Market Outlook

By Mark T Dodson, CFA

Equity Market Halitosis – stocks have stinky breadth.

Market Risk Index climbed to 88.9%. The Monetary Composite climbed above 50% into the tight money side of neutral, and valuations edged up to the worst 0.1% of readings in history. Psychology improved slightly, enough to keep MRI from climbing above 90% - the level breached at the previous four bull market peaks.

Within the Psychology Composite, the Options Category worsened on mega-cap Tech speculation in options markets, but improvements to the Volatility category offset this. Volatility is extremely low and signals investor complacency, but it's in a regime that tends to be associated with additional stock market gains over the short term, thus the positive readings. Volatility is the only category of indicators in our Psychology Composite with positive (bullish) readings.

Speculative fervor in markets continues to provide cover for Powell and central bankers to keep interest rates elevated. If you were a policymaker wanting to be confident that inflation is under wraps, stock prices at new highs make it easy to stay the course. Markets stubborn attempts to front-run the first Fed rate cut on favorable inflation rate shifts (measured in tenths of a decimal point) perpetually delay the arrival of said cut. Until markets get spooked, the Fed can keep rates where they are. Our Monetary Composite is only starting to hint that keeping rates higher for longer is beginning to impact financial conditions.

Monetary Conditions have steadily worsened every week since their most bullish reading in early April, moving to the tight-money side of neutral in the last two weeks. The shift to positive growth in Monetary Aggregates has coincided with a weakening of our Velocity category. It's not bearish yet, but it's the first sign since the Fed started tightening that the behavior of economic participants is beginning to shift. In an attempt to wrap the data with a narrative, it could be that Households have sapped the last bit of their stimulus windfall, or higher rates are beginning to lead to financial distress under the surface in credit markets – either regional banks, real estate, or private credit. There's no shortage of over-levered bagholders this time around.

Coincidentally, almost to the day our Monetary Composite started worsening, we saw breadth and participation deteriorate in equity

Market Risk Index

Rec Allocation 25% Underweight

88.9%

Category Percentiles

Psychology - P6: 96.8%

Monetary - M4: 53.8%

Valuation - Extremely Overvalued: 99.9%

Trend: 47.0%

Largest Psychology Influences

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

Largest Monetary Influences

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

Valuation

7-10 Year Equity Return Forecast	-0.2%
10Yr US Treasury Yield	4.3%

Market Trends

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

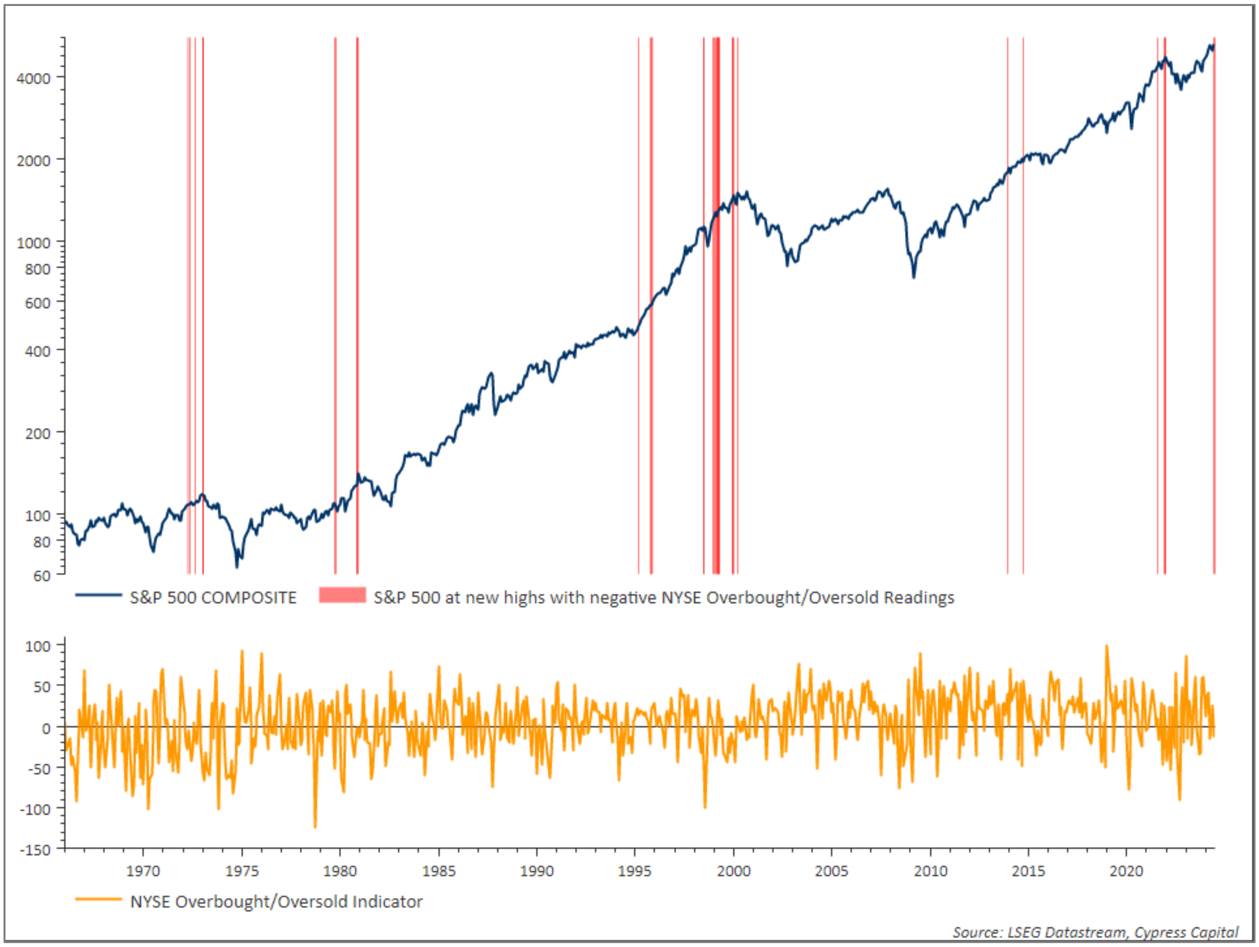
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets based on our model & opinion. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

markets. The stock market highs early in 2024 were broader, suggesting that more new highs would likely follow during the summer. The market changed its stripes in recent weeks, with new highs in the cap-weighted indices experiencing breadth poor enough to call into question the ability of the market to continue its ascent. Recent highs in cap-weighted US indices have seen more new lows than new highs, more declining stocks than advancing stocks, less than half the stocks trading above their respective 50-day moving averages, and a paltry number of key indices and sectors are making highs alongside the market.

By some measures, this market is narrower than the 2000 bull market peak – the market environment that serves as a historical case study for technicians who want to highlight what a market with poor breadth looks like. Still, our favorite measure of a bifurcated market, the NYSE High Low Logic Index, has not triggered a sell signal. However, that possibility is growing more likely over the coming weeks.

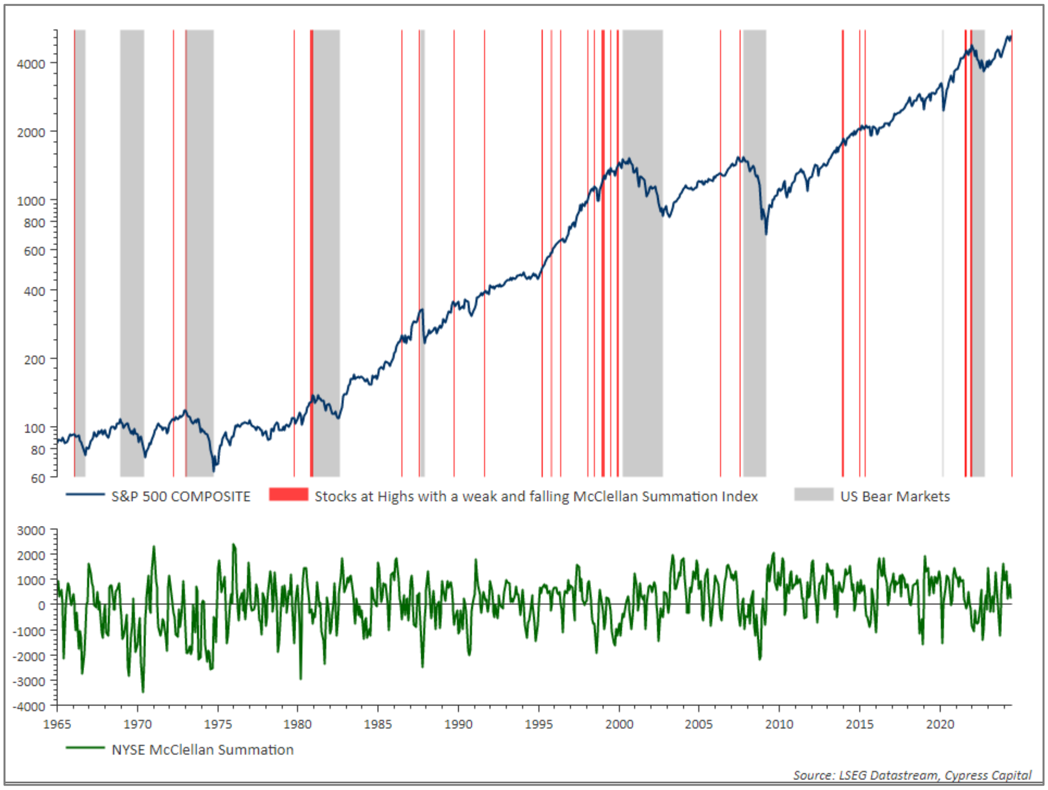
Charts of the Week

S&P 500 at new highs with negative NYSE Overbought/Oversold Readings
Negative readings on our Overbought/Oversold indicator mean that declining stocks have been outnumbering advancing stocks over recent weeks.



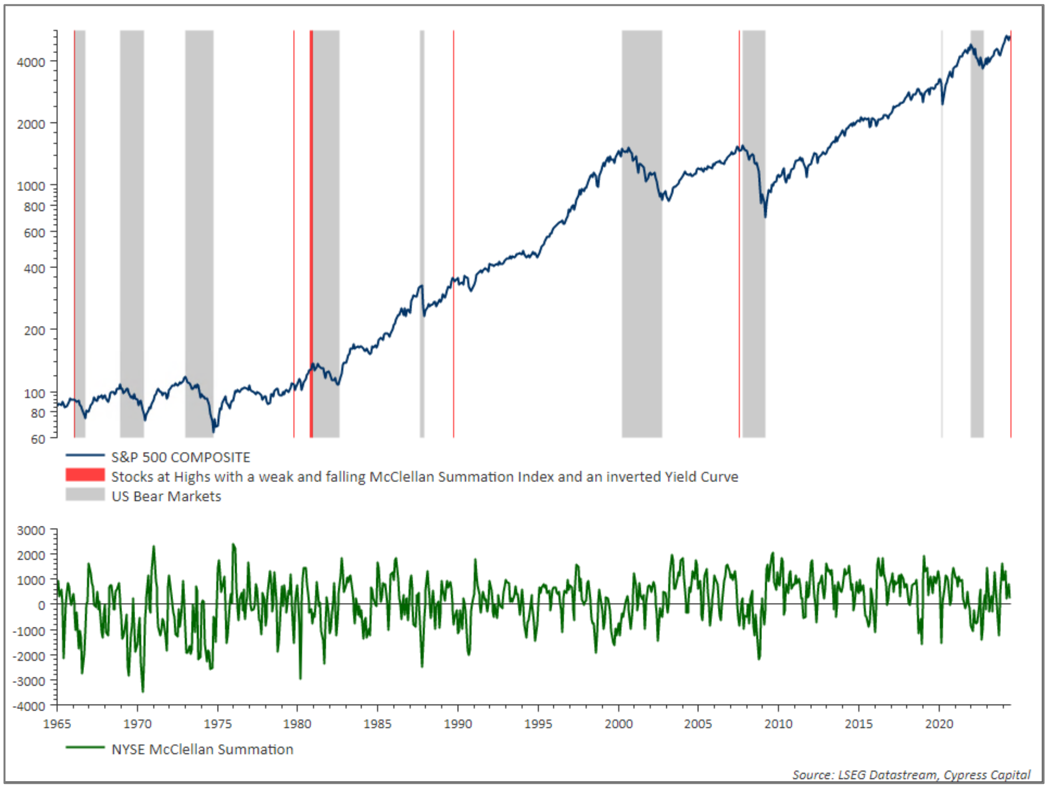
S&P 500 at new highs with weak and falling McClellan Summation index.

Weak and falling McClellan Summation readings mean market participation and breadth are waning. This mix has had its share of false signals, but it was also a precursor to seven of the last nine bear markets.

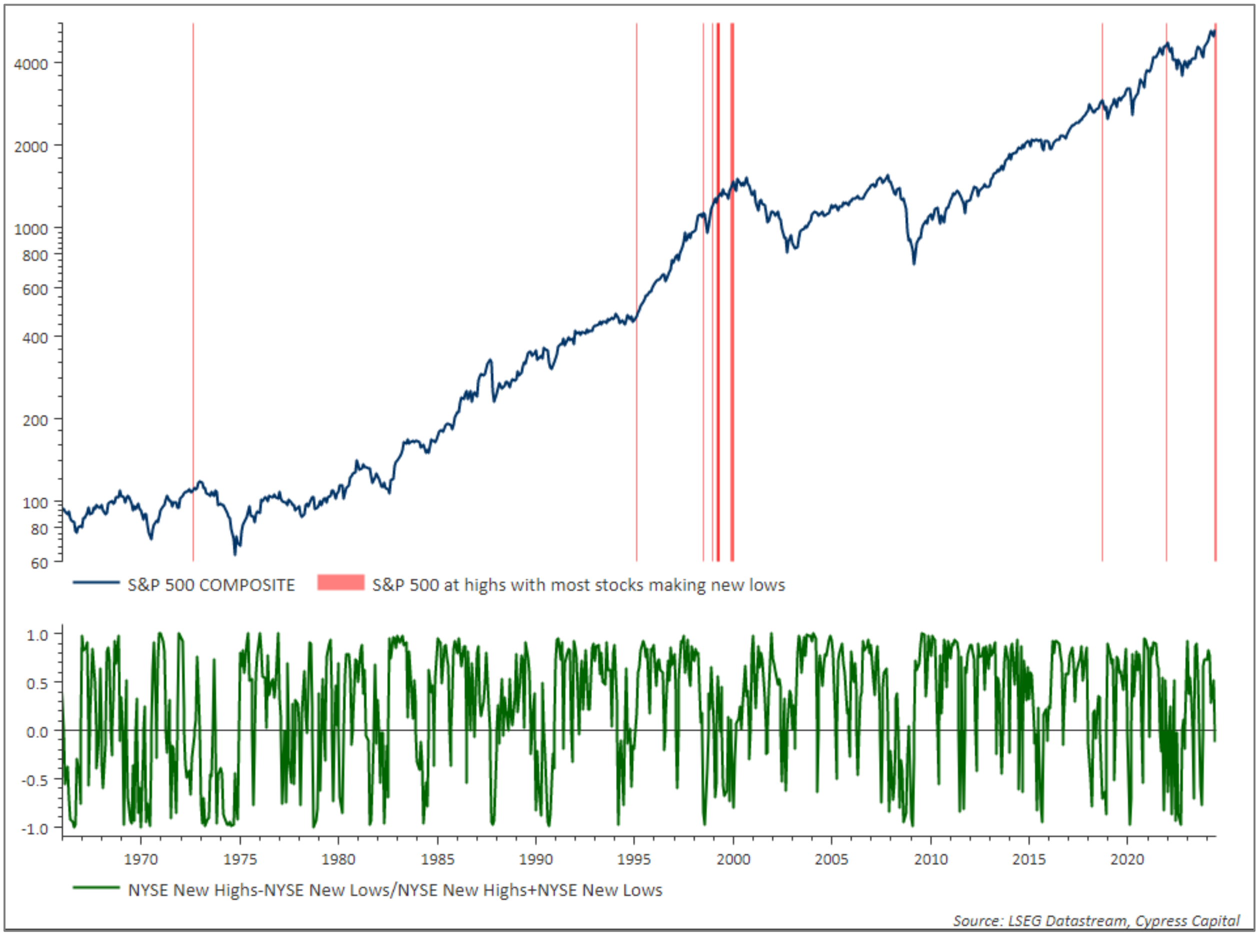


S&P 500 at new highs with weak and falling McClellan Summation index and an inverted yield curve.

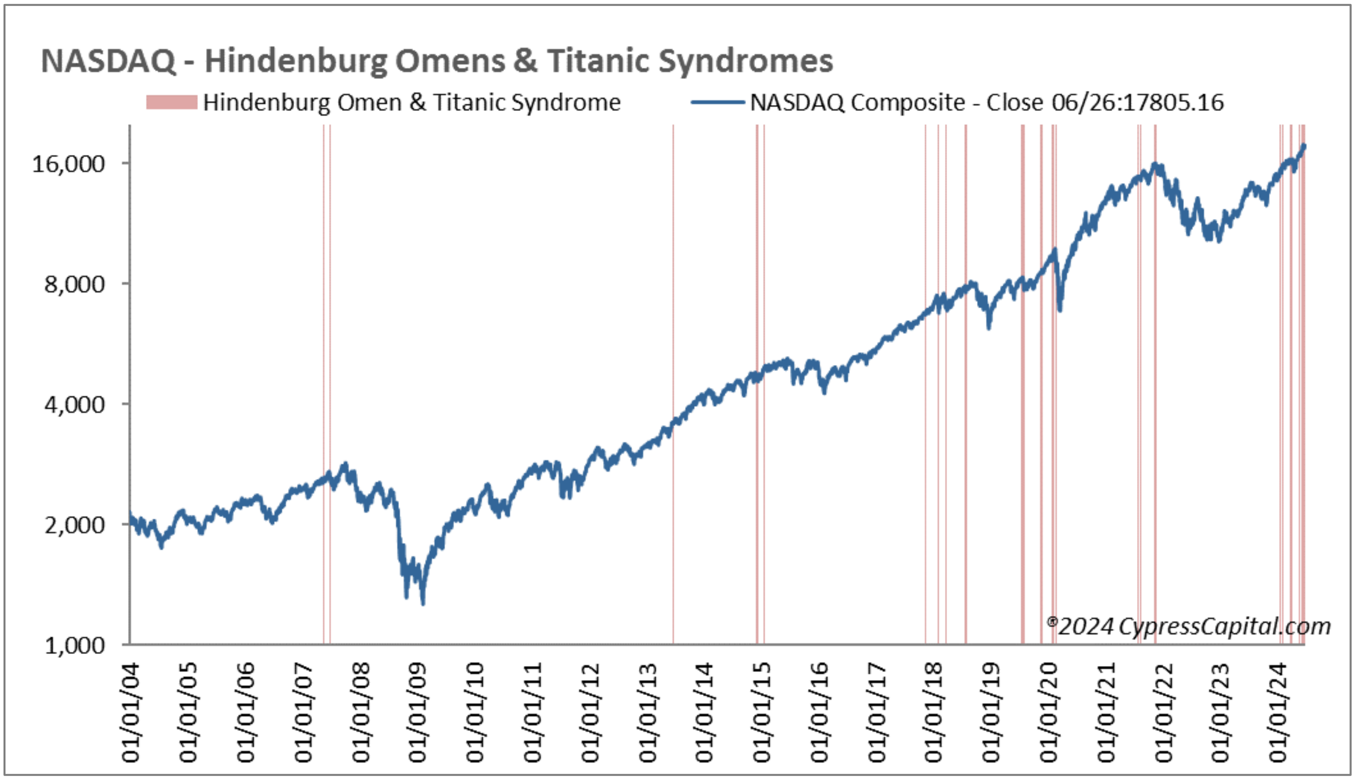
A case for a weight of the evidence approach to markets - the same measure of market breadth occurring in an environment with an inverted yield curve complements long-leading yield curve signals.



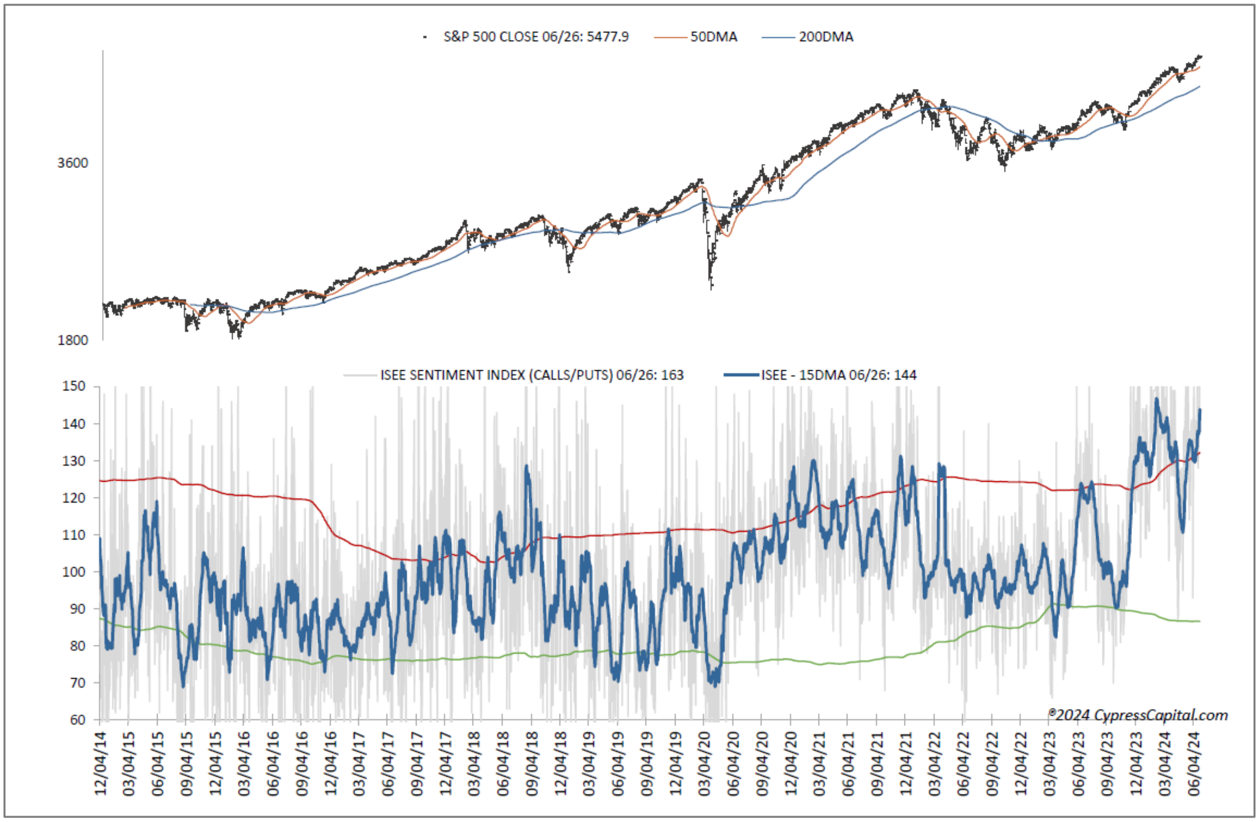
When the S&P 500 is making new highs, but the majority of stocks are making new lows.



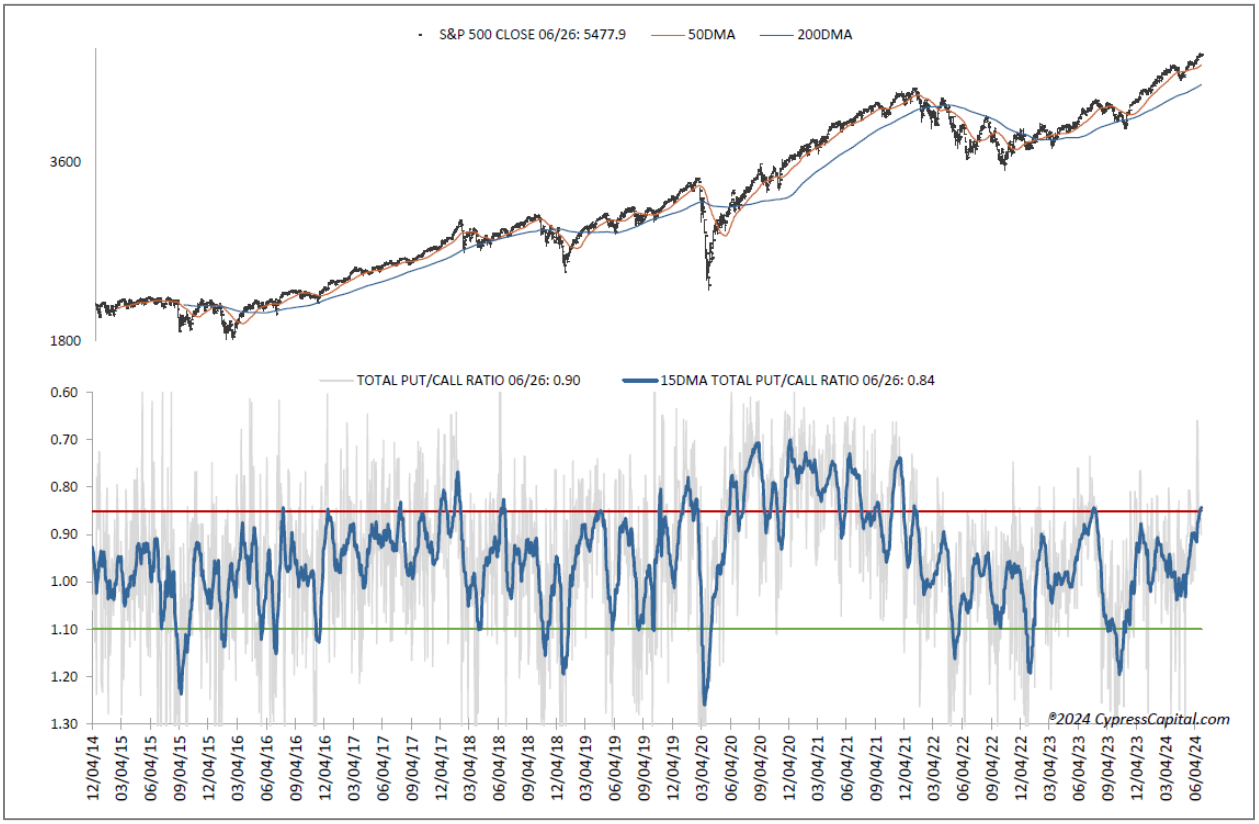
NASDAQ Hindenburg Omens and Titanic Syndromes – 2024 has had a cluster of them.



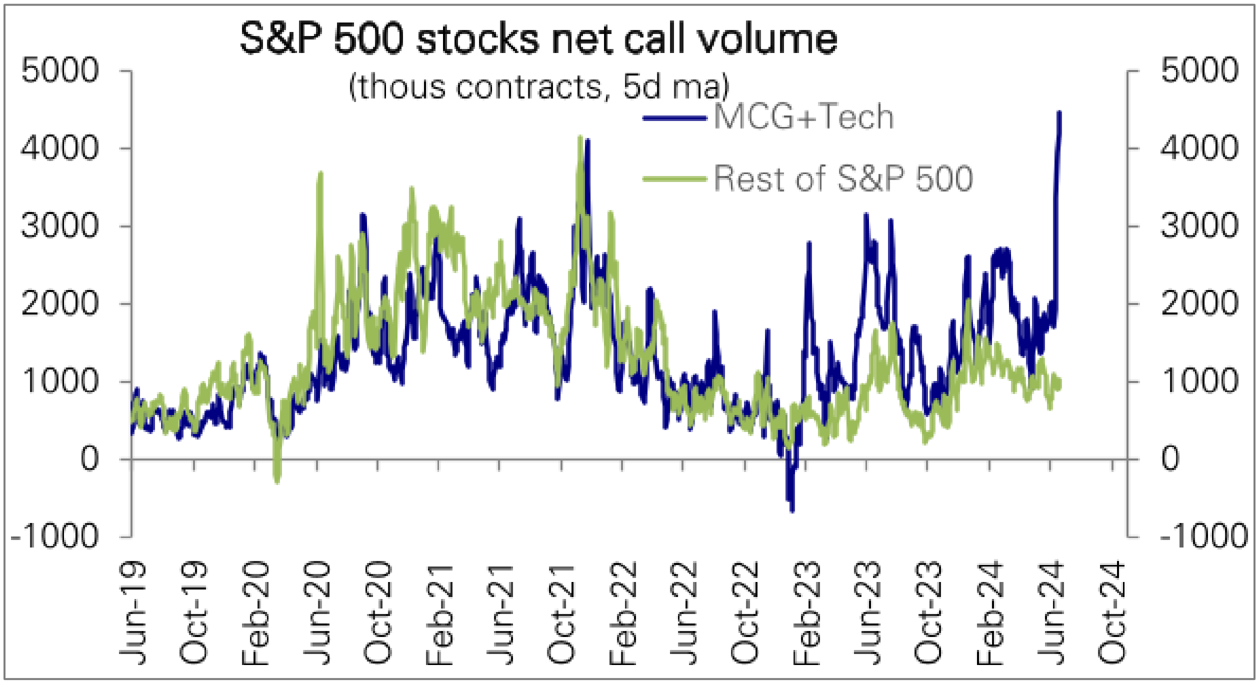
ISEE Sentiment Index – Speculation in call options is ramping back toward bull market highs.



Heavy call option volume caused the Total Put Call Ratio to red-line this week.



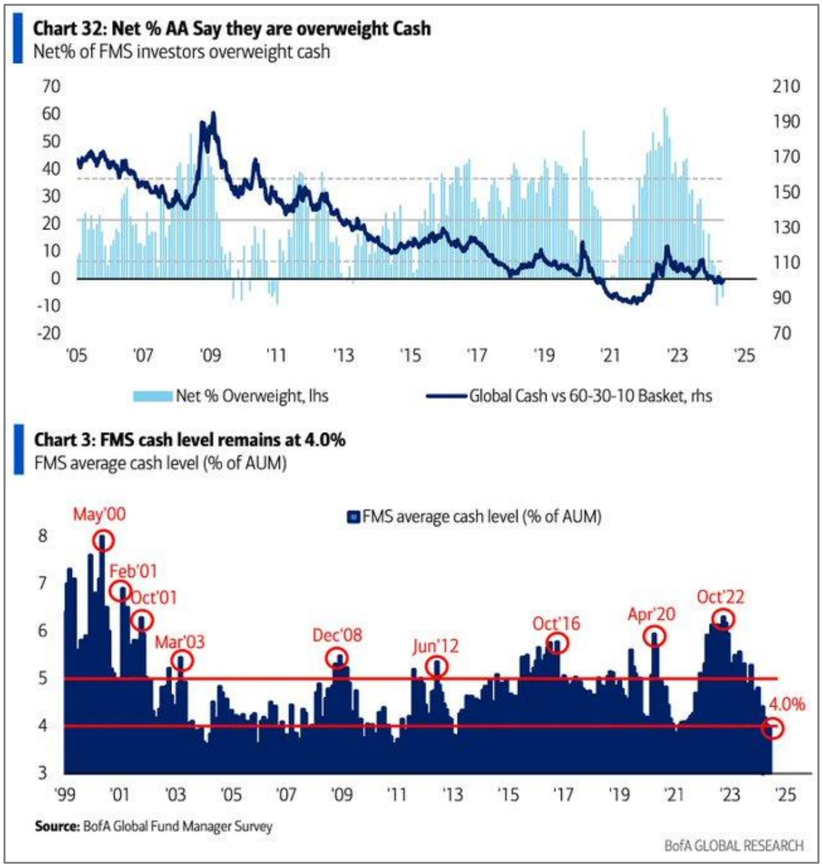
Call option volume in Mega Cap Growth and Tech rocketed higher.



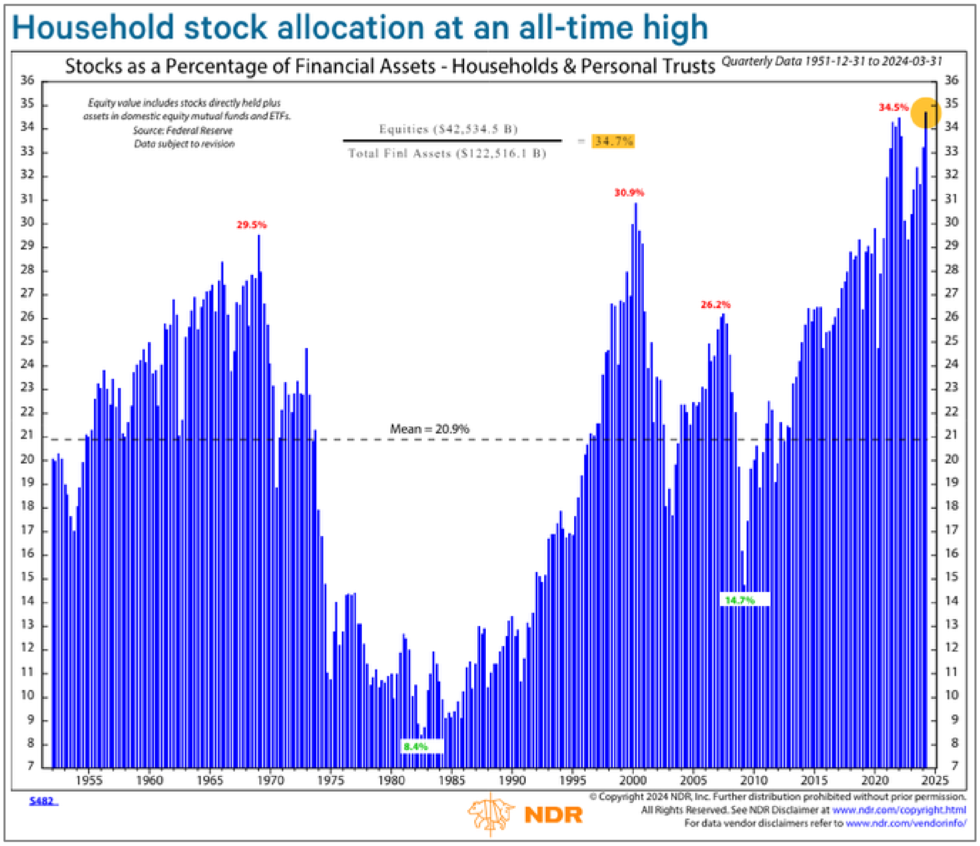
Source: OCC, Axioma, Deutsche Bank Asset Allocation

Dividend yields have fallen close to the 2021 all-time lows, while T-Bills yield more than 5%.

Even with yields north of 5%, cash is still trash in the eyes of complacent investors.

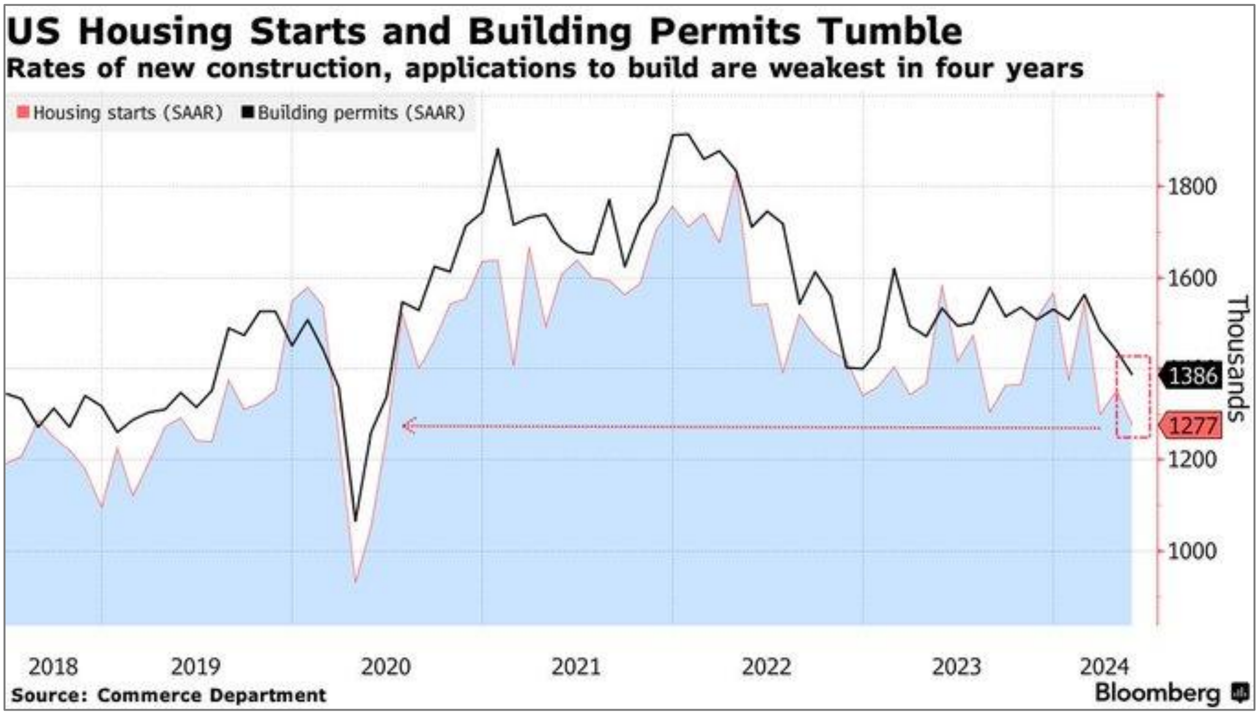


Household stock allocation hit an all-time high in Q1.

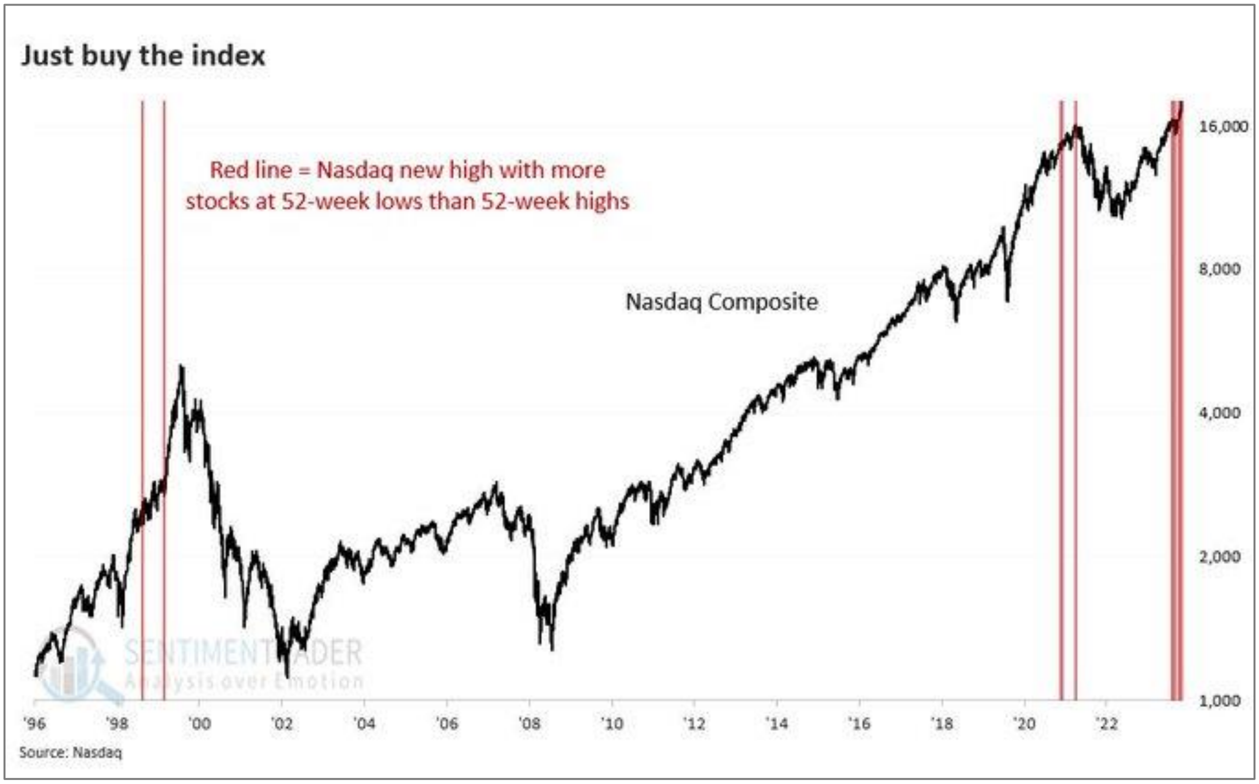


Consumers' Household Income Expectations dropped sharply.

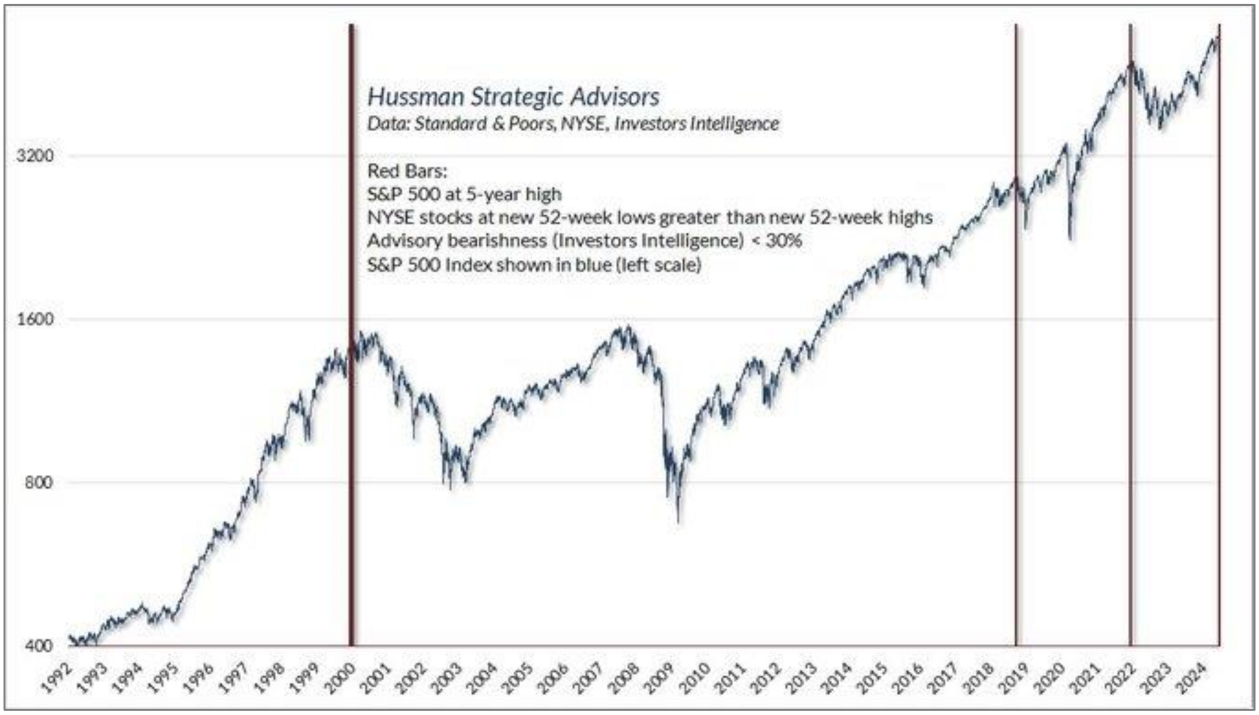
US Housing Starts fall to the lowest level since COVID.



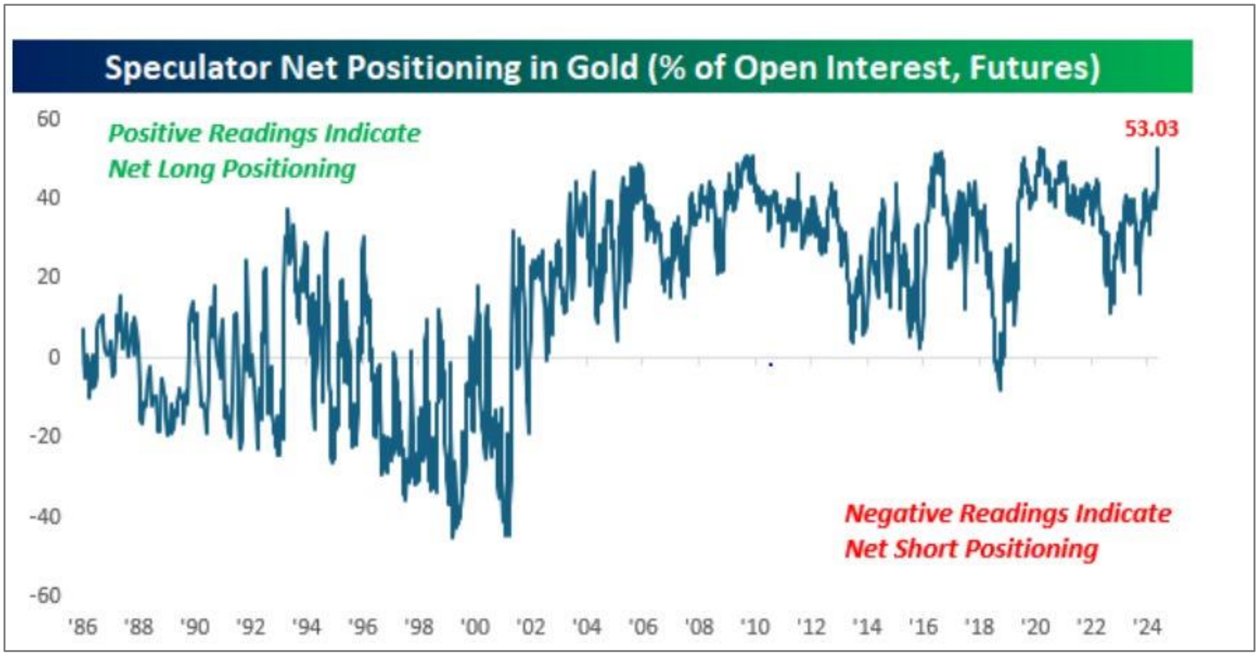
When the NASDAQ hits a new high and new lows outnumber new highs.



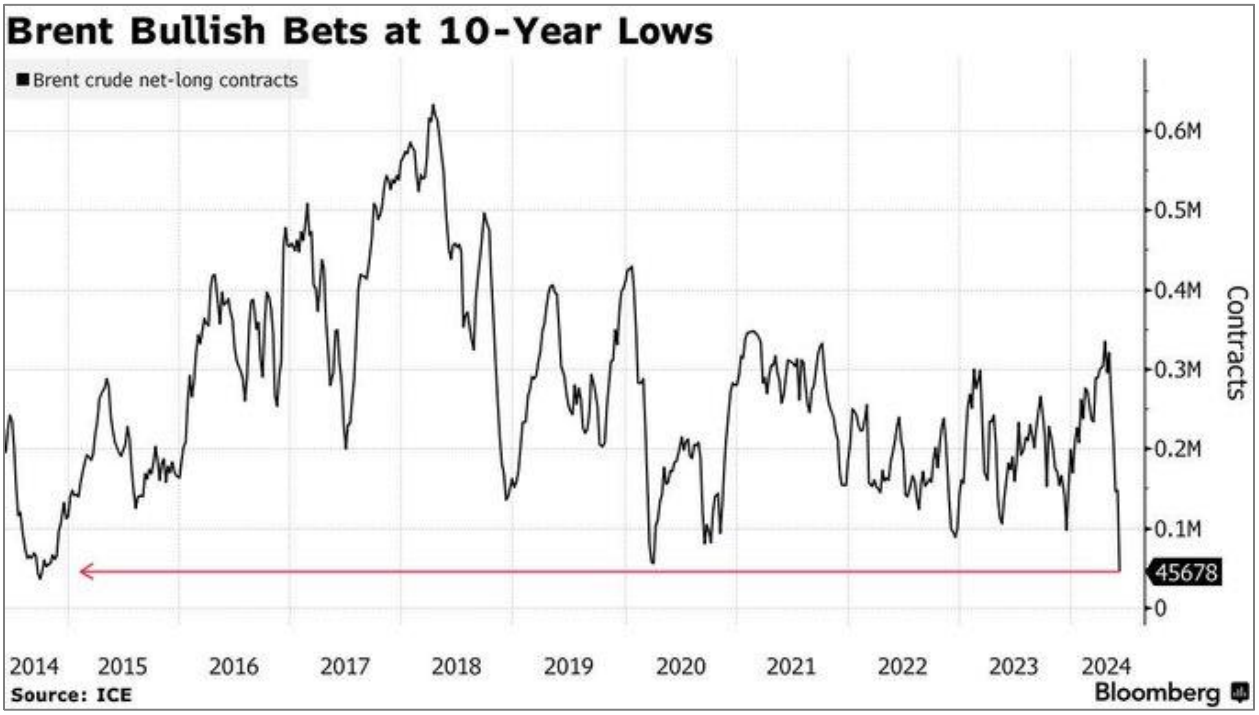
When the S&P 500 is at new highs, new lows outnumber new highs, and investors are complacent.



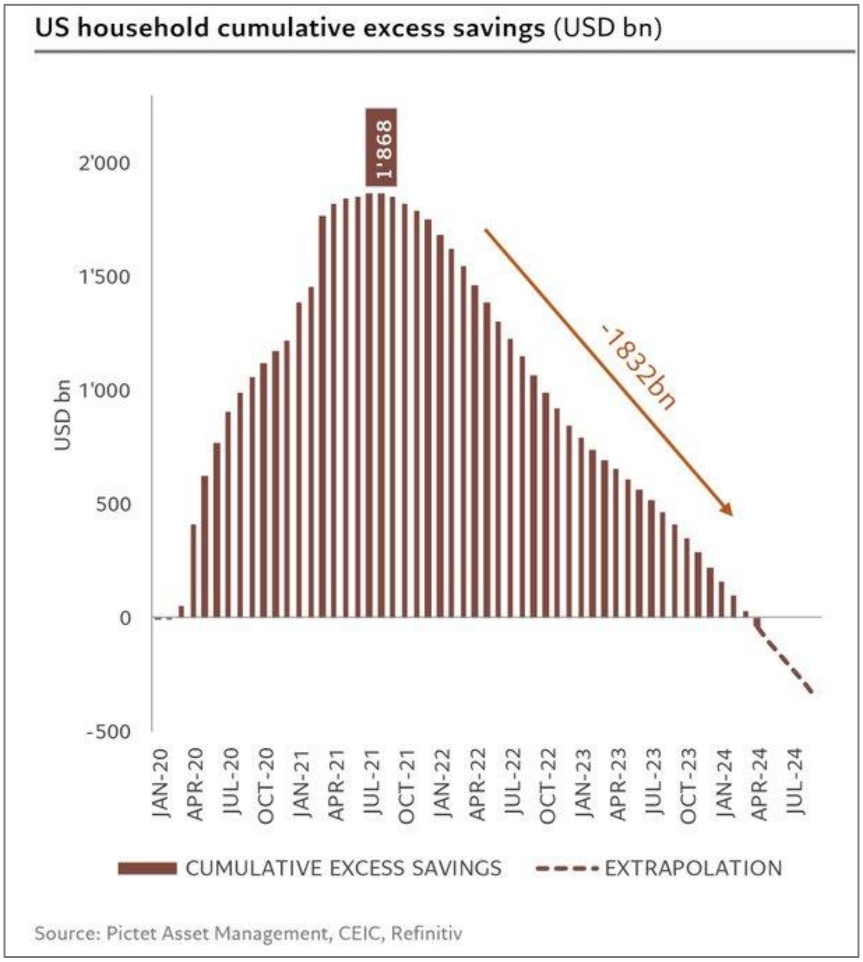
Futures speculators are bullish on gold.



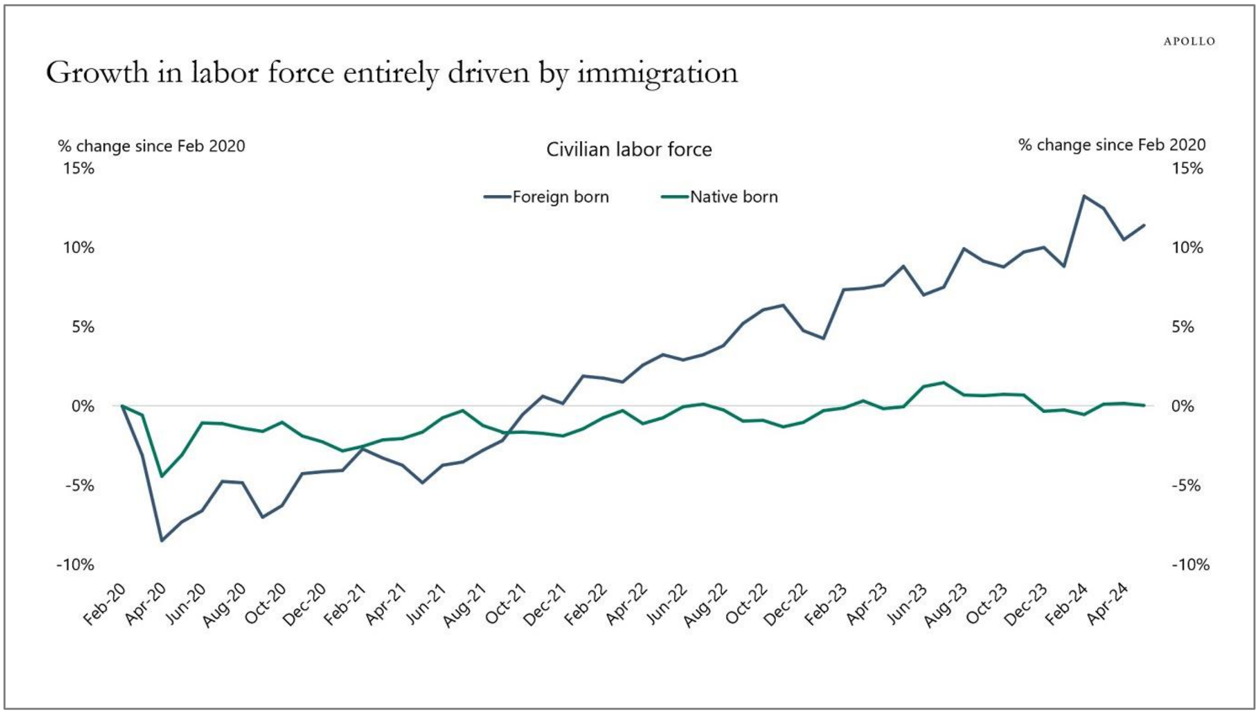
And bearish on Oil.



Another estimate suggesting that Households have spent down COVID-stimulus savings.

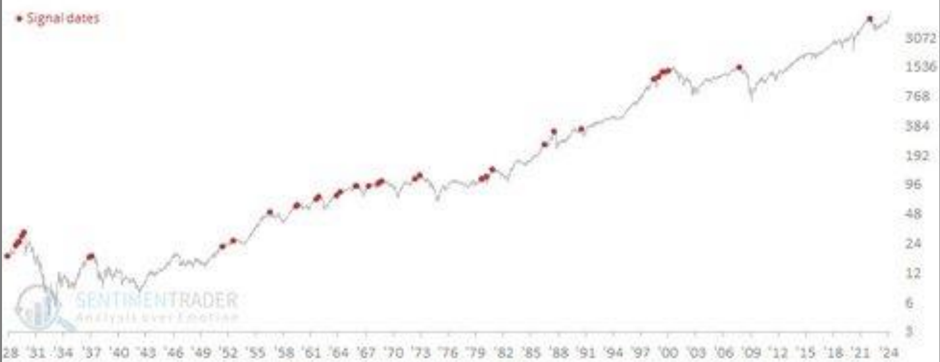


Immigration has driven all the growth in the labor force.



A century of examples of markets experiencing lousy breadth.

S&P 500 after an S&P 500 Advance-Decline Line Divergence Risk-Off Signal



Dates of 38 Signals	1 Week Later (%)	2 Weeks Later (%)	1 Month Later (%)	2 Months Later (%)	3 Months Later (%)	6 Months Later (%)	12 Months Later (%)
1928-01-10	-0.5	0.9	0.2	-0.4	9.7	7.9	32.6
1928-12-06	-1.7	-0.9	8.3	11.0	8.7	14.5	34.5
1929-02-07	-1.5	0.6	2.4	2.4	3.3	15.9	-16.8
1929-03-25	2.7	1.3	3.8	5.4	3.1	26.8	-7.2
1929-07-29	5.8	0.7	9.3	12.4	8.4	-24.4	-21.2
1929-09-24	-2.1	-2.7	-9.1	-32.8	-30.5	-23.4	-31.6
1936-11-20	1.2	-0.5	0.9	2.8	5.2	-2.3	-22.9
1937-03-18	-0.2	1.1	-2.5	-6.1	-9.2	-4.6	-34.2
1951-05-15	-1.4	-3.1	-1.1	0.2	4.7	4.5	9.4
1952-08-15	-0.8	-0.7	-2.7	-5.1	-0.2	1.5	-2.9
1956-08-06	-0.6	-1.2	-1.7	-5.3	-3.8	-10.3	-3.7
1959-06-04	-0.6	-1.0	3.5	5.2	2.2	1.9	-2.4
1959-08-10	0.9	0.4	-2.3	-3.1	-1.9	-4.7	-4.7
1961-08-29	1.3	0.7	-1.4	1.2	6.1	3.9	-13.2
1961-12-19	0.5	-0.9	-3.5	-1.2	-1.1	-23.1	-12.2
1963-11-06	0.7	-0.3	1.6	4.8	6.0	11.2	17.1
1964-04-27	1.4	2.0	1.3	2.3	4.7	7.3	12.2
1965-11-22	0.0	-0.3	0.7	2.0	0.3	-5.9	-12.6
1966-02-21	-2.0	-4.0	-3.0	0.4	-6.2	-14.8	-4.9
1967-05-15	-1.1	-2.4	-0.3	0.0	2.1	-0.8	5.3
1968-05-17	0.3	3.2	3.7	0.8	3.2	8.6	0.4
1968-07-22	-1.6	-2.3	-0.5	4.0	4.7	2.1	-4.0
1968-11-01	1.5	3.0	4.5	-2.6	0.6	2.7	-5.5
1972-06-08	1.1	1.3	0.8	3.2	2.8	10.6	0.9
1972-12-19	0.5	3.0	1.6	-1.6	-6.4	-10.9	-18.7
1979-09-04	0.1	0.5	2.0	-4.5	-1.5	5.0	15.2
1980-02-25	-0.7	-6.0	-12.5	-7.9	-2.4	11.2	12.4
1980-12-04	-6.7	-2.5	1.2	-5.8	-4.9	-3.1	-8.3
1986-07-07	-2.4	-3.2	-2.9	4.0	-4.2	3.3	24.9
1987-08-28	-3.2	-1.2	-1.6	-28.7	-26.5	-18.1	-20.6
1990-07-23	0.1	-5.9	-9.4	-12.3	-12.1	-6.8	7.8
1998-07-23	0.3	-4.4	-5.1	-9.7	-6.1	7.5	19.1
1999-01-14	1.1	5.6	2.4	7.1	8.8	17.0	19.6
1999-05-21	-2.1	0.3	0.4	2.3	0.5	7.1	5.8
1999-07-22	-1.5	-3.5	-1.8	-3.9	-5.3	6.2	9.9
2000-01-04	2.8	4.0	1.8	-0.6	6.8	3.3	-3.7
2007-10-19	2.3	0.6	-4.5	-3.2	-12.7	-8.3	-34.3
2022-01-13	-5.6	-4.9	-5.5	-6.5	-5.7	-17.8	-14.3
Mean	**-0.3**	**-0.6**	**-0.6**	**-1.8**	**-1.3**	**0.0**	**-1.9**
Median	**-0.1**	**-0.4**	**-0.1**	**-0.2**	**0.4**	**2.4**	**-3.7**
% Positive	**47%**	**45%**	**50%**	**50%**	**53%**	**58%**	**42%**
Avg Max Loss	-1.0	-1.4	-3.2	-4.4	-4.7	-5.9	-13.2
Avg Max Gain	0.7	1.0	1.4	2.4	3.8	7.3	9.1
Random Med	0.1	0.3	0.5	1.1	1.6	3.2	6.4
Random % Pos	57%	58%	60%	62%	63%	66%	68%
Z-Score	**-0.6**	**-1.6**	**-0.9**	**-0.9**	**-0.9**	**-0.4**	**-3.6**

© SENTIMENTRADER Numbers are % return after signal; Risk = avg max loss; Reward = avg max gain; Z-Score +/- 2 suggests significance.

Debt and Political Parties - Does your favorite political party share some blame for deficits and inflation? Yes. Both your guy...and the other guy.

Debt under Trump and Biden

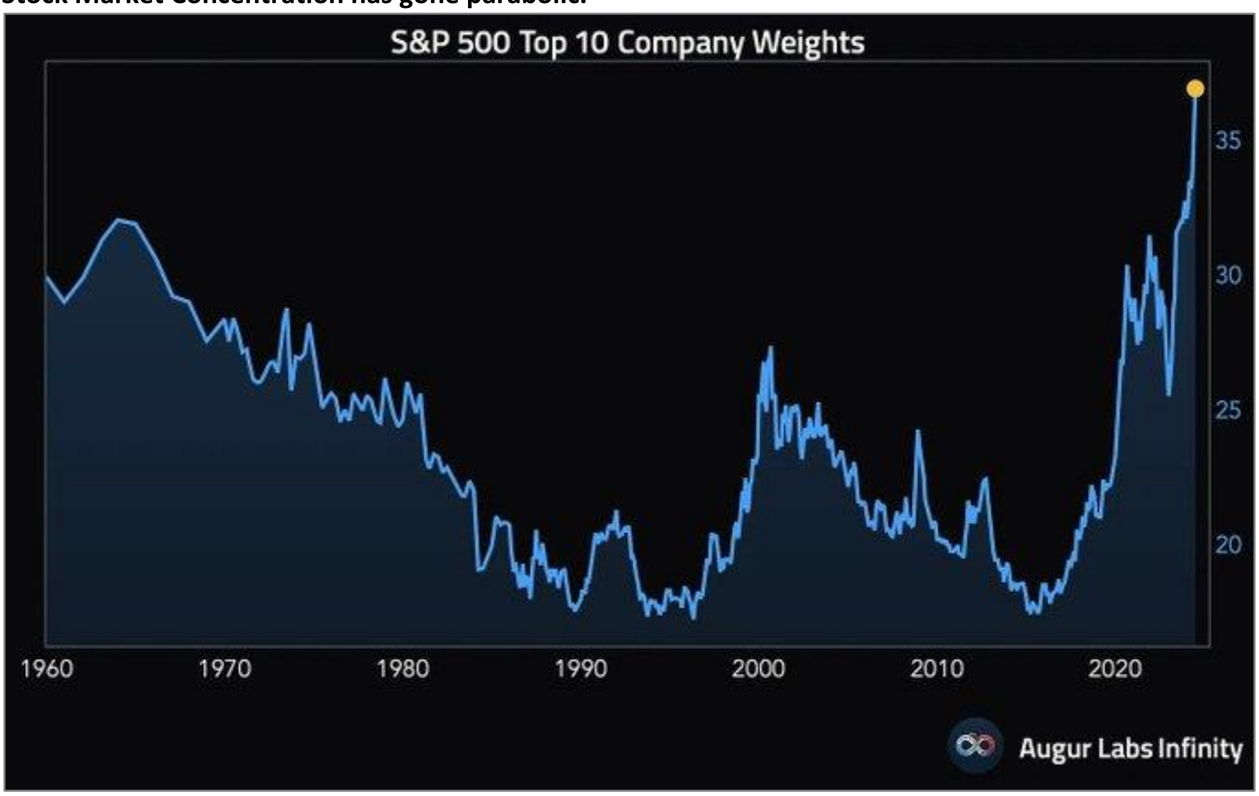
– $9T $0 $9T

PROGRAM	TRUMP	BIDEN
Tax Cuts and Jobs Act	+$1.9T	
Bipartisan Budget Acts	+$2.1T	
ACA tax delays and repeals	+$539B	
Tariffs	–$443B	
Cares Act*	+$1.9T	
Response and Relief Act*	+$983B	
Other covid relief*	+$756B	
American Rescue Plan Act*		+$2.1T
Appropriations for FY2022, FY2023		+$1.4T
Honoring our PACT Act		+$520B
Infrastructure Investment and Jobs Act		+$439B
Student debt actions		+$620B
Fiscal Responsibility Act		–$1.5T
Inflation Reduction Act		–$250B
Executive actions	+$456B	+$419B
Other legislation	+$310B	+$422B
Total	+$8.4T	+$4.3T

Note: * indicates a covid-related program. Programs may not add to totals due to rounding.

Source: Committee for a Responsible Federal Budget NICK MOURTOUPALAS / THE WASHINGTON POST

Stock Market Concentration has gone parabolic.



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.