



MORNING BRIEFING

April 24, 2019

Run, Bull, Run!

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

(1) Run, Forrest, run! (2) Earnings leading the charge to record highs. (3) The bears grumble that the Fed is feeding the bull. (4) Two charts that have been the downfall of the bears so far. (5) Our Boom-Bust Barometer at record high lending support to record high for stocks. (6) S&P 500 forward earnings is the comeback kid. (7) Fairly valued again. (8) Lots of black-and-blue PMIs during April in the US, Europe, and Japan.

Stocks I: Happy New Record High! The S&P 500 made a record high yesterday. Joe and I celebrated the bull's birthday on 3/9, and wished it many happy returns. The bull has reciprocated by providing many happy returns for investors. Yesterday's rally to a new record high was fueled mostly by lots of companies reporting lots of better-than-expected earnings for Q1-2019. If there's an earnings recession out there, it's hard to see in the latest batch of earnings reports.

How did the bull get this far since the bull run started on 3/9/09? The distraught bears say it was all rigged, and they continue to predict that eventually it must all end badly. They believe that their biggest nemesis is the Fed, along with the other major central banks that have pursued ultra-easy monetary policies. Once the central banks reverse course, their thinking goes, stock prices will plummet.

The bears have two favorite charts. One shows the relationship between the S&P 500 and the Fed's holdings of bonds ([Fig. 1](#)). The other shows the S&P 500 versus the assets of the Fed, the European Central Bank, and the Bank of Japan combined ([Fig. 2](#)). Sure enough, the S&P 500 took a dive in late 2015 and early 2016 after the Fed terminated QE on October 1, 2014. The Fed then started reducing its holdings of bonds in October 2017. Again, there were two nasty corrections in 2018. Yet here we are back at record highs for the S&P 500!

The following performance derby shows the percentage changes in the 11 sectors of the S&P 500 since 3/9/09 through yesterday's close: Consumer Discretionary (658.4%), Information Technology (593.3), Financials (443.3), Industrials (399.5), Real Estate (395.2), Health Care (298.8), Materials (231.9), Consumer Staples (192.5), Utilities (156.0), Communication Services (91.4), and Energy (63.1) ([Fig. 3](#)). Two sectors are at record highs, Consumer Discretionary and Information Technology, while two are within 2%-3% of their record highs, Industrials and Utilities.

The following performance derby shows the percentage changes in the forward earnings of the 11 S&P 500 sectors since 3/9/09: Consumer Discretionary (559%), Information Technology (319), Financials (235), Materials (164), Health Care (147), Industrials (146), Consumer Staples (69), Utilities (26), Communication Services (17), and Energy (-1) ([Fig. 4](#)).

The bull market has been driven by rising earnings and rising valuation multiples. It will end when the next recession commences, causing earnings to drop and valuations to plummet. We aren't there yet.

Stocks II: Fundamentally Sound. Our Boom-Bust Barometer (BBB) continues to work as a simple measure of the fundamentals driving the stock market ([Fig. 5](#)). It's a coincident indicator of the stock market, but it provides a helpful confirmation of the trend in stock prices. It took a 14% dive from the week of 5/12 last year to the week of 2/16 this year. It recovered all that was lost since then, jumping 17% through the 4/13 week this year to a new record high. The dive and recovery approximately coincided with the similar performance of the S&P 500, with the BBB leading on the way down, while the S&P 500 led on the way up.

The BBB is very easy to construct. Your kids can do it at home without getting hurt. It is simply the four-week average of the weekly average of the daily CRB raw industrials spot price index divided by weekly initial unemployment claims ([Fig. 6](#)). While it is highly correlated with the S&P 500, which is one of the 10 components of the Index of Leading Economic Indicators, it doesn't give much advance notice of recessions since it tends to mostly look topky before recessions and then plummet during the downturns.

In the recent swing, the dive was attributable to the CRB raw industrials spot price index, with some weakness in initial unemployment claims as well ([Fig. 7](#) and [Fig. 8](#)). The current jump in the BBB was driven by a significant drop in jobless claims at the same time as the commodity index stopped falling.

Why does the BBB work so well? The CRB raw industrials index is very sensitive to global economic activity. Jobless claims provide a sensitive indicator of the US labor market, with important implications for employment and consumer spending. So it's not surprising to us that the BBB is highly correlated with S&P 500 forward earnings ([Fig. 9](#)).

Looking ahead, we see a possible divergence occurring between the BBB and the S&P 500. It's hard to imagine that jobless claims have much more room to decline. They fell to 192,000 during the 4/13 week, which was the lowest since 1969. So if the bull market charges ahead, as we expect, the BBB will follow suit only if the CRB raw industrials spot price index tags along. If the CRB fails to do so, we'll have to reconsider whether the relationship still makes sense. Nothing works forever.

Then again, if weekly S&P 500 forward earnings continues to rise while our BBB flattens out, we most likely would side with forward earnings, thus remaining bullish. Let's review the latest earnings stats:

(1) *Revenues.* Analysts' consensus expectations for S&P 500 revenues growth have stabilized recently and were at 5.1% for this year and 5.5% for next year during the 4/18 week ([Fig. 10](#)). Weekly forward revenues rose to a new record high during the 4/18 week ([Fig. 11](#)). This series tends to be an excellent coincident indicator of quarterly S&P 500 revenues.

(2) *Earnings.* During the 4/18 week, analysts' consensus expectations for earnings growth this year dropped to 3.2%, while their 11.3% estimate for next year remains optimistic ([Fig. 12](#)). The good news is that forward earnings, which dipped slightly late last year and early this year, is making a comeback ([Fig. 13](#)). This weekly series tends to be a good leading indicator of actual quarterly S&P 500 earnings.

(3) *Earnings season.* Below, Joe discusses the latest earnings reporting season. The available actual results and guidance, so far, seem to be weighing on expectations for all four quarters of this year ([Fig. 14](#)). They are all the lowest weekly readings for each of the four quarters: Q1 (-1.8% y/y), Q2 (0.4), Q3 (2.2), and Q4 (8.7). We are counting on an earnings hook, which is a recurring development during earnings reporting seasons, to boost the Q1 growth rate as more earnings results come in.

(4) *Us vs them.* Analysts' consensus expectations for S&P 500 revenues this year and next have rebounded in recent weeks to levels close to our forecasts of \$1,383 and \$1,452 per share, respectively

([Fig. 15](#)). For S&P 500 earnings per share, we estimate \$167 this year and \$176 next year. The analysts are looking for about the same number this year as we are. For next year, they remain too optimistic, in our opinion, with a forecast of \$187 ([Fig. 16](#)). Collectively, analysts have a long history of being too optimistic about the earnings outlook for the coming year and lowering their estimates as it approaches and once it is underway.

Stocks III: Valuation Question. While we view the BBB as a fundamental indicator for the stock market, it clearly has an impact on valuation. For example, the 2018 year-end sell-off was much greater than the drop in forward earnings. During corrections, valuation P/E multiples tend to fall much faster than analysts' consensus earnings expectations. During the current bull market, there have been six corrections, led by declines in forward P/Es rather than in forward earnings per share ([Fig. 17](#)).

During the latest correction, the forward P/Es of the S&P 500/400/600 fell from 16.8, 16.6, and 17.8 on 9/20 last year to 13.5, 12.6, and 13.4 on 12/24 ([Fig. 18](#)). On Monday, they were back up to 17.0, 16.1, and 17.0. Stocks in general are fairly valued, in our opinion. That means that stock gains should be determined by earnings growth, which is likely to trend around 5% for the foreseeable future.

Global Economy: Weak PMIs Again. Yesterday, we wrote that we weren't as impressed by the strength in China's March economic indicators as the financial markets seemed to be upon seeing the data released over the past two weeks. Given the importance of China's economy to the global economy, the latest batch of PMIs for April certainly doesn't suggest that growth in China is improving enough to boost the rest of the world. So far, we have April PMIs for the US, the Eurozone (based on available PMIs for France and Germany), and Japan. Here is what they show:

(1) *US.* At 52.8 during April, the IHS Markit Flash US C-PMI fell to a 31-month low—representing the slowest increase in overall business activity since September 2016. Softer overall demand conditions drove the slower increase in output, according to the survey data presented in Markit's [press release](#).

Included in the composite, the flash NM-PMI fell to a 25-month low of 52.9 during April. Meanwhile, the flash M-PMI was 52.4 in April, unchanged from the prior month, holding at the weakest improvement in operating conditions across the sector since June 2017 ([Fig. 19](#)).

(2) *Eurozone.* For the Eurozone, the IHS Markit Flash C-PMI signaled a lackluster start to Q2, noted Markit's [press release](#). The index touched a three-month low of 51.3 during April. The Eurozone economy "remains in its worst growth spell since 2014." In Germany, solid service-sector performance helped to offset a sharp downturn in manufacturing. France "stagnated," while "the rest of the region saw the worst growth since late-2013." Manufacturing for the overall Eurozone remained in contractionary territory, at a reading of 47.8, and non-manufacturing growth "cooled" at a reading of 52.5 ([Fig. 20](#) and [Fig. 21](#)).

Business expectations "continued to run at one of the gloomiest levels since late-2014." Reasons cited for the weakness were slowing in demand and downgraded forecasts for economic growth. Specifically, concerns focused on political uncertainty (including Brexit), trade wars, protectionism, and auto-sector weakness.

(3) *Japan.* In Japan, the flash M-PMI increased to a three-month high of 49.5, its third straight month below the 50.0 mark—which is neither contractionary nor expansionary ([Fig. 22](#)). Persistent weak demand from domestic and international markets led output to fall further while manufacturing employment remained resilient, [according](#) to Markit. "Japan's manufacturing sector remained stuck in its rut at the start of Q2, with the factors which have prohibited any growth such as US-Sino relations,

growth fears in China and the turn in the global trade cycle, all remaining prominent risks,” a Markit economist quoted in the release said.

CALENDARS

US. Wed: MBA Mortgage Applications, DOE Crude Oil Inventories. **Thurs:** Durable Goods Orders Total, Ex Transportation, and Core Capital Goods 0.7%/0.2%/0.1%, Kansas City Fed Manufacturing Index 9, EIA Natural Gas Report. (DailyFX estimates)

Global. Wed: Germany Business Climate, Current Assessment, and Expectations Indexes 99.9/103.6/96.0, Australia CPI 1.5% y/y, BOC Rate Decision 1.75%, ECB Publishes Economic Bulletin. **Thurs:** Japan Industrial Production 0.0%/m/m/-3.8%/y/y, Japan Retail Trade 0.0%/m/m/0.8%/y/y, Japan Jobless Rate 2.4%, Japan CPI Headline, Core, and Core-Core 1.1%/1.1%/0.7% y/y, BOJ Rate Decision & 10-Year Yield Target, BOJ Outlook Report. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings rose w/w for all of the market-cap indexes. LargeCap's has risen during seven of the past 10 weeks; MidCap's in five of the past six weeks; and SmallCap's in three of the past four weeks. LargeCap's forward EPS is just 1.4% below its record high of \$175.48 in late October; MidCap's is 1.7% below its mid-October high; and SmallCap's is 7.0% below its mid-October high. At their bottoms, LargeCap's forward EPS had been the most below its record high since June 2016, and MidCap's was the lowest since May 2015. SmallCap's had not been this far below since October 2010. The yearly change in forward earnings soared to cyclical highs during 2018 due to the boost from the Tax Cuts and Jobs Act, but tumbled as y/y comparisons became more difficult. But that may be ending soon too. In the latest week, the rate of change in LargeCap's forward earnings fell to a 27-month low of 6.0% y/y from 6.2% y/y. That's down from 23.2% in mid-September, which was the highest since January 2011 and compares to a six-year low of -1.8% in October 2015. MidCap's y/y change rose to 6.0% from a 28-month low of 4.6%, which compares to 24.1% in mid-September (the highest since April 2011) and a six-year low of -1.3% in December 2015. SmallCap's improved to 4.5% from 3.9% and is up from a 31-month low of 3.8% in late March, which is down from an eight-year high of 35.3% in early October and compares to a six-year low of 0.3% in December 2015. Analysts had been expecting double-digit percentage earnings growth in 2019, but those forecasts have been dropping since October. Here are the latest consensus earnings growth rates for 2018, 2019, and 2020: LargeCap (22.7%, 3.1%, 11.9%), MidCap (22.7, 3.2, 12.6), and SmallCap (22.4, 4.5, 18.7).

S&P 500/400/600 Valuation ([link](#)): Forward P/E ratios were mostly slightly lower w/w for all these indexes, but remain well above their multi-year lows in late December. LargeCap's weekly forward P/E was steady at a 14-month high of 16.8, which is up from a five-year low of 13.9 during December. That compares to a 16-year high of 18.6 during January 2018—and of course is well below the tech-bubble record high of 25.7 in July 1999. Last week's level remains above the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap's forward P/E fell 0.4pt to 15.9 from a 28-week high of 16.3. That's up from 13.0 during December, which was the lowest reading since November 2011. MidCap's P/E is down from a 15-year high of 19.2 in February 2017 and the record high of 20.6 in January 2002. However, MidCap's P/E has been at or below LargeCap's P/E for most of the time since August 2017—the first time that alignment has prevailed since 2009. SmallCap's P/E dropped to 16.9 from a six-week high of 17.1, which is well above its seven-year low of 13.6 during December. That's still well below its 51-week high of 20.2 in December 2017 (which wasn't much below the 15-year high of 20.5 in December 2016, when Energy's earnings were depressed). SmallCap's P/E was higher than LargeCap's P/E for a 14th straight week, after being below for much of December for the first time since

2003.

S&P 500 Sectors Quarterly Earnings Outlook ([link](#)): With the Q1 books closed and results beginning to trickle in, the blended Q1 estimate/actual rose in what is typical activity during this point of the earnings season. Last week saw the S&P 500's Q1-2019 EPS forecast jump 24 cents w/w to \$37.37. That's down 6.9% since the end of Q4 in the worst quarter for consensus forecast revisions since Q1-2016. The \$37.37 estimate represents a forecasted pro forma earnings decline for Q1-2019 of 1.7%, up from -2.3% a week earlier and 5.3% at the end of Q4. If it comes to pass, Q1's y/y decline would be its first after 10 straight gains, and down from 16.8% in Q4 and 28.4% in Q3 (which marked the peak of the current earnings cycle). Just four of the 11 sectors are expected to record positive y/y earnings growth in Q1-2019, with none rising at a double-digit percentage rate. That compares to 10 positive during Q4, when seven rose at a double-percentage rate. Six sectors are now expected to match or beat the S&P 500's Q1 growth rate, up from five a week earlier and compared to just four during Q4. Utilities is the only sector expected to post better growth on a q/q basis during Q1. Here are the latest forecasted Q1-2019 earnings growth rates versus their Q4-2018 growth rates: Financials (6.4% in Q1-2019 versus 15.6% in Q4-2018), Health Care (5.1, 13.3), Real Estate (3.1, 6.2), Industrials (1.8, 27.0), Utilities (-0.9, -10.4), Consumer Staples (-1.5, 4.6), Consumer Discretionary (-3.3, 18.1), Communication Services (-5.6, 26.4), Information Technology (-6.1, 10.3), Materials (-15.3, 6.1), and Energy (-27.8, 81.4). On an ex-Energy basis, analysts expect S&P 500 earnings to drop 0.3% y/y in Q1, well below the 14.2% y/y gain in Q4 and the lowest ex-Energy growth rate since Q2-2016.

S&P 500 Q1 Earnings Season Monitor ([link](#)): With nearly 21% of S&P 500 companies finished reporting revenues and earnings for Q1-2019, the y/y growth rates in revenues and earnings have slowed substantially from Q4. The revenue surprise metrics have weakened substantially, but earnings continue to beat forecasts. Of the 104 companies in the S&P 500 that have reported through mid-day Tuesday, 79% exceeded industry analysts' earnings estimates. Collectively, the reporters have averaged a y/y earnings gain of 5.0%, and exceeded forecasts by an average of 5.8%. On the revenue side, just 52% of companies beat their Q1 sales estimates so far, with results coming in 0.7% above forecast and 4.0% higher than a year earlier. Q1 earnings growth results are positive y/y for 71% of companies, vs a higher 78% at the same point in Q4, and Q1 revenues have risen y/y for 71% vs a higher 82% during Q4. These figures will change markedly as more Q1-2019 results are reported in the coming weeks. Looking at earnings during the same point in the Q4-2018 reporting period, a lower percentage of companies (72%) in the S&P 500 had beaten consensus earnings estimates by a lower 2.1%, but earnings were up a higher 12.7% y/y. With respect to revenues at this point in the Q4 season, a higher 59% had exceeded revenue forecasts by a lower 0.6%, and sales rose a greater 9.3% y/y. The early results for Q1 indicate a slowdown in revenue and earnings growth from Q4, but that comes as no surprise to investors. Q4-2018 had marked the tenth straight quarter of positive y/y earnings growth and the 11th for revenue growth. Looking at the Q1 results ex-Financials and Real Estate, the earnings surprise improves to 6.3% from 5.8% and growth falls to 4.3% from 5.0%. The ex-Financials and Real Estate revenue surprise would still be 0.7%, unchanged from the rate with all sectors included, but revenue growth excluding Financials and Real Estate would improve to 5.2% from 4.0%.

US ECONOMIC INDICATORS

Housing Starts & Building Permits ([link](#)): Housing starts fell for the second month in March to its lowest level since May 2017 as builders continue to face headwinds from rising building materials costs as well as land and labor shortages. Starts edged down 0.3% in March to 1.139mu (saar), while revisions show February's (to -12.0% from -8.7%) decline was steeper than first thought, while January's (13.9% from 11.7%) gain was higher; starts were 14.2% below a year ago. Single-family starts slipped 0.4% to 785,000 units (saar) in March after a 19.0% loss in February and a 19.0% gain in

January, while multi-family starts were unchanged at 354,000 units (saar) last month after an 8.9% advance in February and a 0.3% downtick in January. Compared to a year ago, single- and multi-family starts were down 11.0% and 20.5%, respectively. Building permits fell for the third time in March, down 0.2% m/m and 2.9% ytd to 1.288mu (saar), with multi-family permits down 0.4% and 7.2%, respectively, to 472,000 units (saar). Single-family permits dropped for the fifth time in six months, by 0.1% m/m and 4.5% over the period to a 19-month low of 816,000 units (saar). The National Association of Home Builders Housing Market Index (HMI) shows builder optimism is slowly improving through the first four months of this year, to 63 in April from 56 in December. All three components are up over the four-month period: expected sales (to 71 from 61), current sales conditions (69 from 61), and buyer traffic (47 from 43).

Existing Home Sales ([link](#)): Existing home sales contracted in March after posting a double-digit gain in February. “It is not surprising to see a retreat after a powerful surge in sales in the prior month. Still, current sales activity is underperforming in relation to the strength in the jobs markets. The impact of lower mortgage rates has not yet been fully realized,” noted Lawrence Yun, NAR’s chief economist. Existing-home sales—tabulated when a purchase contract closes—sank 4.9% to 5.21mu (saar) after soaring a revised 11.2% (from 11.8%) in February, which was the biggest monthly gain since December 2015; these sales had dropped 5.6% during the three months through January. Regionally, sales fell in all four regions, on both a monthly and yearly basis: Northeast (-2.9% m/m & -1.5% y/y), South (-3.4 & -2.1), West (-6.0 & -10.7), and Midwest (-7.9 & -8.6). March single-family sales sank 4.9% to 4.67mu (saar) following a 12.6% spurt in February, though were still 4.7% below a year ago; multi-family sales fell 5.3% last month to 540,000 units (saar) and were 11.5% below March 2018 sales. The number of single-family homes on the market at the end of March was 1.48 million, climbing from 1.34 million in December. “We had been calling for additional inventory, so I am pleased to see that there has been a modest increase on that front,” said NAR President John Smaby. “We’re also seeing very favorable mortgage rates, so now would be a great time for those buyers who may have been waiting to make a purchase.”

New Home Sales ([link](#)): There are signs of life in new home sales, climbing the first three months of 2019 to its best pace since November 2017, boosted by lower mortgage rates and home prices. New home sales soared 4.5% in March, and 23.1% ytd, to 692,000 units (saar), with the number of properties sold for which construction hasn’t yet started also at a 16-month high, at 200,000 units. Regionally, sales rose in three of the four regions in March—the Midwest (17.6%), West (6.7), and South (3.6)—while sales in the Northeast tumbled 22.2%; compared to a year ago, sales in the South (9.3% y/y) and Midwest (1.2) were in the black, while sales in the West (-4.4) and Northeast (-20.0) were in the red. March’s supply of new homes on the market fell for the second month to 344,000 units, cutting inventories to a 6.0 months’ supply—considered a healthy balance between supply and demand.

Regional M-PMIs ([link](#)): The three Fed districts that have now reported on manufacturing activity for April so far—New York, Philadelphia, and Richmond—show a slight deceleration in growth this month after a slight acceleration during the first three months of this year. We average the composite, orders, and employment measures as data become available. The composite index fell to 7.2 in April after slowly improving from 4.2 in December to 9.1 in March—considerably below the 21.2 monthly average of the first four months of 2018. The New York region’s composite (10.1 from 3.7) measure posted its best growth so far this year, while Philadelphia’s (8.5 from 13.7) slowed a bit, after moving from contraction to expansion in March, and Richmond’s (3 to 10) moved down toward the breakeven point. The new orders gauge (7.1 from 4.6) picked up slightly as orders in both the Philadelphia (15.7 from 1.9) and New York (7.5 from 3.0) regions accelerated this month—Philly’s for the second month after sinking from 21.3 in January to -2.3 in February. Meanwhile, orders in the Richmond (-2 from 9) region are contracting again after expanding during February and March. The employment (14.9 from 15.5)

index shows hirings grew at about the same pace as March's three-month high this month, as factories in Philadelphia (14.7 from 9.6), Richmond (18 from 23), and New York (11.9 from 13.8) all added to payrolls at a healthy pace, though only Philadelphia's accelerated, while Richmond's was the strongest.

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