MORNING BRIEFING
June 22, 2016

Globalization Now & Then

(1) History lesson: Not enough of us study it. (2) Back to the future: Prague, Vienna, and Venice. (3) The Thirty Years' War and the Peace of Westphalia. (4) Globalization under the merchants of Venice. (5) Success breeds discontent. (6) The counter-revolution by populists. (7) Professor Summers thinks technological innovations reducing demand for labor. (8) Why are there more physically and mentally unhealthy white males? (9) The numbers don't add up for Trump unless he scores really big with white males.

Globalization I: The Merchants of Venice. I've been on a grand tour of Prague, Vienna, and Venice over the past week. My family and I had private tour guides in each city so that we could learn and see as much as possible during our short stays. History does tend to repeat itself because human nature hasn't changed much during the course of recorded history. Since most humans don't study history, they tend to repeat it rather than learn from it.

In Prague, our guide observed that the Thirty Years' War started in that city during 1618. It was actually a series of wars in Central Europe that pitted Catholics against Protestants, resulting in the death of millions. Our guide claimed that it was the first war in which atrocities were purposely committed against civilians by the invading mercenary armies. The wars pitted the French against the Hapsburgs, who ruled their empire from Vienna.

The Peace of Westphalia was a series of peace treaties signed between May and October 1648 that ended the Thirty Years' War. The treaties established the concept of sovereign nation states and led to a new world order with more diplomacy guided by international law. They ushered in a period of Globalization that was interrupted by the American and French Revolutions, and the Napoleonic Wars of the late 1700s and early 1800s. During that period of Globalization, the Industrial Revolution significantly increased standards of living throughout Europe as free trade mostly flourished.

One of the previous eras of Globalization occurred during the 13th century. Venice's merchants led the way, by promoting trade with the Byzantine Empire and the Muslim world. By the end of the century, Venice was the most prosperous city in all of Europe. Venetians did their utmost to promote peace, since war was bad for their businesses.

The lesson of history seems to be that Globalization--a period of peace during which free trade integrates national economies--increases standards of living. However, that success may also give rise to lots of discontent. I asked Melissa to examine the causes of today's discontent in the US. Here are her preliminary findings. ...

Globalization II: The Discontented. Every revolution has its counter-revolution. Trends often end when they give rise to new trends. Arguably, Globalization has been a revolution. The end of the Cold War marked the end of one of the greatest trade barriers of all times. It led to the integration of national markets through more free trade and more global competition in both labor and product markets. Consumers benefited everywhere from better and cheaper goods. Standards of living improved around the world. There was less income inequality on a global basis, but that was achieved partly because incomes fell in some countries and industries while rising in others. On balance, there were more winners than losers. But the losers are disgruntled and easily recruited by Globalization's counter-revolutionaries, who tend to be anti-trade and anti-immigration nationalists.

These populists are also trying to reverse the trend toward political correctness (PC), which has developed over the past few decades. Merriam-Webster defines PC as "agreeing with the idea that people should be careful to not use language or behave in a way that could offend a particular group of people." America's number-one populist is Donald Trump, who is clearly not afraid of discussing touchy subjects. He has been railing against PC since the start of his presidential campaign. The strategy obviously has been effective since he is now the presumptive Republican presidential nominee. That's probably because it resonates with a particular voter group that is in distress. And that seems to be mostly the white working class, especially men. Economic forces certainly have contributed to the woes of this cohort. Consider the following:

(1) *Jobless*. The civilian labor force participation rate has been under pressure since the early 2000s for reasons including the need for many students to attain higher education and the retirements of baby boomers. However, the drop in participation among prime-aged working men, aged 25 to 54, can't be explained so easily. Curiously, a drop in their labor force participation rate started before the recession, and the rate has stagnated since it ended. Some of these men may be staying at home with their families by necessity or choice, or receiving disability benefits. Indeed, some of them might be lured back into the workforce should labor force conditions continue to improve. But some of them might be too discouraged or depressed to get back to work.

(2) *Replaced.* Yesterday, we discussed that the future of technology is likely to put lots of people's jobs in jeopardy. That might already be happening for low-skilled workers. And we referenced a Larry Summers keynote address at the Peterson Institute for International Economics in November 2015. In it, the Harvard professor presented an argument that is relevant to today's discussion too.

Summers observed: "[I]n the 1960s, 1 in 20 men between 25 and 54 weren't working. And today, 3 in 20 men between the ages of 25 and 54 aren't working. I think if you looked at that and you did cyclical adjustment and so forth, you'd conclude that it's more like a steady trend than like it all fell off a cliff in 2007. ...

"[Y]ou can't escape the conclusion that there are a lot more men who aren't working. You can't escape the conclusion that on every bit of medical evidence, the population is healthier than it used to be. … But every bit of occupational evidence, work is less physically demanding than it used to be and the fraction of people who are on disability insurance is up, not down. And so, something is going on. … [T]he basic idea [is] that technological progress comes with reduced labor input, sometimes it's early retirement, sometimes it's people who aren't able to get themselves employed, sometimes, it's lower hours, but that is basically the story."

(3) *Unhealthy*. In a September 2015 study, Nobel Prize winner Angus Deaton and his wife Anne Case documented an increase in the mortality rates of white middle-aged Americans between 1999 and 2013. Most unfortunate about the findings was that the spike in death rates was mostly attributable to mental-health-related problems. Those spanned from drug and alcohol poisonings to liver diseases and suicide. The study noted: "Self-reported declines in health, mental health, and ability to conduct activities of daily living, and increases in chronic pain and inability to work, as well as clinically measured deteriorations in liver function, all point to growing distress in this population."

(4) *Depressed.* Carol Graham, a researcher at Brookings Global, recently examined a Gallup survey questioning where respondents expect their life satisfaction to be in five years. She finds that the least optimistic group by far is poor whites. Poor whites also exhibited the most stress, according to the

research. In Graham's view, being unhappy and stressed out is an economic problem.

Logically, people who feel this way aren't likely to invest in their future. It's evident in the words that they use, according to a 2015 study referenced by the researcher. It found: "The words of the wealthy--such as iPads, foam rollers, and exotic travel destinations--reflect knowledge acquisition and health-conscious behaviors; those of the poor--such as guns, video games, diabetes, and fad diets--reflect desperation, short-term outlooks, and patched-together solutions."

Interestingly, Graham observes that individuals tend to define their status based on their well-being relative to reference groups, a commonly used concept among social scientists. For poor whites, the generations before them might seem to have been better off. Meanwhile, other racial groups might perceive just the opposite, Graham notes.

(5) *Poor.* Similarly, growing income inequality, or at least the perception of it, might contribute to the mindset that hard work won't pay off--as higher income brackets become more out of reach. Indeed, the Congressional Budget Office's 6/8 report "The Distribution of Household Income and Federal Taxes, 2013" supports the notion. It concluded that all three measures of income examined within the report--market income, before-tax income, and after-tax income--became less equally distributed between 1979 and 2013.

The increase in inequality in both of the latter measures was the direct result of a significant increase in inequality in the former, mostly due to the substantial income growth at the top of the distribution. In other words, the rich got much richer. Meanwhile, the poor did just a little bit better over the 35-year period. As a result, to tie that back to Graham's research, those in lower income brackets might hold the perception that they are less well off whether or not they actually are so.

(6) *Stagnant*. Data from the Census Bureau's annual income report show that the real median earnings of full-time year-round male workers over 15 years old was 2.2% lower in 2014 than 2007. Between 2013 and 2014, the real median income of non-Hispanic white households declined by 1.7%. It's easy to poke holes in the usefulness of these data, as we've discussed previously. Nevertheless, it's not hard to find more evidence of directional trends that speak to wage stagnation among the prime-aged working white male cohort. Perception could be taking the shape of reality here.

(7) *Trumped.* Donald Trump's message seems to be resonating with many of Globalization's discontented. The question is: Are there enough of them to elect him to be our next President? In a 3/4/15 opinion piece for the *WSJ,* Whit Ayres of the polling firm North Star Opinion Research explained that if the Republican nominee maintains a hold on the 17% share of non-whites voting for Mitt Romney (when Obama defeated him in 2012), then 65% of the white vote would be required to win the election. The pollster recalled that the latter mark has been achieved only one time in the past half-century, by Ronald Reagan in 1984. Romney won 59% of white voters in 2012, Ayres pointed out.

Politico further outlined "Donald Trump's path to victory" in a 6/19 article. It was subtitled: "He needs to best Romney with white men and turn a few reliably blue Rust Belt states red." According to the article, citing the party's own electoral math, the GOP nominee should start the election with a hold on 19 states. That would equate to 164 Electoral College votes. To obtain the 270 that it will take to win the contest, Trump is targeting "America's Rust Belt," Politico notes. If he can also capture Florida and keep North Carolina red, Trump's team thinks he could become the next President.

The likely heavy Hispanic voter turnout in Florida will be a particular challenge for Trump, observes Politico. The polls have shown that Trump's rating among non-whites, especially Hispanics, has been extremely unfavorable. That combined with his poor rating with women will likely mean that Trump won't be occupying the White House.

CALENDARS

US. Wed: Existing Home Sales 5.57mu, FHFA House Price Index 0.6%, MBA Mortgage Applications, Yellen. **Thurs:** Jobless Claims 270k, Leading Indicators 0/2%, New Home Sales 565k, M-PMI Flash Estimate 51.0, Chicago Fed National Activity Index, Weekly Consumer Comfort Index. (Bloomberg estimates)

Global. Wed: Eurozone Consumer Confidence -7, Canada Retail Sales 0.8%. **Thurs:** Eurozone, Germany, and France Composite PMI Flash Estimates 53.0/54.3/51.0, Eurozone, Germany, and France M-PMI Flash Estimates 51.4/52.0/487, Eurozone, Germany, and France NM-PMI Flash Estimates 53.2/55.0/51.6. (DailyFX estimates)

STRATEGY INDICATORS

YRI Weekly Leading Index (*link*): Our Weekly Leading Index (WLI)--a good coincident indicator that can confirm or raise doubts about stock market swings--ticked down 0.4% during the week of June 11 after a two-week climb of 1.9%; it had dropped 4.1% over the prior four weeks. The WLI is 7.9% above this year's bottom in mid-January. Our WLI is the average of our Boom-Bust Barometer (BBB) and Bloomberg's Weekly Consumer Comfort Index (WCCI). Our BBB rose for the third week by a total of 2.8% after a three-week decline of 6.7%. Jobless claims fell for the third week to 269,250 (4-wa) after advancing the prior four weeks from 256,000 (lowest since December 8, 1973) to 278,500. The CRB raw industrials spot price index--another BBB component--has been moving sideways at recent highs. The WCCI sank 3.2% after rebounding 3.6% the prior two weeks.

S&P 500 Sectors Net Earnings Revisions (*link*): The S&P 500's NERI was positive in June for the first time since September 2014, and has improved in six of the past seven months. NERI was positive for 6/10 sectors and improved m/m for six (versus six positive and nine improving in May). Most sectors that dropped off the longest negative-NERI-streak list in May continued to improve in June. Energy is the worst now, with 22 straight months of negative NERI, followed by Financials (21 months) and Utilities (7). Consumer Staples had its highest reading in 77 months, followed by Materials (59-month high), Consumer Discretionary (35), Energy (11), Health Care (10), and Financials (9). Telecom was negative for a second month in June, but stands out with seven positive readings in the past 12 months. Here are June's NERI rankings and their changes: Health Care (10.7% from 8.9% in May), Consumer Staples (9.3 from 7.8), Materials (6.8 from 3.0), Industrials (3.1 from 3.2), Consumer Discretionary (0.9 from 0.8), Tech (0.8 from 1.9), S&P 500 (0.6 from -0.8), Energy (-4.2 from -10.8), Utilities (-5.1 from -5.0), Telecom (-8.7 from -3.7), and Financials (-10.4 from -13.5).

S&P 500 Earnings, Revenues, & Valuation (*link*): S&P 500 consensus forward revenue and earnings forecasts both rose last week. Forward revenues rose less than 0.1% to a 37-week high, and forward earnings gained 0.2% to a 23-week high. The forward profit margin forecast was steady w/w at 10.6%, which is little changed from its 24-month low of 10.4% in late March and its 10.9% record high from September. Forward revenue growth for the S&P 500 edged down to 4.2% from an eight-month high of 4.3%, but that's up from a seven-month low of 2.7% at the end of February. Forward earnings growth rose to a nine-month high of 8.0% from 7.9% and is up from an 11-month low of 4.8% in late February. Valuation fell to 16.5 from 16.8, and is down from April's nine-month high of 17.0 and February 2015's 12-year high of 17.4. Ex-Energy, the forward revenue growth rate edged down to 4.4% from 4.5% and forward earnings growth improved to 8.2% from 8.1%. Despite the collapse in Energy sector forecasts since early 2015 and negative currency translation, forward revenues and forward earnings both remain above their early 2015 lows and close to their record highs from October 2014: Forward revenues is down 1.6%, and forward earnings is down 2.4%. Ex-Energy, the forward profit margin was steady at 11.3%, but is down from 11.5% in September.

S&P 500 Sectors Earnings, Revenues, & Valuation (*link*): Consensus forward revenue forecasts rose last week for 4/10 sectors, and forward earnings rose for 3/10. Both forward revenues and earnings are at or around record highs for 5/10 sectors: Consumer Discretionary, Consumer Staples, Health Care, Industrials, and Tech. Energy's forward earnings rose 0.4% w/w and has soared 26.8% since its 17-year low in April. Forward P/S and P/E ratios rose w/w for just 2/10 sectors: Telecom and Utilities. P/E and P/S ratios have rebounded sharply for most sectors from cyclical lows in February, but have struggled to surpass their six- to 10-year highs achieved during the first half of 2015. Health Care's P/E of 15.0 and P/S of 1.59 remain well below their 2015 highs of 17.9 and 1.88, respectively. P/Es for Consumer Staples (20.4) and Materials (16.6) are near their highest levels since 1999. Energy's P/S ratio of 1.47 compares to a record high of 1.56 in early May and a five-month low of 1.13 in mid-January; its P/E of 44.3 is also down, from an earnings-depressed record high of 57.5 in May. Higher y/y margins are expected for just 5/10 sectors in 2016: Consumer Discretionary (to 7.6% from 7.1%), Consumer Staples (6.6, 6.5), Industrials (9.3, 9.2), Materials (8.9, 8.8), and Tech (18.9, 18.8). Margins are expected to deteriorate the most for Energy (1.7, 4.6), Telecom (10.8, 11.3), and Utilities (10.5, 10.6).

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