Yardeni Research, Inc.

MORNING BRIEFING
May 17, 2017

Back in the Cage?

See the collection of the individual charts linked below.

(1) Swamps, zoos, and Washington, D.C. (2) City slicker in White House doesn't know much about swamps. (3) Less mojo in soft data, which are mostly holding onto post-election bounces. (4) Economic Surprise Index showing weaker-than-expected hard data. (5) Key rail and truck gauges have stalled. (6) Business loans rise to record high despite slow pace of growth. (7) Plenty of good news in earnings. (8) Smooth sailing for stocks in the swamp, so far.

Strategy: The Zoo. Washington is often compared to a swamp, especially by the current occupant of the White House. After Election Day, the US economy was getting compared to a zoo where the animals had been let out of their cages. So-called "animal spirits" were running wild. To keep track of all the commotion, Debbie and I compiled a *chart publication* of all the "soft," survey-based data showing a remarkable and widespread surge in consumer and business confidence. That was also reflected in the post-election rally in the stock market.

Trump has occupied the White House now for 118 days. The swamp waters seem to be rising rather than receding. Apparently, there are many more swamp people than he ever imagined. He alienated them from Inauguration Day when he promised to drain the swamp. Now they are doing their utmost to drown him in the swamp. Having been a real estate tycoon in NYC most of his adult life hasn't prepared Trump for surviving in the swamp, let alone for draining it.

Surprisingly, most of the soft data remain elevated, though they've lost their post-election mojo. So far, there hasn't been strong evidence that the initial surge in confidence has boosted economic growth (i.e., the hard data) much. Consider the following:

(1) *Business surveys mixed.* On the weak side is the May regional business survey conducted by the FRB-NY (*Fig. 1*). The general business conditions index is down from a recent peak of 18.7 during February to -1.0 during May, the lowest since October. At the start of this month, we learned that the national M-PMI dropped during April to 54.8 from a recent peak of 57.7 during February (*Fig. 2*).

(2) *Consumer confidence upbeat.* Measures of consumer confidence are holding up relatively well. That might have more to do with the tightness of the labor market than the election results. Our Consumer Optimism Index, which is the average of the Consumer Sentiment Index and the Consumer Confidence Index, edged down in April to 108.7 from the previous month's cyclical high of 110.9 (*Fig. 3*).

The strong demand for labor is certainly boosting confidence. During April, more than 30% of small business owners said they have positions they can't fill (*Fig. 4*). Last month, 19.1% of consumers said that jobs are hard to get, barely budging from March's 19.0%, which was the lowest such reading since July 2007.

(3) *Surprise index freefalling.* The Citigroup Economic Surprise Index continues to fall (*Fig. 5*). It recently peaked at 57.9 on March 15. Yesterday, it was down to -37.6, the lowest since May 12, 2016.

(4) *Railcars not so loaded.* Transportation indicators have stalled recently. Debbie and I track the 26-week moving average of railcar loadings of intermodal containers (*Fig. 6*). We do so to smooth out this volatile series. This is the time of year when it usually increases as retailers stock up for summer sales. Instead, it has been edging down in recent weeks. This series is also highly correlated with the ATA Truck Tonnage Index, which is seasonally adjusted, but can still be volatile from month to month. Nevertheless, it has clearly been stalled at a record high for the past 14 months.

We also track the 26-week moving average of railcar loadings of motor vehicles, which is highly correlated with monthly auto sales (*Fig. 7*). The former series rose to a cyclical peak during the week of July 2, 2016, and has been on a slight downward trend since then.

(5) *Business loans at record high.* The bad news is that the y/y growth rate in commercial and industrial (C&I) loans plus nonfinancial commercial paper dropped to 1.9% in mid-April, the weakest since early March 2011, and held around that rate through early May (*Fig. 8*). The good news is that the actual level of this series rose to a new record high that same week (*Fig. 9*)! This suggests that some of the anxiety about its recent slowdown might have been overdone.

(6) *Industrial production is up.* As Debbie reports below, despite the slowdown in short-term business borrowing and April's decline in the M-PMI, industrial production rose by a better-than-expected gain of 1.0% m/m in April, with factory output also up 1.0%. The gains were widespread. Production gains were solid for both consumer- and business-related goods.

(7) *S&P earnings continue record run.* Most importantly for the stock market, industry analysts remain upbeat about the outlook for earnings. During the week of May 11, the forward earnings of the S&P 500/400/600 remained in record-high territory and on solid uptrends (*Fig. 10*). For the S&P 500, consensus earnings estimates remain remarkably stable around $147 per share for 2018 (*Fig. 11*). That's 11.8% above the current estimate of $131.57 for this year, which is up 11.5% from last year's result.

The Q1-2017 earnings season is ending with a whimper as many retailers posted disappointing results. Nevertheless, thanks to upside surprises in other industries, there were solid upside hooks in actual earnings compared to estimates at the beginning of the latest season (*Fig. 12*).

(8) *Stocks treading swamp water.* So why are stocks holding up so well in record territory if Trump is either struggling or drowning in the swamp? The widespread view has been that the post-election Trump bump discounted his tax-cutting agenda, which might take longer to achieve if it happens at all. That's true, but it also discounted that a very pro-business group of people would be running the executive branch for the next four years. That branch of government includes all the regulatory agencies, which will either eliminate or simply not enforce lots of regulations that business managers deem unnecessary, onerous, burdensome, and costly.

Besides, earnings are growing, and industry analysts remain optimistic about the outlook through 2018, though they may be assuming some boost from tax cuts. The stock market rallies overseas suggest that global investors are turning more optimistic on global economic growth. Adding to the animal spirits in the global stock markets may be a sense that inflation and interest rates may stay subdued for a long time, so the economic expansion might last a long time as well.

Also bullish in this "Seinfeld market" is that bad things aren't happening. The Eurozone isn't on the verge of disintegrating now that populists have been defeated in recent elections. The Eurozone's economic performance is improving. China's recent credit tightening hasn't rattled global markets, while its Silk Road mega-project is attracting lots of interest from companies that want a piece of the action.

The Fed will probably hike the federal funds rate at the June meeting of the FOMC, and probably nothing bad will happen.

CALENDARS

US. Wed: MBA Mortgage Applications, EIA Petroleum Status. **Thurs:** Jobless Claims 240k, Leading Indicators 0.3%, Philadelphia Fed Manufacturing Index 19.6, Weekly Consumer Comfort Index, EIA Natural Gas Report. (Bloomberg estimates)

Global. Wed: Eurozone Headline & Core CPI 1.9%/1.2% y/y, UK Employment Change & Unemployment Rate 21k/4.7%, Japan Real GDP (annualized) 1.8%, Japan Industrial Production. **Thurs:** UK Retail Sales 2.0% y/y, Australia Employment Change & Unemployment Rate 5k/5.9%, Draghi. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Earnings Season Monitor (*link*): With 92% of the S&P 500 companies and 6/11 sectors finished reporting Q1-2017 results, their revenue and earnings surprise metrics are stronger than at the comparable point of the Q4 season. Of the 458 companies in the S&P 500 that have reported, 75% exceeded industry analysts' earnings estimates by an average of 6.7%; they have averaged a y/y earnings gain of 11.2%. Ex-Energy's 24.9% earnings surprise and 94.1% y/y earnings growth, the S&P 500's earnings surprise drops 0.6ppts to 6.1% and y/y earnings growth falls 1.7ppts to 9.5%. At the same point in Q4-2016, a lower percentage of companies (68%) in the S&P 500 had beaten consensus earnings estimates by a smaller 3.7%. On the revenue side, 63% beat sales estimates so far, coming in 0.7% above forecast and 8.4% higher than a year earlier. Ex-Energy's 1.3% revenue surprise and 33.2% y/y revenue growth, the S&P 500's sales surprise drops just 0.1ppt to 0.6%, but y/y revenue growth falls 2.1ppts to a still impressive 6.3%. During Q4, a lower 50% had revenues above forecast, which exceeded estimates by a smaller 0.1% and rose a lower 4.0% y/y. Q1 earnings results are higher y/y for 62% of companies versus a greater 69% at the same point in Q4, but revenues are higher for 79% versus a lower 71%. The S&P 500's 6.7% earnings beat is the highest in eight quarters, and the 0.7% revenue surprise is the best in nine quarters. The percentage of companies with a positive earnings surprise (75%) is the highest since Q1-2010, and those with a positive revenue surprise (63%) is the highest since Q2-2014. Although the percentage of companies with positive y/y earnings growth weakened q/q to 62% in Q1, the percentage of companies with positive y/y revenue growth (79%) was the highest since Q3-2011. These results to date are very encouraging and bode well for future estimate revision activity. However, y/y growth is likely to slow in the coming quarters as comparisons become less easy.

US ECONOMIC INDICATORS

Industrial Production (*link*): April industrial production was a surprise on the upside, led by the biggest gain in factory output since February 2014. Manufacturing production rebounded 1.0% after a 0.4% decline in March, which was the first loss in seven months. It accelerated 1.7% y/y—a 27-month high. April's increase in manufacturing production was widespread, led by the largest surge in motor vehicles & parts (5.0%) since July 2015 to a new record high. Excluding autos, factory output expanded 0.7%—the most since March 2014, more than reversing March's 0.2% dip. By market grouping, consumer goods production expanded 1.5% in April and 2.9% the past two months—to a new cyclical high—after a 2.2% decline the first two months of the year. Consumer durable goods output rebounded 3.0% following March's 2.2% decline, while nondurables increased 3.6% during the two months through April. Production of business equipment jumped 1.2% last month, the first increase this year, on broad-based gains. Output of information processing equipment advanced for the eighth time in nine months, by a total of 6.1%, to a new record high. Industrial equipment production (1.1) posted its best gain this year, climbing to a 20-month high, while transit equipment continued its up-and-down pattern, rebounding 2.0% after a 1.9% loss and a 0.5% gain the previous two months. Meanwhile, output for mining and utilities increased 1.2% and 0.7%, respectively, last month, with the former 7.3% above a year ago, though still 11.2% below its peak in December 2014.

Capacity Utilization (*link*): The headline capacity utilization rate in April rose for the second month from 75.8% in February to a 20-month high of 76.7% last month, still 3.2ppts below its long-run (1972-2016) average. Manufacturing's capacity utilization rate rebounded to 75.9% (the highest since December 2014) after falling from 75.6% to 75.2% in March. April's reading was 2.5ppts below its long-run average. The capacity utilization rate for mining jumped to a two-year high of 83.3%, though remains well below its long-run average; the operating rate for utilities rebounded 6.2ppts the past two months to 76.3%, the highest reading this year.

Housing Starts & Building Permits (*link*): Housing starts and building permits in April were a surprise on the downside, though homebuilders remained optimistic this month. Builders broke ground on 1.172mu (saar), 2.6% less than March and 9.0% less than February, as multi-family starts slid for the fourth month. Single-family starts edged up 0.4% last month to 835,000 units (saar) after falling 5.1% in March. Still, these starts were up 3.3% ytd, fluctuating around cyclical highs. Multi-family starts plunged 9.2% in April and 26.7% the first four months of this year to 337,000 units (saar), a five-month low. Building permits sank 2.5% last month to 1.229mu (saar) after a rise of 3.4% and a fall of 6.2% the prior two months. Single-family permits fell for the third time in four months by 4.5% m/m and 4.9% over the period to 789,000 units (saar). Meanwhile, very volatile multi-family permits rose for the third time this year by 1.4% m/m, though only 0.9% ytd, to 440,000 units (saar). Builders remained optimistic in May, with the NAHB reporting that "builders' optimism in the housing market is solidifying, even as they deal with higher building material costs and shortages of lots and labor." Its housing market index climbed 2 points this month to 70, just shy of March's cyclical high of 71. Two of the three components of the index rose, sales expectations (to 79 from 75) and current sales (76 from 74), with the former the highest since June 2005.

GLOBAL ECONOMIC INDICATORS

Eurozone GDP Flash Estimate (*link*): The Eurozone economy grew 0.5% last quarter, according to the GDP flash estimate, matching Q4's rate. Among the four largest economies, real GDP growth in Spain (to 0.8% from 0.7%) and Germany (0.6 from 0.4) accelerated from Q4's rate and outpaced the Eurozone as a whole. GDP growth in France (0.3 from 0.5) slowed last quarter, while Italy's matched Q4's 0.2% pace. Meanwhile, Greece's (-0.1 from -1.2) GDP contracted for the second quarter, but is on the verge of turning positive again.

European Car Sales (*link*): EU passenger car registrations, a proxy for sales, posted its biggest drop in four years (-6.6% y/y), mainly because of Easter falling in April this year; the timing of Easter had boosted March sales 11.2%. Most of the major markets experienced a fall, led by a double-digit decline in the UK (-19.8%), followed by Germany (-8.0), France (-6.0), and Italy (-4.6); Spain (1.1) recorded a slight increase. UK sales were impacted by a new vehicle excise duty that went into effect on April 1, which could depress sales further. ACEA noted that positive contributions mainly came from the EU-12 countries (8.2)—those member states that have joined the EU since 2004. Despite April's decline, sales were up 4.7% in the four months through April, with Italy (8.0%), Spain (6.1), Germany (2.5), France (2.0), and the UK (1.1) all posting gains. EU passenger cars sales were at 13.7 million units in the 12 months through April, a tick below March's 13.8mu, which was the best 12-month performance since September 2008.

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