Running Out of Gas?

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(1) Deep freeze freezes economy. (2) An icy soft patch. (3) Weather may not be the only reason for economic weakness. (4) Real GDP outlook: Slow H1, faster H2. (5) Slowing global oil demand suggests slower global economic growth, depressing revenues growth. (6) Oil demand slowing mostly among EMs, especially China. (7) Oil demand rising in US. No longer falling in Europe. (8) After ice melts, there will still be plenty of potholes. (9) How do positive revenues surprises square with near-zero growth? (10) Focus on underweight-rated S&P 500 Energy.

US Economy: Soft & Ice Patches. Thanks to one of the coldest winters on record, the glut of natural gas is gone. The price of natural gas has soared since the start of December from $3.99 per MMBTU to $6.15 (Fig. 1). There is a serious shortage of propane gas. The deep winter freeze around much of the country has frozen the US economy, as evidenced by lots of very weak economic indicators for January and February. The Citigroup Economic Surprise Index plunged from a recent peak of 72.7 on January 15 to -4 yesterday, the first negative reading since November 4, 2013 (Fig. 2).

This weakness might not be entirely attributable to the weather. In addition to an ice patch, the economy may be hitting a soft patch. Previously, Debbie and I have suggested that the botched introduction of Obamacare could weigh on the economy. That may be happening, though it’s hard to prove it. Let’s see how much of a rebound occurs when the weather improves in the spring. In any event, consider the following:

(1) Industrial production dropped 0.3% during January, led by a 5.0% decline in motor vehicle assemblies. Auto sales decreased 1.0% during the month. The weather can be blamed for some of this weakness. However, the ratio of inventories to sales of autos (produced in the US, Canada, and Mexico, and sold in the US) rose to 2.85 during December, the highest reading since June 2009 (Fig. 3).

(2) Housing starts plunged 16.0% last month, with both single-family and multi-family starts down about as much. During the week of 2/14, mortgage applications to purchase a home tanked to the lowest pace since September 2011 (Fig. 4). Again, this weakness may not be all weather related given that home prices have increased sharply over the past few years and that mortgage rates are up by nearly a percentage point since last spring. In other words, housing affordability has deteriorated.

(3) Retail sales declined 0.4% during January. That was mostly weather related. However, there may be a weakening underlying trend given the downward revisions for November (from 0.4% to 0.3%) and December (from 0.2% to -0.1%).

(4) Transportation indicators are mixed. The ATA Trucking Tonnage Index skidded 4.3% during January (Fig. 5). Many highways have been too icy, forcing trucks off the road. However, the trains are still running, with intermodal railcar loadings in record-high territory in early February.
(5) Oil production remained on a near-vertical trajectory through the beginning of February (Fig. 6). US exports of crude oil and petroleum products soared to a record 3.7mbd during the week of February 7.

For now, our assessment is that the economy has slipped into an icy soft patch. We expect Q4-2013 real GDP to be revised downward from the initial estimate of 3.2% to 2.6%, partly as a result of the downward revisions in retail sales. The latest official report on that quarter will be released on February 28. We are forecasting growth of only 1.5% and 2.0% during this year's Q1 and Q2. But then we expect a pickup to 2.5% and 2.7% during Q3 and Q4.

Global Economy: Oil Story. Given the surge in US petroleum exports, the stability of the price of a barrel of Brent crude oil around $110 since mid-2013 is surprising, especially as global economic activity seems to be slowing (Fig. 7). Instead, the price of a barrel of WTI crude oil has jumped by $5.78 a barrel since the start of the year. In other words, the US benchmark is converging toward the international price, rather than the other way around.

Again, this is mighty peculiar given that the latest data, compiled by Oil Market Intelligence, show that the global supply of crude oil jumped to another record high during January, as Debbie discusses below. Global demand did the same, but its growth rate is slowing, led by weakness among emerging economies. Let's review, using 12-month moving averages to smooth out the monthly volatility in the stats:

(1) Global oil demand rose to a record 91.2mbd last month. However, the growth rate fell to 1.0% y/y, the slowest since September 2012 (Fig. 8).

(2) Emerging economies must be slowing, as evidenced by the drop in the growth rate in their demand for oil from a recent peak of 3.5% a year ago to 1.5% this January, the slowest since October 2009 (Fig. 9).

(3) Advanced economies have been reducing their oil demand since 2005. However, their demand has stabilized over the past year, with a very modest pickup in demand among the “Old World” economies (US, Western Europe, and Japan) offsetting some of the weakness in oil demand in the “New World.”

(4) US oil usage has been rising over the past year after mostly falling since the spring of 2007 (Fig. 10). In Europe, it has stopped falling over the past year after mostly falling since 2006. Interestingly, within Europe, it is still falling in Italy and Spain, while it is edging higher in Germany and the UK (Fig. 11).

(5) China’s oil demand has stalled at a record high around 10mbd over the past seven months (Fig. 12). Oil usage rates in Brazil and India continue to rise to new highs, though the pace of ascent may be slowing. (Click ★ to add Global Oil Demand & Supply to MyPage.)

Earnings & Revenues. The recent weakness in the growth rate of global oil demand is not a happy development for the growth in S&P 500 revenues. That’s because the two tend to have a relatively good correlation (Fig. 13). With 82% of S&P 500 companies having reported their Q4-2013 results, the blended revenues number is up a measly 1.3% y/y, well below our 5% target for this year and next year. Is the global economy running out of gas?

More likely, we are all cruising at a slower speed to avoid running out of gas until we can find the next service station. It’s not a great metaphor, but it will do for now to describe the soft patch. The ice patch will melt as the weather improves. However, we may still have to drive at a slow speed until all the pot holes are repaired. Consider how this is all affecting analysts’ expectations for revenues and earnings:
(1) **Forward revenues & earnings.** S&P 500 forward revenues stopped rising into record-high territory last fall and has stalled since then (**Fig. 14**). Forward earnings bucked the trend until nine weeks ago, when it stalled.

(2) **Revenue surprises.** How does the near-zero growth rate in revenues and the flattening of forward earnings square with a 2/18 Bloomberg article titled, “Best S&P 500 Sales Since 2012 Show Economy Spurs Bull Market”? Joe notes that the article’s focus on positive surprise data is interesting, but mostly meaningless since what matters is growth, which is only 1.3%, as noted above.

(3) **Sector revenues.** Joe adds that Q4 revenue growth was held down by Financials and Energy, which were the only two sectors with negative growth. Joe calculated the following blended y/y revenue growth rates for the 10 sectors: Health Care (7.6%), IT (5.5), Utilities (4.5), Consumer Discretionary (3.7), Materials (2.6), Industrials (2.3), Telecom (2.3), Consumer Staples (1.7), Energy (-3.5), and Financials (-9.2). Excluding the two downers, S&P 500 revenues rose 3.8% in Q4. Looking ahead to Q1-2014, the latest consensus of analysts’ forecasts pegs S&P 500 revenue growth at just 2.8%, weighed down again by Energy (-1.2) and Financials (+0.2). Excluding those two sectors, S&P 500 revenues are forecasted to rise 4.1% in Q1.

**CALENDARS**

**US. Thurs:** Headline & Core CPI 0.1%/0.2%, Jobless Claims 335k, Markit M-PMI Flash Estimate 53.5, Philadelphia Fed Composite Index 8.0, Leading Indicators 0.2%, Weekly Consumer Comfort Index. **Fri:** Existing Home Sales 4.65mu. (Bloomberg estimates)

**Global. Thurs:** China Markit M-PMI Flash Estimate 49.4, Eurozone Markit M-PMI & NM-PMI Flash Estimates 54.0/51.9, Germany Markit M-PMI & NM-PMI Flash Estimates 56.3/53.4, France Markit M-PMI & NM-PMI Flash Estimates 49.5/49.3, Germany, France. **Fri:** UK Retail Sales, Canada CPI. (DailyFX estimates)

**STRATEGY INDICATORS**

**Stock Market Sentiment Indicators** ([link](#)): The Investors Intelligence Bull/Bear Ratio climbed to 2.70 this week from 2.40 last week (lowest since October 15). It was at 4.23 eight weeks ago, the highest since March 1987. Bullish sentiment increased to 46.5% after falling five of the prior six weeks from a six-year high of 61.6% to 41.8%. Bearish sentiment inched down to 17.2% after two weeks at 17.4%. The percentage in the correction camp fell 4.5pps to 36.3% (after soaring 13.5pps the previous three weeks to 40.8%), moving back into the bullish camp. The AAII Bull Ratio advanced to 59.5% last week after falling from 64.5% to 43.4% the prior three weeks. Bullish sentiment rebounded to 40.2% after a four-week slide from 43.6% to 27.9%. Bearish sentiment fell to 27.3% after a three-week jump from 21.5% to 36.4%.

**S&P 500 Earnings, Revenues, & Valuation** ([link](#)): S&P 500 forward revenues and earnings fell last week, and remain below recent record highs. Profit margin forecasts were steady for 2014 (10.2%) and the forward 12 months (10.4%). Analysts trimmed expected 2014 revenue and earnings growth 0.1 percentage point each to 3.9% and 8.7%, up from 2013’s revenue and earnings growth of 1.6% and 6.1%, respectively. They expect revenues to fall 0.5% y/y in 2014 for Energy and to rise at a slower rate for Utilities (2.2%), but the remaining eight sectors are expected to see faster y/y revenue growth in 2014 than in 2013. Positive earnings growth is expected for all 10 sectors in 2014, but slower or flat
growth is expected for Financials (down to 8.4% from 19.6%) and Industrials (steady at 7.8%). Analysts expect higher profit margins in 2014 for all but Health Care (down to 9.5% from 9.7%) and Utilities (steady at 9.7%).

S&P 500 Sectors Earnings, Revenues, & Valuation (link): Last week, Financials was the only sector to post gains in both forward revenues and forward earnings. Forward revenues are around record highs for Consumer Discretionary, Consumer Staples, Health Care, and Industrials. Forward revenues and earnings are near cyclical highs for Financials and at or near record highs for four sectors: Consumer Discretionary, Consumer Staples, Health Care, and Industrials. Valuations remain near multi-year cyclical highs for all but Telecom and Utilities, and rose for all 10 sectors last week. Relative valuations are at or near cyclical highs for Health Care, Industrials, and Tech, and near a cyclical low for Telecom.

S&P 500 Q4 Earnings Season Monitor (link): With 82% of S&P 500 companies finished reporting, the Q4-2013 earnings surprise metrics are about the same as at the comparable point of the Q3 season, but the revenue surprise metrics are mixed. Of the 409 companies in the S&P 500 that have officially reported Q4-2013 results, 66% have exceeded industry analysts’ earnings estimates, by an average of 3.5%. That's weaker than the S&P 500 ex-JP Morgan figures for same time period in Q3-2013 when 68% beat estimates by 4.5%. However, 64% have beat Q4 sales estimates so far, exceeding by an average 0.3%, mixed compared to Q3’s comparable ex-JP Morgan figures of 53% and 1.2%. Earnings for the 409 reporters to date are up 10.5% y/y on a sales gain of 1.0%, versus Q3’s comparable 6.9% and 3.2% ex-JP Morgan.

US ECONOMIC INDICATORS

Housing Starts & Building Permits (link): The coldest January in two decades depressed homebuilding last month, following a weather-related slump in December. January housing starts dropped 16.0% to 880,000 units (saar), the biggest decline since February 2011. It followed a 4.8% drop in December and a 22.5% surge in November. Both single- and multi-family builders cut back again last month. Single-family starts fell 15.9% (following a December drop of 4.5%) to 573,000 units (saar); multi-family starts were 16.3% lower (after a 5.4% December decline) to 307,000 units (saar). Permits slumped 5.4% to 937,000 units (saar). Single-family permits fell 1.3% to 602,000 units (saar); multi-family permits (which tend to be very volatile) slid 12.1% to 335,000 units. Winter is impacting homebuilders’ confidence: February’s NAHB housing market index (46) sank to a nine-month low, primarily driven by abnormal weather.

GLOBAL OIL DEMAND & SUPPLY

Global Oil Demand (link): Oil demand continues to climb in non-OECD economies (though at a slower pace), remaining idle in the OECD. (The two are just 1mbd apart.) World oil usage hit a record-high 91.2mbd in January (based on 12-ma), 6.4mbd above its recent low (84.8mbd) in summer 2009. Non-OECD demand was at a record-high 45.1mbd, up 1.9% y/y (half January 2013’s 3.8%). OECD demand (46.1mbd) has stabilized around recent lows. Looking at just “Old World” economies, demand remained around its 19-year low (37.2mbd) in the 12 months ending January. Demand in Europe has leveled off around recent lows; US demand has turned up. Usage in Japan is falling after a recent rebound. Excluding these three economies, “New World” demand is still reaching new record highs (54.1mbd), up 1.5% y/y--half last summer’s pace. At record levels were China, India, OPEC, and most of Latin America, though demand in China has flattened out.

Global Oil Supply (link): Non-OPEC supply has soared to a new record high, while OPEC supply has turned up after recent decline. Based on Oil Market Intelligence data, non-OPEC output climbed
4.7mbd the past 16 months to a record-high 55.2mbd. Output in the US (8.3mbd) and Canada (3.6mbd) combined is at another new record high (climbing 2.8mbd since August 2012), with Canadian output picking up again. OPEC output rose for a second month to 36.4mbd last month, after falling from an 11-month high of 37.5mbd in July to a 30-month low of 35.5mbd in November. Within OPEC, Saudi Arabia output (9.5mbd) is down 0.4mbd from its August peak; Libyan production (0.5mbd) is down sharply from its recent high of 1.6, though moving sideways recently. Iran’s output (2.7mbd) is turning up from recent lows; Iraq’s (3.0mbd) is holding around recent highs.

FOCUS ON S&P 500 ENERGY

S&P 500 Energy Sector (link): Energy’s 3.5% ytd decrease (versus a 0.4% drop for the S&P 500) puts this sector in eighth place among the 10 sectors. That’s the same ranking as last year, when the index rose 22.3% for the year. Forward revenues and forward earnings are down from their cyclical highs in 2011 and 2012, and have fallen the most in the past six months among the 10 sectors. Analysts expect annual earnings to rise 9.4% in 2014 on a sales decline of 0.5%, compared to 2013’s declines of 5.3% (earnings) and 3.8% (revenues). Energy’s NERI was negative for a 28th straight month in January and weakened to a 12-month low of -13.9% from -12.8% in December–lowest among the 10 S&P sectors. Valuation of 12.7 is down from January’s three-year high of 13.0 and at a 15% discount to the market’s P/E.

S&P 500 Coal & Consumable Fuels (link): This industry’s 3.9% ytd decline is the third lowest among the sector’s seven industries, and worse than last year’s 3.8% decline. Forward revenues is at a record high, but forward earnings is down sharply from its cyclical peak in 2011. Analysts expect the industry’s earnings to tumble 66.3% in 2014 on a revenue decline of 12.0%—that outlook ranks as the gloomiest in the Energy sector and the most dismal of any S&P 500 industry. During 2013, earnings fell 16.6% on a revenue decline of 12.0%. Coal’s NERI fell to -11.2% in January from -9.8% in December, and has been negative for 31 months straight. With forward earnings near zero, valuation is meaningless and at a record high of 44.7.

S&P 500 Integrated Oil & Gas (link): The Integrated Oil & Gas industry is a big part of the Energy sector, accounting for more than half of its market cap and 12-month forward earnings. This stock price index is down 6.9% ytd, following an 18.1% gain in 2013. Forward revenues and earnings are trending lower at four-year lows now. Forward revenues is 26% below its cyclical high in April 2012, and forward earnings is down 17.1% from its recent peak in August 2011. Analysts project earnings to rise 2.1% in 2014 on a revenue decline of 1.6%, not as bad as 2013 when earnings fell 9.1% on a revenue decline of 9.9%. This industry’s NERI was down to a 17-month low of -26.3% in January from -26.2%. Valuation is down to 11.4 from a four-year high of 12.1 in January, but the forward profit margin remains relatively strong at 9.0%.

S&P 500 Oil & Gas Drilling (link): This industry’s stock price index is down 8.0% ytd for the worst performance in the sector, and stands 51.6% below its record high. Forward revenues and earnings were at cyclical highs in early January, but revenues is down 0.6% since and earnings have tumbled 6.5%. Analysts expect revenue growth to improve to 9.3% in 2014 from 5.2% in 2013, and think earnings growth will triple to 17.3% this year from 5.5% last year. NERI edged up to -20.6% in January from -20.9% in December, but this industry’s 31-month string of negative NERI is among the sector’s longest. Valuation of 9.3 is up from a 14-month low of 8.9 in early February, but the 31% discount to the market remains near a five-year low.

S&P 500 Oil & Gas Equipment & Services (link): Oil & Gas Equipment & Services is up 2.1% ytd for the second-best gain in the Energy sector. This industry’s uptrend in forward revenues and earnings is stalling now, with revenues 0.8% below its January record high and forward earnings still 2.9% below
its 2008 record. Consensus annual forecasts imply that analysts expect revenue growth to edge down to 8.2% in 2014 from 8.3% in 2013, but they expect earnings growth to soar to 22.6% from 4.7%. NERI has been negative in 26 of the past 27 months and tumbled to -17.0% in January from -6.4% in December. Valuation of 14.3 is down from a two-year high of 14.9 in October, and reflects a relatively low 5% premium to the market.

**S&P 500 Oil & Gas Exploration & Production** (link): Oil & Gas Exploration & Production’s stock price index is down 0.3% ytd after rising 25.6% in 2013. Forward revenues is 4.2% below its record high in January, and forward earnings remains 33.7% below its record high in 2008 when oil prices were soaring. This industry typically has very high leverage--analysts see earnings rising 12.7% in 2014 on a projected revenue gain of 6.3% after rising 10.1% in 2013 when revenues fell 8.4%. NERI was negative for a third straight month in January as it fell to -13.3% from -10.6% in December. Valuation is at 14.8 now and represents a relatively low 2% discount to the market.

**S&P 500 Oil & Gas Refining & Marketing** (link): After rising a sector-leading 80.1% in 2012 and 48.1% in 2013, Oil & Gas Refining & Marketing is down 2.9% ytd. Forward revenues and earnings have risen roughly 2% in the past month, possibly marking an end to the declines from their cyclical highs in November and May. Analysts expect earnings to rise 32.2% in 2014 on a revenue decline of 5.3% after tumbling 29.7% in 2013 on a revenue gain of 3.9%. NERI was positive in January for the first time in nine months, soaring to 25.5% from -7.0% in December. Valuation is following the pattern of an earnings recovery--it’s down to 9.1 now from a three-year high of 10.7 in early January.

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