Cypress CAPITAL

# Market Outlook

By Mark T Dodson, CFA

## Stretched Valuations

Market Risk Index jumped to 77.3%, as all three of the counter-cyclical components of our asset allocation model worsened this week. Psychology edged close to the worst 2 percent of readings, and Valuations moved into the worst 2 percent of readings.

The Valuation Composite hasn't scored this poorly since February 2022, a matter of weeks after the 2020-2021 bull market peaked. One of its components, the Price to Peak (or max) Earnings Ratio, climbed to 25.4. That's a higher valuation than the previous bull market achieved and higher than the valuation at any other bull market peak outside the dot-com bubble. The Price to Peak Earnings ratio removes earnings cycle downturns from the valuation calculation by always using the maximum earnings that the S&P 500 has achieved to date, giving investors a more optimistic outlook on stocks during earnings recessions.

Valuations pushing higher have driven down our expectations for equity returns. Our forecast for US equity returns over the next 7-10 years, using the more lenient era of valuations since the mid-90s, went negative. It's a clear message that the bear market of 2022 did not clear the decks for a typical cyclical bull market and should rule out the notion of a multi-year secular bull market. The enthusiasm for speculation that was a hallmark of 2021's stimulus-fueled bubble is still front and center.

The Fed has worked to maintain a permanently high plateau in stock market valuations for several years. As a result, investor sentiment, the wealth effect, and animal spirits appear to be having a noticeable impact on the economy and inflation. Investors' frantic efforts to front-run Fed cuts have significantly delayed the timing of Fed cuts. The disinflationary trend halted as investors began providing liquidity to markets, and this week's inflation release showed some acceleration under the surface.

On the breadth front, the NASDAQ High Low Logic stayed in the red zone for a second straight week, highlighting the fractured nature of the stock market's advance. Combine fractured internals with excessive valuations and a fragile stock market narrative built upon a disinflationary theme – the bull market has become vulnerable to significant turbulence.

### Market Risk Index

Rec Allocation 25% Underweight

**77.3%**

### Category Percentiles

Psychology - P6: 97.7%

Monetary - M3: 33.5%

Valuation - Extremely Overvalued: 98.0%

Trend: 48.2%

**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 | 0.9% |
| 10Yr US Treasury Yield | 4.2% |

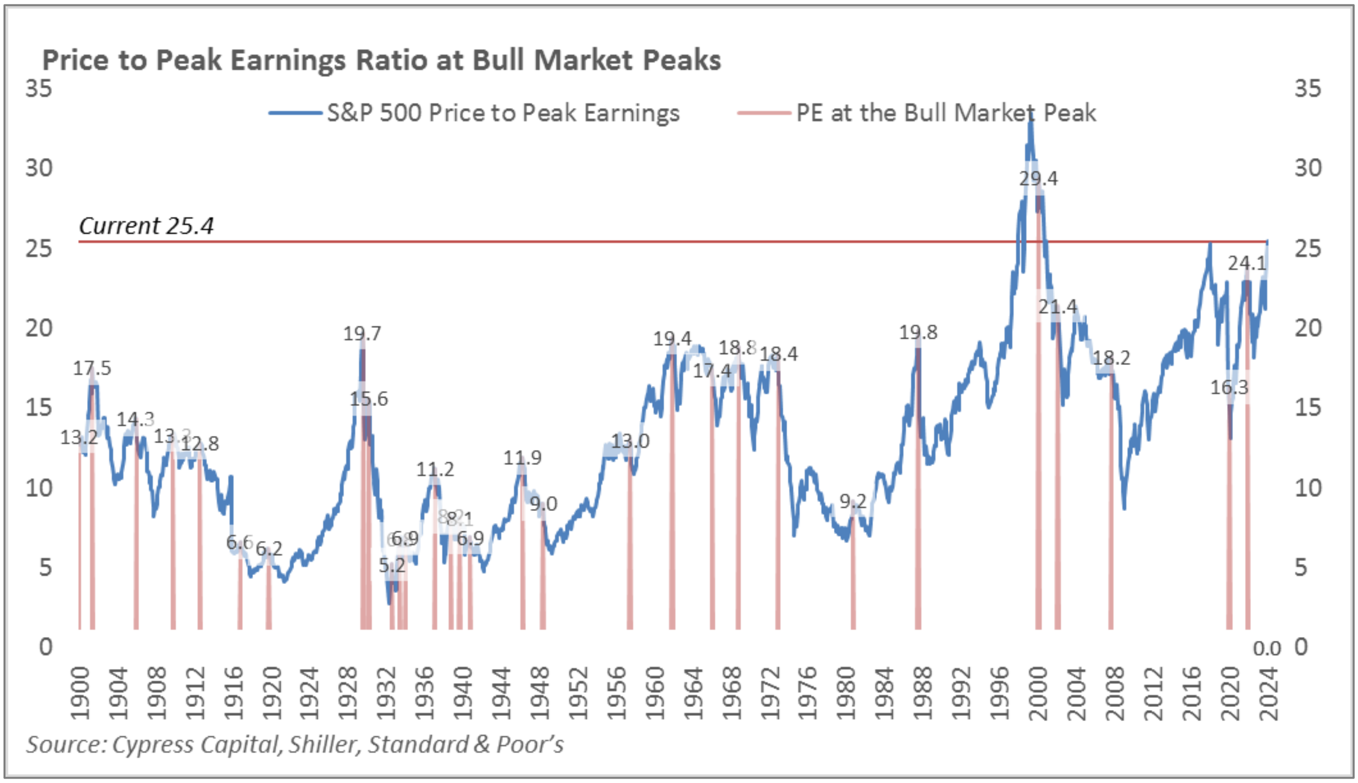
**Market Trends**

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

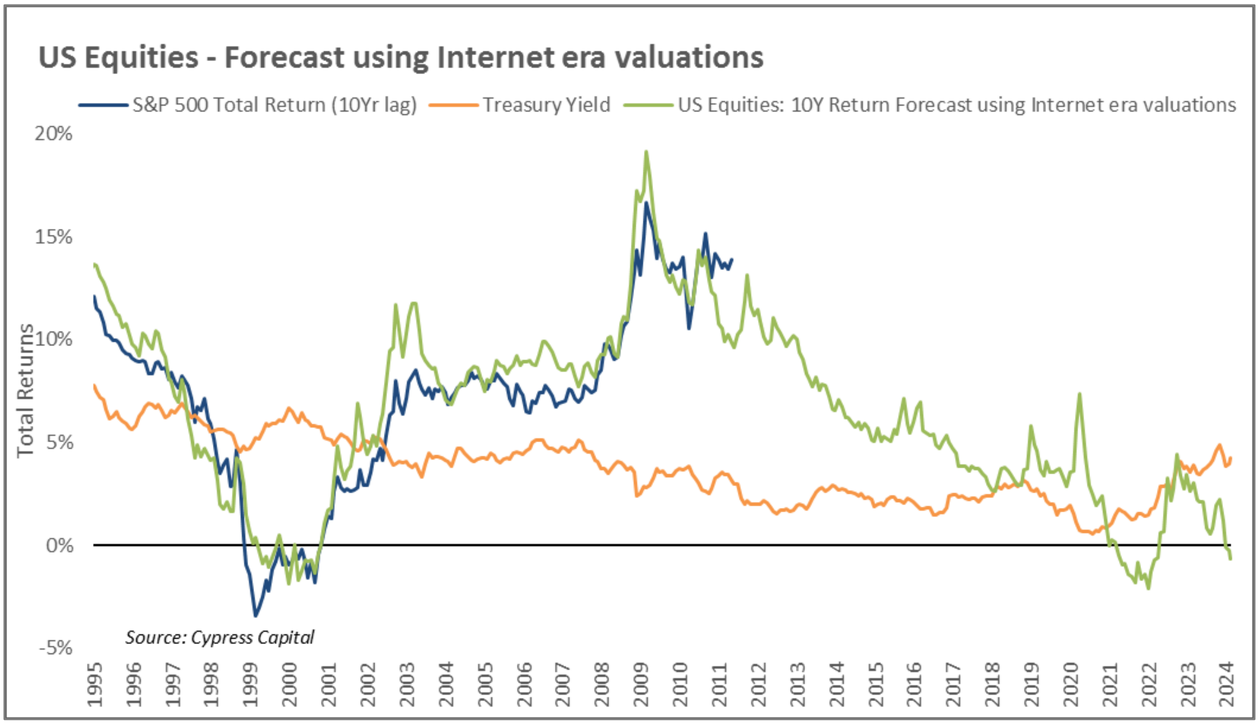
*Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets based on our model & opinion. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.*

## Charts of the Week

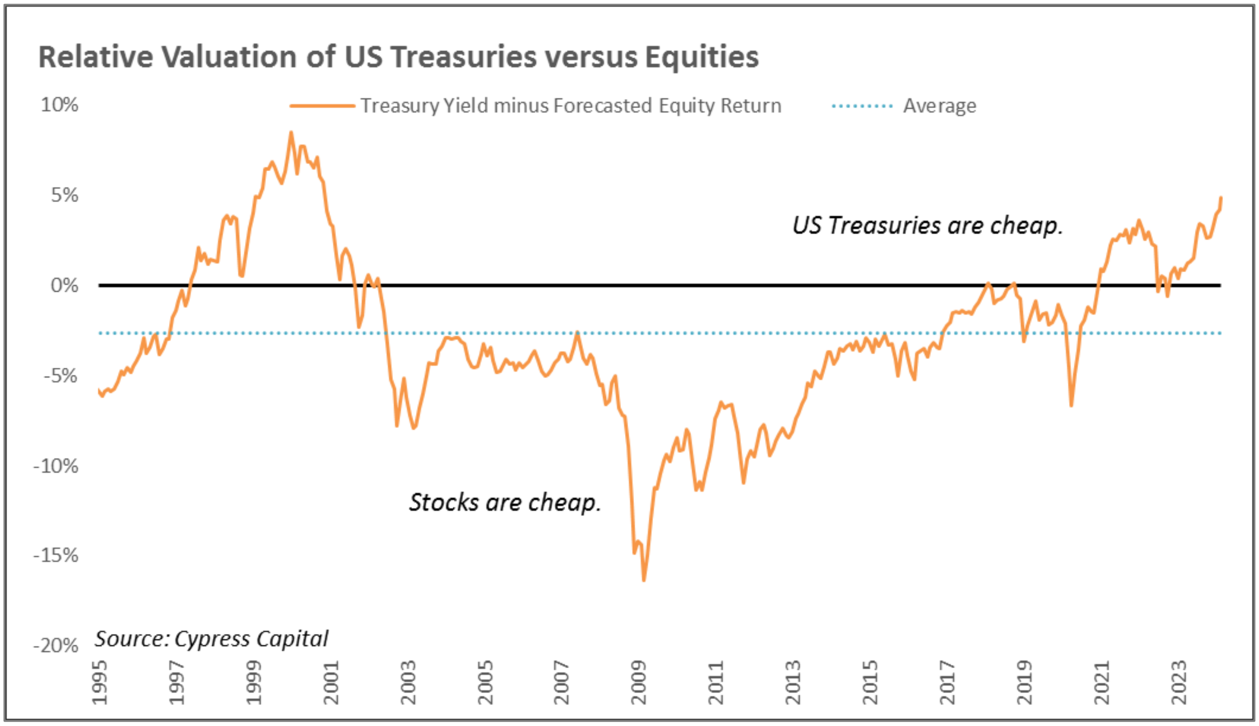
**Stock valuations, using Price to Peak Earnings, are rivaled only by the dot-com bubble peak.**



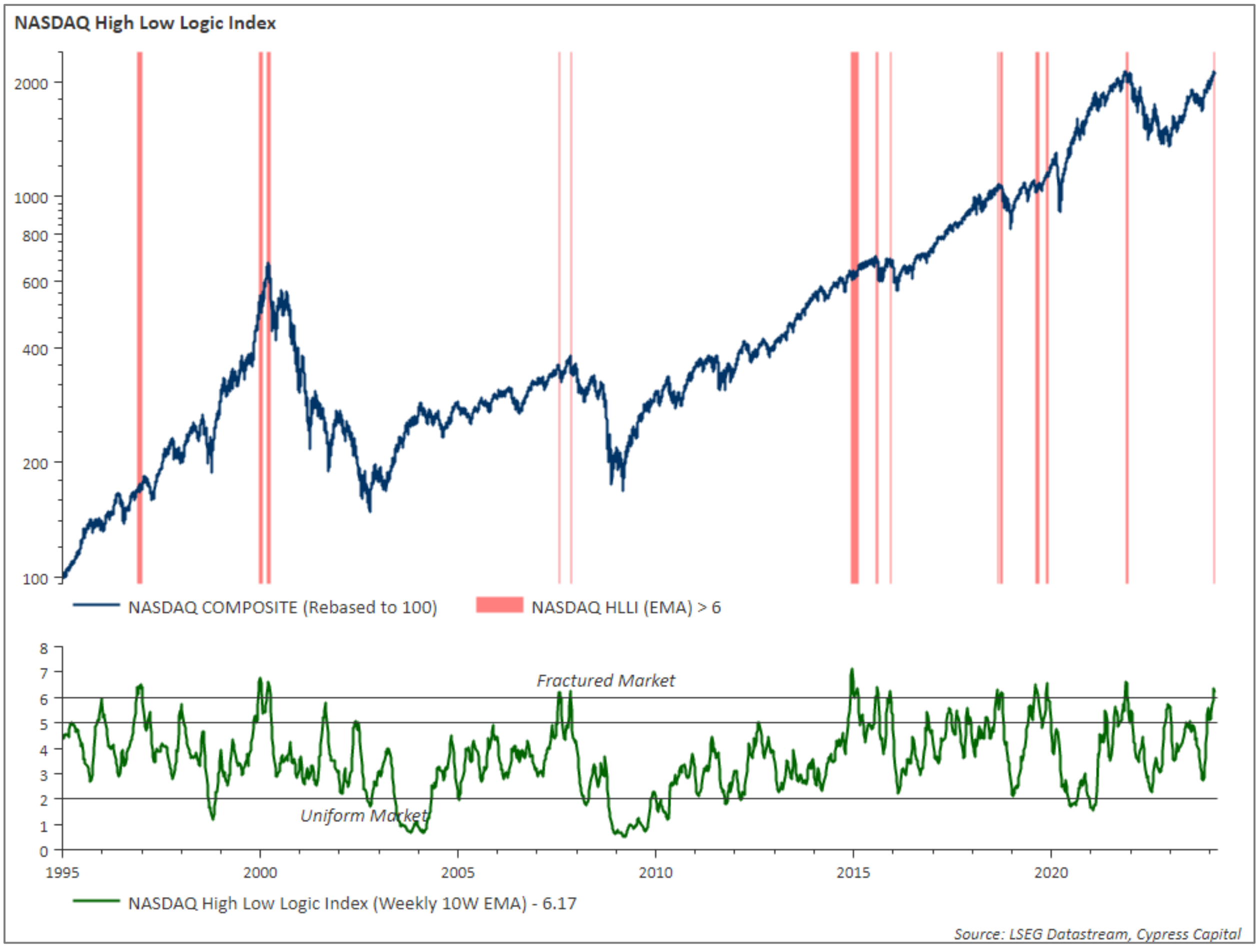

**Expected returns for stocks, using elevated Internet-era valuations, fell below zero.**



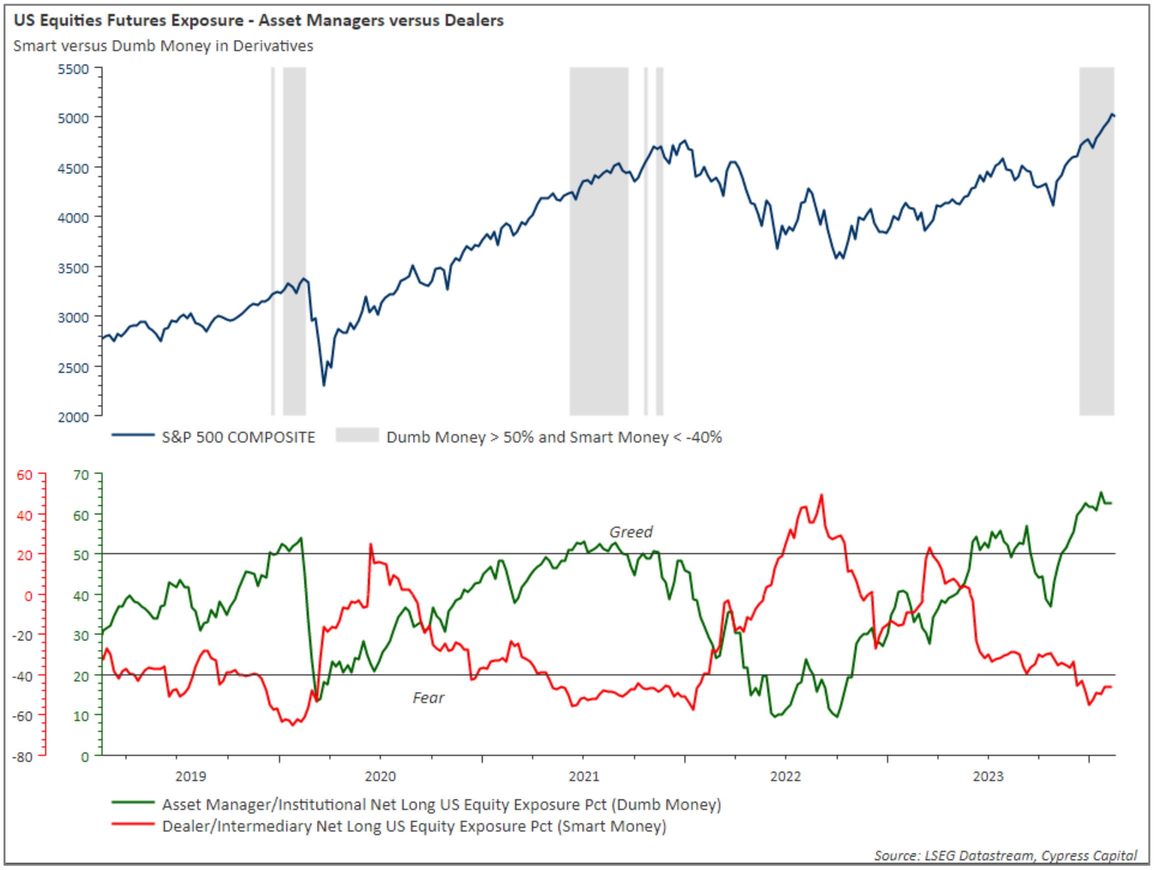
**Treasuries have not been this attractive relative to stocks since early 2001.**



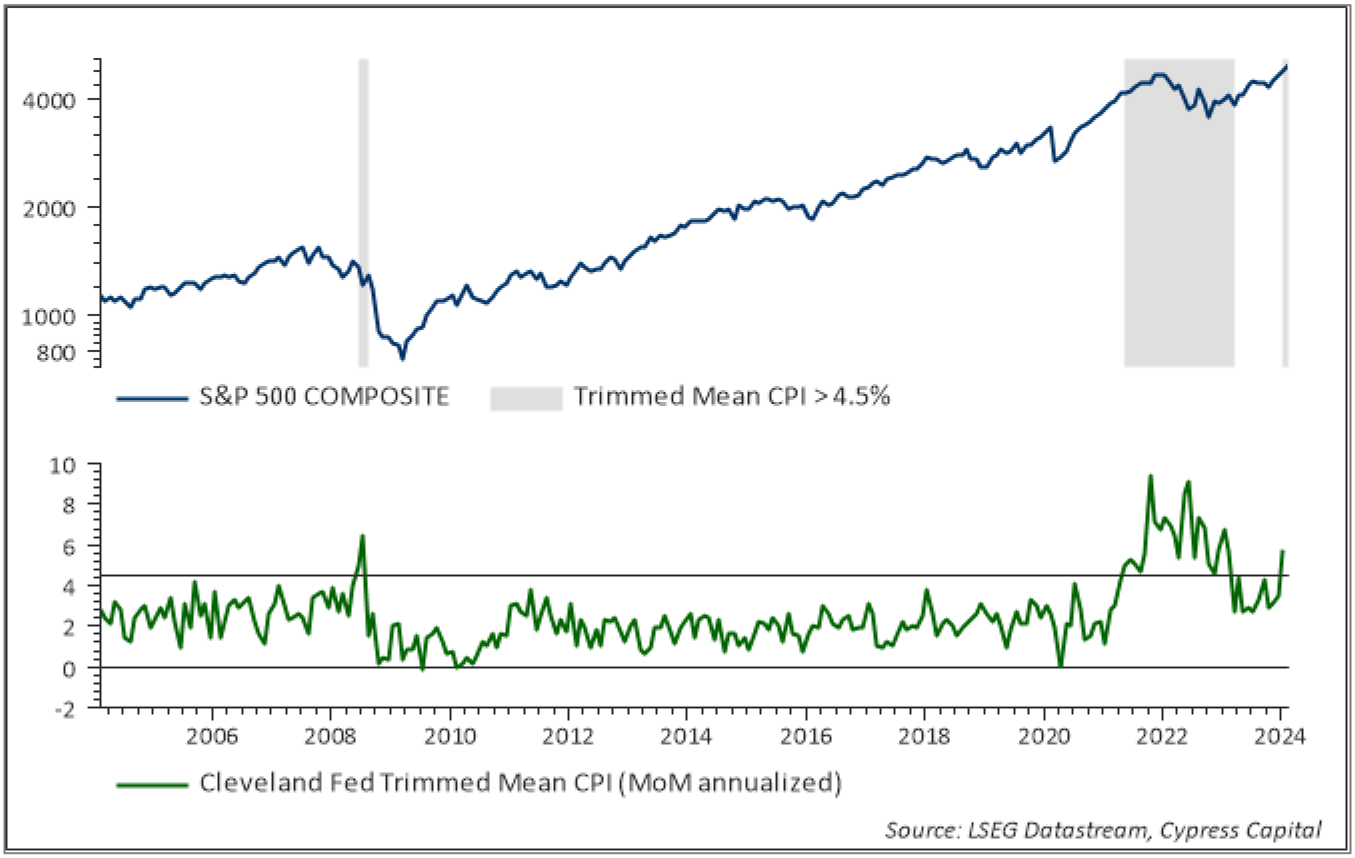

**NASDAQ High Low Logic Index stayed above 6% for the second consecutive week.**



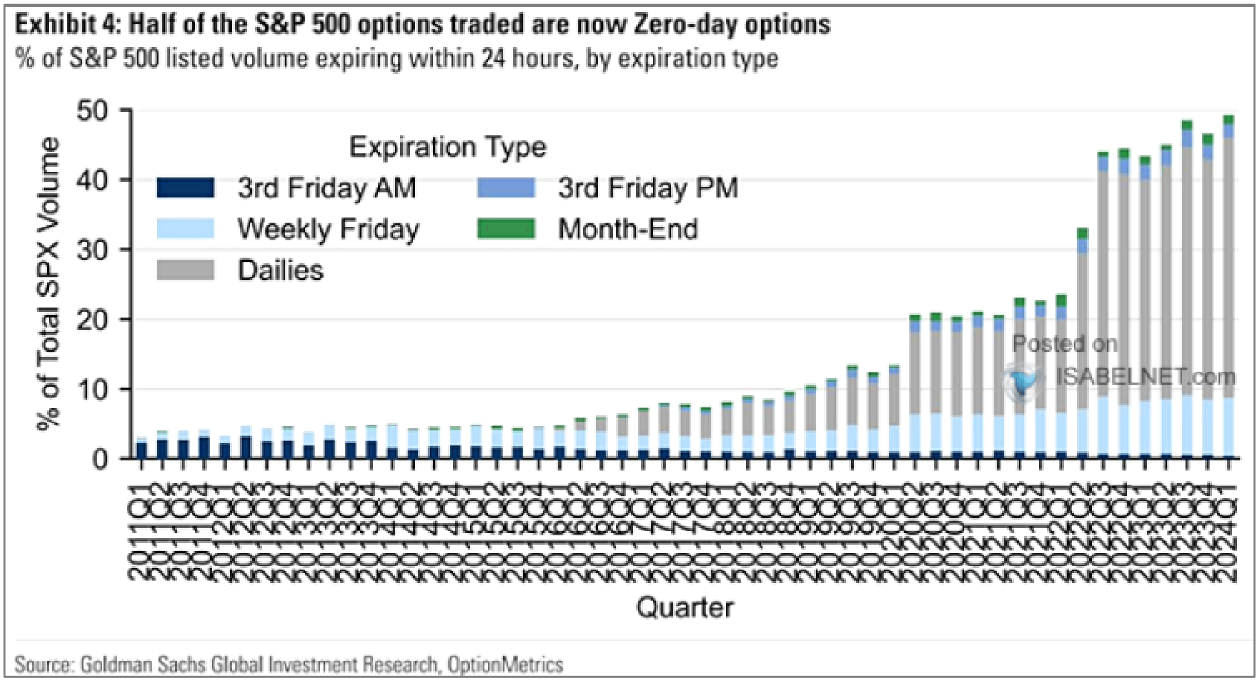
**US Equity Futures – The Smart Money is short, and Dumb Money is long.**



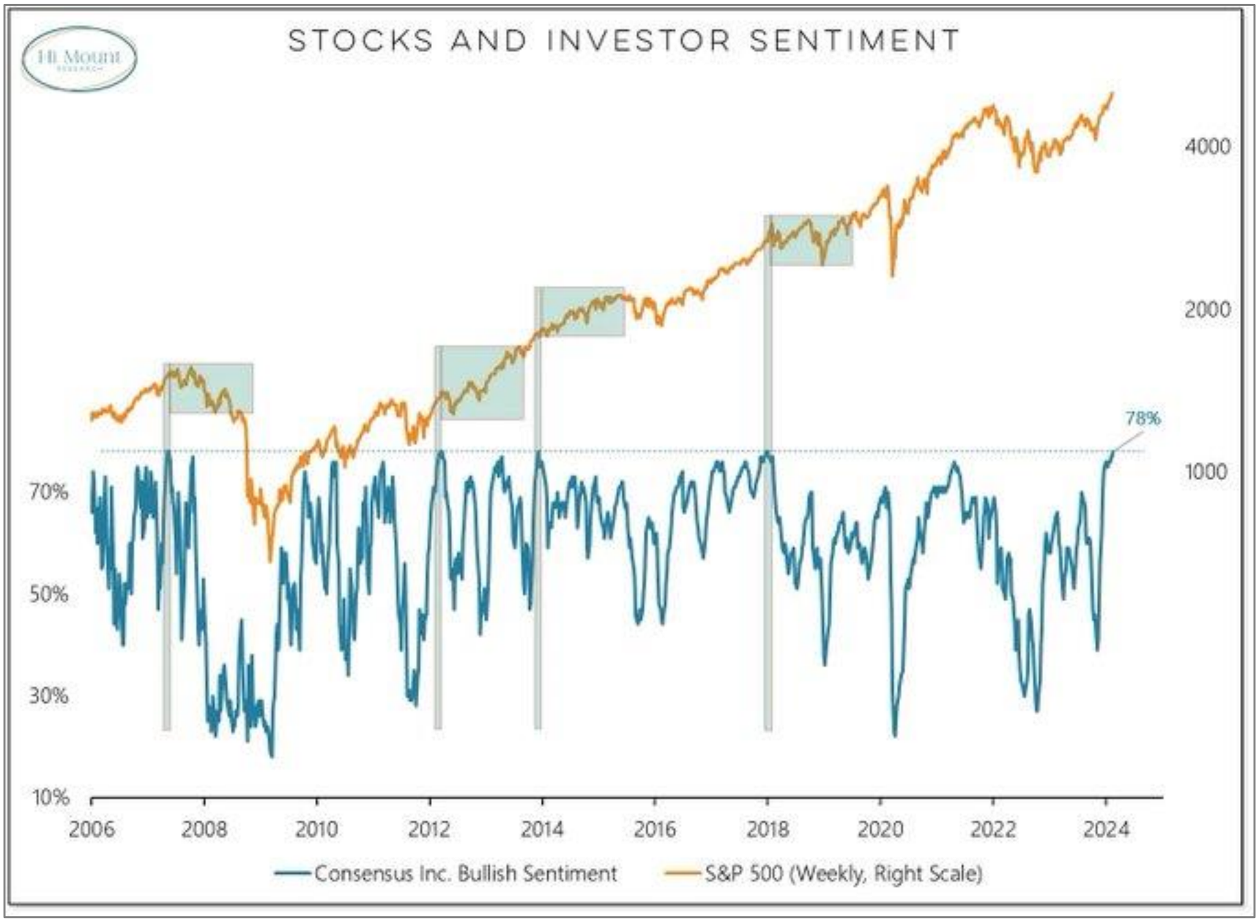

**Inflation, ex its most volatile components, appears to have bottomed last June and is back on the rise.**



**Half of S&P 500 options volume is from Zero-Days-To-Expiration options.**



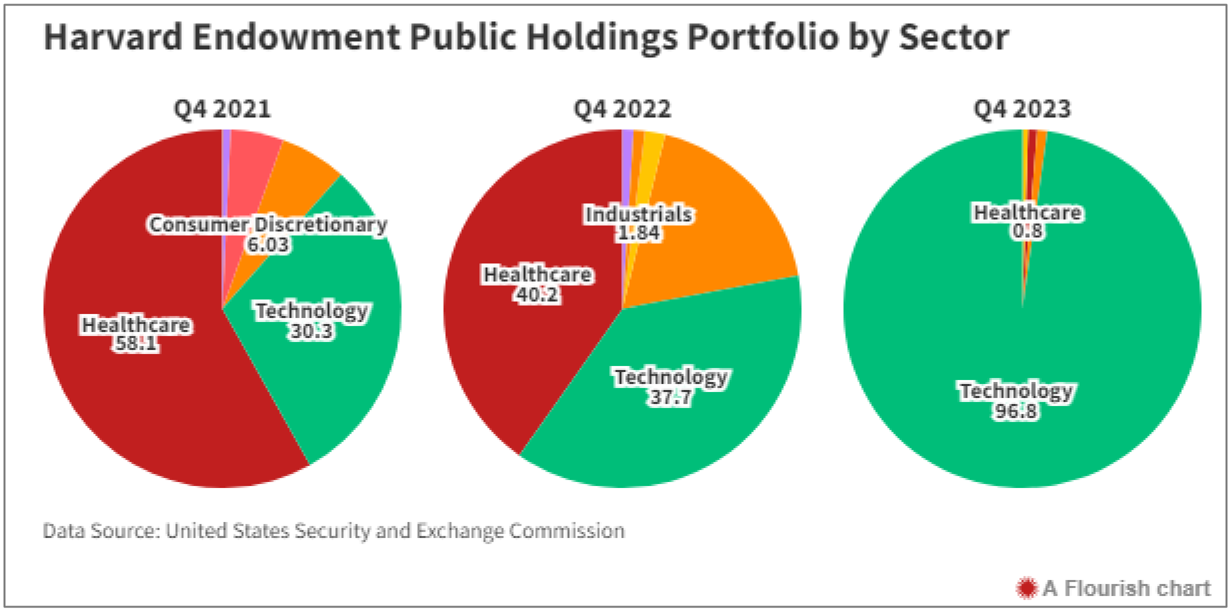

**Consensus Inc. Bullish Sentiment crossed above 78% for only the fifth time in 17 years.**



**This bull market is the narrowest since 2000, beating the 2021 bull market advance.**

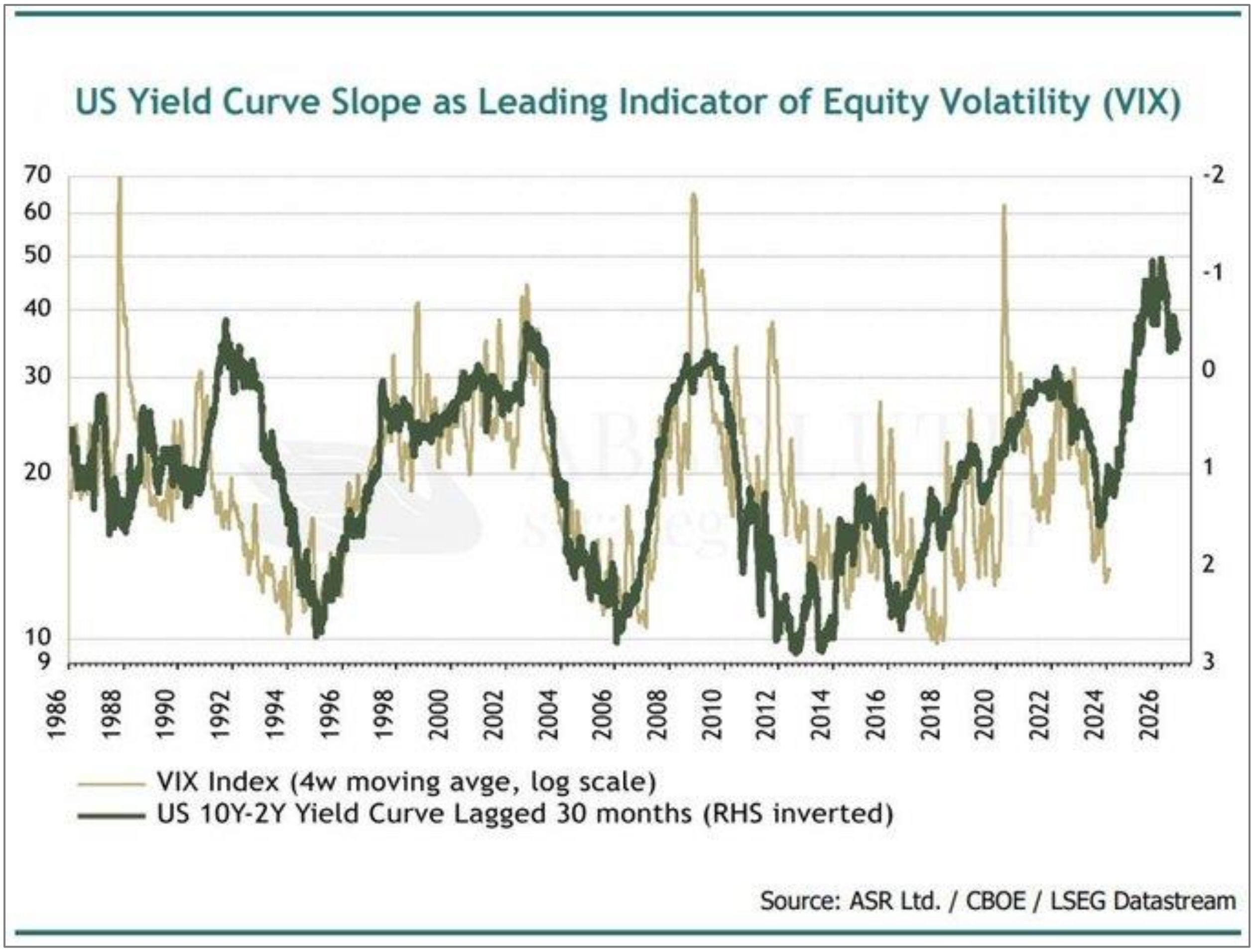

**The US stock market hasn't been this concentrated in a century.**

**Harvard's Endowment public stock market holdings have turned into a Technology Fund.**

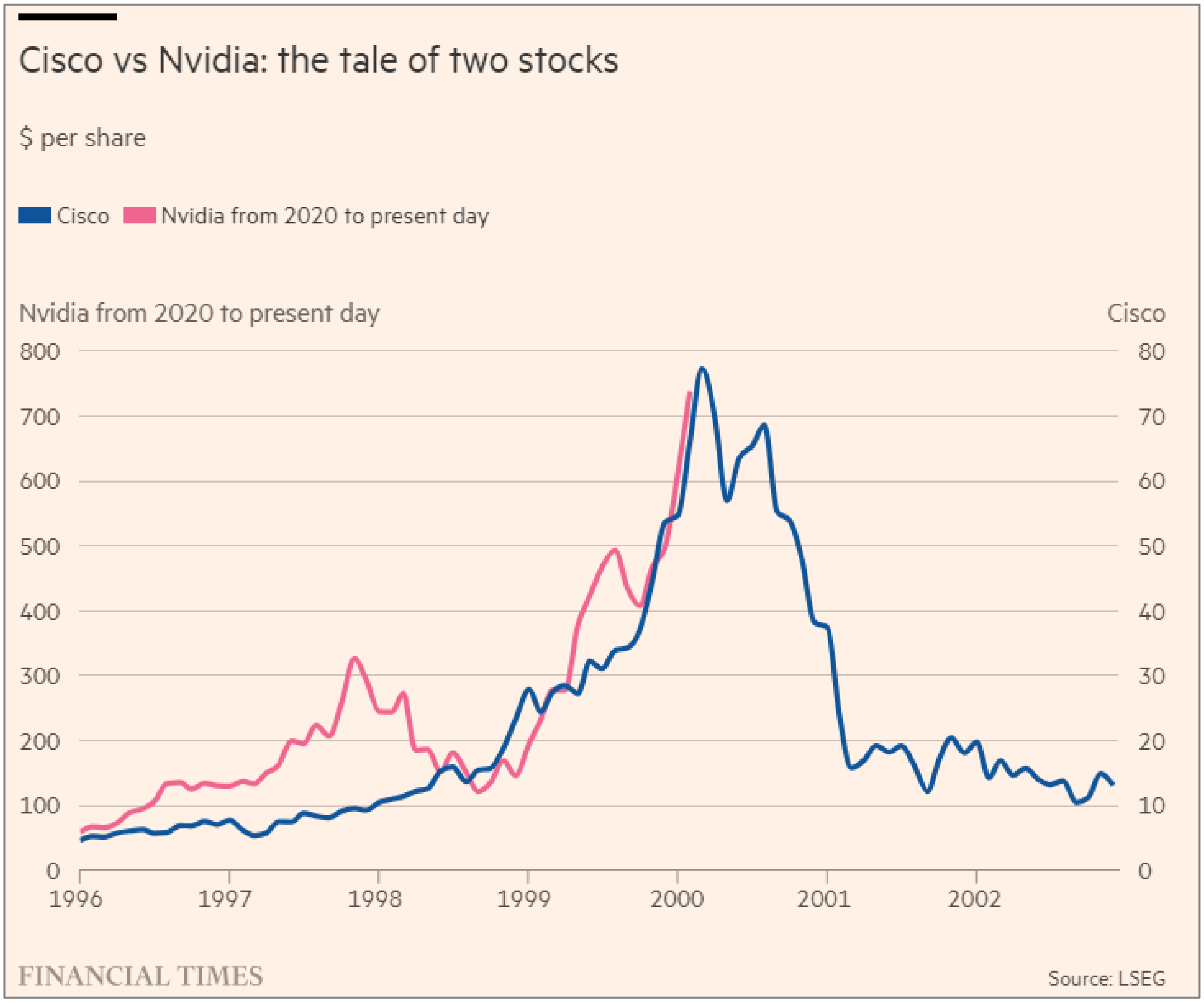



*Source: Harvard Crimson, RBAdvisors*

**The Yield Curve leads High Volatility Regimes by a couple of years.**



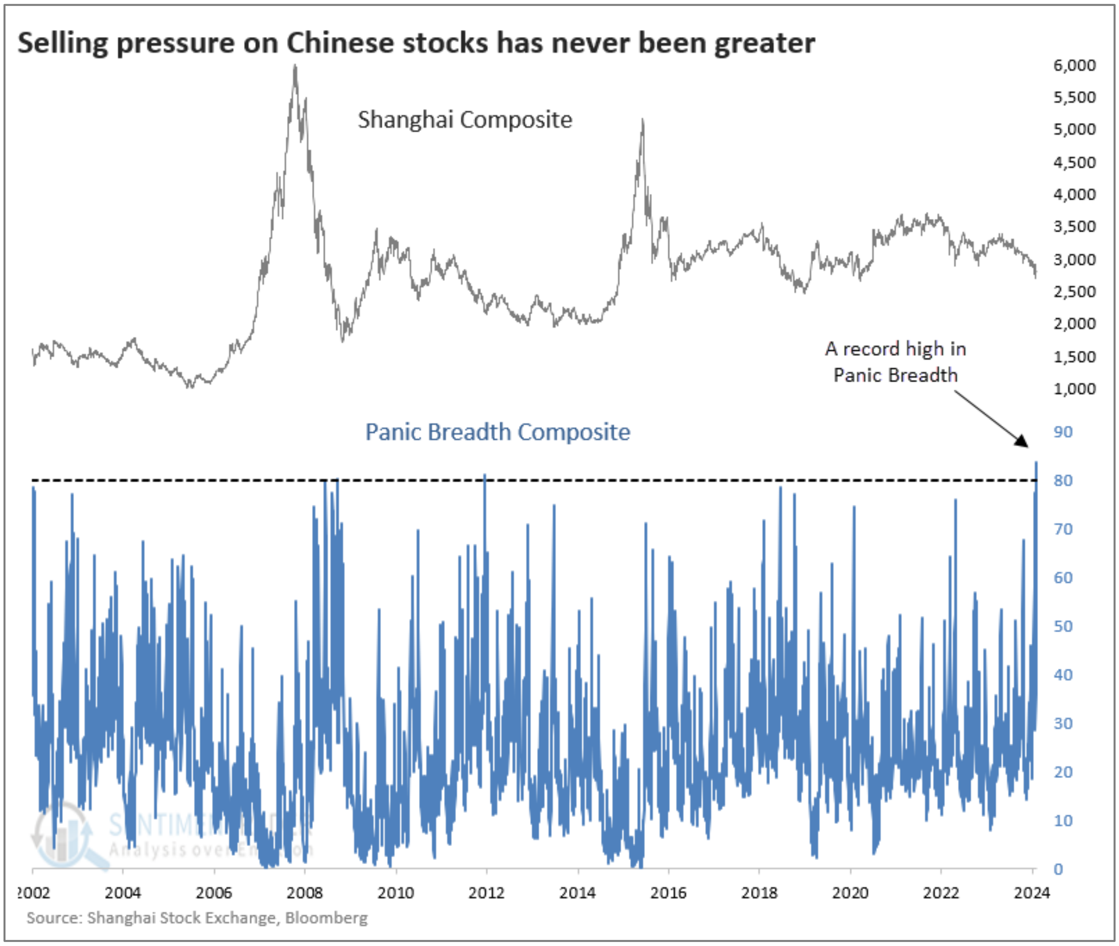
**Nvidia 2024 versus Cisco 2000**



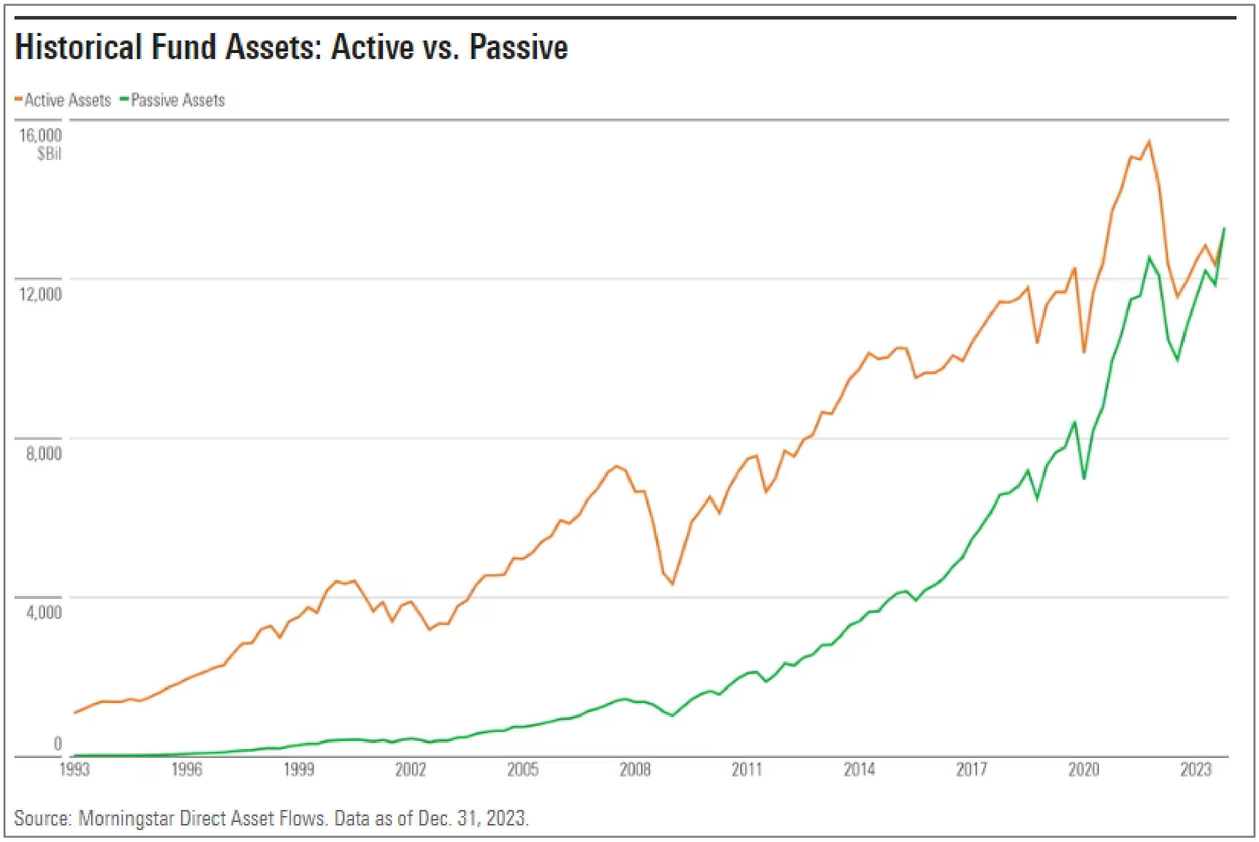

**Nvidia is worth more than the entire Energy sector. (Cisco never quite achieved that feat.)**

**Chinese birth rate is falling to new lows.**

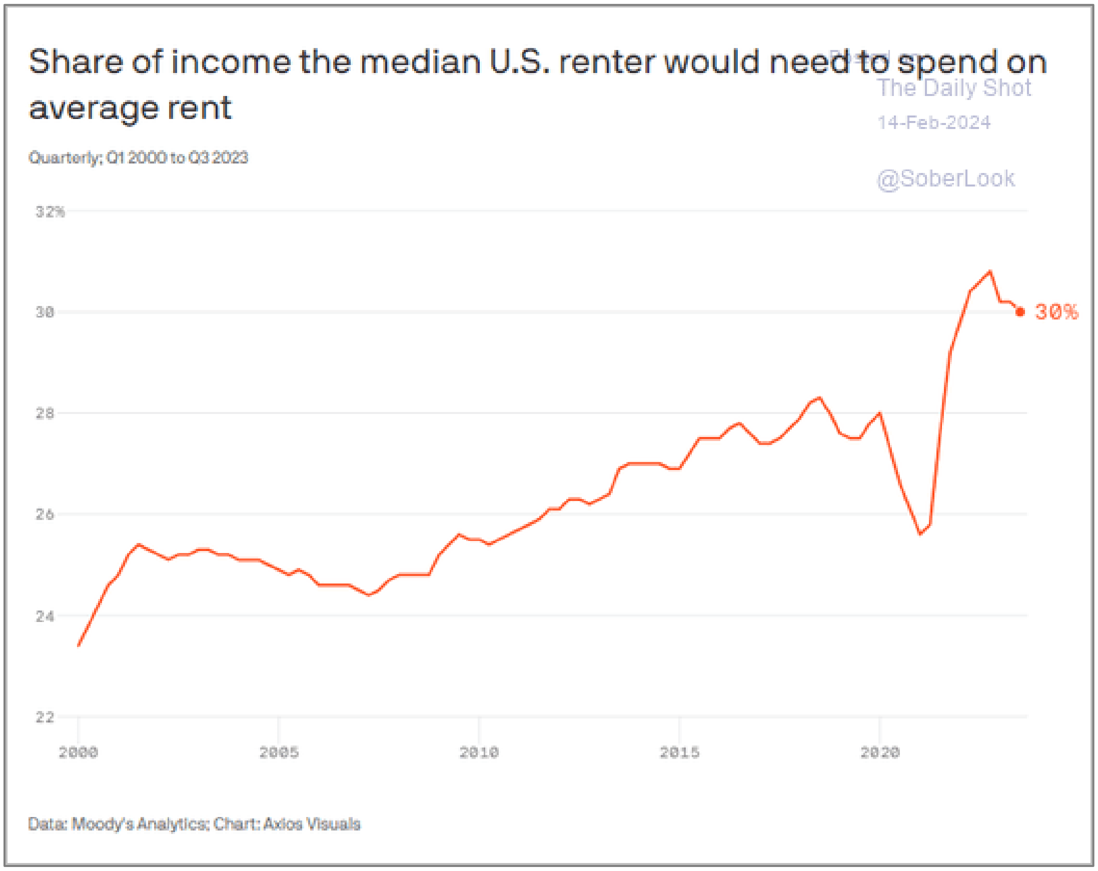

**Panic Selling in China**



**Passive Investing takes the lead.**




**It may be cheaper to rent versus buy in the current environment, but rent is still pricey.**



## 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.