Zacks
INVESTMENT
MANAGEMENT

STOCK MARKET OUTLOOK

FORECASTS OF FUTURE ASSET CLASS RETURNS

John Blank, Ph.D.
Chief Equity Strategist, Zacks Investment Research

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Zacks Investment Management
Born from Research, Built for Performance

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U.S. Markets

The earnings recession of 2019 continues unabated.

On August 2nd, the blended S&P500 index earnings decline for Q2-19 is -1.0%. Yet this was smaller than the earnings decline of -2.7% last week.

If -1.0% is the actual decline for the quarter, it will mark the first time the S&P500 index has reported two straight quarters of y/y declines in earnings since Q1-16 and Q2-16.

- Four sectors have reported y/y earnings growth. Health Care (+8.0%) and Financials (+5.2%) lead that group.
- Seven sectors have reported a y/y decline in earnings. Materials (-17.8%), Industrials (-10.3%), and Info Tech (-7.6%) lead that group.

On August 2nd, the blended revenue growth rate for Q2 is +4.1%. This is above the revenue growth of +3.9% last week. If +4.1% is the final growth rate for Q2, it will mark the lowest revenue growth rate for the index since Q3-16 (it was +2.7% then).

- Eight sectors report y/y growth in revenues. Communication Services (+14.5%) and Health Care (+13.4%) lead the way.
- Two sectors reported a y/y decline in revenues. Materials (-17.5%) stink most.
- One sector (Industrials) reported no growth (0%) in revenue.

Looking at 2H-19, analysts foresee a decline in earnings for Q3 followed by mid-single-digit earnings growth in Q4.

The basic S&P500 sector points – to apply to the U.S. China trade war -- are below.

S&P500 Sector	International Exposure (% of Revenues)
Info Tech	58
Materials	55
Consumer Staples	45
Energy	41
Health Care	38
Industrials	37
Comm. Services	37
Financials	22
Real Estate	14
Utilities	3

If a given S&P500 sector's international revenue exposure exceeds 50% (Info Tech is 58% and Materials is 55%), that sector's earnings suffer more from Trade War tariffs.

These more internationally exposed sector's supply chain costs are heavily exposed to tariffs, cutting down profit margins. Final demand suffers from all-in higher tariff prices.

The Health Care and Financial sectors have much lower international exposure, at 38% and 22% revenue exposure, respectively. Not surprisingly, those sector's earnings benefitted the most, from the insulation of their mostly-domestic business models.

With seven S&P500 sectors suffering EPS declines y/y in Q2, and only 2 sectors suffering a decline in revenues in Q2, one can also infer: The negative trade war effects on profit margins are larger than they are on revenue growth.

If you are looking for a current historical analogy --showing you what you might do as an investor or trader in 2019-- the 2016 period is the best.

In 2016, the big problem for earnings growth was a collapse in crude oil prices (caused by another top-down government actor, the Saudis). An oil bear market boosted U.S. household income, but undermined corporate earnings, especially energy companies.

The consumer hung in there in 2016, and continued to shop and spend.

The timing of the profit downturn was somewhat similar in 2016. It took place in the face of an American economy that continued to grow, albeit slowly.

But the one-two punch of cheap oil and a strong U.S. dollar were powerful enough forces to drown out steady U.S. earnings growth.

What about stocks? 2015 returned -0.73%. 2016 was a volatile year for the S&P500. It marked a +9.54% total return.

As I write, the S&P500 trades at 2,873 on August 6th, 2019. One year ago, it traded at 2,853. That looks and sounds like the flat 2015 return.

Markets are forward looking, though. There is more hope for a bounce, if the market sees an end to the trade war, than you may think.

The date of the next Presidential election, in November 2020, is one Rubicon to think harder about. The stock market may price in an end to the trade war, believing in an end that comes only then.

That would put a 12-month forward bullish (trade war's end with regime change) cyclical rotation at roughly around November 2019.

Global Markets

In early July, on my way to the Naadam festival in Mongolia, I took a flight to Beijing.

What I viewed there is worth sharing. The airport there was 10 years old. There is a checkerboard arrangement to the urban Beijing landscape. Think about 15 of the same apartment blocks covering one square of a checkerboard. Adjacent squares are typically left fallow, in rice production or green space, or something. It's not Calcutta or Chicago. From the air, it is very obviously planned.

There are brand new (10-year-old or less) Bullet Trains running across the urbanized country. There are brand new 8-lane freeways, snaking through where needed.

This gets to the main point about China. The Chinese government is (and/or was) Communist. This means it started this market reform drive owning the means of production, land, labor and capital.

In their stimulus efforts, they sell the national land to private owners. Think of it as a whole square on the checkerboard. These groups then follow up in the constructive direction of what the government wants done on that part of the checkerboard.

In short, over the last 10 years, Chinese growth ultimately is NOT as much about trade relations with the U.S. -- as much as it is about the use of central credit growth.

In June 2019, two top-down BCA China analysts, Peter Berezin and Arthur Budaghyan related heir respective outlooks for China. And on this very Chinese credit creation process!

Specifically, their dialogue exposed why they differ on the macro and stock market implications of --

- A decade-long boom in credit expansion in China,
- The country's prospective potential growth rate, and
- The ensuing implications for returns on related invested capital.

Key Points:

1. Both agree that China produces more than it consumes.

Arthur argues credit policy promoted an environment of profligate bank lending. That led to mal-investment. This will eventually manifest in low corporate profitability and the impairment of bank capital.

Peter argues that Chinese credit growth has served the greater good by propping up employment via capital investment. This is a lesser evil. A rise in unemployment would otherwise ensue from an environment of chronic surplus production (and under-consumption) without government support (via credit expansion) for aggregate demand.

He also argues the state's role in the economy drives the government's willingness and ability to act as a spender of last resort (via fiscal stimulus which manifests in credit expansion) until consumption rises in relation to income.

The crux of their disagreement relates to opposing views on the definition and relevance of economic 'savings' as a driver of the credit expansion that has taken place over the last decade.

2. Importantly, <u>neither</u> Peter nor Arthur assign high odds to a 2008-style financial market meltdown occurring as a result of high leverage, given China's mostly state-owned banking system and government controlled foreign exchange/capital account regime.

Nonetheless, they differ on the likely investment implications of continued reliance on fiscal and monetary stimulus promoting credit creation as a growth lubricant.

Arthur expects productivity and thus trend growth to decline.

Peter expects China's growth rate to decline in absolute terms. But it will converge positively towards higher income nations like South Korea. This is in relative terms, given an educated Chinese workforce.

The former is naturally less sanguine about the outlook for related Chinese financial asset prices than the latter.

3. Both acknowledge that in the current environment, China is likely to stimulate its economy through traditional fiscal and monetary channels given the risk of an external (trade) shock in the coming months.

This dynamic will give rise to another reflationary mini-cycle. That flatters China-geared financial assets and commodity prices, likely in the latter half of 2019.

Arthur expects this shift to occur only after further market capitulation. Since the China government is mindful of the risks of burgeoning leverage and will thus be more parsimonious with stimulus than in the past.

Peter expects the turn could be more imminent. The government has an urgent incentive to bolster its economy in order to gain leverage in trade negotiations with the U.S.

Bottom line:

Different frames of reference on the root sources --and thus sustainability of a large credit expansion in China-- account for Peter's more constructive view and Arthur's pessimism about China's outlook.

When should an investor or trader adopt a more pro-risk stance -- on China-related assets later in 2019, with a forward-looking cast of mind?

Only upon further evidence: That the Chinese government's traditional playbook of indemnifying their own economy from external shocks is coming to fruition.

The Chinese are not caught flat-footed by this escalation in the U.S. China trade war. Evidence of successful new Chinese credit-driven growth can come in the fall of 2019.

2. U.S. Macro Outlook-- San Francisco Fed "Fed Views"

Mark Spiegel, vice president at the Federal Reserve Bank of San Francisco, stated his views on the current U.S. economy and the outlook as of July 11th, 2019.

Current economic growth is above trend, but is projected to slow over the coming year towards our estimated long-run potential pace of slightly below 2%. This expected slowdown was noted in the recent Congressional testimony by Chair Powell, who paid particular attention to cooling business investment, subdued inflation data, and crosscurrents associated with slow global growth and trade tensions.

In contrast to the weakening investment picture, consumption appears to be picking up. Recent reports on automobile and retail sales have been strong, and measures of consumer sentiment remain quite elevated. Many of the other sources of strength in the first quarter, such as inventory adjustment and improvements in net exports, are expected to be transitory.

The labor market continues to display strength. Payroll employment grew by 164,000 in July and by 193,000 jobs in June; monthly gains for the first six months of 2019 have averaged 172,000, far above the level estimated to be consistent with absorbing new entrants to the labor force. The strong job picture continues to draw more searchers into the labor market, resulting in the measured unemployment rate rising up a notch to 3.7%. However, unemployment still remains substantively lower than the estimated long-run natural rate of 4.2%.

Over the past ten years, inflation has been below the FOMC's symmetric 2% target far more often than it has met or exceeded that target. Recent inflation figures remain discouraging, with the personal consumption expenditures (PCE) price index in May only increasing at a 1.5% annualized pace over the previous 12 months. Core PCE inflation rose 1.6% over the same period. The slow increase in wages is one factor keeping inflation below its target level. Despite the continued strength of the labor market, upward pressure on wages remains rather tepid, increasing only 3.1% for the year ending in June.

The federal funds rate, the monetary policy rate, is currently close to the level that we consider consistent with a neutral monetary policy stance.

Treasury yields have increased modestly since the previous FOMC meeting, with the spread between 10-year and 3-month Treasury yields remaining "inverted," in the sense that the 3-month rate currently exceeds the 10-year rate. While such inversions have typically indicated recessions in the past, there is reason to believe that the very low long-term yields prevailing in current markets are partly attributable to special factors. These include the large holdings of long-term treasuries accumulated by the Federal Reserve through its past quantitative easing policy and elevated "safe haven" demand for long-term U.S. Treasuries due to heightened global uncertainty.

The ongoing trade disputes between the United States and its main trading partners, particularly China, represent a prominent source of global uncertainty.

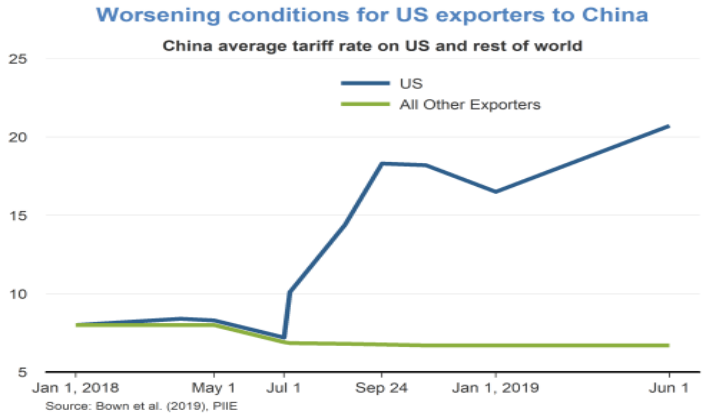
The United States currently is levying a 25% tariff on $250 billion in imports from China, (and will soon levy a 10% tariff on $300 billion more goods on Sept. 1st). Markets rallied following the recent G-20 meeting, after the United States and China agreed to postpone any future tariff increases. However, much uncertainty remains about the ultimate resolution of this conflict, and measures of uncertainty about trade policy remain quite elevated.

A recent report from the Petersen Institute highlights the fact that China responded to U.S. trade restrictions by raising its tariffs on imports from the United States, while lowering them on imports from the rest of the world. These responses have left U.S. exporters at even worse competitive positions for the large Chinese market.

While the United States and other exporters stood on equal footing at the start of 2018, by June of this year tariffs on U.S. products had risen to over 20%, while those on exports from other countries had fallen to 6.7% on

average.

The report also notes that China has been strategic in focusing its tariffs on U.S. goods that are either considered less vital or more easily sourced from other countries. For example, tariffs on agricultural products have been raised from 21% to 43%, while no tariffs are being levied on other more essential imported goods, such as pharmaceuticals.



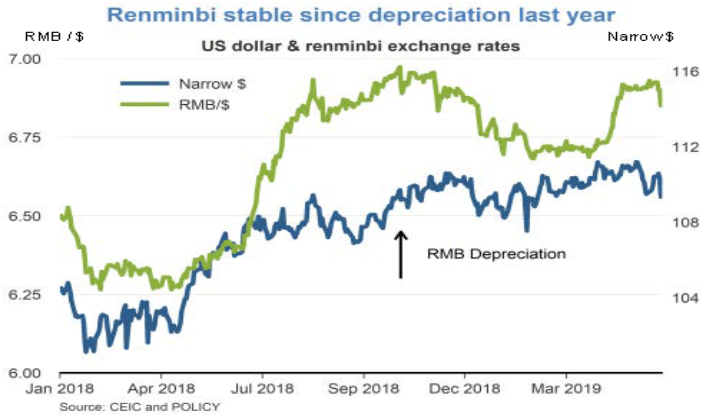
Many goods, particularly manufactured products, cross country borders a number of times during the production process, leading to multiple exposures to tariff duties. This is particularly true for U.S.-Mexican trade, involving goods such as automobiles and appliances.

Components are produced in one country and then can travel back and forth across the border at different stages of production. With a 25% tariff on goods transported from a country to the United States, the final price of the item reflects not only the value added during production but also the added tariffs each time the product crosses the border.

Recent movements in China's exchange rate have been interpreted as reflecting efforts by China to offset the effects of U.S. tariffs on demand for its exports by lowering the price of its currency.

However, although the renminbi depreciated significantly against the dollar in the late spring and summer of 2018, this currency change occurred at roughly the same time as the dollar was appreciating against other currencies, as measured by the narrow dollar index.

Since that time, the renminbi has basically floated within a limited trading range of between 6.75 and 7.00 to the dollar, with little notable trend.



3. Zacks Forecasts at a Glance

Top-Down S&P500 2018 Yearend Targets

Harvard Economist and former U.S. Treasury Secretary Larry Summers had this to say on August 5th:

"We may well be at the most dangerous financial moment since the 2009 Financial Crisis, with current developments between the U.S. and China. Markets are now suggesting the highest risk of recession since 2011, only slightly less than half over the next year. The collapse of medium and long-term interest rates is ominous."

Before the sudden early August plunge in stock values, the S&P500 index showed us a +13.5% YTD return to the end of July.

Ranking S&P500 sector returns YTD (to the end of July) showed cyclicals led the way in 1H-19: Tech $XLK: +22.2% Real Estate $XLRE: +19.3% Communications $XLC: +16.8% Consumer Discretionary $XLY: +16.1% Industrials $XLI: +14.5% Consumer Staples $XLP: +13.5% Utilities $XLU: +11.9% Financials $XLF: +11.8% Materials $XLB: +11.3% Health Care $XLV: +2.7% Energy $XLE: +2.0%

Let's recap how we got here. After the first 61 trading days in 2019, a multi-week V-shaped recovery produced a stellar +13.1% S&P500 total return to early April. This was the strongest trading start in 30 years. Then in early May, and again in early August, the major U.S. indexes got a stiff sell-off, due to U.S. China trade war escalation. In short, the markets are flat to down after the early bounce back this year. Returns are truly flat, and volatile, over the last year.

I remain tepidly bullish on U.S. stocks across 2H-19. However, after the further breakdown in U.S. China talks and Mexico border issues escalating, I worry out loud. Global stocks rise – only if the parties get back together, and make a broad deal (with less sticking points). U.S. stocks are stuck in a flat and volatile pattern.

With the glass half full, however, fundamental U.S. earnings reports for Q2 are doing fine.

From our Research Director, here is how to factually sum up the current U.S. large cap earnings situation-- duly incorporating a soft future Q3-19 earnings season-- but affirming a better Q4-19 showing later on.

After seeing results from 428 S&P500 members through Thursday, August 7th, there are no major surprises on the growth front.

We knew it would be anemic. We should keep in mind (however) that the growth challenge is more a function of tough comparisons to last year's record results than a cyclical downturn in profitability.

Total earnings for the 428 S&P500 index members that reported are up +0.9% from the same period last year on +5.1% higher revenues.

Earnings and revenue growth for the same cohort of companies had been -0.3% and +4.5% in Q1, respectively.

In other words, Q2 earnings growth is tracking modestly above what we saw in Q1. Revenue growth is almost even between Q1 and Q2.

What's 'Fair Value' on the S&P500?

To attempt this, compute earnings growth ahead, like the stock market does, 6 to 12 months.

Very bullish top-down Wall Street strategist calls for the S&P500 end the current year trading at 3,100 or 3,200. The average for 22 strategists listed by Bloomberg had the S&P500 end 2019 at 2,975. Operating earnings averaged $172.34 for 2019.

"Bottoms-up" 2019 analyst earnings sum to $165.80 at the moment I write. They see $183.69 for 2020. A 12 month look-ahead means 5 months of 2019 and 7 months of 2020 = $176.00. This is $4 above the top-down consensus for calendar year 2019.

The S&P500 at 2,850 divided by $176.00 = 16.2. That's one fact check on S&P500 valuation.

Duly noting both sets of earnings, I think 2,900 on the S&P500 for Q3 or Q4 2019 is a fair target. That will sound OK to many, given static earnings growth in Q1 and Q2 and likely Q3.

Cuts to global growth remain the biggest hurdle for non–U.S. stock markets.

The July Caixin small company manufacturing PMIs out of China had a stable 49.9. There was a 49.7 from the official large state-owned company version. The 50 Rubicon was barely broken. The following list of China policy responses have been announced this year, so far:

- On January 2nd, China announced plans to build 3,200 km of new high-speed railways in 2019, with the total length expected to exceed 30,000 km.
- On January 4th, China cut its reserve ratio 1.0%. Those hit Jan. 15th and Jan. 25th.
- On March 5th, Chinese Premier Li Keqiang, in his opening remarks at the annual National People's Congress, announced cuts in taxes and fees worth nearly 2 trillion yuan ($289B).
- In addition, Li announced plans to increase the country's infrastructure financing: Around 2.15 trillion yuan worth of local government special bonds will be issued this year to meet spending needs for key projects.
- The PBoC is expected to lower interest rates twice later in 2019 and once in 2020.
- Further actions will likely be in the form of fiscal stimulus, Goldman Sachs thinks. Some relaxation in property measures could be in the cards too.

The Chinese are more likely going to 'wait it out' versus 'giving in'.

Eurozone bloc Q2-19 GDP growth data came in at +0.2%, down from a +0.4% mark in Q1-19.

It's not all stagnation in the EU bloc. The seasonally adjusted unemployment rate fell, from a revised 7.6% in May to 7.5% in June, its lowest level in 10 years.

For July, IHS Markit's Purchasing Managers' Index (PMI) for German manufacturing, which accounts for about a fifth of the German economy, came in at 43.2.

The latest German PMI reading signaled the steepest decline in overall manufacturing conditions since mid-2012. New export orders dropped the most since April 2009 --amid falling sales to China-- and a slump in the automotive sector. Also, the rate of decline in output was the second-quickest since July 2012 while workforce numbers declined to the greatest extent for seven years and buying levels contracted the most in over a decade.

The U.S. economy is doing fine. Non-farm payroll added +164K jobs in July, +193K in June, +62K in May, +216K in April, +153K in March, a paltry +56K in February, and +312K in January.

The U.S. China trade war did indeed show us negative earnings effects in Q2-19. Seven of 11 sectors in the S&P500 in Q2 shouldered cuts to earnings, with the globally exposed Materials, Industrials, and Info Tech sectors suffering the most.

Can a U.S. stock market bounce materialize this fall?

On August 6th, the S&P500 prices at 16.2X on a forward 12-month earnings outlook. In Jan. 2019, the S&P500 priced at 14.2X. Early August valuations are a mostly in line with a 5-yr average at 16.2 Looking further back,

the S&P500 forward P/E ratio is well above the 10-yr average S&P500 forward valuation of 14.8.

Want the joint catalysts for both U.S. and global bulls? In Q3 or Q4 or later, they are a U.S. China trade deal and/or visible China stimulus. The two are not mutually exclusive. With those in hand, we need a passage of time to repair trade war damage. I mean multiple months of time.

The White House is boxed in --*and uses policy tools and tweets to fight*. A Democratic House is fighting back. Divided government is a reality until the next election.

After the December 2018 stock market plunge, the FOMC downshifted to a dovish stance. Fed Chair Powell cut Fed Funds rates 25 bps at the late July meeting. The August stock market plunge assures another 25 bps cut at the September meeting. I didn't get his thought on the U.S. economy being at 'mid-cycle'. My guess is that he regrets that statement. It's late cycle.

I summarize the U.S. situation in this way. Economic expansion stays underway in the USA, largely gratis an oblivious consumer. Business investment is weak, due to the ramp up in unpredictability. The trade war has escalated again.

- Q1-19 S&P500 earnings finished at -4.6%.
- Q2-19 earnings are coming in around -1.0%.
- Q3-19 earnings are pegged at -1.6%.
- Annual 2019 earnings growth show current estimates at +1.9%.

I remain barely constructive on U.S. stocks. The next quarter's earnings will surely not be openly friendly to long investors in stocks. Hope rests in Q4 and beyond.

How to set stock market returns expectations for 2H-2019 and 1H-2020?

Look back --at the multiple years' sequence of annual positive share returns. Then look ahead at forward earnings fundamentals. You gain the best perspective

2018 returns were a lousy -6.2%. That set up 2019 with lower share price valuations to begin.

What happens to annual S&P500 returns **in 2019** likely looks more like bullish runs in year's past. The annual 2017 S&P500 returns came in at +22.6%. In 2016, this U.S. benchmark rose +12%. In 2015, it rose a paltry +1.4%. In 2014, it rose +14%. In 2013, the index saw the best of years this cycle, at +32%.

Could annual returns match 1-for-1 with annual earnings growth? Possibly. Earnings growth could end with a +1.9% mark across all of 2019. It's a double-digit +10.9% mark for 2020.

Q2-2019 earnings growth rate are at -1.0% (with $41.10 in absolute S&P500 operating earnings). That was a much better quarter than Q1-19 at $38.80. Q3-19 shows quarterly earnings of $42.14. We should mark $43.57 in Q4-19 and a decline to at $42.27 in Q1-20.

In addition, I have more S&P500 revenue & EPS growth positives than negatives to point out.

- S&P500 revenue growth is stable. Q1 revenue growth was +4.5%. Q2 should be +5.1%. Full year 2019 revenue growth is at +4.6%. Q3 is at +3.1%.
- 2019 y/y revenue growth is +4.4%. 2020 y/y revenue growth is at +5.6%.
- 8 sectors reported y/y growth in revenues for Q2. Just 4 of 11 S&P500 sectors marked positive earnings growth in Q2, led by Health Care and Financials.
- Sector breadth is better across all of 2019. Energy (15.8%) Materials (-13.4%) and Industrials

(-0.1%) sector earnings growth are the 3 negatives. Eight are positive.

- The latest "bottom's up" outlook shows a fresh peak in S&P500 operating earnings all the way out in Q3-2020 (at $47.19).

In terms of fundamentals, the "China Trade War" remains the big stumbling block.

How did BCA Research sum up the China financial market situation on July 26th?

"[We are] downgrading Chinese equities (relative to Emerging Markets) to underweight on a tactical basis only. We remain bullish on a cyclical (6 to 12 month) basis. In the near term, the challenged earnings picture for Chinese equities is compounded by uncertainty around how proactive Chinese policymakers will be vis-a-vis stimulus for growth. Over the coming 12 months, we expect reflationary efforts to be successful, however. It's a timing issue."

For progress, I personally think hawks on the U.S. team (Lighthizer, Miller and Navarro) need to be replaced with moderates (Mnuchin and Ross). The Chinese are not budging.

Truly ending this contest may take 10 years. That implies other U.S. administrations come to the table. The Chinese know this. They feel comfortable pushing back on this administration. Deals with a different U.S. President in January 2021 could more easily reverse trade war tariffing.

10% China tariffs were put in place last summer on $200B of goods, mostly of an industrial type. 25% tariffs showed up in early May. Now we have 10% tariffs on $300B of mostly consumer goods. Given the unpredictable nature of the fellow making these calls, and pushback from the Senate and the Courts, none of this is a done deal. Watch tariffs, not trade tweet rhetoric folks. That's the best advice I can give you. And right now, we are getting more and more tariffs.

Why the weak S&P500 Q3-19 earning outlook? Tariffs raised import costs and shut down China investment into the USA. Consumption growth has a headwind from notably higher prices on much of what the USA imports from China. Raw material users clearly suffered from specific tariffs on steel and aluminum in a number of manufacturing industries.

Mueller has resigned, but Congress is on the beat. Multiple other investigations are ongoing. In sum, Presidential tweets to express alarm -- and gin up policies to shore up support with his base– will not be slowing down.

To measure the level of safe-haven attraction, always keep a focus on long-term 10-yr U.S. Treasury bond rates. The early August rate is now an incredible 1.74%. The early June rate was 2.14%. Early May 10-yr rate was 2.44%. April was 2.48%. A high 3.23% rate was here in Nov. 2018. I noted a 2.74% rate on March 5th, 2019. Effectively, 2 or 3 more 25 bps rate cuts are being priced in, along with a weaker consumer inflation outlook.

Fixed income market vigilance remains the right mindset.

2H-2018 global growth got weaker everywhere. 2H-2019 sovereign growth upgrades would get the global stock market bulls running again. That looks more remote now.

A sustained China-led pickup would get Asia, Europe, and USA economies pulling together. U.S traders should focus on forward indicators of global growth, aka the regional PMIs. The latest monthly PMIs showed China manufacturing output growth with no momentum. Sentiment can firm up…if/when major central gov't policy instruments finally get traction.

At their latest meeting, the European Central Bank (the ECB) stayed firm with more easing on the way. A third round of "TLTROs" (2-year or 4-year loans termed Targeted Long-term Refinancing Operations) ends in March 2021. In turn, they will keep dovish rate guidance "through the end of 2019" and likely beyond.

Mario Draghi blew his opportunity to stimulate European and global growth earlier-- in 2018. He failed to factor in the U.S./China trade war. He stayed complacent. In mid-2019, he made up for this. The new ECB head Christine LaGarde will be dovish. I guarantee that.

U.S. yield curve inversion worry is back in vogue again, at the 2-yr and 5-yr points. This is where the European TLTROs (targeted long-term refinance operations) hit. They were announced for the 3rd time this business cycle early this year. The ECB also used a 4-year bank loan offer in June 2014 and June 2016. This core ECB stimulus tool fights low European growth --seen notably in the U.K. and Germany and Italy.

Another big global policymaker (aka China) also stepped up, after an attack to its growth.

From summer 2018 into Q1-2019, China's PBOC provided more domestic accommodation, cutting the Renminbi down -8% and lowering reserve requirements. The central gov't also lowered an auto tax. Multiple arms of China's national and local governments will keep bolstering its domestic economy in 2H-2019; both to neutralize U.S. tariff effects; and meet long-term development goals.

Emerging financial markets always feel pain from any step up in international tension. "Seen one, seen 'em all!" That's what my PhD thesis advisor used to state. However, China's major stock indexes drove the strongest ETF returns earlier this year. If share index momentum recovers (however that's done!), that's a positive for EM stocks.

The USA has a decent economy. It comes with low consumer inflation. Hence, the FOMC can cut rates in the face of new tariffs, without too much worry about overheating. CPI data can stay beneath the Fed's +2.0% statutory target, even as Powell stays dovish. He surely will. The FOMC voted for a 25 bps cut in late July and likely will do another 25 bps in September. The FOMC's 'neutral' rate is below 3.0% now. The effective Fed Funds rate is 2.14% in August.

How about energy demand and supply? In early August, WTI oil prices trade at $54 a barrel. WTI oil traded at $62 a barrel in early May. U.S. hostility towards China, Mexico, Russia, Iran and Saudi Arabia remains unhelpful. But OPEC went for a 1.2 million barrel per day cut in January. Oil price bears noted North American frackers reached a recent peak at 1080 rigs. This fell to 1006 rigs in late March. It was down to 984 rigs on May 31st. It was 942 in early August. The ongoing fall in domestic U.S. oilrigs is bearish.

North American horizontal drilling technology made it the world's leading energy production region again. If OPEC cuts keep working? There is price stability on the horizon. London energy consensus sees WTI at $59 a barrel out to June 2020.

What Produces 2019 Optimism?

First, we have a very, very dovish Fed. Second, 2020 is the current forward look. Annual +1.9% earnings growth and annual +4.4% revenue growth rate across 2019 sound tepid but OK. S&P500 earnings growth at +20.0% across 2018 and roughly +9% annual revenue growth were actually a struggle for risk takers. They spooked about overheating.

Is a lower earnings bar better? Stock prices and investment letter news sentiment can be contrarian.

Actual discretionary spending looks OK in Q2. During Q1, cold weather may have kept consumers online and at home. A summer snap-back happened. Consumer Staples earnings are up too.

A low 3.7% U.S. unemployment rate shows us. Default and other credit risks at households are not a big problem in this cycle. Borrowing rates have also sunk with Fed dovish-ness and with a safe haven uptick, particularly real rates. That keeps business lending rates lower too.

Finally, recognize this: The U.S. keeps stronger growth and higher profit margins vis-à-vis the rest of the developed world. Record stock buybacks support EPS, truly heedless of macro fundamentals

Underlying U.S. sector fundamentals can benefit from an array of catalysts --

- Aging demographics builds Medical Care demand. Ditto health-exchange growth.
- Business equipment & structures investment can pick up. We haven't seen a major boom in U.S. capital expenditures yet. Q4-2019 may show us that. Maybe 1H-2020.
- Semiconductor IoT (Internet of Things) developments hold deep secular implications. Chip stocks had a bull run in 1H-2018 – based mostly on those hopes. The structural can trump the cyclical again.
- Zacks economists call for +2.5% U.S. real GDP growth across 2019. Our call supports a modest bull case.

Hostile Trade War actions and harsh tweets kill off non-U.S. growth and indexes in 2019. But there are several forms of China stimulus on the way. China's 'national team' can revive China shares later on in 2019. Those actions can supply both U.S. and non-U.S. growth. That will bid up stock indexes everywhere.

What should you make of negative U.S. earnings growth in Q2 rolling into a negative Q3? That pulls both risk markets and fundamentals in the opposite bearish direction. But it's just tepid.

What's Alive for Pessimists?

A broad swath of negative Q2 and Q3 earnings estimates -- that's the immediate bear case.

More deeply, it is about financial loan excess in corporate America --leading to a U.S. pullback. These lurk inside the current business-lending environment without being widely understood. There is a near 23% economist consensus probability for an actual 1H-20 slump. I see 50% probabilities out of a few recent models. Consider real estate projects in top urban areas. Have they overbuilt? Who put up the money?

A FAANG correction happened around Labor Day in September 2018. In May 2019, another FAANG selloff landed – the new one is due to a rising potential for anti-trust actions.

Finally, of course, rampant U.S. tariffing cuts down global growth rates and the outlook there.

Is it time to buy U.S. stocks in early August?

<u>My answer is a long-term strategic YES. The Powell "put" is on. However, short-term tactics say build cash too. Play the bull and the bear now</u>.

I update you on share valuations, once again. August's S&P500 12-month forward valuation stands at 16.2X. This is below the 5-yr average at 16.4X. I see no valuation potential inside this stock market in early August.

However, the S&P500's 10-yr forward 12-month valuation average comes in at 14.8X. 16.2? That's a relatively higher valuation in this comparison. That metric suggests stocks are perhaps 10% overvalued. There are good reasons to **not be** that bearish. But there it is. That's the size of a deepening bear case.

Zacks strategists (including me) stay bullish. Can the S&P500 tag and hold above a 2,900 level later this year? Look to Q4 for durable traction.

U.S. earnings growth and trade war worry needs to abate for S&P500 shares to durably lift. And recession worry needs to be put to bed. According to the May Philly Fed Survey of Consensus, there is a low 11.9% chance of a

recession in Q2-19, 13.1% in Q3-19, and 15.8% in Q4-19. 1H-2020 holds higher U.S. recession worry: Q1-20 is at 19.4% and Q2-20 is at 22.8%.

So. Markets must climb two walls of related worry to rally: Trade wars and recessions.

- Bulls see the possible Q4-19 and 1H-20 U.S. EPS strength. Yes, Q2-19 earnings estimates are at -1.0%. Q1-19 earnings were stale at -4.6%. In comparison, Q4-18 earnings finished at +13.1%, the fifth double-digit quarter in a row. Q3-18 earnings growth was +25.9%, Q2-18 was +25.0%, Q1-18 was +24.6%, and Q4-17 was +14.8%. The ECB brought back TLTROs. The ECB, the Swedes & the BoJ keep negative deposit rates on. Chinese authorities ramp up support for the global economy. U.S. and non-U.S. monetary authorities stay uber-accommodative across the rest of 2019.

- Bears (-10% to -20% downside) focus on the escalation in tariff wars by the USA. They short on weak U.S. bond rates, implying a looming U.S. recession. They used to imagine bond rates in the USA rising, inexorably, under pressure from huge public U.S. Treasury debt sales. Now, they worry about business credit leverage. Finally, they see enduring growth negatives across international markets in 2019. Feeding non-U.S. negative sentiment is the poor state of stock and currency markets outside the USA. For example, a strong euro at $1.24 is long gone. The euro trades at $1.12 on August 6th. FX weakness shows capital flowing to U.S. safe haven Treasuries, due to downgraded IMF global growth forecasts, and plenty of other worries about risks outside the USA.

- Range-bound sages note the July 2019 7.5% Euro area unemployment rate. This is high. But it is falling. Non-U.S. indexes offer strikingly better valuations. Domestically, the 10-year U.S. Treasury rate is a very low 1.74%. It exceeded 3.2% last year. Well below a 2.5% 10-yr rate seems the 'new' normal for 2019. A 3.0% 10-yr Treasury rate used to be the Rubicon to watch. U.S. consumer inflation is slightly beneath target. The U.S. sees manageable +3.2% annual wage growth.

The positives: Corporate tax cuts still drive record share buybacks. An Obamacare enrollment boom carries on. The U.S. 3.7% unemployment rate is near a 50-year low. This low household unemployment rate, and still supportive stock prices, feed consumer spending. Core consumer interest rates stay low.

The negatives: An economist consensus -- with a 1H-20 probability of U.S. recession above 20%. Trump is unpredictable. U.S. federal deficits --above $1 trillion a year-- are terrible. Many U.S. consumers feel satiated and/or held back by rising rents and high home prices. The U.S. economy marks stagnant levels of capital investment. Earnings growth in 1H-19 and Q3 stinks.

What of U.S. GDP Growth? This Should Be a Top-of-Mind Fundamental.

The Atlanta Fed Nowcast sees +1.9% for Q3-19 GDP on August 2nd. Q2 was +2.1% in a preliminary estimate. Q1-19 growth showed up at +3.1%. A final +2.2% landed for Q4-18. Further back? GDP ended at +3.4% growth for Q3-18. We booked +4.2% for Q2-18 and +2.2% for Q1-18.

- 2020 annual GDP growth consensus is at +1.9%
- 2019 annual GPD growth consensus is at +2.6%.
- 2018 annual GDP growth finished at +2.9%.
- 2017 annual GDP growth was at +2.2%; notably stronger than 2016 at +1.6%.
- Note: +1.0% in GDP growth over a year is when recession selling triggers.

For 2019, Zacks call is for a trend annual U.S. real GDP growth rate. We model a +2.4% to +2.5% U.S real GDP growth rate.

Slightly negative U.S. earnings growth rates speak: "Worry about a Q1, Q2, and Q3 earnings slowdown

lingering for multiple quarters, ala 2016!"

- But 2020 shows estimates for a renewed double-digit +10.9% annual earnings growth.
- 2019 offers lower +1.9% annual growth. Q1-19 was at -4.6%, with Q2-19 is at -1.0%.
- 2018 marked earnings '2-handles'. Q4 +13.3%. Q3 +25.9%. Q2 +25.0%. Q1 +24.6%.
- When did the serial earnings surge start? Earnings growth went positive in Q3-16.

Realize. This U.S. administration embellishes macro and stock market facts. There should be trader concern, particularly on the China trade war, public debt, weak international stock markets, presidential credibility, and the lack of bipartisan policy making.

Nonetheless, the U.S. stays firmly on a record 121-month expansion. July added +164K jobs. June added +193K jobs. May added +62K jobs, April added +216K jobs and March added +153K jobs. February added +56K jobs. January 2019 added +312K jobs. *Job gains averaged +140K over the last three months.*

U.S. unemployment was 3.7% in July. Be aware! This is well under most 'frictional' or 'natural' unemployment estimates. +140K average monthly job adds --with a household unemployment rate well below a 'natural' level of full employment at 4.5%-- paints a respectable scenario. Rising U.S. stocks remain the base case for 2019. But remain vigilant. A swift turn of events did indeed materialize in early August on the tariff front. More volatility is surely on the way.

August Zacks Industry Ranks Show 3 Sector Opportunities, leading with Health Care and then Consumer Staples and Consumer Discretionary. It was a modestly cyclical outlook.

Health Care returned to Very Attractive. Medical Care and Medical Products look great. So do Drugs. Share returns are poor, on a forward look to post-Presidential regime change.

Consumer Staples remained Very Attractive. This seems to be about a prudent consumer. Shopping is holding up well for a range of staples. DItto for the discretionary items.

Info Tech is a Unattractive. Computer-Software looks best. Semi industry rankings showed up as neutral. After still more tariffs, chip managers have to convince analysts a 2H sales rebound can happen. Many aren't looking for it anymore, in 2019.

Annual S&P500 operating earnings numbers on deck look impressive. For 2020, consensus sees S&P500 operating earnings at $183.69. For 2019, consensus has earnings at $165.80. S&P500 earning for 2018 ended at $161.46. For another yearly reference, 2017 S&P500 earnings ended at $133.08. The big lift from 2017 to 2018 was the corporate tax cut.

Tie on a 16.2 forward P/E to do "fair value" math. Then, 2,775 on the S&P500 marks current low water mark for "fair value" based on 2019 EPS.

Always looking forward, we trade on 2H-19 and 1H-20 earnings at mid-year. A full year 2020 forward "fair value" is roughly an S&P500 index at 2,975. Can we get there? Only if there is a China Trade deal to end U.S. and China tariffs, and/or lots of China stimulus. This lights a fire.

Now do this. Turn the P/E ratio on its head to attain a stock indexes' earnings yield. Divide $165.80 in fresh projected earnings for 2019 by an S&P 500 trading around 2850 on August 6th. <u>That's an attractive 5.8% earnings yield.</u>

Will annual returns be positive this year? The metric above screams YES, with a decent level of certainty. Will we see +20% returns again? It can happen. CIOs Zacks surveyed in August 2019 would pencil in -5.0% to 0.0% in 12 months, though. The actual annual stock market return was -6.2% for 2018, +22.6% in 2017, +12% in 2016, +1.4% in 2015, +12% in 2014, and +32% in 2013. At this point, U.S. share buying is about looking ahead

– bullishly, and factoring in share buybacks.

Outside the USA, central bank support holds down long-term U.S. risk-free rates: Europe keeps a very low policy rate. It brought back TLTROs to goose demand growth. Japan keeps negative or zero deposit rates on. Their +2.0% consumer inflation targets are not in play. These two big macro players pin down long-term global risk-free rates. China is cutting rates.

The "neutral" rate in the USA is just below 3.0%. This remains the destination for the Fed Funds rate in 2019, which is at an effective 2.14% in early August. The 2 to 10 year yield spread is just 12 bps – a bit below the 18 bps level seen across the breadth of the last year.

The U.S. Treasury 10-yr rate was 1.74% in early August, and 2.14% in early June, 30 bps down from 2.44% in early May. This rate was 2.48% in early April, 2.73% in early March 2019, and 2.62% in early January. It was at 3.16% on November 1st, 2018. Finally, a 3.23% 10-yr Treasury high was seen on October 5th. That was the 2018 high. We have lost 150 basis points.

A very low 2.08% was here in Sept 2017. A 1.80% rate was last seen on Nov. 1st, 2016.

Historically, stock earnings yields are +3.0% above any 10-year U.S. Treasury rate. Meaning S&P500 stocks should offer around a 4.7% model return, given greater risks. At the moment, they easily achieve that.

"Risk-on" rallies usually show small cap and international indexes move together. International stocks should have risen with the RUT index. With tariffing, I would no longer link them.

My latest 2019 trading calls: The U.S. stock rally returns, only if a divided government limits U.S. top-down political and therefore market risks effectively. International indexes need to see GDP growth ramp outside the USA. Stocks likely rally there in late 2019, only if the U.S. China trade war is put to bed, or China stimulus ramps up noticeably the global GDP growth rate.

Zacks Outlook: Traders price 2H-19 and 1H-20 earnings for 'fair value' in August.

- Always optimists, the "High End" bulls say the chance of a U.S. recession looks remote. Positive 2020 annual EPS growth supports a rally in large cap share indexes.
- Middle-of-the Road Bulls at Zacks can use a backward-looking $165.80 in earnings for 2019 (and a 16.2 P/E ratio). This computes to an S&P500 at 2,685. This is their low ball target. We are trading well above that, as a standard in-line bull would anticipate.
- Low-End Bulls use the S&P500 2018 operating earnings of $161.14 and a 16.5 to get a fair value of 2,658. That is 200 points below where we are on August 6th. A correction appears underway. Keep this backward looking mark in mind.

We don't have much support from quarterly earnings. Q1 S&P500 earnings growth data were negative. Q2 earnings growth estimates are negative. Q3 is slightly negative too. Q4-18 earnings growth was the last double-digit moment.

Don't forget about a 12-month forward look. Fundamentally bullish 2020 outlooks should matter more and more, as fall 2019 arrives.

What about bond markets? It's about pricing in rate cuts by the Fed in fall 2019 and across early 2020, up to the election. However, there is a case for overbought bonds. The U.S. 10-year Treasury risk-free rate got above 3.1% in early November 2018. Relative bond/stock valuations remain salient. Broad asset allocation consensus can shift.

In sum, U.S. stock indexes can deliver in Q3 or more likely in Q4, lifted by positive earnings growth in Q4-2019

and 1H-2020.

Stocks can get near to a 2020 'fair value' mark around 2,975 at yearend – as long as the U.S. risk-free bond rates stay this low. Can international stocks rally? Perhaps the fire will be lit by China stimulus.

The U.S. relationship with China will be the defining fact of 2019.

S&P500 Earnings Outlooks

Consensus sees +10.9% EPS growth in 2020 and +1.9% in 2019. Compare this bearishly to +20.0% annual EPS growth in 2018. Yet, the looming 2020 outlook stays bullishly in line with +11.0% across 2017. In 2016, the S&P500 marked +0.5%. 2015 was -0.6%. 2014 was +5.1%.

Consensus uses +5.6% for 2020 and +4.4% for 2019 as revenue growth outlooks. That is lower than the +8.7% revenue growth for 2018. Yet, this top line data is solid.

Q3-19 estimates are at -2.2%. Q2-2019 S&P500 earnings growth sits at -1.0%. Q1-2019 S&P500 earnings growth were -4.6%. A sea change did happen. Q4-2018 finished at +13.3%. Q3 was +25.9%. Q2-2018 was +25.0%. Q1-2018 was +24.6%.

For 2018, S&P500 EPS growth was at +20.0%. At +1.9% EPS growth, 2019 earnings should be a much weaker year, in relative terms to 2018.

Utilities (+6.8%) and Financials (+6.2%) earnings led in August across all of 2019. The new Communication Services (+5.8%), Health Care (+5.4%), and Consumer Discretionary (+4.2%), look solid. Real Estate (+3.5%) is middle of the road.

Industrials show a -0.1% annual growth rate, showing the business is not buying. Info Tech (+0.5%) also looks notably weak across 2019 for a perennial growth sector.

The remaining sectors continue to disappoint too. Materials (-13.4%) and Energy (-15.8%) were the true poor annual 2019 EPS performers.

At the very back, a -15.8% EPS cut from Energy shows looming oil price-driven weakness.
Investors – Despite tepid earnings marks into Q3, I would stay optimistic on stocks. They will increasingly trade of 2020 outlooks. As EPS drivers, corporate tax cuts were a one-time event.

The Institute for Supply Management (ISM) told us the USA July PMI registered 51.2%, a decrease of 0.5% percentage points from the June reading of 51.7%. Near 60 is stellar.

Comments from the panel reflect continued expanding business strength, but at soft levels. *July was the fourth straight month of slowing PMI expansion.*

Demand expansion resumed, with the New Orders Index recording marginal growth, the Customers' Inventories Index entering "about right" territory, and the Backlog of Orders Index contracting for the third straight month, at stronger levels compared to prior months. New export orders also contracted.

Consumption (measured by the Production and Employment indexes) continued to expand, but at lower levels. This resulted in a combined decrease of 6.1 percentage points to the PMI calculation due to minimal new-order growth, backlog contraction and customer-inventory gains.

Inputs — expressed as supplier deliveries, inventories and imports — were lower this month, due to inventory tightening for the second straight month and continued slower supplier deliveries, resulting in a combined

3.0-percentage point improvement in the Supplier Deliveries and Inventories indexes. Imports and new export orders contracted.

Overall, inputs indicate (1) supply chains are responding marginally slower and (2) supply managers are closely matching inventories to new orders. Prices contracted for the second consecutive month, indicating lower overall systemic demand.

"Respondents expressed less concern about U.S.-China trade turbulence, but trade remains a significant issue. More respondents noted supply chain adjustments as a result of moving manufacturing from China. Overall, sentiment this month is evenly mixed," says Fiore.

What ISM Respondents Were Saying

- "General business trends are continuing to show signs of weakness resulting from tariffs and cost impacts of importing and exporting." (Electrical Equipment, Appliances & Components)
- "Business is strong mostly due to seasonality. Tariffs surcharges are now being passed through to all customers. Labor is tight, putting pressure on wages costs." (Furniture & Related Products)
- "All aspects of business remain strong, but we're starting to see the frictional effect of tariffs on exports." (Plastics & Rubber Products)
- "We are a third-tier supplier to [a major aircraft manufacturer], and it appears its production slowdown of [an aircraft] is having a direct effect on our slowing orders." (Miscellaneous Manufacturing)
- "Business has slowed, but it is still steady and expected to pick up next month." (Machinery)
- "There is a drop in demand for steel products, which has had a major impact on steel prices and the domestic scrap market." (Fabricated Metal Products)
- "The economy is holding steady. All the uncertainty seems to be priced in accordingly, and supply plans are consistent throughout 2019. Business conditions improving yet still facing headwinds in foreign exchange, commodities, and certain direct materials." (Food, Beverage & Tobacco Products)
- "[Automotive] sales continue to decline, and forecasts have been reduced due to softer predicted demand. Attention to product cost — not sales price — is increasing." (Transportation Equipment)
- "Weakness in end markets accelerating rapidly. Continuing to reduce production based on weakening demand and declining current orders." (Chemical Products)
- "China tariffs continue to be a concern. The uncertainty of future tariffs involving China, Canada, and Mexico is also a concern. China tariffs for electronic parts are averaging 17 percent." (Computer & Electronic Products)

The ISM July PMI indicated U.S. growth for the 123rd consecutive month in the economy, and indicated growth in the manufacturing sector for the 35th consecutive month. Of 18 manufacturing industries, 9 reported growth in July.

How about non-U.S. earnings? S&P500 companies got 43.6% of revenues from abroad in 2017. 2019 and 2018 can see higher revenues from abroad (look at 2014 levels for inspiration).

In 2017, the percentage of S&P 500 sales from foreign countries increased slightly, after two years of measured decreases. The overall rate for 2017 was 43.6%, up from 43.2% in 2016, but down from 44.3% in 2015 and 47.8% in 2014, which was at least an 11-year record high.

Be careful about using this international exposure data. Here is what S&P wrote to us

"Reporting of global sales again improved somewhat in 2017, but once more it was a slight improvement and the overall quantifiable reporting remained poor. While measured messages from senior management abound, tabular charts—not generally required under Generally Accepted Accounting Principles (GAAP)—are reported by only one-half of issuers.

Market participants may need to be careful when determining what data and statistics to use.

- To illustrate this point, based on current 2017 reports, foreign sales appear to account for 27.2% of total S&P 500 sales (26.7% in 2016, 28.4% in 2015, and 31.0% in 2014).
- However, if we use only the companies that reported foreign sales, the rate increases to 38.5% (38.9% in 2016, 40.5% in 2015, and 44.5% in 2014).
- If we eliminate some of the "stranger" values, such as companies reporting at 100% (due to domicile) or reporting a zero rate due to where (and how) the sales were booked (having a zero foreign rate and several foreign plants and outlets leaves some reason for doubt), the rate calculates to 43.6%, up from 2016's 43.2%, which was down from the 44.3% posted in 2015, and significantly down from the 47.8% reported in 2014.

This adjusted rate, 43.6%, is the rate we use for guidance and as a "holding spot" for the actual value of higher-level index and sector attribution."

For the Globe on August 1st —

"The downturn in the global manufacturing sector extended into its third consecutive month in July. Production and new order intakes declined further, as conditions in many domestic markets remained soft and international trade volumes continued to contract. These negative trends filtered through to the labor market, resulting in another round of job losses.

At 49.3 in July, a tick below June's reading of 49.4, the J.P. Morgan Global Manufacturing PMI signaled contraction for the third straight month and fell to its lowest level since October 2012.

Of the 30 nations for which July data were available, 19 had Manufacturing PMIs signaling downturns. China, Japan, Germany, South Korea, Taiwan, France, the UK, Italy and Brazil were among the countries seeing contractions.

Although the U.S. and Canada saw expansions, their respective PMI levels (50.4 and 50.2) were only marginally above the neutral 50.0 mark.

Sector data indicated that the downturn was again focused on the intermediate and investment goods industries. In contrast, the consumer goods category not only continued to register expansion, but also saw a mild improvement in its rate of growth to a three-month high.

Global manufacturing production decreased for the second month running, reflecting a further reduction in new order intakes. International trade volumes contracted for the eleventh month in a row and to the greatest extent since October 2012.

Among the largest regions covered by the survey, new export business decreased in China, the U.S., the euro area, Japan, Taiwan, South Korea, the UK, Canada, Russia and Brazil.

July saw manufacturing employment decline for the third straight month. Spare capacity remained available nonetheless, as highlighted by a further decrease in backlogs of work. Holdings of both raw materials and finished goods stocks both decreased, the former partly due to lower levels of input purchasing.

Price inflationary pressure remained contained in the global manufacturing sector in July. Input costs rose only slightly and to the weakest extent during the current 40-month sequence of increase. Average selling prices were unchanged over the month, the first time that output charges have not risen in almost three years."

Commenting on the survey, Olya Borichevska, from Global Economic Research at J.P.Morgan, said: "*July PMI data signal that the global manufacturing sector remained on a weak footing at the start of the third quarter. The PMI implies no growth in global manufacturing output with the deteriorating trend in international trade flows weighing particularly heavily on performance. Market conditions will need to stage a solid recovery if the growth outlook is to improve during the coming months. However, firms are not expecting this with future output PMI continuing to trend lower through July.*"

Europe —

(1) Europe marked a +1.4% GDP growth rate in 2018. The outlook is for +1.1% in 2019 and +1.2% in 2020. The euro area (not the EU) unemployment rate moved down to 6.2% in July.

"The euro area's manufacturing sector continued to contract during July, and at an accelerated rate. The latest IHS Markit Eurozone Manufacturing PMI posted below the 50.0 no-change mark that separates growth from contraction for a sixth successive month and, at 46.5, pointed to the sharpest deterioration in operating conditions since December 2012. The index was down from 47.6 in June, though slightly higher than the earlier July flash reading of 46.4.

Of the three market groups categories covered by the survey, ongoing contractions were seen in the intermediate and investment goods sectors. For the latter, the deterioration was the greatest since November 2012. In contrast, growth was sustained amongst producers of consumer goods.

Countries ranked by Manufacturing PMI: July

Greece	54.6	3-month high
Netherlands	50.7	no-change
France	49.7	4-month low
Ireland	48.7	75-month low
Italy	48.5	2-month high
Spain	48.2	2-month high
Austria	47.0	57-month low
Germany	43.2	84-month low

Germany remained a source of weakness, with its manufacturing economy recording its sharpest] deterioration in operating conditions for seven years. Austria recorded its lowest PMI level in just under five years, whilst there were also below 50.0 readings seen in France, Ireland, Italy and Spain.

In contrast, the Netherlands and Greece continued to expand, although growth in the former was only marginal and unmoved on June's six-year low.

The downturn in the overall manufacturing economy was driven in the main by a sharp fall in new orders. Latest data showed that the decline was the second sharpest recorded by the survey in just over six years (surpassed only by a contraction in March) as ongoing trade tensions, difficulties in the automotive industry and political uncertainties continued to
weigh on demand both in internal and external markets."

Japan --

(2) Japan marked a +0.8% real GDP growth in 2018. The consensus has +0.7% growth for 2019 and +0.3% for 2020.

Manufacturers in Japan continued to face a challenging business environment in July, according to latest PMI data. Soft demand conditions were a key drag on the sector, with inflows of new work from domestic and external clients falling amid slower global economic growth. Subdued business confidence also persisted into July, with firms discounting charges and reducing input purchasing.

The headline Jibun Bank Japan Manufacturing Purchasing Managers' Index (PMI) recorded 49.4 in July, a fractional increase from June (49.3), signaling a third successive monthly deterioration in the manufacturing business environment.

Keeping the PMI at a subdued level was weak new orders and output data. Manufacturing sales in Japan declined

in July, as has been the case in every month of 2019 so far. According to market grouping splits, capital goods producers noted the sharpest reduction in new business. Panelists indicated that softer growth in both domestic and foreign markets had impacted demand. Latest survey data pointed to a moderate decline in new export orders, reflecting lower sales to key trading partners such as China. There were also some reports that weakness in the automobile industry had affected overseas demand.

Consequently, output was reduced in July as a challenging global economic backdrop led firms to scale back production. Again, investment goods makers recorded the largest fall in output. Nonetheless, firms were able to use existing stocks of manufactured goods to meet outstanding orders. Backlogs of work and postproduction inventories were simultaneously depleted in July.

Looking ahead, manufacturers maintained a subdued outlook for production volumes over the coming 12 months. Spillover effects from the US-China trade conflict, as well as potential escalations of tensions with South Korea reportedly dented optimism. Concerns that weak domestic and global growth would continue to restrict sales was also mentioned.

Commenting on the latest survey results, Joe Hayes, Economist at IHS Markit, said: *"Latest manufacturing PMI data did little to suggest that the worst has passed for the global goods-producing sector. Japanese manufacturers cut output for the seventh consecutive month amid soft demand from domestic and overseas clients.*

"While slowing global growth in key export markets such as China and spillover effects from global trade spats remain a principal concern to companies, the risk now of Japan-South Korea relations deteriorating further merely adds to the already-strong headwinds.

"Forward-looking survey indicators suggest that manufacturers in Japan are set for another difficult quarter, as firms scaled down stocks and input purchasing to keep a lid on costs.

"Furthermore, more signs that the manufacturing downturn has now become deeply rooted was apparent in prices data, as output charges were reduced at the fastest pace in nearly three years amid increasing efforts to stimulate sluggish demand."

From the China Caixin PMI Comment—

(3) China marked a +6.6% growth rate in 2018. Consensus has +6.2% in 2019 and +6.0% in 2020. Indian growth is at +6.9% for 2019 and +7.1% in 2020.

"PMI data indicated that operating conditions across China's manufacturing sector were broadly stable at the start of the third quarter. Output was little-changed following a decline in June amid a slight increase in overall new orders. Subdued demand conditions nonetheless prompted firms to lower their workforce numbers again in July, and at a quicker pace, while inventories of both inputs and finished goods declined. Cost pressures weakened, with input prices rising only slightly while selling prices fell.

Encouragingly, business confidence regarding the year ahead outlook for output picked up from June's record low, but remained subdued over lingering concerns regarding the China-US trade dispute and softer global economic conditions.

At 49.9 in July, the headline seasonally adjusted Purchasing Managers' Index (PMI) posted only fractionally below the neutral 50.0 level to signal broadly stable conditions across China's manufacturing sector. This followed a marginal deterioration in the health of the sector during June (PMI reading of 49.4).

The improvement in the headline index was partly down to the broad stabilization of output in July, following a

marginal drop in June. Some firms commented that relatively firmer demand conditions had led them to leave production volumes unchanged. Total new orders rose at a fractional pace after a modest decline at the end of the second quarter. The upturn was likely driven by stronger domestic demand, as new export orders were little-changed in July. Some companies commented that the ongoing trade dispute with the US continued to weigh on export sales.

Muted order book trends led companies to reduce their headcounts for the fourth month in a row, and at the quickest pace since February. However, a lack of personnel was cited as a key reason for a further increase in unfinished work. That said, the rate of backlog accumulation remained modest.

Following a reduction in June, buying activity rose slightly at the start of the third quarter. However, manufacturers adopted a cautious approach to inventories in light of relatively soft demand conditions, with inputs of both purchased items and post-production goods falling in July.

Chinese manufacturers indicated that average input costs rose again in July. However, the rate of increase was marginal. At the same time, efforts to stimulate customer demand and boost new order intakes led firms to cut their selling prices for the first time since January.

After slipping to its lowest on record in June, business confidence regarding output for the year ahead improved to a three-month high in July. Optimism was often linked to forecasts of improving market conditions and new products. However, concerns over the outcome of ongoing trade negotiations with the US continued to weigh on overall sentiment."

For India —

"Economic growth in India's manufacturing industry was sustained in July. Companies scaled up production in response to a quicker upturn in factory orders. This, coupled with optimistic growth projections, underpinned job creation and an uptick in input purchasing.

As has been the case in 2019 so far, the sector continued to register a general lack of inflationary pressures. Both input costs and output charges increased at marginal rates that were broadly negligible in the context of historical survey data.

Rising from 52.1 in June to 52.5 in July, the IHS Markit India Manufacturing Purchasing Managers' Index (PMI) was consistent with a further strengthening in the health of the sector. The latest reading was slightly higher than the average for calendar year 2018 (52.3), but below its long-run trend (53.9).

Consumer goods producers led the upturn in July for the third month in a row, although there was also a stronger improvement in business conditions at intermediate goods makers. The capital goods sub-sector dipped into contraction, with lower sales causing reductions in output and quantities of purchases, while job creation came to a halt.

Aggregate manufacturing production in India increased in July, as has been observed on a monthly basis for two years. The rate of expansion was below its long-run average, but improved from June.

The main factor boosting production was a sustained rise in new work inflows. Despite quickening from June, the pace of expansion was moderate in the context of historical survey data.

New export orders also continued to rise, but here a slowdown in growth was noted. In fact, external sales rose to the least extent since April 2018 as factories took a hit from subdued global trade flows."

Other Asset Class Summaries

DJIA Similar to the S&P500, the Dow should keep moving higher. Q4-19 and 1H-20 earnings fundamentals look OK. 'Bears' will sell or short on U.S. China tariffs and any tariff hikes, a negative Treasury yield curve, and enduring global growth weakness.

NASDAQ Stay neutral to slightly positive on Info Tech – solely on a full year 2020 forward look ahead. Follow the Zacks Heat Map tech industries. In sum, Zacks #1 Rank IT stocks remain worth buying. But IT earnings struggle mightily under U.S.-China trade war stress.

Yes. Q2-19 Info Tech earnings are at -7.5% and Q3-19 EPS estimates are at -8.8%. This slowdown started with Q4-18 Info Tech earnings growth marking +5.1%. But look back at even earlier pre-US/China trade war quarters. Q3-18 Info Tech earnings were +21.9%. Q2-18 was +26.6%. Q1-18 was +33.6%. You have two different tales to think about.

Across 2019, IT tallies +0.6% EPS growth and +1.7% revenue growth. That is weak but positive.

AAPL stock, as always, is a disproportionate weight inside the QQQs. AAPL is $195 as I write on August 7th, crashing down from a $213 share price, in late July. In May, it was $203. It was $191 in early April and $176 in early March. The yearly chart is still constructive, with a January low around $150.

The S&P500 and the QQQs can rise without AAPL. Share price resurgence from this big stock (and other FAANG stocks) remains critical.

Russell 2000

Russell 2000 stocks lead – as markets go "Risk-on". A 2019 "risk-on" rally can return only if both U.S. and global political risk fall, and global growth shows up. Always be mindful of illiquid small cap shorting. In 'Risk-off" periods, shorts can cut down unprofitable small caps -50%.

Fed Funds

Zacks call is for another rate cut in September 2019 and maybe one more in early 1H-2020. The U.S. Fed is always data-dependent. The odds on when the next hike hits stays entirely data dependent. U.S. wage and inflation data is as important as monthly payroll adds. Non-U.S. growth is starting to play a much bigger factor in their decision-making, as are the related issue of U.S. tariffing.

In sum, the FOMC members lean towards easing as along as: Trump does real damage to domestic GDP accounts; in particular if/when U.S. exports fall too much. They can easily cut rates --if needed-- another 100 basis points.

10-yr Treasury

The 10-yr at 1.74% is here. Believe it or not, above 3.0% happened one year ago, in the fall of 2018. Seeing that benchmark rate climb towards even 2.5% is no longer in play in 2019.

A 10-yr rate from +2.5% to +3.5% showed the range I used across ***2017***. Beyond 2019 – only if there is a favorable trade war settlement-- rising pressure from $900 to $1T in annual deficits could pressure long-term rates to go up.

Corporate High Yield and Investment Grade Bonds

In our August 2019 poll, CIOs thought High Yield be volatile, either expanding or contracting. IG spreads should be more stable.

IG corporates offer the solid coupons. Less attractive risk-free rates drive corporate bond demand. Cash on balance sheets remains impressive. Investors should own these bonds.

Municipal Bonds

Note: In our latest poll done on August 2019, CIOs were negative/bearish on Munis again.

State tax efficient munis always look excellent for older income investors. Having written that, all bond classes get pressured by rising rates (is a tactical bottom close?). Plan to hold to maturity (on 5-year paper?) as a precaution. U.S. rates can rise again. Yes. I know they are very low right now. So is the unemployment rate!

WTI Oil

Look for $59 a WTI barrel to arrive in Sept. 2020, as OPEC maintains cuts. London consensus has $59 a barrel in Sept. 2020. Our oil price outlook is tied to OPEC, U.S. "fracker" rig counts, and any increase in global demand for gasoline-at-the-pump.

Gold

Gold trades at $1508 in early August. We cleanly broke out of the trading range in early June.

Gold price upside hails from worry about a U.S. and European recession, not higher consumer inflation. Now, high inflation worry is more a 2021 than a 2019 or 2020 issue. Also worry on financial contagion has risen with the new August 1st tariffing and weaker global growth.

Symmetrically, gold price downside hails domestically from a low risk U.S. 3.7% unemployment rate, relatively low consumer price inflation, and externally, on any improvement in the global GDP outlook.

NOTE: About Zacks Rank Sector & Industry Forecasts Coming Up Next --

Zacks Research System (ZRS) updates the Zacks Ranking System regularly; and groups each company into three aggregates. Each of the ranking aggregates still apply the standard proprietary Earnings Estimate Revisions system, but they help sort things out within a top-down context.

Zack aggregates are:
- A 16 Sector grouping (versus the S&P500's 10 sector groups),
- A 60 mezzanine grouping, known as "Middle" or Zacks M-Rank.
- And finally, a 250+ industry grouping, we refer to internally as the X- Rank.

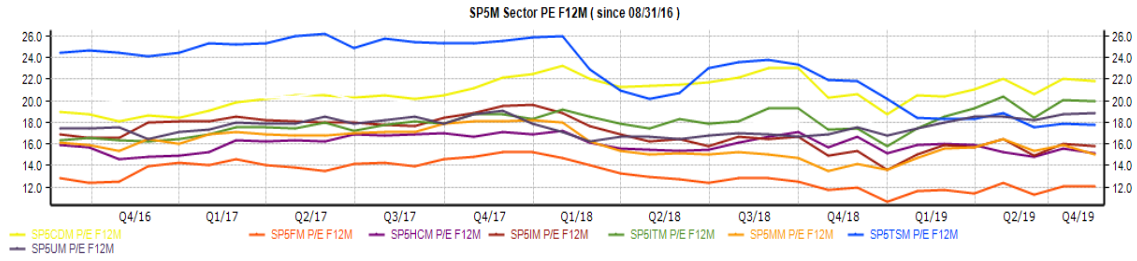
The table in section 6, running four pages long, applied the consolidated ranking information from the 60-industry, Zacks Middle, or M-Rank.

Industries titles listed along with the Zacks Middle Industries are S&P500 Industries, with revisions and additions to reflect specific Zacks industries

TOP-DOWN ZACKS RANK

4. ZRS Chart of the Month

Below: Sector Forward 12-Month Price to Earnings (P/E) valuations over 3 years.
This data effort was done on August 5th, 2019.



Title	HI	LO	MD	CU	SD	ED
S&P 500 Cons Discr Market P/E F12M	23.20	18.12	20.54	21.80	08-31-2016	08-02-2019
S&P 500 Financials Market P/E F12M	15.26	10.63	12.91	12.03	08-31-2016	08-02-2019
S&P 500 Health Care Market P/E F12M	17.22	14.62	15.95	15.16	08-31-2016	08-02-2019
S&P 500 Industrials Market P/E F12M	19.67	13.62	16.76	15.81	08-31-2016	08-02-2019
S&P 500 Info Tech Market P/E F12M	20.39	15.76	17.86	19.96	08-31-2016	08-02-2019
S&P 500 Materials Market P/E F12M	18.17	13.43	15.98	14.97	08-31-2016	08-02-2019
S&P 500 Telecomm Market P/E F12M	26.21	17.49	23.95	17.77	08-31-2016	08-02-2019
S&P 500 Utilities Market P/E F12M	19.13	16.24	17.56	18.84	08-31-2016	08-02-2019

The table (below) shows where S&P500 sector forward 12-month P/E ratios stand, as of August 5th 2019. I list 9 S&P500 sectors. This list excludes **Energy** and **Real Estate.**

S&P500 Sector	Current 12M P/E	5 yr. High 12M PE	Difference (%)
Consumer Discretionary	21.80	20.54	1.26
Consumer Staples (in white)	19.60	19.42	0.18
Financials	12.03	12.91	-0.88
Health Care	15.16	15.95	-0.79
Industrials	15.81	16.76	-0.95
Info Tech	19.96	17.86	2.10
Materials	14.97	15.98	-1.01
Telcos	17.77	23.95	-6.18
Utilities	18.84	17.56	1.28

My first thoughts: S&P500 sector P/E multiples showed recent increases (aka bullish buying) in **Info Tech, Utilities, Consumer Discretionary** and **Consumer Staples,** in that order**.** No other sectors. This set of sectors is worth thinking harder about.

The worst serial valuation decline is in **Telcos.** There appears to be cord-cutting aplenty and price wars at play in this sector. And a change in S&P500 definition is in play too. All other sectors languish without a real show of direction.

5. Zacks Rank S&P500 Sector Picks

Zacks August Sector/Industry/Company Telescope

The month of August is here. The latest Q2 GDP report showed us. The consumer is solid, but business fixed investment is lackluster. I think the Sector ranks this month speak to that.

We have a top sector in Health Care, with strong demographics. Though HC stock returns lagged this year, due to concern about regime change after the 2020 Presidential election. The next 2 top sectors are Consumer Staples and Discretionary, in that order. It seems to be. Sales at retail held up well.

The usual defensive sectors, Communication Services and Utilities, are at the bottom. Taken together, the picture is one of modest cyclical upside in EPS.

(1) Health Care is now the all-around leading Very Attractive sector. The leaders are both Medical Care and Medical Products. Drugs are good too.

(2) Consumer Staples is a Very Attractive sector in August. The leaders are Food/Drug Retail, Agribusiness, and Food.

(3) Consumer Discretionary is a Market Weight sector. The best industries are Non-Food Retail/Wholesale, Apparel, and Publishing.

(4) Energy is a Market Weight. But there are very attractive industries here. Look at Oil & Gas Pipelines and Oil & Gas Integrated.

(5) Financials are a Market Weight. The industry leaders are Finance-Consumer, Real Estate, and Insurance.

(6) Industrials are down to Unattractive. The 2 industries worth looking at here are Aerospace & Defense and Conglomerates. Airlines are bad either.

(7) Info Tech is Unattractive. The trade war is playing an obvious role here. There is a leading industry: Computer-Software Services. The gaming industry and “Fortnite” are helping out. Chips are at Neutral.

(8) Materials stand at Unattractive. There is a winner in Metals-Non-Ferrous to point out. Steel is good too. Stay away from Paper and Chemicals.

(9) Communication Services is Very Unattractive. There is no good option.

(10) Utilities are also Very Unattractive. Again, there is no good option.

6. *Zacks Rank July Industry Tables*

Zacks Forecasts for S&P 500 Industries
(As of July 31, 2019)

Industry Portfolio Rating:	Very Attractive (2.00 to 2.64 Zacks Rank)	Attractive (2.65 to 2.81)	Market Performer (2.81 to 2.99)	Unattractive (3.00-3.20)	Very Unattractive (3.21 or worse)
Consumer Staples **VERY ATTRACTIVE**	Food/Drug Retail Hypermarkets & Supercenters (2.44) Agri-business (2.47) Food Food Distributors Packaged Foods (2.54)	Cons Prod-Misc. Staples (2.81)	Beverages Soft Drinks, Brewers Distillers & Vintners (2.96)	Tobacco (3.20)	
Consumer Discretionary **MARKET WEIGHT**		Non-Food Retail/ Wholesale Department Stores, General Merch. Stores, Specialty Stores (2.75) Apparel Footwear, Apparel & Accessories, Apparel Retail (2.77) Publishing (3.11)	Media Movies & Entertainment Cable & Satellite, Advertising (2.85) Other Cons Disc (2.95) Leisure Service Casinos & Gaming Hotels Leisure Products Restaurants (2.95)	Consumer Electronics (3.00) found via: Internet Retail Computer & Electronics Retail Photographic Products Home Furnishing-Appliance (3.15)	Consumer Autos/Tires/ Trucks Auto Retail, Automotive Manufacturer, Tires & Rubber, Auto Parts & Equipment Distributors (3.28)

Industry Portfolio Rating:	Very Attractive (2.00 to 2.64 Zacks Rank)	Attractive (2.65 to 2.81)	Market Performer (2.81 to 2.99)	Unattractive (3.00-3.20)	Very Unattractive (3.21 or worse)
Energy **MARKET WEIGHT**	Oil & Gas Prod. Pipeline (2.61) Oil & Gas – Integrated (2.62)	Energy - Alternate Sources (2.72)		Oil & Gas Drilling (3.01) Oil Misc. – (3.01) Oil Exp & Prod (3.07)	Coal & Consumable Fuels (3.60)
Financials **MARKET WEIGHT**	Finance Specialized & Consumer Finance (2.42)	Real Estate (REITs), Real Est. Mgmt & Dev. (2.73) Insurance Insurance Brokers Multi-Line Insurance Life & Health Insurance Property & Casualty Insurance (2.81)	Invest Banking & Brokering (2.91)	Banks-Major Regional Banks Diversified Banks, Other Diverse Financial Srvs. (3.07) Investment Funds (3.17)	Banks & Thrifts (3.35)
Health Care **VERY ATTRACTIVE**	Medical Care Health Care Distributors, Health Care Supplies, Health Care Facilities, Managed Health Care (2.43) Medical Products Life Science Tools & Services, Health Care Equipment (2.46)	Drugs Biotech, Pharma (2.72)			

Industry Portfolio Rating:	Very Attractive (2.00 to 2.64 Zacks Rank)	Attractive (2.65 to 2.81)	Market Performer (2.81 to 2.99)	Unattractive (3.00-3.20)	Very Unattractive (3.21 or worse)
Industrials **UNATTRACTIVE**	Aerospace & Defense (2.29) Conglomerates (2.49)	Airlines Air Freight & Logistics (2.72) Business S'vices HR & Employment Services Trade Comps & Distributors (2.75)	Pollution Control (2.88)	Metal Fabricating (3.01) Industrial Products-Services (3.04) Railroads & Trucking (3.07) Business Products Commercial Printing Office Services. & Supplies (3.12) Construction – Building Services (3.16)	Machinery (3.21) Machinery Electrical Electrical Comp. & Equip. (3.51)
Info Tech **UNATTRACTIVE**	Computer Software-Services Home Entertainment Software, Application Software, Systems Software, Internet Software & Services (2.54)		Computer-Office Equipment Office Electronics, (2.83) Electronic-Semiconductors Semiconductors Semiconductor Equipment Electronic Manufacturing Services (2.93)		Telco Equip (3.23) Misc. Tech Data Processing & Outsourcing Services Consulting & Services (3.69) Electronics Electronic Components Equipment & Instruments Computer Hardware, Computer Storage & Peripherals (4.91)

Industry Portfolio Rating:	Very Attractive (2.00 to 2.64 Zacks Rank)	Attractive (2.65 to 2.81)	Market Performer (2.82 to 2.99)	Unattractive (3.00-3.20)	Very Unattractive (3.21 or worse)
Materials **UNATTRACTIVE**	Metals non-Ferrous Diversified Metals & Mining, Gold, Aluminum, (2.07)	Steel (2.80)	Containers & Glass (3.87)	Building Products/ Construction Materials, (3.12)	Paper Paper Packaging Paper & Forest Products, (3.39) Chemicals Fertilizers & Ag. Chemicals Industrial Gases Specialty Chemicals Diversified Chemicals (3.53)
Telecom Services **VERY ATTRACTIVE**				Utility Telephone (3.00)	Telco Services Wireless Telecom Services Integrated Telecom Services (3.20) Telco Equipment (3.23)
Utilities **VERY UNATTRACTIVE**			Utilities – Water Supply (2.84)	Utilities Electric Power (3.08)	Utilities Gas Dist. (2.29)

ASSET ALLOCATION

7. July Sell-Side and Buy-Side— Consensus at a Glance

Sell-Side Consensus

Top-Down S&P 500 End-Of-Year Targets

Where the S&P500 will finish 2019 and how much profit companies will generate?

Wall Street consensus foresees the following S&P500 outcomes in 2019.

Firm	Strategist	2019 Close	2019 EPS
Bank of America	Savita Subramanian	2,900	$170.00
Bank of Montreal	Brian Belski	3,150	$174.00
Barclays	Maneesh Deshpande	3,000	$176.00
Bernstein	Noah Weisberger	2,950	$170.00
BTIG	Julian Emanuel	3,000	$172.00
Canaccord	Tony Dwyer	3,200	$168.00
Citigroup	Tobias Levkovich	3,100	$172.00
Credit Suisse	Jonathan Golub	2,925	$174.00
Deutsche Bank	Binky Chadha	3,250	$175.00
Evercore ISI	Dennis DeBusschere	2,900	$170.00
Goldman Sachs	David Kostin	3,000	$173.00
HSBC	Ben Laidler	3,150	$179.00
Jefferies	Sean Darby	2,900	$173.00
JP Morgan	Dubravko Lakos-Bujas	3,100	$178.00
Morgan Stanley	Mike Wilson	2,750	$171.00
Oppenheimer	John Stoltzfus	2,960	$175.00
RBC	Lori Calvasina	2,900	$171.00
Scotiabank	Hugo Ste-Marie	3,000	$175.00
Stifel Nicholaus	Barry Bannister	2,750	$166.00
UBS	Keith Parker	3,200	$175.00
Weeden & Co.	Michael Purves	2,700	$168.00
Well Fargo	Chris Harvey	2,665	$166.00
	Mean	2,975	$172.34

Note: The S&P500 index marked a 2,510 close on January 2nd, 2019. A 3,200 YE number is +27%. A 3,000 YE number is +19.5%. A 2,800 YE number is +11.5%.

In early 2018, all eight sell-side Wall Street strategists I tracked had made calls for between +4.1% to +16.0% S&P500 returns. (3 at 4%, 2 at 6 to 8%, 3 at 12 to 16%)

The Zacks view difference? We are in-line with this sell-side consensus. The S&P500 can reach 2,975 by YE 2019, with 2,900 a fair value mark for Q3.

Other Sell-Side Views

The “Equity Risk Premium” is an excess return the overall stock market provides above a risk-free fixed income rate. This excess return compensates investors for taking on the relatively higher risk of equities.

Bullish sell-side strategists measured the S&P 500 equity risk premium at 6.2% in early 2019. It's 5.8% now. +4.2% is the average in the recent past. In 2018, Sell-side strategists believed the equity risk premium were a positive force for stocks, given the tax changes.

For other cyclical references, it was +6.2% in 2013 and 6.0% in 2014. It peaked at 7.4% during 2012.

If low LT rates stay relatively low, an arbitrage incentive is there is to buy stocks. 1.6% is here in August. 2.1% was the June 10-yr Treasury data. 2.5% was here in April. 2.7% was here in March and February 2019.

3.16% was here in early Nov. 2018. 2.92% was in June, after a run to 3.10% in May 2018. 2.85% was in March and February 2018.

Bottom-up S&P 500 Earnings
Consensus calls for tepid EPS growth in 2019 tied to U.S. and global real GDP growth levels across 2019.

- U.S. GDP growth will soften in 2019 to perhaps +2.5%. We finished with +2.9% GDP growth for 2018.
- The U.S. garnered +2.3% in 2017, +1.6% in 2016 and +2.6% GDP growth in 2015.

Further out, "bottoms-up "consensus forecasts on EPS growth for individual companies in the S&P 500 index expect growth of +10.9% in 2020. It looks to be +1.9% in 2019; a lull after a strong +20.0% in 2018; +11.0% in 2017; +0.5% in 2016; and -0.6% in 2015.

The Zacks view difference? 2019 delivers a tariffed-down earnings growth rate, also facing tough y/y comps. The U.S. risk markets achieved outstanding nominal S&P500 earnings growth in 2018, on corporate tax policy. That was an historic change. Now, the global economy has been cut down by trade wars.

With tepid earnings growth, but in-line adequate y/y revenue growth, markets look to 1H-20 and beyond for U.S. recession worry. Zacks mostly concurs. Stay vigilant.

Top-down S&P 500 Earnings
Top-down strategists, who track macro forces and apply top-down judgment to forecast S&P 500 earnings, look for a similar +1.9% EPS growth in 2019, after +20.0% growth in 2018 and +11.0% in 2017. This is in line with +0.5% EPS growth in 2016 and -1.1% earnings growth in 2015.

In some sense, this low EPS number in 2019 is 'normal' when placed next to the all-but-forgotten earnings recession of 2016.

Small Cap, Mid Cap, and Large Cap stocks
Q1-2019 saw a rebound on small and mid cap stocks. August 2019 CIOs forecast returns for small caps at a +5 to +10% annual return, with negative sentiment on large caps and mid caps, both at -5% to 0%.

Value is better than growth for large, small, and mid caps.

For perspective, the small caps were on a run in 2018. It was 2H-2017 when small caps turned up. Specifically September 2017.
This followed 2 years of risk-off pessimism. 2016 recorded a bounce for small caps, with regional banks up big after the election.

Fed rates/recession, Trump trade unpredictability, and U.S. Treasury debt sales mark points of worry for bears. A hard Brexit and poor Europe growth data get focus outside the U.S.
The Zacks view difference? Stay bullish on U.S. growth indexes. However, focus on U.S. smaller cap indexes a bit more, given some tractable rotation into them.

Large caps outside the U.S. are not favored, yet. A rotation into them can be confirmed, if GDP growth picks up

outside the USA. India and Taiwan might be positive outliers in the non-U.S. space.

Buy-Side Consensus

S&P 500 and Russell 2000
Our in August 2019 survey-- buy-side consensus came in at 48% positive. This compares poorly to 60% positive in April, and 71% positive in January.

Sentiment was 80% positive in October 2018 and 80% positive in May 2018. It was 74% positive in October 2017, 88% in April 2017, and 85% in January 2017.

Looking further back for when sentiment marked poor numbers like this. Here is 2016: 45% of CIOs were positive on the S&P500 in October 2016 (before the election), versus 63% in July 2016 and 77% in March 2016.

In August 2019, 18% of CIOs expected worse then -5.0% returns, 37% expected -5% to 0% returns, 27% expected 0 to 5% returns, 9% expected +5.0% to +10.0% returns, and 9% had +10 to +15% returns.

In April 2019, 20% of CIOs expected worse than -5% returns. 20% expected -5% to 0% returns. 20% expected 0 to +5% returns in 12 months. 40% expected +5% to +10% returns over the next 12 months; 0% expected 10 to 15% returns. And 0% of CIOs expected large cap S&P500 returns to be more than +15%.

Done in August 2019, small cap Russell 2000 returns deliver a better returns profile over the next 12 months. The small cap mode (36%) is +5% to +10% returns,

S&P 500 and Russell 2000: Value or Growth
August 2019 show a strong preference for Value over Growth for any style of index.

The April and January 2019 and October, May, and Feb 2018 surveys, and October, August and April 2017 surveys also showed a buy-side preference for value over growth stocks in the large mid, and smalls caps too.

Keep in mind. These are long-term investors, not momentum traders.

Fed Funds
In August 2019, a majority of CIOs see less than 250 bps on the Fed Funds rate in 12 months: with 9% at 50 to 100 bps, 9% at 100 to 150 bps, 27% at 150 to 200 bps, and 18% at 200 to 250 bps.

In April, CIOs saw Fed rates out 12 months –as 250 to 300 basis points. In October 2018, it was a lower 200 to 250 bps.

The April 2019 survey showed the buy-side thinks the Fed Funds: (20%) of CIOs called for 200 to 250 bps, with the mode at (60%) that see 250 to 300 bps. Only (10%) see a higher 300 to 350. 10.0% had no opinion

In April 2019, the CIO mode (30%) was for the 5-year U.S. Treasury rate to range between 250 to 300 bps. The 5-yr U.S. Treasury rate as of May 3 2019 was 2.32%. It averaged 2.80% in 2018.

10-yr Treasury
In August 2019, the CIO mode is at 2.0% to 2.5%, with equal weights of response above and below that middle mark.

In April 2019, (10%), 20% of CIOs also had 2.0% to 2.5% U.S. 10-yr. Treasury rates in 12 months time. In turn, (30%) saw 2.5% to 3.0%. (40%) say 3.0 to 3.5%. Another (10%) saw 4.0% to 4.5%.

In October 2018, a mode of (50%) CIOs in our survey also thought the 10-year Treasury rate range should fall

between +3.0 to +3.5%.

Corporate High Yield and Investment Grade Bonds
In August 2019, CIO expected IG bond spreads to remain stable. They expected HY spreads to be volatile, either expanding or contracting.

In April 2019, (50%) of CIOs expected IG bond credit spreads to stay the same and (60%) expected HY credit spreads to widen.

In the October 2018 survey, (87%) of CIOs expected high yield (HY) spreads to expand.

What of late 2017 CIOs? There was similar concern. HY spreads had come in too much. There needed to be a pullback/correction, in their minds.

Municipal Bonds
In our August 2019 survey, 44% of CIOs were bearish, and 33% were at Market Perform.

This has been largely stable in the way of thinking.

In our April 2019 survey, (33%) expected Munis to be a Market Perform fixed income security, while (44%) expected Munis to be Bearish.

In the October 2018 survey, (40%) gave this security a bearish nod and (46%) were neutral

Asset bubbles and debts piling up via bigger U.S. deficits are concerns in 2019.

WTO Oil and Commodities GSCI Index
In the August 2019 survey, WTI oil had 70% of CIOs at Market Perform.

In the April 2019 survey, (30%) of CIOs were Bullish on oil, and (40%) were at Market Perform. (30%) were Bearish.

October 2018 was Market Perform" on Oil prices too.

Nov. 2015 CIOs had Oil negative.

In August 2019, Commodities are 50% Market Perform and 30% Bullish.

Commodities stayed Market Perform in both April and January 2019.

This was also the case for Commodities in May and Feb. 2018 and it was similar to October, August, April and Jan. 2017 & Oct. 2016.

Look back to March 2016 for when Commodities looked firmly bullish.

Gold
In August 2019, 50% of CIOs are at Market Perform on Gold. 30% are Bullish.

In April 2019, 40% of CIOs were Market Perform on Gold. 50% were Bullish. 10% were Bearish.

40% of CIOs were Market Perform in October 2018 (the mode). The CIOs were at Market Perform in Feb and May 2018 too.

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Prospective clients and clients should not assume identical performance results to those shown would have been achieved for their account if it was invested in the Strategies during the period. Clients of the firm may receive different performance than the composites. Client performance may differ due to factors such as timing of investment(s), timing of withdrawal(s), and client-mandated investment restrictions. Wholesale, retail and institutional clients of the firm may have differing performance due to timing of trades.

Investments in the Strategies are not deposits of any bank, are not guaranteed by any bank, are not insured by FDIC or any other agency, and involve investment risks, including possible loss of the principal amount invested. Net of fees performance is based on the maximum fee of 1.75% for a $500,000 account. Lower fees may apply to larger accounts; higher fees may apply to smaller accounts. Separately managed account minimums apply. Inherent in any investment is the potential for loss. Standard management fees are available on request and are described in Part 2A of Form ADV.

Returns for each strategy and the corresponding Morningstar Universe reflect the annualized returns for the periods indicated. The Morningstar Universes used for comparative analysis are constructed by Morningstar (median performance) and data is provided to Zacks by Zephyr Style Advisor. The percentile ranking for each Zacks Strategy is based on the gross comparison for Zacks Strategies vs. the indicated universe rounded up to the nearest whole percentile.

Other managers included in universe by Morningstar may exhibit style drift when compared to Zacks Investment Management portfolio. Neither Zacks Investment Management nor Zacks Investment Research has any affiliation with Morningstar. Neither Zacks Investment Management nor Zacks Investment Research had any influence of the process Morningstar used to determine this ranking.