Why Does Sentiment Not Match Hard Data?

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KATHY JONES: And I'm Kathy Jones.

LIZ ANN: And this is *On Investing*, an original podcast from Charles Schwab. Every week, we analyze what's happening in the markets and discuss how it might affect your investments.

Well, hi, Kathy. Here we are at the end of May. We've got the unofficial start to summer with the Memorial Day weekend in the rearview mirror. Now heading into the meat of summer. We're still seeing headlines these days about turbulence in the bond market and uncertainty with regard to the trade war and tariffs, not to mention the budget. So I'm guessing this may not exactly be a full all-summer- long holiday for fixed income and your world. So what do you think now that we're in the teeth of the summer season?

KATHY: Well, yeah, there's no rest in the bond market these days. Recent news has been a little bit more favorable in the sense that I think central banks and maybe even politicians are starting to wake up to what's going on in the bond market and starting to react to it in the sense that, you know, you can't just run huge deficits and expansionary policies forever without having some consequences. And the most recent news, I think, was from the Bank of Japan. So Japan's been, their yields have been rising relentlessly, really over the past year, especially in the past six months. And Japan, after having accumulated on the balance sheet of the central bank half of the outstanding bonds, they've been trying to let the market kind of take over some of that.

And that price discovery has pushed up yields, but especially now since U.S. yields are rising, and we have trade wars and all this stuff going on, we've seen this just huge rise in global yields led, to some extent, by Japan. But recently, they seem to be signaling that, out of Japan, that they'd like to calm this down a bit. So government appears to be signaling that maybe they'll adjust the amount of bonds that they offer at future auctions.

And that has at least sent a message of calming down the rise in rates that caught people kind of on the wrong side. And just as an aside, the central bank there owns about half of all the outstanding government bonds from Japan. So that's a lot of influence. And if they change their issuance, or if they change the amount they're allowing to come to the market, then that I think can have an impact on all of the yields. So that has helped a little bit after the recent rise in rates, but we still have all

the issues that have led to rates moving up year to date. We still have the trade war and tariffs and the budgets, not just here, but around the world, but particularly in the U.S., the budget to deal with. And there's still a lack of clarity about policy, and that's keeping yields from falling much. So even when they do pull back, there really isn't much decline because there's no certainty, and the volatility is so high no one really wants to take a position at this stage of the game. And you know, the Fed has been pretty clear that they're on hold. They too are waiting for clarity about policy. Unless there's some evidence that the economy is really slowing down or that inflation is going to fall some more, the message we're getting is "Hey, we're not doing much." So it seems like as I prepare my midyear outlook, the one thing I can hang my hat on is that we said coming into the year it would be volatile, and it has been volatile.

LIZ ANN: You nailed it.

KATHY: Yeah, I'm patting myself on the back here. But it's very difficult to come up with a directional move.

We do think, still, the rise in rates will have an impact on the economy and slow things down, and we'll see at least one rate cut later this year. But every day is a new day when it comes to policy. So it's really been a tough go. So how about you, Liz Ann? Same in your world, a lot of policy uncertainty and changes. How do you think markets are going to handle this?

LIZ ANN: Yeah, I mean, I think we are still at the mercy of policy announcements, and not just on trade—that's sort of paramount—but especially these days on the budget, which has now passed in the House, sits with the Senate, and will eventually come back to the House. So there's a lot more to go on that front. To me, what's kind of interesting to think about is, you know, there's this phrase or notion of a "Trump put" to use options lingo.

And we've talked about it on this program before where maybe that put came via the bond market in the early part of April, where you had a little bit of a ride in the bond market, yields spiked higher, the dollar was sinking, the equity market was sinking, and maybe in particular it was the message from the bond market that may have been the trigger for the announcement that came on April 9th about delaying the so-called reciprocal tariffs. So that could be thought of as the Trump put maybe with it being triggered from the bond market. But I can't help but wonder whether maybe there's a Trump call, too. And this one I think could be more about the equity market where you get a sufficient move higher like we have from that intraday low on April 9th to where, as you and I are recording this, still below the all-time high set in mid-February, but certainly has had a sharp rally off the low, and maybe that's

something that triggers, I, you know, "I'm feeling empowered to maybe take a harder-line stance again from a tariff perspective," given the news last week about what we expect or assume will be, as the president mentioned, an announcement on tariffs on goods coming from the European Union into the United States. And there might be different levels for different countries. I also think, given again, as we're taping this, the "buy the dip" mentality is alive and well. And one thing that's … that I think everybody should be aware of, and increasingly, I think, we're going to be hearing and reading more information with some specificity on the power and influence of retail traders.

You see it in the types of stocks, sectors, categories of stocks that have not just done well but have significantly outperformed the S&P 500® on the way up. And a lot of them have that "retail favorite" kind of flair to it, not to mention some of the, frankly, in my view, scarier vehicles, which are some of these leveraged exchange-traded funds—in particular, single-stock exchange-traded funds. So I think the … not just the buy the dip, but almost that gambling mentality that really kicked into higher gear in the pandemic, I think aided by what we may have had something to do with, which is the move to zero commissions. And, you know, maybe that crowd will never be tested sufficiently. It certainly didn't happen to any significant degree at that intraday low on April 9th.

So although there was a bit of a sentiment washout, it wasn't quite the behavioral washout. You didn't see a mass exodus out of, you know, traditional equity mutual funds or equity-oriented exchange-traded funds. But clearly, that was viewed as a buying opportunity. I think the weakness that we saw last week, which was the first real multi-day bout of weakness that we've had since that low, intraday low, on April 9th, sure enough, even with a smaller dip you see that "buy the dip" mentality kick in, and again, I think that's a pretty powerful force.

To step big picture a little bit here, I think the interesting data of note in terms of what we've gotten out of the economy is we did just get a release today, as we're recording this, of consumer confidence. And there's a component of consumer confidence, which is the expectations component. So there's an overall headline reading of consumer confidence on a monthly basis. And then there's two subcomponents: One is the present situation. One is expectations. So basically asking consumers, not just in general, "What's your level of confidence?" But "How does it compare between what you think about your present situation and what you expect the economic backdrop is likely to look like in six months' time?"

And it was a big move back up in the expectations component. In fact, it was the sharpest one-month move higher off fairly depressed levels in about four years. And it's in keeping with the view that we have had. Kevin Gordon and I just wrote a piece

that will post the beginning of the week. Hopefully we'll remember to put a link in the show notes, and it's a bit of an update to a topic we wrote about back in January, which is the differential between hard economic data and soft economic data, the hard data being the actual quantifiable economic data, metrics like just broad GDP, but also jobs data and retail sales, industrial production, versus the soft data, which is that survey-based data, confidence measures.

And it's been our view that the most likely path for that wide spread between the very weak soft data and the much more resilient hard data might be a bit of convergence in the two, where you see a combination of some catch-up on the part of the soft data just because of how compressed it got on many measures, to a degree of lack of confidence even beyond what we saw throughout the course of the global financial crisis. So really extreme loss of confidence, a bit of catch-up there, and then maybe a little bit of catch-down on the part of the hard economic data. And that's certainly what we're waiting to see, especially over the next week and a half, with the data we're going to get on the labor market front.

And to your point about Fed policy, I do think that the labor market really holds the key. I think it holds the key to consumption trends, to this hard data versus soft data, but also arguably to Fed policy. But so far the week's off to a good start from an equity-market perspective. The one thing that would potentially concern me about that is that you have the potential to build some froth in, again, in sentiment indicators. And that's one of the things that Helene Meisler and I talked about on the episode last week was we can't control all this incoming policy-related stuff and the impact that that has on your world in the bond market and my world in the equity market, but we can analyze the setup. And I think it's good to know what the setup is. If you get to a point of incredible despair and a washout in sentiment and a dramatically oversold equity market, the setup is there.

Then if you get any kind of positive catalyst, you probably have more upside than would otherwise be the case. Of course, it works in reverse order, too. When the setup is maybe overly frothy sentiment, a market that gets overbought, you're then potentially at the mercy to any negative catalyst. So that's, again, just the way I think you can think about the equity market in this kind of backdrop, given that none of us have any idea what's going to happen from a policy announcement perspective.

KATHY: Yeah, I think one of the things you see in the bond market is sentiment as expressed by, say, credit spreads, right? The extra yield people demand to hold, say, a corporate bond or a high-yield corporate bond versus a Treasury never really reached extreme levels on the negative side. It actually stayed very, very positive for a long time.

Then we saw a little bit of a sign of some deterioration in optimism, but not that much. Not as much as you might have expected given the sentiment and the sort of ominous views people had towards the economy. So credit spreads kind of held in there pretty tight for a long time, and they reverted very quickly even after a modest widening, which tells you it's not the corporate sector that investors really are worried about. I think, you know, the way I interpret that is people think companies are going to generally be OK, especially big corporate entities that are publicly traded. There's a lot of feeling that they're impervious to a lot of what's going on. It's on a different level. They're worried about the government's budget. They're worried about policy and how it might affect the economy, but not that concerned about how it affects major corporations.

Very interesting kind of development, very different from most cycles. Usually in most cycles when you get a lot of negative sentiment about the economy, and people worried about where the economic policy is going, you see it transfer immediately into the corporate bond market. And this time we just haven't seen it. So it's an interesting dichotomy this time around. Very different from what we've seen before. The focus is really on government entities and how they're doing. So we'll see how this plays out. I feel sometimes like we're in the midst of a late '90s kind of market, where you remember the tech bubble, and it just kept going and going and going, and nothing seemed to really do anything to it until it stopped.

LIZ ANN: Until it did.

KATHY: Yeah. Now I'm not saying this is a bubble either. I'm just saying it feels a lot like the "buy the dip," the retail traders, the overconfidence in the corporate sector. It feels very much like the late '90s. And of course, that didn't necessarily end well. But you know, every time's different. It's not a repeat by any means.

But that being said, the one other area that I'm really focused on is the dollar and the currency markets, because what we're seeing there is really sort of setting the tone for a lot of markets. So the Japanese yen was soaring. Now it's pulled back. The dollar was falling pretty precipitously, and now it's bounced back. And you can see the influence of policy, particularly tariff policy, playing out in the Forex market in a way that I think spreads to the other markets. So if we calm down the foreign exchange market, you probably get calmer and more positive markets elsewhere. But you do look at the policy setting right now, and a weaker dollar will accomplish a lot of what the administration wants in terms of rebalancing trade. And at a cost, definitely at a cost of inflation.

But if part of the game here, part of the goal here, is to rebalance trade and make it easier, without tariffs, to be more competitive, then certainly a weaker dollar plays

into that with all of the consequences that come with it. So more to be seen on that because we still don't have any policy to hang our hats on. It keeps changing every day.

LIZ ANN: On a looking-forward basis as we head into June, what is on your radar over the next week or two?

KATHY: Yeah, well, we'll start to get some labor data coming up so that as always, as you mentioned, the consumer, I think consumers are good until they lose their jobs, and then they that's when they stop spending. So we'll be getting the JOLTS numbers, the Job Opening and Labor Turnover Survey, and the weekly jobless claims numbers were sort of interesting last week. They actually were kind of unchanged, down a little bit, but the areas that saw the biggest increase in claims were right around Washington, D.C. So it looks like some of those federal cutbacks, those agency layoffs, are starting to work their way through.

But there are federal workers in every state. And you'd be surprised how many there are in the West and Alaska and all kinds of other places. So with the spending cutbacks in federal agencies, I would expect that to start to pick up and to be seen in other areas. But so far, claims have been pretty low. Continuing claims, kind of edging higher and holding up there, but nothing dramatic yet. And then of course, with the JOLTS numbers, always want to see, how much are the job openings relative to the population of people looking for work?

So I think that's going to be, along with what's going on in Washington, will be my focus. What about you, Liz Ann?

LIZ ANN: I don't always obsess over them, but we're getting more regional Fed surveys out. And I think what may be interesting in this backdrop, a couple of things. One, verbatims that you often get from companies operating in that region. But most, if not all, the regional Feds typically put in a special question on a monthly basis when they do their surveys.

Philadelphia Fed was the most recent one to do it. We wrote a bit about that in the report that published this week about their thoughts on prices and their plans around prices. So it wouldn't surprise me if there are more tariff, trade-war policy, you know, "What's your pricing strategy?"-type questions in those regional Fed surveys, which could help put some color on this uncertainty.

We continue to get housing data. I think especially given the move back up in the 10-year yield, housing data, I think, comes into the spotlight a little bit more. We get the Institute for Supply Management readings on the Purchasing Managers Indexes,

both on the services side and the manufacturing side. Also, lots of good stuff that comes out in those surveys in terms of verbatims from companies. So my advice is not just to look at the headline, but read some of the details.

And then the last area that I think is going to be interesting to watch is anything with regard to consumer credit, because a lot of people don't realize that there was a moratorium on the publishing of delinquencies for student loans that came about during the pandemic. And it was just the month of May this year where that moratorium ended.

And what you've already seen is a pretty significant spike up in student loan delinquencies. And that certainly has the potential to have feeders into credit scores that individuals have and then the ability to get other kinds of loans, auto loans, mortgages. So there could be ripple effects of that moratorium having ended. So that's going to be on my radar as we get data on consumer credit over the next month or two.

KATHY: That's a pretty crucial point. I think you're definitely on to something there. We'll have to see how the consumer, although optimistic, generally speaking, about spending ability, see how that goes.

LIZ ANN: Yeah, the ability to kind of spend out of your wallet based on confidence in jobs is one thing. It's the bigger-picture purchases, bigger-ticket purchases of autos or homes that could now have some new constraints associated with credit scores and credit availability. So we'll see.

So that's it for us this week. As always, thank you for listening. You can keep up with us in real time on social media. We both post regularly on X and LinkedIn. I'm @LizAnnSonders on X and LinkedIn. My usual PSA to make sure you follow the actual me and not one of my many imposters.

KATHY: And I'm @KathyJones—that's Kathy with a K—on X and LinkedIn. And you can always read our written reports, including charts and graphs, at schwab.com/learn. And if you've enjoyed the show, we'd really be grateful if you'd leave us a review on Apple Podcasts or a rating on Spotify or feedback wherever you listen. We'll talk to you next week.

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