

WHAT'S THE SIGNIFICANCE OF THE PMI?

As widely reported, the Purchasing Managers Index (PMI) published by the Institute for Supply Management dropped below the 50 level at the end of August, suggesting a contracting economy (levels above 50 suggest an expanding economy). Perhaps of more importance to investors is whether the PMI level has any significance with regard to future stock market returns.

We examined monthly PMI values from January 1948 to present and identified 37 months when the PMI moved from above 50 in a month to below 50 the following month. For each of these 37 months we then calculated the return of the S&P 500 over the following 12 months. On average, the S&P 500 gained 13.9% over the next 12 months after the PMI crossed the 50 level on the downside, and posted positive returns in over 78% of the next 12-month periods.

In fact, when the PMI is below 50, returns for stocks over the following 12 months have actually been higher than when the PMI is above 50. The table below summarizes all 860 months from 1948 to the present and shows that the PMI was above 50 in 70.2% of the months and below 50 in 29.8% of the months. The average return of the S&P 500 over the 12 months following a PMI below 50 was 17.2%, well above the average of 10.6% following a PMI above 50.

PURCHASING MANAGERS INDEX (PMI) AND STOCK MARKET RETURNS

January 1948 to August 2019, Monthly Data

	PMI Above 50	PMI Below 50
Percent of Occurrences	70.2%	29.8%
S&P 500 Average Return, Next 12 Months	10.6%	17.2%
Percentage of Positive S&P 500 Returns, Next 12 Months	78.0%	82.8%
Percentage of Negative S&P 500 Returns, Next 12 Months	22.0%	17.2%

Data from 1/1/48 through 8/31/19.

Sources: Institute for Supply Management, S&P Dow Jones

The outcome of today's economic uncertainty remains to be seen, but a simple approach of selling out of stocks when the PMI falls below 50 has historically been unprofitable.

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REFERENCED INDICES

(Indices are unmanaged and are not available for direct investment.)

Purchasing Managers Index (PMI)—The Purchasing Managers Index (PMI) is an indicator of economic health for manufacturing and service sectors. The purpose of the PMI is to provide information about current business conditions to company decision makers, analysts, and purchasing managers.

S&P 500 Index—The S&P 500 Stock Index is a market capitalization weighted index and consists of 500 stocks chosen for market size, liquidity and industry group representation.