MORNING BRIEFING
July 20, 2017

Cashless

See the collection of the individual charts linked below.

(1) Can you say "goodbye to cash" in Swedish? (2) "Swish," "zelle," or "venmo" it to pay by phone. (3) Fewer hold-ups. (4) Cybercriminals cashing in. (5) It's gloomy in India. (6) Services rain on India's agricultural parade. (7) India MSCI not cheap. (8) Modi's motives are questionable. (9) Cow vigilantes. (10) Economy decelerating in India. (11) RBI under pressure to cut rates as inflation plummets.

Banks: Going Mobile. One of Jackie's friends is visiting family in Sweden this summer, and her cousin advised against exchanging dollars into krona. Unfortunately, the cousin wasn't offering to pick up the tab for the visit. She was merely cautioning that cash is rarely used in Sweden. Many shop owners literally don't accept paper currency. Some local banks don't even have cash at their branches. Instead, Swedes are using electronic payments or credit cards to purchase just about anything. Electronic payments is just one of the many disruptive technologies that Jackie and I have been monitoring. I asked her to have a closer look—though on her PC in her home office rather than with an all-expenses-paid trip to Sweden. Here is what she found:

Instead of using cash, Swedes are increasingly using Swish, an app downloaded to cell phones that lets users make or receive payments directly to or from their bank accounts. Something similar launched in the US last month. It's called "Zelle," and it has the backing of some of the largest US banks, including Chase, Bank of America, and Wells Fargo. Here's a look at the two apps that may make cash as antiquated as gold coins or clam shells in the not-too-distant future:

(1) *Swish it.* Swish was developed in 2012 by Sweden's largest banks, including Nordea, Handelsbanken, SEB, Danske Bank, and Swedbank. Only customers of those banks can use Swish—so our American friend will have to use her US credit cards.

The app uses cell phone numbers and an account with a participating Swedish bank to transfer money via cell phone or to make an Internet purchase. Transactions are free to consumers, presumably because it costs banks less money for transactions to occur in the ether than it would were hard currency used. Cash costs banks money. It has to be handled, counted, and transported.

Even Swedish churches have adopted the technology. Churches will display their phone numbers at the end of each service and ask parishioners "to use Swish to drop their contribution into the virtual Sunday collection," explained a 6/4/16 article in *The Guardian*.

Using Swish is so popular in Sweden that "Krona notes and coins in circulation have fallen every year for the past decade and accounted for only a fifth of all payments in Swedish stores last year, far below the global average of 75%," a 7/7 *FT* article reported.

(2) *Fewer stickups, more fraud.* The move to a cashless society in Sweden has led to a reduction in physical crime. "The Swedish National Council for Crime Prevention counted only 23 bank robberies in 2014, down 70 percent from a decade earlier. In the same period, muggings dropped 10 percent. While it's unclear the extent to which the transition to cashless has affected the rate of street crime, police

point out that there's a lot less incentive to rob a bus driver, cabbie, or shopkeeper if they don't accept cash. Many workers say they now feel much safer," reported a 5/8/16 article in *Wired*.

However, having a cashless society may be escalating cybercrime. Fraud in Sweden—usually involving identity theft—has more than doubled, the *Wired* article continued. And that probably understates the amount of fraud occurring because Swedish banks don't publicly share how often their customers' card information is stolen. Privacy advocates have raised concerns that consumers are giving banks and app providers a lot of personal information about what they are purchasing.

(3) *Zelle it?* For a number of years, US consumers made person-to-person payments with apps like Venmo (a unit of PayPal Holdings), Apple Pay, and Google Wallet. These apps lured away banking clients, especially Millennials, who turned "venmo" into a verb.

But last month, the big banks drew a line in the sand. They launched Zelle, undoubtedly in hopes of retaining customers. Zelle, which seems very similar to Swish, was built by Early Warning Services, a company owned by Bank of America, BB&T, Capital One, JPMorgan Chase, PNC, U.S. Bancorp, and Wells Fargo.

Today, Zelle is being offered by Bank of America, Capital One, Chase, Fifth Third Bank, First Bank, PNC, USBank, USAA, and Wells Fargo. Another 25 banks and credit unions have partnered with Zelle, but haven't launched yet, according to Zellepay.com.

Zelle can be used to split a check with your friend or to make a payment to a business. Right now, banks are linking their smartphone apps to the Zelle transfer network, which will eventually be able to reach 86 million consumers. So, for example, Chase QuickPay is now QuickPay with Zelle. Later this year, a standalone Zelle app will be available to consumers and transfers will run on Visa's and Mastercard's payment networks.

(4) *Zelle versus Venmo*. A 2/22 Bloomberg article did a great job explaining the difference between Zelle and Venmo: "Request $40 from a roommate over the Zelle network using BofA's app, and the money shows up in your account within minutes of when he agrees to send it. On Venmo, that $40 would show up in your Venmo wallet right away, but then it stays there. To get the cash into your hands, you need to log into your Venmo account, cash out your balance, and wait—sometimes days—for the money to show up in your bank account."

Venmo's appeal is that it doesn't require two customers to bank at the same institution. The two customers just have to have the Venmo app. Venmo also has a more social bent than Zelle. Venmo users can choose to make their transactions and any related messages public. Users will check their Venmo account just to see what friends are buying.

Which network will come out on top remains to be seen. But if the US market develops at all similarly to the Swedish market, the days of counting your greenbacks may be numbered.

India I: Monsoon Season. As I noted last week, Sandra Ward, formerly of *Barron's*, has joined us as a senior contributing editor. She wrote an informative and relatively bullish piece on Brazil last week. This week, she isn't as upbeat on India. Here is her take:

It's monsoon season in India, one of the hottest emerging markets and, until recently, the fastest-growing big economy the past three years. The drenching rains tend to send spirits soaring and set expectations for a strong agricultural harvest and subsequent boost in farmers' fortunes and surge in consumer spending. The giddiness often spills into the stock market, as a 5/10 *Times of India* article observed at the start of this rainy season. The S&P BSE Sensex set new highs last week, its best weekly showing in four months (*Fig. 1*). After plunging Tuesday, as tobacco stocks reacted to new taxes, it quickly resumed its bullish track Wednesday.

Anyone betting on a correlation between a good monsoon and good stock market returns may end up all wet. Celebrating its 70th anniversary of independence on August 15, India is a whole lot less reliant on agriculture as an engine of economic growth than previously. Agriculture now represents 17.4% of gross domestic product, according to the World Bank, compared with 51.8% in 1950. The services sector, at 53.8%, is the biggest contributor to India's GDP, up from 30% in 1950, and attracts the most foreign investment. Still, agriculture was the only sector where growth accelerated—up 4.9% y/y in India's Q1, ended March—as total GDP growth slowed to a 6.1% pace. All other sectors decelerated, with services gaining 7.2% y/y compared with 10.0% in the previous year, and manufacturing slumping to a 5.3% gain versus an increase of 12.7% in the year-ago period. Construction turned negative, contracting by 3.7% y/y. Without the 31.9% y/y rise in government spending, growth in GDP would've been closer to 4.1%, said a 5/31 *FT* article.

The MSCI India Share Price Index, already up 25.8% in US dollars ytd through Tuesday's close, looks vulnerable to a correction (*Fig. 2*). The MSCI India Index is trading at a forward P/E of 18.1, despite a forward earnings growth outlook of 15.5% and revenue growth expectations of 12.2% (*Fig. 3* and *Fig. 4*). Here's a look at some of the clouds that could rain on India's economy and stock market:

(1) *Modi's honeymoon ending?* Against a backdrop of a slowing economy and an expensive stock market, India's reform-minded prime minister, Narendra Modi, is undergoing a reappraisal after enjoying an extended honeymoon since his election in 2014 on the promise of improving the business climate and creating jobs. There's been much ink spilled on whether his bold moves to root out corruption and streamline India's famously bureaucratic systems—including finally pushing through a unified Goods and Services Tax that was 17 years in the making—have been the right ones.

A 6/24 *The Economist* cover story criticized the reforms and job creation as illusory. *The New York Times* echoed those sentiments in a 7/17 editorial. It pointed out that Modi's election promises have fallen short and voiced concern that the Hindu nationalist tendencies of his Bharatiya Janata Party are on the rise. Modi's May ban on selling cattle for slaughter was widely seen as anti-Muslim and pandering to conservative Hindus, who hold cows sacred. His delay in condemning attacks by vigilantes on workers in the cattle-slaughter industry reinforced suspicions about the motive for the ban. The move also called into question his commitment to creating jobs and boosting exports: The $16 billion meat and leather industry employs millions and generates $4 billion in exports of beef and $6 billion in leather exports. For now, the ban has been suspended by India's Supreme Court, a 7/11 *Al Jazeera* article pointed out.

Sentiment on Modi is souring to such a degree, a story in the 7/12 *Indian Express* noted, that a prospective bride and groom in the state of Uttar Pradesh called off their wedding after arguing about whether Modi is to blame for the current economic slowdown.

(2) *Demon policy*. No program, however, has engendered more controversy than Modi's demonetization policy, instituted in a surprise move on November 8—the same day as US voters elected Donald Trump president. By banning 86% of commonly used bank notes, Modi slammed the brakes on commerce and consumer spending in the traditional cash-based society and has been widely blamed for throwing the economy into a tailspin.

India II: Running Out of Steam? While it's easy to demonize the demonetization program as the cause of the current economic slowdown, truth be told, the economy began slowing long before demonetization took effect, though the currency ban certainly exacerbated the stresses. Consider the following:

(1) *GDP*. GDP growth has been decelerating for much of the last year. From a high of 9.1% y/y reported in Q1-2016, growth dropped to 6.1% in Q1-2017, down from 7.0% in the previous quarter, when demonetization began (*Fig. 5*).

(2) *Households.* Household consumption growth slowed to 7.3% y/y in Q1 from 11.1% the previous quarter (*Fig. 6*). Growth in household consumption had been slowing throughout 2016, and the Q4 jump likely reflected a surge in spending ahead of the ban, noted a 7/11 piece in *Focus Economics*.

(3) *Capital spending.* Capital spending has been slipping since Q4-2015 and is now firmly in negative territory for the first time since early 2014, contracting 2.1% y/y in the most recent quarter as banks have tightened lending standards and companies continue to be heavily indebted, the *Financial Express* explained in a 6/1 article (*Fig. 7*). Capital spending represented 28.5% of GDP in fiscal Q4-2017, down from 31.2% in fiscal Q1-2016.

(4) *Government spending.* Government spending rose 31.9% y/y in Q1, boosted by a pay raise for the bureaucratic sector, a not-insignificant prop to total GDP (*Fig. 8*).

(5) *Production.* Industrial production rose a measly 1.7% y/y in May, with the manufacturing and electricity industries supplying the gains, according to a 5/31 Moody's Analytics article (*Fig. 9*). It cited supply bottlenecks and high debt levels as crimping factory output. Moody's noted that a country the size of India should see industrial production expanding at double-digits.

(6) *Inflation.* Consumer price inflation reached a record low of 1.5% y/y in June, down from 2.2% a month earlier (*Fig. 10*). Food prices account for half the CPI, and they continue to drop following last year's good monsoon season and disruptions in the food supply chain due to demonetization.

The challenges facing the Indian economy clearly are not reflected in the stock market. While Modi's moves to retool the economy may prove effective in the long run, in the short run they have made a fragile situation more fraught. That's led to increased pressure on the Reserve Bank of India (RBI) to cut interest rates by another 25 basis points when it next meets in August. The RBI last eased in October, when it cut rates by 25 basis points to 6.25%.

A rate cut could create more exuberance for stocks—and rate-sensitive issues such as banks and real estate would benefit, as would debt-heavy companies. But ultimately, when there's a slowing economy and a soaring stock market, there will be a day of reckoning.

CALENDARS

US. Thurs: Leading Indicators 0.4%, Jobless Claims 246k, Philadelphia Fed Manufacturing Index 22.0, Weekly Consumer Comfort Index, EIA Natural Gas Report. **Fri:** Baker-Hughes Rig Count. (Bloomberg estimates)

Global. Thurs: Eurozone Consumer Confidence -1.1, UK Retail Sales 2.5% y/y, Australia Employment & Unemployment Rate 15k/5.6%, ECB Central Bank Rate Decision 0.00%, ECB Marginal Lending Facility & Deposit Facility Rate 0.25%/-0.40%, ECB Asset Purchase Target (euros) 60b, BOJ Policy Balance Rate & 10-Year Yield Target -0.10%/0.0%, Kuroda. **Fri:** Canada CPI -0.1%m/m/1.1%y/y, Canada Retail Sales 0.3%. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Investors Intelligence Bull/Bear Ratio (BBR) rebounded back above 3.00 this week, jumping to 3.46 after falling the prior two weeks from 2.95 to 2.69, which was near its low for the year of 2.60. Bullish sentiment soared 7.8ppts to 57.8% as the correction count sank 5.9ppts to 25.5%, and bearish sentiment was 1.9ppt lower at 16.7%—dropping to the bottom of its 16.5%-18.3% range shown most of this year. The AAII Ratio fell last week for the third week, from 53.0% to 48.8%. Bullish sentiment fell from 32.7% to 28.2% over the three-week period, while bearish sentiment ticked down to 29.6% after rising the prior two weeks from 28.9% to 29.9%.

S&P 500 Earnings, Revenues & Valuation (*link*): S&P 500 consensus forward revenues rose w/w to a record high for a fourth week, and forward earnings was at a record high for a 15th straight week. The forward profit margin forecast remained steady at a record high of just over 11.0%. The profit margin's record high is its first since September 2015 and up from a 24-month low of 10.4% in March 2016. Forward revenue growth for the S&P 500 was steady w/w at 5.2%, but is down from 5.8% in late January, which was the highest since May 2012 and compares to a cyclical low of 2.7% in February 2016. Forward earnings growth ticked down to 11.2% from a six-month high of 11.3%. It remains near January's 11.7%, which was the highest since October 2011 and compares to a cyclical low of 4.8% in February 2016. S&P 500 forward revenues and forward earnings growth are enjoying a tailwind now due to easy y/y comparisons for Energy and improving forward growth rate forecasts for revenues (STRG) and earnings (STEG) for Industrials, Materials, Tech, and Utilities. However, Energy's contribution to forward growth peaked at the start of 2017. Looking at last week's results, the S&P 500 ex-Energy's STRG of 4.6% is 0.6ppt lower and STEG of 9.4% is 1.8ppts lower. However, the S&P 500 ex-Energy forward profit margin was at a record high of 11.6%, which is its first since August 2007. Valuation rose w/w to 17.7 from 17.6, which compares to a 13-year high of 18.0 in early March and a 15-month low of 14.9 in January 2016. On an ex-Energy basis, valuation rose to 17.3 from 17.2, which compares to a 13-year high of 17.6 in early March.

S&P 500 Sectors Earnings, Revenues & Valuation (*link*): Consensus forward revenue and earnings forecasts rose last week for five of the 11 sectors. Health Care and Materials had both measures rise 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 is at an eight-month low now after stalling at a 15-month high since March, and its forward earnings is down from June's 21-month high to an 11-week low now. The forward P/S ratio rose w/w for 5/11 sectors, and the P/E ratio rose for 6/11 sectors. Health Care is surging recently; its P/E of 16.3 and P/S of 1.73 are near their highest levels since August 2015, but remain well below their early 2015 highs of 17.9 and 1.88, respectively. Financials' P/E is up from 12.0 before the election to 13.9, and is approaching the post-election high of 14.6 in early March. With Energy's forward revenues and earnings up from cyclical lows in early 2016, its valuations are coming back to Earth; its P/S ratio of 1.29 compares to a record high of 1.56 in May 2016, and its P/E of 25.8 is down from a record high of 57.5 then. Higher y/y margins occurred for only 7/11 sectors in 2016, but margins are expected to improve in 2017 for all but 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 19.2% in 2016), Real Estate (16.9, 25.2), Financials (15.5, 14.3), Telecom (11.3, 11.2), Utilities (10.9, 11.4), S&P 500 (10.5, 10.1), Health Care (10.4, 10.3), Materials (9.9, 9.4), Industrials (9.2, 8.9), Consumer Discretionary (7.3, 7.2), Consumer Staples (6.7, 6.5), and Energy (4.1, 1.2).

S&P 500 Q2 Earnings Season Monitor (*link*): With nearly 11% of S&P 500 companies finished reporting Q2-2017 results, their revenue and earnings surprise data are better than at the comparable point of the Q1 season, but y/y growth comparisons are mixed. Of the 54 companies in the S&P 500 that have reported, 78% exceeded industry analysts' earnings estimates by an average of 5.7%; they have averaged a y/y earnings gain of 36.0%. At the same point during the Q1-2017 reporting period, a lower percentage of companies (75%) in the S&P 500 had beaten consensus earnings estimates by a higher 6.0%, and earnings were up a lower 11.7% y/y. On the revenue side, 70% beat sales estimates so far, with results coming in 1.3% above forecast and 5.2% higher than a year earlier. At this point in the Q1 season, a lower 63% had exceeded forecasts, companies reported revenues a lower 0.9% above forecast, and sales rose a slightly lower 4.4% y/y. Q2 earnings results are higher for 72% of companies vs 75% at the same point in Q1, but revenues are higher for 87% vs 79% a quarter ago. Although these figures will change markedly as more Q2-2017 results are reported in the coming weeks, the early results are encouraging. Q2-2017 should mark the fourth straight quarter of positive y/y earnings growth, but growth is likely to fall back into the single digits following Q1's double-digit percentage growth, which was the first double-digit growth seen since Q3-2011.

US ECONOMIC INDICATORS

Housing Starts & Building Permits (*link*): Housing starts in June rose for the first time in four months after sinking to an eight-month low in May. Builders broke ground on 1.215mu (saar), rebounding a larger-than-expected 8.3% after a three-month slide of 12.9%. Single-family homes jumped 6.3% to 849,000 units (saar) after a three-month drop of 8.9%, while volatile multi-family starts soared 13.3% to 366,000 units after contracting 29.8% the first five months of the year. Regionally, starts posted sizeable gains in the Northeast (83.7%) and Midwest (22.0) last month, while they edged up 1.6% in the West and fell 3.8% in the South. (This data tend to be very volatile on a monthly basis.) Building permits advanced for the first time in three months, climbing 7.4% in June to 1.254mu (saar) after contracting three of the previous four months by 10.2%. Single-family permits rose 4.1% to 811,000 units (saar) after a three-month decline of 6.6%, while multi-family permits were 13.9% higher at 443,000 units after recording a 10.4% drop in May and no change in April. Meanwhile, July's NAHB's Housing Market Index fell for the third time in four months to an eight-month low of 64 after reaching a cyclical peak of 71 in March. All three components posted losses over the period, though remain at healthy levels: current sales conditions (to 70 from 77 in March), sales expectations in the next six months (73 from 78), and buyer traffic (48 from 53). NAHB's chief economist noted, "The HMI measure of current sales conditions has been at 70 or higher for eight straight months, indicating strong demand for new homes. However, builders will need to manage some increasing supply-side costs to keep home prices competitive."

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