



MORNING BRIEFING

July 6, 2017

Fireworks

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

(1) Lots of bucks per bang. (2) Wickedly awesome IPOs. (3) Biotech returns with healthy returns. (4) More Tech IPOs. (5) Not much energy in Energy. (6) Buybacks drown new issues. (7) Banks pass Fed's stress test and reward investors with dividend hikes and buybacks. (8) Tech should rebound after some profit taking. (9) World semiconductor sales at record high.

Strategy I: IPO Extravaganza. The Fourth of July is a great day for Americans. We celebrate our independence by going to the beach or enjoying a barbeque in the backyard with family and friends. Then we go to see fireworks at the end of the day. Firecrackers come with some great names and can be surprisingly pricey. The Wickedly Awesome 115 shot retails for \$199.99, while the Swashbuckler 72-shot is \$149.99, according to [Fireworks.com](#). So perhaps it should be no surprise that the US fireworks industry had \$1.2 billion in revenue last year, according to the American Pyrotechnics Association, or [Americanpyro.com](#)—we kid you not.

In our business, there have been some impressive fireworks in the IPO market so far this year. The Renaissance IPO index has returned 20.5% ytd through June 30, surpassing the S&P 500's 8.2% return over the same period. Likewise, the average IPO gained 11% in Q2, compared to the S&P 500's 2.3% return. But it's the top performing IPOs priced in 2017 that have really been on fire, in some cases returning north of 60%. Let's take a look at what's been heating up the IPO market so far this year.

(1) *Healthy returns.* In the first half of 2017, there were 77 IPOs raising \$20.5 billion, the best result in the market since 2015, Renaissance Capital [reports](#). With the year only halfway done, the IPO market has raised more than was raised in all of 2016.

The largest number of IPOs in the first half were done in the Health Care sector, which saw 18 deals, according to Renaissance. The sector was also home to the top performing IPO, BeyondSpring, which enjoyed a 141.8% return since its March offering through July 3. The biotech company, which generates no revenue, is testing drugs that it hopes will reduce infection in chemotherapy patients and will treat certain lung cancers. Other Health Care names among the top 10 best performing IPOs priced this year through July 3 are AnaptysBio, up 66.7%, Biohaven Pharmaceutical Holding, up 53.0% and Athenex, up 51.4%, according to [IPOScoop.com](#). The recent upturn in the S&P 500 Biotechnology stock price index suggests that investors are looking for healthy returns from this sector again.

But the Health Care sector also housed a number of the IPO market's biggest clunkers. Notably, Zymeworks, a biotech company, is down 36.3% from its April IPO and ObsEva S.A., a biotech company developing drugs to increase women's reproductivity, has lost 50.1% since its January offering.

(2) *Home sweet home.* Benefitting from the boom in home purchases and renovation, the IPO of Floor & Décor Holdings has gained 82.5% since its April IPO, making it the second best performer of the IPOs priced this year. The company's "same-store sales have grown by double-digit percentages for eight consecutive years, fueling investor appetite for its initial public offering..." a 5/3 [WSJ article](#)

reported. The company has 72 locations, but would like to grow to 400 stores by increasing its store base by about 20% a year.

Another consumer goods company, Canada Goose Holdings, was the fourth best performing IPO priced this year. Since its March IPO, shares of the maker of very pricey winter coats have gained 54.8%. Another sign that times are good: Canada Goose returned to the well last Tuesday, selling \$259.4 million of shares that were owned by investors in and managers of the company.

(3) *Snap, crackle, pop.* The Tech sector had the largest dollar-volume of deals in the first half, \$5.6 billion, according to the Renaissance report. The tally was boosted by the year's largest IPO, the \$3.4 billion deal from Snap. However bigger doesn't necessarily mean better. Snap shares have risen only 3.5% since its March IPO. Shares have come under pressure as Facebook has become increasingly competitive in the same space through its Instagram division.

Tech companies developing software to sell to corporations have fared better in the IPO market this year. Shares of Appian, which makes software for developing enterprise applications, are up 47.6% from its May IPO. Shares of MuleSoft, which sells companies software to integrate their applications, have gained 47.2% since a March offering. And SMART Global Holdings, a semiconductor company, has shares that climbed 42.8% just since its May 24th IPO.

This year's second largest IPO has fared a bit better than the year's largest offering. Altice USA's \$1.9 billion IPO has gained 6.3% since June 22 offering. A subsidiary of the Netherland's-based Altice NV, the US company was formed by last year's merger of Cablevision Systems and Suddenlink Communications.

(4) *No energy.* With the price of Brent down 13% ytd, it's not surprising that IPOs in the Energy sector have had a tough time. Shares of Antero Midstream GP, the general partner of Antero Midstream, which owns assets like gathering pipelines and compressor stations, are down 6.8% since its May IPO. The IPO of Select Energy Services, which provides water solutions to US frackers, has dropped 13.4%, and the January IPO of Keane Group, which provides well completion services to fracking companies, fell 14.3%.

(5) *Up and down.* The Fed's tally of new nonfinancial corporate equity issuance, which includes initial and secondary stock offerings, has also had a solid rebound, with companies raising \$43.1 in the first five months of this year, compared to the \$32.4 raised last year over the same period. Activity is slowly climbing back to the elevated levels enjoyed in 2014 and 2015, before the volume of stock offerings dropped sharply last year ([Fig. 1](#)).

Despite the elevated IPO and secondary issuance, outstanding equities continue to shrink thanks to share buyback activities. Nonfinancial corporate equities outstanding have shrunk by \$550 billion over the past four quarters through Q1-2017 ([Fig. 2](#)).

Strategy II: Shifting Sands. As the first half of the year wrapped up, sector leadership took a dramatic turn: The S&P 500 Financials sector suddenly surged ahead and the S&P 500 Tech sector stumbled badly. It's quite a reversal from earlier in the year. Let's take a closer look at what's causing these changes just as the year enters its second half.

(1) *Financials gaining.* Over the four weeks through July 3, the S&P 500 Financials sector gained 6.8%, making it the best performing S&P 500 sector, while the Tech sector dropped 4.9%, making it the worst performer.

The change in momentum has reduced the ytd (through July 3) return for the Tech sector to 15.4%, but it remains the best performing sector so far this year. Likewise, the Financials sector's return this year has improved to 7.4%, but it continues to lag behind the S&P 500's 8.5% ytd performance. The sector that has shown the steadiest returns is the Health Care sector, which is the second best performing sector both ytd—up 15.2%—and over the past four weeks—up 3.1% ([Fig. 3](#)).

(2) *Passing the test.* The industries propelling Financials to the top of the heap over the past four weeks include Diversified Banks (9.8%), Regional Banks (7.9), Investment Banking & Brokerage (7.7), Consumer Finance (7.4), and Asset Management & Custody Banks (6.8). Diversified Banks is the third best performer among the 100 industries that we track and the other Financial industries are among the top 10 performing industries ([Fig. 4](#)).

The S&P 500 Financials stock price index was boosted by news last Wednesday that all of the banks taking the annual Federal Reserve stress test passed it and many were given permission to increase their dividends and stock repurchases. It also didn't hurt that the Federal Reserve raised interest rates by a quarter point on June 14 and has indicated it plans to reduce its balance sheet in the coming months. Fed officials have implied an announcement laying out their plans could come as soon as September, the 7/4 *WSJ* [reported](#). Financials also improved as the spread between the fed funds rate and the 10-year Treasury yield widened from 98 bps on June 26 to 119 bps on Monday.

The Financials sector remains at the top of the heap on a y/y basis through July 3, up 35.3%, with a nice lead over the Tech sector, which is up 30.6%. Both have far outpaced the S&P 500's 15.5% return over the same period ([Table 1](#)).

Earnings in the S&P 500 Financials sector are expected grow 12.1% over the next 12 months and the sector has a forward P/E of 13.9 ([Fig. 5](#) and [Fig. 6](#)). Meanwhile, analysts forecast S&P 500 Tech sector earnings will grow by 11.6% over the next year and it has a forward P/E of 18.1 ([Fig. 7](#) and [Fig. 8](#)). Looked at side by side, it's easy to understand why investors may be willing to give the underperforming Financials sector a go as the year enters the home stretch.

(3) *Chips with salsa.* Some of the highest flying industries in the Tech sector have fallen the hardest over the past four weeks. The S&P 500 Semiconductor Equipment industry index, which was up 44.4% ytd through June 2, has fallen 12.8% since then. Likewise, the Semiconductors index, which climbed 13.4% ytd through June 2, has fallen 7.3% in the four subsequent weeks. And after climbing 27.7% from the start of the year through June 2, the Internet Software & Services index has dropped 6.0% ([Fig. 9](#)).

The recent downward move may be just what some of the Tech industries need to consolidate their gains before moving higher in step with above-average earnings growth. Worldwide semiconductor sales continue to hit new record highs, most recently in April ([Fig. 10](#)). The Semiconductor Equipment industry is expected to grow earnings 15.6%, higher than the industry's forward 13.7 price-to-earnings ratio. And Semiconductors is expected to grow earnings 11.0%, has a forward P/E of 14.9.

CALENDARS

US. Thurs: ADP Employment 178k, Jobless Claims 244k, Merchandise Trade Balance -\$46.2b, ISM & Markit & NM-PMIs 56.5/53.0, Weekly Consumer Comfort Index, EIA Petroleum Status, Powell, Fischer. **Fri:** Total & Private Nonfarm Payroll Employment 170k/164k, Unemployment Rate 4.3%, Average Hourly Earnings 0.3%/m/m/2.6%/y/y, Average Workweek 34.4hrs, EIA Natural Gas Report, Baker-Hughes Rig Count, Monetary Policy Report to Congress. (Bloomberg estimates)

Global. Thurs: Germany Factory Orders 1.8%*m/m*/4.5%*y/y*. **Fri:** Japan Leading & Coincident Indexes 104.6/115.5, Canada Employment Report. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): The Investors Intelligence Bull/Bear Ratio (BBR) slipped to 2.79 this week after climbing to 2.95 last week following a two-week decline from 3.05 to 2.65—which was near its low for this year of 2.60. (The BBR has been below 3.00 six of the past seven weeks.) Bullish sentiment sank to 52.5% this week, after a two-week jump of 4.9ppts to 54.9%, with most of the bulls fleeing to the correction camp (to 28.7% from 26.5%). Bearish sentiment ticked up from 18.6% to 18.8% this week, near its high for the year of 19.4% posted two weeks ago. The AAll Ratio edged down from 53.0 to 52.5% last week, showing little change the past few weeks. Bullish sentiment ticked down from 32.7% to 29.7%, while bearish sentiment fell from 28.9% to 26.9%.

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 improved to 9/9% *y/y* from 9.8% *y/y*, which compares to a 64-month high of 10.2% eight weeks ago and a six-year low of -1.8% in October 2015; MidCap's was up to a 65-month high of 13.2% from 13.1%, which compares to a six-year low of -1.3% in December 2015; and SmallCap's rose to 12.5% from 12.1%, 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 11.4% and 13.7%, and SmallCap 9.8% and 19.0%.

S&P 500/400/600 Forward Valuation ([link](#)): Forward P/E ratios were mostly steady for the 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 was down *w/w* to 17.4 from 17.5, which compares to early June's 11-week high of 17.7 and 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 was steady at 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 was steady at 19.2, which compares to a 10-week high of 19.7 the week before that and 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 1.95 is at a record high, while MidCap's 1.30 is close to its record high of 1.37 in late February. 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 for the 11 S&P 500 sectors were little changed last week during the final week of the quarter as analysts held back on their typical downward pre-earnings season adjustments. The Q2 consensus fell *w/w* for four of the 11 S&P 500 sectors, rose for two, and was steady for the remaining five. Utilities rose 1.0% *w/w*, ahead of Industrials (0.1). Sectors with the biggest *w/w* decline in their Q2 forecast: Energy (-0.6), Financials (-0.3), Materials (0.2), and Consumer Discretionary (-0.1). The S&P 500's Q2-2017 EPS forecast edged down 1 cent *w/w* to \$31.45, and is down just 2.0% from \$32.04 at the end of Q1. That represents a forecasted pro forma earnings gain for Q2-2017 of 8.0% *y/y*, down from Q1's blended 15.3%, which is

the strongest growth since Q3-2011 owing mostly to easier comps for Energy. The Q2-2017 forecast is up from 7.9% a week earlier, but down from 11.9% at the end of Q4. Since the end of Q1, Q2 estimates are lower for ten sectors and higher for one. Industrials' Q2 forecast has risen 0.8%. Energy's has dropped 12.4% for the worst decline, followed by the Q2 forecasts for Materials (-5.4), Telecom (-4.4), and Consumer Discretionary (-4.2). The S&P 500's Q2-2017 forecasted earnings gain of 8.0% 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 two are expected to beat the S&P 500's forecasted y/y earnings gain of 8.0%. 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 (668.5% in Q2 vs a return to a profit in Q1), Tech (11.2% vs. 19.8%), S&P 500 (8.0, 15.3), Financials (7.6, 19.9), Materials (4.2, 19.3), Consumer Staples (3.6, 3.7), Industrials (2.4, 4.1), Health Care (2.3, 7.3), Real Estate (1.9, 2.8), Telecom (1.0, -4.9), Consumer Discretionary (1.0, 6.0), and Utilities (-2.8, 2.7).

S&P 500 Q2 Earnings Trend vs. Past Quarters ([link](#)): With the June-quarter books closed at the end of last week, the current Q2-2017 EPS forecast of \$31.45 has dropped 2.0% over the 14 weeks since the quarter's start. That marks the 25th straight quarter that forecasts have fallen, but is the smallest drop in the 12 quarters since Q2-2014, and well above the average 4.3% decline in the quarter's estimate since 1994. Analysts expect EPS for Q2-2017 to be up 6.2% y/y on a frozen actual basis, behind the 9.5% gain for Q1-2017, but the fourth straight quarter of higher EPS on a y/y basis. However, we think that Q2's EPS will be \$31.75 and that earnings will rise 7.2% y/y following Q1's 14.5% which was the S&P 500's first double-digit growth quarter since Q3-2011. Since 1994, the Q1 earnings surprise has been positive in 20/23 years (all but 1998, 2002, and 2008). We think Q2 will mark the S&P 500's 34th straight quarter of positive surprises—a streak dating back to Q1-2009 and longer than the prior 10-quarter positive surprise streak (Q1-2003 to Q2-2005).

S&P 500 Earnings, Revenues & Valuation ([link](#)): S&P 500 consensus forward revenues rose less than 0.1% w/w to a record high, but forward earnings was at a record high for a 13th straight week. The forward profit margin forecast was unchanged w/w, remaining at a record high of 11.0%. The profit margin's record high is its first since September 2015 and up from a 24-month low of 10.4% in March 2016. Forward revenue growth for the S&P 500 was steady w/w to 5.3%, and is down from 5.8% in late January, which was the highest since May 2012 and compares to a cyclical low of 2.7% in February 2016. Forward earnings growth was down to 11.2% from 11.3%, but remains steady near January's 11.7%, which was the highest since October 2011 and compares to a cyclical low of 4.8% in February 2016. S&P 500 forward revenues and forward earnings growth are enjoying a tailwind now due to easy y/y comparisons for Energy and improving prospects for Financials, but currency translation is a slight drag from the year-earlier quarter. However, Energy's contribution to forward growth peaked at the start of 2017. Looking at last week's results for the S&P 500 ex-Energy, the forward growth rates for revenues (4.6%) and earnings (9.1) are lower, but improving. The ex-Energy forward profit margin of 11.5% is down from late June's record high of 11.5%, which was its first since August 2007. Valuation rose w/w to 17.8 from 17.7, which compares to a 13-year high of 18.0 in early March and a 15-month low of 14.9 in January 2016. Ex-Energy valuation rose to a 15-week high of 17.5, and is just below the 13-year high of 17.6 in early March.

S&P 500 Sectors Earnings, Revenues & Valuation ([link](#)): Consensus forward revenue forecasts rose last week for 7/11 sectors, and forward earnings rose for 4/11 sectors. Industrials, Real Estate, and Tech were the only sectors that had both measures rise w/w. Forward revenues and earnings are at or around record highs for 5/11 sectors: Consumer Discretionary, Consumer Staples, Health Care, Industrials, and Tech. Energy's forward revenues has slipped to a seven-month low now after stalling at a 15-month high since March, and its forward earnings is stalled at early June's 21-month high. The

forward P/S and P/E ratios rose w/w for 7/11 sectors (all but Consumer Staples, Tech, Telecom, and Utilities. Health Care is surging recently; its P/E of 16.6 and P/S of 1.75 are at their highest levels since August 2015, but remain well below their early 2015 highs of 17.9 and 1.88, respectively. Financials' P/E is up from 12.0 before the election to 13.9, and is approaching the post-election high of 14.6 in early March. With Energy's forward revenues and earnings improving, its valuation is beginning to come back to Earth; its P/S ratio of 1.29 compares to a record high of 1.56 in May 2016, and its P/E of 24.9 is down from a record high of 57.5 then. Higher y/y margins occurred for only 7/11 sectors in 2016, but margins are expected to improve in 2017 for all but Real Estate and Utilities. However, Real Estate's forecasted margin should improve as the year progresses when gains on property sales are included in the forecasts. Here's how the 11 sectors rank based on their current 2017 forecasts: Information Technology (to 19.9% in 2017 from 19.2% in 2016), Real Estate (16.9, 25.2), Financials (15.5, 14.3), Telecom (11.3, 11.2), Utilities (10.9, 11.4), S&P 500 (10.6, 10.1), Health Care (10.4, 10.3), Materials (9.9, 9.4), Industrials (9.2, 8.9), Consumer Discretionary (7.3, 7.2), Consumer Staples (6.7, 6.5), and Energy (4.4, 1.1).

US ECONOMIC INDICATORS

Auto Sales ([link](#)): Motor vehicle sales in June fell to the lowest level since February 2015, holding below 17.0mu for the fourth month. Sales slipped to 16.5mu (saar) in June, nearly 2.0mu below the cyclical high of 18.4mu reached just six months ago. Domestic car sales slumped to a new cyclical low of 4.3mu—the lowest since December 2011. Sales of imports fell to 3.5mu (saar), down from its cyclical high of 3.9mu at the end of last year. Light truck sales ticked up to 8.8mu (saar) last month after sliding to a nine-month low of 8.5mu in May; sales were at a cyclical high of 9.3mu in February.

Construction Spending ([link](#)): Construction spending remained near record highs. Total spending was flat in May after slumping 0.7% in April--half the initial estimate of a 1.4% decline; spending had increased six of the prior seven months by a total of 4.2% to a new record high. Public construction spending remains in a volatile flat trend, rebounding 2.1% in May after a 2.7% drop in April. Meanwhile, private construction spending slipped 0.8% during the two months ending May after an 11-month surge of 8.5% to a new cyclical high. Residential investment dipped 0.6% in May following a 12-month jump of 12.6%, while nonresidential investment hasn't posted a gain this year, falling 0.7% m/m and 3.3% ytd. Within residential investment, a 3.3% drop in multi-family construction accounted for nearly all of May's decline; single-family (-0.3%) and home-improvement (-0.1) investment were only fractionally lower after big gains in prior months. Weighing on nonresidential investment are setbacks in manufacturing, health-care, and transportation building, while spending on amusement & recreation, lodging, and commercial building is looking topky.

GLOBAL ECONOMIC INDICATORS

US Manufacturing PMIs ([link](#)): Manufacturing activity in June rebounded to a new cyclical high according to ISM's survey, while it grew at the weakest pace since last September according to Markit's. The ISM M-PMI jumped from 54.9 to 57.8 last month, the highest reading since August 2014. The strength was widespread. The production (62.4 from 57.1) and new orders (63.5 from 59.5) measures accelerated back above 60.0, with the latter getting a boost from new export orders (59.5 from 57.5) which returned to its cyclical high. The employment (57.2 from 53.5) gauge is back near its cyclical high, while the supplier deliveries (57.0 from 53.1) measure soared to its highest reading since the end of 2014. Meanwhile, inventories (49.0 from 51.5) was the outlier, returning to contractionary territory. Markit's M-PMI eased for the fifth month since reaching a 22-month high of 55.0 at the start of this year, falling to a nine-month low of 52.0 last month. According to the report, slower rates of output

and new business growth were the main factors dragging the M-PMI lower, with the former the slowest in nine months and the latter easing for the fifth straight month.

Contact us by [email](#) or call 480-664-1333. (L2)

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

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