

Market Observations May 2017

SENTIMENT

The post-U.S. election lift in stock prices certainly has been welcome and seems to have reflected a positive shift in sentiment. As more data has become available, however, rising stock prices appear to have had more to do with fundamentals than with sentiment. More recent reports have been less clear on economic well-being, yet sentiment has remained high. How might trends in economic fundamentals and sentiment impact stock prices in the period ahead? Some perspective can be helpful.

Perspective

U.S. consumer sentiment as measured by the University of Michigan has trended irregularly higher from a cycle low reached in November, 2008 (and nearly repeated in August, 2011). As can be seen in **Chart I**, low levels of sentiment have corresponded perfectly with low points in the stock market and subsequent double-digit gains over the next year. High levels of sentiment have not corresponded with subsequent stock market losses but they generally have foreshadowed periods of below average stock market returns.

Table I provides comparative data for consumer sentiment and two elements that likely influence its level: employment and stock market returns. Consumer sentiment certainly has improved over the past twelve months but its rate of improvement falls well-below average twelve-month gains. The improvement in employment over the past twelve months has been well-above average twelve-month gains. As has been widely reported, the unemployment rate used here may not tell the complete employment story. Other measures such as under-employment have shown more gradual improvement. Nevertheless, some part of higher consumer sentiment would seem to reflect more employment generally.

The U.S. stock market return has been quite favorable over the past year and moderately above average twelve-month gains. This is good news. The absolute gain likely has lifted sentiment along with personal wealth but the relative gain has not been excessive. The foreign stock market return has been favorable as well but well-below average twelve-month gains. The lagging foreign stock return relative to the U.S. stock return likely has been with reason but the outcome now may be a relative opportunity in foreign markets.

Investment Implications

Sentiment likely has cause and effect interactions with both economic activity and investment returns. Analysis suggests the exact nature of these interactions can be elusive with outcomes that are quite variable. Extremes of any kind often can portend sharp reversals of prevailing trends. Fortunately at this time, the trends in sentiment, economic activity and stock markets appear to be favorable without excess. Nevertheless, the watchword is vigilance not complacency, and the prudent portfolio response is diversification.



Chart I

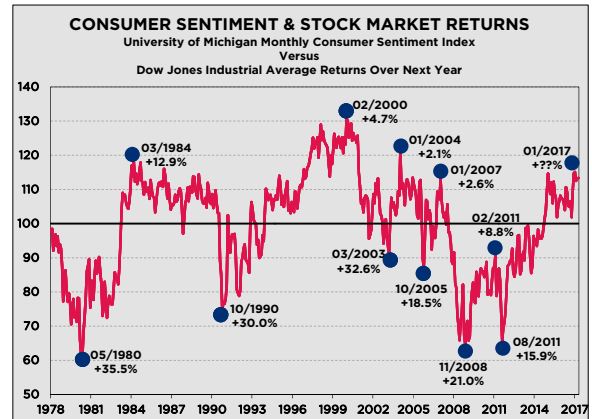


Table I

KEY ECONOMIC & MARKET TRENDS		
MEASURE	LATEST TWELVE MONTHS	AVERAGE 12-MONTH GAIN ¹
U.S. CONSUMER SENTIMENT ²	+6.8%	+10.2%
U.S. EMPLOYMENT ³	+13.6%	+9.8%
U.S. STOCK MARKET RETURN ⁴	+20.9%	+18.3%
FOREIGN STOCK MARKET RETURN ⁵	+11.6%	+20.8%

¹From January 1978
²University of Michigan Index
³BLS Unemployment Rate (Inverse)
⁴Dow Jones Industrial Average
⁵MSCI All World ex USA