Market Outlook

By Mark T Dodson, CFA

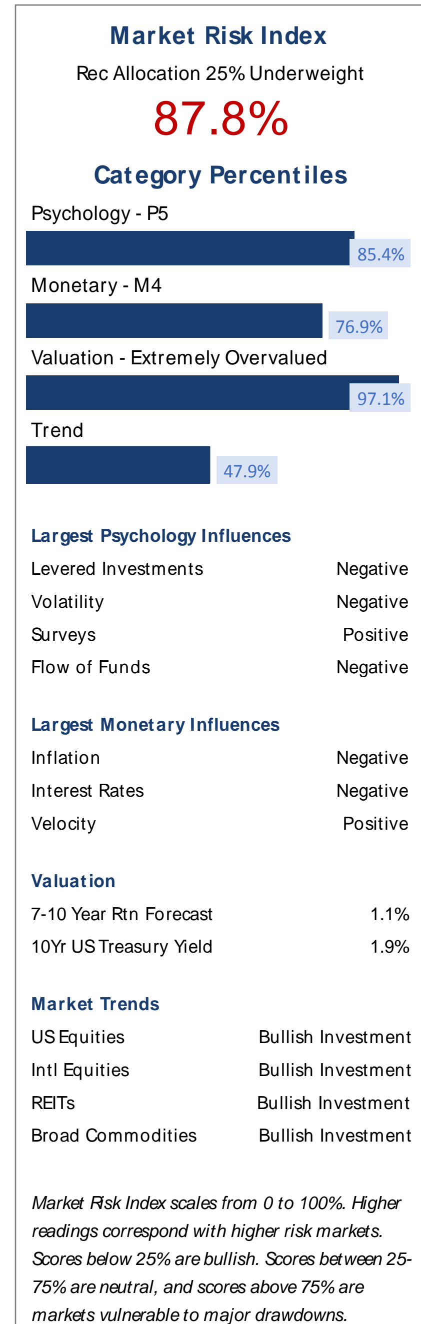
Russian invasion increases investor anxiety.

Market Risk Index fell below the 90th percentile for the first time in 2022 after initially crossing above 90% in the last week of 2021. However, readings are still well above levels associated with a constructive risk-reward tradeoff for more aggressive investment in equities.

The Russian invasion of Ukraine has increased investor anxiety, leading to a notable improvement in our Psychology composite. But, at the risk of sounding flippant about those affected by the invasion, financial markets are just that, flippant, often forming short-term bottoms on news of geopolitical crises. Sometimes, it's because the crisis wasn't as bad as feared, and other times it is a response to central banks coming to the rescue to alleviate market concerns.

The bond market's response should dash the hopes of the latter, as inflation is still first and foremost the single biggest problem staring at the Federal Reserve and still the single most significant headwind for markets. Treasury and Fed Funds markets are still pricing in rate hikes. A stock market that immediately rebounds as it did yesterday and follows through as it did today also reinforces the likelihood of rate hikes. One could go as far as to tie the Covid stimulus induced high inflation environment as enabling Vladimir Putin to take such a gamble. It's difficult for elected politicians who face electorates to have the spine to enact especially punitive sanctions, knowing it would lead to even higher prices on essential commodities at home in the short run. The leader of Russia has the luxury of not having to worry about voters.

That quintessential drop in longer duration Treasuries that signals the Fed is getting inflation under control hasn't occurred, putting our Bond Momentum indicator in the hot seat. Bond Momentum is an indicator we have relied on for a very long time due to its impressive efficacy to indicate whether we are in a rising or falling interest rate environment. The indicator remains in a risk-off regime for credits, but it has not shifted away from its stance of recommending investing in longer-term Treasuries. A reversal is unlikely to occur in March either, so a shift to short-term Treasuries is not on the horizon in the near term.



Market Risk Index

Rec Allocation 25% Underweight

87.8%

Category Percentiles

Category	Percentile
Psychology - P5	85.4%
Monetary - M4	76.9%
Valuation - Extremely Overvalued	97.1%
Trend	47.9%

Largest Psychology Influences	
Levered Investments	Negative
Volatility	Negative
Surveys	Positive
Flow of Funds	Negative

Largest Monetary Influences	
Inflation	Negative
Interest Rates	Negative
Velocity	Positive

Valuation	
7-10 Year Rtn Forecast	1.1%
10Yr US Treasury Yield	1.9%

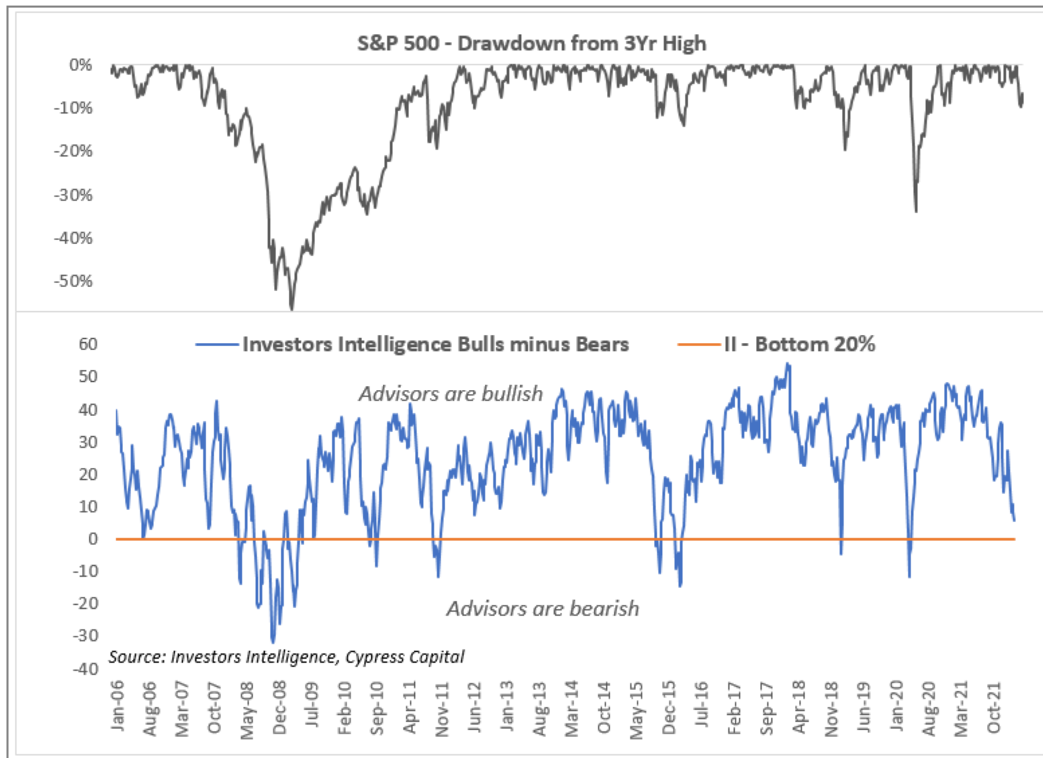
Market Trends	
US Equities	Bullish Investment
Intl Equities	Bullish Investment
REITs	Bullish Investment
Broad Commodities	Bullish Investment

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

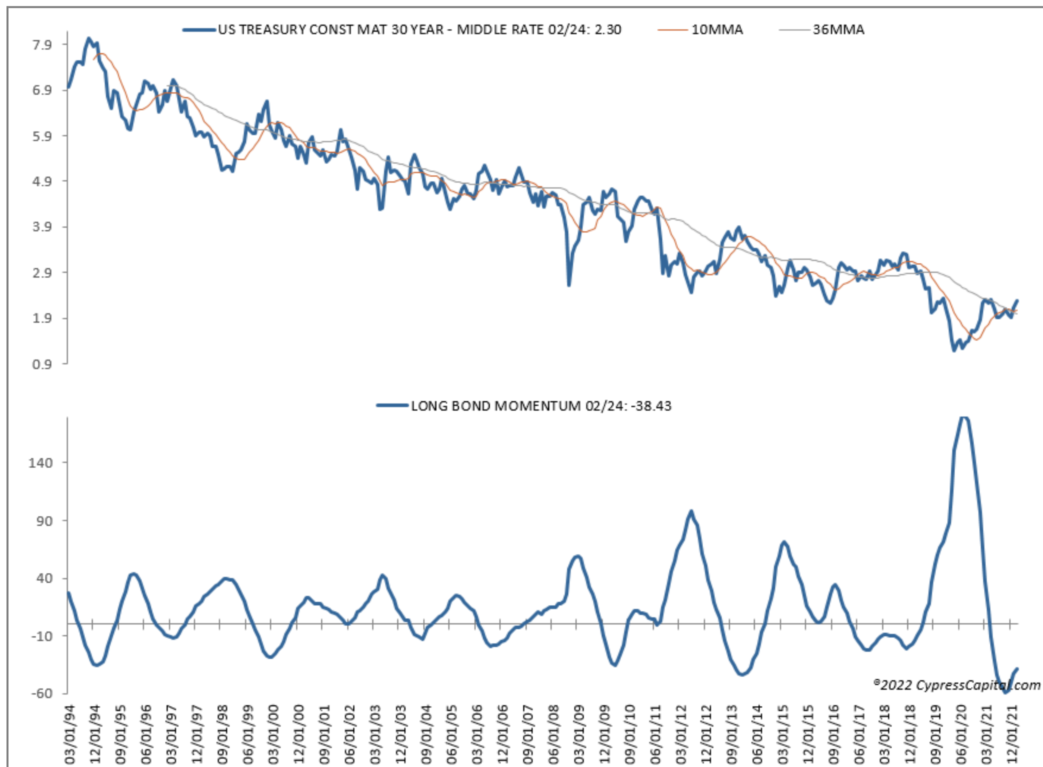
Other than skittishness showing up in surveys and some of our de-trended psychology indicators, there's little sign that investors have de-risked their portfolios or have abandoned risk assets en masse, one of a few reasons that MRI remains so high. Moreover, in absolute terms, many of our longer-term indicators have not met the standard threshold that we see breached in your typical run-of-the-mill market correction. It's not time to back the truck up.

Charts of the Week

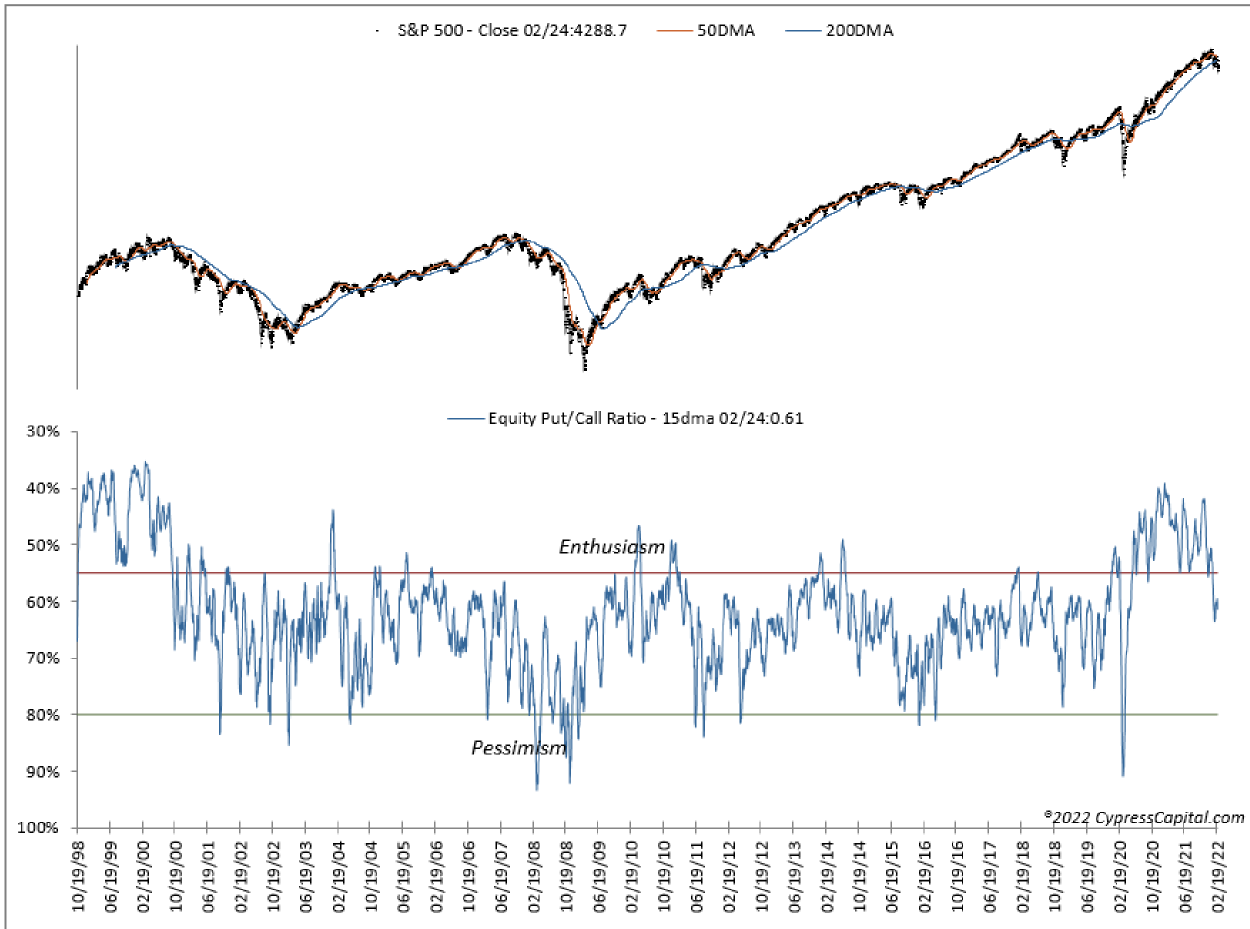
Investors Intelligence - Bulls minus Bears edged closer to the bottom 20% of readings.



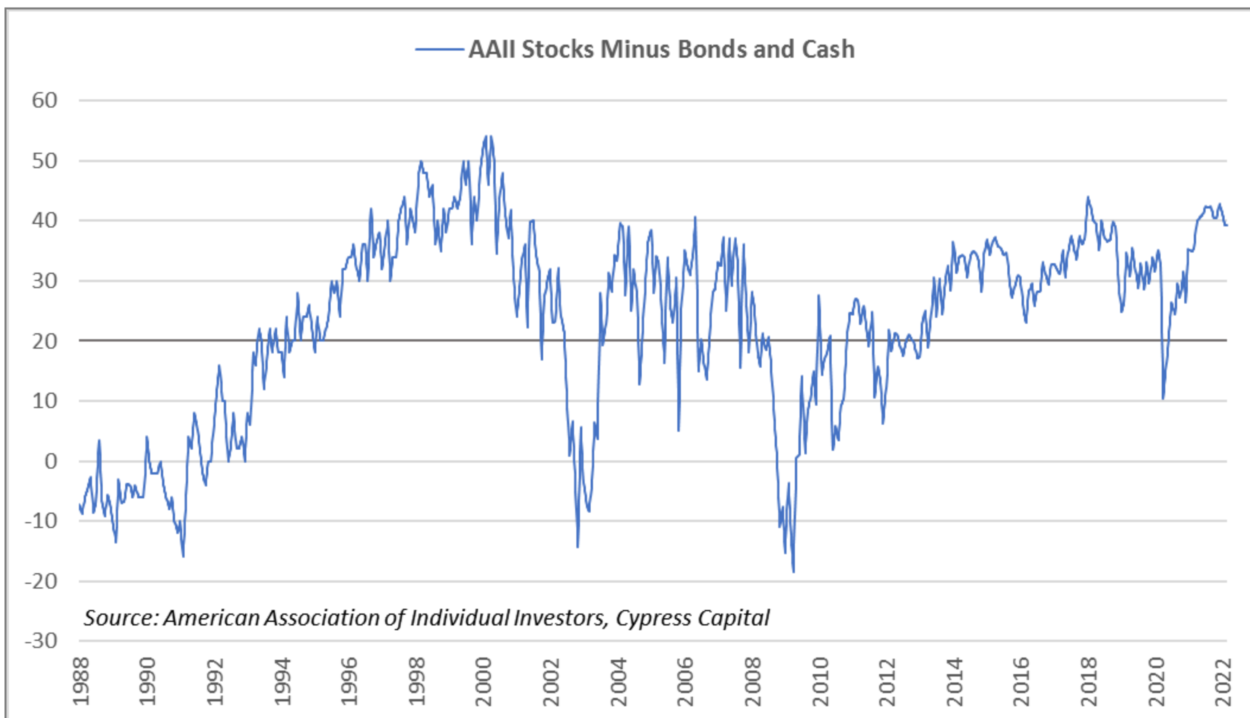
Bond Momentum has yet to waver in its recommendation to buy long-duration Treasuries.



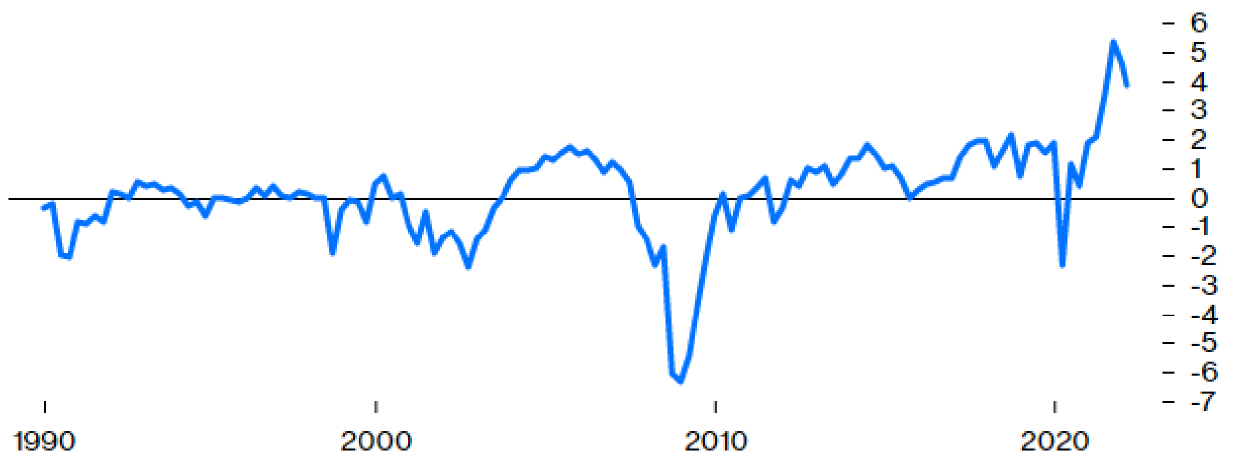
Equity Put Call Ratio suggests the meme stock, Robinhood, post Covid era of retail trading hasn't ended yet.



Individual Investor allocations aren't consistent with a rebuilt wall of worry.

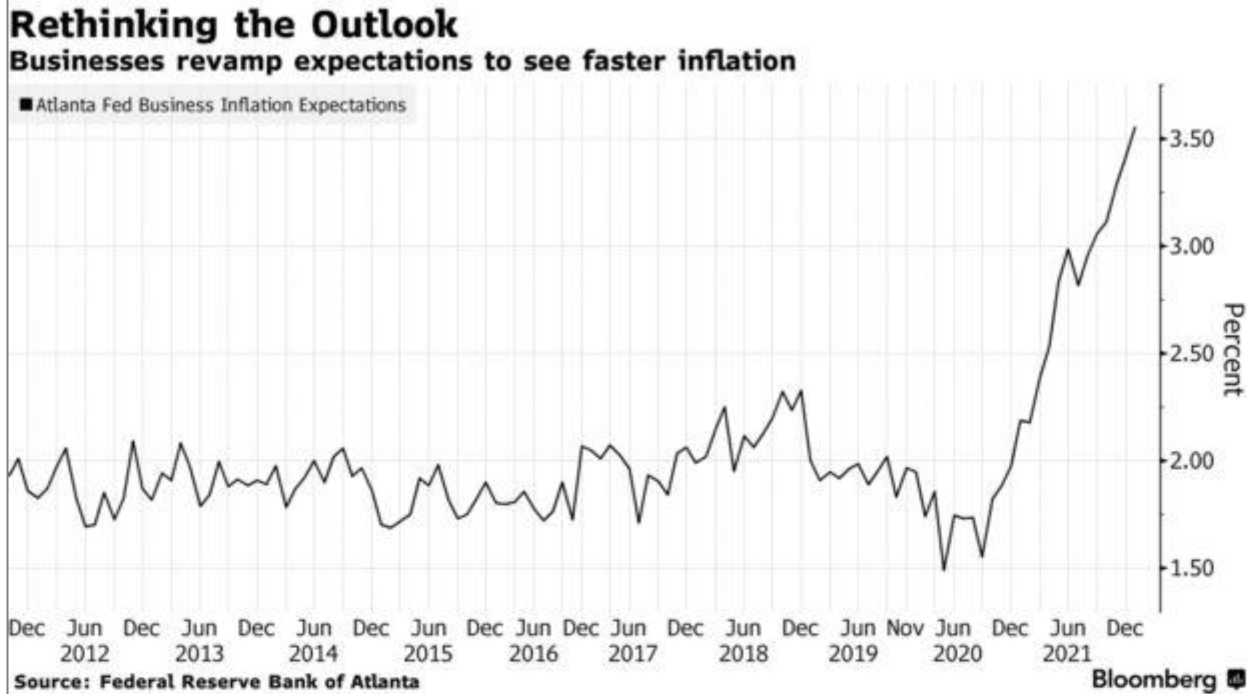


Not tight money, only a peak in easy money.



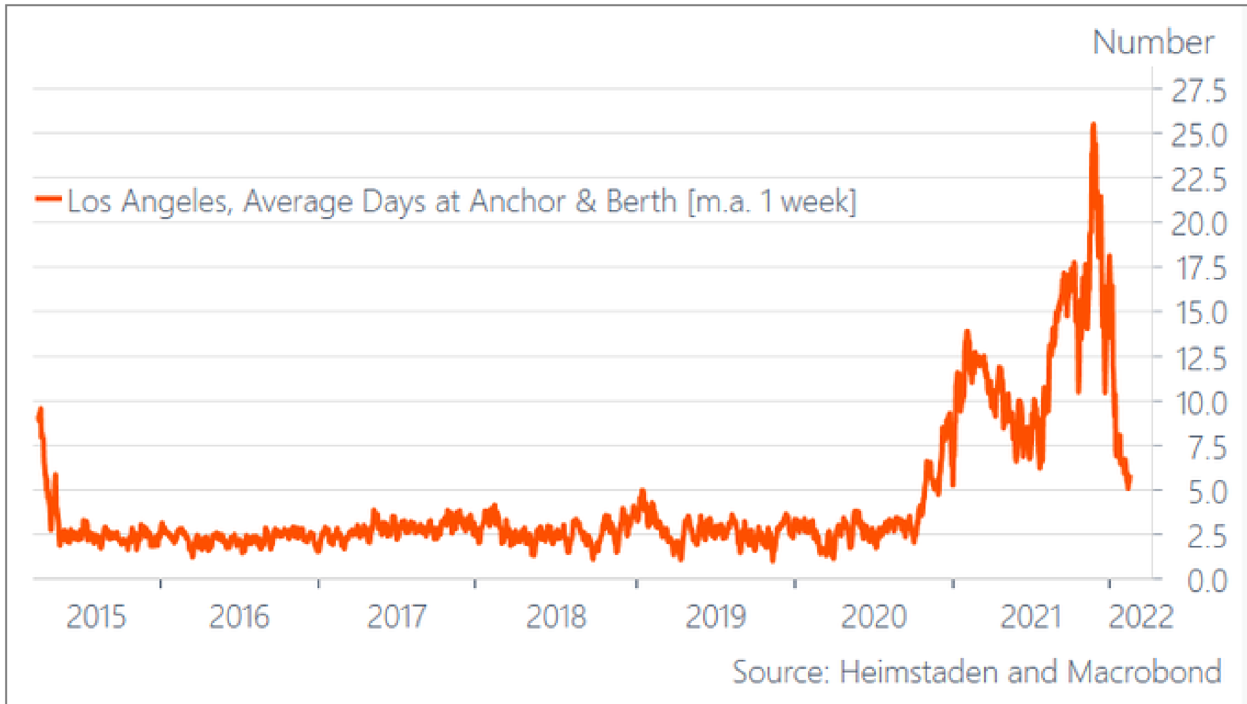
How is an inflation breakout of this magnitude not considered a massive policy failure of central bankers?

Inflation expectations of businesses have yet to peak.

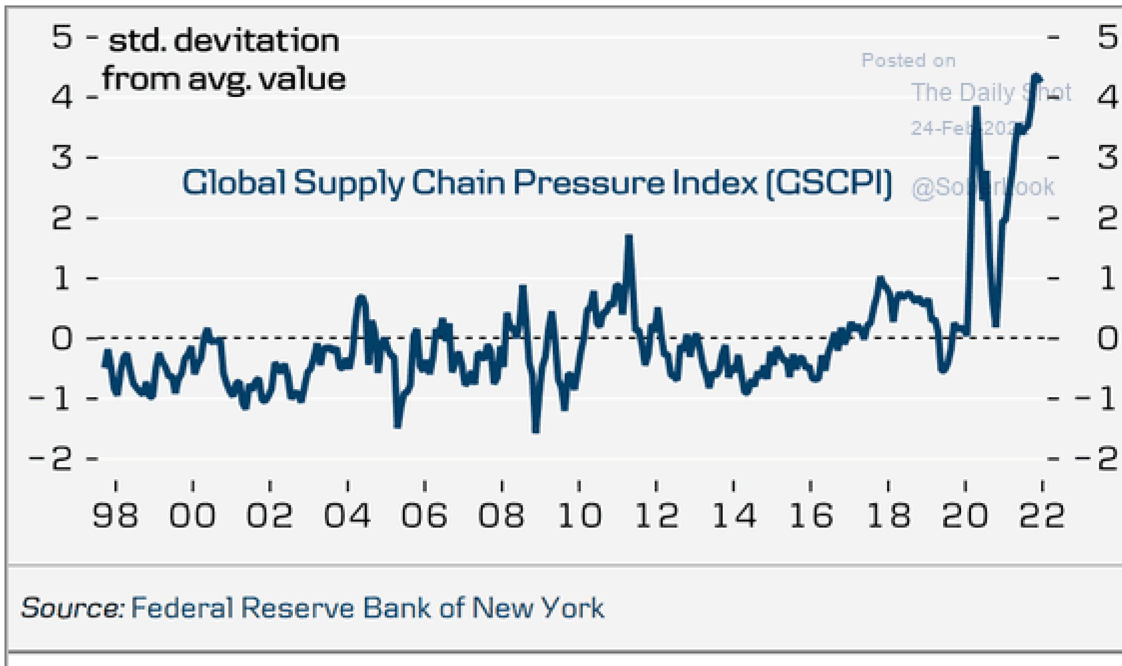


German PPI inflation is the highest since 1949.

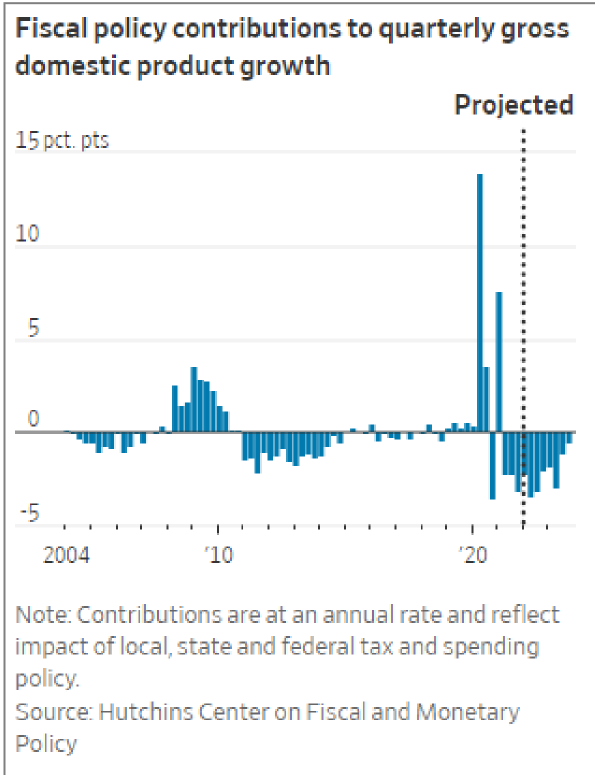
Port delays in Los Angeles are improving rapidly.



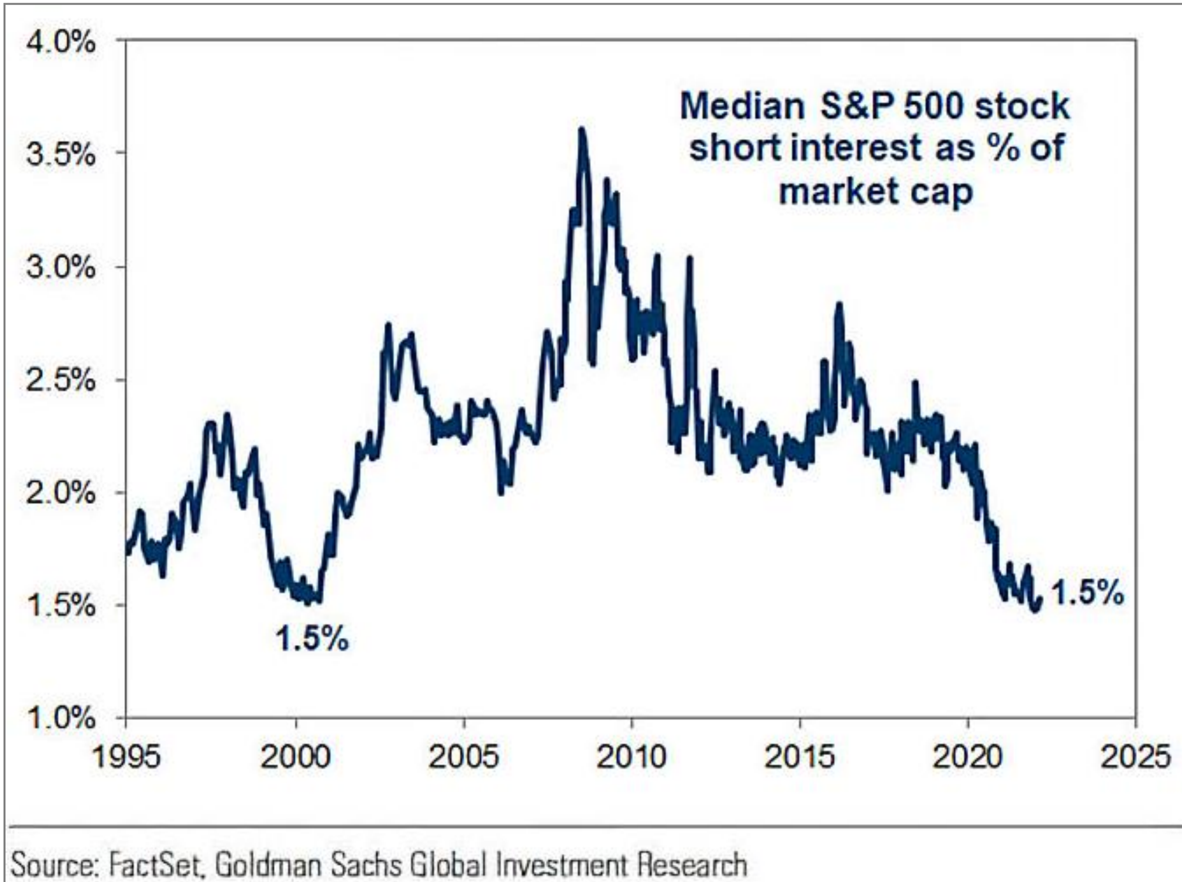
Global Supply Chain pressure remains high.



Fiscal policy drag will weigh on the economy in the coming quarters.



The shorts are still too nervous about making big bets.



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 porfolio 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.

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