



MORNING BRIEFING

August 22, 2018

Superstars

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

(1) Nice view of the Grand Tetons. (2) Hot topic: “Changing Market Structure and Implications for Monetary Policy.” (3) Are multinationals getting too much market power? (4) And what about online shopping? (5) How has banking evolved since financial crisis of 2008? (6) “Superstar firms” are either depressing or boosting productivity. (7) Not enough creative destruction? (8) Expect déjà vu all over again from predictable Powell.

Fed I: Jackson Hole. On Thursday and Friday, prominent central bankers, finance ministers, academics, and members of the media will gather in Jackson Hole, WY for the 2018 Economic Symposium—a.k.a. simply “Jackson Hole.” The annual event, hosted by the Kansas City Fed since 1978, focuses on a single economic issue with significant importance to the US and global economies. Jackson Hole is close to Grand Teton National Park and Yellowstone National Park.

Despite the resort-like atmosphere, the Jackson Hole topics of focus are heavily academic and comprehensively examined via papers, panel discussions, and presentations. This year’s topic is “Changing Market Structure and Implications for Monetary Policy.” A [News Release](#) issued by the Kansas Fed last Friday provided this high-level overview: “This year’s symposium topic will explore dynamics that have contributed to shifts in productivity, growth and inflation that are of concern to central bankers.” It added that understanding the market dynamics behind these shifts is “vital for policymakers as they seek to promote conditions that can best foster long-run sustainable growth with stable prices.”

We won’t know the specific talking points to be covered until the 2018 program is available on the Kansas City Fed’s [website](#) when the event opens on Thursday at 6:00 p.m. MT (8:00 p.m. EST). Papers presented will be posted to the website as delivered, and a list of attendees will be available after the event. (Here’s last year’s participant [roster](#).) Meanwhile, it’s worth reading the Kansas City Fed’s depiction of the three key areas in focus from the News Release:

(1) *Multinationals & market concentration.* “Within product markets, there has been a notable increase in economic activity associated with large multinational corporations along with increased market concentration in many industries. These developments suggest that large firms today may have greater market power than in the past, and this shift may result in a decrease in competition within many industries. These shifts should concern central bankers since they likely have important linkages to observed structural changes in the global economy, including lower capital investment, a declining labor share, slow productivity growth, slow wage growth and declining dynamism.”

(2) *Online retailers & technology.* “The marketplace for consumers also has seen rapid changes due to advances in technology along with changes in consumer behavior. New markets are emerging online as traditional retailers struggle to adapt. This shift may be altering pricing behavior of firms in an increasingly global marketplace. In particular, it may limit the ability of firms to raise prices in response to rising demand which may affect deviations from the law of one price. As pricing behavior evolves,

inflation dynamics will also evolve, suggesting that the monetary policy transmission mechanism within and between countries may change as well.”

(3) *Banking markets & bank regulation*. “Finally, the marketplace for the banking industry has also changed, leading to an increased focus on financial stability in the aftermath of the financial crisis that has raised questions about potentially competing trade-offs between competition, efficiency and stability. Disentangling these potential tradeoffs requires an improved understanding of the relationship between competition and bank risk. Analysis of changes in banking markets and bank regulation across countries before and after the financial crisis can provide valuable insights for regulatory policy makers and central bankers concerned about the monetary transmission mechanism.”

Fed II: Markets Too Concentrated? Rising market concentration may help explain the recent productivity slowdown and slow wage growth, observed the cover story of the Richmond Fed’s Q1 *Econ Focus* [publication](#). The article—titled “Are Markets Too Concentrated?,” by Tim Sablik—reviews the relevant literature without offering a concrete answer or solutions. Melissa and I wouldn’t be surprised to find this article and its references vetted at Jackson Hole given the symposium’s focus on market dynamics, which the News Release emphasized as important to understand.

The article centers primary around two questions: 1) Have markets become more concentrated because of uncompetitive practices or have firms just become more efficient? 2) What are the economic ramifications of the increased market concentration? Studies conflict on the answers to both questions, the article suggests; we suspect there’s a bit of truth in the various viewpoints, with their applicability differing by industry and company. With market concentration on the minds of central bankers right now, let’s review the main points of the Richmond Fed story:

(1) *Efficiency or market power?* There are two schools of thought on market concentration. One originated in the 1950s from University of California, Berkeley economist Joe Bain. Bain reasoned that as market concentration rises, surviving firms would collude to reduce competition and increase prices. On the other hand, during the 1970s, economists from the University of Chicago noted that concentration might rise simply as more efficient firms outperform their rivals, increasing their market shares.

(2) *Superstar firms*. A 2017 study published in the *American Economic Review* found that the industries that have become the most concentrated in recent decades have also been the most productive. “Superstar firms,” more efficient than their competitors, are behind the increase in market concentration.

Sablik notes that 90% of all search traffic is sourced from Google. And Google and Apple produce the operating systems that run on nearly 99% of all smartphones. Four companies—Verizon, AT&T, Sprint, and T-Mobile—provide 94% of U.S. wireless services. And the five largest banks in the US control nearly half of all bank assets in the country.

The tech sector is a prime example of where “superstar” firms have gained market share. Some economists worry that the rise in “one-stop shops” may “limit the ability of new firms to contest the market share of incumbents.” Exhibiting this trend, market entry rates for new firms have fallen in recent years.

(3) *Market power & wages*. Academics seem to agree that rising market power has probably suppressed wages. The question is whether that’s a result of collusion or not. On the one hand, “firms might collude to reduce competition for workers and thus pay lower wages.” In 2010, for example, “the Department of Justice investigated claims that Apple, Google, Intel, Intuit, Pixar, and Adobe had

entered into agreements not to poach each other's employees, suppressing competition for tech workers. The firms agreed to end the practice as part of a settlement." On the other hand, "superstar" firms may rely on fewer workers due to the firms' higher productivity.

(4) *Market power & innovation.* "Policymakers at the Fed are also interested in the long-term growth potential of the economy, and some economists have argued that rising concentration may have a negative effect on innovation." One school of thought suggests that "creative destruction" drives productivity growth via competition from innovative new entrants. Another suggests that innovation and productivity gains largely come from incumbent firms that are improving themselves rather than from startups.

(5) *No easy solutions.* If indeed rising market concentration is having such negative effects, what to do about it? The story concludes with a quote from MIT economist Richard Schmalensee, an expert on the industrial organization of platforms: "You worry about a firm that has market power, ceases to innovate, and just charges high prices. But competition sometimes has winners, and one of the worst things you can do as a policymaker is pick on the winners."

Fed III: Powell's Upcoming Speech—Déjà Vu? Jackson Hole presenters tend not to give tactical guidance on the outlook for monetary policy. No major announcements have come out of the event since Bernanke's speech at Jackson Hole in 2010. That won't stop investors from tuning in for clues on where Fed policy is headed next. In particular, Jerome Powell will be widely watched on Friday at 10:00 a.m. EST as he delivers his first Jackson Hole speech as Fed chairman, which will be about "monetary policy in a changing economy."

Melissa and I suspect that Powell will be singing the same song that he has been singing since he became Fed chairman in February, but we'll be listening closely for any changes in his tune and lyrics. As a baseline for Powell's perspective, let's revisit his 7/17 [Semiannual Monetary Policy Report to the Congress](#). As we discussed in our 7/19 [Morning Briefing](#), Powell continued to characterize the risks to the economic outlook as remaining balanced on the upside and downside—suggesting that the Fed will continue to gradually raise interest rates "for now."

Recently, the phrase "for now" has received lots of attention in media reports speculating about Powell's likely messaging at Jackson Hole. Their consensus seems to be that "for now" means that the Fed isn't on autopilot and may move to tighten monetary policy faster (or slower) than gradual if necessary.

We don't think "for now" is worth harping on because the point isn't anything new. Since the Fed started to normalize monetary policy under Janet Yellen, Powell's predecessor, Fed officials have emphasized that they will set policy based on incoming data. That's a longer way of saying that they'll stay the course "for now." Investors will also be listening for clues on possible changes to the timing and scope of the Fed's balance-sheet reduction, which Powell has previously suggested won't be of any consequence for markets.

In any event, below we repeat 10 quotes from Powell's testimony, which represent points he's made before:

(1) *Continuing to gradually increase rates.* "With a strong job market, inflation close to our objective, and the risks to the outlook roughly balanced, the FOMC believes that—for now—the best way forward is to keep gradually raising the federal funds rate."

(2) *Risks to the outlook are balanced.* "Overall, we see the risk of the economy unexpectedly

weakening as roughly balanced with the possibility of the economy growing faster than we currently anticipate” ([Fig. 1](#) and [Fig. 2](#)).

(3) *Inflation objective is symmetric*. “Many factors affect inflation—some temporary and others longer lasting. Inflation will at times be above 2 percent and at other times below. We say that the 2 percent objective is ‘symmetric’ because the FOMC would be concerned if inflation were running persistently above or below our 2 percent objective” ([Fig. 3](#)).

(4) *Low productivity explains low wage growth*. “Over a long period of time, wages can’t go up sustainably without productivity also increasing. It’s a different thing to say that higher productivity guarantees our wages. ... I don’t think that’s true” ([Fig. 4](#)).

(5) *Education & investment may solve low productivity*. “Part of [the productivity problem] is ... stagnation of educational achievement. ... It’s also partly evolution of technology and investment. I think ... we had a number of years of very weak investment after the crisis because there was no need to invest.”

(6) *Labor force participation is improving*. “So prime age labor force participation ... has been climbing here in the last couple of years. That’s a very healthy sign. Because prime age labor force participation [has] been weak in the United States compared to other countries. So it’s very troubling, and the fact that that’s coming back up ... is a very positive thing” ([Fig. 5](#)).

(7) *Staying in his lane*. “I’m firmly committed to staying in our lane, and our lane is the economy. Trade is really the business of Congress. And Congress has delegated some of that to the Executive Branch.”

(8) *Tax & trade difficult to predict*. “It is difficult to predict the ultimate outcome of current discussions over trade policy as well as the size and timing of the economic effects of the recent changes in fiscal policy.”

(9) *Open trade policy is good*. “[C]ountries that have remained open to trade—that haven’t erected barriers, including tariffs—have grown faster, had higher incomes, higher productivity, and countries that have ... gone in a more protectionist direction have done worse. I think that’s the empirical result.”

(10) *Fiscal policy outcome in a range*. “[L]ate in the cycle near full employment, the effects may be less. They may or may not be. There’s a lot of uncertainty. One of the great things about the Fed is we get a healthy range of things, which is a healthy thing.”

See the C-SPAN link [here](#) for the full transcript of Powell’s 7/17 testimony.

By the way, two important developments that Powell didn’t focus on during his testimony are the potential for yield curve inversion and emerging markets turmoil. That may be because he isn’t too concerned about either of them “for now.” The Fed’s policies may play a hand in the outcome of both of these potentially troubling issues.

If the Fed raises rates too quickly, then the yield curve may invert with short-term interest rates rising above long-term interest rates, which has historically signaled a recession ([Fig. 6](#)). Powell isn’t too worried about that, he said in his 6/13 [press conference](#), because that’s what happens when the Fed raises the short end of the curve. However, he’s unsure about what’s keeping a lid on longer-term yields.

Separately, the IMF has been warning for a while that if the Fed raises rates too quickly, emerging

market economies (EMEs) may suffer mainly because they carry a lot of dollar-denominated debt, which could become more difficult to service. Further, as US interest rates rise, there could be greater demand for US fixed-income assets and a flow away from EMEs, all else being equal. Some observers say that, on balance, EMEs will be able to handle a gradual rise in US interest rates; others disagree. Powell shares the view of those who believe the concern over EMEs is probably overstated, as he discussed in a 5/8 [speech](#).

CALENDARS

US. Wed: Existing Home Sales 5.425mu, MBA Mortgage Applications, EIA Petroleum Status Report, FOMC Minutes. **Thurs:** Jobless Claims 215k, C-PMI, M-PMI, & NM-PMI Flash Estimates 55.6/55.1/56.0, New Home Sales 649k, FHFA Price Index 0.4%, Kansas City Manufacturing Index 23, EIA Natural Gas Report, Jackson Hole Annual Economic Symposium. (Econoday estimates)

Global. Wed: Canada Retail Sales -0.2%. **Thurs:** Eurozone Consumer Confidence -0.7, Eurozone, Germany, and France C-PMI Flash Estimates 54.4/55.1/54.6, Eurozone Germany, and France M-PMI Flash Estimates 55.2/56.5/53.4, Eurozone, Germany, and France NM-PMI Flash Estimates 54.4/54.3/55.1, Japan M-PMI Flash Estimate, Japan CPI Total, Core, and Core-Core 1.0%/0.9%/0.3% y/y, ECB Account July 26 Monetary Policy Meeting. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 TCJA Earnings Leaders & Laggards ([link](#)): The 2018 earnings forecast for the S&P 500 has surged 10.7% in the 36 weeks since the TCJA was signed into law on December 22. This outstanding performance has no comparison over the years since consensus earnings forecasts were first derived in 1978. The rate of change in the consensus forecasts has slowed since the Q1 earnings season as analysts appear to have fully incorporated lower tax rates into their estimates. The top sector gainers since the TCJA was passed: Energy (38.5%), Telecom (20.5), Materials (13.4), Financials (13.4), and Industrials (11.5). Consumer Staples is now the smallest gainer, with an increase of 1.3%; also underperforming the S&P 500 are Real Estate (2.0), Utilities (2.5), Consumer Discretionary (7.5), Health Care (8.2), and Tech (8.4). Higher oil prices have contributed heavily to the improvement in Energy's 2018 earnings forecast.

S&P 500 Sectors Net Earnings Revisions ([link](#)): The S&P 500's NERI was positive for a 16th straight month in August, its longest positive streak since the 26-month string ending August 2011. With revisions now reflecting the impact of "animal spirits" rather than the passage of the TCJA, NERI remained very strong despite falling to an eight-month low of 7.0% from 7.7% and from a record high of 22.1% in March. NERI improved m/m for 6/11 sectors and was positive for 10 sectors (compared to five improving and nine positive in July). Tech has the longest positive NERI streak, of 25 months, the best since August 2011 when its 28-month streak ended. Financials has the next best positive streak at 23 months, followed by Materials (11), Energy (10), and Industrials (9). Telecom's NERI turned positive in August for the first time in four months, and Real Estate's was positive for just the second time in 12 months. Consumer Staples has the worst track record recently, with four months of negative NERI. Most sectors remain near their recent TCJA-boosted highs; Utilities rose to a 49-month high and Real Estate was at a 12-month high. Here are the sectors' August NERIs compared with their July readings, ranked in descending order: Telecom (21.0% in August, up from -4.3% in July), Tech (12.9, 14.1), Industrials (12.1, 9.8), Health Care (11.4, 8.4), Energy (7.2, 17.4), Financials (6.7, 9.4), Materials (6.3, 10.0), Utilities (5.6 [49-month high], 3.7), Consumer Discretionary (3.2, 5.0), Real Estate (2.6 [12-month high], 1.9), and Consumer Staples (-13.5, -16.7 [39-month low]).

S&P 500 Earnings, Revenues & Valuation ([link](#)): S&P 500 consensus-per-share forecasts for forward

revenues and earnings rose to record highs again last week. As more weight is placed on the lower 2019 y/y growth expectations for revenues and earnings, their forward growth rates will continue to fall. During the latest week, however, the forward revenues growth forecast edged up 0.1ppt to 5.9% from a six-month low of 5.8%, and forward earnings growth was steady at a seven-month low of 13.3%. Forward revenues growth of 5.9% is little changed from an 80-month high of 6.3% at the end of February, and compares to a cyclical low of 2.7% in February 2016. The annual 2018 revenues growth forecast edged up 0.1ppt to 8.3%, and 2019's remained steady at 5.1%. Forward earnings growth of 13.3% is down from 16.9% in February, which was the highest since October 2010. Still, that's up 2.2ppts from 11.1% prior to the passage of the TCJA, and up 8.5ppts from the cyclical low of 4.8% in February 2016. Turning to annual earnings growth expectations, the 2018 forecast rose 0.1ppt to 23.1%, and the 2019 forecast dropped 0.1ppt to 10.1%. The forward profit margin remained steady at a record high of 12.3%, which is up from 11.1% prior to the passage of the TCJA in December and from a 24-month low of 10.4% in March 2016. The S&P 500 ex-Financials forward revenues growth forecast edged up 0.1ppt to 6.1%, and the forward earnings growth forecast remained steady at 12.7%. The S&P 500 ex-Financials forward profit margin remained steady at a record high of 11.4%, and is up from 10.4% before the TCJA. Valuations were lower w/w primarily due to the drop in the index's price. The S&P 500's forward P/E fell to 16.5 from 16.8, and is down from an 18-week high of 16.9 in late July. That compares to a 16-year high of 18.6 at the market's peak in late January and its recent low of 16.0 in early May. The S&P 500 price-to-sales ratio fell 0.03ppt to 2.04 from a 27-week high of 2.07, which compares to late January's record high of 2.16 and early May's low of 1.95.

S&P 500 Sectors Earnings, Revenues & Valuation ([link](#)): Consensus forward revenue and earnings forecasts rose w/w for 7/11 of the S&P 500 sectors. These four sectors had both measures rise w/w: Financials, Industrials, Materials, Tech, and Utilities. The per-share measures for forward revenues and earnings are at or around record highs for 4/11 sectors: Consumer Discretionary, Health Care, Industrials, and Tech. Forward margins are at record highs for 8/11 sectors, all but Energy, Health Care, and Real Estate. Energy's forward revenues and earnings are back on uptrends after stalling during 2016-2017, and its earnings has about tripled from its 18-year low in April 2016. Looking at last week's readings for forward revenue growth among the 11 sectors, just three had a w/w improvement in their forward revenues growth forecast (Energy, Industrials, and Real Estate), and the rest were steady. STEG revisions activity was generally steady last week as two sectors rose (Energy and Telecom) and these four fell: Consumer Staples, Financials, Materials, and Real Estate. Forward P/S and P/E ratios remain below their recent highs in early 2018 for all sectors. In the latest week, just four sectors improved (Consumer Staples, Real Estate, Telecom, and Utilities). Energy's valuations remain elevated relative to historical levels, but are slowly returning to normal now after soaring in 2016 when revenues and earnings collapsed. Energy's P/S ratio of 1.19 compares to a record high of 1.56 in May 2016, and its P/E of 16.0 is down to a 44-month low now from a record high of 57.5 then. Due to the TCJA, higher margins are expected y/y in 2018 for all sectors but Real Estate, but that sector's forward earnings includes gains from property sales and typically improves as the year progresses. During the latest week, the forward profit margin remained steady for all 11 sectors. Here's how the sectors rank based on their current forward profit margin forecasts: Information Technology (22.9%), Financials (18.9), Real Estate (16.0), Telecom (14.0), Utilities (12.6), S&P 500 (12.3), Materials (11.3), Health Care (10.7), Industrials (10.3), Consumer Discretionary (8.1), Consumer Staples (7.6), and Energy (7.4). Energy's forward profit margin remains near the highest level since December 2014. Among the remaining 10 sectors, all but two (Real Estate and Health Care) are at or near recent record highs.

S&P 500 Q2 Earnings Season Monitor ([link](#)): With Q2 earnings streaming in for the retailers, results are now in hand for 94% of the S&P 500 companies. If the current results hold until the last company reports, Q2 will mark a new record high for the most companies with a positive earnings surprise since we began the data series in 1987. Furthermore, revenues are exceeding consensus forecasts by the biggest amount in nearly four years. We're finding a higher percentage of companies reporting positive

surprises than at the same point during the Q1 earnings season but a lower overall percentage surprise. Year-over-year growth rate metrics for the Q2 reporters to date are close to Q1's historically high levels. More specifically, of the 470 companies in the S&P 500 that have reported through mid-day Tuesday, 81% exceeded industry analysts' earnings estimates by an average of 5.2%; they have averaged a y/y earnings gain of 26.5%. At the same point during the Q1-2018 reporting period, a lower percentage of companies (79%) in the S&P 500 had beaten consensus earnings estimates by a higher 7.3%, and earnings were up a lower 24.9% y/y. On the revenue side, 72% of companies beat their Q2 sales estimates so far, with results coming in 1.6% above forecast and 9.8% higher than a year earlier. At this point in the Q1 season, a higher 76% of reporting companies had exceeded revenue forecasts by a lower 1.1%, and sales had risen by a lower 8.4% y/y. Q2 earnings results are higher y/y for 84% of companies, vs a higher 86% at the same point in Q1, and Q2 revenues are higher y/y for 86% vs a higher 87% a quarter ago. These results are very encouraging, particularly the percentage of companies growing revenues y/y and their Q2 surprise. Q2-2018 marks 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.

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](#).