MORNING BRIEFING
March 22, 2017

Nothing Happened

See the collection of the individual charts linked below.

(1) Another age-old adage. (2) Baron Rothschild's secret. (3) The Bull/Bear Ratio may be too high. (4) Streets covered in blood vs. paved with gold. (5) Seinfeld market. (6) From tapering to tightening tantrums. (7) Emerging Markets growing faster despite Fed headwinds. (8) Bond funds still seeing net inflows. (9) Corporate bond liquidity crisis still a no-show. (10) Timeout for Trump rally? (11) Nothing to fear but profit-taking.

Strategy: Action & Reaction. Yesterday, we discussed some oft-quoted adages in the stock market. Today, let's add another one: "Buy on the rumor, sell on the news." Stock prices often go up on good news, unless it was widely anticipated, in which case they might go down on profit-taking. Stock prices often go down on bad news even if it was widely expected. However, if the news was worse than expected, gutsy traders and investors will step in and buy what others are dumping at distressed prices.

Investopedia notes: "Baron Rothschild, an 18th century British nobleman and member of the Rothschild banking family, is credited with saying that: 'The time to buy is when there's blood in the streets.' He should know. Rothschild made a fortune buying in the panic that followed the Battle of Waterloo against Napoleon. But that's not the whole story. The original quote is believed to be: 'Buy when there's blood in the streets, even if the blood is your own.'"

With the benefit of hindsight, Rothschild's adage for the ages worked like a charm during late 2008 and early 2009 when the Bull/Bear Ratio (BBR) compiled by Investors Intelligence was below 1.0, stocks sold at bargain-basement prices (*Fig. 1*). Of course, if you bought before the S&P 500 fell to an intra-day low of 666 on March 6, 2009, you had to spill some of your own blood for a short but painful time.

As I've observed before, the BBR works better as a contrary buy signal when it is at 1.0 or less than as a contrary sell signal when it is at 3.0 or higher (*Fig. 2* and *Fig. 3*). That might be because blood is flowing in the streets in the former scenario, while the streets are paved with gold in the latter one. It is easier to panic investors out of stocks when they are losing their own money than when they are giving back some of their profits.

Early in the current bull market, there were two wicked corrections (*Fig. 4*). The S&P 500 dropped 16.0% from April 23 to July 2, 2010. It plunged 19.4% during from April 29 to October 3, 2011. The BBR fell to a 2010 low of 0.78 during the week of August 31, and to a 2011 low of 0.74 during the week of October 11. Both were great buying opportunities.

On the other hand, the BBR mostly exceeded 3.0 during 2014; the S&P 500 rose 11.4% that year, but then stalled with a decline of 0.7% in 2015. The BBR fell below 1.0 again in early 2016, setting the stage for a 9.5% gain in the S&P 500 last year. Now the BBR has exceeded 3.0 again every week since the week of December 13. Meanwhile, the stock market remains in record-high territory. It seems to have been buoyed by concerns about bad things that didn't play out. I've described it as the "Seinfeld market"—as long as nothing happens, it tends to go up. Consider the following:

(1) *Another memorable year.* There was a 13.3% correction at the end of 2015 through early 2016 ([Fig. 5] and [Fig. 6]). Most of it occurred at the beginning of last year after two Fed officials reiterated that the FOMC's December 16, 2015 dot plot predicted four rate hikes. The selloff was somewhat reminiscent of the emerging markets' mini-crisis at the start of 2014 and the 5.8% decline during May and June 2013, which was widely described as a "taper tantrum" ([Fig. 7] and [Fig. 8]). On May 21, Fed Chairman Ben Bernanke suggested that the Fed might soon start tapering its QE program. It didn't do so until the end of October 2014, when the program was terminated.

The "tightening tantrum" at the beginning of last year turned out to be a great buying opportunity, as Joe and I predicted it would be on January 25. The actual low in the S&P 500 was made on February 11, when JP Morgan CEO Jamie Dimon announced that he was buying a slug of his company's shares. The price of oil also happened to bottom that day. The Fed did raise the federal funds rate again last year, but only once, at the end of the year. The S&P 500 is up 28.2% since last year's low through yesterday's close.

There was another buying opportunity last year following the unexpected Brexit vote. However, the selloff lasted just two days, through June 28. Since then, the S&P 500 is up 15.1%. Stocks sold off before Election Day in the US. It was widely believed (not by us) that if Trump won, the market would tumble. The S&P 500 is up 9.6% since Election Day.

(2) *EMs stopped submerging.* Emerging markets (EM) stocks and currencies fared relatively poorly from the spring of 2013 through early 2016 ([Fig. 9] and [Fig. 10]). Investors feared that Fed tapering, then tightening would cause financial capital to pour out of EMs, and to trigger stress among EM borrowers who would have to pay higher rates, assuming they even could borrow the funds they needed.

Well, the Emerging Markets MSCI stock price index bottomed on January 21, 2016 rising 30.2% and 41.2% since then in local currencies and in US dollars through Monday. The Emerging Markets MSCI currency index bottomed on January 20, 2016 and is up 12.0% since then. In other words, the EMs didn't submerge into oblivion following the termination of the Fed's QE in late 2014, the rate hikes in 2015 and 2016, and again last week. Nothing terrible happened, as was widely feared.

Joe reports that industry analysts covering EM companies have been raising their 12-month forward consensus expected growth rates for both revenues and earnings, currently up to 9.4% and 16.6%, respectively ([Fig. 11]). Joe and I have been warming up to EMs since last fall, figuring their growth rates remain high and their forward P/Es are relatively cheap.

(3) *Corporate bond market didn't implode.* The plunge in oil prices during the second half of 2014 through early 2016 heightened fears of a financial contagion triggered by defaults in the corporate bond market, particularly by energy companies that had issued junk bonds. The yield spread between high-yield corporate and US Treasury 10-year bonds rose from a 2014 low of 253bps on June 23 to a high of 844bps during February 11, 2016. However, there was no crisis and certainly no contagion, we know now that the spread is back down to 352 bps.

So far, there has been no panic selling in the investment-grade corporate bond market. It had been widely feared that once the Fed started to tighten monetary policy, the corporate bond market would become very illiquid as a result of Wall Street's reduced market-making role. Interestingly, since the May 2013 taper tantrum through January of this year, bond mutual funds and ETFs have continued to enjoy net inflows ([Fig. 12] and [Fig. 13]).

(4) *Timeout for Trump rally.* Yesterday's 1.2% drop in the S&P 500 stood out because it was the biggest one-day drop since October 11, 2016. However, it was no big deal. Nothing really happened to

trigger it other than investors decided to take some profits before Thursday's vote in Congress on the GOP's healthcare reform bill, which they reckon could make or break the rest of Trump's agenda. Or maybe it was a delayed reaction to the Fed's widely expected rate hike last week. It was the third one since 2015, so maybe yesterday was the obligatory stumble following such an event. This past weekend, the G20 finance ministers dropped their pledge to avoid protectionism, at the insistence of the Trump administration.

Then again, if the market's rally since early last year was driven by lots of bad things not happening, maybe yesterday's selloff is about nothing more than profit-taking. Maybe the Bull/Bear Ratio is just too high. Let's all turn bearish so that the bull market can continue.

CALENDARS

US. Wed: Existing Home Sales 5.555mu, FHFA House Price Index 0.5%, MBA Mortgage Applications, EIA Petroleum Status Report. **Thurs:** Jobless Claims 240k, New Home Sales 566k, Kansas City Manufacturing Index, Weekly Consumer Comfort Index, EIA Natural Gas Report, Yellen, Kashkari, Kaplan. (Bloomberg estimates)

Global. Wed: Japan All Industry Activity Index 0.0%. **Thurs:** Eurozone Consumer Confidence -5.8, Germany GfK Consumer Confidence 10, UK Retail Sales 0.3%m/m/3.2%y/y. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Sectors Net Earnings Revisions (*link*): The S&P 500's NERI weakened to an 11-month low of -3.3% in March from -2.3% in February, and is down from a 25-month high of 0.7% in October. However, NERI was positive for 5/11 sectors and improved m/m for five (compared to three positive and six improving in February). Energy topped all sectors in February, and Utilities was the highest since November 2015. Telecom fell to an eight-year low. Industrials and Utilities turned positive m/m. Energy has the longest positive NERI streak of nine months, followed by Tech (8) and Financials (6). Real Estate's is the worst, with 19 straight months of negative NERIs, followed by Telecom (11). Here are the sectors' March NERIs compared with their February readings, ranked in descending order: Energy (7.4% in March, down from 7.9% in February), Financials (6.6, 13.1), Tech (2.8, 2.2), Utilities (0.1 [16-month high], -0.6), Industrials (0.1, -1.0), S&P 500 (-3.3, -2.3), Real Estate (-9.8, -11.8), Materials (-10.1, -7.2), Health Care (-10.2, -11.4), Consumer Discretionary (-11.2, -9.3), Consumer Staples (-15.5, -15.0), and Telecom (-28.2 [lowest since January 2009], -23.3).

S&P 500 Earnings, Revenues & Valuation (*link*): S&P 500 consensus forward revenues and earnings rose slightly last week to fresh record highs. The forward profit margin forecast was steady at a 16-month high of 10.8%, nearing the record high of 10.9% in September 2015 and up from its 24-month low of 10.4% in late March. Forward revenue growth for the S&P 500 was steady w/w at 5.5%. That compares to 5.8% in late January, which was the highest since May 2012 and up from a seven-month low of 2.7% in late February 2016. Forward earnings growth was steady at 10.6%, but is down from 11.7% in early January; that was the highest since October 2011 and compares to an 11-month low of 4.8% in February 2016. Valuation rose to 17.9 from 17.8, which compares to a 13-year high of 18.0 in early March and a 15-month low of 14.9 in January 2016. S&P 500 forward revenues and forward earnings are enjoying a tailwind now from easier y/y comparisons for Energy and improving prospects for Financials, but currency translation looks likely to remain a challenge. Looking at last week's results ex-Energy, the forward revenue and earnings growth rates are lower at 4.1% and 7.7%, respectively. However, the ex-Energy forward profit margin improves to 11.4%, which is close to its record high of 11.5% in August 2007.

S&P 500 Sectors Earnings, Revenues & Valuation (*link*): Consensus forward revenue forecasts rose last week for 9/11 sectors, and forward earnings rose for 4/11. Financials, Materials, Real Estate, and Tech saw both measures improve w/w. Forward revenues and earnings are at or around record highs for 5/11 sectors: Consumer Discretionary, Consumer Staples, Health Care, Industrials, and Tech. Energy's forward revenues and earnings are at or near 15-month highs. Forward P/S and P/E ratios rose w/w for nearly all 11 sectors, but all but Health Care remain a hair below their recent multi-year highs. Financials' P/E is up from 12.0 before the election to 14.4. Health Care's P/E of 16.1 and P/S of 1.70 are at 19-month highs, but remain well below their early 2015 highs of 17.9 and 1.88, respectively. With Energy's forward revenues and earnings improving, its valuation is beginning to come back to Earth; its P/S ratio of 1.34 compares to a record high of 1.56 in May 2016, and its P/E of 27.2 is down from a record high of 57.5 then. Higher y/y margins occurred for only 7/11 sectors in 2016 and are expected to improve in 2017 for all but Health Care, Real Estate, and Utilities. However, Real Estate's forecasted margin should improve as the year progresses when gains on property sales are included in the forecasts. Here's how the 11 sectors rank based on their current 2017 forecasts: Information Technology (to 19.9% in 2017 from 19.4% in 2016), Real Estate (16.1, 25.5), Financials (15.8, 14.5), Telecom (10.9, 10.8), Utilities (10.8, 11.4), S&P 500 (10.6, 10.2), Health Care (10.4, 10.4), Materials (10.1, 9.4), Industrials (9.0, 8.9), Consumer Discretionary (7.4, 7.3), Consumer Staples (6.8, 6.6), and Energy (4.5, 1.1).

GLOBAL INFLATION INDICATORS

US CPI (*link*): The core CPI rate was just above the Fed's target rate of 2.0% y/y again in February, edging down to 2.2%—from the 2.3% peak rate recorded in January (as well as August and February of last year). The three-month rate accelerated 2.9% (saar), the most since August 2011. On a monthly basis, core prices rose 0.2% after a 0.3% gain in January, which was a five-month high. During February, costs for shelter, recreation, apparel, air fares, motor vehicle insurance, education, and medical care rose, partially offset by declines in prices for communication, used cars & trucks, new vehicles, and household furnishings & operations. The headline CPI advanced only 0.1% in February after spiking 0.6% in January, which was the biggest gain since February 2013; the yearly rate for the headline CPI has been steadily increasing since last August, rising 2.7% y/y in February, the fastest pace since March 2012.

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