How Do the Stock Market and the Economy Interact?

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LIZ ANN SONDERS: We all know that the stock market's action is connected to economic and earnings fundamentals. That's a tried and true relationship, but I think the timing of it tends to be one of the things that throws investors off. And I want to use an example, a couple of examples to describe this relationship between economic or earnings, overall macro fundamentals and what the stock market does, because in investors' minds it often seems a disconnected.

Go back to March of 2009. That's an extreme, but I think very perfect example of the power of the stock market to sniff out inflection points in the economic or earnings data. So if you think about circa March 2009, which we know with the benefit of hindsight was the low in this bull market, at that time, whether you look at the month, specifically, or you look at the first quarter of 2009, we know, in general, but you can look at the data, that most of the economic and earnings fundamentals were pretty abysmal at that time. Whether it was job growth, whether it was the unemployment rate, or GDP growth, or consumer spending, retail sales, confidence measures were all probably at, basically, the bottom. But the stock market has a remarkable tendency to figure this out, to figure out when the data has stopped getting worse and is going to start getting better, that bottom of the V. That tends to be the launch point for the stock market. We all know as sort of Main Street people, that's an environment we don't tend to feel very good because the data is so bad, but that tends to be a launch point for the market.

An example of the opposite when it kicks in would be circa 2000. So everybody was incredibly enthusiastic about the market, the economic fundamentals were quite, quite strong—again, job growth, GDP growth, industrial production, consumer confidence. But the market has a tendency to figure out when things stop getting better and start getting worse, the top of the V, when the data is incredibly good.

Now, I don't think we're at either one of those extremes right now, but given that we're seeing more consistency in this economic data, given one of my themes coming into this year that this would be a year that probably Main Street would feel better than Wall Street, understand that there's a component of 'be careful what you wish for,' that at usually a point where the economic earnings fundamental data is really, really strong, the market starts to figure out 'is this as good as it gets?'. So understanding those relationships, I think, is one of the most important things investors can do to be successful.

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