BRENTON POINT
WEALTH ADVISORS

November 16, 2020

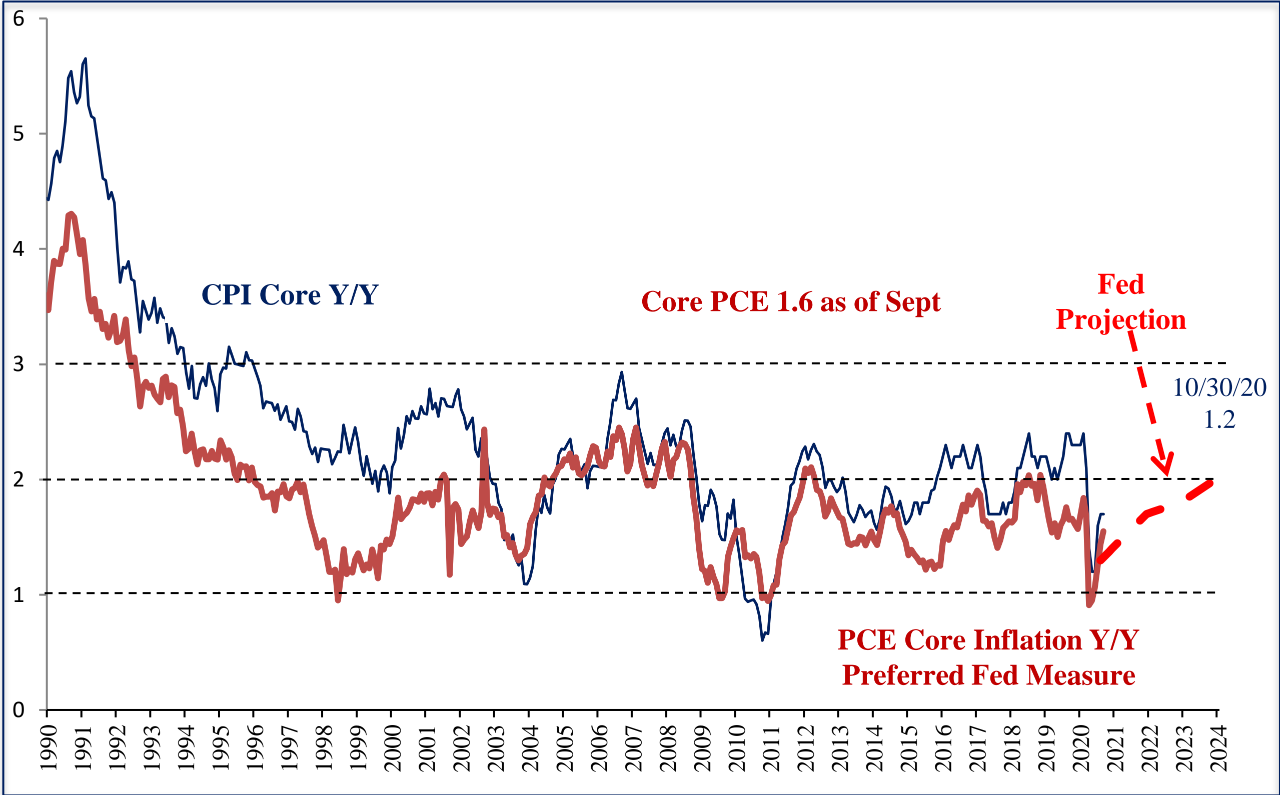
Investing Environment Review and Outlook – Volume 42

The election and COVID-19 pandemic have dominated the news and investors' attention. So far stocks have followed the historical pattern around elections; mixed prior to the election in September and October then stronger and more consistent following the election in November and December. Gridlock in Washington has been bullish for stocks historically, but economic conditions are more significant. The unexpectedly strong economy, combined with a loose Fed is potent for stock returns. We will discuss the supporting data and evidence of our conviction in markets. Equity ratings remain bullish along with commodities and gold. Long-term bonds remain at a cautious 1, due to the high probability that long-term rates will move higher.

Fed Chairman Powell Speaks Plainly: "We are NOT out of Ammo"

On 11/5 Fed Chairman Powell gave a press conference after the FOMC meeting, making it very clear the Fed was fully committed. "Fedspeak" was a term used to describe former Fed Chairman Alan Greenspan's testimony, where he would never clearly delineate the Fed's plans. In theory, the unpredictability kept speculation in check. Today the situation is reversed. Powell could not have been clearer when he said, "Monetary policy is not out of ammunition. No one should have any doubt about that. There is more that can be done." Even the Fed's inflation projections don't reach their own 2% target for over 3 years. No investor should count on a loose Fed for that long, but it is a good bet that despite the reversals in both commodity prices and inflation measures like CPI, the Fed is still nowhere near hiking interest rates, particularly bullish for equities when paired with a strong ISM index.

Chart 1: Fed Projects Hitting 2% Inflation Target in 2023



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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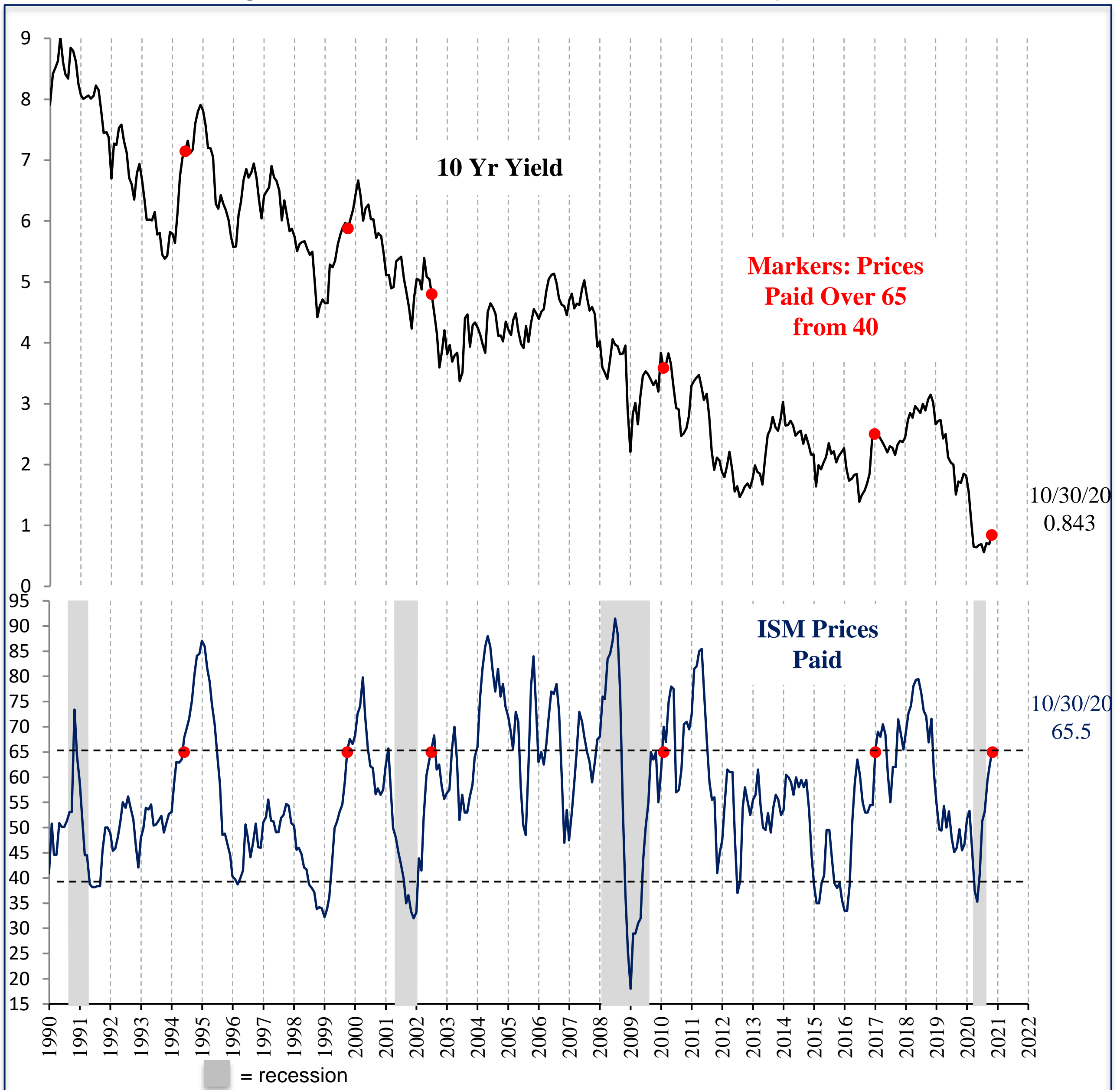
ISM Index: Unexpectedly Strong Economy Bullish for Equities

The ISM manufacturing index beat expectations and rose to 59.3 in October, the 94th percentile since 1990, and back to where the ISM index was prior to the trade war. S&P 500 historical returns are consistently bullish at 17% annualized in this zone, including a 27% return since 2004. A strong economy with a loose Fed and no inflation is a potent combination for stocks. Conditions are a different story for long-term bonds. The ISM Prices Paid component, an inflation measure, is up from 40 but still neutral at 65 (58th percentile since 1948). In prior cycles when Prices Paid reached 65, the 10-year Treasury yield had risen an average of 1.25% vs. just 0.40% this year. The latest rise in the 10-year yield (0.90% up from 0.50% in August) might be some catch-up with more to come, putting long-term bond prices at further risk.

Chart 2: Higher Prices Paid: Prior Cases 10 Yr Yield Up: 1990 - 2020



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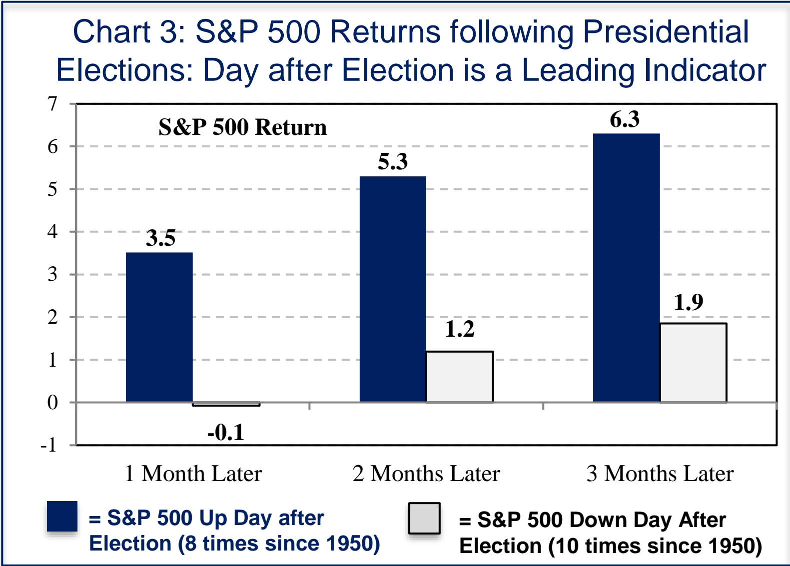
Day after Election Signal: Bullish
Generally, politics are not significant for stock market returns, but the market move the day after presidential elections is significant, reflecting investors' consensus on the outcome. In the 8 years when the S&P 500 was up on the day after the election since 1950, on average it was up a further 3.5%, 5.3% and 6.3% one, two and three months later (blue). That compares to -0.1%, 1.2% and 1.9% average for the 10 years the S&P 500 was down (grey).



This year the market rose 2.2% the day after the election, so higher subsequent returns would be consistent with prior history.

Chart 4: S&P 500 Returns in YEAR 4 of Presidential Cycle Mixed in Sep/Oct, Bullish in Nov/Dec

Ending	Current President	P	Winner	P	Pres. W/L	Party W/L	S&P 500 Perf *Before Election	S&P 500 Perf *After Election
1952	Truman	D	Eisenhower	R		L	-1.0%	9.4%
1956	Eisenhower	R	Eisenhower	R	W	W	-3.4%	3.1%
1960	Eisenhower	R	JFK	D		L	-5.7%	9.5%
1964	Johnson	D	Johnson	D	W	W	4.2%	0.4%
1968	Johnson	D	Nixon	R		L	5.1%	0.9%
1972	Nixon	R	Ford	R		W	0.9%	6.3%
1976	Ford	R	Carter	D		L	0.6%	5.2%
1980	Carter	D	Reagan	R	L	L	5.4%	7.0%
1984	Reagan	R	Reagan	R	W	W	0.4%	1.5%
1988	Reagan	R	Bush	R		W	7.2%	0.3%
1992	Bush	R	Clinton	D	L	L	1.5%	4.7%
1996	Clinton	D	Clinton	D	W	W	8.5%	5.4%
2000	Clinton	D	Bush	R		L	-5.7%	-7.4%
2004	Bush	R	Bush	R	W	W	2.6%	7.6%
2008	Bush	R	Obama	D		L	-24.2%	-6.2%
2012	Obama	D	Obama	D	W	W	0.7%	1.5%
2016	Obama	D	Trump	R		L	-1.8%	5.8%
2020	Trump	R	Biden	D		L	-6.3%	

		*Before Election	*After Election
1950 - 2020	Average	-0.3%	3.2%
	Median	0.7%	4.7%
	% Up	65%	88%
All Other Years	Average	1.3%	3.8%
	Median	1.8%	4.2%
	% Up	64%	79%

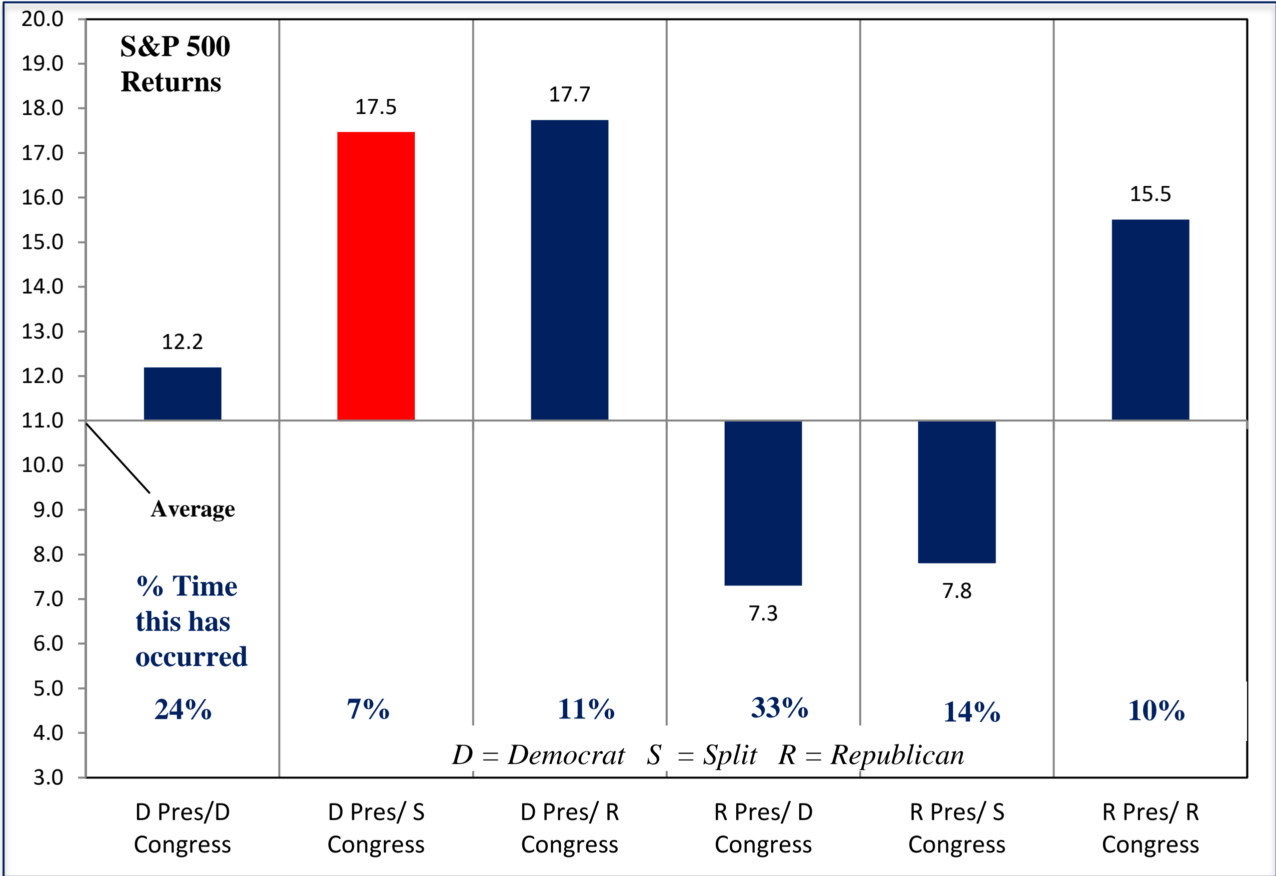
Incumbent wins

Incumbent loses

Political Gridlock: Bullish

Since 1950 the S&P 500 returned 17.5% in years when a Democrat was president and Congress was split. This occurred 7% of the time since 1950, but all cases were recent, post the Global Financial Crisis when Obama was president. The only slightly better combination was a Democrat as President and a Republican (instead of split) Congress, when the S&P 500 returned 17.7%. Political gridlock pays. However, gridlock the other way (Republican President, split or Democrat Congress) resulted in weak S&P 500 returns at 7.3% and 7.8%, below the norm. It appears that all gridlock is not created equal. In the event the Senate goes to the Democrats in the run-off elections, that would put us in the 12.2% zone, close to the historical norm of 11%.

Chart 5: Political Gridlock is Bullish This Year
S&P 500 Returns 1950-2020



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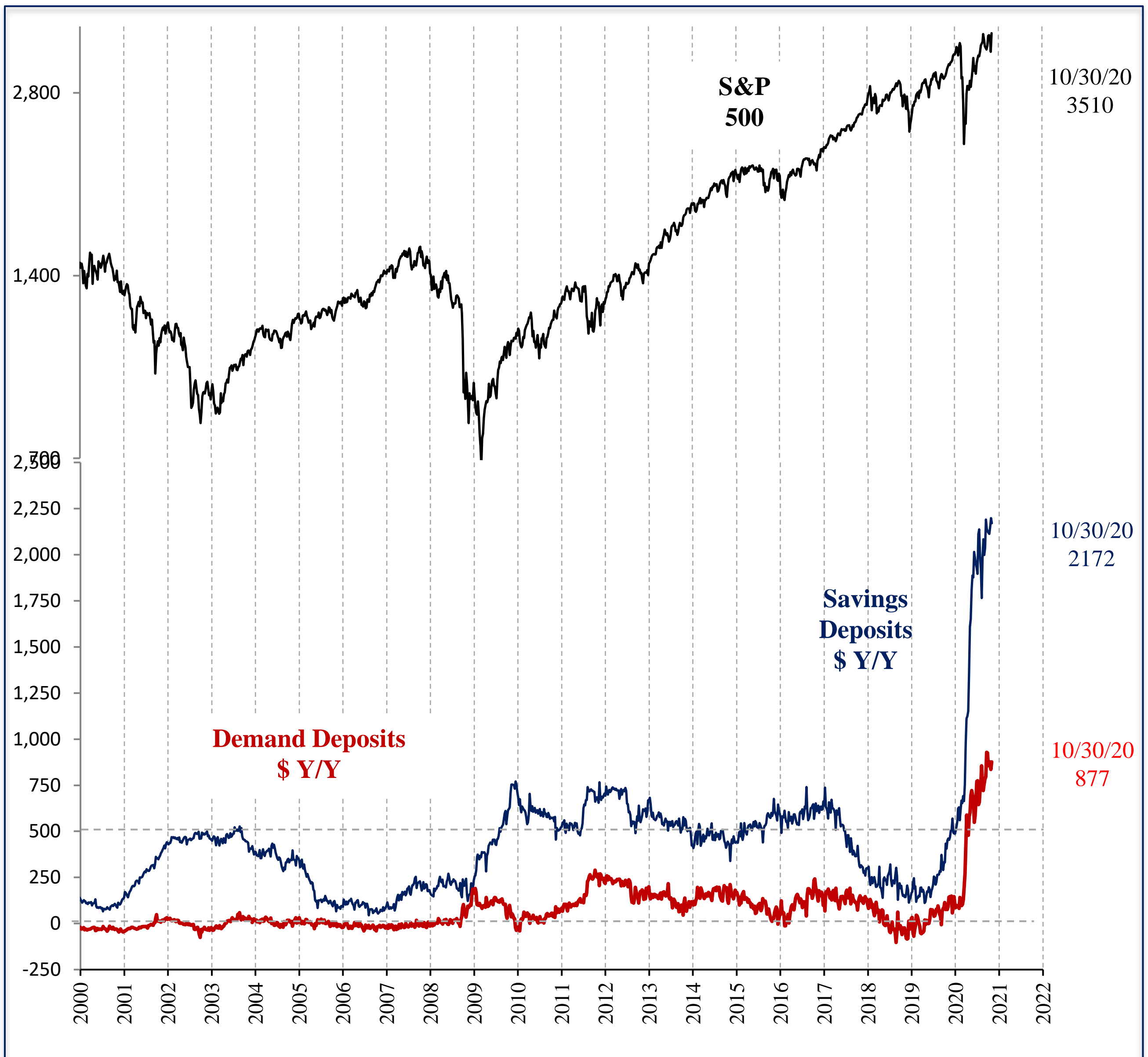
Savings: Pent-up demand Bullish

Savings deposits are up $2.1 trillion, demonstrating the power of fiscal programs amid a rebounding economy and a high savings rate. This represents pent-up demand available for future support both for equities and the economy, potentially unleashing a demand shock once a vaccine is available. Both the 2003 and 2009 bull markets continued higher while savings deposits held their gains Y/Y. Bear markets and recessions did not start until savings deposits were no longer growing. This cycle savings deposits are up almost 3x what they were after the 2008 Global Financial Crisis.

Chart 6: Savings Deposits Up $2.1T Y/Y



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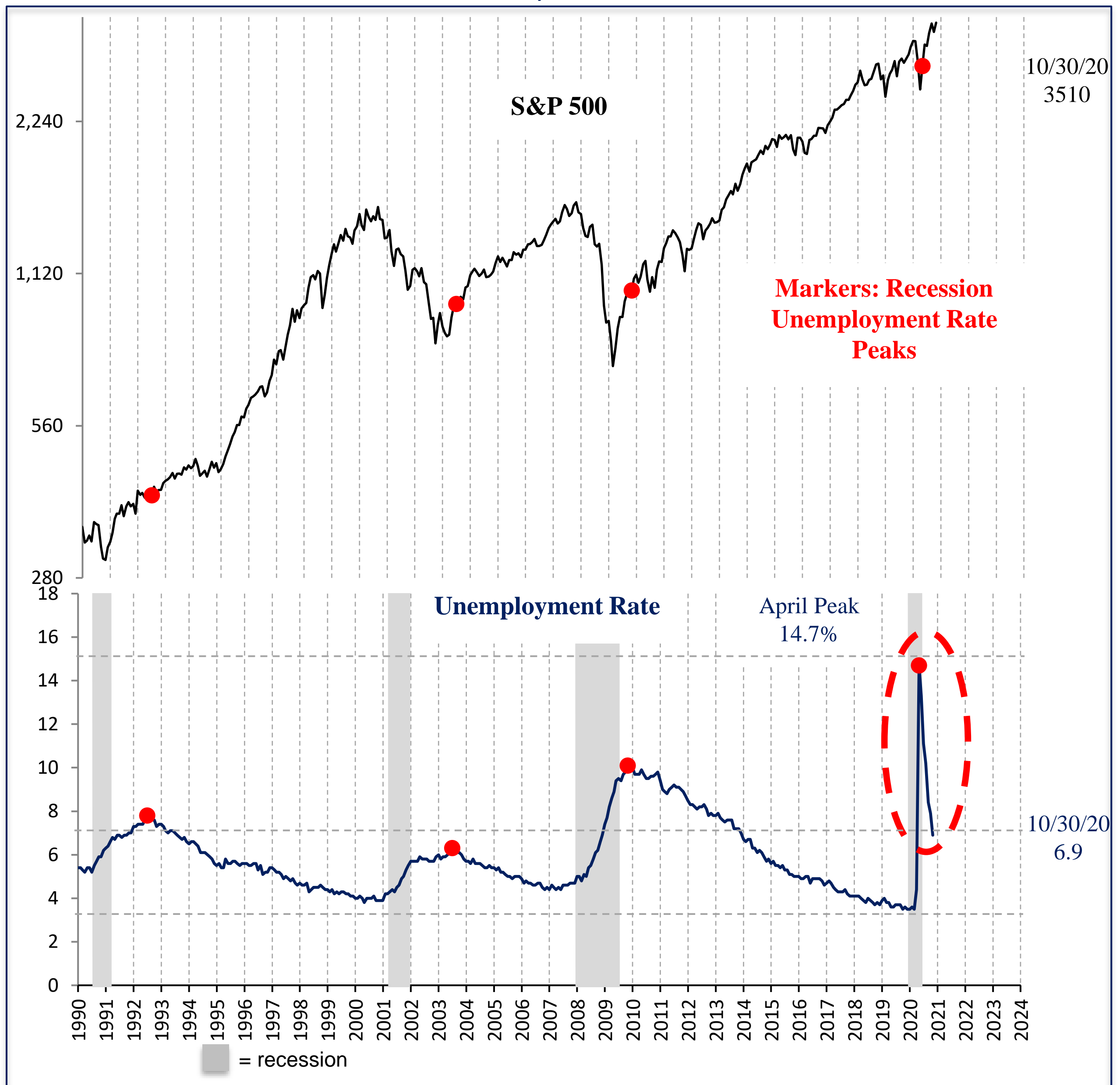
Unemployment Rate Surprise: Stable Part of the Economic Cycle

The Unemployment Rate also surprised economists, falling to 6.9% in October from the April peak of 14.7%. For perspective, the Unemployment Rate was 7% in 2013, 5 years after the Global Financial Crisis. A far greater monetary and fiscal stimulus response is working. Today marks 6 months from the April Unemployment Rate peak and the S&P 500 is up 12%, close to the average of 11% in 13 prior cases since 1928. In those prior cases, the S&P 500 returns over the next 6 months were flat. This confirms other studies showing we have likely entered a more stable stage of the economic cycle, with smaller equity gains than experienced since the March low, but also less volatility. Usually by this point the Federal Reserve is at least talking about raising rates to prevent inflation. Quite the opposite today.

Chart 7: Recession Unemployment Rate Peaks
6.9% Down from April Peak of 14.7%



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Summary

Of our hundreds of indicators we monitor daily, the economy, Federal Reserve Policy and inflation are the most important factors in determining equity market returns. With intense media coverage of politics and COVID-19, investors are constantly distracted, more so today than ever before. Our testing helps us stay focused on the most relevant facts today – the economy is surprising to the upside and the Fed is fully committed to easing monetary conditions. Historically, the S&P 500 has returned 17% with these conditions, with lower volatility than early cycle moves. Equity risks will rise later in the cycle when inflation rises, the Fed tightens monetary policy and investor confidence is extreme. Until then, we are maintaining our bullish 5 ratings on equities, commodities and gold. We are also maintaining our cautious view for long-term bonds given the risk of higher long-term interest rates. Thank you for your trust and please contact your advisor with any questions.

Michael Schaus
Director of Market Research