MORNING BRIEFING
July 12, 2017

Steady Does It

See the collection of the individual charts linked below.

(1) The four seasons. (2) Industry analysts holding onto double-digit S&P 500 earnings growth for 2017 and 2018. (3) Earnings outlook more likely buoyed by improving global economy than by Trump agenda, which is still on the come. (4) Consensus forward revenues and earnings providing bullish guidance. (5) Global PMIs signaling slow but steady growth. (6) European holiday: lots of festive indicators. (7) French are world-class shoppers. (8) Two drags on growth: labor shortages and subdued wage gains.

Earnings & Revenues: Upbeat Forward Guidance. Earnings seasons are when industry analysts often revise their earnings estimates based on the latest quarterly results reported by their companies. They are also influenced by managements' conference calls discussing those results as well as their forward guidance on their business prospects. We will see how the Q2-2017 season plays out over the next few weeks.

Joe and I aren't expecting any significant downside surprises. *Au contraire*, as the French say, we remain impressed by the recent steadiness of the S&P 500/400/600 consensus earnings expectations for this year (*Fig. 1*). Industry analysts are currently projecting growth rates of 10.3%, 7.0%, and 6.2% on a pro forma basis for the three S&P indexes. Even more impressive is the steadiness, since last September, of their S&P 500/600 estimates for 2018, while the estimate for the S&P 400 has been on a modest uptrend. The analysts are estimating 2018 growth rates of 12.0%, 14.2%, and 19.3%.

It is quite unusual to see such steadfastness since the coming year's estimates for the S&P 500 typically tend to fall over time, though there remains plenty of time for them still to do so (*Fig. 2*). The quarterly estimates for the S&P 500 are also holding up relatively well for the remainder of this year (*Fig. 3*).

This steadiness, despite a long history of overly optimistic estimates being revised downward more often than not, might be attributable to expectations of a corporate tax cut effective in 2018. A couple of months ago, as Washington's swamp turned murkier, Joe and I changed our minds about a retroactive cut starting in 2017. But we still expect one for 2018.

Perhaps a more likely explanation for the steadfastness of earnings estimates so far this year is that the global economy is showing signs of improving. This certainly explains why both S&P 500/400/600 forward earnings (which would be directly boosted by a tax cut) and forward revenues (which wouldn't be directly impacted) all are continuing to rise to record highs (*Fig. 4*).

So while we await the conference calls and managements' guidance, the forward guidance provided by S&P 500/400/600 forward earnings and revenues—which are based on analysts' consensus expectations for this year and next year—remains upbeat.

Our Blue Angels analysis for the S&P 500/400/600 stock price indexes shows that while valuation multiples are high for all three, forward earnings seems to be rising at a faster pace into record territory (*Fig. 5*).

Global Economy: Growing Steadily. Just about every month, Joe and I note that there is a decent correlation between S&P 500 revenues and the US M-PMI and NM-PMI measures of domestic economic activity. Both were solid in June, which augurs well for revenues. So do the solid PMIs for the global economy during June, with the global composite remaining steady around 54.0 for the past six months (*Fig. 6*).

Yesterday, Debbie reviewed May's OECD leading indicators report, which tracks indexes for 32 of the 35 OECD advanced economies, as well as 6 of 15 OECD non-member economies, which include Brazil, Russia, India, and China. They also were mostly on a steady course, confirming that the current slow-but-steady growth of the global economy should continue. On the other hand, if you are looking for somewhat better economic growth than slow-but-steady, then take a European vacation this summer. Here are some of the sights you'll enjoy:

(1) *Pretty PMIs.* The Eurozone's M-PMI rose to 57.4 in June, while the region's NM-PMI dipped to a still-solid reading of 55.4 (*Fig. 7* and *Fig. 8*). Germany led the way on the M-PMI with a very strong 59.6, while the NM-PMI was led by Spain (58.3) and France (56.9).

(2) *Shopping galore.* France is also leading the Eurozone in the volume of retail sales (excluding autos). The region's sales are up 2.6% y/y through May, with solid gains in France (4.2%), Spain (2.9), Germany (2.3), and Italy (1.0) (*Fig. 9*). New passenger car registrations remain on solid uptrends in the major European economies (*Fig. 10*).

(3) *Lots of oomph.* The strongest economy in the Eurozone is Germany's, where industrial production rose 5.0% y/y during May to a fresh record high (*Fig. 11*). The country is benefitting from booming exports, which also confirms that the global economy is doing well.

US Economy: Steady Drags. We've been bullish since the start of the bull market in equities during March 2009. One day, we will be bearish. That will happen when we believe that a recession is imminent. Hopefully, we will figure that out either before or at least at about the same time as the stock market does so. Meanwhile, to maintain our credibility (and maybe our sanity too), we continue to do the best we can to balance our optimism with a realistic assessment of the risks. For now, we continue to see many more white swans than black swans. Nevertheless, here are a couple of recent concerns:

(1) *Labor shortage.* One of my daughters recently opened a very successful breakfast and lunch bistro in Petaluna, located in Sonoma County, California. Sarah's Eats & Sweets has a five-star rating on Yelp with 74 reviews already. The only problem that Sarah has so far is getting help to meet all the demand for her culinary delights. She reports that it doesn't make sense to try paying more to attract workers. She simply can't find qualified workers. She is not alone. This is a nationwide problem and may put a lid on economic growth.

The latest survey of small business owners conducted by the National Federation of Independent Business (NFIB) found that 32.3% reported job openings that could not be filled on average over the past three months through June, the highest reading since January 2001 (*Fig. 12*). This series starts in January 1986 and is highly correlated with the JOLTS data on the national job openings rate, which is available since December 2000, and is in record-high territory.

(2) *Subdued wages.* So far, the big surprise is that despite all the job openings, wage inflation remains around 2.5%. During the previous three cyclical peaks in jobs openings, wage inflation was around 4.0% (*Fig. 13*). Even more puzzling is that the national quits rate rose to a new cyclical high in May. Workers usually leave and take another job for better pay (*Fig. 14*).

If job growth is restrained by a shortage of qualified workers and wages remain subdued, then the probability of faster economic growth is low. Previously, we've suggested that wage inflation is being held down by even lower price inflation. That means that real wages are still growing, but not by much, since they are determined by productivity, which isn't growing by much.

CALENDARS

US. Wed: MBA Mortgage Applications, Atlanta Fed Business Inflation Expectations, EIA Petroleum Status Report, Beige Book, Yellen. **Thurs:** Jobless Claims 245k, PPI Headline, Core, and Core Less Trade Services 0.0%/0.2%/0.2%, Treasury Budget, Weekly Consumer Comfort Index, EIA Natural Gas Report, Yellen, Brainard, Evans**.** (Bloomberg estimates)

Global. Wed: Eurozone Industrial Production 1.0%m/m/3.5%y/y, UK ILO Unemployment Rate 4.6%, BOC Rate Decision 0.75%. **Thurs:** Germany CPI 0.2%m/m/1.6%y/y, China Trade Balance $43.0b, BOE Credit Conditions & Bank Liabilities Survey. (DailyFX estimates)

STRATEGY INDICATORS

S&P/Russell LargeCaps & SMidCaps (*link*): All these price indexes have pulled back slightly since attaining record highs beginning in mid-June. The SmallCap and MidCap market-cap indexes have outperformed LargeCaps since the election, but are trailing LargeCaps on a ytd basis. Here's the ytd score through Monday's close and their percentage changes since Election Day: S&P LargeCap 500 (8.4% ytd, 13.5% since the election), Russell LargeCap 1000 (8.3, 13.5), Russell MidCap (6.7, 12.9), S&P MidCap 400 (5.0, 15.2), Russell SmallCap (3.8, 17.8), and S&P SmallCap 600 (1.4, 17.0). 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 for the S&P indexes: LargeCap 11.4% and 11.9%, MidCap 11.2% and 13.6%, and SmallCap 10.1% and 19.0%.

S&P 500 Growth vs. Value (*link*): The S&P 500 Growth index is up 12.9% ytd, well ahead of the 3.4% gain for its Value counterpart. Growth had trailed Value in the four months following the election. Now, Growth's 15.0% gain since the election is leading the 11.2% increase for Value. During 2016, the S&P 500 Growth index underperformed its Value counterpart by a wide margin, rising just 5.1% vs Value's 14.3% gain. Growth is expected to deliver higher forward revenue growth (STRG), but lower forward earnings growth (STEG), than Value over the next 12 months: 7.1% STRG and 10.9% STEG for Growth, respectively, vs 4.2% and 11.5% for Value. Growth's P/E of 20.2 is at a 14-year high, while Value's 15.4 is down from early March's 14-year highs of 16.2. Regarding NERI, Growth's was positive in June for a second month as it improved to a six-year high of 8.0% from 7.7% in May; that compares to a five-year low of -16.2% in April 2015. Value's NERI was positive again in June following 33 months of negative readings through April, and improved to a six-year high of 4.7% from 4.1%; that compares to a five-year low of -20.3% in April 2015.

US ECONOMIC INDICATORS

NFIB Small Business Optimism Index (*link*): "Small business optimism dropped in response to the gridlock in the Senate over the healthcare reform bill," according to NFIB's president. "This happened in

March, when optimism dipped after the House initially failed to repeal Obamacare. I hope every senator is paying attention, because small business owners are paying attention to them." The Small Business Optimism Index (SBOI) has been drifting lower since reaching a cyclical high of 105.9 in January, slipping to 103.6 last month—that's still 8.7 points above its reading of 94.9 just before the November election. The four "hard" measures of the index posted mixed results: both job measures—job openings (-4ppts to 30%) and job creation (-3 to 15)—fell last month, while inventory investment plans (+3 to 4) and capital spending plans (+2 to 30) rose. According to NFIB's chief economist, "Hiring activity remains strong by historical standards, but the drop in June was unmistakable. Whether this is the start of a negative trend or a one-month blip is something we'll have to keep an eye on."

JOLTS (*link*): Job openings sank by 301,000 in June to 5.666 million after rising the prior four months by a total of 428,000 back to a record high of 5.967 million. Meanwhile, hirings rebounded by 429,000—the biggest monthly gain since March 2004—to 5.472 million, while separations climbed by 251,000 to 5.259 million. The latest hirings and separations data yielded an employment advance of 213,000 for May, 61,000 above May's payroll gain of 152,000—coming in above payroll employment for the third time in four months. May's job-opening rate slipped to 4.0% after returning to its record high of 4.2% in April, while the total hires rate rose from 3.8% back to its record high of 4.2%; the quit rate rose to a new record high of 2.5%. The ratio of unemployed workers per job opening (1.21) was little changed near April's cyclical low of 1.17.

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