BRENTON POINT
WEALTH ADVISORS

July 10, 2019

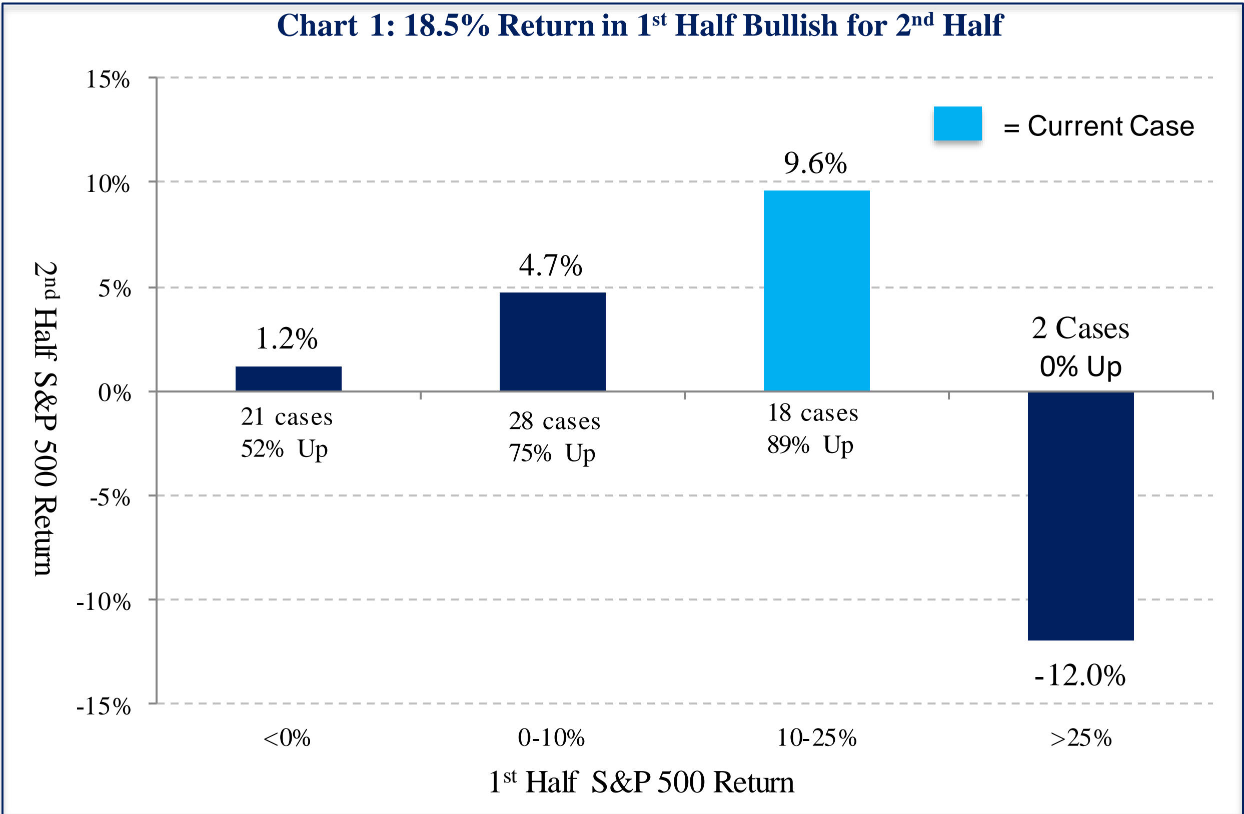
Investing Environment Review and Outlook – Volume 28

Although sentiment indicators reversed to neutral since we wrote about them last month, our equity rating remains a bullish 5 due to positive liquidity conditions and historical patterns related to sentiment and institutional fund flows discussed below. We are raising the long-term bond rating to a neutral 3 and we are cutting the commodity rating to a neutral 3 because of mixed economic outlook indicators.

S&P 500 Up 18.5% in 1st Half of the Year: Bullish for the 2nd Half

The S&P 500 was up 18.5% from January through June, the 7th strongest 1st half return since 1950, and best since 1995. In the 18 prior cases when the return was up from 10-25%, as it is currently, the average 2nd half return from July to December was 9.6%, and 89% of those cases were higher (chart 1). This compares to just a 1.2% return and 52% cases higher for the 21 years when the S&P 500 was down in the 1st half. It is likely related to institutional buying patterns which cause strength to persist.

1987 is an interesting case. The market was up 25.5% in the 1st half, then down 18.7% in the 2nd half, including a historic one day 20% crash on Monday, October 19th, the crash famously predicted by Marty Zweig. This bearish exception is telling because conditions then were so different from this year. For instance, that year inflation rose to 4.2% in August (vs. 1.8% today) and the 10-year yield rose to 10% vs. just a 2.0% level today.



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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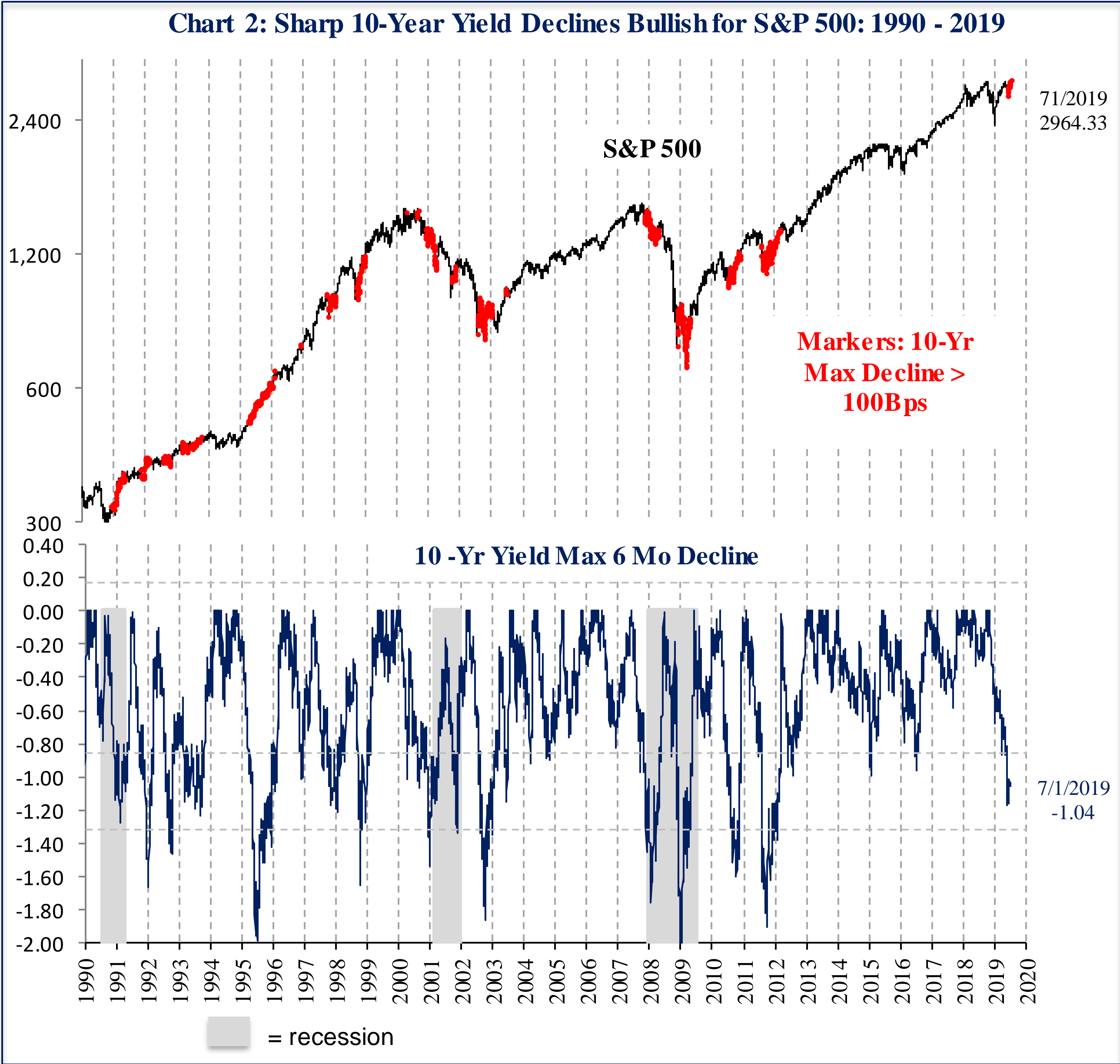
10-Year Treasury Yield Down: Bullish for Stocks and Gold

Investors are worried about the continued mid-cycle slowdown, as June economic indicators showed slower growth. However, the 1.2% drop in the 10-year Treasury yield from 3.2% to 2.0% since November 2018 is positive for the S&P 500 and gold. Since 2000 the S&P 500 returned 18.6% when the 10-year yield was falling (chart 2), as it is currently. When the 10-year yield was rising strongly, the S&P 500 returned only 3.0% on average. In prior cases like 2010, 2011 and 2009, the Fed was cutting rates and people were worried about stocks because the economy was also slowing, yet stocks rallied. Bonds are competition for stocks, so a lower yield pushes investors into stocks, pushing prices higher.



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The sharp decline in the 10-year Treasury yield is also positive for gold. For instance, since 2000 gold returned 20.4% annualized when yields were down, as it is currently, over a 6 month period. This is 2.4x the norm of 8.4%. The T-Bill yield is just 0.25% above Consumer Price Index (CPI) inflation. In this zone with the real yield from 0-2%, gold returned 26.1% since 2000. With real rates this low, there is very little competition or opportunity cost to buying gold. Although inflation outlook indicators are neutral, gold has significant upside potential with all the major central banks providing liquidity and potentially devaluing their currencies to boost exports.

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Bond Rating +1 to Neutral 3

We are raising our long-term bond rating to a neutral 3 this month based on neutral economic outlook indicators and weak industrial commodities. The low nominal yield and the high bond allocations by most investors remains a risk in owning long-term bonds. The neutral rating allows us flexibility to add to bonds if the economy weakens further, or to cut back if indicators improve and the economy rebounds. In the latter case, long-term interest rates would rise and bond prices would weaken.

Commodity Rating -1 to Neutral 3

We are cutting our commodity rating to a neutral 3 this month based on the weak trend of commodities and the weaker economy. From the April peak in the CRB Industrials Index when it was up 4% YTD, the index has declined 8%, breaking the 2018 low. Finally, in prior cases when the 10-year yield declined this sharply, industrial commodities remained weak, particularly during the seasonal weakness through October. After moving sideways this year, a move in the U.S. Dollar either way would be telling for commodities as well, since there is a strong inverse relationship. The CRB Index is flat since 2007. As a result, commodity allocations and expectations are low, setting up for potential upside when conditions are right.

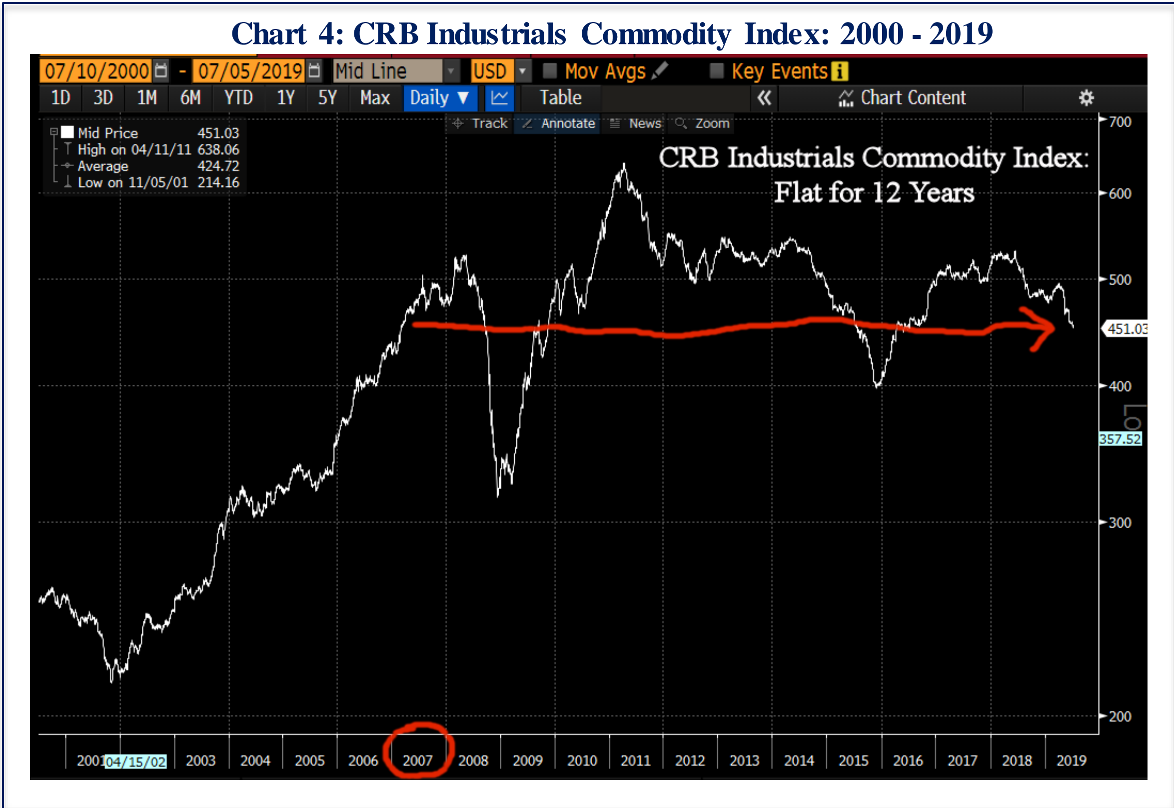

Chart 4: CRB Industrials Commodity Index: 2000 - 2019

Michael Schaus
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