Yardeni Research

MORNING BRIEFING
June 3, 2019

Trade: Helter Skelter

See the collection of the individual charts linked below.

(1) Stepping up the pressure on Mexico. (2) Will there be any relief for the latest panic attack? (3) Recession signals from the bond market? (4) Yield curve predicting easier monetary policy. (5) US beef with China is about more than just trade. (6) China's M-PMI shows weakening economy. (7) Mexican standoff. (8) Clarida's Put. (9) Slicing and dicing NIPA profits. (9) Movie review: "Rocketman" (+ +).

Trade: More Game of Thrones. Geopolitics rarely matters to financial markets until it matters. Trump's escalating trade war with China expanded last Thursday to a second front on America's southern border. On 6/10, Trump will slap a 5% tariff on all goods imported from Mexico. That tariff will be increased to 10% on 7/10, 15% on 8/10, 20% on 9/10, and 25% on 10/10 unless the Mexican government does something to stem the tide of illegal immigrants crossing the border into the US.

Very often in the past, geopolitical crises have created buying opportunities for stock investors. Joe and I think that's the case again with the latest selloff. So we still view it as Panic Attack #63 rather than the beginning of a bear market. The previous 62 attacks since the start of the current bull market were followed by relief rallies. Admittedly, it is getting harder to see such a rally as Trump's trade war escalates and widens to more fronts.

The S&P 500 is down 6.6% from its record high of 2945.83 on 4/30 as a result of Trump's escalating and widening trade war (*Fig. 1*). With the benefit of hindsight, this is another year when selling in May was a good idea. It's been a brutal month for the S&P 500's cyclical sectors that are most disrupted by tariffs. Here is May's performance derby for the 11 sectors: Real Estate (0.9%), Utilities (-1.3), Health Care (-2.5), Consumer Staples (-4.0), Communication Services (-6.0), Financials (-7.4), Consumer Discretionary (-7.7), Industrials (-8.1), Materials (-8.5), Information Technology (-8.9), and Energy (-11.7) (*Fig. 2*).

The problem with the sell-in-May concept is that it hasn't always worked, and when it did, the next trick was to know when to jump back in to the stock market. Given Trump's helter-skelter approach to trade dealing, it wouldn't take much to trigger a significant relief rally if Trump declares that both China and Mexico have made enough concessions so that deals can be struck without slapping a 25% tariff on another $300 billion of made-in-China imports (on top of the $200 billion that has the tariff) and without the graduated tariff hikes on goods from Mexico.

Meanwhile, recession jitters have been mounting, as the 10-year US Treasury bond yield dropped to 2.14% on Friday, the lowest since 9/11/17 (*Fig. 3*). The yield curve spread between this bond and the federal funds rate turned negative, falling to -23bps on Friday, the lowest since 1/21/08 (*Fig. 4*).

We're still not convinced that this is a sure sign of an imminent recession. As we observed in our *Topical Study #83*, "The Yield Curve: What Is It Really Predicting?," inverted yield curves don't cause recessions; rather, they anticipate Fed easing such as occurred in the past as a result of financial

crises, which caused subsequent recessions. This time, the credit system remains relatively calm and stable. The US labor market remains strong.

Admittedly, that could all change for the worse if Trump's helter-skelter approach to trade goes berserk. For now, we're sticking with our view that all sides in Trump's trade disputes need deals. If we are wrong about that, then mounting recessionary pressures will most likely be offset by Fed easing, as suggested by Fed Vice Chairman Richard Clarida in a speech last week. But before we go there, consider the following trade-related developments:

(1) *China.* The trade talks with China blew up when the Trump administration insisted that the Chinese change laws as part of the enforcement mechanism, not just regulations (which they've agreed to change). The Chinese say they are still willing to talk, but no talks have been held since early May, and the Chinese semi-official media has turned increasingly bellicose with President Xi Jinping, who has called on the nation to be ready for a "new long march."

Meanwhile, the US Acting Secretary of Defense Patrick M. Shanahan suggested in a speech Saturday that America's beef with China is about much more than trade and intellectual property: "Behavior that erodes other nations' sovereignty and sows distrust of China's intentions must end." He got more specific during Q&A after the speech, citing examples of China's bad behavior that will no longer be ignored such as its island-building in the South China Sea and the 5G controversy: "Huawei is too close to the government. The integration of civilian businesses with the military is too close. That's too much risk for the [defense] department. We can't trust that those networks will be safe." However, Shanahan also stated: "I don't see a trade war. I see trade negotiations that are ongoing."

Meanwhile, China's official M-PMI was released over the weekend. It dropped from 50.1 during April to 49.4 during May. Output remained above 50.0 at 51.7, but new orders fell to 49.8. Employment continued to weaken to 47.0. Trump's trade war clearly is hurting China's economy.

(2) *Mexico.* Trump, self-proclaimed "Tariff Man," confirmed the accuracy of this appellation last week when he threatened to impose tariffs on Mexico to deal with an immigration problem. Using tariffs as an immigration policy tool certainly is unconventional. And it jeopardizes Trump's first and only significant trade success to date—replacing NAFTA with a renegotiated trade deal with Mexico and Canada, which has yet to be approved by Congress. Why put that progress at risk, especially since Mexico may simply not have the resources to fix the problem?

Moreover, disrupting supply chains in Mexico in addition to China could depress US manufacturing. It undoubtedly would depress Mexico's economy, which would only exacerbate the US's immigration problem.

Fed: Clarida's Put. Fed Vice Chairman Richard Clarida spoke on Thursday at the Economic Club of New York. He started off by observing that in July, the current economic expansion will be the longest on record, at least since the 1850s, when records were first kept. Twice, he said that "the US economy is in a good place." Actually, the second time, he said it is in "a very good place."

This means that the FOMC will remain "patient." He asked rhetorically: "What does this mean in practice?" He answered: "To me, it means that we should allow the data on the U.S. economy to flow in and inform our future decisions."

Clarida states that the FOMC's range for the federal funds rate, between 2.25% and 2.50% since January, is exactly where it should be using a Taylor-type rule. He notes that the FOMC isn't concerned about the "softness in recent inflation data" because it "will prove to be transitory."

He implied that the Fed won't hesitate to ease if necessary: "However, if the incoming data were to show a persistent shortfall in inflation below our 2 percent objective or were it to indicate that global economic and financial developments present a material downside risk to our baseline outlook, then these are developments that the Committee would take into account in assessing the appropriate stance for monetary policy."

Profits I: NIPA's Latest Numbers. The first revision to the GDP data for Q1-2019 was released last Thursday. There weren't any significant changes. At the same time, preliminary data were released for the quarter's profits for all corporations as reported in the National Income and Product Accounts (NIPA). They were remarkably unremarkable.

In fact, profits before tax (PBT) has remained stalled at a record high around $2.2 trillion since Q1-2012 (*Fig. 5*). The same can be said about profits after tax (PAT), which has stalled around $1.8 trillion over the same period. That's remarkable because Trump's corporate tax cut had little apparent impact on this measure of profits. It's also remarkable how well the stock market has done even though NIPA profits have been flat-lining for so long. Needless to say, the bears have been growling about this divergence for some time.

To cut to the chase, the NIPA profits data include items that are not relevant to the performance of the stock market. According to "Chapter 13: Corporate Profits" of the *NIPA Handbook*:

"Corporate profits measures the income, before deducting income taxes, of organizations treated as corporations in the NIPAs. These organizations consist of all entities required to file federal corporate tax returns, including mutual financial institutions and cooperatives subject to federal income tax; nonprofit organizations that primarily serve business; Federal Reserve banks; and federally sponsored credit agencies." US corporations include private ones and S corporations.

The IRS website explains: "S corporations are corporations that elect to pass corporate income, losses, deductions, and credits through to their shareholders for federal tax purposes. Shareholders of S corporations report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates. This allows S corporations to avoid double taxation on the corporate income. S corporations are responsible for tax on certain built-in gains and passive income at the entity level."

So the profits (and losses) of S corporations are included in pre-tax NIPA profits, but their taxes are not reflected in after-tax NIPA profits. S corporations can have no more than 100 shareholders. A 1/13/14 Tax Foundation article reported that the US then had 1.7 million traditional C corporations and 7.4 million partnerships and S corporations. Now consider the following:

(1) *Record-low corporate tax rate.* Trump's tax reform package slashed the corporate income tax rate from 35% to 21% at the start of 2018 (*Fig. 6*). In the NIPA, taxes on corporate income consists of taxes paid on corporate earnings to federal, state, and local governments and to foreign governments.

The global effective tax rate based on NIPA (i.e., PBT minus PAT divided by PBT) dropped from 18.6% at the end of 2017 to 10.9% during Q1-2019. (Remember that S corporations' profits are included in PBT, but not subtracted from PAT. The Fed's profits are included in PBT, and are returned to the US Treasury.)

Interestingly, the 12-month sum of US federal government corporate income tax receipts fell by $106 billion from $303 billion during May 2017 to $197 billion during the latest period through April (*Fig. 7*).

That's a 35% drop, but the dollar amount seems like a relatively smaller tax cut than suggested by all the hoopla on both sides of the political aisle.

(2) *Record dividends.* In the NIPA, corporate dividends rose to a record $1.25 trillion over the past four quarters through Q1-2019 (*Fig. 8*). Over the same period, the S&P 500 companies paid a record $462 billion in dividends.

(The *NIPA Handbook* defines net dividends as "payments in cash or other assets, excluding the corporation's own stock, made by corporations located in the United States and abroad to stockholders who are U.S. residents. The payments are netted against dividends received by U.S. corporations, thereby providing a measure of the dividends paid by U.S. corporations to other sectors.")

(3) *Record cash flow.* The NIPA tend to focus on after-tax profits "from current production," which is PAT with the Inventory Valuation Adjustment (IVA) and the Capital Consumption Adjustment (CCAdj) applied. These two adjustments restate the historical-cost basis used in profits tax accounting for inventory withdrawals and depreciation to the current-cost measures used in GDP (*Fig. 9*). (PBT and PAT without the adjustments are sometimes called pre-tax and after-tax "book profits.")

Corporate cash flow equals PAT from current production less dividends plus tax-reported depreciation (*Fig. 10*). It's been at a record high of about $2.6 trillion (saar) for the past four quarters through Q1-2019. This is what drives capital spending. Retained earnings (PAT less dividends) is actually relatively small compared to tax-reported depreciation, which rose to a record $1.9 trillion (saar) during Q1.

Previously, Joe and I have observed that the widespread notion that dividends and buybacks are sucking all the air out of profits, leaving nothing for capital spending, is just plain wrong. There's plenty of cash available for capital spending thanks to depreciation allowances. Dividends do reduce retained earnings. Buybacks, on the other hand, have no such impact, especially if they are mostly offsetting dilution attributable to stock compensation plans. In this case, the buybacks in effect are paid for by the expense of the compensation paid in stock! (See our *Topical Study #84*, "Stock Buybacks: The True Story.")

Profits II: NIPA vs S&P 500. Now that we are having so much fun slicing and dicing the latest NIPA data, let's compare them to S&P 500 aggregate net income. The latter is a "cleaner" measure of stock-market-relevant profits than PAT is. Now consider the following:

(1) Not surprisingly, after-tax book profits—i.e., PAT—is highly correlated with S&P 500 reported net income, which is compiled by Standard & Poor's based on GAAP-reported data (*Fig. 11*). Historically, the latter has accounted for roughly 50% of NIPA's PAT (*Fig. 12*).

(2) The S&P 500's reported net income is up 40.7% from Q1-2012 through Q1-2019. So it has been much more bullish than NIPA's series over this same period.

(3) There's a fairly close fit between the S&P 500 profit margin based on reported earnings and the ratio of PAT to nominal GDP (*Fig. 13*). During Q1, the former was 10.5% while the latter was 9.2%.

The NIPA profit margin ratio has been inversely correlated with total compensation and capital-spending costs relative to nominal GDP since 1948 (*Fig. 14*). That makes sense, since the costs ratio should be inversely related to the profits margin.

In the past, costs would rise faster than GDP during booms at the end of expansions. That would squeeze profit margins, which subsequently would take a dive when the booms turned to busts, as they

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are wont to do.

So far, this time has been different. The cost ratio has increased from a low of 64.0% during Q1-2010 to 66.3% during Q1-2019. However, it remains historically low. That's because company managements have been focusing on raising and maintaining their profit margins ever since the Great Financial Crisis. So they've kept a tight lid on costs. As a result, there hasn't been a boom (so far), which reduces the risk of a bust.

Slicing and dicing some more, we can see that the cost ratio has been held down mostly because compensation relative to GDP during the current economic expansion has been the lowest since the late 1940s and early 1950s (*Fig. 15* and *Fig. 16*).

Movie. "Rocketman (+ +) (*link*) is a biopic about the early career of Elton John. His meteoric rise occurred in his 20s thanks to his amazing collaboration with Bernie Taupin, who wrote the lyrics that Elton put to music. As he rocketed to international super-rock-stardom, he did what many superstars have done, i.e., turn to drugs and drink to dull the pain of loneliness. In Elton's case, he felt that his mom and dad didn't love him. Eventually, he entered rehab, found his true life partner, adopted two boys, and lived happily ever after. The movie juxtaposes Elton's great hits in a way that relates them to what was happening in his life. It's all about the fantastic music.

CALENDARS

US. Mon: Motor Vehicle Sales 16.8mu, Construction Spending 0.4%, ISM & IHS Markit M-PMIs 53.0/50.6, ISM Prices-Paid Index 51.0, Bullard, Quarles. **Tues:** Factory Orders -0.9%, Powell, Williams, Brainard. (DailyFX estimates)

Global. Mon: Eurozone, Germany, France, and Italy M-PMIs 47.7/44.3/50.6/48.5, UK M-PMI 52.2, China IHS Markit M-PMI 50.0. **Tues:** Eurozone Headline & Core CPI Flash Estimates 1.3%/0.9% y/y, Eurozone Unemployment Rate 7.7%, RBA Cash Target 1.25%. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance (*link*): Last week saw the US MSCI index tumble 2.6% to 6.6% below from its record high on May 3. That was its fourth straight weekly decline and the worst since December. The US MSCI's weekly performance ranked 41st among the 49 global stock markets we follow in a week when 18/49 countries rose in US dollar terms. That compares to the prior week's 33/49 ranking, when the US MSCI fell 1.2% as 21 markets rose. The AC World ex-US index fell 1.1%; that performance was also its fourth straight weekly decline and compares to a 0.8% drop a week earlier. EM Latin America was the best performer with a gain of 3.9%, followed by EMEA (2.8%), EM Eastern Europe (1.6), BRIC (0.9), and EM Asia (0.3). The regions underperforming last week: EMU (-2.4) and EAFE (-1.9). Greece was the best-performing country, soaring 15.1% for its best gain in nearly four years, followed by Turkey (10.3), Brazil (7.2), Indonesia (4.8), and Malaysia (3.8). Of the 24 countries that underperformed the AC World ex-US MSCI last week, Israel fared the worst, falling 3.7%, followed by Sweden (-3.4), Italy (-3.4), and Austria (-3.2). In May, the US MSCI tumbled 6.5% in its worst performance since December, ranking 28/44 as the AC World ex-US index fell 5.9% and nearly all regions declined. That compares to the US MSCI's 3.9% rise in April, which was its best gain since January 2018 and ranked 11/49 as it beat the 2.4% gain for the AC World ex-US, in a month when all regions rose. The best-performing regions in May: EM Eastern Europe (1.0), EMEA (-1.1), EM Latin America (-2.4), and EAFE (-5.4). May's worst-performing regions: EM Asia (-9.1), BRIC (-8.0), and EMU (-7.4). The US MSCI's ytd ranking dropped three places last week to 10/49, with its 10.1% ytd gain still nearly double that of the AC World ex-US (5.6). All regions and 38/49 countries are in positive

territory ytd. Among the regions, three are outperforming the AC World ex-US ytd: EM Eastern Europe (12.8), EMEA (7.1), BRIC (6.3), EMU (5.9), and EAFE (5.7). Regions underperforming the AC World ex-US: EM Asia (2.7) and EM Latin America (4.6). The best country performers ytd: Greece (22.9), Russia (20.1), Egypt (19.7), New Zealand (14.0), and Canada (13.0). The worst-performing countries so far in 2019: Sri Lanka (-10.0), Turkey (-10.0), Chile (-8.7), Pakistan (-5.9), and Morocco (-5.4).

S&P 1500/500/400/600 Performance (*link*): All three of these indexes fell for a fourth straight week for the first time since August 2011. LargeCap's 2.6% drop was better than the declines recorded by MidCap (-2.8%) and SmallCap (-3.1). LargeCap ended the week 6.6% below its record high at the end of April. MidCap dropped back into a correction at 11.7% below its 8/29 record high, and SmallCap moved closer to a bear market at 19.1% below its 8/29 record. All 33 sectors moved lower last week, the broadest decline since mid-December and compared to four rising a week earlier. The best performers in the latest week, albeit with declines: LargeCap Real Estate (-0.8%), LargeCap Tech (-1.9), MidCap Tech (-2.0), and SmallCap Communication Services (-2.0). SmallCap Consumer Discretionary (-4.8) was the biggest decliner, followed by MidCap Consumer Staples (-4.6), SmallCap Energy (-4.5), MidCap Energy (-4.5), and LargeCap Energy (-4.4). All three market-cap indexes fell in May and registered their worst declines since December. LargeCap's 6.6% drop was smaller than the declines recorded by MidCap (-8.1) and SmallCap (-8.9). Just one of the 33 sectors advanced in May, compared to 25 sectors rising during April. May's best performers: LargeCap Real Estate (0.9), LargeCap Utilities (-1.3), SmallCap Utilities (-1.3), MidCap Utilities (-1.5), LargeCap Health Care (-2.5). May's laggards: SmallCap Energy (-21.7), MidCap Energy (-17.9), SmallCap Materials (-16.2), LargeCap Energy (-11.7), and SmallCap Consumer Discretionary (-11.3). In terms of 2019's ytd performance, all three indexes are still up for the year. However, LargeCap leads with a gain of 9.8% ytd, ahead of MidCap (8.9) and SmallCap (5.2). Thirty of the 33 sectors are positive ytd, with the cyclicals leading the top performers: LargeCap Real Estate (17.0), LargeCap Tech (15.6), MidCap Tech (15.0), LargeCap Communication Services (13.5), and LargeCap Consumer Discretionary (12.4). MidCap Energy (-5.4) is the biggest decliner so far in 2019, followed by these underperformers: SmallCap Energy (-3.8), SmallCap Health Care (-0.1), MidCap Consumer Staples (0.2), and LargeCap Health Care (0.6).

S&P 500 Sectors and Industries Performance (*link*): All 11 S&P 500 sectors fell last week as seven outperformed or matched the S&P 500's 2.6% decline. That compares to three rising a week earlier, when five outperformed the S&P 500's 1.2% decline. Real Estate was the best-performing sector, albeit with a decline of 0.8%, ahead of Tech (-1.9%), Materials (-2.1), Consumer Discretionary (-2.3), Industrials (-2.5), Health Care (-2.6), and Utilities (-2.6). Last week's biggest underperformers: Energy (-4.4), Consumer Staples (-3.5), Financials (-3.1), and Communication Services (-3.0). The S&P 500 tumbled 6.6% in May as just one of the 11 sectors moved higher and five beat the index. That compares to eight rising and five beating the S&P 500's 3.9% rise in April. The leading sectors in May: Real Estate (0.9), Utilities (-1.3), Health Care (-2.5), Consumer Staples (-4.0), and Communication Services (-6.0). May's laggards: Energy (-11.7), Tech (-8.9), Materials (-8.5), Industrials (-8.1), Consumer Discretionary (-7.7), and Financials (-7.4). All 11 sectors are still higher so far in 2019, compared to just two sectors rising during 2018, when the S&P 500 fell 6.3%. These five sectors have outperformed the S&P 500's 9.8% rise ytd: Real Estate (17.0), Information Technology (15.6), Communication Services (13.5), Consumer Discretionary (12.4), and Industrials (11.6). The ytd laggards: Health Care (0.6), Energy (1.9), Materials (4.0), Financials (8.8), Consumer Staples (9.2), and Utilities (9.4).

Commodities Performance (*link*): Last week, the S&P GSCI index tumbled 4.5% as eight of the 24 commodities moved higher. That was the index's worst decline since mid-December and compares to a 3.6% drop a week earlier, when 12 commodities moved higher. The index nearly climbed out of a correction during mid-April, with a drop of just 10.0% from its high in early October after being down as

much as 26.9% from that high on 12/24. It has since weakened to 18.9% below its October high. Coffee was the strongest performer for the week, as it rose 12.1%, ahead of Kansas Wheat (7.0%), Soybeans (5.8), Corn (5.6), and Sugar (3.8). Crude Oil was the biggest decliner, with a drop of 8.7%, followed by Brent Crude (-8.1), Unleaded Gasoline (-7.4), Feeder Cattle (-7.1), and Heating Oil (-6.7). May saw seven of the 24 commodities climb as the S&P GSCI Commodities index tumbled 8.7% for its worst decline since November. That compares to eight rising in April when the S&P GSCI Commodities index rose 2.8%. May's best performers were Kansas Wheat (20.1), Corn (17.8), Wheat (17.3), Coffee (12.3), and Soybeans (2.8). May's laggards: Crude Oil (-16.3), Unleaded Gasoline (-14.3), Brent Crude (-14.0), Heating Oil (-11.4), and Cotton (-11.3). The S&P GSCI commodities index is up 8.9% ytd following a decline of 15.4% in 2018. The top-performing commodities so far in 2019: Lean Hogs (40.9), Unleaded Gasoline (36.0), Crude Oil (17.8), Brent Crude (15.2), and Corn (13.9). The biggest laggards in 2019: Live Cattle (-16.8), Natural Gas (-16.5), Lead (-10.6), and Feeder Cattle (-9.3).

S&P 500 Technical Indicators (*link*): The S&P 500 price index fell 2.6% last week and weakened relative to its short-term 50-day moving average (50-dma) and its long-term 200-day moving average (200-dma). The index's 50-dma relative to its 200-dma dropped for the first time in 16 weeks from a 32-week high, but the index was in a Golden Cross for a tenth week after being in a Death Cross for 16 weeks. It had been in a Golden Cross for 137 weeks through late November, and its previous Death Cross lasted 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 Golden Cross reading of 3.7% is down from 3.8% a week earlier, but 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 fell for the first time in 16 weeks as the index dropped to a 22-week low of 4.2% below its now-falling 50-dma from 1.7% below its rising 50-dma a week earlier. That's down from 6.6% during mid-February, which was its highest since October 2011 and compares to a seven-year low of 12.0% below at the end of December. The 200-dma fell for a second week after rising for 16 weeks. It had been falling from October to February in the first downtrend since May 2016, when it had been slowly declining for nine months. The 200-dma turned negative for the first time in 12 weeks as it dropped to a 16-week low of 0.6% below its falling 200-dma from 2.0% above its falling 200-dma a week earlier. That's down from a 32-week high of 6.4% at the beginning of May and compares to 14.5% below its falling 200-dma on 12/24, which was the lowest since April 2009. 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 below their 50-dmas last week, compared to three above their 50-dmas a week earlier. All 11 had been above in early April, and all 11 were last below in early January. The longer-term picture—i.e., relative to 200-dmas—shows six sectors trading above currently, down from eight a week earlier as Financials and Industrials fell below. Materials was below its 200-dma for a fourth week, Energy for a 34th week, and Health Care for an eighth week. Nine sectors are in the Golden Cross club (with 50-dmas higher than 200-dmas), unchanged from a week earlier and the highest count since early November. Financials has been back in a Golden Cross for just five weeks, while Health Care was out for a fifth week and Energy for a 29th week. 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). Just two sectors have rising 50-dmas now, down from seven a week earlier, as these five turned down in the latest week: Communication Services, Consumer Discretionary, Consumer Staples, Tech, and Utilities. Energy's 50-dma fell for a fifth week and Health Care's for an eighth week after mostly rising since mid-2016. Four sectors have rising 200-dmas, down from six a week earlier as Consumer Discretionary and Tech turned lower in the latest week and Health Care fell for a fourth week. Among the remaining laggards: Energy, Financials, and Materials have had mostly falling 200-dmas for about eight months now, which compares to just two sectors with rising 200-dmas 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 accelerated by a revised 3.1% (saar) during Q1, little changed from its advance estimate of 3.2%, after slowing steadily from 4.2% during Q2-2018 to 2.2% during the final quarter of last year. While the revision to headline growth was insignificant, there were notable revisions within the components. Trade gave the biggest boost to Q1 GDP growth, as the real trade deficit (to -$903.6 billion from -$955.7 billion) narrowed dramatically from Q4's record gap, though was slightly wider than the initial Q1 estimate of -$899.3 billion. Revisions show real exports (to 4.8% from 3.7%, saar) rose at a faster pace than first reported, while real imports (-2.5 from -3.7) fell at a slower rate (which is a subtraction in the calculation of GDP). Real consumer spending grew at is slowest pace in a year, expanding only 1.3% (saar)—little changed from the 1.2% advance estimate—as follows: Consumer spending on durable goods (-4.6 from -5.3) contracted less than initially reported, while spending on both consumer nondurable goods (2.0 from 1.7) and services (2.1 from 2.0) were little changed from initial estimates, expanding at their slowest rates in a year. Real capital spending (2.3 from 2.7) was slightly slower than first reported and less than half Q4's 5.4% rate. The Q1 growth rate for spending on structures (1.7 from -0.8) was revised from a negative to a positive, while equipment's (-1.0 from 0.2) was revised from a positive to a negative; intellectual property products (7.2 from 8.6) was less positive than first estimated, though still robust. Revisions still show Q1's real private inventory investment ($125.5 billion from $128.4 billion) accumulated inventories at their best rate since Q2-2015, just slightly below the initial estimate. Real government spending (2.5 from 2.4) barely budged from its advanced estimate, swinging back into positive territory, as Q1 growth in state & local expenditures (4.0 from 3.9) was virtually unrevised at its best rate in three years; real federal spending (-0.1 from 0.0) also was little changed from its initial estimate, slowing steadily from Q2-2018's 3.7%. Meanwhile, real residential (-3.5 from -2.8) fell at a sharper pace than first reported, posting its fifth consecutive quarterly decline.

Contributions to GDP Growth (*link*): Trade was the number-one contributor to GDP growth last quarter, pushing consumer spending down to the number-two spot; real residential investment remained the biggest drag on GDP. Some details: (1) Real net exports of goods & services accounted for 0.96ppt of Q1 GDP as both exports (0.58) and imports (0.39) contributed positively. (2) Real consumer spending added 0.90ppt to growth last quarter, as positive contributions from services (0.96) and nondurable goods (0.27) consumption more than offset the drag from durable goods (-0.33) spending. (3) Inventory investment (0.60) rounded out the top three, with nonfarm (0.61) inventories once again accounting for the entire gain. (4) Real government spending (0.42) contributed to growth last quarter after subtracting at the end of last year; state & local spending (0.42) accounted for the entire gain. (5) Nonresidential fixed investment (0.31) continued to elevate economic growth last quarter, driven by intellectual property products (0.32); structures (0.05) and equipment (-0.06) investment had little impact. (6) Residential investment (-0.13) subtracted from GDP growth for fifth consecutive quarter.

Personal Income & Consumption (*link*): Nominal consumer spending in April climbed to a new record high, while real spending was stalled at its record high. Meanwhile, inflation remained subdued. Nominal spending rose 0.3% in April and 1.7% ytd, while real consumer spending was flat last month after increasing 1.2% during the three months through March. We calculate real consumer spending expanded 2.1% (saar) during the three months through April, based on the three-month average, improving steadily from no growth in February. Real consumer outlays on nondurable goods and services accelerated 2.4% and 2.2% over the comparable three-month period, while consumer durable goods consumption increased 0.6% (saar) after being in the red the first three months of the year. Last month, real wages & salaries held at its record high, after climbing the first three months of the year— accelerating 3.1% (saar) during the three months through April, based on the three-month average, up

from 0.6% at the end of 2018. Meanwhile, April data show headline inflation was only 1.5% y/y, while the core rate—the Fed's preferred measure—climbed to 1.6% y/y from a 14-month low of 1.5% in March, remaining below its target rate of 2.0%.

Consumer Sentiment (*link*): Mid-May readings boosted the Consumer Sentiment Index (CSI) to its highest level since January 2004, though the exuberance was quashed during the last two weeks of May—due to unfavorable references to tariffs. Despite the setback during the latter half of May, the CSI still rose last month, from 97.2 in April to an eight-month high of 100.0, boosted by a rise in expectations from 87.4 to 93.5—which was the highest since January 2004. (The mid-May readings were 102.4 and 96.0, respectively.) Meanwhile, the present situation component fell from 112.3 to a three-month low of 110.0 during the month—below the mid-month reading of 112.4. According to the University of Michigan's report, tariffs were spontaneously mentioned in an unfavorable context by 35% of all consumers in the last two weeks of May, more than double the 16% posted during the first half of the month and the 15% recorded in April. That matched its peak rate recorded last July in response to the initial imposition of tariffs. Meanwhile, the expected inflation for the year ahead accelerated from 2.5% to a seven-month high of 2.9%, impacting buying conditions for appliances and other large household durable goods—which fell to their lowest level in four years. Still, consumers have expressed the highest level of confidence since 2002 in the government's ability to keep both inflation and unemployment at reasonably low levels.

Pending Home Sales (*link*): The Pending Home Sales Index (PHSI)-measuring sales contracts for existing-home purchases-unexpectedly fell 1.5% in April to 104.3, and was down 2.0% y/y, the 16th straight month of annual declines. Regionally, sales only rose in the Midwest in April, while they were below year-ago levels in all four regions. Here's a tally: Midwest (+1.3%m/m & -2.4%y/y), West (-1.8 & -1.5), South (-2.5 & -1.8), and Northeast (-1.8 & -2.1). Lawrence Yun, NAR chief economist, said the sales dip has yet to account for some of the more favorable trends in homeownership, such as lower mortgage rates. "Though the latest monthly figure shows a mild decline in contract signings, mortgage applications and consumer confidence have been steadily rising," he said. "It's inevitable for sales to turn higher in a few months." Meanwhile, home appreciation has been highest at the lower end of the market, as the supply of inventory for homes priced under $250,000 has been tight at only 3.3 months; inventory for homes priced at $1 million and above was 8.9 months.