Buying Dips

One of this year’s investment themes continues to be “buy on dips” in the stock market. So far, the deepest dip was the 5.6% decline over eight trading days from January 22 through February 3 (Fig. 1). During the current dip, the S&P 500 was down through Thursday by just 3.9% since its record high on July 24. At Friday’s close, it was still slightly below its 50-day moving average (Fig. 2). However, that’s been a good buying opportunity several times this year and last year too. Since the start of 2013, there have been 10 dips to this average (not including the current one) that were followed by solid gains.

There was also plenty of bad news at the beginning of last week coming out of Ukraine. So the 8/5 Investors Intelligence survey showed a sharp drop in the Bull/Bear Ratio to 2.95 from 3.43 the week before (Fig. 3). The percentage of bulls dropped from 55.6% to 50.5%. But the bulls didn’t join the bear camp. Rather, the percentage expecting a correction jumped from 26.3% to 32.4% over the past two weeks. In other words, sentiment is consistent with buying dips rather than with panic selling. Friday’s rebound was also fueled by reports that Russia’s defense ministry ended military exercises near Ukraine.

As I’ve noted previously, geopolitical crises in the Middle East tend to be bearish for stocks if they cause oil prices to soar. The price of a barrel of Brent rose just 0.2% on Thursday when Kurdish forces were attacked by Islamic State of Iraq and Syria (ISIS) militants, who had grabbed control of a couple of Kurdish oilfields on August 2 (Fig. 4). On Friday, the price rose another 0.2% when US jets bombed ISIS artillery positions, raising expectations that the US might now intervene to stop the onslaught of the jihadi barbarians. The price remains $11 below this year's high on June 19.

Strategy II: Bond Dips. Developments in the credit markets have contributed to the buy-the-dips performance of the stock market. That’s because there have been no significant dips in bond prices this year. So the yield of the 10-year US Treasury has been falling almost in a straight line from 3.00% at the start of the year to 2.42% on Friday (Fig. 5). In other words, the bond market has been easing even though the Fed has been tightening by tapering QE and signaling that the federal funds rate will be rising next year.

On May 8, when the bond yield was 2.61%, I listed nine reasons in our Morning Briefing why bond yields were falling rather than rising as widely expected: (1) bond shortage, (2) portfolio rebalancing, (3)
bond fund inflows, (4) Fed still buying, (5) yields plunging in Europe, (6) inflation remaining subdued, (7) slow global growth, (8) ultra-easy monetary policy, and (9) safe havens.

Of all of these plausible explanations, the most compelling one has been the plunge in Eurozone bond yields, in my opinion. Last Thursday, the German 10-year government bond yield was down to 1.06% from 1.94% at the start of the year (Fig. 6). That's down 88bps, while the comparable US Treasury is down 57bps and offers a yield that is more than twice as high. (Click to add Global Interest Rates to MyPage.)

In early May, I noted that “the recovery in industrial production has been lackluster since last summer” in Europe. The situation hasn’t improved. While there were upticks in June for Germany (0.2%), France (1.3%), and Italy (0.9%) production (excluding construction), they followed bigger declines the month before (Fig. 7).

Central Banks: ECB Dips. The euro has dipped 3.6% from this year’s high of 1.39% on May 6 to 1.34% on Friday (Fig. 8). ECB President Mario Draghi would like to see it continue to dip. He said so at his monthly press conference following the latest meeting of the ECB’s Governing Council on 8/7. He hopes a weaker euro will boost the Eurozone’s exports and inflation rate. In his prepared remarks, he pledged: “Concerning our forward guidance, the key ECB interest rates will remain at present levels for an extended period of time in view of the current outlook for inflation.” He added that “the Governing Council is unanimous in its commitment to also using unconventional instruments within its mandate, should it become necessary to further address risks of too prolonged a period of low inflation.”

Again, one of Draghi’s main goals is to talk the euro down further. His concern is that the “risks surrounding the economic outlook for the euro area remain on the downside.” He noted that there are “heightened” geopolitical risks. He also mentioned that bank credit continued to fall on a y/y basis during June. In addition, he indicated some impatience with “insufficient structural reforms.” He reiterated: “These efforts now need to gain momentum to enhance the euro area’s growth potential.”

In other words, monetary policy can’t fix all of the region’s problems. Nevertheless, a weaker euro would help. In his Q&A comments, Draghi said that “the fundamentals for a weaker exchange rate are today much better than they were two or three months ago.”

US Economy: Post Dip. The US economy dipped during the first quarter, with real GDP falling by 2.1% (saar). It then bounced back by 4.0% during the second quarter. There has been much angst about the subpar pace of economic growth during the current expansion. However, much of that is attributable to weakness in government spending.

That’s confirmed by last week’s productivity report showing that the real output of nonfarm business has been hovering around 3% y/y since Q2-2010, consistently higher than real GDP growth, which has been fluctuating around 2% over the same period, with the former up 2.9%, on average, while the latter is up 2.2%, on average (Fig. 9). Over the past four quarters through Q2-2014, the former is up 3.2% while the latter is up 2.4%. During the latest quarter, real nonfarm business output jumped 5.2% (saar) after falling 2.4% during the first three months of the year (Fig. 10 and Fig. 11).

Movie. “The Hundred-Foot Journey” (+ +) (link) is a light-hearted and big-hearted movie about how different cultures can learn to coexist and even like each other. I know that’s hard to believe given all the ethnic and religious conflicts around the world. Maybe everyone should be required to see it to learn that paths can be found towards peaceful coexistence. The plot centers on the conflict resolution of two bullheaded restaurateurs. One is running a French restaurant. The other has an Indian eatery 100 feet across the street. After seeing the movie, my wife and I chose to eat at a local Indian restaurant.
CALENDARS

US. Mon: Fischer. Tues: NFIB Small Business Optimism Index 95.8, Job Openings 4.588m, Treasury Budget -$96.0b. (Bloomberg estimates). (Bloomberg estimates)

Global. Mon: Japan Consumer Confidence, Japan Machine Tool Orders. Tues: Japan GDP -7.1% (annualized), Japan Industrial Production, Eurozone ZEW Economic Sentiment. (DailyFX estimates)

PERFORMANCE & ASSET ALLOCATION

Global Stock Markets Performance (link): The 0.3% gain for the MSCI US index last week ranked seventh of the 49 markets as seven markets rose in US dollar terms and the AC World ex-US index decreased 2.1%. EM Asia outperformed all regions last week with a drop of 1.1%, followed by BRIC (-1.3%) and EM Latin America (-1.6) as the 2.5% gain for Egypt led all countries. The US ranks 11th of the 49 markets so far in August, with a net change of 0.0% versus a 2.8% drop for the AC World ex-US. EM Latin America’s 0.8% decline is the best performance of all regions in August and Egypt’s 2.5% gain is best among the countries. EMU (-3.6) is the biggest regional underperformer this month, and Portugal (-12.6) is the worst-performing country. The 2014 ytd leaders: Indonesia (-26.2), Egypt (23.4), and Argentina (21.9). The 2014 laggards: Portugal (-23.1), Hungary (-19.8), and Russia (-19.2). EM Asia and EM Latin America lead the regional indexes ytd with gains of 6.2% and 5.3%, respectively. The worst-performing indexes ytd: EM Eastern Europe (-15.8), EMEA (-11.6), and EMU (-6.1).

S&P 1500/500/400/600 Performance (link): All three market-cap indexes were higher last week for the first time in five weeks as 22/30 market-cap sectors rose, compared to the prior week when all three indexes and 29/30 market-cap sectors fell. SmallCap was the best performer with a gain of 1.4% for the week, ahead of MidCap (0.9%) and LargeCap (0.3). SmallCap is the best performer in August, with a gain of 1.1%, ahead of MidCap (0.6) and LargeCap (0.0). Only two of the 30 sectors were higher in July, but 21 are so far in August and 20 in 2014. That’s up from nine sectors up ytd in early April, but down from all 30 sectors rising over the course of 2013. LargeCap and MidCap lead ytd with respective gains of 4.5% and 2.7%, ahead of SmallCap’s 2.0% decline. The SuperComposite 1500 index is up 4.1% ytd, paced by the following sectors: Health Care (8.6), Utilities (8.0), Tech (7.9), Energy (7.7), and Materials (6.1). The worst-performing SuperComposite sectors: Consumer Discretionary (-1.0), Industrials (-0.8), Telecom (1.4), Financials (2.0), and Consumer Staples (2.4).

S&P 500 Sectors and Industries Performance (link): The S&P 500’s ytd performance improved to a 4.5% gain last week from 4.2% a week earlier. Six of the 10 sectors moved higher w/w compared to all 10 falling a week earlier. Last week’s top performers: Consumer Discretionary (1.1%), Materials (1.0), and Consumer Staples (1.0). The worst performers were Telecom (-2.1) and Health Care (-0.6). Just two of the 10 sectors were higher in July, with the S&P 500 falling 1.5%, but six are higher so far in August with the S&P 500 unchanged. The best-performing sectors so far in August: Consumer Staples (1.7) and Materials (1.1). The worst performers in August: Telecom (-3.0) and Tech (-0.7). The ytd performance is positive now for eight of the 10 sectors, up from just two in early April. The 2014 leaders: Health Care (9.0), Tech (8.8), Utilities (8.8), Energy (8.0), and Materials (6.4). Sectors that are trailing the S&P 500’s ytd gain of 4.5%: Consumer Discretionary (-0.8), Industrials (-0.7), Telecom (1.2), Consumer Staples (1.9), and Financials (2.1).

Commodities Performance (link): Eight of the 16 commodities that we follow rose last week, up from three rising during the prior week. Commodities with the biggest increases last week: Soybean (5.7%), Natural Gas (4.3) and Wheat (2.8). Last week’s laggards: Silver (-2.1) and Zinc (-1.7). Only four of the 16 commodities were higher in July, but six are higher in August and five are higher ytd. August’s
leaders: Soybean (4.9), Wheat (3.6), and Natural Gas (3.2). August’s laggards: Zinc (-3.7), Tin (-2.6), and Silver (-2.3). The ytd leaders: Gold (8.9), Zinc (8.7), Platinum (8.0), and Silver (2.9). The biggest ytd losers: Cotton (-24.6), Corn (-16.6), Wheat (-9.3), and Copper (-8.0).

Assets Sorted by Spread w/ 200-dmas (link): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 9/19 commodities, 1/9 global stock index, and 32/44 US stock indexes versus 4/19, 3/9, and 1/44 the week earlier. Six of the 19 commodity indexes trade above their 200-dmas, down from eight a week earlier. Commodities’ average spread rose to -3.5% last week from -4.0% a week earlier. Six of the nine global indexes trade above their 200-dmas, down from seven a week earlier as their average spread fell to 2.5% from 4.0%. Thirty-five of the 44 US stock indexes trade above their 200-dmas, up from 26 a week earlier. Their average spread improved to 2.1% from 1.7%.

Commitments of Traders (link): What were Large Speculators doing in the futures pits on August 5? They were slightly bearish on the S&P 500 and slightly bullish on the 10-year Treasury note. They were bullish on the US dollar and bearish on the euro. They were bullish on the pound, Canadian dollar, and on the Aussie dollar. They remained very bearish on the yen. They were bullish on gold. They had large bullish positions in crude oil and gasoline.

US ECONOMIC INDICATORS

Productivity & Unit Labor Costs (link): Productivity was stronger than expected during Q2 and weaker than initially reported during Q1. Productivity rebounded 2.5% (saar) last quarter after a downwardly revised 4.5% decline (from -3.2%) during Q1, the steepest quarterly drop since 1981. Real output jumped 5.2% (saar) after sliding a revised 2.4% during Q1--more than double the initial estimate of a 1.1% drop. Hours worked accelerated 2.7% (saar), its fastest pace in nine quarters, following a 2.1% rise during Q1, little changed from its initial estimate. Hourly compensation increased 3.1% (saar), less than half Q1’s two-year high of 6.8%, which was considerably above initial reports of a 2.3% increase. Unit labor costs barely budged during Q2, edging up 0.6% (saar), after soaring 11.8% (saar) during Q1, the biggest increase since the end of Q4-2012 and way above the 5.7% initial gain. Over the past year, productivity accelerated 1.2% from 0.7% during Q1, with output (3.2) growing faster than hours worked (2.0). Hourly compensation was up 3.1% y/y, in line with Q1’s 3.3%; growth in unit labor costs slowed from 2.6% to 1.9% y/y.

Consumer Credit (link): Consumer credit increased at a slower pace again in June, rising $17.3 billion after a $19.6 billion advance in May and a larger-than-expected $26.1 billion gain in April. As in prior months, June’s gain was driven by non-revolving credit (up $16.3 billion), which includes auto and student loans. This component has increased every month since August 2011 for a total gain of $460 billion. Revolving credit advanced for the sixth time in seven months, up $0.9 billion m/m and $19.7 billion over the period to its highest level since May 2010, though still depressed.

GLOBAL ECONOMIC INDICATORS

Germany Industrial Production (link): German industrial production (including construction) increased for the first time in four months in June, though the 0.3% increase was one-quarter of the expected 1.2% jump. Production had contracted the prior three months by a total 2.4% from February’s cyclical high. Manufacturing output was flat after falling two of the prior three months by a total of 1.8%. Within manufacturing, increases in consumer (1.7%) and intermediate (0.5) goods production offset a decline in capital goods production (-0.9) during the month. Energy output was up 0.8%, while construction was 1.2% higher. The Economy Ministry said that second quarter weakness was expected after the exceptionally strong first quarter, though acknowledged that geopolitical events probably contributed to
the slowdown. Germany’s M-PMI began the third quarter on an up note, climbing from an eight-month low of 52.0 in June to 52.4 in July, though still considerably below January’s cyclical peak of 56.5.

**France Industrial Production (link):** Industrial production (excluding construction) rebounded a larger-than-expected 1.3% in June after a 1.6% slump in May. It was led by a 1.6% jump in manufacturing output (which accounts for 80% of the index) after a 2.3% May decrease. June’s gains were not sharp enough to prevent a contraction of 0.5% in total production last quarter and 1.2% drop in factory output. Capital (2.6%) and consumer (2.5) goods production led June’s increase, with both consumer durable (2.9) and nondurable (2.5) goods output posting solid gains. Recent moves in France’s M-PMI are discouraging, falling from a cyclical high of 52.1 in March to a seven-month low of 47.8 in July—the third consecutive reading below 50.

**Italy Industrial Production (link):** Output in the Eurozone’s third-largest economy grew at its fastest pace in five months in June, though remains stuck around cyclical lows. Industrial production (excluding construction) advanced a larger-than-expected 0.9% in June after slumping 1.2% in May. June’s gain was driven by increases in capital (2.6%) and consumer (2.5) goods production, the latter is the largest advance since May 2013. Energy output edged up 0.3%; intermediate goods production edged down 0.2%. Compared to a year ago, headline production increased 0.4%, on a working-day adjusted basis, after falling below zero (-1.7) in May. Italy’s M-PMI fell in July for the third month, to 51.9, after reaching a cyclical high of 54.0 in April.

**Spain Industrial Production (link):** Spain’s industrial production (excluding construction) increased for the eighth consecutive month in June on a year-over-year basis, though the pace slowed. Output advanced 0.8% y/y, calendar adjusted, slowing from the recent peak of 4.0% in April and matching March’s five-month low. (Monthly data show a two-month decline of 1.5%.) The yearly gain was led by production of nondurable consumer goods (2.8%), intermediate goods (2.0), and Energy (1.0) output; durable consumer goods production slumped 3.8% y/y. The outlook is favorable according to Spain’s M-PMI (53.9), which held close to June’s seven-year record of 54.6 last month. It was as low as 48.6 in November.

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
Mali Quintana, Senior Economist, 480-664-1333
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333

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