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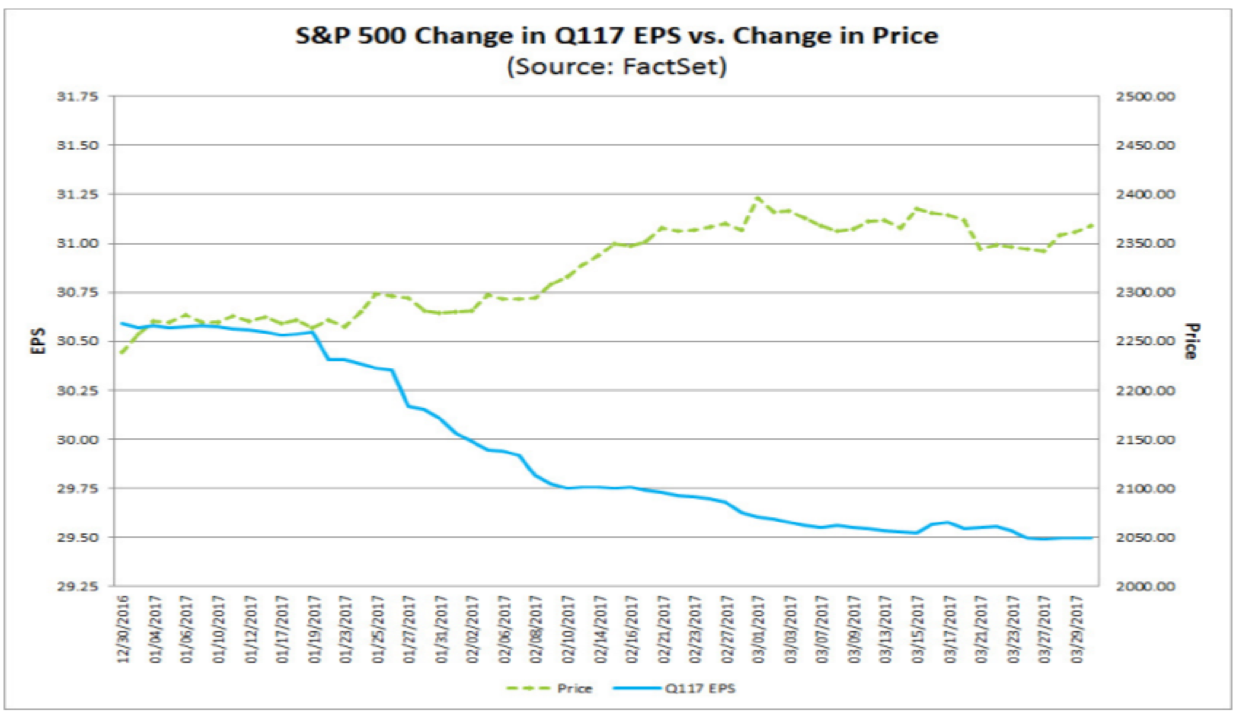
April 2017

Caught Between a Rock and a Soft Place

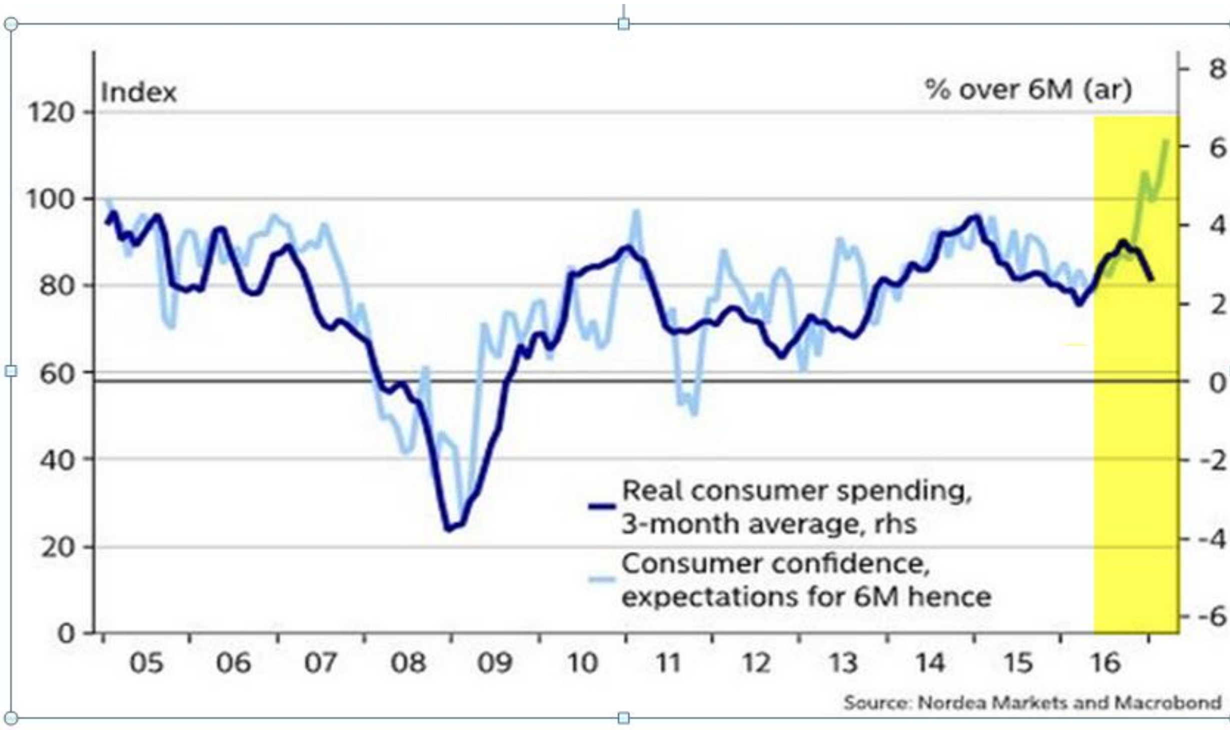
"There are things known and there are things unknown, and in between are the doors of perception" – Aldous Huxley

Since the Presidential election, optimism has driven the stock market higher. From November 8th of last year through the end of the first quarter of 2017, the S&P 500 is up over 10%. At the same time earnings for these same companies have waned. In fact, earnings for the S&P 500 companies have declined in 16 of the past 20 quarters. The chart below compares the earnings of the S&P 500 (blue line) to the price of the index (green line) since the beginning of the year. As prices have ground steadily higher, profits of these same companies are trending downward.



This dichotomy highlights the difference between what is known as "hard data" (actual results) versus "soft data" (perception).

Another example of significant divergence between these two measures is consumer confidence (soft data) against consumer spending (hard data). Take a look at the highlighted area of the graph below. Since the end of 2016 consumer confidence has soared (light blue line), but consumer spending has been trending downward (dark blue line). Approximately 70% of US economic activity is driven by consumer spending. If consumers aren't spending, it will be difficult for our economy to take off.



So what can be gleaned from this data? Currently there is a significant difference between what people believe will happen and what is actually occurring. It is true that the stock market is a leading indicator, and it may portend better times ahead. It is also true that it can sometimes lead down blind alleys, as it did in 2000 when the tech bubble burst taking the rest of the stock market with it, and in 2017 prior to the financial crisis.

We believe we are positioned to take advantage of opportunities as they present themselves. In the meantime, we will continue to monitor whether perception becomes reality.