Cypress CAPITAL

Market Outlook

By Mark T Dodson, CFA

Complacency Prevails

Market Risk Index climbed to 91.8%, the highest level since the 2021 bull market peak. Improvements to our Psychology Composite weren't enough to overcome another move in the wrong direction from the Monetary Composite.

Psychology improved, but it's still in the top 10% of euphoric readings. The Surveys and Option Activity categories became two of the four largest detractors of the Psychology Composite, as the reprieve in sentiment for those categories after the August 5th stock market decline was short-lived. Bullishness among the most popular investor surveys has rebounded, and put/call volume has shifted back to enthusiastic call buying.

Any time we start to question whether our Psychology composite is over-estimating the level of complacency and greed present in markets, we seem to get anecdotal evidence of the persistent speculative gamification of financial markets, like news stories this week of watch parties at the local bar counting down the release of NVDA earnings.

Asset Managers' Futures positioning came close to challenging record-long exposure for both US Equities and US Treasuries. It's consistent with the Consumer Confidence survey release, which showed consumers haven't been this confident that stocks are going higher and interest rates are headed lower since 2001. For leveraged investors, we think it means that gross exposure to financial assets is too high, which implies any stock market correction could prove more violent and limit the ability of traditional safe havens to do their job.

Monetary Conditions worsened again as a result of further deterioration in Velocity. One symptom of this was an acceleration of MZM growth in July, which fits the message from a yield curve whose slope is attempting to normalize. Traditionally, a pickup in M2 and MZM growth that coincides with a yield curve trying to re-steepen is a recession warning.

Unlike Futures speculators, we still believe that TIPS are the only attractive, longer-duration option for fixed-income investors. Real yields on TIPS are relatively high, and nominal Treasuries are trading at levels consistent with two percent inflation. There's a lingering belief in bond markets that we will revert to the pre-COVID era of

Market Risk Index

Rec Allocation 25% Underweight

91.8%

Category Percentiles

Psychology - P6: 92.9%

Monetary - M4: 63.7%

Valuation - Extremely Overvalued: 100.0%

Trend: 47.0%

Largest Psychology Influences

Leveraged Investments	Negative
Consumer Confidence	Negative
Option Activity	Negative
Surveys	Negative

Largest Monetary Influences

Interest Rate Spreads (Yield Curve)	Negative
Lending & Leverage	Positive
Monetary Velocity	Negative

Valuation

7-10 Year Equity Return Forecast	-0.4%
10Yr US Treasury Yield	3.9%

Market Trends

US Equities	Bullish Investment
Intl Equities	Bullish Investment
REITs	Bullish Investment
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.

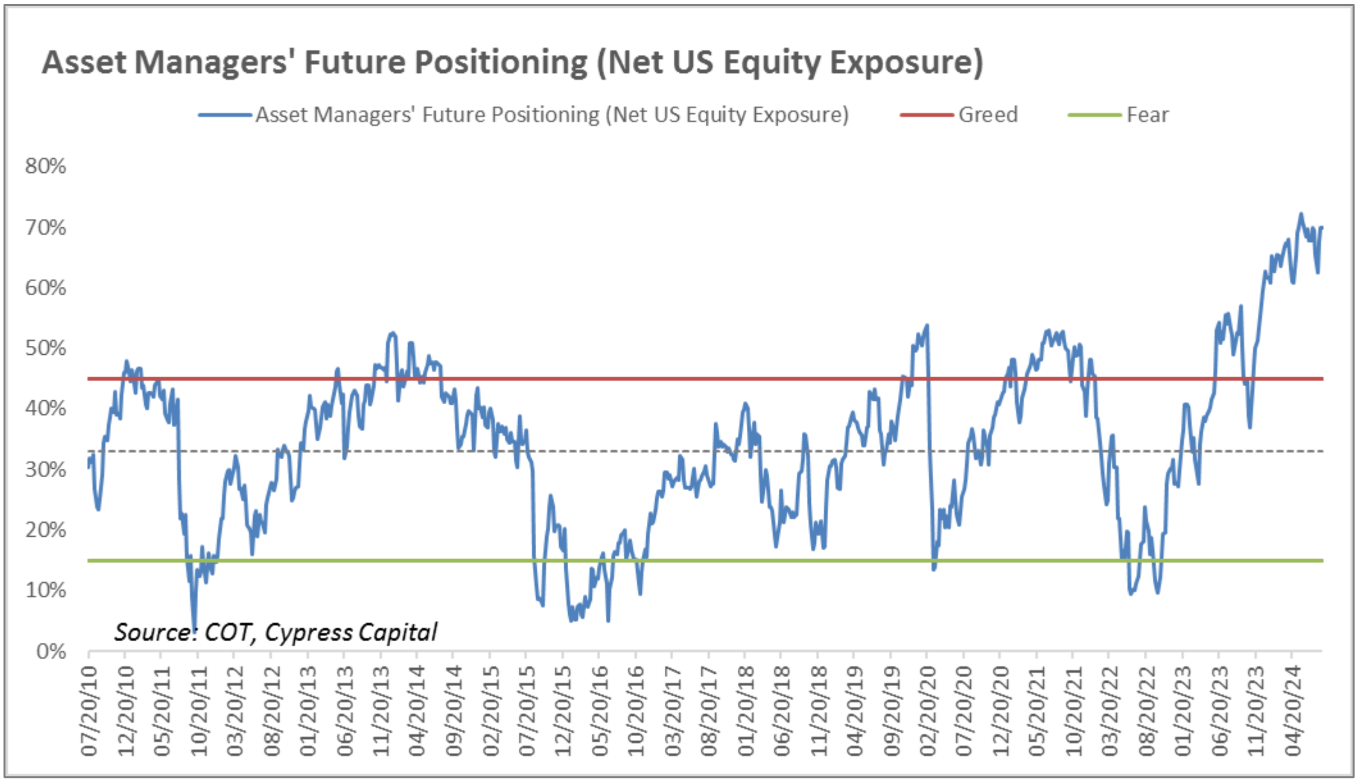
inflation and Fed Funds rate. Persistent, recession-level government deficits should give fixed income investors less confidence in that view.

Valuations were unmoved – stuck at a reading in the 100th percentile. The average valuation metric inside our composite is at all-time highs, and our equity return forecast based on Internet-era valuations hit a new all-time low this week. That forecast regresses forward stock market returns against valuations that have prevailed since the mid-1990s, when the book "Stocks for the Long Run" was released and the Internet became a thing. Since that period, valuations have generally been higher than those that prevailed for most of US financial market history.

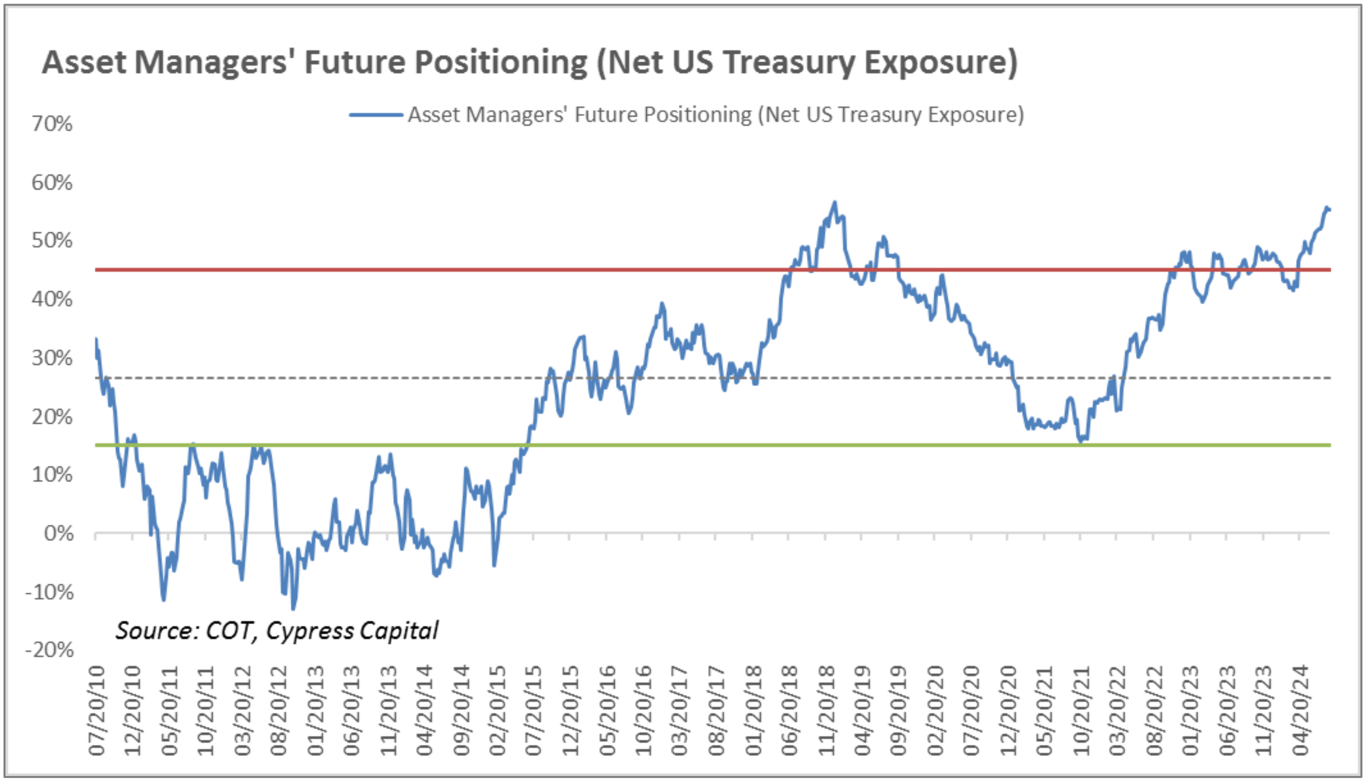
While we respect and take arguments about improving breadth, seasonality surrounding elections, and Fed-engineered soft landings to heart, a non-existent margin of safety keeps us from being aggressive in our equity allocations.

Charts of the Week

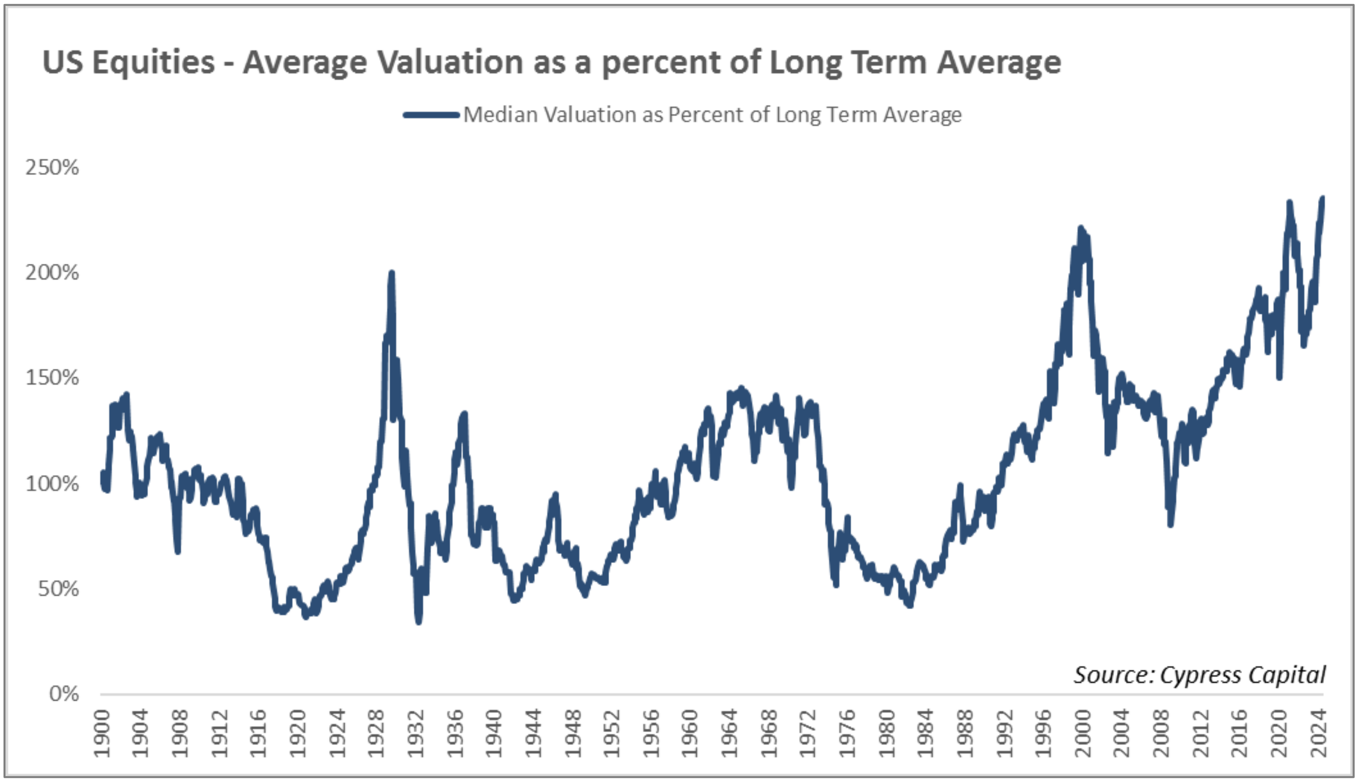
Leverage among Asset Managers swung back within three percent of a new all-time high.



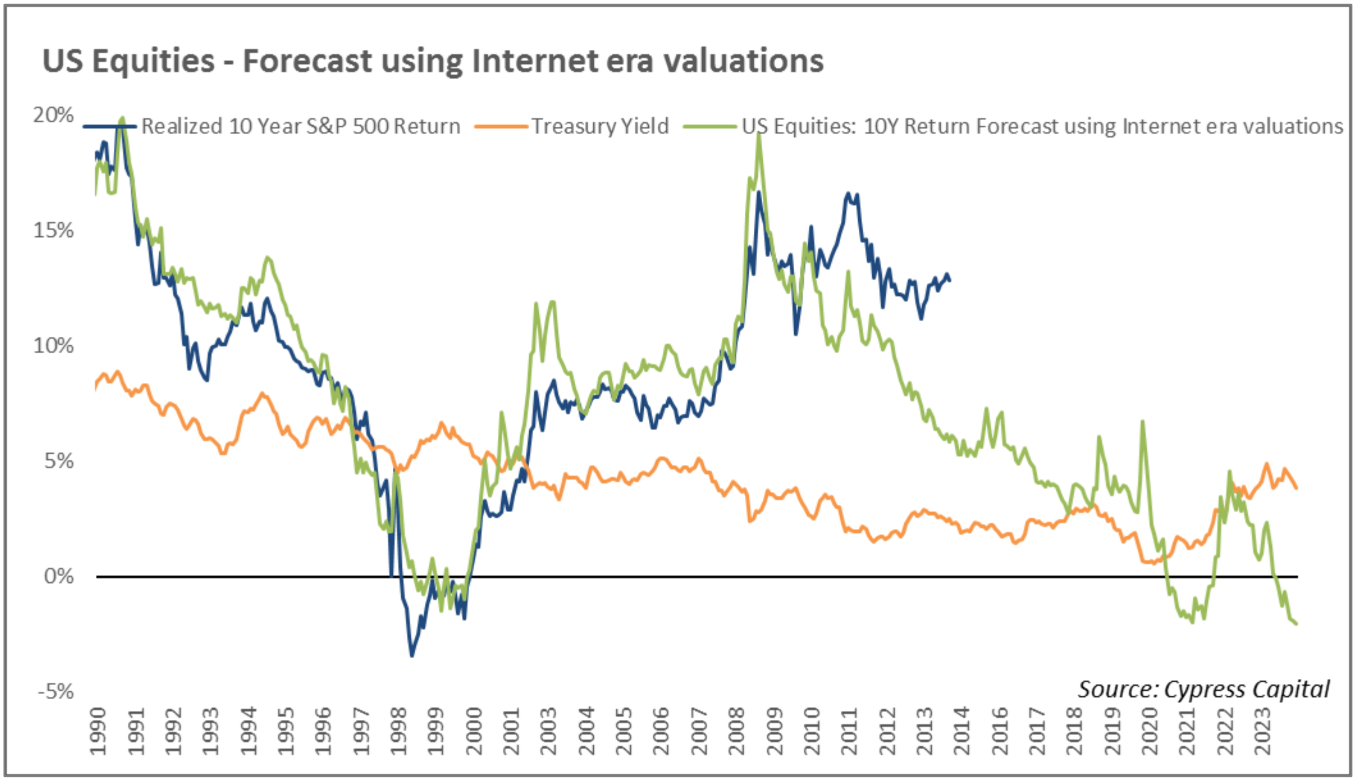
Leverage among Asset Managers to US Treasuries is within one percent of an all-time high.



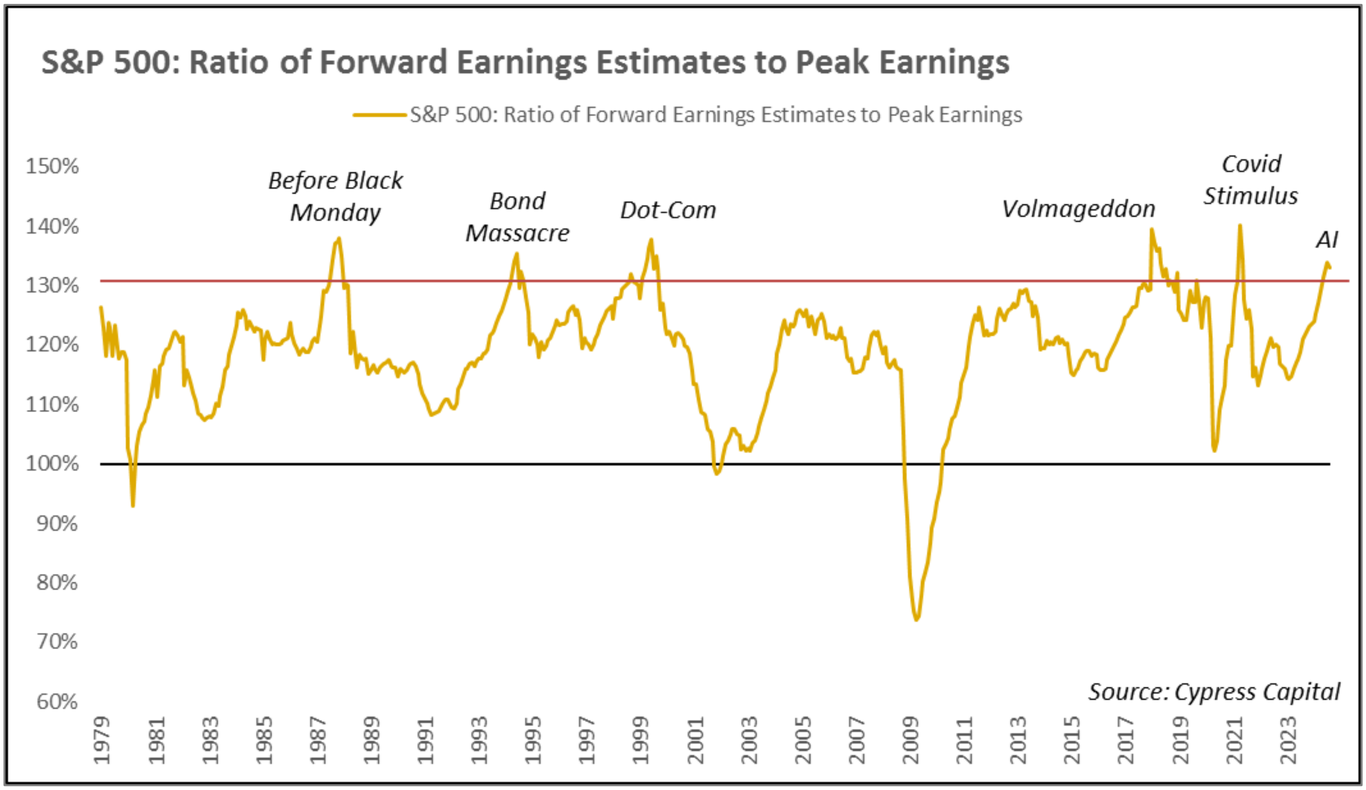
The Average Valuation Indicator inside our Valuation Composite is at all-time highs.



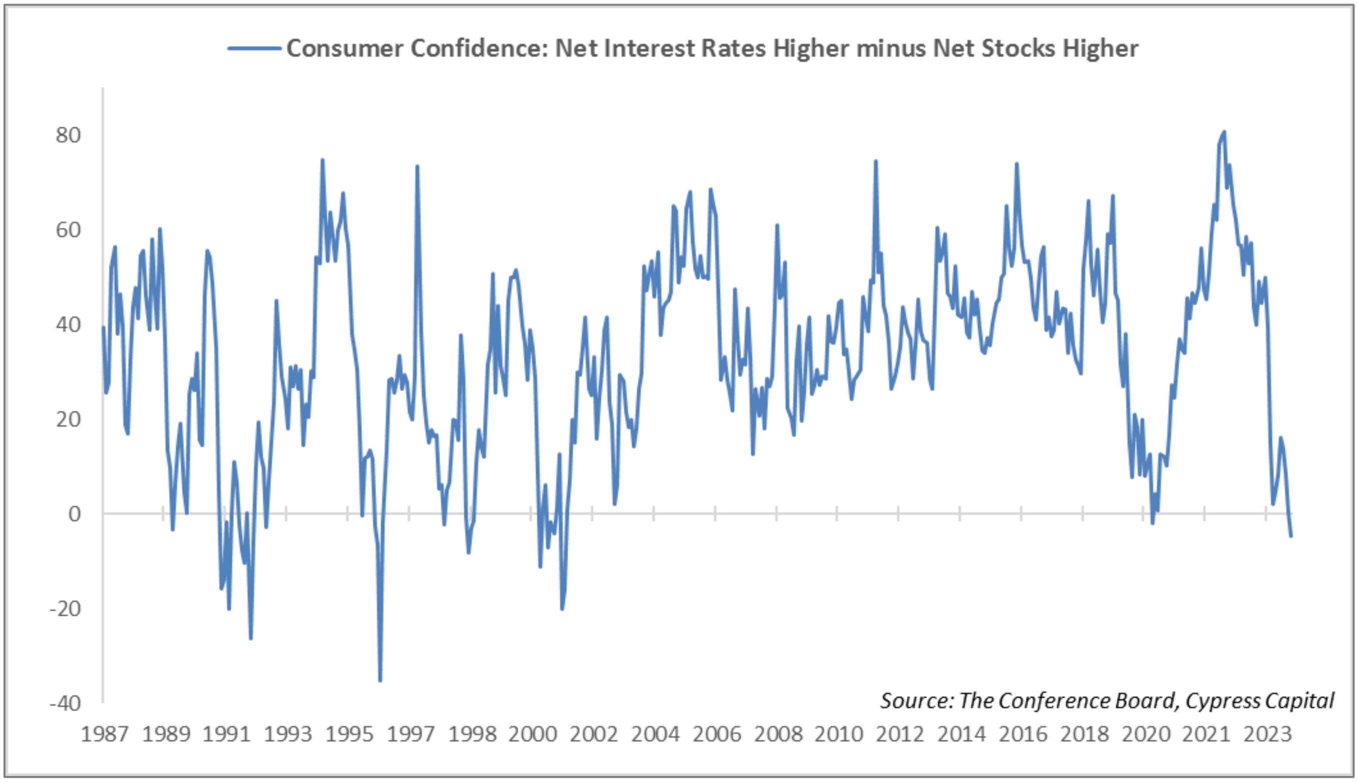
Equity Return Forecasts based on Internet-era valuations are at all-time lows.



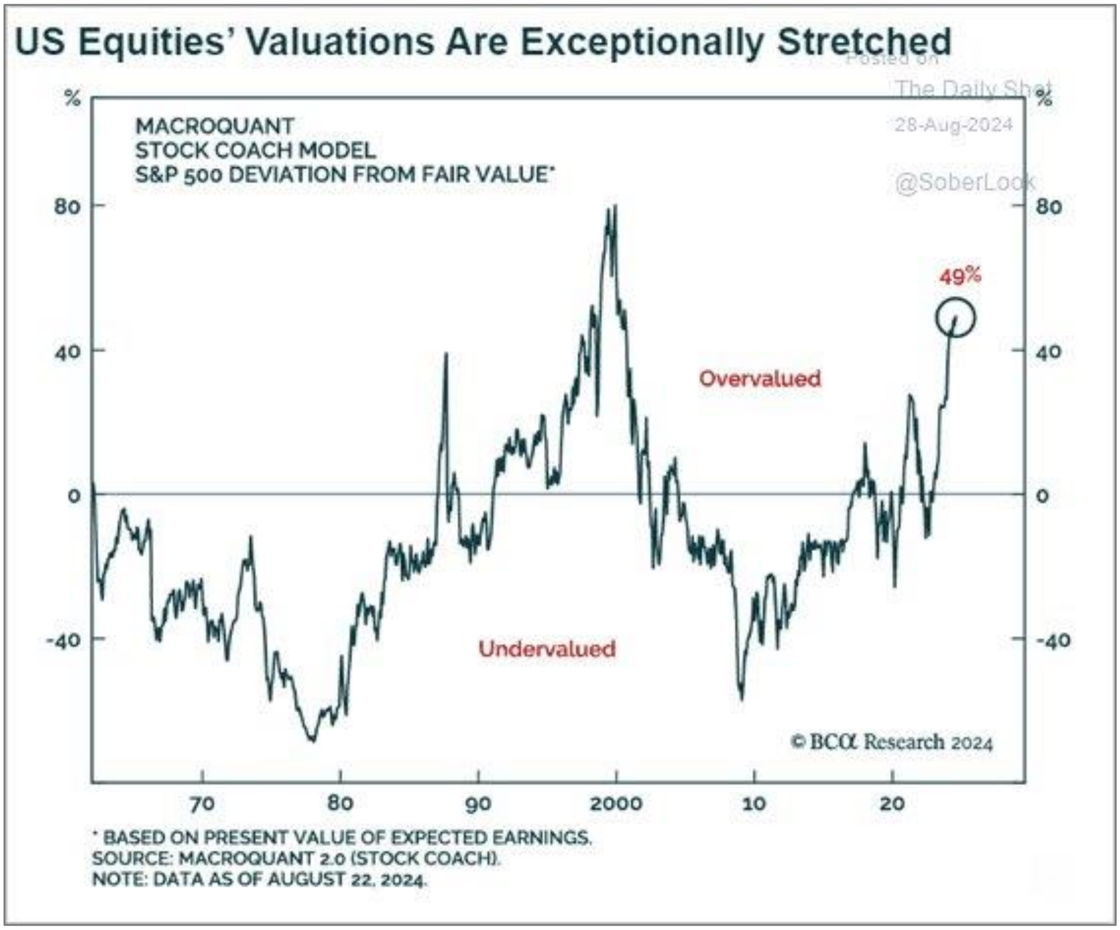
Analyst expectations for earnings growth have hit levels that have traditionally proven too optimistic.



Consumers haven't been this confident about higher stock prices and lower interest rates since 2001.

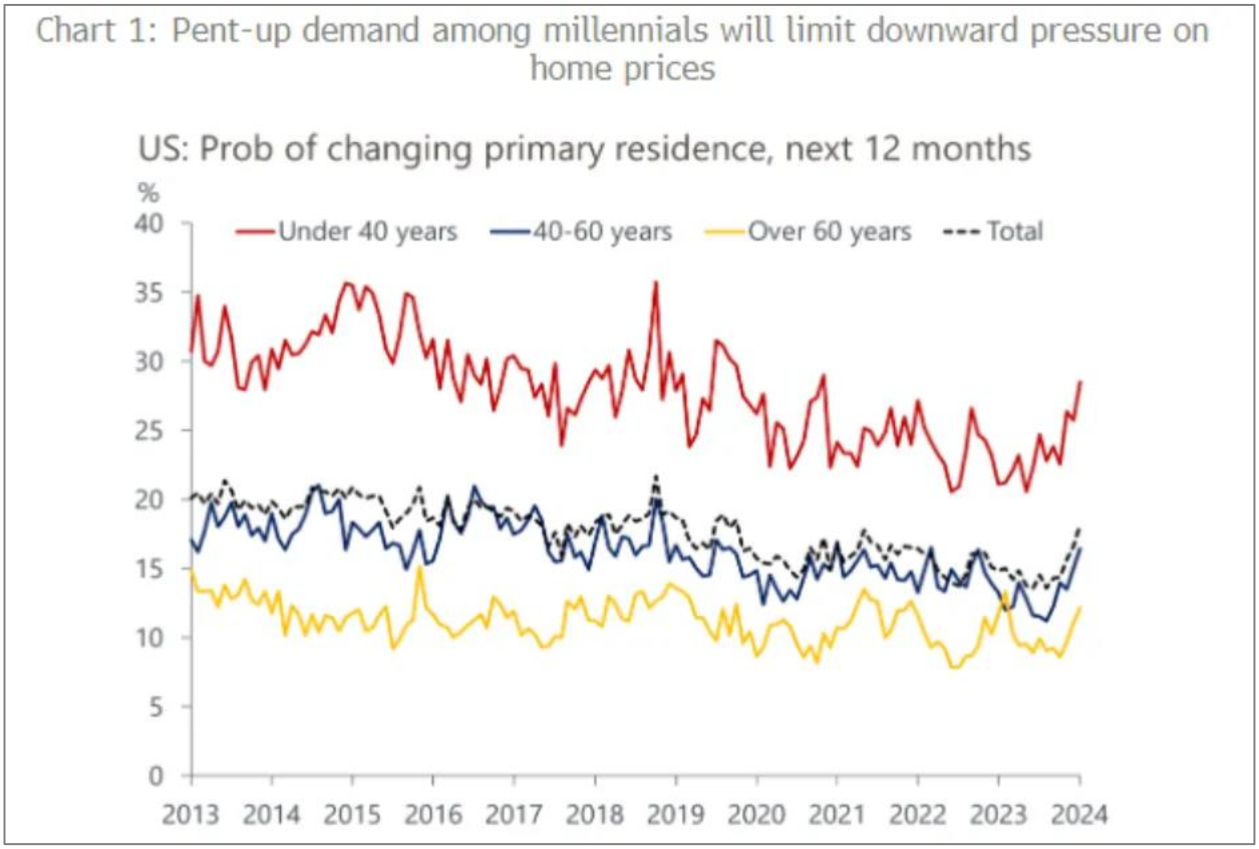


Stocks are 49% overvalued based on the present value of expected earnings.



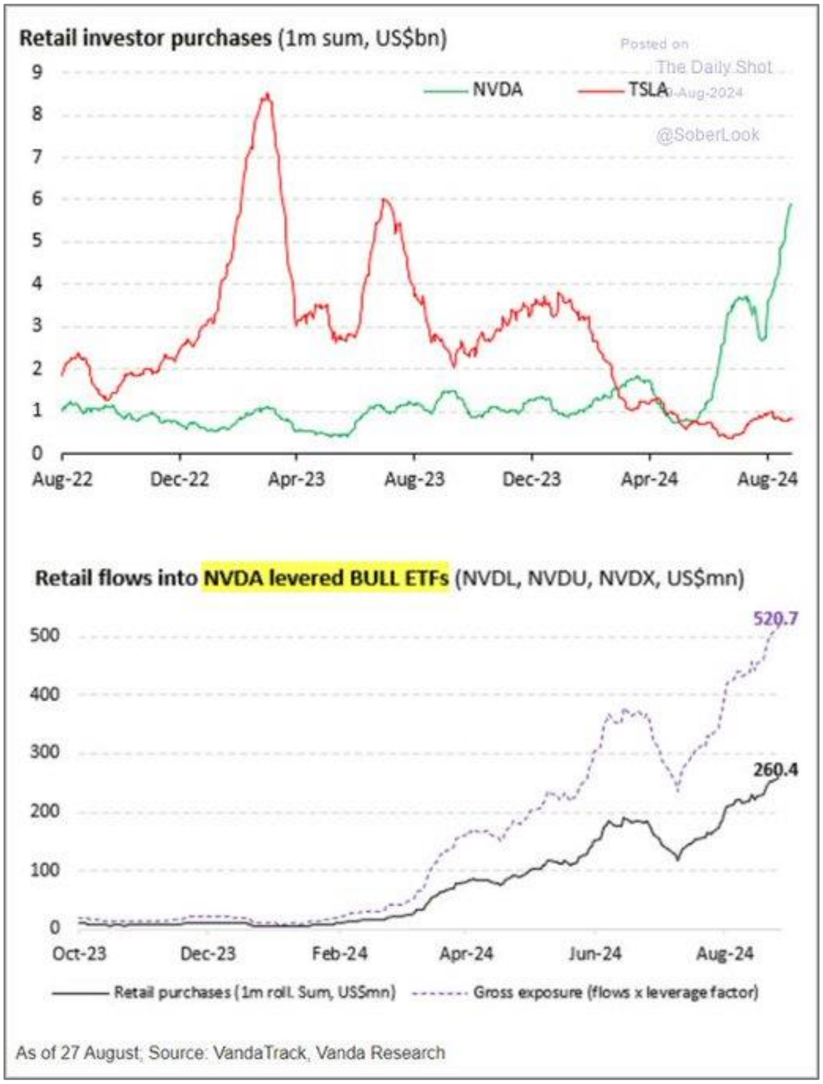
Pending Home Sales have fallen below the COVID pandemic lows.

Pent-up demand among millennials to buy a house.

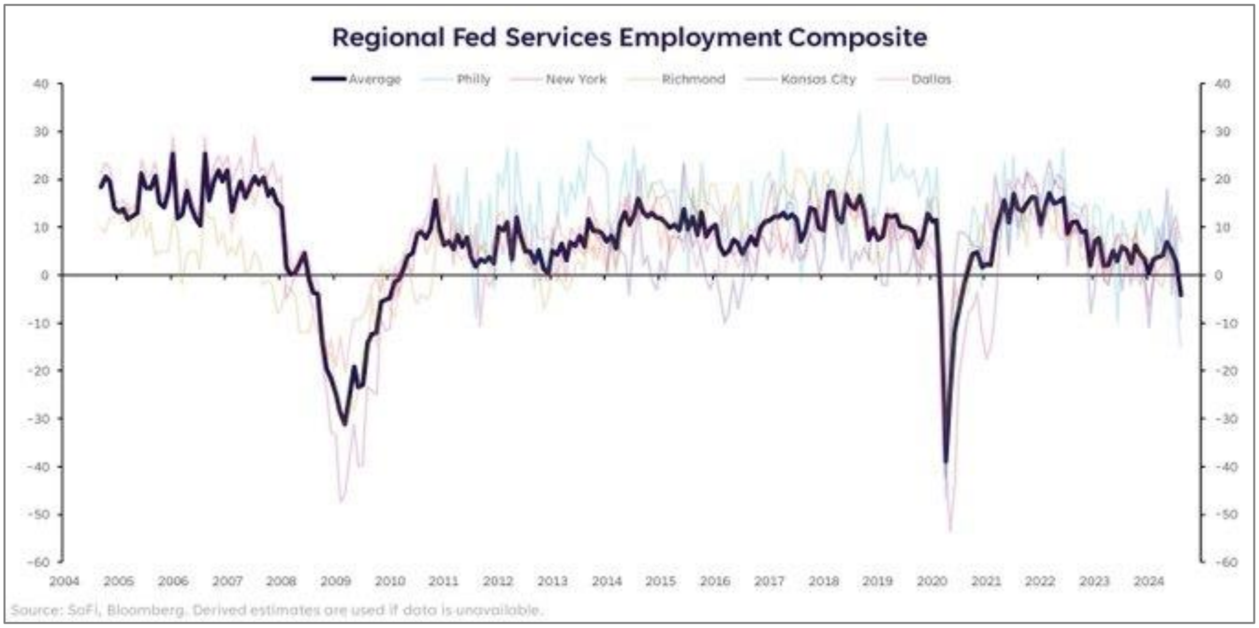


Source: DailyChartbook

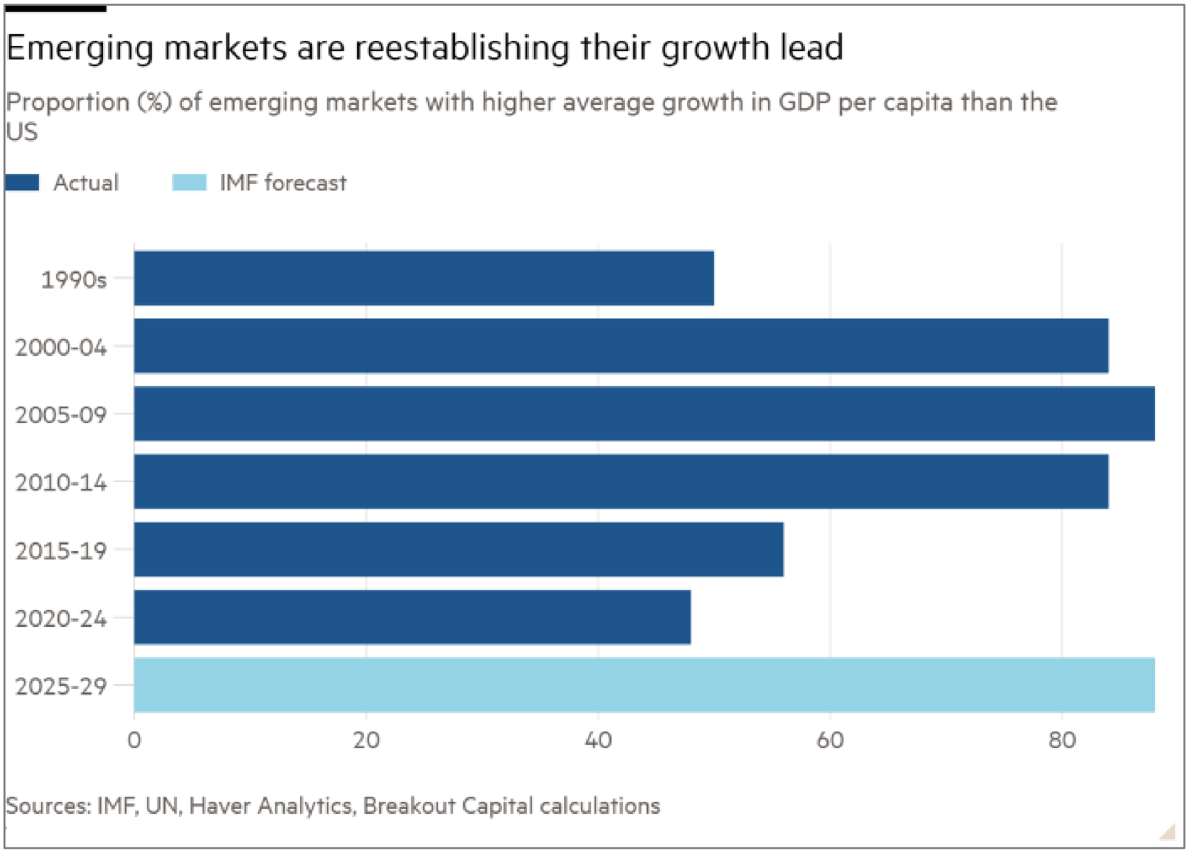
Retail investors have swapped TSLA for NVDA.



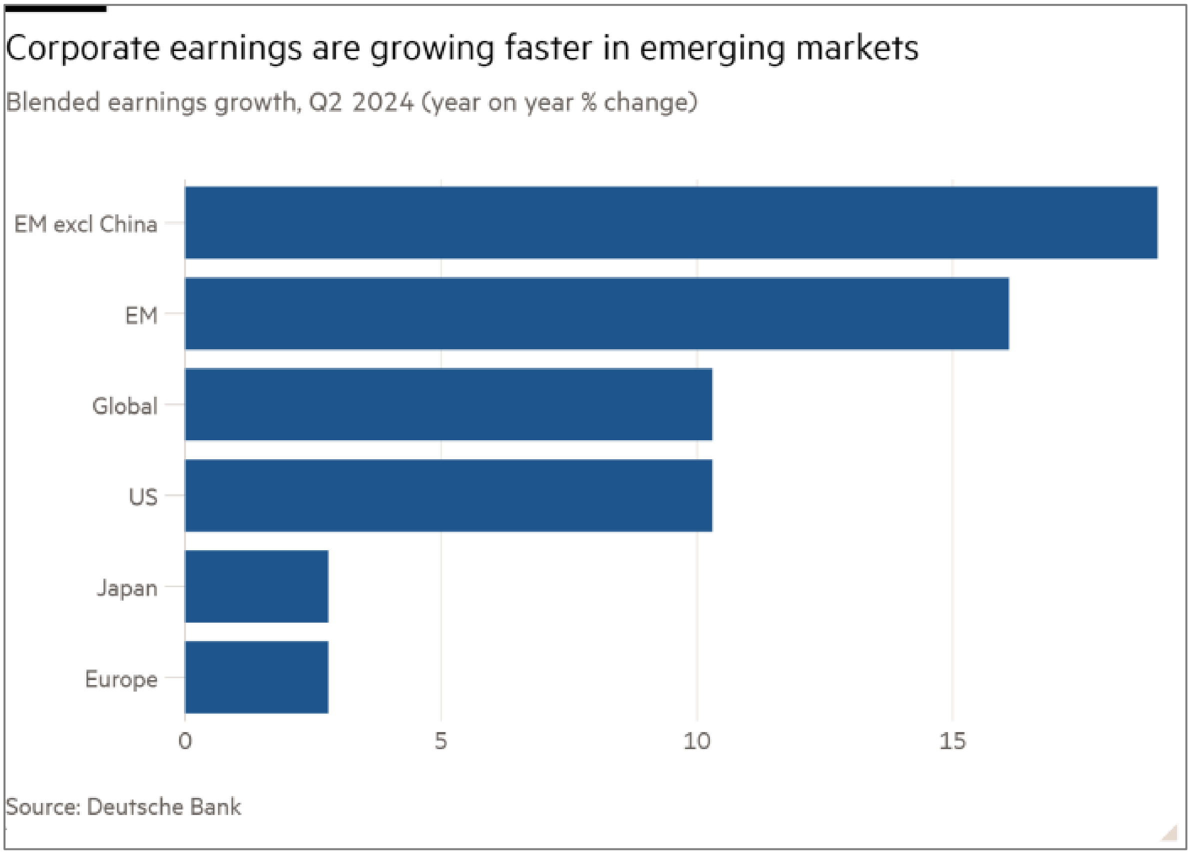
Regional Fed Services Employment turns negative.



Economic growth for Emerging Market economies has improved.

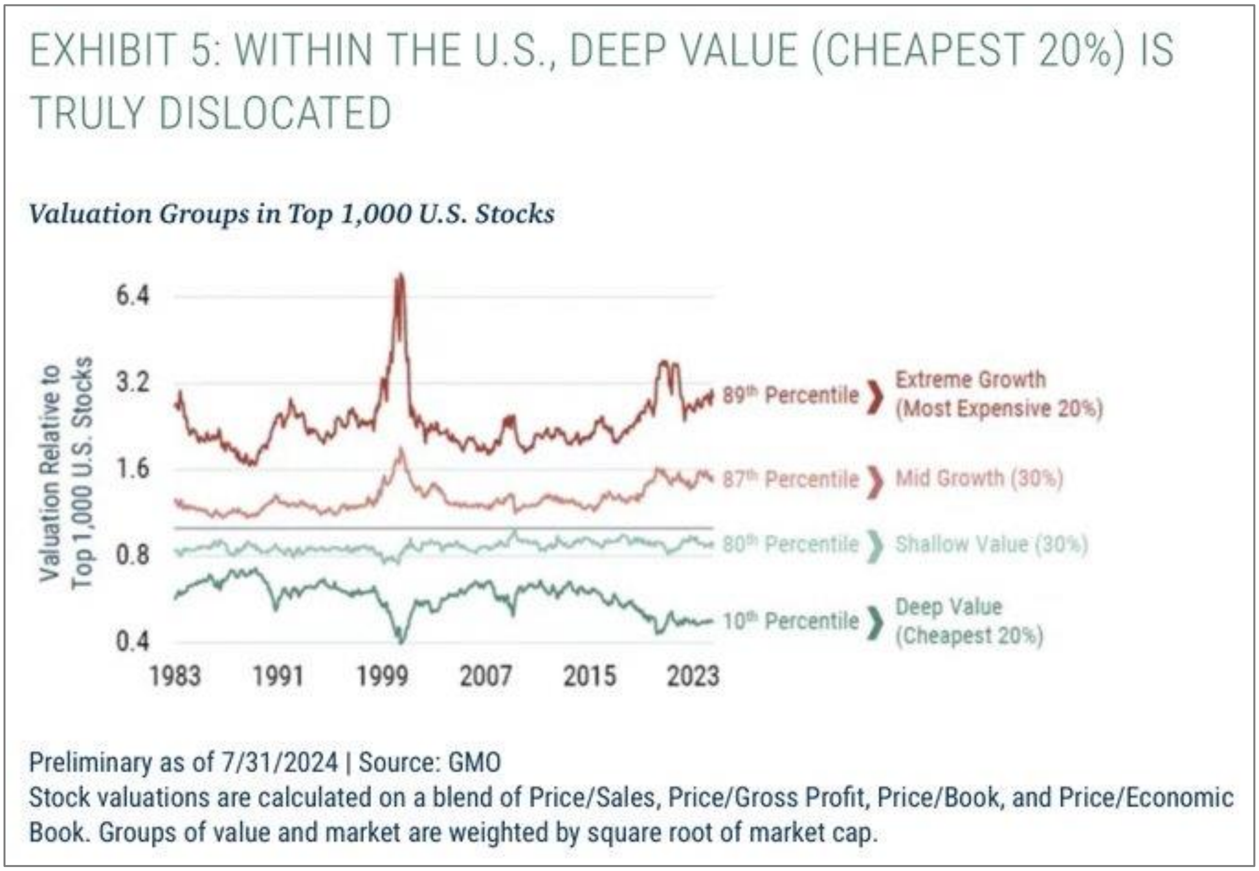


Emerging Market corporate earnings are growing again as well.

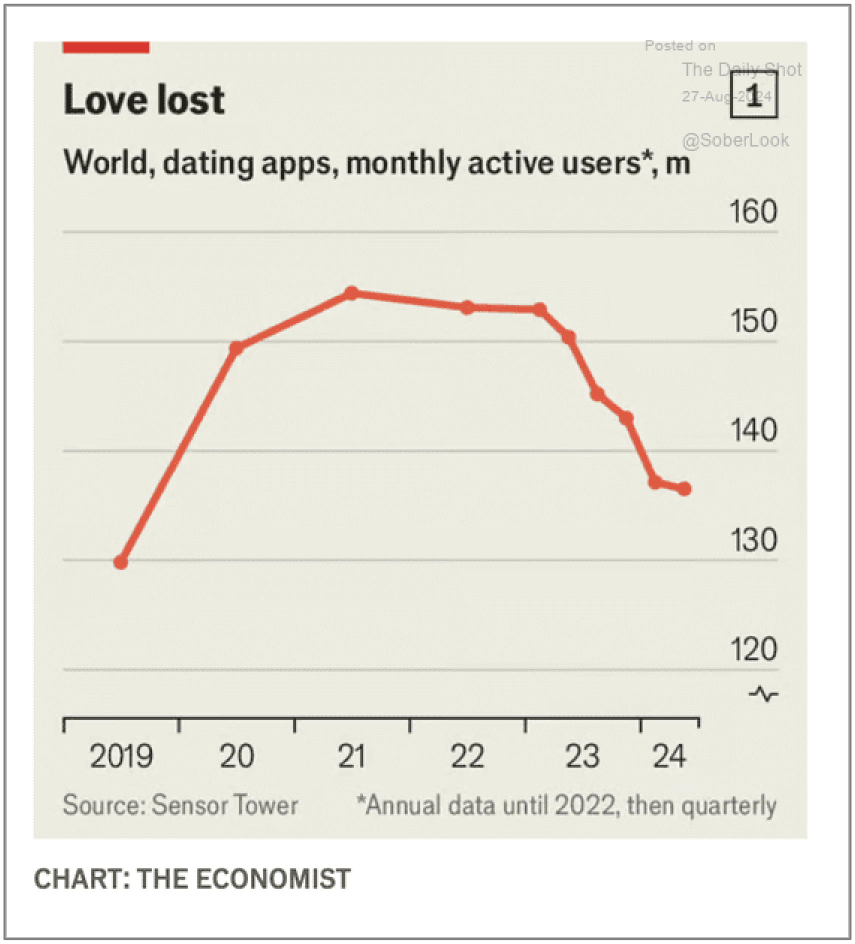


Chinese stocks have bounced when yields fell below 2% previously.

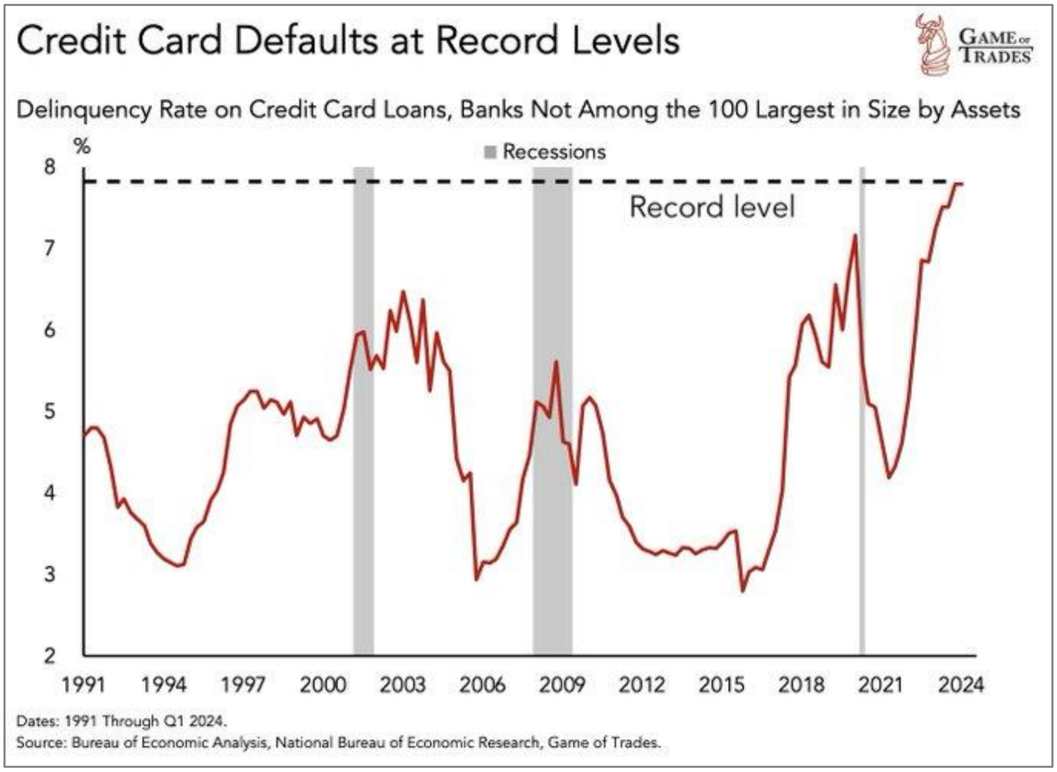
Deep Value looks attractive on a relative basis.



Dating Apps are rapidly losing users.



Credit Card Delinquencies at Smaller Banks are at Record Levels.



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.