Market Outlook

By Mark T Dodson, CFA

Market Risk Index jumps higher

The Market Risk Index jumped to 74.1%, just shy of the 75% level we use to denote markets with significant drawdown risks. Both Monetary Conditions and Psychology conditions deteriorated noticeably.

The Monetary composite's worsening has come as the Velocity category has shifted from positive to neutral over recent weeks. This category and its indicators are our attempts to measure velocity in the economy in novel ways – by measuring the interactions between banks, the Federal Reserve, and Households. The shift to neutral could be the first sign that tight monetary policy from the Fed and apprehension by banks to lend might finally be leading to a desire for households to hold onto more of their cash. Since the government dumped $5 trillion on Households in the name of fighting Covid, they've only shown an interest in spending down that cash, driving inflation higher as the money chased goods and services in the economy. Our Velocity category turns negative when Households' desire to hold more cash increases rapidly.

Psychology is edging closer to the worst 10 percent of readings, but we aren't close to the pervasiveness of euphoria we saw at the end of July. Still, softer-than-expected inflation readings and renewed hopes for a Fed pivot are putting investors in a more ebullient mood. The deluge of bullish stories of rare breadth thrusts named for market technicians from previous eras may also be having a bullish impact on sentiment. Global search interest in 'breadth thrusts' hit five-year highs.

Once a rarity, breadth thrusts seem to have become an annual re-occurring event, with this being the third year in a row with a bevy of different breadth thrusts occurring around the start of a new year. The first two years had mixed results and were not the slam dunk case studies for throwing caution to the wind because of a breadth thrust.

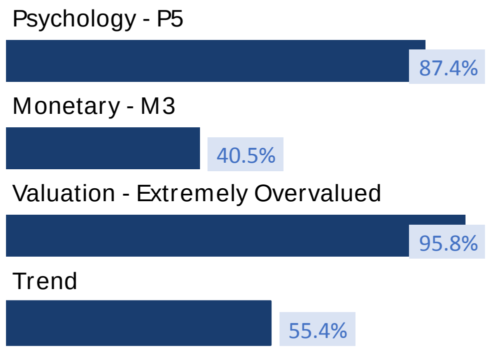
An increasing prevalence of breadth thrusts would not be the first area of indicators impacted during the speculative era of retail trading ushered in post-Covid. We have previously noted that extreme readings in equity put/call ratios have become more prevalent, likely due to the explosion in 0DTE options trading. Case in point – the standard deviation (variability) of the CBOE Equity Put/Call ratio is at all-time highs.

Market Risk Index

Rec Allocation 25% Underweight

74.1%

Category Percentiles



Largest Psychology Influences

Leveraged Investments	Negative
Technical Indicators	Negative
Bank Sentiment	Negative
Insider Sentiment	Positive

Largest Monetary Influences

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

Valuation

7-10 Year Equity Return Forecast	1.6%
10Yr US Treasury Yield	4.4%

Market Trends

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

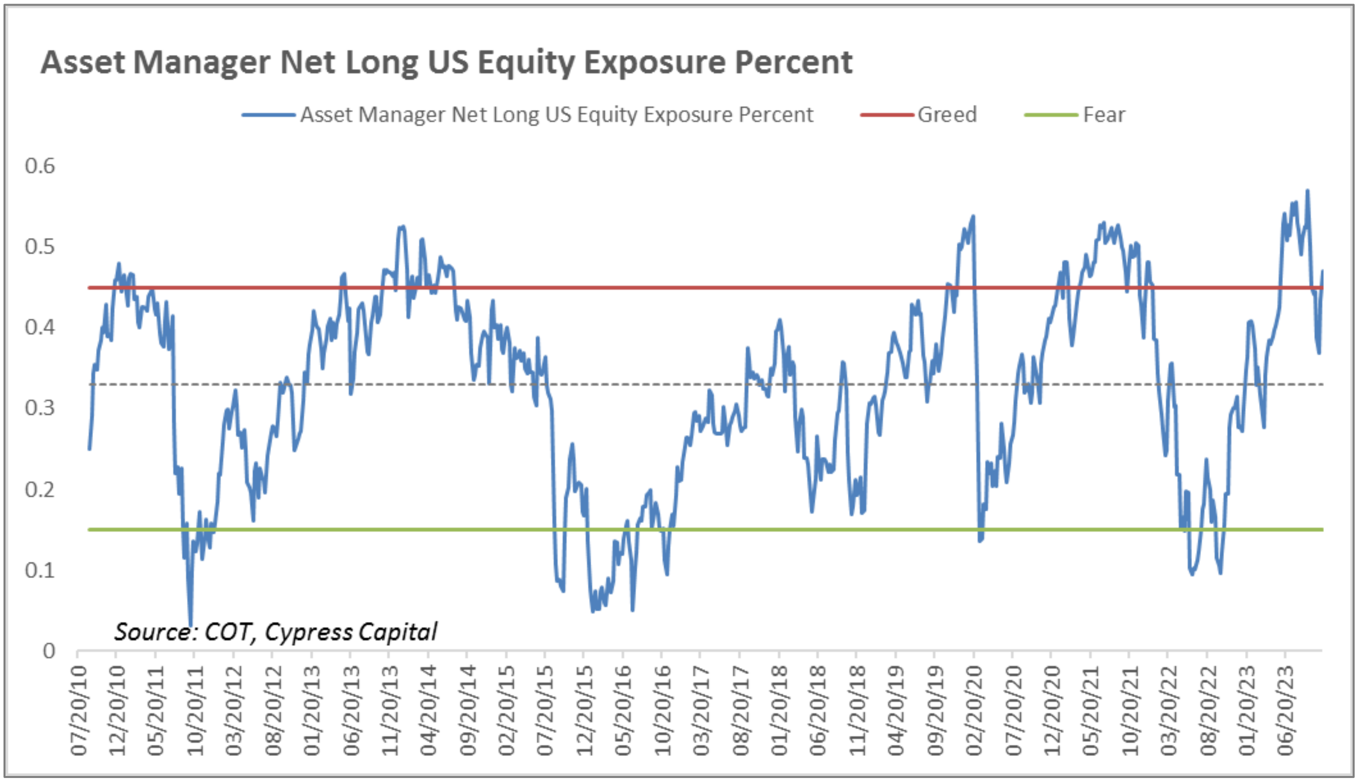
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets based on our model & opinion. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

The most notable extreme breached in Psychology was in derivatives markets. Equity futures positioning among asset managers has grown euphoric again, confirming a similar move we witnessed from investors in Leveraged ETFs the previous week.

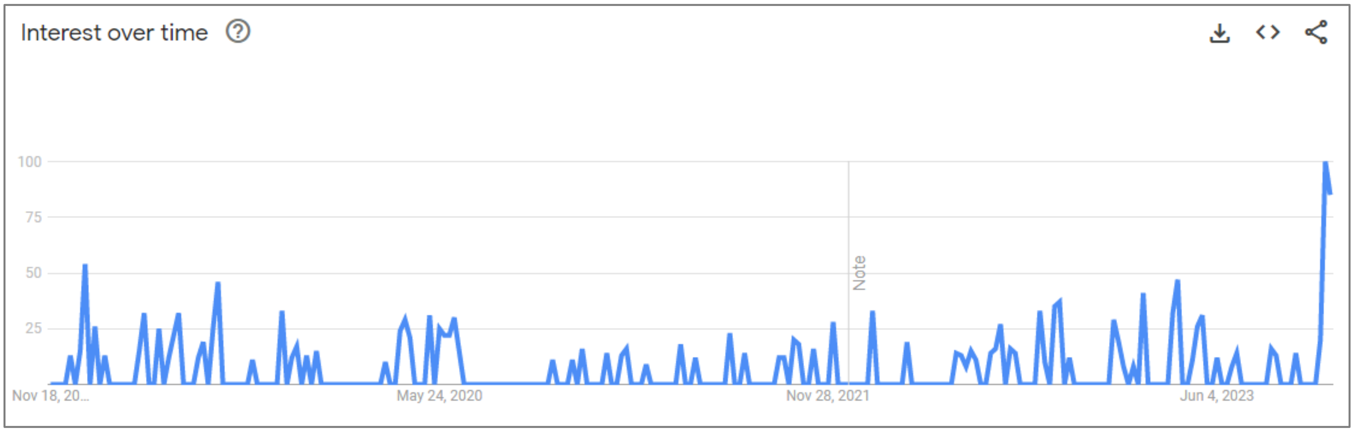
Have a Happy Thanksgiving. We will not issue a Market Outlook next week unless market conditions warrant it. Thanks for reading.

Charts of the Week

Leverage is back! After a short reprieve, futures positioning in US Equities has gotten greedy again.

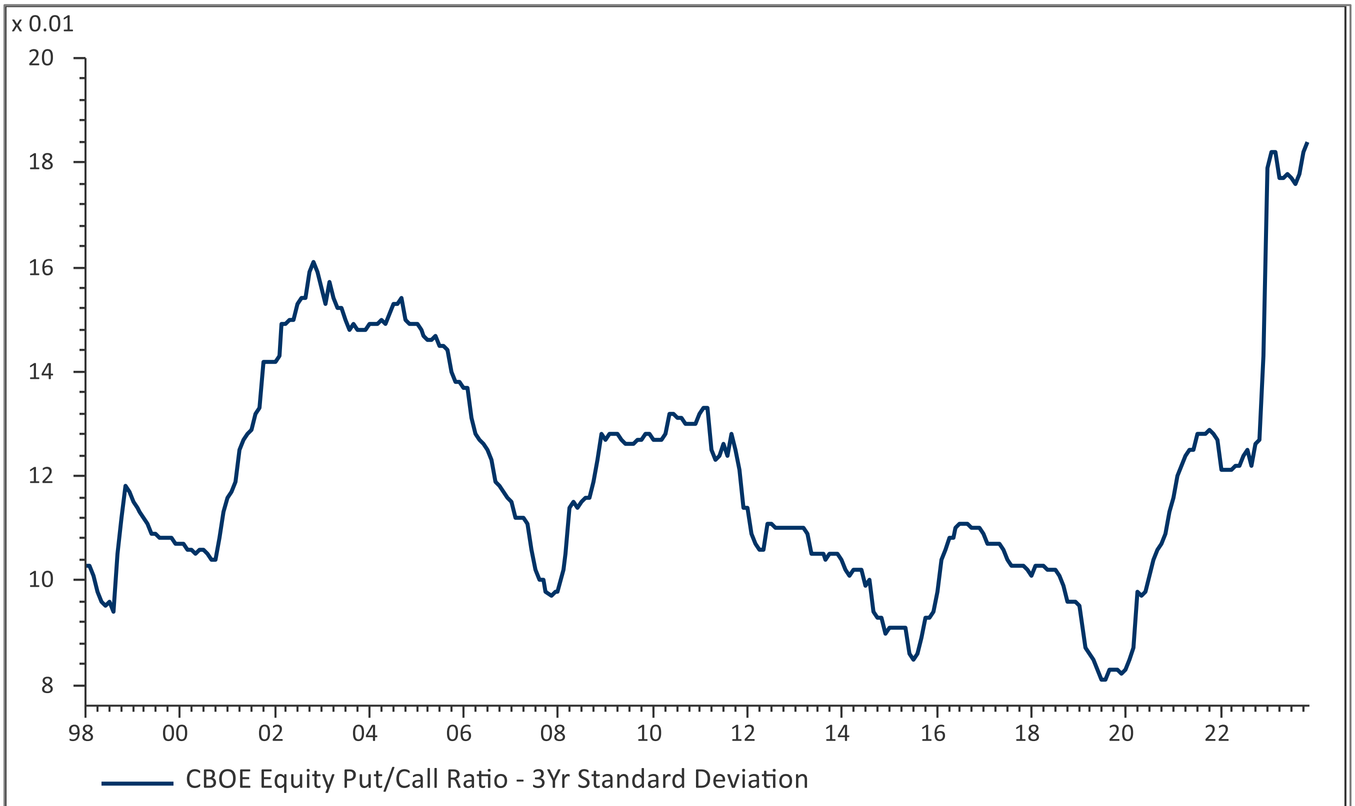


Global Search Interest in Breadth Thrusts is hitting five-year highs.



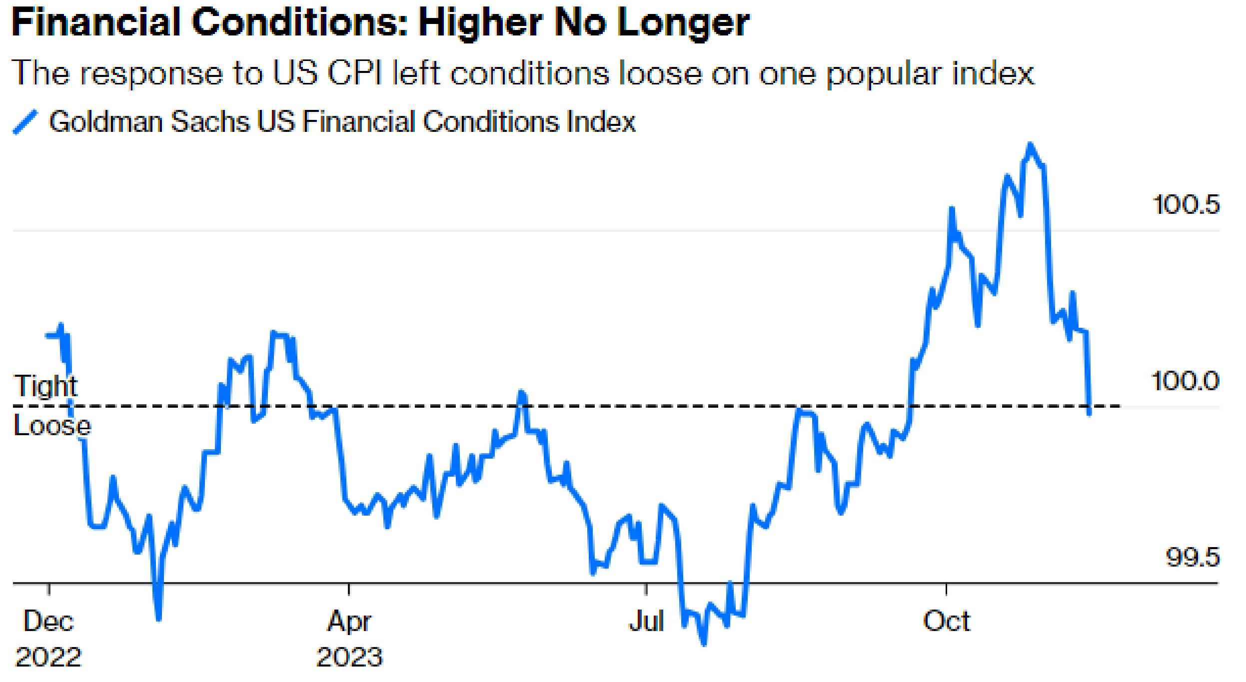
Source: Google Trends

Standard Deviation of Equity Put/Call Ratio is hitting all-time highs.
Extreme equity put/call ratio readings are more prevalent in the era dominated by 0DTE options trading.



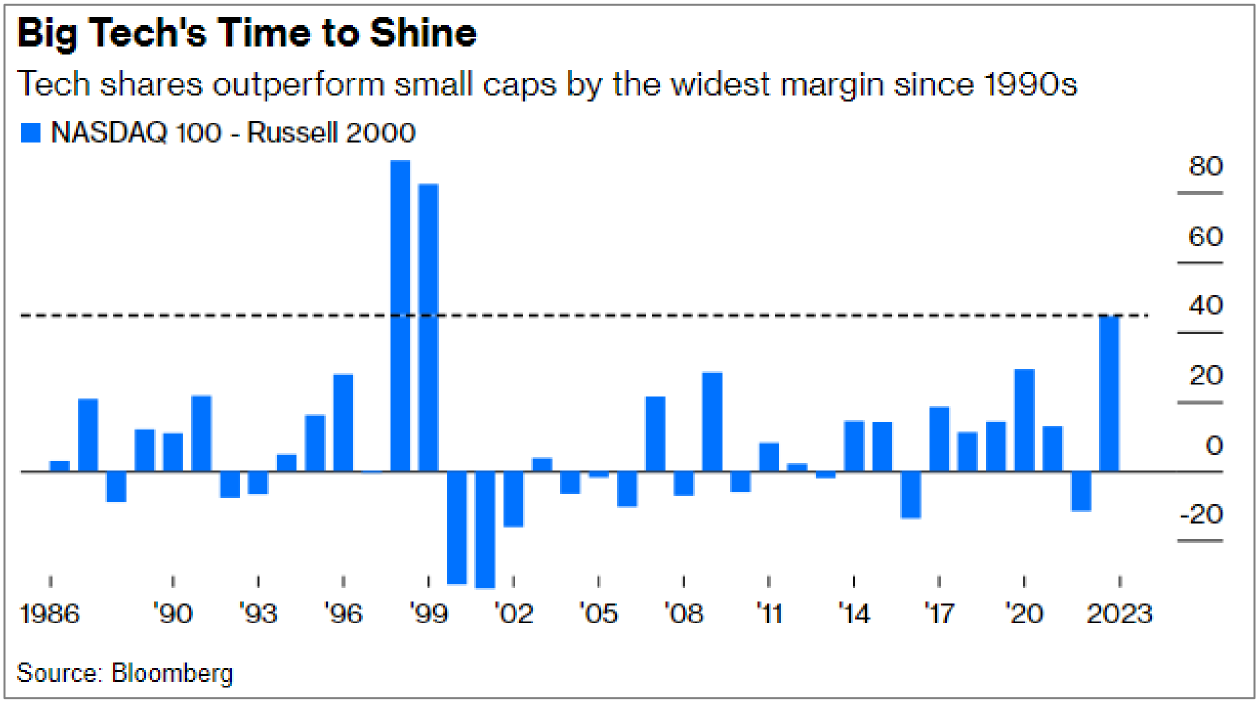
Source: LSEG Datastream, Cypress Capital

Bullish investor response to CPI results has led to easier Financial Conditions.

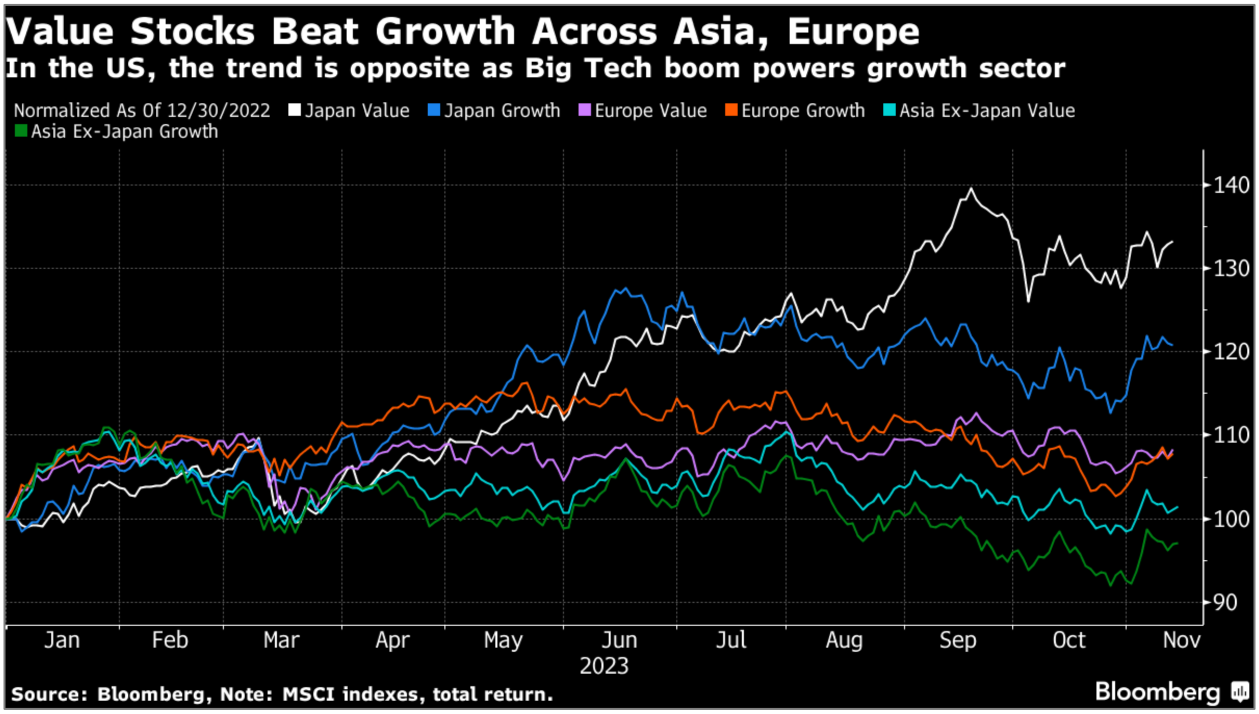


Source: Bloomberg

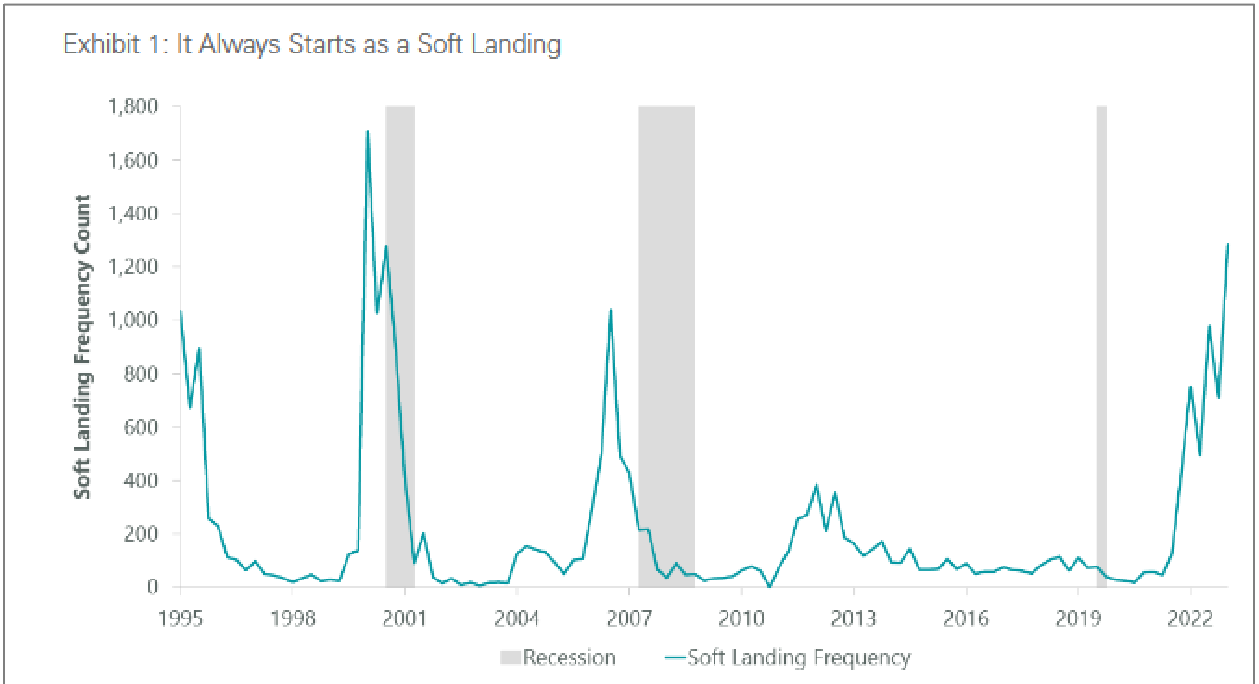
Tech stocks outperform small caps by the widest margin since the dot-com era.



Value has fared better than Growth outside the United States.

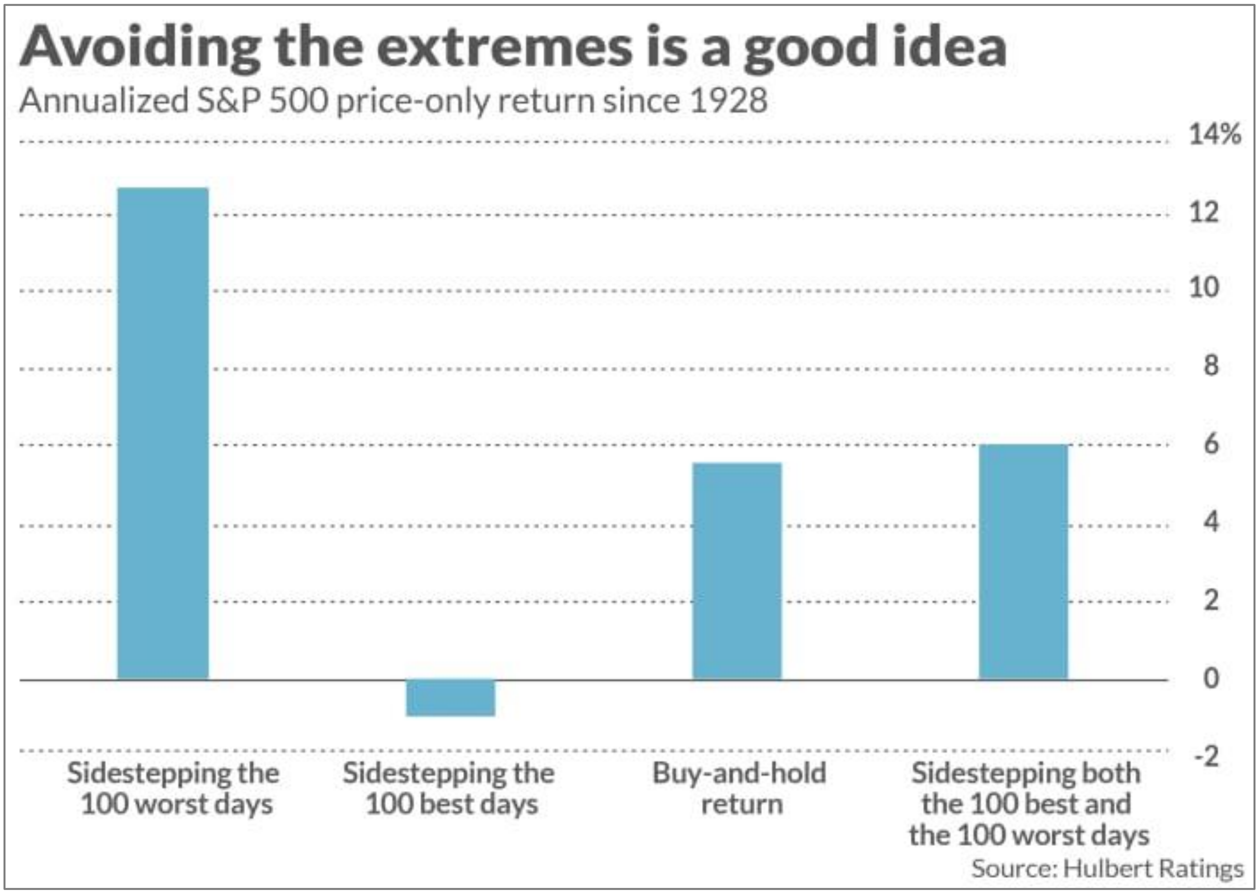


Interest in Soft-Landings has not slowed.

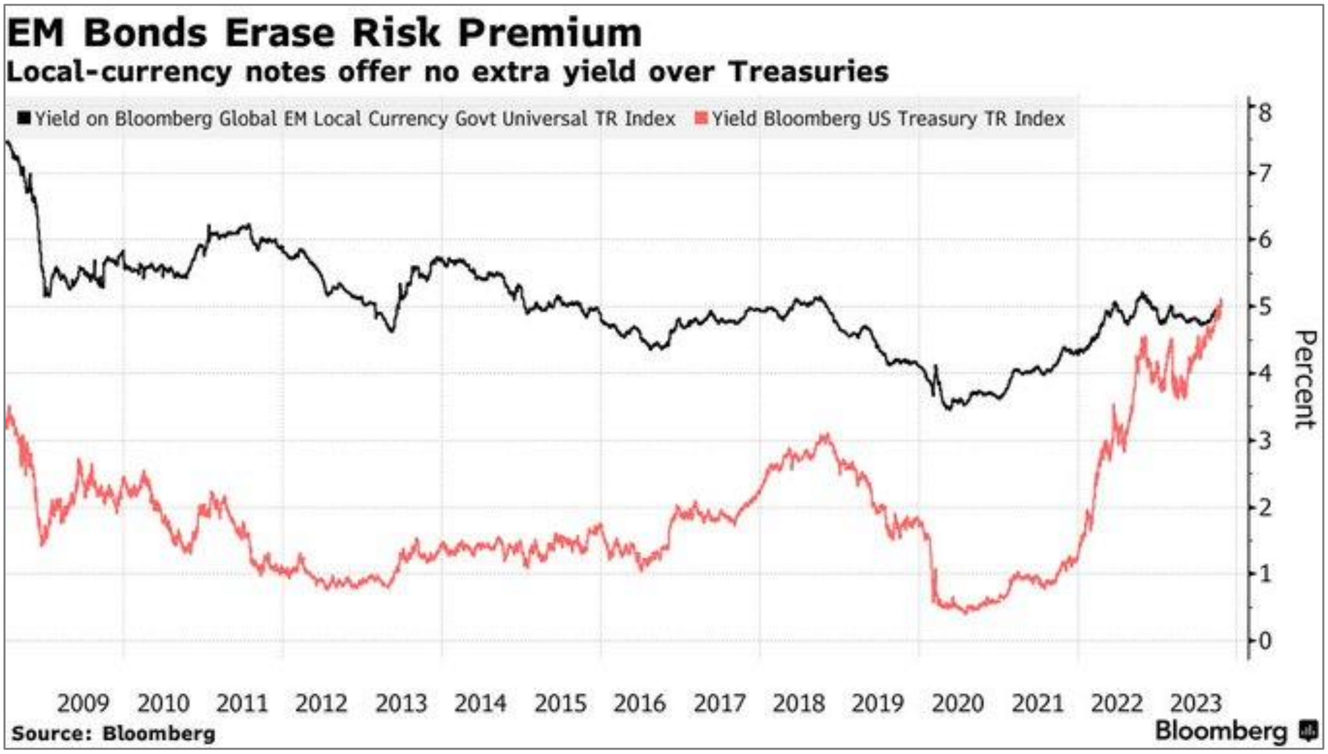


Note: Soft landing frequency is the count of mentions of the term "soft landing" in company filings, transcripts, and presentations since 3Q95. Data as of Sept. 30, 2023. Source: NBER and Bloomberg.

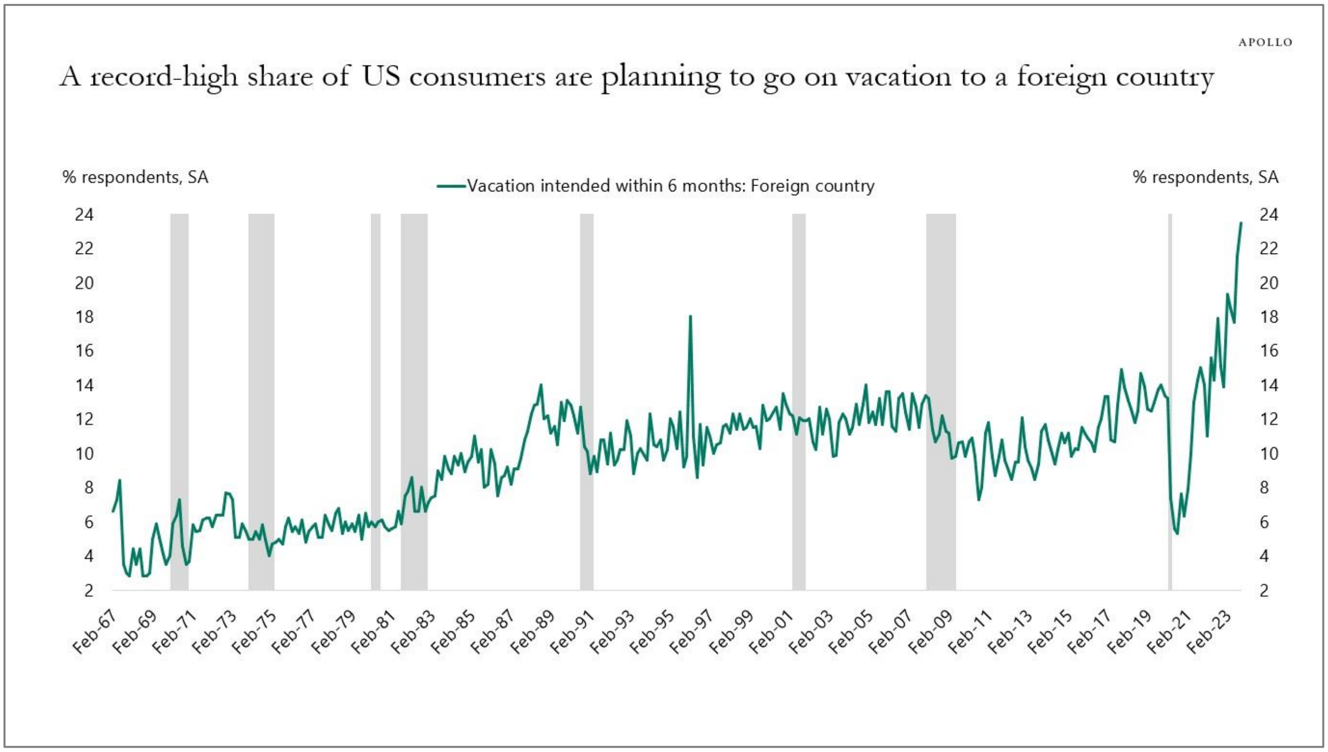
Avoiding extremes in markets.



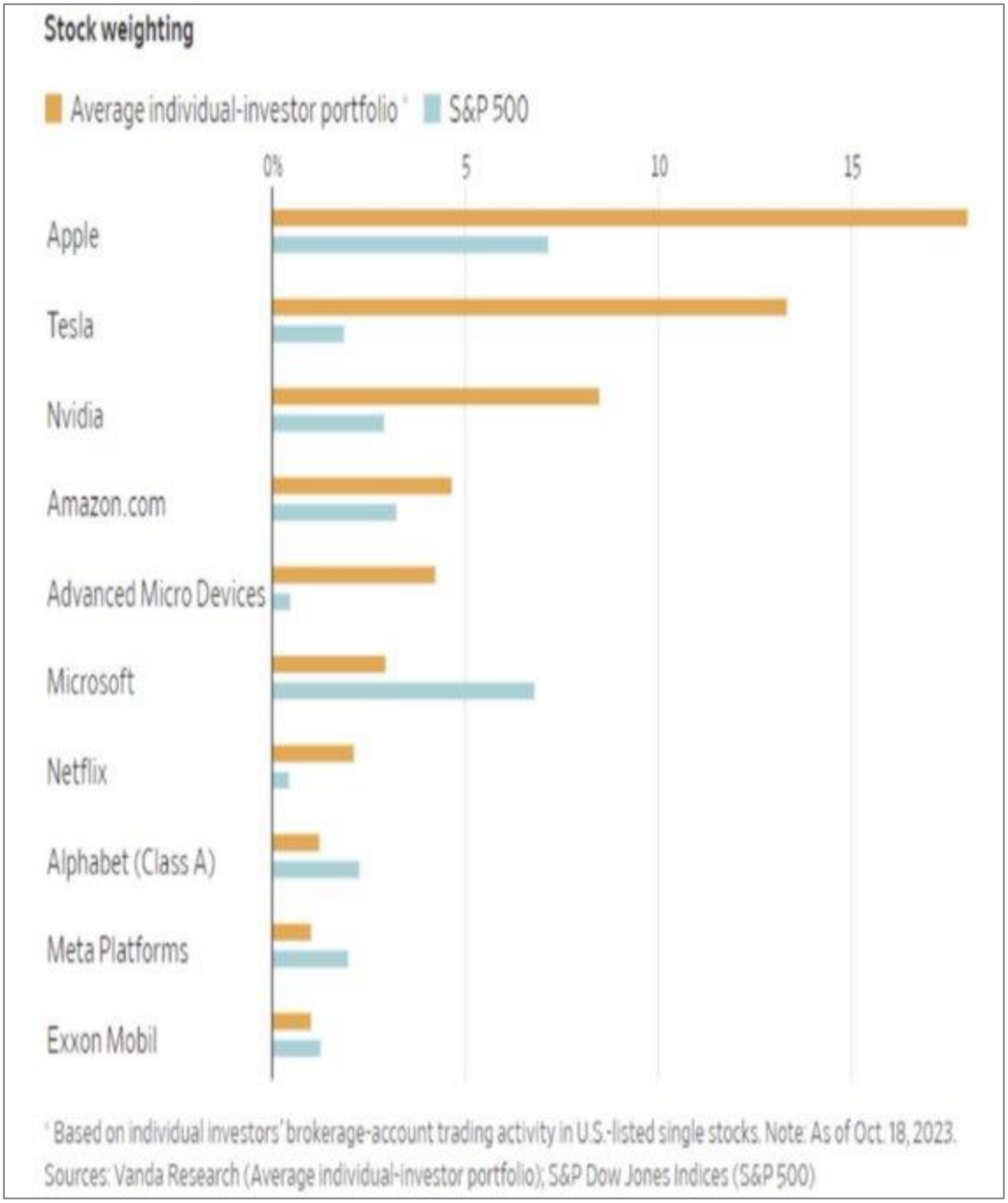
No premium for owning Emerging Market Debt.



Record share of US consumers are planning on vacationing in a foreign country.



Retail investors haven't been afraid to concentrate positions in the Magnificent Seven.



Source: @MichaealAArouet

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.