BRENTON POINT
WEALTH ADVISORS

July 15, 2021

Investing Environment Review and Outlook – Volume 50

Economic Transition

After a year-long boom phase when the economic outlook was strong and the economy itself accelerated upward, a subtle shift in our economic outlook indicators marks a new economic transition period. We shifted ratings this month to account for the new risks and opportunities.

Equity Ratings Downtick

This month we cut the U.S. Equities rating to a neutral 3 based on the economic outlook reversal, extreme investor positioning and the negative seasonality through September. We also cut foreign developed and emerging markets equities to a bullish 4 rating based on their high correlation with U.S. equities. As we discussed last month, foreign equities rate higher since they have less downside risk and more upside potential due to under ownership and economies still accelerating. We also raised the long-term bond rating to a neutral 3 based on the neutral economic outlook, and we cut the commodity rating to a neutral 3 as well. Gold remains a bullish 5 rating.

Economic Outlook Downticks to Neutral

For the first time in over a year the economic outlook indicators downticked to neutral this month on the reversal in the 10-year yield to 1.3% from a March peak of 1.75%, weak commodity prices like copper and lumber, and slowing momentum in stock indices after a very strong 12 months. It signals a slowing of economic growth ahead from an unsustainable peak growth rate in the 2nd quarter. It also signals a possible exit from the boom phase of the economic cycle to either a Goldilocks period of slower growth and low inflation or stagflation when slowing growth is combined with high inflation. The consensus of economists expects peak GDP growth of 9.1% in Q2 falling to 3.8% by Q1 2022 as fiscal stimulus and the reopening surge fades.

In the last 20 years the S&P 500 returned 20.4% annualized (almost 3x the norm) when the economic outlook was strong and the Fed was loose, but just 3.0% when the economic outlook was neutral. When we consider other conditions today like extreme investor positioning and negative seasonality through September, the estimated annualized return for the S&P 500 is closer to the norm of 10%, appropriate for a neutral equity rating. It will allow us the flexibility to add exposure if conditions improve or cut back further if conditions deteriorate. As investor enthusiasm surges, it is a good time to focus on capital preservation as the top priority.

This review and outlook report by Brenton Point Wealth Advisors LLC represents our views and beliefs regarding the current market outlook. Please also read the important disclosures at the end of this report.

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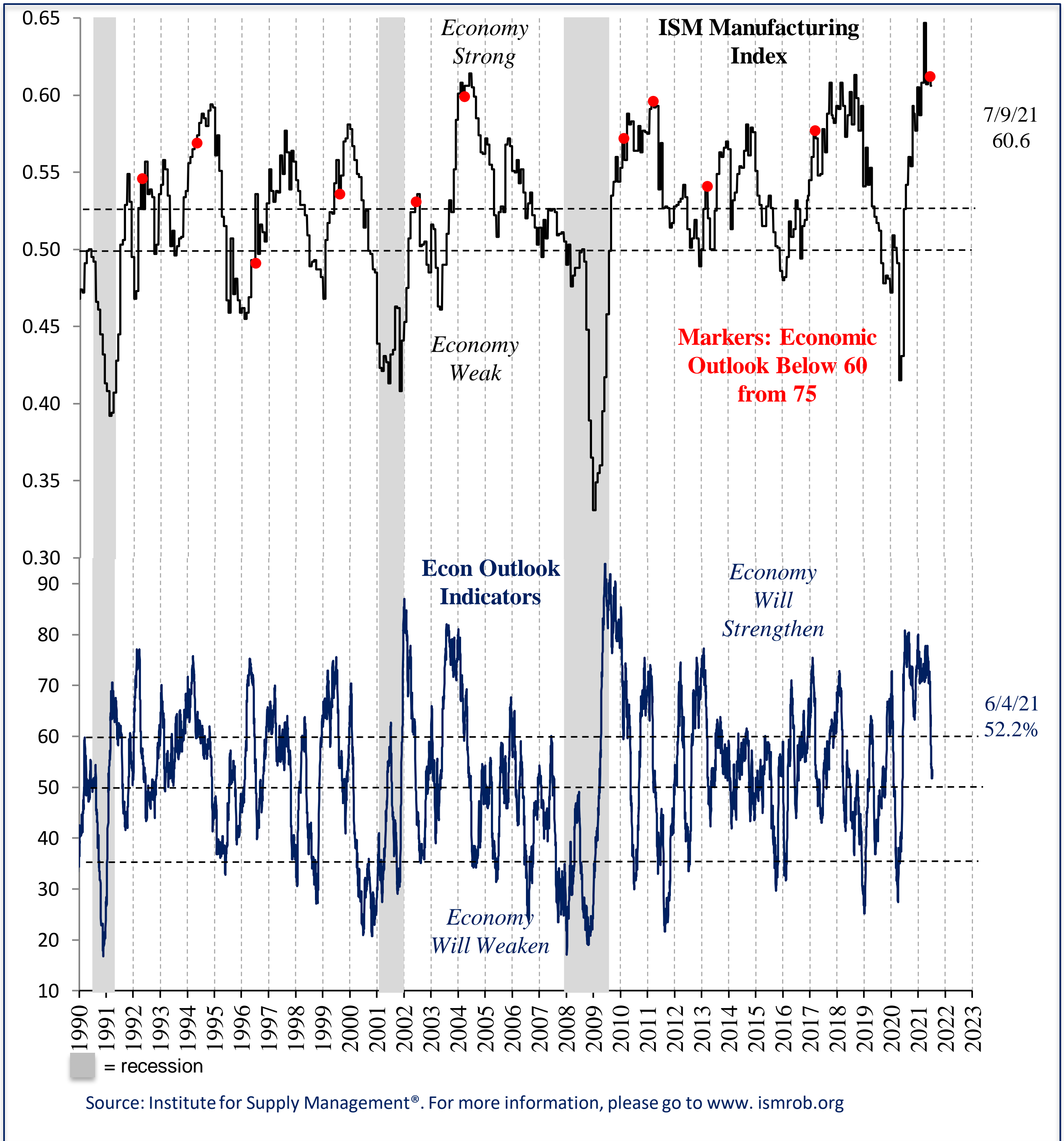
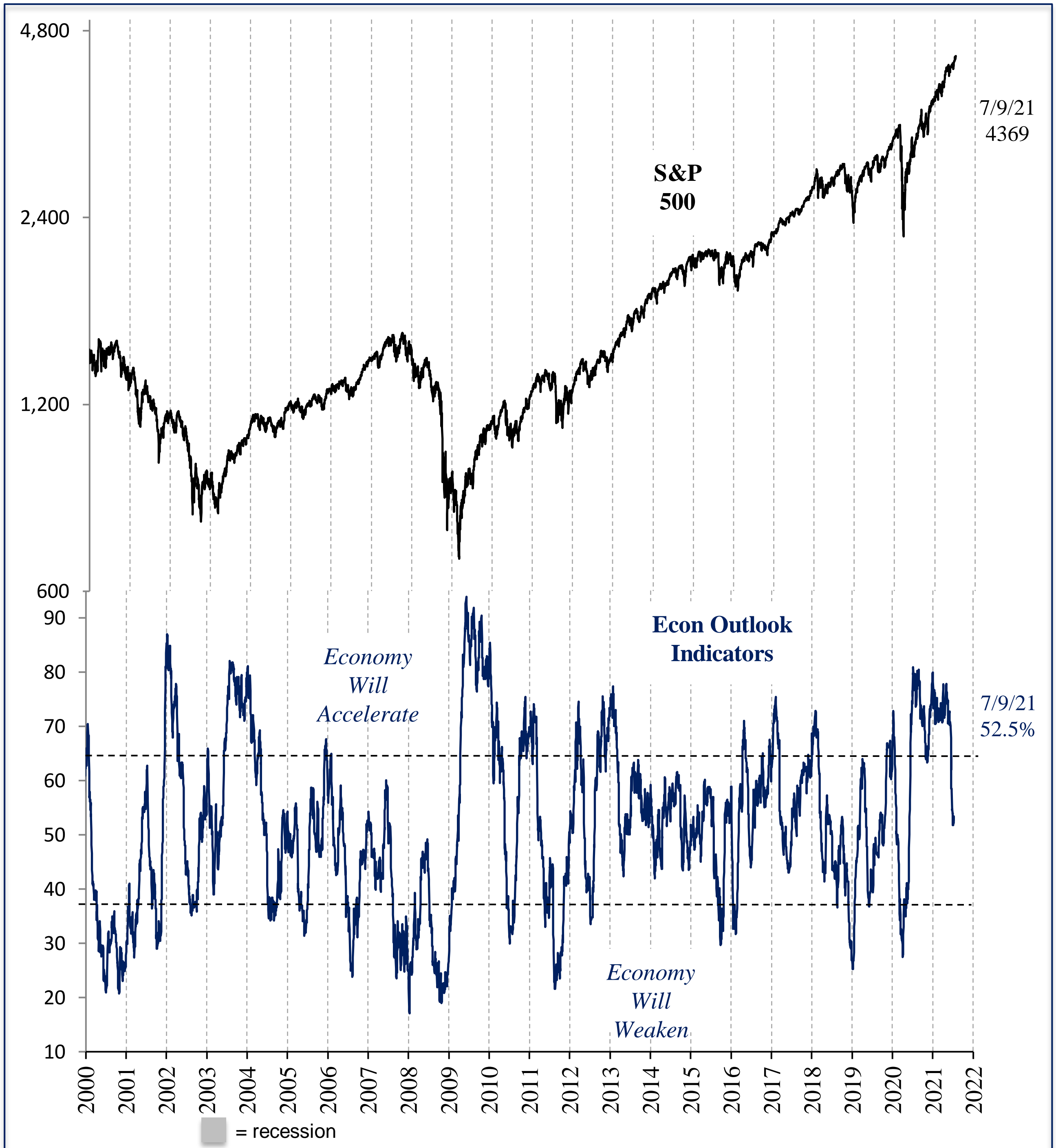
Economic Outlook Reversing



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

Economic Outlook vs. U.S. Equities



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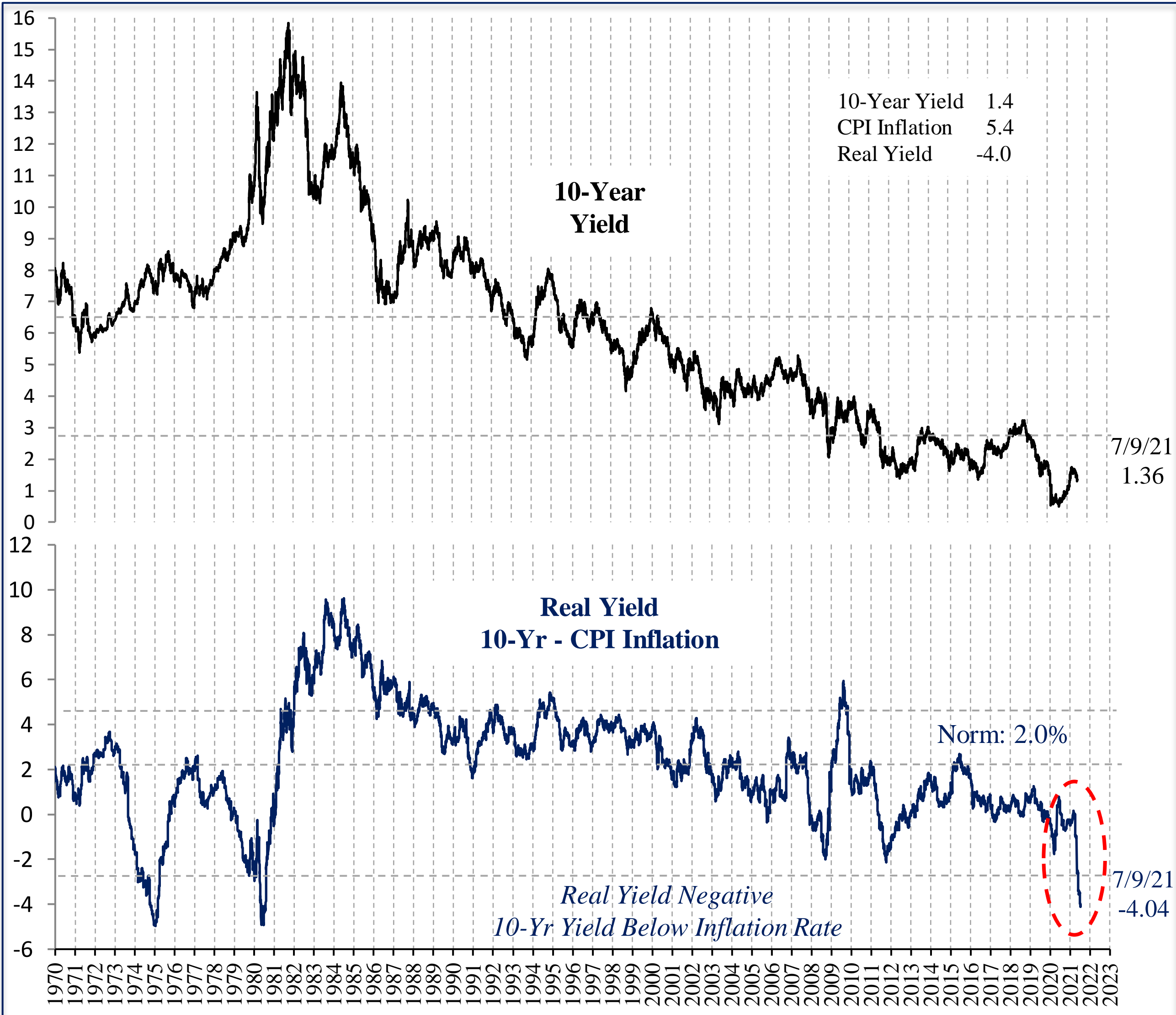
10-Year Treasury 4% Below Inflation

With inflation surprising economists by rising to 5.4% in June and consensus expecting an extreme 9.1% GDP growth in the second quarter that just ended, there is good reason for confusion why bond yields have declined since March to an extreme 4.0% below inflation. For comparison, since 1970 the 10-year yield averaged 2.2% over the inflation rate since 1970. For the short term, the simplest explanation is timing, that the 10-year yield moves ahead of the economy, which moves ahead of inflation. In other words, inflation is the most lagging indicator. Consider the sequence of events the last 12 months. The 10-year yield bottomed in August 2020 at 0.5% and rose until it peaked in March 2021 at 1.75%. Inflation then followed from 1.3% last August to 5.4% today. Bonds are not reacting to the inflation move since yields already moved higher. The recent decline in the 10-year yield may make more sense in 6 months when we look back if we see that economic growth and inflation followed lower.

10-Yr. Yield 4.0% Below Inflation



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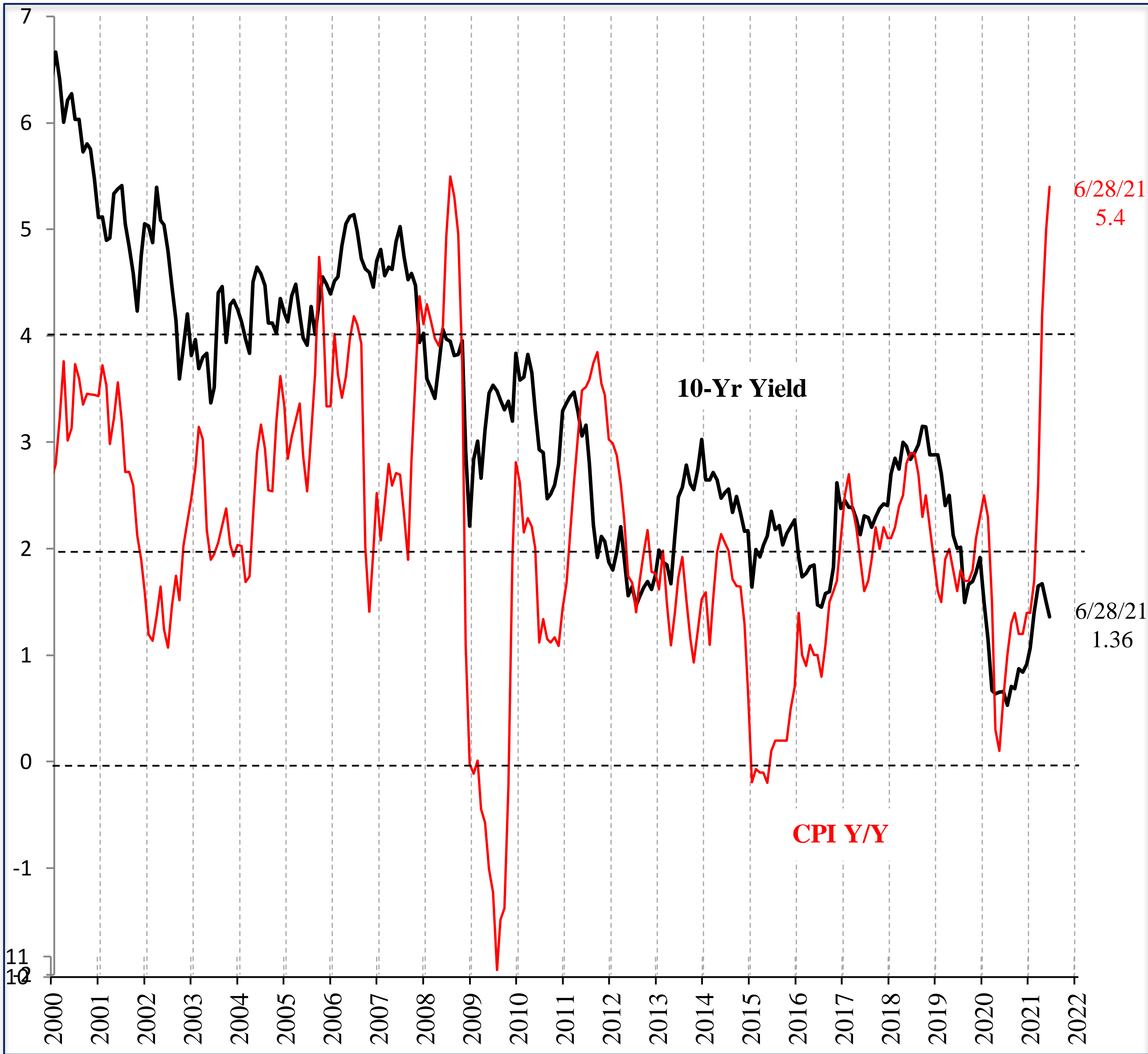
10-Yr. Yield Leads Inflation



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Extreme 6 and 12-Month Stock Market Rally: Lower Returns Ahead

The S&P 500 was up 21% in the 2nd half of 2020 and another 15% in the first half of this year for a 12-month total of 38%. There were only 4 prior years up over 10% in both the first half and the prior 2nd half of the year. In those cases, the average prior 6-month return was 17.2%, followed by the next 6 month return averaging just 1/3 of that at 5.2%. The next 10% was higher in all 4 cases, but lower returns and a consolidation period would be normal, particularly in the next 3 months. This also coincides with the negative seasonal period of the year through September.

S&P 500 Returns after H1 and Prior H2 Up 10%

	Date	Prior Year H2	H1 Pr 6 Mos	Y/Y	Cum Returns Later 1M	Later 3M	Later 6M
1	06/30/55	23.2%	14.0%	40.5%	4.96	7.43	12.91
2	06/30/83	28.3%	19.5%	53.4%	-3.27	-0.14	0.26
3	06/30/86	10.1%	18.7%	30.7%	-5.40	-7.56	-0.79
4	06/30/97	10.5%	19.5%	32.0%	7.72	8.18	8.62
5	06/30/21	21.2%	15.3%	38.6%			
	Average	18.6%	17.4%	39.0%	1.00	1.98	5.25
	Prob Up				50.00	50.00	75.00
	Norm				0.87	2.61	5.23

Investor Positioning Remains Extreme

After a 38% move in the S&P 500 over 12 months and no declines over 4% this year, it is no surprise that investors remain fully invested as a group. 6 of 10 investor groups we follow have reached the top deciles of their historical ranges. In prior cases a 5-10% decline occurred at some point, pushing the positioning indicators back to neutral and setting up the next leg higher.

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Equity Investor Positioning Extreme
6 of 10 Groups Extreme

Optimism - Fully Invested

Pessimism - Underinvested

Group	Value
Option Traders	6
Futures Traders	10
Newsletters	8
Nasdaq	9
Individuals	7
Advisors	10
Institutions	10
Quant Hedge Funds	10
Long Hedge Funds	9
Vol Traders	5

Vol Traders scale: Short Vol (top) – Long Vol (bottom)

Summary

After a year of strong economic outlook indicators, accelerating economic growth, surging commodity prices and investor optimism during a classic boom phase of the economic cycle, we are now entering an economic transition phase with more uncertainty for asset prices. As a result, we are cutting risk by reducing equity and commodity ratings and moving bond ratings to neutral. If and when equity volatility returns, it may present opportunities to those with the cash to invest. We will continue to monitor conditions on a daily basis and adjust our outlook as the facts change. Thank you for your continued support and please contact your advisor with any questions.

Michael Schaus
Director of Market Research