October 14, 2024

Morning Briefing

Happy Second Birthday!

Check out the accompanying chart collection.

Executive Summary: As the bull market turns two, Dr. Ed fondly recollects the performance of the young raging bull. At times, the bull charged and at times stomped its hooves on the ground in reaction to the monetary policy, earnings expectations, and economic outlooks waved in front of it. Yet the bull trampled even our heady expectations this year, passing our year-end S&P 500 forecast ahead of schedule. At the risk of more hoof marks, we're maintaining our year-end targets of 5800, 6300, and 6800 for 2024-26. They reflect a bullish earnings outlook, which reflects rising profit margins in our Roaring 2020s scenario, hinging on a tech-led productivity boom. We might increase our 30% meltup odds if the bull keeps charging ahead over the remainder of this year.

YRI Weekly Webcast. Join our live webcast with Q&A on Mondays at 11 a.m., EST, with Ed and Eric. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available *here*.

Strategy I: Anatomy of a Bull Market. The current bull market started two years ago. We've loved it from the start even though it was among the most widely hated bull markets in history. Its many detractors all were in the hard-landing camp. They were sure that the tightening of monetary policy from March 2022 through August 2024 would cause a recession and a bear market. Consider the following:

(1) *S&P 500 and LEI.* The bears were right for a while when the S&P 500 fell 25.4% from January 3, 2022 through October 12, 2022 (*Fig. 1*). That jibed with the Index of Leading Economic Indicators (LEI), which includes the S&P 500 as one of its 10 components. However, the S&P 500 started to diverge from the LEI during the final through months of 2022 through today, as the latter has continued to fall through August of this year.

The LEI is down 15.5% from its record high on December 2021. The S&P 500 is 21.2% above its previous record high on January 3, 2022.

(2) *S&P 500 and CEI*. The S&P 500 recovered from its relatively short bear market because

the economy did not fall into a recession as was widely feared. Indeed, the Index of Coincident Economic Indicators (CEI) continued rising into record-high territory during the period of monetary tightening (*Fig. 2*). That's what it typically did in the past until the tightening triggered a financial crisis that turned into a credit crunch and a recession.

This time has been different because the Fed averted this chain of events during March 2023, when a banking crisis emerged, by providing an emergency liquidity facility. It worked like a charm, so much so that the Fed raised the federal funds rate by 25bps on March 22, right after the crisis, did so again two more times in May and July of 2023, and didn't start cutting the rate until September of this year.

(3) *S&P 500 forward earnings*. While we didn't flinch in our commitment to the no-landing economic scenario, industry analysts did so from June 2022 through February 2023. S&P 500 forward earnings per share (which is the time-weighted average of their operating EPS estimates for the current year and coming year) dipped back then (*Fig. 3*).

We are big fans of this series, which closely tracks the CEI. However, we sided with the CEI, which continued making new record highs while forward earnings was dipping. Now both series are at record highs.

(4) *S&P 500 actual earnings*. There was no recession in actual S&P 500 EPS, which rose from $208.1 in 2021 to $218.1 in 2022 to $221.4 in 2023 (Fig. 4). EPS is on track to hit $242.11 this year, $276.10 next year, and $312.17 in 2026 according to the latest analysts' consensus estimates. We are still forecasting $250 this year, $275 next year, and $300 in 2026.

On a quarterly basis, there have been only three modest negative y/y readings in earnings growth since the start of 2021: Q4-2022 (-1.5%), Q1-2023 (-3.1%), and Q2-2023 (-5.8%). The S&P 500's latest bull market started before those negative readings were available.

(5) *S&P 500 forward P/E.* On October 12, 2022, the forward P/E of the S&P 500 bottomed at 15.3 (*Fig. 5*). The bears couldn't believe that their bear market could have ended with the valuation multiple that high. But that's what it did. We had no problem believing it, as noted below.

(6) *Just another bull market.* In any event, the S&P 500 bottomed on October 12, 2022 and is up 62.6% since then (*Fig. 6*). That's about on par with the previous eight bull markets.

Strategy II: Not Bullish Enough. After the S&P 500 closed at 4769.83 on the last trading day of 2023, our 2024 year-end target for the S&P 500 was 5400, which was among the most bullish forecasts among Wall Street's investment strategists. It was exceeded on June 12. So we raised it to 5800. That level was exceeded on Friday last week.

It was a similar story in 2023: At the end of 2022, when the S&P 500 was 3839.50, we forecast that the S&P 500 would end 2023 at 4600. That was also among the most bullish forecasts out there. It came close to exceeding our year-end target five months ahead of schedule on July 31. We kept it there and predicted a 10% correction, which occurred as we expected. The S&P 500 ended 2023 at 4769.83, slightly above our target.

So what do we do now? We are sticking with our forecast of 5800 by year-end, 6300 in 2025, 6800 in 2026, and 8000 by the end of the decade in 2029. Our targets are based on our bullish outlook for S&P 500 forward earnings at the ends of 2024, 2025, 2026, and skipping ahead to 2029 of $275, $300, $325, and $400. We are using a forward P/E of 21.0 for each year to derive our S&P 500 year-end targets (*Fig. 7*, *Fig. 8*, and *Fig. 9*).

And by the way, our bullish outlook for earnings assumes that the S&P 500 profit margin will increase to record highs of 14.0% and 14.6% over the next two years, consistent with our productivity-led Roaring 2020s scenario (*Fig. 10*).

For the past three years, Joe, Eric, and I have been among the most bullish investment strategists on the Street. Yet we've been trampled by the stampeding bull this year. We have hoof marks on our backs.

We could choose to run ahead of the bull market and forecast 6000 or higher for the S&P 500 by the end of this year, as have other investment strategists recently. We aren't joining them, for now. Our underlying forecasts for S&P 500 revenues, the profit margin, earnings, and the valuation multiple are all bullish enough, in our opinion.

We think that the year-end Santa Claus rally got a head start in September this year thanks to "Santa Jay," better known as Fed Chair Jerome Powell. So far, there hasn't even been a year-end tax-loss selling season, as often sets the stage for a Santa Claus rally at year-end.

If the stock market continues to fly to new highs, we will probably raise our 30% subjective probability of a 1990s-style meltup scenario. We are currently also assigning 50% to our Roaring 2020s scenario that lifts both the economy and the stock market, and 20% to a 1970s-style stagflationary outlook, the worst case for stocks.

Strategy III: A Bull Market for All Seasons. Birthdays and anniversaries are usually times for nostalgic reflection. So we went back in time to see what we wrote when the young bull was born two years ago:

(1) *Our October 12, 2022* [commentary] was titled "The Most Widely Anticipated Recession In History." We were bullish on the economy during 2022 when the consensus became increasingly convinced that the economy was heading into a recession. We wrote that the "US economy is actually doing well even though we think it has been in a 'rolling recession,' hitting different industries at different times, since the start of this year. So rather than a hard landing, we think we are already experiencing a soft landing, a.k.a. a 'growth recession.'"

Indeed, as first reported in 2022, real GDP fell 1.4% (saar) during Q1 and 0.9% during Q2, but then rose 2.6% and 2.9% during Q3 and Q4. However, on September 26, 2024, the Bureau of Economic Analysis revised these numbers higher to -1.0%, 0.3%, 2.7%, and 3.4%, respectively. So even the technical recession during H1-2022 was revised away. In addition, the level of real GDP during Q2-2024 was revised up by 1.3% (*Fig. 11*). It had been widely expected that real GDP would be revised down to close its widening gap with real Gross Domestic Income (GDI). Instead, the level of real GDI was revised higher by 3.6% (*Fig. 12*, *Fig. 13*, and *Fig. 14*).

(2) *Our October 18, 2022* commentary was titled "Going Fishing." We were fishing for bottoms in stock and bond prices. We saw a double bottom in the S&P 500: "We are thinking that instead of a V-shaped capitulation bottom, the S&P 500 may very well remain in a volatile trading range around the June 16 low of 3666 for a while longer before moving back toward the August 16 high of 4305 over the rest of this year." The S&P 500 rose as high as 4080.11 by the end of November before ending the year at 3839.50.

(3) *Our October 31, 2022* commentary was titled "Bear Bottoms." We wrote: "The bear market has clawed 30% out of stock valuations, returning the S&P 500's forward P/E to its historical average of 15. But October 12 may have marked the bear's bottom. If GDP and inflation perform as we expect and the Fed does what everyone expects, that bottom should hold."

(4) *Our March 16, 2022* commentary was the first in which we nailed the economy and the stock market outlooks. That was because we nailed the outlook for inflation. We thought it would moderate without an economy-wide recession. We wrote the following on March 16,

2022: “At the beginning of last week, Debbie and I raised our inflation forecast as a result of the Ukraine crisis. We now expect that the core PCED inflation rate will peak at 6.0%-7.0% around mid-year and fall to 4.0%-5.0% by the end of the year. Then it might decline to 3%-4% in 2023, maybe.” During H2-2023, we projected that it would fall to 2.0%-3.0%.

Calendars

US: **Mon:** Federal Budget Balance $61.0b; Consumer Inflation Expectations; OPEC Monthly Report; Kashakri. **Tues:** NY Empire State Manufacturing Index 3.40; IEA Monthly Report; Daly; Bostic. (FXStreet estimates)

Global: **Mon:** Dhingra. **Tues:** Eurozone Industrial Production 1.8%m/m/-1.2%y/y; Eurozone ZEW Economic Sentiment 16.9; Germany ZEW Economic Sentiment 10.2; Germany WPI 0.2%; France CPI -1.2%m/m/1.5%y/y; Spain CPI -0.1%/m/1.7%y/y; UK Average Earnings Including & Excluding Bonus 3.8%/5.0%; UK Claimant Count Change 20.2k; UK Unemployment Rate 4.1%; Canada CPI -0.2%m/m/1.2%y/y; Japan Industrial Production -3.3%; Japan Core Machinery Orders -0.1%m/m/3.6%y/y; Nagel. (FXStreet estimates)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index rose 1.2% last week to close at a record high. The AC World ex-US index dropped 0.4% w/w to 3.2% below its June 15, 2021 record high. EMU was the best performing region last week with a gain of 0.5%, followed by Europe (0.5%), EMEA (0.4), EAFE (0.2), and the AC World ex-US. EM Latin America was the worst regional performer, with a drop of 2.9%, followed by EM Asia (-1.9) and EM (-1.7). Eight of the 17 major selected country markets that we follow rose last week. Taiwan performed the best, with a gain of 3.5%, followed by Switzerland (1.4), the United States (1.2), and Germany (0.8). China was the worst performer, tumbling 7.0%, followed by Hong Kong (-6.6), Brazil (-3.7), Mexico (-2.3), and Sweden (-1.0). The US MSCI’s 21.7% ytd gain remains well ahead of the AC World ex-US index’s (10.0). EM Asia is still ahead of the pack as the leading region ytd with a gain of 18.7%, followed by EM (13.3) and the AC World ex-US. The worst performing regions so far in 2024: EM Latin America (-18.0), EMEA (3.9), Europe (7.9), EMU (8.0), and EAFE (8.2). Looking at the major selected country markets that we follow, Taiwan is now the best ytd performer with a gain of 32.4%, followed by China (25.8), the United States (21.7), India (20.7), and South

Africa (17.1).

US Stock Indexes (*[link]*): Forty-six of the 48 major US stock indexes that we follow rose w/w, up from 25 rising a week earlier. The S&P 500 LargeCap Transportation index was the best performer, with a gain of 5.0%, ahead of S&P 500 LargeCap Pure Growth (2.7%), Dow Jones 20 Transports (2.7), and Russell MidCap Growth (2.4). The Dow Jones 15 Utilities index was the worst performer with a decline of 1.9%, followed by Nasdaq Industrials (-0.5), S&P 600 SmallCap Pure Growth (0.1), and S&P 600 SmallCap Pure Value (0.2). Looking at their ytd performances, all 48 indexes are now positive so far. The S&P 500 LargeCap Growth index remains in the top spot as the best performer so far in 2024, with a gain of 29.0%, ahead of S&P 500 LargeCap Pure Growth (27.1), Russell 1000 Growth (25.4), S&P 100 MegaCap (25.1), and Russell 3000 Growth (24.8). The worst performing major US stock indexes ytd: S&P 600 SmallCap Pure Value (0.8), S&P 400 MidCap Pure Value (2.0), Dow Jones 20 Transports (2.1), S&P 600 SmallCap Value (3.2), and S&P 600 SmallCap Equal Weighted (3.8).

S&P 500 Sectors Performance (*link*): Six of the 11 S&P 500 sectors rose last week, and four were ahead of the S&P 500's 1.1% gain. That compares to six sectors rising a week earlier when five were ahead of the composite index's 0.2% gain. The outperformers last week: Information Technology (2.5%), Industrials (2.1), Financials (1.8), and Health Care (1.5). The underperformers last week: Utilities (-2.6), Communication Services (-1.4), Consumer Discretionary (-0.8), Energy (-0.5), Real Estate (-0.3), Consumer Staples (0.3), and Materials (1.0). The S&P 500 is up 21.9% ytd, with all 11 sectors in positive territory and four sectors ahead of the index. During the September 6 week, a ytd high of five sectors were ahead of the index for the first time since mid-May. Information Technology is now the best ytd performer with a gain of 32.2%, ahead of Communication Services (27.9), Utilities (25.0), and Financials (23.5). These sectors are lagging the S&P 500 so far in 2024: Real Estate (8.3), Consumer Discretionary (11.2), Energy (11.6), Materials (12.2), Health Care (12.9), Consumer Staples (14.9), and Industrials (21.3).

US Economic Indicators

Consumer Price Index (*link*): Both the headline and core CPI came in above expectations in September, though the yearly headline rate eased for the sixth successive month. *Headline* CPI rose 0.2% (vs 0.1% expected), while the *core* rate increased 0.3% (vs 0.2% expected). On a *year-over-year basis,* the *headline* rate slowed to 2.4%, its lowest rate since February 2021 and down from June 2022's peak rate of 9.1%. Meanwhile, the core rate ticked up to 3.3% in September, after slowing from September 2022's 6.6% to 3.2% in both July and August of this year—which were three-year lows. *Goods inflation* fell 1.3% y/y in September, with durable goods prices dropping 2.9% y/y, down from the 18.2% peak in January 2022, while the rate for nondurable goods (-0.7% y/y) was just below zero, down from 14.4% in June 2022. *Services excluding energy services* is drifting lower, though remains relatively high at 4.7%, well above rates a couple of years ago. Looking at *durable goods prices*, there's lots of red in the yearly percent changes: used cars & trucks (-5.1% y/y), furniture & bedding (-2.3), major appliances (-2.6), and new vehicles (-1.3), though most are up from recent lows, while motor vehicle parts & equipment (1.9) moved back above zero for the first time since August 2023. Here's a snapshot of yearly rates for some key *nondurable goods* prices from highest to lowest: recreational commodities (8.5), food (2.3), apparel (1.8), medical care commodities (1.6), and housekeeping supplies (0.4). Energy prices (-6.8% y/y) fell back below zero in August, and fell deeper into negative territory in September, after five months above. It posted a recent peak of 3.7% in May. Turning to services inflation, *rent of shelter* remains high, though the yearly rates are easing from their recent highs in April 2023: rent of primary residence (to 4.8% from 8.8%) and owners' equivalent rent (5.2 from 8.1). Turning to *non-housing-related services*, the yearly rate of transportation service (8.5) remains high, though is down from recent highs, as is the rate for recreation services (2.2), which is the lowest since mid-2021. Meanwhile, the yearly rate for education & communication services is hovering around 2.0%, while the medical services (3.6) rate has been on an accelerating trend, up from its recent bottom of -2.6% in September 2023. The rate for other personal services (4.1) eased again in September, after moving up to 5.1% in July from 4.0% in May—which was the lowest rate since October 2021.

Producer Price Index (*link*): The PPI for *final demand* was flat in September for the fourth time this year, following a 0.2% uptick in August and no change in July. September's *yearly inflation rate* was 1.8%, easing from its recent peak of 2.9% in June, which was the highest since February 2023. It was at a recent low of 0.8% last November. *Core prices excluding trade services* edged up 0.1% in September, slowing from 0.2% and 0.4% the prior two months, with the yearly rate easing to 3.2%—slightly below its recent peak of 3.4% in July and May. *Final demand goods* slipped 0.2% last month after no change in August and posted declines in three of the last five months. The yearly rate has dropped below zero, from a recent peak of 1.7% in July to -1.1% in September. *Final demand services* rose 0.2% in September following a 0.4% gain and a 0.2% loss the prior two months, with the yearly rate climbing from 2.6% in July to 3.1% in September. The PPI for *personal consumption* eased for the fourth month, from May's 15-month high of 3.0% y/y to an eight-month low of 1.8% y/y in September; it was at 0.9% last November. The yearly rate for *personal* *consumption excluding food & energy* rose from a recent low of 2.1% last November to 3.3% y/y this June—which was the highest since April 2023—easing to 2.6% in July before ticking up to 2.8% in August and September. The former and latter reached record highs of 10.4% and 8.1%, respectively, in March 2022.

Consumer Sentiment Index (*link*): "Despite strong labor markets, high prices and inflation remain at the top of consumers' minds," notes Joanne Hsu, director of the survey. *Consumer sentiment* unexpectedly fell for the first time in three months, slipping to 68.9 in mid-October, after climbing the prior two months from 66.4 to 70.1. Sentiment is up 8% from a year ago and nearly 40% above June 2022's trough. *Current conditions* dipped to 62.7 after increasing from 61.3 in August to 63.3 in September, while *expectations* fell to 72.9 after advancing the prior two months from 68.8 in July to 74.4 in September. *Turning to inflation, year-ahead* inflation expectations rose to 2.9% in mid-October from 2.7% in September and has been below 3.0% since July; it was at 4.2% last October. Expectation for inflation over the *next five years* edged down to 3.0% this month from 3.1% last month. *Turning to politics*, the report notes "with the upcoming election on the horizon, some consumers appear to be withholding judgement about the longer-term trajectory of the economy."

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