



MORNING BRIEFING

April 12, 2017

Back to the Future?

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

(1) Chauncey Gardner's favorite season. (2) S&P 500 revenues and earnings are growing again. (3) Green shoots. (4) Forward revenues and earnings at record highs for S&P 500/400/600. (5) Industry analysts may be boosting 2018 estimates to reflect impact of Trumponomics. (6) A few downbeat hard-data indicators. (7) Back to slower, but longer growth? (8) Demography and technology did not change on Election Day. (9) The CBO's estimate for potential real GDP growth at odds with Trump's MAGA ambitions for economy. (10) Hard to Make America Young Again. (11) Both labor force and productivity growth weighing on economic growth. (12) Earnings remain on growth track for stock market.

Strategy: Spring-Like Earnings Season. In the satirical movie "[Being There](#)," the presumed-to-be-great-economist Chauncey Gardner assures the President of the United States "there will be growth in the spring." His simple reasoning strikes the President as profoundly wise: "As long as the roots are not severed, all is well and all will be well in the garden," explains Gardner. "In a garden, growth has its season. There is spring and summer, but there is also fall and winter. And then spring and summer again." The irony: Chauncey actually is a gardener, talking about gardening.

In a 6/7/16 *National Review* [editorial](#), conservative columnist Jonah Goldberg compared Donald Trump to Chauncey Gardner. Specifically, he questioned the presidential candidate's conservative credentials: "It's more like Trump is a kind of angry Chauncey Gardner who benefits from intellectuals' reading deeply—too deeply—into his outbursts."

Happily for stock investors, Joe and I anticipate that there will be lots of growth in this spring's earnings season as companies report their Q1-2017 results. On a y/y basis, S&P 500 operating earnings per share (using Thomson Reuters data) declined during the five quarters from Q2-2015 through Q2-2016 ([Fig. 1](#)). We attributed the earnings recession over this period mostly to the plunge in the S&P 500 Energy sector's earnings. Last summer, we predicted that there would be growth in the second half of 2016 after the price of oil rebounded during the first half of the year. So far, so good:

(1) *Quarterly earnings.* Sure enough, green shoots began to sprout during Q3-2016 when earnings rose 4.1% y/y. That was followed by a gain of 6.0% during Q4-2016. Now we are predicting that Q1-2017 will be up 10.3%.

(2) *Quarterly revenues.* S&P 500 revenues per share actually started to recover (ever so slightly) during the first quarter of 2016 after declining during all four quarters of 2015 ([Fig. 2](#)). Revenues per share rose 4.2% during the last quarter of 2016. We estimate it rose 7.1% last quarter, the best growth since Q4-2011.

(3) *Forward ho!* S&P 500 forward revenues, the time-weighted average of industry analysts' consensus expectations for the current year and the next year, is a great coincident indicator of four-quarter-trailing revenues. The former is available weekly, while the latter is available only quarterly and with a lag of about six weeks ([Fig. 3](#)). The weekly forward revenues series peaked at a record high during the week

of October 9, 2014, and then slumped along with oil prices. Last year, it began to rebound during the week of February 25, and rose to a new record high during the week of September 1. It has continued to rise to record highs right through the end of March of this year.

A similar pattern was traced by S&P 500 forward earnings per share, which serves as a leading (not coincident) indicator of four-quarter-trailing S&P 500 earnings per share ([Fig. 4](#)). The former is also at a record high.

By the way, S&P 400 forward revenues is rebounding back to its 2016 high, while S&P 600 forward revenues continues to make new highs, after holding up very nicely during the energy recession ([Fig. 5](#)). Forward earnings for the S&P 500/400/600 are all rising in record-high territory ([Fig. 6](#)).

(4) *This year & next year.* Currently, industry analysts are predicting that S&P 500 earnings will rise 10.9% this year to \$130.86 and 12.2% next year to \$146.77 ([Fig. 7](#)). Joe and I are using \$142 for this year and \$150 for next year. (See [YRI S&P 500 Earnings Forecast](#).) We expect that deregulation and a retroactive cut in the corporate tax rate will boost earnings in 2017. If the tax cut isn't retroactive, then it should boost 2018 instead of 2017 earnings, and the market should be happy either way, in our opinion.

We are impressed by the stability in analysts' high expectations for 2018's S&P 500 earnings per share. They can't incorporate the impact of Trump's policies on earnings until company managements provide some guidance, which would be premature currently. However, analysts' high hopes for next year suggest that they may be adding a positive fudge factor for the impact of Trumponomics on earnings.

The same story can be told for S&P 400 earnings, which are expected to increase 10.1% this year and 13.3% next year. Ditto for S&P 600, with growth estimated at 9.1% this year and 20.3% next year.

US Economy: Back to Slower, Longer? In my meetings in London last week, many of our accounts were skeptical that the strength in the soft data in the US will trickle down to the hard data until the Trump administration actually succeeds in cutting taxes and in boosting infrastructure spending. The soft data consist mostly of surveys of consumers, CEOs, purchasing managers, small business owners, industry analysts, and investors. They all turned remarkably upbeat after Election Day, as Debbie and I have been monitoring in our new [Animal Spirits](#) chart publication.

On the other hand, a few hard-data indicators are downright downbeat. Auto sales totaled 16.6 million units (saar) during March, down from a recent high of 18.4 million units at the end of last year. Payrolls in general merchandise stores have dropped 89,300 over the past five months through March as a result of widespread store closings due to competition from Amazon ([Fig. 8](#)). Then again, employment in construction, manufacturing, and natural resources rose 175,000 during the first three months of this year ([Fig. 9](#)). The sum of commercial and industrial bank loans and nonfinancial commercial paper has been flat since the start of the year.

A bigger question is whether there has been a structural decline in the potential growth of the economy that may defy both the animal spirits that seem to have been unleashed by Trump's election as well as his "Make America Great Again" (MAGA) fiscal policies, assuming they get fully implemented. If so, then the long-term trend of growth for both the real economy and corporate earnings may be lower than in the past. The good news in this scenario is that it might mean that a boom is less likely, which obviously would reduce the risk of a bust.

While much has changed since Election Day, some things have not. Demography hasn't changed. Neither has technology. Globalization might change, but for now the world remains very competitive as

a result of relatively free (though not necessarily fair) trade. Productivity growth remains abysmal, and might improve as a result of MAGA policies, or might not. Consider the following:

(1) *Potential output.* The Congressional Budget Office (CBO) calculates a quarterly series for potential real GDP growth that starts in 1952 and is available through 2027 ([Fig. 10](#)). The outlook for this year and beyond is based on demographic projections used to estimate labor force growth and assumptions about productivity.

From 1952 through 2001, potential real GDP grew in a range mostly between 2.5% and 4.0%, averaging 3.5%. Since then, growth has consistently been below 3.0%, and actually below 2.0% since Q1-2007.

(2) *Real GDP.* Debbie and I constructed a series for the underlying growth in real GDP simply as the 40-quarter percent change in real GDP annualized ([Fig. 11](#)). It tells more or less the same story as the CBO's estimate for potential output. From 1960 through 1975, growth averaged 4.7%. From 1975 through 2007, it averaged 3.7%. It plunged during the Great Recession, and has remained consistently below 2.0% since Q3-2009.

(3) *Labor force.* Trump may or may not succeed with his MAGA plans. However, he certainly can't Make America Young Again (MAYA). He can't bring back the Baby Boom. There has been a dramatic slowing in the growth of the working-age population and the labor force, particularly of the 16- to 64-year-olds ([Fig. 12](#) and [Fig. 13](#)). The actual growth rates of this age segment of the working-age population and the labor force are down to 0.5% and 0.3% over the past 10 years at annual rates ([Fig. 14](#)).

(4) *Productivity.* The big unknown is whether Trump's MAGA policies can revive productivity growth. That's the only way that real GDP growth might finally exceed 2.0%. Getting it up to Trump's 4.0% goal seems very unlikely. Nonfarm productivity growth has been below 1.0% since Q4-2014, based on the five-year percent change at an annual rate ([Fig. 15](#)). Surprisingly, manufacturing has contributed greatly to this weakness, also rising less than 1.0% since Q4-2015.

(5) *S&P 500 earnings.* The potential growth of the economy matters a great deal for the stock market since it determines the potential growth of corporate earnings. Surprisingly, so far, the S&P 500 forward earnings since 1979, which is when the data start, remains on a 6%-7% annualized growth trajectory ([Fig. 16](#)). Over this same period, the S&P 500 has been tracking growth of 8%-9%, with more upside and downside volatility than in forward earnings ([Fig. 17](#)).

CALENDARS

US. Wed: Import & Export Prices -0.2%/0.1%, MBA Mortgage Applications, Atlanta Fed Business Inflation Expectations, EIA Petroleum Status, Treasury Budget. **Thurs:** Jobless Claims 243k, Headline, Core & Core Less Services 0.0%/0.2%/0.2%, Consumer Sentiment Index 97.0, Weekly Consumer Comfort Index, EIA Natural Gas Report, Baker-Hughes Rig Count. (Bloomberg estimates)

Global. Wed: UK Employment Change & Unemployment Rate 68k/4.7%, China CPI & PPI 1.0%/7.5% y/y, BOC Rate Decision 0.50%, Carney. **Thurs:** Germany CPI 0.2%/m/m/1.6%/y/y, China Trade Balance \$12.5b, Australia Employment Change & Unemployment Rate 20k/5.9%. (DailyFX estimates)

STRATEGY INDICATORS

S&P/Russell LargeCaps & SMidCaps ([link](#)): All these price indexes attained post-election record

high in February and March as the SmallCap and MidCap market-cap indexes outperformed LargeCaps. However, SmallCaps are underperforming so far in 2017. Here's the ytd score and their percentage changes since Election Day: S&P LargeCap 500 (5.3% ytd, 10.2% since the election), Russell LargeCap 1000 (5.3, 10.4), Russell MidCap (4.9, 10.7), S&P MidCap 400 (3.0, 13.0), Russell SmallCap (0.7, 14.4), and S&P SmallCap 600 (-1.0, 14.3). The yearly change in forward earnings is up from six-year lows in early 2016 for all three indexes as y/y comparisons have eased. In the latest week, LargeCap's forward earnings rose to a 62-month high of 8.8% y/y from 8.7%, which compares to a six-year low of -1.8% in October 2015; MidCap's dropped to 11.0% from a 30-month high of 11.5%, which compares to a six-year low of -1.3% in December 2015; and SmallCap's fell to 12.1% from 12.6%, which compares to a 34-month high of 12.8% in mid-March and a six-year low of 0.3% in December 2015. Growth rates now expected for 2017 and 2018 before the impact of tax-rate changes: S&P LargeCap500: 10.8% and 12.2%; MidCap 400: 10.1% and 13.3%; and SmallCap 600: 9.1% and 20.3%.

S&P 500 Growth vs. Value ([link](#)): The S&P 500 Growth index is up 7.9% ytd, ahead of the 2.4% gain for its Value counterpart. Since the election, Growth's 9.9% gain has trailed the 10.1% increase for Value. During 2016, the S&P 500 Growth index underperformed its Value counterpart by a wide margin, rising just 5.1% vs Value's 14.3% gain. Growth is expected to deliver higher forward revenue growth (STRG), but lower forward earnings growth (STEG), than Value over the next 12 months: 6.3% STRG and 9.4% STEG for Growth, respectively, vs 5.1% and 12.0% for Value. Growth's P/E of 20.0 is at a 14-year high, while Value's 15.7 is down from early March's 14-year highs of 16.2. Regarding NERI, Growth's has been negative for five straight months and improved to -2.3% in March from -3.0% in February; that compares to a five-year high of 5.8% in June 2016 and a five-year low of -16.2% in April 2015. Value's NERI was negative for a 32nd straight month in March, and dropped to a seven-month low of -3.9% from -2.8% in February; that compares to a 10-month low of -18.0% in February 2016 and a five-year low of -20.3% in April 2015.

US ECONOMIC INDICATORS

NFIB Small Business Survey ([link](#)): Small business optimism was sustained in March, though it did tick down for a second month. NFIB's president notes, "Small business owners remain optimistic about the future of the economy and the direction of consumer confidence. We are encouraged by signs that optimism is translating into economic activity, such as capital investment and job creation." March's Small Business Optimism Index (SBOI) slipped for the second month, by a total of 1.2 points, after soaring from 94.1 in September to 105.9 in January—which was the highest since December 2004. Of the 10 components, two rose (hirings and capital spending plans), two were unchanged (now is a good time to expand and expected credit conditions), while six fell. But all the moves were by just a few points, except for sales expectations, which fell 8ppts to 18%—still a relatively high level. NFIB's chief economist warned the Uncertainty Index, a subset of data on how small business owners see the near-term future, climbed to 93 in March, the second-highest reading in the survey's history, as "more small business owners are having a difficult time anticipating the factors that affect their businesses, especially government policy." April's survey should be telling, since it will be the first full survey since Congress failed to pass a bill repealing and replacing Obamacare, which was a big reason for the soaring optimism in recent months.

JOLTS ([link](#)): Job openings rose 118,000 in February, and 204,000 for the first two months of the year, to 5.743 million—within 230,000 of last July's record high of 5.973 million. Meanwhile, hirings fell for the first time in five months, by 110,000 to 5.314 million, following a four-month gain of 245,000. Separations also fell for the first time in five months, by 176,000 to 5.071 million after a four-month advance of 305,000. The latest hirings and separations data yielded an employment advance of 243,000 for February, 24,000 above February's payroll gain of 219,000—coming in above for the fourth

time in five months. February's job-opening rate (4.1%) held just below its record high of 4.2% last July, while the total hires rate (4.0) also remained just below its cyclical high of 4.2%. The quit rate (2.4) was unchanged for the sixth month at its record high. The ratio of unemployed workers per job opening fell to 1.31, back near its cyclical low of 1.30 posted last July.

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