



MORNING BRIEFING

March 20, 2018

The Animals Remain Spirited

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

(1) Animal spirits remain elevated following Trump's Election Day upset. (2) Hard data on earnings are bullish for stocks, while other hard data are mixed. (3) CEOs are ecstatic. (4) Small business owners are euphoric. (5) Purchasing managers are upbeat. (6) Consumer optimism and our Boom-Bust Barometer are boosting our Weekly Leading index, which is bullish for stocks. (7) Weird Q1 weakness in GDP showing up again. (8) Truckers have the pedal to the metal. (9) Widening trade deficit may offset some of Trump's fiscal stimulus.

US Economy I: Strong Soft Data. It has been almost a year and a half since the election victory of President Donald Trump on November 8, 2016. The surprising upset seemed to awaken the economy's animal spirits. They remain aroused. The soft data, based mostly on surveys, remain strong. On the other hand, the hard data, based on business cycle indicators, remain mixed.

However, the hard data that matter most to the stock market, i.e., earnings, remain bullish. The hard data that are the most important to the Fed and the bond market are dotted with soft patches, which augur for a continuation of the Fed's gradual normalization of interest rates. Without any further ado, let's have a closer look first at the hard soft data, then at the mixed hard data:

(1) *CEOs' optimism is flying.* Previously, Melissa and I described the mood of corporate managements during the Q4-2017 earnings season as "giddy." We listened to several earnings conference calls during January and read the transcripts for all 30 DJIA companies' calls. Managements were elated by the cut in the corporate tax rate at the end of last year. Their elation was confirmed by the Q1-2018 CEO Outlook Index compiled by Business Roundtable. It jumped to 118.6, the highest on the record for this series, which started during Q1-2003 ([Fig. 1](#)). It is very highly correlated with the yearly percent change in capital spending in both nominal and real terms.

(2) *Small business owners are euphoric.* The NFIB Small Business Optimism Index was 107.6 during February (the second-highest reading in the 45-year history of the survey), up from 94.9 during October 2016 ([Fig. 2](#)). The net percentage of respondents agreeing that now is a good time to expand jumped from 9.0% during October 2016 to 32.0% during February, the highest in the history of the series, which starts in 1974 ([Fig. 3](#)).

(3) *Purchasing managers reporting robust growth.* The M-PMI rose to 60.8 during February, up from 51.8 during October 2016 and the highest since May 2004 ([Fig. 4](#)). This index happens to be highly correlated with the y/y growth rate in S&P 500 revenues per share, which jumped to 9.4% during Q4-2017, the highest since Q3-2011.

(4) *Consumer sentiment is upbeat.* The Consumer Sentiment Index rose during the first half of March to 102.0, the highest reading since January 2004 ([Fig. 5](#)). It was 87.2 during October 2016, just before the election. It was led by a jump in its current conditions component to a record high of 122.8. It was 103.2 just before the election.

The Weekly Consumer Comfort Index (WCCI) has been hovering around 56.5 over the past five weeks ([Fig. 6](#)). It's up from 44.6 at the end of October 2016. It's the highest since February 2001.

(5) *Boom-Bust Barometer is hot*. Often in the past, we've stir-fried the WCCI with our Boom-Bust Barometer (BBB) to derive our Weekly Leading Index (WLI) ([Fig. 7](#)). We derive our BBB as the ratio of the CRB raw industrials spot price index and initial unemployment claims. It rose to a record high in late February. So did our WLI, which has been very highly correlated with the S&P 500 since 2000 ([Fig. 8](#)).

(6) *Vertical ascent for forward earnings*. Industry analysts turned cautious on the outlook for the earnings of the S&P 500/400/600 during late 2014 through mid-2016, as evidenced by the flat-lining of the forward earnings of these three stock market composites ([Fig. 9](#)). These three forward earnings series started to move into record territory again during the second half of 2016, reflecting the end of the global energy-led earnings recession and mounting signs of a synchronized global economic upturn. Following the passage of the Tax Cut and Jobs Act at the end of last year through early March, industry analysts scrambled to raise their earnings outlooks for 2018.

US Economy II: Mixed Hard Data. The strength in measures of consumer confidence is undoubtedly attributable to the upbeat tone of the labor market. Initial unemployment claims have recently been the lowest since 1969. The unemployment rate is down to 4.1%. Payroll employment is up 3.1 million since November 2016. On the other hand, retail sales have been surprisingly weak recently.

The [GDPNow](#) model estimate for real GDP growth in Q1-2018 was 1.8% on March 16, down from 1.9% on March 14. The latest release notes: "The nowcast of first-quarter real private fixed-investment growth increased from 2.4 percent to 3.3 percent after this morning's new residential construction release from the U.S. Census Bureau and this morning's industrial production and capacity utilization release from the Federal Reserve Board of Governors. This increase was more than offset by the modest downward revisions to the nowcasts of the contributions of real consumer spending, real net exports, and real inventory investment to first-quarter real GDP growth."

As Debbie and I have previously observed, the Q1's real GDP growth consistently has been the weakest of each year's four quarters since 2010. This quarter may be shaping up to be no exception. Even though the data are seasonally adjusted, this seasonal aberration has been a persistent phenomenon. Some of that seasonality can be observed in the Citigroup Economic Surprise Index, which has tended to weaken during most of the Q1s since 2010 ([Fig. 10](#)). Most recently, it peaked at 84.5 on December 22, 2017 and has been hovering around 40 since the end of January. That's consistent with describing the hard economic indicators as being "mixed."

US Economy III: Keep on Trucking! In January, the ATA Truck Tonnage Index jumped to yet another record high ([Fig. 11](#)). It is up 12.6% since November 2016. That's an extraordinary ascent. Where are all the trucks going, and what are they carrying? The index is highly correlated with real business inventories ([Fig. 12](#)).

It's unlikely that truck traffic would be at a record high if the inventory building is involuntary. Business sales (which includes manufacturing shipments and distributors' sales) rose 5.7% y/y during January. That's a solid pace. This suggests that notwithstanding the recent weakness in retail sales, total final demand remains strong in the US. The problem may be that more of the truck traffic is carrying surging imports.

US Economy IV: Trade Weighing on GDP. So why isn't the strength in final demand showing up in GDP? The problem is that some of that demand is being met with goods supplied by imports. President Donald Trump and his supply-side economic advisers believe that cutting regulations and tax rates

could boost real GDP growth from 2% closer to 4%.

That might be hard to achieve if the trade deficit continues to widen. On a y/y basis, the growth rate of real final sales to domestic purchasers has exceeded the growth rate of real GDP since late 2014 ([Fig. 13](#)). That's because the real trade deficit in goods and services has widened by 77% from \$368 billion (saar) during Q4-2013 to \$652 billion during Q4-2017 ([Fig. 14](#)).

It's no wonder that the Trump administration is focusing on trade issues. A significant portion of the economic stimulus attributable to the administration's policies may leak through the trade deficit to benefit other countries. For the stock market, solid global economic growth is bullish no matter how it is derived. It won't be bullish if the administration imposes protectionist barriers to trade.

CALENDARS

US. Tues: FOMC Meeting Begins. **Wed:** Existing Home Sales 5.420mu, MBA Mortgage Applications, Current Account -\$126.8b, EIA Petroleum Status Report, FOMC Meeting Announcement 1.625%. (*Wall Street Journal* estimates)

Global. Tues: Eurozone Trade Balance €22.3b. **Wed:** UK ILO Employment Change & Unemployment Rate (3-month) 84k/4.4%. (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—increased seven of the past nine weeks through the week of March 10, up 10.1% over the period, hovering around its record high. Our WLI is the average of our Boom-Bust Barometer (BBB) and Bloomberg's Weekly Consumer Comfort Index (WCCI). Our BBB jumped 16.4% over the nine-week period, fractionally below its record high at the end of February. Jobless claims, one of the components of our BBB, ticked down from 222,250 to 221,500 (4-wa) during the week of March 10, back near the 220,500 reading at the end of February—which was the lowest level since 1969. Meanwhile, the CRB raw industrial spot price index, another BBB component, remains on its uptrend, though has stalled in recent sessions. The WCCI is fluctuating around its cyclical high—at the highest levels since February 2001.

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings rose to record highs last week for the LargeCap and MidCap indexes, but SmallCap's dropped for the first time in 14 weeks. LargeCap's forward earnings was higher for a 33rd straight week, its longest streak since mid-2011; and MidCap's was higher for a 29th week, which now exceeds its prior record streak, ended in mid-2002. Momentum remains strong, as the yearly change in forward earnings is up from six-year lows in early 2016 and should remain strong in 2018. In the latest week, the rate of change in LargeCap's forward earnings rose to 20.3% y/y from 20.2%, which is its highest since May 2011 and compares to a six-year low of -1.8% in October 2015; MidCap's was steady at 23.1%, which is down from late February's seven-year high of 23.9% and compares to a six-year low of -1.3% in December 2015; and SmallCap's edged down to 23.6% from 23.7%, which was the highest since July 2011 and compares to a six-year low of 0.3% in December 2015. Here are the latest consensus earnings growth rates for 2018 and 2019: LargeCap 19.5% and 10.0%, MidCap 20.4% and 12.5%, and SmallCap 23.9% and 16.0%.

S&P 500/400/600 Forward Valuation ([link](#)): Last week saw forward P/E ratios mostly edge down from five-week highs for these three indexes. LargeCap's weekly forward P/E dropped to 17.0 from 17.3. That compares to 18.6 on January 26—the highest since May 2002—but is up from its post-election low of 16.3 in early February. Looking back further, that's up from 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. MidCap's forward P/E fell to 17.1 from 17.3, which is up from the panic attack's 23-month low of 16.2. MidCap's P/E has been at or below LargeCap's P/E since August for the first time since 2009. It's down from a 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 was steady w/w at 18.5, which compares to a post-election low of 17.6. SmallCap's P/E remains well below its 51-week high of 20.2 in December (which wasn't much below the 15-year high of 20.5 in December 2016, when Energy's earnings were depressed), but is comfortably above its three-year low of 15.5 in February 2016. Looking at their forward price/sales (P/S) ratios relative to their panic attack lows on February 8 and their recent highs, valuations have recovered somewhat for the three indexes: LargeCap's P/S of 2.06 is up from the panic low of 1.95, but down from a record high of 2.19 on January 26; MidCap's 1.33 is up from 1.28, but remains below its record high of 1.40 then; and SmallCap's 1.05 is up from 0.99, which compares to 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 and post-TCJA guidance essentially complete, the Q1-2018 earnings forecast dropped for a second week following 12 weeks of gains. The S&P 500's Q1-2018 EPS forecast was down to \$36.20 from \$36.21 a week earlier. Still, that's up 5.2% since the end of Q4 and 5.8% since the passage of the TCJA. The \$36.20 estimate represents a forecasted pro forma earnings gain for Q1-2018 of 18.2%, up from 18.1% a week earlier, and compares to Q4-2017's blended 14.8%, Q3-2017's 8.5%, Q2-2017's 12.3%, and Q1-2017's 15.3% (which then was the strongest growth since Q3-2011 owing mostly to easier comps for Energy). Since the end of Q4, Q1-2018 estimates are higher for 10 sectors and down for one. Energy's Q1 forecast has jumped 18.1%, followed by the forecasts for Telecom (up 14.7%), Financials (12.5), and Utilities (5.1). Real Estate is the sole decliner, with its Q1-2018 forecast down 6.0%, followed by small gains for Materials (0.5), Consumer Staples (0.5), Tech (1.9), Consumer Discretionary (3.9), Industrials (4.2), and Health Care (4.7). The S&P 500's Q1-2018 forecasted earnings gain of 18.2% y/y would be its seventh straight gain after four declines and its strongest since Q1-2011. All 11 sectors are expected to record positive y/y earnings growth in Q1-2018—with seven rising at a double-digit percentage rate—and four are expected to beat the S&P 500's forecasted y/y earnings gain of 18.2%. That's better than the 10 sectors rising y/y during Q4-2017, when seven also rose at a double-digit pace or better. Analysts expect Energy to report another large profit jump in Q1 relative to very low earnings a year ago, but the pace will slow from triple digits in Q4. All 11 sectors last rose y/y during Q2-2017, which was the first time that had happened since Q3-2011. The latest forecasted Q1-2018 earnings growth rates vs their blended Q4-2017 growth rates: Energy (73.1% in Q1-2018 vs 123.4% in Q4-2017), Materials (27.6, 35.9), Financials (24.4, 14.5), Tech (22.5, 20.1), S&P 500 (18.2, 14.8), Industrials (14.5, 1.8), Telecom (13.3, 4.8), Health Care (10.5, 9.0), Utilities (9.8, 13.0), Consumer Staples (9.8, 12.1), Consumer Discretionary (8.7, 10.4), and Real Estate (3.1, -4.0). On an ex-Energy basis, S&P 500 earnings are expected to rise 16.3% y/y in Q1, up from a blended 12.6% in Q4 and 6.1% in Q3 (which was the slowest growth since ex-Energy earnings rose just 2.2% in Q2-2016).

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