MORNING BRIEFING
August 15, 2017

Global Rounds

See collection of the individual charts linked below.

(1) This bull gets reenergized after it stumbles. (2) On a global basis, the P/E is 16.0, which isn't extremely high. (3) Global sectors show widespread strength in earnings. (4) Global PMIs signal solid growth. (5) Measures of world exports and production are upbeat. (6) Lots of oompah in German business confidence and retail sales. (7) Usually led by exports, Germany and Japan showing surprising strength in domestic demand. (8) China is growing without fanfare. (9) Puzzle: US income tax receipts weak, despite strong jobs growth. (10) Spotting fewer autos on railcars.

Global Strategy: Reenergized Bull. From a global perspective, the bull market in equities that started on March 9, 2009 has been three bull markets interrupted by two mini-bear markets, a.k.a. corrections—so far. To be more specific, the All Country World MSCI stock price index (in local currency) rose 170.6% since the start of the bull market through Friday's close (*Fig. 1*). Now let's have a closer look at its three phases so far:

(1) *Phase I*. During the first phase of the bull market, the index rose 81.3% to peak on February 18, 2011. The dramatic recovery was a typical bull market rebound following the end of a severe bear market. It was led by a solid upturn in forward earnings around the world (*Fig. 2*). Forward earnings (in local currency) rose 43.4% during the first phase of the bull market (*Fig. 3*). The forward P/E rose from a low of 8.7 during the week of October 30, 2008 to a high of 14.6 during the week of September 17, 2009 (*Fig. 4*).

The All Country World MSCI index then fell 20.6% through October 4, 2011. The correction (mini-bear) was mostly caused by concerns that the Eurozone's Greek debt crisis could lead to the disintegration of the monetary union and to another global financial crisis.

(2) *Phase II*. These concerns magically evaporated following ECB President Mario Draghi's pledge to do "whatever it takes" to defend the euro. He said so in a speech on July 26, 2012. During 2012, forward earnings stalled along with global economic activity, particularly in the Eurozone.

From the October 4, 2011 low, the world index rose 76.1% to a record high on April 27, 2015. Leading the way was the forward P/E, which rose from 9.7 to 15.7. Forward earnings, which had stalled in 2012, resumed rising gradually during 2013 through 2014. But they were tackled again by the energy recession during 2015 through early 2016. That precipitated another correction, with the index falling 19.1% from the 2015 peak to bottom on February 11, 2016.

(3) *Phase III*. It's been up, up, and away since the low in early 2016, with the index up 31.8% since then through Friday's close. This time, both earnings and valuations contributed to the latest phase. Forward earnings is up 13.9% since early 2016 through early August of this year, and the forward P/E is up from about 13.8 to 16.0.

In other words, the bullish phases of the bull run since early 2009 seem almost like mini-bull markets following mini-bear markets. The latest mini-bull started early last year. From this perspective, the bull market may be keeping relatively young by pausing every now and then as it charges ahead.

Global Economy: Old & New Worlds. As noted above, after mostly stalling from mid-2011 through mid-2016, the All Country World MSCI forward earnings (in local currency) has been rising steadily, and has been doing so in record territory since March 24. Joe, who is the world's greatest slicer-and-dicer of the world's earnings data, calculates the forward earnings by sectors for the global index (*Fig. 5*). The recent cyclical upturn in forward earnings for the composite (in US dollars) has been led by Consumer Staples, Energy, Financials, Industrials, Information Technology, Materials, and Utilities. In other words, it has been broad-based. That confirms other global economic indicators showing widespread improvement in global growth:

(1) *Global PMIs.* The Composite PMI, Manufacturing PMI, and Nonmanufacturing-PMI for the global economy have been remarkably stable at recent cyclical highs from December 2016 through July 2017 (*Fig. 6*). Over this period, the global C-PMI has been hovering between 53.0 and 54.0. The global M-PMI has been hovering around 53.0, while the global NM-PMI has been hovering close to 54.0 since late last year. Interestingly, the PMIs for the advanced economies continue to outperform those for emerging economies, as they have since the second half of 2013.

(2) *Global production & exports.* Data available through May show both global production and world exports volume in record-high territory (*Fig. 7*). Their growth rates (on a y/y basis), which were close to zero early last year, have picked up to 3.5% for the former and 5.3% for the latter (*Fig. 8*). The world export volume growth rate is highly correlated with the growth rate of the sum of real US exports plus imports, which was 4.2% during June (*Fig. 9*).

(3) *Advanced vs emerging economies.* Interestingly, the data on global industrial production show that output growth among emerging economies has been relatively stable around 3.5% y/y since roughly early 2015 (*Fig. 10*). Apparently, the energy recession hit advanced economies hardest as their production index fell slightly on a y/y basis during late 2015 through mid-2016. It has recovered nicely since then with a gain of 3.4% during May.

Now let's take a quick tour around the world to see the sights—actually, to cite some of the noteworthy indicators of economic activity.

Global Economy: Europe. Germany's economy is *wunderbar*. Most amazing is the IFO business confidence index, which soared to a record high during July (*Fig. 11*). Also impressive is that much of that strength is coming from domestic demand both in Germany and the Eurozone, rather than mostly from exports to other parts of the world as in the past. The volume of retail sales excluding motor vehicles is at a record high in the Eurozone, with a 3.1% y/y increase through June led by a 3.6% gain in Germany, also to a new record high (*Fig. 12*).

Global Economy: Asia. Like Germany, Japan historically has been an export-led economy, relying more on foreign demand than domestic demand for growth. Like Germany, Japan is surprising us all with strong domestic demand recently. Japan's real GDP rose 4.0% (saar) during Q2, the best quarterly gain since Q1-2015, led by a 5.2% increase in domestic demand (*Fig. 13*). Consumer spending rose 3.7% and capital formation jumped 11.7% during the quarter.

On the other hand, China's latest statistics have been lackluster, though consistent with recent readings. During July, industrial production was up 6.4% y/y and inflation-adjusted retail sales rose 9.0% (*Fig. 14*).

Global Economy: USA. Here in the US, economic growth also remains lackluster, though our lackluster is certainly slower than their lackluster (over in China). Here are a few recent tidbits pointing to slow growth in the US:

(1) *Income tax receipts.* Debbie and I are puzzled by individual income tax receipts collected by the federal government ([*Fig. 15*]). The 12-month sum of this series has been virtually flat just under $1.6 trillion since November 2015, following a strong uptrend that started in 2011. That's despite strong payroll employment gains over this same period totaling 3.8 million, and reflected in the record high in payroll taxes. Maybe all those jobs don't pay much, which is why they may be boosting payroll taxes but not income taxes. (Let us know if you have a better explanation.)

(2) *Railcar loadings of autos.* Less of a mystery is the stalling of auto sales over the past seven months just below the cyclical peak of 18.2 million units (saar) during December. Lenders are curbing their enthusiasm for making subprime auto loans as used car prices fall. Debbie and I track weekly railcar loadings of motor vehicles, which confirms that sales remain stalled ([*Fig. 16*]).

CALENDARS

US. Tues: Retail Sales Total, Ex Autos, Ex Autos & Gas, and Control Group 0.3%/0.3%/0.4%/0.5%, Business Inventories 0.4%, Empire State Manufacturing Index 9.8, Import & Export Prices 0.2%/0.2%, Housing Market Index 65, Treasury International Capital. **Wed:** Housing Starts & Building Permits 1.225mu/1.246mu, MBA Mortgage Applications, Atlanta Fed Business Inflation Expectations, EIA Petroleum Status Report, FOMC Minutes. (Bloomberg estimates)

Global. Tues: Germany GDP 0.7%q/q1.9%y/y, UK Headline & Core CPI 2.7%/2.5% y/y, Japan Industrial Production, RBA August Meeting Minutes. **Wed:** Eurozone GDP 0.6%q/q/2.1%y/y, Italy GDP 0.4%q/q/1.4%y/y, UK ILO Unemployment Rate (3m) 4.5%. (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—rose by 2.7% during the four weeks ending August 5, after falling six of the prior seven weeks by 3.6%; it's within 1.1% of its record high recorded 11 weeks ago. Our WLI is the average of our Boom-Bust Barometer (BBB) and Bloomberg's Weekly Consumer Comfort Index (WCCI). Our BBB climbed 2.5% over the four-week period, after contracting 4.5% over the prior seven-week period; it's 2.0% below its record high posted during the week of May 20. Jobless claims sank for the fourth week to 241,000 (4-wa) after rising from 235,500—which was the lowest since April 1973—to 246,000 the prior seven weeks. The CRB raw industrial spot price index—another BBB component—continued to move higher. Meanwhile, the WCCI climbed for the fourth week, by a total of 9.4%, more than reversing the 8.2% decline the prior six weeks.

S&P 500/400/600 Forward Earnings ([*link*]): LargeCap and MidCap forward earnings rose w/w to record highs last week, but SmallCap's edged down for a third week to 1.0% below its mid-July record. Momentum remains strong as the yearly change in forward earnings is up from six-year lows in early 2016, but the easy y/y comparisons may be waning. In the latest week, LargeCap's forward earnings improved to 9.8% y/y from 9.7% a week earlier, which compares to a 64-month high of 10.2% in mid-May and a six-year low of -1.8% in October 2015; MidCap's was steady at a 66-month high of 14.0% y/y, which compares to a six-year low of -1.3% in December 2015; and SmallCap's dropped to a six-month low of 10.9% from 12.0%, which compares to a 39-month high of 13.0% in mid-July and a six-year low of 0.3% in December 2015. LargeCap and MidCap consensus growth rates expected for 2017 have been edging higher lately, leading to a slight decline in the 2018 growth rates. However, 2018 should improve if the corporate tax rate changes. Here are the latest consensus earnings growth rates: LargeCap 11.5% and 11.0%, MidCap 12.0% and 12.8%, and SmallCap 7.6% and 19.2%.

S&P 500/400/600 Forward Valuation (*link*): Forward P/E ratios moved lower for the three indexes last week. Valuations have improved from their more-than-five-month lows in mid-April, but remain below their multi-year highs in early March. P/Es are easing now after melting up since the election, but the "E" still remains low as analysts await legislative changes to the tax rate and its impact on corporate earnings. LargeCap's forward P/E fell for the first time in four weeks to a 12-week low of 17.4 from a 20-week high of 17.7, which compares to the 13-year high of 17.8 in early March. That's up from a 15-month low of 14.9 in January 2016 and the post-Lehman-meltdown P/E of 9.3 in October 2008, but remains well below the Tech bubble's record high of 25.7 in July 1999. MidCap's forward P/E fell to a post-election low of 17.3 from 17.8, which compares to a 15-year high of 19.2 in late February and the record high of 20.6 in January 2002. MidCap's was up from a three-year low of 15.0 in January 2016. SmallCap's was also down to a post-election low of 18.6 from 18.9, which compares to a recent high of 19.7 in early June and a 15-year high of 20.5 in early December, when Energy's earnings were depressed. That's up from a three-year low of 15.5 in February 2016, but down 2.3 points from SmallCap's record-high P/E of 20.9 in April 2002. Looking at their daily forward price/sales (P/S) ratios since data became available in 2004, valuations last week were similarly lower for the three indexes: LargeCap's P/S of 1.93 on Friday is down from a record high of 1.97 in late July; MidCap's 1.24 is down from a record high of 1.39 in early March, and SmallCap's 0.95 is down from 1.08 in early March and its record high of 1.17 in November 2013.

S&P 500 Sectors Quarterly Earnings Outlook (*link*): Q3 earnings estimates for the 11 S&P 500 sectors were mostly lower last week as analysts continued to make adjustments following Q2 earnings results. The Q3 consensus fell w/w for nine of the 11 S&P 500 sectors and was steady for two: Real Estate and Tech. Sectors with the biggest w/w decline in their Q2 forecast: Materials (-1.0%), Consumer Staples (-0.8), Energy (-0.8), and Real Estate (-0.8). The S&P 500's Q3-2017 EPS forecast fell 11 cents w/w to $33.26, and is down 1.7% from $33.82 at the end of Q2. That represents a forecasted pro forma earnings gain for Q3-2017 of 6.8% y/y, down from Q2's blended 12.0% and Q1's 15.3%, which was the strongest growth since Q3-2011 owing mostly to easier comps for Energy. The Q3-2017 forecast is down from 7.1% a week earlier, and down from 8.7% at the end of Q2. Since the end of Q2, Q3 estimates are lower for eight sectors and higher for two. Real Estate's Q3 forecast has risen 2.5%, Tech's is up 1.1%, and Telecom is unchanged. Energy's has tumbled 18.8% for the worst decline, followed by the Q3 forecasts for Consumer Discretionary (-3.6), Materials (-3.2), and Utilities (-2.6). The S&P 500's Q3-2017 forecasted earnings gain of 6.8% y/y would be its fifth straight gain after four declines. Nine of the 11 sectors are expected to record positive y/y earnings growth in Q3-2017, but only three are expected to beat the S&P 500's forecasted y/y earnings gain of 6.8%. That's because analysts expect Energy to report another large profit jump in Q3 relative to very low earnings a year ago. That's down from Q2-2017 when all 11 sectors rose y/y on a blended basis, the first time that has occurred since Q3-2011 when 10/10 sectors rose y/y. The latest forecasted Q3-2017 earnings growth rates vs their blended Q2-2017 growth rates: Energy (131.3% in Q3 vs 538.7% in Q2), Tech (9.7% vs. 16.3%), Industrials (7.8, 7.2), S&P 500 (6.8, 12.0), Financials (5.2, 12.1), Health Care (3.9, 8.5), Consumer Staples (3.4, 4.6), Materials (2.1, 7.7), Real Estate (3.0, 4.9), Consumer Discretionary (0.9, 3.7), Telecom (-1.1, 4.8), and Utilities (-1.8, 6.1).

S&P 500 Q2 Earnings Season Monitor (*link*): With over 91% of S&P 500 companies finished reporting Q2-2017 results, their revenue and earnings surprise data and y/y growth comparisons are mixed relative to the comparable point of the Q1 season. Of the 456 companies in the S&P 500 that have reported through noon yesterday, 73% exceeded industry analysts' earnings estimates, by an average of 6.1%; they averaged a y/y earnings gain of 12.1%. At the same point during the Q1-2017 reporting period, a higher percentage of companies (75%) in the S&P 500 had beaten consensus earnings estimates by a higher 6.7%, and earnings were up a lower 11.2% y/y. On the revenue side, 68% beat sales estimates so far, with results coming in 1.1% above forecast and 5.6% higher than a year earlier. At this point in the Q1 season, a lower 63% had exceeded forecasts, companies reported revenues a lower 0.7% above forecast, and sales rose a higher 8.4% y/y. Q2 earnings results are higher for 71% of companies vs 62% at the same point in Q1, but revenues are higher for 80% vs 79% a quarter ago. The gulf between the percentage of companies reporting higher y/y earnings growth and the percentage of those reporting higher y/y revenue growth is the biggest since Q1-2012 and suggests that margins may be under pressure. Q2 results are not expected to change markedly as the remaining 44 companies report, but the results to date suggest a return to more normalized growth rates following the Energy recession of 2015-2016. Q2-2017 should mark the fourth straight quarter of positive y/y earnings growth, but we expect growth will fall back into the single digits during Q3. That would follow double-digit percentage earnings growth during Q1 and Q2, which were the first double-digit quarters seen since Q3-2011.

GLOBAL ECONOMIC INDICATORS

Eurozone Industrial Production (*link*): Output in June fell for only the second time this year, after reaching a new cyclical high in May. Industrial production (excluding construction) sank 0.6% after rising the prior three months by a total of 2.0%. June's decline was driven by sizable declines in both capital (-1.9%) and consumer durable (-1.2) goods output, while nondurable consumer (-0.4) and intermediate (-0.3) goods production posted smaller declines; all except consumer nondurable goods production were at cyclical highs in May. Meanwhile, energy output climbed for the third month, up 1.8% m/m and 5.8% over the period. The top four Eurozone economies show production declines exceeded 1.0% in both Germany (-1.1%) and France (-1.2) after sizeable gains of 1.4% and 1.9%, respectively, in May—Germany's to a new record high. Output in Italy advanced for the fourth time in five months by 1.1% in June and 2.9% over the period to a new cyclical high; production in Spain was flat after rebounding 1.7% in May. Of the remaining countries for which data are available, the biggest monthly declines were recorded in Ireland (-7.5) and Malta (-3.2), while the largest increases were recorded in Luxembourg (3.4), the Netherlands (1.2), and Estonia (1.2). Yearly growth rates for Germany (to 2.1% from 4.7% y/y), France (2.5 from 3.3), and Spain (3.2 from 3.7) all slowed from May's pace, while Italy's (5.3 from 2.7) accelerated, recording its best yearly gain this year.

Contact us by email or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor & Webmaster, 570-775-6823

Copyright (c) Yardeni Research, Inc. Please read complete copyright and hedge clause.