



## MORNING BRIEFING

January 13, 2020

### Stocks & Bonds: In the Fast Lane

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

(1) Back to the future: forward P/E back at 18.4. (2) Getting closer to 3500 too fast, too soon. (3) S&P 500 forward revenues at new high, while forward earnings has stalled. (4) Is the stock market discounting a productivity growth rebound in the decade ahead? (5) Technology: from jets to main frames to PCs to a brave new world. (6) Reach-for-yield driving stock and bond prices higher. (7) Falling high yields. (8) Counting the number of jobs versus the number of workers. (9) Percentage of full-time workers highest since March 2008. (10) Movie review: "1917" (+ +).

**Stocks: Discounting Productivity Rebound?** The S&P 500 stock price index rose to 3274.70 on Thursday, which was yet another record high ([Fig. 1](#)). The index edged down on Friday, but was still up 1.1% ytd following last year's 28.9% monster rally. The forward P/E of the S&P 500 was 18.4 on Friday, approaching the previous cyclical peak of 18.6 on 1/23/18 ([Fig. 2](#)). A breakout and meltup in this valuation multiple would push the forward P/E to new highs for the current bull market and closer to the previous record high of 25.7 during 4/12/99.

A 7.2% increase in the S&P 500 price index would put it at our year-end target of 3500. That could happen well ahead of schedule, which would cause Joe and me to consider whether to raise our target or stick with it. We would like to see the market's fundamentals catch up with the P/E. So far, S&P 500 forward revenues remains on an upward trend and actually hit another record high during the 1/2 week ([Fig. 3](#)). That's comforting, for sure. We aren't getting the same warm, fuzzy feeling from S&P 500 forward earnings, which has stalled in recent weeks, though at a record high ([Fig. 4](#)).

It's also hard to get a warm, fuzzy feeling about the stock market's likely returns over the decade ahead. That's because the S&P 500 scored average gains of 11.8% per year during the previous decade and strong 10-year returns tend to be followed by weak ones ([Fig. 5](#)).

Then again, perhaps the stock market is discounting a significant rebound in productivity growth. The 10-year average percent change in the S&P 500 tends to lead the comparable

growth rate in nonfarm productivity by a few years ([Fig. 6](#)). Consider the following:

(1) *Productivity cycles*. The data show that productivity growth, on a 10-year average annual basis, was particularly strong during the early 1950s and most of the 1960s ([Fig. 7](#)). It weakened substantially during the late 1970s and early 1980s, improved somewhat during the late 1980s and early 1990s, then jumped during the second half of the 1990s and remained strong until just before the Great Recession of 2008. It weakened considerably during that recession and continued to do so until it bottomed at 0.5% during Q4-2015. Since then, it has been trending higher, doubling to 1.0% during Q3-2019.

(2) *Technology cycles*. Melissa and I attribute the productivity cycle to the cycle in technological innovations. During the 1950s and 1960s, the innovations included civilian jet aircraft and mainframe computers.

Jet passenger service began in the US during the late 1950s with the introduction of Boeing 707 and Douglas DC-8 airliners. Pan American introduced overseas flights on 707s in October 1958. The UNIVAC I (UNIVersal Automatic Computer I) was the first commercial mainframe computer produced in the US, in March 1951. IBM introduced its first mainframe in 1952.

The first PCs, introduced in 1975, came as kits. The all-in-one IBM PC was introduced on 8/12/81. But it took a while, until the mid-1990s, for this technology to proliferate and become sufficiently productive to impact the overall economy's productivity.

(3) *Brave new world*. Technological innovation has exploded in recent years. Last Thursday, Jackie reviewed some of the new innovations that were spotlighted at the latest Consumer Electronics Show. Among the most significant technologies that are likely to proliferate in the coming decade are electric and drone vehicles, high-capacity batteries, solar panels, as well as a myriad of applications for artificial intelligence, augmented reality, and robotics.

**Bonds: Discounting Recession or Expansion?** The 10-year US Treasury bond yield fell from a 2018 high of 3.24% on 11/8 to a low of 1.47% last year on 9/4 ([Fig. 8](#)). It rebounded from there to a high of 1.94% on 11/8/19 as fears of a recession abated. Yet it was back down to 1.83% on Friday. It has remained below 2.00% since 8/1.

Of course, helping to keep the bond yield below that level is that the Fed lowered the federal

funds rate three times last year to a range of 1.50%-1.75%. During his 10/30/19 [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.” He undoubtedly was referring to the core personal consumption expenditures deflator (PCED) inflation rate, which remains subdued.

In other words, the Treasury bond yield isn’t signaling that a recession is imminent but rather that interest rates are likely to remain low for the foreseeable future. That’s why the stock market is soaring. An economic outlook that includes ongoing growth and historically low interest rates is likely to continue to fuel a reach-for-yield rally in stock prices, i.e., as investors continue to reach for dividend yield. In addition, they are likely to grant high valuation multiples to companies that can grow their earnings at a relatively fast pace in a world where economic growth is likely to remain slow and inflation is likely to remain subdued.

The no-recession signal is evident in both the yield-curve spread and the credit-quality yield spread:

(1) The spread between the 10-year US Treasury bond yield and the federal funds rate was 28bps on Friday, up from a recent low of -66bps last year on 9/4 ([Fig. 9](#)).

(2) The credit-quality spread between the yields of the high-yield corporate bond composite and the 10-year Treasury narrowed to only 334bps last week, the lowest since 10/17/18 ([Fig. 10](#)). The yield on the corporate bond composite actually fell to 5.17% at the end of last week, the lowest reading since 6/24/14 ([Fig. 11](#)). There’s certainly no signal of a recession in either this yield or its credit-quality spread.

On the other hand, there is a clear reach-for-yield signal in both. Not surprisingly, corporations are scrambling to meet the high demand for their bonds at historically low yields. CNBC [reported](#) that companies rushed to sell \$69 billion in investment-grade bonds last week. The volume last week is second only to the \$76 billion issued during the week of 9/6/19, roughly two weeks ahead of the Fed’s September meeting and second rate cut of last year.

**US Labor Market: More Full-Time Jobs.** December’s employment release was widely perceived to be disappointing. That’s because everyone focuses on the payroll employment survey. Debbie and I weren’t disappointed because we also track the household employment

survey, which was very upbeat.

The payroll survey counts the number of jobs, so one worker with two part-time jobs counts as two jobs. The household survey counts the number of workers irrespective of their number of jobs, so one worker with two part-time jobs counts as one worker. The latest data show jobs that are full-time growing faster than part-time jobs, which should be better for workers who can swap juggling a couple of part-time jobs for holding down a full-time one. The percentage of full-time jobs in household employment rose to 83.0% during December, the highest since March 2008, and up from the most recent cyclical low of 79.9% during January 2010 ([Fig. 12](#)).

Let's have a closer look at the data:

(1) *Household employment* rose 267,000 during December and 2.0 million during 2019 to a record high ([Fig. 13](#)). The number of full-time jobs increased 194,000 during December and 1.9 million during 2019. Part-time employment increased 34,000 during December and only 10,000 last year.

(2) *Payroll employment* rose 145,000 during December and 2.1 million during 2019. The fact that full-time employment rose faster than part-time employment, according to the household survey, would tend to weigh more on the payroll than the household measure.

(3) *How the two surveys' differences skew results*. By the way, skewing the household employment level higher versus the payroll survey is its broader definition of "employment" (e.g., including agricultural workers, self-employed workers with unincorporated businesses, unpaid family workers, private household workers, and people on unpaid leave—all excluded by the payroll survey). Another impactful difference is that the household survey is limited to workers 16 years of age and older, while the payroll survey is not limited by age.

**Movie.** "1917" (+ +) ([link](#)) received the Best Picture award during the Golden Globe Awards held on 1/5/20. It was well deserved. Directed, co-written, and produced by Sam Mendes, the film is about two young British soldiers during World War I who were ordered to deliver a message deep in enemy territory to save 1,600 of their compatriots from an ambush by German forces. The acting is excellent, and the cinematography is outstanding, with very long camera shots creating the impression of one continuous take. The depiction of war's horrors was also exceptional. Even more exceptional was the 2018 documentary "They Shall Not

Grow Old,” directed and produced by Peter Jackson. That film was created using original WWI footage that had been digitally restored. The agony of war, particularly trench warfare, was remarkably graphic.

## CALENDARS

**US:** **Mon:** Monthly Budget -\$15.0b, Bostic. **Tues:** Headline & Core CPI 2.4%/2.3% y/y, NFIB Small Optimism Index 104.9, Williams. (DailyFX estimates)

**Global:** **Mon:** UK GDP 0.0%/m/m/-0.1%3m/3m, Headline & Manufacturing Industrial Production -1.3%/-1.6% y/y, UK Trade Balance -£3.5b. **Tues:** Mersch, Kuroda. (DailyFX estimates)

## STRATEGY INDICATORS

**Global Stock Markets Performance** ([link](#)): Last week saw the US MSCI index rise 1.0%, for its 12th gain in 14 weeks, and rank 14th of the 49 global stock markets we follow in a week when 23/49 countries rose in US dollar terms. That compares to a 0.2% gain for the AC World ex-US index. EM Eastern Europe was the best performer with a gain of 1.8%, ahead of EM Asia (1.4%), BRIC (1.1), and EMEA (1.0). EM Latin America (-1.7) was the worst performer, followed by EAFE (-0.1) and EMU (0.0). Turkey was the best-performing country, rising 6.6%, followed by Korea (3.2), Pakistan (3.2), Russia (2.8), and Jordan (2.5). Of the 26 countries that underperformed the AC World ex-US MSCI last week, Hungary fared the worst, falling 3.4%, followed by Brazil (-2.7), Peru (-2.5), Colombia (-2.2), and Ireland (-1.5). During 2019, the US MSCI ranked an impressive 8/49 for the year, with its 29.1% gain well ahead of the AC World ex-US (18.1). The US MSCI ranks 15/49 with a gain of 1.2% so far in 2020. Among regions, these are outperforming the AC World ex-US's 0.6% ytd gain: EM Eastern Europe (3.1), BRIC (2.6), EM Asia (2.2), and EMEA (1.7). The ytd laggards: EM Latin America (0.0), EAFE (0.2), and EMU (0.3). The best country performers ytd: Pakistan (8.0), Turkey (5.7), Chile (4.9), Russia (4.4), and China (3.6). The worst-performing countries so far in 2020: Hungary (-3.8), Sri Lanka (-2.7), Greece (-2.7), and Peru (-1.8).

**S&P 1500/500/400/600 Performance** ([link](#)): Two of these three market-cap indexes fell last week, but LargeCap and MidCap remain near their record highs. LargeCap rose 0.9% last week, ahead of the declines for MidCap (-0.2%) and SmallCap (-1.0). LargeCap ended the week 0.3% below its record high on Thursday, while MidCap and SmallCap are 0.8% and

8.0% below their 12/26/19 and 8/29/18 records, respectively. Eleven of the 33 sectors moved higher, the lowest count in seven weeks and down from 13/33 sectors rising a week earlier. Tech and Health Care dominated the biggest gainers in the latest week: LargeCap Tech (2.2), MidCap Health Care (2.0), LargeCap Communication Services (2.0), LargeCap Health Care (1.5), MidCap Tech (1.3), and SmallCap Health Care (1.3). SmallCap Energy (-6.9) was the biggest decliner last week, followed by MidCap Energy (-4.7), SmallCap Materials (-2.5), SmallCap Consumer Staples (-2.4), SmallCap Utilities (-2.3), and MidCap Materials (-1.6). Regarding 2019 performance, all three indexes ended the year with healthy double-digit gains; LargeCap was up by 28.9%, followed by MidCap's 24.1% rise and SmallCap's 20.9% gain. Two of those indexes are down so far in 2020: LargeCap leads with a gain of 1.1%, ahead of MidCap (-0.6) and SmallCap (-1.0).

**S&P 500 Sectors and Industries Performance** ([link](#)): Seven of the 11 sectors rose last week, but just three outperformed the S&P 500's 0.9% gain. That compares to three rising and six outperforming the S&P 500's 0.2% decline a week earlier. Tech was the best-performing sector with a gain of 2.2%, ahead of Communication Services (2.0%) and Health Care (1.5). Energy was the biggest underperformer with a drop of 1.1%, followed by the also-underperforming Materials (-0.3), Financials (-0.2), Industrials (-0.2), Real Estate (0.3), Consumer Discretionary (0.4), Consumer Staples (0.6), and Utilities (0.8). During 2019, the S&P 500 soared 28.9% for its best gain since 2013 as all 11 sectors rose for the first time since 2010. The S&P 500 is up 1.1% so far in 2020, with five sectors posting gains and just three ahead of the index. The 2020 ytd leaders: Tech (2.8), Communication Services (2.7), and Industrials (1.5). The 2020 ytd laggards: Materials (-3.1), Energy (-0.6), Utilities (-0.5), Consumer Staples (-0.4), Financials (-0.4), Real Estate (-0.2), Consumer Discretionary (0.8), and Health Care (0.8).

**Commodities Performance** ([link](#)): Last week, the S&P GSCI index tumbled 3.0% for its first decline in six weeks. The index nearly exited a correction during the week but ended with a drop of 14.4% from its cyclical high on 10/3/18. Sugar was the best performer last week with a gain of 5.7%, followed by Kansas Wheat (4.2%), Lean Hogs (4.1), Feeder Cattle (3.3), and Nickel (3.2). Heating Oil and Crude Oil were the biggest decliners with drops of 6.4%, followed by Brent Crude (-5.9), Coffee (-5.9), and GasOil (-5.1). The S&P GSCI commodities index is down 1.4% so far in 2020 after ending 2019 with a gain of 16.5%. The top-performing commodities so far in 2020: Sugar (4.8), Zinc (4.6), Cotton (3.3), Gold (2.7), and Feeder Cattle (2.2). The biggest laggards in 2020: Coffee (-8.3), Heating Oil (-4.6), Crude Oil (-3.4), GasOil (-3.3), and Brent Crude (-2.2).



**S&P 500 Technical Indicators** ([link](#)): The S&P 500 price index rose 0.9% last week, and improved relative to its short-term 50-day moving average (50-dma) and its long-term 200-day moving average (200-dma). The index's 50-dma relative to its 200-dma rose for a 12th week following nine straight declines. Its 50-dma is now at a 22-month high of 5.8% above its 200-dma and has formed a Golden Cross for 42 weeks after 17 weeks in a Death Cross formation. The S&P 500's 50-dma rose for a 14th week following three down weeks, as the price index rose to 3.3% above its rising 50-dma from 3.0% a week earlier, but that's down from a 23-week high of 4.1% above its rising 50-dma in mid-December. It had bottomed recently in late August at 3.5% below its 50-dma, which was down from 6.6% above during mid-February—its highest level since October 2011. The 200-dma rose for a 31st week. It had been rising for 16 weeks through mid-May after falling from October 2018 to February 2019 in the first downtrend since May 2016 (when it had been slowly declining for nine months). The index traded above its 200-dma for a 32nd week and improved to 9.2% above its rising 200-dma from 8.6%. However, that's down from 9.6% above its rising 200-dma on Thursday, which was its highest reading since it peaked at a seven-year high of 13.5% above its rising 200-dma during January 2018. That compares to 14.5% below on 12/24/18, which was the lowest since April 2009.

**S&P 500 Sectors Technical Indicators** ([link](#)): Ten of the 11 S&P 500 sectors traded above their 50-dmas last week, unchanged from a week earlier, as Materials was below for a second week and for the first time since early October. Energy was above its 50-dma for a sixth week in another effort to break out of its long downtrend. The longer-term picture—i.e., relative to 200-dmas—had all 11 sectors trading above for a third straight week. That's up from just six at the end of August, which was the lowest count since early June. Energy was above for just a fourth time since October 2018. Ten sectors are in the Golden Cross club (with 50-dmas higher than 200-dmas), unchanged from a week earlier. That compares to just two sectors in the club during February and all 11 in January 2018. Energy has not been in a Golden Cross for 61 straight weeks. Ten sectors have rising 50-dmas now, up from nine a week earlier and down from all 11 in early November. Still, that's up from just three in early October. Utilities' 50-dma turned up again w/w and has been stalling since early November. Real Estate's 50-dma was down for a tenth week and for the first time since January. Ten sectors have rising 200-dmas, unchanged from a week ago. The sole laggard, Energy, has been mostly falling since October 2018. Materials and Financials moved higher for a 20th week in their successful attempts at new uptrends for the first time since September 2018. That compares to just two sectors with rising 200-dmas in early January, in what was then the lowest count since all 11 sectors had falling 200-dmas two years before.

## US ECONOMIC INDICATORS

**Employment** ([link](#)): Job gains in December fell short of expectations, and there were downward revisions to the prior two months. Employment climbed 145,000 (vs 160,000 expected) last month, its slowest pace since May, while revisions left November (to 256,000 from 266,000) and October (152,000 from 156,000) gains a net 14,000 lower. Private payrolls advanced 139,000 during the final month of 2019, following a downward revision to November (243,000 from 254,000) payrolls and a slight upward one to October's (164,000 from 163,000) for a net loss of 10,000. For all of 2019, total nonfarm (2.11 million y/y in December) and private (1.95 million) payrolls posted their smallest gains since 2001—amid the tight labor market and slower growth: Service-providing jobs increased 1.77 million over the 12-month period, goods-producing 176,000. Here's a tally of the 2019 gains by private industries, from highest to lowest: health care & social assistance (556,500 y/y in December), professional & business services (397,000), leisure & hospitality (388,000), construction (151,000), financial activities (122,000), education services (90,400), wholesale trade (62,000), transportation & warehousing (57,000), manufacturing (46,000), and retail trade (8,500); mining & logging (-21,000) and utilities (-2,400) companies lost jobs last year.

**Earned Income Proxy** ([link](#)): Our Earned Income Proxy (EIP), which tracks consumer incomes and spending closely, continued to set new highs in December, though the pace has slowed. (It hasn't posted a decline since February 2016.) Our EIP climbed 0.2% last month, after gains of 0.5% and 0.1% the prior two months; it posted a 0.8% gain in August—which was its strongest during all of 2019. December's reading was 3.8% above a year ago, down from 5.7% at the start of 2019 and the lowest since January 2017. Average hourly earnings (AHE), one of the components of our EIP, rose 0.1% last month after gains of 0.3% in each of the prior two months. The yearly rate slipped to 2.9% y/y—its first reading below 3.0% since July 2018; it had peaked at 3.4% during February 2019, which was the highest rate since April 2009. Meanwhile, aggregate weekly hours—the other component of our EIP—also ticked up only 0.1% in December after a 0.2% gain and a 0.1% loss the prior two months. It was up 0.9% y/y, its first reading below 1.0% since July 2010—down from its 2.4% peak at the start of the year.

**Unemployment** ([link](#)): December's unemployment rate held at a 50-year low of 3.5%, down from 4.0% at the start of the year, while the U6 unemployment rate—which includes marginally attached workers plus those working part time for economic reasons—sank to a new record low of 6.7%. During the 12 months through December, employment was up 1.98 million as



1.45 million workers returned to the labor force and 533,000 unemployed workers found jobs. The number of full-time jobs jumped 1.93 million over the 12-month period, to a new record high of 131.8 million. The participation rate held around recent highs, at 63.2%. Here's a look at how some key unemployment rates finished 2019: African American (5.9%, near August's record low of 5.4%), Hispanic (4.2%, a couple of ticks above September's record low of 3.9%), White (3.2%, holding around 50-year lows), and Asian (2.5%, fluctuating in a flat trend just above June's record low of 2.1%). By education, the story is similar for those 25 and older: less than a high-school degree (5.2%, just above September's 4.8% record low), a high-school degree (3.7%, within striking distance of November 1999's record low of 3.2%), some college (2.7%, near its 2.4% record low), and a Bachelor's degree and higher (1.9%, a new cyclical low).

**Wages** ([link](#)): Average hourly earnings climbed to a new record high last month, though the yearly rate sank to a 17-month low of 2.9% y/y. The 12-month wage rate for service-providing industries (2.9% y/y) continued to ease from February's series high of 3.6%, posting its weakest rate since April 2018. Meanwhile, the goods-producing rate (2.8) was just south of its recent high of 3.1%. Within goods-producing, the yearly wage rate for manufacturing (3.0) accelerated to a three-year high, while construction's (2.3) dropped to its lowest rate since May 2017. The natural resources' rate (5.6) remained on a volatile uptrend just south of October's six-year high of 6.5%. Within service-providing industries, only the rate for professional & business services (3.7% y/y) accelerated, while the rate for financial activities (2.8) barely budged from November's 26-month low of 2.7%. Moving lower were rates for leisure & hospitality (3.1, 15-month low), retail trade (2.7, 15-month low), information services (2.5, 53-month low), wholesale trade (2.3, 15-month low), transportation & warehousing (2.3, two-month low), education & health services (1.8, six-month low), and utilities (0.7, 63-month low).

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