BRENTON POINT
WEALTH ADVISORS

March 8, 2019

Investing Environment Review and Outlook – Volume 24

Our equity rating remains a bullish 5, with most conditions unchanged during February. Moderate economic growth, strong stock market performance, mixed investor sentiment, falling inflation, and a neutral Fed were bullish conditions for stocks historically. We remain in the Boom phase of the economic cycle due to strong consumer confidence and rising commodities, although some elements of the Goldilocks phase like falling inflation and investor pessimism are an added positive for stocks.

Reducing Long-Term Bond Rating to Bearish 2: Improving Economic Outlook and Higher Long-Term Rates Ahead

We reduced the Long-Term Bond rating to a bearish 2 based on a sharp improvement in our economic outlook indicators to 51 from 25 in December (chart 1). Central banks are fueling the fire by providing liquidity around the world. The Fed is neutral, the Bank of Japan and European Central Bank have pegged their long-term rates close to zero, and now total credit issued in China, a potent leading economic indicator, turned higher in January. As is typical, this follows China's four reserve requirement cuts from 17% to 13.5% in the last year. Commodity prices, like copper and crude, are also confirming accelerating economic growth with moves to the upside, and the U.S. 10-year yield is also on the move, from 2.54 in January, to 2.73 in early March. Global stock markets are strong as well, including an 18% rally in the S&P 500 and a 21% rally in the Shanghai Composite. Finally, uncertainty from political issues like Brexit and the trade war with China are likely creating pent-up demand as we saw before the 2016 election. With so much focus on the downside risks, any resolution will likely be followed by a stronger economy and higher long-term rates.

Despite the lower rating, bonds remain a key piece of any portfolio for risk control through diversification. Of the three benefits bonds offer investors: capital gains, interest income, and portfolio stability through low correlation with stocks, the last two apply regardless of the direction of interest rates. A smaller allocation to, or shorter maturity of bonds, are ways to lower the risk from rising interest rates but still capture these benefits.

This review and outlook report by Brenton Point Wealth Advisors LLC represents our views and beliefs regarding the current market outlook. Please also read the important disclosures at the end of this report.

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Persistent Rebound Rallies: Bullish for Equities

Last month we discussed the bullish implications when the S&P 500 was up 8% in January historically. In a related study this month, we look at the implications of this year's persistent equity rally since December (chart 2).

From the December 24th low to February 15th, the S&P 500 rallied 18% (chart 3). Although 18% rallies are not unusual, there were only 9 prior cases of persistent rebounds like this year since 1950. We define rebounds as a rally from below the 200-day average, and persistence as no 3% or greater decline along the way. This year the rally started from 14% below the 200-day average and the biggest correction was just -2.5% in January. The consensus reaction to the rally has been to cut back equity exposure after such a big move, since the market is "due" for a correction. However, the results from the 9 prior cases since 1950 show otherwise.

For instance, 3 months later, the S&P was higher in all prior cases by an average of 8.1%, 3x the buy and hold norm. 6 months out, all the cases were higher by 13.9% and 1 year out, all were higher an average of 20.8%. Within 3 months, the worst declines averaged just -1.5%, compared to an average gain of 9.7% for the best rallies. In other words, prior persistent rebounds continued higher up to a year later with very little downside volatility.

I can only speculate on why this happens, but we know the extreme negative sentiment we saw in December meant investors mistakenly cut their equity exposure back, and it may take up to a year to get reinvested. In the meantime, even small declines are met with buyers looking to add exposure.

Chart 2: S&P 500 Returns after Persistent Rebounds

18% Rallies from below 200-Day Average without a 3% decline.

	Date	S&P 500 Returns 3M Later	6M Later	1 Yr. Later	3 Months Out Worst	Best	Next Move
1.	01/30/61	6.0	9.4	13.3	-1.2	8.3	Up
2.	01/03/63	8.1	12.0	22.3	0.0	8.1	Up
3.	02/29/72	3.5	5.3	7.8	-1.2	4.6	Up
4.	01/29/75	14.3	17.5	35.2	-1.3	14.1	Up
5.	07/07/80	12.8	19.6	15.1	-1.1	12.8	Up
6.	09/03/82	14.6	28.6	41.1	-1.4	17.8	Up
7.	02/11/91	3.0	7.0	15.9	-1.4	6.5	Up
8.	11/05/98*	9.7	19.4	22.4	-1.4	13.2	Up
9.	06/16/03	0.8	6.6	13.9	-4.3	2.5	Up
10.	02/15/19*						
Average of Above Periods		8.1	13.9	20.8	-1.5	9.7	
Average Return (1950 - 2019)		2.7	5.5	11.1			
Difference:		**5.4**	**8.4**	**9.7**			

* See chart 3

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Chart 3: Comparable S&P 500 Periods: 7/1/98 – 7/1/99 vs. 3/6/18 – 3/6/19

Our equity rating remains a bullish 5. Due to the improvement in the economic outlook indicators, we cut the long-term bond rating to a bearish 2 with the expectation that long-term rates will rise. Commodities remain a bullish 4 and gold a bullish 5 despite negative seasonality in the first half of March. Please contact me or your advisor with any questions.

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