



MORNING BRIEFING

July 11, 2019

Powell Gets Trumped!

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

(1) The Fed responds to Trump's trade war. (2) Powell mentioned "trade" eight times yesterday. (3) Method in Trump's madness. (4) The Fed's existential crisis: Inflation isn't a monetary phenomenon. (5) FANGs getting bitten. (6) Ten Asian rivers account for most of the plastic garbage in the oceans. (7) Getting hyper on hyperloops. (8) Consumers still in the mood to spend and have fun.

The Fed: Trump's Powell Play. President Donald Trump wants the Fed to lower interest rates. Fed Chair Jerome Powell claims that the Fed is independent and won't bow to political pressure. Yet Trump has figured out the perfect way to force the Fed to lower interest rates. All he has to do is keep creating uncertainty about US trade policy. In his congressional [testimony](#) yesterday on monetary policy, Powell mentioned the trade issue eight times in his prepared remarks:

(1) "However, inflation has been running below the Federal Open Market Committee's (FOMC) symmetric 2 percent objective, and crosscurrents, such as **trade** tensions and concerns about global growth, have been weighing on economic activity and the outlook."

(2) "The slowdown in business fixed investment may reflect concerns about **trade** tensions and slower growth in the global economy."

(3) "Moreover, a number of government policy issues have yet to be resolved, including **trade** developments, the federal debt ceiling, and Brexit."

(4) "At the time of our May meeting, we were mindful of the ongoing crosscurrents from global growth and **trade**, but there was tentative evidence that these crosscurrents were moderating."

(5) "The latest data from China and Europe were encouraging, and there were reports of progress in **trade** negotiations with China."

(6 & 7) "Apparent progress on **trade** turned to greater uncertainty, and our contacts in business and agriculture report heightened concerns over **trade** developments."

(8) "Since then, based on incoming data and other developments, it appears that uncertainties around **trade** tensions and concerns about the strength of the global economy continue to weigh on the U.S. economic outlook."

The message to Trump is clear: Keep trade negotiations ongoing and alternate your messaging about how they are going between well and not so well. The more uncertainty the better to get the Fed to lower interest rates. Then later this year or early next year, declare victory in the trade wars with China, India, Japan, Europe, and the rest of the world. It's all about winning a second term and playing Powell to do so.

In this scenario, the S&P 500 gets to our year-end target of 3100 ahead of schedule, and to 3500 by the end of next year, or sooner.

After listening to Powell's testimony yesterday, Melissa and I are joining the consensus expecting a 25bps rate cut at the July 30-31 FOMC meeting. We still think it would be a mistake (though not a tragic one), since we don't see the need to use some of the Fed's scarce ammo at this time.

By the way, in the Q&A session of his testimony, Powell inadvertently suggested that the Fed is facing an existential crisis, and we don't mean Trump's threats to limit the Fed's independence. Rather, Powell expressed concern that if inflation gets too close to zero, the federal funds rate will also be too close to zero, not leaving the Fed much room to ease during the next recession.

That existential threat helps to explain why Fed officials continue to believe (hope) that their easing policies will boost inflation. We think that by now they should have realized that inflation may not be a macroeconomic phenomenon that can be fine-tuned with monetary policy. Instead, it might be driven by the "4Ds" (Détente, Demographics, Disruption, and Debt), which we discussed in the 3/26 [Morning Briefing](#).

Sector Roundup: Revisiting Old Friends. There were lots of headlines in recent days that hit upon many of the themes we've highlighted this year. Some themes were notable because of their broad impact, and others we called out because they weren't getting enough attention. So here's a quick update from Jackie that takes a look, both forward and backward:

(1) *Tech: FANG bites.* We've spilt considerable ink on how the Internet giants have come under attack from politicians at home and abroad for their business practices and their overwhelming size, including in the 6/6 [Morning Briefing](#). The frenzy will certainly continue next week when executives from Alphabet, Amazon, Apple, and Facebook testify at a US House of Representatives hearing on online platforms and market power.

Their appearances follow a new probe launched on Monday by the House Energy and Commerce Committee into fake reviews on Amazon. Fake reviews can put honest sellers at a disadvantage, and their writers may have learned how to trick Amazon's algorithms that highlight certain products. "In March, ReviewMeta, an American data company, released a report that found nearly 60% of the reviews they analyzed on Amazon within the first three months of 2019 were from unverified buyers. That was up from 9% in the same period in 2018," a 7/9 [article](#) in *The Washington Times* reported.

Amazon also got bad news from a US federal appeals court that ruled the company could be held liable for defective items sold by third parties over Amazon's website. The decision goes against two earlier court cases ruling that Amazon was not liable because it wasn't the seller of the products. We'll keep an eye on the appeals process, as third-party sales represented 18.5% of the company's total revenue.

In this case, Heather Oberdorf bought a dog collar from "The Furry Gang," a third-party retailer on Amazon, according to the decision by the 3rd US Circuit Court of Appeals in Philadelphia in [Oberdorf vs. Amazon](#). When her dog lunged, the ring on the collar broke, and the leash recoiled. It hit Oberdorf's face and eyeglasses, leaving her blind in the left eye. She tried to sue Furry Gang, but neither she nor Amazon has been able to locate a representative of the company.

The court decision notes that Amazon does more than just list the products third-party companies are selling. Amazon also collects order information from the consumer, processes payments, and formats the product's listing information. Amazon and third-party sellers have an agreement that gives Amazon

a “royalty-free, non-exclusive, worldwide, perpetual, irrevocable right and license to commercially or non-commercially exploit in any manner the information provided by third-party vendor.” In addition, vendors agree to not charge more on Amazon than they charge for the product in any other sales channel and to communicate with customers only over the Amazon platform.

FANG—the acronym for the stocks of four tech giants, i.e., Facebook, Amazon, Netflix, and Google’s parent Alphabet—hasn’t outperformed the S&P 500 since early 2018 ([Fig. 1](#)). At its peak last year, FANG represented 10.5% of the S&P 500’s market capitalization. That percentage has contracted only slightly since then, to 9.9%, so FANG is still an important component of the broader index ([Fig. 2](#)). The S&P 500’s forward P/E is 17.2, but without the FANG gang it’s only 16.0 ([Fig. 3](#)).

(2) *Materials & Energy: Dirty business.* In the 7/3 [Morning Briefing](#), we discussed how the surge in fracking and low gas prices have led to a boom in plants that produce the feedstocks for plastic—and, conversely, how a move to recycle more could threaten that boom.

Some eagle-eyed readers noted that the world’s oceans would still be polluted even if US residents became hyper-conscious recyclers, because 90% of the plastic found in the world’s oceans is traced to eight rivers in Asia and two in India, according to a 2017 study in *Environmental Science & Technology*.

Fortunately, the US isn’t alone in its recycling efforts. The 7/5 *WSJ* ran an excellent [article](#) about India’s efforts to reduce single-use plastics. Many of India’s products are sold in single-use containers to keep the price low. By the end of next year, India will require consumer goods companies to collect and find alternative uses for multilayer plastic packaging equal to the amount of plastic packaging that’s used in the new products they sell. Doing so will require consumers to clean out and sort their garbage, and companies may employ a bevy of pickers to find and sort the material.

London might not be a huge source of plastic pollution in the oceans, but two girls with help from their mother launched a petition asking McDonald’s to stop putting plastic toys in Happy Meals, according to a 7/8 *WSJ* [article](#). The petition has attracted 325,000 signatures since launching late last year, and it follows calls by the UK Environment Minister Thérèse Coffey for McDonald’s to end plastic toys in Happy Meals.

The *WSJ* article noted that a McDonald’s working group is looking into the environmental issues related to Happy Meal packaging and toys. The group is exploring ways to make the toys from plastic that is more readily recyclable and from renewable materials.

(3) *Hyper for hyperloops.* While it was Elon Musk who wrote a famous [white paper](#) outlining the ideas behind hyperloops, three other companies are turning those ideas into a reality. The 3/7 [Morning Briefing](#) took a look at Virgin Hyperloop One, which created a test track in Las Vegas; Hyperloop Transportation Technologies (HTT), which is building a test track in Toulouse; and TransPod, a Canadian company with plans to start building a test track in Canada and France. The wheels of hyperloop progress are moving slowly, with technological issues still to solve, major government red tape involved, and billions in funding still to be raised. Here’s a look at some of the current projects under consideration:

Hyperloops at home. A proposed hyperloop from Kansas City to Saint Louis would shrink the 250-mile trip to 30 minutes and cost an estimated \$7 billion to \$10 billion, a 5/23 *WSJ* [article](#) stated. A theoretical Great Lakes Hyperloop would get you from Cleveland to Chicago in under 30 minutes. Another hyperloop under consideration would run from Pittsburgh to Chicago via Columbus. And lastly, Colorado and Virgin Hyperloop One are conducting a feasibility study for a 215-mile hyperloop from Cheyenne, Wyoming through Denver (with a line to Vail), to Colorado Springs, noted an [article](#) in *Travel*

Weekly.

Hyperloops abroad: Virgin Hyperloop One has a “framework” agreement with India’s state of Maharashtra for a 100-mile hyperloop between Mumbai and Pune. HTT is hoping to build another hyperloop between Dubai and Abu Dhabi and expects the first portion of the line will be operating by the October 2020 World Expo, the *Travel Weekly* article stated. In Europe, Hardt Hyperloop dreams of a system connecting the European continent’s major cities, extending over 10,000 kilometers, a 7/1 [article](#) in *The Brussels Times* reported.

Consumer Discretionary: Getting Some Respect. Fourth of July festivities may be over, but the market saw fireworks yesterday as the S&P 500 briefly passed 3,000 for the first time on rate-cut optimism. Here’s the performance derby for the S&P 500’s sectors ytd through Tuesday’s close: Technology (28.4%), Consumer Discretionary (24.1), Real Estate (22.5), Communication Services (20.8), Industrials (19.2), S&P 500 (18.9), Financials (17.8), Consumer Staples (16.5), Utilities (14.8), Materials (14.2), Energy (10.3), and Health Care (7.7) ([Fig. 4](#)).

The S&P 500 Consumer Discretionary sector has been an unsung hero of this market. But as business spending has slowed in recent months, the consumer is getting some respect. Both PepsiCo CEO Ramon Laguarta and Fed Chair Powell called out the strength of the US consumer in comments this week.

From PepsiCo’s Laguarta: “We see a healthy consumer. A consumer where price statistics are good and so we cannot see any signals that tells us that consumer is slowing down, at least in our categories.” And from Fed Chair Powell: “While growth in consumer spending was weak in the first quarter, incoming data show that it has bounced back and is now running at a solid pace.”

So while department stores and malls continue to struggle, consumers keep spending in other areas. The stock price indexes of fun-related industries are having a great year, as these ytd gains attest: Casinos & Gaming (27.0%), Restaurants (26.6), and Hotels, Resorts & Cruise lines (20.0) ([Fig. 5](#)).

Meanwhile, lower interest rates have reignited investors’ enthusiasm for housing-related industries, which have surged higher ytd: Household Appliances (33.6%), Homebuilding (23.8), and Home Improvement Retail (20.7). All things auto have rallied too, even as auto sales have plateaued: Automobile Manufacturing (21.4), Automotive Retail (21.3), and Auto Parts & Equipment (20.4) ([Fig. 6](#)).

CALENDARS

US. Thurs: Headline & Core CPI 1.6%/2.0% y/y, Jobless Claims 221k, EIA Natural Gas Report, Powell Testifies Before Senate Banking Committee, Williams, Kashkari. **Fri:** PPI Final Demand Headline & Core 1.6%/2.1% y/y, Baker-Hughes Rig Count, Evans. (DailyFX estimates)

Global. Thurs: Germany CPI 0.3%*m/m*/1.6%*y/y*, ECB Publishes Account of June Policy Meeting, BOE Publishes Financial Stability Report, Coeure. **Fri:** Eurozone Industrial Production 0.2%*m/m*/-1.6%*y/y*, Japan Industrial Production, China Trade Balance \$45.2b, Mexico Industrial Production -1.5%*y/y*. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): The Bull/Bear Ratio (BBR) rose this week for the fifth consecutive week, climbing further above 3.00, as bullish sentiment jumped to a new high for this year. The BBR climbed for the fifth week to 3.10 after sliding the prior five weeks from 3.17—which was the

first reading above 3.00 since October—to 2.31 (lowest since mid-February). Bullish sentiment has soared 14.0ppts the past five weeks, to 56.7%, after a five-week plunge of 13.7ppts, from 56.4% to 42.7%—which was the fewest bulls since the first week of this year. The recent move to the bullish camp came entirely from the correction camp, which dropped 13.8ppts to 25.0%. The correction count had soared 13.0ppts the previous five weeks—from 25.8% to 38.8%—which was the highest percentage since just before Christmas. Bearish sentiment was at 18.3% this week, fluctuating in a small band from 18.0% to 18.5% the past six weeks. The AAll Ratio rose for the fourth week last week to 50.6% after a four-week decline from 65.0% to 34.6%. Bullish sentiment increased from 22.5% to 33.2% over the two-week period, while bearish sentiment edged up slightly last week to 32.4% after falling the prior three weeks from 42.6% to 32.1%.

S&P 500 Earnings, Revenues, Valuation & Margins ([link](#)): Consensus S&P 500 forward revenues and earnings were back at a record high during the week of 7/4. Analysts expect forward revenues growth of 5.3% and forward earnings growth of 7.9%. Forward revenues growth is down 1.0ppt from a seven-year high of 6.3% in February 2018, but is up from a 31-month low of 5.0% in mid-February. Forward earnings growth is down 9.4ppts from a six-year high of 16.9% last February, but has improved steadily from a 34-month low of 5.9% in late February. Prior to the passage of the Tax Cuts and Jobs Act (TCJA), forward revenues growth was 5.5% and forward earnings growth was 11.1%. Turning to the annual growth expectations, analysts expect revenues growth to slow from 8.5% in 2018 to 4.4% in 2019 and 5.3% in 2020. They're calling for earnings growth to slow sharply from 24.1% in 2018 to 2.6% in 2019 before improving to 10.8% in 2020. The forward profit margin was steady w/w at 12.1%, and is down just 0.3ppt from a record high of 12.4% in mid-September. That compares to 11.1% prior to the passage of the TCJA in December 2017 and a 24-month low of 10.4% in March 2016. Analysts are expecting the profit margin to fall from 12.0% in 2018 to 11.7% in 2019 before rising to 12.4% in 2020. The S&P 500's forward P/E rose 0.4 point w/w to a 14-month high of 17.2. That's up from 14.3 during December, which was the lowest reading since October 2013 and down 23% from the 16-year high of 18.6 at the market's valuation peak in January 2018. The S&P 500 price-to-sales ratio improved w/w to a 10-month high of 2.08 from 2.03. That's up from 1.75 during December, when it was the lowest since November 2016, and down 19% from its then-record high of 2.16 in January 2018.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins ([link](#)): Consensus forward revenues rose w/w for nine of the 11 S&P 500 sectors and forward earnings for all 11 sectors. Financials and Industrials were the only sectors to have forward revenues fall w/w. Forward revenues and earnings are at or around record highs for 4/11 sectors: Consumer Discretionary, Health Care, Industrials, and Tech. Forward P/S and P/E ratios are now well above their multi-year lows during December 2018 for all sectors, and are at multi-year or record highs for four sectors: Communication Services, Real Estate, Tech, and Utilities. Due to the TCJA, the profit margin for 2018 was higher y/y for all sectors but Real Estate. The outlook for 2019 shows higher margins are expected y/y for just 4/11 sectors: Consumer Discretionary, Financials, Industrials, and Utilities. The forward profit margin rose to record highs during 2018 for 8/11 sectors, all but Energy, Health Care, and Real Estate. Since then, it has moved lower for nearly all of the sectors. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (21.9%, down from 23.0%), Financials (18.6, down from 19.2), Real Estate (15.8, down from 17.0), Communication Services (14.9, down from 15.4), Utilities (13.0, matching its record high in mid-May), S&P 500 (12.1, down from 12.4), Materials (10.3, down from 11.6), Health Care (10.5, down from 11.2), Industrials (10.4, matching its record high in mid-March), Consumer Discretionary (7.6, down from 8.3), Consumer Staples (7.4, down from 7.7), and Energy (7.2, down from 8.0).

GLOBAL ECONOMIC INDICATORS

UK GDP ([link](#)): The economy returned to growth in May after falling in April, while March's decline was

revised to an increase. May real GDP expanded 0.3% (at the top end of expectations) after contracting 0.4% in April, while March's 0.1% loss was revised to a 0.1% gain—reducing the risk of negative Q2 GDP growth. Real GDP growth slowed to 0.3% during the three months through May, based on the three-month average, slowing from 0.4% and 0.5%, respectively, over the comparable periods for April and March. Two of the three major industry groupings posted gains during the three-month period through May, while construction's was flat after gains of 1.0% and 1.4%, respectively, during the comparable periods for April and March. The service industries (which account for about 80% of the private-sector economy) expanded 0.3% during the three months through May, matching April's pace. Meanwhile, production industries (which include manufacturing) slowed to 0.3% over that three-month period, from 0.6% in April and 1.1% in March, as April saw the biggest monthly decline in car production on record, halting manufacturing activity; factories were unable to reverse closures planned when Britain was expected to leave the EU. Looking at yearly percent changes, real GDP rose 1.5% y/y in May, with both construction (1.7% y/y) and service industries (1.7) in the plus column, while production industries expanded 0.9% y/y in May after contracting 1.0% in April.

UK Industrial Production ([link](#)): Output returned to growth in May, posting its fourth gain this year. Headline production rebounded 1.4% in May after a big drop in car production pushed April production down 2.9%; manufacturing output also climbed 1.4% in May after plunging 4.1% in April. Looking at the main industrial groupings, capital goods production posted the biggest monthly gain (5.8%) in May after posting the steepest monthly decline (-6.7) in April—pushing the ytd change back above zero, at 0.4%. Consumer durable goods production was also strong, jumping 2.3% in May and 6.5% ytd, while consumer nondurable goods output fell 2.1% and was basically flat with a year ago. Meanwhile, intermediate goods production was unchanged in May, though up 1.3% so far this year.

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