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Weekly commentary

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Are cycles always circular?

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Key takeaways

- Short cycles, long cycles, and even super cycles all get thrown together in the world of finance as investors compete with one another to define and defend them.
- The clear takeaway from the report was that the data continued along its positive trajectory.
- As we progress through the rest of the year, it is likely US Corporate earnings will see less of a negative impact from the US dollar and commodity sensitive sectors going forward.
- Looking at the global financial markets, data and charts as a Rorschach test, it is likely we will have different interpretations of what we see.

Full commentary

Lately there seems to be considerable attention being given to cycles; economic cycles, business cycles, interest rate cycles, default cycles, the list can be quite long. So while the term 'cycle' seems to be getting itself attached to a dizzying number of nouns, its meaning when applied across different markets, data, and charts is less defined and open to much interpretation. Short cycles, long cycles, and even super cycles all get thrown together in the world of finance as investors compete with one another to define and defend them. Something everyone should be able to agree on is the very nature of a cycle; it is circular, and things which have happened before are likely to happen again. In this light, perhaps every market, chart, or cycle can be considered a Rorschach test. People can see anything they wish but we should all agree we are looking at an inkblot test. A Rorschach test is a great example of how the same set of data can elicit so many different interpretations. But the idea of cycles can help us define where we have come from, where we are now and where we might be heading next.

Jobs and Economic Data

Last week brought market participants the latest insight into the U.S. job market with the highly scrutinized monthly non-farm payrolls release. Many were quick to point out the outliers, which is to say some of the data came in below expectations. While others came in above, each attempted to defend where they believe we are within the jobs cycle. The clear takeaway from the report was that the data continued along its positive trajectory. However, as our first chart shows, while annual growth in NFP was positive, the data continued to make a lower low from its peak in the first quarter of 2015.

One notable sign that the U.S. job market is in a healthy, albeit likely mature; phase is the number of job leavers. This figure reported by the U.S. Bureau of Labor Statistics (BLS), tracks unemployed workers who have voluntarily quit their job to find other employment. It is generally thought of as a positive sign that companies are hiring with competitive wages to entice people to quit their jobs. Last week, the BLS reported job leavers as a percentage of the total unemployed represented 10.8%. This is up from the recent cycle low of 5.5% in September 2010, but still off the previous peak of 12.6% in May 2006.

Earnings

At the conclusion of last week, 87% of the companies in the S&P 500 Index reported first quarter 2016 earnings. According to Factset, 71% had reported earnings above mean estimates. I have never been a fan of earnings beats or misses, as it is never clear whether the estimate was bad or the actual results good or vice versa. However, more concrete is that the first quarter of 2016 experienced an earnings decline of 7.1% from the prior year. Some of this decline is attributed with dollar translation effects and a drop in commodity prices. Nonetheless, it was the first time since 2009 that the index has seen four consecutive quarters of year-over-year declines. As we progress through the rest of the year, it is likely US Corporate earnings will see less of a negative impact from the US dollar and commodity sensitive sectors going forward. Recently the Federal Reserve has mentioned the lack of private sector investment as a growing concern. There are five principal uses of corporate cash; capital expenditures, acquisitions, buybacks, dividends, and debt paydown. So what are companies doing with their cash these days? The second chart we bring to your attention shows the increasing nature of companies buying back shares as a way to boost earnings.

The Cycle

Looking at the global financial markets, data and charts as a Rorschach test, it is likely we will have different interpretations of what we see. It is my hope that we can at the least agree markets follow a cycle and that one or two spots of data only serve to fit themselves into a larger picture of where have we come from, where are we now, and where are we likely to go next?

This week's market developments

Monday, May 2
- Markit Eurozone Manufacturing PMI (final estimate) increased to 51.7 (s.a.) for April
- Markit US Manufacturing PMI (final estimate) remained at 50.8 (s.a.) for April
- US ISM Manufacturing Index decreased to 50.8 (s.a.) for April

Tuesday, May 3
- Markit UK Manufacturing PMI decreased to 49.2 (s.a.) for April

Wednesday, May 4
- Markit Eurozone Services PMI (final estimate) decreased to 53.1 (s.a.) for April
- Markit US Services PMI (final estimate) increased to 52.8 (s.a.) for April
- US Factory Orders growth increased to 1.1% m.o.m. (s.a.) for March
- US Durable Goods Orders growth (final estimate) remained at 0.8% m.o.m. (s.a.)

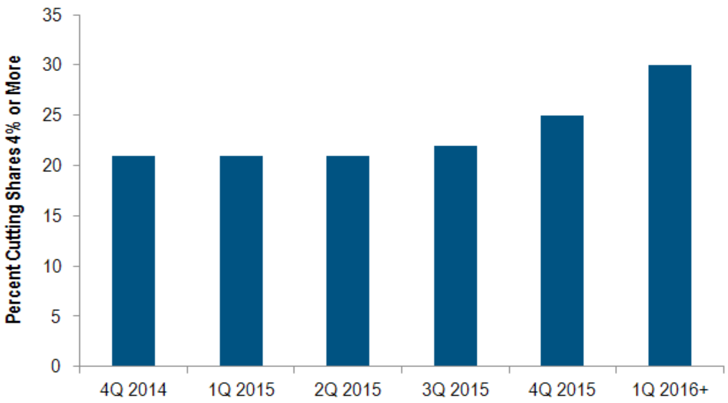
Thursday, May 5
- US Initial Jobless Claims increased to 274,000 for the week

Friday, May 6
- US Change in Nonfarm Payrolls was 160,000 m.o.m. (s.a.) for April
- US Unemployment Rate remained at 5.0% (s.a.) for April

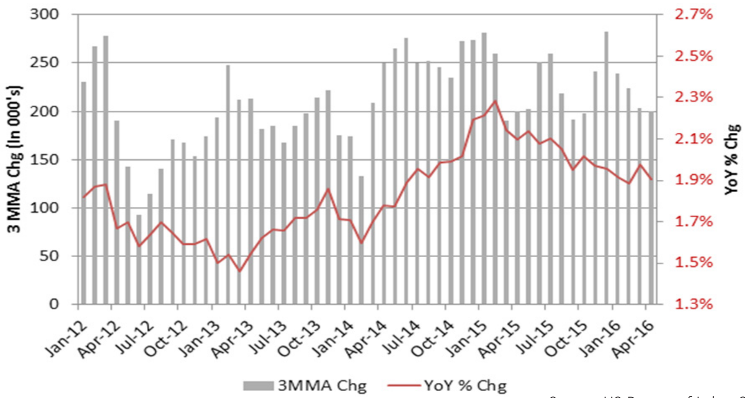
Source: Bloomberg, as of end May 6, 2016

Charts of the week

Buybacks Play Bigger Role in S&P 500 Earnings (top) and Nonfarm Payrolls 3-month moving average (bottom)



Source: Bloomberg



Source: US Bureau of Labor Statistics

Central Bank watch

	Last move	Date of move	Current policy rate	Implied 3m rate on March 2016 Interest Rates Futures Contract	Next meeting
Fed	+25 basis points	December 16, 2015	0.25 % - 0.50 %	0.38 %	June 15, 2016
ECB	-5 basis points	March 10, 2016	0.00 %	-0.17 %	June 2, 2016
BoJ	-20 basis points	February 16, 2016	-0.10 % - 0.00%	0.06 %	June 16, 2016
BoE	-50 basis points	March 5, 2009	0.50 %	0.59 %	May 12, 2016

Source: Bloomberg

Next week's market developments

Monday, May 9

- Germany Factory Orders growth is expected to increase to 0.6% m.o.m. (s.a.) for March

Tuesday, May 10

- Germany Industrial Production growth is expected to increase to -0.2% m.o.m. (s.a.) for March
- US Wholesale Inventory growth is expected to increase to 0.1% m.o.m. for March

Wednesday, May 11

- UK Industrial Production growth is expected to increase to 0.5% m.o.m. (s.a.) for March
- UK Manufacturing Production growth is expected to increase to 0.3% m.o.m. (s.a.) for March

Thursday, May 12

- Eurozone Industrial Production growth is expected to be 0% m.o.m. (s.a.) for March

Friday, May 13

- Eurozone First Quarter GDP growth (preliminary estimate) is expected to remain at 0.6% q.o.q. (s.a.).
- US Retail Sales growth (advanced estimate) is expected to increase to 0.8% m.o.m. for April
- US PPI Final Demand growth is expected to increase to 0.3% m.o.m. (s.a.) for April
- Japan Tertiary Industry Index growth is expected to remain at -0.1% m.o.m. (s.a.) for March

Source: Bloomberg, as of end May 6, 2016