Yardeni Research, Inc.

MORNING BRIEFING
February 27, 2017

Timing Isn't Everything

See the collection of the individual charts linked below.

(1) On the verge of civil, trade, and cyber wars? (2) The curse of Cain on Little Kim. (3) Stocks staying focused on setting record highs. (4) Saber-rattling at the FOMC. (5) Bond yield remains in our 2.00%-2.50% range. (6) S&P 500 revenues rise to record high during Q4-2016. (7) More evidence that the earnings recession is over. (8) Margins remain at record levels, frustrating reverting-to-the-mean bears. (9) CEO of Dow Chemical says Trump administration is the most pro-business ever. (10) Bull market may remain resilient even if Trump's bullish agenda falls behind schedule. (11) Movie Review: "Bitter Harvest" (- -).

Strategy I: Revenues. We live in turbulent times. The headlines make it sound like the nation is on the verge of a civil war, trade wars, and cyberwars. The Russians have a spy ship 30 miles off our East Coast. That seems odd, since they've been accused of accessing any and all information they want out of the US simply by hacking into our computers from the comfort of their basements. Little Kim—North Korea's version of a Stalinist "Big Brother"—is suspected of having had his half-brother fatally poisoned with the nerve agent VX, an internationally banned chemical weapon that can kill within minutes. That should worry anyone in range of his missiles who wasn't already concerned. Mexicans are burning effigies of President Donald Trump. Anti-Trump protesters in cities across our country took to the streets last Monday, which was President's Day, for "Not My President's Day" rallies. Mutual political enemies reportedly are compiling lists of one another, presumably for nefarious reasons. How much of all this is fake news, we can't be sure.

Yet the S&P 500 is up 10.6% since Election Day to a record high (*Fig. 1*). That's even though the administration has yet to move forward on actually cutting taxes and repatriating overseas profits, which presumably is why the stock market has been so strong. Last week, some of the infrastructure-related stocks that have been doing so well since Election Day weakened on news (possibly fake, as we explain below) that the administration may not be ready to do much to stimulate infrastructure spending until next year. The market moved higher regardless, led by the S&P 500 Utilities sector, as bond yields eased--with the US Treasury 10-year yield remaining comfortably in our 2.00%-2.50% range for the first half of the year. That happened despite saber-rattling by the members of the FOMC in the minutes of their January 31-February 1 meeting released last Wednesday (*Fig. 2* and *Fig. 3*).

Most significantly, the minutes said that "many participants expressed the view that it might be appropriate to raise the federal funds rate again fairly soon if incoming information on the labor market and inflation was in line with or stronger than their current expectations." That certainly doesn't preclude a hike at the March 14-15 meeting. Yet even the dollar gave back some of its recent gains last week (*Fig. 4*). Also notable is that the yield spread between high-yield corporate bonds and the US Treasury 10-year bond yield fell last week to the lowest since September 9, 2014 (*Fig. 5*). That's a strong vote of confidence in the economy, for sure.

So far, the market is remaining calmly bullish and ignoring the tempestuous headlines. As for the delays in the bullish items in the Trump administration's economic agenda, don't worry, be happy—they'll probably happen, as Melissa discusses below. Timing isn't everything, as long as investors are convinced that Trump will deliver on his bullish goodies in the foreseeable future, i.e., within the next two years. Meanwhile, we can take comfort in the recovery of S&P 500 revenues and earnings. Joe updated our chart publications with the Q4 data released at the end of last week. Here are the key developments for revenues:

(1) *Record high.* S&P 500 revenues per share rose to a record high during Q4-2014 (*Fig. 6*). The severe recession in the energy sector depressed total revenues during 2015. However, total revenues recovered over the past three quarters through Q4-2016. On a per-share basis, it was up 4.5% y/y, the best growth rate since Q3-2014 (*Fig. 7*). These comparisons have actually been increasingly positive during each of last year's quarters after falling during each quarter of 2015.

(2) *Looking higher ahead.* The y/y growth rate of S&P 500 revenues per share is highly correlated with the y/y growth rate in manufacturing and trade sales (*Fig. 8*). The latter was up 5.2% during December. The growth rate in revenues per share is also highly correlated with the US M-PMI, which rose sharply in January (*Fig. 9*). The three available Fed district business surveys through February show an incredibly strong increase in their average composite indexes, from 3.2 during October to 25.3 during February (the highest since July 2004!), suggesting that February's M-PMI will surpass January's elevated reading (*Fig. 10*). Also looking up is the weekly series for S&P 500 forward revenues per share. It continues to rise in record-high territory (*Fig. 11*).

(3) *Minor dollar impact.* Joe and I continue to be amazed by how little effect the strong dollar has had on S&P 500 revenues (*Fig. 12*). The trade-weighted dollar is up 23% since July 1, 2014, yet most of the weakness in revenues during 2015 seems to have been energy-related, as evidenced by last year's recovery in revenues. Perhaps production of goods is so globally intertwined that currencies don't have the impact they once did on revenues, earnings, exports, and imports. What companies lose on exports, they gain on imports. It's not as clear how revenues and earnings have become less currency-sensitive. In any event, this highly integrated global system doesn't augur well for Trump's attempts to upset it (or vice-versa!).

Strategy II: Earnings & Margins. S&P 500 operating earnings per share, based on Thomson Reuters data, rose 6.2% y/y during Q4-2016 *(Fig. 13*). This series fell 11.7% from its record high during Q4-2014 to its recent low during Q1-2016 (*Fig. 14*). That earnings recession was mostly attributable to the collapse in earnings in the S&P 500 Energy sector. Total S&P 500 earnings are up 16.3% over the past three quarters to a new record high. The recession was deeper based on S&P operating earnings data, which aren't as liberal as Thomson Reuters when it comes to excluding bad stuff.

We can calculate profit margins using the earnings and revenues data (*Fig. 15*). The bottom line is that both actual and forward margins, based on Thomson Reuters data, are holding up near their recent record highs. The bears, who've been growling about margins reverting to their means, have gone into hibernation and can probably stay there for a while longer.

Joe and I also keep track of earnings for the 10 major sectors of the S&P 500 (*Fig. 16*). The sector earnings data using both S&P and Thomson Reuters sources show continuing uptrends since the start of the bull market in 2009 for Consumer Discretionary, Financials, Health Care, Industrials, and Information Technology.

We continue to forecast that S&P 500 earnings per share will get a big boost this year from significant cuts in the statutory corporate tax rate to 15% and the costs of complying with onerous government business regulations. We concede that these Trump policy initiatives may take longer to accomplish than we had expected when we raised our 2017 S&P 500 earnings estimate from $128 to $142 on December 13. That may not be a problem if these changes are made retroactive to this year. If not, and they don't kick in until next year, then we will revert our 2017 forecast back down to (now) $129, but keep our 2018 estimate at $150, up from $137, our pre-Trump estimate. (See *YRI Earnings Forecasts*.) We don't think the market will mind. Read on.

US Fiscal Policy: Pro-Business. President Trump will deliver a speech before Congress on Tuesday. President Barack Obama didn't officially give a State of the Union address in 2009, and no president since John F. Kennedy has called his first speech before Congress a "State of the Union." Nevertheless, Trump's will be closely followed and parsed by investors for any signs that the administration's tax reform or infrastructure programs might be delayed. Indeed, a few stock market gurus already have advised their followers to sell before the speech since it may mark the beginning of a growing realization that now the hard part is ahead for the new administration—namely, realizing their lofty goals on cutting taxes and boosting infrastructure spending.

Melissa, Joe, and I believe that the market may prove surprisingly resilient to any hint of delays in delivering the goodies that the market has been discounting since Election Day. One reason we're sanguine is that business leaders on Trump's business advisory council, such as Dow Chemical CEO Andrew Liveris, appear to be. ABC News quoted Liveris last Thursday, after a second White House meeting with other business leaders: "Some of us have said that this is probably the most pro-business administration since the founding fathers … There is no question that the language of business is occurring here at the White House. The working groups are right down the sweet spots of bringing back manufacturing jobs for the new century, back to this country."

Maybe that's all we have to know to stay bullish. Maybe that's why the market might not drop much on any timing delays. Besides, by the time we know whether the tax cuts hit this year or next year, we will be at least half way closer to 2018, at which point forward earnings will be evenly weighted by this year's estimate and next year's estimate. I asked Melissa, who has volunteered to be our fiscal policy watcher, to summarize the latest timing issues:

(1) *First, ACA R&R.* Repealing and replacing (R&R) the Affordable Care Act (ACA) is the political priority for Republicans in Congress, which could delay tax reform. It is an especially contentious issue that does not have broad bipartisan support, though a surprising number of Democratic lawmakers say they'd play ball if the changes aren't too far-reaching, according to Politico. Under the usual process, a filibuster in the Senate by the Democrats would likely be inevitable for the ACA R&R. Republicans could not stop it with their 52-vote majority because 60 votes would be required to do so.

But there's a potential way around it via the so-called reconciliation process. As we discussed last week, it prohibits filibusters and only requires a simple majority vote to expedite the passage of bills. It doesn't automatically turn bills that pass this round into law. Instead, reconciliation indicates general bi-partisan agreement that the budgetary guidelines outlined in the directive will be adhered to by congressional committees. Reportedly, congressional Republicans are aiming to utilize reconciliation to get both the ACA R&R and tax reform done this year. Reconciliation aside, Treasury Secretary Steven Mnuchin said in a 2/23 CNBC interview: "We want to get [the tax cuts] done by the August recess. We've been working closely with the leadership in the House and the Senate and we're looking at a combined plan." But again, the ACA R&R is currently scheduled to go first.

(2) *For the record*. The wording in our prior notes on the subject implied that reconciliation would seem to preclude both from happening this fiscal year. Although a long shot, it might be possible that both do get done this fiscal year after all. Chuck Gabriel, a very good friend of ours and a leading expert on the budget process, sent us the following heads-up by email: "There would be nothing stopping the GOP Congress from passing a revenue-related FY17 reconciliation bill, containing repeal of Obamacare taxes, say by April [or] May … then passing an FY18 budget resolution, rebooting the process and

allowing them to pass another revenue-related reconciliation bill (to enact tax reforms) by August."

Chuck, who is president of Washington-based research firm Capital Alpha Partners, has been following the reconciliation process since the first time it was used in 1981. He added that while congressional Republicans probably won't be able to meet these aggressive timelines, procedural obstacles won't be to blame. It's true that only one reconciliation bill of such complexity can be approved at once. But that rule pertains only to the governing budget resolution, which is currently FY17. Once that's done, then another reconciliation bill could be passed under the FY18 budget during the 2017 calendar year—or even this fiscal year.

(3) *Speed bumps*. A 2/12 *Forbes* article outlined how the GOP's "grand scheme" to leverage reconciliation could quickly fall apart. The author opined: "The GOP leadership could delay the FY18 budget resolution until the ACA repeal reconciliation bill is enacted, but that would greatly reduce the amount of time available for both the 2018 appropriations and tax reform." Such a time crunch would spell trouble: "It would virtually guarantee that federal departments and agencies would start fiscal 2018 with a continuing resolution instead of the individual appropriations the House and Senate leadership have promised." Broken promises of quick ACA R&R and tax reform would "seriously exacerbate what has already become a significant political problem for congressional Republicans and the Trump administration."

"Finally, if ACA repeal isn't enacted by the time the next budget resolution is adopted, that FY18 budget resolution could include new reconciliation instructions for both the repeal and tax reform so the process would begin again," the author explained. "But the budget process rules prohibit more than one tax or spending reconciliation bill from being considered in response to the instructions included in a budget resolution and ACA includes both tax and spending provisions. Therefore, to do both ACA repeal and tax reform at the same time, all of the changes would have to be included in a single, very large and extremely controversial reconciliation bill." Such a controversial bill could "prevent the GOP from getting even a simple majority on their two highest legislative priorities."

(4) *Traffic jam.* On a separate but related matter, Republican sources reportedly told Axios that Trump is putting off his promise to stimulate infrastructure spending until next year. The article suggested that Trump has his hands full with the ACA R&R and tax reform. Other news media picked up on this headline, reporting that the Trump team was prioritizing just $137 billion in projects versus the $1 trillion promised at campaign time. It seems to us that the sources sound a bit speculative and the numbers misconstrued. It seems to us that the sources might not be well informed and might have misconstrued the numbers.

As Melissa and I previously discussed, Trump's infrastructure plan could be based on a pre-Election Day white paper written by Peter Navarro, who now heads Trump's new National Trade Council, and the now-Secretary of Commerce Wilbur Ross. It explained that the administration might encourage private investors via an 82% tax credit to commit to a $167 billion equity investment to generate $1 trillion in infrastructure stimulus over the next 10 years. The Trump administration hasn't officially committed to this plan. Adding to the confusion, a post-election version of Trump's website indicated that the federal government would fund $550 billion in infrastructure projects. But it seems reasonable to us that tax incentives toward infrastructure might be included in the tax reform agenda, which is the number-two priority for Team Trump. Either way, it's all just speculation.

The clock is ticking on President Donald Trump's "100-day action plan to Make America Great Again." Nearly 40 days into his presidency, Trump has moved toward making good on some of his campaign promises. From the view of the markets, it shouldn't matter much precisely when Trump's tax and spending plans are turned into law, as long as the legislative process moves forward and gets the big items implemented either this year or next year.

Movie. "Bitter Harvest" (- -) (*link*) is a badly executed movie about a very important tragic historical event that has received all too little attention and is particularly relevant today. Millions of Ukrainians died during a 1932-33 famine that was exacerbated by the collectivist policies of Stalin's Soviet regime. Ukraine has a long history of suffering from imperialist intervention by its Russian neighbor. Ukraine gained its independence from the Soviet Union in 1991. Yet Russia under Putin annexed the Crimean Peninsula in 2014 and has been using military force in eastern Ukraine. History continues to rhyme.

CALENDARS

US. Mon: Durable Goods Orders Total and Ex Transportation 1.8%/0.5%, Pending Home Sales 1.1%, Dallas Fed Manufacturing Index, Kaplan. **Tues:** Real GDP & Price Deflator 2.1%/2.1%, Consumer Confidence Index 111.0, Advanced Merchandise Trade Balance-$66.0b, Richmond Fed Manufacturing Index, Chicago PMI 52.9, S&P Case Shiller Home Price Index 0.7%m/m/5.4%y/y. (Bloomberg estimates)

Global. Mon: Eurozone Economic Confidence 108.1, Eurozone M3 4.8% y/y, Japan Industrial Production 0.4%m/m/4.4%y/y, Japan Retail Trade 0.3%m/m/1.0%y/y. **Tues:** France GDP 0.4%q/q/1.1%y.y, Australia GDP 0.7%q/q/1.9%y/y, China Official & Caixin/Markit M-PMI 51.2/50.2, Japan Housing Starts 916k. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance (*link*): The US MSCI index rose 0.7% last week, ranking 11th of the 49 markets as 14 rose in US dollar terms--compared to 14th a week earlier, when it gained 1.5% as 34 markets moved higher. The AC World ex-US index underperformed the US MSCI for the 12th time in the past 15 weeks, falling 0.2% for the week versus a 0.8% gain a week earlier. EM Asia was the best-performing region last week, with a gain of 0.7%, followed by BRIC (0.1%). The week's worst-performing regions: EM Eastern Europe (-1.4), EMU (-0.9), EMEA (-0.7), EAFE (-0.3), EM Latin America (-0.3). Last week's best-performing countries: Mexico (3.2), Korea (1.8), India (1.7), Singapore (1.7), Indonesia (1.3), and Poland (1.1). Egypt (-4.0) was the worst performer, followed by Hungary (-3.7), Morocco (-3.4), Austria (-3.2), and Argentina (-3.0). The US MSCI is up 5.9% ytd, which ranks 18/49, and has been underperforming the AC World ex-US (5.2) on a ytd basis for the past seven weeks. Forty-three of the 49 markets are positive ytd, led by Argentina (21.9), Poland (16.8), Brazil (15.5), Egypt (12.5), and China (11.6). The worst country performers ytd: Greece (-6.0), Italy (-5.3), Russia (-3.7), Sri Lanka (-3.1), and Ireland (-1.3). The best-performing regions ytd: EM Latin America (11.9), BRIC (10.6), and EM Asia (10.1). The worst-performing regions, albeit with gains: EM Eastern Europe (0.8), EMU (1.2), EMEA (2.4), and EAFE (3.9).

S&P 1500/500/400/600 Performance (*link*): LargeCap and MidCap rose for a fifth straight week, but SmallCap dropped for the first time in five weeks. LargeCap rose 0.7%, beating the gain for MidCap (0.1%) and SmallCap's 0.2% decline. Eighteen of the 33 sectors rose in the latest week, down from 23 rising a week earlier. LargeCap ended the week at a new record high, but MidCap and SmallCap closed 0.7% and 1.0% below their record highs on Tuesday. Last week's best performers among sectors: LargeCap Utilities (4.0), SmallCap Utilities (3.0), MidCap Utilities (2.4), LargeCap Telecom (2.4), LargeCap Real Estate (2.1), and MidCap Real Estate (2.0). MidCap Telecom (-6.5) was the worst sector performer last week, followed by SmallCap Energy (-4.6), MidCap Energy (-3.9), and SmallCap Telecom (-3.2). Twenty-five of the 33 sectors are positive ytd, with LargeCap (5.7) beating MidCap (4.6) and both easily ahead of SmallCap (1.8). The biggest sector gainers ytd: LargeCap Tech (9.9), MidCap Health Care (9.2), LargeCap Health Care (8.3), MidCap Materials (7.9), MidCap Tech (7.9), and

SmallCap Health Care (7.1). The worst performers ytd: MidCap Energy (-9.4), SmallCap Energy (-8.6), LargeCap Energy (-6.8), and SmallCap Telecom (-5.5).

S&P 500 Sectors and Industries Performance (*link*): Eight of the 11 sectors rose last week, and six outperformed the S&P 500's 0.7% gain--compared to 10 sectors rising a week earlier, when five outperformed the S&P 500's 0.8% gain. Utilities was the best-performing sector for the week with a gain of 4.0%, followed by Telecom (2.4%), Real Estate (2.1), Consumer Staples (1.5), Health Care (1.5), and Tech (0.8). Energy was last week's worst performer, with a decline of 1.3%, followed by Financials (-0.1), Industrials (-0.1), Materials (0.3), and Consumer Discretionary (0.3). Nine of the 11 sectors are higher so far in 2017, and four are outperforming the 5.7% gain for the S&P 500. The best performers in 2017 to date: Tech (9.9), Health Care (8.3), Consumer Staples (6.7), and Consumer Discretionary (6.7). The seven sectors underperforming the S&P 500: Energy (-6.8), Telecom (-2.3), Real Estate (4.1), Financials (4.8), Industrials (5.0), Materials (5.5), and Utilities (5.6).

Commodities Performance (*link*): Ten of the 24 commodities we follow rose last week, up from eight rising a week earlier. The week's best performers: Silver (1.7%), Gold (1.5), and Cotton (1.4). Last week's laggards: Natural Gas (-5.6), Lean Hogs (-3.9), Sugar (-2.2), Coffee (-2.2), and Feeder Cattle (-2.1). The best performers in 2017 so far: Silver (15.1), Lead (12.5), Kansas Wheat (11.6), Aluminum (11.4), and Zinc (10.1). This year's laggards to date: Natural Gas (-25.2), Cocoa (-6.2), Heating Oil (-4.6), and Feeder Cattle (-2.8).

Assets Sorted by Spread w/ 200-dmas (*link*): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 7/24 commodities, 3/9 global stock indexes, and 13/33 US stock indexes compared to 7/24, 6/9, and 19/33 rising a week earlier, respectively. Seventeen commodities trade above their 200-dmas, down from 19 a week earlier as Coffee and Soybeans turned negative w/w. Commodities' average spread fell to 4.8% from 5.7%. Zinc leads all commodities and all assets at 17.4% above its 200-dma, followed by Unleaded Gasoline (16.4%) and Copper (15.2). Gold (-0.4) improved 1.6ppts w/w relative to its 200-dma for the week's best performance among all commodities. Commodities dominate the lowest-trading assets relative to 200-dmas, with these four commodities at the steepest discounts of all: Cocoa (-24.6), Feeder Cattle (-7.1), Natural Gas (-6.9), and Sugar (-2.7). Natural Gas fell 6.0ppts w/w for the worst performance of all commodities. The global indexes trade an average of 6.9% above their 200-dmas, down from 7.4% above in the prior week. All nine of the global indexes trade above their 200-dmas, unchanged from a week earlier. Brazil (13.1) leads the global indexes, followed by Japan (10.3) and Germany (10.3). China (5.1) was the group's best performer last week, with a gain of 1.3ppts. Indonesia (2.9) is trading at the lowest relative to its 200-dma of the global assets, but Brazil had the weakest performance of its country peers last week, as it fell 2.7ppts. The US indexes trade at an average of 7.2% above their 200-dmas, with 31 sectors above, down from a 7.8% average a week earlier when 31 sectors were also above. LargeCap and MidCap Energy both turned negative last week as LargeCap Real Estate and Telecom turned positive. LargeCap Financials leads all US stock indexes at 17.3% above its 200-dma, followed by SmallCap Financials (17.2), MidCap Financials (16.5), and SmallCap Tech (15.2). LargeCap Utilities was last week's best performer among US stock indexes and all assets, as it improved 3.9ppts w/w to 4.3%. The following sectors trade at the deepest discounts to their 200-dmas among the US indexes: MidCap Energy (-1.9) and LargeCap Energy (-0.9). MidCap Telecom (4.1) was last week's worst performer among US stock indexes and all assets as it fell 7.6ppts.

S&P 500 Technical Indicators (*link*): The S&P 500 remained in a Golden Cross last week for a 44th 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 12th straight week. Its 50-dma improved to a 20-week high of 4.8% above its 200-dma from 4.7% 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 March 2016. The S&P

500’s 50-dma moved higher for a 15th week after six weekly declines, and the index closed the week above its 50-dma for a 15th week after nine weeks below. The S&P 500 improved to 3.4% above its rising 50-dma from 3.1% a week earlier. That’s down from a 38-week high of 4.8% above its rising 50-dma on December 13 and compares to a 52-month high of 6.2% in March 2016 and a five-month low of -7.8% in January 2016. The S&P 500’s bounce off its 200-dma in early November continued last week as the index rose to a 37-month high of 8.0% on Wednesday. It ended the week 8.3% above its rising 200-dma, up from 6.7% a week earlier and compared to a six-month low of -10.0% in February 2016. The 50-dma and 200-dma both rose together for a 14th week after falling for eight weeks.

S&P 500 Sectors Technical Indicators (*link*): The short-term picture improved for five of the 11 S&P 500 sectors last week, and the long-term picture improved for 7/11. Ten sectors trade above their 50-day moving averages (dmas), up from nine a week earlier as Telecom turned positive and Energy remained below. That’s a big turnaround from 16 weeks ago, when all 11 sectors traded below their 50-dmas for the first time since December 11, 2015. Nine of the 11 sectors were above their 200-dmas last week, unchanged from a week earlier as Real Estate and Telecommunication Services remained below. Only seven sectors are in a Golden Cross now, with 50-dmas higher than their 200-dmas: Consumer Discretionary, Energy, Financials, Industrials, Information Technology, Materials, and Telecommunication Services. All 11 had been in a Golden Cross during a 21-week streak that ended October 24, the longest such stretch since October 2014. Nine of the 11 sectors have rising 50-dmas, unchanged from a week earlier as Energy and Telecommunication Services continued falling. Eight have rising 200-dmas, unchanged from a week earlier. Real Estate is the only sector with a falling 200-dma (albeit slightly), and these two have just started rolling over: Telecom and Utilities.

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 ninth week during the week of February 18 to another new record high, up 1.0% w/w and 7.7% over the period. Our WLI is the average of our Boom-Bust Barometer (BBB) and Bloomberg’s Weekly Consumer Comfort Index (WCCI). Our BBB rose for the seventh time in nine weeks by a total of 12.4% to a new record high, as jobless claims sank to 241,000 (4-wa)—the lowest reading since 1973. The CRB raw industrials spot price index—another BBB component—is stalled around recent highs; meanwhile, the WCCI was little changed after rebounding 6.4% the prior three weeks.

US ECONOMIC INDICATORS

Existing Home Sales (*link*): Existing home sales—tabulated when a purchase contract closes—jumped to a 10-year high in January. According to NAR’s chief economist, “Much of the country saw robust sales activity last month as strong hiring and improved consumer confidence at the end of last year appear to have sparked considerable interest in buying a home." He noted that while market challenges remain, homebuyers shunned “inventory levels that were far from adequate and deteriorating affordability conditions.” Existing home sales rose for the fifth time in six months, by 3.3% in January and 6.8% over the time span to 5.69mu (saar), the best since February 2007. Single-family sales rose 2.7% and 5.9% over the comparable period to 5.04mu (saar), also the highest since February 2007. Multi-family sales remained in a very volatile flat trend, climbing 8.3% in January to 650,000 units (saar), after falling 10.5% in December and rising 9.8% in November. The number of existing single-family homes on the market ticked up to 1.51mu from 1.45mu in December, which was the lowest supply since December 1994. Unsold inventory was a very low 3.6 months’ supply.

New Home Sales (*link*): New home sales in January rose less than expected as heavy rains and flooding in California depressed sales out West. New home sales, which tend to be volatile, climbed 3.7% to 555,000 units—vs. a consensus estimate of 570,000—after a 7.0% loss in December and a 1.2% gain in November. (These sales are tabulated when contracts are signed, making it a timelier barometer of the residential market than existing home sales.) Regionally, sales in the Northeast (15.8%), Midwest (14.8), and South (4.3) all rose last month, more than offsetting a 4.4% drop in the West. In January, there were 265,000 new single-family homes on the market, the highest level since July 2009. The months' supply of homes held at 5.7, above July's 17-month low of 4.6 months and near its recent high of 5.8 months. A 6.0-month supply is viewed as a healthy balance between supply and demand. February's survey of the National Association of Homebuilders (NAHB) showed builders' optimism dipped for the second month, to 65, since reaching an 11-month high of 69 at the end of last year.

Consumer Sentiment Index (*link*): Consumer sentiment in February recorded its first post-election drop as Republican and Democrats were sharply divided on whether they expect a boom or bust; Independents leaned more toward optimism. Richard Curtin, director of the consumer survey, noted, "We've never recorded such a divide in our data," with some questions going back to the late 1940s. The Consumer Sentiment Index slipped to 96.3 (above the mid-month reading of 95.7) after climbing from 87.2 in October to 98.5 in January—the highest since January 2004. This month's retreat was led by a 3.8-point drop in the expectations component to 86.5 after reaching a two-year high of 90.3 in January; it was above the mid-month reading of 85.7. The present situation component edged up to 111.5—rather than ticking down to 111.2 as the preliminary estimate forecast—just shy of December's cyclical high of 111.9.

Regional M-PMIs (*link*): Three Fed districts so far have reported on manufacturing activity for February—New York, Philadelphia, and Kansas City—and show a big pickup in economic activity. We average the composite, orders, and employment measures as data become available. The composite index (to 25.3 from 13.0) was in positive territory for the sixth straight month at its highest reading since July 2004. Philadelphia (43.3 from 23.6), New York (18.7 from 6.2), and Kansas City (14.0 from 9.0) gauges all improved dramatically. The new orders index (25.8 from 16.4) accelerated for the sixth consecutive month, reaching its fastest pace also since July 2004. Again, the Philadelphia (38.0 from 26.0), New York (13.5 from 3.1), and Kansas City (26.0 from 20.0) measures all showed faster growth, with Philly's the best since the 1970s. The employment index (10.0 from 5.7) was positive for the second month after negative readings the prior 16 months. Kansas City's (17.0 from 6.0) gauge showed the strongest job growth in the region's manufacturing sector since March 2011, while Philly's (11.1 from 12.8) slowed slightly; New York's (2.0 from -1.7) showed manufacturers adding to payrolls for the first time since last May.

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