



## MORNING BRIEFING

August 1, 2019

### Cleaning Up

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

(1) Innovation and pricing help Consumer Staples post positive surprises. (2) Shaving is out, but clean clothes are still in. (3) Chinese consumers are young, optimistic, and spending on cosmetics. (4) Coke and Pepsi courting the health conscious. (5) Nuclear fusion: It's not fission or a spicy new cuisine. (6) Several companies chase the opportunity to jolt the world with nuclear fusion.

**Consumer Staples: Doing Fine.** Fed Chairman Jerome Powell was panned by the markets yesterday after signaling that Wednesday's rate cut may not be the first in a series of rate cuts. His description of the Fed's move as a "mid-course correction" sent the Dow Jones Industrial Average down 333.75 by the close. Supporting Powell's take-it-slow position were recent earnings results out of the S&P 500 Consumer Staples sector confirming that consumers are still spending. The sector, which rose 4.4% in July, reported results that were better than expected because of product innovations, strength in the emerging markets, healthy consumers, and the ability to raise prices around the world.

Here's the performance derby for the S&P 500 sectors for the month of July through Tuesday's close: Information Technology (4.8%), Consumer Staples (4.4), Communication Services (4.2), Financials (2.7), S&P 500 (2.4), Consumer Discretionary (2.1), Real Estate (2.0), Industrials (1.7), Materials (1.1), Utilities (0.1), Health Care (-0.7), and Energy (-1.3) ([Fig. 1](#)).

Despite July's strong results, Consumer Staples continues to lag behind the S&P 500's ytd performance through Tuesday's close: Information Technology (32.2%), Consumer Discretionary (23.5), Communication Services (23.3), Industrials (22.2), Real Estate (20.8), S&P 500 (20.2), Consumer Staples (19.5), Financials (19.1), Materials (17.2), Utilities (13.0), Energy (9.6), and Health Care (6.3) ([Fig. 2](#)).

Analysts have recently grown more optimistic about the sector. The S&P 500 Consumer Staples sector's net earnings revisions have been positive in June and July for the first time since April 2018 ([Fig. 3](#)). The industry's revenue and earnings are expected to grow by only 3.4% and 1.2% this year, improving to 3.6% and 6.8% in 2020 ([Fig. 4](#) and [Fig. 5](#)). Yet the industry's forward P/E multiple is 19.6 as of 7/25, a premium to the S&P 500's and 2.3ppts higher than it was a year earlier ([Fig. 6](#)). I asked Jackie to take a look at some of the recent earnings that have helped the sector catch fire of late. Here's her report:

(1) *P&G performs.* Procter & Gamble turned in fiscal Q4 results that grew awfully fast for such a large company. The company [reported](#) a 4% increase in sales, and if you exclude the impact of foreign exchange, acquisitions, and sales, the figure jumps to 7%. Sales benefitted both

from price increases of 2%-4% across its business lines and unit-volume increases in all but one segment (grooming, where it declined by 1%). Excluding the company's one-time, non-cash write-down of its Gillette Shave Care business, EPS jumped 17% to \$1.10, beating analysts' estimates by five cents.

P&G also forecast for fiscal 2020 3%-4% organic sales growth and adjusted EPS growth of 4%-9%. Wall Street analysts were expecting a 3.5% jump in sales and a 5.1% earnings increase, according to a 7/30 CNBC [article](#). The company has been simplifying its portfolio into 10 categories of products that people use every day. All 10 categories grew sales last quarter, and the company gained market share in eight of the 10 categories, CFO Jon Moeller told CNBC.

P&G shares jumped 3.9% after its earnings report, and they're up 31.0% ytd. Procter is a member of the S&P 500 Household Products industry, which has climbed 27.2% ytd ([Fig. 7](#)). The industry is forecast to grow revenue and earnings by 1.0% and 3.9% this year, followed by a 3.1% and 6.1% improvement in 2020 ([Fig. 8](#) and [Fig. 9](#)). Household Products' forward P/E has climbed sharply, to a 19-year high of 23.3 from 16.5 in May 2018 ([Fig. 10](#)).

(2) *Estee puts on a good face.* The S&P 500 Personal Products industry is the top performer in the Consumer Staples sector, having risen 48.6% ytd ([Fig. 11](#)). It's composed of Estee Lauder shares, up 45.3% ytd, and Coty, up 70.6%. Estee Lauder credited strength among Chinese consumers, travel sales, and its skincare lines when reporting stronger-than-expected fiscal Q3 earnings. Net sales rose 11% in the quarter to \$3.74 billion, above expectations for \$3.57 billion. Adjusted EPS was \$1.55, above the \$1.30 analysts' forecast, according to a 5/1 Reuters [article](#). The company also increased its fiscal 2019 net sales forecast to 7%-8% from 5%-6%. Sales in Asia-Pacific, which includes sales in China, grew 25%.

In a 6/24 *Barron's* [article](#), Estee Lauder's CEO Fabrizio Freda discussed the differences between the company's US and Chinese consumers. The most powerful consumer in the US and Europe tends to be around 38-42 years old. In China, the average is 25. The Chinese "millennials tend to be only children, and get more attention and access to family wealth. Not only that, they have better jobs than their parents and are more educated, and because of this, their initial compensation is much higher than previous generations."

He continued: "And while in the U.S. millennials are much more dedicated to being cool and trying new things, the power of their spending is lower and less concentrated. Our statistics show that the most independent millennial women globally are in China and this makes them the best consumers in the world. The other big difference is attitude. When we interview people in Europe and the U.S., the reaction today is that the outlook is not as good as yesterday and I'm worried about my future. When you pose the same question in China or India, the answer is that today is better than yesterday and I'm excited about my future."

The S&P 500 Personal Products industry is expected to grow sales and earnings by 4.7% and 12.1%, respectively, in 2019 and 5.3% and 10.3% next year ([Fig. 12](#) and [Fig. 13](#)). Investors already have rewarded this industry, too, with a generous forward P/E of 30.1, which is higher than the industry's forward P/E has been since 1999 ([Fig. 14](#)).

(3) *Sweet results from Mondelez.* The chocolatier is another company that recently has upped expectations for future financial results. Mondelez said Tuesday that its organic revenue would rise more than 3% this year, more than the 2%-3% it has previously signaled, and its 2019 EPS now is expected to rise 5% compared to the prior forecast of 3%-5%. Q2 organic sales jumped 4.6%, and adjusted EPS climbed to 57 cents from 21 cents a year ago, meeting analysts' estimates, a 7/30 Reuters [article](#) reported. Mondelez benefitted from a 7.6% surge in organic sales in emerging markets, with notable strength in China, India, Southeast Asia, Russia, and Mexico. The company did warn that a hard Brexit could hurt consumer spending in the UK.

Mondelez is a member of the S&P 500 Packaged Foods & Meats industry, which has gained 21.5% so far this year ([Fig. 15](#)). The industry is forecast to grow revenue by 3.3% this year and 2.2% in 2020 ([Fig. 16](#)). Earnings growth is expected to improve from a 2.6% decline this year to a 6.4% gain in 2020 ([Fig. 17](#)). With a forward P/E of 17.0, the industry is still moderately valued relative to the past two decades ([Fig. 18](#)).

(4) *Bubbly results.* Coca-Cola and PepsiCo both produced better-than-expected Q2 results by creating new, innovative products and shrinking portion sizes, helping to more than offset slack demand for sugary and sports drinks. Coke shares have climbed 13.5% ytd through Tuesday's close, and Pepsi's shares are up 18.1%, both trailing the S&P 500's 20.2% return.

At Coca-Cola, organic revenue climbed 6%, operating income adjusted for currency climbed 14%, and operating EPS climbed 4% to 63 cents—beating estimates by two cents. Results benefitted from double-digit volume growth globally in Coca-Cola Zero Sugar and new offerings like Coca-Cola Plus Coffee and Orange Vanilla Coca-Cola. The company jumped into the coffee business with its \$5.1 billion acquisition of Costa Coffee earlier this year. It introduced a Costa Coffee ready-to-drink chilled product in Great Britain and its first energy drink, Coca-Cola Energy.

The company raised its forecast for full-year organic revenue to 5%, up from about 4%, and operating income adjusted for currency is now forecast to rise 11%-12%, up from an earlier forecast of 10%-11%, a 7/23 *WSJ* [article](#) reported.

Meanwhile at PepsiCo, last quarter's results benefitted from the company's shift to using smaller can sizes with better margins. The company offered new flavors earlier this year, including berry-, lime-, and mango-flavored soda. To appeal to the health conscious, PepsiCo will also be offering Bubly sparkling waters in new fruity flavors. Organic revenue for the quarter rose 4.5%, and excluding one-time items, EPS came in at \$1.54, four cents higher than expectations, a 7/9 Reuters [article](#) reported.

The S&P 500 Soft Drinks stock price index has climbed 16.6% ytd ([Fig. 19](#)). The industry's revenue is expected to expand nicely this year and in 2020, by 7.2% and 4.5% ([Fig. 20](#)). Earnings growth is set to improve from 0.1% this year to 8.4% in 2020 ([Fig. 21](#)). Net earnings revisions have just turned positive in the last two months, and the industry's forward P/E, at 23.6, is high relative to those in recent years, but far below the late 1990s when the industry's

P/E was a bubbly 41.3 ([Fig. 22](#)).

**Disruptive Technology: Hot Topic.** Nuclear fusion has long been the Holy Grail of energy. It's not the method used in traditional nuclear plants. That's nuclear *fission*, where atoms are split in order to generate energy, and the resulting waste remains radioactive for thousands of years. Nuclear fusion is the process that powers the sun and the stars. Atoms are fused together to release energy, and it generates no nuclear waste.

The problem with fusion is that it requires insanely hot temperatures for a reaction to happen. So scientists around the world are working on how to generate more energy from nuclear fusion than a reaction requires, so that additional energy can be harnessed. Let's take a look at some recent developments in this electrifying subject:

(1) *ITER unites the world.* The International Thermonuclear Experimental Reactor (ITER) is developing the first industrial nuclear fusion reactor, which will maintain fusion for long periods of time and produce "net energy," i.e., more than is needed to trigger a reaction. It's expected to generate 500 megawatts of fusion power from the 50 megawatts needed for a reaction.

ITER took a large step toward its goal when major parts were delivered to the reactor construction site, according to a 7/24 [article](#) in ClimateWire. Now the project is 65% complete, and the organization aims to launch operations by 2025.

Started in 1985, ITER members include China, the European Union, Japan, Korea, Russia, and the US. Each member contributes funding and structures for the reactor's construction.

(2) *Bezos jumps in too.* Amazon's Jeff Bezos is one of many investors who collectively have put up \$127 million in funding for General Fusion, a British Columbia company that has built all the components for a reactor. Next comes a prototype, to be built over the next five years, followed by a full-scale reactor capable of powering a small city.

General Fusion "injects plasma (or ionized gas), which is surrounded by liquid metal, into a compression chamber where magnets help contain the gas. Then, pistons put pressure on the chamber to compress the plasma to fusion conditions. The now heated liquid metal gets turned into heat, which then gets turned into electricity," explained a 3/6 CNBC [article](#).

(3) *MIT brains at work.* Commonwealth Fusion Systems, which was spun out of MIT, is working in partnership with MIT to create its own reactor. The partnership is creating magnets out of rare-Earth barium copper oxide, the CNBC article stated.

Meanwhile, Lockheed Martin is working on a compact fusion reactor that's 10 times smaller than existing reactors and would fit on the back of a truck. Earlier this week, the US Department of Energy [announced](#) \$14 million in funding for 10 university-led research projects using the DIII-D National Fusion Facility. Scientists hope that one of these methods will work to replace fossil fuels and reverse the ills of climate change.

## CALENDARS

**US. Thurs:** Construction Spending 0.4%, Motor Vehicle Sales 16.9mu, Jobless Claims 212k, ISM M-PMI 52.0. **Fri:** Nonfarm Payroll Employment Total, Private, Manufacturing 169k/165k/5k, Unemployment Rate 3.7%, Average Hourly Earnings 0.2%*m/m*/3.2%*y/y*, Average Workweek 34.4hrs, Consumer Sentiment Index 90.1, Merchandise Trade Balance - \$54.6b, Factory Orders, Baker-Hughes Rig Count. (DailyFX estimates)

**Global. Thurs:** Eurozone, Germany, France, and Italy M-MPIs 46.4/43.1/50.0/48.0, UK M-PMI 47.7, China Caixin M-PMI 49.6, BOE Bank Rate & Asset Purchase Target 0.75%/ £435b, BOE Inflation Report, BOJ Minutes of June Policy Meeting, Carney. **Fri:** Eurozone Retail Sales 0.2%*m/m*/1.3%*y/y*. (DailyFX estimates)

## STRATEGY INDICATORS

**S&P 500 Earnings, Revenues, Valuation & Margins** (*link*): Consensus S&P 500 forward revenues and earnings edged down slightly w/w again from their record highs in mid-July. Analysts expect forward revenues growth of 5.2% and forward earnings growth of 7.6%, unchanged from a week earlier. Forward revenues growth is now down 1.1ppt 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 9.3ppts 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 4.2% in 2019 and 5.3% in 2020. They're calling for earnings growth to slow sharply from 24.1% in 2018 to 2.0% 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 11.9% in 2018 to 11.7% in 2019 before rising to 12.3% in 2020. The S&P 500's forward P/E rose 0.3pts w/w to an 18-month high of 17.4. 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 rose to an 11-month high of 2.10 from 2.07. 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 four of the 11 S&P 500 sectors and forward earnings for 3/11 sectors. Consumer Staples and Health Care had both measures improve 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 two sectors: Consumer Discretionary and Financials. 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, including four sectors in the latest week. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (22.0%, down from 23.0%), Financials (18.5, down from 19.2), Real Estate (15.7, down from 17.0), Communication Services (14.8, down from 15.4), Utilities (12.9, down from its record high of 13.0 in May), S&P 500 (12.1, down from 12.4), Materials (10.1, down from 11.6), Health Care (10.5, down from 11.2), Industrials (10.2, down from its record high of 10.4 in early July), Consumer Discretionary (7.6, down from 8.3), Consumer Staples (7.4, down from 7.7), and Energy (7.0, down from 8.0).

**S&P 500 Q2 Earnings Season Monitor** ([link](#)): With the Q2 earnings season nearly 60% complete for the S&P 500, the results compared to the same point during Q1 show that revenues are beating by a greater amount, and a higher percentage of companies is reporting positive revenue surprises and y/y revenue growth. The earnings surprise is smaller than in Q1, but y/y earnings growth is nearly a full percentage point higher despite Boeing's dismal Q2 results. Of the 297 S&P 500 companies that have reported through midday Wednesday, 75% exceeded industry analysts' earnings estimates. Collectively, these reporters have averaged a y/y earnings gain of 4.5% and exceeded forecasts by an impressive 6.4%. Ex-Boeing, y/y earnings growth improves 2.2ppts to 6.7%. On the revenue side, 62% of companies beat their Q2 sales estimates so far, with results coming in an impressive 1.0% above forecast and 3.7% higher than a year earlier. Q2 earnings growth results are positive y/y for 69% of companies, versus a lower 67% at the same point in Q1, and Q2 revenues have risen y/y for 71% versus a lower 69% during Q1. Looking at earnings during the same point in the Q1-2018 reporting period, a slightly higher percentage of companies (77%) in the S&P 500 had beaten consensus earnings estimates by a slightly higher 6.8%, and earnings were up a lower 3.6% y/y. With respect to revenues at this point in the Q1 season, a lower 58% had exceeded revenue forecasts by a sharply lower 0.2%, and sales rose a slightly higher 3.9% y/y. Compared to 2018's stellar results, these mid-season readings for Q2 indicate a continuation of a marked slowdown in revenue and earnings growth and a slight deterioration in profit margins. But that should come as no surprise to investors. Q1-2019 had marked 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. That has happened just five times in the 42 quarters since the bull market started in Q1-2009. As more companies have reported, it's looking less possible that Q2-2019 will make the sixth.

**Stock Market Sentiment Indicators** ([link](#)): The Bull/Bear Ratio (BBR) increased this week for the seventh time in eight weeks, to 3.35—remaining above 3.00 for the fifth straight week. The BBR rebounded from last week's decline—which was the first in seven weeks—rising to 3.35; it was at 2.31 eight weeks ago, which was the lowest ratio since mid-February. Bullish sentiment (to 57.2% from 54.3%) rebounded from its brief decline last week, and was back near its high for the year of 58.0% posted two weeks ago; bullish sentiment is up 14.5ppts since falling to 42.7% eight weeks ago—which was the fewest bulls since mid-January. Nearly all of the move up in bullish sentiment the past eight weeks came from the correction camp (to 25.7% from 38.8%), which fell 13.1ppts over the period. Bearish sentiment was little changed

for the second week, at 17.1%, after fluctuating in a small band from 18.0% to 18.5% over the prior six-week period. The AAll Ratio fell for the first time in seven weeks last week, to 49.8%, after rising the prior six weeks from 34.6% to 55.6%. Bullish sentiment slipped to 31.7% last week after climbing the prior six weeks from 22.5% to 35.9%, while bearish sentiment rose for the second week to 32.0% after falling from 42.6% to 27.5% the prior five weeks.

## US ECONOMIC INDICATORS

**ADP Employment** ([link](#)): “Job growth is healthy, but steadily slowing. Small businesses are suffering the brunt of the slowdown. Hampering job growth are labor shortages, layoffs at bricks-and-mortar retailers, and fallout from weaker global trade,” according to ADP’s recently released employment report. Private industries added 156,000 in July, following upwardly revised gains in both June (to 112,000 from 102,000) and May (46,000 from 41,000), with revisions showing a net gain of 15,000; these payrolls averaged monthly increases of 224,250 the first four months of this year. In July, service-providing industries added 146,000 jobs, up from 113,000 and 68,000 the prior two months—led by professional & business services (44,000), health care & social assistance (35,000), and leisure & hospitality (26,000); information services (-5,000) cut jobs for the third straight month. Employment in goods-producing industries (9,000) rose for the first time in three months as construction jobs rebounded 15,000 after a two-month loss of 27,000. Manufacturers added only 1,000 jobs last month and a total of 15,000 the past four months; this pales in comparison to the 39,000 increase the first two months of the year. Natural resource & mining companies cut payrolls for the fourth straight month by 6,000 in July and 12,000 over the period. Large companies (78,000), which are better equipped to compete for labor in a tight labor market, posted the best job growth again last month, while small businesses (11,000) eked out a small gain after cutting payrolls 47,000 during the two months through June. Meanwhile, medium-sized companies held onto the number-two spot, adding 67,000 jobs last month, accelerating steadily since May’s 10,000—which was the smallest in over nine years.

**Employment Cost Index** ([link](#)): Labor costs in the private sector slowed on both a quarterly and yearly basis, with both recording their lowest rates since the end of 2017. Total compensation costs climbed 0.5% last quarter, after gains of 0.7% in each of the prior two quarters; costs during Q1-2018 had jumped 0.9%—the biggest quarterly gain since Q4-2007. Last quarter, gains in both wages & salaries (to 0.6% from 0.7%) and benefits costs (0.4 from 0.5) slowed. Compensation costs rose 2.6% y/y, slowing steadily from 3.0% during the final quarter of last year—which was the highest in a decade. The rate for wages & salaries was unchanged at 3.0% y/y last quarter, down from 3.1% during the final two quarters of 2018—which was the biggest yearly gain since Q2-2008. The rate for benefits costs slowed to a 10-quarter low of 1.8% y/y, down from its recent peak of 2.8% during Q2-2018.

## GLOBAL ECONOMIC INDICATORS

**Eurozone CPI Flash Estimate** ([link](#)): July’s CPI rate remained below 2.0% for the ninth consecutive month, according to the flash estimate, while the core rate moved back below 1.0%. The headline rate ticked down from 1.3% to 1.1%—the lowest rate since February 2018; it was at a recent peak of 2.3% last October. Looking at the main components, food, alcohol &

tobacco (to 2.0% from 1.6% y/y) is expected to have the highest rate, followed by services (1.2 from 1.6)—though the former is accelerating, while the latter is decelerating. Non-energy industrial goods (0.4 from 0.3) is expected to have the lowest rate, continuing to hover just above zero. Meanwhile, the rate for energy (0.6 from 1.7) is heading toward zero, slowing steadily from 5.3% in March/April. The core rate—which excludes energy, food, alcohol, and tobacco—is expected to slow to 0.9% after accelerating from 0.8% to 1.1% in June.

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