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Market Sentiment

-Manchester Capital Management Strategy Group

Lorie, Shaull. "An Eagles Fan Celebrates as Confetti Falls on the Field at Super Bowl LII, Minneapolis MN." Flickr, 5 Feb. 2018, www.flickr.com/photos/number7cloud/40074198602.

Investors have long sought adages or superstitious indicators to help time their entry into or exit from the stock market. Some of the more popular adages include the "first five days of January" indicator. There is some historical validity (though not enough to trade on consistently and profitably) that if the market is up for the first five trading days in January, it is likely to increase for the full year. This does work about 70% of the time, however the stock market tends to increase two years out of three regardless of what happens in the first five days. Another superstition is the Super Bowl indicator.[1] It says that if a team from the original NFL (like the Philadelphia Eagles this year) wins the Super Bowl, the market will be up for the year. Prospects are not as good for the market if a team from the upstart AFL (like the Boston/New England Patriots) wins. This indicator has actually worked 41 out of 51 times, though this can only be chalked up to coincidence since there is no reason investors should feel more bullish about older teams winning the game. Finally, the hemline index is a theory presented by economist George Taylor in 1926.[2] He posited that hemlines on women's dresses rise and fall along with stock prices. Subsequent studies have found that there is a correlation, but that a peak in the economic cycle leads a drop in hemlines by three years on average, rendering the indicator of limited value for market timing.

Putting these old adages aside, there are a number of sentiment indicators that investors follow in an effort to ascertain where we are in the cycle of "fear and greed." Some investors have found that there is a correlation between certain measures of sentiment and stock market valuations.[3] One of the more popular indicators is the CBOE Volatility Index, or VIX. The VIX tends to increase when investors buy put options in order to insure their portfolios against losses. A rising VIX indicates an increased interest in portfolio insurance, and a rapid rise in the index can indicate that fear has overwhelmed the market and created a buying opportunity. Currently, the VIX index is "neutral" relative to its history, with no strong bullish or bearish signal.

The American Association for Individual Investors (AAII) Sentiment Survey has been around since 1987. It asks members a simple question, "Are you bullish, neutral, or bearish on the market?", and compiles the results. Currently, 37% of respondents are bullish, 37% are neutral, and 26% are bearish.[4] Extraordinarily high bullish sentiment (in excess of 60%) and extraordinarily low bearish sentiment (below 10%) have generally worked well as signals of a market peak, though they have not worked perfectly and do not cause prices to change direction. Current readings are decidedly neutral and offer no signal.

Similarly, the Investors Intelligence Bull and Bear survey tracks hundreds of newsletters and assesses each author's current stance on the market.[5] Bullish and bearish extremes can be contrarian indicators, as advisors may be wrong when too many start thinking the same thing. Like the AAII survey, current readings are neutral.

The NYSE High/Low index measures the number of stocks hitting one-year highs relative to those making one-year lows. Recent readings are neutral, with highs and lows in balance. Rather than looking simply at price changes, the McClellan Volume Summation Index measures advancing and declining volume on the NYSE. Recently, more of each day's trading volume has traded in advancing versus declining issues, indicating that market breadth is improving. The index is still toward the lower end of its range of the last two years, indicating that the market is not at an extreme level.[6]

While none of these measures is a perfect predictor of future stock price movements, history has shown that sentiment indicators are worth paying attention to. It is comforting that none of them—the CBOE Volatility Index, the AAII Sentiment Survey, the Investors Intelligence Bull and Bear Survey, the NYSE High/Low Index, and the McClellan Volume Summation Index—are at euphoric levels, which would suggest a correction ahead. Lacking any strong signals from the sentiment indicators, we may resort to the old adages. If so, we'll have the first five days of January and the Eagles to thank if 2018 ends up being a good year in the market!

ENDNOTES

[1] Roberts, Ken. "Market Beat: The Super Bowl Indicator 2018." Truckee Sun, 30 Jan. 2018, www.truckeesun.com/news/business/market-beat-the-super-bowl-indicator-2018/.

[2] van Baardwijk, Marjolein, and Philip Hans Franses. "The Hemline and the Economy: Is There Any Match?" EconPapers, 28 July 2010, econpapers.repec.org/paper/emseureir/20147.htm.

[3] Brown, Gregory W., and Michael T. Cliff. "Investor Sentiment and Asset Valuation." The Journal of Business, vol. 78, no. 2, 2005, pp. 405–440. JSTOR, JSTOR, www.jstor.org/stable/10.1086/427633.

[4] American Association of Individual Investors. | AAII: The American Association of Individual Investors, 25 Apr. 2018, www.aaii.com/sentimentsurvey.

[5] US Advisors' Sentiment Report - Signals When You Need Them – near Important Market Tops and Bottoms. Investors Intelligence Advisors Sentiment: Daily Hotline Report, www.investorsintelligence.com/x/us_advisors_sentiment.html.

[6] McClellan Financial Publications. Market Breadth Data. https://www.mcoscillator.com/market_breadth_data/ (accessed May 1, 2018).