

Macro Update

January 30, 2018

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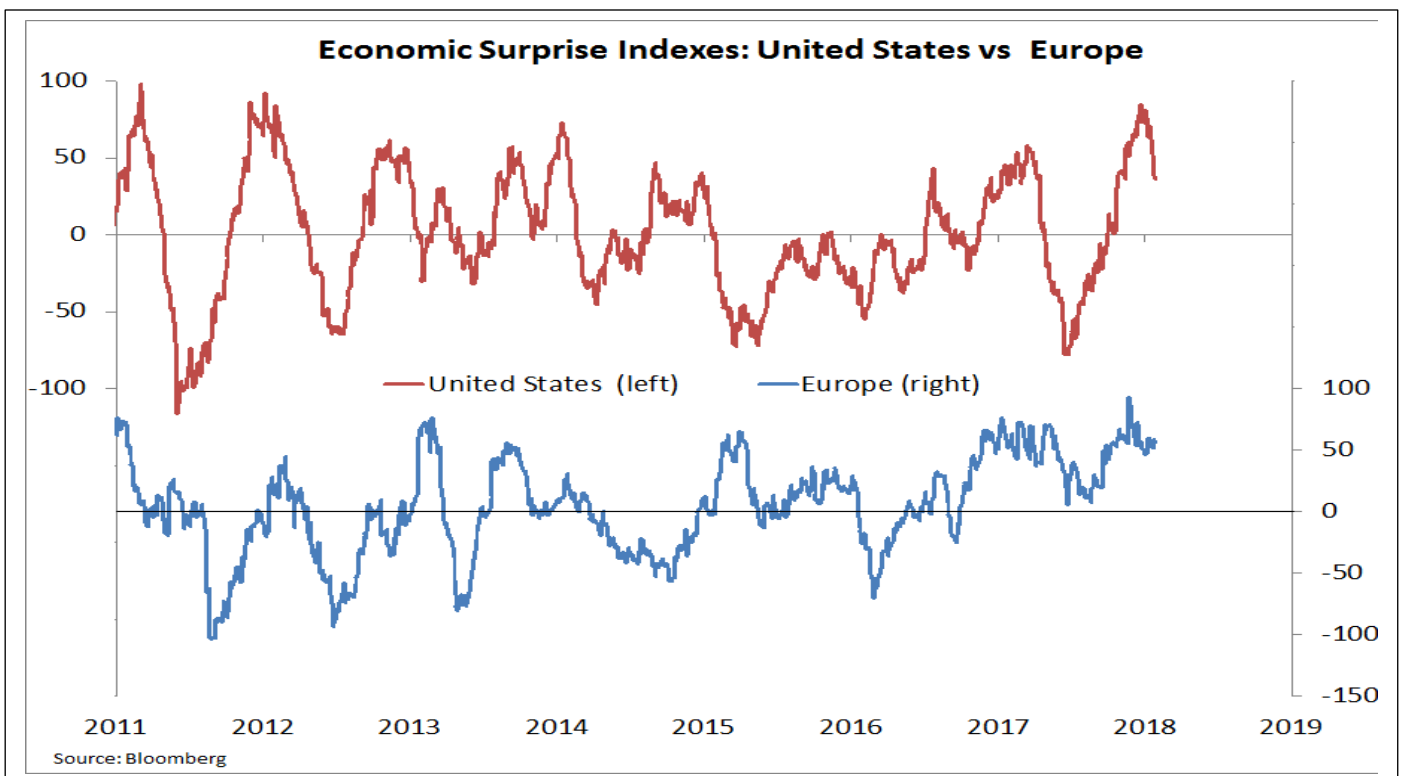
Please refer to Appendix – Important Disclosures.

Elevated Expectations Make Upside Surprises More Of A Challenge

Key Takeaways: Economic surprise indexes have pulled back from their recent highs reflecting elevated expectations more than emerging economic weakness. Economic confidence is at or near multi-year highs in the United States and Europe. Leading economic indicators continue to point higher and economic strength is leading to positive sales surprises as companies report Q4 earnings.

Economic surprise indexes in both the United States and Europe moved steadily higher over the second half of 2017 as economic data consistently exceeded expectations. As expectations have caught up to reality, economic surprises have started to wane and these indexes have retreated from their respective multi-year highs. This is part of the normal cyclical pattern in these indexes. There is also a hint of seasonality in the economic surprise indexes – they tend to weaken in the first part of the year and strengthen over the course of the second half.

Expectations are elevated and this sets a high bar to be cleared. Elevated economic confidence can be a self-fulfilling prophecy, but there are other indications that expectations are running hot right now. As mentioned in this space last week ([Valuations Are Stretched as Investors Focus on 2018 Earnings](#)), earnings expectations for 2018 have surged in recent weeks. They are now expected to grow over 30% (on a reported basis) this year. This may indicate a lot of good news on the economy is already reflected in the stock market.



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Consumer confidence can be a two-edged sword. While elevated confidence readings reflect an optimistic consensus that can work against stock prices, they can also signal a willingness to increase economic activity. In this way, elevated confidence is part of a virtuous, self-fulfilling cycle that is at times dismissed as little more than “animal spirits.”

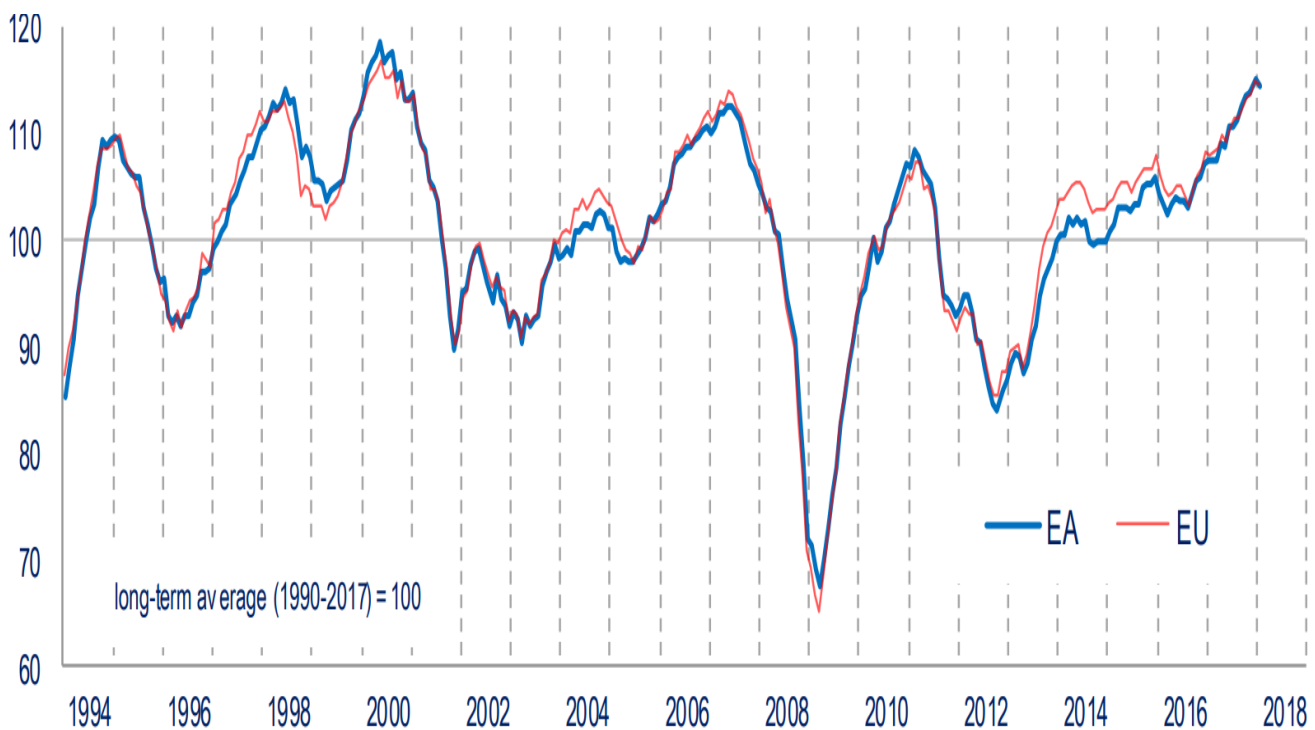
In both the United States and Europe, confidence in the economy has surged to new multi-year highs. This reflects the better-than-expected growth that was seen over the course of 2017, and could fuel further growth in 2018. At a time when consumer confidence and economic sentiment are at their highest levels in years, it's not surprising that upside surprises would be harder to come by.

Consumer Confidence Index and Components



Source: The Conference Board

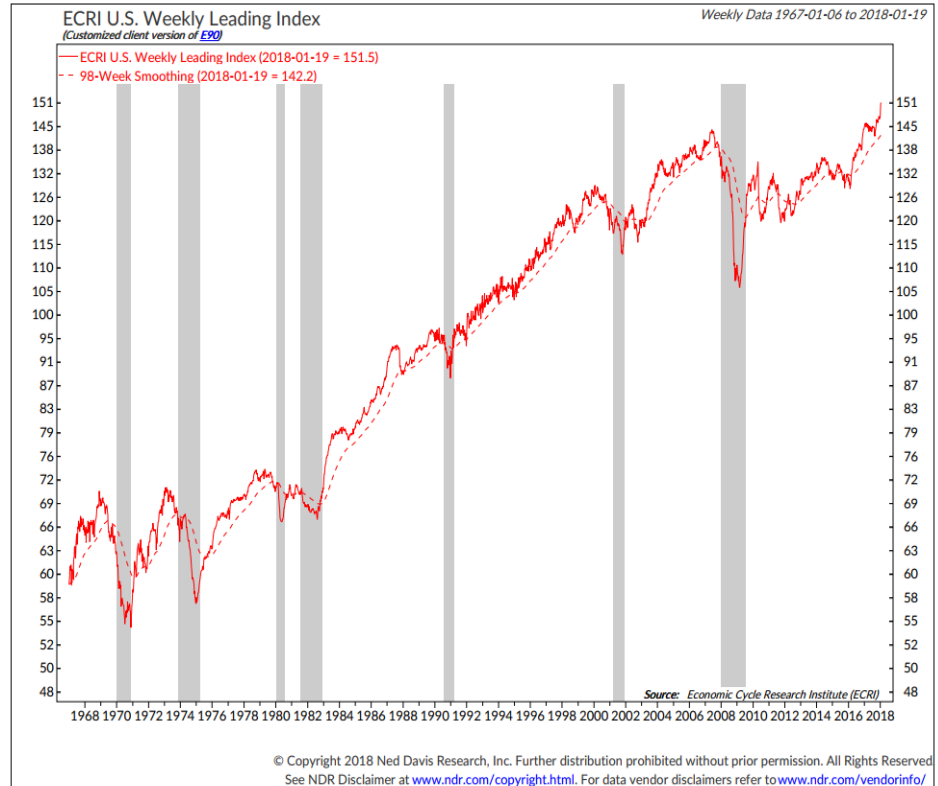
Economic Sentiment Indicator: Euro Area (EA) and European Union (EU)



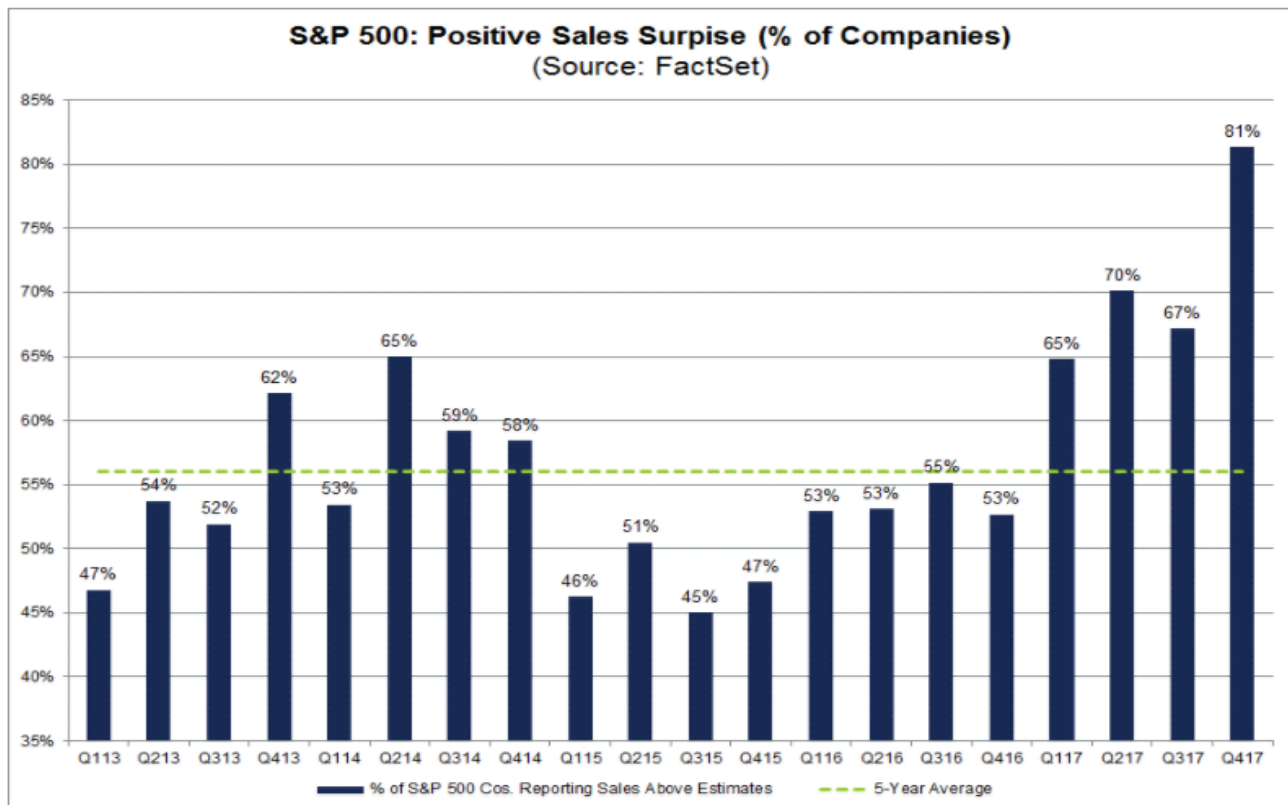
source: European Commission services

At this point, this confidence in the economy appears justified. There is little evidence to suggest a meaningful deterioration in economic conditions. Looking at the Weekly Leading Index, the opposite case could be made – that economic growth is set to continue to accelerate.

Another encouraging sign for both the economy and the stock market is that companies are reporting much better-than-expected sales numbers for the fourth quarter. At this point in the reporting season (one-quarter of companies have reported), 81% of companies in the S&P 500 have reported positive sales surprises. If this holds, it would be the best showing since FactSet started tracking this data nearly a decade ago.



Source: Ned Davis Research



Source: FactSet

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