



MORNING BRIEFING

August 30, 2017

Tariffing

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

(1) Space Race. (2) Mail order rockets. (3) Li'l Kim is Rocket Boy. (4) Trump is fighting Kim's missiles with tariff threats on China. (5) Like Starship Enterprise, S&P 500 flying into uncharted space. (6) Our Fundamental Stock Market Indicator showing plenty of solid rocket fuel. (7) Our Boom-Bust Barometer is going vertical. (8) Consumer confidence indicators justify high P/Es and suggest lower unemployment rate ahead. (9) Despite plentiful jobs, wage inflation remains subdued.

Geopolitics: Rocket Boy. When I was a teenager growing up in Campbell, California during the early 1960s, my friends and I wanted to go to space, or at least be rocket scientists. On October 4, 1957, the Soviets launched Sputnik 1, the world's first artificial satellite. The US launched its first Earth satellite on January 31, 1958. On October 1, 1958, Congress and the President of the United States created the National Aeronautics and Space Administration (NASA) with an "Act to provide for research into the problems of flight within and outside the Earth's atmosphere, and for other purposes." NASA's birth was directly related to the pressures of national defense. After World War II, the United States and the Soviet Union were engaged in the Cold War. During this period, space exploration emerged as a major area of contest and became known as the "Space Race."

NASA began to conduct space missions within months of its creation. Project Apollo became NASA's top priority on May 25, 1961, when President John F. Kennedy announced: "I believe that this nation should commit itself to achieving the goal, before this decade is out, of landing a man on the Moon and returning him safely to Earth." NASA's major achievement during its early years involved the human exploration of the Moon, with the first landing occurring on July 20, 1969.

Here on Earth, young wannabe rocket scientists like me and my friends in California during the 1960s could experiment with model rockets as a hobby. We ordered them by mail from the Estes catalogue. Vern Estes established this company over 50 years ago as a leading manufacturer of innovative hobby products for the model rocket industry. The company now sells model rockets on its [website](#) and on [Amazon](#).

North Korean leader Kim Jong Un has a rocket fetish too. However, unlike hobbyists, he likes the big intercontinental variety that can carry nuclear warheads. He was officially declared "the supreme leader" following the state funeral of his father on December 28, 2011. He is currently somewhere between 33 and 35 years old, depending on the source. The United Nations Security Council has passed several resolutions banning Pyongyang's missile tests. That hasn't stopped Li'l Kim from attempting to rapidly develop his country's nuclear and missile programs.

Despite President Donald Trump's "fire and fury" warning to North Korea on August 8 to cease and desist, another NK missile was fired on Tuesday just before 6 a.m. in Japan. It flew over Japan, where the launch set off alarms in the northern part of the country, with people urged to seek shelter. In response, US President Donald Trump warned that "all options are on the table."

One of the options has been to pressure the Chinese to do something about North Korea's supreme

Rocket Boy. That hasn't worked, as evidenced by the latest missile test over Japan. At some point, the US may have no choice but to shoot down a test missile notwithstanding the potentially dire consequences to South Korea. For now, Trump is turning up the heat on the Chinese by threatening trade protectionism. Implicit in his threats is that if China neuters the pesky brat, he'll back off on imposing tariffs.

On Sunday, Jonathan Swan [reported](#) on the Axios website that during General John Kelly's first week as Trump's chief of staff, "Kelly convened a meeting to discuss the administration's plans to investigate China for stealing American intellectual property and technology. Kelly stood beside Trump, behind the Resolute desk. In front of the desk were U.S. Trade Representative Robert Lighthizer, senior trade adviser Peter Navarro, top economic adviser Gary Cohn, and Trump's former chief strategist Steve Bannon. Trump, addressing Kelly, said, 'John, you haven't been in a trade discussion before, so I want to share with you my views. For the last six months, this same group of geniuses comes in here all the time and I tell them, 'Tariffs. I want tariffs.' And what do they do? They bring me IP. I can't put a tariff on IP.' (Most in the room understood that the president can, in fact, use tariffs to combat Chinese IP theft.) 'China is laughing at us,' Trump added."

Swan reported that the meeting ended with Trump saying, "John, let me tell you why they didn't bring me any tariffs. I know there are some people in the room right now that are upset. I know there are some globalists in the room right now. And they don't want them, John, they don't want the tariffs. But I'm telling you, I want tariffs."

Strategy: Fundamentally Sound. Speaking of rocket ships, the stock market has been like the Starship Enterprise on "Star Trek." It continues to "boldly go where no man [or woman] has gone before." The S&P 500 has been setting new record highs with only two significant corrections since March 28, 2013, when it was 1569.19. It is up 58.5% since the prior bull market record high as of the most recent record high of 2480.91 set on August 7.

In other words, it has been 1,594 days in outer space. During the previous bull market of the 2000s, it was in outer space (i.e., exceeded the previous bull market record high) for only 133 days ([Fig. 1](#)). Granted, the air is thin in outer space, as measured by various valuation gauges. However, there's no gravitational pull either, so the Starship S&P 500 can continue to fly as long as it doesn't run out of rocket fuel. The fundamental gauges for the S&P 500 that Joe and I watch show plenty of solid rocket fuel:

(1) *The Fundamental Stock Market Indicator* (which we sometimes call the "YRI Weekly Leading Index") rose to a new record high during the week of August 19, as Debbie reported yesterday ([Fig. 2](#)). It has been very highly correlated with the S&P 500 since 2000.

Our indicator isn't a leading index of the S&P 500. Nothing leads the S&P 500, since it is a leading indicator itself, and is one of the 10 components of the Conference Board's Index of Leading Economic Indicators. Our indicator simply confirms or raises doubts about the underlying trend in the stock market. Its new high certainly confirms that the bullish trend in stocks remains intact.

Our indicator comprises just three components that reflect the underlying strength or weakness in the domestic and global economies. It is the average of the Consumer Comfort Index (which is a four-week average) and the four-week average of the Boom-Bust Barometer, which is the CRB raw industrials spot price index (weekly average) divided by weekly initial unemployment claims.

(2) *The CRB raw industrials spot price index* is up 30% since it bottomed late in 2015 ([Fig. 3](#)). It had stalled during late 2016 through the first half of 2017, but has been advancing again in recent weeks.

One of its 13 components is the price of copper, which has gone vertical in recent days ([Fig. 4](#)).

(3) *The Boom-Bust Barometer* (BBB) is simply the ratio of the CRB raw industrials spot price index divided by initial unemployment claims ([Fig. 5](#)). To smooth it out, we track the four-week moving average, which is extremely procyclical. The BBB has taken off like a rocket ship since late 2015 and has been in record-high territory this summer.

It is also highly correlated with the S&P 500 since 2000 ([Fig. 6](#)). That's not surprising since it is highly correlated with another very procyclical indicator, namely S&P 500 forward earnings ([Fig. 7](#)).

(4) *Consumer confidence* is the third component of the Fundamental Stock Market Indicator (FSMI), which averages the Weekly Consumer Comfort Index (WCCI) and the BBB ([Fig. 8](#)). While the BBB is highly correlated with the S&P 500, the FSMI better tracks the stock index. That's because the BBB is highly correlated with forward earnings and the WCCI is highly correlated with the S&P 500 forward P/E ([Fig. 9](#)). The WCCI has recovered sharply since late 2011, and so has the P/E.

US Consumers: Fearless. While North Korea's Li'l Kim is doing his best to terrify the US and our allies in Asia, President Trump is doing his best to "tariffy" the Chinese. Showing no fear are US consumers, which may be one reason why stock investors continue to push stock prices higher. The WCCI is highly correlated with the S&P 500 forward P/E, as noted above. Both are in Happy Land, where terrifying things don't happen.

Also in Happy Land are August's readings of the Consumer Sentiment Index and the Consumer Confidence Index (CCI). The WCCI is most highly correlated with the expectations component of the University of Michigan's Consumer Sentiment Index ([Fig. 10](#)). Let's review the latest monthly data:

(1) *CCI and CSI*. The two monthly indexes include components showing opinions about current conditions and expectations ([Fig. 11](#)). Standing out is the outstanding ascent in the current conditions component of the CCI to the highest reading since July 2001.

(2) *COI*. Debbie and I like to average the CCI and CSI to derive the Consumer Optimism Index and its two components ([Fig. 12](#)). The COI current conditions index is the highest since March 2001.

(3) *Jobs*. Debbie and I think that the CCI provides greater insights into the labor market than does the CSI. Indeed, the survey used to construct the former includes an important question on whether jobs are plentiful, available, or hard to get. In August, the percentage saying jobs were hard to get fell to 17.3%, the lowest since August 2001, while the percentage saying jobs are plentiful rose to 35.4%, the highest since July 2001 ([Fig. 13](#)). The former is highly correlated with the unemployment rate, and suggests the jobless rate could fall from 4.3% currently to 4.0% soon!

The big puzzle is why wage inflation remains subdued. The jobs plentiful series has been highly correlated with the yearly percent change in average hourly earnings for production and nonsupervisory workers in the past, suggesting that wage inflation should be moving higher ([Fig. 14](#)). Yet it has been stuck around 2.5% since December 2015.

The jobs-plentiful series is highly correlated with the percent of small business owners reporting that they have job openings ([Fig. 15](#)). In July, 33.0% had job openings, the highest since the start of 2001. Yet, wage inflation remains subdued ([Fig. 16](#)).

CALENDARS

US. Wed: GDP & PCE 2.8%/3.0%, Corporate Profits, ADP Employment 182k, MBA Mortgage Applications, EIA Petroleum Status, Powell. **Thurs:** Personal Income & Consumption 0.4%/0.4%, Headline & Core PCED 1.4%/1.4% y/y, Jobless Claims 237k, Pending Home Sales 0.4%, Chicago PMI 58.6, Weekly Consumer Comfort Index, Challenger Job-Cut Report, EIA Natural Gas Report, Kaplan. (Bloomberg estimates)

Global. Wed: Eurozone Economic Confidence 111.3, Germany CPI 0.1%*m/m*/1.8%*y/y*, UK Gfk Consumer Confidence -13, Japan Industrial Production 5.1% y/y, Japan Small Business Confidence. **Thurs:** Eurozone Headline & Core CPI Flash Estimate 1.4%/1.2% y/y, Eurozone Unemployment Rate 9.1%, Germany Unemployment Change & Unemployment Rate -6k/5.7%, Germany Retail Sales -0.6%*m/m*/2.9%*y/y*, Canada GDP 3.7%*q/q*/4.1%*y/y*, Japan Housing Starts 995k, China M-PMI 51.3. (DailyFX estimates)

US ECONOMIC INDICATORS

Consumer Confidence ([link](#)): Consumer confidence beat expectations again in August. The Consumer Confidence Index rose for the second month to 122.9—the second-highest reading in 16 years, surpassed only by March’s 124.9. This month’s improvement was driven by the fourth straight gain in the present situation component, which climbed from 140.3 in April to 151.2—the highest reading since July 2001. The expectations component climbed for the second month to 104.0, after falling the prior three months from 112.3 in March to 99.6 in June. Consumers’ view of the current job market is the best in 16 years, with those saying jobs plentiful (to 35.4% from 33.2%) rising to its highest level since July 2001 and those saying jobs hard to get (17.3 from 18.7) falling to its lowest reading since August 2001. As for the six-month job outlook, the percentage expecting more jobs (17.1%) continued to surpass those expecting fewer jobs (13.0), though the spread has narrowed steadily from 11.1ppts in March to 4.1ppts in August, holding the expectations component below March’s cyclical high.

GLOBAL ECONOMIC INDICATORS

France GDP ([link](#)): The Eurozone’s second-largest economy expanded 1.9% (saar) during Q2, in line with the previous two quarters, after little growth the prior two quarters. Strong foreign demand drove economic growth last quarter. Exports accelerated at a four-year high of 10.0% (saar), after contracting 3.4% during Q1, outpacing Q2 imports (1.5%, saar) nearly 7 to 1. Meanwhile, gross fixed capital investment increased 2.7% (saar), slowing from Q1’s 5.4%, which was the best growth rate since Q4-2011, while household (to 1.1% from 0.4%, saar) and government (1.5 from 1.1) consumption accelerated slightly from Q1’s anemic paces.

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

Copyright (c) Yardeni Research, Inc. Please read complete [copyright and hedge clause](#).