BRENTON POINT
WEALTH ADVISORS

April 8, 2019

Investing Environment Review and Outlook – Volume 25

Reducing Long-Term Bond Rating to Bearish 1: Strong Economic Outlook

We cut the Long-Term Bond rating this month to a bearish 1 from a 2 based on the continued sharp improvement in our economic outlook indicators to 62 from 50 in March, and 25 in December.

Consensus Negative

As we noted last month, consensus economic expectations were already negative due to the Q4 stock market decline, persistent headlines about the China trade war, and Brexit uncertainty. Confirming these worries, on March 20th the Fed indicated no further hikes this year. In response, investors bought bonds, driving the 10-year yield down 0.30% to 2.41%, below the 3-month T-Bill rate for the first time since 2007. This yield curve inversion pushed economic expectations even lower due to recession headlines. As the FT reported, “there is deep anxiety about the health of the global economy.”

However, our economic outlook indicators show otherwise (chart 1). For instance, the yield curve inversion is indeed generally negative for the economy, but it has since reversed course after just two days. More importantly, our economic outlook indicators improved, predicting a stronger economy ahead. This change is driven by higher stock prices and commodity prices, both of which are effective leading economic indicators. For instance, from the December low, the S&P 500 is up 22% and China’s Shanghai Composite Index is up 31%. Over the same period, crude oil is up 46%. In prior cases when the economic outlook indicators were this strong, long term bond prices declined as 10-year yields moved higher, often before the economy itself improved.

If the economy is near a turning point, the sharp drop in bond yields seems confusing. Our research identified two similar cases, and they marked turning points for bond yields with a 1.35% move higher in 2003 and 1.70% in 2010, over 5 and 6 months respectively (chart 2). Those moves translated into roughly 6% declines in the Barclays Aggregate Bond index.

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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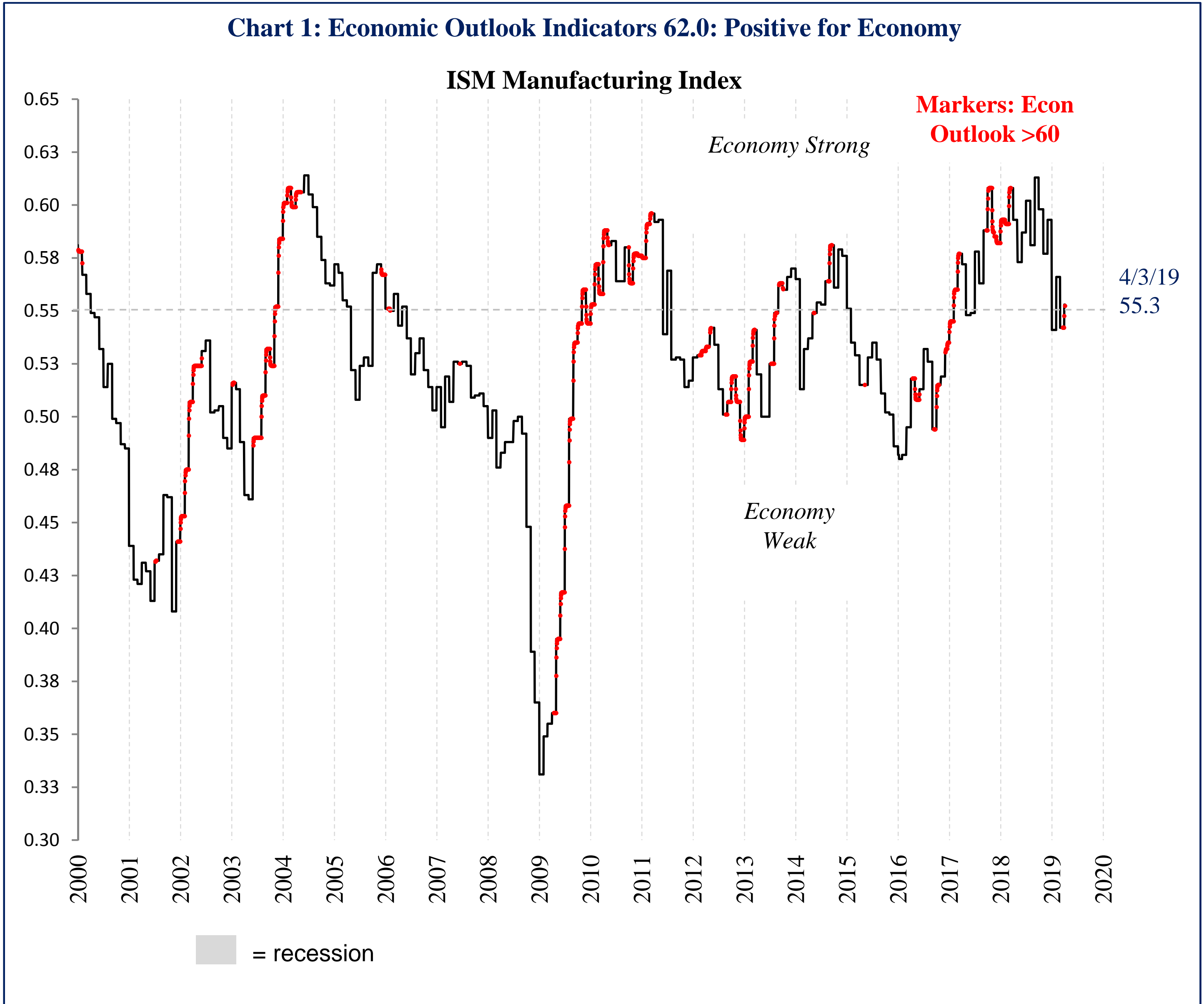

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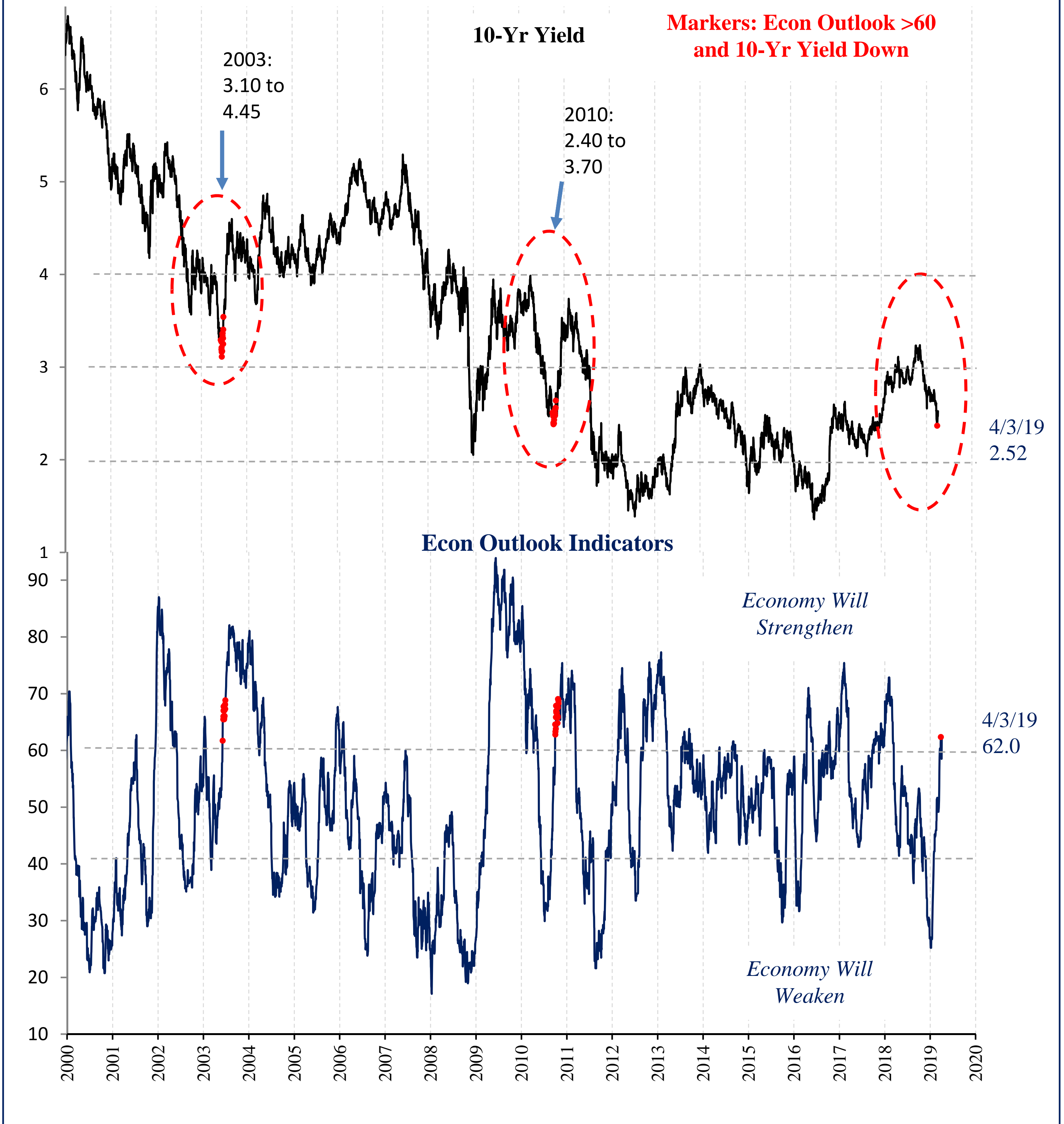

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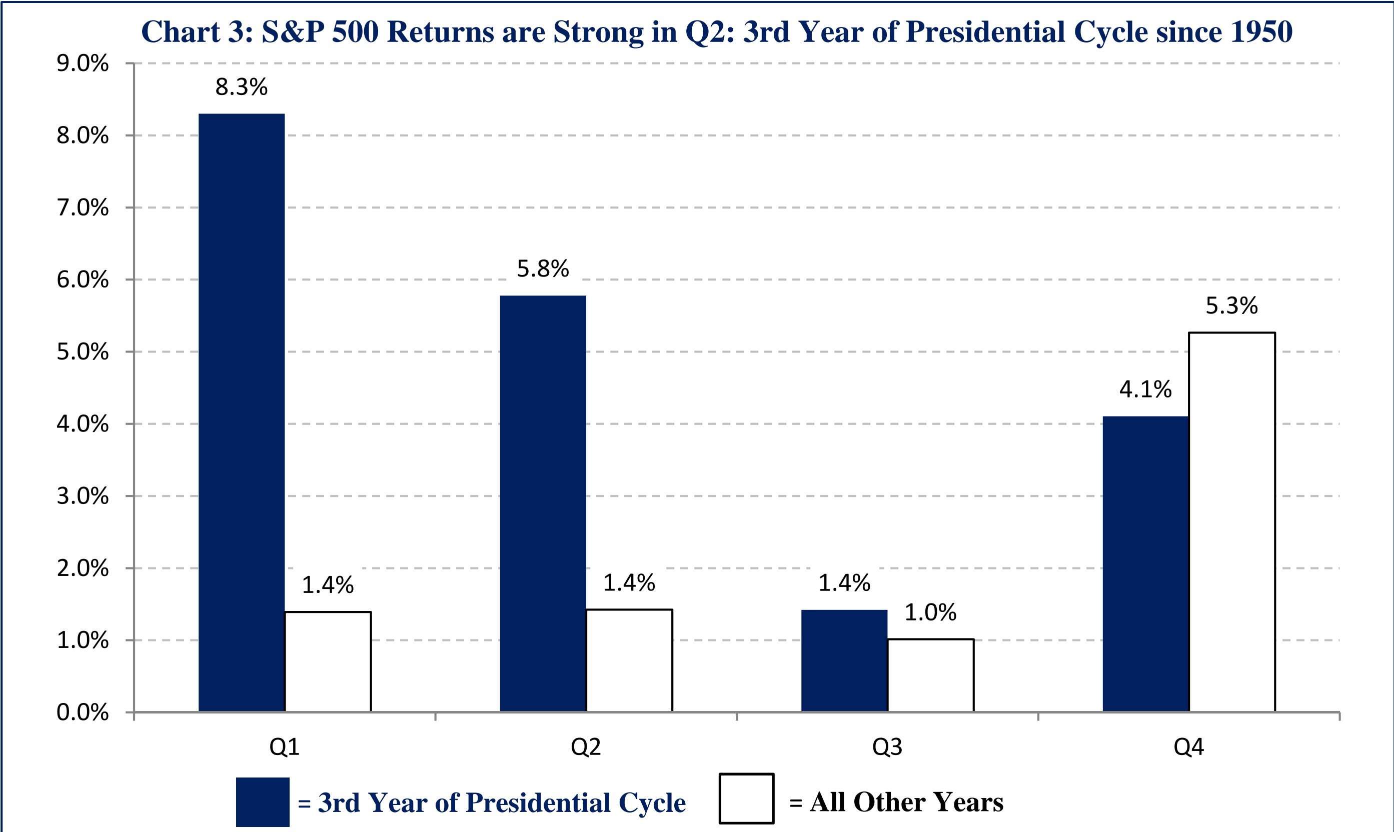
Presidential Cycle: Bullish for Q2

S&P 500 returns during the 3rd year of a presidential cycle were historically positive with a 21% average annual return (2x the norm) and no down years since 1950. This is likely due to fiscal or monetary stimulus applied by the incumbent party. The intention would be to boost the economy before the election the following year. Second quarter returns (April through June) in the 17 prior cases since 1950 were up an average of 5.8%, 4x the 1.4% average for all other years. 88% of prior cases were higher vs. just 62% for Q2 in all other years (chart 3).



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 1 with the expectation that long-term rates will rise. Commodities remain a bullish 4 and gold a bullish 5. Please contact me or your advisor with any questions.

Michael Schaus
Director of Market Research