



MORNING BRIEFING

January 15, 2020

Lots of Good News

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

(1) Tough comps for 2019 earnings. (2) 2020 should be better for earnings. (3) S&P 500 forward revenues and earnings at record highs. (4) Forward earnings implies a 9% increase in earnings this year. (5) Last year's worries are so yesterday. (6) The Mullahs are cornered, and must fear the US after their top general was droned. (7) Is there method to Trump's madness? (8) Trump's favorite popularity poll is the stock market. (9) Valuation multiples are flying closer to the sun.

Strategy I: Here Comes Another Earnings Season. First, the bad news: During the 1/9 week, industry analysts estimated that S&P 500 earnings per share fell 1.7% y/y in Q4-2019 ([Fig. 1](#)). They currently estimate that earnings rose just 1.1% last year ([Fig. 2](#)). That was mostly because the comparison with 2018 was tough, as earnings soared 23.8% that year thanks to Trump's tax cut for corporations.

In addition, S&P 500 revenues per share growth was remarkably strong during 2018, rising 8.9% ([Fig. 3](#)). In other words, the S&P 500 profit margin jumped 14.9% during 2018 mostly thanks to the tax cut (i.e., $14.9\% = 23.8\% - 8.9\%$) ([Fig. 4](#)). That's a hard act to follow, as demonstrated by 2019's so-called "earnings growth recession."

The good news is that the outlook for 2020, both from industry analysts and from YRI, calls for better earnings growth. Consider the following:

(1) *Forward revenues at another record high.* For starters, S&P 500 forward revenues per share—which is a great weekly coincident indicator of actual revenues—rose to a new record high during the 1/2 week ([Fig. 5](#)).

(2) *Forward earnings uptick to record high.* S&P 500 forward earnings edged up to a record high the following, 1/9 week, and the forward profit margin is holding up surprisingly well around 12%. The resilience of the margin is impressive given rising labor costs and tariff-

related costs. Both cost pressures may actually ease this year if productivity makes a rebound, as we expect, and the Trump administration deescalates its trade wars.

(3) *Upside surprise?* By the way, forward earnings tends to be a great year-ahead leading indicator of actual earnings as long as there is no recession on the horizon ([Fig. 6](#)). Forward earnings rose to \$178 per share during the 1/9 week (which will be the 1/7 week in 2021). We estimate that earnings totaled \$163 per share during 2019. That implies that earnings will grow around 9% this year. That would be a nice rebound from last year's near-zero growth rate. Joe and I still project that S&P 500 earnings will rise 5.5% to \$172 per share this year, but we are considering revising our number higher ([Fig. 7](#)). (See [YRI S&P 500 Earnings Forecast](#).)

Strategy II: Stocks Priced for Good News. Stock prices have continued to soar to new highs ever since the S&P 500 last exceeded its 9/20/18 high of 2930.75 on 10/10/19 ([Fig. 8](#)). As of yesterday's close, it was up 12.0% since 9/20/18 and up 39.6% from the Christmas Eve 2018 massacre low of 2351.10. It's definitely been a meltup since then, led by the forward P/E multiple, which rose from a low of 13.5 back then to 18.5 yesterday ([Fig. 9](#)).

Investors have concluded that there is nothing to fear but fear itself. Last year's worries about Trump's escalating trade wars have abated dramatically as he deescalated them, especially the one with China. The Phase 1 trade deal with China will be signed today. Additionally, the Fed reversed course last year. Instead of raising the federal funds rate three or four times, it was cut three times. Trump undoubtedly will claim bragging rights for this pivot since he harangued the Fed to do just that.

When Trump took executive action against the top Iranian general on Friday 1/3, the stock market flinched on Monday 1/6, but then resumed its climb to record highs. Therefore, Joe and I are NOT adding this event to our diary of panic attacks during the current bull market, for now.

The Iranians did retaliate with a missile attack on a US military base in Iraq. However, no one was killed or injured, suggesting that the Mullahs gave a heads up to the US to avoid American casualties. Trump may have convinced them that he is willing to obliterate their regime if they attack Americans and America's allies anywhere in the world. Meanwhile, pro-Mullah demonstrations in the streets of Iran have been followed by widespread anti-Mullah protests. The Mullahs are cornered. In the past, they might have unleashed chaos in the Middle East to

deflect attention from their internal crisis, which has been greatly exacerbated by Trump's sanctions on Iran. Now, they might be loath to pick a fight with Trump, maybe.

While roughly half the country hates Trump, nearly all Democrats hate him, believing that he is the Devil incarnate or at least deranged. (The President also has an uncanny ability to trigger "Trump Derangement Syndrome" among his adversaries.) His supporters see him as a great dealmaker, using the economic and military power of the US to make trade and geopolitical deals that benefit the US.

Love him or hate him, the question for those of us who invest is whether Trump is bullish or bearish for the financial markets. The answer is obvious: The markets believe that there is method in his madness. The S&P 500 is up 53.4% since Trump was elected president ([Fig. 10](#)). It helps that the President keeps talking up the stock market, which he seems to view as his most important popularity poll.

I think it's reasonable to assume that the markets expect that Trump will be reelected. If so, that will be bad news for his opponents. For investors, it could be good news. However, Joe and I are concerned that there is nothing to fear but nothing to fear. If the meltup continues, then the stock market's valuation multiple will rise toward nose-bleed levels. If that sets the stage for another meltdown correction like the one during Q4-2018, it would probably be yet another buying opportunity and not the end of the bull market. It's credit crunches, which lead to recessions, that cause bear markets.

So for now, we have nothing to fear but nothing to fear.

One final note on this subject: My job is to be an investment strategist. I do "bullish" or "bearish." I'm not a preacher. I don't do "good" or "bad." So all I am saying is that Trump has been bullish for the stock market and is likely to remain so. If you would prefer not to give him any credit for the bull market, you can give it all to the major central banks. I have been predicting since last fall that the latest round of easy money being provided by the major central banks could cause a meltup in the US stock market. See for example the 11/3/19 CNBC [interview](#) with me titled "A 'market melt-up' is becoming a real risk as stocks hit new highs, Wall Street bull Ed Yardeni warns."

Recall that President Barack Obama also was not loved by all. However, anyone who stayed

out of the stock market because of their political antipathy for the President missed a great bull market. The S&P 500 rose 140.3% under Obama mostly because the Fed pursued ultra-easy monetary policies ([Fig. 11](#)).

Obama certainly wasn't as much of a cheerleader for the stock market during his administration as Trump has been during his. However, Obama was a great investment strategist. On 3/3/09, Obama told reporters: "What you're now seeing is [price-to-earnings] ratios are starting to get to the point where buying stocks is a potentially good deal if you've got a long-term perspective on it." At the time, the forward P/E was 10.5. That was truly a great call. We came to the same conclusion later that same month.

Strategy III: Valuations Soaring. In our analysis above, we focused on the forward P/E. It's at a cyclical high, though still well below the tech bubble high of 25.7 on 4/12/99. Nevertheless, if you are looking for trouble, then you'll find it in the S&P 500 forward price-to-sales ratio (P/S) ([Fig. 12](#)). It is simply the S&P 500 stock price index divided by forward revenues. Last week, we demonstrated that it very closely tracks the Buffett Ratio, which is the US equity market capitalization excluding foreign issues divided by nominal GNP ([Fig. 13](#)).

The forward P/S rose to a record high of 2.2 during the 1/2 week. That exceeds the tech-bubble peak in the Buffett Ratio at 1.9 during Q1-2000. Here's another outlier: The PEG ratio—which is the forward P/E of the S&P 500 divided by analysts' consensus expectations for long-term earnings growth at an annual rate over the next five years—also soared to a record high during the 1/2 week ([Fig. 14](#)).

CALENDARS

US: Wed: PPI Final Demand 0/2%/m/m/1.3%/y/y, Empire State Manufacturing Index 3.5, MBA Mortgage Applications, DOE Crude Oil Inventories, Beige Book, Harker, Kaplan. **Thurs:** Retail Sales Headline, Ex Autos, Ex Autos & Gas, and Control Group 0.3%/0.5%/0.4%/0.3%, Business Inventories -0.1%, Jobless Claims 220k, Philadelphia Fed Manufacturing Index 3.6, NAHB Housing Market Index 74, Import Prices 0.3%/m/m/0.5%/y/y, EIA Natural Gas Report. (DailyFX estimates)

Global: Wed: Eurozone Industrial Production 0.3%/m/m/-1.0%/y/y, Eurozone Trade Balance €22.0b, Germany GDP (2019) 0.6% y/y, Germany Public Finances Balance-GDP Ratio (2019)

1.2%, UK Headline & Core CPI 1.5%/1.7% y/y, Japan Machine Orders -5.4% y/y, Saunders. **Thurs:** European New Car Registrations, Germany CPI 0.5% m/m/1.5% y/y, China GDP 1.4% q/q/6.0% y/y, China Retail Sales 7.9% y/y, China Industrial Production 5.9% y/y, BOE Bank Liabilities/Credit Conditions Report, BOE December Meeting Minutes, Lagarde. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Q4 Earnings Season Monitor ([link](#)): With 5% of S&P 500 companies finished reporting revenues and earnings for Q4-2019, revenues and earnings are beating the consensus forecasts by 1.0% and 4.4%, respectively. Those are in line with their respective 0.8% and 5.0% beats at the same point in Q3, but the percentages of companies showing a positive revenue surprise and positive y/y revenue growth are sharply higher. Of the 25 companies in the S&P 500 that have reported through mid-day Tuesday, 84% exceeded industry analysts' earnings estimates. Collectively, the small sample of reporters has a y/y earnings gain of 1.3%. On the revenue side, 68% of companies beat their Q4 sales estimates so far, with results 3.1% higher than a year earlier. Overall Q4 earnings growth results are positive y/y for 68% of companies, and revenues have risen y/y for 88%. These figures will change markedly as more Q4-2019 results are reported in the coming weeks, but what companies say about their growth and margin prospects for 2020 will be investors' main focus.

US ECONOMIC INDICATORS

CPI ([link](#)): December's core CPI rate held at 2.3% y/y, a tick below its recent peak rate of 2.4% during August and September. (It first reached 2.4% during July 2018—which was the highest since September 2008.) Before accelerating to 2.4% last August, the core rate had fluctuated in a narrow band from 2.0% to 2.2% for 12 months. Core prices rose 0.1% in December following gains of 0.2% in each of the prior two months; the three-month rate slowed for the fourth month, to 2.0% (saar), after accelerating from 1.6% in May to 3.4% in August—which was the fastest pace since May 2006. Here's a ranking of the 12-month core rates for 2019, on a December-over-December basis, from lowest to highest for goods: apparel (-1.2% y/y), used cars & trucks (-0.7), new vehicles (0.1), alcoholic beverages (0.5), medical care commodities (2.5), and tobacco & smoking products (5.5). Of those, only the rate for medical care commodities has been on an accelerating trend. Here's the same drill for the core services rates: motor vehicle insurance (0.0), physicians' services (1.4), airfares (1.7), hospital services (3.0), motor vehicle maintenance & repair (3.4), owners' equivalent rent (3.3), and rent of

primary residence (3.7). Only the physicians' and hospital services rates have been on accelerating trends, though the latter stalled in December. The headline CPI rate moved above 2.0% last November for the first time since November 2018 and accelerated again in December—rising steadily from 1.7% in September to a 14-month high of 2.3% y/y at the end of 2019.

NFIB Small Business Optimism Index ([link](#)): “December marked the end of another banner year for the small business economy, as owners took full advantage of strong consumer spending, and federal tax and regulatory relief,” said NFIB Chief Economist William Dunkelberg. “2020 is starting out with a solid foundation for continued growth, two-years into the Tax Cuts and Jobs Act that’s providing fuel to grow small businesses and their workforce.” The Small Business Optimism Index (SBOI) dipped 2.0 points in December to 102.7, after posting its largest gain in 18 months (2.3 points) in November. It remains at a historically high level, within 6.1 points of August 2018’s record high of 108.8. Six of the 10 components of the SBOI fell last month, while two rose—those expecting better business conditions (+3 points to 16%) and sales expectations (+3 to 16); plans to increase inventories (3%) and expected credit conditions (-3) were unchanged. Earnings trends (-10 points to 8%) took the biggest hit last month, followed by current job openings (-5 to 33) and current inventory (-5 to -4), though both earnings trends and job openings remained at high levels. The uncertainty index climbed 8 points to 80 last month, though held around its lowest readings since the 2016 election. The report noted: “What really matters to small business owners are issues directly impacting their bottom lines. Currently, their biggest problem is finding qualified labor, surpassing taxes or regulations,” said Dunkelberg. “Two years ago, Congress and the President provided real, significant tax relief to small business owners. Now owners are anxious to have their tax cuts made permanent.”

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

Copyright (c) Yardeni Research, Inc. Please read complete [copyright and hedge clause](#).