

Monday Morning UpdateApril 2, 2018

This is what I am thinking.

Expectations for earnings this year are Trump-huge. Time and time again CNBC reports earnings estimates as high as +20% for the upcoming 1st qtr. And then estimates as high as +25% for the 2nd and 3rd quarters of 2018. Recent economic data has not been stellar. Treasury yields went down, not up, last week. P/E's are being ratcheted down. And since 2019 is not that far away, expectations for even more growth in earnings versus what will be Trump-huge comparisons to deal with in 2018 make it very difficult for P/E's to expand above 18. And a P/E of 16 seems more like the proper planning tool than using 18 for your multiple on earnings. Earnings approaching \$200 a share and a P/E of only 16 makes for the S&P 500 at 3200. A 21% increase in the S&P, all from earnings, and none from P/E expansion. Traders and investors have not seen this for quite some time. Half of the 22% gain in the S&P in 2017 came not from earnings, but from P/E expansion. Take note. With respect to interest rates, the 10-year Treasury still has not had a definitive breakout from its downtrend in yields since the late 1980's. The 10-year has been beating its head up against the 2.85% - 2.90% trend line originating back to Sept 1987; it couldn't break out above this very long trend line. Now we face a retest of 2.65% on the 10-year. I have my doubts traders will take the yield this low, if for no other reason than a break lower to 2.65% will also take the yield all the way down to 2.40%. This is not what we want to see happen. It is very doubtful it will happen. But a break below 2.85% on the 10-year is very troublesome. Somebody smells something, and it is not Easter lilies.

The Fed – Short-term rates are now set at 1.50% - 1.75%. One week T Bills yield a 1.66%. The Fed is “plotted” to raise their target rate two more times in 2018. Some on the Fed favor three more moves. Suffice to say, short-term rates will be at or above 2.00% at year-end. And barring any exogenous shocks to the USA, short-term rates will be at or above 2.50% at year-end 2019.

Inflation – investors and traders see more wage data in this Friday's employment report. The Fed's Five Year Forward is at a 2-month low. Inflation break evens from 1 year out to 10 years out are all moving lower, in sync. So much for expectations for a 3-4% GDP with rising inflation !

Treasuries – if Fed Funds are at 2.00% at year end, with expectations for a 2.50% yield at year-end 2019, this puts the target for the 2-year Treasury somewhere between 2.25% - 2.65%. It closed last Thursday at a 2.28%. Then the 5-year has a target of 2.55% - 2.95%. It closed last Thursday at a 2.58% yield. The 10-year would have a target of between 2.75% - 3.15%; it closed at a 2.76% last week. Watch inflation expectations. Watch revisions in GDP. Watch the revisions in late 2018-2019 earnings estimates.

The S&P 500 – The S&P 500 continues to be unable to build any support around its 50-day moving average. The 50-day moving average sits at 2730 for today's opening. We closed at 2641 last week. We traded above the 50-day Tuesday last week, but that was it. The S&P can't set new highs, or revisit old highs until it closes above 2730, and stays above 2740 for a while.

Crude Oil – Crude prices look very healthy above \$60 a barrel. Oil for Jan 2020 delivery is being priced at \$57.20, versus last week's close of \$65.18. Any moves above \$66 a barrel makes for a target all the way up at \$75-76 a barrel.

Municipals – muni yields on maturities under 5 years are still below corporate bond yields, for both the 21% taxpayers and 35% taxpayers. 20-year finals with an 8-10 year call feature can yield over 3.15% tax-free to the call date. Dilly Dilly !

Corporates ---the widening in corporate spreads took a pause late last week. IG spreads closed at +109 bps. HY spreads closed at +354 bps to Treasuries. Yields move higher as Treasury yields move higher. Add spread widening to this concoction, and income investors are very, very happy.

The US Dollar – the trend for the USD is lower, not higher, against the major currencies.

PDR Advisors 4033 Ivystone Ct. Charlotte NC 28277 704 845 2303