



MORNING BRIEFING

February 5, 2019

Revenues: Good & Bad News

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

(1) Good news for revenues in January's M-PMI. (2) New orders index rebounded last month, while new factory orders continued to grow in November. (3) Hard to match last year's revenues growth. (4) Weak global economic indicators weighing on outlook for S&P 500 revenues growth. (5) Global M-PMI falling. (6) Global leading indicators increasingly downbeat, especially for Europe and China. (7) Copper starting to shine. (8) Dollar remains a headwind for revenues growth.

Strategy: Revenues & PMIs. Debbie and I have some good news and some bad news for S&P 500 revenues. Let's start with the upbeat news:

(1) *Rebounding M-PMI.* The good news is that the US M-PMI rebounded during January after taking a dive during December, as we discussed yesterday. This business indicator is highly cyclical and also highly correlated with S&P 500 aggregate revenues ([Fig. 1](#)). The M-PMI is also highly correlated with the yearly percent change in the S&P 500 ([Fig. 2](#)).

(2) *Rebounding new orders.* That's not surprising since both the S&P 500 and the new orders sub-index of the US M-PMI are among the 10 components of the Index of Leading Economic Indicators (LEI). Sure enough, the new orders series is highly correlated with the yearly changes in both S&P 500 aggregate revenues and the S&P 500 stock price index ([Fig. 3](#) and [Fig. 4](#)).

The growth rate in aggregate S&P 500 revenues is also highly correlated with the growth rate of new factory orders, also on a y/y basis ([Fig. 5](#)). Data for the latter was released yesterday, but only through November, showing a gain of 4.1% y/y. That's down from its recent peak of 10.3% in August. Of course, causality runs both ways: Strong (or conversely weak) revenues growth should boost (or moderate) capital spending.

(3) *A surprisingly good year.* S&P 500 aggregate revenues rose 9.0% y/y during Q3, and 10.7% on a per-share basis ([Fig. 6](#)). Joe and I previously have marveled at the strength of revenues growth last year despite all the chatter about a slowdown in the global economy. A rebound in oil prices helped to boost revenues. However, the S&P 500's aggregate revenues was up 7.5% even excluding the S&P 500 Energy sector ([Fig. 7](#)).

Strategy II: Bad News for Revenues. Now for the bad news. The global economy weakened significantly as 2018 came to a close, and is showing no signs of improving. Since almost half of S&P 500 revenues comes from abroad, global weakness will weigh on the 2019 growth rates of both S&P 500 revenues and earnings. The strong dollar is also a negative for both. The US economy may be able to decouple from the global economy, but the S&P 500 cannot do the same.

Joe and I have been predicting slower revenues-per-share growth this year (4.0% y/y) than last year (10.7% y/y through Q3). However, we are thinking about lowering our estimate given the ongoing

slowdown overseas. Consider the following:

(1) *Global M-PMI falling.* The global M-PMI fell to 50.7 during January ([Fig. 8](#)). That's down from a recent peak of 54.4 at the end of 2017 and the lowest since August 2016. (Excluding the US, the global M-PMI slumped to the 50.0 breakeven point.) The M-PMI for developed economies fell from a recent high of 56.3 last January to 51.8 this January, the lowest since September 2016. The M-PMI for emerging economies dropped below 50.0 for the first time since June 2016. It registered 49.5 last month, down from 52.1 during December 2017 and the lowest since mid-2016. China's official M-PMI has been under 50.0 for the past two months.

(2) *Global leading indicators weakening.* As Debbie and I observed last week, the LEI in the US stalled at a record high during the final three months of 2018. We expect it made a new record high last month, led by the S&P 500 and the M-PMI's new orders index. The bad news is that the LEI for the 36 member countries of the OECD continues to weaken, as it has been doing since February when it was at 100.4 ([Fig. 9](#)). It was down to 99.3 during November. This global business cycle indicator is also highly correlated with the growth in S&P 500 aggregate revenues, and does not augur well for revenues growth. However, the two series have diverged from time to time.

Among the weakest LEIs in the OECD countries are those for the major European economies ([Fig. 10](#)). The weakest of the four BRICs are China and Russia ([Fig. 11](#)).

(3) *Commodity prices get a boost from the Fed.* The one bright spot for the global economy is the price of copper. It is starting to shine again. It is very sensitive to US monetary policy and Chinese economic growth. The nearby futures price has rallied from a recent, January 3 low of \$2.568 per pound to \$2.805 yesterday. Like the stock market, the price of copper is responding positively to the more dovish approach to monetary policy (as Melissa and I discussed yesterday) and Trump's cheerleading on the progress in US-China trade talks.

The price of copper is highly correlated with the 10-year expected inflation rate embodied in the yield spread between the 10-year US Treasury bond and the comparable TIPS ([Fig. 12](#)). The spread has increased 19bps from a recent low of 1.68% on January 3 to 1.87% yesterday.

(4) *The dollar remains a headwind.* The prices of most commodities traded globally in dollars, including the price of copper, are inversely correlated with the foreign exchange value of the trade-weighted dollar ([Fig. 13](#)). If the Fed pauses hiking rates for a while and US-China trade talks end amicably, the dollar should weaken, or at least stop strengthening. That would be a positive for the growth rate of S&P 500 revenues, which is inversely correlated with the dollar ([Fig. 14](#)).

For now, the dollar remains a headwind for revenues, since it is up 6% y/y. It might not weaken much, and could even strengthen, if the ECB keeps its official deposit rate at just below zero—as seems likely given the weakness in European economies. The Bank of Japan also seems to be stuck in the mud with its ultra-easy monetary policy.

Global Economy: What's the Matter? Can we blame Trump's trade wars for the global slowdown? The uncertainty created by mounting trade tensions between the US and its major trade partners undoubtedly is contributing to the slowdown.

However, Europe and China both have lots of homegrown problems. Both have geriatric demographic profiles, i.e., rapidly aging populations, because people are living longer while births are down sharply. Europe has lots of political turmoil including Brexit, the "Yellow Vest" protests in France, anti-immigration sentiments in Germany and Sweden, and anti-unification movements in Italy and Eastern

Europe. Europe also does lots of business with emerging economies, especially China, which is also slowing.

Most of these issues are structural rather than cyclical in nature. Nevertheless, the global economic indicators discussed above are cyclical, and will undoubtedly improve. The question is when? The answer might be later this year or early next year. An imminent improvement is unlikely.

CALENDARS

US. Tues: ISM & IHS Markit NM-PMIs 57.1/54.2. **Wed:** Merchandise Trade Balance -\$54.0b, Productivity & Unit Labor Costs 1.6%/1.7%, MBA Mortgage Applications, EIA Petroleum Status Report, Powell. (Econoday estimates)

Global. Tues: Eurozone Retail Sales -1.6%/m/m/0.5%/y/y, Eurozone, Germany, France, and Italy C-PMIs 50.7/52.1/47.9/49.5, Eurozone, Germany, France, and Italy NM-PMIs 50.8/53.1/47.5/50.0, UK C-PMI & NM-PMI 51.5/51.0, Japan C-PMI & NM-PMI, RBA Cash Target Rate 1.50%. **Wed:** Germany Factory Orders 0.3%/m/m/-6.7%/y/y. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings fell for a fourth straight week for all three of these indexes, continuing the declines that began during October. LargeCap's forward EPS is now 2.3% below its record high of \$175.48 in late October, while MidCap's and SmallCap's are now 2.1% and 4.8% below their mid-October highs, respectively. LargeCap's forward EPS is the most below its record high since June 2016, while MidCap and SmallCap have not been this far below since April 2016 and December 2010, respectively. The yearly change in forward earnings remains healthy compared to the past due to the boost from the Tax Cuts and Jobs Act (TCJA), but is tumbling now as y/y comparisons become more difficult. In the latest week, the rate of change in LargeCap's forward earnings fell to a 16-month low of 9.4% y/y from 11.3%. That's down from 23.2% in mid-September, which was the highest since January 2011 and compares to a six-year low of -1.8% in October 2015. MidCap's y/y change was down to a 22-month low of 10.9% from 12.5%, which compares to 24.1% in mid-September (the highest since April 2011) and a six-year low of -1.3% in December 2015. SmallCap's dropped to a 12-month low of 16.4% from 18.5%, which is down from an eight-year high of 35.3% in early October and compares to a six-year low of 0.3% in December 2015. Analysts had been expecting double-digit percentage earnings growth in 2019, but those forecasts have been dropping since October. Here are the latest consensus earnings growth rates for 2018, 2019, and 2020: LargeCap (22.4%, 5.0%, 11.7%), MidCap (21.7, 6.5, 11.5), and SmallCap (21.6, 12.2, 15.4).

S&P 500/400/600 Valuation ([link](#)): Forward P/E ratios rose w/w across the board after rising for four straight weeks from multi-year lows to their highest levels since November. LargeCap's weekly forward P/E of 15.8 is up from 15.5 a week ago and a five-year low of 13.9 during December. That compares to a six-month high of 16.8 in mid-September and a multi-year high of 18.6 on January 26 (highest since May 2002), and of course is well below the tech-bubble record high of 25.7 in July 1999. Last week's level remains above the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap's forward P/E of 15.1 is up w/w from 14.8 and from 13.0 during December, which was the lowest reading since November 2011. MidCap's P/E is down from a 15-year high of 19.2 in February 2017 and the record high of 20.6 in January 2002. MidCap's P/E has been at or below LargeCap's P/E for most of the time since August 2017—the first time that alignment has prevailed since 2009. SmallCap's P/E of 16.0 is up from 15.7 a week earlier and from 13.6 during December, which had also marked its lowest reading since November 2011. That's well below its 51-week high of 20.2 in December 2017 (which wasn't much below the 15-year high of 20.5 in December 2016, when Energy's earnings were depressed).

SmallCap's P/E was higher than LargeCap's P/E for a second week after being below for much of December for the first time since 2003.

S&P 500 Sectors Quarterly Earnings Outlook ([link](#)): With the Q4 earnings season nearly half finished and more reports pouring in this week, analysts will likely continue to cut their Q1 forecasts further. Last week, the usual positive surprise bias saw the S&P 500's Q4-2018 EPS forecast jumped 22 cents w/w to \$40.52. That's down 4.8% since the end of Q3, but up 4.2% since the beginning of 2018 and 5.0% since the passage of the TCJA. The \$40.52 estimate represents a forecasted pro forma earnings gain for Q4-2018 of 15.5%, compared to 14.3% a week earlier and 20.1% at the end of Q3. While Q4's y/y gain would be its tenth straight after four declines, it marks the slowest growth since Q4-2017 and is down from 28.4% in Q3 (which is sure to mark the peak of the current earnings cycle). Ten of the 11 sectors are expected to record positive y/y earnings growth in Q4-2018, with six rising at a double-digit percentage rate due to the lower corporate tax rate. That compares to all 11 positive during Q3, when 10 rose at a triple- or double-percentage rate. Four sectors are expected to beat the S&P 500's Q4 growth rate, the same as in Q3. However, Industrials and Real Estate are the only sectors expected to post improved growth on a q/q basis during Q4. Analysts expect Energy to report another large profit jump in Q4 relative to very low earnings a year ago, but the pace is slowing substantially from Q3. Here are the latest forecasted Q1-2019 earnings growth rates versus their blended Q4-2018 growth rates: Health Care (6.9% in Q1-2019 versus 12.8% in Q4-2018), Industrials (6.8, 27.0), Financials (5.0, 16.7), Real Estate (3.4, 6.4), Consumer Staples (1.3, 3.3), Utilities (0.8, -10.7), Consumer Discretionary (-0.7, 13.9), Communication Services (-3.1, 19.8), Information Technology (-5.4, 9.3), Materials (-6.9, 2.0), Energy (-10.8, 78.3), Industrials (26.3, 18.9), Communication Services (17.9, 26.1), Financials (17.1, 44.8), S&P 500 (14.3, 28.4), Consumer Discretionary (13.1, 25.4), Health Care (11.5, 16.5), Tech (8.9, 29.1), Real Estate (6.7, 5.3), Materials (3.3, 30.1), Consumer Staples (3.3, 11.4), and Utilities (-10.3, 10.9). On an ex-Energy basis, analysts expect S&P 500 earnings to rise 1.3% y/y in Q1, well below the 12.9% in Q4.

S&P 500 Q4 Earnings Season Monitor ([link](#)): With nearly half of the S&P 500 companies finished reporting earnings and revenues for Q4-2018, y/y revenue and earnings growth remains strong, but the surprise metrics have weakened relative to Q3's results due to Q4's trading turmoil and slowing growth in China. Of the 238 companies in the S&P 500 that have reported through mid-day Monday, just 74% exceeded industry analysts' earnings estimates. Collectively, the reporters have averaged a y/y earnings gain of 15.5% and exceeded forecasts by an average of 3.1%. On the revenue side, just 61% of companies beat their Q4 sales estimates so far, with results coming in 0.5% above forecast and 7.7% higher than a year earlier. Q4 earnings growth is positive y/y for 77% of companies, vs a higher 86% at the same point in Q3, and Q4 revenues have risen y/y for 79% vs a higher 83% during Q3. Looking at earnings during the same point in the Q3-2018 reporting period, a higher percentage of companies (79%) in the S&P 500 had beaten consensus earnings estimates by a greater 6.7%, and earnings were up a higher 25.9% y/y. With respect to revenues at this point in the Q3 season, a lower 57% had exceeded revenue forecasts by a higher 0.9%, and sales rose a greater 8.9% y/y. The results for Q4 are still subject to change as more companies report, but the slowdown in revenue and earnings growth from Q3 is becoming more apparent. Q4-2018 should mark the tenth straight quarter of positive y/y earnings growth and the 11th for revenue growth. Looking at the Q4 results ex-Financials and Real Estate, the earnings surprise improves to 3.8% from 3.1%, but earnings growth falls to 14.9% from 15.5%. The ex-Financials and Real Estate revenue surprise would be 0.6% instead of 0.5%, with revenue growth improving to 8.3% from 7.7%.

US ECONOMIC INDICATORS

Manufacturing Orders ([link](#)): Both core capital goods orders and shipments remained stalled around recent highs again in November. Nondefense capital goods orders ex aircraft (a proxy for future

business investment) fell 0.6% in November after a 0.5% gain and a 0.6% loss the prior two months. However, these orders were up a robust 6.5% y/y, accelerating steadily from September's 1.5%. Meanwhile, the comparable shipments measure (used in calculating GDP) ticked down 0.2% after rising 0.8% in October and falling 0.3% in September; these shipments rose 3.9% y/y, slowing steadily from October 2017's peak rate of 10.3%. Overall factory orders contracted 2.7% during the two months through November after expanding 2.9% the prior two months—holding around recent highs. They rose 4.1% y/y, slowing from August's 10.3%.

GLOBAL ECONOMIC INDICATORS

Global Manufacturing PMIs ([link](#)): Global manufacturing activity moved closer to stagnation in January, posting its weakest performance since August 2016—and was at the breakeven point of 50.0, excluding the US. JP Morgan's M-PMI eased for the 12th time since reaching a seven-year high of 54.4 at the end of 2017, slumping to 50.7 at the start of this year. Developed nations (to 51.8 from 52.3) continued to record stronger growth than emerging ones (49.5 from 50.3), though both have deteriorated—with the former the slowest since September 2016 and the latter contracting for the first time since June 2016. The US (54.9 from 53.8) remained one of the stronger-performing countries in January, accelerating for the third time in five months, while China (48.3 from 49.7) was the main drag, moving further into contraction territory. Meanwhile, the Eurozone (50.5 from 51.4) and Japan (50.3 from 52.6) M-PMIs fell to 50- and 29-month lows, respectively. Within the Eurozone, the following countries outperformed the area as a whole: the Netherlands (55.1, 28-month low), Greece (53.7, 3-month low), Austria (52.7, 29-month low), Ireland (52.6, 27-month low), Spain (52.4, 2-month high), and France (51.2, 3-month high); only the latter two accelerated last month, however. Meanwhile, activity in the two largest Eurozone economies contracted last month, with M-PMIs in Germany (49.7) and France (47.8) the lowest in 50 and 68 months, respectively.

US Manufacturing PMIs ([link](#)): Manufacturing activity in January accelerated, according to both the ISM and IHS Markit measures. The ISM M-PMI (to 56.6 from 54.3) recovered most of December's plunge, driven by sharp accelerations in both the new orders (58.2 from 51.3) and production (60.5 from 54.1) components, which rebounded from their lowest readings since August 2016 and October 2016, respectively, in December. The inventories (52.9 from 51.2) component also improved last month, while the employment (55.5 from 56.0) and supplier deliveries (56.2 from 59.0) measures continued to slow, though remained well above the 50.0 breakeven point. IHS Markit's M-PMI showed an acceleration in growth at the start of this year, climbing from 53.8 in December to 54.9 last month—above the long-run series average. According to the report, overall operating conditions across the manufacturing sector improved, led by faster expansions in output and new orders—driven by domestic demand; exports rose only marginally. Consequently, factories expanded their workforce at a solid rate—picking up from December's recent low.

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