



MORNING BRIEFING

February 13, 2017

Good Rotation

See the [collection](#) of the individual charts linked below.

(1) Dictionary definitions. (2) Chump change, chunk of change, and Trump change. (3) QE was terminated in late 2014, yet equity bull continues to charge ahead. (4) No Great Rotation so far, but maybe the start of a Good Rotation. (5) Piling into savings deposits. (6) December was a good month for equity funds. (7) China's rooster starts the new year with a loud crow. (8) UK factories booming. (9) No sign of zerosumitis. (10) Movie Review: "A Dog's Purpose" (+ +).

Strategy: Lots of Dough. Let's start with some definitions from the dictionary. "Chump change" is a small or insignificant amount of money. "Chunk of change" is a lot of money. Equity mutual funds have attracted chump change since the start of the current equity bull market. A large chunk of change has been going into bond mutual funds instead. At the same time, the amount of liquid assets held in savings deposits has been soaring to new record highs.

Since Election Day, there is some evidence that "Trump change" is reviving animal spirits among business executives, purchasing managers, and consumers. At least that was the initial response to Trump's victory. The stock market also responded favorably, with the S&P 500 up 8.3% since Election Day ([Fig. 1](#)). Bond holders, on the other hand, experienced capital losses as the yield rose 53bps to 2.41% since Election Day ([Fig. 2](#)).

Since late 2014, there has been much chatter about a "Great Rotation" out of bonds and into stocks. It was deemed to be the only way that the stock market could continue to make new highs once the Fed had terminated its QE program and started raising interest rates.

Perma-bears had been tracking the close correlation between the S&P 500 and the assets held by the Fed ([Fig. 3](#)). They argued that but for the Fed's ultra-easy and unconventional QE monetary policies, the bull market would have ended long ago. My response to that amazing insight was: "So what's their point?"

Lo and behold, the Fed terminated its QE program on October 29, 2014. The FOMC hiked the federal funds rate by 25bps on December 16, 2015 and again on December 14, 2016 to a range of 0.50%-0.75%. The futures market has priced in an increase to 1.16% within the next 12 months ([Fig. 4](#)). Yet the S&P 500 is up 16.8% since QE was terminated!

Joe and I observed that rising earnings were also driving the bull market, not just the fumes from the Fed's QE ([Fig. 5](#)). Another significant driver of the bull market, which we spotted early on, was the huge inflows of corporate cash through stock buybacks and dividend payouts. Together, they've totaled \$5.5 trillion from Q1-2009 through Q3-2016 ([Fig. 6](#)). That's likely to continue to drive the market higher, particularly if "Trump change" includes the repatriation of some significant portion of the \$2.5 trillion that US corporations have parked overseas.

There is some preliminary evidence that investors may finally be starting to rotate out of bonds and into stocks. Debbie and I aren't rooting for a Great Rotation, since that might push bond yields up to levels

that pose a threat to the economy and the bull market in stocks. We would be happy to see a Good Rotation. Let's review the latest data that we will continue to monitor in coming months:

(1) *Savings deposits.* It's amazing to see that savings deposits (including money market deposit accounts) rose \$4.5 trillion since the second week of March 2009 to a record high of \$8.9 trillion during the final week of January this year ([Fig. 7](#)). Over the past 52 weeks, the amount in savings deposits is up \$577 billion ([Fig. 8](#)). This really is money for nothing, with deposit rates near zero. If individual investors turn more bullish on equities as a result of Trump change, they might rotate out of their liquid assets rather than their bonds.

(2) *Bond flows.* Monthly data compiled by the Investment Company Institute show that bond mutual funds as well as ETF bond index funds together attracted net inflows during every month of 2016 except for November ([Fig. 9](#)). On a 12-month-sum basis, there have been significant bond inflows during the current bull market in equities with the exception of minor outflows during early 2014 ([Fig. 10](#)).

(3) *Equity flows.* A similar analysis for equities shows that mutual funds had outflows every month last year except during February, March, and December ([Fig. 11](#)). In contrast, equity ETFs had net outflows only during January and February. Together, they had inflows of \$78.4 billion during December, the best monthly pace since December 2007.

(4) *Good Rotation.* December's big inflow into aggregate equity funds might have been the start of the Good Rotation. It wasn't a Great Rotation given that aggregate bond funds attracted \$7.6 billion during December, following a net outflow of \$6.6 billion during November. There's no sign of a panic exit from the bond market into either cash or equities.

(5) *Summing it up.* Since the start of the equity bull market during March 2009, savings deposits are up \$4.5 trillion, while net inflows into bond mutual funds have added up to \$1.7 trillion ([Fig. 12](#)). Those are large chunks of change. Equity mutual funds' net inflows, which are dominated by individual investors, have amounted to chump change, totaling just \$205 billion. However, net inflows into equity ETFs, which reflect a more diverse universe of investors, totaled \$1.1 trillion ([Fig. 13](#)).

Again, there is likely to be a large chunk of change in repatriated earnings going back into the stock market as additional buybacks and dividends. A Good Rotation by individual investors could unfold if the Fed continues to raise the federal funds rate at a gradual pace.

This all augurs for higher stock prices. The only problem is that valuations are awfully high. That problem could be solved by higher earnings if Trump succeeds in cutting corporate taxes and regulatory costs on business. If he also manages to cut personal income taxes and boost economic growth, that would help as well. The market is clearly betting that he just might succeed. So are we—for now.

World Economy: Global Warming. The dictionary defines "eating crow" as humiliation after admitting being proven wrong after taking a strong position. On the other hand, "crowing" is defined as saying something in a tone of gloating satisfaction, usually after being proven right after all.

Debbie and I have been arguing that the weakness in global economic activity, particularly in the US, since the second half of 2014 through the end of 2015 might have been mostly attributable to the energy industry's recession. Last year, we saw mounting signs that it was ending so that economic and earnings growth should improve. Though crowing isn't our style, we've been taking some satisfaction in this scenario since last summer,

In recent months, we've been seeing more signs of better economic activity overseas as well. Since this is the Year of the Rooster in China, it is only fitting that it starts with some economic data that the country can crow about. Specifically, during January, merchandise exports and imports (in yuan) rose 22.1% and 44.4% y/y ([Fig. 14](#) and [Fig. 15](#)). We aren't surprised since we noted just last week that the sum of exports plus imports is highly correlated with China's railways freight traffic, which rose sharply during the second half of 2016 ([Fig. 16](#)).

Some of the increase in imports undoubtedly reflects rising oil prices, which has weighed a bit on China's trade surplus ([Fig. 17](#)). Nevertheless, the country's proxy for 12-month net capital outflows improved some more during January as the pace of decline in international reserves eased ([Fig. 18](#)).

Also doing some crowing are pro-Brexit Brits, who can claim that so far instead of a calamity, their economy's manufacturing sector is showing signs of strength, as Debbie reviews below ([Fig. 19](#)). Of course, the 16% plunge in the pound since the Brexit vote on June 23 has helped to boost exports. However, the global economy isn't showing signs of "zerosumitis," which is a word you won't find in any dictionary.

Movie. "A Dog's Purpose" (+ +) ([link](#)) is a movie for dog lovers. Our family includes a Cocker Spaniel and two Cavalier King Charles Spaniels. So my wife and I really enjoyed the film very much. It confirms the age-old adage that if you want a true friend for life, get a dog. President Harry Truman reportedly said that about Washington, though there is no proof that he ever did say so. Nevertheless, it applies to Washington more than ever. Maybe if all our red and blue politicians got dogs, they finally would have something in common. After all, there are no red dogs or blue dogs.

CALENDARS

US. Mon: None. **Tues:** NFIB Small Business Optimism Index 104.5, PPI-FD Total, Core, and Core Less Trade Services 0.3%/0.2%/0.2%, Yellen, Kaplan. (Bloomberg estimates)

Global. Mon: China CPI & PPI 2.4%/6.6% y/y, Japan Industrial Production, European Commission Economic Forecasts. **Tues:** Eurozone GDP 0.5%q/q/1.8%y/y, Eurozone Industrial Production - 1.5%m/m/1.7%y/y, Germany ZEW Survey, Germany CPI -0.6%m/m/1.9%y/y, Germany GDP 0.5%q/q/1.8%y/y, Italy GDP 0.3%q/q/1.0%y/y, UK Headline & Core CPI 1.9%/1.7% y/y. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance ([link](#)): The US MSCI index rose 0.8% last week, ranking 19th of the 49 markets as 26 rose in US dollar terms--compared to 25th a week earlier, when it gained 0.2% as 26 markets moved higher. The AC World ex-US index underperformed the US MSCI for the tenth time in the past 13 weeks, rising 0.3% for the week versus a 0.1% gain a week earlier. BRIC was the best-performing region last week, with a gain of 2.0%, followed by EM Asia (1.6) and EM Latin America (1.3). The week's worst-performing regions: EMU (-1.5), EM Eastern Europe (-0.8), EMEA (-0.5), and EAFE (0.0). Last week's best-performing countries: Egypt (9.2), Peru (3.5), Jordan (3.1), and China (2.9). Greece (-4.1) was the worst performer, followed by Norway (-3.9), Spain (-2.9), and Italy (-2.7). The US MSCI is up 3.7% ytd, which ranks 31/49, and has been underperforming the AC World ex-US (4.6) on a ytd basis for the past five weeks. Forty-five of the 49 markets are positive ytd, led by Argentina (26.9), Poland (14.6), Brazil (14.2), Peru (13.0), and China (9.4). The worst country performers ytd: Greece (-7.4), Italy (-3.0), Sri Lanka (-1.2), and Russia (-0.3). The best-performing regions ytd: EM Latin America (11.1), BRIC (9.2), and EM Asia (8.3). The worst-performing regions,

albeit with gains: EMU (1.1), EMEA (2.8), EM Eastern Europe (2.9), and EAFE (3.4).

S&P 1500/500/400/600 Performance ([link](#)): All three indexes rose for a third straight week. SmallCap rose 1.0%, beating the gains for MidCap (0.8%) and LargeCap (0.8). Twenty-nine of the 33 sectors rose in the latest week, up from 20 rising a week earlier. LargeCap and MidCap ended the week at new record highs, but SmallCap remained 0.9% below its respective record high in early December. Last week's best performers among sectors: MidCap Telecom (3.1), MidCap Consumer Discretionary (2.4), SmallCap Consumer Discretionary (2.3), and SmallCap Consumer Staples (1.9). SmallCap Energy (-2.5) was the worst sector performer last week, followed by LargeCap Energy (-0.7), MidCap Energy (-0.5), and SmallCap Telecom (-0.3). Twenty-four of the 33 sectors are positive ytd, with MidCap (3.6) edging out LargeCap (3.5) and both easily ahead of SmallCap (1.4). The biggest sector gainers ytd: MidCap Materials (7.7), LargeCap Tech (7.2), MidCap Health Care (6.3), MidCap Telecom (6.1), MidCap Tech (5.6), and SmallCap Tech (5.4). The worst performers ytd: LargeCap Telecom (-4.7), LargeCap Energy (-3.6), MidCap Energy (-2.1), and SmallCap Consumer Staples (-1.8).

S&P 500 Sectors and Industries Performance ([link](#)): Ten of the 11 sectors rose last week, and five outperformed the S&P 500's 0.8% gain--compared to five sectors rising a week earlier, when five also outperformed the S&P 500's 0.1% gain then. Industrials was the best-performing sector for the week with a gain of 1.6%, followed by Consumer Discretionary (1.4%), Tech (1.2), Consumer Staples (1.1), and Real Estate (1.0). Energy was last week's worst performer, with a decline of 0.7%, followed by Materials (0.0), Financials (0.3), Telecom (0.3), Health Care (0.5), and Utilities (0.7). Nine of the 11 sectors are higher so far in 2017, and four have outperformed the 3.5% gain for the S&P 500. The best performers in 2017 to date: Tech (7.2), Consumer Discretionary (5.3), Materials (4.9), and Health Care (4.1). The sectors underperforming the S&P 500: Telecom (-4.7), Energy (-3.6), Utilities (1.3), Real Estate (1.5), Financials (2.0), Industrials (3.4), and Consumer Staples (3.4).

Commodities Performance ([link](#)): Twenty of the 24 commodities we follow rose last week, up from 17 rising a week earlier. The week's best performers: Unleaded Gasoline (12.8%), Wheat (7.0), Kansas Wheat (6.9), Copper (5.6), and Zinc (4.8). Last week's laggards: Cocoa (-5.5), Sugar (-3.2), Live Cattle (-2.1), and Feeder Cattle (-1.0). The best performers in 2017: Lead (19.6), Zinc (13.9), Wheat (12.8), Silver (12.5), and Kansas Wheat (12.5). This year's laggards to date: Natural Gas (-16.7), Cocoa (-7.9), Heating Oil (-3.2), Live Cattle (-2.5), and Feeder Cattle (-2.2).

Assets Sorted by Spread w/ 200-dmas ([link](#)): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 18/24 commodities, 6/9 global stock indexes, and 22/33 US stock indexes compared to 17/24, 1/9, and 12/33 rising a week earlier, respectively. Twenty-one commodities trade above their 200-dmas, up from 20 a week earlier as Silver turned positive w/w. Commodities' average spread surged to 7.0% from 4.9%. Zinc leads all commodities and all assets at 23.9% above its 200-dma, followed by Lead (20.7%) and Copper (20.0). Unleaded Gasoline (18.1) improved 13.2ppts w/w relative to its 200-dma for the week's best performance among all commodities and all assets. Commodities also dominate the lowest-trading assets relative to 200-dmas, with these three commodities at the steepest discounts of all: Cocoa (-27.3), Feeder Cattle (-7.3), and Gold (-2.3). Sugar (1.2) fell 4.0ppts w/w for the worst performance of all commodities and all assets. The global indexes trade an average of 7.2% above their 200-dmas, up from 6.3% above in the prior week. All nine of the global indexes trade above their 200-dmas, unchanged from a week earlier. Brazil (13.8) leads the global indexes, followed by Japan (11.8) and Germany (10.0). Brazil and Canada (6.9) were the group's best performers last week, with gains of 1.4ppts. South Korea (2.9) is trading at the lowest relative to its 200-dma of the global assets, but Germany (10.0) had the weakest performance of its country peers last week, as it fell 0.3ppt. The US indexes trade at an average of 7.6% above their 200-dmas, with 31 sectors above, up from a 7.1% average a week earlier when 29 sectors were above. SmallCap Materials leads all US stock indexes at 17.3% above its 200-dma, followed by SmallCap

Tech (17.2), SmallCap Financials (16.1), and LargeCap Financials (15.7). MidCap Telecom was last week's best performer among US stock indexes, as it improved 3.2ppts w/w to 7.5%. The following LargeCap sectors trade at the deepest discounts to their 200-dmas among the US indexes: Real Estate (-1.5) and Telecom (-1.5). SmallCap Energy (15.6) was last week's worst performer among US stock indexes, as it fell 3.7ppts.

S&P 500 Technical Indicators ([link](#)): The S&P 500 remained in a Golden Cross last week for a 42nd week (after 17 weeks in a Death Cross) as the index's 50-day moving average (dma) improved relative to its 200-dma for a tenth straight week. Its 50-dma improved to a 17-week high of 4.5% above its 200-dma from 4.3% a week earlier and a six-month low of 2.0% in early December. That's down from a 30-month high of 5.4% in mid-September, but up from a 52-month low of -4.5% in March 2016. The S&P 500's 50-dma moved higher for a 13th week after six weekly declines, and the index closed the week above its 50-dma for a 13th week after nine weeks below. The S&P 500 improved to 2.1% above its rising 50-dma from 1.7% a week earlier. That's down from a 38-week high of 4.8% above its rising 50-dma on December 13 and compares to a 52-month high of 6.2% on March 21 and a five-month low of -7.8% in January 2016. The S&P 500's bounce off its 200-dma in early November continued last week as the index rose to a nine-week high of 6.7% above its rising 200-dma from 6.1%, but remains below the 17-week high of 6.9% above its rising 200-dma on December 13. That compares to a 20-month high of 7.1% in mid-August and a six-month low of -10.0% in mid-February. The 50-dma and 200-dma both rose together for a 13th week after falling for eight weeks.

S&P 500 Sectors Technical Indicators ([link](#)): The short-term picture improved for eight of the 11 S&P 500 sectors last week, and the long-term picture improved for 8/11 as well. Nine sectors still trade above their 50-day moving averages (dmas), unchanged from a week earlier as Energy and Telecom remained below. That's still a big turnaround from 14 weeks ago, when all 11 sectors traded below their 50-dmas for the first time since December 11, 2015. Nine of the 11 sectors were above their 200-dmas last week, up from seven a week earlier as Consumer Staples and Utilities moved above their 200-dmas. The two sectors still trading below their 200-dmas: Real Estate and Telecommunication Services. Only seven sectors are in a Golden Cross now, with 50-dmas higher than their 200-dmas: Consumer Discretionary, Energy, Financials, Industrials, Information Technology, Materials, and Telecommunication Services. All 11 had been in a Golden Cross during a 21-week streak that ended October 24, the longest such stretch since October 2014. Ten of the 11 sectors have rising 50-dmas, down from all 11 rising a week earlier as Energy started falling in the latest week. Six have rising 200-dmas, unchanged from a week earlier. These six still have a rising 200-dma: Consumer Discretionary, Energy, Financials, Industrials, Materials, and Tech. Health Care and Real Estate are the only sectors with a falling 200-dma, and these three are flat: Consumer Staples, Telecom, and Utilities.

US ECONOMIC INDICATORS

Consumer Sentiment Index ([link](#)): Consumer sentiment in mid-February pulled back more than expected after reaching a 13-year high in January. The Consumer Sentiment Index fell to 95.7 this month after climbing from 87.2 in October to 98.5 in January—the highest since January 2004. This month's retreat was led by a 4.6-point drop in the expectations component to 85.7 after reaching a two-year high of 90.3 in January. The present situation component edged down for the second month to 111.2, though was little changed from December's cyclical high of 111.9. Richard Curtin, the Surveys of Consumers chief economist, said "While currently distorted by partisanship, the best bet is that the gap will narrow to match a more moderate pace of growth." He went on to say, "Nonetheless, it has been long known that negative rather than positive expectations are more influential in determining spending, so forecasts of consumer expenditures must take into account a higher likelihood of asymmetric downside risks."

Import Prices ([link](#)): Import prices in January accelerated 3.7% y/y, the biggest 12-month gain since February 2012. They had bottomed at -11.6% in September 2015. Petroleum prices soared 60.9% in the 12 months through January, the highest reading since March 2010. Nonpetroleum products edged up 0.3% y/y last month—turning positive in December (0.2% y/y) for the first time since November 2014. During January, total import prices rose for the fourth time in five months, up 0.4% m/m and 1.4% over the period as petroleum prices jumped 5.2% and 19.8% over the comparable periods. Nonpetroleum prices were flat in January after falling two of the prior three months by a total of 0.2%; these prices had climbed 0.7% during the three months through September.

GLOBAL ECONOMIC INDICATORS

UK Industrial Production ([link](#)): UK industrial production in December was a surprise on the upside, jumping 1.1% after a 2.0% surge in November. Factory production, which accounts for roughly 70% of industrial production, rose 2.1% in December and 3.5% the past two months; the results were boosted by volatile pharmaceutical output, which was up 8.3% and 18.8% over the comparable periods. December's gain was broad-based, with nine out of 13 subsectors posting gains. Production of metals (4.5%), computers & electronic products (3.7), and textiles (2.3) joined pharmaceuticals as the major drivers of December's advance. The latest ISM survey suggests that manufacturing output last month continued to climb. January's M-PMI was 55.9, only a couple of ticks below December's two-and-a-half year high of 56.1, as output expanded at its fastest pace since May 2014. Of the remaining three industrial sectors, electricity (-2.0) and mining & quarrying (-1.1) fell during December, while waste supply, sewage & waste management (0.0) was unchanged.

Italy Industrial Production ([link](#)): Output in the Eurozone's third-largest economy increased in five of the final six months of last year to its highest level in five years. Production, excluding construction, advanced 1.4% in December and 4.3% over the period, with factory output up 1.4% and 3.7% over the comparable time spans. All the main industrial groupings recorded solid output gains during the last six months of 2016: energy (12.4%), intermediate goods (5.0), investment goods (4.8), and consumer goods (2.7). January's M-PMI (53.0) showed Italy's manufacturing sector continued to grow at a healthy pace, as output and new orders continued to expand, and job creation was the best in nine months. A separate report shows business confidence last month was the most optimistic since October 2015.

Mexico Industrial Production ([link](#)): Industrial production in Latin America's second-largest economy remained volatile around record highs in December, while factory output set a new record high. Headline production ticked down 0.1% after no gain in November and a 0.3% advance in October, dragged lower by declines in mining (-1.4%) and construction (-0.3). Manufacturing production climbed for the seventh time in eight months by 0.6% m/m and 4.0% over the time span. On a year-over-year basis, headline production fell 0.6%—continuing to bounce around zero as mining output plunged 10.5%, the steepest decline since October 1995. Utilities (3.9% y/y), manufacturing (1.8), and construction (1.8) output were all above year-ago levels.

India Industrial Production ([link](#)): Industrial output in Asia's third-largest economy contracted in December by 0.4% y/y, after a 5.7% gain in November, due to declines in consumer (-6.9% y/y) and capital (-3.0) goods output—as well as the impact from demonetization. Other sectors showed a gain in basic (5.4) and a decline in intermediate (-1.2) goods production. By industry, manufacturing production (-2.0) fell, while electricity (6.3) and mining (5.2) rose. After the report, India's finance minister said that output was expected to expand in coming months.

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