Market Outlook

By Mark T Dodson, CFA

Euphoric End to 2023

Market Risk Index fell to 67.9% on improving Monetary Conditions. As Investor Psychology grows more euphoric, the short-term liquidity picture in financial markets has improved dramatically. The Psychology Composite closed the year in the worst decile of readings, and returns implied by current valuations are as low as they were at the start of the 2022 bear market.

A bevy of breadth thrusts and an improving technical picture over the 4th quarter has driven the Technical Indicators category to become one of the most prominent bullish influences on our Psychology Composite. However, it's not enough to offset a picture of excessive greed coming from most categories in the composite. The first wart on the Technical picture occurred this week, with the NASDAQ High Low Logic breaching its first sell threshold. As the technical picture on the NYSE has improved markedly, the NASDAQ is showing its first signs of a bifurcated market.

Asset Manager Net Long US Equity Exposure using derivatives closed the year at a record high. Our Short-Term Sentiment composite, comprised of our favorite measures of short-term investor sentiment, hit the most euphoric reading since the summer of 2021. Extremes in the Rydex Ratio and assets in Leveraged ETFs confirm an over-confident desire by investors to leverage up stock market gains. Smart money corporate insiders took advantage of investors' excitement for stocks and started selling their stock at a rapid clip.

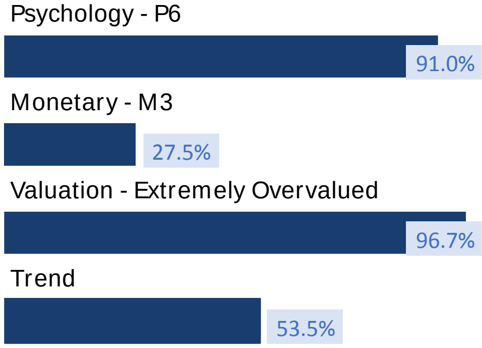
The enthusiasm for the Fed's pivot and a soft landing is reaching a crescendo. Still, sentiment and valuations leave little in the way of historical precedents for a cyclical bull market to stretch its legs and leave no margin of safety for investors who rank permanent loss of capital ahead of potential gains.

Market Risk Index

Rec Allocation 25% Underweight

67.9%

Category Percentiles



Largest Psychology Influences

Leveraged Investments	Negative
Surveys	Negative
Flow of Funds	Positive
Technical Indicators	Positive

Largest Monetary Influences

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

Valuation

7-10 Year Equity Return Forecast	1.4%
10Yr US Treasury Yield	3.8%

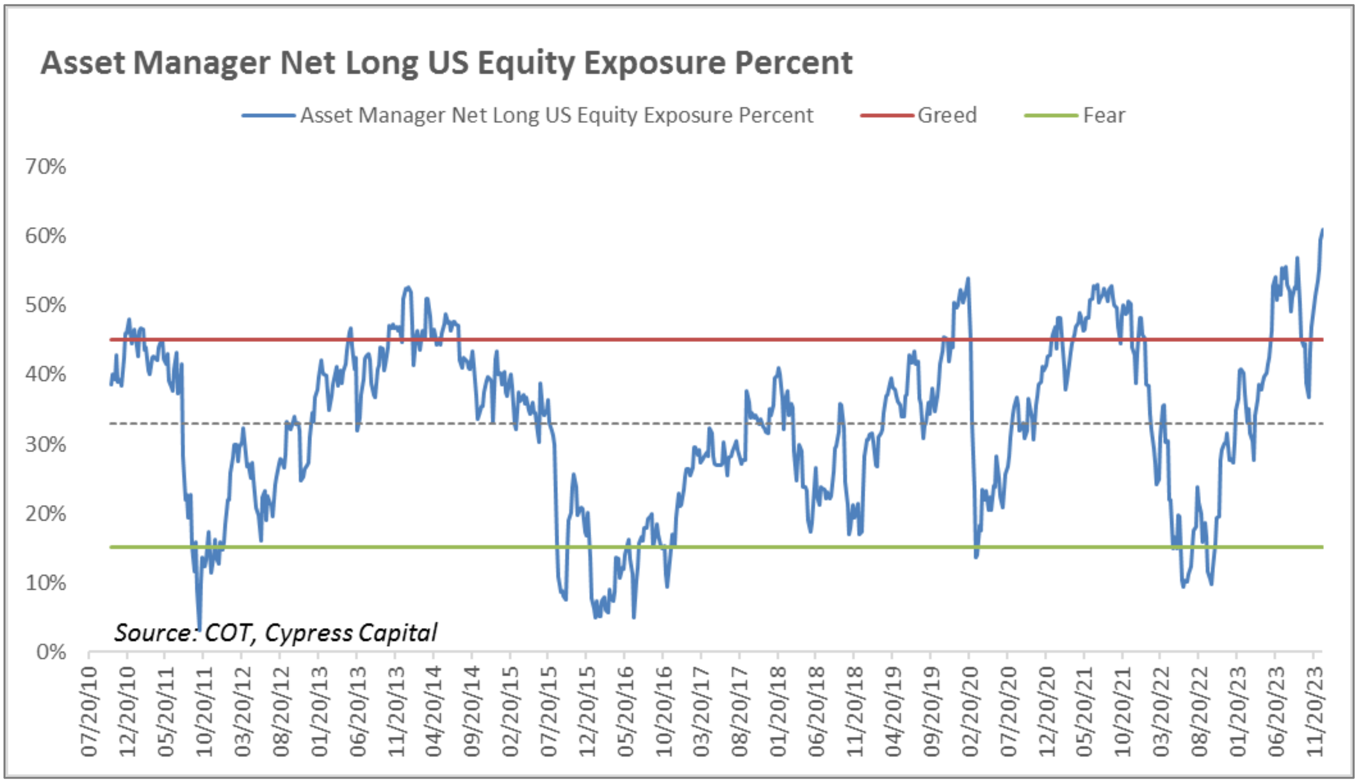
Market Trends

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

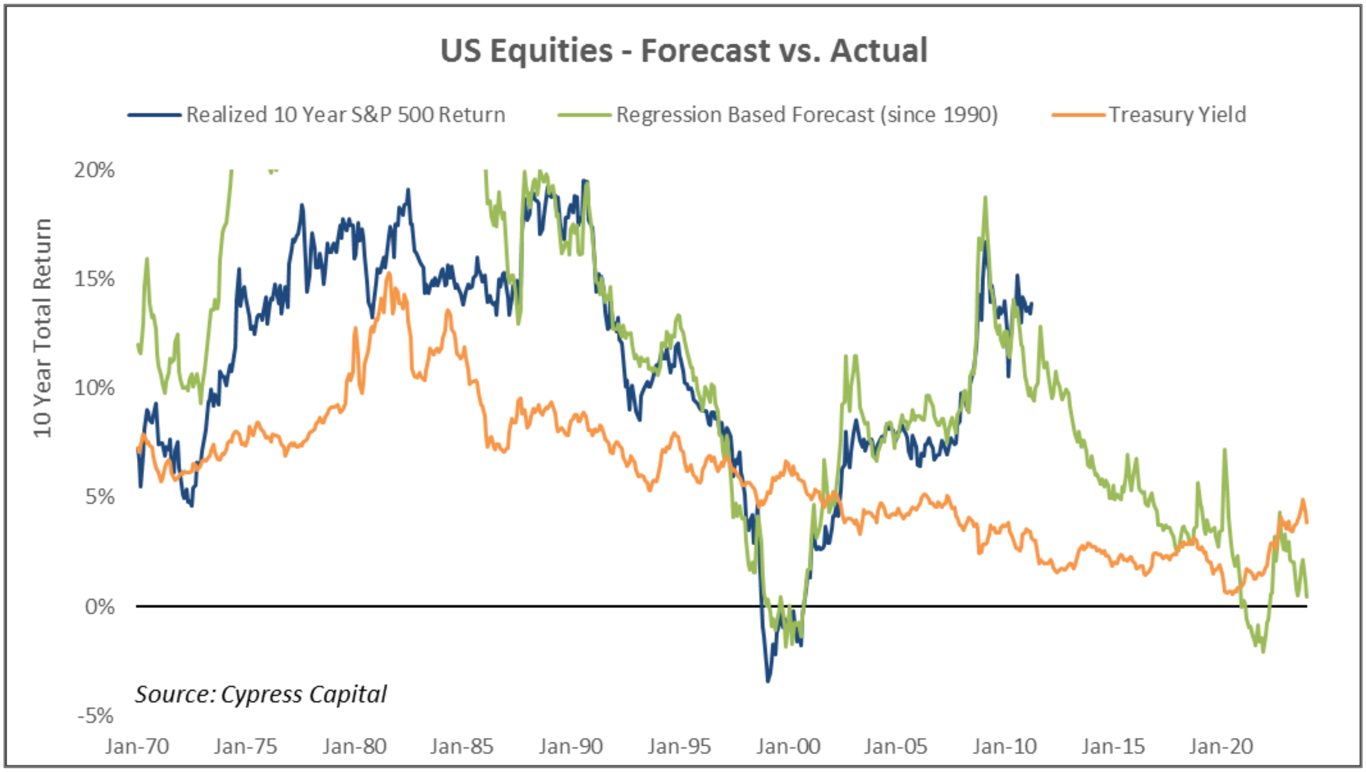
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets based on our model & opinion. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

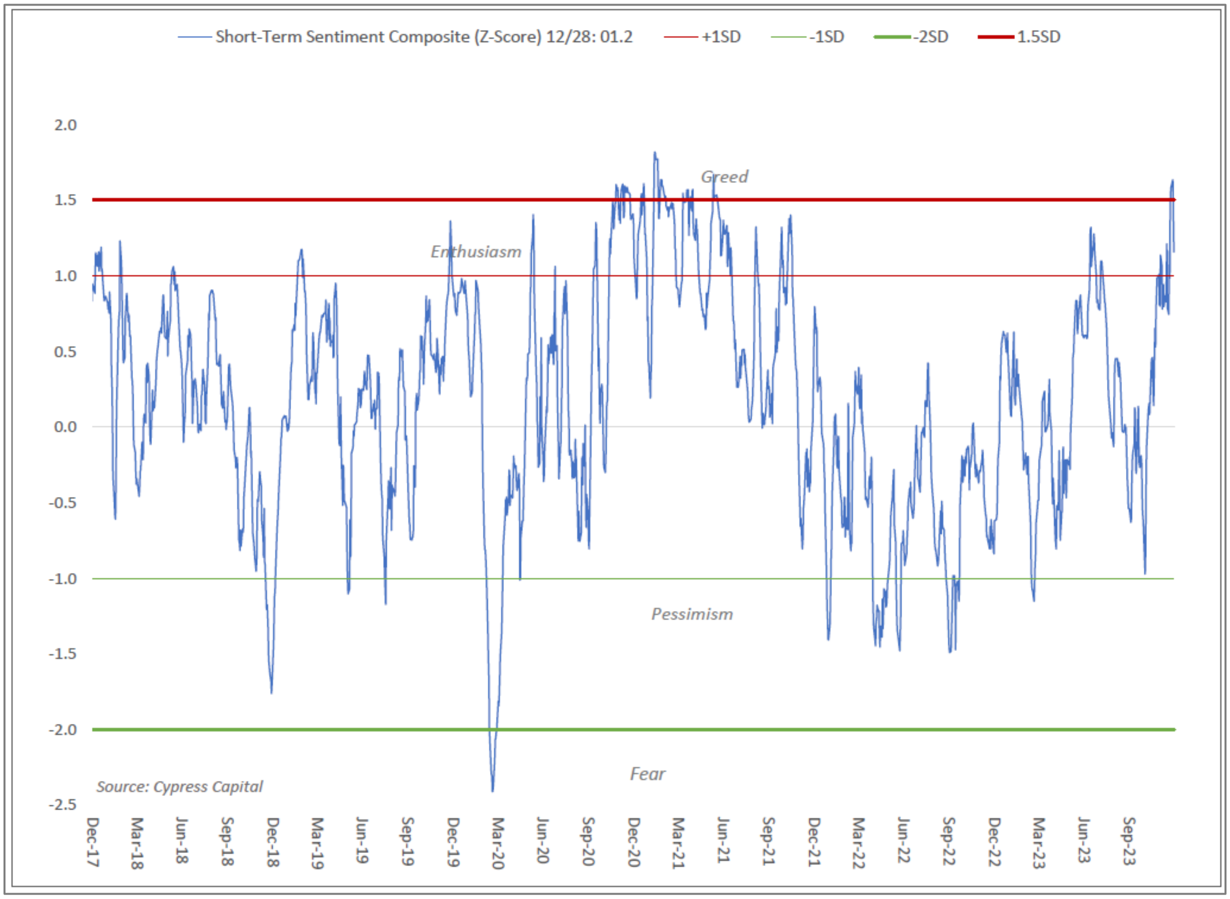
Asset Managers' equity derivatives exposure finished the year at a record high.



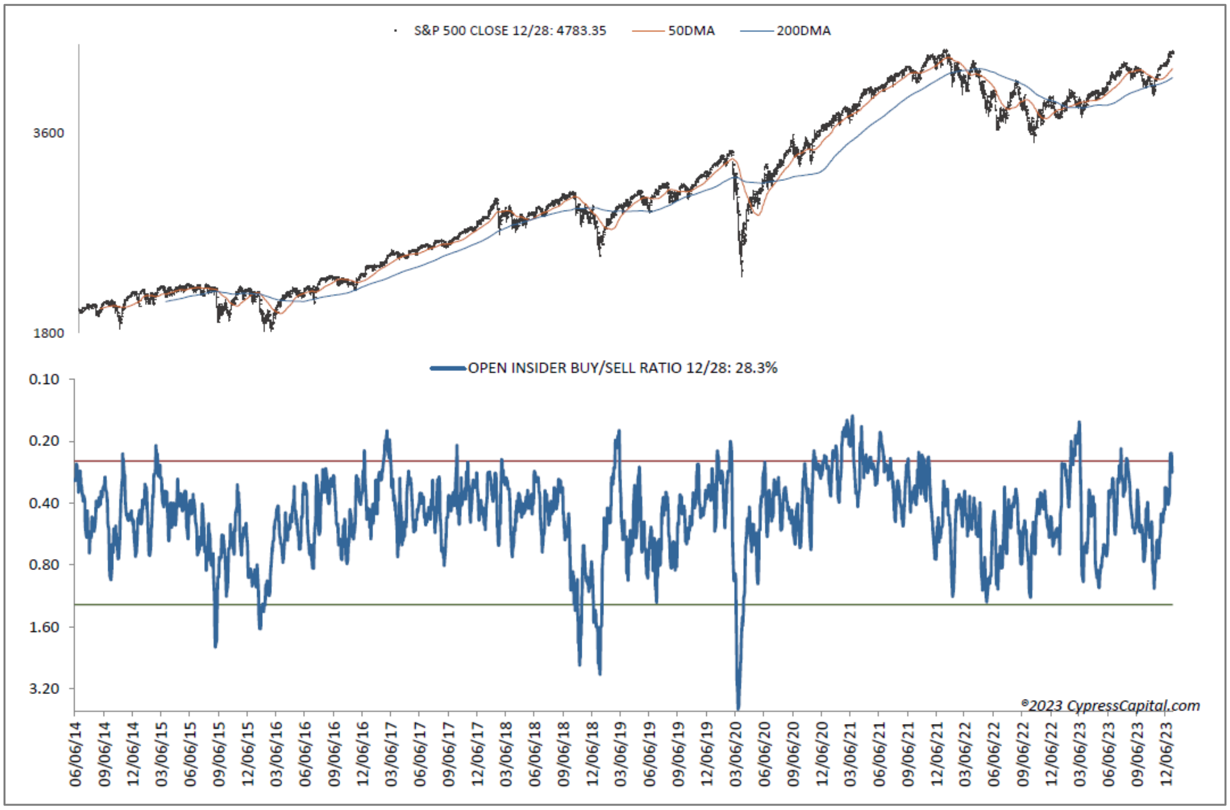
Equity Valuations are as unfavorable as they were at the start of the 2022 bear market.



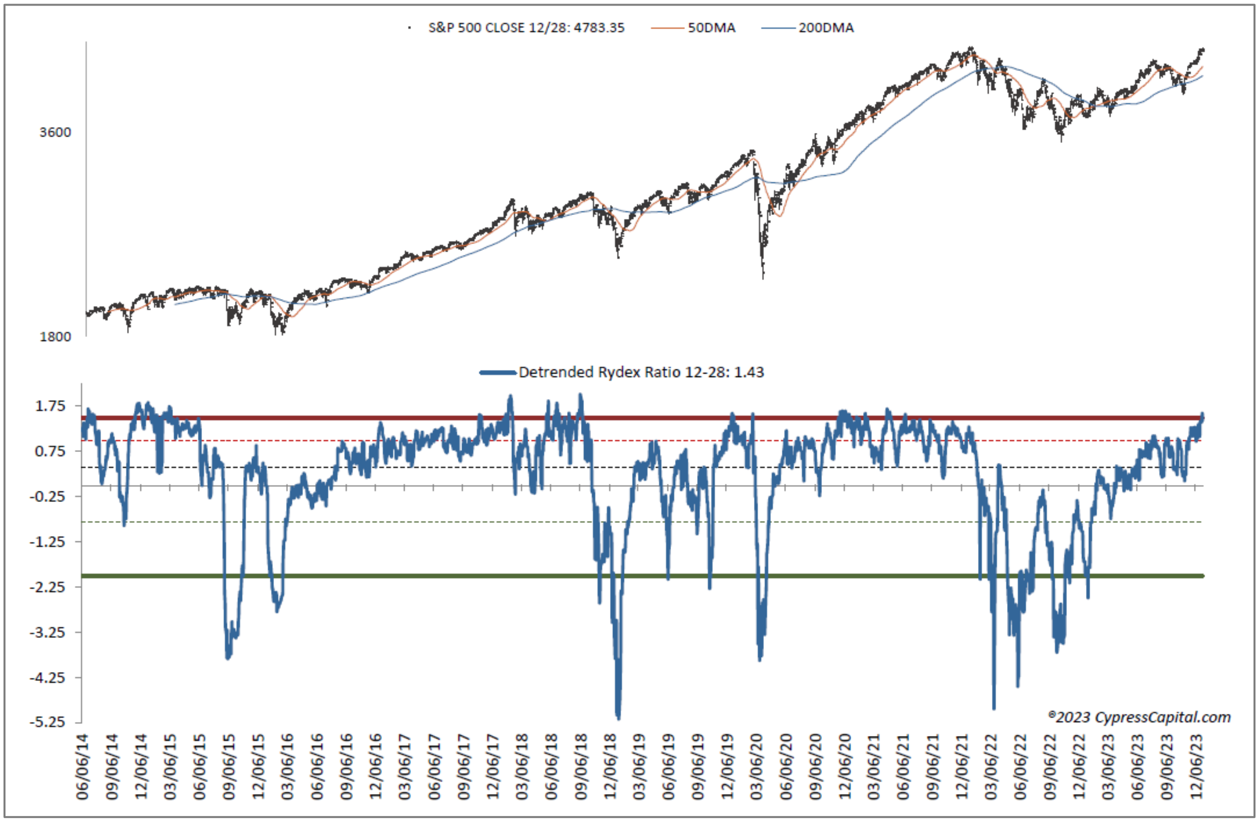
Greediest reading on our Short-Term Sentiment Composite since the summer of 2021.



Corporate Insiders closed out the year unloading their stock.

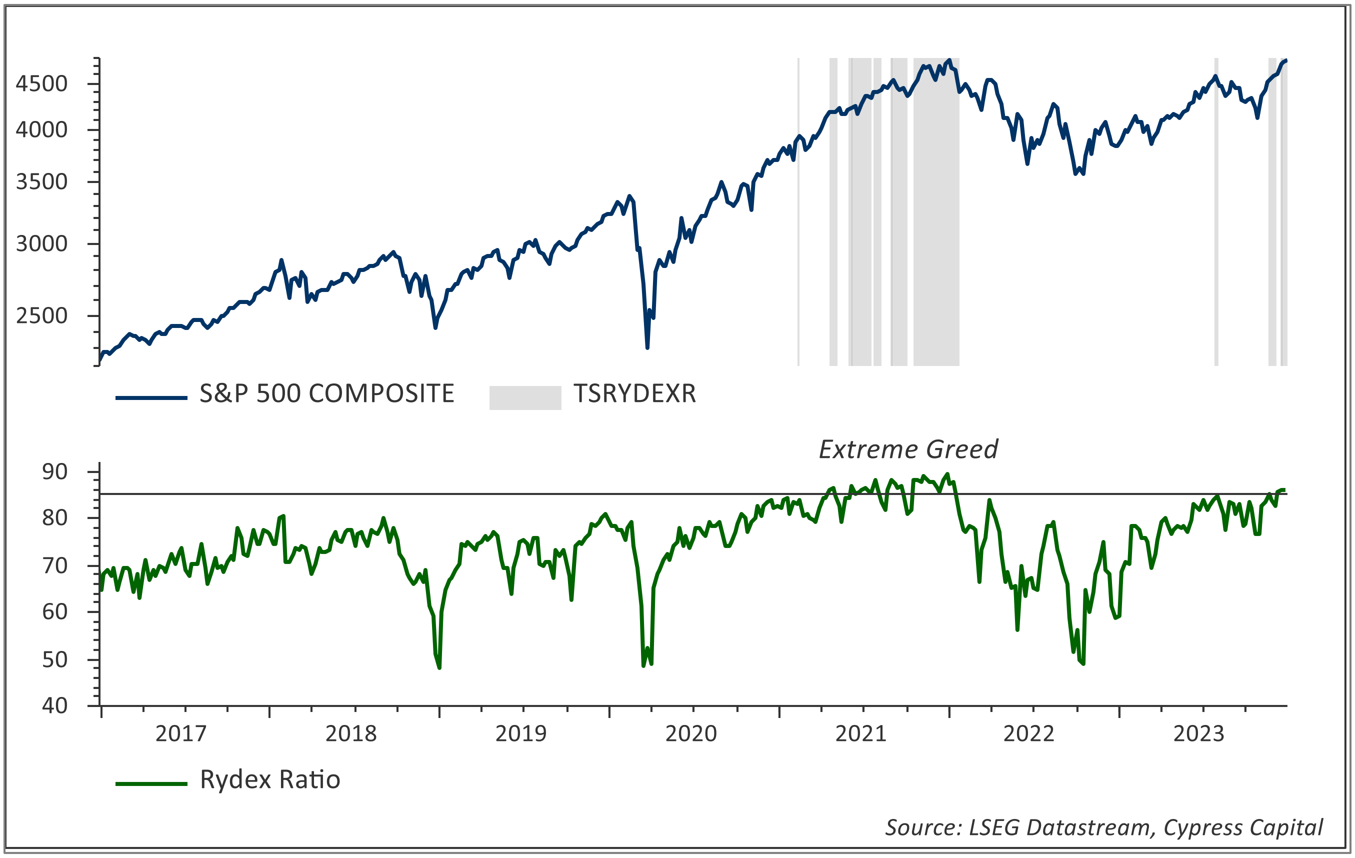


De-Trended Rydex Ratio is registering extreme greed.

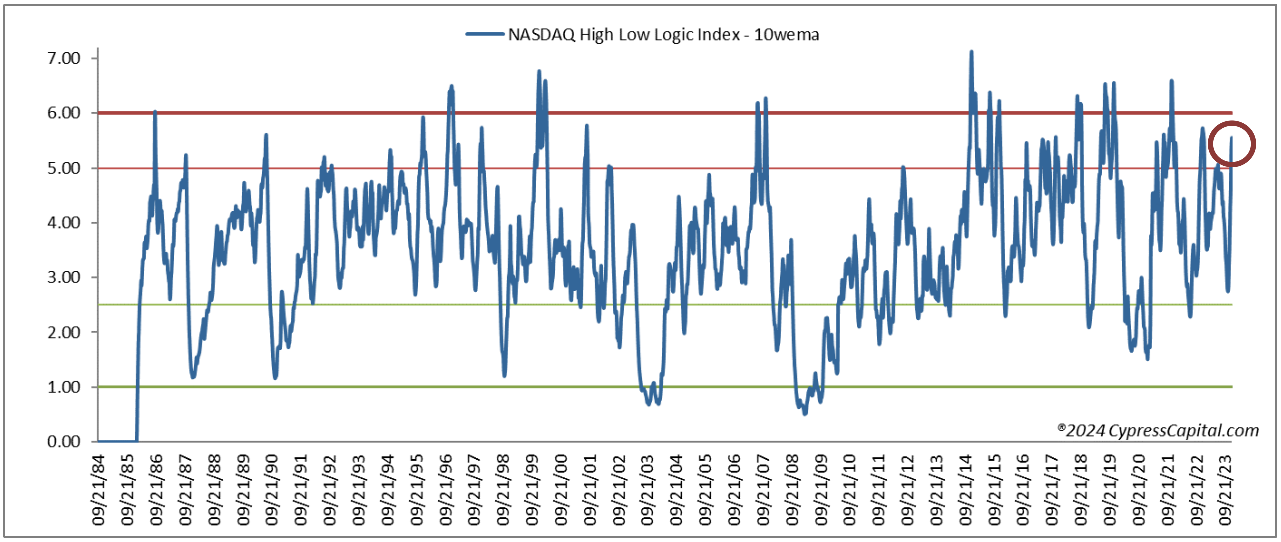


Rydex Ratio is partying like it's 2021.

The indicator turns 30 years old next year, but readings above 85% only became possible in the Covid/QE stimulus era.

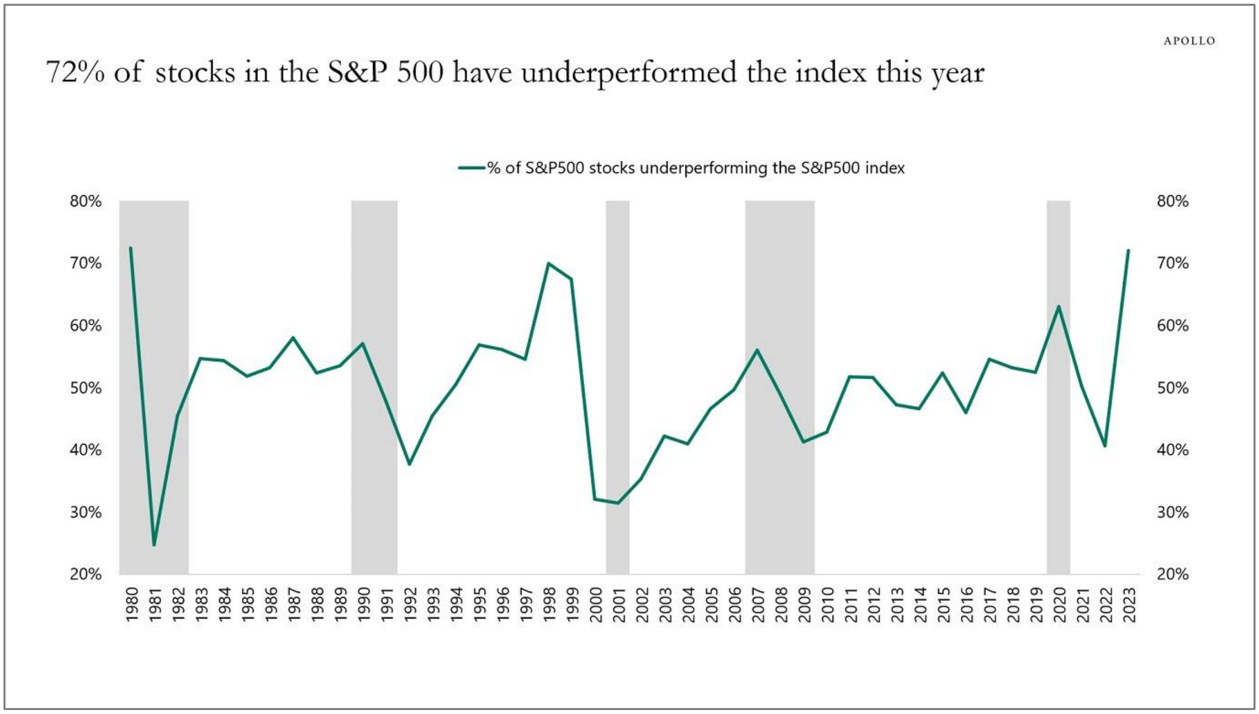


NASDAQ High Low Logic Index flashes its first warning sign since the rally began.

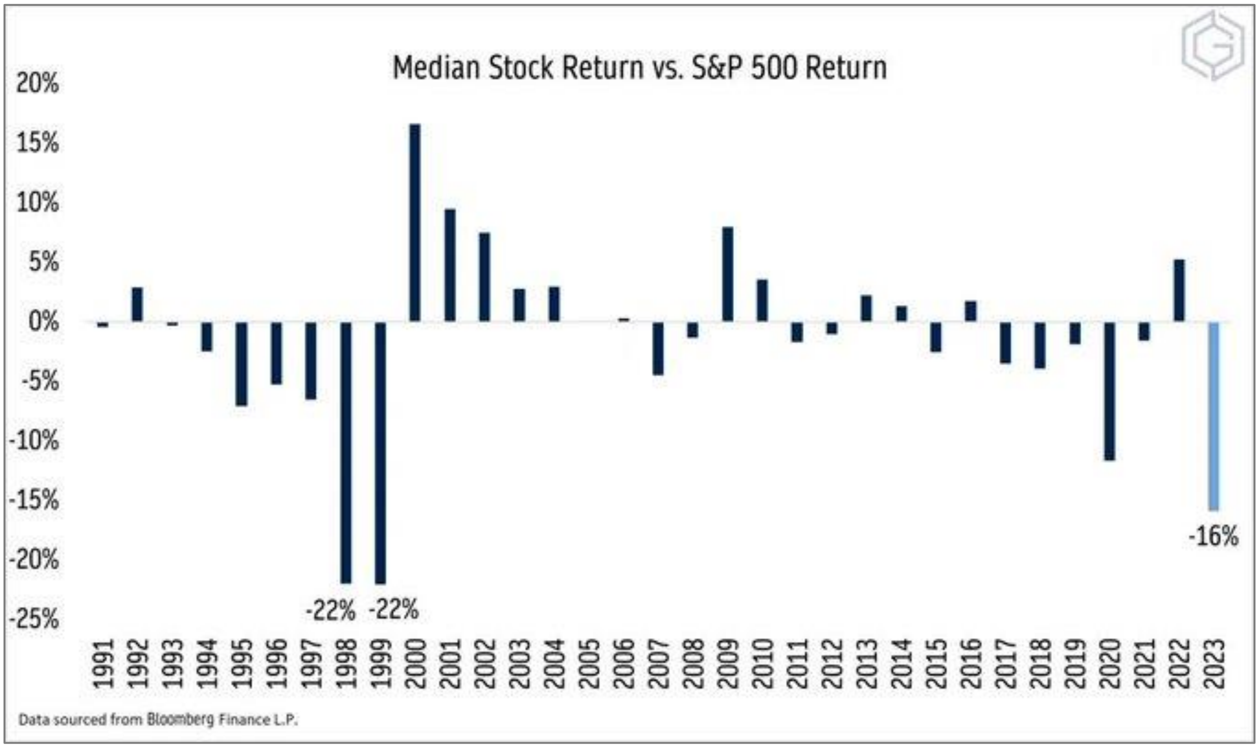


Retail went all-in on the Fed pivot trade.
Covid stimulus has created an era of retail stock trading not seen since the dot-com era.

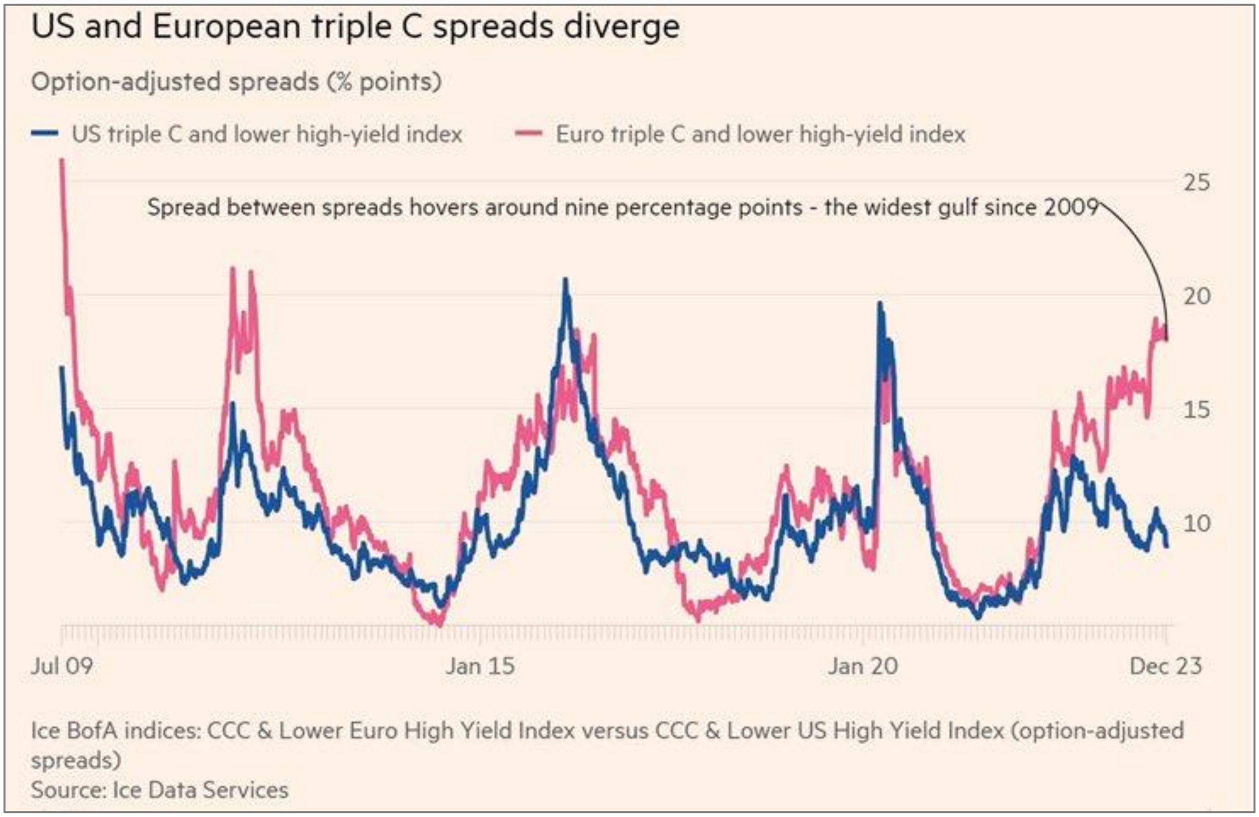
Almost three-fourths of stocks underperformed the market in 2023.



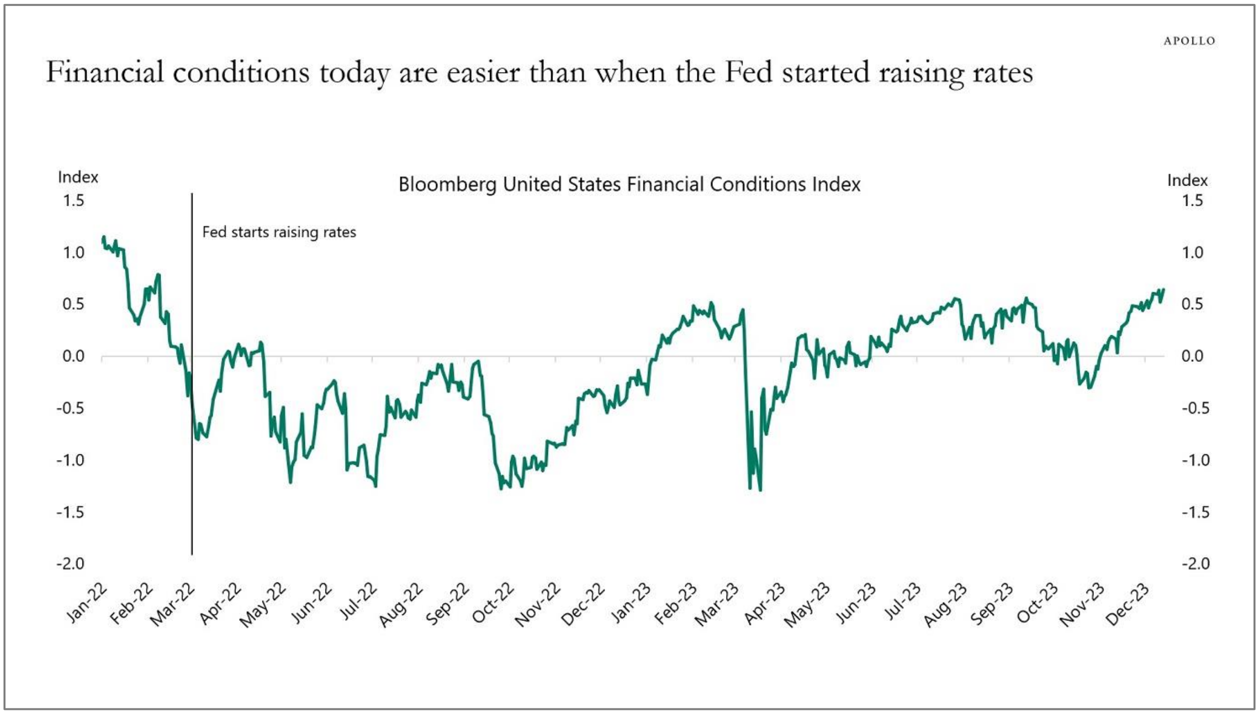
Median stock underperformed the S&P 500 by the most since 1999.



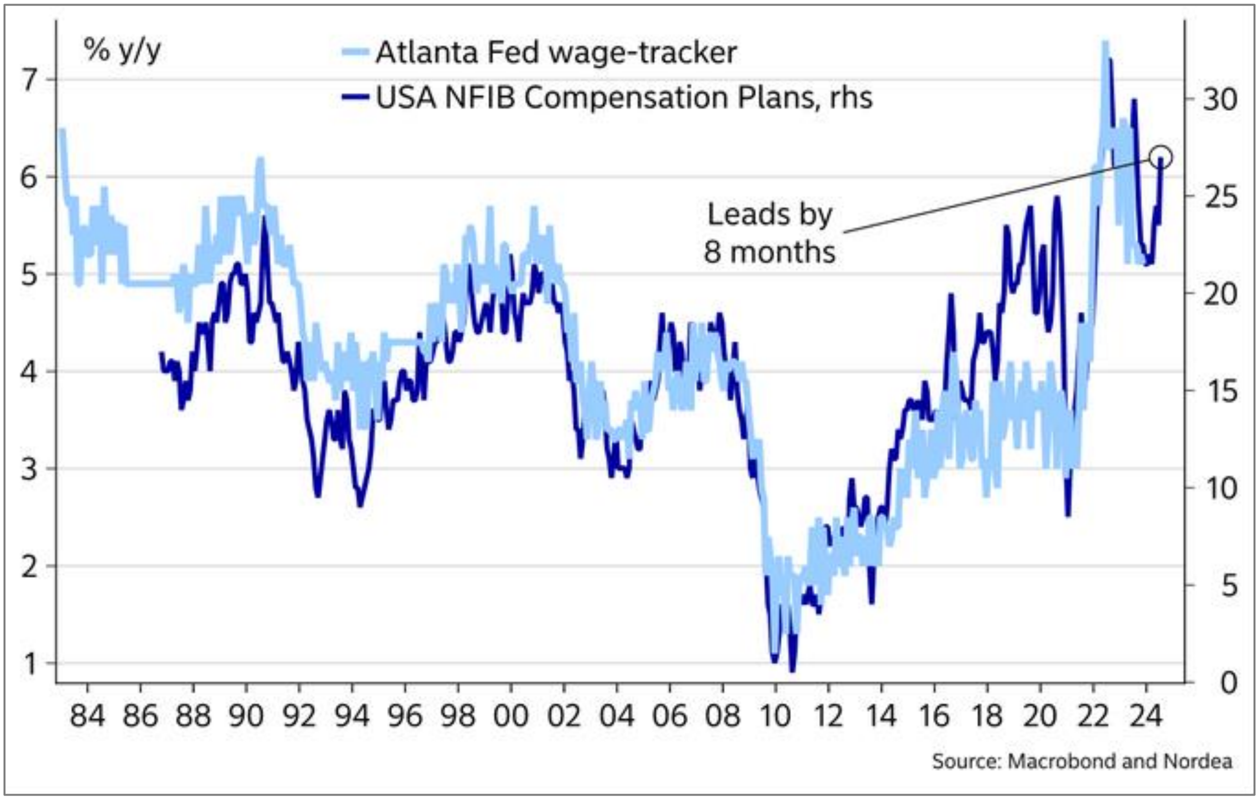
Soft-Landing enthusiasm appears to be a uniquely American phenomenon.



Financial conditions are easier than at the start of the Fed tightening cycle.

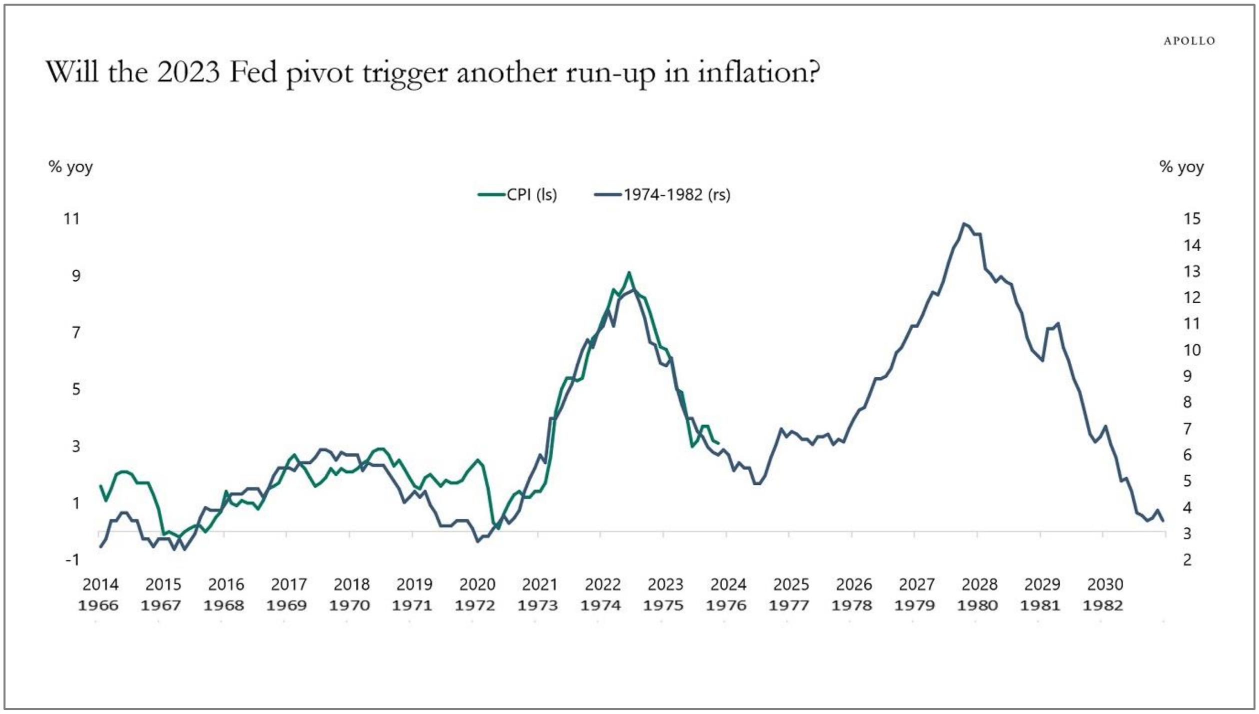


Businesses see higher wage costs on the horizon.

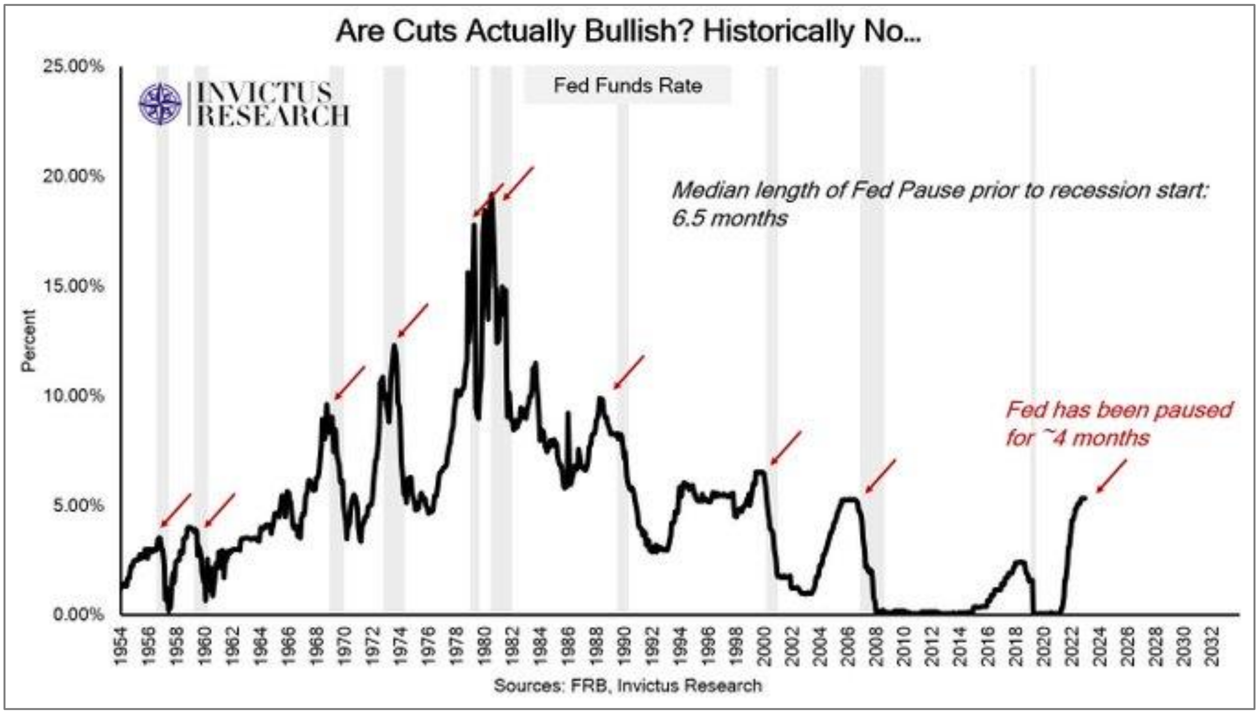


Wage inflation isn't over.

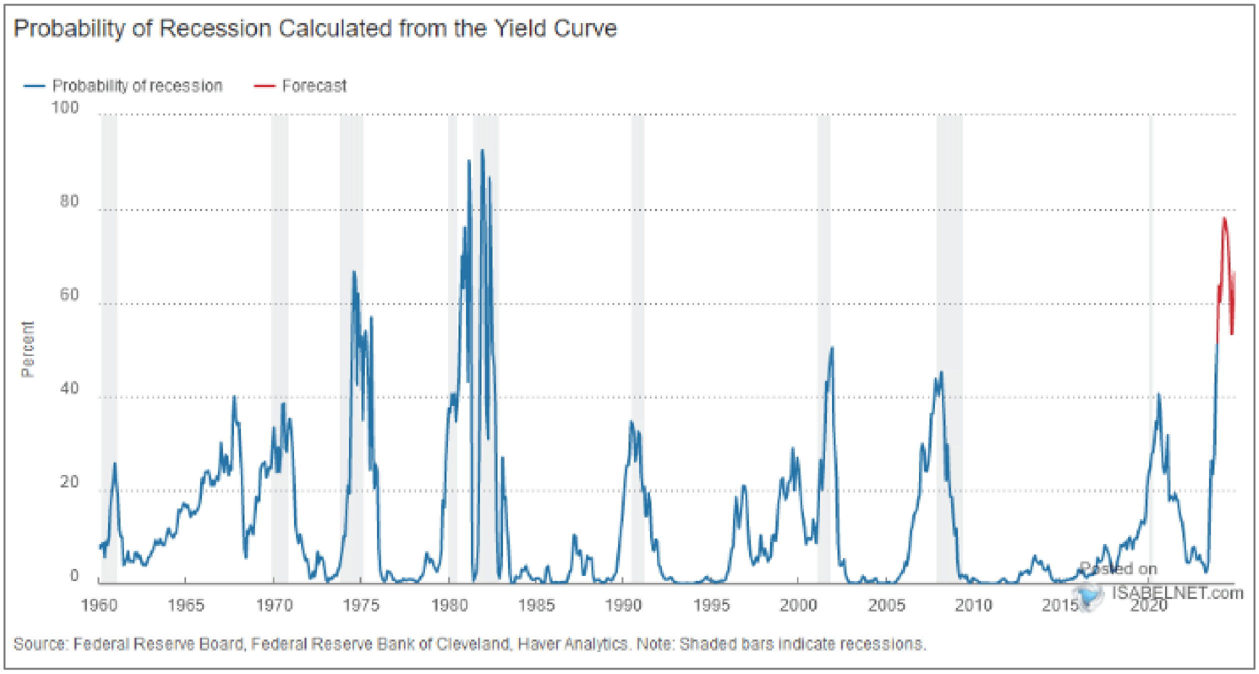
Powell's pivot looks like it's following Arthur Burn's playbook.



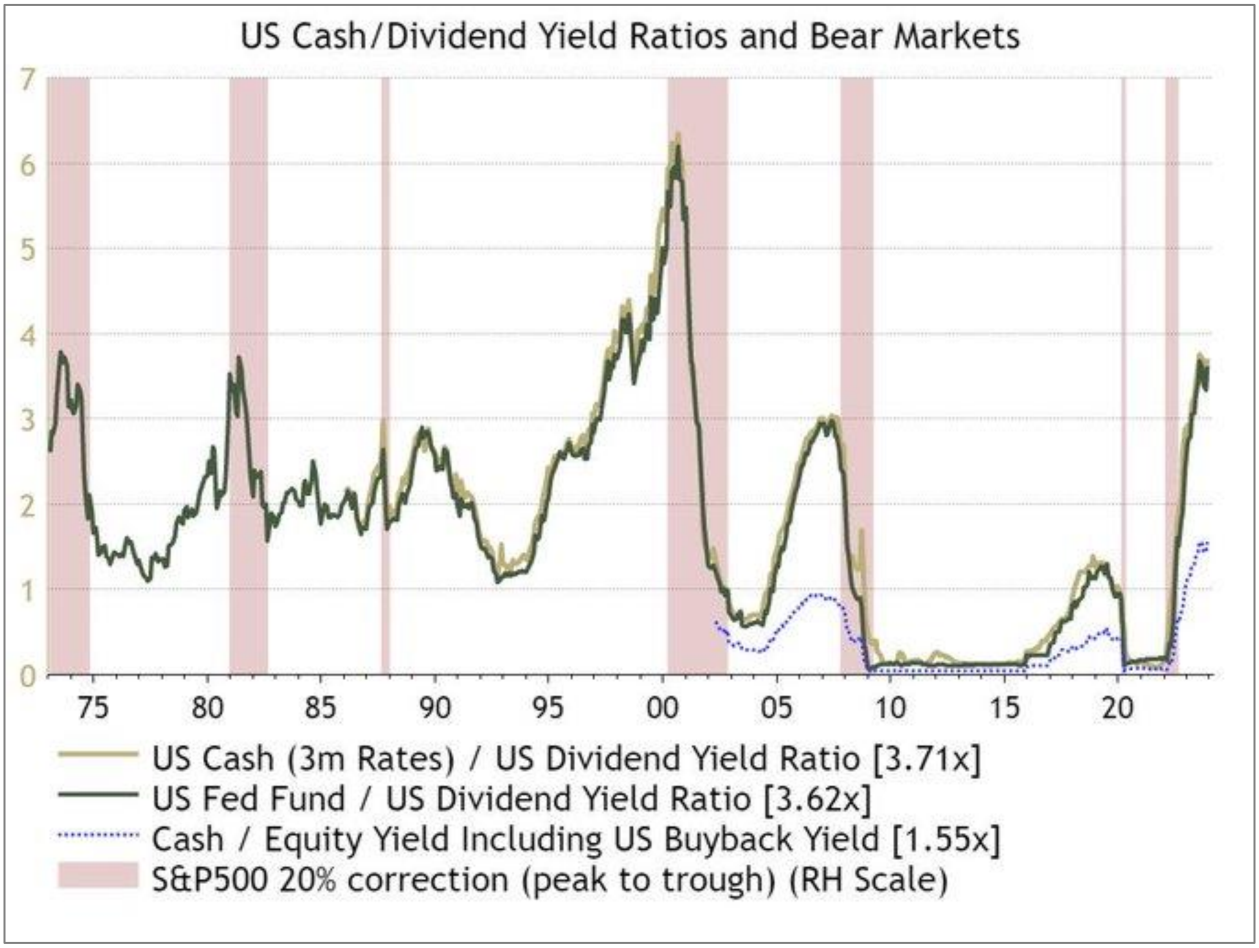
The Fed's first cuts aren't historically bullish for stocks.



Yield Curve Recession Probabilities are on the rise again.



Yields on Cash to Stock Dividends are peaking.



Source: @IanRHarnett

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.