

Bullish Sentiment of Newsletter Writers & Retail Investors at Rare Divergence

This week, Rocky White of Schaeffer's Investment Research wrote an **article** discussing the divergence in bullish sentiment among investment newsletter writers and retail investors. Specifically, he looked at AAI's **Investor Sentiment Survey** and the weekly **Investors Intelligence** (II) sentiment poll and how bullish sentiment between the two indicates very different expectations.

But first, some background. AAI's Investor Sentiment Survey is open to all AAI members, who can vote each week on where they believe the market will be going over the next six months. Specifically, they can state if they are bullish (they think the market will go up), bearish (they believe the market will go down) or neutral (they believe there will be no change in the market). According to White, the II poll is compiled by the editors of Investors Intelligence, who look at published investment newsletters and decide whether they are bullish, bearish or expecting a correction (this is short-term bearish but long-term bullish). White points out that the differing methodologies of the polls make the AAI sentiment survey results more volatile, as members can go bullish to bearish (or vice versa) anonymously on a weekly basis. In contrast, newsletters are more apt to maintain their outlook for longer periods until they are proven correct.

According to White, the II eight-week bullish average topped out at 60% earlier this year and is at levels last seen in 2014. In contrast, bullish sentiment among AAI members fell 3.3 percentage points this week to 25.7%, its lowest level since the November 8 presidential election, but still above lows set last year. The eight-week average of bullish sentiment fell to its lowest level since November 17. Currently, AAI member sentiment is in the least optimistic quartile, dating back to the Sentiment Survey's inception in 1987. Based on White's analysis, three- and six-month forward returns for the S&P 500 index are the strongest versus the other three quartiles. In contrast, the II survey is in its most optimistic quartile of dating back to 1987. Historical data shows that the average three- and six-month returns for this quartile are the worst relative to the other three.

White took his analysis one step further to examine how stocks behaved when there was such a disparity between the bullish readings of these two polls. He found that there have been 23 occurrences where AAI bullish sentiment was in the lowest quartile and II bullishness was in the top quartile. What he found was that, on average, the S&P 500 tended to underperform, as the index averaged a loss of 0.4% over the next three months compared to the average three-month return over the entire period of 2.12%. Looking at the average six-month returns in the S&P for these 23 occurrences, the S&P 500 tended to lag compared to the average six-month return over the entire period.

I have also written about using the AAI Sentiment Survey as a contrarian indicator, and AAI Journal editor Charles Rotblut **updated** that research in 2013. What we found was that low levels of bullishness have, historically, been more correlated with rising markets than high levels.

Earnings Season Update

A few weeks ago, FactSet was forecasting that U.S. companies would report their strongest quarterly earnings since the fourth quarter of 2011. As of the end of the first quarter, analysts were expecting earnings for S&P 500 companies to grow by 9.1% in the first quarter compared to a year ago. However, this is down from the 12.5% growth that was forecasted at the start of 2017 for the first quarter.

This week, five current SSR stocks reported their first-quarter earnings and all five companies beat their consensus earnings estimates.

To date, eight of the 36 stocks currently held in the SSR tracking portfolio have reported results for the first calendar quarter of 2017. All eight have reported positive earnings surprises, where reported earnings exceeded their I/B/E/S consensus estimate. For this earnings season, the median earnings surprise for the SSR companies is +5.4%.

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