Yardeni Research

MORNING BRIEFING
April 30, 2019

Abigail vs Scrooge McDuck

See the collection of the individual charts linked below.

(1) Abigail's complaint. (2) How much is too much? (3) The ultra-rich are different than the rest of us. (4) In 2016, the "1%" included 1.3 million taxpayers earning $500,000 or more. (5) Either round them all up, or make them pay more taxes. (6) Stiglitz's complaint. (7) Have incomes stagnated for 90% of Americans since 1989? (8) A very flawed measure of income. (9) Using PCED rather than CPI eliminates a great deal of stagnation. (10) Households with singles have fewer mouths to feed than those with married couples and their children. (11) Lots of measures of income and consumption confirm that the standard of living is at a record high for many, if not most, Americans.

Income Distribution I: Fairy Tales Can Come True. Anger isn't an emotion often associated with things Disney, but Abigail Disney, a great niece of Walt Disney and granddaughter of his brother and company co-founder Roy O. Disney, is fighting mad. Ms. Disney, 59 years old, has no formal connection to the company beyond holding an undisclosed number of shares. Yet she has been very vocal lately about the $65 million pay package awarded to Disney's CEO Robert Iger. She believes the sum far exceeds any reasonable pay for any CEO on this planet.

Ms. Disney wants to see Iger's pay cut and divvied up among Disney's other employees, especially those who say they aren't making enough to make ends meet even though the company's minimum wage is $15 an hour, double the federal minimum wage. A company spokesperson noted that 90% of Mr. Iger's compensation is based on performance, and that Disney's stock price has increased to $132 a share from $24 a share when Iger became CEO in 2005. I guess that means Iger can only count for certain on $6.5 million per year. Then again, the 450% increase in Disney's stock price since 2005 is very impressive when compared to the 133% increase in the S&P 500 over the same period.

Iger is a member of a very small group of the ultra-rich in America. There is an increasingly large and vocal group of Progressives in America who believe that the ultra-rich have become filthy rich. They advocate raising taxes on their incomes and even slapping them with a tax on their wealth to punish them for doing so well. Even a few of the mega-rich are calling for higher taxes on their incomes, if not on their wealth. They include Warren Buffet and Ray Dalio, two of the many ultra-rich with so much money they give most away via charitable foundations.

Let's put the situation into some perspective with IRS data for tax year 2016, which are the latest available, posted on the agency's website:

(1) *Number of returns*. During 2016, 150.3 million taxpayers filed personal tax returns (*Fig. 1*). However, only 100.1 million paid any federal income tax, while 50.2 million showed no income taxes paid at all, though everyone pays the payroll tax. Just 16,087 taxpayers reported $10 million or more in adjusted gross income (AGI).

So all we have to do is round up the members of this cabal, and *voila!*—no more egregious income inequality in America. That may not be enough, though. While we are at it, let's round up all of the

424,442 taxpayers with AGI exceeding $1 million. But that larger group still accounts for only 0.3% of all tax returns.

(2) *Adjusted gross income.* To get all of the grossly overpaid so-called "1%" on Wall Street, Silicon Valley, and the C-Suites, we need to lock up everyone with AGI exceeding $500,000. That would be 1.3 million taxpayers (*Fig. 2*). Collectively, the 1% paid 26.9% of their AGI in taxes, and what they paid represented 36.5% of all federal income tax paid by all taxpayers who paid any taxes at all (*Fig. 3* and *Fig. 4*).

That's not fair! Instead of rounding them all up, let's make them pay at least 50% of all federal income taxes! Why not 75%? They would be less rich, but the country would be richer, unless they leave the country or have less incentive to create new businesses, jobs, and wealth.

(3) *Taxes paid.* Iger and his friends in the $10-million-plus club paid a measly $121.4 billion in taxes. The 1% crowd paid $527.7 billion, while the rest of us working stiffs—*who filed returns with taxable income*—shelled out $918.3 billion (*Fig. 5*). By the way, 2.1 million returns were filed with zero AGI, and received tax credits (a.k.a. the negative income tax) totaling $201.1 million, or $9,576 per return on average.

(4) *Bottom line.* No wonder people want to come to America. If they don't earn enough, the IRS will provide some support. That's in addition to the many other social welfare programs for low-income Americans such as food stamps, Medicaid, and others. If the aspirational immigrants get wildly rich, they get to remain wildly rich, unless Progressives gain control of Washington and correct all the injustices they see in the IRS data.

Income Distribution II: Goofy's Data. The Progressives have some data from other sources besides the IRS to prove that—despite the (Old) New Deal, the Great Society, and Obamacare—income distribution remains disturbingly unequal and must be fixed with more progressive taxes. Who would know better than Joseph Stiglitz? After all, he is a Nobel laureate in economics. In 1972, I took Stiglitz's course on microeconomics in Yale's PhD program. He gave me a good grade, so I like him.

In a 4/19 *NYT* article titled "Progressive Capitalism Is Not an Oxymoron," he lamented: "Despite the lowest unemployment rates since the late 1960s, the American economy is failing its citizens. Some 90 percent have seen their incomes stagnate or decline in the past 30 years. This is not surprising, given that the United States has the highest level of inequality among the advanced countries and one of the lowest levels of opportunity—with the fortunes of young Americans more dependent on the income and education of their parents than elsewhere."

That's certainly a problem that needs to be fixed! But hold on: There would surely be a revolution in America if 90% of our citizens have suffered stagnation or worse as Stiglitz claims has happened for the past 30 *freaking* years—i.e., since 1989! Real GDP is up 110% since then, yet only 10% of Americans have benefitted, he claims. Is it possible that the great silent majority have had no increase in their standard of living since they entered the labor force in 1989? No freaking way, Joe!

Melissa and I have taken deep dives into the data on the standard of living and income inequality. Nowhere can we find a credible series that confirms a 30-year drought in the standard of living for almost all Americans. Instead, the data show that Americans have never been better off. We aren't making a political statement, just a statement of facts (which, we acknowledge, do have political implications). Consider the following:

(1) *The worst data series ever!* Stiglitz must be relying on annual data compiled by the Census Bureau

on real *median* household income (*Fig. 6*). We hate this series with a passion because it is an extremely flawed measure of income, yet it is widely used by Progressives to prove their claim of widespread and prolonged income stagnation. It is up only 13% since 1989. The flakiness of this measure is confirmed by the modest 27% increase in real mean household income (which gives more weight to the rich) since 1989 despite a 54% increase in real GDP per household since 1989.

In Chapter 7 of my book, *Predicting the Markets*, I discuss all the problems with the Census income measure in the last section titled "Income stagnation myth." It is woefully misleading, because it grossly underestimates Americans' standard of living. It is based only on surveys that focus just on money income. On its website, the Census Bureau warns: "[U]sers should be aware that for many different reasons there is a tendency in household surveys for respondents to underreport their income."

Furthermore, the Census measure of money income, which is used to calculate official poverty rates, is missing key noncash government-provided benefits that boost the standard of living of many Americans, including Medicare, Medicaid, the Supplemental Nutrition Assistance Program, and public housing. That's insane: The government's bean counters are excluding many of the beans provided by government programs designed to reduce income inequality. So the Census series will never show the progress made by progressive programs, requiring more of them to fix a problem that might have been mostly fixed by the programs already! (Software programmers call this phenomenon a "Do Loop," which is to be caught in a series of actions that repeat endlessly.) Enough will never be enough. No wonder the Progressives love this series, while we hate it.

(2) *Price deflator makes a big difference.* The Census series uses the CPI, which is based on an indexing formula that gives it an upward bias over time. That's simple to fix by dividing the nominal version of the Census measures of median household income by the PCED. Since 1989 through 2017, it is up only 7.4% using the CPI, but 21.5% using the PCED (*Fig. 7*). That blows away the income stagnation myth without much effort.

(3) *Smaller households distorting income stagnation and inequality measures.* Another problem with any income series on a per-household basis is that growth of the single population (aged 16 and older) continues to outpace that of the married population. It's been doing so since the start of the data in 1976 (*Fig. 8*).

What's changed in recent years is that the former cohort exceeds the latter, as singles are getting married later in life and unattached seniors are living longer (*Fig. 9*). That means more single-person households, which tend to have lower incomes than married-couple households. That trend will weigh down both median and mean per-household incomes, exaggerating income stagnation and inequality.

(4) *The true story is a happier one.* While the political agendas of Joe Stiglitz and other Progressives rest on a flawed measure of income, plenty of other indicators tell a different story. Over the past 30 years, from March 1989 through March 2019, inflation-adjusted average hourly earnings of production & nonsupervisory workers is up 32%, using the PCED and a measure of wages that covers more than 80% of payroll employment (*Fig. 10* and *Fig. 11*). That's NOT stagnation!

Median measures of income are hard to find. However, the Bureau of Labor Statistics (BLS) has a quarterly series on pre-tax median usual weekly earnings of full-time wage and salary workers that starts in 1979 and is based on survey data. Dividing this series by the PCED shows that it is up 25% since the start of 1989 (*Fig. 12*). Clearly, American workers haven't been reporting stagnant paychecks over the past 30 years to the BLS survey takers.

Finally, we believe that the best measures of the standard of living are the disposable income and consumption series compiled monthly by the Bureau of Economic Statistics on a per-household basis. Deflated by the PCED, the former is up 62%, while the latter is up 67% from March 1989 through March 2019 (*Fig. 13*). (As noted above, real GDP per household is up 54% over this period.)

Admittedly, these alternative measures of the standard of living are means rather than medians, but the rich don't eat much more than the rest of us. Based on the data discussed in the first section, there aren't enough of them to make a difference to average measures of income and spending. Furthermore, as noted above, there are fewer mouths to feed per household as the population of adult singles continues to grow faster than married couples.

(5) *Bottom line*. American households are enjoying record standards of living. Income stagnation is a myth. Income inequality isn't a myth but an inherent characteristic of free-market capitalism, an economic system that awards the biggest prizes to those capitalists who benefit the most consumers with their goods and services. Perversely, inequality tends to be greatest during periods of widespread prosperity. Rather than bemoaning that development, we should celebrate that so many households are prospering, even if a few are doing so more than the rest of us.

Income Distribution III: Mickey's Buybacks. Joe is working on more detailed data on share buybacks by the S&P 500. Previously, he found that total basic shares outstanding for the current S&P 500—with data for all quarters since 2007 and adjusted for stock splits and stock dividends—fell 7.8% from Q1-2011 through Q4-2018. That's an average annual decline of 1.1%. In the 4/2 *Morning Briefing*, we concluded that only one-third of buybacks over this period may be attributable to corporations seeking to boost their earnings per share, while the remaining two-thirds may represent actions to reduce dilution resulting from employee compensation paid in stock.

Joe reports that the S&P 100 share count is down 11.6% since Q1-2011 (*Fig. 14*). By the way, Disney's share count is down 21.5% over the same period (*Fig. 15*).

CALENDARS

US. Tues: Consumer Confidence 59.0, Employment Cost Index 0.7%, Pending Home Sales 0.7%, S&P Case-Shiller 20-City Home Price Index 3.1% y/y, Chicago PMI 59.0. **Wed:** ADP Employment 180k, Motor Vehicle Sales 170.mu, Construction Spending 0.1%, ISM & IHS Markit M-PMIs 55.0/52.4, MBA Mortgage Applications, FOMC Rate Decision 2.38% (2.25%-2.50%), Interest Rate On Excess Reserves 2.40%, Powell.(DailyFX estimates)

Global. Tues: Eurozone GDP 0.3%q/q/1.1%y/y, Eurozone Unemployment Rate 7.8%, Germany Unemployment Change & Unemployment Claims Rate -5k/4.9%, Germany Gfk Consumer Confidence 10.3, Germany CPI 0.5%m/m/1.5%y/y, France GDP 0.3%q/q/1.1%y/y, Italy GDP 0.1%q/q/-0.1%y/y, Canada GDP 0.0%m/m/1.4%y/y, China IHS Markit M-PMI & NM-PMI 50.6/55.0. Poloz. **Wed:** UK M-PMI 53.1, Japan M-PMI, Guindos. (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 eight of the past 11 weeks; MidCap's in six of the past seven weeks; and SmallCap's in four of the past five weeks. LargeCap's forward EPS is just 0.9% below its record high of $175.48 in late October; MidCap's is 1.3% below its mid-October high; and SmallCap's is 6.8% 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 rose to 6.2% y/y from a 27-month low of 6.0% 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 6.2% from 6.0%, 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 dropped to 4.0% from 4.5%, 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 are down substantially since October. Here are the latest consensus earnings growth rates for 2018, 2019, and 2020: LargeCap (22.7%, 3.4%, 11.9%), MidCap (22.7, 3.4, 12.8), and SmallCap (22.4, 4.4, 18.4).

S&P 500/400/600 Valuation (*link*): Forward P/E ratios were higher w/w for all these indexes to levels well above their multi-year lows in late December. LargeCap's weekly forward P/E rose to a 13-month high of 16.9 from 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 rose 0.1pt to 16.0 from 15.9. That's down from a seven-month high of 16.3 in early April, but 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 rose to 17.0 from 16.9, 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 15th 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 results beginning to flood in, the blended Q1 estimate/actual surged in what has become the typical positive earnings surprise hook seen during this point of the earnings season. Last week saw the S&P 500's Q1-2019 EPS forecast jump 52 cents w/w to $37.89. That's down 5.7% since the end of Q4 in the worst quarter for consensus forecast revisions since Q1-2016. The $37.89 estimate represents a forecasted pro forma earnings decline for Q1-2019 of 0.3%, up from -1.7% 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 five 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, which compares 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 (7.0% in Q1-2019 versus 15.6% in Q4-2018), Health Care (6.2, 13.3), Consumer Discretionary (5.4, 18.1), Industrials (5.0, 27.0), Real Estate (4.4, 6.2), Utilities (-0.3, -10.4), Consumer Staples (-1.2, 4.6), Information Technology (-3.3, 10.3), Communication Services (-8.8, 26.4), Materials (-14.8, 6.1), and Energy (-29.4, 81.4). On an ex-Energy basis, analysts expect S&P 500 earnings to rise 1.2% y/y in Q1 compared to a drop of 0.3% a week earlier. Still, that's 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 half 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 232 companies in the S&P 500 that have reported through mid-day

Monday, 78% exceeded industry analysts' earnings estimates. Collectively, the reporters have averaged a y/y earnings gain of 4.4%, and exceeded forecasts by an average of 6.3%. On the revenue side, just 56% of companies beat their Q1 sales estimates so far, with results coming in 0.2% above forecast and 3.8% higher than a year earlier. Q1 earnings growth results are positive y/y for 69% of companies, vs a higher 77% at the same point in Q4, and Q1 revenues have risen y/y for 69% vs a higher 79% 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 (74%) in the S&P 500 had beaten consensus earnings estimates by a lower 3.1%, but earnings were up a higher 15.5% y/y. With respect to revenues at this point in the Q4 season, a higher 61% had exceeded revenue forecasts by a higher 0.5%, and sales rose a greater 7.7% y/y. The results so far 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 6.6% from 6.3% and growth falls to 3.6% from 4.4%. The ex-Financials and Real Estate revenue surprise would drop to 0.0% from the 0.2% rate with all sectors included, but revenue growth excluding Financials and Real Estate would improve to 4.2% from 3.8%.

US ECONOMIC INDICATORS

Personal Income & Consumption (*link*): Consumer spending finished Q1 at a robust pace, with the monthly gain in nominal spending the best in 9.5 years and real spending the best in two years. Meanwhile, inflation remain subdued. Real consumer spending accelerated 0.7% during March after no change in February and a 0.4% advance in January—setting a stronger base for growth in consumption heading into Q2. Real spending on consumer durable goods orders was particularly strong last month, at 2.9% (the most since March 2015), followed by consumer nondurable goods (0.8), and services (0.3) spending. Nominal spending jumped 0.9%, driven by a 1.7% gain in goods consumption; services consumption was 0.5% higher. Personal income ticked up only 0.1% during March, though wages & salaries accelerated 0.4%; in real terms, wages & salaries was up a healthy 4.2% y/y. Meanwhile, March data show headline inflation was only 1.5% y/y, while the core rate—the Fed's preferred measure—slowed to a 14-month low of 1.6%, remaining below its target rate of 2.0%.

Regional M-PMIs (*link*): Five Fed districts have now reported on manufacturing activity for April—New York, Philadelphia, Kansas City, Richmond, and Dallas—and collectively 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 5.7 in April after slowly improving from 2.3 in December to 8.9 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; meanwhile, gauges for the Kansas City (5.0 from 10.0), Richmond (3.0 to 10.0), and Dallas (2.0 from 6.9) areas are moving down toward the breakeven point. The new orders gauge (8.2 from 4.0) picked up slightly as orders in the Philadelphia (15.7 from 1.9), Kansas City (10.0 from 4.0), Dallas (9.8 from 2.2), 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 (-2.0 from 9.0) region are contracting again after expanding during February and March. The employment (10.2 from 14.5) index shows hirings continued to expand, as factories in Philadelphia (14.7 from 9.6), Richmond (18.0 from 23.0), and New York (11.9 from 13.8) all added to payrolls at a relatively healthy pace, though only Philadelphia's accelerated this month, while Richmond's was the strongest. Meanwhile, jobs growth in the Dallas (4.6 from 12.2) and Kansas City (2.0 from 14.0) regions has slowed. The regions' prices-paid indexes showed inflationary pressures remained on an easing trend, while the prices-received measures were a mixed bag. Here's a look at the prices-paid indexes for April versus their respective peaks during 2018: Philadelphia (to 21.6 from

60.0), Kansas City (15.0 from 52.0), New York (27.3 from 54.0), Dallas (7.9 from 54.2) and Richmond (3.0 from 5.7)—with only Philadelphia showing a slight acceleration this month. Meanwhile, New York's prices-received measure eased for the second month, to 14.0, after accelerating the prior two months from 12.8 to 22.9—nearly matching its recent peak of 23.3 last June. The prices-received index for the Philly region dropped to 20.0 this month, after hovering in a flat trend around 26.0 the prior six months; it peaked at 35.0 last July. Kansas City's prices-received index has been more volatile than the rest; it ticked up to 10.0 this month after dropping from 23.0 to 7.0 the prior two months; it was at 8.0 at the end of last year. Meanwhile, Dallas' (6.0 from 6.5) is hovering around recent lows, versus its 2018 peak of 26.2, while Richmond's (1.8 from 2.8) continued to ease from its 2018 peak. (Note: Richmond prices are not diffusion indexes but rather average annualized inflation rates.)

GLOBAL ECONOMIC INDICATORS

Eurozone Economic Sentiment Indicators (*link*): The Economic Sentiment Index (ESI) fell markedly in April for both the Eurozone (-1.6 points to 104.0) and the EU (-1.5 to 103.7). Since reaching 18-year highs of 114.5 and 114.4, respectively, at the end of 2017, the former has dropped 10.5 points and the latter 10.7 points to their lowest levels since September 2016 and August 2016. Except for the Netherlands' (+0.4 points to 105.6) gain, sentiment deteriorated in the largest Eurozone economies this month: Spain (-2.6 to 104.1), Germany (-1.5 to 105.1), France (-1.0 to 101.0), and Italy (-1.0 to 100.0). At the sector level, sentiment fell in four of the five industries included in the ESI: Industry (-2.5 points to -4.1), retail trade (-1.4 to -1.1), construction (-0.8 to 6.7), and consumer (-0.7 to -7.9)—with industry the lowest since 2014; services sentiment was unchanged at 11.5 this month.

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