BRENTON POINT
WEALTH ADVISORS

August 12, 2021

Investing Environment Review and Outlook – Volume 51

Mid-cycle Slowdown

The drop in the 10-year Treasury yield to 1.2% this month confused many investors also seeing 5.4% inflation and 6.5% Q2 GDP growth. From Bloomberg news on 8/4/21: "Bearish Citi strategists point to technical factors behind the recent drop in yields, such as the unwinding of short positions and supply dynamics." [1] Last month we discussed a possible transition of the U.S. and world economy out of the boom phase. Weaker economic indicators since then signified a typical mid-cycle slowdown is underway despite the strong Q2 GDP and July employment reports, both lagging indicators, and making a lower 10-year yield more logical in retrospect. This month we discuss historical cases and the implications for assets. We also review the recent gold price decline. Asset ratings were unchanged this month. The U.S. equities rating remains a neutral 3. Foreign developed and Emerging Markets remain a bullish 4. Bonds and commodities remain a neutral 3 rating and gold remains a bullish 5.

US and China Synchronized Deceleration

The U.S. ISM manufacturing index was down again in July to 59.5, down 5 points from the March peak of 64.7 as the reopening and fiscal stimulus fades. China's PMI was down as well to 50.3 from the November peak of 54.9. Counter cyclical forces in China include the recent "regulatory tightening" of firms accessing foreign capital and loan growth turning negative in March. In the U.S., the Fed remains stimulative by any standard but the post COVID reopening burst and the record fiscal stimulus are fading, acting to slow growth rates and inflation.

Prior U.S./China synchronized decelerations (2005, 2012, 2015 and 2019) demonstrate it is a typical post recession pattern. CPI inflation generally follows the economy lower as it did in the last three cases. The most dramatic was in 2012 when inflation slowed to 1.4% from 3.9% in 2011. As you would expect, the 10-year Treasury yield typically falls during these reversions as well. These decelerations did not end in recessions but lasted 12-18 months (Q1 or Q2 2022 in this case) and served to extend the business cycle by lowering inflation, postponing overheating and the inevitable Fed tightening.

[1] *Source: www.Bloomberg.com, "Citi's Levkovitz is Still Bearish On Stocks But Likes Cyclicals", 8/4/21*

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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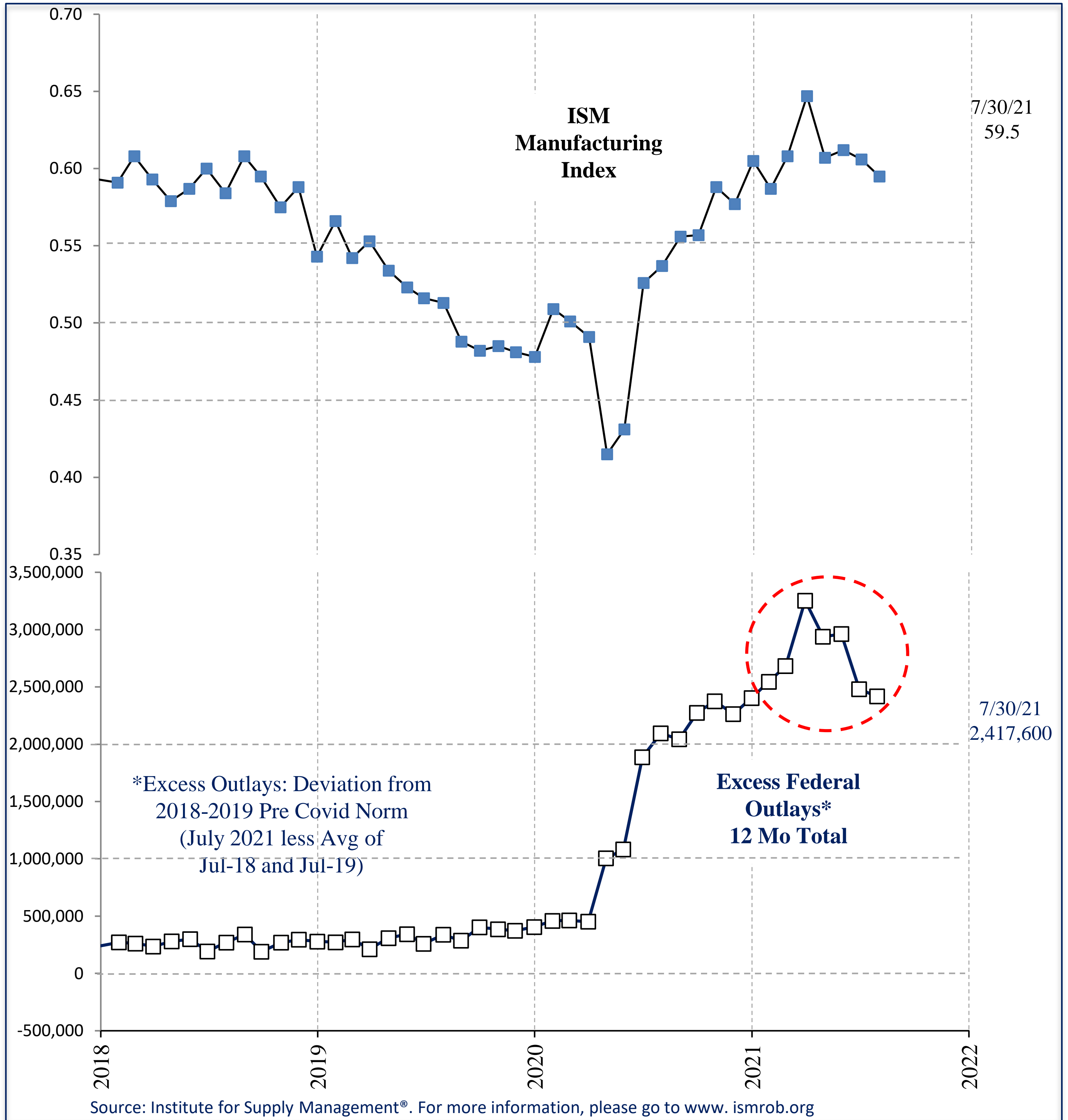
U.S. Fiscal Spending Fading / Less Stimulus for U.S. Economy



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

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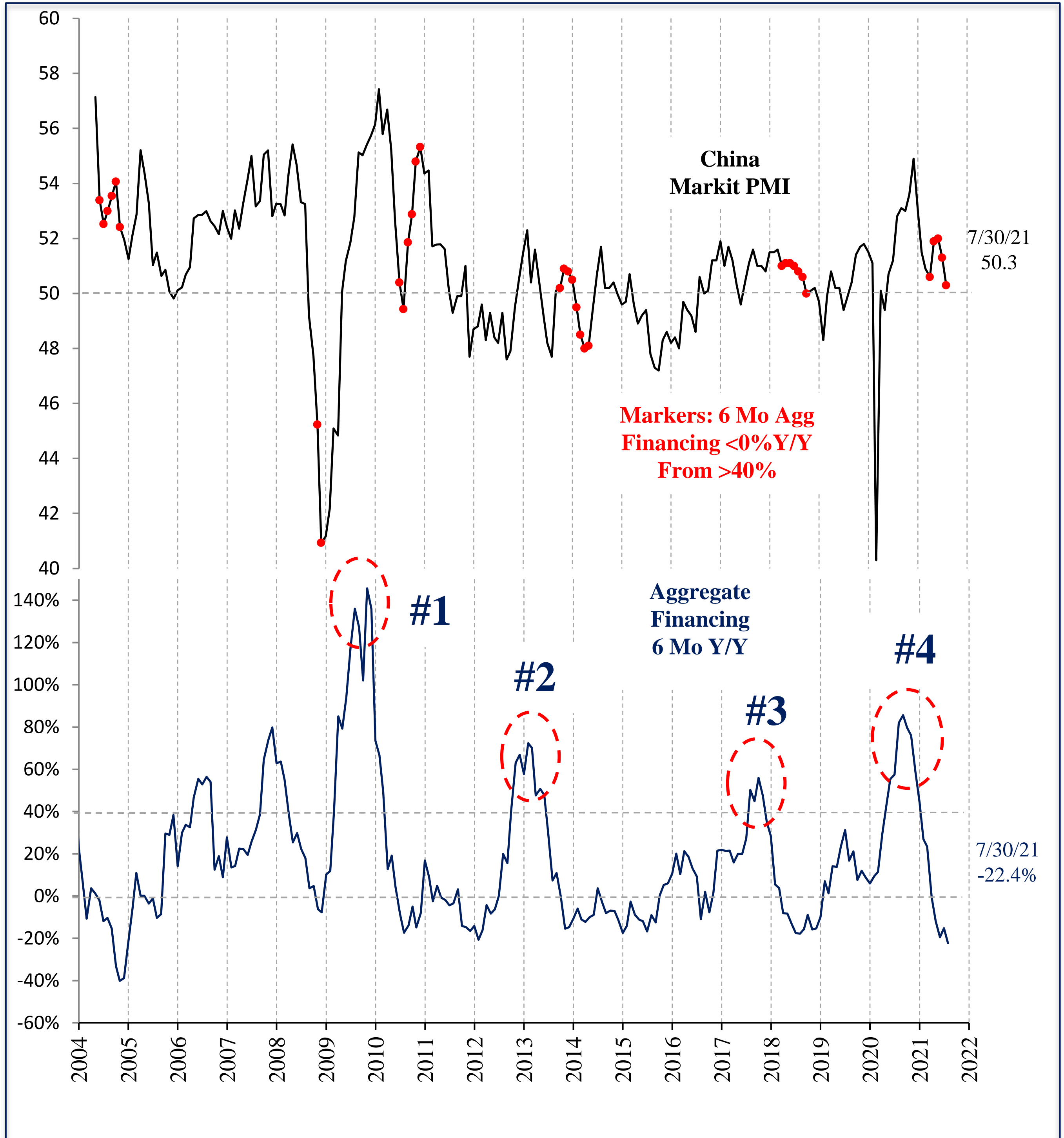
China Aggregate Financing Contracting / Less Stimulus for Chinese Economy



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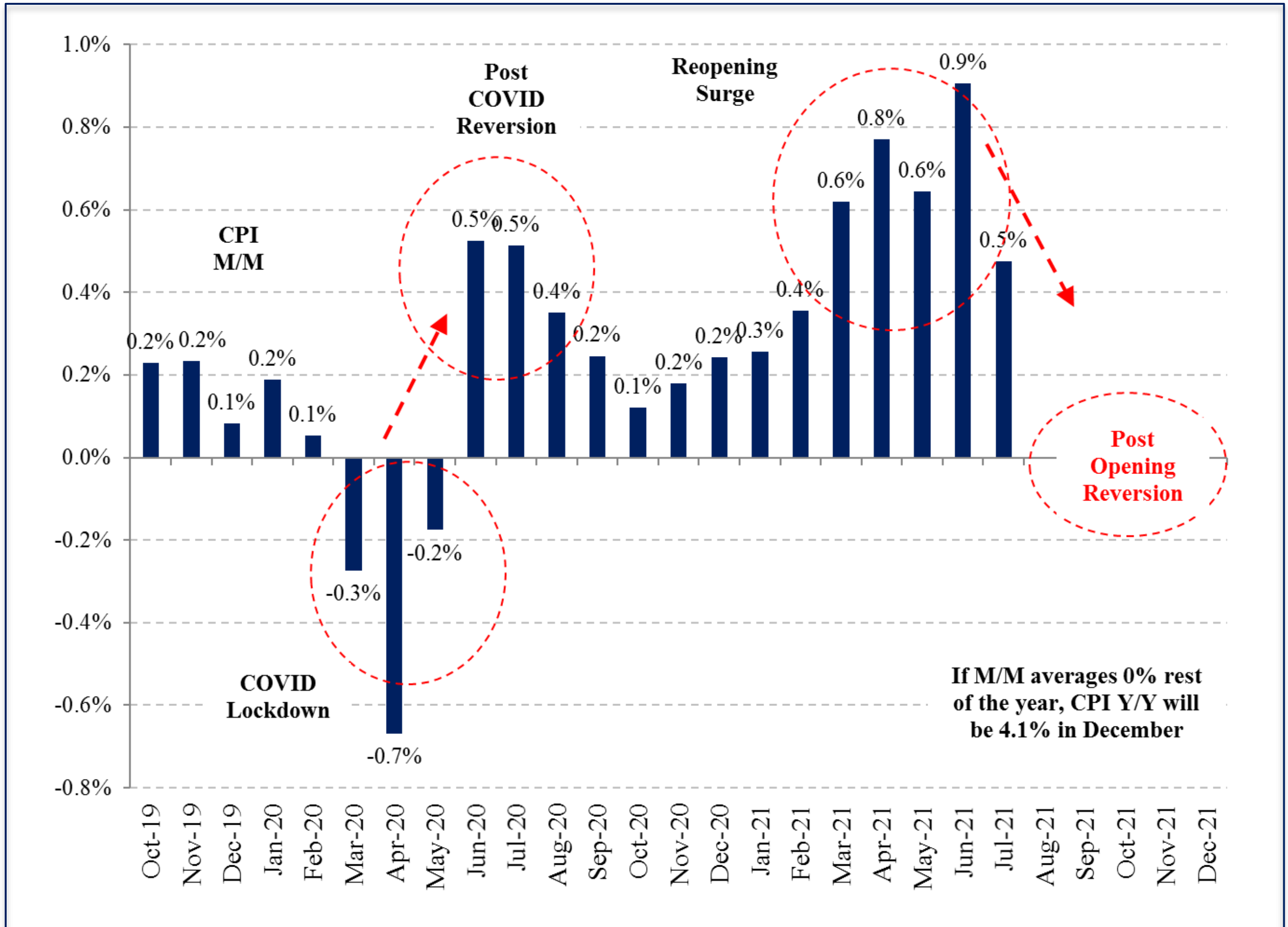
CPI Inflation Reverting Lower after Reopening Surge



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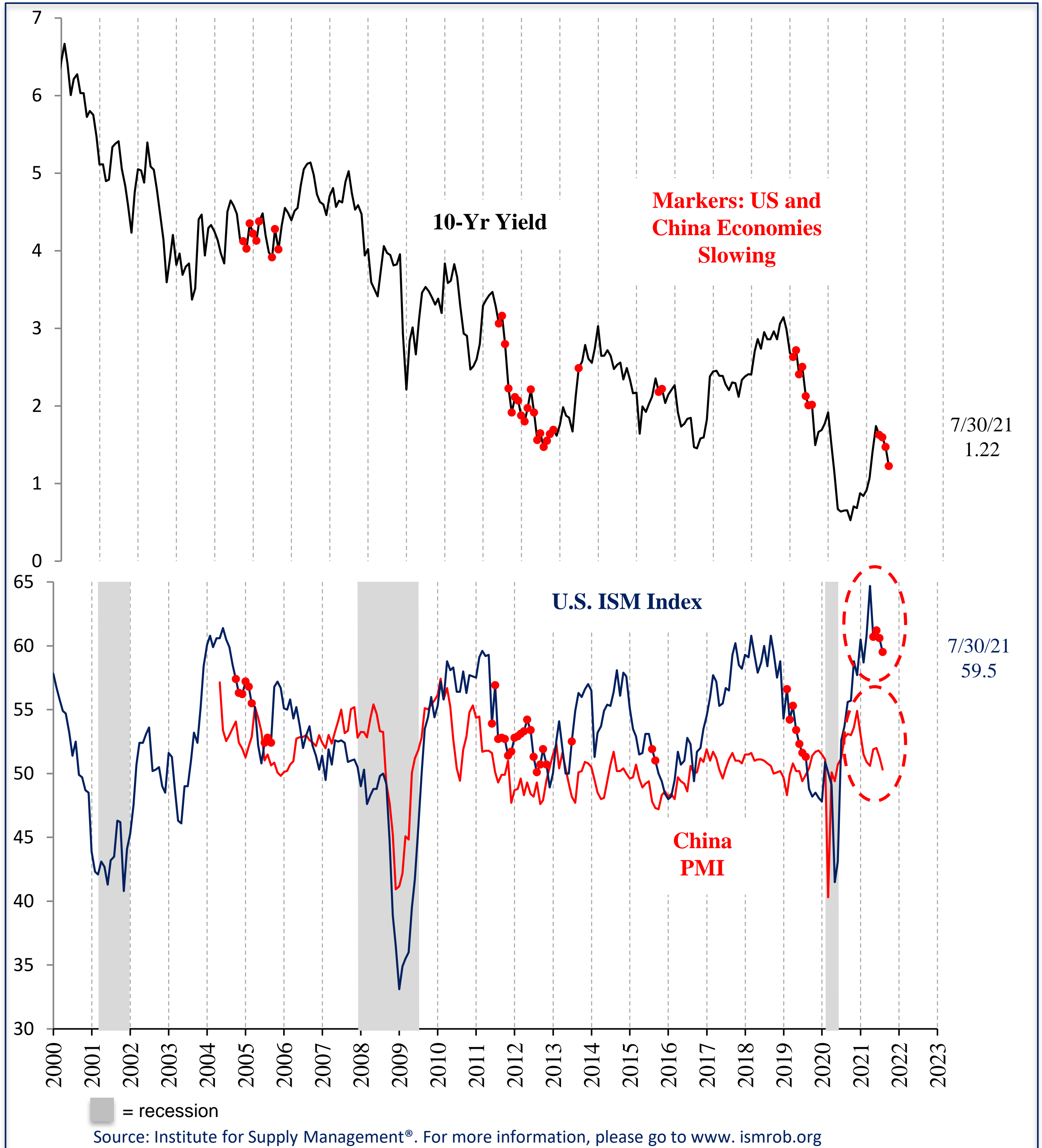

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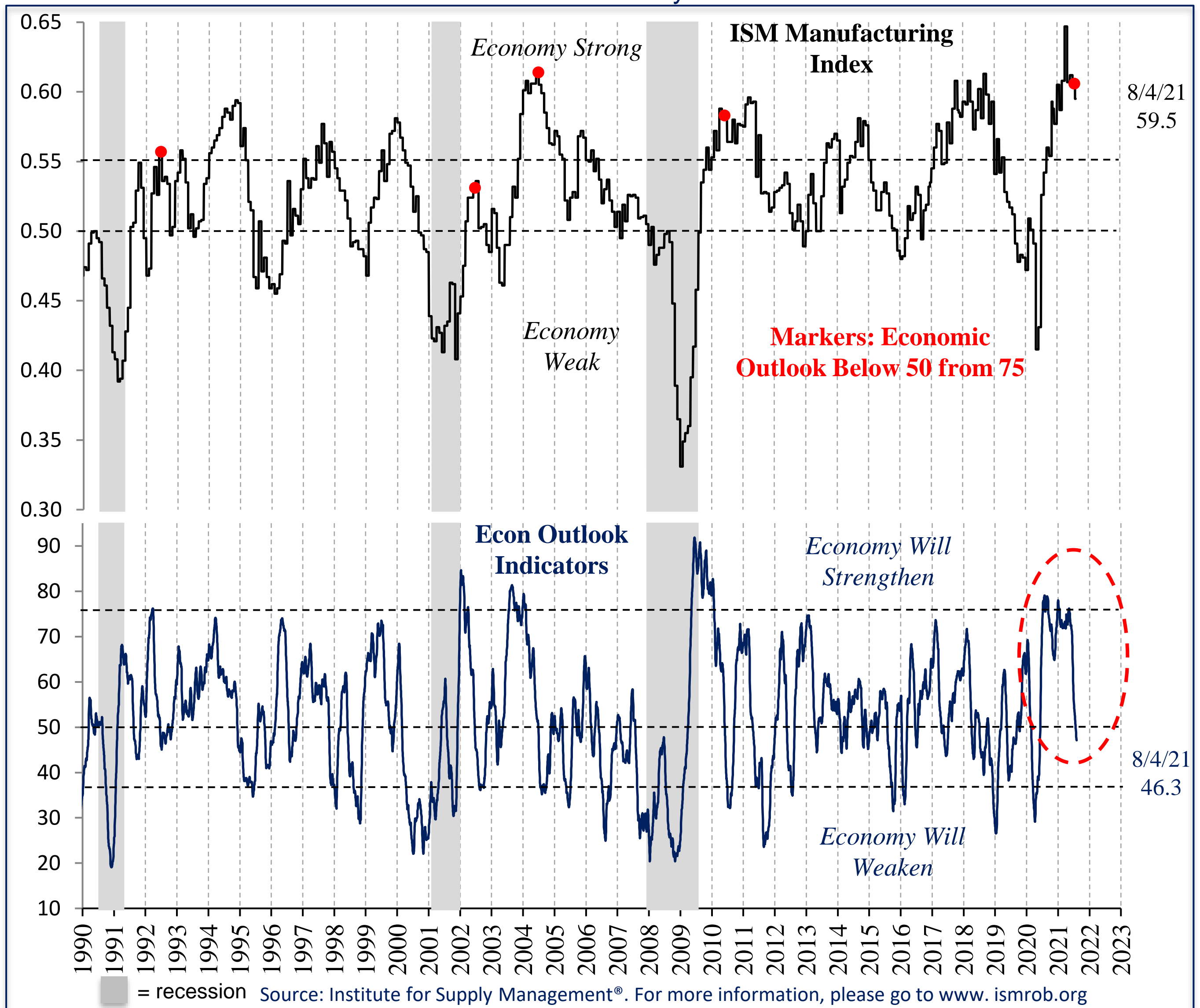
Economic Outlook Lower: Mixed S&P 500 Returns

Aside from a synchronized U.S./China slow down, our economic outlook indicators also fell further this month to a low neutral 46 from a peak of 75 in March. Commodities like crude oil, copper and iron ore are trending lower together, consistent with slower growth ahead. The implications for investors are interesting. Since 1970, when the economic outlook was neutral and the economy was strong as it is now (ISM over 58), the S&P 500 returned -1.4% annualized, no disaster but 11% below the norm. However, once the economy and ISM index reversed lower to a neutral range between 48-58, the S&P 500 returned 11.9% annualized, almost 2% above the norm. In other words, expected returns are mixed until the economy slows, and it becomes obvious to investors. For now, it appears expectations are too high for strong returns ahead.

Economic Outlook Below 50 / Mid-Cycle Slowdown Ahead



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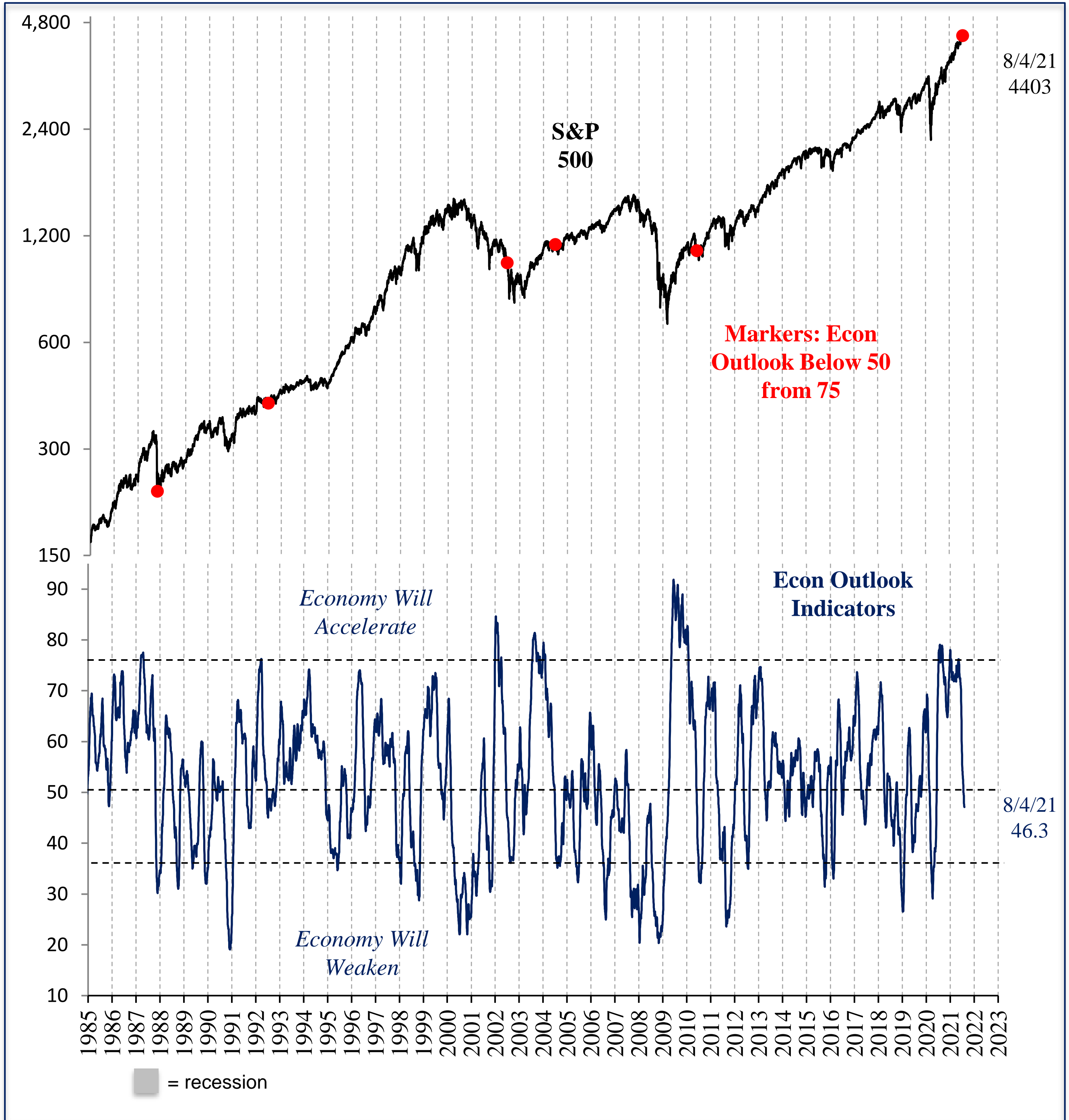
Equity Returns Initially Mixed During Mid-Cycle Slowdowns



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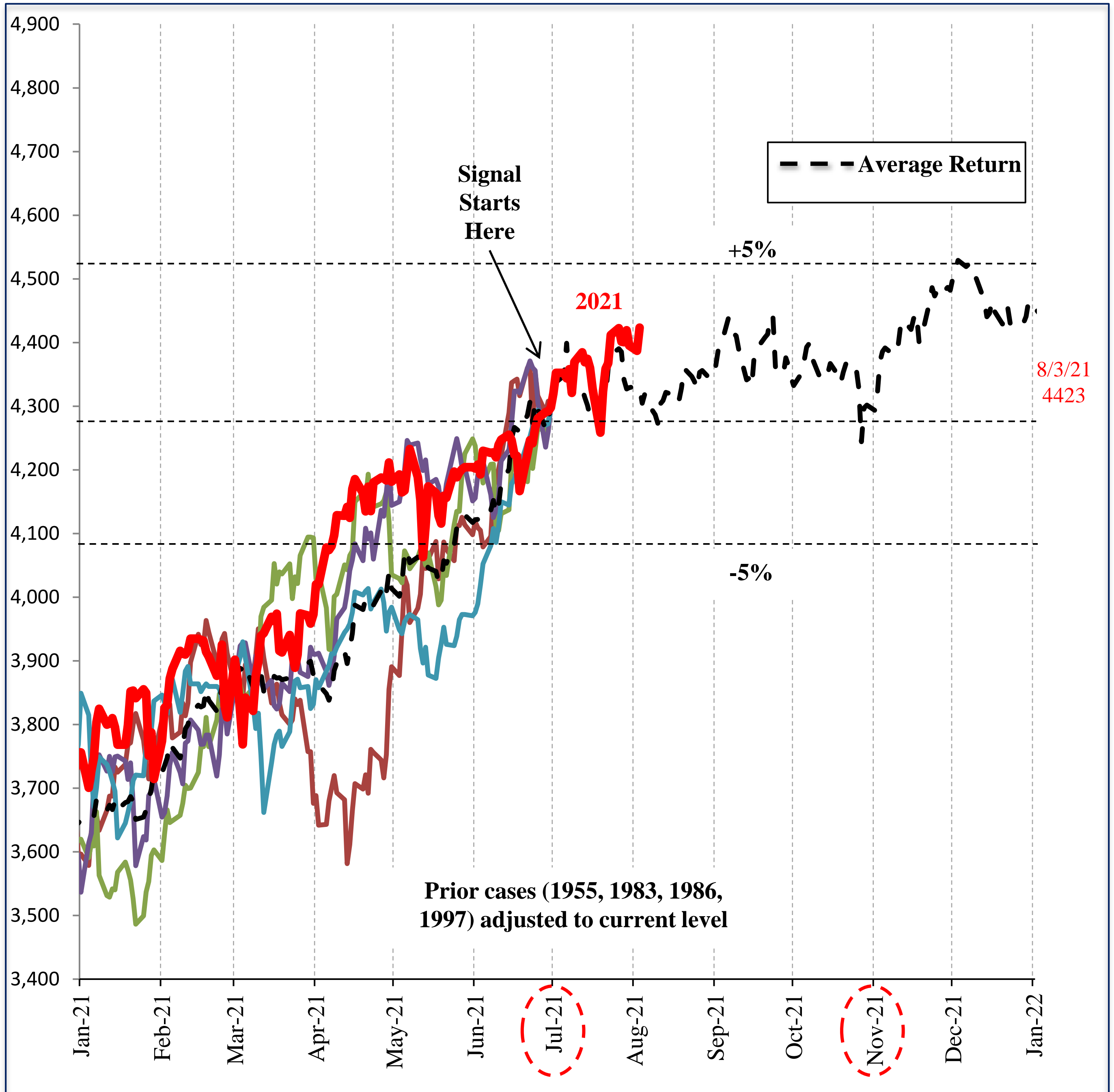
Strong S&P 500: Mixed Returns Ahead

Last month we discussed the implications of the S&P 500 up 38% Y/Y through June. This chart shows the average return in prior cases was flat through the end of October. This would be consistent with mixed returns predicted ahead during mid-cycle slowdowns.

S&P 500 Up 38% Y/Y through June
4 Prior Cases were Flat July through October



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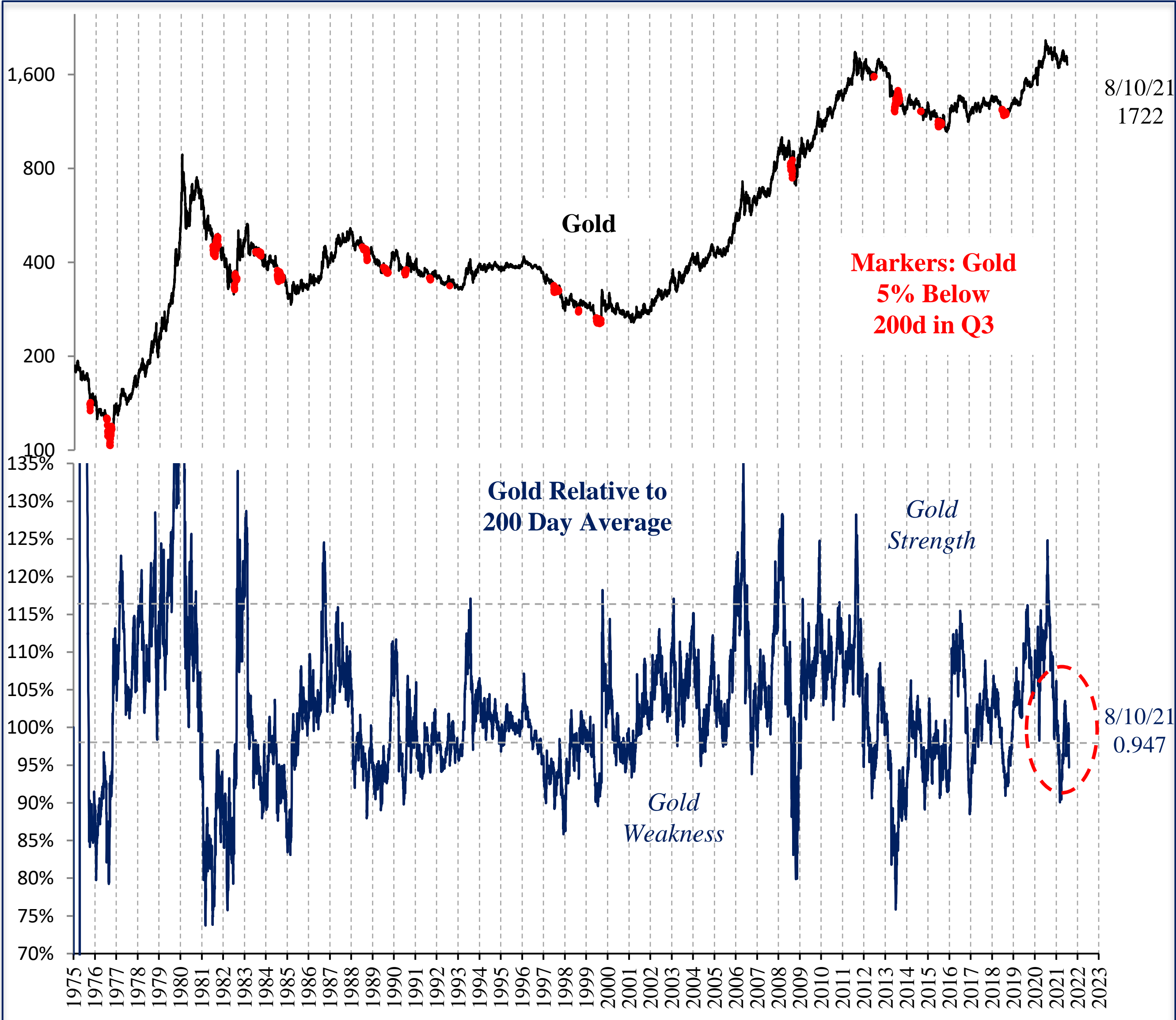
Gold Down: Out of Favor

Gold is down 16% from the August peak of 2,058 and down 9.1% YTD. Investors are reacting to the likelihood of lower inflation ahead, possible Fed tapering at the upcoming Jackson Hole meeting, recent dollar strength and a reversal in Bitcoin. In the last 12 months Bitcoin and gold were inversely correlated. In other words when Bitcoin rallied, gold declined. Sentiment is one sided with 84% of futures trader's bearish gold and 80% bullish bitcoin. A stronger dollar and bitcoin are risks for gold, but on the flipside, gold weakness is bullish historically. Since 1985, gold returned 11.9% (2x norm) when over 5% below the 200-day average as it is today. Ironically, the return was even higher at 17.3% (3x norm) when 5% below the 200 day and the Dollar Index was up 4% like it is today. The bigger long-term risk for U.S. portfolios is a decline in the Dollar due to unsustainable fiscal deficits and unprecedented central bank policy. We are maintaining our bullish 5 rating.

Gold 5% Below 200 Day Average: Positive



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Bitcoin vs. Gold

Summary

While the boom phase of the economy has clear implications for asset prices, namely long equities and commodities and short bonds, the prospect of a mid-cycle economic slowdown has more mixed and subtle implications. To this point we have pulled ratings in equities, commodities and bonds toward neutral until probabilities are stronger in one direction or the other. Since the length of mid-cycle slowdowns are never identical, we will watch indicators closely for the next move. Thank you for your support and please contact your advisor with any questions.

Michael Schaus
Director of Market Research