



MORNING BRIEFING

January 24, 2018

Off the Charts

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

(1) The teetotaler-in-chief. (2) High on tweets. (3) Stocks are high on after-tax earnings. (4) Since the TCJA, industry analysts have been scrambling to boost earnings estimates. (5) Forward earnings rising faster than forward revenues, sending forward profit margins higher. (6) A good problem to have: stock prices going through the roof and our charts' scales. (7) Adding another angel to Blue Angels. (8) Lovefest in Davos as IMF raises world economic outlook.

Strategy: Trump's Pick-Me-Up. President Donald Trump doesn't drink alcohol. He is a teetotaler. He has raised his five children to be the same. He wants them to abstain from drinking liquor, and also from taking drugs. His pick-me-up seems to be tweeting. When he feels down after someone attacks him, he sends a tweet. The stock market has had very few down days and many record-setting up days thanks to Trump's indulgence in deregulation and tax cuts.

Joe and I estimate that without the corporate tax cut enacted at the end of last year, S&P 500 operating earnings per share would have been \$141.00 this year, up 7.2% from last year. We estimate that the tax cut will boost earnings by \$6.00, putting this year's earnings at \$147.00, up 11.8%. Earnings growth should resume its trend growth of roughly 7% next year, rising to \$157.50 ([Fig. 1](#)). (See [YRI S&P 500 Earnings Forecasts](#).)

Since the end of 2017, when the S&P 500 closed the year at 2673.61, our target for the index has been 3100. That would be a 15.9% increase ([Fig. 2](#)). The index closed at 2839.13 yesterday, so our year-end target implies a 9.2% increase in the S&P 500 over the rest of this year.

Our forecasts for the S&P 500 and its earnings for 2019 imply that the forward P/E will increase from 18.6 on Monday to 19.7 at the end of this year ([Fig. 3](#)). Now let's see how our numbers compare to the consensus of industry analysts. The bottom line is that they are guzzling Trump's tax-cutting punch:

(1) *Annual earnings estimates for 2018 and 2019.* Since the week of December 15, 2017 through the week ending January 19, consensus expected S&P 500 earnings has increased \$5.50 per share for the current year to \$151.76 ([Fig. 4](#)). That raises the consensus growth rate for this year from 11.5% then to 15.7% now ([Fig. 5](#)). The estimate for 2019 is currently up 10.4% from 2018.

Why the big discrepancy between our estimates and the consensus ones? Industry analysts tend to be too optimistic and lower their estimates over time as they approach reporting seasons. Once they've incorporated the tax cuts into their spreadsheets, they are likely to shed some of their optimism. This pattern is very visible in our tracking of monthly earnings expectations for every year since 1980 ([Fig. 6](#) and [Fig. 7](#)). From 1980 to 2017, there have been 38 "Earnings Squiggles" with 30 (79%) of them having endpoints below their starting points. The up-year exceptions were 1980, 1988, 1995, 2004, 2005, 2006, 2010, and 2011.

(2) *Quarterly estimates for 2018.* Consensus earnings estimates are also up sharply since December 15, 2017 ([Fig. 8](#)). Here are the Q1-Q4 upward revisions: \$1.29, \$1.41, \$1.41, and \$1.46. The y/y growth

rates are now 14.9% for Q1, 15.1% for Q2, 16.3% for Q3, and 14.6% for Q4 ([Fig. 9](#)).

(3) *Forward earnings flying.* S&P 500 forward earnings jumped 4.8% over the past five weeks to a record \$152.66 per share ([Fig. 10](#)). The forward earnings of the S&P 400 and S&P 600 are also up at record highs, rising 4.5% and 5.6%, respectively, over the same period.

(4) *Forward revenues and profit margins at new highs.* The forward revenues of the S&P 500/400/600 remain in uptrends in record-high territories ([Fig. 11](#)). While Trump's tax cuts may boost economic growth, there's no sign that analysts are significantly raising their revenues projections. They've been bullish on revenues since early 2016 when forward revenues estimates resumed their climbs to fresh record highs after stalling during 2015. Their bullishness on revenues has been fueled by mounting evidence of a global synchronized expansion, which has become increasingly visible since mid-2016.

With forward earnings estimates outpacing revenues estimates, the forward profit margins of the S&P 500/400/600 have gone vertical since late last year ([Fig. 12](#)). This margin is at a record 11.5% for the S&P 500.

(5) *Off the charts.* The practical problem we are having at YRI is keeping our charting system working properly. The charts are automatically updated, but the system doesn't have a feature that resets the left and right scales when a data series goes off the chart. We have to do that manually once we've detected the problem. It's a good problem to have when stock prices are going off the charts, confirming our bullish stance.

For example, in our Blue Angels analysis of the S&P 500/400/600, we've had to make headroom for all three, and we've added implied stock price series using valuation multiples of 20x forward earnings for the S&P 500/400 and 22x for the S&P 600 ([Fig. 13](#)). This analytical construct shows quite clearly that the recent ascent in stock prices has been earnings-led more than P/E-led. However, we are making room for more P/E expansion on top of the post-TCJA (Tax Cuts and Jobs Act) surge in forward earnings.

Davos: Lovefest. The World Economic Forum meets in snow-filled Davos once a year. It is a bit of a lovefest among the world's self-declared elite. This year's meeting is starting off with a warm and fuzzy forecast from the International Monetary Fund (IMF) about the outlook for the global economy. President Trump and his entourage (with the exception of Melania) will arrive this week. He undoubtedly will be expecting to receive lots of praise for single-handedly reviving the global economy and stock markets. Of course, that's not quite true, but it will be the narrative of his tweets from the mountains of Switzerland. Trump has nothing in common with Julie Andrews other than that the "hills" will soon be "alive with the sound" of his tweets about himself, as everyone chatters about them.

On Monday at the start of the conference, Christine Lagarde, the IMF chief, spoke briefly about the organization's recently updated [World Economic Outlook](#). It's quite upbeat, revising the IMF's forecast for the world economy's growth in both 2018 and 2019 to 3.9%. For both years, that is 0.2ppt higher than last October's forecast, and 0.2ppt higher than the IMF's current estimate of last year's global growth. Lagarde said, "All signs point to a further strengthening [in global growth] both this year and next. This is very welcome news."

The update observes, "The pickup in growth has been broad based, with notable upside surprises in Europe and Asia." It doesn't mention Trump, of course, but it does note: "The U.S. tax policy changes are expected to stimulate activity, with the short-term impact in the United States mostly driven by the investment response to the corporate income tax cuts."

CALENDARS

US. 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. **Thurs:** Advance Merchandise Trade Balance -\$69.0b, Leading Indicators 0.5%, Jobless Claims 240k, New Home Sales 680k, Retail & Wholesale Inventories 0.1%/0.3%, Kansas City Fed Manufacturing Index 14, EIA Natural Gas Report, Weekly Consumer Comfort Index. (*Wall Street Journal* estimates)

Global. 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. **Thurs:** Germany Ifo Business Climate, Current Assessment, and Expectations Indexes 117.0/125.3/109.2, Germany GfK Consumer Confidence 10.8, Canada Retail Sales 0.8%, Japan Headline, Core, and Core-Core CPI 1.1%/0.9%/0.4% y/y, BOJ Minutes of Policy Meeting, ECB Rate Decision 0.00%, ECB Margin Lending Facility & Deposit Facility Rates 0.25%.-0.40%, Draghi. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Q4 Earnings Season Monitor ([link](#)): With nearly 14% of S&P 500 companies finished reporting earnings and revenues for Q4-2017, their earnings surprise and y/y growth results are mixed compared to the same point during the Q3 earnings season, but all their revenue metrics have improved. Of the 68 companies in the S&P 500 that have reported, 78% exceeded industry analysts' earnings estimates by an average of 4.2%; they have averaged a y/y earnings gain of 15.6%. At the same point during the Q3-2017 reporting period, a higher percentage of companies (83%) in the S&P 500 had beaten consensus earnings estimates by a higher 5.4%, but earnings were up a lower 14.5% y/y. Q4's earnings surprise is typically smaller relative to Q3, so we're not concerned. On the revenue side, 84% beat sales estimates so far, with results coming in 1.4% above forecast and 8.1% higher than a year earlier. At this point in the Q3 season, a lower 73% had exceeded revenue forecasts by a slightly lower 1.2%, and sales rose a lower 6.9% y/y. Q4 earnings results are higher y/y for 81% of companies vs a stronger 85% at the same point in Q3, but revenues are higher y/y for 94% during Q4 vs 85% a quarter ago. These figures will change markedly as more Q4-2017 results are reported in the coming weeks. The earnings surprise is typically smaller during Q4 relative to Q3 because the Financials typically clear their books during Q4, so we're not concerned. The early results on revenues are very encouraging, particularly with the percentage of companies growing y/y. Q4-2017 should mark the sixth straight quarter of positive y/y earnings growth despite the potential negative impact of write-offs related to the TCJA.

S&P 500 Sectors Net Earnings Revisions ([link](#)): The S&P 500's NERI was positive for a ninth straight month in January, its longest positive streak since the 26-month string ending August 2011. Powered by big revisions due to the passage of the TCJA, NERI soared to an eight-year high of 12.9% from 4.2% in December. NERI improved m/m for all 11 sectors in January and was positive for nine sectors (compared to nine improving and seven positive in December). Tech has the longest positive NERI streak of 18 months, the best since August 2011 when its 28-month streak ended. Financials has the next best positive streak at 16 months, followed by Materials (4). Real Estate is the worst recently, with five straight months of negative NERIs, followed by Telecom (3). Here are the sectors' January NERIs compared with their December readings, ranked in descending order: Financials (29.4% in January [record high], up from 7.6% in December), Energy (20.9 [114-month high], 12.2), Industrials (17.3 [nine-month high], 3.2), Tech (16.5, 16.3), Consumer Staples (12.0 [96-month high], 2.9), Materials (11.1 [78-month high], 6.8), Consumer Discretionary (5.5 [67-month high], -5.0), Utilities (2.4, 1.3), Health Care (2.4, -2.0), Telecom (-5.1, -14.9), and Real Estate (-5.7, -6.1).

S&P 500 Earnings, Revenues & Valuation ([link](#)): Last week saw S&P 500 consensus forward revenues and earnings rise to new record highs. The forward profit margin forecast rose 0.1ppt for a fourth straight week to a record high of 11.5%. Prior to the passage of the TCJA, the profit margin had been steady at 11.1% since October, which was the highest since September 2015 and up from a 24-month low of 10.4% in March 2016. Forward revenue growth for the S&P 500 rose 0.1ppt to a 12-month high 5.7% from 5.6%. Those readings compare to 5.8% in January 2017, which was the highest since May 2012, and a cyclical low of 2.7% in February 2016. Forward earnings growth jumped 1.0ppt to 14.8% from 13.8%, and is the highest since August 2011. That up 3.7ppts from 11.1% prior to the passage of the TCJA, and 10.0ppts from the cyclical low of 4.8% in February 2016. Energy and Financials were the biggest contributors to the w/w improvement in forward earnings growth; Energy surged 4.4ppts to 46.2%, and Financials rose 1.8ppts to 25.6%. Energy's contribution to forward growth peaked at the start of 2017. Looking at last week's results, the S&P 500 ex-Energy's forward growth was 5.2% for revenues and 13.6% for earnings. The S&P 500 ex-Energy forward profit margin rose to a record high of 12.1%, which is up from 11.7% before the TCJA. The forward P/E edged up to a 16-year high of 18.5 from, which compares to the 15-month low of 14.9 in January 2016. The S&P 500 price-to-sales ratio rose 0.3ppt to a record high of 2.13, and was at a record high of 2.21 on an ex-Energy basis. The ex-Energy forward P/E rose to a 14-year high of 18.2 from 18.1.

S&P 500 Sectors Earnings, Revenues & Valuation ([link](#)): Consensus forward earnings forecasts rose last week for 10 of the 11 sectors (all but Real Estate). However, forward revenues rose w/w for just 6/11 sectors (all but Consumer Staples, Health Care, Tech, Real Estate, and Utilities). Forward revenues and earnings are at or around record highs for 5/11 sectors: Consumer Discretionary, Consumer Staples, Health Care, Industrials, and Tech. Energy's forward revenues and earnings are ticking higher now, but remain near their lowest levels since the spring of 2017. Forward P/E ratios remain near cyclical highs for all sectors except Energy, Health Care, and Telecom. Energy's forward revenues and earnings appear to be back on uptrends after stalling during 2016-2017, but its valuations remain elevated; its P/S ratio of 1.41 compares to a record high of 1.56 in May 2016, and its P/E of 24.6 is down from a record high of 57.5 then. Higher y/y margins are expected in 2018 for all but Real Estate, but the sector's earnings includes gains from property sales and typically improve as the year progresses. Financials' forecasted forward profit margin rose 0.4ppt w/w (it's up 1.6ppts in three weeks), rose 0.2ppt for Telecom, and edged up 0.1ppt for five other sectors: Consumer Discretionary, Energy, Health Care, Industrials, and Materials. Here's how the sectors rank based on their current forward profit margin forecasts: Information Technology (21.4%), Financials (18.2), Real Estate (17.0), Telecom (11.8), S&P 500 (11.5), Utilities (11.5), Materials (10.9), Health Care (10.8), Industrials (9.6), Consumer Discretionary (7.8), Consumer Staples (6.9), and Energy (5.7).

US ECONOMIC INDICATORS

Regional M-PMIs ([link](#)): Three Fed districts so far have reported on manufacturing activity for this month—New York, Philadelphia, and Richmond—and they show that growth in the sector remains steadfast. We average the composite, orders, and employment measures as data become available. The composite index slipped this month for a second month, to a still-high 18.0 from 25.1 last month (the highest since May 2004) and has averaged 21.9 over the past six months. All three regions, Philadelphia (to 22.2 from 27.9), New York (17.7 from 19.6), and Richmond (14 from 20) showed that growth eased, though remained robust. The new orders gauge (12.7 from 21.1) slowed to an eight-month low after hovering north of 20.0 the prior five months. Both the Philly (10.1 from 28.2) and New York (11.9 from 19.0) regions showed orders' growth continued to slow from recent highs; meanwhile, Richmond's reading was unchanged at 16—though down from November's recent peak of 35. The employment measure fell from 20.9 to 10.2 this month as manufacturers in the Philadelphia (16.8 from

19.7) and Kansas City (10 from 20) regions continued to add to payrolls at a steady, though slower pace, while jobs' growth in the New York (3.9 from 22.9) region slowed dramatically.

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

Copyright (c) Yardeni Research, Inc. Please read complete [copyright and hedge clause](#).