What’s New? Not Much!

See the collection of the individual charts linked below.

1) Global M-PMIs: some, but not much, improvement. 2) Trump making sausage out of trade talks? 3) Emerging economies showing better M-PMIs than developed ones. 4) Latest US M-PMI a downer for S&P 500 revenues growth. 5) Is trade-related uncertainty certainly bearish for stocks? 6) The Fed is probably done for now, but a one-and-done rate cut is possible early next year. 7) Looking forward to better earnings. 8) A few bond-friendly developments.

Strategy I: High Hopes. Debbie and I had some high hopes Monday morning. We were hoping that November’s global M-PMIs would show a clear improvement. They showed some improvement, but not a clear improvement.

In addition, on Monday, President Trump threw a wet rag on the stock market when he announced that he was slapping steel tariffs on Brazil and Argentina. Also on Monday, at the NATO meeting in London, Trump threatened more tariffs on France. Yesterday morning, Trump tweeted that he is in no rush to do a trade deal with China. He is willing to wait until after next year’s US presidential election. That increases the odds that the administration will impose the additional tariffs on $250 billion of Chinese imports that Trump said would kick in on 12/15 if there’s no deal by then.

This could all be “the art of the deal,” as practiced by our fearless leader. The problem is that Chinese President Xi has his own approach to the art of the deal. Then again, you never know when it comes to the eventual outcome of deal-making. It’s like watching sausage-making, not very pretty. The question is whether there will be any meat in an eventual deal, assuming there is one. Meanwhile, Trump’s latest escalation of his trade wars is likely to continue to weigh on global manufacturing. Let’s have a closer look at the M-PMI data:

1) The good, the bad, and the mediocre. On the M-PMI front, as we noted yesterday, China’s official data were better than expected, while the US ISM manufacturing survey was worse than expected. The Eurozone was less bad, but still bad.

Here is a performance derby for a selection of November’s M-PMIs, from highest to lowest: Greece (54.1), Hungary (53.0), Colombia (52.9), Brazil (52.9), France (51.7), Canada (51.4), Philippines (51.4), India (51.2), Vietnam (51.0), World (50.3), China (50.2), Australia (49.9), Taiwan (49.8), Ireland (49.7), the Netherlands (49.6), Turkey (49.5), Malaysia (49.5), South Korea (49.4), Thailand (49.3), Japan (48.9), UK (48.9), Indonesia (48.2), US (48.1), Mexico (48.0), Italy (47.6), Spain (47.5), Eurozone (46.9), Poland (46.7), Austria (46.0), Russia (45.6), Germany (44.1), and Czech Republic (43.5).

2) Developed vs emerging economies. On balance, they all added up to a continuation of the recovery in the global M-PMI since July, when it bottomed at 49.3 (Fig. 1). It was up to 50.3 last month, back near where it was during April 2019. Most of the improvement from July to November reflects a rebound in the M-PMI for emerging market economies (Fig. 2). It has been above 50.0 for most of this
year and was at 51.0 last month. The M-PMI for developed market economies has been below 50.0 since May of this year. It rebounded from a recent low of 48.6 in both September and October to 49.6 in November. The US, UK, Eurozone, and Japan were all below 50.0 last month (*Fig. 3*). Three of the four BRICs were above 50.0 (*Fig. 4*).

(3) *Revenues matter*. Investors care about the M-PMIs because they have always been useful economic indicators. Perhaps we should care less for them because the nonmanufacturing economy has been growing faster than the manufacturing one around the world. On the other hand, for stock investors, it matters that manufacturing is a very cyclical component of corporate profits. That explains why the y/y growth in S&P 500 aggregate revenues is highly correlated with the US M-PMI (*Fig. 5*). The former was down to 2.2% y/y during Q3-2019 from a recent peak of 10.0% during Q2-2018.

Joe and I expect revenues growth to rebound to 4%-5% next year. So we would like to see a V-shaped recovery in the US M-PMI. Could that happen even if there’s no trade deal between the US and China until 2021? We think so given the strength in consumer spending and housing activity in the US. Real wages and salaries rose solidly during October by 3.5% y/y, while real consumer spending rose 2.3% (*Fig. 6*). Anecdotal evidence suggests this year’s holiday shopping season is going gangbusters. Mortgage applications for new purchases remains on an upward trend, auguring well for the sum of new plus existing single-family home sales (*Fig. 7*).

What about business spending in the US? It still looks weak. The y/y growth rate in nondefense capital goods orders ex-aircraft is highly correlated with the US M-PMI (*Fig. 8*). The former was down 0.8% during October, hovering around its weakest yearly growth rate since November 2016. Ongoing trade uncertainty may continue to weigh on business spending.

(4) *Can stocks rally while the M-PMI is below 50.0?* The short answer is “yes,” since that’s what they’ve been doing all year. The S&P 500 rose to yet another record high of 3153.63 on 11/27. However, the y/y percentage change in the S&P 500 has been very highly correlated with the M-PMI (*Fig. 9*). Year-over-year losses in the stock market typically have occurred when the M-PMI was below 50.0.

Then again, the Fed pivoted from projecting three hikes in the federal funds rate this year to actually cutting it three times so far. Fed officials attributed their reversal mostly to “uncertainties” created by Trump’s trade wars. Another round of uncertainty might convince the Fed to cut some more. Last Tuesday, we wrote: “If there is no deal, stock prices could crater. However, Trump views the DJIA as his most important poll. So he would likely respond to a market selloff with some encouraging words. More importantly, Fed officials would most likely signal a willingness to ease some more if trade headwinds threaten to depress the US economy.”

**Strategy II: Forward Looking.** Meanwhile, S&P 500 forward revenues per share remained on an uptrend in record-high territory during the 11/21 week (*Fig. 10*). That augurs well for actual revenues during the final quarter of this year. It also augurs well for earnings. However, there is clearly lots of air (i.e., higher forward P/E) between the S&P 500 stock price index and earnings.

Forward earnings per share for the S&P 500 rose to $177 during the 11/28 week (*Fig. 11*). This weekly series tends to be a very good year-ahead indicator of actual earnings on a four-quarter trailing basis. The latter was $164 through Q3.

In other words, forward earnings is implying a 7.9% increase in earnings through late 2020. That may be too optimistic, though the weekly series tends to be mostly dead-on right with only one significant exception: Industry analysts don’t see recessions coming. If you agree with us that a recession is unlikely through the end of next year, then there is a good chance earnings could be up solidly in 2020.
as industry analysts expect, based on forward earnings.

**Bonds: Home on the Range.** Melissa and I are still thinking that the Fed is done finetuning monetary policy for the year and maybe for next year too. We are expecting that the Fed’s target range for the federal funds rate will stay at 1.50%-1.75% through the November 2020 elections. We expect that the 10-year US Treasury bond yield will range between 1.50% and 2.00% through the end of next year.

However, the news on Monday and Tuesday slightly increases the odds of a one-and-done rate cut early next year. Nevertheless, we are sticking with our range for the bond yield, for now.

The 10-year US Treasury bond yield rose from this year’s low of 1.47% on 9/4 to a recent high of 1.94%, mostly on news that Trump was deescalating his trade war and that the prospects for the global economy are improving. Over the past two days, this bond-bearish scenario looks a bit shaky, which is why the yield was back down to 1.72% yesterday.

Some of the indicators we track for insights into the bond market actually remain bond-friendly. Consider the following:

(1) **Inflation.** As we observed yesterday, the core PCED inflation rate remains subdued. It was only 1.6% y/y during October (*Fig. 12*). The spread between the nominal bond yield, and the core inflation rate has been fluctuating between zero and 1.0ppt since 2011 (*Fig. 13*). It’s been highly correlated with the 10-year TIPS yield since the start of the data in 2003.

Helping to hold the nominal bond yield down is that the TIPS yield was only 0.09% yesterday, while the spread between the nominal and TIPS yield was only 1.63% (*Fig. 14*). The spread is widely deemed to be a proxy for the annual expected inflation over the next 10 years.

(2) **Commodity prices.** We’ve observed a tight correlation between the bond yield and the ratio of the CRB raw industrials spot price index to the gold price (*Fig. 15*). The ratio remains near this year’s low.

(3) **Economic surprise index.** The 13-week change in the bond yield tends to be highly correlated with the Citigroup Economic Surprise Index. This index was weak during the first half of this year, bottoming at a low of -68.8 on 4/25. It rebounded to the year’s high of 45.7 on 9/25. On Monday, it was back down to 8.7. (See our *Citigroup Economic Surprise Index*.)

(4) **M-PMI.** Last but not least, the bond yield has been highly correlated with the M-PMI in recent years (*Fig. 16*). The surprising weakness in November’s M-PMI along with Trump’s renewed trade confrontations have brought risk-averse investors back into the bond market.

**CALENDARS**

**US.** *Wed:* ADP Employment 140k, ISM & IHS Markit NM-PMIs 54.5/51.6, MBA Mortgage Applications, DOE Oil Inventories, Quarles. *Thurs:* Merchandise Trade Balance -$48.9b, Factory Orders 0.3%, Jobless Claims 215k, Challenger Job Cuts Report, EIA Natural Gas Report, Quarles. (DailyFX estimates)

**Global.** *Wed:* Eurozone, Germany, France, and Italy C-PMIs 50.3/49.2/52.7/50.6, Eurozone, Germany, France, and Italy NM-PMIs 51.5/51.3/52.9/51.2, UK C-PMI &NM-PMI 48.5/48.6, BOC Rate Decision 1.75%. *Thurs:* Eurozone GDP 0.2%/q/q/1.2%/y/y, Eurozone Retail Sales -0.5%/m/m/2.2%/y/y, Germany Factory Orders 0.4%/m/m/-4.7%/y/y, Japan Household Spending -3.2% y/y, Lane. (DailyFX estimates)
STRATEGY INDICATORS

S&P/Russell LargeCaps & SMidCaps (link): All of these Russell and S&P price indexes have healthy gains so far in 2019; only one, the S&P SmallCap 600, was still in correction territory measured from the indexes' record highs. Here’s how they rank ytd through Monday’s close, along with their percentage changes since their record highs: Russell LargeCap 1000 (24.4% ytd, 1.3% from record high), S&P LargeCap 500 (24.2, -1.3), S&P MidCap 400 (20.0, -2.7), Russell SmallCap 2000 (19.2, -7.7), and S&P SmallCap 600 (16.2, -10.6). All of these indexes are up since 7/30, the day before the Fed announced their first fed funds rate cut in over 10 years: S&P 500 (3.3%), Russell LargeCap 1000 (3.1), S&P SmallCap 600 (1.4), Russell SmallCap 2000 (1.4), and S&P MidCap 400 (0.5). These indexes began a forward-earnings uptrend during March, but only LargeCap is near a record high. LargeCap’s forward earnings has risen during 29 of the past 42 weeks, MidCap’s 21 of the past 38 weeks, and SmallCap’s 19 of the past 36 weeks. LargeCap’s is just 0.4% below its record high 11 weeks ago, while MidCap’s and SmallCap’s are 5.5% and 9.4% below their October 2018 highs.

MidCap’s forward earnings is near an 18-month low now, while SmallCap’s forward earnings is near September’s 17-month low because analysts are now including a large goodwill writeoff in their 2019 annual forecast for Frontier Communications. Analysts had been expecting double-digit percentage earnings growth for 2019 last October, but those forecasts are down substantially since then. Here are the latest consensus earnings growth rates for 2018, 2019, and 2020: LargeCap (22.7%, 0.2%, 9.9%), MidCap (22.7, -7.3, 12.3), and SmallCap (22.4, -19.5, 36.5).

S&P 500 Growth vs Value (link): The S&P 500 Growth and Value price indexes are near recent record highs and remain strong ytd. Growth now leads with a gain of 24.4% ytd through Monday’s close and is down just 1.4% from its record high last Wednesday. However, Value has been attaining record highs only since 10/22—and for the first time since 1/26/18. Both of these indexes are up since the Fed cut the fed funds rate at the end of July, but Value is outperforming hugely, with a gain of 5.1% since then versus a 1.8% rise for Growth. Measuring their performance since the election in late 2016, Growth’s 56.6% gain continues to outpace the 33.3% increase logged by Value. Looking at the fundamentals, Growth is expected to deliver higher revenue growth (STRG) and earnings growth (STEG) than Value over the next 12 months. Specifically, 8.0% STRG and 11.5% STEG are projected for Growth, respectively, versus 3.6% and 6.8% for Value. Growth’s valuation peaked at 22.0 last Wednesday, its highest level since May 2002 when the Tech bubble was deflating. Through Monday, Growth’s P/E was down to 21.7, up from its 50-month low of 15.9 on 12/24/18. Value’s forward P/E rallied from its recent low of 13.1 in mid-August to 15.0 last Wednesday, which is the highest since February 2018. That’s up from a six-year low of 11.5 on 1/3 of this year, but down from a 16-year high of 16.6 on 1/3/18. Regarding NERI, Growth’s was negative in November for a fourth straight month, weakening to a 43-month low of -5.8% from -2.3% in October. That compares to a record high of 22.3% in March 2018. Value’s NERI was negative in November for a 13th month, and also down to a 43-month low of -10.4% from -8.0%; that compares to a record high of 21.2% in March 2018. The Tax Cuts and Jobs Act (TCJA) sharply boosted the consensus forward earnings estimates and the forward profit margin for both Growth and Value. Growth’s forward profit margin of 15.7% is up from 14.4% prior to the TCJA’s passage but down from its record high of 16.7% during September 2018. Value’s forward profit margin of 10.1% is down from a record high of 10.5% in December 2018, but up from 9.1% prior to the TCJA.

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