Yardeni Research, Inc.

MORNING BRIEFING

June 13, 2017

Tech Now & Then

See the collection of the individual charts linked below.

(1) The life and death of bulls. (2) Matadors and recessions. (3) An aging bull that remains frisky. (4) Charge of the bullish brigade. (5) Tech now and in 1999/2000. (6) Beware of sectors with too much market cap. (7) Tech's valuation and LTEG aren't excessively high. (8) There's lots of jalapenos in the salsa dip for chips. (9) Semiconductor forward earnings flying with worldwide sales.

Strategy I: Hard-Charging Bull. Bulls tend to live 18-22 years. The average age of the past 22 equity bull markets since 1928 has been 1,007 days, or 33 months (*Fig. 1*). (See *our S&P 500 Bull & Bear Markets Table*.) The current one has lasted for 3,007 days, or 99 months. So far, it is the second-longest bull market since 1928. The previous longest ones lasted for 4,494 (150 months) and 2,954 days (98 months).

Bulls die of old age, unless they are prematurely killed by a matador in a bull ring. Bull markets don't die of old age. Instead, they terminate when the economy falls into a recession (*Fig. 2*). So far, while the current economic expansion has been among the slowest on record, it has lasted 96 months, which makes it the third-longest one since 1928. (See *NBER US Business Cycle Expansions and Contractions*.) The previous longest expansions lasted 120 and 106 months.

As Debbie and I discussed yesterday, using the average of the past five business expansions to benchmark the current one, we pinpoint the next recession to start during March 2019. That doesn't come with a money-back guarantee. It is simply a benchmark based on the average experience of recent business-cycle history. However, we will guarantee that the next recession will kill the current bull market.

Meanwhile, the old bull continues to age and to charge ahead despite his advanced age. For example, here is the performance derby of the S&P 500 and its 11 sectors since last year's low on February 11, 2016 through Friday of last week (*Fig. 3* and *Table 1*): Financials (51.1%), IT (50.3), Materials (40.0), Industrials (36.9), S&P 500 (33.0), Consumer Discretionary (32.1), Health Care (22.0), Energy (19.8), Real Estate (19.3), Utilities (17.0), Consumer Staples (14.9), and Telecom Services (1.5). That's an impressive performance for an old-timer.

Of course, the charge since March 9, 2009, when the current bull market began, is truly superb (*Fig. 4* and *Table 2*): Consumer Discretionary (471.2%), Financials (380.3), Information Technology (379.8), Industrials (336.6), S&P 500 (259.4), Health Care (253.0), Materials (214.2), Consumer Staples (191.0), Utilities (137.8), Telecommunication Services (81.5), and Energy (56.5).

Strategy II: Relative Exuberance. Is it 1999/2000 all over again for the S&P 500 Information Technology sector? Not so far. Consider the following:

(1) *First vs third place.* During the bull market from October 11, 1990 through March 24, 2000, the sector soared 1,697.2%, well ahead of the 417.0% gain in the S&P 500 and all the other sectors (*Fig. 5*). During the current bull market, it is in third place.

(2) *Market-cap and earnings shares*. At the tail end of the bull market of the 1990s, the S&P 500 IT sector's share of the overall index's market capitalization rose to a record 32.9% during March 2000 (*Fig. 6*). However, its earnings share peaked at only 17.6% during September 2000. This time, during May, the sector's market-cap share rose to a cyclical high of 22.9%, while its earnings share, at a cyclical high of 22.0%, was much more supportive of the sector's market-cap share. As a rule of thumb, Joe and I get nervous when a sector's shares of either or both rise close to 33%. We aren't nervous yet about IT, though we are just a little twitchy.

(3) *No contest on valuation basis.* During the second half of the 1990s through the early 2000s, the forward P/E of the Tech sector soared relative to the broad index (*Fig. 7*). The former peaked at a record 48.3 during March 2000. That same month, the forward P/E of the S&P 500 was 22.6. Both then proceeded to trend lower through 2008, when they finally converged. During the current bull market, the Tech sector's forward P/E hasn't diverged much at all from that of the overall index. Last month, the former was 18.1, while the latter was 17.3.

(4) *Less irrational exuberance about long-term growth.* Joe and I regularly monitor LTEG for the S&P 500 and its 11 sectors and 100+ industries. LTEG is analysts' consensus long-term earnings growth expectations over the next five years at an annual rate. It soared to a record high of 18.7% during August 2000 for the S&P 500, up from 11.5% at the start of 1995 (*Fig. 8*). Keep in mind that the historical trend growth in the S&P 500 during economic expansions tends to be around 7% (*Fig. 9*)! The ascent in this growth expectation trend for the S&P 500 during the second half of the 1990s was led by an even more wildly irrational rerating of expected LTEG for the Tech sector from 16.6% at the start of 1995 to a record high of 28.7% during October 2000.

Since those peaks, both LTEGs have come back down closer to the Planet Earth. During April, they were 12.3% for the S&P 500 and 12.7% for the IT sector. Those are still more optimistic than what is likely to be delivered, but at least they are back to the rationally exuberant normal bias of analysts.

(5) *Less air in this bubble so far.* All of the above suggests that the Tech sector is trading much closer to realistic expectations for fundamentals than during the bubble of the 1990s. The S&P 500 IT stock index nearly exceeded its March 27, 2000 high for the first time just last week on June 8 (*Fig. 10*). The sector's forward earnings rose to a record high at the start of June, exceeding the 2000 peak by 168.6% (*Fig. 11*).

The sector has the highest forward profit margins among the S&P 500 sectors. It has been at a record high around 20% since late last year, up from a cyclical low of around 12% at the start of 2009 (*Fig. 12*).

(6) *Chips with salsa.* Among the 10 top-performing S&P 500 industries since last year's February 11 low are Semiconductor Equipment (#1 with a gain 142.9%) and Semiconductors (#9, 67.4%) (*Fig. 13* and *Fig. 14*). The forward earnings of the former has gone vertical, doubling since early last year (*Fig. 15*). As a result, the forward P/E of this high-flying but cyclical industry was only 14.7 at the beginning of June.

The forward earnings of the Semiconductors industry has also been like eating chips dipped in salsa with extra hot jalapenos. Not surprisingly, it is highly correlated with worldwide sales of semiconductors, which rose to a record $376 billion (saar) during April (*Fig. 16*).

CALENDARS

US. Tues: NFIB Small Business Optimism Index 104.0, Headline & Core PPI-FD 0.1%/0.2%, FOMC Meeting Begins, Dudley. **Wed:** Retail Sales Total, Ex Autos, Ex Autos & Gas, and Control Group 0.2%/0.2%/0.3%/0.3%, Business Inventories -0.1%, Headline & Core CPI 2.0%/1.9% y/y, MBA Mortgage Applications, EIA Petroleum Status Report, FOMC Announcement. (Bloomberg estimates)

Global. Tues: Germany ZEW Economic Sentiment 21.8, UK Headline & Core CPI 2.7%/2.3% y/y. **Wed:** Eurozone Retail Sales 0.5%m/m/1.4%y/y, Germany CPI -0.2%m/m/1.5%y/y, UK ILO Unemployment Rate (3M) 4.6%, China Retail Sales 10.7%, China Industrial Production 6.4% y/y, Japan Industrial Production. (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—is hovering around its record high. It retreated 1.6% over the two weeks ending June 3 after a two-week jump of 2.3% to a new record high. Our WLI is the average of our Boom-Bust Barometer (BBB) and Bloomberg's Weekly Consumer Comfort Index (WCCI). Our BBB contracted 2.2% over the two-week period, following a two-week surge of 3.3%, also to a new record high, as jobless claims rose for the second week to 242,000 (4-wa) from 235,500 two weeks ago—which was the lowest reading since April 1973. The CRB raw industrial spot price index—another BBB component—fell but has stabilized in recent sessions. Meanwhile, the WCCI slumped 2.5% after a three-week climb of 3.0%.

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