



## MORNING BRIEFING

January 26, 2017

### Another Milestone

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

(1) Another nice round number. (2) Is popularity overrated? (3) Love him, or hate him. (4) Lots of happy surveys of consumer confidence, purchasing managers, regional business activity, and investor sentiment. (5) Silicon Valley may change the future more than Washington will. (6) Jackie explains why there might be more upside in both Semiconductors and Homebuilding.

**Strategy: Another Happy Day.** Yesterday was another happy day for the bull market that started on March 9, 2009, when the DJIA was 6547.05. Yesterday, it crossed 20,000 ([Fig. 1](#)). It closed above 1000 on November 14, 1972, 5000 on November 21, 1995, 10,000 on March 29, 1999, and 15,000 on May 7, 2013 ([Fig. 2](#)). I first joined Wall Street during January 1978 when EF Hutton hired me as an economist. The DJIA is up 2,314% since the start of my career on the Street. It is up 207% so far since March 9, 2009.

Despite the record high for stocks, polls like the [one](#) conducted by *The Washington Post* and ABC News showed that Donald Trump is the least popular incoming president of the past 40 years by a large margin. Needless to say, polls have been somewhat off the mark during the current election season. However, it's fairly obvious that roughly half the country is for him and half isn't. That's why I often start my latest analysis of his proposed and implemented policies with the phrase "love him, or hate him."

In any event, my job isn't to be a preacher judging Trump's character or actions against standards of right and wrong. Rather, I am an investment strategist. So my job is to judge whether his policies are likely to be bullish or bearish. For now, I remain bullish on stocks.

Love him or hate him, the DJIA is up 1,736 points, or 9.5%, since Election Day. The S&P 500 is up 7.4% since then ([Fig. 3](#)). Weekly and monthly measures of consumer confidence are up since Election Day ([Fig. 4](#)). The Consumer Confidence Index for people 55 years old and older jumped in December to the highest since February 2007, while it remained high, though not as euphoric, for younger people ([Fig. 5](#)). I guess Trump might have more fans among older folks than younger ones, especially Bernie supporters.

There's more. Markit's flash M-PMI rose to 55.1 during January, the highest since March 2015 ([Fig. 6](#)). The average of the three available business conditions indexes from the Fed regional surveys for NY, Philly, and Richmond is up from 0.5 during October to 14.0 during January, the highest since November 2014.

The only problem is that sentiment may be too bullish. The Investor Intelligence Bull/Bear Ratio has exceeded 3.00 for seven consecutive weeks ([Fig. 7](#)). Not to worry: Perhaps investors are simply coming around to my view that it isn't a good idea to underestimate President Trump, or to bet against him--whether you love him or hate him.

**Technology: Hot Semiconductors.** While we and everyone else have been focusing on Washington,

life goes on elsewhere. Without a doubt, the regime change in DC is dramatic. It is bound to significantly affect and alter the future course of our political, economic, and financial systems—well, at least for the next four years. However, the near and distant future may very well be even more significantly affected by what is happening in Silicon Valley.

Certainly, recent developments in autonomous cars, robotics, and artificial intelligence have captured the imagination of tech investors. One way they've played the future is by investing in the manufacturers producing the semiconductor chips that will run all of these new technologies. The S&P 500 Semiconductor industry index gained 42.9% over the past 12 months through Tuesday's close ([Fig. 8](#)). The Semiconductor Equipment industry index gained even more over the same period, 72.4%, making it the second best-performing of the S&P 500 industries we track for the period ([Fig. 9](#)).

Semi stocks have also been boosted by lots of M&A activity and hopes that semiconductor revenues growth will pick up to the mid-single-digits this year. Gartner expects that last year's lackluster 1.5% y/y sales growth will be followed by a 7.2% y/y increase in worldwide revenue to \$364.1 billion in 2017, according to the company's 1/23 [press release](#).

The pickup in growth doesn't come from traditional areas like cell phones and computers. Those segments have moved from growth mode to replacement mode. Instead, the growth is coming from new areas like self-driving cars, the Internet-of-things, and cloud computing. Here's a look at some of the recent developments charging up the chip industry:

(1) *Driving sales.* The more our cars can do, the more computing power they must include. That's good news for the semiconductor industry. "J.P. Morgan estimated that the total available market for semiconductors used in semiautonomous and fully autonomous cars will reach about \$7.3 billion by 2025, a compounded annual growth rate of approximately 62.5% starting in 2017," reported an 8/27 MarketWatch [article](#). "That estimate assumes that semiautonomous and fully autonomous cars together will make up about 15.7% of a projected 109.6 million light vehicles produced globally. The total cost of all the chips per vehicle will rise to \$400 to \$500 a car, up from \$300 to \$400 from ADAS functions." The total world market for automotive semiconductors grew to \$30.3 billion last year, and is expected to hit about \$41 billion in 2020.

(2) *Game on.* Nvidia has been one of the best-performing semi stocks over the past year, climbing 269.4% y/y through Tuesday's close. Known for graphics processing chips that power video game machines, Nvidia's shares have performed so well because investors believe the company's chips will be used in gadgets that have artificial intelligence and in driverless cars.

Nvidia has "an ambitious goal of getting a Level 4 driverless car--an almost fully autonomous car--on the market by 2020, which it is executing through a partnership with Audi. It also announced an initiative with Bosch to enhance artificial intelligence in automobiles, e.g., cars that can sense when you are sleeping or texting while driving, as well as a smart home hub through its Shield brand that will be powered by Alphabet Inc's Google Now artificial intelligence," relayed a 1/7 MarketWatch [article](#).

According to the *FT*, Nvidia has a technological lead over industry titan Intel. Nvidia "is widely credited with having developed the best chips for training the artificial neural networks built by companies including Google, Amazon and Baidu to do things like recognize images or understand language," as a 12/30 *FT* [article](#) explained. It quoted Patrick Moorhead, a chip analyst at Moor Insights and Strategy: "I've never seen such agreement about a technology. I think they're two to three years ahead of Intel." But he added that Intel also has the same market in its sights and shouldn't be counted out.

After their strong rally over the past year, Nvidia's shares, at a recent \$107.33, trade at almost 40 times

Wall Street analysts' 2017 consensus earnings estimate of \$2.75 a share. If achieved, that would mark earnings growth of 13.6%.

(3) *Stale chips*. Not all semiconductor stocks have been moonshots. Intel shares, for example, have risen 25.7% y/y, modestly faster than the S&P 500's 19.6% gain. The company has been held back relative to other semiconductor peers because more of its chips are used in personal computers, which have suffered from declining sales, and in servers, which have slowing sales. Worldwide PC shipments fell 3.7% y/y in Q4, and for all of 2016 they declined 6.2% y/y, estimates Gartner in a 1/11 [press release](#). PC shipments have declined annually since 2012 and are expected to remain stagnant.

Semis for servers kick in about a third of Intel's revenue, and that market is also undergoing radical change. Fewer companies are buying servers because they're using cloud services from Amazon.com, Alphabet's Google, and Microsoft. Those cloud companies are certainly buying servers, but their large size gives them a better bargaining position. "Their growing market clout gives them the ability to push Intel for more specialized designs, which raises Intel's costs. The data-center group's operating earnings fell 1.6% year over year for the 12-month period ended Oct. 1, despite a 7% gain in sales in that time," noted a 1/23 [WSJ article](#). Shares of Intel, which reports earnings today, trade at 13.4 times Wall Street analysts' fiscal 2017 consensus earnings estimates.

(4) *M&A boost*. The semi industry has been blessed with a torrid M&A environment as small companies specializing in some of the new technologies are getting snapped up by larger competitors. A 11/14 [WSJ article](#) reported: "Semiconductor companies have capped more than \$240 billion worth in mergers and acquisitions in the past two years, according to Dealogic. This year's total to date--\$130.2 billion--is a record, 16% above the previous high set last year. Big deals skew the dollar total, but there have been plenty of those, too. Six transactions in the past two years have been worth more than \$10 billion and three topped \$30 billion."

More normal years since 2000 have seen only \$20 million to \$40 million of deals done annually. The author's conclusion: The pace of M&A will likely slow as the best companies have been purchased and those with the ability to do a deal have already done so. That conclusion leaves us wondering how much of an acquisition premium remains in smaller stocks and whether that premium will dissipate.

(5) *The numbers*. Analysts expect the S&P 500 Semiconductors industry to grow revenue by 8.9% this year and 4.4% in 2018 ([Fig. 10](#)). The industry's forward profit margin has increased by 4.2ppts to a record high of 24.2% since the beginning of 2016 ([Fig. 11](#)). As a result, earnings are thought to grow 15.9% this year and 8.3% in 2018 ([Fig. 12](#)). Net earnings revisions have been positive since the second half of 2016, with readings of 15.6% in January, 17.1% in December, and 15.6% in November ([Fig. 13](#)).

The S&P 500 Semiconductors industry's forward earnings multiple has ranged between 10 and 20 times over the past 20 years, with the exception of the 1999-2000 Tech bubble when the multiple soared much higher ([Fig. 14](#)). With a forward P/E of 15.2 and earnings still growing, this industry looks like it still has room to head higher.

(6) *Shovel-makers*. Another way to invest in the sector is to purchase stocks in the S&P 500 Semiconductor Equipment industry, composed of companies that make the equipment to manufacture the chips. However, this strategy is far from a secret. As we mentioned above, the industry has gained 72.4% over the past year, and one of its largest stocks, Applied Materials, gained 99.6% over the past year. That leaves Applied Materials' shares trading at 14.4 times 2017 expected earnings and leaves the industry's forward P/E at 13.8.

Normally a below-market multiple would be a good thing. However, semi equipment companies are

typically cyclical. Earnings multiples are high at the bottom of the cycle when earnings are low and shares are undervalued. Conversely, multiples are low when earnings are high at the top of the cycle. The S&P 500 Semiconductor Equipment industry cycle, Joe informs us, lasts about a year or two, and the current cycle is long in the tooth, having begun in 2015 ([Fig. 15](#)). Earnings are at record levels, as are margins ([Fig. 16](#) and [Fig. 17](#)).

In the past when forward earnings peaked, the industry's forward P/E was between 10 and 15. There were two exceptions: During the tech boom of 1999-2000, when the forward earnings multiple exceeded 30 and earnings were hitting a peak, and in 2002, when the excesses of the tech boom were still being shed ([Fig. 18](#)). So while the technology being developed seems awfully cool, the numbers are warning that there have been better times to buy this industry.

**Consumer Discretionary: Housing Has Upside.** Homebuilding stocks have lagged the S&P 500 over the past year due to concerns about rising interest rates and rising costs. The S&P 500 Homebuilding index gained 13.1% over the past year, trailing the S&P 500's 19.6% run. The industry may be worth another look, however, because higher rates have only slightly dented demand and inventories of homes for sale remain exceedingly low.

Existing home sales dropped 2.8% in December m/m, as the median sale price rose 4.0% y/y and mortgage rates jumped to 4.32% from 3.50% in early November, a 1/24 [WSJ article](#) reported. For the full year, existing home sales hit 5.45 million units, the best in a decade, even as sales declined in December.

What gives us optimism about the future is the lack of homes on the market. The number of existing homes available for sale in December fell to 1.65 million; that's 10.8% below November's level and 6.3% lower than year-ago levels. Existing home sale inventories are at the lowest level since NAR began tracking the supply of housing in 1999. "[Inventory] has fallen year-over-year for 19 straight months and is at a 3.6-month supply at the current sales pace," reported the National Association of Realtors' 1/24 [press release](#) ([Fig. 19](#) and [Fig. 20](#)).

Recent reports from homebuilders have been reassuring. DR Horton reported on Tuesday a 31.0% jump in earnings to 55 cents a share in its December quarter, which beat Street estimates by 8 cents. The company also reaffirmed its 2017 revenue guidance, a range of \$13.4 billion to \$14.8 billion, and said new orders in the quarter increased 14%. The shares jumped 6.6% on the news Tuesday and sent other shares in the industry higher as well.

Homebuilders are expected to post revenue growth of 11.7% and earnings growth of 15.1% this year and 11.1% in 2018 ([Fig. 21](#) and [Fig. 22](#)). This too is a cyclical industry, so investors are wise to buy when earnings multiples are high and sell when they are low. Homebuilders' forward P/E is 10.1, not as high as it was during the housing market's implosion but likewise not the single digits it was in the run-up to 2006 ([Fig. 23](#)). With inventories tight and the job market strong, this sector's staying power may surprise doubters.

## CALENDARS

**US. Thurs:** Leading Indicators 0.4%, Jobless Claims 246k, New Home Sales 595k, Advance Merchandise Trade Balance -\$65.5b, Kansas City Fed Manufacturing Index, Chicago Fed National Activity Index, NM-PMI Flash Estimate, Weekly Consumer Comfort Index, EIA Natural Report. **Fri:** Real GDP & Price Deflator 2.2%/2.1%, Durable Goods Orders Total and Ex Transportation 2.6%/0.5%, Consumer Sentiment Index 98.2, Baker-Hughes Rig Count. (Bloomberg estimates)

**Global. Thurs:** UK GDP 0.5%q/q/2.1%y/y, Japan Headline, Core, and Core-Core CPI 0.2%/-0.3%/-0.1% y/y. **Fri:** Germany Retail Sales 0.6%m/m/0.4%y/y. (DailyFX estimates)

## STRATEGY INDICATORS

**Stock Market Sentiment Indicators** ([link](#)): The Investors Intelligence Bull/Bear Ratio (BBR) slipped to 3.33 this week from 3.50 last week--which was the highest reading since early May 2015. It's the seventh straight week above 3.00. Bullish sentiment fell to 58.2% from 60.6% last week, which was the most bulls since July 2014. Bearish sentiment was 17.5%, little changed from last week's 17.3%, which was the fewest bears since July 2015. The correction count climbed to a nine-week high of 24.3%; it remains near its 20.6% reading four weeks ago, which was the lowest since June 2014. The AAll Bull Ratio fell for the second week last week to 53.1% after climbing the prior three weeks from 58.0% to 64.7%. Bullish sentiment fell from 46.2% to 37.0% over the two-week span, while bearish sentiment rose from 25.2% to 32.7% over the period.

**AC World ex-US MSCI** ([link](#)): This index is up 3.2% ytd in dollar terms after rising 1.7% in 2016. In local-currency terms, the index has risen 1.2% ytd compared to its 4.1% gain for all of 2016. Local-currency forward revenues has risen 4.4% from a five-year low in March 2016, but has been more stable longer term and is down just 6.3% from its October 2014 record high. Local-currency forward earnings has performed better, with a 10.3% rise from its six-year low in March 2016, but remains 14.2% below its September 2008 record. Revenues are expected to rise 6.5% in 2017 and 4.8% in 2018 following a 0.7% decline in 2016, and earnings are expected to rise 14.2% (2017) and 10.0% (2018) after rising 2.5% (2016). Analysts are forecasting STEG of 13.6%, a 45-month high and up from their 6.3% forecast in January 2016, which was the lowest in seven years. The implied profit margin is expected to rise to 7.4% in 2017 from 6.9% in 2016 before improving to 7.8% in 2018. NERI turned positive in January for the first time since March 2011, rising 1.1ppts to 0.4% from -0.7% in December, and compares to a 51-month low of -11.3% in March 2016. The P/E edged down to 14.1 in January from 14.2 in December, which compares to a 16-month low of 12.4 in February 2016 and a six-year high of 15.3 in April 2015. The index's 10% discount to the World P/E has deepened from a 6% discount last April and is near historical lows.

**EMU MSCI** ([link](#)): The EMU's MSCI price index has gained 2.3% ytd in dollar terms after falling 1.2% in 2016. In euro terms, the price index is up a lower 0.3% ytd following a 1.2% decline for all of 2016. Euro-based forward revenues has improved 1.8% from its six-year low in May 2016, but remains 2.4% below its cyclical high (August 2015) and 9.0% from its record high (September 2008). Euro-based forward earnings is stalled too--at 1.0% below its cyclical high (September 2015) and 28.6% below its record high (January 2008)--but has improved 5.9% from its 23-month low in June 2016. Analysts expect revenues to rise 4.7% and 3.5% in 2017 and 2018, respectively, after falling an expected 1.6% in 2016, but think earnings will rise 12.3% in 2017 and 10.7% in 2018 after a forecasted 1.0% gain in 2016. STEG of 12.2% is down slightly from a 17-month high of 12.7% in December, which compares to a seven-year low of 5.6% in April 2016 and is well below April 2015's 15.6%. STEG has been higher than LTEG (9.0%) since July after trailing it since late 2015. The forward profit margin has improved 0.8ppts to 7.0% from a cyclical bottom of 6.2% in May 2013. The implied profit margin is expected to improve to 7.0% in 2017 from 6.4% in 2016 before rising another 0.5ppts to 7.4% in 2018. NERI was positive for a second straight month in January as it improved 2.4ppts m/m to a 19-month high of 2.6% from 0.2% in December. NERI is up from a 24-month low of -13.2% in April 2016, but down from a 56-month high of 4.0% in May 2015. The P/E of 14.2 is down from a 13-year high of 16.4 in April 2015, but up from a 30-month low of 12.2 in February 2016. That represents a 9% discount to the World MSCI's P/E now, up from a record-low 25% discount during 2011. But the current reading is still well below the 1% premium during April 2015--the post-euro-inception record high.

**Emerging Markets MSCI** ([link](#)): The EM MSCI price index is up 5.4% ytd in US dollar terms after rising 8.6% in 2016. In local-currency terms, EM has gained 4.0% ytd compared to a 7.1% gain in 2016. Local-currency forward revenues is up 2.2% from a four-year low in June to 14.0% below its November 2014 record. Local-currency forward earnings has improved 10.5% from April 2016's six-year low and is down just 9.6% from its January 2014 record. Revenues are expected to rise 9.4% in 2017 and 7.9% in 2018 following a 2.6% gain in 2016, leading to earnings gains of 14.8% (2017) and 11.6% (2018) following an 8.6% rise in 2016. STEG of 14.7% is up from a seven-year low of 6.0% in February 2016, and is above LTEG (13.5%) for the first time since July 2013. The implied profit margin is expected to improve to 6.6% in 2017 from 6.3% last year before moving even higher to 6.9% in 2018. The forward profit margin of 6.6% is more than 3ppts below its 10.3% record high (December 2007), but up from a record low of 6.0% in February 2016. NERI--negative for 71 months--improved m/m to 2.9% from -3.1% in December, which compares to a 63-month high of -1.6% in September 2016 and an 83-month low of -10.2% in March 2016. Emerging Markets' valuation has been more stable recently than that of the rest of the world. The P/E edged down to 11.9 in January from 12.0 in December, which compares to a 17-month low of 10.2 in August 2015 and a four-year high of 12.6 in April 2015. The index is trading at a 24% discount to the World MSCI P/E, up from a 10-year-low 30% discount in August 2016.

**MSCI World & Region Net Earnings Revisions** ([link](#)): Analysts' recent earnings revisions through January suggest rising optimism about profits across the world as all regions improved m/m except the United States. The AC World MSCI's NERI was negative for a 67th straight month, but improved 0.8ppts to a 56-month high of -0.4% from -1.1% in December. The AC World Ex-US was positive for the first time in 70 months, improving 1.1ppts to 0.4% from -0.7% in December. EM Eastern Europe and Europe were positive for a fourth straight month; EAFE and EMU were positive for a second month. January's scores among the regional MSCIs: EM Eastern Europe (up to an 81-month high of 3.8% from 3.1% in December), EAFE (78-month high of 3.3, 1.2), Europe (72-month high of 2.8, 1.2), EMU (19-month high of 2.6, 0.2), Europe ex-UK (19-month high of 2.3, -0.7), AC World ex-US (70-month high of 0.4, -0.7), AC World (56-month high of -0.4, -1.1), EM Latin America (-2.0, -2.5), United States (-2.2, -2.2), Emerging Markets (-2.9, -3.1), and EM Asia (-3.2, -3.4).

**MSCI Countries Net Earnings Revisions** ([link](#)): NERI was positive for 23/44 MSCI countries in January, the highest in 70 months and up from 20/44 in December. NERI improved m/m in January for 30/44 countries, the most in three months and up from 27/44 improving in December. Hungary's NERI was at a record high, followed by Egypt (160-month high), Hong Kong (72), Chile (65), Sweden (56), Malaysia (37), Poland (35), and Australia (34). On the flip-side, Mexico was at a 20-month low, followed by Argentina (14) and Greece (10). The 10-month positive NERI streak for Hungary is the best, followed by nine-month positive streaks for Peru, Portugal, and Russia. NERI turned positive for six countries: Australia, Finland, Ireland, Netherlands, Norway, and Spain. NERI turned negative for three countries: Belgium, Czech Republic, and Greece. Hungary's is the strongest recently, with positive readings in 20 of the past 21 months. Brazil's NERI has been negative for 79 straight months, followed by the negative streaks of Singapore (70), Chile (66), and Malaysia (53).

**S&P 500 Earnings Season Monitor** ([link](#)): With nearly 18% of S&P 500 companies finished reporting Q4-2016 results, their revenue and earnings surprise metrics are weaker than at the comparable point of the Q3 season. On a mixed note, their y/y earnings growth comparisons are stronger, but y/y revenue growth has slowed. Of the 89 companies in the S&P 500 that have reported, 70% exceeded industry analysts' earnings estimates by an average of 3.8%; they have averaged a y/y earnings gain of 9.9%. At the same point in Q3-2016, a higher percentage of companies (79%) in the S&P 500 had beaten consensus earnings estimates by a larger 7.3% and earnings were up a smaller 4.0% y/y. On the revenue side, 47% beat sales estimates so far, coming in exactly as analysts forecasted and 1.9% higher than a year earlier. During Q3, a higher 65% were above forecast, which exceeded estimates by 0.8% and rose 2.5% y/y. Q4 earnings results are higher for 78% of companies versus 68% at the same

point in Q3, and revenues are higher for 70% versus 72%. These figures will change markedly as more companies report Q4 results, but early data suggest Q2 was indeed the bottom for y/y earnings growth.

## GLOBAL ECONOMIC INDICATORS

**Germany Ifo Business Climate Index** ([link](#)): “The German economy made a less confident start to the year,” Ifo President Clemens Fuest said; that January result comes after business confidence finished 2016 at its highest level since March 2014. The Ifo business climate index unexpectedly retreated to 109.8 this month after climbing from a recent low of 106.3 in August to a cyclical high of 111.0 in December. Businesses were more optimistic about the present but somewhat less optimistic about the future. The present situation component advanced for the fifth straight month from 113.0 in August to 116.9 this month--the highest since November 2011. Meanwhile, the expectations component declined for the second time in three months, falling to 103.2, after reaching a cyclical high of 106.0 in October. The expectations component correlates closely with German factory orders and production; the overall index tracks exports more closely. Recent data still indicate a pickup from the summer slowdown, though not as robust as December sentiment suggested.

---

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 & Webmaster, 570-775-6823

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