



MORNING BRIEFING

September 29, 2018

Remarkable Revenues

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

(1) Nothing funky about strong revenues growth. (2) The bottom line is that the top line is looking good across the board. (3) Trump's policies are mostly bullish for business sales, which are at record highs. (4) S&P 500 forward revenues at record high again, and again. (5) There is a divergence between strong S&P 500 revenues and weak OECD leading indicators. (6) The dollar doesn't seem to matter much. (7) Mario Draghi says ECB's policy is a work in progress. (8) BOJ still dreaming the impossible dream: A 2% inflation rate. (8) Bottom line: ECB and BOJ will continue to be ultra-easy until further notice.

Strategy: Slicing & Dicing. Joe and I have been very impressed with the strength of S&P 500 revenues this year. They've been strong despite the escalating trade war and the proliferating emerging markets crisis. The dollar has also been strong this year, which should have weighed on the dollar value of revenues earned abroad. We decided to slice and dice the data to determine if there is something funky going on.

The bottom line is that the top line is all good: Revenues are strong across the board. This suggests that US corporate managements are doing a remarkably good job of bolstering their worldwide sales despite the challenging global environment. It may also be, dare we say, that Trump's policies of deregulation and tax cuts are working to stimulate the US economy, just as supply-siders predicted. Deregulation may be opening up more business opportunities. The 20% corporate tax rate makes America a great place to do business. Let's slice and dice the revenues data:

(1) *Business sales.* Each month, along with retail sales, the government releases data on manufacturing shipments, wholesale sales, and retail sales. These business sales include only goods that are either sold at home, exported, or added to inventories. There are no monthly data series for services.

Nevertheless, the growth rate of business sales on a y/y basis is remarkably well correlated with the comparable growth rate of S&P 500 aggregate revenues, which includes sales of goods and services ([Fig. 1](#)). The former was up 8.1% during July, while the latter was up 9.1% during Q2. Both are very solid readings. It's been a nice recovery for both since 2015 when these growth rates were negative as a result of the worldwide growth recession. That event was attributable to the retrenchment in the commodity industry, when oil and other commodity prices plunged.

The latest data show that all three components of business sales are at record highs: manufacturing (\$6.02 trillion, saar), wholesale (\$6.07 trillion), and retail (\$5.37 trillion) ([Fig. 2](#)). Their latest respective growth rates are 8.1%, 9.8%, and 6.2% y/y ([Fig. 3](#)).

(2) *Forward revenues.* In addition to monitoring the monthly business sales data, Joe and I track the close relationship between quarterly S&P 500 revenues per share and weekly S&P 500 forward

revenues per share ([Fig. 4](#)). The latter tends to be a coincident indicator of the former. S&P 500 forward revenues per share has been rising to record highs this year through the 9/6 week. This augurs well for the quarterly data series, suggesting that it will also be at a new record high during Q3.

The y/y growth rates of the quarterly and weekly series are very close ([Fig. 5](#)). The weekly series is up 9.7% y/y. So the prospects for revenues growth and earnings growth remain very good ([Fig. 6](#)). S&P 500 forward earnings (a leading indicator for actual earnings) has been boosted this year not only by the tax cut, but also by the solid upward trend in revenues.

(3) *Sectors*. Following the end of the Q2 earnings season, we showed that revenues are strong in most of the 11 S&P 500 sectors ([Fig. 7](#)). Here is the y/y performance derby for the revenues per share of these sectors: Energy (33.6%), Materials (17.8), Health Care (15.4), Tech (14.9), S&P 500 (10.4), Industrials (9.7), Financials (9.3), Consumer Discretionary (8.5), Real Estate (6.1), Consumer Staples (-1.6), Utilities (-3.0), and Telecom Services (-6.4).

S&P 500 forward revenues are at record highs for the following sectors: Consumer Discretionary, Health Care, Industrials, and Tech ([Fig. 8](#)). With the exception of Telecom Services and Utilities, all of the sectors have solid uptrends.

Here are analysts' consensus expectations for revenues growth this year and next year for the 11 sectors: Consumer Discretionary (7.4%, 5.9%), Consumer Staples (4.4, 3.5), Energy (20.8, 4.9), Financials (4.6, 4.7), Health Care (6.1, 5.2), Industrials (8.2, 5.2), Tech (12.5, 7.6), Materials (11.2, 2.5), Real Estate (12.1, 4.6), Telecom (7.4, 4.1), and Utilities (1.4, 2.1).

(4) *The dollar & exports*. Interestingly, there is also a very strong correlation between the growth rate in S&P 500 aggregate revenues and the OECD leading economic indicator ([Fig. 9](#)). Over the past couple of years, the former has been much stronger than the latter. This suggests that the US economy is outperforming the rest of the world. More ominously, it might also suggest that the US won't decouple for much longer from the rest of the world, in which case revenues growth will weaken.

There is also a good correlation between the y/y growth rates of S&P 500 aggregate revenues and US merchandise exports ([Fig. 10](#)). So far, the escalating trade war hasn't depressed US exports, which were up 9.6% y/y during July.

The trade-weighted dollar jumped sharply since February on mounting concerns about Trump's escalating trade war ([Fig. 11](#)). There is a weak correlation between the y/y growth rate in S&P 500 revenues per share and the inverted percentage change in the trade-weighted dollar ([Fig. 12](#)). It is especially weak now given that the dollar is up 5.3% y/y, while S&P 500 revenues per share is up 10.3% y/y.

Central Banks I: ECB's Contradictions. Last week, the European Central Bank (ECB) slightly lowered its economic growth forecasts for the Eurozone in 2018 and 2019, mainly due to weaker foreign demand. As previously forecast, the region's CPI inflation rate is expected to be 1.7% in 2018, 2019, and 2020, which is below the ECB's 2.0% medium-term target. The headline rate was 2.0% during August, but the core was only 1.0% ([Fig. 13](#)).

One would think that this would put into question the bank's previous plan to phase-out monetary easing by stopping its bond purchases. But the bank reaffirmed its commitment to doing so at its September 13 meeting. However, at his post-meeting [press conference](#), ECB President Mario Draghi reiterated a previous commitment to keep the ECB's key interest rates "at their present levels at least through the summer of 2019, and in any case for as long as necessary" to ensure that the bank's

inflation goal is achieved. Let's consider the ambiguous reasoning for these apparent contradictions:

(1) *Bye buy bonds.* The ECB said in a September statement that it still plans to terminate its bond purchase program by yearend as initially promised in June. Since the program started, bond purchases have totaled approximately €2.5 trillion. The ECB committed to purchase an additional €30 billion in bonds this month and €15 billion per month until the end of the year when purchases will end. Melissa and I tend to agree with analysts who have suggested that the end of the bond-buying program probably has more to do with the ECB's inability to sustain it rather than the bank's desire to substantially pullback on easing.

(2) *Deposit rates to stay negative for now.* To that point, at his latest press conference, Draghi said: "When we stop [purchasing bonds], this doesn't mean our monetary policy stops being" accommodative. He added: "The amount of accommodation will remain very significant, through our reinvestment policy and through our forward guidance and interest rates." Further, the ECB President indicated concern over risks to the outlook from US protectionism and potential spillover from emerging market vulnerabilities. The interest rates on the main refinancing operations, the marginal lending facility, and the deposit facility are presently held at 0.00%, 0.25% and -0.40%, respectively.

(3) *2019 policy TBD.* Equally as unclear is where ECB monetary policy is headed next. Draghi was asked at his press conference how the ECB would respond to slowing growth or inflation. Draghi gave a non-answer: "I'm pretty sure there will be a time when we will have to discuss these questions, but it's premature."

In his opening remarks, Draghi provided little detail on the reinvestment of maturing bonds, saying it will continue "for an extended period of time after the end of our net asset purchases, and in any case for as long as necessary." To a question on how the bank might handle reinvesting proceeds from maturing bonds next year, Draghi replied: "Frankly, ... we haven't even discussed when we are going to discuss it." Having said that, there are only two more meetings left this year, he noted. So it will probably be discussed before December.

Central Banks II: BOJ's Contradictions. The Governing Board of the Bank of Japan (BOJ) also made seemingly contradictory policy adjustments at its July meeting. Essentially, these adjustments gave BOJ Governor Kuroda more wiggle room on policy without having to make any further announcements. Japan's economy has chugged along. But despite the BOJ's unconventional easing, Kuroda hasn't been able to lift inflation much above zero since he took office in March 2013 ([Fig. 14](#)). Soon after taking office, the Governor set an inflation target of 2.0% in two years, but later removed the time-frame for the target.

As it stands now, the BOJ is expected to leave monetary policy unchanged from July at its September meeting, held yesterday and today. Bankers are presumed to be wary of a sales-tax increase, which is set to hit Japan's economy in October 2019. Further adjustment is not expected until after that point. For now, let's review the background leading up to the latest meeting:

(1) *Key easing elements unchanged.* The key components of the BOJ's monetary policy include: maintaining a negative interest rate on commercial bank deposits, conducting yield curve control (YCC) by targeting a zero-yield on 10-year Japanese government bonds (JGBs), and annually purchasing about 80 trillion yen in JGBs. So far this year, the BOJ has been tracking below its target level of purchases on an annualized basis.

(2) *Confusing adjustments in July.* Contradictory tweaks were made at the bank's July 30-31 policy meeting, confounding markets. On the one hand, the post-meeting [statement](#) was softened with the

introduction of forward guidance for policy rates. In the statement, a line was added saying that “the current extremely low levels of short- and long-term interest rates” would continue for an “extended period,” taking into account the timing of the scheduled tax hike.

On the other hand, the bank pulled back on YCC. Kuroda said in a post-meeting briefing that he would keep the key deposit rate unconventionally low, but also allow the 10-year yield on JGBs to rise up to 0.2% or as low as low as -0.2% (from 0.1% previously), [according](#) to Reuters. That upper limit potentially enables the BOJ to buy fewer bonds than it needed to before to maintain the 10-year yield target.

(3) *Stealth tightening or still easy?* Some investors interpreted the BOJ’s adjustments as a “stealth tightening” while others focused on the “extended period” language as further easing. We tend to be in the stealth camp. Bankers are probably wary of being out of policy options if Japan’s economy takes a turn for the worse, especially after the sales-tax increase. So, they probably feel inclined to take at least a little ease out of policy to save it for a rainy day. Like the ECB, the BOJ may also be facing some sustainability issues with the level of its purchases.

We agree with ex-BOJ official Takashi Kozu who was quoted in a 9/9 Bloomberg [article](#) saying: “The BOJ has reached a limit to the ambiguous rhetoric used in July, which can’t be repeated anymore. The next move will have to be explained based on fundamentals.”

Ideally, Kuroda and the BOJ will start to make more sense after the BOJ statement in the wake of today’s meeting. But that might be wishful thinking.

CALENDARS

US. Wed: Housing Starts & Building Permits 1.240mu/1.320mu, MBA Mortgage Applications, Current Account Balance -\$104.0b, EIA Petroleum Status Report. **Thurs:** Leading Indicators 0.5%, Jobless Claims 210k, Philadelphia Fed Manufacturing Index 19.2, Existing Home Sales 5.360mu, EIA Natural Gas Report. (Econoday estimates)

Global. Wed: UK Headline & Core CPI 2.4%/1.8% y/y, BOJ Rate Decision, Draghi. **Thurs:** Eurozone Consumer Confidence -2.0, UK Retail Sales Excluding & Including Auto Fuel 2.3%/2.3% y/y, Japan CPI Headline, Core, and Core-Core 1.1%/0.4%/0.9% y/y. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Q3 Earnings vs Past Quarters Trend ([link](#)): Earnings estimate revisions activity for Q3-2018 is returning to usual pattern of falling ahead of the earnings reporting season. This follows the unusual estimate increases recorded during Q1- and Q2-2018 due to the TCJA. With less than two weeks before the September-quarter books close, the current Q3-2018 EPS forecast of \$41.06 is down 1.1% over the 11 weeks since the quarter’s start. That drop compares to an average decline of 4.0% over the same time period in the 97 quarters dating back to 1994, and the TCJA-boosted gains of 5.1% and 0.6% during Q1 and Q2, respectively. Analysts expect EPS for Q3-2018 to be up 21.4% y/y on a frozen actual basis, which would mark the ninth straight quarter of higher EPS on a y/y basis and the fourth straight quarter of double-digit percentage growth. While the current forecast is below the 26.0% growth rate recorded for Q2-2018, it has a good chance of beating that mark and achieving the strongest growth since a 34.2% gain during Q4-2010. Since 1994, the Q3 earnings surprise has been positive in 18/24 years (all but 1997-1998, 2001, 2005, and 2007-2008). Q3 should mark the S&P 500’s record 39th straight quarter of positive surprises—a streak dating back to Q1-2009.

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