



## MORNING BRIEFING

April 10, 2019

### Is the Earnings Recession Over?

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

(1) Stock market looks forward, not backward. (2) Green shoots popping up in revenues and earnings estimates. (3) S&P 500 forward earnings may be starting to bottom. (4) Consensus Q1 earnings estimate is down y/y, but actual results could be up slightly thanks to the “hook.” (5) Lots of angst about income inequality despite record readings for labor market indicators. (6) Income inequality seems to be worst during boom times. (7) Still more job openings than jobless workers. (8) Real hourly wage at record high. (9) The income stagnation myth is based on one flawed data series. (10) Consumption equality: We all eat about the same every day.

**Earnings: In the Spring, There Will Be Green Shoots.** Joe and I rarely pay much attention to trailing earnings when thinking about valuation. That’s because the stock market tends to look forward, not backward. It has been doing a good job of looking past the challenging outlook for earnings during Q1 and Q2 of this year. Perhaps the correction at the end of last year discounted the likelihood that tough y/y comparisons would depress earnings growth during the first half of this year.

The remarkable V-shaped recovery in the S&P 500 since the day after Christmas suggests that fears of an economic recession subsided quickly, and so did any concerns about a prolonged downturn in earnings. Now that spring has arrived, we are seeing green shoots in analysts’ expectations for earnings:

(1) *Revenue expectations remain on the sunny side of the street.* S&P 500 revenues growth slowed significantly at the end of last year. On a per-share basis, it was 4.0% y/y, down from a recent peak of 11.2% during Q2-2018 ([Fig. 1](#)). On an aggregate basis, it was just 2.2%, down from a recent high of 10.0%.

On an annual basis, revenues rose 8.9% last year ([Fig. 2](#)). According to the consensus of industry analysts, the y/y growth rate of S&P 500 revenues is expected to be 5.5% both this year and next year as of the 3/28 week. Those are solid growth rates for revenues.

There may be a couple of green shoots in revenue expectations for this year and next year ([Fig. 3](#)). Both have turned up during March following a short bout of downward revisions that started late last year.

Forward revenues, which is the time-weighted average of the consensus estimates for this year and next year, seems to be moving into new record-high ground ([Fig. 4](#)).

(2) *Earnings may be starting to blossom too.* During Q4-2018, S&P 500 operating earnings growth was up 14.3% per share and up 12.3% in aggregate ([Fig. 5](#)).

On an annual basis, earnings rose 23.8% during 2018 thanks to the big gain in revenues and the huge

boost to the profit margin from the cut in the corporate tax rate ([Fig. 6](#)). Growth expectations for this year have plummeted from 10.3% last October to 3.6% as of the 3/28 week. However, earnings growth is expected to be 11.4% next year.

The consensus estimates for the levels of earnings this year and next year are still falling but at a slower rate than earlier this year ([Fig. 7](#)). As a result, forward earnings may be bottoming after falling earlier this year. It has been up during six of the past eight weeks through the 4/4 week ([Fig. 8](#)). Add that to the green-shoots list.

(3) *Latest earnings reporting season will test market's foresight.* Will the market look past the upcoming earnings season, which is widely expected to be a weak one? We think so. The Q1 estimate is still falling, but the Q2 and Q3 estimates seem to be stabilizing after falling since late last year ([Fig. 9](#)). The growth rate for Q1 was -2.0% y/y during the 4/4 week ([Fig. 10](#)). It could easily turn slightly positive once the actual results are all in. That's because there has often been an "earnings hook" during corporate reporting seasons.

Meanwhile, the consensus expected growth rates are stabilizing in positive territory for Q2 (1.0% y/y), Q3 (2.6), and Q4 (9.1).

Here are the current consensus analysts' expectations for the earnings growth rates of the S&P 500 sectors during Q1: Health Care (4.5%), Industrials (2.8), Real Estate (2.5), Financials (2.3), Utilities (-0.3), Consumer Staples (-2.1), Consumer Discretionary (-3.5), Communication Services (-5.7), Information Technology (-6.1), Materials (-15.3), and Energy (-20.4).

**US Labor Market: Cornucopia.** It's bizarre: The US labor market is booming, with lots of indicators making history, yet the perma-bears and the "resistance" continue to moan and groan about income stagnation and inequality. Debbie and I aren't denying that there is income and wealth inequality. But there always has been and will be income and wealth inequality in a capitalist system that is based on (relatively) equal opportunities but doesn't guarantee (or deliver) equal outcomes. Ironically and perversely, inequality is likely to be greater during periods of prosperity, when the rich usually get richer faster than the rest of us, which helps to explain all the moaning and groaning.

The stock market focuses on earnings, not on income distribution. However, companies do best when personal income is as broadly distributed as possible. Their managements have an incentive to cultivate and to expand their customer bases' purchasing power. They can do it by offering better goods and services at lower prices. To do so, they must boost their productivity. By doing so, wages tend to rise faster than prices—resulting in higher inflation-adjusted incomes. Now consider the following upbeat batch of income-related indicators:

(1) *Jobless claims at all time-low relative to employment.* Weekly initial unemployment claims averaged 213,500 during March, one of the lowest readings in nearly 50 years. Just as impressive is that over the past 12 months through March, jobless claims totaled 11.37 million, the lowest since March 1970 ([Fig. 11](#)). The ratio of this 12-month sum to the level of monthly payrolls was just 0.08 during March, the lowest on record going back to 1946 ([Fig. 12](#)).

(2) *Job openings exceed unemployed workers.* Yesterday's JOLTS report showed that job openings fell by 538,000 to 7.087 million during February ([Fig. 13](#)). Our positive spin is that job openings continued to exceed the number of unemployed workers during February for the 12th month in a row. While pessimists undoubtedly will pounce on the drop as a sure sign that labor market demand is weakening, it may just as well reflect an increased supply of workers, so it takes less time to fill open positions.

(3) *Real average hourly earnings at record high.* The average hourly earnings index of production and nonsupervisory workers rose to yet another new record high during March ([Fig. 14](#)). This measure of the real wage is up 20% since January 2000, contradicting the oft-stated claim that incomes have stagnated since then.

It's extremely unlikely that the top "1%" of income earners is skewing this average since none of the people in the 1% are production and nonsupervisory workers, who account for about 80% of payroll employment.

(4) *Real median weekly wages at record high.* Besides, there is also a quarterly data series for median (rather than mean) "usual weekly earnings of wage and salary workers," which also belies the stagnation claim ([Fig. 15](#)). Adjusted for inflation, it is up 12% since the start of 2000.

The income stagnation myth has been based mostly on just one annual data series compiled by the Census Bureau. It is real median household income ([Fig. 16](#)). It is up only 2% from 2000 through 2017. It is based on survey data that focuses on just money income. In my book [Predicting the Markets](#), I discussed the numerous deficiencies in this data series as a measure of purchasing power.

I concluded that real mean consumption per household, which is up 28% from January 2000 through December 2018, is the best measure of the standard of living, which clearly hasn't stagnated. I seriously doubt that the 1% is seriously skewing the consumption series, since there aren't enough of them to make much of a difference to most categories of consumer spending. They certainly eat about as much as everyone else.

## CALENDARS

**US. Wed:** Headline & Core CPI 1.8%/2.1% y/y, Monthly Budget Statement -\$200.0b, MBA Mortgage Applications. **Thurs:** PPI-FD Total, Core, Core Ex Trade Services 0.3%/0.2%/0.2%, Jobless Claims 201k, EIA Natural Gas Report, Bowman, Bullard, Clarida, Quarles, Kashkari. (DailyFX estimates)

**Global. Wed:** UK GDP 0.0%/m/m/0.2%3-month, UK Headline & Manufacturing Industrial Production -0.8%/-0.7% y/y, UK Trade Balance -£3900m, Japan Machine Tools, China New Yuan Loans ¥1225.0b, China Aggregate Financing ¥1985.0b, ECB Rate Decision 0.00%, ECB Marginal Lending Facility & Deposit Facility Rates 0.25%/-0.40%, Draghi, Kuroda. **Thurs:** Germany CPI 0.4%/m/m/1.3%/y/y, China CPI & PPI 2.3%/0.4% y/y, Mexico Industrial Production -0.5%. (DailyFX estimates)

## STRATEGY INDICATORS

**S&P/Russell LargeCaps & SMidCaps ([link](#)):** All of these price indexes are up so far in 2019, and only the S&P SmallCap 600 is still in a correction. Here's how they rank ytd through Monday's close, along with their percentage changes since SMidCap's record highs in late August and LargeCap's on September 20: S&P MidCap 400 (17.2% ytd, -4.9% from record high), Russell SmallCap 2000 (17.1, -9.3), Russell LargeCap 1000 (15.9, -1.2), S&P LargeCap 500 (15.5, -1.2), and S&P SmallCap 600 (14.2, -12.2). Forward earnings rose w/w for all of the S&P market-cap indexes for a second week, possibly signaling an end to the downtrend that began in late October. The forward EPS for LargeCap and MidCap are just 1.4% and 1.8% below their respective record highs, while SmallCap's is 7.6% below. During October, analysts had been expecting double-digit percentage earnings growth for 2019. While those forecasts have dropped sharply since then, they are stabilizing now. Here are the latest consensus earnings growth rates for 2018, 2019, and 2020: LargeCap (22.7%, 3.5%, 12.0%), MidCap (22.7, 3.7, 12.5), and SmallCap (22.4, 4.5, 18.6).

**S&P 500 Growth vs Value** ([link](#)): The S&P 500 Growth index is up 16.4% ytd through Monday's close, ahead of the 14.5% gain for its Value counterpart. Growth has risen 24.7% since the bottom on December 24, ahead of the 21.5% gain for Value. Both of these indexes are out of a correction now: Growth is now 1.4% below its October 1 record high, while Value is 4.2% below its record high on January 26, 2018. Since the election in late 2016, Growth's 46.6% gain is double the 23.0% increase logged by Value. Looking at the fundamentals, Growth is expected to deliver higher revenue growth (STRG) and earnings growth (STEG) than Value over the next 12 months. Specifically, 8.5% STRG and 8.0% STEG are projected for Growth, respectively, versus 4.3% and 4.8% for Value. Prior to the selloff in February 2018, Growth's P/E of 21.8 on January 26, 2018 was its highest since May 2002, while Value's 16.6 on January 3, 2018 was its highest since April 2002. Through Monday, Growth's P/E was back up to 21.2 from its 50-month low of 15.9 on December 24, and Value's 13.9 was up from a six-year low of 11.5 on January 3. Regarding NERI, Growth's was negative in March for a fourth month after 19 straight positive readings, but improved to -2.6% from a 25-month low of -4.4%; that compares to a record high of 22.3% in March 2018 and a five-year low of -16.2% in April 2015. Value's NERI was negative in March for a fifth month, but up to -8.7% from a 34-month low of -9.8%; that compares to a record high of 21.2% in March 2018 and five-year low of -20.3% in April 2015. The Tax Cuts and Jobs Act (TCJA) sharply boosted the consensus forward earnings estimates and the forward profit margin for both Growth and Value, but Growth's margin is falling now. Growth's forward profit margin of 15.7% is up from 14.4% prior to the TCJA's passage, but down a full point from its record high of 16.7% during mid-September. Value's forward profit margin of 10.2% is down from a record high of 10.5% in December, but up from 9.1% prior to the TCJA.

## US ECONOMIC INDICATORS

**NFIB Small Business Optimism Index** ([link](#)): The Small Business Optimism Index (SBOI) has stabilized at a historically high level, following the end of the government shutdown. "Small business owners continue to create jobs, expand their operations, and are enjoying strong sales," said NFIB President and CEO Juanita Duggan. "Since Congress resolved the shutdown, uncertainty has declined as small business owners add jobs, increase sales, and invest in their businesses and employees." The SBOI rose for the second month, to 101.8, after sliding from a record high of 108.8 in August to 101.2 in January—which was the lowest since November 2016. In March, five of the 10 components rose, three fell, and two were unchanged. The labor market components continued to improve, with hiring plans (to 18% from 16%) and job openings (39 from 37) rising—with the latter back up at its record high. Also gaining ground was the outlook for expansion (23 from 22), sales expectations (19 from 16), and earnings trends (-8 from -9), while capital spending plans (27) held steady. The major soft spot in the report came from current inventories (-6 from -2)—with stocks viewed as too large—as well as plans to invest in inventories (-1 from +1), which turned slightly negative. Overall, the SBOI anticipates "solid growth, keeping the economy at 'full employment' with no signs of a recession in the near term," according to the report.

**JOLTS** ([link](#)): Job openings in February sank 538,000 to 7.087 million, after a 146,000 gain and a 147,000 loss the prior two months; openings are 539,000 below November's record high of 7.626 million. Hirings have been in a volatile flat trend the past several months, bouncing around November's record high of 5.877 million—falling 133,000 in February, and 181,000 since October—to 5.696 million. Meanwhile, total separations rose 87,000 during the two months through February to 5.556 million—to within 119,000 of last July's cyclical high of 5.675 million. The latest hiring and separations data yielded an employment advance of 140,000 in February, 107,000 above February's payroll increase of 33,000—overstating the increase for the third time in four months. Those quitting their jobs remained at record highs, dipping only 3,000 from January's record high of 3.483 million. February's private industry job-opening (4.8%) rate fell further below its record high of 5.2% posted in October and November, while the quit rate remained at its cyclical high of 2.6%. The total hire rate (4.2) is in a volatile flat trend

around its cyclical high. February's ratio of unemployed workers per job opening was below 1.00 for the 12th month—at 0.88—rising for the third month from November's record low of 0.79.

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