BRENTON POINT
WEALTH ADVISORS

October 20, 2023

Investing Environment Review and Outlook – Volume 76

- U.S. Equities Shift to Bullish 5 Rating
- U.S. Treasury Bonds oversold extreme: Bullish
- Gold Futures Traders Short: Bullish
- Weak European Investor Confidence: Bullish

Geopolitical Risk

The human tragedy of war is a constant over time. However, market impacts can be vastly different. The October 1973 Yom Kippur War, when Israel was invaded by Egypt and Syria, was followed by a quick 10% S&P 500 decline. The 1990 Iraqi invasion of Kuwait was followed by a U.S. bear market and recession. In both cases the price of oil spiked (up 4x in 1973 due to an Arab Oil Embargo and doubled in 1990 from $20 to $40 a barrel). In January 1991, the U.S. responded with an invasion of Kuwait. In that case equity markets rallied sharply and began a new bull market. While the escalation and wider involvement of the war is unknowable, transmission mechanisms like commodity prices, interest rates, and international equity indices are predictive signposts.

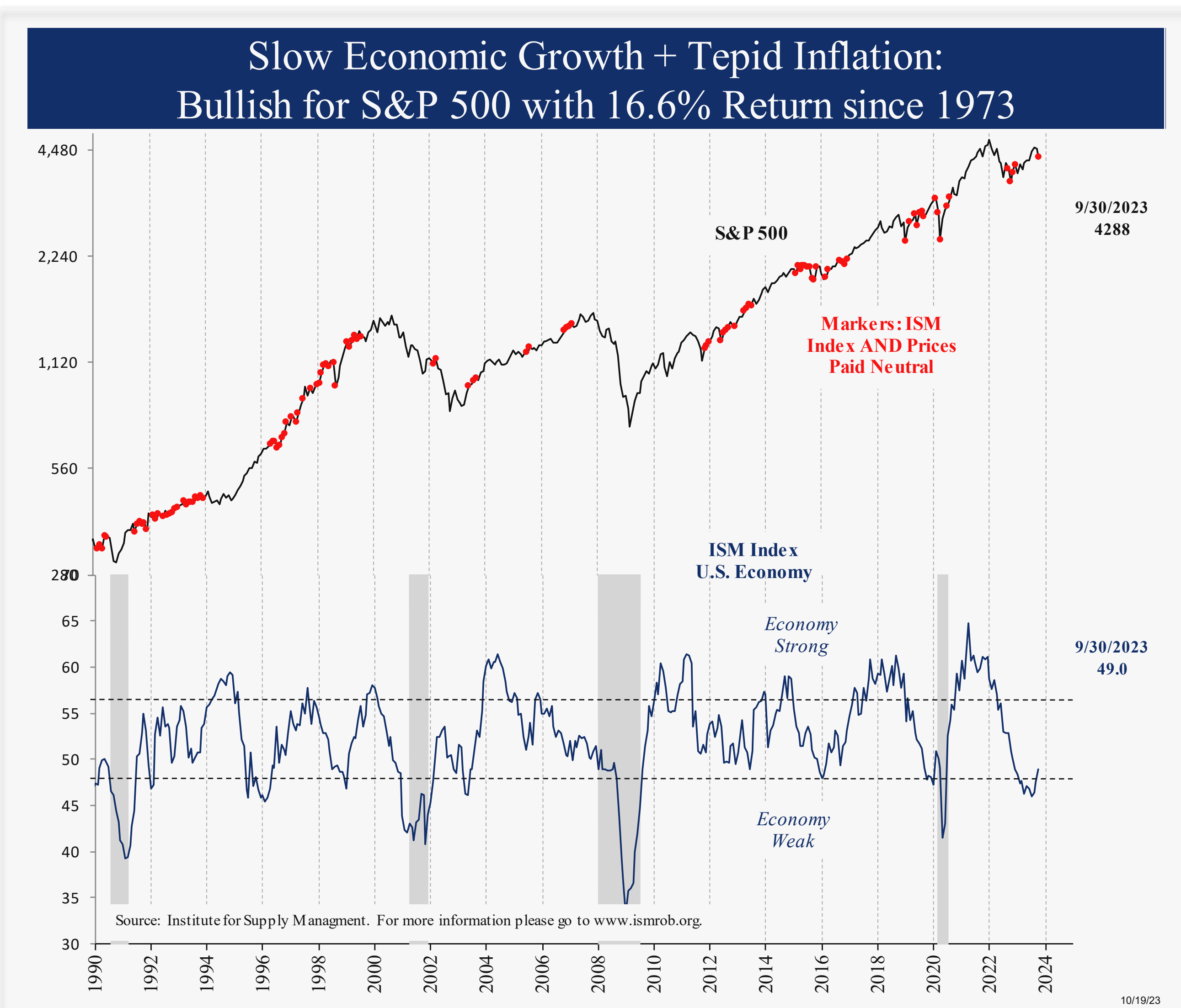
In this case, despite intense world interest in the Israel Hamas war, new signals have been muted. For instance, since the war started, crude oil rallied just $6, not even breaking the $92 September peak. Rising Treasury bond yields are more of a concern, but that upward trend was in place before the war started.

Last month, we discussed the investment implications of recent moves higher in the dollar, crude oil and inflation. This month, we discuss the positive conditions for equities despite the extreme move in bond yields, the negative positioning in gold, and the counter intuitive bullish conditions for European equities. We raised U.S. equities to a bullish 5 rating. Foreign-developed and emerging markets equities remain bullish 5 ratings. Long-term bonds remain a neutral 3 rating. Gold remains a bullish 5 rating. Lastly, we cut industrial commodities to a bullish 4 rating.

October 20, 2023

Raising S&P 500 Rating to a Bullish 5: Goldilocks in Q4

In July with the S&P 500 up 19% YTD, investment conditions were neutral. Since then, there was a typical 3-month consolidation period when the S&P 500 declined 6.7% and the Russell 2000 declined 14.3%. Despite the daily headlines of war, recession and inflation, equity market conditions have shifted bullish once again. The historical combination of slow growth and neutral inflation outlook indicators resulted in an S&P 500 return of 16.6% vs. the norm of 10.5% since 1973. It is counter intuitive for most investors to view slower growth as a positive. In fact, it is the STRONG growth periods, historically, when equity returns turn negative, particularly if accompanied by rising inflation. Today is the opposite. Combine these bullish economic conditions with low investor positioning in the fourth quarter and you have strong historical odds of equity upside through year end. The spike in the 10-year yield is certainly an offset for now, holding equities back, but any reversal will act like a spring for equities to the upside.

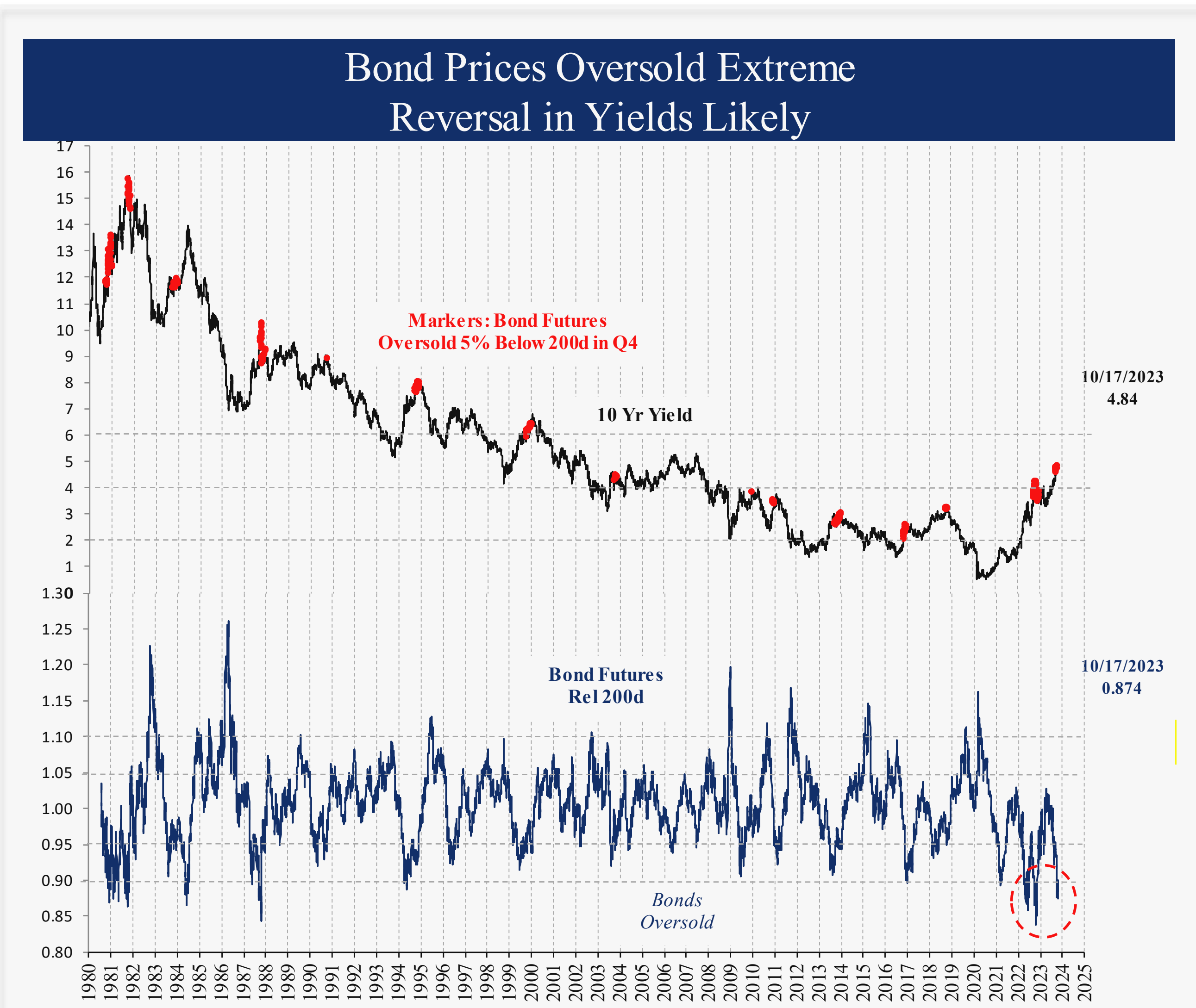


BRENTON POINT
WEALTH ADVISORS

October 20, 2023

Bonds Oversold Extreme: Bullish

U.S. Treasury yields are up a full 1% from 3.8% to 4.8% just since July. Bond futures have only been this weak less than 1% of the time back to 1980. When this type of weakness occurred in the fourth quarter, typically yields were close to a reversal. In this case more fundamental bond indicators like weak industrial metals and weak equity markets are pointing to lower yields, making a reversal in yields and rise in bond prices more likely.

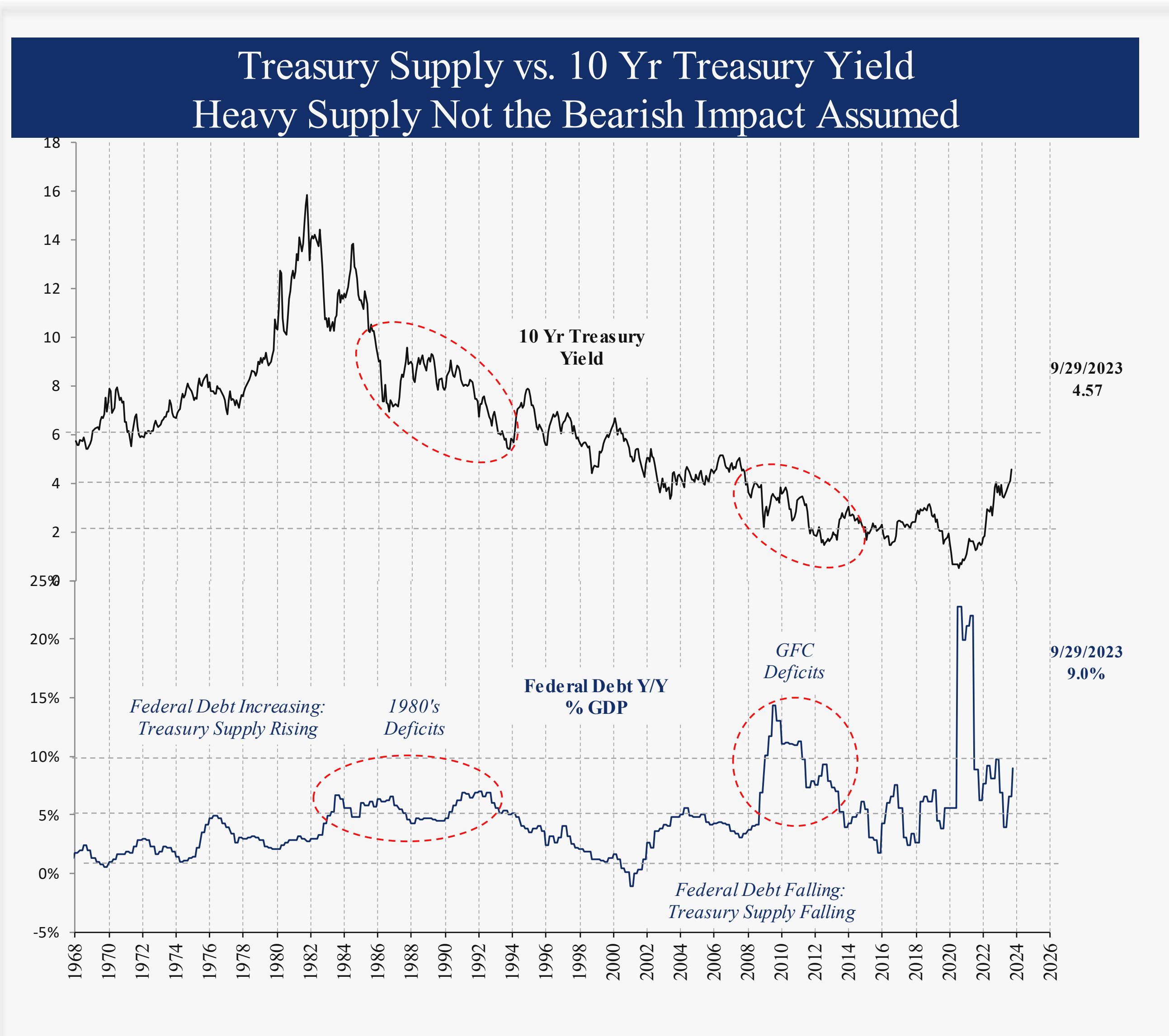


10/19/23

BRENTON POINT
WEALTH ADVISORS

October 20, 2023

Treasury Bond Supply: Not the Bearish Impact Assumed
One of the media stories explaining the move is Treasury issuance of bonds overwhelming demand. It sounds logical that an increase in supply of bonds will cause a lower price (and consequent higher yield). However, a look at history shows many cases of the opposite, when a large supply of government bonds like we saw during the 1980's deficits is often accompanied by falling interest rates. Higher bond supply during deficits in 2008-2010 was also accompanied by falling interest rates, so history does not support the case.



BRENTON POINT
WEALTH ADVISORS

October 20, 2023

S&P 500 up 10% in First Half: Bullish for Q4

It is no secret that stocks tend to rise in the fourth quarter (up 79% of the time since 1950). However, conditions are even better this year. In the 22 prior years since 1950 when the S&P 500 rallied over 10% in the first half (up 15.9% this year), Q3 often consolidated (as it did this year falling 3.7%) with an average return of just 1.5%. Q4 was even stronger than the norm, with an average return of 6.1%. 86% of cases were higher. The outlier was 1987 when the market crashed and finished the quarter off 23.2%. Conditions were different that year, including a 10-year yield reaching 10%, double this year.

S&P 500 Up 10% in First Half: Q3 Consolidation/Q4 Higher

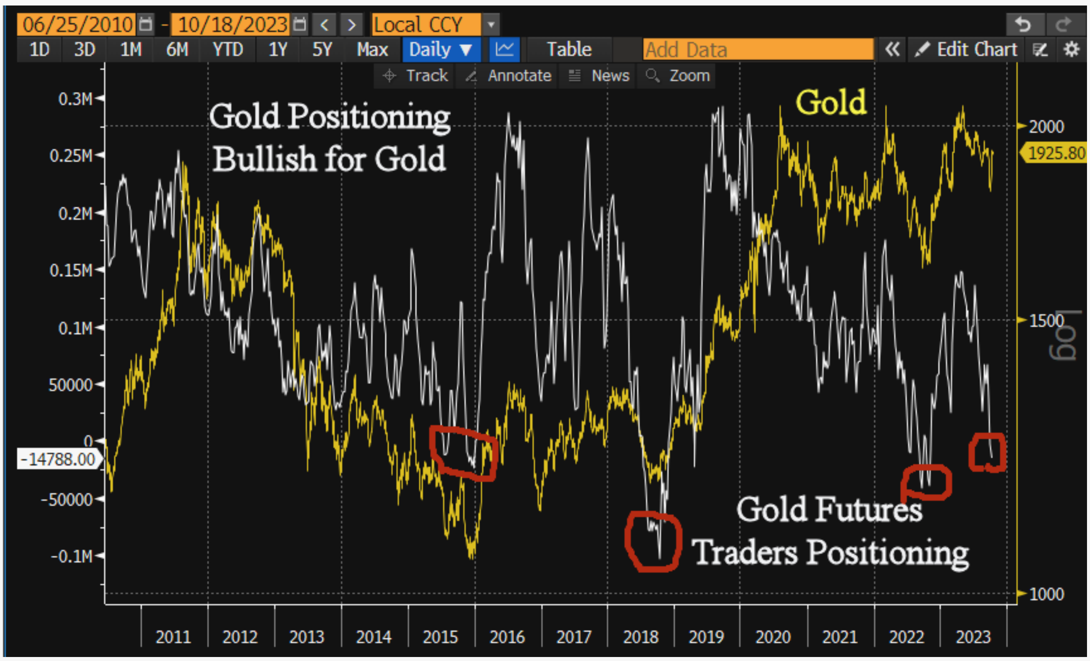
	Year	Jan-Jun	Q3	Q4
1.	1954	17.7%	10.6%	11.4%
2.	1955	14.0%	6.4%	4.1%
3.	1958	13.1%	10.7%	10.3%
4.	1961	11.2%	3.2%	7.2%
5.	1967	12.8%	6.7%	-0.2%
6.	1975	38.8%	-11.9%	7.5%
7.	1976	15.6%	0.9%	2.1%
8.	1983	19.5%	-1.2%	-0.7%
9.	1985	14.7%	-5.1%	16.0%
10.	1986	18.7%	-7.8%	4.7%
11.	1987	25.5%	5.9%	-23.2%
12.	1988	10.7%	-0.6%	2.1%
13.	1989	14.5%	9.8%	1.2%
14.	1991	12.4%	4.5%	7.5%
15.	1995	18.6%	7.3%	5.4%
16.	1997	19.5%	7.0%	2.4%
17.	1998	16.8%	-10.3%	20.9%
18.	1999	11.7%	-6.6%	14.5%
19.	2003	10.8%	2.2%	11.6%
20.	2013	12.6%	4.7%	9.9%
21.	2019	17.3%	1.2%	8.5%
22.	2021	14.4%	0.2%	10.6%
23.	2023	15.9%	-3.7%	
	Average		1.5%	6.1%
	Median		2.7%	7.4%
	% Up		65%	86%

BRENTON POINT
WEALTH ADVISORS

October 20, 2023

Gold Futures Traders Positioning: Bullish

The recent 13% decline in gold from May to October was followed by traders cutting positions. In the last 10 years positioning this low was followed by higher gold prices.



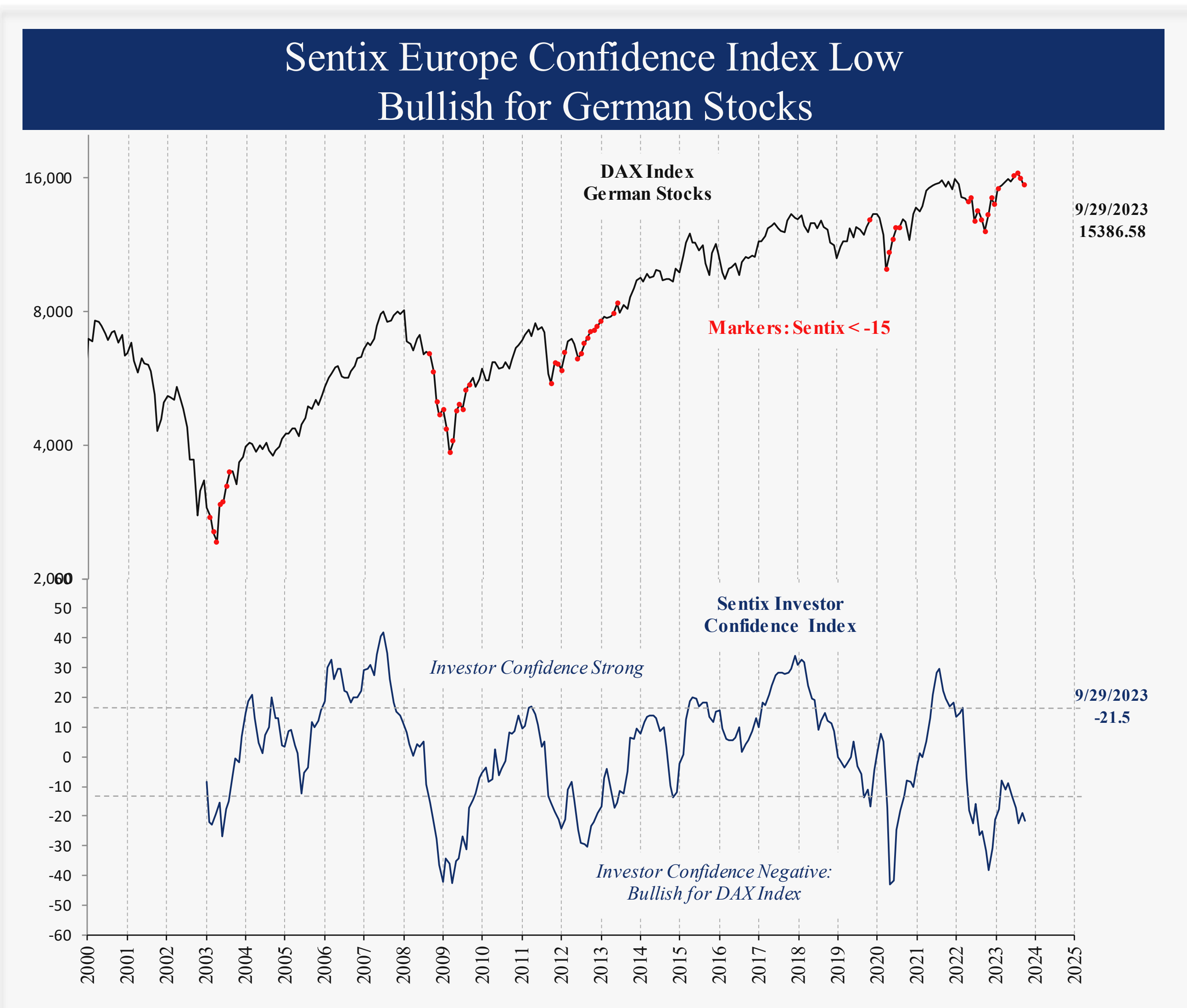
Treasury Yield Inversely Correlated to Gold Price

The 13% decline in gold from May to early October was accompanied by the large rise in the 10-Year Treasury Yield (inverted on this chart). A further rise in the 10-year yield would be negative for gold, but an oversold reversal in bonds, as we discussed, would be a big positive for gold prices.

October 20, 2023

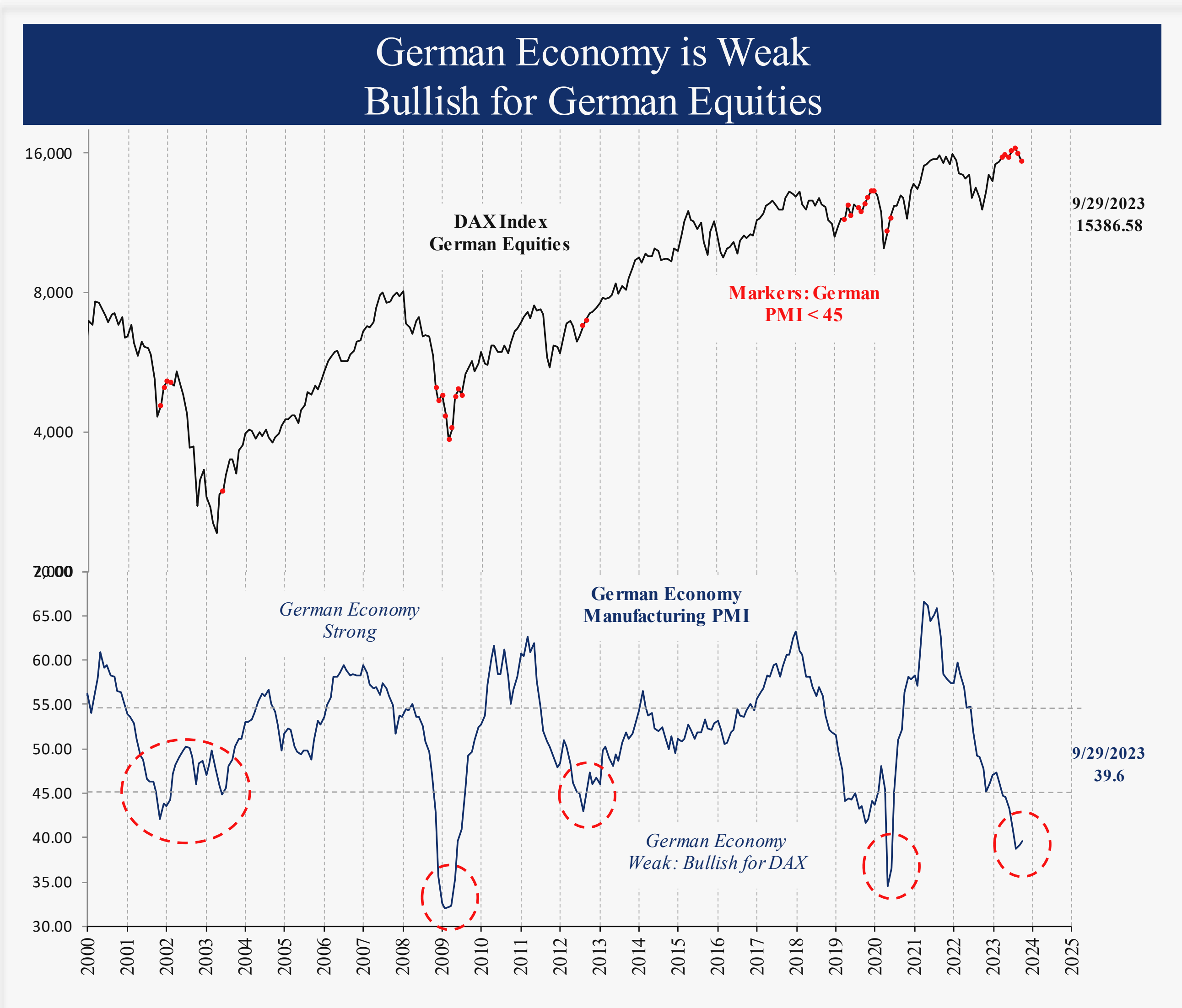
Weak European Economy and Investor Confidence: Bullish for Equities

By almost any measure, the European economy is weak. For instance, Germany's GDP was negative in 3 of the last 5 quarters since Russia invaded Ukraine. The September German manufacturing purchasing managers index was 39.6, weaker only during recessions in 2020 and 2008. The September Sentix European Investor Confidence Index was -21.5, in the bottom 20% of readings since inception. Following the weak economy and underperformance to the U.S., many investors have reduced their exposure to European equities. While logical, historical observations show that a weak economy and even low investor confidence was bullish for German equities like the DAX Index. For instance, when the German Purchasing Managers Index was below 47, the DAX returned 11.8%, over 2x the norm since 1998. Likewise, the DAX returned 24.9% since 2002 when the Sentix was below -15, over 3x the norm of 7.0% over that period. In other words, despite the pervasive investor gloom, equities rallied when faced with these economic conditions historically.



BRENTON POINT
WEALTH ADVISORS

October 20, 2023



Summary

This month we discussed the renewed bullish conditions for U.S. equities after a 3 month consolidation period, despite the heightened geopolitical risk from the Israel Hamas war. In addition to the economic conditions, low investor positioning in the fourth quarter further increase the odds of upside through year end. Similar conditions exist in Europe, with low investor confidence and a weak German PMI testing well for the DAX Index of German stocks. Gold remains a bullish 5 rating partly due to the low investor positioning there, as well, following the 13% decline from May to October. We will continue to watch our indicators on a daily basis and shift exposures as needed. Thank you for your support and please contact us with any questions.

Michael Schaus
Director of Market Research