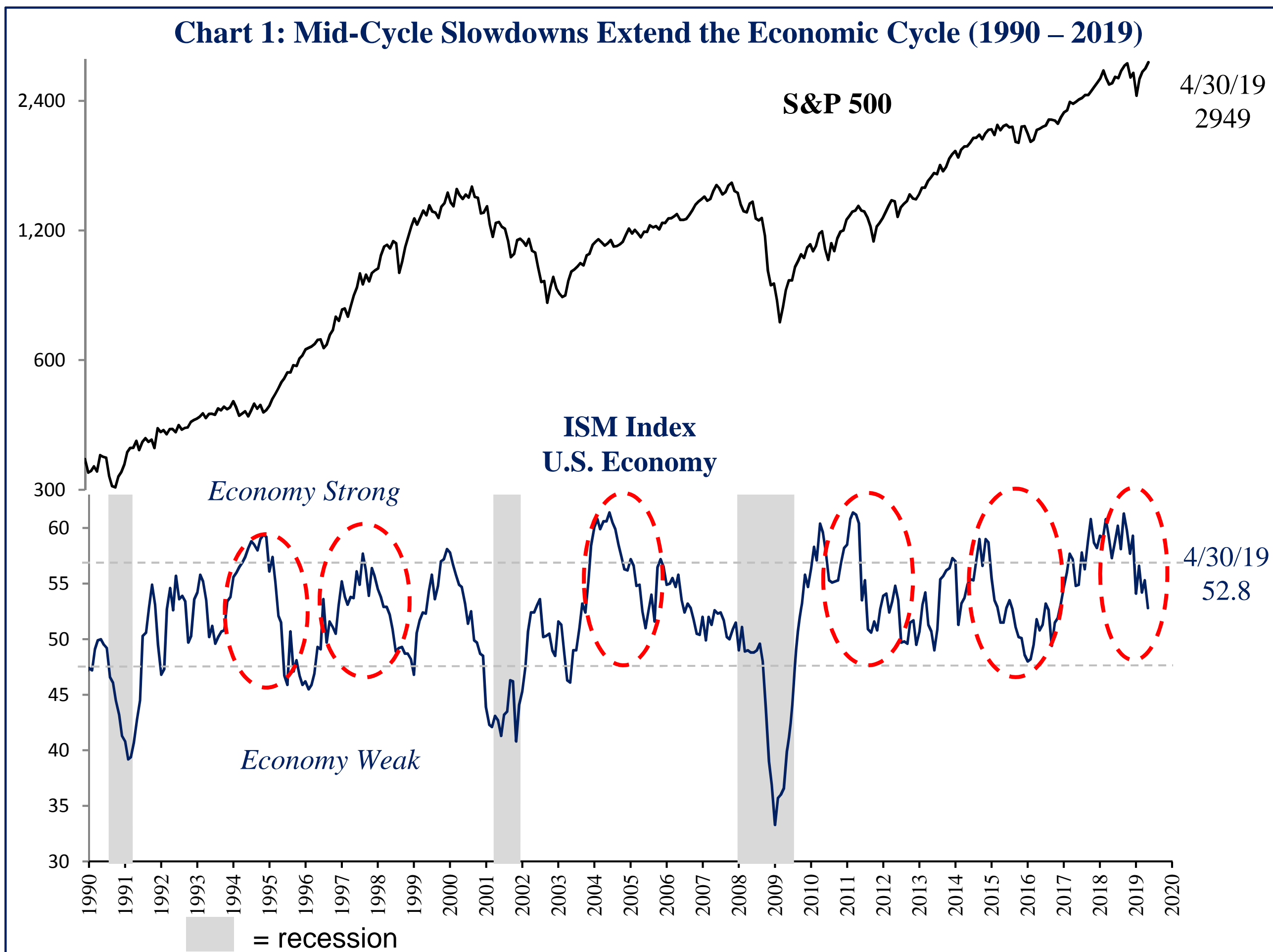
BRENTON POINT
WEALTH ADVISORS

May 13, 2019

# Investing Environment Review and Outlook – Volume 26

## Mid-Cycle Slowdown Continues

The equity rating remains a bullish 5. The U.S. economy weakened in April based on our indicators. We view the recent weakness, however, as a mid-cycle slowdown, the third in this cycle. Although some economic declines lead to equity bear markets and recessions, most are a normal part of every expansion, similar to equity market declines within bull markets. As you can see in the chart below (chart 1), the latest move in the ISM since August is similar to the European crisis in 2011-12 and the crude oil collapse in 2015 during this cycle. The previous two slowdowns in the economy served to extend the cycle by delaying economic overheating and higher inflation, key precedents to bear markets and recessions. One key benefit already was the Federal Reserve's shift to neutral at the end of December, which was a catalyst for the markets' rebound this year. In addition, we now have very low investor expectations for economic growth. Consensus is the Fed will tolerate a bigger inflation increase before hiking again, which effectively lengthens the runway for this expansion and equity bull market.




*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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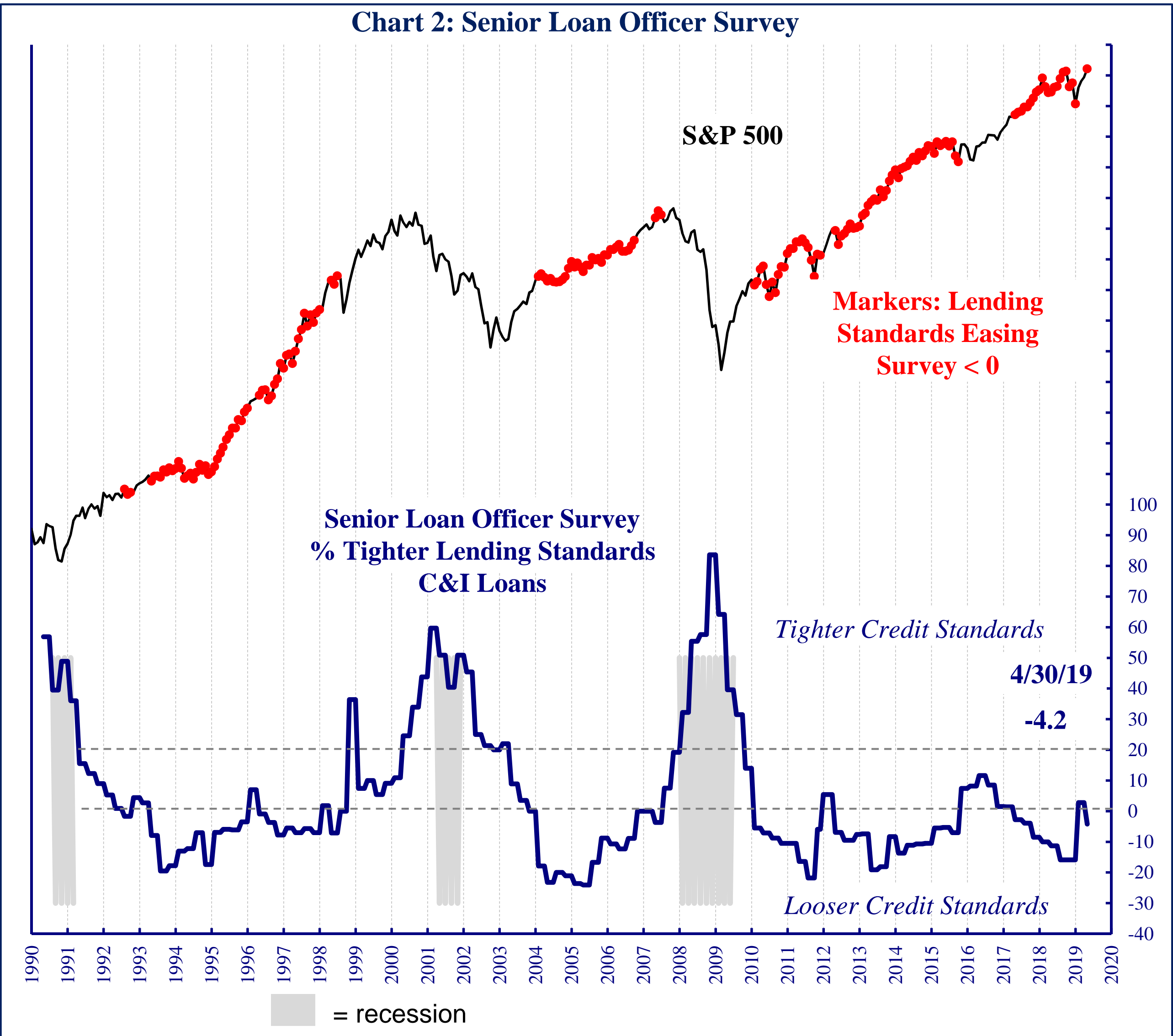
**Recession Risk: Low**

The risk for equities is that a weakening economy will fall into a recession. Our indicators show that the risk of a recession is very low. Historically, one of the most reliable indicators is the trend of bank lending standards. Prior to a recession, loan officers have typically tightened standards, restricting credit, which can lead to a reduction in commercial and industrial activity. The most recent survey in April surprisingly showed conditions easing, with a reading of -4.2 (chart 2). Historically, a reading over 20 signifies standards are tight. In addition, since 1990 the S&P 500 returned 11.1% when credit standards were easing (and the Fed was hiking) as they are today. This compares to a -9.3% S&P 500 return when this survey showed tighter credit standards (above 20).



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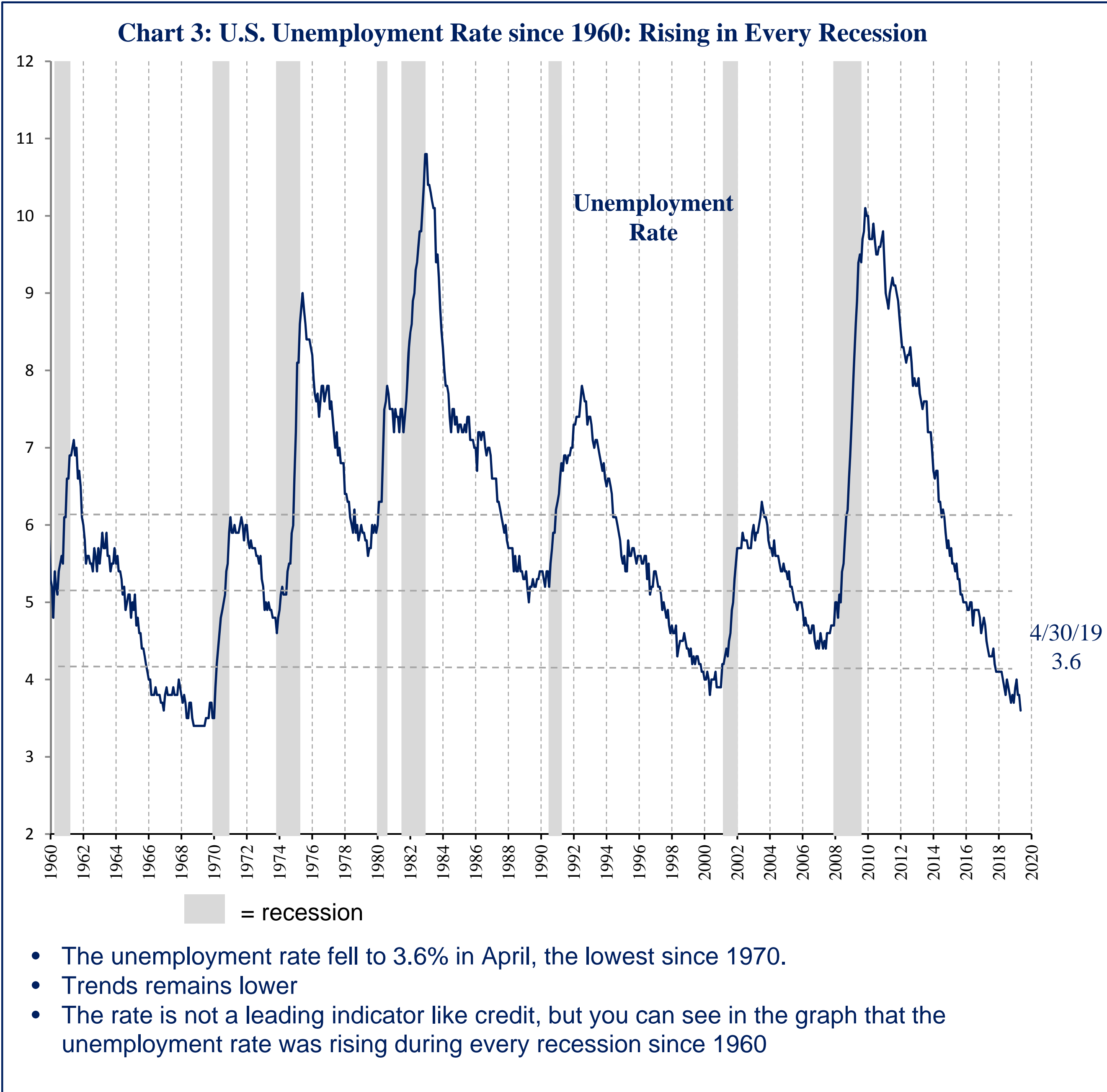
## Unemployment Rate Falling: Low Recession Odds




- The unemployment rate fell to 3.6% in April, the lowest since 1970.
- Trends remains lower
- The rate is not a leading indicator like credit, but you can see in the graph that the unemployment rate was rising during every recession since 1960

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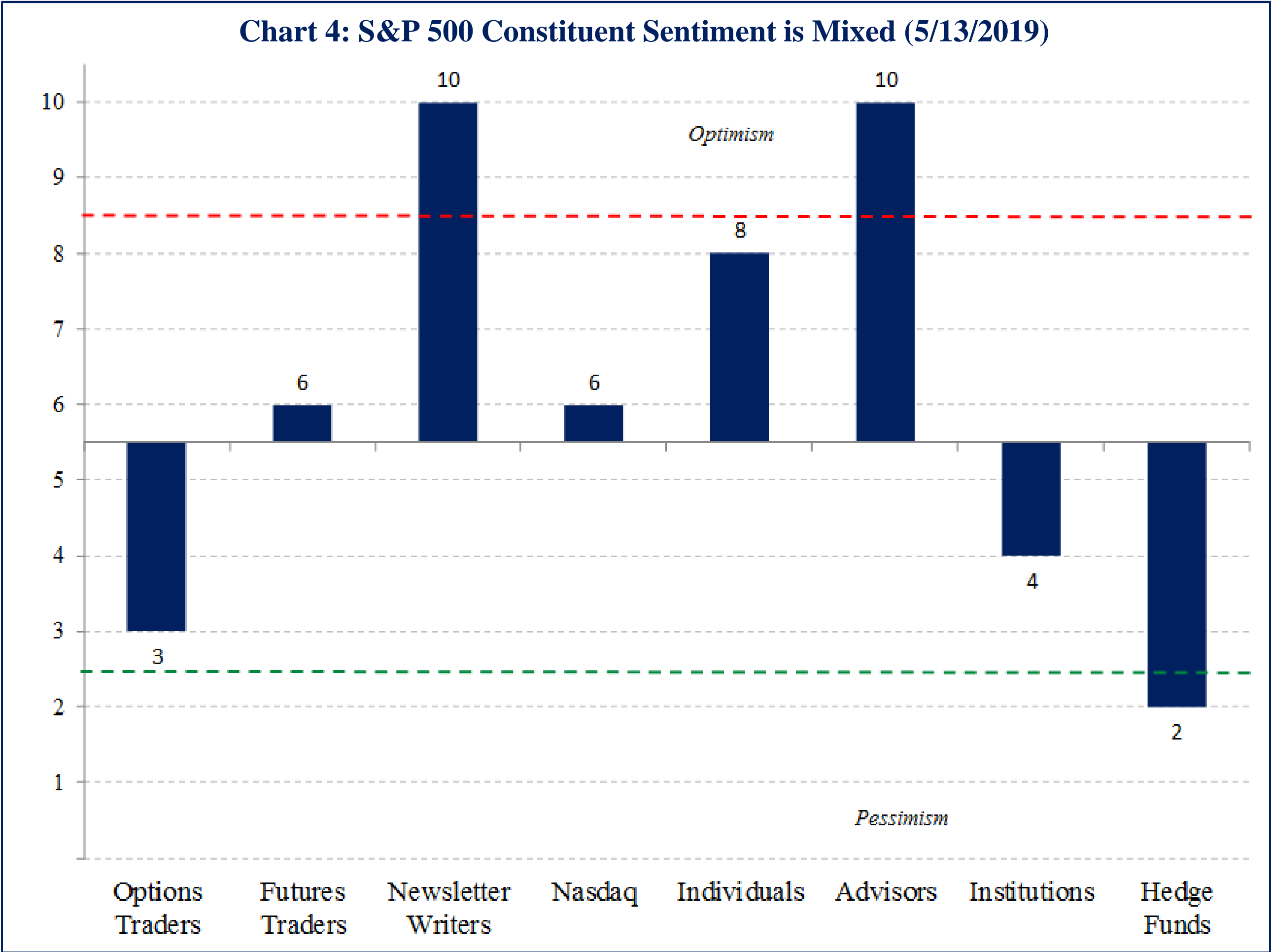
**Equity Sentiment: Mixed**

Stock market sentiment is neutral (Chart 4). Institutions and hedge funds as a group are still underinvested after the December decline. When all groups reach an extreme, as they did in January 2018, it will be a risk for the stock market, since it will mean allocations are high, with very little cash available for investors to push prices higher.



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**Rising Tariffs: Does not provide a strong signal on the implications for stocks**

The escalation of the trade war with China may be contributing to the recent stock market volatility. Despite the dire headlines, in a July 2018 study of prior tariff hikes back to 1820, we concluded there were no significant investment implications. The 1921 and 1931 cases were bearish for commodities, coming amidst the end of WW I and the Great Depression. However, the 1862 case during the Civil War, and the 1899 case during the Spanish American War, were bullish. Prior cases gave a very mixed picture for stocks as well. It appears that the effect of tariff increases depends on the circumstances and does not provide a strong signal on the implications for stocks. This confirms why we continue monitoring our key indicators like the economic outlook, the Federal Reserve, inflation, and the dollar for investment implications rather than daily headlines.

**Michael Schaus**
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