Cypress CAPITAL

Market Outlook

By Mark T Dodson, CFA

Markets in Speculative, Trend Extrapolating Feedback Loop

Market Risk Index jumped to 81.6%, as the risk score from our Monetary Composite increased by nearly 6%. Valuations also worsened and are now in the worst 0.3% of readings. Our bottom-up equity return forecast has fallen to 0% and is forecasting the lowest equity return since January 2022.

Improvements to the Psychology Composite have stalled without making it out of the worst decile of readings – not a shock given echoes of 2021's meme stock craze making headlines. Futures positioning and bullishness among Asset Managers to US Equities shot up to a new all-time high, and the ISEE Sentiment index also shows options sentiment shifting back in favor of heavy call option buying. Current positioning and the concentration of bets in a handful of names imply that even non-bear market corrections could be more severe than average.

The sharp increase in the Monetary Composite score was a surprise, and we'll see if it reverses over the coming weeks. If not, that's the first notable deterioration in the fundamental backdrop of the economy since the bull market began. Over the last six weeks, our inflation category has moved from positive to neutral, and both our Velocity and Monetary Aggregates categories have softened. The softening of the latter two categories appears to be coinciding with a possible end to the spend-down of excess Covid-stimulus savings.

However, the Monetary score itself is more of a neutral reading and is still associated with bullish outcomes for stocks. The Monetary Composite has been the pillar holding the bull market together, and it has been reflective of a feedback loop between persistent speculative sentiment, Fed-cut front-running, and easy financial conditions. The actual stance of Fed policy has been largely left out of that loop. Even now, bond markets are back to predicting two cuts for 2024 after the latest CPI reading came in better than expected – except should that month-over-month rate of change in CPI continue, inflation will be back above 4% by year-end.

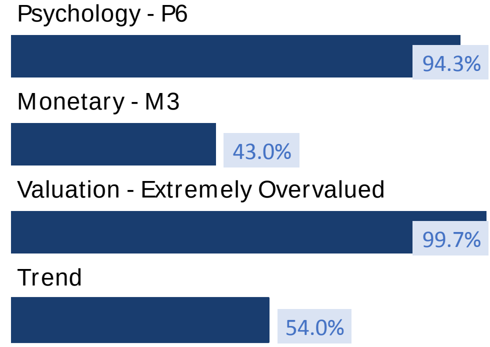
As investors in both equity and bond markets appear to be extrapolating the same trends without , we close with this gem of a quote from the CEO of Bridgewater below:

Market Risk Index

Rec Allocation 25% Underweight

81.6%

Category Percentiles



Largest Psychology Influences

Leveraged Investments	Negative
Consumer Confidence	Negative
Technical Indicators	Negative
Bank Sentiment	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	4.4%

Market Trends

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

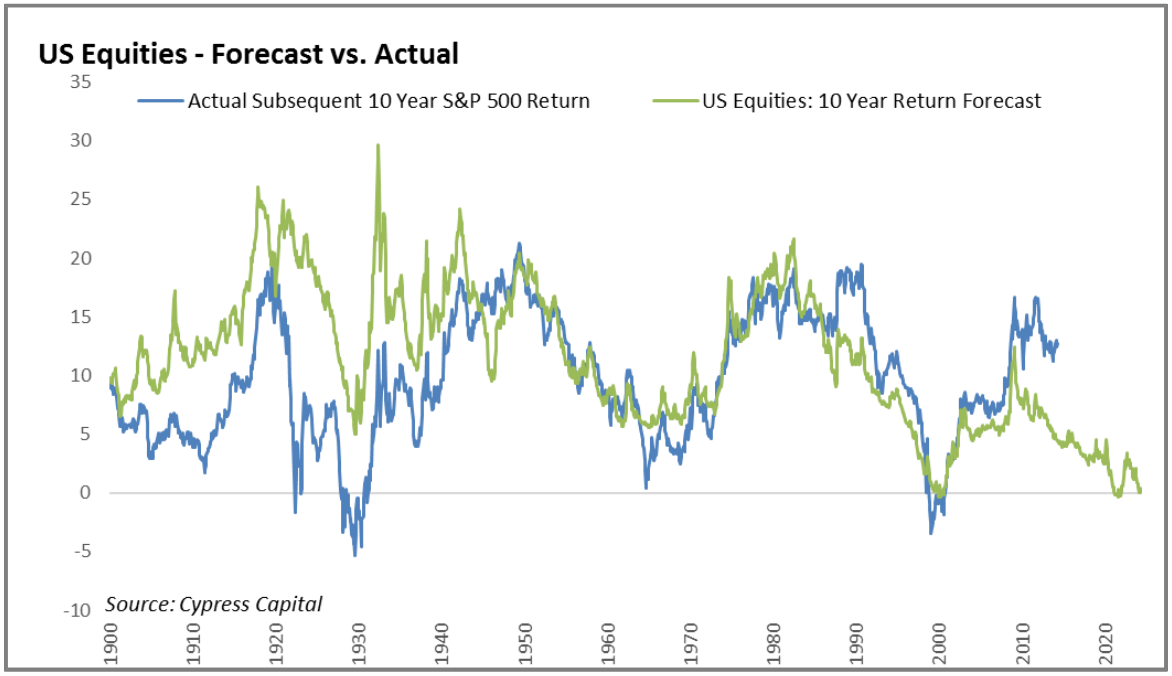
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets based on our model & opinion. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

> *"The biggest mistake I think that investors make is they develop overconfidence. My advice to investors here is don't use the playbook for the last 10 to 15 years for the next 10 to 15 years." Nir Bar Dea, Bridgewater CEO*

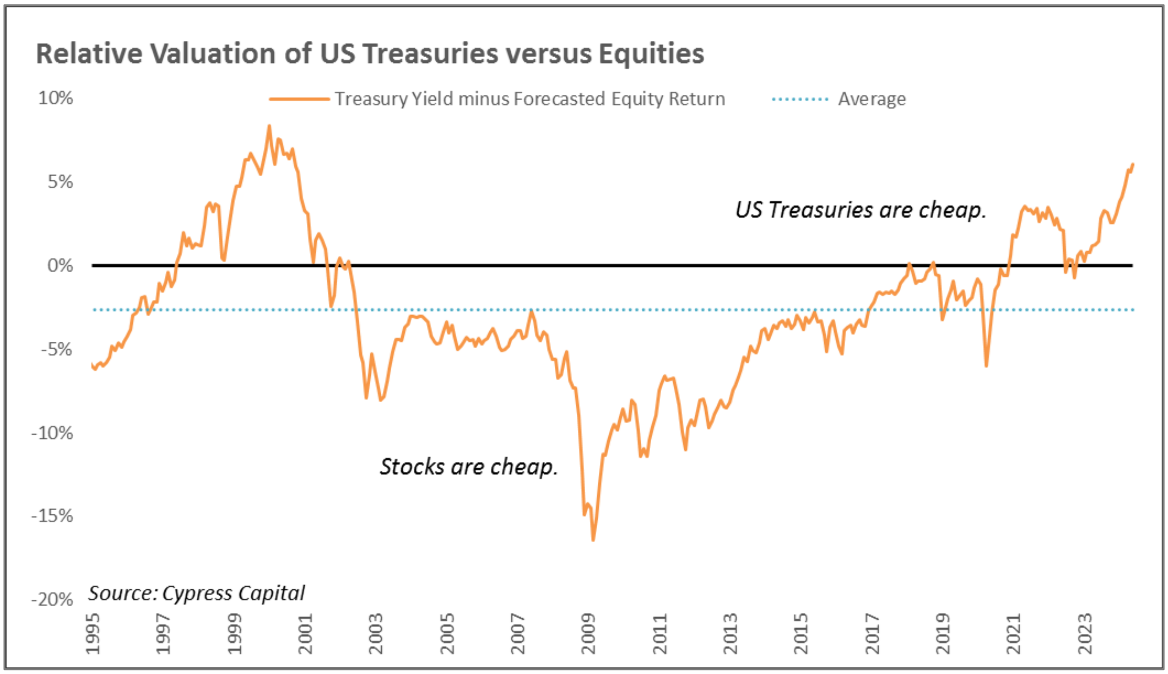
Note: I was traveling last week and could not get a report released over the weekend. After a lot of blood, sweat, and tears, I completed my Master's degree at the University of Pennsylvania and was at commencement. We'll use the unintentional adjustment in the release as an opportunity to shift the Market Outlook deliveries to Tuesdays or Wednesdays each week.

Charts of the Week

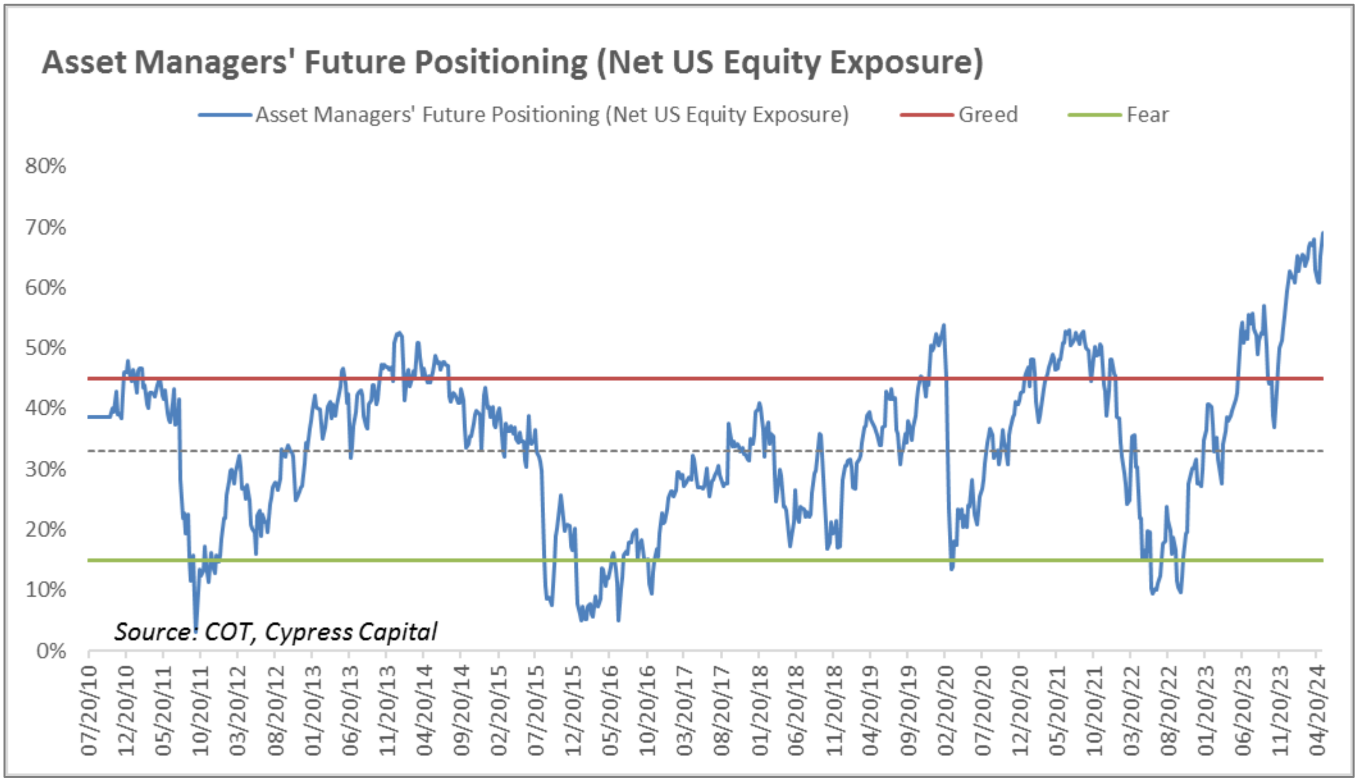
Valuations have driven our bottom-up equity return forecast to the lowest since January 2022.



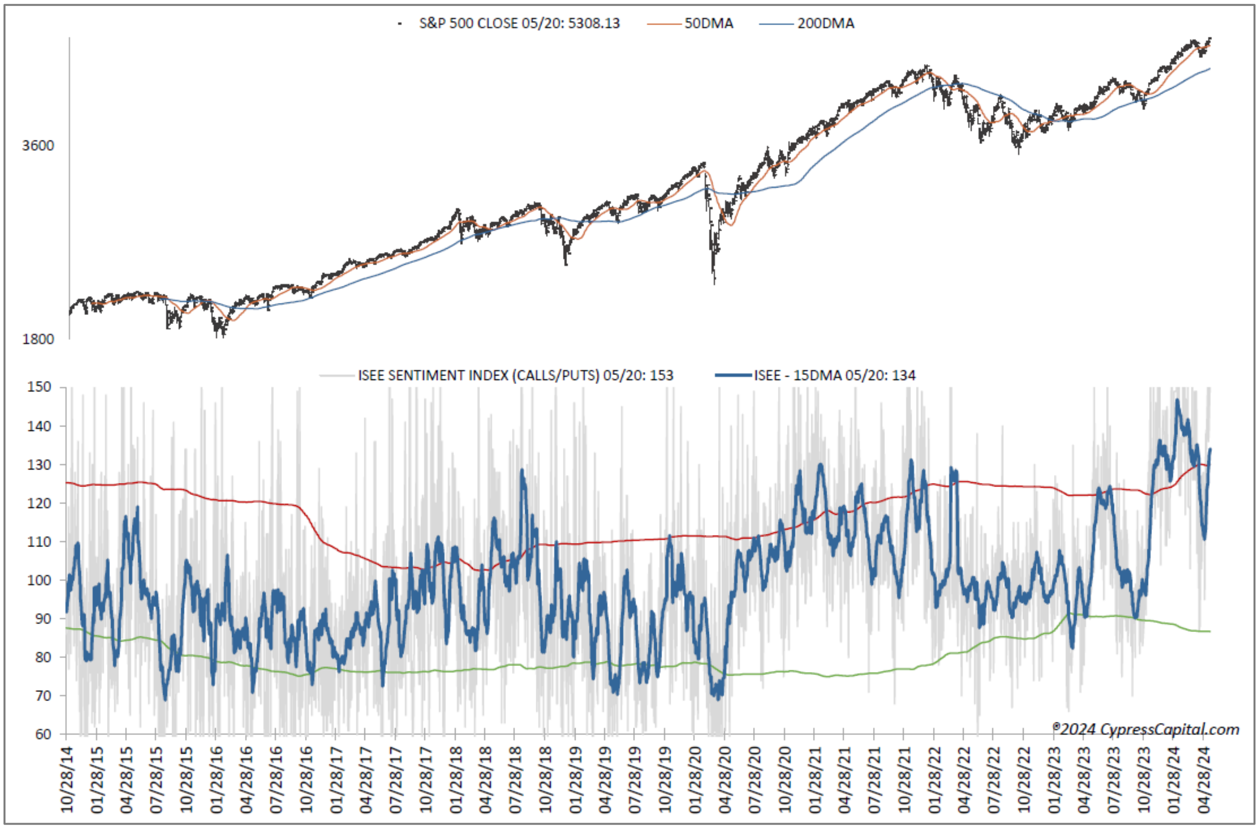
Relative Valuation of Treasuries versus Stocks is approaching the 2000 extreme.



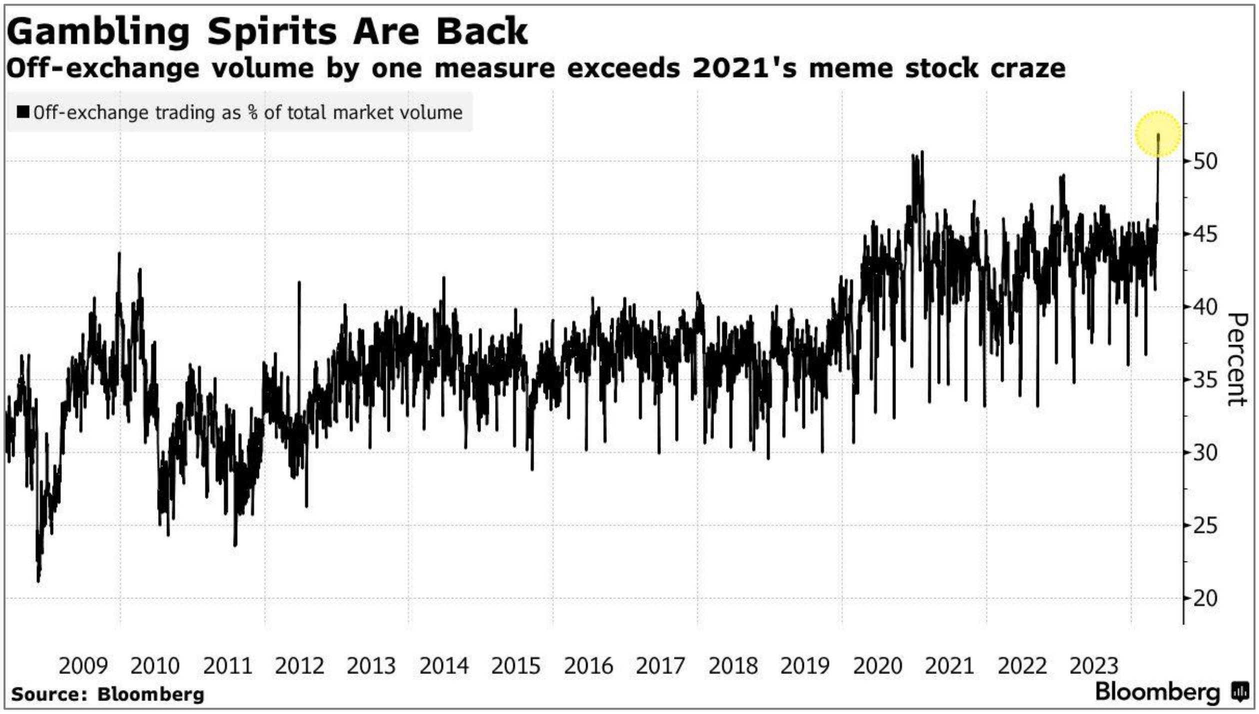
Asset Managers' have Record Confidence in US Equity Markets.



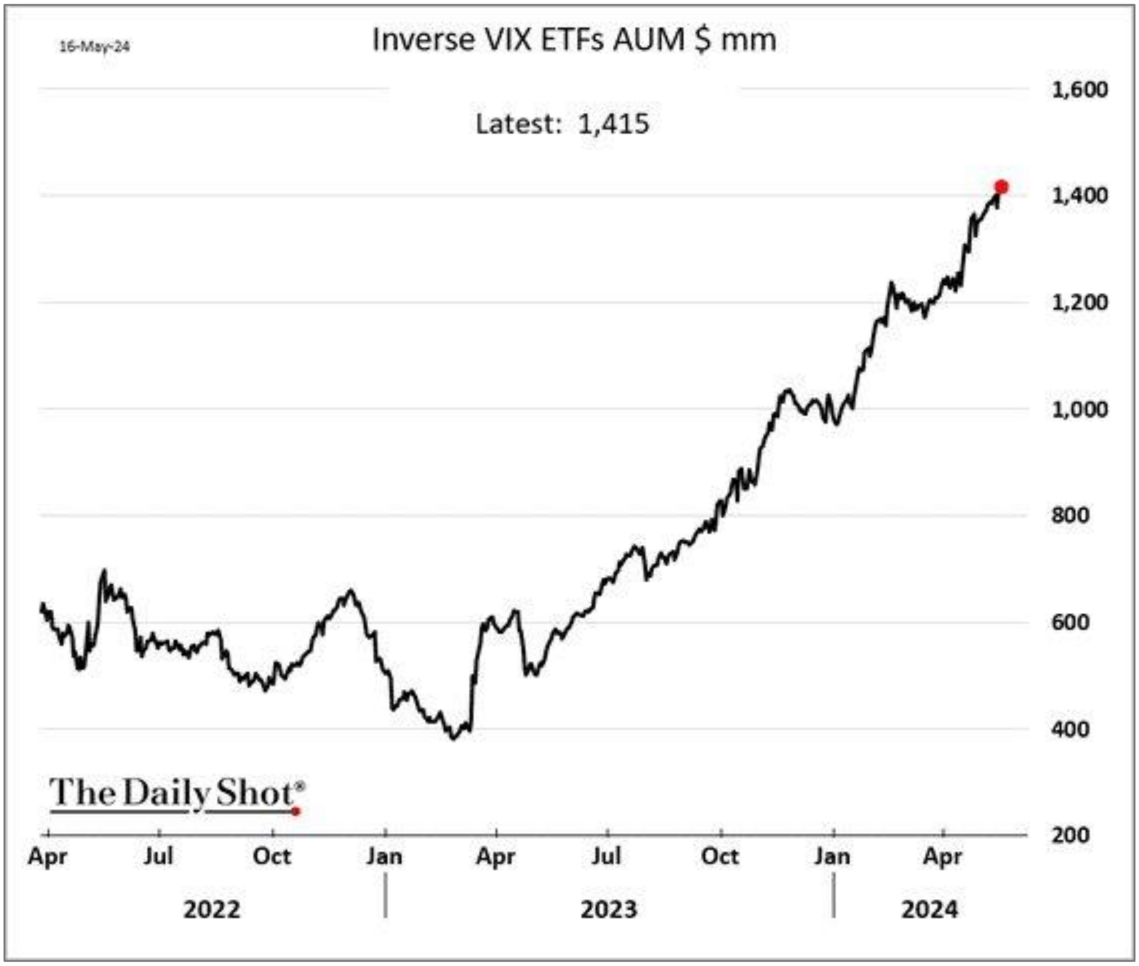
ISEE Sentiment Index shows enthusiasm in options markets has rebounded.



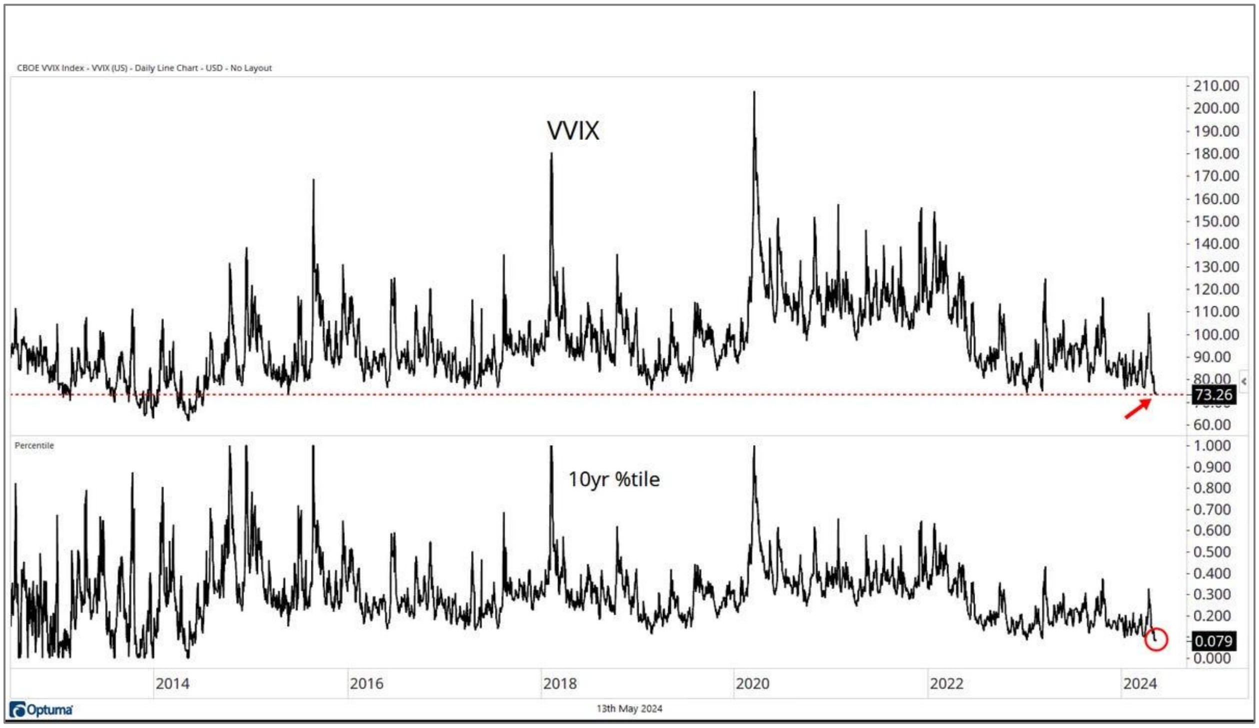
Off-exchange volume, an indication of retail enthusiasm, surpassed the January 2021 euphoric peak.



Assets in Inverse VIX ETFs have tripled over the last 12-18 months.

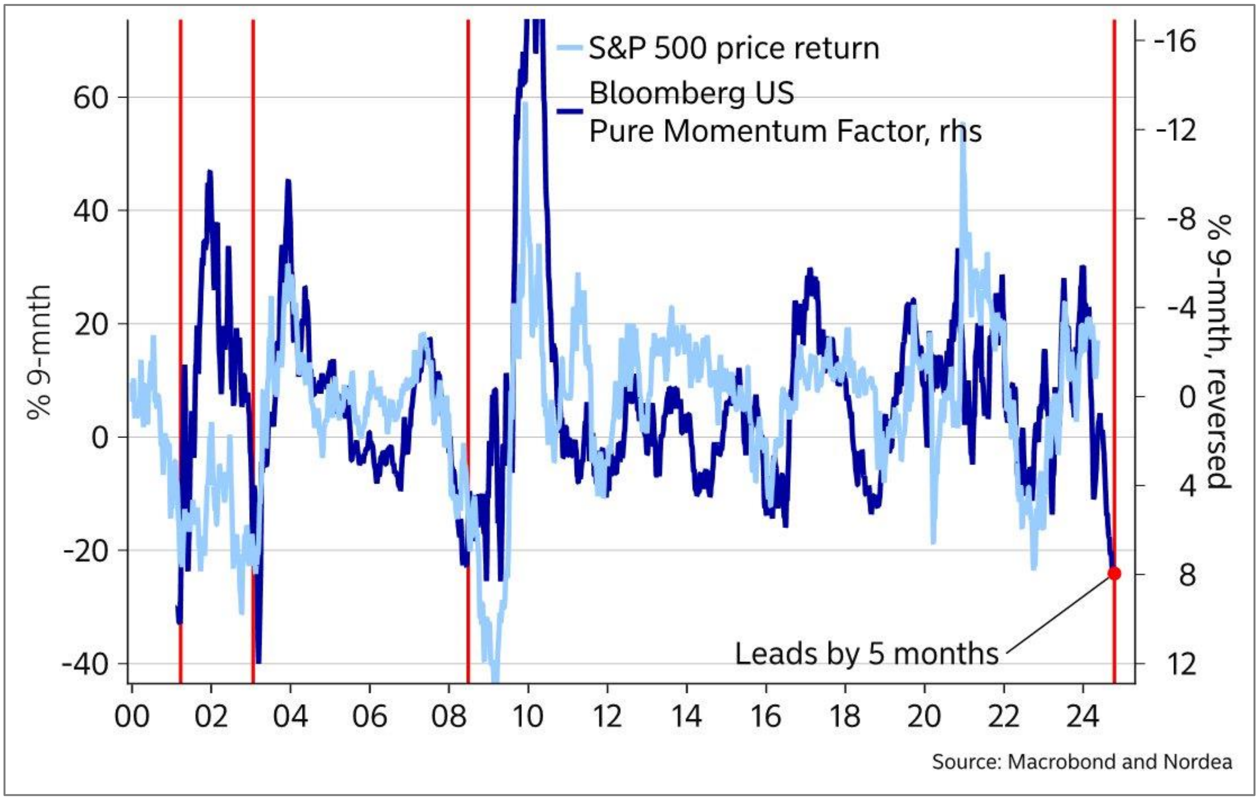


While Inverse VIX assets are surging, the volatility of the VIX is approaching record lows.

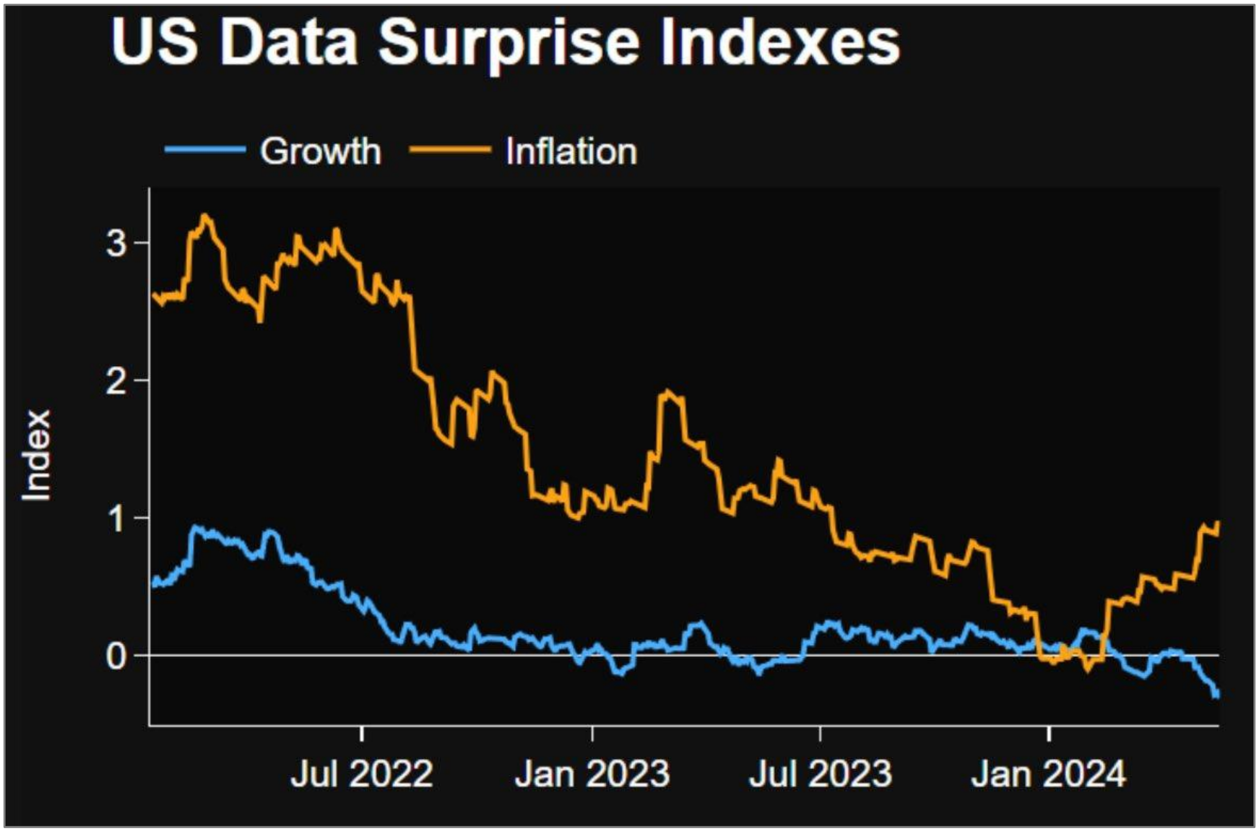


Source: @andrewthrasher

Dramatic Momentum outperformance tends to lead to stock declines by five months.

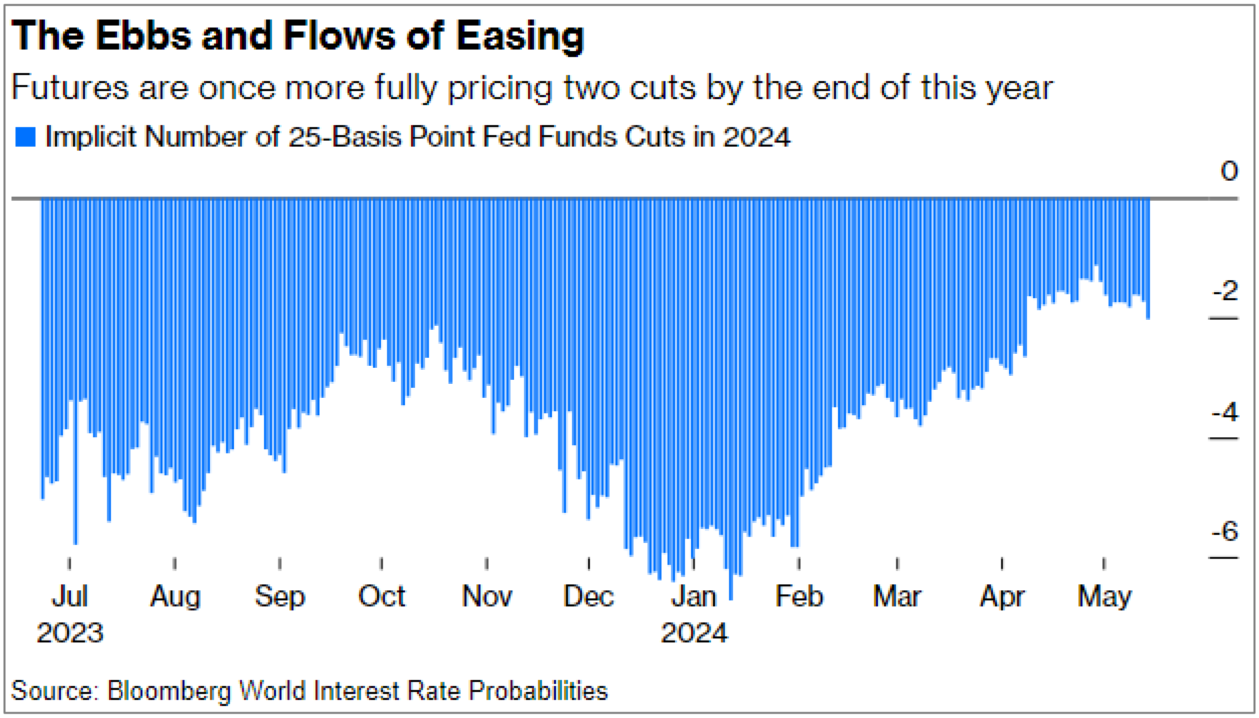


Economic Surprises have been looking more stagflationary than reflationary.

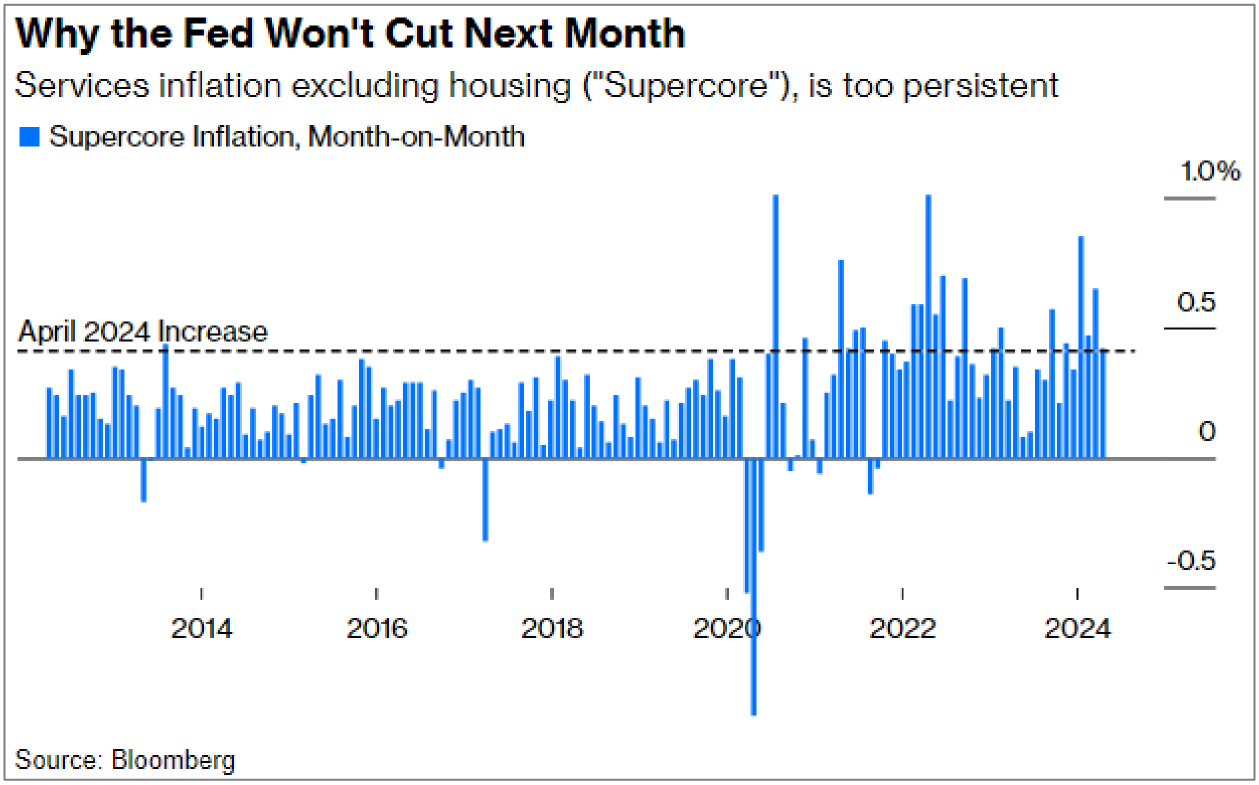


Source: @AnnaEconomist

Bond Markets are back to pricing in two cuts in 2024.



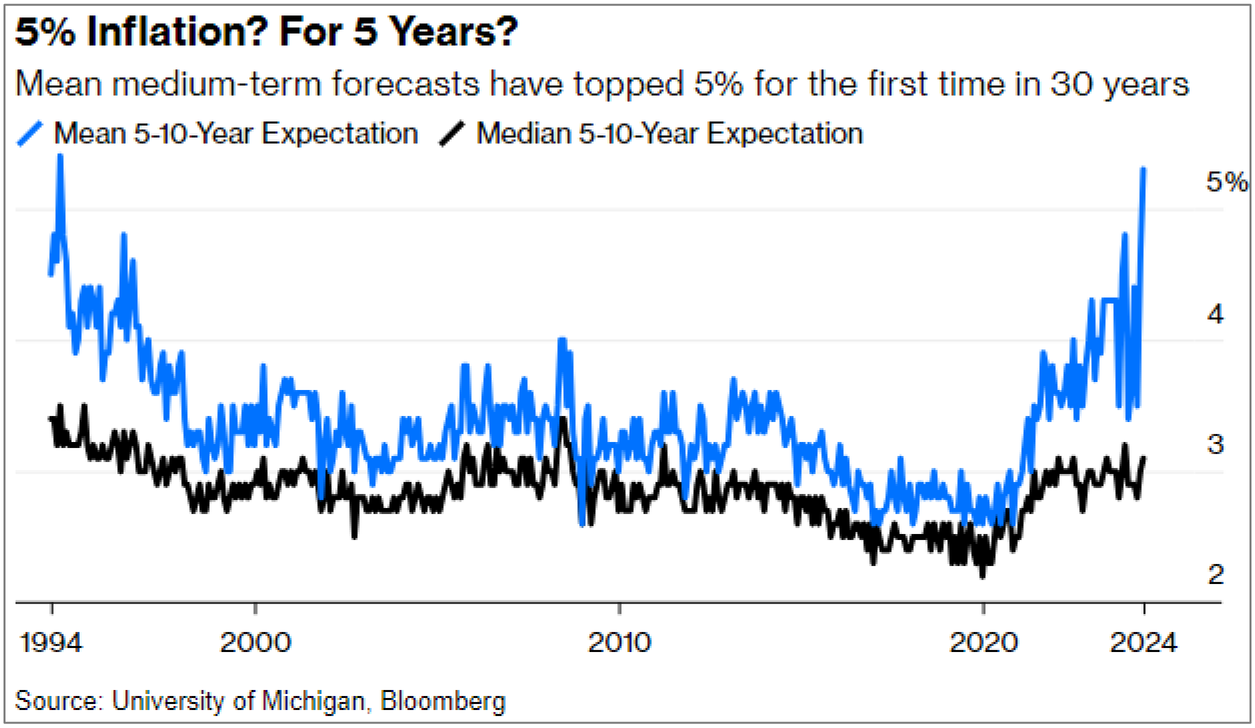
One of those cuts expected by the bond market is unlikely to occur in June.



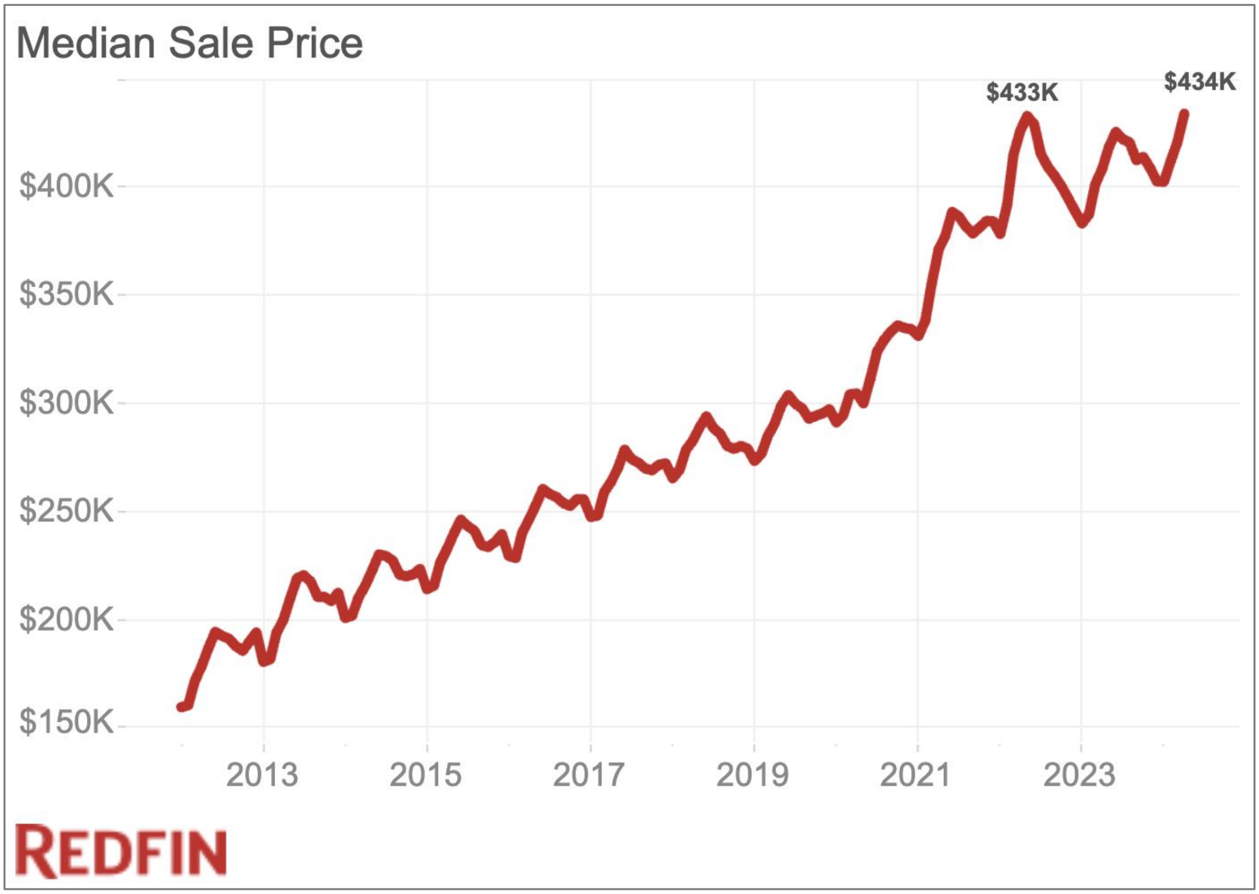
Should the most recent CPI MoM reading persist (0.3%), inflation will be back above 4% by year-end.

Source: @GS_CapSF

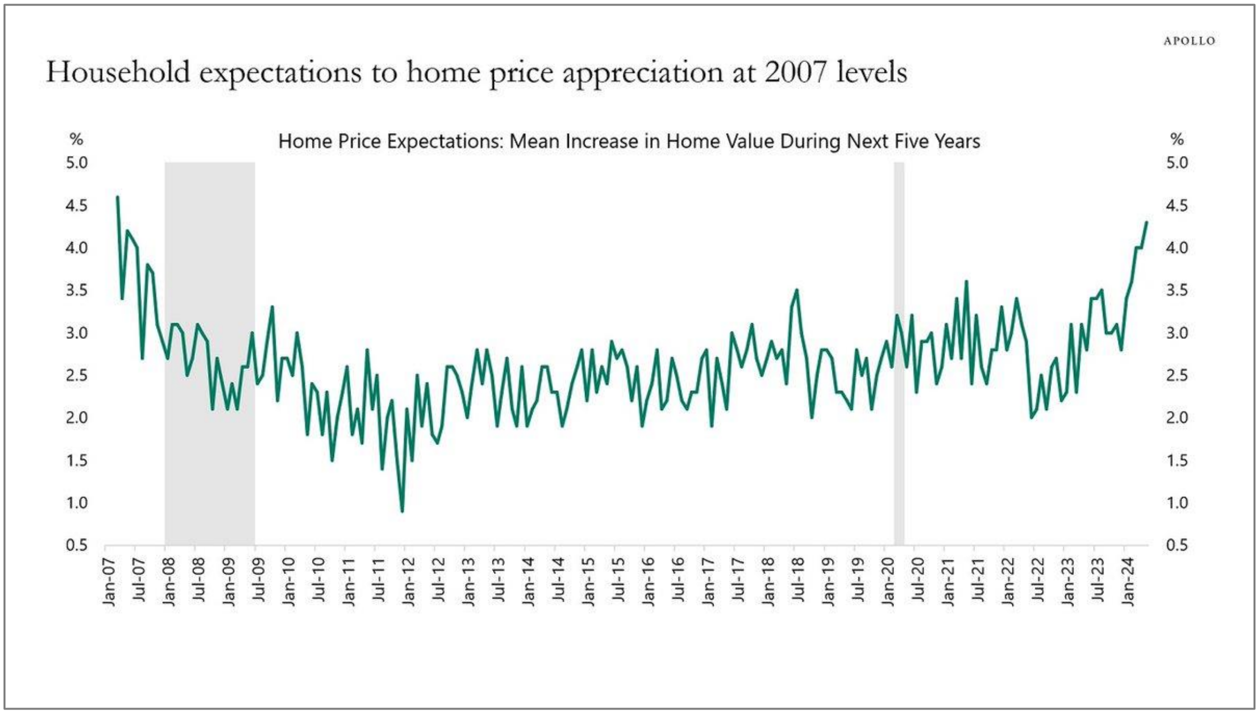
Consumer expectations for inflation climb above 5% for the first time in 30 years.



Is Fed Policy Restrictive? Not based on record home values.

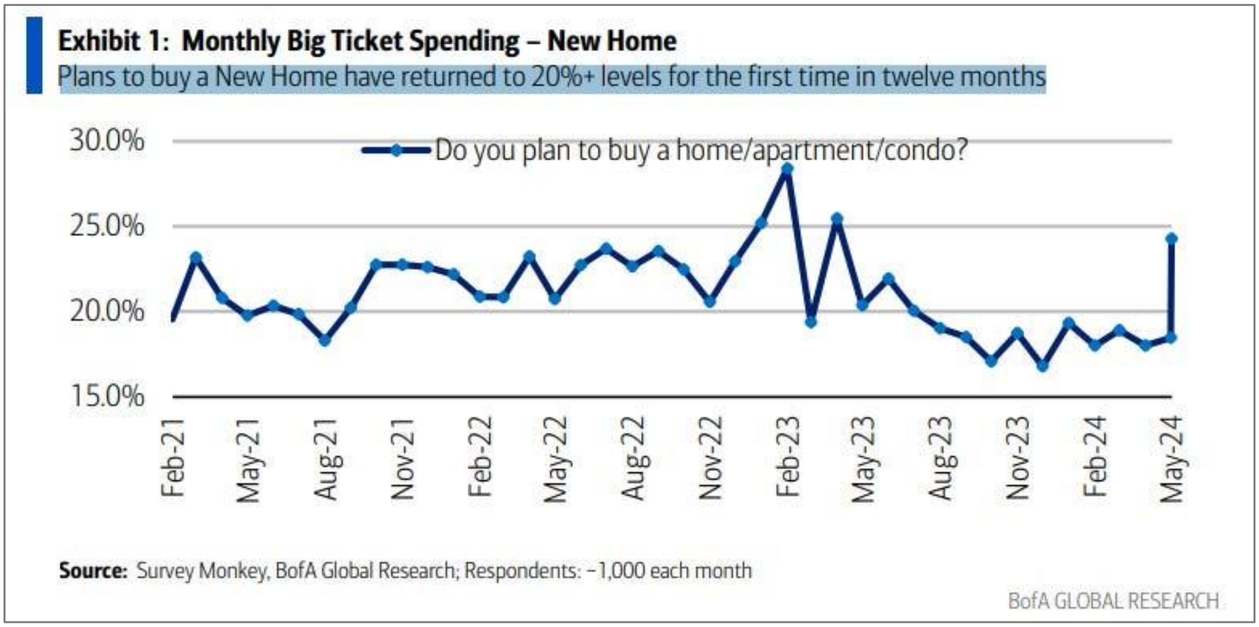


Household expectations for additional home price appreciation are back to 2007 levels.

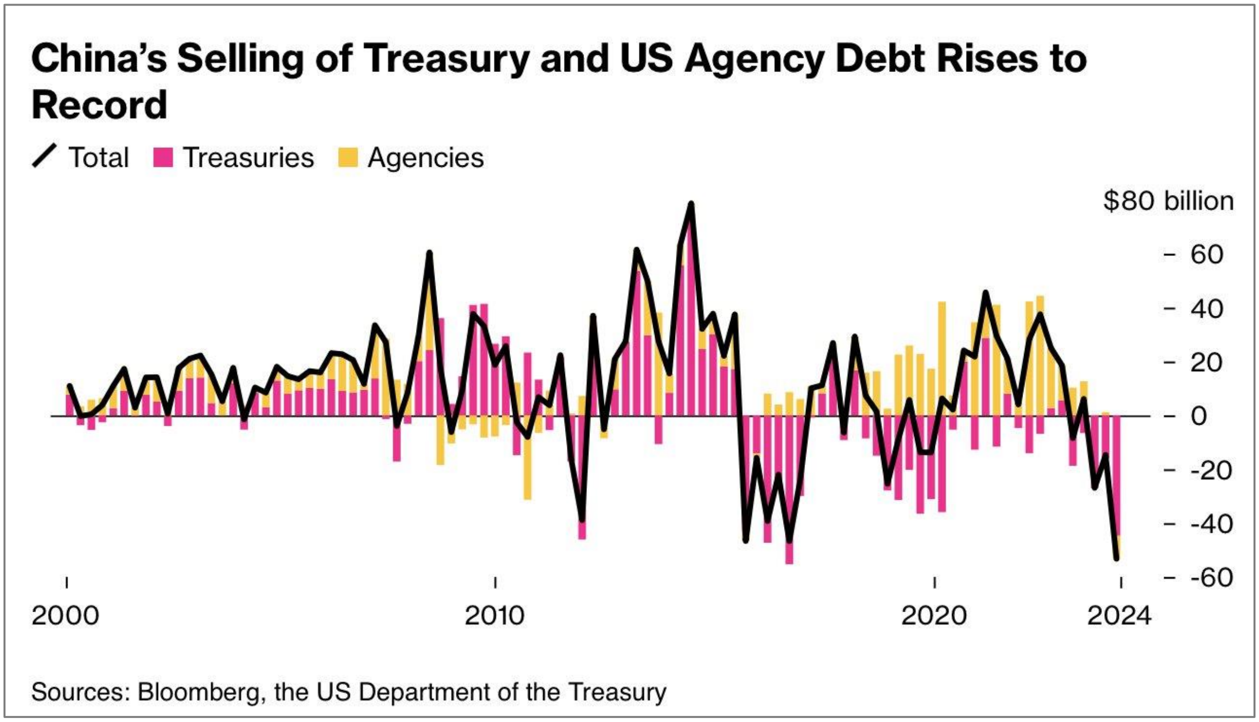


Source: Torsen Slok

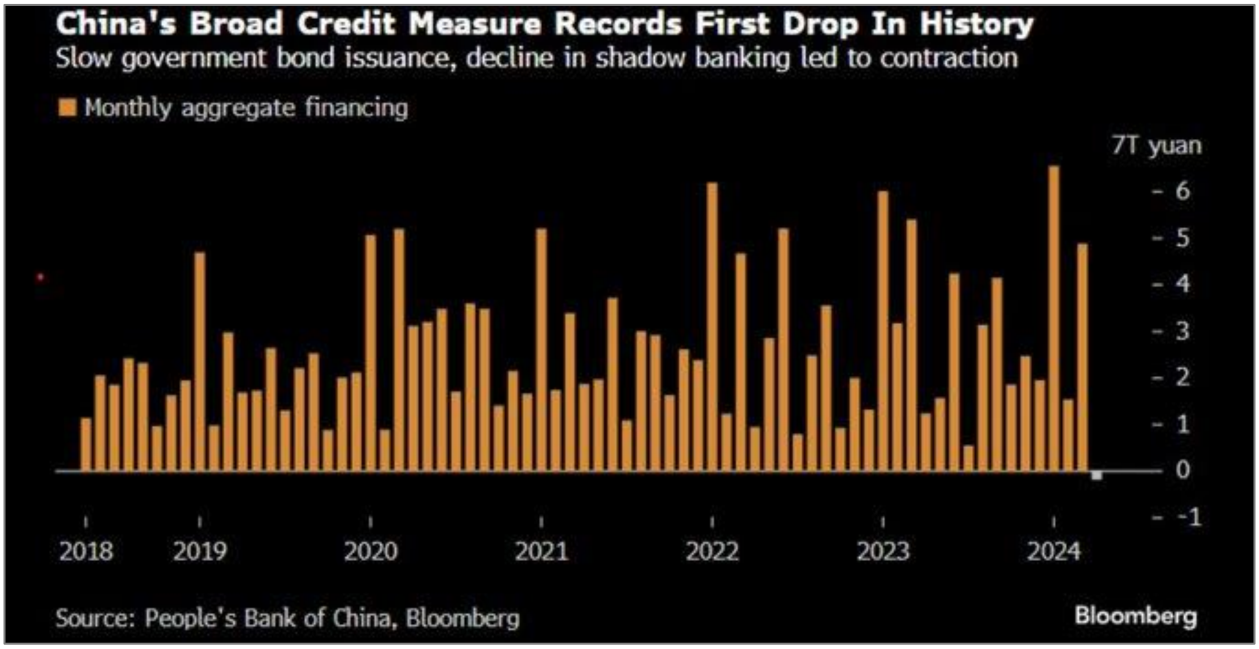
Surge in the percentage of Households planning to buy a new home.



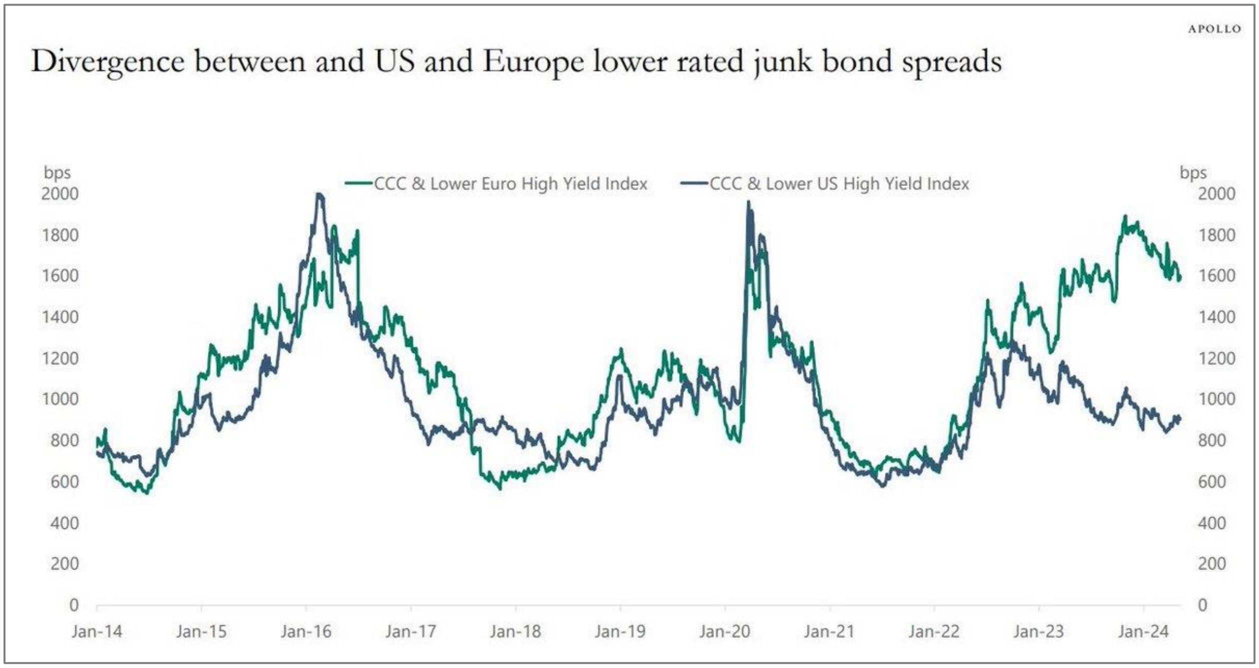
The Treasury market has been unphased by China's record pace of selling.



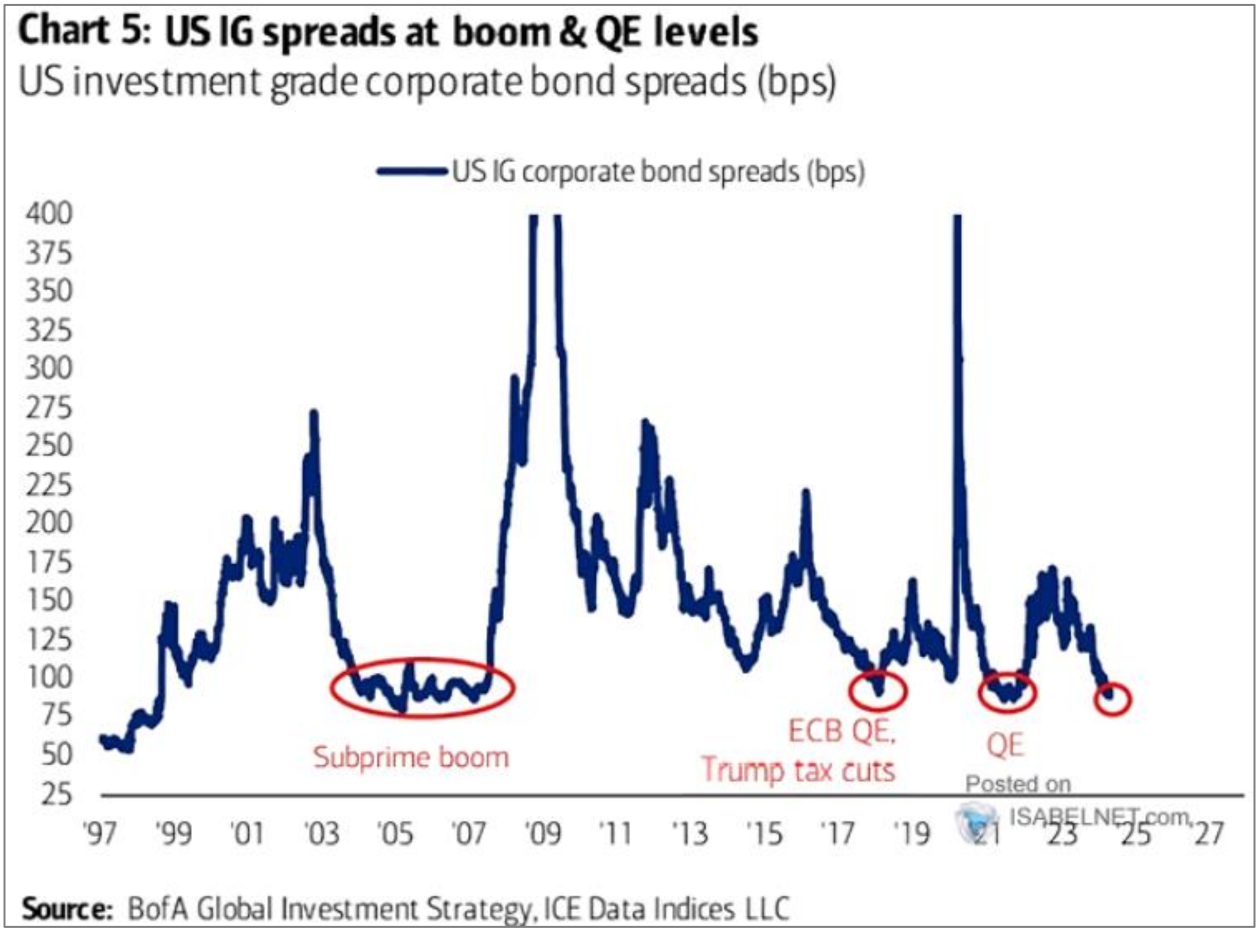
Credit in China records its first drop ever.



Wide gap between junk bond appetites in the US and Europe.

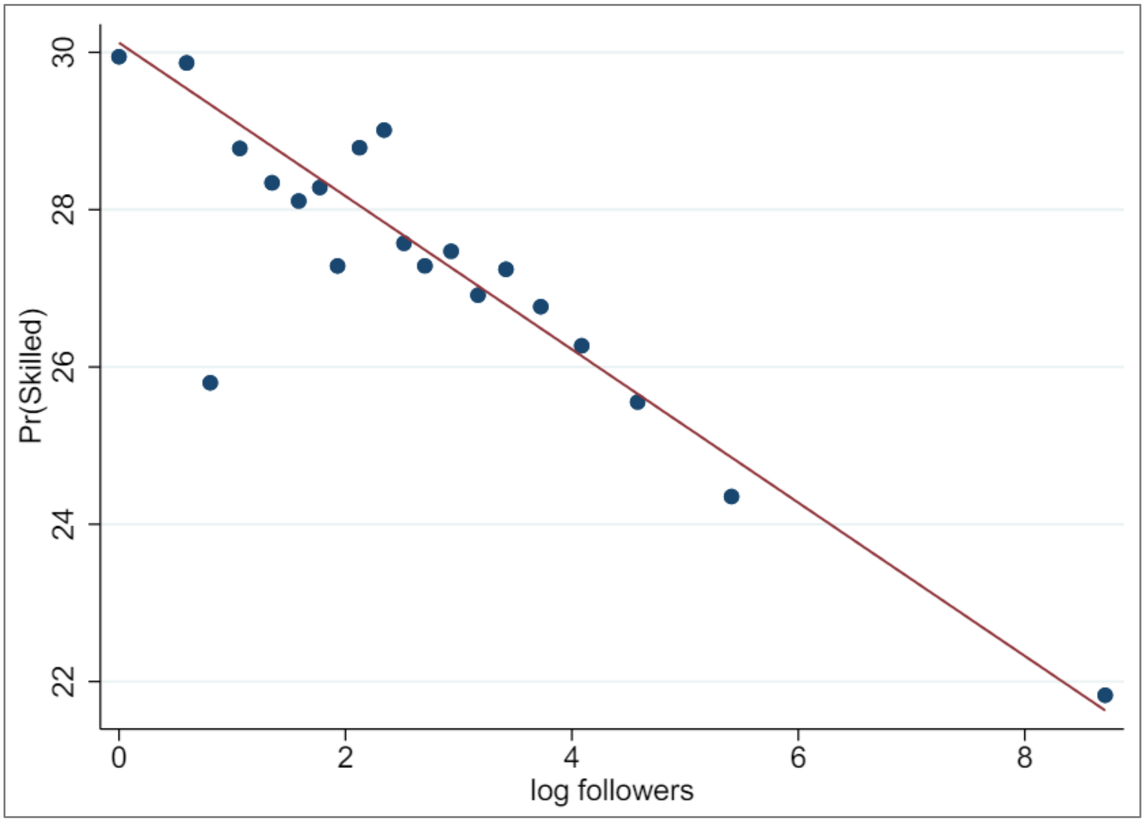


Is the Fed tight? IG Corporate spreads are at levels associated with easy-money environments.



Analyst Long Term Growth Estimates are a contrarian signal.

Researchers find a strong inverse relationship between Fin-twit follower count and skill.



Source: Finfluencers∗ Ali Kakhbod UC Berkeley Seyed Kazempour Rice University Dmitry Livdan UC Berkeley, CEPR Norman Sch¨urhoff University of Lausanne, SFI, CEPR April 25, 2023

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.