BRENTON POINT
WEALTH ADVISORS

July 19, 2023

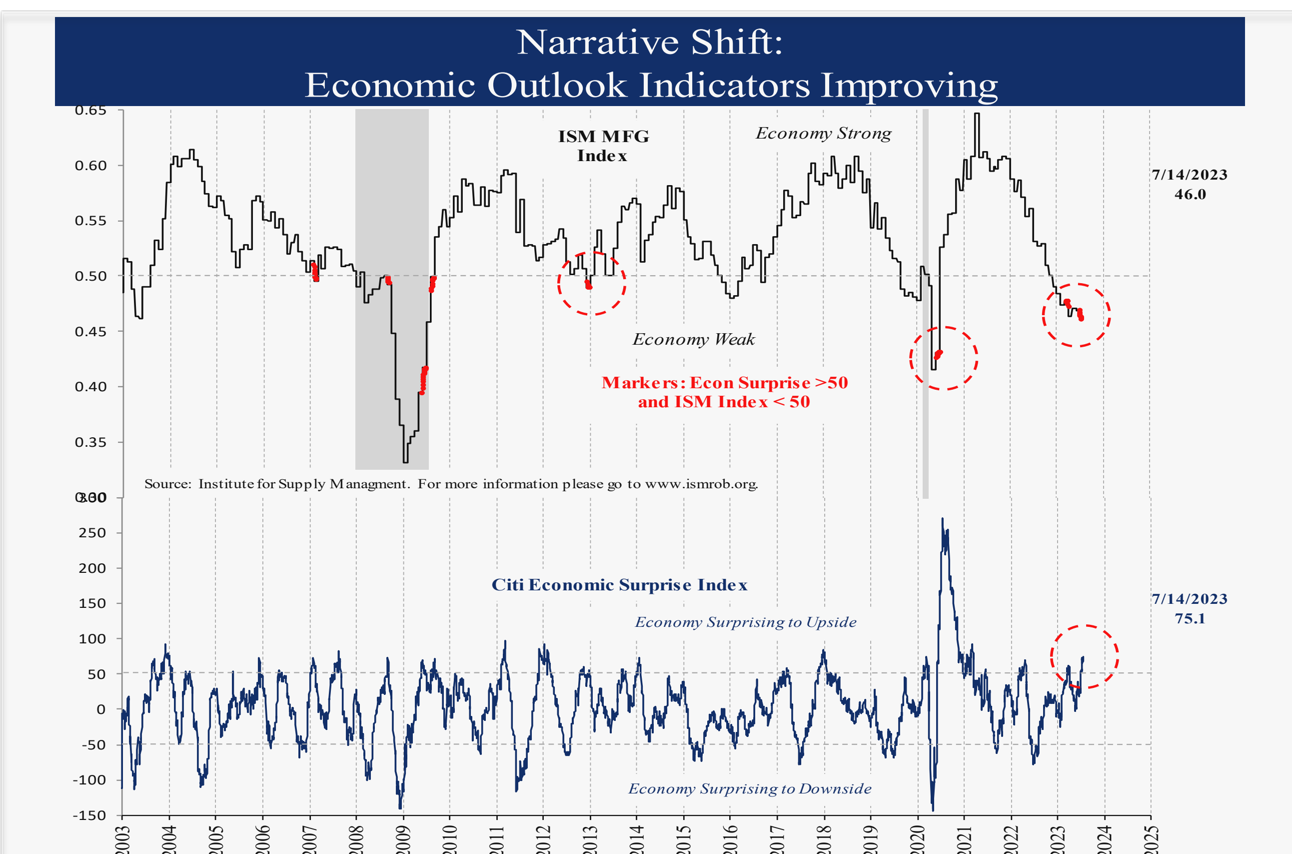
Investing Environment Review and Outlook – Volume 73

Narrative Shift

- Economic outlook uptick to Positive
- CPI inflation down, outlook weak
- U.S. equity rating downtick to Neutral

Last month we discussed the industrial commodities rating uptick due to the weak dollar and improving economic outlook. Since then, economic outlook indicators improved further and the S&P 500 continued higher, reaching 4500 last week and converting even more bears to bulls. The S&P 500 is up 19% YTD and 28% since the October low in just 9 months. This month we discuss why we cut the U.S. equity rating to neutral, and the investment implications of the downside inflation surprise and sharp break in the dollar last week. A turn in the economic indicators may mark an inflection point in the market narrative from recession watch to economic acceleration. Gauging market impact and the Fed's reaction separately will be important.

This month we cut U.S. equities to a neutral 3 rating. Foreign-developed and emerging markets equities remain bullish 5 ratings. Long-term bonds remain a neutral 3 rating. Gold and industrial commodities remain bullish 5 ratings.



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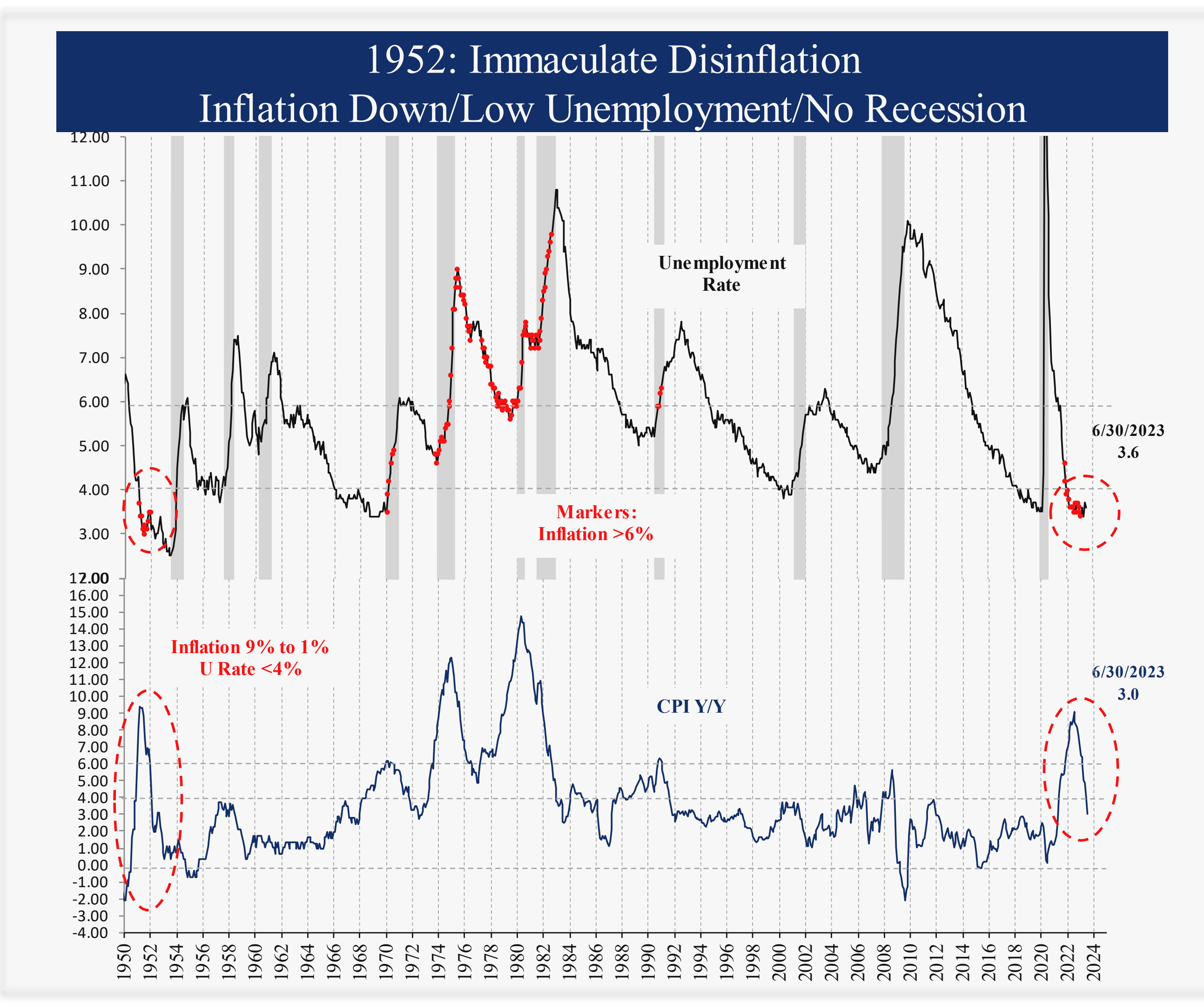
Strong Economic Outlook

For over 12 months the financial media has focused on an imminent recession and further downside for equities. So far, the U.S. has not entered a recession, and instead conditions are shifting in the opposite direction, as our economic outlook indicators broke above 60 last week. For instance, the Citi economic surprise index reached 75 on 7/14/23, the highest in over 2 years. Other leading indicators like equity prices and commodity prices are giving positive signals as well. The evidence shows the U.S. economy is more likely to accelerate in the second half than weaken into a recession.

One reason most economists expect the unemployment rate to rise and a recession to follow is this pattern occurred after every inflation spike since 1960. However, the 1951 inflation spike reversed without economic collateral damage. The CPI move from 0% to 9% was caused by a consumer consumption rush, following the start of the Korean War in June 1950. Memories of WW II shortages were still fresh, so consumers stocked up. Since production kept up, the demand-led inflation spike reversed from 9% to 1% by 1952 without a rise in unemployment or a recession until late 1953.



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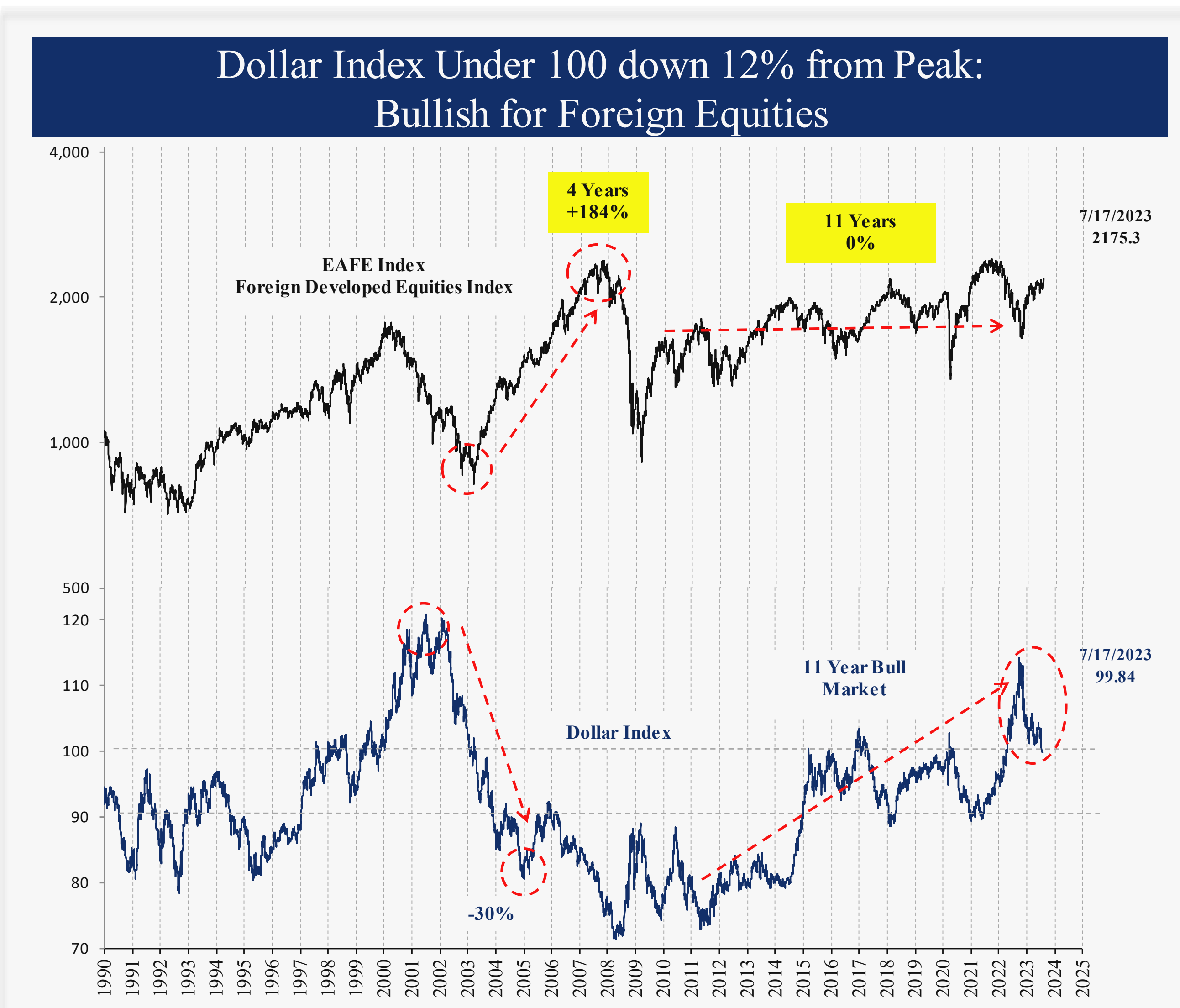
Dollar Index Declines Below 100: Bullish Foreign Equities/Commodities

The Dollar Index peaked in October at 113, marking the potential end of an 11-year bull market. The dollar decline has important implications for investors, namely strong returns for foreign equities like the EAFE Index of foreign-developed countries. Most investors are unaware the 2003 dollar reversal was followed by a 4 year 184% EAFE rally. After 11 years of EAFE underperformance and zero return for foreign equities, investors are naturally underinvested at the exact time when they are most likely to outperform going forward. We have bullish 5 ratings on foreign-developed equities, emerging markets, gold, and industrial commodities. Historically they provided important diversification for any portfolio as well as significant upside potential when the dollar declined.



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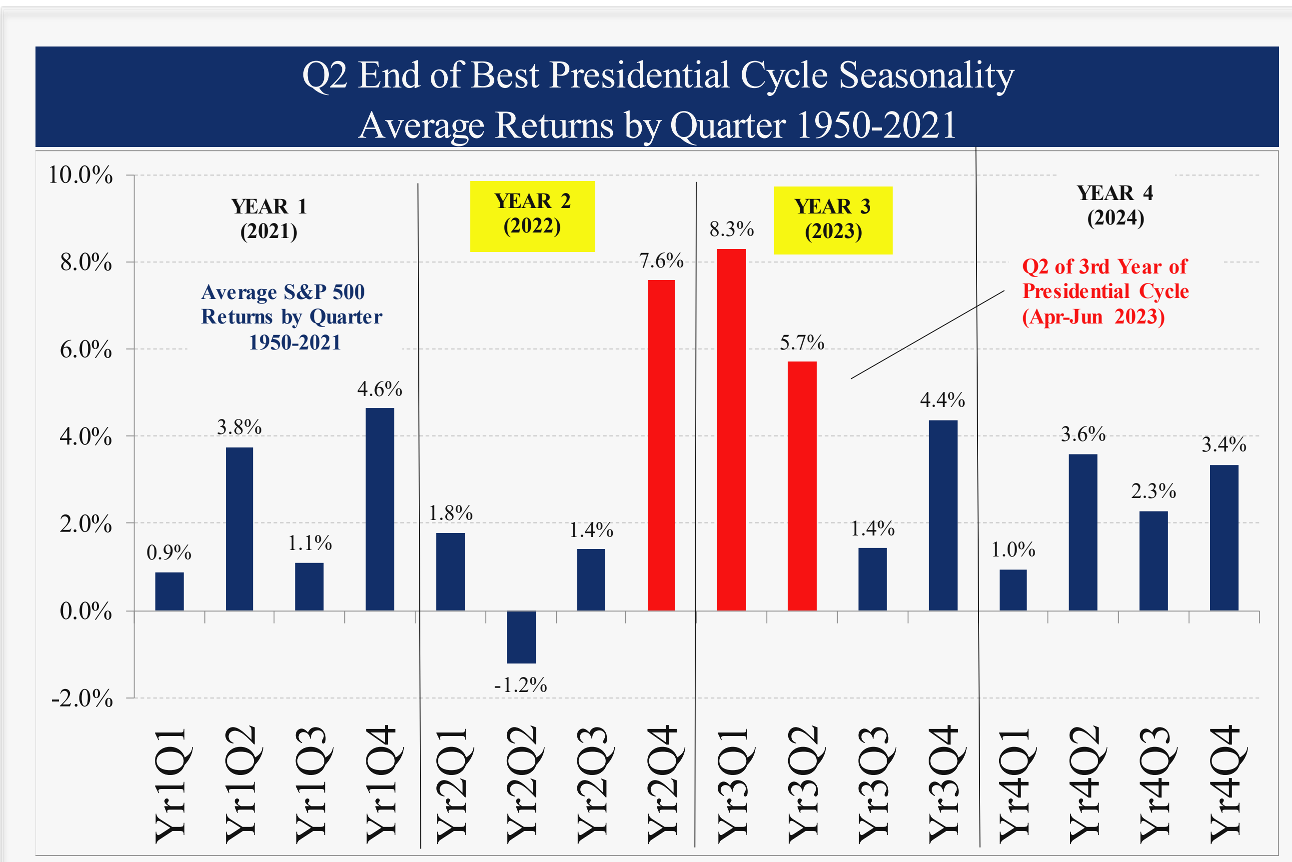
U.S. Equity Downtick

The economic fundamentals for equities remain positive. Since 1973, the S&P 500 returned 18.9% with falling inflation, a weak economy, and a strong economic outlook. However, other equity risks are up, like negative Q3 seasonality, the overbought condition of the S&P 500 after a 17% H1 rally, and long investor positioning. Finally, there is the risk the Fed will overreact to a stronger economy even if inflation continues to fall. This month we cut U.S. equities to a neutral 3 rating for the first time since October 2022.



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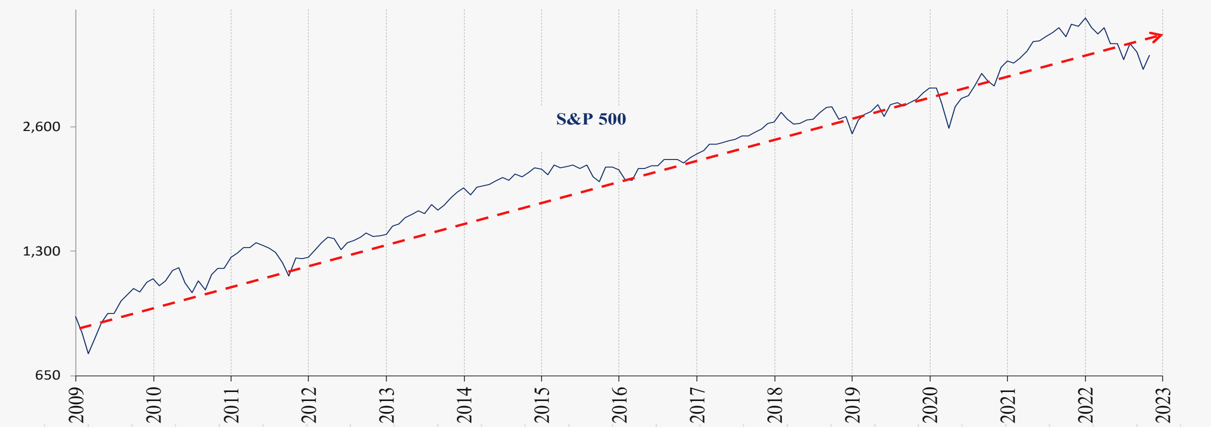
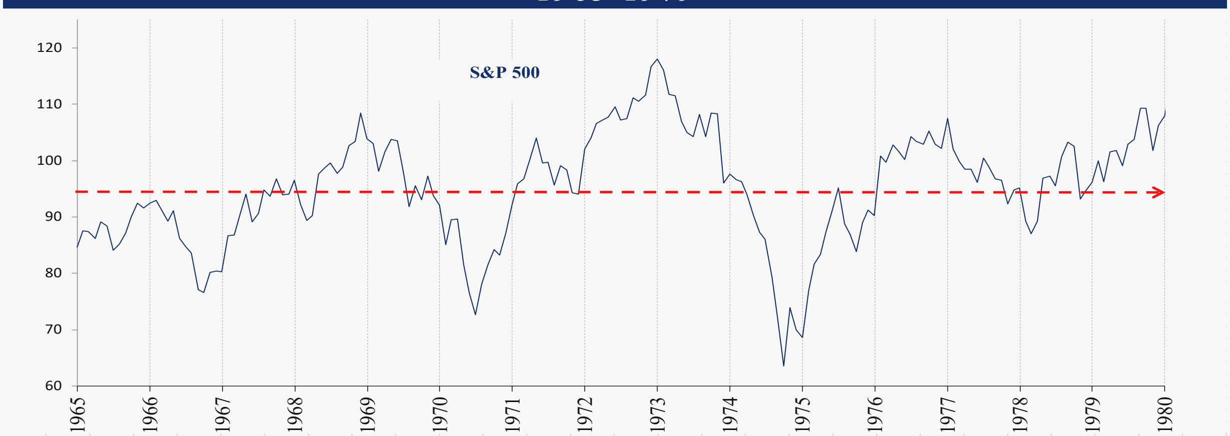
S&P 500 Up 15 Years 2009-2023



The Risk: S&P 500 Volatile but Flat for 15 Years 1965-1979



Summary

This month we discussed the improving economic outlook and the sharp decline in the Dollar Index below 100. Fundamental conditions remain positive for equities, but we cut the U.S. equity rating to a neutral 3 based on rising risks like seasonality and long investor positioning. These conditions represent a great opportunity for forward-looking investors with flexible and liquid portfolios to shift exposure out of U.S. equities into foreign equities and commodities. U.S. equities have outperformed virtually every other asset class over the last 15 years. Over the past 100 years of stock market history, long periods of flat returns and high volatility were normal. For instance, from 1965-1979 U.S. equities generated virtually zero return combined with the volatility of three bear markets. Like 2023, the 1965 period was also characterized by elevated inflation and a weak dollar. Shifting exposure from U.S. equities to foreign equities and commodities during this period would have resulted in higher returns and lower volatility for flexible minded investors with liquid investment options.

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