BRENTON POINT
WEALTH ADVISORS

May 19, 2023

# Investing Environment Review and Outlook – Volume 71

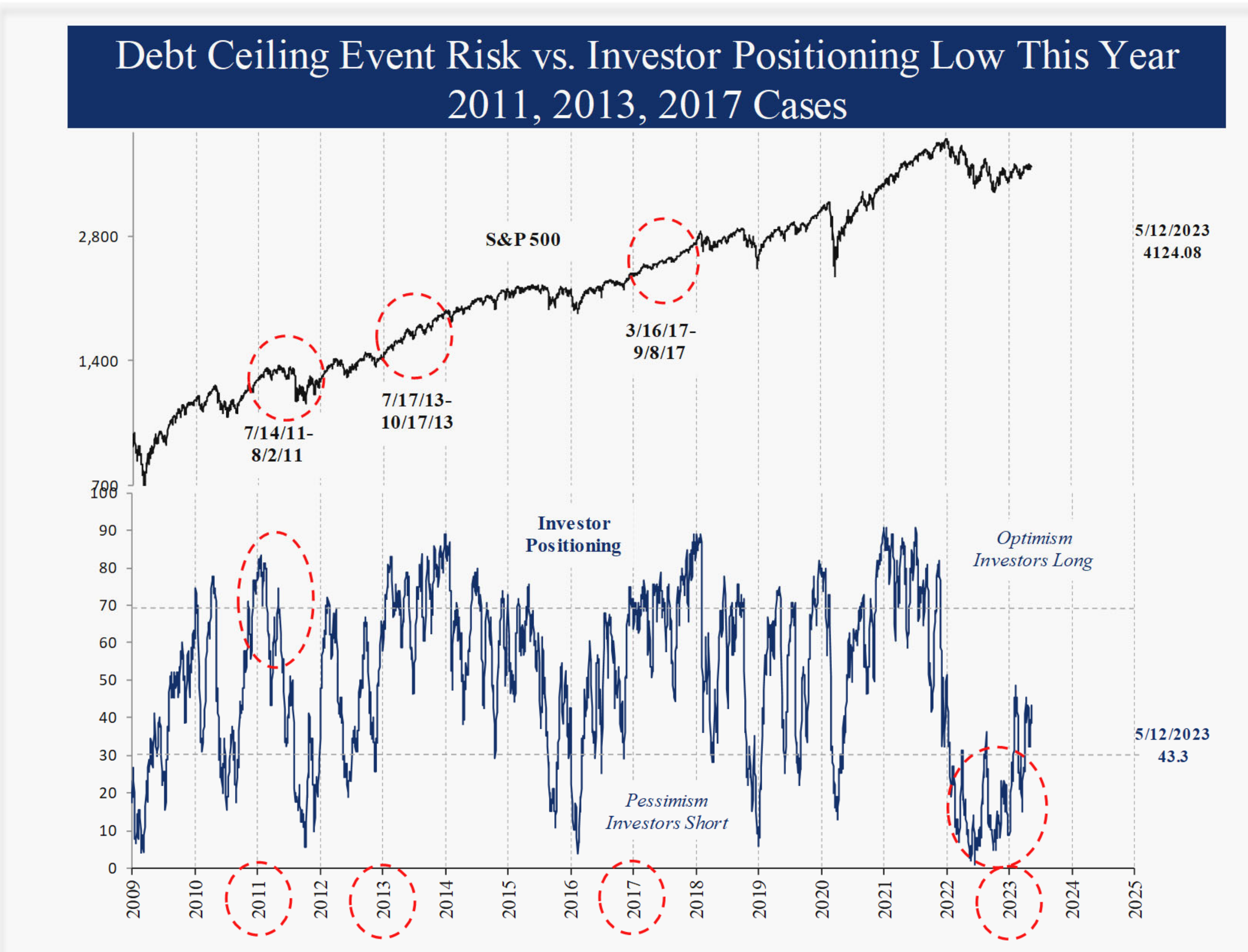
## Banking Panic to Default Risk and Beyond

Last month we discussed the Fed response to the March banking panic and the implications of the weak dollar. Since then, as it became clear the banking system had stabilized, the media was quick to shift to a potential U.S. debt default as their next disaster story. The recession drumbeat is louder than ever, and as a result most investor groups remain under invested despite a 7-month equity rally from the October low. Conditions we monitor like the weak economy, mixed monetary policy, falling inflation, low investor positioning and strong tape indicators as a group are positive for equities historically despite the possibility of a recession ahead. Recessions are great for historians, but mostly useless for investors since they are somewhat arbitrary and only defined after the fact. This month we discuss the event risk posed by the debt ceiling debate, and the more serious issue behind it, strength in China lending and presidential cycle seasonality. U.S., Foreign-Developed, and Emerging Markets equities remain bullish 5 ratings. Long-term bonds remain a neutral 3 rating. Gold remains a bullish 5 rating and Industrial Commodities remain a neutral 3 rating.

## Debt Ceiling Debate Event Risk

Market consensus has focused primarily on the 18% S&P 500 decline during one prior debt ceiling debate in 2011, illustrating their tendency toward "if it bleeds it leads." Coverage usually omits the two other recent debt ceiling debates in 2013 and 2017 which ended without incident for the equity market. One reason equities are at less downside risk today is investor positioning is a mirror image from 2011 when investors started the year fully invested. This year investors were extremely pessimistic and underinvested, with significant cash available to support stock prices. Despite the YTD rally investors remain cautious. A Federal debt default would certainly cause significant short-term disruption, but the more serious issue for forward looking markets is the sustainability of Federal spending levels.

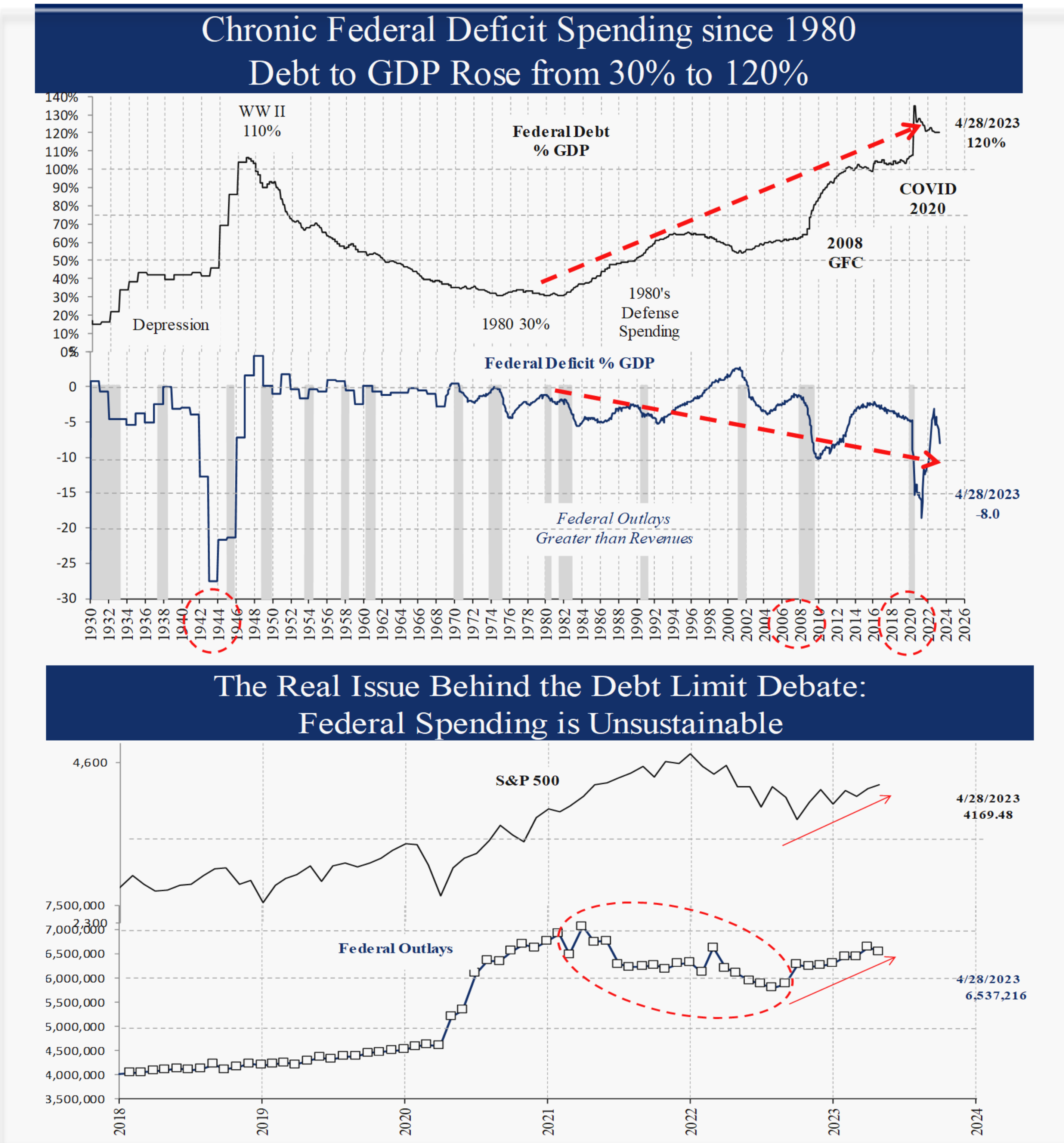
For perspective, the debt limit itself was enacted over 100 years ago in 1917 when federal debt was just $5.7 billion at 10% of GDP. It rose to 30% of GDP during WW I. During WW II the debt rose to a record 110% of GDP before strong post war growth followed by inflation in the 1970's caused a decline in federal debt to just 10% of GDP by 1980. Since then, federal deficit spending resulted in a new record high of 120% debt to GDP today. That's equivalent to $92,000 per capita up from just $4,000 per capita in 1980.



BRENTON POINT
WEALTH ADVISORS

May 19, 2023

Deficit spending and rising debt like we've seen since 1980 is stimulative since it is essentially pulling consumption forward in time. In the 1960's a 3% deficit was considered large. In the last 20 years deficit spending has been a bad habit without consequences. Today we're running an 8% deficit even without a recession. When the debt cycle turns there are major tail risks like persistent inflation, a weaker dollar and higher interest rates. Fiscal austerity may be forced by the market.

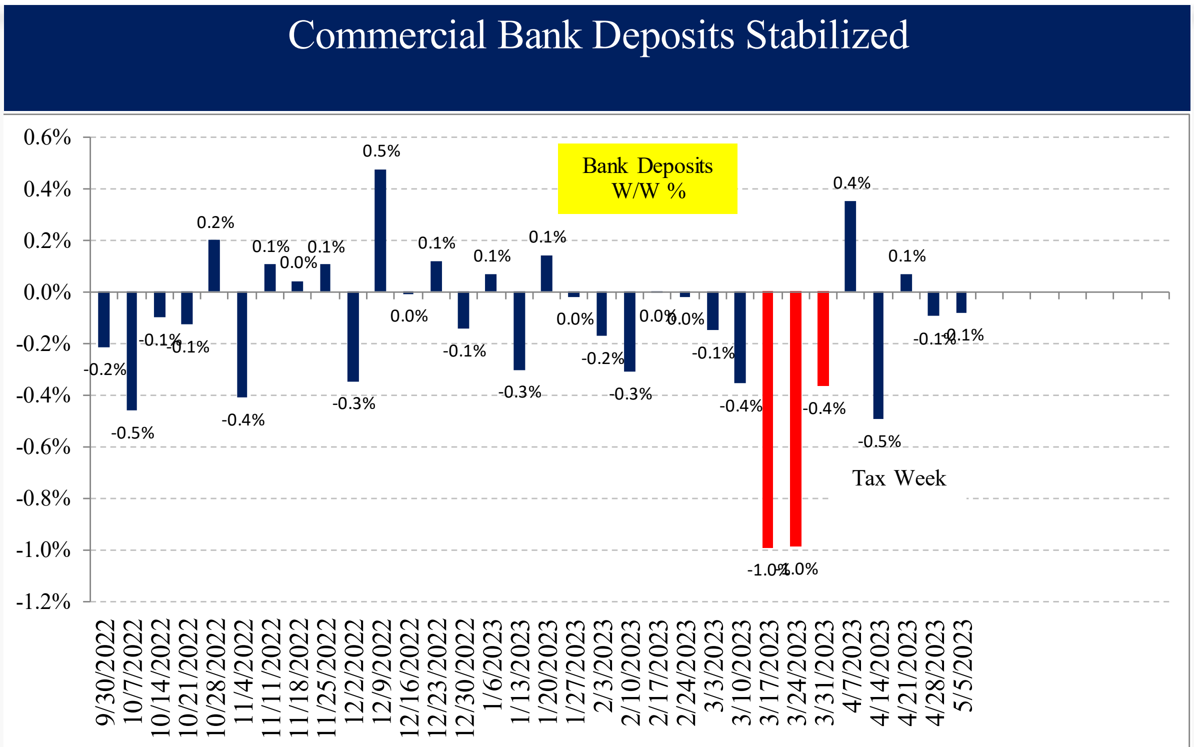


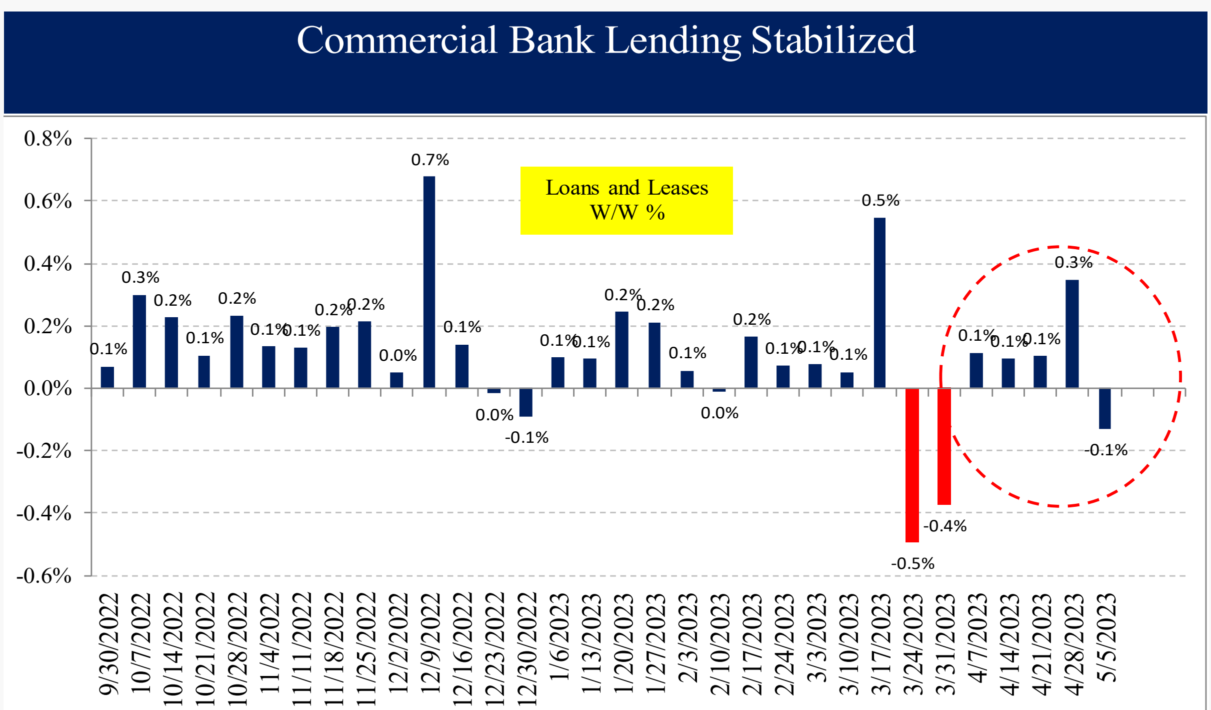
BRENTON POINT
WEALTH ADVISORS

May 19, 2023

**Banking Panic Stabilized**

The banking panic started on March 10th when the SVB failure caused two weeks of extreme deposit outflows which have since stabilized. Loans, which declined initially in the first two weeks have also stabilized, while banks stocks were up 7% on 5/17/23. It appears fears over a mass deposit run were overblown, but we will continue to watch for further deterioration.

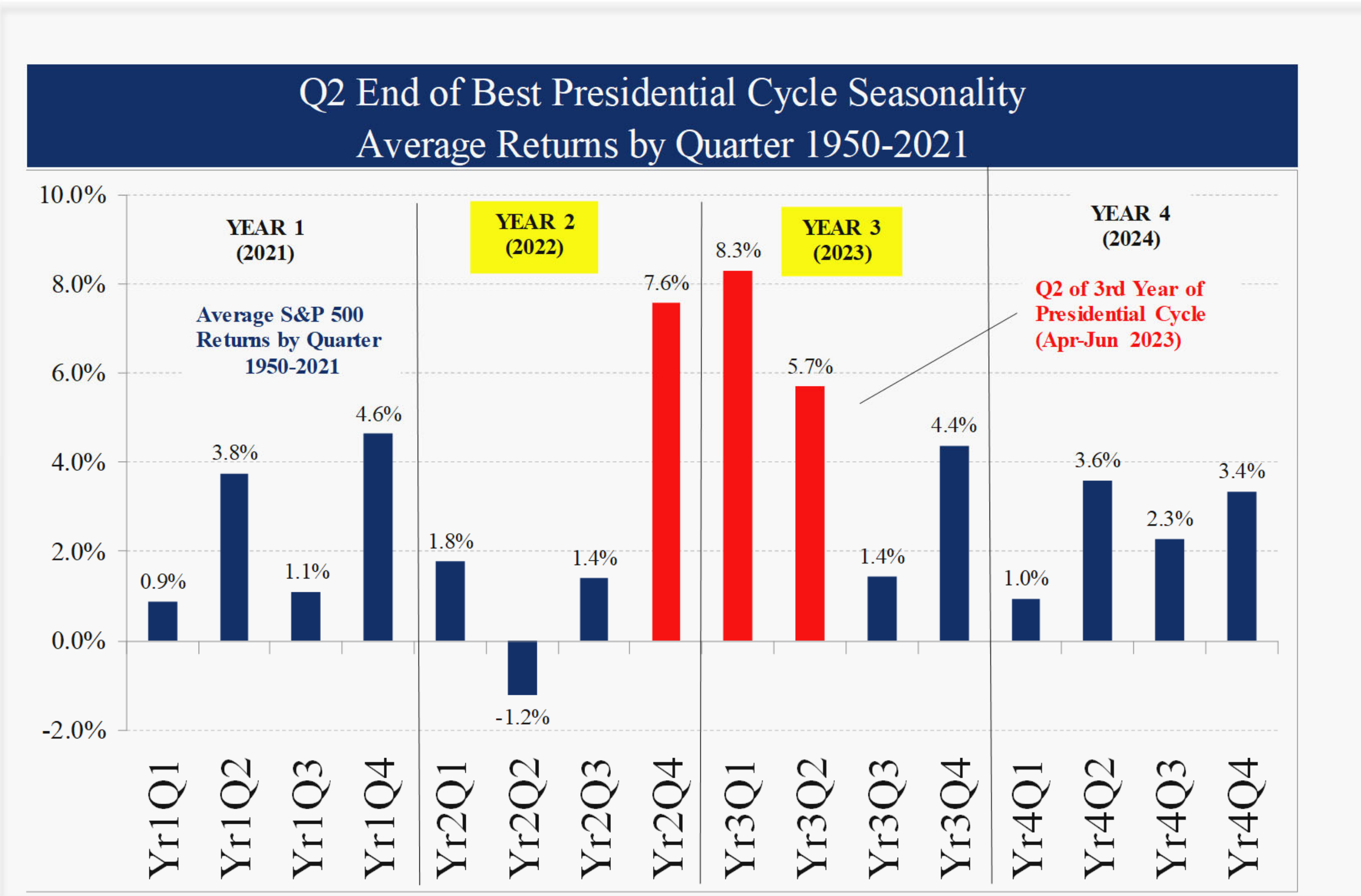


May 19, 2023

**Presidential Cycle Positive Seasonality Ending**

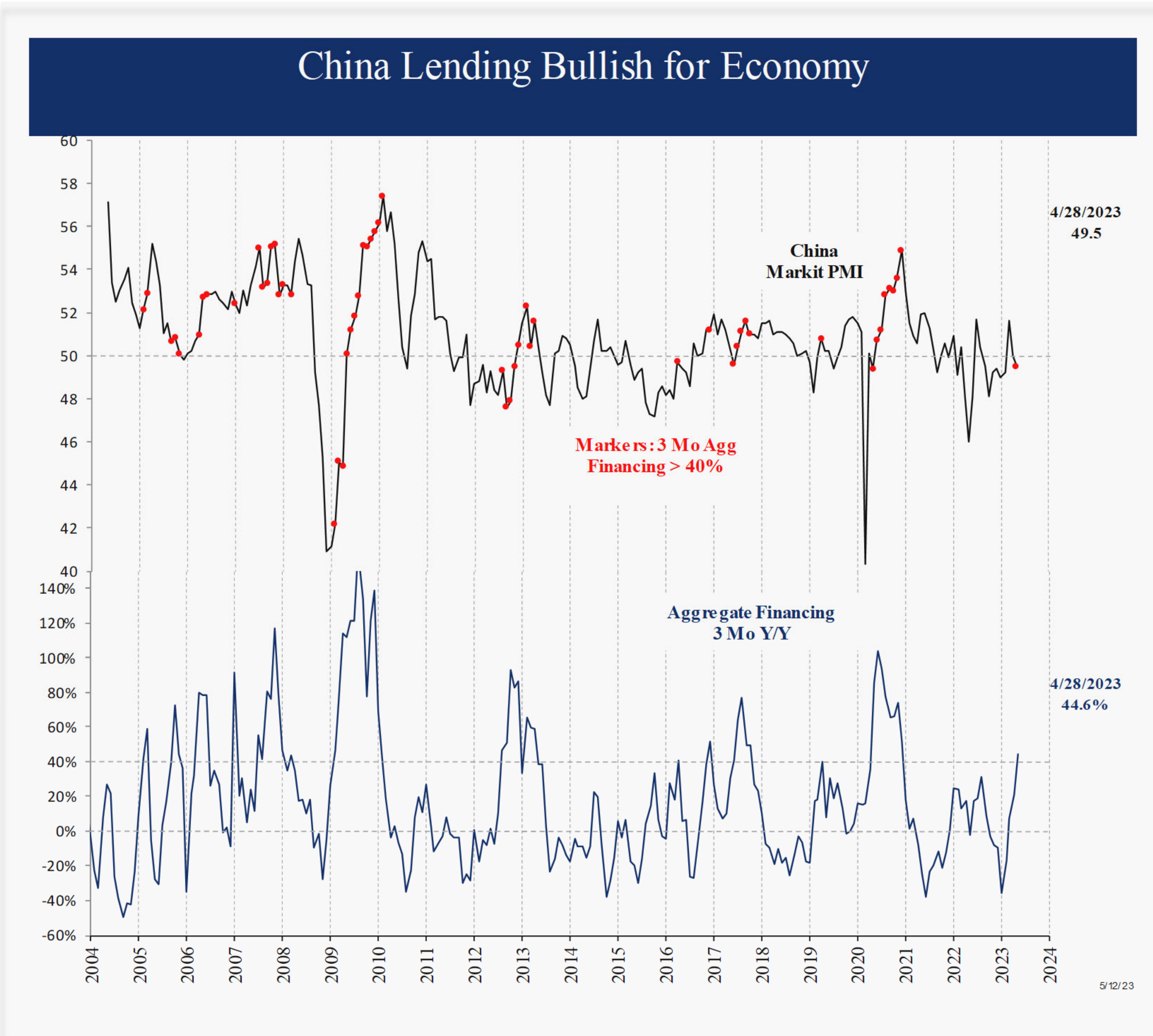
2023 is the third year of the presidential cycle. Historically the best three quarters of the four-year cycle were Q4 in year 2 and Q1 and Q2 of year 3. This means the positive seasonality ends at the end of Q2 just a month away. At that point depending on conditions at the time we will determine whether seasonality is significant either way.



May 19, 2023

## China Lending Up: Bullish for Economy

The China reopening story was supported by the data in Q1, but has since faded as economic releases showed slower growth. Perhaps in response, China bank lending, directed by the PBoC, has exploded by 44% Y/Y in the last 3 months. Prior cases were bullish for the Chinese economy, and may be one reason we could avoid a global recession.

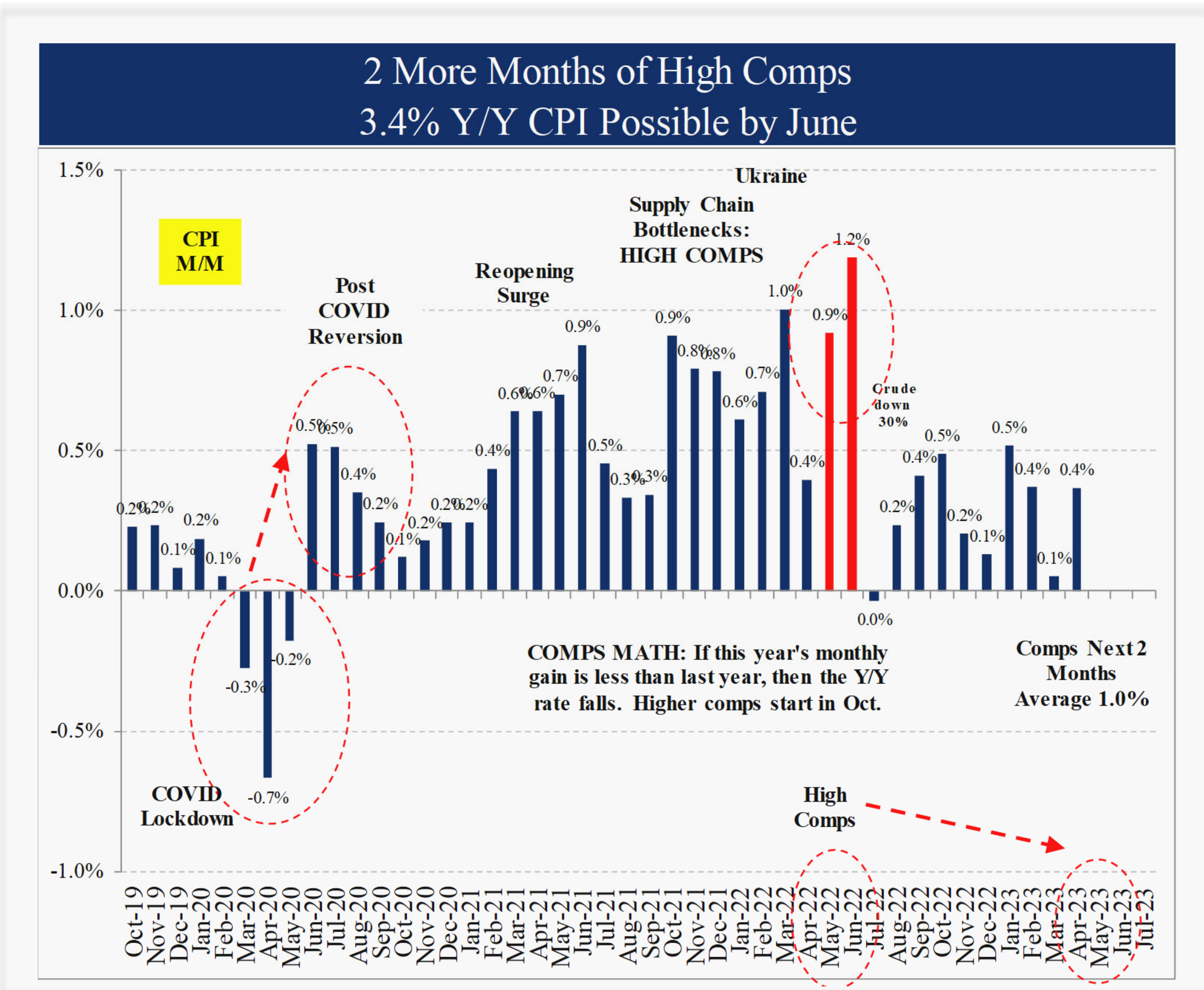


BRENTON POINT
WEALTH ADVISORS

May 19, 2023

**Lower Inflation Ahead**

Besides the recession drumbeat, there has also been a parade of Fed governors insisting their job is not done with more hikes to come. What they may not be considering is the year ago CPI numbers were extreme in May and June, averaging 1.0% M/M. What that means is if the M/M in May and June this year average 0.3% as is likely based on recent releases, then the CPI headline Y/Y would be 3.4% by June. And that would certainly give the Fed cover to pause hiking. Our inflation outlook indicators remain neutral as well.



May 19, 2023


**Summary**

This month we discussed the stabilization of the banking crisis and the longer-term implications of the debt ceiling debate beyond a potential technical default.  The debt fueled deficit spending is certainly unsustainable and means bigger long-term risks like sustained inflation and a weaker dollar are significant.  However, for now conditions for equities are positive despite the media focus on recession.  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