Cypress CAPITAL

Market Outlook

By Mark T Dodson, CFA

Asset Managers Are Record Long

Market Risk Index edged higher to 74.0% but has been hesitant to cross above 75%, the line that history tells us is the zone that denotes market environments with risk of substantial drawdown. Monetary Conditions worsened, but a slight improvement in Psychology offset them.

Despite Psychology Composite being in the worst 3% of readings and Valuations being in the worst 4% of readings, Monetary Conditions continue to wave a more bullish flag for markets. Financial conditions are loose, even in the face of the highest Fed Funds rate in over 20 years. Investor's enthusiastic efforts to front-run the Fed have done the Fed's job for them, and judging from the most recent economic releases, it appears those efforts may bring inflationary pressures back along with them. The Fed has created an army of investors who buy the dip with abandon, having been conditioned on over a decade of Fed policy and still armed with liquidity funded by a Federal deficit. This army's over-enthusiasm to get in front of anticipated rate cuts is worsening the likelihood that investors will get as many cuts as they want, or when they want them.

On the breadth front, The NASDAQ High Low Logic Index finished less than 0.1% away from crossing above 6%, which would register the first major warning for the NASDAQ Composite since November 2021. High Low Logic is maybe our favorite measure of stock market internals – both because of its resistance to being skewed in the era of decimalization and its unique record in highlighting bull market peaks over the years.

Meanwhile, its cousin, the NYSE High Low Logic Index, is still in a green zone, and the divergence between these two measures of market internals is another sign of the unprecedently narrow nature of the current stock market's advance. (We highlighted the times this divergence occurred a couple of weeks back using a daily calculated version of the indices.)

The NASDAQ High Low Logic Index gave prescient, timely warnings at the bull market peaks in 2000, 2007, and 2021. Crossing above 5% (the traditional number used for the NYSE version of the index) is also a valuable warning, but it has been fraught with more false signals for the NASDAQ in recent years. It's still worth following, as a move above 5% came the week before the 1987 stock market crash.

Finally, in another blow to the wall of worry, Asset Managers' net exposure to the stock market using derivatives climbed to another new all-time high, and individual investor exposure to leveraged ETFs is right behind it.

Market Risk Index

Rec Allocation 25% Underweight

74.0%

Category Percentiles

Psychology - P6: 96.6%

Monetary - M3: 30.6%

Valuation - Extremely Overvalued: 96.7%

Trend: 50.1%

Largest Psychology Influences

Leveraged Investments	Negative
Bank Sentiment	Negative
Option Activity	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	1.4%
10Yr US Treasury Yield	4.0%

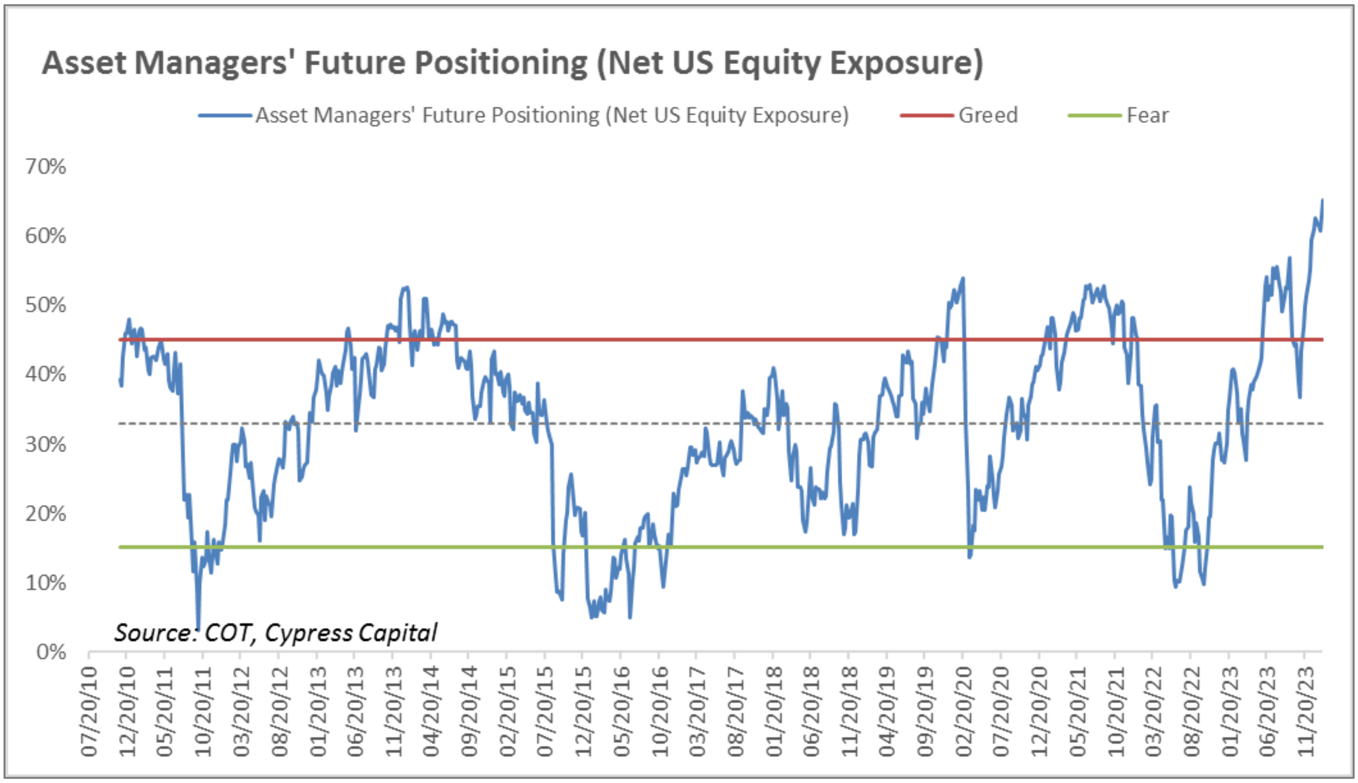
Market Trends

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

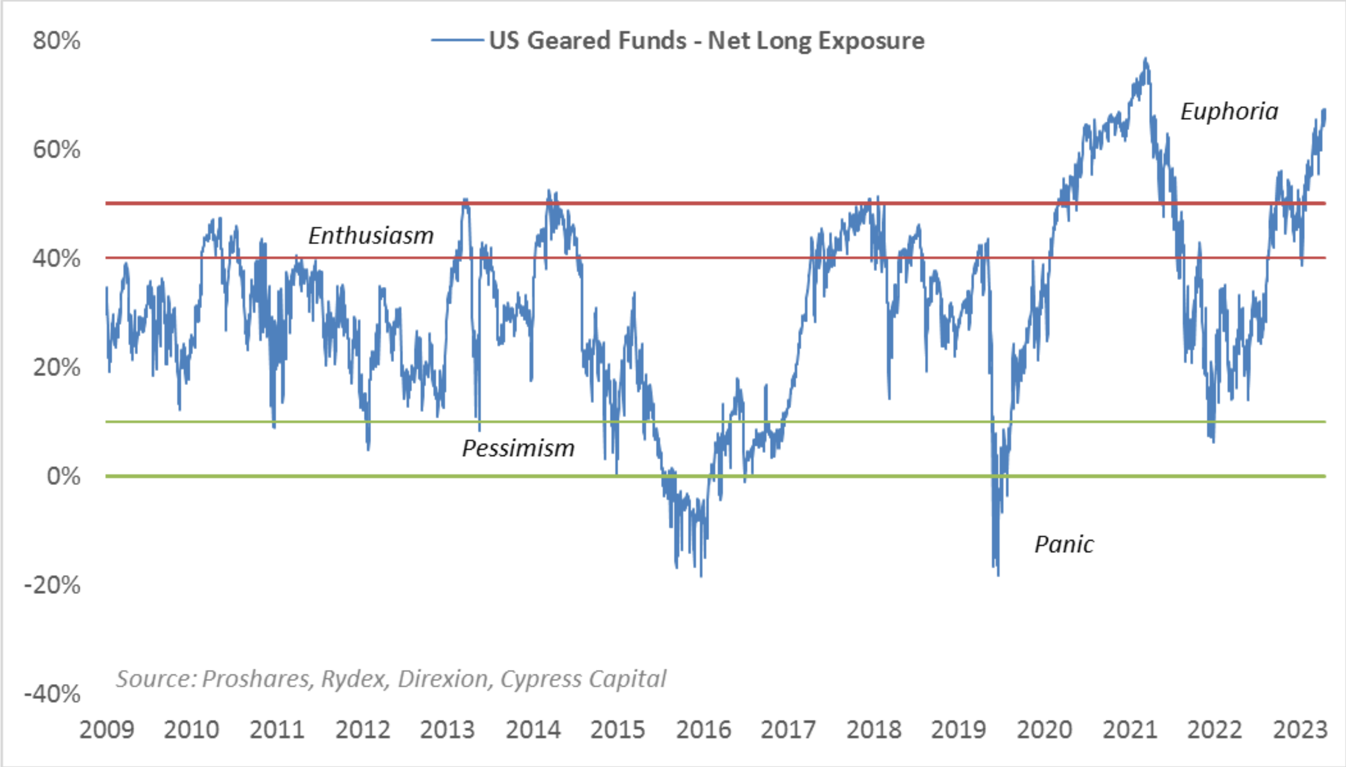
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets based on our model & opinion. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

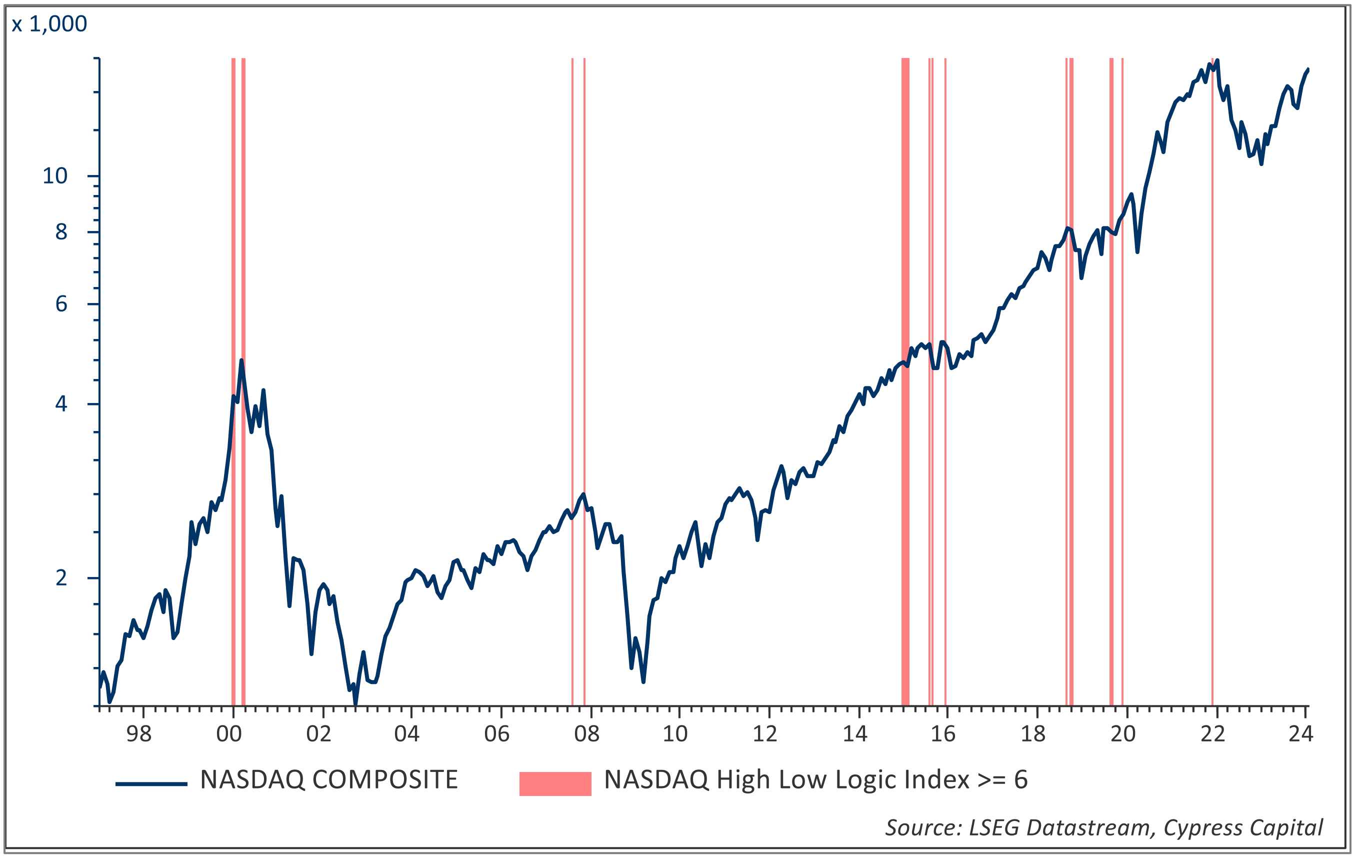
Asset Managers are record long US Equity Futures.



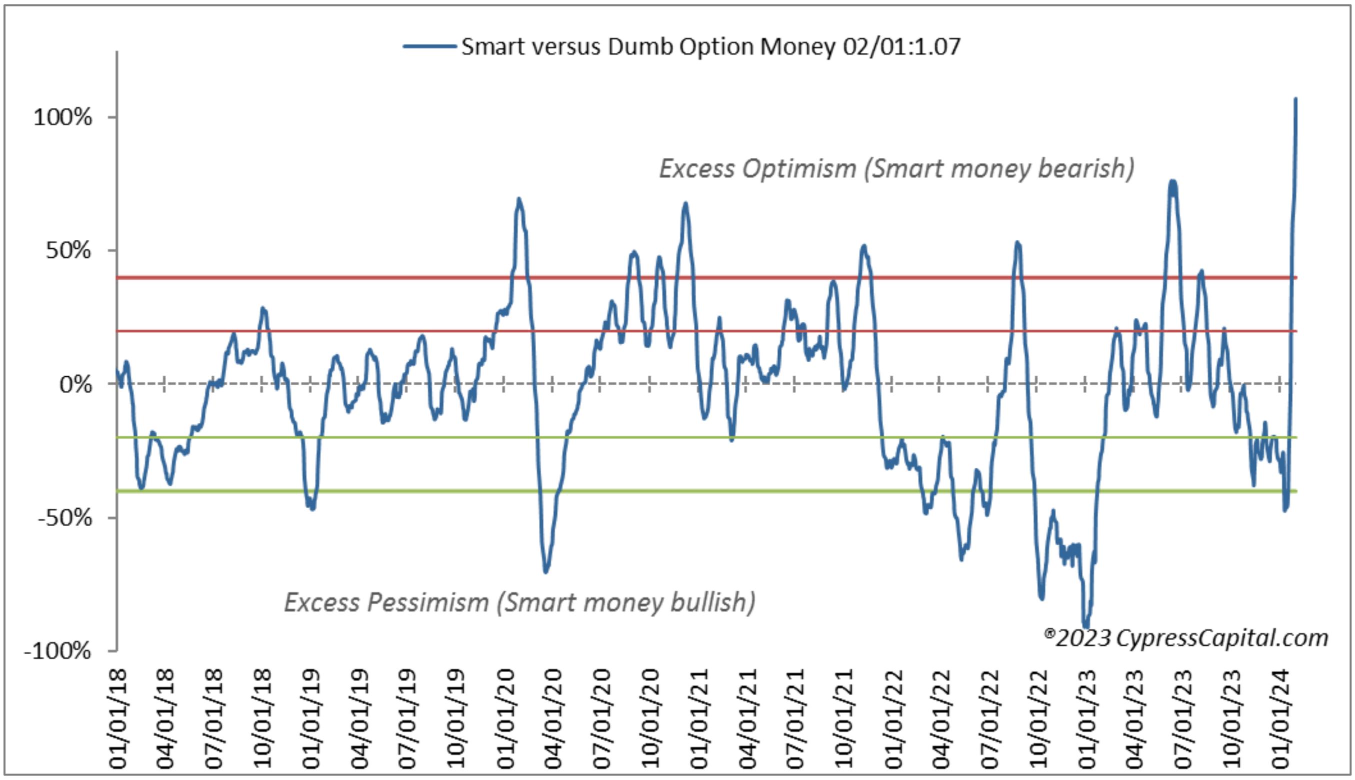
Net Long Positioning in Leveraged US ETFs set a new bull market high.



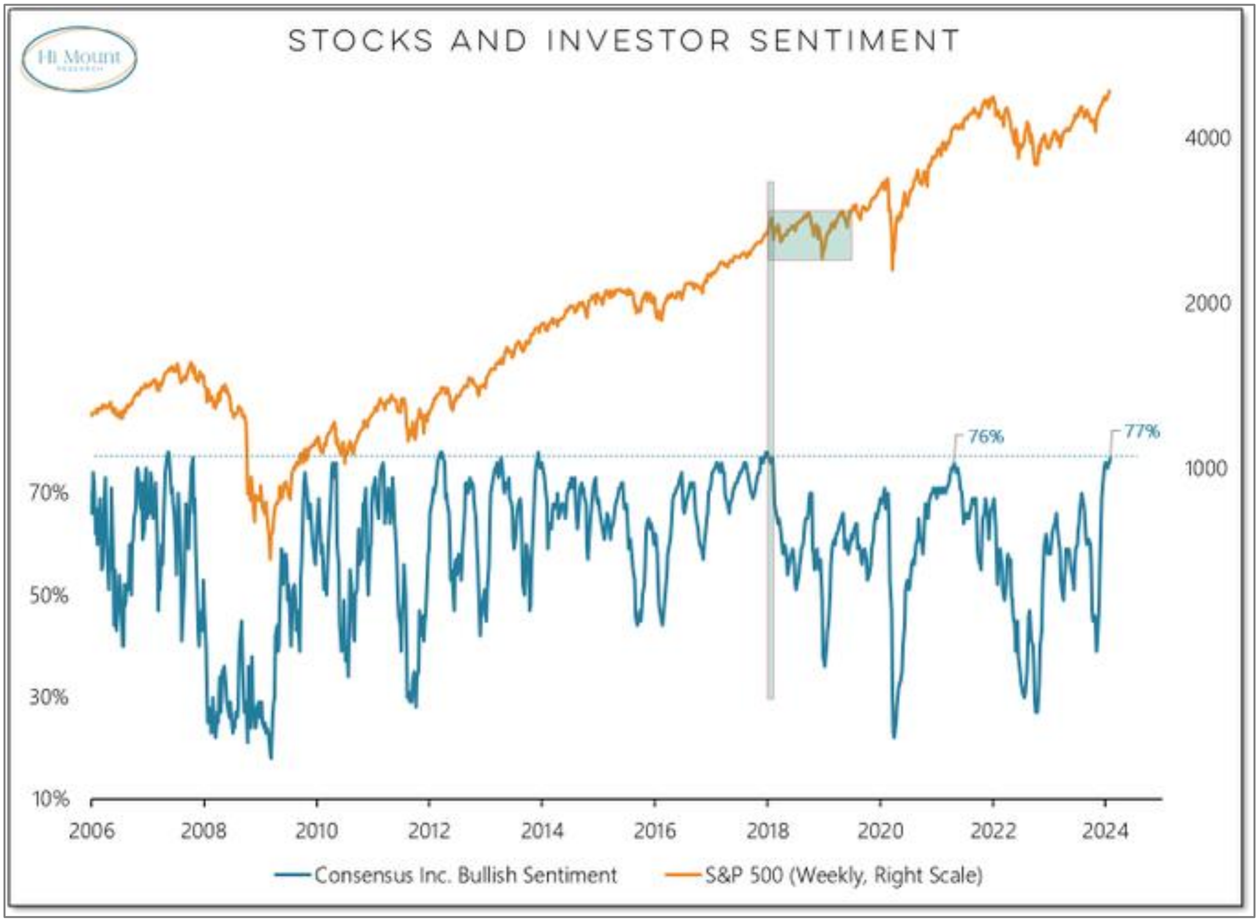
NASDAQ High Low Logic closed just 0.1% shy of a reading above 6% for the first time since Nov 2021.
The chart displays times that High Low Logic has crossed above 6% for the NASDAQ Composite.



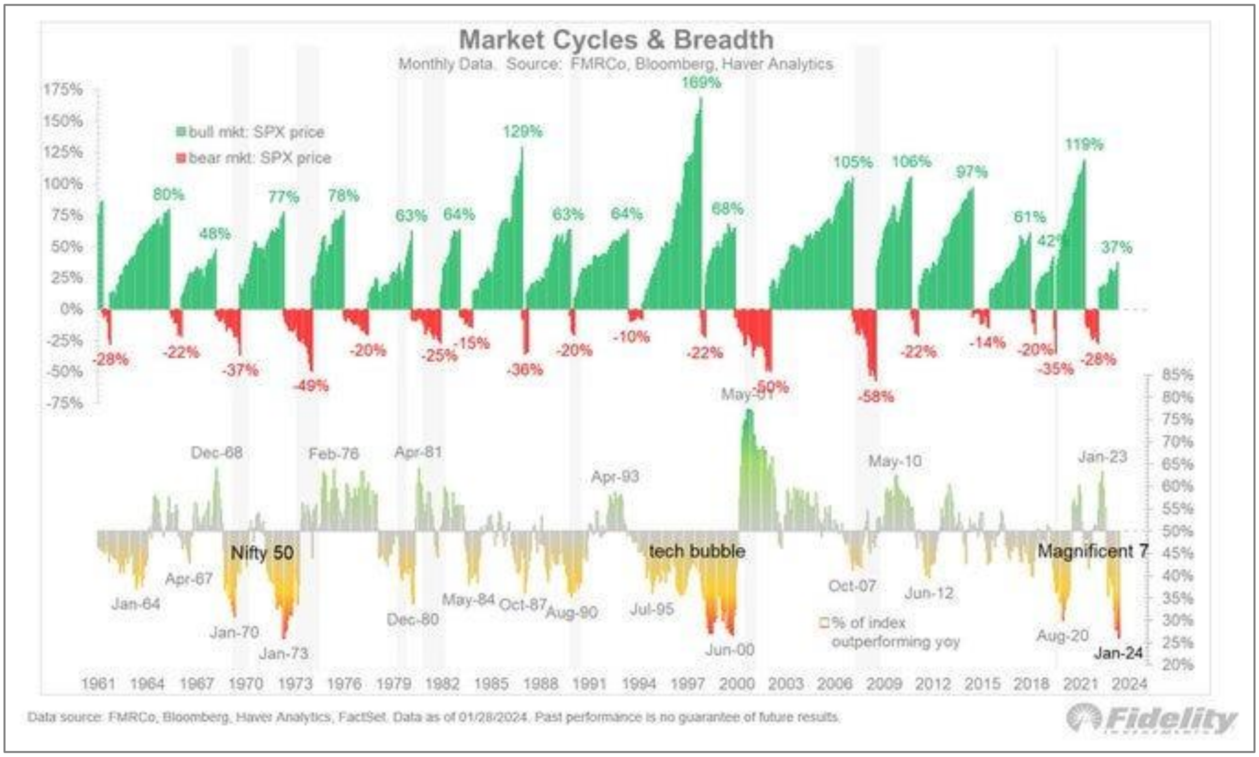
Our Smart versus Dumb Option Money Indicator shot even higher.



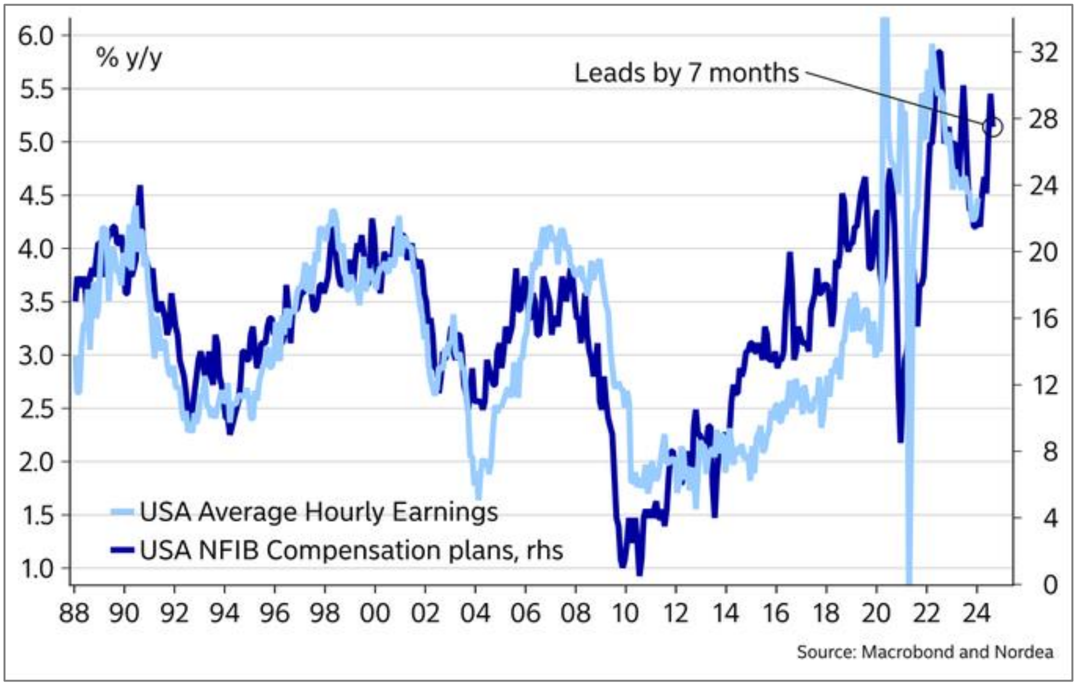
Consensus Bullish Sentiment hit the highest level since 2018.



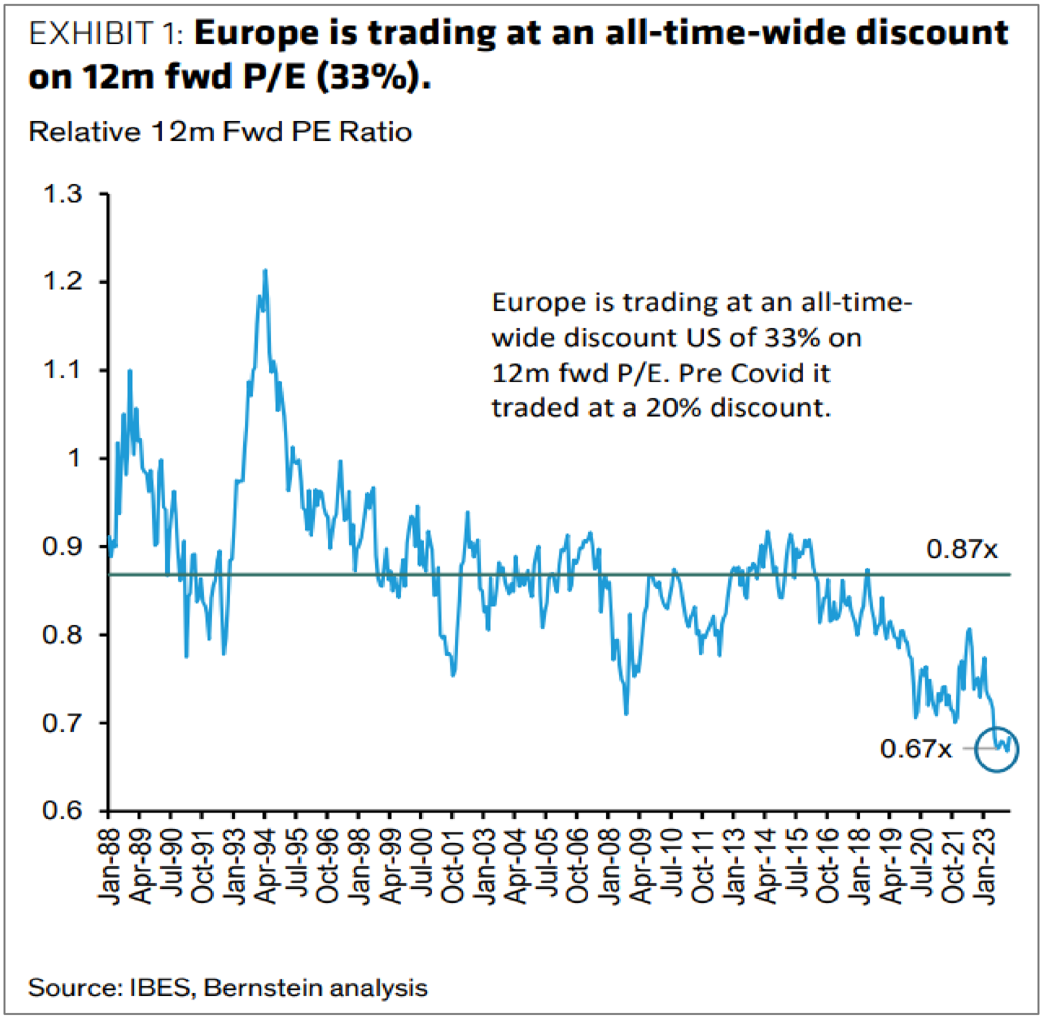
By this measure, stock market breadth is more narrow than it was during the Nifty 50 era.



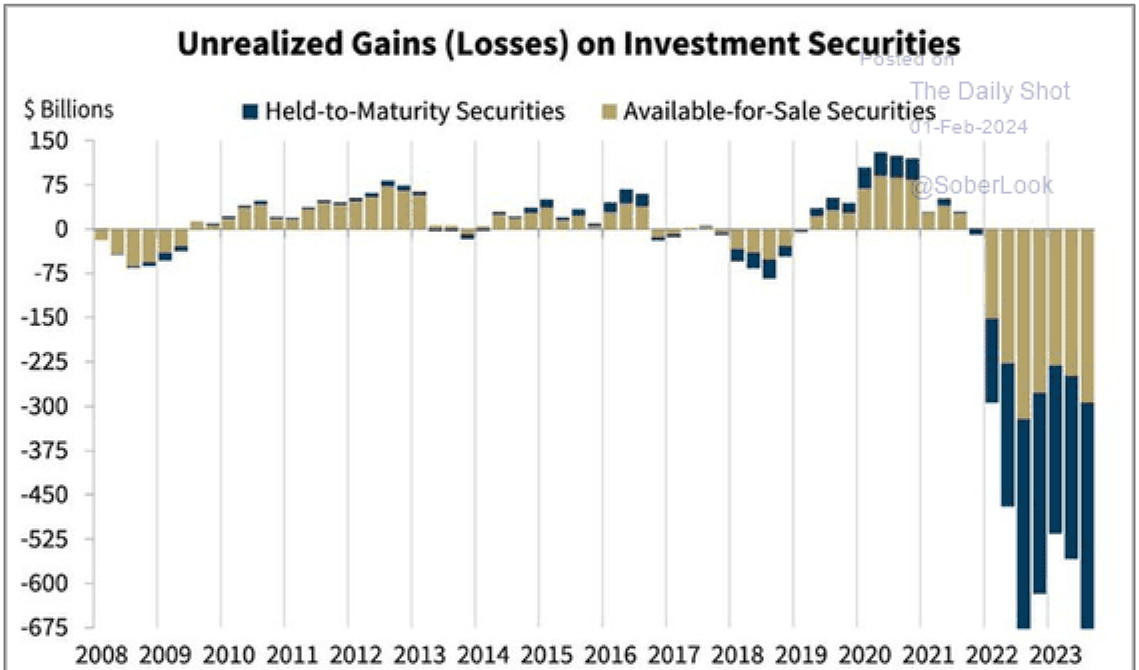
Wage inflation appears set to move higher.



European stocks are trading at a record valuation discount to US stocks.

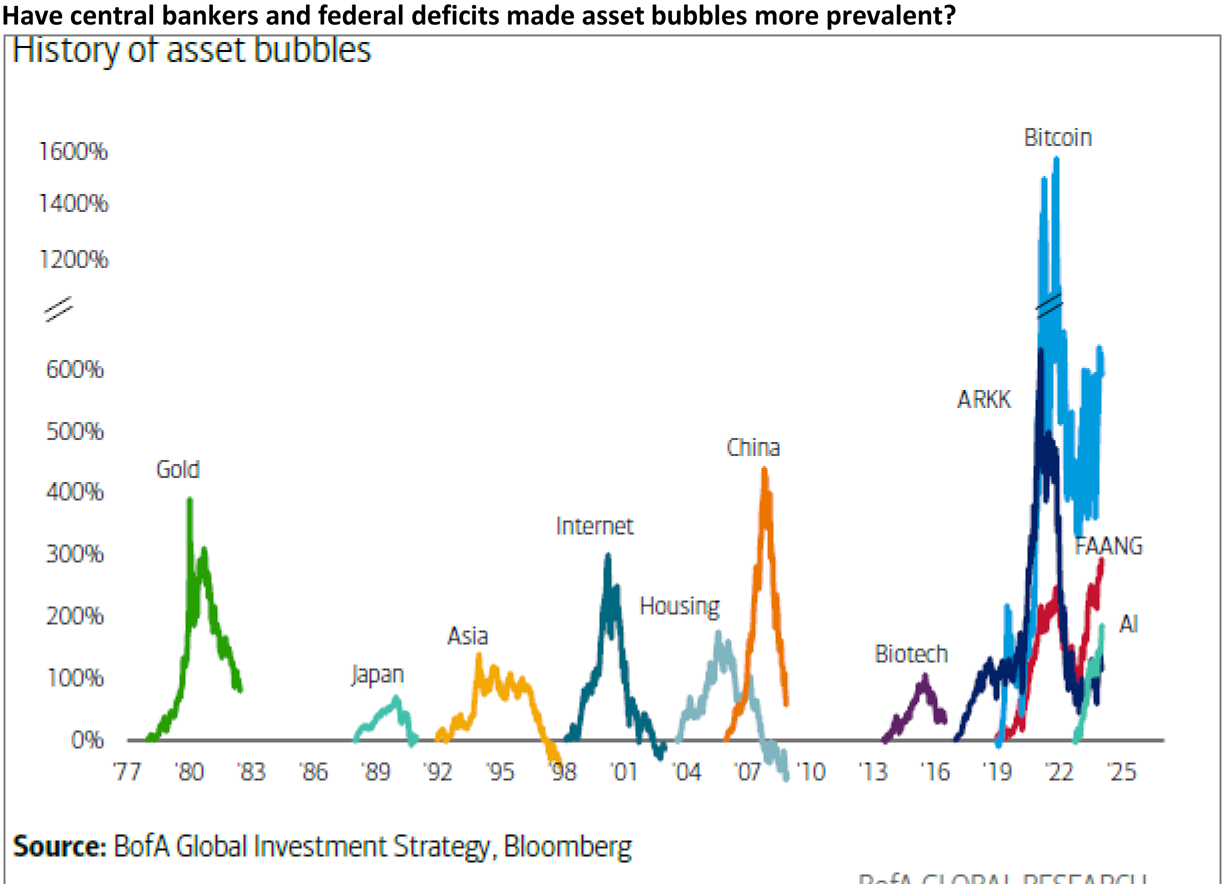


Banks are still nursing losses from investments they bought when yields were much lower.



Source: FDIC.
Note: Insured Call Report filers only. Unrealized losses on securities solely reflect the difference between the market value as of quarter end and the book value of non-equity securities.

Have central bankers and federal deficits made asset bubbles more prevalent?



Source: BofA Global Investment Strategy, Bloomberg

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.