Forward Guidance: Investor Concerns and Market Trends for 2019 | Peter Boockvar

January 8th, 2019

Then the Gods of the Market tumbled, and their smooth-tongued wizards withdrew And the hearts of the meanest were humbled and began to believe it was true That All is not Gold that Glitters, and Two and Two make Four And the Gods of the Copybook Headings limped up to explain it once more. — The Gods of the Copybook Headings

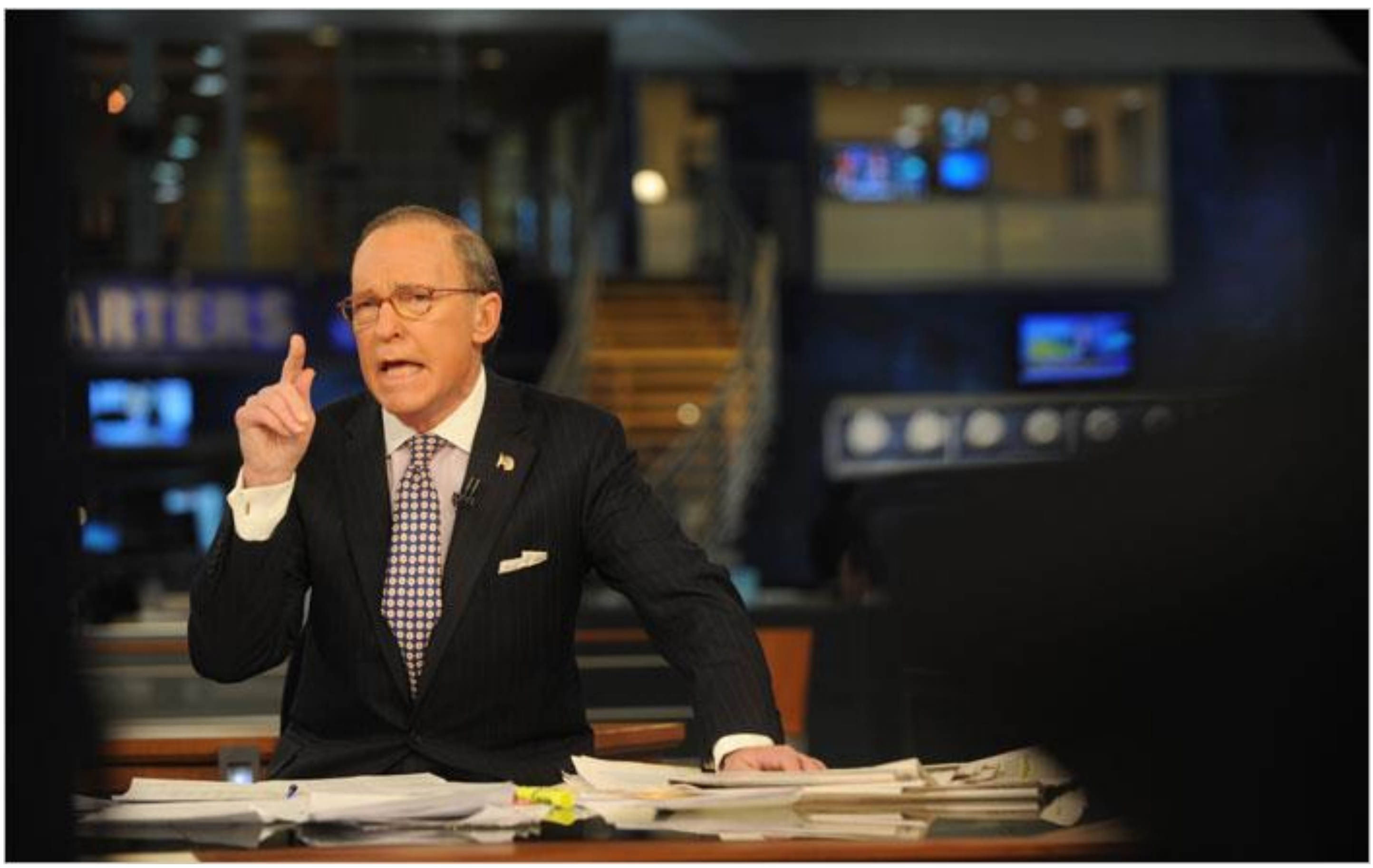
INTRODUCTION

Peter Boockvar is the Chief Investment Officer of Bleakley Advisory Group, a $3.5B wealth management firm. He is also Editor of The Boock Report. He previously was the Chief Market Analyst for The Lindsey Group, a macro economic and market research firm started by Larry Lindsey. Prior to this, Peter spent a brief time at Omega Advisors, a New York-based hedge fund, as a macro analyst and portfolio manager. Before this, he was an employee and partner at Miller Tabak + Co for 18 years where he was recently the equity strategist and a portfolio manager with Miller Tabak Advisors. Peter graduated Magna Cum Laude with a B.B.A. in Finance from George Washington University.

WHY DO I CARE?

Every now and then, I find it helpful to have people from the financial press and broadcast media on my program for their perspective on what the "chattering class" is saying about the health of our economy and financial markets. Peter spends a great amount of time around these folks in his role as regular commentator for CNBC, so he is in a good position to serve as a representative for what the rest of the media is thinking.

Having someone like Peter on also allows me to run the tables on timely market issues, which I don't have the luxury to do with other guests. The topics that I'm most interested in covering on today's show include the latest market data, earnings season, expectations for further Fed tightening, liquidity, financial stocks, the government shutdown, democratic socialism, Trump-inspired volatility, US-China trade war, Apple, Marijuana, and Tesla.



Latest Economic Data

Positives

- ⇒ ***Payrolls*** — December nonfarm payroll employment grew by 312k, well above the estimate of 184k, while net revisions to the 2 previous months were up by 58k. This was the biggest jobs growth since February. [1][2]
- ⇒ ***Household Survey, Labor Force, and Unemployment*** — The household survey showed job growth of 142k which combined with an increase of 419k in the size of the labor force brought the unemployment rate up by 2 tenths to 3.9%. The all in U6 rate though held at 7.6%. The participation rate increased by 2 tenths to 63.1%, matching the highest since September 2013, *suggesting that the rise in unemployment was driven by an increase in the number of people seeking employment*. [3][4][5]
- ⇒ ***Personal Income Data*** — Hours worked totaled 34.5 vs 34.4 in November and 34.5 in October. Combine this with a .4% MoM and 3.2% YoY increase in average hourly earnings – the quickest pace since 2009 and one tenth better than expected – and *average weekly earnings grew by 3.2% YoY, similar to the trend seen in 2018*. [6]
- ⇒ ***Jobs Added*** — Smoothing out the monthly volatility has the 3 month job gain average at 254k, the 6 month at 222k, and the full year at 220k. This compares to last year's average of 182k, the 2016 average of 195k and the 2015 average of 226k. *This is an improvement over both of the last two years*. [7]
- ⇒ ***Vehicle Sales*** — December vehicle sales totaled 17.5mm at a SAAR, above the estimate of 17.24mm but the trend is no different than what was seen from 2015 thru 2017. ***SAAR (seasonally adjusted annual rate) [8]
- ⇒ ***Fed*** — Jay Powell now says he's flexible with both the fed funds rate and the balance sheet after saying the latter was on auto pilot. [9]
- ⇒ ***PBoC*** — To help lift the economy, the PBoC cut reserve requirement ratios (RRR) by 100 bps with half to go into effect on January 15th and the other half on January 25th. The PBoC said this would equate to 800b yuan (about $115b) of freed up cash to all bank lenders as opposed to the more scattered bank approach the PBoC has taken over the past few years. [10]
- ⇒ ***Chinese Services PMI*** — China's Caixin private sector services PMI for December which was 53.9 vs 53.8 in November and that was above the estimate of 53. This level does match the best print since February 2018. Caixin said "Among the gauges included in the survey, the one for new business dipped slightly in December after a rebound the month before, suggesting steady demand across the services sector. The employment measure stayed in positive territory but edged down further, indicating that the employment absorption capacity of the services industry weakened mildly…The measure for business expectations also rose, reflecting service providers' strengthening confidence in their prospects." China's state sector weighted services PMI in December rose to 53.8 from 53.4. That's above the estimate of 53.2. [11]
- ⇒ ***Hong Kong PMI*** — Hong Kong's December PMI was 48 vs 47.1 in November. This does mark the 9th month in a row below 50. Markit said "With soft demand conditions, as indicated by another decline in new business inflows, particularly from China, firms were pessimistic about the business outlook, citing increasing uncertainty in the economic environment as well as greater competition." Markit equates this level of activity to below 3% growth in Q4 and they have a 2.6% growth estimate for 2019. [12]
- ⇒ ***Japanese PMI*** — Japan's final manufacturing figure was 52.6 from 52.2 in November and vs 52.9 in October. [13]
- ⇒ ***PMI's elsewhere in Asia…*** — PMI's elsewhere in Asia: Thailand 50.3 vs 49.8, South Korea 49.8 vs 48.6 and Indonesia 51.2 vs 50.4. [14][15][16]
- ⇒ ***UK PMI*** — The UK services PMI did improve by .8 pts to 51.2 but "The final two months of 2018 saw the weakest back-to-back expansions of business activity since late 2012" according to Markit. The UK

manufacturing PMI rose to 54.2 from 53.6, above the estimate of 52.5. But, Markit said this was due to "short term boosts to inventory holdings and inflows of new business as companies stepped up their preparations for a potentially disruptive Brexit." [17]

⇒ ***German Unemployment*** **—** While economic activity has clearly slowed in Germany, it hasn't yet led to any deterioration at all in their labor market as companies just sit tight waiting to see how things play out from here. The number of unemployed fell by 14k in December as expected and their unemployment rate held at 5%, the lowest since reunification. [18]

⇒ ***Eurozone CPI*** **—** December CPI in the Eurozone rose 1.6% YoY, one tenth less than expected and down from 2% in November. The collapse in oil prices helped out. The core rate held at 1% as expected. [19]

⇒ ***Eurozone Credit Growth*** **—** The ECB said corporate lending grew by 4% YoY in November vs 3.9% in October while loans to households grew by 3.3%, up 10 bps from October. That loan growth to households is actually the best since 2009 but keep in mind that these are all nominal figures, highlighting still ordinary growth. Money supply growth was higher by 3.7% YoY, down from 3.9% in the month prior and one tenth less than expected. [19][20]

Negatives

⇒ ***Pause in Fed Tightening?*** **—** Is the Fed going to get stuck with a fed funds rate of only 2.50% and still a very fat balance sheet going into the next downturn because we can't handle any further tightening? We already know the BoJ, ECB, BoE, SNB, etc., have no options left to deal with challenges that will come their way.

⇒ ***ISM Manufacturing Index*** **—** The December ISM manufacturing index fell to 54.1 from 59.3 and that was 3.4 pts below expectations. It's also the weakest print since November 2016, the month of the presidential election. New orders fell a sharp 11 pts to just 51.1, barely above the breakeven of 50. Backlogs dropped by 6.4 pts to exactly 50. Of the 18 industries surveyed, just 11 saw growth from 13 in November and 6 reported a contraction vs 3 in the month prior. Only 6 industries saw growth in new orders from 11 in November. The ISM said "Comments from the panel reflect continued expanding business strength, but at much lower levels." [21][22]

⇒ ***Jobless Claims*** **—** Initial jobless claims were 11k more than expected at 231k and up from 221k last week (revised up by 5k). Holidays are big influence on the seasonals however. [23]

⇒ ***Real Estate Finance*** **—** The MBA said purchases fell 7.6% W-o-W and refi's were lower by almost 11% as everyone is focused on the holidays and the MBA doesn't do good job with seasonal adjustments this time of the year. ***Mortgage Bankers Association (MBA) [24]

⇒ ***Chinese Manufacturing PMI*** **—** China's private sector weighted manufacturing PMI for December fell by .5. to below 50 at 49.7. The estimate was for no change and it's the first time it's in contraction since May 2017. Caixin said "In general, China's manufacturing sector faced weakening domestic demand and subdued external demand in December. Companies had a stronger intention to destock and prices of industrial products were declining, which could further drag on production." China's state sector weighted manufacturing PMI in December fell below 50 to 49.4. The estimate was for no change. [25]

⇒ ***Singapore, India, et.al. Manufacturing PMI*** **—** Singapore's PMI fell to 52.7 from 53.8 after last month's 1.2 rise. India's services PMI was .5 lower MoM to 53.2. Other manufacturing PMI's out of Asia: Taiwan 47.7 vs 48.4, Malaysia 46.8 vs 48.2, Philippines 53.2 vs 54.2, India 53.2 vs 54 and Vietnam 53.8 vs 56.5.

⇒ ***Eurozone Services PMI*** **—** The services PMI from the Eurozone for December was revised down to 51.2 from the first print of 51.4. That's the weakest level in over 4 years and is getting close to the flat line. This brings the manufacturing and services composite index to 51.1 from 52.7 in November. Markit said "While a drop in business activity in France could be partly blamed on the 'yellow vest' protests, the rest of the region lacks any such mitigating factors, albeit with the recent weakness of the autos sector hopefully a temporary setback. Importantly, with expectations of output dropping to the lowest for over 4 years, companies are not anticipating any imminent revival in demand. Worries reflect multiple headwinds from trade wars, Brexit, heightened political uncertainty, financial market volatility and slower global economic growth." [26]

⇒ ***Hong Kong Retail Sales*** — Hong Kong retail sales rose 1.4% YoY in November vs the estimated 4.5%. This is the slowest pace since June 2017. A government spokesman said "Consumer sentiment could be affected by weaker asset prices and the external uncertainties." [27]

⇒ ***South Korean Exports*** — South Korea said its December exports fell 1.2% YoY, well worse than the forecast of up 2.5%. [28]

⇒ ***Australian Housing Market*** — The Australian housing bubble continues to deflate. Australian house prices continue to fall, dropping 1.3% MoM in December and that is the 14th straight month of declines. [29]

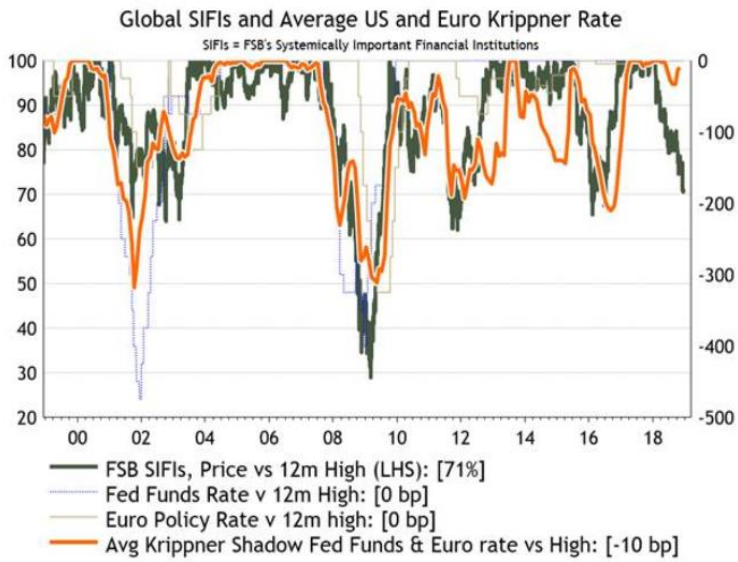
⇒ ***Singapore GDP*** — Singapore reported a softer than expected GDP report for Q4 as its economy grew by 2.2% YoY, below the forecast of up 2.5%. That's the slowest pace of gain since Q3 2016. [30]

⇒ ***Global Liquidity*** — The combined balance sheets of the Fed, ECB and BoJ will start to contract in Q1. [31]

Earnings Season — **Q:** What are the key earnings reports that you will be paying particular attention to over the next few weeks?

Forward Guidance — "US data seem to be on track to sustain good momentum into the new year," Fed chairman Powel said at the American Economic Association's Annual Meeting (ASSA) in Atlanta, adding that the Fed would take a "patient" approach to monetary policy tightening. He also seemed to revise previous comments about the intractability of the Fed's balance sheet contraction by stating that although he did not think that recent market volatility was cause for concern that the Fed "wouldn't hesitate" to change balance sheet policy if the need should arise. The markets proceeded to rally, sending the S&P 500 up by 3.4%, the NASDAQ by 4.3%, and the Dow Jones by 3.3%. Treasuries sold off, pushing the 10-year US government bond yield up by 11 basis points to 2.66%. **Q:** Where does the Federal Reserve Board stand at this time? **Q:** Is the Fed truly "data dependent," or will they take the recent volatility and price signals from the market into account when it comes to further tightening? **Q:** How are markets distinguishing between Fed rate rises and further balance sheet contraction? **Q:** How concerned are markets about liquidity?

Financial Stocks — Financial sector stocks had a rough December, with the S&P 500 Financials Index down almost 18% in the three weeks leading into Christmas (+25% off their highs), culminating with a bizarrely confusing (and possibly alarming) message from Steven Mnuchin's office at Treasury meant to reassure markets that there were no issues with liquidity at the nation's largest banks. **Q:** What are we to make of this pronouncement and have markets made up their minds about what it means? (i.e. Do we read into it? Does it suggest something more serious?) **Q:** What do we make of the persistent sell-off in financial stocks given the positive economic data that we continue to see? In the chart to the right, the price of global SIFI's (systemically important financial institution's) are plotted against the Fed Funds Rate, the Euro Policy Rate, and what is known as the Krippner Rate, which tries to compensate for the role of extraordinarily accommodative monetary policy on the effectiveness of traditional interest rate measures for gauging liquidity. **Q:** How much of this is being driven by the physics of dollar liquidity (Fed balance sheet contraction)? It's a funny thing, because higher rates also give banks the opportunity to make money on the carry. **Q:** Is the interest carry now broken? **Q:** How important are traditional lending practices to banks' business in 2019?

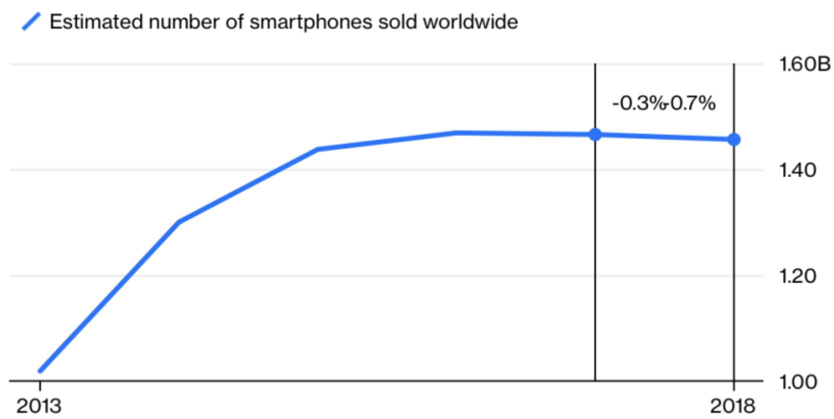


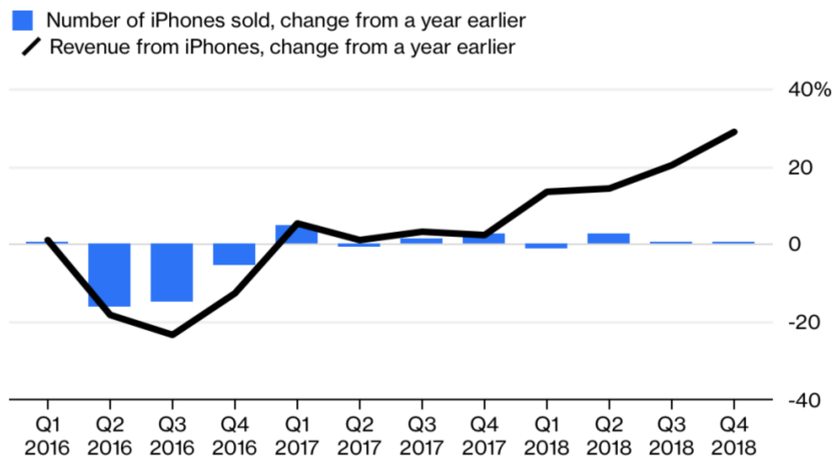
Normally, with Global SIFIs down 30% from their 12m peak, rates have typically been 200bp lower (or when rates were already at zero — shadow rates had come down by a similar amount as QE was expanded rapidly)…with policy makers resisting doing that, the pressure is just going to build (and we are now seeing this in the OIS-Libor spreads and TED spreads). – Ian Harnett, Absolute Strategy Research

Government Shutdown — If nothing changes, the government shutdown will be entering its fourth week when this episode airs, making it the longest on record (beating the 1995 congress in which Newt Gingrich was Speaker of the House). **Q:** What is the material vs. perceived impact of this shutdown? Up until now, financial markets have seemed largely unphased by the dysfunction in congress, as well as by the manifest ineptitude of the executive branch (ex: personnel issues & departures). **Q:** What will it take for what is happening in Washington to have an impact on markets?

Apple — In a 1,400-word letter to its investors, Apple lowered revenue guidance to $84 billion, from the $89-$93 billion it had previously projected, blaming a variety of factors for the December quarter miss (*their first miss in recent memory*) driven entirely by lower than expected iPhone sales. Apple indicated that the majority of the revenue shortfall was "primarily in Greater China," but also said that upgrades to new iPhone models in other countries were "not as strong as we thought they would be." The next day, Apple's shares dropped by 10%, the company's worst one-day performance in five years, leaving it valued at $675bn, less than Microsoft, Amazon and Alphabet. (In a matter of months, it lost over $300bn of market capitalization from its peak of just over $1 trillion.) **Q:** What can you tell us about how markets and the financial media reacted to this news? **Q:** What is the significance of Tim Cook's warning to investors? ***Research firm IDC estimates global sales of smartphones declined slightly in 2018 (as they also did in 2017).

Apple has managed to grow revenues by increasing prices on new models. **Q:** How much of this story is Apple specific (changes in upgrade behavior, more competition, smartphone market saturation, etc.), and how much is it being driven by the trade war as Tim Cook was suggesting in his comments to Josh Lipton? **Q:** What are investors looking for from Apple (more innovation, new products, larger service offerings, more enterprise clients, etc.)? It's important to note that this is a very different company than the one that launched the iPhone almost 12 years ago. Back then, Apple had *17,787 employees*, according to regulatory filings from late 2006. Apple's headcount now stands at *132,000* (doubling since 2012). Their research and development budget continues to soar (up 23% YoY), yet despite this, they seem to have lost something with the passing of Steve Jobs. Apple built itself back up to become the largest company by market cap in the world off of the back of revolutionary innovation. **Q:** Apple's brand remains closely tied to that image, but has its culture become too focused on process? **Q:** How did investors value Apple during the Steve Jobs era, and what metrics are they using to judge it today?





"**If you look at our results, our shortfall is over 100 percent from iPhone and it's primarily in greater China**," Cook told CNBC's Josh Lipton in an interview Wednesday. "**It's clear that the economy began to slow there for the second half and what I believe to be the case is the trade tensions between the United States and China put additional pressure on their economy.**" – Tim Cook, Apple CEO

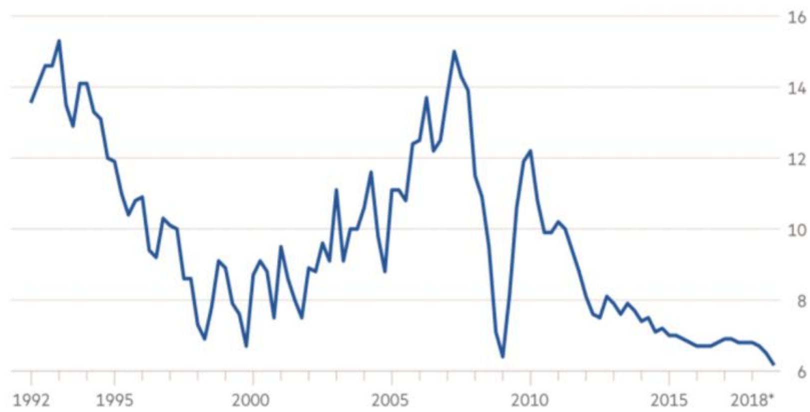
"You know what it is? People get confused. Companies get confused. When they start getting bigger they want to replicate their original success. And they start to think that somehow there is some magic in the process of how that success was created. So they start to institutionalize the process across the company. But before very long people get confused and think that the process is the content. And that was ultimately the downfall of IBM. IBM had the best process people in the world but they forgot about the content. And **that's what happened a little bit at Apple too. We had a lot of people who were great at management process and they didn't have a clue as to the content.** And in my career, I found that the best people are the ones who understand the content. They are a pain in the butt to manage. You put up with it because they are so great at the content. **And that's what makes a great product. It is not process. It is content.**" – Steve Jobs, The Lost Interview

China Weakness — Tim Cook's statements on Apple's weaker than expected iPhone sales in China are anecdotal evidence in support of the view that the US-China trade war is having a bigger and more immediate impact on the Chinese economy than has been generally understood. China's car market recently suffered its steepest monthly fall in more than six years, as it heads for its first annual drop since the 1990's (three decades). Profits also fell for the first time in nearly three years last month at Chinese industrial companies. Industrial profits declined 1.8% in November from a year earlier, the first negative reading since December 2015 and a steep fall from 3.6 per cent growth in October. The release of the official data coincided with China's internet regulator announcing tighter controls on financial information providers. In addition, China's national statistics agency recently forced Guangdong province (the southern export hub) to stop publishing its monthly purchasing managers' index (PMI), a closely watched gauge of manufacturing activity and sentiment. **Q:** What can we infer about the health of China's economy from the numbers and from the anecdotal evidence? **Q:** How are markets pricing the possibility of a slowdown in China, and how are they pricing the risk of the long-feared 'hard landing?' **Q:** How can investors protect themselves from escalations in the trade war and from deterioration in trade relations? **Q:** Do you and most other analysts and commentators expect to see a resolution in the near future. If so, when?

Global Dimensions — **Q:** Generally speaking are markets discounting the possibility that we could head into another financial crisis? There was an unexpected level of anxiety around Chairman Powell's remarks at the panel in Atlanta, and Steve Mnuchin's "reassurances" remain an odd data point for investors. Even if US banks are in better shape than they were in 2008, European banks are still suffering and China's banking system remains a tangled web of liabilities.

China's economy is slowing

Real growth in gross domestic product (annual % change)



*Q4 2018=forecast
Sources: National Bureau of Statistics, CEIC, UBS
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Key indicators point to worsening Chinese slowdown

Annual % growth, monthly

*Year to date
Sources: National Bureau of Statistics; CEIC
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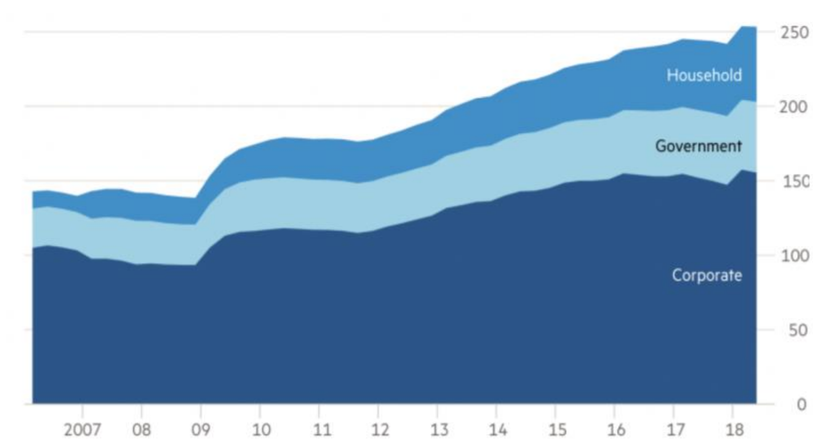
Rise in debt limits Beijing's space for stimulus

Debt as share of GDP (%)



Source: Bank for International Settlements
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Telsa — Tesla is the bellwether stock for the health of this long-running bull market in equities and credit. It has been *remarkably* resilient, in my view, given the horror show that is its balance sheet, management, and competitive landscape. It faces many headwinds. **Q:** What do you feel accounts for the resilience of Tesla's stock price? **Q:** What is the feeling among financial journalists and media-types about the company's prospects?

Marijuana Stocks — The legal cannabis sector has gone absolutely berserk this past year, as it seems to have absorbed the air that was seeping out of the crypto balloon. Indeed, marijuana stocks, crypto, and tesla all seem to be riding the same wave of millennial money. ***I believe that Constellation Brands reports this week. **Q:** What are your thoughts on this sector? **Q:** How has it performed in 2018? **Q:** Do you see any interesting short opportunities here?

Stocks Oversold? — Generally speaking, do you feel that stocks are oversold at these levels? There seemed to be a lot of pessimism at the height of the sell-off in December, but much of the anxiety being channeled by the media seems to have given way to talk about "buying the dip." **Q:** Are you a buyer at these levels, and if so, of what? **Q:** What is your opinion on some of the tech stocks that were most hammered, like Facebook?

Populist Dems — The recent arrival of a new batch of activist, populist democrats (some of them with very socialist agendas) may hint at what is to come in 2020: a rebirth of democratic socialism, with proposals for large tax increases, more regulation, and more government spending. The probability of a backlash against the Trump base is the most likely macro prediction I can make. **Q:** Why is no one talking about this? **Q:** Why is the focus entirely on social issues?