BRENTON POINT
WEALTH ADVISORS

March 20, 2023

Investing Environment Review and Outlook – Volume 69

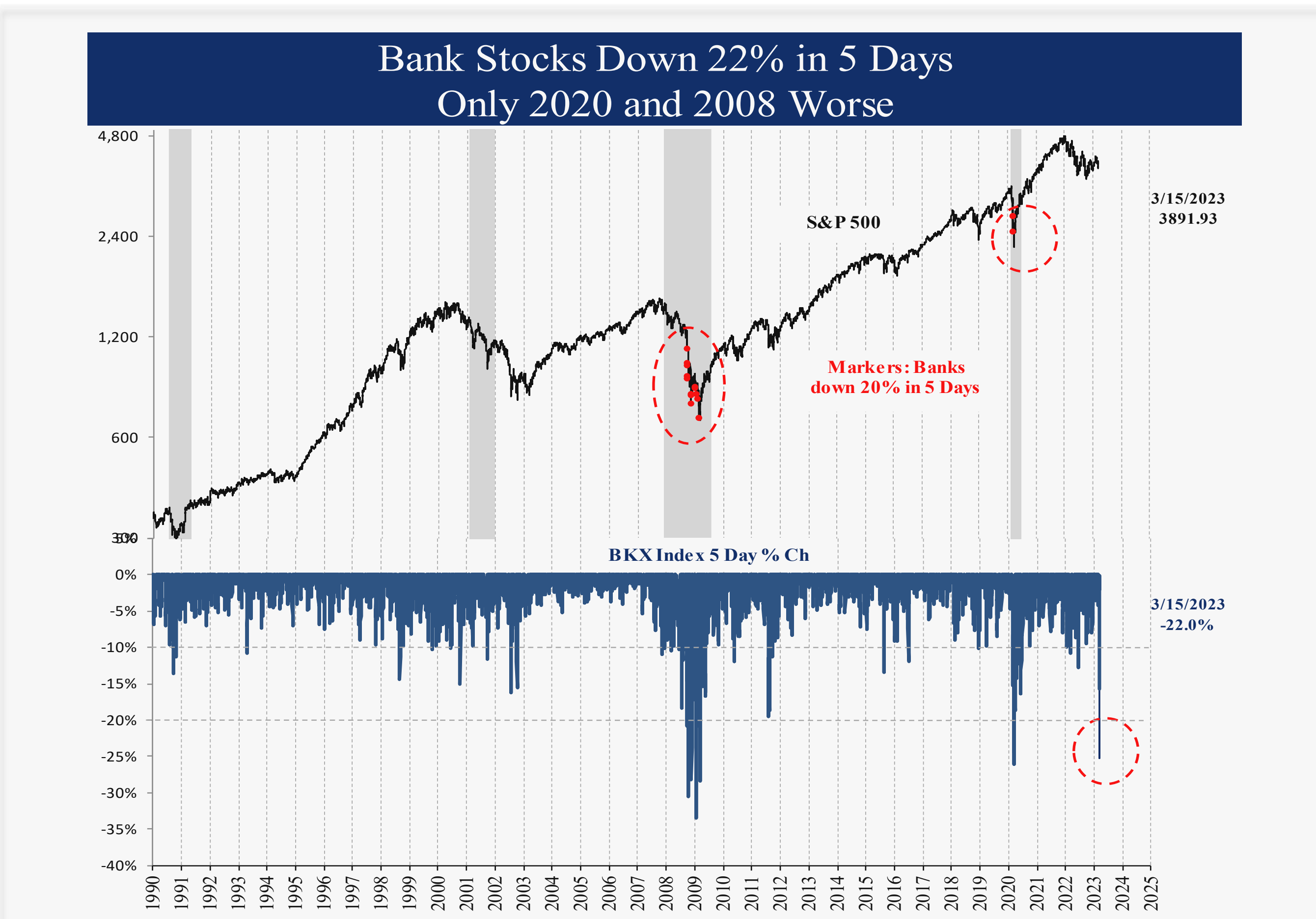
Fear and Interest Rate Volatility

Last month we discussed the strong economic outlook indicators. The market volatility following the bank failures this week caused many of those indicators to reverse back to neutral. This type of change is a great example of why we rely on known conditions to set investment allocations rather than predictions. The facts can, and often do change quickly. This month we discuss the implications of some of those changes behind the dramatic headlines, including interest rate volatility, the return of extreme investor positioning, and of course, inflation.

Long-term bonds upticked to a neutral 3 rating. U.S., foreign-developed, and emerging markets equities remain bullish 5 ratings. Gold remains a bullish 5 rating and industrial commodities downticked to a neutral 3 rating.

Bank Stocks Volatility Extreme

Bank stocks declined 29% from their February peak to 3/15, including a near record 22% decline in 5 days. The only bigger 5 day declines since 1990 were in 2008 and 2020.



March 20, 2023

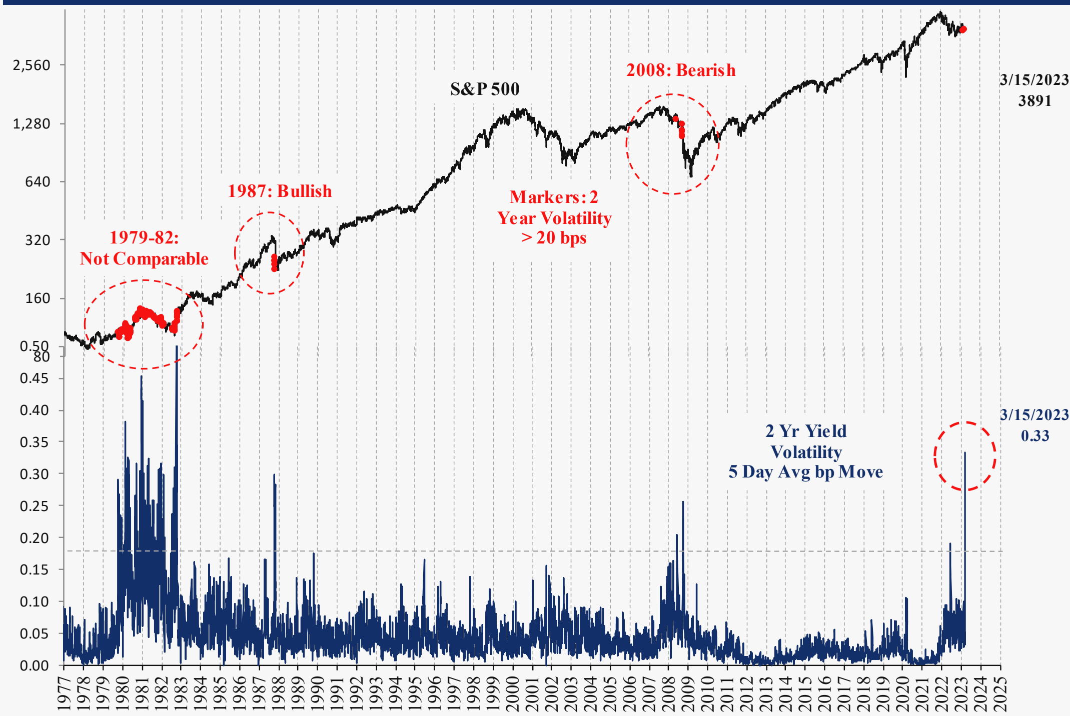
2 Year Yield Volatility

The 2-year Treasury yield fell from 5% to 4% in just 3 days last week following the Silicon Valley Bank failure on 3/10. The fear of contagion and systemic risks caused Fed rate hike expectations to fall from three to just one, and the 2-year yield trend lower. To put this 2-year rate move in perspective, the average daily move in the last 5 days was 33 bps, the highest since 1982, 41 years ago. Even in 2008 during the global financial crisis, the peak 5-day volatility was just 25 bps. Most investors assume it is a bearish indication for equities as it was in 2008. However, this kind of volatility was bullish in the 1987 case coming after the October crash. The move indicated the Fed would provide any liquidity necessary. Today's Bank Term Lending Program is similar, assuring investors deposits are secure. 2008 was different in that borrowers were at risk, rather than the banks themselves. In bank jargon, it is a liability (bank security holdings) issue, not an asset (loan) issue. Whether contagion spreads is unknowable at this point, but junk-yield spreads are not showing recession risk for now, an indication this crisis can be contained.

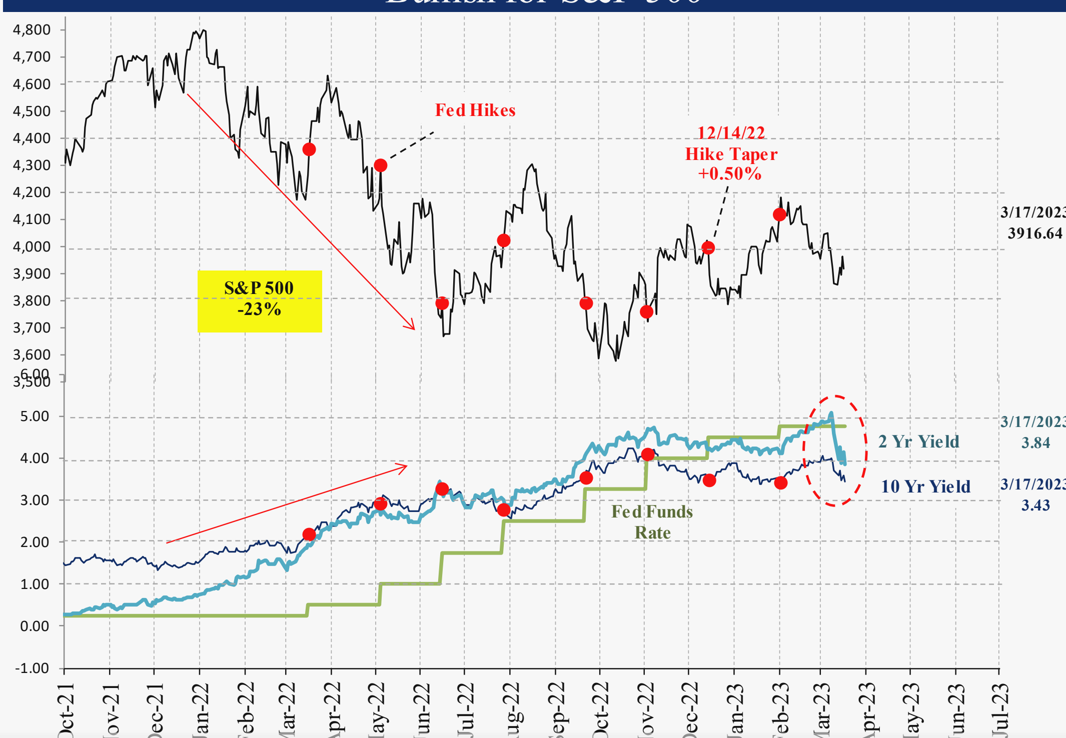
BRENTON POINT
WEALTH ADVISORS

March 20, 2023

2 Year Yield Volatility Highest Since 1982
1987 Bullish/ 2008 Bearish



Interest Rates Turn Lower
Bullish for S&P 500

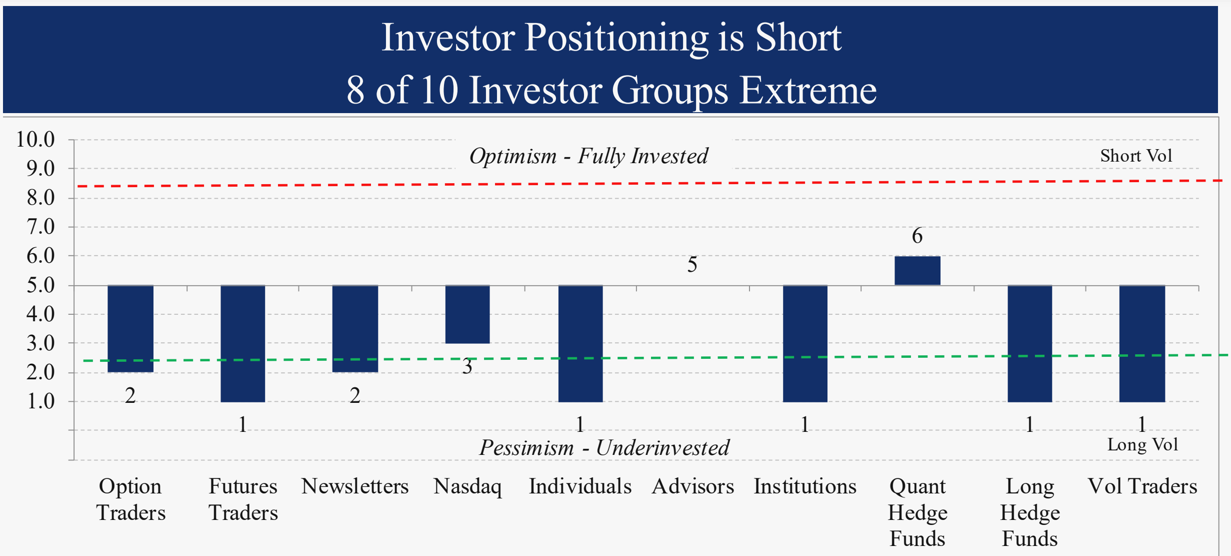


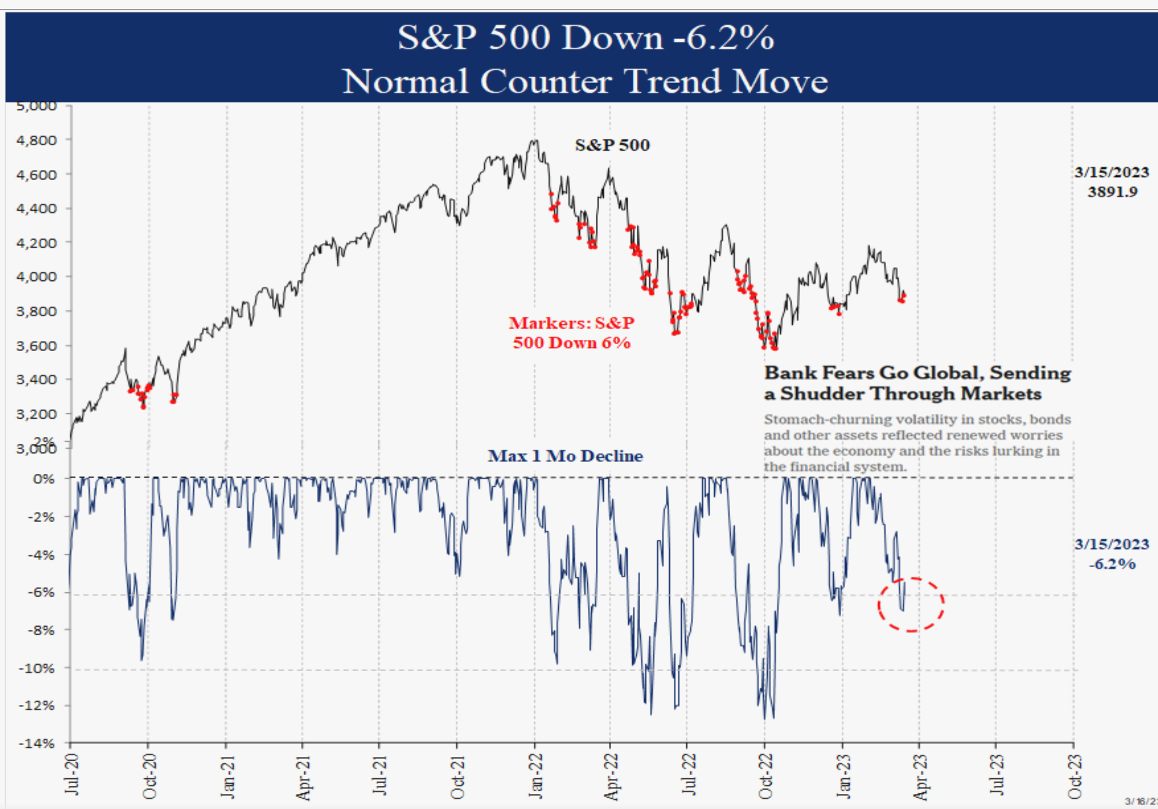
BRENTON POINT
WEALTH ADVISORS

March 20, 2023

Investor Positioning Extreme: Bullish

After a week of dramatic headlines, investor positioning has again reached extreme levels like we saw in December. Historically, when most investor groups cut back their exposure, equities have less downside risk and more upside potential, since investors have more cash on the sidelines to drive stocks higher. Extreme positioning is more significant when other economic indicators line up as well like we have today. After extreme positioning in December, equities rallied 6.2% in January. The current 6% decline in the S&P is a normal counter trend move, despite the headlines to the contrary. Obviously, bank stocks were more extreme.

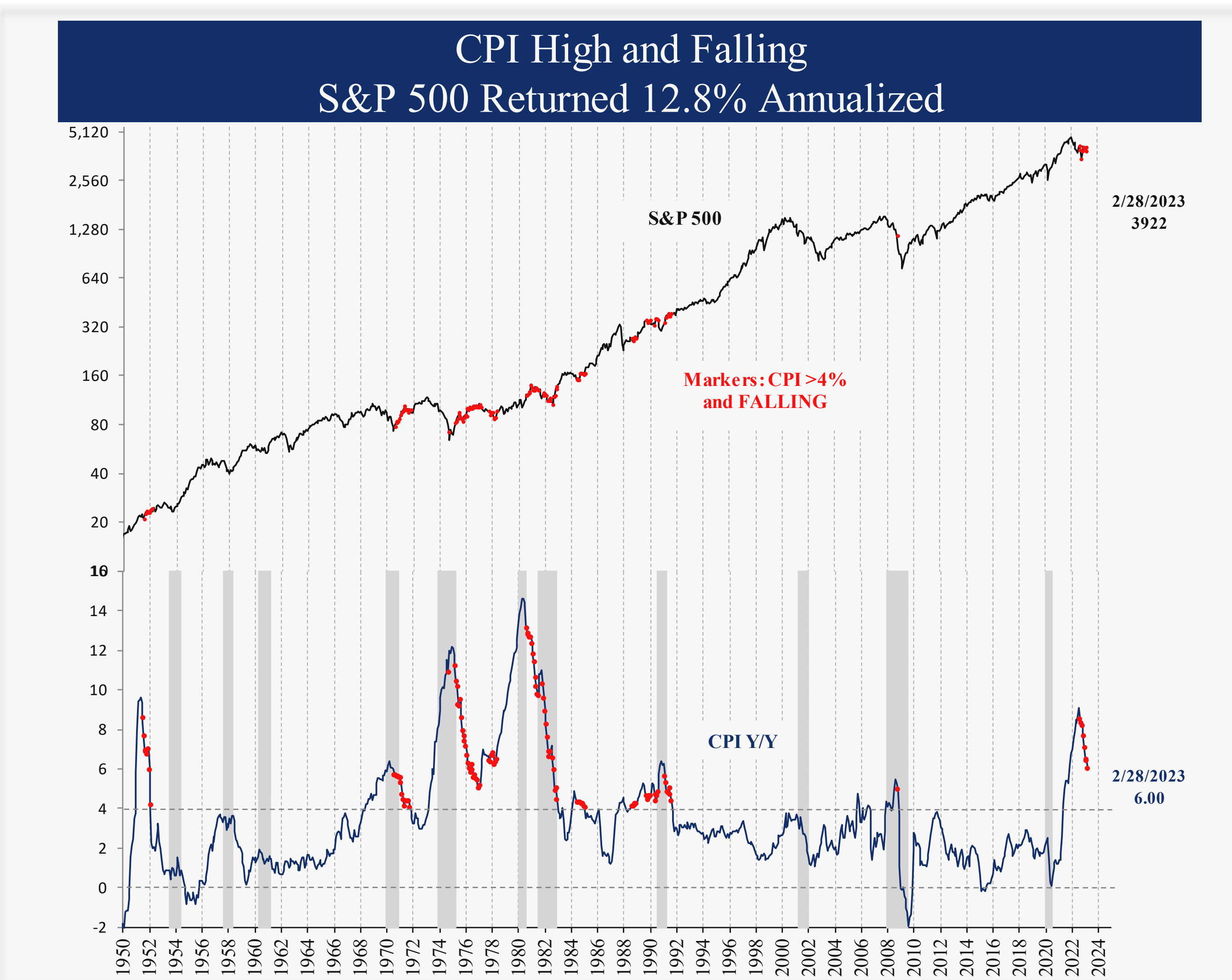




March 20, 2023

Inflation is Falling: Bullish

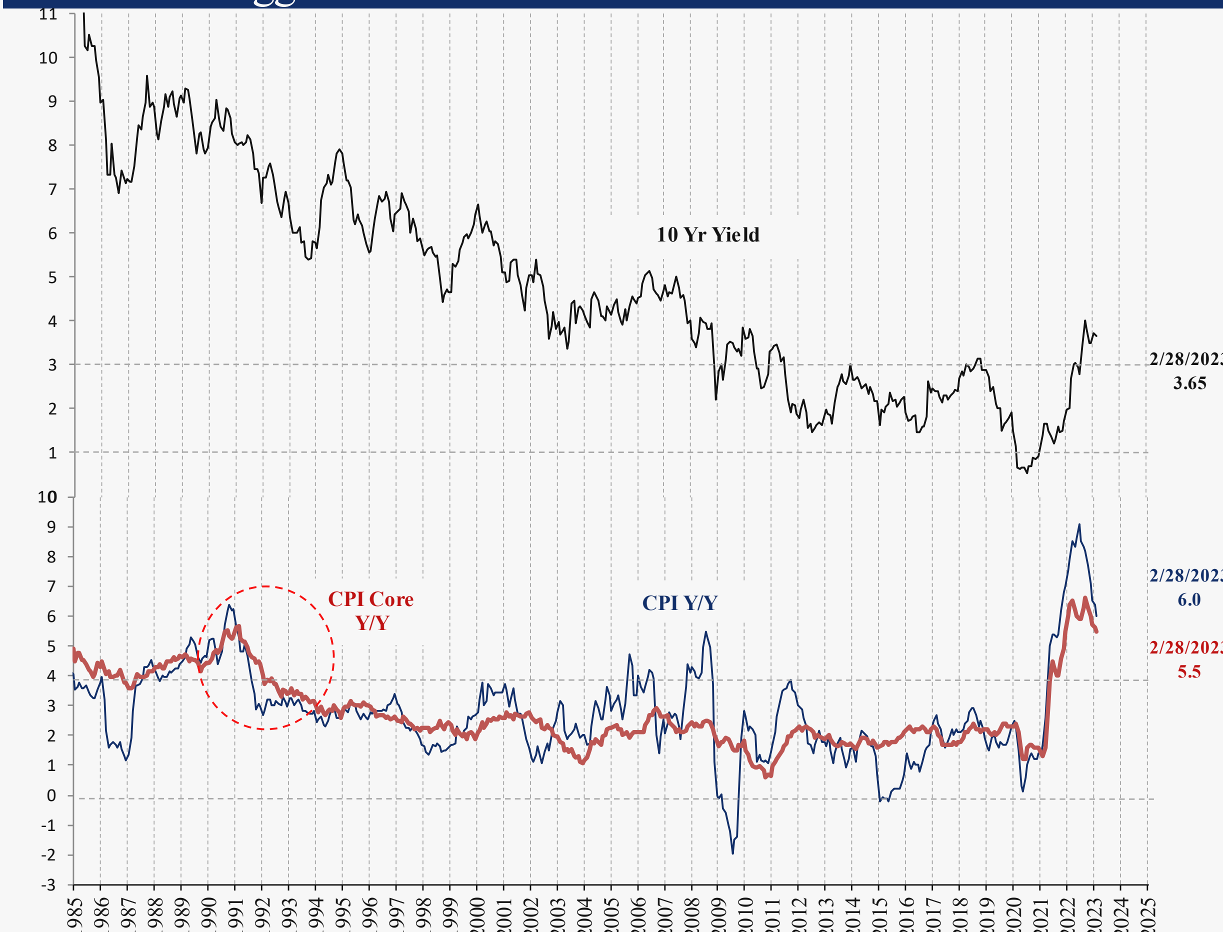
Headline February inflation was 6.0% Y/Y, down from the 9.1% June peak and falling faster than prior inflation spikes. Falling inflation while the Fed was hiking rates was bullish historically for the S&P 500 with a 15% annualized return, above the norm. Also consider that leading inflation indicators are pointing lower. Our inflation outlook model was 40.3 in February and crude oil is already down 10% in March. Finally, the prior year comps averaged 0.9% M/M for the next 4 months, which means any M/M number this year below that will translate into a lower Y/Y number. For instance, if CPI averages 0.4% over the next 4 months, CPI Y/Y will be just 4.0% by June. How low inflation will go is unknowable, but we can say the inflation spike is over, and bullish.



BRENTON POINT
WEALTH ADVISORS

March 20, 2023

CPI Headline and Core Converging
Core Lagged Headline in 1991: So What? Trend is Down



Summary

This month we discussed the interest rate volatility, extreme investor positioning, and the declining inflation rate. The bank failures certainly hit confidence and may have delayed the economic rebound, but equity indicators improved even further with more cash on the sidelines and lower inflation more likely. Declining inflation and a falling 10-year yield are bullish for equities, even when the Fed is hiking rates. Further contagion remains an unknowable risk, but given current conditions today, equities are likely to move higher. We cut the commodity rating due to the reversal in the economic outlook model back to neutral combined with the recent strength in the dollar. We moved long-term bonds to neutral also due to the more neutral economic outlook, but we expect that to reverse higher. We will continue to watch our indicators on a daily basis for changes. Thank you for your support and please contact us with any questions.

Michael Schaus
Director of Market Research