



MORNING BRIEFING

April 3, 2018

Record Corporate Cash Flow

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

(1) April is a big month for dividend payouts. (2) That might explain “Go away in May.” (3) TCJA likely to provide one-time boost to level of dividends. (4) Repatriated earnings likely to boost buybacks more than dividends. (5) February outflows from equity funds surprisingly small given the selloff in stocks that month. (6) US-based ETFs still seeing large net inflows, especially to global ones. (7) Foreign investors warmed up to US stocks last year. (8) Solid gains in NIPA profits from current production last year. (9) Plenty of corporate cash available from internal funds and bond issuance to fund lots of share buybacks and capital spending.

Strategy I: Dividends for Stocks. Joe and I have been monitoring the flow of funds into the US stock market for a very long time. We’ve frequently noted that the current bull market has been primarily driven by corporations buying back their shares and paying out dividends, which tend to be used by their recipients to buy more shares. We also started to observe in early 2017 a significant increase in money pouring into equity ETFs.

We were intrigued by a 3/29 Bloomberg [story](#) titled “Stocks Are About to Get a \$400 Billion Dividend Boost.” It was based on a research note by Morgan Stanley strategists. They report that as much as \$400 billion is set to be paid to investors between March and May. They state, “April in particular tends to be a strong month for global equity returns.”

That might be one reason why the adage about “Go away in May” might work on occasions, especially if spring performance has been particularly good. Joe will have a closer look at this notion after he comes back from visiting colleges with his daughter this week.

The Bloomberg article’s headline number seemed awfully big to us until we read that it’s the dividends that are likely to be paid on equities around the world. Before he went on his road trip, Joe reported the following to me:

(1) Global companies usually pay semiannually, while US corporations typically pay dividends either quarterly or semiannually.

(2) Gross dividends in the US for the S&P 500 totaled \$108.95 billion in Q1-2018, down slightly from \$109.09 billion in Q4-2017 ([Fig. 1](#)). US dividends are roughly 40% of the MSCI AC World total.

(3) S&P 500 dividends totaled \$424 billion last year using Thomson Reuters data, which are based on the composition of the current index. Thomson Reuters analysts expect \$450 billion in 2018, up 6.2% y/y, and \$486 billion in 2019, up 8.0%.

(4) We both expect that the corporate tax cut enacted along with the Tax Cut and Jobs Act (TCJA) late last year will be reflected in a permanent one-shot increase in the level of dividends. So the growth rate

in dividends is likely to be higher in 2018. The TCJA will also temporarily boost repatriated earnings, which are likely to lift share buybacks more than dividend payouts.

(5) There is definitely a seasonal pattern in S&P 500 dividends: They're often down in Q1, because Q4 typically has a boost from "special" or one-time dividend bonuses, and higher in Q2 and Q4 because of semiannual and special dividends.

From 1965-2019, the Q1-is-less-than-Q4 pattern holds true 45 of the 54 years. Q2-Q3-Q4 dividends are typically sequentially higher q/q, with Q2 and Q4 boosts ahead of Q3.

Strategy II: Buybacks & Dividends. Corporations like to please their shareholders and attract more of them by paying out some of their after-tax profits in dividends. Ideally, they like to increase their dividends every year in a predictable fashion. That's hard to do during recessions, but tends to be the norm during economic upturns, as can be seen by the steady uptrend in S&P 500 dividends during the current and previous economic expansions ([Fig. 2](#)).

Corporations also buy back their shares as a way of rewarding their shareholders. This practice tends to be much more cyclical than dividend payments ([Fig. 3](#) and [Fig. 4](#)). Let's have a closer look at the data:

(1) *Dividends vs buybacks.* Dividends rose to a record high of \$436 billion last year using S&P's measure, which is the sum of the year's four quarters calculated with the actual, rather than the current, composition of the S&P 500. They've been on a steady upward trend since mid-2010. Buybacks slowed to \$548 billion over the past four quarters through Q4-2017, down from a comparable cyclical high of \$646 billion during Q1-2016.

(2) *Dividends plus buybacks.* The sum of dividends and buybacks has stalled around \$940 billion, based on the four-quarter sum of this series since 2014. During the previous bull market, this sum peaked at \$834 billion ([Fig. 5](#)).

(3) *Operating earnings vs buybacks plus dividends.* Last year, the S&P 500 companies had operating earnings totaling a record \$1,066 billion, while buybacks plus dividends totaled \$938 billion ([Fig. 6](#)). The ratio of the latter to the former suggests that corporations have been paying out roughly 100% of their after-tax operating earnings to shareholders through dividends and buybacks over the past couple of years, leaving virtually nothing for capital spending. That's an erroneous conclusion since operating earnings tends to be a small fraction of cash flow, which is the sum of retained earnings and depreciation expense.

Strategy III: ETFs and Foreigners. Another important source of funds into global stock markets since early 2017 has been net inflows into US-based active and passive funds, especially ETFs. Interestingly, despite the sharp drop in stock prices during February, equity mutual funds and ETFs saw net outflows of only \$19.0 billion during the month ([Fig. 7](#)). The 12-month net inflows have been hovering around \$300 billion since mid-2017 ([Fig. 8](#)).

On a 12-month basis, net inflows into equity ETFs well exceeded the net outflows from equity mutual funds. Among equity ETFs, funds that invest only in domestic equities continue to attract sizeable inflows but at a pace that's been slowing since early 2017 ([Fig. 9](#)). On the other hand, money is pouring into US-based ETFs that invest globally at a record pace, rising to \$173.6 billion over the 12 months through February.

Foreign investors may be starting to reciprocate the favor by purchasing more US equities. The Fed's

data compiled in the [Financial Accounts of the United States](#) show that the “rest of the world” bought \$134.3 billion in US equities last year, the best pace since Q4-2012 ([Fig. 10](#)). They had been heavy net sellers during 2016, according to the Fed’s stats.

Strategy IV: Corporate Profits. Along with the third revision in GDP, released on March 28, the Bureau of Economic Analysis also provided a second revision for corporate profits in the National Income and Product Accounts (NIPA). The data show that after-tax book profits (as reported to the IRS) fell 6.0% y/y ([Fig. 11](#)). Not to worry: NIPA after-tax profits from current production (i.e., on a cash-flow basis) rose 4.8% y/y. The divergence was mostly attributable to the impact of the TCJA, which was also reflected in S&P 500 aggregate income, which was up 10.7% y/y on a reported basis but up 20.4% on an operating basis.

Strategy V: Cash Flow & Capital Spending. Collectively and on average over time, corporations tend to pay out roughly 50% of their after-tax profits in dividends ([Fig. 12](#)). There has been quite a bit of volatility around this average, especially for the S&P 500. In recent quarters, the NIPA dividend payout ratio has declined from a cyclical high of 68.6% to 55.5% during Q4-2017.

As a result, NIPA dividends have been virtually flat at a record high around \$1.0 trillion in recent quarters (saar) ([Fig. 13](#)). Undistributed corporate profits (on a cash-flow basis) rebounded from a recent low of \$464 billion (saar) during Q4-2015 to \$787 billion during Q4-2017, nearly matching the record high during Q3-2010 ([Fig. 14](#)).

Thanks to the TCJA, depreciation reported on tax returns jumped by \$266 billion (saar) during the final quarter of 2017 to a record \$1,803 billion ([Fig. 15](#)). The result was that corporate cash flow rose to a record \$2,438 billion (saar) at the end of last year. That was enough to fund stock buybacks and plenty of capital spending.

Keep in mind that some of the buybacks and capital outlays were paid for with proceeds raised in the bond market. The Fed’s database mentioned above allows us to track the sum of capital spending plus buybacks of nonfinancial corporations (their major uses of funds) to their cash flow plus net bond issuance (their major sources of funds) ([Fig. 16](#)). Not surprisingly, the two series track closely, and both have remained relatively flat at record highs over the past two years.

The data show that nonfinancial corporations had \$1.7 trillion of capital expenditures last year. They had cash flow at \$2.0 trillion, with depreciation accounting for \$1.4 trillion ([Fig. 17](#)).

CALENDARS

US. Tues: Motor Vehicle Sales 17.0mu. **Wed:** ADP Employment 180k, Factory Orders 1.7%, ISM & Markit NM-PMIs 59.0/54.1, MBA Mortgage Applications, EIA Petroleum Status Report, Mester. (*Wall Street Journal* estimates)

Global. Tues: Eurozone, Germany, France, and Italy M-PMIs 56.6/58.4/53.6/55.5, UK M-PMI 54.7, Germany Retail Sales 0.2%/m/m/2.4%/y/y, RBA Cash Rate Target 1.50%. **Wed:** Eurozone Headline & Core CPI 1.4%/1.1% y/y, Eurozone Unemployment Rate 8.5%. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance ([link](#)): The US MSCI index rose 1.9% last week, ranking fourth out of the 49 markets in a week when 32 countries rose in US dollar terms and the AC World ex-US index gained 0.6%. That compares to the index’s 5.9% drubbing a week earlier, which ranked 48th as

six markets rose and the AC World ex-US index fell 2.8%. EM Latin America performed best week with a gain of 1.1%, ahead of EMU (1.0%) and EAFE (0.8). The underperforming regions were EMEA (-1.7), EM Eastern Europe (-1.5), BRIC (-0.4), and EM Asia (0.2). Peru was the best-performing country as it rose 3.5%, followed by Portugal (2.4), Korea (2.0), the United States (1.9), Chile (1.8), and Spain (1.8). Of the 24 countries that underperformed the AC World ex-US MSCI last week, South Africa fared the worst, falling 4.0%, followed by New Zealand (-3.1), Poland (-2.2), Israel (-2.0), and Greece (-2.0). In March, the US MSCI fell 2.6%, ranking 31/44 and behind the 2.1% decline for the AC World ex-US index as all regions fell. That compares to a 3.9% decline in February, when it ranked 22/44, ahead of the 4.9% decline for the AC World ex-US in a month when all regions fell. The best regions in March, albeit with declines: EM Latin America (-1.1), EMU (-1.4), and EM Asia (-1.5). March's worst-performing regions: EMEA (-4.4), EM Eastern Europe (-3.9), BRIC (-3.2), and EAFE (-2.2). On a ytd basis, the US MSCI improved w/w to a 1.1% decline from -3.0% a week ago, and improved in the performance ranking to 29/33 from 32/33. The US MSCI now leads the AC World ex-US (-1.8) again in the ytd period. The emerging market regions and 25/49 countries are in positive territory ytd. EM Latin America has risen 7.2% ytd and leads EM Eastern Europe (4.0), BRIC (2.0), EMEA (1.1), EM Asia (0.6), and EMU (-0.7). EAFE (-2.2) is the only laggard relative to the AC World ex-US's performance.

S&P 1500/500/400/600 Performance ([link](#)): All three market-cap indexes rose last week as MidCap performed best with a gain of 2.1%, ahead of LargeCap (2.0%) and SmallCap (1.7). LargeCap is now down 8.1% from its record high on January 26, worse than the declines of MidCap (-5.8) and SmallCap (-4.2) since then. Thirty-one of the 22 sectors rose in the latest week, up from just one rising a week earlier. The best performers in the latest week: MidCap Utilities (4.1), MidCap Consumer Staples (4.0), SmallCap Real Estate (3.9), and MidCap Real Estate (3.8). The biggest underperformers for the week: SmallCap Energy (-1.8) and SmallCap Tech (-0.1). Two of the three market-cap indexes moved higher in March, which compares to all three falling in February for the first time since March 2017. SmallCap's gain of 1.9% was ahead of MidCap's (0.8) and LargeCap's (-2.7) performances. Nineteen of the 33 sectors advanced in March, up from just one in February, which was the lowest since August 2015. March's best performers: MidCap Energy (6.6), MidCap Utilities (5.2), SmallCap Utilities (5.1), and SmallCap Health Care (4.2). The LargeCaps dominated March's biggest laggards: LargeCap Financials (-4.5), LargeCap Materials (-4.4), and LargeCap Tech (-3.9). LargeCap is now down 1.2% ytd, a bit worse than the 1.1% decline for MidCap and also trailing SmallCap's ytd gain of 0.2%. Nine sectors are still positive to date in 2018, up from just three in early February. The best-performing sectors ytd: SmallCap Health Care (13.0), MidCap Health Care (6.0), MidCap Tech (3.9), LargeCap Tech (3.2), and LargeCap Consumer Discretionary (2.8). The worst performers ytd: SmallCap Real Estate (-11.6), SmallCap Energy (-10.1), LargeCap Telecom (-8.7), LargeCap Consumer Staples (-7.8), MidCap Real Estate (-7.6), and MidCap Energy (-7.4).

S&P 500 Sectors and Industries Performance ([link](#)): All 10 sectors rose last week as five outperformed the S&P 500's 2.0% gain. That compares to all 10 falling a week earlier, when eight outperformed the S&P 500's 6.0% decline. Consumer Staples was the best-performing sector with a gain of 3.5%, ahead of Real Estate (3.2), Telecom (3.1), Utilities (3.0), and Financials (2.7). Energy was the biggest underperformer, albeit with a gain of 1.0%, followed by Consumer Discretionary (1.1), Materials (1.5), Tech (1.7), Health Care (2.0), and Industrials (2.0). The S&P 500 fell 2.7% in March for its second straight monthly decline as three sectors moved higher and six beat the index. That compares to all 11 sectors falling and three beating the S&P 500's 3.9% decline in February. The leading sectors in March: Utilities (3.4), Real Estate (3.3), Energy (1.6), Telecom (-1.1), Consumer Staples (-1.3), and Consumer Discretionary (-2.5). Financials was the biggest laggard in March as it fell 4.5%, followed by Materials (-4.4), Tech (-3.9), Health Care (-3.2), and Industrials (-2.8). Just two sectors are in the plus column so far in 2018, down from nine in early March, but up from just one a month earlier. Only two sectors are ahead of the S&P 500's 1.2% ytd decline: Tech (3.2) and Consumer Discretionary (2.8). The nine sectors that are underperforming the S&P 500 ytd: Telecom (-

8.7), Consumer Staples (-7.8), Energy (-6.6), Materials (-6.0), Real Estate (-5.8), Utilities (-4.2), Industrials (-2.0), Health Care (-1.6), and Financials (-1.4).

Commodities Performance ([link](#)): The S&P GSCI index rose 0.6% for the week as 14 of the 24 commodities we follow moved higher. That compares to a 2.4% gain in the prior week, when 8/24 commodities rose. Last week's strongest performers: Corn (3.1%), Natural Gas (2.9), Zinc (2.3), and GasOil (1.8). Last week's biggest decliners: Live Cattle (-5.4), Aluminum (-3.5), Sugar (-3.3), and Feeder Cattle (-3.2). March saw ten of the commodities climb as the S&P GSCI Commodities index rose 2.2%, compared to 12 rising in February when the index fell 2.9%. March's best performers were led by Cocoa (15.2), Lean Hogs (13.9), and Brent Crude (7.1). March's laggards: Live Cattle (-16.8), Kansas Wheat (-10.5), Wheat (-8.9), and Feeder Cattle (-8.8). The S&P GSCI commodities index is now up 2.4% ytd, but that's down from its peak 4.7% ytd gain on January 26. The best performers so far in 2018: Cocoa (35.1), Unleaded Gasoline (12.5), Corn (10.5), Kansas Wheat (9.4), Soybeans (8.6), and Crude Oil (7.5). The biggest laggards of 2018 to date: Sugar (-18.5), Live Cattle (-15.6), Aluminum (-11.9), Natural Gas (-7.5), and Copper (-7.4).

Assets Sorted by Spread w/ 200-dmas ([link](#)): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 9/24 commodities, 2/9 global stock indexes, and 17/33 US stock indexes, compared to 8/24 commodities, 0/9 global stock indexes, and 1/33 US stock indexes rising a week earlier. Commodities' average spread fell w/w to 4.1% from 4.5%. Fourteen commodities trade above their 200-dmas, down from 15 a week earlier. Cocoa leads all commodities and all assets at 24.8% above its 200-dma, but Corn (7.1%) rose 3.3ppts w/w for the best performances of all commodities and all assets. Live Cattle trades at 12.7% below its 200-dma, the lowest of all assets; it fell 4.7ppts w/w for the worst performance among all commodities and all assets. The global indexes trade at an average of 0.5% above their 200-dmas, up from -0.4% in the prior week. Three of the nine global indexes trade above their 200-dmas, unchanged in the latest week and down from seven a week earlier. Brazil (13.5) still leads the global indexes, but the UK (-4.7) improved 1.6ppts w/w for the best performance among global indexes. Germany and the UK both trade 4.7% below for the lowest among global assets, but China (-1.3) dropped 3.4ppts w/w for the worst performance among global assets. The US indexes trade at an average of 0.5% above their 200-dmas, with 14 of the 33 sectors above, up from 1.4% below a week earlier, when 15 sectors were above. SmallCap Health Care (15.5) still leads all US stock indexes relative to their 200 dmas, followed by LargeCap Tech (5.9) and LargeCap Consumer Discretionary (5.8). MidCap Consumer Staples (-0.1) rose 3.1ppts for the biggest gain among US stock indexes last week. SmallCap Real Estate (-9.7) trades the lowest among all US stock indexes, but SmallCap Energy (-2.3) fell 3.2ppts for the worst performance among US stock indexes and all assets.

S&P 500 Technical Indicators ([link](#)): The S&P 500 price index rose 2.0% last week and improved relative to its short-term 50-dma and long-term 200-dma trend lines. The index remained in a Golden Cross (50-dma higher than 200-dma) for a 100th straight week (after 17 weeks in a Death Cross), yet the index's 50-day moving average (50-dma) relative to its 200-dma dropped for an eighth week to a 16-week low of 4.9% from 5.8%, and is down from a 55-month high of 7.2% in early February. This Golden Cross reading compares to a four-year low of -4.5% in March 2016. The S&P 500's 50-dma fell for a second straight week and just the second time since mid-August, but the pace of decline eased slightly from a week earlier, which was the worst since February 2016. The 200-dma continued to rise, as it has done since May 2016, and also rose faster compared to a week earlier, which was the slowest pace since October 2011. The index improved 3.1% below its falling 50-dma from a 25-month low of 5.6% below a week earlier, which compares to a two-year high of 6.2% above its rising 50-dma on January 29. The S&P 500 appears to have successfully tested its 200-dma, improving to 1.7% above its rising 200-dma from 0.1% below its rising 200-dma a week earlier, which is its first negative reading of Trump's presidency and the lowest since June 2016. That compares to a seven-year high of 13.5%

on January 29, the prior post-election low of 3.0% in mid-August, and a four-year low of -10.1% in August 2015.

S&P 500 Sectors Technical Indicators ([link](#)): Last week saw all 11 sectors improve relative to their 50-dmas and 200-dmas. At the week's end, nine of the 11 sectors traded below their 50-dma (all but Real Estate and Utilities), compared to a week earlier when all 11 were below for the first time since February 2016. The longer-term picture—i.e., relative to 200-dmas—shows 7/11 sectors trading below, up from 8/11 below a week earlier, which was the lowest since January 2016. Industrials moved above its 200-dma in the latest week and joined these three sectors: Consumer Discretionary (73 straight weeks), Financials (29 weeks), and Tech (91 straight weeks). Consumer Staples was below for a sixth week, Real Estate below for a 13th week, and Utilities below for a 15th week. All 11 sectors had been above both their 50-dmas and 200-dmas briefly in mid-December for the first time since July 2016. However, eight sectors are still in a Golden Cross (50-dmas higher than 200-dmas), unchanged from a week earlier. All 11 had been in a Golden Cross in mid-January for the first time since a 26-week streak ended in October 2016. Consumer Staples was out of the Golden Cross club last week for a second week, Real Estate was out for an eighth week and the first time since last April, and Utilities was out for a tenth week and for the first time since March 2016. All 11 sectors had falling 50-dmas for a second week; that's the worst sector count since before the election in November 2016. Real Estate fell for the 13th time in 15 weeks, and Utilities moved lower for an 11th straight week. However, seven sectors still have rising 200-dmas, unchanged from a week earlier. That's up from six in early February, which was the lowest since May 2017. The 200-dmas for Real Estate and Utilities fell for a 12th week, and those for Consumer Staples and Telecom dropped for a sixth week.

US ECONOMIC INDICATORS

Personal Income & Consumption ([link](#)): Real disposable personal income (DPI) in February continued to climb to new highs, while real consumer spending remained stalled around record highs. Real DPI expanded 3.2% (saar) in the three months through February, based on the three-month average, accelerating steadily from near zero in October; real wages & salaries also accelerated 3.2% (saar) over the comparable period, double the rate near the end of last year. Real consumer spending was unchanged in February after contracting 0.2% in January, which was the first decline in a year. Its three-month growth rate slowed to 2.2% (saar) after accelerating at a three-year high of 4.0% in December. Our Earned Income Proxy, which tracks consumer spending and wages & salaries closely, continues to set new highs, indicating that the consumer will continue to be a major contributor to economic growth.

Consumer Sentiment ([link](#)): A record-high reading in the University of Michigan's present situation component in March pushed the overall Consumer Sentiment Index (CSI) to its highest reading since January 2004. The CSI rose for the second month, from 95.7 in January to 101.4 last month, slightly below the mid-month reading of 102.0. According to the survey, "Importantly, all of the March gain in the Sentiment Index was among households with incomes in the bottom third (+14.4); those in the middle third were unchanged, while the Index fell among households in the top third (-5.6)." The latter had greater concerns with government economic policies than they did in February, especially trade policies. The present situation component climbed from 114.9 in February to 121.2 last month—the highest reading in the history of the series going back to the 1950s. The expectations component of the CSI eased from 90.0 to 88.8, bouncing around recent highs. (Both measures were little changed from their preliminary readings of 122.8 and 88.6, respectively.)

US Manufacturing PMIs ([link](#)): Manufacturing activity in March accelerated at its fastest rate in three years according to IHS Markit, while ISM's measure remained around February's near 14-year high. The ISM M-PMI slipped to 59.3 from 60.8 in February—which was the highest reading since May 2004.

All measures slowed last month, though remained at elevated levels. Both the new orders (61.9 from 64.2) and production (61.0 from 62.0) indexes edged down again in March, though remained above 60.0 for the tenth consecutive month; the new export orders index (58.7 from 62.8) slipped below 60.0 after moving above that threshold in February for the first time since April 2011. The employment (57.3 from 59.7) measure remained in a volatile flat trend just below 60.0, while the supplier deliveries (61.1 from 60.6) gauge held just above 60.0. Inventories (55.5 from 56.7) stayed at recent highs, after contracting the last three months of 2017. IHS Markit's M-PMI edged up from 55.3 to 55.6 in March, the fastest growth since March 2015, with both output and new orders expanding markedly, while job creation was also impressive.

Construction Spending ([link](#)): Construction spending in February remained stalled at record highs, as an increase in private construction spending was offset by a decline in public construction expenditures. Public construction spending sank 2.1% after jumping the prior six months by 11.0% to its highest reading in two years. Private construction investment climbed for the third time in four months, by 0.7% in February and 3.5% over the period. Nonresidential investment was up 1.5% and 4.2% over the comparable periods, residential spending by 0.1% and 3.0%. Within residential construction, investment in single-family homes continued to soar to new record highs, rising 16 of the past 17 months by a whopping 18.8%, while multi-family investment remains volatile around record highs, falling 1.3% in January. Meanwhile, home-improvement spending has stalled around its record high in recent months.

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