MORNING BRIEFING
October 26, 2015

Silver Linings

Strategy: Clouds. Bears tend to see clouds, and rarely see their silver linings. Bulls tend to have a sunny disposition, so they are always looking for the silver lining in any clouds. John Milton coined the phrase “silver lining” in *Comus: A Mask Presented at Ludlow Caste* (1634):

> "Was I deceived, or did a sable cloud
> Turn forth her silver lining on the night?
> I did not err; there does a sable cloud
> Turn forth her silver lining on the night,
> And casts a gleam over this tufted grove."

During the Victorian era, optimists said, “There’s a silver lining to every cloud.” The currently used version of this proverb is “Every cloud has a silver lining.”

The bears attributed the 1.7% rally in the S&P 500 last Thursday to ECB President Mario Draghi’s reiteration during his latest press conference that he intends to do whatever it takes to revive the Eurozone’s economy. More specifically, he said: “In this context, the degree of monetary policy accommodation will need to be re-examined at our December monetary policy meeting, when the new Eurosystem staff macroeconomic projections will be available. The Governing Council is willing and able to act by using all the instruments available within its mandate if warranted in order to maintain an appropriate degree of monetary accommodation.”

The bears warned that Thursday’s rally was a head-fake since by now it should be obvious that central banks have run out of credible options for boosting economic growth. They might have overlooked the following silver linings:

(1) *Easier money in the Eurozone.* Actually, Thursday’s rally suggested that investors still believe that central banks can make a difference. Investors concluded that the ECB might provide more QE and perhaps also lower official interest rates further into negative territory.

The ECB announced that it was going below zero on June 5, 2014. The deposit rate was reduced by 10bps to -0.10% effective June 11, 2014. Going further into sub-zero territory, the ECB once again reduced this interest rate effective September 10, 2014 by 10bps to -0.20%.
Some ECB watchers are starting to speculate that the next stop might be -0.40% at the December meeting of the central bank’s Governing Council. They are doing so because Draghi said, “Further lowering of the deposit facility rate was indeed discussed, and it’s one of the instruments of monetary policy that I referred to when I said all instruments have been discussed.”

If nothing else, more negative interest rates in the Eurozone certainly would make stocks more appealing, as long as the region’s economy continues to muddle along. The EMU MSCI stock price index (in euros) is up 12.7% since its recent correction bottom on September 24 (Fig. 1).

(2) **Markit had plenty of good news.** On Friday morning, we learned from Markit’s press release that the Eurozone’s “economic upturn regained some momentum at the start of the fourth quarter. The Markit Eurozone [Composite] PMI rose from September’s four-month low of 53.6 to reach 54.0 in October, according to the flash estimate. The latest reading remained slightly below that seen in August but still signaled one of the strongest monthly expansions seen over the past four years.” The strength in the services components more than offset the weakness in manufacturing (Fig. 2, Fig. 3, and Fig. 4).

Markit also reported last Thursday that Japan’s flash M-PMI rose from 51.0 in September to 52.5 this month, the highest reading in over a year and a half (Fig. 5). The Japan MSCI stock price index (in yen) is up 13.0% since its recent low on September 29 (Fig. 6).

Furthermore, the latest reading of Markit’s flash M-PMI for the US “pointed to the fastest upturn in business conditions since May.” It rose from 53.1 during September to 54.0 this month. In addition: “October data indicated a robust and accelerated expansion of production levels across the manufacturing sector. The latest rise in output was the fastest since March, which brought the pace of expansion back in line with the post-crisis average. Survey respondents mainly cited improving demand from domestic markets and competitive pricing strategies. At the same time, global economic uncertainty and lower energy sector capex were reportedly factors acting as a brake on manufacturing growth in October.” (Click to add Markit Flash PMIs to MyPage.)

(3) **Cyclical stocks have made a great comeback.** Since the August 25 correction low, cyclical stocks have rebounded impressively. They didn’t run out of steam last week according to our Performance Derby for the S&P 500’s 10 sectors: IT (4.6%), Industrials (3.8), Financials (2.5), Consumer Staples (2.1), S&P 500 (2.1), Materials (2.1), Consumer Discretionary (1.7), Telecom Services (1.6), Utilities (-0.5), Health Care (-0.7), and Energy (-1.0).

(4) **Technology is a leader again.** Earlier this year, the bears were concerned that the bull market was narrowing to a few Information Technology and Biotechnology leaders and that they were starting to look tired. Looks like IT may be leading the way higher again, although Biotech may continue to stumble because politicians are making an issue out of drug pricing.

Alphabet (a.k.a. Google) and Amazon helped power the Nasdaq back above both its 50-dma and 200-dma at the end of last week (Fig. 7). By the way, even the S&P 500 Transportation index, which has been sounding the Dow Theory alarm siren since late 2014, is seeing some blue sky. It fell 24.7% from its record high on January 22 to its recent low on August 25. It is up 15.3% from that low, near its 200-dma, which is still falling though (Fig. 8).

Last week was another great one for IT in particular. Leading the way since August 25 were some of the sector’s biggest losers for the year, as a pickup in M&A activity revived some of them (Fig. 9). Here is the performance derby for the major IT industries since August 25 and ytd: Semiconductors (26.6%, -0.2), Systems Software (23.4, 4.8), Application Software (19.2, 17.8), Internet Software & Services
(19.1, 27.1), Semiconductor Equipment (16.9, -22.0), Communications Equipment (16.0, -3.6), and Technology Hardware, Storage, & Peripherals (14.4, -0.1).

The Industrials sector also has rebounded smartly. It has been an underperformer all year (down 2.4% ytd), but its 12.8% gain since August 25 has outpaced the S&P 500’s 11.1% rise. Leading the way has been Industrial Conglomerates (21.3) (Fig. 10).

(5) Some companies finding lots of silver in the Cloud. The bears have their heads in a dark cloud, so they might not have seen the silver lining in the Cloud. On Thursday after the close, Alphabet, Amazon, and Microsoft all reported much-better-than expected Q3 results, mostly because their Cloud businesses are booming. All three rallied strongly in after-hours trading, and again on Friday.

As a result, the S&P 500 (which includes MSFT) jumped 2.8% during Thursday and Friday. It is now only 2.6% below its record high on May 21 (Fig. 11). It is back up above its 200-dma, having been tracing out since August a pattern that resembles a mini-version of the 2011 correction (Fig. 12). Joe and I didn’t see the dark cloud coming in late August, but we did see a silver lining on August 27, two days after the bottom in the most recent correction, as we were confident that the sun was behind there somewhere.

At Yardeni Research, we’ve been using the Amazon Cloud for the past four years. Our system is designed to detect any updates to all of the thousands of time series provided by our data vendors. It then instantaneously updates all the charts that use the series on our Cloud server. The refreshed charts are then automatically uploaded to their specific publications, which also reside on our Cloud server, as does our website. We have been and remain big fans of the Cloud.

(6) More hot air out of China lifting the clouds. It shouldn’t have come as a surprise, but the stock market was happily surprised by another round of easing by the PBoC on Friday. The one-year lending rate was cut to 4.35% from 4.60%, while the one-year deposit rate was lowered to 1.50% from 1.75%. Reserve requirements for all banks were lowered by 50 basis points, with an extra 50-basis-point reduction for some institutions (Fig. 13). It was the sixth interest-rate cut since November. Chinese stock prices are responding positively to the PBoC’s latest effort to revive economic growth (Fig. 14).

There are still plenty of clouds around. But they do have silver linings. In fact, we might even be starting to see some blue sky.

Movie. “Steve Jobs” (+ +) (link) is an intense film about an intense entrepreneur. An uncompromising visionary, Jobs was the Howard Roark of the computer industry (hero of Ayn Rand’s The Fountainhead). Jobs passed away prematurely on October 5, 2011. Set backstage at three iconic product launches, the movie is literally a behind-the-scenes look at the personal computing revolution inspired by Jobs. He wasn't a particularly nice man, according to the movie, but he certainly was a great technology revolutionary. Michael Fassbender is superb as Jobs.

CALENDARS

US. Mon: New Home Sales 549k, Dallas Fed Manufacturing Index -6.0. Tues: Consumer Confidence 102.5, Durable Goods Orders Total and Ex Transportation -1.0%/-0.1%, Richmond Fed Manufacturing Index -2, NM-PMI Flash Estimate 55.3, S&P Case-Shiller HPI 5.1% y/y, FOMC Meeting Begins. (Bloomberg estimates)
Global. Mon: Germany Ifo Business Climate, Current Assessment, and Expectations Indexes 108.0/113.3/102.3. Tues: China Industrial Profits, UK GDP 0.6%q/q/2.4%y/y, Japan Retail Trade 1.0%m/m/0.6%y/y. (DailyFX estimates)

PERFORMANCE & ASSET ALLOCATION

Global Stock Markets Performance (link): The US MSCI index rose 1.9% last week and ranked eighth of the 49 markets as 28 markets rose in US dollar terms, compared to 14th and a 0.9% rise a week earlier when 23 markets rose. The AC World ex-US index underperformed as it rose 0.6% for the week compared to a 0.3% gain a week earlier. The best-performing regions last week: EMU (1.4%), EAFE (0.8), and EM Asia (0.8). The week’s worst: EM Eastern Europe (-1.4), EMEA (-0.9), EM Latin America (0.2), and BRIC (0.5). Germany and Indonesia were last week’s best performers among countries, both with gains of 3.4%, followed by New Zealand and Hong Kong with 3.1% increases. Last week’s biggest decliners: Poland (-4.1), Hungary (-3.9), and Portugal (-3.2). This year to date, the US MSCI ranks 15/49 with a gain of 0.7%, ahead of the 3.1% decline for the AC World ex-US index; 15 of the 49 markets are positive ytd compared to 14 a week earlier. EM Eastern Europe is the best regional performer ytd with a gain of 5.9%, ahead of EMU (1.4) and EAFE (0.1). The worst-performing regions: EM Latin America (-24.8), BRIC (-8.4), EMEA (-6.0), and EM Asia (-5.7). The best country performers ytd: Hungary (25.0), Denmark (17.4), Russia (17.0), and Ireland (13.3). The worst ytd performers: Greece (-46.0), Brazil (-36.0), and Colombia (-31.3).

S&P 1500/500/400/600 Performance (link): All three market-cap indexes index moved higher last week, but LargeCap was the winner with a gain of 2.1% compared to MidCap (0.4%) and SmallCap (0.7). LargeCap now stands 2.6% below its May 21 record high, MidCap 7.1% below its June 23 record, and SmallCap 6.9% below its June 23 record high. Nineteen of the 30 sectors rose last week, the same as in the prior week as LargeCap had 7/10 sectors rise versus just six apiece for MidCap and SmallCap. SmallCap Telecom was the best performer of the week as it rose 9.2% and was followed by LargeCap Tech (4.6). MidCap Energy was the biggest decliner for the week as it fell 4.5% and was followed by SmallCap Energy (-3.7). LargeCap is the best performer so far in October with a whopping gain of 8.1%, and is on pace for its best month since it rose 10.8% in October 2011. SmallCap’s mtd gain of 6.2%, were it to hold, would be the cap size’s best monthly performance since a 7.0% rise in October 2014, and MidCaps’ mtd 5.2% rise would be its best since a 6.1% gain in July 2013. LargeCap has taken the reins as the best performer ytd with a gain of 0.8%, but is not much ahead of SmallCap (-0.6) and MidCap (-0.9). The SuperComposite Consumer Discretionary is the top sector performer ytd (8.4), ahead of Tech (6.4), Consumer Staples (4.2), and Health Care (1.6). These SuperComposite sectors are down the most ytd: Energy (-14.5), Materials (-8.5), Utilities (-5.6), Telecom (-2.6), Industrials (-2.3), and Financials (-1.6).

S&P 500 Sectors and Industries Performance (link): Seven of the S&P 500’s 10 sectors rose last week as the index rose 2.1%. That compares to eight sectors rising a week earlier when the S&P 500 gained 0.9%. The index is now 2.6% below its record high, but that’s up 11.1% from its 2015 low of 1867 on August 25. Tech rose 4.6% for the best gain of the week, followed by a 3.8% rise for Industrials. Last week’s decliners: Energy (-1.0%), Health Care (-0.7), and Utilities (-0.5). The S&P 500 is up 8.1% so far in October with four sectors outperforming the index: Materials (12.6), Energy (11.9), Tech (11.2), and Industrials (9.9). October’s laggards, albeit with gains: Utilities (3.1), Health Care (4.5), and Telecom (5.3). The S&P 500’s ytd gain of 0.8% is up from a ytd decline of 9.3% at the August 25 correction low, and not far off its peak ytd gain of 2.6% at its record high on May 21. Four of the 10 sectors are positive ytd compared to just one sector three weeks earlier, and four are ahead of the S&P 500. The ytd leaders: Consumer Discretionary (10.3), Tech (6.6), Consumer Staples (4.2), and Health Care (1.1). The ytd laggards: Energy (-13.9), Materials (-7.4), and Utilities (-5.7).
Commodities Performance (link): Just one of the 15 commodities we follow rose last week, down from six rising a week earlier. Last week’s best performers: Corn (0.8%), Soybean (-0.3), Wheat (-0.4), and Tin (-0.5). The biggest laggards: Natural Gas (-5.9), WTI Crude Oil (-5.6), and Brent Crude Oil (-4.7). The leading commodities so far in October: Platinum (10.2), Silver (9.0), and Cotton (5.5). October’s laggards: Natural Gas (-9.4) and Wheat (-4.3). During 2014, just one commodity rose for the year, Zinc (2.7), down from five in 2013. Five commodities were positive ytd at the end of Q2; now just two are positive. The best-performing commodities ytd: Cotton (4.1), Silver (1.6), and Gold (-1.7). With the metal- and food-based commodities improving recently, energy-related commodities are beginning to take over the worst ytd performers again: Heating Oil (-21.2) and Natural Gas (-20.9).

Assets Sorted by Spread w/ 200-dmas (link): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 1/18 commodity, 8/9 global stock indexes, and 29/44 US stock indexes compared to 8/18 commodities, 2/9 global stock indexes, and 27/44 rising a week earlier. Corn now leads all commodities at 0.6% above its 200-dma and is the only one above its dma, having risen 0.9ppt w/w for the sole improvement in its asset group. A week earlier, three commodities were trading above their 200-dmas. WTI Crude Oil fell the most among commodities last week (down 5.2ppt to -12.1%). Commodities’ average spread slipped to -7.5% from -5.8% a week ago. Seven of the nine global indexes still trade below their 200-dmas. South Korea and Chile lead at 0.9% and 0.4% above, respectively, and China is the most below at -11.8%. Germany had the leading improvement w/w, rising 6.2ppt to -2.4%. All countries improved w/w except for China, which was flat. The average spread of the global indexes improved to -4.0% from -5.9%. Nineteen of the 44 US stock indexes trade above their 200-dmas, up from 12 a week earlier, as their average spread rose to -1.9% from -2.9%. SmallCap Telecom now leads all US stock indexes relative to their 200-dmas, at 8.0% above, and was the best performer last week at it improved 9.1ppt. At the other end of the spectrum, SmallCap Energy continues to lag the US stock indexes at 24.9% below its 200-dma, but MidCap Energy was the weakest last week, slipping 3.8ppt to -13.4%.

S&P 500 Technical Indicators (link): There were more positive changes among the moving averages last week, but the S&P 500 and its 10 sectors are still in a Death Cross. For the first time in three months, the S&P 500’s price index closed above its 200-day moving average (dma), and its 200-dma began rising again. The S&P 500 rose 2.1% w/w to 11.1% above its 2015 low on August 25 and to 2.6% below its record high on May 21. The S&P 500 improved to 5.0% above its still-falling 50-dma from 2.6% above a week earlier, and improved to 0.7% above its now-rising 200-dma from 1.3% below. However, its 50-dma relative to its 200-dma weakened to 4.1% below from 3.8% below. Eight sectors (all but Energy and Utilities) had their price indexes improve relative to their 50-dmas, and seven (all but Energy, Health Care, and Utilities) improved relative to their 200-dmas. Health Care is still the only sector trading below its 50-dma. Five sectors now trade above their 200-dma as Industrials joined Consumer Discretionary, Consumer Staples, Tech and Utilities. Four sectors now have a rising 50-dma versus two a week earlier. Four turned higher w/w (Consumer Discretionary, Consumer Staples, Industrials, and Tech), but two started falling again (Energy and Utilities). A week earlier, just two sectors had a rising 200-dma (Consumer Discretionary and Tech); now five are rising, as Consumer Staples, Financials, and Industrials turned up last week.

US ECONOMIC INDICATORS

Leading Indicators (link): There’s been no gain in the leading indicators since June. The Leading Indicators Index (LEI) fell 0.2% in September after no growth the prior two months, which followed a four-month surge of 2.2% to a new cyclical high. According to the Conference Board, “Despite September’s decline, the U.S. LEI still suggests economic expansion will continue, although at a moderate pace. . . .The U.S. economy is on track for moderate growth of about 2.5 percent in the coming quarters, despite the mixed global economic landscape.” Six of the 10 indicators contributed
positively to September’s LEI, led by the interest-rate spread (0.22ppt), jobless claims (0.10), and the leading credit index (0.10); real consumer goods orders, real nondefense capital goods orders, and consumer expectations each contributed only 0.01ppt. That was more than offset by negative contributions from stock prices (-0.19), building permits (-0.16), average workweek (-0.13), and the new orders diffusion index (-0.11).

Coincident Indicators (link): The Coincident Indicators Index (CEI) hit another record high last month. The CEI rose for the 18th time in 20 months, up 0.2% in September and 4.3% over the period, and hasn’t posted a decline since January 2013. Three of the four components advanced last month, each reaching new record highs: 1) Nonfarm payroll employment climbed 0.1%; it hasn’t posted a decline since July 2010. 2) Personal income--excluding transfer payments--increased for the 22nd time in 23 months, up 0.3% m/m and 7.1% over the time span. 3) Real manufacturing & trade sales climbed 0.2% m/m and 5.9% over the past 20 months. 4) Industrial production sank -0.2% in September, the seventh decline this year; July’s 0.8% increase is the only gain so far this year.

Regional M-PMIs (link): Early indications from regional PMIs suggest manufacturing activity continued to contract this month. Three Fed districts have reported so far: New York, Philadelphia, and Kansas City; we average the composite, orders, and employment measures as data become available. The three region average shows the composite index was negative for the third month, coming in at -5.6 this month after sinking to nearly a six-year low of -9.6 in September. Philly’s index (from -6.0 to -4.5) was below zero for the second month, after 18 months above zero; New York’s (-14.7 to -11.4) held near spring 2009 lows. Kansas City’s (-8 to -1) is heading toward positive territory after bottoming at -13 in May. The new orders measure (-3.8 to -7.5) deteriorated to its weakest performance since May 2009. New York’s gauge (-12.9 to -18.9) showed orders fell at the fastest pace since November 2010. Philadelphia’s (9.4 to -10.6) was below zero for the first time since May 2013; Kansas City’s (-8 to 7) was above zero for the first time this year. The employment index (-1.0 to -4.4) posted its fifth negative reading in six months. Both New York (-6.2 to -8.5) and Philadelphia (10.2 to -1.7) manufacturers cut jobs, the former at its fastest pace since November 2012. Kansas City’s gauge has improved for the third straight month from -19 in July to -3 this month.

GLOBAL ECONOMIC INDICATORS

US M-PMI Flash Estimate (link): Manufacturing activity accelerated at its fastest pace since May this month. Markit’s M-PMI flash estimate improved to 54.0 from 53.1 in September and 53.0 in August (the lowest since October 2013). Output expanded at its fastest rate in five months, with the pace of expansion back in line with the post-crisis average. New order volumes were the strongest in seven months. Although export sales made only a modest contribution, the latest increase in new orders from abroad was the fastest since February. Job creation rebounded to a three-month high from September’s 27-month low.

Eurozone PMI Flash Estimates (link): Eurozone business activity continued to show steady growth in October. The Flash Composite Index climbed from a four-month low of 53.6 to a two-month high of 54.0 this month as service-sector growth accelerated. The NM-PMI advanced from 53.7 to 54.2, while the M-PMI was unchanged at 52.0. Output in the service sector picked up this month, and inflows of new business hit a six-month high. Meanwhile, manufacturing production posted its smallest rise in five months, while new orders growth weakened. Job creation was at a five-month high for the service sector and an eight-month low for manufacturing. Composite indexes for the region’s two largest economies--Germany (from 54.1 to 54.5) and France (51.9 to 52.3)--both showed acceleration in growth. Germany’s was mixed: its NM-PMI (54.1 to 55.2) climbed to a seven-month high, while its M-PMI (52.3 to 51.6) slumped to a five-month low. Both France’s NM-PMI (51.9 to 52.3) and M-PMI (50.6
to 50.7) climbed to four-month highs. Available data for the rest of the region showed growth picked up slightly, but remained below the pace seen earlier this year.

**Japan M-PMI Flash Estimate** ([link](#)): Japan’s manufacturing sector grew at its fastest pace this month in over a year and a half, according to its flash estimate. The Nikkei/Markit Flash M-PMI climbed from 51.0 in September to 52.5 this month, the highest since March 2014. Both output and new orders grew at a faster rate, with new export orders expanding rather than contracting. Consequently, job creation moved from negative to positive.