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Sometimes good economic news isn't good for stocks. Here's why we're seeing such a moment right now.

Well, last week was a real “meh” moment for markets as US stocks shrugged off the news of strong earnings. Certain high-profile companies reported strong results, and 86% of S&P 500 Index companies have beaten market expectations so far, with 60% of the index's companies reporting.<sup>1</sup> But despite those strong results, the S&P 500 Index closed the week virtually flat. Let's face it — the US is in a “MEH” market environment right now: **M**onetary policy-driven, **E**ntitled and **H**esitant. And that may make it harder for good news to have a market impact. Let me explain:

- **Monetary policy-driven.** The current stock market rally began because the Federal Reserve stepped in and provided unusually extraordinary monetary policy accommodation. As in the global financial crisis, I believe today's monetary policy intervention has distorted risk and reward profiles for asset classes — and markets in general. When monetary policy is extremely accommodative, investors are more likely to cheer disappointing news and boo positive news because they want to see that accommodative stance continue. And so being driven by monetary policy carries with it certain risks — most notably that the stock market has clearly become extremely dependent upon very accommodative monetary policy. The very thought of beginning to reduce monetary policy support is likely to be jarring to markets if only in the very short term — think of the Taper Tantrum in 2013 (where the Fed pulled back from their quantitative easing program, causing rates to rise and stocks/credit to sell off).
- **Entitled.** In my opinion, investors were simply unfazed by the blowout earnings from a number of high-profile companies. If anything, they seemed entitled to all the strong earnings reports. As stated earlier, we are now at the point where 60% of S&P 500 Index companies have reported earnings for the first quarter, with 86% of them beating earnings estimates.<sup>1</sup> And these earnings “beats” aren't small. The average beat is 22.8% above estimates, which compares very favorably to the five-year average of 6.9% above estimates.<sup>1</sup> Last week's market behavior leads me to believe that this quarter's strong earnings season has been priced into stocks, and that next quarter will need to be better to sustain momentum. But I should add that I'm not worried, as I expect an even better positive surprise in the second quarter. As Apple CEO Tim Cook mentioned last week, increased sales, especially in China, reflect “optimism consumers seem to feel about better days ahead for all of us.”<sup>2</sup>
- **Hesitant.** The stock market is cautious. After all, stocks have already rallied dramatically, and there are concerns about the unsustainability of the current very positive environment given that government debt is growing and higher taxes are expected. This caution is also borne of being monetary policy-dependent, because sticky inflation could be around the corner, and that might force the Fed to remove the punch bowl (as we've already seen the Bank of Canada start to do). For example, last week we saw the price of lumber skyrocket.

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And this is not an isolated phenomenon — the prices of many materials are on the rise. But so far we haven't seen any dramatic increase in inflation, and I remain optimistic that any rise in inflation would be transitory, the product of a surge in spending as the economy re-opens and re-accelerates, but that spending ultimately normalizes. Last week we also got the sense that there may be cracks forming in the united front of the Federal Open Market Committee (FOMC): Dallas Fed President Robert Kaplan said that he is seeing excesses and imbalances in financial markets,"<sup>3</sup> suggesting it is time for the Fed to discuss a reduction in its bond purchase program. Investors certainly aren't ready to hear that a few strict chaperones at the Fed may want to pull away the punch bowl soon. Finally, there is still underlying concern about the pandemic. As I mentioned in a previous blog, the tragedies occurring in countries such as India and Brazil also present massive risks to the rest of the world. When the virus is able to spread so rapidly and broadly, it increases the chances that mutant strains might develop — including ones that may be resistant to current vaccines. It was reported last week that 41 cases of the mutant double strain of COVID-19 that originated in India have been found in Israel — and that strain has infected some people who had already been vaccinated.<sup>4</sup> While it is believed that the vaccines will be somewhat effective in at least minimizing the impact of the virus, this is not the news anyone wants to hear.<sup>4</sup>

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### **Positive data gets overshadowed**

Given this "MEH" environment, investors largely dismissed the positive economic developments we saw last week. And there were quite a few:

- We got a phenomenal number on Chicago-area manufacturing for April, clocking in at 72.1.5 This is the highest level since December 1983, and I believe it gives us a taste of what's to come in terms of strong manufacturing growth across the US in coming months as the economic recovery heats up.
- US household income rose 21.1% in March.<sup>6</sup> Of course, that comes after a disappointing February and seems largely the result of significant stimulus, but it does indicate that fiscal stimulus is very likely to help juice consumer spending in coming months.
- The price of copper hit \$10,000, near an all-time high, on expectations of a strong global economic recovery — and a substantial infrastructure spend.<sup>7</sup> Since my earliest days in the industry, I have known copper as "Dr. Copper" because of its history as a leading indicator of economic expansions. In my opinion, this development underscores the potential for a strong economic recovery.
- The FOMC held its regularly scheduled meeting last week and made clear the Fed remains very accommodative despite all the economic progress — and signs of rising prices — we have been seeing.

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There is even concern among some clients that we could see a significant correction this summer. While such a correction is entirely possible, I can't help but ask — how much farther could the stock market climb before any potential correction? What I have learned in more than 25 years following markets is that humans are terrible market timers. In my view, it's better to stay invested and well-diversified in order to ride out all kinds of market environments, including the "MEH" markets, than "proactively" abandon stocks because of correction fears.

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### Looking ahead

This coming week, there will be many economic data releases globally, but the one garnering the most attention will be the US jobs report for April. I expect we will see strong job creation — a blowout. And that might present a problem for investors who are already anxious and monetary policy dependent, as a strong jobs report would give the Fed one more reason to start normalizing monetary policy. However, I can't stress how important it is for investors to take a step back and not worry about what happens in the short run. Perhaps investors might even be willing to take time to actually enjoy watching the strong global economic recovery, with China and the US in the lead, and many other economies following close behind.

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### Source

<sup>1</sup>Source: FactSet Research Systems as of April 30, 2021

<sup>2</sup>Source: Apple press release, April 28, 2021

<sup>3</sup>Source: Bloomberg, "Fed's Kaplan Wants to Talk Taper, Breaks Ranks With Powell," April 30, 2021

<sup>4</sup>Source: Haaretz, "Indian COVID Strain Spreads in Israel, Also Among Vaccinated," April 29, 2021

<sup>5</sup>Source: Institute for Supply Management

<sup>6</sup>Source: US Census BureauSource: US Census Bureau

<sup>7</sup>Source: Bloomberg, L.P.

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### Important information

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

All investing involves risk, including the risk of loss.

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