



MORNING BRIEFING

March 4, 2019

The Truth About Buybacks

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

(1) Older, but wiser. (2) A simple model of the bull market driven by share buybacks. (3) Why aren't earnings per share growing much faster than aggregate earnings? (4) Goldman says corporations will continue to be biggest buyers of stocks. (5) Contrary to popular belief, few buybacks benefit shareholders. (6) Buybacks are mostly offsetting the dilution resulting from stock grants. (7) Three measures of shares outstanding down only modestly during current bull market. (8) Dividend payouts are the only true cash return to investors and remain around 50% of after-tax profits. (9) Fed's data on buybacks widely misinterpreted. (10) Progressive politicians should leave buybacks alone. (11) Movie review: "Free Solo" (+ + +).

Buybacks I: Having My Doubts. As we age, most of us get wiser. We learn from our experiences, successes, and failures. Birthdays are good times to reflect on the lessons of our past. I will be 69 years old on March 15. The bull market will be 10 years old on March 9. Looking back, I must say that it's been a great run for me, because I've been consistently bullish since mid-March 2009. Actually, my critics have sometimes accused me of being a perma-bull. I view that as a compliment rather than as an insult. I won't mind if my tombstone says, "He was mostly bullish, and mostly right." In my book [Predicting the Markets](#) (2018), I review the first 40 years of my career on Wall Street, during which stock prices mostly went up.

One of the main reasons I have been bullish during the current bull market is the proliferation of corporate stock buybacks. Early on during the current bull market, the bears were growling that stock prices were on a "sugar high" and "running on fumes." They claimed that the economy remained weak and vulnerable to another recession. Earnings, they claimed, were boosted by cost-cutting without much help from revenues. I argued that the economy was recovering and so were revenues and earnings. The bears countered that the data showed that neither individual nor institutional investors were buying stocks, which meant that stock prices couldn't continue to rally.

I argued that the mounting pace of stock buybacks meant that corporations were likely to be the big buyers of their own shares. I attributed this development to rising profits and cash flow and a significant spread between the forward earnings yield of the S&P 500 and the after-tax cost of borrowing money in the corporate bond market ([Fig. 1](#)). In a sense, this spread revived the Fed's Stock Valuation Model, but as a corporate finance model rather than as a stocks-vs-bonds asset allocation model. I showed that there was a strong correlation between the S&P 500 and the sum of S&P 500 buybacks and dividends ([Fig. 2](#)).

It was a simple analysis of what was driving the bull market, and it worked very well for me. However, along the way, I had two major unanswered questions about this model:

(1) Foremost was that there wasn't much difference between the growth rates of S&P 500 earnings per share and aggregate earnings. Surely, if corporations were buying back their shares to the tune of several hundred billion dollars per year, the former should grow measurably faster than the latter. That

wasn't happening and didn't support the widespread view—which remains widespread—that the whole point of buybacks is to increase earnings *per share* to drive up stock prices. I knew that buybacks must be bullish, but that belief wasn't confirmed by the relatively narrow spread between the growth rates of aggregate and per-share earnings.

(2) The [*Financial Accounts of the United States*](#), compiled quarterly by the Fed, has data for nonfinancial corporations that seemed to corroborate my simple model and the now-widespread view that the activity of corporate repurchasers has driven the bull market, not the activity of investors. Indeed, the data backed up the basic premise of a 2/25 NYT [article](#) by ace financial reporter Matt Phillips titled “This Stock Market Rally Has Everything, Except Investors.” Here is the introduction of the piece:

“Armchair investors have been selling stock. So have pension funds and mutual funds, as well as a whole other category of investors—nonprofit groups, endowments, private equity firms and personal trusts. The stock market is off to its best start since 1987, but these investors are expected to dump hundreds of billions of dollars of shares this year. So who is pushing prices higher? In part, the companies themselves. American corporations flush with cash from last year's tax cuts and a growing economy are buying back their own shares at an extraordinary clip. They have good reason: Buybacks allow them to return cash to shareholders, burnish key measures of financial performance and goose their share prices. The surge in buybacks reflects a fundamental shift in how the market is operating, cementing the position of corporations as the single largest source of demand for American stocks.”

That's exactly the story I've been telling during the bull market. It's now the consensus view, as evidenced by Matt's story, which was based partly on flow-of-funds projections by Goldman Sachs. Now that Goldman has embraced my spin on the bull market, that's all the more reason to question the underlying premise of the consensus view of buybacks. The urgency of getting to the true story has been heightened by the sudden interest of politicians to regulate, if not ban, buybacks, as I discussed in the 2/20 [Morning Briefing](#) titled “In Praise of Folly: Stopping Stock Buybacks.”

Buybacks II: Right for the Wrong Reason. I've come to the conclusion that I've been right for the wrong reason. The true story is hiding in plain sight. As I wrote in my 2/20 analysis, here is the reason that buybacks haven't boosted per-share earnings:

“[T]he S&P 500 companies are mostly buying back their shares to offset the dilution of their shares resulting from compensation paid in the form of stocks that vest over time, not just for top executives but also for many other employees. So the latest bull market has been driven by rising earnings, but they haven't been artificially boosted on a per-share basis by stock buybacks! Nevertheless, buybacks might have provided a lift to stock prices since the buybacks occur in the open market, while the issuance of stock as compensation has no immediate market impact, especially if not yet vested.”

And here is the whole truth, and nothing but the truth, about buybacks (as I now see it):

(1) *Buybacks are not designed “to return cash to shareholders,”* as widely believed. While dividends are paid directly to investors, buybacks don't have any direct impact on investors. Most buybacks result in equities getting purchased in the open market to offset stocks distributed to corporations' employee stock plans. Those shifts from unconstrained sellers to constrained buyers (who can't sell until their stock awards vest) might have a net bullish impact that indirectly benefits all investors.

(2) *Buybacks don't increase earnings on a per-share basis,* not significantly anyway. They transfer stocks from open-market sellers to corporate buyers, who then pay some of their employees' compensation through participation in the companies' employee stock plans.

(3) *Buybacks shouldn't be compared to profits.* The cost of buying back shares for the purpose of covering the obligations of employee stock plans is in effect treated as a compensation-related expense in calculating profits. So: It makes zero sense to compare the amount that S&P 500 corporations spend on buybacks to their after-tax profits, as is often done (and in the past done even by yours truly)! Money spent on buybacks (to cover employee stock plan obligations) doesn't come out of the after-tax profits pool as dividend payouts and capital outlays do. So the contention that money used for buybacks would be better invested in growth of the business is faulty.

(In the National Income & Product Accounts [NIPA], dividend distributions, on the other hand, do come out of after-tax profits, leaving undistributed profits. These undistributed profits, along with cash flow from the depreciation allowance, can be spent on capital outlays. The cost of the buybacks that are turned around as stock compensation to employees is reflected in the income statement as an expense.)

(4) *Buybacks aren't accorded an advantage over dividends by the tax code.* While buybacks may have a bullish impact on stock prices, there's certainly no guarantee that stock prices can't fall even for corporations that are buying back their shares. This discredits the notion that companies prefer buybacks because capital gains are taxed at a lower rate than dividend income. If my basic premise is correct, companies don't view buybacks as a way to return cash to shareholders but rather as a way to offset all or most of the dilution caused by stock compensation. Dividends remain the way that companies return cash to shareholders.

Buybacks III: Deep Dive into the Data. Now let's put on our diving suits and take a deep dive into the pool of relevant data:

(1) *Buybacks galore.* S&P 500 buybacks totaled \$4.5 trillion since the start of the bull market during Q1-2009 through Q3-2018, while dividends totaled \$3.1 trillion. Over this same period, the market capitalization of all equity issues traded in the US soared by \$36.3 trillion ([Fig. 3](#)).

Dividends are the best tangible confirmation of earnings. The percentage of S&P 500 companies paying dividends rose from 73% during 2009 to 82% during 2018 ([Fig. 4](#)). In a low-interest-rate environment, they attracted lots of yield-hungry investors, driving stock prices higher.

In my narrative, buybacks have more to do with paying employees with stock grants than returning cash to shareholders. Current-dollar labor compensation totaled \$91.5 trillion from 2009 through 2018. A small portion of that reflected the stock grants.

(2) *Keeping track of the share count.* Buybacks have returned cash to shareholders and boosted earnings per share, but not by much. That's clear when we see that three measures of shares outstanding have fallen only modestly since the start of the bull market. The S&P 500 divisor is used to ensure that changes in shares outstanding, capital actions, and the addition or deletion of stocks to the index do not change the level of the index. It is down 3.3% over the 10-year period, or only 0.3% per year on average ([Fig. 5](#)). That's a tiny contribution to earnings-per-share growth ([Fig. 6](#)).

The divisor is highly correlated with two alternative measures that Joe and I have concocted. For one, we divide the Fed's series on the market value of all equities traded in the US by the S&P 500 stock price index ([Fig. 7](#)). Joe also constructed a series showing total shares outstanding for current S&P 500 companies with data for all periods and adjusted for stock splits and stock dividends ([Fig. 8](#)). His measure is down only 1.9% from Q1-2009 through Q3-2018! (In tomorrow's *Morning Briefing*, we will have more details on Joe's measure.)

(3) *Dividend payout ratio remains around 50%.* Collectively, since the mid-1960s, the corporate dividend payout ratio (dividends divided by after-tax S&P 500 reported earnings, or NIPA book profits) has fluctuated around 50% ([Fig. 9](#)). There's no sign that this ratio has been at all affected by buyback activity.

So historically, corporations have tended to return cash to shareholders with a 50% dividend payout relative to after-tax profits. The notion that buybacks have nearly doubled this measure of corporate largess to investors to close to 100% of profits makes no sense whatsoever ([Fig. 10](#)).

This means that the notion of the S&P 500 having a “buyback yield” comparable to the dividend yield makes no sense either ([Fig. 11](#)). In my narrative, it is a meaningless concept!

(4) *Accounting for employee stock options.* A February 2008 BEA Briefing [reported](#): “NIPA accounting and tax accounting have always treated employee stock options as an expense only when (and if) options are exercised. It is an operating expense and therefore always a cost deduction in the NIPA profits calculation.” Prior to 2006, “GAAP option expense reporting was completely at a company’s discretion and reported as a nonoperating expense or, often, not reported at all. Since 2006, options grant expense was mandated by GAAP. It was included in the Standard & Poor’s reporting starting in 2006 as an operating profits deduction.”

Buybacks IV: The Fed’s Method to the Accounting Madness. All of the above brings me back full circle to the NYT article linked above, which cited Goldman data showing that only corporations are buying equities. The data comes from the Fed, and it shows that nonfinancial corporations (NFC) have been huge buyers of stocks for the past 15 years, as retirements (i.e., resulting from buybacks and M&A activity) well exceed gross issuance (including initial public offerings, seasoned equity offerings, and private equity). Not surprisingly, the Fed’s series for net NFC equity issuance is highly correlated with the S&P 500 buybacks series, which the Fed uses to compile its series ([Fig. 12](#), [Fig. 13](#), [Fig. 14](#), [Fig. 15](#), and [Fig. 16](#)).

What it does not include is employee stock plans. At first, I thought that must be a remarkable oversight. However, it makes lots of sense within the context of the Fed’s financial accounting system. It also happens to confirm my narrative. As I concluded above, buybacks have very little to do with returning cash to investors or boosting earnings per share by reducing the number of shares outstanding. They are mostly driven by stock compensation plans. So buybacks are mostly about the process of redistributing shares from public-market sellers to employees.

The Fed’s website includes a [note](#) titled “Equity Issuance and Retirement by Nonfinancial Corporations.” It carefully explains how the data series on equity issuance is constructed. It states:

“The figure also indicates that equity retirements have been consistently greater than issuances over this period, resulting in the negative values for net equity issuance reported in the Financial Accounts of the United States. This reflects the continued importance of share repurchases as a means of distributing earnings to shareholders, due in part to the tax advantage to shareholders of repurchases when compared to dividend payouts (see Brown et al., 2007). In addition, firms also use repurchases to offset the dilution of existing shareholders that occurs through the granting of equity to employees and executives, a common incentive compensation device.”

I disagree with all but the first and last sentences of this statement.

Buybacks V: Politicians Meddling. Progressive politicians are pouncing on buybacks as a major

source of income and wealth inequality, subpar capital spending, and lackluster productivity. (At least they aren't blaming buyouts for climate change.) I countered these concerns in my previous piece on buybacks cited above. I also observed that it was progressive politicians who passed a law in 1993 that limited the deductibility of an executive's pay above \$1 million in cash, which led to the proliferation of stock grants. (In tomorrow's *Morning Briefing*, we will discuss how Trump's tax reform changed the rules again.)

I'm coming around to believe that corporations should pay more of their employees even more in stock grants. As passive investing gains market share from managed investing, there will be fewer shareholders concerned about corporate governance matters. If more employees become bigger stakeholders as they accumulate shares, their opinions on such matters will carry more clout. They might even push and get some seats on their boards. That should make progressives very happy.

Movie. "Free Solo" (+ + +) ([link](#)) is an edge-of-your-seat documentary about Alex Honnold, a daredevil rock climber. The film won Best Documentary Feature at the 91st Academy Awards. Alex climbs sheer precipices around the world without any ropes, which is called "free solo." He views himself as a warrior who must go into a fight to win or accept the fact that he will die. Several of his peers have died in recent years when they lost their footing. The movie shows Alex preparing to achieve his lifelong dream, climbing the 3,000-foot El Capitan In Yosemite National Park. There's even a touching love story along the way, as Alex's girlfriend remains amazingly understanding of Alex's need to achieve perfection even though the alternative is certain death. Sometimes, my job raises the same stark choices, though I always wear a parachute just in case.

CALENDARS

US. Mon: Motor Vehicle Sales, Construction Spending 0.6%. **Tues:** ISM & IHS Markit NM-PMIs 57.2/56.2, New Home Sales 591k, Treasury Budget \$0.0b, Rosengren. (Econoday estimates)

Global. Mon: Eurozone Sentix Investor Confidence -3.1. **Tues:** Eurozone Retail Sales 1.3%_{m/m}/2.1%_{y/y}, Eurozone, Germany, France, and Italy C-PMIs 51.4/52.7/49.9/48.6, Eurozone, Germany, France, and Italy NM-PMIs 52.3/55.1/49.8/49.5, UK C-PMI & NM-PMI 50.1/50.0, Italy GDP -0.2%_{q/q}/0.1%_{y/y}, Japan C-PMI & NM-PMI, China Caixin NM-PMI 53.5, RBA Cash Rate Target 1.50%, Carney, Lowe. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance ([link](#)): Last week saw the US MSCI index rise 0.4% for its ninth gain in 10 weeks. That performance ranked 22th of the 49 global stock markets we follow in a week when 25/49 countries rose in US dollar terms. That compares to the prior week's 37/49 ranking, when the US MSCI gained 0.6% and 41 markets rose. The AC World ex-US index rose 0.2% compared to a 1.9% gain a week earlier, and has also risen in nine of the past 10 weeks. EMU was the best-performing region with a gain of 1.8%, ahead of EAFE (0.5%) as most regions underperformed the AC World ex-US. EM Latin America was the worst performer with a drop of 4.3%, followed by EM Eastern Europe (-0.9), EMEA (-0.6), BRIC (-0.2), and EM Asia (0.1). Belgium was the best-performing country, rising 6.1%, followed by Ireland (3.0), Austria (3.0), Greece (2.7), and Italy (2.3). Of the 25 countries that underperformed the AC World ex-US MSCI last week, Argentina fared the worst, falling 8.4%, followed by Chile (-5.4), Brazil (-4.9), and Egypt (-4.6). In February, the US MSCI rose 3.1%, ranking 15/44. The developed market regions all rose in February as the AC World ex-US index gained 1.8%. That compares to the US MSCI's 8.1% surge in January, which was its best since October 2011 and ranked 22/49, ahead of the 7.5% gain for the AC World ex-US in its best month since March 2016 as all regions rose. The best-performing regions in February: EMU (3.1), and EAFE (2.3). February's worst-

performing regions: EM Latin America (-4.3), EMEA (-2.4), EM Eastern Europe (-2.3), BRIC (1.1), and EM Asia (1.6). The US MSCI ranks 11/49 so far in 2019, with its 12.2% ytd gain ahead of that of the AC World ex-US (9.6). All regions and nearly all countries are in positive territory ytd. Among the regions, those outperforming the AC World ex-US ytd include: BRIC (11.5), EMU (10.6), and EM Asia (9.6). Regions underperforming the AC World ex-US: EMEA (6.7), EM Eastern Europe (8.2), EM Latin America (8.2), and EAFE (9.2). The best country performers ytd: Colombia (19.7), China (16.0), Egypt (16.0), Belgium (15.9), and Canada (15.7). The worst-performing countries so far in 2019: Morocco (-2.3), India (-1.2), and Sri Lanka (-0.8).

S&P 1500/500/400/600 Performance ([link](#)): Only one of these three indexes rose last week. LargeCap rose 0.4%, ahead of the declines for MidCap (-0.4%) and SmallCap (-0.9). LargeCap was up for a fifth straight week, but MidCap's decline was its first in 10 weeks and ended its best winning streak in 20 years. All these indexes remain below their record highs. LargeCap ended the week 4.3% below its record high on September 20, with MidCap and SmallCap 6.1% and 10.9% below their August 29 records, respectively. Among the 33 sectors, 13 moved higher last week compared to 26 rising a week earlier. The biggest gainers in the latest week: MidCap Communication Services (2.6%), SmallCap Consumer Discretionary (1.3), Small Communication Services (1.3), LargeCap Energy (1.1), and LargeCap Information Technology (1.0). SmallCap Real Estate (-3.2) was the biggest decliner last week, followed by MidCap Real Estate (-2.6), SmallCap Utilities (-2.1), and SmallCap Industrials (-1.9). All three of these market-cap indexes extended their gains in February after soaring in January. SmallCap and MidCap rose 4.2% and 4.1%, respectively, ahead of the 3.0% gain for LargeCap. Twenty-nine of the 33 sectors advanced in February, compared to all 33 sectors rising during January in what was then the broadest gain since March 2016. February's best performers: MidCap Information Technology (9.5), SmallCap Materials (7.9), SmallCap Information Technology (6.7), LargeCap Information Technology (6.6), and LargeCap Industrials (6.1). February's laggards: MidCap Energy (-3.3), MidCap Real Estate (-1.0), SmallCap Utilities (-0.1), and SmallCap Real Estate (-0.1). In terms of 2019's ytd performance, all three indexes are off to a great start. SmallCap and MidCap are both up 15.8% ytd, followed by LargeCap (11.8). All 33 sectors are positive ytd, with the SmallCap and MidCap cyclicals leading the top performers: SmallCap Materials (26.9), SmallCap Energy (22.8), MidCap Tech (22.4), SmallCap Tech (20.0), and MidCap Communication Services (18.3). The "stable" sectors are dominating the biggest underperformers so far in 2019: SmallCap Utilities (5.0), LargeCap Consumer Staples (7.0), LargeCap Utilities (7.2), LargeCap Health Care (7.2), MidCap Consumer Staples (7.8), and MidCap Utilities (7.8).

S&P 500 Sectors and Industries Performance ([link](#)): Seven of the 11 of the sectors rose last week, and four outperformed the S&P 500's 0.4% gain. That compares to nine rising a week earlier, when six outperformed the S&P 500's 0.6% gain. Energy was the best-performing sector, with a gain of 1.1%, ahead of Information Technology (1.0%), Financials (0.8), and Communication Services (0.6). Materials (-1.6) was the biggest decliner, following by these underperforming sectors: Real Estate (-1.2), Consumer Staples (-0.4), Utilities (-0.1), Consumer Discretionary (0.1), Industrials (0.2), and Health Care (0.3). The S&P 500 rose 3.0% in February as all 11 sectors moved higher and four beat the index. That compares to all 11 rising and six beating the S&P 500's 7.9% rise in January, the best January since 1987 and the best month for the index since October 2011. The leading sectors in February: Information Technology (6.6), Industrials (6.1), Utilities (3.6), and Materials (3.0). February's laggards, albeit with gains: Consumer Discretionary (0.6), Communication Services (0.8), Real Estate (0.8), Health Care (1.0), Energy (1.9), Consumer Staples (2.1), and Financials (2.2). All 11 sectors are higher so far in 2019, compared to just two sectors rising during 2018, when the S&P 500 fell 6.3%. These four sectors are outperforming the S&P 500's 11.8% rise ytd: Industrials (18.2), Energy (15.2), Information Technology (14.8), and Consumer Discretionary (12.0). The ytd laggards, albeit with gains: Consumer Staples (7.0), Utilities (7.2), Health Care (7.2), Materials (8.5), Real Estate (11.5), Financials (11.6), and Communication Services (11.8).

Commodities Performance ([link](#)): Last week, the S&P GSCI index fell 1.9% as nine of the 24 commodities moved higher. That compares to a 1.4% gain a week earlier, when 18 commodities moved higher. The index is still in a correction with a drop of 16.2% from its high in early October after being down as much as 26.9% on December 24. Natural Gas was last week's strongest performer, rising 4.4%, followed by Lead (3.3%), Zinc (2.4), Lean Hogs (1.7), and Nickel (1.5). Wheat was the biggest decliner, with a drop of 7.0%, followed by Sugar (-5.1), Silver (-4.7), and Kansas Wheat (-4.6). February saw 10 of the 24 commodities climb as the S&P GSCI Commodities index rose 4.5%. That compares to 20 rising in January, which was the most since September 2016, as the S&P GSCI Commodities index surged 9.0% higher. February's best performers were Unleaded Gasoline (27.2), Brent Crude (9.0), Heating Oil (8.0), GasOil (6.6), and Crude Oil (6.4). February's laggards: Wheat (-11.0), Kansas Wheat (-10.9), Lean Hogs (-7.2), and Coffee (-7.0). The S&P GSCI commodities index is up 12.6% ytd following a decline of 15.4% in 2018. The top-performing commodities so far in 2019: Unleaded Gasoline (32.9), Nickel (23.5), Crude Oil (22.9), Brent Crude (20.9), and GasOil (19.4). The biggest laggards in 2019: Wheat (-9.1), Kansas Wheat (-9.0), Cocoa (-8.2), Lean Hogs (-7.5), and Natural Gas (-2.8).

S&P 500 Technical Indicators ([link](#)): The S&P 500 price index was up 0.4% last week, weakening relative to its short-term 50-day moving average (50-dma) and improving relative to its long-term 200-day moving average (200-dma). The index's 50-dma relative to its 200-dma improved for the fourth time in five weeks, but was in a Death Cross for a 13th week; it had been in Golden Cross for 137 weeks through late November. It was last in a Death Cross for 17 weeks through April 2016 when its 50-dma bottomed at a then-four-year low of 4.5% below its 200-dma in March 2016. The current Death Cross reading of -3.5% is up from -5.2% in early February, which had matched the lowest reading since November 2011. It's still down from a 55-month high of 7.2% in February 2018. The S&P 500's 50-dma rose for the fourth time in five weeks, after falling for 16 straight weeks in its worst downtrend since before the 2016 election. The index closed 5.8% above its rising 50-dma, down from 6.6% a week earlier, which was its highest since October 2011. That compares to a seven-year low of 12.0% below at the end of December. The 200-dma rose for a fifth week after falling in 11 of the prior 15 weeks in the first downtrend since May 2016, when it had been slowly declining for nine months. The S&P 500 improved to a 20-week high of 2.1% above its rising 200-dma from 1.7% a week earlier. That compares to 14.5% below its falling 200-dma on December 24, which was the lowest since April 2009. However, it remains well below the seven-year high of 13.5% above its rising 200-dma during January 2018.

S&P 500 Sectors Technical Indicators ([link](#)): All 11 of the S&P 500 sectors traded above their 50-dmas for a fifth straight week, and for the first time since early August. That's a dramatic improvement from eight weeks ago when all 11 were below. The longer-term picture—i.e., relative to 200-dmas—shows eight sectors trading above currently, unchanged from a week earlier. When Utilities was the only sector above its 200-dma during December, that had been the lowest count since all 11 were below in January 2016, and was a relatively swift reversal from the September 26 alignment, when all 11 sectors were above their 200-dmas. During the recent correction, two long-term 200-dma leaders left the building: Tech fell below its 200-dma for the first time in 121 weeks, and Consumer Discretionary fell below its 200-dma for the first time in 102 weeks. These three sectors still trade below their 200-dmas: Energy, Financials, and Materials. Just two sectors remain in the Golden Cross club (with 50-dmas higher than 200-dmas), unchanged from a week earlier: Real Estate (34 straight weeks) and Utilities (30). At the end of November, Consumer Discretionary and Tech left the club for the first time since April 2016. Among the laggards, Financials has been out of Golden Cross territory for 19 straight weeks and during 31 of the past 35 weeks, Materials has been out for 43 straight weeks, Energy for 15 weeks, and Industrials for 14 weeks. All 11 sectors had been in a Golden Cross in January 2018 (for the first time since a 26-week streak ended in October 2016). All 11 sectors have rising 50-dmas, unchanged from a week earlier when Utilities and Consumer Staples turned up. Eight

sectors have rising 200-dmas, also unchanged from a week earlier when Tech turned positive. Energy, Financials, and Materials are the only members of the falling 200-dma club. That compares to just two sectors with a rising 200-dma in early January in what was then the lowest count since all 11 sectors had falling 200-dmas two years before.

US ECONOMIC INDICATORS

GDP ([link](#)): Real GDP growth slowed for the second quarter during Q4, though accelerated for 2018 as a whole. The US economy expanded 2.6% (saar) during the final quarter of 2018, slowing from 3.4% during Q3 and 4.2% during Q2. For all of 2018, GDP accelerated 2.9% from 2.2% in 2017 and 1.6% in 2016. Real personal consumption expenditures grew a still-healthy 2.8% (saar) during the final quarter of 2018, though not as robust as the gains of 3.5% and 3.8% the prior two quarters. Consumer goods consumption expanded 3.9% (saar), slowing steadily from Q2's 5.5%, while growth in services consumption eased to 2.4% (saar) after accelerating 3.2% during Q3. Within goods consumption, spending on consumer durable goods sped up 5.9% (saar) last quarter from 3.7% during Q3—led by spending on cars & trucks—while nondurable goods growth eased from 4.6% to 2.8%. Meanwhile, real nonresidential fixed investment gained momentum, growing 6.2% (saar) last quarter—more than double Q3's 2.5% pace. Spending on intellectual property products and equipment gained speed, expanding 13.1% (saar) and 6.7%, respectively, more than offsetting a 4.2% decline in structures last quarter. Also booting GDP growth was private inventory investment (to \$97.1 billion from \$89.8 billion, saar), which was the strongest in more than three years. As for government spending, a 1.6% (saar) increase in federal government spending more than offset a 0.3% dip in state & local government expenditures, with overall spending eking out a 0.4% uptick. Trade was a drag on growth, with the net exports gap widening to a record -\$963.2 billion (saar) last quarter as imports (2.7%, saar) grew at a faster pace than exports (1.6). Real residential investment fell every quarter of 2018, contracting 3.5% (saar) last quarter after a nearly identical decline during Q3.

Contributions to GDP Growth ([link](#)): Real consumer spending once again was the number-one contributor to GDP growth last quarter; real residential investment and trade were the only drags. Some details: (1) Real consumer spending accounted for 1.92ppts of real GDP growth last quarter, boosted by services (1.11), though consumer durable (0.41) and nondurable (0.39) goods consumption also contributed. (2) Nonresidential fixed investment (0.82) continued to elevate economic growth, as positive contributions from intellectual property products (0.56) and equipment (0.39) more than offset the second straight negative contribution from structures (-0.13). (3) Inventory investment (0.13) rounded out the top three, with nonfarm (0.15) inventories accounting for the entire gain. (4) Real government spending (0.07) added marginally to GDP growth last quarter, as a gain in federal (0.10) spending more than offset a slight setback in state & local government spending (-0.03). (5) Trade (-0.22) subtracted from growth for the second quarter, driven entirely by imports (-0.41); exports added 0.19ppt. (6) Residential investment (-0.14) subtracted from GDP growth for fourth consecutive quarter.

Consumer Sentiment ([link](#)): “The bounce-back from the end of the federal shutdown faded in late February,” Richard Curtin, director of the Michigan survey, said in a statement. “While the overall level of confidence remains diminished, it is still quite positive.” The overall Consumer Sentiment Index climbed to 93.8 last month, below the 95.5 mid-month reading, after sinking to 91.2 in January—which was the lowest since October 2016; it was at a 14-year high of 101.4 last March. The expectations component rebounded to 84.4 (vs 86.2 preliminary) after falling steadily from 90.5 in September to a 27-month low of 79.9 in January, as long-term inflation expectations fell to the lowest level in the past half-century. The present situation component ticked down to 108.5 (vs 110.0 preliminary), after sinking from 116.1 to 108.8 in January; it was at a record high of 121.2 just 11 months ago.

GLOBAL ECONOMIC INDICATORS

Global Manufacturing PMIs ([link](#)): Global manufacturing activity moved closer to stagnation in February, posting its weakest performance since June 2016. JP Morgan's M-PMI eased for the 14th time since reaching a seven-year high of 54.4 at the end of 2017, slumping to 50.6 last month. Developed nations (to 50.4 from 51.8) and emerging ones (50.6 from 49.5), both were just above 50.0, though the latter improved, moving back into expansionary territory after contracting in January for the first time since June 2016. M-PMIs were above the global average of 50.6 in the US (53.0 from 54.9), UK (52.0 from 52.6), India (54.3 from 53.9), Brazil (53.4 from 52.7), Mexico (52.6 from 50.9), Canada (52.6 from 53.0), and Australia (52.9 from 53.9). Meanwhile, the Eurozone's (49.3 from 50.5) manufacturing sector contracted in February for the first time since June 2013, while Japan's was negative for the first time since August 2016; China's M-PMI (49.9 from 48.3) recovered to just below the breakeven point of 50.0. Within the Eurozone, Greece (54.2, 9-month high), Ireland (54.0, 2-month high), and France (51.5, 5-month high) were the only ones to accelerate last month, while the Netherlands (52.7, 32-month low), Austria (51.8, 37-month low), Spain (49.9, 63-month low), Italy (47.7, 69-month low), and Germany (47.6, 74-month low) continued to deteriorate—with only the last three below the global average.

US Manufacturing PMIs ([link](#)): Manufacturing activity in February slowed, according to both the ISM and IHS Markit measures. The ISM M-PMI (to 54.2 from 56.6) reversed January's rebound, falling to its lowest level since November 2016 last month. Both the new orders (55.5 from 58.2) and production (54.8 from 60.5) components eased, though were still at elevated levels. The employment (52.3 from 55.5) measure fell for the third month, to its lowest reading since November 2016, while supplier deliveries (54.9 from 56.2) eased for the fourth month to a 21-month low. Meanwhile, the inventories (53.4 from 52.8) component improved for the second month. IHS Markit's M-PMI showed manufacturing activity was at an 18-month low, falling from 54.9 to 53.0 last month. According to the report, production increased at the slowest rate since September 2017—and below the long-run trend. Similarly, new business received by manufacturers expanded at a slower rate in February, recording its weakest showing since mid-2017.

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