ALL ALONG THE WATCHTOWER, PART I

Scott Welch – Chief Investment Officer, Model Portfolios
03/18/2021

"There must be some way out of here," said the joker to the thief
"There's too much confusion, I can't get no relief
Businessmen, they drink my wine, plowmen dig my earth
None of them along the line know what any of it is worth"

"No reason to get excited," the thief, he kindly spoke
"There are many here among us who feel that life is but a joke
But you and I, we've been through that, and this is not our fate
So let us not talk falsely now, the hour is getting late"

(From "All Along the Watchtower" by Bob Dylan, 1967, covered by Jimi Hendrix, 1968)

In this two-part blog series, we will discuss what we believe are a collection of under-reported—or perhaps underappreciated—market metrics. Specifically, we will discuss **sentiment** and **behavior** and what they might tell us about future market movements. In this first part, we will discuss confidence indicators and personal income and consumption metrics. In the second part, we will focus on investor sentiment and trading behavior.

Investor sentiment and behavior, whether retail or institutional, capture the market "mood"—is it optimistic or pessimistic? The given level of a given indicator may be less important than its trend—that is, which direction it is moving. This may provide information about how investors are likely to behave in the near to mid future.

Confidence Indicators

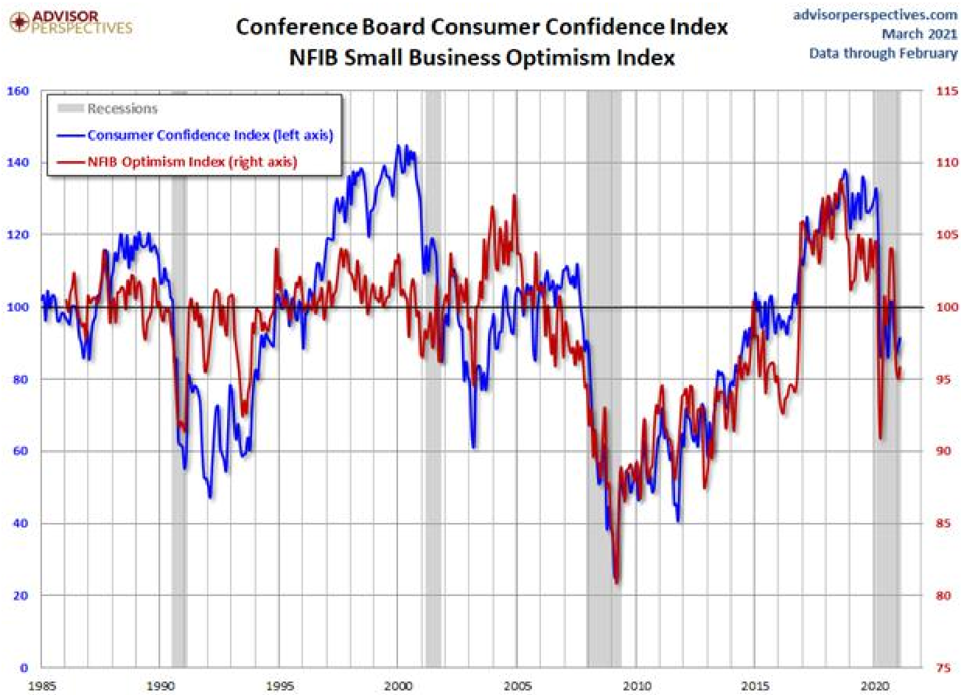
The three most commonly referenced confidence indicators are the University of Michigan Consumer Sentiment Index, the Conference Board Consumer Confidence Index and the NFIB (National Federation of Independent Businesses) Small Business Optimism Index.

The first two of these are surveys of families and households, asking their opinions of general economic conditions, family financial health, expectations for the future and so forth. Since personal consumption drives roughly 70% of the U.S. GDP, gauging the "mood" of individuals and families can be very helpful for anticipating future consumption patterns, which may, in turn, influence future market movements.

The NFIB Index surveys small business owners and asks them about such things as hiring plans, optimism regarding the economy, anticipated sales, etc. Small businesses employ roughly 50% of all U.S. workers, and so, again, knowing how they feel about the economy and their anticipated hiring plans can provide important information regarding potential future income and consumption.

Through the end of February, these indicators showed dramatic decline in the early days of the pandemic, followed by another sharp decline immediately after the elections in November, but now have improved slightly. There may still be some level of residual uncertainty regarding COVID-19 and new uncertainty over the future state of taxes and regulations under the new administration.

Source: St. Louis Fed (FRED), data through February 2021.

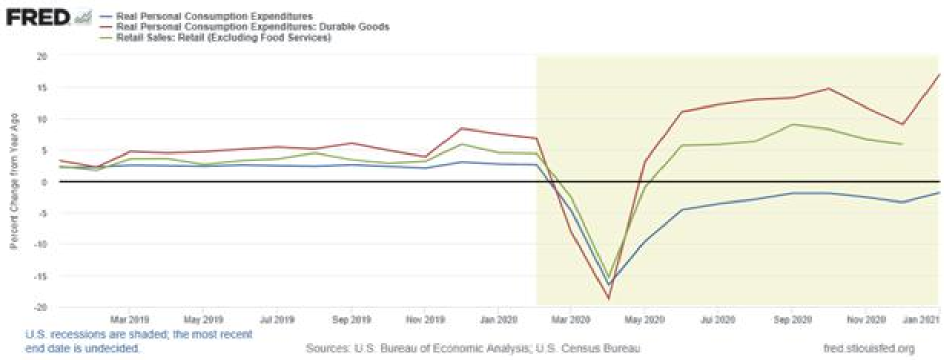


Source: dShort.com, data through February 2021.

Personal Income and Consumption

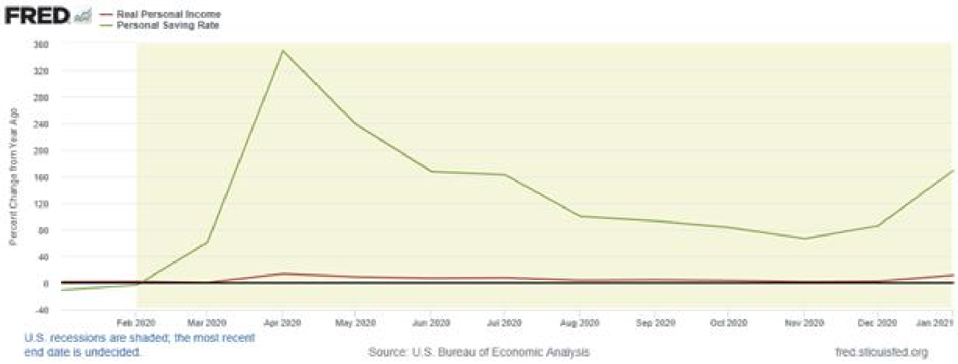
Other useful metrics concern the financial health and spending patterns of consumers. These metrics indicate how much money consumers have to spend, how much they choose to save instead of spend (the higher the savings level, the more pessimistic the consumer) and how they choose to spend.

We believe the current readings of these various metrics send generally positive but slightly mixed signals. Retail sales and durable goods sales seem to have regained and passed pre-pandemic levels, no doubt encouraged by the December $600 stimulus checks and by expectations for additional checks following the recent passing of the new $1.9 trillion fiscal stimulus package.



Source: St. Louis Fed (FRED), data through February 2021. Note that we excluded "food services" from the retail sales metric due to the continuation of restaurant capacity restrictions in many parts of the country.

Next, let's compare the change in personal income (which, again, was and will be boosted by transfer payments from the stimulus packages) to the change in the personal savings rate. What is interesting is that, despite only modest increases in personal income, the savings rate has been quite volatile. We saw a sudden spike last year as the pandemic hit, followed by a steady decline as confidence returned over the rest of the year (a bullish signal), but then a sudden spike again over the past two months—perhaps people are becoming cautious again over virus, economic and inflation concerns.



Source: St. Louis Fed (FRED), data through February 2021.

Some good news is that, perhaps because they were locked down over much of 2020, consumers took the opportunity (and their stimulus checks) to strengthen their family balance sheets. This was no doubt aided by a more than 10% increase in average home prices (as measured by the S&P/Case-Shiller U.S. National Home Price Index) and a dramatic drop in mortgage refinancing rates.

Source: St. Louis Fed (FRED), data through December 2020.

Conclusions, Part I

While uncertainty remains over new taxes and regulations that are almost certain to come under the Biden administration and a Democrat-controlled Congress, the general mood of most consumers seems to be one of cautious optimism.

Stimulus checks should spur additional consumption and provide a strong growth catalyst to an already recovering economy. As the vaccination-received levels increase and families and businesses begin to return to more normal spending patterns once again, we may see a burst of consumption—which should provide a “consumption put” under the equity markets, despite concerns over frothy valuations and rising interest rates.

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DEFINITIONS

University of Michigan Consumer Sentiment Index : a consumer confidence index published monthly by the University of Michigan. The index is normalized to have a value of 100 in December 1966.[1] Each month at least 500 telephone interviews are conducted of a contiguous United States sample. Fifty core questions are asked.

Conference Board Consumer Confidence Index : The monthly Consumer Confidence Survey®, based on a probability-design random sample, is conducted for The Conference Board by Nielsen, a leading global provider of information and analytics around what consumers buy and watch. The Conference Board is a global, independent business membership and research association working in the public interest.

NFIB Small Business Optimism Index : NFIB Research Foundation has collected Small Business Economic Trends Data with Quarterly surveys since 1973 and monthly surveys since 1986. The sample is drawn from the membership files of the National Federation of Independent Business (NFIB).

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Bullish : a position that benefits when asset prices rise.

S&P/Case-Shiller Home Price Indexes : A group of indexes that tracks changes in home prices throughout the United States. The indexes are based on a constant level of data on properties that have undergone at least two arm's length transactions. Case-Shiller produces indexes representing certain metropolitan statistical areas (MSA) as well as a national index.