BRENTON POINT
WEALTH ADVISORS

June 8, 2020

# Investing Environment Review and Outlook – Volume 37

We raised the equity ratings to 5 for U.S. stocks, foreign developed, and emerging markets, based on growing evidence the economy could surprise and rebound strongly to the upside in the second half of the year. The wide breadth of signals includes commodity rallies (in copper, crude oil and iron ore), stock rallies like the Russell 2000 in the U.S., strong Asian stocks in Japan and South Korea, and a recent turn higher in the 10-year Treasury yield. The strong economic outlook, combined with unprecedented Fed and Fiscal stimulus, and finally bullish technical market signals, give us confidence the economic recovery and a new bull market cycle are under way. We cut our long-term bond rating to a 1 based on expectations of higher long-term yields, typical as the economy strengthens. With stronger than expected industrial demand and a weaker dollar, we also raised our commodity rating to a bullish 5.

## May Unemployment Rate Surprise: Economy Stronger than Expected

| | | Months after Recession | **S&P 500** Cum Return Later | | | |
|---|---|---|---|---|---|---|
| Date | Urate | End | 3M | 6M | 9M | 12M |
| May-1933 | 25.6 | 3.0 | 15.0% | 2.5% | 11.6% | -0.3% |
| Jun-1938 | 20.0 | 1.0 | 5.9% | 13.7% | -5.0% | -6.1% |
| Oct-1949 | 7.9 | 1.0 | 6.3% | 12.0% | 11.2% | 21.8% |
| Sep-1954 | 6.1 | 5.0 | 11.4% | 13.2% | 27.0% | 35.2% |
| Jul-1958 | 7.5 | 4.0 | 8.8% | 17.4% | 22.0% | 28.2% |
| May-1961 | 7.1 | 4.0 | 2.3% | 7.2% | 5.1% | -10.4% |
| Dec-1970 | 6.1 | 2.0 | 8.9% | 8.2% | 6.7% | 10.8% |
| May-1975 | 9.0 | 3.0 | -4.7% | 0.1% | 9.4% | 9.9% |
| Jul-1980 | 7.8 | 1.0 | 4.8% | 6.5% | 9.2% | 7.6% |
| Dec-1982 | 10.8 | 2.0 | 8.8% | 19.5% | 18.1% | 17.3% |
| Jun-1992 | 7.8 | 16.0 | 2.4% | 6.8% | 10.7% | 10.4% |
| Jun-2003 | 6.3 | 19.0 | 2.2% | 14.1% | 15.6% | 17.1% |
| Oct-2009 | 10.1 | 4.0 | 3.6% | 14.5% | 6.3% | 14.2% |
| Apr-2020 | 14.7 | | | | | |
| Average | 10.5 | 5.0 | 5.8% | 10.4% | 11.4% | 12.0% |
| Median | 7.9 | 3.0 | 5.9% | 12.0% | 10.7% | 10.8% |
| % Up | | | 92.3% | 100.0% | 92.3% | 76.9% |

- May unemployment rate unexpectedly downticked from 14.7% to 13.3%.
- Assuming April was the peak for this recession, there were 13 prior cases since 1928.
- Most of these peaks occurred 1-3 months after the recession ended, (although 1992 and 2003 were outliers at 16 and 19 months later).
- For all cases, the S&P 500 had already rallied an average of 20% from the low on a monthly basis before these peaks.

Despite all the head scratching over the weak economy and strong stock market, this year is typical of past cycles. In prior cases the S&P 500 rallied further an average of 6%, 3 months later, and 10%, 6 months out as highlighted above.

*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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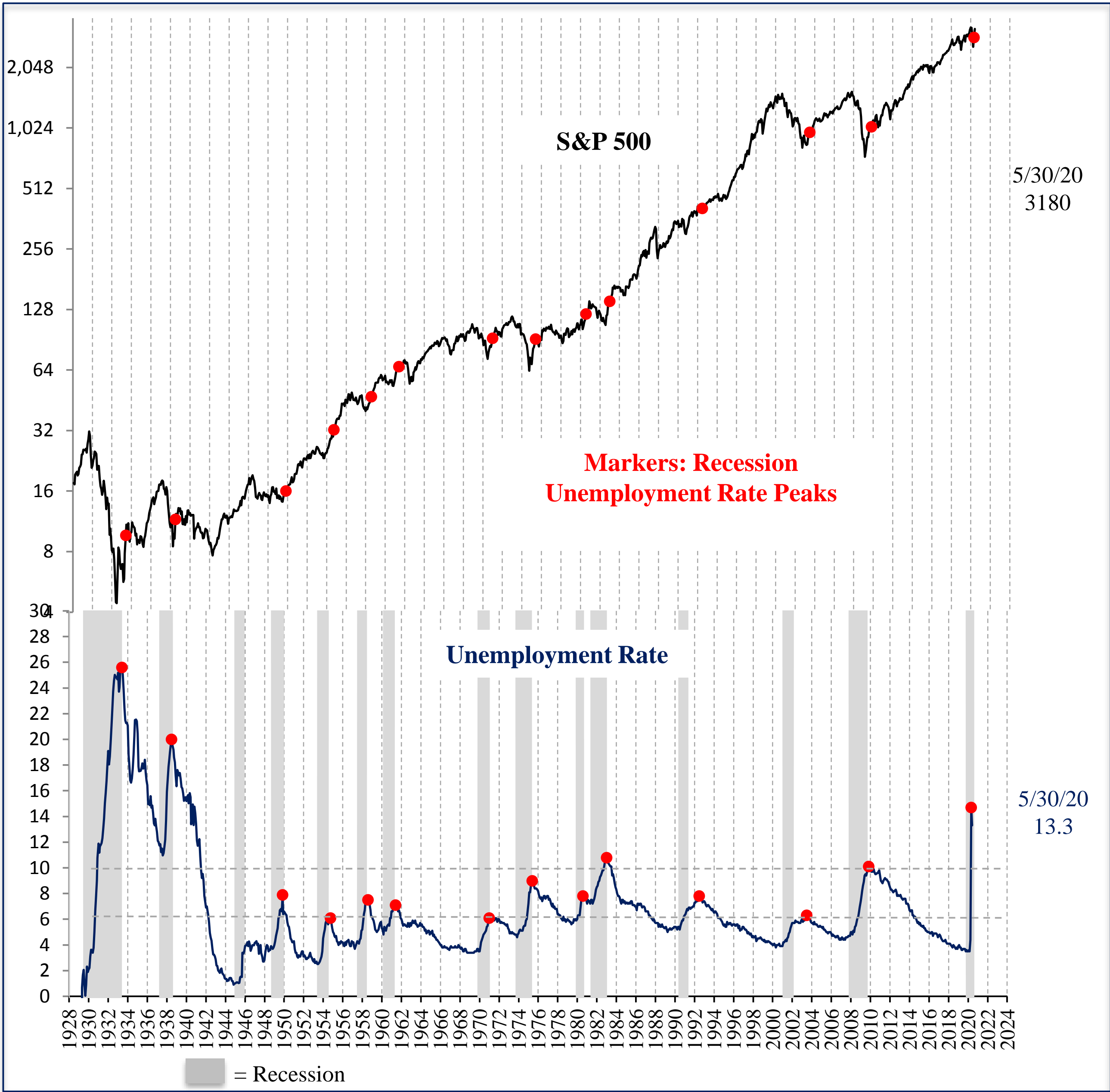
## Chart 1:Recession Unemployment Rate Peaks: 13.3% in May vs. 14.7% in April



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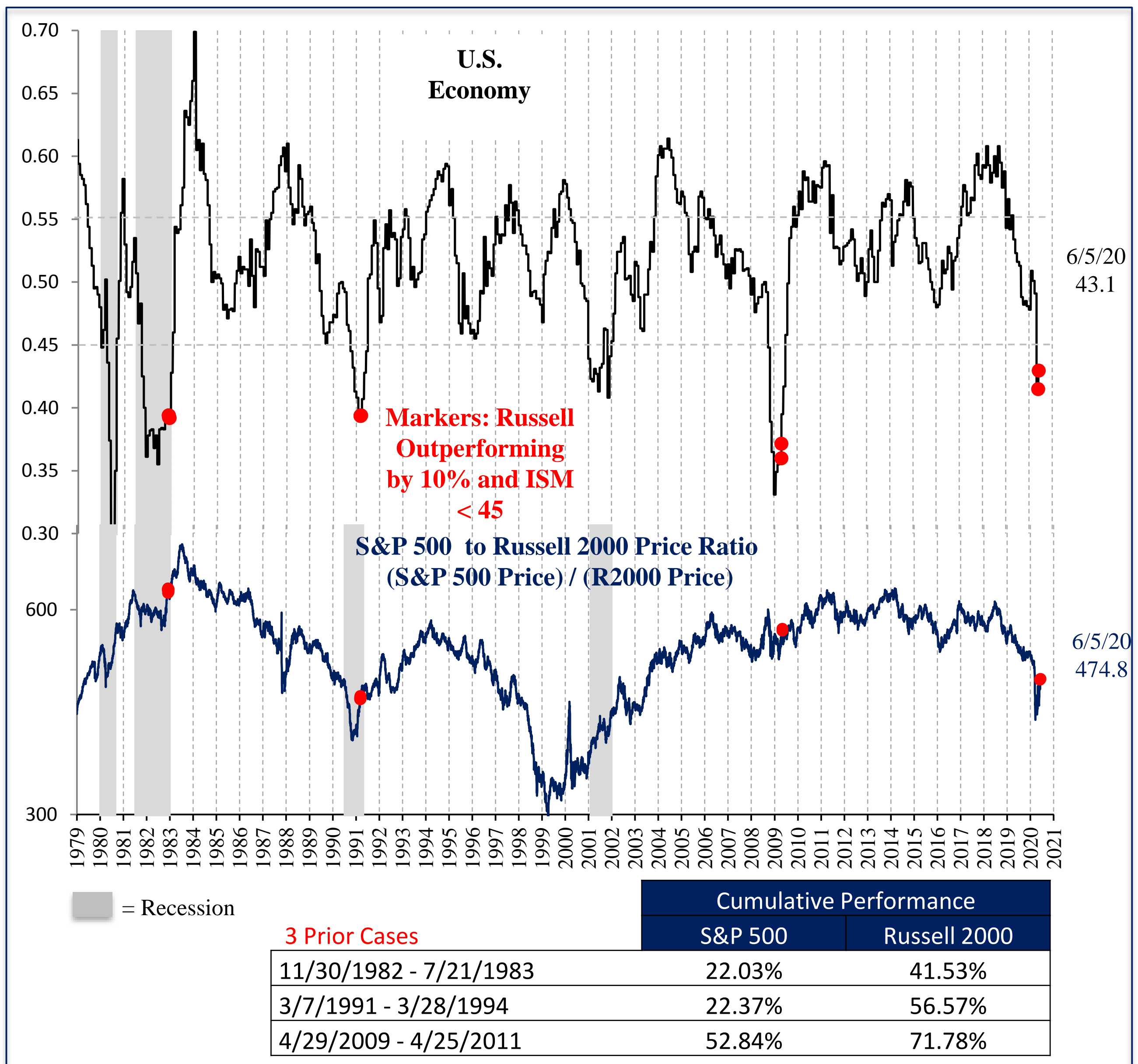
## Russell 2000 Outperformance: Bullish for Economy

The Russell 2000 (small-cap stock index) has outperformed the S&P 500 by 12% since April 16th. There were only 3 prior cases of such outperformance when the economy was in a recession with the ISM index below 45 as it is today. Prior cases in November 1982, March 1991 and April 2009 marked the end of the recession and confirmed a new multi-year bull market in stocks. Small capitalization stocks had been underperforming the larger cap S&P 500 stocks since 2018 by the biggest margin since 2000. This could also mark a multi-year reversion period where small cap stocks outperform the S&P 500 as we saw from 1991-1994.

Chart 2:Russell 2000 Outperformance Bullish For Economy: 1979 - 2020



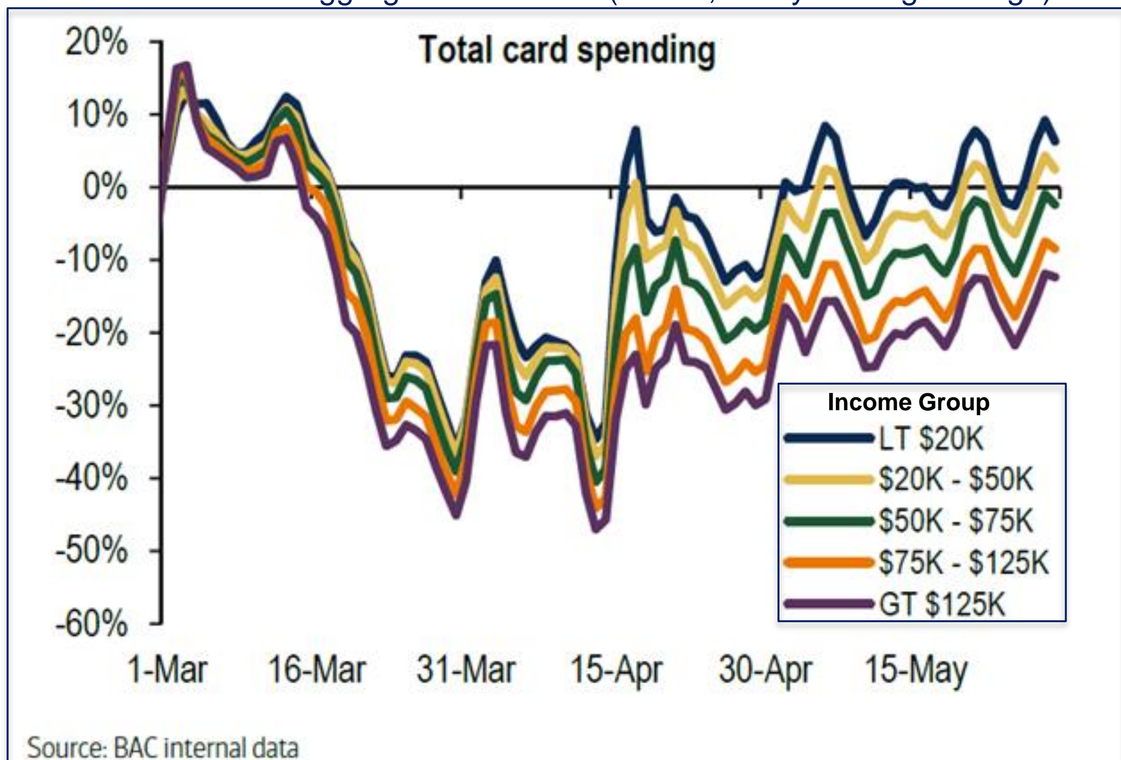

3 Prior Cases

| | Cumulative Performance | |
|---|---|---|
| | S&P 500 | Russell 2000 |
| 11/30/1982 - 7/21/1983 | 22.03% | 41.53% |
| 3/7/1991 - 3/28/1994 | 22.37% | 56.57% |
| 4/29/2009 - 4/25/2011 | 52.84% | 71.78% |

**Consumer Spending Rebound: Economy Recovering Fast**

Despite the COVID-19 pandemic, high frequency economic reports show consumer spending has rebounded quickly. For instance, Bank of America (BAC) reported as of 5/29/20 total credit and debit card spending is down just 10% Y/Y from a low of -40% in April. This is evidence that people and businesses are adapting quickly to the COVID-19 pandemic, with better odds that even a second wave of infections will not hold the economy back. It also shows that pent up demand is real, particularly with strong unemployment benefits filling the gap.

Chart 3:Daily Total Credit Card Spending by Income Group
Based on BAC Aggregate Card Data (% YoY, 3-day moving average)




**Don't Fight the Tape: One Month Thrust is Bullish**

Marty Zweig coined the phrase, "Don't Fight the Tape." Since the March 23rd low, we have seen extremely strong tape (the rally in stocks). For instance, on April 14th the S&P 500 was up 27% within a month, up so sharply it was 10% above the one-month average, known as a one-month thrust. There were only 8 prior times this happened since 1928, and only 2 since 1950, in August 1982 and April 2009. After these two cases the S&P was up a further 30% in 6 months and 40% in a year. So far since that April 14th signal, the S&P 500 is following the pattern of those two cases with a one-month consolidation phase followed by the most recent leg higher. These two cases were 30% higher after 6 months and up 40% a year later.

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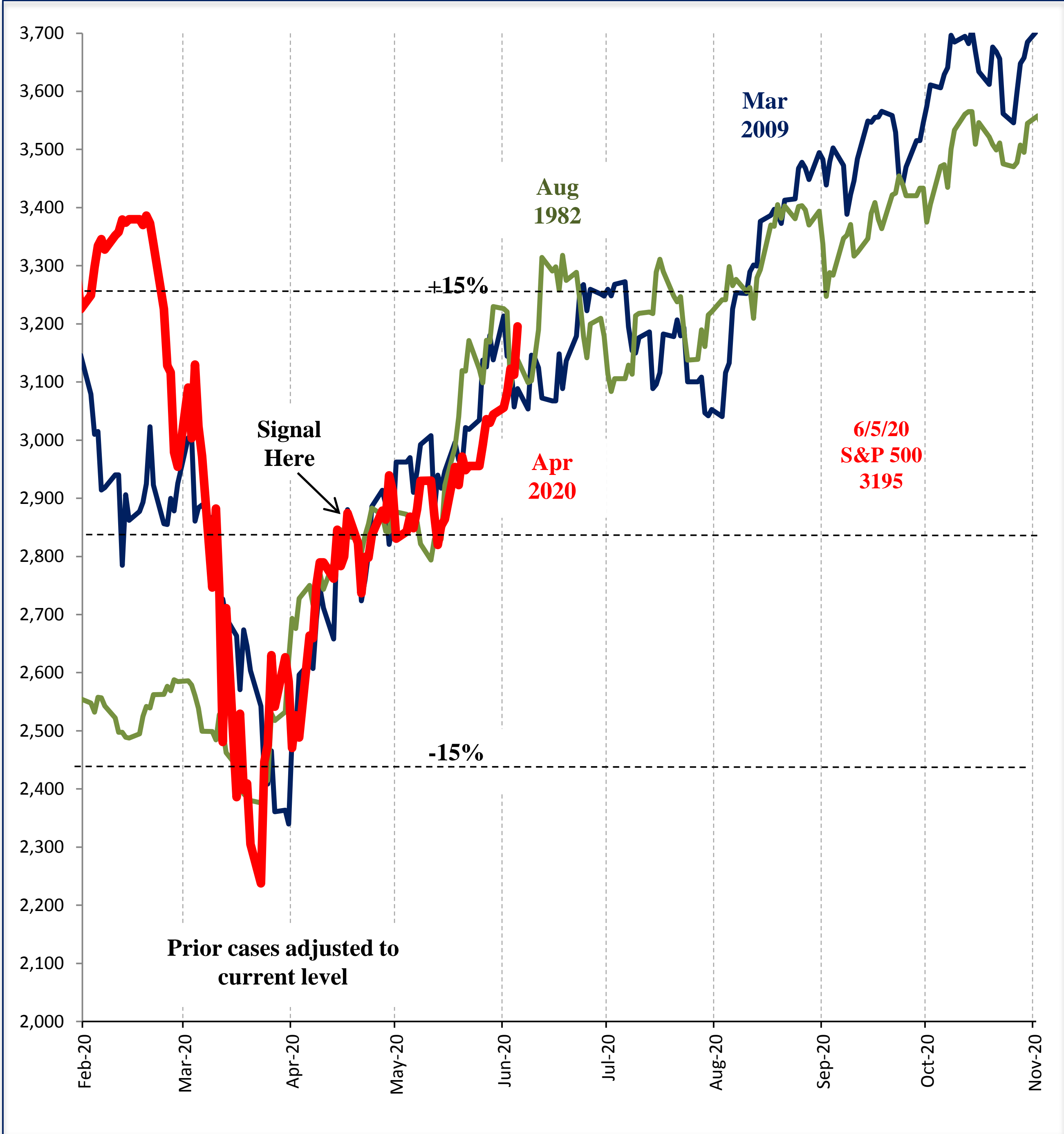
## Chart 4: One-Month Thrusts: 2 Prior Post War Cases: Sep 1982/Mar 2009



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**Zero Rates are Bullish for Equities**

The Federal Reserve cut the Fed Funds target rate to zero on March 16th. Although much focus is on the direct stimulus through balance sheet purchases, zero interest rates are bullish for financial assets, since it lowers the cost of capital for all projects and stimulates investment. The only prior cases of zero rates began in 1932 and 2009, both of which were followed by multi-year bull markets.

Chart 5: Zero Interest Rates are Bullish: T-Bill Yield since 1926

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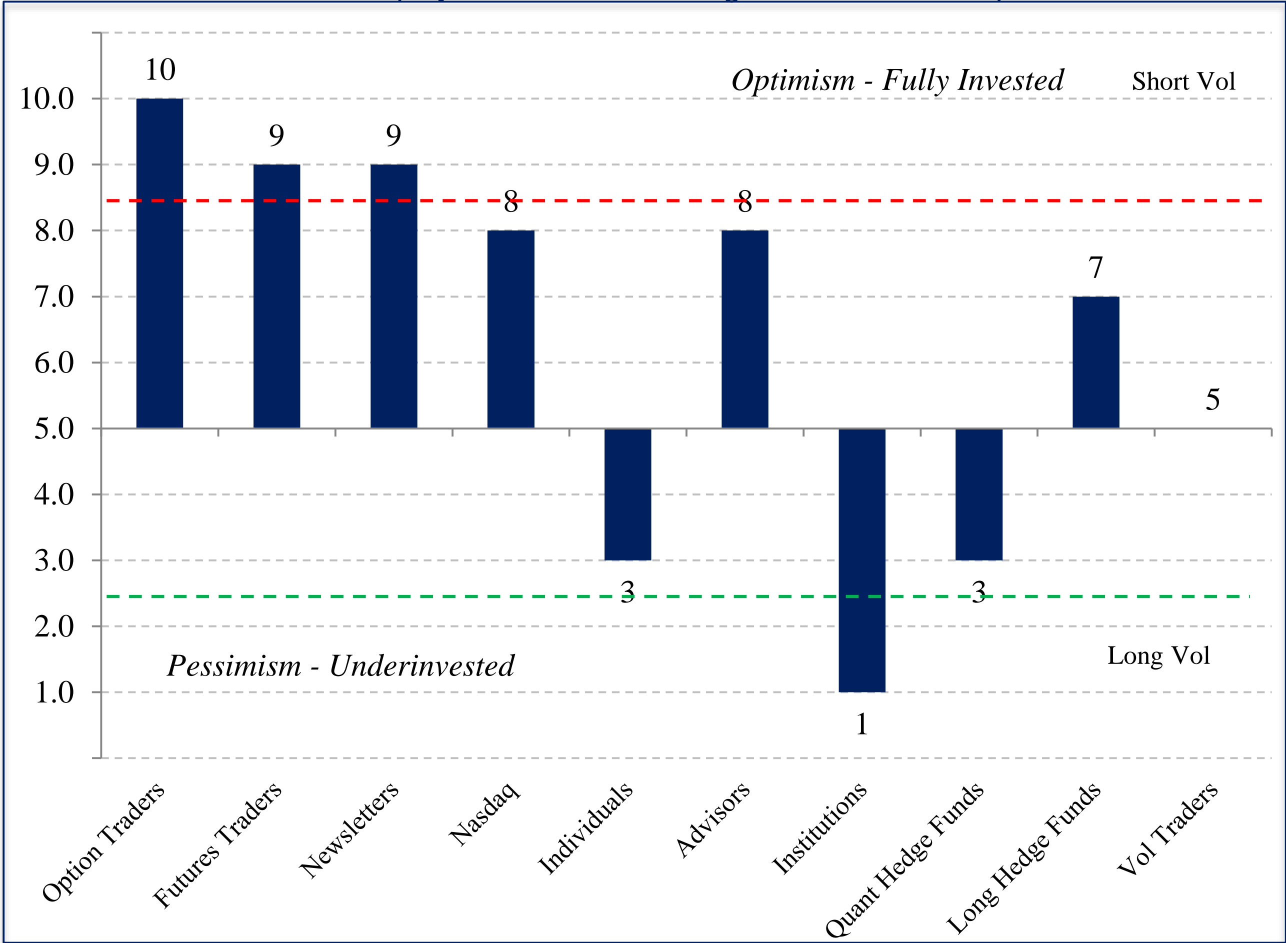
### Equity Investors Positioning Neutral

Equity sentiment shows investor groups are getting more fully invested as the market rallies but remains mixed overall. Options and futures traders are the most bullish, but these are balanced by other groups like individuals and institutions who are still underinvested. When most of the groups are long, another consolidation phase (trading range) for stocks will be more likely.

Chart 6: Equity Investor Positioning: 10 Investor Groups




### Bond Ranking Cut to 1 / Commodity Ranking Raised to Bullish 5

We cut our long-term bond ranking to a 1 based on expectations long term interest rates will rise as the economy strengthens. For the same reason, we raised our commodity rating to a bullish 5. The 10-year Treasury yield and commodity prices, like copper and crude, typically fall sharply ahead of a recession then rebound sharply to the upside prior to an economic recovery. You can see that pattern clearly around the Global Financial Crisis in 2008. So far this year the pattern is similar, with crude and copper higher and the 10-year yield just starting to rise. The rally in commodities this year is also boosted by the 6% decline in the dollar since March. During the last economic recovery, the dollar declined 16% in 2009 while crude oil doubled, and copper tripled in price. Since commodities are priced in dollars, a weaker dollar increases the demand and the price goes higher.

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Chart 7: Crude Oil vs. 10-Year Treasury Yield

### Summary

With a sharply improved economic outlook, there's a better chance the equity bear market ended in March and we have entered the Goldilocks phase of the economic cycle, the best stage for equities. Economic growth combined with a loose Fed, benign inflation and skeptical investors is a bullish combination historically. The biggest unknown is the outcome of the COVID-19 pandemic. Although a 2nd wave is likely, it appears that the economy will still accelerate as people and businesses are adapting quickly. Strong pent up demand combined with Fed and fiscal stimulus will likely overcome pandemic issues. Hong Kong and now U.S. protests are dominating headlines with serious political consequences, but so far, they do not appear to be an economic issue, and therefore, are less relevant for asset returns. The presidential election is another big unknown, with taxes likely going higher. During prior presidential election years, June was a strong month up 82% of the time since 1950, followed by more mixed returns in July to September as the campaigns and rhetoric heat up. For instance, July returns were positive just 47% of the time. We will continue to watch for indicator changes, but for now conditions are extremely positive for stocks. It is important to expect 5-10% declines in stocks, as they are normal even when conditions are positive. Thank you for your support and please contact your advisor with any questions.

**Michael Schaus**
Director of Market Research