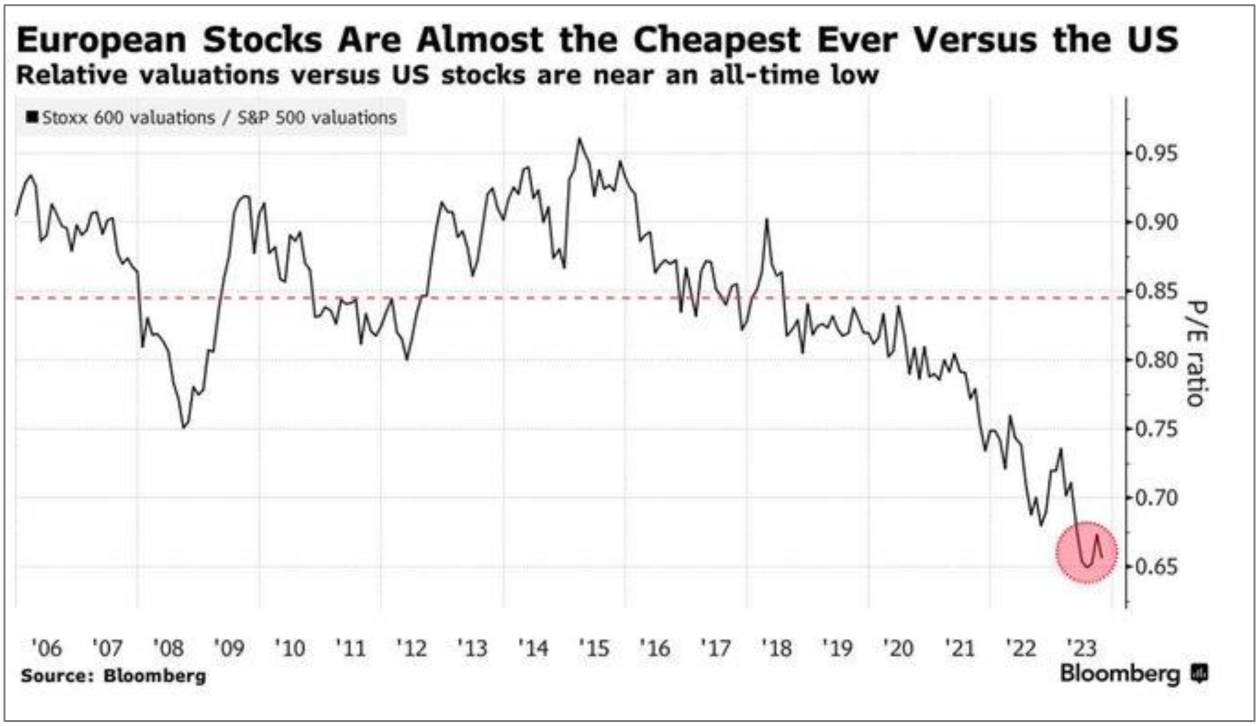


ECB has raised interest rates to an all-time high.

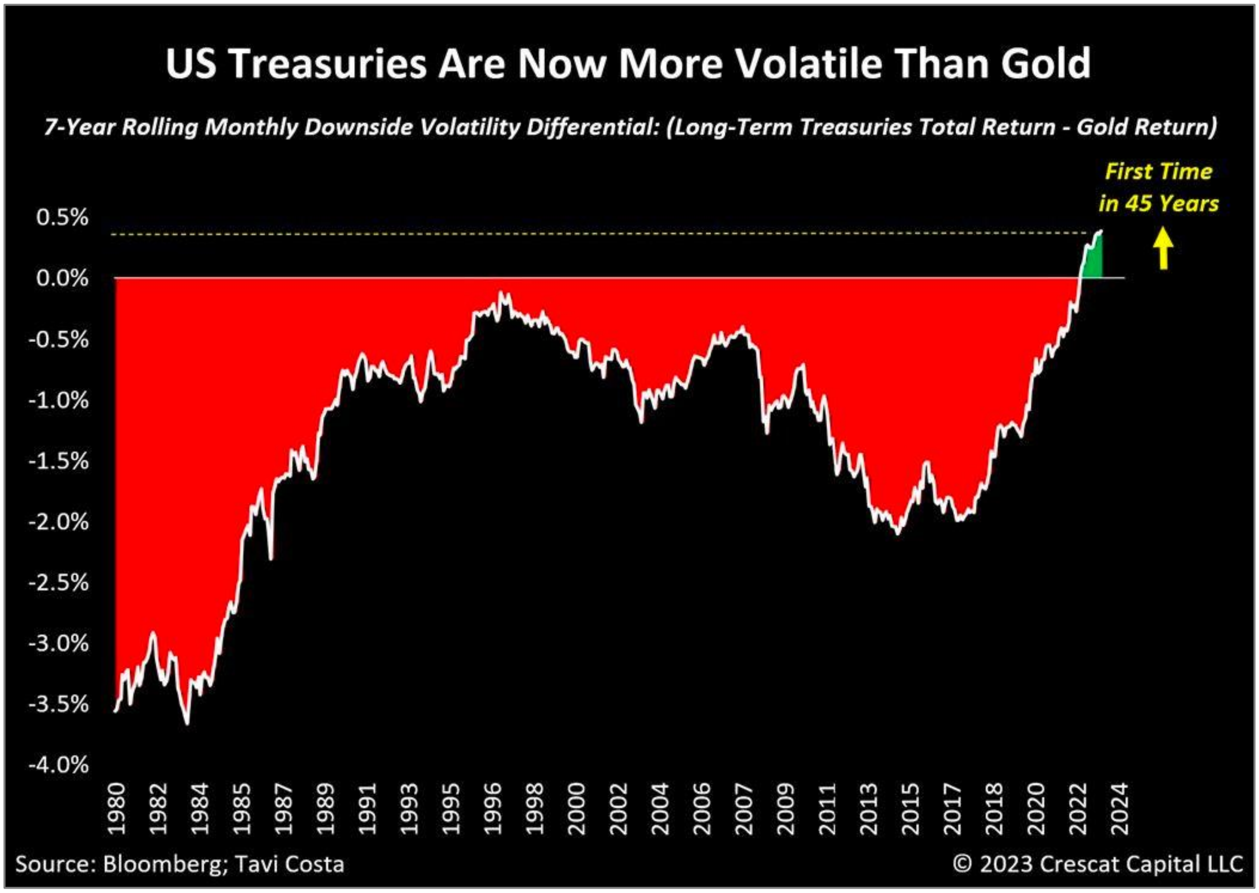


Source: Financial Times

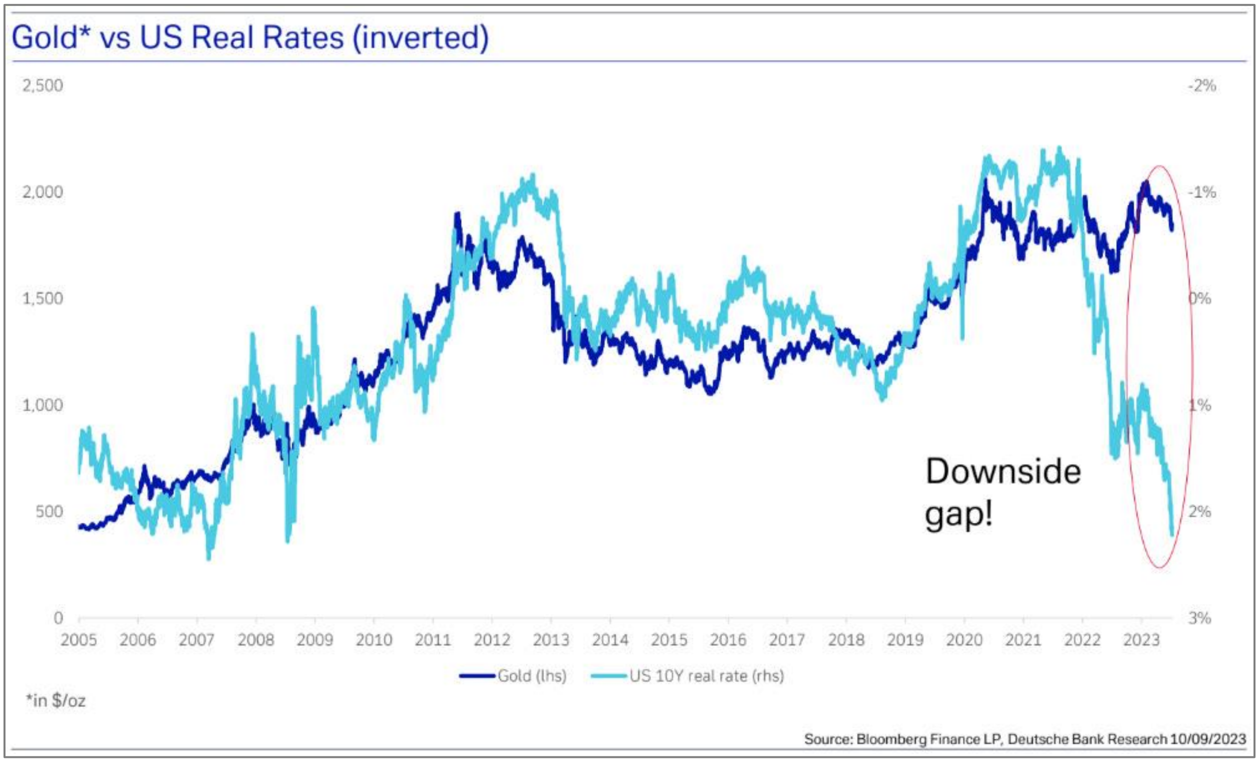
Europe vs. US Relative Valuations are near an all-time low.



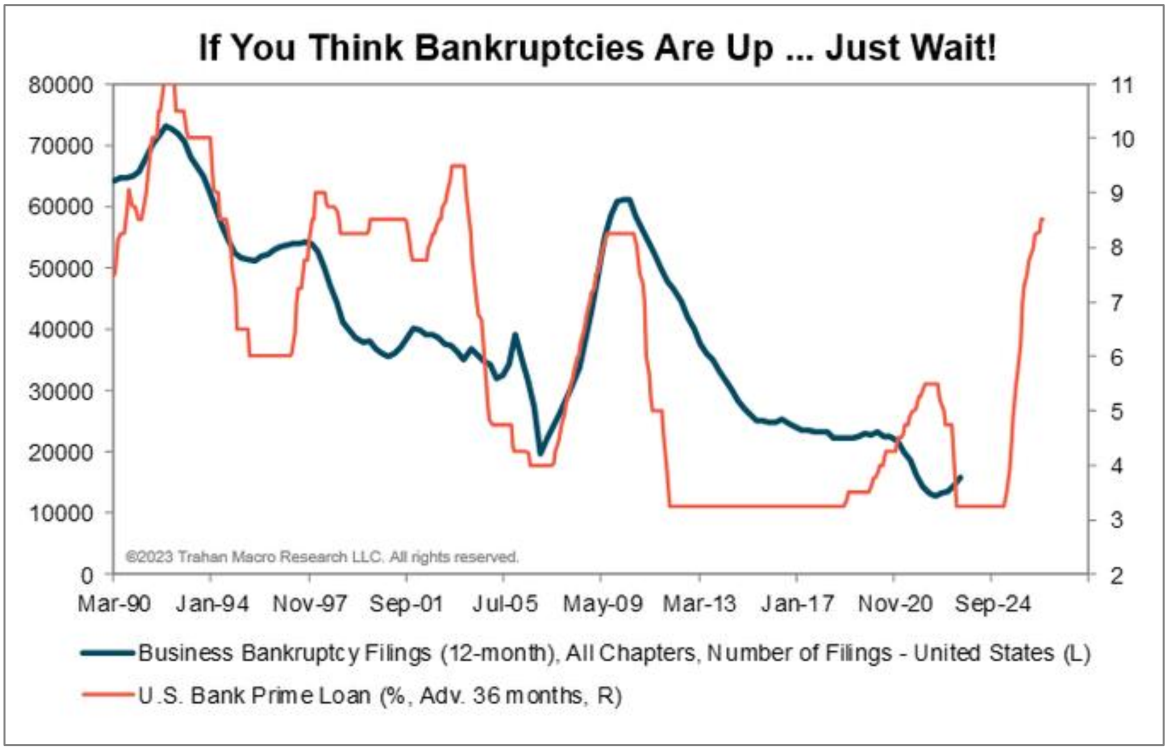
Treasuries have been more volatile than gold for the first time in 45 years.



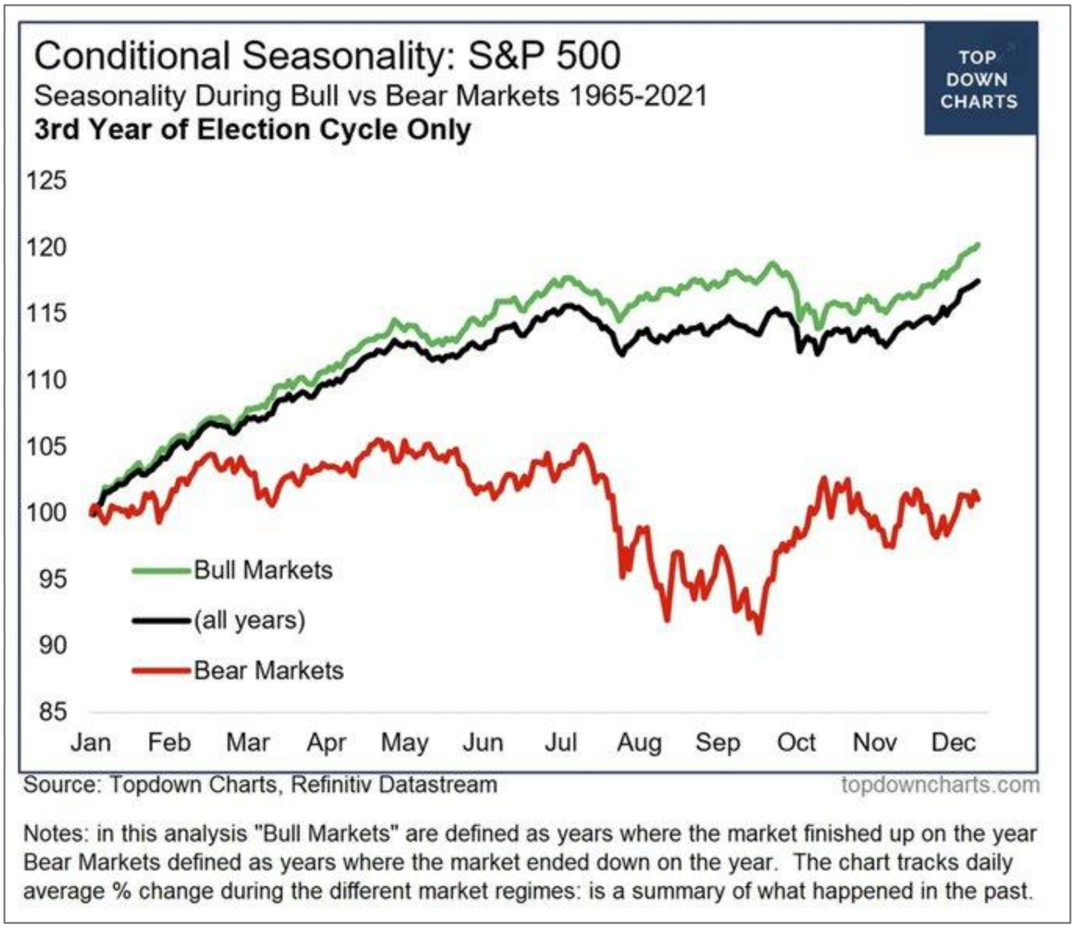
Gold has some downside potential (or TIPS have some upside).



Bankruptcies are likely to climb.



Even bear markets tend to see a Q4 bounce in the 3rd Year of the Election Cycle.



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.