



## MORNING BRIEFING

April 3, 2017

### The Third Mandate

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

(1) More fuel for the melt-up. (2) Financial stability is the third mandate. (3) Putting odds on Nirvana, melt-up, or meltdown. (4) The S&P 500's Price/Sales (a weekly version of Buffett Ratio) is in outer space. (5) Nose-bleed valuations unless Trump can boost earnings. (6) The melt-up mechanism may be in gear. (7) Stock buybacks plus equity ETF inflows are boosting stock prices. (8) Passive is the new active. (9) Valuation-dependent: Fed officials saying market is "a little rich" and "a little frothy." (10) Dudley wants to add more fruit juice to the punch bowl. (11) Keep drinking for now; even fruit punch can cause a sugar high. (12) Movie Review: "The Zookeeper's Wife" (+ +).

**Strategy: Fueling the Melt-Up.** Fed officials have more or less been declaring "mission accomplished" since early March. They mostly are convinced that they have achieved their dual congressional mandate of full employment with low and stable inflation. The unemployment rate has been below 5.0% for the past 10 months through February ([Fig. 1](#)). The "jobs-hard-to-get" series compiled by the Conference Board (with data collected from a monthly survey of consumer confidence) fell in March to 19.5%, the lowest reading since July 2007. It is highly correlated with the jobless rate and suggests this rate might be heading closer to 4.0%. So does the initial unemployment claims series, which is hovering around its lowest since 1973 ([Fig. 2](#)).

The headline and core PCED inflation rates, on a y/y basis, were 2.1% and 1.8% during February, close enough to the Fed's 2.0% target for the Fed's preferred measure of core consumer price inflation ([Fig. 3](#)). The headline and core CPI inflation rates were 2.8% and 2.2% in February ([Fig. 4](#)).

Now, as Melissa and I discuss below, Fed officials seem to be moving surprisingly quickly toward their third, though unofficial, mandate—i.e., financial stability. This is a subject many of them have discussed from time to time since the Great Recession, but it has always taken a back seat to the official dual mandate.

Until recently, Fed officials had been stressing that monetary policy was "data-dependent." In other words, it would remain very accommodative, even ultra-easy, until the economic data confirmed that the labor market was at full employment with inflation rising closer to the 2.0% target. Believing that they were nearing the Promised Land, the members of the FOMC voted to raise the federal funds rate by 25bps at the end of 2015, 2016, and again this year on March 15. They also signaled that they would stick with a gradual normalization of monetary policy with two more rate hikes this year and three next year. But some of the natives are getting restless, recently saying that a faster pace of normalization might be appropriate.

What has changed? The "hard data" still look relatively soft. The Atlanta Fed's [GDPNow](#) is tracking a growth rate of only 0.9% currently. On the other hand, as we've been monitoring in our new [Animal Spirits](#) publication, the "soft data" have been remarkably strong. Leading the way has been investor confidence, as evidenced by the surge in stock prices since Election Day. In our opinion, Fed officials may be starting to turn from being data-dependent (focusing on the economy) to being valuation-

dependent (focusing on the stock market). A few already may be worrying about a melt-up scenario in the stock market.

On March 7, Joe and I lowered our subjective probability of a Nirvana scenario for the stock market from 60% to 40%. At the same time, we raised the odds of a melt-up scenario from 30% to 40%. Consequently, we raised the odds of the meltdown scenario from 10% to 20%. We figured that if the odds of a melt-up have increased, so have the odds of a subsequent meltdown.

Valuation measures are elevated across the board, for sure. The forward P/E of the S&P 500 is currently 17.7 ([Fig. 5](#)). It is highly correlated with the forward price-to-sales ratio (P/S) of the same stock market index. This valuation metric closely tracks the Buffett Ratio, which is equal to the market capitalization of the entire US equity market (excluding foreign issues) divided by nominal GNP ([Fig. 6](#)). During Q4-2016, the Buffett Ratio was 1.67, not far below the record high of 1.80 during Q3-2000. The forward P/S rose from 1.58 in early 2016 to a record high of 1.93 in March.

These all are nose-bleed levels. However, they may be justified if Trump proceeds with deregulation and succeeds in implementing tax cuts. His policies may or may not do much to boost GDP growth and S&P 500 sales (a.k.a. revenues). Nevertheless, they could certainly boost earnings.

The risk is that Trump's victory activated a melt-up mechanism that has nothing to do with sensible assessments of the fundamentals or valuation. Instead, structural market flows may be driving the market's animal spirits. Consider the following:

(1) *Lots of corporate cash is still buying equities.* At the end of last week, Joe updated our chart publications with Q4-2016 data for S&P 500 buybacks. They remained very high at a \$541 billion annualized rate ([Fig. 7](#)). For all of last year, buybacks totaled \$536 billion, a slight decline from the previous year's cyclical high of \$572 billion. S&P 500 dividends rose to a record high of \$396 billion last year. Since the start of the bull market during Q1-2009 through the end of last year, buybacks totaled \$3.4 trillion, while dividends added up to \$2.4 trillion. Combined, they pumped \$5.7 trillion into the bull market, driving stock prices higher without much, if any, help from households, mutual funds, institutional investors, or foreign investors ([Fig. 8](#)).

(2) *Passive is the new active.* On the other hand, equity ETFs have been increasingly consistent net buyers of equities during the current bull market ([Fig. 9](#)). Their net inflows totaled a record \$281 billion over the past 12 months through February. Since the start of the bull market during March 2009, their cumulative net inflows equaled \$1,167 billion, well exceeding the \$179 billion trickle into equity mutual funds ([Fig. 10](#)).

So there you have it: The bull may be chasing its own tail. We know that image doesn't quite jibe with the bull charging ahead, but work with us here. The bull has been on steroids from share buybacks by corporate managers, who have been motivated by somewhat different and more bullish valuation parameters than those that motivate institutional investors, as we have discussed many times before. Most individual investors seemingly swore that they would never return to the stock market after it crashed in 2008 and early 2009. But time heals all wounds, and suddenly some of them may have turned belatedly bullish on stocks after Election Day. Add a buying panic of equity ETFs by individual investors to corporations' consistent buying of their own shares, and the result may very well be a melt-up.

**The Fed: Valuation-Dependent.** Fed officials may be starting to get it. If so, then monetary policy may pivot from being data-dependent to being valuation-dependent. This would imply that the pace of raising interest rates might be stepped up. A couple of Fed officials seem to be signaling that now.

Consider the following:

(1) *Rosengren & Williams*. Last Wednesday, both FRB-Boston President Eric Rosengren and FRB-SF President John Williams seemed to be turning more hawkish. In an [interview](#) with Bloomberg, Rosengren said some asset markets are “a little rich.” He called for a rate hike at every other FOMC meeting through yearend, which would add up to four, rather than three, rate hikes this year.

Then Williams warned that stock market valuations “may be a little frothy” and might “come down” on fiscal policy disappointment. He told reporters during a Q&A in New York that “I do think that the market’s perceptions of what’s going to happen ... kind of got ahead of reality” on fiscal policy. Williams also echoed Rosengren in saying that he “would not rule out more than three increases total for this year.” Interestingly, he also said that the “growing wealth-to-income ratio is another reason to keep raising rates.” Indeed, this ratio rose to 6.5 during Q4-2016, the highest on record ([Fig. 11](#))!

(2) *Evans*. Also last Wednesday, FRB-Chicago President Charles Evans said that “for the first time in quite a while, I see more notable upside risks to growth.” Speaking at a conference in Frankfurt, he said the environment “reflects both strong economic fundamentals and, possibly, stronger fiscal support over the medium term.” He told reporters after his speech the Fed could lift rates four times this year “if things proceed even better” than currently expected. Apparently, he did not specifically mention asset prices as a concern.

(3) *Fischer, Powell, and Kaplan*. Rosengren, Williams, and Evans are quite influential members of the FOMC. Until not too long ago, they all were deemed to be doves. Now they seem hawkish. However, of the three, only Evans gets to vote on the FOMC this year. Recently, three other voting members were a bit more dovish than their non-voting colleagues at the end of March. In an interview with CNBC on Tuesday, Fed Vice Chairman Stanley Fischer said that his forecast mirrors that of the FOMC’s median estimate of about two more hikes in 2017. He prefers to watch and wait to see how fiscal policies develop, [reported](#) Bloomberg on 3/28. Fed Governor Jerome Powell and FRB-Dallas President Robert Kaplan also seemed to suggest a more gradual approach in comments at the end of March.

(4) *Dudley*. Last Thursday, FRB-NY President William Dudley, who gets to vote, also weighed in on the outlook for monetary policy. In a 3/30 [speech](#), he said: “Even after the latest increase, the federal funds rate target range at three quarters of a percent to 1 percent is still unusually low in both nominal and inflation-adjusted terms. While most FOMC participants judge the equilibrium short-term real interest rate that is consistent with a neutral monetary policy to be low—perhaps in a range of 0 to 1 percent—this is still above the current inflation-adjusted federal funds rate. In such circumstances, it seems appropriate to scale back monetary policy accommodation gradually in order to reduce the risk of the economy overheating, and to avoid a significant inflation overshoot in the medium term.”

So he is still in the “gradual” camp, along with Fed Chair Janet Yellen, who used this word (or “gradually”) to describe the course of monetary policy 21 times in her 3/15 [press conference](#). However, Dudley also said that “there is still considerable uncertainty about fiscal policy and its potential contribution to economic activity.” He added that “it seems likely that it will shift over time to a more stimulative setting.” He concluded that “the risks for both economic growth and inflation over the medium to longer term may be shifting gradually to the upside.”

Dudley indirectly might have alluded to the stock market with the following punch line about the Fed’s punch bowl: “William McChesney Martin, the ninth chair of the FOMC, once famously opined that the Federal Reserve is ‘in the position of the chaperone who has ordered the punch bowl removed just when the party was really warming up.’ I don’t think we are removing the punch bowl, yet. We’re just adding a bit more fruit juice.” Here is the full excerpt from Martin’s [speech](#) given on October 19, 1955:

“In the field of monetary and credit policy, precautionary action to prevent inflationary excesses is bound to have some onerous effects—if it did not it would be ineffective and futile. Those who have the task of making such policy don't expect you to applaud. The Federal Reserve, as one writer put it, after the recent increase in the discount rate, is in the position of the chaperone who has ordered the punch bowl removed just when the party was really warming up.”

Martin was focusing on price inflation in the economy rather than in the stock market. Dudley's comments arguably seem more relevant to the current inflation in the stock market than in the economy. Our advice is keep drinking until they take away the punch bowl! Even fruit juice can provide a sugar high.

**Movie.** “The Zookeeper’s Wife” (+ +) ([link](#)) is a big-screen adaptation of the book of the same name about the remarkable story of an incredibly heroic married Polish couple, Antonina and Jan Żabiński, who owned and operated the Warsaw Zoo before World War II. They lost all their animals when the Nazi's invaded Poland, but kept the zoo as a pig farm during the war. At the same time, the Christian couple secretly saved about 300 Jews from certain death at great risk to their family. Jan was also a leader of the Polish resistance. The Żabińskis reopened the zoo after the war. The world certainly needs more decent people like them.

## CALENDARS

**US. Mon:** ISM M-PMI 57.1, Construction Spending 1.0%, Dudley. **Tues:** Merchandise Trade Balance - \$44.5b, Motor Vehicle Sales 17.4mu, Factory Orders 1.0%, Tarullo. (Bloomberg estimates)

**Global. Mon:** Eurozone Unemployment Rate 9.5%, Eurozone, Germany, France & Italy M-PMIs 56.2/58.3/53.4/55.1, UK M-PMI 55.0. **Tues:** Eurozone Retail Sales 0.5%<sub>m/m</sub>/1.0%<sub>y/y</sub>, RBA Rate Decision 1.50%, Draghi. (DailyFX estimates)

## STRATEGY INDICATORS

**Global Stock Markets Performance** ([link](#)): The US MSCI index rose 0.8% last week, ranking tenth of the 49 markets as 19 rose in US dollar terms—compared to 41st a week earlier, when it fell 1.5% as 21 markets moved higher. The AC World ex-US index underperformed the US MSCI for the first time in four weeks, falling 0.4% compared to a flat performance a week earlier. EMU was the best-performing region last week, with a gain of 0.6%, followed by a slight decline for EAFE (-0.3%). The week's worst-performing regions: EM Eastern Europe (-1.6), EMEA (-1.3), BRIC (-0.6), EM Asia (-0.5), and EM Latin America (-0.4). Portugal (6.2) was the best-performing country last week, followed by Greece (4.8), Australia (2.1), India (1.5), and Singapore (1.2). South Africa (-8.7) was the worst performer, followed by Poland (-3.2), Pakistan (-2.6), Turkey (-2.5), and Japan (-2.2). In March, the US MSCI was flat, ranking 38/44 and well behind the 2.1% gain for the AC World ex-US index as all regions rose. That compares to a 3.7% gain in February, when it ranked 9/44 and was ahead of the 1.4% rise for the AC World ex-US in a month when most regions rose. The best regions in March: EMU (5.9), EM Asia (3.2), and EAFE (2.3). March's worst-performing regions, albeit with gains: EM Latin America (0.4), EMEA (0.8), BRIC (1.6), and EM Eastern Europe (1.7). The US MSCI is up 5.7% ytd, improving to 28/49 from 34/49 a week earlier, but continues to trail the AC World ex-US (7.2) on a ytd basis. Forty-two of the 49 markets are positive ytd, led by Argentina (34.8), Poland (17.7), India (16.7), Korea (16.7), Mexico (15.7), Chile (15.4), and Spain (14.3). The worst country performers ytd: Sri Lanka (-7.0), Russia (-4.6), Morocco (-3.9), Greece (-3.6), and Pakistan (-3.0). The best-performing regions ytd: EM Asia (13.2), EM Latin America (11.6), BRIC (11.4), and EMU (8.3). The worst-performing regions, albeit with gains: EM Eastern Europe (0.1), EMEA (1.0), and EAFE (6.5).

**S&P 1500/500/400/600 Performance** ([link](#)): All three indexes rose last week, but were not able to recover from week-earlier declines that were the biggest since mid-September. LargeCap gained 0.8%, but trailed SmallCap (2.3%) and MidCap (1.5). Twenty-nine of the 33 sectors rose in the latest week, up from four rising a week earlier. LargeCap and MidCap ended the week 1.4% and 2.2% below their March 1 record highs, respectively, and SmallCap ended 2.1% below its record high on February 21. The SmidCap sectors dominated last week's gainers: SmallCap Energy (6.8), MidCap Energy (5.9), MidCap Telecom (3.5), and SmallCap Consumer Discretionary (3.0). LargeCap Utilities (-1.2) was the worst sector performer last week, followed by LargeCap Telecom (-0.8) and MidCap Utilities (-0.3). MidCap and LargeCap fell in March for the first time in five months, posting declines of 0.6% and less than 0.1%, respectively. SmallCap declined 0.3%, but was down for the second time in five months. Fifteen of the 33 sectors advanced in March, down from 25 rising in February. March's best performers: SmallCap Consumer Staples (3.0), SmallCap Telecom (3.0), MidCap Consumer Staples (2.7), and LargeCap Tech (2.5). March's laggards: MidCap Telecom (-9.3), SmallCap Energy (-5.0), MidCap Energy (-4.6), and SmallCap Financials (-3.9). Twenty-three of the 33 sectors are positive ytd, with LargeCap (5.5) beating MidCap (3.6) and both easily ahead of SmallCap (0.7). The biggest sector gainers ytd: LargeCap Tech (12.2), MidCap Health Care (9.5), SmallCap Health Care (9.4), LargeCap Consumer Discretionary (8.1), and LargeCap Health Care (7.9). The worst performers ytd: MidCap Telecom (-15.1), MidCap Energy (-14.2), SmallCap Energy (-13.5), LargeCap Energy (-7.3), and LargeCap Telecom (-5.1).

**S&P 500 Sectors and Industries Performance** ([link](#)): Eight of the 11 sectors rose last week, and six outperformed the S&P 500's 0.8% gain. This compares to eight sectors rising a week earlier, when six outperformed the S&P 500's 1.4% decline. Energy was the best-performing sector for the week, with a gain of 2.2%, followed by Consumer Discretionary (1.7), Materials (1.3), Tech (1.1), Industrials (0.9), and Financials (0.8). Utilities was last week's worst performer with a decline of 1.2%, followed by Telecom (-0.8), Consumer Staples (-0.1), Health Care (0.1), and Real Estate (0.8). The S&P 500 edged down less than 0.1% in March for its first decline in five months as three sectors moved higher and three beat the index; that compares to nine sectors rising and six beating the S&P 500's 3.7% surge in February. The leading sectors in March: Tech (2.5), Consumer Discretionary (1.8), and Materials (0.2). Financials was the biggest laggard in March with a drop of 2.9%, followed by Real Estate (-1.5), Telecom (-1.2), Energy (-1.1), Industrials (-0.8), Consumer Staples (-0.7), Health Care (-0.6), and Utilities (-0.5). So far in 2017, nine of the 11 sectors are higher, and four have outperformed the S&P 500's 5.5% gain. The best performers in 2017 to date: Tech (12.2), Consumer Discretionary (8.1), Health Care (7.9), and Consumer Staples (5.6). The seven sectors underperforming the S&P 500: Energy (-7.3), Telecom (-5.1), Financials (2.1), Real Estate (2.7), Industrials (4.0), Materials (5.3), and Utilities (5.4).

**Commodities Performance** ([link](#)): Thirteen of the 24 commodities we follow rose last week, up from eight rising a week earlier. Energy dominated the week's best performers: Crude Oil (5.5%), Unleaded Gasoline (5.4), Brent Crude (5.1), and Heating Oil (4.7). Last week's laggards: Sugar (-5.4), Soybeans (-3.0), Lean Hogs (-2.5), and Zinc (-2.2). March saw just seven of the 24 commodities climb, down from 15 rising in February and led by Natural Gas (15.0), Cocoa (9.7), Lean Hogs (9.2), Feeder Cattle (6.4), and Lead (3.6). March's laggards: Sugar (-12.8), Kansas Wheat (-9.3), Nickel (-8.8), Soybeans (-8.7), and Crude Oil (-6.3). Fourteen commodities are higher so far in 2017 versus 18 rising during all of 2016. The best performers in 2017 so far: Lead (16.4), Aluminum (15.9), Silver (14.2), Lean Hogs (11.6), and Cotton (9.5). The energy-related commodities mostly dominate this year's laggards to date: Natural Gas (-14.3), Sugar (-14.1), Heating Oil (-8.9), GasOil (-6.7), Crude Oil (-5.8), and Brent Crude (-5.8).

**Assets Sorted by Spread w/ 200-dmas** ([link](#)): Spreads between prices and 200-day moving averages

(200-dmas) rose last week for 11/24 commodities, 3/9 global stock indexes, and 28/33 US stock indexes compared to 8/24, 3/9, and 3/33 rising a week earlier, respectively. Seventeen commodities trade above their 200-dmas, up from 12 a week earlier as these five turned positive w/w: Brent Crude, Crude Oil, GasOil, Heating Oil, and Silver. Commodities' average spread rose to 2.5% from 1.9%. Among assets, Commodities walked away with three of the top four spots last week: Lean Hogs leads all commodities and indeed all assets at 19.5% above its 200-dma; next in line among Commodities are: Unleaded Gasoline (13.7%), Aluminum (13.5), Lead (11.8), Copper (10.2), and Zinc (10.2). Unleaded Gasoline performed the best of all commodities last week as it improved 5.7ppts. Sugar (-17.4) trades the lowest among all commodities and all assets, and was also the worst performer among all assets last week, as it fell 4.5ppts. The global indexes trade an average of 6.9% above their 200-dmas, down from 7.1% above in the prior week. All nine of the global indexes trade above their 200-dmas, unchanged from a week earlier. Chile (13.9) leads the global indexes, followed by Germany (12.4). Germany was also the group's best performer last week, with a gain of 1.7ppts. China (3.3) is trading at the lowest relative to its 200-dma of the global assets, but Japan (6.0) had the weakest performance of its country peers last week, as it fell 2.5ppts. The US indexes trade at an average of 4.4% above their 200-dmas, with 26 of the 33 sectors above, up from a 3.2% average a week earlier when 26 sectors were above. The US stock indexes no longer dominate the top ten assets trading above their 200-dmas. LargeCap Tech now leads all US stock indexes at 11.7% above its 200-dma, followed by SmallCap Tech (11.1), MidCap Tech (10.8), and LargeCap Financials (10.6). SmallCap Energy rose 6.1ppts w/w to -1.3% for the biggest gain among US stock indexes and all assets. MidCap Telecom trades 13.4% below its 200-dma, the lowest among the US stock indexes. LargeCap Utilities had the worst performance of the US stock indexes, declining 1.4ppts to 3.7%.

**S&P 500 Technical Indicators** ([link](#)): The S&P 500 remained in a Golden Cross last week for a 49th 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 17th straight week. Its 50-dma rose to a 34-month high of 5.4% above its 200-dma. That's up from a six-month low of 2.0% in early December and a 52-month low of -4.5% in March 2016. The S&P 500's 50-dma moved higher for a 20th week after six weekly declines, and the index closed the week above its 50-dma for a 20th week after nine weeks below. The S&P 500 improved to 0.9% above its rising 50-dma from a 20-week low of 0.3% last Monday. 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 closed the week 6.4% above its rising 200-dma. That's up from a seven-week low of 5.7% last Monday, but down from a 38-month high of 9.4% on March 1. The 50-dma and 200-dma both rose together for a 19th week, and at a slightly faster pace than a week earlier.

**S&P 500 Sectors Technical Indicators** ([link](#)): The short-term and long-term pictures improved for seven of the 11 S&P 500 sectors last week. These four sectors weakened relative to their 50- and 200-dmas: Consumer Staples, Health Care, Telecom, and Utilities. Eight of the 11 sectors trade above their 50-day moving averages (dmas), up from six a week earlier, as Industrials and Materials turned positive. Energy remained below its 50-dma for an 11th straight week, and Financials and Telecom were below for a second week. All 11 were above their 50-dmas during mid-January, and all 11 were below the week before the election for the first time since December 11, 2015. Eight of the 11 sectors were above their 200-dmas last week, unchanged from a week earlier, as Energy and Real Estate remained below for a fourth week and Telecom for a second. Nine sectors are in a Golden Cross now, with 50-dmas higher than their 200-dmas, unchanged from a week earlier and leaving just Real Estate and Telecom still out of the club. 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 these two continued falling: Energy and Telecommunication Services. Nine sectors have rising 200-dmas, also unchanged from a week earlier, as Energy turned

positive and Telecom joined Real Estate and started falling.

## US ECONOMIC INDICATORS

**GDP** ([link](#)): Real GDP expanded at a revised 2.1% (saar) last quarter—faster than the 1.9% previous estimates—slowing from Q3's 3.5% rate. Most of the revision reflected an upward revision to personal consumption expenditures (to 3.5% from 3.0%, saar), led by services (2.4 from 1.8) and nondurable goods (3.3 from 2.8) consumption; growth in durable goods expenditures (11.4 from 11.5) held around its robust pace. The upward revision to consumer spending was partially offset by downward revisions to nonresidential fixed investment (0.9 from 1.3) and exports (-4.5 from -4.0). Within the former, the entire downward revision reflected slower investment in intellectual property products (1.3 from 4.5); the contraction in structures (-1.9 from -4.5) was much smaller, while spending on equipment was unchanged at 1.9% (saar). As for trade, while exports fell at a faster pace, imports (9.0 from 8.5) expanded at a faster pace. Growth in residential investment was unchanged at 9.6% (saar), while government spending (0.2 from 0.4) showed little growth.

**Contributions to GDP Growth** ([link](#)): Real consumer spending last quarter once again was the number-one contributor to GDP growth; real trade was the only drag. Some details: (1) Real consumer spending accounted for 2.40ppts of real GDP growth, as goods consumption added 1.29ppt—durable (0.82ppt) and nondurable (0.47)—while services consumption contributed 1.11ppt. (2) Inventory investment (1.01) added positively to growth for the second quarter—all nonfarm (1.15)—after a five-quarter string of negative contributions. (3) Residential investment (0.35) contributed to GDP growth for the first time in three quarters. (4) Nonresidential fixed investment (0.11) contributed to GDP growth for the third quarter as positive contributions from equipment (0.11) and intellectual property products (0.05) more than offset a decline in structures (-0.05); it was the first positive contribution for equipment since Q3-2015. (5) Real government expenditures (0.03) added to GDP growth—entirely state & local government spending (0.11), which had contributed negatively the previous two quarters; federal government spending (-0.08) detracted from growth for the third time in four quarters. (6) Trade (-1.82) subtracted from growth for the first time in a year, as both imports (-1.27) and exports (-0.55) were a drag on growth.

**Personal Income & Consumption** ([link](#)): Real consumer spending in February contracted for the second month after climbing to a new record high at the end of last year, supporting forecasts of softer consumer spending during Q1. However, while spending continued to weaken in February, real wage growth improved. Real spending dipped 0.1% in February after a 0.2% drop in January, which followed a four-month advance of 0.9%. Both real consumer durable goods (-1.2%) and services (-0.2) consumption fell over the two-month period; consumer nondurable goods spending edged up 0.1% in February after no change in January. Over the three months through February, real personal consumption expenditures expanded 1.9% (saar), based on the three-month average, down from a recent peak of 4.2% last June and the weakest in nearly a year. Over the comparable period, real spending on consumer nondurable goods (3.0%) was in line with prior readings, while consumer durable goods (4.2) and services (1.2) consumption slowed, with the former the slowest since April 2016 and the latter the slowest since summer 2013. Meanwhile, real wages & salaries increased 0.4% in February (the most since last July) after little movement the prior few months. Solid gains in employment along with accelerating wages should support robust spending during Q2.

**Consumer Sentiment** ([link](#)): Consumer sentiment cooled in late March, though was still above February's reading. "Overall, the data indicate both rising optimism as well as rising uncertainty due to the partisan divide," according to Richard Curtin, the survey's chief economist. The Consumer Sentiment Index edged up to 96.9—below the mid-month reading of 97.6—after falling from a cyclical high of 98.5 in January to 96.3 in February, which was the first decline in sentiment since the election.

The present situation index increased for the fourth time in five months from 103.2 in October to 113.2 in March—the highest reading since June 2005; it was down from its mid-month reading of 114.5. The expectations component was unchanged at 86.5, down slightly from its 86.7 preliminary estimate; it had reached a two-year high of 90.3 in January. Curtin also noted, “The continued strength in consumer sentiment has been due to optimistic views on three critical components: higher incomes and wealth, more favorable job prospects, and low inflation expectations.”

## GLOBAL ECONOMIC INDICATORS

**Eurozone Economic Sentiment Indicators** ([link](#)): The Economic Sentiment Index (ESI) for both the Eurozone (-0.1 to 107.9) and the EU (+0.2 points to 109.1) were little changed again in March, with the former edging down from February’s cyclical high and the latter edging up to a new cyclical high. This month, only Germany’s (+0.9 to 109.2) ESI rose, while Spain’s (-1.8 to 106.9) and France’s (-1.0 to 104.9) fell; ESIs for Italy (-0.1 to 105.5) and the Netherlands (-0.3 to 108.2) were marginally lower. At the sector level, construction confidence (+0.2 to -9.9) continued to reach new cyclical highs, while industry confidence (-0.1 to 1.2) held around its cyclical high; services confidence (-1.2 to 12.7) fell from February’s high. Meanwhile, consumer confidence (+1.2 to -5.0) remained in a volatile flat trend around its cyclical high; retail trade confidence was unchanged this month at 1.8 after falling the prior two months.

**Eurozone CPI Flash Estimate** ([link](#)): March’s CPI rate is expected to be 1.5% y/y, according to the flash estimate, slowing from 2.0% y/y in February, which surpassed the ECB’s inflation target of just under 2.0% for the first time in four years. Of the main components, energy (to 7.3% from 9.3% y/y), food, alcohol & tobacco (1.8 from 2.5), and services (1.0 from 1.3) costs all slowed, while the gain in non-energy industrial goods prices was unchanged at 0.2%. Meanwhile, the core inflation rate—which excludes food, alcohol & tobacco—increased 0.7% y/y, down from 0.9% the prior three months and near its record low of 0.6% in spring 2015.

---

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](#).