BRENTON POINT
WEALTH ADVISORS

April 12, 2021

# Investing Environment Review and Outlook – Volume 47

## Boom Phase Extremes

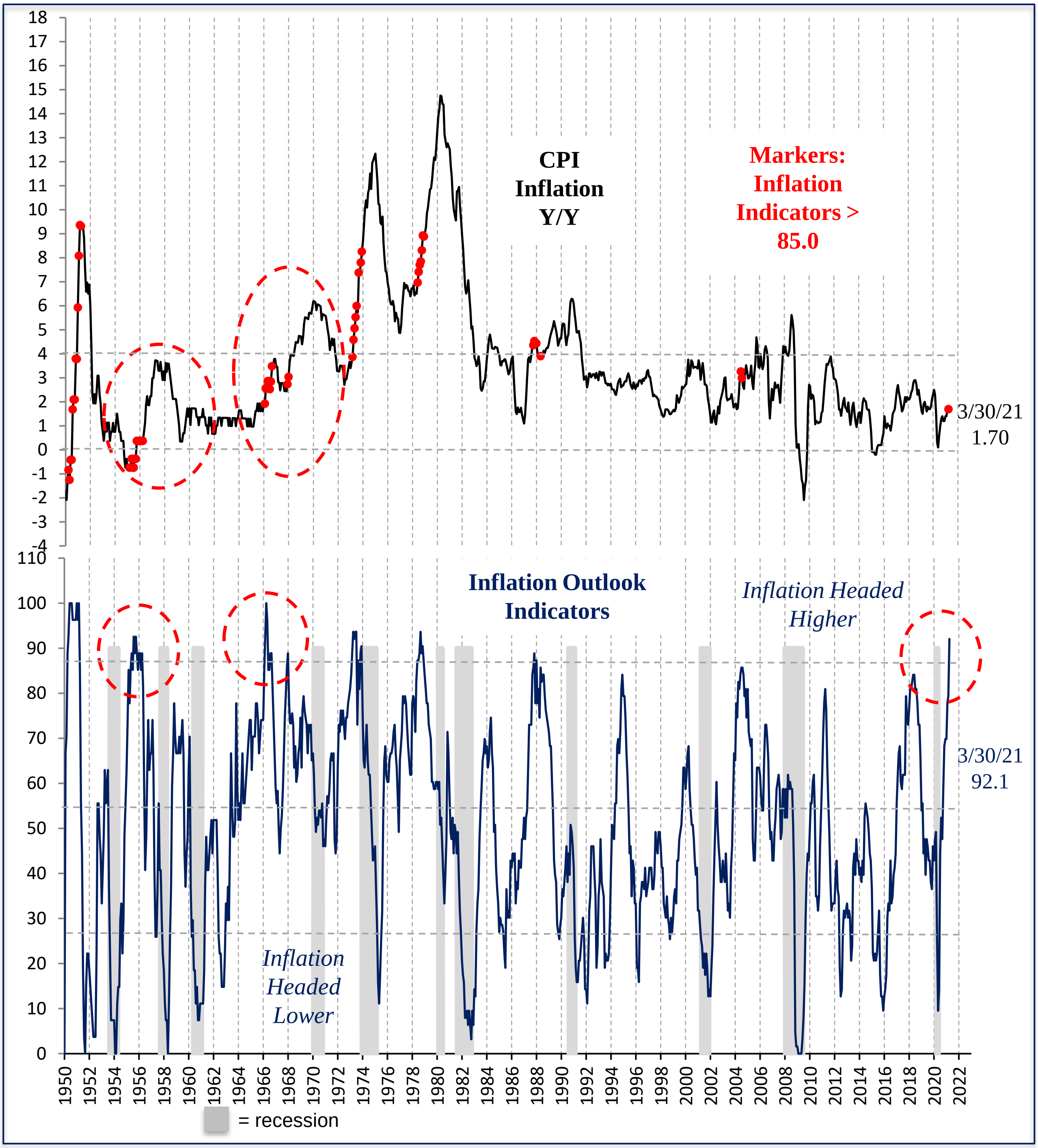
Last month we discussed the arrival of the boom phase of the economic cycle, when the economy is extremely strong, industrial commodities like copper and crude oil rally, long-term interest rates rise, and overall confidence surges. Since then, we saw further confirmation from the ISM manufacturing index release on April 1st reaching the 96th percentile, the 800,000 March jobs number, and the surprising rebound in consumer confidence to 109.7. Usually at this point in the cycle the Fed would be hiking rates to head off potential inflation, at least to a neutral zone. But this time really is different as the Fed is not only holding rates at zero, but stating they want higher inflation. This month we discuss two extremes and the investment implications of the inflation outlook and investor positioning. Our U.S. equity rating remains a bullish 4. Foreign developed and emerging market equities remain a bullish 5, along with gold and commodities. Long-term bonds remain a cautious 1.

## Inflation Outlook Indicators Extreme

Inflation outlook indicators reached an extreme in March at 92.1, the highest since 1978. Components include stronger PMI readings for the economy as well as prices paid, stronger consumer confidence and a weak dollar. After the 7 prior cases since 1950, inflation rose in every case, but 1955 and 1966 are probably the best comparable cases, when inflation rose to the 3-5% range. Higher inflation is a consensus view with investors and Fed Chairman Powell, although most side with Powell that it will be a temporary surge as fiscal stimulus fades by year end. What we do know is that CPI will be 3.5% Y/Y or more by May due to the weak readings a year ago. The green line in the 2nd chart shows the market now expects one hike during 2022 up from none in January. The top line shows consensus expects Fed Funds at 2.2% by the end of 2025. The black line shows how the 10-year Treasury yield rose this year with expectations of Fed actions. Historically the Fed hiked Fed Funds above the inflation rate during tightening cycles when they were trying to slow inflation. With the inflation outlook model so strong, inflation will likely break above 3%, and the 10-year yield with it. This is an immediate risk to long-term bond prices since prices decline as rates rise. Once the Fed decides that rising inflation is an issue and starts hiking rates, that will be a new risk for the economy and equities.

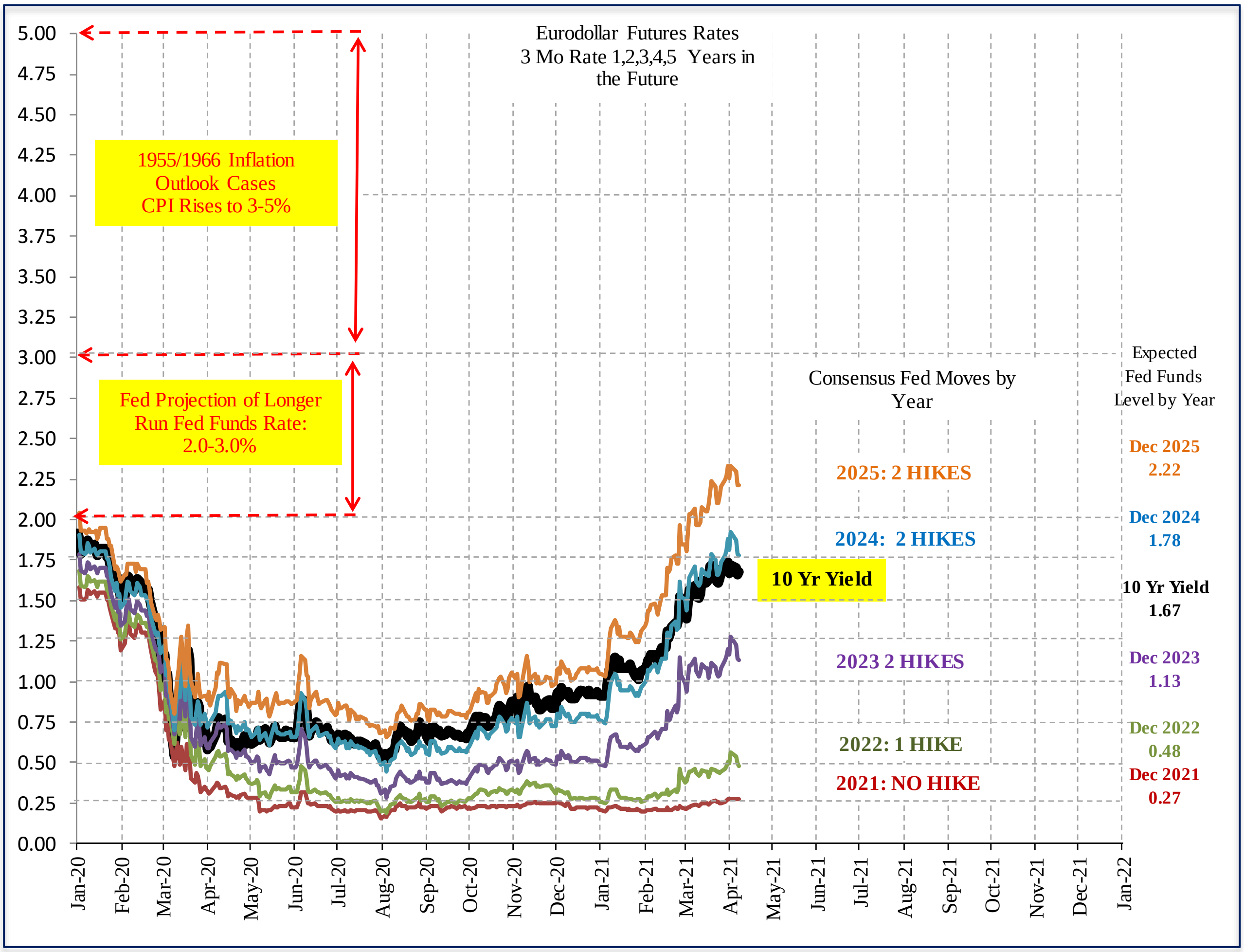
April 12, 2021

## Inflation Outlook Extreme: Higher Inflation Ahead



April 12, 2021

10-Year Rises with Expectations for Fed Action: 3%-5% Plausible

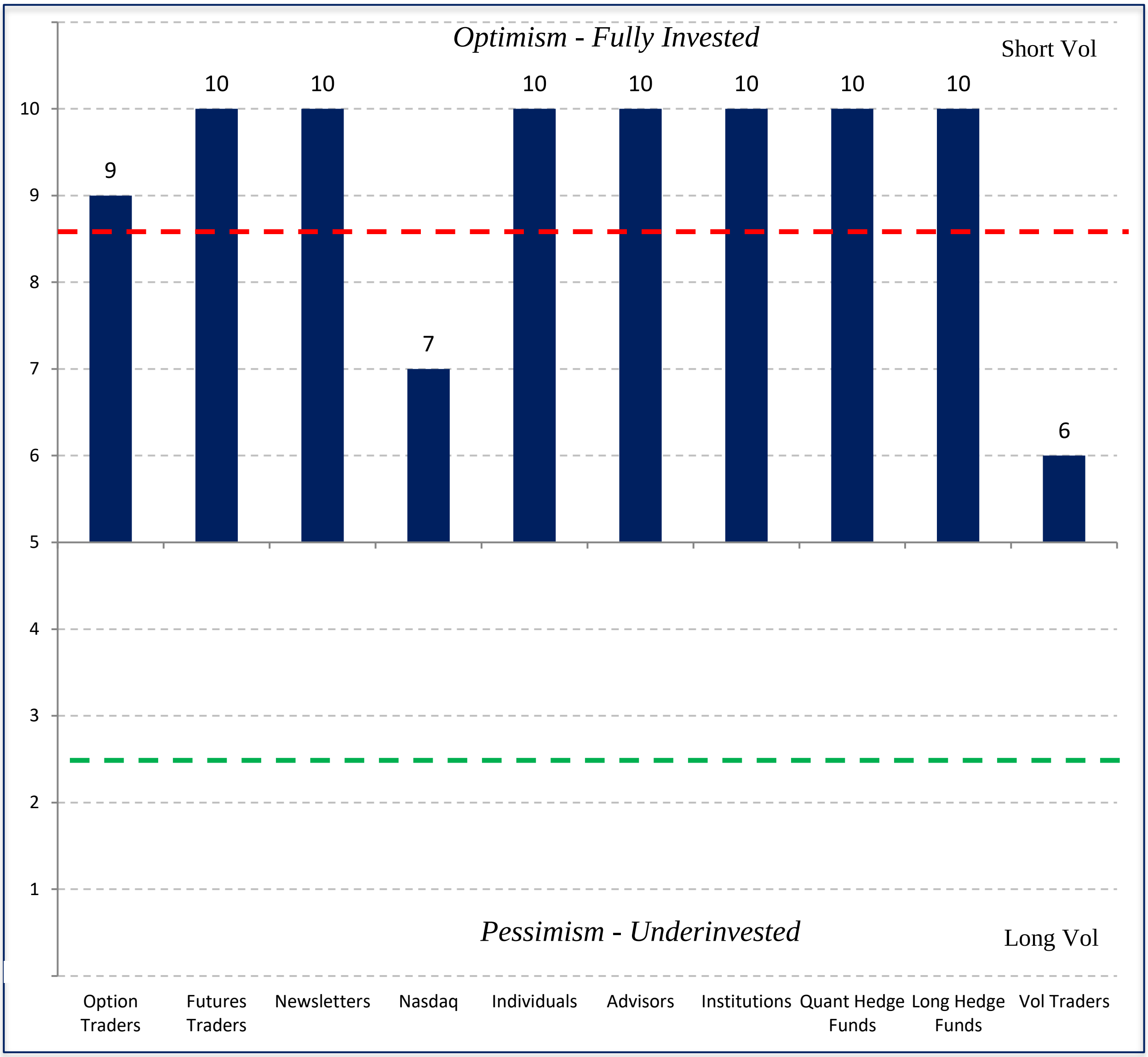



## Investor Positioning Extreme: Muted Returns Ahead

After largely positive headlines from vaccines, dropping COVID cases, passage of the stimulus bill and a 9% S&P 500 rally in a month, investor positioning reached an extreme on April 8th, with 8 of 10 investor groups now in the top quintile historically. Investors added equity exposure during the rally as usual, leaving less cash available for future purchases. Last year we noted extreme positioning in the fourth quarter was not significant for markets. However, in prior cases in April or May, extremes like this were more negative for forward returns in the S&P 500. No disasters followed, but returns were flat 2-3 months out and the next 4% and 8% moves were up 3 times and down 4 times. Investor sentiment is not the most effective indicator, but it is an important check on our emotions, which do their best to cloud our rational thinking. The third chart shows extreme optimism by individual investors in the Ameritrade Investor Movement Index.

April 12, 2021

## Equity Investor Positioning Extreme
## 8 of 10 Groups Extreme



April 12, 2021

Investor Positioning Back to Extreme:
3 Comps in April/May followed by 6-15% Declines

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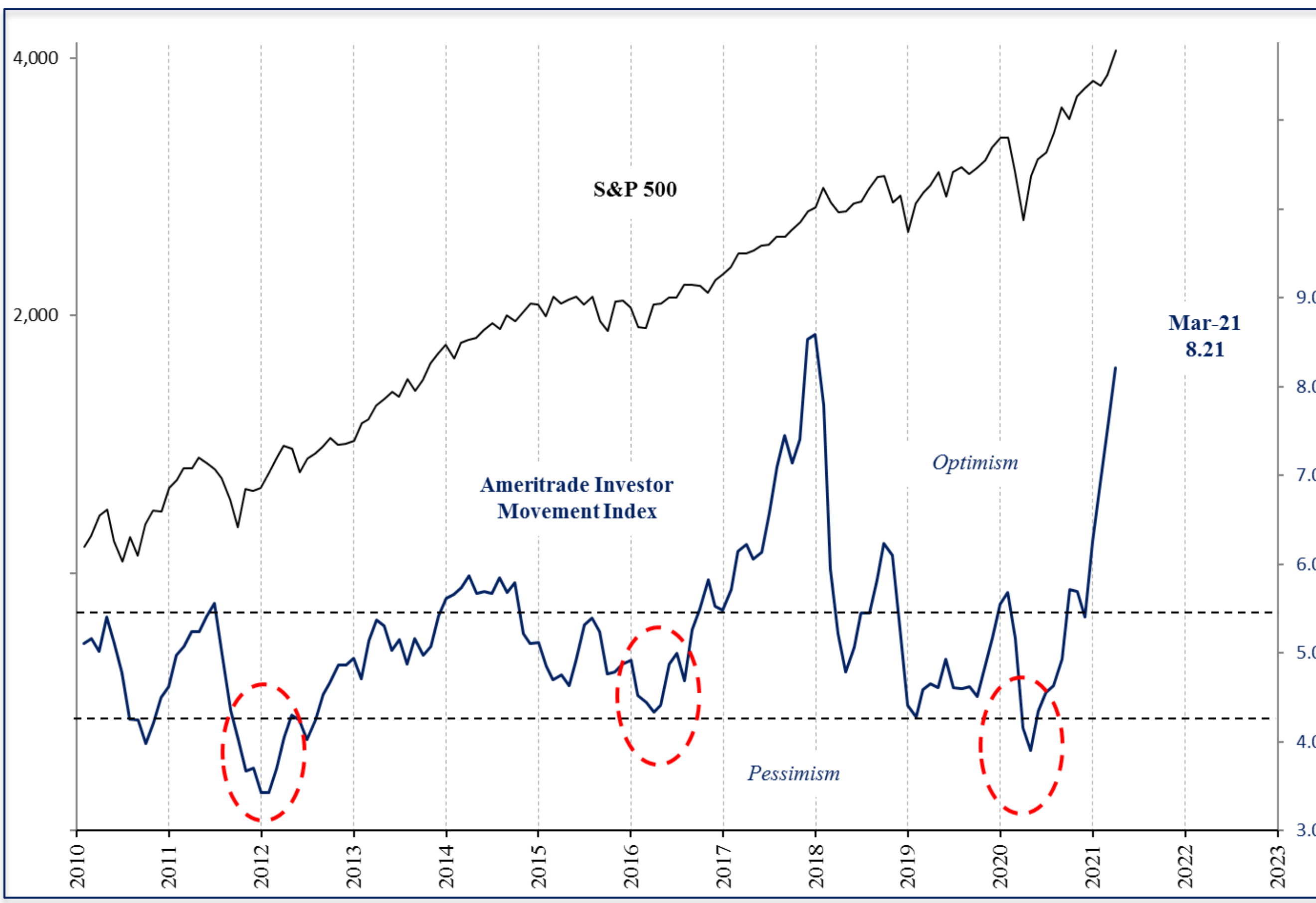
April 12, 2021

## S&P 500 Returns after Positioning Extreme in April or May
## Mixed Returns 2-3 Months Out

| Cases | Date | 1M Later | 2M Later | 3M Later | Worst 3M | Best 3M | Next 4% | Next 8% |
|---|---|---|---|---|---|---|---|---|
| 1 | 04/20/07 | 2.9 | 2.3 | 3.8 | -0.3 | 5.1 | UP | DN |
| 2 | 04/05/10 | -1.7 | -10.0 | -13.5 | -13.5 | 2.6 | DN | DN |
| 3 | 05/02/11 | -3.2 | -1.2 | -5.0 | -6.7 | 0.0 | DN | DN |
| 4 | 05/10/13 | 0.8 | 1.5 | 4.1 | -3.5 | 5.1 | UP | UP |
| 5 | 04/24/15 | 0.6 | 0.0 | -1.3 | -2.9 | 1.0 | DN | DN |
| 6 | 04/26/17 | 1.4 | 2.5 | 4.3 | -1.1 | 4.3 | UP | UP |
| 7 | 04/29/19 | -5.2 | 0.3 | 3.2 | -6.5 | 3.3 | DN | UP |
| 8 | 04/01/21 | | | | | | | |
| | Average | -0.63 | -0.65 | -0.62 | -4.92 | 3.06 | | |
| | Median | 0.61 | 0.34 | 3.16 | -3.46 | 3.32 | | |
| | Prob Up | 57.14 | 57.14 | 57.14 | | | 43% | 43% |
| | Market | 0.80 | 1.60 | 2.41 | | | | |

## Ameritrade Investor Movement Extreme



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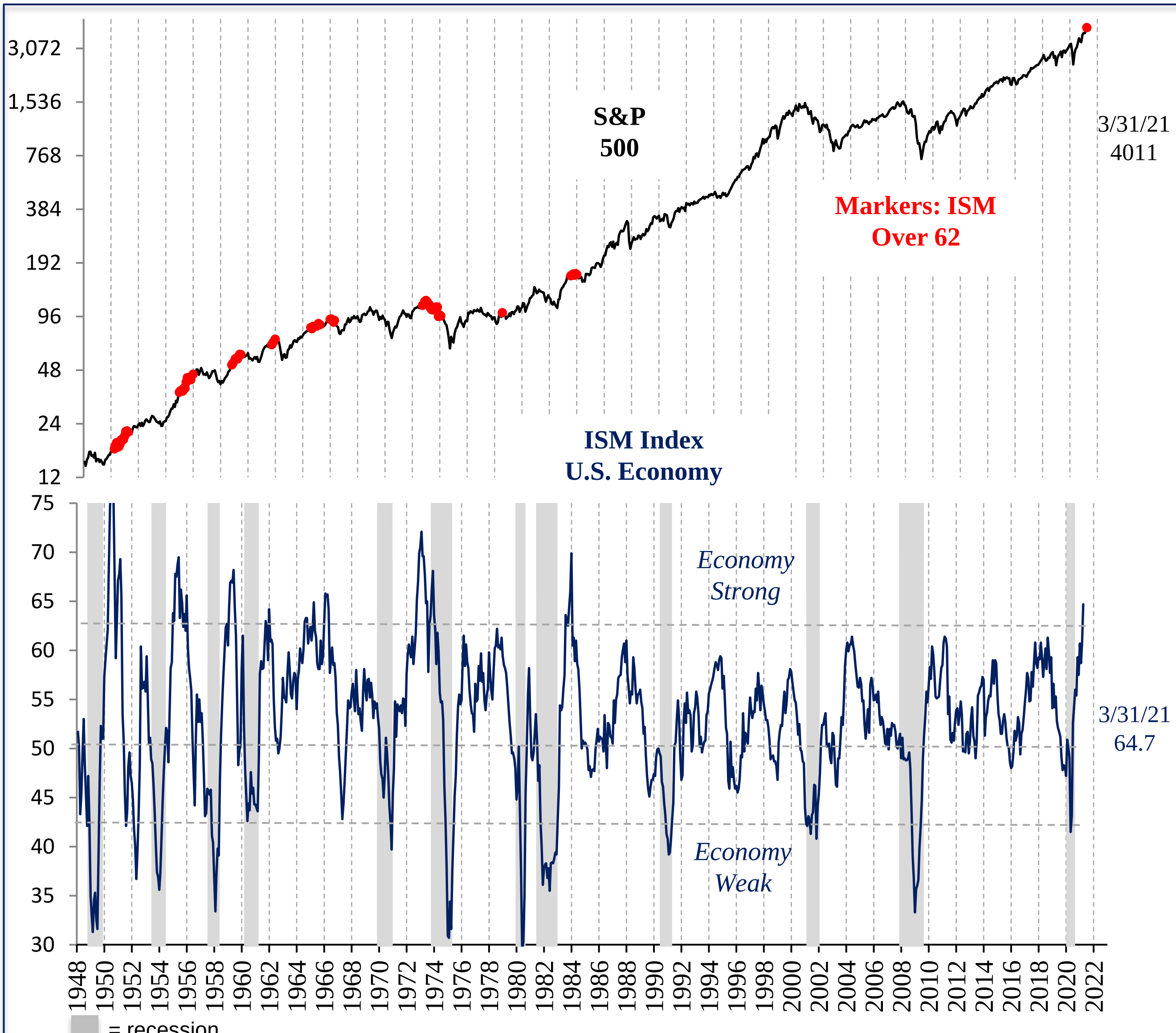
April 12, 2021

## U.S. Economic Strength 96th Percentile: Boom Phase of Cycle Confirmed

The ISM Manufacturing Index for March was widely reported at 64.7, the highest since 1983, and the 96th percentile of readings since 1948. It confirmed the U.S. is indeed firmly in the boom phase of the economic cycle. The most "recent" cases in 1983, 1973 and 1966 were negative for equities but were accompanied by Fed hiking rates, very different monetary conditions from today. Fed Chair Powell stated that he wanted to run the economy hot, and he was not kidding. A strong economy and economic outlook combined with a loose Fed is a potent and bullish combination for equities, with an 18% annualized return historically. This is particularly true while inflation remains below 4%.

ISM Manufacturing Index 64.7 in March
96th Percentile since 1948 (100th since 1990)




Source: Institute for Supply Management®. For more information, please go to www. ismrob.org

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April 12, 2021


**Summary**

It is incredible to reflect how different the investment landscape is today compared to one year ago. From the depths of recession and dismal investor sentiment, conditions have completely reversed to extreme economic strength and near universal optimism. Although the 2020 COVID induced crash was one of a kind, so far, the economic and market recovery have been very typical of prior cycles. While our indicators gave us confidence in the strong economic outlook since last June, based on prior cycles we have the same conviction for higher inflation and higher interest rates today. Since no two cycles are exactly the same, we will continue watching our indicators on a daily basis for any significant changes. Thank you for your trust, and please contact your advisor with any questions.



**Michael Schaus**
Director of Market Research

April 12, 2021

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