Market Outlook

By Mark T Dodson, CFA

Oversold Stock Market is not much of a concern to investors.

Market Risk Index climbed to 76.4%, staying above the 75% level that denotes markets with substantial drawdown risk. Monetary Conditions worsened for the second week in a row, as higher volatility and uncertainty around Fed policy manifested itself as a weakening of financial conditions. The Psychology Composite was unchanged, and Valuations improved slightly.

The stock market is oversold for the first time since last October, which sets up conditions for a short-term bounce, or a signal of additional volatility and selling to come. The VIX argues for the latter. A less well-known measure that attempts to time regime shifts by the VIX triggers a warning when the 50-day standard deviation climbs above 1.25%, which occurred this week. We learned about the work from our friends at the Leuthold Group, and the original work was from Tom McClellan several years ago. It's been superb at timing corrections for the last decade, but it's without fault. It had some rough periods with lots of false signals, like the mid-90s, when the volatility of the VIX remained low for long periods.

We're watching the Leveraged Investments category closely for signs that the lack of risk aversion among investors is beginning to shift away from euphoria. Levered ETF Assets saw their first significant pullback of the year, but net exposure using Futures among Asset Managers set another new record high. Dealers, the smart money, were more than happy to take the other side of that bet – their net exposure set a new cycle low. They haven't been this short since February 2020, when the phrase COVID came into the national vocabulary.

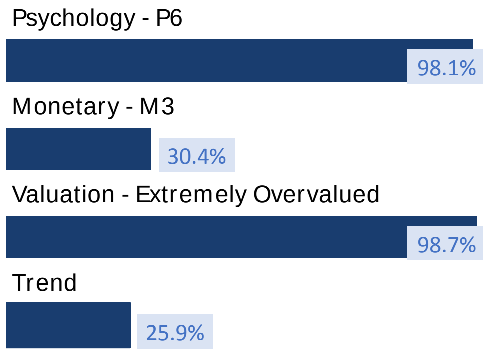
The Flow of Funds category in the Psychology Composite became the single largest bullish influence as buybacks have surged again. Unlike any time in more than 20 years, however, these buybacks are coming at a time when a cool-headed analysis of the cost of capital would favor paying down corporate debt and issuing equity to do so. Corporate bond yields are higher than earnings yields on stocks, so we expect this round of buybacks to harm shareholders. Those same corporate insiders who are buying back stock with corporate money seem to agree with our take when it comes to their own money, as they have been selling their shares at the fastest pace in a decade.

Market Risk Index

Rec Allocation 25% Underweight

76.4%

Category Percentiles



Largest Psychology Influences

Leveraged Investments	Negative
Surveys	Negative
Consumer Confidence	Negative
Flow of Funds	Positive

Largest Monetary Influences

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

Valuation

7-10 Year Equity Return Forecast	0.4%
10Yr US Treasury Yield	4.6%

Market Trends

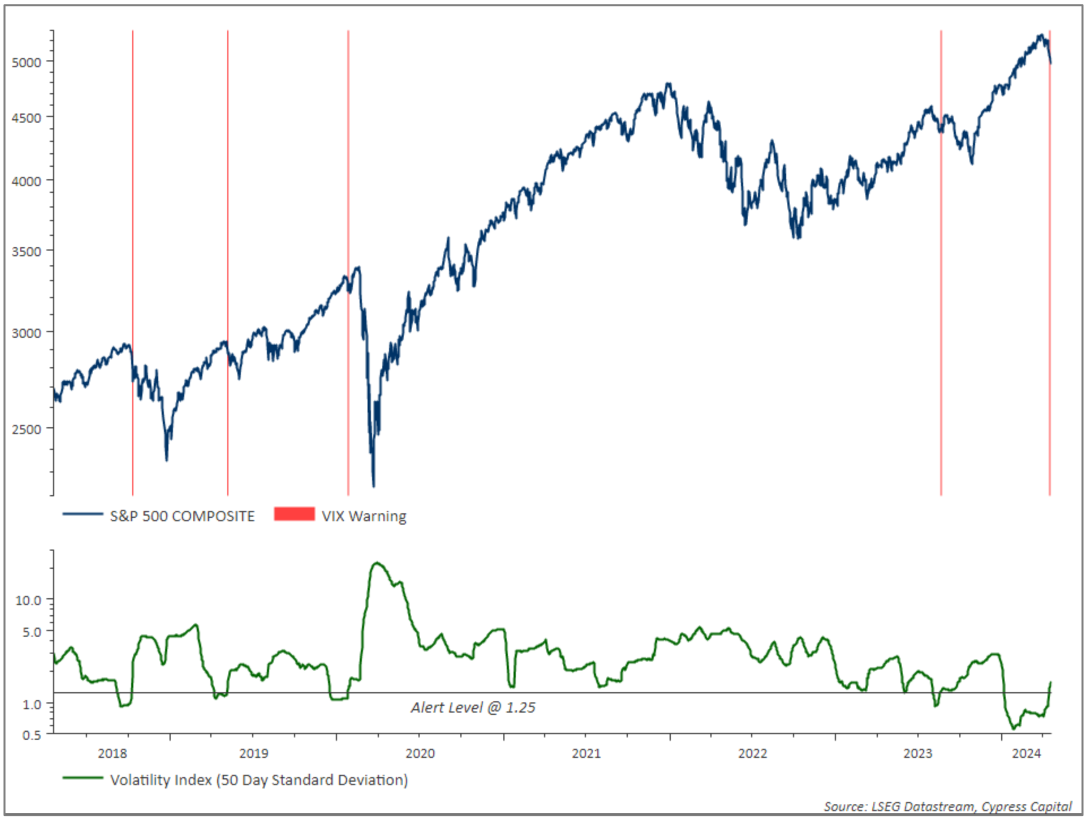
US Equities	Bullish Investment
Intl Equities	Bullish Investment
REITs	Neutral Trade
Broad Commodities	Bullish Investment

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

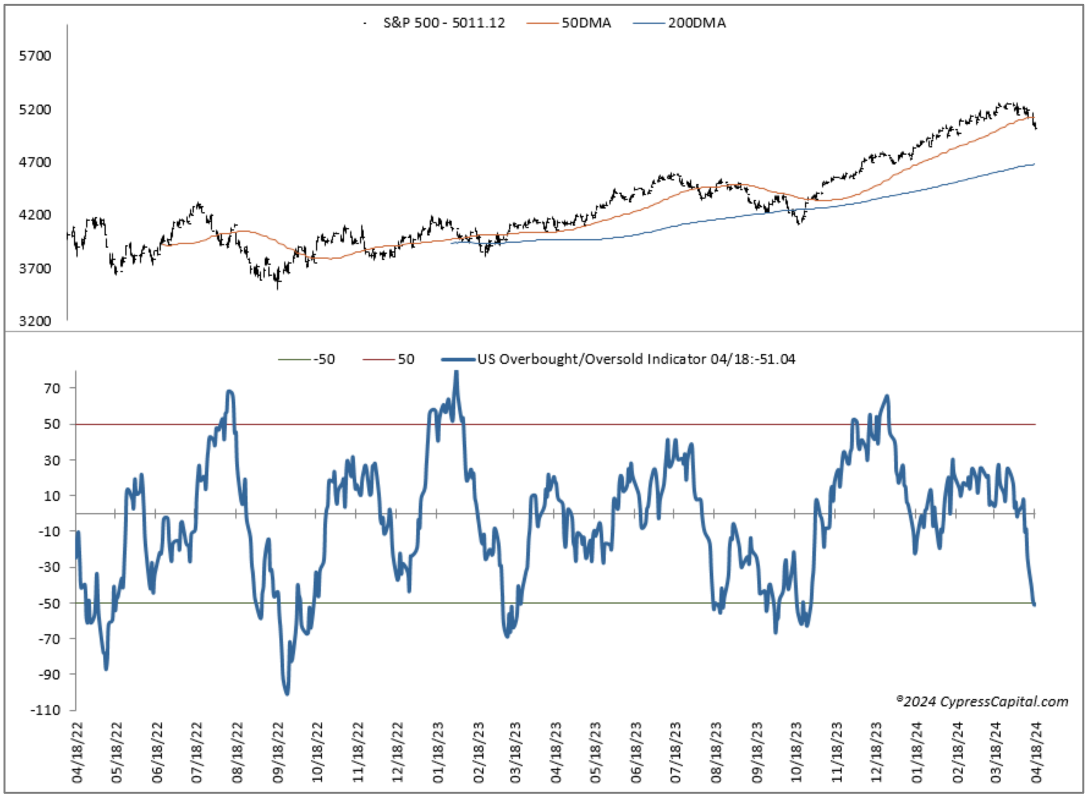
McClellan VIX Warning

This indicator has done an excellent job of highlighting the onset of market corrections over the last decade.

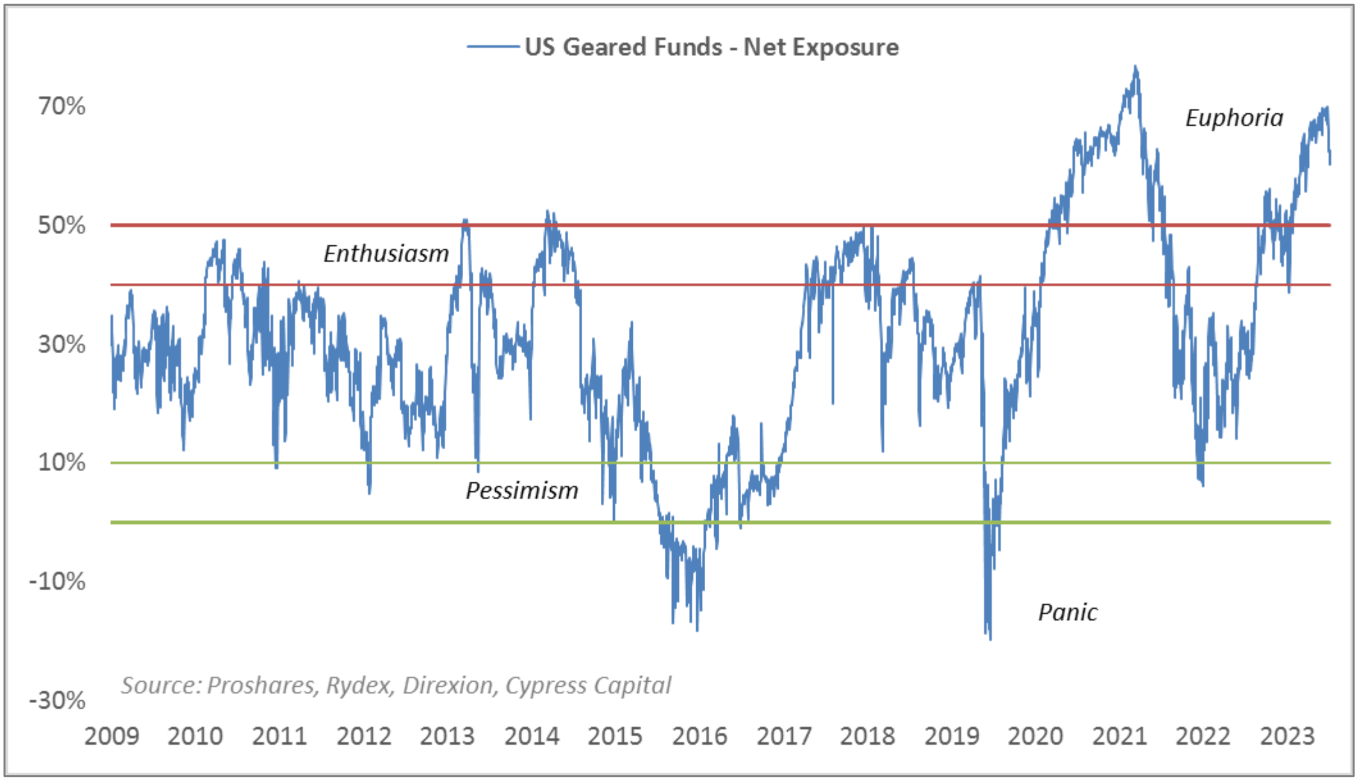


H/T: Tom McClellan, The Leuthold Group

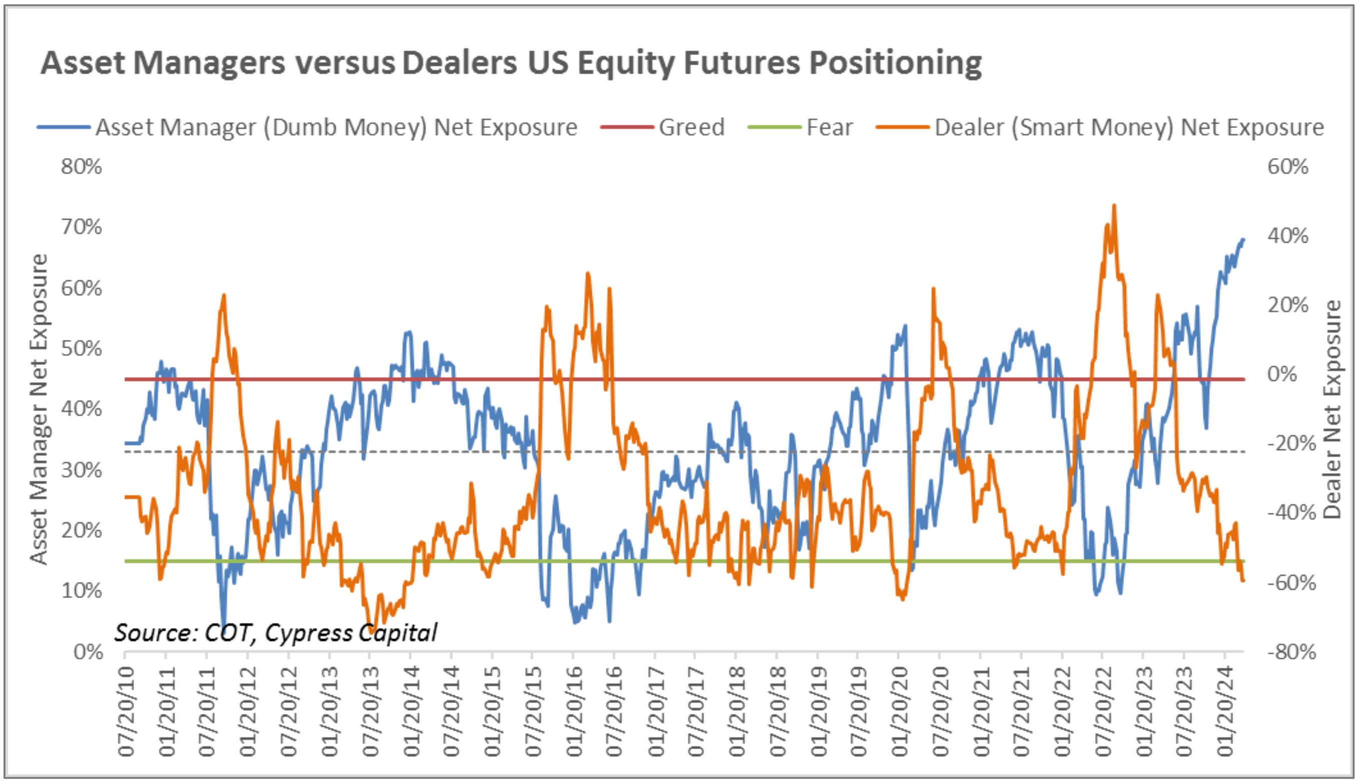
Our Overbought/Oversold Indicators hit oversold for the first time since fall.



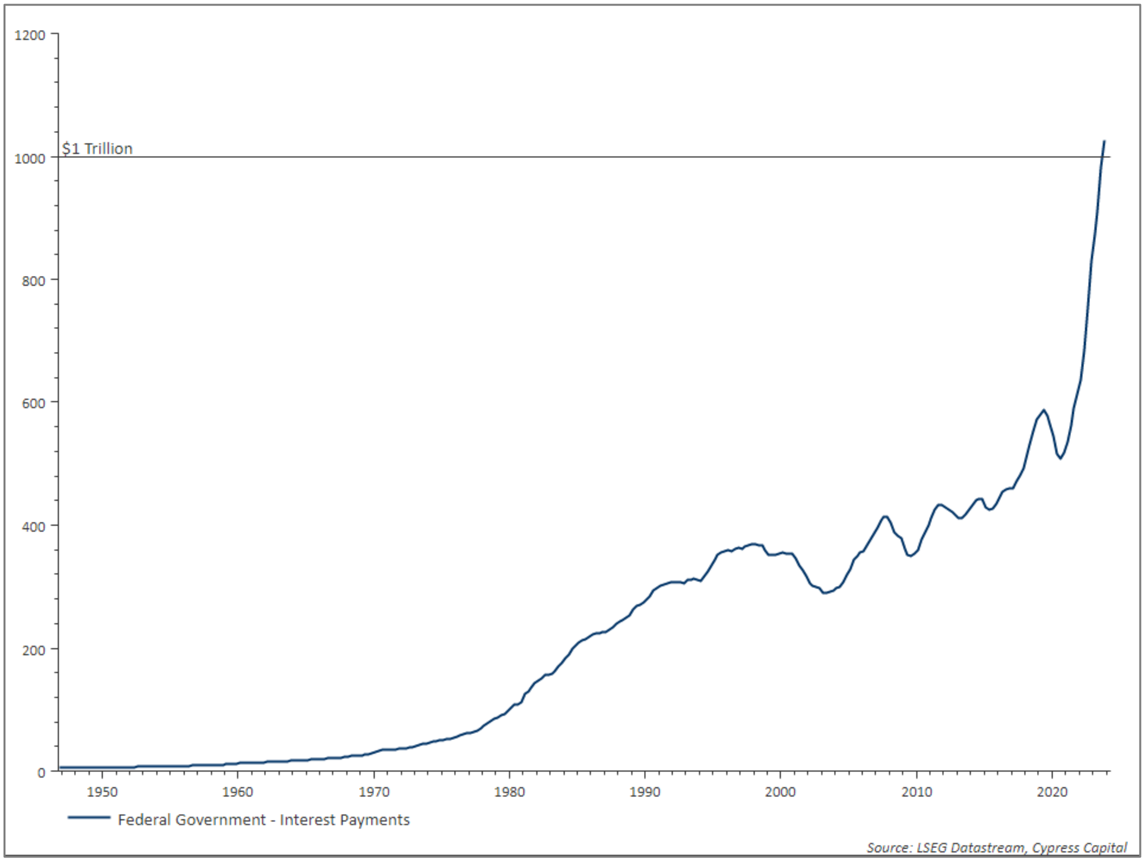
Leveraged ETF investors started their first pullback in risk-taking in 2024.



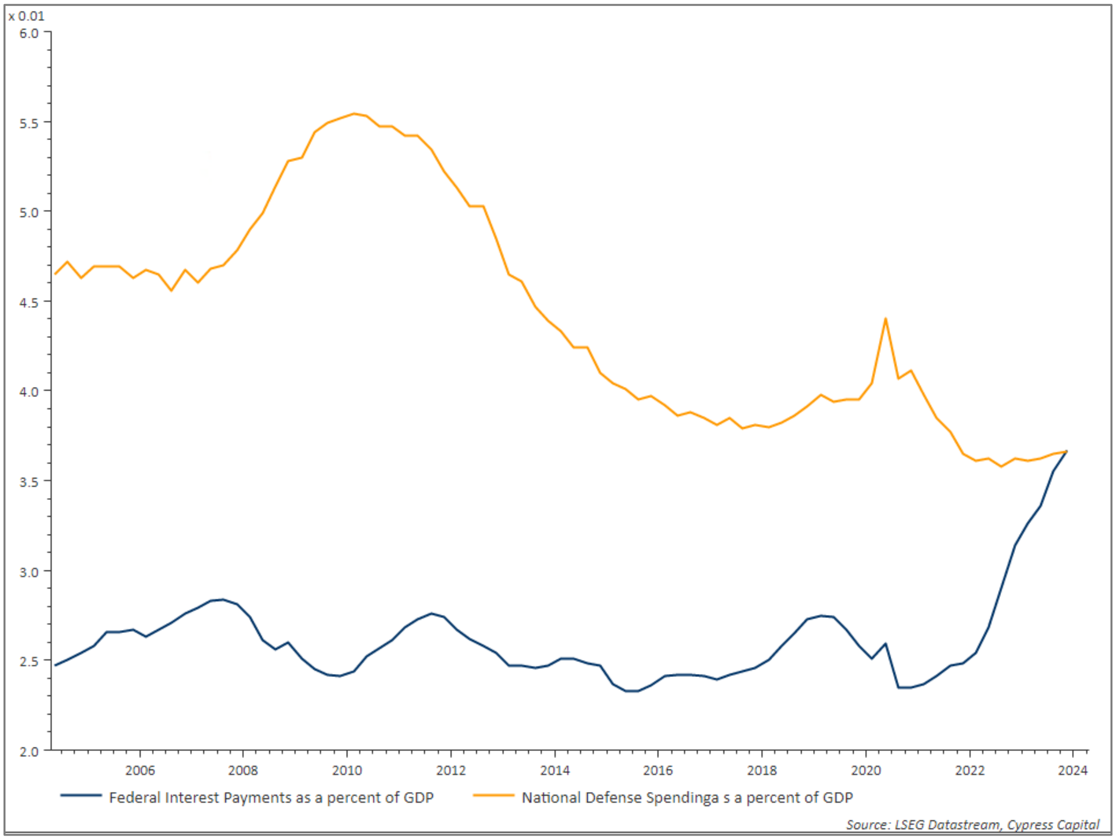
Asset Managers went the other way, setting another record in Net Equity Exposure.
Dealers, the smart money, exposure is the lowest since February 2020.



Interest payments on the Federal Debt surpass $1 Trillion for the first time.

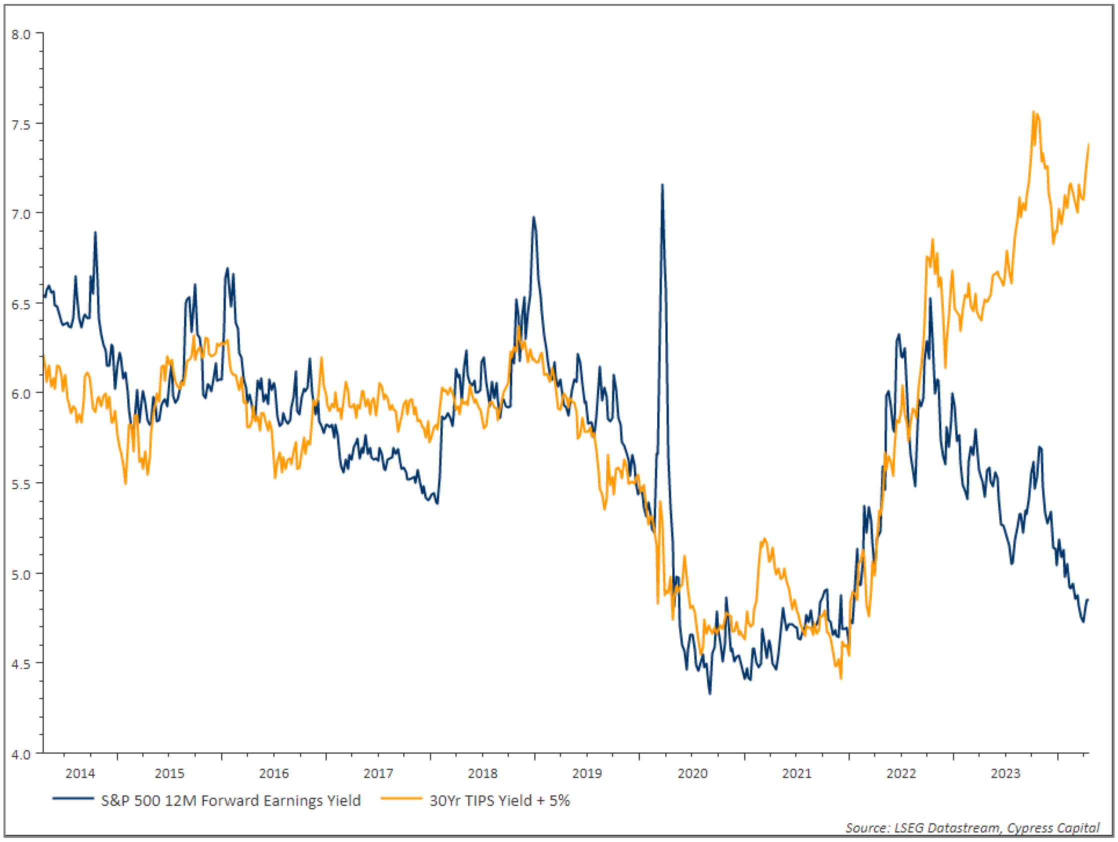


Federal Interest Payments have also surpassed Defense spending.



Stock valuations have been ignoring the bond market since 2023.

Stock valuations and TIPS yields have tracked closely for the last 10-20 years.

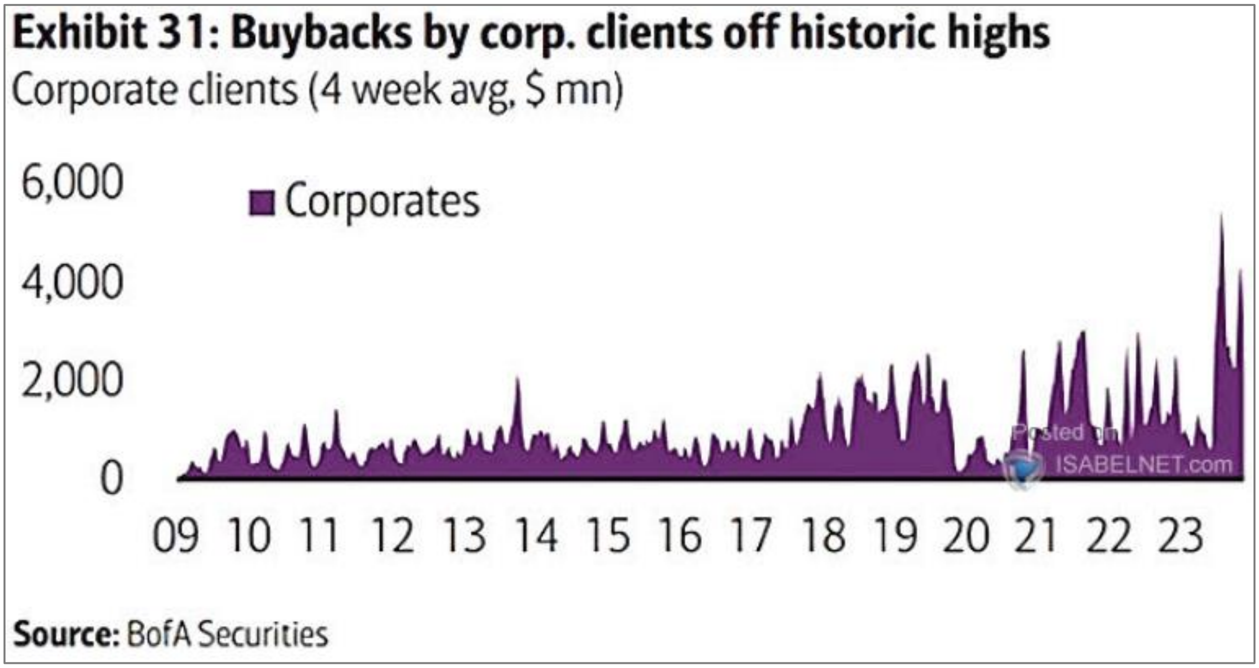


This is the least favorable period for buybacks to add value in over 20 years.

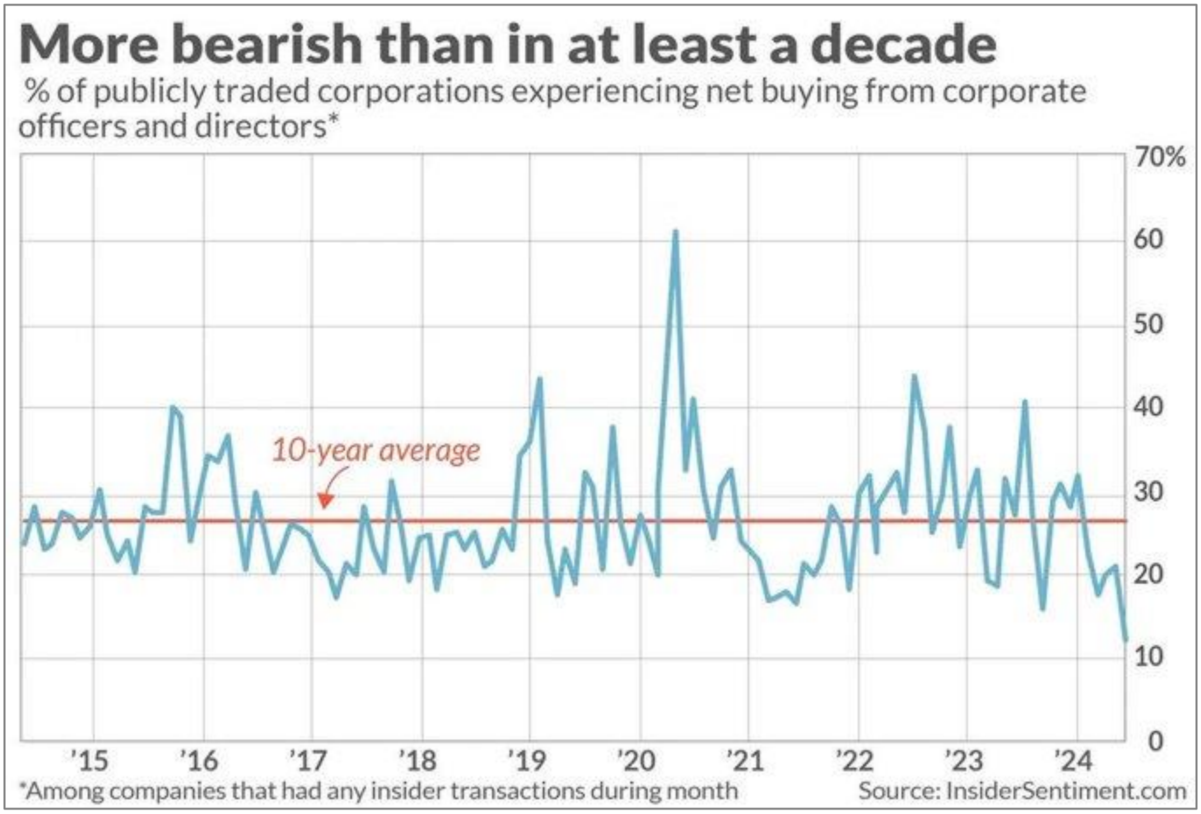
Corporations, through buybacks, have driven equity demand since 2000.

Source: Goldman Sachs Global Investment Research

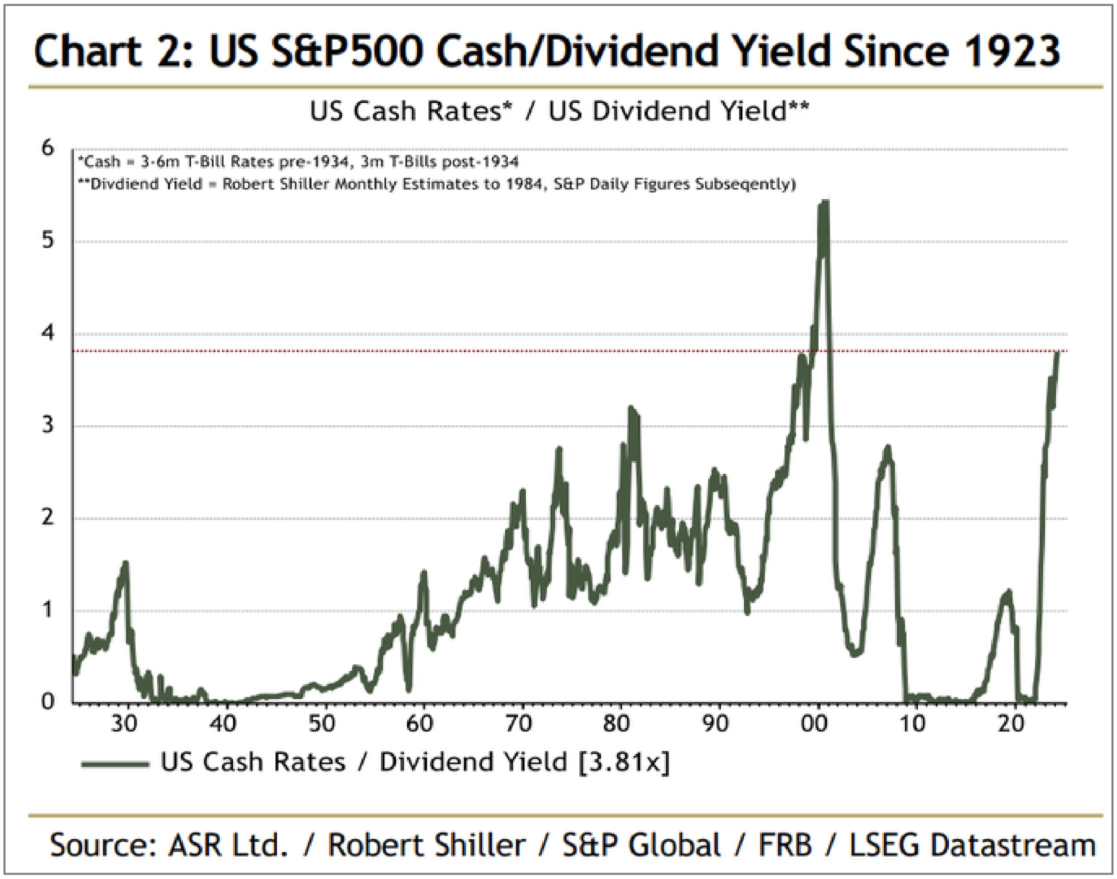
Corporate buybacks have surged this year.



Meanwhile, corporate executives are selling their own stock at the fastest pace in a decade.

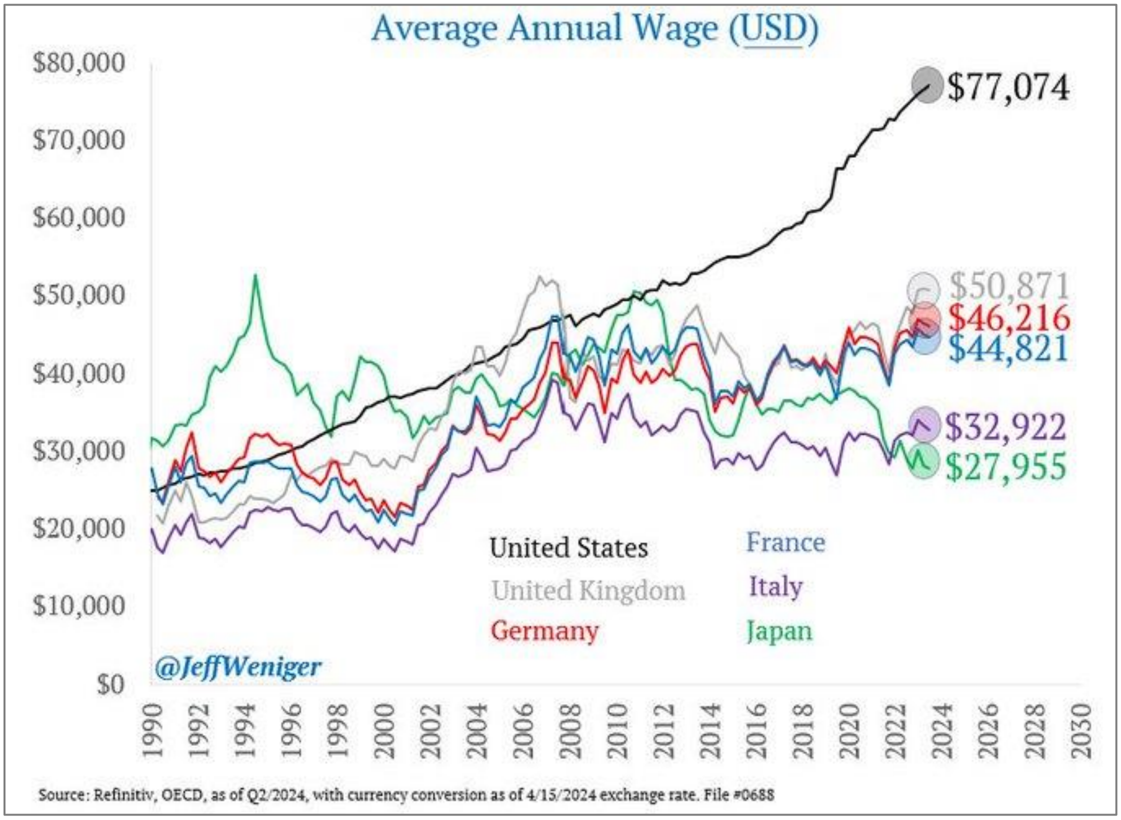


Yields on Cash versus Stock Dividend Yields are the most attractive since 2000.

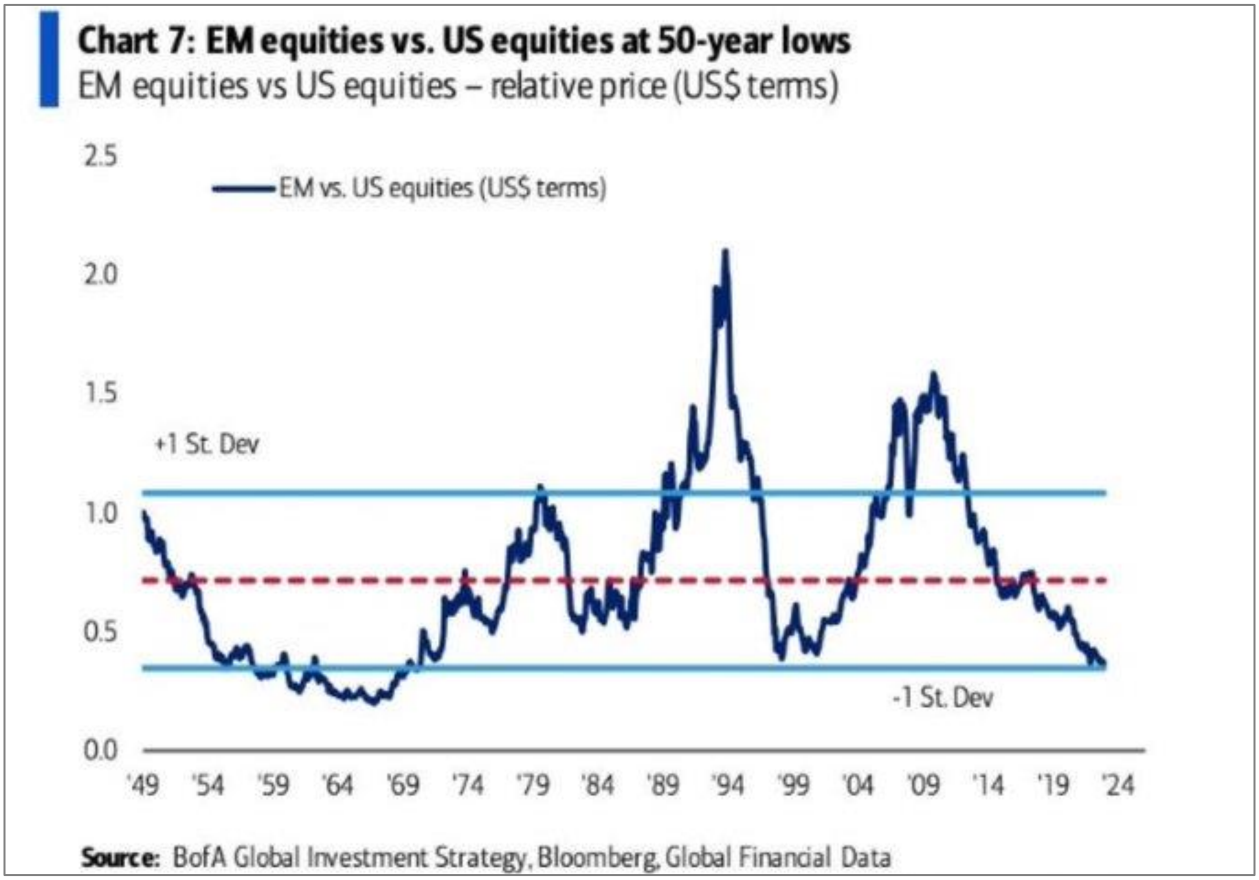


Source: @IanRHartnett

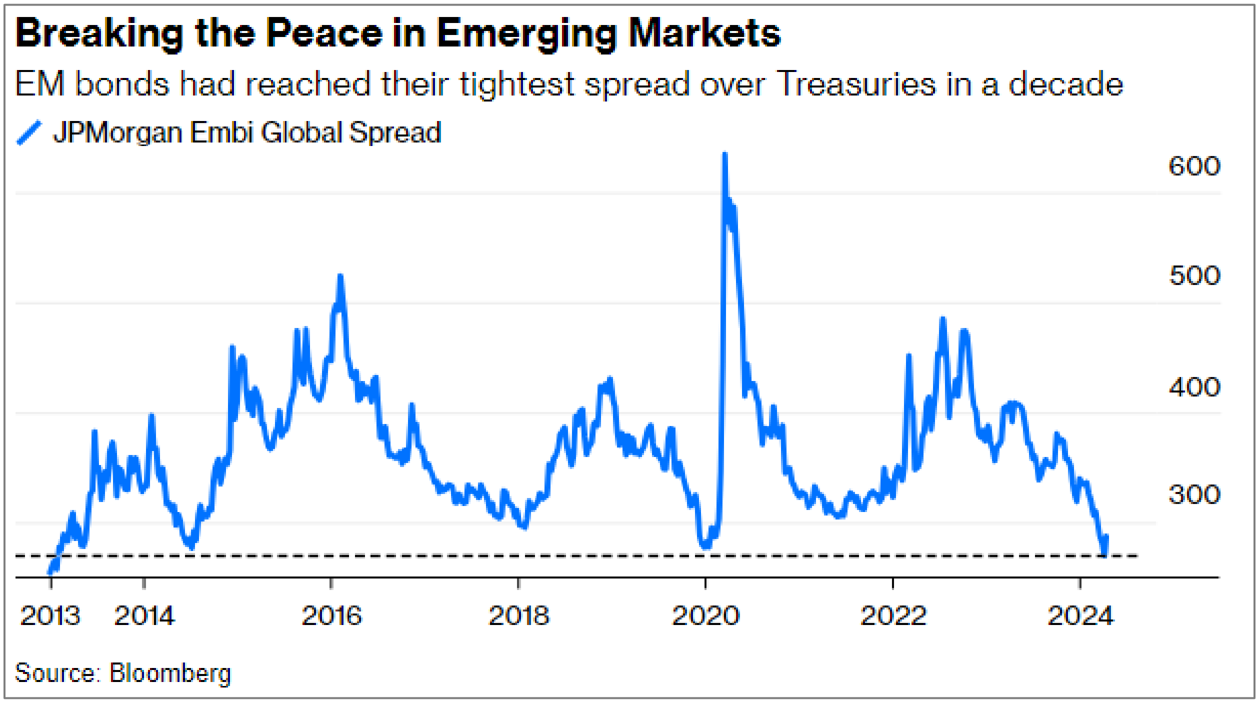
The average annual wage in the United States dwarfs that of other developed countries.



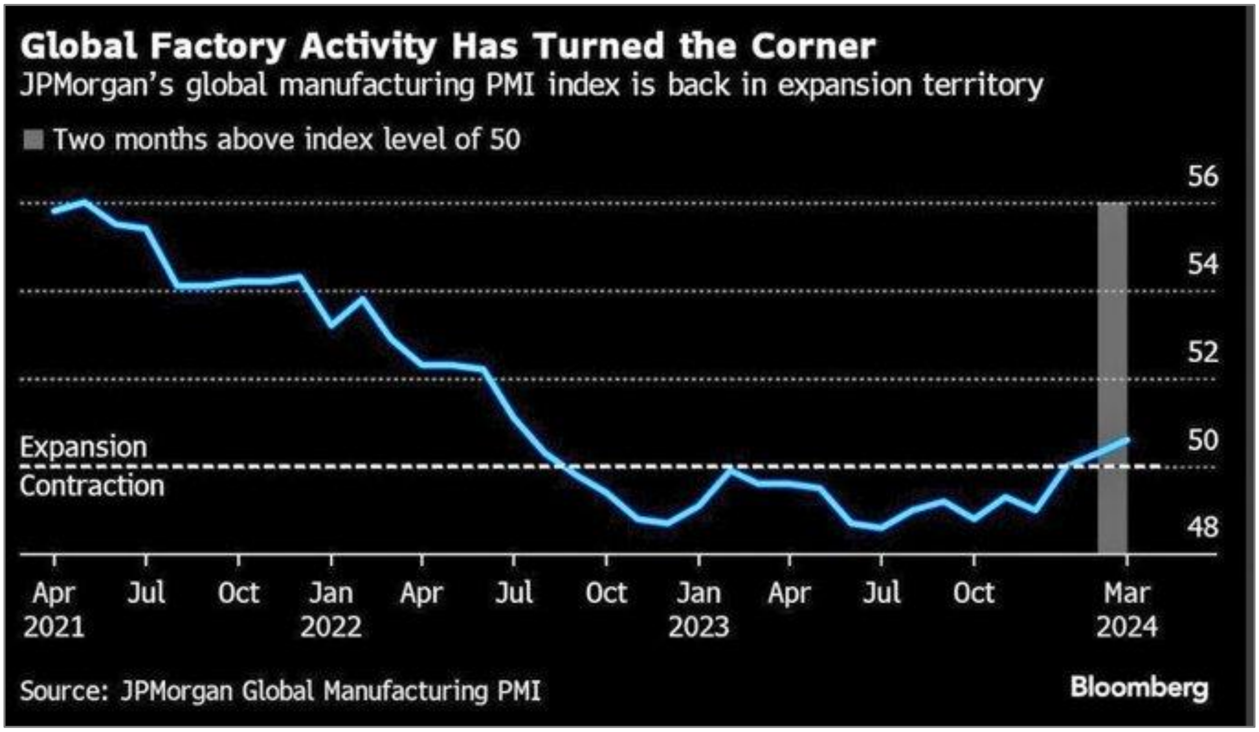
Emerging Markets – relative performance at 50-year lows.



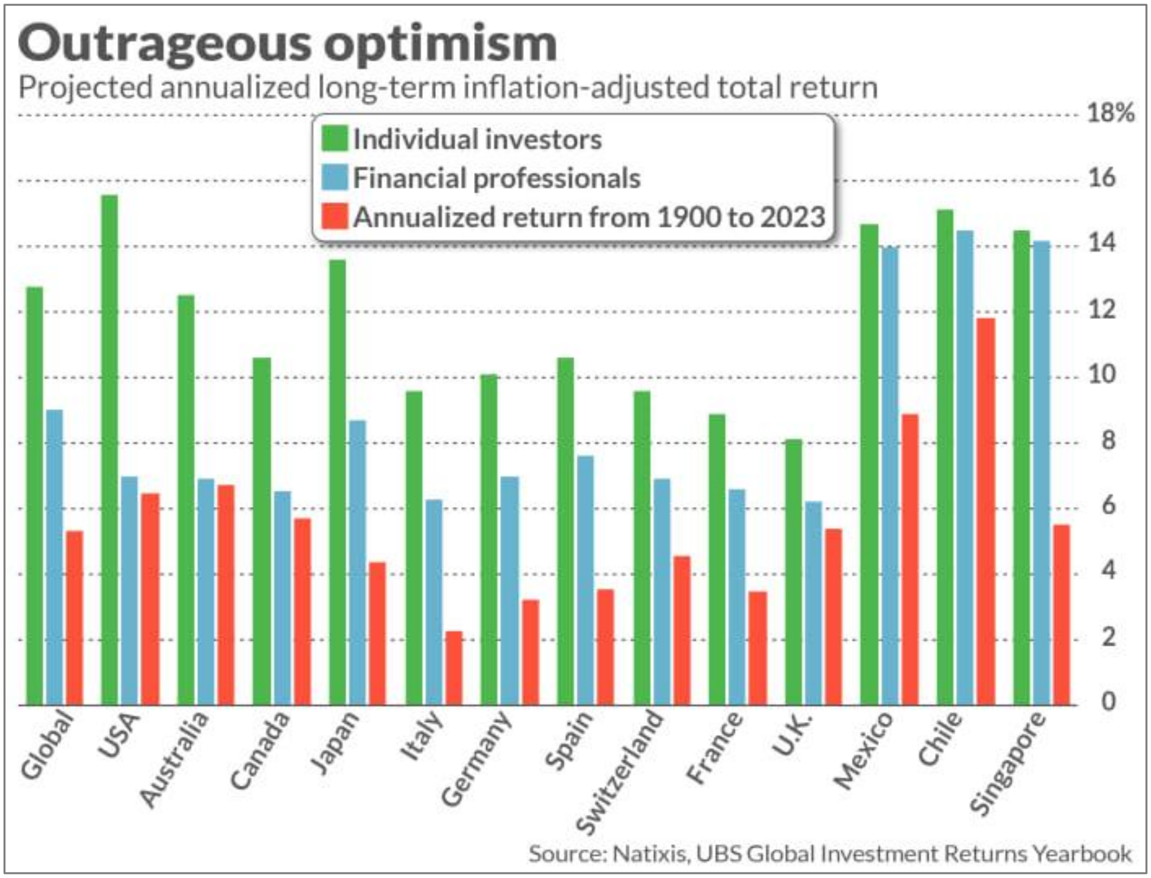
Emerging Market Bond spreads are the tightest in a decade.



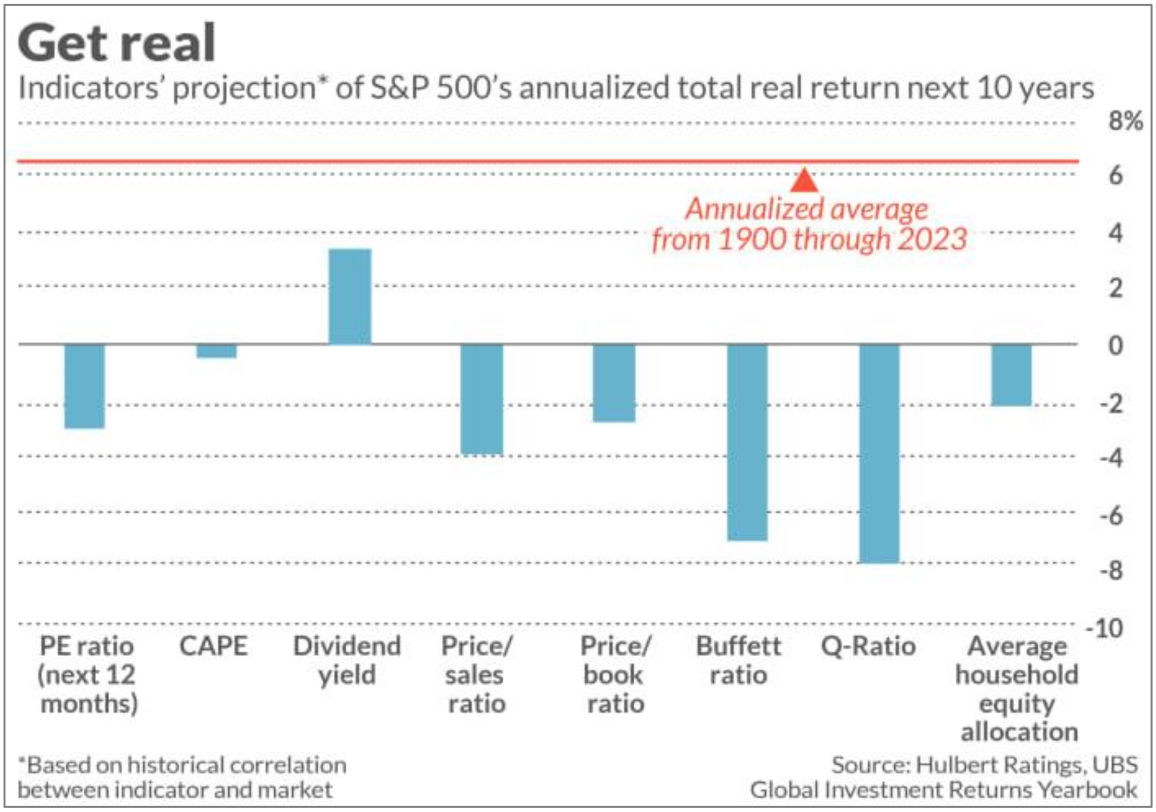
Global Manufacturing is back in expansion.



Wide gulf between investor expectations for stock returns versus historical returns.



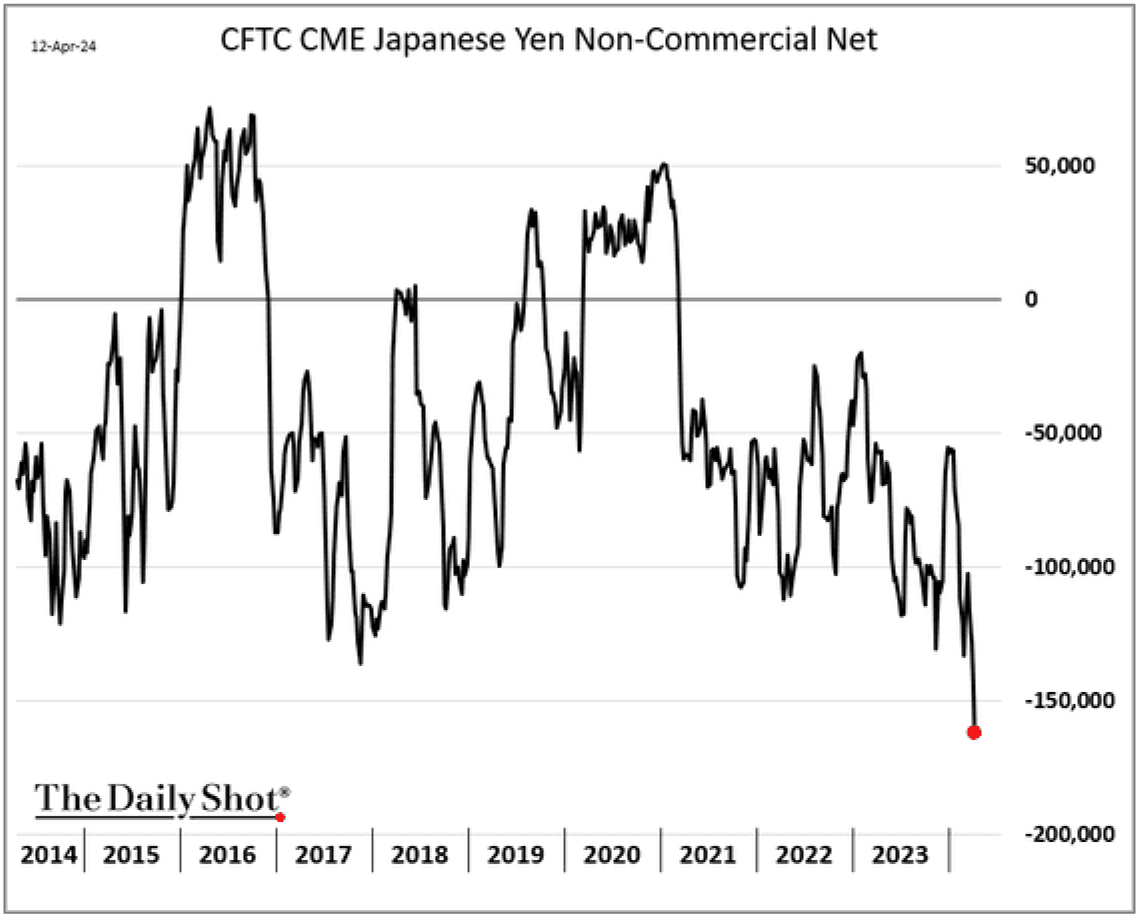
Valuations aren't as optimistic as investors.



How excessive inflation distorts economic signals in one chart.

10Yr Annualized Commodity returns turn positive.

Bets against the Yen are hitting extremes.



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.