Market Outlook

By Mark T Dodson, CFA

Breadth Thrust Sways Sentiment

Market Risk Index increased to 67.7% this week as the Monetary Composite moved out of its recent range to hit the worst reading since March of this year. March marked a bullish break for Monetary conditions, occurring right around the time of the SVB failure, but the steep yield curve inversion prevented Monetary Conditions from improving to the point of suggesting a new credit cycle was afoot.

For those of our technically astute readers, it's week-old news that the market triggered what is known as a Zweig Breadth Thrust last Friday. The thrust occurs when the percent of NYSE advancing stocks moves from 40% to 61.5% over the previous ten trading days. The odd choice of cutoffs has always struck us as a classic case of data mining – but a lot of takes on breadth are precisely that – data mining. However, ZBT's successful track record in forecasting short to intermediate-term strength in markets post-WWII is undeniable. We follow it for that reason.

Whether breadth thrusts have become more prevalent and less meaningful since decimalization is an ongoing debate, and there are breadth thrusts by other names. Breadth thrusts were widely reported at the start of 2022, just as the bear market began. There were breadth thrusts lauded at the start of 2023 (and in March 2023 for Zweig if you calculate it using a simple moving average), which panned out superbly for the Magnificent-Seven stocks but not for most stocks, which have been flat or underwater for much of the year. By definition, narrow market advances shouldn't follow thrusts in breadth, just as bull markets aren't supposed to see small-cap indices take out their bear market lows in a year.

While we wouldn't condone fighting the tape, we aren't prone to diving headfirst into markets based solely on a single breadth measure. The weight of all the evidence sways us and drives our equity allocations. Regardless, it has swayed sentiment, as investors appear eager to re-inflate the bubble. AAII Bullish sentiment saw its largest one-week jump in 13 years. After being burned repeatedly, bond markets are again making strong bets on a Fed pivot to lower rates – causing the yield curve inversion to worsen. Assets in leveraged ETFs relative to inverse ETFs have rebounded into the Euphoria Zone. Call options volume shot higher, and even activity in cryptocurrency markets looks like animal spirits are reigniting.

Market Risk Index

Rec Allocation 25% Underweight

67.7%

Category Percentiles

Psychology - P5: 83.2%

Monetary - M3: 35.9%

Valuation - Extremely Overvalued: 95.6%

Trend: 57.5%

Largest Psychology Influences

Leveraged Investments	Negative
Option Activity	Positive
Bank Sentiment	Negative
Volatility	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	4.5%

Market Trends

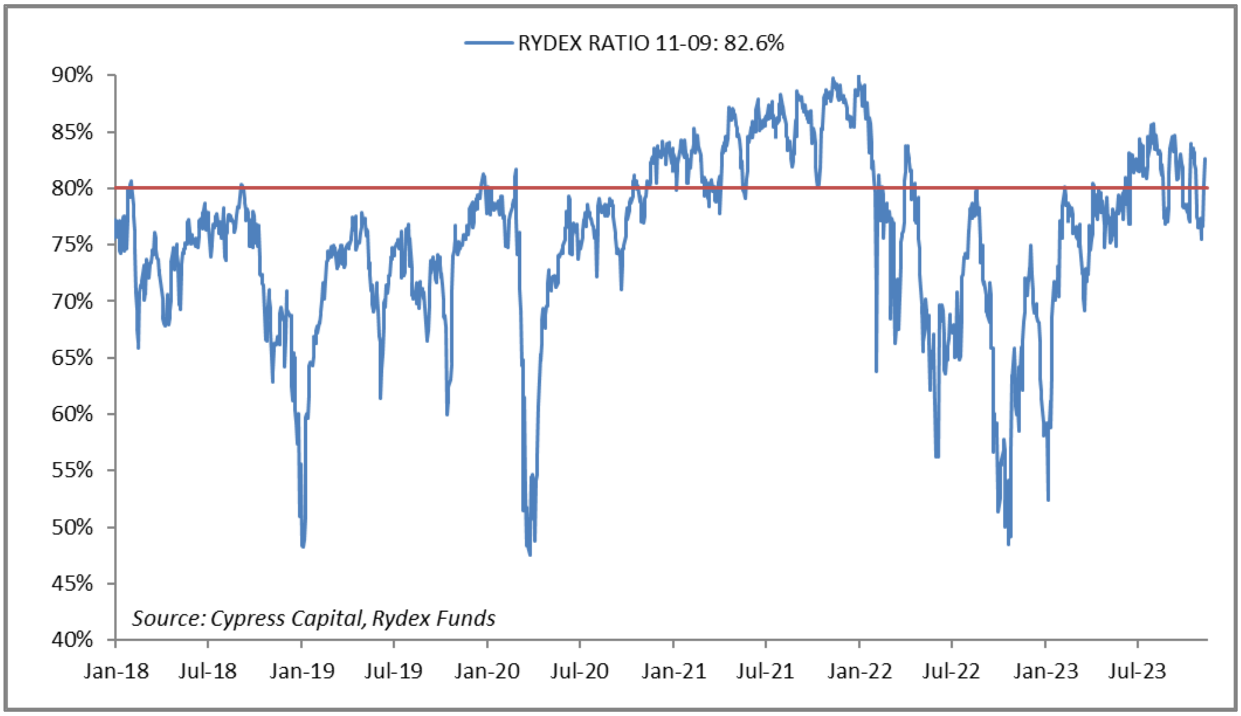
US Equities	Bullish Investment
Intl Equities	Bearish Trade
REITs	Bearish Trade
Broad Commodities	Bullish Trade

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.

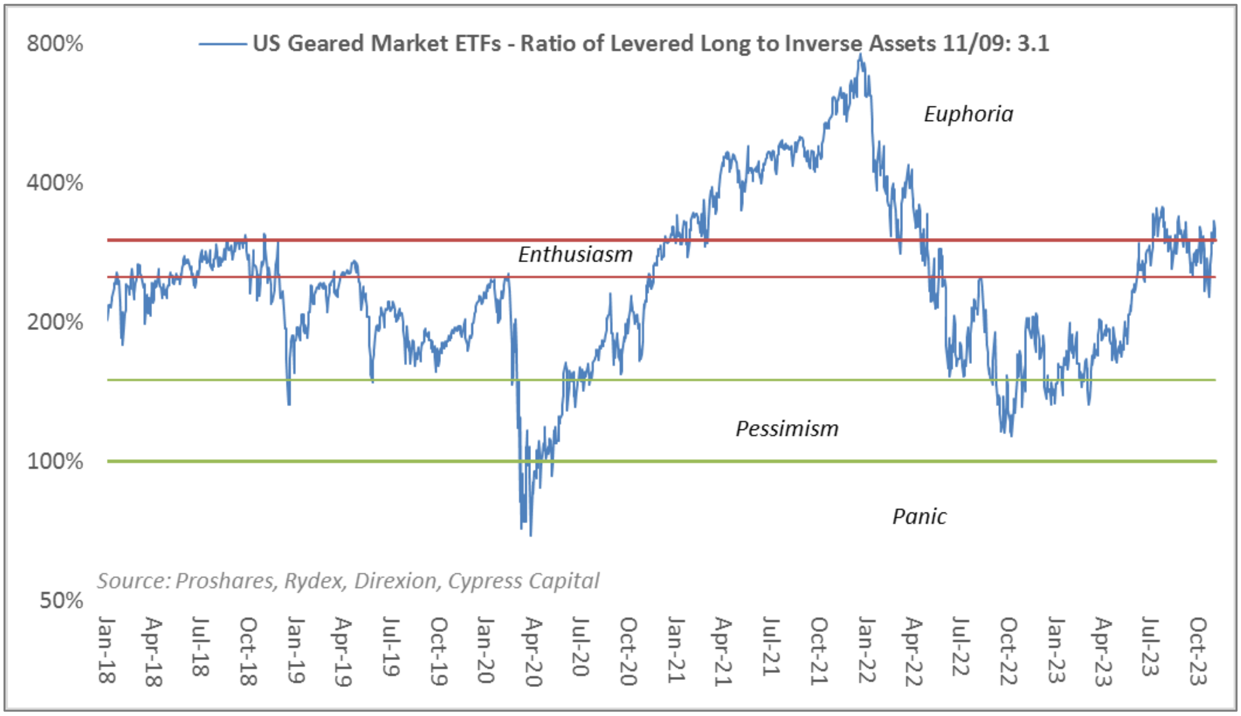
The labor market may be softening on the margins, but it remains tight. The federal government is running recession-level deficits in a full employment environment, and the University of Michigan's consumer survey suggests that consumers' inflation expectations are still rising. This backdrop, combined with another speculative interlude from markets causing financial conditions to ease, makes it more difficult for the Fed to make the pivot upon which the speculative story rests.

Charts of the Week

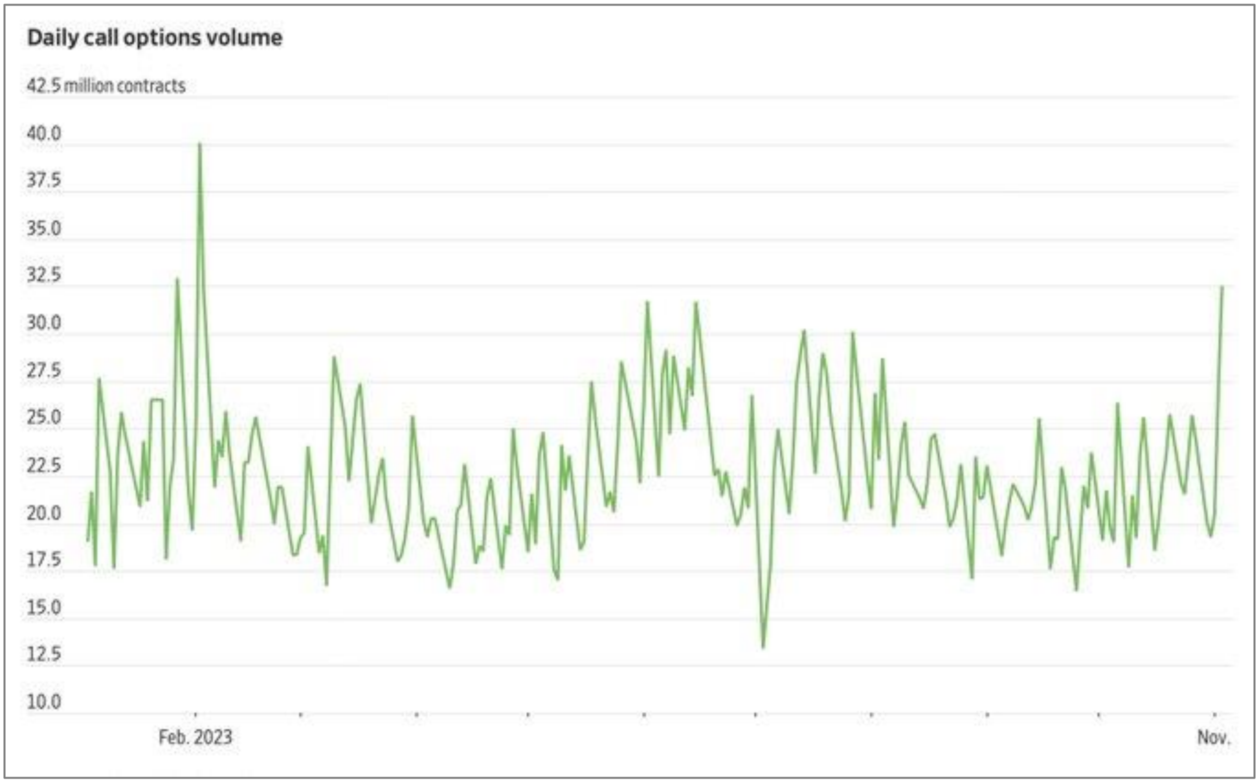
Rydex Ratio is back above 80% - October decline was barely a blip.



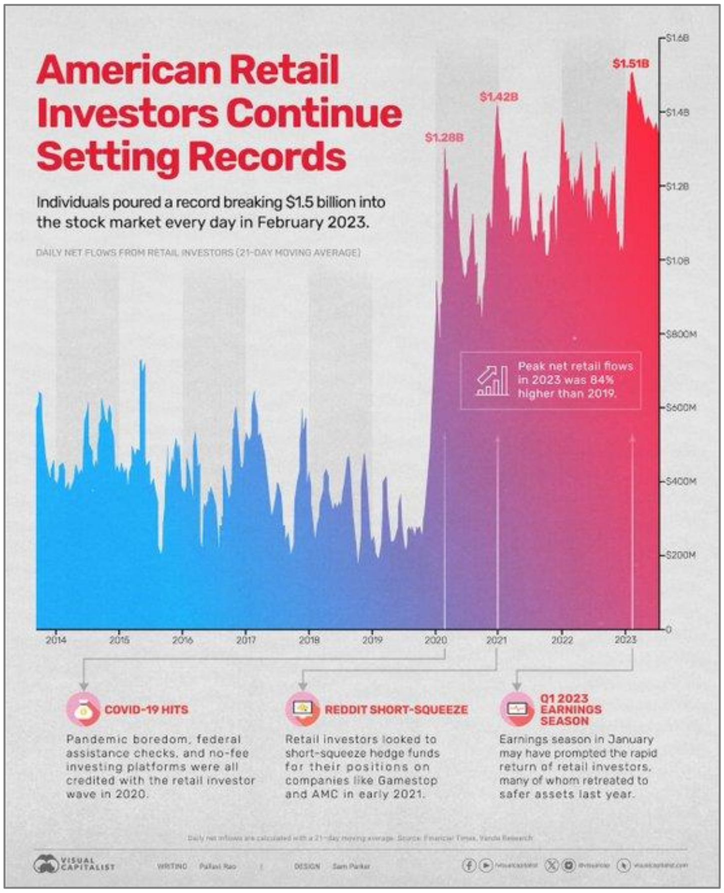
Leveraged to Inverse Assets crossed back into the Euphoria Zone



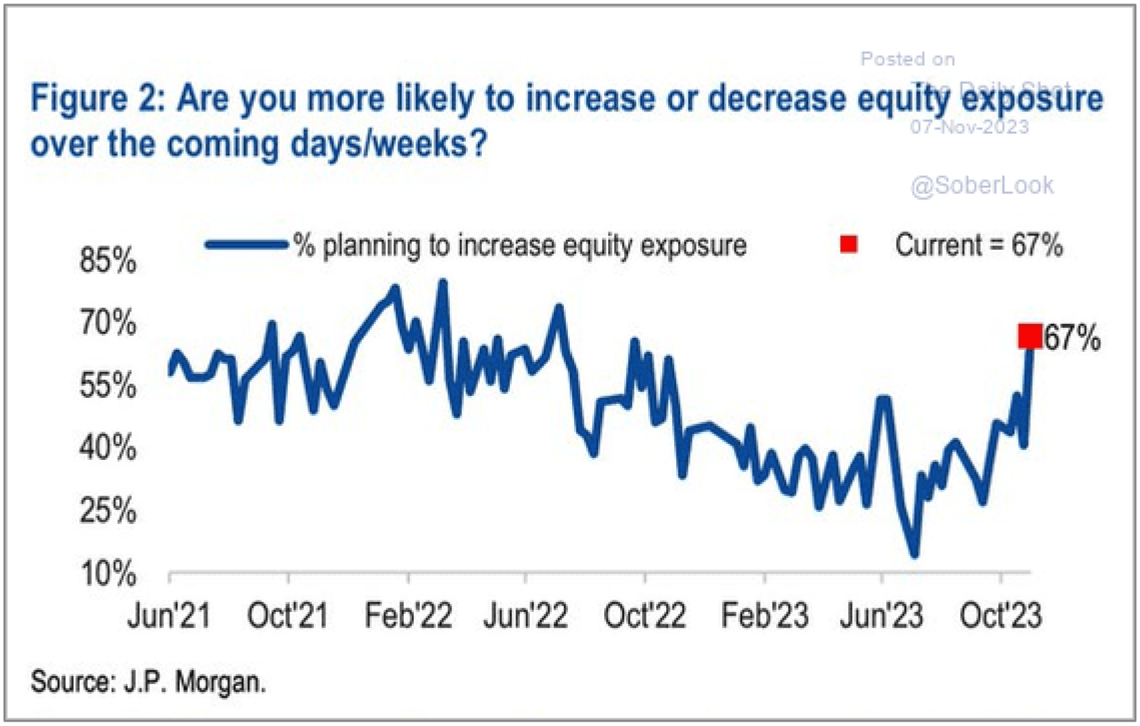
Call Options volume surged to the highest level since February.



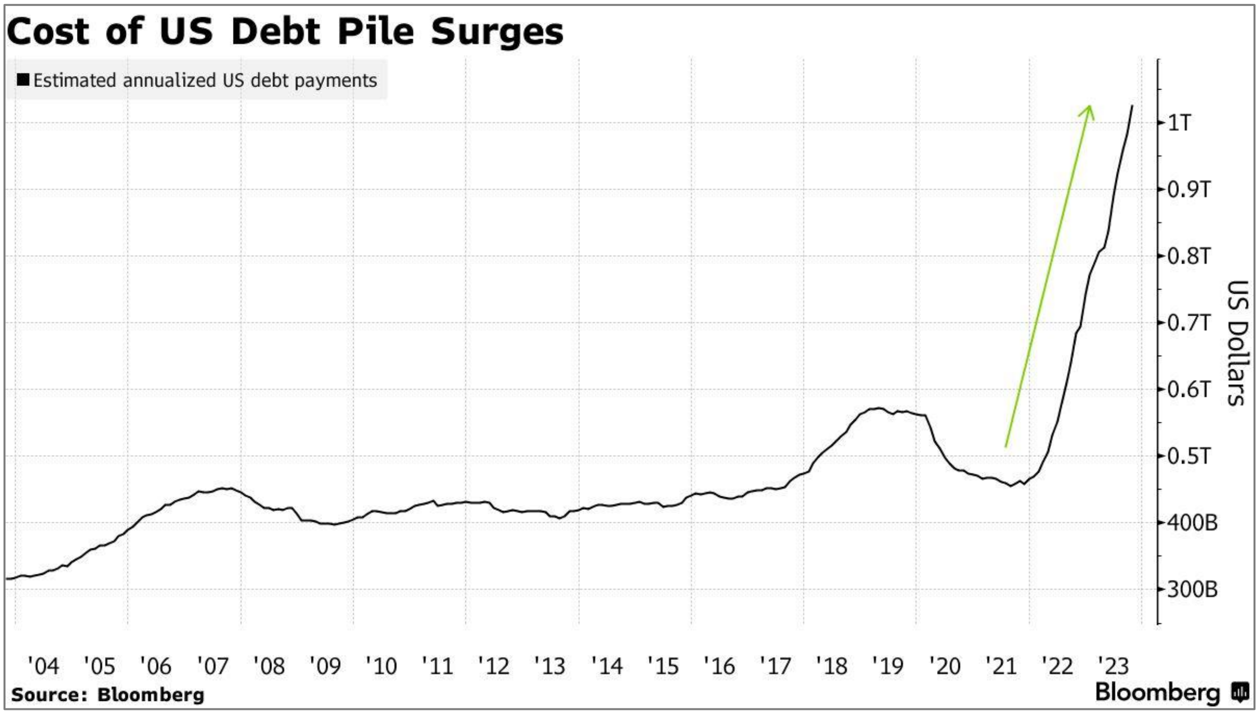
The post-Covid-era of retail stock market speculation has not ended.



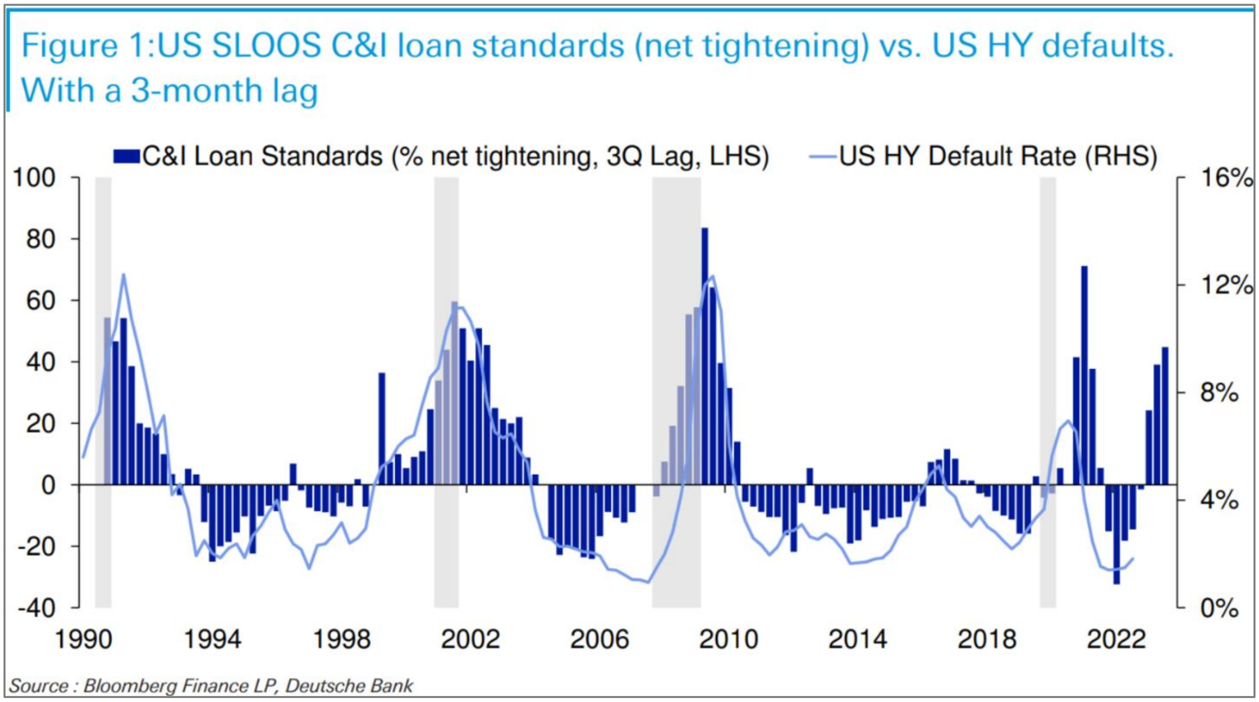
Investors are looking to increase equity exposure.



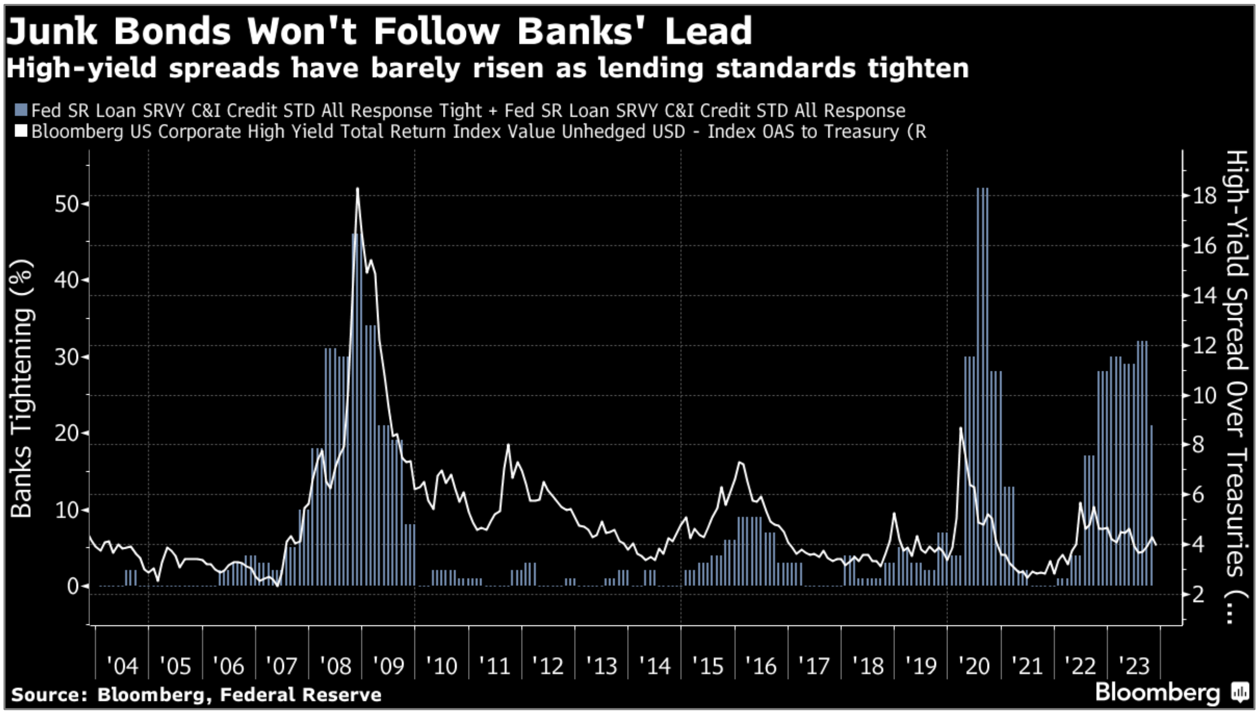
US Debt payments broke above the $1 Trillion level, more than doubling from 2022.



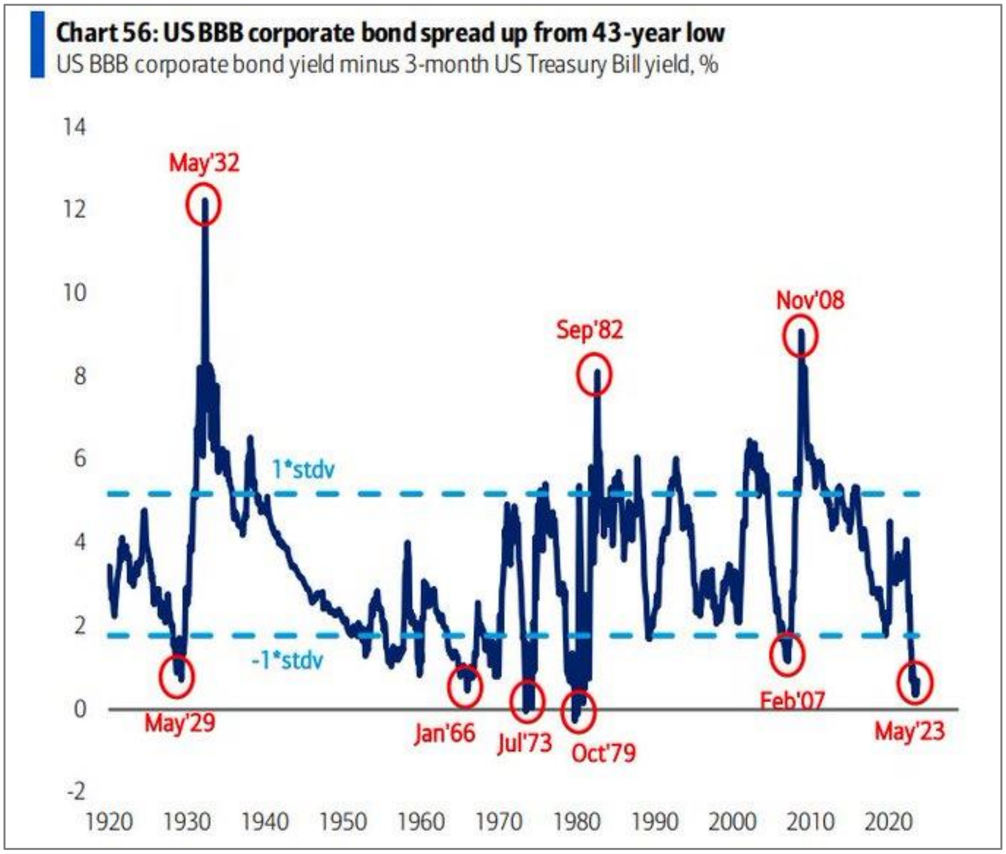
Bankers apprehension to lend suggests that High Yield defaults will likely rise over the next nine months.



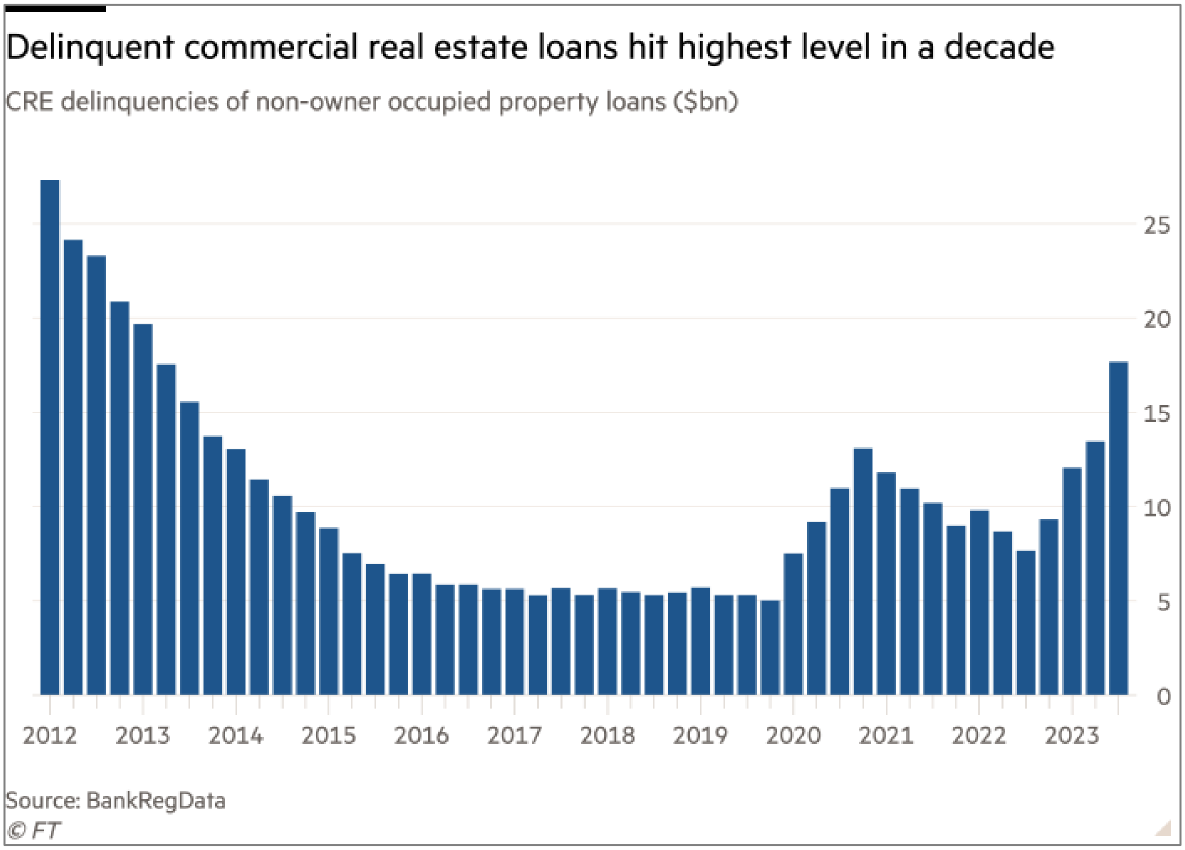
But, Junk Bond investors don't believe it – High yield spreads have barely risen.



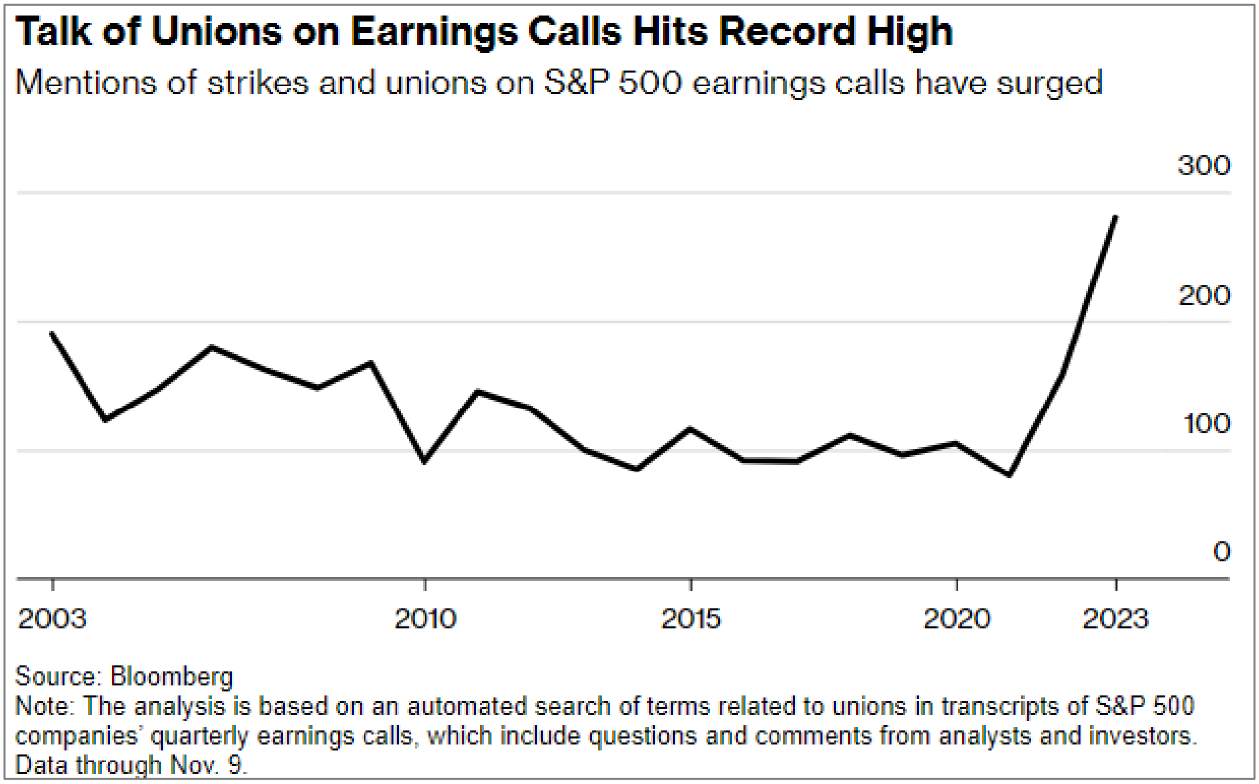
Corporate Bond spreads versus T-Bills set a 43-year low this year.



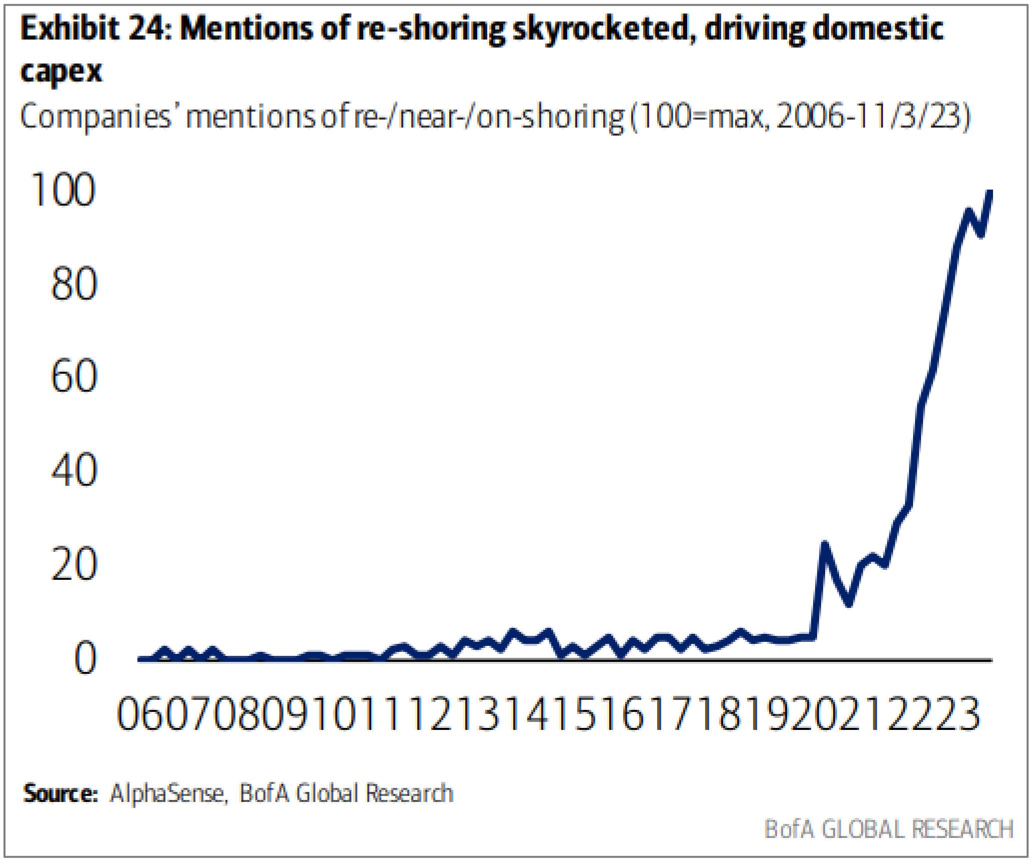
Commercial Real Estate Delinquencies are hitting 10 Year Highs.



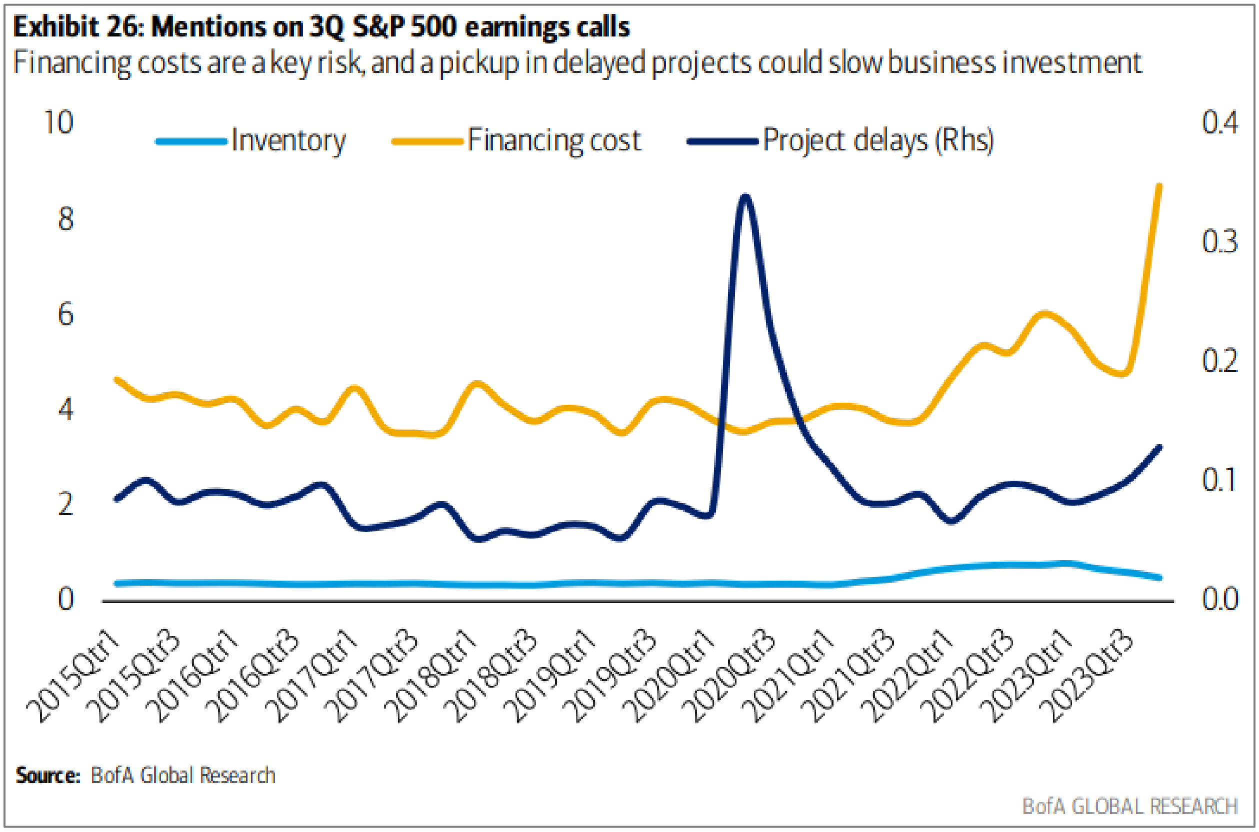
Mentions of strikes and unions have become popular on earnings calls.



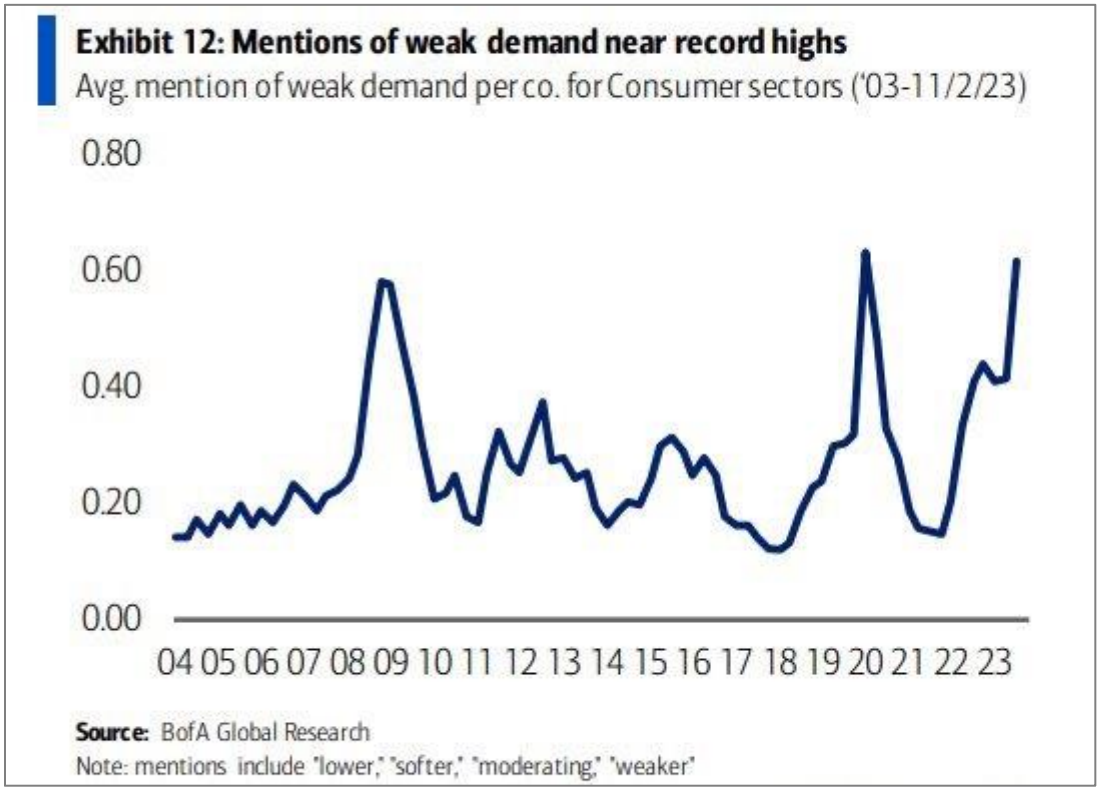
Mentions of re-shoring have also dominated earnings calls.



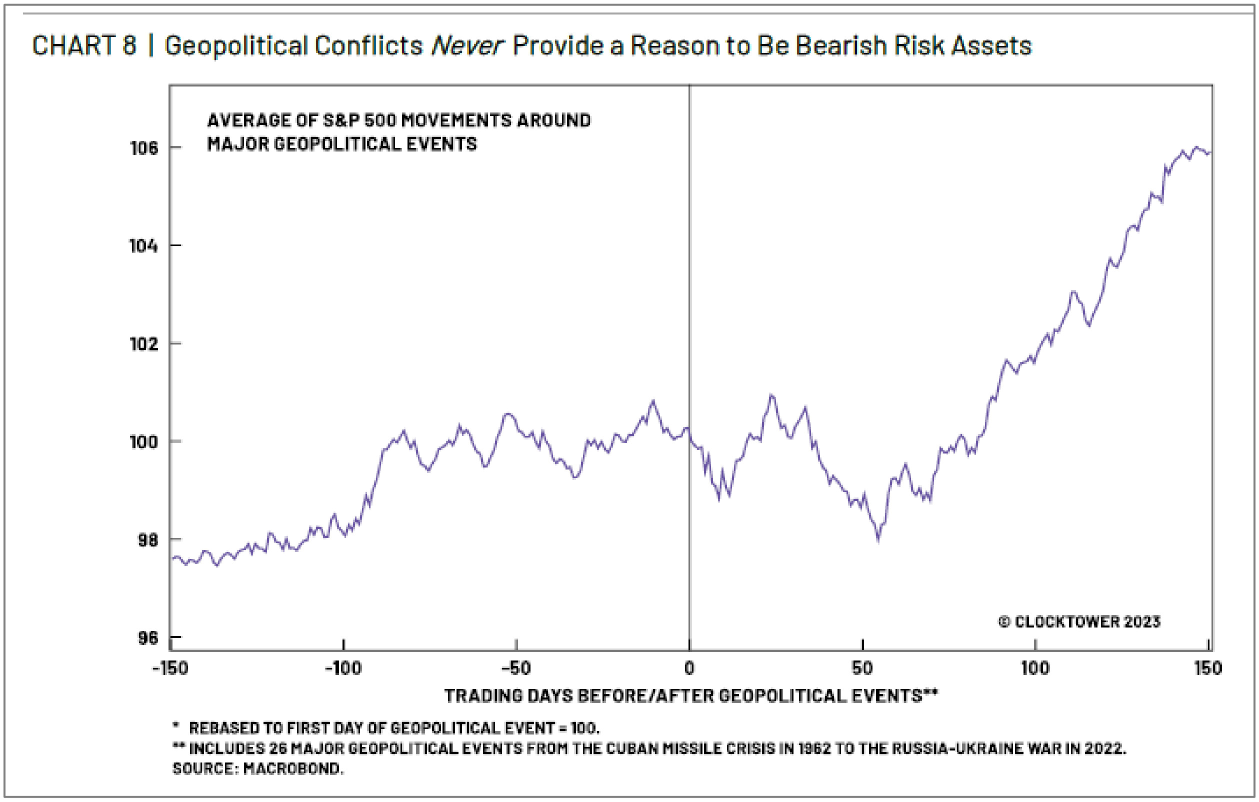
High interest rates – another popular topic on quarterly earnings calls.



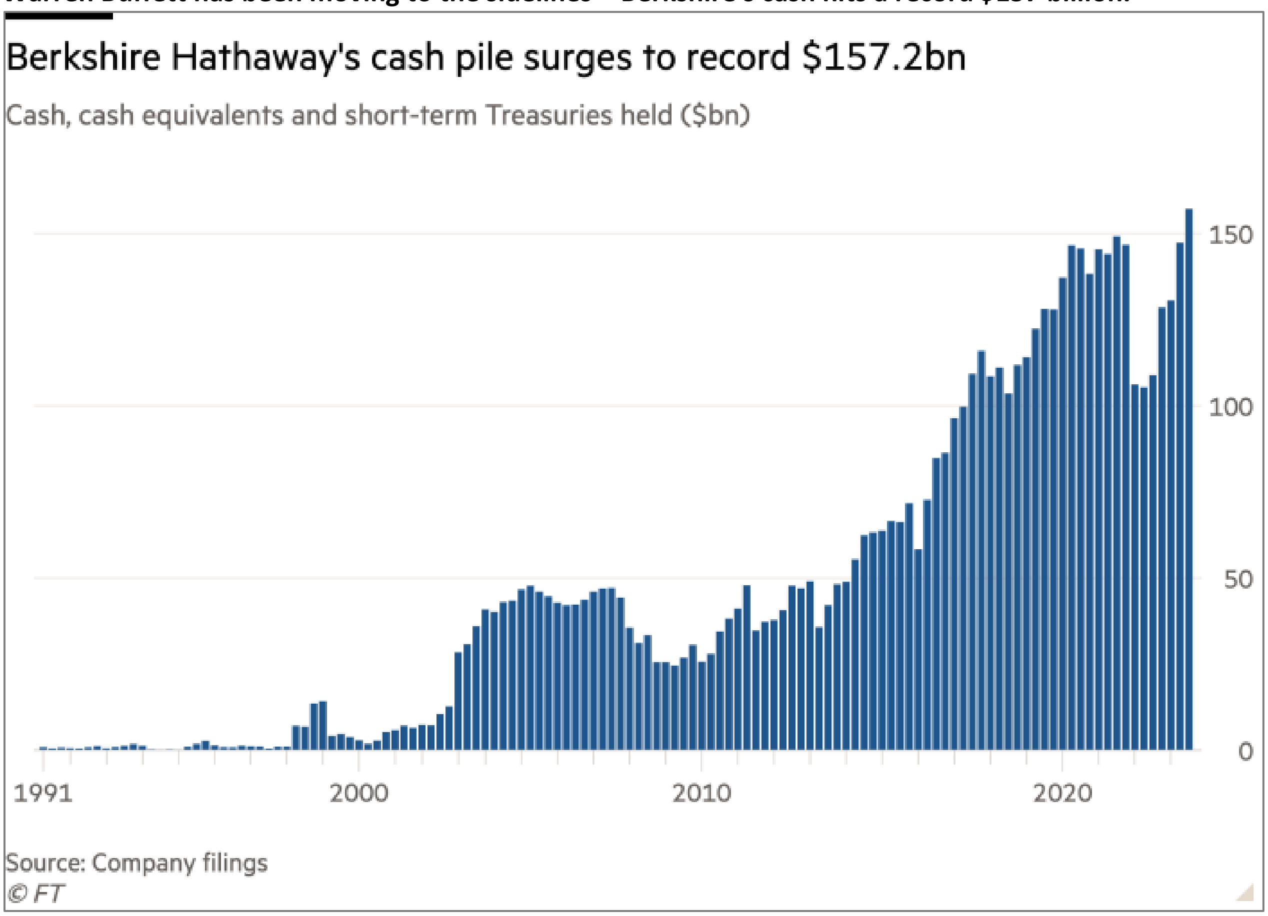
Weak demand – that's also on the minds of corporate executives.



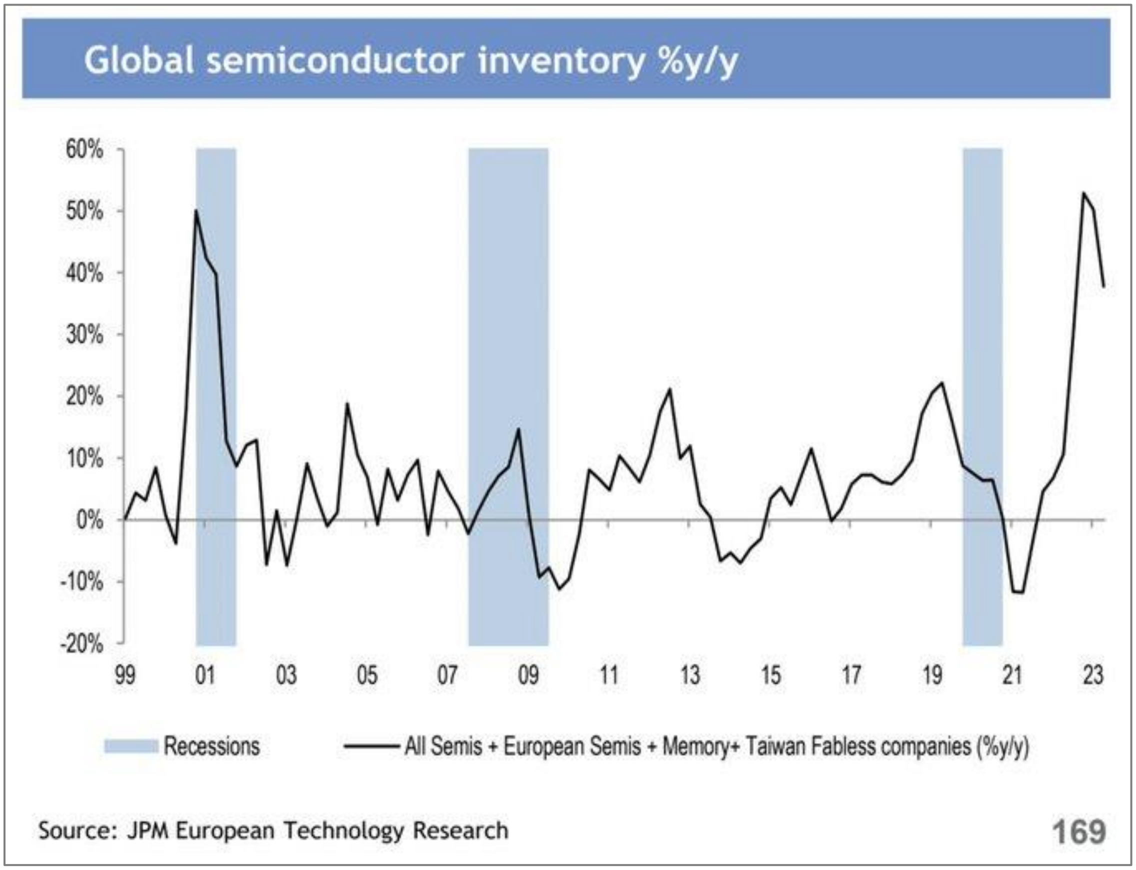
Post WWII, being bearish because of geopolitical events has been a bad idea.



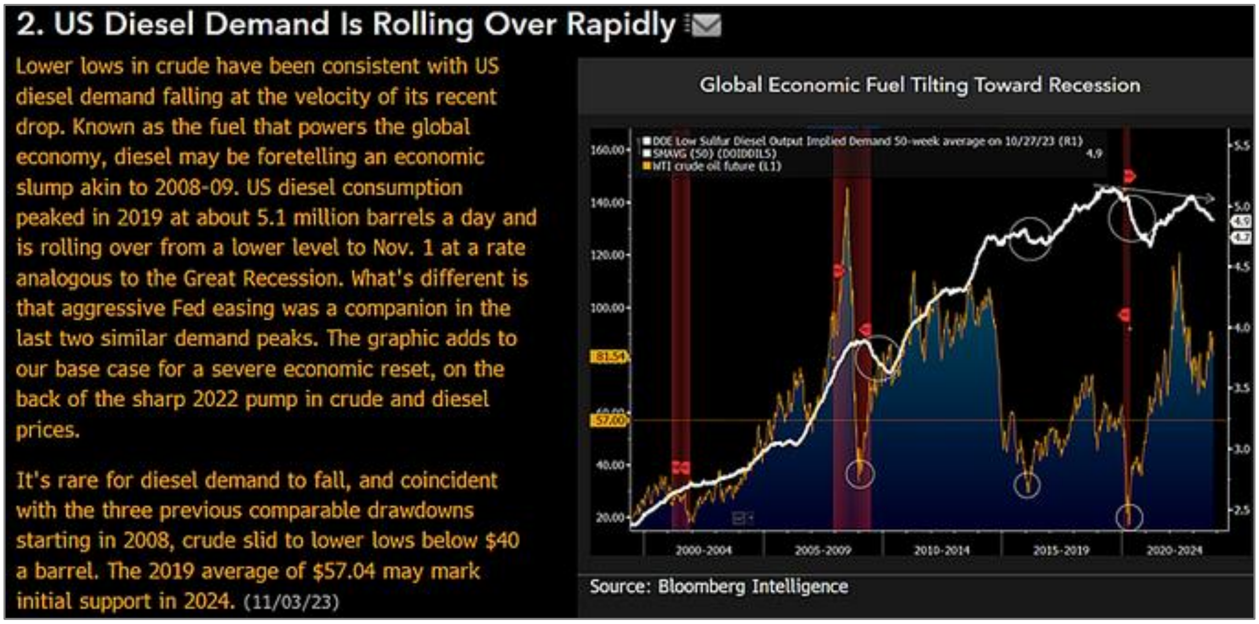
Warren Buffett has been moving to the sidelines – Berkshire's cash hits a record $157 billion.



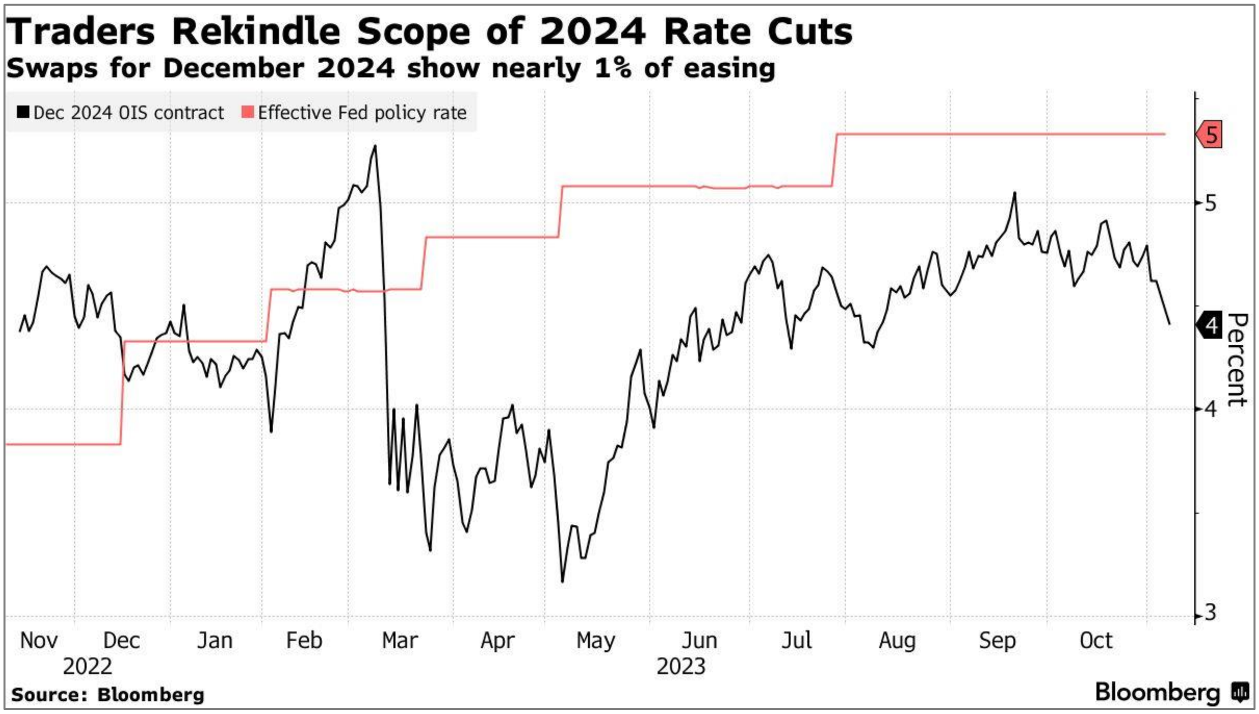
Global semiconductor inventories are rolling over.



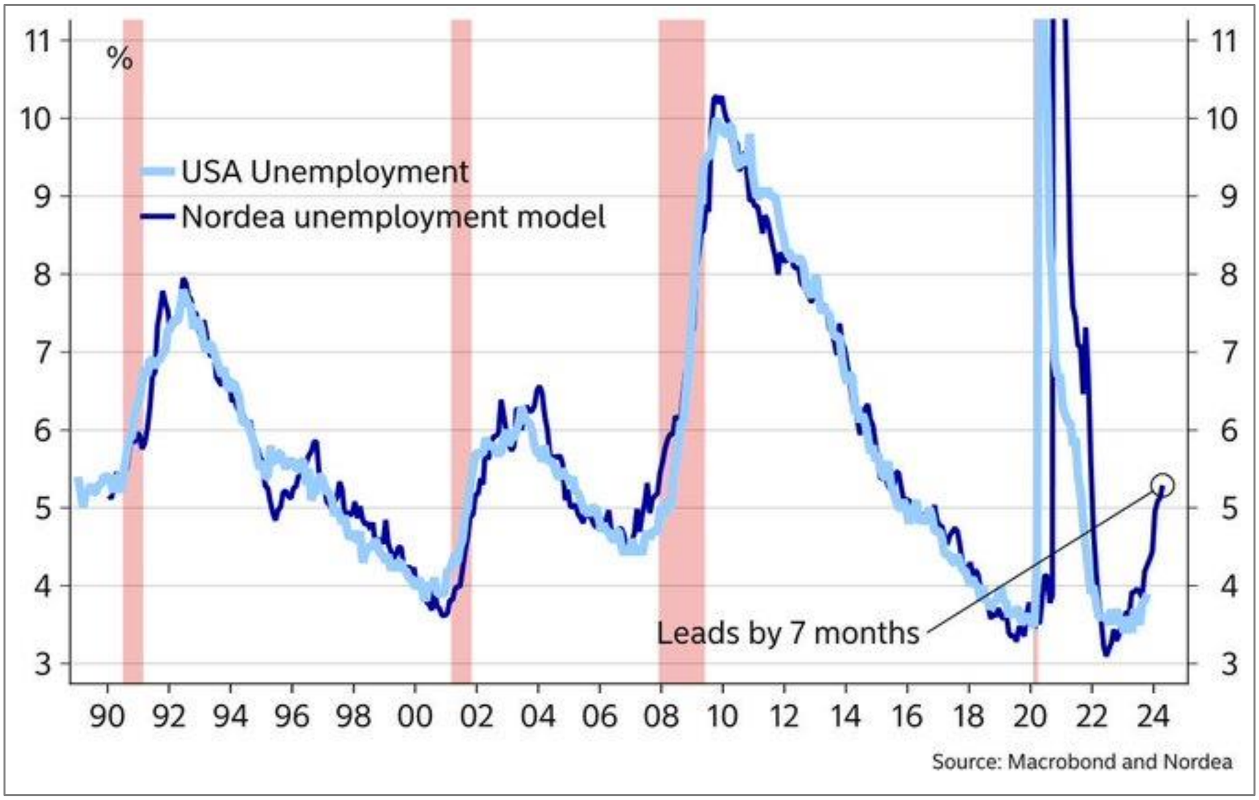
US Diesel Demand is rolling over.



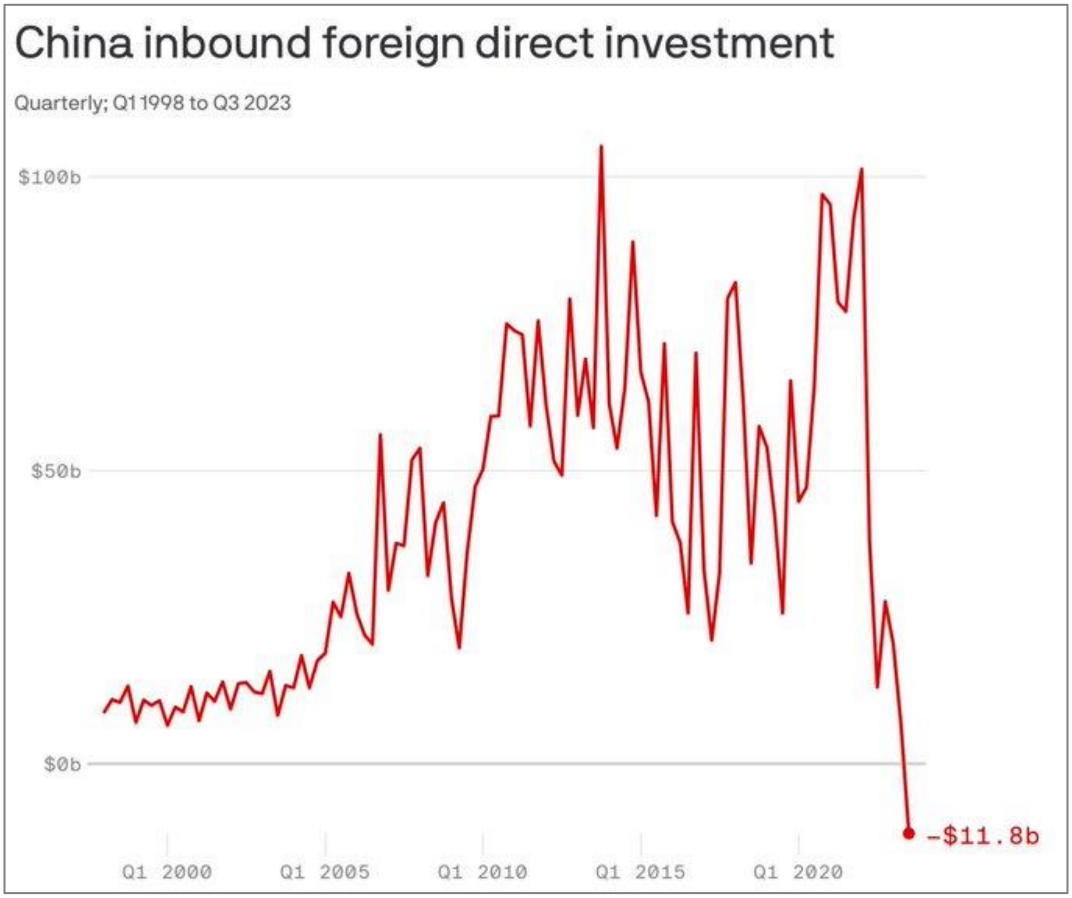
The bond market is betting on a Fed pivot again.



Nordea's unemployment model implies 5% unemployment by next summer.



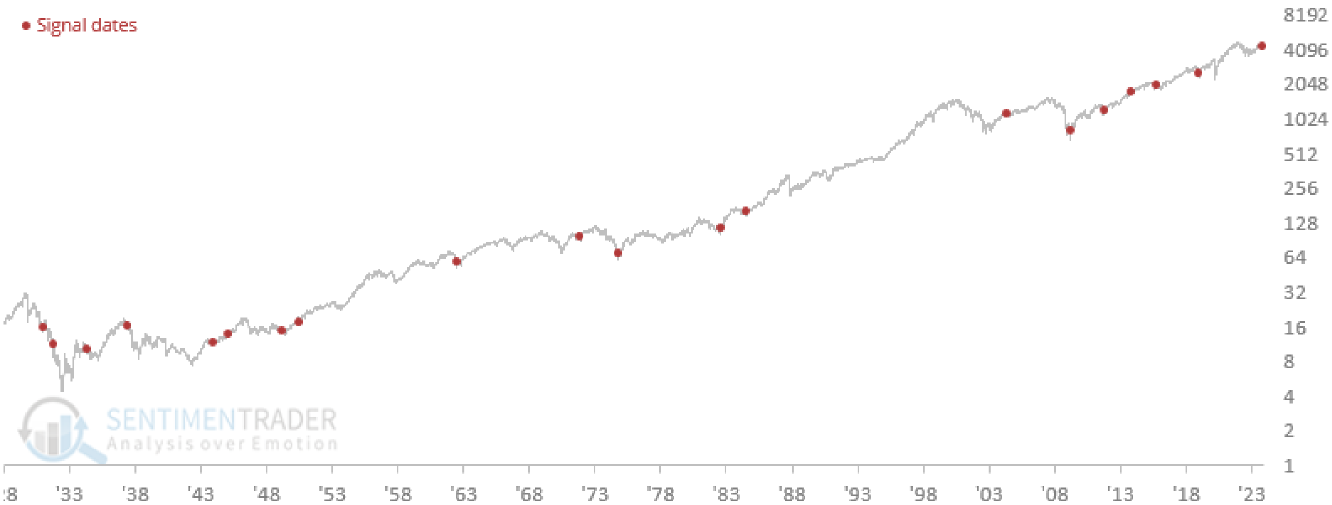
People pulling money out of China. Foreign Direct Investment turns negative for the 1st time since 98.



Inflation expectations of US consumers hit a 12-year high.

Zweig Breadth Thrusts going back to 1930.
It has never failed over six and twelve months going back to 1943.

S&P 500 after first NYSE Zweig Breadth Thrust in > 1 year



Dates of 19 Signals	# Days Since Thrust	1 Week Later	2 Weeks Later	1 Month Later	2 Months Later	3 Months Later	6 Months Later	12 Months Later
1931-01-05	1463	-0.6	-3.0	1.9	8.7	2.2	-4.2	-52.6
1931-11-06	253	-3.5	-11.3	-18.8	-22.9	-31.4	-45.9	-37.7
1934-06-11	345	2.8	-3.6	-1.0	-9.5	-13.8	-9.0	1.3
1937-07-06	795	0.9	4.2	4.7	-5.5	-16.4	-32.8	-25.3
1943-12-08	1326	-0.5	0.9	3.4	0.9	4.4	7.0	12.7
1945-02-05	345	1.5	3.7	3.1	0.8	9.2	6.0	32.0
1949-03-08	1157	0.6	-0.8	0.2	0.2	-7.1	2.6	15.0
1950-07-21	387	0.6	3.1	6.3	9.2	13.5	20.9	26.9
1962-07-11	3072	-2.7	-2.2	-0.5	1.2	-0.9	12.1	20.8
1971-12-03	2259	0.6	3.3	5.2	7.9	11.2	13.1	20.9
1974-10-10	718	2.0	0.6	7.3	-3.6	4.0	20.6	26.6
1982-08-20	1927	3.6	8.5	10.5	23.2	22.4	30.5	44.7
1984-08-03	494	1.9	1.1	1.6	0.1	3.2	10.0	17.9
2004-05-25	4997	1.1	1.6	1.9	-1.6	-0.7	5.7	6.9
2009-03-18	1210	2.5	2.1	9.5	14.5	14.6	34.5	46.8
2011-10-14	650	1.1	4.9	2.2	-1.0	5.6	13.6	17.6
2013-10-18	504	0.9	1.0	2.7	3.8	5.7	7.7	9.1
2015-10-08	495	0.5	1.9	4.3	2.5	-4.5	1.4	7.0
2019-01-07	815	1.3	3.3	7.1	7.6	13.6	16.9	27.0
2023-11-03	1215							
Median	**805**	**0.9**	**1.6**	**3.1**	**0.9**	**4.0**	**7.7**	**17.6**
% Positive		**79%**	**74%**	**84%**	**68%**	**63%**	**79%**	**84%**
Avg Max Loss		-0.4	-0.6	-0.6	-2.3	-3.2	-4.5	-4.5
Avg Max Gain		1.5	3.1	4.8	4.9	6.0	12.1	19.7
Z-Score		2.0	1.5	1.8	-0.1	0.8	1.0	1.9

 Numbers are % return after signal; Risk = avg max loss; Reward = avg max gain; Z-Score +/- 2 suggests significance.

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.