



MORNING BRIEFING

April 27, 2017

Earnings Boosting Stocks

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

(1) Nasdaq titans breach 6000. (2) Yet Industrials and Materials are leading April run in S&P 500 so far. (3) Beating expectations and raising guidance. (4) Finding more traction in the slippery oil patch. (5) CAT purring with Asian tigers. (6) Solstice: One of Honeywell's sweet spots. (7) Are Millennials childish or adultish? (8) The basement suburban legend. (9) Education matters. Having children not so much.

Sector Focus: Industrious Industrials. Apple, Facebook, Netflix, and other tech titans helped the Nasdaq breach the 6,000 level for the first time on Tuesday. However, in the month of April so far, Tech has not been the leading sector in the S&P 500. It's the mundane Materials and Industrials sectors leading the way. A pop in basic metals prices, a surge in US fracking activity, and strong economic activity in Asia have boosted the two basic sectors.

Here's how the 11 sectors in the S&P 500 have performed in April through Tuesday's close: Materials (2.4%), Industrials (2.3), Consumer Staples (1.8), Tech (1.8), Consumer Discretionary (1.7), Real Estate (1.4), Utilities (1.3), S&P 500 (1.1), Financials (0.5), Health Care (0.4), Energy (-1.6), and Telecom (-3.3) ([Table](#)).

A string of strong earnings reports has been bolstering the performance of Industrials, as many results have beat Street expectations. Just over half (57%) of large-cap Industrials have reported Q1 earnings as of Wednesday morning, and they've beaten earnings forecasts by 10.0% and revenue forecasts by 1.4%, according to Joe. Those results are well ahead of the S&P 500's aggregate surprises of 6.0% above earnings estimates and 0.9% above revenue estimates.

Looking ahead, the news gets even better: With strong Q1 results as a foundation, a number of companies proceeded to push up earnings guidance for 2017. If President Trump manages to lower the corporate tax rate to 15%, investors will have yet another positive development to embrace, as many Industrials have corporate tax rates that are well north of 20%. Let's take a look at some of the positivity emanating from the Industrials sector in recent days:

(1) *Improving oil patch.* The price of oil may be far from what the fuel fetched in the heady days at the start of this decade, but it has bounced 87% from its low of \$27.88 a barrel on January 20, 2016 to \$52.10 recently ([Fig. 1](#)). The jump in prices seems to have been just enough to get US frackers to start drilling again. US oil field production has rebounded 10% from its recent low of 8.43 million barrels per day during the week of July 1, 2016 to 9.27mbd through the week of April 21 ([Fig. 2](#)). The US Baker Hughes oil rig count has increased to 688 from a low of 316 during May 2016 ([Fig. 3](#)). That has led to a bounce off the lows in related hiring and equipment purchases ([Fig. 4](#) and [Fig. 5](#)).

Dover has benefitted from the drilling revival. Energy, one of Dover's four divisions, develops pumps, sensors, and monitoring solutions to boost the efficiency and safety of extracting oil and gas. So more rigs in service is very good news for the company. After reporting Q1 results, Dover boosted its FY earnings guidance to \$4.05 to \$4.20 a share, up from prior guidance of \$3.40 to \$3.60 a share. The jump was attributed to the "solid first quarter performance, higher expectations in Energy, and overall

strong bookings activity,” explained the Q1 [press release](#). CFO Brad Cerepak said Dover’s energy segment is now expected to grow 20%-23% organically in 2017, thanks to growth in drilling and production and automation businesses. That growth is up seven percentage points compared to the forecast given in the company’s Q4 [conference call](#).

The number of new rigs put to work should continue to increase but at a slower rate, predicted CEO Bob Livingston, according to the Q1 earnings conference call [transcript](#). However, the number of uncompleted wells has been growing in Q1, so well completion activity should pick up, “especially in the second half of the year,” he said. “I think it really is setting this energy segment up well for continued well completion activity into 2018 and perhaps even beyond.” Analysts have increased their 2017 consensus EPS estimate for Dover to \$3.98, up from \$3.57 a month ago, but that’s still below the company’s new, rosier forecast. Dover’s Q1 tax rate: 25.7%.

Dover is part of the S&P 500 Industrial Machinery index, which has risen 60.4% from the January 20, 2016 low ([Fig. 6](#)). The industry is expected to grow revenues by 5.4% over the next 12 months and earnings by 10.1% ([Fig. 7](#)). The forward profit margin has improved from a cyclical low of 9.8% at the end of 2015 to a record high of 10.7% ([Fig. 8](#)). The shares have priced in much of the good news, with the industry’s forward P/E at 19.2, near the top of the range its traded in over the past 20 odd years ([Fig. 9](#)).

(2) *Roaring Asian tigers*. China’s 7.1% Q1 GDP growth may be inflated by government spending, but that doesn’t mean US companies don’t stand to benefit from it ([Fig. 10](#)). The strength in Asia has been accompanied by a 26% rebound in the CRB raw industrials spot price index from a low on November 23, 2015 through Tuesday’s close, which undoubtedly has helped US industrials as well ([Fig. 11](#)).

Sales in Asia were a bright spot in Caterpillar’s surprisingly strong Q1 results. Asia/Pacific Q1 sales in Caterpillar’s construction division jumped 23% y/y to \$1.1 billion, while sales in Latin America rose 8%; in North America and in Europe/Africa/Middle East, sales fell 7% and 4%, respectively, according to the company’s [press release](#). Likewise, Asia/Pacific sales in Caterpillar’s resource industries division grew 23%, but they slumped 13% in the energy & transportation division.

All in all, Caterpillar reported revenue of \$9.8 billion, up from \$9.5 billion a year ago, and profits excluding restructuring expenses came in at \$1.28 a share, up from 64 cents and well above analysts’ estimate of 63 cents a share. Like Dover, Caterpillar increased its full-year 2017 earnings outlook to \$3.75 a share excluding restructuring costs. Its previous outlook, given in January, was for \$2.90 a share of earnings. Caterpillar’s Q1 tax rate: 31.1%.

Caterpillar resides in the S&P 500 Construction Machinery & Heavy Trucks stock index, which has jumped 71.2% since January 25, 2016 ([Fig. 12](#)). The industry is the fourth-best performer in April among the industries we follow in the S&P 500. Despite its mighty climb, the Construction Machinery & Heavy Trucks index has failed to make a new high for the past seven years and isn’t much higher than where it stood in 2007. The industry’s forward P/E is a lofty 20.7 because forward earnings estimates have fallen for much of the past five years and only began to hook up at the end of last year ([Fig. 13](#)). If industry revenues revive, there’s much room for improvement, as forward profit margins are 6.8%—well off the peak margin level topping 9.5% in 2012 ([Fig. 14](#)).

(3) *Beating estimates*. On their face, Q1 results at Honeywell weren’t fabulous, with reported sales flat y/y. However, excluding the impact of foreign exchange, acquisitions, and divestitures, sales rose 2% y/y. Add in margin expansion and a slightly reduced share count, and adjusted EPS rose 11% to \$1.66.

The results beat Honeywell’s January guidance by two cents, and the company increased the low end

of its 2017 guidance by five cents to \$6.90 to \$7.10 a share. The upshot: Honeywell shares hit a record high on Monday.

Strong results came from Honeywell's performance materials and technologies division, where sales rose 5% and margins expanded by 260bps. The materials division was helped by increasing sales of Solstice, which Honeywell developed to replace hydrofluorocarbons, a gas that is believed to contribute to global warming.

The 3% jump in adjusted sales in the safety and productivity solutions group was aided by a 20% jump at Intelligrated, which Honeywell purchased for \$1.5 billion last August. The company provides software, equipment, and services to fulfillment centers used by retailers, manufacturers, and logistics providers. Its sales were predominately in the US, and Honeywell aims to help the company expand sales internationally. Honeywell's Q1 tax rate: 22.7%.

Honeywell is a member of the S&P 500 Aerospace & Defense index, which has outpaced the broader market and risen 3.5% in April ([Fig. 15](#)). The industry is expected to see a revenue jump of 2.7% over the next 12 months and an earnings gain of 7.4% ([Fig. 16](#)). Investors are optimistic that President Trump will successfully push through a \$54 billion increase in defense spending. Like many industries, however, Aerospace & Defense's forward P/E, at 18.6, has risen to close to the top of its 20-year range ([Fig. 17](#)).

Millennials: Adultish. Many Millennials, particularly men, have been unfairly belittled. According to the popular stereotype, they are living in the finished basements of their parents' homes playing video games while snacking on Cheetos. But is this an accurate depiction of the typical Millennial? Today's young adults might be delaying many of the milestones that previously defined adulthood. However, many of them are also redefining what it means to be a responsible adult, as Melissa discussed on Monday. Today, she reviews highlights of the Census Bureau's April [report](#) titled *The Changing Economics and Demographics of Young Adulthood: 1975-2016*. Defending her maligned cohort, she concludes that most Millennials are not as sorry a bunch as some might think. Consider the following:

(1) *Living at home.* Census reports that "1 in 3 young people, or about 24 million 18- to 34-year-olds, lived in their parents' home in 2015," according to Current Population Survey (CPS) data. Buried in the footnotes, however, there is an important disclaimer: "The CPS counts college students living in dormitories as if they were living in their parents' home. As a result, the number of young adults residing in their parents' home is higher than it would be otherwise, especially for 18- to 24-year-olds, who are more likely to be living in college housing." Of the 18- to 24-year-olds living at home, more than half, or 53.6%, of them is enrolled in school. Further, nearly two-thirds, or 67.3% of them, is employed or actively seeking a job. In other words, most younger Millennials living with their parents are not really living at home at all!

Neither are older Millennials. Nearly three-quarters of the 25- to 34-year-olds supposedly living at home is enrolled in school or working. It's the remaining one-quarter of older Millennials living at home whose economic contribution and motivation are questionable. However, the data show that 21.4% of this smaller cohort has at least one child and nearly 30.0% has a disability. Comparatively, of the three-quarters enrolled in school or working, just 17.5% has a child and only 5.0% has a disability. So it could be that a sizable portion of the older Millennials living at home is doing so because they are legitimately struggling. Nevertheless, those who are living at home and also not in school or working make up just a small subset of the Millennials population at large and are hardly representative of the generation.

(2) *Working women.* The image of the idle male Millennial wasting the day away might be a suburban legend. Young women indeed have surpassed young men in terms of educational attainment today.

“There are now more young women than young men with a college degree, whereas in 1975 educational attainment among young men outpaced that of women,” according to the report.

On the other hand, “more young people are working today and have a full-time job that employs them year-round” than in 1975. That’s largely because lots more young women stayed home to take care of the kids during previous generations than do now. The share of employed young women has risen from under one-half to over two-thirds over the same time period. Meanwhile, the share of employed men aged 25- to 34- is “about the same today as it was in 1975.” So women have done better in terms of employment over the generations, but men aren’t worse off.

(3) *Adult milestones.* Many Baby Boomers were eager to leave the nest, buy homes, and start their families. Today’s young adults are more eager to achieve their own personal goals before committing to a relationship or children. Today, 62.0% of adults surveyed says that finishing school is extremely important to becoming an adult, according to the report. “Over half of Americans believe that marrying and having children are not very important in order to become an adult.” Back in the 1970s, 8 in 10 people were married by age 30. Today, that statistic doesn’t occur until age 45. According to research cited in the report, less than 10% of young adults thinks that having kids is necessary to being happy in life. Further, most of those living at home are happy with that arrangement and their family life in general.

CALENDARS

US. Thurs: Durable Goods Orders Total, Ex Transportation, and Core Capital Goods Orders 1.1%/0.4%/0.4%, Advanced Merchandise Trade -\$65.3b, Jobless Claims 244k, Pending Home Sales -0.5%, Kansas City Fed Manufacturing Index, Weekly Consumer Comfort Index, EIA Natural Gas Report. **Fri:** Real GDP, Real PCE, and GDP Price Deflator 1.1%/0.7%/2.0%, Employment Cost Index 0.6%, Consumer Sentiment Index 98.0, Baker-Hughes Rig Count, Brainard, Harker. (Bloomberg estimates)

Global. Thurs: Eurozone Economic Confidence 108.1, Germany CPI -0.1%/m/m/1.9%/y/y, Japan Headline, Core, and Core-Core CPI 0.3%/0.2%/0.0%, Japan Industrial Production -0.8%/m/m/4.0%/y/y, Japan Retail Trade -0.3%/1.5%/y/y, ECB Central Bank, Marginal Lending Facility, and Deposit Facility Rates 0.00%/0.25%/-0.40%, ECB Asset Purchase Target (euros) 60b, BOJ Policy Balance Rate & 10-Year Yield Target -0.10%/0.00%. **Fri:** Eurozone Headline & Core CPI Flash Estimate 1.8%/1.0%/y/y, Germany Retail Sales 0.0%/m/m/2.2%/y/y, France GDP 0.4%/q/q/0.9%/y/y, UK GDP 0.4%/q/q/2.2%/y/y, Canada GDP 0.1%/m/m/2.6%/y/y, Japan Housing Starts 954k. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): The Investors Intelligence Bull/Bear Ratio (BBR) climbed from 2.84 to 3.06 this week; it has been fluctuating around 3.00 the past five weeks, after 15 weeks above. Bullish sentiment rose to 54.7% this week after falling from 56.3% to 51.9% last week; the reading was 63.1% eight weeks ago—which was the most bulls since 1987! Nearly all the moves in recent weeks have been between the bulls and correction camp. This week, 2.4ppts of the 2.8ppts increase in bullish sentiment came from the correction camp, which fell from 29.8% to 27.4%. Bearish sentiment was little changed again this week, edging down to 17.9% after edging up from 17.5% to 18.3% last week. The AAll Bull Ratio slipped to 39.9% last week after climbing from 41.7% to 43.7% the previous week. Bullish sentiment fell from 29.0% to 25.7%, while bearish sentiment rose from 37.4% to 38.7%.

AC World ex-US MSCI ([link](#)): This index is up 9.6% ytd in dollar terms after rising 1.7% in 2016. In

local-currency terms, the index has risen 6.0% ytd compared to its 4.1% gain for all of 2016. Local-currency forward revenues has risen 5.6% from a five-year low in March 2016, but has been more stable longer term and is down just 5.2% from its October 2014 record high. Local-currency forward earnings has performed better, with a 13.8% rise from its six-year low in March 2016 to an eight-year high, but remains 11.5% below its September 2008 record. Revenues are expected to rise 7.1% in 2017 and 4.8% in 2018 following a 0.5% decline in 2016, and earnings are expected to rise 16.4% (2017) and 9.6% (2018) after rising 2.3% (2016). Analysts are forecasting STRG of 6.4%, down from a seven-year high of 6.8% in March and up from a cyclical low of 2.3% in March 2016. Their STEG forecast of 13.7% is down from a four-year high of 14.1% in March, 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 was positive for a fourth month in April for the first time since March 2011, but edged down to 1.7% from a six-year high of 1.8% in March. That compares to a 51-month low of -11.3% in March 2016. The P/E edged down to 13.9 in April from 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 11% 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 13.3% ytd in dollar terms after falling 1.2% in 2016. In euro terms, the price index is up a lower 9.4% 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 2.8% above its prior cyclical high in September 2015 to its highest level since November 2011. It remains 25.9% below its record high (January 2008), but has improved 9.8% from its 23-month low in June 2016. Analysts expect revenues to rise 5.5% and 3.6% in 2017 and 2018, respectively, after falling 1.8% in 2016, but think earnings will rise 13.4% in 2017 and 10.3% in 2018 following a 0.3% gain in 2016. Forecasted STRG of 4.8% is at a six-year high and up from 2.0% last May. Forecasted STEG of 12.2% 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 (11.5%) since July after trailing it since late 2015. The forward profit margin has improved 1.0ppt to 7.2% from a cyclical bottom of 6.2% in May 2013. The implied profit margin is expected to improve to 7.0% in 2017 from 6.5% in 2016 before rising another 0.5ppt to 7.5% in 2018. NERI was positive for a fifth straight month in April as it improved 0.8ppts m/m to a seven-year high of 4.8% from 4.0% in March, which compares to a 24-month low of -13.2% in April 2016. The P/E of 14.3 is down from a 13-year high of 16.4 in April 2015, but up from a 30-month low of 12.2 in February 2016. That represents a 9% discount to the World MSCI's P/E now, up from a record-low 25% discount during 2011. But the current reading is still well below the 1% premium during April 2015—the post-euro-inception record high.

Emerging Markets MSCI ([link](#)): The EM MSCI price index is up 14.0% ytd in US dollar terms after rising 8.6% in 2016. In local-currency terms, EM has gained 9.8% ytd compared to a 7.1% gain in 2016. Local-currency forward revenues is up 3.4% from a four-year low in June 2016 to 12.9% below its November 2014 record. Local-currency forward earnings has improved 15.0% from April 2016's six-year low and is down just 6.0% from its January 2014 record. Revenues are expected to rise 9.9% in 2017 and 8.1% in 2018 following a 2.8% gain in 2016, leading to earnings gains of 19.1% (2017) and 11.2% (2018) following a 7.3% 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 (14.4%) for the first time since July 2013. The implied profit margin is expected to improve to 6.8% in 2017 from 6.2% last year before edging up to 6.9% 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 74 months—improved m/m to a 70-month high of -1.3% from -1.4%

in March, 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 down to 11.9 in April from 12.2 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 24% discount to the World MSCI P/E, up from a 10-year-low 30% discount in August 2016.

MSCI World & Region Net Earnings Revisions ([link](#)): Analysts' recent earnings revisions through April suggest rising optimism about profits across the world as all regions improved m/m except EAFE, EM Eastern Europe, and EM Latin America. The AC World MSCI's NERI was positive for a third month and for the first time since June 2011, as it improved 0.2ppt to 0.8% from 0.6% in March. The AC World Ex-US was positive for a fourth month, but weakened 0.2ppts to 1.7% from 1.9% in March. EM Eastern Europe and Europe were positive for a seventh straight month; EAFE and EMU were positive for a fifth month. April's scores among the regional MSCIs: EMU (80-month high of 4.8%, compared to 4.0% in March), EAFE (4.6, 5.1), Europe ex-UK (78-month high of 3.8, 3.6), Europe (79-month high of 3.6, 3.4), EM Eastern Europe (2.4, 3.5), AC World ex-US (1.7, 1.8), AC World (71-month high of 0.8, 0.6), EM Asia (70-month high of -0.9, -1.2), United States (-1.3, -2.4), Emerging Markets (70-month high of -1.3, -1.4), and EM Latin America (12-month low of -5.5, -4.8).

MSCI Countries Net Earnings Revisions ([link](#)): NERI was positive for 22/44 MSCI countries in April, down from 24/44 in February and March, which was the most since May 2011. NERI improved m/m in April for 19/44 countries, down from 26/44 improving in March. Spain's NERI was at a record high in April, followed by those of Italy (129-month high), Turkey (88), China (77), Hong Kong (75), Poland (75), Malaysia (58), Indonesia (33), and Germany (22). On the flip-side, South Africa was at a 92-month low, followed by those of New Zealand (21), Portugal (13), Peru (12), Russia (12), and Brazil (11). The 13-month positive NERI streak for Hungary is the best, followed by 12-month positive streaks for Peru and Russia, Austria (11), and the UK (9). NERI turned negative for three countries: Egypt, Israel, and Taiwan. Hungary's is the strongest recently, with positive readings in 23 of the past 24 months. Brazil's NERI has been negative for 82 straight months, followed by the negative streaks of Singapore (73), Chile (69), and Malaysia (58).

S&P 500 Earnings Season Monitor ([link](#)): With 36% of S&P 500 companies finished reporting Q1-2017 results, their revenue and earnings surprise metrics and y/y growth are stronger than at the comparable point of the Q4 season. Of the 181 companies in the S&P 500 that have reported, 79% exceeded industry analysts' earnings estimates by an average of 6.0%; they have averaged a y/y earnings gain of 11.7%. At the same point in Q4-2016, a lower percentage of companies (66%) in the S&P 500 had beaten consensus earnings estimates by a smaller 2.7% and earnings were up a lower 9.1% y/y. On the revenue side, 63% beat sales estimates so far, coming in 0.9% above forecast and 4.4% higher than a year earlier. During Q4, a lower 49% were above forecast, which exceeded estimates by a smaller 0.2% and rose a lower 3.2% y/y. Q1 earnings results are higher for 75% of companies versus a similar 75% at the same point in Q4, but revenues are higher for 79% versus 70%. These figures will continue to change as more companies report Q1 results. The early results are encouraging and bode well for future estimate revision activity, but y/y growth is likely to slow in the coming quarters as y/y comparisons become less easy.

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