



MORNING BRIEFING

August 13, 2018

Trump's World

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

(1) No place like home. (2) Stay Home isn't just about trade war; tax cuts also giving the US an edge. (3) The strong dollar isn't just about trade war but also central bank policies—i.e., Fed normalizing while ECB and BOJ policies remain abnormally easy. (4) Copper price isn't just about strong dollar but also reflects some global weakness. (5) Forward earnings of US MSCI outpacing rest of the world since start of current bull market. (6) So far this year, cyclical stocks beating interest-rate-sensitive ones. (7) SmallCap outperformance isn't just about less exposure to trade war.

Stocks I: America First. US stocks have been outperforming other major overseas stock price indexes since early February. That's when President Donald Trump started his "America First" protectionist campaign aimed at making free trade fairer trade with America's major trading partners. During the current bull market, Joe and I had been recommending a Stay Home investment strategy until the fall of 2016. On November 8, 2016, we switched to a Go Global strategy on mounting evidence that the global economy was rebounding from the worldwide energy-led mini-recession of 2015. We switched back to Stay Home in early June of this year in response to the escalating trade war.

US stocks have outperformed the major overseas stock indexes priced in local currencies so far this year. They've done even better when foreign indexes are priced in local currencies because the dollar has soared in response to Trump's escalating trade war. Meanwhile, the 10-year US Treasury bond yield has remained below 3.00% since May 24. All this suggests that the greenback and US financial assets are viewed as the winners in a trade war.

However, Stay Home isn't all about a risk-off approach to overseas economies. In fact, Joe and I believe that the outperformance of Stay Home so far this year also owes a lot to Trump's stimulative tax cuts at the end of last year. Consider the following:

(1) *The dollar.* The preceding statement doesn't seem to apply to the trade-weighted dollar, which jumped 7.4% since the year's low on February 1 ([Fig. 1](#)). That coincides with the implementation of Trump's America First trade campaign.

Debbie and I have often observed that the dollar tends to be strong (or weak) when the rest of the world is looking relatively weak (strong). That explains why the dollar tends to be inversely correlated with commodity prices, as measured by the Goldman Sachs Commodity Index (GSCI) ([Fig. 2](#)). So far this year, the GSCI is holding up reasonably well. However, it is heavily weighted with the prices of petroleum products, which have been propped up by looming US sanctions on Iranian crude oil.

Looking somewhat weaker is the CRB raw industrials spot price index, which has been weighed down by a significant drop in the price of copper in recent weeks ([Fig. 3](#)). The price of copper remains highly and inversely correlated with the value of the dollar ([Fig. 4](#)).

Of course, some of the relative weakness in the rest of the world reflects the relative strength provided the US economy by Trump's tax cuts. In other words, the dollar's strength isn't all about the trade war. Fed officials continue to say that while the trade war may be a threat to US economic growth, they believe the economy will remain strong enough to justify further hikes in the federal funds rate from 1.75%-2.00% currently to possibly 2.75%-3.00% next year. Meanwhile, both the ECB and BOJ show no signs of normalizing their official interest rates, which remain abnormally low just below zero ([Fig. 5](#)).

(2) *Relative forward earnings*. The main reason why Stay Home has been outperforming Go Global since the start of the bull market is that the forward earnings of the US MSCI has outpaced the forward earnings of the All Country World ex-US MSCI (in local currencies) ([Fig. 6](#)). The former is up 172.4% since it bottomed during the 4/30 week of 2009 through the 8/2 week this year, while the latter is up 78.2% over the same period ([Fig. 7](#)).

(3) *S&P 500 sectors*. As Joe and I have previously observed, the ytd relative performance of the S&P 500 sectors' stock indexes suggests that concerns about ongoing Fed rate hikes are having a more pronounced impact on stock prices than worries about the trade war. Here is the ytd derby for the 11 sectors: Information Technology (15.8%), Consumer Discretionary (14.2), Health Care (8.4), S&P 500 (6.0), Energy (3.9), Utilities (0.4), Financials (0.0), Real Estate (-0.4), Industrials (-1.1), Materials (-2.9), Consumer Staples (-7.0), and Telecommunication Services (-8.3) ([Fig. 8](#)). The leaders are mostly cyclical, while the laggards are mostly interest-rate-sensitive sectors.

Drilling down some more, we can see that the ytd relative performance of the S&P 500 sectors' forward earnings can explain some of the price action: Energy (56.3%), Telecommunication Services (20.9), Industrials (20.2), Financials (18.2), Materials (17.8), S&P 500 (17.4), Consumer Discretionary (16.3), Information Technology (15.8), Health Care (14.0), Utilities (5.6), Consumer Staples (5.1), and Real Estate (3.1). (See Table 2E in [Performance Derby: S&P 500 Sectors & Industries Forward Earnings & Revenues](#).)

Stocks II: SmallCaps First. The widely held view is that SmallCaps have outperformed in the US because they are less exposed to the escalating trade and currency wars. That does make sense. However, their underlying fundamentals are improving faster on a relative basis as well. Consider the following:

(1) *Forward revenues*. Here are the ytd performances of forward revenues for the S&P 500/400/600: 6.2%, 6.0%, and 14.4% ([Fig. 9](#)).

(2) *Forward earnings*. Here are the ytd performances of the forward earnings of the three: 16.7%, 16.1%, and 27.9% ([Fig. 10](#)).

(3) *Stock price indexes*. Here are the ytd performances of the S&P 500/400/600 stock price indexes: 6.0%, 5.0%, and 13.4% ([Fig. 11](#)).

SmallCaps may be getting a bigger after-tax earnings boost from Trump's tax cuts than larger corporations that have had the means to dodge taxes better than smaller ones.

That still begs the question of why small companies' revenues are so strong on a relative basis. Perhaps Trump's deregulation policies benefit smaller companies more than larger ones. After all, regulations are often promoted by large companies to keep small competitors at bay. The monthly survey conducted by the National Federation of Independent Business shows that significantly fewer small business owners have been reporting concern about government regulation and taxes since Trump was elected ([Fig. 12](#)).

CALENDARS

US. Mon: None. **Tues:** NFIB Small Business Optimism Index 107.0, Import & Export Prices 0.0%/0.2%. (*Wall Street Journal* estimates)

Global. Mon: None. **Tues:** Eurozone GDP, Eurozone Industrial Production, Germany GDP, Germany CPI, Germany ZEW Economic Sentiment & Expectations, UK Jobless Claims Change & Claimant Count Rate, Japan Industrial Production, China Industrial Production 6.3% y/y, China Retail Sales 9.2% y/y, China Fixed Assets Ex Rural (YTD) 6.0% y/y. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance ([link](#)): The US MSCI index dropped 0.2% last week for its first decline in six weeks, ranking 13th out of the 49 markets in a week when 10 countries rose in US dollar terms and the AC World ex-US index fell 1.4%. That compares to the US MSCI's 0.8% rise a week earlier, which ranked eighth as 15 markets rose and the AC World ex-US index fell 1.4%. EM Asia performed best with a gain of 0.8%, and was followed by BRIC (-0.4%). The underperforming regions relative to the AC World ex-US were EM Latin America (-6.7), EMEA (-6.1), EM Eastern Europe (-6.0), EMU (-2.7), and EAFE (-1.6). Sri Lanka was the best-performing country as it rose 2.8%, followed by Hong Kong (2.2), China (2.0), Indonesia (1.7), and Malaysia (1.3). Of the 26 countries that underperformed the AC World ex-US MSCI last week, Turkey fared the worst as it tumbled 20.5%, followed by Argentina (-12.5), Brazil (-9.1), Russia (-7.0), and Greece (-5.3). On a ytd basis, the US MSCI dropped to a 6.2% gain, but picked up one spot in the ytd performance ranking to 3/49. The US MSCI remains way ahead of the AC World ex-US (-5.6) in the ytd period; 41/49 countries and all other regions are in negative territory ytd. EAFE leads with a decline of 4.9%, putting it ahead of EMU (-5.9). EMEA (-12.8) is the biggest laggard relative to the AC World ex-US's performance, followed by EM Latin America (-9.3), EM Eastern Europe (-9.2), BRIC (-7.1), EM Asia (-6.6), and EMU (-5.9). The best country performers ytd: Israel (6.5), Colombia (6.3), the US (6.2), Finland (5.2), and Peru (5.0). The worst-performing countries ytd: Turkey (-52.3), Argentina (-46.3), South Africa (-18.6), Hungary (-16.8), and Greece (-15.9).

S&P 1500/500/400/600 Performance ([link](#)): Two of these market-cap indexes fell last week as SmallCap's 0.8% gain beat the 0.2% declines recorded by MidCap and LargeCap. SmallCap is down 0.1% from its record high on Thursday, while MidCap is 0.9% below its record on Tuesday. LargeCap is the biggest laggard, down 1.4% from its record high six months ago on January 26. Fifteen of the 33 sectors rose in the latest week, down from 24 rising a week earlier. The best performers in the latest week: MidCap Telecom (11.8%), SmallCap Consumer Discretionary (2.5), SmallCap Tech (1.6), and SmallCap Industrials (1.3). SmallCap Energy and MidCap Materials (both down 2.2%) were the biggest decliners last week, followed by LargeCap Consumer Staples (-1.9), LargeCap Real Estate (-1.8), SmallCap Real Estate (-1.4), and MidCap Real Estate (-1.4). LargeCap is now up 6.0% ytd and ahead of MidCap (5.0) in recent weeks after trailing it for much of the year, but both are significantly trailing SmallCap's 13.4% gain. Twenty-three sectors are now positive to date in 2018, down from 26 a week earlier and compared to just three in early February. The best-performing sectors ytd: SmallCap Health Care (37.6), MidCap Health Care (27.7), LargeCap Tech (15.8), LargeCap Consumer Discretionary (14.2), and MidCap Energy (14.1). The worst performers ytd: LargeCap Telecom (-8.3), LargeCap Consumer Staples (-7.0), LargeCap Materials (-2.9), and SmallCap Real Estate (-2.5).

S&P 500 Sectors and Industries Performance ([link](#)): Three sectors rose last week, and four matched or outperformed the S&P 500's 0.2% decline. That compares to seven rising a week earlier, when six outperformed the S&P 500's 0.8% rise. Consumer Discretionary, with a gain of 0.8%, was the best-

performing sector and beat the performances of Telecom (0.7%), Tech (0.3), and Health Care (-0.2). Consumer Staples was the biggest underperformer, with a drop of 1.9%, followed by Real Estate (-1.8), Industrials (-1.0), Materials (-0.9), Utilities (-0.6), Financials (-0.6), and Energy (-0.3). Five sectors are in the plus column so far in 2018, down from seven a week earlier and down from nine in early March. However, just three sectors are outperforming the S&P 500's 6.0% ytd gain: Tech (15.8), Consumer Discretionary (14.2), and Health Care (8.4). The eight ytd underperformers: Telecom (-8.3), Consumer Staples (-7.0), Materials (-2.9), Industrials (-1.1), Real Estate (-0.4), Financials (0.0), Utilities (0.4), and Energy (3.9).

Commodities Performance ([link](#)): Last week, the S&P GSCI index fell 0.9% w/w for its fifth decline in six weeks as 10 of the 24 commodities that we follow moved higher. That compares to the prior week's 0.5% decline when 8/24 commodities rose. Last week's strongest performers: Aluminum (4.3%), Natural Gas (3.3), Cocoa (3.2), Kansas Wheat (2.2), and Nickel (2.2). Last week's biggest decliners: Unleaded Gasoline (-5.6), Soybeans (-4.5), Zinc (-3.6), Cotton (-3.3), and Sugar (-2.9). The S&P GSCI commodities index is up 3.6% ytd and near its highest level since December 2014, but is down 7.5% from its high in May and remains about 50% below its record high in July 2008 just before the financial crisis. The top performer so far in 2018 is Kansas Wheat (35.7), followed by Wheat (32.3), Cocoa (11.6), Crude Oil (11.0), and GasOil (9.3). The biggest laggards of 2018 to date: Sugar (-30.5), Lean Hogs (-28.7), Zinc (-23.3), Lead (-15.6), and Copper (-14.5).

Assets Sorted by Spread w/ 200-dmas ([link](#)): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 11/24 commodities, 2/9 global stock indexes, and 11/33 US stock indexes, compared to 10/24 commodities, 4/9 global stock indexes, and 22/33 US stock indexes rising a week earlier. Commodities' average spread fell w/w to -2.8% from -2.5%, and 10 commodities now trade above their 200-dmas, down from 11 a week earlier. Kansas Wheat leads all commodities at 18.7% above its 200-dma, but Aluminum (-2.8%) performed the best among commodities last week, rising 4.1ppts. Lean Hogs trades at 27.8% below its 200-dma, the lowest of all commodities and all assets. Unleaded Gasoline (-0.6) had the worst performance of all commodities last week, tumbling 6.2ppts. The global indexes trade at an average of 2.8% below their 200-dmas, down from -2.0% in the prior week. Just two of the nine global indexes trade above their 200-dmas, down from four a week earlier. The UK (2.5) now leads the global indexes, followed closely by Canada (2.4). China (-12.5) remains the biggest laggard among global indexes, but gained 2.7ppts last week for the best w/w improvement among global assets. Brazil (-3.7) was the worst performer among the global indexes and all assets as it tumbled 6.4ppts. The US stock indexes trade at an average of 5.4% above their 200-dmas, with 28 of the 33 sectors above, down from 5.5% a week earlier, when 28 sectors were above. SmallCap Health Care (19.0) continues to lead the US stock indexes and all assets, but MidCap Telecom (11.5) soared 11.6ppts w/w for the biggest gain among US stock indexes and indeed all assets last week. LargeCap Materials (-1.0) now trades the lowest among all US stock indexes, but SmallCap Energy (4.8) dropped 2.8ppts for the worst performance among US stock indexes.

S&P 500 Technical Indicators ([link](#)): The S&P 500 price index fell 0.2% 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 first time in three weeks. The index remained in a Golden Cross (50-dma higher than 200-dma) for a 120th straight week (after 17 weeks in a Death Cross) as the S&P 500's 50-dma relative to its 200-dma rose for the ninth time in 10 weeks following 17 straight weekly declines. The current Golden Cross reading of 2.6% is at a 15-week high and up from 2.4% a week earlier, but 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 an 11th week, but has fallen in eight of the past 21 weeks—including four straight weeks of decline through mid-April that constituted its worst performance since before the 2016 election. The index appears to have successfully tested its 50-dma at the end of June, but dropped to 1.8% above its rising 50-dma from 2.5% a week earlier. 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 a pace near its slowest since October 2011. The S&P 500 successfully tested its 200-dma in early April, and ended the week at 4.4% above its rising 200-dma, down from a 20-week high of 4.9% a week earlier. 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, only two improved last week relative to their 50-dmas and 200-dmas: Consumer Discretionary and Telecom. Nine of the 11 sectors are trading above their 50-dmas, down from 10 a week earlier and from all 11 the week before that, which had been the most since early December. Materials moved below its 50-dma in the latest week, joining Energy. 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 8/11 sectors trading above, down from nine a week earlier. That's up from just four sectors trading above their 200-dmas in early May (which matched the lowest count since January 2016). Consumer Staples moved below its 200-dma in the latest week, where it has resided in 25 of the past 27 weeks. Sectors trading the longest above their 200-dmas: Tech (above 200-dma for 110 straight weeks), Consumer Discretionary (92 straight weeks), and Energy (17 weeks). Telecom has been below for 21 straight weeks. All 11 sectors had been above both their 50-dmas and 200-dmas briefly in mid-December (for the first time since July 2016). Six sectors are in a Golden Cross (with 50-dmas higher than 200-dmas), up from five a week earlier, as Utilities joined the club for the first time in 29 weeks. 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 19th week and Consumer Staples for a 21st. Nine sectors have rising 50-dmas now, down from 11 a week earlier as Energy and Materials reversed lower in the latest week. That compares to all 11 sectors with falling 50-dmas during early April (the worst count since before the election in November 2016). Eight sectors have rising 200-dmas, down from 10 a week earlier and six in mid-July (which was tied with a count in February for the lowest since May 2017). The 200-dma turned lower in the latest week for Consumer Staples and Materials, joining Utilities in the declining 200-dma club.

US ECONOMIC INDICATORS

CPI ([link](#)): The core CPI rate in July continued to accelerate, coming in above the Fed's target rate of 2.0% y/y for the fifth straight month. July's rate climbed to 2.4% y/y—the fastest pace since September 2008. Meanwhile, the three-month rate picked up to 2.3% (saar) from below 2.0% the previous three months; it was at a 10-year high of 3.1% in February. On a monthly basis, core prices rose 0.2% for the third month, matching its average monthly gain so far this year. Along with the shelter index, the indexes for used cars & trucks, air fares, new vehicles, household furnishings & operations, and recreation all increased—partially offset by declines for medical care and apparel. The headline CPI rate remained 2.9% y/y last month—which was the highest since February 2012—as the energy index jumped 12.1% y/y; the headline rate has been mostly trending upward since falling to 1.6% in June 2017.

PPI ([link](#)): The PPI for final demand was flat in July after climbing 0.3% and 0.5% the previous two months. Prices for final demand goods ticked up 0.1% last month, while prices for final demand services ticked down -0.1%—the first monthly decline this year. During the first half of this year, both measures averaged monthly gains of 0.3%. The July advance in prices for final demand goods can be traced to a 0.3% rise in the index for final demand goods less foods & energy, led by pharmaceutical preparations. In contrast, prices for final demand energy fell -0.5%, and the index for final demand foods decreased -0.1%. Leading the July decline in prices for final demand services was a 12.7% drop in margins for fuels & lubricants retailing. The indexes for machinery and equipment parts & supplies

wholesaling, food retailing, hospital outpatient care, and airline passenger services also moved lower. The yearly inflation rate for the headline series edged down to 3.3% y/y, from 3.4% in June—which was highest rate since November 2011. The services rate (to 2.6% from 2.8% y/y) slowed from June's rate—which matched March's record high—while the goods rate (4.5 from 4.3) was the highest since the end of 2011. Meanwhile, the core (2.7 from 2.8) rate held around June's rate, which was the highest since fall 2011; the core ex trade services (2.8 from 2.7) moved back toward March's record high of 3.0%.

GLOBAL ECONOMIC INDICATORS

UK GDP ([link](#)): Real GDP growth for Q2 (0.4%) accelerated from the weather-impacted Q1 pace (0.2), but lost momentum in June (0.1%, down from 0.3% in May), estimates the Office for National Statistics (ONS). (Last month, the ONS started producing a monthly UK GDP estimate as well as its quarterly updates on growth in order to give a more timely guide on the direction of the economy.) Of the four industry groupings, services (0.6 from 0.3)—which accounts for 80% of the UK economy—grew last quarter at double the Q1 pace, while construction (0.8 from -0.8) got a boost from warmer weather after heavy snow depressed Q1 activity. Meanwhile, the production group, which includes manufacturing and mining, contracted -0.9%—the first quarterly decline since Q3-2016—as the manufacturing (-0.9 from -0.1) sector slumped into recession for the first time since the Brexit vote; mining (0.6 from 2.5) output slowed from Q1's robust pace. Agriculture output posted its third straight quarterly decline, falling -0.1% q/q and -1.8% over the period. (The second release of GDP data will show the expenditure breakdown.)

UK Industrial Production ([link](#)): Industrial output rose in June for the first time in four months. Headline production expanded 0.4% after a three-month slide of -1.3%. Meanwhile, manufacturing production recovered 1.1% during the two months ending June, following a three-month drop of -1.7%. Consumer durable goods production advanced for the seventh time in eight months, by a total of 9.2%, to a new cyclical high, while consumer nondurable goods output expanded by 3.4% during the five months ending June. Meanwhile, capital (0.0%) and intermediate (-0.1) goods production were flat in June. Looking forward, the UK's M-PMI fell to a three-month low of 54.0 in July, well below the highs achieved around the turn of this year, though comfortably above its long-run average of 51.8. According to the report, July saw slower rates of expansion in both output and new orders, as weaker growth of new work from domestic sources offset a stronger increase in new export orders.

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