

MARKET SIGHT LINES



Negative Headlines Threaten Confidence, But U.S. Resilience May Prevail

By Michael O'Keeffe, *Chief Investment Officer*



I have been writing and talking a lot about Animal Spirits, or the emotions and instincts that influence economic decision-making, especially confidence and sentiment. When Animal Spirits are positive, consumers spend more, businesses invest and hire, and investors take on risk – all of which drive economic growth. In markets, this optimism supports higher valuations and sustained upward momentum. Lately, the headlines have turned quite negative, which may well be dampening Animal Spirits. In this week's Sight|Lines, we discuss the potential influence of the media on the economy and markets, then look to how U.S. resilience may prevail to sustain economic and market growth.

THE TAKEAWAY: HEADLINES ARE NEGATIVE, BUT UPSIDE STILL POSSIBLE

While negative headlines may be dampening Animal Spirits and growth, we see potential drivers for market relief and continued growth from here. In summary:

- In their 2009 book on Animal Spirits, Robert Shiller and George Akerlof revive the term to show how emotions and psychology can influence economic decisions beyond pure rationality.
- In their work, they discuss how widespread pessimistic news coverage can dampen consumer spending and investment, potentially leading to economic downturns.
- In an informal review of recent tariff news articles, a good majority had negative headlines, but the articles themselves were more balanced.
- In one headline example on another topic, editors described April's stock market performance as the worst since 1932, but results ended up quite typical.
- As we've discussed before, some "soft data," which can reflect Animal Spirits, has turned negative. This includes consumer confidence and small business optimism.
- But important "hard data" – actual results – has remained positive and resilient.
- As we look forward, we should consider the possibility of shifts, such as announced trade deals and lower taxes, as possible drivers of positive equity market performance.

IN-DEPTH: NEGATIVE HEADLINES CAN DAMPEN ANIMAL SPIRITS, BUT U.S. RESILIENCE AND POSSIBLE SHIFTS MAY PROVIDE RELIEF AND MOVE MARKETS HIGHER

These days, negative headlines may well be dampening Animal Spirits and economic growth, and yet, shifts like possible trade deals and even lower taxes may drive market relief and continued growth from here. Going deeper:

- In *Animal Spirits: How Human Psychology Drives the Economy, and Why It Matters for Global Capitalism* (2009), Robert Shiller and George Akerlof revive the term Animal Spirits:
 - Originally coined by John Maynard Keynes in *The General Theory of Employment, Interest and Money* (1936), Animal Spirits describes how emotions and psychology influence economic decisions beyond pure rationality.
 - In their work, Shiller and Akerlof discuss how widespread pessimistic news coverage can dampen consumer spending and investment, potentially leading to economic downturns.
- I recently ran an informal review of tariff news articles since April 1:
 - About three-quarters of the articles had negative, and sometimes sensational, headlines.
 - But among those that were negative, about two-thirds of the articles were neutral to positive.
 - Combining these, we see the content of the articles overall was more balanced.
- Here is one headline – “Dow Headed for Worst April Since 1932 as Investors Send ‘Sell’ Signal”:
 - The Dow is a very concentrated index and does not represent the stock market.
 - A more diversified index, the S&P 500, fell 11.2% to start the month, the second worst move since 1932, but then recovered 11.8%, the fifth best recovery since then, ending the month down only 0.7%, a common, modestly negative return.
- Some “soft data,” which can reflect Animal Spirits, has turned negative recently:
 - The Conference Board Consumer Confidence Index fell to a 13-year low of 86.0 in April.
 - NFIB Small Business Confidence Index declined to 97.4 in March from 105.1 in December, placing it just below the 51-year average of 98.
- But some important “hard data” – actual results – has remained positive and resilient:
 - The consumption component of first quarter GDP grew at a 1.8% annualized rate.
 - 83% of companies in the S&P 500 have reported earnings growth of 13.6% for Q1.
- As we look forward, we should consider the possibility of shifts:
 - We anticipate the Trump administration will begin announcing some trade deals.
 - The administration is also focused on extending the 2017 tax cuts and implementing more.

CONCLUSION

When positive, Animal Spirits, or the emotions and instincts that influence economic decision-making, can push consumers to spend more, businesses to invest and hire, and investors to take on risk – some drivers of economic growth. But headlines have turned quite negative lately, which are likely weighing on Animal Spirits. This emotional shift may be the cause of the next recession. But as we unpack hard data and remind ourselves of the history of U.S. resilience, investors are well served to consider the potential upside looking forward if that resilience takes hold.

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