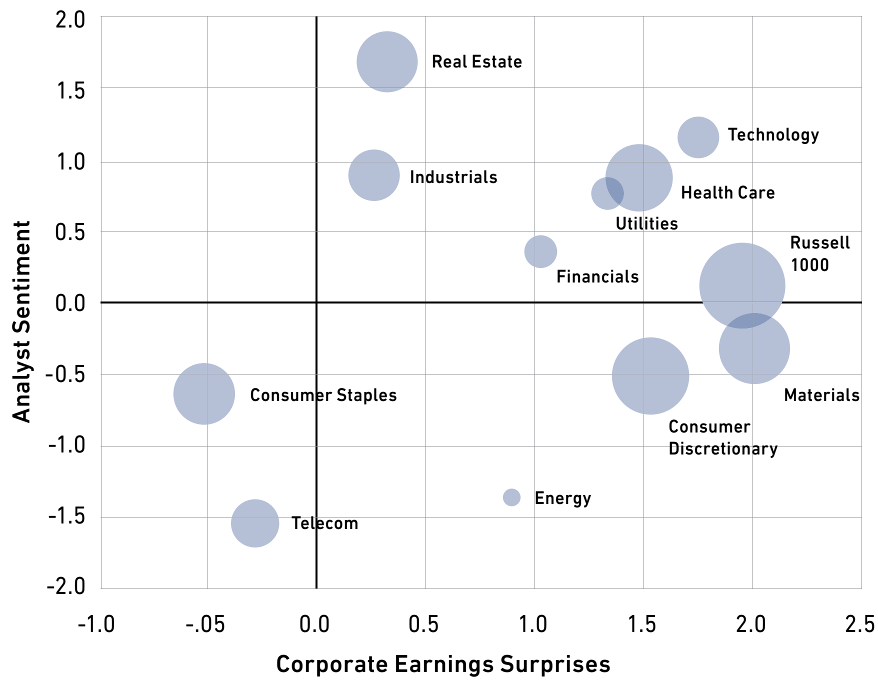
Wall Street Mood Monitor™

The Wall Street Mood Monitor is a three-factor model gauging the climate or "mood" for active management within each sector. The factors include sentiment, earnings trends and correlations. Sectors in the top right represent areas where active management conditions may be favorable based on positive earnings surprises and positive analyst sentiment, as measured by the number of upward revisions during the quarter. Correlations are assessed by comparing each sector's current intra-sector correlations to its historical average. Larger circles represent lower correlations.



Circle size represents magnitude of difference between current correlation to long-term average correlation (i.e., larger equals lower correlation).

Below we examine the three components of the chart in more detail, including corporate earnings, analyst sentiment and correlations.

Earnings Trounce Expectations

In the second quarter, corporate earnings delivered... and then some. Fifty-five percent of companies beat consensus estimates by more than one standard deviation in the second quarter—the highest rate of substantial earnings beats in 15 years. Conversely, only 12% of companies reported substantial earnings misses, the lowest level since 2010. Put together, the spread between one standard deviation beats and misses is at its highest level since 2002.

Earnings surprises were strongest in the technology, materials, and consumer discretionary sectors. The materials sector hit a milestone, with the spread between companies reporting significant earnings surprises and significant earnings misses hitting its highest (most positive) level since 2004. Within the consumer discretionary sector, the spread between companies reporting a substantial earnings surprise or miss is at its highest level since 2011.

June Swoon in Sentiment?

Sentiment on Wall Street had been riding high in the first, and most of the second quarter, but cooled suddenly in June. The months ahead will reveal whether this marks a negative turning point or mere speed bump amid more positive expectations.

For the entire quarter, the net difference between upward analyst earnings revisions and downward revisions was at its highest level since the spring of 2012. Strong corporate earnings were likely underpinning improved expectations. In June, however, there were slightly more downward revisions than positive ones.

While the total portion of positive earnings revisions was high, sentiment was not high across all sectors. The percentage of downward earnings revisions in the telecom sector hit its highest level since 2015. A high proportion of analysts also reduced forecasts for energy companies in June, as oil prices sank. Estimate upgrades have been notably strong in the technology, industrials and health care sectors.

Correlations are Low for Most Sectors

Intra-market correlations remain near 15-year lows after steadily falling from the historically high levels measured in late 2015. The low correlation environment has been persistent: Stocks are experiencing the longest period in which market correlations were below long-term averages since before the Financial Crisis.

Correlations in the materials and consumer discretionary sectors have declined the most relative to their long-term averages. Correlations within the energy and technology sectors have moved higher from lows seen in March and April, though intra-sector correlations within the technology sector are still below long-term averages.

Low intra-sector correlations in the health care sector have put the sector in the sweet spot of our three-factor model.

Sector Spotlight: Health Care, Technology

Health Care Healing

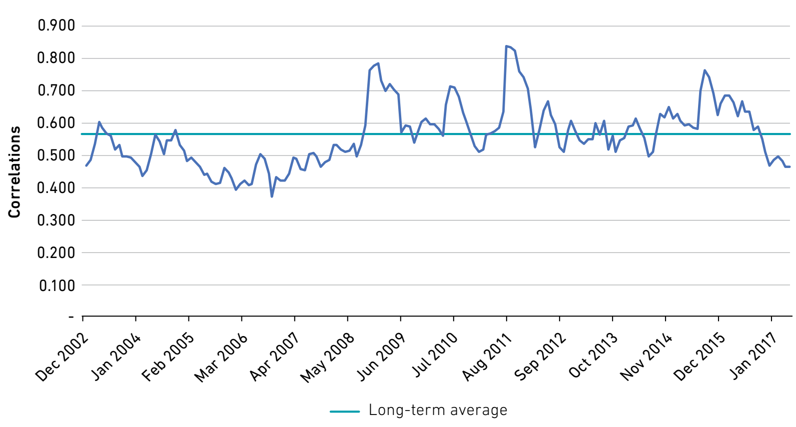
Conditions are ripe for active managers in the health care sector, where sentiment is high, earnings trends are strong and correlations are low.

The sector recently hit a few positive inflection points on our three-factor model. The most notable being a change in analyst sentiment, where analysts' earnings estimate revisions went from largely negative in the first quarter to largely positive the last three months. The sentiment change has been rapid, and substantial: In the beginning of 2017, analyst sentiment toward health care stocks was at its lowest level in eight years. Sentiment is now the most positive since 2015.

Sentiment is improving as more health care companies outpace earnings expectations. The spread between significantly positive versus negative earnings surprises turned positive this quarter, with 51% of health care companies reporting at least a one standard deviation earnings announcement during the quarter.

Low intra-sector correlations among health care stocks also provide a favorable backdrop for active managers. As the chart shows, correlations among health care stocks sit at the lowest levels of the post-crisis bull market.

Intra-Sector Correlations



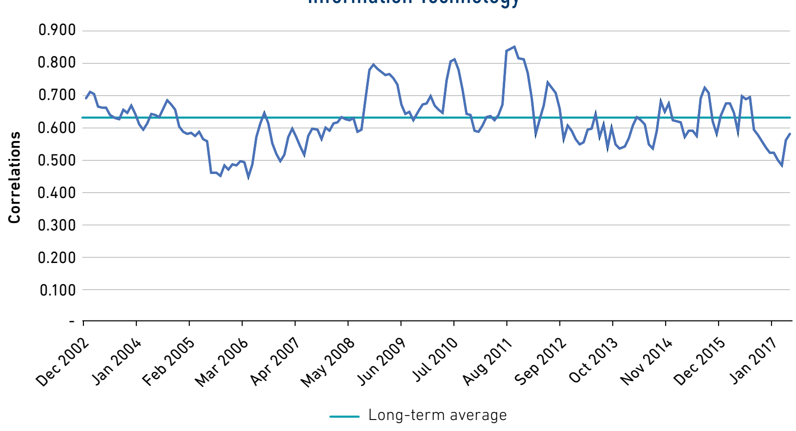
- Correlations among health care stocks sit at the lowest levels of the post-crisis bull market.

Sentiment High for Tech Sector

The conditions for active management are also favorable within the technology sector, where sentiment is particularly high. For perspective, the ratio of positive-to-negative earnings estimate revisions in the sector is at its highest level since 2010. The software and semiconductor industries experienced the highest ratio of positive estimate revisions, with both over 80%.

Earnings strength also bodes well for technology stocks. The sector experienced the highest percentage of significant positive surprises (70%) and lowest percentage of negative surprises (4.3%) among all GICS sectors. Here too, the software and semiconductor industries shined, with both industries experiencing a large spread between substantial positive and negative earnings surprises.

Correlations among technology stocks are still below their long-term average, suggesting the sector may be a sound area of the market for active stock picking. However, as the chart shows, correlations have risen since the beginning of the year.



- Correlations among technology stocks are still below their long-term average.

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