



MORNING BRIEFING

December 18, 2019

2020 Vision

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

(1) DaVinci Code 2020. (2) Hard to see a credit crunch next year with central banks still easing. (3) Less geopolitical tumult in 2020? (4) No regime change in 2021 White House. (5) 2020 vs 2019: Tighter labor market, less trade tension. (6) Another good year for consumers, and a better one for housing industry. (7) Productivity growth likely to surprise to the upside. (8) The Fed is done for a while. (9) Risks: Round up the usual suspects and the zombies too. (10) Stock market meltup? (11) Earning the coupon on bonds. (12) Neutral on the dollar at this level.

US Economy: More of the Same in 2020? Next year's number includes two "2"s and two "0"s. Could there be a message in that unusual coincidence? As an amateur numerologist who also happens to be an economist, I'm thinking that the number "2020" strongly implies zero chance of a recession, with real GDP growing around 2.0% while inflation remains just below 2.0%. That just happens to be our outlook for next year, though we would never say "never" when it comes to predicting recessions. They are always possible.

But Debbie and I don't see a recession in next year's economy. That's because credit crunches invariably cause recessions. With the major central banks on course to increase the sizes of their balance sheets in 2020, a credit crunch seems very unlikely. (See our "More Easy Money in 2020" in the 12/11 [Morning Briefing](#).)

Will 2020 turn out to be much like 2019 for the economy and financial markets? Consider the following:

(1) *Political assumptions.* Our outlook assumes that geopolitical tensions abate next year from this year's concerns about US trade relations with the rest of the world, the upheaval in Hong Kong, and Brexit. Then again, they could all get worse in the coming year. Furthermore, the Middle East is always primed for yet another crisis. Iran is particularly hard-pressed by US sanctions and could instigate a war with either Saudi Arabia or Israel, or both.

Here at home, 2020 is likely to be just as acrimonious in the political arena as was 2019. Nevertheless, the US economy continues to perform well despite all the noise coming out of Washington. Our working assumption is that there won't be a radical regime change in the White House at the beginning of 2021, i.e., Trump will get a second term as POTUS. No matter who wins, the checks-and-balances system of government invented by our Founders continues to work relatively well.

(2) *Real GDP.* On a y/y basis, real GDP growth in the US has been hovering around 2.0% since Q1-2010 ([Fig. 1](#)). Since then through Q3-2019, it has ranged between a low of 0.9% and a high of 4.0% ([Fig. 2](#)). In our forecast table, we are projecting that real GDP will increase 2.5% next year, a bit better than this year's 2.3%. (See [YRI Economic Forecasts](#).)

We expect that real consumer spending will increase 2.5% next year, the same as this year. A slowdown in hiring as a result of a tight supply of workers should be offset by better growth in real

wages, if productivity growth rebounds, as we discuss below. We are expecting that the pace of growth in real capital spending will double from 2.0% this year to 4.0% next year as trade uncertainties and recession fears diminish. There is also likely to be a significant swing in residential fixed investment in real GDP from -1.3% this year to 4.3% next year.

(3) *Productivity*. The surprise next year is likely to be that a tightening labor market boosts productivity, which would allow nominal wages to continue increasing faster than consumer prices. The resulting increase in real wages should bolster consumers' purchasing power and fuel consumer spending growth. We are projecting an increase in nonfarm business (NFB) productivity growth from 1.7% this year to 1.9% next year.

The growth in inflation-adjusted NFB output closely tracks the growth in real GDP ([Fig. 3](#)). Actually, the former has been slightly outpacing the latter since mid-2010. NFB productivity growth has been fluctuating between 1.0% and 1.8% y/y since the start of 2017. It was 1.5% during Q3.

Productivity is one of the two variables that determines real output growth. The other is NFB hours worked, which rose just 0.9% y/y during Q3, little changed from Q2's 0.8%, which was the weakest pace since Q2-2010. The tightening labor market is weighing on the supply of labor.

In other words, real GDP growth might be about the same in 2020 as in 2019, but more of it is likely to be based on productivity than labor input. That would be a positive development for keeping inflation down, while boosting real wage growth and the profit margin. It would be a win-win-win situation for sure.

(4) *Inflation*. In our 2020 outlook, inflation remains dead or at least in a coma for another year. We are predicting a core PCED inflation rate of 1.8% next year, the same as this year ([Fig. 4](#)). The major central banks are likely to persist in trying to offset the four deflationary forces (i.e., the "4Ds") with ultra-easy monetary policies. They should continue to avert deflation but be frustrated by their inability to achieve their 2.0% inflation target.

(5) *The Fed and interest rates*. In our scenario, the Fed is likely to remain on hold through next year's 11/3 presidential and congressional elections. In his 10/30 [press conference](#), Fed Chair Jerome Powell said, "So I think we would need to see a really significant move up in inflation that's persistent before we would consider raising rates to address inflation concerns."

So the federal funds target range should remain 1.50%-1.75% through the end of next year ([Fig. 5](#)). In our outlook, the 10-year US Treasury bond yield should range between 1.50% and 2.00%.

(6) *Rest of the world*. We are expecting somewhat better growth overseas during 2020 than in 2019. The "peace dividend" from the de-escalation of Trump's trade wars should benefit global growth. So should yet another round of ultra-easy monetary policies from the major central banks.

The latest data aren't there yet. As Debbie reported yesterday, the Eurozone's flash M-PMI remained weak at 45.9 during December ([Fig. 6](#)). On the other hand, the NM-PMI remained above 50.0 at 52.4.

The good news is that passenger car registrations in the European Union (EU) have been ticking up over the past three months through November, based on the 12-month sum of unit sales ([Fig. 7](#)). However, on the same basis, automobile sales in both the US and China continued to weaken during November to the lowest since July 2015 in the US and the lowest since June 2016 in China. Auto sales in China, the EU, and the US combined totaled 56.4 million units over the 12 months through November, down 7.7% from a record high of 61.1 million units during August 2018 ([Fig. 8](#)).

US Economy II: Curve Balls in 2020? For contrarians, the problem with our outlook for 2020 is that it is probably close to the consensus outlook. The big surprises this year have been mostly bullish for the stock market. The Fed pivoted from warning us during the fall of 2018 about the prospect of three or four rate hikes in 2019 to actually cutting the federal funds rate three times this year. Trump escalated his trade wars earlier this year, but has been deescalating them in recent months. Also earlier this year, widespread fears that the inverted yield curve was signaling an imminent recession have abated as the yield curve spread turned positive as a result of the Fed's third rate cut this year at the end of October.

The two biggest surprises this year would be a rebound in inflation and/or a recession:

(1) *Inflation risk.* A rebound in price inflation is long overdue according to the Phillips curve model. Perhaps the model will finally work in 2020 as a very tight labor market boosts wage inflation, which then boosts price inflation.

Actually, the Phillips curve model is finally working to explain rising wage gains, as the jobless rate has been below 4.0% for the past 10 months and for 16 of the past 17 months ([Fig. 9](#)). Average hourly earnings for production and nonsupervisory workers rose 3.7% y/y during November, the most since February 2009.

However, there's no sign that rising labor costs are boosting the core PCED inflation rate so far ([Fig. 10](#)). That's because productivity growth is offsetting much of the increase in the Employment Cost Index, which is keeping a lid on the core PCED inflation rate ([Fig. 11](#)). As we've previously noted, the happy outcome is that real wages are growing without putting any upward pressure on prices or downward pressure on profit margins.

(2) *Recession risk.* The other surprise relative to the current consensus outlook would be a recession in 2020. Melissa and I have been writing about the zombie apocalypse. We've argued that the ultra-easy monetary policies of the major central banks are deflationary because they are enabling supply-side companies that should be out of business to stay in business, while two to three consecutive decades of easy money have dulled the stimulative impact of those policies on demand-side borrowers.

Historically low interest rates are causing investors to reach for yield, while paying less attention to credit quality. The result has been that of the \$7.1 trillion in US nonfinancial corporate debt (including bonds, loans, and revolving credit) at the start of this year, \$2.9 trillion was rated BBB (i.e., only one grade above junk) while \$2.4 trillion was rated as junk, according to S&P Global's 5/17 [report](#), "U.S. Corporate Debt Market: The State Of Play In 2019."

It's not too hard to imagine that this pile up of dodgy debt could set the stage for a credit crunch, which would bury the walkng-dead zombies, forcing them to shut down their capacity and to let go of their workers. The good news is that unlike 2008, the banks are in great shape. Furthermore, rising defaults by nonfinancial corporations may not cause a credit crunch if distressed assets funds act as a shock absorber in the capital markets as they did during the 2015 crunch.

In any event, for now, zombies are safe. The central banks continue to pump lots of liquidity into the global financial markets stimulating lots of reach-for-yield demand for the dodgy credits. It could all end badly, but not likely to do so in 2020.

Stocks: Meltup in 2020? Another risk is that investors could conclude that there is nothing to fear but fear itself. That could lead to a meltup. When the S&P 500 rose to our 3100 target for this year on 11/15, we started to consider the possibility of a meltup scenario involving an advance to our 3500

year-end 2020 target well ahead of schedule in early 2020. We may be experiencing that meltup now given that the S&P 500 is getting close to 3200 already!

As you know, Joe and I have been keeping a diary of panic attacks since the start of the current bull market. By our count, there have been 65 of them so far, followed by 65 relief rallies ([Table of S&P 500 Panic Attacks Since 2009](#)). The latest one occurred in August. The S&P 500 has been making new record highs in recent weeks as investors have been relieved by the de-escalation of Trump's trade wars, the diminishing risks of a global recession, and the prospect of more easy central bank policies in 2020.

Bonds: Lower Longer in 2020? Given our outlook above, we believe that the 10-year US Treasury bond yield will remain subdued between 1.50% and 2.00% through the end of next year. Credit quality spreads should remain tight as long as recession fears don't make a comeback next year. Helping to keep US yields low are the slightly negative yields on comparable German and Japanese bonds. We don't expect that real growth and inflation will surprise to the upside and push yields higher in Germany and Japan.

Currencies: Less Mighty Dollar in 2020? The US trade-weighted dollar has had a great run since the summer of 2011. It is up 33% since then. It may not have much more upside, but we don't see much downside either. Usually, the dollar is strongest when investors overweight US investments in a global portfolio (i.e., they "Stay Home" in the US). It is weakest when investors underweight US investments (i.e., they "Go Global").

As we started to observe in early October, stocks are cheap overseas compared to the US, and the outlook for the global economy is improving in 2020. However, the US still looks like the best environment for long-term investors seeking a diversity of major world-class industries with lots of market cap.

CALENDARS

US. Wed: MBA Mortgage Applications, DOE Crude Oil Inventoried, Brainard, Evans. **Thurs:** Leading Indicators 0.1%, Jobless Claims 225k, Philadelphia Fed Manufacturing Index 8, Existing Home Sales 5.44mu (-0.4%), EIA Natural Gas Storage. (DailyFX estimates)

Global. Wed: Eurozone Headline & Core CPI 1.0%/1.3% y/y, Germany Ifo Business Climate, Current Assessment, and Expectations Indexes 95.5/98.1/93.0, UK Headline & Core CPI 1.4%/1.7% y/y, Australia Employment Change & Unemployment Rate 15k/5.3%, BOJ Rate Decision, Lagarde. **Thurs:** UK Retail Sales Including & Excluding Autos 2.1%/2.0% y/y, Gfk Consumer Confidence -14, BOE Asset Purchase Target £435b, BOE Bank Rate 0.75%, Japan Headline, Core, and Core-Core CPI 0.5%/0.5%/0.7% y/y, Lane. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Buybacks ([link](#)): S&P 500 quarterly buybacks rose 6.3% q/q during Q3-2019 to \$175.9 billion from Q2's six-quarter low of \$164.5 billion. Buybacks were up for the first time in three quarters, but remain 21.1% below the record high of \$223.0 billion during Q4-2018. The \$175.9 billion reading is still the sixth-highest quarterly buyback amount on record, dating back 87 quarters to Q1-1998, and is back above the prior cycle's record high in Q3-2007. The four-quarter sum of buybacks was down for a second straight quarter for the first time since it fell for five quarters through Q2-2017. It fell 3.5% q/q to \$770.1 billion from \$798.0 billion, and is down 6.4% from a record high of \$823.2 billion in Q1-2019. S&P 500 buybacks in Q2 edged up to 0.71% of the total market capitalization for the S&P 500, up from

Q2's six-quarter low of 0.67%. That compares to 0.87% during Q1, a 29-quarter high of 1.06% in Q4-2018 and the record high of 1.28% during Q3-2007.

S&P 500 Sectors Buybacks ([link](#)): Buybacks rose q/q during Q3-2019 for seven of the 11 sectors and fell for four. That's up from three rising and eight falling during Q2-2019 and Q1-2019, and compares to eight rising and three falling during Q4-2018. The q/q gainers among the 11 sectors during Q3-2019: Materials (up 123.1% q/q to \$5.4 billion from \$2.4 billion), Communication Services (54.6%, to a record high of \$11.0 billion from \$7.1 billion), Financials (26.4%, to a record high of \$47.8 billion from \$37.8 billion), Real Estate (25.1%, to \$694 million from \$555 million), Consumer Discretionary (16.5%, to \$18.4 billion from \$15.8 billion), Energy (7.2%, to \$4.9 billion from \$4.6 billion), and Consumer Staples (5.6%, to \$7.5 billion from \$7.1 billion). The q/q decliners: Industrials (-16.4%, to a seven-quarter low of \$14.2 billion from \$17.0 billion), Utilities (-11.1%, to \$784 million from \$882 million), Information Technology (-10.8%, to a seven-quarter low of \$49.2 billion from \$55.2 billion), and Health Care (-6.2%, to \$16.0 billion from \$17.1 billion). Tech accounted for the biggest portion of total S&P 500 buybacks in Q3-2019 for an eighth straight quarter, but fell to a 28% share from 33% during Q2. Tech had held the top spot for 16 straight quarters through Q3-2016 before trading places with Financials and Health Care for four quarters through Q3-2017. Financials' share was second for a fifth straight quarter, as it improved to 27% from 23% in Q2.

S&P 500 Cash Return & Buyback Yield ([link](#)): During Q3-2019, the S&P 500 companies continued their long-established trend of spending more on buybacks than dividends, as buybacks of \$175.9 billion outpaced the quarterly dividend payments of \$122.8 billion. Buybacks have exceeded dividends in 56 of the past 61 quarters back to Q3-2004, except during the financial crisis from Q4-2008 to Q4-2009, when all sectors cut buyback spending drastically. Although the quarterly buyback amount turned back up in Q3, the four-quarter sum of buybacks and dividends, or cash returned to investors, fell for a second straight quarter to \$1.247 trillion from \$1.267 trillion during Q2, and is now 3.0% below its record high of \$1.285 trillion during Q1. The S&P 500's buyback yield fell to a four-quarter low of 3.12% from 3.27%, and is down from a 29-quarter high of 3.84% in Q4-2018. The dividend yield edged up to 1.93% from 1.92%. Adding both Q3 figures together, the buyback + dividend yield (or cash return) dropped to a four-quarter low of 5.05% in Q3 from 5.19% in Q2, and is down from a 29-quarter high of 6.00% during Q4-2018.

S&P 500 Sectors Cash Return & Buyback Yield ([link](#)): During Q3-2019, the four-quarter buyback + dividend yield rose q/q for just 3/11 sectors, and only four were ahead of the S&P 500. Here's how they ranked by their buyback + dividend yield: Financials (7.60%), Energy (5.91), Tech (5.73), Industrials (5.11), S&P 500 (5.05), Materials (4.84), Health Care (4.61), Consumer Staples (4.55), Consumer Discretionary (4.40), Utilities (3.41), Real Estate (3.39), and Communication Services (2.72). Here's how they ranked just by their dividend yield as just five sectors improved q/q and six were ahead of the S&P 500: Energy (3.90%), Real Estate (2.99), Utilities (2.96), Consumer Staples (2.74), Financials (2.16), Materials (2.10), S&P 500 (1.93), Industrials (1.92), Health Care (1.79), Information Technology (1.42), Communication Services (1.37), and Consumer Discretionary (1.29). Looking solely at their buyback yield, just four sectors improved q/q, and only three were ahead of the S&P 500. Here's how they ranked according to their buyback yield: Financials (5.44%), Information Technology (4.31), Industrials (3.19), S&P 500 (3.12), Consumer Discretionary (3.10), Health Care (2.82), Materials (2.74), Energy (2.01), Consumer Staples (1.81), Communication Services (1.35), Utilities (0.45), and Real Estate (0.39). Just five sectors have paid out more in dividends than buybacks over the past four quarters: Real Estate, Utilities, Energy, Consumer Staples, and Communication Services.

US ECONOMIC INDICATORS

Industrial Production ([link](#)): Output snapped back in November after a strike at GM factories sent

production south the prior two months. Industrial production rebounded 1.1% (the biggest gain since October 2017) after falling 1.3% during the two months through October—as a 12.4% surge in motor vehicle & parts production pushed manufacturing output up 1.1% last month. Still, both headline and manufacturing production are down 0.8% y/y. By market group, output of business equipment remains on a modest downtrend, falling 1.4% y/y, as declines in production of transit (-3.8% y/y) and industrial (-3.7) equipment more than offset the solid gain in the production of information processing (6.8) equipment—which remains on a steep uptrend at record highs. Output of consumer goods was 1.3% below year-ago levels in November, led by a 1.4% y/y drop in consumer nondurable goods production. Consumer durable goods (-0.8) production was only slightly below a year ago, as a big gain in computer, video & audio (9.4) equipment helped to nearly offset declines in other areas. Auto output was flat with a year ago. Meanwhile, mining production rose 2.0% y/y, while utilities output fell 4.1% y/y.

Capacity Utilization ([link](#)): The headline capacity utilization rate rose to 77.3% in November after sinking to a 25-month low of 76.6% in October. The rate was at a cyclical high of 79.6% a year ago. November's rate was 2.5ppts below its long-run (1972-2018) average. Manufacturing's capacity utilization rate rebounded to 75.2% after falling to 74.5% in October (which was also a 25-month low), as the rate for motor vehicles & parts jumped from 69.5% to 78.1% last month. November's manufacturing rate was 3.1ppts below its long-run average; the rate peaked at 77.3% at the end of last year. The utilization rate for mining fell for a third month, to a 20-month low of 88.6%, yet was still 1.7ppts higher than its long-run average, while the rate for utilities increased 2.1ppts to 77.3%, though remained well below its long-run average.

Housing Starts & Building Permits ([link](#)): The US housing market is hot! Housing starts continued to rebound in November, while building permits (an indicator of future housing demand) soared to its best reading since May 2007. In addition, NAHB's December survey shows builders haven't been this optimistic in 20 years! Housing starts jumped 7.8% during the two months through November to 1.365mu (saar), nearly recovering from September's 7.9% drop, which followed August's 14.2% surge to a new cyclical high of 1.375mu. Single-family starts advanced for the fifth time in six months, climbing 2.4% during November and 15.2% over the period, to 938,000 units (saar)—moving back toward January's cyclical high of 966,000 units. Volatile multi-family starts rebounded 17.3% during the two months through November, to 427,000 units (saar), after slumping 21.9% during September. In the meantime, housing permits shot up 1.4% in November and 20.3% during the five months through November, to 1.482mu (saar)—with both single- and multi-family permits contributing. Single-family permits climbed for the seventh straight month, up 0.8% m/m and 16.8% over the period, to a new cyclical high of 918,000 units (saar). Multi-family permits rose four of the past five months, climbing 2.5% last month and 37.9% over the period to 564,000 units (saar), its highest reading since June 2015. NAHB's Housing Market Index (HMI) surged to 76 this month, the highest since June 1999 and a big jump from last December's reading of 56. All three measures of the HMI are up big from last December: current sales (to 84 from 61), expected sales (79 from 61), and buyer traffic (58 from 43).

JOLTS ([link](#)): Job openings in October recovered 235,000 to 7.267 million, to within 359,000 of last November's record high of 7.626 million. October's ratio of unemployed workers per job opening was below 1.00 for the 20th straight month, at 0.81, with job openings exceeding unemployed workers by 1.4 million. Hirings fell for the second time in three months in October—by a total of 214,000, to 5.764 million—while separations fell 174,000 over the same period to 5.636 million. The latest hiring and separations data yielded an employment advance of 128,000 in October, 28,000 below October's payroll gain of 156,000—understating the increase for the third straight month. Those quitting jobs rose 41,000 in October to 3.512 million. The quit rate remained at 2.3%, just below its cyclical high of 2.4% during July and August, while the hires rate fell to 3.8% from 3.9% the prior three months—fluctuating in a range from 3.8% to 4.0% for over a year. October's job openings rate rose from 4.4% to 4.6%, moving back toward its record rate of 4.8% at the start of the year.

GLOBAL ECONOMIC INDICATORS

European Car Sales ([link](#)): EU passenger car registrations (a proxy for sales) rose 4.9% y/y in November, the third straight month of growth. The report noted that during the same month last year, registrations fell 8.0%, setting a low base of comparison for 2019. Of the major European markets, only the UK (-1.3% y/y) posted a decline in sales last month, while Germany (9.7) had the strongest performance, followed by Spain (2.3), Italy (2.2), and France (0.7). Looking at sales through the first 11 months of this year, EU (-0.3% y/y) sales were almost back to the comparable level a year ago. Of the five major markets, only Germany (3.9% y/y) recorded growth ytd. Spain (-5.7) and the UK (-2.7) recorded the biggest declines in sales, while Italy (-0.6), and France (0.3) sales nearly matched year-ago levels ytd.

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