MORNING BRIEFING
August 2, 2023

Global Smorgasbord

Check out the accompanying chart collection.

Executive Summary: While the economies of China and the Eurozone countries have been lethargic, with a contracting M-PMI in China and declining industrial sentiment in the EU, the US economy has been anything but. The Atlanta Fed's GDPNow model shows Q3 GDP growth tracking at 3.9%. We're increasingly confident about our no-landing/rolling-recovery outlook over the next 18 months, to which we ascribe 85% subjective odds. … Also: S&P 500 forward earnings continues to recover. … And Joe reports reassuring takeaways from recently released July data on analysts' estimate revisions for earnings and revenues.

Global Economy: Fizzling. Tourists sightseeing in Europe in recent weeks have had to do so in sweltering heat. On the other hand, the European economy has been not so hot. Also lackluster has been China's economy. Meanwhile, the US economy continues to surprise on the upside. It all adds up to a global economy that is growing but at a subdued pace. Let's start with a quick tour of China and Europe before coming back stateside:

(1) *China's PMIs weakening*. China's official M-PMI rose slightly to 49.3 last month, remaining below the 50.0 mark that separates expansion from contraction for the fourth month in a row (*Fig. 1*). The NM-PMI, which measures activity in the services and construction sectors, eased to 51.5 (*Fig. 2*). A subindex focused on services also declined to 51.5, from June's 52.8.

New manufacturing export orders continued to decline, with the subindex inching down to 46.3 from 46.4 in the previous month. A manufacturing employment subindex remained in contraction for a fifth straight month. A subindex measuring nonmanufacturing employment edged down to 46.6 from 46.8 in the previous month.

Government officials have promised to implement measures to stimulate consumption. On Friday, the government announced a slew of initiatives to help industries in home goods, food, plastic products, leather, and other industries.

(2) *Europe's ESIs & PMIs falling*. The European Union's economic sentiment index (ESI) fell further below 100.0, to 93.6, in July (*Fig. 3*). It has been below 100.0 since July 2022. So

has the Eurozone's ESI, which declined to 94.5 in July. Leading the weakness in the Eurozone's ESI has been its industrial component, while the consumer component has been rebounding since late last year because a milder-than-expected winter and plenty of natural gas calmed concerns about freezing in the dark.

Germany has been leading the downturn in the Eurozone's ESI for the industrial sector (*Fig. 4*). The same can be said for the Eurozone's M-PMI, which was down to 42.7 in July, with Germany's index down to 38.8 (*Fig. 5*). The Eurozone's NM-PMI has also been falling in recent months but remained above 50.0 in July, at 51.1, with France's measure falling to 47.4 (*Fig. 6*).

(3) *Euro-based CESI is down and out.* Confirming the weakness of the Eurozone economy is the euro-based Citigroup Economic Surprise Index. It has been hovering below 100.0 since February 7 and is well below the neutral reading of 0.0 (*Fig. 7*). It's showing the lowest readings since early 2020 when the pandemic started.

(4) *Our Global Growth Barometer upticks*. Meanwhile, our Global Growth Barometer (GGB) has rebounded slightly in recent days, as both the Brent price of oil and the CRB raw industrials spot price index have moved higher (*Fig. 8* and *Fig. 9*). However, the increase in the price of oil may have more to do with less supply than with more demand. On July 31, Reuters *reported*: "OPEC oil output has fallen in July after Saudi Arabia made an additional voluntary cut as part of the OPEC+ producer group's latest agreement to support the market and an outage curbed Nigerian supply."

US Economy: Sizzling. While the rest of the world is fizzling, the US economy is sizzling. For the past year and a half, we have been in the soft-landing camp. We've promoted the "rolling recession" scenario. Now it's looking increasingly like a no-landing and rolling recovery scenario for the next year and a half. We turned more optimistic on Monday by assigning 85% subjective odds to this scenario and only 15% to a hard landing one. Previously we had been at 75/25.

Let's review the latest US economic indicators, which indicate that all is well in the US economy:

(1) *CESI is hot.* The Citigroup Economic Surprise Index (CESI) for the US rose to 76.1 on July 31 from this year's low of 24.7 on January 18 (*Fig. 10*). The spread between the US CESI and Eurozone CESI is 192.1 (*Fig. 11*).

(2) *M-PMI bottoming.* The M-PMI has been below 50.0 since November (*Fig. 12*). We think that it has been reflecting the rolling recession that has depressed goods producers and distributors, as consumers pivoted from buying goods to purchasing services since mid-2021. We think that the recession is bottoming, as evidenced by the bottoming of the M-PMI around 45.0 in recent months. It ticked up to 46.4 during July.

(3) *Construction is booming.* Construction spending rose to a record high in June (*Fig. 13*). Private residential construction actually rose 3.8% during the two months through June, having posted only three gains since it peaked at a record high last May (*Fig. 14*). Private nonresidential construction was flat in June following a 0.8% decline in May from April's record high, reflecting a pause in the vertical ascent in construction of manufacturing facilities. Public construction edged up to a new record high, led by record spending on water supply, sewage, and waste disposal. (See our *Construction Spending* chart book.)

(4) *Lots of job openings again.* The labor market continues to provide lots of job openings. The number of available positions declined to 9.6 million in June according to the JOLTS report. That is the lowest since April 2021, but it remains elevated. Odds are good that it remained so during July according to the "jobs plentiful" series included in the Conference Board's consumer confidence survey (*Fig. 15*).

The decline in openings was led by goods-producing sectors such as manufacturing, while several service industries, including health care and arts and entertainment, registered increases. The ratio of openings to unemployed people was little changed at 1.6 in June. Prior to the pandemic, it was about 1.2.

(5) *SLOOS is not loose.* The Fed's latest Senior Loan Officer Opinion Survey, or SLOOS, was released on Monday. It showed that banks reported having tighter credit standards and seeing weaker loan demand from both businesses and consumers. Banks expect to tighten their lending standards further over the rest of 2023 as well. So far, there's no evidence in the Fed's weekly report on commercial banks' balance sheet suggesting that an economy-wide credit crunch is underway.

(6) *GDPNoW is WOW!* The earliest read on Q3's GDP was a whopping 3.5% on July 28, according to the Atlanta Fed's *GDPNow* tracking model. The estimate was raised to 3.9% on August 1. It's too soon to place much faith in these numbers. But they are certainly consistent with our more optimistic no-landing outlook for the economy.

US Strategy I: Earnings Looking Up. The current earnings reporting season for the S&P

500 showed an uptick in the Q2 blended number of actual and estimated results during the July 27 week (*Fig. 16*). More importantly, the Q3 and Q4 estimates stopped falling during the final week of July. Even more significant is that the S&P 500's forward earnings continued its recovery, which started earlier this year (*Fig. 17*). Industry analysts are currently estimating that operating earnings per share will be $245.15 next year, up 12.5% from this year's $217.83 estimate.

US Strategy II: Mostly Positive Revisions. Last week, Refinitiv released its July snapshot of the monthly consensus estimate revisions activity over the past month. While Refinitiv provides raw data for all its polled measures, we focus primarily on the revenues and earnings forecasts, as shown in our *Stock Market Indicators: Net Revenue & Earnings Revisions By Sectors* report. There, the analysts' revisions activity is indexed by the number of forward earnings estimates up less number of estimates down, expressed as a percentage of the total number of forward earnings estimates. We look at their activity over the past three months because it encompasses an entire quarterly reporting cycle, which is less volatile (and misleading) than a weekly or monthly series.

July's reading comes at the beginning of the Q2 earnings reporting cycle, when revisions activity typically pauses as analysts wait to see how actual results for the quarter compare with their forecasts before revising their annual estimates. The pause follows a long period of mostly downward revisions through April, when analysts began to realize that instead of a deep recession, there would be a mid-cycle slowdown with negative y/y quarterly growth comparisons due to very strong results and pricing power a year earlier.

Below, Joe highlights notable points after analyzing the July estimate revisions data:

(1) *S&P 500 NERI back on positive footing.* The S&P 500's NERI index measures the net revisions activity for earnings forecasts; a zero reading indicates an equal number of raised and lowered estimates over the past three months. NERI improved for a fourth straight month in July and edged even higher into positive territory. It rose to a 14-month high of 1.3% from 0.6% in June. July's release is up from a 30-month low of -15.6% in December and is well above the average reading of -2.2% seen since March 1985 (when NERI was first calculated).

(2) *More than half of sectors now have positive NERI.* Seven of the 11 S&P 500 sectors registered positive NERI in July, up from six in June and zero in March and April. Six sectors improved m/m, down from all 11 improving m/m in May. But May was unusual in this regard: There was a flurry of upward earnings revisions as analysts scrambled to raise

forecasts following broad-based Q1 earnings strength—in fact, May saw the broadest earnings improvement among the sectors since July-September 2020. June's improvement continued in July, when six of the 11 sectors reached their highest NERI readings in at least nine months. Among them, Communication Services turned positive for the first time in 21 months. Energy and Financials both remained on lengthy negative NERI streaks, at 13 and 12 months, respectively.

Here's how NERI ranked for the 11 S&P 500 sectors in July: Industrials (9.3%), Consumer Discretionary (8.6, 21-month high), Information Technology (4.1, 14-month high), Communication Services (3.5, 21-month high), Real Estate (3.3, 12-month high), Health Care (1.8), Consumer Staples (1.7), S&P 500 (1.3, 13-month high), Utilities (-0.7), Financials (-7.0, 12-month high), Materials (-7.5), and Energy (-17.9).

(3) *S&P 500 NRRI index for revenues still positive and stabilizing.* The NRRI index, which measures the revisions activity in analysts' revenue forecasts, ticked down for the S&P 500 to 3.5% in July from 3.7% in June but was positive for a sixth straight month. That's still above the average reading of -0.2% when NRRI data were first compiled in March 2004.

(4) *NRRI index positive for seven sectors now.* NRRI's m/m performance was a tad weaker than the NERI index's by one measure: Just five sectors had NRRI readings improve m/m, versus six with improving NERI. However, seven sectors registered positive NRRI during the month, with three standouts leading the way: Communication Services, Information Technology, and Real Estate all posted their highest NRRI readings in at least nine months. Notably, Tech's was positive for the first time in 13 months. Of the 11 sectors, only Energy and Materials have still-depressed NRRI readings.

Here's how the S&P 500 sectors' NRRI readings ranked in July: Utilities (12.5%), Real Estate (10.2, 9-month high), Industrials (9.9), Health Care (9.7), Consumer Discretionary (8.9), Consumer Staples (7.3), S&P 500 (3.5), Information Technology (2.0, 14-month high), Financials (-1.1), Communication Services (-7.0, 15-month high), Materials (-13.4), and Energy (-21.4).

Calendars

US: **Wed:** ADP Nonfarm Employment 188k; MBA Mortgage Applications; Crude Oil Inventories & Gasoline Production. **Thurs:** Productivity & Unit Labor Costs 2.0%/2.6%; Factory Orders 2.3%; ISM NM-PMI 53.0; Initial & Continuous Jobless Claims 227k/1.70m;

Fed’s Balance Sheet; Natural Gas Storage. (Bloomberg estimates)

Global: Wed: Japan M-PMI & NM-PMI 50.4/53.9; China Caixin NM-PMI 52.5; Australia Retail Sales -1.8%. **Thurs:** Eurozone, Germany, and France C-PMIs 48.9/48.3/46.6; Eurozone, Germany, and France NM-PMIs 51.1/52.0/46.5; Eurozone PPI -0.2%m/m/-3.1%y/y; Germany Trade Balance 15.0b; Italy Retail Sales 0.0%m/m/4.0%y/y; UK C-PMI & NM-PMI 50.7/51.5; BoE Interest Decision 5.25%; Panetta; Bailey. (Bloomberg estimates)

Strategy Indicators

S&P 500 Q2 Earnings Season Monitor (*link*): With the Q2-2023 earnings season now over 58% complete, the indications from the companies that have reported so far suggest a similar earnings surprise than in Q1-2023 but a weaker revenues surprise. During Q4-2022, the earnings surprise was the lowest since Q4-2008 and the revenue surprise the smallest since Q1-2020. Furthermore, the earnings surprise failed to outpace the revenue surprise in Q4-2022 for the first time since we began tracking that data in Q1-2009. With 292 of the S&P 500 companies finished reporting for Q2-2023, revenues are ahead of the consensus forecast by 1.5%, and earnings have exceeded estimates by 7.3%. At the same point during the Q1 season, revenues were 2.1% above forecast, and earnings had beaten estimates by 7.7%. For the 292 companies that have reported Q2 results so far through mid-day Tuesday, only 63% has reported a positive revenues surprise; if the companies yet to report don’t raise that number, Q2 would have the narrowest revenues beats reading since Q1-2020. But the percentage with positive earnings surprises is well above the pace of the prior six quarters. The reporting companies’ aggregate y/y revenues and earnings growth rates are mixed from their Q1-2023 readings: tumbling to -6.2% from -0.6% for earnings growth and dropping to 0.9% from 3.8% for revenues growth. Over the past 57 quarters through Q1-2023, y/y earnings growth has trailed y/y revenues growth in only 15 quarters including the past five, and it’s already doing so again in Q2-2023 as Energy sector results are being reported. Excluding the Energy sector’s results from the S&P 500 companies that have already reported underscores Energy companies’ outsized drag on the S&P 500’s y/y growth rates: earnings growth improves to -0.3% from -6.2%, and revenue growth rises to 4.6% from 0.9%. Significantly fewer companies have been reporting positive y/y earnings growth in Q2 (59%) than positive y/y revenues growth (69%). These figures will continue to change as more Q2-2023 results are reported in the coming weeks, but the overall tune has been set. We expect the overall y/y revenues growth rate to remain positive in Q2, but results from the companies in the Energy and Materials sectors are likely to cause the biggest y/y earnings decline for the S&P 500 since Q2-2020.

US Economic Indicators

JOLTS (*link*): There are signs in June's JOLTS report that the job market is cooling, though it still remains solid. *Job openings* have been on a downtrend so far this year, dropping 34,000 in June and 1.65 million ytd to 9.6 million. The series peaked at a record-high 12.0 million last March. Prior to the pandemic, in early 2020, the highest level of job openings recorded was 7.6 million. Openings reached 10 million in June 2021 for the first time in the history of the series going back to 2000. There were 6.0 million people unemployed in June, so there were 1.61 available jobs for each unemployed person that month, little changed from May's 1.58—which was the lowest since October 2021—though still a strong number. It was a record high of 2.01 last March. By industry, the *biggest decreases* in job openings in June occurred in accommodations & food services (-98,000), transportation & warehousing (-78,000), retail trade (-36,000), and durable goods manufacturing (-23,000). The *biggest increase* occurred in health care & social assistance (136,000)—rebounding from May's 309,000 plunge—followed at a distance by wholesale trade (+17,000). *Within government*, job openings in state & local government excluding education (+62,000) increased, while openings in state & local government education (-29,000) and federal government (-21,000) fell. Total separations fell 288,000 in June to 5.6 million. Separations include quits, which are generally voluntary separations initiated by employees—serving as a measure of workers' willingness or ability to leave jobs. Quits during June fell for the fourth time this year, sinking 295,000 m/m and 319,000 ytd to 3.8 million. Quits have been in a downtrend since its peak of 4.5 million during April 2022. Still, quits remain above pre-pandemic levels. Hirings fell 326,000 in June to 5.9 million. It was at a recent peak of 6.8 million during November 2021.

Construction Spending (*link*): Construction spending continued to reach new record highs in June, and May's data was revised higher—with private residential investment showing the first back-to-back gain in over a year. *Total* construction spending hasn't posted a decline this year, climbing 0.5% in June and 5.3% ytd. *Private* construction investment rose 0.5% and 4.7% over the comparable periods—also to a new record high. *Public* construction spending increased for the 12th time in 13 months, by a total of 14.8%, to yet another new record high. Within *private construction*, residential investment rose for the second month in June, by a total of 3.8%, breaking out of an 11-month slump. Meanwhile, nonresidential investment took a breather, showing no change in June after a 0.8% drop in May from April's record high; it had soared 22.4% during the 11 months ending April. Within residential investment, *single-family* construction rebounded 3.7% during the two months through June, after a 12-month plunge of 26.5% to its lowest level since November 2020.

*Home improvemen*t spending has been volatile, falling 0.6% in June following a 5.2% gain and a 5.6% loss the prior two months; it's 6.1% below last May's record high. Meanwhile, *multi-family* construction remains on a steep uptrend, soaring 23.1% over the past 11 months to a new record high!

Global Economic Indicators

Global Manufacturing PMIs (*link*): "Global manufacturing downturn continues in July as output and new order fall at faster rates" was the headline of the July release. The JP Morgan Global M-PMI in July was unchanged at June's six-month low of 48.7—below the breakeven point of 50.0 for the 11th straight month. According to the survey, there was acute weakness in the Eurozone in July and signs of a slowdown in China. The weak environment has softened inflationary pressures—with both input and output prices remaining below the 50.0 mark. July data are available for 29 nations, with only seven signaling expansions in output and 22 signaling contractions. Here's how June *M-PMIs ranked by country/region* from highest to lowest: India (57.7), Greece (53.5), Indonesia (53.3), Mexico (53.2), Kazakhstan (52.7), Russia (52.1), Philippines (51.9), Turkey (49.9), Australia (49.6), Japan (49.6), Canada (49.6), South Korea (49.4), China (49.2), US (49.0), WORLD (48.7), Vietnam (48.7), Colombia (48.4), Brazil (47.8), Malaysia (47.8), Spain (47.8), Ireland (47.0), Netherlands (45.3), UK (45.3), France (45.1), Italy (44.5), Taiwan (44.1), Poland (43.5), EUROZONE (42.7), Czech Republic (41.4), Germany (38.8), and Austria (38.8).

US Manufacturing PMI (*link*): July's M-PMI was in contractionary territory for the ninth straight month—the longest string of readings below 50.0 since the Great Financial Crisis (2007-09). July's M-PMI edged up to 46.4 after falling to a 37-month low of 46.0 in June. Looking at July's report, both the new orders (47.3 from 45.6) and production (48.3 from 46.7) measures improved, with the former climbing to a nine-month high—though both remained in contractionary territory. Factories continued to cut payrolls (44.4 from 48.1) in July, falling to the lowest reading in three years. The *supplier deliveries* (46.1 from 45.7) measure continues to hover around May's level, which was lowest since March 2009's 43.2—down sharply from May 2021's peak of 78.8. (A reading below 50.0 indicates faster deliveries to factories.) Meanwhile, the inventories (46.1 from 44.0) gauge showed only a slight improvement from June's reading, which was the slowest since January 2014, as businesses continue to carefully manage inventories. ISM's *prices-paid* (42.6 from 41.8) measure is not far from December's 32-month low of 39.4. It peaked at 92.1 in mid-2021—which was the fastest since the summer of 1979.

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