



Market Outlook

By Mark T Dodson, CFA

Keep Your Pants On

Market Risk Index jumped to 73.2%. Monetary Conditions worsened marginally, and the Psychology Composite climbed into the worst five percent of readings. However, Psychology is still slightly better than at the July stock market peak. Valuations were unchanged and are also in the worst five percent of readings.

Within Psychology, the Surveys Category has worsened notably over the last two weeks to become one of the four most negative factors impacting current readings, as professional investors have joined retail investors in their enthusiasm for stocks. The Investors Intelligence survey and NAAIM Exposure Index have registered the most bullishness since the 2021 bubble environment over recent weeks.

NAAIM also publishes the market exposure of their most bearish respondent, and we like to track it for signs that bullish sentiment is pervasive, looking for those periods where even the bears have gotten long. The most bearish respondent of the survey had positive equity exposure at the end of the year for the first time since the August peak.

Despite current investor sentiment and valuation extremes, technical and breadth-based work still leans toward a continued stock market rally. We would remind those inclined to speculate heavily in the current environment of Warren Buffett's observation about market cycles: "You only find who is swimming naked when the tide goes out." Our quantitative framework suggests that this is a stock market at high tide. While we aren't telling you not to avoid the water altogether, we think you should keep your pants on.

Market Risk Index

Rec Allocation 25% Underweight

73.2%

Category Percentiles

Psychology - P6



Monetary - M3



Valuation - Extremely Overvalued



Trend



Largest Psychology Influences

Leveraged Investments	Negative
Surveys	Negative
Flow of Funds	Negative
Bank Sentiment	Negative

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	4.0%

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

Small Cap Valuations

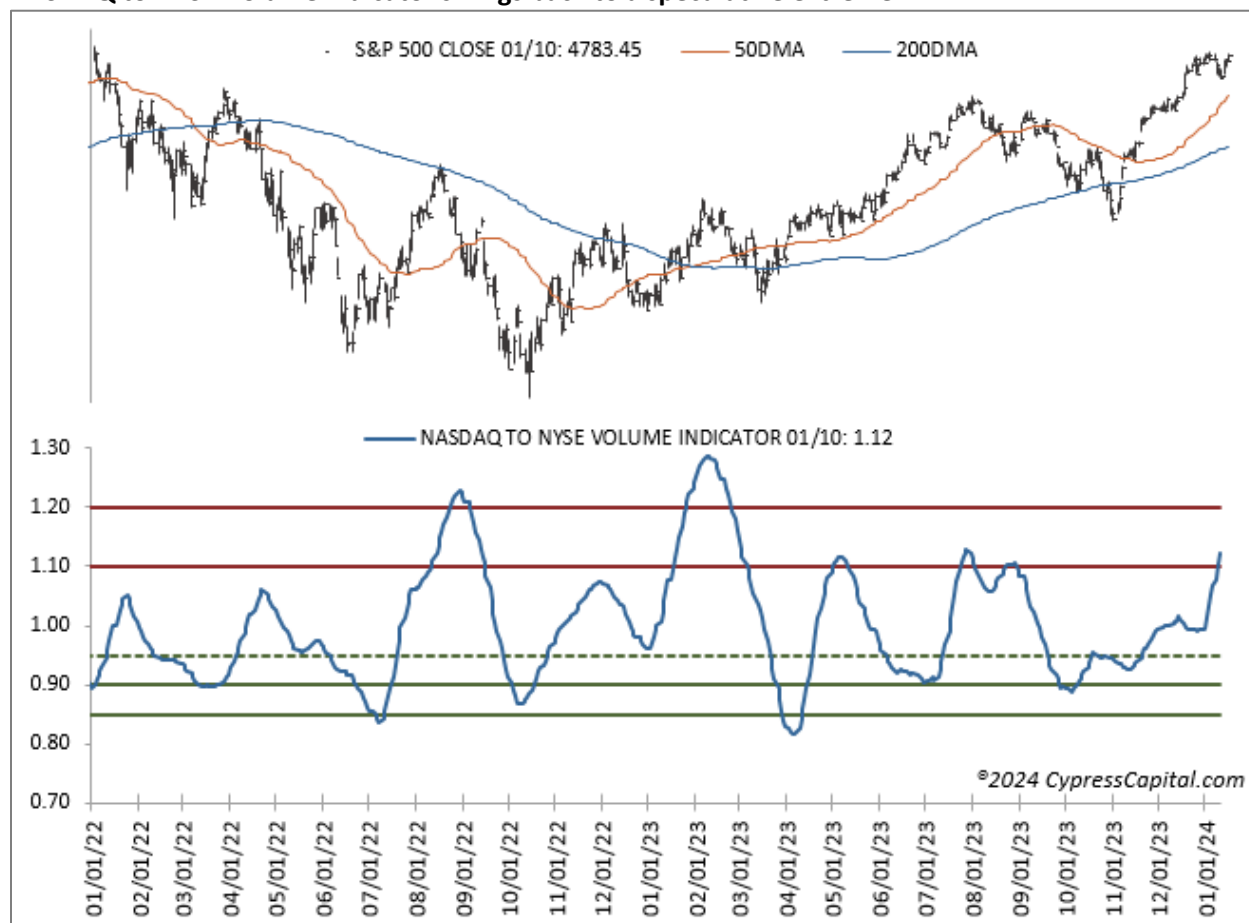
Small caps may be attractive relative to the Magnificent Seven stocks, but they aren't so attractive on an absolute basis. A rally to the worst 10% of valuations has an implied upside of less than 4%, whereas an improvement to the best 10% of valuations implies a drawdown of more than 25%.

SmallCap Drawdown Estimates based on ValueLine Median Appreciation Potential

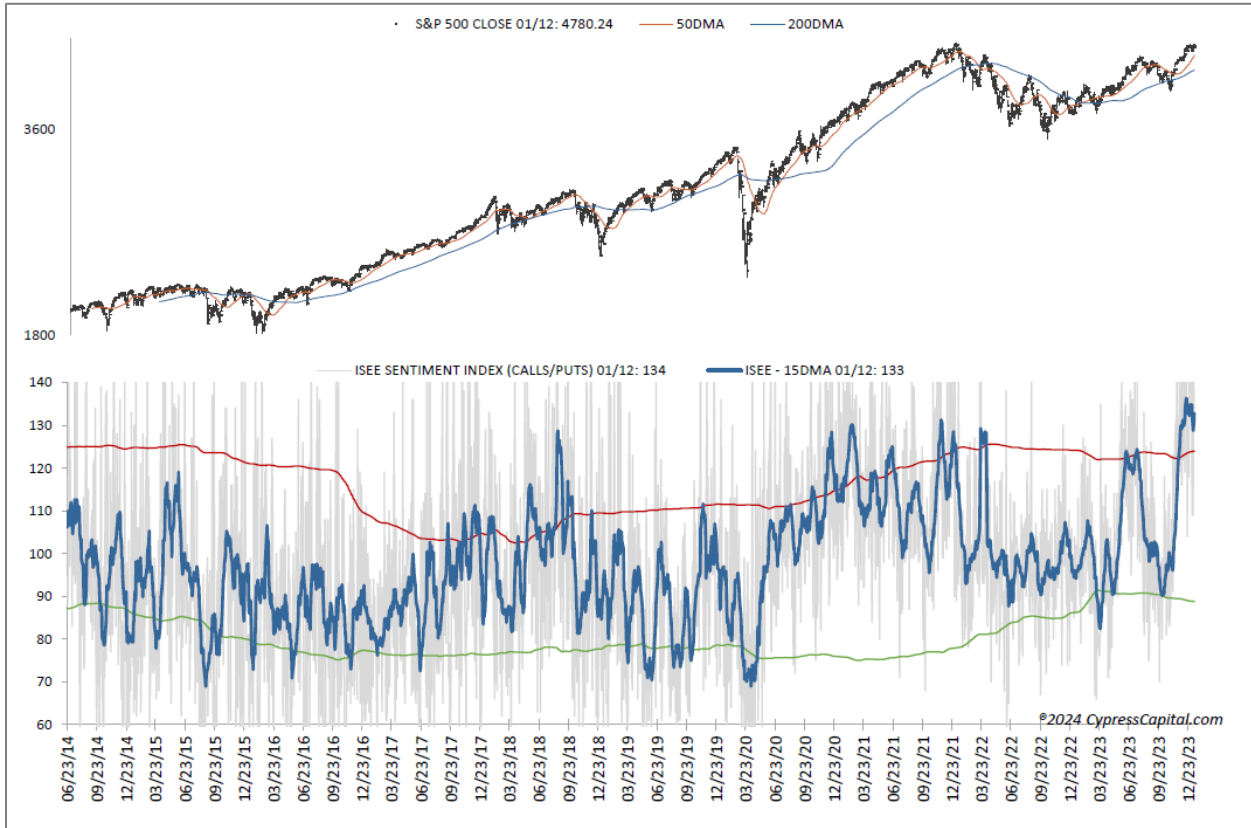
VLMAP Levels	Value	Avg Value Line Geometric Price Forecast	Implied Drawdown	Avg S&P 600 Price Forecast	Implied Drawdown
Current	45	0.8%		6.7%	
Median	65	3.5%	-14.31%	8.2%	-7.60%
Bear Bottoms	126	11.7%	-68.17%	12.7%	-33.57%
Best 10%	110	9.6%	-52.55%	11.5%	-26.38%
Worst 10%	35	-0.6%	6.60%	6.0%	3.63%
Back the Truck Up at 100	100	8.2%	-43.28%	10.7%	-22.00%

S&P 600 and Value Line Geometric data since 1973

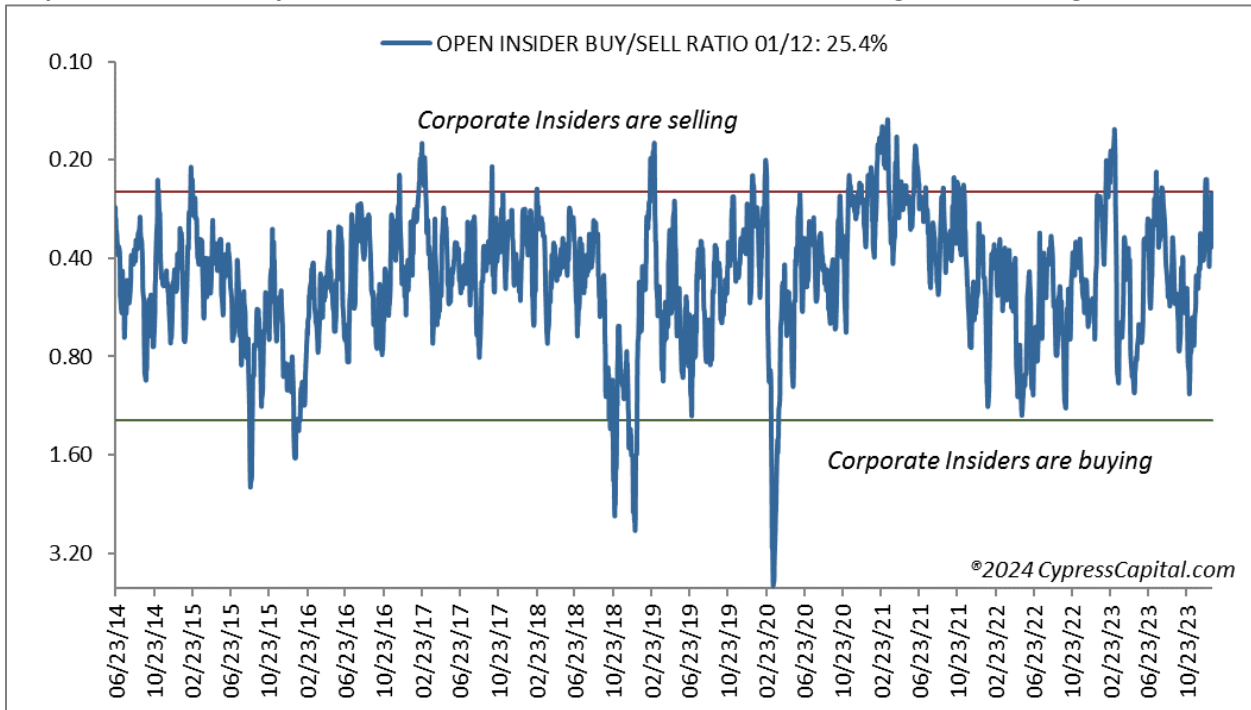
NASDAQ to NYSE Volume Indicator swings back to a speculative extreme.



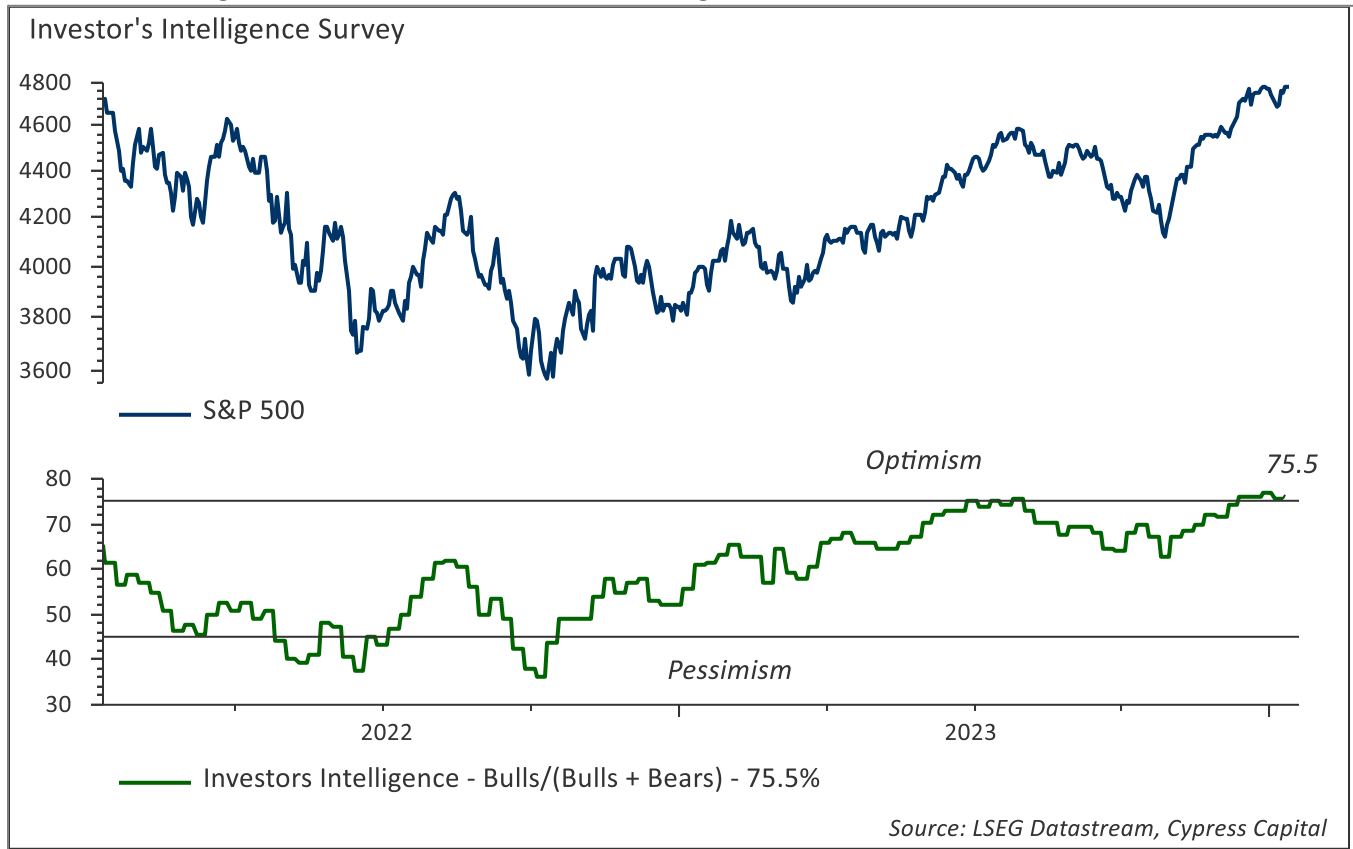
ISEE Sentiment Index is rolling over from 10-year highs.



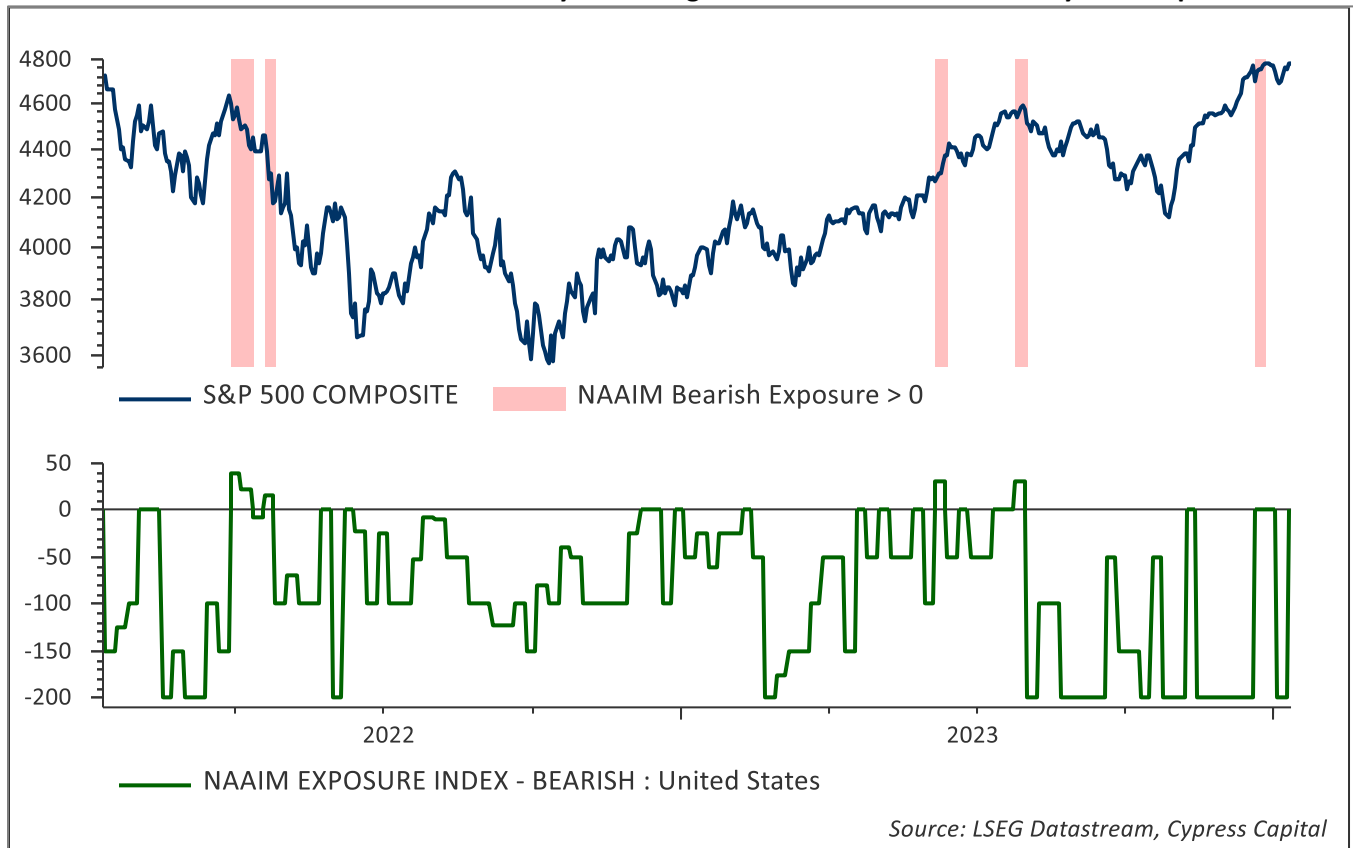
Corporate Insiders' Buy/Sell Ratio fell back under 25% - insiders are selling market strength here.



Bullishness among Investment Pros has climbed to the highest level of the bull market.

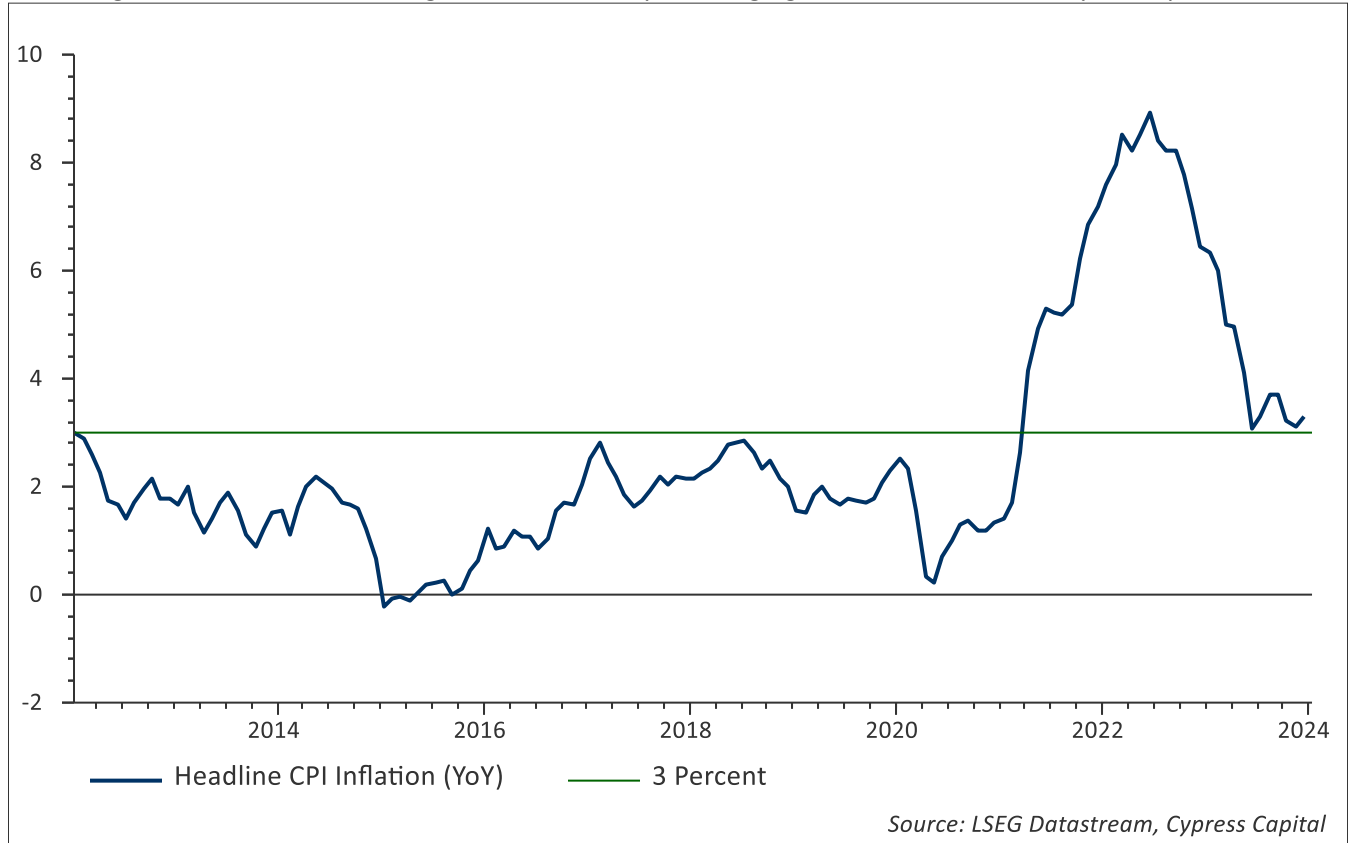


The most bearish advisor in the NAAIM Survey went long for the first time since the July market peak.



Headline CPI Inflation appears to have stopped declining last June.

Mounting Federal deficits and a reignition of animal spirits hinging on rate cuts aren't likely to help here.



2024 has started with a Negative Santa Claus Rally and a Negative First Five Days

Something For The Bulls To Consider
 S&P 500 Performance After A Negative Santa Claus Rally and Negative First Five Days

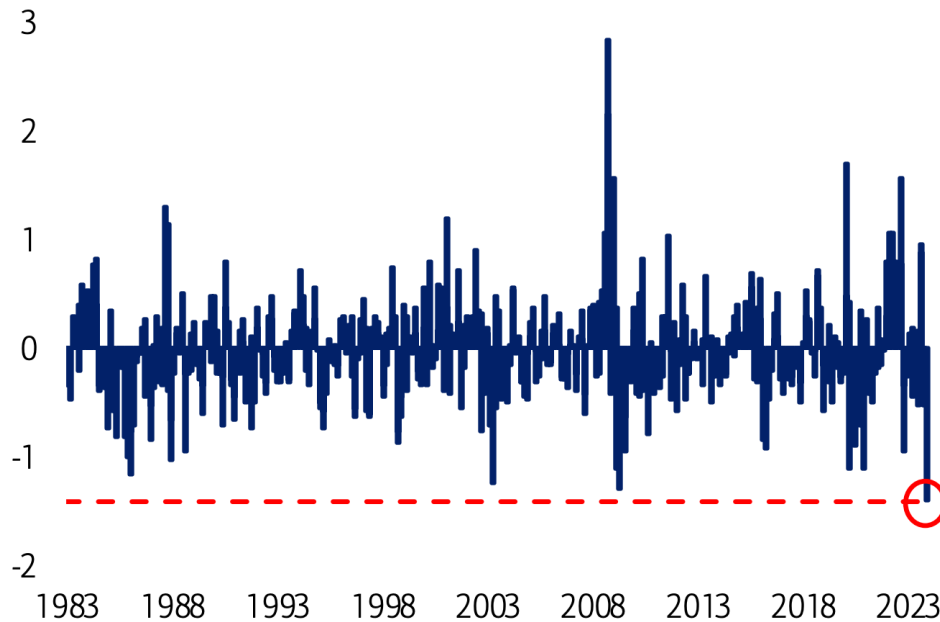
Year	Santa Claus Rally	First 5 Days	S&P 500 Index Returns		
			January	Q1	Calendar Year
1956	-0.9%	-2.1%	-3.6%	6.6%	2.6%
1969	-1.2%	-2.9%	-0.8%	-2.3%	-11.4%
1978	-0.3%	-4.7%	-6.2%	-6.2%	1.1%
1982	-1.8%	-2.4%	-1.8%	-8.6%	14.8%
1985	-0.6%	-1.9%	7.4%	8.0%	26.3%
1991	-3.0%	-5.0%	4.2%	13.6%	26.3%
1993	-1.1%	-1.5%	0.7%	3.7%	7.1%
2000	-4.0%	-1.9%	-5.1%	2.0%	-10.1%
2005	-1.8%	-2.1%	-2.5%	-2.6%	3.0%
2008	-2.5%	-5.3%	-6.1%	-9.9%	-38.5%
2016	-2.3%	-6.0%	-5.1%	0.8%	9.5%
2024	-0.9%	-0.4%	?	?	?
Average			-1.7%	0.5%	2.8%
Median			-2.5%	0.8%	3.0%
% Positive			27.3%	54.5%	72.7%

Source: Carson Investment Research, FactSet 01/08/2024
 The Santa Claus Rally is the final 5 trading days of a calendar year and the first two of the following year.
 @ryandetrick

Investor enthusiasm for the pivot has led to the fastest easing of financial conditions in history.

Exhibit 2: The fastest easing of financial conditions in history

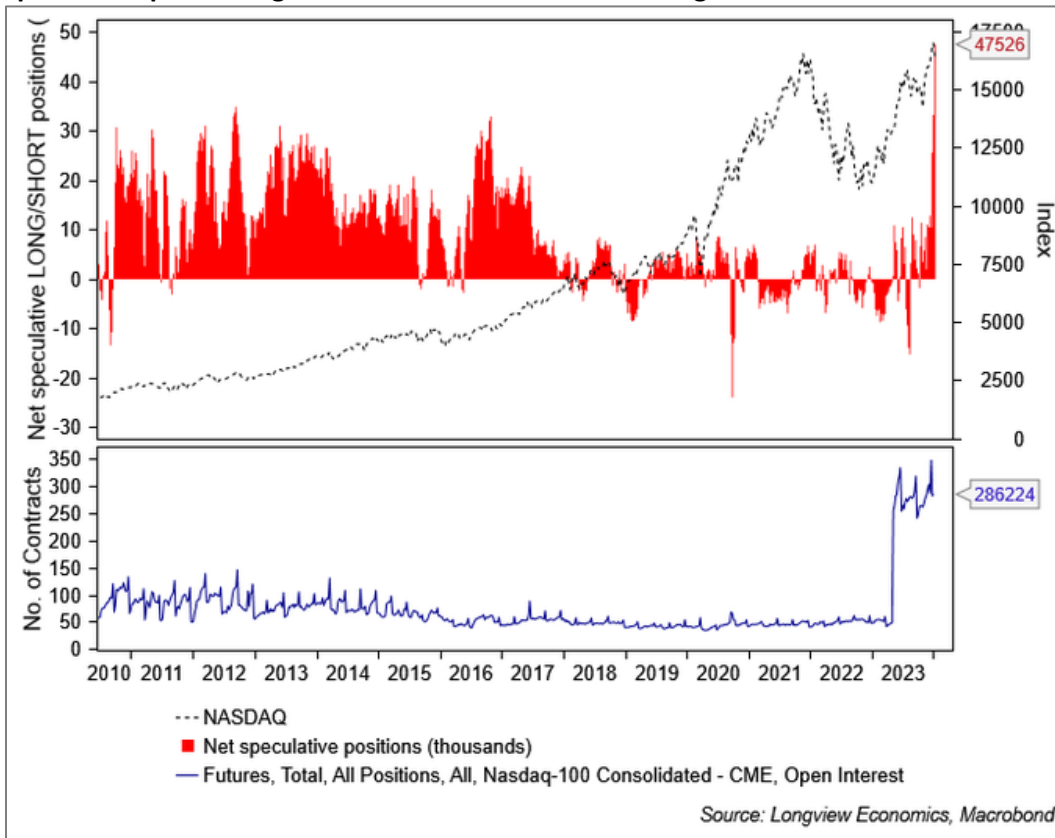
GS US Financial Conditions Index, 2 month change



Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

Speculative positioning in NASDAQ futures hit all-time highs.



--- NASDAQ
 ■ Net speculative positions (thousands)
 — Futures, Total, All Positions, All, Nasdaq-100 Consolidated - CME, Open Interest

Source: Longview Economics, Macrobond

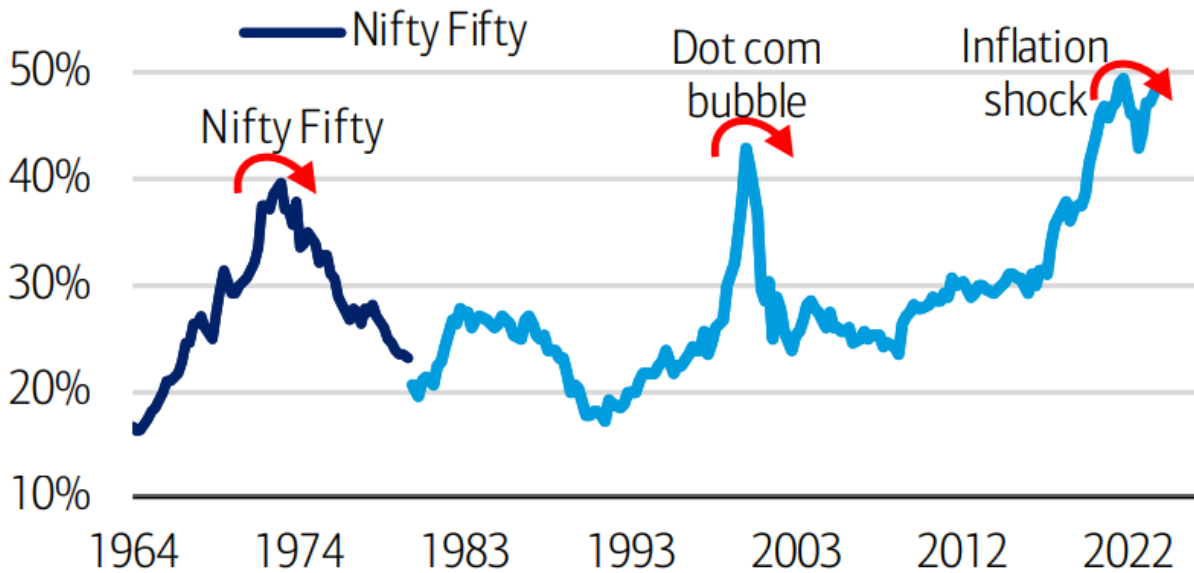
World Food Prices are coming down.



The three eras of post-WWII frothy stock markets

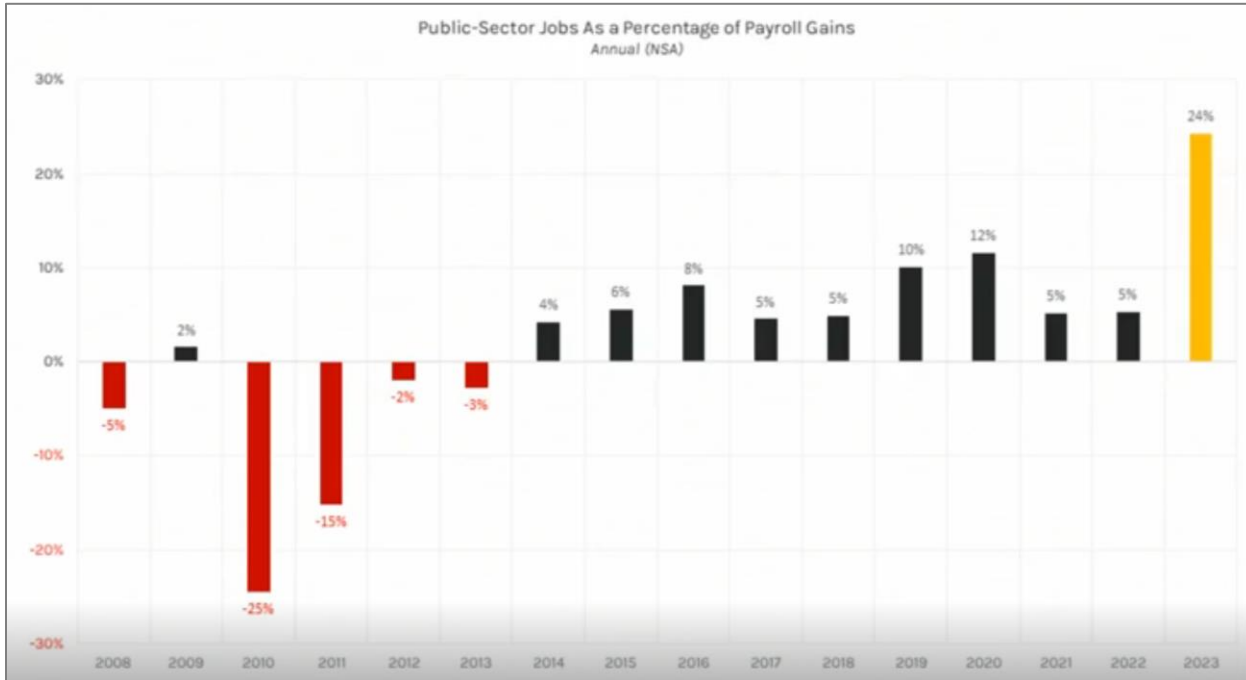
Exhibit 10: Higher tech concentration = higher geopolitical risk

S&P 500 concentration over different market regimes



Source: BofA Global Research, Global Financial Data, Standard and Poor's, Bloomberg. "New" economy = Tech + Communication Services + Consumer Discretionary

Government hiring has been padding the payroll stats?



Source: Hedgeye

Remember when we all wanted to own BRIC?



Source: BofA Global Investment Strategy, Bloomberg, Global Financial Data

Apartment supply hitting the market is set to reach 50-year highs.

RealPage: Apartment supply hitting the market in 2024 is set to reach its highest level since 1974

RealPage is forecasting that 671,953 apartment units will be completed in 2024

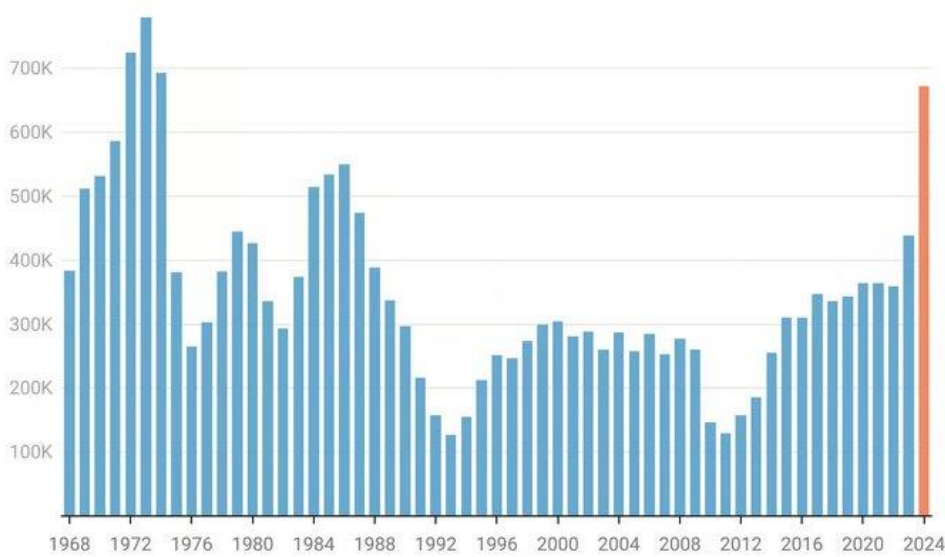


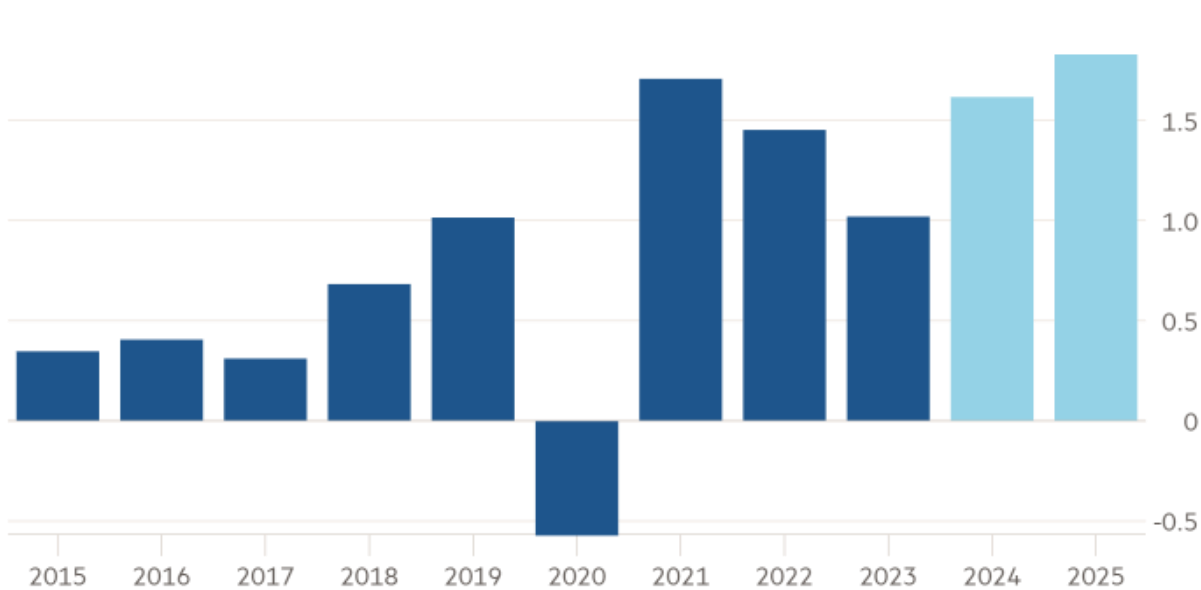
Chart: Lance Lambert • Source: RealPage • Created with Datawrapper



U.S. Treasury Issuance entered a new era post-Covid.

Glut of Treasuries

Net supply expected to surge to record levels (\$tn)

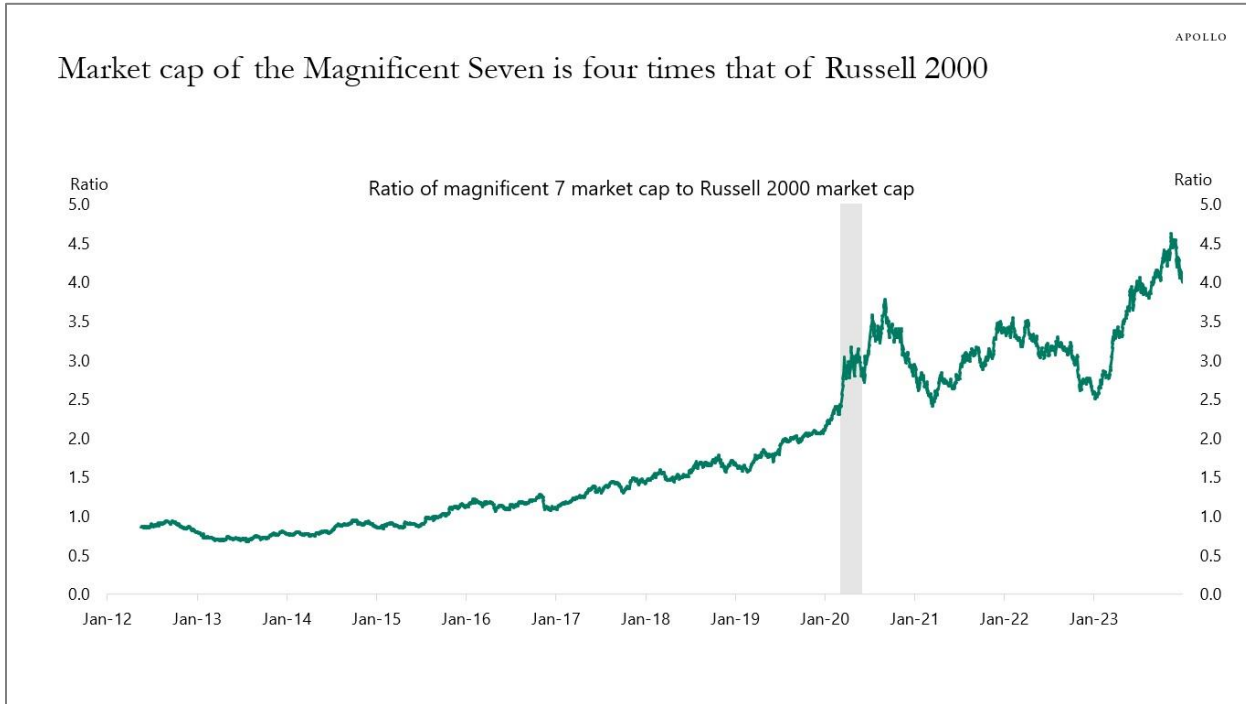


Nominal bond issuance net of private sector redemptions and Federal Reserve purchases (12 months to end of September)

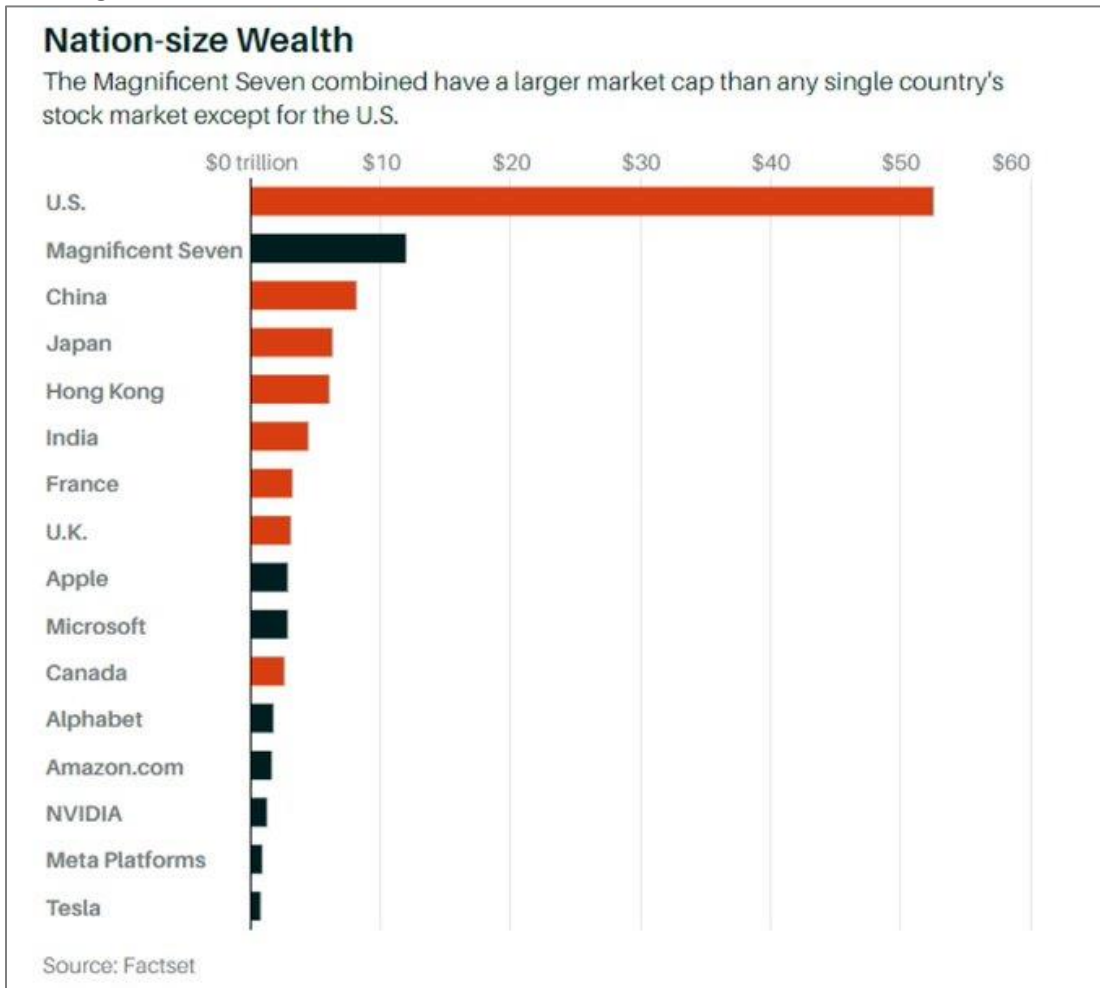
Source: RBC Capital Markets

© FT

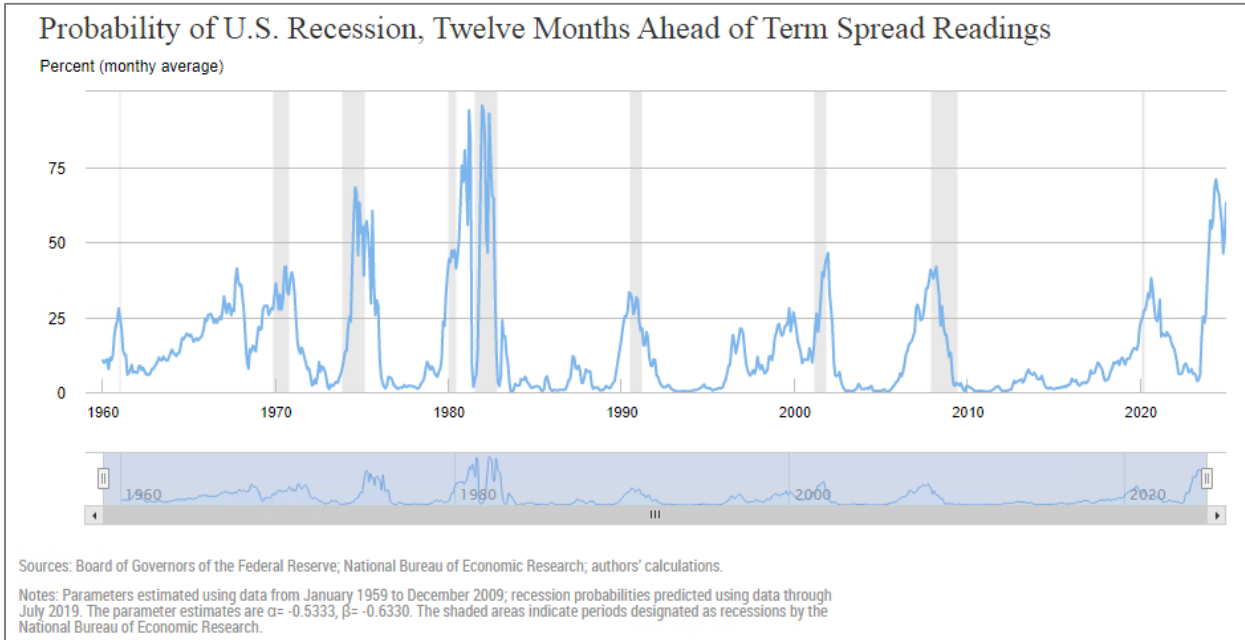
The Magnificent Seven could absorb all of the Russell 2000 companies - four times over.



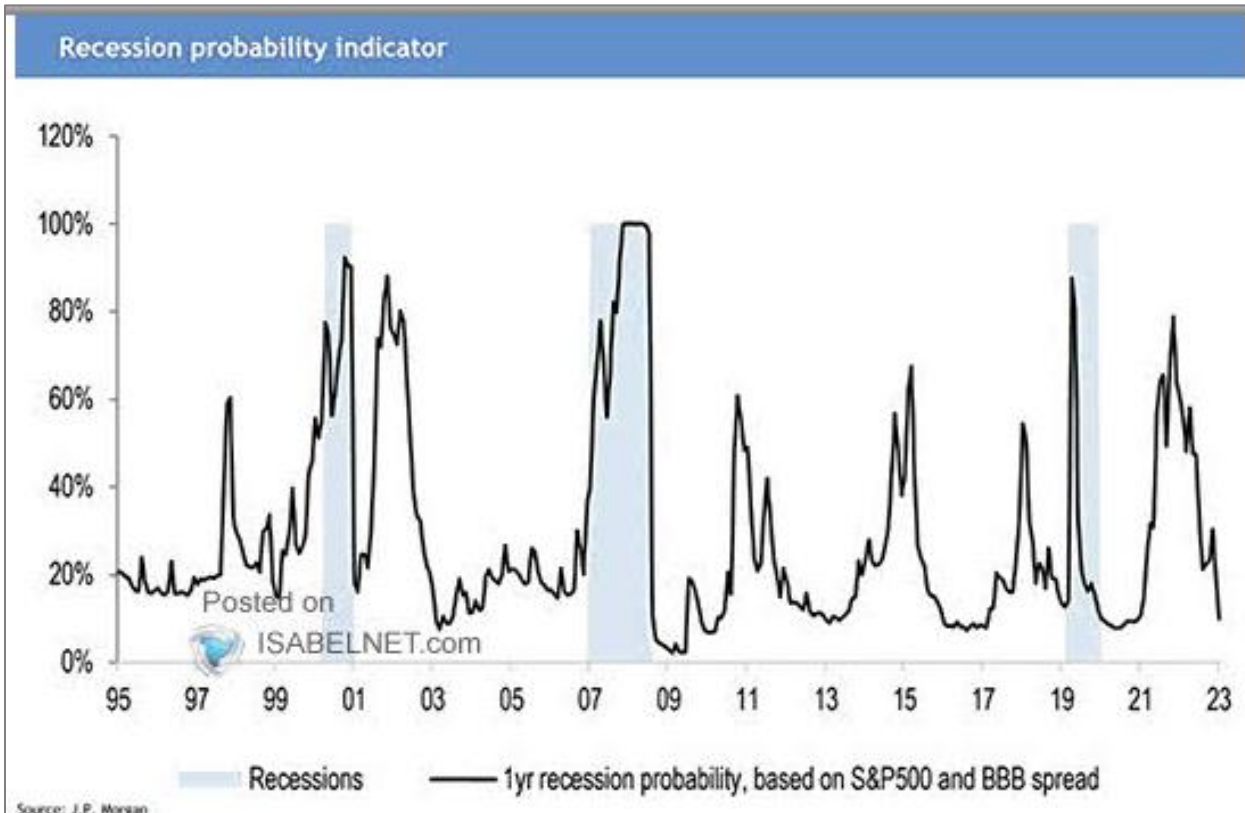
The Magnificent Seven are wealthier than all countries outside the U.S.



The Yield Curve's estimate of the Probability of a U.S. Recession is high and climbing.



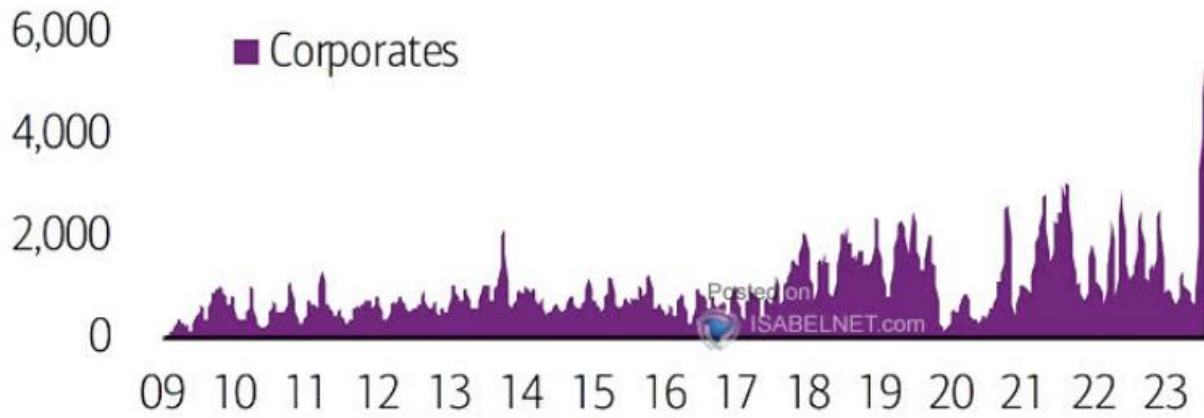
Meanwhile, financial markets predict a low (and falling) recession probability.



Corporate buybacks are surging...

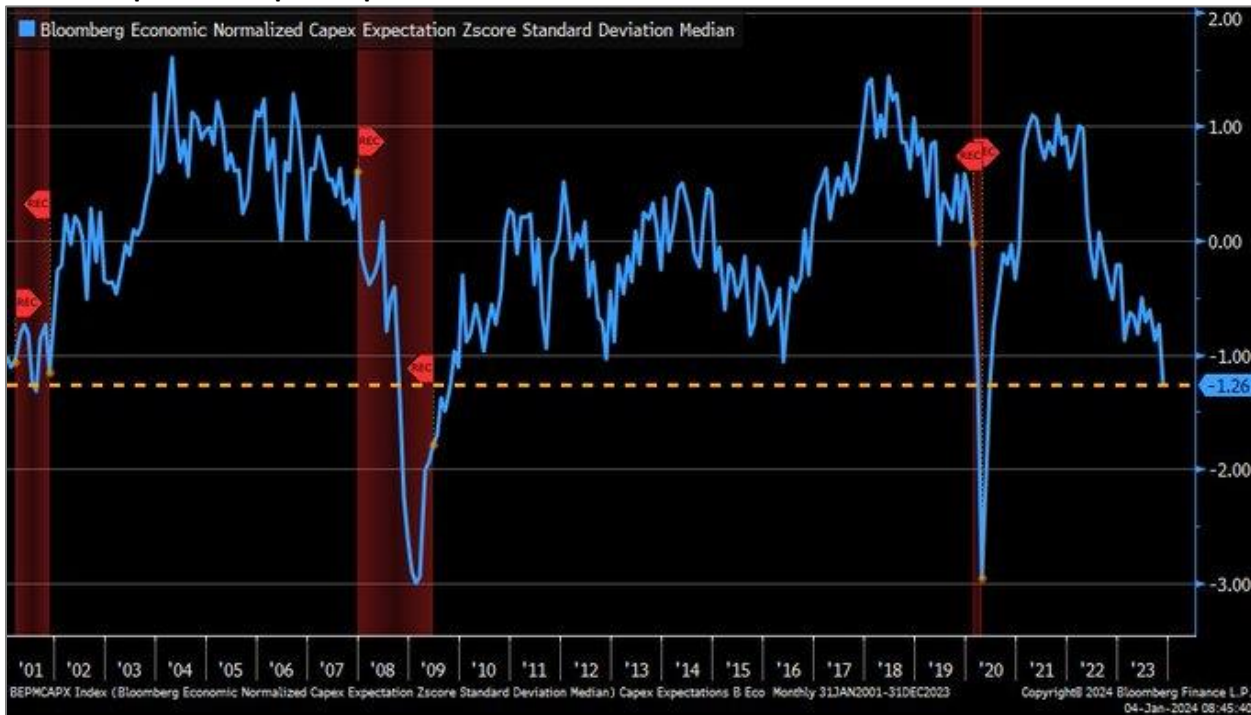
Exhibit 32: Buybacks by corp. clients at historical high levels

Corporate clients (4 week avg, \$ mn)



Source: BofA Securities

...at the expense of Capital Expenditures.



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.