BRENTON POINT
WEALTH ADVISORS

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Investing Environment Review and Outlook – Volume 79

- Treasury Bonds Short: Mixed Evidence
- Myth Busting: "A lot of Cash on the Sidelines"
- Hang Seng Index Slow Motion Collapse: Opportunity

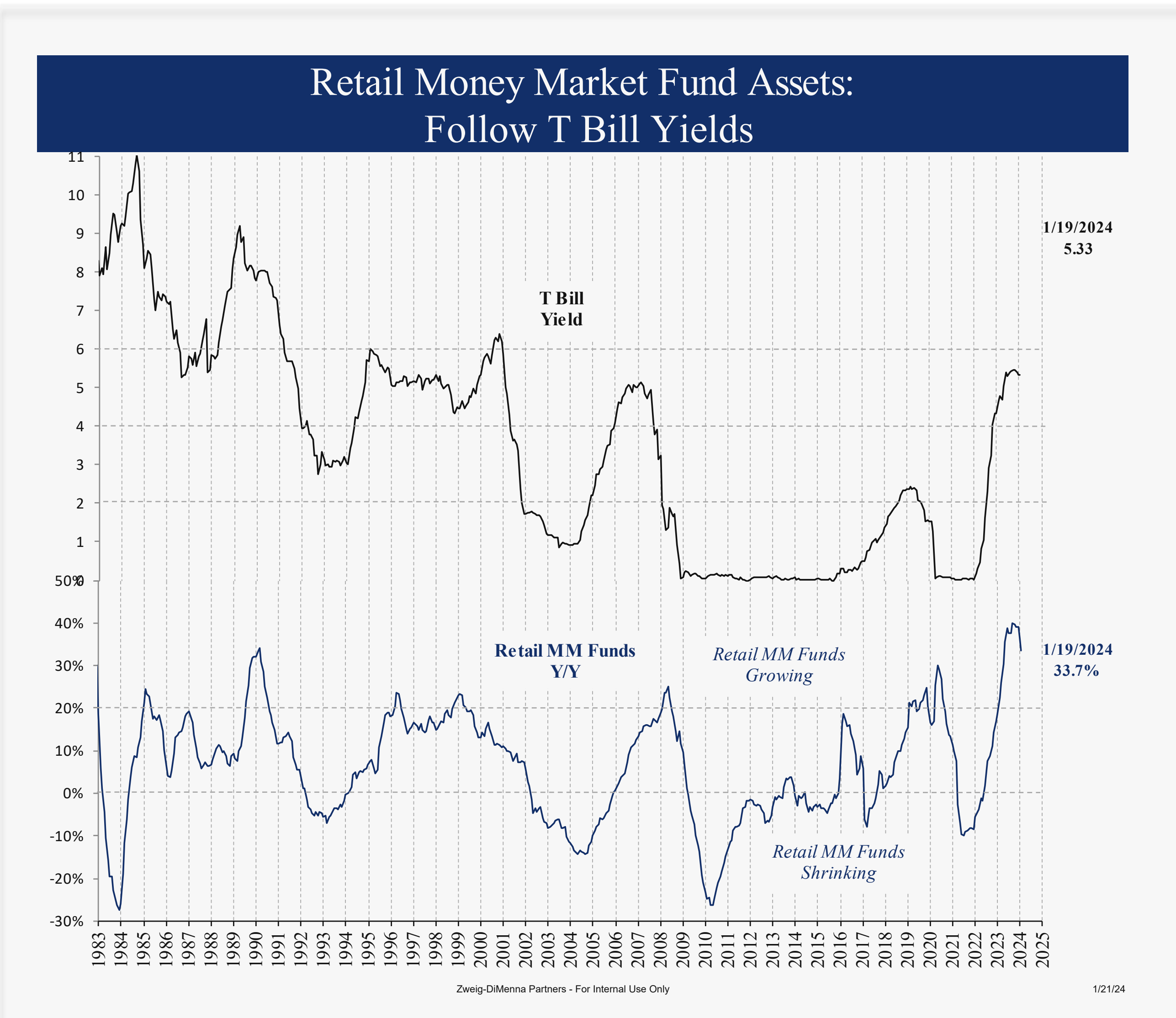
Last month we discussed the extreme move in bonds, the long equity investor positioning in equities compared to the short positioning in crude. This month we discuss Treasury bonds, the rise in money market fund assets and the Hang Seng Index collapse as an opportunity relating to the deeply out of favor emerging markets index. 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. Long term bonds remain a bearish 2 rating.

Treasury Bonds Short: Mixed Evidence

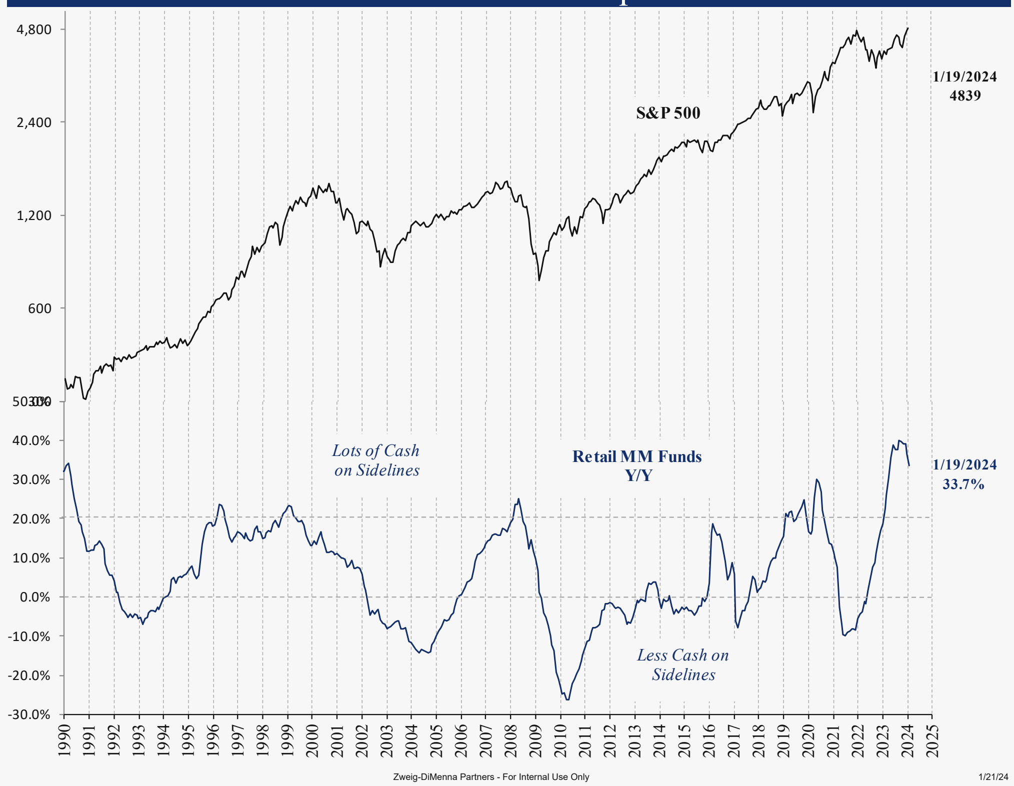
From the 12/27 low of 3.80%, the 10-year Treasury yield reversed higher by 30 bps to 4.12 on 1/19/24 as expectations for 2024 Fed cuts were walked back. Today conditions are more mixed for bonds, at least until economic signals firm up. For instance, the CRB industrials commodity index was up in December, but has since reversed lower. And a timely coincident economic indicator, the Philadelphia Fed Manufacturing Index, was flat in January. Finally, our economic outlook model remains neutral at 44. We will be watching leading economic indicators for confirmation of economic strength to support higher yields ahead. Short Treasury bonds remains a great opportunity since investor consensus is so strong for economic weakness and lower rates ahead.

Myth Busting: "A Lot of Cash on the Sidelines"

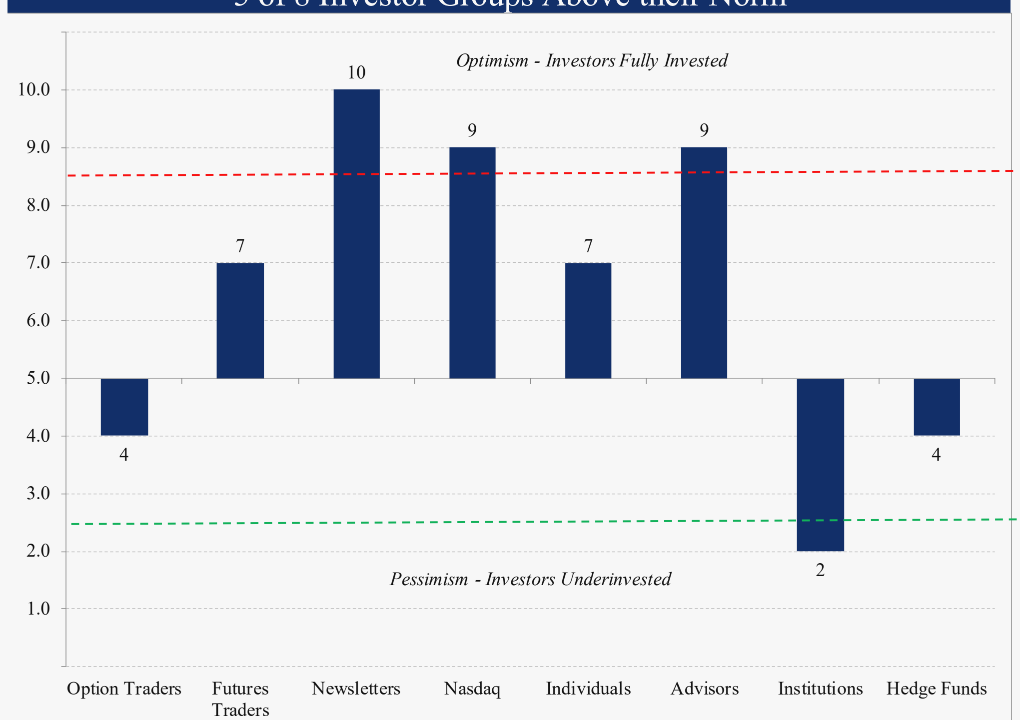
Retail money market fund assets have grown 33% over the last year, leading some bulls to declare a high level of cash on the sidelines. A close look at prior cycles since 1983 shows money market funds follow short-term interest rates rather than reflecting equity investor positioning. For example, when the Fed cut short-term interest rates to zero in 2020, money market assets declined by 10%, despite the fact that every sentiment measure showed low equity investor positioning. The same pattern occurred after the Fed cut rates in the 2008 Global Financial Crisis. In that case, money market fund assets declined even more by 20% in 2009. Our more comprehensive measures of investor activity show positioning is back to neutral today with just 5 of 8 investor groups above their norm. This was a shift down from the net long position we discussed in December. The implications of investor positioning for equity prices are usually not significant until extremes are reached.



Retail Money Market Funds Up: Not Predictive for Equities

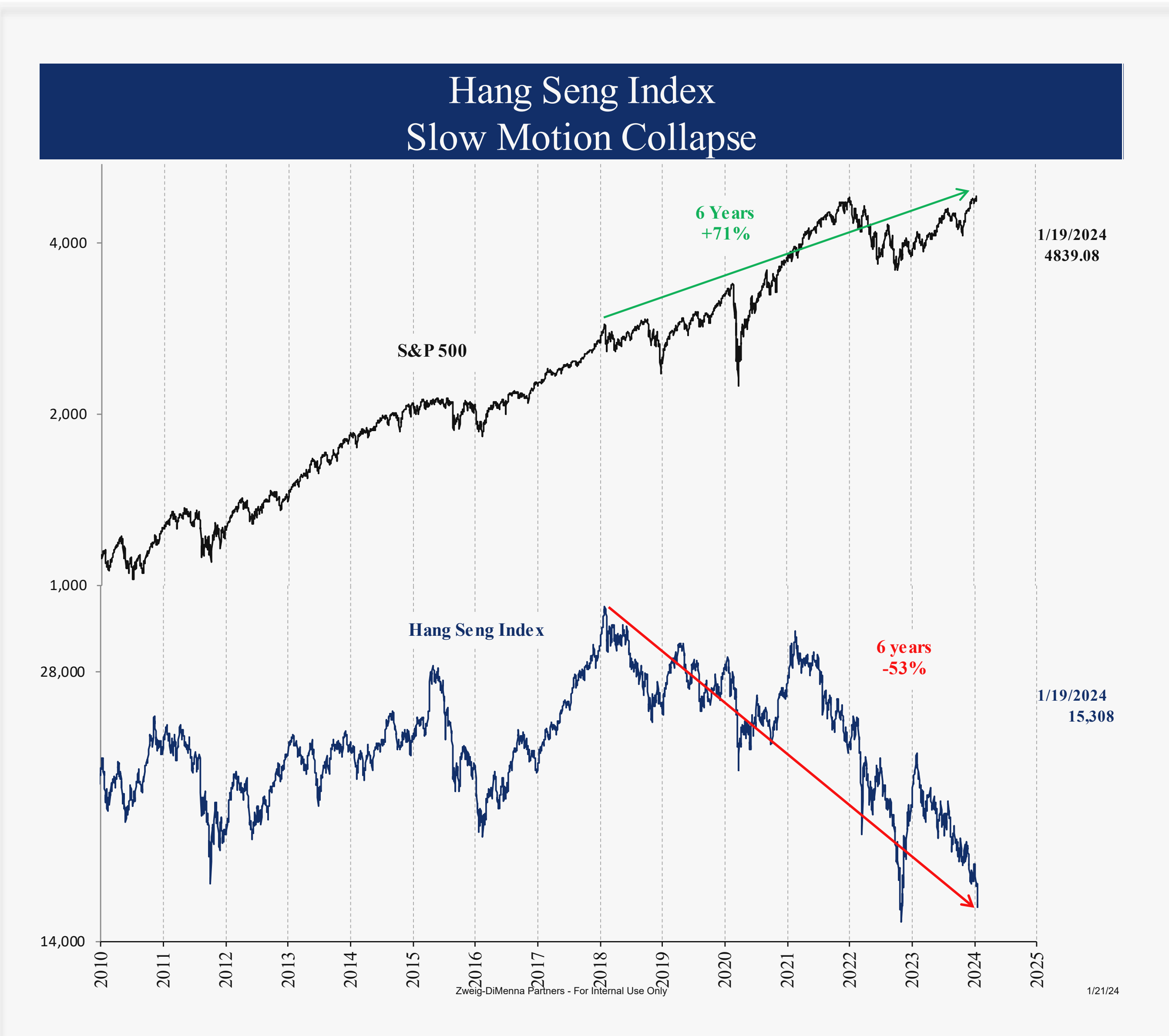


Equity Investor Positioning Neutral 5 of 8 Investor Groups Above their Norm



Hang Seng Index Slow Motion Collapse: Opportunity

Over the last 6 years the Hang Seng Index is down 53%. This is more incredible considering over that same period the S&P 500 is UP 71%. China's more diversified main stock index, the Shanghai Composite, was also negative but down just 18%. Japan's Nikkei Index was up 55% and India's Sensex index was up 110%, confirming the declines were due to China specifically, not Asia in general. The property, political and demographic issues which have been well covered by the press. With the help from a 23% allocation to China, the MSCI Emerging Markets Index is down 22% over the last 6 years. China, India, Taiwan, and South Korea make up 68% of the index.



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We have not found the divergence to be predictive for the U.S., but the heightened volatility of the Hang Seng Index may indicate capitulation and a potential turning point for emerging markets. The opportunity for patient contrarian investors is a combination of cheap valuations (Hang Seng Index at 8x earnings and the MSCI Emerging Markets Index at 14x compared to 23x for S&P 500), China monetary stimulus underway (Aggregate financing the strongest since COVID in 2020), and a near-term catalyst in the weak Dollar Index. The last two dollar declines in 2017 and 2020 were followed by 50% and 85% rallies in the MSCI Emerging Markets Index. Since the October 2022 dollar peak, the Emerging Markets Index is up just 6.5%.

Falling Dollar Bullish for Emerging Markets

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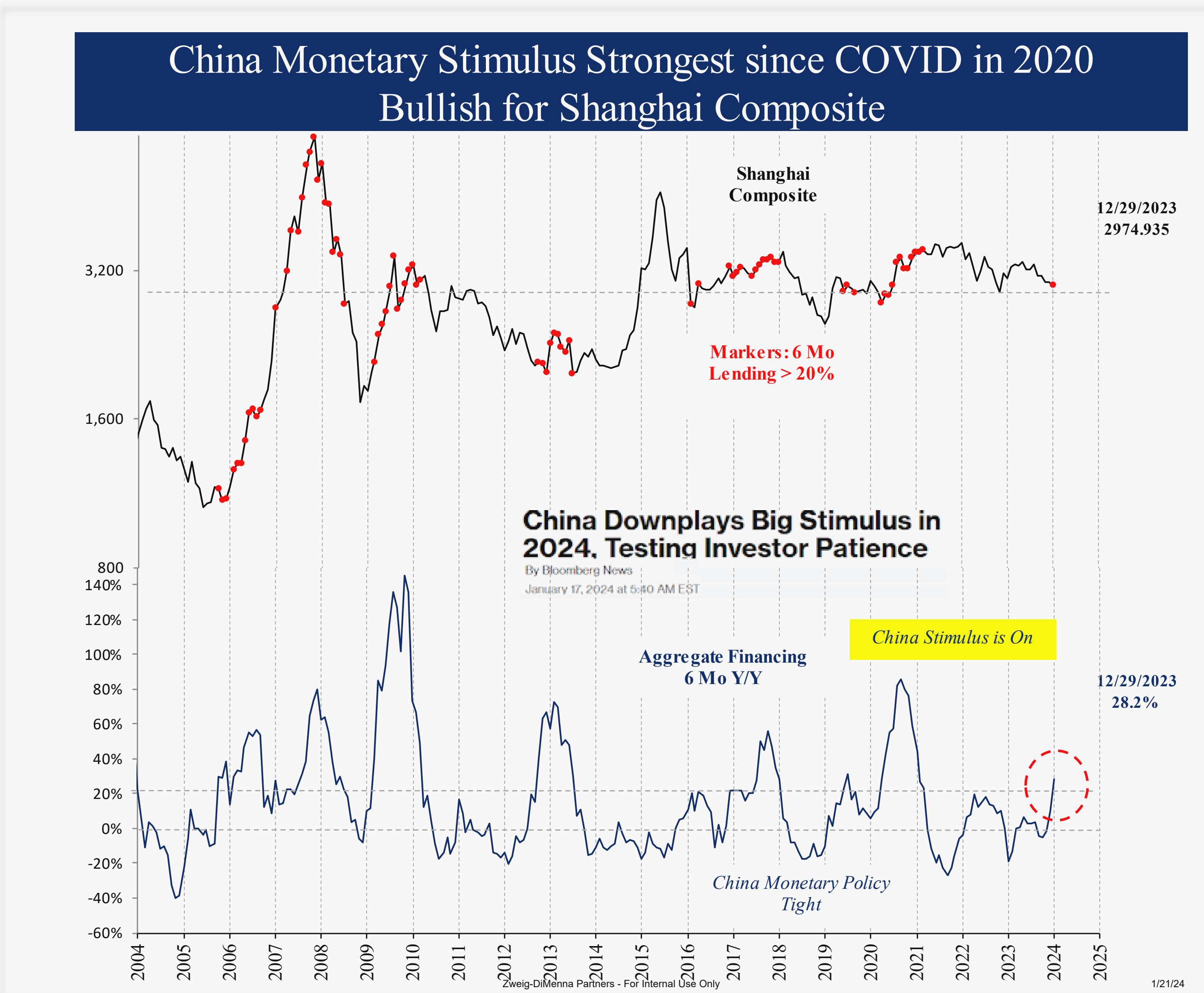

Summary

This month we discussed the Hang Seng Index collapse and how it presents an opportunity for emerging markets as an asset class. For patient and contrarian investors, the positives continue to line up including valuation, China's monetary stimulus and the declining Dollar Index. The conditions for a Treasury bond short remain from a contrarian perspective given the widespread investor consensus expecting lower rates on the long and short end of the yield curve. Further upside economic surprises will be needed for higher rates ahead. Conditions remain positive for equities both in the U.S. and abroad with Goldilocks conditions of moderate economic growth, falling inflation and a pause by central banks. We will continue to watch our indicators on a daily basis and shift exposure targets as needed. Thank you for your support and please contact us with any questions.

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