Market Outlook

By Mark T Dodson, CFA

Stock Market Welfare

There was little movement in the Asset Allocation Model this week. Market Risk Index moved slightly higher to 78.8%, north of the line denoting markets laden with drawdown risk. Improving Psychology was offset by worsening Valuations and Monetary Conditions.

Although Psychology improved week over week, much of the progress to repairing the wall of worry stalled due to stock market strength over the last two weeks. The prevailing mood is still a speculative one with more signs of excess than apprehension when it comes to risk-taking amongst investors in aggregate.

The stock market rallied almost immediately upon reaching oversold levels on our NYSE Overbought/Oversold indicator on April 17th. This is a good sign technically, even if the same indicator is on the cusp of another overbought reading. While markets can pause on overbought readings, such a rapid and favorable response by the market implies that at least some of the cap-weighted indices will likely see new highs over the summer.

That speculation aside, valuations moved back into the worst one percent of readings, and our bottom-up equity return forecast has again fallen to a rounding error away from a zero percent forecast for equities. The bull market will have to flirt with a new new-era of valuation if it is going to have any legs, and there will be no shortage of pundits and strategists happy to rationalize why those valuations make sense. For now, it's a speculators' bull market fueled by reverberations of Covid-stimulus excess, and it hinges on the narrative of a Fed cut being just around the bend.

We would be surprised to see the bull market last another 12 months. Financial market strength appears tied at the hip with inflation in this post-Covid era, inadvertently transforming Fed policy into a governor on stock market speculation. Additionally, strong cyclical bull markets are fueled by robust credit cycles, and the still-inverted yield curve is a clear indication that this backdrop is nonexistent. That leaves bulls hoping for further deterioration in Uncle Sam's balance sheet, as deficit spending has served as welfare for speculators since 2020.

Market Risk Index

Rec Allocation 25% Underweight

78.8%

Category Percentiles

Psychology - P6: 94.7%

Monetary - M3: 37.2%

Valuation - Extremely Overvalued: 99.0%

Trend: 47.5%

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	0.2%
10Yr US Treasury Yield	4.5%

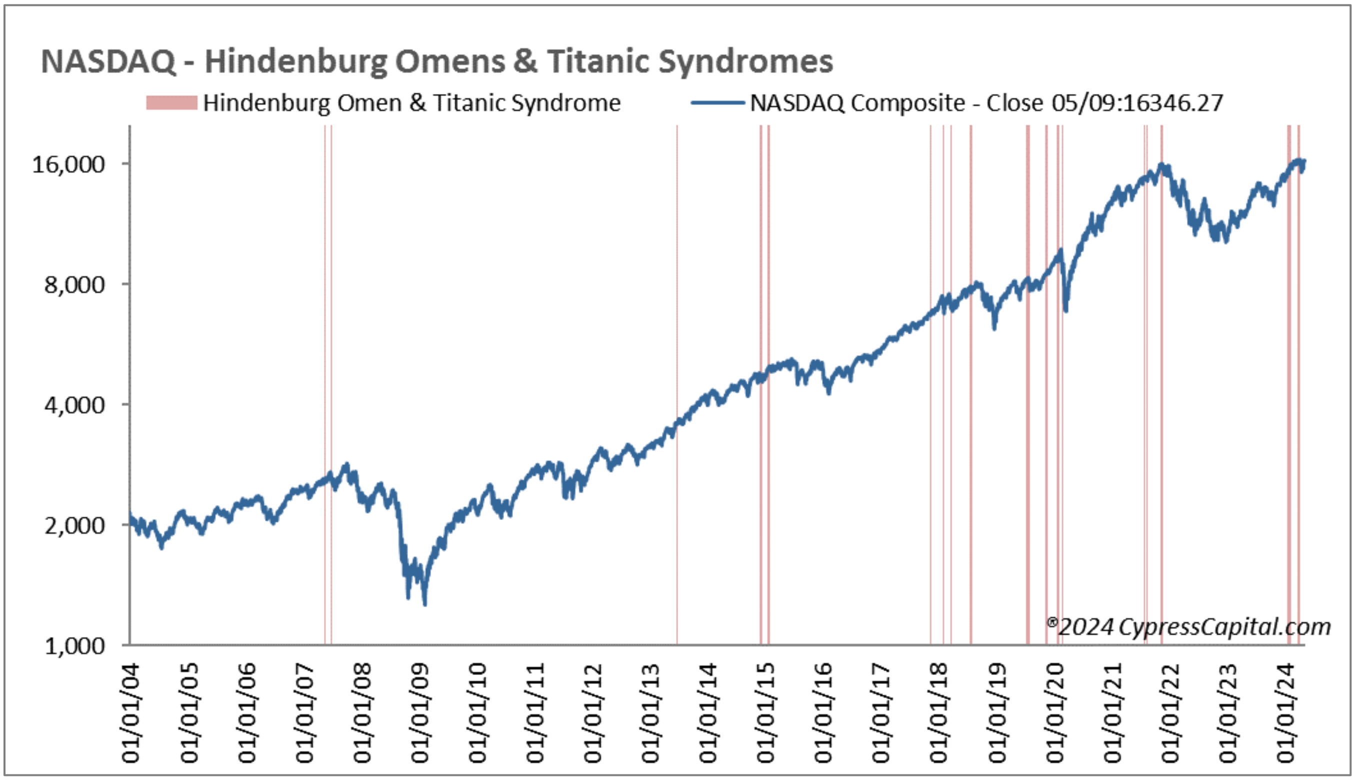
Market Trends

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

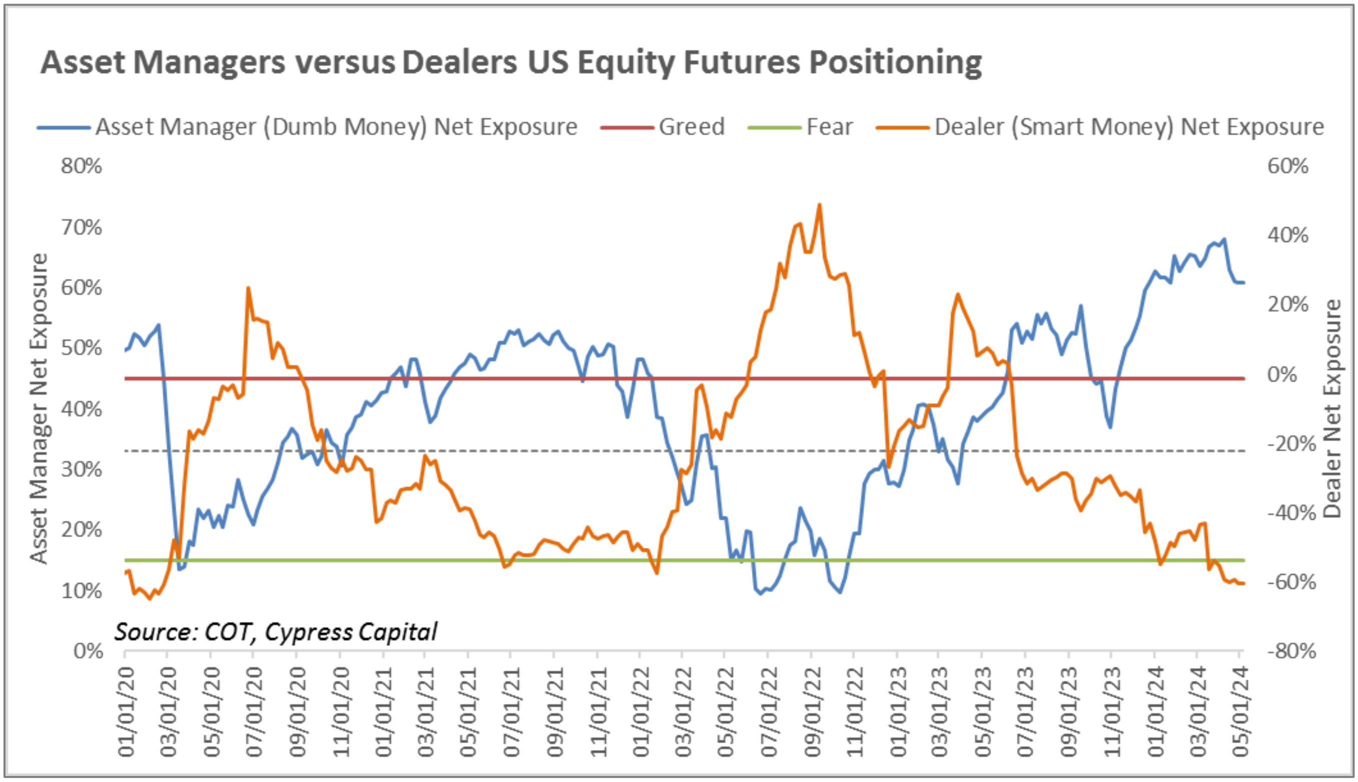
Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets based on our model & opinion. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

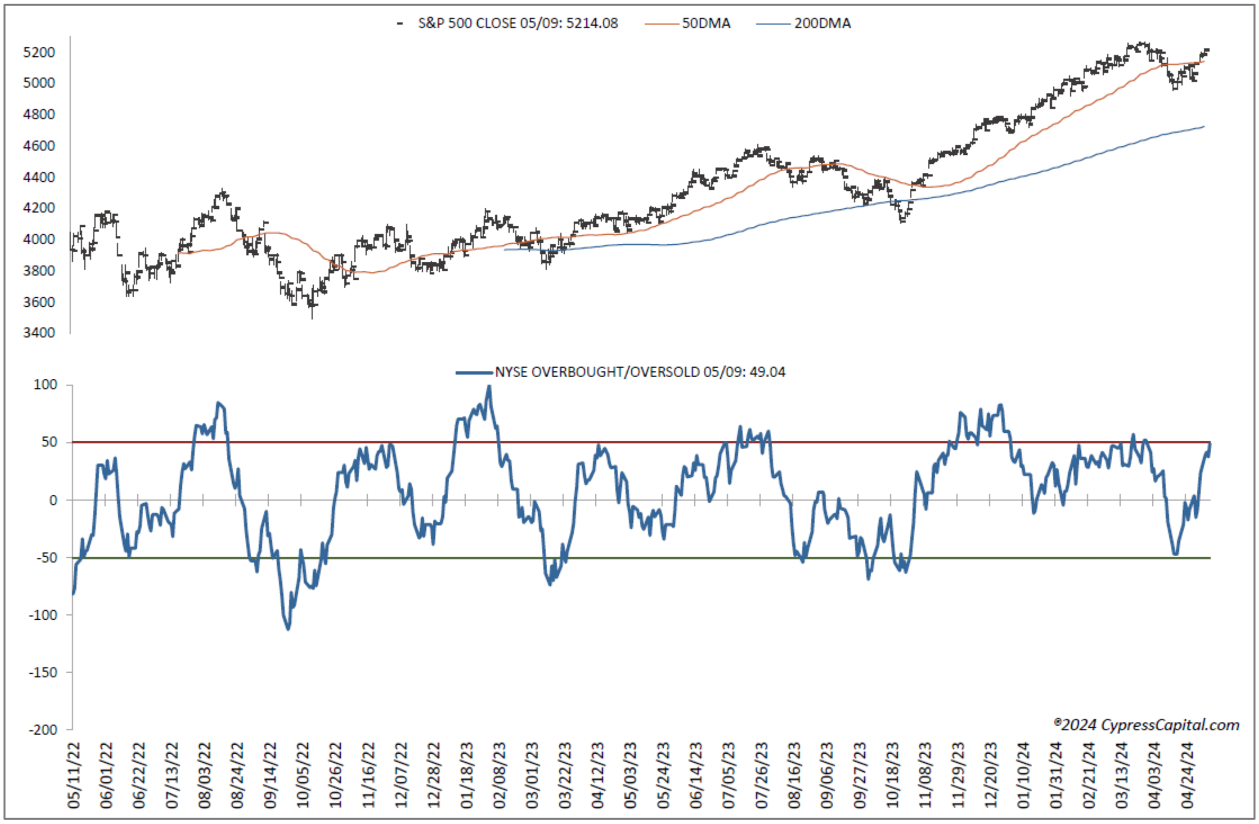
Clusters of Hindenburg Omen & Titanic Syndromes have been helpful warnings over the last 20yrs.



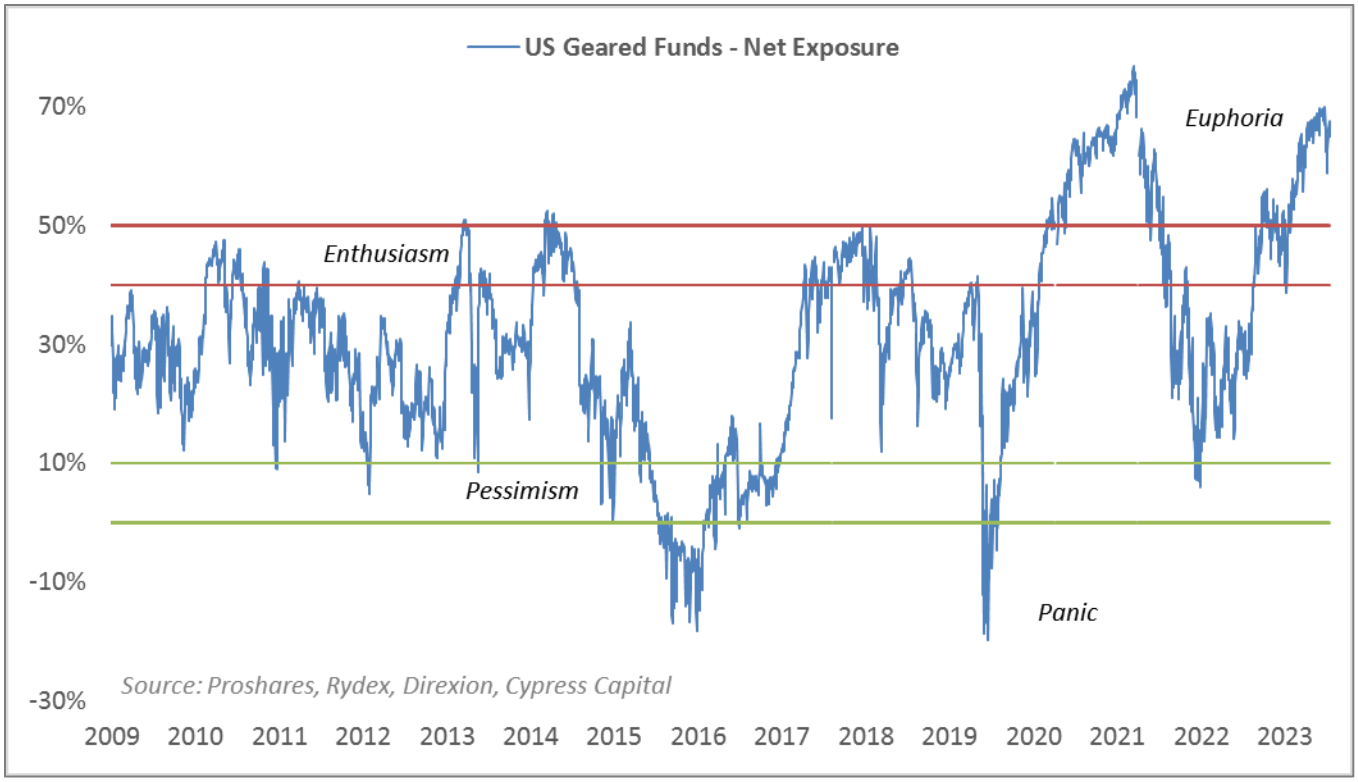
Dumb Money is still euphoric, but a little less so, while Smart Money set a new low in net positioning.



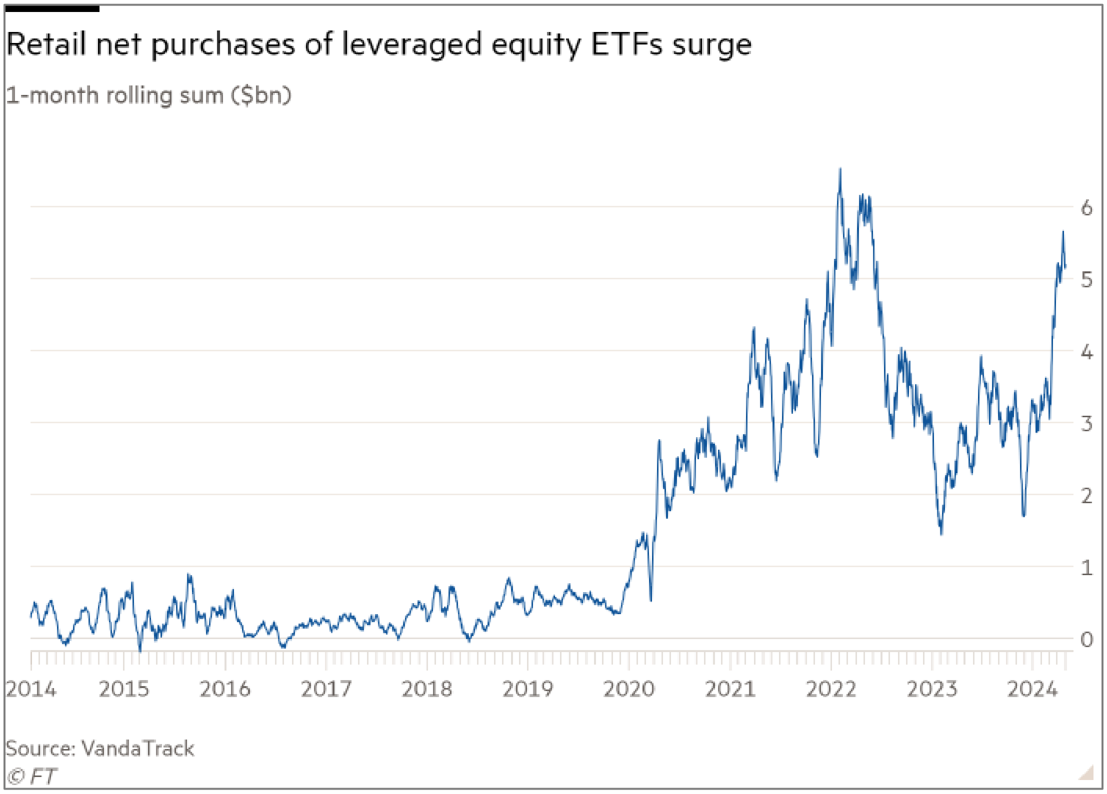
NYSE Overbought Oversold Indicator – from oversold to overbought in three weeks.



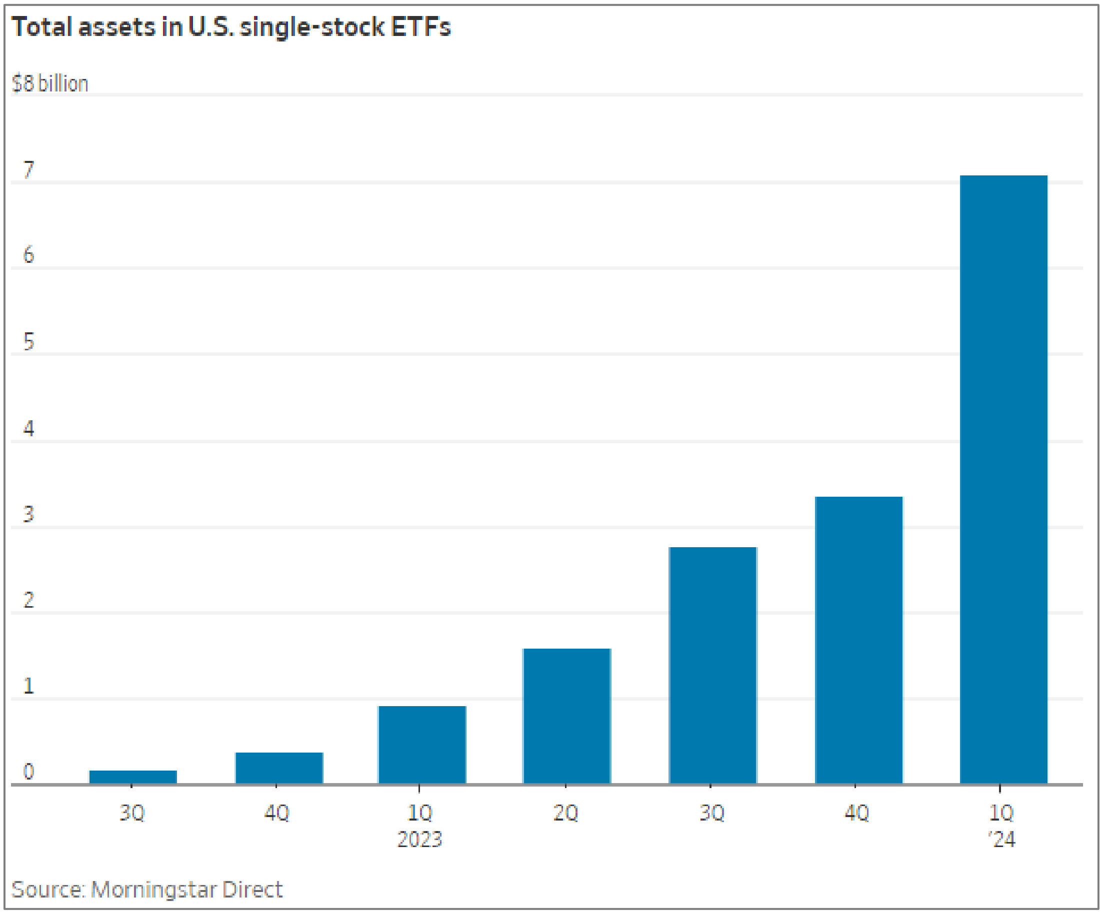
Net Exposure using Leveraged ETFs has rebounded back toward cycle highs.



Retail Investor purchases of Leveraged Equity ETFs is approaching all-time highs.

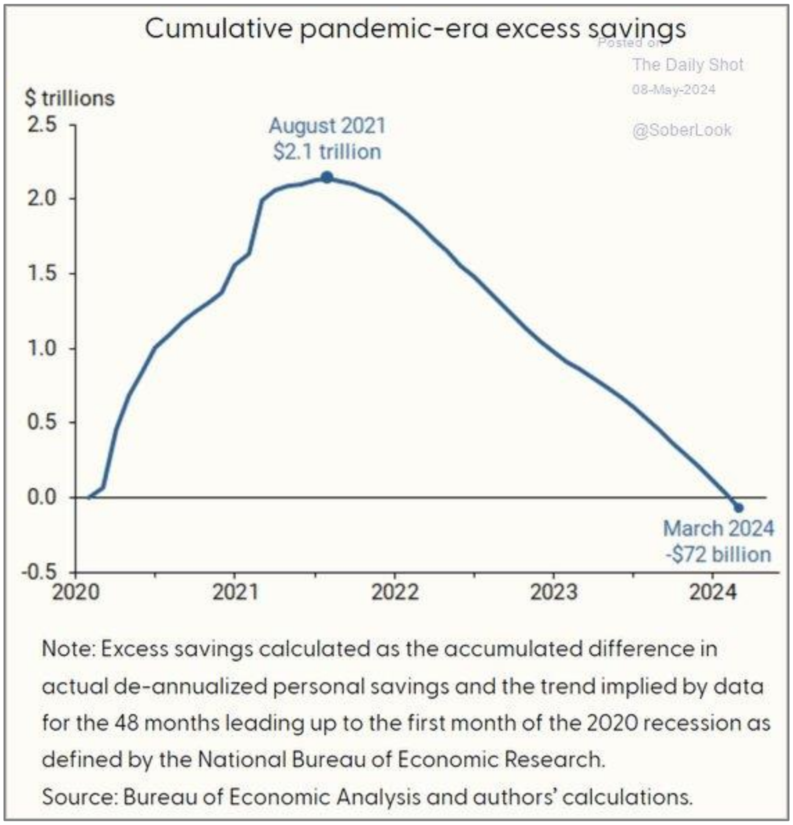


Assets in Single-Stock ETFs have exploded in 2024.



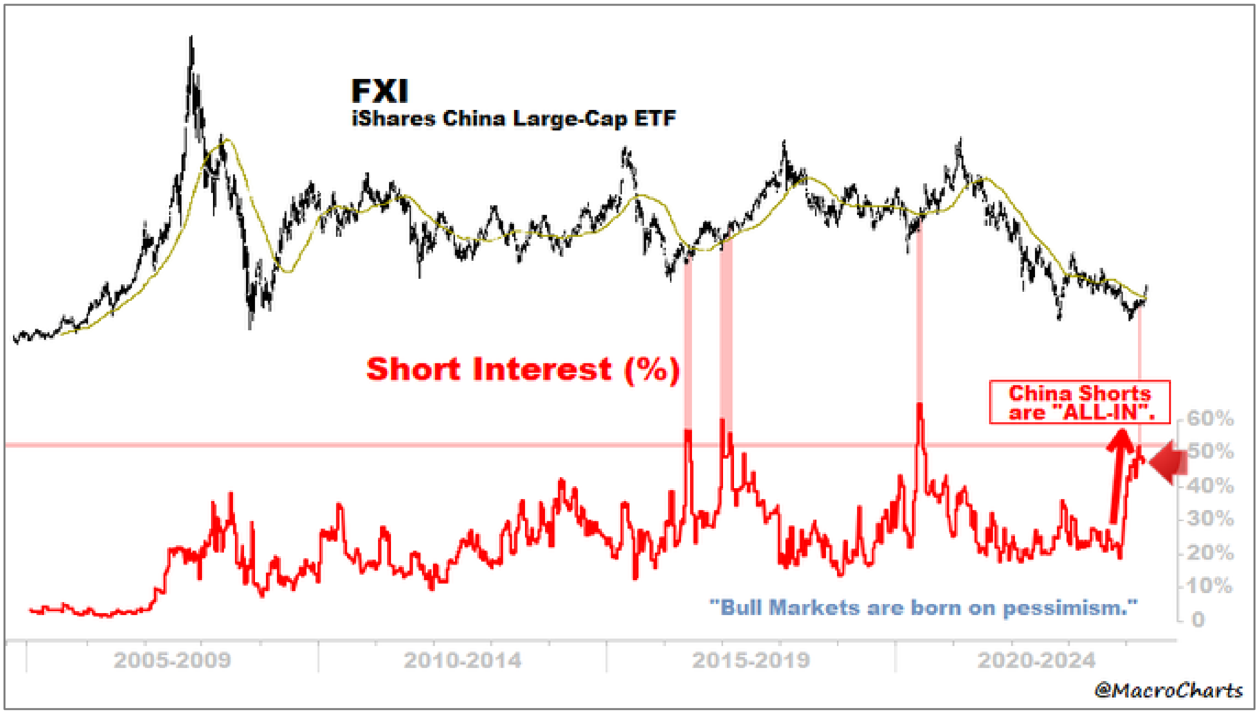
Consumers have finally spent their pandemic-era savings (stimulus)

At the end of April, we noted that the first upturn in M2 growth in 16 months was likely the first sign that Households were nearing the end of trying to spend down their COVID stimulus windfall. This is additional evidence.

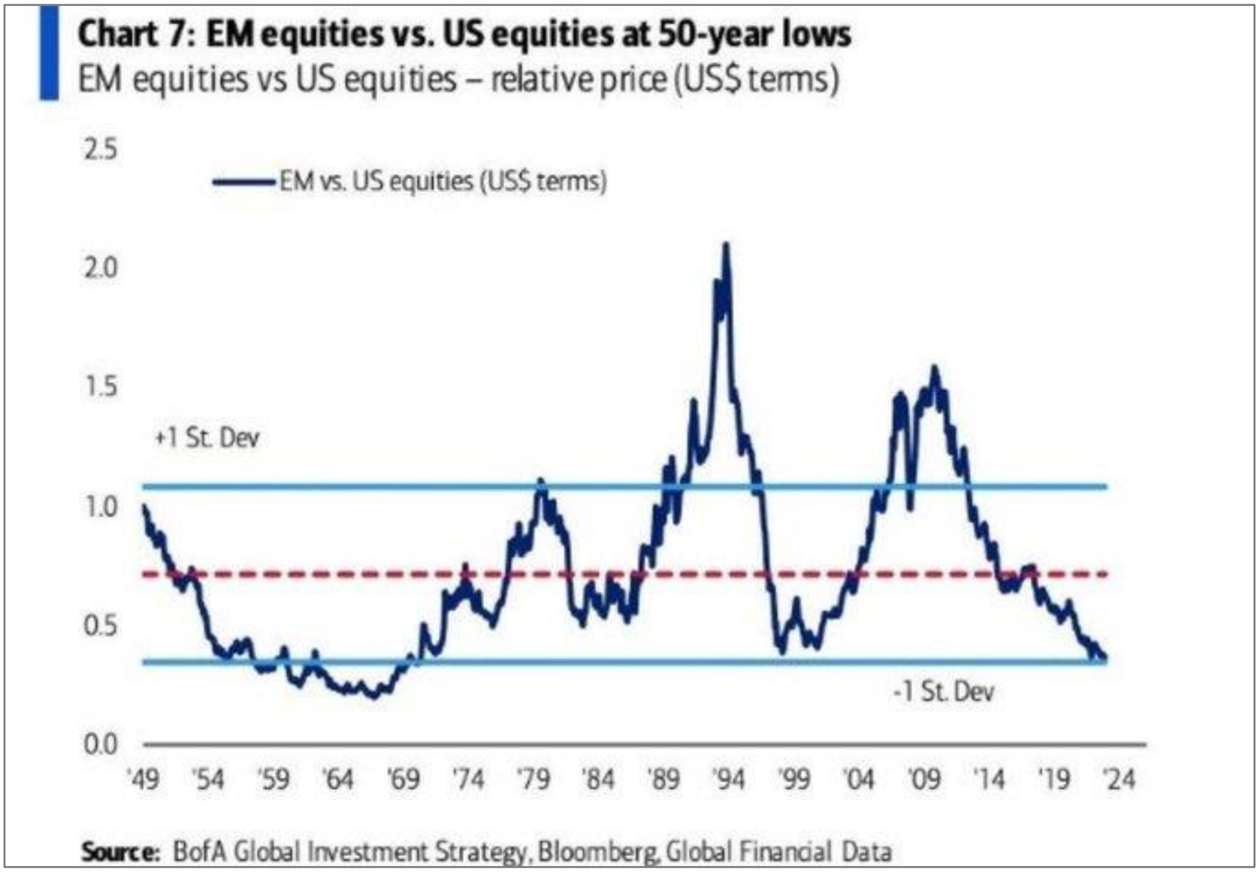


China's "Fed Model" for valuation shows severe undervaluation for stocks relative to bonds.

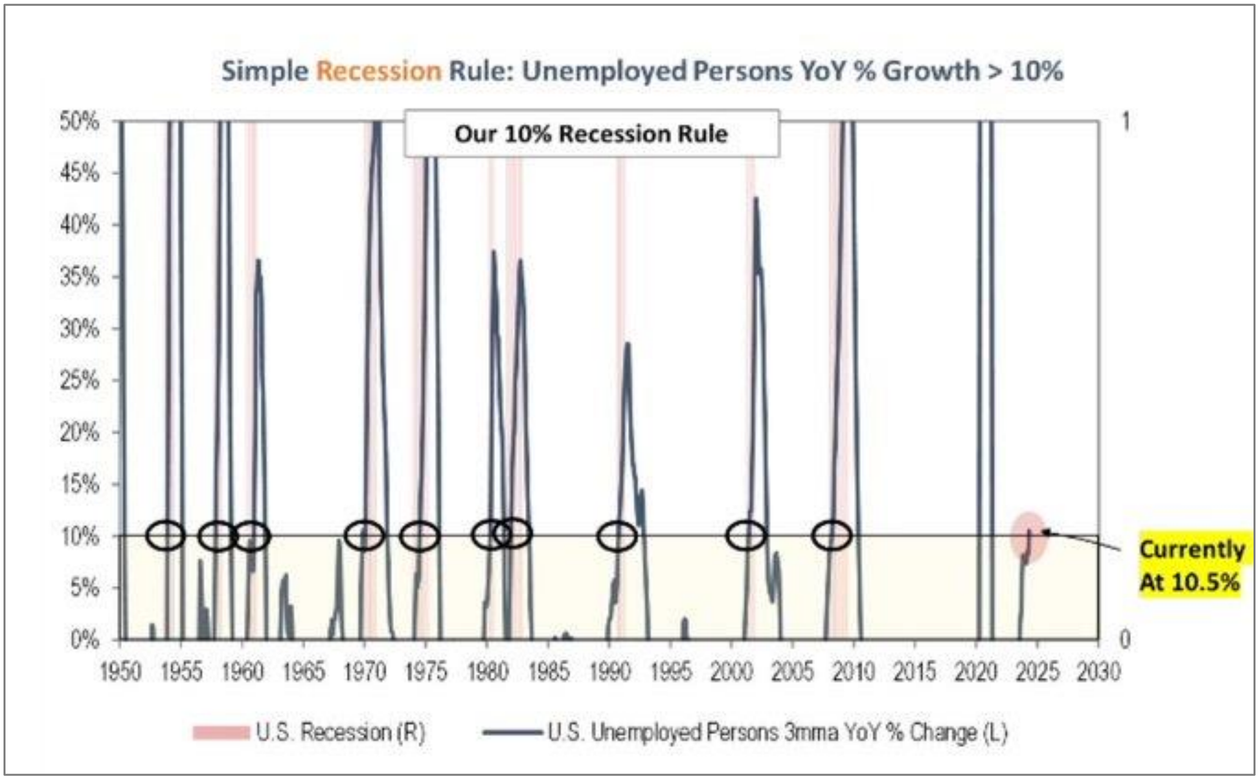
Short interest in FXI has surged to levels that tend to start short-term rallies.



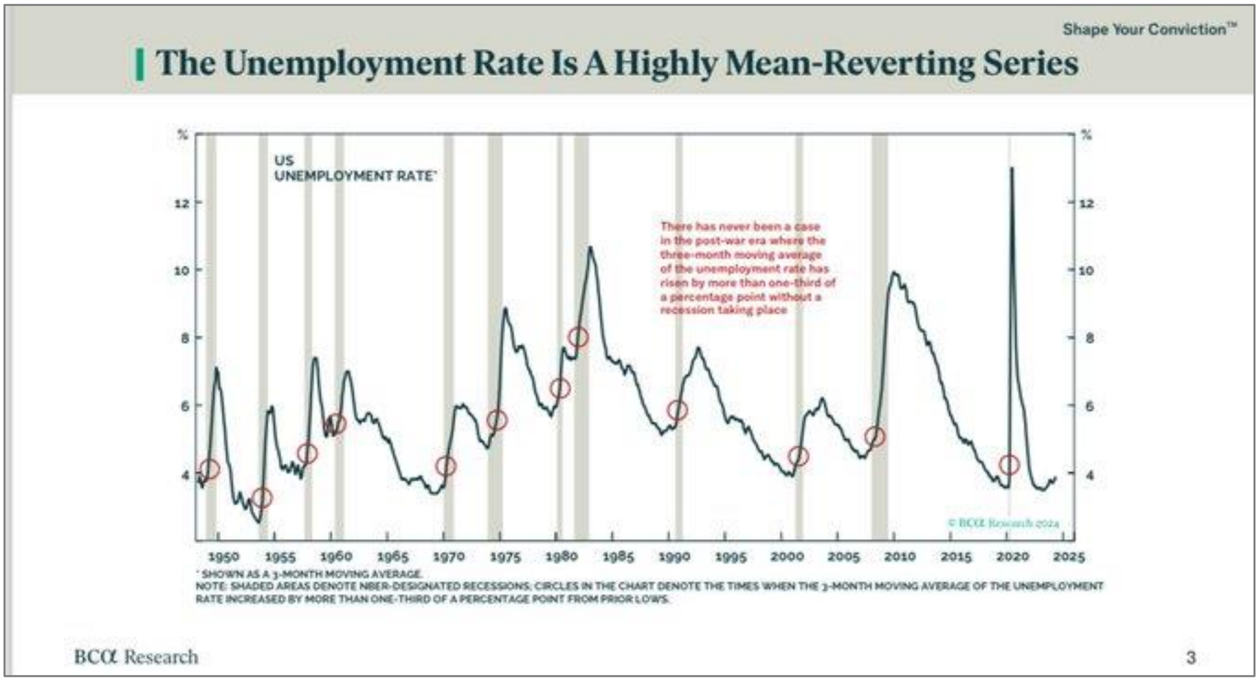
Emerging Markets are at 50-Year Relative Lows.



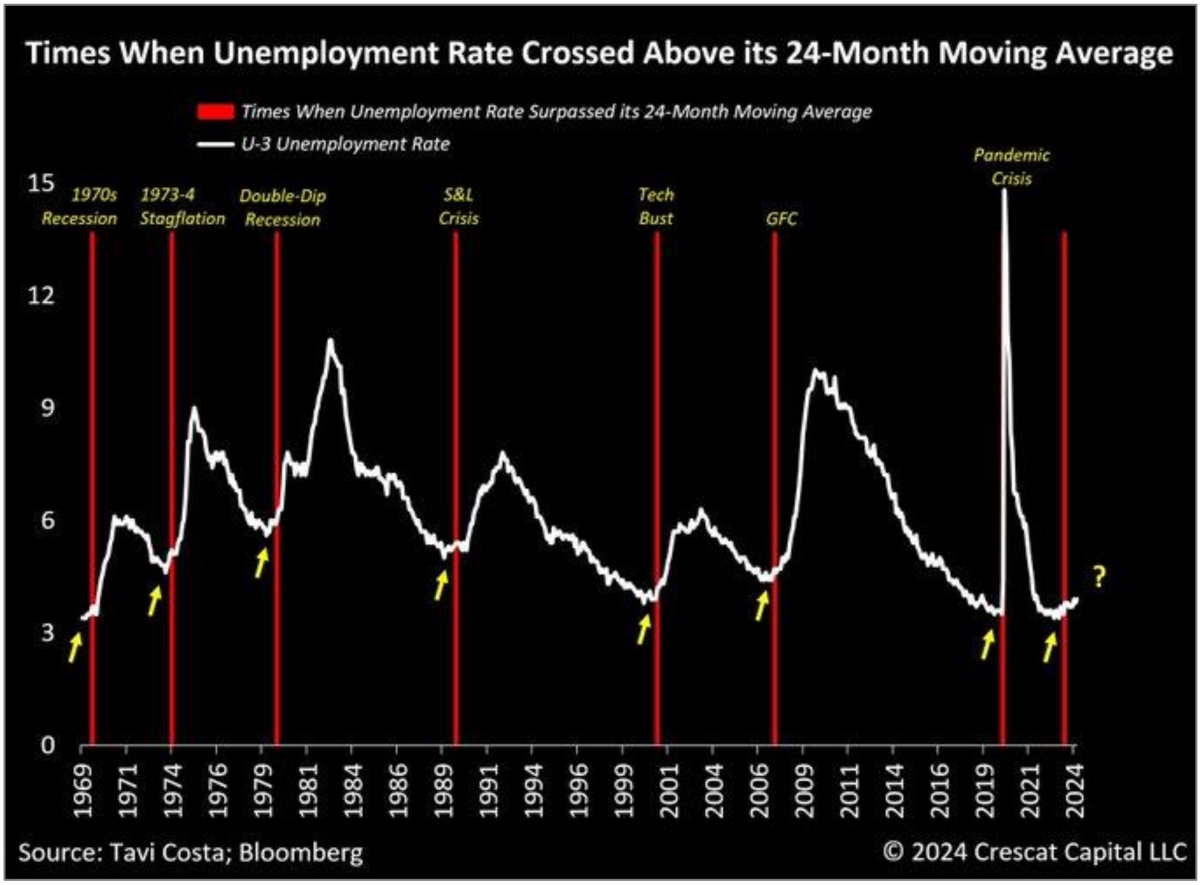
Growth in Unemployed Persons has hit a level that tends to coincide with the onset of recessions.



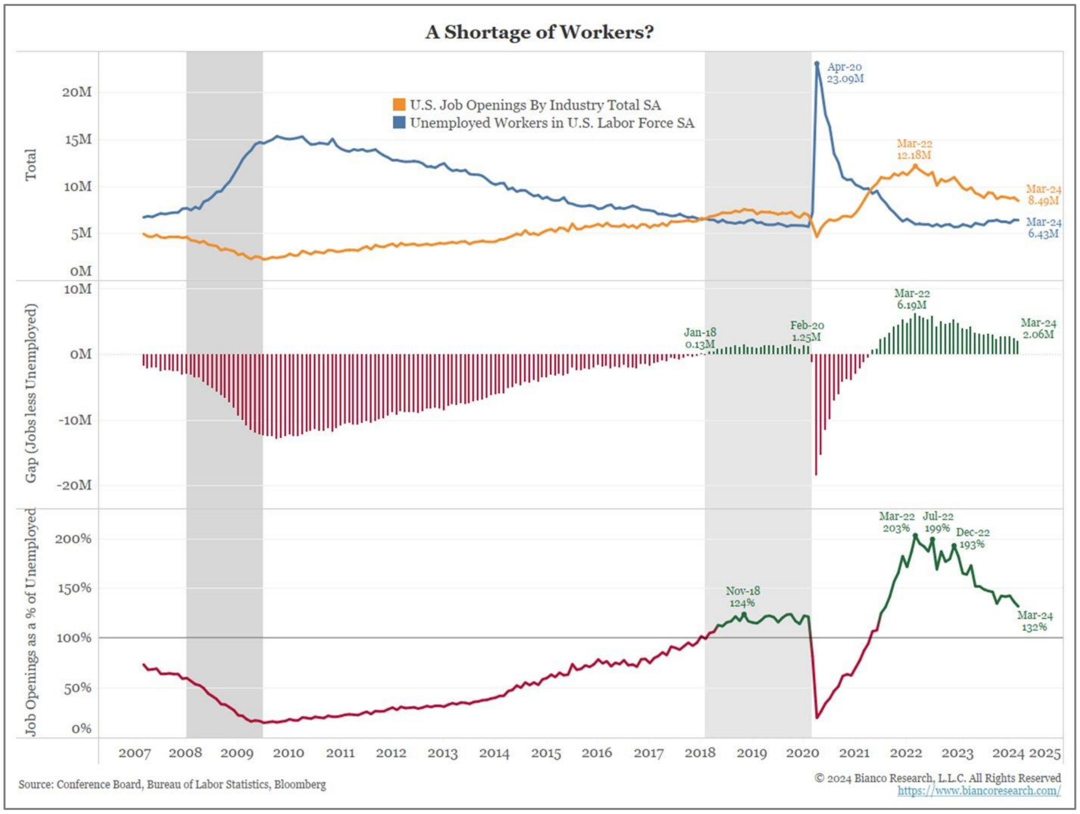
A rise in Unemployment (3MMA) by 1/3 of a percent has always coincided with Recession.



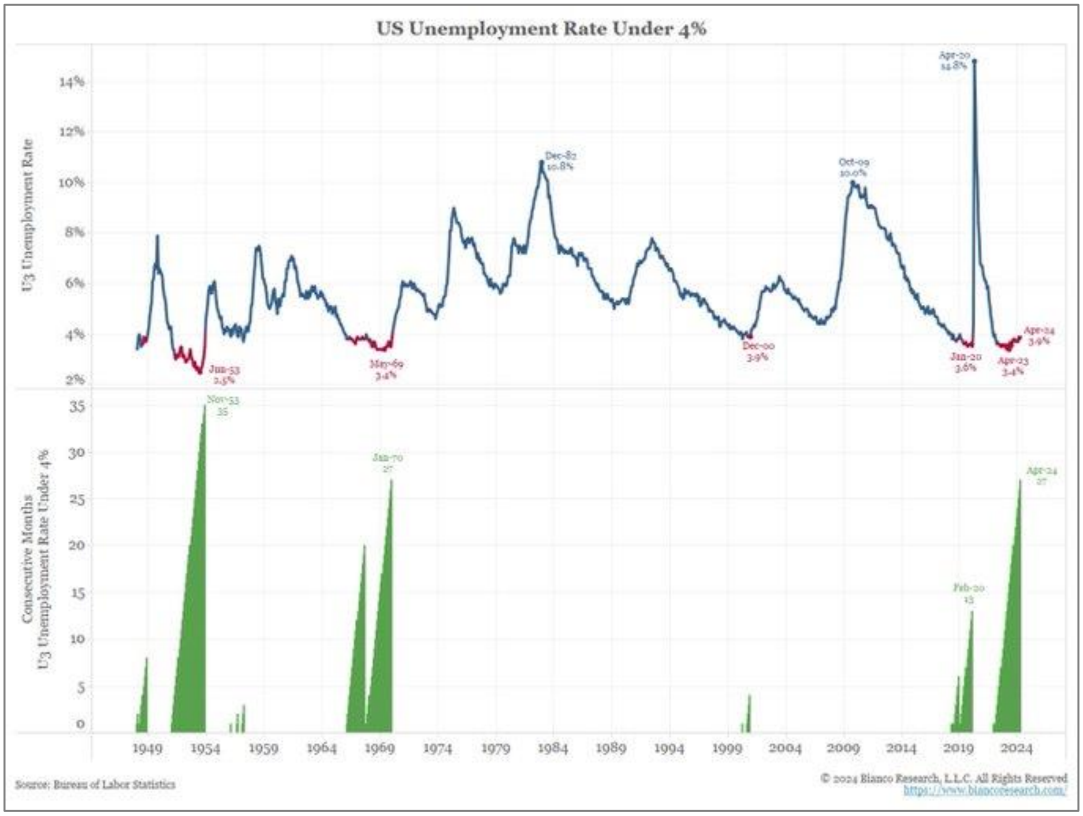
Similar message when you look at periods where Unemployment crosses above its 24MMA.



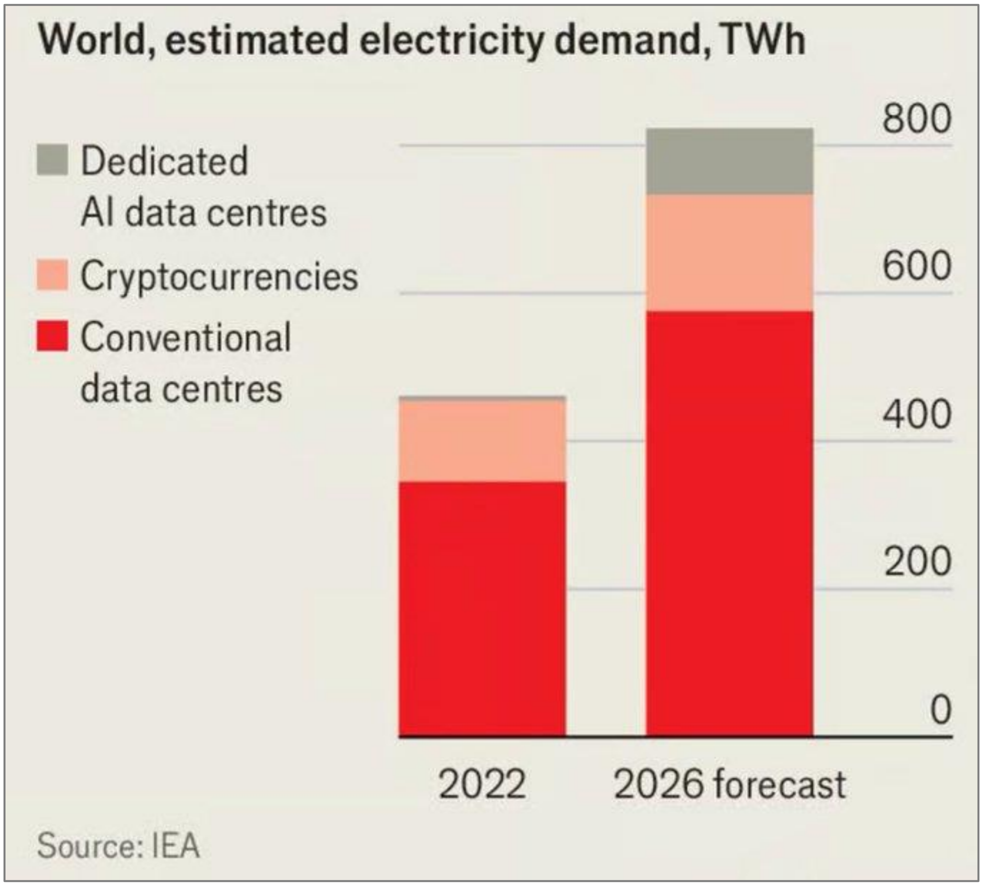
Despite that evidence, there still appears to be a shortage of Labor.



Longest stretch of sub 4% unemployment readings in over 50 years.



Electricity demand is expected to surge as a result of demand from Data Centers and Crypto.



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.