US Macroeconomics

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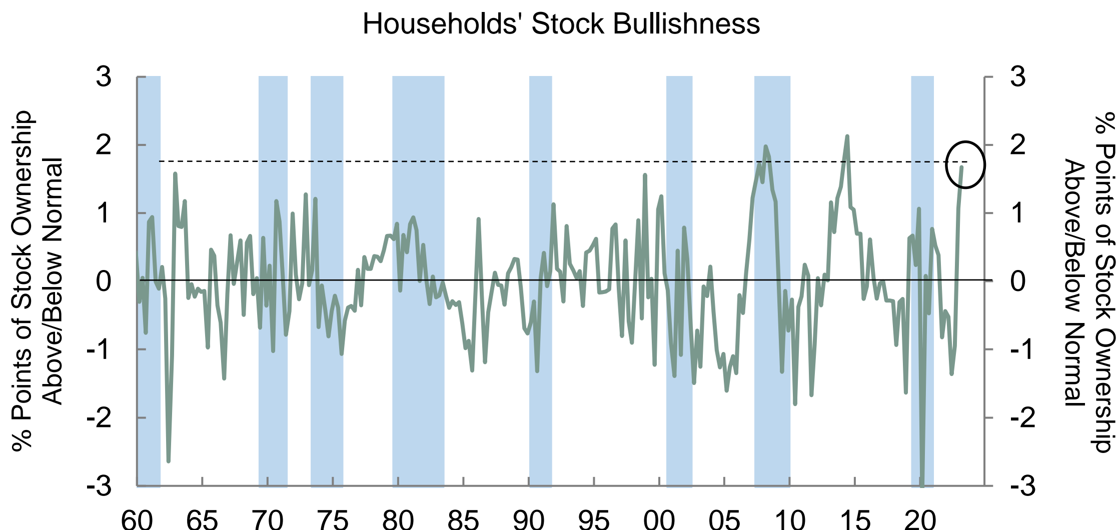
All Their Eggs in One Basket (Part 2)

On August 9th, we discussed the extent to which households were vulnerable to a correction in equities prices, due to abnormally high equities ownership (26%). Current readings sit in the 96th percentile historically which is occurring despite an unfriendly macro backdrop. **What does this mean for future asset allocation and returns? Also, could this behavior simply reflect ambitious earnings multiples currently being assigned to equities?**

Households' aggressive equities allocation presents a headwind for future equities performance. For example, how much more can households really allocate to stocks from essentially record levels? Logically, this implies that incremental demand for stocks from households, and thus returns, are likely to be lower in the future. This can be seen empirically too. **In the one, three and five years following cyclical peaks in household equities ownership, the total return of the S&P Composite Index returned -7.2%, +4.0%, and +7.9%, on average.** Compare this with its 11.9% average annual return since 1936.

Some may point to near record equities ownership as simply a reflection of elevated earnings multiples. Yet, after econometrically controlling for this, interest rates, growth, and productivity, we still find that this behavior is hyper aggressive. Fed Funds is at its highest level since 2001 and US treasury yields are at the highest levels since June of 2008. At the same time, growth indicators have been mixed (recessionary LEI, declining GDI, recovering GDP and flat productivity). **After accounting for the above factors, we estimate that households' equities ownership (as a percent of net worth) should be approximately 2 percentage points *lower* than what is observed at present.** In other words, households' tolerance toward financial risk is higher than it ought to be after controlling for macroeconomic fundamentals. This ebullience is on par with other notable periods as shown in the chart below. Either retail investors are too exuberant or economic indicators are missing another upswing.



Sources: Author's Calculations, Federal Reserve, S&P, NBER, Haver

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