BRENTON POINT
WEALTH ADVISORS

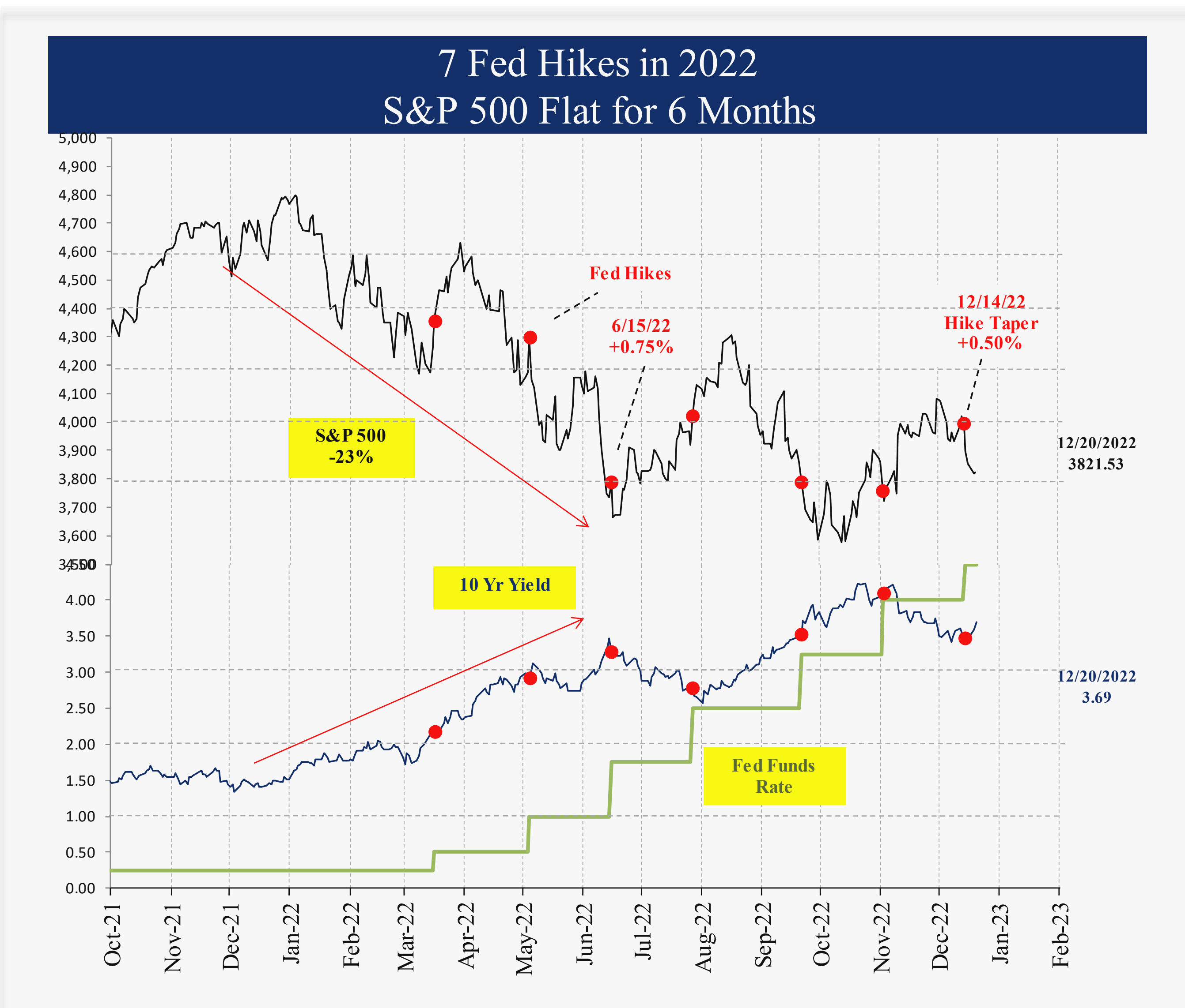
December 22, 2022

Investing Environment Review and Outlook – Volume 66

Ratings Unchanged in December

Last month we discussed the dollar trend change following the June Inflation peak and early November long- term interest rate peak at 4.3%. This month we review the implications of major central bank moves in December and the extreme investor positioning to end the year. Both support our bullish ratings on U.S. and foreign equities as well as bullish ratings for commodities.

U.S., Foreign Developed and Emerging Markets equities remain a bullish 5 rating. Long-term bonds remain a neutral 3 rating. Gold and commodities remain a bullish 5 rating.



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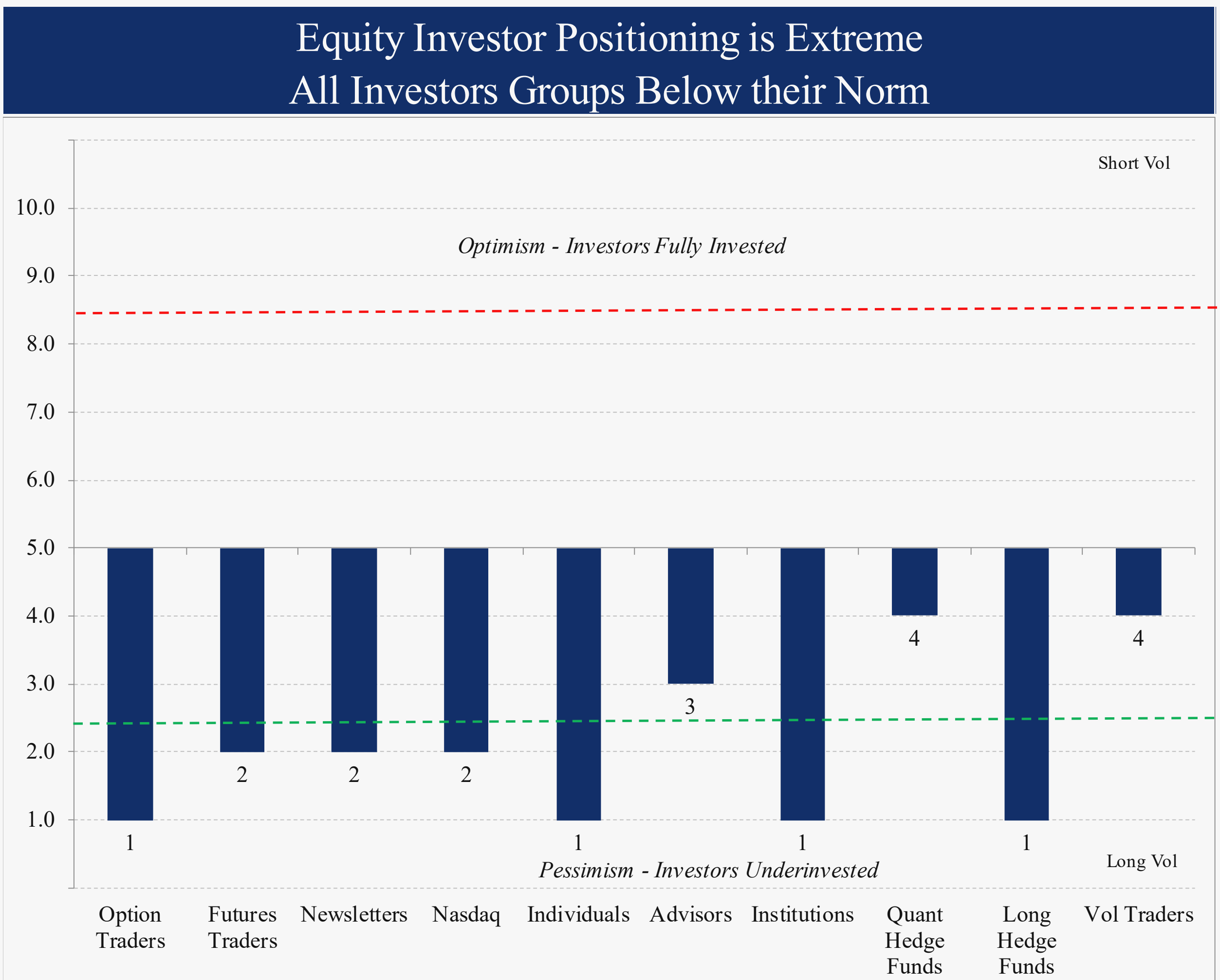
Equity Investor Positioning Extreme: Positive

After a 2 week 7% decline in the S&P 500, investor positioning is extreme. All 10 investor groups we follow are below their norm, and 6 of those are at extreme levels. This means there are high levels of cash on the sidelines available to drive stock prices higher, and less available for further equity sales going forward. It also means the bar is low for an upside surprise to consensus views.



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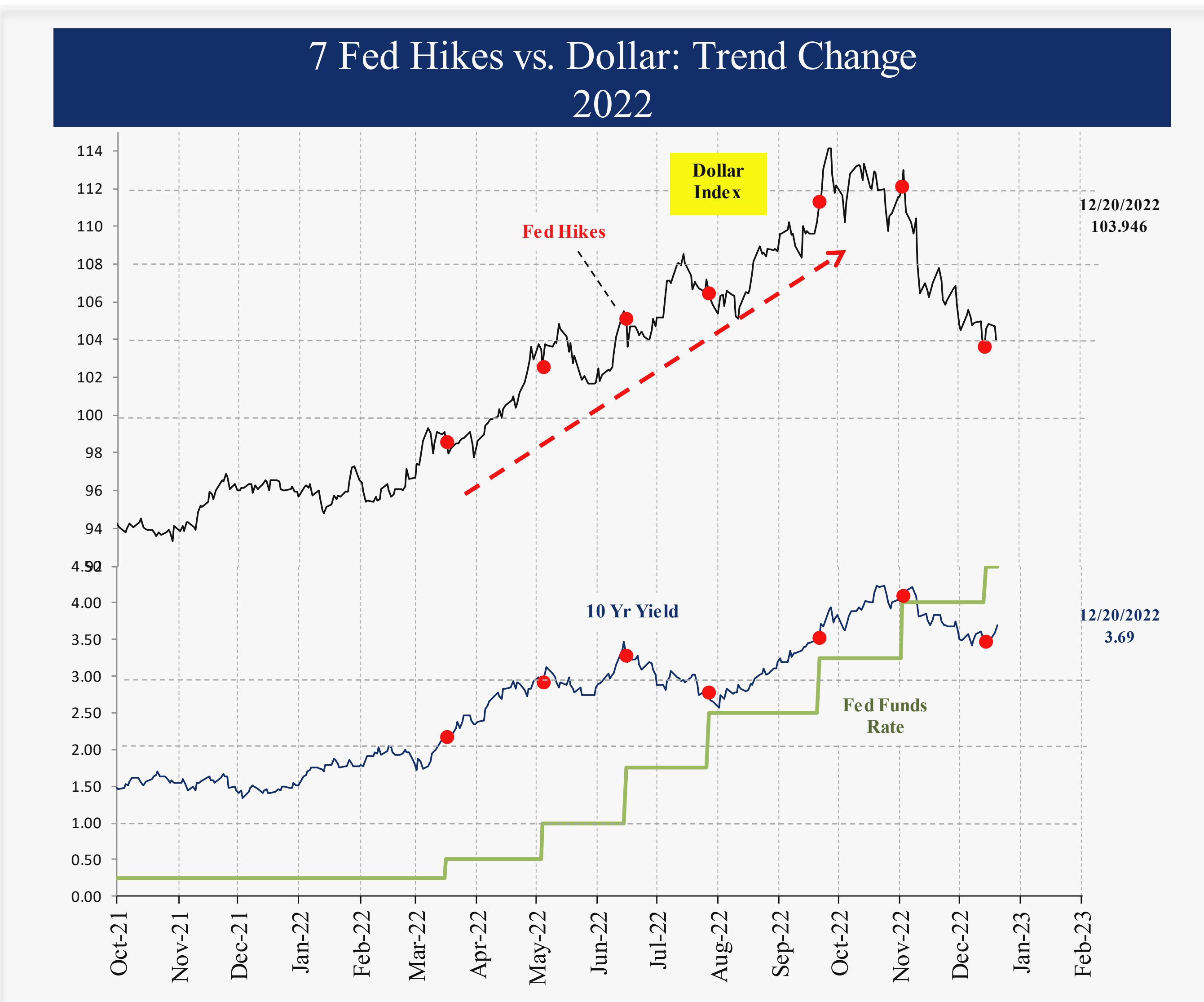
Central Bank December

December might be remembered for dramatic world Central Bank action confirming the Dollar inflection point. On 12/14 Fed Chairman Powell hiked the Fed Funds target rate for the 7th time this year by 0.5% to 4.5%, a smaller move than the prior 4 consecutive 0.75% hikes. He confirmed less hawkishness by saying that a further slowing of the pace of hiking was appropriate. Meanwhile Foreign Central Banks moved in the opposite direction. For instance, a day later, on 12/15, the European Central Bank hiked their deposit rate for the 4th time by 0.5% to 2.0%. ECB president Lagarde stated this was not a pivot, and the ECB had more ground to cover than the Fed. Then 5 days later, on 12/20, the Bank of Japan, understood by most as the most dovish major Central Bank, surprised markets by widening the band for the 10-year yield, allowing a rise to 0.50% from the previous limit of 0.25%. This relative hawkish shift from the Fed to Foreign Central banks explains the reversal in the Dollar index. The Dollar index is now down almost 9% from the September peak, reversing over half the YTD Dollar rally. As we discussed last month, the weak dollar was significantly bullish for commodities and foreign equities historically.



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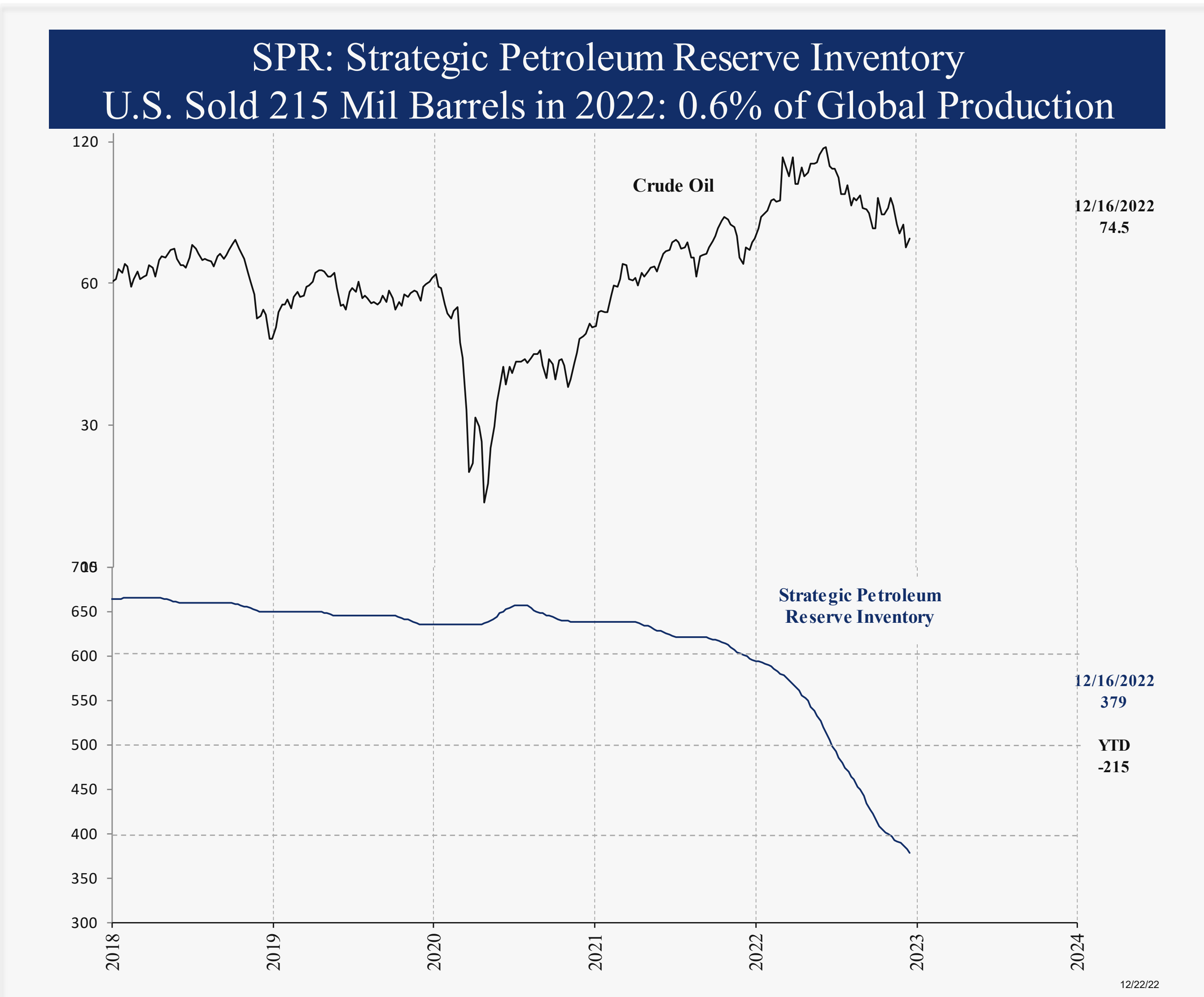
SPR Strategic Petroleum Reserve Inventory Reversal

The U.S. sold 215 million barrels of crude oil this year from the Strategic Petroleum Reserve, supposedly to bring down high gasoline prices. Last week they announced buy backs will begin to build the inventory back up, raising the question whether purchases will push crude oil higher. For perspective, the 215 million barrels sold this year is a large 36% decline in the reserve, but represents just 2 days of global oil production, or 0.6%. Since the global economy slowed this year, it is not clear that SPR changes affect the crude oil price. For instance, in the first half of the year 88 million barrels were sold from the SPR on the open market yet crude was up 56%. Our tests show that currency moves, geopolitical events like the Ukraine invasion, and global economic strength are more significant factors for crude oil.



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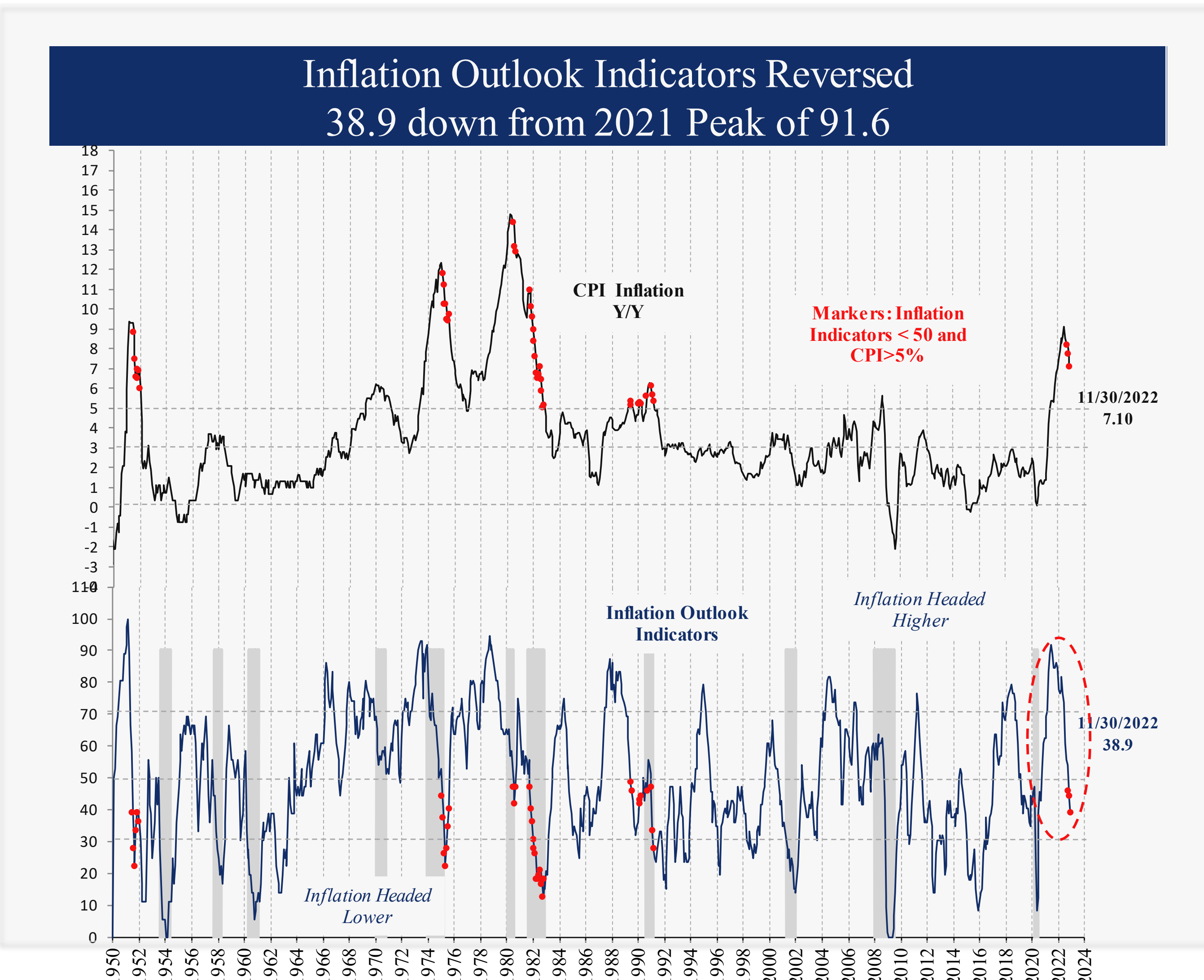
Inflation Indicators Weak

Leading inflation indicators continued lower in November to 38.9 down from a 2021 peak of 91.6. In prior cases the inflation rate continued to decline. In addition, the CPI decline to 7.1% in November was in line with prior inflation peaks in 1951, 1970, 1974, 1980 and 1990. If that norm holds, inflation will reach 4% sometime next year. More importantly, a continued CPI decline would give the Fed cover to pause hiking rates once inflation crosses below the Fed Funds target. This could occur by June and may explain the consensus for a peak Fed Funds rate under 5% by May. The inflation decline is also occurring in Europe, Brazil and China, although Japan's inflation is still trending higher.



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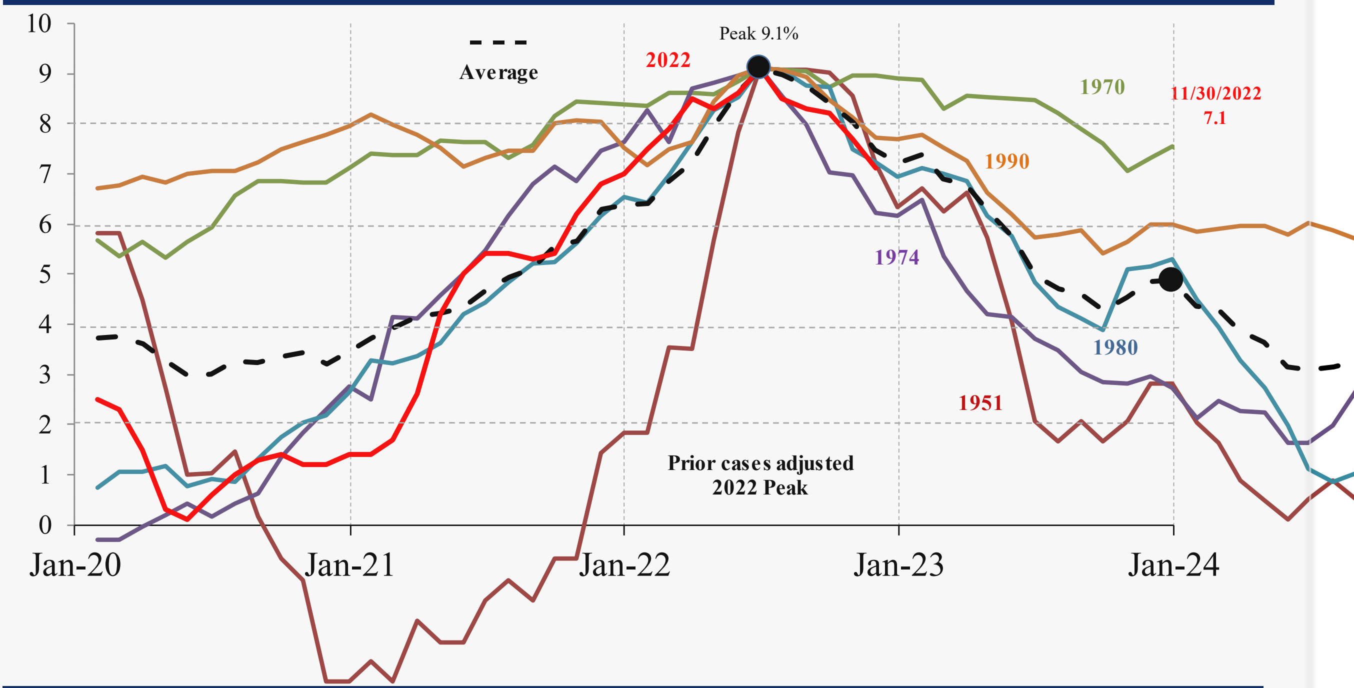
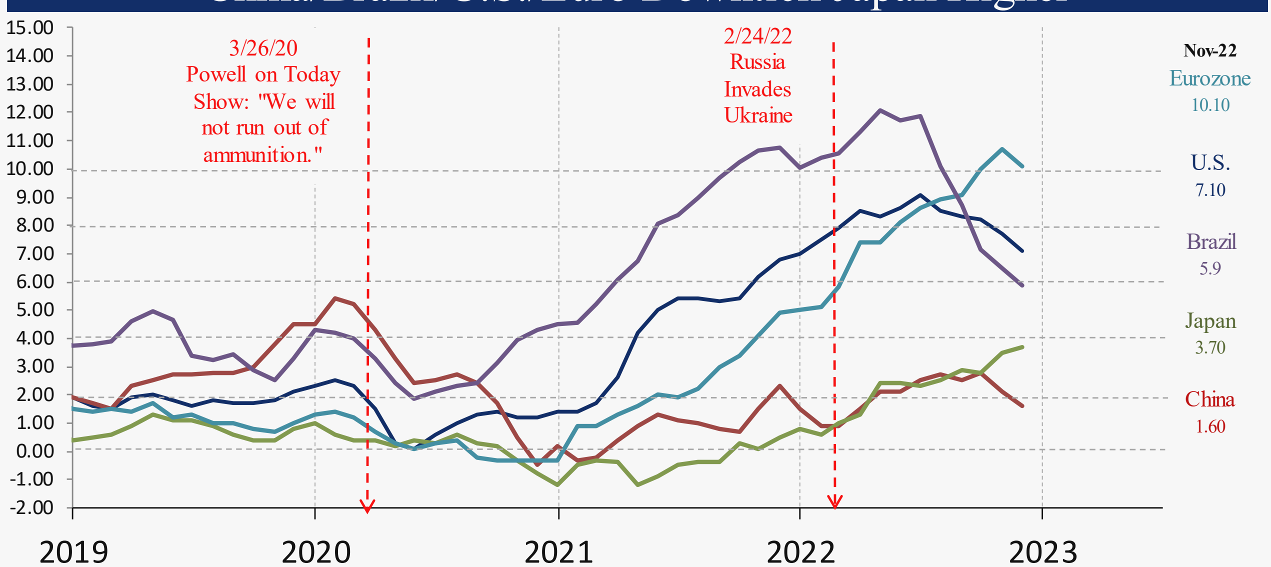
2022 CPI Decline In Line with Prior Inflation Peaks
5 Prior Cases 1951/1970/1974/1980/1990



Global Inflation Rolling Over
China/Brazil/U.S./Euro Downtick Japan Higher



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Conclusion

The major Central Bank moves in December explain and confirm the dollar turning point we discussed last month, as peak hawkishness belatedly shifts from the U.S. Federal Reserve to the European Central Bank, and even to the Bank of Japan. The weak dollar is significantly bullish for foreign equities and commodities. China's 180-degree shift on COVID and their reopening will have major economic implications. Despite the dire health consequences, markets may be looking through the worst of it to more government stimulus and consumer demand ahead. Finally, the extreme investor positioning in U.S. equities to end the year combined with the positive Q1 seasonality ahead should set up equities for a strong start to 2023. We will continue to monitor our indicators on a daily basis for changes to our outlook. Thank you for your support and please contact us with any questions.

Michael Schaus
Director of Market Research