



MORNING BRIEFING

April 17, 2018

More Ups Than Downs

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

(1) Retail sales is one of the three components of business sales. (2) Monthly business sales is a good leading indicator of S&P 500 revenues. (3) The revenues growth cycle may be peaking. (4) The Energy-led growth recession and recovery may have run their courses. (5) After exuberant upward revisions, analysts may be starting to curb their enthusiasm about revenues. (6) US PMIs remain upbeat on S&P 500 revenues growth. (7) GDPNow down to 1.9%. (8) Three explanations for why retail sales were so weak during Q1. (9) Online retail sales now at record 31.0% of GAFO sales.

US Economy I: Business Sales Strong. March retail sales data were released yesterday. So were data on total business sales of goods through February. The latest retail sales data are included in an advance report, while the business sales data are lagged because of the longer delay in the availability of data for manufacturing shipments and wholesalers. Most economists, and all of the financial media, focus on retail sales and ignore the business sales release.

Debbie and I tend to focus more on the business sales data even though it is a bit stale. That's because the y/y growth rate in business sales is a good indicator of the comparable growth in S&P 500 revenues, which is quarterly with even a longer lag. Consider the following:

(1) *Total.* Business sales is up 5.8% y/y through February ([Fig. 1](#)). This growth rate is up from a recent trough of -4.2% during August 2015. It has been highly correlated with the yearly growth rate in S&P 500 aggregate revenues since the start of the S&P 500 revenues data in 1993. The growth rate in business sales has been tracking the growth rate in the S&P 500 series remarkably well since 2008. This is remarkable because business sales includes only goods, while the S&P 500 series includes goods and services.

(2) *Excluding energy.* The plunge in oil prices during the second half of 2014 through the end of 2015 also weighed heavily on nonenergy business sales, accounting for most of the recent cycle in nonpetroleum sales. Excluding petroleum, business sales growth dropped from around 4.0% during 2014 to zero during 2015 and 2016 ([Fig. 2](#)). The plunge in oil prices, along with the widespread weakness in commodity prices during the second half of 2014 through 2015, depressed global economic growth. However, that growth rebounded in late 2016 through 2017, as evidenced by the uptrend in the growth of both nonpetroleum business sales and S&P 500 aggregate revenues excluding the revenues of the S&P 500 Energy sector.

(3) *Global growth.* Our Global Growth Barometer (GGB) is simply the average of the CRB raw industrials spot price index and the price of a barrel of Brent crude oil ([Fig. 3](#) and [Fig. 4](#)). It remains on the solid uptrend that began in early 2016.

(4) *Peak growth.* While the GGB continues to signal solid global economic growth, odds are that the growth rates in S&P 500 revenues both with and without Energy peaked during Q4-2016 at 8.6% and

7.1%, respectively. Industry analysts may already be starting to curb their enthusiasm about the outlook for revenues this year and next year ([Fig. 5](#) and [Fig. 6](#)). Their consensus expectations for both rose sharply since late last year through mid-March, but have flattened since then through early April. Nevertheless, they are currently predicting solid gains in S&P 500 revenues growth with growth of 7.0% and 4.5% this year and next year.

(5) *Elevated PMIs*. By the way, Debbie and I have previously observed that the cycles in both the US M-PMI and NM-PMI track S&P 500 revenues per share relatively well ([Fig. 7](#) and [Fig. 8](#)). The M-PMI edged down in March to 59.3 from 60.8 in February, while the NM-PMI ticked down to 58.8 from 59.5. Both remain relatively high, and upbeat for revenues growth.

US Economy II: Retail Sales Weak. Weighing on business sales during the first quarter have been weak retail sales numbers. Inflation-adjusted retail sales fell 3.1% (saar) during Q1-2018 vs Q4-2017 ([Fig. 9](#)). Debbie uses the CPI for goods to deflate the retail sales data. Core retail sales (excluding consumer spending categories that are treated separately in GDP) fell 2.8%. Confirming the slowdown is the flattening of revolving consumer credit outstanding ([Fig. 10](#) and [Fig. 11](#)).

That's quite surprising given the strength in payroll employment, which raked up average monthly gains of 202,000 per month during the first quarter. Hourly wages also rose, pushing our Earned Income Proxy to a new record high in March ([Fig. 12](#)).

The drop in real retail sales should be offset by an increase in consumption expenditures on services. Nevertheless, total personal consumption was weak during the first quarter. Indeed, the Atlanta Fed's [GDPNow](#) model now estimates that real GDP rose only 1.9% during the quarter, down from 2.0% on April 10. That was because "first-quarter real personal consumption expenditures growth declined from 1.1 percent to 0.9 percent after this morning's retail sales release from the U.S. Census Bureau." There are a few possible explanations:

(1) *Seasonal aberration*. There is a well-known seasonal-adjustment aberration in the real GDP's data showing that since 2010, economic growth has been weaker than growth over the remaining four quarters of the years since then ([Fig. 13](#)). It seems to be driven by the personal consumption expenditures component of real GDP ([Fig. 14](#)).

(2) *Tax cuts and hikes*. The weakness in retail sales during the first three months of the year is especially odd given that the Tax Cut and Jobs Act enacted on December 22 of last year boosted the take-home pay of lots of taxpayers at the start of the year. On the other hand, many taxpayers lost their deductions for state and local taxes exceeding \$10,000. There is also lots of uncertainty about how sole proprietorships will be taxed.

(3) *Revisions*. Finally, the retail sales data might be revised up. The data are prone to revisions. Retail sales revisions are usually worth mentioning, but this time around sales for January and February were unchanged at -0.1%.

US Economy III: Online Retail Sales Strong. Meanwhile, online retailers' share of GAFO rose to a record 31.0% during February ([Fig. 15](#)). It has more than doubled from 15.0% during February 2006. (GAFO is general merchandise, apparel and accessories, furniture, and other sales. It includes sales of retailers that specialize in department-store types of merchandise such as furniture & home furnishings, electronics & appliances, clothing & accessories, sporting goods, hobby, book, and music, general merchandise, office supply, stationery, and gift stores.)

Online retailers continue to take share away from department stores, which are down to 12.1% of

GAFO from 37.2% during March 1992, near the start of the data. Online retailers have also been slowly chipping away at the share of warehouse clubs and super stores, which are down to 25.2% from a record high of 27.2% during January 2014.

On average, households spent \$15,500 (saar) at the end of last year on in-store and online GAFO ([Fig. 16](#)). In-store GAFO was \$10,700 per household, just about unchanged since 2008. Online GAFO was a record \$4,800 per household at the end of last year, up 144% since late 2008 ([Fig. 17](#)).

CALENDARS

US. Tues: Headline & Manufacturing Industrial Production 0.4%/0.2%, Capacity Utilization 78.0%, Housing Starts & Building Permits 1.269mu/1.311mu, Williams, Quarles, Evans. **Wed:** MBA Mortgage Applications, EIA Petroleum Status Report, Beige Book, Dudley. (*Wall Street Journal* estimates)

Global. Tues: Germany ZEW Survey Expectations -1, UK Employment Change & Unemployment Rate (3M) 55K/4.3%, Japan Industrial Production, Japan Trade Balance ¥499.2b, China GDP 1.5%q/q/6.8%y/y, China Retail Sales 9.7% y/y, China Industrial Production 6.4% y/y, RBA April Minutes. **Wed:** Eurozone Headline & Core CPI 1.4%/1.0% y/y, UK Headline & Core CPI 2.7%/2.5% y/y, BOC Rate Decision 1.25%. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings rose to record highs last week for all three indexes. LargeCap's forward earnings has been up in 37 of the past 38 weeks, and MidCap's was higher last week for a 33rd straight week, which now exceeds its prior record streak, ended in mid-2002. Earnings momentum remains healthy, 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 edged down to 19.8% y/y from 20.1% y/y, which is down slightly from a seven-year high of 20.3% in mid-March and compares to a six-year low of -1.8% in October 2015; MidCap's dropped to 23.5% from 23.8%, which compares to a seven-year high of 24.0% in mid-March and a six-year low of -1.3% in December 2015; and SmallCap's ticked down to 27.5% from a seven-year high of 27.7%, which 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 19.7% and 10.1%, MidCap 19.7% and 12.2%, and SmallCap 23.1% and 17.3%.

S&P 500/400/600 Forward Valuation ([link](#)): Last week saw forward P/E ratios improve from post-election lows for all three indexes. LargeCap's weekly forward P/E rose to 16.3 from 16.1 in the prior week, but is down from 18.6 on January 26—the highest since May 2002. These recent levels are well above the post-Lehman-meltdown P/E of 9.3 in October 2008 but well below the tech-bubble record high of 25.7 in July 1999. MidCap's forward P/E rose to 16.3 from a 25-month low of 16.1, but remains down from a 15-year high of 19.2 in February 2017 and the record high of 20.6 in January 2002; however, it is up from a three-year low of 15.0 in January 2016. MidCap's P/E has been at or below LargeCap's P/E since August for the first time since 2009. SmallCap's P/E improved to 17.5 from 17.2, which compares to a post-election low of 17.0 in mid-March. That's 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 daily forward price/sales (P/S) ratios, the three indexes were little changed w/w and remain well below their recent highs in January: LargeCap's P/S of 1.98 is down from a record high of 2.19 on January 26; MidCap's 1.28 compares to its record high of 1.40, also on January 26; and SmallCap's 0.98 is down from 1.05 then, 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 complete, the Q1-2018 earnings forecast was surprisingly flat w/w during a period when forecasts typically move lower. The S&P 500's Q1-2018 EPS forecast edged down a penny w/w to \$36.15, which is up 5.0% since the end of Q4 and 5.7% since the passage of the TCJA. The \$36.15 estimate represents a forecasted pro forma earnings gain for Q1-2018 of 18.9%, which compares to Q4-2017's 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 nine sectors and down for one. Energy's Q1 forecast has jumped 15.8%, followed by the forecasts for Telecom (up 14.4%), Financials (11.9), and Utilities (6.6). Real Estate is the sole decliner, with its Q1-2018 forecast down 6.8%, followed by Materials (0.0), Tech (1.1), Consumer Staples (2.1), Industrials (3.6), Health Care (3.9), and Consumer Discretionary (4.1). The S&P 500's Q1-2018 forecasted earnings gain of 18.9% 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 nine rising at a double-digit percentage rate—and four are expected to beat the S&P 500's forecasted y/y earnings gain of 18.9%. That's better than the 10 sectors rising y/y during Q4-2017, when seven 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 Q4-2017 growth rates: Energy (71.4% in Q1-2018 vs 120.4% in Q4-2017), Materials (26.8, 35.9), Financials (26.7, 14.6), Tech (23.4, 20.1), S&P 500 (18.9, 14.8), Industrials (14.3, 1.8), Telecom (12.6, 4.8), Health Care (10.7, 9.1), Consumer Staples (10.6, 12.1), Utilities (10.4, 13.0), Consumer Discretionary (9.5, 10.7), and Real Estate (2.9, -4.1). On an ex-Energy basis, S&P 500 earnings are expected to rise 17.1% y/y in Q1, up from a 12.7% in Q4 and 6.1% in Q3 (which was the slowest growth since ex-Energy earnings rose just 2.2% in Q2-2016).

S&P 500 Q1 Earnings Season Monitor ([link](#)): With nearly 7% of S&P 500 companies finished reporting earnings and revenues for Q1-2018, the percentage of companies with positive surprise results are lower compared to the same point during the Q4 earnings season, but their overall surprise and y/y growth metrics are stronger. Of the 34 companies in the S&P 500 that have reported, 71% exceeded industry analysts' earnings estimates by an average of 4.5%; they have averaged a y/y earnings gain of 33.2%. At the same point during the Q4-2017 reporting period, a higher percentage of companies (77%) in the S&P 500 had beaten consensus earnings estimates by a lower 2.9%, and earnings were up a lower 18.4% y/y. On the revenue side, 79% beat sales estimates so far, with results coming in 1.4% above forecast and 9.4% higher than a year earlier. At this point in the Q4 season, a higher 87% had exceeded revenue forecasts by a slightly lower 1.3%, and sales rose a lower 8.8% y/y. Q1 earnings results are higher y/y for 91% of companies vs a lower 80% at the same point in Q4, and revenues are higher y/y for 94% during Q1 vs 93% a quarter ago. These figures will change markedly as more Q1-2018 results are reported in the coming weeks. The early results on revenues are very encouraging, particularly the percentage of companies growing revenues y/y. Q1-2018 should mark the seventh straight quarter of positive y/y earnings growth and the strongest since Q4-2010 in part due to lower tax rates.

US ECONOMIC INDICATORS

Retail Sales ([link](#)): Consumers started shopping again in March after taking a break the prior three months—recording the longest stretch of declines since April 2012. Retail sales rebounded 0.6% last month after falling negligibly in each of the prior three months. Core retail sales climbed 0.4% after no change in February and declines of 0.1% and 0.3% in January and December, respectively. (The BEA uses this core retail sales measure to estimate personal consumption expenditures each month.) We

estimate real retail sales rose for the first time in four months, rebounding 1.1% last month. Despite March's increase, these sales contracted 3.1% (saar) during Q1, the first quarterly decline since Q2-2011; sales had accelerated 6.3% during Q4. We estimate real core retail sales rose 1.1% in the two months through March after a two-month slide of 1.4%. These sales fell 2.8% (saar) last quarter after a 3.8% expansion during the final quarter of last year. Eight of the 13 major nominal sales categories rose in March, led by sizable gains by motor vehicle (2.0%) and health & personal care (1.4) establishments, followed by nonstore (0.8), furniture (0.7), electronics (0.5), food services & drinking (0.4), general merchandise (0.3), and food & beverage (0.2) retailers. Partially offsetting these gains were declines in sales by sporting goods (-1.8), clothing (-0.8), gasoline (-0.3), and miscellaneous store (-0.3) retailers. Our Earned Income Proxy, which tracks consumer spending closely, continues to set new highs, indicating the consumer will likely be a major contributor to economic growth once again this quarter.

Business Sales & Inventories ([link](#)): Nominal business sales in February climbed to a new record high, while real sales in January fell from December's record reading. The details: Nominal manufacturing & trade sales (MTS) more than reversed January's 0.3% decline, rising 0.4% in February; it was the ninth increase in 10 months, jumping 5.8% over the period. Inflation-adjusted MTS sank 1.0% in January after rebounding 3.9% during the last eight months of 2017; sales had slumped 1.0% during the first four months of last year. Real sales of both retailers and wholesalers have weakened over the past two months since reaching record highs in November, while manufacturers' sales have been stalled at their cyclical high. January's real inventories-to-sales ratio climbed to 1.42 from 1.40 the prior two months—which were the lowest readings mid-2013; February's nominal inventories-to-sales ratio remained at 1.35; it was at a three-year low of 1.33 during the final two months of last year.

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