Wells Capital Management

WELLS FARGO ASSET MANAGEMENT

Economic and Market Perspective

March 7, 2017 Bringing you national and global economic trends for more than 30 years

Vroom!

James W. Paulsen, Ph.D
Chief Investment Strategist,
Wells Capital Management, Inc.

The stock market has recently been revving its engine. The S&P 500 has risen by almost 20% in the last year, about 14% since election night and nearly 5% since year end. Many attribute the racing stock market to a "Trump Bump" and worry that either a presidential misstep or a failure to soon deliver on campaign promises will leave stocks vulnerable to a significant correction. We believe the stock market is far less susceptible to Trump antics (or to whether significant government action ever actually materializes) than most fear because for the first time in this recovery, the primary foundation underpinning the current rally is a broad global synchronized bounce in economic momentum.

Lost among the daily obsession with U.S. politics is a much more important event for this economic and financial market cycle. For the first time in this recovery, during the last couple of years, economic policy has been replicated about the globe. Central bank balance sheets have been expanded, money supplies quickened and yields significantly lowered simultaneously in all corners of the globe. No longer do we have U.S. economic stimulus in direct conflict with eurozone fiscal austerity, Japanese policy indifference or China's earlier quest to moderate their recovery.

Chart 1 illustrates the lagged success of finally synchronizing global economic policies and highlights the uncommonly broad-based nature of the current level of global economic momentum. The Citigroup Global Economic Surprise Index is at a seven-year high close to its highest level of the entire recovery! Moreover, the 52-week moving average of this index has recently risen to near a six-year high! Not only is the current level of positive global economic surprises near a recovery high, but positive economic momentum has not been this persistent in almost six years (i.e., the 52-week average has not been this high since early 2011). Finally, until about a year ago (i.e., early April 2016), the 52-week average of the positive surprise index was close to -10, one of the lowest readings of the entire recovery. Therefore, while the stock market is up an impressive 20% in the last year, global economic momentum during this same time has improved from almost "worst to best" for the recovery. That is, this has not been a stock market rally based on some flimsy "Trump Hope." Rather, it has been importantly underpinned by one of the largest and most persistent economic improvements of the entire global economic recovery.

Chart 1

Citigroup Global Economic Surprise Index
Solid — Weekly surprise index level.
Dotted — 52-week moving average of weekly index level.

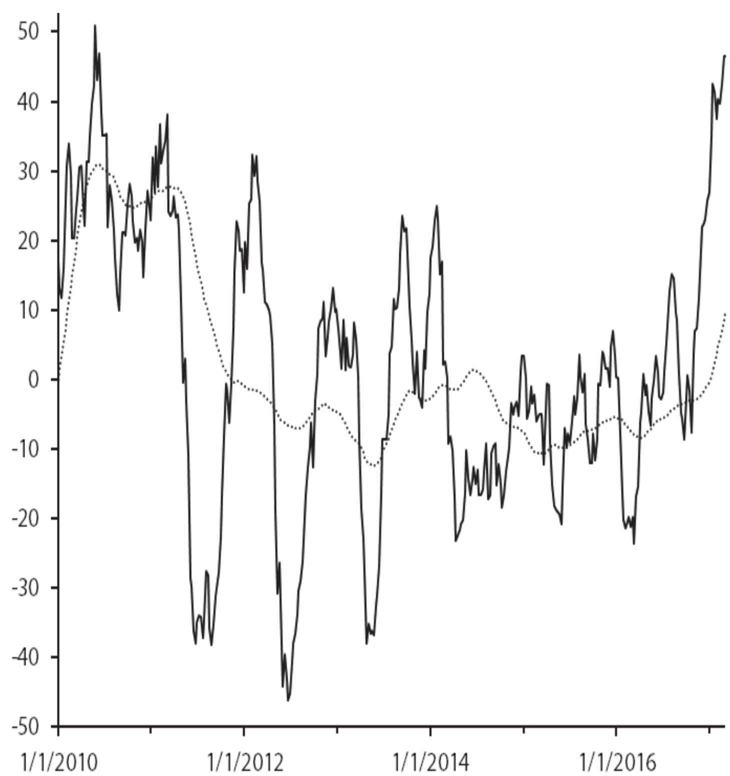


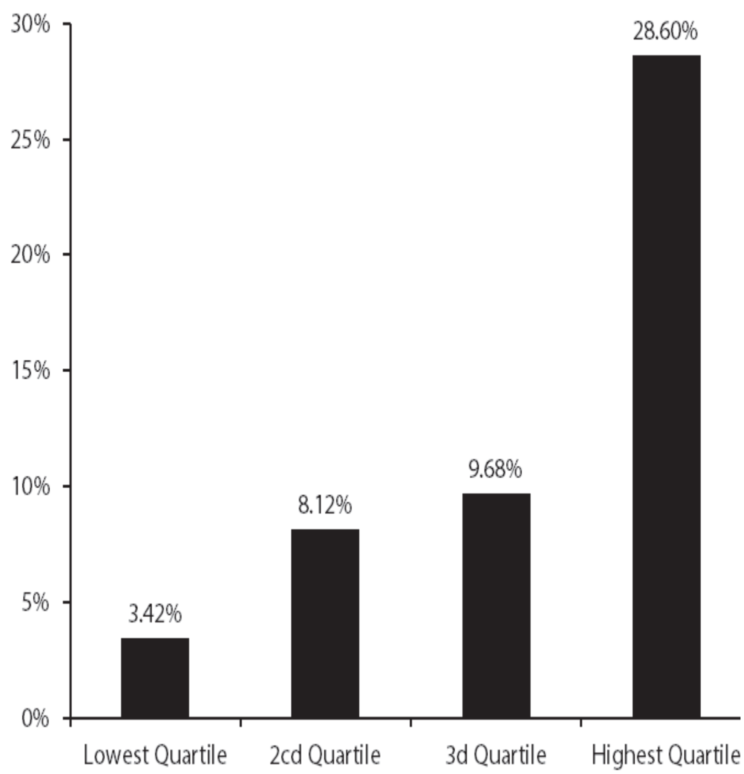
Chart 2 examines how important the level of global economic momentum has been for the performance of the U.S. stock market. Many believe the direction of global economic surprises (i.e., whether Chart 1 is rising or falling) is what is most important for the stock market. However, as shown in Chart 2, the “level” of economic surprises (whether economic surprises overall are common or rare) appears to be importantly tied to the performance of the stock market. Since the beginning of 2010, the S&P 500 has appreciated in price by about 11% per annum. However, when the Global Economic Surprise Index has been in the lowest quartile, the S&P 500 has only appreciated by about 3.4% annually compared to almost 28.6% annualized gains when the Global Economic Surprise Index among the highest quartile readings.

Currently, many worry that global economic momentum is so good it will likely slow some in the coming months. We concur. However, as shown in Chart 2, as long as economic surprises remain in the upper quartile, the stock market may continue to perform far better for longer than most anticipate. The highest quartile in Chart 1 is any reading above 18. Currently, the index is slightly above 47. Even if positive economic surprises diminish somewhat, they may remain at a level sufficient to keep fundamentally driving stock prices higher.

Chart 2

Average annualized percentage price gain in S&P 500 Composite Stock Price Index for each quartile of Citigroup Economic Surprise Index.*

*Based on weekly data since January 1. 2010. Lowest quartile represents the weakest Global Economic Surprise Index readings since 2010.



Summary

It would not be surprising for the stock market rally to pause or even suffer a temporary setback along the way. However, this rally is not nearly as dependent or vulnerable to Trump’s antics or potential government policies as many investors hope or fear. Rather, as the Global Economic Surprise Index illustrates, this rally has a fairly solid foundation. And, if readings on this index remain in the upper quartile, the stock market rally may surprise many by not just vrooming but perhaps before it is over, by even va-va-vooming!

Thanks for taking a Look!!

Written by James W. Paulsen, Ph.D.

An investment management industry professional since 1983, Jim is nationally recognized for his views on the economy and frequently appears on several CNBC and Bloomberg Television programs, including regular appearances as a guest host on CNBC. *BusinessWeek* named him Top Economic Forecaster, and *BondWeek* twice named him Interest Rate Forecaster of the Year. For more than 30 years, Jim has published his own commentary assessing economic and market trends through his newsletter, *Economic and Market Perspective*, which was named one of “101 Things Every Investor Should Know” by *Money* magazine.

Wells Capital Management, Inc. | 525 Market Street | San Francisco, California 94105