Yardeni Research

October 30, 2024

Morning Briefing

Trick Or Treat?

Check out the accompanying chart collection.

Executive Summary: The stock market doesn't seem to mind today's "SNAFU" state of affairs, but the bond market has legitimate concerns about a federal debt crisis. We do, too, and are incorporating that prospect into our three-scenario odds. We now see a 30% chance of a crisis—either a US government debt crisis and/or a geopolitical crisis—up from 20%. We're less bullish on the stock market near term and are lowering our odds of a meltup to 20% from 30%. We remain bearish on bonds. … Also: Melissa summarizes the latest geopolitical frights that don't seem to be concerning markets. … Joe shares takeaways from the 3Q earnings data of the early reporting S&P 500 companies.

Strategy: The SNAFU Stock Market. Stocks are trading at record highs as though there is nothing to worry about. As far as stock investors are concerned, the situation is normal, all "fouled up." The military acronym for this state of affairs is "SNAFU." In other words, the situation is bad, but that's normal.

We mostly agree, but we are becoming concerned about the outlook for the widening federal government deficit—partly as a result of soaring net interest outlays—and the mounting federal debt. We've often said that we will worry about these fiscal excesses when the bond market starts doing so. It is doing so now, as it did from August to October 2023, when the 10-year Treasury bond yield soared from a low of 4.00% to a high of 5.00% (*Fig. 1*).

We now must make room for this possible debt-crisis scenario in our three-scenarios framework and their subjective probabilities, which must add up to 100%. We are sticking with our 50% odds of a Roaring 2020s scenario. We are lowering the odds of a 1990s-style stock market meltup back to 20% from 30%. We are raising the odds of a crisis scenario, either a 1970s-style geopolitical crisis and/or a 2023-style government debt crisis, to 30%, up from 20%.

The bottom line is that we are still bearish on bonds, as we have been since our August 19 *Morning Briefing* titled "Get Ready To Short Bonds?" We are less bullish on stocks for now.

So we feel comfortable with our decision to stay with our year-end target of 5800 for the S&P 500. We remain bullish longer term, with targets of 6300 by the end of next year and 8000 in 2029. We think that the odds of a recession remain low.

Meanwhile, "SNAFU" best describes current events:

(1) The economy is performing well, yet measures of consumer and business confidence are relatively depressed. The jobs data looked weak during the summer but has seemed fine since then. However, the Fed's September 4 and October 23 Beige Books were relatively downbeat about the labor market. *Barron's* posted an October 28 story titled "Why It's So Hard to Find a Job in This Strong Labor Market." The article suggests that perhaps the labor market isn't that strong. There may still be plenty of job openings, but employers aren't rushing to fill them (*Fig. 2* and *Fig. 3*). We think the labor market remains in good shape. (See our latest QuickTakes titled "Help Still Wanted.")

(2) The Fed cut the federal funds rate by 50bps on September 18 largely because labor market indicators were weakening. Fed officials expected that it would be the start of a monetary easing cycle. The Bond Vigilantes had a different idea, as the 10-year Treasury bond yield rose from 3.70% on September 18 to 4.30% currently. Even the 2-year Treasury yield is up over this period from 3.61% to 4.10%.

In their September 18 Summary of Economic Projections, Fed officials indicated that they expected to continue to cut the federal funds rate through 2025 and 2026 (*Fig. 4*). They might have to reconsider if their easing moves cause the Bond Vigilantes to tighten credit conditions.

(3) The Bond Vigilantes seem to believe that the economy and the labor market are stronger than Fed officials believed when they cut the federal funds rate last month. Recent data confirm this view, which has been our view. The Bond Vigilantes clearly believe that the so-called "neutral" interest rate is higher than Fed officials think, as do we.

Furthermore, Fed officials often state that they intend to "stay in their lane" by avoiding any discussion of fiscal policy. The Bond Vigilantes may be starting to freak out about ballooning federal deficits and mounting federal debt, just as they did last year from August through October. Unlike Fed officials, they are aware that Washington's fiscal follies may only get worse no matter who is in the White House next year.

(4) Meanwhile, the geopolitical issues can also be described as a "SNAFU." The Middle

East conflict remains incendiary. However, because there might be a pause in the tit-for-tat retaliation between Israel and Iran, the price of oil fell sharply on Monday (*Fig. 5*). A loose alliance of emerging economies including the original BRICs is seeking to topple America's supremacy in global finance. Many of their central banks are buying gold. So the price of gold has been soaring (*Fig. 6*). Yet the dollar has been relatively firm in recent weeks (*Fig. 7*).

(5) The US stock market, meanwhile, continues to rise (*Fig. 8* and *Fig. 9*). Nevertheless, we still think that the S&P 500 will be around 5800 by the end of the year and resume climbing in 2025. Then again, the stock market isn't fazed by all the SNAFUs, so maybe our expectations aren't bullish enough.

Geopolitics: SNAFUs or Nightmares? Halloween is on Thursday. Financial and commodity markets haven't been spooked by the latest unsettling geopolitical developments. US stocks are trading at record highs. The dollar remains firm. Oil prices have declined.

Let's focus on the latest geopolitical frights:

(1) *BRICS*. From October 22-24, more than 30 countries convened in Kazan, Russia, where Russia's President Vladimir Putin played *host* to member leaders from Brazil, India, China, South Africa, Iran, Egypt, Ethiopia, Saudia Arabia, the UAE, and other nations, including NATO member Turkey. Even the United Nations Secretary-General António Guterres attended.

The participants signed a 134-point "Kazan Declaration," which outlines positions on *everything* from climate change and pandemic response to countering drug trafficking and terrorism. Yet its main focus is on expanding BRICS ranks and subverting Western dominance, conjuring a world less tethered to the dollar. That vision remains more shadow than substance. Far-reaching dollar-alternative global payment systems would be highly complex to implement. The BRICS's New Development Bank, with *$5 billion* in annual funding, is small compared to the World Bank's *$72.8 billion*.

Meanwhile, China's economy remains shaky despite hefty government support. Russia's economy is muddling along at best, supported by the government's military spending. Despite playing the BRICS's host, Russia fell short of the geopolitical backing it sought. The culminating declaration, in fact, urged peaceful negotiations aligned with UN policies to end the war in Ukraine. The next BRICS summit will be in Brazil in 2025.

(2) *Russia & North Korea*. North Korea's foreign minister arrived in Russia on Tuesday, *Reuters reported*, possibly to coordinate the 10,000 North Korean troops in Russia joining the front lines against Ukraine.

In June, Russia and North Korea inked a defense *pact* to support each other in case of an armed attack, signaling the tightest ties between them since the Cold War. The arrangement raises unsettling questions about what Putin may be providing North Korea in exchange for the troops.

South Korea’s response is likely to be *limited* to providing lethal aid to Ukraine. That’s a marked shift from its prior humanitarian stance.

(3) *Israel & Iran*. In retaliation for missiles fired at Israel by Iran on October 1, Israel conducted airstrikes on Iran early Saturday, which threatened to ignite a broader Middle Eastern conflict. For now, however, the exchanges appear intended to achieve mutual deterrence while avoiding a full escalation to war. Brent crude oil prices have fallen more than 6% since the start of the week as Iranian oil fields were left untouched.

Iran quickly *downplayed* the strikes, noting that Israel hadn’t disrupted energy supplies. Israel’s focus stayed on Tehran’s military and other facilities, steering clear of nuclear or oil infrastructure.

(4) *Israel, Gaza & Lebanon*. Tensions in Gaza and Lebanon persist as the Israel Defense Forces (IDF) carry out operations targeting Hamas and Hezbollah. Following the IDF’s October 17 *assassination* of Hamas leader Yahya Sinwar, Israel has yet to *share* what it intends next for Gaza’s leadership.

In Lebanon, the IDF is systemically forcing Hezbollah away from the northern Israeli border following the *killing* of Hezbollah leader Hassan Nasrallah. Hezbollah’s drone attacks on Israel continue to be effective.

In the background, trust between Israel and the US is haunted by recent surprises and differing strategies. Reportedly, the Biden administration was *in the dark* on the IDF’s assassinations of Sinwar and Nasrallah. While the US advocates for ceasefires and humanitarian aid, Israel remains focused on military solutions. With the US presidential election imminent, uncertainty about future policies seems to be making Israel hesitant to fully disclose its intentions.

(5) *India & China*. India and China *struck* a recent accord to dial back four years of heated tensions along their Himalayan border. This new pact, which aims to cool a military standoff that's been simmering since 2020, could signal significant reset in Asia's balance of power. Both sides *reportedly* disengaged from two points along their border temporarily to ease tensions, a positive signal but by no means a permanent solution.

The recent accord may prove insignificant if bilateral relations between the two nations fail to improve. Following the 2020 clash, India curbed Chinese imports, barred Chinese telecom companies from national projects, and banned several Chinese apps. While these policies remain in place, the accord could signal the first step toward lifting them.

The timing of the agreement on the eve of the BRICS meeting is likely unsettling for Washington. China's strategic charm offensive with India sidesteps Western efforts to bind New Delhi closer. As Russia, India, and China continue to consolidate under BRICS, this accord signals an emergent front that complicates the West's coalition-building ambitions in Asia and beyond.

Nevertheless, India and China are global competitors, which will likely override the ties that bind them.

(6) *China & Taiwan*. Daily reports of Chinese vessels near Taiwan's coast serve as a constant reminder of the precariousness of peace in the South China Sea. Beijing labels these exercises a "warning" against Taiwan's democratic separatism.

Last week, Beijing conducted a blockade "exercise" in the Taiwan Strait. Taiwan's Defense Minister *warned* that a real Chinese blockade would be an act of war, with the potential to send global trade into a tailspin. Taiwan, backed by the US and other allies, argues that the Strait is free for global passage. Nevertheless, China declared no no-flight or no-sail zones in its latest war games.

This was just a drill.

Earnings: S&P 500 Q3 Earnings Season Update. The S&P 500 companies' Q3 earnings reporting is nearly 42% complete through midday Tuesday, and the early results are encouraging. Aggregate Q3 earnings for the 209 companies that have reported so far are 6.7% above forecast, and revenues have beat by 1.6% (*Fig. 10* and *Fig. 11*). That beats Q2's beat measures. Earnings surprises continue to outpace revenue surprises on a percentage basis, continuing a 15-year trend.

Below, Joe dissects the results so far and weighs in with his thoughts:

(1) *Financials earnings growth broadening*. Due to their status as early reporting companies, the Financials sector tends to weigh heavily on the early results, as it does every quarter. Financials' Q3 season is nearly two-thirds finished, while all other sectors are between 10% and 45% complete. The sector has reported a 9.7% earnings surprise and 9.7% y/y earnings growth so far. That's the biggest surprise in nine quarters. More impressively, nearly 80% of the sector has reported positive y/y revenue and earnings growth. That's the biggest percentage of Financials' firms reporting earnings gains in three years.

(2) *Autos driving Q3 surprise too*. Also surprising were the big earnings beats and positive guidance coming out of General Motors and Tesla. Not surprising was Ford's slip. The earnings beats by GM and Telsa easily rank in the top nine of the S&P 500's biggest total dollar earnings surprises so far.

(3) *Double-digit earnings growth, without Boeing.* While Boeing's strike-impacted Q3 results came close to its recently reduced forecasts, its $6.4 billion loss was more than triple a year earlier and the biggest in the S&P 500. Boeing's loss reduced the S&P 500's y/y growth rate for Q3-2024 by 2.3ppts to 7.7%.

Excluding Boeing, the S&P 500's y/y earnings growth rate improves to 10.0%, which ranks among the strongest earnings growth quarters since Q1-2022, when the US economy was still recovering from the pandemic.

Calendars

US: Wed: Real GDP & Price Index 3.0%2.0%; ADP Employment Change 101k; Pending Home Sales 0.9%; MBA Mortgage Applications; Crude Oil Inventories & Gasoline Production. **Thurs:** Personal Income & Spending0.3%/0.4%; Core PCED 0.3%; Employment Cost Index 0.9%q/q; Initial Claims 231k; Chicago PMI 47.1; Fed's Balance Sheet. (FXStreet estimates)

Global: Wed: Eurozone GDP 0.2%q/q/0.8%y/y; Eurozone Business & Consumer Survey 96.4; Eurozone Consumer Confidence -12.5; Eurozone Industrial Sentiment -10.5; Germany GDP -0.1%q/q/-0..3%y/y; Germany CPI 0.2%m/m/1.8%y/y; Germany

Unemployment Rate 6.1%; France GDP 0.3%q/q; Italy GDP 0.2%q/q/0.7%y/y; Spain GDP 0.6%q/q/3.0%y/y; Spain CPI 1.7%y/y; BOJ Interest Rate Decision 0.25%; Japan Industrial Production 0.9%; Japan Retail Sales 2.1%yy; Japan Household Confidence 36.7; China M-PMI & NM-PMI 50.0/50.5; Schlegel; Schnabel; Nagel; Rogers; Macklem. **Thurs:** Eurozone Headline & Core CPI 1.9%/2.6%y/y; Eurozone Unemployment Rate 6.4%; Germany Retail Sales -0.8%; France CPI 0.2%m/m/1.5%y/y; Italy CPI 0.0%Italy Unemployment Rate 6.2%; ECB Economic Bulletin; Japan Housing Starts -4.2%; China Caixin M-PMI 49.7; Breeden. (FXStreet estimates)

US Economic Indicators

Consumer Confidence (*link*): "Consumer confidence recorded the strongest monthly gain since March 2021, but still did not break free of the narrow range that has prevailed over the past two years," noted Dana Peterson, chief economist at the Conference Board. *Headline consumer confidence* rose 9.5 points (to 108.7 from 99.2); it was at 97.5 in April, which was the lowest reading since July 2022. The *present situation* component rebounded 14.2 points (138.0 from 123.8) after tumbling 10.9 points in September, while the *expectations* component climbed 6.3 points (89.1 from 82.8). Meanwhile, all five components of the index improved. Consumers' assessments of *current business conditions* turned positive this month, with 21.4% saying business conditions were good, up from 18.6% in September, while 16.4% viewed business conditions as bad, down from 20.5% in September. *Turning to the labor market*, consumers' appraisals also improved, with 35.1% saying *jobs were plentiful*, up from 31.3% in September, and 16.8% saying *jobs are hard to get*, down from 18.6% in September. Consumers turned more optimistic on their assessment of *short-term business conditions* six months from now, with 21.0% of consumers expecting business conditions to improve, up from 19.4% in September, and 13.2% expecting business conditions to worsen, down from 17.1% in September. Consumers' assessments of the *short-term labor market* were more optimistic than pessimistic in October for the first time since July 2023, as 17.8% of consumers expected more jobs to be available, up from 17.1% in September, and 17.1% anticipated fewer jobs, down from 18.8% in September. Consumers' assessments of their *income prospects* were unchanged this month at 18.9%, while 12.8% expected their incomes to decrease, a tick below September's 12.9%. As for *inflation expectations*, the 12-month expected inflation rate rose to 5.3% in October from 5.2% in September and 4.9% in August—which was the lowest since March 2020. October's higher expectations rate likely reflects continued upward pressures on food and services prices, though was still well below its peak rate of 7.9% in March 2022.

JOLTS (*link*): *Job openings* in September fell to their lowest level since January 2021, though remain above pre-pandemic levels. Job openings sank 418,000 last month and 1.9 million over the past 12 months to 7.443 million, falling steadily since March 2022's 12.2 million peak. Prior to the pandemic in early 2020, the highest level of job openings recorded was 7.6 million. Openings reached 10.0 million in June 2021 for the first time in the history of the series going back to 2000. Openings remain at relatively high levels but down sharply from the series' peak. There were 6.8 million people unemployed in September, so there were 1.1 available jobs for each unemployed person. This ratio was at a recent high of 2.0 during March 2022. *By industry*, the number of job openings fell in health care and social assistance (-178,000), trade, transportation & utilities (-134,000), accommodations & food services (-102,000), state & local governments, excluding education (-79,000). Partially offsetting these declines are increases in job openings in financial activities (93,000) and professional & business services (77,000). *Separations* include quits, which are generally voluntary separations initiated by employees—serving as a measure of workers' willingness or ability to leave jobs. *Total quits* have been in a downtrend since peaking at 4.5 million during April 2022, falling to 3.1 million in September—the lowest since summer 2020.

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