



MORNING BRIEFING

August 22, 2019

Consumers Still Consuming

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

(1) The issue for consumer spending isn't one of whether but where. (2) Wallets are cracking open in many a retail channel, just not department or electronics/appliances stores. (3) Broad spending indicators are flashing green, as consumers' jobs outlook is rosy. (4) Saving rates are up too. (5) Target and the home improvement retailers are in the right place at the right time. (6) The greenback may get a run for its money as digital currencies spring up.

Consumer Discretionary: Shoppers Still Shopping. It's hard to read that Macy's Q2 profits fell 48.2% y/y and not worry about consumer spending. Macy's has 870 department and specialty stores in 43 states and had \$25.0 billion of sales last year. But the slow, painful decline of department stores does seem to be isolated from the rest of retailing. It doesn't appear to reflect the health of the consumer but rather the consumer's changing tastes.

Consumer spending, looked at from many different angles, still looks healthy. Consumers are spending at Walmart and at Target. They're spending at restaurants and hotels. And they may have room to spend more, as the saving rate was relatively high at 8.1% during June and personal savings rose to a record \$1.3 trillion over the past 12 months through June ([Fig. 1](#) and [Fig. 2](#)). Over that same period, real disposable income is up solidly, with a gain of 3.3% ([Fig. 3](#)). Here's a look at some more consumer-spending metrics and this week's earnings reports from retailers confirming that consumer wallets are open—just not at department stores:

(1) *Broad indicators are positive.* Nominal US retail sales rose 0.7% m/m in July. Adjusted for inflation, they rose 5.4% on a three-month, seasonally adjusted moving average ([Fig. 4](#)). Growth rates differ dramatically by category. Shoppers are spending more online (14.7% y/y), at health & personal care stores (4.3), at warehouse clubs & super stores (3.8), on food either at stores or in restaurants (3.6), and at general merchandise stores (2.1). Consumers are shopping less at department stores (-4.7) and electronics & appliances stores (-3.5).

Online sales rose to a record \$694 billion (saar) during June, well exceeding department stores sales (\$138 billion) and sales at warehouse clubs and superstores (\$496 billion) ([Fig. 5](#)). Online shopping now accounts for a record 35% of GAFO (general merchandise, apparel and accessories, furniture, and other sales), which includes retailers that specialize in department-store types of merchandise such as furniture & home furnishings, electronics & appliances, clothing & accessories, sporting goods, hobby, book, and music, general merchandise, office supply, stationery, and gift stores ([Fig. 6](#)).

Bank of America often has a good, early read on consumer spending because it boasts 66 million consumer and small business clients. The bank's CEO Brian Moynihan [told](#) CNBC yesterday that its consumer base spent \$2 trillion ytd, a 5.9% increase y/y. "The U.S. consumer continues to spend and that will keep the U.S. economy in good shape," he said.

(2) *Plenty of dry powder.* Consumers are benefiting from more jobs and higher wages. The unemployment rate was 3.7% in July, a tick above the 3.6% rate during April and May—which was the lowest rate since December 1969 ([Fig. 7](#)). Real average hourly earnings of production and nonsupervisory workers continued to climb in June, up 1.9% y/y, marking its 80th month of gains ([Fig. 8](#)).

While consumers are spending some of their newfound dough, they're saving lots too. The US personal saving rate is in an uptrend, as the absolute amount saved has climbed to new highs, as noted above. Typically, saving rates fall during economic booms as consumers get more optimistic and spend excessively. Saving rates often rise during recessions, when consumers turn more cautious. The saving-rate jump may mean consumers will be able to keep spending more, longer.

(3) *Target hits the bullseye.* Target showed that if you build it right, shoppers will come. The company is remodeling stores, introducing new brands, and expanding online purchase delivery options. Last quarter saw a 1.5% y/y increase in comparable-store sales, a 34% y/y jump in comparable digital sales, a 2.4% y/y increase in traffic, and a 0.9% y/y increase in average ticket prices.

The company's operating margins expanded, and its Q2 EPS rose 20% y/y. The strong performance allowed Target to increase its full-year EPS estimate by 15 cents to \$5.90-\$6.20—with the midpoint implying a 12% y/y jump. The shares soared 20.4% on Wednesday.

Target and two dollar-store companies are members of the S&P 500 General Merchandise Stores stock price index, which is up 22.0% ytd through Tuesday's close ([Fig. 9](#)). The industry is expected to grow revenue 4.5% in 2019 and 4.2% in 2020 ([Fig. 10](#)). Bottom lines are expected to grow sharply as well: 6.0% in 2019 and 9.8% in 2020 ([Fig. 11](#)). Despite that strong growth, the industry's forward P/E is 15.7, in the middle of its P/E range over the past 15 years ([Fig. 12](#)).

(4) *Lowe's beats Q2 estimates.* The home improvement industry is doing fine, Q2 reports show, but fine is much better than expected, so shares of Home Depot and Lowe's rallied on the news. Lowe's total revenue was basically flat y/y, at \$21.0 billion, but US same-store-sales were up 3.2% y/y. At Home Depot, comparable-store sales rose 3.1%. Lowe's adjusted EPS of \$2.15 increased 3.9% y/y, beating analysts' average estimate by 14 cents and sending the shares up 10.4% on Wednesday.

"We capitalized on spring demand, strong holiday event execution and growth in Paint and our Pro business to deliver strong second quarter results. Despite lumber deflation and difficult weather, we are pleased that we delivered positive comparable sales in all 15 geographic regions of the U.S. This is a reflection of a solid macroeconomic backdrop and continued

momentum executing our retail fundamentals framework," said Lowe's CEO Marvin R. Ellison in the company earnings [press release](#).

Home Depot and Lowe's are members of the S&P 500 Home Improvement Retail stock price index, which is up 20.7% ytd ([Fig. 13](#)). Analysts are forecasting the industry will grow revenue by 2.4% this year and 4.1% in 2020 ([Fig. 14](#)). Analysts have been trimming their earnings estimates for this industry. As a result, earnings growth is expected to slow this year to 4.3% and accelerate in 2020 to 11.3% ([Fig. 15](#)). At 17.8, the industry's forward P/E is toward the top end of its range over the past 10 years ([Fig. 16](#)).

Disruptive Technology: Transforming Transactions. When it comes to the financial transactions of global trade, there's no doubt that the dollar and the use of the SWIFT (Society for Worldwide Interbank Financial Telecommunication) system dominate. Roughly 39% of international transactions occur in dollars, and 63% of foreign currency reserves are in dollars.

But at the margins, the advent of cryptocurrencies is changing the status quo. The massive market's evolution will determine whether the dollar will continue to dominate global transactions and allow the US to impose its will through sanctions on other countries. New cryptocurrencies could also reduce the time and fees involved with transactions between companies and institutions.

Earlier this summer, Facebook made waves with the introduction of Libra, a cryptocurrency backed by a basket of established currencies, which we discussed in the 6/20 [Morning Briefing](#). Others are interested in getting into the crypto transaction business as well, including China, which is working on a digital yuan, and JPMorgan, which is testing JPM Coin backed by the dollar.

Here's Jackie's news roundup on recently introduced forms of digital currency:

(1) *Yuan going digital*. China is developing the systems needed to offer a digital yuan, according to an 8/12 Bloomberg [article](#), citing a speech given by Mu Changchun, deputy director of the payments unit at the People's Bank of China (PBOC). He noted that the digital yuan is "close to being out."

The advent of a digital yuan is ironic given that China had banned the trading of digital currencies and initial coin offerings early in the development of cryptocurrencies because of the wild price swings that occurred. It's also the latest indication that the nation is paying close attention to Facebook's Libra project.

Libra shows there could be a new, global "strong international currency," which could challenge cross-border payments and weaken the role of sovereign currencies that don't have a stable value, said Zhou Xiaochuan, former governor of the PBOC, according to a 7/11 *South China Morning Post* [article](#). China should learn from Facebook's white paper, he said.

China is concerned that Libra could reinforce the dollar's dominance. "If the digital currency is closely associated with the US dollar, it could create a scenario under which sovereign

currencies would coexist with US dollar-centric digital currencies,” said Wang Xin, the PBOC’s research chief according to the *South China Morning Post* article.

China has hoped to expand the use of the yuan in global transactions, in part through the country’s Belt and Road Initiative. It aims to reduce the transaction costs of international trade, reduce exchange-rate risks, and increase the number of financial transactions in yuan. The Chinese currency is used in only about 2% of global transactions. The broad adoption of a digital yuan may be limited by fears of China’s state surveillance of transactions.

(2) *The JPM Coin arrives.* JPMorgan is expected to start trials of the JPM Coin with several of its corporate customers as early as this year, according to a 6/25 Bloomberg [article](#). The coin is initially exchangeable one-for-one with the US dollar, but in the future the company believes it could be used with other major currencies as well.

JPM Coin will be used only by JPMorgan institutional clients over a blockchain-based system. “When one client sends money to another over the blockchain, JPM Coins are transferred and instantaneously redeemed for the equivalent amount of U.S. dollars, reducing the typical settlement time,” the bank explained in this [primer](#). The currency initially will be used for international payments between large corporate clients, but in the future it might also be used in the issuance of debt securities and in Treasury services, a 2/14 CNBC [article](#) explained.

Because the coins are essentially backed by whatever currency they purchase, they’re considered “stablecoins.” And that’s what makes them very different from cryptocurrencies like bitcoin, which JPMorgan’s CEO Jamie Dimon famously has bashed in the past. Bitcoins don’t have the backing of any currency or any country.

The bank believes JPM Coin will reduce clients’ counterparty and settlement risk, decrease capital requirements, and enable instant value transfer. However, it theoretically would increase client’s exposure to JPMorgan, which is probably why the bank highlights in the primer its “strong” \$2.6 trillion balance sheet, the trillions it spends on cybersecurity, and the regulatory oversight with which it complies.

(3) *Other stablecoins arriving too.* UBS Group and 13 other big banks in the US, Europe, and Japan have created a new company, Finality International, to develop the utility settlement coin, or USC. The USC token will carry information and act as a payment device for trades over a blockchain system. It will be backed by “bank-owned currency held at central banks,” a 6/3 *WSJ* [article](#) reported. The token still needs regulatory approval, but it’s expected to be operational within a year.

Mitsubishi UFJ Financial Group, the world’s fifth-largest bank, plans to issue J-Coin, a blockchain-based stablecoin pegged 1-for-1 to the Japanese yen. The bank will make J-Coin available to retail customers for use in paying restaurants, convenience stores, and shops as well as transferring currency to other participants’ accounts, according to a 4/9 [article](#) on Cointelegraph.

The world’s third-largest cryptocurrency exchange, Binance, is developing stablecoins pegged

to currencies around the world. The exchange already has three stablecoins pegged to bitcoin, the British pound, and the dollar, USD Coin.

(4) *Fed's Bullard adds his two cents.* James Bullard, President of the Federal Reserve Bank of St. Louis, seemed skeptical about the flurry of cryptocurrencies hitting the market in a 7/19 speech. According to the [press release](#) and a [power point presentation](#), Bullard suggested that the US appears to be “drifting” toward a system of multiple currencies, which he believes can compete and coexist. But he warned that systems with multiple currencies are typically volatile and historically have been disliked (e.g., in 1830s America).

Competing currencies currently exist in the global market, but they can be volatile and attempts at trying to fix exchange rates “as suggested by ‘stablecoins,’” often have failed, he said. “Currencies have to be reliable and hold their value ... This is probably why government backing has been important historically, combined with a stable monetary policy that promotes stability of the currency.”

Stable currencies impart certainty about future issuance, so they can be appropriately valued. “With cryptocurrencies, there is a monetary policy encoded in the system, perhaps a fixed volume of ‘coins.’ But the system can also bifurcate, creating two fixed volumes of coins—a process that can happen multiple times.” And fixed exchange rates tend eventually to collapse.

Bullard concluded: “Cryptocurrencies may unwittingly be pushing in the wrong direction in trying to solve an important social problem, which is how best to facilitate market-based exchange.”

CALENDARS

US. Thurs: Leading Indicators 0.2%, Jobless Claims 218k, M-PMI & NM-PMI Flash Estimates 50.5/52.8, Kansas City Fed Manufacturing Activity Index 2, EIA Natural Gas Storage, Annual Federal Reserve Symposium in Jackson Hole Begins. **Fri:** New Home Sales 645k, Baker-Hughes Rig Count, Powell Speaks at Jackson Hole Symposium. (DailyFX estimates)

Global. Thurs: Eurozone, Germany, and France C-PMI Flash Estimates 51.2/50.6/51.9, Eurozone, Germany, and France M-PMI Flash Estimates 46.2/43.0/49.5, Eurozone, Germany, and France NM-PMI Flash Estimates 53.0/54.0/52.5, Eurozone Consumer Confidence -7, Japan Headline, Core, and Core-Core CPI 0.5%/0.6%/0.5% y/y, Japan Machine Tool Orders, ECB Publishes Account of July Policy Meeting. **Fri:** Canada Retail Sales -0.3%. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) showed little movement again this week as bullish sentiment held just below 50.0%. The BBR ticked up for the second week to 2.74 from 2.69 two weeks ago; it had increased seven of the prior eight weeks from 2.31 (lowest since mid-February) to 3.35. Bullish sentiment edged down to 49.1% this week after edging up to 49.5% last week; sentiment had plunged 9.1ppts (to 48.1% from 57.2%) two

weeks ago. The correction count ticked up to 33.0% this week after declining to 32.4% last week; it had jumped 8.3ppts (34.0% to 25.7%) two weeks ago. Over the prior eight-week period, bullish sentiment (57.2 from 42.7) jumped 14.5ppts, while the correction count (25.7 from 38.8) sank 13.1ppts. Bearish sentiment slipped to 17.9% this week after climbing from 16.8% to 18.1% over the prior three-week period; it had fluctuated in a small band from 18.0% to 18.5% from early June through early July. The AAll Ratio climbed to 34.1% last week after slumping from 61.5% to 31.0% the prior week. Bullish sentiment (to 23.2 from 21.7) rose, while bearish sentiment (44.9 from 48.2) fell.

S&P 500 Q2 Earnings Season Monitor (*link*): With the Q2 earnings season over 94% complete for the S&P 500 companies, 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 earnings surprises; the earnings surprise is a tad smaller; and y/y earnings growth is only 1.5ppts lower despite Boeing's dismal Q2 results. Of the 471 S&P 500 companies that have reported through midday Wednesday, 74% exceeded industry analysts' earnings estimates. Collectively, these reporters have averaged a y/y earnings gain of 1.6% and exceeded forecasts by an impressive 6.0%. Ex-Boeing, Q2's y/y earnings growth improves 1.6ppts to 3.2%. On the revenue side, 58% of companies beat their Q2 sales estimates so far, with results coming in an impressive 1.2% above forecast and 3.9% higher than a year earlier. Q2 earnings growth results are positive y/y for 66% of companies, versus a lower 64% at the same point in Q1, and Q2 revenues have risen y/y for 67% versus a slightly higher 68% during Q1. Looking at earnings during the same point in the Q1-2019 reporting period, a higher percentage of companies (76%) in the S&P 500 had beaten consensus earnings estimates by a higher 6.5%, and earnings were up a higher 3.1% y/y. With respect to revenues at this point in the Q1 season, a slightly lower 57% had exceeded revenue forecasts by a sharply lower 0.2%, and sales rose a higher 4.9% y/y. Compared to 2018's stellar results, these 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. With the earnings season nearly complete, it looks like Q2-2019 will make the sixth.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): Consensus S&P 500 forward revenues and earnings edged down w/w from their record highs. Analysts expect forward revenues growth of 5.4% and forward earnings growth of 8.0%, up 0.1ppt and unchanged, respectively, from a week earlier. Forward revenues growth is now down 0.9ppt 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 8.9ppts 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 5.4% in 2020. They're calling for earnings growth to slow sharply from 24.0% in 2018 to 2.0% in 2019 before improving to 10.3% 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 drop 0.3ppt y/y from 12.0% in 2018 to 11.7% in 2019 before improving to 12.2% in 2020. The S&P 500's forward P/E was down 0.2pt w/w to a 10-week low of 16.3 and from an 18-month high of 17.4 in late July. 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. Similarly, the S&P 500 price-to-sales ratio was down w/w to an 11-week low of 1.96 from 1.99 and from an 11-month high of 2.10 in late July. 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 just three of the 11 S&P 500 sectors and forward earnings did so for five sectors. Energy and Utilities were the only sectors to have both measures rise 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 have declined from recent multi-year or record highs for four sectors: Communication Services, Real Estate, Tech, and Utilities. However, all sectors remain well above their multi-year lows during December 2018. 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 one sector now: 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. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (21.7%, down from 23.0%), Financials (18.6, down from 19.2), Real Estate (16.0, down from 17.0), Communication Services (14.9, down from 15.4), Utilities (13.0, matching its record high in May), S&P 500 (12.1, down from 12.4), Materials (10.2, down from 11.6), Health Care (10.5, down from 11.2), Industrials (10.3, down from its record high of 10.4 in early July), Consumer Discretionary (7.5, down from 8.3), Consumer Staples (7.4, down from 7.7), and Energy (6.9, down from 8.0).

S&P 500 Sectors Net Earnings Revisions (*link*): The S&P 500's NERI weakened for a third straight month in August and was negative for the eighth time in 10 months as nearly half of the sectors fell to cyclical lows. NERI fell to a five-month low of -5.9% in August from -2.4% in July, which compares to February's recent low of -7.9% and a record high of 22.1% in March 2018. NERI improved m/m for three of the 11 sectors; that compares to three improving in July and six improving in June. All 11 sectors had improved m/m in May, which was the first time that had happened since January 2018. NERI was positive in August for 3/11 sectors, unchanged from July and down from five in June. That compares to negative readings for all 11 sectors from February to April. Consumer Staples' NERI turned negative in August for the first time in three months, and Communication Services was positive for the first time in 10 months. Materials has the worst track record, with 11 months of negative NERI, followed by Industrials (10), Financials (9), and Utilities (9). Here are the sectors' August NERIs compared with their July readings: Health Care (11.5% in August [16-month high], up from 9.0% in July), Real Estate (7.8 [25-month high], 6.9), Communication Services (1.1 [10-month high], -1.8), Consumer Staples (-0.5, 2.6 [15-month high]), Tech (-5.0, -1.3), Utilities (-6.1 [40-month low], -3.4), Consumer Discretionary (-7.3 [28-month low], -2.7), Industrials (-8.9 [31-month low], -3.9),

Financials (-14.2 [37-month low], -9.1), Materials (-14.7, -11.9), and Energy (-23.0 [40-month low], -10.3).

US ECONOMIC INDICATORS

Existing Home Sales ([link](#)): Existing home sales—tabulated when a purchase contract closes—showed signs of life in recent months, posting its first y/y increase since February 2018. Sales in July rose for the second time in three months, up 2.5% m/m and 4.0% over the period to 5.42mu (saar); ytd sales are up a robust 8.4%. Regionally, sales rose everywhere but the Northeast last month, with sales in the South and Midwest above year-ago levels, and the West’s about to turn positive. Here’s a tally: South (1.8% m/m & 2.7% y/y), Midwest (1.6 & 0.8), West (8.3 & -0.8), and Northeast (-2.9 & -4.3). Single-family sales advanced 2.8% in July and 8.8% ytd to 4.84mu (saar), while multi-family sales were unchanged at 580,000 units (saar), up 5.5% ytd. “Falling mortgage rates are improving housing affordability and nudging buyers into the market,” said Lawrence Yun, NAR’s chief economist. However, he added that the supply of affordable housing is severely low. The number of single-family homes on the market at the end of July edged down to 1.67 million, remaining slightly below year-ago levels, while the months’ supply (4.1) remained near historical lows.

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