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# *Special Report*


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May 2006

## Surveys: What Question Is Being Asked?

Understanding the opinions of large groups of people can provide valuable insights about the financial markets. For example, during the last presidential election we detailed how the S&P 500 was closely tracking the odds of Bush being re-elected in a Market Facts. While we have argued that markets such as Tradesports.com provide the best way to gauge the likelihood of future events (due to the fact that the people trading contracts on this website actually have money on the line), surveys and polls can be yet another valuable tool in understanding consensus opinions.

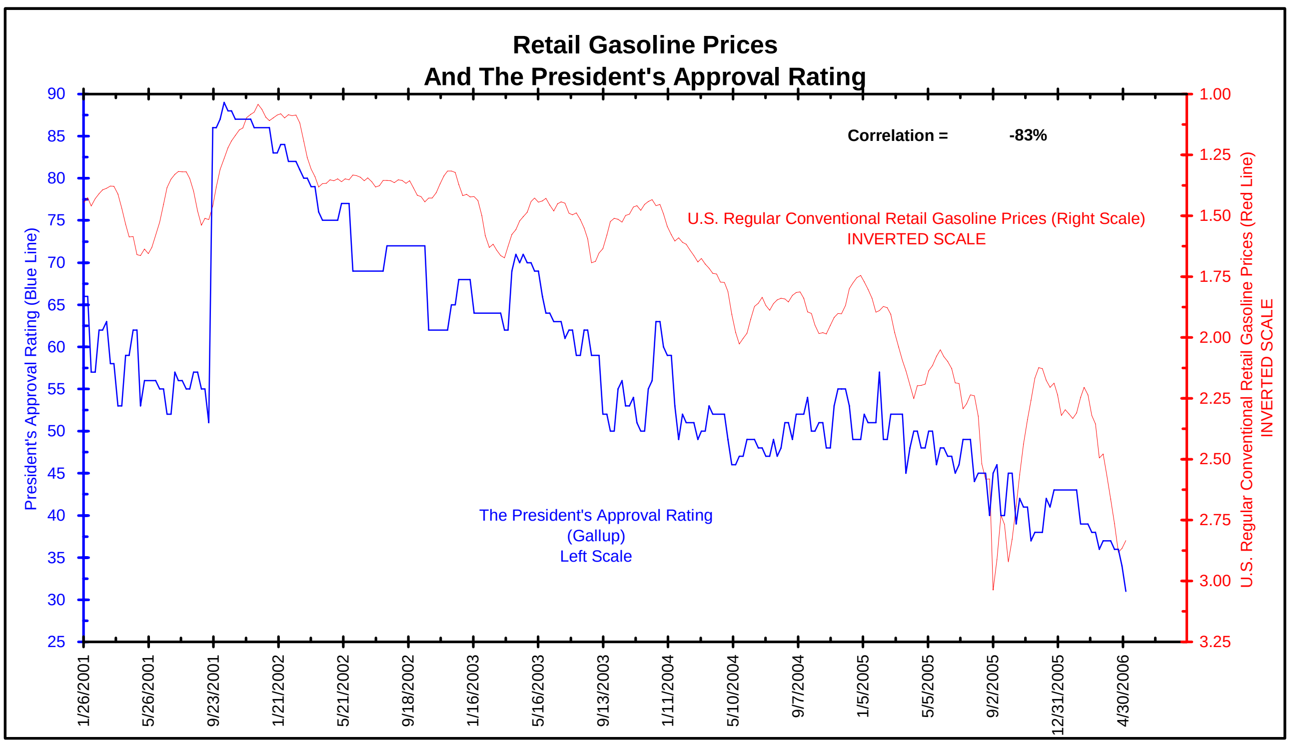
### Taking Survey

Pollsters get paid a lot of money because writing a good poll question is a specialized skill that is very valuable. The problem with most poll questions is the respondents are often not answering the question asked. When the questions are too abstract or ambiguous, they interpret them.

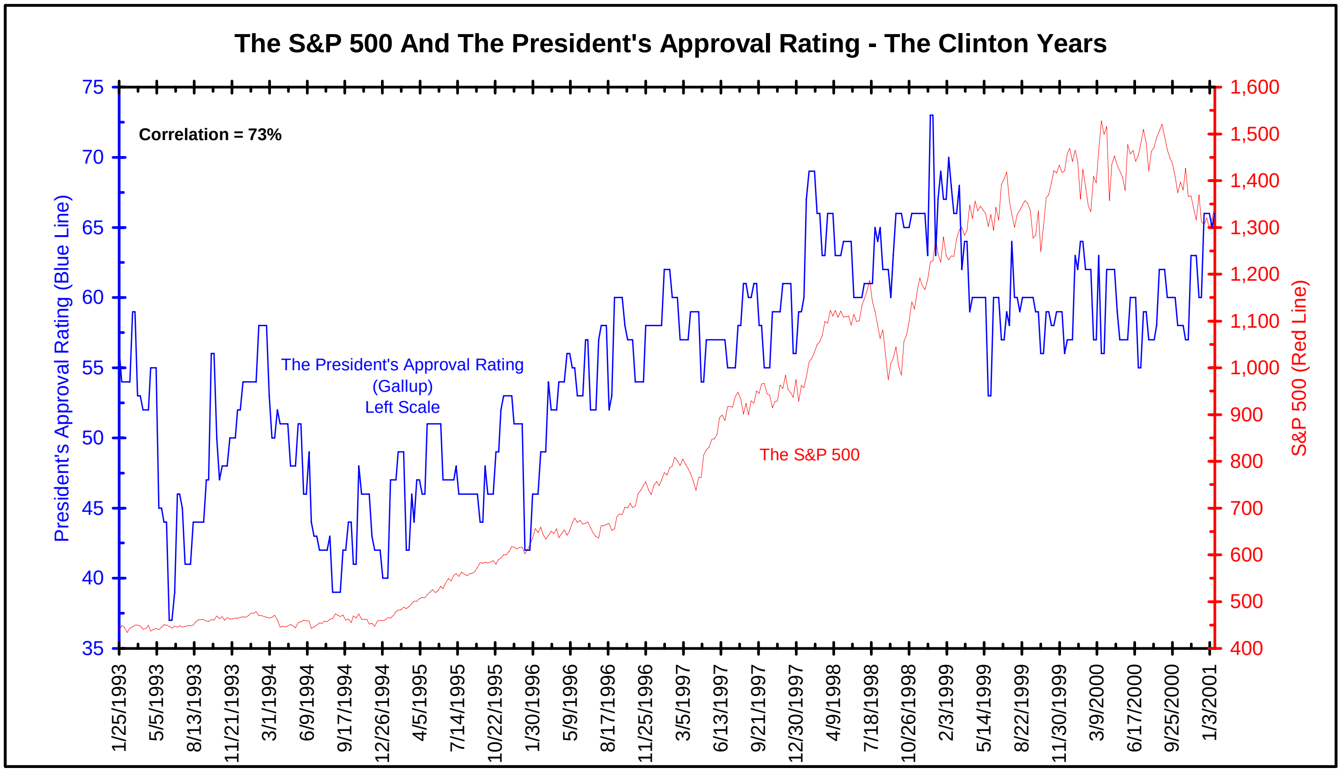
A good example of this phenomenon is the President's approval rating. Most people are not in a position to evaluate the President skills as the CEO of the Federal Government (which is what the question is asking), so instead they give an emotional response to how they think the country is doing. Pollsters understand this, which is why they offer analysis of the data and what it means.

### What Drives The President's Approval Rating?

For instance, take a look at the chart of the President's approval rating and gas prices below. These two have had a negative correlation since the beginning of President Bush's term in January 2001. So, when people are asked about the President's management skills, are they answering how they feel about gas prices?



However, during President Clinton's administration, stock prices dominated. His approval rating and stock prices were 73% correlated, as shown below (and a near random 13% to gas prices). By comparison, Bush's approval rating currently holds a negative correlation to stock prices.




The real issue with these surveys is not what they say but rather what question is being answered. And when determining that, the simpler explanation is often better.

**Consumer Confidence**

We believe consumer confidence suffers from the same phenomenon in that respondents to these polls are answering a completely different question than what they are asked - and have been so for years.

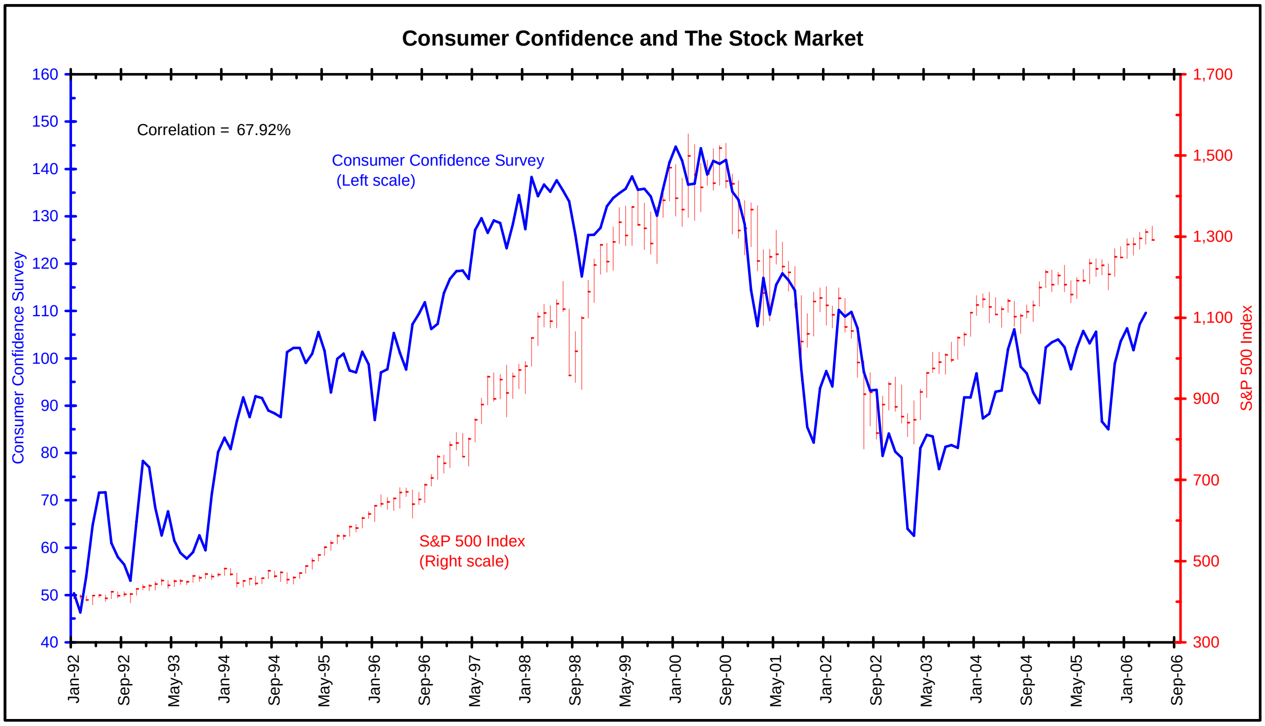
For the record, the conference board index is calculated by asking consumers a series of five questions:

1. Appraisal of current business conditions
2. Expectations regarding business six months hence
3. Appraisal of current employment conditions
4. Expectations regarding employment conditions six months hence
5. Expectations regarding total family income six months hence

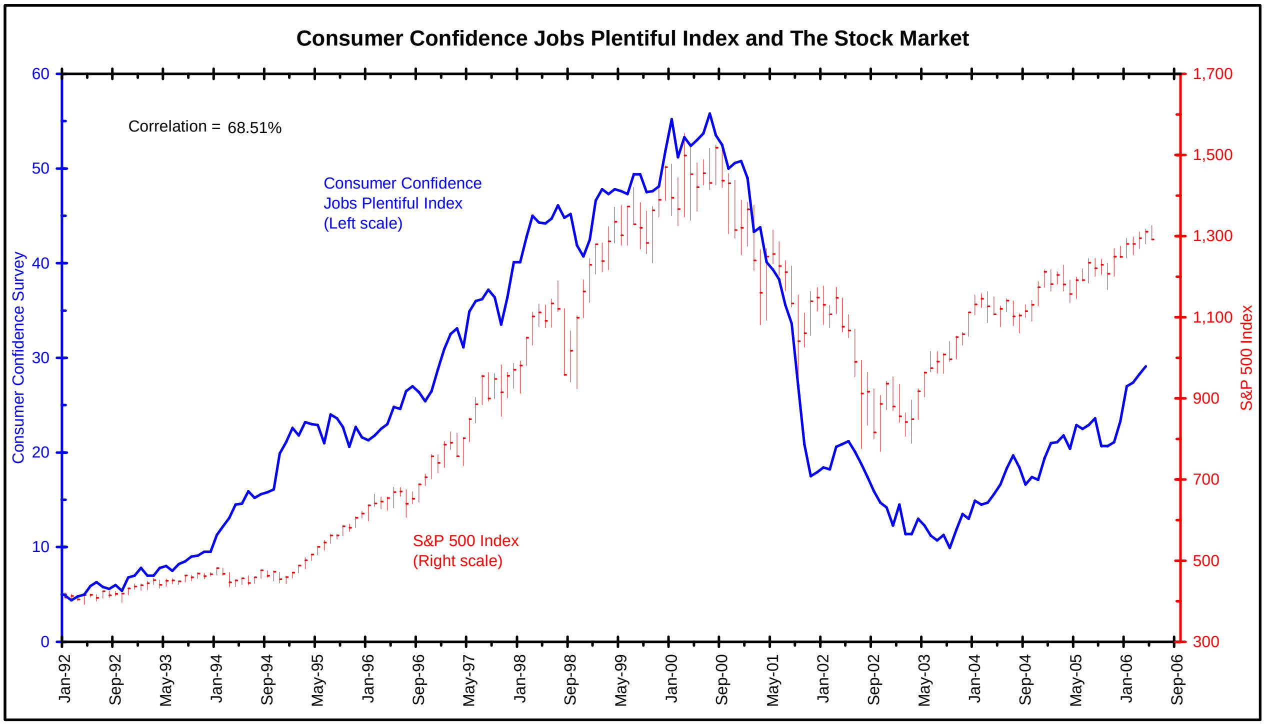
Respondents answer either positive, neutral, or negative to each question, and an index is then calculated according to the responses.

Based on the questions which are asked of the respondents, it would be reasonable to believe that this index should reflect both current and future expectations of the economy. However, this question is too abstract for most consumers. So, they answer the question by telling you what they believe the most important economic indicator has done in the last month.

As the chart below shows, the consumer confidence survey has tracked the S&P 500 very closely in recent history. Since January 1992, these two series have been 68% correlated, and even higher in recent years.




In this month's survey the market was focused in the Jobs Plentiful Index which surged to its highest level since August 2001. Surely this has little to do with the stock market as the goal of this index is to show the percentage of people who view jobs as easily attainable. Again, we believe consumers find this question too abstract, so they tell us what the stock market did last month. Like consumer confidence above, this index has an almost identical correlation of 69% to the stock market since January 1992. In other words, it is the same thing as overall consumer confidence and the stock market.

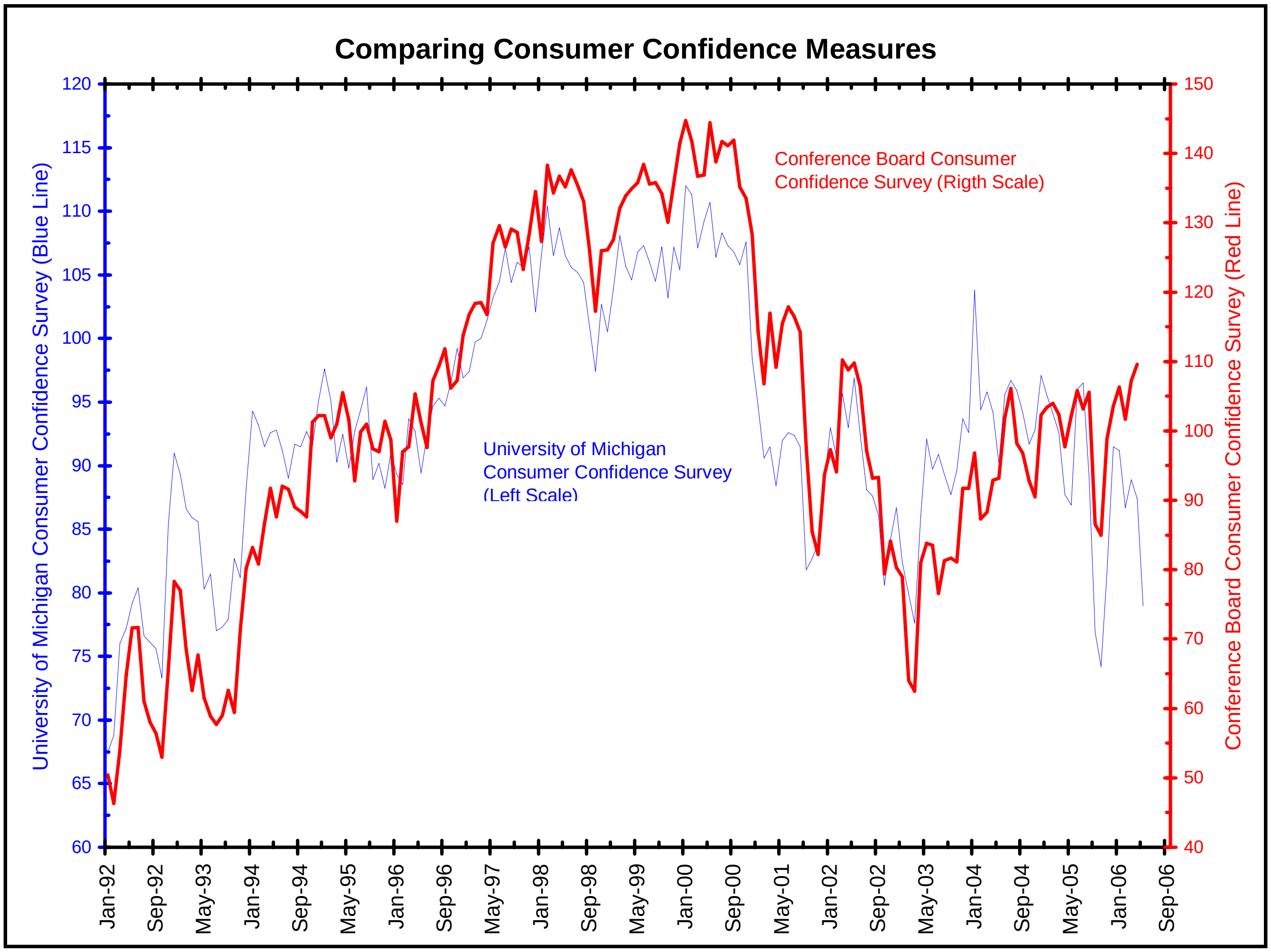


Most people assume these series are good indicators of retail sales. However, as we detailed in a September 2005 **Commentary**, history shows us they are not.

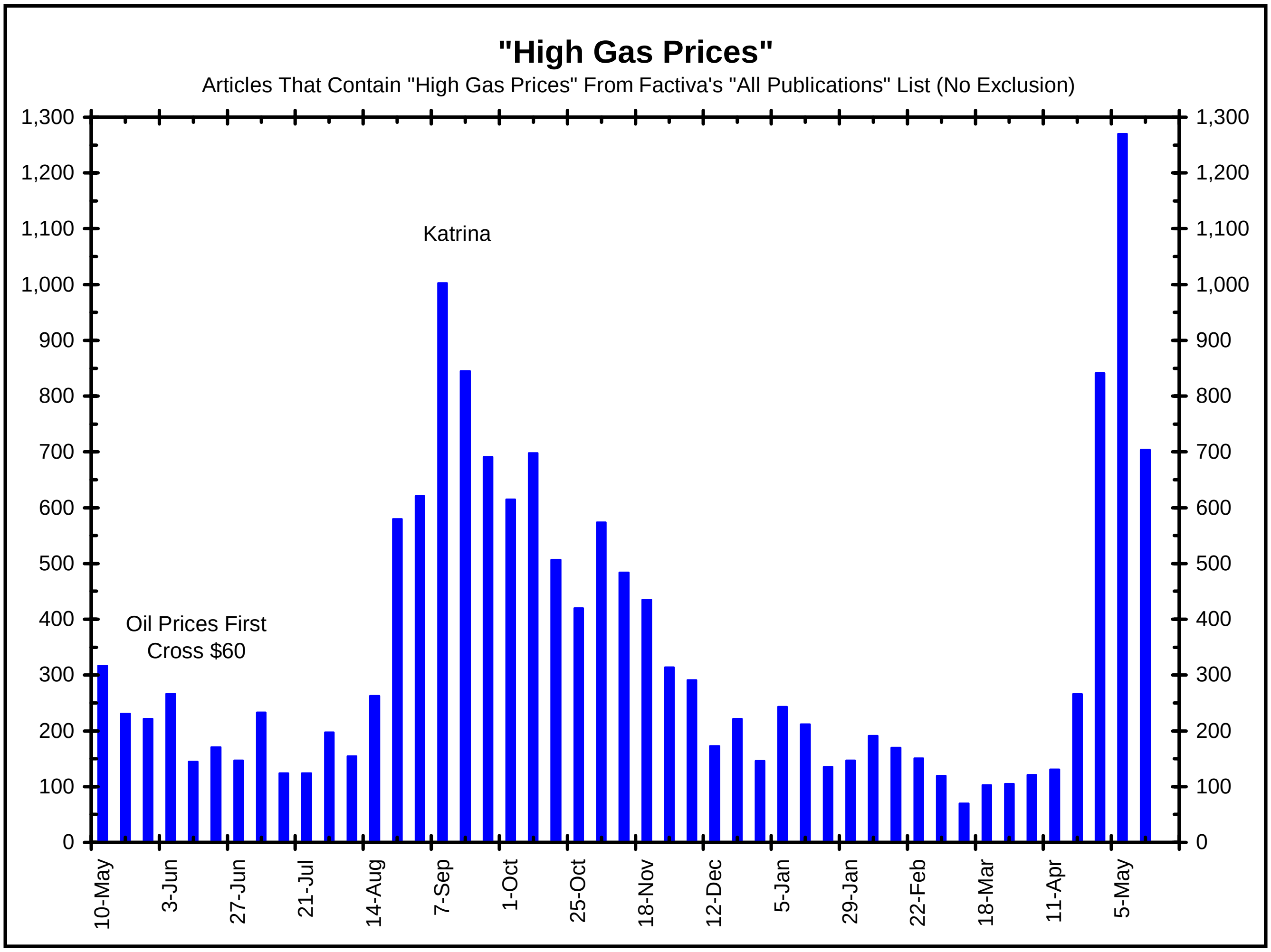
**Objections**

Supporters of the usefulness of consumer confidence surveys often object to our characterization that they are nothing but last month's stock prices. They argue that "pocket book" issues like gasoline prices, income and employment prospects drive these surveys. They argue that this month's University of Michigan consumer confidence survey, whose decline of 10 points was attributed to gasoline prices, is evidence it is not just a reflection of the stock market.

The chart below overlays the Conference Board's consumer confidence survey (which, as shown above, is highly correlated to stock prices) against the University of Michigan's survey. Other than the last plot, they are remarkably similar – as you would expect.




Why did gasoline prices dominate the Michigan survey? See the chart on the next page.




A six-fold increase in the screaming by the press about gas prices drowned everything else out.

Unless the press reports about high gasoline prices stay at this extreme level, we expect these surveys will revert back to their historical norm – describing last month's stock market action. If so, their usefulness will be limited.

**Conclusion**

In his **February testimony** to Congress Federal Reserve Chairman Ben Bernanke said:

> *The possibility of significant further increases in energy prices represents an additional risk to the economy; besides affecting inflation, such increases might also hurt consumer confidence and thereby reduce spending on non-energy goods and services.*

This is not what consumer confidence measures. And, to assume it does will lead to policy errors and incorrect judgments about the economy.

The ever larger market reactions to the confidence numbers show that many believe this is an important piece of data for a Fed that is "data-dependent" in setting policy.

Do they understand that this effectively means the stock market is playing an important role in setting policy? We would guess the answer is no.

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