Putting It All Together

EISI's macro teams' views are in sync currently, so we put everything together in a simple report. The overarching theme is a relatively simple, but uncertain. Growth and inflation have slowed, but central banks are easing and if the 4B tariff list (see bottom of page 8) is avoided, high expected cash returns, an improving earnings growth outlook and negative sentiment will support further gains by the S&P. Avoiding 4B in particular and an escalation of the trade war in general are critical though.

Ed Hyman EISI company surveys have declined but are still consistent with +2.5% real U.S. GDP growth. Global central banks are accommodative and inflation is not threatening central bank policy.

Krishna Guha expects the Fed to continue easing with 25bp cuts in Sept, Oct and some chance of another 25bp cut in Dec. The ECB is set to deliver an aggressive stimulus package in September, and Germany to provide a modest fiscal boost.

Don Straszheim Does not expect a near-term trade deal, but it is likely there is an indefinite hold before Dec 15 scheduled tariffs on list 4B. Don’s China Synthetic Growth Index is encouraging, but there is no take-off. Expect more monetary and fiscal steps coming pre Oct 1.

Oscar Sloterbeck Front-End Surveys show the U.S. consumer is still solid and employment surveys remain a support to growth.

Stan Shipley notes inflation expectations are lower than actual inflation, suggesting elevated policy uncertainty is suppressing expectations and 10yr yields. Uncertainty will likely remain high near term, but credit markets are not signaling a high near-term risk of recession.

Rich Ross says the S&P 500 trend remains intact despite a torrent of macro headwinds; target 3,100. 10yr yields are the most oversold in 21 years. However, dollar strength continues to weigh on yields, inflation, and risk appetite, “for now.”

Jaewoo Nakajima notes the three most important drivers for Japan’s growth – global growth, the yen, and consumers – all showed signs of further weakening last week. That is worrisome with a VAT hike just 4 months out.
ED HYMAN – Economics

U.S. GROWTH SLOWING BUT STILL OK: EVRISI surveys of US companies ticked down last week but remained at a level consistent with +2.5% real GDP growth y/y. If real GDP growth is the +2.2% q/q a.r. in 3Q that GDPNow is estimating, then it will be up +2.1% y/y, versus +2.7% y/y in 1Q and +2.3% in 2Q.

NO WARNINGS SIGN OF RECESSION: Cyclical sectors, eg, autos, housing, and capex, relative to GDP typically increase to 28.0% or more before a recession starts.
INFLATION DECIDEDLY MIA: Odds are low that the Fed will hit its inflation target any time soon.

SIGNIFICANT GLOBAL EASING CYCLE: Krishna expects -25bp cuts in both Sep and Oct and for the Fed’s balance sheet to start to increase +$9b per month. ECB’s balance sheet is set to increase +$34b per month. BoJ’s balance sheet is set to continue to increase +$20b per month.
Rising economic policy uncertainty has weighed down Treasury yields in 2019. Recent events suggest it could go higher.

Though core CPI and the PCE deflator have been higher than expected for the past two months, inflation expectations have plunged. Inflation expectations should climb higher, along with 10yr yields, as long as the trade war doesn’t escalate further.
Credit markets are not signaling a high near-term risk of recession. Investment grade credit
spreads are range bound and the credit yield curve is still positive.

OSCAR SLOTERBECK – Company Surveys
Surveys slowing, but the level is consistent with U.S. real GDP growth of roughly 2.5%.
Front-End Surveys show U.S. consumers still solid even as industrial data remains weak.

Employment surveys show labor demand remains a support for growth.
Fed leadership will continue to ease monetary policy with further 25bp rate cuts likely in both September and October, and some chance of a fourth 25bp cut in December. But while they will adopt a relatively open-ended stance as to how far this adjustment may need to extend, they will not change gears to slash rates aggressively unless they see a further marked increase in recession risk, and will avoid setting out a concrete road map on rates, in part out of respect for internal disagreements, in part due to uncertainty about key aspects of the outlook, and in part to avoid inviting further trade escalation.

The ECB will deliver an aggressive stimulus package in September with both rate cuts and QE. On rates, we expect a 10bp rate cut, tiering of the negative rate to reduce the burden on banks, and a new inflation threshold that will commit the ECB to keep rates at present or lower levels until it is close to achieving its inflation target; this should transmit negative rates along the front end of the yield curve and put downward pressure on the euro. On QE we expect an open-ended program around E30bn a month (E20-40bn depending on the design). We think there will be a safety valve of some kind to prevent QE from driving bund yields to crazy negative levels. We think the ECB will increase the share of private assets relative to public and we see a much higher than consensus (50-50 vs consensus 10-20 per cent likely) chance the ECB will start buying bank bonds.

We think German fiscal stimulus is coming but investors need to be realistic about the timeline and content. The fiscal outcome will be shaped by the political context – a weak grand coalition. The SPD-led finance ministry will need to reach an agreement with Merkel’s CDU and this will not be easy given the two may contest an election soon. Further, we think stimulus this time will look different from 2009, less focused on near-term consumption and more focused on medium term public infrastructure and private investment. This would provide multi-year support for the German / Eurozone economy but would limit the amount of fiscal stimulus in 2020, perhaps to 50bp. There will be on-off talk about US fiscal stimulus, but in our base case no actual stimulus due to political divisions between Republicans and Democrats who control the House.
DON STRASZHEIM – China

US-China relations (trade & other) are the worst they have been in decades. Do not expect a near-term deal; tariffs by U.S. increasing Oct 1. However, it is likely there is an indefinite hold before Dec 15 scheduled tariffs.

The #1 & #2 global economies are fighting, which is an ongoing negative. Long-term global supply chains are minimizing exposure to China, killing capex. Hong Kong’s future is grim.

Our Synthetic Growth Index is encouraging, but no take-off. Real GDP will slow in 2019 & 2020. Expect more monetary and fiscal steps coming pre Oct 1.

Implementation of tariffs on list 4B would be a significant negative as there are no alternative sources for those goods.
Although IP rebounded +1.3% (M/m) in July, it remains in a weakening trend and the Y/y reading is down -1.1%. Leading up to VAT hikes in the past, IP was going up.

The widely-followed Japan leading index plunged -1.7% M/m in June, falling to a new low. This is the weakest reading for the LEI with a VAT hike just 4 months out. Going into previous VAT hikes in 1989, 1997, and 2014, the LEI had been increasing.
Declines in job openings probably should be taken seriously, because over the past 35 years, every peak in job openings has signaled a recession except for the 2012 recession.

RICH ROSS – Technical Analysis
The S&P 500 trend remains intact despite a torrent of macro headwinds; target 3,100.
10yr yields are the most oversold in 21 years; “it’s a start, not a bottom.” The risk reward is more favorable for higher, not lower, yields from here.

Dollar strength continues to weigh on yields, inflation, and risk appetite, “for now.” A dollar reversal would be a significant positive for markets.
DENNIS DEBUSSCHERE – Portfolio Strategy

Equity markets remain biased higher as global central banks will continue to keep financial conditions easy. Easy financial conditions are a support for S&P multiples as is the decline in 10yr yields.

The price of the S&P relative to the level of cash return is low compared to history, which is significant because total payout is one of the most important drivers of long-run stock market returns.
U.S. consumer indicators remain strong, and as long as personal consumption continues to grow at a rapid pace, a recession is unlikely.

We continue to recommend fading certainty as trade war induced volatility is unforecastable, but likely to persist. So far this year, the VIX has typically been around 15 and being long volatility around 13/14 and short/selling volatility around 18 has been a profitable strategy.
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