Down Under Daily, 8 January 2018

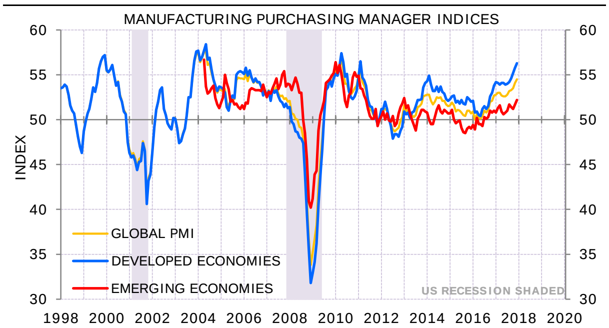
Corporate Bull

Corporates are almost as exuberant as investors. Upbeat corporate sentiment points to faster GDP growth, higher investment, and upgrades to EPS forecasts. All this is bullish. This is increasingly consensus. Consensus views get priced in. This is the setting for a blow-off equity rally. This is also the setting for a subsequent market correction.

Businesses haven't been this upbeat since 2011, particularly in developed economies (Exhibit 1).

Exhibit 1

Exuberance Develops

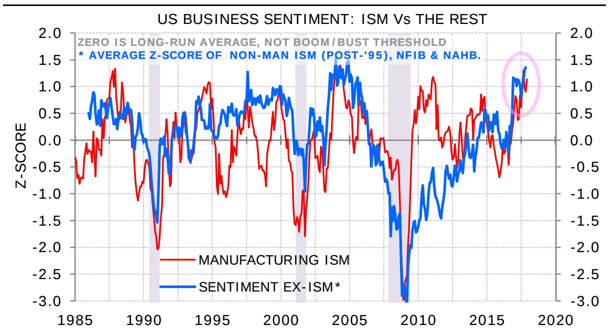


Source: JP Morgan, Markit, NBER; Minack Advisors

Exhibit 1 shows sentiment amongst manufacturers, but the bullishness seems widespread. In the US, sentiment in non-manufacturing sectors is stronger than in manufacturing (Exhibit 2).

Exhibit 2

Everyone's Bullish In The US

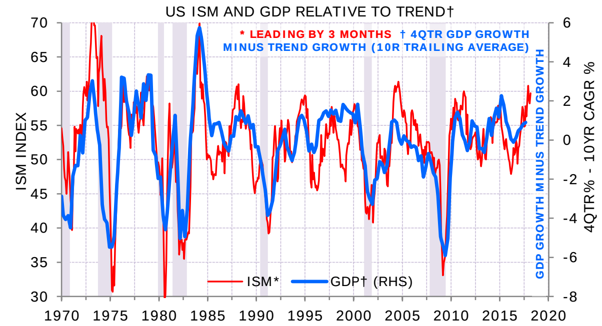


Source: ISM, NAHB, NFIB, NBER; Minack Advisors

Corporate sentiment is a fairly reliable leading indicator for GDP growth. In the US, the manufacturing ISM index has historically provided a good lead on GDP (Exhibit 3 shows growth relative to trend). This fits with the likely near-term boost to growth from the Trump fiscal stimulus.

Exhibit 3

Corporate Sentiment Points To Stronger GDP

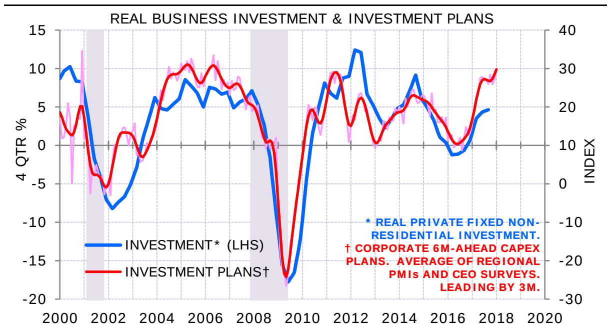


Source: ISM, BEA, NBER; Minack Advisors

Corporate sentiment indicators are, unsurprisingly, a good leading indicator for corporate investment spending. Exhibit 4 shows US business investment and corporate investment sentiment indicators.

Exhibit 4

Bullish Corporates Invest More

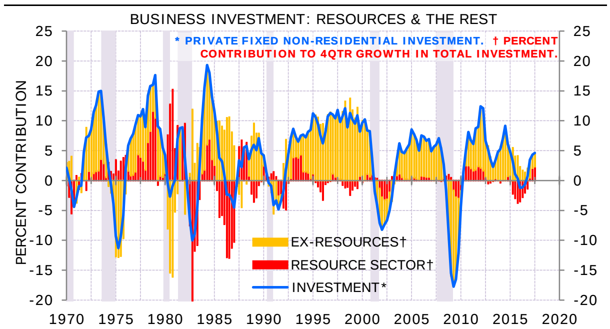


Source: BEA; Business Roundtable; Federal Reserve Banks of Dallas, NY, Kansas City, Philadelphia and Richmond; NBER; Minack Advisors

As an aside, the acceleration in total investment spending is partly due to the end of the recession in resource sector investment (Exhibit 5).

Exhibit 5

The End Of The Resource Recession Helps

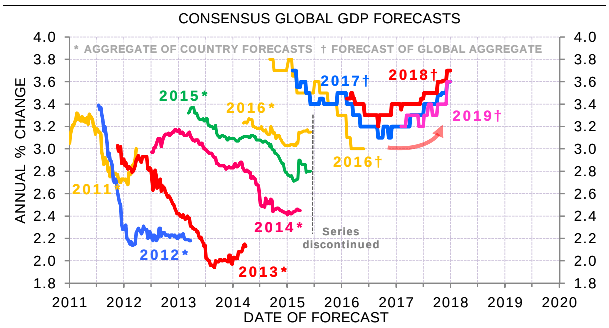


Source: BEA, NBER; Minack Advisors

These trends are global. Global growth forecasts were upgraded throughout 2017, and the upgrades are likely to continue into 2018 (Exhibit 6).

Exhibit 6

Global Growth Upgrades

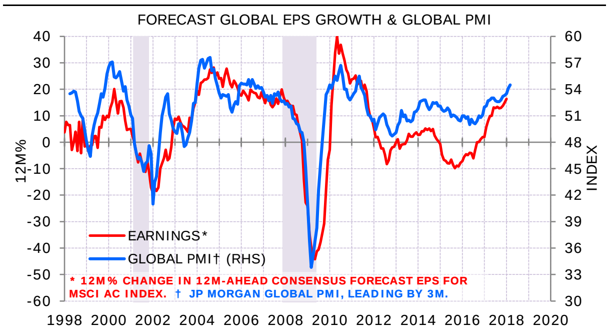


Source: Bloomberg, NBER; Minack Advisors

All this is near-term bullish for risk assets. Corporate sentiment provides a short-term lead on consensus EPS forecasts. The strength in the global purchasing managers' index points to further upgrades in consensus EPS forecasts (Exhibit 7).

Exhibit 7

More EPS Upgrades Coming

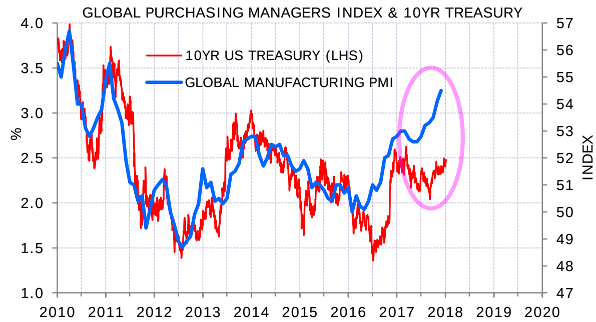


Source: IBES/DataStream, MSCI, NBER; Minack Advisors

In a typical cycle this strength comes with a sting: bond yields are also rising. Not this time: long end yields remain exceptionally low (Exhibit 8).

Exhibit 8

But Bond Yields Don't Follow The Usual Pattern

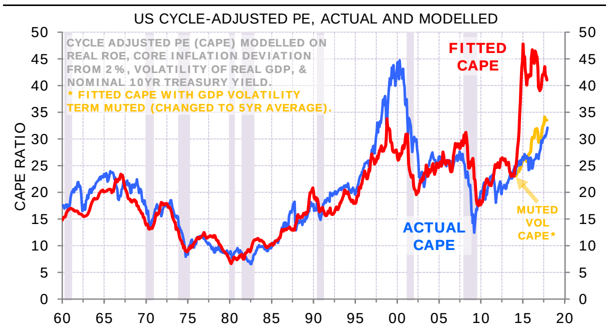


Source: Bloomberg, JP Morgan; Minack Advisors

It's hard to see a cloud on the macro horizon (ahem, ignoring political risks, as markets tend to). As this is becoming the consensus view it is being priced into markets. This is a setting conducive to further equity re-rating – which fits the CAPE (cycle-adjusted price earnings) model in Exhibit 9. This is not a fair value model. It is an attempt to explain what drives equity valuation. The model suggests that equity valuations could go higher in the near term. As more and more good news is factored into prices it will take less and less bad news to trigger a correction. Policy tightening and higher long-end rates are likely catalysts for a correction in 2018.

Exhibit 9

Enjoy It While It Lasts



Source: Standard & Poor's, BLS, BEA, MSCI, NBER; Minack Advisors

Minack Advisors

Office Suite 6, Level 4, 95 Pitt Street, Sydney NSW 2000, Australia
Postal PO Box 284, Mosman NSW 2088, Australia
Phone +61 419 247 981 (m) +61 2 8249 8219 (o)
Email info@minackadvisors.com
Web www.minackadvisors.com
Authorised Representative No. 443937
Minack Advisors Pty. Ltd.   ABN: 84 163 503 044