Market Outlook

By Mark T Dodson, CFA

Front-Running the Cowbell

Market Risk Index climbed to 78%, the highest level since July/August and above the 75% level that we use to denote markets with substantial drawdown risk. Psychology, Monetary, and Valuations all worsened since our last report.

Psychology is scoring in the worst decile of readings – any bricks added to the wall of worry in October have been toppled. Euphoric sentiment is not as pervasive across all the categories of our composite as it was back at the July market peak, but some indicators are breaking that threshold. Net bullishness among the AAII Investor Sentiment Survey has broken above the giddy sentiment from July, and the percentage of bearish respondents is the lowest in almost five years. The VIX fell to the lowest level since January 2020, and the ISEE Sentiment Index (15dma) saw the ratio of opening calls to puts climb to the highest level since November 2021, when the NASDAQ Composite peaked.

The Leveraged Investments category is the most prominent negative influence on the composite and is close to its maximum negative score. Exposure by investors to equities using derivatives and leveraged ETFs and funds is firmly in euphoria territory.

Extreme greed readings have become commonplace over recent years, as Buy The Dip was fostered and encouraged by policymakers with post-Lehman policy and then taken to the extreme with post-Covid policy. The answer to every problem for policymakers has been more cowbell. Charlie Munger, may he rest in peace, called this era a “speculative orgy” and likened it to a drunken brawl. Investors have learned the rules of the speculative game so much that the mere anticipation of the possibility of cowbell (the hopes of a Fed pivot) is enough to re-ignite animal spirits.

The yield curve inversion has worsened since October, and both Treasury Bills and Bonds yield more than the earnings yields on stocks. This environment is rewarding patience monetarily like no environment since the dot-com bubble. Yet, investors are doing their best to front-run the cowbell.

Market Risk Index

Rec Allocation 25% Underweight

78.0%

Category Percentiles

Psychology - P6: 91.9%

Monetary - M3: 41.5%

Valuation - Extremely Overvalued: 96.2%

Trend: 47.1%

Largest Psychology Influences

Leveraged Investments	Negative
Bank Sentiment	Negative
Consumer Confidence	Negative
Flow of Funds	Negative

Largest Monetary Influences

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

Valuation

7-10 Year Equity Return Forecast	1.6%
10Yr US Treasury Yield	4.3%

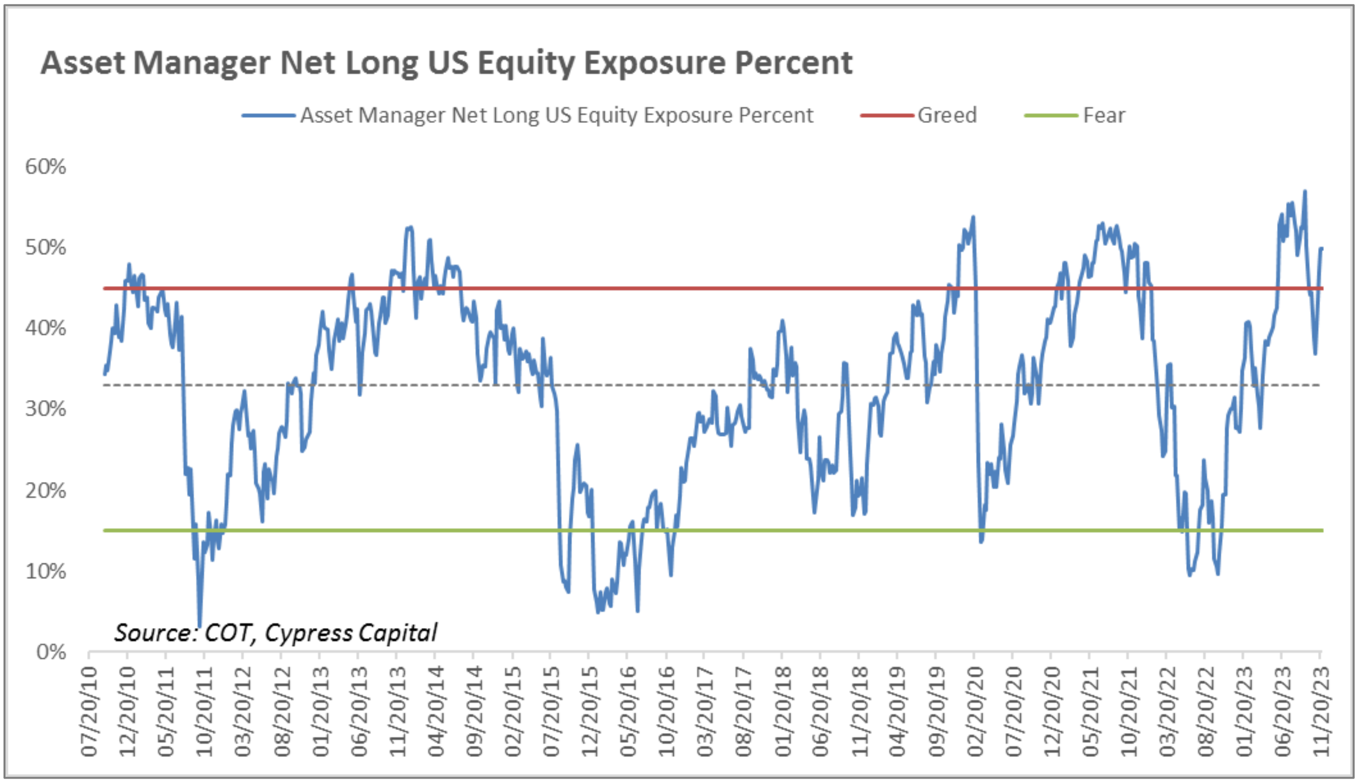
Market Trends

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

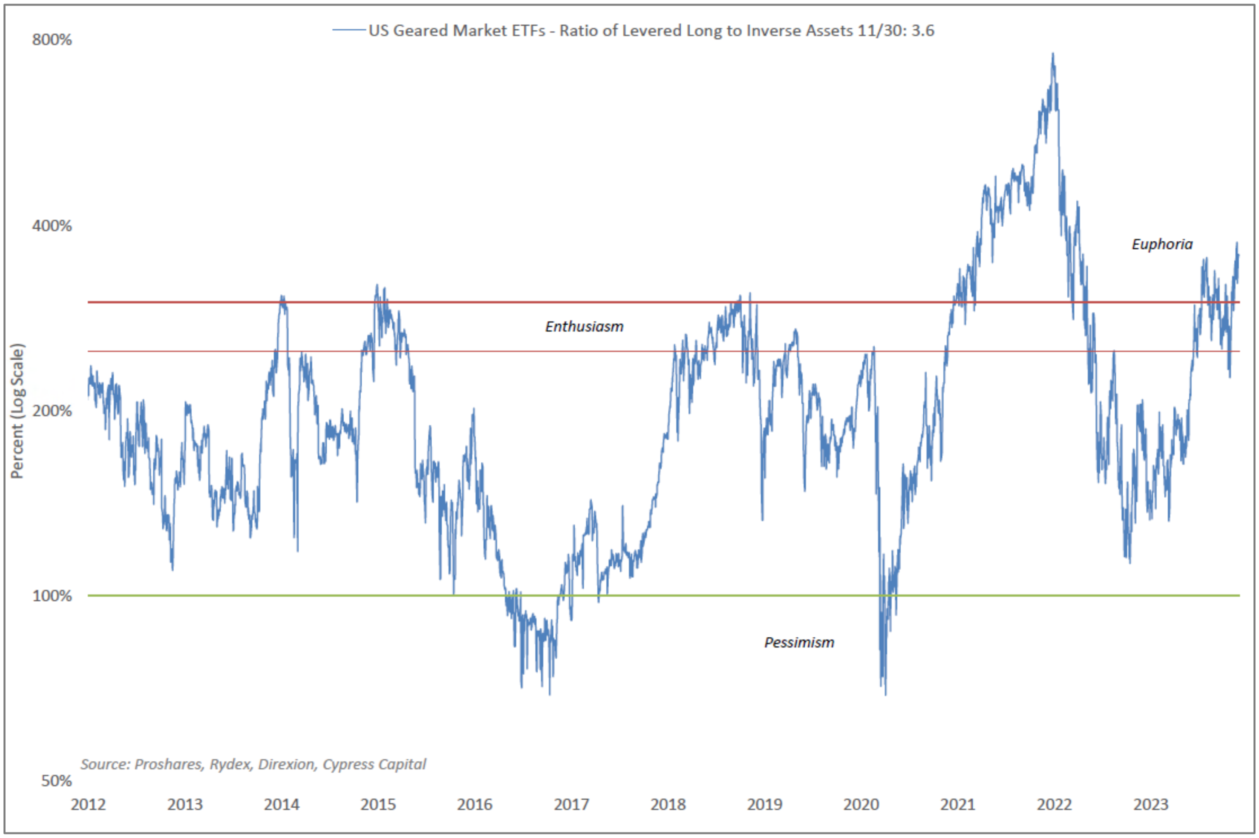
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets based on our model & opinion. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

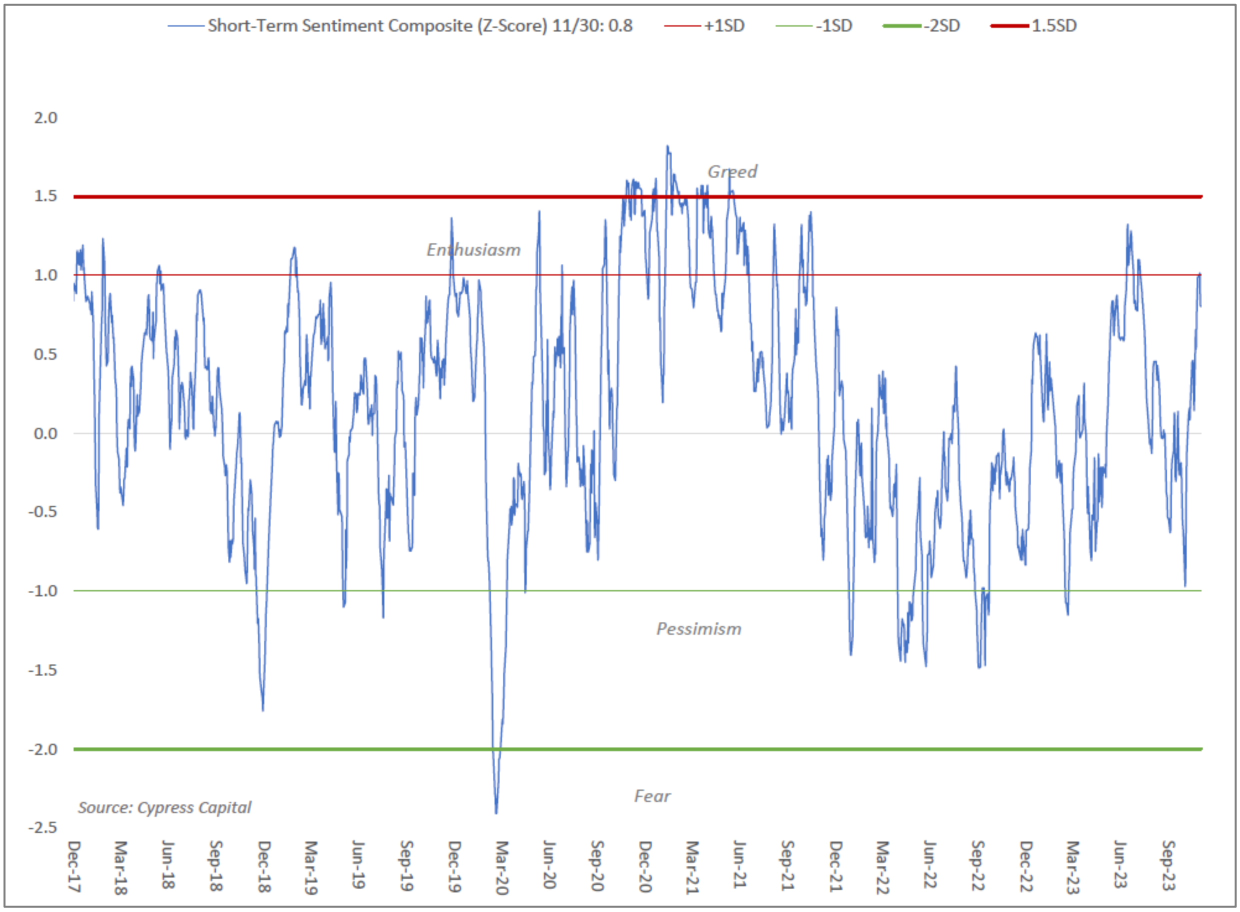
Asset Manager use of equity derivatives got greedier in November.



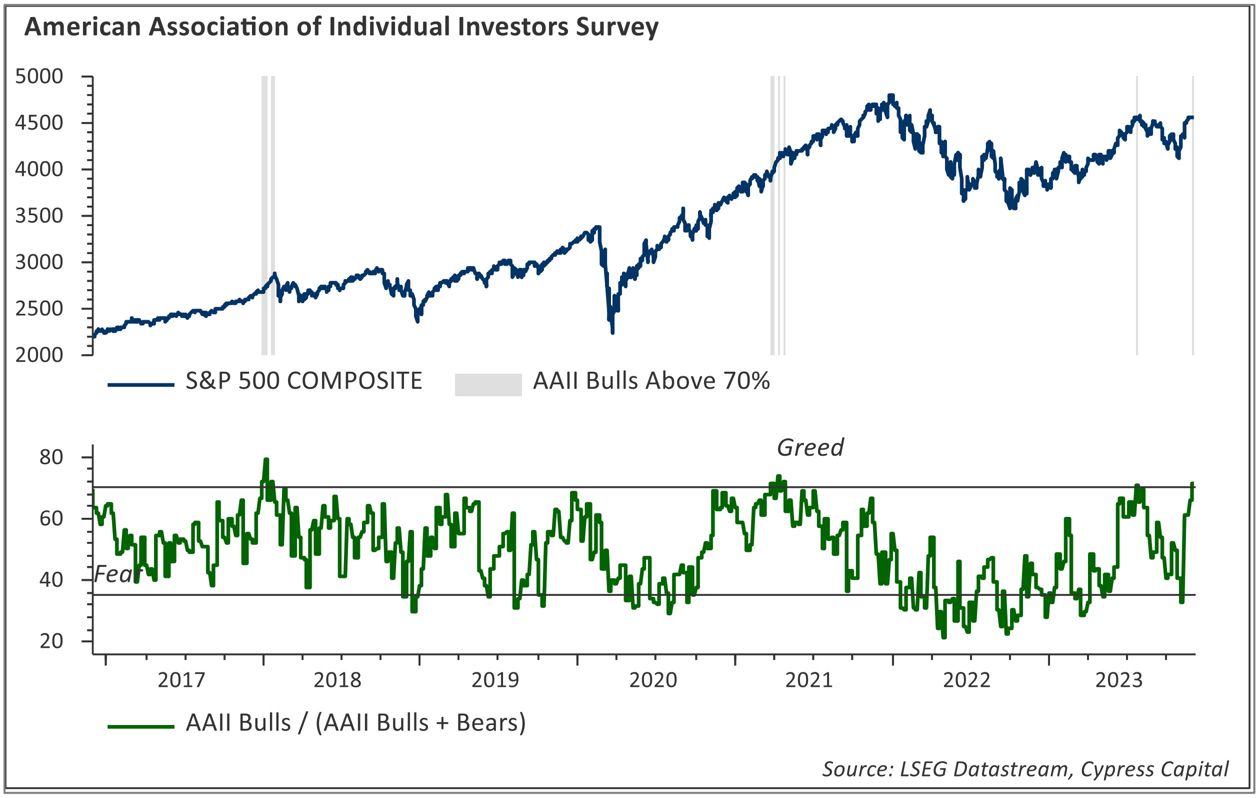
Assets in Leveraged ETFs are experiencing a reverberation of 2021's greedy blowoff.



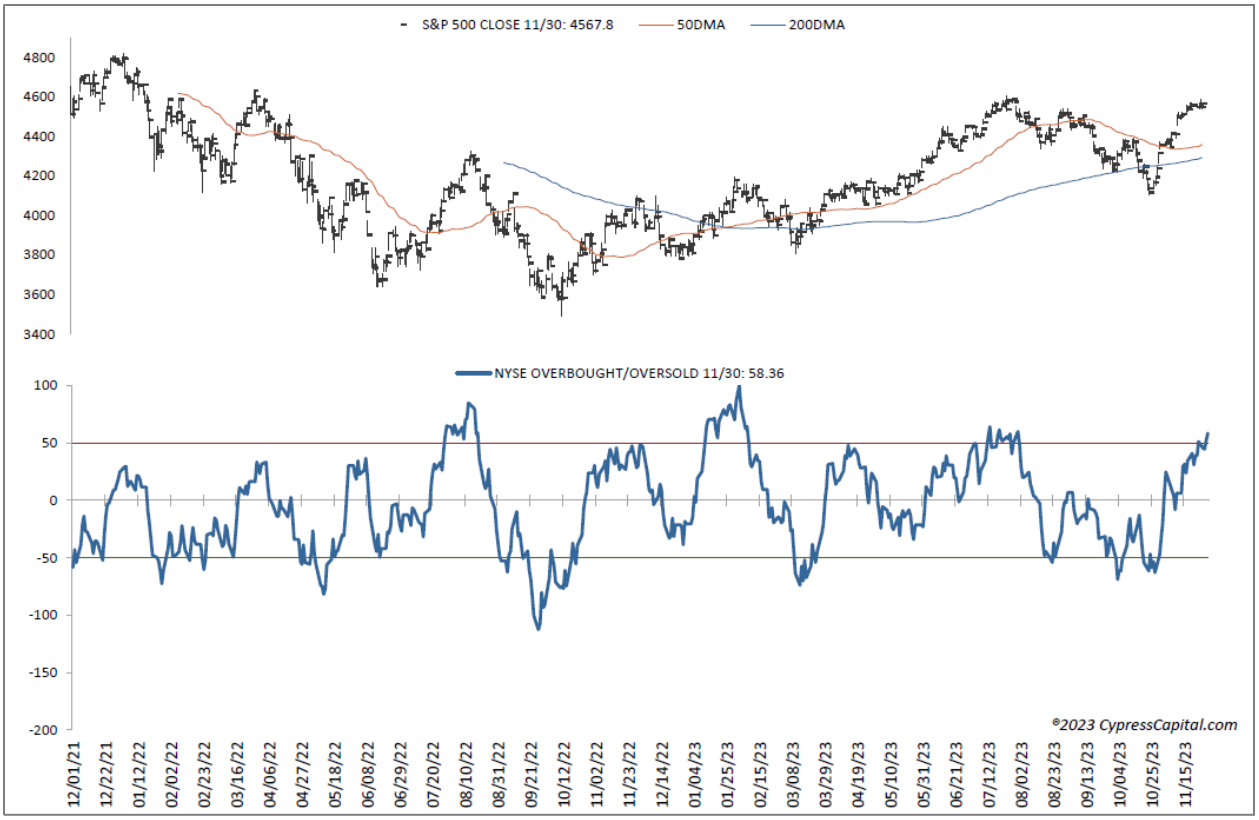
Our Short-Term Sentiment Composite breached Enthusiasm for the for first time since July.



Individual Investors enthusiasm for stocks hit extremes this week.

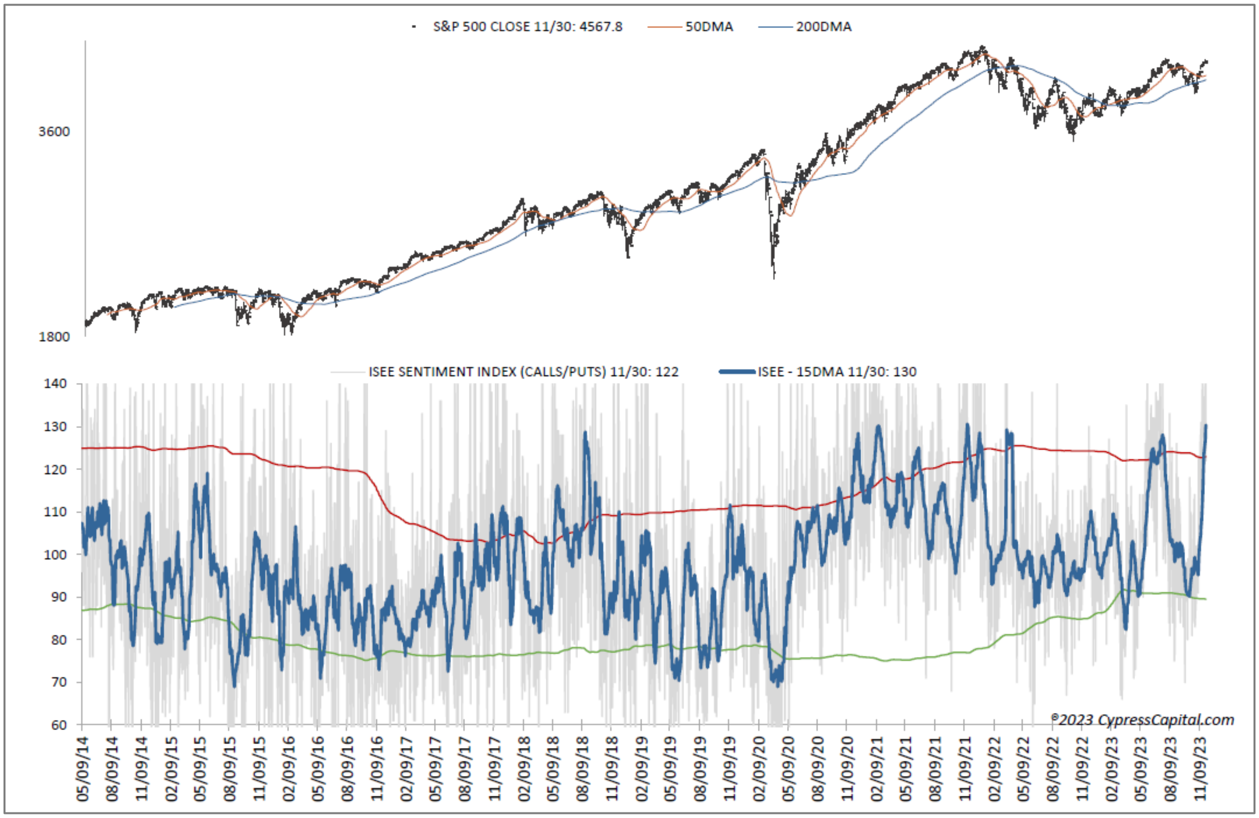


Our favorite Overbought/Oversold stock market indicator hit overbought for the first time since July.

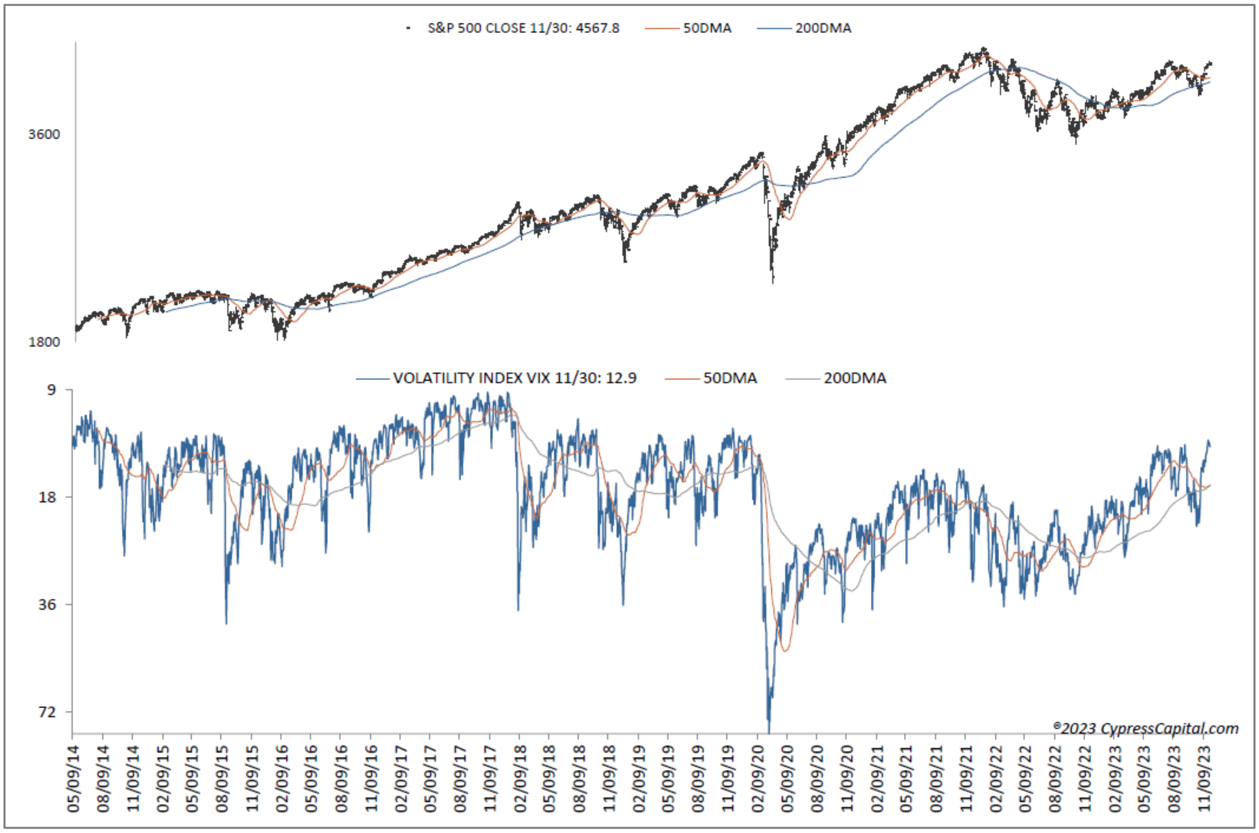


Treasury Bills are rewarding investors to be patient and wait for better stock market valuations.

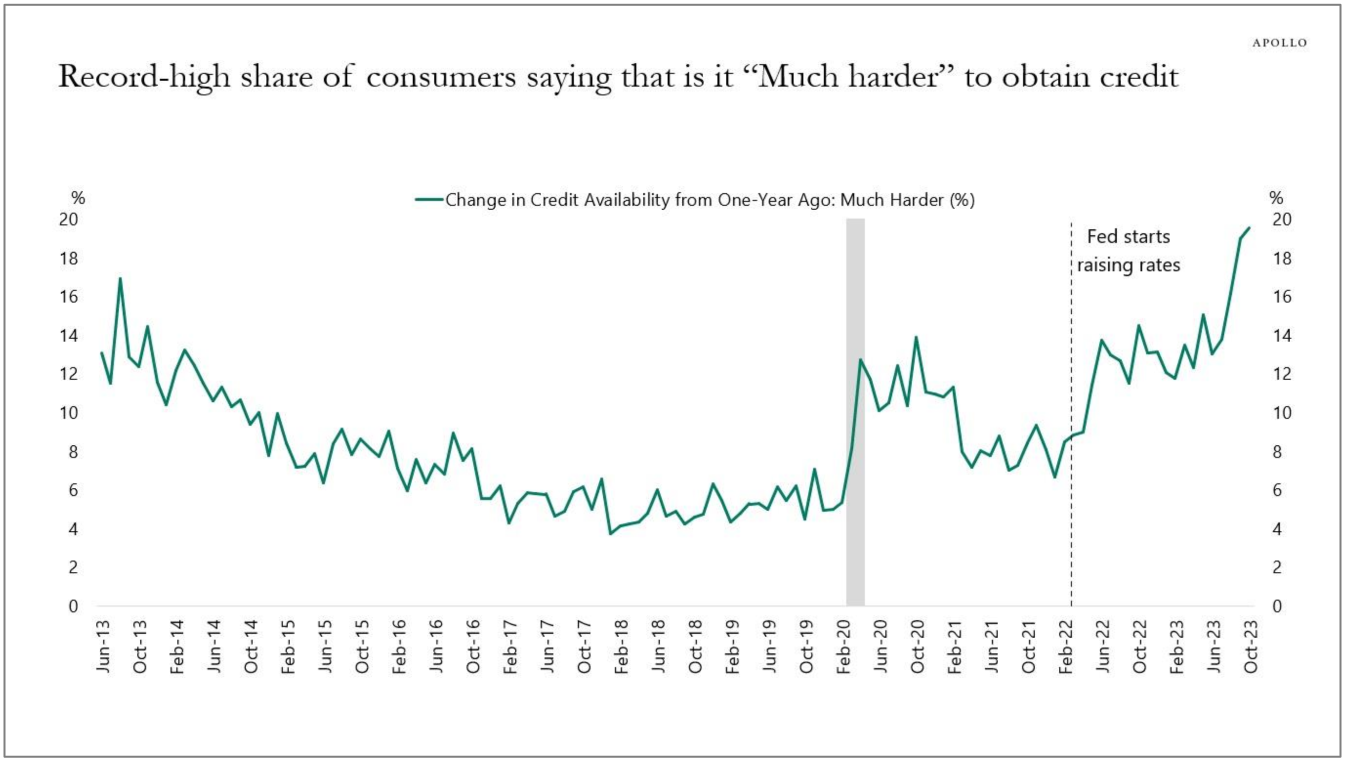
ISEE Sentiment Index (15dma) hit the highest level since November 2021.



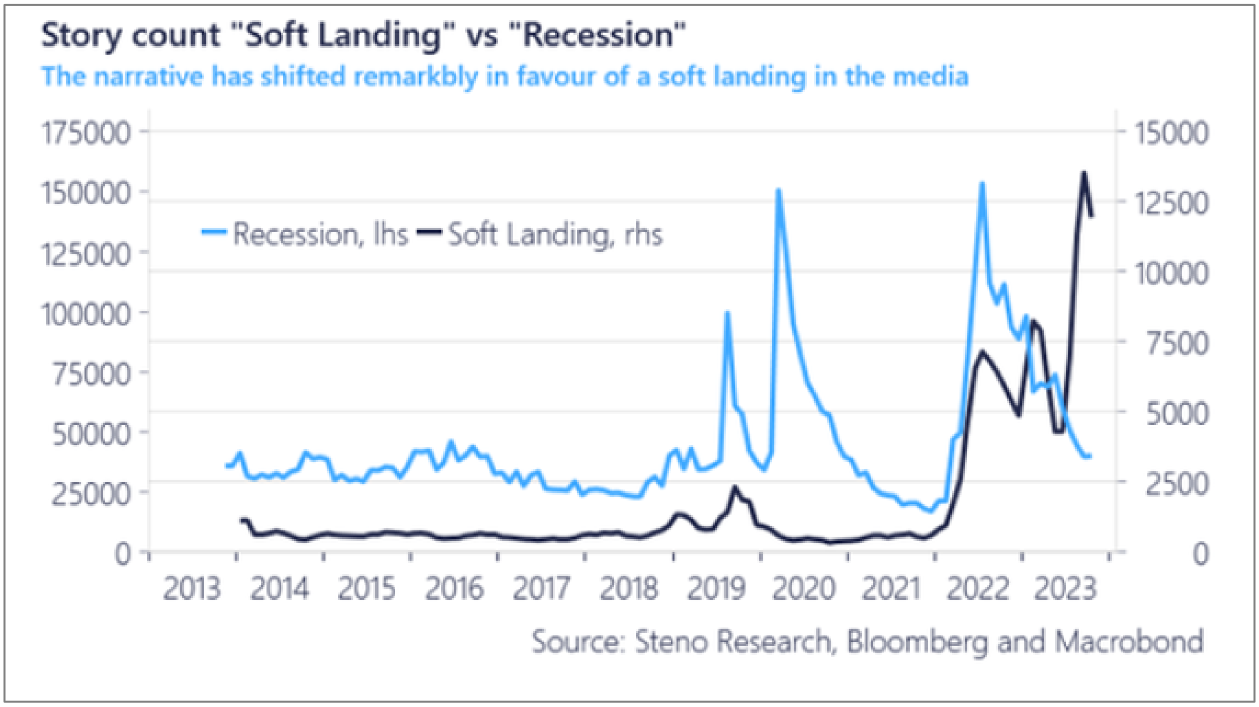
Lowest VIX reading since early 2020.



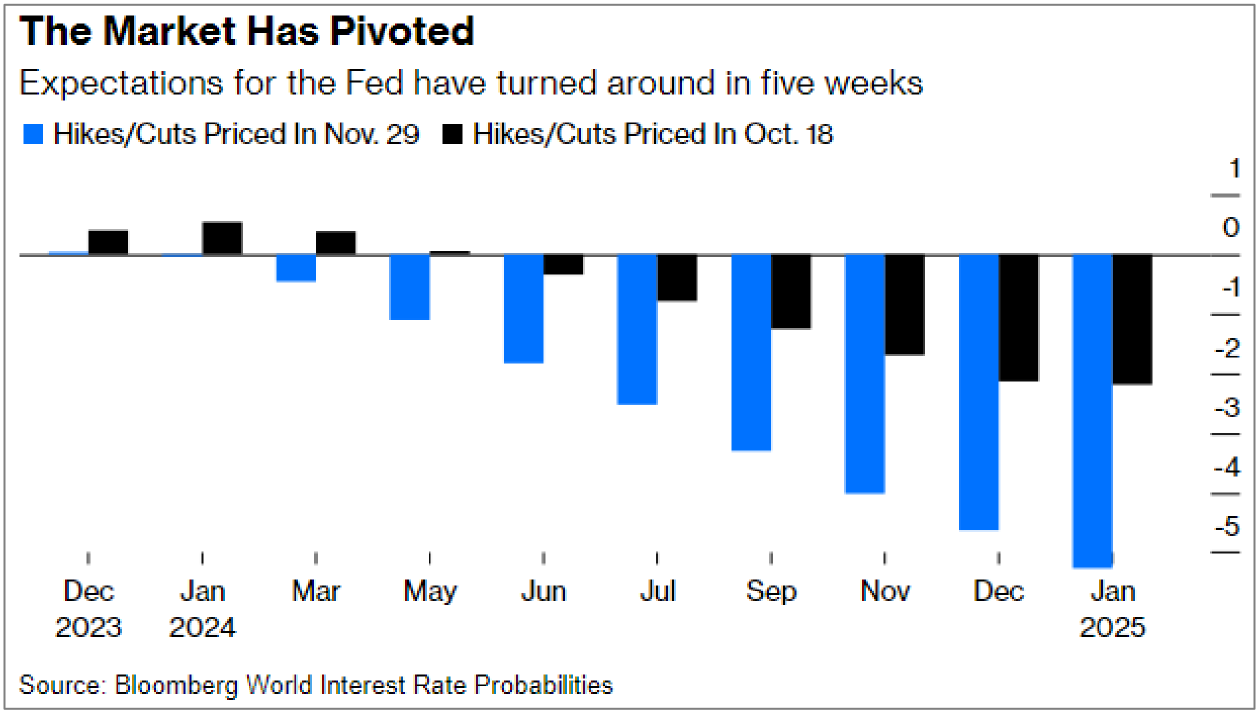
A record share of consumers say that they are having trouble obtaining credit.



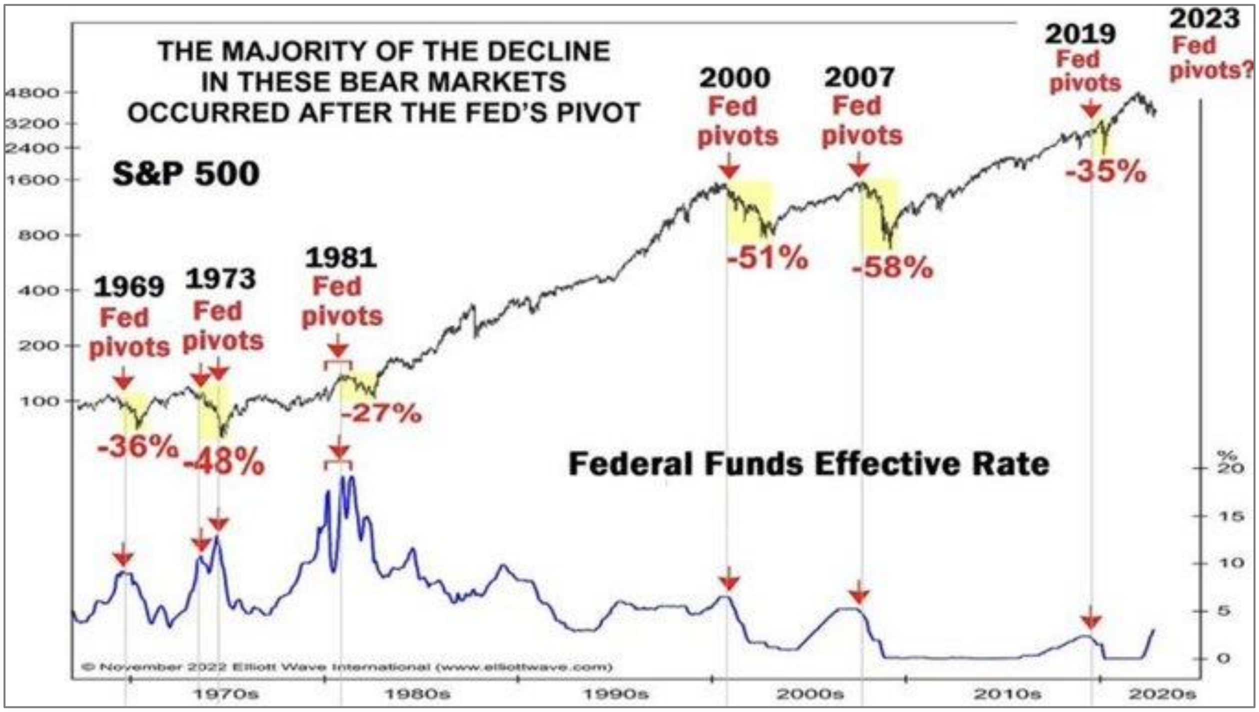
The media is betting on a Soft-Landing.



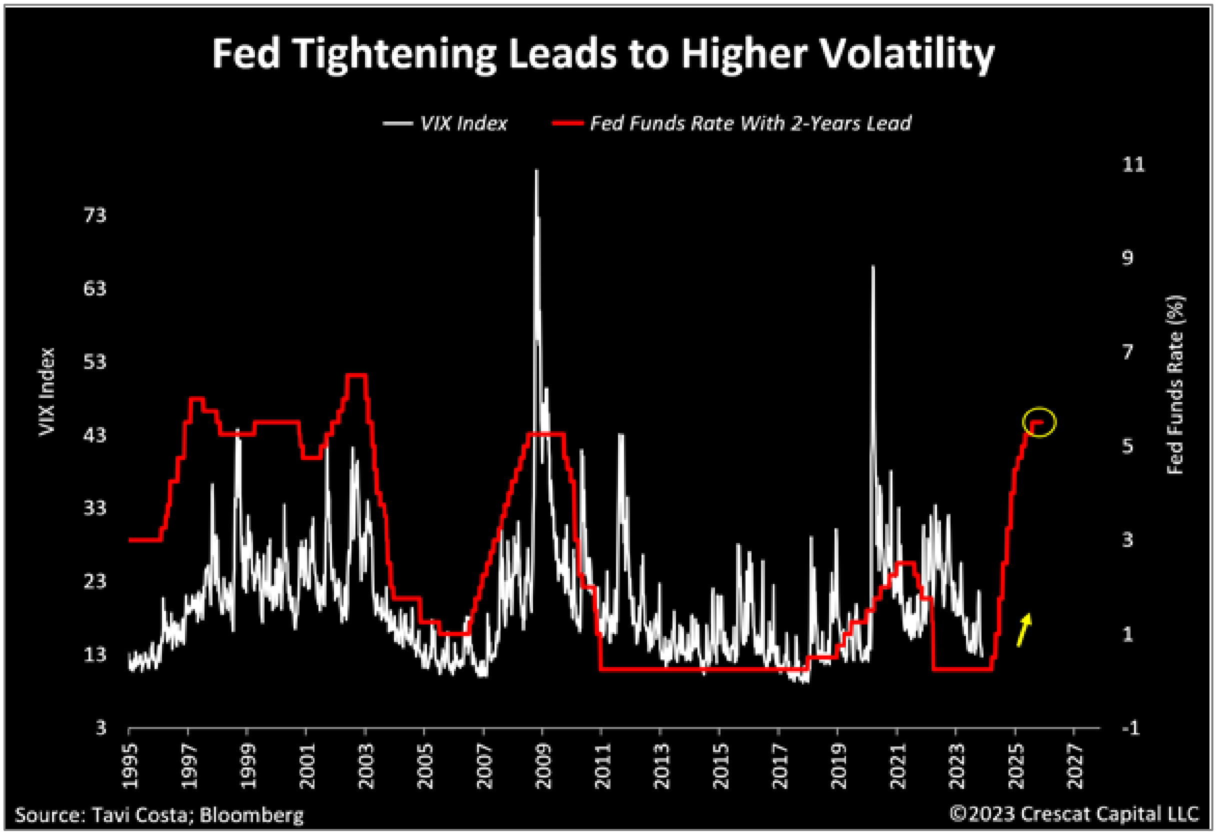
Markets are pricing in the Pivot



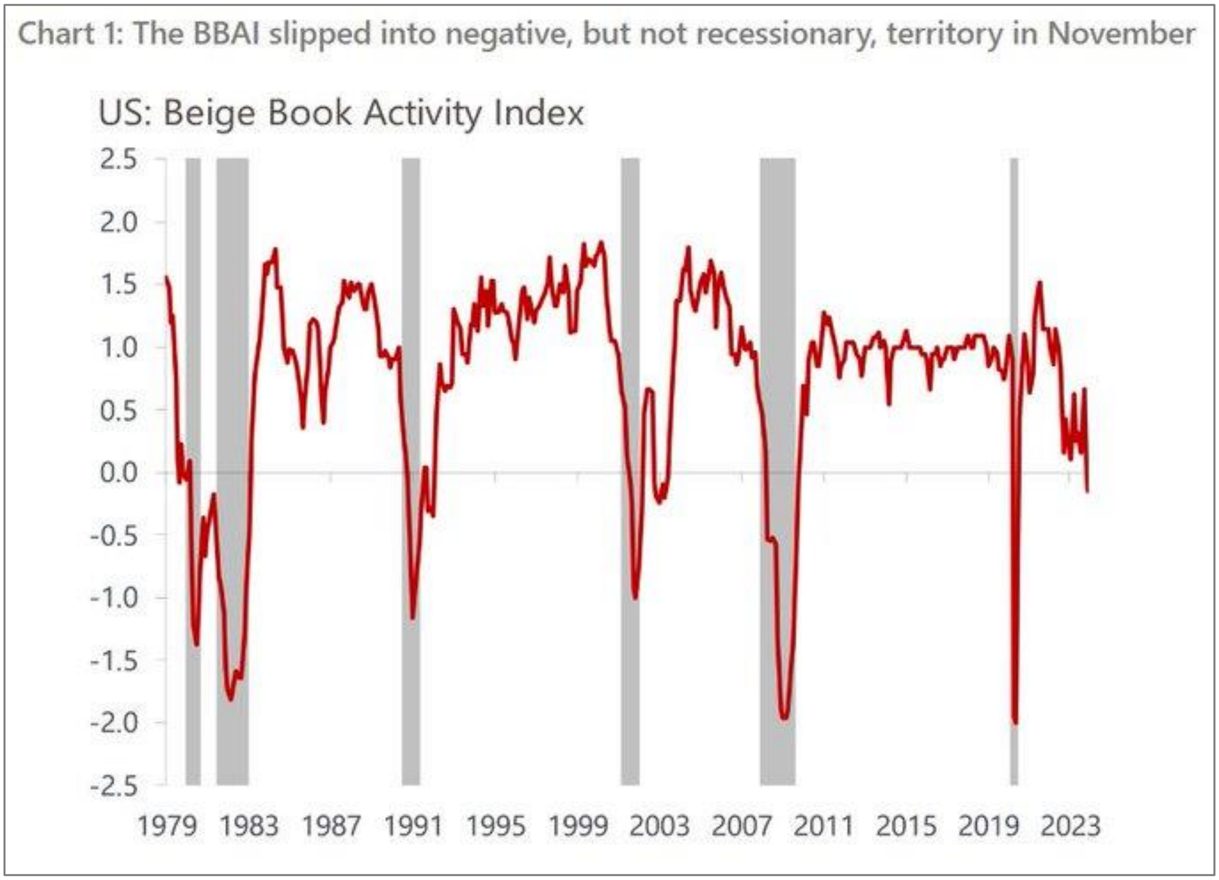
Getting bullish on Fed pivots looks like a game of Russian Roulette.



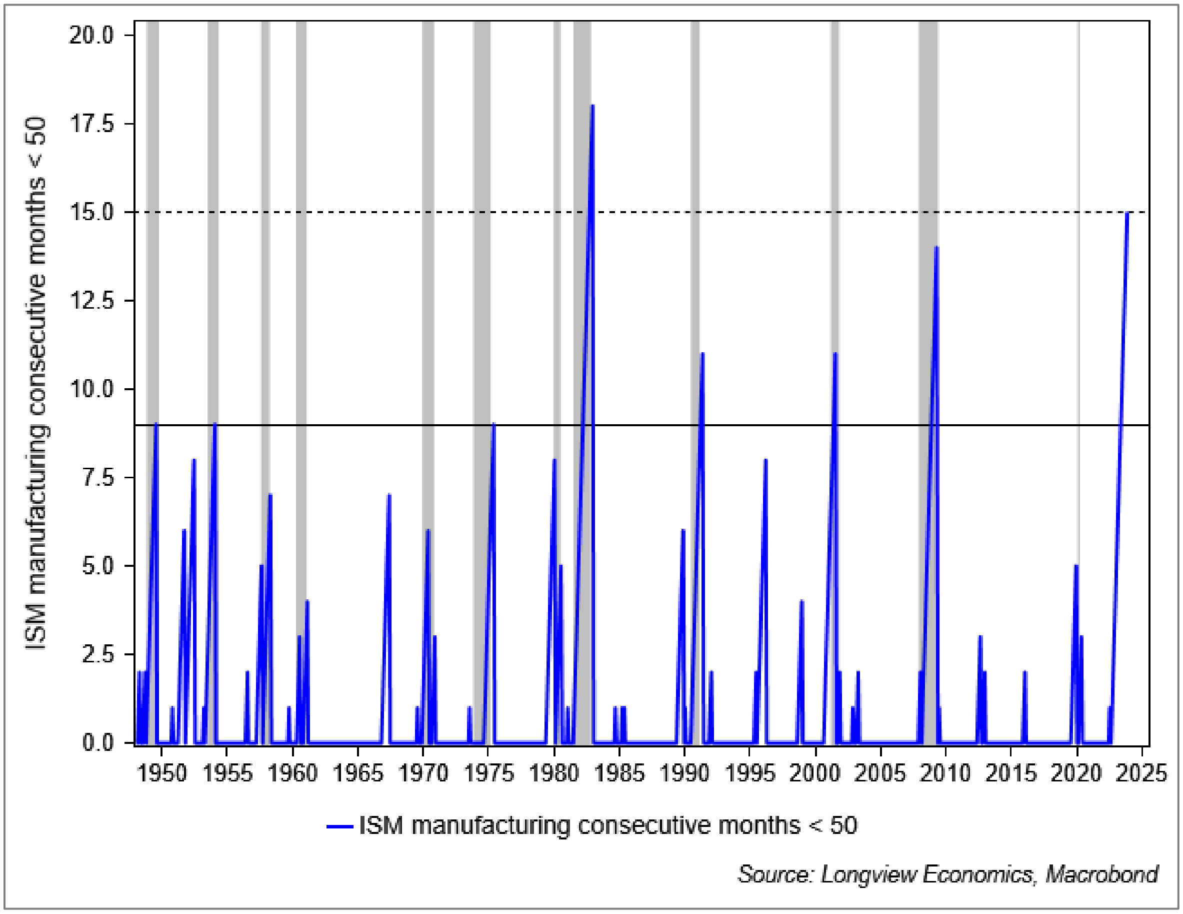
The Monetary Policy Lag – Fed Tightening tends to lead Volatility by a couple of years.



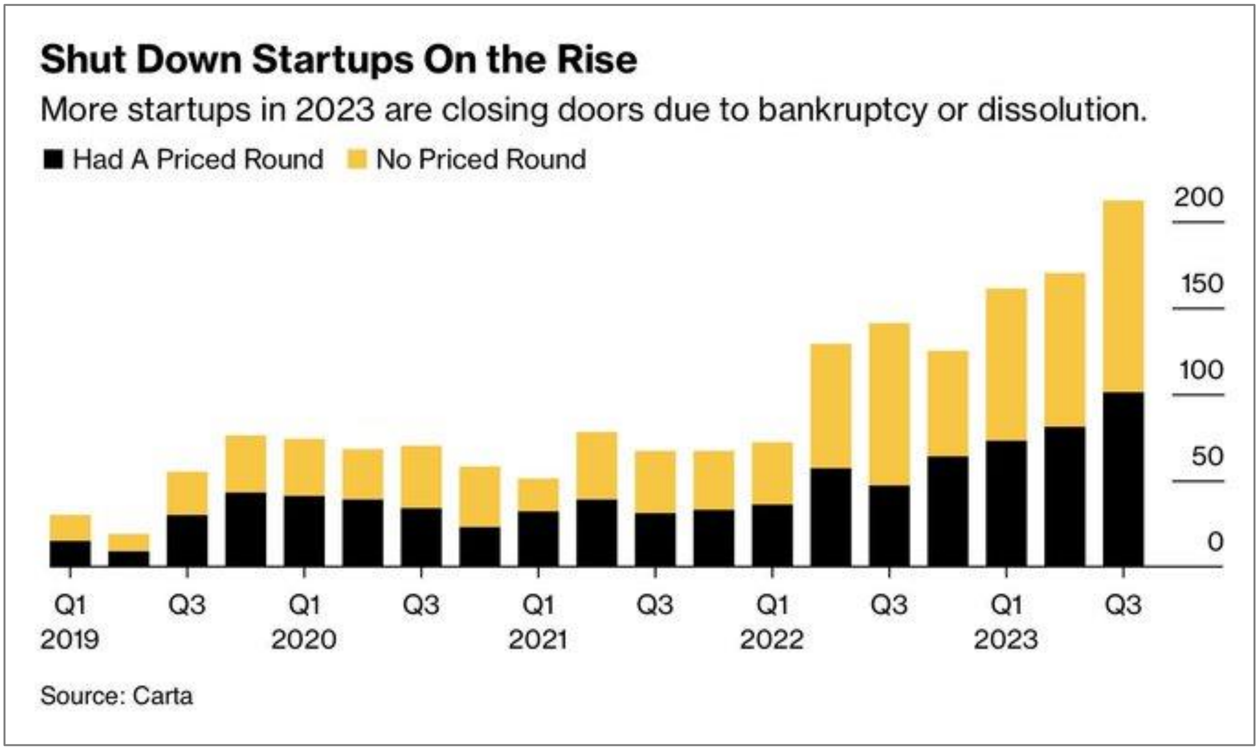
US Beige Book Activity Index turns negative for the first time since 2020.



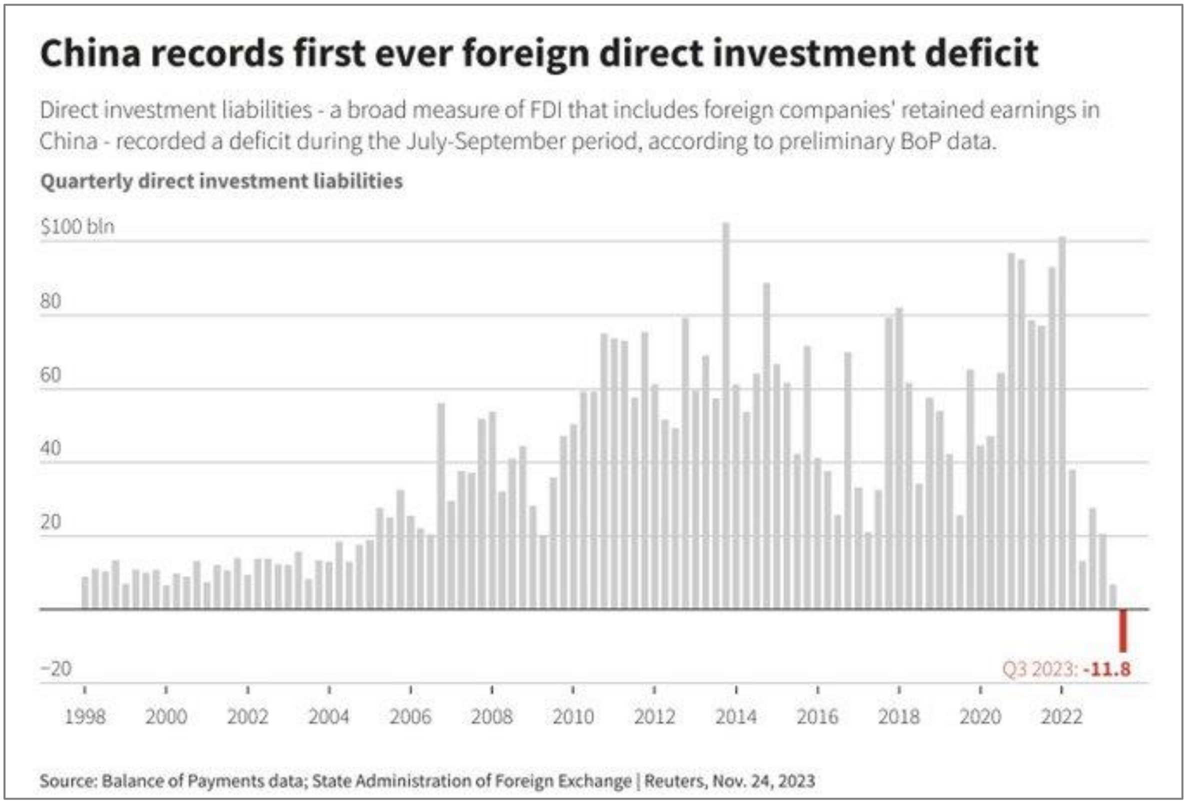
Duration in the contraction of ISM Manufacturing is the second longest on record.



Tight Monetary Policy has put financial pressure on startups.

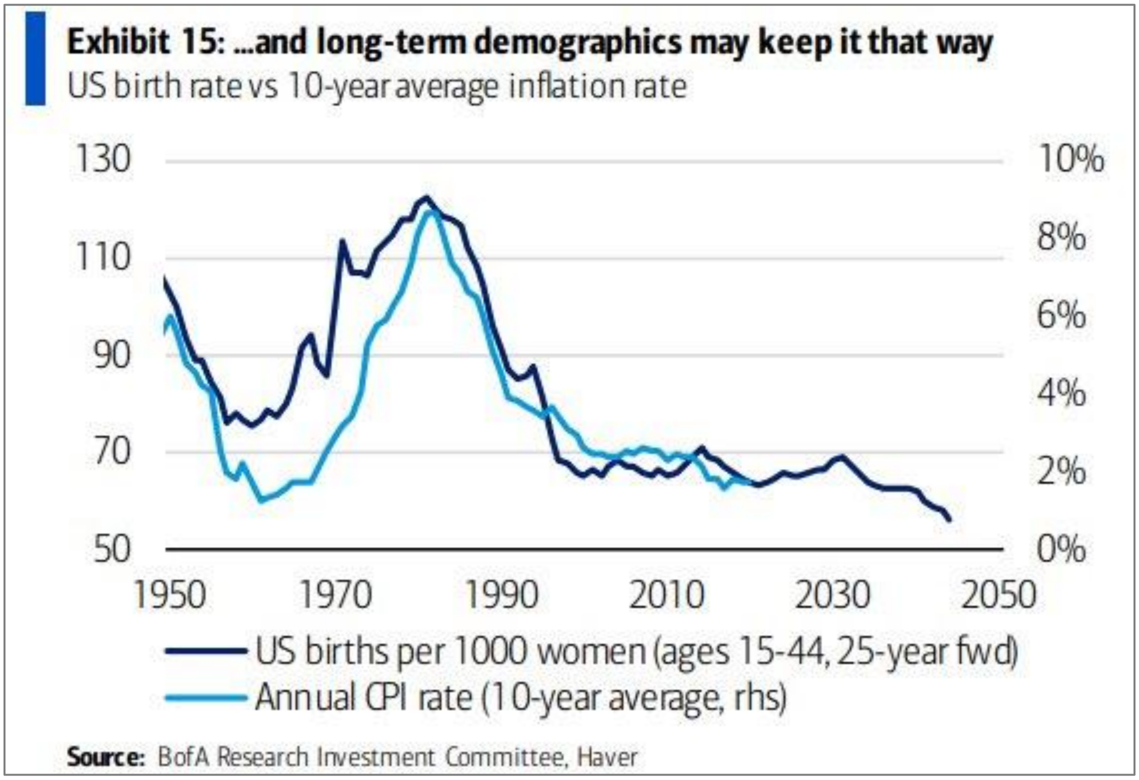


Corporations are pulling their investments from China.

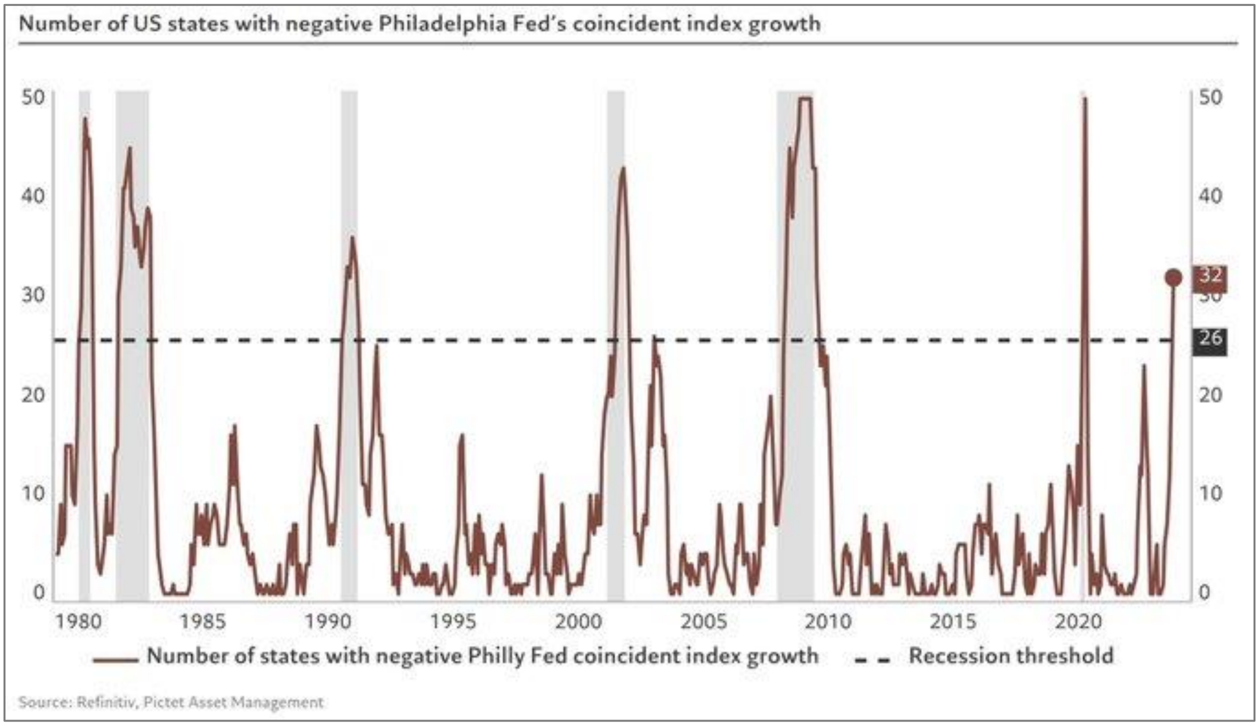


Either TIPs are a good buy (we think so), or Gold appears overvalued.

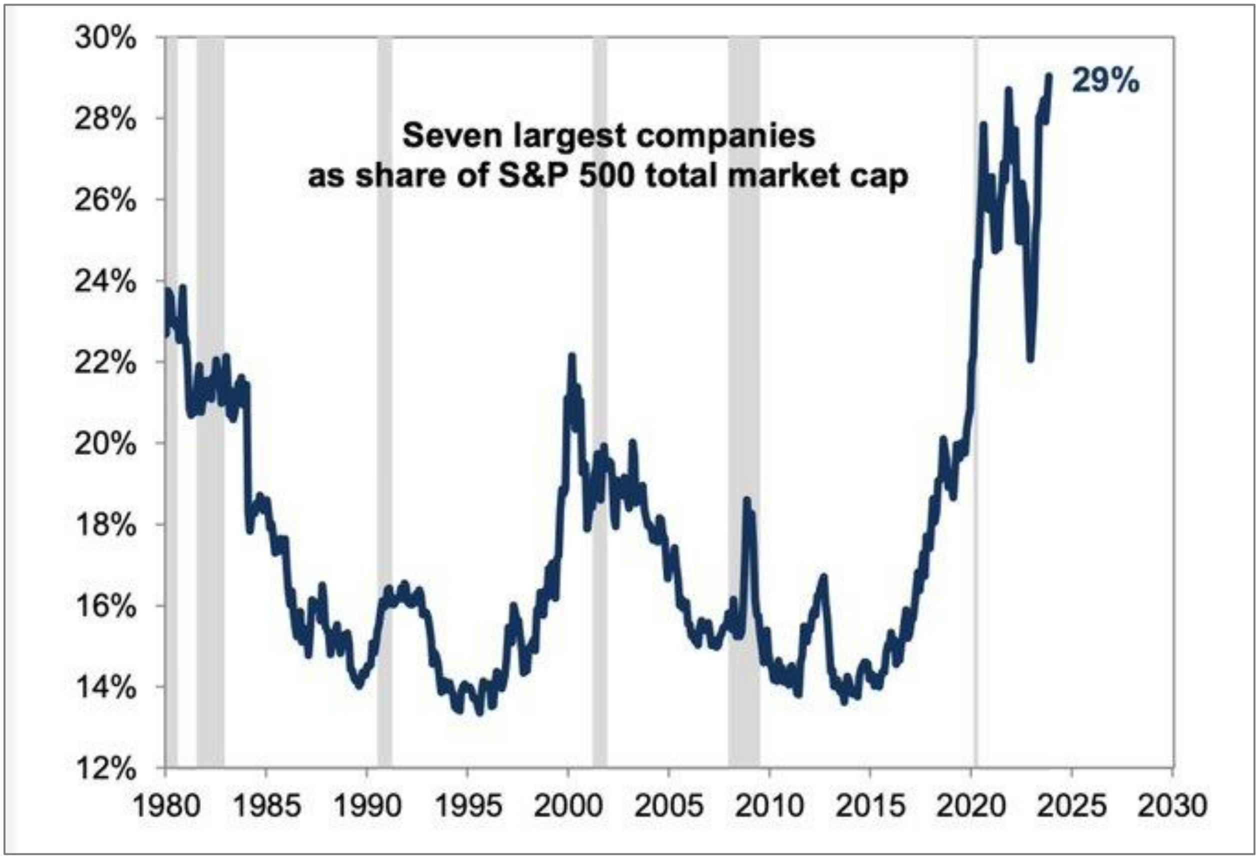
Demographics suggest low inflation, but central bankers & politicians seem bent on testing the theory.



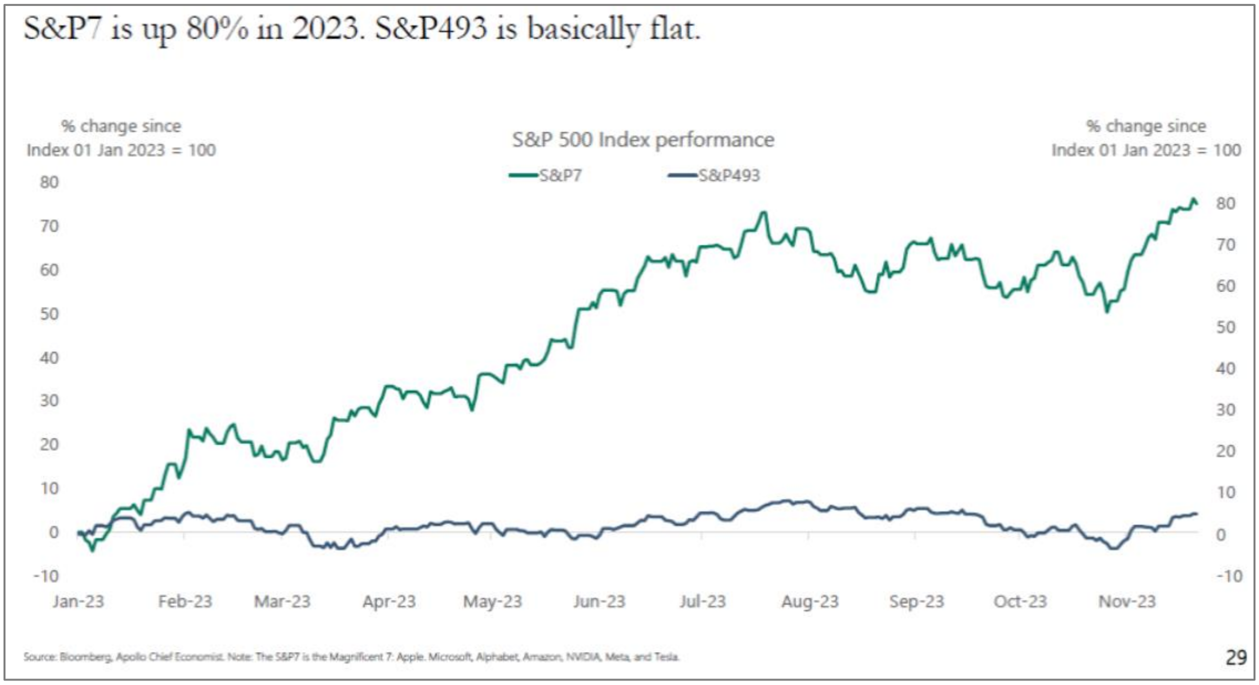
Number of US states with negative coincidence growth looks recessionary



The S&P 500's largest seven stocks have never been this magnificent.



The rising tide has only lifted the Seven in 2023.



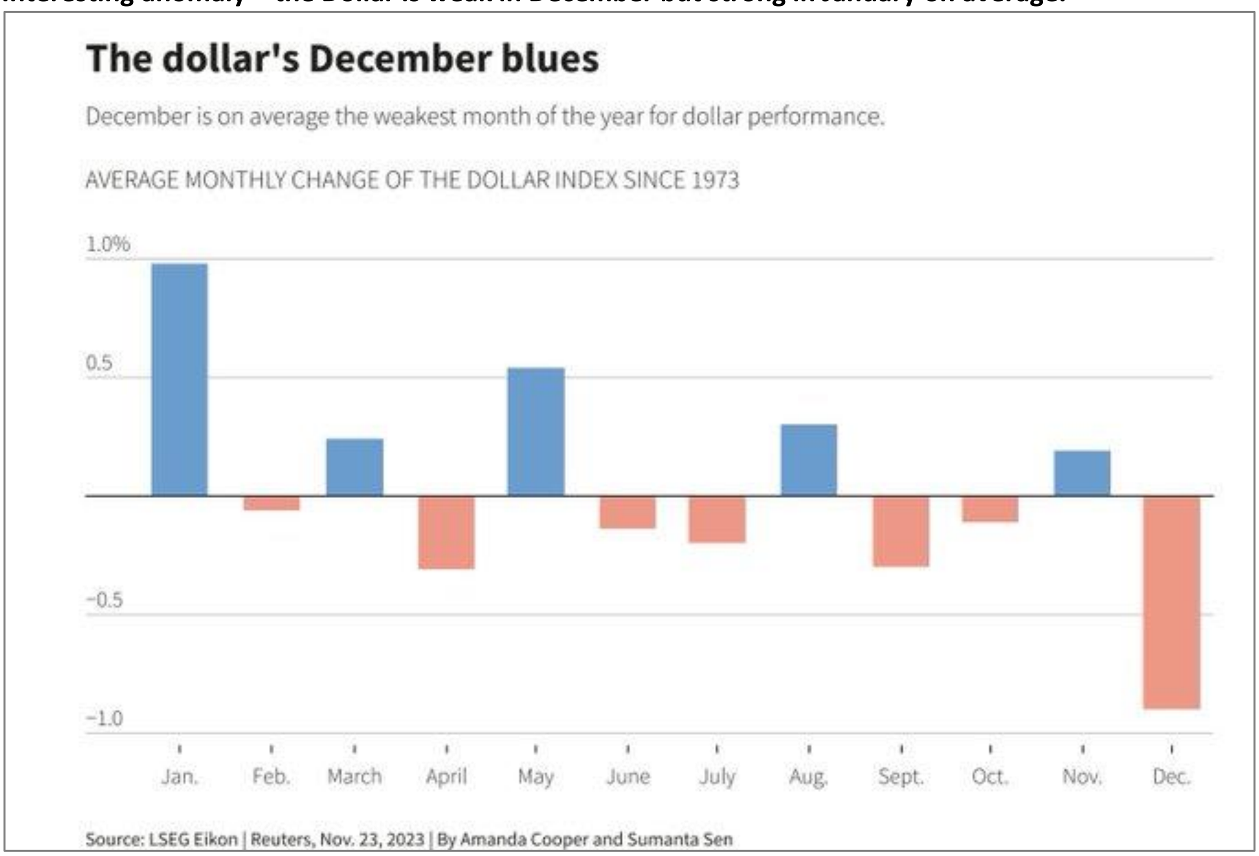
Those seven stocks are valued like the Nifty Fifty from the 70s and the Dot-Coms in 2000.

S&P7 stocks are as overvalued as the Nifty Fifty and tech in 2000

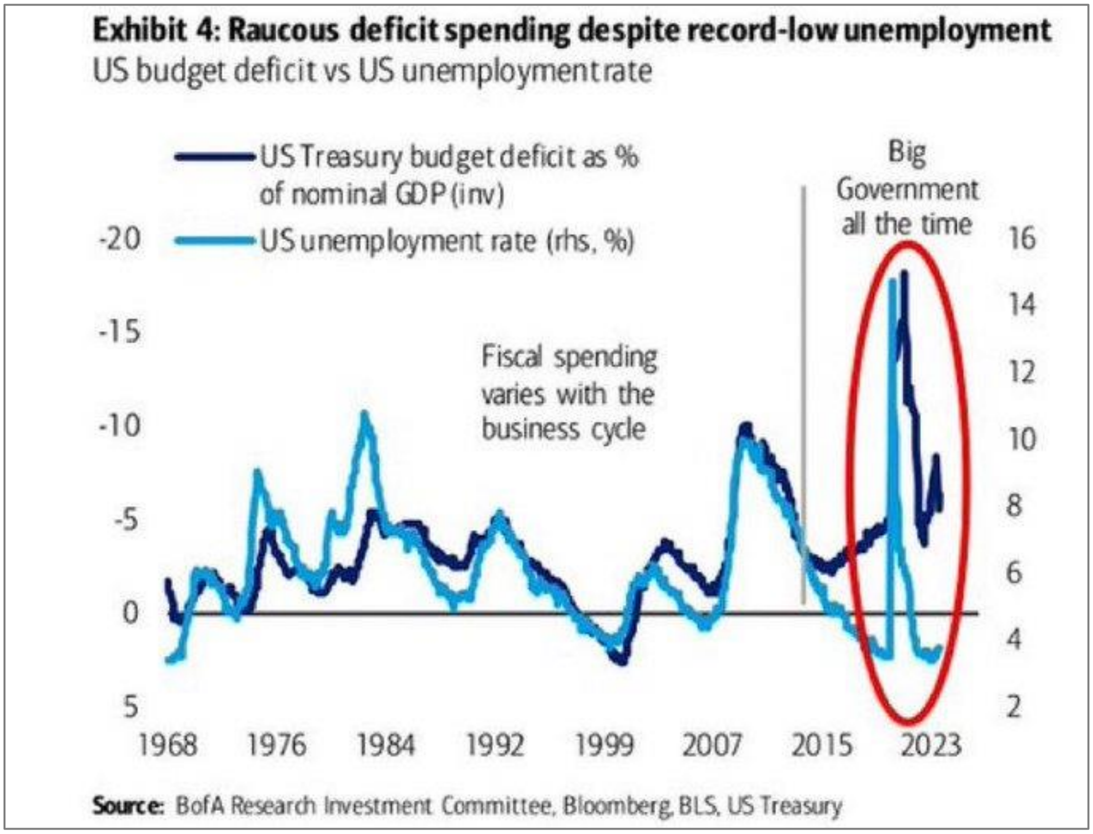
S&P7	Trailing P/E	Tech bubble	March 2000 P/E	Nifty Fifty	1972 P/E
Meta	22	Intel	41	Coco-Cola	46
Amazon	68	Cisco	100	McDonalds	71
Apple	31	Dell	57	Texas Instrument	40
Google	25	Microsoft	51	IBM	36
Microsoft	36			Xerox	46
Nvidia	115			Polaroid	95
Tesla	75				
Average P/E ratio	**53**	**Average P/E ratio**	**62**	**Average P/E ratio**	**56**

Source: Bloomberg, Apollo Chief Economist

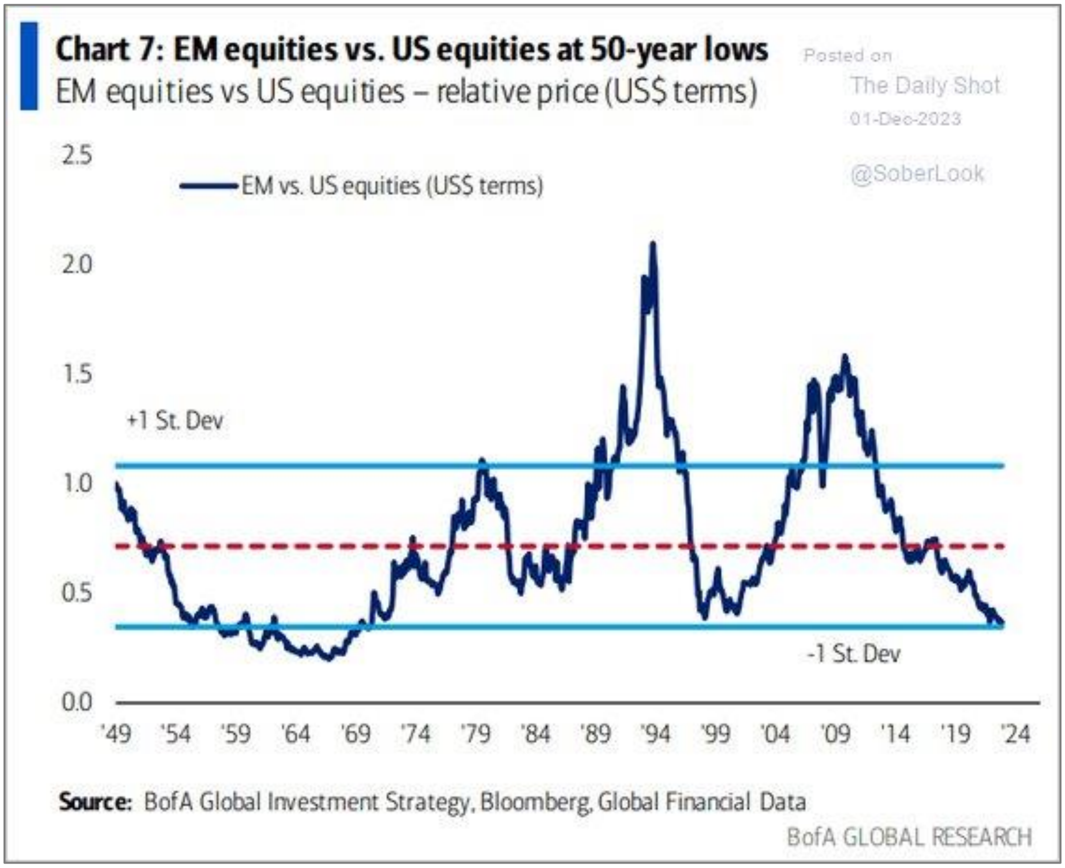
Interesting anomaly – the Dollar is weak in December but strong in January on average.



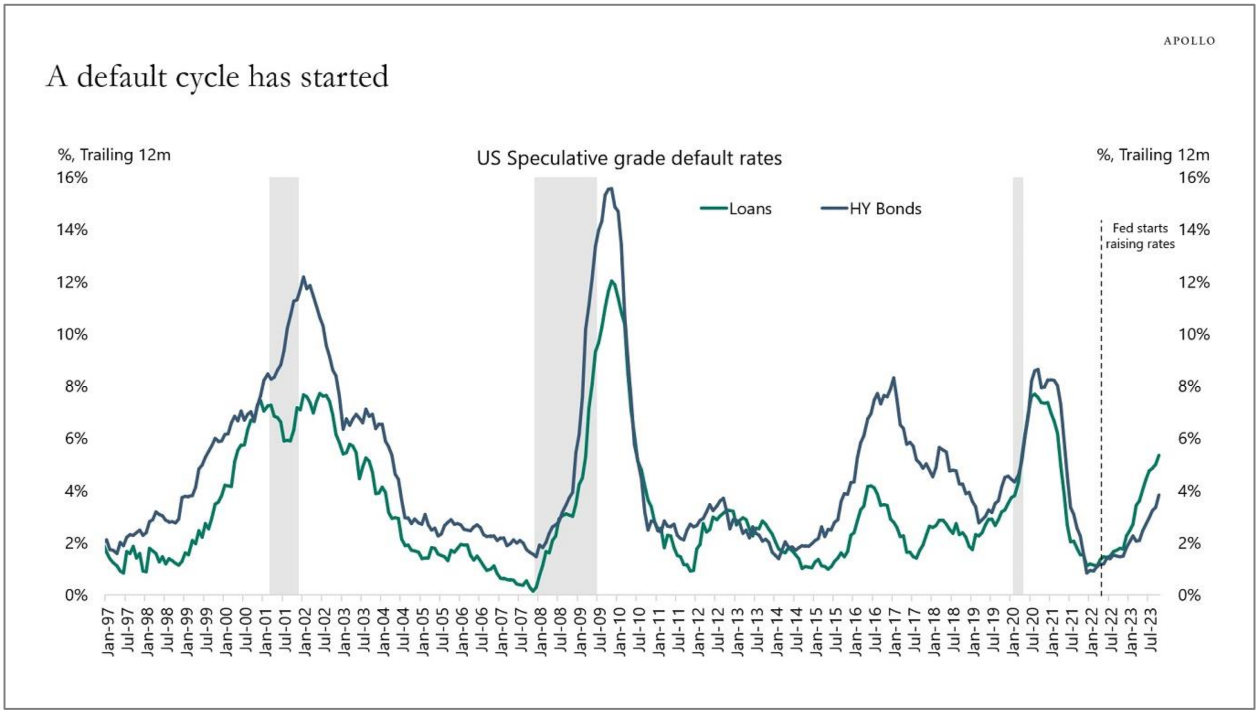
Both the political parties have lost any fear of government deficits.



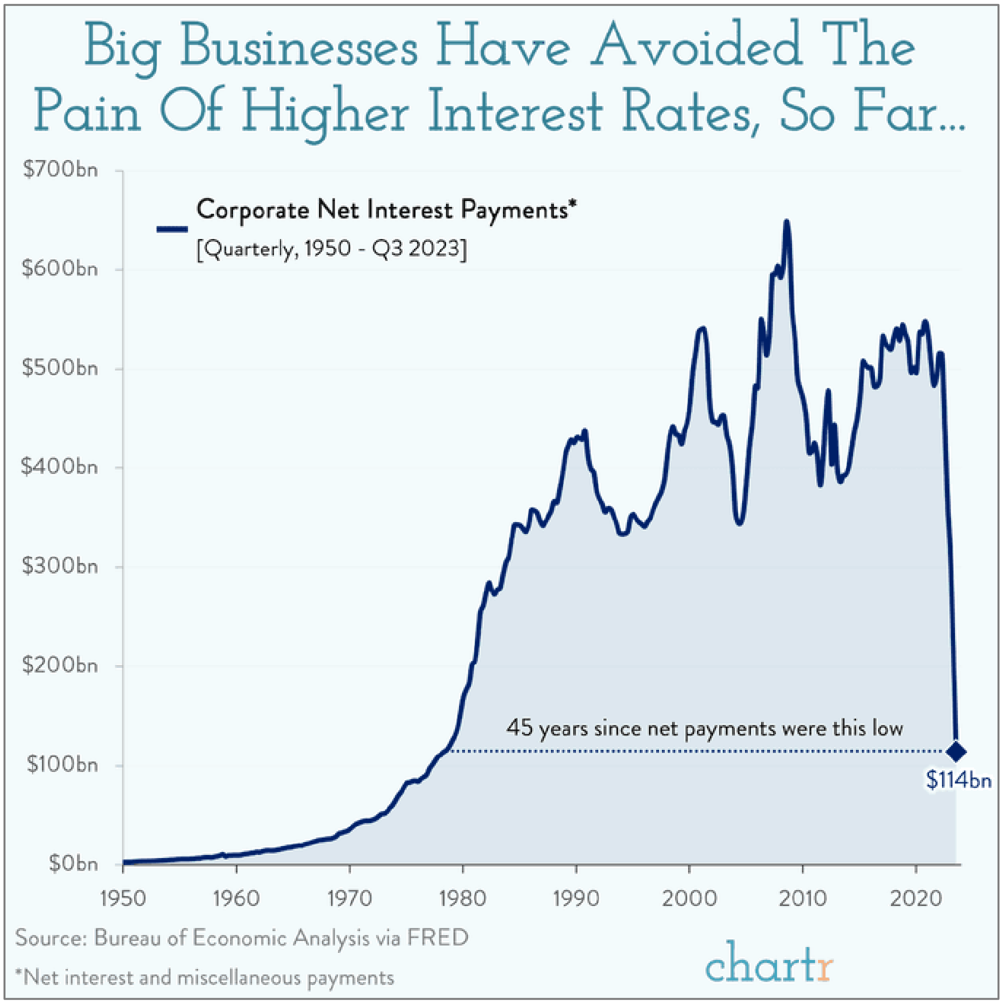
Waiting for Mean Reversion - Emerging Market Stock Relative Performance is at 50-Year Lows



Defaults are on the rise.



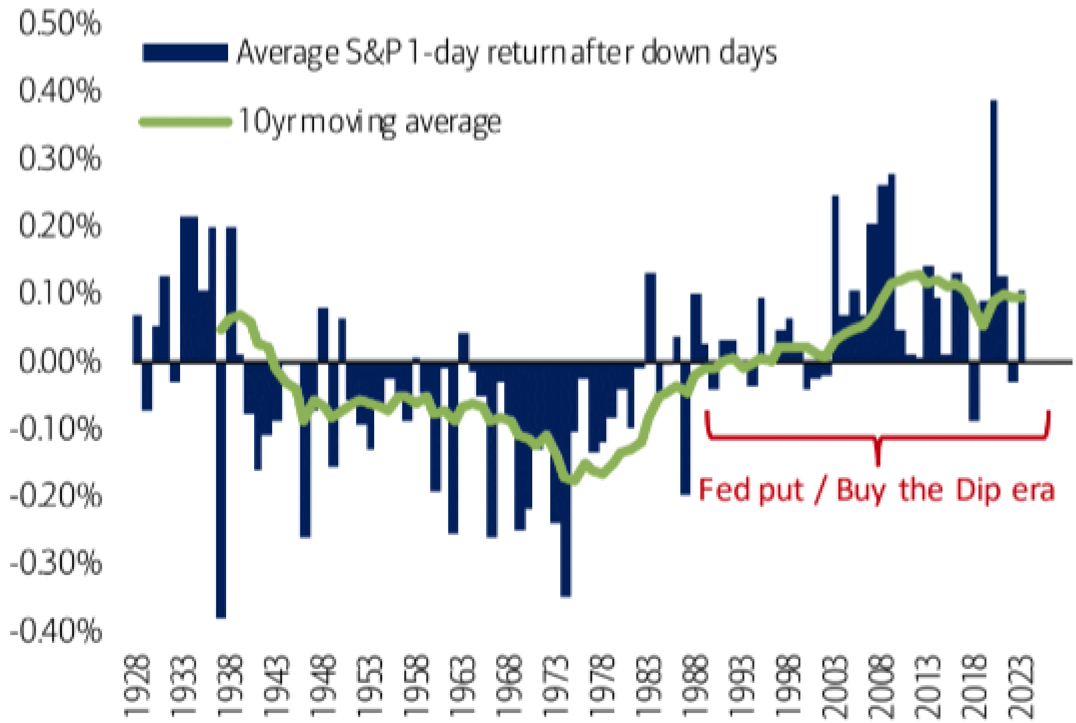
Large corporations locked in low rates and remain immune to rate hikes thus far.



Buy-The-Dip is winning for big cap-weighted indices in 2023.

Exhibit 7: Buy-the-dip strategies are having another strong year in 2023, as equity investors remain most concerned about the upside

S&P 1-day returns after down days (calendar-year average)



Source: BofA Global Research. Data from 1928 to 7-Nov-2023.

BofA GLOBAL RESEARCH

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.