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Are You Better Off? Take a Look at the Stock Market

By Betsey Stevenson & Justin Wolfers - Sep 10, 2012

Do you remember the news four years ago? Banks collapsed, markets cratered, companies struggled to make payroll and millions of people lost their jobs. Your retirement savings were decimated, the value of your house plunged, credit was unobtainable. Politicians dithered and economists argued. Only confusion prospered.

Against this background, it's surprising to hear Republicans returning to Ronald Reagan's classic debate question: "Are you better off than you were four years ago?" To anyone whose memory extends a full electoral cycle, the answer is clearly yes.

When assessing our politicians, what matters isn't just the here and now. It's at least as important to consider how well we are set up for tomorrow, next year and the decades that follow.

This distinction is particularly important in assessing the aftermath of the last recession. The anxiety that gripped us in late 2008 wasn't born out of a typical cyclical decline that hurts for a year or two before the economy returns to growth. Rather, it was a fear that something more fundamental had changed, altering our whole economic trajectory.

Only a forward-looking indicator can pick up both this fear and its ultimate resolution. Unfortunately, most economic statistics tell us only what happened last month, last quarter or last year.

Stock Market

The stock market, by contrast, is obsessively focused on the future. When investors decide whether to buy a company's stock, they aren't just thinking about its current earnings (if they were, a company like Twitter Inc. would be worthless). They are trying to figure out what its future earnings will be, and what that stream of income should be worth today. Their collective judgment, while far from perfect, tells a compelling story about how America's prospects have changed over the past four years.

On the day of President Barack Obama's inauguration, the Standard & Poor's 500 Index (SPX) closed at 805, just over half its pre-recession level. In other words, investors thought the recession had done so much damage that the future earnings of corporate America were worth only about half what they were before. And because corporate earnings are a roughly constant share of the broader economy, the stock prices suggested a decline of historic magnitude in investors' assessment of the long-run prospects for the entire U.S. economy.

As of Sept. 10, the S&P 500 index stood at 1429, about 78 percent higher than it was on inauguration day. Probable translation: Investors believe the long-run outlook for the American economy has improved enormously.

True, the stock market can rise for various reasons. Investors might expect corporate profits to grow faster than the economy, or corporate taxes to fall. They might have become more patient, causing them to place a higher value on earnings way out in the future. Given the current political climate, and the way the crisis shattered peoples' complacency, none of these stories seems particularly plausible.

The stock market is also an imperfect proxy for the outcomes we truly care about. If there were futures markets more directly tied to economic output, unemployment or perhaps even well-being, they would provide an even better picture.

Surveys asking people to evaluate their well-being can also provide a useful insight given that people's responses are influenced by their outlook. One index run by research company Gallup Inc., for example, shows people's perceived well-being at a four-year high. (Disclosure: Justin Wolfers is a senior scientist at Gallup.)

Of course, the stock ticker can't answer the most important political questions. It can't say we are better off because of Obama's policies, or for other reasons. It can't say whether we are better off than we would have been under President Mitt Romney. It does, however, capture well the narrative of disaster, survival and recovery that has marked the past four years. It helps us to remember how bad we felt back then, and to appreciate where we are today.

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