Yardeni Research, Inc.

**MORNING BRIEFING**
**September 20, 2017**

## A Trillion Here, A Trillion There

*See the collection of the individual charts linked below.*

(1) Dirksen's "real money" was in billions. Now it's trillions. (2) Policy-making trillionaires remain bullish for asset prices. (3) Less bang per buck, euro, yen, and yuan. (4) China's monetary extravaganza. (5) US government redistributing lots of money. (6) Three central bank amigos on major liquidity binge. (7) Stocks on central bank high. (8) Bye-bye, buybacks? (9) The corporate finance buyback model favors more buybacks. (10) Bond borrowing binge continues. (11) More upside for stock valuations based on corporate bond yield.

**Global Economy: The Trillionaires.** Everett Dirksen was a Republican politician from Illinois who served in both houses of Congress from 1933 to 1969. He was the Senate Minority Leader from 1959 to 1969. He helped write and pass the Civil Rights Act of 1964 and the Civil Rights Act of 1968. This man was a professional politician and a conservative, who recognized that the government's spending habits were turning into a compulsive disorder. Dirksen is quoted as having said, "A billion here, a billion there, pretty soon, you're talking real money." Although there is no direct record of the remark, he is believed to have made it during an appearance on *The Tonight Show Starring Johnny Carson.*

In today's world, this observation needs to be amended to, "A trillion here, a trillion there, pretty soon, you're talking real money." That's the kind of money that fiscal and monetary authorities around the world have been spending to keep the world turning. It certainly has been spinning the heads of conservatively inclined people, like me. However, as I often have observed, in our business we can't afford to be preachers. We don't do right vs. wrong. We do bullish vs. bearish. So far, the policy-making trillionaires have been wildly bullish for asset prices. They've been able to be so because powerful structural forces have been keeping a lid on price inflation, so much of their trillion dollars in spending has gone into asset inflation.

Yet it is somewhat disconcerting to see that despite everything they've done to boost economic growth, which was presumably their main goal, the policy-making trillionaires haven't delivered as much bang per buck, euro, yen, and yuan as was expected. Consider the following:

(1) *Trillions of yuan.* In China, bank loans have quadrupled from $4.4 trillion at the end of 2008 to a record $17.5 trillion during August (*Fig. 1*). By comparison, US commercial bank loans increased $2.1 trillion to a record $9.3 trillion over this same period. On a 12-month basis, Chinese bank loans are up $2.0 trillion through August, the fastest pace on record (*Fig. 2*).

How well did all that cash stimulate China's economy? Not so well. Since the end of 2008, Chinese bank loans rose 284%, while industrial production rose 126%. The ratio of loans to production, which had been relatively stable around 100 from 2000-2008, soared to 174 during August (*Fig. 3*). The y/y growth rate of industrial production declined from just over 20% during early 2010 to roughly a third as much this year (*Fig. 4*).

(2) *Trillions of dollars.* Here in the USA, the federal government's spending rose to a record $4.0 trillion over the past year through the end of Q2-2017 (*Fig. 5*). That's according to the US Treasury's data. According to the Bureau of Economic Analysis, federal government spending on goods and services,

which is included in nominal GDP, has been flat around $1.3 trillion since 2010! The difference between the two is federal government spending on entitlements, i.e., on redistributing income. It rose to a record $2.8 trillion over the four quarters through mid-2017. Outlays on income redistribution now account for a record 70% of total government spending (*Fig. 6*).

How well did that work out? Not so well. Real GDP has been lumbering along at a y/y growth rate of about 2% since mid-2010. In the past, this pace was called the "stall speed" because the economy always fell into a recession after growth had slowed to it (*Fig. 7*).

(3) *Trillions of high-powered money.* The three major central banks have weighed in with their trillion-dollar QE programs. During August, the balance-sheet assets of the ECB, BOJ, and Fed were all at record highs, of $5.1 trillion, $4.7 trillion, and $4.4 trillion (*Fig. 8*). That added up to a record $14.1 trillion, up 249.5%, or $10.1 trillion, since August 2008 (*Fig. 9*).

They've succeeded in stimulating subpar growth in the US, Europe, and Japan. So far, they've averted another financial crisis. They've been frustrated in their goal of boosting their inflation rates to their targets of 2.0%. The core CPI inflation rate for the G7 industrial economies has been below that target and hovering around 1.5% since late 2011 (*Fig. 10*).

Debbie and I find it hard to view this "miss" as a serious problem. However, the central bankers view it as such. They are mostly maintaining their ultra-easy monetary policy, although there is increasing evidence that their economies don't need it. The main beneficiary of all this monetary largess continues to be financial markets. The All Country World MSCI (in US dollars) continues to soar into record-high territory (*Fig. 11*).

**Strategy: Bye-Bye, Buybacks?** Speaking of trillions, S&P 500 buybacks plus dividends totaled $6.2 trillion during the current bull market from Q1-2009 through Q2-2017 (*Fig. 12*). Over this period, the market capitalization of the S&P 500 has increased by a whopping $15.6 trillion to a record $21.4 trillion (*Fig. 13*). Together, buybacks and dividends have been the main driving force behind the bull market, with the former totaling $3.6 trillion and the latter totaling $2.6 trillion.

Buyback activity may be slowing, but it isn't suddenly going to come to a halt, thus slamming the brakes on the bull market. That's because the after-tax corporate borrowing rate remains well below the forward earnings yield of the S&P 500. That provides a great incentive to borrow in the bond market to buy back shares. It also suggests that there is room for the S&P forward earnings yield to decline as buyback activity continues to arbitrage the relationship between this equity yield and the corporate bond yield. Consider the following:

(1) *Buybacks*. During Q2, buybacks slowed to an annualized rate of $480 billion, the second slowest pace since Q2-2014 (*Fig. 14*). The S&P 500 forward earnings yield was 5.70% in mid-September, while the pre-tax corporate bond yield was under 4.00%.

(2) *Bond borrowing.* Over the past 12 months through July, gross issuance in the corporate bond market totaled $1.7 trillion, with nonfinancial corporations raising $880 billion while financial ones borrowed $773 billion (*Fig. 15* and *Fig. 16*).

(3) *Impact on valuation.* This bull market has been driven by the corporate finance version of the Fed's Stock Valuation Model rather than the asset allocation version. This suggests that the forward P/E should be driven more by the corporate bond yield than by the Treasury bond yield. Using the reciprocal of either one shows more upside for the forward P/E.

## CALENDARS

**US. Wed:** Existing Home Sales 5.48mu, MBA Mortgage Applications, EIA Petroleum Status Report, FOMC Announcement 1.125%. **Thurs:** Leading Indicators 0.2%, Jobless Claims 303k, Philadelphia Fed Manufacturing Index 18.0, FHFA House Price Index 0.4%, Weekly Consumer Comfort Index, EIA Natural Gas Report. (Bloomberg estimates)

**Global. Wed:** UK Retail Sales 0.0%m/m/1.4%y/y, Lowe. **Thurs:** Eurozone Consumer Confidence -1.5, BOJ Policy Balance Rate & 10-Year Yield Target -0.10%/0.00%, BOJ Monetary Policy Statement, ECB Publishes Economic Bulletin, Draghi, Kuroda, Lowe. (DailyFX estimates)

## STRATEGY INDICATORS

**S&P 500 Sectors Net Earnings Revisions** (*link*): The S&P 500's NERI was positive for a fifth straight month in September, its longest positive streak since the five months ending September 2014. NERI dropped to a still-strong 3.1% in September from 4.0% in August, and is down from a six-year high of 6.2% in June. NERI improved m/m for 3/11 sectors in September and was positive for 5/11 sectors (compared to four improving and seven positive in August). That's the lowest number of sectors to improve m/m in 10 months. Tech topped all sectors in September for a second month in a row. Real Estate and Consumer Staples returned to negative territory. Tech has the longest positive NERI streak of 14 months, the best since August 2011 when a 28-month streak ended. Financials has the next best positive streak at 12 months, followed by Industrials (7). Telecom has had the worst recently, with 17 straight months of negative NERIs, followed by Energy (6). Here are the sectors' September NERIs compared with their August readings, ranked in descending order: Tech (14.8% in September, down from 79-month high of 15.4% in August), Health Care (9.2, 10.7 [14-month high]), Financials (8.2, 9.3), Industrials (5.4, 9.1), Utilities (1.0, 2.2), Consumer Discretionary (-0.4, -1.5), Materials (-0.8, -0.8), Telecom (-0.9, [17-month high], -1.6), Real Estate (-1.1, 2.7), Consumer Staples (-1.3, 0.4), and Energy (-22.2, -22.8 [16-month low]).

**S&P 500 Earnings, Revenues & Valuation** (*link*): Last week saw S&P 500 consensus forward revenues rise w/w—for the ninth time in 10 weeks—to a record high. Forward earnings rose w/w to a new record high as well. The forward profit margin forecast was steady w/w at a record high of 11.1%. The profit margin's record high was 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 ticked up to a 24-week high of 5.5% from 5.3%. That's 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 improved to a nine-week high of 11.1% from 10.8%, which compares to a six-month high of 11.3% in early July. It remains 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 forward growth rate forecasts for revenues (STRG) and earnings (STEG) for Industrials, Materials, and Tech. However, Energy's contribution to forward growth peaked at the start of 2017. Looking at last week's results, the S&P 500 ex-Energy's STRG of 5.2% is 0.3ppt lower and STEG of 9.8% is 1.3ppts lower. The S&P 500 ex-Energy forward profit margin was steady w/w at a record high of 11.7%, which is its first since August 2007. The index price rose w/w, and the forward P/E improved to an eight-week high of 17.8 from 17.6, which is down from late July's 13-year high of 18.0 and compares to a 15-month low of 14.9 in January 2016. The price-to-sales ratio improved to 1.97 from 1.95, which matches late July's record high of 1.97. On an ex-Energy basis, valuation rose to a seven-week high of 17.4 from a 16-week low of 17.2, which compares to late July's 21-week high of 17.5 and a 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 8/11 sectors, and forward earnings rose for 3/11. Health Care and Industrials had both measures improve w/w. Consumer Staples and Industrials had both measures decline. 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 is stabilizing now near a 10-month low, and its forward earnings is around an eight-month low. The forward P/S ratio rose w/w for 9/11 sectors, and the P/E ratio rose w/w for 10/11 sectors (all but Utilities). These four sectors posted notable w/w gains in both measures: Energy, Financials, Health Care, and Industrials. Health Care's P/E of 16.8 and P/S of 1.79 are at 25-month highs now, but remain below their early 2015 highs of 17.9 and 1.88, respectively. Financials' P/E is up from 12.0 before the election to 13.6, but remains below the post-election high of 14.6 in early March. With Energy's forward revenues and earnings up from cyclical lows in early 2016, its valuations are coming back to Earth; its P/S ratio of 1.31 compares to a record high of 1.56 in May 2016, and its P/E of 27.5 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. Materials had its forecasted forward profit margin improve 0.2ppts w/w, but Financials' edged down 0.1ppt. Here's how the 11 sectors rank based on their current 2017 forecasts: Information Technology (to 20.1% in 2017 from 19.2% in 2016), Real Estate (18.4, 24.9), Financials (15.5, 14.3), Telecom (11.3, 11.2), Utilities (11.0, 11.4), S&P 500 (10.6, 10.1), Health Care (10.5, 10.3), Materials (9.7, 9.1), Industrials (9.2, 8.9), Consumer Discretionary (7.3, 7.2), Consumer Staples (6.6, 6.4), and Energy (3.9, 1.1).

**S&P 500 Buybacks** (*link*): S&P 500 quarterly buybacks fell 9.8% q/q to $120.1 billion during Q2-2017, and was down 5.8% y/y. While Q1-2017 marked the 17th highest quarterly buyback amount on record, dating back 76 quarters to Q1-1998, it was 30.1% below Q3-2007's record quarterly high of $172.0 billion, and lower q/q in four of the past five quarters since its Q1-2016 cyclical peak of $161.4 billion. Furthermore, the four-quarter buybacks sum was lower for a fifth straight quarter as it fell 1.5% q/q to a 14-quarter low of $500.8 billion from $508.1 billion, and is down 15.0% from Q1-2016's record high of $589.4 billion, which at the time was its first since Q4-2007. S&P 500 buybacks in Q2 accounted for 0.58% of the total market capitalization, the lowest since Q1-2010 and down from 0.66% in Q1-2017. That compares to a cyclical peak of 1.15% in Q3-2011, and a record high of 1.28% during Q3-2007.

**S&P 500 Sectors Buybacks** (*link*): Buybacks rose q/q during Q2-2017 for six of the 11 sectors and fell for five. That compares to six rising and five falling during Q1-2017. The biggest q/q buyback gainers on a percentage basis in Q2-2017: Real Estate (up 100.5% q/q to $1.2 billion from $0.6 billion), Telecom (47.6%, to a six-quarter high of $282.0 million from $191.0 million), Energy (47.5%, to a seven-quarter high of $3.1 billion from a $2.1 billion), Consumer Discretionary (38.0%, to a five-quarter higher of $22.4 billion from a 15-quarter low of $16.26 billion), Industrials (4.9%, $14.8 billion from $14.1 billion), and Tech (0.5%, $27.6 billion from $27.5 billion). The biggest percentage q/q decliners: Utilities (-87.7%, $19.5 million from $158.1 million), Health Care (-53.2%, to an 18-quarter low of $12.6 billion from $27.0 billion), Consumer Staples (-28.8%, $10.3 billion from $14.5 billion), Materials (-24.9%, to a 19-quarter low of $1.0 billion from $1.4 billion), and Financials (-9.1%, to $26.8 billion from a 40-quarter high of $29.5 billion). Tech accounted for the biggest portion of total S&P 500 buybacks in Q2-2017, improving to a 23.0% share from 20.6% in Q1. Tech regained the top slot for the first time in three quarters, a position it had previously held for 16 straight quarters through Q3-2016. Financials slipped to second from first, but its share edged up to 22.3% from 22.2%. Industrials was third (up to 12.3% from 10.6%), and Health Care was fourth (down to 10.5% from 20.3%).

**S&P 500 Cash Return & Buyback Yield** (*link*): During Q2-2017, the S&P 500 companies continued their long-established trend of spending more on buybacks than dividends, as buybacks of $120.1 billion outpaced the record-high quarterly dividend payment of $103.8 billion. Buybacks have exceeded dividends in 38 of the past 43 quarters, except during the financial crisis from Q4-2008 to Q4-2009, when all sectors cut buyback spending drastically. However, with the pace of buybacks continuing to slow, the four-quarter sum of buybacks and dividends, or cash returned to investors, of $906.7 billion during Q2 was at a nine-quarter low. The cash return was down for a fifth straight quarter from $908.1 billion in Q1-2017, and has dropped 7.0% from a record high of $974.6 billion in Q1-2016. On a positive note, companies earned more than they paid out to investors for a second straight quarter after paying out more than they earned for six straight quarters: Q2-2017's four-quarter sum of operating earnings of $996.8 billion was at a 10-quarter high and exceeded the $906.7 billion returned to investors. The cash return was at a 10-quarter low of 9.0% lower than trailing-four-quarter operating earnings during Q1, compared to 5.3% lower than operating earnings in Q1-2017, 1.3% above during Q4-2016, and a 28-quarter high of 13.5% above operating earnings during Q1-2016. The improvement in operating earnings was helped in part by strong Tech earnings and by the Energy sector, which recorded positive trailing-four-quarter operating earnings for a second quarter**.** The S&P 500's figures are much better on an ex-Energy basis. Operating earnings exceeded the cash return for a fourth straight quarter, with the percentage dropping to a 12-quarter low of 88.1% from 91.1% in Q1-2017, and is down from a 28-quarter high of 102.2% in Q2-2016. Including Energy, the S&P 500's buyback yield was down to a 28-quarter low of 2.41% from 2.51% in Q1, and the dividend yield fell to a 10-quarter low of 1.96% from 1.97% in Q1. Adding both together, the buyback + dividend yield (or cash return) was down to a 29-quarter low of 4.37% in Q2 from 4.49% in Q1.

**S&P 500 Sectors Cash Return & Buyback Yield** (*link*): During Q1-2017, eight of the 11 sectors had enough operating earnings on a trailing-four-quarter basis to cover their buybacks and dividends (cash returned to investors), up from 7/10 sectors during Q1-2017. Real Estate has been added to this analysis because it now has four quarters of data. Consumer Staples failed to cover its cash return for a tenth straight quarter, and the Energy sector missed for a ninth straight quarter. However, Energy was profitable on a GAAP operating earnings basis for a second quarter after five quarters of losses. On a positive note, Industrials covered its cash return for the first time in nine quarters, Consumer Discretionary did so for a second quarter after missing for 12 quarters, Materials did so for just the third time since Q1-2014, and Tech did so for only the fourth time over that same time period. Here's how the sectors' four-quarter cash returns relative to four-quarter earnings ranked in Q2-2017: Energy (214.4%), Consumer Staples (108.3), Real Estate (105.8), Consumer Discretionary (97.5), Industrials (97.2), S&P 500 (91.0), Health Care (90.9), S&P 500 ex-Energy (88.4), Information Technology (81.7), Financials (80.8), Telecommunication Services (76.6), Materials (67.5), and Utilities (64.1). The four-quarter buyback + dividend yield rose q/q for Consumer Discretionary, Energy, and Telecom, and fell for the remaining seven sectors. Here's how the 10 sectors ranked: Telecom (5.30% [six-quarter high]), Financials (5.28% [six-quarter low]), Consumer Staples (5.05 [five-quarter low]), Industrials (4.73 [19-quarter low]), Consumer Discretionary (4.66), S&P 500 (4.37 [29-quarter low]), Health Care (4.30 [six-quarter low]), Tech (3.74 [29-quarter low]), Energy (3.54 [four-quarter high]), Utilities (3.42 [four-quarter low]), Materials (3.22 [18-quarter low]), and Real Estate (3.08 [first quarter for which data is available]).

## US ECONOMIC INDICATORS

**Housing Starts & Building Permits** (*link*): Homebuilders in August broke ground on fewer homes for the fifth time in six months, hindered by shortages of skilled labor and lots along with rising materials' costs. Starts fell 0.8% last month and 8.4% over the six-month period to 1.180mu (saar), as multi-family starts retreated 6.5% and 20.0% over the comparable periods, to a nine-month low of 329,000 units (saar). Single-family starts climbed 1.6% in August to 851,000 units (saar) after falling four of the prior four months by 4.4%; starts are still up 5.3% ytd. Building permits rebounded 5.7% to 1.300mu (saar) last month—back to January's 19-month high. Volatile multi-family permits soared 19.6% to a high for this year of 500,000 units (saar) after a 9.9% decrease in July and a 19.3% increase in June; single-family permits sank 1.5% to 800,000 units (saar) after a two-month advance of 4.2%. Looking ahead, September homebuilders' confidence dropped 3 points to 64, back at its low for the year. "The recent hurricanes have intensified our members' concerns about the availability of labor and the cost of building materials," said NAHB Chairman Granger MacDonald. "Once the rebuilding process is underway, I expect builder confidence will return to the high levels we saw this spring."

**Import Prices** (*link*): Import prices in August accelerated 2.1% y/y after decelerating steadily from February's five-year high of 4.7% to 1.2% in July; the rate had bottomed at -11.6% in September 2015. The yearly rate for petroleum prices was back in double digits again, rising 15.8% y/y, up from 6.0% and 3.2% in July and June, respectively. August's rate is still considerably below February's seven-year high of 74.1%. Nonpetroleum products advanced 1.0% in the 12 months through August, hovering around that rate most of this year; the yearly rate had turned positive last December (0.3% y/y) for the first time since November 2014. Total import prices increased for the first time in four months, by 0.6% in August—matching the high for this year. Nonpetroleum import prices also matched the high for this year, climbing 0.3% after a 0.1% loss and a 0.1% gain the previous two months.

---

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.