BRENTON POINT
WEALTH ADVISORS

October 8, 2018

Investing Environment Review and Outlook – Volume 19

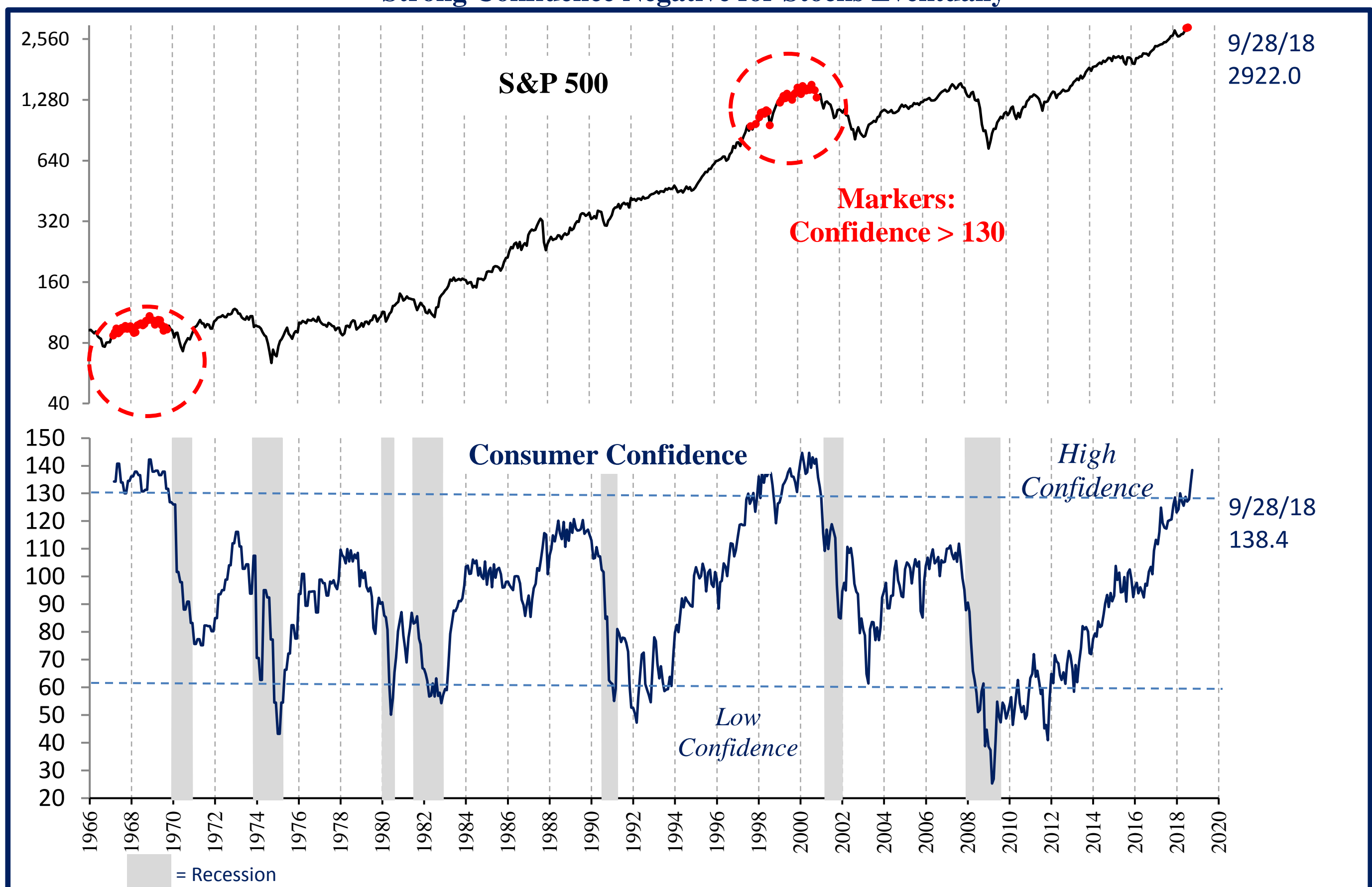
Consumer Confidence Rises to Extreme

The September Conference Board Consumer Confidence Index rose to 138.4, the highest reading since September 2000, and in the top 2% of historical readings since 1967. In addition, strong confidence today is not limited to consumers. Other surveys show the same for business executives, purchasing managers and bank lending officers. Even the Fed Chairman Jerome Powell, in his 9/26 press conference declared, "Our economy is strong. Growth is running at a healthy clip."

Strong confidence is a normal consequence of a sustained economic expansion and equity bull market, as the memory of the prior recession fades and people extrapolate current conditions into the future. The two prior periods of extreme confidence from 1967-1969, and 1998-2000 were also preceded by long economic expansions and bull markets. It confirms we are in the boom phase of the economic cycle. But more importantly, what are the implications for investment assets?

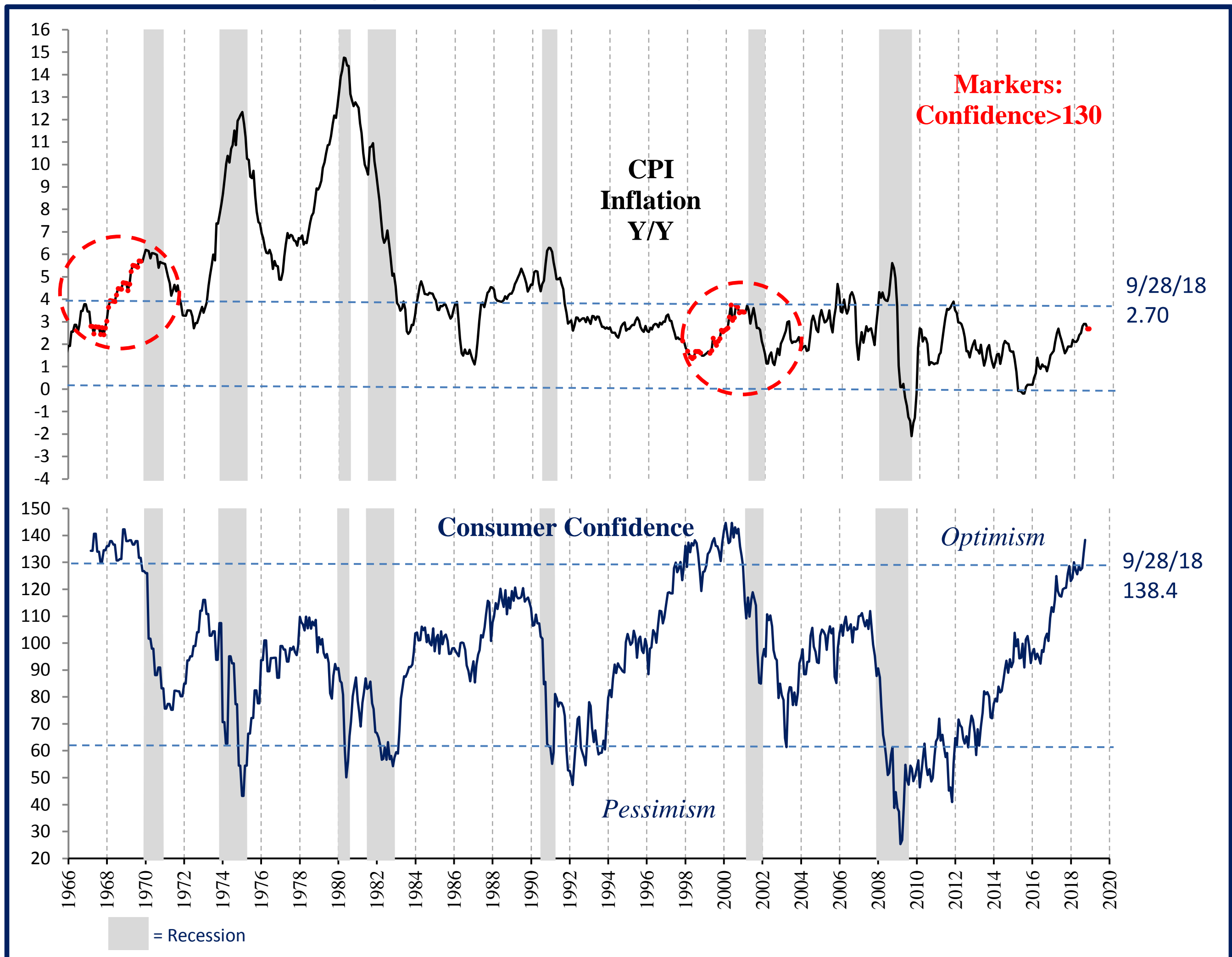
Stocks: Depends on other conditions

The last time confidence was this high was September 2000, the peak of that bull market. This sounds ominous for stocks, but consider confidence first reached that level over two years prior in June 1998. The other case of extreme confidence was 2 years prior to the bull market peak in 1969. This one also followed a long economic expansion and bull market in equities. Strong confidence is actually a positive for stocks in the near term. For instance, in Q4 on average, stocks returned 3x the norm when confidence was strong (29.5% return, 87% probability higher).



Inflation: Higher

CPI inflation went higher in both prior cases, rising from 2.4% to 5.7% in the 1967 case, and from 1.6% to 3.7% in the 2000 case. As people are more confident, they become more willing to pay higher prices for goods and services they want. Businesses begin to pay up for more inventory, since they now see that the risk of running low on inventory is higher than the risk of excess inventory. A 2-3% inflation increase would be a surprise to markets today given the low expectations. Additionally, gold would benefit since the inflation rate would be even further above the Fed Funds rate.



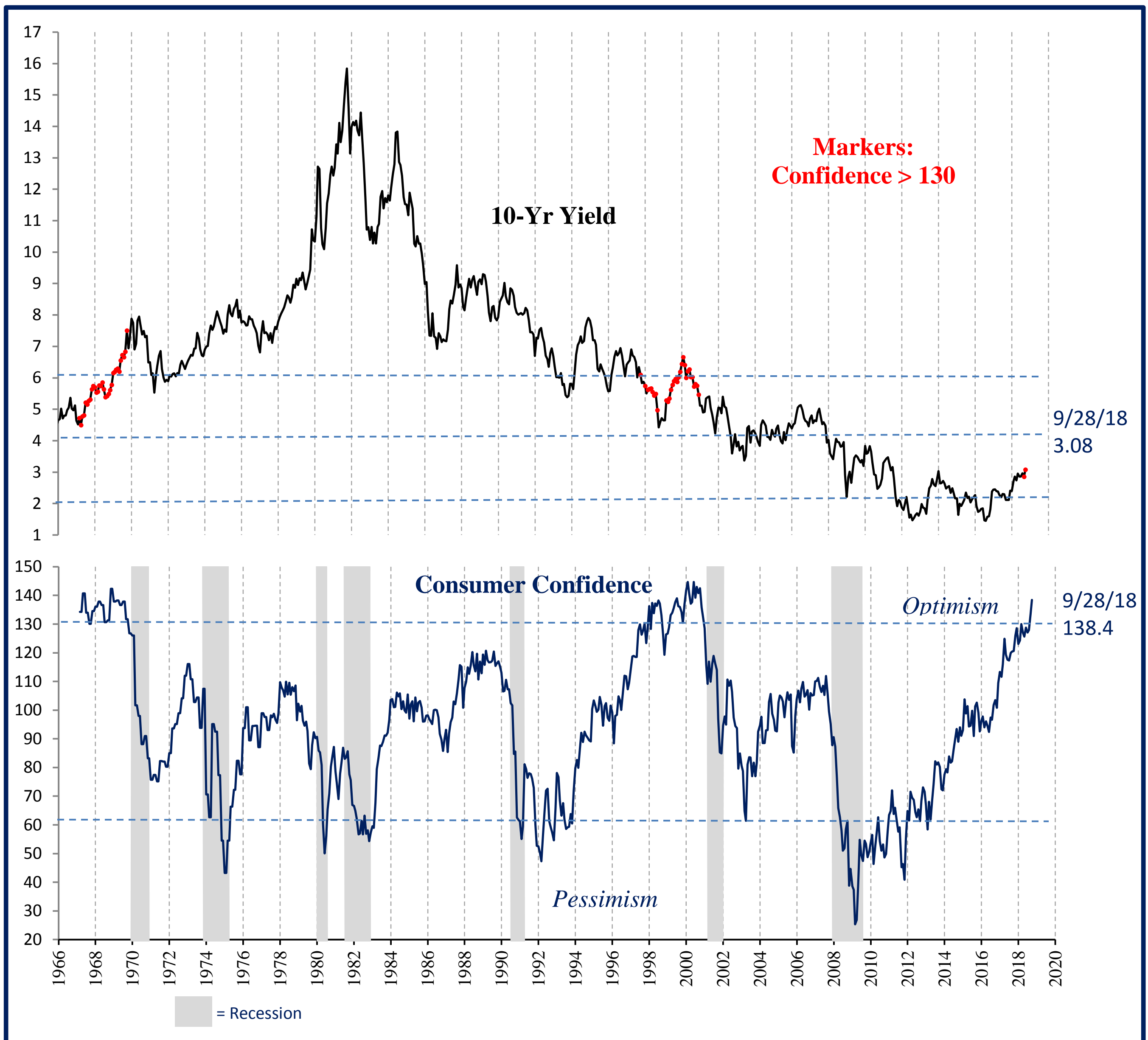
BRENTON POINT
WEALTH ADVISORS

October 8, 2018

10 Year Government Rates: Higher

The 10-Year Treasury yield rose from 4.5% to 7.5% in the 1967 case and from 4.6% to 6.7% in the 2000 case. These are consistent with the inflation rise. Again, a 2-3% rise in yields would be a big surprise for the economy and bond holders.

Strong Confidence followed by Higher 10-Year Yield: 1966 -



BRENTON POINT
WEALTH ADVISORS

October 8, 2018

Economy: Not predictive

Prior cases of high confidence were not predictive for the next move in the economy. It confirms that historically confidence is a lagging economic indicator, reflecting what the economy has already done rather than what it will do next.

Although we expect higher inflation ahead, the outlook for equities remains a 5 (bullish) rating with the combination of a strong economy and neutral ISM inflation. In addition, the seasonality of equity returns in the fourth quarter are strong, particularly when volatility is low as it is today. The equity sentiment indicators are back to neutral after the recent decline in early October. Despite the 12% decline in gold from the January peak, our rating remains a 5 (bullish). Weak emerging markets and the strong dollar have been headwinds, but similar gold declines in Q3 were bullish historically. In addition, the Fed Funds rate below the inflation rate lead to higher gold prices historically. In other words, while inflation is higher than Fed Funds rate, gold returns are strong. Finally, gold sentiment has reached extreme pessimistic levels, indicating futures speculators are short as a group. Prior cases marked turning points for gold. Bonds and commodities remain a 3 (neutral) rating. A decline in the dollar may mark the resumption of higher commodity prices.

Michael Schaus
Director of Market Research