MORNING BRIEFING
October 3, 2017

Thanks a Trillion!

See the collection of the individual charts linked below.

(1) Several explanations for why the global economy is doing so well. (2) Central bankers remain on easing streak. (3) Benefit of lower oil prices flowing through now. (4) Immigration usually boosts growth. (5) Big positive wealth effect from global bull market in stocks. (6) Trillions here and there adding up to serious money. (7) Happy canaries in S. Korean coal mines. (8) Eurozone economic sentiment auguring better growth. (9) US M-PMI and key components all above 60.0. (10) Forward revenues and earnings rebounding smartly overseas.

Global Economy I: Booming? The global economy is showing more signs of booming, as Debbie and I review in the next section. Why might that be happening? Several explanations come to mind. They are not mutually exclusive. Consider the following:

(1) *Global monetary policy remains ultra-easy.* While the Fed has started to unwind its balance sheet in a very gradual fashion, the ECB and BOJ are continuing to load up on securities through their respective QE programs. Over the past 12 months through August, the Fed's assets were unchanged at $4.4 trillion. The ECB's assets soared $1.3 trillion to a record-high $5.1 trillion. The BOJ's assets also hit a record high during August of $4.7 trillion, up $184 billion y/y. Altogether, the balance sheets of the Three Sisters rose $1.5 trillion y/y to a record $14.1 trillion (*Fig. 1* and *Fig. 2*).

(2) *Chinese bank lending is at a record high.* No piker in this central bank monetary extravaganza is the People's Bank of China, with assets of $5.2 trillion during August (*Fig. 3*). That's actually down slightly by $178 billion y/y. On the other hand, China's bank loans have increased by a record $2.0 trillion over the past 12 months through August to a record high of $17.5 trillion (*Fig. 4*).

(3) *The 50% cut in oil prices since mid-2014 is a big windfall.* We estimate that the drop in oil prices since mid-2014 through mid-2017 has saved $1.8 trillion for global oil consumers (*Fig. 5*). The initial plunge in oil prices seemed to depress global economic activity as the oil industry retrenched quickly. The rebound in the price of a barrel of Brent from a low of $27.88 on January 20, 2016 to $56.09 currently has revived the oil industry. US oil field production is back at the highs of early 2015 (*Fig. 6*). However, there remains a substantial windfall for consumers at current prices, which remain much lower than they were during H1-2014.

(4) *Mass immigration into Europe is boosting the region's growth.* The number of people with an immigrant background in Germany rose 8.5% to a record 18.6 million in 2016, largely due to an increase in refugees, the Federal Statistics Office said last Tuesday. Germany took in more than a million migrants, many fleeing war and poverty in the Middle East and Africa in 2015 and 2016.

Chancellor Angela Merkel's decision to open borders initially hit her popularity and boosted the anti-immigrant Alternative for Germany (AfD) party, though she won a fourth term as chancellor in elections last month. In any case, the surge in immigrants might also explain the faster pace of growth in Germany.

(5) *The global bull market in stocks is having a very positive wealth effect on growth.* The value of all equities traded just in the US alone soared $23.4 trillion since the start of the current bull market from a low of $10.9 trillion during Q1-2009 to a record $34.3 trillion during Q2-2017 (*Fig. 7*). It's up 62% since the previous bull market high during Q2-2007!

Global Economy: Booming! A trillion here, a trillion there: It's all adding up to serious money. Any one of the stimulative developments mentioned above could contribute to better global economic activity. Put them altogether, and the result could be a global boom. Consider the following:

(1) *South Korean exports soaring.* Our focus on the global economy today was inspired by South Korea's September exports data released yesterday (*Fig. 8*). They mostly meandered sideways at record highs from 2011-2014. Then they fell during 2015. They recovered to their record highs by early 2017. During September, they went vertical, jumping by 17% m/m and 38% y/y. It will be interesting to see if September data for any of the other major Asian economies outside of China confirm that something big is up in the global economy (*Fig. 9*).

(2) *Economic Sentiment & M-PMIs very strong in Europe.* Another notable sign of a global boom is September's Economic Sentiment Indicator (ESI) for the Eurozone (*Fig. 10*). It rose to 113.0, the highest reading since June 2007. It is very highly correlated with the y/y growth in the region's real GDP. Leading the way is Germany's industrial component of the ESI (*Fig. 11*).

Germany's M-PMI led the pack of rising indexes among the major European countries (*Fig. 12*). It rose to 60.6 last month, confirming the strength in Germany's industrial ESI and in the German Ifo business confidence index. Solid M-PMI readings were also registered last month in France (56.1), Italy (56.3), Spain (54.3), and the UK (55.9).

(3) *German unemployment at record low.* German unemployment slid to a record low in September. The jobless rate dropped to 5.6% in September, down from 5.7%. That's impressive considering the migration inflow over the past two years.

(4) *US M-PMI in the 60s.* In the US, the national M-PMI rose to 60.8 during September (*Fig. 13*). That's the best reading since May 2004. The composite's three major components had readings exceeding 60.0: New Orders (64.6), Production (62.2), and Employment (60.3). That trifecta is a very unusual occurrence.

(5) *Global M-PMI.* The global M-PMI remained relatively high at 53.2 last month, as Debbie discusses below (*Fig. 14*). While the M-PMI for emerging economies dipped to 51.3, the index for advanced economies rose to 54.6, the highest since February 2014.

(6) *Forward revenues and earnings rising rapidly.* Over the past year, forward revenues and earnings have been rising to new record highs for the US MSCI stock price index. Since early this year, there has been a significant rebound in the forward earnings of the All Country World ex-US MSCI (*Fig. 15* and *Fig. 16*)

CALENDARS

US. Tues: Total & Domestic Motor Vehicle Sales 16.7mu/12.6mu, Powell. **Wed:** ADP Employment 150k, ISM & Markit M-PMIs 55.4/55.1, MBA Mortgage Applications, EIA Petroleum Status Report, Yellen. (Bloomberg estimates)

Global. **Tues:** Japan Consumer Confidence 43.5, RBA Rate Decision 1.50%. **Wed:** Eurozone, Germany, France, and Italy Composite PMIs 56.7/57.8/57.2/55.9, Eurozone, Germany, France, and Italy Nonmanufacturing PMIs 55.6/55.6/57.1/55.0, UK Composite & Nonmanufacturing PMIs 53.8/53.2, Eurozone Retail Sales 0.3%m/m/2.6%y/y. (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—sank 8.6% during the four weeks ending September 23 (after a seven-week surge of 5.0% to a new record high), driven by a hurricane-related jump in jobless claims. Our WLI is the average of our Boom-Bust Barometer (BBB) and Bloomberg's Weekly Consumer Comfort Index (WCCI). Our BBB tumbled 13.7% over the four-week period, following a seven-week jump of 5.5% to a new record high, as jobless claims spiked to a 19-month high of 277,750 (4-wa). Claims were at 236,750 four weeks ago, not far from late May's 235,500—which was the lowest since April 1973. The CRB raw industrial spot price index—another BBB component—continued to move down from recent highs. Meanwhile, the WCCI climbed 2.0% after sinking 5.1% the prior three weeks.

S&P 500/400/600 Forward Earnings (*link*): Forward earnings rose to a yet another record high last week for LargeCap and MidCap, and SmallCap's was at a record for the first time since mid-July. 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 edged up w/w to 9.7% y/y from 9.6%, 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 improved to 13.7% from 13.2%, which compares to a 66-month high of 14.0% in early August and a six-year low of -1.3% in December 2015; and SmallCap's dropped to a nine-month low of 9.3% from 9.4%, 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's consensus growth rates expected for 2017 have remained strong throughout this year instead of falling. Furthermore, the growth rates for 2018 should remain strong for all three indexes if the corporate tax rate changes sooner rather than later. Here are the latest consensus earnings growth rates: LargeCap 11.1% and 11.0%, MidCap 11.2% and 13.6%, and SmallCap 5.4% and 20.8%.

S&P 500/400/600 Forward Valuation (*link*): Forward P/E ratios rose for all three indexes last week. Looking at the daily valuation, LargeCap's forward P/E was at an eight-month high of 17.7, and 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 rose to an eight-week high of 18.0. MidCap's P/E is higher than LargeCap's again after being below in recent weeks for only the second time since 2009. MidCap's P/E, which compares to a 15-year high of 19.2 in late February and the record high of 20.6 in January 2002, is up from a three-year low of 15.0 in January 2016. SmallCap's surged to a 28-week high of 20.0, which compares to 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, and only 0.9ppt below SmallCap's record-high P/E of 20.9 in April 2002. Valuations have improved from their more-than-five-month lows in mid-April, but remain below their multi-year highs in early March. SmidCap P/Es stalled for most of 2017 following the post-election melt-up, but are rising again now. However, the "E" still remains low for all three indexes as analysts await the passage of legislative changes to the tax rate and its positive impact on corporate earnings. Looking at their daily forward price/sales (P/S) ratios, valuations last week were similarly higher for the three indexes: LargeCap's P/S of 1.99 was at a record high, MidCap's 1.28 is down from a record high of 1.39 in early March, and SmallCap's 1.03 is down from 1.08 in early March and its record high of 1.17 in November 2013.

S&P 500 Q3 Earnings Trend vs. Past Quarters (*link*): With the September-quarter books closed, the current Q3-2017 EPS forecast of $32.76 has dropped 3.1% over the 13 weeks since the quarter's start. That's about the same as the 3.0% decline recorded for Q2 over the same time period. It marks the 26th straight quarter that forecasts have fallen, but the decline is smaller than the average 4.0% decrease over the same time period and below the average 4.3% decline in the quarter's estimate since 1994. Analysts expect EPS for Q3-2017 to be up 5.0% y/y on a frozen actual basis, behind the 10.0% gain for Q1-2017, but that would mark the fifth straight quarter of higher EPS on a y/y basis. Since 1994, the Q3 earnings surprise has been positive in 17/23 years (all but 1997-1998, 2001, 2005, and 2007-2008). We think Q3 will mark the S&P 500's 35th straight quarter of positive surprises—a streak dating back to Q1-2009 and longer than the prior 10-quarter positive surprise streak (Q1-2003 to Q2-2005).

US ECONOMIC INDICATORS

Construction Spending (*link*): Construction spending advanced in August for the first time in three months, climbing 0.5% after a two-month slide of 2.0%. Private construction investment rose for the third time in four months, by 0.5% m/m and 1.3% over the period, while public construction spending rose 0.7% after plunging 7.2% the prior two months. Within private construction spending, nonresidential investment rose 0.5% in August—only the second increase this year—with spending down 3.2% ytd. Meanwhile, residential construction has only declined once this year; it was up 0.5% m/m and 5.1% ytd to its highest reading since April 2007. Within residential investment, single-family construction remains strong, advancing ten of the last 11 months by a total of 11.2%, while home-improvement continues its steep ascent, jumping 6.6% during the four months ending August, after a brief 2.6% dip in April. Multi-family construction improved slightly in August, increasing 0.9% after a three-month slide of 4.3%.

GLOBAL ECONOMIC INDICATORS

Global Manufacturing PMIs (*link*): Global manufacturing activity in September continued to expand at a healthy pace. The JP Morgan M-PMI held at August's 75-month high of 53.2; the developed nations (54.6) continued to record much stronger growth than emerging markets (51.3). Manufacturing in the Eurozone (58.1) grew at its fastest pace in 79 months. Germany (60.6, 77-month high) bounced back to the top of the leader board, followed by the Netherlands (60.0, 79-month high), Austria (59.4, 4-month low), Italy (56.3, unchanged), France 56.1 (77-month high), Ireland (55.4, 2-month low), Spain 54.3, (3-month high), and Greece (52.8, 111-month high). Growth in the US (53.1) and Japan (52.9) slowed slightly. (Note: ISM's M-PMI [60.8] for the US jumped to its highest reading since May 2004; see details below.) Meanwhile, growth slowed slightly in the UK (55.9), China (51.0), and Taiwan (54.2), while South Korea's (50.6) moved back into expansionary territory after contracting for two months

US Manufacturing PMIs (*link*): Manufacturing activity in September expanded at its fastest pace in over six years according to ISM's survey, while it grew at a pace consistent with its ytd average according to Markit's. The ISM M-PMI soared to 60.8 last month—its highest reading since May 2004! Nearly all the components accelerated last month. The new orders (to 64.6 from 60.3) and production (62.2 from 61.0) measures were both above 60.0 for the fourth month, while the employment (60.3 from 59.9) gauge moved above 60.0 for the first time since June 2011. The new orders index was helped by a bounce back in new export orders (57.0 from 55.5) after a recent slowdown. The supplier deliveries (64.4 from 57.1) index shot up to its highest reading since July 2004; meanwhile, the inventories (52.5 from 55.5) component was the outlier—showing slower investment. Markit's M-PMI (53.1 from 52.8) showed manufacturing activity improved in September, though remains below its 55.0 rate peak at the start of the year. According to the report, output growth was unchanged at August's 14-month low, while new orders growth softened. Still, the rate of job creation was the strongest so far this year.

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