



## MORNING BRIEFING

January 8, 2018

### Crying Wolff

See the [collection](#) of the individual charts linked below.

(1) Author Wolff cries that “wolf” is in the White House. (2) Beware of psychiatrists offering free analysis. (3) Tweets from the genius with the biggest button. (4) Investors see more upside in global economy than downside from latest Washington circus. (5) Global PMIs are hot. (6) Dr. Copper is upbeat. (7) Earnings expectations are pumped up for earnings season. (8) Bulls showing no fear of bears or wolves. (9) Despite mismatch between lots of job openings and jobless workers, wage inflation remains subdued. (10) A match made in Heaven for stock investors: solid growth with low inflation. (11) Double Feature Movie Review: “Molly’s Game” and “I, Tonya” are both rated (+ +).

**Strategy I: Tuning Out the Noise.** Fire and fury raged inside the Beltway last week in the form of a new book about President Donald Trump. Michael Wolff in *Fire and Fury: Inside the Trump White House* essentially claims that the President is “an idiot surrounded by clowns,” as one unnamed source puts it. It’s a caricature, but so is the President. There’s nothing new in Wolff’s book that isn’t already widely known. We know that Trump tends to have the childish disposition of a school-yard bully. We know he is thin-skinned, and feels a need to respond to every criticism.

Psychiatrists are popping up all over the mainstream press claiming that the new book confirms that the President suffers from attention deficit disorder and narcissism. Trump isn’t exactly the first president to be a narcissist. But he is the first to tweet lots of off-the-wall messages on a daily basis. Last Monday, North Korea’s deranged leader Kim Jong Un said he had a button ready to launch nuclear weapons installed in his desk. The next day Trump tweeted that he, too, has a nuclear button, “but it is a much bigger & more powerful one than his, and my Button works!”

Responding to questions about his mental health on Saturday, Trump tweeted, “Actually, throughout my life, my two greatest assets have been mental stability and being, like, really smart.” He said he was a “VERY successful businessman” and television star who won the presidency on his first try. “I think that would qualify as not smart, but genius....and a very stable genius at that!”

What if Trump is right, and all his critics are wrong? I know that sounds crazy, so perhaps I need to have my head examined. Then again, so should Mr. Stock Market! Apparently, investors aren’t worried that our President is deranged. The market’s performance suggests they think Trump is crazy like a fox. How else to explain that the S&P 500 is up 28.2% since Election Day, November 8, 2016 to yet another record high on Friday ([Fig. 1](#))? The Nasdaq is up 37.4% over the same period ([Fig. 2](#)). Here’s the performance derby of the S&P 500 sectors since Election Day: Information Technology (44.2%), Materials (33.0), Industrials (30.4), Consumer Discretionary (29.5), S&P 500 (28.2), Health Care (25.1), Consumer Staples (8.7), Energy (8.6), Real Estate (6.5), Telecom Services (4.7), and Utilities (4.6) ([Fig. 3](#)).

Money flows also suggest comfort with Trump. Equity mutual funds and ETFs attracted \$315.1 billion over the 12 months through November 2017 ([Fig. 4](#)). Money is still coming out of equity mutual funds, but that’s more than offset by hefty inflows into equity ETFs ([Fig. 5](#)). They attracted \$355.8 billion over the past 12 months, with \$197.8 billion going into equity ETFs that invest domestically and a record

\$158.1 billion into those that invest globally.

The interest in investing globally confirms that the stock market rally since November 8, 2016 isn't all about Trump. Trump may think it is, but the rally has been mostly driven by rising earnings expectations as the global economy has continued to show more and more signs of booming without reviving inflation. In other words, while Washington is generating lots of noise, the global economy is providing a clearly bullish signal for earnings and stock prices:

(1) *World stock prices.* Since November 8, 2016, the All Country World ex US MSCI stock price index is up 23.9% in local currency and 28.1% in dollars ([Fig. 6](#)). Here is the performance derby over this period for the major MSCI stock market indexes in dollars: EMU (33.4%), Emerging Markets (33.1), US (28.1), World (27.4), Japan (26.1), and UK (23.0). In dollars, the rest of the world has been mostly outperforming the US, though much of that outperformance was attributable to the weaker dollar ([Fig. 7](#)). In any event, foreign equity markets' solid gains certainly have more to do with the global synchronized economic boom than Trump's presidency.

(2) *Global PMIs.* Debbie and I believe that the global economy fell into an energy-led growth recession during 2015. That was followed by a global synchronized recovery in 2016 and expansion during 2017. This year, there could be a global synchronized boom based on the strength shown late last year in many economies around the world. That's confirmed by the global composite PMI, which rose to 54.4 during December, up from a recent low of 50.6 during February 2016 ([Fig. 8](#)). Leading the way higher over this period has been the global M-PMI, which rose from 50.0 to 54.5.

(3) *Dr. Copper.* The nearby futures price of a pound of copper rose to \$3.29 on December 28, the highest since February 25, 2014 ([Fig. 9](#)). It's up 28% y/y.

(4) *Forward revenues and earnings.* It's too soon to tell how the cut in the corporate tax rate late last year will affect the consensus earnings estimates of industry analysts. Undoubtedly, they will be raising their estimates. But they may wait until they get more guidance from company managements during the Q4 earnings season this month. At the end of last year, weekly S&P 500 forward consensus earnings estimates through the 12/28 week resumed their relatively flattish trends during most of 2017 for both 2017 and 2018 ([Fig. 10](#)). Earnings estimates for 2019 have been moving noticeably higher during the final weeks of last year.

At the end of last year, industry analysts predicted that S&P 500 operating earnings per share will rise this year by \$15.76 (or 12.0%) to \$147.23 and next year by \$14.99 (10.2%) to \$162.23. (Joe and I are using \$147.00 for this year and \$157.50 for next year. We are assuming that the cut in the corporate tax rate will add \$6 per share to this year's earnings.)

Forward earnings—which will soon be calculated as the time-weighted average of 2018 and 2019 estimates—rose to a record high of \$147.23 per share at the end of last year. It has been tracking the record-setting trend of forward revenues all last year. Those revenues won't be affected by the tax cut as much as earnings will be in 2018. So we will be watching both of them closely in coming weeks. For now, it's clear that the solid gains in both last year reflected the strengthening global economy.

**Strategy II: Less Panic Prone.** Crying “Wolf” no longer rattles the stock market. Joe and I continue to count the number of panic attacks in the current bull market in stocks, which started in 2009. We ambiguously define them as any significant selloff tied to panic-worthy news. There have been 59 of them by our count. There were only two short ones in 2017. (See our [S&P 500 Panic Attacks Since 2009](#).)

Back in early 2013, when the panic attack about the “fiscal cliff” late in 2012 proved unjustified as fears didn’t pan out, I argued that we have nothing to fear but nothing to fear. I started to discuss the possibility of a meltup.

Interestingly, the market had another great day on Friday despite the fire and fury coming out of Washington about the President’s mental capacity. Instead, the market might be responding very positively to the tax reform plan passed late last year. Now there is talk of moving on to welfare reform and an infrastructure spending program. There is also more talk starting between North Korea and South Korea.

The Q4 earnings season is just starting, and investors are anticipating that many companies will be taking one-time charge-offs on deferred tax assets, but will have a lower tax rate for the foreseeable future. A few companies have announced that some of their tax windfalls will be used to make bonus payments to their workers. Some companies are likely to talk about how much money they expect to repatriate from abroad, and whether those funds will be used for buying back shares and paying out more dividends.

For all of these reasons, it’s hard to convince investors that they should be afraid of the big bad wolf.

**Unemployment & Inflation: Heavenly Match.** As Debbie reports below, payroll employment rose only 148,000 during December, with private payrolls up 146,000, according to the Bureau of Labor Statistics. That was much weaker than the ADP survey of private payrolls, which showed a gain of 250,000 during the month. The economy is clearly at full employment given that there are roughly 6 million job openings and 6 million unemployed workers ([Fig. 11](#)). This suggests that there are skill and geographical mismatches between the people looking for jobs and the available ones.

The most notable mismatch is the expected Phillips curve tradeoff between the unemployment rate and wage inflation. The jobless rate remained at a cyclical low of 4.1% at the end of last year. Yet wage inflation remains subdued around 2.5% ([Fig. 12](#)). The core PCED inflation rate is even lower at 1.5% ([Fig. 13](#)).

This explains some of Friday’s euphoria in the stock market. What could be more bullish for stocks than solid economic growth with subdued inflation?

**Movies.** “Molly’s Game” (+ +) and “I, Tonya” (+ +) ([link](#)) are two true stories of two very aspirational young ladies. Molly Bloom ran high-stakes poker games in LA and NYC for celebrities as well as scoundrels, many of whom were one and the same persons. She was extremely successful. Her downfall came when the FBI arrested her for racketeering with the expectation that she would rat on her high-stakes clientele, which she refused to do. Hamstrung by her redneck upbringing, Tonya was barred from the respect of the ice skating elite. Yet she was a great skater and could have been an Olympian contender but for her involvement in an attempt to break the kneecaps of her top US competitor.

## CALENDARS

**US. Mon:** Consumer Credit \$18.0b, Williams, Bostic. **Tues:** NFIB Small Business Optimism Index 107.9, Job Openings 6.038m. (*Wall Street Journal* estimates)

**Global. Mon:** Eurozone Retail Sales 1.3%/m/m/2.4%/y/y, Eurozone Economic Confidence 114.8, Germany Factory Orders 0.0%/m/m/7.8%/y/y. **Tues:** Eurozone Unemployment Rate 8.7%, Germany Industrial Production 1.8%/m/m/4.0%/y/y, Germany Trade Balance (euros) 21.2b, Japan Consumer

Confidence Index 45. (DailyFX estimates)

## STRATEGY INDICATORS

**Global Stock Markets Performance** ([link](#)): The US MSCI index rose 2.6% last week for its biggest gain since December 2016 and its sixth gain in seven weeks. The index ranked 27th out of the 49 markets in a week when all but two countries rose in US dollar terms. That compares to 47th a week earlier, when it fell 0.4% as 44 countries moved higher. The AC World ex-US index rose 2.7% for its best gain since mid-July and has outperformed the US MSCI for three straight weeks; that result compares to a 1.1% gain a week earlier. EM Eastern Europe performed best last week with a gain of 5.1% as all regions rose, followed by EM Latin America (5.0%), BRIC (4.9), EMEA (4.1), EM Asia (3.7), and EMU (3.3). EAFE (2.4) was the worst-performing region. Pakistan was the best-performing country, with a gain of 7.9%, followed by Colombia (6.6), Peru (6.5), Sri Lanka (6.4), Russia (6.1), and Brazil (6.1). Egypt was the worst performer as it fell 2.2%, followed by Jordan (-0.3).

**S&P 1500/500/400/600 Performance** ([link](#)): All three market-cap indexes ended the week at record highs. LargeCap soared 2.6% and outperformed both MidCap (1.9%) and SmallCap (1.4). Twenty-four of the 33 sectors rose w/w, compared to 15 a week earlier. Last week's biggest gainers: SmallCap Energy (6.0), LargeCap Tech (4.2), MidCap Energy (4.1), MidCap Tech (4.1), and LargeCap Materials (4.0). Utilities and Real Estate dominated last week's worst performers: LargeCap Utilities (-2.5), MidCap Real Estate (-2.3), SmallCap Utilities (-2.2), MidCap Utilities (-2.2), SmallCap Real Estate (-2.1), LargeCap Real Estate (-1.9), and SmallCap Consumer Staples (-1.9).

**S&P 500 Sectors and Industries Performance** ([link](#)): Eight of the 11 sectors rose last week, and six outperformed the S&P 500's 2.6% gain. That compares to six sectors rising a week earlier when six outperformed the S&P 500's 0.4% decline. Tech was the best-performing sector as its 4.2% gain edged out the advances of Materials (4.0) and Energy (3.9), and solidly exceeded the gains of these other outperforming sectors: Consumer Discretionary (3.3), Health Care (3.2), and Industrials (2.8). Utilities (-2.5) was the worst performer, followed by these underperformers: Real Estate (-1.9), Telecom (-1.3), Consumer Staples (0.1), and Financials (1.7).

**Commodities Performance** ([link](#)): The commodities markets settled down last week: Thirteen of the 24 commodities we follow rose for the week as the S&P GSCI commodities index gained 0.3%. That compares to outsized gains the prior week, when 23/24 commodities rose and the broad S&P GSCI commodities index soared 3.1%, its biggest weekly advance since July. Last week's strongest performers: Kansas Wheat (2.4%), Lead (2.2), Coffee (1.8), Crude Oil (1.7), and Zinc (1.2). Last week's biggest laggards: Natural Gas (-5.4), Aluminum (-3.1), Live Cattle (-1.9), Nickel (-1.9), and Copper (-1.8).

**Assets Sorted by Spread w/ 200-dmas** ([link](#)): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 12/24 commodities, 8/9 global stock indexes, and 24/33 US stock indexes, compared to 22/24 commodities, 5/9 global stock indexes, and 11/33 US stock indexes rising a week earlier. Commodities' average spread weakened w/w to 6.3% from 6.7%. Seventeen commodities trade above their 200-dmas, up from 16 a week earlier. Brent Crude still leads all commodities and all assets at 22.6% above its 200-dma, but Kansas Wheat (-2.4%) rose 2.2ppts w/w for the best performance of all commodities. Brent Crude is followed closely by Heating Oil (21.6), GasOil (20.9), Crude Oil (20.6), and Nickel (18.5). Natural Gas (-8.1) trades at the lowest of all commodities relative to their 200-dmas; it fell 5.0ppts last week, for the worst performance of all commodities and indeed all assets. The global indexes trade at an average of 8.7% above their 200-dmas, up from 6.9% in the prior week. All nine global indexes still trade above their 200-dmas, the same as a week earlier. Japan (15.2) leads the global indexes as it rose 4.1ppts w/w for the best



performance among global assets. The UK (4.1) trades the lowest among its country peers and rose only 0.4ppts w/w for the worst performance among global indexes. The US indexes trade at an average of 6.9% above their 200-dmas, with 26 of the 33 sectors above, up from an average of 5.6% a week earlier, when 28 sectors were above. SmallCap Energy (14.7) improved 6.8ppts w/w for the best performance of the US stock indexes and all assets. MidCap Energy (17.0) now leads all US stock indexes relative to their 200 dmas, followed by SmallCap Energy (14.7), LargeCap Tech (14.2), and SmallCap Health Care (13.8). MidCap Telecom trades at a sharp discount relative to its 200-dma of 11.8%, the lowest among not just the US stock indexes but all assets. SmallCap Utilities (0.3) fell 2.6ppts 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 88th week (after 17 weeks in a Death Cross) as both the short-term and long-term trends improved for the first time in three weeks. However, the index's 50-day moving average (50-dma) relative to its 200-dma rose to a 65-week high of 5.6% from 5.4% a week earlier. That compares to 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 19th 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 an 18th 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 surged to a 56-week high of 4.1% above its rising 50-dma from a five-week low of 2.0% above a week earlier. These 50-dma readings compare to a four-month low of 1.0% below the index's falling 50-dma in mid-August and a 52-month high of 6.2% in March 2016. The S&P 500 surged to a four-and-a-half-year high of 9.9% above its rising 200-dma from a five-week low of 7.5% a week earlier, which compares to a post-election low of 3.0% in mid-August, its previous post-election 38-month high of 9.4% on March 1, and an eight-month low of -0.1% immediately before the 2016 election.

**S&P 500 Sectors Technical Indicators** ([link](#)): Among the 11 sectors, last week saw seven improve w/w relative to both their 50-dmas and their 200-dmas. Three of the other four—Real Estate, Telecom, and Utilities—weakened relative to both dmas, and Energy's performance was mixed. Nine of the 11 sectors traded above their 50-dmas for a third week, down from 10 in mid-December before Real Estate fell below and joined Utilities. Still, that's up sharply from six at the end of November and contrasts real favorably with the week before the 2016 election, when all 11 were below (for the first time since December 11, 2015). The longer-term picture—i.e., relative to 200-dmas—shows nine sectors trading above, down from 10 a week earlier as Real Estate fell below for the first time in 24 weeks and joined Utilities. All 11 had been above in mid-December for the first time since mid-February. Ten sectors are in a Golden Cross, with 50-dmas higher than 200-dmas. That's unchanged from a week earlier when Consumer Staples joined the Golden Cross club for the first time in 11 weeks, and leaves Telecom out for a 44th straight 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 sectors have rising 50-dmas, up from nine a week earlier as Health Care's 50-dma rose after a one-week decline and Utilities' dropped for a third week. Ten sectors have rising 200-dmas, unchanged from a week earlier. Telecom's 200-dma fell for a 19th straight week, and Energy's 200-dma rose for a third week after falling for 34 weeks.

## US ECONOMIC INDICATORS

**Employment** ([link](#)): Employment growth slowed considerably in December, with private payroll gains more than 100,000 below ADP's count for the month. BLS data show US companies added 148,000 jobs last month after posting gains north of 200,000 the prior two months. Private payrolls added only 146,000 jobs—in contrast to the nine-month high of 250,000 reported by ADP. Revisions to BLS data showed both headline and private payroll data recording upward revisions to November and downward

revisions to October, though the net two-month change was modest for both at -9,000 and -7,000, respectively. Meanwhile, the breadth of job creation (percent of private industries increasing payrolls) for the one-month span (64.2%) was above 60.0% for the seventh straight month, while the three-month span (71.8) shot above 70.0% for the first time since the end of 2014.

**Earned Income Proxy** ([link](#)): Our Earned Income Proxy (EIP) in December continued to set new record highs, increasing 14 of the last 16 months. It rose 0.5% last month, with average hourly earnings, one of the components of our EIP, climbing 0.3%, while aggregate weekly hours, the other component, rose 0.2%. Over the past 16 months, our EIP accelerated 6.4%, with the AHE up 3.5% over the period and aggregate hours 2.9% higher. Our proxy tracks income and spending closely and continues to predict healthy gains in both.

**Employment by Industry** ([link](#)): Leading gains in December payrolls were health care, construction, manufacturing, and restaurants. Health care jobs continued to trend higher, expanding 31,400 in December and 299,700 for all of 2017—below 2016's 378,900. Meanwhile, payroll increases for construction and manufacturing accelerated last year. Construction payrolls expanded 30,000 in December and 210,000 during all of 2017, above 2016's 155,000 increase; manufacturing jobs advanced 25,000 last month and 196,000 for last year—after a 16,000 loss during 2016. Restaurants hired 25,100 workers last month and 248,600 in 2017—in line with 2016's increase. While professional & business services expanded payrolls by only 19,000 last month—below 2017's average monthly gain of 44,000—last year's 527,000 y/y increase was in line with 2016's performance. Employment in other major industries—including mining, wholesale trade, transportation & warehousing, information services, financial activities, and government—showed little change last month.

**ADP Employment** ([link](#)): “We’ve seen yet another month where the labor market has shown no signs of slowing,” according to ADP, with small businesses ending 2017 on a high note, adding more than double their monthly average for the past six months. In December, private industries added a nine-month high of 250,000 to payrolls after a slight downward revision to November's count (to 185,000 from 190,000) and a slight upward revision to October's (238,000 from 235,000) for a net loss of only 2,000. Service-providing industries (222,000) accounted for nearly 90% of December's gain, though goods-producing industries (28,000) registered another relatively strong performance, led by a 16,000 gain in construction jobs. The increase in manufacturing jobs slowed to 9,000 last month, though the sector hasn't cut payrolls since last November, adding 221,000 factory jobs over the period. Within service-providing companies, once again the biggest increase came from professional & business services (72,000), followed by trade, transportation & utilities (45,000), health care & social assistance (34,000), and leisure & hospitality (28,000). The report noted significant growth in services' jobs during 2017, except for an overall loss of jobs in the shrinking information sector. By company size, medium-sized companies remained at the top of the leader board, adding 100,000 jobs—86,000 service-providing and 14,000 goods-producing. Small companies (94,000) were a close second, adding the most service-providing jobs (91,000) since March. Large companies (56,000) remained in the bottom slot—with a mix of 45,000 service-providing jobs and 11,000 goods-producing ones.

**Unemployment** ([link](#)): December's unemployment rate was at a 17-year low of 4.1% for the third month, while the participation rate was unchanged at 62.7% over the period. The latter has showed little movement on net over the past year. The adult (3.7%) unemployment rate remained at its cyclical low again last month, while the college grad (2.1) rate was unchanged just above October's cyclical low of 2.0%. Meanwhile, the volatile teenage rate sank to 13.6% after rising the prior two months from 13.0% in September (lowest since fall 2000) to a high for last year of 15.9% in November. Those working part-time for economic reasons (a.k.a. “involuntary part-time workers”) edged up 64,000 last month to 4.9 million (3.1% of the civilian labor force), after falling to its lowest level since January 2008 in November. The sum of the underemployment and jobless rates (7.2) is just above its 7.1% cyclical

low posted in October and November, while the U6 rate (8.1)—which includes marginally attached workers—is just above its cyclical low of 8.0% the previous two months.

**Wages** ([link](#)): Wage inflation—as measured by the average hourly earnings rate for all workers on private nonfarm payrolls (AHE)—increased 2.5% y/y, up slightly from 2.4% the prior two months, finishing the year below its 2017 high of 2.8% posted in September and February. The wage rate for goods-producing industries (2.1% y/y) remained on a volatile downtrend, while the service-providing rate (2.6) held below September's 2.9%—which was the highest since April 2009. Within goods-producing, the manufacturing rate (1.6) was near October's 28-month low of 1.5%, while construction's (3.0) was back up at September's eight-month high; the natural resources rate (0.3) fell back below 1.0%. Within service-providing, the rates for financial activities (3.6) and transportation & warehousing (3.2) climbed back to recent highs, while the rate for information services (3.0) held at recent lows, along with the utilities' (1.7) rate. The education & health services rate (2.2) is fluctuating just above 2.0%, while wholesale trade's (1.3) was above 1.0% after sinking below in October. The rate for retail trade (2.1) jumped nearly a percentage point from November's eight-month low of 1.2%.

## GLOBAL ECONOMIC INDICATORS

**Eurozone CPI Flash Estimate** ([link](#)): December's CPI rate is expected to move back down to 1.4% y/y, according to the flash estimate, after rising in November from 1.4% to 1.5%. So December's rate should remain below the ECB's goal of just under 2.0%. Looking at the main components, while energy (to 3.0% from 4.7% y/y) is once again expected to have the highest annual rate, it's retracing November's acceleration from 3.0% to 4.7%. Meanwhile, the yearly rates for the remaining components show a slight acceleration in non-energy industrial (to 0.5 from 0.4) prices and a slight deceleration in food, alcohol & tobacco (2.1 from 2.2), while the rate for services (1.2) is expected to match gains of the prior two months. The core rate—which excludes energy, food, alcohol, and tobacco—is expected to come in at 0.9% y/y for the third month.

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