



MORNING BRIEFING

June 6, 2017

Chirping Canaries

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

(1) Animal spirits still mostly animated. (2) Hard data remain soft. (3) Home in the range for the S&P 500. (4) Hannibal's FAANG elephants leading the bulls to new heights. (5) Adding sentinel animals to the zoo. (6) Go Global beating Stay Home so far this year. (7) Solid global PMIs. (8) Lots of happy canaries in Europe and Asia. (9) Global trade growth picking up. (10) Asian exports also showing signs of life. (11) Forward earnings for major overseas MSCI indexes increasingly upbeat.

US Economy: Thin Air. Since Election Day, there has been lots of chatter about “animal spirits.” The evidence of animated animal spirits has come mostly in the form of “soft data” based on surveys of consumers and businesses that showed remarkable jumps in confidence following the election. So far, the euphoria hasn't trickled down to the US economy's hard data, as most recently evidenced by May's weaker-than-expected employment report released last Friday. May's Consumer Optimism Index, which averages the Consumer Sentiment Index and Consumer Confidence Index, remained near its recent cyclical high during March ([Fig. 1](#)). So did April's Small Business Optimism Index ([Fig. 2](#)).

Yet the Citigroup Economic Surprise Index (CESI) dropped to -44.7 yesterday ([Fig. 3](#)). That's down sharply from a recent peak of 57.9 on March 15, and the lowest reading since February 18, 2016. That has helped to bring the US Treasury 10-year bond yield down from a recent high of 2.42% on May 9 to 2.18% yesterday ([Fig. 4](#)). The 13-week change in this yield tends to be highly correlated with the CESI ([Fig. 5](#)). The Treasury yield curve spread has narrowed from a recent high of 213bps to 124bps at the end of last week, the lowest since October 3 ([Fig. 6](#)).

Yet the S&P 500 continues to chalk up new record highs, rising to 2439.07 on Friday, already putting it comfortably within our yearend target range of 2400-2500! Yesterday, Joe and I chalked this accomplishment up to “Hannibal spirits,” which is the relentless drive to scale the Alps even with a herd of elephants. More specifically, we observed that money is pouring into ETFs at a record pace.

The biggest elephants in the stock market are the five FAANG stocks, which now account for 11.9% of the S&P 500's market capitalization, up from 5.8% on April 26, 2013. Collectively, over this period, they've accounted for \$1.6 trillion of the \$6.9 trillion increase in the S&P 500! Their collective forward P/E is now 27.1 and 42.8 with and without Apple, respectively. The S&P 500's forward P/E is 17.7 and 16.9 with and without the FAANGs. These elephants continue to sprint up mountains, leading the market's bulls, even though the air is getting thinner.

Yesterday, we wrote that money coming out of actively managed equity mutual funds into passive equity ETFs might be more bullish for the largest-cap stocks, like the FAANGs, than for the rest of the market. One of our accounts told us that only makes sense if money is coming out of mutual funds that have underperformed because they've underweighted FAANGs. That's certainly a possibility.

Global Economy: Fresh Air. Today, we would like to bring “sentinel animals” into our discussion of financial-markets zoology. They are used to detect risks to humans by providing warning of a danger. The classic example is canaries in a coal mine. While a few canaries in the US seem to be having

trouble breathing, most of them continue to chirp without a care in the world. The ones in other parts of the world are especially chirpy. This might explain why the major stock indexes in the US and Europe are rising in record-high territory. Global economic growth seems to be improving, while inflation remains subdued. Central bankers may be looking for ways to unwind their ultra-easy monetary policy, but they are likely to do so very gradually. This is a very bullish scenario for stocks.

So far this year, that's been especially so for the outperforming EMU MSCI and EM stock price indexes because their forward P/Es are lower than the one for the US MSCI ([Fig. 7](#) and [Fig. 8](#)). Here is the performance derby ytd of the major MSCI stock price indexes in dollars through Friday: EMU (18.4%), Emerging Markets (17.7), All Country World (11.3), Japan (11.1), UK (10.1), and US (9.2). Now consider the following:

(1) *Commodity prices*. There's no boom in our trusty CRB raw industrials spot price index, nor is there a bust. It has stalled in recent weeks, but remains 27% above its most recent cyclical low at the end of 2015.

(2) *PMIs*. As Debbie reviews below, the global composite PMI was 53.7 during May, remaining between 53.0 and 54.0 since October ([Fig. 9](#)). The M-PMI of the advanced economies has been especially steady at a robust level around 54.0 for the past six months. The same can be said for the NM-PMI of the advanced economies. Emerging economies have shown some weakness in recent months for the M-PMI, while the NM-PMI has been rising.

(3) *Eurozone business*. Eurozone M-PMIs were exceptionally strong last month, with the following readings: Germany (59.5), Eurozone (57.0), Spain (55.4), Italy (55.1), and France (53.8). So were the region's NM-PMIs during May as follow: Spain (57.3), France (57.2), Eurozone (56.3), Germany (55.4), and Italy (55.1).

(4) *World trade*. Debbie and I believe that among the most reliable indicators of global economic activity are the ones based on merchandise trade data. The CPB Netherlands Bureau for Economic Policy compiles a monthly composite of the volume of world exports. Its growth rate on a y/y basis is highly correlated with the comparable growth rate in the sum of inflation-adjusted US exports plus imports ([Fig. 10](#)). The former was up 6.1% during March, the best performance since April 2011. The latter was up 4.4% during April, which was well ahead of the 2.0% decline recorded a year ago.

(5) *Asian trade*. Debbie and I closely monitor and compare the exports data coming out of Asia, in dollars and on a y/y basis. Many of the region's economies have become highly integrated with one another. China, obviously, ties them all together given the size of its imports and exports. Among the most closely tied to China are South Korea, Taiwan, and Singapore. Their exports have been mostly on uptrends since early 2016 ([Fig. 11](#)). The same can be said about the exports of India, Indonesia, Malaysia, and Thailand ([Fig. 12](#)).

(6) *Forward earnings*. Confirming the global happy-canaries scenario is our analysis of forward earnings for the All Country-World ex-US MSCI stock price index in local currency ([Fig. 13](#)). It was mostly flat to down from mid-2011 through early 2016. It was gasping for air for sure, while forward earnings for the US MSCI continued to rise to new record highs before stalling during the second half of 2014 through 2016, as a result of the recession in the energy sector.

Since early 2016, both measures of forward earnings have been rising. The US is back in record territory, while the overseas measure is the highest since November 2008. It's more or less the same story for the Developed Countries ex-US MSCI and the Emerging Markets MSCI, both in local currencies ([Fig. 14](#) and [Fig. 15](#)).

CALENDARS

US. Tues: Job Openings 5.754m. **Wed:** Consumer Credit \$17.0b, MBA Mortgage Applications, EIA Petroleum Status. (Bloomberg estimates)

Global. Tues: Eurozone Retail Sales 0.1%*m/m*/2.1%*y/y*, RBA Rate Decision 1.50%. **Wed:** Germany Factory Orders -0.3%*m/m*/4.7%*y/y*, Japan GDP (annualized) 2.4%*q/q*, Australia GDP 0.3%*q/q*/1.6%*y/y*, OECD Economic Outlook. (DailyFX estimates)

STRATEGY INDICATORS

YRI Weekly Leading Index ([link](#)): Our Weekly Leading Index (WLI)—a good coincident indicator that can confirm or raise doubts about stock market swings—was little changed around its record high during the final week of May. It retreated slightly, by 0.4%, after a two-week jump of 2.3% to a new record high. Our WLI is the average of our Boom-Bust Barometer (BBB) and Bloomberg's Weekly Consumer Comfort Index (WCCI). Our BBB slipped 0.8% following a two-week surge of 2.3%, also to a new record high, as jobless claims rose to 238,000 (4-wa) from 235,500 the prior week, which was the lowest since April 1973. The CRB raw industrial spot price index—another BBB component—is holding around recent highs. Meanwhile, the WCCI climbed for the third straight week by a total of 3.0%.

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings rose last week to record highs for all three market-cap indexes. 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 edged down to 9.7% *y/y* from 9.9%, which compares to a 64-month high of 10.2% four weeks ago and a six-year low of -1.8% in October 2015; MidCap's was down to 12.0% from a 32-month high of 12.6%, which compares to a six-year low of -1.3% in December 2015; and SmallCap's eased to 11.1% from 11.2%, which compares to a 34-month high of 12.8% in mid-March and a six-year low of 0.3% in December 2015. Consensus growth rates now expected for 2017 and 2018 before the impact of tax-rate changes: LargeCap 11.4% and 11.8%, MidCap 11.0% and 13.5%, and SmallCap 8.6% and 19.7%.

S&P 500/400/600 Forward Valuation ([link](#)): Forward P/E ratios were higher for all three indexes last week. Valuations have improved from their more-than-five-month lows in mid-April, but remain below their multi-year highs in early March. P/Es have melted up since the election, but the "E" still remains low as analysts await legislative changes to the tax rate and its impact on corporate earnings. LargeCap's forward P/E rose *w/w* to an 11-week high of 17.7 from 17.5 and remains near the 13-year high of 17.8 in early March. That's up from a 15-month low of 14.9 in January 2016 and the post-Lehman-meltdown P/E of 9.3 in October 2008, but remains well below the record high of 25.7 in July 1999. MidCap's forward P/E improved to 18.3 from 18.0, which compares to a 15-year high of 19.2 in late February and the record high of 20.6 in January 2002. MidCap's is up from a three-year low of 15.0 in January 2016. SmallCap's rose to 19.5 from 19.2, which compares to a 15-year high of 20.5 in early December, when Energy's earnings were depressed. That's up from a three-year low of 15.5 in February 2016 and remains close to SmallCap's record-high P/E of 20.9 in April 2002. Looking at their forward price/sales ratios since data became available in 2004, valuations are similarly elevated for the three indexes: LargeCap's P/S of 1.93 and MidCap's 1.27 are close to their recent record highs of 1.94 and 1.37, while SmallCap's 1.01 is down from 1.15 in July 2015 and a record high of 1.17 in November 2013.

S&P 500 Sectors Quarterly Earnings Outlook ([link](#)): Q2 earnings estimates tilted to the downside last week, as post-Q1 earnings season revision activity slowed. The Q2 consensus fell *w/w* for six of the 11 S&P 500 sectors and was steady for the remaining five. Sectors with the biggest *w/w* decline in their Q2

forecast: Tech (-2.1), Energy (-0.8), and Telecom (-0.3). The S&P 500's Q2-2017 EPS forecast fell 4 cents w/w to \$31.52, but is down just 1.7% from \$32.04 at the end of Q1. That represents a forecasted pro forma earnings gain for Q2-2017 of 8.4% y/y, down from Q1's blended 15.4%, which is the strongest growth since Q3-2011 owing mostly to easier comps for Energy. The Q2-2017 forecast is down from 8.5% a week earlier and 11.9% at the end of Q4. Since the end of Q1, Q2 estimates are lower for nine sectors and higher for two. Real Estate's Q2 forecast has risen 2.4%, followed by a 0.5% gain for Industrials. Energy has dropped 8.3% for the worst decline, followed by Materials (-4.2), Telecom (-4.1), Tech (-3.7), and Consumer Discretionary (-3.4). The S&P 500's Q2-2017 forecasted earnings gain of 8.4% y/y would be its fourth straight gain after four declines. Ten of the 11 sectors are expected to record positive y/y earnings growth in Q2-2017, but only three are expected to beat the S&P 500's y/y earnings gain of 8.4%. That's because analysts expect Energy to report a large profit jump in Q2 relative to very low earnings a year ago. Still, that matches the 10/11 sectors that rose y/y on a blended basis during Q1-2017. The latest forecasted Q2-2017 earnings growth rates vs their blended Q1-2017 growth rates: Energy (707.7% in Q2 versus a return to a profit in Q1), Tech (11.0% vs. 20.9%), Financials (9.3, 19.9), S&P 500 (8.4, 15.4), Materials (4.7, 19.3), Consumer Staples (3.5, 3.6), Real Estate (3.3, 2.8), Health Care (2.3, 7.3), Telecom (1.3, -4.9), Industrials (1.7, 4.1), Consumer Discretionary (1.0, 6.3), and Utilities (-3.3, 2.7).

US ECONOMIC INDICATORS

Auto Sales ([link](#)): Motor vehicle sales remained around recent lows in May, holding below 17.0mu for the third month. Sales slipped to 16.7mu (saar) from 16.9mu in April, back near March's 16.6mu—which was the lowest pace since February 2015. That's nearly 2.0mu below the cyclical high of 18.4mu reached just five months ago. Light truck sales continued to slide, falling to a nine-month low of 8.5mu (saar); it reached a cyclical high of 9.3mu in December. Domestic car sales slumped to a new cyclical low of 4.5mu—the lowest since December 2011. Sales of imports were unchanged at 3.6mu (saar), not far from the cyclical high of 3.9mu at the end of last year.

Construction Spending ([link](#)): Construction spending in April remained near record highs. Total spending slumped 1.4% after increasing five of the prior six months by a total of 6.1% to a new record high. Public construction spending sank 3.7% after a two-month advance of 4.2%. Meanwhile, private construction spending slipped 0.7% following a six-month surge of 7.5% to a new cyclical high. Residential investment eased 0.7% after a six-month spurt of 15.4%, while nonresidential investment fell for the third month by a total of 2.9% since reaching a record high in January. Within residential investment, single-family investment advanced for the seventh month, by a total of 10.8%, while multi-family construction (-0.2%) was little changed after a three-month jump of 6.9% to a record high. Home-improvement spending retreated 2.9% after soaring 27.8% the previous six months to a new record high.

US Trade ([link](#)): The real merchandise trade deficit widened in April, suggesting trade could be a drag on growth this quarter. The gap widened from \$60.7 billion in March to \$63.5 billion in April, above the average monthly deficit of \$62.2 billion last quarter. In April, real exports fell fractionally for the third month from January's record high, down 0.4% m/m and 0.8% over the period; real imports rebounded 1.3% after a two-month decline of 2.9%. April's decline in exports was driven by consumer goods ex autos (-4.4%) and autos (-4.2), which more than offset gains in food (5.3) and industrial supplies (1.4) exports; capital goods ex autos (-0.3) was little changed. The increase in imports was led by consumer goods ex autos (3.9), food (2.5), and capital goods ex autos (1.6)—the latter reaching a new record high; imports of autos (-2.6) and industrial supplies (-0.9) moved lower.

GLOBAL ECONOMIC INDICATORS

Global Composite PMIs ([link](#)): Global economic activity in May remained robust. The J.P. Morgan Global Composite Output Index (C-PMI) ticked up to 53.7 last month, holding around January's cyclical high of 53.9. The M-PMI slipped for the second month to 52.6 from its cyclical high of 53.0 the previous two months; the NM-PMI climbed to 53.8, back near its cyclical high of 54.0 at the beginning of the year. C-PMIs for the Eurozone (56.8), the UK (54.4), and the US (53.6) showed solid growth, with the Eurozone holding at April's six-year high. Within the Eurozone, C-PMIs for Germany (57.4) and France (56.9) were the highest in 73 months and 72 months, respectively, with the former's driven by the manufacturing sector and the latter's by the service sector. Growth in Spain (57.2) and Italy (55.2) was also solid, though slowed to two-month lows. Among other developed economies, C-PMIs showed growth accelerating in the US (to 53.6 from 53.2) and Japan (53.4 from 52.6); it slowed in the UK (54.3 from 56.2), though still managed to outpace the other two. In the emerging economies, growth accelerated in Russia (56.0 from 55.3) and India (52.5 from 51.3), and to a lesser extent in China (51.5 from 51.2); Brazil (unchanged at 50.4) continued to show minimal growth.

Global Non-Manufacturing PMIs ([link](#)): Service-sector growth in May accelerated to a four-month high. The J.P. Morgan NM-PMI advanced to 53.8 from 53.6 the prior two months, back near January's 17-month high of 54.0. Once gain, the Eurozone remained the bright spot, with its NM-PMI (56.3) little changed from April's six-year high. The steepest pace of expansion was recorded in Spain (57.3), followed closely by France (57.2); growth in Germany (55.4) and Italy (55.1) was slower, but still robust. The US (53.6) posted its best growth in three months, while Japan's (53.0) was the best since August 2015. Meanwhile, the UK (53.8) is bouncing around recent highs. Among emerging economies, service-sector growth in India (56.4) and Russia (56.4) is exceeding China's (52.8), while Brazil's (49.2) moved back into contractionary territory.

US Non-Manufacturing PMI ([link](#)): The US service sector in May continued to grow at a fast pace according to the ISM survey, while expanding at a more subdued pace according to Markit's. ISM's NM-PMI slipped to 56.9 last month from 57.5 in April, fluctuating above 56.0 for the sixth time in seven months. Two of the four components had major moves: employment (to 57.8 from 51.4) to the upside and new orders (57.7 from 63.2) to the downside, though the latter's was still at a vigorous pace. The remaining two components, business activity (60.7 from 62.4) and supplier deliveries (51.5 from 53.0) eased, though the former's was above 60.0 for the sixth time since November. Markit's NM-PMI rose for the second month to 53.6 after falling the prior two months from a 14-month high of 55.6 in January to 52.8 in March. According to the report, new business growth accelerated at its fastest pace since the start of the year, boosting job creation to a three-month high.

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