



MORNING BRIEFING

April 3, 2019

Room with a View

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

(1) A CEO summit. (2) Avoiding cabin fever. (3) Anxiety about an imminent recession turns to concerns about high valuations. (4) S&P 500 revenues and earnings growth rates may be starting to bottom. (5) What about the earnings recession? (6) Flying to record highs with the Blue Angels. (7) Sentiment on outlook for China and the global economy improving. (8) What's the matter with Germany? (9) Green regulations cause German auto sales to skid.

Strategy: NYC Meetings. I'm visiting some of our accounts in NYC this week and also speaking at the Tiburon CEO Summit. Tiburon Strategic Advisors offers markets research, strategy consulting, and other related services primarily to financial services firms. The firm's annual summits are among the premier gatherings of chief executives in the financial services industry. This year, the summit is being held at The Wagner at the Battery, across the street from Battery Park. I have a room at the hotel with a spectacular view of New York Harbor and the Statue of Liberty.

Since my firm is virtual, my home office is literally at my home. To avoid getting cabin fever, I enjoy meeting regularly with our accounts around the country and overseas. In my meetings on Monday, we talked about everyone's favorite subject lately—namely, the yield curve. I'm detecting less anxiety about the flattening of the curve as the S&P 500 has been rapidly reversing last year's correction and approaching last year's record high ([Fig. 1](#)). Now I'm sensing mounting anxiety that valuation multiples might be too high again. (There's always something!)

The V-shaped recoveries in the S&P 500/400/600 forward P/Es have been truly remarkable ([Fig. 2](#)). However, there is still more upside potential evident in these valuation multiples when we compare their lows late last year to their levels on Monday and their most recent highs in early 2018: S&P 500 (13.5, 16.6, 18.6), S&P 400 (12.6, 15.8, 18.6), and S&P 600 (13.4, 16.9, 20.1).

Helping to fuel the rebound in valuations recently have been the improving prospects for revenues and earnings growth of the S&P 500. Consider the following:

(1) **Revenues.** S&P 500 revenues growth closely tracks the growth rate of business sales, which is released along with retail sales with a one-month lag. In January, business sales rose 2.8% y/y, a slight uptick from 2.1% at the end of last year, which was the weakest growth since November 2016 ([Fig. 3](#)). December might have marked the bottom for now in revenues growth. Confirming that assessment is a similar January uptick in the growth of new factory orders ([Fig. 4](#)).

In addition, the US M-PMI at 55.3 during March is also a favorable reading for revenues growth ([Fig. 5](#)). Last but not least is the uptick in analysts' consensus expectation for 2019 revenues growth during the 3/21 week to 5.4%, matching the expected growth for 2020 ([Fig. 6](#)).

(2) **Earnings.** The 2019 and 2020 consensus earnings estimates are still falling, though at a slower

pace ([Fig. 7](#)). More importantly, forward earnings (the time-weighted average of this year and next year) has been trending higher slowly but surely over the past seven weeks through the 3/28 week, after falling during the previous 15 weeks. Then again, analysts' consensus expectations for 2019 earnings growth fell to a new low for this year of 3.7%, but the 2020 growth estimate rose to a new high for next year of 11.4% ([Fig. 8](#)).

What about the earnings recession? During the final week of March, industry analysts estimated a 1.9% y/y decline in earnings during Q1-2019 and a meager 0.8% increase during Q2-2019 ([Fig. 9](#)). While the latter could turn negative, the former might turn positive if the traditional “earnings hook” occurs during the upcoming earnings reporting season. In any event, Joe and I believe that the market discounts forward earnings, which is showing signs of recovering, as noted above.

(3) *Blue Angels*. Putting the pieces of the S&P 500 puzzle together using our Blue Angels framework, we see room for still higher forward P/Es at the same time that forward earnings resumes its uptrend, perhaps to new highs in 2020 ([Fig. 10](#)). Our S&P 500 targets remain at 3100 for this year and 3500 for next year.

Global Economy I: Stimulating China. The Chinese celebrated their Lunar New Year holiday from February 5-19. According to the Chinese Zodiac, 2019 is the Year of the Pig. My research on the Chinese Zodiac suggests that stock bulls do especially well when they are pigs too during such years. I'm kidding, of course. Actually, we should all have been pigs on December 24, 2018, when the S&P 500 bottomed at 2351.10. It is up 22.0% since then.

Since almost everyone in China is on vacation during the holiday, with many people travelling back to their home villages and towns, China's economic indicators tend to reflect the annual hiatus from work. Since the Chinese prepare for the holiday during January, celebrate it during February, and recover from it during March, assessing the performance of China's economy during the first three months of the year is a bit more difficult than usual.

You might recall that stocks sold off in the US and abroad on March 7, when Chinese merchandise trade data showed big drops in exports (down 38.6% m/m in yuan) and imports (down 27.7%) during February ([Fig. 11](#) and [Fig. 12](#)). The widespread interpretation was that these declines were more than seasonal, suggesting that China's economy and the global economy both were getting weaker. That spin might have been correct given the big, 19.0% m/m drop in Chinese railways freight traffic during February ([Fig. 13](#)).

Then on Monday, data on China's official M-PMI came out. It was like the sun emerging from cloud cover: Sentiment abruptly changed to a sunnier global outlook during the Year of the Pig. The overall index rose from 49.2 during February to 50.5 during March. The rebound was led by the output index (from 49.5 to 52.7) and the new orders index (from 50.6 to 51.6), and is reminiscent of a similar V-shaped formation in early 2016.

The rebound is probably more than seasonal given that the Chinese government once again is responding to an economic slowdown with ultra-easy monetary policy. The People's Bank of China has slashed the reserve requirements for large banks from 17.0% at the end of 2017 to 13.5% during March ([Fig. 14](#)). That's the lowest since late December 2007, when the global financial crisis was well underway. The banking system responded with loans soaring \$525.3 billion during January, the fastest m/m pace on record ([Fig. 15](#)).

Global Economy II: Depressing Germany. What's the matter with Germany? That question popped up a couple of times in my recent meetings with some of our NYC accounts. The widespread view is

that Germany, which is very exposed to the global economy, is suffering from weaker exports, especially to China. The latest upbeat Chinese M-PMI data could also augur better times for Germany, maybe. The data suggest that Germany has some problems closer to home. Consider the following:

(1) *Exports*. Germany's exports (in euros) actually rose 1.8% y/y to a record high in December ([Fig. 16](#)). Yet new factory orders and industrial production during January fell 2.6% and 1.1%, respectively.

(2) *Autos*. The big problem is the freefall in German auto output to 4.9 million units during March (using the 12-month sum) from 5.6 million units a year ago ([Fig. 17](#)). Zacks Equity Research [reported](#):

"The newly implemented Worldwide Harmonized Light Duty Vehicles Test Procedure (WLTP) regime, which replaced the New European Driving Cycle (NEDC) regime, has rattled the European automotive market. Per Reuters, the new WLTP test, which came into effect on Sep 1, gives higher carbon dioxide reading than the old NEDC test system. This, in turn, pushes vehicles into a higher tax bracket. ... The kickoff of new WLTP system resulted into disruption and halt in the production of some models."

US Economy: Cold Spring? According to the calendar, winter turned to spring on March 20. Yet it was winter-coat weather in NYC on Monday, though it started warming up on Tuesday. Like Chauncey Gardiner (see the movie "Being There"), I promised that there will be growth in the spring. So Tuesday's report of a 0.2% m/m decline in retail sales doesn't count because it was for February.

But that also means I can't gloat about February's 1.0% m/m increase in construction spending, with solid gains in public (3.6%) and residential (0.7%) construction, despite the bad weather ([Fig. 18](#)). I also can't put the solid reading for the March M-PMI (to 54.2, up from 55.3) in the plus column of my spring forecast.

In any event, the Atlanta Fed's [GDPNow](#) model has been showing upward revisions in real GDP growth during Q1, which is now estimated at 2.1% (saar). Perhaps the winter weather didn't freeze up economic growth all that much. Of course, the seasonal adjustment factor should make the adjustment for the season. However, as Debbie and I have observed, Q1 has been the weak quarter for real GDP growth during six of the past nine years.

Bottom line: There will be growth in the spring.

CALENDARS

US. Wed: ADP Employment Change 180k, ISM NM-PMI 58.0, MBA Mortgage Applications, Kashkari.
Thurs: Jobless Claims, Challenger Job Cuts, EIA Natural Gas Report, Mester. (DailyFX estimates)

Global. Wed: Eurozone Retail Sales 0.1% m/m/1.5% y/y, Eurozone, Germany, and France C-PMIs 51.4/51.5/49.0, Eurozone, Germany, France, and Italy NM-PMIs 52.7/54.9/48.9/50.6, UK C-PMI & NM-PMI 51.2/51.1. **Thurs:** Germany Factory Orders 0.3% m/m/-3.1% y/y, Japan Household Spending 2.0% y/y, ECB Publishes Account of March Meeting. (DailyFX estimates)

STRATEGY INDICATORS

AC World ex-US MSCI ([link](#)): This index is up 10.8% ytd in dollar terms after tumbling 16.4% in 2018. In local-currency terms, the index is up 10.9% ytd compared to a 13.0% decline for all of 2018. The US dollar price index is up 13.1% since its December low and has improved to 13.5% below its cyclical high in January 2018. It had been down as much as 23.6%—and in a bear market—in December. The local-currency price index is up 12.9% since its December low to 7.5% below its record high in January

2018. It had been down as much as 18.1% on December 26. Local-currency forward revenues was steady m/m at a record high, which is now up 15.5% from a five-year low in March 2016. Local-currency forward earnings fell 1.0% m/m and is down 4.3% from its record high in early November. Revenues are expected to rise 3.2% in 2019 and 4.8% in 2020 following a gain of 6.9% gain in 2018, and earnings are expected to rise 5.4% (2019) and 9.5% (2020) after rising 5.1% (2018). The industry analysts' sales forecasts imply short-term 12-month forward revenue growth (STRG) of 3.7%, up 0.1ppt m/m. Their STRG forecast compares to a seven-year high of 6.8% in March 2017 and is up from a cyclical low of 2.3% in March 2016. Their short-term 12-month forward earnings growth (STEG) forecast of 6.5% is up from a 10-year low of 6.0% in February, and compares to a four-year-high forecast of 14.1% in March 2017. The profit margin estimate implied by analysts' earnings and revenue estimates rises to 7.8% in 2019 and to 8.2% in 2020 from 7.8% in 2018. The forward profit margin forecast of 7.9% is down from 8.0% in February and a nine-year high of 8.3% in October. The Net Earnings Revision Index (NERI) for the AC World ex-US MSCI was negative in March for a 12th straight month following six positive readings. It slipped to -7.9% from -7.5%, but remains above its 33-month low of -8.4% in January. That compares to a 76-month high of 2.7% in May 2017 and a 51-month low of -11.3% in March 2016. The forward P/E of 13.2 is up from a five-year low of 11.4 in late December, which then was the lowest reading since June 2013. That compares to a 31-month high of 14.8 in January 2018, a six-year high of 15.3 in April 2015, and a cyclical bottom of 12.3 in January 2016. The index's current 12% discount to the World MSCI P/E is up from its record-low 15% discount during early November.

EMU MSCI ([link](#)): The EMU's MSCI price index has gained 10.8% ytd in dollar terms after tumbling 18.8% in 2018 for the worst performance of all the MSCI regions. In euro terms, the price index is up a greater 12.8% ytd following a decline of 14.7% last year. The US dollar price index is up 13.5% since its December low and has improved to 16.6% below its cyclical high in January 2018. It had been down as much 26.5% and in a bear market in December. The local-currency price index is up 15.3% since its December low to 8.3% below its cyclical high in January 2018. It had been down as much as 20.5% on December 27. Euro-based forward revenues edged down 0.3% m/m and is now down just 1.4% from its five-year high in early November. That's still 4.9% above its six-year low in May 2016, but remains 6.2% below its record high (September 2008). Euro-based forward earnings had stalled from 2011 to 2016 before reaching its highest level in 10 years during early November. It edged down 0.1% m/m and is now 3.0% below its 10-year high in November and 18.1% below its record high (January 2008). Analysts expect revenues to rise 3.1% in 2019 and 4.5% in 2020, above the 2.1% in 2018. They're also looking for faster earnings growth. Earnings are expected to rise 5.9% in 2019 and 9.9% in 2020 following a gain of 3.2% in 2019. Forecasted STRG of 3.6% is up from 3.4% a month earlier, which compares to a six-year high of 5.0% in April 2017 and a cyclical low of 2.0% in May 2016. Forecasted STEG of 7.0% has dropped m/m from 7.5%, which compares to a 78-month high forecast of 21.0% (February 2017) and a seven-year low of 5.7% (April 2016). STEG had been higher than LTEG (currently 9.4%) from July 2016 to May 2017, but is trailing now. The forward profit margin was steady m/m at 7.8%, which compares to a nine-year high of 7.9% in January and a cyclical bottom of 6.2% in May 2013. The implied profit margin is expected to improve to 7.7% in 2019 and 8.0% in 2020 from 7.5% in 2018. NERI was negative in March for a sixth straight month and in 17 of the past 20 months. NERI improved m/m to -7.3% from -8.3%, and remains above December's 31-month low of -8.7%. That compares to an 11-year high of 8.1% in May 2017. The P/E of 13.2 is up from 11.3 in early January, which was then its lowest reading since July 2013. That's down from a nine-month high of 14.9 in January 2018 and compares to a 13-year high of 16.4 in April 2015 and a 30-month low of 12.2 in February 2016. The current valuation represents an 11% discount to the World MSCI's P/E now, up from February's 14% discount, which was then the lowest since August 2016. That compares to a record-low 25% discount during 2011 and is well below the 1% premium during April 2015—the post-euro-inception record high.

Emerging Markets MSCI ([link](#)): The EM MSCI price index is up 10.8% ytd in US dollar terms after falling 16.6% in 2018. In local-currency terms, EM has risen 10.4% ytd compared to a drop of 12.2% in 2018. The US dollar price index is up 14.5% since its October low and has improved to 15.9% below its cyclical high in January 2018. It had been down as much 26.6% and in a bear market in October. The local-currency price index is up 13.3% since its October low to 10.4% below its cyclical high in January 2018. It had been down as much as 20.9% on October 29. Local-currency forward revenues rose 0.7% m/m to a record high and is up 20.9% from a four-year low in June 2016. However, local-currency forward earnings fell 0.7% m/m to 6.3% below its record high in early October. Still, it's up an impressive 31.7% from its six-year low in April 2016. Revenue growth is expected to slow markedly to 5.4% in 2019 and 7.5% in 2020 from an 11.8% gain in 2018. That's expected to lead to earnings gains of 7.0% in 2019 and 13.1% in 2020, following a 7.3% gain in 2018. Forecasted STRG was up to 6.0% from a 34-month low of 5.8% in February, but that's down from a four-year high of 9.6% in January 2017. STEG jumped to 8.6% from 7.0%; that's up from a 10-year low of 6.6% in late January but remains well below its cyclical peak of 17.5% in March 2017 and is below LTEG (14.5%) again. The implied profit margin is expected to edge up 0.1ppt to 6.6% in 2019 before improving to 6.9% in 2020. The forward profit margin remained steady m/m at 6.7%, which is down from a six-year high of 7.4% in May. It's now 3.6ppts below its 10.3% record high in December 2007 and compares to a record low of 6.0% in February 2016. NERI was negative for a 14th month in March, but improved to -6.5% from -6.6% in February. NERI had been positive for only three months through January 2018 after 80 months of negative readings through October 2017, and compares to an 83-month low of -10.2% in March 2016. Emerging Markets' forward P/E of 12.0 is up from a 56-month low of 10.0 at the end of October and compares to an eight-year high of 13.1 in January 2018. The index is trading at only a 20% discount to the World MSCI P/E, which is near the best levels since early 2013. That's up from a four-year-low 27% discount in late October, and compares to a 10-year-low 30% discount in August 2016.

MSCI World & Region Net Earnings Revisions ([link](#)): Analysts' recent earnings revisions through March suggest continued pessimism about profits across most of the world, but most areas are up from their recent three-year lows. The AC World MSCI's NERI was negative for a sixth month following 20 straight positive readings through September, as it slipped to -7.5% in March from -7.3% in February. That's still up from a 33-month low of -8.4% in January. EM Latin America remains in the lead among all regions, but was negative for a 14th straight month. The US was negative for a fifth month following 18 straight positive readings, as its NERI improved to -6.5% from a 34-month low of -7.6%, but remains well below its corporate-tax-rate-cut-boosted record high of 21.8% last March. Here are March's scores among the regional MSCIs: EM Latin America (-2.2% in March, up from -2.8% in February), EM Eastern Europe (-3.7, -3.9 [34-month low]), United States (-6.5, -7.6 [34-month low]), Emerging Markets (-6.5, -6.6), EMU (-7.3, -8.3), EM Asia (-7.5, -7.5), AC World (-7.5, -7.3), Europe (-7.7, -8.6), AC World ex-US (-7.9, -7.5), Europe ex-UK (-8.0, -9.4 [34-month low]), and EAFE (-8.7, -8.8 [34-month low]).

MSCI Countries Net Earnings Revisions ([link](#)): NERI was positive for 4/44 MSCI countries in March, up from February's lowest count since March 2016. However, NERI improved m/m in March for 28/44 countries, the most since July and up from 22/44 countries improving in February. That compares to 8/44 improving in December, which was then the lowest count since April. Among the countries with improving NERI in March, New Zealand was at a 34-month high, followed by: the Philippines (14-month high), Belgium (12), and Brazil (12). Among countries with weaker NERI m/m, Austria and Thailand were at 42-month lows, followed by Canada (38), France (33), Japan (32), and Singapore (29). NERI turned positive in March for three countries: Argentina, New Zealand, and the Philippines. The two-month positive NERI streak for Brazil is now the best among countries as the Czech Republic turned negative in March for the first time in 22 months. Russia also turned negative m/m, for the first time in 18 months. South Africa's NERI has been negative for 59 straight months, followed by the negative streaks of Mexico (29-months), Pakistan (28), Denmark (20), and Germany (20). The highest NERI readings in March: Argentina (3.1% [10-month high]), Brazil (2.7 [12-month high]), New Zealand (2.2

[34-month high]), and the Philippines (0.9 [14-month high]). The weakest NERIs occurred this month in Korea (-14.4), Denmark (-13.0 [11-month low]), Peru (-12.8), Thailand (-12.6 [42-month low]), and Finland (-12.0).

US ECONOMIC INDICATORS

Durable Goods Orders & Shipments ([link](#)): Core capital goods orders in February contracted for the third time in four months, though remain at an elevated level, while core capital goods shipments held at their record high. Nondefense capital goods orders ex aircraft (a proxy for future business investment) ticked down 0.1% in February and is only 1.4% below July's cyclical high, while the comparable shipments measure (used in calculating GDP) was flat at its record high. Core capital goods orders contracted 3.4% (saar) during the three months ending February, based on the three-month average, deteriorating sharply from last summer's double-digit growth. Meanwhile, the comparable shipments measure expanded 3.3% (saar) over the comparable three-month period, accelerating from the 1.6% gain at the end of 2018. Total durable goods orders sank 1.6%, after a three-month jump of 2.3%, as civilian aircraft orders tumbled 31.1% during February. Excluding transportation, orders are fluctuating in a volatile flat trend at cyclical highs, ticking up 0.1% in February after a 0.1% loss and a 0.3% gain the prior two months.

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