Market Outlook

By Mark T Dodson, CFA

It's Officially a Split Market

Market Risk Index climbed above 75%, the line in the sand for MRI that denotes stock market environments with a substantial drawdown risk, and it did so during the same week that another longstanding indicator issued a major warning for the bull market.

The NASDAQ High Low Logic Index crossed above 6 percent for the first time since the NASDAQ bull market peak of 2021. It's officially a split market, and it's uniquely split in that the NYSE High Low Logic Index still has muted readings – also something that last occurred in 2021 when the NASDAQ peaked before the S&P 500.

Finding indicators that are good at pinpointing bull market peaks with reasonable accuracy and also do it with good timing is a tall order. Few indicators fit that bill, and the High Low Logic Index is one of them. The record isn't perfect, but it's enviable. Every bear market since weekly data exists for the NASDAQ was preceded by a high reading on the NASDAQ High Low Logic Index – on some occasions, the timing was impeccable. The last initial breach of 6% for NASDAQ High Low Logic occurred on 11/19/2021 – the NASDAQ Composite's bull market peak occurred on the same day.

The same week that MRI crossed above 75% and the Nasdaq High Low Logic index breached 6%, we also saw our valuation-driven equity return forecast fall below 1% for the first time since 2021. Additionally, our forecast for equity returns based solely on a regression against historically high post-Internet era valuations fell to 0%. The only examples that we have history for comparison are the Internet bubble and the most recent 2021 Covid stimulus bubble.

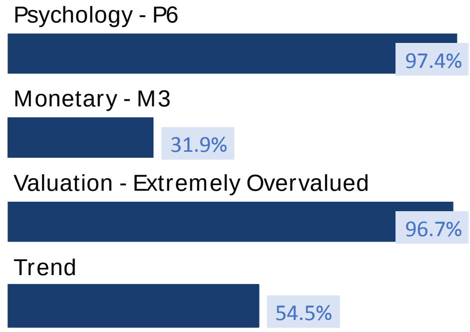
Seeing the present state of valuations and headlines of the S&P 500 closing above 5,000 for the first time, our memories were taken back to the time that the NASDAQ Composite first breached 5,000 in March 2000 – that level and that week marked the peak of the Internet bubble. From there, the NASDAQ proceeded to lose more than 75% of its value over the next two and a half years, and it took the NASDAQ almost 15 years to the day to see 5,000 again. Judging by the level of speculation we are seeing in leveraged funds, futures, and options, there is a large contingent of investors who are confident that substantial market declines like that are no longer possible.

Market Risk Index

Rec Allocation 25% Underweight

75.7%

Category Percentiles



Largest Psychology Influences

Leveraged Investments	Negative
Option Activity	Negative
Surveys	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	4.1%

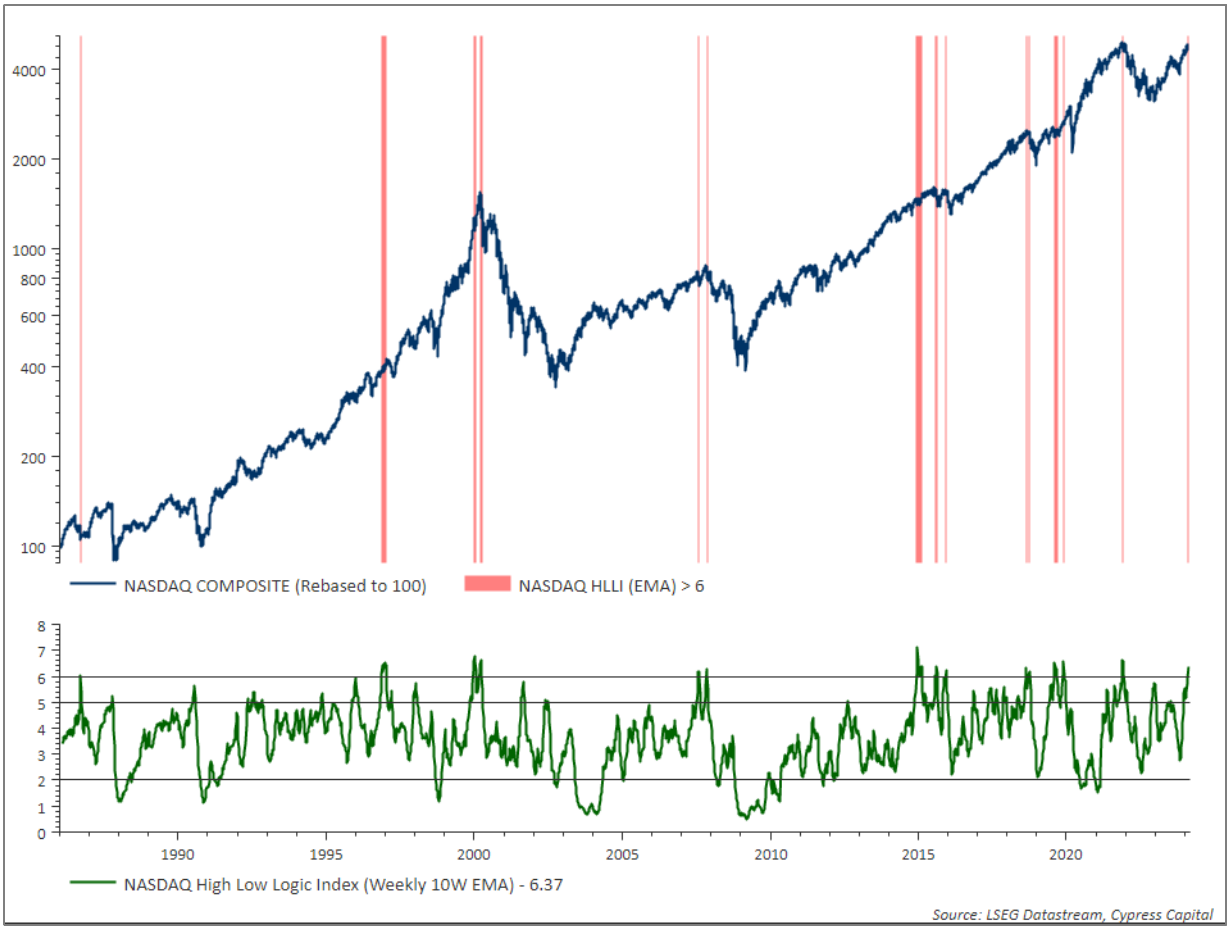
Market Trends

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

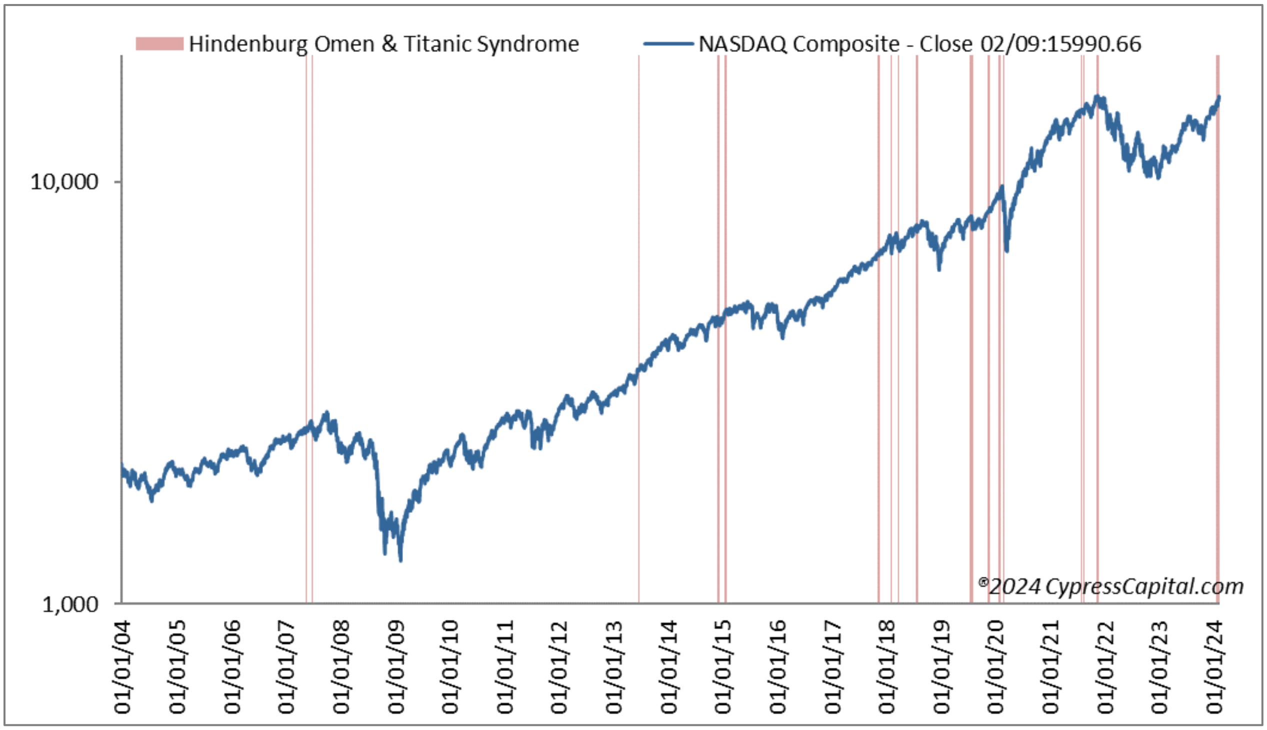
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets based on our model & opinion. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

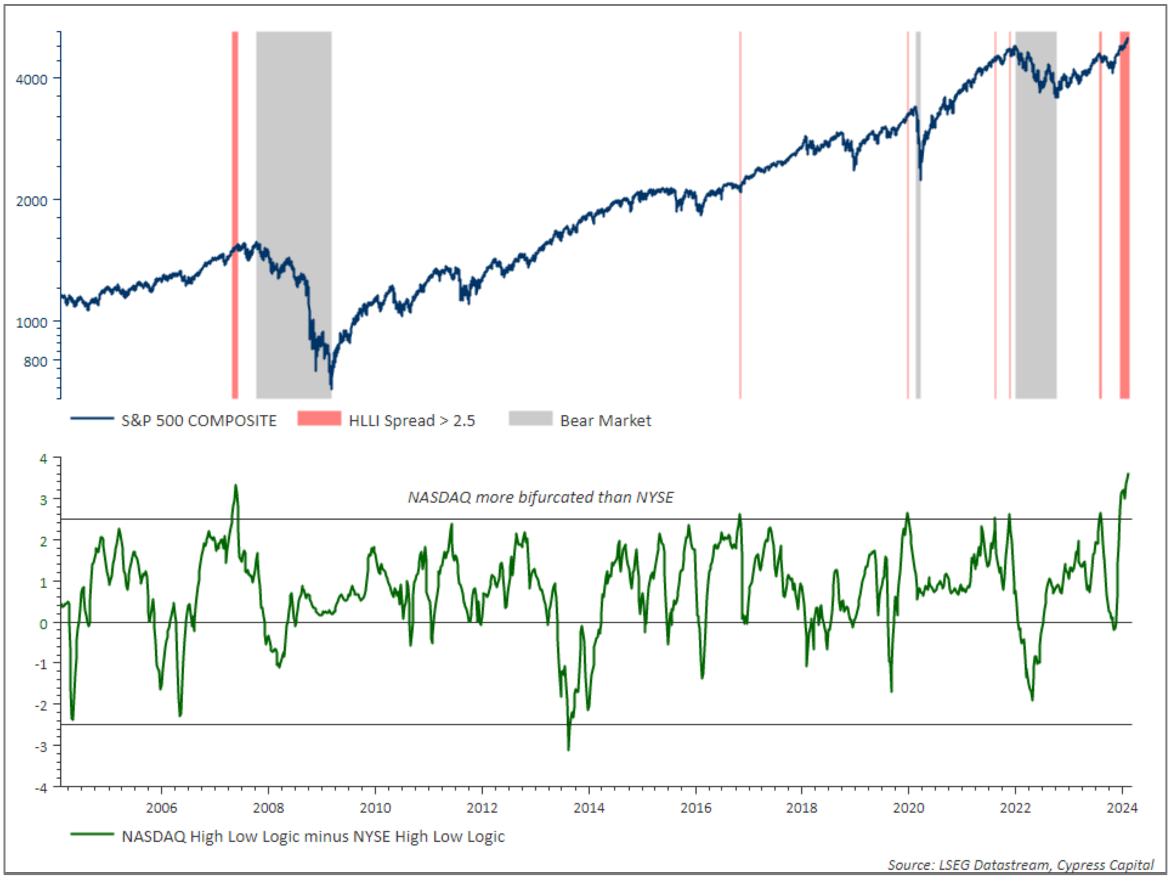
NASDAQ High Low Logic Index breaches 6% and signals a warning for stock market investors.



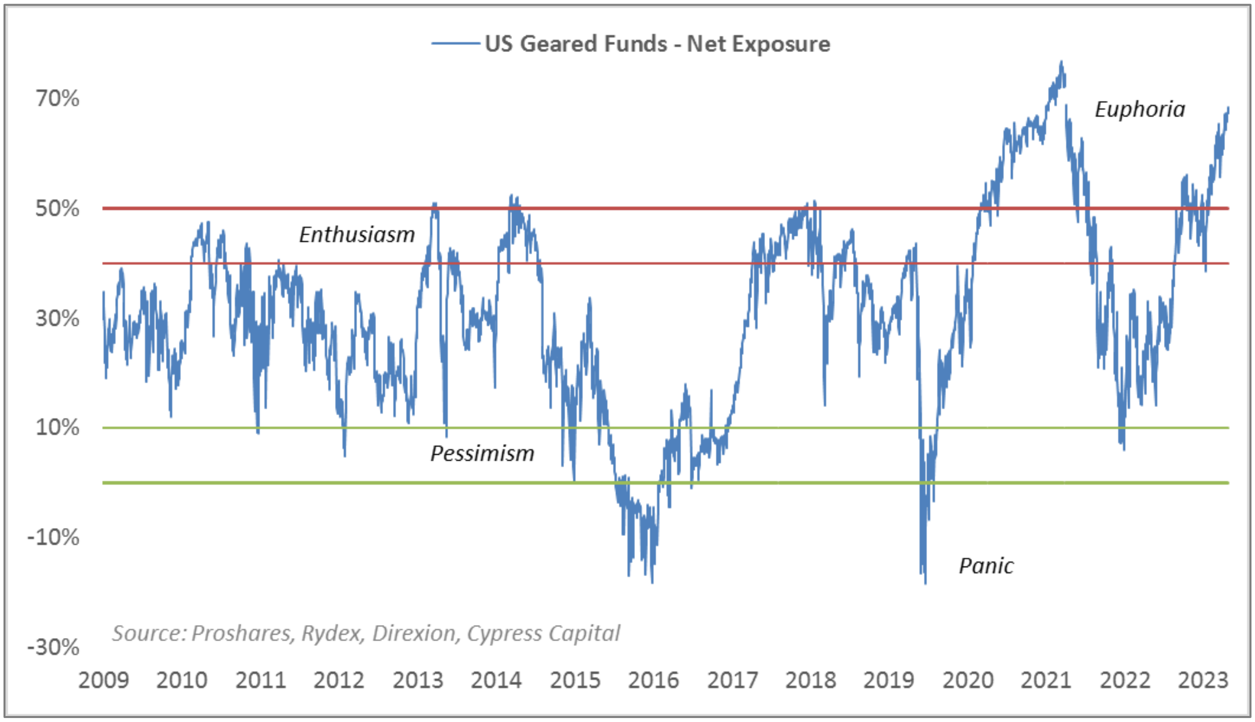
NASDAQ is seeing a cluster of technical warnings.



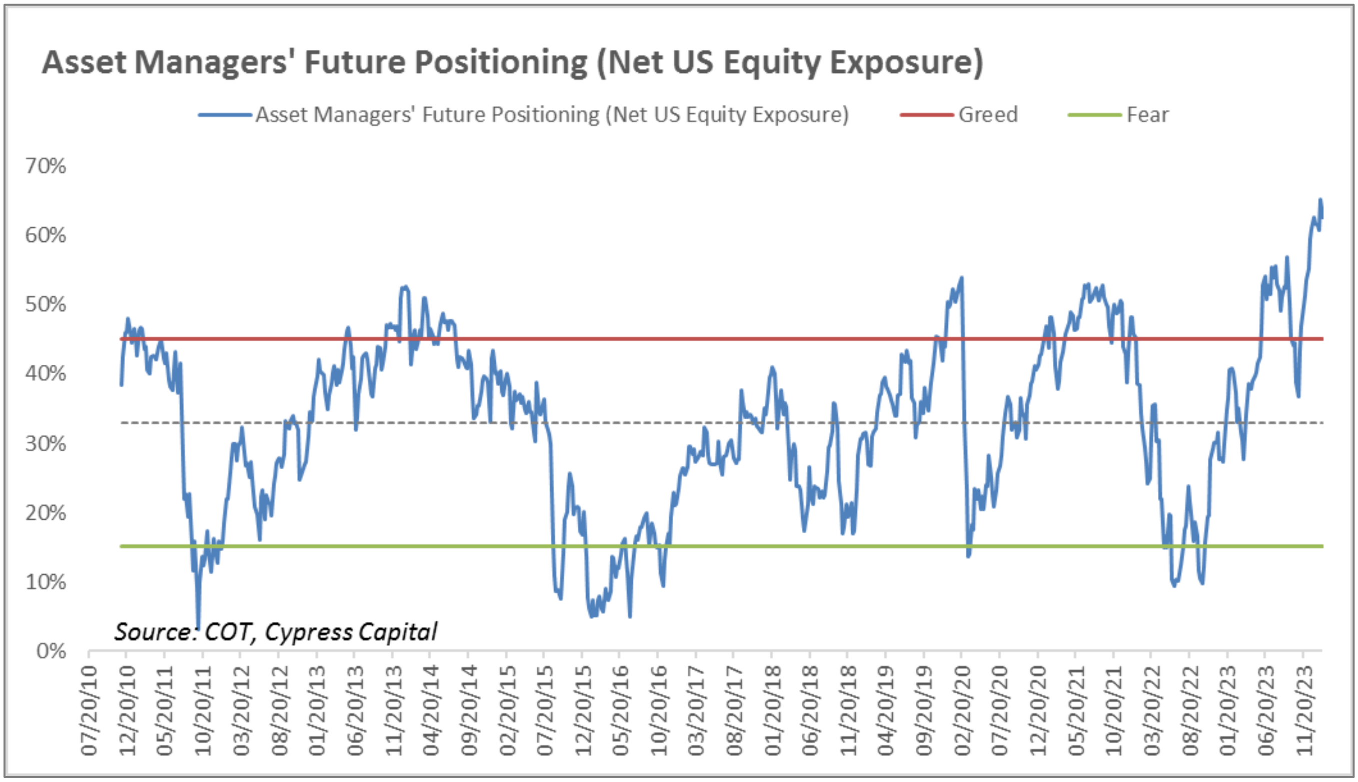
NASDAQ High Low Logic minus NYSE High Low Logic
It's not unusual to see a wide spread between the NASDAQ and NYSE versions of the High Low Logic index. It's been a helpful warning in its own right.



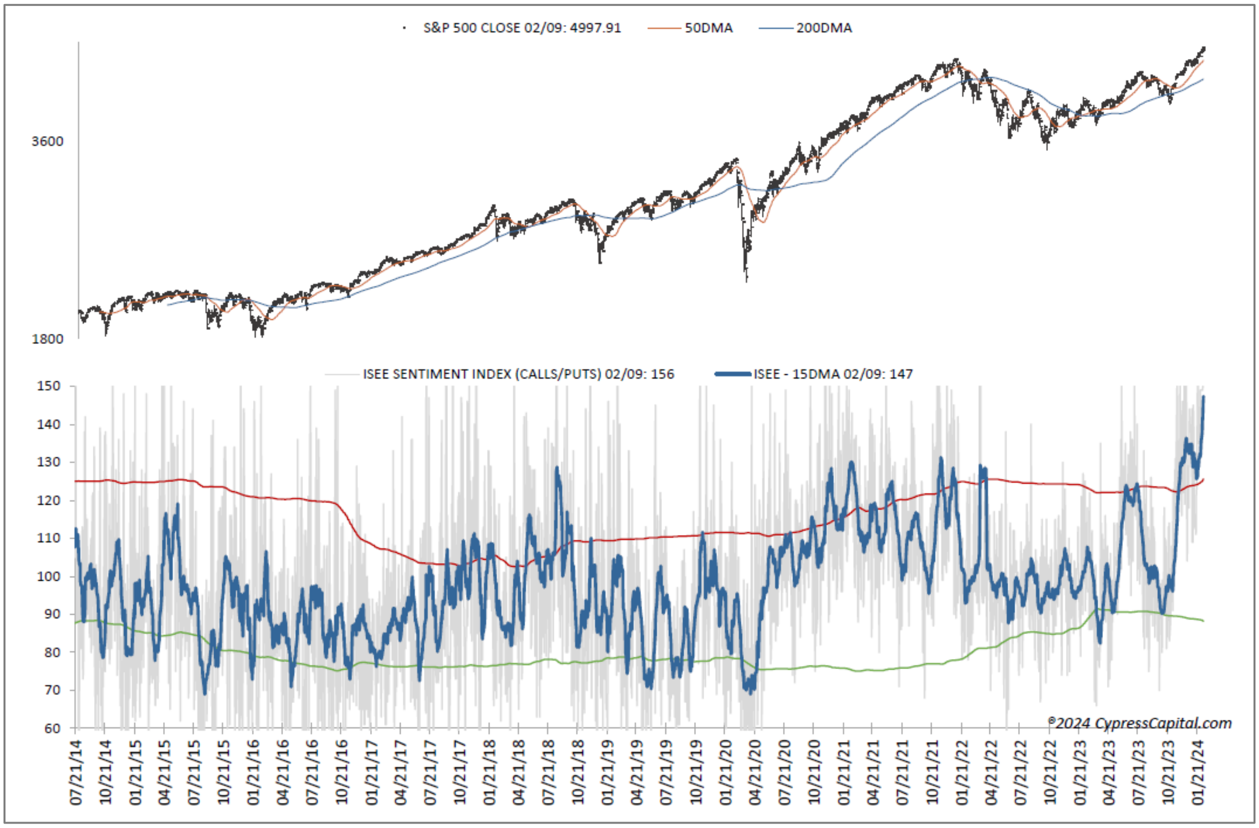
Bullishness among Leveraged ETF Investors set a new bull market high.
Each week in 2024 has brought it closer to breaching the 2021 record peak.



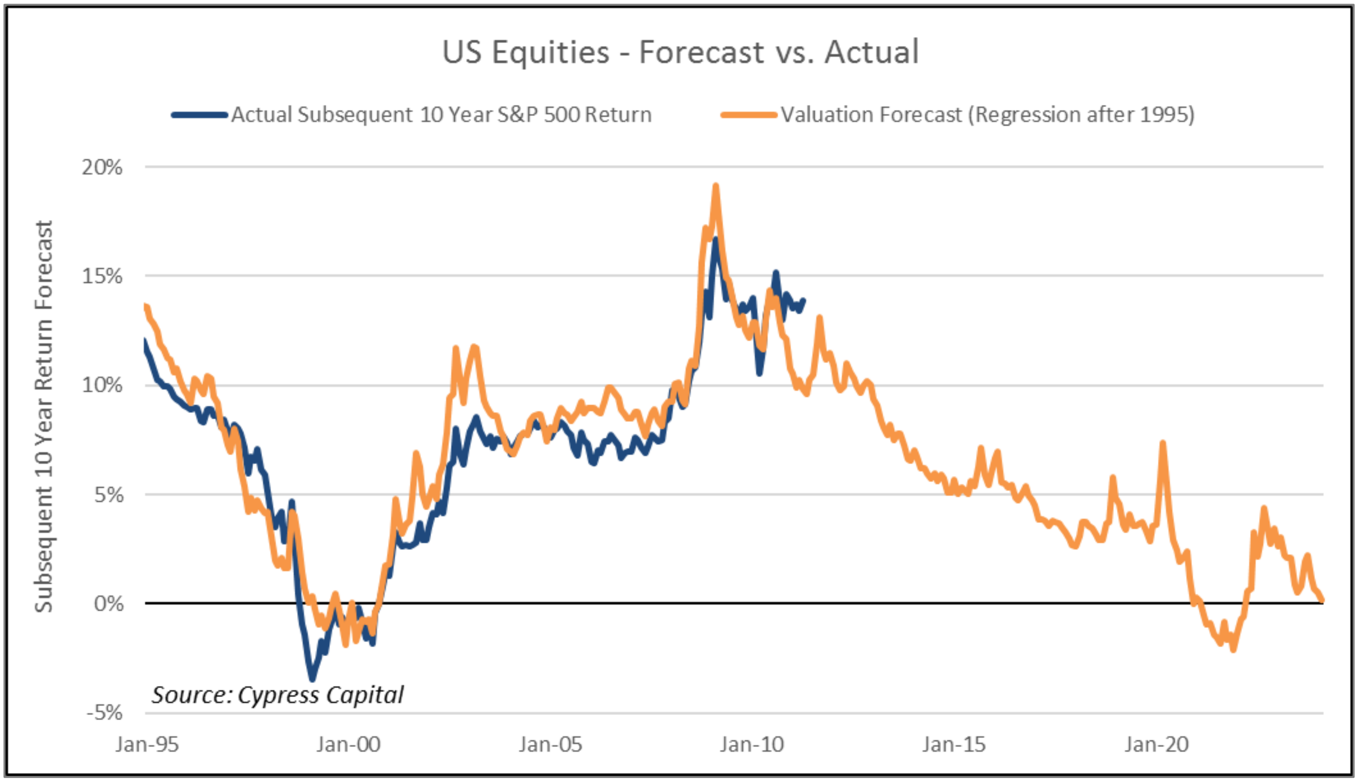
Asset Managers have never been more confident in buying derivatives to gain exposure to US stocks.



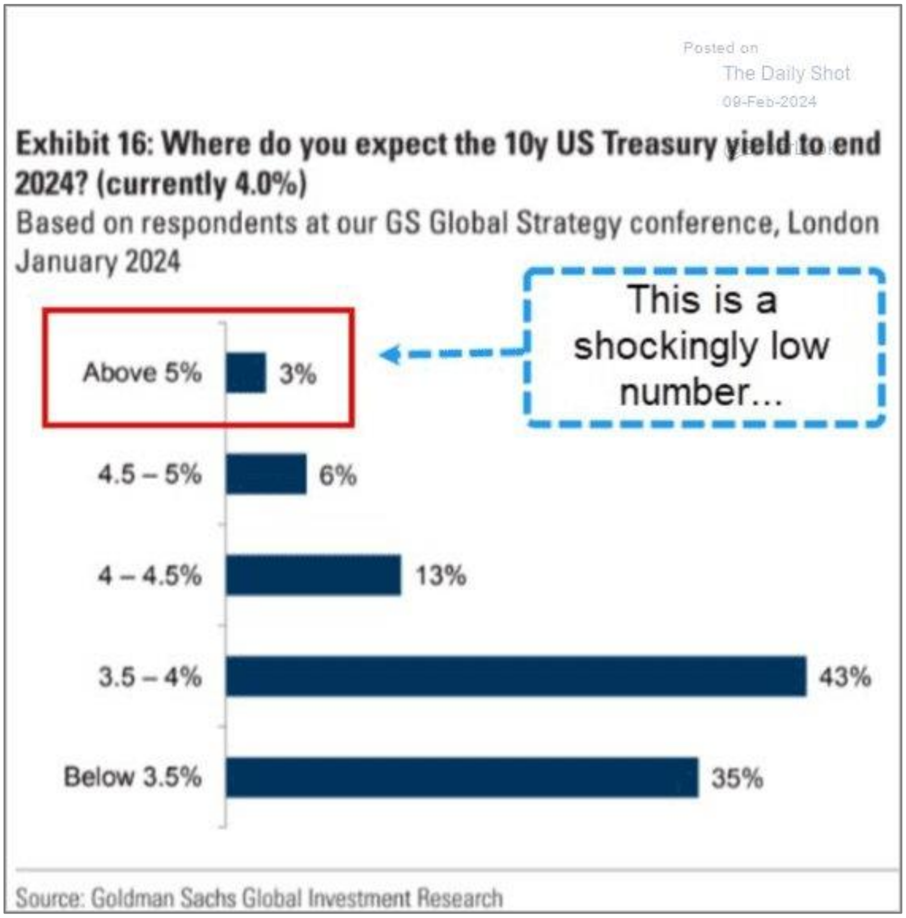
Investor appetite for call options is running hot. ISEE Sentiment Index shot higher.



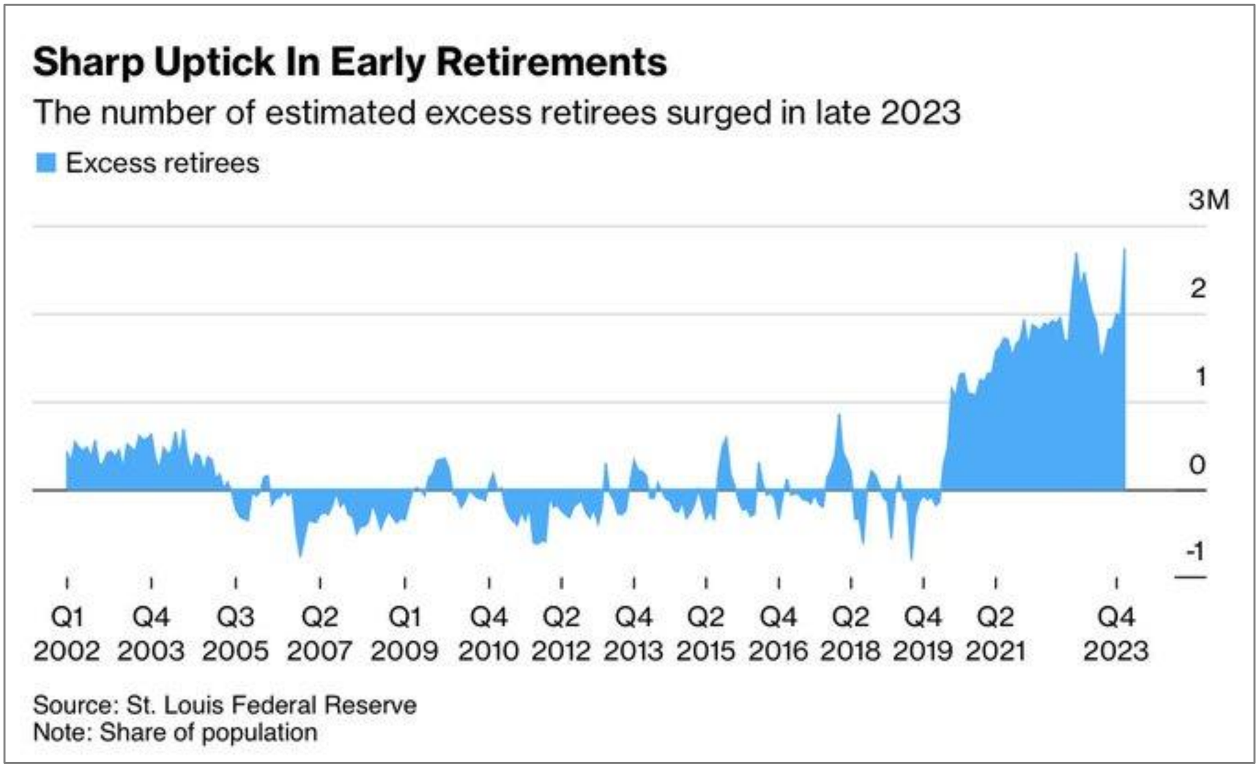
Expected returns inferred from current stock market valuations have fallen to 0%.



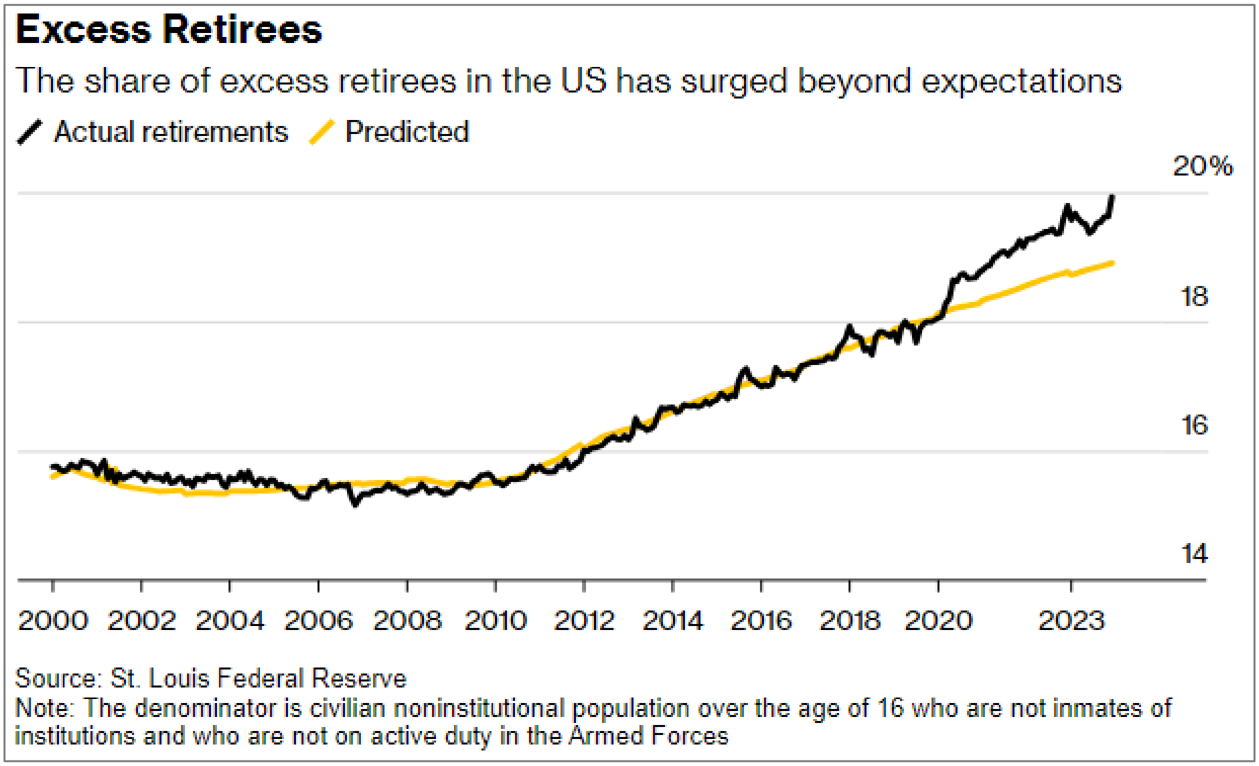
No one expects Treasury yields to move higher here.



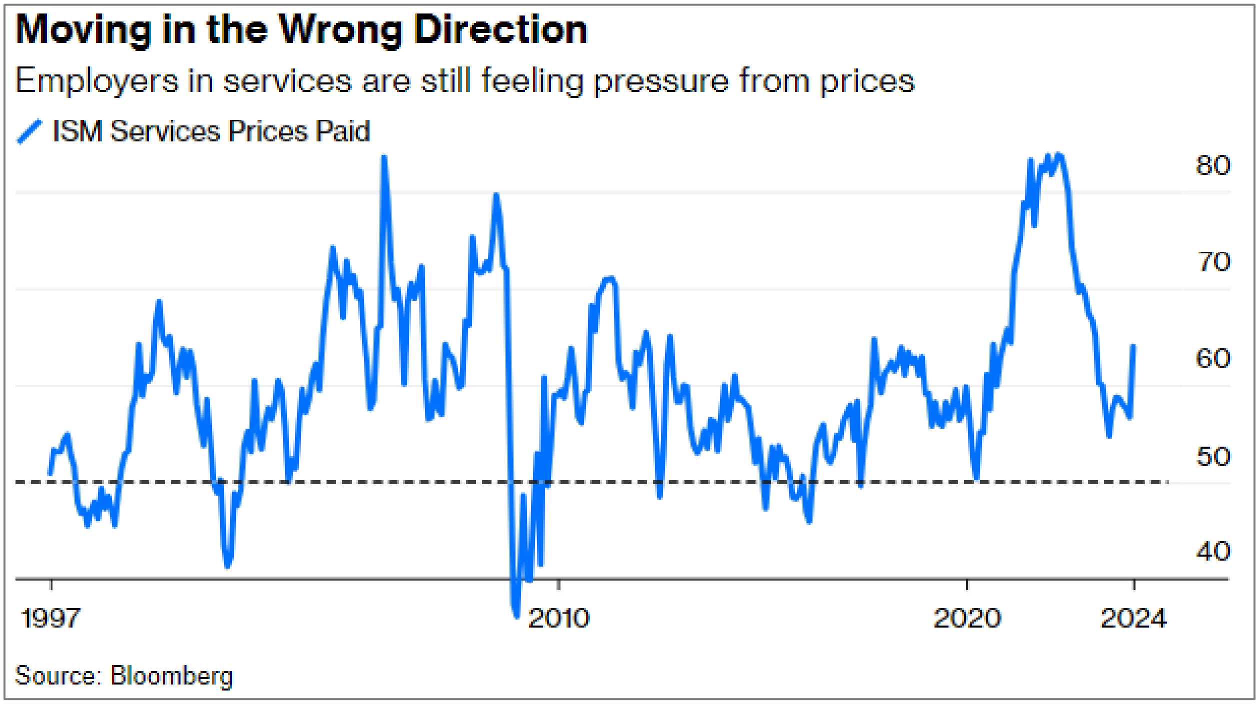
Early Retirements are surging again.



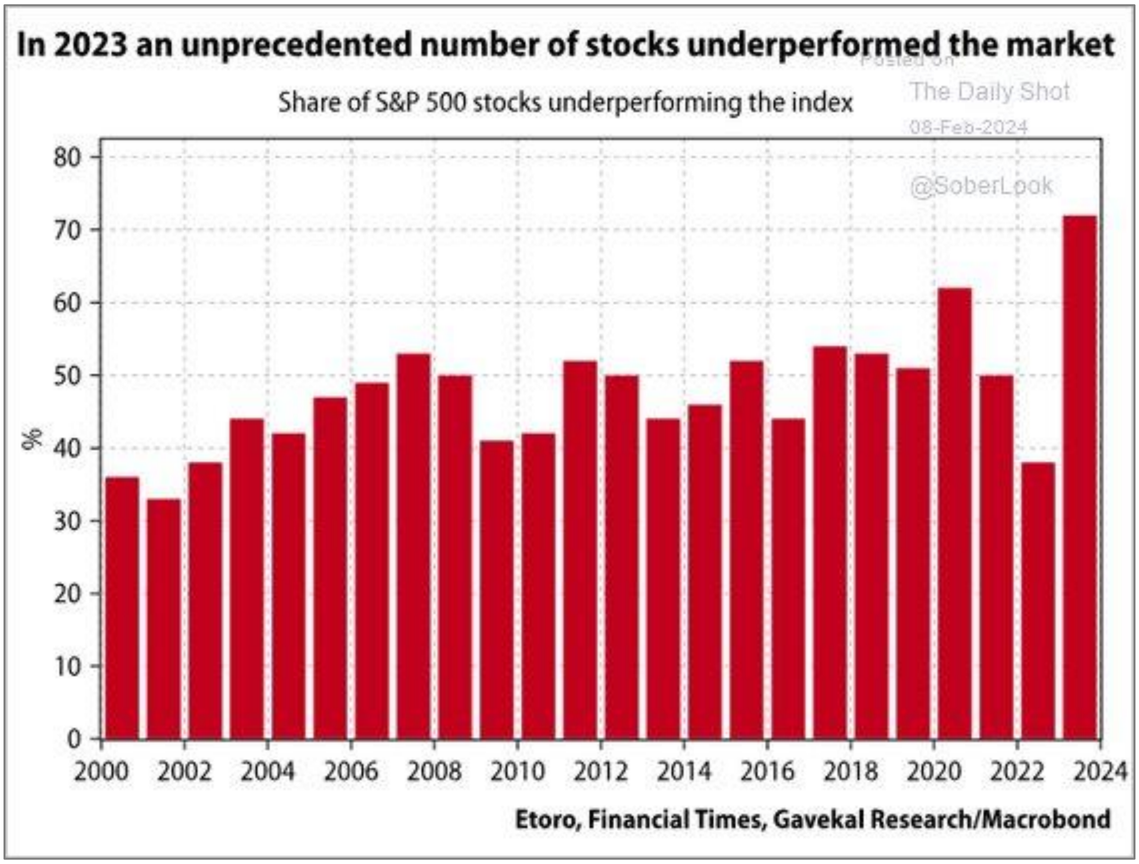
Retirements have been running hot ever since the Covid stimulus, tightening the supply of labor.



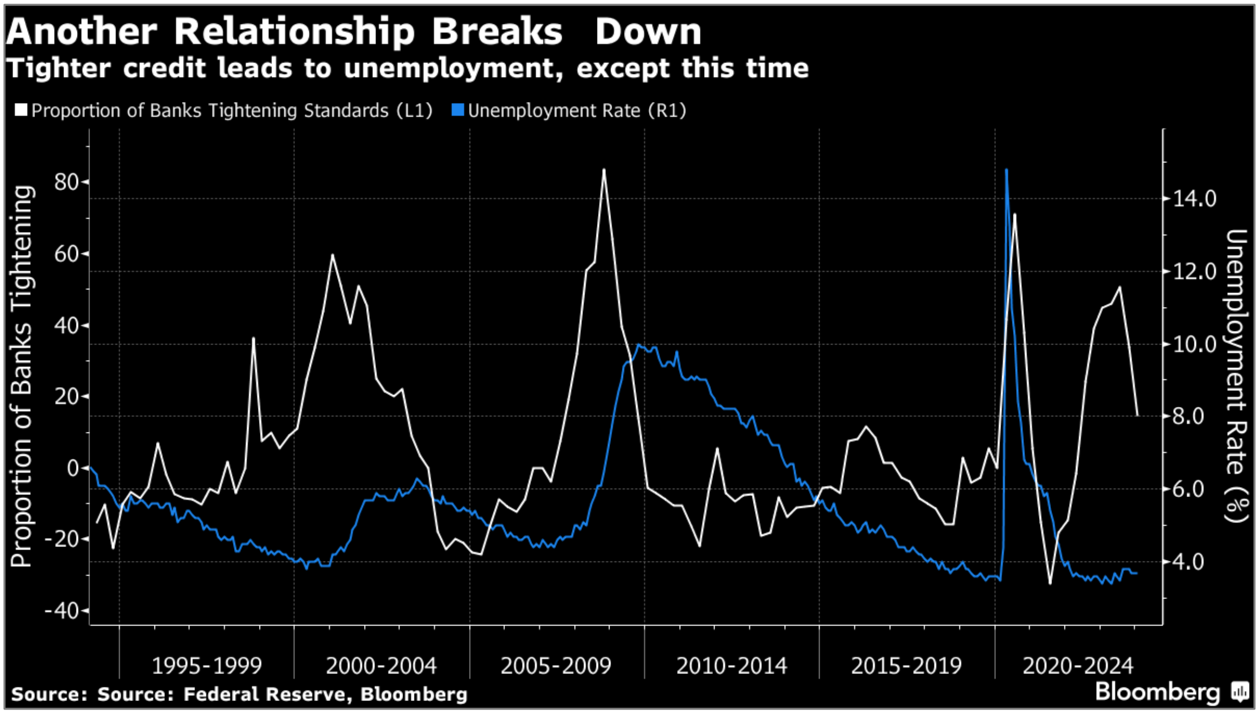
Businesses are seeing another uptick in inflation pressures.



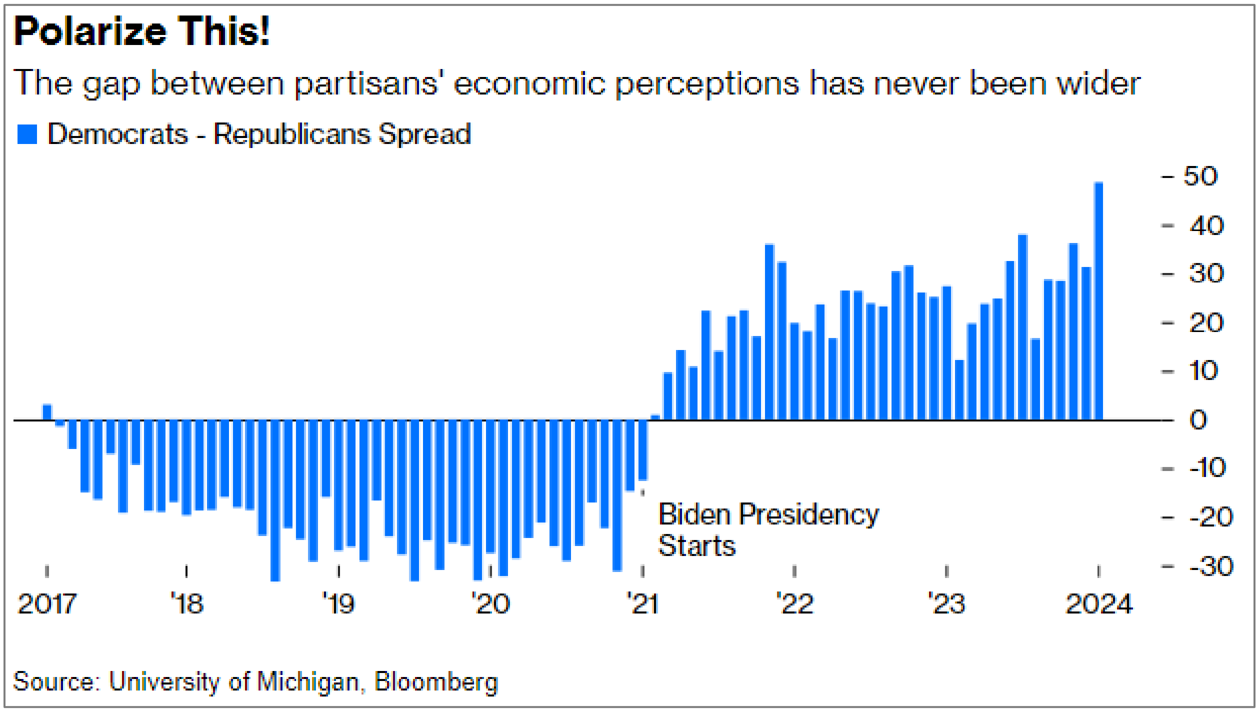
2023 was a terrible year for picking stocks by throwing a dart.



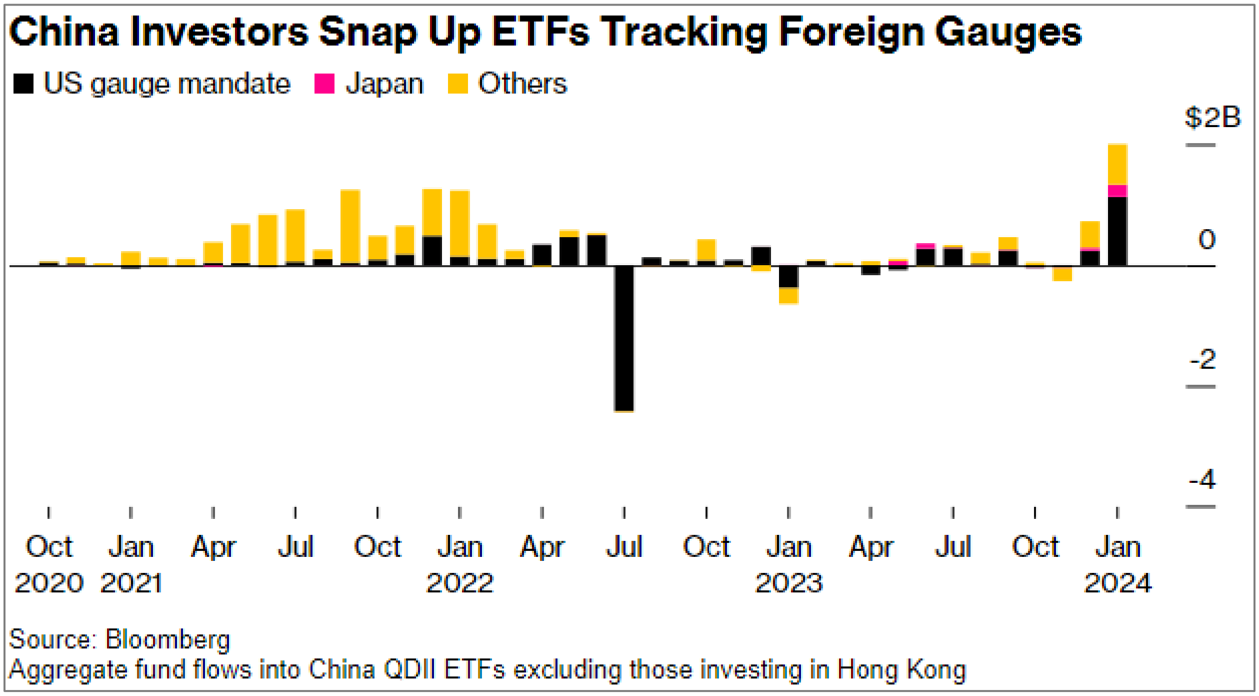
This may be the first time tight credit did not lead to higher unemployment.



Consumer Confidence has become highly partisan over the last decade.

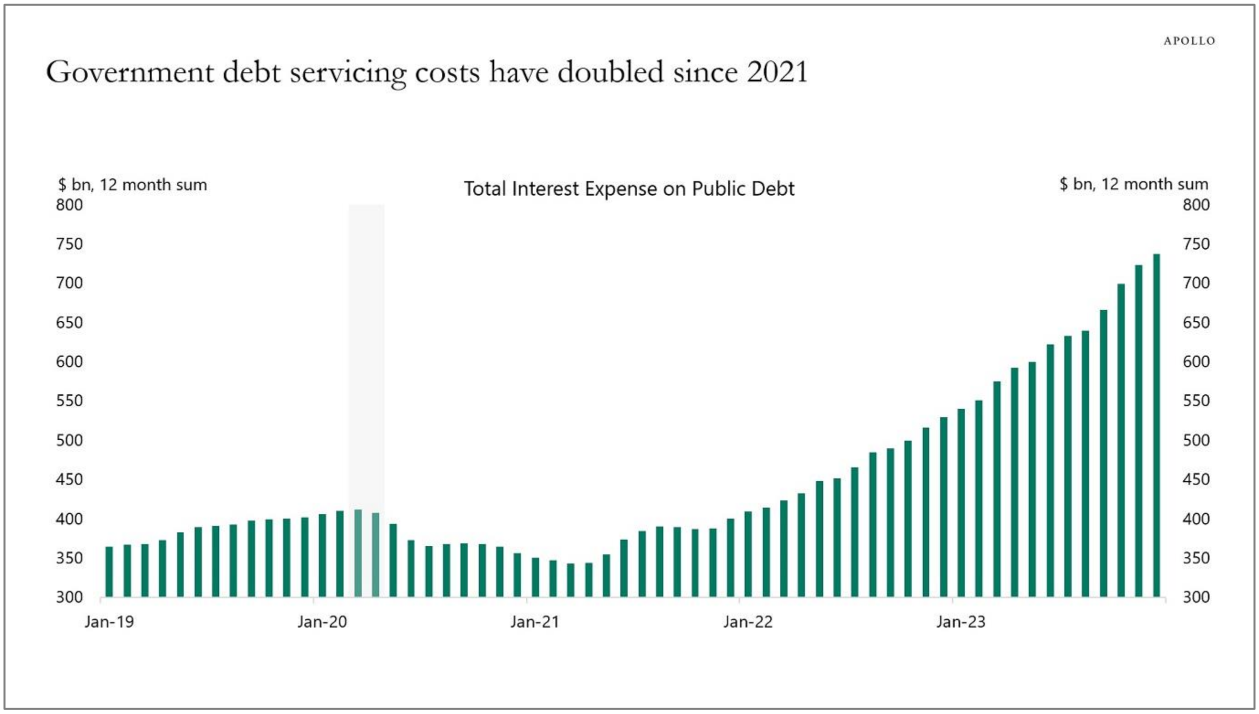


China Investors are pouring their money into US stocks.

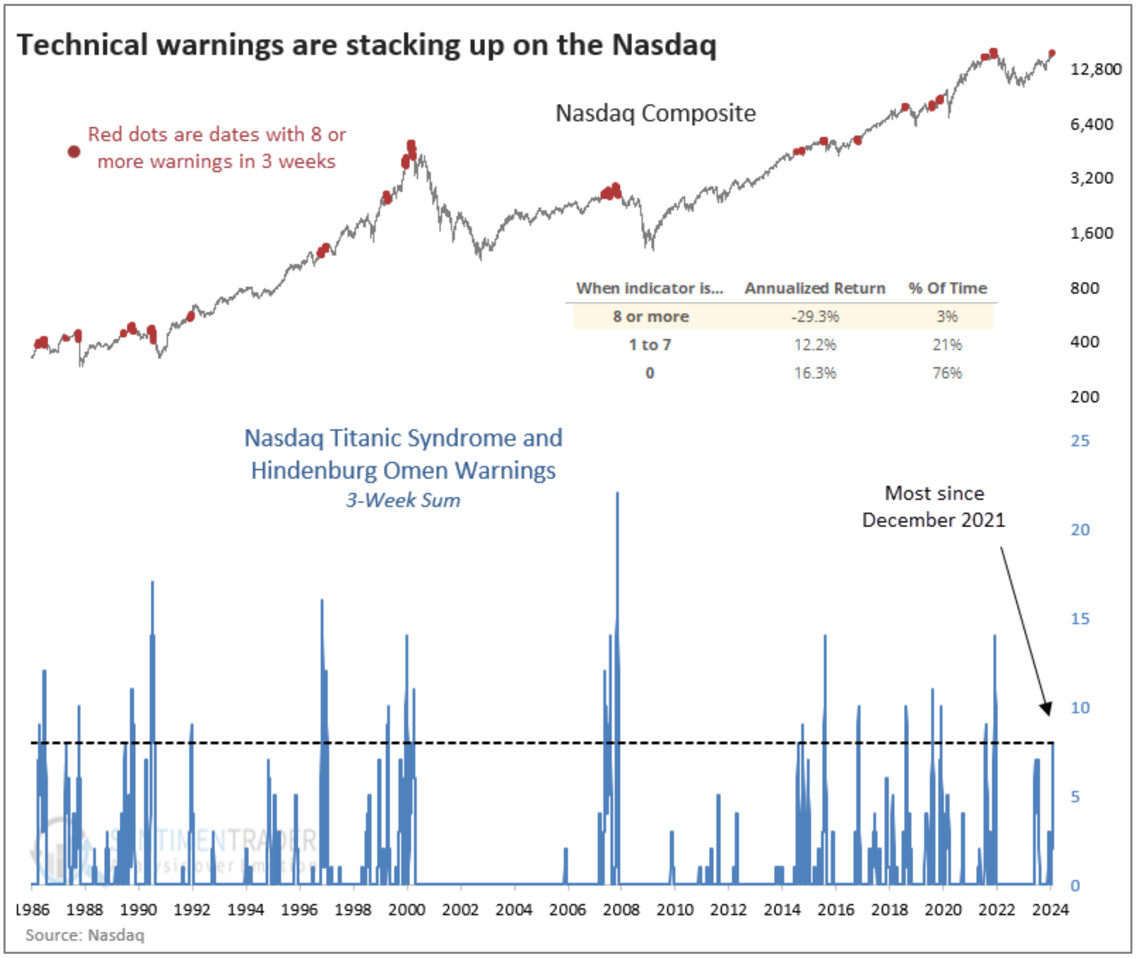


Good times for government workers.

Interest Expense has added about $400b stimulus to the economy since the Fed started tightening.



Technical warnings are stacking up on the NASDAQ.



Source: SentimenTrader.com

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.