Happy New Year!

See the collection of the individual charts linked below.

(1) The sixth correction. (2) Trump calibrates China trade talk updates to boost stock prices. (3) Fed officials all stressing “patience” and “flexibility.” (4) Reduced earnings estimates are easier to beat. (5) Highly correlated: Oil price goes up, dollar goes down, EM stock prices go up. (6) Risk-on making a big comeback for stocks and credit. (7) 2016 all over again? (8) Government shutdown impacting economic data availability. (9) Available data showing growing economy. (10) Data-dependent Fed has enough to monitor economy. (11) Beige Book is colorful. (12) Movie review: “Stan & Ollie” (+ +).

Strategy: Relief Rally #62. Panic attack #62 has been followed by relief rally #62. The S&P 500 dropped 19.8% from September 20 through December 24 (Fig. 1). It felt like a bear market, but technically speaking it was the sixth 10.0%-19.9% correction of the current bull market. The S&P 500 index is now up 13.6% since the December 24 low and down 8.9% from the September 20 record high. It is still slightly below its 200-day moving average (Fig. 2). The index is now unchanged from where it began 2018, instead of down 12.1% ytd as it was on December 24 (Fig. 3). Consider the following related developments:

(1) The Trump Put. The S&P 500 is up 24.8% since Election Day November 8, 2016. President Trump can still take some credit for that gain as a result of his deregulation policies and tax cuts. However, his escalating trade war with China certainly accounted for some of last year’s stock market losses. Trump seems to believe that the stock market is the best measure of his success or failure as the President. So not surprisingly, he responded to December’s plunge in stock prices by getting the word out that trade talks with China are going very well.

Last Thursday, stock prices rose sharply on news reports that the Treasury was pushing to reduce some of the current tariffs on Chinese imports to get a better deal in the talks. That was quickly denied by a Treasury spokesperson. Then on Friday came reports that, in early January, the Chinese offered to buy $1 trillion of US goods over the next six years. Stocks jumped again despite reports that Trump’s negotiators want to see that happen over a shorter time span.

(2) The Fed Put. Trump likes to take credit for the sun rising in the morning. So he undoubtedly believes that the Fed’s recently announced policy of “patience” and “flexibility” is all because he threatened to fire Fed Chairman Jerome Powell. All the market cares about is that Fed policy is no longer set on autopilot. That’s the message conveyed by numerous Fed officials so far this year.

(3) Earnings beat. The Q4 earnings-reporting season is still underway. But so far, it hasn’t put a damper on the relief rally. That’s mostly because analysts cut their estimates following the Q3 season as companies provided lots of cautious guidance. At the start of October, analysts predicted an 18.2% y/y growth rate for the S&P 500’s Q4 earnings (Fig. 4). The estimate dropped to 12.5% during the 1/10 week. This increases the odds of yet another upward hook in earnings results relative to analysts’ forecasts.
(4) **Oil-price bounce.** The price of a barrel of Brent crude oil plunged 42% last year from October 3 through December 24 (*Fig. 5*). It is up 24% since then. The rebound reflects more confidence in the global economic outlook in the beliefs that the Fed will pause as promised and the US and China will work out a trade deal by the start of March. With oil prices moving higher and the Fed on pause for now, the trade-weighted dollar is down 2.0% since mid-December. With a weaker dollar and the Fed on hold, the Emerging Markets MSCI stock price index (in local currency) is showing signs of bottoming (*Fig. 6*).

(5) **Cyclical sectors on fire.** Since the December 24 low, the cyclical sectors of the S&P 500 have led the way in the recent rebound: Energy (18.4%), Consumer Discretionary (17.1), Financials (16.5), Industrials (16.3), Communication Services (14.4), S&P 500 (13.6), Information Technology (13.4), Materials (13.0), Health Care (11.6), Real Estate (9.3), Consumer Staples (7.5), and Utilities (3.1) (*Fig. 7*). Also rebounding have been the forward P/Es of the S&P 500 (from 13.5 on Christmas Eve to 15.5 on Friday), the S&P 400 (12.6 to 14.7), and the S&P 600 (13.4 to 15.6) (*Fig. 8*).

(6) **Credit-spread narrowing.** The Bank of America Merrill Lynch composite for the yield on US high-yield corporate bonds fell 112bps from 8.05% on December 26 to 6.93% on Friday (*Fig. 9*). Over this same period, the yield spread between this composite and the 10-year Treasury yield dropped from 524bps to 426bps.

(7) **Treasury-yield bounce.** Although the Fed may be on hold, the 2-year Treasury yield, which tends to reflect the market’s prediction of the federal funds rate a year ahead, increased from a recent low of 2.39% on January 3 to 2.62% on Friday (*Fig. 10*). The Fed’s current target range for the federal funds rate is 2.25%-2.50%. So the 2-year yield suggests either none-and-done or one-and-done this year. The 10-year Treasury yield has increased from its recent low of 2.56% on January 3 to 2.79% on Friday.

(8) **Déjà vu all over again.** If all of the above triggers the feeling that we’ve seen this video before, that’s because it’s remarkably similar to the scenario at the beginning of 2016. That was a happy new year. So far, Joe tells me that the performance of the S&P 500 ytd through Friday is the fifth best for those dates in any year since the start of the daily data during 1929.

**US Economy I: Data MIA.** All of the above also reflects a remarkable V-shaped shift from risk-off to risk-on pricing of financial assets. The tail (stock prices) has been wagging the dog (the economy). The fear has been that even if the plunge in stock prices wasn’t foreshadowing a recession, it might actually cause one! The problem is that as a result of the partial government shutdown, several economic indicators will be MIA. For example, December’s retail sales report is not available.

Nevertheless, there are enough indicators available to conclude that the economy is still growing. The Atlanta Fed’s latest GDPNow forecast for Q4 real GDP, at 2.8%, suggests little evidence of an imminent recession. So does industrial production, as Debbie discusses below. It rose 0.3% m/m during December, led by a 1.1% increase in manufacturing output (*Fig. 11*). Defense & space equipment rose 2.3% m/m (*Fig. 12*). There was also notable strength in automotive products (4.5%), transit equipment (2.9), and information processing equipment (1.3) (*Fig. 13* and *Fig. 14*).

**US Economy II: Fed’s Beige Book Is Neither Black nor White.** In response to the plunge in stock prices late last year, Fed officials have been scrambling in recent weeks to assure us that they are “data dependent” rather than set on a rigid course of rate hikes and balance-sheet tapering. Of course, thanks to the government shutdown, there is less data that they can depend on. However, the Fed is open for business and produces a number of economic reports, including industrial production.
Wednesday, the Fed released the latest *Beige Book*, which is a qualitative survey of businesses in each of the 12 Fed districts. Here’s Melissa’s summary of the latest findings:

(1) **Activity & outlook have dimmed.** Eight districts reported “modest to moderate growth” compared to 10 in the previous 12/5 *Beige Book*. In the New York and Kansas City regions, economic activity was flat compared to the last update. St. Louis reported that the pace of growth had slowed. Economic activity increased “slightly” in the Cleveland district. Although outlooks for the US economy “generally remained positive,” many districts reported less optimism “in response to increased financial market volatility, rising short-term interest rates, falling energy prices, and elevated trade and political uncertainty.” Insufficient labor supply also was noted as a growth deterrent.

(2) **All workers wanted.** Labor shortages were characterized with stronger language than in previous editions. The latest *Beige Book* said, “[A]ll Districts noted that labor markets were tight” and “firms were struggling to find workers at any skill level.” The previous one suggested that severe labor shortages were seen mainly at the low- and middle-skill levels.

Dallas contacts noted a lack of both high- and low-skilled workers, especially in construction, energy, hospitality, health care, banking, and transportation. Contacts across the San Francisco region “observed intense compensation pressures for more highly skilled workers.” A majority of Kansas City area respondents “continued to report labor shortages for low- and medium-skill workers.”

(3) **Higher wages boosting hiring.** Boston contacts noted that finding workers was difficult, especially skilled engineers. However, “one contact reported that after a ‘market adjustment’ raised compensation by 10 percent to 15 percent, difficulties in hiring and retention dramatically eased.”

In contrast, Minneapolis area staffing firms noted “continued reluctance among some clients to raise wages enough to change hiring difficulties.” A Minneapolis retailer noted that “every business is hiring and the hiring pool is shallow.”

(4) **Wage pressures rising.** Wage growth is on the rise, with the “majority of Districts reporting moderate gains.” The previous *Beige Book* indicated that wage increases were on the “higher side of a modest to moderate pace.” The January book reported wage increases across all skill levels.

New York district employers are “budgeting for moderately larger wage increases in 2019 than they did for 2018.” Philadelphia area contacts “typically cited increases for wages and benefits that averaged 3.0 to 3.5 percent. In one of the District’s tightest labor markets, average wage rates were up 6.0 percent over the prior year.” Dallas firms reported 4.5% annual wage growth in 2018, slowing to 4.0% in 2019.

(5) **Starting wages moving up.** Across districts, employers are increasing starting wages to attract talent. Richmond area contacts indicated “sharp increases in starting wages for particular positions.” St. Louis region contacts in information technology and manufacturing reported that labor market tightness led to increases in starting wages. San Francisco employers “with vacancies in the information technology, cybersecurity, and management fields continued to boost starting salaries to attract qualified candidates.”

(6) **Minimum-wage pressures.** New York area business contacts “expressed concern about the recent hike” in New York State’s minimum wage. Atlanta business contacts “noted that announcements by large national companies to raise their minimum wage intensified pressure among similar jobs.” St. Louis contacts cited starting-wage increases in healthcare and the public sector.

(7) **Price pressures mixed.** Not much changed since December’s edition in terms of prices. “Modest to
“moderate” increases in prices were noted across districts. Input prices rose, but the nationwide summary called reports “mixed” in terms of firms’ ability to pass higher costs on to customers. The input cost increases were attributed to rising material and shipping costs as well as tariffs.

The report detailed more instances of firms not passing costs on than doing so. Most Philadelphia area manufacturing firms “continued to anticipate paying higher prices for inputs, while those firms expecting to receive higher prices for their own goods” fell to less than half. Kansas City contacts said that “gains in input prices continued to slightly outpace those of selling prices.” Most Dallas area firms were “not able to raise selling prices fully in step with cost increases.”

(8) Industry growth mixed. Nationwide, growth across industries was mixed. Modest growth was seen for nonauto retail sales, non-financial services, and financials. Flat growth was seen in auto sales and residential and commercial real estate. Growth slowed for many manufacturers and for the energy and agriculture industries.

Outlooks among Dallas manufacturers “turned slightly negative in December” because of “declining oil prices, labor constraints, political uncertainty, higher interest rates, and reduced activity in the housing and energy sectors as factors restraining growth or damping outlooks.” Energy activity in the Dallas district “remained strong but growth slowed notably, and outlooks worsened.” Contacts in San Francisco attributed agricultural product sales weakness to “trade policy changes and the appreciation of the dollar.”

On the other hand, retailers were upbeat. Upstate New York retailers characterized “sales as fairly strong.” Retailers in Boston reported 2.0%-4.0% y/y same-store sales growth, with consumer confidence high. Districts continued to see high levels of online sales.

(9) Capital spending mixed. Lower nationwide energy prices curtailed capital-spending expectations in the energy sector, specifically in Kansas City and Dallas. Dallas contacts said that worry about lower energy prices caused about half of the region’s energy firms to lower capital-spending plans for 2019.

Cleveland manufacturing contacts suggested that trade uncertainty and financial market volatility contributed to a pullback in capital spending. Several auto contacts in the Kansas City district noted recent “downward revisions to capital spending plans for 2019.”

However, Kansas City manufacturers “expected modest increases in capital spending in the coming months.” Chicago business contacts said that capital spending increased “modestly” and expect that to continue.

Movie. “Stan & Ollie” (+ +) (link) is a very sweet movie about two sweet comedians, Laurel & Hardy, played with great affection by Steve Coogan and John Reilly. They remind us of bygone days when people laughed at jokes, slapstick, and skits that weren’t political, crass, and vulgar. They were very close friends, which occasionally led to disappointments and inevitable reconciliation. We need more of their simple humor in our lives and close friendships even with people with different political views.

CALENDARS

US. Tues: Existing Home Sales 5.24mu. Wed: Richmond Fed Manufacturing Index, FHFA House Price Index 0.3%, MBA Mortgage Applications. (Econoday estimates)

Global. Tues: Germany ZEW Survey Expectations -18.5, UK Employment Change & Unemployment Rate (3-month) 88k/4.1%, Japan Trade Balance -¥35.3b. Wed: Eurozone Consumer Confidence -6.5,
Canada Retail Sales -0.7%, Japan All Industry Activity Index -0.4%, BOJ Rate Decision, BOJ Outlook Report. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance (link): Last week saw the US MSCI index rise 2.9% for its best gain in seven weeks. That performance ranked fourth of the 49 global stock markets we follow in a week when 45/49 countries rose in US dollar terms. That compares to the prior week’s 26/49 ranking, when the US MSCI gained 2.6% and 45 markets rose. The AC World ex-US index rose 1.3%; that compares to a 3.2% rise a week earlier which was then its best in 10 weeks. EMEA was the best performing region with a gain of 2.1%, ahead of BRIC (2.0%), EM Eastern Europe (1.9), EM Latin America (1.8), and EM Asia (1.7). EAFE was the worst performer, albeit with a gain of 1.1%, followed by EMU (1.3). Turkey was the best-performing country, rising 11.7%, followed by Egypt (5.0), Chile (3.2), Canada (2.9), and China (2.6). Of the 25 countries that underperformed the AC World ex-US MSCI last week, Greece fared the worst, falling 3.1%, followed by Denmark (-0.3), and Jordan (-0.2). The US MSCI ranks 20/49 so far in 2019, with its 6.7% ytd gain now ahead of the AC World ex-US (5.4). All regions and nearly all countries are in positive territory ytd. Among the regions, those outperforming the AC World ex-US include: EM Latin America (11.8), EM Eastern Europe (8.1), EMEA (6.8), and BRIC (6.5). Regions underperforming the AC World ex-US: EM Asia (4.1), EMU (4.7), and EAFE (5.0). The best country performers ytd: Argentina (14.0), Brazil (13.2), Chile (11.3), Colombia (10.7), and Canada (10.5). The worst-performing countries so far in 2019: Sri Lanka (-2.2), India (-1.5), Morocco (-1.0), and Jordan (-0.1).

S&P 1500/500/400/600 Performance (link): All of these indexes rose for a fourth straight week, the first time that has occurred since January 2018. However, they remain well below their record highs this time around. LargeCap rose 2.9% last week, below MidCap’s 3.0% rise and ahead of SmallCap’s 2.5% gain. LargeCap ended the week 8.9% below its record high on September 20, while MidCap and SmallCap are 11.4% and 15.8% below their August 29 records, respectively. Among the 33 sectors, all but LargeCap Utilities moved higher last week, little changed from the week before when all 33 rose. The biggest gainers in the latest week: LargeCap Financials (6.1%), MidCap Financials (5.2), SmallCap Materials (4.3), MidCap Energy (4.3), and SmallCap Financials (3.6). LargeCap Utilities (-0.2) was the sole decliner last week, followed by small gains for SmallCap Tech (1.4), SmallCap Consumer Discretionary (1.4), LargeCap Consumer Staples (1.5), and SmallCap Communication Services (1.6). In terms of 2019’s ytd performance, all three indexes are off to a great start: SmallCap (9.4), MidCap (9.3), and LargeCap (6.5). All 33 sectors are positive ytd with Energy dominating the top performers: MidCap Energy (22.5), SmallCap Energy (20.7), SmallCap Materials (13.0), LargeCap Energy (11.2), and SmallCap Communication Services (11.1). Utilities dominate the biggest underperformers so far in 2018: LargeCap Utilities (0.4), SmallCap Utilities (1.2), MidCap Utilities (2.6), LargeCap Consumer Staples (3.2), and LargeCap Health Care (4.2).

S&P 500 Sectors and Industries Performance (link): Ten of the 11 of the sectors rose last week, and three outperformed the S&P 500’s 2.9% gain. That compares to all 11 rising a week earlier, when five outperformed the 2.5% gain for the S&P 500. Financials was the best-performing sector with a gain of 6.1%, ahead of Industrials (3.3%) and Energy (2.9). Utilities (-0.2) was the sole decliner, followed by gains for Consumer Staples (1.5), Communication Services (1.8), Real Estate (2.1), Consumer Discretionary (2.3), Materials (2.3), Health Care (2.5), and Information Technology (2.8). All 11 sectors are also higher so far in 2019, compared to just two sectors rising during 2018 when the S&P 500 fell 6.2%. These five sectors are outperforming the S&P 500’s 6.5% rise ytd: Energy (11.2), Financials (9.0), Industrials (8.9), Consumer Discretionary (8.4), and Communication Services (7.9). The ytd laggards, albeit with gains: Utilities (0.4), Consumer Staples (3.2), Health Care (4.2), Real Estate (5.3), Information Technology (5.4), and Materials (5.8).
Commodities Performance (link): Last week, the S&P GSCI index rose 2.5% as 17 of the 24 commodities moved higher. That compares to a 4.2% rise a week earlier, which was the biggest gain since mid-April as 16 commodities moved higher. However, the index is still in a correction with a drop of 17.8% from its high in early October after being down as much as 26.9% on December 24. Last week’s strongest performers: Natural Gas (8.8%), Crude Oil (4.2), Zinc (3.7), Unleaded Gasoline (3.6), and Brent Crude (3.3). Cocoa was the biggest decliner with a drop of 2.1%, followed by Silver (-1.6), Feeder Cattle (-1.4), and Gold (-0.5). The S&P GSCI commodities index is up 10.4% ytd following a decline of 15.4% in 2018. The top-performing commodities so far in 2019: Crude Oil (19.0%), Brent Crude (16.3), Heating Oil (13.6), Unleaded Gasoline (12.6), and GasOil (12.5). The biggest laggards in 2019: Cocoa (-4.5), Feeder Cattle (-2.7), Lead (-1.1), and Silver (-0.9).

S&P 500 Technical Indicators (link): The S&P 500 price index rose 2.9% last week, and improved relative to its short-term 50-day moving average (50-dma) and its long-term 200-day moving average (200-dma). However, the index’s 50-dma relative to its 200-dma fell for a 15th straight week, and was in a Death Cross for a seventh week; it had been in Golden Cross for 137 weeks. It was last in a Death Cross for 17 weeks through April 2016 when its 50-dma bottomed at a then-four-year low of 4.5% below its 200-dma in March 2016. The current Death Cross reading of -4.9% is now the lowest since November 2011; it’s down from -4.4% a week earlier and a 55-month high of 7.2% in February 2018. The S&P 500’s 50-dma fell for a 15th week following 19 straight weekly gains, which compares to declines during eight of the 10 weeks from mid-March to late May in what was then the worst performance since before the 2016 election. However, the index closed above its 50-dma for the first time in 15 weeks, improving to 2.5% above its falling 50-dma from 1.0% below its falling 50-dma a week earlier. That compares to a seven-year low of 12.0% below at the end of December and is down from a two-year high of 6.2% above its rising 50-dma on January 29. The 200-dma rose for the first time in eight weeks, but barely so. The 200-dma has dropped in 10 of the past 14 weeks in the first downtrend since May 2016, when it had been slowly declining for nine months. The S&P 500 improved to 2.6% below its falling 200-dma from 5.3% below a week earlier, but remains well below the seven-year high of 13.5% above its rising 200-dma during January 2018.

S&P 500 Sectors Technical Indicators (link): All 11 S&P 500 sectors improved last week relative to their 50-dmas, and all but Utilities improved relative to their 200-dmas. Nine of the 11 sectors moved above their 50-dmas, a dramatic improvement from just two weeks earlier when all 11 were below. The longer-term picture—i.e., relative to 200-dmas—shows two sectors trading above currently, unchanged from a week earlier. When Utilities was the only sector above its 200-dma during December, that had been the lowest count since all 11 were below in January 2016, and was a relatively swift reversal from the September 26 alignment, when all 11 sectors were above their 200-dmas. Two long-term 200-dma leaders left the building during the recent correction: Tech fell below its 200-dma for the first time in 121 weeks, and Consumer Discretionary fell below its 200-dma for the first time in 102 weeks. Four sectors remain in the Golden Cross club (with 50-dmas higher than 200-dmas), unchanged from a week earlier: Health Care and Real Estate (28 straight weeks), Utilities (24), and Consumer Staples (19). At the end of November, Consumer Discretionary and Tech left the club for the first time since April 2016. Among the laggards, Financials has been out of Golden Cross territory for 14 straight weeks and 26 of the past 30 weeks, Materials has been out for 38 straight weeks, Energy for 10 weeks, and Industrials for nine weeks. All 11 sectors had been in a Golden Cross back in mid-January (for the first time since a 26-week streak ended in October 2016). Communication Services is the only sector with a rising 50-dma now, compared to two a week earlier when Real Estate and Utilities were the only members of that club. Four sectors had rising 200-dmas at the end of last week: Consumer Discretionary, Health Care, Real Estate, and Utilities. That’s the same lineup as a week earlier and up from two rising in early January in what was then the lowest count since January 2016, when all 11 sectors had falling 200-dmas.
US ECONOMIC INDICATORS

Industrial Production (link): Industrial production finished 2018 on an upnote, climbing for the seventh straight month—to a new record high—with manufacturing output the strongest in 10 months. Total production climbed 0.3% last month as sizeable gains in manufacturing (1.1%) and mining (1.5) output (1.5) more than offset a -6.3% weather-related plunge in utilities. The 1.1% jump in manufacturing output was led by a 4.7% surge in motor vehicles, though excluding autos, factory production was still up an impressive 0.8%. By market grouping, business equipment output advanced for the seventh straight month, by 6.1%, to its highest level since November 2014. Within business equipment, output of information processing equipment rebounded 1.8% during the two months through December, after a minor -0.6% slump the prior three months. Transit equipment production also posted strong gains the last two months of 2018, jumping 3.4% to its best reading since October 2015. Meanwhile, output of industrial equipment sank -1.0% last month after no gain in November—though had soared 5.7% the previous five months to nearly a four-year high. Consumer goods production was unchanged in December after dropping -0.7% in November, depressed by a two-month -1.7% drop in consumer nondurable goods output—reflecting a -6.2% plunge in energy; consumer durable goods production rebounded 2.7% after no change in December and a -1.4% dip in November.

Capacity Utilization (link): The headline capacity utilization rate in December rose for the second month, from 78.4% in October to a nearly a four-year high of 78.8% last month. Still, it was 1.1pptts below its long-run (1972-2017) average. Meanwhile, the manufacturing capacity utilization rate rebounded to 76.5%—the highest since November 2014—after falling the prior two months from 76.1% to 75.8%; it was roughly 2.0pptts below its long-run average. The utilization rate for mining jumped more than a percentage point the final two months of 2018, to 94.8%—well above its long-run average of 87.0%. Meanwhile, the utilities rate sank -5.2pptts to 75.0% last month, as warmer-than-usual temperatures lowered the demand for heating; the rate is 10.0pptts below its long-run average.

Regional M-PMIs (link): Both Fed districts that have reported on manufacturing activity for January so far—Philadelphia and New York—show growth picked up for the former and slowed for the latter. We average the composite, orders, and employment measures as data become available. The composite (to 10.5 from 10.3) index showed growth matched December’s pace this month—running at less than half the pace of the first half of 2018. The Philadelphia region’s composite index (17.0 from 9.1) shows growth was almost double the pace of last month, though considerably below last year’s high of 32.2; New York’s (3.9 from 11.5) gauge shows the slowest pace of growth since May 2017. The new orders gauge (12.4 from 13.4) fell to an 18-month low, as the New York’s (3.5 from 13.4) measure showed growth slowed to nearly a standstill; meanwhile, Philly’s (21.3 from 13.3) accelerated at the fastest pace in six months. According to the employment (8.5 from 18.3) measure, hirings were the slowest since February 2017, as manufacturers in both the Philly (9.6 from 19.1) and New York (7.4 from 17.5) regions added to payrolls at the slowest pace since September 2017 and January 2018, respectively.

Consumer Sentiment (link): Consumer sentiment in mid-January fell to the lowest level since Trump was elected. “The loss was due to a host of issues including the partial government shutdown, the impact of tariffs, instabilities in financial markets, the global slowdown, and the lack of clarity about monetary policies,” said Richard Curtin, chief economist for the survey. The Consumer Sentiment Index (CSI) sank to 90.7—the lowest reading since October 2016; it was at a 14-year high of 101.4 10 months ago. The biggest drop occurred in the expectations (to 78.3 from 87.0) component, though the present situation (110.0 from 116.1) also took a hit. The former is the lowest since October 2016, down from a recent high of 100.5 during September; the latter is at a five-month low, down from March 2018’s record high of 121.2.