ADVISER INVESTMENTS

AI MARKET METRICS

Job Losses May Mean Market Gains

In the current "slow-growth, not no-growth" environment, the level of U.S. unemployment has remained stubbornly high. Nevertheless, we have seen some progress in the jobs market and we expect to see more in the year ahead.

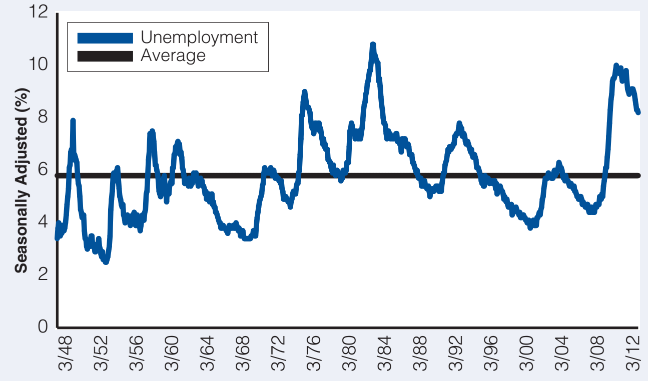
There's no doubt that economic growth and job creation go hand in hand. Currently, there are a range of risks to their sustainability. A protracted financial crisis in the euro zone, coupled with an accelerating slowdown in China, ongoing turmoil in the Middle East and, of course, the political uncertainties of the upcoming November election continue to be a drag on what would otherwise be a stronger economic and jobs market recovery.

How should the current unemployment levels impact investment decision-making? To put today's job market progress in historical perspective, and to lend a sense of our cautious optimism about it, we looked back at the unemployment rate since 1948, the longest accurate data set available. The chart below shows that, while there has been a recent steep decline, the unemployment rate has stubbornly lingered above 8% for the past three years. Only two other times, in 1975 and 1982–1983, did the unemployment rate climb above 8%. In both cases, we saw a sharp V-shaped recovery in employment. In the current period, we've seen some declines, then several retracements followed by further declines.

While we would never recommend making a major move based on a solitary market metric, a high level of unemployment has proven to be a contrarian indicator for stocks. In other words, periods with higher unemployment are typically better times to invest in stocks, while lower unemployment rates signal economies in full flush and are often followed by lower stock market returns.

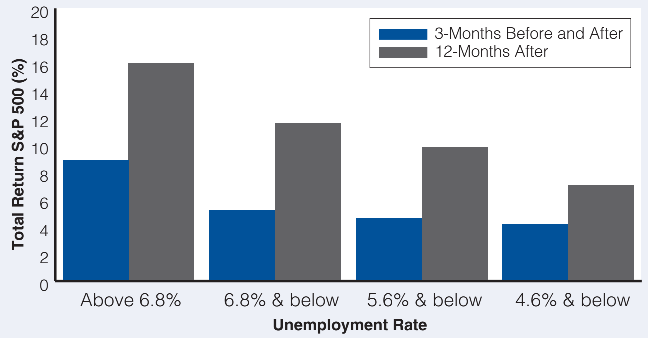
In the past, when the unemployment rate rose past 8%, we saw marked market lows. In 1974–1975 we saw a generational low in the stock market (as represented by the S&P 500 index). Between 1975 and 1980, stocks returned

Unemployment Rate 1948–2012



Source: Bureau of Labor Statistics

Higher Stock Returns Accompany Higher Unemployment



Sources: Bureau of Labor Statistics, Bloomberg, Morningstar
Analysis: Adviser Investments

over 100%. As unemployment rose to over 10% in 1982, the markets saw the start of a nearly two-decade-long bull run that ended with the 2000 tech bubble. And since February 2009, when the unemployment rate first hit 8%, the S&P 500 has returned over 100%. None of these were comfortable or "feel good" times for investors, but all proved to be advantageous times to invest in stocks.

Examining the full unemployment dataset further tests its contrarian signal. In the bottom-right chart on the previous page, we broke the data into four different categories—those where unemployment ran at 6.8% or higher, periods when unemployment ran below 4.6%, and two middling periods where unemployment ran at 6.8% and lower, and 5.6% and lower. (The ranges chosen represent the four quartiles into which we broke our data, as well as the median unemployment rate for the entire data set.) Finally, we calculated the stock market's performance in the three months before and after each period, as well as in the 12 months following.

AI Summary

Our analysis demonstrates that the stock market tends to have higher performance during and following periods of higher unemployment. Moreover, the data also suggests that when unemployment is below average, stock market returns tend to be lower.

Investors who are waiting for an "all-clear" signal on jobs may be doing themselves a disservice if they continue to shun the stock market. We believe we are poised for further gains during 2012.

—AI Research Dept.