



MORNING BRIEFING

February 7, 2018

Panic Attack #60

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

(1) Stock market still suffering from PTSD. (2) Counting the number of panic attacks on 12 hands. (3) A few Fed tapering and tightening tantrums along the way. (4) From FOMO to LIFO. (5) Missing Yellen already. (6) Asking to see the Powell Put. (7) No ETF flash crash so far. (8) Valuation correction leaves stocks pricey, but not excessively so. (9) It may be too late to panic.

Strategy: From FOMO to LIFO. The current bull market has been plagued by panic attacks. That's not surprising given how traumatic the preceding bear market from October 9, 2007 through March 9, 2009 was, with the S&P 500 dropping 56.8%. Ever since then, it hasn't taken much to scare the living daylights out of investors, particularly those with a pessimistic streak. In other words, investors are still suffering from PTSD resulting from the previous bear market.

Joe and I have been keeping track of the current bull market's panic attacks in [S&P 500 Panic Attacks Since 2009](#). By our count, there have been 60 of them including the latest one. Four of them were associated with outright corrections, defined as a 10%-20% drop in the S&P 500 ([Fig. 1](#)). There have been plenty of mini-corrections, defined as 5%-10% declines.

In addition to those corrections, Joe and I count any minor selloff that was associated with a panic-provoking event. So, for example, we count the two-day Brexit selloff (down 5.3%) during June 2016 as a panic attack. The Fed was a source of angst a few times. There was a "tapering tantrum" during May 2013. There was a Fed tightening tantrum in early 2016 and again during September of that year ([Fig. 2](#)). All together, we counted seven panic attacks in 2016. There were only two last year.

This year started with a 7.5% meltup during January that set the stage for a fast 6.1% reversal during Friday and Monday, again mostly on Fed tightening concerns. Consider the following related observations about the current selloff:

(1) *Flow of funds.* From a flow-of-funds perspective, Joe and I have noted that over the past year, equity ETFs saw record inflows. This development suggested that the bull market was starting to attract buyers motivated by FOMO, i.e., fear of missing out. In recent days, many of them seem to have concluded that they managed to get in right at the top. So they made a top (not necessarily *the* top) by panicking out of their recently acquired stock holdings. Instead of a FOMO-led meltup, we may suddenly have a meltdown driven by LIFO, i.e., last in first out.

(2) *The Fed & inflation.* The stock market may be a market of stocks, but it also occasionally has a collective agenda to force new Fed chairs to pay respect. The market did that to Fed Chairman Alan Greenspan in October 1987 with a meltdown that caused the new Fed head to introduce the Greenspan Put. Was it a coincidence that the stock market plunged on Friday as Fed Chair Janet Yellen was leaving the building in that role for the last time, to be replaced by Jerome Powell on Monday?

The higher-than-expected 2.9% increase in wages in Friday's employment report might not have upset

stock traders at all if Yellen had remained in charge. That's because she would have said that while 2.9% is welcome, she wants to see 3.0%-4.0%. Left to his own devices, Powell probably would have said the same, and stressed that Yellen's policy of gradually monetary normalization will be maintained. However, the market's selloff may be the market's way of forcing the new chairman to declare his allegiance and show he is willing to provide a Powell Put if necessary.

(3) *Bond yields.* Of course, the issue for the stock market this time isn't earnings over the foreseeable future, but rather inflation and interest rates. Our view is that inflation is likely to remain subdued around 2.0%. Bond yields, on the other hand, may be normalizing around the world as the major central banks ease off on easing off. That's a good thing because it confirms that the global economy has achieved self-sustaining growth and no longer requires propping up by the central banks.

It no longer makes much, if any, sense for Germany's 10-year government bond yield to be below 1.00%, as it has been since late September 2014 ([Fig. 3](#)). Neither does it make much sense that Japan's government bond yield remains near zero ([Fig. 4](#)). From this perspective, the US Treasury bond yield at 2.80% certainly is already a lot more normal than comparable yields overseas.

If the Fed proceeds with three rate hikes this year, as widely expected, that will push the top of the federal funds rate target range from 1.50% to 2.25%. The US bond yield could rise to 3.00%-3.50% in that scenario. The bull market in stocks could certainly resume in that environment, especially if the higher interest rates confirm that solid economic growth is boosting earnings.

(4) *Another panic attack.* The bottom line is that Joe and I view the latest selloff as Panic Attack #60 rather than the beginning of a bear market. We can't rule out a 1987-like event, which amounted to a one-day bear market. Back then, it was portfolio insurance that caused stocks to plunge on Black Monday, October 19. So far this time around, we have Blue Friday followed by Black Monday. There's no evidence of an ETF flash crash so far, which—if it happens—might accelerate the selloff much as portfolio insurance did in 1987. While investors have suffered a black-and-blue bruising, we believe that the underlying strength in the global economy combined with the Trump tax cuts will boost earnings significantly this year.

Valuation: Too Late To Panic? In the stock market, panic attacks occur when investors fret that valuation multiples are too high because a recession suddenly seems more likely and even imminent, or because an upside inflation surprise raises the risk that the Fed will be forced to raise rates, which raises the risk of a recession. Panic attacks occur when the market's P/E takes a dive on these concerns, but the rout is abated by continued gains in earnings. The bull market resumes as recession fears abate.

While industry analysts have been scrambling to raise their earnings forecasts in the weeks following passage of the tax cut at the end of last year, investors decided to throw a tantrum on Friday and Monday that caused the forward P/Es of the S&P 500 to drop 6.1% from 18.0 on Thursday of last week to a 13-month low of 16.9 on Monday this week ([Fig. 5](#)). Over this same period, the forward P/Es for the S&P 400 and 600 dropped 5.5% to a 15-month low of 16.8 and 5.7% to a 15-month low of 18.1, respectively.

As we've been noting in recent weeks, our Blue Angels analysis shows that forward earnings are soaring for the S&P 500/400/600 into record-high territory ([Fig. 6](#)). Bear markets don't happen when earnings expectations are going up for perfectly good reasons.

The last correction lasted 100 days and took the S&P 500 down by 13.3%. It occurred from November 3, 2015 through February 11, 2016. In our 1/25/16 [Morning Briefing](#), we wrote, "Joe and I believe that it

may be too late to panic and that Wednesday's action might have made capitulation lows in both the stock and oil markets." The S&P 500 bottomed on 1829.08 back then. At the risk of pushing our luck, we'll try it again: "It may be too late to panic." (BTW: In that same piece, I reported that I stayed in Room 666 at the Radisson Blu Hotel in Zurich, which I viewed as another reason to be bullish since that number helped me to get bullish in March 2009. On Monday of this week, the DJIA fell 666.)

S&P 500 Industries: Two-Day Losing Streak? Not surprisingly, most of the S&P 500 industries that had been big winners last year through January were among the biggest losers during the selloff on Friday and Monday ([Table 1](#)). Here is the performance derby of the S&P 500 sectors from best to worst over this two-day period: Utilities (-2.4%), Real Estate (-3.7), Consumer Discretionary (-4.3), Consumer Staples (-5.4), Health Care (-5.8), Materials (-5.9), S&P 500 (-6.1), Industrials (-6.4), Telecom Services (-6.7), IT (-6.9), Financials (-7.1), and Energy (-8.3).

CALENDARS

US. Wed: Consumer Credit \$20.0b, MBA Mortgage Applications, EIA Petroleum Status Report, Williams, Dudley. **Thurs:** Jobless Claims 235k, Weekly Consumer Comfort Index, EIA Natural Gas Report. (*Wall Street Journal* estimates)

Global. Wed: Germany Industrial Production -0.5%/m/m/6.8%/y/y, Japan Leading & Coincident Indexes 108.1/120.5, Japan Trade Balance (yen) 514.3b. **Thurs:** Germany Trade Balance (euros) 21.0b, China Trade Balance \$54.7b, China Foreign Direct Investment, Canada Housing Starts 210k, BOE Bank Rate & Asset Purchase Target 0.50%/435b, BOE Inflation Report, ECB Publishes Economic Bulletin. (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—climbed 5.8% during the three weeks ending January 27 to a new record high. Our WLI is the average of our Boom-Bust Barometer (BBB) and Bloomberg's Weekly Consumer Comfort Index (WCCI). Our BBB also reached a new record high, jumping 9.7% over the three-week period, as jobless claims—one of the components of our BBB—fell from 250,750 to 234,500 (4-wa) over the time span, back near its cyclical low. The CRB raw industrial spot price index, another BBB component, climbed to its highest reading since September 2014, though has edged lower in recent sessions. Meanwhile, the WCCI remains on a steep uptrend.

S&P 500 Q4 Earnings Season Monitor ([link](#)): With 55% of S&P 500 companies finished reporting earnings and revenues for Q4-2017, their revenue and earnings surprise metrics are better compared to the same point during the Q3 earnings season. Of the 275 companies in the S&P 500 that have reported, 78% exceeded industry analysts' earnings estimates by an average of 4.6%; they have averaged a y/y earnings gain of 16.4%. At the same point during the Q3-2017 reporting period, a lower percentage of companies (75%) in the S&P 500 had beaten consensus earnings estimates by a higher 5.0%, and earnings were up a lower 9.5% y/y. On the revenue side, 80% beat sales estimates so far, with results coming in 1.2% above forecast and 9.6% higher than a year earlier. At this point in the Q3 season, a lower 66% had exceeded revenue forecasts by a higher 1.6%, and sales had risen by a lower 6.6% y/y. Q4 earnings results are higher y/y for 81% of companies vs a lower 74% at the same point in Q3, and revenues are higher y/y for 89% during Q4 vs a lower 83% a quarter ago. These figures will continue to change as more Q4-2017 results are reported in the coming weeks. Q4's earnings surprise is typically smaller relative to Q3 because Financials typically clear their books at the end of the year, so we're not surprised to see that metric weaken q/q. The early results on revenues are very encouraging, particularly with the percentage of companies growing y/y. Despite the potential

negative impact of write-offs related to the TCJA, Q4-2017 should mark the sixth straight quarter of positive y/y earnings growth and the seventh quarter of positive revenue growth.

US ECONOMIC INDICATORS

Merchandise Trade ([link](#)): Trade data for the final three months of 2017 confirm the big drag from trade on Q4 real GDP growth released last month. The real merchandise trade deficit widened to -\$68.4 billion in December—the largest since February 2007, deteriorating steadily from June's -\$60.8 billion gap. The deficit averaged -\$66.8 billion last quarter, considerably larger than Q3's -\$62.0 billion gap. December's report was a strong one, as growth in both real exports and real imports once again exceeded 2.0%—setting new record highs. December's gain in real exports was led by food (4.6%), industrial supplies (4.0), and capital goods ex autos (2.5), which more than offset declines in consumer goods ex autos (-1.3) and autos (-0.6). The rise in real imports was across the board, driven by consumer goods ex autos (6.3), autos (3.5), food (3.2), and capital goods ex autos (1.5); real imports of industrial supplies (0.2) was little changed.

JOLTS ([link](#)): Job openings fell during two of the final three months of 2017, sinking 167,000 in December and 366,000 during the quarter, to 5.811 million—still not far from September's record high of 6.177 million. Meanwhile, hirings fell 104,000 over the two months through December to 5.488 million after rebounding 272,000 in October to a new cyclical high of 5.592 million; separations rose 26,000 in December to 5.238 million after falling three of the prior four months by a total of 150,000. The latest hirings and separations data yielded an employment advance of 250,000 for December, 90,000 above December's payroll gain of 160,000—coming in above payroll employment for fourth straight month. December'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%) held just below its cyclical high of 4.2%; the quit rate (2.5) was back up at May's cyclical high. December's ratio of unemployed workers per job opening (1.13) moved up for the third month after sinking to a new record low of 1.09 in September.

GLOBAL ECONOMIC INDICATORS

Germany Manufacturing Orders ([link](#)): “German industry should make a strong start in 2018,” according to the ministry. December factory orders soared 3.8% to a new record high, surpassing the previous record high—recorded in November 2007—by 6.6%. December's advance was led by a 5.9% surge in foreign orders to a new record high; domestic orders were 0.7% higher. The escalation in the former was led by an 11.2% jump in billings from within the Eurozone; orders from outside the Eurozone accelerated 2.7%. Capital goods orders from within the Eurozone (18.5%) and outside the Eurozone (4.0) drove December's gain in overall orders, with the former the largest monthly advance since September 2013; domestic capital goods orders were flat. There was broad-based strength in intermediate goods orders, led by a 3.1% increase in domestic orders; billings from inside and outside the Eurozone rose 2.3% and 1.5%, respectively. Meanwhile, consumer goods orders were weak as declines in domestic orders (-8.3) and foreign billings from outside the Eurozone (-6.5) more than offset the 1.8% gain in orders from within the Eurozone.

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

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