



MORNING BRIEFING

June 18, 2019

Progressive Economics for Dummies (PED)

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

(1) Everything for free. (2) Wealth taxes and MMT. (3) Heaven on Earth for all. (4) Are you better off than you were 20 years ago? (5) Never enough. (6) Bill and Elizabeth's excellent adventure. (7) So why are consumers so upbeat? (8) Happy to quit. (9) Real pay per worker on uptrend since 2000, and so is real income per household. (10) Only 1.3 million taxpayers are in the 1% club. (11) S corporations exaggerate profits' share of national income. (12) Why are corporations buying their shares back after they've run up so much? (13) MMT will make your head spin.

PED I: Voters Are Dumb. Progressive politicians must think that voters are dumb. We will find out whether they're right after the next round of national elections on 11/3/20.

The Progressives are promising to give Americans free universal health care, free pre-kindergarten, free college education, and full-time jobs. They promise to forgive student loans and to provide a Universal Basic Income to anyone who gets out of bed (or not).

They intend to pay for all the freebies by slapping a wealth tax on the rich. If that doesn't raise enough money, they will borrow all the rest based on their belief in Modern Monetary Theory (MMT). According to MMT, the US government can borrow an unlimited amount of dollars as long as inflation remains subdued.

Like all Socialists, Progressives are promising their voters Heaven on Earth. Their Green New Deal will make our planet a better place to live once we get rid of cows, cars, gasoline, and plastic, i.e., everything made from petroleum.

To convince voters that Progressive policies will bring progress to their lives, the Progressives spend a lot of effort convincing Americans that most of them have made no progress because they've been shafted for the past 20 years. Their key point is that median household income in America has stagnated for two decades. They claim that most Americans are no better off and quite a few are worse off. Their kids are doomed to have a lower standard of living than their parents unless Progressive policies are implemented as soon as possible.

Progressives never explain why all of their previous policies, from the New Deal to the Great Society to Obamacare, haven't improved the lives of most Americans. They argue that their policies have made a difference, but more needs to be done.

Progressives blame the wealthy for most of our problems. The rich have exploited everyone from workers to consumers to get incredibly rich, exacerbating income and wealth inequality along the way. As NYC Mayor Bill De Blasio has often claimed, "There's plenty of money in this world, plenty in this country. It's just in the wrong hands."

Besides, the rich didn't get rich without the help of all the rest of us, so they say. Senator Elizabeth

Warren (D-MA) famously once ranted: “I hear all this, you know, ‘Well, this is class warfare, this is whatever.’ No. There is nobody in this country who got rich on his own. Nobody. You built a factory out there? Good for you. But I want to be clear: you moved your goods to market on the roads the rest of us paid for; you hired workers the rest of us paid to educate; you were safe in your factory because of police forces and fire forces that the rest of us paid for. You didn’t have to worry that marauding bands would come and seize everything at your factory, and hire someone to protect against this, because of the work the rest of us did. Now look, you built a factory and it turned into something terrific, or a great idea? God bless. Keep a big hunk of it. But part of the underlying social contract is you take a hunk of that and pay forward for the next kid who comes along.”

PED II: Consumers Are Dumb. Consumers must be dumb. They obviously don’t realize how poorly they’ve been doing. They should know they’re no better off than they were 20 years ago. Yet surveys of consumer confidence show that they are very happy.

Debbie and I average the monthly Consumer Sentiment Index and the Consumer Confidence Index to derive our Consumer Optimism Index (COI). In May of this year, it stood near recent cyclical highs around 117 ([Fig. 1](#)). Consumers are almost as upbeat as they were during the start of the 2000s, when the COI was setting records, peaking at 128 during January 2000. The same can be said about the COI’s Current Condition component. Now, consider the following related developments:

(1) *Quits and higher wages.* Workers who aren’t happy with their jobs can quit and find a better one very easily. The number of job openings exceeded the number of unemployed workers by a record 1.63 million during April ([Fig. 2](#)). The percentage of consumers saying that jobs are hard to get was down to only 10.9% in May, the lowest since September 2000 ([Fig. 3](#)). The percentage who said that jobs are plentiful rose to 47.2% during May, the highest since January 2001. This series is highly correlated with the number of workers who quit, which has been at a record high in recent months ([Fig. 4](#)).

The Atlanta Fed’s median wage growth tracker shows that “job switchers” tend to get bigger wage gains than “job stayers” ([Fig. 5](#)).

(2) *Real pay per worker.* In both my book [Predicting the Markets](#) (2018) and subsequent research, I have demonstrated that contrary to the popular Progressive myth of stagnation in the standard of living, nearly all measures of inflation-adjusted mean incomes have been growing solidly over the past few decades.

Let’s begin with wages. From the start of 2000 through the end of 2018, real average hourly earnings rose 19% ([Fig. 6](#)). I am using the series that applies only to production and nonsupervisory workers, who tend to be rich only if they’ve won the lottery. They account for roughly 80% of all workers.

Total real compensation—which includes wages, salaries, and benefits per worker (using the household measure of employment)—rose 20% from the start of 2000 through the end of 2018 ([Fig. 7](#)).

Admittedly, both of these measures of pay per worker are arithmetic means rather than medians. The Bureau of Labor Statistics also compiles a quarterly series on “real median usual weekly earnings.” It is a pre-tax measure and based on a survey. It includes both private- and public-sector employees, but excludes all self-employed persons. It is up 12% since 2000 through the end of 2018 ([Fig. 8](#)).

(3) *Household standard of living.* Of course, the best way to measure the standard of living is on a household basis. There are plenty of such measures that discredit the stagnation myth. Real personal income per household rose 28% before taxes and 32% after taxes since 2000 through the end of 2018

([Fig. 9](#)). Skeptics will pounce on the fact that these are means, not medians, and so might be upwardly biased by the enormous incomes of the ultra-rich. I doubt that, as evidenced by real personal consumption per household, up 28% over the same period. The rich don't eat more than the rest of us to distort the mean.

My basic assumption is that there aren't enough ultra-rich—often dubbed the “1%” for a reason—to bias the mean series I've constructed for personal income and consumption. Sure enough, [IRS data for tax-year 2016](#) show 150.3 million taxpayers filed personal tax returns, but only 1.3 million of them (i.e., 1%) had adjusted gross annual income exceeding \$500,000.

(4) *Share of National Income*. The fatal flaw with all my happy talk about the standard of living seems to be the indisputable fact that the pre-tax compensation of labor (i.e., wages, salaries, and benefits) has been falling as a share of National Income, while the share of pre-tax corporate profits has been rising since the late 1980s ([Fig. 10](#) and [Fig. 11](#)). From Q4-1986 through Q1-2019, the former is down 4.9ppts from 67.1% to 62.2%, while the latter is up 4.5ppts from 8.1% to 12.6%. That's because S corporations are exaggerating profits' share of National Income.

(5) *S corporations*. It's important to know that in the early 1980s, C corporations produced almost all business income. In 2013, only 44% of the income of business owners was earned through C corporations. Owners of S corporations and partnerships now earn about half of all income from businesses. The shift occurred because of tax and legal changes that benefitted pass-through business owners and made the pass-through form more attractive to file. For instance, in 1986, the top individual income tax rate fell below the corporate tax rate. This created significant incentives for a business to un-incorporate and for new businesses to organize as pass-throughs. (See [9 facts about pass-through businesses](#), a Brookings report dated 5/15/17.)

The IRS estimates that there were 4.6 million S corporation owners in the United States in 2014--over twice the number of C corporations.

The Bureau of Labor Statistics notes on its [website](#): “S corporations are legal entities that pay no Federal corporate profits taxes; instead, all of their earnings are treated as taxable income of shareholders, regardless of whether the income is distributed as dividends or retained by the corporation. As a result, most income is paid out as dividends. Since 1998, S corporation dividends generally represented 82 to 92 percent of the profits of S corporations that reported gains. When losses are included, dividends accounted for more than 100 percent of net S corporation profits for most years during that period.”

S corporations tend to distribute most of their earnings to their limited number of shareholders as dividends, which are then taxed as personal income. So they boost corporate profits even though they actually directly benefit the employees of the S corporations. This also explains why the effective corporate tax rate has been well below the statutory rate in the National Income & Product Accounts (NIPA).

Not surprisingly, the personal dividends series included in personal income (along with labor compensation) closely tracks dividends paid by all corporations according to NIPA ([Fig. 12](#)). There is a third dividend series compiled by the IRS that tracks both and is disaggregated into the dividends paid by S corporations and other corporations ([Fig. 13](#)). The data start during 1991, when S corporations accounted for only 18.0% of total dividends ([Fig. 14](#)). They've accounted for around 40% of total dividends from 2000-2015.

The IRS data on S corporation dividends and the BEA data on corporate profits from current production

show that the ratio of the two has increased from 8% during 1991 to about 20% from 2000-2015 ([Fig. 15](#)). This suggests that S corporations have had a significant impact on exaggerating the increase in corporate profit's share of National Income over this period. Obviously, I am assuming that S corporation dividends are more like labor compensation than profits. Excluding these dividends from profits shows that this adjusted measure's share of National Income has been relatively flat around 9%, while the all-inclusive measure has been trending higher since 1991 ([Fig. 16](#) and [Fig. 17](#)).

PED III: CEOs Are Dumb. Progressives are convinced that American corporations are managed by dummies who need the government's help to do better. A recent report produced by the office of Senator Tammy Baldwin (D-WI) observed that stock buyback activity peaks and dips in unison with the S&P 500 market index. The conclusion is obvious: "By definition, if executives are buying high and selling low, they are managing their company's cash poorly, which should disturb all of their stakeholders—not just shareholders, but bondholders, employees, and taxpayers—as the potential for insolvency rises."

Apparently, it never dawned on Baldwin and her staff that the buybacks may be mostly associated with efforts to reduce share dilution resulting from employee stock compensation plans rather than a nefarious conspiracy to boost earnings per share for the benefit of management. Baldwin wants to ban buybacks, which would squelch employee stock compensation plans that benefit not only management but also plenty of other employees. (For more, see our [Topical Study #84](#), "Stock Buybacks: The True Story.") Progressives' best laid plans often have adverse unintended consequences.

PED IV: Stock Investors Are Dumb. Stock investors must be dummies. The S&P 500 is near its all-time record high reached at the end of April. That makes no sense if the incomes of most Americans have stagnated for the past two decades. But how could company earnings be at record highs if most of their customers are doing as badly as claimed by Progressives? How could the rich be so rich unless the economy was growing well enough to increase the incomes of most of their customers?

PED V: Bond Buyers Are Dumb. Progressives must believe that the dumbest people on Earth are bond buyers. According to their MMT ideology, as long as inflation remains subdued, bond buyers will buy all the bonds that Progressives will need to issue to pay for their multi-trillion dollar programs. Previously, I've observed that MMT isn't a theory, but rather a good description of the past 10 years.

The US federal deficit has ballooned since 2009 ([Fig. 18](#)). During President Obama's eight years in the White House, publicly-held federal debt soared 127% to \$14.4 trillion ([Fig. 19](#)). It is up 12% so far under President Trump. Yet, inflation remains subdued, and investors have been purchasing all those Treasury securities at historically low interest rates. Of course, enabling this MMT scenario have been the major central banks with their NZIRP, ZIRP, NIRP, and QE.

So MMT may very well continue to finance Heaven on Earth. More likely, if Progressives come into power, such a radical regime change (with higher taxes and renewed business regulation) could trigger a bear market in stocks and a recession. MMT might not work to revive growth since it has managed to raise debt to levels that seem to be weighing on economic growth rather than stimulating it. Bond buyers may not be as dumb as Progressives believe.

CALENDARS

US. Tues: Housing Starts & Building Permits 1.235mu/1.290mu, FOMC Meeting Begins. **Wed:** MBA Mortgage Applications, DOE Crude Oil Inventories, FOMC Rate Decision Upper & Lower Bounds 2.25% to 2.50%, Rate on Excess Reserves 2.35%, Powell. (DailyFX estimates)

Global. Tues: European Car Sales, Eurozone Headline & Core CPI 1.2%/0.8% y/y, Germany ZEW Current Situation & Expectations 6.1/-5.8, RBA Minutes of June Policy Meeting, Draghi, Carney. **Wed:** UK Headline & Core CPI 2.0%/1.7% y/y, Canada Headline & Core CPI 2.1%/1.9% y/y, Draghi, Juncker. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings rose last week for LargeCap and SmallCap, but MidCap's dropped for the first time in three weeks. LargeCap's was higher for a ninth straight week and at a record high for a second week for the first time since late October. The recent trend has been positive: LargeCap's has risen during 15 of the past 18 weeks; MidCap's 10 of the past 14 weeks; and SmallCap's nine of the past 12 weeks. While LargeCap's forward EPS is at a record high, MidCap's and SmallCap's are 1.3% and 6.0% below their mid-October highs. 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. In the latest week, the rate of change in LargeCap's forward earnings dropped to a 30-month low of 4.3% y/y from 4.6% y/y. That's down from 23.2% in mid-September, which was the highest since January 2011. MidCap's y/y change dropped to a 34-month low of 3.0% from 3.3%, which compares to 24.1% in mid-September (the highest since April 2011). SmallCap's 0.2% y/y is the lowest since January 2010. That compares to an eight-year high of 35.3% in early October. Analysts had been expecting double-digit percentage earnings growth for 2019 last October, but those forecasts are down substantially since then. Here are the latest consensus earnings growth rates for 2018, 2019, and 2020: LargeCap (22.7%, 2.9%, 11.7%), MidCap (22.7, 1.1, 14.2), and SmallCap (22.4, 2.8, 18.7).

S&P 500/400/600 Valuation ([link](#)): Forward P/E ratios were steady for all three indexes last week. LargeCap's weekly forward P/E of 16.4 compares to a 13-month high of 16.9 in early May and is up from a five-year low of 13.9 during December. That also 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 of 15.4 is 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 of 16.0 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 a tad below LargeCap's P/E for a third 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 Q2 earnings season set to begin in less than a month, analysts are no doubt contemplating the trade war's impact on earnings. While revisions activity remains light, last week saw the S&P 500's Q2-2019 EPS forecast drop 19 cents w/w to \$40.49. That's still in line with our forecast of \$41.00, which assumes there will be yet another earnings hook during the reporting season. The consensus' \$40.49 estimate is down 2.1% since the start of the quarter, which represents an earning decline of 1.2% y/y. On a pro forma basis, it represents an earnings gain of 0.3% y/y, compared to 0.4% a week earlier and 2.9% at the end of Q1. If Q2 earnings growth is positive, it would be the 12th straight y/y rise, compared to 1.6% in Q1, 16.9% in Q4, and

28.4% in Q3 (which marked the peak of the current earnings cycle). Five of the 11 sectors are expected to record positive y/y earnings growth in Q2-2019, with only one rising at a double-digit percentage rate. That compares to six positive during Q1, when one also rose at a double-digit percentage rate. Five sectors are expected beat the S&P 500's Q2 growth rate, the same as during Q1. However, Communication Services and Utilities are the only sectors to post better growth on a q/q basis during Q2, just as they did during Q1. Here are the latest Q2-2019 earnings growth rates versus their Q1-2019 growth rates: Communication Services (16.4% in Q2-2019 versus -9.9% in Q1-2019), Financials (6.0, 8.0), Health Care (2.8, 10.3), Utilities (2.2, -0.5), Real Estate (1.1, 6.3), Consumer Discretionary (0.0, 8.1), Industrials (-0.2, 6.9), Energy (-0.6, -26.1), Consumer Staples (-1.3, 0.9), Information Technology (-8.4, -1.1), and Materials (-28.2, -13.4). On an ex-Energy basis, S&P 500 earnings are expected to rise 0.3% y/y in Q2, down from 3.0% in Q1 and well below the 14.2% y/y gain in Q4. Q2's forecasted gain would mark the lowest ex-Energy growth rate since Q2-2016.

US ECONOMIC INDICATORS

Regional M-PMI ([link](#)): The New York Fed is the first district to report on manufacturing activity for June, and was a big disappointment on the downside, as growth contracted for the first time in more than two years. The composite index tanked 26.4 points (its biggest monthly decline on record) to -8.6—the lowest reading since October 2016. The new orders (to -12.0 from 9.7) measure fell at its fastest pace since January 2016, plummeting 21.7 points this month, while shipments (9.7 from 16.3) expanded at a slower pace than last month. Meanwhile, unfilled orders (-15.8 from 2.1) declined at the fastest pace since the end of 2015, while delivery times (-4.5 from 0.7) were somewhat shorter than last month and inventories (-5.3 from -4.1) continued to contract. The employment indicators were disappointing, with the number of employees (-3.5 from 4.7) posting the first negative reading in over two years and the average workweek (-2.2 from 4.4) sinking back below zero. As for inflation, the prices-paid (27.8 from 26.2) index showed prices rose at about the same pace as last month, while the prices-received (6.8 from 12.4) index exhibited a deceleration in selling prices for the fourth consecutive month. The six-month outlook was generally lower than last month: The index for future business conditions fell 4.9 points to 25.7, while indexes for future new orders and shipments fell to similar levels. Meanwhile, firms expected solid increases in employment but no change in the average workweek in the months ahead.

Contact us by [email](#) or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-775-6823

Copyright (c) Yardeni Research, Inc. Please read complete [copyright and hedge clause](#).