This Sentiment Index Could Be Signaling A Buying Opportunity In Stocks

View from the Observation Deck

1. In July 1987, the American Association of Individual Investors (AAII) began polling its own members in an effort to gain insight into the moods of individual investors.
2. Each week they ask their members if they are bullish, neutral or bearish on the stock market looking out six months. We have chosen to focus on the bullish indicator.
3. As indicated in the chart, the 52-week moving average, which helps smooth out some of the sharper fluctuations over time, for the Bullish sentiment reading was 27.79% on 11/3/16. That was below where it stood on 11/1/90 (28.81%) and well below the historical average for the period in the chart (39.27%). Investors, on average, were not bullish on stocks at the start of November 2016.
4. We chose November 1990 as our start date because it just happened to be the last time that investor sentiment was this negative per this index. What is interesting about November 1990 is that the U.S. economy was in recession. The recession lasted from July 1990 through March 1991, according to the National Bureau of Economic Research. U.S. GDP growth was an annualized 2.9% in Q3’16, according to the Bureau of Economic Analysis.
5. When sentiment readings notably fall below or rise above their respective historical norms, some investors may interpret the moves as signals to either buy or sell stocks. A contrarian might view the current readings as a signal to buy.
6. We need to acknowledge that past performance is no guarantee of future results. Having said that, from 10/31/90-10/31/91, the S&P 500 Index posted a total return of 33.50%, according to Bloomberg. While we are not suggesting that a return of that magnitude is in the cards over the next 12 months, anything positive would likely be well-received by investors, in our opinion.

This chart is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions and other expenses incurred when investing. Investors cannot invest directly in an index. The S&P 500 Index is a capitalization-weighted index comprised of 500 stocks used to measure large-cap U.S. stock market performance.