



MORNING BRIEFING

June 6, 2018

Around the World

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

(1) Trump's monkey wrench. (2) Commodities holding their regained ground. (3) Fed's gradual normalization and Trump's protectionism lift dollar. (4) Higher US interest rates and stronger US dollar is a bad cocktail mix for some emerging economies. (5) Our international capital flows indicator could soon be signaling outflows from the rest of the world to the US if dollar remains strong. (6) Global M-PMI is down from recent peak, but still solid. (7) Some signs of weakness in global exports. Blame Trump? (8) Forward revenues for major MSCI global stock composites showing strength, not weakness. (9) Stay Home may trump Go Global as long as Trump goes rogue on protectionism.

Global Economy I: Commodity Prices. Has President Donald Trump's protectionism thrown a monkey wrench into the global synchronized growth mechanism? Joe, Debbie, and I started to see mounting signs of this scenario during the summer of 2016. We attributed it to the end of the energy-led commodity bust, which began during the second half of 2014 and ended in early 2016.

Debbie and I observed that the CRB raw industrials spot price index and the price of a barrel of Brent crude oil had bottomed at the start of 2016. We combine these two series to derive our Global Growth Barometer (GGB) ([Fig. 1](#) and [Fig. 2](#)). It plunged 50.5% from June 20, 2014 through January 20, 2016. Since then, it is up 63.6% to one of the highest readings since November 2014, confirming the solid rebound in the global economy. By the way, one of our accounts observed that our GGB is nearly identical to the Goldman Sachs Commodity Index ([Fig. 3](#)).

Global Economy II: The Dollar & Capital Flows. Since 2006, there has been a strong inverse correlation between our Global Growth Barometer and the trade-weighted US dollar ([Fig. 4](#)). They've diverged significantly recently as commodity prices remained firm while the dollar jumped 4.9% since February 1. This could spell trouble for the global synchronized growth scenario.

First, let's briefly review why there has been an inverse correlation between the two. When the global economy is strong, commodity prices tend to move higher. Most commodities are priced in dollars. When foreign commodity exporters receive more dollars, they tend to diversify some of their windfalls into other currencies, particularly the euro and the yen. Commodity prices tend to fall when the global economy is weak, providing fewer dollars for commodity exporters to convert to other currencies.

The recent surge in the dollar coincided with Trump's protectionist saber-rattling. Contributing to the dollar's strength has been the growing realization that the Fed is likely to continue to raise interest rates and unwind its QE portfolio of securities, while both the ECB and BOJ may be doomed to maintain their ultra-easy monetary policies for the foreseeable future. Higher US interest rates and the stronger dollar can be a lethal cocktail mix for emerging market economies (EMEs) that have been guzzling lots of short-term debts denominated in dollars.

In other words, all the international capital that flowed into EMEs when the global economy and

commodity prices were strong, and when EMEs had relatively attractive interest rates, can quickly turn into outflows when US interest rates are rising relative to the rest of the world and the dollar is strengthening.

Debbie and I constructed a proxy for global capital flows in and out of the US to the rest of the world by subtracting the world's merchandise trade surplus with the US (on a 12-month basis) from the y/y change in world non-gold international reserves ([Fig. 5](#) and [Fig. 6](#)). (For more information on this, see the "Capital Flows In and Out" section of my book [Predicting the Markets](#), pp. 406-410.)

Our confidence in our proxy is increased by its strong inverse relationship with the yearly percent change in the dollar ([Fig. 7](#)). The dollar tends to strengthen when capital is flowing into the US from the rest of the world. It weakens when capital is flowing out of the US into the rest of the world. The recent surge in the dollar suggests that capital is flowing back to the US, which explains the weakness in EME stock prices and currencies ([Fig. 8](#) and [Fig. 9](#)).

Global Economy III: Purchasing Managers. Confirming the global slowdown is the Global Manufacturing PMI, which fell to 53.1 during May, down from a recent peak of 54.5 during December ([Fig. 10](#)). Over this same period, the Advanced Economies component of this index fell 1.5 points to 54.7, while the Emerging Economies component fell 1.1 points to 51.1. Keep in mind that the latest readings for the overall index and its Advanced Economies component are still above their early 2014 readings. Furthermore, as Debbie reports below, the Global NM-PMI remained strong as well during May, led by the US.

Global Economy IV: Exports. Data available through March—i.e., just when Trump started to go rogue on protectionism—show world exports volume continued to rise into record-high territory late last year through early this year ([Fig. 11](#)). That's confirmed by the sum of real US exports plus imports.

On the other hand, May data from the US ISM survey show that the sum of the sub-indexes for manufacturing new exports and for imports fell sharply from a record high of 123.3 during February to 109.7 in May, which is still a high reading ([Fig. 12](#)). This homebrewed indicator is highly correlated with the y/y growth in world exports, which fell to just 1.1% during March. So there are some preliminary signs that Trump's protectionist saber-rattling may be starting to rattle trade.

Global Economy V: Forward Revenues. Joe and I aren't seeing any signs of a global slowdown in analysts' 52-week forward consensus expectations for the revenues of the MSCI stock composite indexes for the US, Developed World ex-US, and Emerging Markets ([Fig. 13](#) and [Fig. 14](#)). The US series has been rising in record-high territory since February 2017, and continues to do so. The Developed World ex-US is showing a more robust rebound since early 2016 in local currencies than when denominated in dollars. The same can be said for Emerging Markets, though their revenues series in local currencies has been rising in record-high territory over the past year.

Global Economy VI: Stay Home. On Monday, we wrote: "Under the circumstances, Joe and I once again are recommending a Stay Home investment strategy rather than a Go Global one. We had been staying home during the current bull market until late 2016, when we saw signs of global synchronized growth and recommended a globally market-weighted stance on stocks. Now we are back to overweighting the US."

A glance at the ratio of the US MSCI stock price index to the All Country World ex-US index shows that it was on a solid uptrend from 2011 through late 2016. It moved down sharply during 2017 in dollars and was relatively flat in local currencies ([Fig. 15](#)). Since late 2017, the ratio has been rising again in both dollars and local currencies.

The Eurozone may be on the verge of another existential crisis. Japan has been in a slow-motion geriatric crisis. EMEs could turn more distressed if the dollar continues to move higher ([Fig. 16](#)). Of course, hanging over all these concerns are Trump's increasingly disjointed, convoluted, and muddled protectionist policies.

CALENDARS

US. Wed: Trade Balance -\$49.0b, Productivity & Unit Labor Costs 0.7%/2.8%, MBA Mortgage Applications, EIA Petroleum Status Report. **Thurs:** Jobless Claims 225k, Consumer Credit \$14.0b, Chain Store Sales, Weekly Consumer Comfort Index, EIA Natural Gas Report. (*Wall Street Journal* estimates)

Global. Wed: Australia GDP 0.8%q/q/2.7%y/y. **Thurs:** Eurozone GDP 0.4%q/q/2.5%y/y, Germany Factory Orders 0.8%m/m/3.6%y/y, Japan GDP -0.5%(saar), Japan Leading & Coincident Indexes 105.6/117.8. (DailyFX estimates)

STRATEGY INDICATORS

S&P/Russell LargeCaps & SMidCaps ([link](#)): SmallCaps are now outperforming LargeCaps and MidCaps so far in 2018, and are at record highs recently for the first time since January. Here's how they rank ytd through Monday's close, along with their 2017 performance and their percentage changes since their record highs in January: S&P SmallCap 600 (9.5% ytd, 11.7% in 2017, at a record high), Russell SmallCap 2000 (7.3, 13.1, at a record high), S&P MidCap 400 (3.6, 14.5, -1.4), Russell LargeCap 1000 (2.9, 19.3, -4.0), and S&P LargeCap 500 (2.7, 19.4, -4.4). Forward revenues and earnings are at record highs now for all the S&P and Russell indexes. Earnings momentum remains healthy for the S&P indexes, 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 21.4% y/y from 21.3%, which compares to a seven-year high of 21.7% in mid-May and a six-year low of -1.8% in October 2015; MidCap's rose to 23.1% from 22.8%, 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 slipped to 28.9% from 29.1%, which compares to a seven-year high of 30.2% in mid-May and a six-year low of 0.3% in December 2015. Here are the latest consensus earnings growth rates for 2018 and 2019: LargeCap 22.1% and 9.6%, MidCap 20.3% and 12.5%, and SmallCap 24.7% and 16.5%.

S&P 500 Growth vs Value ([link](#)): The S&P 500 Growth index is up 8.2% ytd, well ahead of the 3.0% decline for its Value counterpart. Value is 8.6% below its January 26 record high and no longer in a correction, while Growth is down 0.5% since then. During 2017, Growth's 25.4% gain was double the 12.6% rise for Value. Growth had trailed Value in the four months following the election. Now Growth's 38.2% gain since the election is more than double the 17.4% increase logged by Value. During 2016, the S&P 500 Growth index underperformed its Value counterpart by a wide margin, rising just 5.1% vs Value's 14.3% gain. Growth is expected to deliver more than double the rate of revenue growth (STRG) that Value does over the next 12 months, but forward earnings growth (STEG) is only slightly higher for Growth; specifically, 9.4% STRG and 16.2% STEG are projected for Growth, respectively, vs 4.6% and 14.9% for Value. Prior to February's selloff, Growth's P/E of 21.8 on January 26 was its highest since May 2002, while Value's 16.6 on January 3 was its highest since April 2002. Through Monday, Growth's P/E was back up to 19.8 from its 15-month low of 18.8 on April 2 and Value's 14.0 remains close to its 25-month low of 13.9 on March 23. Regarding NERI, Growth's was positive in May for a 13th straight month, but dropped to a still-impressive 11.8% from 15.9%; that compares to a record high of 22.3% in March and a five-year low of -16.2% in April 2015. Value's NERI was also positive in May for a 13th month (following 33 months of negative readings), but eased to 7.3% from 11.3%; that

compares to a record high of 21.2% in March and five-year low of -20.3% in April 2015. The TCJA has boosted the consensus 2018 earnings estimate and the forward profit margin for both Growth and Value. Growth's 2018 estimate has risen 9.4% vs Value's 7.9% gain. Growth's forward profit margin has jumped to a record high of 16.5% from 14.4% prior to the TCJA's passage, and Value's has risen to a 10-year high of 10.0% from 9.1%.

US ECONOMIC INDICATORS

JOLTS ([link](#)): Job openings in April jumped to yet another new record high of 6.698 million, up 65,000 m/m and 1.03 million ytd. Meanwhile, hirings recovered 92,000 in April to 5.578 million, more than reversing the 88,000 drop the prior two months—within striking distance of October's cyclical high of 5.609 million; separations climbed for the second month, by a total of 235,000, to a new cyclical high of 5.408 million. The latest hirings and separations data yielded an employment advance of 170,000, 11,000 above April's payroll gain of 159,000 and exceeding the payroll gain for the eighth straight month. April's job-opening rate was unchanged at March's 4.6% record high, while the quit rate (2.5%) was back below March's cyclical high of 2.6%. The total hires rate was unchanged at 4.1%, just below its cyclical high of 4.2%. April's ratio of unemployed workers per job opening (0.95) sank to another new record low!

GLOBAL ECONOMIC INDICATORS

Global Composite PMIs ([link](#)): Global economic activity saw a modest acceleration again in May, though remained below February's 3.5-year high. The JP Morgan Global Composite Output Index (C-PMI) ticked up for the second month to 54.0 last month, after falling in March (to 53.3) for the first time in six months; it had climbed the prior five months from 53.8 in September to 54.8 in February—which was its best reading since September 2014. The NM-PMI recovered for the second month from 53.2 in March to 54.3 in May, while the M-PMI fell for the fourth time in five months, from 54.5 in December to a nine-month low of 53.1 last month. Developed markets (to 54.8 from 54.4) continued to outperform emerging markets (52.2 from 52.4) markets, with the former's C-PMI measure rising to a three-month high last month while the latter's slipped to a six-month low. C-PMIs show the US (56.6 from 54.9) was the prime driver of growth last month, accelerating at its fastest pace in 3.5 years—surpassing growth in the Eurozone (54.1 from 55.1) for the first time since January 2017. The Eurozone's C-PMI has slowed steadily since reaching 58.8 in January. Spain (55.9) posted the best growth of the top four Eurozone economies in May, while France (54.2) and Germany (53.4) posted their weakest performances in 16 and 20 months, respectively; Italy (52.9) remained the weakest performer for the fifth straight month. Meanwhile, growth in the UK (54.5 from 53.2) accelerated for the second time since falling to a recent low of 52.4 in March, while Japan's (51.7 from 53.1) eased. Emerging economies show growth in China (52.3) holding steady at April's pace, while Russia (53.4 from 54.9) and India (50.4 from 51.9) grew at slower rates than April, with the latter near a standstill; economic activity in Brazil (49.7 from 50.6) contracted after expanding the first four months of the year.

Global Non-Manufacturing PMIs ([link](#)): The global service sector in May continued to rebound back toward February's three-year high. The JP Morgan's NM-PMI climbed from 53.2 in March to 54.3 in May, the second highest rate during the past three years—February's 54.8 being the highest. The report notes that the US (to 56.8 from 54.6) was the leader in the global service economies covered by the survey, expanding at its fastest pace in three years. NM-PMIs for the UK (54.0 from 52.8), Spain (56.4 from 55.6), and Italy (53.1 from 52.6) showed these countries also enjoyed faster growth last month, with all at three-month highs. Service-sector slowdowns in Germany (52.1 from 53.0) and France (54.3 from 57.4) pulled growth in the overall Eurozone (53.8 from 54.7) down to a 16-month low. Meanwhile, service sectors in Japan, China, and India all were below the global average, with NM-PMIs showing growth slowing in Japan (51.0 from 52.5), holding steady in China (52.9), and contracting in

India (49.6 from 51.4). Elsewhere, Russia's (54.1 from 55.5) serviced sector slowed, though remained at a relatively high rate, while Brazil's (49.5 from 50.0) contracted.

US Non-Manufacturing PMIs ([link](#)): The US service sector grew at a faster pace in May according to both the ISM and IHS Markit measures. ISM's NM-PMI (to 58.6 from 56.8) accelerated again in May, rebounding back near January's 59.9—which was the fastest rate since August 2005. Last month, all four components picked up—business activity (61.3 from 59.1), new orders (60.5 from 60.0), supplier deliveries (58.5 from 54.5), and employment (54.1 from 53.6). Markit's NM-PMI shot up to 56.8 in May—its best reading since April 2015. According to the report, output growth was the strongest in over three years, while the pace of new business remained among the fastest in three years. Meanwhile, order backlogs accumulated at the quickest pace in over a year, prompting companies to hire at the strongest pace since September 2015.

Eurozone Retail Sales ([link](#)): Retail sales expanded in April for the third month, after contracting the previous two months from November's record high. Sales rose a smaller-than-expected 0.1% in April (vs a 0.5% expected advance), after an upwardly revised gain in March (to 0.4% from 0.1%) and an unrevised 0.3% in February; sales had contracted 1.4% during the two months ending January. Spending on nonfood products (ex auto fuel) rebounded 1.7% in April after a two-month decline of 0.5%—climbing to within 0.4% of November's record high and more than offsetting declines in spending on food, drinks & tobacco and automotive fuel. Sales of the former fell 0.7% after a two-month jump of 1.7% to a new cyclical high, while the latter declined 0.8% after a 0.4% slide in March. April sales are available for three of the Big Four economies: Sales in Germany rose for the first time in five months, rebounding 2.3%—the biggest increase among all the Eurozone economies reporting so far, while France (-1.2%) and Spain (-0.7) recorded their first sales declines in three months and four months, respectively. Ireland (1.5) joined Germany among biggest gainers, while Portugal (-4.1), Slovenia (-2.0), and Estonia (-1.8) were the biggest losers.

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