Yardeni Research

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Morning Briefing

Updating Global Economy & S&P 500 Earnings

Check out the accompanying chart collection.

Executive Summary: Today, Melissa takes us on a world tour, reviewing the takeaways from the latest economic releases of major economies. Those in Europe are a mixed bag, with the tourist economies of Spain and Italy looking good as Germany struggles. In Asia, the fast-growing Indian economy stands head and shoulders above the rest, though Japan's is improving. The "ABC" commodities exporting economies—Australia, Brazil, and Canda—are underperforming for country-specific reasons. … Also: Joe reviews how several S&P indexes performed last year on the fundamental measures of forward revenues, earnings, and profit margins, and he shares takeaways from his new breadth data for the S&P's three market-capitalization indexes.

Global Economy I: Eurozone. Over the past couple of weeks, the Eurozone's economic data have been a mixed bag. The economic fundamentals of Southern European tourist destinations like Spain and Italy have improved. Meanwhile, stalwarts such as France and Germany continue to struggle with political strife and macroeconomic deterioration. Here's what the latest economic releases tell us:

(1) *The Eurozone economy is limping along.* The Eurozone economy is growing at a snail's pace. The HCOB Composite Purchasing Managers' Index (PMI) for the Eurozone marginally improved to 49.6 in December 2024 but remains below the 50-point mark that separates expansion from contraction (*Fig. 1*). The manufacturing sector remained especially weak (45.1), while the services sector rebounded into expansionary territory (51.6).

Flash Eurozone consumer confidence, however, fell in December 2024 to below its long-term average. Real GDP grew just 1.0% y/y in Q3-2024.

To spur recovery, the European Central Bank (ECB) further cut interest rates in December 2024 by 25bps to 3.0%. Headline CPI inflation cooled to 1.7% y/y in September before rising again, to 2.4% in December. It remains above the ECB's 2.0% target (*Fig. 2*).

The markets still expect the ECB to cut interest rates by an additional 75bps over the next year, based on overnight index swaps tied to the benchmark euro short-term rate (ESTR) (*Fig. 3*). That would put the ECB deposit rate to 175bps lower than the federal funds rate (FFR) based on what the markets expect the Fed to do, per 12-month FFR futures.

We believe the gap between US and European benchmark rates could widen from around 150bps today to more than 200bps by 2026. That's because we expect US growth to beat expectations, while the ECB may have to cut rates swiftly to shore up growth in the Eurozone, especially as Brussels clamps down on fiscal spending. This is also one of the reasons that European stock indexes have done relatively well despite the weak economic outlook.

Rate cut expectations have pressured the euro down 5.3% against the dollar over the past year, which boosts profits earned abroad by European businesses when they are converted into euro. Lower rates will also help indebted telecom and manufacturing businesses refinance and invest.

(2) *Spain leads the pack.* Spain's real GDP grew 3.3% y/y in Q3-2024, well exceeding recent economic growth for the collective Eurozone (1.0%) as well as for France (1.2), Italy (0.4), and Germany (-0.3) (*Fig. 4*). Spanish real GDP growth is expected to increase by 2.9% this year, per the *International Monetary Fund*, lifted by immigration, tourism, foreign investment, and public spending.

Spain's relative performance is attributable to its tilt toward a service-oriented economy, but its manufacturing sector is also expanding. The HCOB Spain Manufacturing PMI rose to 53.3 in December 2024 from 53.1 in November 2024, remaining above 50.0 for the 11th straight month (*Fig. 5*).

Businesses are boosting inventory and jobs as demand is strengthening. The number of registered unemployed people in Spain dropped in December 2024 to the lowest figure since July 2008 (*Fig. 6*).

(3) *Germany trails the pack.* Germany's economy needs a confidence boost from the February 23 early elections after Chancellor Olaf Scholz's Social Democratic coalition fractured in November. Conservative opposition leader Friedrich Merz is likely to become the new chancellor and is open to reversing constitutional restrictions on pro-growth spending and investment.
"The weakness of the German economy has become chronic," the Ifo reported along with

the results of its recent surveys. The Ifo Business Climate indicator for Germany fell to 84.7 in December 2024, the lowest level since May 2020 (*Fig. 7*). Results for the Expectations Index fell sharply to 84.4, while the Current Conditions Index slightly rose to 85.1.

Germany's HCOB Manufacturing PMI (final) was 42.5 in December 2024, further contracting from readings of 43.0 in both October and November (*Fig. 8*). Declines were seen in output as demand for new orders slowed. Companies cut jobs and inventories.

Germany's unemployment rate remained at 6.3% in December 2024, matching the August 2024 low. Consumer sentiment remained exceptionally weak.

(4) *France is struggling as well.* Like Germany, France is in political paralysis. Prime Minister Michel Barnier resigned after losing a vote of confidence, leaving President Emmanuel Macron to appoint a successor, who will lack a majority until elections are constitutionally permitted in June.

France’s recent economic indicators are telling a similar story to Germany’s, unfortunately. The HCOB France Manufacturing PMI (final) sharply dropped to 41.9 in December 2024 from 43.1 in November 2024 (*Fig. 9*). Businesses cut employment amid persistently weak demand.

(5) *Italy’s economy is slowly improving.* December brought an uptick in the HCOB Manufacturing PMI (final) to 46.2 from 44.5 in November (*Fig. 10*). Construction output jumped 3.4% y/y in October, nearly double September’s 1.8% y/y growth rate.

Producer prices deflated in November at a slower pace than they did the prior month. Consumer and business confidence indicators didn’t change much in December 2024 from the previous month’s weak readings.

Global Economy II: Asia. The overall economic picture of Asia’s major economies likewise is mixed. India’s stands out as a stable engine of economic growth, while Japan’s economic fundamentals look potentially promising. South Korea’s latest survey data suggest a dim view of its economy amid political upheaval. Here’s more:

(1) *India leads Asian economies.* The Reserve Bank of India (RBI) expects India’s real GDP growth to approach the government’s 7.0% target during its fiscal year 2025-26 (*Fig. 11*). The region remains the world’s fastest growing economy. With the India MSCI trading at 22.6 times forward earnings, however, investors certainly are paying for that growth.

India’s annual inflation rate is expected to run at 4.8% in 2025, which is higher than the RBI previously expected. But it is not expected to run hot enough for the bank to raise interest rates. The RBI has held rates at 6.5% since February 2023.

The HSBC India Manufacturing PMI (final) fell to 56.4 in December, the softest expansion in 2024 (*Fig. 12*). However, new orders, purchases of inventory, and jobs creation remained strong, while output growth slightly weakened. Both the HSCB Composite and Services PMIs further expanded in December 2024.

(2) *Japan’s economy is improving.* Japan’s domestic consumption is growing as wages are rising. Retail sales increased by 2.8% y/y in November, up from 1.3% the previous month. The Jibun Bank Japan Composite PMI rose from 50.1 in November to 50.5 in December (*Fig. 13*).

Japan's real GDP growth rate turned slightly positive in Q3-2024 to 0.4% y/y, following a 0.9% decline in Q2-2024.

Inflation in Japan has been inching higher. The annual headline consumer inflation rate climbed from 2.3% in October to 2.9% in November (*Fig. 14*).

The Bank of Japan decided last month to keep its key interest rate at 0.25% after placing it there in July 2024. Before that, the bank had last changed the rate when it was raised out of negative territory in March 2024. One out of the eight voters on the bank’s board dissented in December, however, preferring an additional 0.25bps increase. Appetite to tighten monetary policy has waned after the yen strengthened rapidly over the summer, hurting Japanese stocks and sparking inquiries from Japanese politicians.

(3) *Confidence in South Korea’s economy has nosedived.* Recent data suggest that consumers and businesses are highly concerned about the South Korea’s political future after President Yoon Suk Yeol was impeached on December 14 following a failed martial law decree.

South Korea’s Composite Consumer Sentiment Index plummeted to 88.4 December 2024 from 100.7 in November 2024 (*Fig. 15*). The Business Survey Index for South Korea's manufacturing sector also dropped from November to December. Industrial production and retail sales both fell on an annual basis in November from the previous month’s levels.

South Korea's economy grew 1.6% y/y in Q3-2024, slowing from 2.3% in Q2-2024.

Global Economy III: ABCs. We usually view Australia, Brazil, and Canada as a unit because these commodities producers' economies tend to be driven by global commodities markets. Looking at these countries' respective economic indicators over the past couple of weeks, however, shows diverse reasons for their recent underperformance.

The main thing that these economies currently have in common is that none of their economic fundamentals look particularly attractive. Their political situations are equally unnerving. Here's a quick look:

(1) *Australia's economy is suffering from weak demand for its exports.* Exports for several of Australia's key commodities have fallen in recent months, including iron ore, coal, and natural gas (*Fig. 16*). Australia's Judo Bank Manufacturing PMI (final) fell to 47.8 in December 2024, the eleventh consecutive month of deteriorating manufacturing conditions (*Fig. 17*).

The Westpac-Melbourne Institute Consumer Sentiment Index in Australia fell to 92.8 in December 2024, reversing two months of increases.

On the political front, Prime Minister Anthony Albanese has faced criticism as the next election approaches with an uncertain timeline.

(2) *Brazil's central bank is intentionally stunting economic growth.* Record grain harvests and strong domestic consumption caused the IBC-Br, an indicator of economic activity in Brazil, to soar to a record high during October 2024 (*Fig. 18*). Brazil's unemployment rate fell to 6.1%, the lowest on record, for the three months ended November 2024, supported by strong fiscal spending.

Robust economic activity and elevated inflation in Brazil have caused the country's central bank to raise its Selic rate by 100 bps to 12.25% on December 16. Rising interest rates and concerns about persistent inflation resulted in December's six-month-low reading of 92.0 (sa) for Brazil's FGV-IBRE Consumer Confidence Index (*Fig. 19*). The S&P Global Brazil Manufacturing PMI fell to 50.4 in December 2024, the slowest expansion since August.

(3) *Canada's economy is muddling along with fingers crossed.* Canada's economic outlook is uncertain owing to potential trade policy changes under incoming US President Donald Trump; more targeted potential tariffs than expected would be a relief. Canada's Prime

Minister Justin Trudeau resigned on Monday as the country braces for potential trade challenges under Trump 2.0.

Recent economic indicators in Canada show anemic growth both for businesses and households. The CFIB's Business Barometer for Canada dropped from 59.8 in November 2024 to 56.4 in December 2024. Domestic retail sales gained a slight 1.5% y/y during October 2024.

Despite the softness, manufacturing activity accelerated, according to S&P Global's PMI data, as producers attempted to get ahead of potential new US tariffs on global exports.

The Bank of Canada lowered its main interest rate by 50bps in December 2024 to total 175bps of cuts from 5.0% since June 2023.

Strategy I: 2024 Market Data in Review. It was another great year for the US stock market indexes. Many indexes traded at record highs, especially after Trump's election released the animal spirits.

The Magnificent-7 stocks, with a collective market-capitalization gain of 46.3%, easily outperformed the S&P 500's 24.4% rise and beat the index for the 11th time in 12 years. The S&P 500 without the Magnificent-7 (a.k.a. the "S&P 493") lagged despite a healthy gain of 15.7%. The "SMidCaps" likewise rose but lagged their larger-cap counterparts: The S&P MidCap 400 rose 12.2% for the year; the S&P SmallCap 600 gained 6.8%.

Last year's best price performers did well not because they're bigger but because their fundamentals continued to improve markedly to new record highs. Below, Joe details the strides that the companies in each index collectively made in forward fundamentals last year (forward revenues and earnings are the time-weighted averages of analysts' consensus estimates for the current and following year; the forward profit margin is derived from forward revenues and earnings):

(1) *Forward revenues.* The Magnificent-7's forward revenues forecast soared 15.8% last year, more than double the 6.3% rise for the S&P LargeCap 500 and triple the S&P 493's 5.3% gain (*Fig. 20*). The S&P MidCap 400 posted a decent gain in forward revenues too, of 5.4% to a record high. But the S&P SmallCap 600 lagged considerably with a forward revenues decline of 2.2%. SmallCap's forward revenues is now 5.2% below its September 2022 record high (*Fig. 21*).

(2) *Forward earnings.* Forward earnings forecasts rose to record highs in 2024 for all but the SMidCaps. The Magnificent-7's forward earnings soared 35.6% last year, ahead of the S&P LargeCap 500 (12.0%), S&P 493 (8.3), and the S&P MidCap 400 (3.8) (*Fig. 22*). Once again, the S&P SmallCap 600 lagged all these indexes last year, but with a 0.9% decline in its forward revenues (*Fig. 23*).

(3) *Forward profit margin.* The Magnificent-7's forward profit margin expansion last year was no less than stunning: The margin started the year at a record 21.6% and finished at a new record high of 25.4%.

The S&P 500's forward profit margin began 2024 at 12.7% and improved steadily to 13.4% in September, surpassing its prior record high of June 2022. It ended the year a point higher at 13.5% (*Fig. 24*).

The S&P 493's forward profit margin rose from 11.6% at the year's start to a 20-month high of 12.0% in September before ending 2024 at 11.9%. That's a healthy gain considering that some sectors' margins shrank (Industrials, Energy, and Health Care).

The SMidCaps' margins expanded, but barely (*Fig. 25*). The S&P MidCap 400's forward profit margin inched just 0.1ppt higher last year to 8.2%, well below its record high of 9.1% from June 2022. The S&P SmallCap 600's forward profit margin edged up 0.2ppt to 6.4%, 0.8ppt below its 7.2% record high from February 2022.

Strategy II: YRI's New Breadth Measures. While it's easy for investors to track an index's performance since the data are broadly disseminated, knowing how much a few very large companies, such as the Magnificent-7, have distorted the overall index's performance isn't so easy.

That's why Joe recently created a breadth database covering the S&P's three market-cap indexes. It tracks each company's forward revenues, earnings, and profit margin, as well as their price and valuation. We like to track an index's breadth over a 13-week period since it captures the estimate revisions analysts make over the course of a quarterly reporting cycle. Here's what Joe found:

(1) The percentage of companies with rising forward earnings has weakened for the LargeCap and MidCap indexes from their two-year highs in Q3 (*Fig. 26*). Nearly 74% of the S&P 500 LargeCap companies have higher forward earnings over the past three months, down from 81% recently. That's well above the current readings for MidCap (53.6%) and

SmallCap (50.8). SmallCap's measure has trailed those of both MidCap and LargeCap over the long term since 1998; but the index has been on a path to broader improvement since late 2023, when it dropped to its lowest non-crisis level since the tech meltdown of 2001.

(2) We see the same general result when looking at the forward profit margin's breadth. It too has waned recently for LargeCap and MidCap and is also on a stalled upward path for SmallCap (*Fig. 27*). Nearly 59% of LargeCap companies saw their forward profit margin improve q/q, down slightly from 63% recently. MidCap has 52% of its companies rising, and SmallCap's measure has improved to the 50% mark for the first time in over a year.

Calendars

US: Wed: ADP Employment Change 143,000; Consumer Credit Change $12.5b; MBA Mortgage Applications; 30-Year Bond Auction; FOMC Minutes; Waller. **Thurs:** Wholesale Inventories -0.2%; Fed Balance Sheet; Barkin; Harker. (FXStreet estimates)

Global: Wed: Eurozone Economic Sentiment 95.8; Eurozone PPI 1.6%m/m/-1.2%y/y; Germany Factory Orders 0.4%; Germany Retail Sales 0.4%; France Consumer Confidence 89. **Thurs:** Eurozone Industrial Production 0.5%; Eurozone Retail Sales 0.4%; Germany Industrial Production 0.5%; Japan Household Spending -0.9%m/m/-0.6%y/y; China CPI 0.1%m/m/-2.5%y/y. (FXStreet estimates)

US Economic Indicators

JOLTS (*link*): Job openings rose unexpectedly again in November, indicating that companies are still looking for workers. November *job openings* rose 259,000 to 8.098 million (higher than consensus estimates of 7.7 million), building on November's 467,000 jump. 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. Job openings have been on a steady downtrend since March 2022's 12.2 million peak. There were 7.1 million people unemployed in November, so there were 1.1 available jobs for each unemployed person for the fifth successive month. This ratio was at a recent high of 2.0 during March 2022. *By industry*, the biggest gains in job openings in November were led by professional & business services (273,000), finance & insurance (105,000), health care & social assistance (44,000), and private educational services (38,000). The biggest declines occurred in accommodation & food services (102,000), information services (-89,000), leisure & hospitality (-83,000), and transportation, warehousing & utilities (-36,000). *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 on a downtrend since peaking at 4.5 million during April 2022, falling to 3.1 million in November—which was the lowest since summer 2020; quits fell 218,000 in November and 451,000 versus a year ago.

US Non-Manufacturing PMI (*link*): The US service sector continued to expand in December, beating expectations. The *ISM N-PMI* climbed to 54.1 (versus consensus estimate of 53.3), after having slipped from 56.0 in October—which was the highest since summer 2022—to 52.1 in November. December's reading marked the 10th time this year the index has been in expansionary territory. The *business activity/production* index increased 4.5 ppts (to 58.2% from 53.5%) in December, its sixth straight month of expansion, finishing 2024 with the third highest reading of the year. The *new orders* measure edged up 0.5 ppts (54.2 from 53.7), though was down from September's 59.4—which was the best reading since February 2023 (62.6). Meanwhile, the employment (51.4 from 51.5) gauge was little changed in December, remaining just above the breakeven point of 50.0 for the fifth time in six months. The *supplier deliveries* (52.5 from 49.5) measure returned to expansionary territory in December—indicating "slower" supplier deliveries—finishing 2024 with a six-month split: six months in expansion and six months in contraction. (Supplier deliveries is the only ISM component that is inversed—with a reading above 50.0 indicating slower deliveries.) On the *inflation* front, the price index (to 64.4 from 58.2) accelerated in December, posting its first reading above 60.0 since the start of this year, when it was at 64.0. Its record high was 84.5 at the end of 2021.

Global Economic Indicators

Eurozone CPI Flash Estimate (*link*): The *Eurozone CPI* is expected to rise to 2.4%y/y in December, according to the flash estimate, accelerating steadily from September's 1.7%—which was the lowest rate since April 2021. Meanwhile, the *core CPI* is expected to be at 2.7% for the fourth successive month. The headline and core CPIs are down sharply from their recent peaks of 10.6% in October 2022 and 5.7% in March 2023. Looking at the components, the *services* rate is forecast to tick up to 4.0% in December from 3.9% in November; it has hovered around 4.0% for several months. The rate for *food, alcohol & tobacco* is expected to hold at November's 2.7% in December, after moving up from 2.3% in July and August to 2.9% in October. The rate for *non-energy industrial goods* is forecast to ease to 0.5% in December, after ticking up from 0.5% to 0.6% in November; it was at 1.1% in March. Among the four *largest Eurozone countries*, Germany (2.8% from 2.4% y/y) and Spain (2.8 from 2.4) are both expected to show the biggest spread from month to month, 0.4ppts, showing identical yearly rates in November and December. France (1.8 from 1.7) and Italy (1.4 from 1.5) rates are expected to be little changed from November to December.

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