



MORNING BRIEFING

January 23, 2018

Commodity & Currency Review

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

(1) Stocks having more fun. (2) The length of a mile is getting shorter for stocks' marathon runners. (3) DJIA's 5000 markers. (4) Commodity prices signal global growth. (5) Dr. Copper is too busy making money to make house calls. (6) Oil prices rising despite lots of US oil production. (7) The trade-weighted dollar is inversely correlated with our Global Growth Barometer. (8) The former is weak, while the latter is strong.

Stocks: A Shorter & Shorter Mile. Stocks have been getting all the attention from the financial press. That makes sense since stocks have been making record highs on almost a daily basis since late 2016. Since Election Day, November 8, 2016, the DJIA has climbed 7881.86 points to another record high of 26214.60 yesterday ([Fig. 1](#)). Rising in increments of 1000 is becoming less and less of a feat, arithmetically speaking. The recent rise from 27000 to 28000 was only a 3.7% increase, while the gain from 17000 to 18000 was a 5.9% increase.

The 1000-point milestones aren't what they used to be. The same can be said of the 5000-point milestones. Let's revisit the DJIA's dash past several of these key milestones:

(1) *1000 to 5000 (five-fold)*. It took the DJIA roughly 157 months to rise from 1000 to 5000, from October 11, 1982 to November 21, 1995. That was a five-fold increase.

(2) *5000 to 10000 (double)*. The index then doubled to 10000 by March 29, 1999. It only took 40 months to do so thanks to the rocket fuel provided by the tech bubble.

(3) *10000 to 15000 (50.0%)*. The DJIA then meandered around 10000 until it crashed in 2008 and early 2009. But then it rebounded to a new record high of 15000 on May 7, 2013. That 50% increase required about 170 months to happen.

(4) *15000 to 20000 (33.3%)*. The sprint to 20000 took about 44 months, through January 1, 2017. But it covered less ground in percentage terms, providing a gain of one-third.

(5) *20000 to 25000 (25.0%)*. The dash to 25000 provided a 25.0% gain and transpired in less than 12 months through January.

(6) *25000 to 30000 (20.0%)*. The DJIA could easily and quickly melt up to 30000 since it is already above 25000. But that would be a fairly pedestrian gain of 20% compared to the previous 5000-point gains.

Commodities I: Industrials Looking Up. For a change from the mesmerizing ascent of stock prices, let's see what's been happening in the more humdrum world of commodities and currencies markets. The basic message from both is that the global economy is enjoying a synchronized expansion. It's not a boom just yet, based on the action Debbie and I see in the commodities pits. However, if stocks continue to melt up, the resulting wealth effect could stimulate a global economic boom. Let's start with our favorite commodity index, the CRB raw industrials spot price index, which doesn't include any

petroleum products:

(1) *Industrial commodity prices stepping up.* The CRB index we favor tracks the spot prices of 13 raw industrials ([Fig. 2](#)). It took a dive during the second half of 2014 through late 2015 as the plunge in oil prices initially depressed global economic growth, as producers were forced to severely retrench. However, those lower prices helped to stimulate growth, with a lag, as consumers of oil benefitted from lower oil prices. The major central banks continued to pump liquidity into the global economy. Emerging market economies showed signs of re-emerging.

No matter the cause, the revival of global economic growth was confirmed by a sharp rebound in the CRB index during 2016. The index then stalled in 2017 below its 2014 levels, but has been showing signs of moving back to those levels in recent weeks.

(2) *Dr. Copper is in good health.* Leading the CRB index's way higher has been its metals component ([Fig. 3](#)). Leading this component's way has been the price of copper ([Fig. 4](#)). The price of copper is highly correlated with the overall CRB index ([Fig. 5](#)). It is also highly correlated with the Emerging Markets MSCI stock price index (in local currencies) ([Fig. 6](#)). This stock price index has soared 79.0% since early 2016, confirming that the emerging market economies are emerging once again.

Commodities II: Oil Demand Gushing Again. The price of a barrel of Brent crude oil rose to \$68.88 a barrel yesterday, one of the highest recent readings since December 2, 2014. That's a spectacular 147% rebound from the January 20, 2016 low of \$27.88. It's remarkable because it follows a 76% crash in the price of this commodity from its June 19, 2014 peak ([Fig. 7](#)). The price of oil is highly correlated with the CRB raw industrials spot price index. That makes sense since both oil and other industrial commodity prices are influenced by the global business cycle. They can diverge from time to time because the supply-demand balance in the oil market includes a geopolitical component that's absent from other commodity markets.

Just for fun, Debbie and I constructed a global economic indicator that is the average of the CRB index and the price of a barrel of Brent ([Fig. 8](#)). This Global Growth Barometer rebounded in 2016, stalled in early 2017, but has been moving higher again to the highest level since late November 2014.

The rebound in the price of oil is remarkable given that the most recent freefall was attributable to the rapidly rising oil output of US producers ([Fig. 9](#)). US production didn't fall much when oil prices plunged. Now that production is back to as high as it was in 2014. Yet the price of oil has been rising, and US crude oil inventory stocks have been declining ([Fig. 10](#)). The obvious conclusion is that global oil demand is outpacing supply—yet another confirmation of the strength of the global economic expansion.

The Dollar: Looking Down. The trade-weighted US dollar tends to do well when the US economy is outperforming overseas economies. It tends to weaken when the rest of the world's economies are gaining momentum. It rose 26% from the summer of 2014 through early 2017 ([Fig. 11](#)). That's when the global economy was hard-hit by the drop in commodity prices. Since early last year, there were mounting signs of better global economic activity, and that was reflected in the 9% drop in the trade-weighted dollar since then. Not surprising is that our Global Growth Barometer is inversely correlated with the dollar ([Fig. 12](#)).

CALENDARS

US. Tues: Richmond Fed Manufacturing Index 18. **Wed:** C-PMI, M-PMI, and NM-PMI Flash Estimates 54.0/55.0/54.0, Existing Home Sales 5.750mu, FHFA Housing Price Index 0.5%, MBA Mortgage

Applications, EIA Petroleum Status Report. (*Wall Street Journal* estimates)

Global. Tues: Eurozone Consumer Confidence 0.6, Germany ZEW Survey Expectations 17.9, Japan Trade Balance (yen) 520b, BOJ Rate Decision & 10-Year Yield Target -0.10%/0.00%, BOJ Outlook Report. **Wed:** Eurozone, Germany, and France C-PMI Flash Estimates 57.9/58.5/59.2, Eurozone, Germany, and France M-PMI Flash Estimates 60.3/63.0/58.6, Eurozone, Germany, and France NM-PMI Flash Estimates 56.4/55.5/58.9, UK ILO Unemployment Rate 4.3%, Japan M-PMI Flash Estimate, Japan Leading & Coincident Indicators. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings surged to yet more record highs last week for all three indexes as more analysts incorporated the lower tax rate into their models. LargeCap's forward earnings was higher for a 26th straight week; MidCap's was higher for a 22nd week; and SmallCap's has risen in 20 of the past 26 weeks. 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 14.2% y/y from 13.1%, which is its highest since October 2011 and compares to a six-year low of -1.8% in October 2015; MidCap's jumped to 19.7% from 18.8%, which is the highest since September 2011 and compares to a six-year low of -1.3% in December 2015; and SmallCap's rose to 15.8% from 15.0%, which is the highest since January 2012 and compares to 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 11.5% and 15.3%, MidCap 10.6% and 18.6%, and SmallCap 5.8% and 23.7%.

S&P 500/400/600 Forward Valuation ([link](#)): Forward P/E ratios edged lower for the three indexes last week despite the jump in forward earnings. LargeCap's weekly forward P/E edged down to 18.4 from a 14-year high of 18.5. That's up from a 15-month low of 14.9 in January 2016 and the post-Lehman-meltdown P/E of 9.3 in October 2008, but remains well below the tech bubble's record high of 25.7 in July 1999. SMidCap's P/E had stalled for most of 2017 following the post-election meltup, but has been rising again recently. MidCap's forward P/E was steady w/w at 18.4, which matches LargeCap's P/E. MidCap had been below LargeCap's P/E recently for only the fourth time since 2009. MidCap's P/E remains below its 15-year high of 19.2 in February 2017, when the Energy sector's earnings were depressed, and the record high of 20.6 in January 2002, but is up from a three-year low of 15.0 in January 2016. SmallCap's P/E edged down to 19.9 from 20.0, which compares to a 51-week high of 20.2 at the beginning of December and a 15-year high of 20.5 in December 2016, when Energy's earnings were depressed. That's up from a three-year low of 15.5 in February 2016, and just 0.9ppt below SmallCap's record-high P/E of 20.9 in April 2002. Looking at their forward price/sales (P/S) ratios, valuations rose last week for the three indexes: LargeCap's P/S rose to a record high of 2.14 from 2.10, MidCap's 1.38 was a tad below its record high of 1.39 in March 2017, and SmallCap's 1.08 matches its prior cyclical high of 1.08 in March 2017, but remains below its record high of 1.17 in November 2013 when Energy revenues were depressed.

S&P 500 Sectors Quarterly Earnings Outlook ([link](#)): With the Q4 earnings season underway and more companies giving post-TCJA guidance, earnings revision activity is picking up. The S&P 500's Q4-2017 EPS forecast rose w/w to \$34.95 from \$34.78, and is up 0.3% from \$34.84 at the end of Q4. The \$34.95 estimate represents a forecasted pro forma earnings gain for Q4-2017 of 12.4%, up from 12.1% a week earlier, and compares to Q3-2017's 8.5%, Q2's 12.3%, and Q1's 15.3% (which was the strongest growth since Q3-2011 owing mostly to easier comps for Energy). Since the end of Q3, Q4 estimates are higher for three sectors, lower for seven, and steady for one. Energy's Q4 forecast has jumped 23.5%, followed by the forecasts for Utilities (up 2.4%), Tech (2.0), and Telecom (0.0).

Materials' Q4-2017 forecast has fallen 9.6% for the worst decline, followed by forecasts for Industrials (-8.7), Financials (-5.7), Consumer Discretionary (-5.2), Real Estate (-5.1), Health Care (-2.5), and Consumer Staples (-1.2). The S&P 500's Q4-2017 forecasted earnings gain of 12.4% y/y would be its sixth straight gain after four declines. Nine of the 11 sectors are expected to record positive y/y earnings growth in Q4-2017, and four are expected to beat the S&P 500's forecasted y/y earnings gain of 12.4%. That's because analysts expect Energy to report another large profit jump in Q4 relative to very low earnings a year ago. That's better than Q3-2017, when eight sectors rose y/y, but down from Q2-2017, when all 11 sectors rose y/y for the first time since Q3-2011. The latest forecasted Q4-2017 earnings growth rates vs their Q3-2017 growth rates: Energy (140.0% in Q4 vs 162.6% in Q3), Materials (26.1, 7.0), Tech (15.9, 24.2), Financials (14.2, -7.3), S&P 500 (12.4, 8.5), Consumer Staples (9.0, 4.7), Utilities (8.4, -4.6), Consumer Discretionary (5.8, 3.9), Health Care (5.0, 8.3), Industrials (4.5, 3.1), Real Estate (-1.3, 3.8), and Telecom (-1.9, -2.8). On an ex-Energy basis, S&P 500 earnings are expected to rise 9.9% y/y in Q4, up from 6.1% in Q3 (which was the slowest growth since ex-Energy earnings rose just 2.2% in Q2-2016) but down from gains of 9.6% in Q2 and 11.0% in Q1.

US ECONOMIC INDICATORS

Housing Starts & Building Permits ([link](#)): Housing starts posted its biggest decline in just over a year as 2017 drew to a close, yet housing starts, building permits, and homes completed all hit 10-year highs for calendar-year 2017, despite the year-end drag. Starts sank 8.2% last month to 1.192mu (saar), as single-family starts plunged 11.8% to 836,000 units (saar), after jumping 13.9% the prior two months to 948,000 units—which was the highest since August 2007. Volatile multi-family starts rose 1.4% to 356,000 units (saar) last month after a 6.2% loss and a 14.4% gain the previous two months. Home construction fell in all four regions, led by a 14.2% drop in the South. Building permits were little changed for the second month, slipping 0.1% to 1.302mu (saar) last month, but the fact that it topped 1.3mu for the third straight month suggests faster home building in the spring. Single-family permits rose for the fourth month, by a total of 10.1%, to a new cyclical high of 881,000 (saar); multi-family permits dropped 3.9% to 421,000 units, after decreasing 6.0% and increasing 15.9% the prior two months. NAHB's builder confidence for January slipped 2 points to 72—holding near December's 18-year high. According to the report, "Builders are confident that changes to the tax code will promote the small business sector and boost broader economic growth. Our members are excited about the year ahead, even as they continue to face building material price increases and shortages of labor and lots."

Consumer Sentiment ([link](#)): Confidence in mid-January fell for the third month, though has remained trendless since the start of last year. The Consumer Sentiment Index (CSI) slipped to 94.4 this month after reaching a 13-year high of 100.7 in October. The expectations component edged up to 84.8 after falling from 90.5 to 84.3 the prior two months. It's within 5.7 points of October's 33-month high of 90.5. Meanwhile, the present situation fell from 113.8 to 109.2 this month; it had reached a cyclical high of 116.5 in October. Richard Curtin, chief economist of Surveys of Consumers, noted that 34% of respondents mentioned tax reform in the latest survey; of those, 70% said the impact from the new tax reform law would be positive, while only 18% said it would be negative. He said, "The disconnect between the future outlook assessment and the largely positive view of the tax reform is due to uncertainties about the delayed impact of the tax reforms on the consumers."

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