MORNING BRIEFING
November 29, 2023

Breaking Good

Check out the accompanying chart collection.

Executive Summary: Many of investors' fears in 2023 turned out to be unfounded; all they really had to fear was fear itself. Now that investor sentiment has improved as investors have cast some fears aside, will undue fearlessness be a concern for the stock market in 2024? … Also improved from a year ago has been the consensus outlook of Wall Street strategists for S&P 500 operating earnings per share; our own estimates for this year and next have been and are still higher than the consensus. … Also: Joe shares the latest net estimate revisions data, showing more estimate cutting than hiking over the past three months. But analysts still expect positive y/y growth in both revenues and earnings next year.

Strategy I: From Fear to Less Fear. Investors were very fearful near the end of last year. They mostly feared that inflation would be persistent, forcing the Fed to raise interest rates still higher until a credit crunch and recession occurred. Wouldn't you know it? These fears were most intense when the stock market bottomed on October 12, 2022.

One metric we use to assess investor fear is the Investor Intelligence Bull/Bear Ratio. It bottomed last year at 0.57 during the October 17 week (*Fig. 1*). This past summer, it rebounded to 3.06 during the July 10 week, just in time for a 10% correction in the S&P 500 that occurred from July 31 through October 27. During the November 21 week, it was at 2.36, which is a relatively neutral reading. The comparable AAII Bull/Bear Ratio followed the same script (*Fig. 2*).

Another interesting sentiment index is the stock-prices-lower-in-12-months series included in the monthly consumer confidence survey conducted by The Conference Board. From a contrarian perspective, it is a bit more bullish, with 36.1% of respondents expecting stock prices to be lower in 12 months according to the latest November survey (*Fig. 3*).

The current consensus outlook is less fearful than it was a year ago. The widespread view is that the Fed is done raising interest rates because inflation is heading in the right direction (i.e., down toward 2.0%) and that this could continue to happen without a credit crunch and recession. The drop in gasoline prices since September has been a welcome development that will help to moderate inflation and avert a recession (*Fig. 4*).

Geopolitical fears have also abated somewhat. Last Wednesday, China's President Jinping Xi delivered a very dovish speech in San Francisco, as we discussed *yesterday*. China's economy is a mess, reducing the risk that Xi and his comrades will invade Taiwan anytime soon. Israel and Hamas would like to destroy one another but were able to negotiate a truce for a few days to exchange Israeli hostages for Palestinian prisoners. So far, Hezbollah hasn't joined the war.

The big debate now seems to be when and by how much the Fed will lower interest rates. The federal funds rate peaked just before eight of the past 10 recessions (*Fig. 5*). It plunged during all of them. The optimists (including yours truly) aren't expecting a recession through the end of 2024, so we expect that any rate cutting by the Fed next year will be limited, maybe to two to four cuts of 25bps each. The diehard hard-landers expect that a recession in 2024 will force the Fed to cut the federal funds rate significantly. Russia's war against Ukraine hasn't been as threatening to the global economic outlook as it was last year.

With the benefit of hindsight, 2023 has been a year of nothing to fear but fear itself. In 2024, we may have to worry that there isn't enough fear to temper investor optimism.

As noted above, the consumer confidence survey for November was released on Tuesday morning. The Consumer Confidence Index (CCI) was up slightly at 102.0 (*Fig. 6*). The percentage of respondents reporting "jobs plentiful" remained relatively high at 39.3% (*Fig. 7*). The "jobs hard to get" response rose to 15.4% in November from a recent February 2023 low of 10.5%, suggesting that the unemployment rate may continue to edge up as in recent months (*Fig. 8*).

Strategy II: Earnings Heading Our Way. Also breaking good since the end of 2022 has been the outlook for S&P 500 operating earnings per share. There was lots of pessimism over the past year, with a few influential Wall Street strategists predicting that this year's result could break bad, i.e., below $200. We stuck with our projections of $225 for this year and $250 for 2024, which seemed farfetched (if not delusional) late last year. But then again, we were in the soft-landing camp, not the hard-landing one.

Let's compare our forecasts to the latest consensus of industry analysts:

(1) *2023 & 2024 quarterly consensus.* There was another earnings hook during Q3's earnings reporting season. S&P 500 earnings per share turned out to be 4.1% better than expected at the start of the season (*Fig. 9*). However, Q4's estimate was cut by more in response to cautious guidance by company managements as well as to the impact of the

United Auto Workers' strike. The quarterly consensus estimates for 2024 have been mixed recently (*Fig. 10*).

(2) *2023 & 2024 annual consensus estimates.* The annual consensus estimates for 2023 and 2024 have been relatively stable so far this year. They were $220.85 and $245.98 during the November 23 week (*Fig. 11*). Both are about $4.00 below our forecasts (*Fig. 12*). Joe and I are sticking with our projections for now.

Strategy III: Estimate Revisions Activity Turns Negative. Last week, LSEG released its November snapshot of industry analysts' consensus estimate revisions activity over the past month. While the company provides raw data for all its polled measures, we focus primarily on the revenues and earnings forecasts. We use these data to create our Net Revenues Revisions Index (NRRI) and Net Earnings Revisions Index (NERI), captured in our *S&P 500 NRRI & NERI* chart book.

There, the analysts' estimate revisions activity is indexed by the number of upward revisions in forward earnings less the number of downward ones, expressed as a percentage of total forward earnings estimates. A zero reading indicates that an equal number of estimates were raised as were lowered over the past three months. We capture this activity over the past three months because that timespan encompasses an entire quarterly reporting cycle. Since analysts tend to revise their estimates to different degrees at different points in the three-month cycle, the three-month data are less volatile—and misleading—than a weekly or monthly series would be.

November's NRRI and NERI readings come at the end of the quarterly reporting cycle, when analysts typically adjust their financial models to take into account management's future guidance along with the just-released results. The indexes show that more analysts now are cutting than raising their revenues and earnings forecasts. That's an about-face from earlier in 2023 when the majority were raising their revenues forecasts following the Q4-2022 season and their earnings forecasts after Q2-2023.

While that may seem to be bad news, the current readings reflect a return to normal revision activity following the extended period of abnormally high positive revisions resulting from the recovery from the pandemic shutdowns.

Furthermore, NRRI and NERI measure the net percentage of estimates raised or lowered without regard for *how much* those estimates were changed. While the greater cutting than raising indicates that analysts are a bit less bullish than they had been before the Q3

earnings season, that's not to say they aren't bullish: Their consensus y/y growth rate forecasts for revenues and earnings remain solidly positive for all of the quarters through the end of 2024.

Joe highlights what's most notable about the November crop of revisions data below:

(1) *S&P 500 NERI turns negative again.* The S&P 500's NERI index was negative in November for the first time in seven months as it weakened to a seven-month low of -5.3% from 0.6% in October (*Fig. 13*). November's release is up from a 30-month low of -15.6% in December 2022 and is below the average reading of -2.2% seen since March 1985, when the data first were calculated. Looking at recent trends since the pandemic, NERI had been positive for 23 straight months from August 2020 to June 2022, and was then negative for the next 10 months through April 2023 as analysts posited that the Fed's aggressive monetary policy would hurt earnings.

(2) *Nearly all sectors now have negative NERI.* There was just one S&P 500 sector with positive NERI in November, Energy (*Fig. 14*). That's down from five sectors with a positive reading in October and September and down from a 13-month high of seven sectors during July. November marked the lowest count of sectors with positive NERI since April, when all 11 sectors were negative.

Looking at November versus October NERI data, all 11 sectors' NERI weakened. The last time that all 11 sectors' NERIs weakened on a m/m basis was in October 2022. This compares with eight sectors posting a NERI that declined m/m in October 2023.

(Such broad-based deterioration is a far cry from all 11 sectors' NERIs improving m/m in May; but that month was unusual, as analysts then were scrambling to raise forecasts after Q1 earnings reports revealed broad-based strength. In fact, May's revisions activity marked the broadest earnings improvement among the sectors in two and a half years, since September 2020.)

To highlight the good news about the S&P 500 sectors' November NERI readings, nearly all remained above their lowest levels earlier in 2023. Only the Consumer Staples sector bucked that trend, with its NERI at a 13-month low.

Here's how NERI ranked for the 11 sectors in November: Energy (11.4%, two-month low), Information Technology (-1.0, seven-month low), Communication Services (-2.6, seven-month low), Consumer Discretionary (-5.0, eight-month low), Financials (-5.1, four-month

low), S&P 500 (-5.3, seven-month low), Utilities (-5.6, seven-month low), Industrials (-5.6, 10-month low), Consumer Staples (-10.1, 13-month low), Real Estate (-10.7, seven-month low), Materials (-11.2, three-month low), and Health Care (-12.5, 10-month low).

(3) *S&P 500 NRRI index for revenues is negative again and at 11-month low.* The NRRI index dropped for the S&P 500 to an 11-month low of -7.5% in November from -0.1% in October and is down from a 12-month high of 5.0% in July (*Fig. 15*). November's negative reading is the second straight one after eight positive monthly readings through September. It comes on the heels of six straight negative readings from August 2022 to January 2023. The S&P 500's NRRI now is below the average -0.2% reading since the index was first compiled in March 2004.

(4) *NRRI index now negative for 10 sectors.* NRRI's m/m performance was about the same as that of the NERI index by all measures but one: Energy's NRRI improved m/m versus none with improving NERI (*Fig. 16*).

Looking at the 11 sectors' NRRI levels, slightly more than half remained above their 2023 lows. Among those that sank below their 2023 lows, Consumer Staples' November NRRI reading was at a 43-month low, followed by Financials (41-month low), Real Estate (36-month low), and Utilities (30-month low).

Here's how the sectors' NRRIs ranked in November: Energy (14.1%, 13-month high), Utilities (-0.6, 30-month low), Industrials (-2.3, 10-month low), Real Estate (-4.6, 36-month low), Financials (-5.0, 41-month low), Health Care (-7.1, 10-month low), S&P 500 (-7.5, 11-month low), Information Technology (-8.3, 10-month low), Consumer Discretionary (-9.3, 11-month low), Communication Services (-12.4, seven-month low), Consumer Staples (-19.1, 42-month low), and Materials (-20.2, three-month low).

(5) *Less Energy in S&P 500's NRRI and NERI.* Since the Energy sector can be especially volatile in terms of revisions activity, hiding trends in the broad S&P 500 index, we also like to look at the data with Energy's data sliced out. Without the Energy sector, the S&P 500's November NRRI reading falls to an 11-month low of -8.3% from -0.4% in October and its November NERI is negative for a second month, dropping to a six-month low of -6.3% from -0.1% in October.

As we discussed in the October 25 *Morning Briefing*, there are several possible reasons for the recent weakness in the revisions data. The impact of higher interest rates is now starting to be reflected in estimate revisions. Also, waning inflation may be lowering

revenues as well as impacting companies' pricing power and ultimately their earnings.

October's NRRI and NERI readings were very close to the zero mark that indicates equal numbers of estimates rising and falling, and the index's m/m comparisons were down only slightly; they weren't collapsing. That suggested to us then that analysts collectively were generally satisfied with their forecasts. That takeaway had all the earmarks of a nice, gentle soft-landing, as we wrote on October 25. Now with a second month of higher net estimate cuts than increases, has our opinion changed? No. While November's large drop could be seen as worrisome, it's not cause for alarm, since earnings and revenue growth rates are expected to remain positive through the end of 2024.

Calendars

US: **Wed:** GDP & Price Index 4.9%/3.5%; Real Consumer Spending & PCE Price Index 4.0%/2.9%; Corporate Profits; Goods Trade Balance -$86.7b; MBA Mortgage Applications; Wholesale Inventories 0.1%; Crude Oil Inventories & Gasoline Production; Natural Gas Storage; Beige Book; Mester. **Thurs:** Personal Income & Spending 0.2% & 0.2%; Headline & Core PCED 0.1%m/m/3.1%y/y & 0.2%m/m/3.5%y/y; Initial & Continuous Jobless Claims 218k/1.855m; Chicago PMI 45.0; Pending Home Sales -1.5%; Williams. (FXStreet estimates)

Global: **Wed:** Eurozone Business & Consumer Survey 93.8; Eurozone Consumer Confidence -16.9; Germany CPI -0.2%m/m/3.5%y/y; Germany Import Prices; France Nonfarm Payrolls -0.1%; Spain CPI 3.7%y/y; Italy Business & Consumer Confidence 96.0/102.0; Italy PPI; Japan Industrial Production 0.8%; Japan Retail Sales 5.9%; China M-PMI & NM-PMI 49.6/51.1; European Central Bank Non-monetary Policy Meeting; Bailey; Nakamura. **Thurs:** Eurozone Headline & Core CPI 2.8% & 3.9%y.y; Germany Import Prices 0.1%m/m/-13.2%y/y; Germany Retail Sales 0.5%m/m/-1.9%y/y; Germany Unemployment Change & Unemployment Rate 23k/5.8%; France GDP 0.1%q/q/0.7%y/y; Italy Unemployment Rate 7.5%; Japan Household Confidence 35.6; Japan Housing Starts -6.8%; Japan Unemployment Rate 2.6%; Japan M-PMI 48.1; China Caixin M-PMI 49.3; Lagarde; Nagel; Enria; McCaul; Jochnick. (FXStreet estimates)

US Economic Indicators

Consumer Confidence (*link*): Consumer confidence in November increased for the first time in four months as expectations moved higher and the present situation index fell for the fifth successive month. According to Dana Peterson, chief economist at The Conference Board, "November's increase in consumer confidence was concentrated primarily among householders aged 55 and up; by contrast, confidence among householders aged 35-54 declined slightly. General improvements were seen across the spectrum of income groups surveyed in November. Nonetheless, write-in responses revealed consumer remain preoccupied with rising prices in general, followed by war/conflicts and higher rates." *Headline* consumer confidence rose 2.9 points this month, to 102.0, after a three-month slump of 14.9 points (to 99.1 from 114.0). *Expectations* increased 5.1 points this month to 77.8, after plunging 15.3 points over the prior three-month period from an 18-month high of 88.0 in July to 72.7 during October. The report notes that the expectations component remained below 80.0 for the third straight month—a level that historically signals a recession within the next year. The *present situation* fell for the fifth successive months, by 17.1 points (to 138.2 from 155.3). *Current business conditions*, on balance, were a bit more optimistic, with the percentage of consumers saying business conditions were good climbing to 19.8% from 18.3% last month and the percentage saying business conditions were bad at 19.5%, up from 18.8% last month. Meanwhile, consumers' assessment of the *current labor market* was mixed this month, with 39.3% of consumers saying jobs are plentiful, up slightly from 37.9% in October; 15.4% said jobs are hard to get, up from 14.1% last month. *Short-term business conditions* (six-month outlook) on balance were less pessimistic in November: The percentage expecting conditions to improve climbed to 17.3% from 15.5% last month, while those expecting business conditions to worsen edged down to 19.5% this month from 20.9% last month. Consumers' assessment of the *short-term labor market* was slightly more favorable, with the percentage of consumers expecting more jobs to be available six months from now climbing to 16.1% from 15.3% last month and the percentage anticipating fewer jobs at 19.6%, a tick down from October's 19.7%. Consumers' *short-term financial prospects* improved in November, with 17.2% expecting their incomes to improve, up from 15.6% in October and 12.1% expecting their incomes will decrease, below October's 13.4%.

Regional M-PMIs (*link*): Five Fed districts now have reported on manufacturing activity for November—New York, Philadelphia, Kansas City, Dallas, and Richmond—and collectively they showed a slowing in the rate of decline. *Manufacturing activity* (to -4.7 from –7.6) contracted at the slowest pace since last July, as the New York (9.1 from -4.6) region

moved from contraction to expansion, while the Kansas City (-2.0 from -8.0) and Philadelphia (-5.9 from -9.0) regions were less negative. The Dallas (-19.9 from -19.2) area continued to contract at a fast pace, while Richmond (-5.0 from 3.0) moved from expansion to contraction. _New orders_ (-5.8 from -7.0) declined at a steady pace not far from the breakeven point of zero, with New York (-4.9 from -4.2) and Richmond (-5.0 from -4.0) billings contracting steadily as Philadelphia's (1.3 from 4.4) continued to expand at a sluggish pace and Kansas City's (0.0 from -22.2) stabilized after a steep contraction. Meanwhile, orders in the Dallas (-20.5 from -8.8) region contracted at a much faster rate. _Employment_ (-0.3 from 3.4) continued to hover around the breakeven point of zero, returning to negative territory this month after a brief move above zero, as factories in the Dallas (5.0 from 6.7) region continued to hire at a steady pace, Philadelphia (0.8 from 4.0) hirings were at a near standstill, and Richmond's (0.0 from 7.0) were at a standstill. Meanwhile, New York (-4.5 from 3.1) hirings swung from positive to negative, while Kansas City's (-3.0 from -4.0) continued to fall at a slow pace.

Regional Prices Paid & Received Measures (_link_): We now have November prices-paid and -received data for the five Fed regions—New York, Philadelphia, Richmond, Kansas City, and Dallas. (Note: The New York, Philadelphia, Dallas, and Kansas City measures are diffusion indexes, while Richmond's measures are average annualized inflation rates—which we multiply by 10 for easier comparison to the other regional measures.) The _prices-paid_ measure in November slowed for the second month to 17.5 this month, bouncing around its recent lows; this followed a pickup from 16.7 in June to 24.8 in September. It was as high as 40.7 this February, though peaked at 90.1 during November 2021. Looking at prices-paid indexes, the Philadelphia (14.8 from 23.1) measure has eased the past couple of months, after a brief move up to 25.7 in June, while the New York (22.2 from 25.5), Dallas (12.6 from 13.6), and Richmond (30.8 from 30.2) measures are increasing at a steady pace. Meanwhile, while Kansas City's (7.0 from -2.0) accelerated from October's dip into negative territory. Turning to the _prices-received_ measure, it eased in November for the second month, to 7.3—the slowest since August 2020. It was at a record high of 59.0 in March 2022. Prices-received indexes saw the New York (11.1 from 11.7) and Richmond (19.7 from 20.7) measures hold steady, while Philadelphia's (14.8 from 14.6) measure held steady just above 14.0 for the fourth month, down from May's recent peak of 23.0. Kansas City's (-3.0 from 0.0) measure continued to hover around zero, up from July and August readings of -7.0 and -6.0, respectively, while the Dallas measure (-6.2 from -2.1) remained in negative territory.

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