BRENTON POINT
WEALTH ADVISORS

February 11, 2020

Investing Environment Review and Outlook – Volume 35

Coronavirus vs. Markets

The Coronavirus created fear and headlines, particularly when China issued and enforced travel bans on January 23rd. Although there have been numerous virus outbreaks historically, the 2003 SARS pandemic was most similar. Our analysis of that case showed no equity market impact from the time it first became news in the U.S. However, this year when China travel bans were followed by sharp declines in commodity prices, stock prices, and interest rates, it became a significant event with investment implications. For instance, our economic outlook indicators slipped from a high of 72 on January 10th to a neutral 50 on February 5th, cutting the odds of near-term economic acceleration that we expected in January. A slower world economy also means any Fed tightening is likely further out in time, a positive for equities. In response we made several rating changes this month, increasing our equity and long-term bond rankings, and cutting commodities.

U.S. Equities Rating +2 to Bullish 5

We raised our U.S. equity ranking to a bullish 5 this month. In January before the Coronavirus made headlines we took the equity ranking down to a neutral 3 due to the extreme sentiment readings and the concern of a 5-10% decline in U.S. stocks sometime in January or February. We did, in fact, see a slight correction January 24th which brought the S&P down 3.1% through January 30th. The decline was smaller than we anticipated, but it was enough to move equity sentiment back to neutral - in line with how previous extreme sentiment cases ended. It means that investors reduced their stock exposure, creating the ability to re-invest when conditions improve. Without the overheated sentiment, bullish Goldilocks conditions still dominate. Current conditions include moderate growth, a loose Fed with quantitative easing, low inflation, and positive seasonality in Q1. In addition, if the Coronavirus slows the world economy as anticipated, the Fed will likely remain loose for longer, which should extend the economic cycle and equity bull market. The consolidation we saw in January was typical of January returns following big annual rallies like 2019. February and March, however, were strong, up 80% of the time an average of 4.1%. The biggest decline in those cases was just 1.2% in 1993.

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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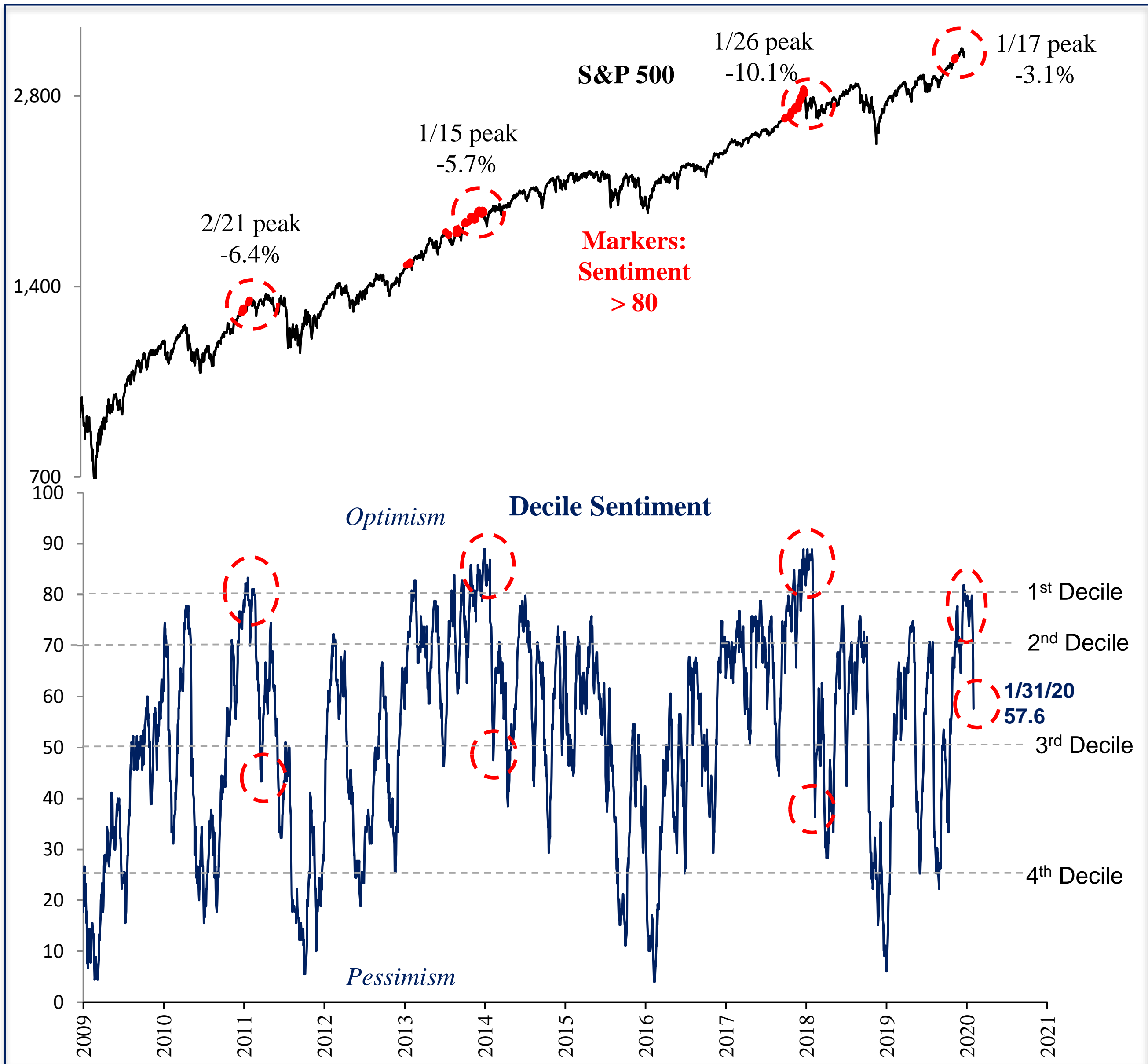
Chart 1: Equity Sentiment Reverts back to Neutral – Declines in Jan/Feb



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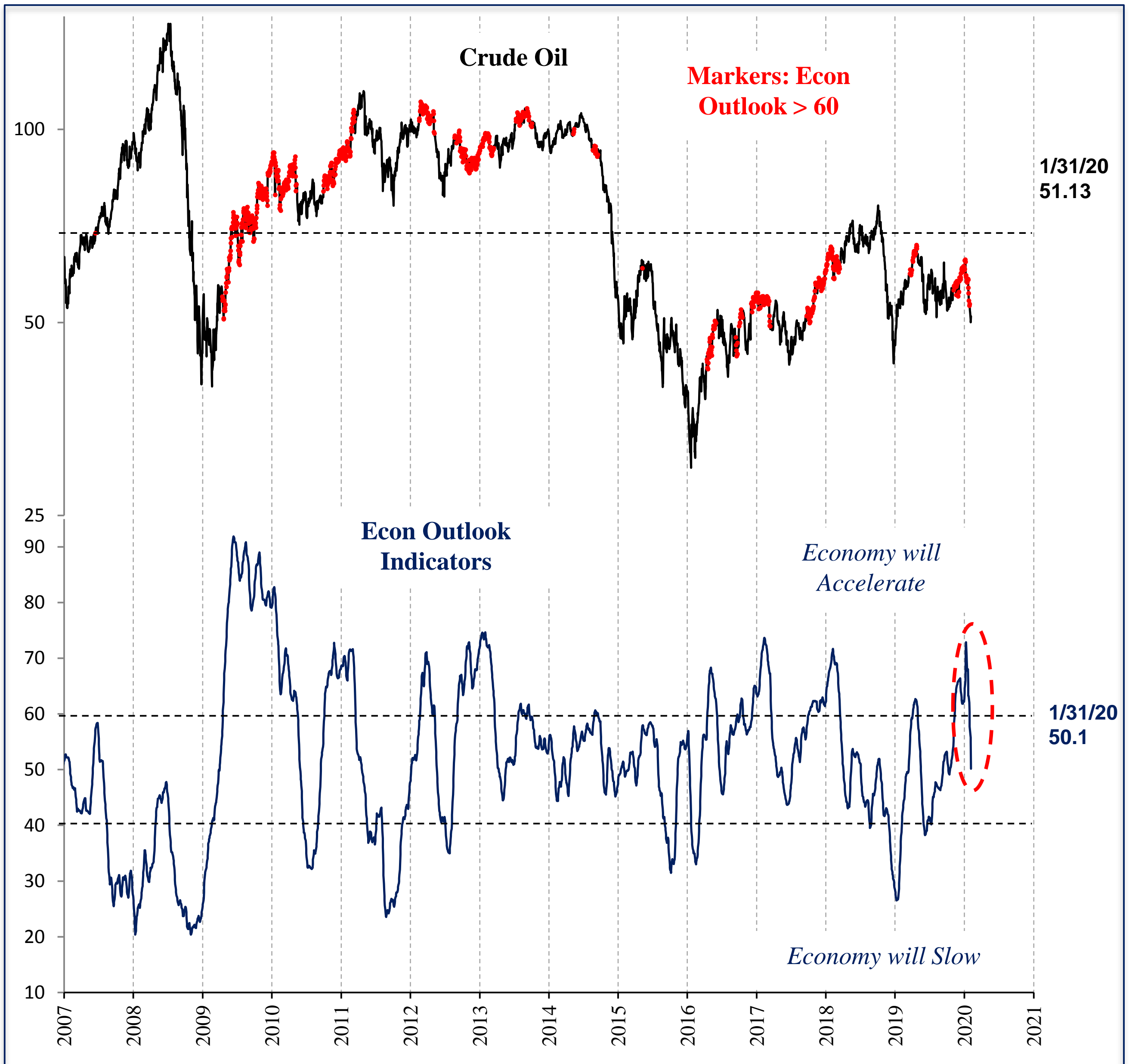
February 11, 2020

Commodities Rating -1 to Neutral 3

We cut our commodities rating to a neutral 3 this month based on the drop in economic outlook indicators to neutral following the Coronavirus outbreak (chart 2). In addition, the dollar remains in a tight trading range. A significant move to the downside would be bullish, since commodities like crude oil are priced in dollars. The Coronavirus will likely cause an economic slowdown, particularly in China, but like a labor strike, snowstorm, or hurricane, pent up demand is expected to rebound quickly, along with the expected return for industrial commodities like crude oil and copper. In that case we will reassess our commodity position.

Chart 2: Economic Outlook Reversal: No Longer Bullish for Crude Oil



BRENTON POINT
WEALTH ADVISORS

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Long Term Bonds Rating +2 to Neutral 3

We raised our rating on long term bonds to a neutral 3 this month. Although prior virus outbreaks were not significant for markets, our economic outlook indicators declined to neutral after sharp declines in equity indices and industrial commodities like crude oil and copper. This meant at the very least our assumption of economic acceleration could be pushed off into the 2nd quarter. For instance, after copper has declined like this, bonds returned 8.5% vs. -3.9% when copper was rising (chart 3). If it proves to be a short-lived episode and economic outlook indicators rebound, it would increase the downside risk for long-term bonds and we would reconsider our bond position at that time. The neutral position gives us the flexibility to wait for clearer signals.

Chart 3: Copper Down: Higher 10 Yr Yield Less Likely: 2016 -

10 Yr Yield
2/6/2020
1.642

Copper
2/6/2020
259.75

2016 2017 2018 2019 2020 2021

In summary, we raised equities to a bullish 5 rating because background conditions remain bullish for stocks after the recent 3% decline. We also raised long term-bonds and cut the commodities rating to a neutral 3 rating since the timing of any economic acceleration is now less certain. Thank you for your continued support and please contact your advisor with any questions.

Michael Schaus
Director of Market Research