



MORNING BRIEFING

March 23, 2017

Unchained

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

(1) If Trump lifts regs as promised, many companies will benefit big time. (2) Jackie recaps which industries stand to gain the most. (3) Financials, freed from Dodd-Frank shackles, would be a huge winner. (4) Other potential jackpot-hitters include autos, energy, homebuilders, and maybe even pharma. (5) Analysts project big earnings growth in 2017. (6) Joe gives us the lowdown on projected growth by sector.

Strategy: Regulatory Relief. This week, markets got the first evidence that even President Donald Trump and his Cabinet of deal-makers might have a tough time negotiating deals in Washington, DC's political swamp. His proposed repeal and replacement of Obamacare is running into resistance in Congress even within his own party. This is raising some doubts about whether Trump can push other parts of his agenda through Congress. As of Tuesday's close, the S&P 500 is down 2.2% from its record high of 2395.96 on March 1, but it's up 9.6% since Election Day.

A pullback after the strong rally in recent months should be the pause that refreshes if investors conclude that Trump will have an easier time and move even more aggressively on reducing regulations, as he has promised. If he's even partially successful, corporations stand to save billions on lower costs to adhere to regulations, and revenues may rise if CEOs are emboldened to expand their businesses once the shackles are off.

In other words, Jackie, Joe, and I aren't convinced that the Trump rally has been just about tax reform. It's also been about one of the most pro-business administrations in history. A cut in the corporate tax rate is still likely, and it is likely to boost earnings significantly when it happens. Meanwhile, deregulation may have a more immediate positive effect on earnings as well as animal spirits.

During the election campaign, Candidate Trump touted his intention to cut regs by 70%. Now President Donald Trump is following through on that promise, though 70% is certainly a stretch. Within 10 days of moving into the White House, Trump signed an executive order requiring federal agencies to slash two old regulations for every new regulation they write. In addition, any costs generated by the new rule must be offset by the costs eliminated by the two revoked regulations. There will be new task forces at every federal agency to identify regulations for elimination or modification. And starting next year, the director of the White House Office of Management and Budget will give each federal agency a target for how much the agency should aim to increase or cut costs resulting from regulations. How's that for setting the tone from the top? Let's take a look at what regulations Trump has in his sights and how much companies may benefit:

(1) *Financials.* Perhaps no other sector has been saddled with more regulations in recent years than the S&P 500 Financials. After the Great Recession, Congress aggressively wrote laws and established new institutions aimed at insuring against a repeat of the devastating crisis. The legislation mostly gave President Barack Obama's financial regulators a carte blanche to chain the financial institutions with a myriad of regulations. But they might have taken a well-intentioned idea too far with, for example, the Dodd-Frank law spanning 2,300 pages and spawning many more pages of regs.

Hopes are high that less regulation under a Trump administration will mean lower compliance costs and more earnings for financial institutions. Medy Agami, co-founder of Opimas, a management consultancy firm focused on capital markets, estimated that the reduction in regs could “redirect” \$25 billion of capital in financial services over the next 18-24 months, according to a 1/21 [Business Insider article](#).

Trump has already taken a number of steps toward reducing regulations in the Financials sector. He signed in February an executive order directing the Treasury and regulatory agencies to report to Trump about what can be done to scale back the “overreaching” aspects of the Dodd-Frank law, [UPI reported](#) on 2/3. Revising the law supposedly would increase liquidity at the banks and generate new areas of revenue and profitability.

Trump also delayed the implementation of a fiduciary rule, which was going to require financial advisers to act in the “best interests” of clients with retirement accounts. Scheduled to go into effect in April, the rule is now under review by the Labor Department. It was set to affect about \$3 trillion of retirement assets and could have forced companies to offer products with the lowest fees even if they weren’t the best products for clients. The rule would also open up money managers to greater legal liabilities if sued by disgruntled clients.

Also in Trump’s sight: changing the Financial Stability Oversight Council, an overhaul of Fannie Mae and Freddie Mac, and changing the mission of the Consumer Financial Protection Bureau by installing a new person at its helm.

“Americans are going to have better choices and Americans are going to have better products because we’re not going to burden the banks with literally hundreds of billions of dollars of regulatory costs every year,” White House National Economic Council Director Gary Cohn said in a 2/3 [WSJ interview](#). “The banks are going to be able to price product more efficiently and more effectively to consumers.”

(2) *Autos*. Flash back to 2012. Near the start of the year, the price of oil was \$126 per barrel. President Obama announced new vehicle fuel-efficiency standards that required US auto fleets to have an average 54.5 miles per gallon by 2025, which translates into 36.0 mpg on the road. The deal also set an emissions standard of 144 grams of carbon dioxide per mile for passenger cars and 203 grams for trucks.

At the time, the press described the deal as “uncontroversial” and “endorsed by industry and environmentalists alike,” as it was a grand compromise among government, auto makers, and California, which was pushing for even tougher standards. “By 2025, the EPA said, the standards would cut U.S. oil consumption by 2.2 million barrels per day compared with 2010 levels, save \$1.7 trillion in fuel costs and result in an average fuel savings of more than \$8,000 per vehicle,” noted a 8/28/12 [Washington Post article](#).

One constituency did complain: auto dealers. They warned that the changes required to meet the efficiency standards would increase the average price of a vehicle by \$3,000 by the time the rules are fully implemented. The article quoted the chair of the National Automobile Dealers Association asserting that the increase “shuts almost 7 million people out of the new-car market entirely and prevents many millions more from being able to afford new vehicles that meet their needs.”

Flash forward five years. The price of oil is now down to \$51 per barrel, SUVs and light trucks are hot sellers, and there’s a new resident in the White House. The Obama vehicle standards from 2022 through 2025 are in the midst of a midterm evaluation. The EPA under Obama concluded that the rules should stand, but the Department of Transportation hasn’t signed on yet, according to a 3/15 [article](#) on

Vox.com. And that has opened the door to a major revision of the rules.

Last fall, the Alliance of Automobile Manufacturers sent President Trump a letter asking him to ease the requirements, arguing that they cost too much. According to the organization's 9/22 [statement](#) to the House Subcommittee on Commerce, Manufacturing, and Trade: "The Federal government estimates the total cost of the current [One National Program] to be about \$200 billion from 2012-2025. This is a significant regulatory burden on the auto industry and an accurate and thorough evaluation of potential employment impacts is critical for both the success of One National Program and the continued health of the manufacturing sector and the overall U.S. economy." Read between the lines, and they're saying the rule could hurt sales and cost American jobs.

But changing the rules for the whole country may not be easy. Remember, the original rule involved California. The state was pulled into the compromise because it has a waiver under the Clean Air Act that allows it to have its own stricter car emission regulations than the federal government, the Vox article explains. It's a good assumption that if the Trump administration rolls back the mileage and emission rules, California could institute its own set of tighter rules. That's something the auto industry certainly wouldn't want. The EPA could try to rescind the waivers. The state could sue to block. The upshot: Things could get messy.

(3) *Energy*. President Trump didn't come up with the phrase "Drill, baby, drill," but his actions certainly support it. In his first month on the job, he signed executive memos that make it easier for TransCanada to construct the Keystone XL pipeline and for Energy Transfer Partners to build the remainder of the Dakota Access pipeline. He also signed House Joint Resolution 41, eliminating a federal rule that requires energy companies to disclose royalties and government payments. The rule was imposed by the Obama administration last year to improve transparency. The Trump administration said it puts US energy companies at a disadvantage, reported a 3/6 UPI [article](#).

The Trump administration is expected to loosen environmental regulations that often hamstring energy companies. The proposed federal budget would cut the Environmental Protection Agency's (EPA) budget by 31%, from \$8.1 billion to \$5.7 billion. It would reduce the agency's headcount by 3,200 positions, or more than 20% of the current 15,000 person workforce, reported a 3/16 *Washington Post* [article](#). The proposed budget would also end funding for the Clean Power Plan, Obama's effort to regulate carbon dioxide emissions from power plants.

Already, the EPA under Scott Pruitt has repealed a rule enacted under Obama that required oil and natural gas companies to provide the EPA with information about methane emissions. Opponents of the rule said the rule's costs hurt smaller oil companies. "The EPA's rules when combined with other recently imposed federal methane regulations were expected to cost as much as \$155 million in 2020 rising to \$290 to \$400 million by 2025. That's roughly three times more than EPA's projected cost, according to a study by the National Economic Research Associates," the Daily Caller [reported](#) on 3/3.

The administration has said it plans to roll back an Obama rule requiring companies that drill for oil and natural gas on federal lands to disclose chemicals used in fracking, according to a 3/16 [article](#) by the Associated Press. It has also pledged to revive the coal industry using clean coal technology, and the President signed House Joint Resolution 38 to end an Obama administration rule that protected waterways from coal-mining waste. Trump's administration said the rule puts mining companies at a competitive disadvantage, a 3/6 UPI [article](#) reports.

Trump laid out his overarching intentions in his ["An America First Energy Plan."](#) It states: "For too long, we've been held back by burdensome regulations on our energy industry. President Trump is committed to eliminating harmful and unnecessary policies such as the Climate Action Plan and the

Waters of the U.S. rule. Lifting these restrictions will greatly help American workers, increasing wages by more than \$30 billion over the next 7 years.”

The plan also says the administration will care for the environment: “Lastly, our need for energy must go hand-in-hand with responsible stewardship of the environment. Protecting clean air and clean water, conserving our natural habitats, and preserving our natural reserves and resources will remain a high priority. President Trump will refocus the EPA on its essential mission of protecting our air and water.” Good luck with that: Achieving both goals will be tough, to say the least.

(4) *Homebuilders*. While not much has been done for homebuilders so far, speeches by Candidate Trump indicate that help may be forthcoming. When speaking to the National Association of Home Builders Board of Directors in August, Trump said, “No one other than the energy industry is regulated more than the home building industry,” according to a NAHB 8/11 [article](#). “Twenty-five percent of the cost of a home is due to regulation. I think we should get that down to about 2 percent.”

The housing industry is hopeful that Trump will revise the Waters of the US Rule, published last year by the EPA and the Army Corps of Engineers. As we mentioned above, Trump has targeted the rule, which is disliked by those in the energy and housing industries. The Clean Water Act historically applied to navigable and interstate bodies of water. The Waters of the US rule expanded the reach of the Clean Water Act to “all tributaries, adjacent waters, wetlands and other waters.”

“NAHB and others have objected to those terms as broad and vague, and have said the new definition could subject ponds, creeks, and ditches on private property to federal oversight and their owners to additional regulatory red tape,” explains a 4/15/15 [article](#) in ConstructionDive.com.

The industry would also like to be rid of the overtime rule, written last year by the Department of Labor (DOL) but hung up by numerous lawsuits in the courts. Before the rule, employees making \$23,660 a year would receive overtime if they were classified as “executive,” “administrative,” “professional,” or “computer professional.” The overtime rule lifted the cap to \$47,476 and instituted a plan to raise the minimum salary every three years based on an index.

The rule was estimated to impact more than 4.2 million workers, and critics said it didn’t take into consideration regional differences in pay and it could force employers to convert some salaried workers into hourly positions. NAHB Chairman Ed Brady called the DOL’s rule an action of “sheer arrogance.”

(5) *Pharmaceuticals*. Drug industry CEOs met with President Trump in January, and his message was: Bring your companies and production back to America and lower drug prices, and he’ll work on reducing regulations. “So you have to get your companies back here. We have to make products ... We have to get rid of a tremendous number of regulations,” Trump said according to a 1/31 CNN [article](#). “I know you have some problems where you cannot even think about opening up new plants. You can’t get approval for the plant and then you can’t get approval to make the drugs.” He aims to resolve those problems.

Sector Focus: Earnings. As the market gets bumpier, investors can take solace in analysts’ call for solid 2017 earnings growth. Overall, the S&P 500’s earnings are expected to increase 9.9% in 2017 to \$128.57 a share, up from miserly growth of 1.6% last year, when the energy recession and the strong dollar weighed on results in the first half of the year.

Indeed, growth this year is being bolstered by easy comparisons to Q1-2016, when S&P 500 earnings fell 5.7% y/y ([Fig. 1](#)). Sectors that had weak starts to last year include Tech, where Q1-2016 earnings fell 12.2% and Q2-2016 earnings dropped 6.6%, and Industrials, where Q1-2016 earnings dropped

5.3% ([Fig. 2](#) and [Fig. 3](#)). Telecom services saw earnings drop in each quarter of 2016, and Financials posted declines in earnings in the first half: 11.5% in Q1 and 6.2% in Q2 ([Fig. 4](#) and [Fig. 5](#)).

Here are the earnings growth rates analysts are targeting for all of 2017: Energy (422.2%), Materials (12.3), Financials (12.2), S&P 500 (9.9), Tech (9.8), Consumer Discretionary (7.0), Consumer Staples (5.6), Health Care (4.7), Industrials (3.2), Telecom (0.4), Utilities (-0.1), and Real Estate (-33.5).

As is the norm this long into an economic recovery, 2017 earnings estimates are being trimmed as the year progresses. But the decline in expectations has been comparatively modest ([Fig. 6](#)). At the start of the year, analysts were calling for an 11.6% increase in S&P 500 earnings, so the estimate has fallen by 1.7ppts. From 2011 to 2016, the annual growth rate forecast fell an average of 2.3ppts over the same time period from the start of those years.

Here's how much the 2017 earnings-per-share estimates have changed for each of the S&P 500 sectors since the start of the year: Financials (+0.4%), Industrials (0.1), Utilities (-0.1), Energy (-1.0), Information Technology (-1.0), Consumer Staples (-1.2), S&P 500 (-1.4), Consumer Discretionary (-1.9), Telecommunication Services (-2.8), Materials (-3.3), Real Estate (-3.5), and Health Care (-4.2).

CALENDARS

US. Thurs: Jobless Claims 240k, New Home Sales 566k, Kansas City Manufacturing Index, Weekly Consumer Comfort Index, EIA Natural Gas Report, Yellen, Kashkari, Kaplan. **Fri:** Durable Goods Orders, Total, Ex Transportation, and Core Capital Goods 1.5%/0.8%/0.5%, M-PMI Flash Estimate, Baker-Hughes Rig Count, Evans. (Bloomberg estimates)

Global. Thurs: Eurozone Consumer Confidence -5.8, Germany GfK Consumer Confidence 10, UK Retail Sales 0.3%*m/m*/3.2%*y/y*. **Fri:** Eurozone, Germany, and France Composite PMI Flash Estimates 55.8/56.0/55.9, Eurozone, Germany, and France M-PMI Flash Estimates 55.3/56/5/52.4, Eurozone, Germany, and France NM-PMI Flash Estimates 55.3/54.5/56.1, France GDP 0.4%*q/q*/2.1%*y/y*, Japan M-PMI Flash Estimate, Canada CPI 0.2%*m/m*/2.1%*y/y*. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): The Investors Intelligence Bull/Bear Ratio (BBR) rebounded from 3.05 to 3.28 this week; three weeks ago it was at 3.82—which was the highest reading since April 2015. It's the 15th straight week above 3.00. Bullish sentiment climbed to 56.7% after falling the prior two weeks from 63.1% (which was the most bulls since 1987) to 53.4%. This week's move to the bulls came from the correction camp, which fell 3.1ppts to 26.0%; it had jumped 8.7ppts the prior two weeks. Bearish sentiment showed little movement this week, ticking down from 17.5% to 17.3%; three weeks ago, it was at 16.5%—the fewest bears since July 2015. The AAll Bull Ratio increased to 44.6% last week after dropping the previous two weeks from 54.3% to 39.2%. Bullish sentiment rose from 30.0% to 31.2%, while bearish sentiment fell from 46.5% to 38.7%.

AC World ex-US MSCI ([link](#)): This index is up 7.8% ytd in dollar terms after rising 1.7% in 2016. In local-currency terms, the index has risen 4.6% ytd compared to its 4.1% gain for all of 2016. Local-currency forward revenues has risen 4.5% from a five-year low in March 2016, but has been more stable longer term and is down just 6.2% from its October 2014 record high. Local-currency forward earnings has performed better, with a 12.0% rise from its six-year low in March 2016, but remains 12.9% below its September 2008 record. Revenues are expected to rise 7.1% in 2017 and 4.8% in 2018 following a 0.7% decline in 2016, and earnings are expected to rise 15.8% (2017) and 9.8% (2018) after rising 2.3% (2016). Analysts are forecasting STRG of 6.6%, a 67-month high and up from a

cyclical low of 2.3% in March 2016. Their STEG forecast of 13.8% is down from a 47-month high of 13.9% in February, but 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 7.5% in 2017 from 6.9% in 2016 before improving to 7.9% in 2018. NERI had turned positive in January for the first time since March 2011, and improved another 0.5ppt in March to a 73-month high of 1.8% from 1.3% in February. That compares to a 51-month low of -11.3% in March 2016. The P/E was steady at 14.2 in March, 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 12% discount to the World P/E has deepened from a 6% discount last April and is near the historical lows recorded in 2001, 2008, and early 2016.

EMU MSCI ([link](#)): The EMU's MSCI price index has gained 7.1% ytd in dollar terms after falling 1.2% in 2016. In euro terms, the price index is up a lower 4.5% ytd following a 1.8% gain for all of 2016. Euro-based forward revenues has improved 2.5% from its six-year low in May 2016, but remains 1.7% below its cyclical high (August 2015) and 8.3% from its record high (September 2008). Euro-based forward earnings had stalled since 2011--but is now 1.4% above its prior cyclical high in September 2015 to its highest level since November 2011. It remains 26.9% below its record high (January 2008), but has improved 8.3% from its 23-month low in June 2016. Analysts expect revenues to rise 4.8% and 3.6% in 2017 and 2018, respectively, after falling 1.3% in 2016, but think earnings will rise 13.3% in 2017 and 10.7% in 2018 following a 0.3% gain in 2016. Forecasted STRG of 4.5% is down from a 64-month high of 4.6% in January. Forecasted STEG of 12.5% is down from a 21-month high of 13.6% in February, which compares to a seven-year low of 5.6% in April 2016. STEG has been higher than LTEG (11.0%) since July after trailing it since late 2015. The forward profit margin has improved 0.9ppt to 7.1% 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 0.4ppt to 7.4% in 2018. NERI was positive for a fifth straight month in March as it improved 0.2ppts m/m to a 78-month high of 4.0% from 3.8% in February, which compares to a 24-month low of -13.2% in April 2016. The P/E of 14.4 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 10% 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 12.9% ytd in US dollar terms after rising 8.6% in 2016. In local-currency terms, EM has gained 8.6% ytd compared to a 7.1% gain in 2016. Local-currency forward revenues is up 1.8% from a four-year low in June 2016 to 14.3% below its November 2014 record. Local-currency forward earnings has improved 12.3% from April 2016's six-year low and is down just 8.1% from its January 2014 record. Revenues are expected to rise 9.7% in 2017 and 7.7% in 2018 following a 2.6% gain in 2016, leading to earnings gains of 17.9% (2017) and 11.6% (2018) following a 7.2% rise in 2016. Forecasted STRG of 9.4% is back on an uptrend since early 2016, but is down slightly from a four-year high of 9.6% in late January. STEG of 16.6% is the highest since February 2011 and up from a seven-year low of 6.0% in February 2016, and is above LTEG (14.8%) for the first time since July 2013. The implied profit margin is expected to improve to 6.7% in 2017 from 6.3% last year before moving even higher to 7.0% in 2018. The forward profit margin of 6.8% 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 73 months--improved m/m to a 69-month high of -1.4% from -2.5% in February, which compares to 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 was steady at 12.0 in March, 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 25% 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 March suggest rising optimism about profits across the world as all regions improved m/m except EM

Latin America and the United States. The AC World MSCI's NERI was positive for a second month and for the first time since June 2011, as it improved 0.2ppt to 0.6% from 0.4% in February. The AC World Ex-US was positive for a third month, improving 0.6ppt to 1.8% from 1.2% in February. EM Eastern Europe and Europe were positive for a sixth straight month; EAFE and EMU were positive for a fourth month. March's scores among the regional MSCIs: EAFE (81-month high of 5.1%, compared to 4.8% in February), EMU (78-month high of 4.0, 3.8), Europe ex-UK (77-month high of 3.6, 3.6), EM Eastern Europe (3.5, 2.6), Europe (78-month high of 3.4, 3.1), AC World ex-US (73-month high of 1.8, 1.3), AC World (70-month high of 0.6, 0.4), EM Asia (-1.2, -2.5), Emerging Markets (-1.4, -2.5), United States (-2.4, -1.5), and EM Latin America (-4.7, -3.5).

MSCI Countries Net Earnings Revisions ([link](#)): NERI was positive for 24/44 MSCI countries in March, the most since May 2011 and unchanged from 24/44 in February. NERI improved m/m in March for 26/44 countries, up from 22/44 improving in February. Spain's NERI was at a 137-month high in March, followed by those of Italy (128-month high), Australia (120), Netherlands (78), Norway (76), Hong Kong (74), China (74), Poland (73), Malaysia (57), Japan (45), and Israel (36). On the flip-side, Portugal and South Africa were at 12-month lows, followed by those of Peru (11), Belgium (10), and Brazil (10). The 12-month positive NERI streak for Hungary is the best, followed by 11-month positive streaks for Peru and Russia, and 10 months for Austria. NERI turned positive for two countries: Finland and Israel. NERI turned negative for two countries: Argentina and Portugal. Hungary's is the strongest recently, with positive readings in 22 of the past 23 months. Brazil's NERI has been negative for 81 straight months, followed by the negative streaks of Singapore (72), Chile (68), and Malaysia (57).

US ECONOMIC INDICATORS

Existing Home Sales ([link](#)): Existing home sales—tabulated when a purchase contract closes—retreated in February after jumping to a 10-year high in January, as a shortage of houses on the market continued to push home prices higher. Existing home sales sank 3.7% to 5.48mu (saar) after jumping 3.3% in January to 5.69mu—the highest since February 2007. Single-family sales dropped 3.0% to 4.89mu (saar) after advancing four of the prior five months by a total of 6.8%. Multi-family sales remained in a very volatile flat trend, plunging 9.2% in February to 590,000 units (saar) after an 8.3% increase and a 10.5% decrease the previous two months. Despite February's setback, total (5.8% y/y), single- (5.4), and multi-family (1.7) sales all remained above year-ago levels. Regionally, single-family sales were above year-ago levels in the West (11.0), South (6.1), Midwest (2.8), and Northeast (1.8). The number of existing single-family homes on the market ticked up for the second month to 1.54mu, from 1.45mu in December, which was the lowest supply since December 1994. Unsold inventory was a very low 3.8 months' supply. According to NAR's chief economist, "A growing share of homeowners [in NAR's first quarter HOME survey](#) said now is a good time to sell, but until an increase in listings actually occurs, home prices will continue to move hastily."

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