



MORNING BRIEFING

October 2, 2019

Looking Forward to 2021

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

(1) We didn't start the fire. (2) Updating Billy Joel's list of troubles. (3) M-PMI drops below 50.0, but not to recession level. (4) Regional business surveys also weak through September. (5) Exports index takes a dive. (6) M-PMI signaling S&P 500 revenues recession, but NM-PMI remained upbeat through August. (7) Meanwhile, S&P 500 forward revenues and earnings at record highs. (8) Forward profit margin holding steady around 12.0%. (9) Another regime change ahead: From community organizers to deal makers to central planners? (10) Catching up on Elizabeth Warren's 45 plans.

Strategy I: Cause for Concern? One of my favorite songs is “We Didn’t Start the Fire” (1989), by Billy Joel, who is one year older than I am. The lyrics are simply a long list of major personalities and issues that have pleased, pained, and plagued my generation—the Baby Boomers—since our parents started to have children during the late 1940s. The lyrics include brief, rapid-fire allusions to more than 100 domestic and global headlines during the Cold War, from 1949 through 1989. Many of them refer to troublesome events during that period.

Today, Billy Joel would have no trouble updating his list of troublesome events: Red China, North Korea, South Korea, vaccine, Ayatollah’s in Iran, foreign debts, homeless vets, China’s under martial law, impeachment, MMT, negative rates, deflation, inverted yield curve, M-PMI, and many more. Actually, the first eight items were in Joel’s original [lyrics](#).

Yesterday’s cause for concern was the release of September’s M-PMI report. It wasn’t pretty. It was weak across the board ([Fig. 1](#)). Consider the following:

(1) *Weak, but still no recession.* The overall index fell to 47.8 from 49.1 during August. These are the first readings below 50.0 since 2016. There was no recession back then. The latest readings don’t signal a recession now according to the Institute for Supply Management (ISM), which conducts the PMI survey:

“A PMI® above 42.9 percent, over a period of time, generally indicates an expansion of the overall economy. Therefore, the September PMI® indicates growth for the 125th consecutive month in the overall economy, and the second month of contraction following 35 straight months of growth in the manufacturing sector. The past relationship between the PMI® and the overall economy indicates that the PMI® for September (47.8 percent) corresponds to a 1.5-percent increase in real gross domestic product (GDP) on an annualized basis.”

(2) *Regional surveys also mostly down and out.* The three major components of the M-PMI were all below 50.0 during September: new orders (47.3), production (47.3), and employment (46.3), as Debbie reviews below. The weakness in the M-PMI was confirmed by the composite and orders averages for the regional business surveys conducted by five Federal Reserve district banks ([Fig. 2](#)). However, the regional average employment index rebounded during September, while the employment component of

the M-PMI fell to the lowest reading since January 2016 ([Fig. 3](#)).

(3) *Trade war hits exports index*. Also standing out on the weak side was the M-PMI's new exports component, which plunged from last year's peak of 62.8 during February to 41.0 during September ([Fig. 4](#)). That was the lowest reading since March 2009. Trump's escalating trade war has depressed US exports, according to the latest ISM survey. The imports index, however, edged up from 46.0 during August to 48.1 last month.

(4) *Bad news for S&P 500 revenues*. The growth rate in S&P 500 aggregate revenues, on a y/y basis, is highly correlated with the M-PMI ([Fig. 5](#)). September's reading for the latter suggests that the former could turn negative. That would imply negative earnings growth too. Aggregate revenues were up 3.0% during Q2.

The good news is that aggregate revenues growth is also highly correlated with the NM-PMI, which probably remained well above 50.0 during September ([Fig. 6](#)). It edged up to 56.4 during August. September's number will be out tomorrow.

Strategy II: No Cause for Concern? Industry analysts aren't singing Billy Joel's song. They may be reading the headline news about the slowdown in the global economy, but it isn't showing up in their upbeat expectations for S&P 500 revenues and earnings:

(1) *Revenues*. S&P 500 forward revenues rose to yet another record high during the 9/19 week ([Fig. 7](#)). This time-weighted measure of expectations for the current year and the coming year is rapidly converging to the 2020 consensus estimate. Joe has updated our forward revenues (and earnings) charts with consensus 2021 expectations. Industry analysts are expecting S&P 500 revenues to grow 4.3% this year, 5.5% next year, and 4.5% in 2021 ([Fig. 8](#)).

Joe and I are big fans of the forward revenues series because it is available weekly and it is a great coincident indicator of the trend in actual quarterly revenues ([Fig. 9](#)).

(2) *Earnings*. Also impressive, given the depressing headline news, is the fact that S&P 500 forward earnings has been inching upward in record-high territory in recent weeks through the 9/26 week ([Fig. 10](#)). This series tends to be a good leading indicator of the trend in actual S&P 500 operating earnings.

Undoubtedly, industry analysts are too optimistic about the outlook for earnings, as they often have been in the past. They are currently forecasting earnings growth of 2.0% this year, 10.1% next year, and 10.3% in 2021 ([Fig. 11](#)). That implies that the profit margin, which is at a record high, will continue to move higher.

(3) *Profit margin*. Meanwhile, the forward profit margin, which is a coincident indicator of the actual quarterly profit margin, has stabilized just below its record high late last year around 12.0% ([Fig. 12](#)). That's impressive given the news about shortages of workers driving up labor costs and tariffs driving up prices paid for imports.

(4) *Earnings season ahead*. On a quarterly basis, S&P 500 earnings rose 2.8% during Q1 and 0.8% during Q2. Prior to their earnings seasons, both quarters were expected to show slight declines in earnings. Now, Q3 is expected to be down 3.2% y/y ([Fig. 13](#) and [Fig. 14](#)). Another "earnings hook" could turn that number slightly positive, as occurred during the first two quarters of this year.

That would still leave earnings growth in the very low single digits and the weakest since 2016, when it was only 0.5%. Industry analysts are currently projecting it will be just 1.1% this year, while we are at

3.1%. Next year, they are at 11.2%, while we are at 5.4%. (See [YRI S&P 500 Earnings Forecasts](#).)

Politics: Warren Has a Plan for That. As President Donald Trump sinks in the Beltway swamp, Elizabeth Warren's chances of becoming the Democratic Party's presidential nominee are rising. If she continues to advance and Trump continues to sink, taking current Democratic frontrunner Joe Biden down with him, she could be the president in 2021.

That would mean yet another radical regime change, from community organizers and lawyers under Obama, to deal-makers under Trump, to central planners under Warren.

"Elizabeth has a lot of plans, but they're really one simple plan: We need to tackle the corruption in Washington that makes our government work for the wealthy and well-connected, but kicks dirt on everyone else, and put economic and political power back in the hands of the people," according to her [website](#).

By our count, 11 of her 45 campaign-platform "plans" would dramatically impact the US economy and financial markets. Here are our short, factual summaries of those 11, scrubbed of her anecdotes and biases:

(1) *Imposing an ultra-millionaire tax.* Warren would tax the wealth of households with a net worth of \$50 million or more, or the top 0.1%. They'd pay an annual 2% tax on every dollar of net worth above \$50 million and a 3% tax on every dollar of net worth above \$1 billion. This would bring in an estimated \$2.75 trillion in revenue over 10 years, based on [research](#) by University of California, Berkeley Professors Emmanuel Saez and Gabriel Zucman noted on Warren's website.

(2) *Making higher ed affordable for all.* Warren would cancel student-loan debt for more than 95% of the nearly 45 million Americans with such debt; more than 75% would see theirs eliminated entirely. This is intended to "provide an enormous middle-class stimulus that will boost economic growth, increase home purchases, and fuel a new wave of small business formation." She also plans to create "universal free college." The entire cost of the plan, \$1.25 trillion over ten years, would be paid for by the ultra-millionaire tax. The debt cancellation has a phase-out feature and wouldn't be offered for people with household income above \$250,000. Funding would also be made available to cover non-tuition-related expenses such as books and boarding.

(3) *Stopping the "coming" economic crash.* This "plan" is a catch-all for several plans. Warren is worried about household and corporate debt, a manufacturing slowdown, and the inverted yield curve. She cites a survey that projects the next recession will come by the end of 2021. To "stop" it, she says we need to reduce household debt by increasing the minimum wage and canceling student-loan debt, lowering the cost of rent, providing universal affordable childcare, and instituting universal free college. To tackle corporate debt, Warren plans to monitor corporate lending, especially leveraged lending, upon which she'd enforce new guidance. Her Green Manufacturing Plan will make "a \$2 trillion investment in American green research, manufacturing, and exporting over the next decade."

(4) *Reducing corporate influence over the Pentagon.* Warren dislikes the "coziness" of corporate defense contractors and lobbyists with the Pentagon. She would cut the US defense budget—but doesn't say by how much—and sever connections between "giant corporate contractors" (like Lockheed Martin) and the Pentagon.

(5) *Empowering workers via "accountable capitalism."* Warren aims to change what she sees as the primary aim of corporations: "maximizing shareholder value." Her plan requires US corporations with more than \$1 billion in revenue to obtain a federal charter as a "United States corporation," which would

obligate directors to consider the interests of all corporate stakeholders, not just shareholders, and mandate that employees elect at least 40% of the company's board members. To keep execs focused on the long term, directors and officers at large US companies would be prohibited from selling company shares within five years of receiving them or within three years of a stock-buyback program. Finally, before large companies could engage in political funding, they'd need to undergo an approval process.

(6) *Ending Wall Street's "stranglehold" on the economy.* Warren's Wall Street focus targets private equity. To transform the industry, she plans to make private-equity firms responsible for the debt and pension obligations of companies they buy, limit these private-equity firms' fees and dividends, raise the tax rates on their deals, and close the carried-interest loophole. To reduce speculative excesses on Wall Street, she would enact her 21st Century Glass-Steagall Act, rebuilding the wall between commercial banks and investment banks; institute new executive compensation rules for bankers; and strengthen rules on big banks' capital, liquidity, leverage, and resolution-planning. (These plans are tied into her plan for "Holding Wall Street Accountable.")

(7) *Implementing new trade approaches.* Warren is not for free trade that supports only corporations but for trade that benefits "the people." In a Warren administration, trade agreements would be negotiated and approved via a transparent process with public disclosures and commentary. Countries would have to meet a set of standards as a precondition for trading with the US. She'd also strengthen trade-rule enforcement and end "Investor-State Dispute Settlement," the "favorable enforcement approach we offer corporations."

(8) *Breaking up Big Tech.* Warren wants to break up market-dominating tech companies like Amazon, Facebook, and Google. To start, she'd require "large tech platforms to be designated as 'Platform Utilities' and broken apart from any participant on that platform." Regulators would be appointed to revise illegal and anti-competitive tech mergers. (These "plans" are tied into her plan to promote competitive markets.)

(9) *Defending & creating American jobs.* Warren plans to "pursue an agenda of economic patriotism, using new and existing tools to defend and create quality American jobs and promote American industry" through "fundamental, structural changes in our government's approach to the economy" that put "American workers and middle-class prosperity ahead of multinational profits and Wall Street bonuses." To do so, she plans to mirror other countries' plans like "Made in China 2025." Warren says it's not globalization, automation, and the skills gap that are to blame for American job losses and flat wages but Washington's trade and tax policies. Some of her "more aggressive tactics" include: "[m]ore actively managing our currency value to promote exports and domestic manufacturing," leveraging federal R&D, and instituting a new agency focused on growing well-paying jobs.

(10) *Providing health care as a human right.* Warren supports "Medicare for All." She also plans to institute the Affordable Drug Manufacturing Act to "allow the Department of Health and Human Services to step in where the market has failed." Warren's Behavioral Health Coverage Transparency Act "would hold insurers accountable for providing adequate mental health benefits." Warren's CARE Act with Rep. Elijah Cummings (D-MD) "would invest \$100 billion in federal funding over the next ten years" to fight the Opioid Crisis.

(11) *Implementing a new tax law: Real Corporate Profits Tax.* This new tax would apply to companies that report more than \$100 million in profits. For every dollar of profit above \$100 million, corporations would pay a 7% tax (with no "loopholes," deductions, or exemptions) to ensure that no major corporations have a zero tax liability. "Any company profitable enough to hit the Real Corporate Profits Tax will pay that tax in addition to whatever its liability might be under our current corporate tax rules."

According to an estimate from Saez and Zucman noted on Warren's website, the tax would bring in \$1 trillion in revenue over the next 10 years.

To limit potential shocks to the markets, Warren also plans not to tweet as much as Trump does. Her plans would be shocks enough.

CALENDARS

US. Wed: ADP Employment Change 140k, Motor Vehicle Sales, MBA Mortgage Applications. **Thurs:** ISM & IHS/Markit NM-PMIs 55.0/50.9, Factory Orders -0.5%, Jobless Claims 215k, Challenger Job-Cuts Report, EIA Natural Gas Report, Clarida, Evans, Quarles, Kaplan. (DailyFX estimates)

Global. Wed: Eurozone Unemployment Rate 7.5%, Germany Retail Sales 0.5%*m/m*/2.9%*y/y*, Germany Unemployment Change & Unemployment Claims Rate 5k/5.0%, Germany CPI 0.0%*m/m*/1.3%*y/y*, UK GDP -0.2%*q/q*/1.2%*y/y*, Japan Jobless Rate 2.3%, Japan Tankan Survey, Japan M-PMI, Japan Housing Starts 902k. **Thurs:** Eurozone Retail Sales 0.3%*m/m*/2.0%*y/y*, Eurozone, Germany, France, and Italy C-PMIs 50.4/49.1/51.3/50.0, Eurozone, Germany, France, and Italy 52.0/52.5/51.6/50.4, UK C-PMI & NM-PMI 50.0/50.3, Guindos, Tenreiro, Ellis. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Q3 Earnings Season Monitor ([link](#)): With just over 3% of S&P 500 companies finished reporting revenues and earnings for Q3-2019, the y/y growth rates in revenues and earnings have slowed from the same point during Q2. However, revenues and earnings are beating the consensus forecasts by 0.9% and 5.1%, respectively. That's about the same rate during the same point in Q2, but the percentages of companies beating their revenue forecasts and showing positive y/y revenue growth are weaker. Of the 16 companies in the S&P 500 that have reported through mid-day Tuesday, 88% exceeded industry analysts' earnings estimates. Collectively, the reporters have a y/y earnings decline of 17.8%, primarily due to Micron Technology's earnings deceleration. On the revenue side, just 44% of companies beat their Q1 sales estimates so far, with results 1.3% higher than a year earlier. Ex-Micron, the S&P 500's y/y earnings growth jumps to 11.9% from -17.8% and revenue growth improves to 5.4% from 1.3%. Overall Q3 earnings growth results are positive y/y for 81% of companies, and revenues have risen y/y for 75%. These figures will change markedly as more Q3-2019 results are reported in the coming weeks, but what companies say about their expectations for Q4-2019 and their early peek at 2020 will be the main focus of the earnings season's results.

GLOBAL ECONOMIC INDICATORS

Global Manufacturing PMIs ([link](#)): Global manufacturing activity in September contracted for the fifth consecutive month, though moved closer to stabilization, increasing for the second month to a four-month high. JP Morgan's September M-PMI (to 49.7 from 49.5) ticked up slightly for the second month from July's 49.2—which was the weakest reading since October 2012. It was at a seven-year high of 54.4 at the end of 2017. The emerging nation's M-PMI improved for the third month, to a six-month high of 51.0, after falling from 51.0 in March to 49.9 in June; it was at 49.5 in January—which was the first reading below 50.0 since mid-2016. Meanwhile, the M-PMI (48.6 from 48.8) for developed nations was in contractionary territory for the fifth consecutive month, after recovering to 50.2 in April, following a brief dip below 50.0 in March (to 49.9). M-PMIs deteriorated in 15 of the countries covered in September's report. Among the larger industrial nations, the US (to 51.1 from 50.3) and China (51.4 from 50.4) continued to expand, along with the Eurozone countries of Greece (53.6 from 54.9) and the Netherlands (unchanged 51.6); France (50.1 from 51.1) was at the breakeven point. Meanwhile, the overall Eurozone (45.7 from 47.0) contracted at its fastest pace since October 2012, dragged lower by

the collapse in Germany's (41.7 from 43.5) manufacturing sector—which fell at its fastest pace in 123 months and was the weakest among all the countries' manufacturing sectors in September's report. Meanwhile, Japan (48.9 from 49.3) contracted for the fifth straight month, and matched February's recent low—which was the weakest since mid-2016—while manufacturing activity in Ireland (48.7 from 48.6), the UK (48.3 from 47.4, Italy (47.8 from 48.7), Spain (47.7 from 48.8), and Russia (46.3 from 49.1) also remained in the red.

US Manufacturing PMIs ([link](#)): Manufacturing activity in September contracted at a faster pace, according to the ISM survey—though ISM notes that last month's reading is consistent with roughly a 1.5% annualized increase in real GDP, based on the past relationship of the two measures. Meanwhile, IHS Markit's measure showed a slight acceleration last month. ISM's composite (to 47.8 from 49.1) index sank to its lowest reading since June 2009, as manufacturing companies cut production (47.3 from 49.5) and employment (46.3 from 47.4) at the fastest rates since April 2009 and January 2016, respectively. The new orders (47.3 from 47.2) measure was little changed from August's low—which was the weakest since June 2012. The remaining two index components showed that the supplier deliveries (51.1 from 51.4) gauge was heading back down to June's 35-month low of 50.7, while inventories (46.9 from 49.9) contracted at the fastest pace since December 2016. Meanwhile, weak foreign demand pushed the new export orders (41.0 from 43.3) sub-index to its worst performance since March 2009. According to the report: "Global trade remains the most significant issue, as demonstrated by the contraction in new export orders that began in July 2019. Overall, sentiment this month remains cautious regarding near-term growth." IHS Markit's M-PMI (51.1 from 50.3) rose to a five-month high, though the overall picture remained one of a "struggling goods producing sector that has suffered its worst quarter since 2009," according to the report. Growth in both new orders and production remained modest, with firms increasing their workforce numbers only tentatively. Business confidence remained relatively gloomy.

Eurozone CPI Flash Estimate ([link](#)): September's CPI rate was below 2.0% for the 11th consecutive month, according to the flash estimate, and below 1.0% for the first time since November 2016; the core rate continued to fluctuate around 1.0%. The headline rate is forecast to slip to 0.9% y/y for September—the lowest rate since November 2016; it was at a recent peak of 2.3% last October. Looking at the main components, food, alcohol & tobacco (to 1.6% from 2.1% y/y) is expected to have the highest rate, followed by services (1.5 from 1.3)—with the former decelerating from August's rate and the latter accelerating. Non-energy industrial goods is expected to be unchanged at 0.3%. Meanwhile, the rate for energy (-1.8 from -0.6) is forecast to fall further below zero, after slipping below in August for the first time since November 2016; it's been heading lower steadily since March/April's rate of 5.3%. The core rate—which excludes energy, food, alcohol, and tobacco—is expected to tick up to 1.0% y/y from 0.9% the prior two months; it has fluctuated between 0.8% and 1.1% the past five months.

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