



## MORNING BRIEFING

October 31, 2018

### Consumers Getting Older

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

(1) Is 3M stock price a reliable indicator of global economic activity? (2) Not a perfect barometer, though it is correlated with M-PMI in US and Eurozone. (3) Is the global slowdown Trump's fault? (4) Can't blame Trump for aging demographics. (5) China's slowing retail sales growth showing country's aging trend. (6) Italians want to retire earlier. (7) Brazilians are retiring young. (8) Happy consumers once meant high P/Es. Not this year. (9) Misery Index remains near cyclical lows. (10) Investors fear low jobless rate will lead to higher inflation and interest rates. (11) Despite plentiful jobs, wage inflation remains subdued.

**Global Economy: Elderly-Led Slowdown.** Industrial conglomerate 3M reported disappointing Q3 results on October 23. The company missed analysts' estimates for Q3, and management lowered full-year growth and earnings estimates. The company's stock price is widely viewed as an indicator of not only the US economy but also the global economy. If so, then it is signaling tough times ahead globally. It started doing so when it peaked on January 26 ([Fig. 1](#)). It is down 28% since then through Monday's close, and down 21% y/y, the lowest such comparison since May 2009.

After last week's clunker, one of the most widely distributed finance-related charts on the Internet showed the y/y percent change in 3M's stock price versus the manufacturing purchasing managers index (M-PMI) ([Fig. 2](#)). There's a reasonably close correlation between the cycles of these two variables. So it is obviously an alarming chart. A similar chart replacing the US M-PMI with the global M-PMI is also unsettling ([Fig. 3](#)). The same can be said of a chart showing 3M's stock price versus the Eurozone's M-PMI, which has been weakening all year ([Fig. 4](#)).

Joe and I aren't convinced that 3M is a perfect barometer for domestic and global manufacturing. The company has its own issues that may not reflect widespread problems for the economy. However, there is no getting around the fact that the global economy is slowing.

The question is: Is it all Trump's fault? Another question: Is the problem cyclical or structural? Debbie and I don't believe that it is Trump's fault. It's easy to blame him for starting a trade war earlier this year with most of America's major trading partners. But US negotiations with both Mexico and Canada occurred rapidly and successfully. Negotiations are underway with the European Union, without any significant actions or threats to disrupt our trading relationships.

The major trade confrontation is with China, which may be slowing as a result of tit-for-tat tariffs, with more probably to come. China's slowdown may actually have more to do with slowing consumer spending as a result of the country's rapidly aging population, which seems to be an increasingly widespread global problem. Consider the following:

(1) *China*. I have previously discussed the significant slowdown in the growth rate of real retail sales in China in recent years and especially over the past year ([Fig. 5](#) and [Fig. 6](#)). Thanks to the government's one-child policy, which was imposed during 1979 and terminated during 2015, most young adults have

no siblings and two old parents to support. If they get married, the couple will be burdened with four old parents. In China, children are still expected to take care of their elderly parents, since public support programs are very limited.

(2) *Europe*. Europe also has a problem with a rapidly aging population. European governments have very generous support programs for their senior citizens. But that means that public funds are increasingly being used to support these social security programs rather than to repair and build new infrastructure. The consequences of that were plain to see in the disastrous bridge collapse in Italy on August 14.

Italy's new populist government is proposing to reduce Italy's retirement age to 62 (from 66.7 currently for men and 65.7 for women) for those who have paid their contributions for at least 38 years. The goal is to pump new blood into its workforce, but Tito Boeri, president of the Istituto Nazionale Previdenza Sociale, told parliament the move will increase the retirement system's debt by "about 100 billion euros."

(3) *Brazil*. Another example of the burden that aging demographics and pensions are putting on growth is Brazil. The AP [reported](#) yesterday: "Brazil's President-elect Jair Bolsonaro signaled Monday his administration would make tackling the country's budget-crushing pension system a top priority, doubling down on a campaign promise that made him the choice of the business community despite frequently saying he doesn't understand the economy. ... Attempts to reform the bloated pension system have failed repeatedly and will again be met with opposition over everything from the retirement age—currently many retire in their early 50s—to who gets excluded from reforms. Bolsonaro has said he wants to exclude military personnel and police from any reduction in benefits."

**US Consumers: Happier Than P/Es Show.** In the past, a happy consumer was associated with cyclically high valuation multiples. The latest surveys show that consumers are very happy indeed, yet S&P 500/400/600 forward P/Es have been declining all year. What gives? Let's first review the data:

(1) *Low Misery Index*. The Consumer Confidence Index (CCI) is inversely correlated with the Misery Index, i.e., the sum of the inflation rate (using the y/y percent change in the CPI) and the unemployment rate ([Fig. 7](#)). At 6.0% during September, the Misery Index remains near previous historical lows. The CCI rose during October to the highest reading since September 2000.

There is an inverse correlation between the Misery Index and the forward P/E of the S&P 500 ([Fig. 8](#)). That inverse relationship worked for quite a while since the start of the bull market during March 2009. It hasn't worked well this year, as the forward P/E dropped from 18.5 during January to a low of 16.2 during October, using monthly data, and as low as 15.0 using daily data.

The problem may be that investors have learned that when the unemployment rate gets down to previous cyclical lows, a bear market isn't far behind ([Fig. 9](#)). They fear that a tight labor market is inherently inflationary, which implies tighter monetary policy.

(2) *Labor market is source of confidence*. This time may or may not turn out to be different. So far, though, it has been different. During September, average hourly earnings rose at a subdued pace of 2.8% y/y, while both the headline and core PCEDs rose 2.0% y/y—right at the Fed's target ([Fig. 10](#)).

Meanwhile, the "jobs plentiful" series included in the CCI survey jumped to 45.9% during October, the highest since January 2001 ([Fig. 11](#)). In the past, this series was highly correlated with wage inflation, which has not been the case so far during the current business-cycle expansion ([Fig. 12](#) and [Fig. 13](#)).

(3) *For your Bloomberg terminal.* Finally, we should note that there has also been a close correlation between the S&P 500 forward P/E and Bloomberg's Weekly Consumer Comfort Index since 1995 ([Fig. 14](#)). That was no longer true this year, as the former fell while the latter rose. (We lost access to the Bloomberg series in mid-August, when limits on its availability were imposed.)

## CALENDARS

**US. Wed:** ADP Employment 178k, Employment Cost Index 0.7%, Chicago PMI 60, MBA Mortgage Applications, EIA Petroleum Status Report. **Thurs:** Productivity & Unit Labor Costs 2.3%/1.1%, Jobless Claims 212k, Challenger Job-Cut Report, Construction Spending 0.2%, ISM & IHS M-PMIs 59.0/55.9, EIA Natural Gas Report. (Econoday estimates)

**Global. Wed:** Eurozone Headline & Core CPI 2.2%/1.1% y/y, Eurozone Unemployment Rate 8.1%, Germany Retail Sales 0.5%/m/m/1.0%y/y, UK Gfk Consumer Confidence -10, Canada GDP 0.1%/m/m/2.4%y/y, Japan Consumer Confidence 43.5, Japan Housing Starts 950k, Australia CPI 0.5%/q/q/1.9%y/y, China M-PMI & NM-PMI 50.6/54.9, BOJ Rate Decision. **Thurs:** UK M-PMI 53.0, Canada M-PMI, China Caixin M-PMI 50.0, Japan M-PMI, BOE Bank Rate & Asset Purchase Target 0.75%/£435b, BOE Inflation Report, Carney. (DailyFX estimates)

## STRATEGY INDICATORS

**S&P 500 Q3 Earnings Season Monitor** ([link](#)): With over 55% of S&P 500 companies finished reporting earnings and revenues for Q3-2018, the earnings surprise beat is stronger compared to the same time period in Q2, but the revenue surprise and the y/y revenue and earnings growth metrics have eased somewhat from Q2's stellar results. Of the 279 companies in the S&P 500 that have reported through mid-day Tuesday, 77% exceeded industry analysts' earnings estimates by an average of 6.3%; they have averaged a y/y earnings gain of 24.6%. On the revenue side, 57% of companies beat their Q3 sales estimates so far, with results coming in 0.8% above forecast and 8.1% higher than a year earlier. At the same point during the Q2-2018 reporting period, a higher percentage of companies (83%) in the S&P 500 had beaten consensus earnings estimates by a lower 5.2%, and earnings were up a slightly higher 26.7% y/y. With respect to revenues, a sharply higher 72% had exceeded revenue forecasts at this point in the Q2 season by a higher 1.1%, and sales rose a higher 10.3% y/y. Q3 earnings results are higher y/y for 86% of companies, vs 87% at the same point in Q2, and Q3 revenues are higher y/y for 83% vs a greater 86% a quarter ago. These figures will continue to change markedly as Q3-2018 results flood in this week. Q3-2018 is sure to mark the ninth straight quarter of positive y/y earnings growth and among the highest-growth quarters since Q4-2010; and y/y revenue growth will be positive for a tenth straight quarter, with its pace slowing somewhat but remaining well above the historical trend. The strong results are mostly due to lower tax rates and improved business conditions, but cost pressures and global growth concerns are increasing. Furthermore, fewer companies are reporting positive y/y revenue and earnings growth.

## US ECONOMIC INDICATORS

**Consumer Confidence** ([link](#)): "Consumers' assessment of present-day conditions remains quite positive, primarily due to strong employment growth," Lynn Franco, director of economic indicators at the Conference Board, said in a statement. The expectations gauge indicates "that consumers do not foresee the economy losing steam anytime soon. Rather, they expect the strong pace of growth to carry over into early 2019." October consumer confidence reached an 18-year high, with consumers more optimistic about both the present and future. The Consumer Confidence Index increased for the fourth month from 127.1 in June to 137.9 in October, not far from the all-time high of 144.7 reached during 2000. October's expectations component rebounded sharply for the third month—soaring from

102.4 in July to 114.6—its best reading since September 2000. Meanwhile, the present situation component climbed for the fifth time in six months, from 157.5 in April to 172.8 in October, back up at August's reading, which was the highest since December 2000. The current jobs outlook remained very favorable last month: Jobs plentiful (to 45.9% from 44.1%) jumped to its highest reading since January 2001, while jobs hard to get (13.2 from 14.1) was back down near August's cyclical low of 12.1%. The six-month jobs outlook also remained very favorable, with the percentage reporting more jobs (21.9 from 22.1) ticking down a bit, while those expecting fewer jobs (10.5 from 11.4) sank to its lowest percentage since July 2000. The spread between the two jumped to 11.4ppts—the highest percentage since the 1980s.

## GLOBAL ECONOMIC INDICATORS

**Eurozone Economic Sentiment Indicators** ([link](#)): October's Economic Sentiment Index (ESI) for the Eurozone (-1.1 points to 109.8) fell for the tenth time this year, sinking -5.4 points from December's 17-year high of 115.2, to its lowest level since May 2017; the EU's (-0.8 to 110.4) declined for the eighth time this year, down -4.6 points from its 17-year high of 115.0 at the end of last year. Among the Eurozone's five largest economies, only Spain's (+1.9 points to 107.4) ESI rose this month, while ESIs for Germany (-1.3 to 111.2), the Netherlands (-1.3 to 108.2), France (-1.2 to 105.1), and Italy (-0.9 to 107.1) booked losses. At the sector level, only consumer (+0.2 to -2.7) confidence eked out a small gain, while construction (-0.3 to 8.0) confidence recorded a negligible decline from September's record high. Meanwhile, retail trade (-3.2 to -0.8), industry (-1.7 to 3.0), and services (-1.1 to 13.6) confidence all deteriorated.

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