MORNING BRIEFING
December 5, 2019

’Tis the Season for Shopping

See the collection of the individual charts linked below.

(1) This year’s holiday season has fewer shopping days. (2) Cyber Monday saw record spending. (3) Ritholtz warns investors to beware of seasonal hype. (4) While some retailers are raking it in, shifts in shopping patterns have stranded others in the cold. (5) Two S&P 500 retail industries with fraying earnings cloaks: Department Stores and Apparel, Accessories & Luxury Goods. (6) Likewise, there are haves and have-nots in the S&P 500 Technology sector. (7) High P/Es in S&P 500 Application Software industry mean there’s little room to err.

Consumer Discretionary: They Shopped ’til They Dropped. Santa came early to the retailers, as consumers do what they do best when they have jobs and cash-lined pockets: They shopped.

On Cyber Monday, shoppers increased spending 19.7% y/y to a record $9.4 billion, according to an Adobe Analytics report, which tracks 80 of the top 100 US web retailers. And the National Retail Federation (NRF) and Prosper Insights & Analytics reported that the number of consumers shopping online and in stores over the five days through Cyber Monday jumped 14% y/y to 189.6 million, and the average amount each spent increased by 16% y/y to $361.90.

Yesterday, in a Bloomberg Opinion column, our friend Barry Ritholtz warned about the NRF’s tendency to hype up the holiday selling season with guesstimates rather than hard data: “They are based on sentiment surveys, not real spending. The NRF conducted its Annual Thanksgiving Weekend Consumer Survey by asking 6,746 adult consumers how much they expected to spend. It then presents this as if its actual money that consumers parted with. … The trade organization has no interest in being accurate; instead, its goal is to promote a sense of excitement to the benefit of the shopping malls and retailers who are members of the NRF.”

The double-digit y/y gains reported by the NRF are based on survey respondents’ recollection of how much they spent during last year’s holiday shopping season. Do you recall how much you spent?

In any event, holiday shoppers may be more hyper because there are six fewer days between Thanksgiving and Christmas this year. On average, 52% of consumers had completed their shopping by the end of the weekend, up from 44% last year, reported the NRF, which forecasts a 3.8%-4.2% y/y spending jump in November and December. While these numbers may or may not be hyped up, consumers’ purchasing power is at a record high, and is likely to make for a record holiday selling season for most, but not all, retailers.

Let’s take a quick look at why consumers are comfortable opening their wallets more this year than last year:

(1) *Jobs are plentiful.* Total US unemployment remains near record lows, and a number of other indicators continue to show that the extra slack is slowly coming out of the labor market. The latest data

point from ADP was less than inspiring, with private payrolls only adding 67,000 jobs compared to the 150,000 expected. We're not convinced the job market is rolling over, however; we look forward to Friday's Labor Department report on November payrolls, which should include the return of striking GM workers.

When last reported for October, unemployment stood at 3.6%, little changed from September's 3.5%, which was the lowest since December 1969 (*Fig. 1*). The number of people in part-time jobs for economic reasons has fallen to 4.4 million, down from the September 2010 peak of 9.2 million (*Fig. 2*). The number of workers who've been unemployed for 27 weeks or longer has fallen to 1.3 million, down from 6.8 million in April 2010 (*Fig. 3*). Even the U-6 unemployment rate—which includes those who are unemployed, plus all who are marginally attached to the labor force and those who work part-time for economic reasons—has fallen to 7.0% down from the record high of 17.1% in spring 2010 (*Fig. 4*).

(2) *Pockets are full.* Those who are working are also benefitting from rising wages. The real Employment Cost Index rose 1.6% y/y in Q3 and has gained 1.5% annually since 2015. Real average hourly earnings rose 2.2% y/y in October, and has risen 1.3% annually since 2012 (*Fig. 5*).

(3) *Confident consumers shop.* Consumers are optimistic about their ability to land a new job and confident in general. Almost 45% of respondents said jobs are plentiful, according to The Conference Board (*Fig. 6*). And while consumer confidence has come off its peak, it remains near the highs. The Conference Board's consumer confidence index came in at 125.5 in November, down a bit from the high of 137.9 last year (*Fig. 7*).

(4) *Winners and losers.* More jobs, higher wages, and confident consumers have led to strong gains in retail sales, particularly online. Retail sales excluding gasoline increased 3.9% y/y in October (*Fig. 8*). The S&P 500 Consumer Discretionary sector's revenues are expected to climb 4.0% this year and 6.1% next year, while its earnings are forecast to inch up 0.9% this year and 12.9% next year (*Fig. 9* and *Fig. 10*).

Despite the uptick in spending, not all retailers will benefit as consumers continue to change where and how they shop. The resulting rash of retail bankruptcies continues, with A.C. Moore closing 145 craft stores and retailers like Payless, Gymboree, and Forever 21 filing for bankruptcy protection earlier this year. Survivors, like Target and Walmart, are left to take market share. So while earnings are expected to drop this year in the S&P 500 Department Stores industry and Apparel, Accessories & Luxury Goods industry, falling by 24.1% and 1.2%, respectively, they're expected to jump 9.4% in the General Merchandise Stores industry and 10.6% in the Consumer & Electronics Retail industry. It pays to shop carefully.

Information Technology: Flying Too Close to the Sun? The S&P 500 Technology sector is up 39.8% ytd, and while that's awfully impressive it understates how well certain segments of the sector have performed this year. The S&P 500 Semiconductor Equipment industry has climbed 80.7%, and the S&P 500 Technology Hardware, Storage & Peripherals industry is 61.7% higher ytd, thanks in large part to Apple.

Software stocks, however, have had mixed performance. Shares of two of the fastest growing software companies, Salesforce.com and Workday, have had a lackluster year. They both reported earnings Tuesday evening, and, despite turning in pretty stellar results, their shares sold off, leaving ytd returns through Wednesday's close at 14.2% for Salesforce and 3.6% for Workday. I asked Jackie to take a look at why these previous high-fliers have fallen to Earth. Here is what she found:

(1) *Forecasts not quite good enough.* Salesforce, which provides customer relationship management

software in the cloud, reported fiscal Q3 (ended October) revenues that climbed 34% in constant currency and adjusted earnings of 75 cents a share, above analysts' forecast of 67 cents a share.

It was Salesforce's financial forecasts that disappointed investors. The company's fiscal Q4 (ending January) adjusted earnings target of 54 to 55 cents a share was below analysts' estimate of 61 cents a share, a 12/4 MarketWatch article reported. Salesforce's forecast for next year's fiscal Q1 (April) revenue was also light: $4.80 billion to $4.84 billion compared to analysts' forecast of $4.85 billion. And the software company's fiscal 2021 revenue target is $20.80 billion to $20.90 billion, below analysts' $20.95 billion forecast.

The modest difference between the company's and analysts' forecasts might not seem worthy of a selloff. However, Salesforce's stock sports a lofty multiple that doesn't leave room for disappointment. At a recent $155.35, the shares trade at 53.9 times next year's adjusted EPS consensus.

(2) *The growth story*. Salesforce has historically sold customers software that manages sales contacts in the cloud. The company expanded through two recent acquisitions. In 2018, Salesforce purchased MuleSoft, which connects companies' apps, data, and devices whether they be legacy systems on terra firma or software in the cloud. It broadened Salesforce well beyond its customer-relationship software base.

Then this August, Salesforce purchased Tableau, an analytics platform, for $15.7 billion in stock. In the press release for the deal Salesforce's co-CEO Marc Benioff said, "Together we can transform the way people understand not only their customers, but their whole world—delivering powerful AI-driven insights across all types of data and use cases for people of every skill level." Again, the goal appears to be moving beyond the company's traditional customer-relationship software base.

In Salesforce's fiscal Q3 earnings conference call transcript, Benioff noted that Salesforce's software now can connect a company's data from across sales, service, marketing, and commerce to give companies better information while also removing any obstacles from accessing that data in legacy systems. And if the economy does slow, Benioff noted that "digital transformation" was the last thing that companies would stop investing in. "[D]igital transformation is number one on everybody's list and everybody wants a trusted digital advisor."

Salesforce wants to be its customers' digital advisor and software provider. If the cloud's leading software provider sees itself branching into other areas, it could mean greater competition for other cloud software providers.

(3) *Industry still on a roll.* Salesforce is a member of the S&P 500 Application Software industry, which is up 30.9% ytd through Tuesday's close to its high for the year (*Fig. 11*). The industry is forecast to grow revenue 20.6% this year and 17.0% in 2020 (*Fig. 12*). Earnings growth is expected to rise 23.5% this year and another 16.7% in 2020 (*Fig. 13*). That growth doesn't come cheap: The industry's forward P/E is 36.5 (*Fig. 14*).

Some of the top performers in the industry have had performances that left Salesforce and Workday in the dust. The shares of Ansys, an engineering simulation software and services company, have climbed 75.2% ytd. Not far behind are Synopsys shares, up 60.5% ytd; that company provides software to companies developing semiconductor chips. Cadence Design Systems, with shares are up 50.0% ytd, makes electronic devices and software.

CALENDARS

US. Thurs: Merchandise Trade Balance -$48.9b, Factory Orders 0.3%, Jobless Claims 215k, Challenger Job Cuts Report, EIA Natural Gas Report, Quarles. Fri: ADP Employment 140k, ISM & IHS Markit NM-PMIs 54.5/51.6, MBA Mortgage Applications, DOE Oil Inventories, Quarles. **Fri:** Employment Change Total, Private, and Manufacturing 190k/179k/40k, Average Hourly Earnings 0.3%m/m/3.0%y/y, Unemployment Rate 3.6%, Average Weekly Hours 34.4, Consumer Sentiment Index 97.0, Consumer Credit $16.0b, Baker-Hughes Rig Count. (DailyFX estimates)

Global. Thurs: Eurozone GDP 0.2%q/q/1.2%y/y, Eurozone Retail Sales -0.5%m/m/2.2%y/y, Germany Factory Orders 0.4%m/m/-4.7%y/y, Japan Household Spending -3.2% y/y, Lane. **Fri:** Germany Industrial Production 0.1%m/m/-3.6%y/y, Canada Employment Change & Unemployment Rate 10k/5.5%. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) remained above 3.00 for the sixth week, though eased a bit this week. The BBR slipped to 3.17 this week after climbing from 2.77 to 3.40 the prior seven weeks. Once again, there were wide swings in bullish sentiment and the correction count. Bullish sentiment dropped 3.3ppts to 54.8% this week after jumping 10.5ppts (to 47.6% from 58.1%) the prior seven weeks. The correction count climbed 3.1ppts to 27.9% after falling 10.4ppts (35.2% from 24.8%) the previous seven weeks. Bearish sentiment ticked up to 17.3% from 17.1% the previous two weeks—fluctuating in a very narrow band most of this year. The AAII Ratio declined for the third week last week from 62.7% to 52.6% over the period. Bearish sentiment rose from 23.9% to 30.3% over the three-week span, while bullish sentiment fell from 40.7% to 33.6% the past two weeks.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): Consensus S&P 500 forward revenues and earnings dropped again last week from their record highs in early October. Forward revenues is down 0.5% since then, and forward earnings is 0.9% lower. Analysts expect forward revenues growth of 5.0% and forward earnings growth of 8.8%, with each measure steady w/w. Forward revenues growth is down 1.3ppt from a seven-year high of 6.3% in February 2018 and now matches its 31-month low of 5.0% in mid-February. Forward earnings growth is down 8.1ppts from a six-year high of 16.9% in February 2018 but is still comfortably above its 34-month low of 5.9% in February 2019. 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 3.9% in 2019 and 5.0% in 2020. They're calling for earnings growth to slow sharply from 24.0% in 2018 to 1.1% in 2019 before improving to 9.1% in 2020. The forward profit margin was steady w/w at a five-month low of 12.0% and is down 0.4ppt from a record high of 12.4% in September 2018. 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 0.4ppt y/y from 11.9% in 2018 to 11.5% in 2019 before improving to 12.0% in 2020. The S&P 500's forward P/E rose 0.3pt w/w to a 22-month high of 18.1. That's up from 14.3 during December 2018, which was the lowest reading since October 2013 and down 23% from the 16-year high of 18.6 at the market's valuation peak in January 2018. The S&P 500 price-to-sales ratio gained 0.03pt w/w to a record high of 2.16. That's up from 1.75 during December 2018, 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 and earnings rose w/w for two of the 11 S&P 500 sectors last week. 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 remain near record or cyclical highs for Communication Services, Consumer Discretionary, Information Technology, Real Estate, and Utilities. Financials and Health Care are rebounding from cyclical lows, while the remaining sectors are 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 two sectors now: Financials and Utilities. 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 the sectors. Industrials is the only sector with its forward profit margin still at a record high. 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 (18.3, down from 19.2), Real Estate (15.8, down from 17.0), Communication Services (14.9, down from 15.4), Utilities (13.1, down from a record high of 13.2 in mid-November), S&P 500 (12.0, down from 12.4), Health Care (10.5, down from 11.2), Industrials (10.4, record high), Materials (10.3, down from 11.6), Consumer Discretionary (7.4, down from 8.3), Consumer Staples (7.4, down from 7.7), and Energy (6.2, down from 8.0).

US ECONOMIC INDICATORS

ADP Employment (*link*): "The job market is losing its shine. Manufacturers, commodity producers, and retailers are shedding jobs. Job openings are declining and if job growth slows any further unemployment will increase," according to November's report. Private industries added only 67,000 jobs in November, slowing steadily from 159,000 in August. Revisions to the prior two months show October's (to 121,000 from 125,000) gain was slightly lower, while September's (124,000 from 93,000) was 31,000 higher. Private industries averaged monthly job gains of 224,250 the first four months of this year. Goods-producing employment has declined six of the past seven months, down 18,000 in November and 55,000 over the period—with natural resources & mining (-29,000), manufacturing (-18,000), and construction (-8,000) all falling over the seven-month span. Service-providing industries added 85,000 to payrolls—only the second reading below 100,000 since 2017 and considerably below the average monthly gain of 179,000 the first four months of this year. The biggest increase in service-providing employment was once again posted by health care & social assistance (36,000), followed by professional & business services (28,000) and leisure & hospitality (18,000). Trade, transportation & utilities (-15,000) employment fell last month after averaging monthly gains of 22,400 the prior five months. Medium (to 29,000 from 68,000 in October) and large (27,000 from 42,000) companies remained at the number-one and -two spots in November—though gains in both slowed noticeably. Small companies (11,000 from 12,000) remained in the cellar.

Auto Sales (*link*): Motor vehicle sales remain in a volatile flat trend around 17.0mu, moving back above in November. Total sales climbed to 17.2mu (saar) last month after sinking to a six-month low of 16.6mu in October. So far this year, sales have fluctuated from a low of 16.5mu to a high of 17.5mu. Domestic light-truck sales was back up at its cyclical high of 10.0mu (saar) in November—1.0 million units above the start of the year. Meanwhile, domestic car sales edged up to 3.3mu (saar) after sinking to 3.1mu in October—the weakest since April 2009; sales peaked at 6.0mu during August 2014. Sales of imports have fluctuated between 3.8mu and 3.9mu for over a year—and was at 3.9mu in November.

GLOBAL ECONOMIC INDICATORS

Global Composite PMIs (*link*): Global economic growth picked up in November as both manufacturing and services activity improved. The JP Morgan Global Composite Output Index (C-PMI) rose for the first time in four months, to a four-month high of 51.5; it fell fairly steadily from a peak of 54.8 in February 2018 to a 44-month low of 50.8 this October. The Global PMI for the service sector (to 51.6 from 51.0) continues to outperform that of the manufacturing sector (50.3 from 49.8)—though the latter is expanding again after contracting for six months. The C-PMI for the emerging economies climbed to an eight-month high of 52.7—up from a recent low of 50.9 in June—while the C-PMI for the developed ones averted falling into negative territory, ticking up to 50.9 in November after falling from 51.7 in July to 50.3 in October. Among the nations for which C-PMI data are available, China's (to 53.2 from 52.0) performance was the most impressive, expanding at its fastest pace since February 2018, while India's (52.7 from 49.6) jumped to a four-month high after contracting for two months. The C-PMI for the US (52.0 from 50.9) continues to recover from its recent low of 50.7 in August. The Eurozone's C-PMI was unchanged at 50.6—with growth in Ireland (52.0 from 50.6), France (52.1 from 52.6), and Spain (51.9 from 51.2) continuing to expand, while Italy's (49.6 from 50.8) turned negative again. Germany's C-PMI (49.4 from 48.9) has been contracting for three months, though continued to bounce off September's low of 48.5. Meanwhile, C-PMIs for the UK (49.3 from 50.0) and Australia (49.7 from 50.0) dipped back into contractionary territory, while Japan's (49.8 from 49.1) might be returning to expansionary territory after dipping below 50.0 in October for the first time since September 2016.

Global Non-Manufacturing PMIs (*link*): November saw the rate of growth in the global service economy expand at a three-month high, though growth remained subdued. JP Morgan's Global NM-PMI edged up to 51.6 in November from 51.0 in October—which was the weakest performance since February 2016. The NM-PMI for emerging economies (to 53.2 from 51.8) shot up to a seven-month high, while the one for developed nations (51.1 from 50.7) was little changed around October's recent low. According to the report, Russia (55.6) and China (53.5) recorded the strongest growth in non-manufacturing activity, while advances were also recorded in India (52.7), the Eurozone (51.9), the US (51.6), Brazil (50.9), and Japan (50.3). Within the Eurozone, the strongest growth was in Ireland (53.7) and Spain (53.2), followed by France (52.2), Germany (51.7), and Italy (50.4). Meanwhile, service sectors in both Australia (49.7) and the UK (49.3) contracted, but remain near the breakeven point of 50.0.

US Non-Manufacturing PMIs (*link*): ISM's November survey shows non-manufacturing activity slowed slightly in November, holding near September's three-year low, while IHS Markit's measure saw a slight acceleration from October's pace, which was the slowest since the expansion began in February 2016. ISM's NM-PMI (to 53.9 from 54.7) remains on a volatile downtrend, though November's reading is consistent with a 1.9% increase in real GDP growth on an annualized basis. The big standout in November's report was a significant slowing in the business activity (51.6 from 57.0) component as "major projects are nearing completion," according to the report. In November, 56% said business activity was the same as October, while 24% said it was higher and 20% said it was lower; that compares with 52%, 30%, and 18%, respectively, in October. Meanwhile, the remaining three components show new orders (57.1 from 55.6) remain very strong and employment (55.5 from 53.7) is picking up. The supplier deliveries (51.5 from 52.5) component moved lower, though remains on a volatile uptrend. IHS Markit's NM-PMI (to 51.6 from 50.6) showed a slight acceleration, though activity remained subdued and well below the long-run series trend. The report noted domestic demand was slightly stronger last month, though foreign demand contracted for the fourth consecutive month, at its slowest pace in three months.

Contact us by email or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-775-6823