BRENTON POINT
WEALTH ADVISORS

October 7, 2019

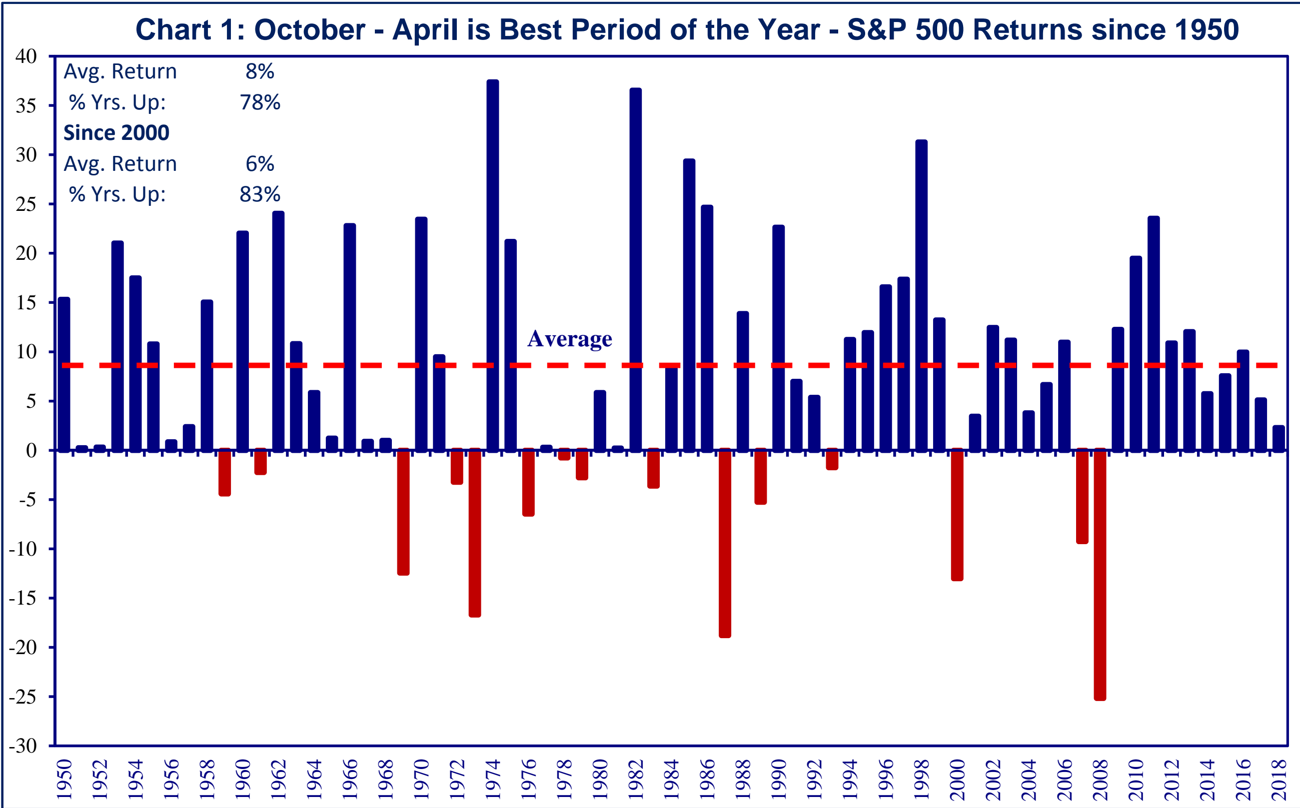
Investing Environment Review and Outlook – Volume 31

Equity Rankings Bullish: Return of Goldilocks in The Economic Cycle

This month we increased our U.S. and foreign developed equity rankings to a bullish 5. A number of factors changed to improve the outlook for stocks since we reduced to a neutral 3 rating in August. First, Goldilocks economic conditions returned, marked by moderate growth, a loose Fed, falling interest rates, falling inflation, and investor skepticism. Despite the political distractions of impeachment, trade war, and Brexit, the Goldilocks stage of the economic cycle is the best for stock returns historically. Since 1950, the S&P 500 returned on average 20.3% annualized with these conditions, almost twice the norm of 11.3% over that period, and returns were consistent over time. For instance, since 2005, the S&P 500 returned on average 17.0% when Goldilocks conditions were present (26% of the time) vs. just 6.4% for all other periods.

Secondly, October 1st marks the beginning of the best seasonal period for equity returns. The S&P 500 has been up 78% of the time, an average of 8.0% in the October through April period since 1950 (chart 1), including 83% of the time higher since 2000. For comparison the May-September period was up just 65% of the time since 1950 and since 2000 averaged a -0.6% decline.

Although conditions are bullish for stocks, 5-6% declines were normal in these prior periods. No one likes downside volatility in their portfolio. Expecting declines and finding the conviction to remain invested during these periods is one of the most critical parts to successful investing, and one of the focuses of our research.



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 Scare

On 10/1/19 the September ISM Manufacturing Index dropped more than expected to 47.8, seemingly causing a 2-day 3% drop in the S&P 500. Investors focused on the probability of a recession and sold stocks. However, of the 16 prior cases when the ISM dropped below 48 since 1950, a recession followed only 50% of the time, and only once in the last 5 cases. This index is the best coincident economic indicator I have found, but it is not a leading indicator. Notably absent from media coverage was the implication for equities. In fact, after those 16 prior cases, the next 6% move was higher 81% of the time. Of the negative cases, where the S&P 500 declined by 10% within 3 months (1970, 1981, 2001), inflation was over 6% and rising in the first two, and the Fed was hiking in the last one, so they were not comparable to today's conditions. A collapse in economic activity would likely be negative for equities, but our leading indicators, like our economic outlook model, show less than a 50% chance of a recession. As usual, if conditions change, we will re-evaluate our ratings.

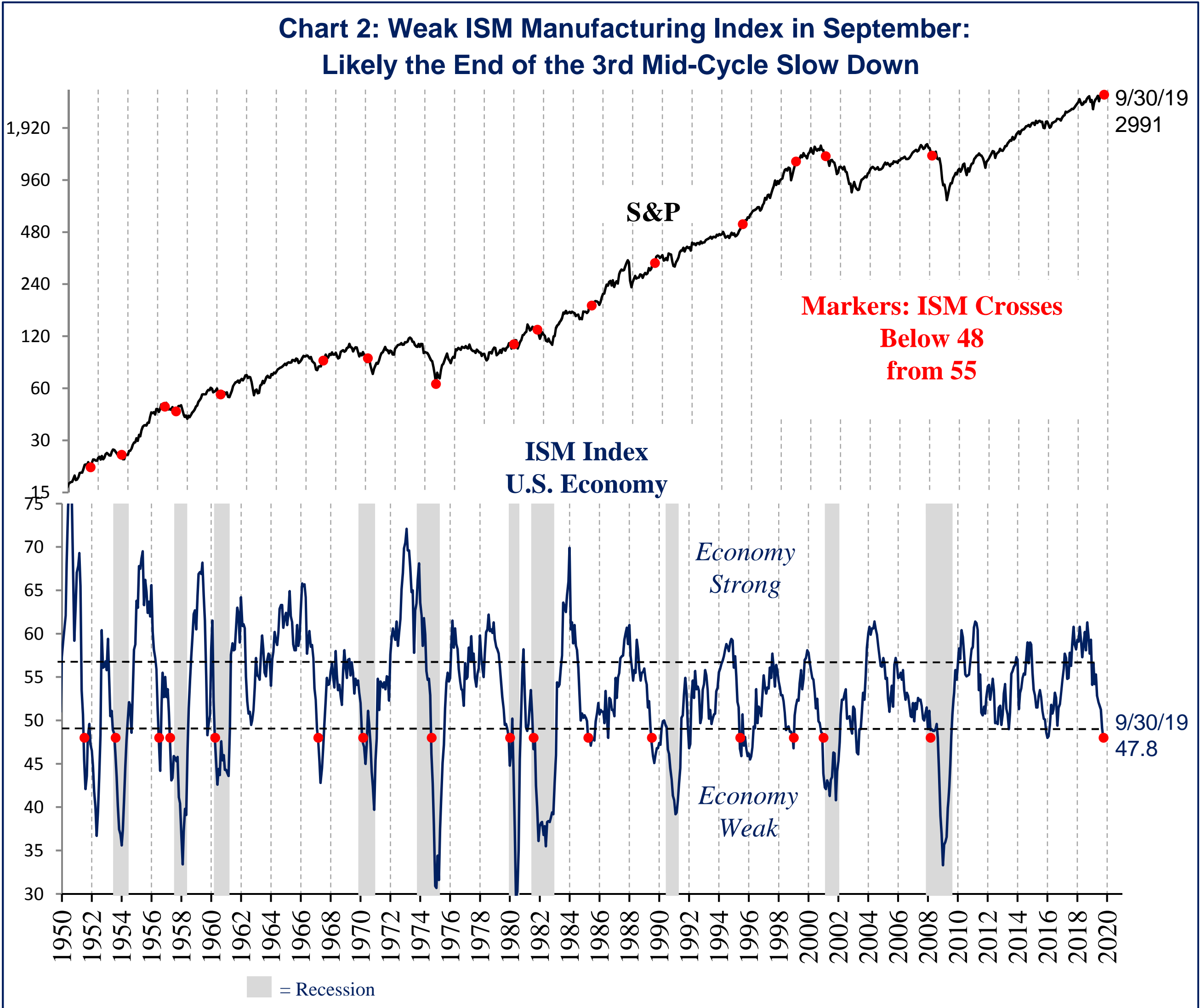

Chart 2: Weak ISM Manufacturing Index in September: Likely the End of the 3rd Mid-Cycle Slow Down

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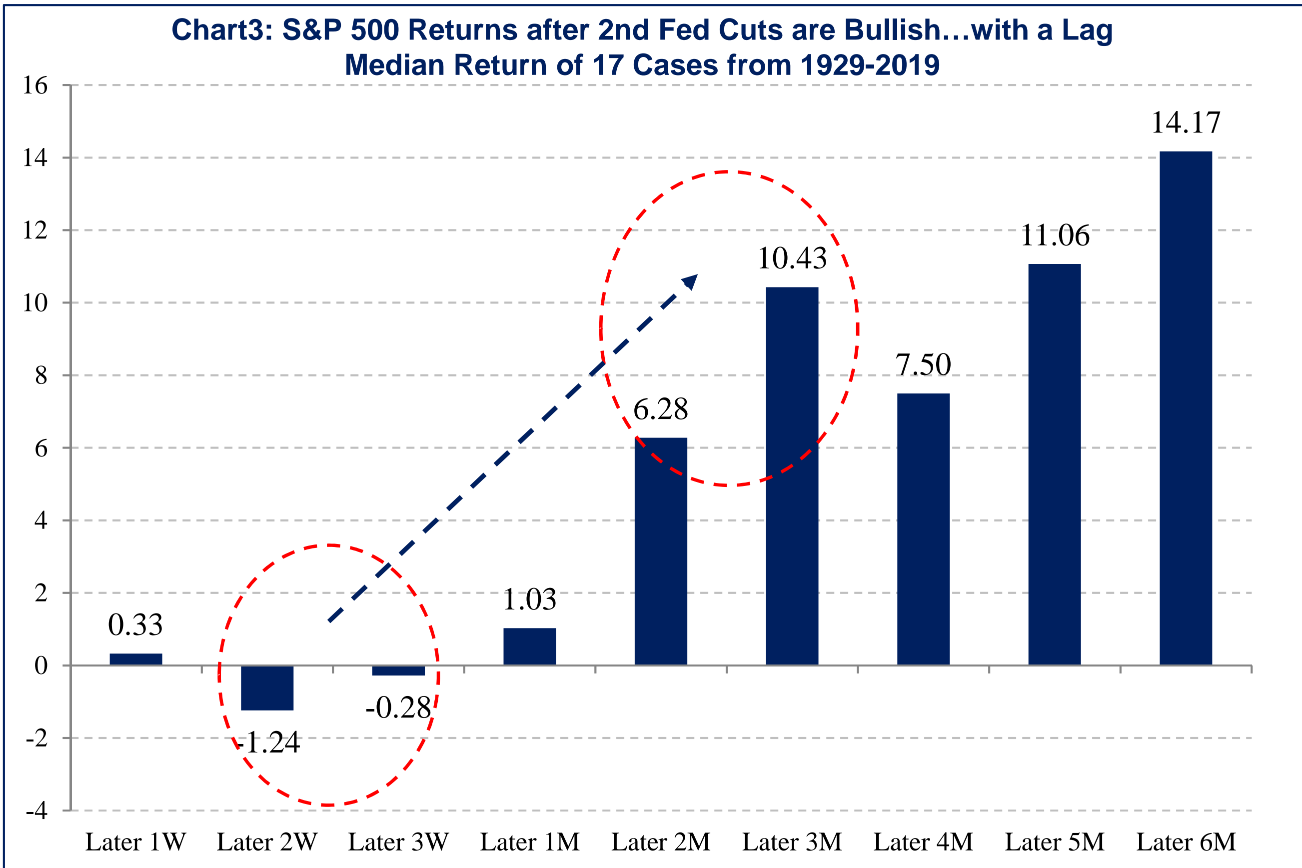
2nd Fed Interest Rate Cuts: Bullish with a Lag

On 9/18/19 the Fed cut the Fed Funds target for the second time in this cycle to 2.0%. Of the 17 prior cases since 1929 when the Fed cut for the second time, the S&P 500 was down on average 2-3 weeks afterwards. This year we are following the same pattern, with the S&P 500 down 4% in the first two weeks, the second worst return of all prior cases. This may lead investors or even the Fed itself to believe Fed cuts are not working. However, from two weeks out to 2 months out after 2nd cuts, the S&P 500 was up an average of 9.5%, with 88% of cases higher. Our founder Marty Zweig coined the phrase often repeated today, "Don't Fight the Fed." Today it is particularly relevant.



In summary, Goldilocks economic conditions returned, therefore the environment for equities have improved significantly to warrant an increase in the U.S. and foreign equity rankings to a bullish 5. We are leaving our long-term bond, commodities and gold rankings at a neutral 3, and emerging markets remain a bullish 5. With the media louder than usual with impeachment, trade war and Brexit making headlines, it is important to realize that despite the media focus, most political events should be ignored by investors, particularly public statements which are often contradicted the next day. If political activity is significant, it will show up in our sentiment, economic or trend indicators in some form. Thank you for looking this over and please contact me or your advisor with any questions.

Michael Schaus
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