



Market Outlook

By Mark T Dodson, CFA

Record Divergence in US Equity Futures Positioning.

Market Risk Index climbed to 89.8%, just shy of the worst 10% of readings, as the Psychology and Monetary Composites worsened this week. The last four bull market peaks registered MRI readings above 90%.

For Psychology, it was deterioration in Technicals and a return to euphoric readings for some of the indicators in the Options category that increased the risk score. ISEE Sentiment Index, which measures the Call to Put ratio for the opening options transactions, set a 10-year high this week on enthusiasm for call options from retail investors.

Also on the investor sentiment front, Futures dealers' (smart money for derivatives) net short position in US equity futures fell below the February 2020 lows, setting a 10-year record. They are within a few percent of an all-time low in net exposure. The move by Dealers drove our Smart Money Index for US equity futures to a record bearish divergence, as Asset Managers' (dumb money) exposure to derivatives still hovers near record long exposure. Dumb money has never been so confident betting on a bull market, while smart money has never been so willing to take the other side of that bet.

Monetary conditions moved further into the tight money side of neutral – this week hurt by a bearish shift to the Interest Rates category. This slide in our Monetary Composite away from its bullish, easy money zone, has coincided with several recent negative economic surprises, and some additional evidence from the ISM release that makes a case for an economy in a stagflationary environment.

Euphoric sentiment and a Monetary shift in the direction of tighter financial conditions have put MRI on the cusp of a breach of 90%. Add mounting evidence of a bifurcated market with anemic participation and breadth – this bull market rests upon an unsteady footing.

Note: There will not be a Market Outlook next week unless unusual market behavior warrants it.

Market Risk Index

Rec Allocation 25% Underweight

89.8%

Category Percentiles

Psychology - P6



Monetary - M4



Valuation - Extremely Overvalued



Trend



Largest Psychology Influences

Leveraged Investments	Negative
Option Activity	Negative
Surveys	Negative
Technical Indicators	Negative

Largest Monetary Influences

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

Valuation

7-10 Year Equity Return Forecast	-0.3%
10Yr US Treasury Yield	4.5%

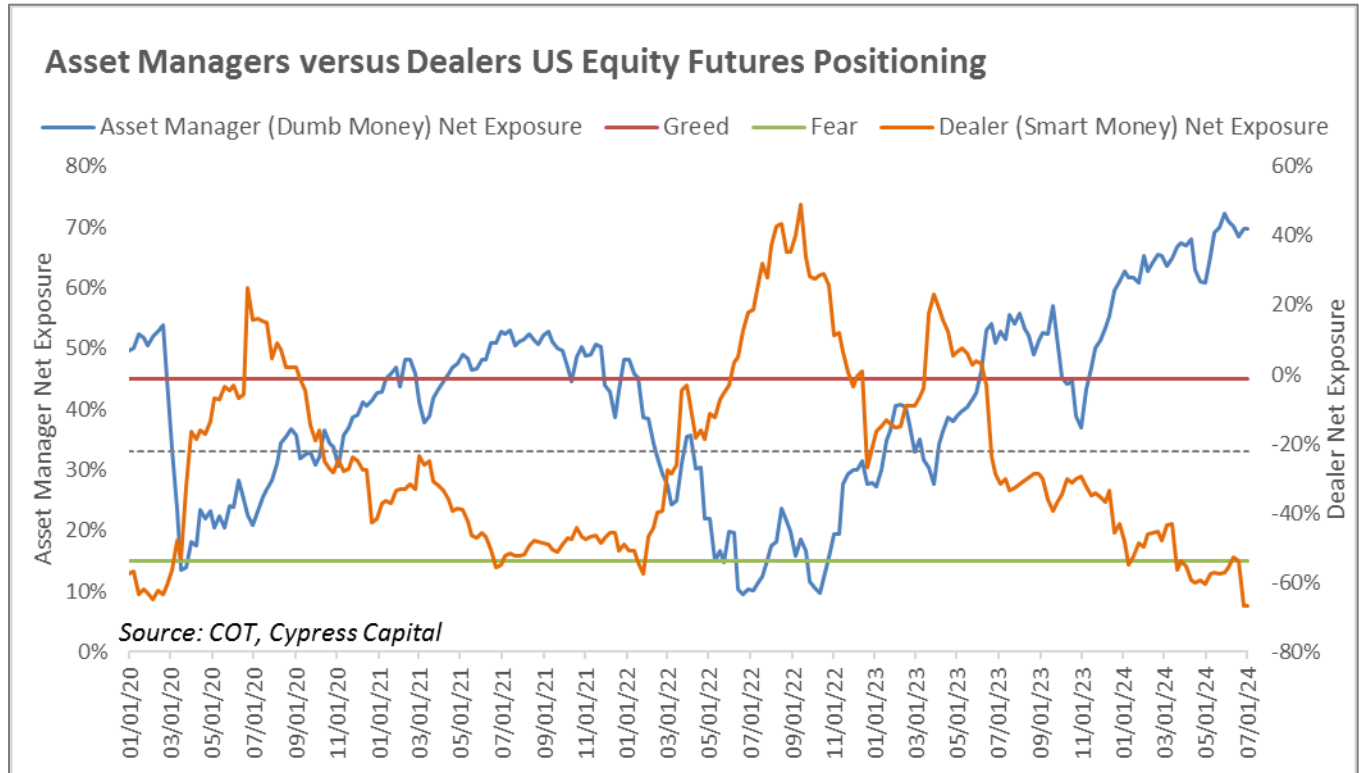
Market Trends

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

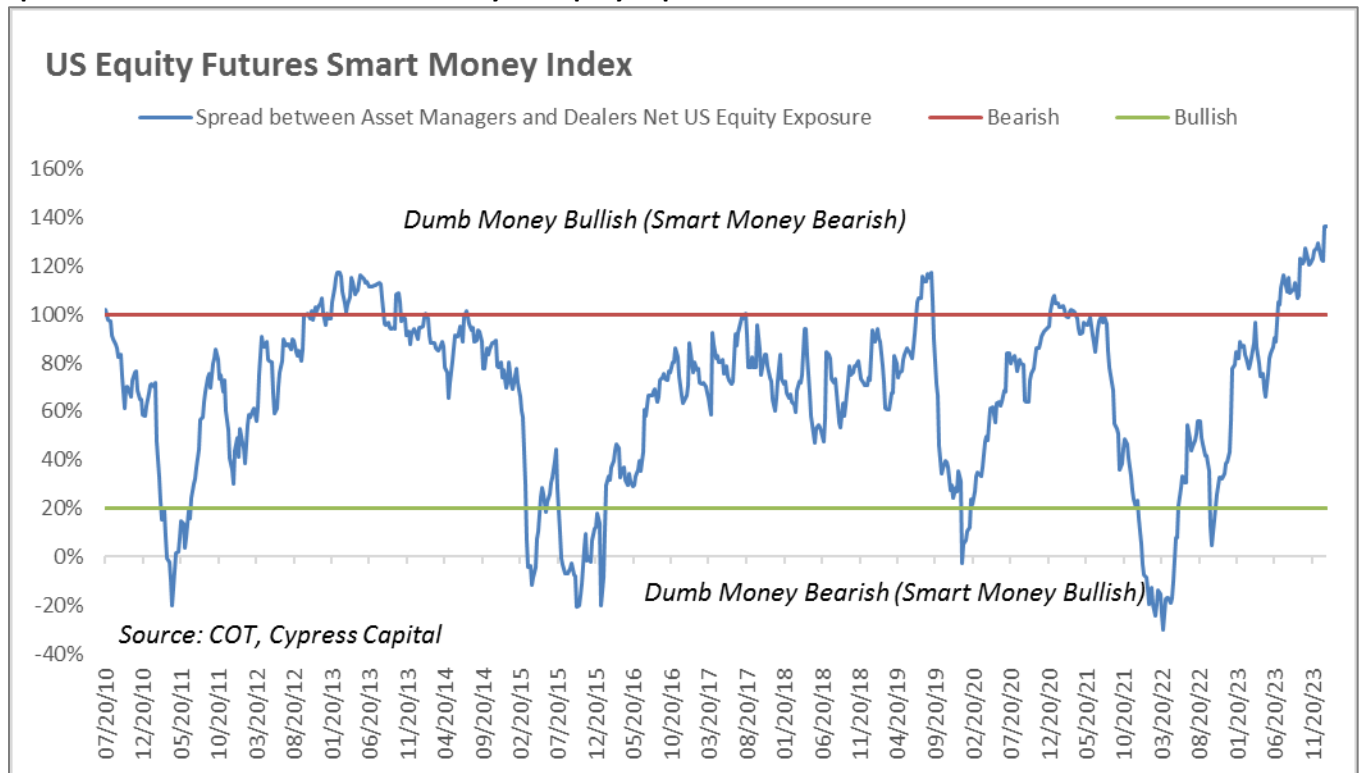
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets based on our model & opinion. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

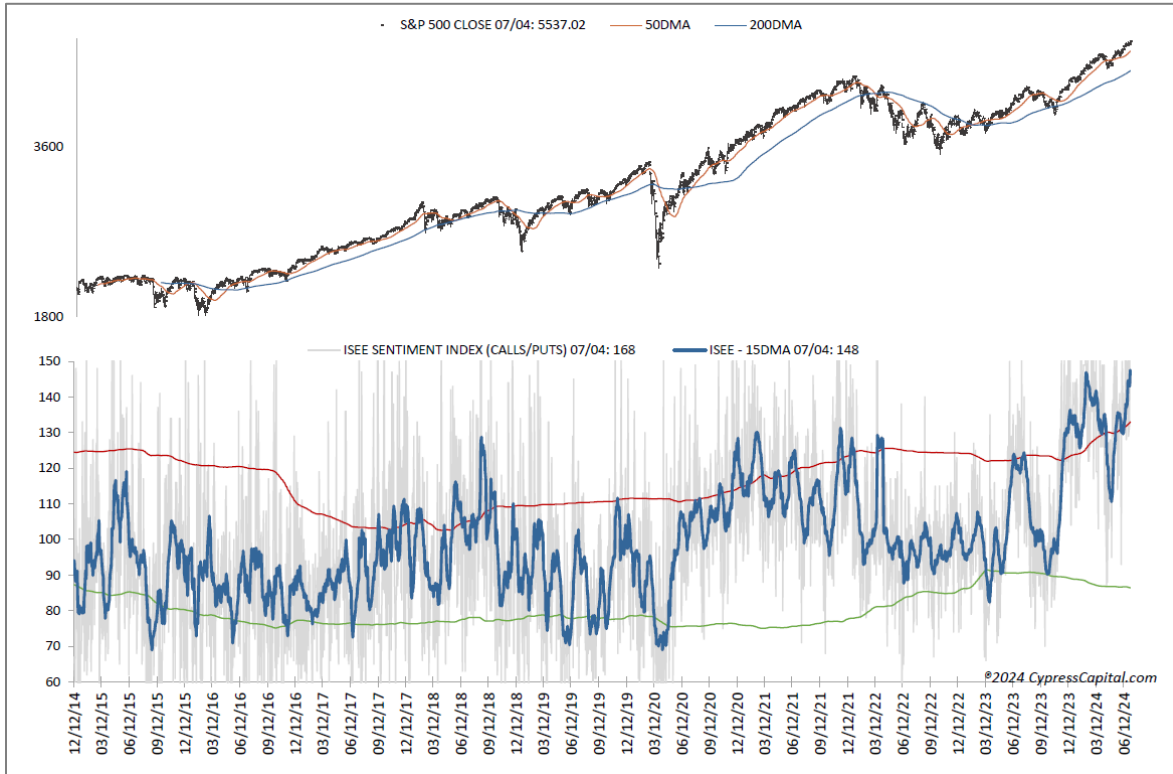
Dealers (Smart Money) net short exposure sets a 10-year record.



Spread between smart and dumb money US Equity exposure set a new record.

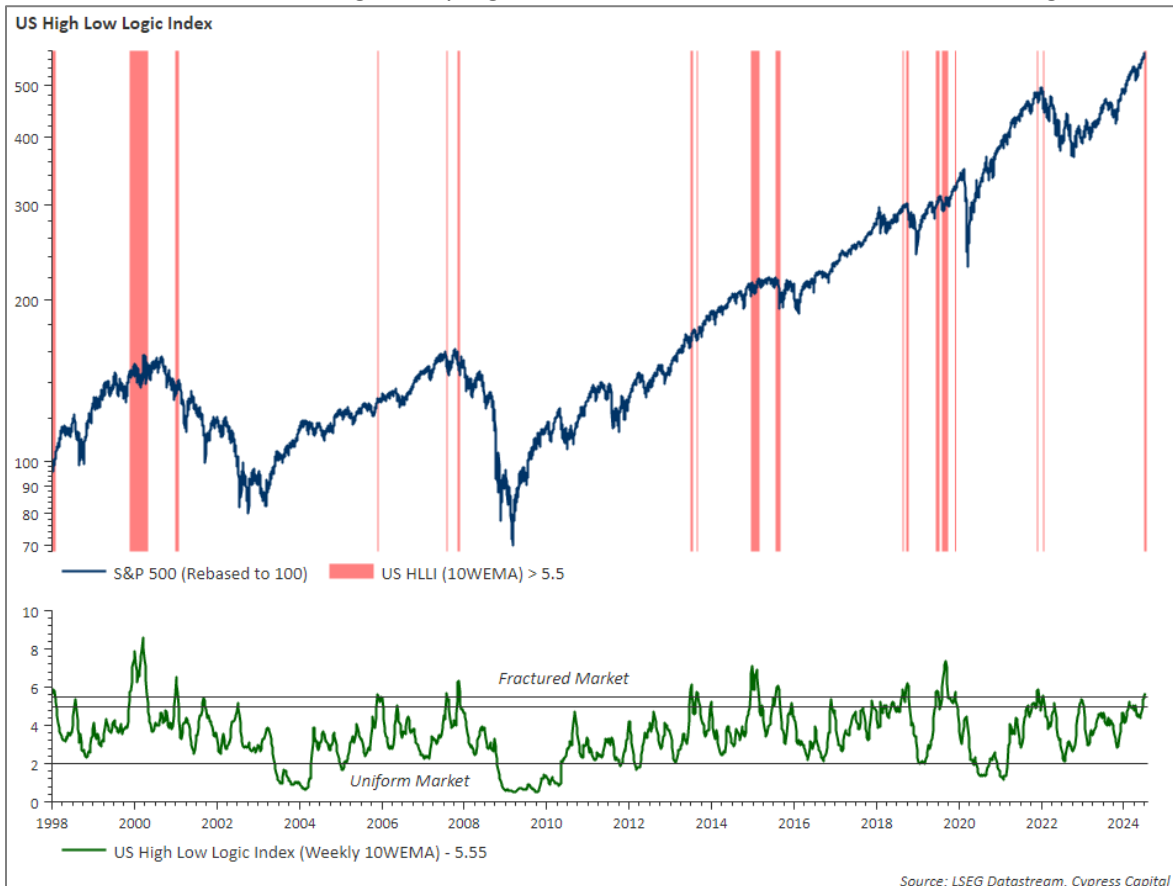


ISEE Sentiment Index set a 10 year high.

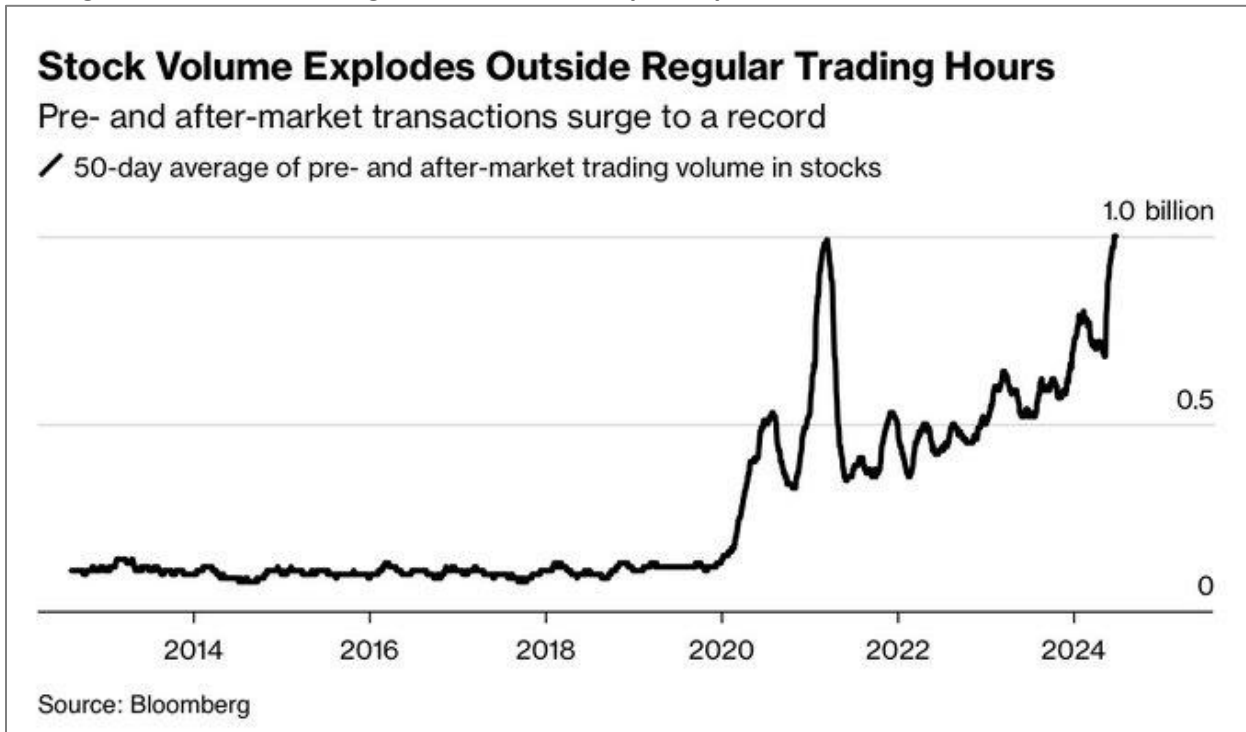


US High Low Logic Index signals a split, uneven market advance.

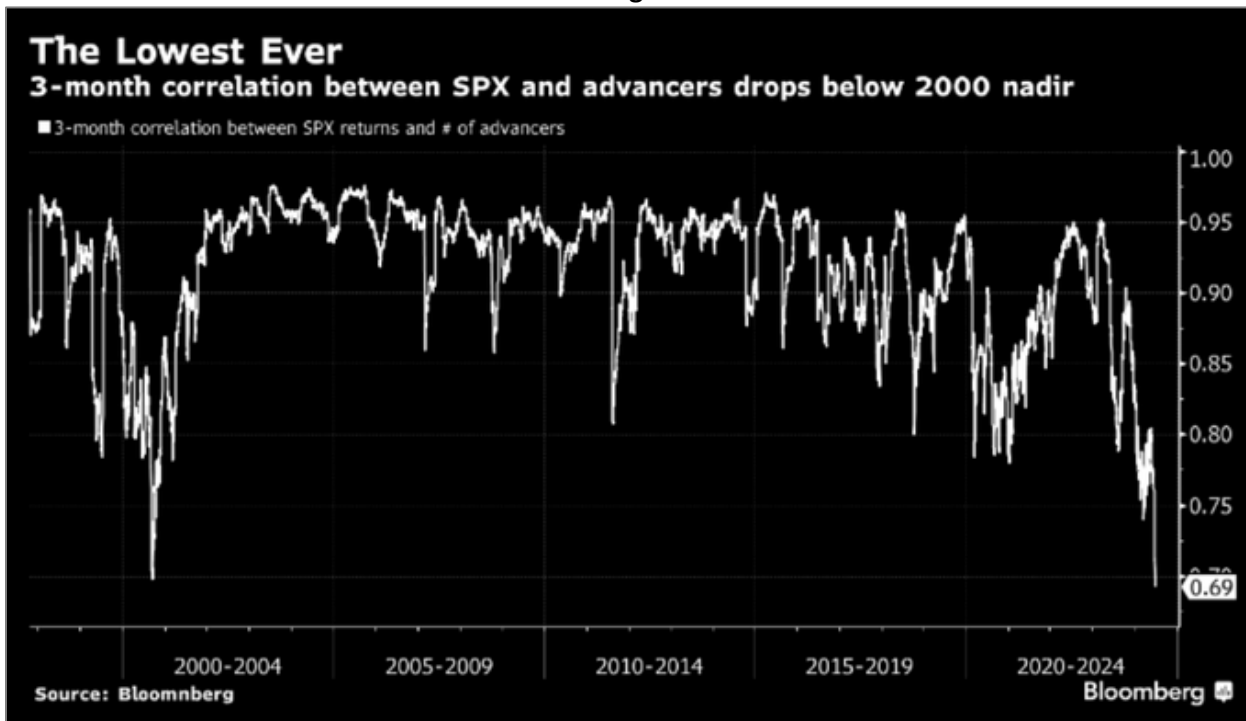
This version is calculated using weekly highs and lows on the NASDAQ and NYSE exchanges.



Trading outside normal trading hours breaks the euphoric peak from 2021.



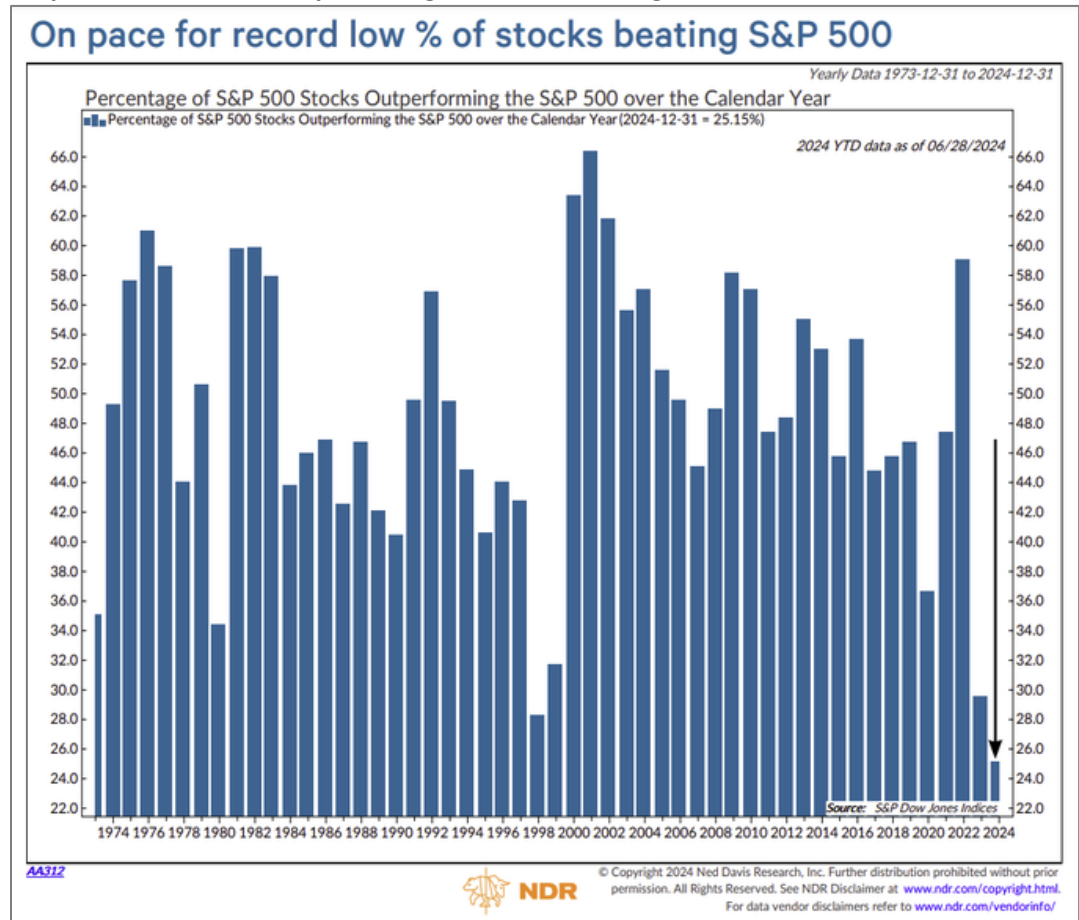
Record narrow mkt - Correlation between advancing stocks and the S&P 500 breaks the 2000 record.



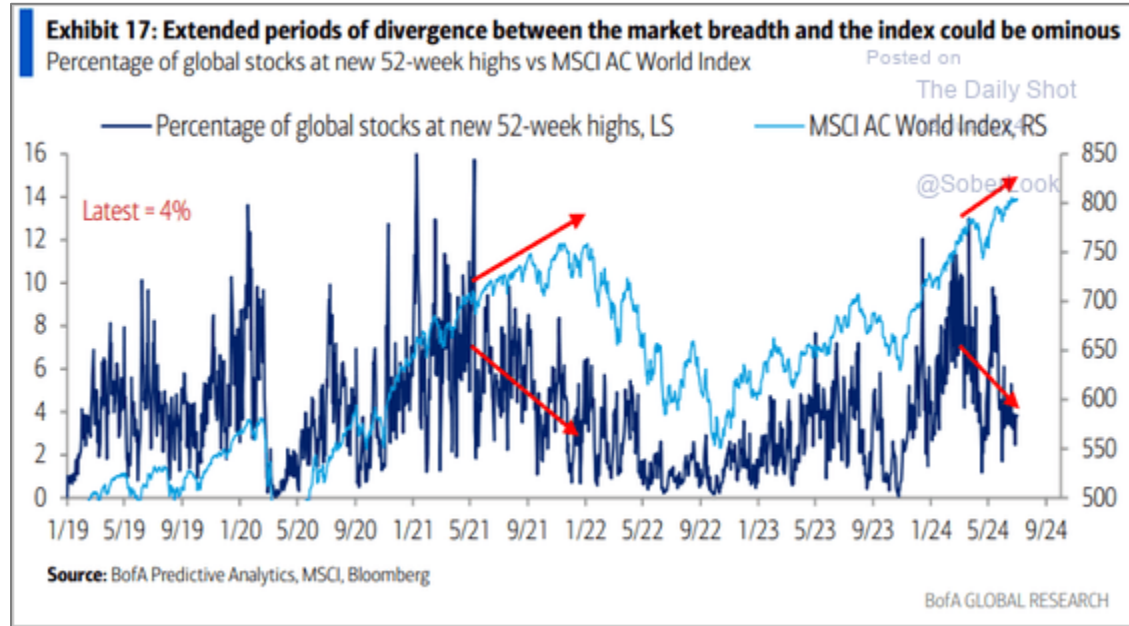
US Stock Market Concentration sets a 100-year record.



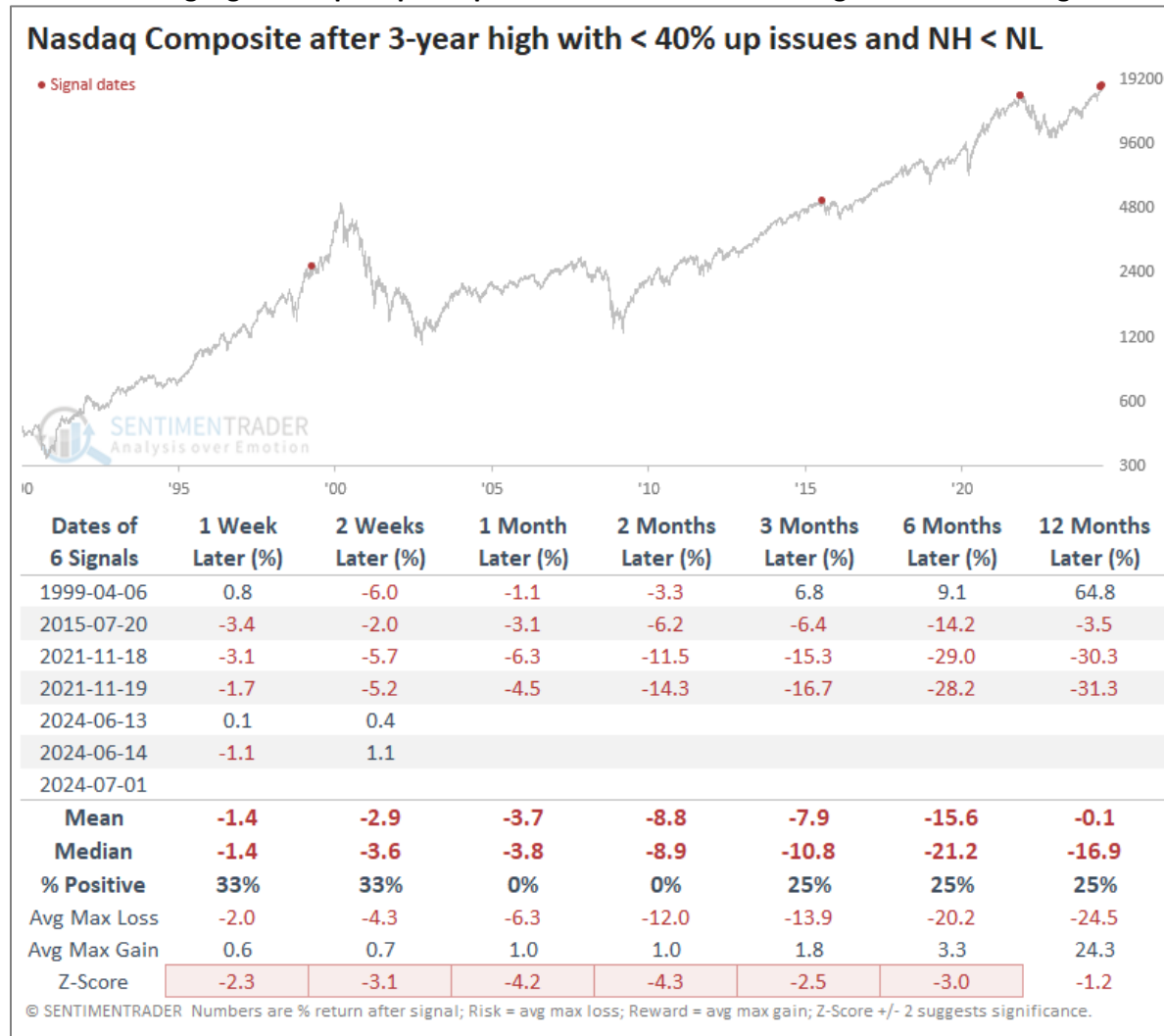
On pace for a record low percentage of stocks beating the S&P 500.



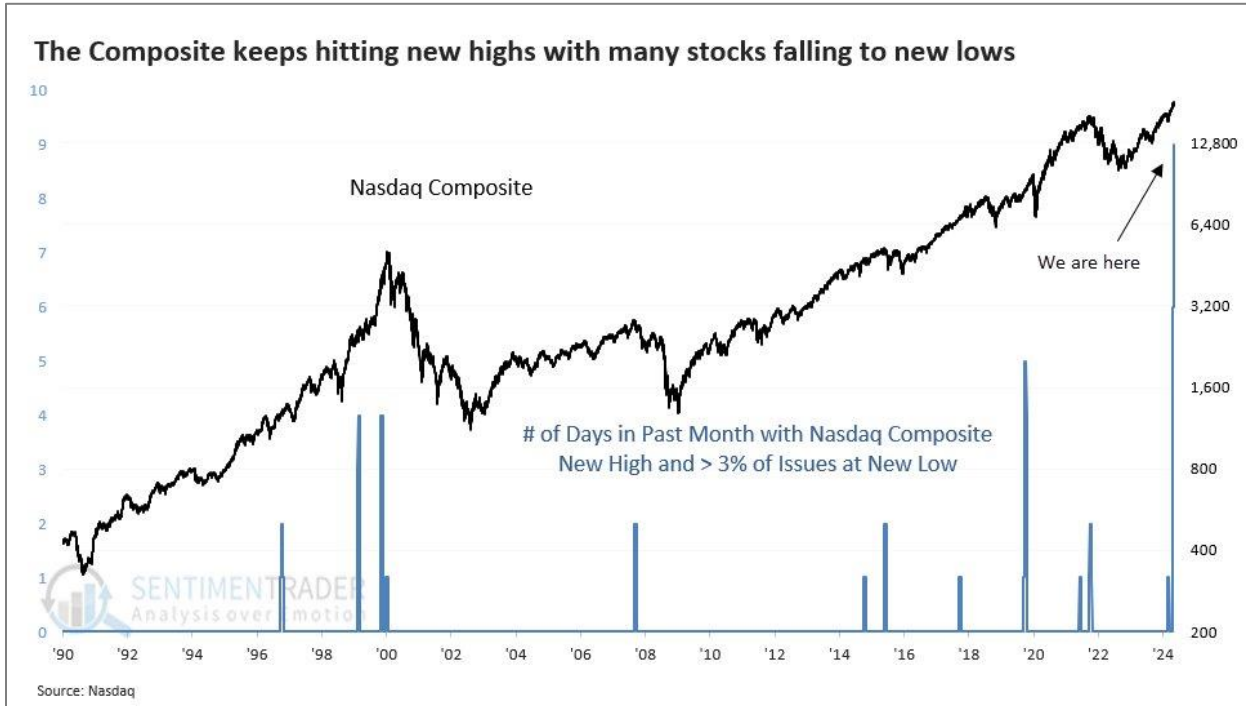
Divergence between breadth and the indices is reminiscent of the 2021-22 stock market peak.



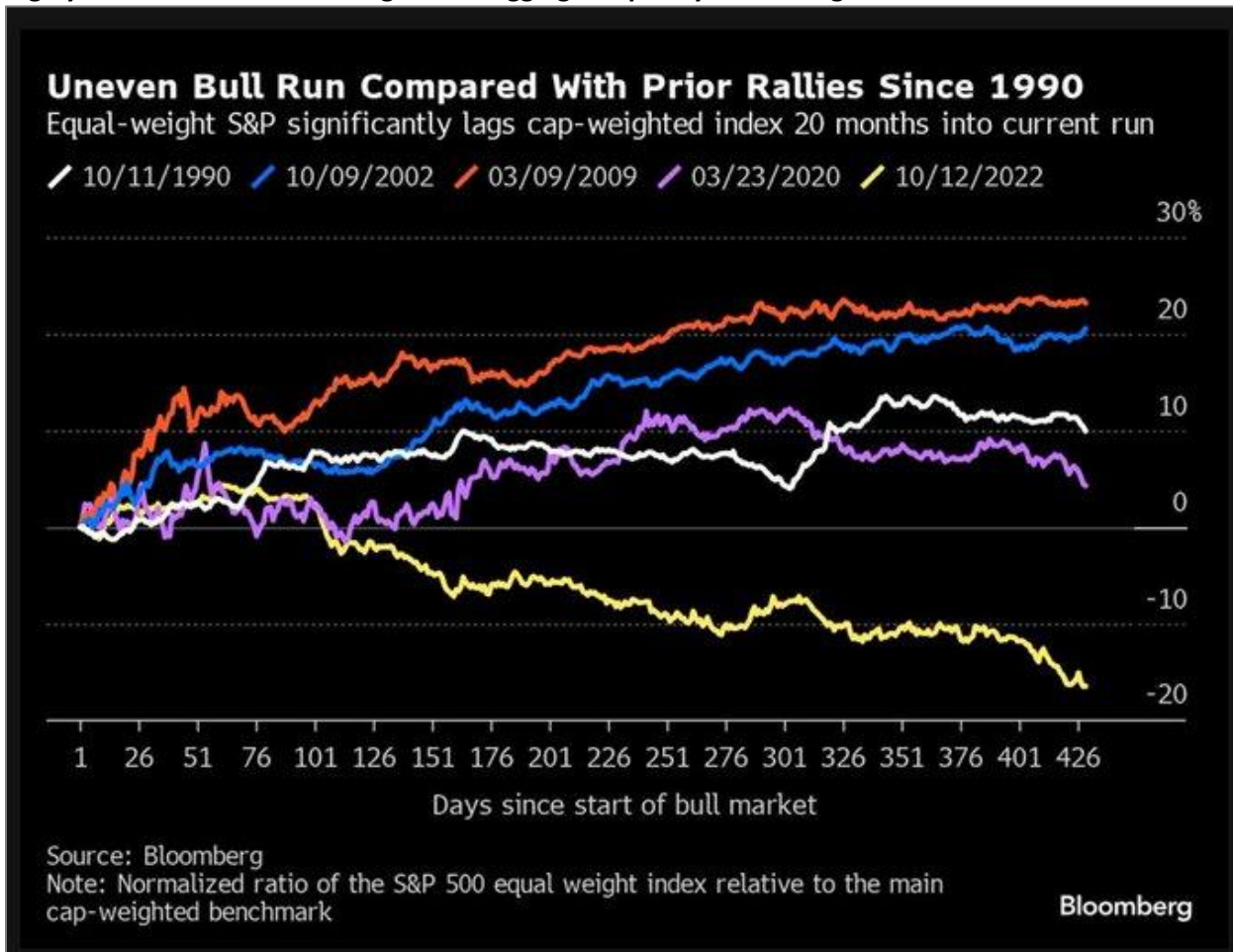
NASDAQ hitting highs with poor participation and more stocks making new lows than highs.



NASDAQ keeps hitting highs with a large number of individual stocks setting new lows.

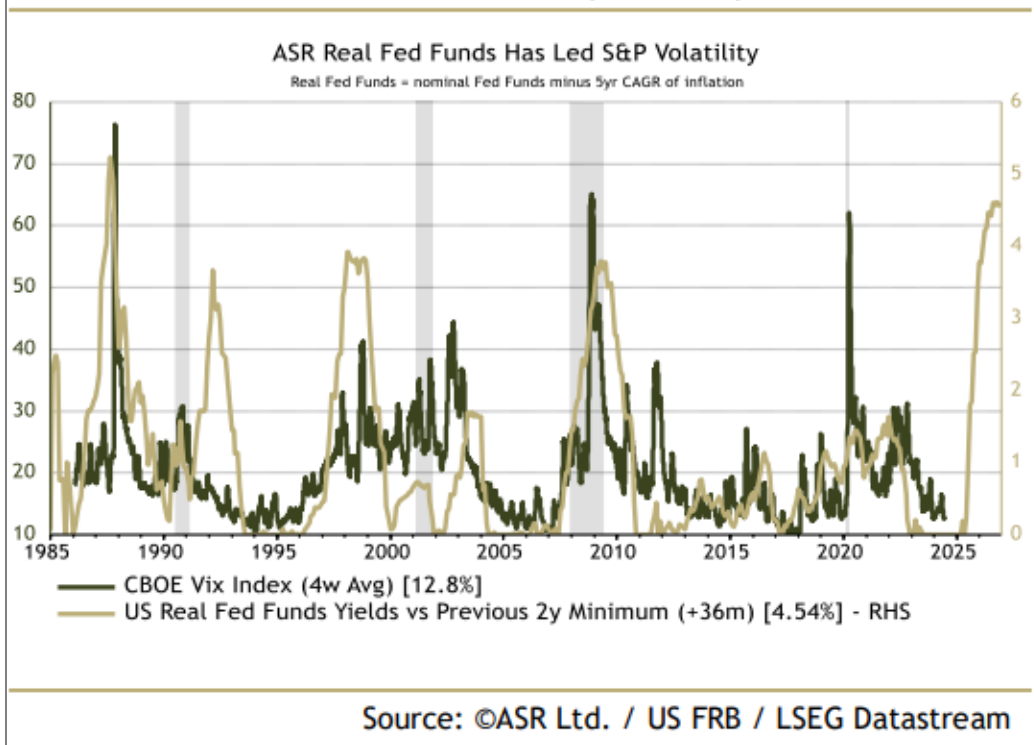


Highly unusual to see the average stock lagging this poorly at this stage of a bull market.



Long lead times of Fed policy - Real Fed Funds tends to lead Stock Market Volatility by three years.

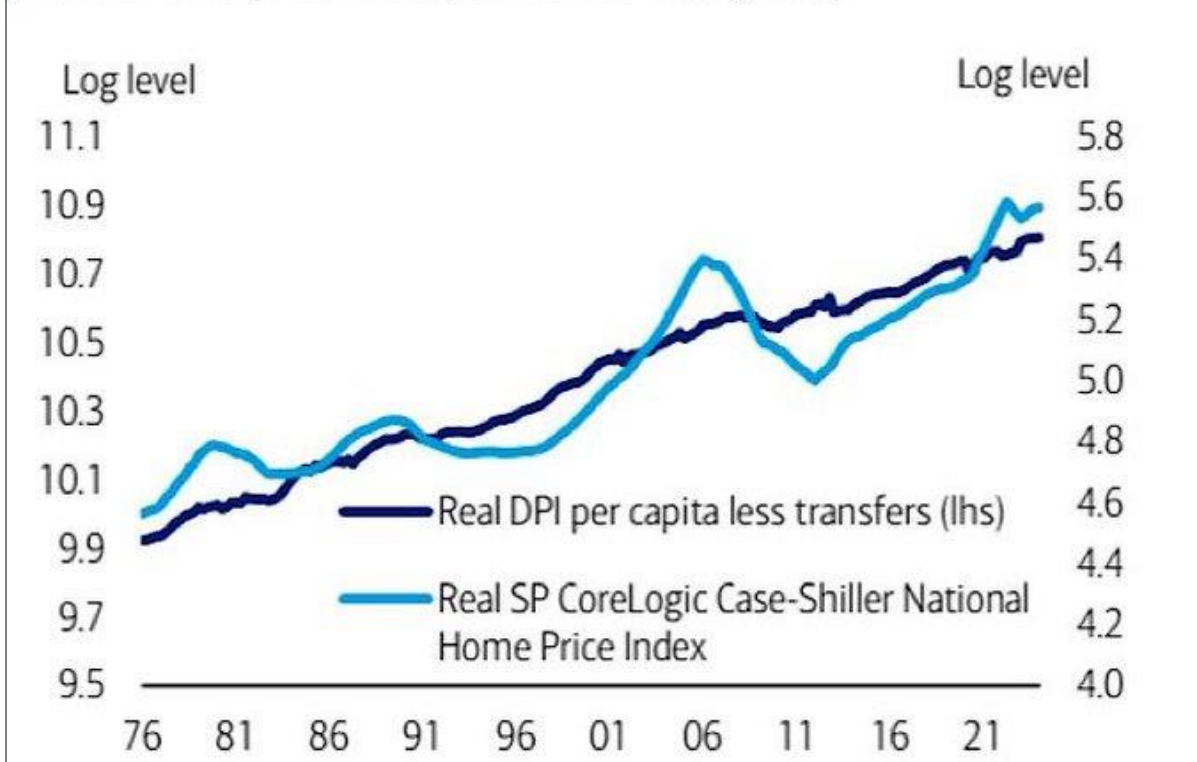
Chart 3: The VIX and US Real (Ex-Post) Fed Funds



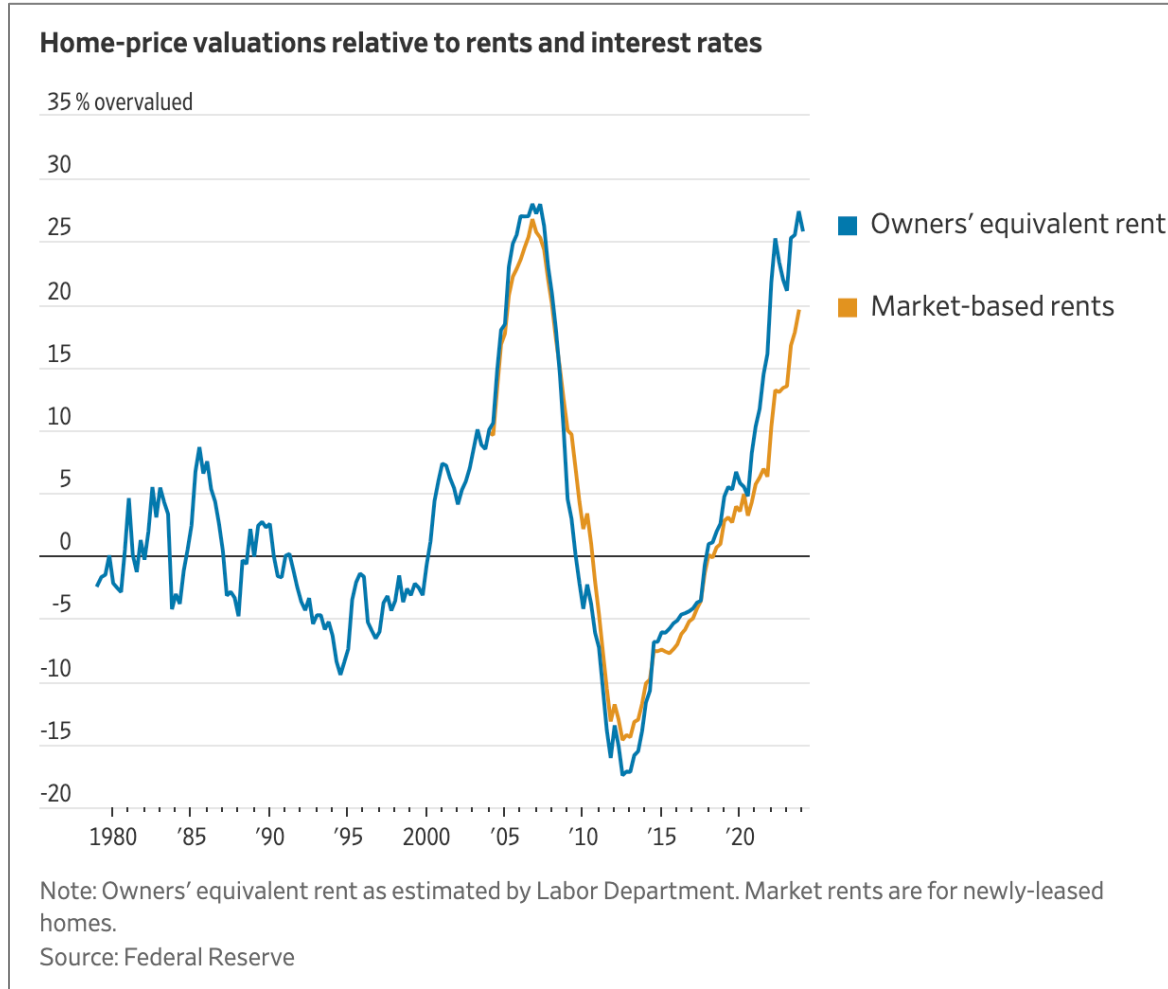
Home prices relative to personal income are expensive.

Exhibit 2: Home prices have overshoot their long-run level

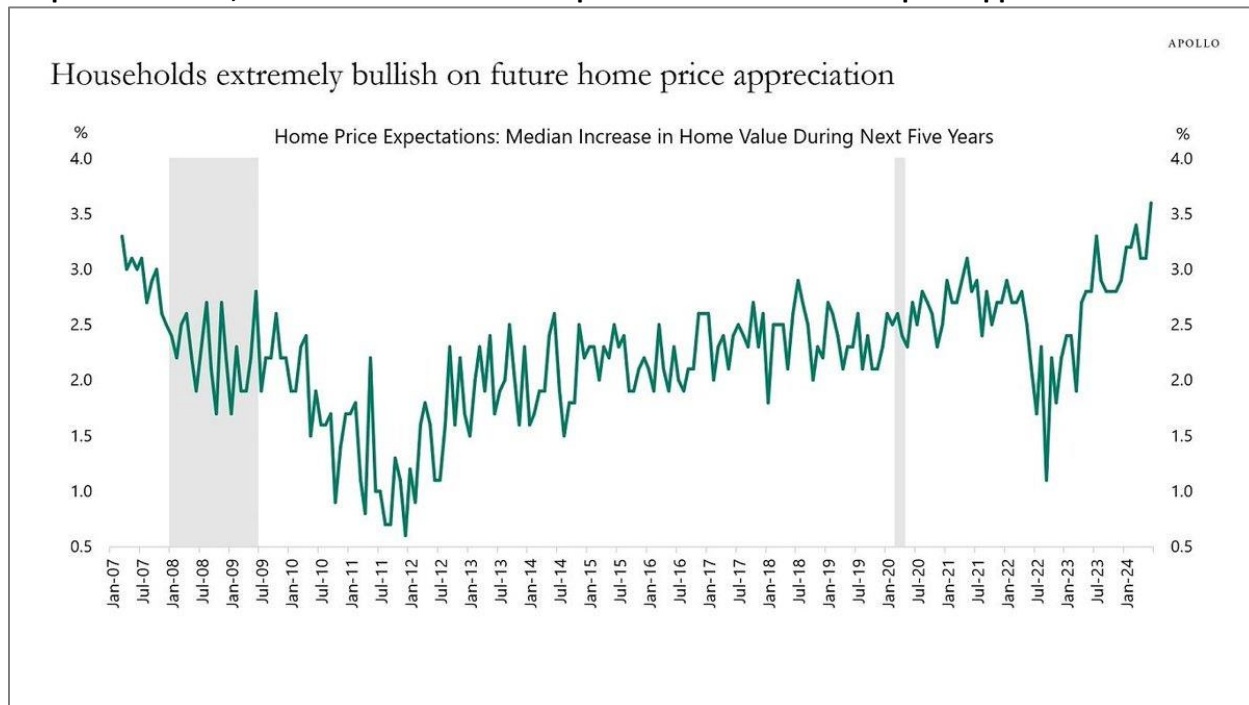
National home prices versus personal income (log levels)



Home prices versus rents are also expensive.



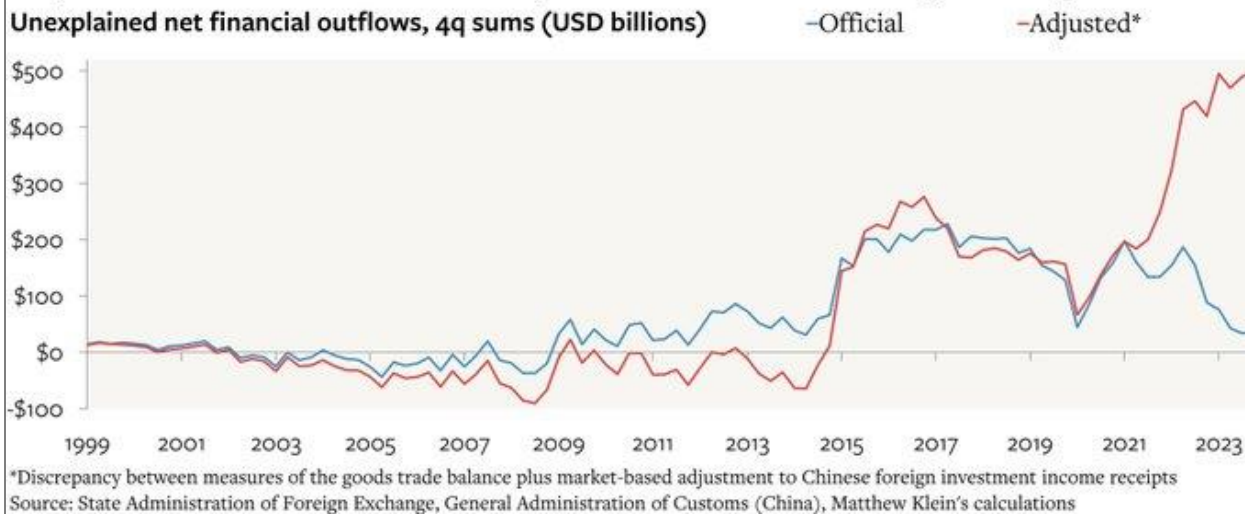
Despite valuations, Households have bullish expectations for more home price appreciation.



Money appears to be sneaking out China's back door.

Sneaking Out?

"Net errors and omissions" in China's balance of payments are ostensibly worth just \$40 billion/year, but plausible alternative estimates of surreptitious outflows are closer to \$500 billion/year.

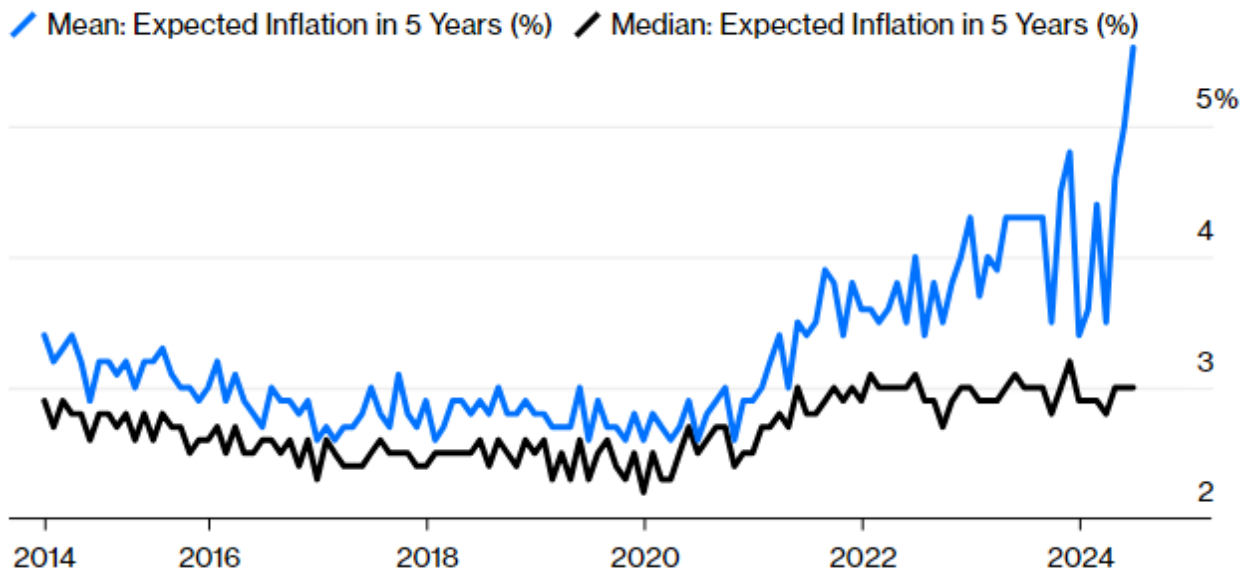


Inflation Expectations Right Tail

There is a contingent of consumers with very high inflation expectations.

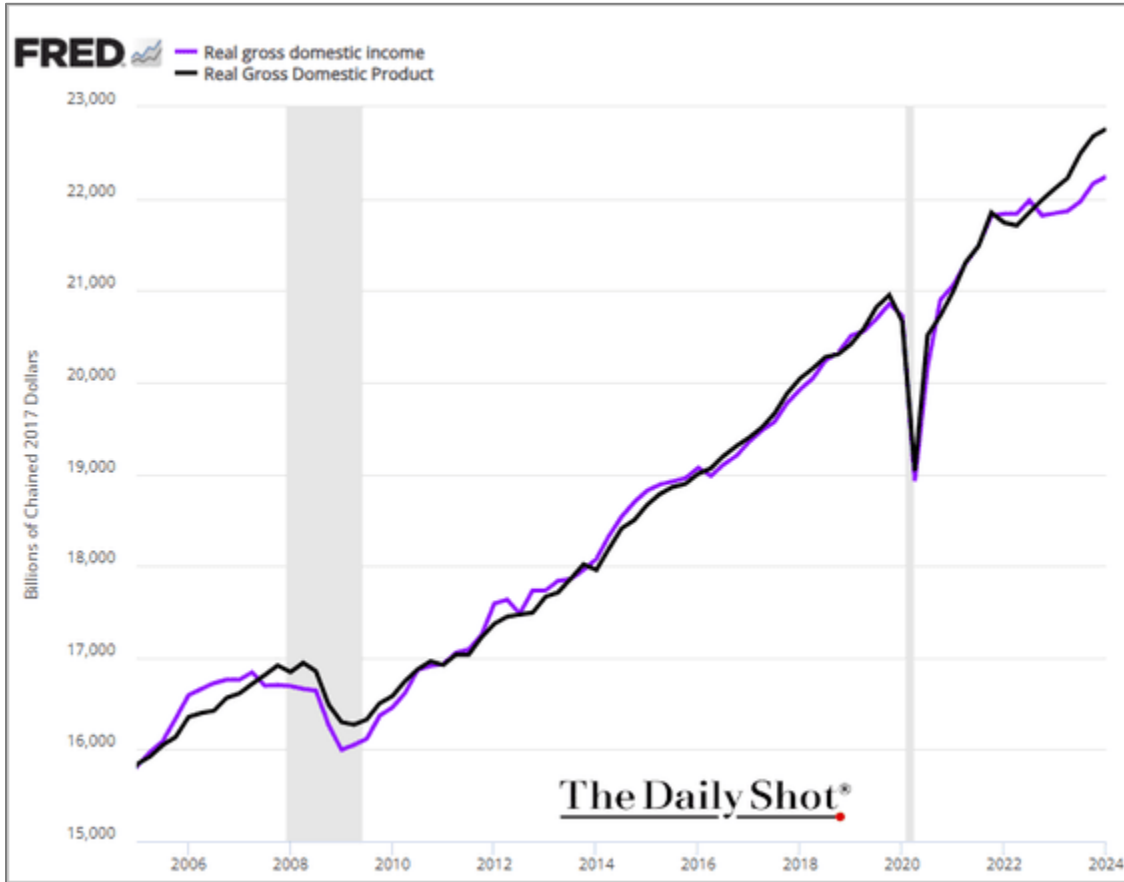
Braced for Disaster

A significant, growing number of people expects out-of-control inflation



Source: University of Michigan, Bloomberg

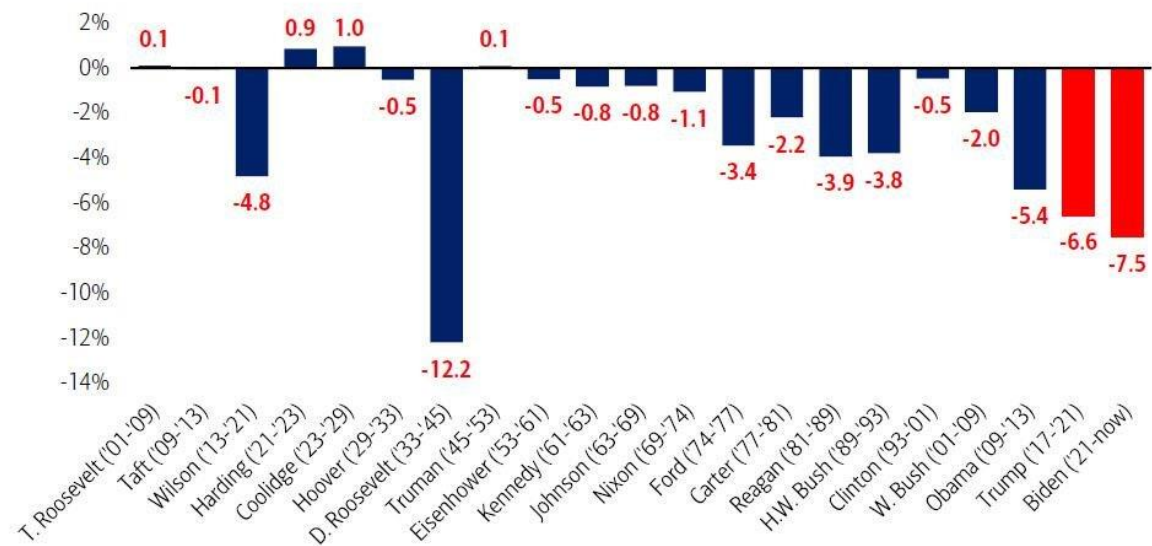
The messages from Gross Domestic Product and Gross Domestic Income will converge at some point.



The Post-COVID Era of Big Government

Chart 2: US government budget deficits under Biden & Trump highest since FDR

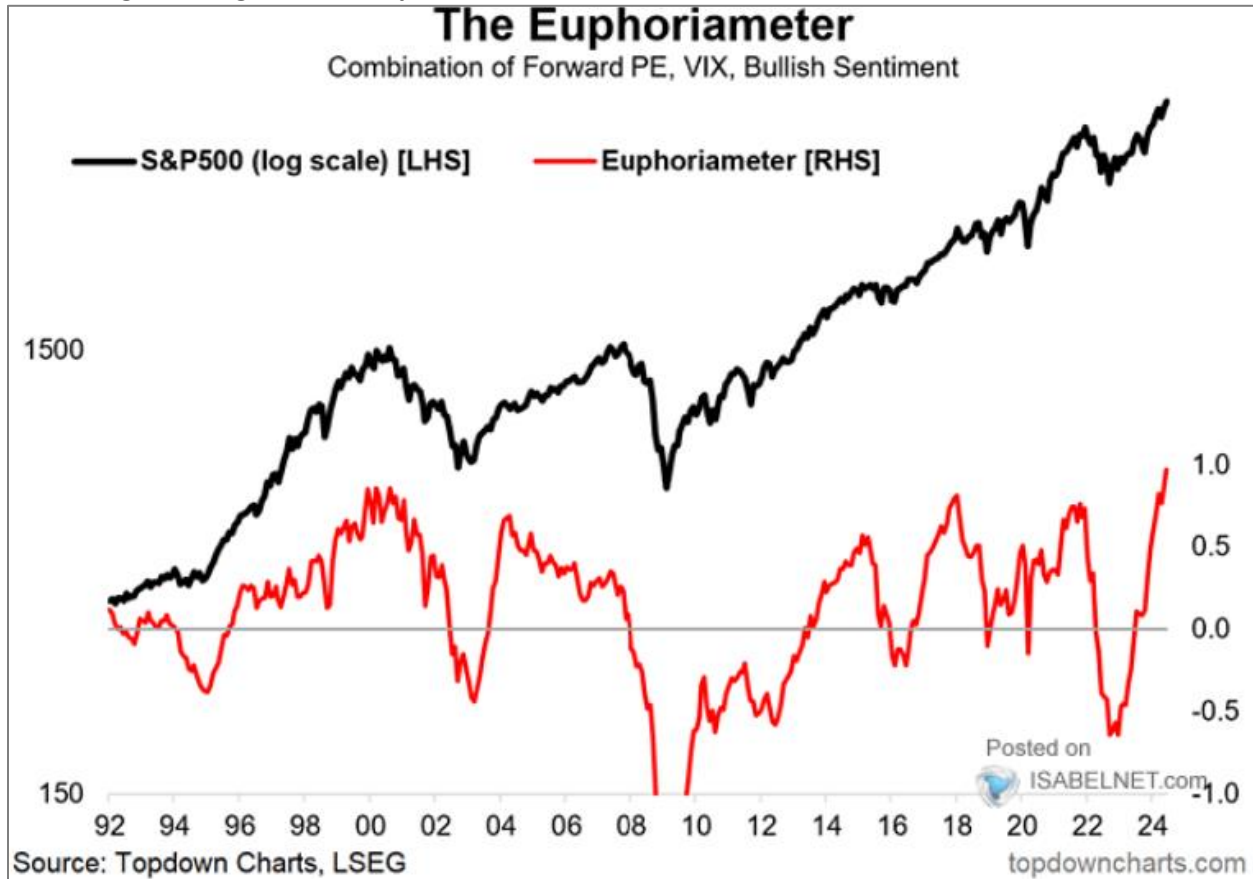
Average US government deficit as % of GDP under each President since 1900



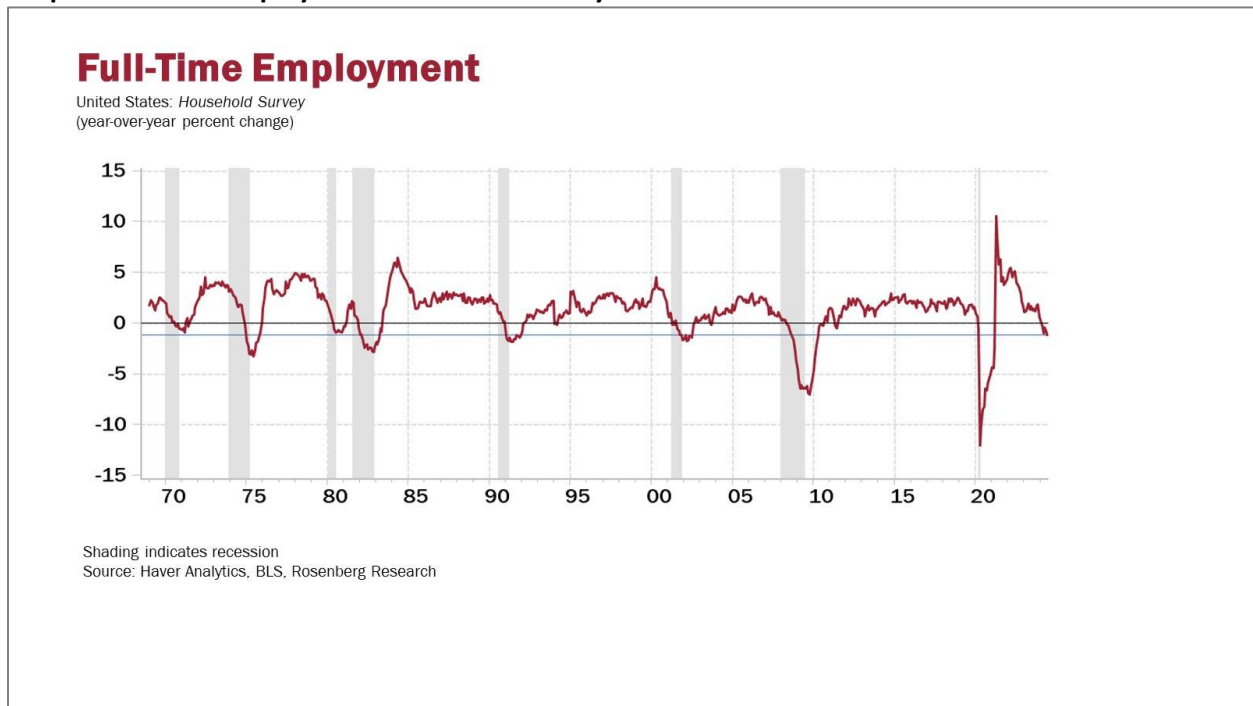
Source: BofA Global Investment Strategy, GFD Finaeon, Haver

BofA GLOBAL RESEARCH

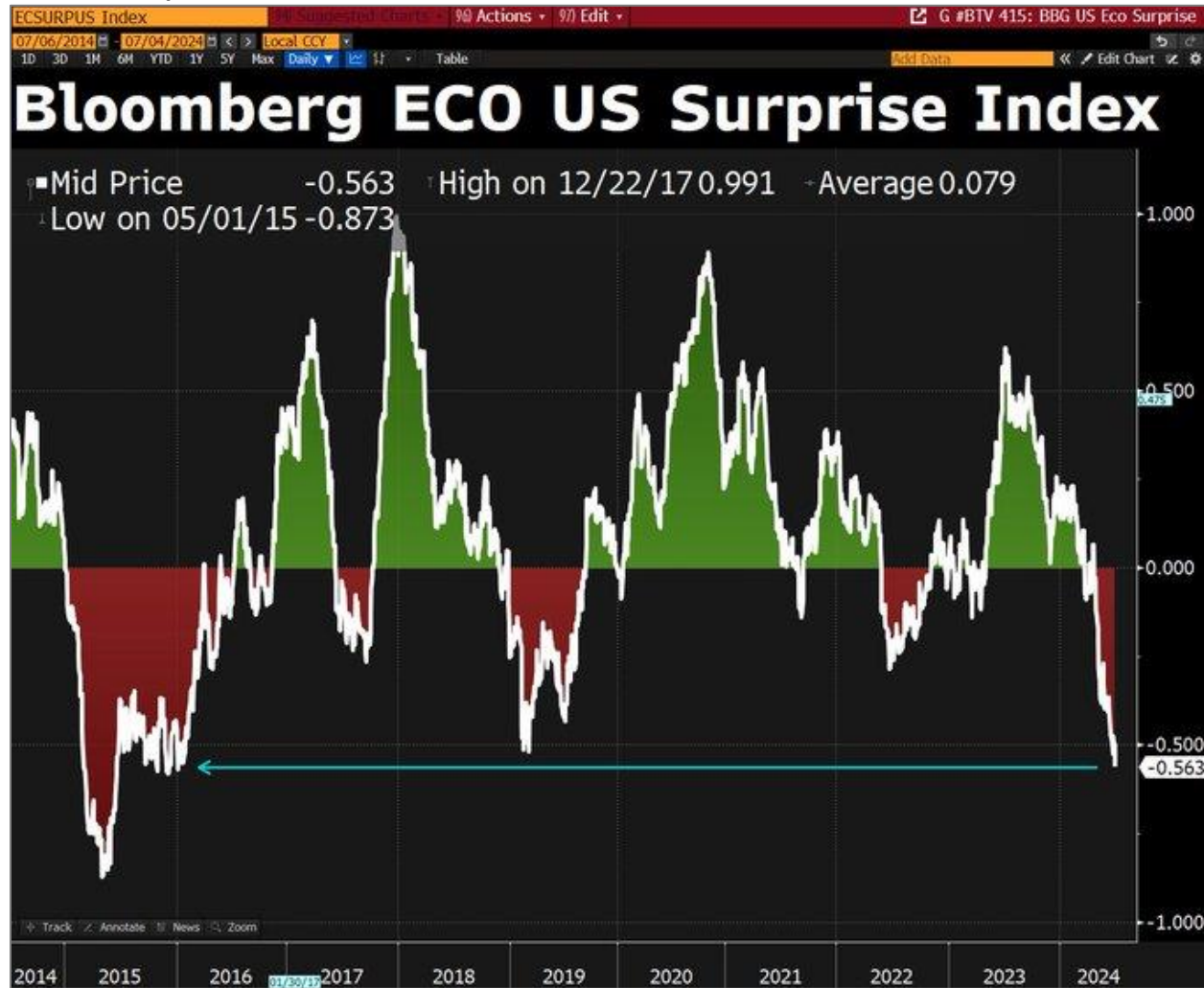
Record high reading from the Euphoriameter



Drop in Full-Time Employment looks recessionary.



Economic Surprises are near all-time lows.



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.

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