



MORNING BRIEFING

November 15, 2018

Better To Be Healthy Than Techie

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

(1) Old dog, new tricks. (2) A social media star is born, maybe. (3) Sonogram showing investors in fetal position. (4) Companies that build new headquarters are often cursed. (5) OPEC reports that oil supply exceeds demand. So does a chart of the price of oil. (6) For Energy industry analysts, it may be 2015 déjà vu all over again. (7) Quantum computing solves problems fast.

Social Media. Who says you can't teach an old dog new tricks? I've been learning about and using social media to promote my book [Predicting the Markets: A Professional Autobiography](#). I've had some success, especially on LinkedIn, which just named me one of the 10 "[Top Voices](#)" on the economy and finance in 2018. What's next? We are working on a YouTube channel with video podcasts organized in playlists corresponding to the chapters of the book. And I just signed a contract with Netflix: For \$7.99 a month, I can stream any of their movies on my digital devices. (Old joke.)

Strategy I: Leadership Cha-Cha-Changes. The S&P 500 sector leadership for 2018 has officially changed. The S&P 500 Tech sector, which led the market for the vast majority of the year, has lost its crown to the Health Care sector. The move is quite a comeuppance. Tech's ytd return has fallen by 13.7 percentage points since October 3, when it was up 20.5% ytd.

Here's the performance derby for the S&P 500 sectors ytd through Tuesday's close: Health Care (10.1%), Consumer Discretionary (8.3), Tech (6.8), Utilities (4.3), S&P 500 (1.8), Real Estate (0.7), Consumer Staples (-1.5), Financials (-4.5), Industrials (-6.1), Energy (-9.4), Materials (-10.9), and Communications Services (-11.5) ([Fig. 1](#)).

The Technology sector has fallen victim to the market's vicious rotation into safety sectors and out of growth sectors since the S&P 500 peaked on September 20. Here's the S&P 500's performance derby since then: Utilities (4.0%), Consumer Staples (2.2), Real Estate (-0.2), Health Care (-3.4), Communication Services (-6.6), S&P 500 (-7.1), Financials (-7.6), Consumer Discretionary (-9.0), Tech (-10.2), Materials (-11.4), and Energy (-12.6) ([Table 1](#)).

It's notable that the sectors leading the market since the September peak are not the sectors that analysts expect will produce the strongest earnings growth next year. Here are analysts' 2019 earnings growth estimates: Energy (96.9%), Industrials (19.3), Consumer Discretionary (9.8), Financials (9.4), S&P 500 (9.0), Tech (7.6), Health Care (7.0), Materials (6.6), Communications Services (6.3), Consumer Staples (5.0), Utilities (4.8), and Real Estate (-3.7).

Strategy II: Beware New HQs. Could Tech's recent woes have something to do with the Curse of New Headquarters? The Curse may be an old wives' tale, but there are some awfully good examples of companies that have gone downhill shortly after moving into expensive new digs.

Perhaps building a glitzy new HQ is a sign of self-congratulatory hubris, indicating a laurels-resting

management that is no longer focused on the bottom line. Perhaps the downfalls after ribbon-cuttings are just coincidental. But we were reminded of the legend when Amazon announced this week that it would open not just one, but two, new headquarters. Granted, Amazon appears to be moving into existing buildings, and the curse historically has applied just to new construction. However, the tech sector could worry instead about Apple's new headquarters, which had a reported price tag of almost \$5 billion when it opened to employees last year.

Dare we mention that GE broke ground on a new headquarters in Boston [last year](#)? Additional examples of the new-HQ-cursed companies are mentioned in this 11/10/09 Business Insider [article](#). Some standouts: Bear Stearns opened a new building in 2002, and the AOL Time Warner Center broke ground in 2000. It's now the Time Warner Center.

Energy: Return of the Glut. There can be too much of a good thing. That's especially true in the commodity markets, where the slightest shift in supply or demand can throw a market out of whack. So when OPEC [reported](#) on Tuesday that global demand was a touch softer, and global supply a bit higher, than the organization had forecast, already weak crude prices continued to tumble.

The price of Brent crude oil futures has fallen to \$65.47 a barrel as of Tuesday, down 24% from its October 3 peak of \$86.29, and the price of West Texas Intermediate crude futures has declined to \$55.69, 27% below its October 3 peak of \$76.41 ([Fig. 2](#) and [Fig. 3](#)). The decline has sent the S&P 500 Energy industries tumbling ytd anywhere from 4.4% (Oil & Gas Refining & Marketing) to 28.4% (Oil & Gas Equipment & Services) ([Fig. 4](#)).

The oil cartel explained: "Although the oil market has reached a balance now, the forecasts for 2019 for non-OPEC supply growth indicate higher volumes outpacing the expansion in world oil demand, leading to widening excess supply in the market. The recent downward revision to the global economic growth forecast and associated uncertainties confirms the emerging pressure on oil demand observed in recent months."

The organization appears to be making a case to cut production at its next meeting, on December 6, despite President Trump's tweets calling for the continuation of today's low prices. OPEC is reportedly considering a 1.4mbd cut in oil production, according to unnamed sources cited in an 11/14 Reuters [article](#). The news report helped crude oil prices enjoy a small bounce yesterday. Let's take a look at OPEC's projected global supply and demand data:

(1) *Swimming in oil.* OPEC reported that its oil output rose by 127,000bd to 32.9mbd in October. The problem: The world only needs 32.6mbd from OPEC members this year—a y/y drop of 0.9mbd—and will only need 31.5mbd from them in 2019, according to the organization's forecast.

The excess occurs in part because supply is rising faster than expected. OPEC sees non-OPEC supply rising to an average of 62.09mbd in 2019. That's an increase over the 59.86mbd produced this year and the 57.55mbd produced in 2017. The 2019 estimate was boosted by 0.12mbd in the November report. Most of the increase this year comes from the US (2.06mbd) and former Soviet Union (0.13mbd). Next year, the vast majority of the increase also comes from the US (1.69mbd).

(2) *Economies slowing.* Additional pressure on oil prices comes from slower-than-expected demand for black gold as a result of lighter world economic growth than previously thought. OPEC forecasts that oil demand will average 100.08mbd in 2019, an increase of 1.29mbd over the 2018 forecast—which is 70,000bpd less than the organization predicted in October. It's the fourth consecutive reduction of its demand forecast, a 11/13 Reuters [article](#) reported.

(3) *Blame the US*. The US shale miracle has played havoc with the global oil market, as the US has swung from an oil importer to an oil exporter. US net imports have fallen to 1.8mbd (four-week ma), down from 13.6mbd at the peak in November 2005 ([Fig. 5](#)). Exports have increased even as a lack of capacity on certain pipelines has constrained growth.

Adding to the pressure on oil and other commodity prices is the US dollar's appreciation in response to Fed tightening. The dollar is up 10% since February 1 ([Fig. 6](#)).

(4) *Expect downward revisions*. If crude oil prices remain at current levels, it's highly likely that industry analysts in the energy sector will need to reduce their earnings forecasts. The S&P 500 Energy sector is expected to grow revenues by 22.4% this year and 10.6% in 2019 ([Fig. 7](#)).

Earnings were expected to recover this year from a weak environment in 2017. So analysts have been boosting their earnings estimates throughout this year, and now forecast earnings growth of 96.9% in 2018 and 28.0% in 2019 ([Fig. 8](#)). The industry's forward P/E has fallen sharply to 14.1 as its earnings have improved ([Fig. 9](#)).

Eye on Innovation: Quantum Power. Quantum computers are still at their nascent stage, but scientists are already using them to solve problems that were previously unsolvable on classic computers. Many of the problems involve optimization. Problems of optimization typically have many variables that can be combined in many different ways before arriving at the ultimate answer.

D-Wave Systems, a privately held Canadian company, and IBM both are helping companies figure out how to use quantum computers in the fields of medicine, materials, traffic flows, and investing. Let's take a look:

(1) *Easing traffic jams*. Volkswagen is using a D-Wave quantum computer to develop a traffic management system that will "improve the performance of fleet services like taxis and public buses," an 11/5 [article](#) in Engadget reported. Volkswagen's quantum algorithm uses data collected from smartphones and transmitters in vehicles to arrive at the fastest way to travel and reduce congestion. The company would like to test its program in Barcelona, but it theoretically could be used in any city. A more detailed description of Volkswagen's research is available in this 9/27/17 company [presentation](#).

(2) *Lighter, stronger materials*. Earlier this year, D-Wave and the Vector Institute programed a quantum computer to simulate how a material behaves during a phase transition, according to a company [synopsis](#). The hope is the company will continue to harness the power of quantum computers to help scientists develop and understand the properties of new and existing materials.

Lockheed Martin hopes that quantum technology will help it develop new, lightweight materials for its airplanes and tougher materials to help its spacecraft survive the harsh environs of space, explained Kristen Pudenz, a quantum research scientist at Lockheed Martin, in this [video](#). Novel materials developed with quantum computers could be used in new medications or batteries.

(3) *Optimizing radiation*. Roswell Park Cancer Institute used a D-Wave quantum computer to determine the optimal amount of radiation for treating a patient. It compared the outcome of the quantum computer to two other traditional methods of coming up with a radiation plan. The quantum computer arrived at an answer similar to that derived by one traditional method, but its answer was less effective than that derived by the second traditional method. In both cases, the quantum computer arrived at the answer three to four times faster than the traditional methods. The scientists concluded that more research into using quantum computers in this area is warranted, especially as the technology improves, according to a 5/21/15 [abstract](#) of their research.

(4) *JPM and IBM*. More than 94,000 researchers have accessed IBM's quantum computers via the cloud. IBM also allows certain corporate clients to access 20 of its most powerful quantum computers. IBM's partners in financial services, including JPMorgan, are exploring how to use quantum computing to optimize trading strategies, analyze risk, and construct the best-performing investment portfolios, explained Kathryn Guarini, vice president of IBM Industry Research, in an 10/12 [podcast](#). IBM believes that quantum computers' much faster speed relative to traditional computers might allow some investing-related tasks to be done twice a day instead of just at the close of business.

Guarini suggests that companies start thinking about what quantum computing will mean for their businesses and learn quantum programming. "This is something people want to get ahead of."

Correction: Driving Lesson. Yesterday, we wrote: "The situation is akin to driving a car with the left foot bearing down on the accelerator while the right foot taps the brakes, as we've noted frequently this year." I received a number of emails reminding me that the right foot goes on the accelerator and the left foot goes on the brakes. I'll do that next time I go for a drive, and remind my colleagues to do the same. That should lower our auto insurance premiums.

CALENDARS

US. Thurs: Retail Sales Total, Ex Autos, Ex Autos & Gas, and Control Group 0.5%/0.5%/0.4%/0.3%, Business Inventories 0.3%, Jobless Claims 215k, Philadelphia Fed Manufacturing Index 20.5, Empire State Manufacturing Index 20.0, Import & Export Prices 0.0%/0.1%, EIA Natural Gas and Petroleum Status Reports, Powell, Quarles, Bostic. **Fri:** Headline & Manufacturing Industrial Production 0.2%/0.3%, Capacity Utilization 78.2%, Kansas City Manufacturing Index, Baker-Hughes Rig Count, Treasury International Capital, Evans. (Econoday estimates)

Global. Thurs: Eurozone Trade Balance €16.3b, UK Retail Sales Including & Excluding Auto Fuel 2.8%/3.4% y/y, Australia Employment Change & Unemployment Rate 20k/5.1%, Mexico Overnight Rate 8.00%. **Fri:** Eurozone Headline & Core CPI 2.2%/1.1% y/y, Draghi. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): Our Bull/Bear Ratio (BBR) edged up to 2.26 this week after falling the prior five weeks from 3.32 to 2.15—which was its lowest reading since early May. Bullish sentiment was little changed this week—ticking up to 42.9%—after plunging 19.3ppts the prior five weeks from 61.8% to a 30-week low of 42.5%. Meanwhile, the correction count continued to climb, up 18.5ppts the past six weeks to a 31-week high of 38.1%. Bearish sentiment remained subdued at 19.0%, fluctuating from 19.0% to 19.8% the past four weeks, after trading in a narrow band of 17.6% to 18.8% since early June. The AAI Ratio climbed for the second week from 40.6% to 57.0%. Bullish sentiment rose from 28.0% to 41.3% over the two-week period, while bearish sentiment fell from 41.0% to 31.2%.

S&P 500 Earnings, Revenues & Valuation ([link](#)): S&P 500 consensus-per-share forecasts for forward revenues rose to a record high, but forward earnings dropped for the third time in four weeks to 0.2% below its record high a week earlier. 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. Analysts expect forward revenues growth of 5.8% and forward earnings growth of 9.9%, compared to 5.7% and 10.3% a week ago. Forward revenues growth is down from an 80-month high of 6.3% at the end of February. Forward earnings growth is down to the lowest level since August 2016 from 16.9% in February. Prior to the passage of the Tax Cuts and Jobs Act (TCJA), forward revenue growth was 5.5% and forward

earnings growth was 11.1%. Turning to the annual revenue growth expectations, the 2018 forecast improved w/w to 8.8% from 8.5%, and 2019 rose to 5.6% from 5.5%. Looking at annual earnings growth, the 2018 forecast rose 0.3ppt w/w to 23.9% and dropped 0.4ppt to 9.0% for 2019. The forward profit margin of 12.3% is down 0.1ppt w/w from a record high of 12.4%. That's up from 11.1% prior to the passage of the TCJA in December and compares to a 24-month low of 10.4% in March 2016. The S&P 500 ex-Financials forward revenue growth forecast rose 0.1ppt w/w to 6.0%, but forward earnings growth fell 0.5ppt to 9.7%. The S&P 500 ex-Financials forward profit margin dropped 0.1ppt w/w from a record high of 11.5%, but that's still up from 10.4% before the TCJA. Valuations rose for a second week from their lowest levels since February 2016. The S&P 500's forward P/E improved w/w to 16.2 from 15.6, which compares to a 16-year high of 18.6 at the market's prior peak in late January and its 33-month low of 15.3 in late October. The S&P 500 price-to-sales ratio rose to 2.00 from 1.93, which compares to late January's record high of 2.16 and an 18-month low of 1.89 in late October.

S&P 500 Sectors Earnings, Revenues & Valuation ([link](#)): Consensus forward revenue forecasts rose w/w for five of the 11 of the S&P 500 sectors, but forward earnings rose for only one. Financials was the only sector to have both measures rise w/w. Forward revenues rose w/w for Communication Services, Energy, Materials, and Real Estate. 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 are now well below their 2018 highs 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 1.11 compares to a record high of 1.56 in May 2016, and its P/E of 14.1 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. Higher y/y margins are expected in 2019 for nine of the 11 sectors, all but Communication Services and Real Estate. During the latest week, the forward profit margin edged lower for 10/11 sectors and rose for Financials. Here's how the sectors rank based on their current forward profit margin forecasts: Information Technology (22.9%), Financials (19.1), Real Estate (15.5), Communication Services (14.8), Utilities (12.8), S&P 500 (12.3), Materials (11.0), Health Care (10.6), Industrials (10.2), Energy (7.9), Consumer Staples (7.5), and Consumer Discretionary (7.5).

US ECONOMIC INDICATORS

CPI ([link](#)): The core CPI rate in October eased a bit, holding above the Fed's target rate of 2.0% y/y for the eighth straight month. October's rate slowed for the second time in three months, to 2.1% y/y, from July's 2.4%—which was the fastest pace since September 2008. Meanwhile, the three-month rate moved further below 2.0%, to a 16-month low of 1.6% (saar), after accelerating to 2.3% in July. On a monthly basis, core prices rose 0.2%, following advances of 0.1% in each of the prior two months—the monthly gain has fluctuated between 0.1% and 0.2% since February. Last month, prices rose for shelter, used cars & trucks, medical care, household furnishings & operations, motor vehicle insurance, and tobacco; prices fell for communication, new vehicles, and recreation. The headline CPI rate ticked up to 2.5% y/y in October after slowing from 2.9% in June and July—the highest since February 2012—to 2.3% by September; the headline rate had been mostly trending upward since falling to 1.6% in June 2017.

GLOBAL ECONOMIC INDICATORS

Eurozone GDP Flash Estimate ([link](#)): The Eurozone economy expanded at its slowest pace in four years, according to the GDP flash estimate. Real GDP grew only 0.2% last quarter, half the 0.4% pace

recorded during Q1 and Q2, and one-third the 0.6% rate posted during each of the final three quarters of 2017. Among the four largest economies, only Spain (0.6%) and France (0.4) were above the Eurozone's real GDP growth rate last quarter, while Germany's economy (-0.2) contracted for the first time since Q2-2014; Italy's (0.0) showed no growth after expanding the previous eight quarters. The Eurozone grew 1.7% y/y during Q3, a percentage point below Q4-2017's 2.7% rate. Among the top four economies, only Spain (2.5% y/y) bested the Eurozone's 1.7% rate; France (1.5), Germany (1.2), and Italy (0.8) fell short.

Eurozone Industrial Production ([link](#)): Output in the Eurozone has lost momentum, falling in September for the third time in four months, though remaining within 0.9% of November's cyclical high. Industrial production (excluding construction) slipped -0.3% in September after a 1.1% increase and a -0.8% decrease the prior two months. Of the main industrial groups, only capital goods output is showing signs of life, climbing for the fifth time in six months, by 0.3% m/m and 4.5% over the period—just shy of a new record high. Production of consumer nondurable goods was on a volatile uptrend, but has stalled around recent highs, falling three of the past four months by a total of -1.2%. Over the four months through September, both intermediate and consumer durable goods production contracted -1.3%. September production data are available for three of the top four Eurozone economies and show production fell in France (-1.8%), Spain (-0.8), and Germany (-0.2). It was the first decline in output for France in five months and the first for Spain in three months, while Germany recorded its third decline in production in four months. Among the Eurozone countries for which data are available, the biggest declines were registered in Latvia (-3.3%), Lithuania (-3.1), and Portugal (-2.8); the biggest gains were recorded in Ireland (2.2) and the Netherlands (1.2).

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