



MORNING BRIEFING

February 21, 2018

Soarin' Fundamentals for Stocks

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

(1) The Magic Kingdom. (2) FastPass+ is the way to go. (3) Our Boom-Bust Barometer is soaring to new highs. (4) The same goes for our Weekly Leading Index, as weekly consumer confidence soars. (5) Forward earnings has been flying. (6) Analysts raised S&P 500 earnings for 2018 by over \$11 since TCJA. (7) A year's increase in 9 weeks for 2018 earnings of S&P 500/400/600. (8) Joe drills down to the S&P 500 sectors and industries to determine impacts of TCJA.

Strategy I: BBB & WLI Going Vertical. I spent the long President's Day weekend with my family in Disney World. It was the first time that my four-year-old granddaughter Cecelia (a.k.a. "CeCe") attended the theme park. The park's staffers are trained to say "Have a magical day" whenever they greet visitors. Cece had a magical weekend, and so did the rest of my family. The weather was great, and my wife wisely obtained FastPass+ reservations for most of the rides.

Stock investors have enjoyed a magical bull market since March 2009. It was particularly magical during 2017, when the S&P 500 rose 19.4% ([Fig. 1](#)). Such a double-digit return is quite extraordinary for an aging bull market going on nine years old in 2018. The magic seemed to stop abruptly when the S&P 500 plunged 10.2% over 13 days from late January through early February ([Fig. 2](#)).

Joe and I believe that the latest selloff marked the fourth correction in this bull market, not the beginning of a bear market. The economic fundamentals remain bullish:

(1) *Boom-Bust Barometer.* Our Boom-Bust Barometer (BBB) is simply the CRB raw industrials spot price index divided by initial unemployment claims. It is a great coincident indicator of the US business cycle ([Fig. 3](#)). As Debbie reviews below, it soared into new record-high territory in recent weeks. It did so as the CRB index rose to a new cyclical high following its freefall from the second half of 2014 through the end of 2015 ([Fig. 4](#)). At the same time, weekly initial unemployment claims have dropped to their lowest levels since March 1973 ([Fig. 5](#)).

(2) *Weekly Leading Index.* Debbie and I have devised a Weekly Leading Index (YRI-WLI) that is an average of our BBB and Bloomberg's weekly Consumer Confidence Index (CCI). It is highly correlated with the index compiled by the Economic Cycle Research Institute (ECRI-WLI) ([Fig. 6](#)). Our WLI is based on an open-source formulation, while theirs is based on a secret sauce. Both have been rising in record-high territory in recent weeks.

The YRI-WLI is soaring because the BBB is doing so, and so is the CCI ([Fig. 7](#)). Consumers have lots of reasons to be overjoyed with the unemployment rate at a cyclical low and many of them bringing home paychecks boosted by tax cuts. The CCI is the highest since February 2001.

(3) *Forward earnings.* Interestingly, the S&P 500 forward earnings is highly correlated with both the Boom-Bust Barometer and the YRI-WLI ([Fig. 8](#) and [Fig. 9](#)). The earnings measure is a time-weighted average of analysts' consensus expectations for S&P 500 earnings during the current year and the coming year. It's been soaring ever since the end of last year when the Tax Cut and Jobs Act (TCJA) slashed the statutory corporate tax rate.

(4) *Stock prices*. Given all of the above, it's no wonder that the S&P 500 stock price index is highly correlated with the YRI-WLI ([Fig. 10](#)). The latter, which is up 9.4% y/y, remains bullish for the former.

Strategy II: 2018 Earnings Going Vertical. During our weekend away, my family and I took a trip around the world on Disney's flight simulator, Soarin'. Back on Earth, the S&P 500 forward earnings is soaring because 2018 estimates have been rising rapidly during the current earnings season. Industry analysts have been getting guidance by corporate managements on the very positive impact of TCJA on their earnings. Joe and I have been keeping track of these estimates on a weekly basis. Here are our latest observations:

(1) *2018 estimates*. Over the past nine weeks since TCJA was enacted, the 2018 consensus earnings estimate for the S&P 500 has increased by \$11.21 per share from \$146.26 to \$157.47 ([Fig. 11](#)). That's a 7.7% increase. During the four quarters of 2018, estimates have increased by \$1.98 (Q1), \$2.85 (Q2), \$3.02 (Q3), and \$3.55 (Q4) ([Fig. 12](#)).

(2) *Forward earnings*. The forward earnings of the S&P 500/400/600 have increased by 9.5%, 8.3%, and 10.4% since the passage of TCJA ([Fig. 13](#)). The forward profit margins of all three have soared as well ([Fig. 14](#)).

(3) *Sectors*. I asked Joe to calculate the percentage increases in the analysts' consensus earnings estimates for 2008 since the TCJA's passage for the 11 sectors of the S&P 500. He reports that from the 12/14 week through the 2/15 week, the results were: Energy (23.3%), Telecom Services (17.2), Financials (11.5), Industrials (9.0), S&P 500 (7.7), Consumer Discretionary (7.4), Materials (6.0), Health Care (5.2), Information Technology (4.9), Consumer Staples (3.9), Utilities (1.0), and Real Estate (-1.8) ([Fig. 15](#)). (For industry detail, see [S&P 500 Forward & Annual Earnings Since TCJA](#).)

CALENDARS

US. Wed: C-PMI, M-PMI, and NM-PMI Flash Estimates 54.0/55.0/53.5, Existing Home Sales 5.65mu, MBA Mortgage Applications, FOMC Minutes. **Thurs:** Leading Indicators 0.6%, Jobless Claims 230k, Kansas City Fed Manufacturing Index 16.5, Weekly Consumer Comfort Index, EIA Petroleum Status Report, EIA Natural Gas Report, Dudley, Bostic. (*Wall Street Journal* estimates)

Global. Wed: Eurozone, Germany, and France C-PMI Flash Estimates 58.4/58.5/59.2, Eurozone, Germany, and France M-PMI Flash Estimates 59.2/60.5/58.0, Eurozone, Germany, and France NM-PMI Flash Estimates 57.6/57.0/59.0, UK Employment Change (3m/3m) 180k, UK ILO Unemployment Rate (3m) 4.3%, Japan M-PMI, Carney. **Thurs:** Germany Ifo Business Climate, Current Assessment, and Expectations Indexes 117.0/127.0/107.9, UK GDP 0.5%q/q/1.5%y/y, Japan Headline, Core, and Core-Core CPI 1.3%/0.8%/0.3% y/y, ECB Publishes Account of January 24-25 Policy Meeting. (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—was stalled around its record high during the week of February 10 following a four-week surge. Our WLI barely budged, edging down 0.3%, after a four-week jump of 8.4% 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 slipped 1.5%, after soaring 14.3% the previous four weeks to a new record high, as jobless claims—one of the components of our BBB—rose to 228,500 (4-wa) after plunging from 250,750 to 225,000 (the lowest since March 1973)

the previous four weeks. Meanwhile, the CRB raw industrial spot price index, another BBB component, is rebounding from its recent setback. The WCCI remains on a steep uptrend, setting new cyclical highs.

S&P 500 TCJA Earnings Leaders & Laggards ([link](#)): The 2018 earnings forecast for the S&P 500 has surged 6.4% in the nine weeks since the TCJA was signed into law on December 22. This outstanding performance has no comparison over the years since consensus earnings forecasts were first derived in 1978. The top sector gainers since the TCJA was passed: Energy (23.3%), Telecom (17.2), Financials (11.5), and Industrials (9.0). Real Estate is the sole decliner, with a drop of 1.8%. Also underperforming the S&P 500 are Utilities (1.0), Consumer Staples (3.9), Tech (4.9), Health Care (5.2), Materials (6.0), and Consumer Discretionary (7.4). Higher oil prices, a.k.a. “animal spirits,” have contributed heavily to the improvement in Energy’s earnings. The remaining leading sectors are well ahead in part due to higher exposure to the US tax system and because their Q4 earnings season are more complete than the laggards, so analysts have already adjusted forecasts based on their companies’ post-TCJA earnings guidance. However, we expect their strong upward pace of revisions to wind down along with the Q4 earnings season in the coming weeks. We also expect that the change in the lagging sectors’ 2018 estimates will continue to trail that of the S&P 500.

S&P 500 Sectors Net Earnings Revisions ([link](#)): The S&P 500's NERI was positive for a 10th straight month in February, 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 a record high of 21.0% from 12.9% in January. NERI was at a record high in February for four sectors as it improved m/m for 9/11 sectors and was positive for 10 sectors (compared to all 11 improving and nine positive in January). Tech has the longest positive NERI streak of 19 months, the best since August 2011 when its 28-month streak ended. Financials has the next best positive streak at 17 months, followed by Materials (5). Real Estate is the worst recently, with six straight months of negative NERI. Here are the sectors’ February NERIs compared with their January readings, ranked in descending order: Financials (33.1% in February [record high], up from 29.4% in January), Industrials (27.8 [record high], 17.3), Energy (26.8 [148-month high], 20.9), Consumer Staples (25.2 [record high], 12.0), Telecom (24.8 [record high], -5.1), Tech (20.8 [92-month high], 16.5), Materials (19.5 [140-month high], 11.1), Consumer Discretionary (17.2 [92-month high], 5.5), Health Care (16.4 [80-month high], 2.4), Utilities (0.7, 2.4), and Real Estate (-11.1 [12-month low], -5.7).

S&P 500 Earnings, Revenues & Valuation ([link](#)): Last week saw S&P 500 consensus forward revenues and earnings rise to new record highs. However, the forward profit margin forecast was steady for the first time in eight weeks at a record high of 11.9%. 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 improved 0.2ppt w/w to 6.3%, which is its highest level since September 2011. That reading compares to a cyclical low of 2.7% in February 2016. Forward earnings growth rose 0.3ppt w/w to 16.8% from 16.5%, and is the highest since October 2010. That’s up a whopping 7.7ppts from 11.1% prior to the passage of the TCJA, and 14.0ppts from the cyclical low of 4.8% in February 2016. Energy, Industrials, and Health Care had the biggest w/w improvement in forward earnings growth; Energy surged 3.6ppts to 54.6%, Industrials gained 1.4ppts to 16.8%, and Health Care rose 1.3ppts to 10.8%. 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 5.5% for revenues and 15.3% for earnings. The S&P 500 ex-Energy forward profit margin was steady at a record high of 12.5%, which is up from 11.7% before the TCJA. The forward P/E edged up to 17.1 from 17.0, which compares to a 16-year high of 18.6 at the market’s peak in late January and a 15-month low of 14.9 in January 2016. The S&P 500 price-to-sales ratio edged up to 2.04 from 2.03, which compares to late January’s record high of 2.16.

S&P 500 Sectors Earnings, Revenues & Valuation ([link](#)): Consensus forward earnings forecasts rose last week for 10/11 sectors (all but Real Estate), and forward revenues rose w/w for 9/11 sectors (all but Health Care 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/S and P/E ratios are down from their highs for all sectors. 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 1.20 compares to a record high of 1.56 in May 2016, and its P/E of 19.4 is down from a record high of 57.5 then. Higher margins are expected y/y in 2018 for all but Real Estate, but the sector's earnings includes gains from property sales and typically improves as the year progresses. The forward profit margin rose 0.3ppt w/w for Tech, 0.2ppt for Telecom, and 0.1ppt for Consumer Staples, Industrials, and Utilities. Here's how the sectors rank based on their current forward profit margin forecasts: Information Technology (22.2%), Financials (18.5), Real Estate (16.8), Telecom (13.2), S&P 500 (11.9), Utilities (11.8), Materials (11.2), Health Care (11.1), Industrials (10.0), Consumer Discretionary (8.0), Consumer Staples (7.1), and Energy (6.2).

S&P 500 Q4 Earnings Season Monitor ([link](#)): With over 82% of S&P 500 companies finished reporting earnings and revenues for Q4-2017, their revenue and earnings surprise metrics are mostly better compared to the same point during the Q3 earnings season. Q4-2017 is on track to be the sixth straight quarter of positive y/y earnings growth and the seventh straight quarter of positive y/y revenue growth, as well as the quarter with the highest y/y revenue and earnings growth since Q3-2011. Of the 412 companies in the S&P 500 that have reported through mid-day Tuesday, 76% exceeded industry analysts' earnings estimates by an average of 4.8%; they have averaged a y/y earnings gain of 16.3%. At the same point during the Q3-2017 reporting period, a lower percentage of companies (73%) in the S&P 500 had beaten consensus earnings estimates by a higher 5.7%, and earnings were up a lower 8.2% y/y. On the revenue side, an impressive 79% beat sales estimates so far, with results coming in 1.3% above forecast and 8.5% higher than a year earlier. At this point in the Q3 season, a lower 67% had exceeded revenue forecasts by a similar 1.3%, and sales had risen by a lower 5.8% y/y. Q4 earnings results are higher y/y for 79% of companies vs a lower 71% at the same point in Q3, and revenues are higher y/y for 88% during Q4 vs a lower 79% a quarter ago. The percentages of companies growing y/y are the highest since we first began tracking them during Q1-2009.

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