MORNING BRIEFING
September 26, 2018

The Next Gen

A pdf of this Morning Briefing *is available as well.*

(1) Introducing Generation Z! (2) Post-Millennials are not mini-Millennials. (3) Gen Zers are motivated self-directed doers. (4) Predicting good things for US labor force with career-minded Gen Zers headed up the ladder. (5) Lots of Gen Zers want to start a business. (6) Forget traditional education, say Gen Zers; hack online school instead! (7) Will Gen Zers eschew Millennials' minimalism? (8) Attention: Gen Z shoppers want cool products with no hassle, in hand fast. (9) Not just tech savvy, Gen Zers are "always on" digital natives. (10) Future Gen Z households to be full of "framilies." (11) Watch out for pre-K Gen Alpha kids flying drones!

Demography: Generation Z Coming of Age. Evaluating demographic cohorts can be helpful for predicting economic trends, as generational shifts in behavior have significant ripple effects throughout the economy. Melissa and I have given lots of attention to the Millennials over the past few years; now it's time to turn our attention to Generation Z, an important group of up-and-coming labor force participants and consumers.

While the oldest Millennials are now around 37 years old, the oldest Gen Zers are around 21—thus on the verge of becoming productive adult participants in the US economy. Although the cutoff years defining Gen Z haven't been firmly established, the rough timeframe that makes sense to us encompasses those born between 1997 and 2010, as discussed a 3/1 Pew Research Center article and a 3/29/17 *Forbes* article, respectively (*Fig. 1*).

While Gen Zers share some similarities with their older counterparts, Gen Zers are not mini-Millennials. Many Gen Zers were born into a post-9/11 world. Growing up in an atmosphere of terrorism and financial instability, Gen Zers are generally a risk-averse lot. Many were just young children during the Great Recession and watched their parents suffer financial hardships. Many witnessed the Millennials struggling to make it on their own.

These influences have played out to make Gen Zers more realistic, career-minded, and better prepared than the Millennials. Gen Zers are instinctively digital, while Millennials are merely tech savvy. Gen Zers are characterized as active volunteers, culturally blended, mature, makers, future focused, and hard workers. Millennials are characterized as "slacktivists" (who care, but don't act), multi-cultural, immature, "sharers" (rather than makers), focused on the now, who want to be discovered. Those characteristics were compiled from multiple sources by advertising firm Sparks & Honey and presented in a comprehensive 2014 slideshow.

Gen Zers are often characterized as motived and self-directed. Their motto: "Good things come to those who act," according to Ford's 2015 Trend report. (Meet some Gen Z "doers" in this video by JWT Intelligence.) Since Gen Zers are still young, their impacts once they reach full independence are still unknown, but their ambitious aspirations suggest big change. I asked Melissa to further explore the emerging characteristics of Gen Zers and how they might influence various aspects of the US economy as they grow up. Here is her report:

(1) *Gaining on the working population*. As more and more Baby Boomers retire, senior management positions are starting to be filled by Millennials and Gen Zers are starting to step into entry-level positions. Ethnically, America's Gen Zers are more diverse than any previous generation: 55% Caucasian, 24% Hispanic, 14% African American, and 4% Asian, cited a 10/20/17 Huffington Post article, according to Frank N. Magid.

(2) *Ladder hoppers*. We think that a few possible economic outcomes of Gen Zers' influence could be higher labor force participation, higher wage growth, and faster job turnover. Born and raised when their parents were suffering financial losses, many Gen Zers are motivated by a quest for financial security. More than half of high-school students already feel pressured to gain early professional experience, observed Sparks & Honey.

Flexible work arrangements may be enticing for Millennials, but Gen Zers are more likely to respond to career advancement opportunities and money down the line, according to a 2014 study by Millennial Branding, a Gen Y-focused research firm. However, Gen Zers aren't loyalists. Millennial Branding observes that when asked about the number of employers they expect to work for over their lives, Gen Zers and Millennials say four and five, respectively.

(3) *Entrepreneurial at heart*. Soon, the labor force may consist of an increasing number of self-employed individuals. Self-directed and resourceful, many Gen Zers have expressed the desire to start their own business one day. Specifically, 72% of high-school students say they want to do so, observed Sparks & Honey. The Millennial Branding study said that 17% of Gen Zers, vs 11% of Millennials, want to start a business and employ others. Ford estimates that Gen Zers are 55% more likely to do so than Millennials.

(4) *Highly self-educated*. Gen Zers are likely to be the most self-educated generation yet. However, they are acutely aware of the cost of a traditional college education and worried about accumulating student debt. Of Gen Zers, 64% are considering earning an advanced degree, vs 71% of Millennials, according to Ford. Some Gen Zers are expected to explore less expensive alternatives to traditional schooling, preferring online study and other lifestyle options. Some Gen Zers may pursue online degrees while working simultaneously right after high school.

Many Gen Zers are focused on constantly developing their skills. And they have unlimited access to lots of online learning tools. Sparks & Honey noted that 85% of Gen Zers have done research online. The Ford study observed that 52% of Gen Zers use YouTube or social media for typical research assignments. Thirteen-year-old Logan LaPlante's 2013 TED talk titled "Hackschooling Makes Me Happy" explores nontraditional self-directed learning and has received nearly 10 million views on YouTube.

(5) *Consumers of convenience*. The jury is still out on whether Gen Zers will be quite as minimalistic as Millennials in their adulthood. Gen Zers already strongly influence household purchases, according to Sparks & Honey. According to an infographic by Deep Focus, 60% of Gen Zers would prefer a cool product over a cool experience vs just 23% of Millennials. They value ethically made and DIY products, per the 2017 JWT Intelligence video linked above.

As consumers, Gen Zers highly value convenience. They prefer not to carry around a lot of baggage, the Ford study indicated (having to carry a book bag heavy with text books when e-books exist is a particular pet peeve of one Gen Zer we know). Many may opt to pay for stuff on their mobile phones or wearable devices rather than carrying around bulky wallets. They also love to shop online, observed Sparks & Honey. Hardly remembering the days before Amazon Prime, Gen Zers want their products delivered fast.

(6) *Heavy multi-tech users*. "Digital natives," Gen Zers are heavy tech users and influencers, having been raised on iPads and smartphones. Whereas Gen X began life with cable, the Millennials with dial-up Internet, younger Gen Zers can't remember a time before 24/7 WiFi-connected HD devices. They learned to swipe before they could type. (See this real-life 2011 clip of a one-year-old disenchanted with a print magazine that won't work like an iPad.)

As hyper-connected individuals, many Gen Zers view their technology as an extension of themselves. Indeed, a 2011 *Time* article reported that a majority of youth would rather lose their sense of smell than their technology, according to a study by McCann. Yet they seem to be as disassociated from their parents' and grandparents' technology as they are tied to their own. Several YRI team members with Gen Z kids complain that they typically tune out ringing landlines!

Nearly all Gen Zers in the US have a digital footprint, a trail of their personal data created either intentionally or unintentionally online, noted a 9/21/17 *Forbes* article. Gen Zers are great multi-taskers, their neurobiology having adapted to toggling among multiple screens at one time. On average, they use five different screens daily, according to Sparks & Honey.

(7) *Communication matters*. Technology is an essential component of Gen Zers' relationships. Surprisingly, however, 53% of Gen Zers prefer person-to-person communication over digital communication, according to the Millennial Branding study. Maybe that's because they've grown up on FaceTime, whereas the Millennials grew up typing back and forth over Instant Messenger. Gen Zers can connect face-to-face with anyone in their network at any time (except when forbidden by parents or schools, still run by Boomers and Millennials!), and many have large, global social media networks. Sparks & Honey notes that 26% of Gen Zers would need to fly to visit most of their social network friends.

(8) *"Framily" values*. With all that access, many Gen Zers may have trouble forming committed relationships. That may influence household composition in the future. Many Gen Zers may opt for alternatives to traditional relationships, having a different concept of family than the traditional nuclear family. Sprint recently unveiled its "framily" plan, which includes close friends in family networks; that term may come closer to describing Gen Zers' familial attitudes than "family" in the nuclear sense. By the way, of US adults under age 35, 40% agree that changing your last name when you get married is old fashioned, observed Ford.

(9) *Generation Alpha*. Gen Zers are growing up fast. But look out! The budding Generation Alpha, now loosely defined as those born after 2010, is next. The aptly named Generation Z captures the last of those born in the 1900s. Generation Alpha will be the first generation wholly born in the 21st century. They are mostly the children of the Millennials, who started having kids around 30 years old, which is later in life than preceding generations did.

Just as Melissa, an older Millennial, was writing this piece, she got an early inkling of the forces that will shape the research piece on Generation Alpha I'll be asking her to write in about 10 years: She was informed that her four-year-old daughter will be learning about coding, 3-D printing, and drones in her pre-K class!

CALENDARS

US. Wed: New Home Sales 630,000 units, MBA Mortgage Applications, EIA Petroleum Status Report, Fed Announcement 2.125% (2.000% to 2.250%), FOMC Forecasts, Powell Press Conference. **Thurs:**

GDP & PCE 4.3%/3.8%, GDP Price Index 3.0%, Durable Goods Orders Total, Ex Transportation, and Core Capital Goods 2.2%/0.5%/0.4%, Richmond Fed Manufacturing Index, Jobless Claims 216k, Pending Home Sales 0.0%, Advance Merchandise Trade Balance -$70.8b, EIA Natural Gas Report, Powell. (Econoday estimates)

Global. Wed: None. **Thurs:** Eurozone Economic Confidence 111.2, Germany Gfk Consumer Confidence 10.5, Germany CPI 0.1%m/m/2.0%y/y, UK Gfk Consumer Confidence -8, Japan Industrial Production 1.5%m/m/1.5%y/y, Japan Jobless Rate 2.5%, Japan CPI Headline, Core, and Core-Core 1.1%/0.9%/0.6% y/y, ECB Publishes Economic Bulletin, Draghi, Carney, Kuroda. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 TCJA Earnings Leaders & Laggards (*link*): The 2018 and 2019 earnings forecasts for the S&P 500 have surged 10.7% and 10.8%, respectively, in the 38 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 2018 earnings gainers and their 2019 change since the TCJA was passed: Energy (2018 up 38.4%, 2019 up 45.4%), Telecom (19.6, 21.2), Financials (13.5, 12.0), Materials (13.0, 10.0), and Industrials (11.5, 11.4). Consumer Staples (1.2, -0.6) is the smallest gainer; also underperforming the S&P 500 are Utilities (2.6, 1.9), Real Estate (4.4, -5.3), Consumer Discretionary (7.4, 7.9), Health Care (8.0, 6.5), and Tech (8.7, 10.4). Higher oil prices have contributed heavily to the improvement in Energy's earnings forecasts.

S&P 500 Sectors Net Earnings Revisions (*link*): The S&P 500's NERI was positive for a 17th straight month in September, 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 a nine-month low of 6.7% from 7.0% and from a record high of 22.1% in March. NERI improved m/m for 5/11 sectors and was positive for 10 sectors (compared to six improving and 10 positive in July). Tech has the longest positive NERI streak, of 26 months, the best since August 2011 when its 28-month streak ended. Financials has the next best positive streak at 24 months, followed by Materials (12), Energy (11), and Industrials (10). Consumer Staples has the worst track record recently, with five months of negative NERI. Nearly all sectors are down from their TCJA-boosted highs in February and March, but Utilities rose to a 50-month high in September. Here are the sectors' September NERIs compared with their August readings, ranked in descending order: Telecom (22.4% in September, up from 21.0% in August), Industrials (13.4, 12.1), Tech (11.8, 12.9), Health Care (11.0, 11.4), Financials (6.2, 6.7), Utilities (6.0 [50-month high], 5.6), Materials (4.4, 6.3), Consumer Discretionary (4.2, 3.2), Energy (2.5, 7.2), Real Estate (2.1, 2.6 [12-month high]), and Consumer Staples (-12.7, -13.5).

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. However, they remained steady last week. Analysts expect forward revenues growth of 5.8% and forward earnings growth of 12.6%. Forward revenues growth is little changed from an 80-month high of 6.3% at the end of February, but forward earnings growth is down to an eight-month low from 16.9% in February, which was the highest since October 2010. Forward revenue growth was 5.5% prior to the passage of the TCJA, and forward earnings growth was 11.1% then. Turning to the annual revenue growth expectations, the forecasts remained steady w/w at 8.4% for 2018 and 5.2% for 2019. Looking at annual earnings growth, the 2018 forecast edged down 0.1ppt to 23.1%, and the 2019 forecast was steady at 10.3%. The forward profit margin remained steady at a record high of 12.4%, 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 growth forecasts rose 0.1ppt w/w to 6.0% for revenues and was steady at 12.2% for earnings. The S&P 500 ex-Financials forward profit margin was steady at a record high of 11.5%, which is up from 10.4% before the TCJA. Valuations were higher w/w primarily due to the rise in the index's price to new record highs, and near the highest levels since mid-March. The S&P 500's forward P/E rose to 16.9 from 16.8, which compares to a 16-year high of 18.6 at the market's prior peak in late January and its recent low of 16.0 in early May. The S&P 500 price-to-sales ratio was up to 2.09 from 2.08, 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 forecasts rose w/w for six of the 11 of the S&P 500 sectors, and forward earnings rose for five. Tech and Industrials had both measures rise w/w, while Consumer Staples and Utilities had both fall. The per-share measures for both 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 the 18-year low in April 2016. Forward P/S and P/E ratios remain below their recent highs in early 2018 for all sectors. 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 1.22 compares to a record high of 1.56 in May 2016, and its P/E of 16.2 is down 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 fell for Health Care and was steady for the remaining 10 sectors. Here's how the sectors rank based on their current forward profit margin forecasts: Information Technology (23.0%), Financials (19.1), Real Estate (16.2), Telecom (14.0), Utilities (12.7), S&P 500 (12.4), Materials (11.3), Health Care (10.6), Industrials (10.3), Consumer Discretionary (8.1), Consumer Staples (7.6), and Energy (7.6). Energy's forward profit margin is 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.

US ECONOMIC INDICATORS

Consumer Confidence (*link*): September consumer confidence reached an 18-year high, with expectations exceptionally euphoric the past two months! The Consumer Confidence Index once again beat expectations, posting another big gain this month, climbing 10.5 points the past two months—from 127.9 to 138.4 over the period. "The September reading is not far from the all-time high of 144.7 reached in 2000. Consumers' assessment of current conditions remains extremely favorable, bolstered by a strong economy and robust job growth," said Lynn Franco, Director of Economic Indicators at The Conference Board, noting that these historically high confidence levels "should continue to support healthy consumer spending, and should be welcome news for retailers as they begin gearing up for the holiday season." September's expectations component rebounded sharply for the second month—soaring from 102.4 in July to 115.3 this month—its best reading since September 2000. Meanwhile, the present situation component climbed for the fifth month—from 157.5 in April to 173.1 last month—its highest reading since December 2000. The current jobs outlook remained very favorable last month: Jobs plentiful (to 45.7% from 42.3%) jumped to its highest reading since January 2001, while jobs hard to get (13.2 from 12.1) was little changed from August's percentage, which was the lowest since November 2000. The six-month jobs outlook was the best in more than three decades, with the percentage reporting more jobs (22.5 from 21.5) climbing and those expecting fewer jobs (11.0 from 13.2) sinking to the lowest percentage since September 2000. The spread between the two jumped to 11.5ppts—the highest percentage since the 1980s!

Regional M-PMIs (*link*): The four Fed districts that have now reported on manufacturing activity for September—Philadelphia, New York, Dallas, and Richmond—showed growth recorded one of the strongest readings in the past 14 years. We average the composite, orders, and employment measures as data become available. The composite index rose to 24.8 this month from 23.1 last month; it has averaged 24.5 the past four months and 23.3 since last September. The Philadelphia region's composite index (to 22.9 from 11.9) shows growth was roughly double the pace of last month, while Richmond's (29.0 from 24.0) posted record growth. Meanwhile, Dallas' (28.1 from 30.9) gauge remained near August's strong pace, while New York's (19.0 from 25.6) eased from August's 10-month high, though remained at an elevated level. The new orders gauge (21.7 from 19.0) accelerated toward May's reading of 25.1—which was the best growth since March 2006. Billings in the Philly (21.4 from 9.9) region accelerated sharply this month, as did Richmond's (34.0 from 25.0), while orders growth in New York (16.5 from 17.1) virtually matched August's pace. Meanwhile, Dallas' (14.7 from 23.9) slowed to a six-month low, after averaging 26.5 the prior five months. The employment measure (16.2 from 20.3) shows job gains slowed for the third month since peaking at 24.1 in June, as manufacturers in both the Dallas (17.7 from 28.9) and Richmond (16.0 from 25.0) regions recorded slower growth this month. Philly (17.6 from 14.3) factories hired at a slightly faster pace than August, while New York's (13.3 from 13.1) virtually matched their August pace.

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