MORNING BRIEFING
October 31, 2017

Is Everybody Happy?

See the collection of the individual charts linked below.

(1) Remembering Ted Lewis' catchphrases. (2) Consumer confidence highest since 2004. (3) Five Fed district business surveys pointing higher. (4) Eurozone confidence index points to faster real GDP growth. (5) Flash M-PMIs are hot. (6) Go Global beating Stay Home. (7) In perfect harmony. (8) Real hourly wage at record high. (9) Proprietors' income is strong, and as important as corporate profits to jobs growth. (10) Comprehensive measures of standard of living have been rising to record highs for quite some time.

Global Economy: Upbeat Goes On. "Is everybody happy?" was the catchphrase made famous by Ted Lewis, a multitalented entertainer who was popular before and after World War II. The answer to that question today is "Yessir!" That was another one of his well known catchphrases. Everybody seems to be happy in the US and Europe. Stock investors are joyous around the world. Consider the following happy stuff:

(1) *US consumer confidence.* The Consumer Sentiment Index, compiled by the University of Michigan Survey Research Center, jumped 5.6 points during October to 100.7, the highest reading since January 2004 (*Fig. 1*). Its two major components rose sharply too: The current conditions index rose 4.8 points to 116.5, the best level since November 2000, while the expectations index rose 6.1 points to 90.5 (*Fig. 2*).

(2) *US regional surveys.* The average of the business conditions indexes for the available five Fed regional surveys (New York, Philadelphia, Richmond, Kansas City, and Dallas) jumped from 14.0 in July to 24.1 this month—the highest reading since July 2004 (*Fig. 3*). The average of the new orders indexes showed billings rose from 11.9 to 21.3 over the same period, back near March's record high of 24.5. The average of the employment indexes jumped from 10.2 during July to 18.8 this month, the best jobs rate in the history of this series going back to June 2004. No wonder consumers are so happy!

(3) *European consumer & business confidence.* Everybody is very happy in Europe. That's according to the Economic Sentiment Index (ESI) for the European Union, which jumped this month to 114.2, the highest since June 2007 (*Fig. 4*). The Eurozone ESI kept pace, rising to 114.0, the highest since January 2001, suggesting that real GDP growth is continuing to improve in the region (*Fig. 5*). Leading the pack is Germany, where the ESI rose to 114.5, the highest reading since April 2011 (*Fig. 6*). Germany's Industrial ESI has been especially strong in recent months (*Fig. 7*).

(4) *Flash M-PMIs.* Markit's October flash M-PMI for the Eurozone rose to 58.6 this month, well above its reading of 53.5 a year ago (*Fig. 8*). October's flash for the region's NM-PMI has been hovering at an elevated range around 55.0 all year.

For the US, Markit also reported solid increases to solid levels in both the M-PMI (from 53.1 to 54.5) and NM-PMI (from 55.3 to 55.9) (*Fig. 9*).

(5) *Exports in GDP.* Boosting the Eurozone's growth is exports of goods and services (as measured in the region's real GDP), which rose 4.4% y/y during Q2 to a new record high (*Fig. 10*). This measure is up 19.9% over the past four years (since Q2-2013). US exports of goods and services in real GDP edged up to a record high during Q3-2017, but is only up 8.0% over the past four years (*Fig. 11*).

(6) *World stock markets.* Are you getting a warm fuzzy feeling about the global economy? You should be. Debbie and I have been since last fall. Over the same period, Joe and I have embraced a more Go Global investment posture with less commitment to our long-held Stay Home investment strategy. It's been working this year. Here is the performance derby (in dollars) for the major MSCI stock price indexes so far ytd through last Friday: Emerging Markets (28.8%), EMU (24.1), Japan (17.8), All Country (17.5), US (15.4), and UK (11.1) (*Fig. 12*).

Doesn't all this make you want to have a Coke? Blissed-out investors worldwide are swaying to the bubbly soda's theme song in celebration of the global synchronized boom:

I'd like to build the world a home,
And furnish it with love,
Grow apple trees and honey bees
And snow white turtle doves.
I'd like to teach the world to sing
In perfect harmony.
I'd like to hold it in my arms,
And keep it company.

US Consumers: Getting Personal. The Bureau of Economic Analysis in the Commerce Department released September data on personal income yesterday. It was all good news, though Fed officials must be depressed to see that the core PCED inflation rate at 1.3% y/y remains depressed below their 2% target (*Fig. 13*). The good news: Such a low inflation rate and lots of jobs are boosting consumer confidence and spending. We guess that means that everyone is happy except Fed officials. Consider the following happy developments:

(1) *Wages & salaries.* Wages and salaries in the private sector rose 3.4% y/y to a record high during September (*Fig. 14*). Inflation-adjusted average hourly earnings for production and nonsupervisory workers remained unchanged at a record high during September, and up 0.9% y/y (*Fig. 15*). It is up 19.5% since January 1999, belying the widely held notion that real incomes have stagnated for the past 18 years.

(2) *Proprietors' income.* One of the most neglected economic series of them all is the proprietors' income component of personal income (*Fig. 16*). It reflects the profits of small business owners, and tends to be about three-quarters as large as pre-tax corporate profits. As Debbie and I have observed in the past, small businesses account for lots of jobs in our economy. So it was good to see September's proprietors' income holding onto recent record highs. If Trump's tax reform agenda happens and it benefits proprietors' after-tax income, the result is likely to be greater demand for labor.

(3) *Standard of living.* Everybody is happy because most Americans have been enjoying increases in their standard of living (SOL) to record levels. You wouldn't know that based on the widely followed Census series on real median household income, which was up just 0.6% during 2016 compared to 1999 (*Fig. 17*). Much more accurate and comprehensive measures of the SOL are real mean household personal income and consumption. Both are at record highs, with the former up 25.8% since the start of 2000 and the latter up 28.2% over the same period. No wonder everybody is happy!

CALENDARS

US. Tues: Consumer Confidence Index 121.0, Employment Cost Index 0.7%, Chicago Fed PMI 62.0, S&P Corelogic Case-Shiller HPI 0.6%m/m/6.0%y/y, FOMC Meeting Begins. **Wed:** ADP Employment 220k, Total & Domestic Motor Vehicle Sales 17.5mu/13.6mu, ISM & Markit M-PMIs 59.5/54.5, Construction Spending 0.1%, MBA Mortgage Applications, EIA Petroleum Status Report, FOMC Announcement 1.125%. (*Wall Street Journal* estimates)

Global. Tues: Eurozone GDP 0.5%q/q/2.3%y/y, Eurozone Headline & Core CPI Flash Estimate 1.5%/1.0% y/y, Canada GDP 3.5% y/y, China M-PMI 52.1, BOJ Balance Rate & 10-Year Yield Target -0.10%/0.00%, Kuroda, Poloz, Wilkins. **Wed:** UK-MPI 55.9, China Caixin/Markit 51.0, Japan M-PMI, Poloz, Wilkins. (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—rebounded 7.3% during the four weeks ending October 21 to within 1.6% of its record high, posted during the final week of August. This follows a four-week period in which the WLI sank 8.6% on 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 jumped 13.2% over the most recent four-week period, after tumbling 13.7% the prior four weeks, as jobless claims fell to 239,500 (4-wa) from a 19-month high of 277,000 four weeks ago. Claims are nearing late May's 235,500—which was the lowest since April 1973. Meanwhile, the CRB raw industrial spot price index—another BBB component—is down, though may be finding a bottom in recent sessions. The WCCI is bouncing around recent highs.

S&P 500/400/600 Forward Earnings (*link*): Forward earnings rose to yet another record high last week for all three indexes. LargeCap's was higher for a 14th straight week, and SMidCaps' (i.e., MidCaps' and SmallCaps' forward earnings) were up for a 10th week. 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 will likely slow until tax reform occurs. In the latest week, LargeCap's forward earnings edged down to 9.7% y/y from a three-month high of 9.9%, 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 rose to a 69-month high of 14.4% from 14.0%, which compares to a six-year low of -1.3% in December 2015; and SmallCap's rose to an 11-week high of 10.4% from 9.9%, 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 10.6% and 11.6%, MidCap 9.6% and 15.4%, and SmallCap 4.9% and 22.0%.

S&P 500/400/600 Forward Valuation (*link*): Forward P/E ratios were flat for the three indexes last week. Looking at the weekly valuation, LargeCap's forward P/E of 18.0 is at the highest level since March 2004. It'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. SMidCap's P/Es had stalled for most of 2017 following the post-election melt-up, but are rising again recently. MidCap's forward P/E was steady at 20-week high of 18.3, and is higher than LargeCap's P/E again after being below during August and September for only the second time since 2009. MidCap's P/E remains below its 15-year high of 19.2 in late February and the record high of 20.6 in January 2002, but is up from a three-year low of 15.0 in January 2016. SmallCap's was steady at 19.9, 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 0.7ppt below SmallCap's record-high P/E of 20.9 in April 2002. Prices remain near record highs for all three indexes, but their "E"s still remain low 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 2.03 was at a record high, MidCap's 1.30 was down from a record high of 1.39 in early March, and SmallCap's 1.04 was 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*): Q4 earnings revisions activity has turned robust as companies provided official corporate guidance following the release of their Q3 results. The S&P 500's Q4-2017 EPS forecast dropped 19 cents w/w to $34.85, but that's down only 0.4% from $34.98 at the end of Q3. The $34.85 estimate represents a forecasted pro forma earnings gain for Q4-2017 of 11.9%, compared to Q3-2017's blended estimate/actual of 6.7%, Q2's 12.3%, and Q1's 15.3%, which was the strongest growth since Q3-2011 owing mostly to easier comps for Energy. Since the end of Q3, Q4 estimates are higher for four sectors and lower for seven. Energy's Q4 forecast has risen 11.4% followed by these sectors': Utilities (up 2.4%), Telecom (1.1), and Tech (0.5). Industrials' Q4-2017 forecast has fallen 9.4% for the worst decline, primarily due to the 44% decrease in GE's forecast. Also falling are Materials (-7.6), Real Estate (-2.9), and Consumer Discretionary (-2.1). The S&P 500's Q4-2017 forecasted earnings gain of 11.9% y/y would be its sixth straight gain after four declines. Nine of the 11 sectors are expected to record positive y/y earnings growth in Q4-2017, and four are expected to beat the S&P 500's forecasted y/y earnings gain of 11.9%. That's because analysts expect Energy to report another large profit jump in Q4 relative to very low earnings a year ago. That's better than Q3-2017, with eight sectors expected to rise y/y, but down from Q2-2017, when all 11 sectors rose y/y for the first time since Q3-2011. The latest forecasted Q4-2017 earnings growth rates vs. their blended Q3-2017 growth rates: Energy (108.3% in Q4 vs. 164.3% in Q3), Materials (26.3, 4.7), Financials (15.5, -7.3), Tech (12.4, 18.4), S&P 500 (11.9, 6.7), Consumer Discretionary (9.3, 3.1), Consumer Staples (9.0, 3.8), Utilities (8.6, -4.8), Health Care (6.2, 6.8), Industrials (5.4, 2.3), Telecom (-0.2, -2.0), and Real Estate (-0.6, 2.6). On an ex-Energy basis, S&P 500 earnings are expected to rise 10.0% y/y in Q4, up from 4.3% in Q3, which is the slowest growth since ex-Energy earnings rose just 2.2% in Q2-2016. That compares to gains of 9.6% in Q2 and 11.0% in Q1.

S&P 500 Q3 Earnings Season Monitor (*link*): With nearly 56% of S&P 500 companies finished reporting Q3-2017 earnings and revenue results through midday Monday, their percentage surprise and y/y growth results are mostly weaker compared to the same point during the Q2 earnings season, but more companies have reported positive y/y revenue and earnings growth. Of the 278 companies in the S&P 500 that have reported, 75% exceeded industry analysts' earnings estimates, by an average of 5.0%; they have averaged a y/y earnings gain of 9.5%. At the same point during the Q2-2017 reporting period, a lower percentage of S&P 500 companies (72%) had beaten consensus earnings estimates by a higher 5.8%, and earnings were up a higher 19.2% y/y. On the revenue side, 66% beat sales estimates so far, with results coming in 1.6% above forecast and 6.6% higher than a year earlier. At this point in the Q2 season, a higher 70% had exceeded revenue forecasts by a lower 1.4%, and sales rose a lower 5.9% y/y. Q3 earnings results are higher for 74% of companies, vs 65% at the same point in Q2, and revenues are higher for 83%, vs 85% a quarter ago. Although these figures will change markedly as more Q3-2017 results are reported in the coming weeks, particularly for the insurers, the early results are very encouraging. Q3-2017 should mark the fifth straight quarter of positive y/y earnings growth despite the negative impact of the three hurricanes. However, growth is likely to fall back into the low single digits following double-digit percentage growth in Q1 and Q2, which was the first double-digit growth seen since Q3-2011.

US ECONOMIC INDICATORS

Personal Income & Consumption (*link*): No sign of a slowdown in consumer spending in September's data. Real consumer spending rebounded 0.6% last month, more than reversing August's 0.1% downtick, and just shy of March's high for the year of 0.7%. (Some of the gain was likely hurricane-related as residents in Florida and Texas replaced hurricane-damaged motor vehicles, though the Commerce Department could not quantify the total impact of the storms.) Real goods consumption (1.4%) posted its best monthly gain since March 2015, led by a 3.5% surge in durable goods consumption, which was the strongest since March 2010; real nondurable goods spending was 0.3% higher. Real services consumption climbed 0.3%, a six-month high. Real wages & salaries ticked higher last month, reaching yet another new record high. Our Earned Income Proxy, which tracks consumer spending and wages & salaries closely, continues to set new highs, indicating stronger growth in both up ahead.

Regional M-PMIs (*link*): Five Fed districts have now reported on manufacturing activity for this month—New York, Philadelphia, Richmond, Kansas City, and Dallas—and they show growth in the sector accelerated for the third straight month to very high levels. We average the composite, orders, and employment measures as data become available. The composite index rebounded from 14.0 in July to 24.1 this month, the best reading since July 2004. The New York (to 30.2 from 24.4), Philadelphia (27.9 from 23.8), Dallas (27.6 from 21.3), and Kansas City (23 from 17) measures all accelerated sharply this month, while Richmond's (12 from 19) slowed. The employment measure (18.8 from 13.3) jumped to a new record high as Philadelphia (30.6 from 6.6) manufacturers hired at their best pace in the history of the series going back to May 1968, while Kansas City (21 from 18), Dallas (16.7 from 16.3), and New York (15.6 from 10.6) factories expanded payrolls at the fastest rates since March 2001, April 2014, and March 2015, respectively. Meanwhile, Richmond (10 from 15) manufacturers continued to add jobs, though at a slower pace. The new orders gauge showed billings (21.3 from 20.6) accelerated for the third month, climbing back near March's record high of 24.5, as billings in the Kansas City (27 from 10) and Dallas (24.8 from 18.6) regions accelerated sharply this month, more than offsetting an easing of orders' growth in the New York (18.0 from 24.9), Philadelphia (19.6 from 29.5), and Richmond (17 from 20) districts.

GLOBAL ECONOMIC INDICATORS

Eurozone Economic Sentiment Indicators (*link*): The October Economic Sentiment Indexes (ESI) for the Eurozone (+0.9 points to 114.0) and the EU (+1.1 points to 114.2) climbed to their highest readings since January 2001 and June 2007, respectively. This month, ESIs for four of the five largest Eurozone economies improved, led by a 2.1-point gain in Germany to 114.4—its best level since April 2001. Italy (+1.0 to 111.9), Spain (+0.3 to 110.2), and the Netherlands (+0.1 to 111.0) were also in the plus column, reaching their best levels since June 2006, December 2015, and November 2007, respectively. France's ESI fell to 110.0 from 111.6 in September—which was its highest reading since March 2001. At the sector level, increases in confidence were across the board: retail trade (+2.5 to 5.5), construction (+1.9 to 0.2), industry (+1.2 to 7.9), services (+0.8 to 16.2), and consumer (+0.2 to -1.0).

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