December 27, 2023

Investing Environment Review and Outlook – Volume 78

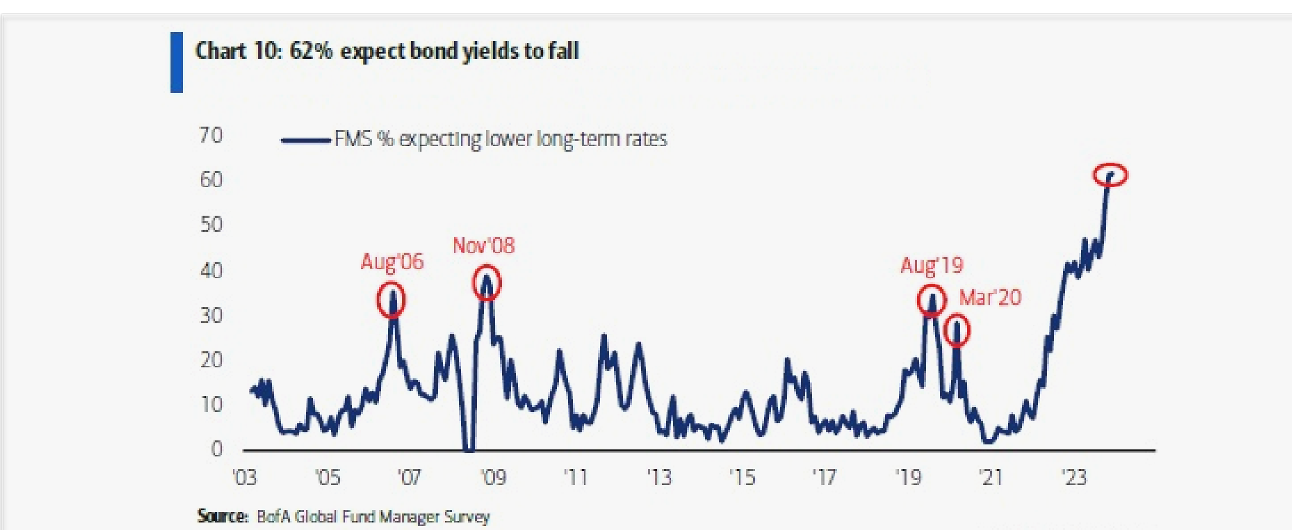
- 10-Year Yield Decline: Risk for Treasury Bonds
- Equity Investor Positioning Long
- Presidential Seasonality Turning Negative
- Crude Oil Positioning Extreme: Bullish

Last month we discussed the Q4 equity rally, the bullish Zweig Breadth Thrust and the turn in the 10-Year yield. Since then, the S&P 500 rallied further, and the 10-year Treasury bond yield continued its decline from the October peak. This month we discuss the implications for Treasury bond yields and the change in the presidential cycle seasonality. U.S. equities, foreign-developed and emerging markets equities remain bullish 5 ratings. Gold remains a bullish 5 rating and industrial commodities remain a bullish 4 rating. We cut long-term bonds to a bearish 2 rating.

10-Year Yield Decline to 3.9%: Risk for Treasury Bonds

At the 12/13 FOMC meeting, Fed Chair Jay Powell initiated the "Fed Pivot" by stating we are likely at or near a peak in rates for this cycle. This further extended an already extreme move in the 10-year Treasury yield from 5% in October to 3.9% on 12/22. At 3.9% the 10-year yield is low by historical standards, down to the 35th percentile of rates since 1950 and just 0.8% above the CPI inflation rate. However, the norm since 2008 of just 2.2% during the Fed QE period has resulted in extreme investor positioning in bonds as many investors believe rates are still high, despite the Fed regime shift in 2022 away from QE. According to the December BofA monthly survey, surprisingly more investors believe the 10-year yield will fall today than at the height of COVID in March 2020 or the Global Financial Crisis in November 2008 when economic conditions were extremely weak.

Finally, economic outlook indicators like base metals and even equity indices (S&P up 16% since October) are higher. Historically, such moves were followed by higher yields, particularly after such an extreme rate decline since October that is not justified by economic weakness. As a result, we are cutting our bond rating to a bearish 2.



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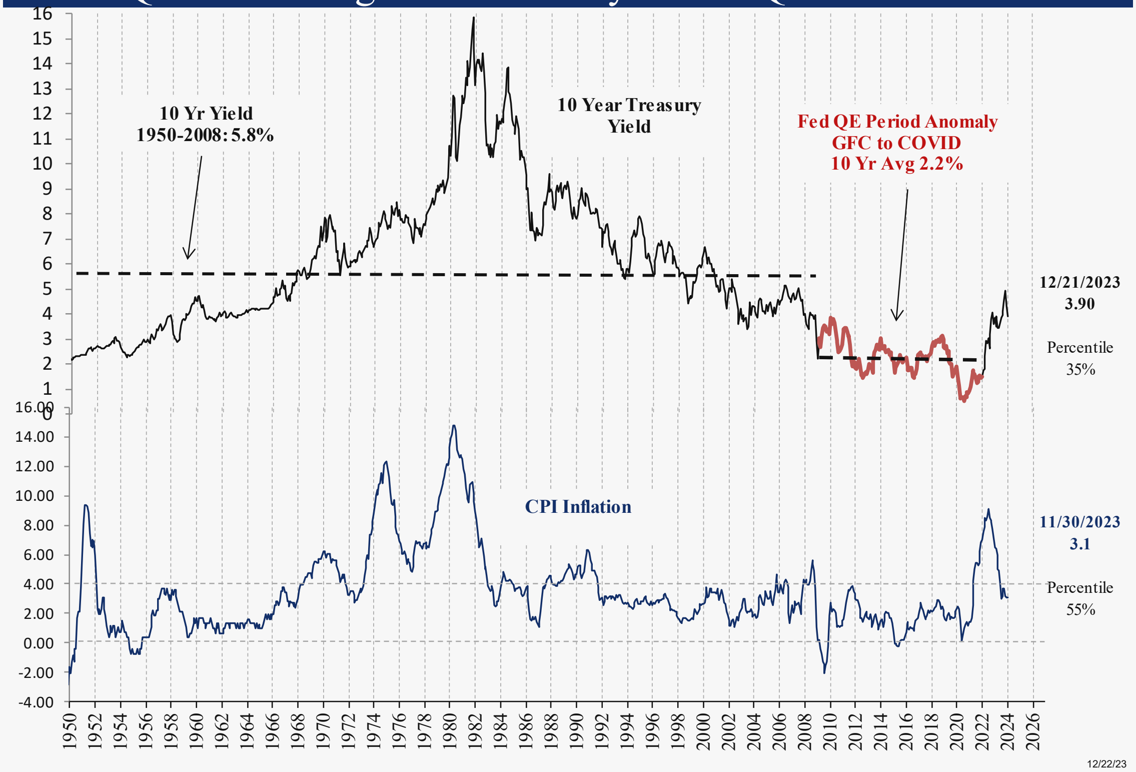
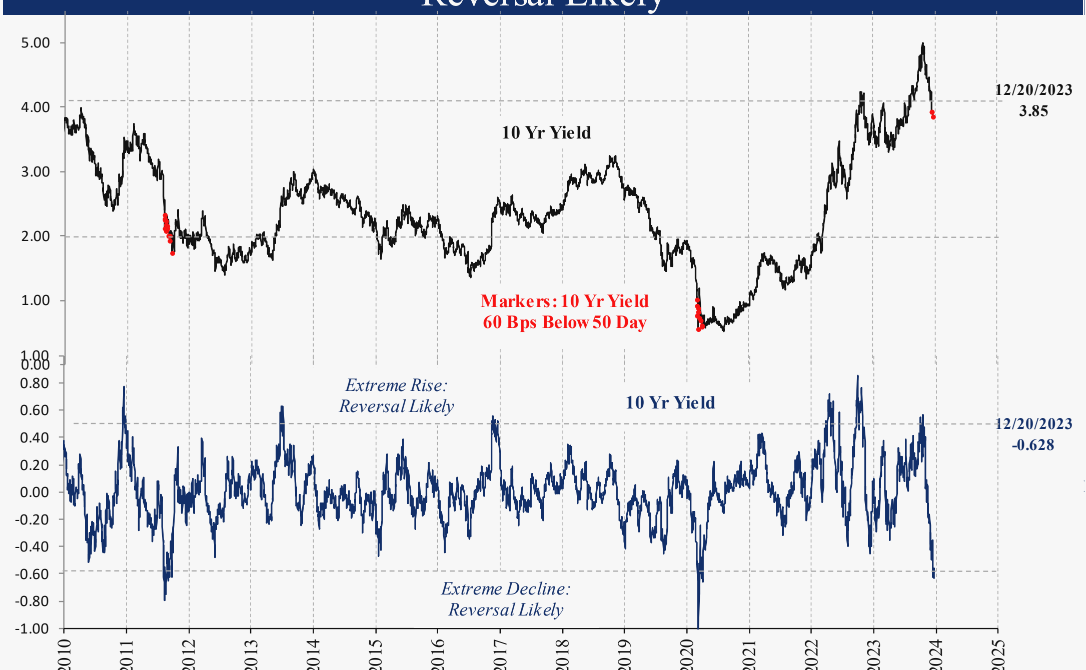
Investor Recency Bias with 10-Year Treasury Yield
QE Period Avg 2.2% Anomaly vs. Pre QE Norm 5.8%



10-Year Treasury Yield Move Extreme
Reversal Likely



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Equity Investor Positioning Long

The 16% S&P 500 rally since October 27th resulted in an expected reversal in investor positioning from the widespread pessimism in October. As of 12/20/23, 7 of 8 investor groups were above their norm and 5 of those were extreme. Despite the 14 month rally from the October 2022 low, institutions remain neutral, offering room for positioning to extend further to the upside before it becomes a significant negative for markets.

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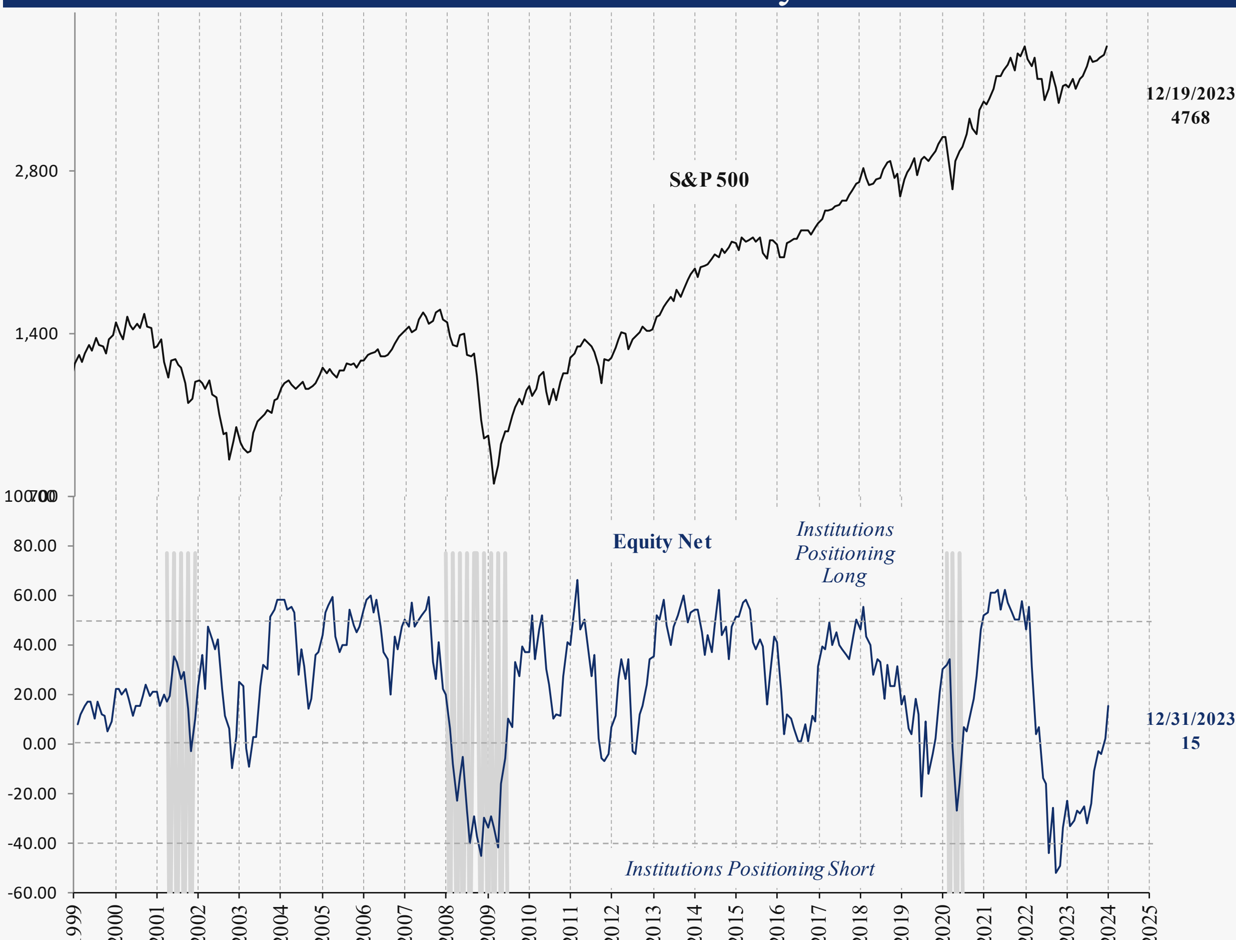
Institutions Positioning Neutral
December BofA Survey +15



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12/19/23

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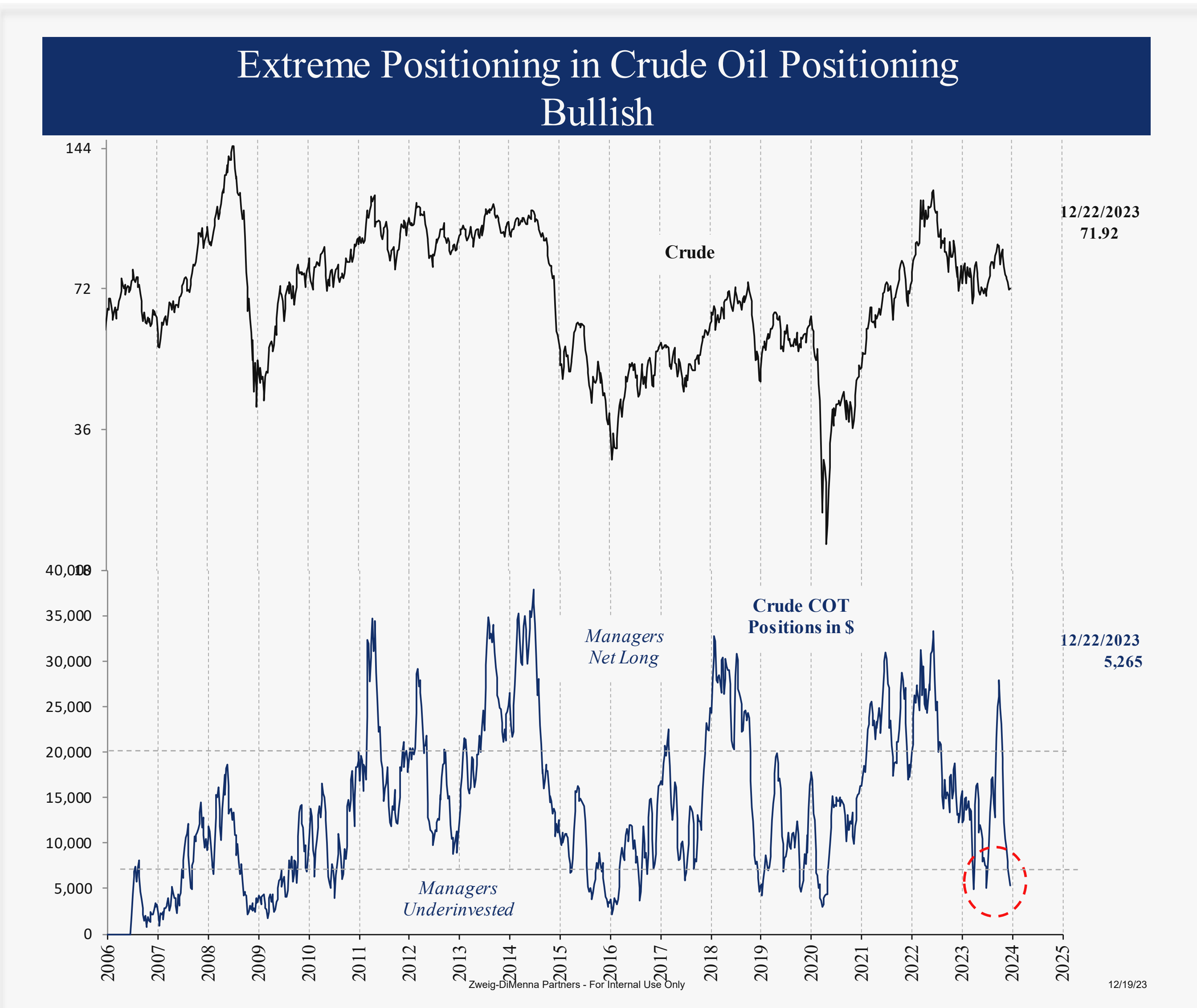
Crude Oil Positioning Extreme: Bullish

After the sharp crude oil decline to $70 from $90 in September, crude oil positioning is extremely low. In prior cases, low points in sentiment like this marked turning points in crude oil. In addition to positioning, seasonality is positive for crude, the economic outlook has improved to neutral and the dollar has reversed lower.



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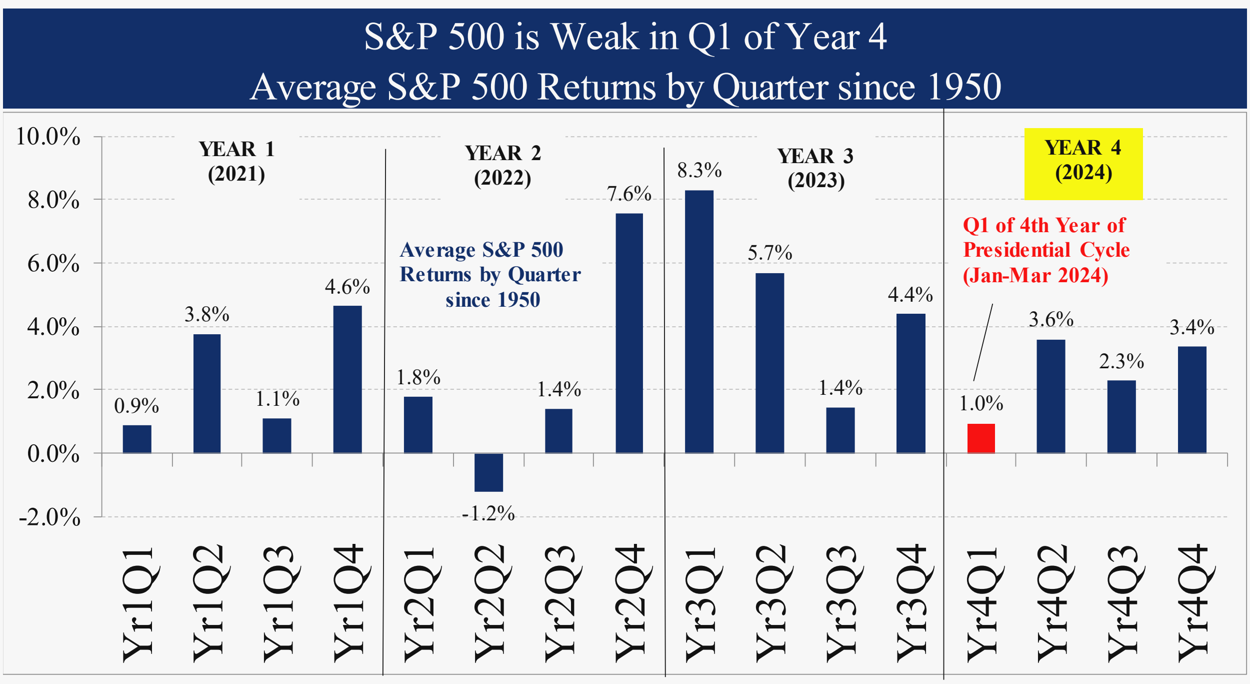
S&P 500 Weak in Q1 of Year 4

January marks the beginning of the last year of the presidential cycle. Since 1950, Q1 of year 4 was among the 3 worst quarters of the whole cycle, averaging just a 1.0% return. The worst cases included 2020 (-19.6%) and 2008 (-9.4%), however these were offset with the two best in 1976 (15.0%) and 2012 (12.6%). In Q1 just 61% of the cases were higher, compared to 89% of the years higher in Q4 of year 3.



Summary

This month we discussed the likely reversal in the 10-year yield after such a strong consensus move lower, the bullish positioning in equities and the bearish positioning in crude oil. Although the S&P 500 is overbought in the short term and we expect higher volatility in January, fundamental conditions like declining inflation, declining rates and the improving economic outlook were followed by further upside in equities historically. The Zweig Breadth Thrust also remains bullish. Finally, the weak dollar is bullish for foreign equities and commodities like crude, copper and gold. We will continue to watch our indicators on a daily basis and shift exposure targets as appropriate. Thank you for your support and please contact us with any questions.

Michael Schaus
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