



Market Outlook

By Mark T Dodson, CFA

Stock Market Rally Broadens

Market Risk Index improved to 78.1% on improved Monetary Conditions, but it remains above the 75% level that denotes markets with substantial drawdown risk. With the Fed hinting at the possibility of rate cuts in 2024, financial markets did more heavy lifting in easing conditions and providing liquidity. Consequently, the Interest Rates category of the Monetary Composite is likely to revert to having bullish implications for markets.

Stock market action broadened considerably with a sharp rally in the stocks left behind in 2023. Net new highs on the NYSE as a percentage of total issues climbed above 10% for the first time since June 2021. This broadening out in participation is often lauded as bullish, and it generally is, with caveats. The market tends to outperform your average buy-and-hold return after such signals, with a win rate that is also better than buy-and-hold over the next year. However, these signals tend to occur at different points in the cycle, and not all signals of an expansion in new highs should be treated equally.

As a lesson in the value of the weight of the evidence approach to allocating capital, what happens when we look at expansions in the net percentage of NYSE stocks making new highs to periods where the yield curve is also inverted? In that case, the market return is negative over periods from 6 months all the way out to 5 years. It turns out that it's not uncommon to see surges in the percentage of stocks making new highs in speculative markets where investors ignore economic cycle warnings. It is a reasonable approximation of the point that investors have lost patience and started ignoring the yield curve's ongoing warnings.

The Fed's tightening cycle may have tamed inflation, but investors' desire to speculate has proven untameable thus far. Signs of a speculative resurgence are growing. Here's this week's list. Volume in call options set a new record, and the CBOE's exchange-traded products put/call ratio (15dma) hit the lowest level since April 2021. Leveraged ETF daily dollar volume grew euphoric. Assets in Leveraged ETFs set a new cycle high, and the 2021 bubble peak is in sight. Asset Manager net long futures positioning is only 2 percent from setting a new record. AAll Bullish sentiment also set a new cycle high, reaching the highest level since April 2021.

Market Risk Index

Rec Allocation 25% Underweight

78.1%

Category Percentiles

Psychology - P6



Monetary - M3



Valuation - Extremely Overvalued



Trend



Largest Psychology Influences

| | |
|-----------------------|----------|
| Leveraged Investments | Negative |
| Surveys | Negative |
| Bank Sentiment | Negative |
| Consumer Confidence | Negative |

Largest Monetary Influences

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

Valuation

| | |
|----------------------------------|------|
| 7-10 Year Equity Return Forecast | 1.5% |
| 10Yr US Treasury Yield | 4.2% |

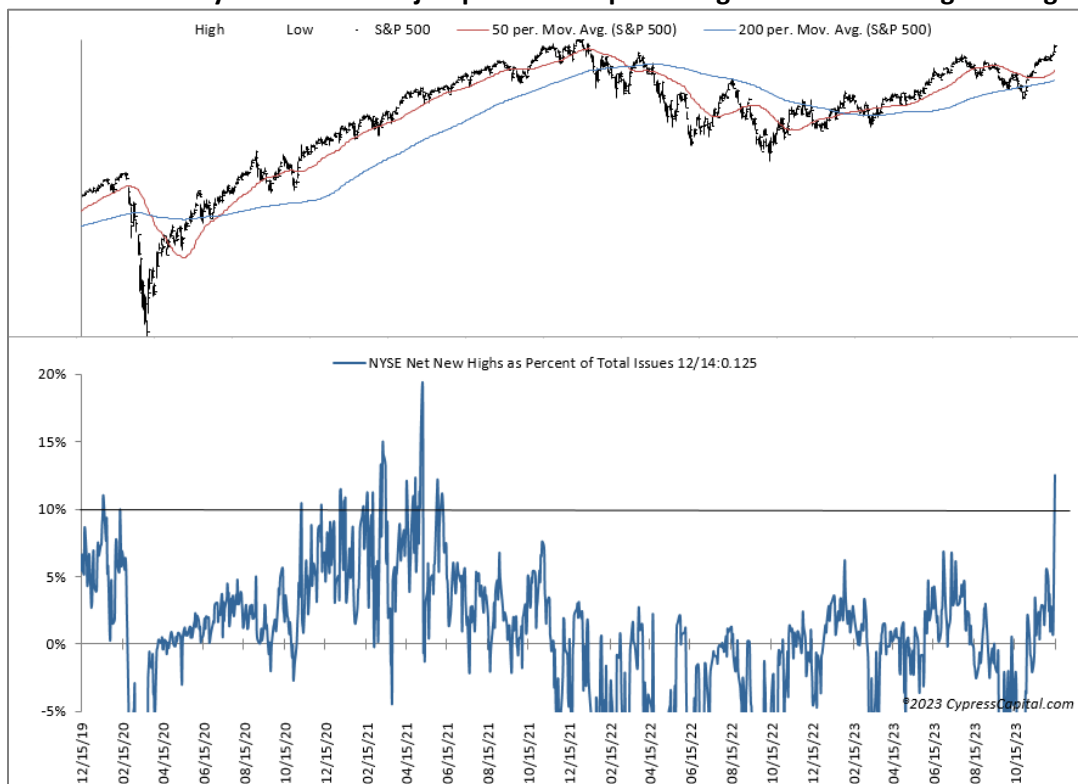
Market Trends

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

Stock market rally broadened – a jump in the net percentage of stocks making new highs on the NYSE.



Spikes in Net New Highs have historically been moderately bullish...

| NYSE Net New Highs / NYSE Total Issues Greater than 10% | | | | | | |
|---|-------|-------|-------|-------|-------|-------|
| | 1M | 3M | 6M | 1Y | 18M | 2Y |
| Average | 1.0 | 2.0 | 4.8 | 11.1 | 9.1 | 6.9 |
| Max Gain | 12.0 | 13.1 | 26.3 | 36.8 | 33.1 | 24.6 |
| Max Loss | -11.8 | -13.9 | -10.3 | -13.9 | -22.1 | -23.9 |
| Win Rate | 68% | 65% | 66% | 89% | 84% | 85% |
| Buy & Hold Return | 0.7 | 2.0 | 4.1 | 8.2 | 7.8 | 7.6 |
| Buy & Hold Win Rate | 61% | 65% | 68% | 74% | 77% | 80% |

S&P 500 price returns since 1965

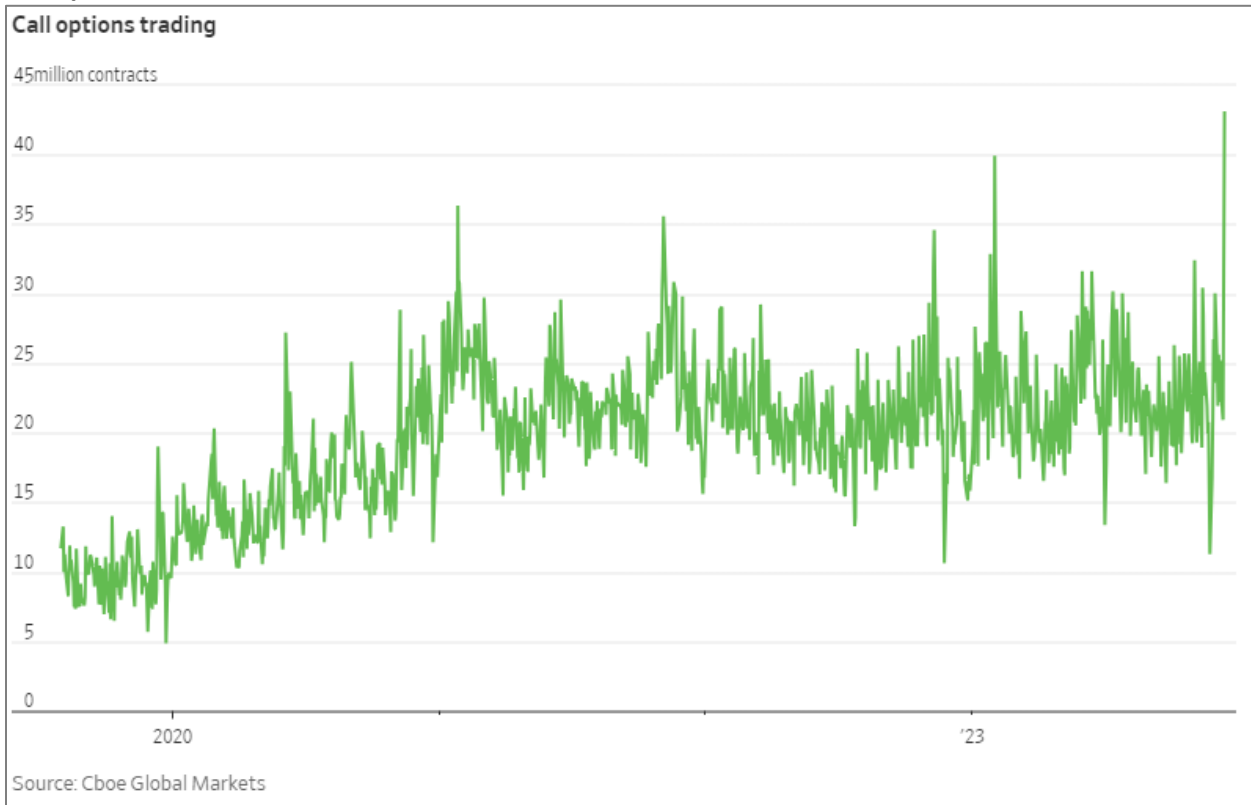
...Except when the yield curve is inverted.

This happened in 1974, 1980, 1989, 2006, 2007.

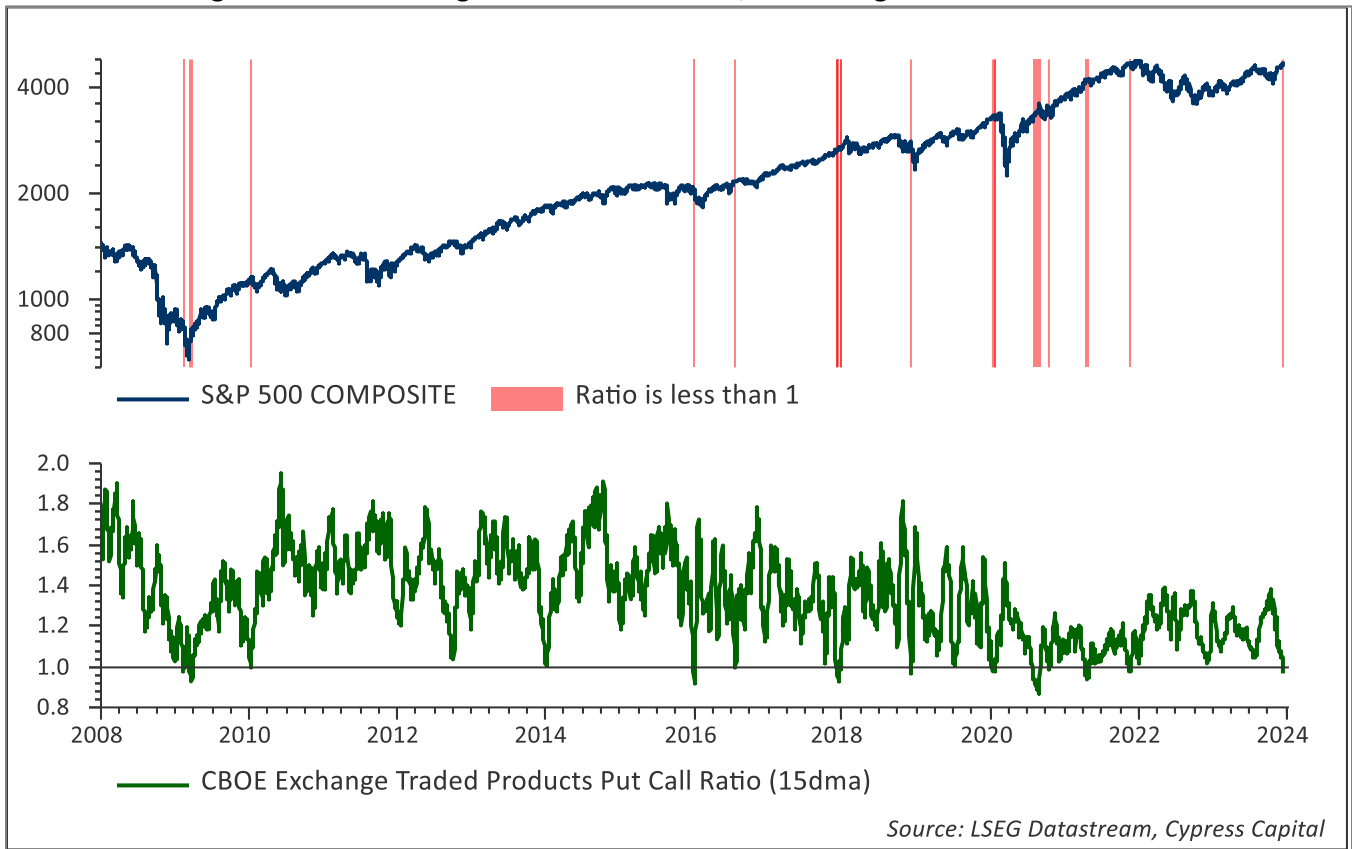
| NYSE Net New Highs / Total Issues Greater than 10% with an inverted yield curve | | | | | | |
|---|------|------|-------|-------|-------|-------|
| | 1M | 3M | 6M | 1Y | 18M | 2Y |
| Average | -1.0 | 0.1 | -0.9 | -4.2 | -8.7 | -16.8 |
| Max Gain | 3.7 | 5.5 | 9.7 | 10.5 | 1.5 | 6.2 |
| Max Loss | -7.6 | -8.5 | -34.6 | -16.0 | -27.8 | -27.3 |
| Win Rate | 52% | 58% | 61% | 35% | 16% | 23% |
| Buy & Hold Return | 0.7 | 2.0 | 4.1 | 8.2 | 7.8 | 7.6 |
| Buy & Hold Win Rate | 61% | 65% | 68% | 74% | 77% | 80% |

S&P 500 price returns since 1965

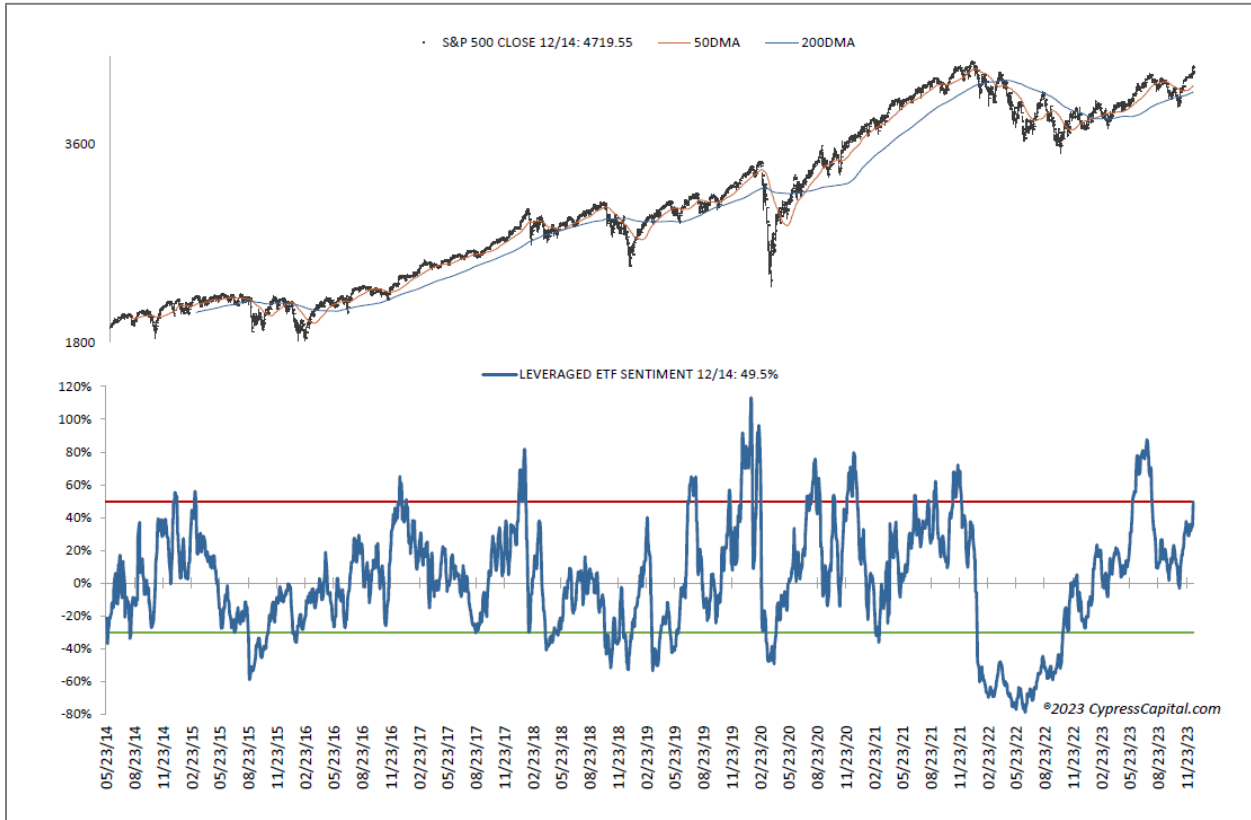
Call options volume set a new record.



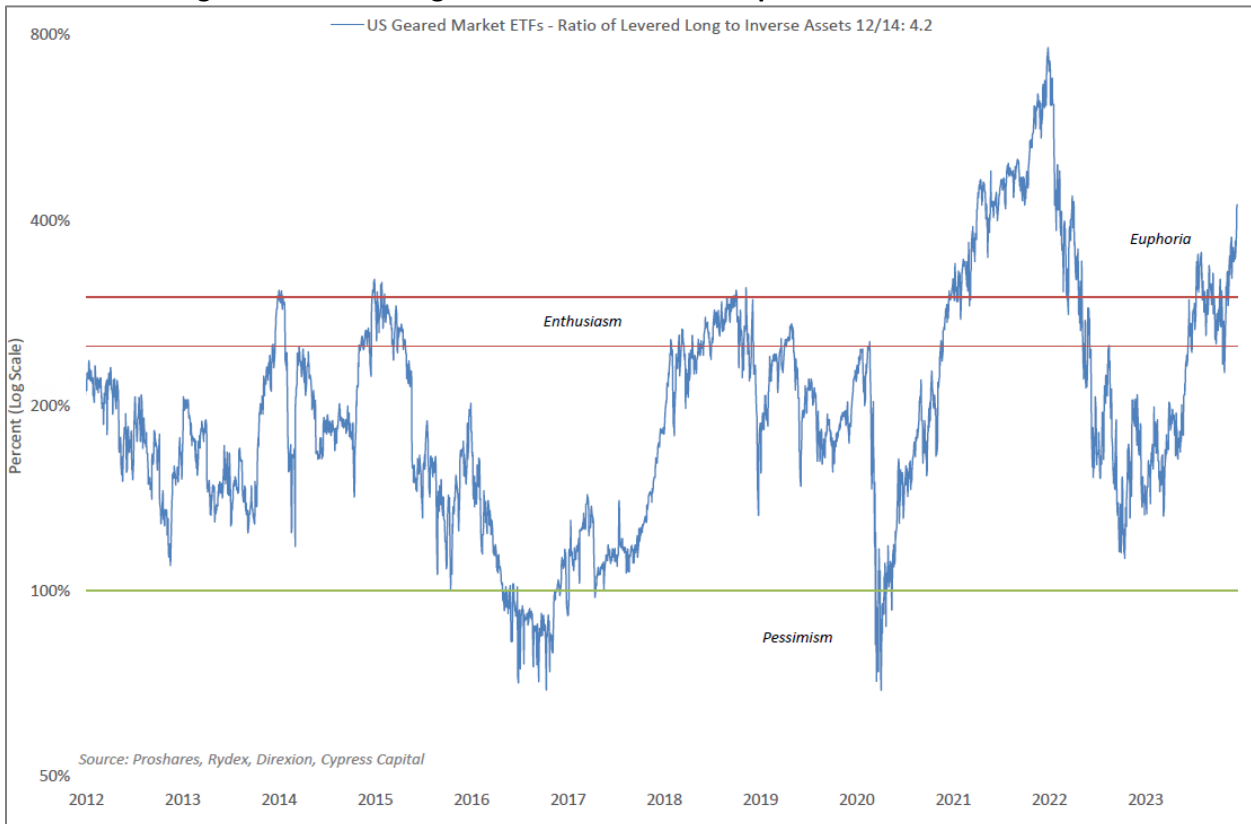
Sentiment coming from CBOE Exchange Traded Products Put/Call Ratio got bullish.



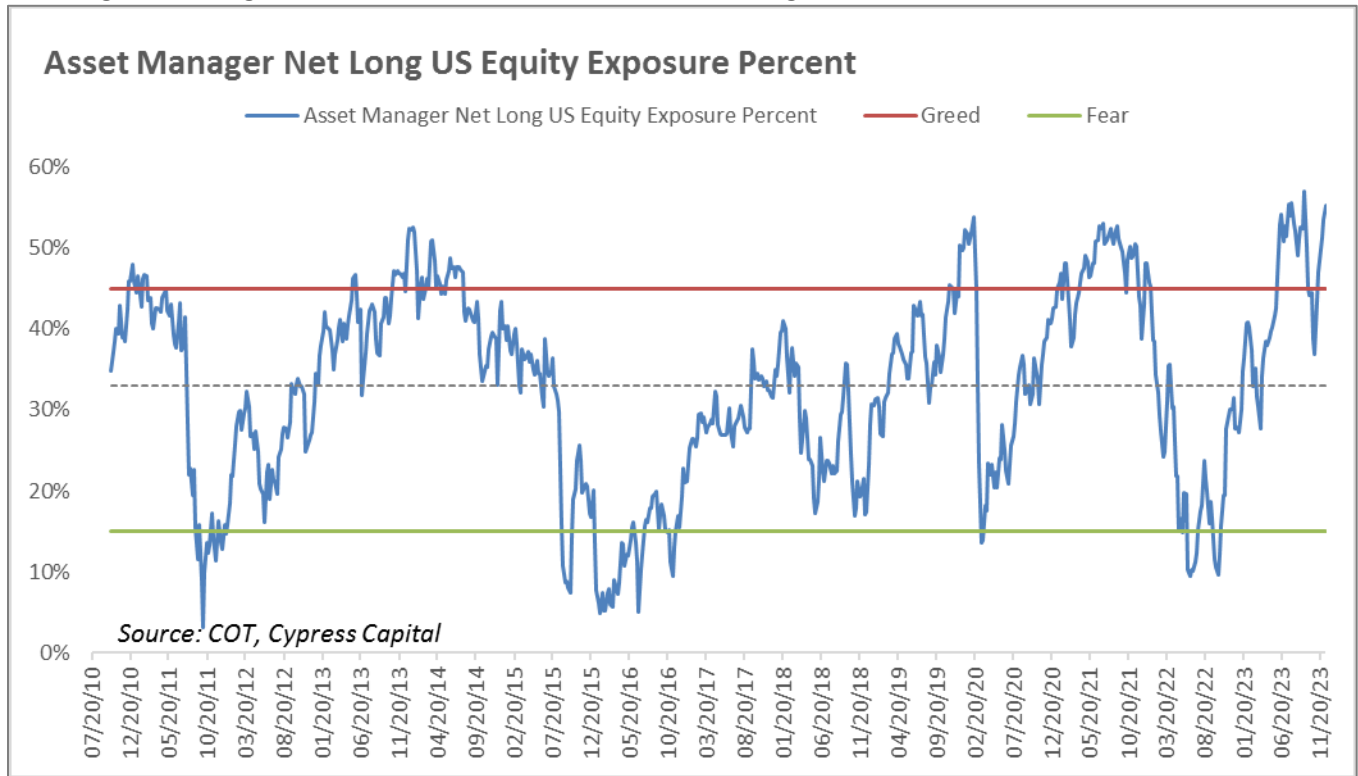
Euphoric levels of volume in Leveraged ETFs.



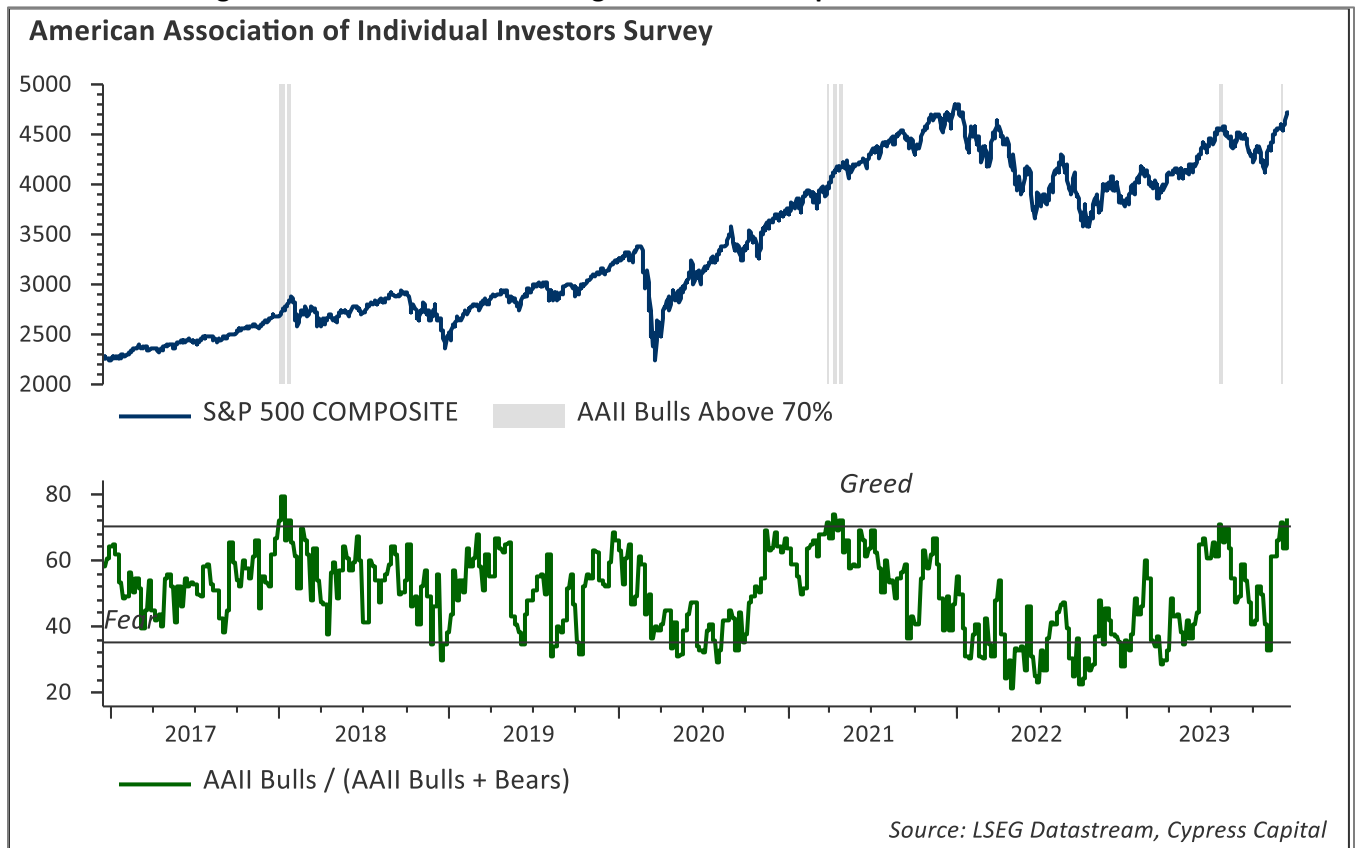
Assets in Leveraged ETFs are making a run at the 2021 bubble peak.



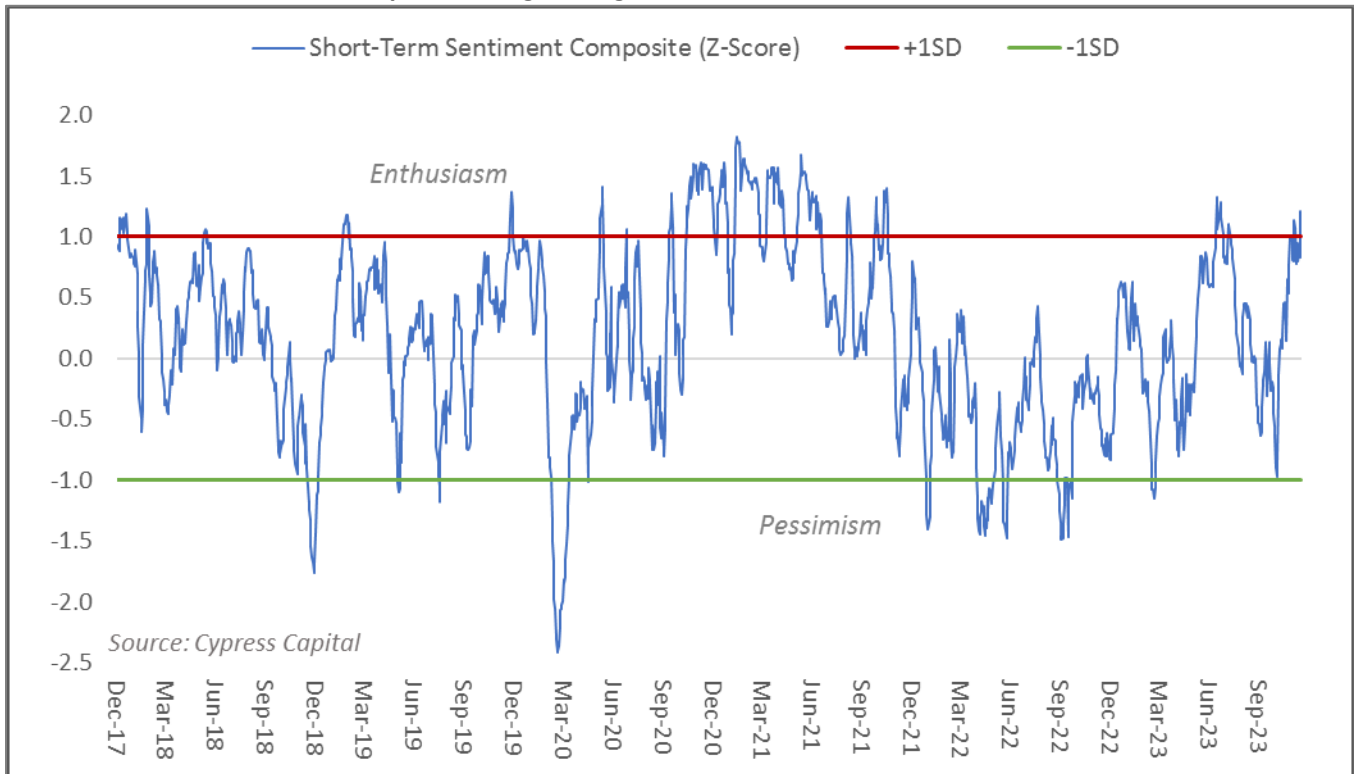
Net Long Positioning in Futures is within 2 Percent of a record high.



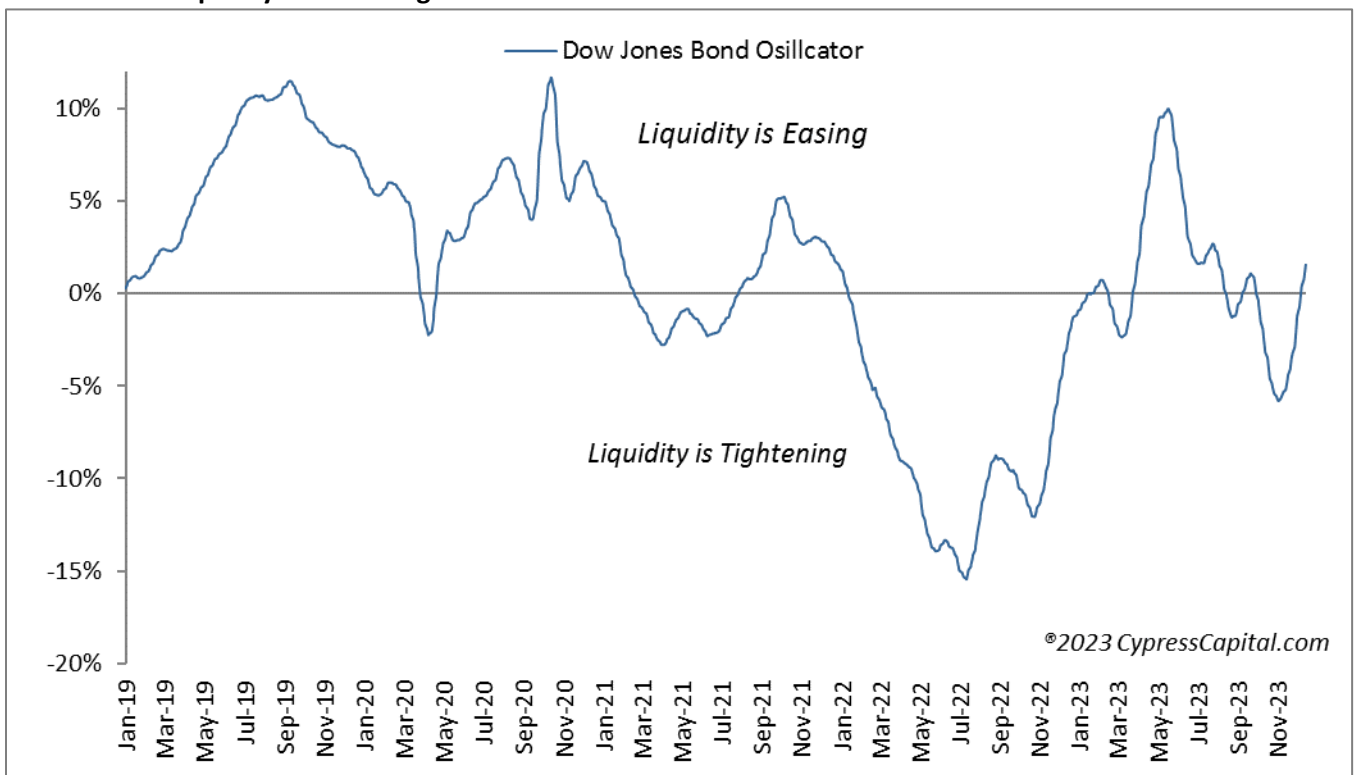
Bullishness among individual investors hit the highest level since April 2021.



Our Short-Term Sentiment Composite is registering enthusiasm.



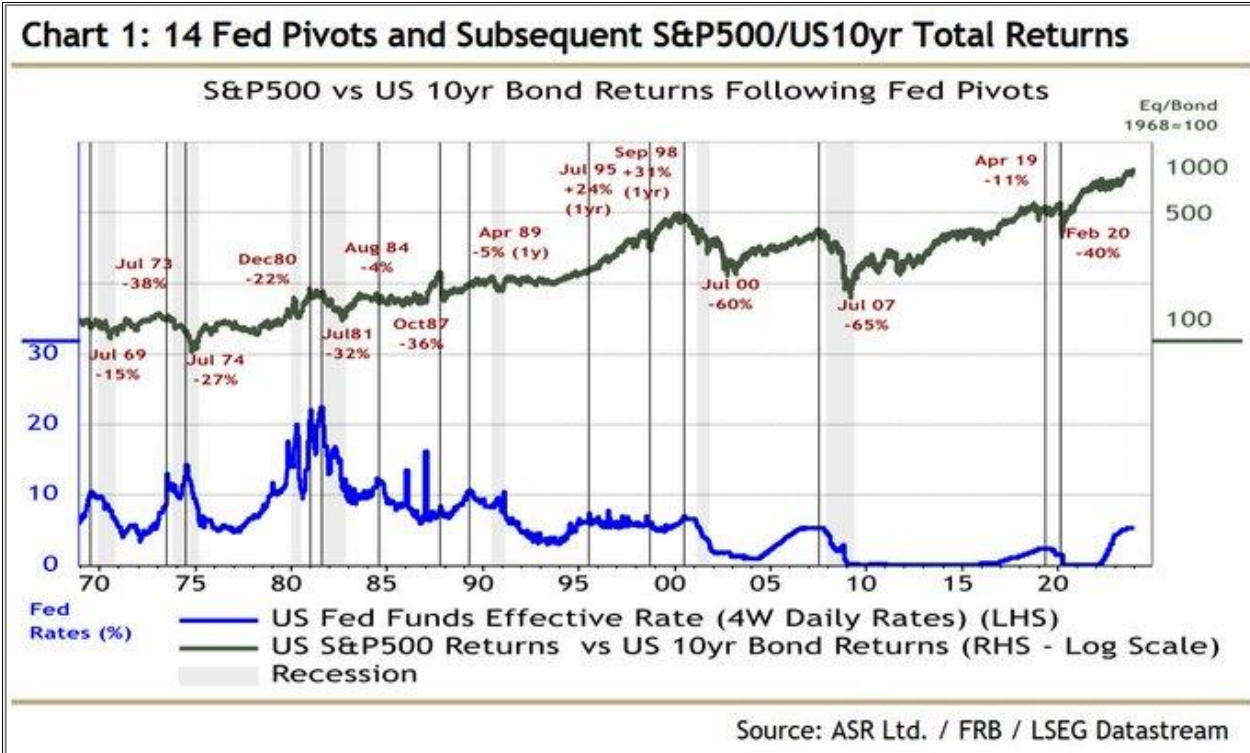
Bond Market Liquidity is increasing.



The rally in bond markets has worsened the Yield Curve Inversion.



Win rates on Fed Pivots shouldn't inspire the investor giddiness that it has.

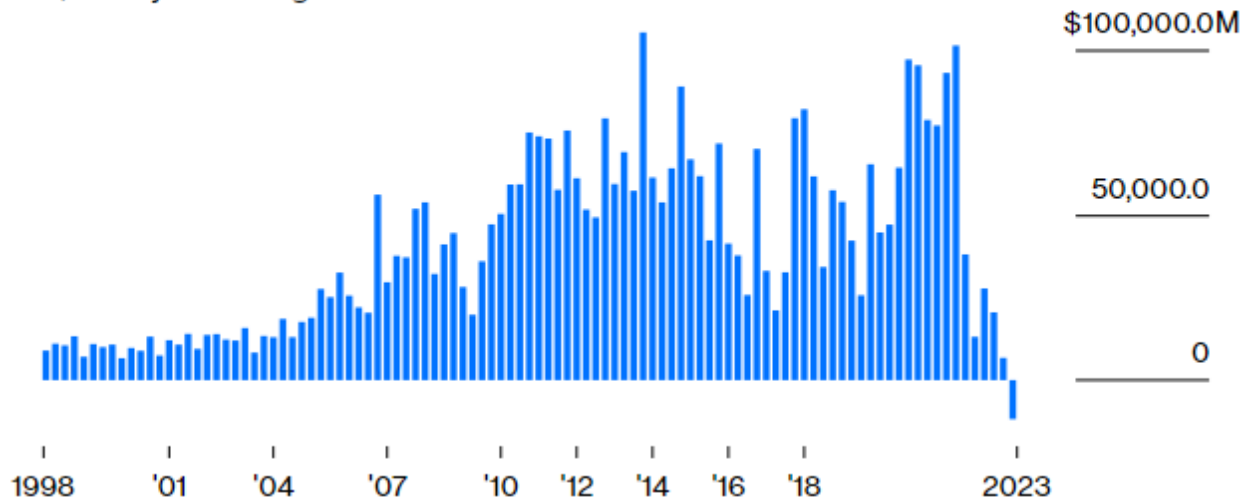


This chart & headline isn't one a country aspiring to be a reserve currency wants to see.

The Tide Turns

For the first time since China joined the WTO, FDI is negative

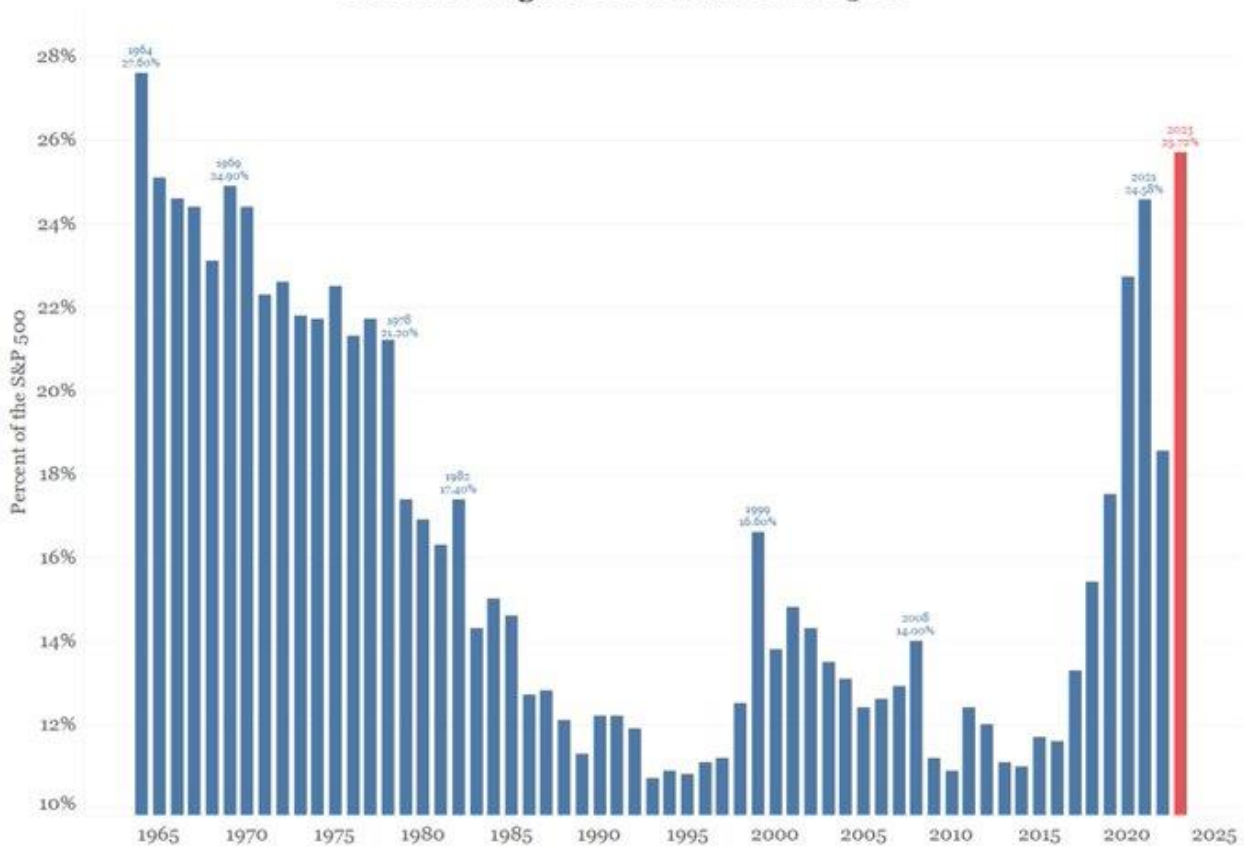
■ Quarterly Net Foreign Direct Investment in China



Source: Bloomberg

Stock market Concentration has taken out the 2021 bubble peak.

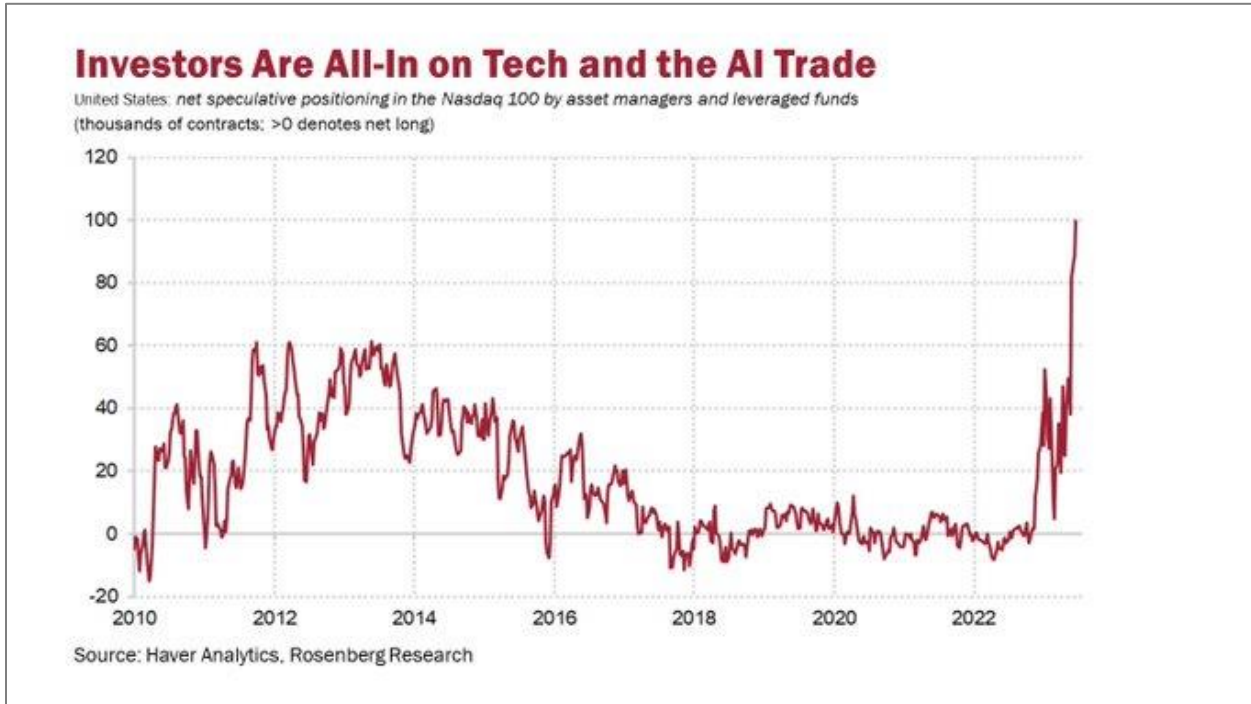
The Five Largest Stocks in the S&P 500



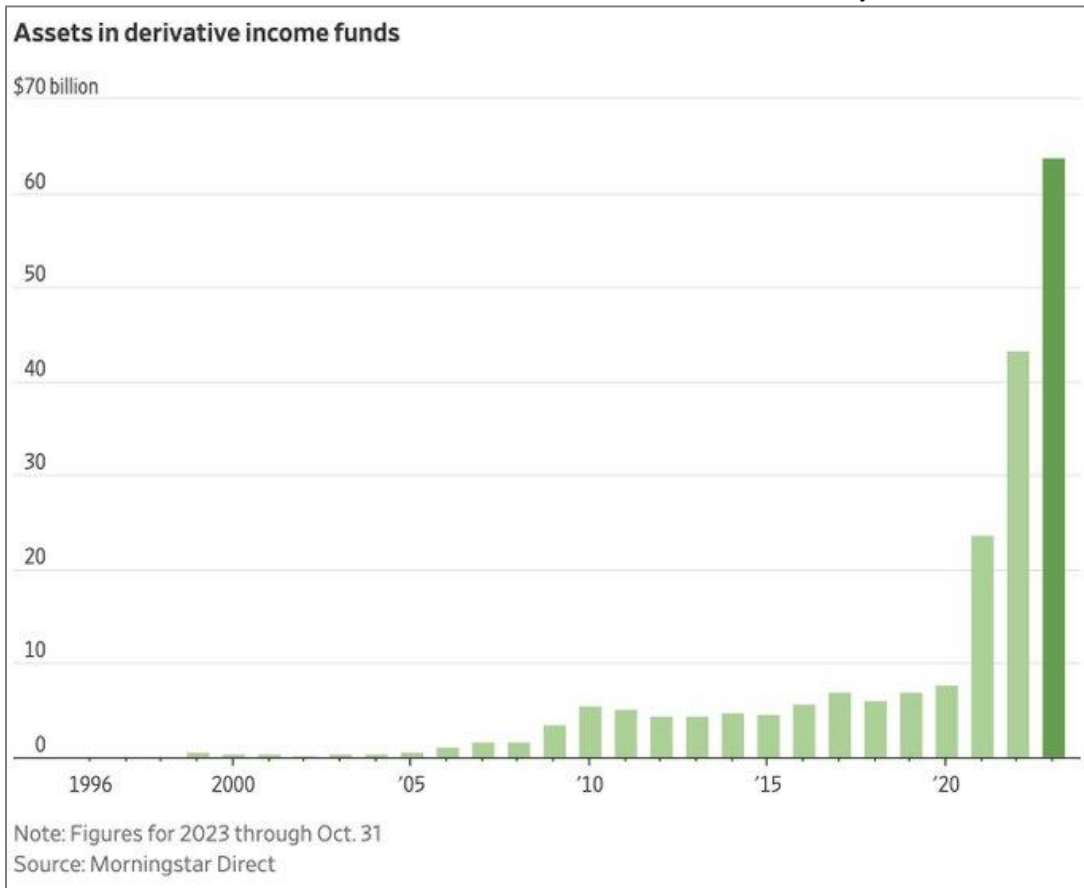
Source: S&P, Dow Jones, Bloomberg

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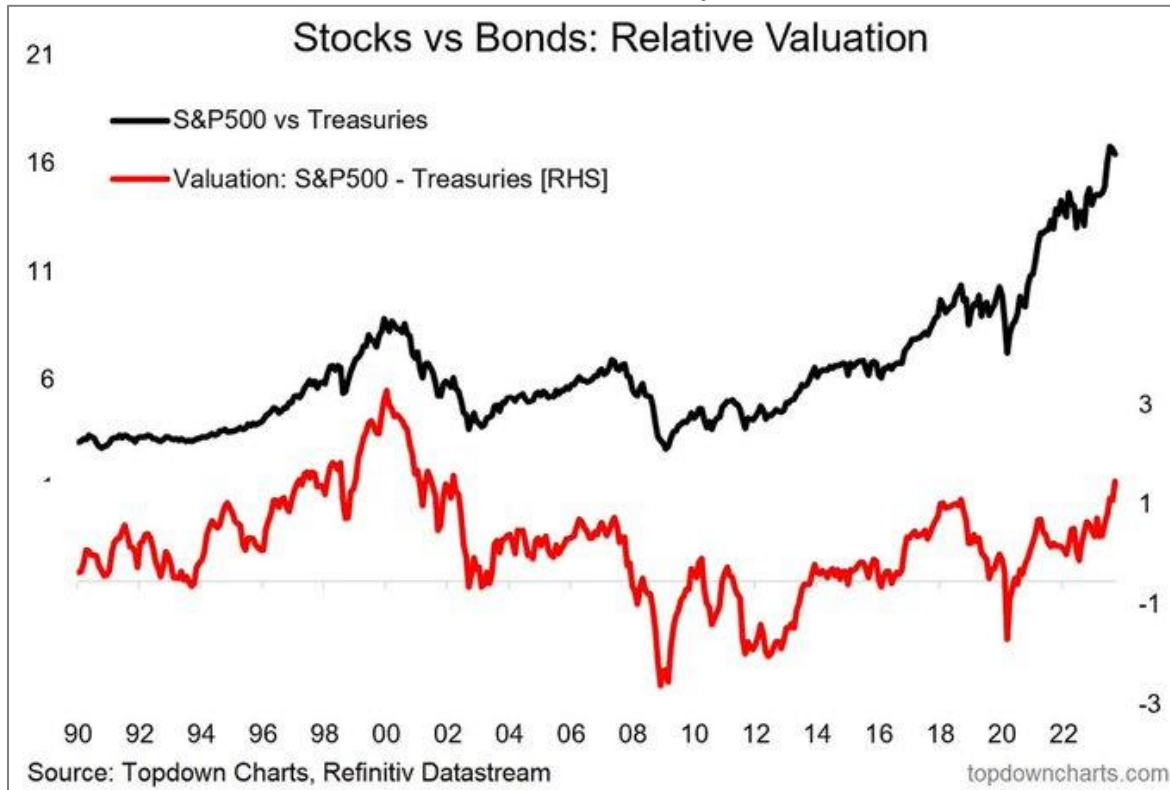
Net speculative positioning in NASDAQ 100 derivatives has skyrocketed.



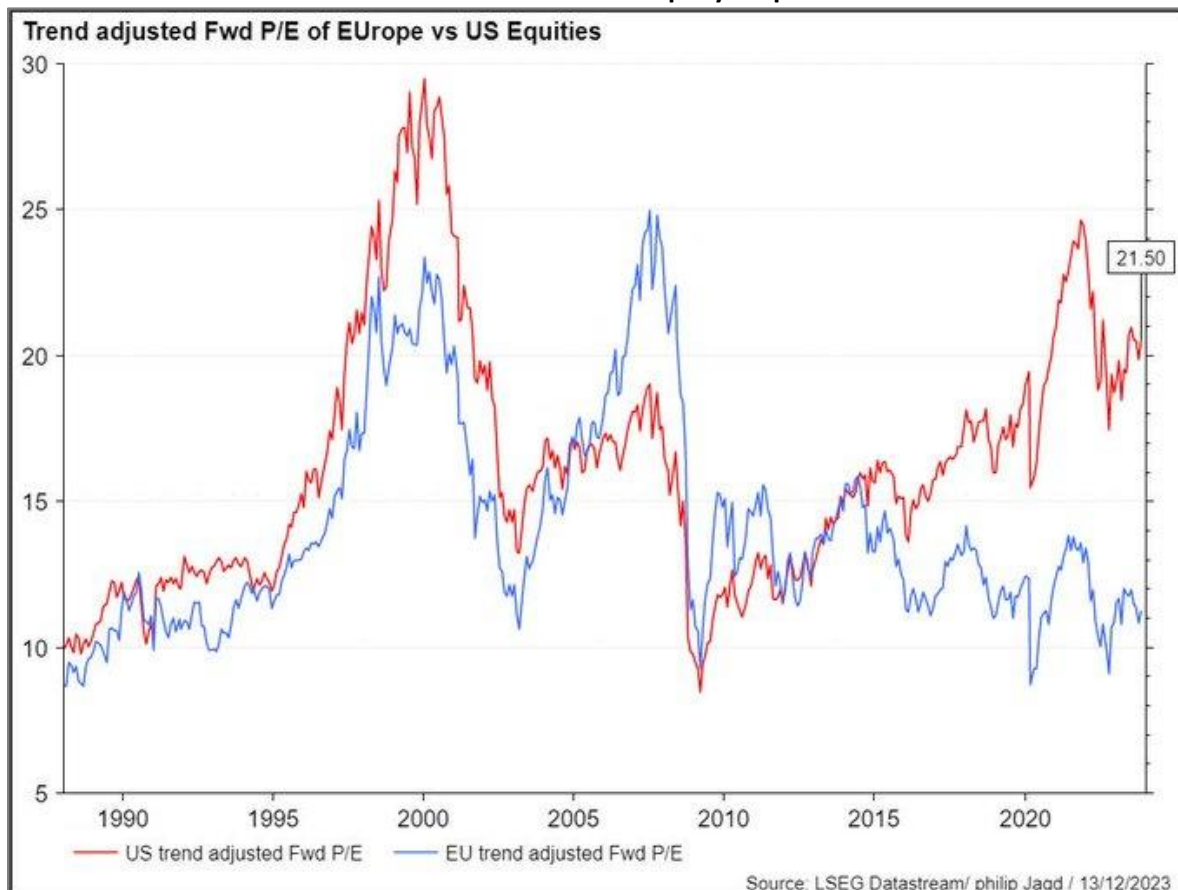
Assets in derivative income funds have risen six-fold over the last few years.



Relative valuations on stocks versus bonds favor bonds by the most since 2000.



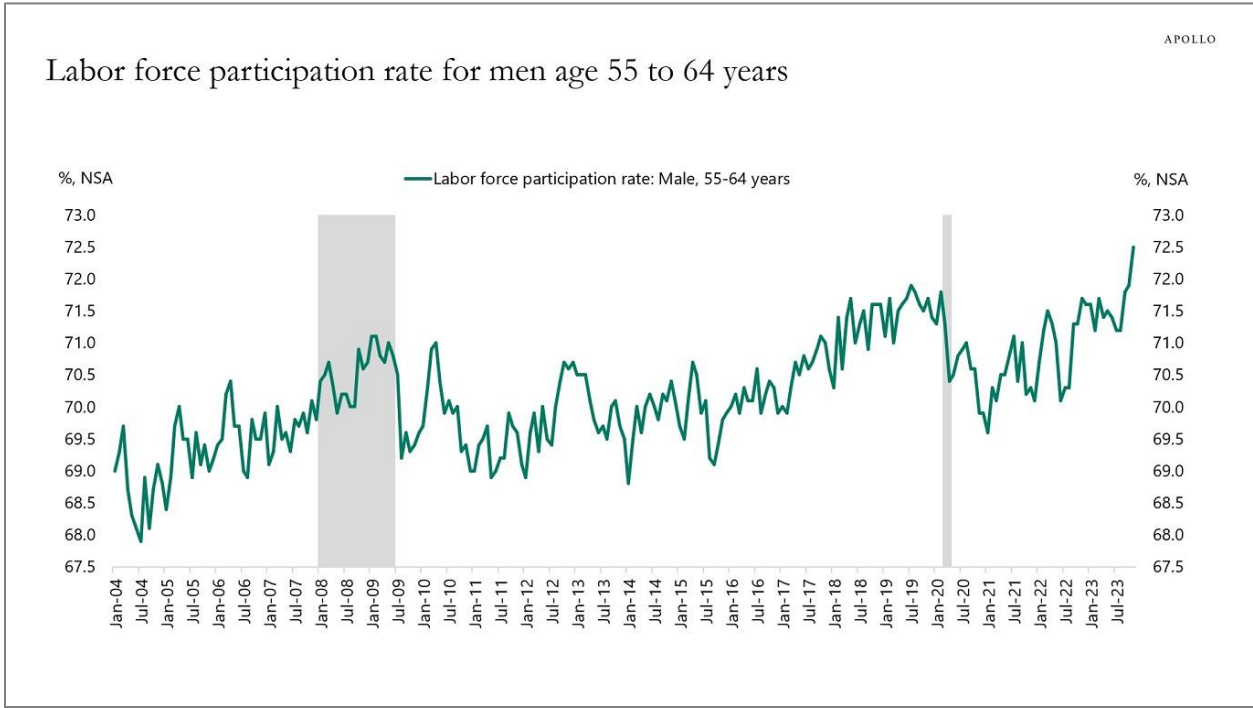
Post-Covid stock market overvaluation has been a uniquely US phenomenon.



3-year Growth in US house prices is close to 40-year highs.

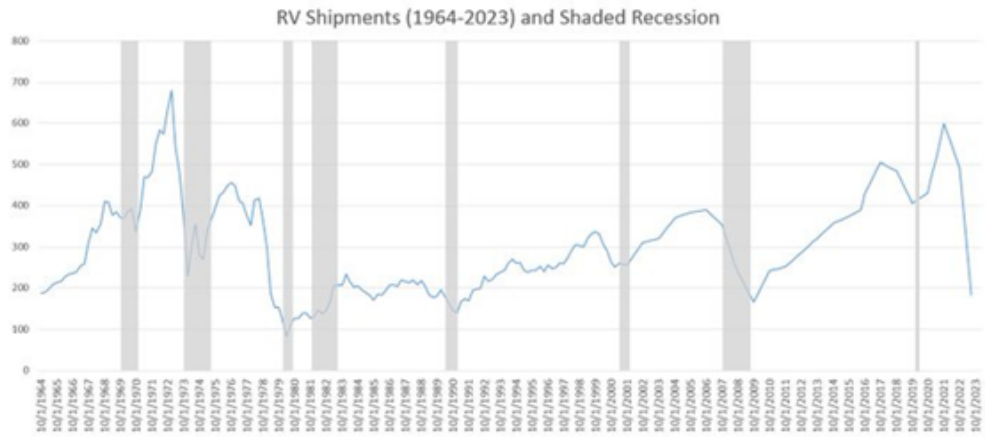


55-64 yr olds retired during the pandemic, and inflation has them returning to the workforce.



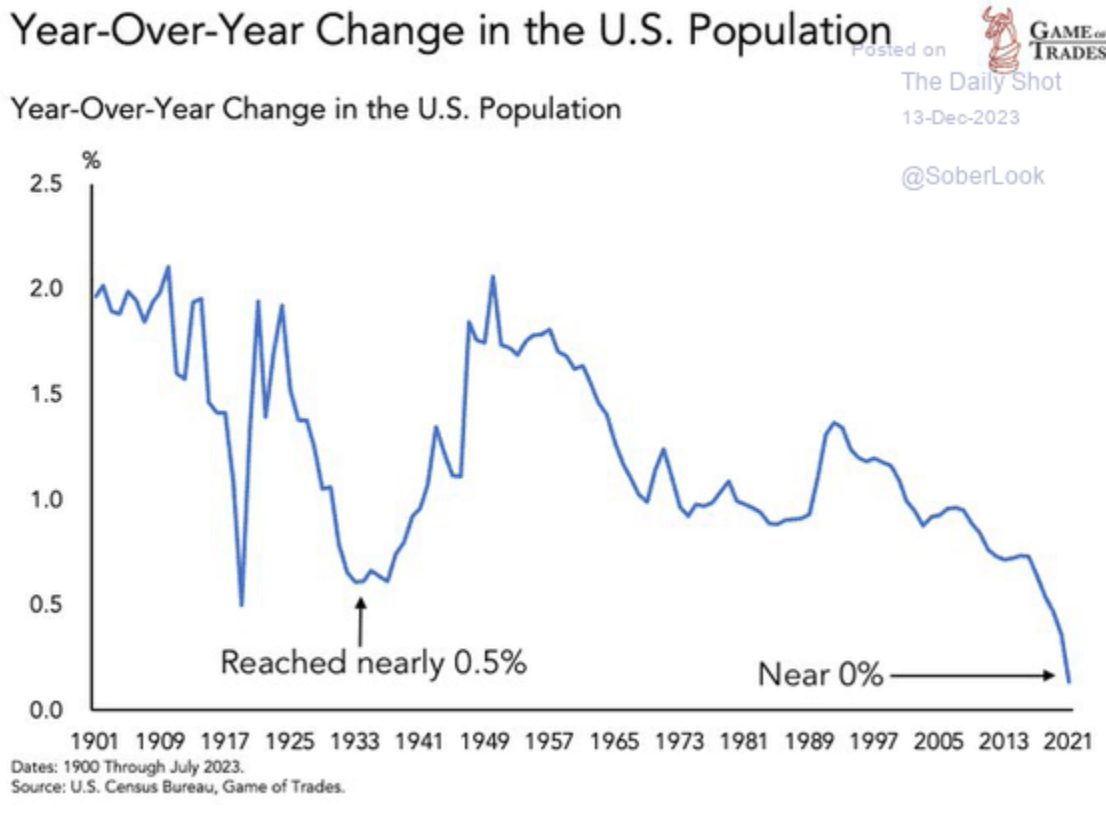
RV shipments are dropping like a recession is underway.

1. RV shipments. "The magnitude of the current drop in [recreational vehicle] shipments is larger than either of the last two economic recessions. Only the decline in 1973 surpasses what the industry is currently experiencing."



[Frank K. Martin via @jessefelder](#)

US Population growth is setting new lows.



Fed tightening leads stock market volatility by about 2 years.



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.