



MORNING BRIEFING

July 2, 2018

Buybacks, Inflation Targets, and CLOs

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

(1) Buybacks by the numbers and the sectors. (2) Buybacks explain overall market performance better than sector performance. (3) No contest: Stay Home beating Go Global since start of bull market. (4) Trade issues weighing on EU, China, and Mexico. (5) Strong dollar (attributable to Fed's rate hikes and Trump's "America First" campaign) is weighing on EMs. (6) Fed and ECB hit their inflation targets. Now what? (7) Should we worry about CLOs? (8) Movie review: "Sicario: Day of the Soldado" (+).

Strategy I: Buybacks by Sectors. Last Wednesday, Joe and I reviewed S&P 500 share buybacks with data just released for Q1-2018. Today, let's drill down into the buyback data for the individual S&P 500 sectors:

(1) *S&P 500.* For the overall composite, buybacks totaled \$189.1 billion during Q1, the best quarterly rate on record ([Fig. 1](#)). The previous record high was \$171.9 billion during Q3-2007. The grand total since the start of the bull market during Q1-2009 is \$4.1 trillion.

(2) *Sectors Q1-2018:* Here is the Q1 buybacks derby from highest to lowest for the sectors: Information Technology (\$63.4 billion), Health Care (35.6), Financials (33.8), Consumer Discretionary (18.7), Industrials (16.6), Energy (10.1), Consumer Staples (7.3), Materials (2.3), Real Estate (0.8), Telecom Services (0.2), and Utilities (0.2).

(3) *Sectors' price performance.* The buybacks help to explain the outperformance of the S&P 500 Information Technology sector so far this year. Explaining other sectors' performance with the buybacks data is harder to do. For example, although Health Care had record buybacks during Q1, the sector is up only 1.0% ytd, slightly underperforming the S&P 500 ([Fig. 2](#)).

Here is the performance derby of the S&P 500 sectors' stock price indexes ytd: Consumer Discretionary (10.8%), Information Technology (10.2), Energy (5.3), S&P 500 (1.7), Health Care (1.0), Real Estate (-1.0), Utilities (-1.5), Materials (-4.0), Financials (-4.9), Industrials (-5.6), Consumer Staples (-9.9), and Telecom Services (-10.8). The outperformers have been the cyclical sectors, while the underperformers have been the defensive sectors that tend to be inversely correlated with the bond yield and weighed down by a flattening yield curve.

In other words, the buybacks along with dividends may have driven the overall market more than they have impacted the sectors' relative performance ([Fig. 3](#)).

Strategy II: Performance Derbies Since March 2009. Perhaps a longer-term perspective might find a better correlation between buybacks and sector performance. Here is the buybacks derby for the sectors since start of the bull market during Q1-2009: Information Technology (\$1,007 billion), Consumer Discretionary (\$632), Financials (\$619), Health Care (\$578), Industrials (\$450), Consumer Staples (\$405), Energy (\$248), Materials (\$89), Telecom Services (\$39), and Utilities (\$15) ([Fig. 4](#)).

Let's see if these flows might explain the relative performance of the S&P 500 sectors over the same period: Consumer Discretionary (592%), Information Technology (511), Financials (427), Industrials (353), S&P 500 (302), Health Care (281), Materials (234), Consumer Staples (165), Utilities (131), Energy (81), and Telecom Services (68.1) ([Fig. 5](#)). The four sectors that outperformed by the most have also had the most buybacks.

While we are on the subject of performance derbies, let's compare Stay Home vs Go Global since March 9, 2009:

(1) *Stay Home vs Go Global in dollars*. Here it is in dollars for the major MSCI stock price indexes: United States (302), Emerging Markets (120), Japan (110), EMU (106), and the United Kingdom (102) ([Fig. 6](#)).

(2) *Stay Home vs Go Global in local currencies*. Here it is for the same indexes in local currencies: United States (302), Japan (135), Emerging Markets (134), EMU (123), and the United Kingdom (111) ([Fig. 7](#)).

It's no contest: The US remains well ahead of the pack. Joe and I expect this will continue to be the case at least through year-end and maybe beyond. We don't foresee the trade-weighted dollar getting much stronger, nor do we see much dollar weakness up ahead ([Fig. 8](#)). What we do see currently are ongoing tensions within the European Union (EU) resulting from unchecked immigration, notwithstanding last week's voluntary agreement among EU leaders about how to handle the problem.

Trump's tariffs are another major issue for the EU, as well as for China and Mexico. We see pressure on Chinese financial markets resulting from Trump's protectionist campaign, as evidenced by the recent drop in the yuan's value ([Fig. 9](#)). On Sunday, the Mexicans elected a left-wing version of Trump as President. More broadly, the strong dollar (attributable to the Fed's rate hikes and Trump's America First campaign) is weighing on most emerging market economies.

The Fed & ECB: Bullseye. Fed officials must be celebrating with high fives. On January 25, 2012, the FOMC issued a [statement](#) explicitly setting an official 2.0% target for the y/y PCED inflation rate, particularly the core rate. The latter has been below that target ever since, but finally hit the mark in May, according to data released on Friday ([Fig. 10](#)). The headline rate was 2.3%, while the core rate was 2.0%, a perfect bullseye.

The folks governing monetary policy at the ECB must also be doing a celebration dance. The Eurozone's CPI inflation rate jumped to 2.0% during June, according to the flash estimate, thanks to rapidly rising oil prices. The core rate remained weak at 1.0% ([Fig. 11](#)). Now the bad news:

(1) *ECB*. Trump's protectionism may be starting to weigh on the Eurozone's economy. The immigration crisis may also be doing so. Early last month, the ECB said it expected to end its QE program in December. But the narrowness of the rebound in inflation and the slowing pace of economic growth might convince the ECB to hold off on exiting QE for a while longer.

(2) *The Fed*. Fed officials have said that their current gradual course of monetary normalization will be maintained even if inflation rises moderately above their 2.0% target for a short period of time. However, like their colleagues at the ECB, they must have some concerns that the uncertainty unleashed by protectionist saber-rattling might weigh on business expansion decisions. They are also likely to explain inflation rates above 2.0% as being transitory—resulting from the tariffs that have already been imposed.

Credit: Concerning CLOs. Complex structured finance products were not the root cause of the 2008 financial crisis. In our opinion, the primary cause of the crisis was too much credit extended to unqualified borrowers in the mortgage market. Nevertheless, structured finance products did greatly exacerbate the crisis. Leading up to the crisis, investors in products like residential mortgage-backed securities (RMBS) did not fully comprehend the risks. Many RMBS investors didn't see the housing market bubble until it burst. They all assumed that home prices would never fall. So deadbeats would lose their homes, which would be sold to recover the funds they borrowed. Instead, home prices plunged as delinquencies soared.

Significant concerns are now building around another type of structured finance product: collateralized loan obligations (CLOs). "Managers of the vehicles have already raised \$66 billion this year. If they continue apace the market will surpass the full-year record of about \$120 billion set in 2014, according to data from S&P Global Ratings. CLOs now comprise about 60% of the \$1 trillion leveraged loan market," [reported](#) the 6/26 *WSJ*.

The worrisome growth trend in CLO issuance was flagged last year in a *FT* opinion [piece](#) titled "The sequel to the global financial crisis is here." It's true that no financial product is without risk, and growing debt is usually not a comforting sign. But does it make sense to equate the recent rise in CLO issuance to the rise in RMBS-related products that preceded the crisis? Melissa and I don't think so. That's because while the products are similarly structured, they are composed of different types of credit. Leveraged corporate loans underlie CLOs, while RMBS-related products are composed of consumer mortgage loans.

Further, CLOs generally performed well during the crisis compared to the horror show put on by RMBS-related products at that time. Currently, corporate credit continues to expand, but fears of a corporate credit bubble may be allayed for the reasons discussed in our 6/19 [Morning Briefing](#). Let's have a closer look at CLOs:

(1) *C&I bank loans at record high.* Commercial and industrial (C&I) loans held by all US commercial banks rose to a record \$2.23 trillion during the 6/20 week ([Fig. 12](#)). This category is up \$116 billion y/y. It is up \$1.05 trillion since its cyclical low in mid-2010. That accounts for the C&I loans held by the banks. Lots of their loans are also packaged as CLOs.

(2) *CLO 101.* CLOs purchase a diversified pool of senior secured bank loans made to companies, which are typically rated below investment grade. CLO debt is divided into tranches, each of which has a unique risk/return profile. Many investors perceive that all structured credit comes with greater risk than more straightforward, plain-vanilla fixed-income products.

(3) *Lower default rate.* That's because CLOs are often associated with other forms of structured credit, such as RMBS-related products, that were at the epicenter of the financial crisis. Historical data discredits the negative perception of CLOs. CLOs experienced significantly lower default rates than corporate bonds between 1994 and 2013, according to a 4/5/17 [analysis](#) by Guggenheim, a global asset management firm. We should note that the firm has structured finance products in its offerings. However, the data in the analysis are sourced from Standard & Poor's. Guggenheim notes: "In fact, AAA and AA-rated CLO tranches have never experienced a default or loss of principal, even during the depths of the financial crisis."

(4) *Skin in the game.* Nevertheless, CLOs were hit with additional regulatory requirements following the crisis. CLO funds were subject to Dodd-Frank Act rules, requiring investment managers to hold some of the risk of their deals. Earlier this year, those requirements were reversed, as discussed in a 2/13

Reuters [article](#). Reuters noted that “CLO funds performed well during the financial crisis and saw the application of risk-retention rules as unfairly maligning the asset class by lumping [it] in with similar funds that were blamed for” the crisis.

So the Loan Syndications and Trading Association (LSTA) sued the Fed and the SEC in 2014 on the basis that the rules imposed on CLOs were unfounded. An initially unfavorable ruling for the LSTA was ultimately appealed and overturned during early February in a win for the roughly \$500 billion asset class, according to Reuters.

(5) *Win for CLO funds*. In a 3/29 [post](#), PIMCO's CLO team wrote they expect that repeal of the risk retention rules will lead to greater CLO volatility as funds sell existing positions that were held to meet the rule. Further, PIMCO also expects CLO issuance to rise along with the repeal of the regulatory requirement. PIMCO didn't say anything about the potential for increased risk associated with CLOs given the rollback of the rule. That outcome seems appropriately excluded from PIMCO's points because CLOs weren't behind the risk that led to the rule in the first place.

(6) *Now isn't then*. In response to the alarming *FT* article (cited above), Dechert, a global law firm, wrote a [note](#) titled “The Sequel to the Global Financial Crisis Is Not the CLO! (Ok, Not Yet).” It stated: “I think [the author of the article] is looking under the wrong rock for the next global financial crisis.” The note explains that CLOs today are a lot more plain-vanilla and conservative than such products were preceding the crisis. It continues: “The underlying loans largely have full covenants, recourse and structure which is highly coincident with any portfolio lender product and in some ways more rigorous than some.” In fairness, the law firm may be biased, as its bread and butter seems to come from the CLO market. However, at the 1/11 CREFC 2018 conference, the panelists [corroborated](#) the legal firm's claims.

Movie. “Sicario: Day of the Soldado” (+) ([link](#)) is a timely movie about the border between the US and Mexico. Its central premise is remarkably Trumpian: The drug cartels are making lots of money trafficking in people desperate to come to America to escape violence in Central America. That violence is perpetrated by the cartels to drum up their human-trafficking business. So the movie suggests that the cartels should be included on the US's list of terrorist organizations and dealt with accordingly. The movie doesn't dwell very long on this intriguing thesis. Instead, it gets bogged down in a rogue, clandestine operation sponsored by the US government to start a war among the cartels.

CALENDARS

US. **Mon:** ISM & IHS Markit M-PMIs 58.3/54.6, Construction Spending 0.6%. **Tues:** Factory Orders - 0.1%, Motor Vehicle Sales 17.0mu. (*Wall Street Journal* estimates)

Global. **Mon:** Eurozone Unemployment Rate 8.5%, Eurozone, Germany, France, and Italy M-PMIs 55.0/55.9/53.1/52.5, UK M-PMI 54.0, Japan M-PMI, China Caixian M-PMI 51.0. **Tues:** Eurozone Retail Sales 0.1%/m/m/1.6%/y/y, Canada M-PMI, RBA Cash Rate Target 1.50%. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance ([link](#)): The US MSCI index fell 1.4% last week for its biggest drop in 12 weeks, ranking 31st out of the 49 markets in a week when 16 countries rose in US dollar terms and the AC World ex-US index fell 1.1% for its eighth decline in 10 weeks. That compares to the US MSCI's 0.9% drop a week earlier, which ranked 22nd as 12 markets rose and the AC World ex-US index declined 1.3%. EM Latin America and EM Eastern Europe performed best with gains of 1.5%, followed by EMEA (1.1%). Both EAFE and EMU matched the 1.1% decline for the AC World ex-US.

The underperforming regions relative to the AC World ex-US were EM Asia (-2.6) and BRIC (-2.4). Mexico was the best-performing country as it rose 4.5%, followed by Colombia (3.9), Russia (2.8), and the Philippines (2.2). Of the 20 countries that underperformed the AC World ex-US MSCI last week, Argentina fared the worst as it tumbled 17.4%, followed by China (-3.6), New Zealand (-2.7), and Chile (-2.7). In June, the US MSCI rose 0.5%, ranking 12/44 and well ahead of the 2.1% decline for the AC World ex-US index as all regions fell. That compares to a 2.2% rise in May, when it ranked 4/44, well ahead of the 2.8% decline for the AC World ex-US—also in a month when all regions fell. The best-performing regions in June, albeit with declines: EMU (-1.0), EM Eastern Europe (-1.3), EAFE (-1.4), and EMEA (-1.4). June's worst-performing regions: EM Asia (-5.1), BRIC (-4.9), and EM Latin America (-3.3). On a ytd basis, the US MSCI fell w/w to a 1.9% gain and dropped one place in the ytd performance ranking to 7/49. The US MSCI is ahead of the AC World ex-US (-5.3) in the ytd period as 40/49 countries and all other regions are in negative territory ytd. EAFE leads all regions with a decline of 4.5% so far this year and is ahead of EMU (-5.0). EM Latin America (-12.4) is biggest laggard relative to the AC World ex-US's performance, followed by EMEA (-9.0), EM Asia (-5.9), BRIC (-5.6), and EM Eastern Europe (-5.4). The best country performers ytd: Colombia (10.3), Finland (6.6), Peru (5.2), Israel (4.4), and Jordan (4.4). The worst-performing countries ytd: Argentina (-46.0), Turkey (-31.9), the Philippines (-22.1), and Indonesia (-20.3).

S&P 1500/500/400/600 Performance ([link](#)): All three market-cap indexes fell last week, but LargeCap's 1.3% decline was smaller than those for MidCap (-1.9%) and SmallCap (-2.4). MidCap is down 2.6% from its record high while SmallCap and LargeCap are down 3.3% and 5.4% from their respective highs. Eight of the 33 sectors rose in the latest week, down from 16 rising a week earlier and the lowest count since just eight rose 13 weeks ago. The best performers in the latest week: LargeCap Utilities (2.2), MidCap Energy (1.5), and LargeCap Telecom (1.2). SmallCap Financials' 3.7% decline was the biggest underperformance for the week, followed by: SmallCap Consumer Discretionary (-3.5) and MidCap Financials (-3.4). LargeCap is now up 1.7% ytd, trailing MidCap's 2.7% and SmallCap's 8.7% gains. All three market-cap indexes moved higher again in June. SmallCap was the only index to rise for four straight months, while LargeCap rose for a third month. SmallCap gained 1.0% last month, ahead of LargeCap (0.5) and MidCap (0.3). Twenty-two of the 33 sectors advanced in June, down from 27 rising in May and compared to 20 in April, 19 in March, and just one in February (the fewest since August 2015). June's best performers: MidCap Telecom (7.3), SmallCap Telecom (6.1), and MidCap Consumer Staples (5.8). June's biggest laggards: MidCap Financials (-3.5), LargeCap Industrials (-3.4), and MidCap Materials (-2.3). Twenty-one sectors are now positive to date in 2018, unchanged from a week earlier and up from just three in early February. The best-performing sectors ytd: SmallCap Health Care (30.4), MidCap Health Care (18.5), MidCap Energy (16.1), and LargeCap Consumer Discretionary (10.8). The worst performers ytd: LargeCap Telecom (-10.8), LargeCap Consumer Staples (-9.9), LargeCap Industrials (-5.6), LargeCap Financials (-4.9), and LargeCap Materials (-4.0).

S&P 500 Sectors and Industries Performance ([link](#)): Four sectors rose last week, and six outperformed the S&P 500's 1.3% decline. That compares to four rising a week earlier, when seven outperformed the S&P 500's relatively flat performance. Utilities was the best-performing sector with a gain of 2.2%, ahead of the performances of Telecom (1.2%), Real Estate (1.1), Energy (1.0), Consumer Staples (-0.2), and Materials (-0.8). Tech was the biggest underperformer with a drop of 2.2%, followed by Financials (-1.9), Consumer Discretionary (-1.9), Health Care (-1.8), and Industrials (-1.3). The S&P 500 rose 0.5% in June as eight sectors moved higher and seven beat the index. That compares to six rising and three beating the S&P 500's 2.2% gain in May. The leading sectors in June: Consumer Staples (4.1), Real Estate (3.9), Consumer Discretionary (3.5), Utilities (2.5), Telecom (2.2), Health Care (1.5), and Energy (0.6). Industrials was the biggest laggard in June as it fell 3.4%, followed by Financials (-2.0), Tech (-0.4), and Materials (0.1). Just four sectors are in the plus column so far in 2018, unchanged from a week earlier and down from nine in early March. Just three sectors have bested the S&P 500's 1.7% ytd gain—but by a lot: Consumer Discretionary (10.8), Tech (10.2), and

Energy (5.3). The eight ytd underperformers: Telecom (-10.8), Consumer Staples (-9.9), Industrials (-5.6), Financials (-4.9), Materials (-4.0), Utilities (-1.5), Real Estate (-1.0), and Health Care (1.0).

Commodities Performance ([link](#)): The S&P GSCI index rose 3.4% w/w for its biggest gain in 11 weeks as eight of the 24 commodities that we follow moved higher. That compares to the prior week's 1.7% rise during a week when 10/24 commodities rose. Last week's strongest performers: Crude Oil (8.1%), Brent Crude (5.2), Unleaded Gasoline (4.7), and GasOil (4.7). Last week's biggest decliners: Soybeans (-4.0), Kansas Wheat (-3.4), Nickel (-2.4), and Copper (-2.4). June saw just six of the commodities climb as the S&P GSCI Commodities index rose 1.2%, compared to 17 rising in May when the index also rose 1.2%. June's best performers were led by Crude Oil (10.6), Live Cattle (2.7), Feeder Cattle (2.7), Cocoa (2.4), and Brent Crude (2.2). June's laggards: Soybeans (-13.6), Kansas Wheat (-10.0), Cotton (-9.9), Corn (-8.8), and Aluminum (-7.9). The S&P GSCI commodities index is up 10.2% ytd and near its highest level since December 2014, but remains nearly 50% below its record high in July 2008 just before the financial crisis. The top performer so far in 2018 is Cocoa (32.8), followed by Crude Oil (22.7), Unleaded Gasoline (19.8), and Brent Crude (18.5). The biggest laggards of 2018 to date: Sugar (-19.2), Zinc (-14.0), Live Cattle (-12.2), Coffee (-8.8), Soybeans (-8.5), and Copper (-8.4).

Assets Sorted by Spread w/ 200-dmas ([link](#)): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 8/24 commodities, 1/9 global stock indexes, and 8/33 US stock indexes, compared to 10/24 commodities, 2/9 global stock indexes, and 14/33 US stock indexes rising a week earlier. Commodities' average spread was unchanged w/w at 2.7% as 13 commodities trade above their 200-dmas, also unchanged from a week earlier. Crude Oil now leads all commodities at 19.9% above its 200-dma as it soared 8.0ppts for last week's best performance among commodities and all assets. Soybeans trades at 11.9% below its 200-dma, the lowest of all commodities now, but Kansas Wheat (2.9) tumbled 3.8ppts for the worst performance among commodities. The global indexes trade at an average of 3.6% below their 200-dmas, down from 2.8% below in the prior week. Three of the nine global indexes trade above their 200-dmas, unchanged from a week earlier. Canada (2.6) leads the global indexes, but Brazil (-8.1) gained 2.8ppt last week for the best w/w improvement among global assets. China (-11.4) is now the biggest laggard among global indexes after a tumble of 2.3ppts w/w, the biggest decline among global indexes. The US indexes trade at an average of 3.8% above their 200-dmas, with 25 of the 33 sectors above, down from 5.2% a week earlier, when 26 sectors were above. SmallCap Health Care (19.4) continues to lead the US stock indexes, but LargeCap Utilities (0.5) rose 2.3ppts w/w for the biggest gain among US stock indexes last week. LargeCap Industrials (-4.2) trades the lowest among all US stock indexes, but SmallCap Consumer Discretionary (8.9) fell 4.6ppts w/w for the worst performance among US stock indexes.

S&P 500 Technical Indicators ([link](#)): The S&P 500 price index dropped 1.3% last week and weakened relative to both its short-term 50-day moving average (50-dma) trend line and its long-term 200-dma for the fourth time in six weeks. The index remained in a Golden Cross (50-dma higher than 200-dma) for a 114th straight week (after 17 weeks in a Death Cross) as the index's 50-dma relative to its 200-dma weakened for the 18th time in 20 weeks. The current Golden Cross reading of 1.6% is down from 1.7% a week earlier and well below its 55-month high of 7.2% in early February; these compare to its 25-month low of 1.0% at the end of May and four-year low of -4.5% in March 2016. The S&P 500's 50-dma rose for a fifth week, but has fallen in eight of the past 15 weeks—including four straight weeks of decline through mid-April that constituted its worst performance since before the 2016 election. The index fell to a eight-week low of slightly below its rising 50-dma—down from 1.4% above a week earlier and an 18-week high of 3.4% at the beginning of June. That compares to a 25-month low of 5.6% below its falling 50-dma near the end of March and a two-year high of 6.2% above its rising 50-dma on January 29. The 200-dma continued to rise, as it has done since May 2016, but at near the slowest pace since October 2011. The S&P 500 successfully tested its 200-dma in early April, but weakened to

1.6% above its rising 200-dma in the latest week from 3.2%; that's down from an 11-week high of 4.6% in early June. Those readings compare to 0.6% below the index's rising 200-dma on April 3 (the lowest reading since June 2016), a seven-year high of 13.5% above its 200-dma on January 29, and a four-year low of -10.1% in August 2015.

S&P 500 Sectors Technical Indicators ([link](#)): Among the 11 S&P 500 sectors, last week saw four improve relative to their 50-dmas and 200-dmas: Energy, Real Estate, Telecom, and Utilities. Eight sectors now trade above their 50-dmas, up from seven week earlier, as Telecom moved above in the latest week. All 11 sectors had been trading below their 50-dmas at the end of March (a first since February 2016). The longer-term picture—i.e., relative to 200-dmas—shows 6/11 sectors trading above, up from five a week earlier as Utilities turned positive for the first time in 28 weeks. That's up from just four sectors trading above their 200-dmas in early May (which matched the lowest count since January 2016). Financials was below its 200-dma for a third week and for the first time in 10 months after being mostly above since early 2016. Telecom remained below its 200-dma in the latest week, where it's been for most weeks since April 2017. Industrials and Materials were below too, but only for a second week. Sectors trading the longest above their 200-dmas: Tech (above 200-dma for 104 straight weeks), Consumer Discretionary (86 straight weeks), and Energy (11 weeks). Those trading below for a long time include: Consumer Staples (below for a 19th week) and Telecom (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). Just four sectors are in a Golden Cross (with 50-dmas higher than 200-dmas), unchanged from a week earlier and the lowest count since March 2016. All 11 had been in a Golden Cross in mid-January for the first time since a 26-week streak ended in October 2016. Telecom was out for a 13th week, Consumer Staples for a 15th, Real Estate for a 21st, and Utilities for a 23rd. Health Care was out for only a seventh week, but for the first time since February 2017. Seven sectors have rising 50-dmas now, unchanged from a week earlier. Consumer Staples' 50-dma began rising this week for the first time in 21 weeks. Materials' 50-dma resumed falling, as it has been doing for the past five months, and rejoined Financials, Industrials, and Telecom as the only members of the declining 50-dma club. That compares to all 11 sectors with falling 50-dmas during early April (the worst count since before the election in November 2016). Seven sectors have rising 200-dmas, unchanged from a week earlier, and up from six in early February, which was the lowest since May 2017. In the latest week, Real Estate's 200-dma rose for the first time in 25 weeks, and Industrials' turned slightly negative for the first time since March 2016. The 200-dma for Utilities fell for a 25th straight week, Consumer Staples' dropped for a 19th week, and Telecom's fell for an eighth week, though it has been mostly declining since December 2016.

US ECONOMIC INDICATORS

GDP ([link](#)): Real GDP growth for Q1 was revised down slightly again to 2.0% (saar) from 2.2%, according to the third estimate; the advance estimate was 2.3%. The latest revision once again showed downward revisions to inventory investment, consumer spending, and exports, while real nonresidential investment growth continued to get revised up. Real capital spending was revised higher for the second time (to 10.4% from 9.2% from 6.1%, saar), the strongest growth since Q3-2014. Spending on intellectual property products (13.2% from 10.9% from 3.6%) expanded at more than triple the advance estimate—and at its fastest pace since Q3-1999—while investment in structures (16.2 from 14.2 from 12.3) and equipment (5.8 from 5.5 from 4.7) were also stronger. Meanwhile, residential investment (-1.1 from -2.0) contracted at a slightly slower pace, while real inventory investment (\$13.9 billion from \$20.2 billion from \$33.3 billion) and export growth (3.6 from 4.2 from 4.8) were both revised lower for the second time. Real consumer spending (0.9 from 1.0 from 1.1) once again was only slightly below the advance estimate, though there were movements within the components: Durable goods (-2.1 from -2.6 from -3.3) spending was less negative than first reported, while nondurable goods (0.5 from 0.4 from 0.1) consumption was slightly more positive; spending on services (1.5 from 1.8 from 2.1) was a bit

slower than the initial estimate.

Contributions to GDP Growth ([link](#)): Real business investment was the number-one contributor to real GDP growth last quarter, followed by consumer spending. (1) Nonresidential fixed investment accounted for 1.28ppt of Q1's increase, with investment in intellectual property products (0.51), structures (0.44ppt), and equipment (0.33) all adding to growth. (2) Real consumer spending accounted for 0.60ppt of real GDP growth—all services-related (0.69); goods (-0.09) consumption subtracted from growth for the first time since Q2-2011, all durable goods (-0.16). (3) Real government spending added 0.22ppt to growth last quarter, with federal (0.11) and state & local (0.11) government spending equally contributing. (4) The latest revision switched inventory investment (to -0.01 from 0.13) from a positive contributor to a relatively neutral position, with nonfarm's contribution falling to 0.00ppt from 0.15ppt. (5) Trade (-0.04 from 0.08) also switched signs based on the latest revision, as a negative contribution from imports (-0.48 from -0.43) more than offset a positive contribution from exports (0.44 from 0.51). (6) Residential investment (-0.04) was also a slight negative contributor during Q1 after contributing positively during Q4 for the first time in three quarters.

Personal Income & Consumption ([link](#)): Real consumer spending was weak in May, though retained the rebound posted the prior two months. May real personal consumption expenditures were flat after climbing 0.9% during the two months ending April, more than reversing the -0.4% drop the first two months of the year. Real services consumption fell for the first time in three months, edging down -0.2%, while real goods consumption rose for the third straight month, up 0.3% m/m and 1.5% over the period—with both durable (1.8) and nondurable (1.4) goods consumption posting solid gains over the three-month period. Real disposable income advanced for the eighth straight month, up 1.8% over the period to a new record high, while real wages & salaries rose 1.6% over the comparable period, also to a new record high. Our Earned Income Proxy, which tracks consumer spending and incomes closely, continues to set new highs, indicating that the consumer will be a major contributor to growth again during Q2.

Consumer Sentiment ([link](#)): Consumer sentiment in June increased for the first time since reaching a 14-year high in March, though has fluctuated in a narrow band from 98.8 to 98.0 the past three months. The Consumer Sentiment Index (CSI) ticked up to 98.2 in June (below the mid-month reading of 99.3) after retreating the prior two months from March's cyclical high of 101.4 to 98.0 in May. (The CSI has held in a tight eight-point range from 93.4 to 101.4 since the November 2016 election.) The present situation component climbed from 111.8 to 116.5 last month, due to continued favorable assessments of both jobs and incomes, while the expectations components sank from 89.1 to 86.3. Both measures were below their mid-month readings of 117.9 and 87.4, respectively. According to Richard Curtin, the chief economist of the consumer surveys, "The potential impact of tariffs on the domestic economy was spontaneously cited by one-in-four consumers, with most expecting a negative impact on the domestic economy (21% out of 26%). The primary concerns were a downshift in the future pace of economic growth and an uptick in inflation."

GLOBAL ECONOMIC INDICATORS

Eurozone Economic Sentiment Indicators ([link](#)): June's Economic Sentiment Index (ESI) for the Eurozone (-0.2 point to 112.3) registered a marginal decrease for the third month, while the EU's (-0.6 point to 112.2) turned lower after climbing from 112.4 to 112.8 in May. Both measures remained at elevated levels, below their December 17-year highs of 115.2 and 115.0, respectively. Among the Eurozone's five largest economies, ESIs for Italy (+1.2 to 109.6) and France (+1.0 to 109.6) rose noticeably, while the Netherlands' (-1.8 to 109.9) fell sharply—after climbing 1.2ppt in May; the ESI for Germany (-0.8 to 111.9) also moved lower, while Spain's (109.4) was unchanged. At the sector level, ESIs for construction (-1.5 to 5.6) and consumer (-0.7 to -0.5) confidence moved lower, while retail

trade (+0.1 to 0.8) confidence ticked higher; ESIs for industry (6.9) and services (14.4) confidence were both unchanged at May levels.

Eurozone CPI Flash Estimate ([link](#)): June's CPI rate is expected to accelerate to a 16-month high of 2.0%, according to the flash estimate, remaining at the ECB's goal for the second month. Looking at the main components, energy (to 8.0% from 6.1% y/y) is expected to have the highest annual rate in June—quadruple March's recent low of 2.0%. Also expected to move higher are rates for food, alcohol & tobacco (2.8 from 2.5) and non-energy industrial goods (0.4 from 0.3), while the services (1.3 from 1.6) rate is presumed to move lower. The core rate—which excludes energy, food, alcohol, and tobacco—is calculated to edge down to 1.0% y/y, after accelerating to an eight-month high of 1.1% in May.

Contact us by [email](#) or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-775-6823

Copyright (c) Yardeni Research, Inc. Please read complete [copyright and hedge clause](#).