



MORNING BRIEFING

January 10, 2018

Revisiting Animal Spirits

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

(1) Animal spirits higher today than a year ago. (2) The “hard” data is looking harder than a year ago. (3) Remarkable reversal in surprise index. (4) No more chatter about “secular stagnation.” (5) Consumer and business surveys showing that jobs are plentiful and available workers are not. (6) Fewer small businesses complaining about government regulations. (7) M-PMI orders index through the roof. (8) TCJA is jacking up consensus earnings forecasts. (9) Q1 data likely to be firmer than during the previous Q1s of current expansion.

Zoology 102: Still Roaring. A year ago, we all noticed a remarkable heightening of “animal spirits.” Surveys of consumer and business confidence soared during November and December of 2016 and continued to do so during January 2017. It was hard to deny that Trump’s victory in the presidential election had a lot to do with the euphoria. The latest readings show that the animals are either as euphoric or more so than they were a year ago.

A year ago, we all noticed that the euphoria—widespread except among Hillary’s supporters, of course—wasn’t showing up in the “hard” data. Economic indicators were signaling lackluster growth. Last year, the Citigroup Economic Surprise Index (CESI) fell to a low of -78.6 on June 16 ([Fig. 1](#)). Real GDP rose just 1.2% (saar) during Q1 ([Fig. 2](#)). However, since last year’s low, the CESI soared to a recent high of 84.5. It was 73.9 on Monday. Real GDP rose 3.1% during Q2 and 3.2% during Q3 last year, and the Atlanta Fed’s GDPNow is estimating Q4 growth of 2.7%, down from 3.2% on January 3. (The next estimate is due out today.)

Interestingly, consumer and business surveys remained upbeat even last spring and summer when Trump’s economic agenda seemed to be sinking in Washington’s swamp. His success in passing a major tax reform plan at the end of last year is likely to keep sentiment elevated, and it could also stimulate more economic growth this year. Debbie and I aren’t ready to join the 4-percenters, but we are solidly in the 3-percent camp.

Did you notice that since Trump was elected, there is much less chatter about the “new normal” and about “secular stagnation?” It is looking more and more like the old normal, with the economy showing signs of a late-cycle boom. The big difference so far is that there are almost no signs of a late-cycle rebound in inflation. No wonder that spirits and prices in the stock market are soaring so.

Without any further ado, let’s revisit the zoo to gauge the sentiment among the various inhabitants:

(1) *Consumer sentiment.* During December, both the Consumer Sentiment Index (CSI) and the Consumer Confidence Index (CCI) were well above their year-ago levels. Debbie and I derive our Consumer Optimism Index (COI) by averaging the two ([Fig. 3](#)). Our index was 109.0 during December vs 105.8 a year ago. The current conditions component of the COI rose to a cyclical peak of 135.2, the highest since March 2001.

Debbie and I like the CCI more than the CSI because the former is more sensitive to labor market conditions. We are particularly fond of the CCI survey's series on whether respondents believe that jobs are plentiful, available, or hard to get ([Fig. 4](#)). The latter fell last month to just 15.2%, the lowest reading since July 2001. The jobs-are-hard-to-get series is highly correlated with the unemployment rate, which was 4.1% last month, at the lowest level since December 2000 ([Fig. 5](#)). Both are signaling that the labor market is very tight.

(2) *Small business optimism*. The monthly NFIB survey of small business owners confirms that they are having a tough time finding workers. The December survey found that the percent reporting that there are few or no qualified applicants for job openings rose to 54.0%, the highest in the history of the series going back to April 1993 ([Fig. 6](#)). The monthly survey asks respondents to indicate their biggest problem ([Fig. 7](#)). During December 2015, government regulation and taxes tied for first place at 21.2%. At the end of last year, the former was down to 15.7%, while the latter was still high and number one at 21.0%. Undoubtedly, that response will come down significantly now that tax rates have been cut for corporations and sole proprietorships. So while the NFIB survey doesn't include "workers are hard to get" as a response, that may very well be the only significant problem facing small businesses!

(3) *CEO survey*. The CEO economic outlook index compiled by the Business Roundtable rose to 96.8 during Q4-2017 from 74.2 the year before ([Fig. 8](#)). This index is highly correlated with the growth rate in capital spending in real GDP on a y/y basis. Sure enough, the latter rose to 4.6% during Q3-2017, up from a recent low of -1.2% during Q1-2016.

(4) *Purchasing managers indexes*. Purchasing managers also are displaying signs of elevated exuberance, particularly in the manufacturing sector, where the M-PMI rose to 59.7 during December, up from 54.5 a year ago ([Fig. 9](#)). Even more impressive is the new orders component of the M-PMI, which rose from 60.3 a year ago to 69.4 during December.

(5) *Forward earnings and revenues*. Industry analysts have been increasingly upbeat about the prospects for revenues for the S&P 500, and so too for earnings, especially now that the corporate tax rate has been cut by the Tax Cut and Jobs Act (TCJA) ([Fig. 10](#) and [Fig. 11](#)). Even our very own mild-mannered Joe is getting excited about what he is seeing in the latest numbers: "Since the passage of the TCJA, the pace of change in the forward earnings estimate has accelerated. Even better, consensus annual earnings forecasts are rising on an absolute basis instead of posting declines as they typically did in past years. The three-week change (since the TCJA) in forward earnings is 1.8% for LargeCap, 1.4% for MidCap, and 2.3% for SmallCap. That marks LargeCap's biggest three-week change in forward earnings since May 2011."

(6) *Forward P/Es and LTEG*. Forward P/Es are rising, but not as fast as stocks because earnings estimates are on the rise. Valuation multiples are determined by investors, while consensus earnings estimates are determined by analysts. Analysts have also turned more bullish about the prospects for S&P 500 earnings growth over the next five years. During December, they projected an average annual growth rate of 12.9%, up from 12.0% from a year ago.

Last year, in our 11/7 [commentary](#), I wrote: "It may be time to consider the possibility that the US economy is finally entering a boom phase. We aren't there yet, but there is evidence that the pace of real economic activity is quickening. The test of my boom hypothesis might be the performance of the economy during Q1-2018. The first quarter has been a clunker since the start of the current expansion. There's definitely a strange pattern of weakness during Q1 even though the data are seasonally adjusted. Debbie and I will be monitoring the hard data during Q1 to see whether the first-quarter curse disappears, as we expect it might given the mounting signs of an economic boom." We will keep you posted.

CALENDARS

US. Wed: Export & Import Prices 0.4%/0.3%, Wholesale Trade Inventories 0.7%, Atlanta Fed Business Inflation Expectations, MBA Mortgage Applications, EIA Petroleum Status Report. **Thurs:** Jobless Claims 245k, PPI-FD Headline, Core, and Core Ex Trade Services 0.2%/0.2%/0.2%, Treasury Budget - \$36.0b, Weekly Consumer Comfort Index, EIA Natural Gas Report, Dudley. (*Wall Street Journal* estimates)

Global. Wed: China New Yuan Loans 1000b, China Aggregate Financing 1500b, China CPI & PPI 1.0%/4.8% y/y, China M2 9.2% y/y, UK Headline & Manufacturing Industrial Production 1.8%/2.8% y/y, UK NIESR GDP Estimate 0.5%. **Thurs:** Eurozone Industrial Production 0.8%/m/m/3.0%y/y, Germany GDP 2.4% y/y, Japan Leading & Coincident Indexes 108.6/116.4, ECB Account of Monetary Policy Meeting, BOE Credit Conditions & Bank Liabilities Survey. (DailyFX estimates)

STRATEGY INDICATORS

S&P/Russell LargeCaps & SMidCaps ([link](#)): LargeCaps are easily beating the SMidCaps so far in 2018, but all the price indexes are at record highs now. Since the election, the SmallCap market-cap indexes have outperformed LargeCaps and MidCaps. Here's the ytd score through Monday's close, their 2017 performance, and their percentage changes since Election Day: S&P LargeCap 500 (2.8% ytd, 19.4% in 2017, and 28.4% since the election), Russell LargeCap 1000 (2.7, 19.3, 28.5), S&P MidCap 400 (2.4, 14.5, 28.6), Russell SmallCap (1.7, 13.1, 30.7), and S&P SmallCap 600 (1.5, 11.7, 30.9). Forward revenues and earnings are at record highs now for all the S&P and Russell indexes. Momentum remains strong, as the yearly change in forward earnings is up from six-year lows in early 2016 and should accelerate in 2018. In the latest week, the rate of change in LargeCap's forward earnings surged to a six-year high of 11.6% y/y from 11.0%, which compares to a six-year low of -1.8% in October 2015; MidCap's jumped to a six-year high of 17.1% from 16.6%, which compares to a six-year low of -1.3% in December 2015; and SmallCap's rose to a five-month high of 12.0% from 11.3%, which compares to a 39-month high of 13.0% in mid-July and a six-year low of 0.3% in December 2015. Consensus growth rates expected for 2018 improved w/w for all three indexes. Here are the latest consensus earnings growth rates for 2017 and 2018: LargeCap 11.4% and 12.6%, MidCap 10.5% and 15.6%, and SmallCap 5.4% and 21.6%.

S&P 500 Growth vs. Value ([link](#)): The S&P 500 Growth index is up 3.4% ytd, well ahead of the 2.1% gain for its Value counterpart. During 2017, Growth's 25.4% was double the 12.6% rise for Value. Growth had trailed Value in the four months following the election. Now, Growth's 32.1% gain since the election is leading the 23.6% 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 more than double the rate of revenue growth (STRG) than Value over the next 12 months, but forward earnings growth (STEG) is only slightly higher for growth: 9.3% STRG and 13.2% STEG for Growth, respectively, vs 3.8% and 10.7% for Value. Growth's P/E of 20.9 is the highest since February 2004, while Value's 16.4 is the highest since May 2002. Regarding NERI, Growth's was positive in December for an eighth straight month, and improved to 4.1% from 3.1% in November. 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 December for an eighth month (following 33 months of negative readings), and rose to a five-month high of 2.8% from 0.3%. 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](#)): “We’ve been doing this research for nearly half a century, longer than anyone else, and I’ve never seen anything like 2017,” said NFIB Chief Economist Bill Dunkelberg. “The 2016 election was like a dam breaking. Small business owners were waiting for better policies from Washington, suddenly they got them, and the engine of the economy roared back to life.” December’s Small Business Optimism Index (SBOI) dipped 2.6 points to 104.9—still one of the strongest readings in the 45-history of the survey—after soaring 3.7 points in November to 107.5, within 0.5ppt of July 1983’s record high of 108.0. It was at 94.9 last October, just before the election. The SBOI averaged 104.9 for all of 2017—making last year the strongest year in the history of the survey. In December, two of the 10 components posted a gain—capital spending plans (+1ppt to 27%) and current job openings (+1 to 31), five declined, while current inventories (-2%), expected credit conditions (-4), and now is a good time to expand (27) were unchanged. The biggest losses among the decliners were: expect the economy to improve (-11ppts to 37%), plans to increase inventories (-8 to -1%), and sales expectations (-6 to 28%)—with readings for the first and third remaining in record territory. Earnings trends (-5 to -15%) and hirings (-4 to 20%) also moved lower, though the latter was just below November’s record high.

JOLTS ([link](#)): Job openings fell for the second month in November, by 46,000 m/m and 298,000 over the period to 5.879 million, holding around September’s record high of 6.177 million. Meanwhile, hirings fell 104,000 to 5.488 million after rebounding 272,000 in October to a new cyclical high of 5.592 million; separations fell for the third time in four months, by a total of 160,000 to 5.202 million. The latest hirings and separations data yielded an employment advance of 286,000 for November, 34,000 above November’s payroll gain of 252,000—coming in above payroll employment for the seventh time in 10 months. October’s job-opening rate slipped to 4.1%, just below its record high of 4.3% recorded from June through September, while the total hires rate (4.1%) ticked below its cyclical high of 4.2%; the quit rate (2.4) held just below May’s cyclical high of 2.5% for the sixth month. November’s ratio of unemployed workers per job opening (1.13) moved up for the second month after sinking to a new record low of 1.09 in September.

Consumer Credit ([link](#)): Consumer credit accelerated in November for the third month at its fastest pace since 2001, as revolving credit picked up for the fourth month. Credit advanced \$28.0 billion, up from an unrevised \$20.5 billion in October and a downwardly revised \$17.8 billion (from \$19.2 billion) in September. Revolving credit (\$11.2 billion) posed its best monthly gain in a year, while its recent four-month surge of \$30.0 billion was the best four-month performance since January 2008. Credit card debt exceeded \$1.0 trillion in September for the first time in the history of the series going back to 1968. Meanwhile, nonrevolving credit, which includes student and auto loans, rose at a 13-month high of \$16.8 billion, more than triple September’s \$5.3 billion which was the weakest reading since August’s 2011.

GLOBAL ECONOMIC INDICATORS

Germany Industrial Production ([link](#)): German industrial production in November soared to a new record high. Germany’s headline production—which includes construction—rebounded 3.4%, the strongest since September 2009, and nearly double the expected 1.8% increase. That more than wiped away declines of -1.2% and -1.1% the prior two months, though holidays and unseasonable weather accounted for October’s setback. (Excluding construction, production jumped 3.6%, also the best since September 2009.) Manufacturing output rebounded 4.3% in November, after a two-month decline of 3.0%, led by a 5.7% surge in production of capital goods, though consumer (3.6%) and intermediate (3.0) goods output also posted impressive gains. Construction increased 1.5% in November, while energy output fell 3.1% after a 5.2% jump in October. Both total (5.6% y/y) and manufacturing (6.3) production recorded the best yearly gains since August 2011. In a separate report, exports expanded 4.1% in November, while imports were 2.3% higher, bringing Germany’s overall trade surplus to a 19-

month high of €22.3bn. Meanwhile, December's M-PMI jumped to an all-time high of 63.3, with output, new orders, and exports all posting strong and accelerated growth.

Japan Consumer Confidence ([link](#)): Consumer confidence in December unexpectedly fell, though barely budged from November's 50-month high. The consumer confidence index ticked down to 44.7 last month after climbing to 44.9 in November—the best reading since September 2013. The index was at 41.1 last November. Three of the four components eased last month, but remained near recent highs: employment (to 49.0 from 49.3), overall livelihood (42.9 from 43.2), and willingness to buy durable goods (43.8 from 44.0); income growth (43.0) was unchanged at its cyclical high.

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