



## MORNING BRIEFING

January 23, 2017

### Too Hot for Goldilocks?

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

(1) Back to the Old Normal business cycle with a boom followed by a bust? (2) Our “benchmark model” sees the next recession starting in March 2019. (3) Bill, Larry, Janet, and Ronnie. (4) Fed’s Goldilocks now worrying that the economy might run too hot. (5) Obama’s jobless rate followed same track as Reagan’s! (6) The hottest market in America. (7) Buddy, can you spare a worker? (8) Auto industry running out of capacity, especially for light trucks. (9) Lots of tonnage to truck. (10) Driving to and from, and for, work. (11) Trump is the New Abnormal. (12) Movie review: “The Founder” (+ + +).

**US Economy I: Old vs. New Normals.** After Election Day, Debbie and I wrote that it might have marked the end of the New Normal and the resumption of the Old Normal. Instead of another four to eight years of secular stagnation, the traditional business cycle might make a comeback. Instead of “slower growth for longer,” it might be stronger growth with a boom setting the stage for a bust sooner rather than later.

We still think that the next recession isn’t likely to happen until March 15, 2019 (my birthday), but now we think it might be even more likely to happen around then rather than beyond that date. Previously, we’ve shown that during the past six economic upturns, the “recovery periods” (during which ground lost during the previous recessions was fully regained) averaged 33 months. We based that on the monthly Index of Coincident Economic Indicators (CEI) ([Fig. 1](#)). During the “expansion periods,” which followed the recoveries, the CEI rose into record-high territory until the next recession hit. The past five expansion periods lasted 65 months on average. The current expansion period started during November 2013. Using the average of the past five cycles, that would put the next cyclical peak at March 2019.

As we’ve noted in the past, that’s not a forecast but rather a simple benchmark based on the experience of the past five business cycles. The question we’ve addressed is whether the next recession is likely to happen sooner or later than this benchmark, given what we know currently. Since we too were in the slower-growth-for-longer camp prior to Election Day, March 2019 seemed like a reasonably distant time for the start of the next recession. Keep in mind, we first presented this benchmark on March 24, 2015. So far, so good.

Now what? Now that we are all living in Trump World, do we need to alter our outlook? We already did by raising our real GDP growth rate from 2.5% to 3.0% for this year. If Trump’s policies stimulate more growth, then the next recession could occur sooner. However, for now we conclude that a recession in 2019 might be more likely than beyond this benchmark. In other words, we still don’t see a recession this year or next year. With the benefit of hindsight, both the New Normal and its “secular stagnation” implications were more subjective than normative. Consider the following:

(1) *Gross*. The term “New Normal” was popularized by so-called Bond King Bill Gross starting in 2009. It was a very clever way to convince everyone that bonds would probably outperform stocks for the foreseeable future. Both bonds and stocks have done very well since then. In his 1/10 [Investment Outlook](#), Gross argues that his thesis remains intact:

“The longer term negatives of my ‘New Normal’ and Larry Summer's ‘Secular Stagnation’ may have disappeared from the business front pages of the FT and the NYT, but they have never really gone away--Trump or no Trump. Demographic negatives associated with an aging population, high debt/GDP now more at risk due to rising interest rates, technology displacement of human labor, and finally the deceleration/retreat of globalization pose negative ongoing threats to productivity and therefore GDP growth. Trump's policies may grant a temporary acceleration over the next few years, but a 2% longer term standard is likely in place that will stunt corporate profit growth and slow down risk asset appreciation.”

(2) *Summers*. “Secular stagnation” was a thesis popularized during 2013 by Harvard Professor Larry Summers--former Treasury Secretary under Bill Clinton and a card-carrying Keynesian. He was promoting more fiscal stimulus to revive growth. Now that Trump has proposed a program of fiscal stimulus, Summers thinks it's a bad idea. Just last week, he said so at the World Economic Forum in Davos: “The people who will be the victims of populist policies are the lower income and middle class people in whose name the policies are offered.”

(3) *Yellen*. Apparently, Fed Chair Janet Yellen has also changed her tune on fiscal stimulus since Election Day. Less than a month before that day, Jon Hilsenrath posted a 10/14 *WSJ* [article](#) titled “Yellen Cites Benefits to Running Economy Hot for Some Time.” Here is how Jon reported this story:

“The idea is called hysteresis in economic circles. Weak demand begets weak supply, something Ms. Yellen said--with some careful hedges--might be reversed if demand is boosted. ‘If we assume that hysteresis is in fact present to some degree after deep recessions, the natural next question is to ask whether it might be possible to reverse these adverse supply-side effects by temporarily running a ‘high-pressure economy,’ with robust aggregate demand and a tight labor market,’ [said] Ms. Yellen. ‘One can certainly identify plausible ways in which this might occur.’”

Then last Thursday, in a 1/19 [speech](#) at Stanford University, Yellen opined, “That said, I think that allowing the economy to run markedly and persistently ‘hot’ would be risky and unwise. Waiting too long to remove accommodation could cause inflation expectations to begin ratcheting up, driving actual inflation higher and making it harder to control. The combination of persistently low interest rates and strong labor market conditions could lead to undesirable increases in leverage and other financial imbalances, although such risks would likely take time to emerge. Finally, waiting too long to tighten policy could require the FOMC to eventually raise interest rates rapidly, which could risk disrupting financial markets and pushing the economy into recession.”

Yellen actually seemed to already have had second thoughts about fiscal stimulus during her 12/14 [press conference](#) when she said: “Well, I believe my predecessor and I called for fiscal stimulus when the unemployment rate was substantially higher than it is now. So, with a 4.6 percent unemployment and a solid labor market, there may be some additional slack in labor markets, but I would judge that the degree of slack has diminished. So I would say at this point that fiscal policy is not obviously needed to provide stimulus to help us get back to full employment. But, nevertheless, let me be careful that I am not trying to provide advice to the new Administration or to Congress as to what is the appropriate stance of policy.”

(4) *Reagan*. Funny, but we don't recall anyone talking about a New Normal or secular stagnation during the 1980s when Ronald Reagan was president. Yet when we line up the peak of the unemployment rate back then, when it rose to 10.8% during the end of 1982, and the peak of 10.0% during October 2009, the declines in both have been remarkably similar ([Fig. 2](#)). This leads us to conclude that maybe the New Normal this time was just an Old Normal recovery from a really bad recession. Conservatives

can certainly come up with lots of charges that Obama's policies contributed to the slow-paced recovery. Or maybe it just takes more time than usual to recover from a bad recession.

**US Economy II: Old Normal Redux?** Even before Trump won, the economy seemed to be moving toward a more traditional boom scenario, particularly in the labor market. Booms usually end with busts, but it could be a while before this one develops enough steam to raise the risks of a recession. If the Trump tax cuts are revenue-neutral as promised, they might not overheat the economy. If the infrastructure-spending programs really do incentivize the private sector to lead the way, that would be preferable to debt-financed government spending on such projects. So what's booming? Let's have a look:

(1) *Labor demand.* The hottest market in the US now may very well be the labor market. In the Fed's 1/18 *Beige Book* summarizing commentary on current economic conditions in the 12 Fed districts, the word "shortage" appeared seven times, referring to labor in all but one instance. It appeared in the previous recent *Beige Books* as follows 11/30 (7 times), 10/19 (18), 9/7 (14), 7/13 (13), 6/1 (8), 4/13 (12), 3/2 (11), 1/13 (10).

On a three-month-moving-average basis, 29.3% of small business owners surveyed in December by the National Federation of Independent Business (NFIB) reported that they had job positions that they were unable to fill ([Fig. 3](#)). That's the highest reading since March 2001. This series is highly inversely correlated with the national unemployment rate.

This NFIB series is also highly correlated with the Atlanta Fed's median wage growth tracker ([Fig. 4](#)). The latter has moved up sharply to 3.5% y/y in December, from 3.1% at the end of 2015 and 2.3% in mid-2014.

(2) *Auto sales and capacity.* Motor vehicle sales jumped to a cyclical high of 18.4 million units (saar) during December, while sales of domestically produced vehicles rose to 14.5 million units, near last year's cyclical high ([Fig. 5](#)). Sales of domestic light trucks have been in overdrive ([Fig. 6](#)). The industry might actually be capacity-constrained, as the capacity utilization rate has been running hot at around 85% at the end of last year ([Fig. 7](#)).

(3) *Truck tonnage.* The ATA truck tonnage index was very volatile last year, but its 12-month moving average rose to yet another fresh record high ([Fig. 8](#)). It's been doing so almost every month since January 2012!

(4) *Driving.* Gasoline usage rose to a record high last year, and so did vehicle miles traveled ([Fig. 9](#)). Where is everyone going? Fewer consumers are going to the malls or just as many are going less often. Instead, they are ordering what they need online. Such sales totaled a record 29.0% of in-store plus online sales ([Fig. 10](#)). So perhaps more people are driving to work or for work, as suggested by the trucking index.

Election Day not only may have marked the end of the New Normal but also may finally have buried the nattering nabobs of negativism who've been pitching the fearsome "Endgame" scenario since the start of the bull market in early 2009. Recall how they repeatedly warned that "this will all end badly"? We repeatedly said that they were likely to be wrong.

Nevertheless, this all still could end badly if Trump pushes his protectionist anti-trade agenda more aggressively than we expect. We still believe that many of his craziest stances are meant for establishing his negotiating position to make a deal favorable to America's side of the table. The risk is that while that approach might work in private-sector deal-making, it might not work in the domestic and

global political arena, where diplomacy is the norm. Nevertheless, Trump's New Abnormal way of doing deals is showing signs of working already. For example, the 1/18 Bloomberg [reported](#):

"China will cooperate with the incoming administration of Donald Trump to help promote healthy trade development and economic relations, a government spokesman said. 'China and the U.S. can find ways to solve problems through dialogue and negotiation,' Ministry of Commerce spokesman Sun Jiwen said Thursday at a briefing in Beijing. Bilateral trade and economic cooperation have made the two nations inseparable since relations were established more than three decades ago, and that's reinforced every day, Sun said."

**Movie.** "The Founder" (+ + +) ([link](#)) is a great biopic about Ray Kroc, the founder of McDonald's. He was a remarkable entrepreneur. One of his more famous quotes was: "Nothing in the world can take the place of Persistence. Talent will not; nothing is more common than unsuccessful men with talent. Genius will not; unrewarded genius is almost a proverb. Education will not; the world is full of educated derelicts. Persistence and determination alone are omnipotent." The only problem was that he lifted it verbatim from Calvin Coolidge. He also bamboozled the McDonald brothers to sell him their rights to the company including their name. His genius was the ability to take other people's great ideas and turn them into an extremely profitable business.

## CALENDARS

**US. Mon:** None. **Tues:** M-PMI Flash Estimate, Richmond Fed Manufacturing Index, Existing Home Sales 5.538mu. (Bloomberg estimates)

**Global. Mon:** Eurozone Consumer Confidence, Japan M-PMI Flash Estimate. **Tues:** Eurozone, Germany, and France Composite PMI Flash Estimates 54.5/55.4/53.2, Eurozone, Germany, and France M-PMI Flash Estimates 54.8/55.4/53.4, Eurozone, Germany, and France NM-PMI Flash Estimates 53.9/54.5/53.1, Japan Merchandise Trade Balance (yen) 280b, Australia CPI 1.6% y/y. (DailyFX estimates)

## STRATEGY INDICATORS

**YRI Weekly Leading Index** ([link](#)): Our Weekly Leading Index (WLI)--a good coincident indicator that can confirm or raise doubts about stock market swings--rose for the fourth week during the week of January 14 to a new record high, up 2.4% w/w and 4.3% over the period. Our WLI is the average of our Boom-Bust Barometer (BBB) and Bloomberg's Weekly Consumer Comfort Index (WCCI). Our BBB rebounded 4.4% and 7.8% over the comparable periods--also to a new record high. Jobless claims fell for the fourth week to 246,750, (4-wa), the lowest reading since November 1973. The CRB raw industrials spot price index--another BBB component--moved higher during the week, and is currently holding around recent highs. Meanwhile, the WCCI fell for the third week by a total of 3.2% after a five-week jump of 4.2%.

**Global Stock Markets Performance** ([link](#)): The US MSCI index fell 0.2% last week, ranking 20th of the 49 markets as 16 rose in US dollar terms--compared to 37th a week earlier, when it fell 0.1% as 35 markets moved higher. The AC World ex-US index underperformed the US MSCI for the eighth time in the past 10 weeks, falling 0.5% for the week versus a 1.0% gain a week earlier. EM Latin America was the best-performing region last week with a gain of 1.3%, followed by declines for EMU (-0.1%), BRIC (-0.2), EM Asia (-0.4), and EAFE (-0.5). The week's worst-performing regions: EM Eastern Europe (-1.4) and EMEA (-0.7). Last week's best-performing countries: Argentina (2.0), Brazil (1.9), Norway (1.2), Turkey (1.2), Chile (1.1), and New Zealand (1.0). Greece (-3.1) was the worst performer, followed by Egypt (-2.5), Pakistan (-2.4), Russia (1.9), and South Africa (-1.7). The US MSCI is up 1.6% ytd, which

ranks 30/49, and has been underperforming the AC World ex-US (2.5) on a ytd basis for the past two weeks. Forty of the 49 markets are positive ytd, led by Argentina (17.7), Morocco (9.0), Brazil (8.9), Korea (6.0), New Zealand (6.0), and the Philippines (6.0). The worst country performers ytd: Mexico (-3.5), Sri Lanka (-2.7), Greece (-2.1), Russia (-2.0), and Jordan (-1.6). The best-performing regions ytd: EM Latin America (4.9), BRIC (4.1), and EM Asia (3.9). The worst-performing regions: EM Eastern Europe (-0.2), EMEA (0.5), EMU (1.9), and EAFE (2.1).

**S&P 1500/500/400/600 Performance** ([link](#)): All three indexes fell last week, but the decline of 0.1% for LargeCap was smaller than those for MidCap (-0.7%) and SmallCap (-1.5). Thirteen of the 33 sectors rose in the latest week, down from 15 rising a week earlier and 27 the week before that, which was then the highest total in four weeks. LargeCap ended the week 0.2% below its January 6 record high, but MidCap and SmallCap remained 1.2% and 3.5% below their respective record highs in early December. Last week's best performers among sectors: LargeCap Consumer Staples (1.9), LargeCap Telecom (0.8), and LargeCap Real Estate (0.7). SmallCap Health Care (-2.8) was the worst sector performer last week, followed by SmallCap Telecom (-2.0) and SmallCap Consumer Discretionary (-1.8). Twenty-one of the 33 sectors are positive ytd, with LargeCap (1.5) now leading MidCap (0.9) and SmallCap (-1.2). The biggest sector gainers ytd: MidCap Health Care (3.6), LargeCap Tech (3.5), MidCap Telecom (3.3), LargeCap Consumer Discretionary (3.1), and LargeCap Materials (2.8). The worst performers ytd: SmallCap Consumer Staples (-3.4), SmallCap Consumer Discretionary (-2.9), SmallCap Financials (-2.8), and SmallCap Utilities (-2.3).

**S&P 500 Sectors and Industries Performance** ([link](#)): Eight of the 11 sectors rose last week, and nine outperformed the S&P 500's 0.1% decline--compared to four sectors rising a week earlier, when five outperformed the S&P 500's 0.1% decline. Consumer Staples was the best-performing sector for the week with a gain of 1.9%, followed by Telecom (0.8%), Real Estate (0.7), Materials (0.5), Utilities (0.3), Tech (0.2), Industrials (0.1), Energy (0.1), and Consumer Discretionary (-0.1). Financials was last week's worst performer, with a decline of 1.6%, followed by Health Care (-1.5). Eight of the 11 sectors are higher so far in 2017, and five are outperforming the 1.5% gain for the S&P 500. The best performers in 2017 to date: Tech (3.5), Consumer Discretionary (3.1), Materials (2.8), and Industrials (1.7). The sectors underperforming the S&P 500: Telecom (-1.5), Energy (-1.3), Financials (-0.6), Utilities (0.1), Real Estate (0.5), Health Care (1.3), and Consumer Staples (1.4).

**Commodities Performance** ([link](#)): Fourteen of the 24 commodities we follow rose last week, down from 17 rising a week earlier. Agricultural commodities dominated the week's best performers: Corn (3.1%), Coffee (2.6), Aluminum (2.1), Soybeans (2.0), and Silver (1.6). Last week's laggards: Nickel (-7.2), Natural Gas (-5.4), Cocoa (-3.3), Copper (-2.7), and Unleaded Gasoline (-2.6). Seventeen of the 24 commodities are higher so far in 2017, compared to 18 and seven higher during 2016 and 2015, respectively. The best performers in 2017: Lead (15.0), Coffee (11.8), Aluminum (9.2), Zinc (7.7), Silver (6.5), and Soybeans (6.3). This year's laggards: Natural Gas (-13.8), Unleaded Gasoline (-4.6), Heating Oil (-3.8), and Nickel (-3.1).

**Assets Sorted by Spread w/ 200-dmas** ([link](#)): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 10/24 commodities, 3/9 global stock indexes, and 8/33 US stock indexes compared to 16/24, 4/9, and 9/33 rising a week earlier, respectively. Eighteen commodities trade above their 200-dmas, the same as a week earlier, as Corn turned positive w/w and Nickel turned negative. Commodities' average spread fell to 5.4% from 6.2%. Various commodities dominated the relative valuation performance extremes last week: 1) Zinc trades 20.7% above its 200-dma, which is the highest of all commodities and all assets; 2) Corn (2.6%) improved 3.2ppts w/w relative to its 200-dma for the week's best performance among all commodities and all assets; 3) Cocoa (-22.9) trades at the lowest of all commodities and all assets relative to its 200-dma; and 4) Natural Gas (11.4) and Nickel (-3.9) both fell 7.8ppts for the week's worst performance among all commodities and all assets. The

global indexes trade an average of 6.7% above their 200-dmas, down from 7.0% above in the prior week. All nine of the global indexes trade above their 200-dmas, unchanged from a week earlier. Brazil (12.8) leads the global indexes, but China was the group's best performer last week as it gained 1.0ppts to 2.6%. Indonesia (1.7) is trading at the lowest relative to its 200-dma of the global assets, but the UK (7.4) had the weakest performance of its country peers last week as it fell 2.5 ppts. The US indexes trade an average of 6.7% above their 200-dmas, with 29 sectors above, down from a 7.6% average a week earlier when 29 sectors were also above. SmallCap Energy leads all US stock indexes at 20.3% above its 200-dma, but LargeCap Consumer Staples was last week's best performer among US stock indexes, as it improved 1.9ppts w/w to -0.8%. LargeCap Real Estate (-2.6) trades the lowest among US indexes relative to its 200-dma, but SmallCap Health Care was last week's worst performer among US stock indexes as it fell 3.1ppts to 0.8%.

**S&P 500 Technical Indicators** ([link](#)): The S&P 500 remained in a Golden Cross last week for a 39th week (after 17 weeks in a Death Cross) as the index's 50-day moving average (dma) improved relative to its 200-dma for a seventh straight week. Its 50-dma improved to a 13-week high of 3.9% above its 200-dma from 3.6% a week earlier and a six-month low of 2.0% in early December. That's down from a 30-month high of 5.4% in mid-September, but up from a 52-month low of -4.5% in early March. The S&P 500's 50-dma moved higher for a tenth week after six weekly declines, and the index closed the week above its 50-dma for a tenth week after nine weeks below. However, the S&P 500 dropped to 1.4% above its rising 50-dma from 2.1% a week earlier and a 38-week high of 4.8% above its rising 50-dma on December 13; that compares to a 52-month high of 6.2% on March 21 and a five-month low of -7.8% in mid-January. The S&P 500's bounce off its 200-dma in early November lost steam last week for the fourth time in five weeks: The index fell to 5.4% above its rising 200-dma from 5.8%, but remains below the 17-week high of 6.9% above its rising 200-dma on December 13. That compares to a 20-month high of 7.1% in mid-August and a six-month low of -10.0% in mid-February. The 50-dma and 200-dma both rose together for a tenth week after falling for eight weeks.

**S&P 500 Sectors Technical Indicators** ([link](#)): The short-term picture was broadly weaker for the 11 S&P 500 sectors last week, and the long-term picture was mostly weaker. Ten sectors still trade above their 50-day moving averages (dmas), down from all 11 above a week earlier as Energy fell below in the latest week. That's still a big turnaround from 11 weeks ago, when all 11 sectors traded below their 50-dmas for the first time since December 11, 2015. Seven of the 11 sectors were above their 200-dmas last week, unchanged from a week earlier. The four sectors still trading below their 200-dmas: Consumer Staples, Health Care, Real Estate, and Utilities. Only six sectors are in a Golden Cross now, with 50-dmas higher than their 200-dmas: Consumer Discretionary, Energy, Financials, Industrials, Information Technology, and Materials. All 11 had been in a Golden Cross during a 21-week streak that ended October 24, the longest such stretch since October 2014. Ten of the 11 sectors have rising 50-dmas, unchanged from a week earlier, but Consumer Staples' 50-dma turned higher w/w while Health Care's started falling. Six have rising 200-dmas, down from seven a week earlier as Health Care and Telecom turned flat in the latest week. These three still have a falling 200-dma: Consumer Staples, Real Estate, and Utilities.

## US ECONOMIC INDICATORS

**Housing Starts & Building Permits** ([link](#)): Housing starts in December remained very volatile, driven by multi-family starts. Builders broke ground on 11.3% more homes last month, rebounding to 1.23mu (saar) after sliding 16.5% in November to 1.10mu and jumping 25.5% in October to a nine-year high of 1.32mu. Multi-family starts soared 57.3% to 431,000 units (saar) after plunging 39.4% and surging 66.8% the prior two months. Single-family starts fell for the second month since reaching a cyclical high in October, slumping 4.0% m/m and 8.4% over the period to 795,000 units (saar). Single-family permits, on the other hand, rose for the fifth straight month, by a total of 14.9%, to 817,000 units (saar)--its

highest reading since fall 2007. Total building permits fell 4.0% in the two months through December to 1.21mu (saar), as multi-family permits sank 19.1% over the period to 393,000 units.

**Regional M-PMIs ([link](#)):** Two Fed districts so far have reported on manufacturing activity for January--New York and Philadelphia--and show growth accelerated for the third straight month. We average the composite, orders, and employment measures as data become available. The composite index (to 15.1 from 13.7) was in positive territory for the sixth month, climbing to its best reading since November 2014. It was driven by Philadelphia's measure (23.6 from 19.7), which was at a 26-month high; New York's (6.5 from 7.6) slipped a bit from December's eight-month high. The new orders index (14.6 from 12.7) showed activity grew for the fifth month--also reaching a 26-month high--as Philadelphia's index (26.0 from 14.9) soared to its highest reading since November 2014. Orders in New York (3.1 from 10.4) slowed from December's 27-month high. The employment measure in Philadelphia (5.6 from -4.3) was positive for the first time in 17 months as factories there (12.8 from 3.6) hired workers for the second month, at the fastest pace since April 2015. New York's employment measure (-1.7 from -12.2) showed continued job cuts, but at a slower pace.

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