MORNING BRIEFING
September 12, 2017

Over There & Over Here

See the collection of the individual charts linked below.

(1) While the Atlantic Ocean is getting warmer, stocks are getting hotter. (2) Venturing abroad. (3) The weak dollar has contributed greatly to outperformance of Go Global vs. Stay Home this year. (4) Boosting global growth: Lower oil prices, European immigration, Chinese bank loans. (5) Industrial production making record highs in Germany. (6) Chinese using more electricity. (7) Global revenues and earnings outlook looks upbeat to industry analysts around the world.

Global Warming I: Hot Stock Markets. The debate over "Global Warming" is now about "Global Climate Change." The latest two monster hurricanes that hit Texas and Florida certainly provide fuel for the alarmists. The Atlantic Ocean has been warmer than usual, which is why the hurricanes have been larger and more devastating. There's no debate about that. The debate is whether this is a secular or a temporary development. Also being debated is whether humans have contributed to global warming if it is in fact a more permanent development.

There's no debating that global stock markets have been on fire this year. The All Country World MSCI stock price index (in US dollars) edged up to a new record high on March 6, 2014, slightly exceeding the previous record high on October 31, 2007 (*Fig. 1*). It then sold off 18.9% from May 21, 2015 through February 11, 2016 before recovering to a new record high on February 10, 2017. It is now up 33.7% since last year's low, 12.6% y/y, and 12.2% ytd.

Which side is winning in the Go Global vs. Stay Home debate on investment strategy? Joe and I warmed up to the former late last year after staying home during most of the bull market. So that puts us on the "all the above" side of the debate for now.

We saw signs that the global economy was warming up late last year. We reckoned that the negative consequences of the plunge in crude oil prices had played out and that the beneficial consequences of cheaper fuel costs would prevail. We calculate that oil users have been enjoying an annualized windfall of $1.5 trillion since 2014 (*Fig. 2*). For US consumers of oil, the annualized windfall is around $150 billion. Also contributing to global economic warming is better growth in Europe and China, as Debbie and I discuss below.

For now, let's review the global stock market derby:

(1) *World in local currencies.* Through Friday's close, the US MSCI stock price index is up 35.2% since last year's low, 12.8% y/y, and 10.1% ytd (*Fig. 3*). The All Country World (ACW) ex-US MSCI stock price index (in local currencies) is up 30.6%, 11.9%, and 8.5% over the same time frames (*Fig. 4*).

(2) *World in dollars.* The MSCI currency ratio index shows that foreign currencies relative to the US dollar are up 1.6% y/y and 8.6% ytd (*Fig. 5*). So the All Country World ex-US MSCI stock price index (in US dollars) is up 36.2% since last year's low, 13.6% y/y and 17.8% ytd.

(3) *Eurozone & Japan.* The EMU MSCI stock price index in euros is up 13.2% y/y and 7.1% ytd (*Fig. 6*).

In dollars, it is up 20.7% y/y and 21.9% ytd, reflecting the 14.0% rebound in the euro ytd (*Fig. 7*).

The Japan MSCI is up 3.3% ytd in yen and 11.7% in dollars (*Fig. 8*).

(4) *Emerging Markets*. The Emerging Markets MSCI (in local currency) is up to a record high with gains of 44.7% from last year's low on January 21, 16.0% y/y, and 20.7% ytd (*Fig. 9*). In dollars, it remains 18.5% below the 2007 record high, but has gained 17.7% y/y and 26.5% ytd.

(5) *Lots of winners.* Joe and I monitor the relative performance of Stay Home vs. Go Global using the ratio of the MSCI stock price index to the ACW ex-US stock price index (*Fig. 10*). This shows that the US has performed in line with the rest of the world's performance in local currencies since late last year, but underperformed since it peaked out on a relative basis in dollars on December 27, 2016. The bottom line is that it's another great year so far for the global bull market in stocks.

Global Warming II: Hot Economies. Heating up the global economy this year have been Germany and China. Consider the following:

(1) *Germany* stands out among the Eurozone nations, as its production is in record-high territory while the other major regional output indexes are lagging (*Fig. 11*). Germany's IFO business climate index rose to a record high this past summer (*Fig. 12*).

The country has benefitted from a 24% decline in the euro since mid-2014, when the ECB adopted a negative interest-rate policy, through the end of 2016. However, the euro is up 14% ytd, which might start to weigh on Germany and the other Eurozone economies. Then again, there may be another reason why Germany's economy is booming. The huge influx of immigrants over the past couple of years may be boosting the economy much more than widely recognized.

(2) *China* is showing improving growth. That's to be expected as the government continues to encourage debt-led growth. Bank loans are up a record $2.0 trillion over the past 12 months through July (*Fig. 13*). That's helped to fuel another construction boom, as evidenced by the 130% rebound in China's steel price index (for 1mm hot rolled sheet) from the end of 2015 through the week of September 8 (*Fig. 14*).

The 12-month average of electricity output is up 8.0% y/y, the best pace since July 2014 (*Fig. 15*). The China MSCI stock price index (in dollars) has been soaring this year (up 38.5% ytd) along with the price of copper, which is deemed to be very sensitive to Chinese growth (*Fig. 16*).

Global Warming III: Hot Revenues & Earnings. The global stock market rally this year has been fueled by an upturn in the All Country World's forward revenues (in dollars) (*Fig. 17*). Industry analysts around the world are estimating the 2018 global revenues will be up 4.9% from this year. ACW MSCI forward earnings (in dollars) is at a nine-year high and just 2.1% below the July 2008 record high, with analysts expecting earnings to grow 9.8% next year (*Fig. 18*).

CALENDARS

US. Tues: NFIB Small Business Optimism Index 104.8, Job Openings 6.010m. **Wed:** PPI-FD Headline, Core, and Core Less Trade Services 0.3%/0.2%/0.2%, MBA Mortgage Applications, Treasury Budget, EIA Petroleum Status. (Bloomberg estimates)

Global. Tues: UK Headline & Core CPI 2.8%/2.5% y/y, UK House Price Index 4.8% y/y. **Wed:** Eurozone Industrial Production 0.1%m/m/3.3%y/y, Eurozone Employment, Germany CPI

0.1%m/m/1.8%y/y, UK Jobless Rate 4.4%. (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—fell during the week of September 2 for the first time in eight weeks, as Hurricane Harvey boosted weekly jobless claims by 62,000 to 298,000—the highest level in more than two years. Our WLI sank 2.5% after a seven-month surge of 5.0% 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 slumped 4.0%, after jumping 5.5% the prior seven weeks to a new record high, as the big jump in weekly jobless claims pushed the four-week average up to a five-month high of 250,250; claims had dropped to 236,750 the previous week, which was not far from late May's 235,500—the lowest since April 1973. The CRB raw industrial spot price index—another BBB component—continued to move higher though slipped in recent sessions. Meanwhile, the WCCI slipped 1.3% after climbing by a total of 13.4% the prior seven weeks to a new cyclical high.

S&P 500/400/600 Forward Earnings (*link*): Forward earnings rose to a record high last week for LargeCap and MidCap; SmallCap's rose too, but remained 0.6% below its mid-July record. Momentum remains strong as the yearly change in forward earnings is up from six-year lows in early 2016, but the easy y/y comparisons may be waning. In the latest week, LargeCap's forward earnings edged down w/w to 9.5% y/y from 9.6%, which compares to a 64-month high of 10.2% in mid-May and a six-year low of -1.8% in October 2015; MidCap's was down to 13.2% from 13.5% y/y, which compares to a 66-month high of 14.0% in early August and a six-year low of -1.3% in December 2015; and SmallCap's dropped to an eight-month low of 9.5% from 10.4%, which compares to a 39-month high of 13.0% in mid-July and a six-year low of 0.3% in December 2015. LargeCap's consensus growth rates expected for 2017 have been edging higher lately, leading to a slight decline in the 2018 growth rates. However, 2018 should improve if the corporate tax rate changes. Here are the latest consensus earnings growth rates: LargeCap 11.5% and 10.9%, MidCap 11.5% and 12.9%, and SmallCap 5.7% and 20.5%.

S&P 500/400/600 Forward Valuation (*link*): Forward P/E ratios fell 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 are easing now after melting 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 edged down to 17.4 from 17.5, and compares to 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 Tech bubble's record high of 25.7 in July 1999. MidCap's forward P/E fell to 17.3 from 17.6, and is below LargeCap's P/E for only the second time since 2009. MidCap's P/E, which compares to a 15-year high of 19.2 in late February and the record high of 20.6 in January 2002, and is up from a three-year low of 15.0 in January 2016. SmallCap's fell to 18.7 from 18.9, 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, but down 2.5 points from SmallCap's record-high P/E of 20.9 in April 2002. Looking at their daily forward price/sales (P/S) ratios since data became available in 2004, valuations last week were similarly lower for the three indexes: LargeCap's P/S of 1.95 on Friday is down from a record high of 1.97 in late July; MidCap's 1.23 is down from a record high of 1.39 in early March, and SmallCap's 0.96 is down from 1.08 in early March and its record high of 1.17 in November 2013.

S&P 500 Sectors Quarterly Earnings Outlook (*link*): Q3 earnings revisions activity was quiet for the 11 S&P 500 sectors last week. The Q3 consensus rose w/w for two of the 11 S&P 500 sectors, fell for one, and was steady for eight. Materials surged 9.7% w/w; Tech gained 0.2%, and Health Care edged down 0.1%. The S&P 500's Q3-2017 EPS forecast dropped 4 cents w/w to $33.11, and is down 2.1%

from $33.82 at the end of Q2. That represents a forecasted pro forma earnings gain for Q3-2017 of 6.5% y/y, down from Q2's blended 12.4% and Q1's 15.3%, which was the strongest growth since Q3-2011 owing mostly to easier comps for Energy. The Q3-2017 forecast is unchanged from a week earlier, and down from 8.7% at the end of Q2. Since the end of Q2, Q3 estimates are lower for seven sectors and higher for four. Materials' Q3 forecast has risen 4.9%, Real Estate's is up 2.5%, Tech's has risen 1.4%, and Telecom has gained 0.6%. Energy's has tumbled 19.7% for the worst decline, followed by the Q3 forecasts for Consumer Discretionary (-4.4), and Utilities (-2.8). The S&P 500's Q3-2017 forecasted earnings gain of 6.5% y/y would be its fifth straight gain after four declines. Nine of the 11 sectors are expected to record positive y/y earnings growth in Q3-2017, but only three are expected to beat the S&P 500's forecasted y/y earnings gain of 6.5%. That's because analysts expect Energy to report another large profit jump in Q3 relative to very low earnings a year ago. That's down from Q2-2017 when all 11 sectors rose y/y on a blended basis, the first time that has occurred since Q3-2011 when 10/10 sectors rose y/y. The latest forecasted Q3-2017 earnings growth rates vs their blended Q2-2017 growth rates: Energy (132.2% in Q3 vs 533.7% in Q2), Tech (10.0% vs. 18.1%), Industrials (6.7, 7.3), S&P 500 (6.5, 12.4), Financials (4.9, 12.1), Health Care (3.7, 8.7), Real Estate (3.5, 4.6), Consumer Staples (2.7, 4.5), Materials (1.1, 6.0), Consumer Discretionary (0.1, 4.1), Telecom (-1.0, 4.8), and Utilities (-2.1, 6.1).

GLOBAL ECONOMIC INDICATORS

France Industrial Production (*link*): Industrial production in July continued its up-and-down pattern so far this year. Headline production, which excludes construction, advanced 0.5% after a 1.1% loss in June and a 1.9% gain in June, bouncing around May's cyclical high. So far this year, output is up 1.3%. Factory output rose for the second time in three months, by 0.3% in July and 1.5% over the period. Over the three-month period, consumer durable goods (4.8%) as well as capital (1.7), intermediate (1.3), and consumer nondurable (0.9) goods production all were in the black. Meanwhile, France's M-PMI (55.8) for August showed its best growth in France's manufacturing sector since April 2011, with new orders growth hitting an 80-month high.

Italy Industrial Production (*link*): "Our country is finally experiencing a slow recovery, which is not as slow as we thought," according to Prime Minister Paolo Gentiloni. Output in July grew a robust 4.4% y/y to its highest level since December 2011. Strength was widespread, with consumer durable (6.2 y/y), capital (5.9), consumer nondurable (3.8), intermediate (3.5), and energy (3.3) output all posting hardy gains. "Such data was unthinkable just one or two years ago," noted Italy's prime minister. Italy's M-PMI (56.3) for August jumped to a six-and-a-half-year high, reflecting faster growth in output, new orders, and employment, along with a sharper lengthening of supplier delivery times.

UK Industrial Production (*link*): UK industrial output in July increased for the third time in four months, up 0.2% m/m and 0.9% over the period—after sliding 1.9% the first three months of the year. July's increase was weighed down by a 1.4% drop in oil & gas extraction. Meanwhile, manufacturing output climbed 0.5%—the best growth rate so far this year—led by a 2.1% jump in capital goods production to a new cyclical high; intermediate goods output (0.2) eked out a small gain, while consumer durable (-1.4) and nondurable (-0.8) goods output contracted during the month. According to Markit, the UK's M-PMI (56.9) accelerated for the second month in August, posting its second-highest level in over three years—just below April's 57.0. All five of the PMI components—output, new orders, employment, suppliers' delivery times, and stock purchases—were consistent with a stronger performance for the manufacturing sector last month.

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