



MORNING BRIEFING

July 16, 2019

Truck & Train Spotting

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

(1) To be bullish, Dow Theory needs new high for DJTA. (2) Railroads are fine. The problem is Air Freight & Logistics. (3) US & China data showing global economy weaker than their domestic economies. (4) Record employment in trucking. (5) Trucks' crossing: Wage inflation rising, while PPI inflation falling. (6) Railcar loadings growth signaling recession? (7) West Coast ports activity stalled at record high. (8) China railway freight traffic still on uptrend, while trade data stalls. (9) Powell seeing more slack in labor market than he did before.

US Transportation: Mixed Signals. While the Dow Jones Industrials Average (DJIA) rose to a record high on Friday, the Dow Jones Transportation Average (DJTA) remained 8.1% below its record high set on 9/14/18 ([Fig. 1](#)). In other words, the record-setting strength of the DJIA has yet to be confirmed by the DJTA, according to proponents of Dow Theory, who would be more bullish if the DJTA also crossed into record territory.

The S&P 500 Railroads industry accounts for 50% of the market capitalization of the S&P 500 Transportation composite and is within a short station stop away from the record high hit on 5/3 ([Fig. 2](#)). Weighing most heavily on the S&P 500 Transportation composite is the Air Freight & Logistics industry, which accounts for 28% of the composite's market cap and, on Friday, was still 24.4% below its record peak on 1/12/18 ([Fig. 3](#)).

All of the above suggests that the global economy is weaker than the US domestic economy. Debbie and I can see this divergence in the US transportation indicators that we follow:

(1) *Trucking tonnage and employment.* The US trucking industry just keeps truckin' on. In June, payroll employment in truck transportation rose 4,300 m/m and 36,800 y/y to another record high ([Fig. 4](#)). This series is highly correlated with the ATA truck tonnage index, which rose to a record high in May based on the three-month moving average of the series. We've found that the trucking payrolls series is actually a very good leading indicator of the economy ([Fig. 5](#)).

Confirming the strength of the trucking industry is that average hourly earnings in trucking rose 5.9% y/y through May ([Fig. 6](#)). Rapidly rising wages seem to be attracting more truck drivers. Yet the Producer Price Index (PPI) inflation rate for truck transportation is down from a recent peak of 8.2% y/y during October 2018 to 2.8% during June.

(2) *Railcar loadings.* Now for the bad news: Railcar loadings (including both carloads and intermodal container units) are very weak. We track the y/y growth rate in the 26-week moving

average to reduce the volatility in this series. It was down 3.4% during the 7/6 week ([Fig. 7](#)). It is highly correlated with the y/y growth rate in manufacturing output, which has been slowing all year but remained positive during May, though at a meager 0.7%.

(3) *West Coast ports activity*. The growth rate in railcar loadings of intermodal containers is highly correlated with the growth rate in the sum of US real exports and real imports of merchandise ([Fig. 8](#)). The former was down 3.0% y/y through the 7/6 week, while the latter has been fluctuating around zero over the past couple of months through May. The West Coast ports data show that the 12-month sum of their exports has been slipping all year, while the 12-month sum of their imports has been basically flat ([Fig. 9](#) and [Fig. 10](#)).

(4) *Vehicle miles traveled*. Meanwhile, Americans continue to drive, pushing the 12-month sum of vehicle miles traveled up 0.7% y/y in April to another record high ([Fig. 11](#)). By the way, gasoline usage has been relatively flat over the past couple of years, implying that gasoline fuel efficiency is still improving in the US ([Fig. 12](#)).

China Transportation: Moving Forward. We don't have as much data on transportation in China as we have for the US. We do have monthly data on railways traffic in China. Consider the following:

(1) *Railways traffic*. We track the 12-month average of railway freight traffic because the monthly series is quite volatile ([Fig. 13](#)). It rose 8.2% y/y during May to a record high. It is somewhat correlated with the sum of Chinese imports plus exports, also on a 12-month basis and in yuan. The latter has been relatively flat since late last year, rising 8.6% y/y through June, having slowed from October's recent peak of 11.3%.

(2) *Exports and imports*. The implication of China's transportation and trade data—like that of the US data—is that the domestic economy is stronger than the global economy. By the way, China's monthly trade data, as reported widely in the press, are not seasonally adjusted. Our data vendor, Haver Analytics, provides seasonally adjusted data in yuan. They show that both Chinese exports and imports have stalled at record highs since mid-2018 ([Fig. 14](#)).

(3) *PPI*. There's a surprisingly good correlation between the y/y growth rate in railways freight traffic and China's PPI, which was unchanged from a year ago during June ([Fig. 15](#)). That's the lowest such inflation rate since late 2016 and implies that industrial profits are also weakening.

(4) *GDP*. The financial press reports China's real GDP growth rate on a y/y basis. Our friends at Haver also calculate the comparable quarterly data at a seasonally adjusted annual rate (saar). Yesterday's headlines reported that the y/y growth rate slowed to 6.2% through Q2, the weakest in the history of the series, which goes back to Q2-1992 ([Fig. 16](#)). The quarterly number was even weaker at 5.5% (saar).

US Economy: Is the Labor Market as Tight as It Gets? "How Have Lower-Educated Workers Fared since the Great Recession?" is the title of an expository box in the Fed's 7/5 [Monetary Policy Report](#) (MPR). It helps to explain why Fed Chair Jerome Powell said during

his semi-annual testimony to Congress last week that monetary policy may need to be more accommodative. The labor market may not be as tight as it seems based on the unemployment rate. More importantly, it continues to improve, especially for lower-educated workers. The Fed should accommodate that healthy trend, according to the Fed chair.

Powell feels that there may be even more room to run in the labor market, particularly for wage growth. During his testimony, Powell [said](#): “We don’t have any basis or any evidence for calling this a hot labor market.” He observed: “While we hear reports of companies finding it hard to find qualified labor, we don’t see wages responding.”

Our key takeaway from Powell’s comments and the *MPR* box is that a case can be made to run accommodative policy for longer to benefit lower-skilled workers. Let’s further explore the *MPR* box and connect these thoughts:

(1) *Employment-to-population ratio*. Since the end of the Great Recession, the unemployment rate has dropped about 6ppts, and the employment-to-population ratio (EPOP) for prime-aged persons (i.e., between 24 and 54 years old) has risen about 4.5ppts. However, lower- and higher-educated people have fared quite differently in the labor market over that time period, the *MPR* observed.

The EPOP for prime-aged college graduates declined about 2.5ppts during the recession, then steadily recovered from 2010 to nearly its pre-recession level by 2018. For prime-aged persons with a high-school degree or less, the EPOP declined much more dramatically during the recession and did not begin to recover until 2014. It continued to remain below its pre-recession level in 2018, according to staff calculations using the Current Population Survey. (See chart A on page 8 of the *MPR*.)

(2) *Real wages*. Following the recession, the percentage change in inflation-adjusted hourly wages declined more for prime-aged lower-educated workers than it did for prime-aged college graduates. Real wages since have recovered on a percentage basis for both groups, but only recently for lower-educated workers. (See chart B on page 8 of the *MPR*).

(3) *Reasons for relative unemployment*. Evidence suggests that the less educated may benefit less than the highly educated when unemployment is sustained below its natural rate. Lower-educated workers’ underperformance relative to higher-educated ones is a trend apparent in business cycles going back to at least 1980, the report observed.

It may take at least eight years following a recession for the EPOP for lower-educated workers to recover, the report found. One reason may be that employers require higher standards for new hires during a recession, only lowering these restrictions later, during the subsequent recovery. Another reason is that during recessions higher-skilled workers tend to accept jobs requiring lower skills than they would otherwise.

Globalization and technology may also influence labor-market outcomes for lower-skilled versus higher-skilled workers, noted the report.

Owing to these trends, in our view, the employment prospects for lower-skilled workers may deteriorate over time irrespective of the business cycle. However, given that employment trends have continued to improve for lower-skilled workers following the recession up until now, we can see why Powell may be looking for more out of the labor market.

CALENDARS

US. Tues: Retail Sales Total, Ex Gas, Ex Autos & Gas, and Control Group 0.1%/0.1%/0.3%/0.3%, Headline & Manufacturing Industrial Production 0.1%/0.3%, Capacity Utilization 78.1%, Business Inventories 0.4%, Import Prices -0.2%/m/m/-2.1%/y/y, Housing Market Index 64, Net Treasury International Capital Flows, Powell, Bowman, Kaplan. **Wed:** Housing Starts & Building Permits 1.260mu/1.300mu, MBA Mortgage Applications, DOE Crude Oil Inventories, Beige Book. (DailyFX estimates)

Global. Tues: Eurozone Trade Balance €17.5b, Eurozone ZEW Economic Sentiment Survey, Germany ZEW Survey Current Situation & Expectations 5.0/-22.0, UK Unemployment Rate (3m) 3.8%, UK Employment Change (3m/3m) 45k, UK Average Weekly Earnings Total & Ex Bonus (3m) 3.1%/3.5% y/y, RBA Minutes of July Meeting, Carney. **Wed:** European Car Sales, Eurozone Headline & Core CPI 1.2%/1.1% y/y, UK Headline & Core CPI 2.0/1.8 y/y, Canada CPI -0.3%/m/m/2.0%/y/y. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings mostly rose last week for the S&P indexes, and remain in the uptrends that began during March. LargeCap's has risen during 18 of the past 22 weeks; MidCap's 14 of the past 18 weeks; and SmallCap's 11 of the past 16 weeks. LargeCap's improved to 0.1% below its record high at the end of June, while MidCap's and SmallCap's are 0.6% and 5.6% 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 31-month low of 3.7% y/y from 3.8%. That's down from 23.2% in mid-September, which was the highest since January 2011. MidCap's y/y change slipped to a 34-month low of 3.3% from 3.5%, which compares to 24.1% in mid-September (the highest since April 2011). SmallCap's -2.2% 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%, 2.3%, 11.6%), MidCap (22.7, 0.8, 14.2), and SmallCap (22.4, 1.6, 19.3).

S&P 500/400/600 Valuation ([link](#)): Valuations mostly edged lower last week for the three S&P market-cap indexes. LargeCap's forward P/E gained 0.1 point w/w to a 16-month high of 17.1, 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 edged down 0.1 point to 15.8 from a nine-week high of 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 dropped 0.1 point to 16.4 from an eight-week high of 16.5. That's still well above its seven-year low of 13.6 during December and compares to its 15-year high of 20.5 in December 2016, when Energy's earnings were depressed. SmallCap's P/E was below LargeCap's P/E for a ninth 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 on deck, the consensus forecast has held up well despite concerns about the trade war's impact on earnings. Revisions activity remains light for the current quarter: Last week saw the S&P 500's Q2-2019 EPS forecast drop 15 cents w/w to \$40.20. 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' \$40.20 estimate is down 2.8% since the start of the quarter, which represents an earnings decline of 2.0% y/y. On a pro forma basis, it represents an earnings decline of 0.4% y/y, compared to 0.0% 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. Six sectors are expected beat the S&P 500's Q2 growth rate, up from five 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 (16.2% in Q2-2019 versus -9.9% in Q1-2019), Financials (4.3, 8.0), Health Care (3.0, 10.3), Utilities (1.9, -0.5), Real Estate (0.9, 6.3), Consumer Discretionary (-0.2, 8.1), Industrials (-0.4, 6.9), Consumer Staples (-1.0, 1.0), Energy (-7.0, -26.1), Information Technology (-7.9, -1.1), and Materials (-31.4, -13.4). On an ex-Energy basis, S&P 500 earnings are expected to be flat 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.

S&P 500 Q2 Earnings Season Monitor (*link*): With the June quarterly earnings season ready to kick into high gear, 5% of S&P 500 companies are finished reporting revenues and earnings for Q2-2019. The y/y growth rates in revenues and earnings have slowed from Q1, but the revenue and earnings surprise metrics remain strong. Of the 25 companies in the S&P 500 that have reported through midday Monday, 84% exceeded industry analysts' earnings estimates. Collectively, the reporters have averaged a y/y earnings decline of 4.6%, and exceeded forecasts by an average of 4.8%. On the revenue side, 76% of companies beat their Q2 sales estimates so far, with results coming in 0.9% above forecast and 3.0% higher than a year earlier. Q2 earnings growth results are positive y/y for 68% of companies, vs a slightly higher 69% at the same point in Q1, but Q2 revenues have risen y/y for 88% vs a much lower 76% during Q1. These figures will change markedly as more Q2-2019 results are reported in

the coming weeks. Looking at earnings during the same point in the Q1-2018 reporting period, a lower percentage of companies (81%) in the S&P 500 had beaten consensus earnings estimates by a higher 5.5%, and earnings were up a higher 4.3% y/y. With respect to revenues at this point in the Q1 season, a sharply lower 45% had exceeded revenue forecasts by a lower 0.5%, but sales rose a greater 4.0% y/y. The early results for Q2 indicate a continuation of the marked slowdown in revenue and earnings growth compared to 2018 and a slight deterioration in profit margins. But that comes as no surprise to investors. Q1-2019 was the 11th straight quarter of positive y/y earnings growth and the 12th of positive revenue growth. However, earnings growth trailed revenue growth during Q1-2019 for the first time since Q2-2016, which has happened just five times in the 42 quarters since the bull market started in Q1-2009; it's likely to happen for a sixth time in Q2-2019.

US ECONOMIC INDICATORS

Regional M-PMI (*link*): The New York Fed—the first district to report on manufacturing for July—showed activity expanded modestly this month after contracting in June for the first time in more than two years, while optimism picked up a bit. The composite index rebounded 12.9 points this month to 4.3, after plunging a record 26.4 points in June to -8.6—which was the lowest reading since October 2016. Diffusion indexes revealed new orders (to -1.5 from -12.0) continued to contract, though at a slower pace, while shipments (7.2 from 9.7) expanded at a slower rate for the second month; delivery times (4.4 from -4.5) were somewhat longer. Meanwhile, unfilled orders (-5.1 from -15.8) were negative for a second straight month, while inventories (-10.1 from 5.3) declined for the third consecutive month—at the steepest pace since December 2016. Factories cut payrolls at their fastest pace since January 2016, with the employment (-9.6 from -3.5) index contracting again this month; the average workweek (3.8 from -2.2) gauge was back in positive territory. As for inflationary pressures, the prices-paid (25.5 from 27.8) index showed prices increased at the slowest pace since November 2017, while the prices-received (5.8 from 6.8) index exhibited the slowest rate since May 2017. The six-month outlook for the New York region was generally better than last month, as the future business conditions index reversed June's decline, climbing from 25.7 to 30.8—nearing its high for this year of 32.3 in February; it peaked at 49.4 last February.

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