MORNING BRIEFING
November 20, 2017

Giving Thanks

See the collection of the individual charts linked below.

(1) Trick question: Who creates jobs, politicians or employers? (2) Businesses doing well despite Washington. (3) Cutting the government-imposed costs of doing business is a good thing. (4) For small business owners, government regulations are less of a problem than finding workers. (5) Small and medium companies hire more workers than large ones. (6) Just in time for the holidays: Cornucopia of good revenues and earnings. (7) Record-high forward revenues and earnings are bullish. (8) Profit margin remains at record high. (9) Q3 earnings would have been better but for the hurricanes.

US Economy: Thanks for the Jobs. Washington's politicians like to take credit for creating jobs. Washington's macroeconomic policymakers like to claim that their policies have moderated the business cycle. I continue to marvel at how well our economy performs despite Washington's meddling. In our economy, which remains relatively competitive and entrepreneurial, profitable businesses create jobs. Profitable businesses have the resources to grow by hiring more employees and expanding capacity. In our capitalist economy, businesses have a tendency to increase their profits. Washington's policies can either slow down this natural process or move out of the way and let businesses do what they do best, i.e., grow their businesses.

In this context, Trump's proposal to cut corporate tax rates and reduce government regulation on business is to be welcomed. We will soon find out whether the former may be harder to accomplish than the latter. Congress is in the midst of the messy process of passing major tax reform legislation that includes corporate tax cuts. Odds are, it will succeed. Large corporations won't benefit much because they've been gaming the tax code to lower their effective tax rate for many years. Smaller corporations, however, should benefit significantly. That's important, because ADP data show that smaller companies tend to do most of the hiring in the US. Consider the following:

(1) *Small business owners survey.* Last week, the National Federation of Independent Business released its monthly survey of small business owners. Debbie and I track the less volatile six-month averages of the percentages of them who say that their most important problem is one of the following: poor sales, taxes, government regulation, or credit conditions (*Fig. 1*). From October 2008 through July 2012, poor sales was the most frequent response in the survey. From 2014 through early 2016, it was a virtual tie between taxes and regulation.

Over the past 12 months through October, the percentage saying that regulation is the biggest problem dropped from 19.5% to 15.7% (*Fig. 2*). This percentage rose during the late 1980s through mid-1990s. It then mostly fell through 2008. It rose sharply under the Obama administration.

So far, small businesses are confirming that the Trump administration is providing them with regulatory relief. Taxes now show up in the survey as the most frequently cited problem faced by small business. If Congress cuts corporate tax rates, then there won't be much for small business owners to complain about.

Actually, the NFIB survey shows that the latest problem for small business owners is finding workers.

During October, 35.0% of them said that they have job openings, while 52.0% said that they have found few or no qualified applicants for those openings (*Fig. 3*).

The Small Business Optimism Index soared after Trump was elected, and continues to fluctuate around this year's cyclical high, which matches the optimism levels of 2003-04 (*Fig. 4*). It could match or exceed the record high of July 1983 if corporate taxes are cut.

(2) *ADP payrolls.* Small and medium companies do most of the hiring in our economy. That makes sense, since they aspire to grow their businesses into big ones. ADP has compiled private-sector payroll employment data since the start of 2005 for small (1-49 employees), medium (50-499), and large (over 500) firms. Since then through October of this year, small and medium firms have hired 6.5 million and 5.7 million workers, respectively, while large firms have added just 1.7 million to their payrolls (*Fig. 5*). During October, small and medium companies accounted for 41.1% and 36.0% of private-sector employment, while large ones accounted for just 22.9% (*Fig. 6*).

(3) *Forward revenues and earnings.* S&P 600 SmallCap forward revenues rose to a record high during the 11/9 week (*Fig. 7*). Industry analysts are forecasting revenues growth of 0.6% this year, 6.1% during 2018, and 5.5% during 2019. Not surprisingly, S&P 600 forward earnings was also at a record high during the 11/9 week. Industry analysts are estimating earnings growth of 4.9%, 18.3%, and 14.1% this year and over the next two years.

Strategy: Thanks for Revenues & Earnings. Joe reports that S&P 500 revenues and earnings data were released last week. On balance, there is much to be thankful for, thank goodness, since Thanksgiving is around the corner. Let's review the cornucopia of news we should be thankful to receive:

(1) *Revenues.* S&P 500 revenues per share rose 6.0% y/y to a record high during Q3 (*Fig. 8* and *Fig. 9*). The growth rate in this series on an aggregate (rather than per-share) basis is highly correlated with the comparable growth rate in US manufacturing and trade sales, which was up 6.4% during September. Growth rebounded from the energy-led revenue recession during 2015 (*Fig. 10* and *Fig. 11*).

(2) *Earnings & margins.* S&P 500 operating earnings per share (Thomson Reuters data) rose 6.8% during Q3 to a record high (*Fig. 12* and *Fig. 13*). The operating profit margin per share remained at a record high of 10.8% during Q3.

(3) *Forward revenues & earnings.* The weekly time series for S&P 500 forward revenues is a coincident indicator of S&P 500 quarterly revenues (*Fig. 14*). The former has been climbing on a steep vertical uptrend in record-high territory since early 2016 through the 11/9 week.

S&P 500 forward earnings has been following the same trajectory as forward revenues. The former is usually an excellent year-ahead leading indicator of actual four-quarter trailing operating earnings (*Fig. 15*). The only exception is that forward earnings never anticipates recessions.

(4) *Sectors.* Joe reports the following performance derby for the y/y operating earnings growth rates of the S&P 500 sectors (based on Thomson Reuters data): Energy (154.5%), Information Technology (20.5), S&P 500 (6.8), Health Care (6.1), Consumer Discretionary (6.0), Consumer Staples (4.7), Industrials (0.0), Telecom Services (-0.6), Real Estate (-0.9), Utilities (-5.7), Financials (-6.9), and Materials (-11.4). All in all, Q3's overall performance would have been better but for the hit that property and casualty insurance companies (in the Financials sector) took from a couple of nasty hurricanes.

CALENDARS

US. **Mon:** Leading Indicators 0.6%. **Tues:** Existing Home Sales 5.425mu, Chicago Fed National Activity Index 0.20, Yellen. (*Wall Street Journal* estimates)

Global. **Mon:** Draghi. **Tues:** RBA November Meeting Minutes, Lowe. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance (*link*): The US MSCI index fell 0.1% last week for its second straight decline, but its ranking was par for the course: 24th out of the 49 markets in a week when more countries fell (29) than rose (20) in US dollar terms. That compares to 30th a week earlier, when the US fell 0.2% as 16 countries moved higher. The AC World ex-US index fell 0.4% and underperform the US MSCI for the first time in three weeks; that result compares to a 0.2% decline a week earlier. EM Latin America was the best-performing region, with a gain of 0.7%, ahead of EM Asia (0.5), BRIC (0.3), and EMU (-0.2). EMEA was the worst-performing region, falling 1.3% w/w, followed by EM Eastern Europe (-1.0), and EAFE (-0.7). South Africa was the best-performing country, with a gain of 5.3%, followed by Thailand (2.7), and Israel (2.6). Egypt was the worst performer, dropping 5.0%, followed by Australia (-2.9) and Norway (-2.8). So far this year, the US MSCI is up 15.4%. Its ytd ranking dropped one place w/w to 31st of the 49 markets, and it continues to trail the AC World ex-US (20.5) on a ytd basis. Forty-four of the 49 markets are positive ytd, led by Argentina (60.7), China (51.8), Austria (49.1), Poland (46.3), and Korea (46.3). The worst country performers ytd: Pakistan (-27.2), Israel (-10.5), New Zealand (-3.8), Jordan (-2.6), and Russia (-1.9). EM Asia is the best-performing region ytd with a gain of 39.0%, ahead of BRIC (37.3) and EMU (23.2). The worst-performing regions, albeit with gains: EMEA (6.7), EM Eastern Europe (9.6), EAFE (17.9), and EM Latin America (18.6).

S&P 1500/500/400/600 Performance (*link*): LargeCap edged down 0.1% for its second straight weekly decline, but SmallCap rose 1.7% and MidCap gained 0.8% as both rebounded from two straight weekly declines. LargeCap ended the week 0.6% below its record high on November 8, but MidCap rebounded to 0.1% from its October 27 record and SmallCap to 1.1% below its October 3 record. Twenty-five of the 33 sectors rose w/w, compared to 15 a week earlier. Last week’s biggest gainers: SmallCap Consumer Discretionary (4.2%), MidCap Consumer Staples (3.2), SmallCap Health Care (2.8), and SmallCap Consumer Staples (2.6). Energy dominated last week’s worst performers: SmallCap Energy (-5.3), MidCap Energy (-3.7), and LargeCap Energy (-3.4). Twenty-five of the 33 sectors are positive ytd, up from 23 a week earlier, as LargeCap (15.2) continues to outperform both MidCap (10.8) and SmallCap (8.5). Health Care and Tech dominate the biggest sector gainers ytd: LargeCap Tech (36.6), SmallCap Health Care (28.4), MidCap Tech (25.5), MidCap Health Care (20.3), SmallCap Utilities (19.6), and LargeCap Health Care (17.8). Telecom and Energy dominate the worst performers ytd: MidCap Telecom (-49.3), SmallCap Energy (-31.4), MidCap Energy (-23.7), LargeCap Telecom (-17.8), and LargeCap Energy (-10.5).

S&P 500 Sectors and Industries Performance (*link*): Seven of the 11 sectors rose last week, and six outperformed the S&P 500’s 0.1% decline. This compares to five sectors rising a week earlier, when six outperformed the S&P 500’s 0.2% decline. Consumer Discretionary was the best-performing sector as its 1.3% gain beat these other outperforming sectors: Consumer Staples (1.0%), Telecom (0.8), Financials (0.3), Utilities (0.2), Materials (0.2), and Health Care (0.0). Energy (-3.4) was the worst performer, and was followed by these underperformers: Industrials (-1.1), Real Estate (-0.9), and Tech (-0.4). So far in 2017, nine of the 11 sectors are higher, but only three have outperformed the S&P 500’s 15.3% gain. If that holds to the end of the year, it would mark the narrowest number of outperforming sectors since 3/11 sectors beat the market in 2009, and 3/10 way back in 1982. The best performers in 2017 to date: Tech (36.6), Health Care (17.8), and Materials (16.8). The seven sectors underperforming the S&P 500 ytd: Telecom (-17.8), Energy (-10.5), Consumer Staples (6.1), Real Estate (8.7), Industrials (10.5), Financials (12.1), Utilities (14.2), and Consumer Discretionary (14.9).

Commodities Performance (*link*): Eight of the 24 commodities we follow rose last week as the S&P GSCI commodities index fell 0.8% for its first decline in four weeks. That compares to 18 commodities advancing a week earlier, when the GSCI index rose 1.9%. The week's strongest performers: Silver (3.1%), Sugar (2.7), and Gold (1.8). Last week's biggest laggards: Nickel (-4.4), Cocoa (-3.8), Lead (-3.5), and Feeder Cattle (-3.5). Industrial metals-related commodities dominate the best performers in 2017 so far: Aluminum (24.1), Zinc (24.0), Copper (22.3), Feeder Cattle (21.3), Lead (21.0), and Nickel (15.6). This year's laggards: Sugar (-21.2), Natural Gas (-14.3), Coffee (-7.2), Cotton (-1.8), and Soybeans (-1.3).

Assets Sorted by Spread w/ 200-dmas (*link*): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 7/24 commodities, 2/9 global stock indexes, and 21/33 US stock indexes compared to 17/24, 2/9, and 14/33 rising a week earlier, respectively. Commodities' average spread fell w/w to 5.3% from 6.6%. Eighteen commodities trade above their 200-dmas, up from 16 a week earlier. Heating Oil leads all commodities and all assets at 19.9% above its 200-dma, followed by Brent Crude (17.2) and GasOil (16.4). Sugar (0.2) rose 3.5ppts w/w for the best performance of all commodities. Lean Hogs (-4.9) trades the lowest of all commodities relative to their 200-dmas, followed by Coffee (-4.7) and Corn (-4.4). Nickel (11.9) tumbled 5.6ppts w/w for the worst performance of all commodities and all assets. The global indexes trade at an average of 7.1% above their 200-dmas, down from 7.6% in the prior week. Eight of the nine global indexes trade above their 200-dmas, down from nine a week earlier. China (12.8) now leads the global indexes followed by Japan (12.1), which fell 1.9ppts for the worst performance among the global indexes. Brazil (8.2) improved 1.6ppts w/w for the best performance among its peers. The UK (-0.2) trades the lowest among its country peers, followed by Canada (3.4). The US indexes trade at an average of 3.0% above their 200-dmas, with 27 of the 33 sectors above, up from an average of 2.5% a week earlier, when 27 sectors were above. LargeCap Tech leads all US stock indexes at 13.6% above its 200-dma, but SmallCap Consumer Discretionary (6.6) gained 4.0ppts w/w for the best performance of the US stock indexes. MidCap Telecom trades at a sharp discount relative to its 200-dma of 29.0%, the lowest among the US stock indexes and all assets. SmallCap Energy (-3.1) fell 4.3ppts w/w, for the worst performance among the US indexes last week.

S&P 500 Technical Indicators (*link*): Among the 11 sectors, four improved w/w relative to their 50-dmas and three relative to their 200-dmas. These three had improvements in both moving averages: Consumer Discretionary, Consumer Staples, and Telecom. Seven of the 11 sectors trade above their 50-dmas, down from eight a week earlier as Energy moved below for the first time in 10 weeks. Telecom was below for a sixth straight week and Health Care for a third week. Still, 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 similarly strong: Nine of the 11 sectors were above their 200-dmas last week, unchanged from a week earlier. Energy traded above its 200-dma for an eighth week after 29 weeks below; Consumer Staples was below its 200-dma for a ninth week after 32 straight weeks above; and Telecom ended the week below its 200-dma for a 34th straight week. Nine sectors are in a Golden Cross, with 50-dmas higher than their 200-dmas, unchanged from a week earlier. Energy was in the club for a second week after being out for 30 weeks. Consumer Staples was out of the Golden Cross club for a fifth week and for the first time since early March; Telecom was out for a 36th week. All 11 sectors had been in a Golden Cross during a 21-week streak that ended in late October of 2016, the longest such stretch since October 2014. Eight of the 11 sectors have rising 50-dmas, down from nine a week earlier as Health Care fell for the first time in 26 weeks. Consumer Staples' 50-dma has been falling for nine weeks, and Telecom's for seven weeks. Nine sectors have rising 200-dmas, unchanged from a week earlier. Energy's 200-dma fell for a 29th straight week, and Telecom's dropped for a 12th week.

S&P 500 Sectors Technical Indicators (*link*): The S&P 500 index remained in a Golden Cross last week for an 82nd week (after 17 weeks in a Death Cross), but both the short-term and long-term technicals weakened for a fourth straight week. The index's 50-day moving average (50-dma) relative to its 200-dma rose to a 14-week high of 4.3% from 4.1% a week earlier. That compares to a 34-month high of 5.4% in early April, a 39-week low of 3.4% in early October, 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 13th 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 12th 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 finished the week 1.2% above its rising 50-dma after falling to a 10-week low of 0.8% above on Thursday. That compares to 1.8% a week earlier, a 33-week high of 3.1% four weeks ago, and 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. On Friday, the S&P 500 rebounded to 5.5% above its rising 200-dma from a seven-week low of 5.0% a day earlier. That compares to 6.1% a week earlier, a 13-week high of 6.7% five weeks ago, and 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.

US ECONOMIC INDICATORS

Industrial Production (*link*): Headline output in October continued to rebound from August's hurricane-related drop, reaching its best level since the end of 2014. Output posted its strongest monthly performance in six months, up 0.9%, while revisions showed that September's (to 0.4% from 0.3%) gain was slightly more positive and August's (-0.5 from -0.7) loss was less negative. Manufacturing output jumped 1.3% last month, to a new cyclical high, after a 0.4% advance in September—which was stronger than the initial 0.1% estimate. Over the two months through October, production of business equipment and consumer goods products increased 2.1% and 1.3%, respectively, with the latter at a new cyclical high. The former saw solid gains in industrial (3.2%), information processing (1.1), and transit (0.6) equipment output over the two-month period; the latter followed suit, with durable and nondurable consumer goods production up 2.5% and 1.0%, respectively. Hurricane Nate (in early October) caused mining output to contract 1.3% during the month following September's 1.5% rebound; utilities usage jumped 2.0% after a two-month slide of 2.3%. Headline production expanded 2.8% y/y, the best rate since January 2015; manufacturing's (2.5% y/y) was the strongest since July 2014. ISM's November manufacturing survey showed that output remained strong, with the production index (61.0) posting its fifth straight reading above 60.0.

Capacity Utilization (*link*): The headline capacity utilization rate increased for the second month in October from 76.1% to 77.0% over the period—which was the best reading since April 2015. Still, it's 2.9ppts below its long-run (1972-2016) average. Industrial capacity expanded 1.2% y/y last month, accelerating steadily since dipping into negative territory in October 2016. Manufacturing's capacity utilization rate climbed from 75.2% to 76.4% over the two-month period, 2.0ppts below its long-run average. Manufacturing capacity was 0.7% above a year ago and has been hovering around that yearly growth rate since August 2016. Hurricanes continued to interrupt a long string of gains in the mining capacity utilization rate, which slipped to 82.4% in October after rising from 82.6% to 83.7% in September; the utilities' rate rose 1.5ppt to 77.2% last month.

Regional M-PMI (*link*): Three Fed districts so far have reported on manufacturing activity for this month—New York, Philadelphia, and Kansas City—and they show growth in the sector remains steadfast. We average the composite, orders, and employment measures as data become available. The composite index eased this month, though remains at a high level, slipping from 27.0 (which was the highest since July 2004) to 19.4 this month—averaging 22.4 the past four months. In all three regions, Philadelphia (to 22.7 from 27.9), New York (19.4 from 30.2), and Kansas City (16 from 23) growth slowed, though remained robust. The new orders gauge (21.4 from 21.5) was little changed for the third month, posting a steady reading from 21 to 22 since August. The Philly (21.4 from 19.6) and New York (20.7 from 18.0) regions showed slight pickups in orders' growth this month; meanwhile, the pace of Kansas City's (22 from 27) billings slowed, though still outpaced the other two regions by a slim margin. Our employment measure fell from 22.4 to 16.7 this month as manufacturers in the Philadelphia (22.6 from 30.6), New York (11.5 from 15.6), and Kansas City (16 from 21) regions continued to add to payrolls at a healthy pace, just not as fast as last month.

Housing Starts & Building Permits (*link*): Homebuilders in October broke ground on the most homes in a year, though housing activity still lacks momentum. Starts rebounded 13.7% last month to 1.290mu (saar)—the highest since last October—after a three-month slide of 6.7%, moving in a volatile flat trend the past year. Some of October's rebound likely reflects a fading in disruptions caused by recent hurricanes; home building continues to be hampered by shortages of land and labor as well as expensive lumber. Single-family starts rebounded 5.3% to an eight-month high of 877,000 units (saar), after a 4.4% decrease and a 3.6% increase the prior two months; volatile multi-family starts soared 37.1% in the two months through October, to 413,000 units, following a two-month plunge of 16.4%. Regionally, housing starts in the South rebounded 17.2% following the hurricanes, with the Northeast (42.2%) and Midwest (18.4) also in the plus column; starts in the West slipped 3.7%. Building permits are also moving sideways, climbing 5.9% to 1.297mu (saar) last month, after a 3.7% loss and a 3.4% gain the previous two months. Meanwhile, single-family permits advanced for the fourth time in five months, by 1.9% m/m and 7.7% over the period to 839,000 units (saar)—the best since fall 2007. Volatile multi-family permits rebounded 13.9% to 458,000 units (saar) after plunging 14.8% in October. Near the end of last week, the NAHB released its homebuilders' optimism index for November, which reached an eight-month high of 70—the second-highest reading (next to March's 71) since the housing bubble of 2005. The current sales component rose 2 points to 77, while the gauge for future sales dipped slightly to 77—both lofty levels; buyer traffic climbed 2 points to 50.

Import Prices (*link*): Import prices in October decelerated slightly, rising 2.5% y/y, after accelerating the prior two months from 1.2% to 2.7%. The rate was at a five-year high of 4.7% in February after bottoming at -11.6% in September 2015. The yearly rate for petroleum prices was in double digits for the third month at 14.9% y/y, slowing from 21.4% in September—rates well above the recent low of 3.2% y/y in June. October's rate is considerably below February's seven-year high of 74.1%. Nonpetroleum prices advanced 1.4% in the 12 months through October, hovering around that rate most of this year; the yearly rate had turned positive last December (0.3% y/y) for the first time since November 2014. Total import prices increased for the third month by 0.2% m/m and 1.6% over the period after a three-month decline of 0.5%. Nonpetroleum import prices rose 0.6% over the three months ending October after no change the prior three months.

GLOBAL ECONOMIC INDICATORS

European Car Sales (*link*): In October, EU passenger car registrations (a proxy for sales) returned to growth after September's decline—which resulted from a high basis of comparison. (ACEA had noted that the September 2016 figure was the highest total on record to date.) October sales rebounded 5.9% y/y, with nearly all the major EU markets performing well, led by double-digit gains in Spain (13.7% y/y) and France (13.7); sales in Italy (7.1) and Germany (3.9) were in single digits. Meanwhile, registrations in the UK contracted 12.2% y/y—its seventh consecutive negative reading. Once again, the report noted the strong performance in the new EU member states, where registrations were up 20.1% y/y. Through the first 10 months of this year, passenger car registrations advanced 3.9%, totaling more than 12.8 million new vehicles. Among the five largest markets, Italy (8.9) and Spain (7.3) once again posted the two strongest growth rates, followed by France (4.8) and Germany (2.3); UK sales slumped 4.6% ytd.

Eurozone CPI (*link*): October's CPI rate matched its flash estimate of 1.4% y/y, down from 1.5% the prior two months. It remains below the ECB's goal of just under 2.0%. Looking at the main components, energy (to 3.0% from 3.9% y/y) once again had the highest annual rate, though has slowed for the second month from August's 4.0%. Meanwhile, the yearly rates for the remaining components show food, alcohol & tobacco (2.3 from 1.9) accelerated at its fastest pace since February, while rates for services (1.2 from 1.5) and non-energy industrial goods (0.4 from 0.5) eased. The core rate—which excludes energy, food, alcohol, and tobacco—ticked down to 0.9% y/y, the first reading below 1.0% since May; it was at 1.2% in July and August, which was the highest rate in four years. Of the top four Eurozone economies, inflation rates in Spain (1.7% y/y) and Germany (1.5%) were above the Eurozone's 1.4%, while France's (1.2) and Italy's (1.1) were below. Ireland (0.5) had one of the region's lowest rates.

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