Market Outlook

By Mark T Dodson, CFA

Buy stocks, rinse, repeat.

Market Risk Index climbed for the seventh straight week to 82.9%. Monetary Conditions moved closer to the 50th percentile of readings, and Psychology moved back into the worst 5% of readings. Valuations were unchanged and are in the worst 1% of readings.

With the Monetary Composite approaching the 50th percentile, we note that it's the yield curve that continues to weigh heaviest on Monetary Conditions. This month will be the 20th in a row that the yield curve has remained inverted. As yield curve inversions go, it's long in the tooth, but it's not a record. It's still a month shy of the 1980 inversion that Paul Volcker led to squash the 70s-era inflation, and it's three months shy of the 1929 yield curve inversion.

Within the Psychology Composite, the Technical Indicators category turned cautious this week, as the most recent round of new highs by the cap-weighted S&P 500 index were the loneliest of 2024 with a notable drop in participation – Nvidia's good news appeared to have sucked the air out of the room. The money required to lift it higher came at the expense of many other stocks. Before the most recent week, the only glaring fault the market faced technically was the persistent warning coming from the NASDAQ High Low Logic Index, which flashed a sell signal in early 2024.

However, it's the desire to speculate on leveraged, concentrated bets that stands out among the categories of Psychology indicators. Assets in Leveraged ETFs set a new cycle high this month and climbed within 5 percent of the December 2021 all-time high. Rydex Ratio is within two percent of its all-time high, also set in December 2021. Asset Managers' Net Exposure to US equities using derivatives – futures and options on futures – set another new all-time high. Ironically, Asset Manager's Net Exposure to Treasuries is also close to approaching an all-time high.

Levering-up is pervasive – it's an overconfidence in a return to the pre-Covid era of inflation and a confidence, bordering on arrogance, that stocks only go up. If they don't, we call in the central bankers. Buy stocks, rinse, repeat.

Market Risk Index

Rec Allocation 25% Underweight

82.9%

Category Percentiles

Category	Percentile
Psychology - P6	95.2%
Monetary - M3	44.4%
Valuation - Extremely Overvalued	99.7%
Trend	44.1%

Largest Psychology Influences

Leveraged Investments	Negative
Option Activity	Negative
Consumer Confidence	Negative
Flow of Funds	Negative

Largest Monetary Influences

Interest Rate Spreads (Yield Curve)	Negative
Lending & Leverage	Positive
Velocity - Money Supp vs Demand	Positive

Valuation

7-10 Year Equity Return Forecast	0.0%
10Yr US Treasury Yield	4.5%

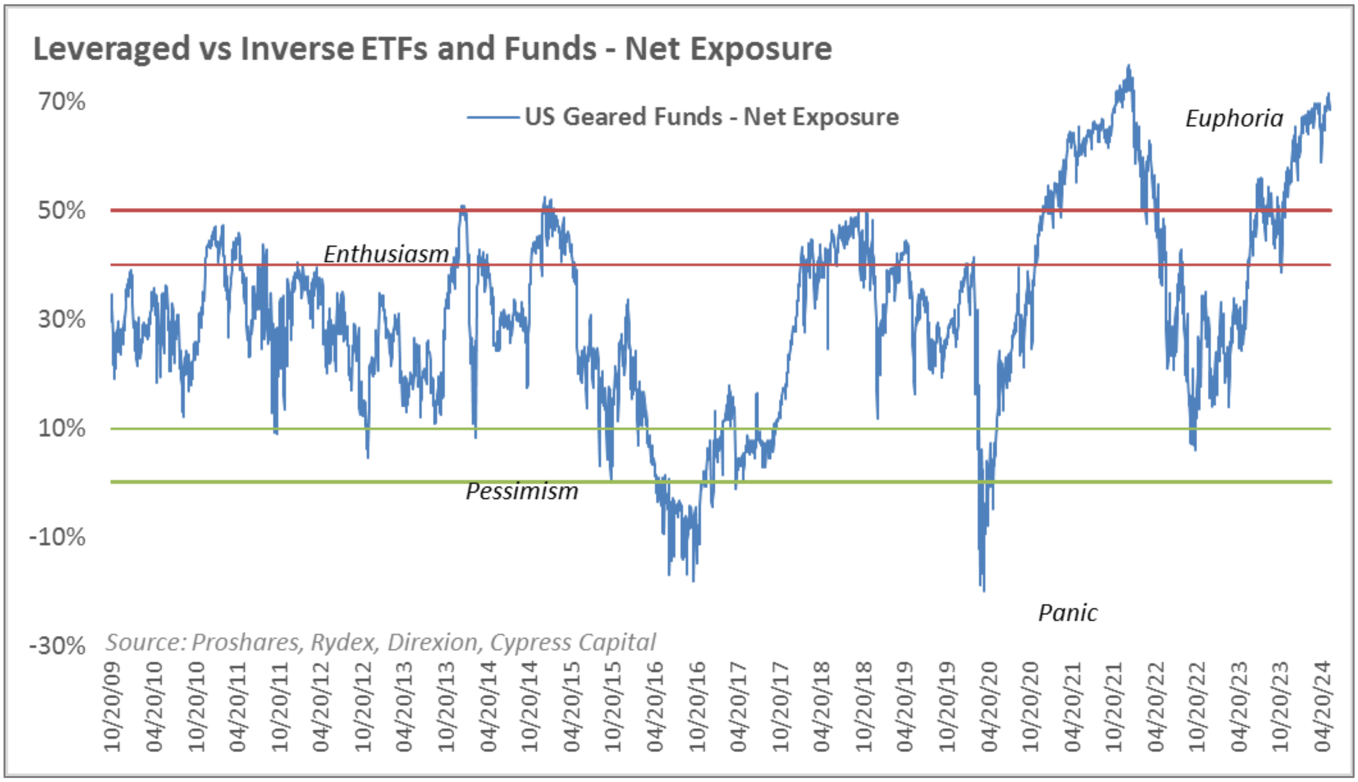
Market Trends

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

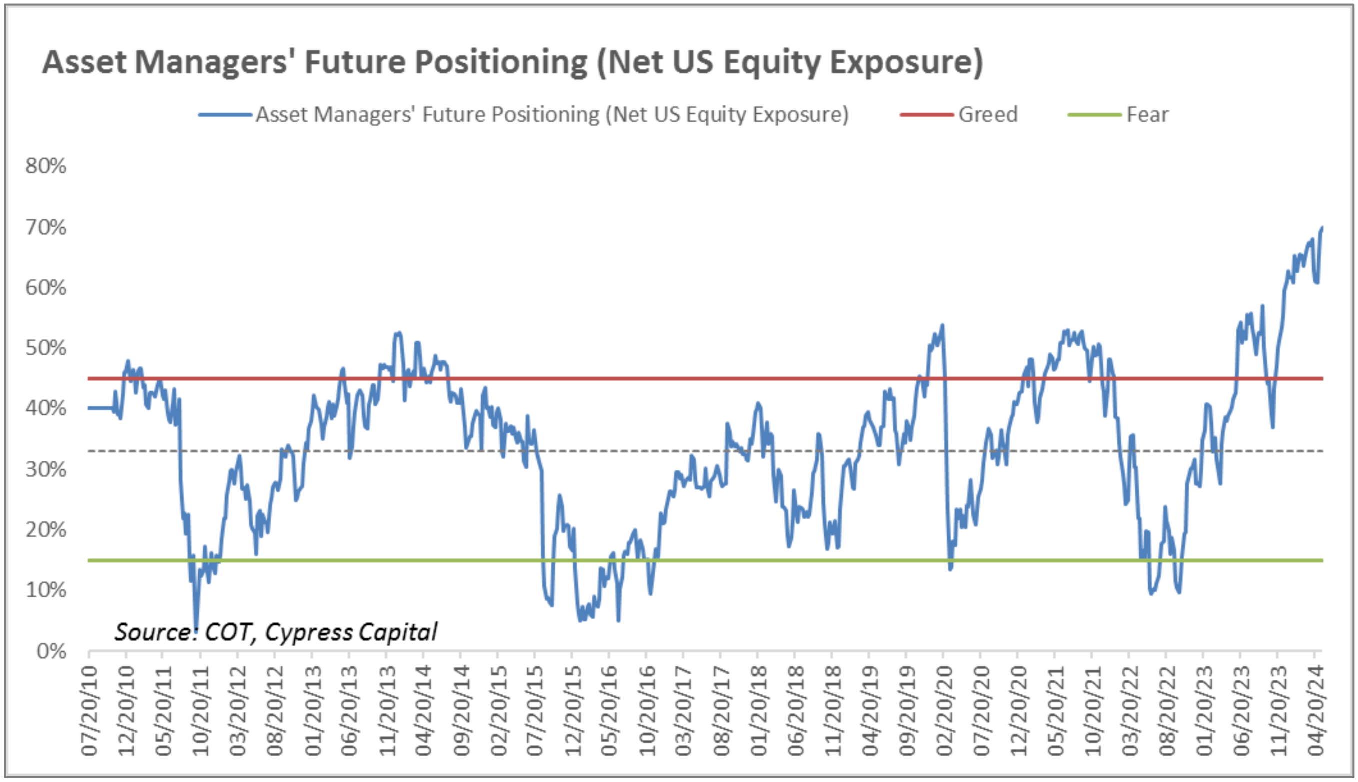
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets based on our model & opinion. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

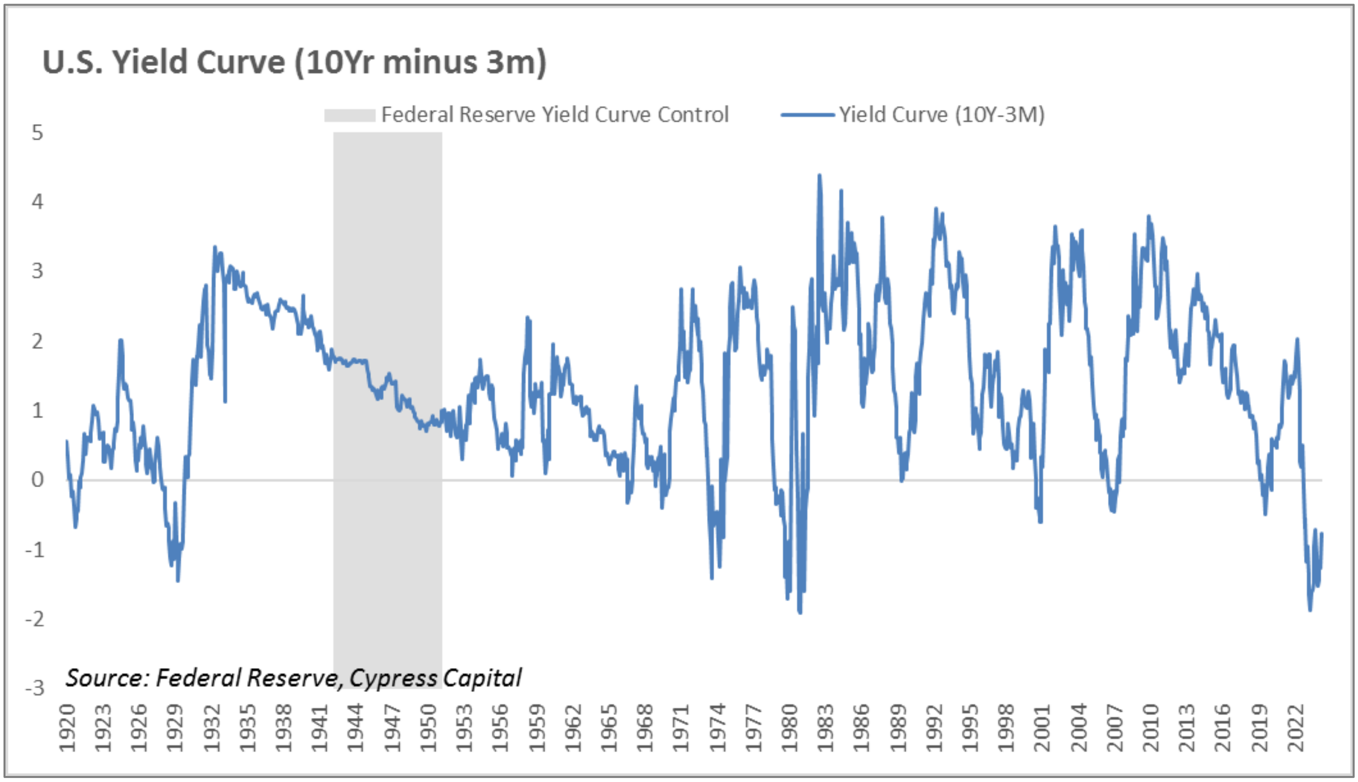
Leveraged ETF Exposure set a new cycle high.



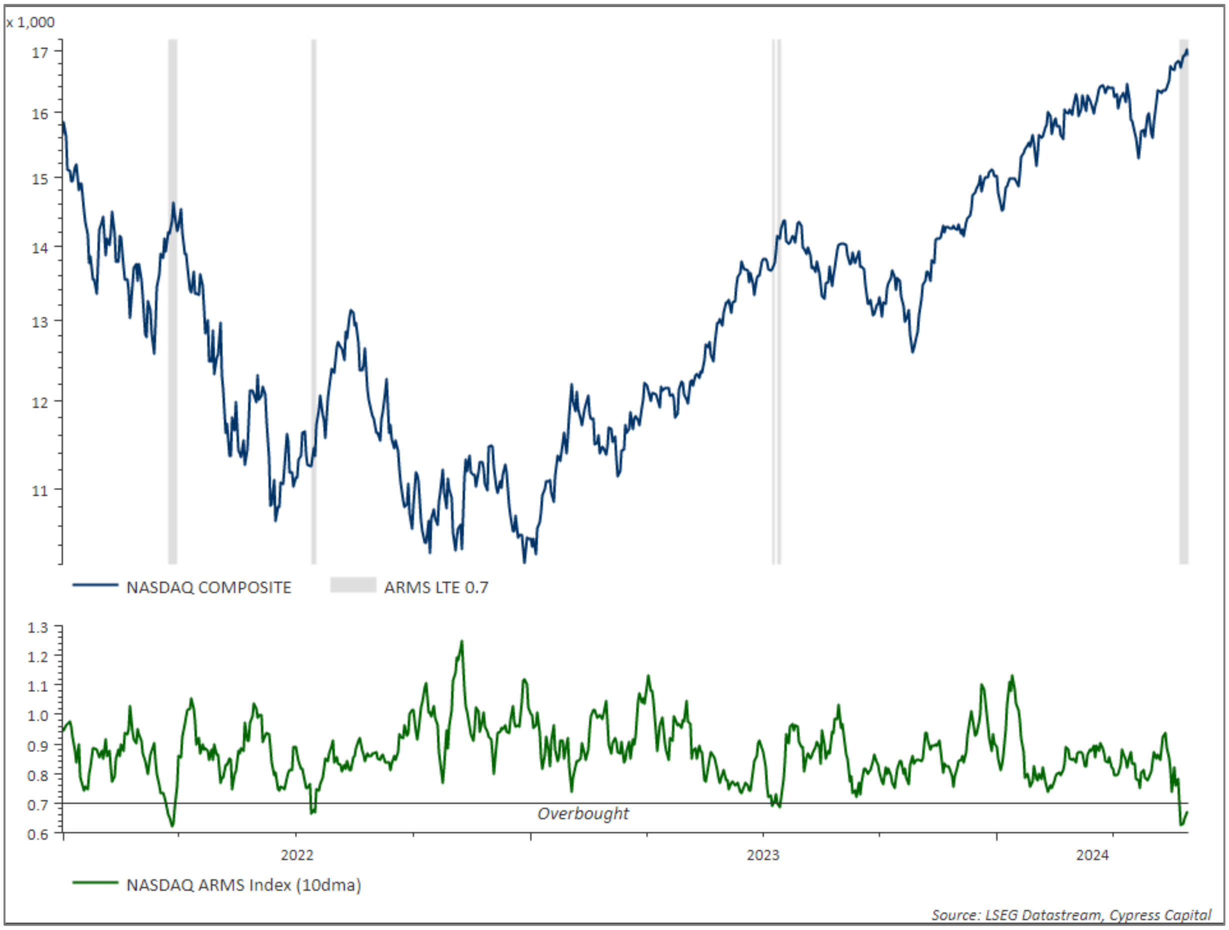
Equity Futures Positioning set another all-time high.



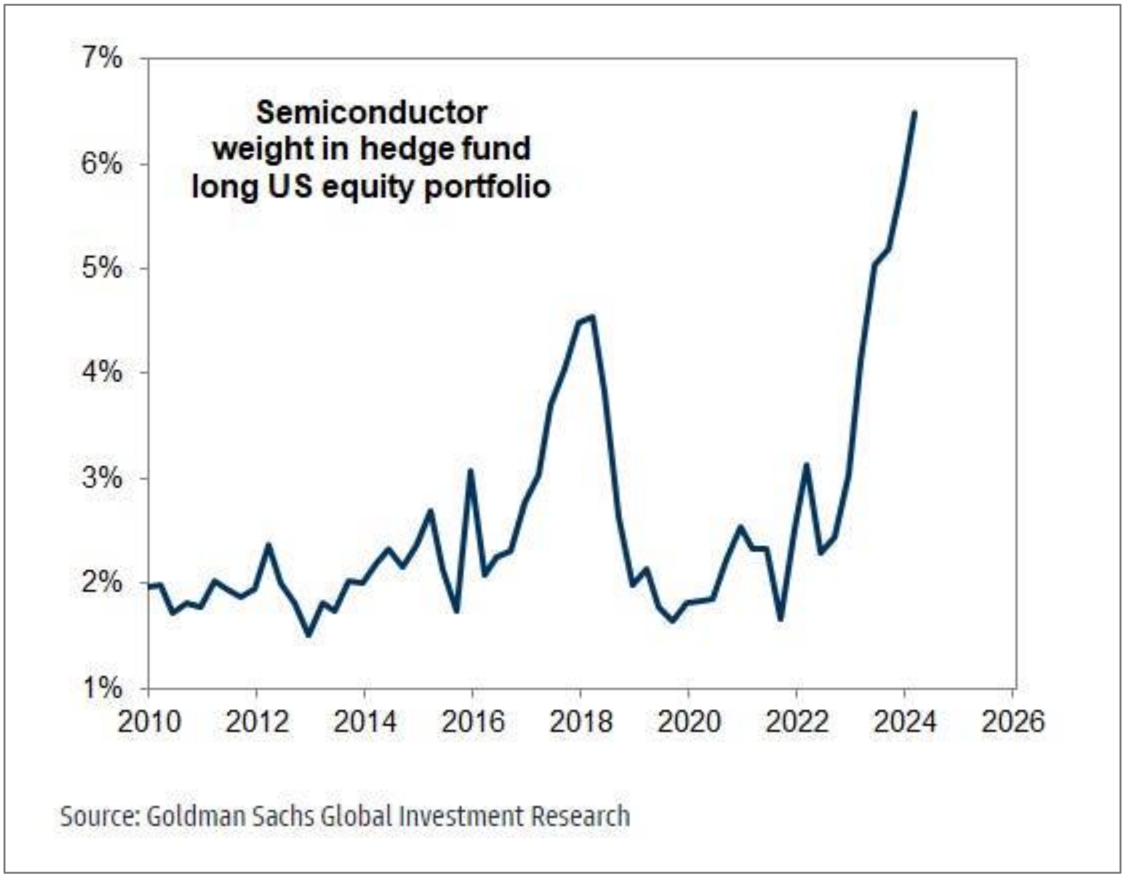
The duration of the yield curve inversion is set to become the longest in a century later this year.



NASDAQ ARMS Reading hit the lowest reading (most overbought) since March 2022.

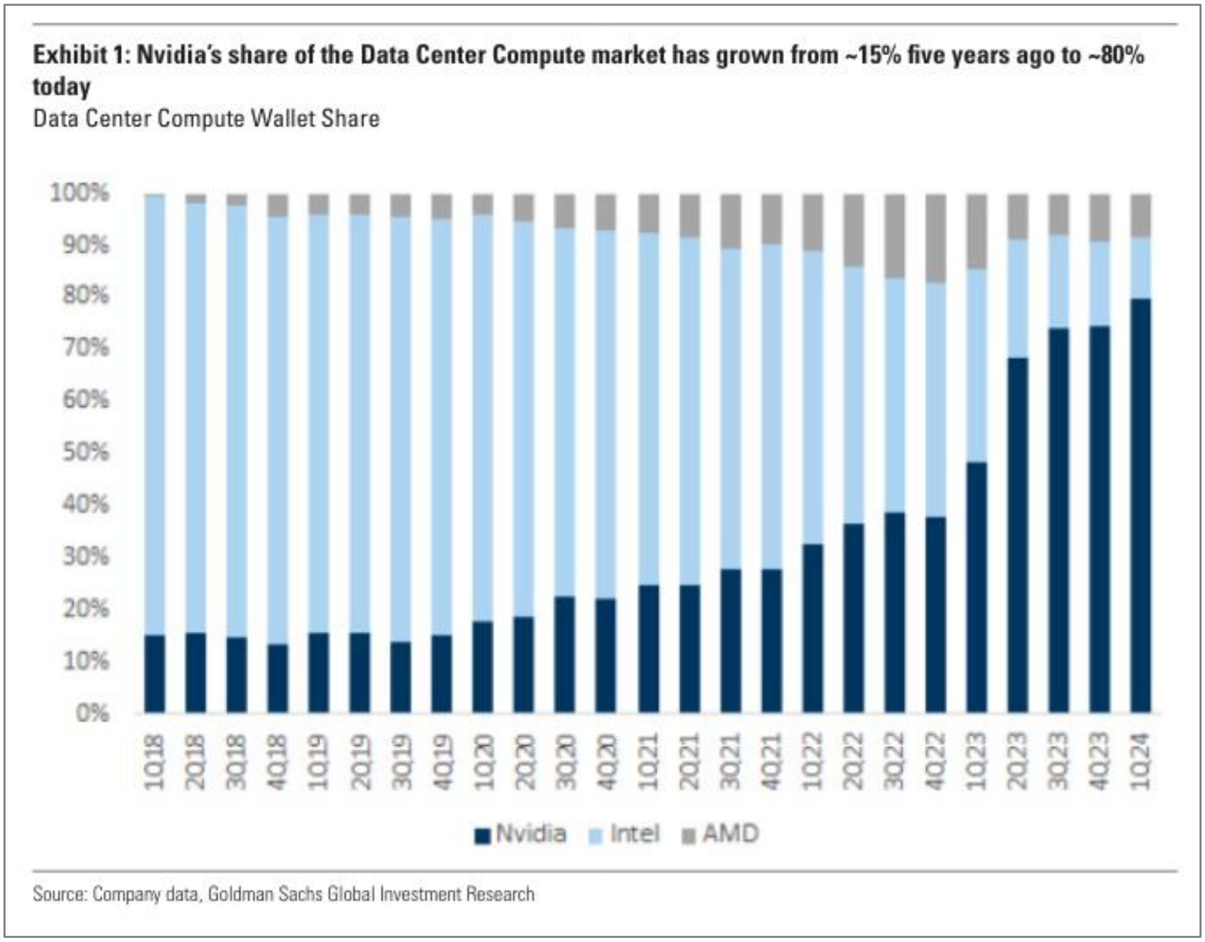


Hedge Funds have loaded up on NVDA.

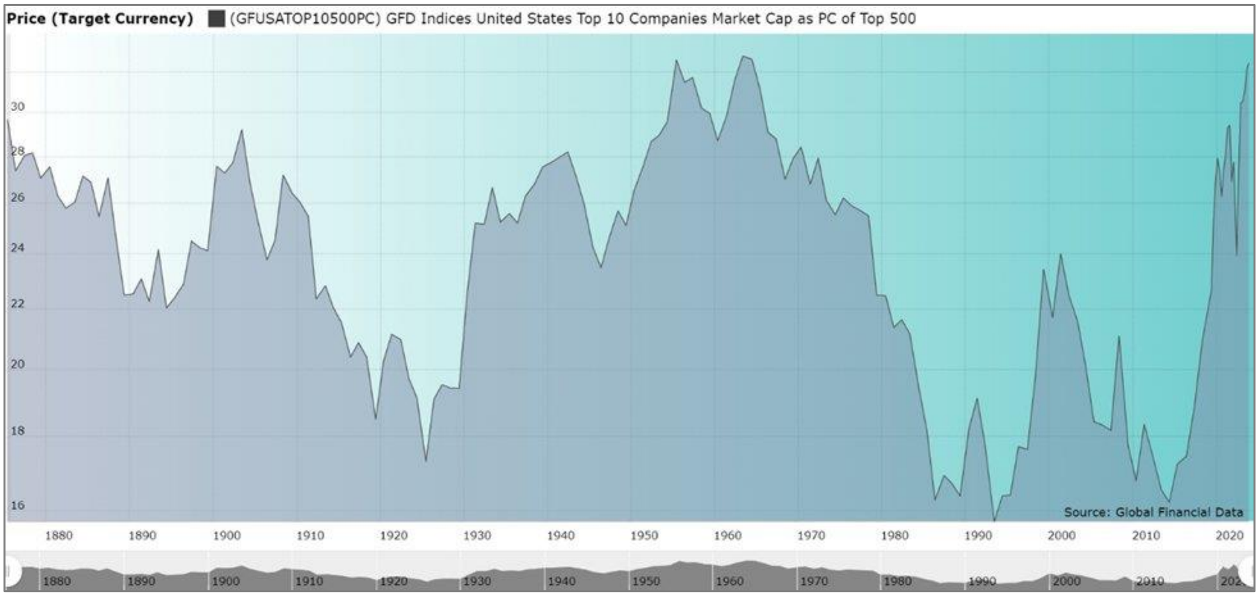


100 Percent of Analysts have Buy recommendations on Nvidia.

Nvidia chips are dominating Data Centers.

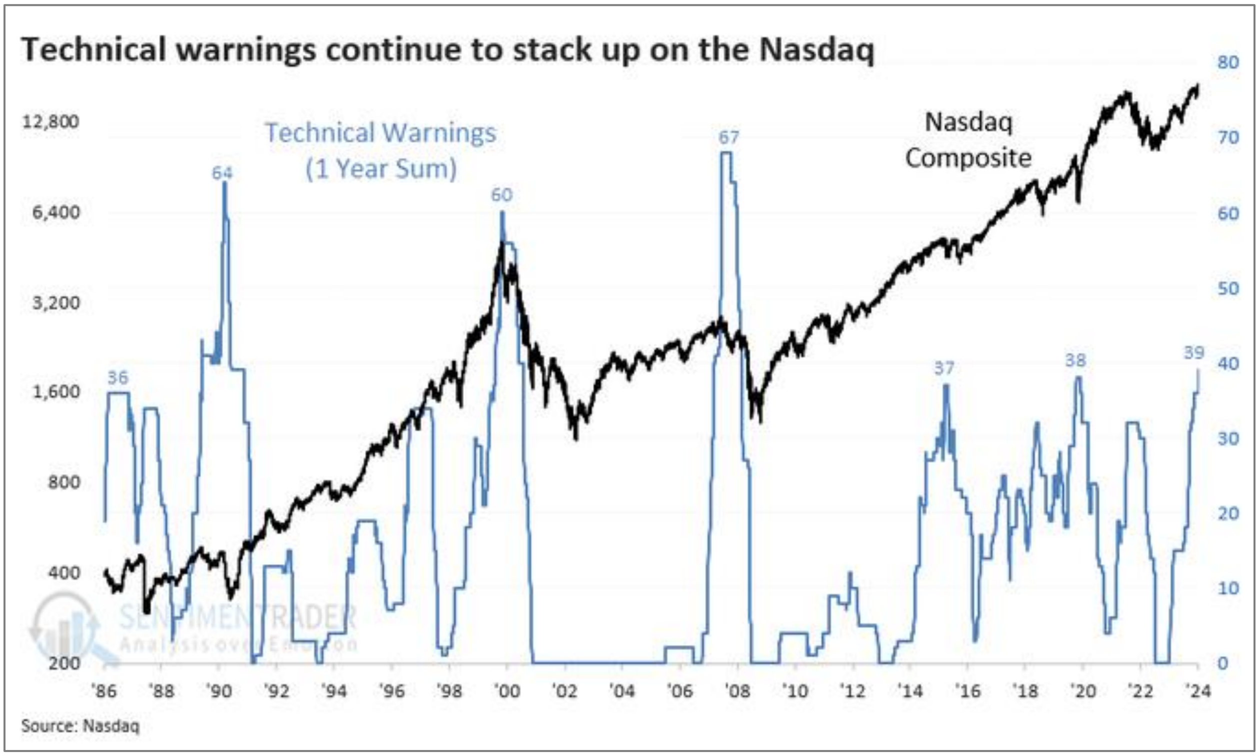


Only the Go-Go Years in the mid-60s saw higher stock market concentration than today.



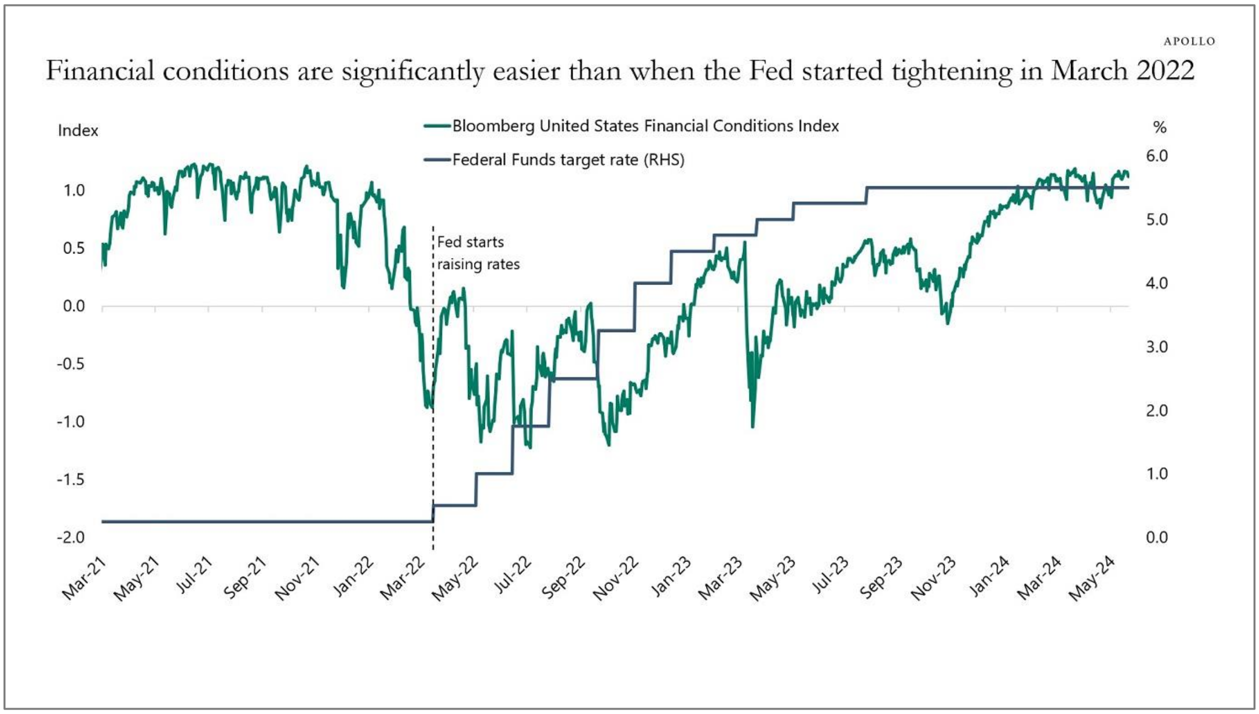
Source: Meb Faber

NASDAQ Technical Warnings are stacking up.
High Low Logic has been elevated since January, which has led to multiple Titanic and Hindenburg Syndromes.



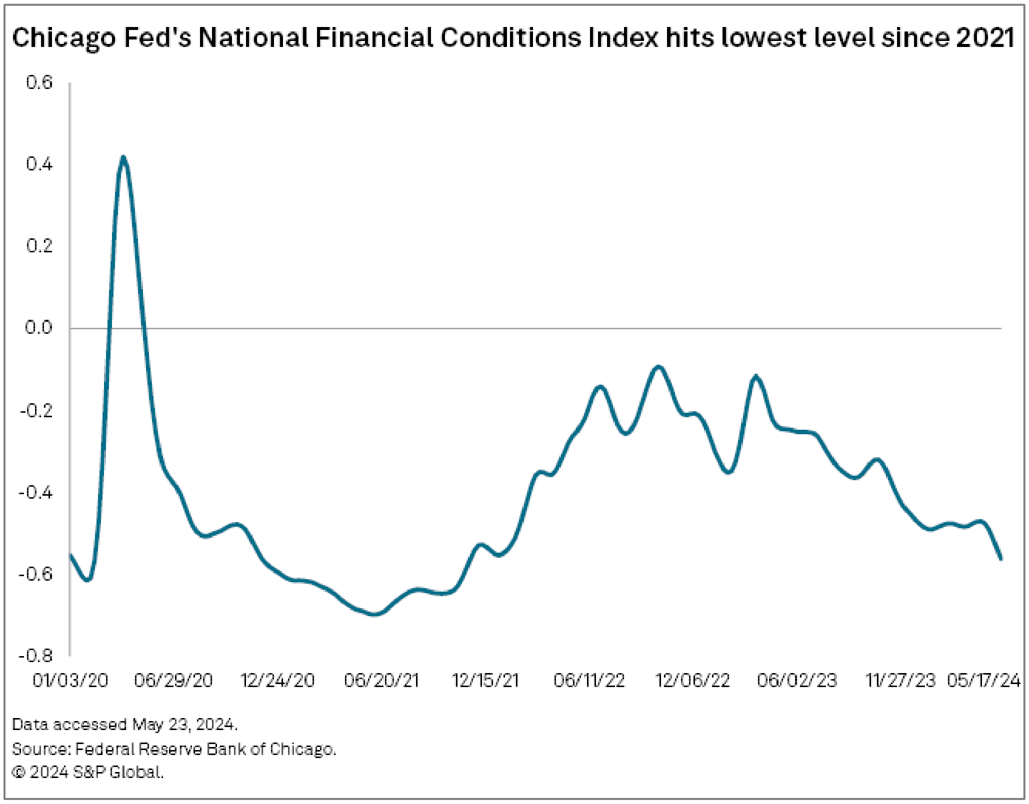
Source: SentimenTrader

Financial Conditions are easier now than when the Fed first started tightening.

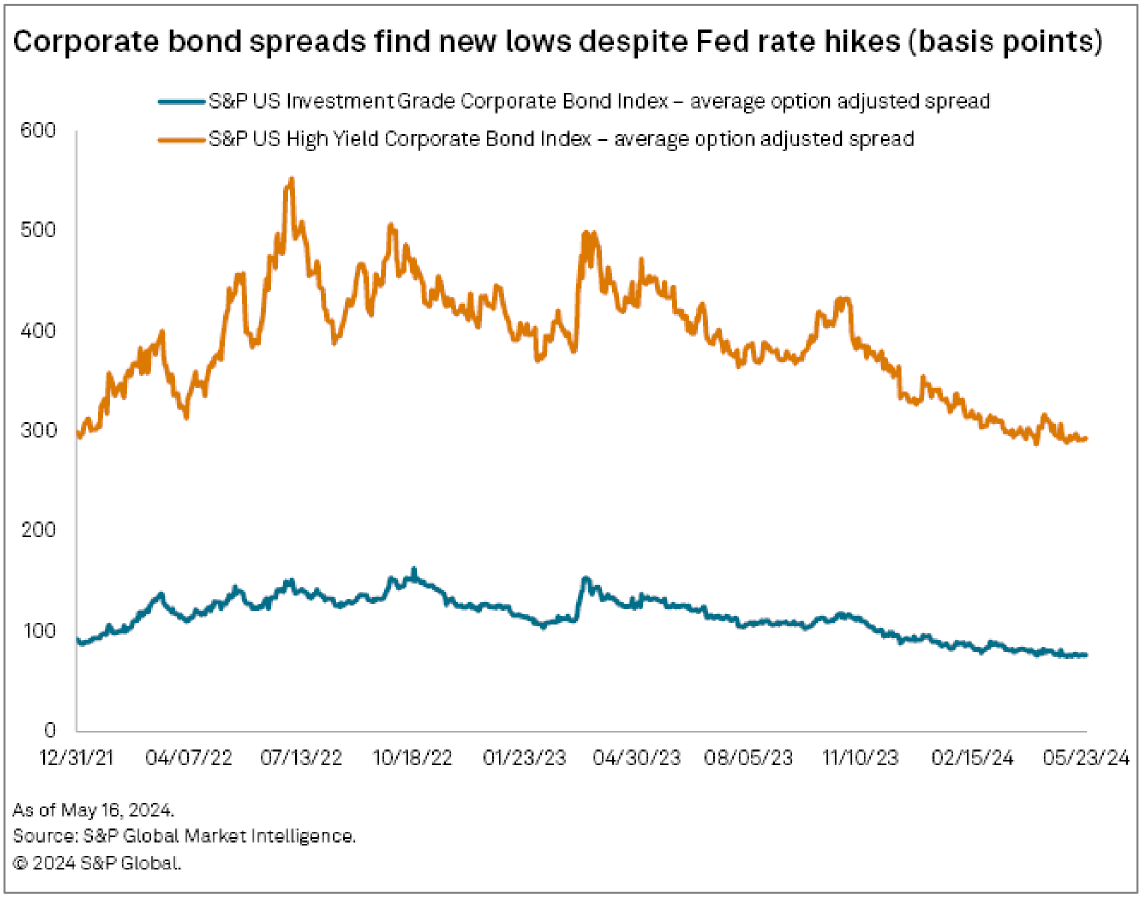


Source: Torsen Slok

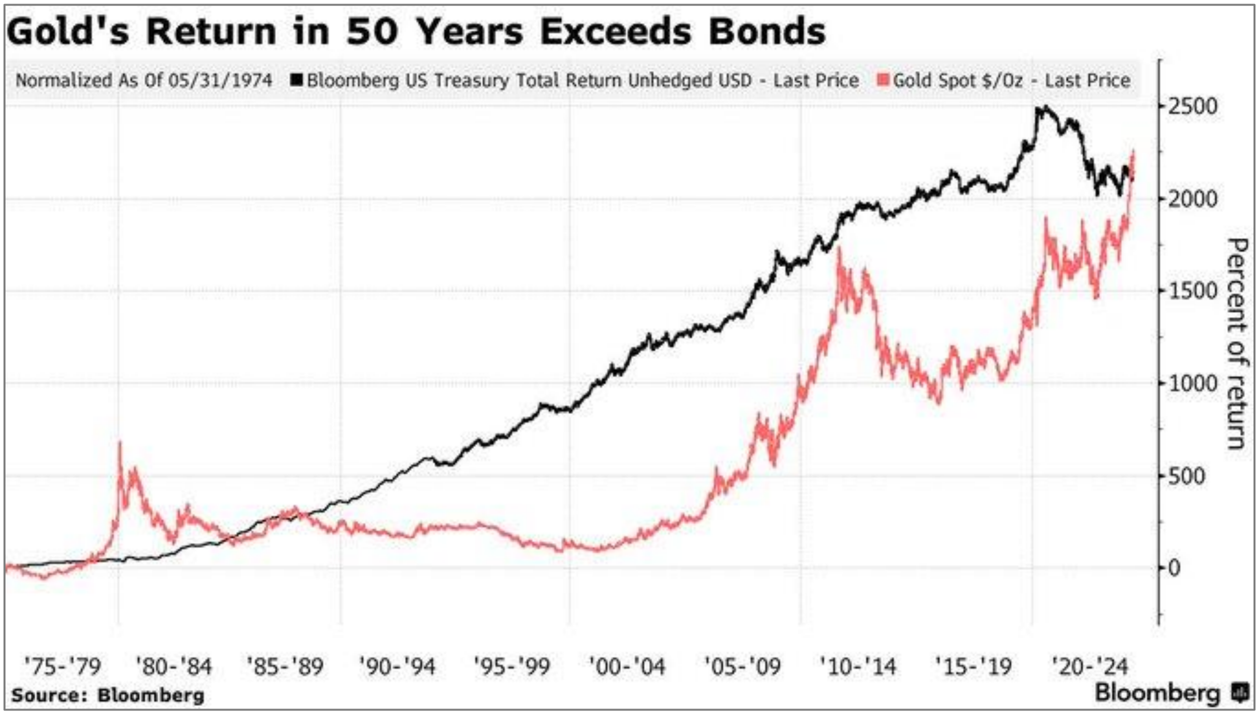
Should we expect Fed cuts if Financial Conditions are as easy as they were when rates were 0%?



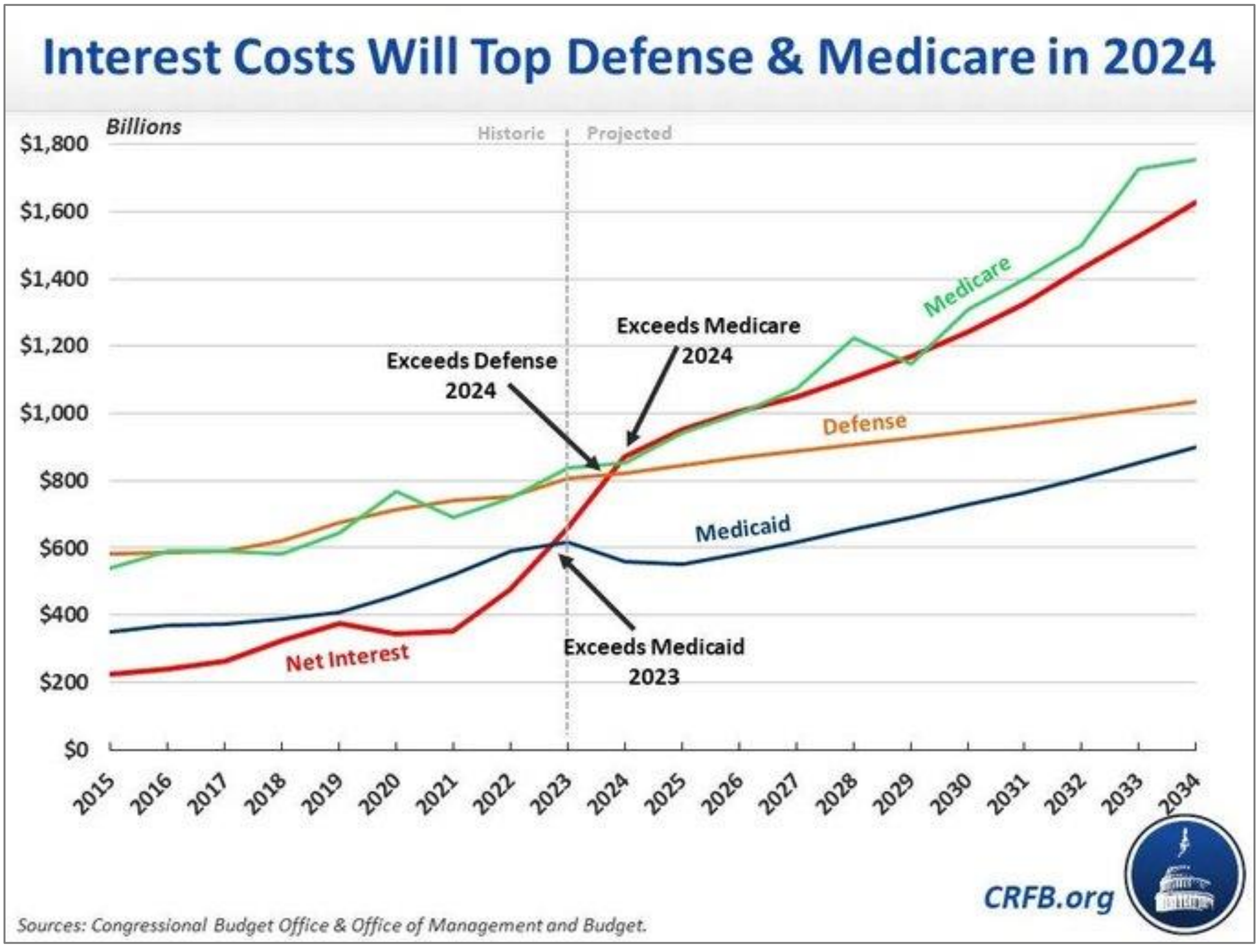
Corporate Bond Spreads aren't arguing for a Fed cut anytime soon.



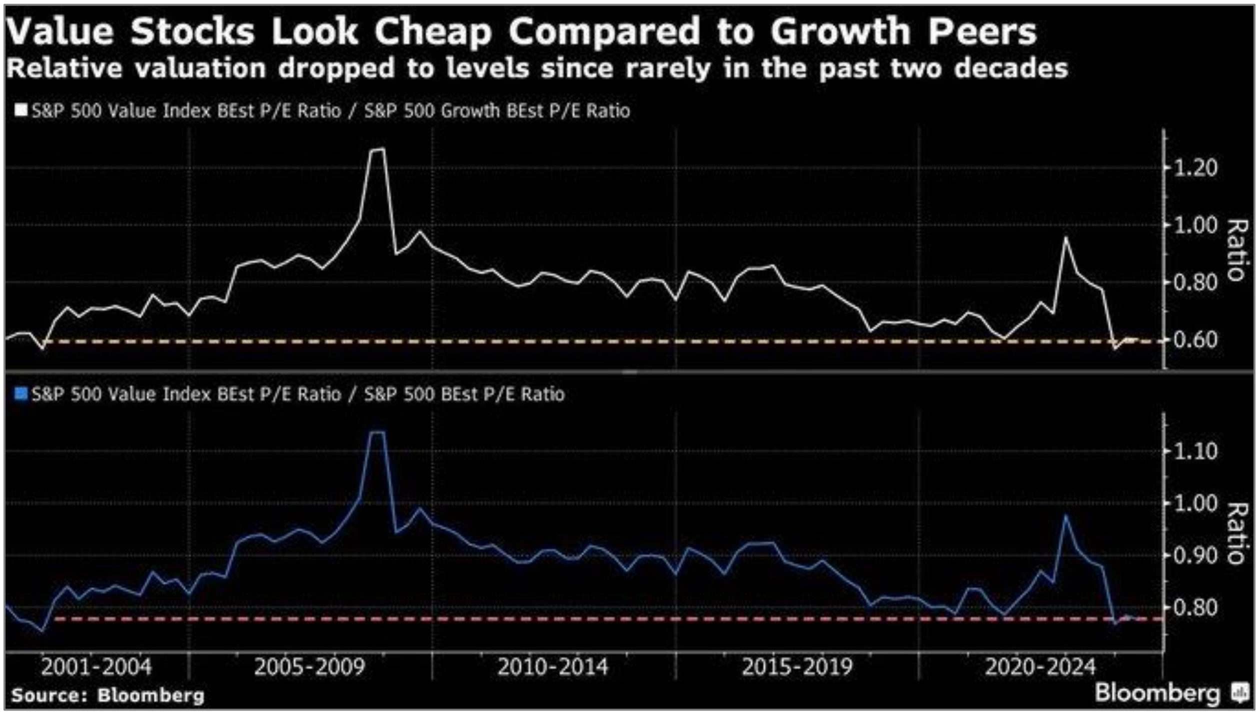
Gold has outperformed Treasuries over the last 50 years.



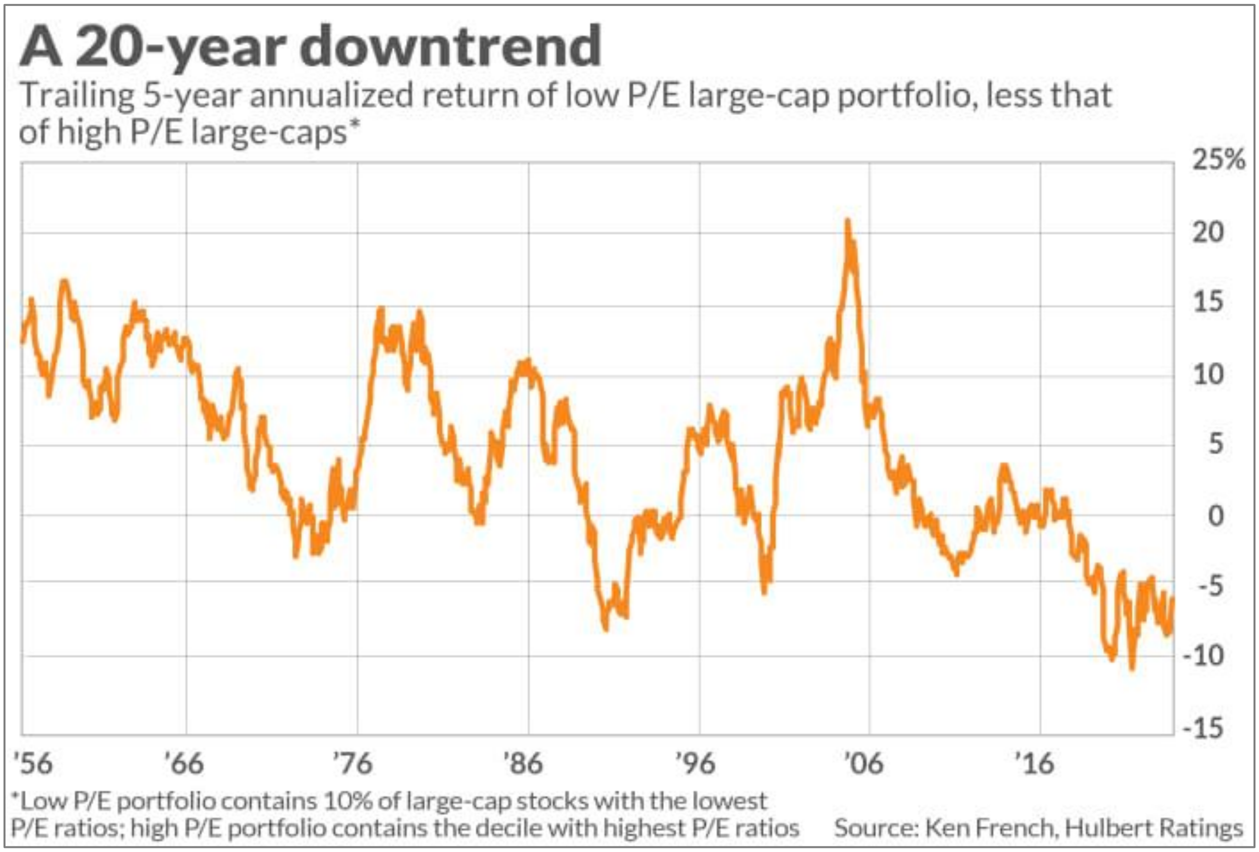
Interest payments on the Federal debt will be higher than Medicare and Defense Spending in 2024.



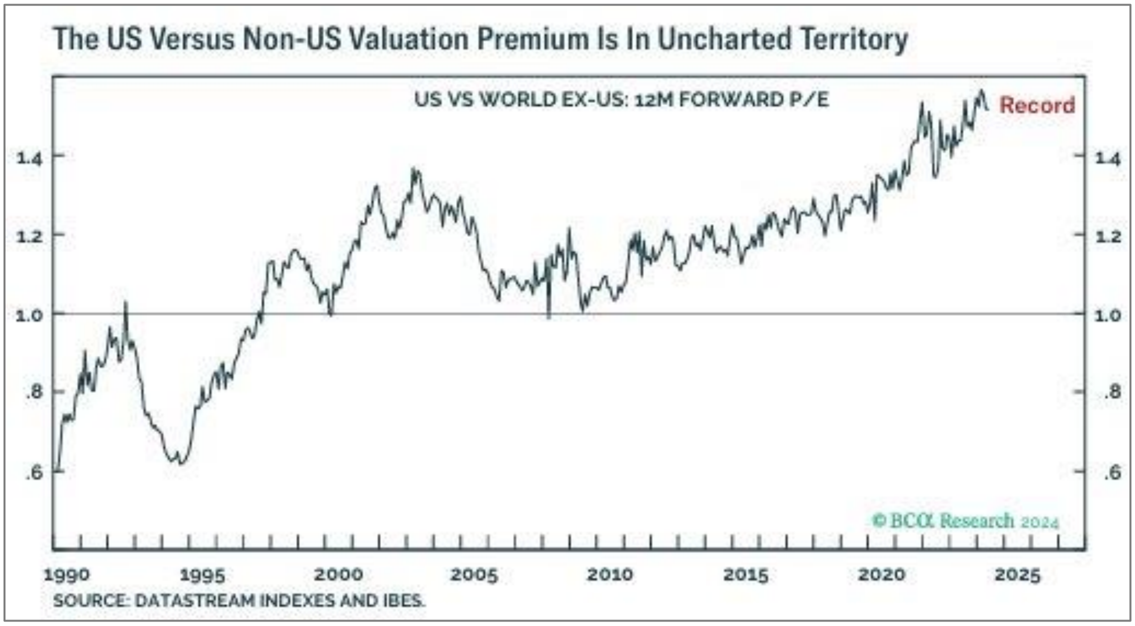
Relative valuation of Value stocks dropped to 20-year lows.



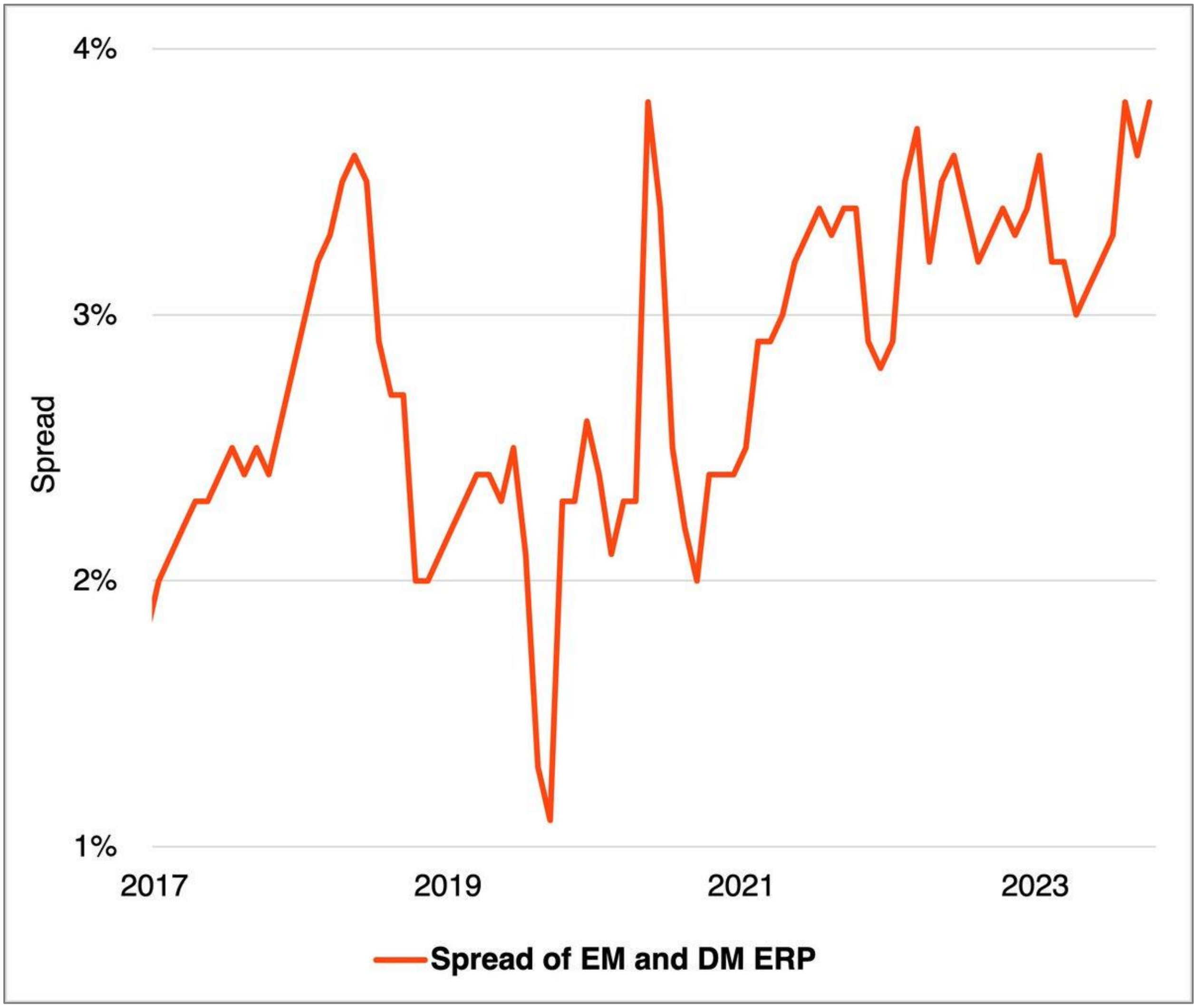
QE and Covid-stimulus eras have coincided with a record stretch of Growth stock outperformance.



US versus International Valuation Premium set a new record.



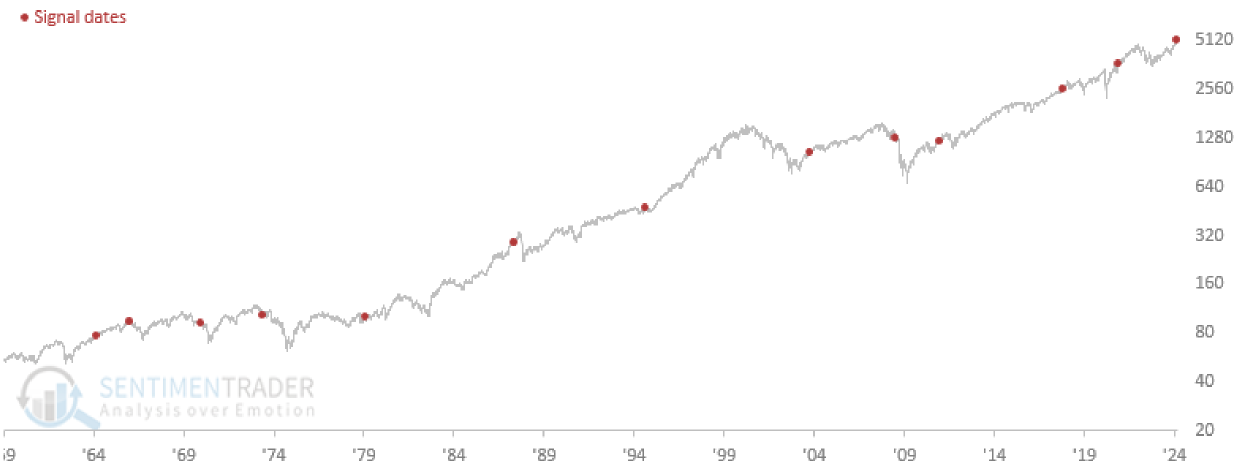
Post-Covid Era stock market investors have shunned Emerging Markets.



Source: DailyChartbook

When Dr. Copper gets bullish, stocks tend to languish.

S&P 500 after copper closes at 3-year high, 1st time in > 1 year



Dates of 12 Signals	1 Week Later (%)	2 Weeks Later (%)	1 Month Later (%)	2 Months Later (%)	3 Months Later (%)	6 Months Later (%)	12 Months Later (%)
1964-02-17	0.3	1.0	2.5	4.0	4.2	6.3	10.6
1966-01-14	0.0	-0.2	0.2	-6.0	-1.6	-6.9	-9.8
1969-12-05	-1.0	-0.4	1.0	-6.4	-3.5	-17.0	-3.1
1973-05-22	2.2	0.7	-0.4	3.8	-2.6	-2.8	-15.1
1979-01-30	-3.0	-2.1	-4.1	0.5	0.6	2.7	12.9
1987-05-11	-1.7	-0.8	2.0	5.8	12.5	-14.1	-12.0
1994-08-31	-0.5	-0.1	-2.7	-0.7	-4.6	2.0	18.0
2003-10-20	-1.3	1.4	-1.0	4.3	9.9	7.6	5.6
2008-07-02	-0.6	-0.1	-0.1	1.3	-8.0	-28.4	-28.9
2010-12-08	0.6	2.5	3.5	7.8	5.4	4.9	2.7
2017-10-13	0.9	1.1	1.2	4.3	8.7	6.0	7.7
2020-11-25	1.0	1.1	2.9	4.3	7.5	15.8	26.6
2024-05-14							
Mean	**-0.3**	**0.3**	**0.4**	**1.9**	**2.4**	**-2.0**	**1.3**
Median	**-0.3**	**0.3**	**0.6**	**3.9**	**2.4**	**2.4**	**4.2**
% Positive	**42%**	**50%**	**58%**	**75%**	**58%**	**58%**	**58%**
Avg Max Loss	-0.8	-1.6	-1.9	-3.0	-3.8	-9.5	-12.9
Avg Max Gain	0.8	1.2	1.9	3.7	5.7	7.9	11.7
Z-Score	-1.0	0.1	0.0	2.2	0.4	-0.2	-0.5

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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.