MORNING BRIEFING
December 18, 2023

A Dozen Reasons To Remain Bullish In 2024

The next *Morning Briefing* will be on January 3, 2024.

Check out the accompanying chart collection.

Executive Summary: The bears who still expect a recession base their arguments on historical precedents: At times in the past when economic indicators were flashing the signs they are today, recessions occurred. But we see good reasons not to apply past rules of thumb to the current set of circumstances. Moreover, our Roaring 2020s thesis that widespread adoption of new technologies will set off a productivity boom is unfolding. As a result, we're bullish on the outlook for the US economy and stock market. Today, we present the bears' talking points and our rebuttals, including 12 good reasons for optimism as we enter 2024. … Also: Dr. Ed reviews "Archie" (+ +).

YRI Bulletin Board. We have launched our new *website*. We will be finetuning it in the coming weeks. We appreciate your patience during the transition and welcome your suggestions.

We will be recharging our batteries for the new year from December 19 to January 2. We won't be publishing the *Morning Briefing* during that period or broadcasting our usual Monday webcasts. We will keep you connected to our ongoing analysis of economic and market-related events as they happen through our *QuickTakes*.

Dr. Ed's next live webcast with Q&A will be at 11:00 a.m. on Monday, January 8. Replays of past weekly webcasts are available *here*.

Strategy I: Here We Go Again. The Great Debate that started in early 2022 between the stock market's bulls and the bears continued in 2023 and is set to continue again in 2024. Both sides are marshalling many of the same debating points they have used since early 2022 and a few new ones.

The basic thesis of the bearish debating team is that it isn't different this time. The Fed raised the federal funds rate by 525bps from March 2020 through August of this year (*Fig. 1*). That's the biggest increase since Fed Chair Paul Volcker tightened monetary policy in late 1979. In addition, this time the Fed has been paring the size of its balance sheet through quantitative tightening. This all comes after the Fed provided ultra-easy monetary policies, including ultra-low interest rates and several rounds of quantitative easing, from 2008 through 2021.

Surely such a massive swing from easy to tight monetary policy must cause a credit crunch and a recession, the thinking goes, and probably a severe one! Monetary policy tightening cycles usually have been followed by recessions (*Fig. 2*). Indeed, each of the past 10 recessions was preceded by such a cycle. Supporting the recession outlook is the yield curve, which has been inverting since the summer of 2022 (*Fig. 3*). The yield-curve spread is one of the 10 components of the Index of Leading Economic Indicators (LEI), which has been falling since it hit a record high during December 2021 (*Fig. 4*). It is down 11.8% since then through October. Granted, the Index of Coincident Economic Indicators rose to a record high in October, but it is bound to fall in 2024, according to the bears. Also, an ominous sign for real GDP growth is that real M2 has been falling on a y/y basis since December 2022 (*Fig. 5*).

Recognizing that consumer spending currently accounts for 68% of nominal GDP, the bears have been attributing the resilience of consumer spending to "excess saving," which they had expected to run out by now. So now they say that whatever is left will be spent in the coming months, forcing consumers to retrench next year. Meanwhile, another alarming signal, they say, is that consumer credit rose to a record $5.0 trillion, with revolving credit up to a record $1.3 trillion, during October. They've also been warning that the resumption of student loan payments during October would depress consumer spending. However, retail sales were surprisingly strong during November, so that is likely to be dropped as a talking point of the bearish squad.

Before we present our rebuttal to the bears' arguments, here's some perspective on our stock market outlook and how it compares to the expectations of other Wall Street strategists.

Strategy II: Bullish Targets. The *current issue* of *Barron's* includes the 2024 S&P 500 targets for six investment strategists including yours truly. Our target is the highest at 5400, based on projected S&P 500 earnings per share of $250 next year. Morgan Stanley's Mike Wilson has the lowest numbers at 4500 for the index's price target and $229 for earnings per share. In last year's *survey* by *Barron's*, we had 4800 as our S&P 500 target for last year with earnings at $225. The low comparable readings were 3930 and $199 for 2023.

Along the way, we trimmed our year-end target to a more reasonable 4600. Then, on June 5, we *wrote*: "Is all the AI euphoria leading the stock market into another 'MAMU'—'Mother of All Meltups'? If so, our 4600 target for the S&P 500 by year-end might prove conservative, not controversial."

On July 19, we *wrote*: "The S&P 500 is now almost at 4600. It closed at 4556.27 on Tuesday. Rather than raise our year-end target, we are raising our expectations for what the bull market could deliver through the end of 2024 and beyond. We think that 5400 is achievable by the end of next year. If that happens, then 5800 would be our target for the end of 2025. In other words, we think that the bull market has staying power."

Last week, we raised our 2025 target for the S&P 500 price index to 6000, as our Roaring 2020s scenario is looking not only possible, but also probable.

Strategy III: A Dozen Good Reasons. Now let's review our talking points on behalf of the bullish team in the Great Debate. Here's an even dozen:

(1) *Interest rates are back to normal.* Perhaps the Fed hasn't been tightening monetary policy so much as normalizing it. Interest rates are back to the Old Normal. They are back to where they were before the New Abnormal period between the Great Financial Crisis and the Great Virus Crisis, during which the Fed pegged interest rates near zero.

The normalization theory implies that the Fed might not lower interest rates next year as much as widely expected. That's because the economy wouldn't require as much easing to reverse the tightening. If the economy remains resilient but inflation continues to fall closer to the Fed's 2.0% target next year—both of which we're expecting—then the Fed might lower the federal funds rate twice next year, by 25bps each time, instead of four times or more as widely anticipated.

(2) *Consumers have purchasing power*. Many consumers may soon run out of their excess saving, as the economy's naysayers are saying. Some consumers could be weighed down by too much consumer debt, especially student loans. Nevertheless, most of them are likely to continue to consume as long as their job security remains high, which it will be as long as there are plenty of job openings and as long as the unemployed and new entrants to the labor force fill those openings. That describes the current state of the labor market.

Indeed, during November, 40% of small business owners reported that they have job openings (*Fig. 6*). During October, there were 8.7 million job openings overall in the labor market versus 6.5 million unemployed that month. The labor force has increased 3.3 million during the first 11 months of this year. The household measure of employment is up 2.7

million over the same period.

Pandemic-related excess saving certainly helped to boost consumer spending over the previous three years when unemployment was very high and real wages stagnated. But unemployment is low now (i.e., below 4.0% since February 2022), and real average hourly earnings is rising once again along its 1.4% annualized trendline that started in 1993 (*Fig. 7*).

Both nominal and real wages & salaries in personal income and unearned personal income (including interest income, dividends, rents, and proprietors' income) rose to record highs during October (*Fig. 8*). They probably did so again in November.

(3) *Households are wealthy and liquid.* The net worth of American households totaled a staggering record-high $151.0 trillion at the end of Q3-2023 (*Fig. 9*). Their portfolios are diversified in various asset holdings that all are at or near record highs (*Fig. 10*). There are certainly lots of liquid assets that might be sold to buy stocks and bonds when the Fed decides to lower short-term interest rates. A record $5.9 trillion is in money market mutual funds (MMMF) with a record $2.3 trillion in retail MMMFs (*Fig. 11*). Commercial bank deposits in M2 totaled $17.3 trillion during the December 12 week (*Fig. 12*).

There are 86 million households who own their own homes, and 40% of them have no mortgages. Many of these homeowners likely are Baby Boomers. They have mostly followed the advice of Star Trek's Spock, who often said, "Live long and prosper." Collectively, the generation held $73.1 trillion of net worth at the end of Q3. Boomers are likely to be among the main beneficiaries of record unearned income streams.

(4) *Demand for labor is strong.* From personal experience, we know that some of the Baby Boomers are providing some financial support to their young adult children. The Boomers are also eating at restaurants and traveling more often. They are visiting their health care providers more frequently to make sure that they live long enough to spend some of their retirement nest eggs.

Not surprisingly, November's better-than-expected retail sales was led by food services, which rose to yet another record high (*Fig. 13*). Employment continues to soar in the leisure & hospitality industry as well as in the health care sector.

(5) *Onshoring boom is boosting capital spending.* American and foreign manufacturing companies clearly are onshoring to the US. Supply-chain disruptions during the pandemic

and growing geopolitical tensions between the US and China have stimulated the onshoring rush. So has a shortage of workers in China.

The onshoring boom and the federal government's increased spending on public infrastructure are boosting new orders for construction machinery, which is up 30.5% over the past 24 months through October (*Fig. 14*). Onshoring and infrastructure investment also explain why construction employment rose to yet another record high of 8.0 million during November despite the recession in single-family housing starts.

Construction spending on manufacturing facilities is soaring because of the increase in onshoring partly owing to federal incentives. In current dollars, it is up a whopping 71.6% and 136.8% on one-year and two-year bases (*Fig. 15*).

(6) *Housing is all set for a recovery.* The plunge in mortgage interest rates since early November undoubtedly will boost new and existing home sales. That should give a boost to housing-related retail sales on appliances, furniture, and furnishings. The rolling recessions in housing and housing-related retailing should turn into rolling recoveries for both.

(7) *Corporate cash flow is at a record high.* The economy's resilience can also be attributed to the awesome ability of US corporations to generate cash flow. It totaled a record $3.4 trillion (saar) during Q3-2023. That's despite the pressure on companies' profit margins coming from high labor costs and higher interest rates over the past couple of years. Corporate cash flow is up 4.1% y/y, with tax-reported depreciation up 6.9% and undistributed profits down 3.3%. The latter has been relatively flat since Q3-2009.

(8) *Inflation is turning out to be transitory.* There can be no debate about the transitory nature of goods inflation since H2-2020. It was back down to 0.0 y/y during November (*Fig. 16*). It turned out to be mostly attributable to the shocks and aftershocks of the pandemic, which have been dissipating since the end of the pandemic.

Almost all the inflationary pressures on durable goods and many nondurable goods stemmed from the pandemic-related supply-chain disruptions, which can be seen in the Global Supply Chain Pressure Index compiled by the Federal Reserve Bank of New York. The index jumped from 0.1 in October 2020 to peak at 4.3 in December 2021. It has plunged since then, returning to 0.1 in November (*Fig. 17*). The PPI inflation rate for transportation & warehousing has followed suit (*Fig. 18*).

Now that the goods inflation shock is behind us, the services inflation shock is showing signs of dissipating. We expect it will do just that in 2024.

(9) *The High-Tech Revolution is boosting productivity.* Companies are allocating more of their capital spending budgets to technology hardware and software to boost their productivity in response to chronic labor shortages. As a result, production of high-tech equipment and spending on software are at all-time highs.

We believe that a major cycle in productivity growth started at the end of 2015, when it bottomed at 0.5% (based on the 20-quarter average) and rose to 1.8% during Q3-2023 (*Fig. 19*). We expect productivity growth will peak around 4.0% by the end of the decade.

(10) *Leading indicators are mostly misleading.* What about all those leading indicators that have been signaling an impending recession since last year? We've often explained why they are misleading. For example, inverted yield curves in the past have anticipated that the Fed's tightening would break something in the financial system, causing a credit crunch and a recession, that's not always the case. There was a mini-banking crisis in March of this year. But it was contained by the Fed so had few systemic ripple effects.

The LEI has misfired its recession signals because its composition is biased toward predicting the goods sector more than the services sector of the economy. There has been a rolling recession in the goods sector, but it has been more than offset by strength in services, nonresidential private and public construction, and high-tech capital spending.

(11) *The rest of the world's challenges should remain contained.* Also booming is industrial production of defense, which is likely to continue rising to new record highs given the geopolitical turmoil around the world. The wars between Russia and Ukraine and between Israel and Gaza should remain contained regionally. China's economic woes reduce the chances that China will invade Taiwan. Nevertheless, these geopolitical hot spots will boost defense spending among the NATO members.

The bursting of China's property bubble should continue to weigh on global economic growth and commodity prices. China will remain a major source of global deflationary pressures. Europe is in a shallow recession and should recover next year as the European Central Bank lowers interest rates.

(12) *The Roaring 2020s will broaden the bull market.* At last week's FOMC meeting, Fed Chair Jerome Powell and his colleagues pivoted toward the soft-landing scenario, which is also known as "immaculate disinflation." In their Summary of Economic Projections (SEP),

they projected three 25bps cuts in the federal funds rate next year, up from September's two rate cuts. They are starting to recognize that inflation can subside without a recession. We think this is happening because China is having a recession and effectively exporting goods deflation to the US. In addition, technology-driven productivity growth is making a comeback, in our opinion.

The current bull market started on October 12, 2023. It received a big boost when AI-related stocks took off late last year. OpenAI launched ChatGPT on November 30, 2022. We believe that date is when the stock market first started to discount our Roaring 2020s scenario. At first, the bull market was narrowly based, but it since has been broadening to include more sectors and industries. We believe that reflects investors' realization that the beneficiaries of the Roaring 2020s theme aren't just the companies that make technology but also those that use it to boost their productivity—i.e., companies generally whatever their industry may be.

Strategy IV: How About All That Government Debt? The bears' latest and most compelling talking point is that federal government deficits are out of control. Federal government spending is growing rapidly, led by outlays on net interest paid. They totaled a record $716.7 billion over the past 12 months through November. That's an unsettling development, for sure.

However, keep in mind the flip side of high interest rates: They represent a big windfall for households that receive interest income, which has increased significantly. In addition, the spending bills passed by Congress last year will continue to boost construction spending on public infrastructure, which is at a record high, and continue to stimulate onshore construction of manufacturing facilities. Better-than-expected productivity-led growth would certainly help to reduce the mounting burden of the federal debt.

Nevertheless, the federal government's need to finance the huge deficit could cause an oversupply of Treasury bonds relative to demand, which could set off a debt crisis. And that certainly could trip up the Roaring 2020s scenario. However, investors realize that nothing will be done to fix the problem in 2024 because it is an election year. Meanwhile, inflation is falling, the Fed is pivoting toward lowering interest rates, and the economy remains resilient.

Movie. "Archie" (+ +) (*link*) is a British television drama series about actor Cary Grant. He was born into poverty in Bristol in 1904 as Archibald Leach before becoming a star in Hollywood with the new stage name. He was very successful as an actor, playing lead roles in several hit movies. However, his personal life was a mess, as evidenced by his five marriages and four divorces. He suffered greatly from the emotional pain of his childhood. He recognized that he was trapped in the past but couldn't escape it. However, near the end of his life, he had a baby girl with his fourth wife, Dyan Cannon; it was then that he finally found peace and great satisfaction in the role of good dad.

Calendars

US: Mon: NAHB Housing Market Index 36. **Tues:** Housing Starts & Building Permits 1.36mu/1.47mu; API Weekly Crude Oil Inventories. **Wed:** Consumer Confidence 103.8; Existing Home Sales 3.78mu; MBA Mortgage Applications; Crude Oil Inventories & Gasoline Production. **Thurs:** Leading Indicators -0.4%; GDP & Price Index 5.2%/3.5%; Headline & Core PCED 2.8%/2.3% Q3; Corporate Profits 4.1%; Initial Claims; Philadelphia Fed Manufacturing Index -3.0; Kansas City Fed Manufacturing Index. **Fri:** Headline & Core PCED 0.0%m/m/2.8%y/y & 0.2%m/m/3.4%y/y; Personal Income & Spending 0.4%/0.2%; University of Michigan Consumers Sentiment, Current Conditions, and Expectations 69.4/74.0/66.4; University of Michigan Inflation Expectations One Year and Five Year 3.1%/2.8%; New Home Sales 695k; Atlanta Fed GDPNow (Q4) 2.6%; Durable Goods Orders Headline, Core, and Nondefense ex Aircraft 1.7%/0.2%/0.2%; Baker-Hughes Rig Count. (FXStreet estimates)

Global: Mon: Germany Ifo Business Climate Index, Current Assessment, and Expectations 87.8/89.5/85.8; Buba Monthly Report; BoJ Monetary Policy Statement; RBA Meeting Minutes; Schnabel; Broadbent; Lane. **Tues:** Eurozone Headline & Core CPI -0.5%m/m/2.4%y/y & -0.6%m/m/3.6%y/y; Canada CPI -0.2%mm/2.9%y/y; BoJ Rate Decision -0.10%; PBoC Loan Prime Rate 3.45%; Elderson; Enria; Breeden. **Wed:** Eurozone Consumer Confidence -16.5; Germany PPI -0.2%; Germany Gfk Consumer Climate -27.0; UK CPI 0.2%m/m/4.4%y/y; UK Input & Output Prices -0.6%/-0.1%; Lane. **Thurs:** Italy PPI; UK CBI Distributive Trades Survey -12; Japan Core CPI 2.5%; Japan Monetary Policy Meeting Minutes; Lane. **Fri:** Germany Import Prices; Spain GDP 0.3%q/q/1.8%y/y; UK GDP 0.0%q/q/0.6%y/y; UK Retail Sales 0.4%m/m/-1.8%y/y; Canada GDP 0.2%m/m. (FXStreet estimates)

Strategy Indicators

Global Stock Markets Performance (*link*): The US MSCI index traded at a 23-month high last week and rose 2.6% w/w to finish at 2.5% below its record high on December 27, 2021. Last week's gain was its seventh straight rise, which is the best winning streak in six years. The US MSCI ranked 17th of the 48 global stock markets that we follow in a week when 44 of the 48 countries rose in US dollar terms. The AC World ex-US index also rose 2.6%, but remains in a 13.9% correction from its June 15, 2021 record high. EM Latin America was the best regional performer with a gain of 3.7%, and was the only region to outperform the AC World ex-US. EM Eastern Europe was the worst performer last week, albeit with a gain of 2.0%, followed by EMU (2.1%), BIC (2.2), EMEA (2.3), EM Asia (2.4), and EAFE (2.6). Peru was the best-performing country last week, with a gain of 17.6%, followed by South Africa (7.3), Mexico (6.2), and Australia (5.7). Among the 28 countries that underperformed the AC World ex-US MSCI last week, the Czech Republic's 2.8% decline was the worst performance, followed by those of Egypt (-1.2), Spain (-0.2), and Singapore (0.0). Looking at 2023's performance so far, the US MSCI is up 23.8%, as its ytd ranking remained steady w/w at 12/48. The AC World ex-US's ytd gain of 10.1% is trailing the US's, with 35/48 countries in positive territory. EM Eastern Europe is the best regional performer ytd with a gain of 39.2%, followed by the gains of EM Latin America (20.8), EMU (19.1), and EAFE (12.8). The regional laggards so far in 2023: BIC (-1.7), EM Asia (3.3), and EMEA (4.4). This year's best ytd country performers: Argentina (59.4), Greece (42.5), Hungary (42.4), Poland (42.2), and Egypt (41.7). Here are the worst-performing countries of the year so far: Hong Kong (-19.5), Thailand (-15.8), China (-13.7), Finland (-10.6), and Jordan (-8.5).

S&P 500/400/600 Performance (*link*): All three of these indexes rose last week and posted their best performance in six weeks. SmallCap's 5.8% gain was well ahead of the 4.3% and 2.5% gains for MidCap and LargeCap. LargeCap's current seven-week winning streak is its longest in six years. At Friday's close, LargeCap improved to 1.6% shy of its record high on January 3, 2022, MidCap slipped further out of a correction at 5.7% from its record high on November 16, 2021, and SmallCap nearly exited correction territory to 11.9% from its November 8, 2021 record high. Thirty-two of the 33 LargeCap and SMidCap sectors moved higher for the week, up from 22 sectors rising a week earlier. SmallCap Tech was the week's best performer with a gain of 7.0%, followed by SmallCap Consumer Discretionary (6.3%), SmallCap Financials (6.2), SmallCap Real Estate (6.2), and SmallCap Health Care (6.0). The biggest underperformers for the week were LargeCap Communication Services (-0.1), MidCap Utilities (0.8), MidCap Consumer Staples (0.8), LargeCap Utilities (0.9), and LargeCap Health Care (1.5). Looking at performances so far in 2023, LargeCap, with a gain of 22.9%, remains far ahead of MidCap (13.0) and SmallCap (11.5); 24 of the 33 sectors are higher ytd. The top sector performers in 2023: LargeCap Tech (55.9), LargeCap Communication Services (48.9), LargeCap Consumer Discretionary (40.9), MidCap Industrials (28.3), and SmallCap Industrials (27.6). Here are 2023's biggest laggards:

MidCap Utilities (-17.3), MidCap Communication Services (-11.6), SmallCap Utilities (-11.4), LargeCap Utilities (-10.1), and SmallCap Health Care (-8.0).

S&P 500 Sectors and Industries Performance (*link*): Ten of the 11 S&P 500 sectors rose last week, and six outperformed the composite index's 2.5% gain. That compares to a 0.2% gain for the S&P 500 a week earlier, when five sectors rose and three outperformed the index. Real Estate was the best performer, with a gain of 5.3%, followed by Materials (4.0%), Industrials (3.6), Financials (3.6), Consumer Discretionary (3.5) and Information Technology (2.5). Communication Services was the worst performer, with a decline of 0.1%, followed by Utilities (0.9), Health Care (1.5), Consumer Staples (1.6), and Energy (2.4). Looking at 2023's performance so far, the S&P 500 is up 22.9% ytd, with just three sectors still outperforming the index and seven higher for the year. The best ytd performers: Tech (55.9), Communication Services (48.9), and Consumer Discretionary (40.9). These are 2023's worst performers: Utilities (-10.1), Energy (-5.1), Consumer Staples (-3.8), Health Care (-1.7), Real Estate (7.4), Financials (8.9), Materials (9.2), and Industrials (14.5).

S&P 500 Technical Indicators (*link*): The S&P 500 rose 2.5% last week and improved relative to its 50-day moving average (50-dma) and its 200-day moving average (200-dma). The index was above its 50-dma for a seventh week after eight weeks below, and was also above its 200-dma for a seventh week after dropping below for the first time in 30 weeks. As for what the dmas themselves have been doing, the 50-dma moved higher for a fifth week after dropping for eight weeks, and the 200-dma rose for a 29th week in its longest positive streak since its 70-week streak ended in March 2022. The S&P 500 rose to a 12-month high of 6.4% above its rising 50-dma from 4.8% a week earlier and compares to a 53-week low of 5.5% at the beginning of November. For perspective, the latest reading compares to a 23-month high of 8.7% above its (rising) 50-dma in August 2022 and a 27-month low of 11.1% below its (falling) 50-dma in June 2022. The index had been trading above its 50-dma from most of late April 2020 to early April 2022; in June 2020, it was 11.7% above, which was the highest since its record high of 14.0% in May 2009. That compares to 27.7% below on March 23, 2020—its lowest reading since it was 29.7% below on Black Monday, October 19, 1987. Turning to the 200-dma, the price index improved to a four-month high of 9.0% above its rising 200-dma from 6.8% above a week earlier and compares to a 42-week low of 3.1% below its rising 200-dma at the beginning of November. That also compares to a 24-month high of 12.4% above its (rising) 200-dma in mid-July. The S&P 500 is well above its 26-month low of 17.1% below its (falling) 200-dma in June 2022 and compares to 17.0% above in December 2020, which was the highest since November 2009 and up from the 26.6% below registered during the Great Virus Crisis on March 23, 2020—the lowest reading since March 2009. At its worst level of the Great Financial Crisis following the failure of Lehman Brothers, the S&P 500 index was 39.6% below its 200-dma on November 11, 2008.

S&P 500 Sectors Technical Indicators (*link*): Ten of the 11 S&P 500 sectors trade above their 50-dmas, unchanged from the prior two weeks. Energy is still the only sector still trading below its 50-dma. Ten sectors have a rising 50-dma, unchanged from a week earlier, with Energy as the only sector still trading below its 50-dma. Looking at the more stable longer-term 200-dmas, eight sectors trade above that level, unchanged from a week earlier. These three sectors still trade below their 200-dmas: Consumer Staples, Energy, and Utilities. The rising 200-dma club expanded measurably this week from six members to 10, leaving Utilities as the only sector in the falling 200-dma club but barely so.

S&P 500/400/600 Forward Earnings (*link*): Forward earnings fell simultaneously for these three indexes last week, for the first time in six weeks. LargeCap's forward earnings dropped 0.1% w/w from its record high a week earlier, but has hit new record highs in 11 of the 14 weeks since it did so in mid-September for the first time in 15 months, dating back to the June 24 week of 2022. MidCap's dropped less than 0.1% w/w to 5.0% below its record high in early June 2022, and SmallCap's dropped 0.1% w/w to 11.1% below its mid-June 2022 record. Through the week ending December 14, LargeCap's forward earnings has risen 8.1% from its 54-week low during the week of February 10; MidCap's is 3.4% above its 55-week low during the week of March 10; and SmallCap's is 2.9% above its 72-week low during the March 17 week. These three indexes' forward earnings downtrends since mid-2022 have been relatively modest compared to their deep double-digit percentage declines during the Great Virus Crisis and the Great Financial Crisis. Forward earnings momentum remains near two-year lows but is steadily ticking higher now. The yearly rate of change in LargeCap's forward earnings has improved to a 13-month high of 6.1% y/y from a 29-month low of -3.2% y/y during the June 23 week. Those levels compare to a record-high 42.2% at the end of July 2021 and, on the downside, to -19.3% in May 2020, which was the lowest since October 2009. MidCap's rate of 0.9% y/y is up from a 31-month low of -5.9% in early June, which compares to a record high of 78.8% in May 2021 and a record low of -32.7% in May 2020. SmallCap's -2.1% y/y rate is at a 10-month high; it's up from a 32-month low of -12.9% in mid-June and down from a record high of 124.2% in June 2021; it compares to a record low of -41.5% in June 2020. Analysts' consensus earnings forecasts for 2023 and 2024 had been heading steadily lower since June of last year, but the 2023 estimate for the S&P 500 ticked higher during the Q1 and Q2 reporting seasons as analysts incorporated the strong earnings beats into their forecasts. Following the Q3 season, they've kept LargeCap's 2023 estimate little changed and have trimmed SMidCap's. Here are the latest consensus earnings growth rates for 2023 and 2024: LargeCap (1.2% and

11.2%), MidCap (-12.7, 10.3), and SmallCap (-8.9, 7.5).

S&P 500/400/600 Valuation (*link*): Valuations moved higher for these three indexes during the December 15 week. LargeCap's forward P/E rose 0.5pt to a 20-week high of 19.3 and is up from a seven-month low of 17.0 during the October 27 week. It's now close to its 18-month high of 19.6 during the July 28 week and is up 4.2pts from its 30-month low of 15.1 at the end of September 2022, which compares to an 11-year low of 11.1 during March 2020. MidCap's forward P/E rose 0.5pt to a 42-week high of 14.5 and is up from a 12-month low of 12.1 at the end of October. It's now just 0.2pts below its 10-month high of 14.7 in early February and up 3.4pts from its 30-month low of 11.1 at the end of September 2022; these compare to a record high of 22.9 in June 2020 and an 11-year low of 10.7 in March 2020. SmallCap's forward P/E rose 0.8pt to a 45-week high of 14.2 and is up from a 12-month low of 11.3 at the end of October. It's now just 0.1pt below its recent 12-month high of 14.3 in early February. It's up 3.6pts from its 14-year low of 10.6 in September 2022 and compares to a record low of 10.2 in November 2009 during the Great Financial Crisis. That also compares to its record high of 26.7 in early June 2020 when forward earnings was depressed. The forward P/Es for the SMidCaps have been mostly below LargeCap's since August 2018. MidCap's 25% discount to LargeCap's P/E is up from its 24-year-low 30% discount during the June 23 week. It had been at a 21% discount during the March 17 week, which was near its best reading since November 2021. SmallCap's 27% discount is up from a 23-year-low 34% discount at the end of October, which compares to a 22% discount during the March 10 week; that one was near its lowest discount since August 2021. SmallCap's P/E had been mostly above LargeCap's since 2003. Looking at SmallCap's P/E relative to MidCap's, it was at a discount for a 130th straight week; the current 2% discount is an improvement from its 20-year-low 9% discount in December 2021.

S&P 500 Sectors Quarterly Earnings Outlook (*link*): Following the Q3-2020 earnings season, when the US economy emerged from the Covid shutdown, analysts began raising their consensus forecasts for future quarters instead of lowering them as is the historical norm. That six-quarter streak of positive revisions throughout the quarter ended during Q1-2022, and the estimate declines accelerated considerably for the three quarters through Q1-2023 before easing for Q2-2023 and Q3-2023. Looking at Q4-2023, the revisions pendulum has turned negative again in the usual performance pattern right before the start of the earnings season ahead of the typical earnings surprise hook. Analysts are forecasting that the S&P 500's earnings will rise 3.1% y/y in Q4-2023. That's below the 4.6% gain in Q3-2023 and up from a 5.8% decline in Q2-2023, which marked the cyclical bottom for earnings growth. On a pro forma basis, they expect an y/y earnings gain of 4.7% in Q4, down from a

7.2% gain in Q3 and up from a 2.8% decline in Q2-2023. S&P 500 ex-Energy earnings are forecasted to be up 7.9% y/y in Q4-2023. That compares to a 12.7% gain in Q3-2023, a 3.6% gain in Q2-2023, the 1.6% decline in Q1-2023, and the 7.4% drop in Q4-2022. Seven sectors are expected to record positive y/y percentage earnings growth in Q4-2023, unchanged from Q3-2023's and Q2-2023's count, but we think that count could improve to a seven-quarter high of eight sectors by the end of Q4's reporting season. That compares to just two sectors doing so a year earlier in Q4-2022. Here are the S&P 500 sectors' expected blended earnings growth rates for Q4-2023 versus their final earnings growth rates for Q3-2023: Communication Services (48.8% in Q4-2023 versus 46.5% in Q3-2023), Utilities (22.6, 10.3), Consumer Discretionary (20.6, 42.4), Information Technology (16.3, 15.3), Real Estate (11.0, -5.4), Financials (8.6, 23.5), S&P 500 ex-Energy (7.9, 12.6), S&P 500 (4.7, 7.2), Consumer Staples (1.6, 6.9), Industrials (-0.8, 12.0), Health Care (-18.6, -17.3), Materials (-20.3, -18.1), and Energy (-23.8, -33.0).

US Economic Indicators

Retail Sales (*link*): Consumers keep shopping! *Total retail sales* beat expectations in November, climbing 0.3% (vs -0.1% expected), rising for the seventh time in eight months by a total of 3.5% to yet another new record high. Meanwhile, sales in the *control group*—which excludes autos, gasoline, building materials, and food services—has recorded only one decline this year, climbing 0.4% in November and 4.5% ytd, also to a new record high. This measure correlates closely with the consumer spending component in GDP. Of the *13 nominal retail sales categories*, eight rose in November while five declined: Here's a snapshot of the 13 categories' *November sales performance versus that of a year ago*: food services & drinking places (1.6% m/m & 11.3% y/y), sporting goods & hobby stores (1.3 & 0.2), nonstore retailers (1.0 & 10.6), health & personal care stores (0.9 & 10.9), furniture & home furnishings (0.9 & -7.3), clothing & accessories stores (0.6 & 1.3), motor vehicles & parts (0.5 & 6.1), food & beverage stores (0.2 & 0.4), general merchandise stores (-0.2 & 1.1), building materials & garden equipment (-0.4 & -2.5), electronics & appliance stores (-1.1 & 12.0), miscellaneous store retailers (-2.0 & 4.5), and gasoline stations (-2.9 & -9.4).

Business Sales & Inventories (*link*): Nominal business sales fell in October from recent highs, while real business sales in September climbed to a new record high. *Nominal business sales* fell for the first time in four months, by 1.0%, following a three-month gain of 3.2%. It remains in record territory, within 1.1% of last June's record. Meanwhile, *real business sales* hasn't posted a decline since April, climbing 0.9% in September and 3.0% over the period to a new high. In the meantime, the real inventories-to-sales ratio fell to 1.54

in September, down from 1.57 in March and April—which was the highest since mid-2020, though up from a recent low of 1.43 in fall 2021. Meanwhile, the nominal ratio ticked up to 1.37, after falling the prior three months to 1.36 in September from 1.40 in the months from March through June—which was the highest since the mid-2020s.

Regional M-PMI (*link*): The New York Fed has provided the first glimpse of manufacturing activity for December and showed it weakened significantly, with the *overall* index plunging 23.6 points (to -14.5 from 9.1), continuing its up-and-down pattern. It had jumped 13.7 points in November, following a 6.5-point loss in October and a 20.9-point gain in September. The *new orders* measure (to -11.3 from 5.1 in September) fell for the third straight month by a total of 16.4 points, while the *shipments* gauge fell 16.4 points (-6.4 from 10.0) in December, following an 8.6-point gain in November and an 11.0-point drop in October. *Unfilled orders* continued to shrink significantly, sinking 18.8 points (to -24.0 from -5.2) over the past three months. *Inventories* (to -5.2 from 9.1) moved lower. Meanwhile, employment (-8.4 from -4.5) continued to decline, while the average workweek (-2.4 from -3.8) edged down. Turning to prices, the *prices-paid* (16.7 from 22.2) index continued to show a slight easing again this month, while the *prices-received* (11.5 from 11.1) gauge was little changed. Both price measures are down sharply from their record highs of 86.4 and 56.1, respectively, during April and March of last year. Looking ahead, the index of *future business conditions* (to 12.1 from -0.9) bounced off November's low, climbing 13 points, after a two-month drop of 27.2 points. New orders and shipments as well as employment are expected to increase only modestly over the next six months

Industrial Production (*link*): Production rose less than expected in November, and October's contraction was revised to show a steeper decline. *Headline production* ticked up 0.2% (vs 0.3% expected) after falling 0.9% (vs -0.6 preliminary estimate) and was little changed over the previous two months. It's down 0.4% y/y. Despite the recent weakness, overall production remains within 0.8% of last September's cyclical high and within 1.3% of the August/September 2018 record high. *Manufacturing* production rose 0.3% after a 0.8% drop in October, which followed a 0.5% gain during the three months through September. It's up 1.3% ytd. *Excluding motor vehicles & parts*, total production fell 0.5% during the two months through November, while manufacturing production fell 0.3%; these measures are both up 1.1% ytd. Meanwhile, mining output remains on a steep upward trend, climbing 33.0% from its recent bottom in May 2020, and is within 3.2% of its September 2019 record high. Utilities output remains in a volatile flat trend near the middle of its range, falling 2.7% over the past three months. By *market group*, *consumer durable goods* production rebounded 3.5% after a 5.4% drop in October, driven by a 7.5% surge in automotive products as the auto workers' strike ended. It's up 1.2% ytd. *Nondurable consumer goods* production has dropped two of the past three months, by 1.0%, and is down 1.5% ytd on widespread weakness. *Business equipment* production remains in a volatile flat trend, though is near the bottom of the range currently; it did post a 1.0% rebound in November, with the ytd change basically flat. Production of information processing (3.6%) and transit (2.1) equipment are showing gains ytd, while industrial & other equipment (-1.7) remains in the red.

Capacity Utilization (*link*): The *headline* capacity utilization rate ticked up to 78.8% in November after slipping to 78.7% in October from 79.5% during each of the prior two months; it peaked recently at 80.8% last September. This November's rate is 0.9ppt below its long-run (1972-2022) average. The *manufacturing* utilization rate edged up to 77.2% after falling to a 21-month low of 77.0% in October. It's currently 1.0ppt below its long-run average. It peaked at 79.9% last spring. Meanwhile, the *mining* utilization rate remains on a steep uptrend, holding just below September's 94.4%, clocking in at 93.7% in November—7.3ppts above its long-run average. Meanwhile, the *utilities* rate remains on a volatile downtrend, falling to a five-month low of 70.8%—not far from February's record low of 69.6%. The utilities rate is substantially below its long-run average.

Import Prices (*link*): Import prices fell for the second month in November as fuel prices continue to tumble. *Import* prices fell 0.4% in November and 1.0% the past two months, with November's decline the seventh one this year. The yearly rate fell -1.4% in November, continuing to narrow from June's recent bottom of -6.1%; it peaked at 13.0% y/y last March. Meanwhile, *nonpetroleum* prices posted its first increase since January, ticking up 0.2% in November, after a nine-month drop of 2.1%. The yearly rate is -0.6%, up from May's recent low of -2.2%; it peaked at 8.1% last March. *Fuel* prices plunged for the second month, by 5.6% in November and 9.0% over the period, after increasing five of the prior six months by 16.9%; that streak followed a nine-month slide of 37.1%. The yearly rate was -10.4% in November, narrowing from June's three-year low of -36.7%; it peaked at 130.1% in April 2021. Meanwhile, here's the yearly rates in *import prices for several industries* from their recent respective peak rates: industrial supplies, which includes fuels & lubricants (to -7.2% from 55.2%); consumer goods ex autos (-0.1 from 3.2), capital goods (0.2 from 4.2), and foods, feeds & beverages (3.2 from 15.7).

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