



MORNING BRIEFING

July 11, 2017

Outbound & Inbound

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

(1) Size matters. (2) Sum of US exports and imports augurs well for global economy and for US factories. (3) The West Coast's hip ports are hopping. (4) ATA truck tonnage index rose to record in May. (5) Kudlow says Trump has Putin over a barrel. (6) Flying Transportation stocks. (7) Forward revenues and earnings bullish for Transports. (8) Net Earnings Revisions Index increasingly positive for Transports.

US Economy: America's Trade Is Great. There's lots more data covering the US economy than other economies. There are even fewer economic series that add up all the national sources to provide a good picture of the global economy. Given the size and importance of the US economy in global trade, it isn't surprising that some of our homegrown trade indicators provide excellent insight into the performance of the global economy. Currently, their signals are very upbeat, which might explain why the S&P 500 Transportation Index is at a new record high. Let's have a look:

(1) *Real exports & imports.* According to the CPB Netherlands Bureau for Economic Policy, the volume of world exports edged down during April from March's record high ([Fig. 1](#)). The growth rate of this series is highly correlated with the growth of the sum of US inflation-adjusted exports plus imports ([Fig. 2](#)). The former was up 3.2% y/y in April, while the latter was up 4.5% in May. Both were closer to zero a year ago.

This augurs well for US industrial production, which is also highly correlated on a y/y basis with both measures of trade growth ([Fig. 3](#)). Indeed, US industrial output was up 2.1% y/y through May, the best reading since January 2015. It had been negative from April 2015 through November 2016, mostly as a result of the rolling recession in the global oil industry.

(2) *West Coast ports.* According to the Beach Boys, the West Coast has the sunshine and hippest girls. It also has ports that do lots of business with Asia. Debbie and I monitor the monthly stats on 20-foot-equivalent containers that go in and out of the ports of Los Angeles and Long Beach ([Fig. 4](#) and [Fig. 5](#)). The series are volatile, so we track the 12-month sums. The sum of the outbound and inbound traffic is highly correlated with the sum of real US exports and imports ([Fig. 6](#)). Both series are on uptrends and at or near recent record highs.

(3) *Rail & truck traffic.* Not surprisingly, intermodal container railcar loadings (on a 52-week average basis) is highly correlated with both measures of US trade activity ([Fig. 7](#) and [Fig. 8](#)). All those exports and imports need to be moved by rail. Some of them must also be keeping the truckers busy. The ATA truck tonnage index jumped to a record high in May, confirming the recent upturn in intermodal container railcar loadings ([Fig. 9](#)).

The bad news for the economy is that railcar loadings of motor vehicles has stalled since late last year ([Fig. 10](#)). Motor vehicle sales have dropped from a cyclical peak of 18.4 million units (saa) during December to 16.5 million units during June, the lowest pace since February 2015.

(4) *Oil exports & imports.* The rebound in US oil field production since late last year has slightly boosted

railcar loadings of chemicals and petroleum products in recent weeks ([Fig. 11](#)). US exports of crude oil and petroleum products have roughly tripled since the start of the current economic expansion ([Fig. 12](#)). Net imports have been cut by about two-thirds since 2007!

Larry Kudlow's 7/8 [commentary](#) on CNBC's website was spot on concerning how the Trump administration is aiming to undermine both Russia's Vladimir Putin and Iran's Mullahs by enabling more oil and gas production in the US. He notes that Trump's speech in Warsaw included the following key line: "We are committed to securing your access to alternative sources of energy, so Poland and its neighbors are never again held hostage to a single supplier of energy." That was a direct slap at Russia.

Kudlow explained: "Trump wants America to achieve energy dominance. He withdrew from the costly Paris climate accord, which would have severely damaged the American economy. He directed the EPA to rescind the Obama Clean Power Plan, which would have led to skyrocketing electricity rates. He fast-tracked the Keystone XL pipeline. He reopened the door for a modernized American coal industry. He's overturning all the Obama obstacles to hydraulic fracturing, which his presidential opponent Hillary Clinton would have dramatically increased. And he has opened the floodgates wide to energy exports."

Love him or hate him, Trump's initiatives could push oil prices lower. The geopolitical benefits of defunding and defanging Russia and Iran, both of which are extremely dependent on oil revenues, could be significant. So could the positive impact of lower oil prices on US consumers. There could be a negative impact on energy capital spending in the US, but that might be offset by the new exploration projects that Trump's policies are enabling.

Strategy I: Transports Flying. All the above provides good fundamental support for the record high in the Dow Jones Transportation Average, which in turn is providing solid confirmation of the bull market in the Dow Jones Industrials Average. There are also lots of upbeat and improving indicators for the fundamental stats on the S&P 500 Transportation stock price index. Consider the following:

(1) *Forward revenues.* The sector's forward revenues remain on a solid uptrend, rising to fresh record highs in June ([Fig. 13](#)).

(2) *Forward earnings.* Apparently, the S&P 500 Railroad industry's forward earnings was hard hit by the energy recession during 2015 ([Fig. 14](#)). However, it has been making a comeback since early 2016. The forward earnings of the S&P 500 Airlines industry also has been recovering this year. Meanwhile, Air Freight & Logistics has been rising faster in record territory so far this year.

(3) *NERI.* The Net Earnings Revisions Index (NERI) of the Transportation sector turned increasingly positive over the past five months through June, following 21 consecutive months of negative readings ([Fig. 15](#)). The rebound in NERI has been led by an impressive turnaround in NERI for the Railroad industry ([Fig. 16](#)).

Strategy II: Another Earnings Season. Joe reports that as the Q2-2017 earnings season is starting, industry analysts are expecting S&P 500 earnings to be up 7.9% y/y. We are expecting about the same, though the result could be a bit better given that analysts tend to lower their estimates too much in the weeks approaching earnings reporting seasons. They've lowered their estimate for Q2 by 3.8% since the start of this year ([Fig. 17](#)). Here are the analysts' current earnings growth expectations for the 11 sectors of the S&P 500: Consumer Discretionary (0.9%), Consumer Staples (3.5), Energy (660.2), Financials (7.5), Health Care (2.3), Industrials (2.4), Materials (4.3), Real Estate (1.9), Tech (11.2), Telecom (1.1), and Utilities (-2.8).

CALENDARS

US. Tues: NFIB Small Business Optimism Index 104.5, Job Openings 5.975m, Wholesale Trade Inventories 0.3%, Brainard, Kashkari. **Wed:** MBA Mortgage Applications, Atlanta Fed Business Inflation Expectations, EIA Petroleum Status Report, Beige Book, Yellen. (Bloomberg estimates)

Global. Tues: Japan Machine Tool Orders. **Wed:** Eurozone Industrial Production 1.0%_{m/m}/3.5%_{y/y}, UK ILO Unemployment Rate 4.6%, BOC Rate Decision 0.75%. (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—continues to hover around its record high. It slipped 0.3% during the week of July 1 after a 0.3% gain and a 0.7% loss the prior two weeks; it's within 1.6% of its record high reached in late April. Our WLI is the average of our Boom-Bust Barometer (BBB) and Bloomberg's Weekly Consumer Comfort Index (WCCI). Our BBB contracted in five of the past six weeks by a total of 3.4%, following a two-week surge of 3.3% to a new record high. Over the six-week period, jobless claims climbed to 243,000 (4-wa) from 235,500, which was the lowest since April 1973. The CRB raw industrial spot price index—another BBB component—continues to move sideways around recent highs. Meanwhile, the WCCI fell for the fourth time in five weeks, by 5.3%.

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 up to 9.9% y/y from 9.8%, which compares to a 64-month high of 10.2% nine weeks ago and a six-year low of -1.8% in October 2015; MidCap's was down to 12.9% from a 65-month high of 13.2%, which compares to a six-year low of -1.3% in December 2015; and SmallCap's rose to a 38-month high of 13.0% from 12.5%, which compares to 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 11.9%, MidCap 11.2% and 13.6%, and SmallCap 10.1% 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 steady w/w at 17.4, 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 dropped to 19.0 from 19.2, which compares to a recent high of 19.7 in early June 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 mostly unchanged last week as analysts and investors await Q2 earnings results. The Q2

consensus fell w/w for two of the 11 S&P 500 sectors, rose for two, and was steady for the remaining seven. Materials rose 0.8% w/w, ahead of Consumer Discretionary (0.6%). Sectors with w/w declines in their Q2 forecast: Energy (-0.6) and Financials (-0.1). The S&P 500's Q2-2017 EPS forecast rose 2 cents w/w to \$31.47, and is down just 1.9% from \$32.04 at the end of Q1. That represents a forecasted pro forma earnings gain for Q2-2017 of 7.9% 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 down from 8.0% 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 12.9% for the worst decline, followed by the Q2 forecasts for Materials (-4.6), Telecom (-4.4), and Consumer Discretionary (-3.6). The S&P 500's Q2-2017 forecasted earnings gain of 7.9% 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 (660.2% in Q2 vs a return to a profit in Q1), Tech (11.2% vs. 19.8%), S&P 500 (7.9, 15.3), Financials (7.5, 19.9), Materials (4.3, 19.3), Consumer Staples (3.5, 3.7), Industrials (2.4, 4.1), Health Care (2.3, 7.3), Real Estate (1.9, 2.8), Telecom (1.1, -4.9), Consumer Discretionary (0.9, 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 \$31.47 has dropped 1.9% 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 below the average 4.3% decline in the quarter's estimate since 1994. Analysts expect EPS for Q2-2017 to be up 6.3% y/y on a frozen actual basis, behind the 9.5% gain for Q1-2017 but representing 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% gain, 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).

US ECONOMIC INDICATORS

Merchandise Trade ([link](#)): The real merchandise trade deficit narrowed in May, though data still suggest that trade was a drag on growth last quarter. The gap narrowed to \$62.8 billion in May after widening from \$60.7 billion in March to \$63.8 billion in April; the average monthly deficit of \$63.3 billion for April/May is above Q2's average monthly deficit of \$62.2. In May, real exports rebounded 1.0% to a new record high, more than reversing the 0.9% decline during the three months through April. Real imports edged up only 0.1%, after a 1.4% jump in April—which reversed only half of the decline the prior two months. May's advance in exports was driven by gains consumer goods ex autos (5.5%), autos (5.0), and industrial supplies (2.0), which more than offset losses in food (-4.2) and capital goods ex autos (-1.0). As for May imports, increases for industrial supplies (2.8) and capital goods ex autos (2.4)—the latter to a new record high—offset declines in consumer goods ex autos (-2.9), autos (-2.5), and food (-2.0).

Consumer Credit ([link](#)): Consumer credit accelerated in May after slowing in April. Credit advanced \$18.4 billion—the best pace this year—after easing to \$12.9 billion in April, which was the weakest pace this year. (April's increase was revised up from the initial estimate of \$8.2 billion.) Revolving credit jumped at a six-month high of \$7.4 billion after increasing only \$1.2 billion in April. Nonrevolving credit, which includes student and auto loans, expanded \$11.0 billion, in line with its average monthly gain so

far this year.

GLOBAL ECONOMIC INDICATORS

Global Leading Indicators ([link](#)): In May, the OECD's composite leading indicators (CLIs)—designed to anticipate turning points in economic activity relative to trend six to nine months ahead—once again pointed to stable growth momentum in the OECD (100.0) as a whole; however, there were signs of a potential easing of momentum in some major advanced economies. While CLIs for the Eurozone (100.4), Japan (100.1), and Canada (100.5) continue to show stable growth momentum, tentative signs of a slowing of growth in the US (99.6), UK (99.6), and Italy (100.0) are emerging. Germany's CLI (100.8) continues to point to growth gaining momentum, and is now joined by France (100.7). As for the major emerging economies, the CLI for Brazil (102.3) is still signaling growth gaining momentum, with similar signs now surfacing in China (99.4) and India (99.6). Meanwhile, in Russia (100.9), signs of slower growth are materializing.

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

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