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GAUGE SHIFTS TO FAVORABLE  |  EARNINGS AND GROWTH RECOVERING  |  SENTIMENT WEIGHS

This week, we’re using this space to discuss the newest partnership between Baird Private Wealth Management and Strategas Research: the Baird Market Gauge. The Market Gauge is a comprehensive look at how we see the environment for US stocks, created by taking 16 building blocks of market conditions, evaluating whether each is favorable or unfavorable to the overall environment, and netting the difference. Read more here.

This quarter we made three changes to the Gauge. We remain impressed with the strength of the recovery, and with multiple vaccines approved and another fiscal stimulus bill looking more likely by the day, the prospects for continued expansion have improved markedly. For that reason, we moved both corporate earnings and economic growth to favorable.

On earnings, US companies had a very strong third-quarter reporting season. S&P 500 aggregate earnings were expected to decline 21% from last year, but only fell 6%. We believe that Q4 earnings should build on this strength. Further, the pace of profit margin contraction slowed during Q3. Stabilizing margins are usually a good sign for stocks.

The second change that we made was to economic growth. Economic activity remains below pre-pandemic levels, but GDP growth did bounce back in Q3. The distribution of vaccines provides the pathway to a V-shaped recovery after economic reopening. Another stimulus package could create a bridge to widespread vaccination sometime in 2021.

Our final change was to move sentiment to unfavorable. In terms of market conditions, extreme investor optimism can be a warning sign for the markets, and 3 of the 7 sentiment indicators we watch are verging on extreme (two put/call ratios and one investor survey). We’ll continue to monitor these and other metrics for evidence of excessive optimism.

With these three changes, the Market Gauge moved to a net favorable position of +2, up from neutral at the end of Q3 when recovery was less certain. The combination of a fiscal stimulus, abundant liquidity, widespread vaccine distribution, economic reopening, and the unleashing of pent-up demand could provide a global synchronized economic expansion.

Please refer to the Market Gauge piece that’s out today for more information and, as always, reach out if you have any questions. We wish you and your family a happy holiday, and we look forward to connecting with you again in the new year.
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