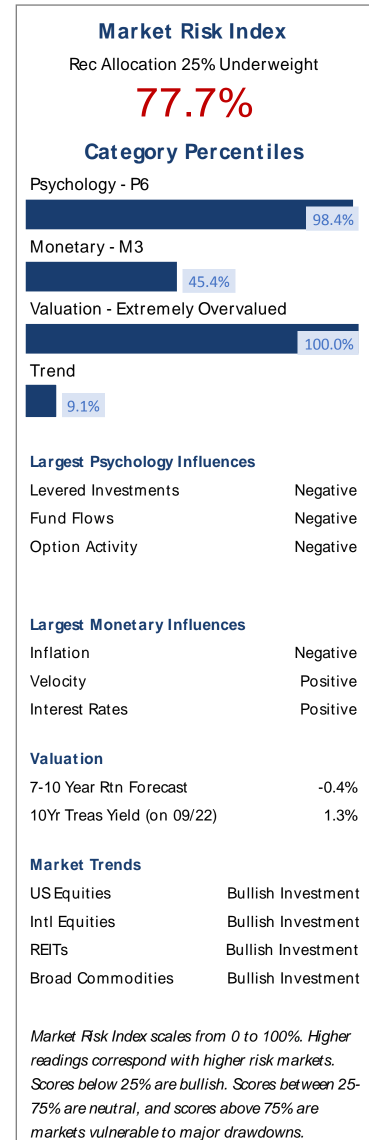
Market Outlook

By Mark T Dodson, CFA

The Rule of 2021 – if it dips, buy it.



Market Risk Index reversed its recent improvements, increasing to 77.7%. A slight improvement in the Psychology composite helped to offset the deterioration in the Monetary and Valuation composites. However, the mild language that we have chosen to describe this week's change is likely too strong, as muted moves in all three of our counter-cyclical baskets of indicators have been the norm for several months.

Some individual psychology indicators improved on the uptick in market volatility, moving the scores for some categories out of excess enthusiasm. For example, the options category saw improvement, as did corporate insider sentiment. In addition, the AAII investor sentiment survey showed bears outnumbering bulls for the second week in a row.

However, as has been the pattern for all of 2021, a sharp single-day pullback was quickly followed by a surge in single-day breadth that looks like a tradable short-term bullish move for technicians. Some pundits have taken to calling the Evergrande-driven spike in volatility a wall of worry (on a 4% pullback), but it looks nothing of the sort when viewed broadly through the lens of our Psychology composite. The froth has come off several indicators, but none have crossed into what is objectively considered "wall of worry" territory.

Instead, this week looked more like another round of *Buy the Dip,* as speculators use even the smallest retracement to make another push into stocks. The daily dollar volume in levered ETFs has tracked the pattern closely. Daily dollar volume in leveraged ETFs was already in a new era of readings in 2021 (similar to the options market), and every dip has coincided with a rush of volume into levered ETFs. The increase was so sharp this week that it nearly broke the one-day record set back in the fall of 2020.

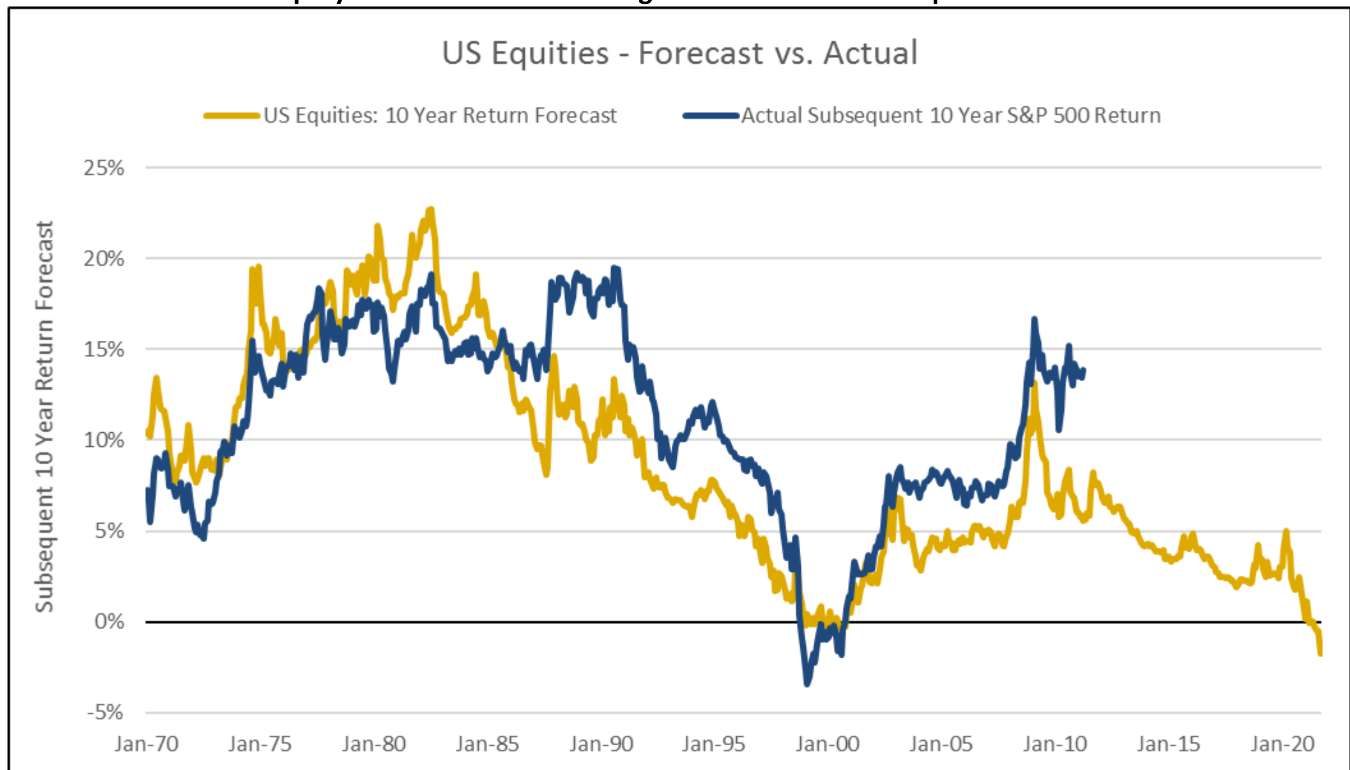
Our hunch is that we'll see more significant deterioration in our stock market breadth work before this pattern of speculative dip-buying will end, but that evidence doesn't exist today.

The Monetary composite reversed its streak of steady improvement, although there is nothing to point to as a chief culprit. Our bond market liquidity indicator pushed further into easing territory, and the real Fed Funds rate is at record lows. These green flags are offset by the red flag coming from the inflation category – the only category hitting its maximum possible score – a difficult message to easily dismiss. Nearly every period where our inflation category had maximum negative readings, it took a recession or a severe market correction to alleviate those inflation pressures.

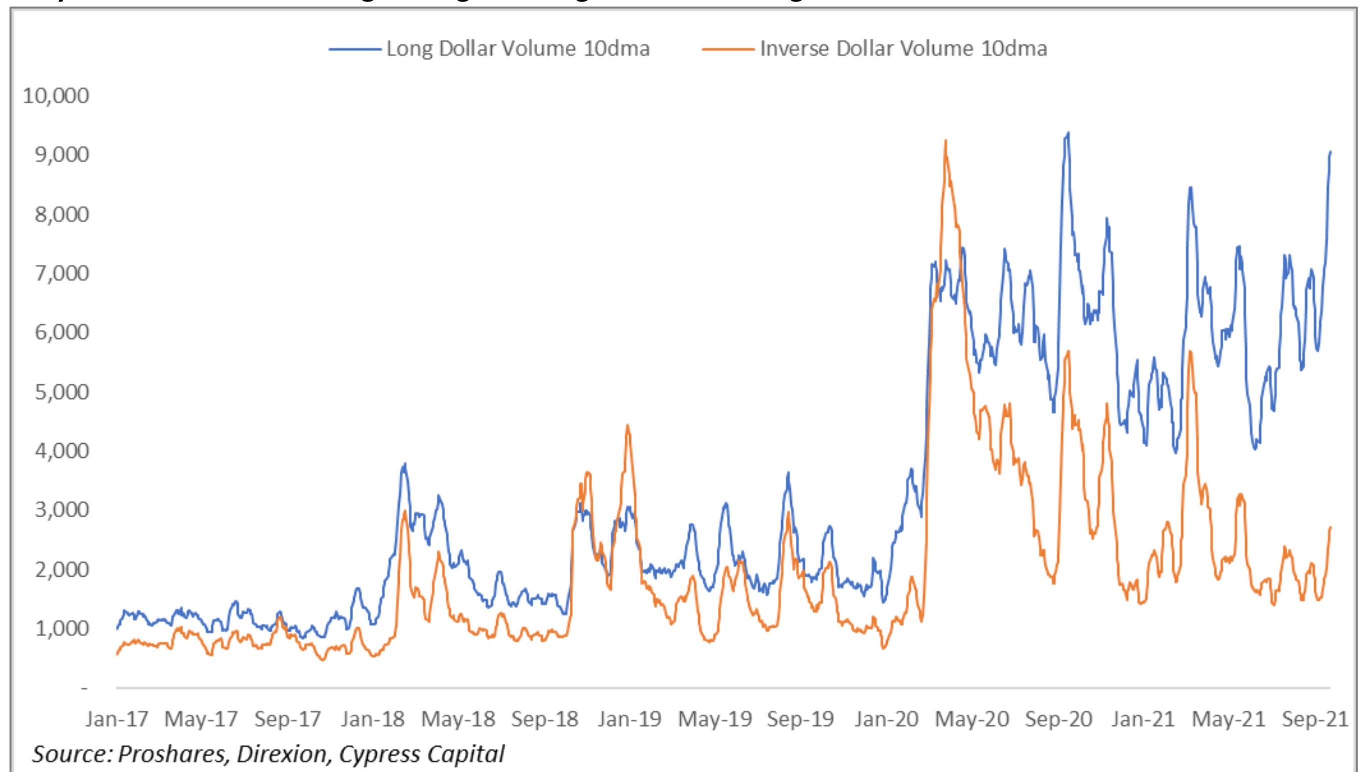
Lastly, the valuation composite moved back to the 100th percentile of readings, as our forward-looking equity return forecast has broken out to a new all-time low. September will also mark the composite's fifth consecutive month of a negative return forecast, breaking the previous record set between July and October 2000.

Charts of the Week

Our Valuation driven equity return forecast is setting another new low in September.

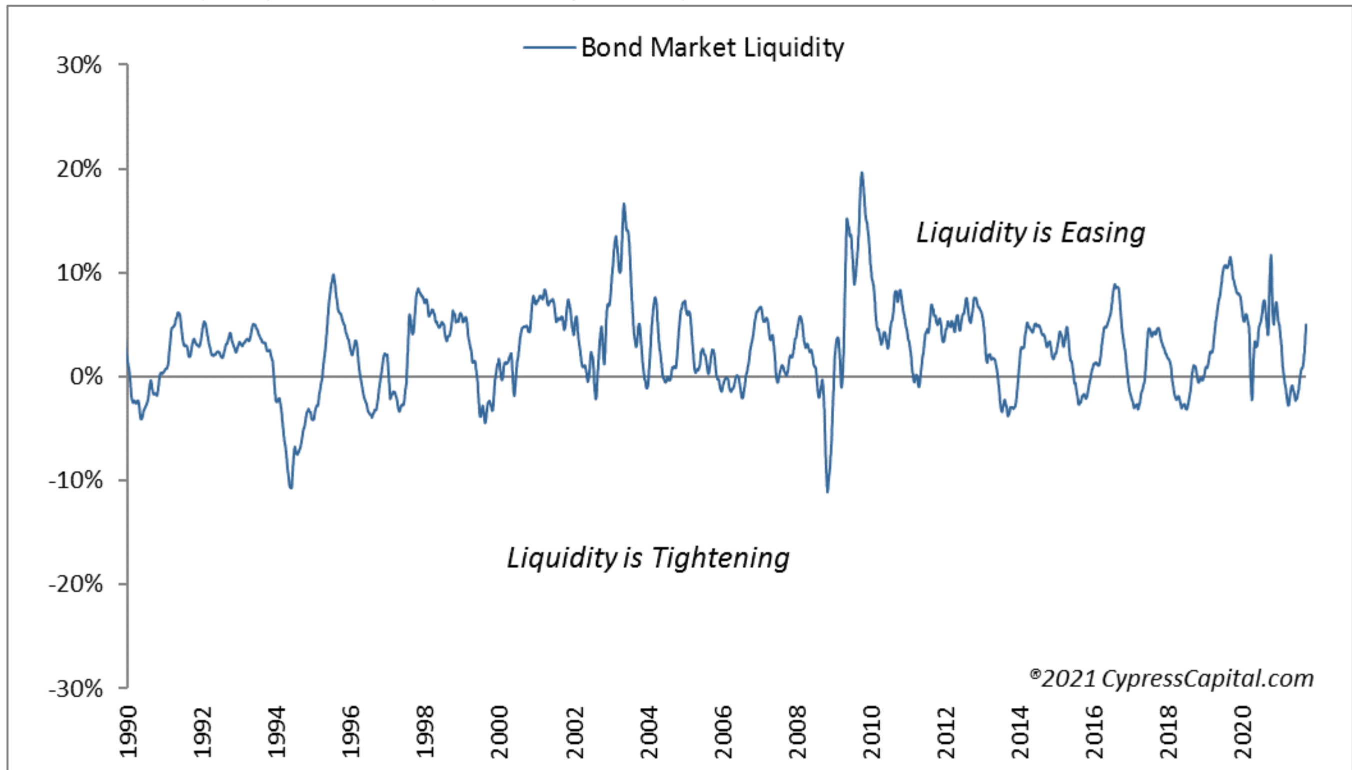


Daily dollar volume in Leveraged Long ETFs surged the second highest level on record this week.

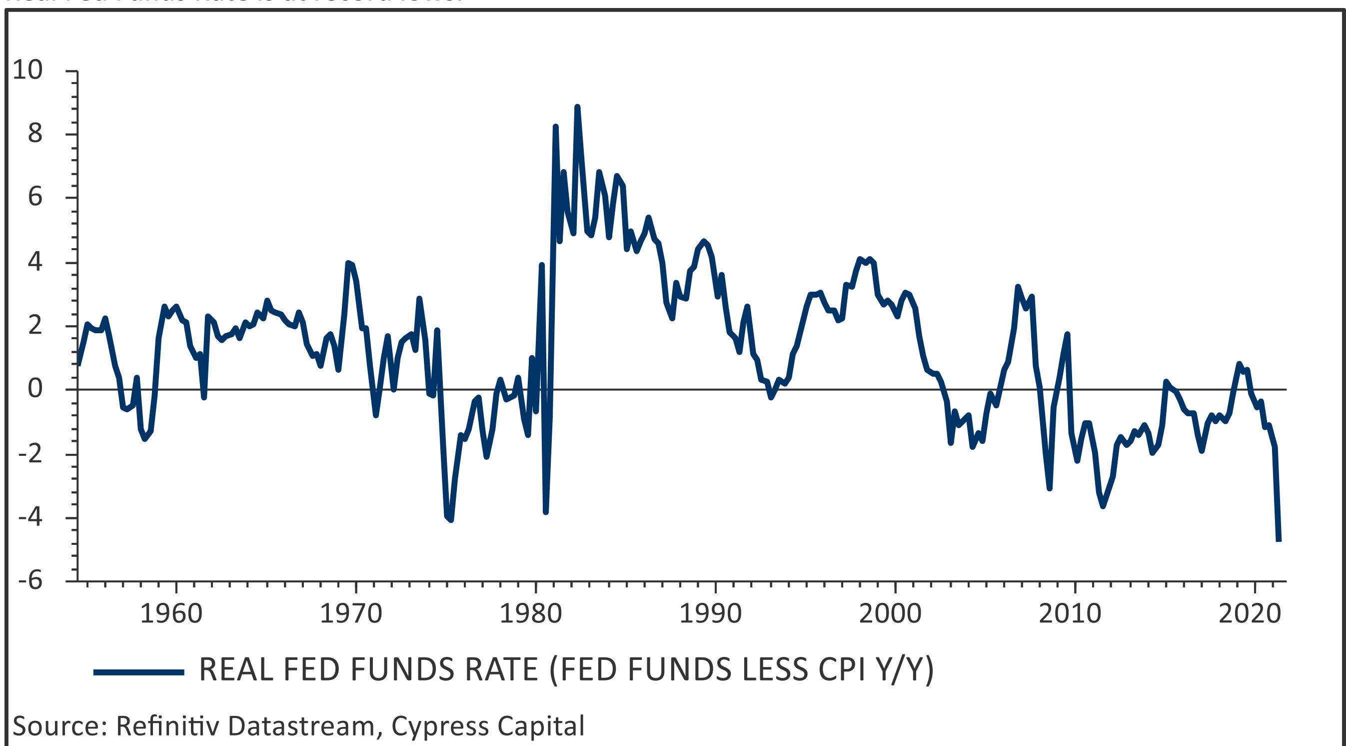


Source: Proshares, Direxion, Cypress Capital

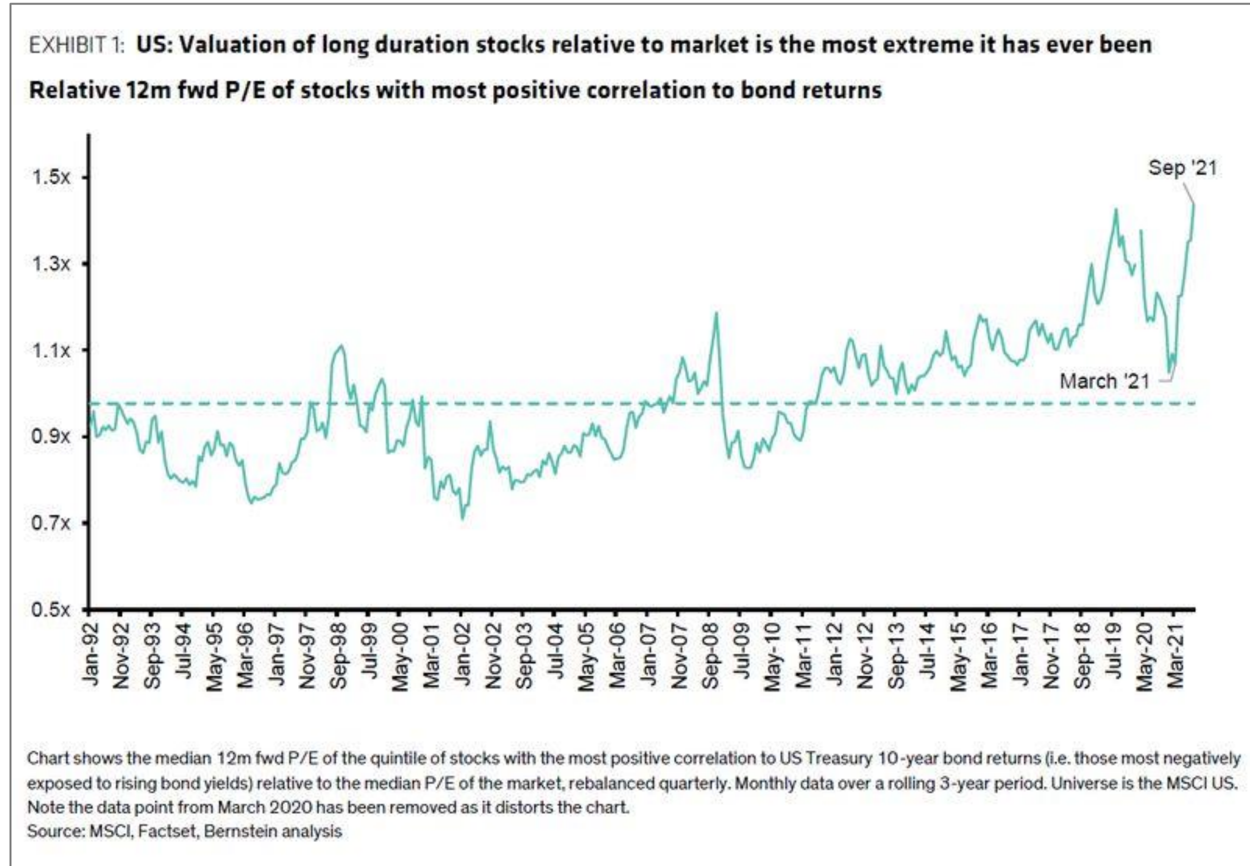
Bond Market Liquidity moves firmly into easing territory.



Real Fed Funds Rate is at record lows.

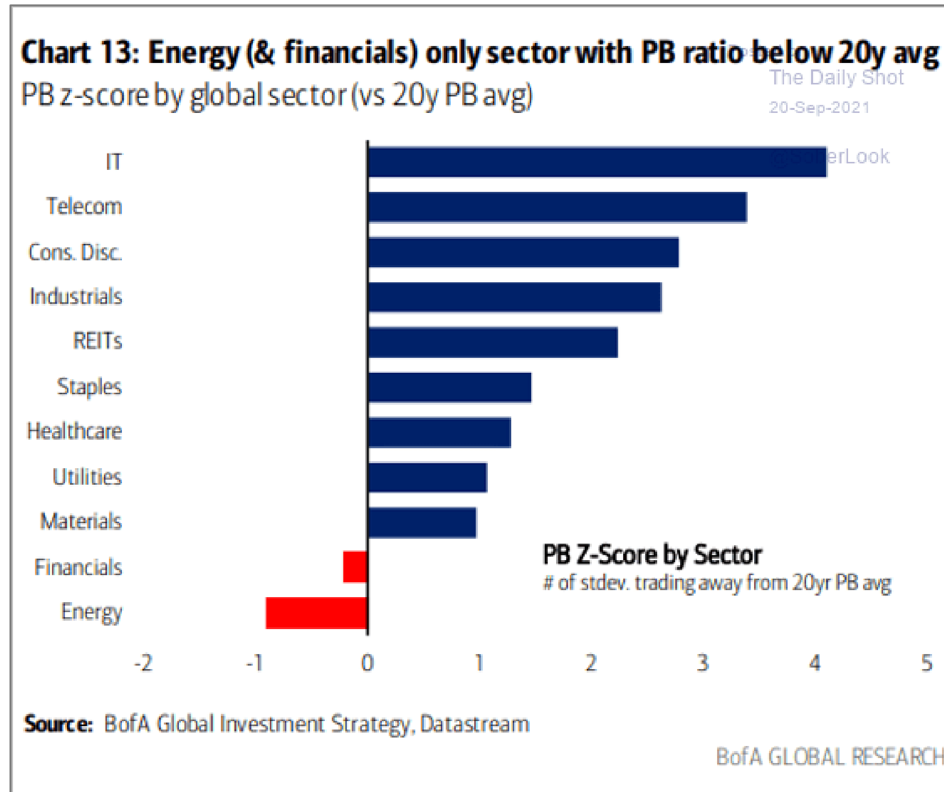


Valuations of the most interest-rate sensitive stocks hit all-time highs in September.

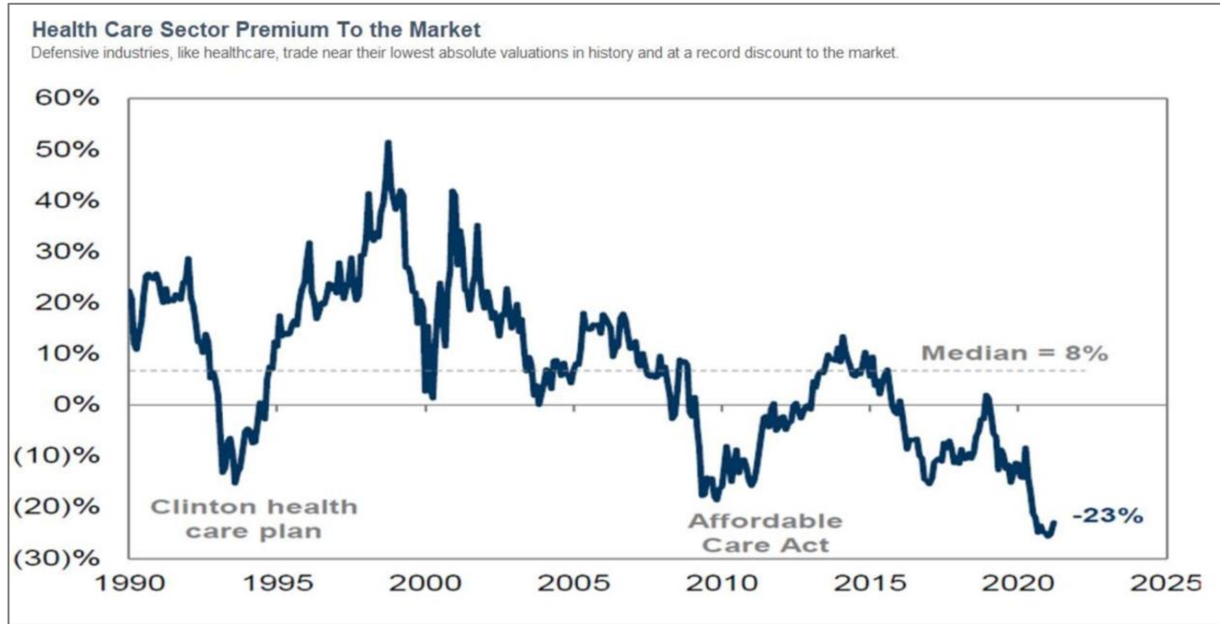


Source: Bloomberg

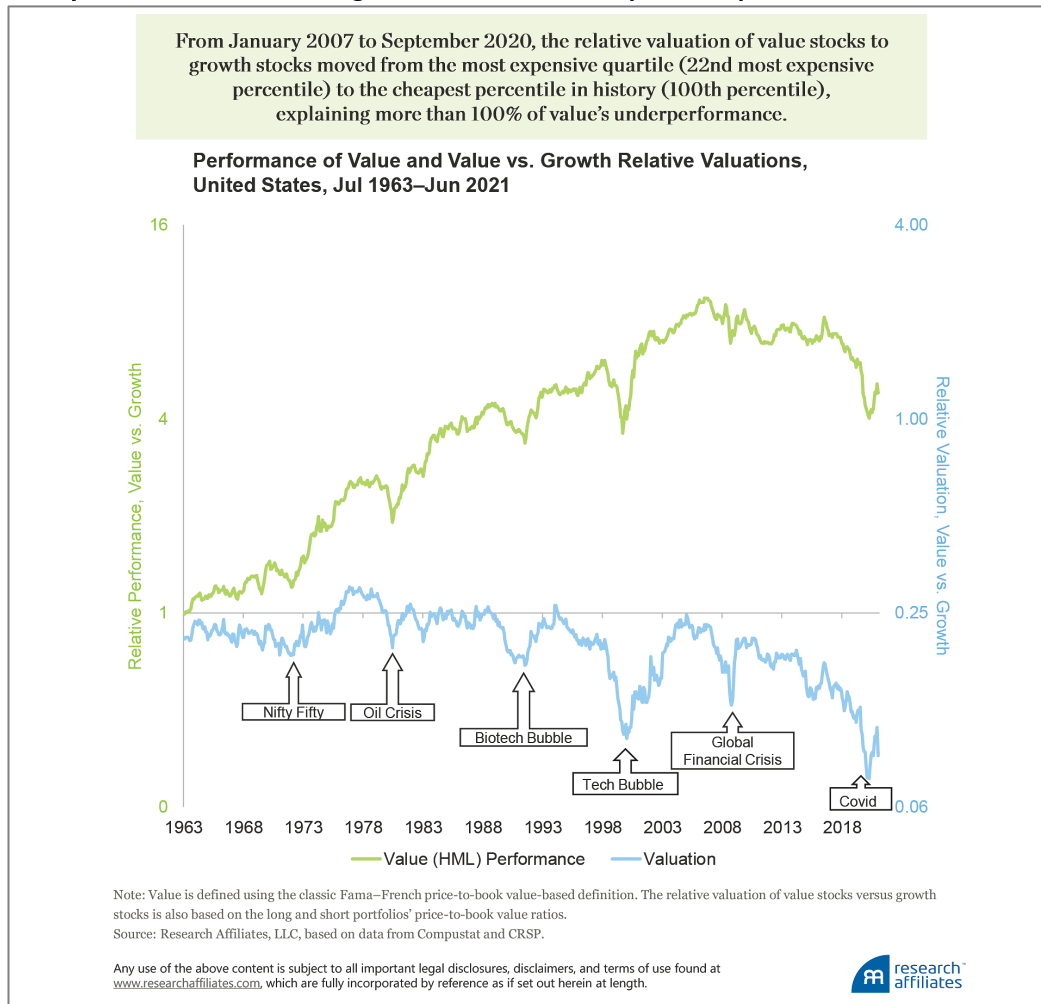
Energy and Financials are the only sectors selling at a Price to Book below their 20 year averages.



Relative valuations of the Healthcare sector are at record lows.



Full cycle: value stocks have gone from the most expensive quartile in 2007 to the cheapest percentile in 2021.



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.

for more information.

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