Martone Capital Management: Weekly Investment Commentary (7/11/2016)

A couple of weeks after the U.K.'s Brexit vote, financial markets have calmed but investors are still faced with a great deal of uncertainty. The good news is that the economies in the U.S. and much of Europe were mildly accelerating before the referendum. We expect the U.S. will continue on a slow-growth path. Consumer spending in the U.S. should benefit from still-strong employment, rising wages, a firming housing market and pent-up demand in the form of savings.

The political implications of Brexit are arguably more important than the economic effects. Brexit raises questions about the EU model of economic unity. The political influence of populist leaders has been rising throughout the world in recent years, and we believe the possibility of a broader move toward nationalist, isolationist and protectionist policies would be a negative for global economic growth and risk assets, including equities. This trend bears watching.

U.S. Treasury yields plummeted following the Brexit vote and have since moved into new record low territory. Normally, low yields are a sign that the economy is weakening (if not heading into recession) and/or that the country is facing deflation concerns. But the underlying economic fundamentals do not appear to match what yield levels are telling us.

At present, global forces are the main driver of U.S. rates, and risks are rising for a clash between international forces pushing yields lower and domestic signs of inflation pushing yields higher. Core inflation rose to an annual rate of 2.2% in May, the seventh consecutive month at a level of 2% or more.

So where does all of this leave investors? The outlook for capital market returns over the next decade is largely a function of the starting point. Following a 30+ year decline in global bond yields, virtually all assets are expensive today by historical standards. For long-term investors, the implication is that prospective real and nominal returns will be low by historical standards, and the trade-off between risk and reward will be comparatively disappointing.

More to the point, equity markets appear more attractive than other asset classes. The current dividend yield of the S&P 500 Index is 2.2% (compared to less than 1.4% for the 10-year Treasury). Furthermore, nearly two-thirds of S&P 500 companies yield more than the 10-year Treasury, while close to half yield more than the 30-year Treasury. These are relatively bullish signals for equities. In other words, equities gains may be rocky, but the stock market is likely to lead this slow-moving parade.

Thank you for your continued confidence in Martone Capital Management.

We welcome your comments and questions.

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William Martone is President and Senior Portfolio Manager of Martone Capital Management, Inc., which was founded in 1994. Bill has 45 years of experience in the financial services industry and manages portfolios for both individual investors and pension funds using multiple investment strategies. Bill is a Chartered Financial Consultant, Chartered Life Underwriter and New York State Registered Investment Advisor. He is frequently quoted in the Westchester Journal Business News as well as other publications. Martone Capital Management was featured on CNNfn.