



MORNING BRIEFING

July 26, 2018

Industrials Under Some Duress

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

(1) Cost pressures mounting for Industrial companies. (2) Will they cut costs, boost prices, or both? (3) Labor shortages in Europe too. (4) Tariffs are the new costs on top of labor and commodity costs. (5) Analysts may be too optimistic about the sector. (6) IMO 2020 rules will force commercial ships to run on low-sulfur fuel, rather than on the stuff at the bottom of the barrel. (7) Higher fuel cost for maritime shipping companies. (8) Refiners scrambling to meet prospective demand. (9) Ford wants you to spend less time driving your car, while AT&T wants you to watch more HBO in your car.

Industrials: Learning a New Dance. CEOs at industrial companies have enjoyed the ease of working in a tepid inflationary environment in recent years. But the jumps in commodity prices, labor costs, tariffs, and the dollar are pushing executives to learn to tap dance in a new pricing environment.

The market has started to reflect the growing pressure on Industrials. The S&P 500 Industrials stock price index, which was keeping pace with the S&P 500 during the bull market, has subsequently underperformed the broader index since December 2016 ([Fig. 1](#)). On a year-to-date basis, here's how the S&P 500 Industrials has performed relative to the other sectors in the S&P 500 through Tuesday's close: Tech (16.6%), Consumer Discretionary (13.2), Health Care (6.1), S&P 500 (5.5), Energy (4.7), Financials (0.3), Utilities (-1.2), Industrials (-2.1), Real Estate (-2.2), Materials (-2.9), Consumer Staples (-8.0), and Telecom Services (-10.4) ([Fig. 2](#)).

Investors soon will learn which companies can successfully adapt in a cost-push inflationary environment and which companies have two left feet. At United Technologies (UTX) and Illinois Tool Works (ITW), the CEOs are counting on a combination of cost cuts and the ability to pass through price increases to offset rising costs. I asked Jackie to discuss some of what they had to say on Q2 conference calls:

(1) *Saved by Uncle Sam.* UTX's incredibly strong airplane and military businesses offset weakness in its Otis and its Climate, Controls and Security units during Q2 and buffered the company against higher costs from commodities and tariffs. UTX's commercial aerospace sales and aftermarket sales each were up 11% organically in Q2, and military OEM sales were up 42%.

Even though UTX expects tariffs to clip earnings by five cents a share this year, the company increased its 2018 EPS target to \$7.10-\$7.25, up from \$6.96-\$7.15.

CEO Gregory Hayes warned analysts in the Q2 earnings [conference call](#) that cost pressures would continue into next year. He described the US and Europe as having a "labor shortage" and noted that the impact of commodity prices and tariffs could be larger next year, as existing contracts for commodities that locked in prices for six to nine months will expire.

To offset rising costs, he said: "[T]he key will be our ability to continue to push price in the marketplace

as these input costs go up. Of course, that's going to lead to a little bit of inflation and hopefully not so much of this is going to curtail demand. But we are always mindful of that tradeoff." The company's shares rose almost 5% on Wednesday, the day its earnings were released.

(2) *ITW gets pricing.* ITW was able to increase its Q2 operating margin by 50 basis points, to 24.3%, because it has a cost-cutting program underway. It was also able to boost the prices it charges "dollar for dollar" to offset its cost increases. ITW expects to continue to raise prices to recoup cost increases in the second half of this year.

"For perspective, full-year projected cost inflation, including tariff impact, represents approximately 3% of our total spend," CFO Michael Larsen said on the company's Q2 [conference call](#). "As many of you know, our model is to source and produce where we sell. And this approach helps significantly mitigate the risk associated with tariffs. By our estimate, the impact of tariffs represents about 10% to 15% of our total projected cost inflation in 2018. In addition, only 2% of ITW's material spend is sourced from China. Our 'produce where we sell' model and the very limited cross-border movement of raw materials and products certainly help mitigate the impact from tariffs." And so far, the company has not seen any decrease in demand from customers due to the tariffs.

The company did lower its full-year 2018 earnings guidance, blaming the dollar's expected strength in the second half of the year. It now sees 2018 EPS coming in at \$7.50-\$7.70, down from the \$7.60-\$7.80 estimated when its Q1 earnings were reported in April.

(3) *Optimism continues.* Despite a stronger dollar, tariffs, and wage inflation, analysts may be overly optimistic about Industrials. They're calling for the sector's revenue to grow 7.5% this year and 5.1% in 2019 ([Fig. 3](#)). Profit margins are expected to continue their expansion, from 8.8% in 2017 to 9.8% this year and 10.5% in 2019 ([Fig. 4](#)). Earnings are slated to jump by 19.1% this year and 12.5% in 2019 ([Fig. 5](#)).

Analysts' quarterly earnings estimates have been trimmed a bit. At the start of April, analysts thought the sector would post Q3 earnings growth of 20.3%, but that's now down to 18.1%. Likewise, their Q4 earnings growth estimate was at 31.1% in April, and now it's 28.9%. More dramatically, Q1-2019 estimates have tumbled from 16.6% in April to 9.1% currently. Keep an eye on tariffs to determine where those estimates are headed next.

Transports & Energy: Low Sulfur on the High Seas. President Trump's trade war may just be the start of headaches for those involved with international trade. Coming in 2020 are new limitations on using fuel with high sulfur content. To comply, ships will have to either spend millions on scrubbers, equipment that cleans a ship's exhaust before it's expelled, or buy more costly, low-sulfur fuel from refiners, some of which have spent millions to upgrade their facilities. The overall impact on fuel prices is up for debate.

Most analysts seem to expect the price for low-sulfur fuel to increase and the price of high-sulfur fuel to decrease in reaction to the rule change. In fact, there could be upward pressure on all refined energy prices thanks to increased demand for cleaner shipping fuel. That said, energy forecasts out to 2020 are more like guesstimates given the many variables—both known and unknown—involved. Let's take a deeper look at this puzzle and its many pieces:

(1) *Welcome to IMO 2020.* In an effort to reduce global pollution, the International Maritime Organization (IMO)—a United Nations agency—introduced in 2016 a rule that requires ocean vessels to use fuel with sulfur content of less than 0.5% m/m (mass by mass) starting January 1, 2020, far below the current 3.5% limit.

Globally, ships consume about 4 mbd of high-sulfur fuel, or about 4% of global oil product consumption. Known as “bunker fuel,” this marine fuel typically comes from what’s left after diesel and gasoline have been separated from crude oil through refining. In other words, bunker fuel is stuff that has few uses outside of the marine industry.

Justin Jenkins and J. Marshall Adkins, analysts at Raymond James, estimate that after the rule change there will be: 2 mbd of demand for low-sulfur fuel; 1 mbd of demand for high-sulfur fuel from ships out of China, Russia, and North Korea, which may cheat and use high-sulfur fuel illegally; and another 1 mbd of demand for high-sulfur oil from ships that have installed scrubbers.

There are a variety of opinions about IMO 2020’s impact on the energy markets. IMO hired consultants, led by CE Delft, which concluded that refiners would be able to produce enough low-sulfur fuel to meet the IMO target; therefore, the fuel market would not be disrupted. Another group of consultants, hired by the International Petroleum Industry Environmental Conservation Association and the Baltic and International Maritime Council, came to a different conclusion. They determined that refining capacity would not be sufficient in 2020 to meet the new guidelines, noted an October 2016 [report](#) by S&P Global Platts.

It seems logical that the change in demand will drive up the price of low-sulfur fuel relative to the price of high-sulfur fuel. And right now, any additional demand for fuel is problematic since there’s little excess global supply. However, a lot can happen before 2020. Doomsayers may not be taking into account the potential acceleration in the adoption of electric vehicles. The domestic and global expansion of fracking, which typically produces low-sulfur fuel, could also help meet demand. Longer term, the adoption of LNG-powered ships could lower demand for marine fuel. And—dare we say it—by 2020, the US could find itself in a recession, which typically destroys demand for oil. Capitalists around the world should pounce on the opportunity to make more money from low-sulfur fuel, thus limiting the upside of any price spike that may come along.

(2) *Shippers set sail.* In the wake of IMO 2020, shipping companies believe they’ll have to spend more, regardless of whether they install scrubbers or buy low-sulfur fuel. AP Moller Maersk, one of the industry’s largest shipping companies, is planning to buy low-sulfur fuel to meet the new requirements. “We think the most sensible solution is to have the refineries remove the sulphur from the fuel instead of us having to construct a desulphurizing plant on the ship, and these scrubbers are huge. So, we would like to buy clean fuel from the refineries,” stated AP Moller Maersk CEO Soren Skou, according to a 4/26 [article](#) in *Seatrade Maritime*.

The shipping company “is bracing for higher expenses stemming from [the] new rules” and “considering passing the higher costs on to customers,” a 2/22 *WSJ* [article](#) reported. The company spent \$3.3 billion on bunker fuel last year, and the low-sulfur fuel it will use in 2020 is about 50% more expensive.

It could cost the shipping industry as a whole \$50 billion to \$60 billion, and container shipping \$10 billion, based on current prices for low-sulfur fuel oil versus high-sulfur fuel oil, the *Seatrade Maritime* article estimated.

Installing a scrubber isn’t inexpensive, either. The cost of retrofitting a ship with a scrubber from a leading supplier can cost anywhere from \$4 million to \$8 million. It’s costly in part because the ship needs to be put into drydock for four to six weeks, then worked on for another month while at sea. The cost to install a scrubber on a new ship is \$3 million to \$4 million, per a 7/23 [article](#) in *Tradewindsnews*. One survey estimates that about 19% of ship owners will install scrubbers.

(3) *Impact on refiners.* Refiners with the ability to extract sulfur from heavy crudes—including ExxonMobil, Chevron, Marathon Petroleum, and Valero Energy—stand to benefit from IMO 2020. And thanks to the recent tax reform, they have the extra cash available and tax incentives to help them boost their existing capacity. Exxon is investing more than \$1 billion in new equipment that will produce lower-sulfur fuels at a refinery in Antwerp, Belgium, while Total has invested \$1.31 billion at its refinery complex in Antwerp to increase its diesel capabilities and cut heavy-oil production, reported an 11/7/17 [WSJ article](#). We'll be sure to revisit this issue before the new rules set sail.

Autos: Strange Bedfellows. It's always intriguing when seemingly unrelated stories converge in unexpected ways. What, for example, do Ford Motor and AT&T have in common? They're both placing big bets on the future of autonomous vehicles.

Ford was in the [news](#) this week for making its autonomous vehicle division a separate, wholly owned company in a bid to attract third-party investors. The company undoubtedly would like a deal akin to SoftBank Group's \$2.2 billion investment in GM Cruise, GM's driverless car operation. Ford also announced that it will invest \$4 billion in its autonomous vehicles arm through 2023.

AT&T was also in the [news](#) this week, reporting that Q2 adjusted revenue increased 0.2% to \$39.9 billion thanks to a \$1.1 billion revenue contribution from its newly acquired media assets of Time Warner, which it owned for 16 days. It too is looking to autonomous vehicles to drive its future. Recode published on 7/9 an [interview](#) of John Stankey, the AT&T executive now running Time Warner, conducted in front of HBO employees. In it, he connected the dots.

AT&T is rolling out 5G wireless service, which will provide for more instantaneous Internet connections. Eliminating any delay in transferring data will make autonomous cars possible. If autonomous cars become popular, they'll free up an hour or two of time daily for many commuters, who then would be looking for great entertainment to fill their new free time.

AT&T, with its new Time Warner assets, wants to be the company to provide that entertainment to consumers, perhaps—may we suggest—while they're sitting behind the wheel of their Ford autonomous vehicle. Circle complete.

CALENDARS

US. Thurs: Durable Goods Orders Total, Ex Transportation, and Core Capital Goods 3.2%/0.5%/0.5% m/m, Advance Goods Trade Balance -\$67.2b, Kansas City Fed Manufacturing Index, Jobless Claims 219k, Weekly Consumer Comfort Index, EIA Natural Gas Report. **Fri:** Real GDP & PCE 4.2%/2.9%, GDP Price Deflator 2.2%, Consumer Sentiment Index 97.1, Baker-Hughes Rig Count. (*Wall Street Journal* estimates)

Global. Thurs: Germany Gfk Consumer Confidence 10.7, Japan Headline, Core, and Core-Core CPI 0.7%/0.7%/0.4% y/y, ECB Rate Decision 0.00%, ECB Marginal Lending Facility & Deposit Facility Rate 0.25%/-0.40%, Draghi Press Conference. **Fri:** Eurozone GDP 0.3%q/q/1.9%y/y. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): Our Bull/Bear Ratio (BBR) edged down to 2.95 this week after climbing from 2.53 to 2.99 the prior two weeks. There was little movement in the measures this week. Bullish sentiment (to 54.9% from 55.3%) was little changed after an 8.2ppts jump the prior two weeks, while the correction count (26.5 from 26.2) barely budged after a two-week 8.1ppts drop. Meanwhile, bearish sentiment (18.6 from 18.5) continued to fluctuate in a narrow band between 17.6%

and 18.6% the past seven weeks. The AAI Ratio slipped to 58.2% last week after climbing the prior two weeks from 41.1% to 59.6%. Bullish sentiment fell to 34.7% after rising the prior week from 27.9% to 43.1%, while bearish sentiment fell for the third week from 40.8% to 24.9% over the period.

AC World ex-US MSCI ([link](#)): This index is down 3.7% ytd in dollar terms after rising 24.1% in 2017 and 1.7% in 2016. In local-currency terms, the index is down 1.2% ytd compared to gains of 15.3% and 4.1% for all of 2017 and 2016, respectively. Local-currency forward revenues has risen 13.2% from a five-year low in March 2016 to record highs since May for the first time since October 2014. Local-currency forward earnings has performed better, with a 32.7% rise from its six-year low in March 2016 to its first record highs since September 2008 beginning four months ago in April. Revenues are expected to rise 6.3% in 2018 and 4.6% in 2019 following an 8.8% gain in 2017, and earnings are expected to rise 9.8% (2018) and 9.0% (2019) after surging 21.7% (2017). Analysts are forecasting STRG of 5.4%, up from 5.3% a month ago. Their STRG forecast compares to a seven-year high of 6.8% in March 2017 and is up from a cyclical low of 2.3% in March 2016. Their STEG forecast of 9.4% is up from 9.2% a month earlier and compares to a four-year-high forecast of 14.1% in March 2017 and a seven-year low forecast of 6.3% in January 2016. The implied profit margin is expected to rise to 8.1% in 2018 and 8.4% in 2019 from 7.8% in 2017. The forward profit margin forecast of 8.3% is at a nine-year high now. NERI was negative in July for a fourth straight month following six positive readings, but improved to -1.5% from a 20-month low of -2.3%. That compares to a 76-month high of 2.7% in May 2017 and a 51-month low of -11.3% in March 2016. The P/E of 13.0 is up from a 28-month low of 12.8 in early July. That compares to a recent 31-month high of 14.8 in January, a six-year high of 15.3 in April 2015, and a bottom of 12.4 in February 2016. The index's current 13% discount to the World P/E matches its record-low discount of March 2017.

EMU MSCI ([link](#)): The EMU's MSCI price index has dropped 2.3% ytd in dollar terms after rising 25.3% in 2017 and falling 1.2% in 2016. In euro terms, the price index is actually up 0.2% ytd following gains of 10.2% in 2017 and 1.8% in 2016. Euro-based forward revenues is 4.6% above its six-year low in May 2016 and is now above its prior cyclical high from August 2015 to the highest level since October 2013, but remains 6.5% below its record high (September 2008). Euro-based forward earnings had stalled from 2011 to 2016, but reached its highest level since November 2008 during July. Although it has improved 22.5% from its 23-month low in June 2016, it remains 17.4% below its record high in January 2008. Analysts expect revenues to rise 3.1% in 2018 and 3.7% in 2019 after a 5.0% gain in 2017, and think earnings will rise 6.8% (2018) and 9.8% (2019) following a 13.3% increase in 2017. Forecasted STRG of 3.5% is up m/m from 3.1%, which compares to a six-year high of 5.0% in April 2017 and a cyclical low of 2.0% in May 2016. Forecasted STEG of 8.7% is up m/m from 8.4%, which compares to a 78-month high forecast of 21.0% during February 2017 and a seven-year low of 5.7% in April 2016. STEG had been higher than LTEG (currently 11.0%) from July 2016 to May 2017, but is trailing now. The forward profit margin edged down m/m to 7.8% from a nine-year high of 7.9%, which is up from a cyclical bottom of 6.2% in May 2013. The implied profit margin is expected to improve to 7.6% in 2018 and 8.0% in 2019 from 7.3% in 2017. NERI was positive in July for the first time in 12 months as it improved to 0.1% from -2.1%. However, that NERI reading is down from an 11-year high of 8.1% in May 2017 and compares to a 24-month low of -13.2% in April 2016. The P/E of 13.5 is up from a 12-month low of 13.2 in early July, but down from a nine-month high of 14.9 in January. That compares to a 13-year high of 16.4 in April 2015 and a 30-month low of 12.2 in February 2016. The current valuation represents a 10% discount to the World MSCI's P/E now, up from an 11% discount in March and a record-low 25% discount during 2011. But the current reading is still well below the 1% premium during April 2015—the post-euro-inception record high.

Emerging Markets MSCI ([link](#)): The EM MSCI price index is down 6.7% ytd in US dollar terms after surging 34.3% in 2017 and rising 8.6% in 2016. In local-currency terms, EM has slipped 2.9% ytd compared to gains of 27.8% (2017) and 7.1% (2016). Local-currency forward revenues is up 17.5%

from a four-year low in June 2016, but down 1.7% from its record high in June, which was its first since November 2014. Local-currency forward earnings has fared substantially better, improving 39.2% from April 2016's six-year low, but has dropped 0.7% from its record high in June, which was its first since January 2014. Revenues are expected to rise 10.0% in 2018 and 7.6% in 2019, down from a 12.2% gain in 2017. That's expected to lead to an earnings gain of 15.7% in 2018 and 11.5% in 2019, which follows a 22.3% surge in 2017. Forecasted STRG dropped to 8.7% in July from 8.8% in June, and is down from a four-year high of 9.6% in January 2017. STEG fell to 13.4% from 13.7%, and is down from a cyclical peak of 17.5% in March 2017 and below LTEG (18.1%) again. The implied profit margin is expected to improve to 7.1% in 2018 and 7.4% in 2019 from 6.7% in 2017. The forward profit margin remained steady m/m at 7.2%, but is down from a six-year high of 7.4% in May. It remains 3.1ppts below its 10.3% record high in December 2007 and compares to a record low of 6.0% in February 2016. NERI was negative for a fifth month in July, but edged up to -3.7% from a 24-month low of -3.8% in June. NERI had been positive for only three months through January after 80 months of negative readings through October, and compares to an 83-month low of -10.2% in March 2016. Emerging Markets' valuation had been more stable recently than that of the rest of the world, and is up to 11.3 from a 28-month low of 11.1 in early July. That compares to an eight-year high of 13.1 in January. The index is trading at a 24% discount to the World MSCI P/E, its lowest reading in seven months, and compares to a 10-year-low 30% discount in August 2016.

MSCI World & Region Net Earnings Revisions ([link](#)): Analysts' recent earnings revisions through July now point toward improving optimism about profits across Europe, but the emerging market regions remain weak. Powered by the US, in the lead among regions, the AC World MSCI's NERI was positive for an 18th month in July as it improved to 1.3% from a nine-month low of 1.2% in June. However, that's down from a 93-month high of 7.1% in February. The US was positive for a 15th straight month as its NERI fell to 8.2% from 9.2% in June and from a record high of 21.8% in March. NERI for the various European indexes turned positive in July for the first time in 12 months, but EM regions outside Europe remained in negative territory for a sixth straight month. July's scores among the regional MSCIs: US (8.2% in July, down from 9.2% in June), AC World (1.3, 1.2), Europe ex-UK (0.7 [12-month high], -1.3), Europe (0.6 [12-month high], -1.3), EM Eastern Europe (0.5, -0.6 [26-month low]), EAFE (0.2, -1.1), EMU (0.1 [12-month high], -2.1), AC World ex-US (-1.5, -2.3 [20-month low]), EM Latin America (-2.5 [nine-month high], -1.6), Emerging Markets (-3.7, -3.8 [24-month low]), and EM Asia (-4.0, -4.1 [24-month low], -3.7).

MSCI Countries Net Earnings Revisions ([link](#)): NERI was positive for 16/44 MSCI countries in July, the lowest count since October 2017 and down from 18/44 in June. NERI improved m/m in July for 14/44 countries, also the lowest count since October, and down from 26/44 countries improving in June. Among the countries with improving NERI in July, the Czech Republic's was at a record high looking back to 1998, followed by the United Kingdom (14-month high), Sweden (13), and these five countries at 12-month highs: Denmark, Finland, France, Netherlands, and Spain. On the flip side, Poland's was at a 28-month low, followed by those of China (23-month low), Malaysia (22), Hong Kong (21), Turkey (20), Thailand (19), and Singapore (18). However, the 21-month positive NERI streak for Hong Kong and Turkey remain the best among countries, followed by the positive streaks of the Czech Republic (14-month high), Switzerland (11), Canada (10), and Russia (10). South Africa's NERI has been negative for 50 straight months, followed by the negative streaks of New Zealand (26-month low), Mexico (21), Pakistan (20), and Israel (16). NERI turned positive in July for three countries: the United Kingdom (first positive reading in 14 months), France (12), and Portugal (5). Five countries slipped back into negative territory this month; among them, China was negative for the first time in 23 months, followed by Peru (first time in 8 months), Chile (4), and Hungary (3). The highest NERI readings in July: the Czech Republic (14.4%), Russia (10.0), Sweden (8.3), the United States (8.2), Italy (6.1), and Canada (5.9). The weakest NERIs occurred this month in Malaysia (22-month low of -11.1), Pakistan (-10.3), Indonesia (-8.8), Ireland (-7.8), and the Philippines (-7.7).

S&P 500 Q2 Earnings Season Monitor ([link](#)): With 30% of S&P 500 companies finished reporting earnings and revenues for Q2-2018, the percentage of companies with positive surprise results is higher compared to the same point during the Q1 earnings season, but companies' overall percent surprise for Q2 and their y/y growth rate metrics have dropped from Q1's historically high levels. Of the 150 companies in the S&P 500 that have reported through mid-day Wednesday, 86% exceeded industry analysts' earnings estimates by an average of 5.8%; they have averaged a y/y earnings gain of 25.8%. At the same point during the Q1-2018 reporting period, a lower percentage of companies (83%) in the S&P 500 had beaten consensus earnings estimates by a higher 7.3%, and earnings were up a higher 27.7% y/y. On the revenue side, 76% of companies beat their Q2 sales estimates so far, with results coming in 1.0% above forecast and 8.9% higher than a year earlier. At this point in the Q1 season, a lower 71% of reporting companies had exceeded revenue forecasts by a higher 1.8%, and sales had risen by a higher 10.4% y/y. Q2 earnings results are higher y/y for 93% of companies, vs a lower 92% at the same point in Q1, and Q2 revenues are higher y/y for 88% vs a higher 92% a quarter ago. These early results are very encouraging, particularly the percentage of companies growing revenues y/y. Q2-2018 should mark the eighth straight quarter of positive y/y earnings growth and among the highest growth since Q4-2010. The strong results are mostly due to lower tax rates and improved business conditions, with a small benefit due to currency translation.

US ECONOMIC INDICATORS

New Home Sales ([link](#)): New home sales—tabulated when contracts are signed—fell to an eight-month low in June, remaining in a volatile flat trend below November's cyclical high, while home prices continued to fall. New home sales sank -5.3% last month to 631,000 units (saar), following a 3.9% gain and a -4.6% loss the prior two months; ytd sales are basically flat after falling -0.8% in June. Regionally, the Northeast (36.8% m/m, 20.9% y/y) was the only region to post a monthly gain last month, while the West (-5.2, -15.0) was the only region recording a y/y decline; here's the sales tally for the South (-7.7, 8.1) and Midwest (-13.4, 7.6). In June, there were 301,000 new homes on the market, up 10.3% y/y, with the months' supply climbing from 5.3 to 5.7—the highest since last August. Meanwhile, the number of properties sold in which construction hasn't started yet rose to a four-month high of 195,000, a good sign. The median sales price fell for the third month to a 16-month low of \$302,100; the price is -4.2% below a year ago. The NAHB reports their housing market index was unchanged at 68 this month, with the components mixed: Current sales conditions remained unchanged at 74 in July, while the component gauging expectations dropped two points to 73 and the metric charting buyer traffic rose two points to 52.

GLOBAL ECONOMIC INDICATORS

Germany Ifo Business Climate Index ([link](#)): Business confidence dipped again this month as escalating trade tensions between Europe and the US heightened export concerns. German business confidence hasn't posted a gain since reaching a record high of 105.2 in November, falling to a 16-month low of 101.7 this month. Of the four sectors—manufacturing, services, trade, and construction—confidence among manufacturing companies continues to slide, while construction's confidence remains at record highs. Meanwhile, the declines in both services' and wholesalers' confidence appear to have found their bottoms, while retailers' confidence remains in a volatile multi-year flat trend. July's present situation component (to 105.3 from 105.2) edged up from June's 12-month low, though is down 3.2 points from its record high of 108.5 at the start of this year. Meanwhile, the expectations component fell for the eighth straight month to a 28-month low of 98.2 from November's peak of 103.7. Ifo's expectations component correlates closely with German factory orders and production, while the overall index tracks exports more closely. Recent Ifo data continue to suggest ongoing easing of growth across

the board. This is supported by the Ifo Institute president's comments after the data release: "The German economy continues to expand, but at a slower pace."

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