



MORNING BRIEFING

February 28, 2019

Intrusive Disruptive Technology

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

(1) Holding onto gains. (2) Hot cyclicals. (3) Waiving a deadline. (4) Downturn in interest rates helps too. (5) About Facebook. (6) Our smart devices are spying on us. (7) Smile for the cameras. (8) Alexa feels your pain. (9) Your DNA can be easily traced. (10) Governments' Big Brothers have our numbers.

Strategy: Too Much Exuberance? Very little has managed to dent the stock market's confidence this year. War games in the sky between India and Pakistan barely caused investors to flinch yesterday. Neither did Michael Cohen's lengthy testimony before the House of Representatives' Committee on Oversight and Reform. Instead, Fed Chairman Jerome Powell's promise to be patient and investors' optimism about a potential trade deal with China helped the S&P 500 to retain almost all of its recent gains, amounting to 11.4% ytd through Wednesday's close.

The market's advance has been broad-based, pushing each of the S&P 500's 11 sectors solidly into positive territory so far this year through Tuesday's close: Industrials (18.1%), Information Technology (14.4), Energy (13.8), Real Estate (11.7), Consumer Discretionary (11.6), S&P 500 (11.5), Communication Services (11.4), Financials (10.9), Materials (10.3), Consumer Staples (7.0), Health Care (6.6), and Utilities (6.5) ([Fig. 1](#)).

The S&P 500's gains are actually dwarfed by the returns enjoyed by some of the most economically sensitive industries. The S&P 500 Homebuilding index has jumped 18.1% so far this year even though the data on home sales haven't been reassuring ([Fig. 2](#)). Likewise, the S&P 500 Automobile Manufacturing index jumped 18.4% ytd despite sluggish car sales ([Fig. 3](#)).

Other outperforming industries include: Copper (27.8%), Semiconductor Equipment (26.0), Personal Products (24.9), Real Estate Services (24.9), Oil & Gas Storage & Transportation (22.4), Aerospace & Defense (22.3), Casinos & Gaming (22.0), Industrial Conglomerates (20.8), Railroads (20.7), Oil & Gas Equipment & Services (20.4), and Specialty Stores (20.2). Let's take a look at what is—and isn't—driving some of these outsized gains:

(1) *Buying the rumor.* There has been progress in US/China trade negotiations. President Trump waived the March 1 deadline for a trade agreement with China and has begun preparing for a summit with Chinese President Xi Jinping.

However, China reportedly has not met US demands to end forced technology transfers. Nor have they met a laundry list of changes US business leaders would like to see, according to a 2/27 [WSJ article](#). The wish list includes: Ending foreign investment restrictions and the requirement to store data locally, eliminating requirements to have a Chinese partner, repealing government preferences for domestic suppliers in strategic sectors, ending the disclosure of source code, and using an independent arbitrator to hear intellectual property disputes.

Even though that wish list looks far from fulfilled, the stocks of many industries with exposure to China have rallied. The S&P 500 Semiconductor Equipment and Auto Manufacturing indexes both have jumped despite recent reports showing slowing semiconductor and auto sales.

Global semiconductor sales in December inched up by 0.6% y/y but fell 7.0% m/m, according to the Semiconductor Industry Association's 2/4 [press release](#) ([Fig. 4](#)). Likewise, auto sales fell during January to a five-month low of 16.7 million units (saar) from 17.6 million units in December ([Fig. 5](#)).

(2) *Interest rates helping.* The spike in the 10-year Treasury yield at the end of last year has reversed, and that appears to be helping homebuilders' stocks in anticipation of a recovery. The 10-year Treasury yield has fallen to 2.64%, down from a high of 3.24% on November 8. That, in turn, has helped the 30-year mortgage rate recede from its high last year of 4.99% to a more recent 4.35% ([Fig. 6](#)).

Homebuilders' sentiment has improved, but home sales have not, at least so far. The National Association of Home Builders' Housing Market Index improved in February for a second month, to 62, after falling to a low of 56 at the end of last year, Debbie reports. Despite an improved mood, actual sales have continued to slump. Housing starts tumbled 11.2% m/m in December, likely hurt by poor weather, and single-family permits fell m/m—for the second time in three months—by 2.9% in December ([Fig. 7](#) and [Fig. 8](#)). Investors in homebuilders' stocks have been buying nonetheless.

Information Technology I: Big Brothers Are Watching Us. The *Wall Street Journal* had an excellent series revealing how apps share users' data with Facebook without users' knowledge. So if you logged your weight, pregnancy status, or blood pressure into certain apps, Facebook got that information too, according to a 2/22 *WSJ* [article](#). In response, a number of the apps announced that they would [stop](#) sharing the data. It's the latest black eye for Facebook, but the company is far from the only organization collecting reams of data on our every move.

As the Internet of Things takes off, the data collected on our "private" behavior is exploding. Any "smart" device—cars, door locks, fitness and health wearables, security systems, speakers, and appliances—may be collecting data about us. And as cameras have gotten less expensive and identification software has improved, cameras have begun popping up in unexpected places, including advertisements and even airplane seats. Perhaps most disconcerting: DNA databases can now identify everyone, regardless of whether or not a person has provided a DNA sample.

So far, there's barely a hue and cry over privacy encroachment. The usefulness of connected items seems to outweigh privacy concerns. In fact, people in China barely blink at all the personal information the government collects. But things have a way of unexpectedly reaching a tipping point. Below, Jackie lays out numerous ways Big Brothers are watching:

(1) *Smile, you're on Candid Camera.* Cameras have gotten small and cheap, and now they're everywhere. There are dozens of hidden cameras built into Westfield shopping centers' digital advertising billboards in Australia and New Zealand. "The semi-camouflaged cameras can determine not only your age and gender but your mood, cueing up tailored advertisements within seconds, thanks to facial detection technology," according to a 2/23 [article](#) in *The Guardian*.

There are more than 1,600 billboards installed in 41 Westfield centers across Australia and New Zealand. The data collected are anonymous and collected using facial detection, not facial recognition, software. In other words, the cameras only want to know how old and cheery you are, not exactly who you are. But that seems like a distinction that could quickly be programmed away without notification.

China has more than 176 million cameras used for street surveillance, policing, and business. In cashless stores, customers pay simply by having their faces scanned. At hotels, customers can check in or pay with a facial scan, *The Guardian* article noted.

Singapore Airlines' planes have a camera in the back of seats. The airline said the cameras were put there by the plane's manufacturer and were disabled and not being used, according to this 2/19 [article](#) on CNET.

And if you think your mug is safe in the USA, think again. New York City has more than 1,600 LinkNYC kiosks, which provide free Wi-Fi to all. Almost 10 feet tall, they have screens filled with advertisements and fun facts. Each kiosk also has three cameras, 30 sensors, and heightened sight lines for viewing above crowds, according to a 9/8 [article](#) in *The Intercept*.

The kiosks are owned by CityBridge, a group of private companies including Intersection. One of Intersection's largest investors is Sidewalk Labs, which is owned by Alphabet. Sidewalk Labs CEO Daniel Doctoroff, who was also NYC's former deputy mayor of economic development, has said: "By having access to the browsing activity of people using the Wi-Fi—all anonymized and aggregated—we can actually then target ads to people in proximity and then obviously over time, track them through lots of different things, like beacons and location services, as well as their browsing activity. So, in effect, what we're doing is replicating the digital experience in physical space."

City officials say they will protect citizens' privacy. "[T]he City does not, and will never, allow the network operator—CityBridge—to exploit individual identifiers or precise location of LinkNYC users," said Samir Saini, Commissioner of the NYC Department of Information Technology and Telecommunications. However, the company doesn't undergo regular audits.

(2) *The spy at home*. Internet-connected devices in our home are increasingly common. And while that may mean added convenience, these devices and their apps may be producing—and collecting—data about you and your home. *Which?*, a UK publication akin to *Consumer Reports*, studied a number of home devices to determine what information was being collected and published results in a 6/1 [article](#).

A HP Envy 5020 printer sends to HP servers the file name, size, and number of pages being printed along with the ink being used. A Philips Sonicare Bluetooth electric toothbrush sends Philips data on users' brushing frequency and technique if the app is being used.

The ieGeek 1080p wireless security camera's app gave testers access to more than 200,000 passwords and device IDs for other ieGeek cameras. "We could then see live video feeds of other users, and talk to those users via the camera's microphone (which we didn't do). ieGeek/Sricam fixed this flaw in late March 2018, but we've subsequently found and disclosed other critical vulnerabilities with the camera and app," the article stated. The iRobot Roomba vac uses a camera to create a map of the rooms in your house that it can store in the company's cloud.

Household devices continue to get smarter. Amazon filed a patent for a new version of Alexa that can analyze speech and emotion, according to a 10/9 [article](#) in *The Telegraph*. A user who is coughing while speaking to Alexa will be offered the opportunity to buy chicken soup or cough drops at Amazon. More creepily, the device can track emotions, detect by your voice if you are bored, tired, or crying, and suggest things to do for those moods.

The Telegraph notes that a patent filing is not proof that the company is working on the features described or will be successful creating such products. But it certainly doesn't seem like a stretch.

(3) *Given away by DNA*. Here's an amazing statistic: Only 2% of people with European heritage have to share their DNA in order to identify DNA samples from the 98% of people who have not shared their DNA. So if your cousin gets her DNA tested, law enforcement officials may be able to tap into that DNA sample to identify you as the killer.

GEDmatch and FamilyTreeDNA allow law enforcement to access their data bases, according to a 2/26 Bloomberg [article](#). Police compared crime-scene DNA to DNA collected by GEDmatch. They found family bloodlines that matched the crime-scene DNA and used other social media sources to build a family tree that led to the arrest of the Golden State Killer.

(4) *The dark side*. While data from a toothbrush or pictures taken by a Wi-Fi booth may seem innocuous, it's easy to see how nefarious situations could arise. "Imagine drug companies using [DNA] to target ads, life insurers using vast networks of relatedness to determine risk, or a scorned ex-lover employing the technique in some very 21st century stalking," the Bloomberg article warned.

Trouble is already brewing in China, which ran a program dubbed "Physicals for All" in Xinjian, home to Muslim Uighurs. The government has detained up to a million Uighurs in camps to "re-educate" them and encourage them to be more subservient to the Communist Party, explains a 2/21 NYT [article](#).

Government officials collected DNA samples, iris scans, and other personal data from 36 million people in Xinjian over two years, presumably without consent. "Collecting genetic material is a key part of China's campaign, according to human rights groups and Uighur activists. They say a comprehensive DNA database could be used to chase down any Uighurs who resist conforming to the campaign," the article explained. A slippery slope indeed.

Information Technology II: Regulating Big Brother? Consider the tech industry officially on notice. Federal Trade Commission's (FTC) Bureau of Competition has [announced](#) the creation of a task force that will monitor competition in US technology markets, watching for anticompetitive conduct. The task force will include experts in online advertising, social networking, mobile operating systems and apps, and platform businesses, and it will coordinate with its counterparts in the FTC's Bureau of Consumer Protection.

Mike O'Rourke, chief market strategist at Jones Trading, highlighted the task force and its formation "under an Administration that touts itself as the most de-regulatory Administration in the history of the United States."

We'll be watching to see if the feds are watching how Big Brother is watching us.

CALENDARS

US. Thurs: Real GDP & GDP Price Deflator 2.2%/1.7%, Jobless Claims 225k, Richmond Fed Manufacturing Index, Chicago PMI 56.1, EIA Natural Gas Report, Clarida, Harker, Kaplan. **Fri:** Personal Income & Spending (Dec) 0.4%/-0.3%, Personal Income (Jan) 0.3%, Headline & Core PCED (Dec) 1.7%/1.9% y/y, Consumer Sentiment Index 95.7, ISM M-PMI 55.0, Baker-Hughes Rig Count. (Econoday estimates)

Global. Thurs: Germany CPI 0.5%/m/m/1.5%/y/y, France GDP 0.3%q/q/0.9%/y/y, UK Gfk Consumer Confidence -15, Japan Headline, Core, and Core-Core CPI 0.4%/1.0%/0.7% y/y, Japan Jobless Rate 2.4%, Japan Housing Starts 953k, China M-PMI & NM-PMI 49.5/54.5, Trump-Kim Summit. **Fri:** Eurozone Headline & Core CPI 1.5%/1.1% y/y, Eurozone Unemployment Rate 7.9%, Eurozone, Germany, France, and Italy M-PMIs 49.2/47.6/51.4/47.0, Germany Retail Sales 1.9%/m/m/1.2%/y/y,

Germany Unemployment Change & Unemployment Claims Rate -5k/5.0%, UK M-PMI 52.0, Canada GDP (annualized) 1.0%, Japan Consumer Confidence 41.6, China Caixin M-PMI 48.7. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): Stock Market Sentiment Indicators ([link](#)): The Bull/Bear Ratio (BBR) climbed this week for the seventh time in eight weeks from 0.86 (which was the lowest since mid-February 2016) to 2.57. The BBR's bullish sentiment component rose for the eighth straight week, by 22.5ppts, to a 19-week high of 52.4% from 29.9% (which was the fewest bulls since February 2016); bullish sentiment was as high as 61.8% in early October. Meanwhile, bearish sentiment has been bouncing in a narrow range between 20.4% and 22.0% the past six weeks, and was at the bottom of that range this week; it was 14.2ppts below its recent high of 34.6% eight weeks ago (which was the most bears since March 2016). The correction count fell for the fourth week, from 33.6% to 27.2%, the lowest since early October; it was at 41.1% 12 weeks ago (which was the highest percentage since late September 2015). The AAI Ratio advanced to 60.8% last week after slipping from 63.6% to 58.3% the prior week. Bullish sentiment rebounded to 39.3% last week after falling the prior week from 39.9% to 35.1%; bearish sentiment moved up for the third week from 22.8% to 25.4%.

S&P 500 Earnings, Revenues, Valuation & Margins ([link](#)): Consensus S&P 500 forward revenues and earnings forecasts both dropped for the sixth time in seven weeks. Forward revenues is now down 1.3% from a record high in early January, and forward earnings is now 2.4% below its record high in early December. Analysts expect forward revenues growth of 5.1% and forward earnings growth of 5.9%, compared to week-earlier readings of 5.0% and 6.0%, respectively. Forward revenues growth is down 1.2ppts from a seven-year high of 6.3% in February 2018 to its lowest level since August 2016, and forward earnings growth is down 11.0ppts from a six-year high of 16.9% last February to its lowest reading since April 2016. Prior to the passage of the Tax Cuts and Jobs Act (TCJA), forward revenues growth was 5.5% and forward earnings growth was 11.1%. Turning to the annual growth expectations, analysts expect revenues growth to slow from 8.6% in 2018 to 4.8% in 2019 and 5.6% in 2020. They're calling for earnings growth to slow sharply from 24.1% in 2018 to 4.2% in 2019 before improving to 11.3% in 2020. The forward profit margin remained steady w/w at a nine-month low of 12.1%, and is down 0.3ppt from a record high of 12.4% in mid-September. Still, 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's forward P/E rose to a 20-week high of 16.4 from 16.2. That's up from 14.3 during December, which was the lowest reading since October 2013 and down 23% from the 16-year high of 18.6 at the market's valuation peak in late January. The S&P 500 price-to-sales ratio of 1.98 is up from 1.96 a week earlier and 1.75 during December, which was the lowest since November 2016 and down 19% from a record high of 2.16 in late January.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins ([link](#)): Consensus forward revenues rose w/w for four of the 11 sectors, but forward earnings was higher for just one sector. Real Estate was the only sector to have both measures rise w/w. In addition, Energy continued to have both measures fall the fastest of all the sectors. Forward revenues and earnings are at or around record highs for 4/11 sectors: Consumer Discretionary, Health Care, Industrials, and Tech. The forward profit margin is rolling over from recent highs for all but Financials and Utilities. They were at record highs during 2018 for 8/11 sectors, all but Energy, Health Care, and Real Estate. Energy's forward earnings had about tripled from the 18-year low in April 2016 through early November, but has tumbled 25.5% since then. Forward P/S and P/E ratios are now well below their 2018 highs for all sectors, and had been at multi-year lows during December for five sectors: Energy, Financials, Industrials, Materials, and Tech. Energy's forward P/E of 17.8 is on the rise again as earnings deteriorate. Due to the TCJA, margins rose y/y in 2018 for all sectors but Real Estate, but that sector's earnings includes gains from

property sales, which typically are infrequent. The outlook for 2019 shows lower margins are now expected y/y for 7/11 sectors: Communication Services, Consumer Staples, Energy, Health Care, Information Technology, Materials, and Real Estate. During the latest week, the forward profit margin actually improved 0.2ppt for Communication Services, and dropped for three sectors: Consumer Staples, Energy, and Materials. Nine sectors are down from record highs just a few months ago. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (22.2%, down from 23.0%), Financials (18.9, down from 19.2), Real Estate (15.2, down from 17.0), Communication Services (14.8, down from 15.4), Utilities (12.8, down from 13.0), S&P 500 (12.1, down from 12.4), Materials (10.6, down from 11.6), Health Care (10.5, down from 11.2), Industrials (at a record high of 10.3), Energy (6.7, down from 8.0), Consumer Discretionary (7.5, down from 8.3), and Consumer Staples (7.4, down from 7.7).

S&P 500 Q4 Earnings Season Monitor ([link](#)): With over 92% 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 461 companies in the S&P 500 that have reported through mid-day Wednesday, just 70% exceeded industry analysts' earnings estimates. Collectively, the reporters have exceeded forecasts by an average of 3.5% and averaged a y/y earnings gain of 14.4%. If those results hold until the end of the quarter, it would mark the smallest earnings beat since Q2-2014 and the slowest y/y growth since Q3-2017. On the revenue side, just 61% of companies beat their Q4 sales estimates so far, with results coming in 0.6% above forecast and 5.9% higher than a year earlier. That marks the smallest revenue beat since Q4-2016, and revenue growth is the slowest in five quarters. Earnings growth is positive y/y for 71% of companies, versus a higher 87% at the same point in Q3, and Q4 revenues have risen y/y for 75% versus a higher 83% during Q3. Looking at earnings during the same point in the Q3-2018 reporting period, a higher percentage of companies (78%) in the S&P 500 had beaten consensus earnings estimates by a greater 6.8%, and earnings were up a higher 27.9% y/y. With respect to revenues at this point in the Q3 season, a slightly lower 61% had exceeded revenue forecasts by a higher 1.4%, and sales rose a greater 8.7% y/y. Excluding the Financials sector, the earnings surprise improves to 4.5% from 3.5%, and the revenue beat edges up to 0.7% from 0.6%. With less than 8% of the companies left to report, the Q4 results are not likely to change drastically. Q4-2018 should mark the tenth straight quarter of positive y/y earnings growth and the 11th of positive revenue growth, but the slowdown in revenue and earnings growth from Q3 is readily apparent.

US ECONOMIC INDICATORS

Manufacturing Orders & Shipments ([link](#)): Core capital goods orders fell during four of the final five months of 2018, while core capital goods shipments were stalled around record highs. Nondefense capital goods orders ex aircraft (a proxy for future business investment) sank a downwardly revised 1.0% (from -0.7%) in December and 2.4% from July's cyclical high, while the comparable shipments measure (used in calculating GDP) showed no gain in December, after a 0.2% loss and a 0.8% gain the previous two months. Core capital goods orders contracted 4.1% (saar) during Q4-2016, the weakest quarterly performance since Q2-2016 and down from Q2's double-digit gain of 10.6%. The comparable shipments measure expanded 1.5% (saar) last quarter, slowing from Q3's 6.8% pace. Total factory orders ticked up 0.1% after a two-month decline of 2.7%, as a jump in volatile civilian aircraft orders was offset by widespread declines in other components. Excluding transportation, orders fell 0.6% in December and 1.9% the last two month of 2018.

Pending Home Sales ([link](#)): The Pending Home Sales Index (PHSI)—measuring sales contracts for existing-home purchases—rebounded in January after sinking to nearly a five-year low in December. January's PHSI jumped 4.5% after falling the final three months of 2018, though still fell 2.3% y/y—the thirteenth straight month of annual decreases. According to Lawrence Yun, NAR's chief economist: "A

change in Federal Reserve policy and the reopening of the government were very beneficial to the market. . . . Homebuyers are now returning and taking advantage of lower interest rates, while a boost in inventory is also providing more choices for consumers." Regionally, sales rose in all four regions last month, led by the South, while only sales in the Northeast were above year-ago levels. Here's a tally: South (8.9%m/m & -3.1%y/y), Northeast (1.6 & 7.6), Midwest (2.8 & -0.3), and West (0.3 & -10.1).

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