MORNING BRIEFING
February 21, 2017

Rules for Paranoids

See the collection of the individual charts linked below.

(1) Historic times, maybe. (2) Paranoids vs. paranoids out to get one another. (3) Alinsky's rule book for middle-class revolutionary youths. (4) Hillary's 1969 senior thesis now available online. (5) OFA organizing to keep Obama's status quo. (6) Historian Hofstadter wrote the book on "paranoid style" in American politics. (7) Rahm tells Trump to cut taxes post haste. (8) More animal spirits in the zoo. (9) Blanchard says secular stagnation wasn't so secular after all.

US Politics: Rules for Radicals. We are witnessing history. There is an epic battle unfolding in Washington between paranoids and radicals. The former are mostly wealthy business people with lots of corporate experience but not much experience in government. They are mostly experts in making business deals. As a result of Trump's Election Day victory, they are in power for at least the next four years. They've staged a radical regime change, possibly a revolutionary one, over the community organizers who ran the government for the past eight years.

The current crew is paranoid because the ousted one (led by the One) is out to get them. The deposed are staging a counter-revolution. Posters, bumper stickers, and fortune cookies often state universal truths. My personal favorite is: "Just because you are paranoid, doesn't mean they aren't out to get you." The quote has been attributed to Woody Allen, Yossarian, and Nirvana. The counter-revolutionaries are out to get Trump and his cronies. They are a wee bit paranoid too. They are using the techniques they learned from Saul Alinsky's 1971 book *Rules for Radicals*. It is the bible of community organizers. It was directed at middle-class youth, who Alinsky believed would be easier to radicalize than workers.

Hillary Clinton wrote her 1969 senior thesis on Alinsky. David Brock, in his 1996 biography *The Seduction of Hillary Rodham*, called Hillary "Alinsky's daughter." Hillary's thesis was put under lock and key at her request by Wellesley College. However, it was finally recently posted on the Internet. Hillary describes Alinsky as a "neo-Hobbesian who objects to the consensual mystique surrounding political processes; for him, conflict is the route to power."

Hillary noted that Alinksky believed that the community organizer must foment and channel conflict and, in his words, be "dedicated to changing the character of life of a particular community." In this capacity, the community organizer "has an initial function of serving as an abrasive agent to rub raw the resentments of the people of the community; to fan latent hostilities of many of the people to the point of overt expressions ... to provide a channel into which they can pour their frustration of the past; to create a mechanism which can drain off underlying guilt for having accepted the previous situation for so long a time. When those who represent the status quo label you [i.e., the community organizer] as an 'agitator' they are completely correct, for that is, in one word, your function—to agitate to the point of conflict."

In her 2003 book *Living History*, Clinton wrote, "He believed you could change the system only from the outside. I didn't. Alinsky said I would be wasting my time, but my decision was an expression of my belief that the system could be changed from within."

Barack Obama was also a community organizer influenced by Alinsky. Like Hillary, Obama too concluded that change from within the system was possible, and he certainly proved that over the past eight years. Now that he is out of office, and now that Hillary has lost, Obama is supporting community organizers who are out to maintain his legacy by doing what they can from outside the system to delegitimize and disempower the Trump administration.

Paul Sperry, a conservative columnist, wrote the following in a 2/18 *NY Post* article: "Organizing for Action, a group founded by Obama and featured prominently on his new post-presidency website, is distributing a training manual to anti-Trump activists that advises them to bully GOP lawmakers into backing off support for repealing ObamaCare, curbing immigration from high-risk Islamic nations, and building a border wall. In a recent Facebook post, OFA calls on activists to mobilize against Republicans from now until February 26, when "representatives are going to be in their home districts." Ironically, the OFA crowd no longer wants change. Rather, they want to keep Obama's legacy as the status quo.

"The Paranoid Style in American Politics" is an essay by American historian Richard J. Hofstadter, first published in *Harper's Magazine* in November 1964; it served as the title essay of a book by the author in the same year. Hofstadter defined politically paranoid individuals as feeling persecuted, fearing conspiracy, and acting overly aggressive. While Hofstadter acknowledges that this ailment can affect both left-leaning as well as right-leaning politicians, his essay was mostly directed at people like conservative Barry Goldwater, who just happened to be the Republican Party's nominee for President of the United States in the 1964 election. The left-leaning historian concluded: "We are all sufferers from history, but the paranoid is a double sufferer, since he is afflicted not only by the real world, with the rest of us, but by his fantasies as well." If he were alive today, Hofstadter would certainly have lots of fun psychoanalyzing Donald Trump as well as his opponents. They are all paranoid because they are all out to get each other!

Strategy: Rahm's Rule. Rahm Emanuel has some very good advice for Trump. Rahm is the current mayor of Chicago. He was formerly the chief of staff in the Obama administration during 2009 and 2010. On November 19, 2008, Rahm famously said, "You never want a serious crisis to go to waste," at a *WSJ* conference of top corporate chief executives. Obama certainly followed Rahm's rule and effectively pushed his agenda through Congress as a result, including fiscal stimulus, Obamacare, and financial regulation. Now Rahm has some thoughts for the new president, shared in a 2/16 interview with John Harwood of CNBC:

"I don't think the president will touch Dreamers. Dodd-Frank, I think they are going to try to fundamentally undermine it. I think not just in the consumer office, but the Volcker Rule, how much cash banks have to have, the kind of checkup to make sure that they're healthy. Of the three you're talking about I think that's the one that's most vulnerable. …. They're finding out that President Obama's health-care plan is a puzzle. This is just not that easy. Each of these changes exposes fault lines within the Republican Party. And they're going to realize, there's only so much you can do. It's going to be easier to get a consensus around taxes than it is health care."

Rahm's latest rule on focusing on tax reform jibes with what I wrote last Thursday: "The bullish scenario is that Trump comes to realize quickly that he must use most of his political capital to fast-track tax cuts, tax reform, repatriated earnings, and deregulation. If that path lifts economic growth, as it should, the strength of the economy should boost Trump's political capital and strength both at home and abroad. Then he can proceed with the rest of his agenda."

Trump gloated last week about the rise in stock prices to record highs since Election Day. He clearly has managed to revive animal spirits. Now he has to deliver by pushing through his tax program. Everything else can wait. If he does so, the S&P 500 should continue to advance toward our yearend target of 2400-2500.

US Economy I: Animal Spirits Unchained. What an amazing difference an election can make. Animal spirits have been revived not only in the stock market but also in the economy. Debbie and I have been monitoring and writing about the vertical ascent in confidence indexes of consumers, small business owners, and purchasing managers since Election Day. The latest is the 19.7-point jump to 43.3 in February's Philly Fed current activity index, led by its orders and shipments components (*Fig. 1*). It is up 32.2 points since October. The New York Fed's survey was also strong in February, on widespread strength, with its current activity index climbing to 18.7 from -5.5 since October (*Fig. 2*).

The unweighted average of the top-line indexes for the two Fed districts rose from 2.8 during October to 31.0 this month, the highest since July 2004 (*Fig. 3*). This average augurs well for February's national M-PMI, which will be released on March 1, though we'll get an early glimpse of the strength this morning with the release of Markit's flash estimate. The Citigroup Economic Surprise Index shot up to 53.6% near the end of last week, the highest reading since January 27, 2014 (*Fig. 4*).

There's more: Our Boom-Bust Barometer (BBB) continues to soar into record-high territory (*Fig. 5*). It is up 44% since its most recent low of 143.1 during the week of January 16, 2016 to 206.6 last week. That's one of the most explosive "rallies" in our BBB on record. Our Weekly Leading Index, which is driven by BBB, is following the same moonshot trajectory and augers well for the Index of Leading Economic Indicators, which rose 0.6% m/m during January, just shy of its record high posted in March 2006, as Debbie discusses below (*Fig. 6*).

US Economy II: Secular Stagnation RIP? Debbie and I have theorized that Election Day might have marked the end of secular stagnation thanks to the revival of animal spirits by Trump's proposals to reform taxes and lower tax rates. Now comes along an interesting paper by three researchers at the Peterson Institute that more or less comes to the same conclusion. It is titled "Short-Run Effects of Lower Productivity Growth: A Twist on the Secular Stagnation Hypothesis." One of the authors is Olivier Blanchard, who is now an economics professor at MIT and was formerly the IMF's chief economist. Here is the gist of their paper:

"For a while one could point to plausible culprits, from a weak financial system to fiscal consolidation. Over time, however, the financial system strengthened and fiscal consolidation came to an end; still, growth did not pick up. We believe that this is largely due to lower optimism about the future, more specifically to downward revisions in growth forecasts, rather than to the legacies of the past. Put simply, demand is temporarily weak because people are adjusting to a less bright future.

"If this explanation is correct, it has important implications for policy and forecasts. It may weaken the case for secular stagnation, as it suggests that the need for very low interest rates to sustain demand may be partly temporary. It also implies that, to the extent that investors in financial markets have not fully taken this undershooting into account, the current yield curve may underestimate the strength of future demand and the need for higher interest rates in the future. To be clear, our hypothesis is not an alternative to the secular stagnation hypothesis but a twist on it. Namely, we do not question that interest rates will probably be lower in the future than they were in the past. We argue that, for a while, they may be undershooting their long-run value."

I guess this means that maybe secular stagnation wasn't so secular after all. It was mostly in our heads. We were depressed about the future. The authors don't really explain why that was the case—though the rebound in animal spirits since Election Day does suggest a plausible answer.

CALENDARS

US. Tues: Markit M-PMI Flash Estimate, Kashkari, Harker. **Wed:** Existing Home Sales 5.75mu, MBA Mortgage Applications, Powell, FOMC Minutes. (Bloomberg estimates)

Global. Tues: Eurozone, Germany, and France Composite Index Flash Estimates 54.4/54.8/53.8, Eurozone, Germany, and France M-PMI Flash Estimates 55.0/56.0/53.5, Eurozone, Germany, and France NM-PMI Flash Estimates 53.7/53.6/53.9, Carney. **Wed:** Eurozone Headline & Core CPI 1.8%/0.9% y/y, Germany Ifo Business Climate, Current Assessment, and Expectations Indexes 109.6/116.7/103.0, UK GDP 0.6%q/q/2.2%y/y. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance (*link*): The US MSCI index rose 1.5% last week, ranking 14th of the 49 markets as 34 rose in US dollar terms--compared to 19th a week earlier, when it gained 0.8% as 26 markets moved higher. The AC World ex-US index underperformed the US MSCI for the 11th time in the past 14 weeks, rising 0.8% for the week versus a 0.3% gain a week earlier. BRIC was the best-performing region last week, with a gain of 1.2%, followed by EMU (1.1%), EM Latin America (1.0) and EM Asia (0.9). The week's worst-performing regions: EM Eastern Europe (-0.8), EMEA (0.3), and EAFE (0.8). Last week's best-performing countries: Egypt (7.2), Israel (4.9), Turkey (3.5), and Netherlands (3.1). Peru (-3.7) was the worst performer, followed by Colombia (-2.3), Mexico (-2.0), and Russia (-1.5). The US MSCI is up 5.2% ytd, which ranks 25/49, and has been underperforming the AC World ex-US (5.4) on a ytd basis for the past six weeks. Forty-four of the 49 markets are positive ytd, led by Argentina (25.7), Brazil (17.3), Egypt (17.2), Poland (15.5), and China (11.2). The worst country performers ytd: Greece (-5.9), Italy (-2.5), Russia (-1.8), Sri Lanka (-0.4), and Ireland (-0.2). The best-performing regions ytd: EM Latin America (12.1), BRIC (10.5), and EM Asia (9.3). The worst-performing regions, albeit with gains: EM Eastern Europe (2.2), EMU (2.2), EMEA (3.1), and EAFE (4.2).

S&P 1500/500/400/600 Performance (*link*): All three indexes rose for a fourth straight week. LargeCap rose 1.5%, beating the gains for MidCap (0.8%) and SmallCap (0.6). Twenty-three of the 33 sectors rose in the latest week, down from 29 rising a week earlier. LargeCap and MidCap ended the week at new record highs, but SmallCap ended 0.3% below its Wednesday record which was its first since early December. Last week's best performers among sectors: MidCap Telecom (4.2), LargeCap Financials (3.0), SmallCap Health Care (2.8), LargeCap Health Care (2.5), and MidCap Financials (2.3). MidCap Energy (-3.7) was the worst sector performer last week, followed by SmallCap Energy (-2.9), LargeCap Energy (-2.1), and MidCap Consumer Staples (-2.0). Twenty-four of the 33 sectors are positive ytd, with LargeCap (5.0) now edging out MidCap (4.5) and both easily ahead of SmallCap (2.0). The biggest sector gainers ytd: MidCap Telecom (10.6), MidCap Materials (9.4), LargeCap Tech (9.1), MidCap Health Care (8.4), MidCap Tech (7.0), and SmallCap Health Care (7.0). The worst performers ytd: MidCap Energy (-5.7), LargeCap Energy (-5.6), LargeCap Telecom (-4.5), and SmallCap Energy (-4.2).

S&P 500 Sectors and Industries Performance (*link*): Ten of the 11 sectors rose last week, and five outperformed the S&P 500's 1.5% gain--compared to five sectors rising a week earlier, when five also outperformed the S&P 500's 0.8% gain then. Financials was the best-performing sector for the week with a gain of 3.0%, followed by Health Care (2.5%), Tech (1.8), Industrials (1.7), and Consumer Staples (1.7). Energy was last week's worst performer, with a decline of 2.1%, followed by Telecom (0.2), Materials (0.3), Utilities (0.3), Real Estate (0.4), and Consumer Discretionary (1.0). Nine of the 11 sectors are higher so far in 2017, and six have outperformed the 5.0% gain for the S&P 500. The best performers in 2017 to date: Tech (9.1), Health Care (6.7), Consumer Discretionary (6.4), Industrials (5.1), Materials (5.1), and Consumer Staples (5.1). The five sectors underperforming the S&P 500:

Energy (-5.6), Telecom (-4.5), Utilities (1.6), Real Estate (1.9), and Financials (5.0).

Commodities Performance (*link*): Eight of the 24 commodities we follow rose last week, down from 20 rising a week earlier. The week's best performers: Nickel (3.6%), Cocoa (2.2), Live Cattle (1.6), Feeder Cattle (1.5), and Coffee (1.3). Last week's laggards: Lead (-6.3), Natural Gas (-4.8), Zinc (-4.0), and GasOil (-2.5). The best performers in 2017: Silver (13.2), Kansas Wheat (12.1), Lead (12.0), Wheat (11.6), and Aluminum (11.0). This year's laggards to date: Natural Gas (-20.8), Cocoa (-5.9), Heating Oil (-4.7), and GasOil (-2.4).

Assets Sorted by Spread w/ 200-dmas (*link*): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 7/24 commodities, 6/9 global stock indexes, and 19/33 US stock indexes compared to 18/24, 6/9, and 62/33 rising a week earlier, respectively. Nineteen commodities trade above their 200-dmas, down from 21 a week earlier as Natural Gas and Sugar turned negative w/w. Commodities' average spread fell to 5.7% from 7.0%. Zinc leads all commodities at 17.7% above its 200-dma, followed by Unleaded Gasoline (17.0%) and Copper (16.6). Nickel (8.3) improved 3.2ppts w/w relative to its 200-dma for the week's best performance among all commodities. Commodities dominate the lowest-trading assets relative to 200-dmas, with these three commodities at the steepest discounts of all: Cocoa (-25.0), Feeder Cattle (-5.5), and Gold (-2.0). Lead (12.2) fell 8.5ppts w/w for the worst performance of all commodities and all assets. The global indexes trade an average of 7.4% above their 200-dmas, up from 7.2% above in the prior week. All nine of the global indexes trade above their 200-dmas, unchanged from a week earlier. Brazil (15.8) leads the global indexes, followed by Japan (10.5) and Germany (10.4). Brazil was the group's best performer last week, with a gain of 2.0ppts. Indonesia (2.6) is trading at the lowest relative to its 200-dma of the global assets, but Japan (10.5) had the weakest performance of its country peers last week, as it fell 1.3ppts. The US indexes trade at an average of 7.8% above their 200-dmas, with 31 sectors above, up from a 7.6% average a week earlier when 31 sectors were also above. LargeCap Financials leads all US stock indexes and all assets at 18.3% above its 200-dma, followed by SmallCap Tech (17.5), SmallCap Financials (17.5), and MidCap Financials (17.0). MidCap Telecom was last week's best performer among US stock indexes and all assets, as it improved 4.2ppts w/w to 11.8%. The following LargeCap sectors trade at the deepest discounts to their 200-dmas among the US indexes: Telecom (-1.2) and Real Estate (-1.1). SmallCap Energy (11.3) was last week's worst performer among US stock indexes, as it fell 4.2ppts.

S&P 500 Technical Indicators (*link*): The S&P 500 remained in a Golden Cross last week for a 43rd week (after 17 weeks in a Death Cross) as the index's 50-day moving average (dma) improved relative to its 200-dma for an 11th straight week. Its 50-dma improved to an 18-week high of 4.7% above its 200-dma from 4.5% 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 14th week after six weekly declines, and the index closed the week above its 50-dma for a 14th week after nine weeks below. The S&P 500 improved to 3.1% above its rising 50-dma from 2.1% 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 31-month high of 8.0% above its rising 200-dma from 6.7%. 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 14th week after falling for eight weeks.

S&P 500 Sectors Technical Indicators (*link*): The short-term picture improved for seven of the 11 S&P 500 sectors last week, and the long-term picture improved for 8/11. Nine sectors still trade above their 50-day moving averages (dmas), unchanged from a week earlier as Energy and Telecom remained below. That's a big turnaround from 15 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, also unchanged from a week earlier as Real Estate and Telecommunication Services remained below. 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. Nine of the 11 sectors have rising 50-dmas, down from 10 rising a week earlier as Telecommunication Services started falling in the latest week and joined Energy. Eight have rising 200-dmas, up from six a week earlier as Consumer Staples and Health Care turned higher w/w. These six also have a rising 200-dma: Consumer Discretionary, Energy, Financials, Industrials, Materials, and Tech. Real Estate is the only sector with a falling 200-dma, and these two are flat: Telecom and Utilities.

US ECONOMIC INDICATORS

Leading Indicators (*link*): "The U.S. Leading Economic Index increased sharply again in January, pointing to a positive economic outlook in the first half of this year. If this trend continues, the U.S. economy may even accelerate in the near term," according to the Conference Board. January's Leading Indicators Index (LEI) jumped 0.6% after a 0.5% gain in December, and is only fractionally below its record high posted in March 2006. It was the seventh increase in eight months for a total gain of 2.3%. January's advance was broad-based with only real core nondefense capital goods orders (-0.01ppt) in the red; the average workweek was unchanged. The remaining eight components all contributed positively, led by the interest-rate spread (0.20), building permits (0.14), jobless claims (0.13), and the new orders diffusion index (0.10).

Coincident Indicators (*link*): The Coincident Indicators Index (CEI) in January advanced to yet another record high. The CEI hasn't posted a decline in 10 months, up 0.1% m/m and 1.6% over the period. Three of the four components contributed positively last month, climbing to new record highs, while industrial production continued its up-and-down pattern. 1) Nonfarm payroll employment climbed for the eighth month by 0.2% m/m and 1.2% over the period. It hasn't posted a decline since July 2010. 2) Real personal income--excluding transfer payments--is rising again after stalling in early 2016 at record highs. It's up 2.5% since declining 0.4% the first two months of last year. 3) Real manufacturing & trade sales climbed 2.5% during the eight months ending January.

Regional M-PMIs (*link*): Two Fed districts so far have reported on manufacturing activity for February—New York and Philadelphia—and show a big pickup in economic activity. We average the composite, orders, and employment measures as data become available. The composite index (to 31.0 from 15.1) was in positive territory for the seventh straight month, at its highest reading since July 2004. Both the Philadelphia (43.3 from 23.6) and New York (18.7 from 6.2) measures improved dramatically, with the former's the best reading in more than three decades. The new orders index (25.8 from 14.6) accelerated for the sixth consecutive month, reaching its fastest pace since March 2006. Again, both the Philadelphia (38.0 from 26.0) and New York (13.5 from 3.1) gauges showed faster growth, with Philly's the best since the end of 1987. The employment index (6.6 from 5.6) was positive for the second month after negative readings the prior 15 months. Philadelphia's (11.1 from 12.8) gauge showed job gains were slightly slower, while New York's (2.0 from -1.7) showed manufacturers adding to payrolls for the first time since last May.

GLOBAL ECONOMIC INDICATORS

European Car Sales (*link*): EU passenger car registrations—a proxy for sales—rose in January by 10.2% y/y, boosted in part by extra working days during the month. Among the five major EU markets, Spain (10.7% y/y) France (10.6), Germany (10.5), and Italy (10.1) all posted double-digit gains. UK sales (2.9) also grew, but at a more modest rate.

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