MORNING BRIEFING
December 13, 2017

Go With the Flows

See the collection of the individual charts linked below.

(1) From global energy-led rolling recession in 2015 to recovery in 2016, and boom in 2017-2018 (?). (2) Global manufacturing PMIs are running hot. (3) China's exports and imports are back to record highs. (4) Citigroup Economic Surprise Index is highly elevated in the US. (5) Odd downward revision in GDPNow. (6) OECD leading indicators led higher by Germany and Brazil. (7) Americans collectively have never been richer as stock prices soar and home values rebound. (8) The Buffett Ratio is back to its previous record high.

Global Economy: Synchronized Boom. It's now widely known that one of the main reasons why global stock markets are soaring is that the global economy is booming. That wasn't as widely recognized during the second half of 2016, when Debbie, Joe, and I spotted more signs the global energy-led economic slowdown and earnings recession were coming to an end. This year, there is mounting evidence of a global synchronized boom. The pace of economic activity has quickened in both the advanced and emerging economies. Consider the following latest developments:

(1) *Global PMIs.* The JP Morgan global M-PMI has soared from last year's low of 50.0 during February to 54.0 during November (*Fig. 1*). Leading the way has been the advanced economies' M-PMI, which is up from 50.8 to 55.8 over this period. Trailing, but still improving considerably, has been the emerging economies' M-PMI, up from 48.9 to 51.7 over this period. The global NM-PMI has stalled around 54.0 since the start of the year, but it is up smartly from the recent low of 50.7 during February 2016.

The performance derby among the advanced economies' M-PMIs is as follows for November: Eurozone (60.1), UK (58.2), US (58.2), and Japan (53.6) (*Fig. 2*). The M-PMIs for economies within the Eurozone are smoking: Germany (62.5), Italy (58.3), France (57.7), and Spain (56.1) (*Fig. 3*). Here is a similar rundown for the BRICs' M-PMIs: Brazil (53.5), India (52.6), China (51.8), and Russia (51.5) (*Fig. 4*).

(2) *China's trade.* Debbie and I also give a lot of weight to China's merchandise trade data as an indicator of global economic activity. These data are among the most timely of the global economic indicators since they are released about two weeks after the end of each month; for example, November data became available on the 7th of this month (*Fig. 5*).

The latest data, in yuan, show that exports are up 10.5% y/y, matching the record high earlier this year. Imports are up 15.2% y/y, nearly matching the record high back during January 2014.

(3) *Positive surprises in the US.* The Citigroup Economic Surprise Index for the US rose to 69.0 yesterday, the highest since early 2014 (*Fig. 6*). On the other hand, the Atlanta Fed's GDPNow model forecast for real GDP growth (seasonally adjusted annual rate) in Q4-2017 was lowered to 2.9% on December 8, down from 3.2%. Oddly, despite the strength of payroll employment, the downward revisions was explained as follows: "The forecasts of real consumer spending growth and real private fixed-investment growth declined from 2.8 percent and 8.1 percent, respectively, to 2.5 percent and 7.0

percent, respectively, after this morning's employment report from the U.S. Bureau of Labor Statistics." That's an odd duck, in our opinion.

(4) *Global leading indicators.* The OECD leading indicators was unchanged at 100.1 during October; it had been below 100 from September 2015 through February of this year (*Fig. 7*). That latest reading certainly isn't showing that a global boom is underway, but it's an indicator that hasn't shown much amplitude other than during extreme booms or extreme busts.

Among the strongest economies according to the OECD leading indicators are those of Germany (not surprisingly) and Brazil (surprisingly so) (*Fig. 8* and *Fig. 9*).

US Flow of Funds: Lots of Money. The Fed recently released the latest quarterly *Financial Accounts of the United States* through Q3. The big story is how much wealth has been accumulated since the financial crisis of 2008. To see this, let's see how much higher wealth is now than it was during the previous peak, before stock prices and home values crashed:

(1) *Total household net worth* rose to a record \$96.9 trillion, up \$29.1 trillion from the Q2-2007 peak (*Fig. 10*). The ratio of this measure to disposable personal income rose to a record high of 6.7, exceeding the previous high of 6.5 at the start of 2007 (*Fig. 11*).

(2) *Household wealth increases across several asset classes.* Households have a record \$22.9 trillion in pension fund reserves, up \$7.8 trillion from the 2007 peak (*Fig. 12*). Corporate equities directly held by households rose to a record \$17.3 trillion, exceeding the 2007 peak by \$6.4 trillion. At \$14.1 trillion, owner's equity in household residential real estate has now fully recovered its losses from the recent housing debacle.

(3) *Stock market valuation.* The total market capitalization of all equities traded in the US rose to a whopping \$43.7 trillion during Q3 (*Fig. 13*). It's up \$30.3 trillion since the Q1-2009 bottom, and exceeds the 2007 peak by \$17.3 trillion. The big holders of equities in the US are households (\$17.3 trillion), equity mutual funds and ETFs (\$12.9 trillion), foreign investors (\$6.6 trillion), and institutional investors (\$3.7 trillion) (*Fig. 14*).

The Buffett Ratio—which is the ratio of the market value of US equities divided by GNP—rose to 1.78 during Q3 (*Fig. 15*). That nearly matches the record high of 1.80 during Q1-2000. A similar ratio of the S&P 500 market cap to S&P 500 revenues rose to 2.02, slightly exceeding its previous peak of 2.01 during Q4-1999.

CALENDARS

US. Wed: Headline & Core CPI 2.2%.1.8% y/y, MBA Mortgage Applications, EIA Petroleum Status Report, FOMC Meeting Announcement 1.375%, FOMC Press Conference. **Thurs:** Retail Sales Total, Ex Autos, Ex Autos & Gas, and Control Group 0.3%/0.7%/0.4%/0.4%, Business Inventories -0.1%, Jobless Claims 239k, Import & Export Prices 0.7%/0.3%, PMI Flash Estimates, Weekly Consumer Comfort Index, EIA Natural Gas Report. (*Wall Street Journal* estimates)

Global. Wed: Eurozone Industrial Production 0.1%m/m/3.3%y/y, Germany CPI 0.3%m/m/1.8%y/y, UK Claimant Count Rate, Kuroda. **Thurs:** European Car Sales, Eurozone, Germany, and France Composite PMI Flash Estimates 57.2/57.2/59.5, Eurozone, Germany, and France M-PMI Flash Estimates 59.7/62.0/57.2, Eurozone, Germany, and France NM-PMI Flash Estimates 56.0/54.6/59.9, UK Retail Sales Including & Excluding Auto Fuel 0.3%/0.2% y/y, Japan Industrial Production, Japan Tankan Survey, China Retail Sales 10.3% y/y, China Industrial Production 6.2% y/y, China Fixed

Assets Ex Rural 7.2% y/y, Australia Employment Change & Unemployment Rate 19k/5.4%, ECB Rate Decision, Marginal Lending Facility, and Deposit Facility Rates 0.00%/0.25%/-0.40%, BOE Bank Rate & Asset Purchase Target 0.5%/435b, Draghi, Poloz. (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—remains stalled just below its record high reached during the final week of October. Our WLI was little changed for the third week during the week of December 2, just 2.5% below its record high. Our WLI is the average of our Boom-Bust Barometer (BBB) and Bloomberg's Weekly Consumer Comfort Index (WCCI). Our BBB rose for the first time in five weeks, edging up 0.5%, to within 4.7% of its record high. Jobless claims, one of the components of our BBB, edged down to 241,500 (4-wa) after climbing the prior three weeks from 231,250 (which was the lowest reading since March 1973) to 242,250; the CRB raw industrial spot price index—another BBB component—is climbing again. Meanwhile, the WCCI continues to bounce around recent highs.

S&P/Russell LargeCaps & SMidCaps (*link*): The LargeCap price indexes are at record highs while the SMidcaps are down slightly to as much 1.4% below their record highs in recent weeks. Since the election, the SmallCap market-cap indexes have outperformed LargeCaps and MidCaps. On a ytd basis, the LargeCaps are easily beating the SMidCaps, and the gap has widened recently. Here's the ytd score through Monday's close and their percentage changes since Election Day: S&P LargeCap 500 (18.8% ytd, 24.3% since the election), Russell LargeCap 1000 (18.7, 24.4), Russell MidCap (15.7, 22.4), S&P MidCap 400 (13.7, 24.8), Russell SmallCap (12.0, 27.2), and S&P SmallCap 600 (10.4, 27.4). Forward revenues and earnings are at record highs now for all the S&P and Russell indexes. The yearly changes in forward earnings for the S&P indexes are up from six-year lows in early 2016, and should remain strong whether the new tax rates take effect in 2018 or 2019. In the latest week, the rate of change in the LargeCap's forward earnings edged up to a 70-month high of 10.3% y/y from 10.2%, which compares to a six-year low of -1.8% in October 2015; MidCap's rose to a 72-month high of 16.4% from 15.8%, which compares to a six-year low of -1.3% in December 2015; and SmallCap's dropped to 10.5% from 11.1%, 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 and 2018 have remained strong throughout this year instead of falling. Furthermore, the growth rates for 2018 should improve for all three indexes if the corporate tax rate change becomes effective in 2018. Here are the latest consensus earnings growth rates for 2017 and 2018: LargeCap 11.4% and 11.2%, MidCap 11.3% and 14.2%, and SmallCap 4.3% and 20.7%.

S&P 500 Growth vs. Value (*link*): The S&P 500 Growth index is up 25.2% ytd, well ahead of the 11.6% gain for its Value counterpart. However, Value's 3.7% gain since the end of October is ahead of Growth's 2.9% rise. Growth had trailed Value in the four months following the election. Now, Growth's 27.5% gain since the election is leading the 20.1% increase for Value. During 2016, the S&P 500 Growth index underperformed its Value counterpart by a wide margin, rising just 5.1% vs Value's 14.3% gain. Growth is expected to deliver nearly double the rate of revenue growth (STRG) than Value over the next 12 months, but forward earnings growth (STEG) is the same for both investment styles: 8.1% STRG and 11.1% STEG for Growth, respectively, vs 4.2% and 11.1% for Value. Growth's P/E of 20.8 is the highest since February 2004, while Value's 16.0 is down from early March's 14-year high of 16.2. Regarding NERI, Growth's was positive in November for a seventh month, but dropped to a still-strong 3.1% from 5.2% the prior month. It remains close to June's six-year high of 8.0%; that compares to a five-year low of -16.2% in April 2015. Value's NERI was also positive in November for a seventh month (following 33 months of negative readings), but barely so as it dropped to 0.3% from 0.8% in October. It's down from June's six-year high of 4.7%; that compares to a five-year low of -20.3% in April 2015.

US ECONOMIC INDICATORS

NFIB Small Business Optimism Index (*link*): November's Small Business Optimism Index (SBOI) soared past 107, closing in on a new record high! The SBOI jumped 3.7 points last month to 107.5—within 0.5ppt of July 1983's record high of 108.0. According to NFIB's chief economist, "NFIB indicators clearly anticipate further upticks in economic growth, perhaps pushing up toward four percent GDP growth for the fourth quarter. This is a dramatically different picture than owners presented during the weak 2009-16 recovery," noting that the change in the management team in Washington has dramatically improved expectations. Eight of the 10 components rose in November, led by big jumps in those expecting the economy to improve (+16ppts to 48%) and sales expectations (+13 to 34), followed by a 6ppts jump in job creation to a new record high of 24%. Also in the plus column, with gains from 1 to 4ppts, were now is a good time to expand (27%), plans to increase inventories (7), current inventory (-2), earnings trends (-12), and expected credit conditions (-4). Meanwhile, missing from November's euphoria were current job openings (-5 to 30) and capital spending plans (-1 to 26), which moved lower, though the former remains in record territory.

PPI (*link*): The PPI for final demand increased 0.4% in November for the third month. Prices for final demand goods jumped 1.0%, after slowing from 0.7% to 0.3% in October, matching its high for this year. Final demand services rose 0.2%, slowing from October's 0.5%, which had matched April's high for this year. Over three-fourths of the gain in the goods data can be traced to energy prices—boosted by a 15.8% surge in gasoline prices—while half of the gain in the services data reflects higher prices for loan services. The yearly inflation rate for the headline series accelerated 3.1%—its highest reading since January 2012. The goods rate climbed a percentage point to 4.2% y/y—the highest since the end of 2011—while the services rate held at its recent high of 2.4% y/y. Meanwhile, the core (2.4% y/y) rate was unchanged at its fastest pace since February 2012, while core ex trade services (2.4) reached a high for this series going back to 2014.

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