MORNING BRIEFING
October 1, 2018

China's Syndromes

See the pdf and the collection of the individual charts linked below.

(1) Downgrading outlook for China's economy. (2) Trump's trade war with China is really about slowing China's advance to becoming a superpower. (3) Moving out of China into Vietnam. (4) Peter Navarro's protectionist agenda isn't just about trade. (5) Trump is shopping around for fairer trade. (6) Arms race in and around the South China Sea. (7) After China entered WTO, manufacturers left the US. (8) Aging demographics may already be weighing on real retail sales in China. (9) Less and less bang per yuan. (10) Urbanization and legacy of one-child policy depressing China's fertility rate and economy. (11) Movie review: "A Simple Favor" (+ + +).

China I: Getting Trumped. I'm coming around to a new working hypotheses on the outlook for China's economy. I think it could be much weaker much sooner than widely recognized. A significant slowing in the growth rate of inflation-adjusted retail sales over the past couple of years suggests that the aging demographic factor—attributable to the government's previous population control measure—may be hitting consumer spending significantly already. As a result, Trump's escalating trade war with China may very well hurt China's economy much harder than widely realized.

Furthermore, what if Trump's trade war with China isn't just about trade? Yes, we all know it is also about intellectual property rights. But what if at heart it's about China's superpower ambitions—as evidenced by its moves to control the South China Sea, to build the "Silk Road" linking China to Europe by way of Central Asia, and to exploit the resources of Africa? The Chinese government, under President-for-life Xi Jinping, is intent on challenging America's status as the world's sole superpower. So why should the US continue to enable Xi's geopolitical masterplan by allowing the Chinese to run a huge trade surplus with the US and to steal US technology?

The Trump administration's overarching policy goal vis-à-vis China, therefore, may be first and foremost to use America's economic power to slow, or even halt, the ascent of China into a superpower, which will challenge America's interests around the world. If so, then any concessions that the Chinese make on trade and technology are likely to be rejected by the Trump administration. In other words, they have nothing to offer that would satisfy Trump other than an unconditional retreat from their geopolitical expansion plans, which they will never do voluntarily.

So Trump may very well raise the ante soon by slapping a permanent 25% tariff on all goods that the US imports from China. The goal isn't to force concessions out of China but rather to get manufacturers out of China and into either the US (ideally) or to countries such as Mexico that do agree to the terms of bilateral trade deals with the US!

Of course, manufacturers who stay in China won't be paying the 25% tariff: US consumers who buy China-made goods will be hit with that price hike. However, to remain competitive in the US, manufacturers are likely to scramble to other countries that can export to the US without having the US dollar price of their goods marked up by 25%.

I have one piece of anecdotal evidence that companies may be starting to move out of China already. A good friend of mine has a small business in Manhattan designing and selling high-end raincoats in the US. He has been manufacturing them in Vietnam. He stopped making them in China a few years ago because labor costs have been rising there, while they remain low in Vietnam. He told me he was shocked recently when his Vietnamese vendor had to lengthen delivery schedules from four months to six months because it was swamped with orders that used to be filled in China prior to Trump's trade war.

Now consider the following recent developments before we review China's depressing demographic outlook:

(1) *Peter Navarro's view.* A Monday 9/24 CNBC article reported that Peter Navarro, director of the National Trade Council at the White House, said getting a trade deal with China will be tough: "The challenge is, they've engaged in so many egregious practices that it's far more difficult to make a deal with China than it would be with Mexico." Navarro is a former economics professor and author of *The Coming China Wars: Where They Will Be Fought, How They Can Be Won* (2006).

A 6/24 Axios article quoted Navarro saying: "Since China joined the WTO [i.e., the World Trade Organization] in 2001, the U.S. has lost over 70,000 factories, more than five million manufacturing jobs, and suffered from substantially lower real GDP growth rates. As America's manufacturing and defense industrial base has weakened, China's has strengthened and we now face a strategic rival in places like the South China Sea whose military forces have been largely financed by the massive trade deficits the U.S. runs with China."

Navarro had more to say on this subject in a 6/20 *WSJ* article titled "Trump's Tariffs Are a Defense Against China's Aggression: Beijing seeks economic and military domination by taking U.S. technology and intellectual property." His opening paragraph said it all: "The Chinese government's Made in China 2025 blueprint reveals Beijing's audacious plans to dominate emerging technology industries. Many of these targeted sectors, such as artificial intelligence and robotics, have clear implications for defense. China seeks to achieve its goal of economic and military domination in part by acquiring the best American technology and intellectual property. President Trump's new tariffs will provide a critical shield against this aggression."

(2) *Higher tariffs.* Also on Monday 9/24, Washington slapped tariffs of 10% on $200 billion of Chinese products that include furniture and appliances, and the rate will increase to 25% by the end of the year. President Xi Jinping's government retaliated by imposing taxes on 5,207 US imports, worth about $60 billion. Products such as liquefied natural gas, coffee, and various types of edible oil will see a 10% levy, while a 5% tax will be imposed on items such as frozen vegetables, cocoa powder, and chemical products.

The US and China already had applied tariffs to $50 billion of each other's goods. Trump has warned that any retaliation by China would prompt Washington to "immediately pursue phase three, which is tariffs on approximately $267 billion of additional imports."

Trump has overtly expressed his desire to narrow the US trade deficit with China significantly and to bring back manufacturing capacity to the US, so he may not declare victory in his trade war with China until Apple is making most of its iPhones in the US. It's also conceivable that Trump may be mollified if Chinese leaders relinquish at least some of the country's unfair trade practices, especially those related to foreign technology investment. But even if Trump's negotiations with China and other countries don't succeed in getting what he wants, they may succeed in providing more opportunities for the US to shop around for fairer trading partners.

Interestingly, cell phones and other household items is the largest category of imports to the US from China, according to the World Economic Forum. China isn't the only place in the world to make cell phones, though. South Korean electronics giant Samsung is "now looking to fend off Chinese companies trying to dominate the market for inexpensive phones" by expanding manufacturing into India, according to an article in the 9/4 *WSJ*. The company's new facility in a New Delhi suburb, to be completed in 2020, will eventually make 120 million handsets a year, or roughly one of every 13 phones in the world. Around 30% of those will be exported.

(3) *Arms race.* On Thursday 9/20, Washington imposed sanctions on a Chinese military unit for purchasing Russian weapons, claiming the transaction violated a US sanctions law known as "Countering America's Adversaries Through Sanctions Act," which was signed by President Trump on August 2, 2017. The act imposed sanctions on Iran, North Korea, and Russia. The Chinese government summoned the US ambassador in Beijing over the matter and said Beijing would recall its navy chief from a visit to the US.

On 9/25, the US approved a $330 million arms sale to Taiwan in another sign of Washington's support for the government in Taipei amid rising Chinese pressure on the country. In the latter years of George W. Bush's presidency, Washington dropped annual weapons sales to Taiwan in favor of bundling sales every few years, a move that was seen as acquiescence to pressure from China. Under Trump, there may be a return to the routine sale of weapons to Taiwan, despite protests from China.

Meanwhile, China has sought to strengthen its claim to the South China Sea by building seven islands on reefs and equipping them with military facilities such as airstrips, radar domes, and missile systems. Five other governments claim territory in the oil- and gas-rich area, through which an estimated $5 trillion in global trade passes annually. Last Thursday, China called a recent mission by nuclear-capable US B-52 bombers over the disputed South China Sea "provocative."

China II: Why Trump Won. Trump won on November 8, 2016 because he appealed to voters who lost manufacturing jobs after China entered the WTO and manufacturers left the US. Previously, I've shown a chart that clearly shows this development. It tracks US manufacturing production and capacity since January 1948 (*Fig. 1*). The two were on similar and solid uptrends—tracking at about 4% per year on average—until China joined the WTO during December 2001. Both have been flat ever since. Debbie and I estimate that if the trend prior to December 2001 had persisted, US manufacturing capacity would be 77% higher than it was during August of this year (*Fig. 2*)!

We can also guesstimate China's impact on jobs. Factory payrolls dropped 4.3 million from December 2001 (when China joined the WTO) through March 2010 to the lowest level since March 1941 (*Fig. 3*). They were still down 3.4 million through Election Day 2016 and 3.0 million through August of this year.

The ratio of US factory jobs to capacity has declined 24% since the end of 2001 through August of this year, presumably reflecting productivity gains (*Fig. 4*). If capacity had remained on its uptrend prior to China joining the WTO, factory employment arguably would be 53%, or 6.7 million jobs, higher than August's level of 12.7 million. (We derived the percentage increase by subtracting 77% from 24%.)

So Trump's victory on Election Day 2016 may largely reflect the hostile reaction of America's manufacturing Heartland to China's ascent, presumably at US factory workers' expense.

China III: The Most Important Indicator. While manufacturing employment may be the key indicator explaining why Trump beat Clinton, inflation-adjusted retail sales in China may be the most important variable for tracking the impact of China's increasingly dismal demographic profile on its economy. Consider the following:

(1) *Real retail sales.* Every month, the Chinese report retail sales and the consumer price index (CPI). We've been monitoring the yearly percent changes in both for many years (*Fig. 5*). The difference between the two is the growth rate in real retail sales. It has been on a downtrend since 2008-2010 when it typically exceeded 15%. During August of this year, it was down to 6.7%, one of the lowest readings since China joined the WTO at the end of 2001. It is down from 9.3% two years ago.

(2) *Industrial production.* Real retail sales has actually been growing faster than industrial production since early 2012 (*Fig. 6*). The latter has been growing around 6.0% y/y since 2015. It is likely to fall sooner rather than later if the downtrend in real retail sales persists (as suggested by the demographic trends discussed below) and Trump's trade war weighs on exports.

(3) *Credit.* All of the above suggests that the Chinese government may have no choice but to continue propping up economic growth with debt-financed infrastructure spending. Bank loans (in yuan) have quadrupled in China since February 2009 (*Fig. 7*). Yet the Chinese are getting less and less bang per yuan. The ratio of Chinese industrial production to bank loans has dropped by roughly 50% since late 2008 (*Fig. 8*).

It's possible that my analysis so far is too negative. Missing is the growing importance of services industries in China. Nevertheless, demography is destiny, and the Chinese government made an increasingly dismal global outlook on this front much worse in China.

China IV: Depressing Demographic Destiny. In Chapter 16 of my book, *Predicting the Markets*, I discuss China's depressing demographic destiny. That discussion is especially relevant to today's commentary:

"The fertility rate in China plunged from 6.1 in the mid-1950s to below 2.0 during 1996 (*Fig. 9*). Still below 2.0, it's projected to remain so through the end of the century. Initially, the drop was exacerbated by the government's response to the country's population explosion, which was to introduce the one-child policy in 1979. While that slowed China's population growth—to a 10-year growth rate of 0.5% at an annual rate in 2016 from a 3.0% pace in 1972—it also led to a shortage of young adult workers and a rapidly aging population.

"So the government reversed course, with a two-child policy effective January 1, 2016. Births soared by 7.9% that year with the deliveries of about 18 million newborns. But that was still short of the government estimates and might not be sustainable. At least 45% of the babies born during 2016 were to families that already had one child. [For more, see link.]

"Meanwhile, urbanization has proceeded apace, with the urban population rising from about 12% in 1950 to 49% during 2010; it was an estimated 57% in 2016 (*Fig. 10*). The urban population has been increasing consistently by around 20 million in most years since 1996 (*Fig. 11*). To urbanize that many people requires the equivalent of building one Houston, Texas per month, as I discuss in Chapter 2. I first made that point in a 2004 study.

"The move to a two-child policy is coming too late, in my opinion. China's primary working-age population peaked at a record high of just over 1.0 billion during 2014 and is projected to fall to 815 million by 2050 (*Fig. 12*). By then, the primary working-age population in China will represent 60% of the total population, below the peak of 74% during 2010 (*Fig. 13*). The elderly dependency ratio will drop from 7.5 workers per senior in 2015 to 2.3 by 2050 (*Fig. 14*).

"In any event, despite the initial mini baby boom, the fertility rate is unlikely to rise much in response to the government's new policy. Many young married couples living in China's cities are hard-pressed to afford having just one child. An October 30, 2015 blog post on the *Washington Post* website, titled "Why Many Families in China Won't Want More than One Kid Even if They Can Have Them," made that point, observing that education is particularly expensive, as parents feel compelled to prepare their child to compete for the best colleges and jobs. Another problem is that most couples are the only offspring of their aging parents, who require caregiving resources that rule out having a second child. As it says in the Bible, 'As you sow, so shall you reap.'"

Movie. "A Simple Favor" (+ + +) (*link*) is a really clever and entertaining movie. Stephanie is a widowed, single mum who runs a mommy vlog. She seeks to uncover the truth behind the disappearance of her best friend. Anna Kendrick plays the part as a quirky nerd with lots of bravado and comic energy.

CALENDARS

US. Mon: ISM & IHS Markit M-PMIs 59.9/54.5, Construction Spending 0.5%, Bostic, Rosengren. **Tues:** Powell, Quarles. (Econoday estimates)

Global. Mon: Eurozone Unemployment Rate 8.1%, Eurozone, Germany, France, and Italy M-PMIs 53.3/53.7/52.5/50.2, Germany Retail Sales 0.5%m/m/1.6%y/y, UK M-PMI 52.5, Canada M-PMI, Japan M-PMI. **Tues:** Japan Consumer Confidence 43.1, RBA Cash Rate Target 1.50%. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance (*link*): The US MSCI index fell 0.5% last week following a 0.8% increase a week earlier, but has risen in 14 of the past 19 weeks. The index ranked 22nd out of the 49 markets in a week when 14 countries rose in US dollar terms, compared to the prior week's 36/49 ranking when 41 markets rose. The AC World ex-US index fell 0.9% compared to a 2.7% rise a week earlier, which was its best gain since mid-February. EM Eastern Europe performed the best among markets abroad with a gain of 3.3%, followed by EMEA (3.0%), EM Latin America (1.2), EM Asia (-0.8), and BRIC (-0.8). Regions underperforming the AC World ex-US last week: EMU (-2.4) and EAFE (-1.1). Turkey was the best-performing country as it soared 7.6%, followed by Russia (4.5), Colombia (4.5), and Egypt (4.3). Of the 25 countries that underperformed the AC World ex-US MSCI last week, Argentina fared the worst, falling 11.3%, followed by Italy (-5.0) and Israel (-4.5). In September, the US MSCI rose 0.3%, ranking 19/44 and just ahead of the 0.2% gain for the AC World ex-US index in a month when regional performances were mixed. That compares to the US MSCI's 3.1% rise in August, when it ranked 2/44 and was well ahead of the 2.3% decline for the AC World ex-US in a month when all regions fell. The best-performing regions in September: EM Eastern Europe (5.8), EMEA (4.8), EM Latin America (4.6), and EAFE (0.6). September's worst-performing regions: EM Asia (-1.9), BRIC (-1.3), and EMU (-0.5). With a gain of 9.1% ytd, the US MSCI ranks 3/49 and remains way ahead of the AC World ex-US (-5.3); 35/49 countries and all other regions are in negative territory ytd. EM Eastern Europe (-0.7) and EAFE (-3.8) lead the AC World ex-US. BRIC (-10.4) is the biggest laggard relative to the AC World ex-US's performance, followed by EM Latin America (-8.9), EM Asia (-8.5), EMEA (-7.1), and EMU (-5.3). The best country performers ytd: Finland (9.9), Israel (9.5), the US (9.1), Norway (8.6), and Colombia (6.9). The worst-performing countries ytd: Argentina (-51.0), Turkey (-46.0), Greece (-25.6), South Africa (-23.3), and the Philippines (-21.5).

S&P 1500/500/400/600 Performance (*link*): All three of these three market-cap indexes moved lower last week. SmallCap (-1.2%) was the worst performer, ahead of the declines for MidCap (-1.1) and LargeCap (-0.5). LargeCap ended the week 0.6% below its record high on September 20, ahead of

MidCap (-1.5, August 29) and SmallCap (-3.3, August 31). Eleven of the 33 sectors rose in the latest week, down from 13 a week earlier. The best performers in the latest week: SmallCap Communication Services (4.4), MidCap Energy (1.9), MidCap Communication Services (1.8), and MidCap Health Care (1.8). LargeCap Materials was the biggest decliner last week, falling 4.5%, and followed by LargeCap Financials (-4.1), SmallCap Materials (-3.4), MidCap Financials (-3.3), and SmallCap Financials (-2.9). Just one of these three market-cap indexes moved higher in September compared to all three rising in August. LargeCap gained 0.4% last month, easily outperforming MidCap (-1.2) and SmallCap (-3.3). LargeCap rose for a sixth straight month while SmallCap's decline was its first in seven months and MidCap's was its first in five. Thirteen of the 33 sectors advanced in September, down from 28 rising in August and July. That compares to 22 rising in June, 27 in May, 20 in April, 19 in March, and just one in February (the fewest since August 2015). September's best performers: SmallCap Communication Services (5.9), LargeCap Communication Services (4.3), MidCap Energy (3.8), MidCap Communication Services (3.4), and LargeCap Health Care (2.8). September's biggest laggards: SmallCap Tech (-6.2), SmallCap Real Estate (-5.2), MidCap Financials (-4.0), SmallCap Financials (-3.7), and SmallCap Consumer Discretionary (-3.5). LargeCap is now up 9.0% ytd; it has beaten MidCap (6.3)—in recent weeks pulling away from MidCap on a ytd basis 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 29 a week earlier and compared to just three in early February. The best-performing sectors ytd: SmallCap Health Care (42.7), MidCap Health Care (32.7), SmallCap Communication Services (25.7), MidCap Energy (20.2), LargeCap Tech (19.5), and LargeCap Consumer Discretionary (19.5). The worst performers ytd: LargeCap Consumer Staples (-5.5), LargeCap Materials (-4.2), SmallCap Real Estate (-4.1), LargeCap Communication Services (-3.3), and MidCap Materials (-2.3).

S&P 500 Sectors and Industries Performance (*link*): Five sectors rose last week, and five outperformed the S&P 500's 0.5% decline. That compares to eight rising a week earlier, when six outperformed the S&P 500's 0.8% gain. Communication Services was the best-performing sector with a gain of 1.1%, ahead of Health Care (0.9%), Tech (0.8), Energy (0.8), and Consumer Discretionary (0.6). Materials was the biggest underperformer, with a drop of 4.5%, followed by Financials (-4.1), Consumer Staples (-2.1), Real Estate (-1.7), Industrials (-1.7), and Utilities (-0.7). The S&P 500 rose 0.4% in September as 6/11 sectors moved higher and six beat the index. That compares to 8/11 rising and three beating the S&P 500's 3.0% gain in August. The leading sectors in September: Communication Services (4.3), Health Care (2.8), Energy (2.4), Industrials (2.1), Consumer Discretionary (1.0), and Consumer Staples (0.6). The biggest laggards in September: Real Estate (-3.2), Financials (-2.4), Materials (-2.3), Utilities (-0.9), and Tech (-0.4). Five sectors are in the plus column so far in 2018, down from nine a week earlier, which had matched the best YTD count also achieved in early March. However, just three sectors are outperforming the S&P 500's 9.0% ytd gain: Tech (19.5), Consumer Discretionary (19.5), and Health Care (15.2). The eight ytd underperformers: Consumer Staples (-5.5), Materials (-4.2), Communication Services (-3.3), Financials (-1.2), Real Estate (-1.0), Utilities (0.0), Industrials (3.3), and Energy (5.2).

Commodities Performance (*link*): Last week, the S&P GSCI index rose 2.6% w/w for only its sixth gain in 13 weeks as 12 of the 24 commodities that we follow moved higher. That compares to the prior week's 2.0% gain when 20/24 commodities rose in the highest count since late April. Last week's strongest performers: Brent Crude (5.7%), Zinc (5.5), Heating Oil (5.3), and GasOil (5.2). Last week's biggest decliners: Cocoa (-5.1), Nickel (-5.0), Sugar (-4.1), and Cotton (-3.5). September saw 15 of the commodities climb as the S&P GSCI Commodities index rose 3.8%, compared to eight rising in August when the index rose 0.8%. September's best performers were led by Lean Hogs (14.9), Live Cattle (9.3), Zinc (7.5), and Brent Crude (6.6). September's laggards: Cocoa (-11.9), Kansas Wheat (-7.6), Cotton (-7.1), and Wheat (-6.7). The S&P GSCI commodities index is up 9.9% ytd and near its highest level since December 2014, but is still down 1.8% from its high in May and remains at half the ytd performance of its record high in July 2008 just before the financial crisis. The top performer so far in

2018 is Brent Crude (23.7), followed by Crude Oil (21.2), GasOil (20.4), Kansas Wheat (19.7), and Wheat (19.2). The biggest laggards of 2018 to date: Sugar (-26.1), Zinc (-20.5), Lean Hogs (-19.3), Coffee (-18.8), and Lead (-18.1).

Assets Sorted by Spread w/ 200-dmas (*link*): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 13/24 commodities, 6/9 global stock indexes, and 10/33 US stock indexes, compared to 20/24 commodities, 9/9 global stock indexes, and 12/33 US stock indexes rising a week earlier. Commodities' average spread rose w/w to -2.3% from -2.6%, and ten commodities trade above their 200-dmas, unchanged from a week earlier. Brent Crude leads all commodities at 14.3% above its 200-dma as it improved 5.5ppts w/w for the best performance among all assets. Lean Hogs (-15.3) trades the lowest of all commodities and all assets, but Cocoa (-12.0) and Nickel (8.1) each fell 5.0ppts w/w for the worst performance among all assets. The global indexes trade at an average of 1.4% below their 200-dmas, down from -1.1% in the prior week. Just three of the nine global indexes trade above their 200-dmas, up from two a week earlier. Japan (7.4) leads the global indexes, but China (-8.6) improved 1.1ppts w/w for the best performance among global assets. Despite that improvement, China (-8.6) continues to trade at the lowest point relative to its 200-dma among global assets. Chile (-3.2) performed the worst among global assets last week, falling 2.5ppts. The US stock indexes trade at an average of 5.2% above their 200-dmas, with 28 of the 33 sectors above, down from 6.2% a week earlier, when 32 sectors were above. SmallCap Communication Services (18.0) now leads the US stock indexes and all assets as it gained 4.4ppts last week for the best performance among US stock indexes. MidCap Financials (-3.8) trades the lowest among all US stock indexes relative to 200-dmas as it fell 3.3 ppts w/w for the worst performance among US stock indexes last week.

S&P 500 Technical Indicators (*link*): The S&P 500 price index fell 0.5% 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 only the fourth time in 13 weeks. The index remained in a Golden Cross (50-dma higher than 200-dma) for a 127th 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 16th time in 17 weeks following 17 straight weekly declines. The current Golden Cross reading of 4.0% is at a 26-week high and up from 3.8% 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 18th week after mostly declining from late March to late May—including four straight weeks of decline through mid-April that constituted its worst performance since before the 2016 election. The index successfully tested its 50-dma at the end of June, but fell to 1.5% 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 last week, 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. It ended the week at 5.6% above its rising 200-dma, down from a 27-week high of 6.4% a week earlier. That compares to 0.6% below the index's rising 200-dma on April 3 (the lowest reading since June 2016) and a seven-year high of 13.5% above its 200-dma on January 29.

S&P 500 Sectors Technical Indicators (*link*): Among the 11 S&P 500 sectors, five improved last week relative to their 50-dmas and 200-dmas: Communications Services, Consumer Discretionary, Energy, Health Care, and Information Technology. Seven of the 11 sectors are trading above their 50-dmas now, down from 10 a week ago. Three sectors—Financials, Materials, and Real Estate—turned negative w/w, joining Utilities. All 11 sectors were trading above their 50-dmas in late July, the most since early December. Just a few months prior, the picture was the opposite: All 11 sectors were 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 nine sectors trading above currently, down from all 11 above a week earlier as Financials and Materials turned negative. That's up from just four sectors trading above their 200-dmas in early May (which matched the lowest count since January 2016). Sectors trading above their 200-dmas for the longest timespans: Tech (117 straight weeks), Consumer Discretionary (99), and Health Care (18). All 11 sectors had been above both their 50-dmas and 200-dmas briefly in mid-December (for the first time since July 2016). Ten sectors now are in a Golden Cross (with 50-dmas higher than 200-dmas), up from nine a week earlier, as Communication Services' 50-dma moved above its 200-dma for the first time in 26 weeks. Materials is the sole laggard, being out of the Golden Cross club for a 22nd week. All 11 sectors had been in a Golden Cross back in mid-January (for the first time since a 26-week streak ended in October 2016). Ten sectors have rising 50-dmas now, the same number as a week earlier. However, Energy turned positive after mostly falling since mid-July, and Materials turned down after rising since late August. That compares to all 11 sectors with falling 50-dmas during early April (the worst count since before the election in November 2016). Seven sectors now have rising 200-dmas, unchanged from a week earlier and compared to six in mid-July (which was tied with a count in February for the lowest since May 2017). Real Estate's and Utilities' 200-dma zigged back up again last week, but Financials and Materials zigged down and joined Consumer Staples and Communication Services as the four members of the declining 200-dma club.

US ECONOMIC INDICATORS

Durable Goods Orders & Shipments (*link*): Both core capital goods orders and shipments took time out in August after soaring the prior four months to new cyclical highs—with each just shy of new record highs. Nondefense capital goods orders ex aircraft (a proxy for future business investment) slipped -0.5% after soaring 5.1% during the four months through July. The comparable shipments measure (used in calculating GDP) edged up only 0.1%, after averaging monthly gains of 0.8% the previous four months. Core capital goods orders accelerated 10.9% (saar) during the three months through August, based on the three-month average, matching its best pace this year and up from negative readings the first two months of the year. The comparable shipments measure accelerated 8.6% (saar), improving steadily from May's 1.6% pace. Total durable goods orders jumped 4.5% in August, after falling three of the past four months by -1.7%, boosted by a 69.1% jump in volatile aircraft orders. Excluding transportation, orders rose for the seventh straight month, by a total of 4.5% to a new cyclical high, though August's 0.1% uptick was the weakest of those months' readings.

Personal Income & Consumption (*link*): The latest monthly data show real consumer spending continued to expand during the first two months of Q3 to new record highs, though the pace was slightly below Q2's. Real personal consumption expenditures (PCE) climbed 0.2% in August following a 0.3% gain in July; that's just a tick below the average monthly gain of 0.3% posted during Q2—when real consumer spending rose a robust 3.8% (saar). Over the two-month period, real spending on goods rose 0.9%—with real spending on nondurable and durable goods up 1.1% and 0.3%, respectively—while services consumption expanded 0.4%. All were at new record highs. Real disposable income advanced for the 14th straight month in July, up 3.4% over the period to a new record high, while real wages & salaries rose 3.1% over the same period, also to a new record high. Consumers boosted savings by $1.03 trillion over the 12 months through August—the best pace since the comparable period through May 2016. Meanwhile, August data show headline inflation eased a bit to 2.2% from 2.3% in July—the highest reading since 2012. The core rate—the Fed's preferred measure—remained at its target rate of 2.0%.

Consumer Sentiment (*link*): Consumer sentiment in September reached its third-highest reading since 2004. The Consumer Sentiment Index (CSI) jumped to 100.1 last month—slightly below the mid-month estimate of 100.8—after falling from a 14-year high of 101.4 in March to 96.2 by August. The CSI topped 100.0 for only the third time in the past 14 years. The expectations index climbed to 90.5 (from 91.1 in mid-September)—which is back up to last October's reading, the highest since January 2015.

Meanwhile, the present situation index recovered to 115.2 (vs 116.1 initial estimate) last month after dropping from a record-high 121.2 in March to a 21-month low of 110.3 in August. According to Richard Curtin, the Survey of Consumers chief economist, "Most of the September gain was among households with incomes in the bottom third, whose index value of 96.3 was the highest since November 2000. In contrast, the Sentiment Index among households with incomes in the top third lost a total of 8.1% during the past seven months since reaching its cyclical peak of 111.9 in February 2018. This divergence across income subgroups has been observed in past economic cycles and indicates that the expansion has now benefitted nearly all population subgroups." He went on to say that consumers expect continued growth in the economy and a slowly declining unemployment rate next year. The single potential negative cited was tariffs—by nearly one-third of all consumers.

Pending Home Sales (*link*): The Pending Home Sales Index (PHSI)—measuring sales contracts for existing-home purchases—fell for the fourth time in five months in August, dropping -1.8% to 92.7, its lowest reading since January. August's PHSI result fell short of year-ago levels for the eighth straight month, contracting -2.3% y/y. Sales fell in all four regions during the month, while sales in three of the four regions were below year-ago levels, with the West (where prices are the highest) particularly weak. Here's the tally: West (-5.9%m/m & -11.3%y/y), Northeast (-1.3 & -1.6), Midwest (-0.5 & -1.1), and South (-0.7 & +1.3). NAR's Chief Economist Lawrence Yun noted: "With prices having risen so quickly, many consumers were deciding to wait to list their homes hoping to see additional price and equity gains. However, with indications that buyers are beginning to pull out, price gains are going to decelerate and potential sellers are considering that now is a good time to list and bring more properties to the market." Yun expects existing home sales this year to decrease 1.6% to 5.46 million units, and the national median existing-home price to increase 4.8%. Looking ahead to next year, existing sales are forecast to rise 2.0% and home prices around 3.5%.

GLOBAL ECONOMIC INDICATORS

Eurozone CPI Flash Estimate (*link*): September's CPI rate is expected to accelerate slightly, according to the flash estimate, matching its highest reading since the end of 2012; it had eased slightly in August. September's report estimates the rate rose to 2.1% y/y last month—after easing from 2.1% in July to 2.0% in August—above the ECB's target rate of just under 2.0% for the fifth month. Looking at the main components, energy (to 9.5% from 9.2% y/y) once again is expected to have the highest annual rate in September, matching its high for the series. Also expected to move higher is the rate for food, alcohol, and tobacco (2.7 from 2.4), while rates for services and non-energy industrial goods are expected to remain at 1.3% and 0.4%, respectively. The core rate—which excludes energy, food, alcohol, and tobacco—is calculated to edge down to 0.9% y/y in September from 1.0% in August and 1.1% in July, which matched May's eight-month high.

Eurozone Economic Sentiment Indicators (*link*): September's Economic Sentiment Index (ESI) for the Eurozone (-0.7 point to 110.9) fell for the ninth time this year, sinking -4.3 points from December's 17-year high of 115.2, to its lowest level since June 2017; the EU's (-0.9 to 111.3) declined for the seventh time this year, down -3.7 points from its 17-year high of 115.0 at the end of last year. Among the Eurozone's five largest economies, ESIs in France (-1.7 points to 106.3, 17-month low) and Spain (-1.5 to 105.5, 24-month low) once again dropped sharply, while ESIs were little changed in Germany (-0.2 to 112.5, 3-month low), Italy (-0.2 to 108.0, 14-month low), and the Netherlands (+0.1 to 109.5, 2-month high). At the sector level, construction (+1.9 to 8.3), retail trade (+0.8 to 2.7), and services (+0.2 to 14.6) confidence rose last month—with construction's climbing to a new record high; consumer (-1.0 to -2.9), and industry (-0.9 to 4.7) confidence both fell.

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