Global Economy: Manufacturing Remains Limp. Joe and I are looking for opportunities to spend some time investing abroad. There are certainly compelling valuations out there, with MSCI forward P/Es in emerging markets (12.1 currently), the UK (12.4), Japan (13.5), and the EMU (13.7) well below that of the US (17.4) (Fig. 1). The problem is that the fundamentals overseas aren’t compellingly upbeat. Actually, they remain mostly downbeat.

To be fair, we only started to take an interest in the rest of the world around mid-October after the Governing Council of the European Central Bank (ECB) voted to provide another round of significant monetary stimulus at their 9/12 meeting, including restarting the ECB’s asset purchase program. That should provide some lift to Eurozone economies, especially if fiscal authorities take advantage of the ECB’s renewed bond buying.

Furthermore, the Fed was widely expected to cut the federal funds rate for a third time this year at the end of October—and didn’t disappoint. As a general rule, Fed easing (tightening) tends to be good (bad) for the stocks, bonds, and currencies of emerging market economies (EMEs). Improving economic activity in the EMEs would benefit European companies. In addition, Trump only recently started to de-escalate his trade wars.

In other words, all the good news on the policy front is recent and may take a few months to boost the global economy. On the other hand, as we discussed yesterday and numerous times before, there are structural problems weighing on global growth, especially in the manufacturing sector, including aging demographic profiles in many countries around the world and too much debt.

Let’s have a closer look at the latest batch of global economic indicators, hoping to find some signs of better growth, particularly overseas:

(1) Bad sentiment in Eurozone. The Economic Sentiment Indicator (ESI) for the Eurozone dropped sharply again during October (Fig. 2). It is down from last year’s peak of 114.5 during December 2017 to just 100.8 last month, the lowest reading since January 2015. This doesn’t augur well for the region’s real GDP growth, which was only 1.1% y/y during Q3.

Leading the way down was the industrial component of the ESI (Fig. 3). Germany’s industrial ESI
remained weak during October at the lowest reading since October 2012 (Fig. 4).

Not surprisingly, October’s M-PMIs were also weak in most of the major Eurozone economies, with three out of four below 50.0 as follows: Germany (42.1), Spain (46.8), Italy (47.7), and France (50.7). The region’s M-PMI was 45.9 last month (Fig. 5).

(2) Bad economic surprises in Eurozone. The Citigroup Economic Surprise Index was mostly above zero during H2-2016 through 2017. It’s been mostly negative since the start of 2018, suggesting that Trump’s escalating trade wars weighed on the region’s economies (Fig. 6). The latest reading we have is 5.0 for Monday.

(3) Mostly weak M-PMIs elsewhere. Japan’s M-PMI fell to 48.4 during October, the lowest reading since June 2016 (Fig. 7). The UK M-PMI rebounded from a recent low of 49.4 during May to 49.6 during October, probably as companies scrambled to stockpile inventories in case Brexit causes trade disruptions. But it is still below 50.0. So is the US M-PMI, at 48.3 during October, up slightly from September’s 47.8. The GM strike may have weighed on this index over the past two months.

Meanwhile, China’s M-PMIs are giving mixed signals, with the official one edging down to 49.3 last month, the sixth consecutive reading below 50.0, and the Caixin Markit M-PMI rising to 51.7, the third consecutive reading above 50.0 (Fig. 8). Here are October M-PMIs for a few other selected economies: Poland (45.6), Russia (47.2), Indonesia (47.7), Korea (48.4), Turkey (49.0), Malaysia (49.3), Vietnam (50.0), Mexico (50.4), India (50.6), Australia (51.6), and Brazil (52.2).

Altogether now: The JP Morgan Global M-PMI edged up to 49.8 during October, the sixth consecutive reading below 50.0 (Fig. 9). Interestingly, this index’s component for developed economies was flat at 48.6 last month, the sixth consecutive reading below 50.0, while the one for EMEs was 51.0 during October, making this reading the eighth of the past nine months above 50.0 (Fig. 10). (See our automatically updated chart book, Global Manufacturing PMIs.)

Strategy I: Wish List for the Bull. Now that the S&P 500 is within shouting distance of our 3100 year-end target, we’re feeling more comfortable with our 3500 target for the end of next year. Given that the forward P/E of the S&P 500 was 17.4 on Monday, we hope that the market moves to our next target in a leisurely fashion, allowing time for earnings growth, rather than valuation, to drive stock prices higher.

Stocks aren’t cheap in the US given that only four of the 11 S&P 500 sectors are trading below the market’s forward P/E multiple: Real Estate (43.0), Consumer Discretionary (21.4), Information Technology (20.5), Consumer Staples (19.6), Utilities (19.6), Communication Services (18.0), Materials (17.6), S&P 500 (17.4), Energy (16.9), Industrials (16.8), Health Care (14.9), and Financials (12.8).

We also would like to see the rally broaden out in 2020. Both the Dow Jones Transportation Average and the S&P 500 Transportation composite are slightly below their respective record highs in September last year. The S&P 400 MidCaps and S&P 600 SmallCaps are also still below their August 2018 highs, while the ratios of the equal-weighted to the market-cap-weight S&P500/400/600 indexes have been declining for about the past three years (Fig. 11).

The year-end 2020 S&P 500 will be determined by forward earnings at that time, which will be identical to analysts’ consensus expectations for 2021 earnings. (Time certainly flies when you are having fun in a bull market.) We wouldn’t be surprised if that number is $190 per share. To get to 3500 would require a forward P/E of 18.4. Stay tuned.

Strategy II: Value Takes the Lead. I asked Joe to continue our Growth versus Value discussion from
last week. Recall that in the 10/29 Morning Briefing, we wrote: “S&P 500 Value has been outperforming S&P 500 Growth since 8/27. That has coincided with the backup in the bond yield and the reversal in the yield-curve spread from slightly negative to slightly positive ... Financials, which tend to be classified as Value stocks, do better when the yield curve is ascending rather than inverting. The current mix of interest-rate trends—with short-term rates falling while long-term rates are rising—is especially good for Financials.”

Value stocks and deep cyclicals typically have performed better when the Fed was starting an accommodative monetary policy, and their recent outperformance seems to confirm that. As we noted last week, the ratio of the price indexes for S&P 500 Growth and S&P 500 Value peaked on 8/27 (Fig. 12). Since then, Value has done Roadrunner’s beep-beep and left Growth choking on its dust like Wile E. Coyote (Fig. 13). The Value index has risen a whopping 11.0% since 8/27 through Monday’s close, 6.8ppt better than the 4.2% gain for Growth. While Value may have arrived late to the party, its participation bodes well for a continuation of the bull market.

Let’s have a closer look at their performances:

(1) **Value’s ytd performance ahead of Growth now.** After lagging the Growth price index on a ytd basis for much of 2019, Value has also taken the lead again. The index had been beating Growth ytd through the end of February, but underperformed considerably over the next six months. By 8/27, the index was up only 11.0% ytd, 6.6ppt behind the 17.6% gain for Growth. Now, Value’s 23.2% gain ytd through Monday’s close has moved 0.7ppt ahead of Growth’s 22.5% rise (Fig. 14).

(2) **Value finally at new highs again after a long absence.** The S&P 500 Value index hit its first recent record high back on 10/22. Prior to that, the index had not been at a record high for nearly 21 months! Monday’s latest record high for the index was only its sixth since 1/26/18. For the sake of comparison, the Growth index has recorded 31 new record highs since then, just 13 of which occurred during 2019. However, the Growth index was just 0.4% below its 7/26 record high on Monday. With Value’s investment style coming into favor again, that bodes well for a continuation of the bull market, which has had few new highs this year.

(3) **Relative P/E meltup averted?** On 8/27, the forward P/Es for Growth and Value were 20.7 and 13.3, respectively. That put their relative P/E ratio at 1.56, which happened to be about the highest level since January 2002.

Based on Monday’s close, Value’s forward P/E was at a 20-month high of 14.7 compared to Growth’s three-month-high P/E of 21.3 (Fig. 15). The relative P/E ratio was down to a 10-month low of 1.45 (Fig. 16).

**Strategy III: Value vs Growth by LargeCaps vs SMidCaps.** The Value-outperforming-Growth theme is also apparent within the MidCap and SmallCap indexes. Here’s how all six of the indexes have performed since 8/27 through Monday’s close: SmallCap Value vs Growth (13.9%, 6.8%), MidCap Value vs Growth (12.3, 5.7), LargeCap Value vs Growth (11.0, 4.2).

I also asked Joe to dig deeper—into the sector levels for the S&P 500 Growth and Value indexes and to compare how they have performed since 8/27. Here’s what he found.

With the exception of Communication Services, ten of the 11 Value sectors have outperformed their Growth counterparts.

Here’s how the Value and Growth components of each sector has performed since 8/27 through
Monday’s close, in descending order by their performance spreads: Information Technology (17.3% for Value, 4.8% for Growth), Materials (11.1, 5.0), Financials (12.9, 7.4), Consumer Discretionary (7.3, 2.7), Industrials (12.9, 8.6), Real Estate (2.8, -1.5), Consumer Staples (1.5, -0.9), Health Care (7.5, 5.3), Energy (10.0, 7.9), Utilities (1.9, 1.5), and Communication Services (5.4, 7.1).

Digging down deeper, it becomes apparent that Apple’s 26% gain has played a big part in Value Tech’s outperformance, but the sector’s Value-versus-Growth outperformance has been broad. Double-digit percentage gains have been recorded for many of the companies in the Technology Hardware, Semiconductor, and Semiconductor Equipment industries in the Value index, while the Growth-heavy Data Processing industry has lagged considerably. Within the Financials sector, companies in Value’s Asset Management & Custody Banks and the Regional Bank industries have registered double-digit percentage gains of 20% on average, while firms in Growth’s Financial Exchanges & Data industry are down slightly.

CALENDARS

**US. Wed:** Nonfarm Productivity & Unit Labor Costs 0.9%/2.2%, MBA Mortgage Applications, DOE Oil Inventories, Williams, Evans, Harker. **Thurs:** Consumer Credit $15.0b, Jobless Claims 215k, EIA Natural Gas Storage, Kaplan. (DailyFX estimates)

**Global. Wed:** Eurozone Retail Sales 0.1%m/m/2.4%/y/y, Eurozone, Germany, France, and Italy C-PMIs 50.2/48.6/52.6/50.2, Eurozone, Germany, France, and Italy NM-PMIs 51.8/51.2/52.9/51.0, Germany Factory Orders 0.1%m/m/-6.3%/y/y, Guindos. **Thurs:** Germany Industrial Production -0.3%m/m/-4.3%/y/y, Japan Household Spending 7.1% y/y, China Trade Balance $40.6b, EU Commission Economic Forecasts, ECB Published Economic Bulletin, UK Sovereign Debt to be Rated by Moody’s, UK Office for Budget Responsibility Publishes Updated Forecasts, RBA Monetary Policy Minutes, Carney. (DailyFX estimates)

STRATEGY INDICATORS

**S&P 500 Q3 Earnings Season Monitor** ([link](#)): With the Q3-2019 earnings reporting season nearly 77% complete, S&P 500 revenues and earnings are beating the consensus forecasts by 0.8% and 4.8%, respectively. At the same point during the previous earnings season for Q2, revenues and earnings had beaten forecasts by a higher 1.5% and 6.4%, respectively. However, a higher percentage of companies has recorded a positive earnings surprise in Q3 than in Q2—76% versus 74%. A slightly lower percentage of companies showed a positive revenue surprise—58% versus 59%. The 383 companies in the S&P 500 that have reported through mid-day Tuesday collectively have recorded a y/y earnings decline of 0.1%, dragged down by Micron Technology’s earnings deceleration. On the revenue side, results are 2.7% higher than a year earlier. Ex-Micron, y/y earnings growth for the S&P 500 jumps 1.1ppt to 1.0% and revenue growth improves 0.1ppt to 2.8%. Adjusting for the dismal y/y growth declines for the Energy sector, Q3’s S&P 500 ex-Energy revenue growth improves 1.4ppt to 4.1% and earnings growth rises 2.6ppt to 2.5%. Overall, Q3 earnings growth results are positive y/y for 64% of companies versus a higher 66% at the same point in Q2, and revenues have risen y/y for 71% compared to a lower 68% in Q2. These figures will continue to change as more Q3-2019 results are reported in the coming weeks. However, y/y earnings growth is likely to trail revenue growth for a third straight quarter, something that hasn’t happened since the last Energy “recession” in H1-2016. Regardless, what companies say about their expectations for Q4-2019 and their early peek at 2020 prospects will be investors’ main focus.
US ECONOMIC INDICATORS

JOLTS (link): Job openings in September fell for the third time in four months, though were still within 602,000 of November's record-high reading of 7.626 million. Openings fell 277,000 in September and 360,000 over the four-month period to 7.024 million. September’s ratio of unemployed workers per job opening was below 1.00 for the 19th straight month, at 0.82, with job openings exceeding unemployed workers by 1.3 million. Hirings climbed for the second time in three months, by 218,000, to 5.934 million, while separations rose 295,999 over the same period to 5.808 million. The latest hiring and separations data yielded an employment advance of 126,000 in September, 54,000 below September’s payroll gain of 180,000—understating the increase for the second time in eight months. Those quitting their jobs fell 170,000 during the two months through September to 3.498 million. The quit rate ticked down to 2.3% from its cyclical high of 2.4% during July and August. September’s job openings rate slipped for the third time in four months, from 4.7% in May to 4.4% in September; it was at a record rate of 4.8% at the start of the year. The hires rate was at 3.9 for the third straight month in September—fluctuating in a range from 3.8% to 4.0% for over a year.

Auto Sales (link): Motor vehicle sales in October remained in a volatile flat trend around 17.0mu. Total sales sank to a six-month low of 16.6mu (saar) in October after rising from 16.9 million to 17.2 million the previous two months. So far this year, sales have fluctuated from a low of 16.5mu to a high of 17.5mu. Domestic light-truck sales fell to 9.6mu (saar), after climbing back up to their cyclical high of 10.0mu (saar) in September, though still remain above the 9.0mu pace at the start of the year. Meanwhile, domestic car sales sank to 3.1mu (saar)—the weakest since April 2009; sales have been in a freefall since peaking at 6.0mu during August 2014. Sales of imports edged up to 3.9mu (saar) last month from 3.8mu in September, fluctuating between 3.8mu and 3.9mu for over a year.

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