MORNING BRIEFING
December 11, 2017

Hot Money

See the collection of the individual charts linked below.

(1) What goes up attracts more buyers. (2) Is it a meltup if earnings are rising along with prices? (3) Flow-of-funds analysis showing lots of money pouring into stocks. (4) Equity ETF inflows at record high over past 12 months through October. (5) Lots of money pouring into mutual funds and ETFs that invest globally. (6) Revenue and earnings squiggles are upbeat. (7) Two obvious risks to the good times. (8) Labor market is tight, yet wages remain subdued. (9) Movie review: "Lady Bird" (+ +).

Strategy I: Equity ETFs Bubble. As the stock market continues to soar, it is attracting more money into stocks. That's what usually happens during meltups. Joe and I think the market may be in the early stages of a meltup. We will call it a "meltup" if our 2018 year-end target of 3100 for the S&P 500 is reached within the next 3-6 months rather than the next 12-18 months. To some observers, reaching 3100 by the end of next year may appear to be a meltup since it would mean that the S&P 500 would have risen 51.7% over the three years 2016-2018—i.e., 16.9% from Friday's close through the end of next year, following the 18.4% gain ytd and 9.5% during 2016 (*Fig. 1* and *Fig. 2*).

Maybe so, but let's see whether earnings continue to rise rapidly, providing fundamental support for the stock gains so far and in the year ahead. A cut in the corporate tax rate, effective next year, along with continued deregulation should bolster profits. So should a continuation of the global synchronized boom.

Meanwhile, the flow-of-funds case for a meltup is mounting as more hot money pours into equity ETFs. Let's follow the money:

(1) *All equity funds: Mutual & ETFs.* Over the past 12 months through October, equity ETFs attracted a record $375.6 billion of net new money (*Fig. 3*). Admittedly, some of that money might have come out of equity mutual funds, which had net outflows of $51.7 billion over this same period. Collectively, equity mutual funds and ETFs had net inflows of $323.9 billion, the best such pace since September 2014.

(2) *All equity funds: Domestic & global.* Over the past 12 months through October, the bulk of the inflows into all US-based equity funds went to those that invest globally. They attracted $240.6 billion, while all equity funds that invest domestically attracted $83.3 billion (*Fig. 4*).

(3) *Equity mutual funds: Domestic & global.* Interestingly, while $143.9 billion poured out of domestic equity mutual funds, $92.3 billion poured into US-based global mutual funds (*Fig. 5*).

(4) *Equity ETFs: Domestic & global.* The hottest hot money flows have been into both domestic ($227.2 billion) and global ($148.4 billion) equity ETFs (*Fig. 6*). The former was near recent record highs, while the latter made a new record high.

(5) *All bond funds: Mutual and ETFs.* Remarkably, net inflows into bond funds outpaced inflows into equity funds over the past 12 months. The bond funds attracted $415.8 billion, with $298.0 billion going

into bond mutual funds and $117.8 billion going into bond ETFs (*Fig. 7*). The total inflows into all bond funds was the best since March 2013.

(6) *All together.* All told, all funds attracted $739.7 billion over the past 12 months through October. That was the best pace on record, going back to mid-2003.

(7) *Bottom line.* Given these massive inflows, it's no wonder that bond yields remain remarkably low, despite the strengthening of economic activity, and that stock prices are continuing to rise in record-high territory.

Strategy II: Happy Squiggles. So far, the exuberance for stocks reflected in equity fund inflows is supported by the exuberance of industry analysts about the outlook for S&P 500 revenues and earnings. The weekly "squiggles" data for revenues and earnings show that industry analysts are turning increasingly bullish on the outlook for S&P 500 revenues and earnings:

(1) *Revenues*. Analysts' consensus expectations show revenues rising 6.2% this year, 5.6% in 2018, and 4.9% in 2019 (*Fig. 8*). Forward revenues, which is the time-weighted average of consensus estimates for the current year and next year, exceeds four-quarter-trailing revenues through Q3 by 7.1%.

(2) *Earnings.* Industry analysts are projecting earnings gains of 10.9% this year, 11.4% next year, and 10.1% in 2019 (*Fig. 9*). Presumably, these numbers don't fully reflect the likely big positive impact of a cut in the corporate tax rate next year.

If that happens before the end of this year, analysts may wait until Q4 earnings calls during January to get some guidance from company managements on how tax reform will impact their earnings estimates on balance. These calls are likely to be very bullish, driving stock prices higher early next year. Forward earnings is up to a record $145.06 per share, 13.2% above the four-quarter-trailing sum through Q3.

US Economy: Operating on All Cylinders. What could be more bullish for stocks than solid economic growth with low inflation and a likely cut in the corporate tax rate with the repatriation of lots of corporate cash from abroad? That's not a trick question. It's a rhetorical one. I can't think of a more bullish scenario.

There are two obvious risks in this scenario. One is that too much of a good thing may be too much of a good thing. With the economy operating on all cylinders, there's a risk that tax cuts might overheat the economy, triggering inflation. A more likely and immediate risk is a stock market meltup, which might set the stage for a meltdown. With so much money pouring into equity ETFs, the potential for a flash crash in these funds can't be ruled out.

But let's not dwell on hypothetical bearish scenarios when the unfolding scenario remains very bullish. The global economy is showing more and more signs of booming. So is the US economy. As Debbie discusses below, the labor market continues to run hot for payroll gains, while wage inflation remains cool:

(1) *Employment.* Payroll employment is up 2.1 million over the past 12 months through November to a record 147.2 million. The household measure of full-time employment rose to a record high of 126.8 million. The adult unemployment rate was unchanged at 3.7%, the lowest since March 2001. The short-term unemployment rate was only 3.1%, while the long-term jobless rate fell to 1.0% (*Fig. 10*).

(2) *Wages.* Average hourly earnings rose 2.5% y/y through November. While that remains surprisingly

low given the tightness of the labor market, it's still ahead of the CPI inflation rate of 2.0% y/y through October. Real hourly pay is at an all-time high. It hasn't stagnated as widely misconceived.

(3) *Earned Income Proxy.* Our Earned Income Proxy for wages and salaries in the private sector rose solidly by 0.7% m/m and 4.8% y/y, the highest since January 2016 (*Fig. 11*).

At the same time that the latest consumer data are showing continued strength, so are housing indicators. Furthermore, capital spending indicators are showing more of it over the past year. Record truck tonnage and intermodal railcar traffic confirm that the economy is operating on all cylinders.

Movie: "Lady Bird" (+ +) (*link*) is a really fine movie about a 17-year-old girl growing up in Sacramento. She is from the wrong side of the tracks, but overcomes her economic disadvantages with poise and smarts. It's more universal than a typical coming-of-age movie about some confused teenager. It's all about learning to live in your own skin and being happy about it.

CALENDARS

US. Mon: Job Openings 6.093m. **Tues:** NFIB Small Business Optimism Index 104.2, PPI-FD Headline, Core, and Core Less Trade Services 0.3%/0.2%/0.3%, Treasury Budget -$134.0b, FOMC Meeting Begins. (*Wall Street Journal* estimates)

Global. Mon: None. **Tues:** Eurozone ZEW Economic Sentiment, Germany ZEW Survey Expectations 18.0, UK Headline & Core CPI 3.0%/2.7% y/y, Japan Machine Tool Orders 2.7%m/m/-3.9%y/y, Lowe. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance (*link*): The US MSCI index rose 0.3% last week for its third straight gain, and ranked 16th out of the 49 markets as 16 countries rose in US dollar terms. That compares to fifth a week earlier, when it rose 1.4% as 12 countries moved higher. The AC World ex-US index edged down 0.1% and has underperformed the US MSCI in seven of the last 11 weeks; that result compares to a 1.5% decline a week earlier, which was its worst performance in 16 weeks. EMU performed best last week with a gain of 0.9%, followed by EMEA (0.5%), EAFE (0.1), and BRIC (0.0). EM Latin America (-1.0%) was the worst-performing region, followed by EM Eastern Europe (-0.7), and EM Asia (-0.2). Turkey was the best-performing country, with a gain of 6.5%, followed by Argentina (5.8), Ireland (2.6), Indonesia (2.6), and Italy (2.2). Egypt was the worst performer as it fell 3.9%, followed by Chile (-3.5) and South Africa (-3.0). The US MSCI is up 18.5% ytd, with its ranking up two places w/w to 23rd of the 49 markets and up 11 places in the last two weeks, but continues to trail the AC World ex-US (20.7) on a ytd basis. Forty-four of the 49 markets are positive ytd, led by Argentina (73.4), Austria (49.9), China (46.6), Poland (44.4), Korea (41.9), and India (31.3). The worst country performers ytd: Pakistan (-29.8), Israel (-5.7), Russia (-2.6), Egypt (-0.5), and Jordan (-0.5). EM Asia is the best-performing region ytd with a gain of 35.6%, ahead of BRIC (34.2) and EMU (24.8). The worst-performing regions, albeit with gains: EMEA (6.5), EM Eastern Europe (8.6), EM Latin America (15.4), and EAFE (19.1).

S&P 1500/500/400/600 Performance (*link*): LargeCap was the only index to reach a record high last week. LargeCap rose 0.4% and outperformed both MidCap (-0.2%) and SmallCap (-1.0). LargeCap ended the week at a new record high, but MidCap was 0.4% below its November 30 record and SmallCap was 1.7% below its November 29 record. Twelve of the 33 sectors rose w/w, compared to 27 a week earlier. Last week's biggest gainers: LargeCap Financials (1.5), SmallCap Consumer Discretionary (1.4), LargeCap Industrials (1.4), and MidCap Materials (1.0). SmallCaps dominated last week's worst performers: SmallCap Energy (-4.0), SmallCap Telecom (-4.0), MidCap Energy (-3.6), SmallCap Tech (-2.4), and SmallCap Materials (-1.8). Twenty-seven of the 33 sectors are positive ytd, down from 28 a week earlier, as LargeCap (18.4) continues to outperform both MidCap (13.9) and SmallCap (10.8). Health Care and Tech dominate the biggest sector gainers ytd: LargeCap Tech (36.3), SmallCap Health Care (31.8), MidCap Tech (24.2), MidCap Health Care (21.6), SmallCap Utilities (20.4), LargeCap Health Care (20.2), and MidCap Industrials (20.2). Telecom and Energy dominate the worst performers ytd: MidCap Telecom (-46.1), SmallCap Energy (-31.5), MidCap Energy (-22.7), LargeCap Telecom (-10.5), LargeCap Energy (-8.1), and MidCap Real Estate (-0.1).

S&P 500 Sectors and Industries Performance (*link*): Seven of the 11 sectors rose last week, and five outperformed the S&P 500's 0.4% gain. This compares to nine sectors rising a week earlier, when seven outperformed the S&P 500's 1.5% rise. Financials was the best-performing sector as its 1.5% gain beat these other outperforming sectors: Industrials (1.4%), Consumer Staples (0.6), Consumer Discretionary (0.5), and Materials (0.5). Utilities (-1.0) and Real Estate (-1.0) were the worst performers, followed by these underperformers: Energy (-0.7), Health Care (-0.4), Tech (0.1), and Telecom (0.2). So far in 2017, nine of the 11 sectors are higher, but five are now outperforming the S&P 500's 18.4% gain versus just three outperforming after Thanksgiving. The best performers in 2017 to date: Tech (36.3), Health Care (20.2), Financials (19.9), Consumer Discretionary (19.2), and Materials (18.9). The six sectors underperforming the S&P 500 ytd: Telecom (-10.5), Energy (-8.1), Real Estate (7.4), Consumer Staples (9.3), Utilities (14.1), and Industrials (16.7).

Commodities Performance (*link*): Just two of the 24 commodities we follow rose last week, the lowest since July 2015 as the S&P GSCI commodities index tumbled 2.1% for its biggest weekly decline in 24 weeks. That compares to 12 commodities advancing a week earlier, when the GSCI index fell 0.4%. The week's strongest performers: Cotton (0.6%), Soybeans (0.0), GasOil (-0.6), Heating Oil (-0.7), and Brent Crude (-0.8). Last week's biggest laggards: Natural Gas (-9.2), Cocoa (-7.5), Sugar (-6.2), Coffee (-5.4), and Zinc (-5.2). Energy-related commodities are doing best so far in Q4: Lean Hogs (14.8), Brent Crude (11.4), Crude Oil (11.1), and Unleaded Gasoline (8.3). Food-related commodities are among Q4's weakest performers to date: Cocoa (-7.6), Natural Gas (-7.5), Wheat (-6.5), Feeder Cattle (-6.2), and Kansas Wheat (-5.6). Industrial metals-related commodities dominate the best performers in 2017 so far: Lead (21.8), Zinc (20.0), Copper (18.6), and Aluminum (18.5). This year's laggards: Sugar (-28.0), Natural Gas (-25.3), Cocoa (-11.2), Coffee (-10.5), Silver (-1.0), and Soybeans (-1.0).

Assets Sorted by Spread w/ 200-dmas (*link*): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 2/24 commodities, 5/9 global stock indexes, and 11/33 US stock indexes, compared to 11/24 commodities, 1/9 global stock indexes, and 26/33 US stock indexes rising a week earlier. Commodities' average spread tumbled w/w to 1.8% from 5.2%. Thirteen commodities trade above their 200-dmas, down from 17 a week earlier. Brent Crude still leads all commodities and all assets at 17.5% above its 200-dma, but Cotton (2.1%) rose 0.7ppts w/w for the best performance of all commodities. Brent Crude is followed closely by Heating Oil (17.1), GasOil (15.9), and Crude Oil (14.8). Natural Gas (-9.4) now trades at the lowest of all commodities relative to their 200-dmas as it fell 9.2ppts for the worst performance of all commodities and all assets. The global indexes trade at an average of 4.7% above their 200-dmas, up slightly from 4.6% in the prior week. Seven of the nine of the global indexes trade above their 200-dmas, down from eight a week earlier. Japan (12.8) leads the global indexes, but Germany (4.7) rose 2.1ppts for the best performance among global assets. Chile (-2.2) fell 2.9ppts for the worst performance among the global indexes, and now trades the lowest among its country peers, followed by UK (-0.1). The US indexes trade at an average of 5.2% above their 200-dmas, with 31 of the 33 sectors above, down from an average of 6.0% a week earlier, when 31 sectors were above. LargeCap Financials now leads all US stock indexes at 12.3% above its 200-dma, as it improved 1.3ppts w/w for the best performance of the US stock indexes. It's followed closely by SmallCap Health Care (11.6), LargeCap Tech (11.5), SmallCap Industrials (11.4), MidCap Industrials

(11.3), and SmallCap Consumer Discretionary (11.1). MidCap Telecom trades at a sharp discount relative to its 200-dma of 20.4%, the lowest among not just the US stock indexes but all assets. SmallCap Telecom (1.4) fell 4.4ppts w/w for the worst performance among the US indexes last week.

S&P 500 Technical Indicators (*link*): The S&P 500 index remained in a Golden Cross last week for an 84th week (after 17 weeks in a Death Cross) as the short-term technical picture weakened for the first time in three weeks and the long-term trend improved for a third straight week. The index's 50-day moving average (50-dma) relative to its 200-dma rose to a 23-week high of 4.9% from 4.6% 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 15th 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 14th 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. However, the S&P 500 dropped to 2.7% above its rising 50-dma from a five-week high of 2.8% above a week earlier, which compares to a 33-week high of 3.1% above eight 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% in December 2016 and a 52-month high of 6.2% in March 2016. The S&P 500 rose last week to a 38-week high of 7.7% above its rising 200-dma from 7.6% a week earlier, which compares to a post-election 38-month high of 9.4% on March 1, a post-election low of 3.0% in mid-August, and an eight-month low of -0.1% immediately before the 2016 election.

S&P 500 Sectors Technical Indicators (*link*): Among the 11 sectors, five improved w/w relative to both their 50-dmas and their 200-dmas—Consumer Staples, Financials, Industrials, Materials, and Telecom—while Consumer Discretionary improved relative to just its 200 dma. All 11 sectors trade above their 50-dmas, unchanged from a week earlier but up sharply from six at the end of November; this is the first time since mid-January that all 11 have been above their 50-dmas. In contrast, the week before the 2016 election, all 11 were below (for the first time since December 11, 2015). The longer-term picture is similarly strong: All 11 sectors were above their 200-dmas last week for the first time since mid-February, up from 10 a week earlier, as Telecom turned positive for the first time since mid-March. For the past five weeks, nine sectors have been in a Golden Cross, with 50-dmas higher than 200-dmas. Consumer Staples was out of the Golden Cross club last week for an eighth week, and Telecom was out for a 40th 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. Ten of the 11 sectors have rising 50-dmas, unchanged from a week earlier as Telecom's 50-dma fell for a tenth week. Nine sectors have rising 200-dmas, also unchanged from a week earlier, as Telecom's 200-dma fell for a 15th straight week and Energy's 200-dma dropped for a 33rd week.

US ECONOMIC INDICATORS

Employment (*link*): Employment posted another solid gain in November, climbing to another record high. US companies added 228,000 to payrolls last month. Revisions show October's (to 244,000 from 261,000) gain was smaller than first reported, while September's (to 38,000 from 18,000) was larger, for a net gain of 3,000 over the two-month period. Meanwhile, private payrolls climbed 221,000, following increases of 247,000 (vs 252,000) and 50,000 (15,000) for a two-month net gain of 30,000. The breadth of job creation (percent of private industries increasing payrolls) for both the one-month (63.0%) and three-month (67.2) spans were above 60.0% for the sixth straight month.

Earned Income Proxy (*link*): Our Earned Income Proxy (EIP) in November continued to set new record highs. It has increased in 11 of the last 12 months, jumping 0.7% last month—the biggest gain this year. Average hourly earnings, one of the components of our EIP, climbed 0.2% last month after slipping 0.1% in October, while aggregate weekly hours, the other component, rose 0.5% after an upwardly revised 0.3% in October. On a y/y basis, our EIP accelerated 4.8% y/y, up from 4.0% in October and the most since the start of 2016. The AHE rate picked up slightly to 2.5% y/y from October's 2.3% gain, though remained below September's 2.8%, which matched its high for the year. Aggregate hours accelerated 2.3% y/y—its first reading above 2.0% since January 2016's 2.4%. Our proxy tracks income and spending closely and continues to predict solid gains in both.

Employment by Industry (*link*): Leading gains in November payrolls were professional & business services, manufacturing, health care, and construction. Professional & business services increased payrolls by 46,000 last month, matching its average monthly gain so far this year; this industry has boosted payrolls 548,000 the past 12 months. Factories continued to expand payrolls, adding 31,000 jobs last month and 189,000 since the recent low in November 2016. Health care jobs have continued to trend higher, expanding 29,500 in November and 303,600 the past 12 months. Construction companies have reduced payrolls only once in the past 15 months, adding 24,000 jobs last month and 251,000 since last September. Employment in other major industries—including mining, wholesale trade, retail trade, transportation & warehousing, information services, financial activities, leisure & hospitality, and government—showed little change last month.

Unemployment (*link*): November's unemployment rate held at a 17-year low of 4.1%, while the participation rate was unchanged at 62.7%; the latter has showed little movement on net over the past year. The adult (3.7%) rate was unchanged at its cyclical low, while the college grad (2.1) rate was little change from October's cyclical low of 2.0%. Meanwhile, the teenage rate (15.9%) rose for the second month since dropping to 12.9% in September, which was the lowest rate since October 2000. Those working part-time for economic reasons (a.k.a. "involuntary part-time workers") edged up 48,000 to 4.8 million (3.0% of the civilian labor force), after falling 573,000 the prior four months to its lowest reading December 2007. The sum of the underemployment and jobless rates (7.1) held at its cyclical low, while the U6 rate (8.0)—which includes marginally attached workers—ticked up slightly from October's cyclical low of 7.9%.

Wages (*link*): Wage inflation—as measured by the average hourly earnings rate for all workers on private nonfarm payrolls (AHE)—accelerated to 2.5% y/y last month from October's 2.3%, though remained below its high for the year of 2.8% posted in September and February. The wage rate for goods-producing industries (2.3% y/y) picked up after slowing to 1.8% in October, which was the lowest rate since July 2015. The service-providing rate was unchanged at 2.5% y/y, holding below September's 2.9%, which was the highest since April 2009. Within goods-producing, the manufacturing rate (1.9) edged up slightly from October's 28-month low of 1.5%, while construction's (2.9) was just below September's eight-month high of 3.0%; the natural resources rate (1.6) moved back above 1.0%. Within service-providing, the rate for information services (3.4) ticked up after slowing the prior three months from a recent high of 5.2% in July to 3.2% in October, while the education & health services rate (2.4) edged up after easing from a multi-year high of 2.6% in August to 2.0% in October; wholesale trade's (1.6) moved back above 1.0% after sinking below in October. Rates for professional & business services (2.5) and transportation & warehousing (2.8) remained stalled at recent highs, while the financial activities (3.4) rate was little changed from October's four-year high of 3.6%. The utilities' rate (3.2) is up from recent lows, while retail trade's (1.1) fell to its lowest level since the end of 2013.

Consumer Sentiment (*link*): Confidence in mid-December fell for the second month, though has remained trendless since the start of the year. The Consumer Sentiment Index (CSI) slipped to 96.8 this month after rebounding 5.6 points in October to a 13-year high of 100.7. Richard Curtin, chief economist of Surveys of Consumers, noted that most of the recent decline was concentrated in the long-term prospects for the economy. The present situation component climbed from 113.5 to 115.9 this month, the second best reading since November 2000—behind October's 116.5 reading. Meanwhile, the expectations component slipped for the second month to 84.6, though is still within 5.9

points of October’s 33-month high of 90.5.

Consumer Credit (*link*): Consumer credit accelerated in October for the second month and at its fastest pace this year, as revolving credit picked up for the third month. Credit advanced $20.5 billion, up from downwardly revised gains of $19.2 billion (from $20.8 billion) in September and $11.4 billion ($13.1) in August. Revolving credit jumped at an 11-month high of $8.3 billion, accelerating steadily from July’s $0.2 billion, with credit card debt exceeding $1.0 trillion for the first time in the history of the series going back to 1968. Meanwhile, nonrevolving credit, which includes student and auto loans, rose $12.2 billion, easing from $13.2 billion in September but double August’s rate of $6.4 billion.

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