



MORNING BRIEFING

January 7, 2020

More Happy Dividend Returns in 2020?

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

(1) Is the market high on a sugar high provided by the central banks? (2) Investors should not be preachers. (3) The problem with P/E-led meltups. (4) The Fed's balance sheet is expanding again. (5) The ECB's balance sheet is expanding again. (6) The BOJ's balance sheet never stopped expanding. (7) The PBOC has cut reserve requirements 7 times since early 2018. (8) Dividends growing solidly despite earnings growth recession. (9) Dividends' CAGR trend is around 6% still. (10) Latest bull market in S&P 500 hugging 2% dividend yield valuation model. (11) Compounding dividends are the 8th Wonder of the World.

Strategy I: Central Bankers Fueling Stock Gains. The bears correctly observe that there was an earnings growth recession last year. So they say that last year's extraordinary stock market rally to new record highs was yet another "sugar high" fueled by the ultra-easy policies of the major central bankers.

My response is: "So what's your point?" The goal of investing is to make money, not to critique monetary policy. If you believe that the central banks are recklessly providing liquidity, thus pushing up stock prices, then you should be bullish until there is solid evidence that they've either run out of ammo or that their policies are starting to boost price inflation, which would force them to reverse course. That's one of the main themes of my 2018 book [Predicting the Markets](#) and my forthcoming book *Fed Watching for Fun & Profit*. In other words, investing isn't about morality (i.e., good versus bad). It is about bullish versus bearish. Investors should not be preachers.

Nevertheless, as Joe and I wrote yesterday, we are concerned that the continuation of ultra-easy monetary policies by the Fed, the European Central Bank (ECB), the Bank of Japan (BOJ), and the People's Bank of China (PBOC) might cause a P/E-led stock market meltup in coming weeks, particularly if stock investors conclude that the latest Middle East crisis won't drive oil prices to levels that cause a global recession, as happened a few times in the past ([Fig. 1](#)).

The problem with P/E-led meltups is that they tend to set the stage for meltdowns, i.e., either nasty corrections or bear markets. Since we don't expect that either a spike in oil prices or a garden-variety meltdown in stock prices will cause a recession this year, any selloff is more likely to be a correction than a bear market and yet another buying opportunity. If we saw signs of a credit crunch, then we would worry about a recession and a bear market.

Let's review the latest doses of sugar provided by the major central banks that are giving stock

prices a high:

(1) *Fed*. In response to the crunch in the repo market last September, the Fed started to expand its balance sheet again by purchasing \$60 billion per month in US Treasury bills. Since this so-called “reserve management operation” started on 11/1/19 and went through the new year’s 1/1 week, the Fed’s balance sheet has increased by \$155 billion to \$4.14 trillion, the highest level since mid-October 2018 ([Fig. 2](#)). That increase included a \$74 billion jump in the Fed’s holdings of Treasuries with maturities of one year or less ([Fig. 3](#)). On the other hand, the Fed is continuing to pare its holdings of mortgage-backed securities ([Fig. 4](#)).

(2) *ECB*. The ECB started its first asset purchase program (QE1) on 1/22/15 and terminated it at the end of 2018. Securities held for monetary policy purposes increased by a whopping €2.5 trillion under the program ([Fig. 5](#)). A second round of purchases (QE2) was started at the end of last year (11/1/19) to the tune of €20 billion euros per month.

(3) *BOJ*. The BOJ started its quantitative and qualitative easing program (QQE) on 4/4/13 ([Fig. 6](#)). It has yet to be terminated. From April 2013 through November 2019, the BOJ’s assets are up 251%, led by a 424% increase in the BOJ’s holdings of JGBs.

According to a 11/18/19 Reuters [interview](#), “[BOJ President Haruhiko] Kuroda also said there was still enough Japanese government bonds (JGB) left in the market for the BOJ to buy, playing down concerns its huge purchases have drained market liquidity. After years of heavy purchases to flood markets with cash, the BOJ now owns nearly half of the JGB market.”

(4) *PBOC*. As we mentioned yesterday, the PBOC cut bank reserve requirement ratios at the beginning of this year (effective 1/6) to the lowest levels since 2007 ([Fig. 7](#)). That action will release about 800 billion yuan (\$115 billion). The PBOC has now cut seven times since early 2018 to free up more funds for banks to lend as economic growth slows to the weakest pace in nearly 30 years.

(5) *Bottom line*. The uptrend in the combined assets of the four major central banks is likely to resume in 2020, which will remain a bullish development for global stock markets ([Fig. 8](#)).

Strategy II: Paying More Dividends. The bears have been characterizing the current bull market as mostly on a sugar high ever since it started in March 2009. In fact, it has been driven by solid growth rates in S&P 500 aggregate revenues, earnings, and dividends. The S&P 500 stock market capitalization is up 355% since 3/9/09 ([Fig. 9](#)). Since then through Q3-2019, S&P 500 aggregate revenues, earnings, and dividends are up 33%, 240%, and 101%.

Revenues and earnings remain on uptrends, but their growth rates have slowed recently ([Fig. 10](#)). On a y/y basis, through Q3-2019, aggregate revenues was up only 2.4%, while aggregate earnings was down 2.8% ([Fig. 11](#)).

There was a growth recession in earnings last year partly because comparisons were tough following the boost to earnings during 2018 by Trump’s corporate tax cut. A cheerier

perspective is provided by S&P 500 aggregate dividends, which rose 5.8% y/y to a record high of \$504 billion at an annualized rate during Q4-2019 ([Fig. 12](#)). There's no sign of a growth recession in S&P 500 dividends. Here are some more thoughts on dividends:

(1) *The trend is your friend.* I asked Joe to track the trend in S&P 500 dividends. He reports that since the end of 1946, trailing-four-quarter dividends have been mostly growing around a 6% compound annual growth rate (CAGR) ([Fig. 13](#)). Since the end of 1959, the CAGR has tended to be between 5.0% and 6.0% ([Fig. 14](#)).

(2) *Stocks are fairly valued relative to 2% dividend yield.* During Q4-2019, the S&P 500 dividend yield was 1.8%. Our Blue Angels analysis for dividends creates hypothetical values for the S&P 500 stock price index using the actual S&P 500 dividend (on a four-quarter-trailing-sum basis) divided by dividend yields from 1.0% to 6.0% ([Fig. 15](#)). Interestingly, during the current bull market, the S&P 500 has been closely hugging its hypothetical value based on actual dividends and a 2.0% dividend yield! The index seems to be continuing that trend, though the recent rally has dropped the dividend yield somewhat.

(3) *Compounding dividends are among the great wonders of the world.* Albert Einstein reportedly said, "Compound interest is the eighth wonder of the world." Actually, even more wonderful are dividends because, unlike the coupon on bonds, they grow. Joe calculates that the current dividend yields of an S&P 500 portfolio purchased in 1970, 1980, 1990, and 2000 are 66%, 43%, 17%, and 4% ([Fig. 16](#)).

CALENDARS

US: Tues: Merchandise Trade Balance -\$43.9b, Factory Orders -0.7%, ISM NM-PMI 54.5.

Wed: ADP Employment Change 160k, Consumer Credit \$15.8b, MBA Mortgage Applications, DOE Crude Oil Inventories, Brainard. (DailyFX estimates)

Global: Tues: Eurozone Headline & Core CPI Flash Estimates 1.3%/1.3% y/y, Eurozone Retail Sales 0.6% m/m/1.5% y/y. **Wed:** Eurozone Economic Confidence 101.4, Germany Factory Orders 0.2% m/m/-4.7% y/y, Japan Consumer Confidence 39.5, China CPI & PPI 4.7%/-0.4% y/y. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): The forward earnings of MidCap and SmallCap rose for a seventh week in a row, and LargeCap's was up for the fifth time in seven weeks. These indexes began a forward-earnings uptrend during March but stumbled from July to November. LargeCap's forward earnings has risen during 33 of the past 47 weeks, MidCap's 26 of the past 43 weeks, and SmallCap's 24 of the past 41 weeks. LargeCap's is less than 0.1% below its record high 16 weeks ago, while MidCap's and SmallCap's are 3.2% and 6.5% below their October 2018 highs. Index changes at the end of 2019 have helped MidCap's forward earnings improve from November's 18-month low, while SmallCap's is up from September's 17-month low. The yearly change in forward earnings soared to cyclical highs

during 2018 due to the boost from the Tax Cuts and Jobs Act but began to tumble in October 2018 as y/y comparisons became more difficult. In the latest week, the rate of change in LargeCap's forward earnings rose to 2.1% y/y from 1.9% and is up from a 38-month low of 1.0% in early December. That's down from 23.2% in September 2018, which was the highest since January 2011. MidCap's was steady w/w at -2.8% y/y, and compares to -5.5% in mid-November, which was the lowest since December 2009. That also compares to 24.1% in September 2018 (the highest since April 2011). SmallCap's -3.5% y/y change was also unchanged w/w, but that's up from -9.6% in mid-September, which was the lowest since December 2009 and compares to an eight-year high of 35.3% in October 2018. Analysts had been expecting double-digit percentage earnings growth for 2019 during late 2018, but those forecasts are down substantially since then. Here are the latest consensus earnings growth rates for 2018, 2019, and 2020: LargeCap (22.7%, -0.2%, 9.7%), MidCap (22.7, -6.2, 12.4), and SmallCap (22.4, -4.4, 15.9).

S&P 500/400/600 Valuation ([link](#)): Valuation edged down last week for LargeCap and MidCap after rising during 11 of the prior 12 weeks, but SmallCap's remained steady. However, the valuations of all three are still near their highest levels in over a year. LargeCap's forward P/E edged down w/w to 18.2 from a 23-month high of 18.3. That compares to a five-year low of 13.9 during December 2018 and a 16-year high of 18.6 during January 2018—and of course is well below the tech-bubble record high of 25.7 in July 1999. Last week's level remains above the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap's forward P/E edged down to 17.0 from 17.1, which compares to a 22-month high of 17.4 in mid-December. That's up from 13.0 during December 2018, which was the lowest reading since November 2011. MidCap's P/E is down from a 15-year high of 19.2 in February 2017 and the record high of 20.6 in January 2002. However, MidCap's P/E has been at or below LargeCap's P/E for most of the time since August 2017—the first time that alignment has prevailed since 2009. SmallCap's P/E remained steady w/w at 17.8, but is down from mid-December's 16-month high of 18.1. That's well above its seven-year low of 13.6 during December 2018 and compares to its 15-year high of 20.5 in December 2016, when Energy's earnings were depressed. SmallCap's P/E is back above LargeCap's again. It had been below for four months through the end of August—the first time that has happened since 2003.

S&P 500 Sectors Quarterly Earnings Outlook ([link](#)): With the books closed on Q4, earnings revisions activity is in its typical slow period as analysts await the release of results. The Q4 EPS forecast dropped just 1 cent w/w to \$40.59. That represents a decline of 1.4% on a frozen actual basis and a drop of 0.3% y/y on a pro forma basis. That compares to a 0.3% decline in Q3 and y/y gains of 3.2% in Q2, 1.6% in Q1, 16.9% in Q4-2018, and 28.4% in Q3-2018 (which marked the peak of the current earnings cycle). If the y/y earnings decline comes to pass in Q4-2019, it would be the second straight decline and the first drop since earnings fell y/y for four straight quarters through Q2-2016. However, seven of the 11 sectors are expected to record positive y/y earnings growth in Q4, with two rising at a double-digit percentage rate. That compares to seven positive during Q3, when none rose at a double-digit percentage rate. The same seven sectors are expected to beat the S&P 500's 0.3% decline in Q4 as in Q3; that's up sharply from just three beating the S&P 500 during Q2. Five sectors are expected to post improved growth on a q/q basis during Q4: Communication Services, Energy, Financials, Tech, and Utilities. On an ex-Energy basis, the consensus expects earnings to rise 2.0% y/y in

Q4. That compares to ex-Energy gains of 2.2% in Q3, 3.9% in Q2, and 3.0% in Q1 but is well below ex-Energy's 25.0% and 14.2% y/y gains in Q3- and Q4-2018, respectively. Here are the latest Q4-2019 earnings growth rates versus their final Q3-2019 growth rates: Utilities (14.0% in Q4-2019 versus 6.7% in Q3-2019), Financials (12.2, 2.6), Health Care (6.0, 8.8), Real Estate (3.9, 5.9), Communication Services (2.0, -1.4), Consumer Staples (1.0, 3.7), Information Technology (0.5, -1.7), Industrials (-5.8, 3.4), Materials (-10.9, -10.9), Consumer Discretionary (-11.3, 1.8), and Energy (-34.7, -37.8).

US ECONOMIC INDICATORS

Auto Sales ([link](#)): Motor vehicle sales remained in a volatile flat trend around 17.0mu in December, but moved back below. Total sales slipped to 16.9mu (saar) last month, after climbing from a six-month low of 16.6mu in October to 17.2mu in November. During all of 2019, sales fluctuated from a low of 16.5mu to a high of 17.5mu. Domestic light-truck sales dipped to 9.6mu (saar) in December, roughly in the middle of 2019's range of 9.0-10.0mu—after reaching the higher end during November, September, and May. Meanwhile, December domestic car sales accelerated during the final two months of last year, climbing to 3.6mu (saar), up from October's 3.1mu—which was the weakest since April 2009. Sales had been in a freefall since peaking at 6.0mu during August 2014. Sales of imports edged down to an 11-month low of 3.7mu (saar) in December after fluctuating between 3.8mu and 3.9mu for nearly a year.

GLOBAL ECONOMIC INDICATORS

Global Composite PMIs ([link](#)): Global economic growth accelerated in December for the second month, expanding at its fastest pace in eight months. The JP Morgan Global Composite Output Index (C-PMI) climbed to 51.7 during the final month of 2019 after falling fairly steadily from a peak of 54.8 in February 2018 to a 44-month low of 50.8 during October 2019. The Global PMI for the service sector (to 52.1 from 51.6) continued to outperform that for the manufacturing sector (50.1 from 50.3)—with the former improving for the second month and the latter taking a slight step back. Still, the manufacturing measure held just above the breakeven point of 50.0 for the second month after contracting the prior six months. Trade remained a drag on manufacturing activity. The C-PMI for the emerging economies eased to 52.2 after reaching an eight-month high of 52.7 in November, still considerably above June's low of 50.9. Meanwhile, the C-PMI for the developed ones accelerated to a five-month high of 51.2 in December after falling to a recent low of 50.3 in October. C-PMIs for December show economic activity increased in India (to 53.7 from 52.7), the US (52.7 from 52.0), China (52.6 from 53.1), Russia (51.8 from 52.9), the Eurozone (50.9 from 50.6), and Brazil (50.9 from 51.8)—with only India and the US showing an acceleration in activity. Looking at the Eurozone, C-PMIs for Ireland (53.0 from 52.0) and Spain (52.7 from 51.9) finished first and second—recording their best performances in six and eight months, respectively—while France (52.0 from 52.1) took the number-three spot. Germany's C-PMI (50.2 from 49.4) returned to expansionary territory, while Italy's (49.3 from 49.6) slumped to an 11-month low. Meanwhile, contractions were posted in the UK (unchanged at 49.3) and Australia (49.6 from 49.7), while output in Japan (unchanged at 49.8) remained below 50.0, based on its flash estimate—

contracting for the third straight month.

Global Non-Manufacturing PMIs ([link](#)): December saw the rate of growth in the global service economy expand at a five-month high, with output, new orders, employment, and new export business all accelerating to five-month highs—the latter increasing marginally for the first time since July. JP Morgan’s Global NM-PMI increased for the second month to 52.1 in December from 51.0 in October—which was the weakest reading since February 2016—as the NM-PMI for developed economies advanced from 50.7 to 51.9 over the two-month period. In the meantime, the NM-PMI for emerging (to 52.4 from 53.2) economies edged lower after shooting up to a seven-month high in November. NM-PMIs show service-sector business activity increased in India (53.3 from 52.7), Russia (53.1 from 55.6), the US (52.8 from 51.6), the Eurozone (52.8 from 51.9), China (52.5 from 53.5), and Brazil (51.0 from 50.9)—accelerating for all except Russia and China. Within the Eurozone, Ireland (55.9 from 53.7) and Spain (54.9 from 53.2) posted the strongest service-sector growth, while activity in Germany (52.9 from 51.7), France (52.4 from 52.2), and Italy (51.1 from 50.4) picked up at the end of last year. Growth in the UK’s (50.0 from 49.3) service sector stabilized in December, while Australia’s (49.8 from 49.7) service-sector activity contracted for the second straight month.

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