



MORNING BRIEFING

August 6, 2019

TINA Versus TIAA

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

(1) The case for cash. (2) Yet another panic attack? (3) Trade war morphs into currency war. (4) Is Hong Kong about to become Tiananmen Square? (5) Weaker yuan offsets some of tariff costs to US consumers. (6) Buffett sitting on record pile of cash. (7) Despite the depressing global economic headlines, S&P 500 forward revenues and earnings at record highs! (8) Will global manufacturing growth recession turn into a full-blown downturn? (9) Eurozone, China, and Japan have homegrown problems.

Strategy I: Panic Attack #64? Randy Forsyth's 8/2 *Barron's* [column](#) is provocatively titled "The Case for Going Into Cash Now." That seems like a timely call. The S&P 500 peaked at a record 3025.86 on July 27 ([Fig. 1](#)). It is down 6.0% since then through yesterday's close. Joe and I are tentatively numbering this selloff as Panic Attack #64. (See our *Table of S&P 500 Panic Attacks Since 2009*.)

Yesterday, the escalating trade war between the US and China became a currency war as the Chinese let the yuan depreciate above 7.00 yuan per dollar ([Fig. 2](#)). They also hit back by halting crop imports from the US.

We expect that the latest escalation will hurt the Chinese economy more than the American economy. By the way, the Chinese Communist government has another major problem brewing in Hong Kong. Pro-democracy demonstrators have staged huge rallies in Hong Kong protesting the authoritarian practices of the regime in Beijing, which is threatening to use military forces to quash the protests. It has the potential for turning very ugly very quickly.

We don't expect that rising trade tensions with China will push the US economy into a recession. The devaluation of the yuan means that some of the tariff costs to US consumers will be offset by the weaker Chinese currency. So Chinese exporters will get lower revenues in their local currency for their dollar sales in the US. In other words, Trump is partly right when he says that the Chinese will absorb some of his tariffs. But they will do so by manipulating their currency to remain competitive in the US.

Strategy II: Is Cash Still Trash? In his aforementioned column, Randy observes that the bull market in stocks has been driven by TINA, which is the acronym for "There Is No Alternative." He reports that the JPMorgan's Global Markets Strategy team is touting TIAA, which stands for "There Is An Alternative," specifically US-dollar cash equivalents.

Joe and I have been bullish on stocks during the current bull market because we have been bullish on earnings. We still are. A certain contingent of bullish strategists hasn't been as

enthused about the bull market in stocks. Their mantra has been “There Is No Alternative.”

It’s hard to get enthusiastic about investing in stocks just because the alternatives aren’t compelling. The most obvious alternative asset class is the one for bonds. The flow-of-funds data clearly show that lots of investors continue to buy bonds, which have done well since early 2009 along with stocks. Since the start of 2009, bond mutual funds have attracted \$2.4 trillion through June of this year ([Fig. 3](#)). ETF bond index funds have attracted \$667 billion over this same period ([Fig. 4](#)).

The most obvious alternative to both stocks and bonds is cash, which has been widely viewed as “trash” because the major central banks have kept their official interest rates near zero since 2009. They’ve actually been slightly negative in the Eurozone and Japan for the past few years. At the end of July, the Fed stopped normalizing the federal funds rate and lowered it for the first time since 2008 ([Fig. 5](#)).

Nevertheless, as Randy reports, cash is an alternative to stocks, especially if the latest panic attack is actually the start of the long awaited and widely anticipated bear market, which we don’t believe it is.

Over the weekend, just by coincidence, we learned that Warren Buffett is sitting on a ton of trash—that is, cash. In quarterly earnings reported on Saturday, Berkshire Hathaway announced it has a staggering \$122 billion in cash and equivalents. That’s a record amount for the investment firm and up from \$112 billion during Q1. According to the 8/3 Bloomberg [story](#) on Buffett, the “growing cash pile is a reflection of the strength of the operating businesses that Buffett has assembled under one roof, and allows the billionaire investor flexibility to move quickly when big deals emerge.” The problem is that he can’t find any stocks to buy that aren’t overvalued. Another panic attack might give him the opportunity to do so.

Strategy III: Are Earnings Still Bullish? Now let’s revisit the most important driver of stock prices. That would be earnings. An 8/4 Bloomberg [story](#) on this subject is titled “It’s Not Just the Fed and Trump That Trouble the Stock Market.” Last week’s selloff in stock prices was not all about Jerome Powell and Donald Trump. During the current earnings season, misses have been punished by more than hits have been rewarded. The article observed:

“Among S&P 500 companies that have reported second-quarter results, those whose trailed analyst estimates saw their stock lagging behind the market by 3 percentage points the day after, data compiled by Goldman Sachs showed. Meanwhile, beats were rewarded by gains of 1.43 percentage points. The spread, more than 4 points, was the third biggest since 2012.

“The divergence in performance shows that even in an environment where macro concerns seem to dominate, getting stock selection right still has consequences. Earnings haven’t lost their ability to move markets—something else to worry about as companies slash their forecasts at the fastest rate in four years.”

Without any further ado, let’s look at the latest stats on S&P 500 revenues and earnings:

(1) *Earnings season.* We are well into the Q2 earnings season. The typical upward “earnings hook” was Missing in Action (MIA—since acronyms are in fashion) until the 8/1 week. The actual/estimate blend for Q2 earnings jumped that week so that the y/y growth rate is now 0.4%, up from -2.0% the prior week ([Fig. 6](#) and [Fig. 7](#)). The prospects for Q3 have turned a bit more negative, with a 1.1% drop now expected by industry analysts. The projected growth rate for Q4 is still solid at 5.7%, but that’s down from 11.7% at the beginning of the year.

(2) *Forward revenues.* The good news is that S&P 500 forward revenues rose to a record high during the 7/25 week ([Fig. 8](#)). That augurs well for actual quarterly results for both Q2 and Q3. On the other hand, revenues growth is expected to fall from 8.9% last year to 4.2% this year. However, that’s still reasonably good growth in the face of lots of gloomy headlines about global economic growth. And next year, revenues are expected to be up 5.3%. There’s no recession in any of these projections.

(3) *Forward earnings.* The forward profit margin has been holding up remarkably well around 12.0% since the start of the year. So the record high in forward revenues is mirrored in the record high in forward earnings during the 8/1 week ([Fig. 9](#)). Although industry analysts currently expect that earnings will grow just 2.0% this year, they remain upbeat about next year, with a 10.8% growth estimate ([Fig. 10](#)).

Strategy IV: Global Manufacturing Recession? The global manufacturing sector has been slowing since early last year. Now the situation is starting to look like a growth recession. It could turn into an outright recession for the sector. The weakness has been mostly blamed on Trump’s escalating trade war. Debbie and I think it might also have a lot to do with the slowing in the economies of the Eurozone, China, and Japan as a result of homegrown problems.

The biggest domestic problem for all of them is demographic profiles that are rapidly turning geriatric, as we’ve discussed numerous times before. All these economies are also drowning in debt, so adding more debt only makes it harder for them to stay afloat! Both fiscal and monetary policies have lost their abilities to stimulate growth. Other than that, everything is hunky-dory, particularly in the global services economy. Let’s review the latest relevant data:

(1) *Commodity prices.* The CRB raw industrials spot price index is down 8% ytd through last Friday, and down 14% since the start of 2018, when Trump started his trade wars ([Fig. 11](#)). The index is the lowest since 4/6/16, when the US and global economies were starting to recover from the 2015-2016 growth recession that was triggered by the plunge in commodity prices back then.

(2) *M-PMIs.* The JP Morgan Global M-PMI edged down to 49.3 during July from 49.4 during June ([Fig. 12](#)). It has been below 50.0 since May. The M-PMI for developed markets fell to 48.6 last month, while the M-PMI for emerging markets was 50.1 ([Fig. 13](#)).

Among the major industrial economies, the M-PMI for the US fell to 51.2 last month, down from an August 2018 high of 60.8 ([Fig. 14](#)). It is the lowest since August 2016. Below 50.0 are the M-PMIs for the Eurozone (46.5), the UK (48.0), and Japan (49.4).

All the BRICs' M-PMIs are below 50.0 except for India's. The latest readings: Russia (49.3), China (49.7), Brazil (49.9), and India (52.5).

(3) *Economic sentiment*. The Economic Sentiment Indicator for the Eurozone fell to 102.7 during July, the lowest reading since March 2016 ([Fig. 15](#)). It is highly correlated with the y/y growth rate of the region's real GDP, which was up only 1.1% during Q2, according to the flash estimate. Leading the weakness in the indicator is the industrial component; here are the data: industrial (-7.4), consumer (-6.6), retail trade (-0.7), construction (5.0), and services (10.6) ([Fig. 16](#)).

CALENDARS

US. Tues: Job Openings, Bullard. **Wed:** Consumer Credit \$16.5b, MBA Mortgage Applications, DOE Crude Oil Inventories, Evans. (DailyFX estimates)

Global. Tues: Germany Factory Orders 0.4%*m/m*/-5.3%*y/y*, Japan Leading & Coincident Indexes 93.5/100.4, RBA Cash Rate 1.00%. **Wed:** Germany Industrial Production -0.5%*m/m*/-3.1%*y/y*, Japan Trade Balance ¥708b. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings mostly fell again for a third straight week for the S&P indexes, but remain in the uptrends that began during March. LargeCap's has risen during 21 of the past 25 weeks; MidCap's 14 of the past 21 weeks; and SmallCap's 11 of the past 19 weeks. LargeCap's was at a record high last week, while MidCap's and SmallCap's weakened to 1.0% and 6.3% 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 33-month low of 2.7% *y/y* from 3.1%. That's down from 23.2% in mid-September, which was the highest since January 2011. MidCap's *y/y* change slipped to a 35-month low of 2.3% from 2.7%, which compares to 24.1% in mid-September (the highest since April 2011). SmallCap's -4.2% *y/y* is the lowest since December 2009. 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%, 2.1%, 11.3%), MidCap (22.7, -0.3, 14.0), and SmallCap (22.4, 0.0, 19.0).

S&P 500/400/600 Valuation ([link](#)): Valuations moved lower last week for all three S&P market-cap indexes. LargeCap's forward P/E fell 0.6 point *w/w* to a six-week low of 16.6 from a 17-month high of 17.2. That's compares to a five-year low of 13.9 during December and 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 declined 0.5 point to a seven-week low of 15.5 from a 12-

week high of 16.0. 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 0.4 point to 16.3 from an 11-week high of 16.7. 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 tenth 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 in high gear, the earnings hook resumed its upward path in the latest week. The S&P 500's blended Q2-2019 EPS forecast surged 2.4% higher, or by 97 cents w/w to \$41.17. That represents an earnings gain of 0.4% y/y compared to the prior week's forecasted earnings decline of 2.0%, and should continue to improve as more companies report in the coming weeks. That's above our forecast of \$41.00 for Q2 EPS and flat earnings y/y. On a pro forma basis, the blended Q2 earnings growth rate is 2.7% y/y, which would be the 12th straight y/y rise and compares to 1.6% in Q1, 16.9% in Q4, and 28.4% in Q3 (which marked the peak of the current earnings cycle). Six of the 11 sectors are expected to record positive y/y earnings growth in Q2-2019, versus five a week earlier, 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. Four sectors are expected to beat the S&P 500's Q2 growth rate, down from five during Q1. Communication Services, Financials, and Materials are the only sectors currently posting better (or less worse) growth on a q/q basis during Q2. Here are the latest Q2-2019 earnings growth rates versus their Q1-2019 growth rates: Communication Services (18.8% in Q2-2019 versus -9.9% in Q1-2019), Financials (9.8, 8.0), Health Care (9.0, 10.3), Real Estate (3.9, 6.2), Consumer Staples (1.0, 1.0), Consumer Discretionary (1.0, 8.1), Utilities (-1.9, -0.5), Information Technology (-2.9, -1.1), Industrials (-9.0, 6.9), Energy (-9.2, -26.1), and Materials (-13.1, -13.4). On an ex-Energy basis, S&P 500 earnings are expected to be up 3.4% y/y in Q2, up from 3.0% in Q1 and well below the 14.2% y/y gain in Q4. Looking ahead to the future, analysts as usual are trimming their forecasts for the next quarter. The S&P 500's Q3-2019 EPS forecast dropped 23 cents w/w to \$42.19. The consensus' \$42.19 estimate is down 1.9% in the four weeks since the start of the quarter, and now represents an earnings decline of 1.1% y/y. On a pro forma basis, the consensus Q3 estimate represents an earnings decline of 0.7% y/y, compared to a decline of 0.6% a week earlier and a gain of 0.8% at the end of Q2.

S&P 500 Q2 Earnings Season Monitor ([link](#)): With the Q2 earnings season nearly 80% complete for the S&P 500, the results compared to the same point during Q1 show that revenues are beating by a greater amount; a higher percentage of companies is reporting positive revenue surprises; the earnings surprise is a tad smaller; and y/y earnings growth is only 1.2ppts lower despite Boeing's dismal Q2 results. Of the 394 S&P 500 companies that have reported through midday Monday, 74% exceeded industry analysts' earnings estimates. Collectively, these reporters have averaged a y/y earnings gain of 2.0% and exceeded forecasts by an impressive 6.4%. Ex-Boeing, y/y earnings growth improves 1.0ppt to 3.8%. On the revenue side, 59% of companies beat their Q2 sales estimates so far, with results coming in an impressive 1.5% above forecast and 3.5% higher than a year earlier. Q2 earnings growth

results are positive y/y for 66% of companies, versus a similar 66% at the same point in Q1, and Q2 revenues have risen y/y for 68% versus a slightly higher 69% during Q1. Looking at earnings during the same point in the Q1-2018 reporting period, a slightly higher percentage of companies (76%) in the S&P 500 had beaten consensus earnings estimates by a slightly higher 6.7%, and earnings were up a higher 3.2% y/y. With respect to revenues at this point in the Q1 season, a slightly lower 58% had exceeded revenue forecasts by a sharply lower 0.3%, and sales rose a higher 5.2% 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 now looking more possible that Q2-2019 will make the sixth.

US ECONOMIC INDICATORS

Construction Spending ([link](#)): Construction spending in June posted its biggest monthly decline since last November on widespread weakness. Overall spending contracted 1.3% in June following a 0.5% drop in May; investment had increased 2.7% the first four months of this year. Still, spending remains at a relatively high level, within 2.8% of May 2018's record high. Spending on private construction spending sank to its lowest level since October 2017 in June, while public construction's has tumbled 4.9% since reaching a record high in April. Private construction spending contracted for the fifth time this year, falling 0.4% in June and 1.6% ytd. Private nonresidential construction dropped 2.0% during the three months through June, after a four-month jump of 3.7% to a new record high. Private residential investment remains very weak. Since reaching a cyclical high during April 2018, spending has plummeted 10.0%, with home-improvement and single-family investment down 18.1% and 8.0%, respectively, over the period. Meanwhile, multi-family construction continues to reach new record highs, soaring 15.4% since its recent bottom last August.

Auto Sales ([link](#)): Motor vehicle sales in July dropped back below 17.0mu (saar) after moving above in May. Total sales declined for the second month, to 16.9mu (saar) in July, after jumping 1.0mu in May—from 16.5mu to 17.5mu—posing its fourth reading below 17.0mu so far this year. Domestic light-truck sales fell for the second month, to 9.7mu (saar) last month, though remained near May's cyclical high of 10.0mu—which was the strongest pace since July 2005. Domestic car sales sank to 3.4mu (saar) last month—the lowest level since February 2010; they've been in a virtual freefall since peaking at 6.1mu during August 2014. Sales of imports were little changed at 3.8mu (saar) in July—not far from May 2018's peak of 4.0mu—which was the strongest pace since August 2009.

GLOBAL ECONOMIC INDICATORS

Global Composite PMIs ([link](#)): Global economic activity in July recorded a slight acceleration, though companies' optimism regarding the year ahead dropped to fresh survey lows for both manufacturing and service providers. The JP Morgan Global Composite Output Index (C-PMI)

ticked up to 51.7 from 51.2 in each of the prior three months; it peaked at 54.8 in February 2018. Global PMIs show the service sector (to 52.5 from 51.9) continued to outpace the manufacturing sector (49.3 from 49.4), which contracted for the third straight month. July C-PMIs reveal that growth in both the emerging (51.5 from 50.9) and developed (51.7 from 51.3) economies improved slightly, both bouncing off recent lows during June and May, respectively. All 12 of the nations for which C-PMI data are available saw economic activity rise during July, though India (to 53.9 from 50.8), the US (52.6 from 51.5), Australia (52.1 from 52.5), and France (51.9 from 52.7) were the only countries to see growth above the global average of 51.7. C-PMIs for both Italy (51.0 from 50.1) and China (50.9 from 50.6) were below the global average, though accelerated last month, while C-PMIs for Brazil (51.6 from 49.0), the UK (50.7 from 49.7), and Russia (50.2 from 49.2) moved from contraction to expansion.

Global Non-Manufacturing PMIs ([link](#)): July saw the rate of expansion in the global services economy pick up slightly for the second month after slowing to a 33-month low in May, though remained below its long-run average of 54.2. JP Morgan's Global NM-PMI edged up again in July, to 52.5, after falling from 53.7 in March to 51.6 in May—as NM-PMIs for both the developed (to 52.6 from 52.0) and emerging (52.1 from 51.5) nations improved to three-month highs. Germany (54.5 from 55.8), India (53.8 from 49.6), the US (53.0 from 51.5), Spain (52.9 from 53.6), and France (52.6 from 52.9) registered growth above the global average of 52.5, though only the US and India showed an acceleration in activity—the latter moving back into expansionary territory.

US Non-Manufacturing PMIs ([link](#)): ISM's July survey shows non-manufacturing activity slowed sharply, posting its weakest performance since August 2016, while IHS Markit's indicates activity accelerated for the second month. ISM's NM-PMI eased for the second month to 53.7 in July from 56.9 in May; it peaked at 60.8 last September. Of the four components, the business activity and new orders' measures deteriorated, while employment's improved and supplier deliveries' was unchanged. The business activity measure plummeted from 61.2 in May to 53.1 in July, while new orders' dropped from 58.6 to 54.1 over the same period—both sinking to their weakest readings since August 2016. Meanwhile, the employment gauge remained at a solid level, recovering to 56.2 in July after falling from 58.1 to 55.0 in June; supplier deliveries was unchanged at 51.5 after dipping below the breakeven level of 50.0 in May for the first time since December 2015. Meanwhile, IHS Markit's NM-PMI (to 53.0 from 51.5) signaled a solid start to H2, driven by an acceleration in both output and new orders in July. According to the report, the pickup in output growth was supported by the quickest expansion in new orders since March, as the rate of growth accelerated for the second straight month. Foreign demand also improved, rising at the sharpest pace since February. While July's report is encouraging, the report notes that business expectations dropped to a series low, with companies growing increasingly concerned about the year ahead—"fueled by trade war worries and wider geopolitical jitters, as well as growing worries that the economic cycle has peaked."

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