MORNING BRIEFING  
March 27, 2018

Meet Jerome Powell

See the collection of the individual charts linked below.

(1) Hotcakes gum up Amazon’s algorithms. (2) Cheaper by the half dozen. (3) Six fed funds rate hikes since start of “normalization.” How many more to go? (4) 3.00% fed funds rate may be the new normal. (5) A refreshing change: Jerome Powell is a lawyer, not an economist. (6) Giving less weight to unobservable measures of slack. (7) The yield curve is neither here nor there. (8) Powell is a low-key middle-of-the-road fellow. (9) Taking a deep dive into the USTR’s case against China’s unfair trade practices. (10) The Chinese government wants more high-tech stuff to be made in China by 2025.

My Book: Selling Like Hotcakes. My book remains #1 Amazon Hot New Release in Investing. It seems that sales were so good in recent days that Amazon’s algorithms weren’t sending orders fast enough to my distributor to replenish inventories at the various Amazon fulfillment centers! So Amazon had been showing “Temporarily out of stock” on my book’s Amazon website over the past few days. We have been shipping more books to Amazon ASAP, and now they are back “In stock.” If you preordered, you should be getting your book this week. If you haven’t yet ordered, now would be a good time after the restocking.

We’ve had numerous requests for bulk purchase pricing by accounts wishing to provide their colleagues with a copy and to send the book to some of their own accounts. We can meet your needs directly with a significant discount to the list price for orders exceeding five books. Please go to our shopping cart.

The Fed I: By the Numbers. It wasn’t hard to predict how the FOMC would vote at its March 20-21 meeting because the Fed’s policymaking committee had signaled three to four rate hikes this year at the last meeting of 2017. Sure enough, last Wednesday, the FOMC voted to raise the federal funds rate another 25bps to 1.50%-1.75%. That makes it the sixth rate hike since December 16, 2015, when the Fed started to “normalize” interest rates (Fig. 1). The federal funds rate had been pegged between 0.00% and 0.25% since December 16, 2008 (Fig. 2).

At last week’s meeting, the FOMC also signaled in its press release two to three more “gradual” rate increases over the rest of this year. The committee likes to do so at the meetings associated with updates of their Summary of Economic Projections (SEP) and a press conference by the Fed chairman. That would put the next rate hikes on June 13 (to 1.75%-2.00%), September 26 (2.00%-2.25%), and December 19 (2.25%-2.50%). The Fed’s latest SEP shows projections for the federal funds rate at year-end 2018 ranging from 1.60% to 2.60%, with a median of 2.10% (Fig. 3).

Assuming more of the same next year would mean 25bps hikes in March (2.50%-2.75%), June (2.75%-3.00%), September (3.00%-3.25%), and December (3.25%-3.50%). The question is: How high will the FOMC raise the federal funds rate before it is deemed to have been normalized? Melissa and I believe
that 3.00% is likely to be the peak of the current rate cycle. That's because we expect that inflation will remain subdued at or below the Fed’s 2% target. The March SEP shows federal funds rate projections for year-end 2019 ranging from 1.6% to 3.9%, with a median of 2.9%. The median projection for the longer run is 2.9%.

**The Fed II: Less Theoretical.** The FOMC undoubtedly will continue to be data dependent, as it always has been in the past. Inflation and the pace of economic activity continue to matter the most in the FOMC’s deliberations. Jerome Powell, the new Fed chairman, was trained as a lawyer rather than as an economist. So he is much less likely to depend on models and theories than his predecessors. That’s a good thing, in my opinion, since one of the main themes of my book is that central bankers have been too dependent on unobservable theoretical measures of economic “slack” such as the nonaccelerating inflation rate of unemployment (NAIRU) and potential output.

During his press conference last week, Powell also observed “that the relationship between changes in slack and inflation is not tight.” When asked about the shape of the yield curve, Powell observed that an inverted yield curve might not signal a recession as it had consistently in the past when “inflation was allowed to get out of control.” So “the Fed had to tighten … and put the economy into a recession.” He concluded, “That's really not the situation we're in now.” Now consider the following measures of slack and the current shape of the yield curve:

(1) **NAIRU.** The Congressional Budget Office (CBO) uses an econometric model to derive estimates of NAIRU (Fig. 4). At the end of last year, it was 4.7%. The actual unemployment rate was 4.1%. So the spread between the two was 0.6 percentage point, the widest since Q2-2001 (Fig. 5). Yet there has been no sign of accelerating wage inflation (Fig. 6).

(2) **Potential output.** The CBO also estimates potential real GDP based on projections of the labor force and productivity. The ratio of actual to potential real GDP just barely exceeded 1.00 during Q4-2017 for the first time since Q3-2007 (Fig. 7). Not surprisingly, this ratio is highly correlated with the Resource Utilization Rate, which Debbie and I derive by averaging the capacity utilization rate and the employment rate (Fig. 8). Presumably, this measure is the inverse of slack, which is the lowest it has been since December 2014. Yet inflation remains subdued.

(3) **Yield curve.** While there are no signs of rising inflation, there are no signs of an imminent recession either. There’s lots of chatter speculating about “what if” the yield curve inverts. However, it hasn’t done so yet (Fig. 9). History shows that inverted yield curves have tended to trigger financial crises, which have caused credit crunches and recessions (Fig. 10). That’s another lesson I discuss at length in my new book.

**The Fed III: Powell’s First Presser.** Fed Chairman Jerome Powell had his first press conference as the new Fed head on March 21. It was an eventful non-event because investors learned that the new Fed chairman will remain on the gradual policy path that his predecessor set out before him. On a 1-10 scale from dovish to hawkish, Powell’s balanced comments put him at a 5, in our view. Powell may not have a PhD in economics, but the new Fed chairman sure sounded like your typical “two-handed” economist. Consider the following:

(1) **Middle ground.** During the Q&A, CNBC’s Steve Liesman asked: “And, your biggest concern or your biggest risk here, is it doing too much, [or] doing too little?” Chairman Powell responded that the Fed is trying to “take the middle ground.”

On the one hand, he said, “the risk would be that we wait too long, and then we have to raise rates quickly. And, that foreshortens the expansion.” On the other hand, he said, “if we raise rates too
quickly,” then that doesn’t get us “sustainably up to 2 percent [inflation],” which “will hurt us going forward.”

(2) **Alternative lingo.** Although it was his first press conference, it wasn’t the first time that the Fed chairman has made public remarks in his new role. Late last month, Powell gave his testimony for the Fed’s *Semiannual Monetary Policy Report to the Congress*. During his testimony, Powell repeatedly emphasized that economic “headwinds” had shifted to “tailwinds” in recent months.

Powell didn’t reuse the headwinds-to-tailwinds metaphor verbatim during his press conference. But Powell’s outlook for the US economy remained bullishly in tune with that sentiment. On the other hand, Powell repeated the word “gradual” about the pace of federal funds rate increases several times during both his press conference and testimony.

(3) **Strong, but uncertain economic outlook.** On the one hand, Powell stated: “The job market remains strong, the economy continues to expand, and inflation appears to be moving toward the FOMC’s 2 percent longer-run goal.” On the other hand, household spending and business investment have moderated, Powell said.

Nevertheless, “[t]he economic outlook has strengthened in recent months. Several factors are supporting the outlook: fiscal policy has become more stimulative, ongoing job gains are boosting incomes and confidence, foreign growth is on a firm trajectory, and overall financial conditions remain accommodative,” Powell said during his opening remarks.

Powell’s press conference was accompanied by the release of the Fed’s latest SEP. Comparing the Fed’s current median projections for the change in real GDP to December’s projections, the outlook slightly strengthened: to 2.7% from 2.5% for 2018 and to 2.4% from 2.1% for 2019. The 2020 outlook and the longer-run projection stayed the same. For 2018, the range of projections slightly narrowed and drifted upward to 2.5%-3.0% from 2.2%-2.8%.

Powell emphasized that “the committee made really one decision at this meeting, and that was to raise the federal funds rate” by 25bps. He said that while the median, the central tendency, and the full range of growth projections all are interesting, these projections also are highly uncertain, especially further out.

(4) **Stimulative tax policies, but trade risks.** On the one hand, Powell’s take on the Tax Cuts & Jobs Act was that it should stimulate demand and promote supply-side growth. “I think in the tax bill there are incentives [i.e., expensing of investments] that should encourage additional investment that should encourage productivity,” stated Powell. He added that there should be “meaningful increases in demand from the new fiscal policies for at least the next … three years.”

On the other hand, Powell mentioned a risk to the outlook discussed by committee members: “[T]rade policy has become a concern” for business leaders, he said, given the potential for widespread action, or retaliation. Trade policy hasn’t been built into projections, but is a “risk to the outlook kind of thing,” he explained.

(5) **Transitory inflation pressures, but flattened Phillip’s curve.** Powell said that he’s waiting for “unusual price declines” to “drop out” of the 12-month inflation calculation. Even so, Powell acknowledged that “there’s no sense in the data that we’re on the cusp of an acceleration in inflation.” Previously, we had taken Powell for more of a rules-based fellow. Yet during the press conference, Powell admitted that the small changes to the Fed’s inflation projections despite expected improvements in the economy reflect “the flatness of the Phillips curve.”
Before the crisis, “unemployment was 10 percent … It’s now 4.1 percent … And that suggests the relationship between the change in [labor market] slack and inflation is not so tight. But … it’s still there.” The March SEP shows lower projections for unemployment than during December, but inflation projections barely budged.

**Trade: China Aims To Dominate Tech.** The USTR’s 215-page report *Findings of the Investigation into China’s Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation Under Section 301 of the Trade Act of 1974* is the culmination of the USTR’s Section 301 investigation into China. It serves as the justification for President Trump’s recent announcement that the US intends to take retaliatory measures against China. (See the USTR [fact sheet](#) for more on the timing and likely extent of these measures.)

The main thesis of the report is that US companies face restrictions and unfair practices in many important Chinese technology markets. Such treatment is not reciprocal; Chinese entities operate with substantially more freedom on US soil. The unlevel playing field gives Chinese technology companies unfair advantages over US competitors in the global market, including easier acquisition of technology innovations. In yesterday’s *Morning Briefing*, we provided an overview of the report. It is so chock full of interesting information on China’s unfair trade practices that Melissa and I have decided to cover the details in a series.

Today, we focus on China’s top-level goals for global technology dominance. For economic and national security reasons, China’s goal is to “attain domestic dominance and global leadership in a wide range of technologies.” That goal is no secret to the public. It has been outlined in “more than 100 five-year plans, science and technology development plans, and sectoral plans over the last decade.” The plans are well thought out and reportedly well funded and well supported by China’s state-led economy.

Important for investors to note are the established and emerging industries within technology that China is targeting. China obviously sees these industries as powerhouses for economic growth and global positioning.

In an ideal world, President Trump’s initiation of Section 301 would help the US to reach fairer agreements with China that will foster innovation and promote global growth in these technology industries. Maybe that’s not realistic. For now, at least the US and China are at the negotiating table. There are indications in the media that both nations can get closer to fair agreements in these areas without sparking a tit-for-tat trade war. Based on the USTR report, the negotiations are long overdue. Below, we outline China’s plans for global technology dominance as discussed in the USTR’s report:

(1) *China’s vision.* According to the USTR report, “The MLP, issued in 2005 and covering the period 2006 to 2020, is the seminal document articulating China’s long-term technology development strategy.” “MLP” stands for “National Medium- and Long-Term Plan for the Development of Science and Technology.” It establishes the specific goal of reducing China’s dependence on foreign technologies identified in 11 key sectors to below 30% by 2020.

(2) *The IDAR approach.* China is gobbling up US technologies through its IDAR approach. According to the USTR report, Section 8(2) of the MLP calls for “enhancing the absorption, digestion, and re-innovation of introduced technology,” abbreviated as “IDAR,” IDAR “hinges on close collaboration between the Chinese government and Chinese industry to take full advantage of foreign technologies.”

The IDAR has four steps: (i) “Introduce: Chinese companies should target and acquire foreign technology.” (ii) “Digest: Following the acquisition of foreign technology, the Chinese government
should collaborate with China’s domestic industry to collect, analyze, and disseminate the information and technology that has been acquired.” (iii) “Absorb: The Chinese government and China’s domestic industry should collaborate to develop products using the technology that has been acquired.” (iv) “Re-innovate: At this stage, Chinese companies should ‘re-innovate’ and improve upon the foreign technology.”

(3) SEIs Beware. The Chinese government introduced another seminal technology development strategy in 2010. It seeks faster development of seven “strategic emerging industries” (SEIs): (i) energy efficient and environmental technologies, (ii) next generation information technology, (iii) biotechnology, (iv) high-end equipment manufacturing, (v) new energy, (vi) new materials, and (vii) new energy vehicles. The 12th Five-year SEI Plan issued during 2012 “recommended specific fiscal and taxation policy support and set a target for SEIs to account for 8% of China’s economy by 2015 and 15% by 2020.” The plan was “reaffirmed” in the 13th Five-year SEI Plan issued during 2016.

(4) Made in China 2025. In 2015, the State Council announced China’s ten-year plan for “advanced technology manufacturing industries,” its Made in China 2025 initiative. Ten such industries were put on notice as needing to step up for the plan to achieve its goals. The goals include these industries’ achieving 40% “self-sufficiency” by 2020, and 70% “self-sufficiency” by 2025, in terms of their core components and critical materials. Beyond establishing “self-sufficiency” goals, Made in China 2025 sets out specific global market share goals for each of these industries. “For example, indigenous new energy vehicles are to achieve an 80% domestic market share with foreign sales accounting for 10% of total sales by 2025.”

The industries targeted are: (i) advanced information technology, (ii) robotics and automated machine tools, (iii) aircraft and aircraft components, (iv) maritime vessels and marine engineering equipment, (v) advanced rail equipment, (vi) new energy vehicles, (vii) electrical generation and transmission equipment, (viii) agricultural machinery and equipment, (ix) new materials, and (x) pharmaceuticals and advanced medical devices.

(5) On the way to 2045. Made in China 2025 is just one “part of a three-step strategy for China to become a world leader in advanced manufacturing,” according to China’s Ministry of Industry and Information Technology, reported the USTR. Step 1: By 2025, China should “approach the level of manufacturing powers” that Germany and Japan reached during their industrialization periods. Step 2: By 2035, China should “enter the front ranks of second tier manufacturing powers.” Step 3: By 2045, China should “enter the first tier of global manufacturing powers.” At that point, China will have “innovation-driving capabilities,” “clear competitive advantages,” and “world-leading technology systems and industrial systems.”

CALENDARS

US. Tues: Consumer Confidence 131.0, Richmond Fed Manufacturing Index 22, S&P Corelogic Case-Shiller HPI, Bostic. Wed: GDP & PCE 2.7%/3.8%, GDP Price Index 2.3%, Corporate Profits, Advance Goods Trade Deficit -$74.0b, Pending Home Sales 2.7%, MBA Mortgage Applications, Wholesale Trade Inventories 0.5%, EIA Petroleum Status Report, Bostic. Wall Street Journal estimates)

Global. Tues: Eurozone Economic Confidence 113.3. Wed: Germany GfK Consumer Confidence 10.7, UK GfK Consumer Confidence -10, Japan Retail Trade 0.6%m/m/1.7%y/y. (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—remains stalled around its record high posted during the final week of February. The WLI slipped 0.3% during the week of March 17 after a 0.2% gain and a 0.3% loss the prior two weeks; it had soared six of the prior seven weeks, by 10.3%, 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 is down 1.1% since reaching a record high during the week of February 24, following a seven-week jump of 16.8%. Jobless claims, one of the components of our BBB, ticked up from 221,500 to 223,750 (4-wa) during the week of March 17, continuing to hover around the 220,500 reading at the end of February—which was the lowest level since 1969. Meanwhile, the CRB raw industrial spot price index, another BBB component, is moving down from recent highs, though remains in a volatile flat trend. The WCCI is fluctuating around its cyclical high—at the highest levels since February 2001.

S&P 500/400/600 Forward Earnings (link): Forward earnings rose to record highs last week for the MidCap and SmallCap indexes, but LargeCap’s edged down for the first time in 35 weeks. LargeCap’s forward earnings had been higher for 34 weeks, its longest streak since mid-2011. MidCap’s was higher for a 30th week, which now exceeds its prior record streak, ended in mid-2002. Earnings momentum remains healthy, as the yearly change in forward earnings is up from six-year lows in early 2016 and should remain strong in 2018. In the latest week, the rate of change in LargeCap’s forward earnings edged down to 20.1% y/y from 20.3%, which was its highest since May 2011 and compares to a six-year low of -1.8% in October 2015; MidCap’s rose to a seven-year high of 24.0% from 23.1% and compares to a six-year low of -1.3% in December 2015; and SmallCap’s rose to 27.1% from 23.6%, which is the highest since April 2011 and compares to a six-year low of 0.3% in December 2015. Here are the latest consensus earnings growth rates for 2018 and 2019: LargeCap 19.6% and 10.1%, MidCap 19.6% and 12.1%, and SmallCap 23.6% and 16.7%.

S&P 500/400/600 Forward Valuation (link): Last week saw forward P/E ratios tumble to post-election lows for these three indexes. LargeCap’s weekly forward P/E dropped to 16.0 from 17.0. That’s down from 18.6 on January 26, which was the highest since May 2002. It compares to the post-Lehman-meltdown P/E of 9.3 in October 2008 and is well below the tech bubble’s record high of 25.7 in July 1999. MidCap’s forward P/E fell to a 25-month low of 16.1 from 17.1. MidCap’s P/E has been at or below LargeCap’s P/E since August for the first time since 2009. It’s down from a 15-year high of 19.2 in February 2017, when the Energy sector’s earnings were depressed, and the record high of 20.6 in January 2002, but is up from a three-year low of 15.0 in January 2016. SmallCap’s P/E tumbled to a post-election low of 17.0 from 18.5. That’s well below its 51-week high of 20.2 in December (which wasn’t much below the 15-year high of 20.5 in December 2016, when Energy’s earnings were depressed), but is comfortably above its three-year low of 15.5 in February 2016. Looking at their forward price/sales (P/S) ratios relative to their panic attack lows on February 8 and their recent highs, valuations have similarly tumbled for the three indexes: LargeCap’s P/S dropped to 1.92 from 2.07 and is down from a record high of 2.19 on January 26; MidCap’s 1.27 is down from 1.33 a week earlier and its record high of 1.40 then; and SmallCap’s 1.01 is down from 1.05 then, which compares to its record high of 1.17 in November 2013 when Energy revenues were depressed.

S&P 500 Sectors Quarterly Earnings Outlook (link): With the Q4 earnings season and post-TCJA guidance complete, the Q1-2018 earnings forecast dropped for a third week following 12 weeks of gains. The S&P 500’s Q1-2018 EPS forecast was down to $36.13 from $36.20 a week earlier. Still, that’s up 5.0% since the end of Q4 and 5.6% since the passage of the TCJA. The $36.13 estimate represents a forecasted pro forma earnings gain for Q1-2018 of 18.4%, up from 18.2% a week earlier, and compares to Q4-2017’s blended 14.8%, Q3-2017’s 8.5%, Q2-2017’s 12.3%, and Q1-2017’s 15.3% (which then was the strongest growth since Q3-2011 owing mostly to easier comps for Energy). Since the end of Q4, Q1-2018 estimates are higher for 10 sectors and down for one. Energy’s Q1 forecast has jumped 15.6%, followed by the forecasts for Telecom (up 14.7%), Financials (11.9), and Utilities
Real Estate is the sole decliner, with its Q1-2018 forecast down 6.8%, followed by small gains for Consumer Staples (0.3), Materials (0.5), Tech (1.9), Consumer Discretionary (3.6), Health Care (3.9), and Industrials (4.2). The S&P 500’s Q1-2018 forecasted earnings gain of 18.4% y/y would be its seventh straight gain after four declines and its strongest since Q1-2011. All 11 sectors are expected to record positive y/y earnings growth in Q1-2018—with seven rising at a double-digit percentage rate—and four are expected to beat the S&P 500’s forecasted y/y earnings gain of 18.4%. That’s better than the 10 sectors rising y/y during Q4-2017, when seven also rose at a double-digit pace or better. Analysts expect Energy to report another large profit jump in Q1 relative to very low earnings a year ago, but the pace will slow from triple digits in Q4. All 11 sectors last rose y/y during Q2-2017, which was the first time that had happened since Q3-2011. The latest forecasted Q1-2018 earnings growth rates vs their blended Q4-2017 growth rates: Energy (72.1% in Q1-2018 vs 120.8% in Q4-2017), Materials (27.6, 35.9), Financials (24.4, 14.6), Tech (23.3, 20.1), S&P 500 (18.4, 14.8), Industrials (14.9, 1.8), Telecom (13.0, 4.8), Health Care (10.7, 9.1), Utilities (9.8, 12.9), Consumer Staples (9.9, 12.1), Consumer Discretionary (9.5, 10.7), and Real Estate (3.0, -4.1). On an ex-Energy basis, S&P 500 earnings are expected to rise 16.6% y/y in Q1, up from a blended 12.7% in Q4 and 6.1% in Q3 (which was the slowest growth since ex-Energy earnings rose just 2.2% in Q2-2016).

S&P 500 Buybacks: S&P 500 quarterly buybacks rose 6.0% q/q to $137.0 billion during Q4-2017, and was up 1.2% y/y. While Q4-2017 marked the ninth highest quarterly buyback amount on record, dating back 80 quarters to Q1-1998, it remains 20.3% below Q3-2007’s record quarterly high of $172.0 billion and 15.1% below its cyclical peak of $161.4 billion in Q1-2016. However, the quarterly buyback amount and its four-quarter sum improved q/q for a second consecutive quarter for the first time since Q1-2014. The four-quarter buybacks sum rose 0.3% q/q to a four-quarter high of $517.7 billion. It remains down 11.9% 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 Q4 accounted for 0.60% of the total market capitalization for the S&P 500, unchanged from Q3 and up from 0.58% in Q2, which was the lowest since Q1-2010. 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: Buybacks rose q/q during Q4-2017 for six of the 11 sectors and fell for five. That matches the six rising and five falling during the previous three quarters of 2017. The biggest q/q buyback gainers on a percentage basis in Q3-2017: Telecom (up 200.0% q/q to $9 million from $3 million), Energy (124.2%, to an 11-quarter high of $5.2 billion from $2.3 billion), Health Care (66.1%, to $15.8 billion from $9.5 billion), Real Estate (63.0%, to a record high of $1.3 billion from $0.8 billion), Materials (46.4%, to a four-quarter high of $2.1 billion from $1.4 billion), and Tech (28.3%, to a nine-quarter high of $35.8 billion from $27.9 billion). The biggest percentage q/q decliners: Consumer Staples (-32.7%, to $10.5 billion from a seven-quarter high of $15.6 billion), Utilities (-24.6%, to $16 million from $22 million), Consumer Discretionary (-14.3%, to $20.8 billion from a six-quarter high of $24.2 billion), Industrials (-11.7%, to a six-quarter low of $11.6 billion from $13.1 billion), and Financials (-1.0%, to $33.9 billion from a record-high of $34.3 billion). Tech accounted for the biggest portion of total S&P 500 buybacks in Q4-2017, retaking the top spot from Financials as it improved to a 26.1% share from 21.6% in Q3. Tech had held the top spot for 16 straight quarters through Q3-2016, but has traded places since then with Financials and Health Care. Financials’ share slipped to 24.8% in Q4 from 26.5% in Q3; Consumer Discretionary’s was third (down to 15.2% from 18.8%), and Health Care’s was fourth (up to 11.5% from 7.4%).

S&P 500 Cash Return & Buyback Yield: During Q4-2017, the S&P 500 companies continued their long-established trend of spending more on buybacks than dividends, as buybacks of $137.0 billion outpaced the record-high quarterly dividend payment of $109.1 billion. Buybacks have exceeded dividends in 40 of the past 45 quarters, except during the financial crisis from Q4-2008 to Q4-2009, when all sectors cut buyback spending drastically. With the pace of buybacks and dividends rising in
Q4, the four-quarter sum of buybacks and dividends, or cash returned to investors, improved for a second straight quarter to a five-quarter high of $938.3 billion from $930.9 billion. The cash return is up 3.5% from a nine-quarter low of $906.7 billion during Q2-2017, but remains 3.7% below its record high of $974.6 billion in Q1-2016. On a positive note, companies earned more than they paid out to investors for a fifth straight quarter after paying out more than they earned for six straight quarters; more specifically, Q4-2017’s four-quarter sum of operating earnings of $1066.0 billion was at a record high and exceeded the $938.3 billion returned to investors. The cash return was 12.0% lower than trailing-four-quarter operating earnings during Q4, the best coverage ratio since Q3-2014 and an improvement from 8.5% lower than operating earnings in Q3-2017. 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 fourth quarter. The S&P 500’s figures are much better on an ex-Energy basis. Operating earnings exceeded the cash return for a fifth straight quarter, with the percentage falling to 86.1%, the lowest since Q4-2013 and compares to 89.5% in Q3-2017 and a 28-quarter high of 102.2% in Q2-2016. Including Energy, the S&P 500’s buyback yield was down to a 31-quarter low of 2.28% from 2.40% in Q3, and the dividend yield fell to a 27-quarter low of 1.84% from 1.91% in Q3. Adding both together, the buyback + dividend yield (or cash return) was down to a 31-quarter low of 4.11% in Q4 from 4.31% in Q3.

S&P 500 Sectors Cash Return & Buyback Yield (link): During Q4-2017, 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), unchanged since Q2-2017 and up from 7/10 sectors during Q1-2017. Consumer Staples failed to cover its cash return for a 12th straight quarter, and the Energy sector missed for an 11th straight quarter. However, Energy was profitable on a GAAP operating earnings basis for a fourth quarter after five quarters of losses. Industrials covered its cash return for a third quarter after missing for seven straight quarters, Consumer Discretionary did so for a fourth quarter after missing for 12 quarters, Materials did so for just the fifth time in the 12 quarters since Q1-2014, and Tech did so for only the sixth time over that same time period. Here’s how the sectors’ four-quarter cash returns relative to four-quarter earnings ranked in Q4-2017: Energy (144.4%), Real Estate (142.2), Consumer Staples (113.3), Industrials (96.7), Consumer Discretionary (95.3), Financials (91.5), S&P 500 (88.0), S&P 500 ex-Energy (86.1), Telecommunication Services (79.9), Health Care (78.0), Information Technology (74.4), Utilities (64.0), and Materials (59.2). Looking at the four-quarter buyback + dividend yield, the sums rose q/q for Energy, Real Estate, Utilities, and fell for the remaining eight sectors; here’s the ranking by sector: Consumer Staples (5.40%), Financials (5.29), Telecom (4.96), Industrials (4.58 [26-quarter low]), S&P 500 (4.31 [30-quarter low]), Consumer Discretionary (4.20 [31-quarter low]), Real Estate (3.80 [only the third quarter for which data is available]), Health Care (3.67 [record low]), Energy (3.60 [six-quarter high]), Utilities (3.46 [four-quarter high]), Tech (3.41 [31-quarter low]), and Materials (2.64 [28-quarter low]).

US ECONOMIC INDICATORS

Regional M-PMIs (link): Four Fed districts now have reported on manufacturing activity for March—New York, Philadelphia, Kansas City, and Dallas—and they show growth in the sector remains strong. We average the composite, orders, and employment measures as data become available. The composite index slowed slightly (to 20.8 from 23.3) this month, but is not too far from its recent high of 26.6 in October—which was the highest reading since July 2004. The New York (22.5 from 13.1) region showed faster growth, while Philadelphia’s (22.3 from 25.8) and Dallas’ (21.4 from 37.2) slowed—the latter dramatically—though both remained robust. Meanwhile, growth in Kansas City (unchanged at 17.0) matched February’s pace. The new orders gauge (15.0 from 19.8) expanded at a slower pace, as an acceleration in orders in both the Philly (35.7 from 24.5) and New York (16.8 from 13.5) regions was more than offset by big moves down in both Dallas (8.3 from 25.3) and Kansas City (-1 from 16)—with the latter turning negative for the first time since August 2016. The employment measure (18.0 from
19.6) was little changed. Kansas City (26 from 23) manufacturers added to payrolls at a record pace in
March, while manufacturers in both the Philadelphia (25.6 from 25.2) and New York (9.4 from 10.9)
regions added to their payrolls at about the same pace as in February—though the rate in Philadelphia
was considerably faster than in New York and virtually matched Kansas City’s rate. Meanwhile, Dallas
(10.8 from 19.1) manufacturers hired at their slowest pace this year.