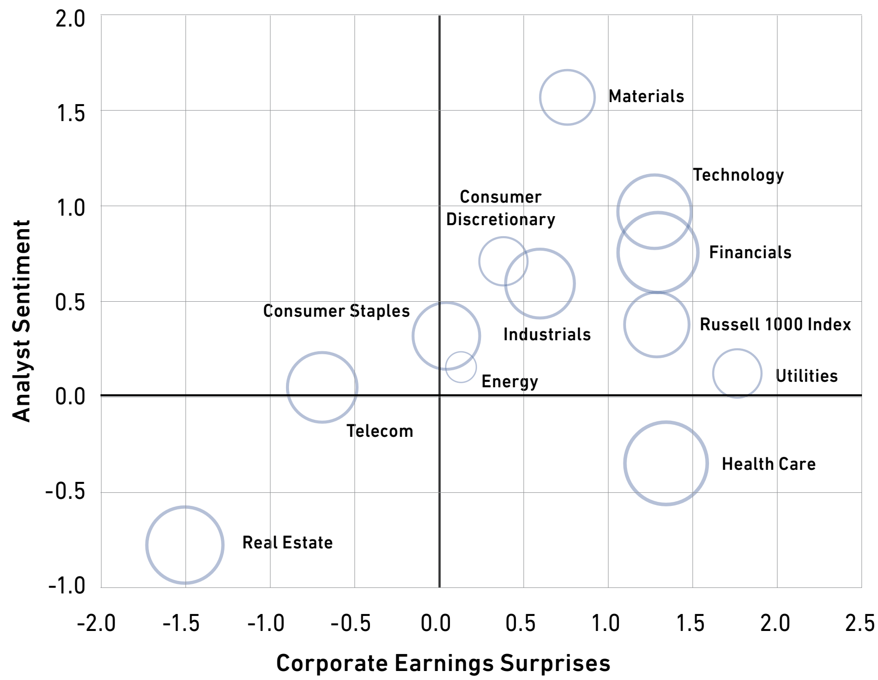
Wall Street Mood Monitor™

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 the magnitude of difference between current correlation to its long-term average (i.e., larger equals lower correlation). Hollow circles indicate a current intra-sector correlation above the sector's 15-year history.

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

Positive Earnings Trends Prevail

Corporate earnings continue to beat expectations at an impressive clip. Fifty-two percent of stocks beat consensus earnings by at least one standard deviation this quarter. That proportion is slightly lower than the near-record high of 54% last quarter but remains high by historical standards.

Meanwhile, only 12% of companies reported earnings one standard deviation below consensus expectations, which remains near the lowest levels recorded since 2010.

The spread between companies reporting one standard deviation beats and misses is not far from the level reported last quarter, which was the highest spread in 15 years of collecting such data. Companies in the Technology and Health Care sectors reported the highest proportion of significant earnings beats.

Analyst Sentiment Hits All-Time High

Wall Street optimism abounds: In January, 74% of analyst earnings estimate changes were upgrades, a record level for the last 15 years. Corporate tax reform had a heavy influence on earnings revisions in the month.

In February and March, upward earnings revisions continued to exceed downward revisions at some of the highest rates since 2012.

At the sector level, the Materials, Technology and Industrials sectors experienced the highest percentages of upwards earnings estimate revisions.

Correlations Ruin the Party

While corporate earnings and analyst sentiment trends remained positive, a dramatic spike in correlations spoiled the market backdrop active managers enjoyed at the end of 2017.

Just last quarter, intra-market correlations sat 20% below any level we measured in the last 15 years. As market volatility spiked in February, correlations rose to levels not experienced since early 2016.

Intra-sector correlations are now above average levels in every sector. For the Technology and Financial sectors, correlations are at levels not experienced since the early recovery years after the financial crisis.

Higher correlations are likely creating a challenging environment for active managers attempting to add value through superior stock selection.

Sector Spotlight: Technology and Materials

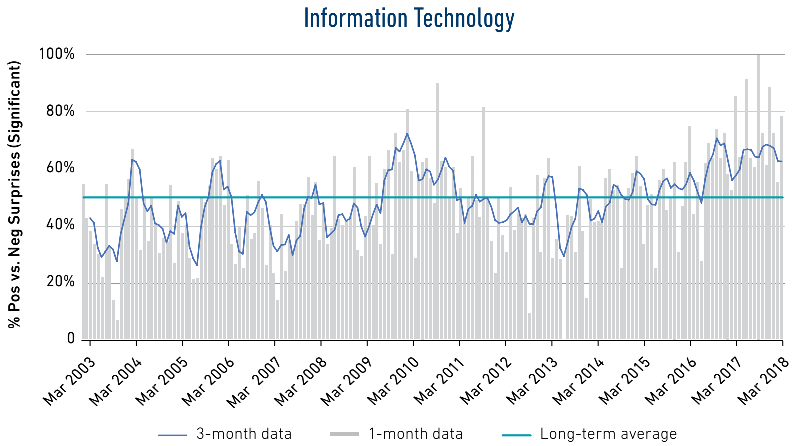
Technology: Earnings Trends Remain Strong

Intra-sector correlations are above their long-term averages within each sector, creating sub-optimal stock picking conditions in nearly every corner of the market.

However, correlations are only one of three factors we use to gauge the conditions for active management. We also measure sentiment and earnings trends, which were both impressive for the technology sector.

Two-thirds of all technology companies reported earnings that were at least one standard deviation above consensus expectations, which was the highest rate for any sector. Only 4% of technology companies reported one-standard deviation earnings misses. The ratio of technology companies reporting significant earnings beats to those reporting significant misses dropped slightly this quarter, but remains well above historical averages (see chart).

Analyst sentiment toward the sector remains extremely high: Sixty-nine percent of earnings estimate revisions were positive. The ratio of earnings estimate upgrades to downgrades is close to its highest level since 2010.



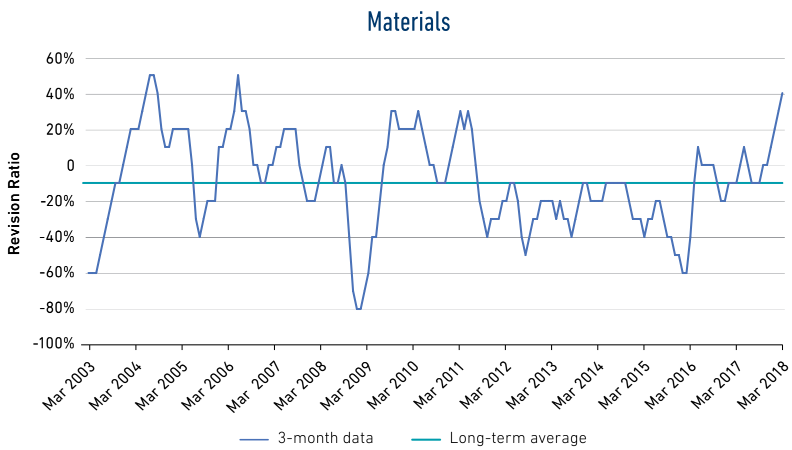
▸ **The ratio of technology companies reporting significant earnings beats to those reporting significant misses dropped slightly, but remains well above historical averages.**

Materials: Sea Change in Sentiment

The Materials sector experienced a dramatic shift in sentiment this quarter, as the ratio of earnings estimate upgrades to downgrades hit its highest level in more than a decade (see chart). The ratio was negative (meaning more estimate downgrades than upgrades) just last quarter. Within the sector, the containers and packaging industry enjoyed the highest percentage of positive revisions at 88%.

Earnings trends in the Materials sector were also favorable, with 51% of materials companies reporting one standard deviation earnings beats and only 13% reporting one standard deviation misses. The ratio between the two was down slightly from last quarter, but remains high.

Similar to other sectors, intra-sector correlations within the Materials sector shot higher, and are above their long-term averages.



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