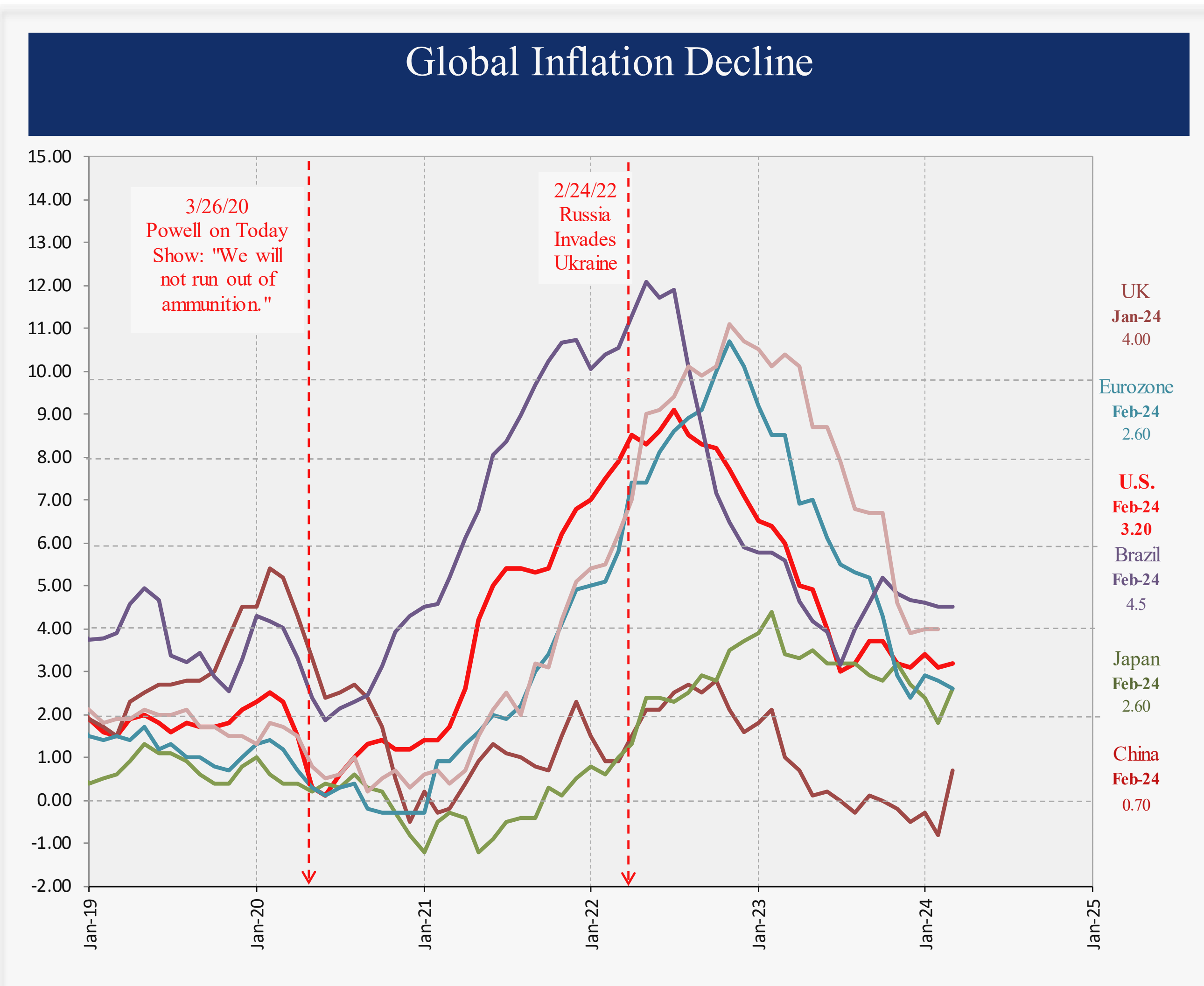
BRENTON POINT
WEALTH ADVISORS

March 21, 2024

Investing Environment Review and Outlook – Volume 81

- Industrial Commodities Up: Economy Strengthening
- High U.S. Equity Valuations: Mixed Implications
- S&P 500 Last 4 Months all Higher: Bullish

Last month we discussed the CPI inflation panic, stronger economic outlook indicators and the natural gas meltdown. This month we take a look at the further improvement in the economic outlook, high U.S. equity valuations and strong equity momentum. There are implications for bonds and equities, in particular. Investor equity positioning has increased. 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 max bearish 1 rating.



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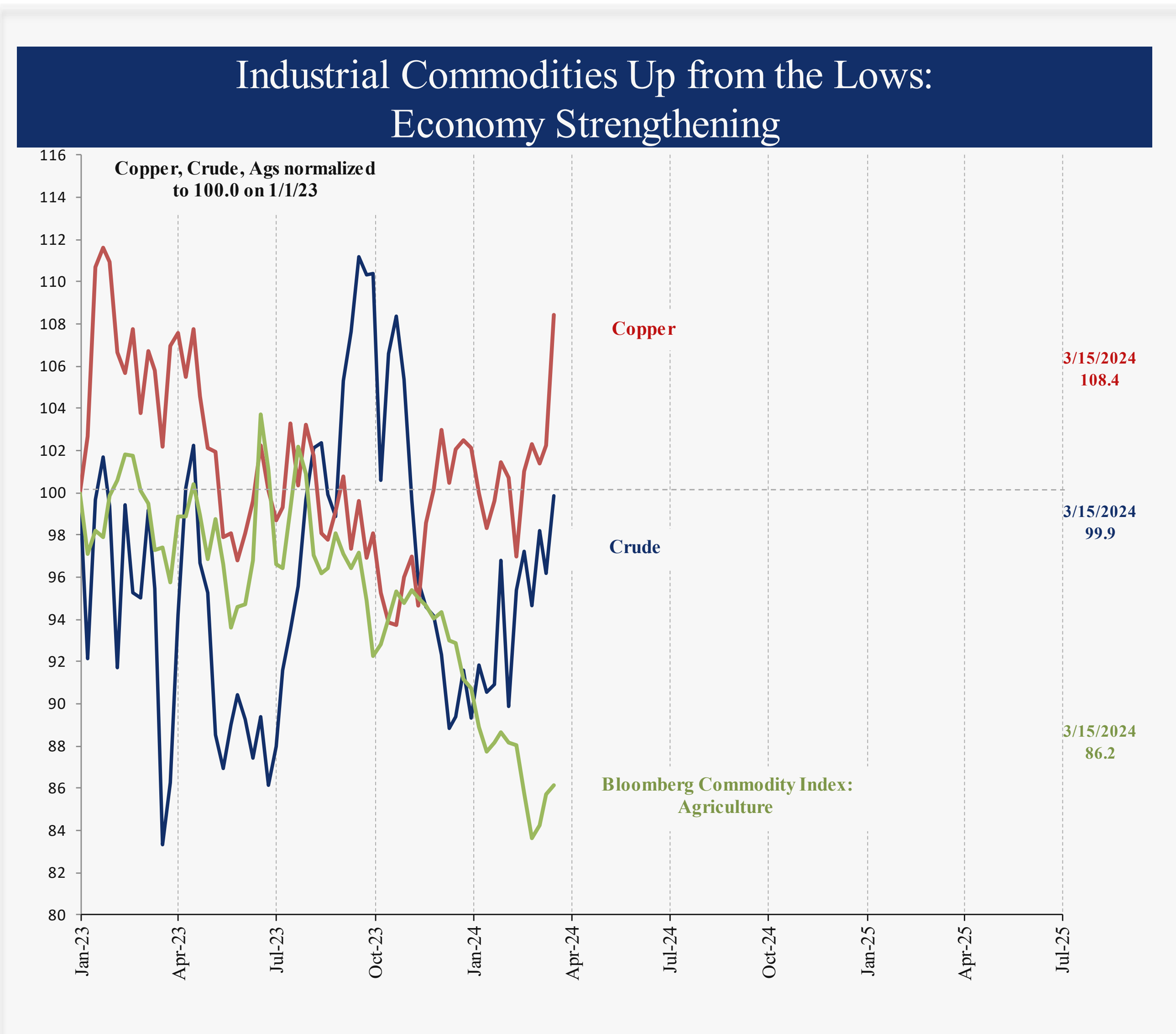
Industrial Commodities Up: Economy Strengthening

Industrial commodities like copper and crude oil are up from the lows in the last three months. As you can see, this is not yet a significant move since neither are even at the highs of the past year. However, these moves are consistent with our economic outlook model up as well to 57.3. Although still neutral, it is up from a recent low of 38 in December. This puts long-term bonds at risk with higher long-term rates likely. The Bloomberg Agriculture Commodity Index is down 14% YTD. Prices for food staples are generally more related to weather than economics, but their prices certainly affect inflation figures. Our inflation outlook indicators remain neutral as the CPI has remained in a 3.0-3.5% range for the last year.



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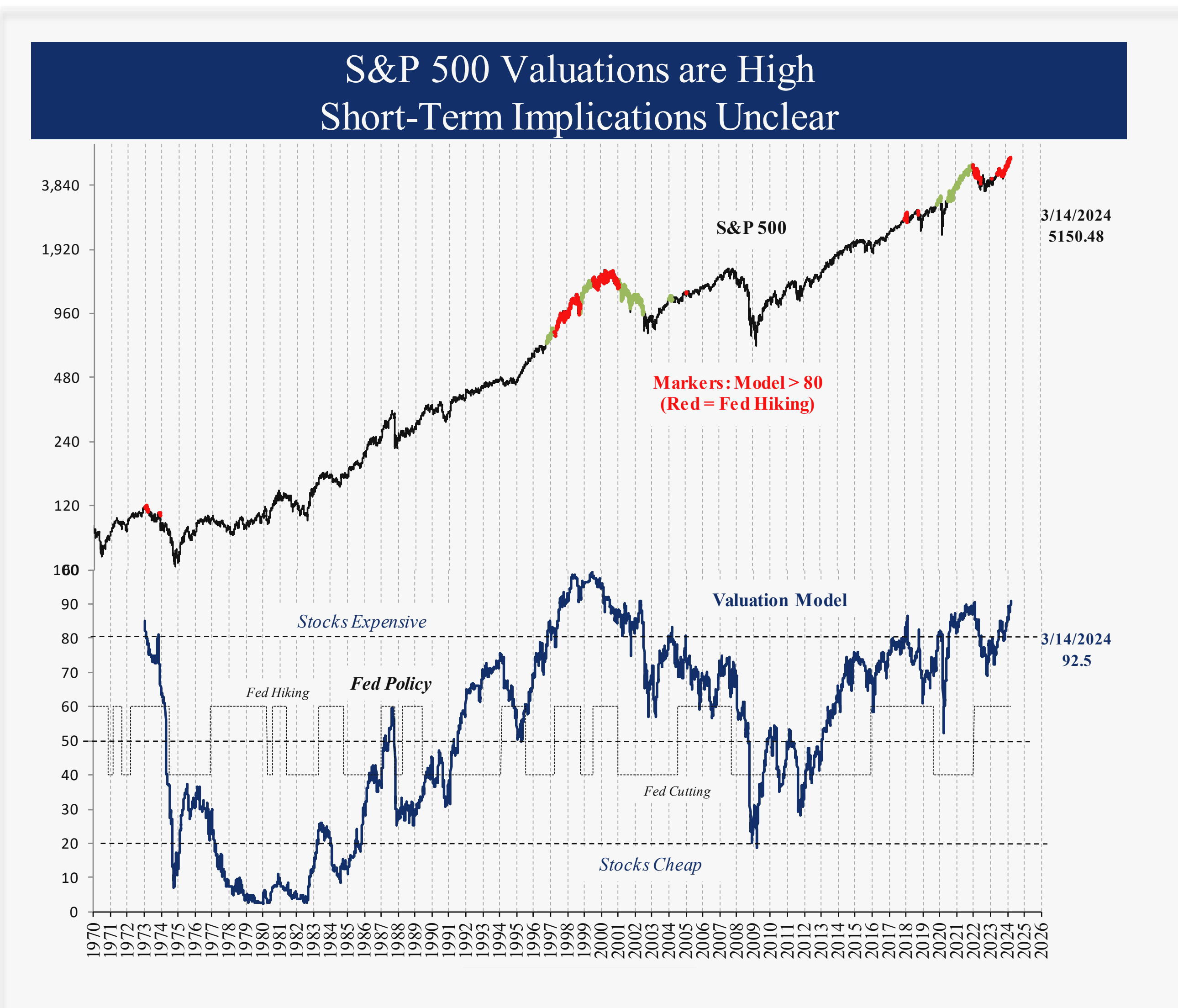
US Equity Valuations are High: Implications Mixed

U.S. equity valuations are high by most measures. The commonly cited S&P 500 price earnings ratio (P/E) at 24.4 was only higher in 2021 and 2000. This measure is not comparable historically since sector weights like technology (with high P/Es) and energy (with low P/Es) have changed dramatically over time. Our valuation model normalizes factors like P/E and price to book value (P/B) for each sector based on its own historical range. This allows for legitimate historical comparisons. The valuation model stands at 92.5, surpassing the 2021 peak valuation, making today the most expensive market in 22 years. While this seems like an obvious negative for equities, prior cases were mixed. For instance, it first reached 90 in July 1997, 2.5 years before the 2000 peak, and again in June 2021, 6 months before the 2022 peak.



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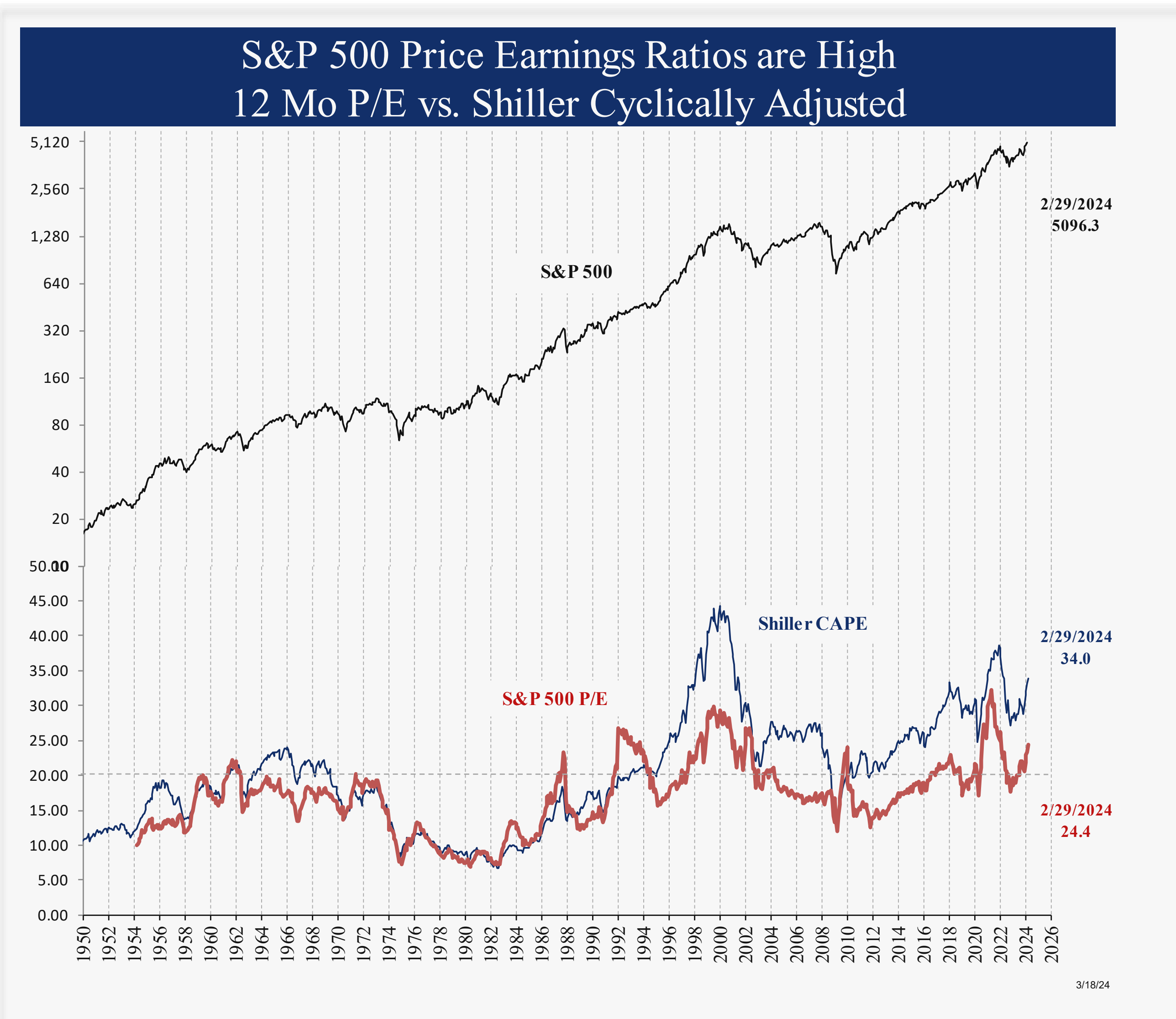
Although valuation is not predictive for short-term equity returns, the 5-10 year expected return for U.S. equities is certainly below the norm, because we cannot count on the contribution from multiple expansion as occurred since 2009. It makes the case for diversification to foreign (and cheaper) equities as well as other assets like commodities, bonds and currencies.



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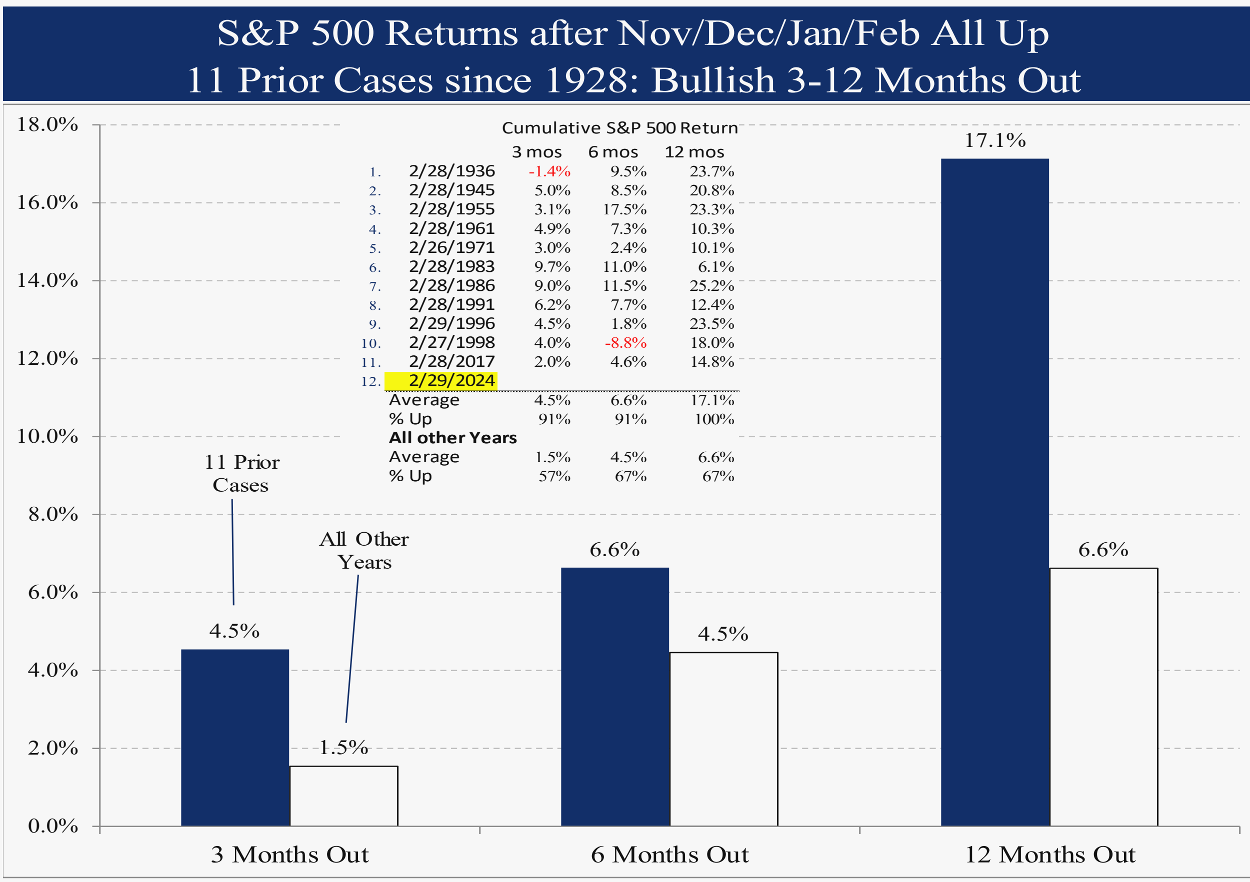
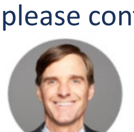
Last 4 Months All Up for S&P 500: Bullish

The S&P 500 was up in each of the last 4 months in November through February. This only occurred 11 times since 1928 (12% of the time). In this case, "the trend is your friend," as one of our firm's founders, Marty Zweig, used to say. 3, 6 and 12 months later, the S&P 500 was up an average of 4.5%, 6.6% and 17.1%. The norm for all other years was just 1.5%, 4.5% and 6.6% respectively. Probabilities were quite strong as well with just one case down 3 and 6 months out. No cases were lower 12 months out compared to 33% lower in all other years.



Summary

This month we discussed further improvement in our economic outlook indicators, and the bullish implications of strong momentum for the S&P 500. We are watching closely for warning signs like excessive investor positioning or a rise in inflation outlook indicators. Extreme U.S. equity valuation is a meaningful negative for long-term U.S. equity returns, which makes the case for diversification outside the U.S. and across other asset classes like (short) bonds, commodities and currencies. 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.



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