MORNING BRIEFING
October 9, 2017

FOMO & MAMU

See the collection of the individual charts linked below.

(1) Deep in the heart of Texas. (2) From fiscal cliff to anxiety fatigue. (3) Nothing to fear but nothing to fear. (4) Mother of All Melt-Ups if Fear Of Missing Out takes hold. (5) It's still Nirvana now, but raising odds of Melt-Up then Meltdown scenarios. (6) Templeton's four seasons of a bull market. (7) No corrections during fourth (euphoria) phase so far. (8) Extreme greed readings. (9) Are SmallCaps frothy?

Strategy I: Melt-Up Musings. I visited our accounts deep in the heart of Texas last week, specifically in Austin, Dallas, Fort Worth, and Houston. They all wanted to talk about the potential for a stock market melt-up. They also asked me what could go wrong for the market. I said that I am most concerned about a melt-up followed by a meltdown. I've been raising the odds of a melt-up this year. And I am doing it again today. Consider the following:

(1) *60/30/10*. On January 24, 2013, I first suggested that if we all just keep calm and carry on, "then maybe the cyclical bull market will morph into a secular bull market." The S&P 500 rose to a new record high on March 28, 2013 for the first time since October 9, 2007. Also in early 2013, I detected "anxiety fatigue" among many of our accounts. After the widely dreaded "fiscal cliff" scare turned out to be a non-event at the start of 2013, they were tired of being anxious that the bull would get tripped by a bear.

On May 9, 2013, I first assigned subjective probabilities of 60/30/10% to Nirvana, Melt-Up, and Meltdown scenarios. On May 16, I observed, "In other words, we have nothing to fear other than an absence of fear. … Perhaps now that investors are no longer fearful that the end is near, all the liquidity pumped into the financial markets by the major central banks over the past four years to avert the Endgame scenario is about to cause the Mother of All Melt-Ups (MAMU)."

(2) *40/40/20.* This year, on March 6, I lowered the odds of the Nirvana scenario (from 60% to 40%), and raised the odds of the Melt-Up one (from 30% to 40%) because stocks were doing just that, melting up. Increased Melt-Up odds implied that I should raise the odds of a Meltdown (from 10% to 20%), since the former scenario tend to lead to the latter one the way that booms lead to busts.

(3) *30/50/20*. Then, on August 2, I wrote: "Today, we are raising the odds of the Melt-Up scenario from 40% to 50%. The Meltdown scenario remains at 20%, while the Nirvana scenario gets cut from 40% to 30%. By the way, a melt-up followed by a meltdown won't necessarily cause a recession. It might be more like 1987, creating a great buying opportunity, assuming that we raise some cash at the top of the melt-up's ascent. Our animal instincts will have to overcome our animal spirits."

(4) *20/55/25.* Today, I'm raising the odds of the Melt-Up scenario to 55% mostly because melting up seems to be what stocks continue to do. I'm also raising the Meltdown odds to 25%. As a result, Nirvana is down to 20%.

The extraordinary rally to multiple record highs this year has been driven by several solid fundamental factors. Earnings have continued to rebound from the energy-led earnings recession during 2015 and the first half of 2016. The pace of global economic growth started to quicken late last year. President

Donald Trump's administration is moving rapidly on deregulation, and more slowly on enforcing current regulations. He has yet to deliver on cutting taxes and bringing back overseas earnings, but both remain possible. Inflation and interest rates remain low, which justifies historically high valuation multiples.

However, this Nirvana scenario seems to be rapidly morphing into the Melt-Up scenario. As one of our NY accounts observed last week in an email exchange with me: It's "a case of FOMO, as the youngsters call it these days—Fear Of Missing Out."

Strategy II: The Fourth Phase. In 1725, Antonio Vivaldi composed *The Four Seasons,* a set of four violin concertos. The sounds of each concerto resemble its respective season. So for example, "Winter" is punctuated with pizzicato notes from the high strings, suggesting icy rain. "Summer" sounds like a thunderstorm in its final movement, which is often called "Storm."

One of the great virtuosos of the investment business was Sir John Templeton. He observed that bull markets experience four phases: pessimism, skepticism, optimism, and euphoria. Similarly, my friend Laszlo Birinyi has also identified four phases: reluctance, digestion, acceptance, and exuberance. Where are we now in the current bull market? See if you agree with the following phase demarcations as I see them for the current bull market:

(1) *First and second.* The first phase started on March 9, 2009 and ended after the second and worst correction of the bull market, on October 3, 2011 (*Fig. 1*).The second phase included three minor corrections, with the last one ending on November 15, 2012.

(2) *Third and fourth.* On July 8, 2014, I wrote that the S&P 500 was moving from the third to the fourth phase. Now I'm thinking that the third phase was extended by the energy-led earnings recession. Instead, the third phase might have ended on February 11, 2016, when the S&P 500 fell to the lowest reading since April 11, 2014, taking out some of the optimism that had been building during the third phase. During the fourth phase since then, there have been no significant corrections, which certainly must be contributing to the mounting euphoria/exuberance about stocks.

(3) *P/E phase profile.* The S&P 500's forward P/E also can be used to identify these four phases (*Fig. 2*). It mostly fell during the first phase, when earnings caught up with the initial bull market euphoria. During the second phase, it rose slightly but remained relatively low as investors continued to fret about another financial crisis and a renewed recession. During the third phase, the forward P/E trended higher, rising to a cyclical peak of 17.2 on February 24, 2015. It was back down to 14.7 on January 20, 2016. It has been above 17.0 ever since January 24, 2017, and was at 18.0 at the end of last week.

This is all still Nirvana territory but bordering on Melt-Up terrain, in my opinion. If the P/E rises over 20.0, that would suggest to me that the exuberance phase of the bull market is well underway.

Strategy III: Front-Cover Curse. The melt-up is making headlines. Randy Forsyth's column in *Barron's* this week is titled "The Meltup Before the Storm?" He notes: "'The bull market in everything' is how the current issue of the *Economist* sums up the state of affairs. The magazine's subhead does ask, 'Are asset prices too high?' which implies that the inevitable correction is at hand. The cover illustration also features a bull, a redoubtable contrarian indicator of trouble ahead."

Randy also observes: "On the CNN Fear & Greed Index, fear was nowhere in evidence on Thursday. The index closed at 95 on a scale of zero to 100, a score deemed to be 'extreme greed.'" Apparently, the so-called "most hated" bull market in stocks is now loved. Let's review some more loving indicators:

(1) *Corrections are MIA.* The S&P 500 hasn't had a significant panic attack or correction since early 2016 ([*Fig. 3*]). The index's level has been above its rising 200-day moving average since May 26, 2016 ([*Fig. 4*]).

(2) *Sentiment is bullish.* The Bull/Bear Ratio (BBR) compiled by Investors Intelligence rose back above 3.00 over the past two weeks as the percentage of bears fell below 18.0% ([*Fig. 5*]).

(3) *VIX is comatose.* The S&P 500 VIX remains in record-low territory, falling to a record low of 9.2 on Thursday and edging up to 9.7 on Friday ([*Fig. 6*]). It is highly correlated with the bearish component of the BBR. It tends to spike in response to panic attacks. The previous spike peaked at 16.0 as a result of a short-lived North Korean crisis ([*Fig. 7*]).

(4) *Dow Theory is smoking.* Both the DJIA and DJTA rose to record highs last week ([*Fig. 8*]). The latter seems to be breaking out of a trading range that started last year.

(5) *P/E multiples are elevated.* On Friday, the S&P 500/400/600 forward P/Es rose to 18.0, 18.2, and 20.2 ([*Fig. 9*]). Daily data since 1999 show that the S&P 500 multiple remains well below its 1999/2000 bubble peaks around 24.0. However, both the S&P 400 and S&P 600 are back to levels that previously marked their cyclical tops.

The Russell 2000 P/E is especially rich at 27.0 at the end of September ([*Fig. 10*]). Even richer is the 34.8 multiple for Russell 2000 Growth ([*Fig. 11*]). Then again, if Trump delivers on deregulation and on tax cuts, smaller corporations might benefit more than larger ones.

CALENDARS

US. Mon: None. **Tues:** NFIB Small Business Optimism Index 105.4, Kashkari, Kaplan. (Bloomberg estimates)

Global. Mon: Germany Industrial Production 0.9%m/m/3.0%y/y, Eurozone Sentix Investor Confidence 28.5. **Tues:** Germany Trade Balance (euros) 19.6b, UK Headline & Manufacturing Industrial Production 0.9%/1.9% y/y, China New Yuan Loans 1230b, China M2 9.0% y/y, Japan Machine Tools 1.0%m/m/0.8%y/y, Annual Meetings of the IMF and the World Bank, Kuroda. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance ([*link*]): The US MSCI index rose 1.2% last week, and ranked 13th out of the 49 markets as 29 countries rose in US dollar terms. That compares to sixth a week earlier, when it rose 0.7% as 10 countries moved higher. The AC World ex-US index under performed the US MSCI for the sixth time in 13 weeks, rising 0.4% compared to a 0.6% decline a week earlier. BRIC performed best last week with a gain of 3.4%, followed by EM Asia (2.4%), and EM Latin America (1.3). EMU was the worst-performing region as it fell 0.5% w/w, followed by EMEA (-0.3), EAFE (-0.1), and EM Eastern Europe (0.1). China was the best-performing country with a gain of 4.3%, followed by Chile (3.7), Argentina (2.9), Sri Lanka (2.6), and India (2.4). Greece was the worst performer as it fell 3.6%, followed by Portugal (-3.2), Egypt (-2.9), Pakistan (-2.8), and Spain (-2.7). The US MSCI is up 14.0% ytd, with its ranking up four places w/w to 31st of the 49 markets, but continues to trail the AC World ex-US (19.1) on a ytd basis. Forty-five of the 49 markets are positive ytd, led by Argentina (65.5), China (46.5), Austria (45.6), Poland (44.2), Chile (35.5), and Korea (31.7). The worst country performers ytd: Pakistan (-25.0), Israel (-4.3), Russia (-2.9), and Jordan (-2.7). BRIC is the best-performing region ytd with a gain of 34.9%, followed closely by EM Asia (32.7) and ahead of EM Latin America (26.2) and EMU (23.7). The worst-performing regions, albeit with gains: EMEA (7.4), EM Eastern Europe (8.4), and EAFE (17.1).

S&P 1500/500/400/600 Performance (*link*): Last week, all three of these indexes rose for a fourth straight week and the sixth time in seven weeks. MidCap's 1.3% rise edged out those of SmallCap (1.2%) and LargeCap (1.2). LargeCap and Midcap ended the 0.1% below their record high on Thursday, and SmallCap was down 0.4% from Tuesday's record. Twenty-seven of the 33 sectors rose w/w, compared to 30 rising a week earlier and just one the week of August 11, which was the lowest since September 2016. Last week's biggest gainers: SmallCap Telecom (4.5%), MidCap Telecom (2.9), MidCap Tech (2.9), MidCap Materials (2.4), SmallCap Tech (2.2), and SmallCap Utilities (2.1). Last week's worst performers: MidCap Energy (-2.6), SmallCap Energy (-2.6), LargeCap Telecom (-1.1), and LargeCap Energy (-0.6). Twenty-six of the 33 sectors are positive ytd, up from 25 a week earlier, as LargeCap (13.9) continues to outperform both MidCap (9.5) and SmallCap (9.2). Tech and Health Care dominate the biggest sector gainers ytd: SmallCap Health Care (28.6), LargeCap Tech (27.9), MidCap Health Care (22.0), LargeCap Health Care (20.4), MidCap Tech (20.3), and SmallCap Utilities (17.5). Energy and Telecom dominate the worst performers ytd: MidCap Telecom (-38.9), SmallCap Energy (-31.5), MidCap Energy (-26.1), LargeCap Energy (-9.1), and LargeCap Telecom (-9.1).

S&P 500 Sectors and Industries Performance (*link*): Eight of the 11 sectors rose last week, and six outperformed the S&P 500's 1.2% gain. This compares to nine sectors rising a week earlier, when only three outperformed the S&P 500's 0.7% rise. Materials and Financials were the best-performing sectors as their 1.9% gains beat these outperforming sectors: Consumer Discretionary (1.8), Tech (1.5), Health Care (1.4), and Industrials (1.3). Telecom (-1.1), Energy (-0.6), and Consumer Staples (-0.3) were the only sectors to decline, followed by these underperformers: Real Estate (0.5) and Utilities (0.7). So far in 2017, nine of the 11 sectors are higher, but only three have outperformed the S&P 500's 13.9% gain. The best performers in 2017 to date: Tech (27.9), Health Care (20.4), and Materials (16.3). The eight sectors underperforming the S&P 500 ytd: Energy (-9.1), Telecom (-9.1), Consumer Staples (4.1), Real Estate (5.2), Utilities (9.7), Consumer Discretionary (12.7), Financials (13.1), and Industrials (13.8).

Commodities Performance (*link*): Thirteen of the 24 commodities we follow rose last week, but the S&P GSCI commodities index tumbled 1.9% for its worst decline in 15 weeks. That compares to 11 commodities advancing a week earlier, when the GSCI index rose 0.3%. Industrial metals-related commodities dominated the week's strongest performers: Copper (2.8%), Aluminum (2.6), and Zinc (2.4). Last week's laggards were dominated by energy-related commodities: GasOil (-5.1), Crude Oil (-4.5), Heating Oil (-3.7), Natural Gas (-3.6), Unleaded Gasoline (-2.2), and Brent Crude (-2.2). Industrial metals-related commodities also dominate the best performers in 2017 so far: Aluminum (26.8), Zinc (26.3), Lead (25.9), Feeder Cattle (24.2), and Copper (20.2). This year's laggards: Sugar (-28.3), Natural Gas (-22.1), Crude Oil (-8.1), Lean Hogs (-7.9), and Unleaded Gasoline (-6.8).

Assets Sorted by Spread w/ 200-dmas (*link*): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 13/24 commodities, 6/9 global stock indexes, and 27/33 US stock indexes compared to 8/24, 5/9, and 26/33 rising a week earlier, respectively. Twelve commodities trade above their 200-dmas, down from 13 a week earlier. Commodities' average spread weakened w/w to 1.4% from 1.8%. Zinc leads all commodities and all assets at 16.1% above its 200-dma, followed by Lead (11.3%) and Copper (11.1), which performed the best of all commodities as it improved 2.6ppts w/w. Lean Hogs (-14.2) trades the lowest of all commodities relative to its 200-dma, followed by Sugar (-13.9). GasOil (8.1) fell 5.9ppts last week for the worst performance of all commodities and all assets. The global indexes trade at an average of 7.1% above their 200-dmas, up from 6.2% in the prior week. All nine of the global indexes trade above their 200-dmas, unchanged from a week earlier. Brazil (14.8) leads the global indexes, followed by Chile (14.5), which gained 2.3ppts for the best performance among its peers. Canada (2.1) trades the lowest among its country peers, but China (7.8) and South Korea (6.1) each edged down 0.4ppts w/w for the worst performances of the group. The US indexes trade at an average of 4.0% above their 200-dmas, with 26 of the 33 sectors above, up from an average of 3.0% a week earlier, when 26 sectors were above. SmallCap Health Care leads all US stock indexes at 14.2% above its 200-dma, followed by LargeCap Tech (10.5) and SmallCap Industrials (10.0). SmallCap Telecom (6.0) rose 4.5ppts w/w for the best performance of the US stock indexes and all asset classes. MidCap Telecom trades 21.2% below its 200-dma, the lowest among the US stock indexes and all assets, followed by SmallCap Energy (-9.4) and MidCap Energy (-6.7), which dropped 1.7ppts for the worst performance among US assets last week.

S&P 500 Technical Indicators (*link*): The S&P 500 index remained in a Golden Cross last week for a 76th week (after 17 weeks in a Death Cross) as both the short-term and long-term technicals improved w/w. However, the index's 50-day moving average (50-dma) relative to its 200-dma fell to 3.3% from 3.4%, and is the lowest since early January. That's down from a 34-month high of 5.4% in early April and compares to a six-month low of 2.0% in early December and a 52-month low of -4.5% in March 2016. The S&P 500's 50-dma and 200-dma both rose together for a seventh straight week, after failing to rise together in mid-August for the first time in 36 weeks. The index closed above its 50-dma for a sixth week after three weeks below, which was its worst streak since it closed below its 50-dma for 10 straight weeks from September 2016 until the November election. The S&P 500 improved to a 29-week high of 2.8% above its rising 50-dma from 1.9% above its rising 50-dma a week earlier, which compares to a four-month low of 1.0% below its falling 50-dma in mid-August. These 50-dma readings compare to a 38-week high of 4.8% on December 13 and a 52-month high of 6.2% in March 2016. The S&P 500 improved to a 10-week high of 6.2% above its rising 200-dma from 4.9% a week earlier, which compares to a post-election low of 3.0% above its rising 200-dma in mid-August. That's down from a 38-month high of 9.4% on March 1, but up from an eight-month low of -0.1% immediately before the election.

S&P 500 Sectors Technical Indicators (*link*): Among the 11 sectors, eight improved w/w relative to their 50-dma and 200-dma. Consumer Staples, Energy, and Telecom had both measures weaken w/w. Eight of the 11 sectors trade above their 50-day moving averages (50-dmas), unchanged from a week earlier and leaving these three with declining 50-dmas: Consumer Staples, Real Estate, and Utilities. That's a turnaround from mid-August when just three sectors traded above their 50-dmas, matching mid-April's reading, which was the lowest since the election. All 11 sectors had been above their 50-dmas during mid-January, and all 11 were below the week before the election, for the first time since December 11, 2015. The longer-term picture is a tad stronger: Nine of the 11 sectors were above their 200-dmas last week, unchanged from a week earlier. Energy traded above its 200-dma for a second week after 29 weeks below; Consumer Staples was below its 200-dma for a third week after 32 straight weeks above; and Telecom ended the week below its 200-dma for a 28th week. Nine sectors are in a Golden Cross, with 50-dmas higher than their 200-dmas, unchanged from a week earlier and leaving Energy and Telecom still out of the club. All 11 had been in a Golden Cross during a 21-week streak that ended October 24, the longest such stretch since October 2014. Eight of the 11 sectors have rising 50-dmas, up from seven a week earlier as Consumer Discretionary and Utilities turned up and Telecom turned down. These two sectors also have declining 50-dmas: Consumer Staples and Real Estate. Nine sectors have rising 200-dmas, unchanged from a week earlier. Energy's 200-dma fell for a 23rd straight week, and Telecom's dropped for a sixth week.

US ECONOMIC INDICATORS

Employment (*link*): Hurricanes caused the first decline in payroll employment since 2010. US companies reduced payrolls by 33,000 in September after an upward revision to August (to 169,000 from 156,000) and a big downward revision to July (138,000 from 189,000) payrolls for a net loss of 38,000. Meanwhile, private payrolls were cut by 40,000, following increases of 164,000 (vs. 165,000 preliminary) and 133,000 (202,000) for a net loss of 70,000. (ADP reported a 135,000 increase in private nonfarm payrolls in September, which was an 11-month low.) The breadth of job creation (percent of private industries increasing payrolls) for the one-month span fell for the third month from 64.9% in May to 55.7% in September; the three-month span fell to 60.0% after climbing the previous three months from 57.7% to 66.5%—which was the highest reading since February 2015.

Earned Income Proxy (*link*): Our Earned Income Proxy (EIP) in September continued to set new record highs, climbing for the ninth time in ten months, by 0.4% m/m and 4.0% over the period. Average hourly earnings, one of the components of our EIP, shot up 0.5% m/m—matching its high for the year, while aggregate weekly hours, the other component, edged down 0.1%. On a y/y basis, our EIP advanced 4.3%, with AHE up 2.9% (the highest this year) and aggregate hours up 1.4%—slowing from 2.0% in August. Our proxy tracks income and spending closely and continues to predict robust gains in both.

Employment by Industry (*link*): The decline in September payrolls reflected a steep hurricane-related decline of 105,000 in restaurants and below-trend growth in other industries. The record decline in restaurant jobs compares with an average monthly gain of 26,400 from January through August. Manufacturing jobs ticked down by 1,000 after averaging monthly gains of 14,000 per month—from its recent low last November through August of this year. Health care companies hired 22,500 to payrolls last month, slightly below its average monthly 27,000 gain the prior 12 months, while transportation & warehousing added 21,800 jobs. Smaller gains were recorded for professional & business services (13,000) and financial activities (10,000)—which averaged monthly gains of 49,800 and 12,300, respectively, the previous 12 months. Employment in other major industries—including mining, construction, wholesale trade, retail trade, information services, and government—showed little change last month.

Unemployment (*link*): September's unemployment rate sank to a new 16-year low of 4.2%. The civilian labor force expanded for the fourth month by 575,000 in September and 1.36 million over the period; those not in the labor force fell for the third time in four months, by 368,000 m/m and 566,000 over the period. The participation rate climbed to 63.1%—the highest since March 2014—though still showing little movement on net over the past year. September's teenage rate dropped to 12.9%, its lowest rate since October 2000, while the adult (3.9%) and college grad (2.3) rates were both back at their May cyclical lows. Those working part-time for economic reasons (a.k.a. "involuntary part-time workers") fell for the third month, by a total of 204,000, to 5.12 million (3.2% of the civilian labor force), the lowest since March 2008. The sum of the underemployment and jobless rates (7.4) and the U6 rate (8.3)—which includes marginally attached workers—both fell to new cyclical lows.

Wages (*link*): Wage inflation—as measured by the average hourly earnings rate for all workers on private nonfarm payrolls (AHE)—was at 2.9% y/y, the highest rate this year. The wage rate for goods-producing industries (2.4% y/y) remained around recent lows, while service-providing's (2.9) accelerated to its highest reading since April 2009. Within goods-producing, the manufacturing rate (2.0) was little changed from August's 25-month low of 1.9%, while construction's (3.0) climbed to an eight-month high; the natural resources rate slowed to 1.4% y/y last month. Within service-providing, the rate for information services (5.2) was back up at its recent high, while the education & health services rate (2.4) eased from August's multi-year high. Rates for professional & business services (3.3) and financial activities (2.7) continued to move sideways, though both were at the top of their ranges. The rate for transportation & warehousing (2.7) remained stalled at recent highs, while wholesale trade's (1.8) held around recent lows. The utilities' rate (2.7) stayed on its volatile downtrend, though may be finding a bottom, while retail trade's (2.0) continued to move up from recent lows.

Consumer Credit (*link*): Consumer credit slowed in August as the pace on nonrevolving credit was more than cut in half. Credit advanced $13.1 billion, easing from July's $17.7 billion pace, as nonrevolving credit—which includes student loans—rose $7.3 billion, down from July's nine-month high of $15.7 billion. Meanwhile, the increase in revolving credit was more than double July's pace, climbing $5.8 billion, the second-largest gain so far this year.

GLOBAL ECONOMIC INDICATORS

Germany Manufacturing Orders (*link*): August orders rebounded to a new cyclical high. The Ministry noted that the solid upswing in manufacturing should continue given the high level of confidence among German businesses. Billings advanced for the third time in four months, soaring 3.6% in August and 5.3% over the period. August's increase reflected a 4.3% increase in foreign orders and a 2.7% gain in domestic ones, with the former driven by a 7.7% jump in billings from outside the Eurozone; foreign orders from within slipped 1.0%. The strength in orders from outside the Eurozone was widespread, with increases surpassing 9% in intermediate (9.7%) and consumer (9.3) goods orders—the former reaching a new record high. Capital goods orders jumped 6.9%. Intermediate goods orders from within the Eurozone were also robust, climbing 3.7%, but were more than offset by declines in capital (-4.1) and consumer (-1.3) goods orders. Intermediate goods also led the gain in domestic orders, up 6.6%, followed by a 5.9% jump in consumer goods billings; capital goods orders fell 1.3%.

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