RAYMOND JAMES

Gleanings
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April 25, 2017

Gleanings

A Monthly Chart Presentation and Discussion Pulling Together the Disciplines of Economics, Fundamentals, Technical Analysis, and Quantitative Analysis

"New Kid in Town"

"Johnny come lately, the new kid in town. Everybody loves you, so don't let them down.

. . . The Eagles (New Kid)

Well, we are not sure everybody loves him, but there is certainly a new kid in town and his name is Donald Trump. Clearly, President Trump has changed many things from reshaping the executive branch of the government to a reversal in foreign policy. Speaking to foreign policy, after meeting with numerous foreign leaders, President Trump launched a missile strike against Syria's Shayrat airbase that destroyed 20% of the Syrian government's operational aircraft. According to Secretary of Defense James Mattis, "The Syrian government has lost the ability to refuel or rearm aircraft at Shayrat airfield and at this point, use of the runway is of idle military interest." Shortly thereafter, the president authorized the dropping of the Mother of All Bombs (MOAB) on an ISIS bunker in Afghanistan. Finally, a taskforce is steaming its way towards the Korean peninsula. To be sure, the geopolitical risks have risen, and risen noticeably, but so far the equity markets have turned a deaf ear to such events. Well, that is until last week when the S&P 500 (SPX/2374) traded below its 50-day moving average (DMA) for the first time since the presidential election. This should come as no surprise to followers of our work, since our models have argued for caution since the first week of February. That said, after Sunday's (April 23rd) "French Twist," markets are looking higher.

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"New Kid in Town"

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It has been nearly three months since that "cautionary call," which saw the SPX changing hands around the 2330 level, and now trades some 50 points higher. As often stated in our missives, "We don't see where much money has been made since mid-February." Yet, investors should take heart because it looks to us as if the equity markets are setting the footings for another leg to the upside. As our friend, and market maven, Leon Tuey writes, "While the market has yet to reach an oversold condition, sentiment backdrop is almost ideal. Pessimism is nearing an extreme. Further weakness, therefore, will cause the market to reverse to the upside." From Leon's lips to God's ears, because on April 19, 2017 our short/intermediate proprietary models "flipped" positive, after mostly being negative since the last week of January and we told participants to ready their "buy lists" the following day. Then, when the French election showed that the internationalist Emmanuel Macron looks to be leading the far-right nationalist Marine Le Pen, the equity markets leaped. Indeed, that "French Twist" ignited markets around the world as it became evident that France is not going to exit the EU. Even if nationalist Marine Le Pen surprises and wins the runoff, it appears she does not have enough support in parliament to maneuver a "Frexit." So our targeted level of 2270 – 2280 (SPX) is not going to happen and we agree with Leon Tuey, this secular bull market has years left to run.

Jeffrey Saut

There's a New Sheriff in Town and His Name is Donald Trump

Donald Trump by marcn (2016) https://www.flickr.com/photos/marcn/24289632064/
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Jeffrey Saut

Change in Policy? You Bet…

President Trump has changed many things from reshaping the executive branch of the government to a reversal in foreign policy. Speaking to foreign policy, after meeting with numerous foreign leaders, President Trump launched a missile strike against Syria's Shayrat airbase. Shortly thereafter the president authorized the dropping of the Mother of All Bombs (MOAB) on an ISIS bunker in Afghanistan. As our friend, and portfolio manager, John Gaynoe writes:

On 13 April 2017, a MOAB was dropped on an ISIS cave complex in Nangarhar Province, Afghanistan. It was the first use of this particular MOAB bomb on the battlefield. The fact that the MOAB was dropped in the same province where Staff Sgt. Mark De Alencar of 7th Special Forces Group was killed on 8 April 2017 is probably not a coincidence. "There might have been a degree of payback here as well," Bill Roggio, editor of the Long War Journal told the Air Force Times. What is a MOAB bomb? It is the GBU-43B Massive Ordnance Air Blast bomb. A large-yield conventional bomb developed for the United States military. MOAB was first tested with the explosive tritonal on 11 March 2003, on Range 70 located at Eglin Air Force Base in Florida. Tritonal is 18% more powerful than TNT.

Source: U.S. Department of Defense.

Jeffrey Saut

The 50-Day Moving Average Gives Way

So far the S&P 500 has turned a deaf ear to such geopolitical events, but that may have change recently when the S&P 500 closed below its 50-DMA for the first time since the presidential election.

Source: Stockcharts.com.

Jeffrey Saut

While the Market Has Yet to Reach an Oversold Condition, Sentiment Backdrop Is Almost Ideal

Suggestive of a potential trading bottom are the Volatility Index (VIX), the CBOE Put/Call Ratio, and the sentiment readings. This is the VIX:VXV.

Source: Stockcharts.com.

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The CBOE Equity Put to Call Ratio – Weekly Oscillators

Source: Stockcharts.com.

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AAII Bulls – Weekly Oscillators – Monthly Oscillators

Source: Stockcharts.com.

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The Long-Targeted 2270-2280 Level

Source: Stockcharts.com.

Jeffrey Saut

Long-Term, We Are in a Secular Bull Market With Years Left to Go

Source: Stockcharts.com

Economic & Market Update

Equity Markets/ Technical Analysis

- **Market Outlook –** Bullish sentiment has reversed and is now cautious, which should be seen as a bullish contrarian signal. We see the recent consolidation and cautious stance as healthy and setting the stage for the next move up.

  After initial setbacks (healthcare reform, immigration policy), the Trump administration has huddled and will try again with healthcare, and the president has softened his stance/pivoted on a number of issues (China, border wall, etc.) and recently renewed his rhetoric on a 15% corporate tax rate.

  Earnings – For 1Q17, the **estimated earnings growth rate** for the S&P 500 is 9.2%. If 9.2% is the actual growth rate for the quarter, it will mark the highest (y/y) earnings growth for the index since 4Q11 (11.6%).

  S&P 500 Earnings estimates*:
  2017 -$129.66, **2018** - $146.36
  Current P/E: 2017 – 18.3x, 2018 – 16.2x

  S&P 500
  Key support: 2360, 2350, 2322-2330, 2300
  Key resistance: 2390, 2401

- **Sectors** – **Materials** and **Financials** are posting higher growth rates after estimate revisions and upside earnings surprises**.**

  Positive: Energy, Financials, Industrials, Tech
  Neutral: Healthcare, Consumer Discretion, Telecom, Materials
  Negative: Real Estate, Utilities, Consumer Staples

Monetary Policy, Inflation, FX

- **FOMC Minutes** (March 14-15) - Nothing surprising here. Fed officials expect to begin reducing the balance sheet (by not replacing maturing securities) later this year – that's been the prevailing view for some time. The Fed recognized the slowdown in consumer spending, but viewed that as benign due to transitory factors. Officials continued to see uncertainty regarding the timing, size, and character of fiscal stimulus, but generally don't see this having an impact until 2018. Some concerns about stock market valuations. No change in the expected timing of future rate increases.
- **Consumer Prices** (CPI – Bureau of Labor Statistics) - The CPI was up 2.4% from a year ago. Ex-food& energy, the CPI rose 2.0% y/y. Note that the Fed uses the **PCE Price Index** as its official target, which has a smaller weighting on shelter and the core PCE Price Index has been trending about 0.4-0.5 percentage point below the core CPI y/y in recent months. **Ex-food, energy, and shelter, the CPI fell 0.3% in March (+1.0% y/y).**
- **The Producer Price Index** (PPI – Bureau of Labor Statistics) - The PPI edged lower in March (median forecast: +0.0%), reflecting a 2.9% decline in energy (-0.5% before seasonal adjustment). The PPI softness reflects the fact that energy prices did not rise as much as they normally do in March. There is still evidence of upward pressure in raw materials, but moderate at the consumer level.
- **Exchange rates** (April 25)

EUR/USD $1.089	GBP/USD $1.282
USD/JPY...... ¥110.72	USD/CAD.....$1.359

U.S. Economy

- **Consumer Confidence** (Conference Board) - A bit lower than expected in the initial estimate for April (the median forecast was 122.9). March was revised to 124.9 (from 125.6 in the advance estimate). Note that the initial figures are based on a partial sample for the month and are subject to revision. Current job market perceptions improved to their best level since August 2001. Respondents were more optimistic about future job availability and income growth.
- **Real GDP – 3rd Estimate 4Q16** (Bureau of Economic Analysis) **-** A bit stronger than expected. Consumer spending was revised to 3.5% (tracking much more slowly in 1Q17). **Private Domestic Final Purchases**, the best measure of underlying domestic demand, rose at a 3.4% annual rate (+2.5% y/y).
- **March Employment Report** (Bureau of Labor Statistics) – Nonfarm payrolls rose by 98K vs. expectations for +180K. The Unemployment Rate edged down to 4.5% (median forecast: 4.7%). Summing it up: a mixed bag. Nonfarm payrolls rose much less than expected, with a 28K net downward revision to the two previous months. The underlying trend (3-mo. avg.) in payrolls remains consistent with moderate strength in the job market and some limitations due to tighter conditions.

Global Economy

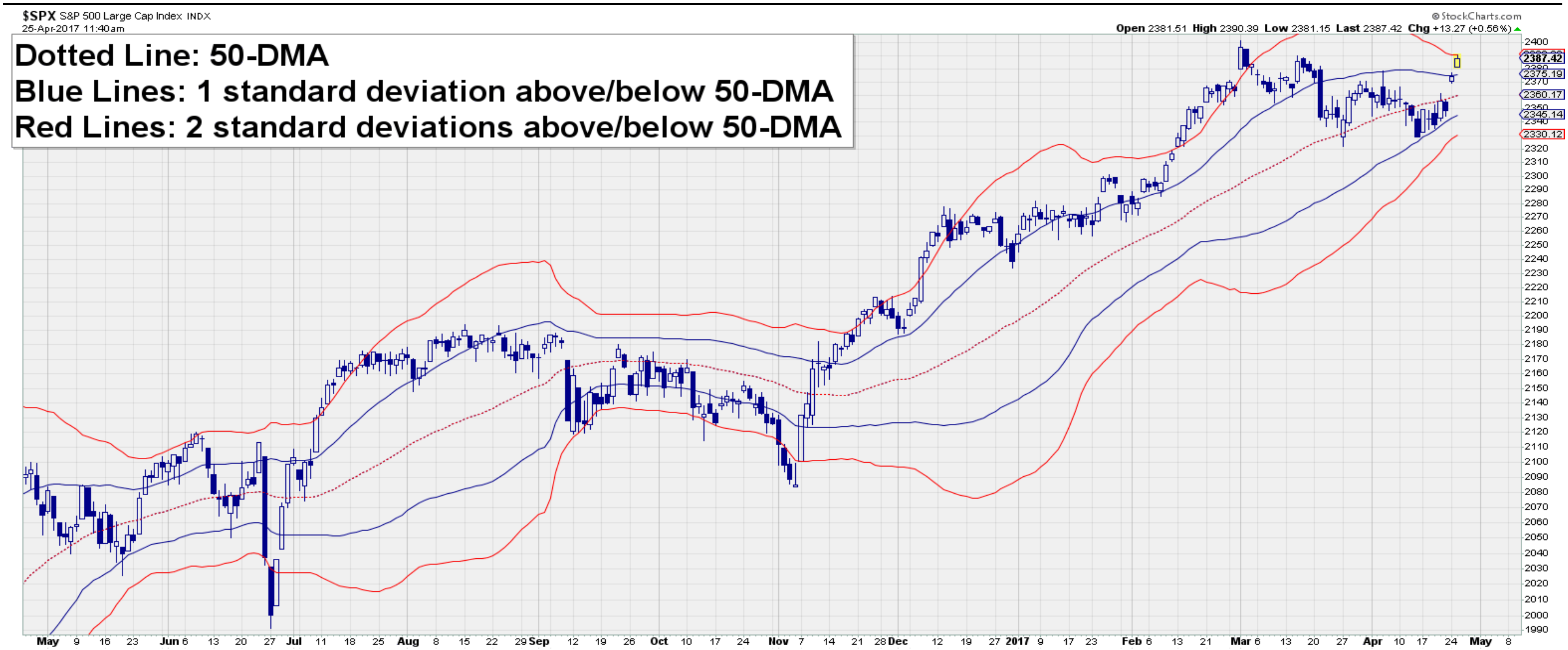
- **French presidential election** – **"Without France (de facto second-largest economy in EU), there is no EU."** With two of the four candidates favoring France leaving the EU, markets breathed a sigh of relief as centrist Macron (and nationalist Le Pen) moved on to run-off on May 7, eliminating a situation where both remaining candidates favored "Frexit." Macron emerges as frontrunner with ~20 pt. lead.
- **ECB** – Many economists are presuming a Macron presidency and are turning to the outlook for monetary policy. A Macron win would remove the tail risk and eyes would turn to Eurozone recovery and the end to monetary stimulus. The release of the ECB's monetary policy decision on April 27 will be hotly anticipated.
- **Brexit** – In a surprise move, PM May recently called to dissolve the government and hold a general election on June 8 (much sooner than the scheduled May 2020 general election). PM May hopes this will garner her stronger parliamentary support and a better position to negotiate the withdrawal.

Source: FactSet, Raymond James Research. *S&P 500 earnings estimates are bottom-up operating earnings as of 4/20/17 market close, provided by Standard & Poor's.

Andrew Adams

S&P 500 Bouncing Hard

The S&P 500 closed below its 50-day moving average on April 12th but never managed to drop more than one standard deviation below that 50-DMA. This lack of follow-through on the downside once again illustrated that buyers are still willing to step in on any little dip, and the index has now rallied hard the last few days. In fact, the S&P 500 is now touching the line two standard deviations above its 50-DMA, though the lack of volatility lately has these bands rather narrow so the index still doesn't seem that overbought. Now we wait to see if the index can climb back up to new all-time highs.

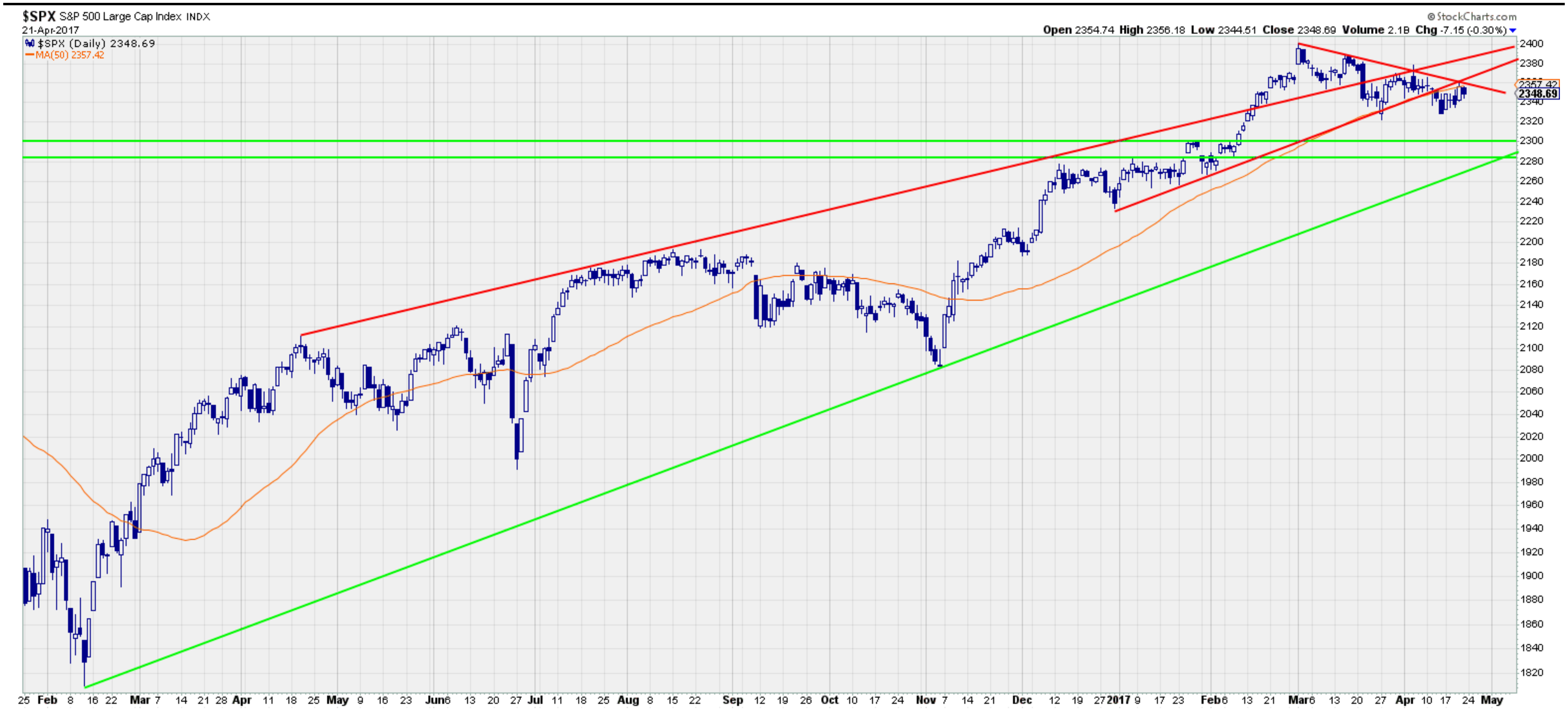


Source: Stockcharts.com.

Andrew Adams

Tug-of-War

The bulls seem to be winning the recent battle of tug-of-war and have taken the S&P 500 back up over some important resistance lines in the process. Now, these lines should help act as additional support and, once again, the big question is whether the index has enough strength to get back up over the March 1st high.

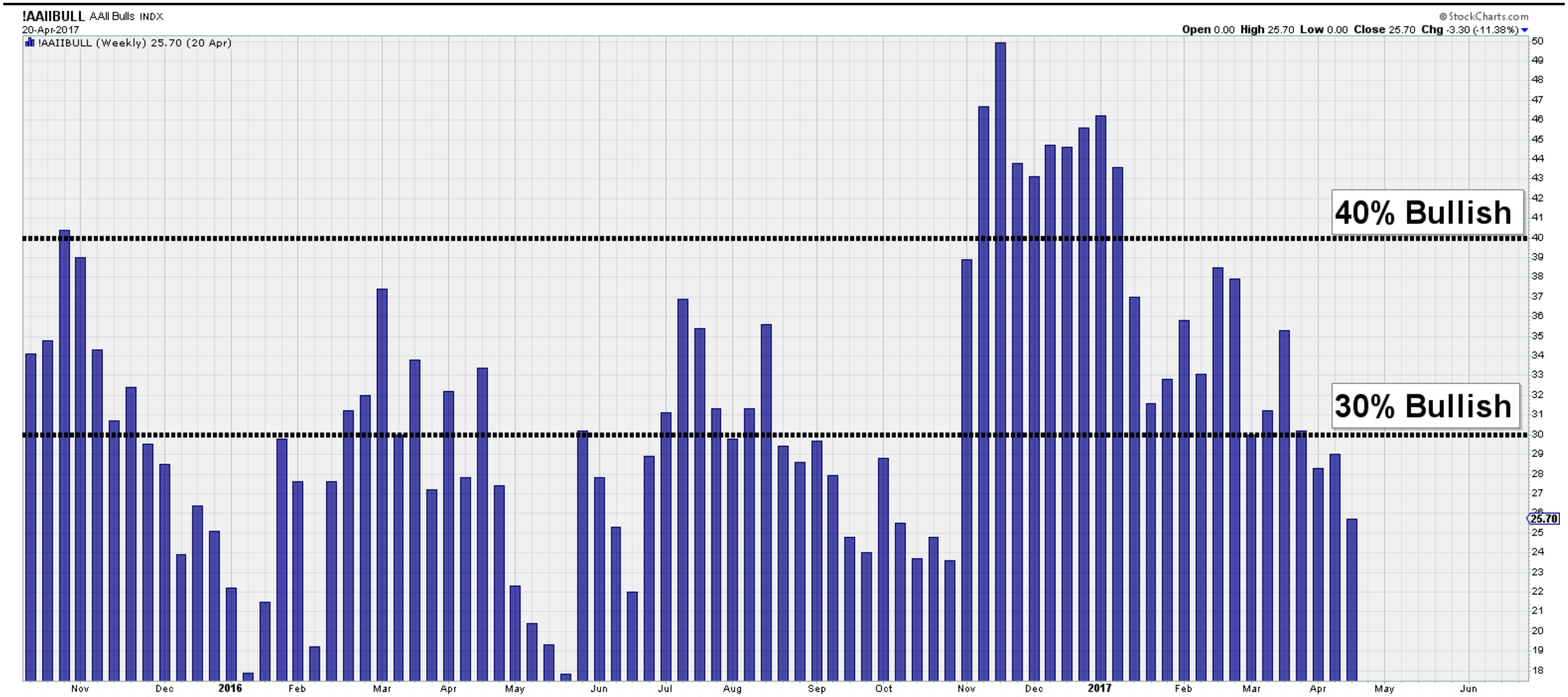


Source: Stockcharts.com.

Andrew Adams

Individual Investors Not Very Optimistic

The pause in the uptrend, coupled with a host of geopolitical concerns and continued cries that the market is too expensive, has produced a collapse in the "Bullish" readings surveyed weekly by the American Association of Individual Investors (AAII). A surge in optimism was seen immediately after the election in November, but since then there has been a steady decline in sentiment and now the figure is back to where it was before the rally of the last few months (25.7%).

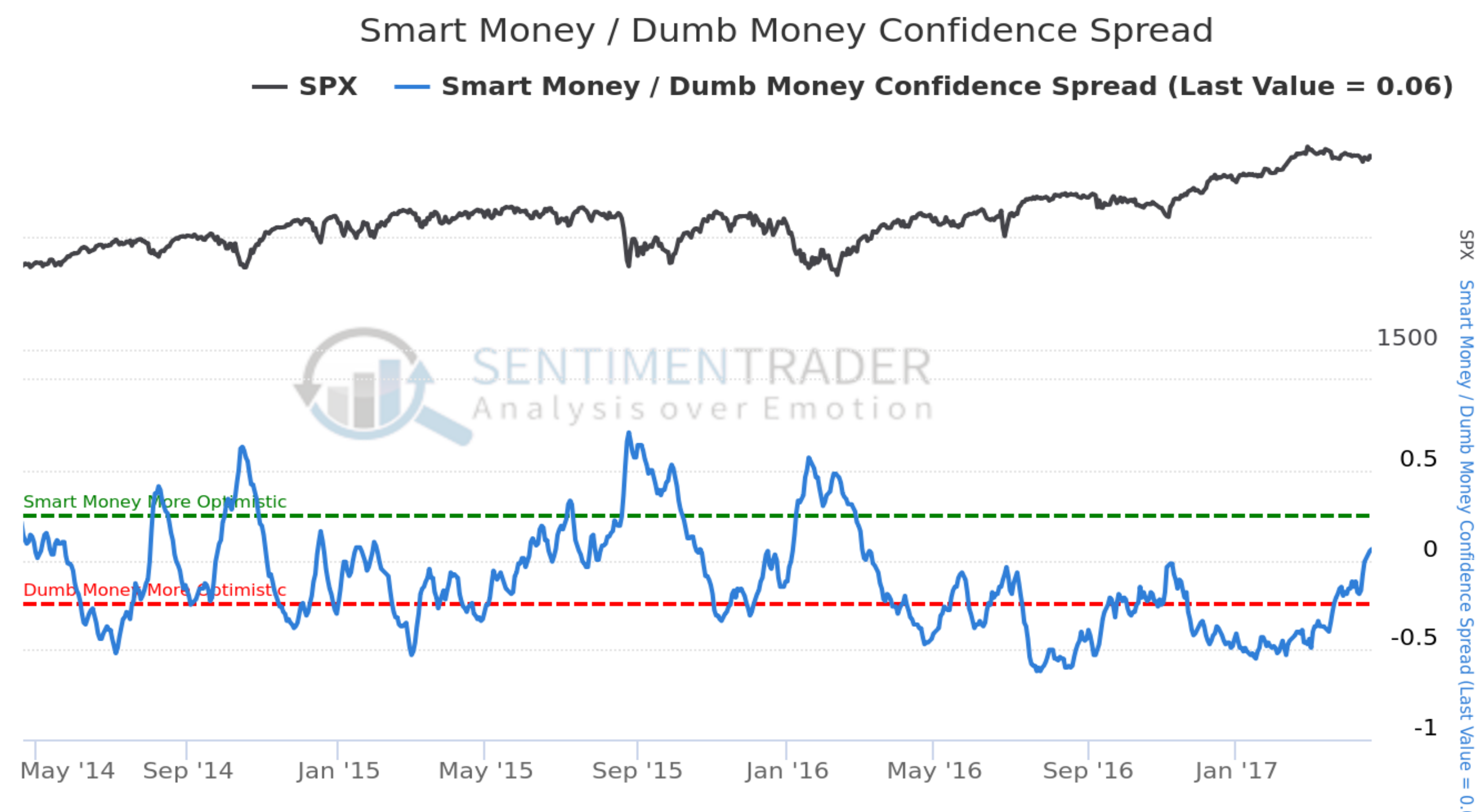


Source: Stockcharts.com.

Andrew Adams

Smart Money More Confident Than Dumb Money

At the same time, the spread between the "smart money" and "dumb money" has swung in favor of the smart money for the first time since March 2016 and seems to reflect that the traders who usually time the market better are becoming more optimistic compared to those who don't usually time the market well. SentimenTrader uses mostly real-money gauges like option put/call ratios and futures positioning between commercial hedgers and small speculators to determine these indicators and historically better forward returns have been seen when the smart money is more confident than the dumb money.

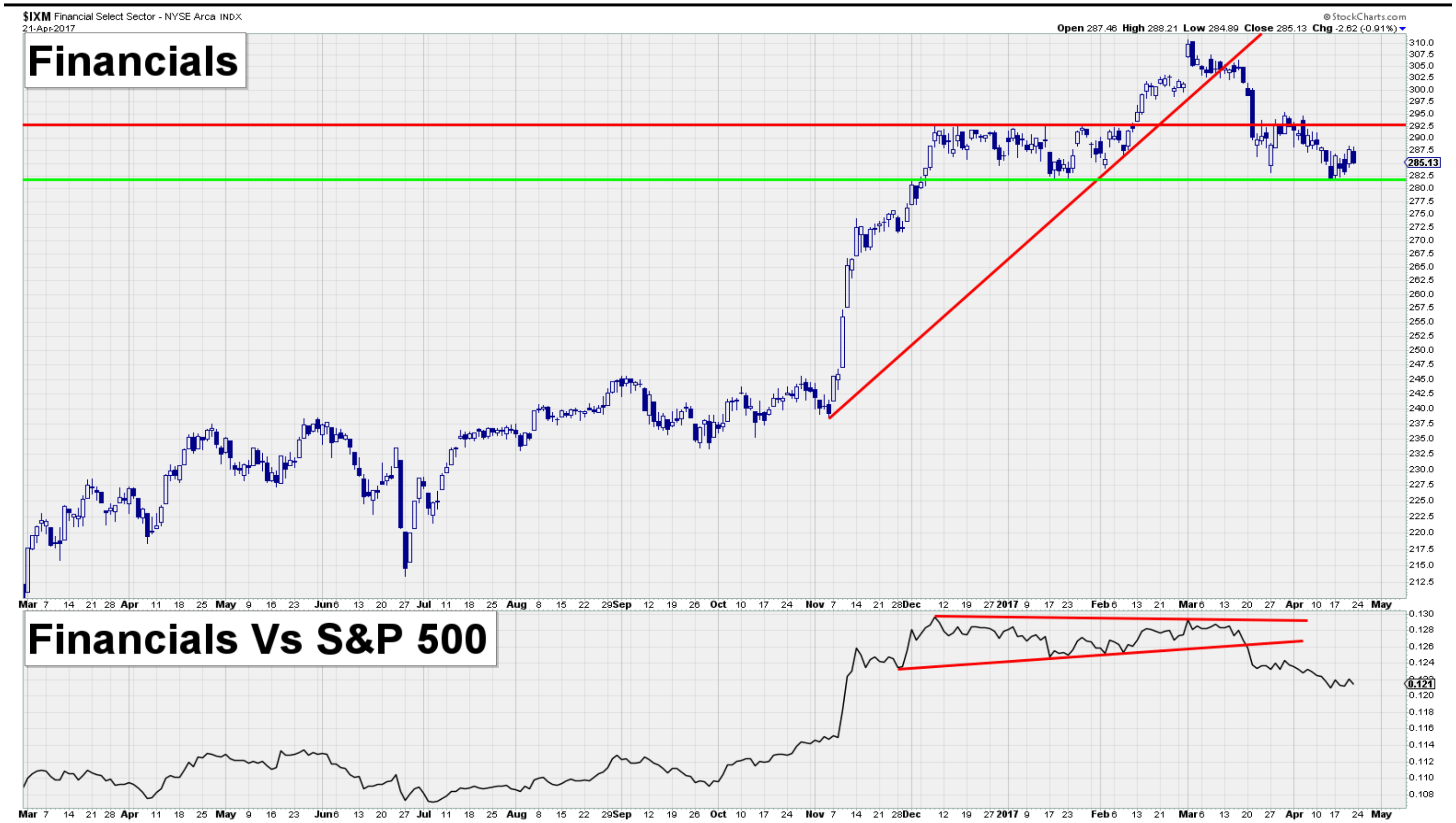


Source: SentimenTrader.com.

Andrew Adams

Financials at a Critical Point

The Financial Select Sector Index has turned from market leader to laggard in the last few months, as the Financials have now fallen back down to where they were at the beginning of December. It may be critical for the sector to rally here now because breaking down below that green line would not be good technical action and could indicate more weakness is on the way. The expectations for higher interest rates and less regulation had investors excited back a few months ago, but with rates under pressure lately and continued uncertainty about when we'll see some action in Washington, the banks have fallen out of favor.



Source: Stockcharts.com.

Andrew Adams

10-Year Treasury Rate About to Rally?

Interest rates in the U.S. have steadily declined over the last few weeks, but the drop has brought the benchmark 10-Year U.S. Treasury rate to support on its weekly chart. The area around 2.20% is not only the post-election low, but a support line connecting the July and September lows from last year also intersects here and could provide a further boost. And if that level should fall, that would likely be a sign that rates want to drop more, which would likely make bonds an interesting near-term opportunity.

Source: Stockcharts.com.

Andrew Adams

Fed Action Has Not Immediately Boosted Interest Rates

The Federal Reserve raised the target federal funds rate in mid-March, only their third rate increase in the last several years. However, starting with that first rate ratchet in December 2015, shorter-term interest rates have actually fallen soon after each of the increases, with the Two-Year U.S. Treasury dropping from around 1.4% to 1.2% after this most recent action. The red vertical lines on the chart below represent the dates of the three Fed rate increases and the red arrows show the top in the yield around the raises.

Source: Stockcharts.com.

Andrew Adams

U.S. Dollar Pinball-ing

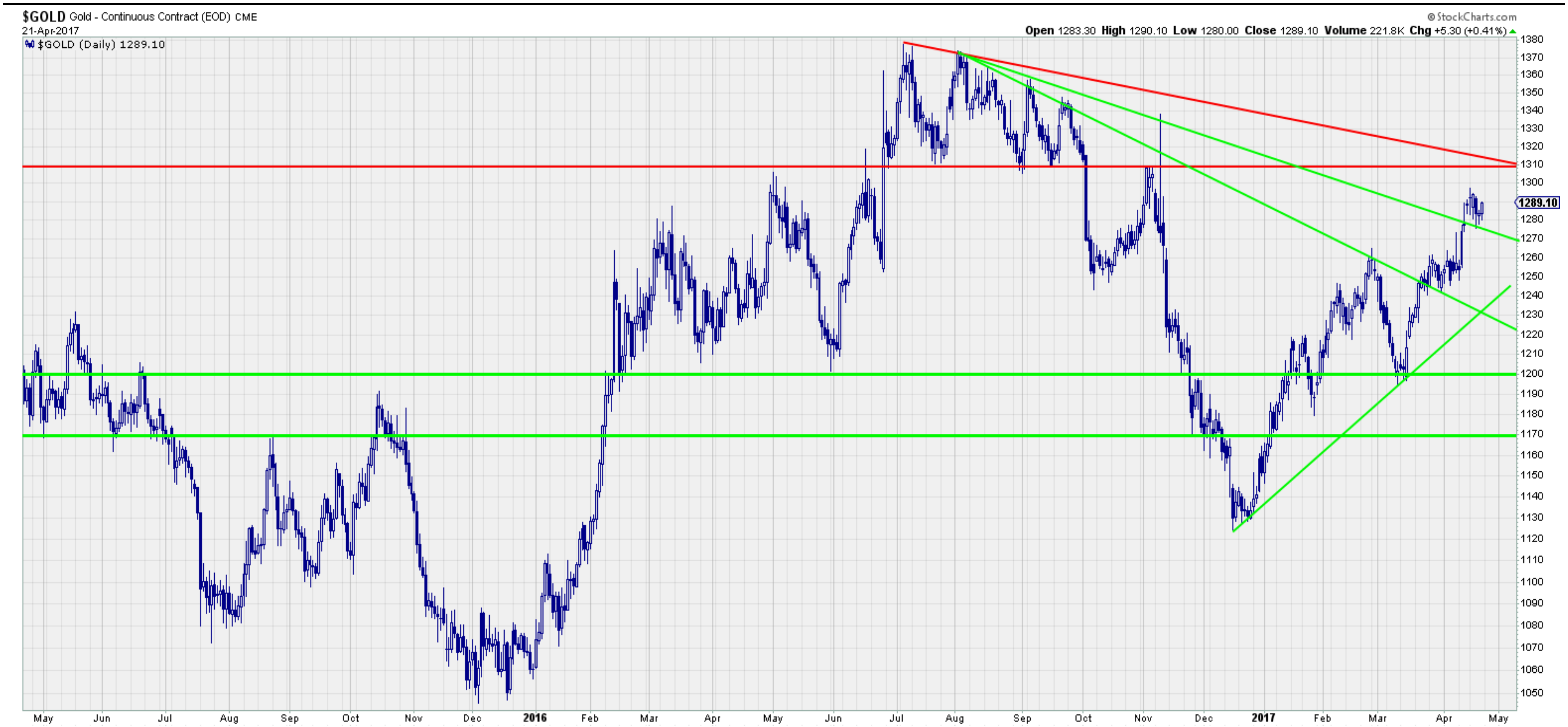
As interest rates have fallen recently, so has the U.S. Dollar Index. It continues to trade within a pretty clear pattern and only a break above or below the red and green lines will give us any hint on its next major move. The index fell back down to the green support line last week but it once again has provided a bounce so far.

Source: Stockcharts.com.

Andrew Adams

Gold in Favor Recently

Gold has been acting well over the last few weeks, likely a partial result of all the geopolitical uncertainty and tension with which we have dealt. It's sort of in a no-man's land right now, but should have some support underneath it around $1270-$1280. Meanwhile, $1300-$1310 could provide some resistance based on history.

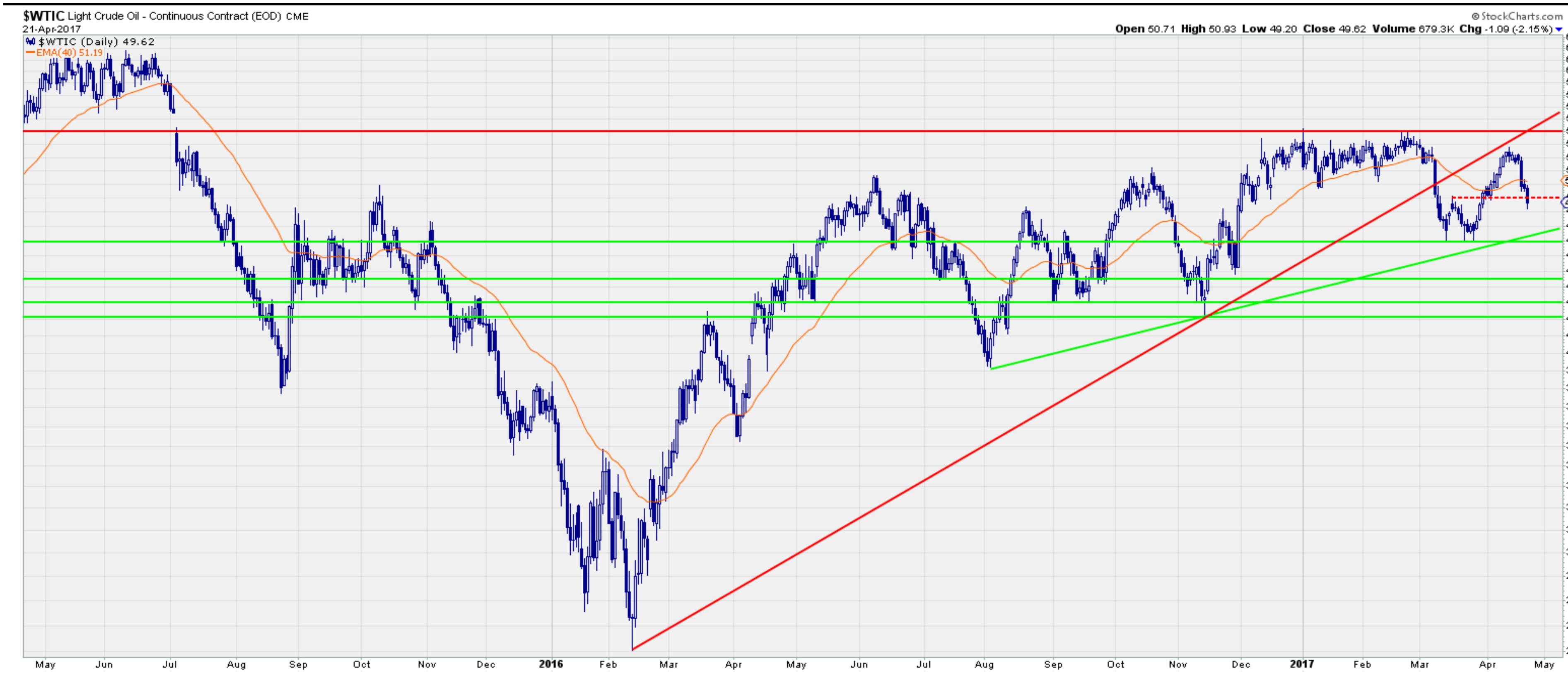


Source: Stockcharts.com.

Andrew Adams

Oil Becoming an Issue Again

Crude oil rallied hard from late March into mid-April to get back once again into the important $50-$55 range. However, the commodity was not able to break above the $55 resistance level and has now turned back over to fall into the $40s. It is still mostly range-bound, but the breakdown could be a sign that it wants to test $47 once again, a level that boosted its price three times last month. Lower oil should continue to put pressure on the Energy sector and may make it difficult for the broad market to begin another leg of its uptrend.



Source: Stockcharts.com.

Scott Brown

The Economy in Brief

Business sentiment and consumer confidence rose sharply into early 2017. However, these “soft data” measures have not been matched by an improvement in the “hard data.” The average monthly growth in private-sector nonfarm payrolls for the first quarter was the same as for all of 2016. Consumer spending, which accounts for about 69% of overall economic activity, slowed sharply in 1Q17 – leading to expectations that the Bureau of Economic Analysis will report meager growth in real GDP.

Following the failure to repeal the Affordable Care Act, much of the Trump agenda (including broad tax reform and large-scale infrastructure spending) appears doubtful. President Trump has reversed several of his campaign positions, backing away from major trade conflicts with Mexico and China, supporting the Export/Import Bank, and signaling that he might re-appoint Janet Yellen as Fed chair.

Soft consumer spending growth in 1Q17 should not be too troublesome. It’s not unusual to see a soft quarter following a strong quarter (real consumer spending rose at a 3.5% annual rate in 4Q16). The household sector fundamentals remain sound, but labor market constraints are still expected to limit economic growth in the quarters ahead.

Scott Brown

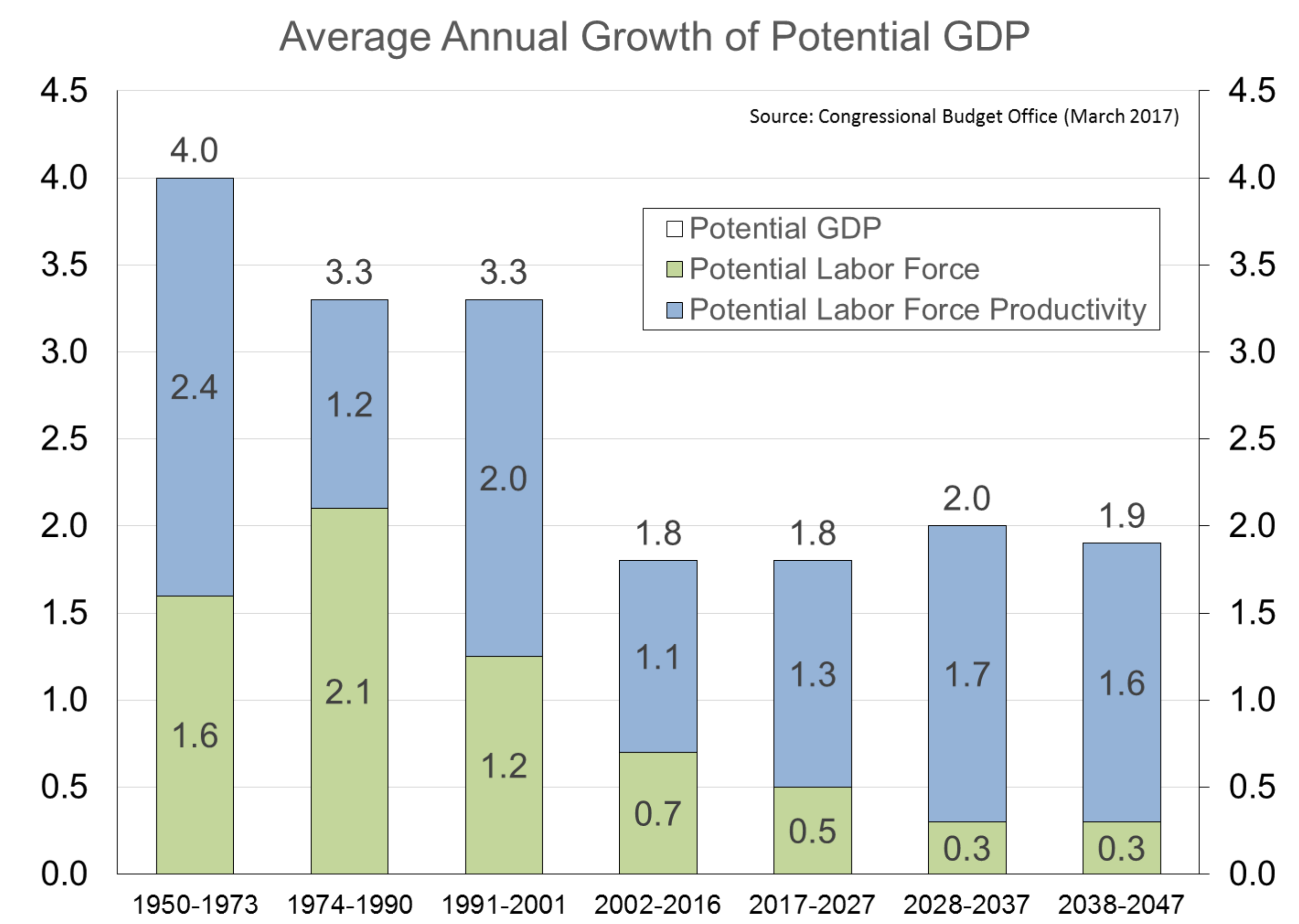
Economic Outlook – Key Themes

Moderate Growth

- Domestic economy
  - Consumer fundamentals remain strong (jobs, wages), but…
    - Gasoline prices are higher year-over-year, restraining purchasing power in the near term
    - Tax refunds were delayed compared to a year ago
    - Many healthcare deductible plans reset at the start of the year
    - Rents outpacing overall inflation
    - Some initial increase in auto loan delinquencies
    - Credit card balances currently high
  - Housing fundamentals are strong, but affordability and supply issues will continue
  - Business fixed investment likely getting some boost from improved sentiment
    - Need to see gains in consumer spending for that to last
- Long-term demographic restraints
    - Slower labor force growth than in previous decades
    - Fed notes some signs that labor market constraints are restraining economic growth
    - Better trend economic growth depends on stronger growth in productivity
- Rest of the world
    - Brexit negotiations set to begin (a two-year process) following the June 8 U.K. election
    - China economic restructuring likely to be uneven, concerns about high debt levels
    - Election uncertainty in France and Germany
    - Near-term global economic outlook has improved
    - Demographic constraints will limit the long-term pace of global growth

Scott Brown

Labor Force Growth Is Slower Than in 1950-2001



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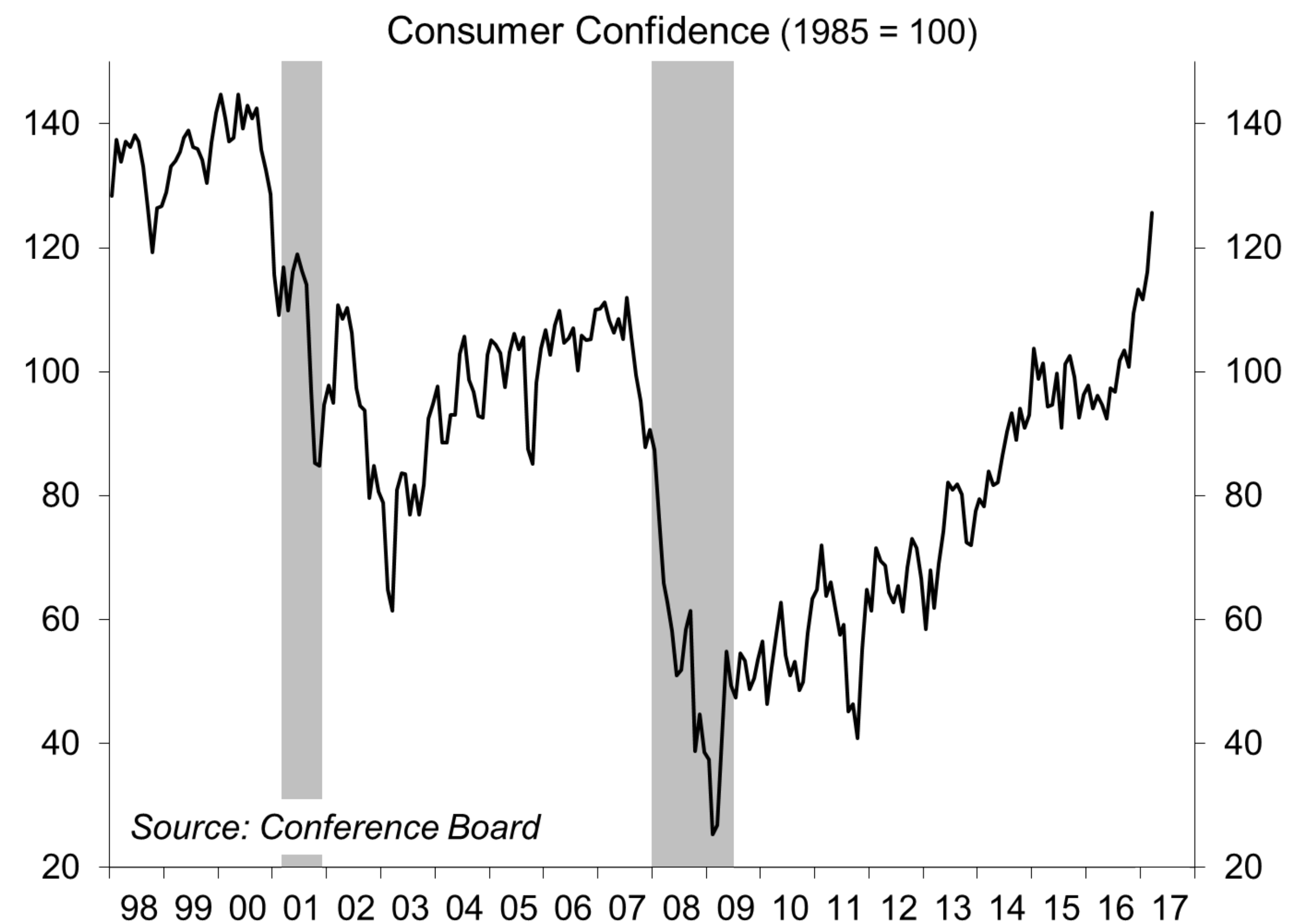
Consumer Confidence Is High



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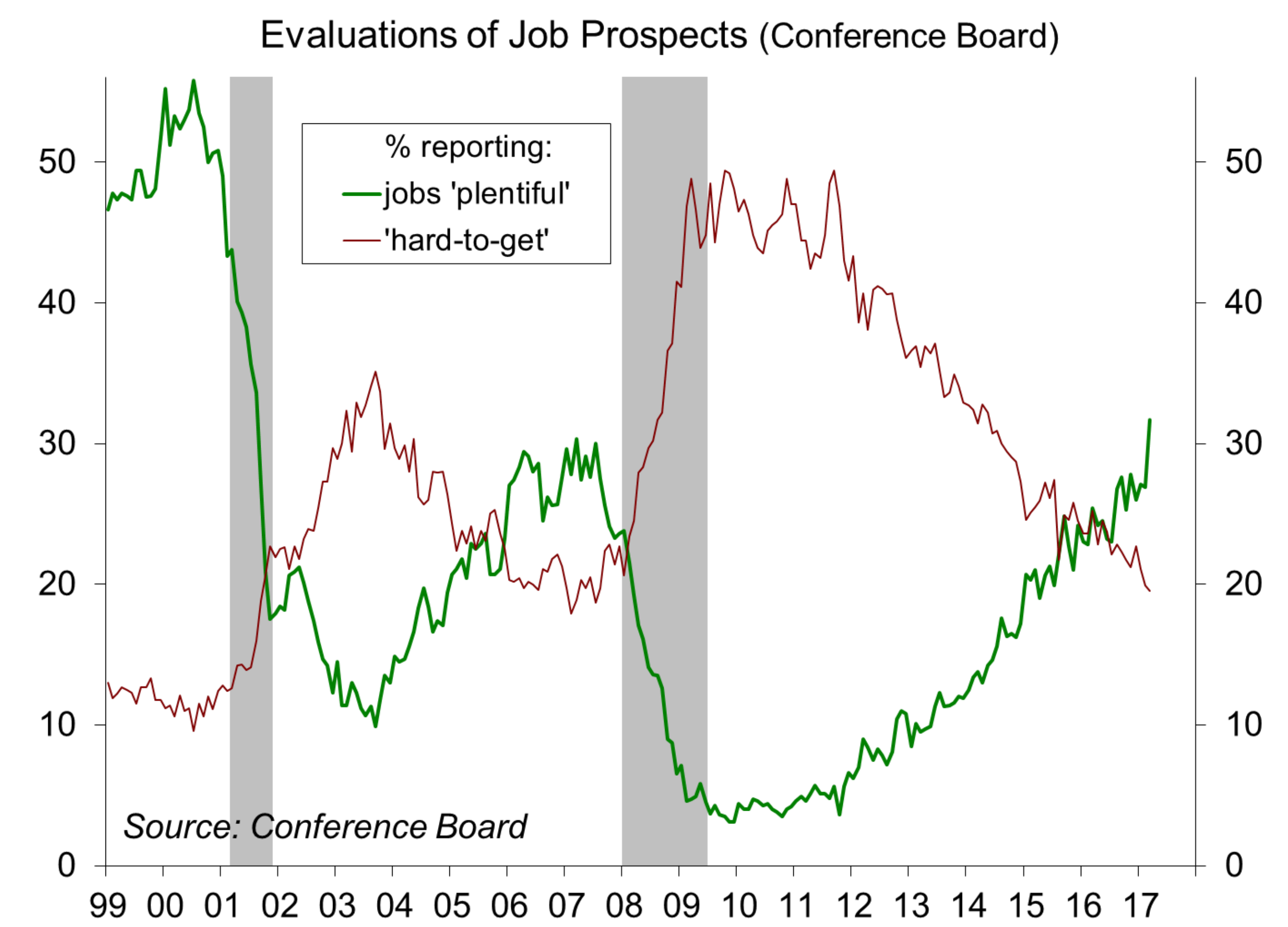
Job Market Perceptions Have Improved



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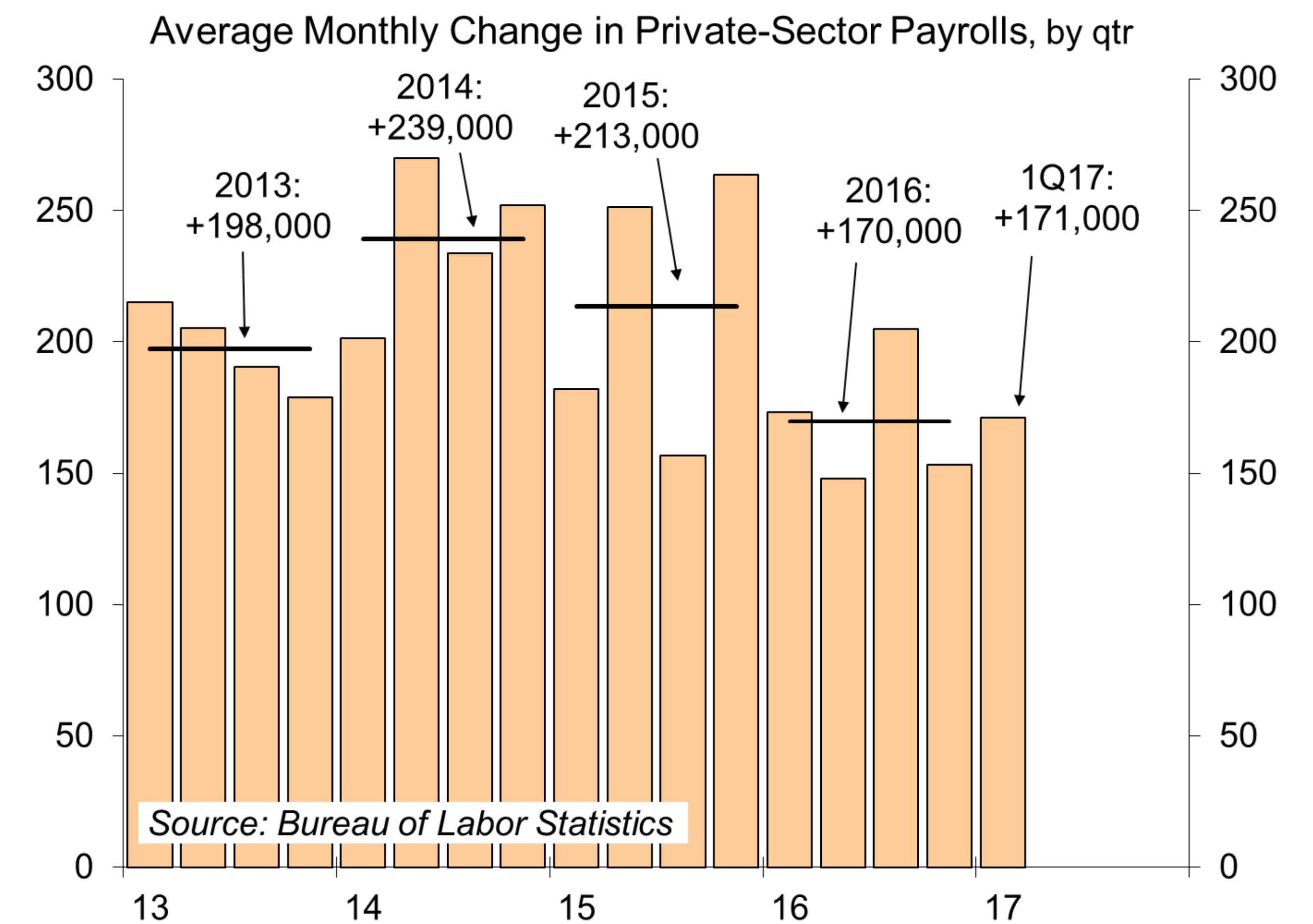
1Q17 Job Growth: More of the Same



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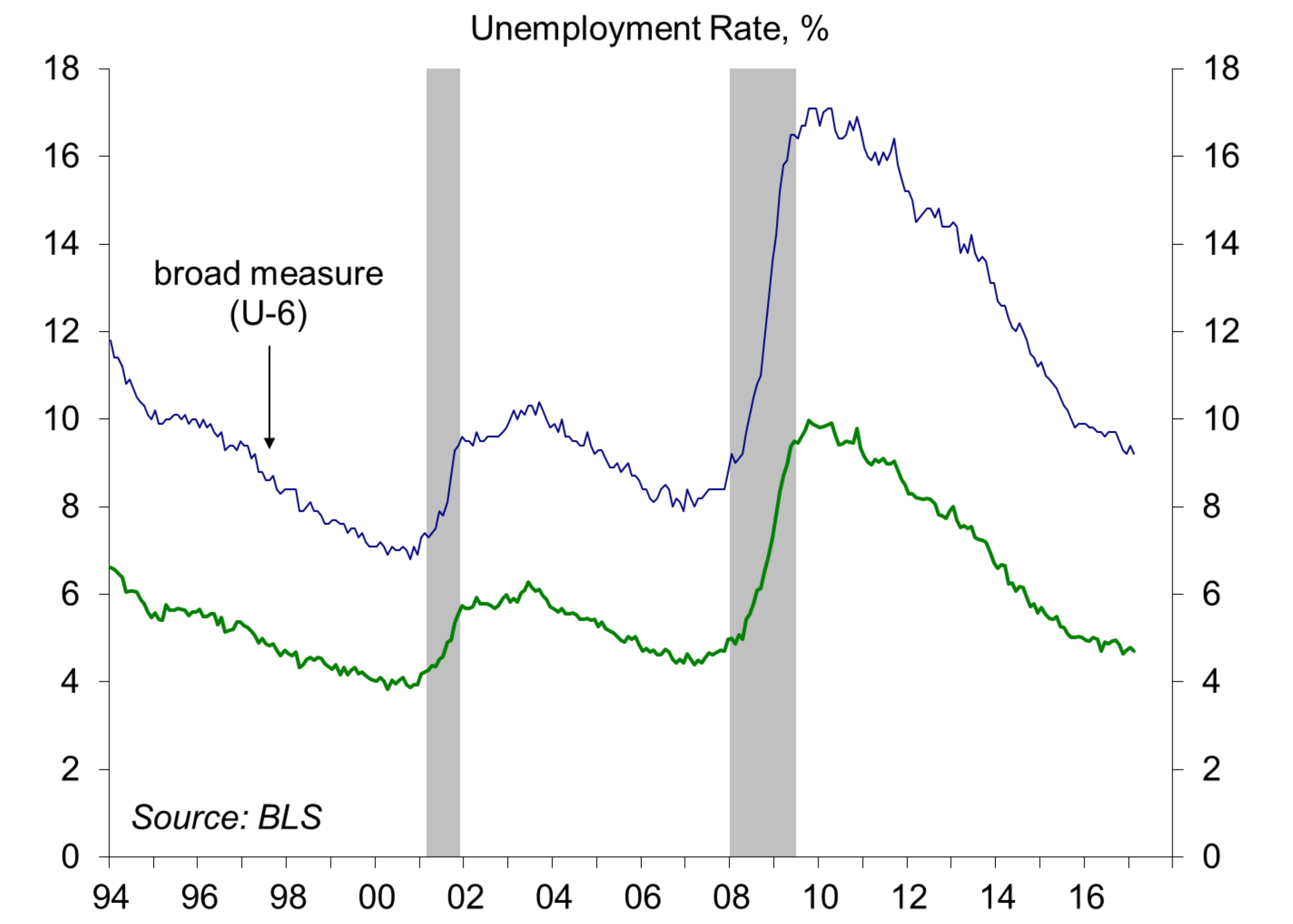
Unemployment Is Low



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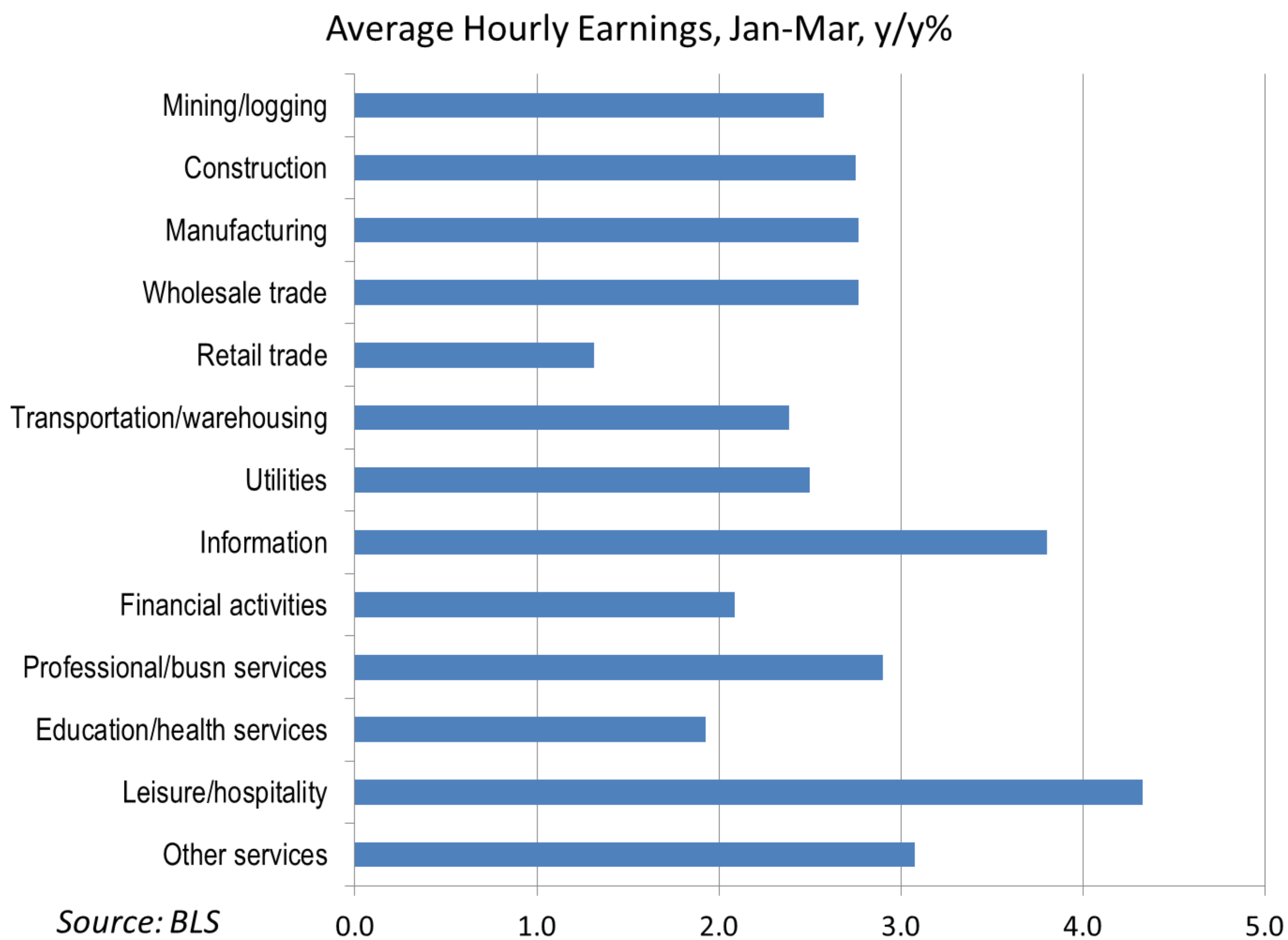
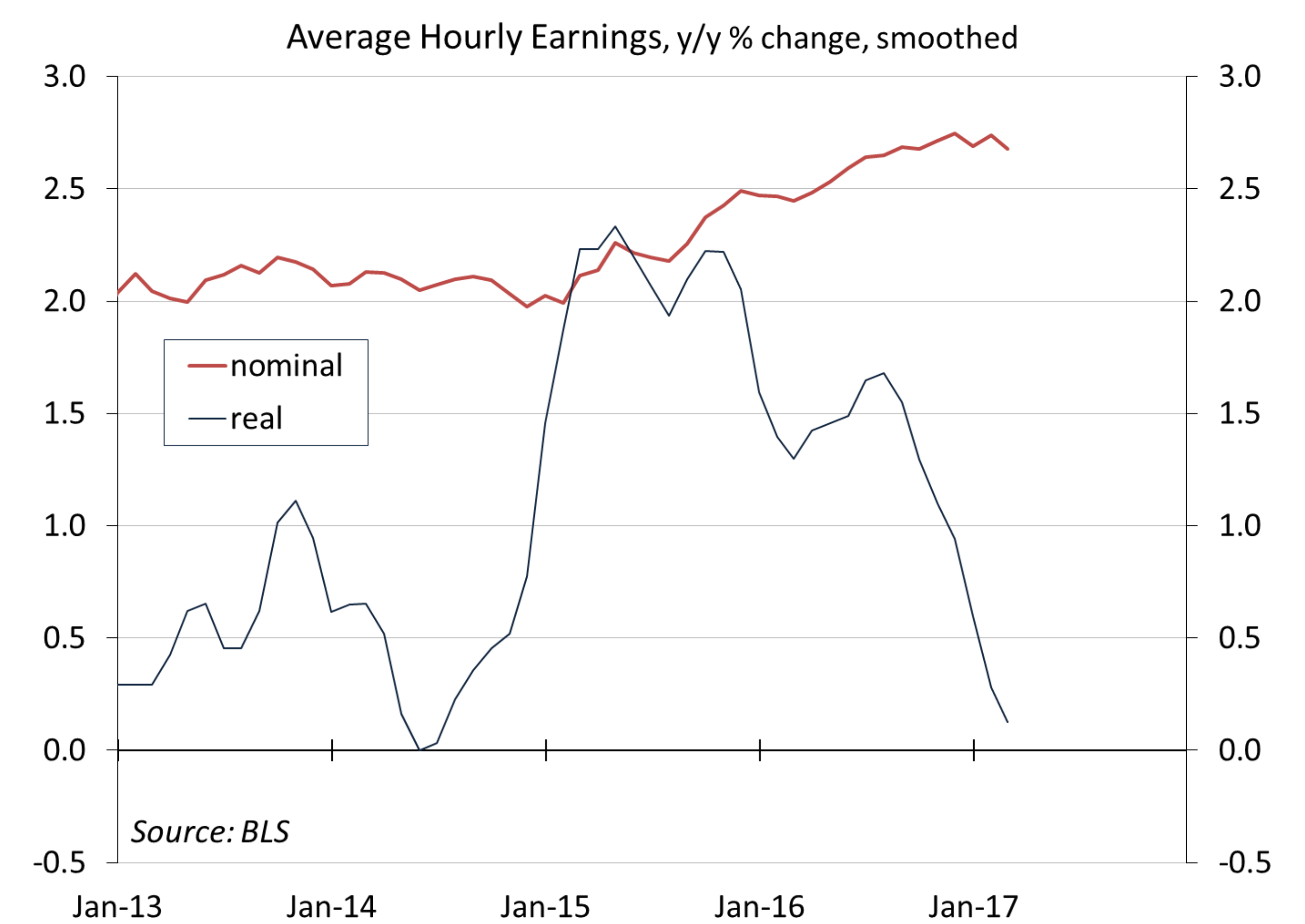
Average Hourly Earnings Have Risen Moderately



Source: BLS

Scott Brown

Inflation-Adjusted Wages About Flat Year-Over-Year



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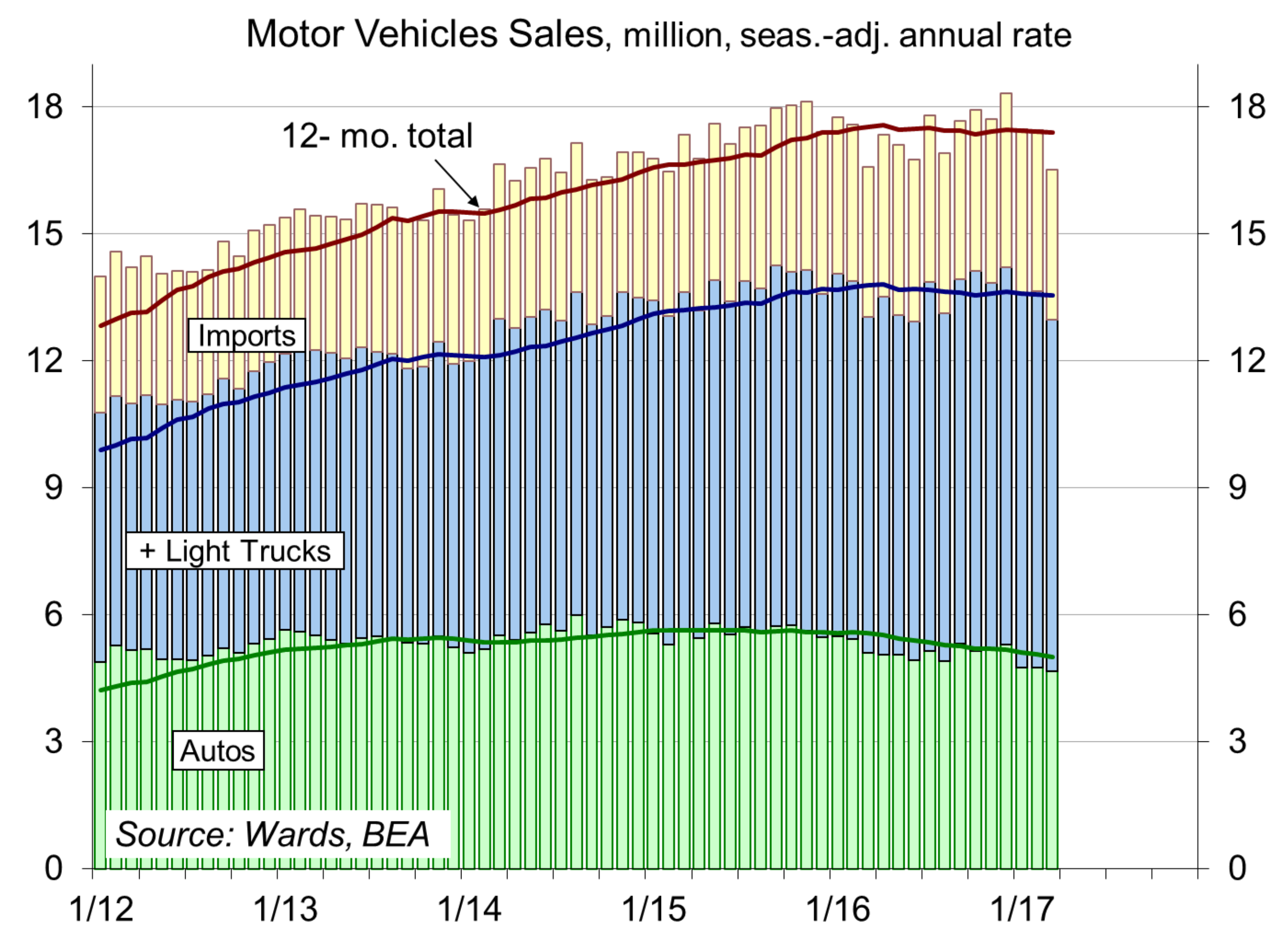
Unit Auto Sales Fell in March, Despite Heavy Discounting



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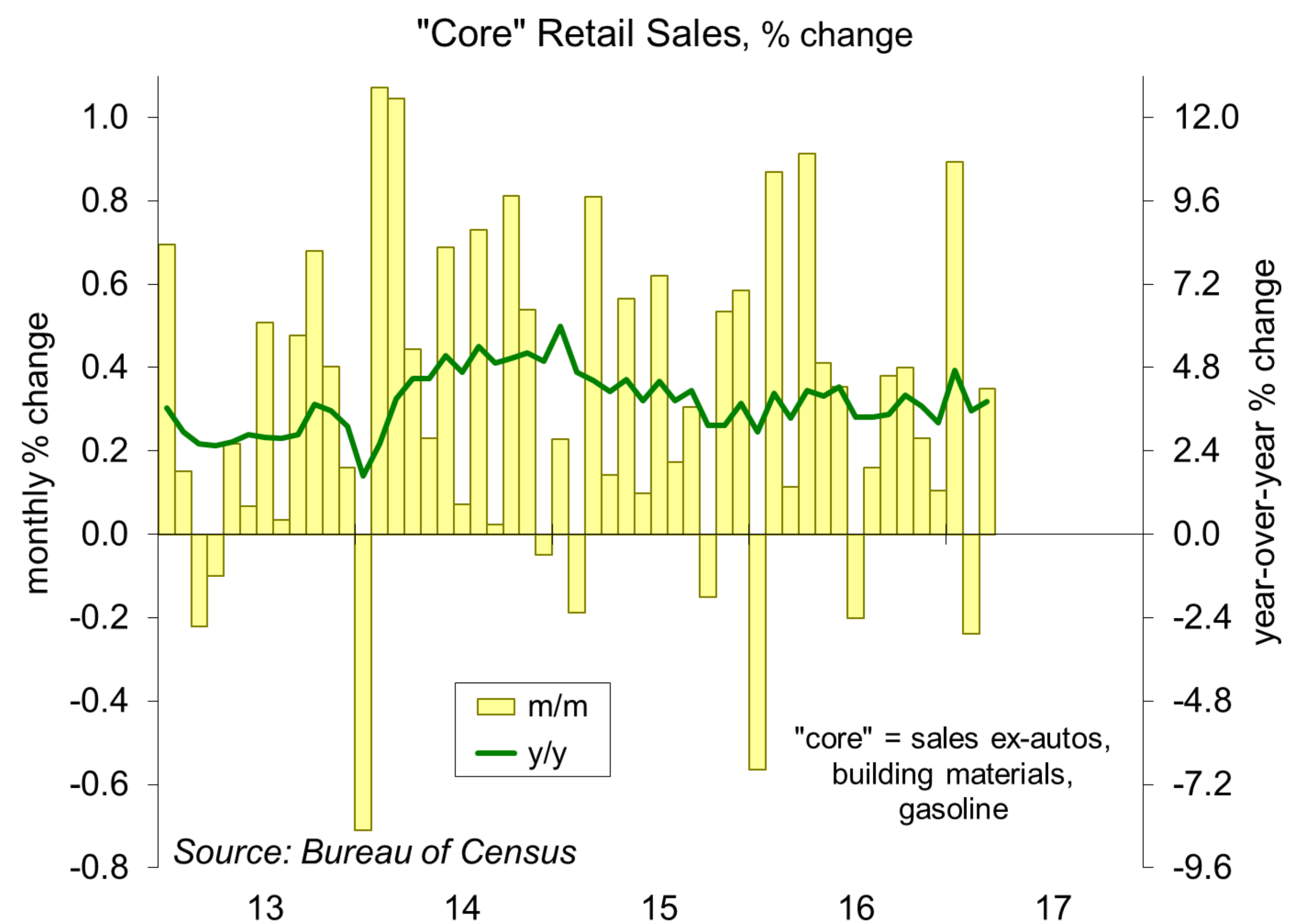
Growth in Core Retail Sales Remains Moderate



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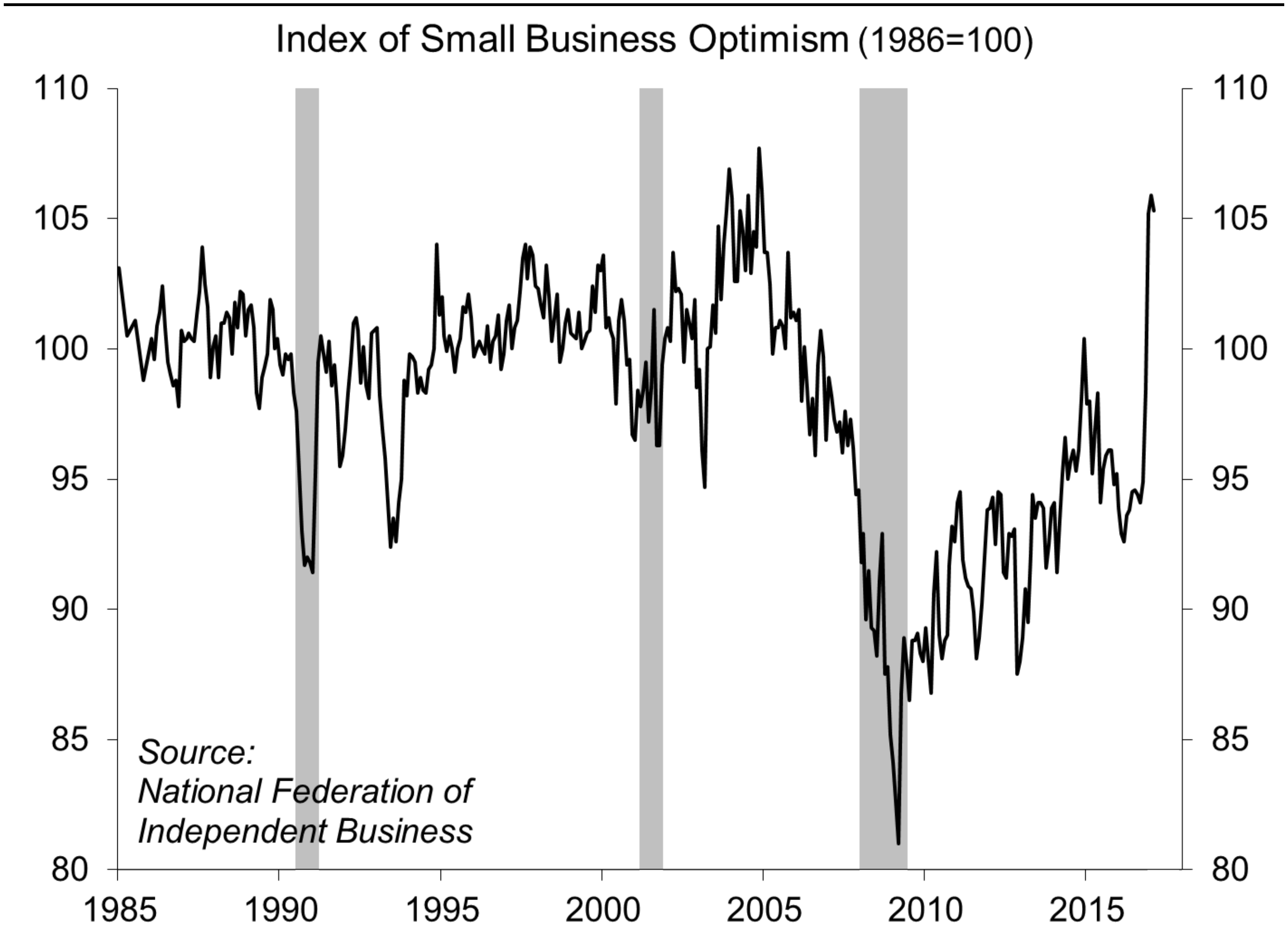
Small Business Optimism Remains Elevated



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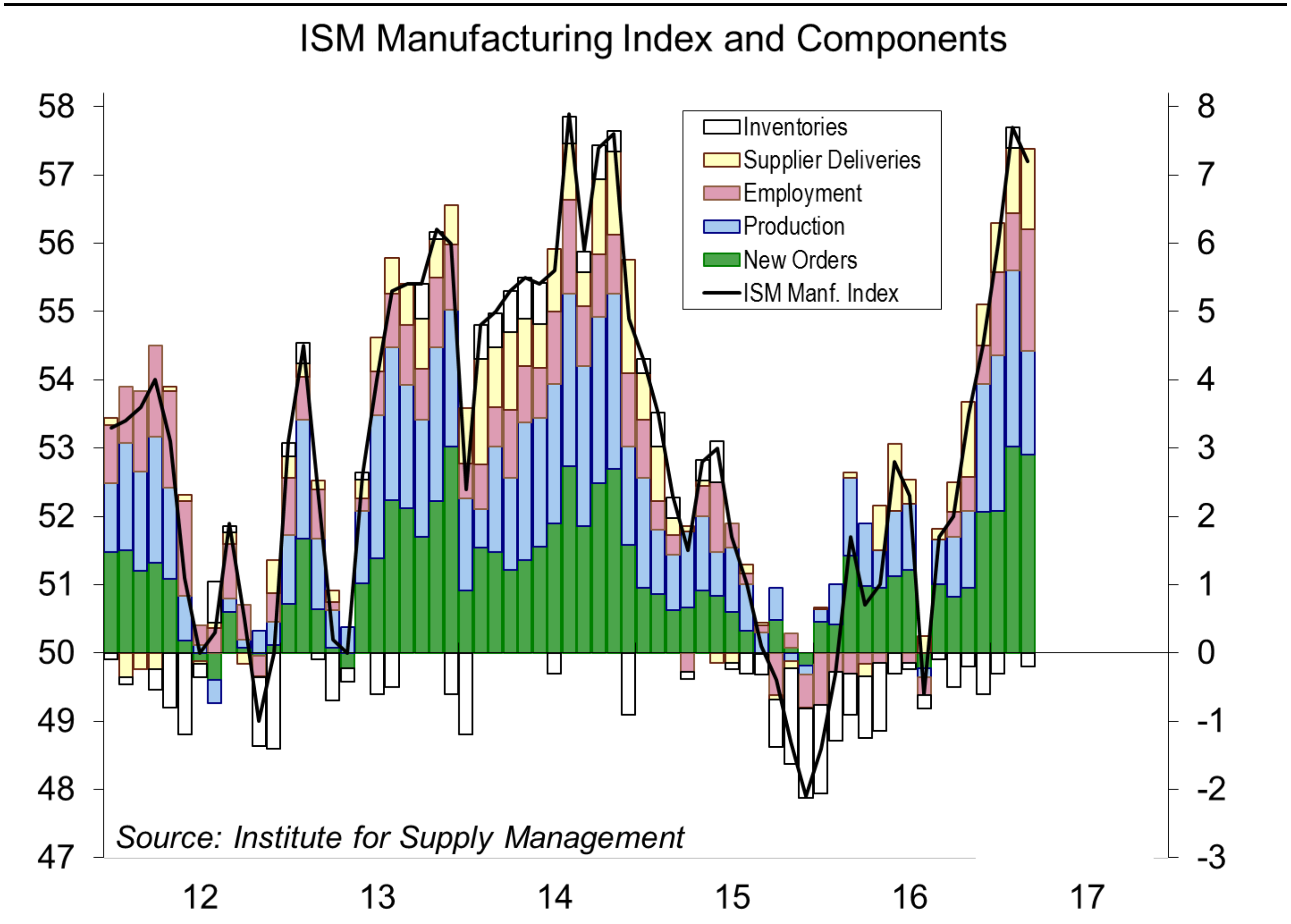
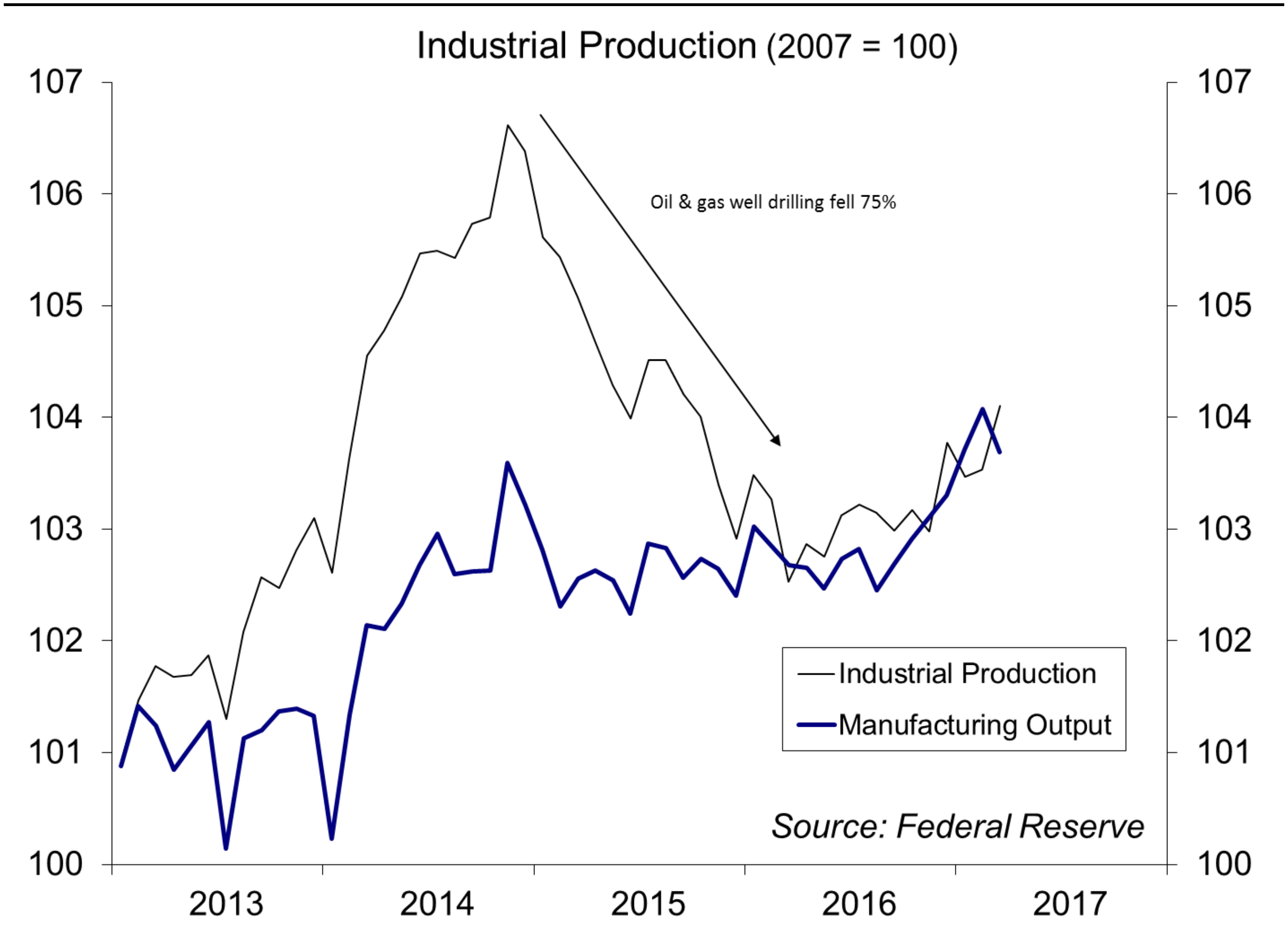
Scott Brown

Manufacturing Sentiment Has Picked Up



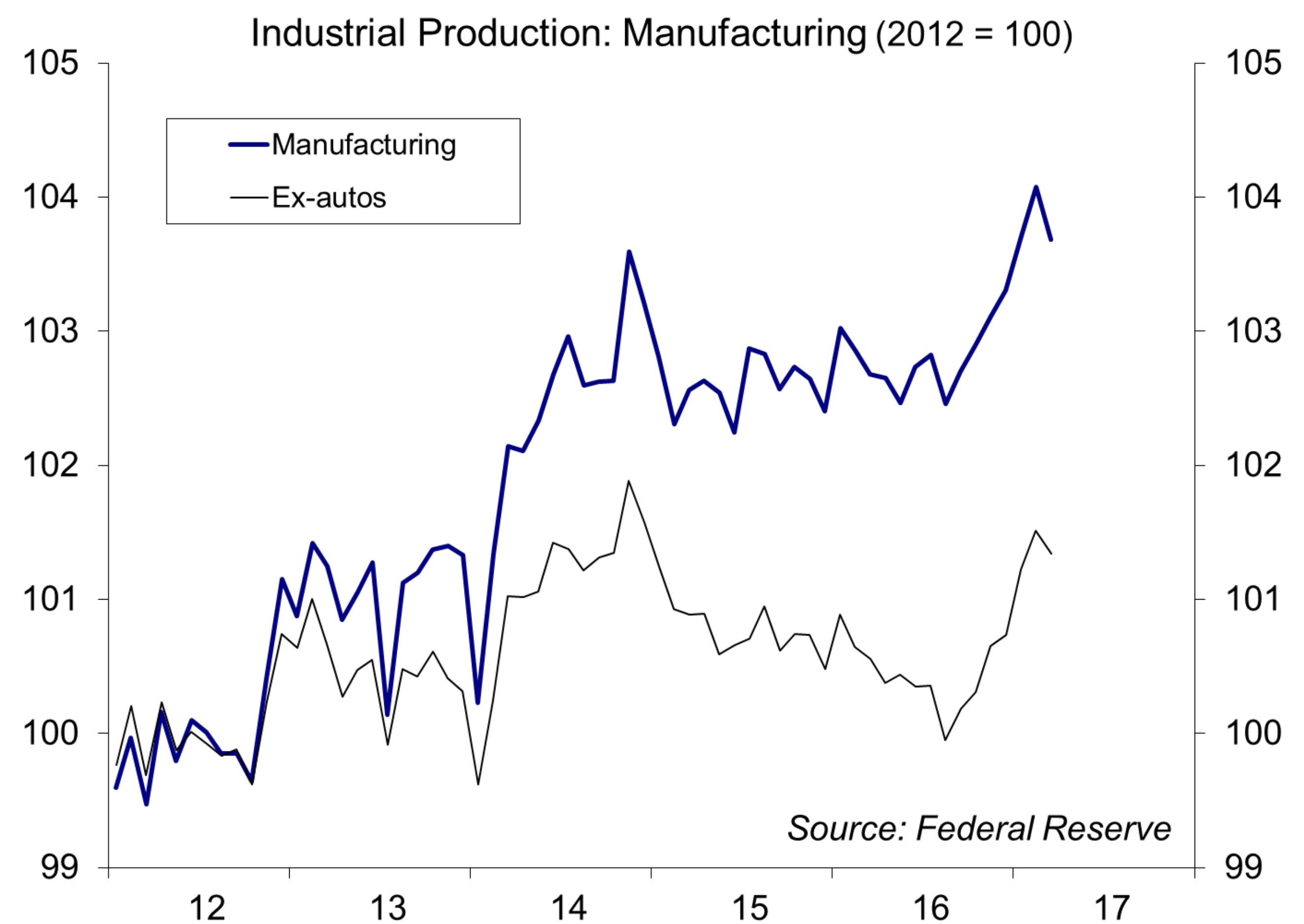
Scott Brown

The Drop in Energy Exploration Is Behind Us



Scott Brown

Factory Output Is Up From Last Summer, but Fell in March (Weather Was Likely A Factor)



Scott Brown

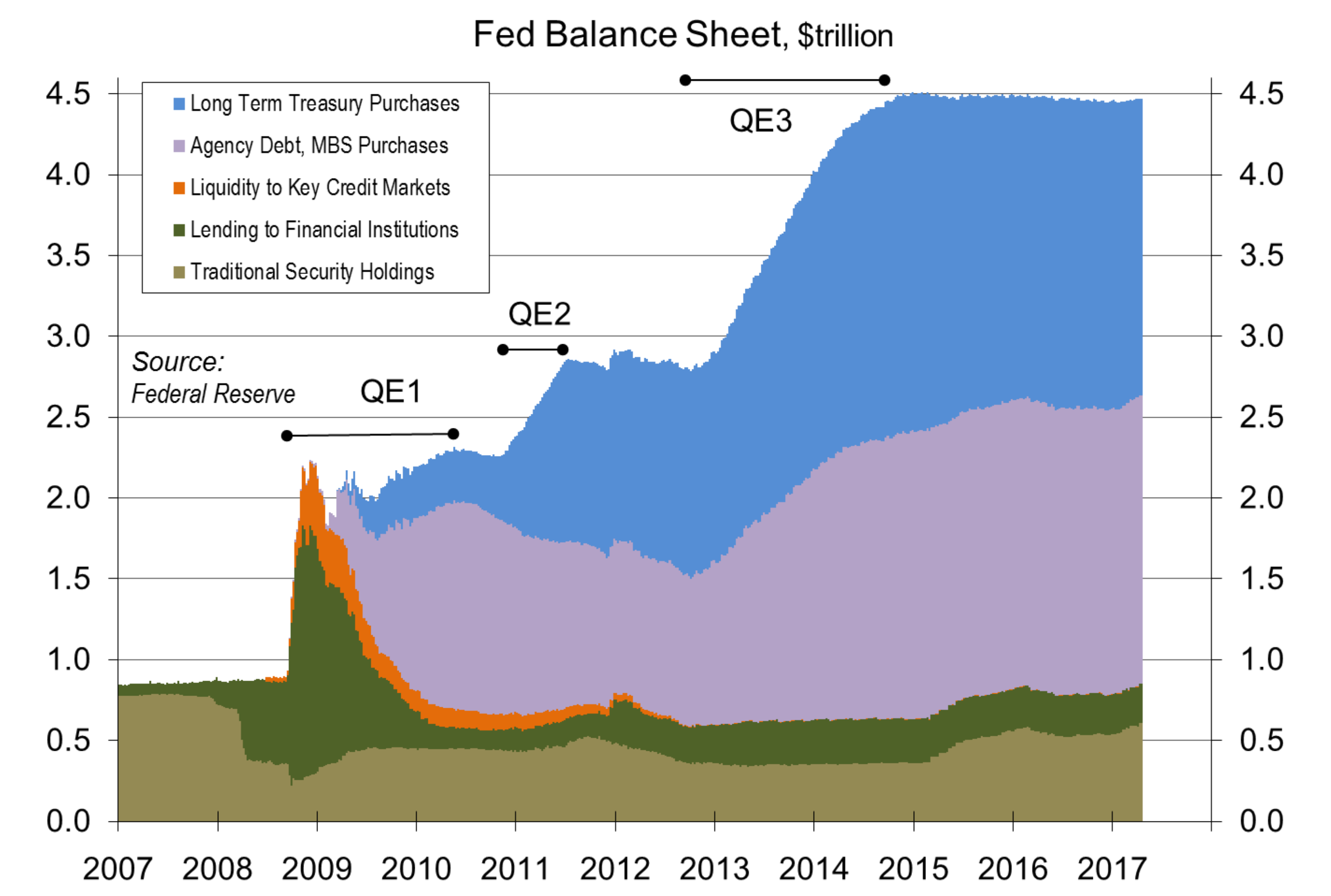
Federal Reserve Portfolio Reinvestment Policy

Through its large-scale asset purchase programs (QE1, QE2, and QE3), the Fed increased the size of its balance sheet by more the $3.5 trillion (see chart). Even before the Fed began to buy, it developed plans for eventually unwinding these purchases and reducing the size of its portfolio. Currently, the Fed purchases new securities to replace maturing Treasuries and Mortgage-Backed Securities, keeping the size of the balance sheet roughly steady. The Fed has long made it clear that the reinvestment policy would end sometime after it had raised the federal funds target rate.

Policy Normalization Principles and Plans (**September 17, 2014**): *"The Committee intends to reduce the Federal Reserve's securities holdings in a gradual and predictable manner primarily by ceasing to reinvest repayments of principal on securities held in the SOMA.* ***The Committee expects to cease or commence phasing out reinvestments after it begins increasing the target range for the federal funds rate; the timing will depend on how economic and financial conditions and the economic outlook evolve****. The Committee currently does not anticipate selling agency mortgage-backed securities as part of the normalization process, although limited sales might be warranted in the longer run to reduce or eliminate residual holdings. The timing and pace of any sales would be communicated to the public in advance."*

Scott Brown

The Fed's Balance Sheet Will Decrease Naturally Over Time (Perhaps 10 Years) As Securities Mature



Scott Brown

Federal Reserve Portfolio Reinvestment Policy

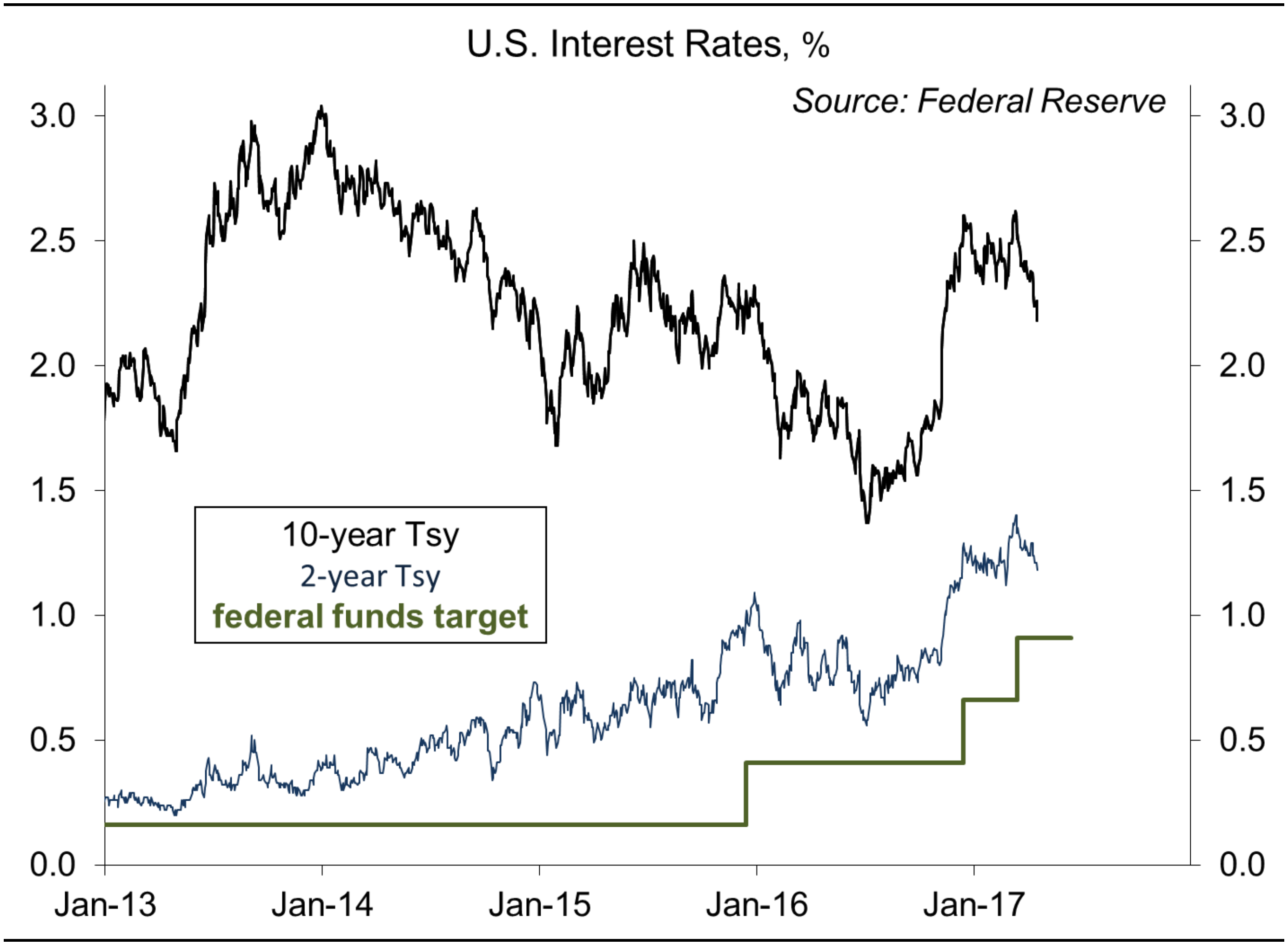
"Provided that the economy continued to perform about as expected, most participants anticipated that gradual increases in the federal funds rate would continue and judged that a change to the reinvestment policy would likely be appropriate later this year." -- FOMC Minutes (March 14-15)

Despite the reaction in the financial press, the Fed's expectation that the reinvestment policy will change later this year is not news. This has been well-telegraphed. **The impact on the financial markets ought to be minor, but the change may generate some confusion (and possible over-reactions)**. Thus, the Fed is likely to refrain from raising the federal funds rate when it makes the change (September seems likely, with rate hikes in both June and December – but that decision will depend on the economic data).

The size of the balance sheet will decline naturally over time, as securities mature. However, to keep the mix of securities balanced, the Fed expects to buy and sell securities of various maturities as the balance sheet decreases. There is no intent to sell securities outright. There will be some uncertainty about the implications for long-term interest rates. Possible legislative changes to Fannie Mae and Freddie Mac could also add uncertainty.

Scott Brown

Long-Term Interest Rates Have Declined Recently



Scott Brown

Economic Indicators

Economic Indicator	Status	Comments
Growth		GDP growth is expected to have been relatively soft in 1Q17, but should rebound in 2Q17. Still, the underlying trend will be limited by job market constraints.
Employment		Job growth remained moderately strong in 1Q17, consistent with a further tightening in overall labor market conditions. Job gains should slow as the job market continues to tighten.
Consumer Spending		The soft 1Q17 in consumer spending growth followed a strong 4Q16. Purchasing power has diminished as gasoline prices are higher than a year ago, but fundamentals remain sound.
Business Investment		Businesses are more optimistic, which should lift capital spending levels in the near term. Higher wage costs ought to lead to more productivity-enhancing investment over time.
Manufacturing		An improving global economy has helped exports. Auto sales and production appear to have plateaued. Ex-autos, factory output is mixed, but moderately higher.
Housing and Construction		Generally improving, but mixed (the spring season is key). Job growth remains supportive. The low end is constrained by high building costs and affordability issues.
Inflation		After some pick-up in January and February, the Consumer Price Index fell in March (reflecting one-offs in wireless telecom, used vehicles, and men's apparel). Wage pressures remain moderate (higher for higher-skilled positions).
Monetary Policy		Policy normalization is expected to continue, and a tighter labor market and (somewhat) higher inflation allows the Fed to move more aggressively than it did in 2015 and 2016. Still, future policy actions will remain data-dependent.
Long-Term Interest Rates		Constraints on the Trump agenda have reduced fears of a large surge in the federal budget deficit. Inflation pressures unlikely to be as strong as was anticipated earlier. Lower interest rates abroad should keep U.S. bond yields from rising rapidly
Fiscal Policy		State and local government budgets are in better shape and spending should add a bit to overall GDP growth. At the federal level, the timing, character, and scale of infrastructure spending and tax cuts is very much in doubt, but expectations have been pared back.
The Dollar		Likely range-bound in the near term, but may soften following a less-aggressive stance in foreign trade policy (no NAFTA cancellation, China "not a currency manipulator").
Rest of the World		Brexit pain lies ahead for the U.K. and China's transition is likely to be uneven, but the global economic outlook is a brighter. The possibility of trade conflicts is a decreased risk.

Scott Brown

Key Calendar Dates

April 27	Durable Goods Orders (March)
April 28	Real GDP (1Q17, advance estimate) Employment Cost Index (1Q17)
May 1	ISM Manufacturing Index (April)
May 3	ADP Payroll Estimate (April)
	ISM Non-Manufacturing Index (April)
	FOMC Policy Decision (no press conference)
May 5	Employment Report (April)
May 12	Consumer Price Index (April)
	Retail Sales (April)
May 16	Building Permits, Housing Starts (April)
	Industrial Production (April)
May 25	Memorial Day Holiday (markets closed)
June 2	Employment Report (May)
June 14	FOMC Policy Decision (Yellen press conference)
July 26	FOMC Policy Decision (no press conference)
September 20	FOMC Policy Decision (Yellen press conference)

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