Yardeni Research

MORNING BRIEFING
November 21, 2019

Consumers Are Consuming

See the collection of the individual charts linked below.

(1) Europe finding a bottom? (2) European car registrations pop, and non-auto retail sales head to new highs. (3) Chinese debt hitting higher highs. (4) Chinese bond defaults strike companies, banks, and municipal entities. (5) In US, all retailers are not having the same year. (6) Target hits multiple bullseyes; Kohl's strikes out.

Europe: Signs of Life! Debbie, Joe, and I have been on the lookout for signs of life in the global economy since early October, when we decided it might be time to venture out of our Stay Home cabin and take a Go Global cruise for a while. We didn't have to wait long to get a batch of better-than-expected economic indicators for Europe. Consider the following:

(1) *Auto sales and production.* On Tuesday, Reuters reported that passenger car registrations in Europe rose 8.6% y/y in October, to their highest October level since 2009 (*Fig. 1*). Demand is robust in Germany and France. The gain was led by a 29% gain for Volkswagen. A year ago, registrations were depressed as carmakers struggled to certify new vehicles to meet the Worldwide Harmonised Light Vehicle Test Procedure.

(2) *German output and sentiment.* This augurs well for German auto production, which plummeted 10.7% y/y during October but has stopped falling over the past three months, based on the 12-month sum (*Fig. 2*). The German Ifo business confidence index also stopped falling in October (*Fig. 3*).

(3) *Retail sales.* Despite the slowdown in Eurozone economic growth since early last year, the volume of non-auto retail sales in the region has continued to trend higher in record-high territory (*Fig. 4*). During September, it was up by a very solid 2.7% y/y.

China: Debts Coming Due. The People's Bank of China lowered the loan prime rate yesterday, the third such cut since the benchmark was introduced in August. The move was telegraphed by a governor of the central bank, Yi Gang, who said on Tuesday that China would increase credit support to the economy and push lending rates lower to prop up slowing growth.

China's economic growth is certainly slowing. GDP expanded 6.0% y/y during Q3, its weakest rate in the history of the series going back to 1992 (*Fig. 5*). Slowing economic growth is a major problem because China has $21.3 trillion of bank loan debt outstanding (*Fig. 6*). Bank debt has increased $16.7 trillion, or 375%, during the last decade, not plateauing until the spring of this year. China's bank loans as a percentage of GDP surged to 152% during 2018 from 94% a decade ago (*Fig. 7*).

In addition to piling up bank loans, there's lots of money being loaned outside of traditional banking channels, through other "social financing." That's an additional roughly $4 trillion. All told, China's corporate, household, and government debt totals roughly $40 trillion, more than 300% of GDP. Companies and municipalities that assumed China's economy would grow 7%-8% a year may have difficulty repaying their debt in a 6% (or less) annual-GDP-growth environment.

There is a growing number of articles about defaults by Chinese companies and municipalities, which may imply a problem brewing. Here's Jackie's look at some of the recent tales of woe from China's credit market:

(1) *Defaults low, but on the rise.* China had its first bond default in 2014, when the government decided to end the perception that it would always bail out businesses. Then in 2016, the government cracked down on the shadow banking market and credit tightened. With the US-China trade war and a slowing economy pressuring issuers too, it's no surprise that record bond defaults ensued.

In the first three quarters of 2019, issuers defaulted on 100 billion yuan ($14 billion) of debt. That's on pace to approximate the full-year defaults of 2018, when 135 billion yuan of bonds defaulted, according to a 10/19 article in the *South China Morning Post*. Granted, the default rate is still low, at 1.03% of all issuers.

(2) *Private companies squeezed.* Chinese lenders are getting more conservative. Money is flowing into state-owned companies, which are considered safer than their private counterparts. Private companies are being asked to provide a large amount of collateral or credit guarantee to secure financing. "[M]any private firms have to issue short-term bonds to support their long-term investments," Moody's Ivan Chung said in a 10/23 *South China Morning Post* article. "When the companies encounter refinancing troubles, they run into liquidity problems."

Tunghsu Optoelectronic Technology, an electronics manufacturer, ran into problems this week. It failed to repay principal and interest worth more than 2 billion yuan ($285 million) on two domestic bonds due Monday. "The delinquency came as a shock to the market because Tunghsu had reported holdings of cash or cash equivalent worth over 18 billion yuan as of the end of September in its latest quarterly report, more than enough to meet the bond repayments," an 11/19 *South China Morning Post* article reported.

In September, Qinghai Salt Lake Industry Group (QSLIC) filed bankruptcy with a Chinese court, and it too is working on a restructuring. QSLIC has about 6.2 billion yuan of bonds outstanding and owns Qinghai Salt Lake Magnesium, which had 42.3 billion yuan ($5.94 billion) of debt and lost 7.9 billion yuan in 2017 and 2018 combined, a 10/11 Caixin Global article stated.

Even dollar-denominated debt has been hit. China Minsheng Investment Group Corp., a conglomerate with $34 billion of debt, missed principal and accrued interest payments on a 3.8% $500 million bond due in August. Creditors agreed to a one-year extension, and now questions are being raised about the company's ability to repay its yuan-denominated debt, a 9/27 Nikkei article reported.

(3) *States to the rescue.* Sometimes, local governments jump in to prevent defaults. Two investment funds of the Heilongjiang provincial government raised their combined stake in Harbin Bank, a lender in northeastern China, to 48% from 20% according to a 11/19 article in the *South China Morning Post*. It's unclear why the rescue was necessary.

In Shandong, three city governments set up a 3 billion yuan fund to support Xiwang Group, a steel and corn processing company struggling to pay debt. And in October, a local state-owned investment firm bought a 26% stake in Shandong Ruyi Technology Group, a fashion group, for 3.5 billion yuan and provided credit guarantees for the company's bonds.

(4) *Local governments need life preserver ring too.* "Lower-tier" governments are under financial stress because their revenue is falling short of their obligations, like paying for education and healthcare. Spending on education jumped to Rmb3.9 trillion in 2017 from Rmb1.1 trillion a decade ago, reported an 11/10 *FT* article.

Chinese courts have listed 831 local governments as being in default for the first 10 months of this year compared to just 100 for all of 2018, the *FT* article noted. The amount owed grew by more than 50% to Rmb6.9 billion ($984 million) from Rmb4.1 billion ($585 million). These defaults don't include any debt owed by local government finance vehicles or companies operated by local governments.

Jilin Transportation Investment Group is one such local government financial vehicle (LGFV). Jilin said in September that it plans to skip the call option on a 1.5 billion yuan 4.64% perpetual note. Instead, it will pay an increased coupon in the 8.00% vicinity, according to a 9/13 article in the *South China Morning Post*.

"If defaults or bankruptcies among high-profile LGFVs become epidemic, it would erode market confidence, tarnish government reputations, and destabilize the financial system," Gloria Lu, an S&P infrastructure analyst said in the 9/13 article in the *South China Morning Post*. "It could also shut down financing to other local state-owned enterprises, at least initially. This would be highly disruptive at a time when China is counting on infrastructure development, along with other fiscal stimuli, to sustain economic growth and social stability."

(5) *Banks are debt heavy.* In May, Chinese regulators seized a bank for the first time in 20 years. Baoshang Bank in northern China was placed in receivership. "The bank was once part of a network of investments controlled by Xiao Jianhua, a tycoon who was ensnared in an anticorruption campaign. Baoshang made several large loans to other companies within Mr. Xiao's financial empire that were never paid back. Still, it remained open for depositors," an 11/7 *NYT* article noted.

Last summer, Bank of Jinzhou received a 3 billion yuan equity infusion from China's biggest bank, Industrial & Commercial Bank of China, and two investment firms, China Great Wall Asset Management and China Cinda Asset Management. And China's sovereign wealth fund made an equity investment into Hengfeng Bank. Two of the bank's former chairmen are under investigation for corruption. Given the amount of debt outstanding and the economic pressures on China, these rolling restructurings may roll on for quite a while.

Consumer Discretionary: Two Sides of the Coin. The S&P 500 General Merchandise Stores industry and the Department Stores industry might both be in the S&P 500 Consumer Discretionary sector, but they are having very different years.

The stocks in the General Merchandise industry are having a banner 2019, led by Target (67.7%) and followed by Dollar General (46.6) and Dollar Tree (18.3). The General Merchandise Stores industry has been the eighth-best-performing industry we track this year, up 47.9% ytd (*Fig. 8*).

Meanwhile, shareholders of stocks in the S&P 500 Department Stores industry may wish the year never started. The shares of Macy's have fallen 49.5%, followed by those of Kohl's (-29.1%) and Nordstrom (-23.8). Altogether, that means the S&P 500 Department Store stock price index has fallen

35.6%, making it the worst-performing index we track (*Fig. 9*).

To understand why the two similar industries are having such different performance, look no further than the Q3 earnings results of Target and Kohl's. Target's Q3 same-store sales rose 4.5%, beating expectations, while Kohl's same-store sales rose only 0.4%, missing Wall Street analysts' target.

Target's total revenues increased 4.7% y/y to $18.7 billion, while Kohl's sales were essentially flat at $4.4 billion. Kohl's blamed a 1% decline in women's clothing sales and warm weather. Target didn't mention either as a problem.

Target's net income from continuing operations jumped 14.5% to $706 million. The results, which beat Wall Street's expectations, helped the company raise its full-year EPS forecast to $6.25-$6.45, up from the prior $5.90-$6.20 range. Conversely, Kohl's operating income was $116 million for the quarter, or 74 cents a share, compared to 98 cents a share a year ago. Kohl's cut its full-year EPS target to $4.75-$4.95, down from the prior range of $5.15-$5.45.

Target believes it's taking market share in apparel and boasted a 31% jump in online sales compared to Kohl's "mid-teens" increase in online sales. Kohl's, which recently introduced a number of new apparel brands and expanded its athletic wear offering, said it remains hopeful that its sales will improve during the holidays.

Both companies have been investing in their stores, renovating, and updating their systems to allow customers to buy online and pick up in the store. They each have certain advantages. Kohl's is accepting Amazon's merchandise returns, which brings new customers into the stores. Target offers groceries, which gives customers a reason to return frequently. Customers may be indicating their preference for stores that offer one-stop shopping for anything from office supplies to food and clothing.

The good news for the economy is that consumers are still shopping.

CALENDARS

US. Thurs: Existing Home Sales 5.49mu, Philadelphia Fed Manufacturing Index 6.1, EIA Natural Gas Report, Kashkari, Mester. **Fri:** Consumer Sentiment Index 95.7, M-PMI & NM-PMI Flash Estimates 51.4/51.4, Kansas City Fed Manufacturing Index -2, Baker-Hughes Rig Count. (DailyFX estimates)

Global. Thurs: Eurozone Consumer Confidence -7.2, Japan CPI Headline, Core, and Core-Core 0.3%/0.4%/0.6% y/y, OECD Economic Outlook, ECB Account of October Policy Meeting, Guindos, Mersch, Poloz. **Fri:** Eurozone, Germany, and France C-PMI Flash Estimates 50.9/49.3/52,8, Eurozone, Germany, and France M-PMI Flash Estimates 46.4/42.9/50.9, Eurozone, Germany, and France NM-PMIs 52.4/52.0/53.0, UK M-PMI & NM-PMI Flash Estimates 48.8/50.0, Canada Retail Sales -0.1%. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) ratio climbed for the sixth week this week, posting its fourth reading above 3.00—increasing from 2.77 to 3.35 over the period. Both bullish and bearish sentiment edged lower this week, though the former's decline was slightly smaller than the latter's; the correction count rose for the first time in six weeks. The wide swings between the bullish and correction camps since early June were put on pause this week: Bullish sentiment ticked down to 57.2% this week after rising 10.0ppts the prior five weeks (to 57.6% from 47.6%), while the correction count rose to 25.7% after falling 10.7ppts the previous five weeks (24.5 from 35.2). During the previous, 10/8 week, the former dropped 7.7ppts, while the latter jumped 7.6ppts. The AAII Ratio was little changed at 62.1% last week after rebounding from 54.4% to 62.7% the prior week, as both bullish (to 40.7% from 40.3%) and bearish (24.8 from 23.9) sentiment edged higher last week.

AC World ex-US MSCI (*link*): This index has risen 1.4% in dollar terms so far in November, and is up 11.9% ytd. In local-currency terms, the index is up a better 1.9% in November compared to a better 15.0% gain for all of 2019. The US dollar price index is up 16.6% since its December 2018 low, but is still in a correction at 10.9% below its cyclical high in January 2018. It had been down as much as 23.6%—and in a bear market—last December. The local-currency price index is up 17.1% since its December 2018 low to 4.1% below its record high in January 2018. It had been down as much as 18.1% on 12/26/18. Local-currency forward revenues rose 0.4% m/m to 1.0% below its record high in early May, but is up 16.0% from a five-year low in March 2016. Local-currency forward earnings rose 0.1% m/m, to 5.4% below its record high in November 2018. Revenues are expected to rise just 2.7% in 2019 and 4.1% in 2020 following a gain of 7.2% in 2018, and earnings are expected to fall 0.6% (2019) and rise 10.1% (2020) after rising 4.7% (2018). The industry analysts' sales forecasts imply short-term 12-month forward revenue growth (STRG) of 4.0%, up 0.1ppt m/m. Their STRG forecast compares to a seven-year high of 6.8% in March 2017 and is up from a cyclical low of 2.3% in March 2016. Their short-term 12-month forward earnings growth (STEG) forecast improved 0.8ppt m/m to 8.9%. That's up from a 10-year low of 6.0% in February and compares to a four-year-high forecast of 14.1% in March 2017. The profit margin implied by analysts' earnings and revenue estimates calls for a drop to 7.4% in 2019, from 7.6% in 2018, and an increase to 7.8% in 2020. The forward profit margin forecast of 7.8% was unchanged m/m, but is down from a nine-year high of 8.3% in October 2018. The Net Earnings Revision Index (NERI) for the AC World ex-US MSCI was negative in November for a 20th straight month following six positive readings. However, it improved to a 13-month high of -6.3% from -7.1% in October, and is up from its 33-month low of -8.4% in January. That compares to a 76-month high of 2.7% in May 2017 and a 51-month low of -11.3% in March 2016. The forward P/E rose 0.4pt m/m to a 22-month high of 13.8, which is up from a five-year low of 11.4 in December 2018. That compares to a six-year high of 15.3 in April 2015 and a cyclical bottom of 12.3 in January 2016. The index's current 13% discount to the World MSCI P/E is up from its record-low 15% discount during early November.

EMU MSCI (*link*): The EMU's MSCI price index is up 1.7% in dollar terms so far this month and up 17.4% for 2019 to date. In euro terms, the price index is up a greater 2.4% in November, compared to a higher 20.9% gain ytd. The US dollar price index is up 20.0% since its December low, but is still in a correction at 11.8% below its cyclical high in January 2018. It had been down as much as 26.5% and in a bear market in December 2018. The local-currency price index is up 23.4% since its December 2018 low to 1.8% below its cyclical high in January 2018. It had been down as much as 20.5% on 12/27/18. The US currency price index remains a whopping 29.8% below its record high in October 2007 while the local price index is down 15.6% from its March 2000 record high. Euro-based forward revenues rose 0.8% m/m to 1.6% below its five-year high in November 2018. That's still 4.7% above its six-year low in May 2016 but 6.4% below its record high (in September 2008). Euro-based forward earnings had stalled from 2011 to 2016 before reaching its highest level in 10 years in November 2018. It was down 0.4% m/m to 3.5% below its 10-year high in November 2018 and 18.5% below its record high (January 2008). Analysts expect revenues to rise 2.3% in 2019 and 3.7% in 2020, above the 2.1% in 2018. They're looking for earnings to fall 1.0% in 2019 and rise 10.8% in 2020 following a gain of 3.4% in 2019. Forecasted STRG of 3.6% is unchanged from a month earlier, which compares to a six-year high of 5.0% in April 2017 and a cyclical low of 2.0% in May 2016. Forecasted STEG rose 0.9ppt m/m to a 12-month high of 9.9%, which compares to a 78-month high forecast of 21.0% (February 2017) and a seven-year low of 5.7% (April 2016). STEG is now higher than LTEG (currently 8.8%) for the first time since May 2017. The forward profit margin dropped 0.1ppt m/m to 7.7%, which compares to a nine-year high of 7.9% in January and a cyclical bottom of 6.2% in May 2013. The implied profit margin is expected to drop from 7.5% in 2018 to 7.2% in 2019 before improving to 7.8% in 2020. NERI was negative in November for a 14th straight month and in 25 of the past 28 months. NERI edged down m/m to -6.3% from -6.2%, but is above December 2018's 31-month low of -8.7%. That compares to an 11-year high of 8.1% in May 2017. The P/E improved 0.5pt m/m to a 22-month high of 14.2 and is up from 11.3 in early January, which was then its lowest reading since July 2013. That's down from a cyclical high of 14.9 in January 2018 and compares to a 13-year high of 16.4 in April 2015 and a 30-month low of 12.2 in February 2016. The current valuation represents a 10% discount to the World MSCI's P/E now, up from February's 14% discount, which was then the lowest since August 2016. That compares to a record-low 25% discount during 2011 and is well below the 1% premium during April 2015—the post-euro-inception record high.

Emerging Markets MSCI (*link*): The EM MSCI price index has risen 1.5% in US dollar terms so far in November to a gain of just 9.5% ytd. In local-currency terms, EM is up a greater 2.0% in November and a higher 10.6% ytd. The US dollar price index is up 13.1% since its October 2018 low and still near a bear market now at 17.0% below its cyclical high in January 2018. It had been down as much 26.6% last October from its cyclical high. The local-currency price index is up 13.6% since its October 2018 low to 10.2% below its cyclical high in January 2018. It had been down as much as 20.9% on 10/29/18. Local-currency forward revenues improved 1.5% m/m to 3.1% from its record high in early May, and is up 19.4% from a four-year low in June 2016. Local-currency forward earnings rose 1.4% m/m to 8.0% below its record high in October 2018. It's up an impressive 29.2% from its six-year low in April 2016. Revenue growth is expected to slow markedly to 4.9% in 2019 and 7.2% in 2020 from an 11.7% gain in 2018. That's expected to lead to earnings gains of 0.4% in 2019 and 14.6% in 2020, following a 7.5% gain in 2018. Forecasted STRG improved 0.2ppt m/m to 7.0%, which compares to a 34-month low of 5.8% in February and a four-year high of 9.6% in January 2017. STEG surged 1.4ppt m/m to 13.4%; that's up from a 10-year low of 6.6% in late January but remains well below its cyclical peak of 17.5% in March 2017. However, it's above LTEG (12.5%) for the first time since May 2017. The implied profit margin drops from 6.5% in 2018 to 6.2% in 2019 before improving to 6.7% in 2020. The forward profit margin remained steady at 6.6%, which is down from a six-year high of 7.4% in April 2018. It's now 3.7ppts below its 10.3% record high in December 2007 and compares to a record low of 6.0% in February 2016. NERI was negative for a 22nd month in November, but improved to a 13-month high of -4.9% from -5.9% in October. NERI had been positive for only three months through January 2018 after 80 months of negative readings through October 2017, and compares to an 83-month low of -10.2% in March 2016. Emerging Markets' forward P/E of 12.2 is near the highest level since early 2018. That's up from a 56-month low of 10.0 at the end of October 2018 and compares to an eight-year high of 13.1 in January 2018. The index is trading at only a 23% discount to the World MSCI P/E, which is also near the best levels since early 2013. That's up from a four-year-low 27% discount in late October and compares to a 10-year-low 30% discount in August 2016.

MSCI World & Region Net Earnings Revisions (*link*): Analysts' recent earnings revisions through October suggest more pessimism about US profits but fewer worries about the rest of the world outside of EM Latin America. The AC World ex-US MSCI's NERI was negative for a 20th month but improved to a 13-month high of -3.6% from -7.1% in October. That's up from a 33-month low of -8.4% in January. The US's NERI was negative for the 12th time in 13 months, falling to a 43-month low of -9.0% from -6.7%—well below its corporate-tax-rate-cut-boosted record high of 21.8% in March 2018. Here are November's scores among the regional MSCIs: EM Eastern Europe (-3.3% in November, up from -3.4% in October), EM Asia (-3.9 [15-month high], -5.8), Emerging Markets (-4.9 [13-month high], -5.9), Europe ex-UK (-6.2, -6.4), AC World ex-US (-6.3 [13-month high], -7.1), EMU (-6.3, -6.2), AC World (-7.0, -7.0), EM Latin America (-7.0, -6.2), Europe (-7.5, -6.8), EAFE (-8.1, -8.1), and the United States (-9.0 [43-month low], -6.7).

MSCI Countries Net Earnings Revisions (*link*): NERI was positive for 6/44 MSCI countries in

November, up from two during September and October, which then matched the lowest count since March 2016. That compares to 11/44 countries positive in May, which was the highest reading since October. NERI improved m/m in November for 22/44 countries, down from 25/44 in October. Among the countries with improving NERI in November, Taiwan was at a 56-month high, followed by the Philippines (24-month high), India (23), Germany (14), Korea (13), and Japan (11). Among countries with weaker NERI m/m, Chile was at a record low, followed by Turkey (60-month low), Indonesia (48), the United Kingdom (47), Canada (43), and the United States (43). The four-month positive NERI streaks for Hungary and Israel are the best among countries. South Africa's NERI has been negative for 66 straight months, followed by the negative streaks of Mexico (37 months), Denmark (28), and Germany (28). Four countries had NERI turn positive m/m: Greece, the Philippines, Sweden, and Taiwan. The highest NERI readings in November: Hungary (5.8%), Taiwan (4.1), Israel (3.9), Greece (2.6), the Philippines (2.1), and Sweden (2.0). The weakest NERIs occurred this month in Peru (-16.2), Chile (-14.9, record low dating back to April 1993), Finland (-14.1), Indonesia (-14.0, 48-month low), and the United Kingdom (-13.3, 47-month low).

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