Market Outlook

By Mark T Dodson, CFA

Patience has a fat yield.

Market Risk Index dropped to 60% this week. Psychology continues to improve but is nowhere near registering the fear that tends to mark the culmination of stock market corrections – something we would like to see before recommending tactical increases to equity allocations.

On the Monetary front, the yield curve inversion has troughed, but uncharacteristic to recent history, the steepening is coming from the long end of the curve. A reversion in the yield curve is often heralded as a bullish development too soon. Instead, it’s usually more of a coincident occurrence alongside recession and bear market declines. A steep yield curve with a stable rate of change is what you look for to fuel the credit cycle and the next bull market. We anticipate it will take at least nine months to see this key indicator of our Monetary Composite again give the green light to a bull market.

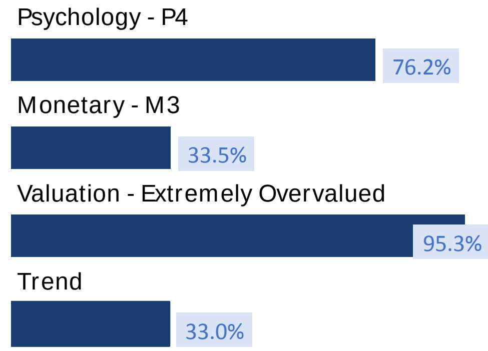
From the valuation perspective, a great deal of excess needs to be squeezed from markets. While we believe it is an iron law that valuations govern the level of drawdown risk, in normal environments, relative valuations can serve as a salve when sitting in a more defensive allocation within a frothy market. For the first time in decades, we are being paid to sit in cash, and paid more than the return that stocks are priced for. Federal Reserve policy is rewarding prudence and rationality at last, and being overexposed to stocks is fighting the Fed. Patience has a fat yield.

Market Risk Index

Rec Allocation 25% Underweight

60.0%

Category Percentiles



Largest Psychology Influences

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

Largest Monetary Influences

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

Valuation

7-10 Year Equity Return Forecast	1.9%
10Yr US Treasury Yield	4.9%

Market Trends

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

Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets based on our model & opinion. 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

Patience has a fat yield.

It's been over 20 years since Treasury-Bill Yields were higher than Earnings Yields on stocks.

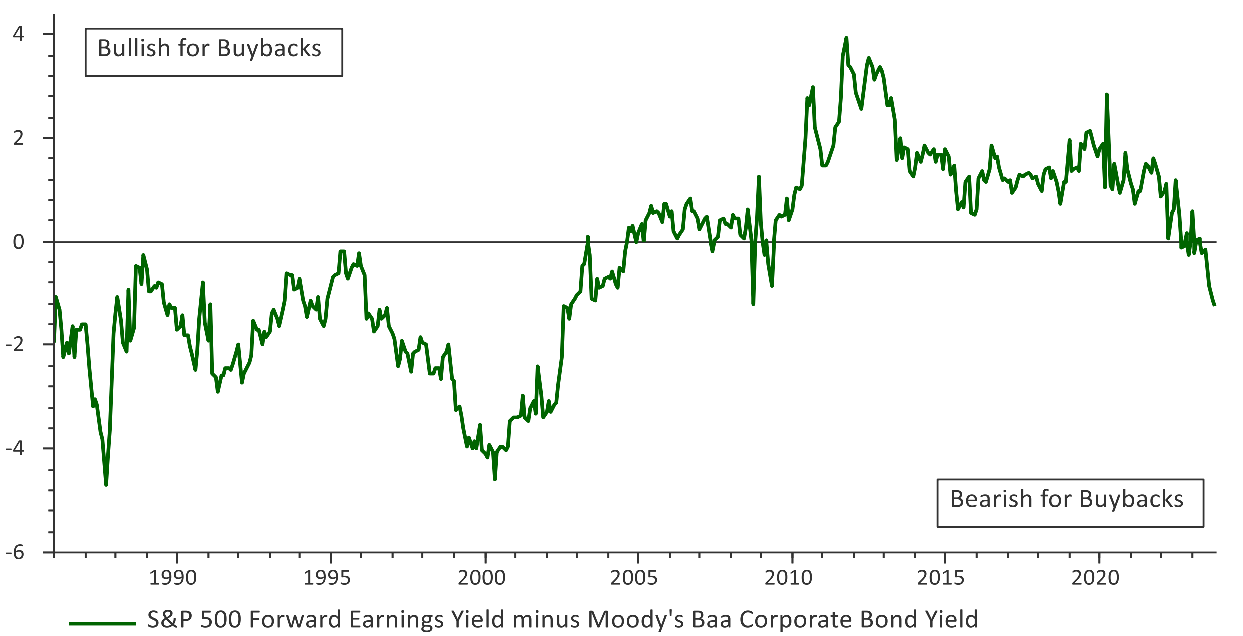
Source: LSEG Datastream, Cypress Capital

Relative valuations are incentivizing corporations to strengthen their balance sheets.

The pendulum has swung in the other direction for balance sheet arbitrage. CFOs should issue stock and buyback debt in the current environment. It also highlights a much more challenging environment for Private Equity.

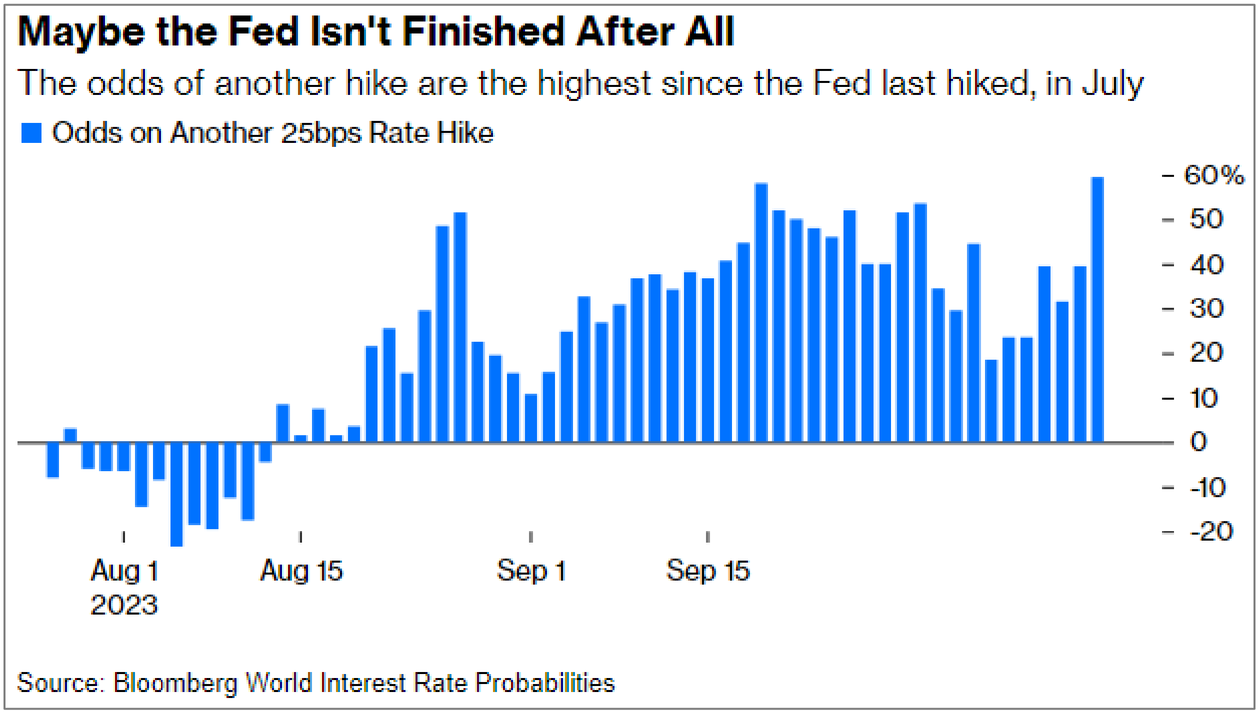
Buyback Indicator

Corporate Equity Valuations versus Corporate Bond Yields

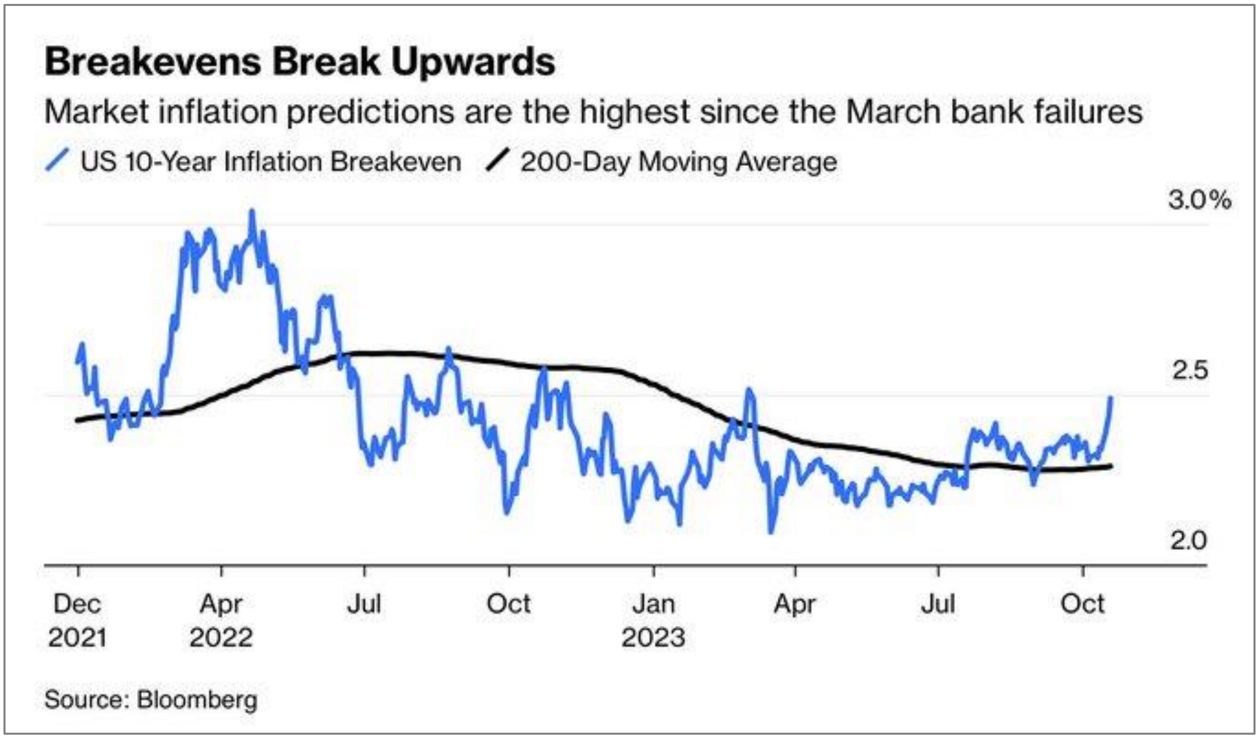


Source: LSEG Datastream, Cypress Capital

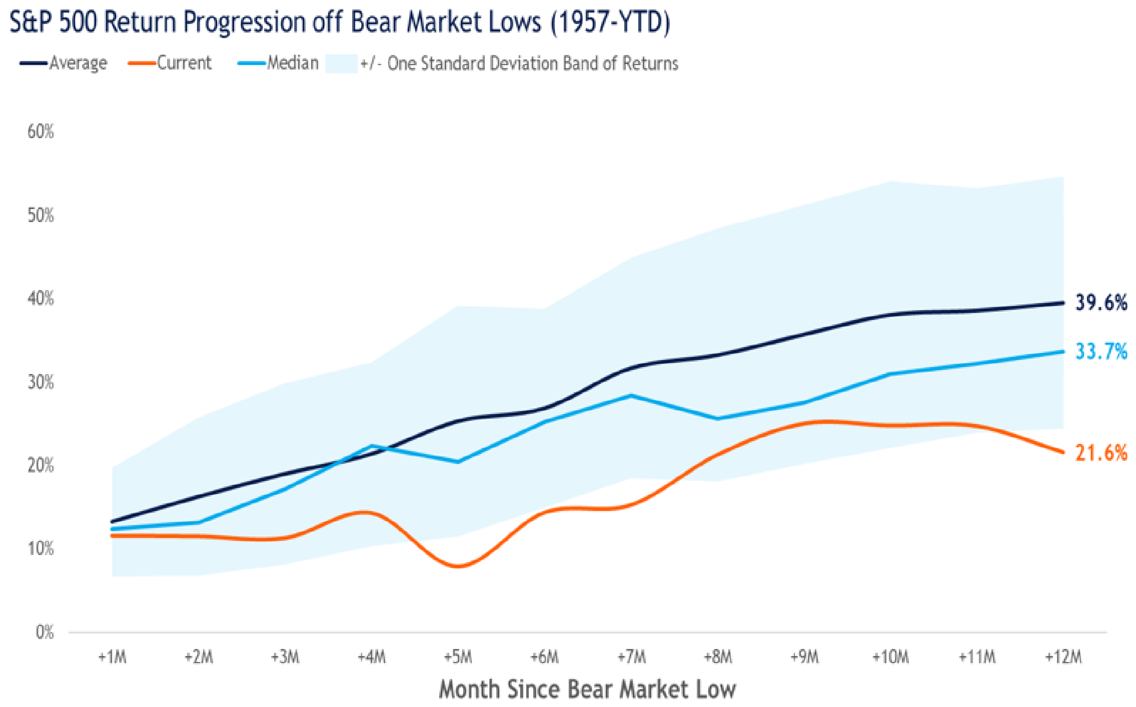
The odds of another rate hike are climbing.



The bond market's inflation expectations are breaking higher.



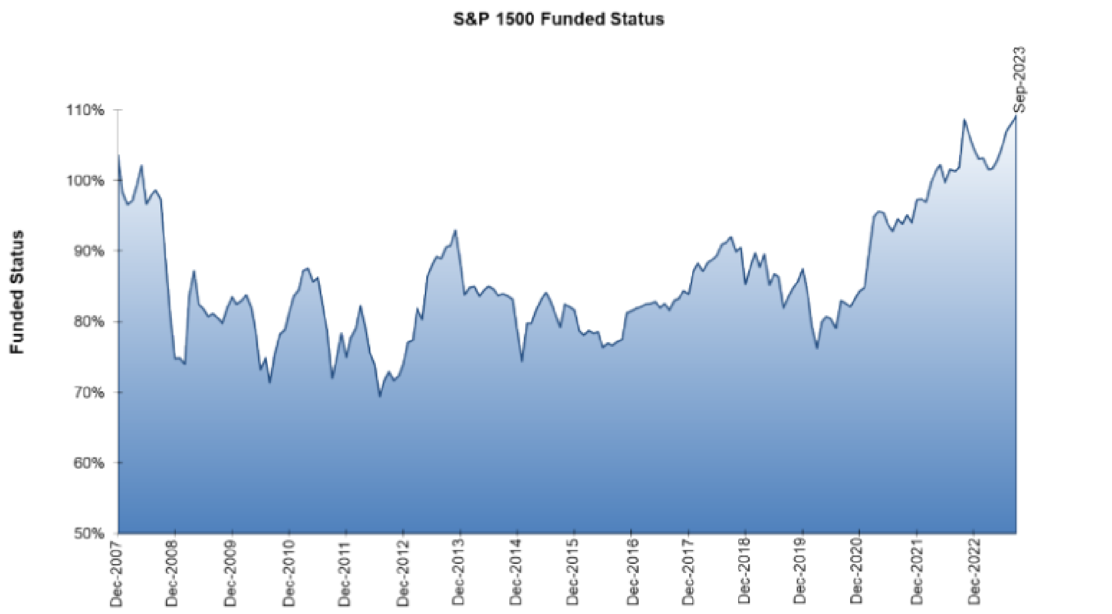
2023 is lowering the bar for new bull market returns



Source: LPL Research, Bloomberg 10/13/23
Past performance is no guarantee of future results. All indexes are unmanaged and can't be invested in directly.
A bear market is when a stock index or security closes 20% or more below a 52-week high. For this analysis, we take liberty with this and included 19%.

Higher interest rates are solving Corporate Pension Funding issues.

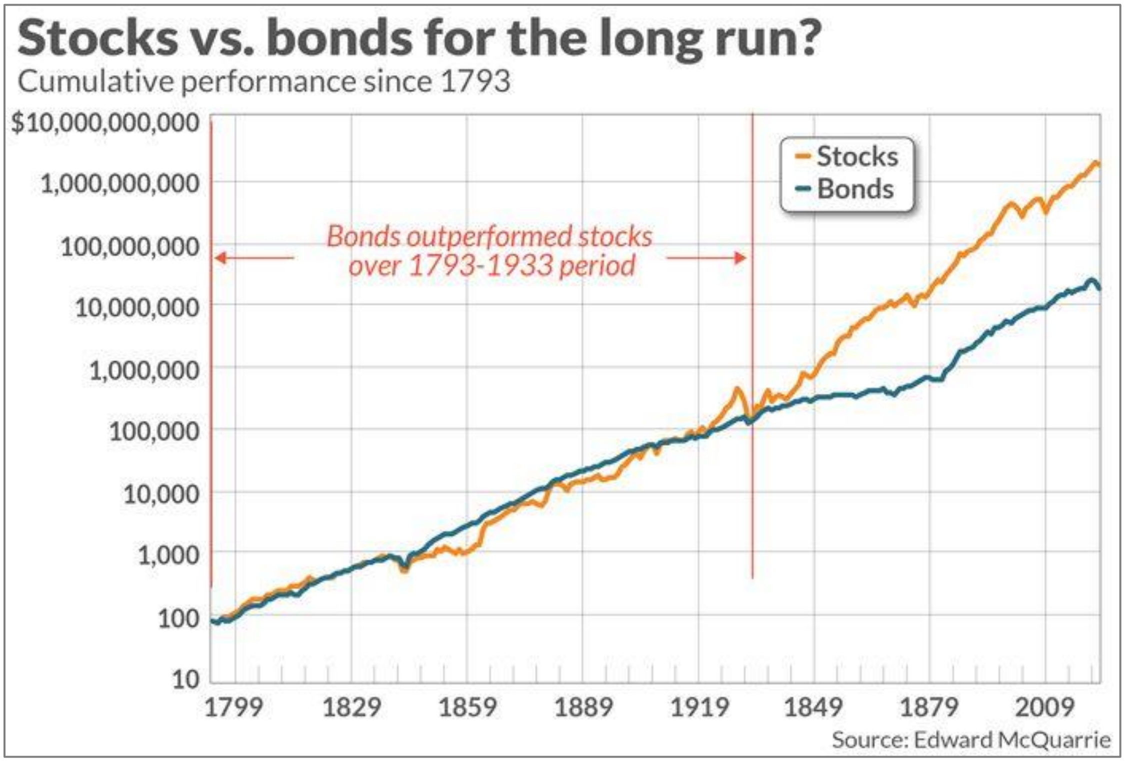
Figure 1 : Estimated aggregate funded status of all plans sponsored by companies in the S&P 1500



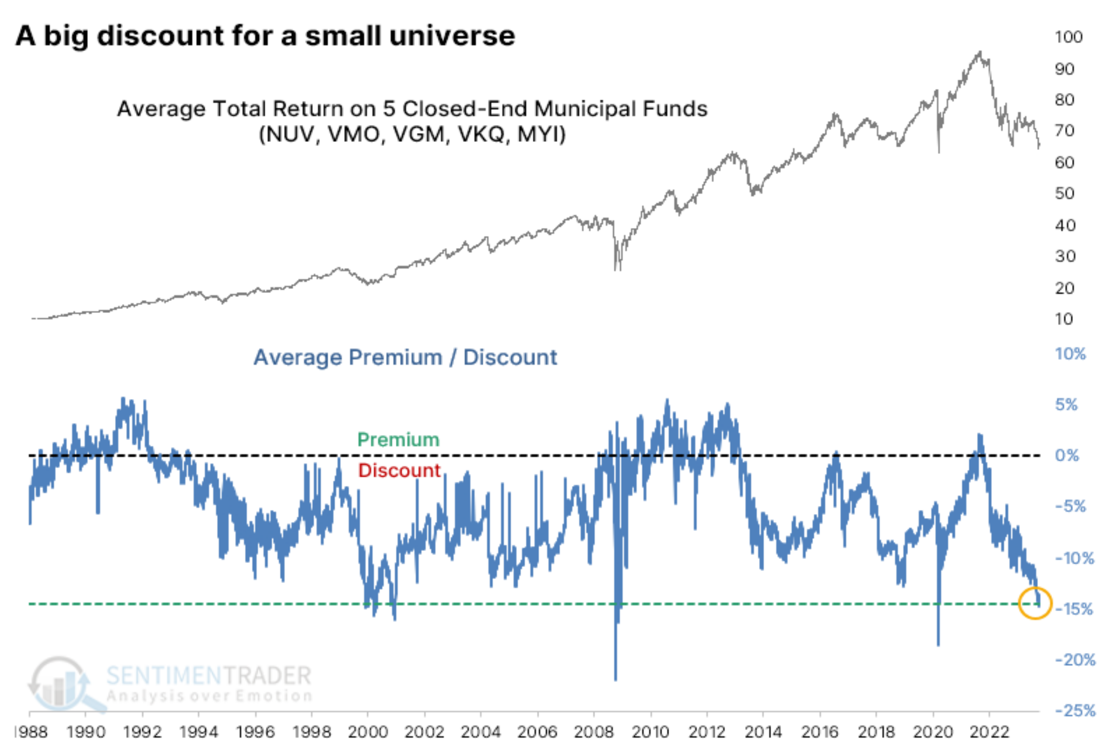
Source: Mercer, September 2023

Sometimes, it's Bonds for the Long Run.

Getting caught blindsided by following rules of thumb at the wrong time can be avoided if valuation is part of your toolkit.



Closed-end Muni Funds are selling at a substantial discount to Net Asset Value.

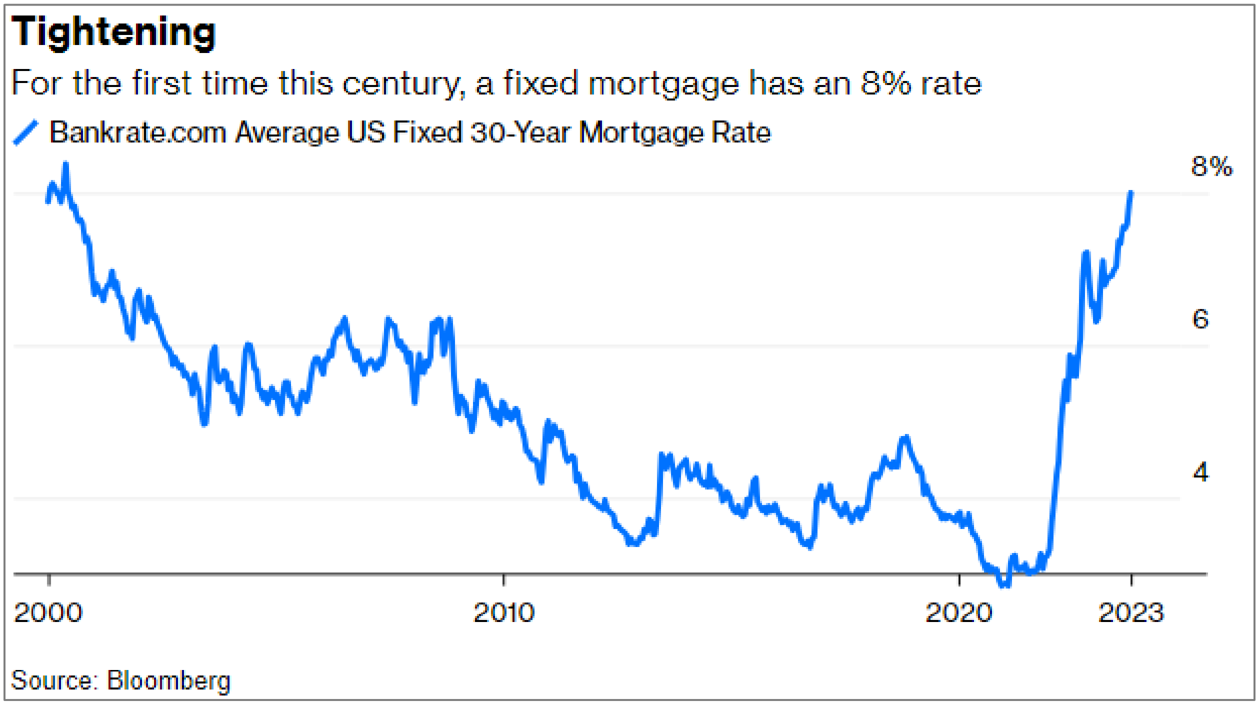


Source: Nuveen, Invesco, BlackRock, Bloomberg

When indicator is...	Annualized Return	% Of Time
Above 4%	-1.2%	2%
-14% To 4%	5.6%	97%
Below -14%	134.4%	1%

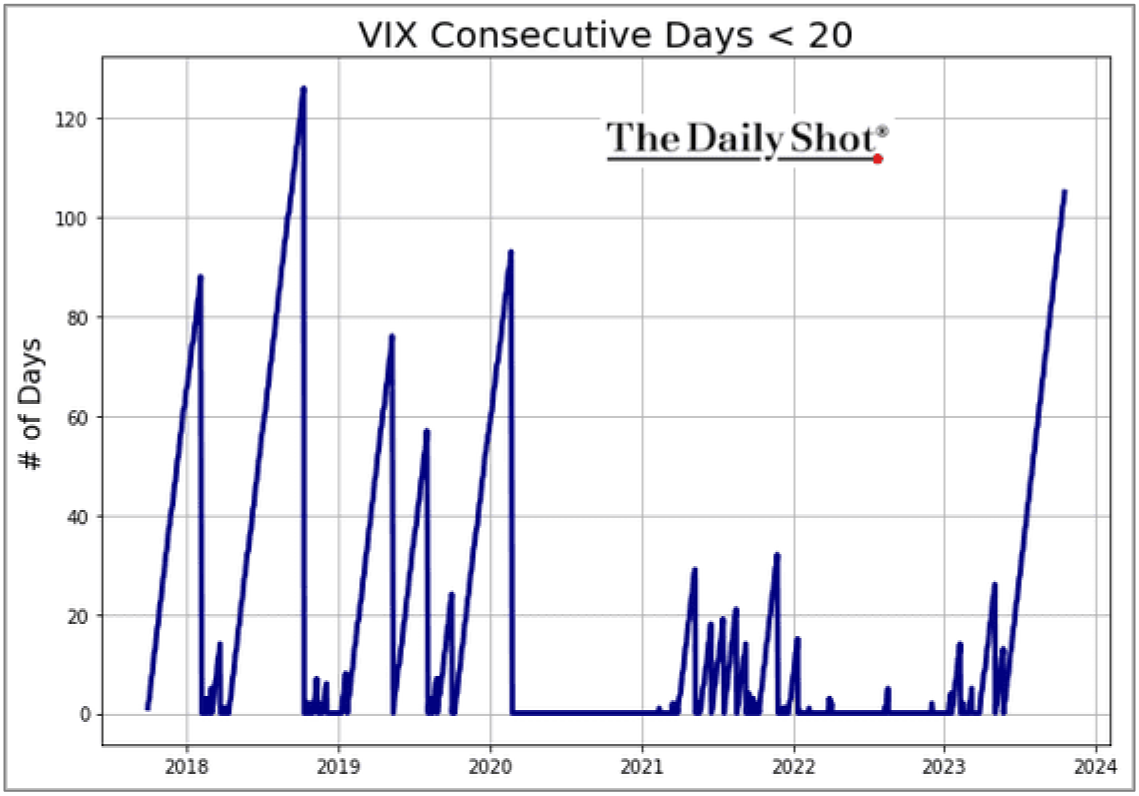
When indicator is...	Annualized Return	% Of Time
Above 0%	-0.3%	16%
-10% To 0%	6.6%	73%
Below -10%	16.2%	10%

Mortgage rates hit 8% for the first time since 2000.

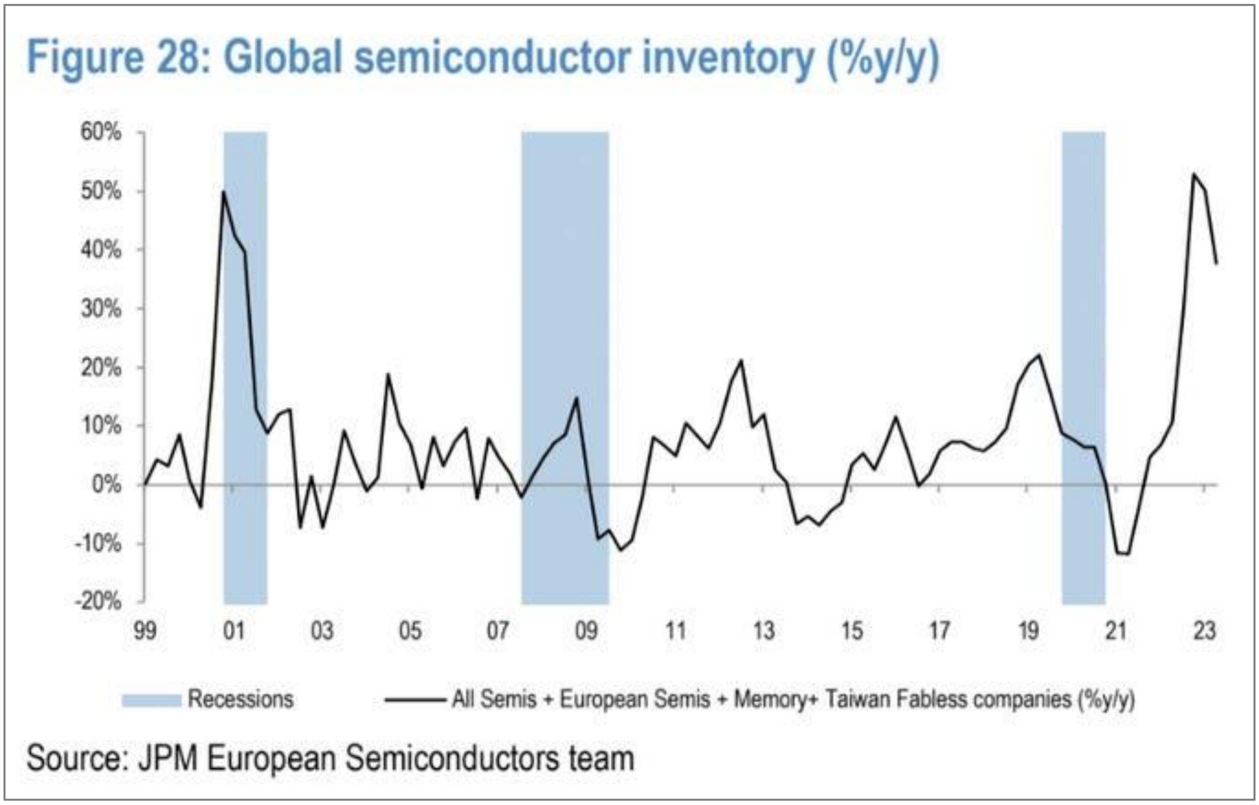


Consequently, mortgage loan applications have fallen to new lows.

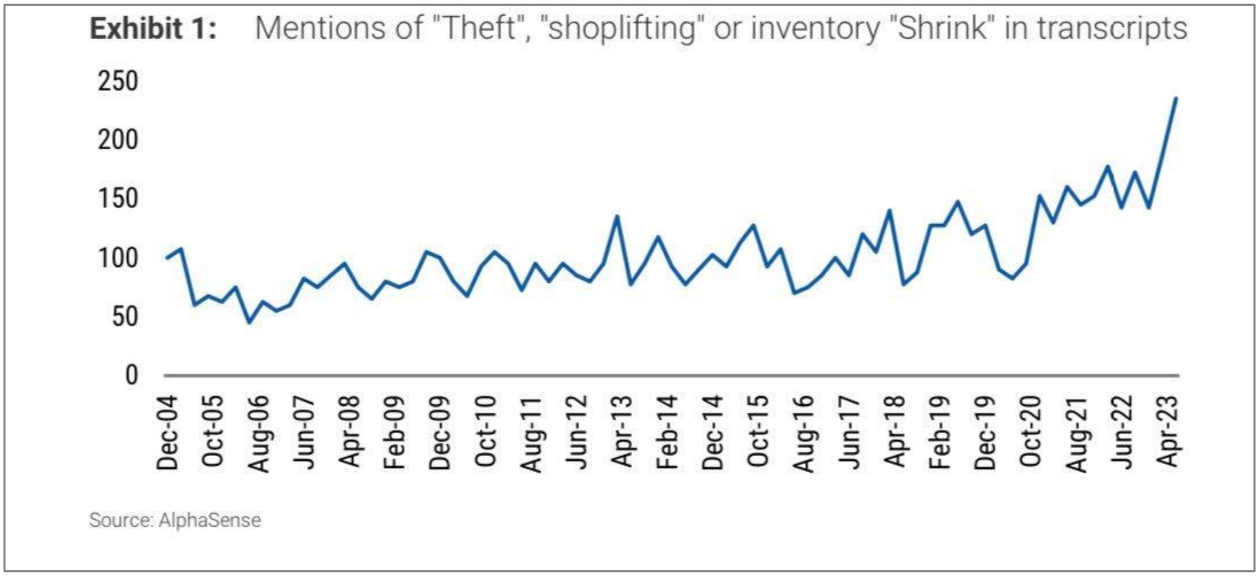
VIX just ended a 100-day streak of readings below 20.



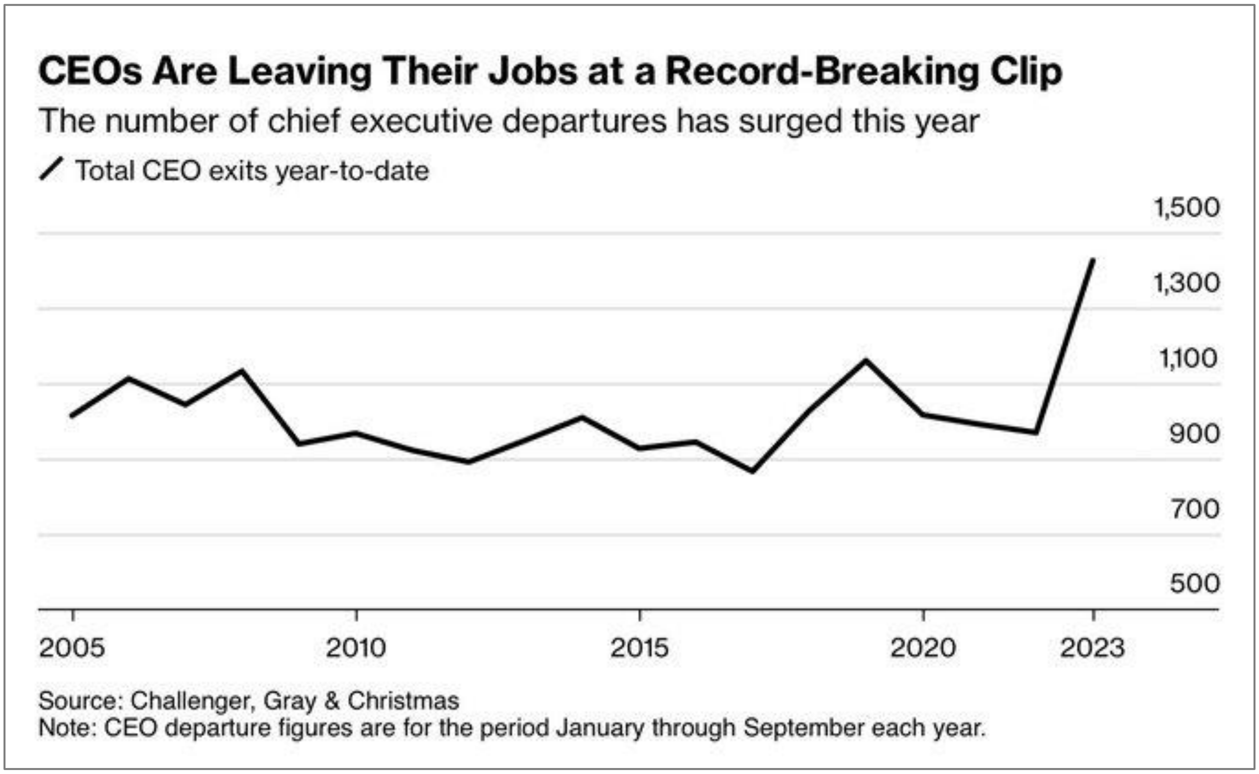
Global semiconductor inventory is rolling over.



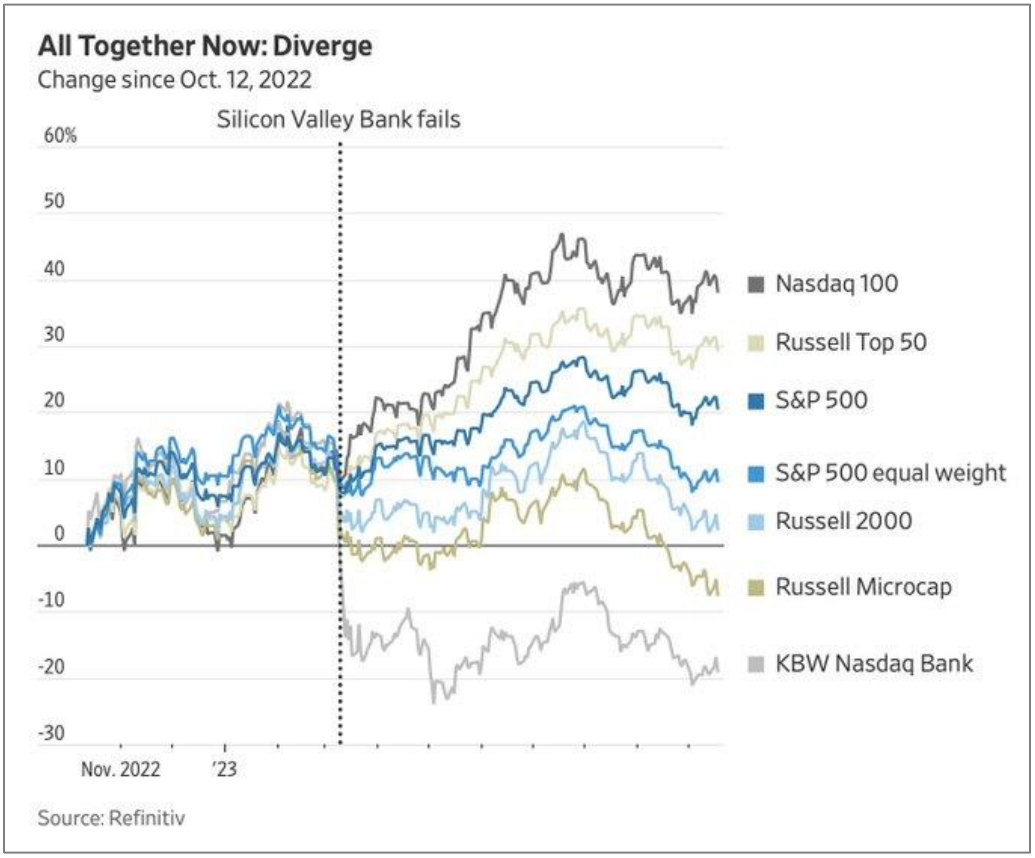
Shoplifting is becoming a bigger problem for businesses.



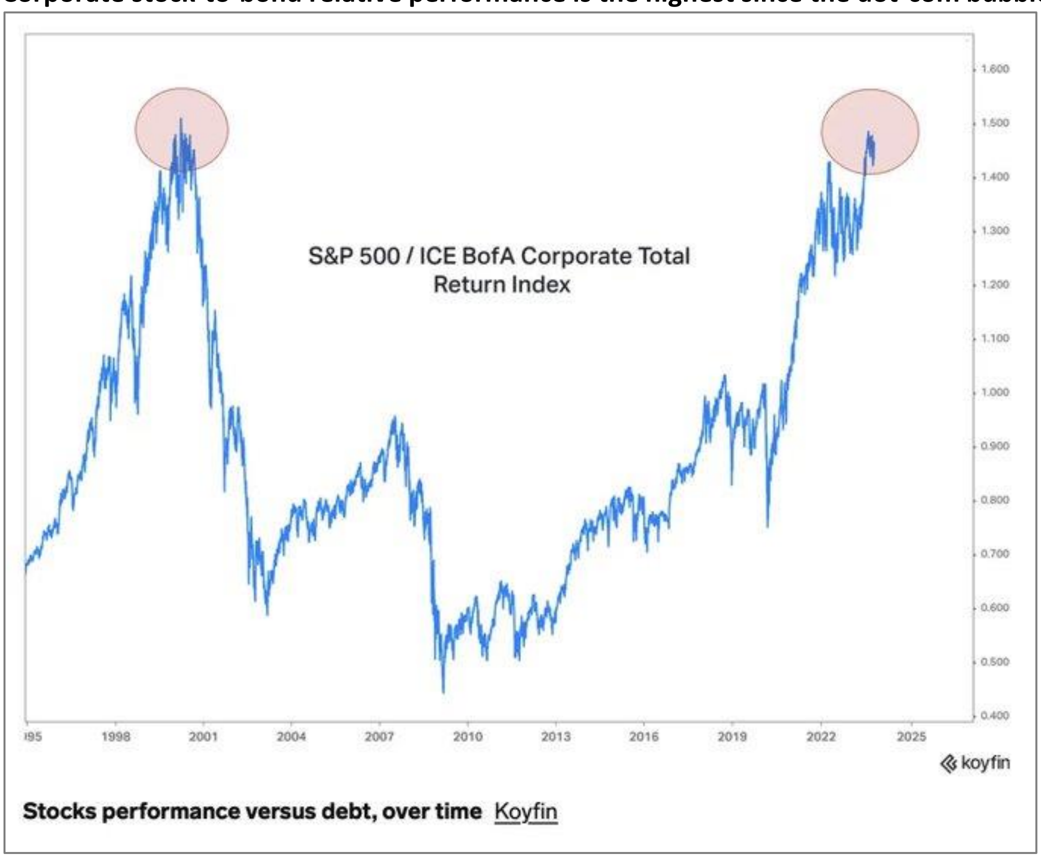
CEOs are bailing en masse this year.



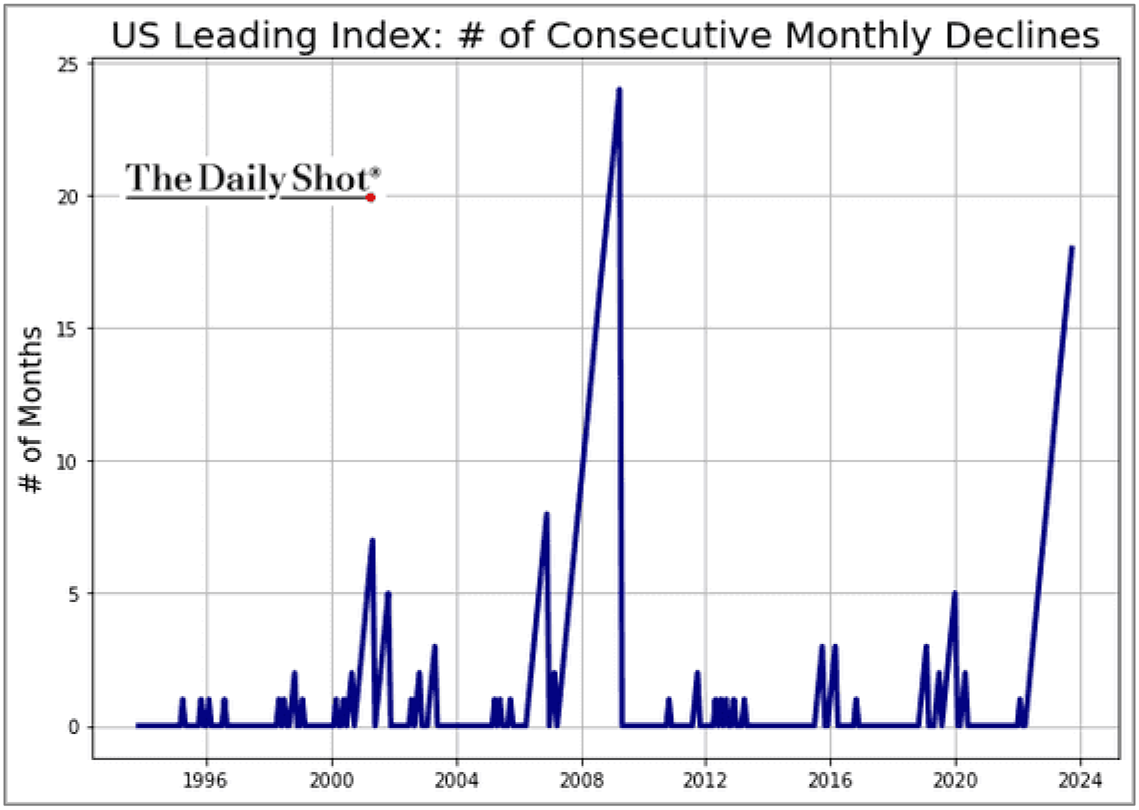
SVB failure appears to mark where the bull market went off the historical rails.



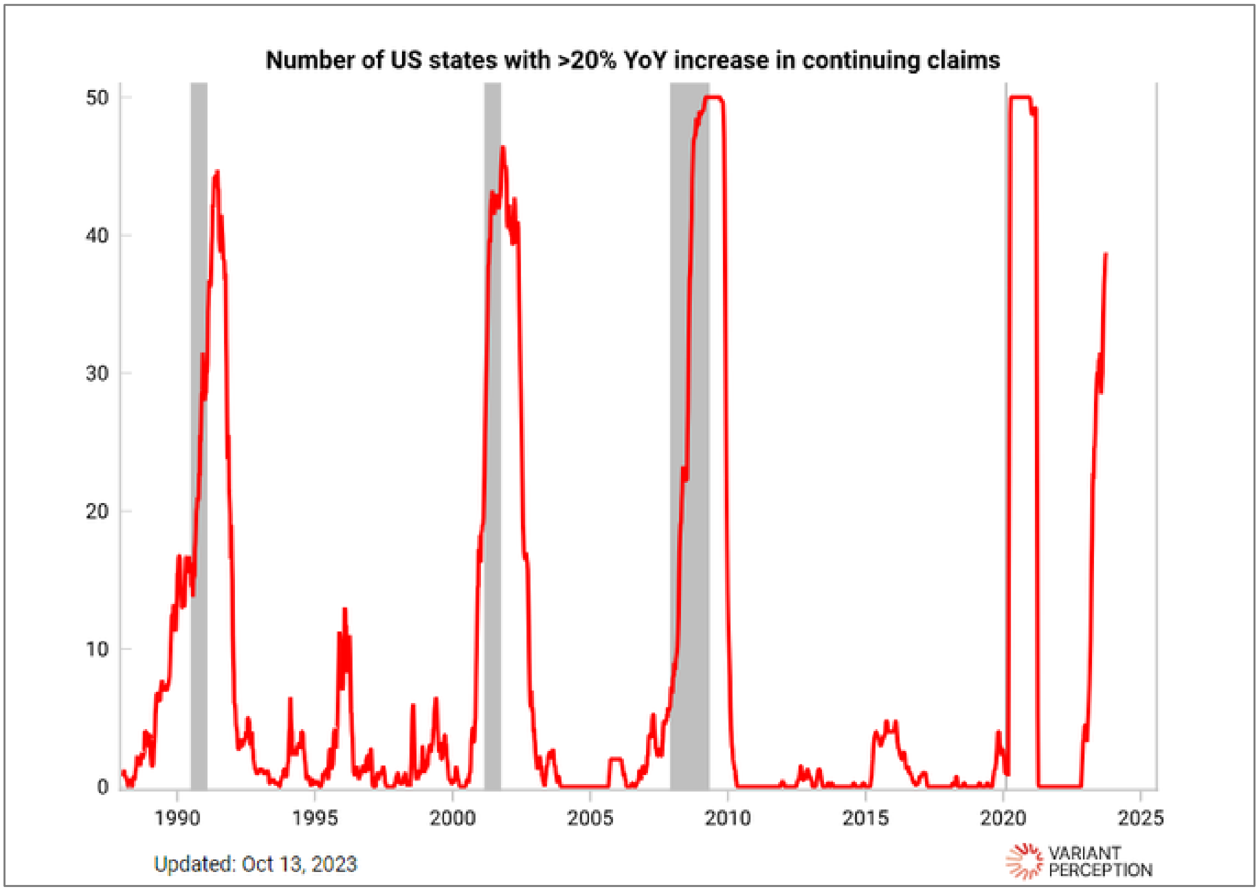
Corporate stock-to-bond relative performance is the highest since the dot-com bubble.



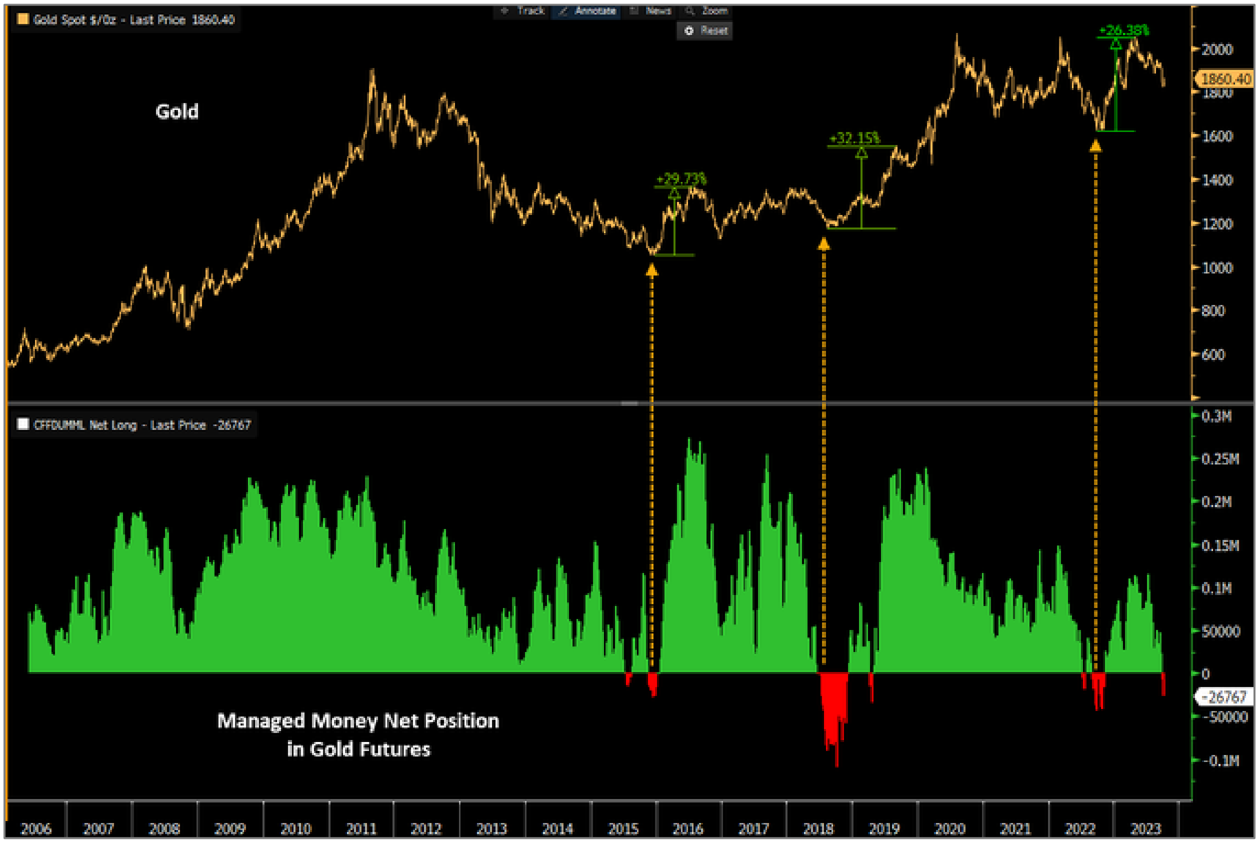
The clock keeps ticking on Leading Index's recession warning.



Rise in the number of US states seeing an increase in continuing jobless claims.

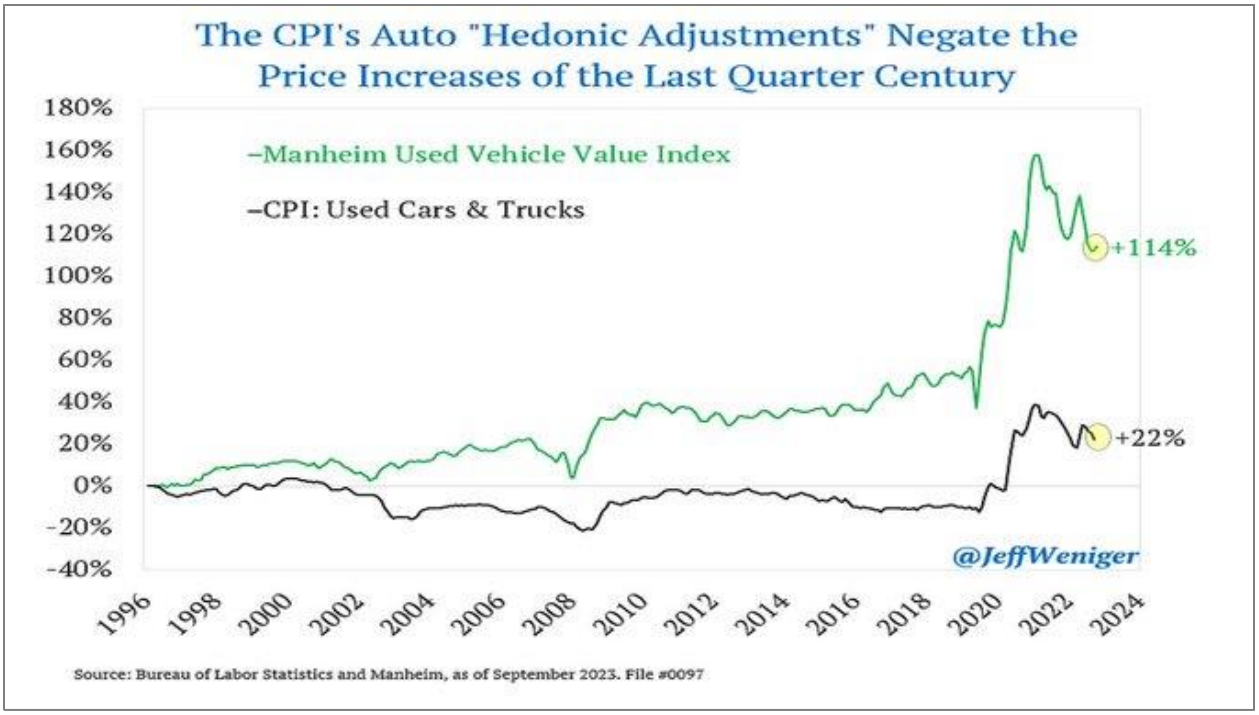


Investor Sentiment on Gold is bearish.

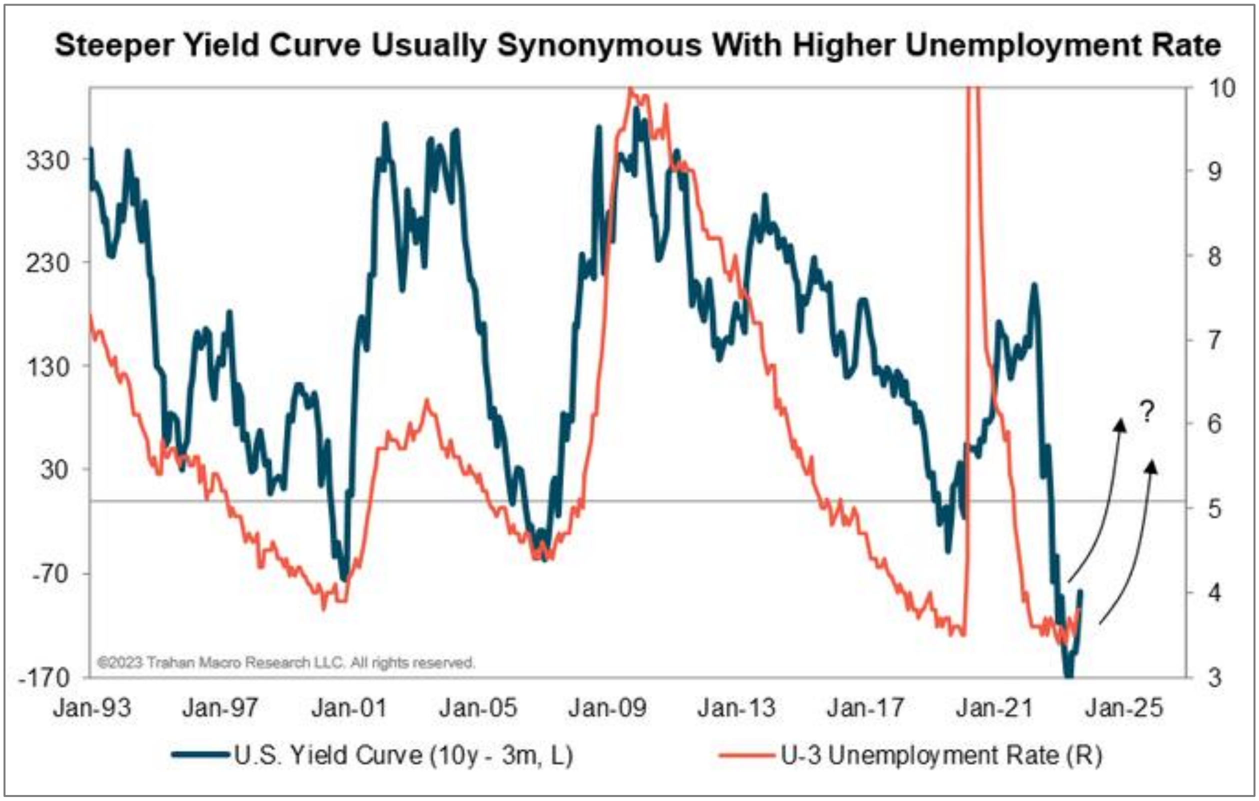


CPI Used Car Inflation versus Used Car Values

Government stats suggest the quality of used cars steadily improved over the years and then skyrocketed because of Covid.



Yield Curve reversions usually coincide with a rise in the Unemployment Rate.



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.