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Bloomberg --

Sentiment is turning against defensive companies in the U.S. stock market alarmingly quickly.

Shares of soapmakers, utility providers and phone companies are falling out of favour and fast, marking one of the S&P 500 Index's biggest reversals of the year. The latest to fade are consumer-staples stocks, which just slumped below the 50-day moving average monitored by chart watchers. A selloff in drugmakers Wednesday also sent health-care shares below that level. The only other industries within the benchmark that have breached deeper short-term technical thresholds? Utilities and telecom stocks.

It's an about-face for investors who spent the 10 months after last August's market meltdown clinging to those industries' high-dividend, low-volatility shares as bond yields plunged and the outlook for economic growth dimmed. That appetite has evaporated since the selloff that followed the U.K. secession vote, with leadership in the S&P 500 shifting to technology, financial and industrial shares.

"As the market broke out, the defensives have been underperforming and it's just a continuation of that," said Jonathan Krinsky, chief market technician at MKM Partners LLC in New York, who last month recommended investors begin selling the shares. "These sectors should continue to underperform the market as their relative trends have been rolling over and continue to be in medium-term downtrends."

Krinsky's bearish take isn't unique. Bets are piling up against the industries, particularly in an ETF that tracks consumer-staples companies in the S&P 500. Short interest as a percentage of shares outstanding -- now at 9.6 percent -- is the highest since June 2015, data compiled by IHS Markit Ltd. show, and has nearly tripled since mid-June.

U.S. stocks slipped for a second day while investors awaited a speech by Federal Reserve Chair Janet Yellen Friday for clues on the trajectory of borrowing costs. The S&P 500 fell 0.1 percent to 2,172.47 at 4 p.m. in New York, to a three-week low. The Dow Jones Industrial Average lost 33.07 points to 18,448.41, and the Nasdaq Composite Index declined 0.1 percent.

Consumer-staples shares slipped for a third-straight session, the longest stretch in four weeks, while utilities were little changed and phone companies edged higher for the second time in six days. About 5.5 billion shares traded hands on U.S. exchanges, 19 percent below the three-month average.

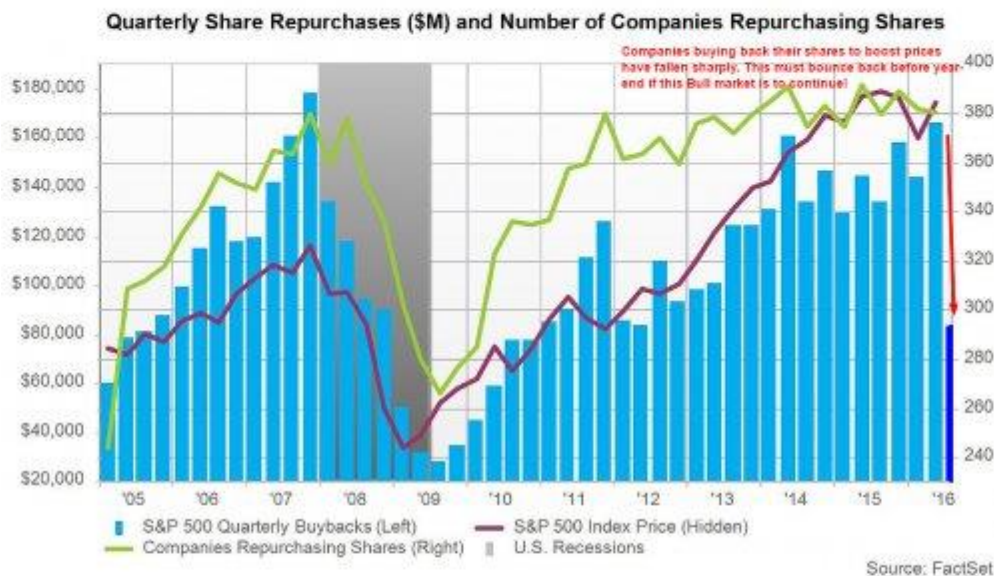
Buybacks Tank - Will Stocks Follow?

Kurt Kallaus

Our recent reports have worried about “short-term” stock market froth in August as indicated by options trader sentiment showing relatively heavy call buying. The additional anxiety over the contrasting US presidential candidates may also send investors and business deals to the sidelines making the fear of lower stocks and a weaker economy a reality, at least temporarily.

The new wrinkle is that Trim Tabs Investment Research indicates that corporate buybacks have suddenly plunged. We show the estimated repurchase levels below in dark blue that mirror the lowly levels of 2012. Share buybacks always rise during equity bull markets.

With paltry organic economic growth since the 2009 recovery, share buybacks become a critical source of buying power to maintain rising stock prices. When repurchases fall sharply, stock prices, in general, are more likely to fall as well.



We can theorize this drop is due to (1) anxiety over anti-business policies discussed by both Presidential candidates or (2) uncertainty over the Federal Reserve desire to raise rates making corporate debt issuance for stock buybacks more costly.

Corporate debt issuance has receded about 8% from the record 2015 levels and is still quite high. We suspect that once we get past the November 8th US presidential election, share buybacks will normalize. However, if they remain weak, then expect stock prices to be valued with far more risk.

Rate Hike?

Federal Reserve Board Presidents have been very vocal these days that strong job growth warrants raising the Fed funds rate sooner rather than later. Sure, the labor market has grown as sharply as any strong economic recovery could and "official" U3 unemployment is low, but the sluggish economy hovering just above stall speed remains a fixture.

U6 unemployment including marginal workers is well over 9%, wage inflation in this strong jobs market has remained below normal and Purchasing Managers Indices (PMI) have stalled. The composite PMI of services and manufacturing indicates a GDP that should be closer to 1% than the 2.5 to 3% many have expected during the 2nd half of 2016.

Sources: IHS Markit, U.S. Bureau of Economic Analysis.

If the Fed was hesitant to raise rates all year, it's hard to fathom how they can justify rate hikes at this juncture with these weak data points and just prior to a murky US election. Such logic has prevailed in preventing rate hikes in 2016 thus far, but there is often a lack of clarity in the messaging from our central bank.

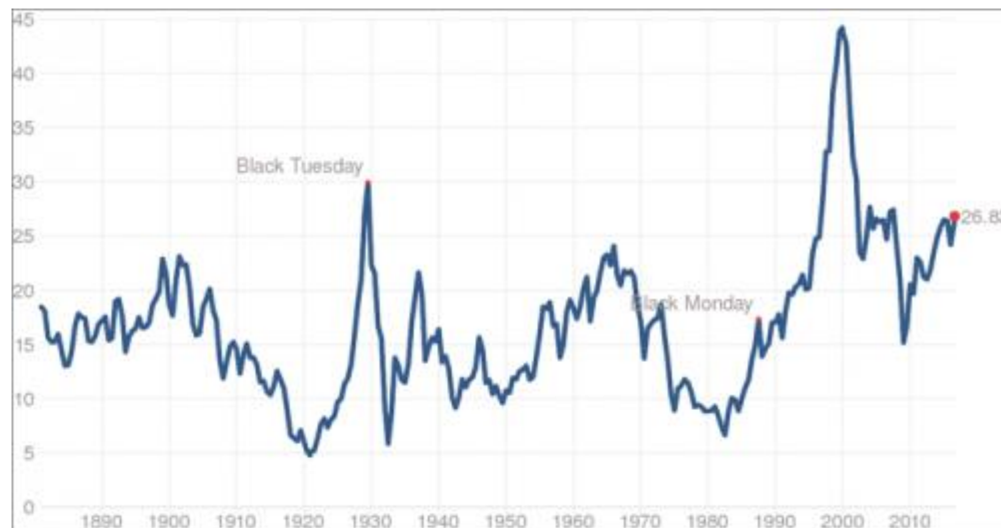
Overbought option trader euphoria, election anxiety, and hints of a Fed rate hike should all send stocks lower short-term into September/October, but a continued dearth of corporate share repurchases could trigger a larger correction that would elevate concern of a bear market. This is still a bull market with a pause in clarity until after November 8th.

A Typical Pattern Shows We're Headed for Recession

Andrew Zatlin

We're witnessing a very typical pattern right before recessions and market collapses.

The market's price-to-earnings (P/E) ratio is currently at a level seen only before recessions.



Before we flat out say there will be a recession, we need to dig deeper into why we're here today.

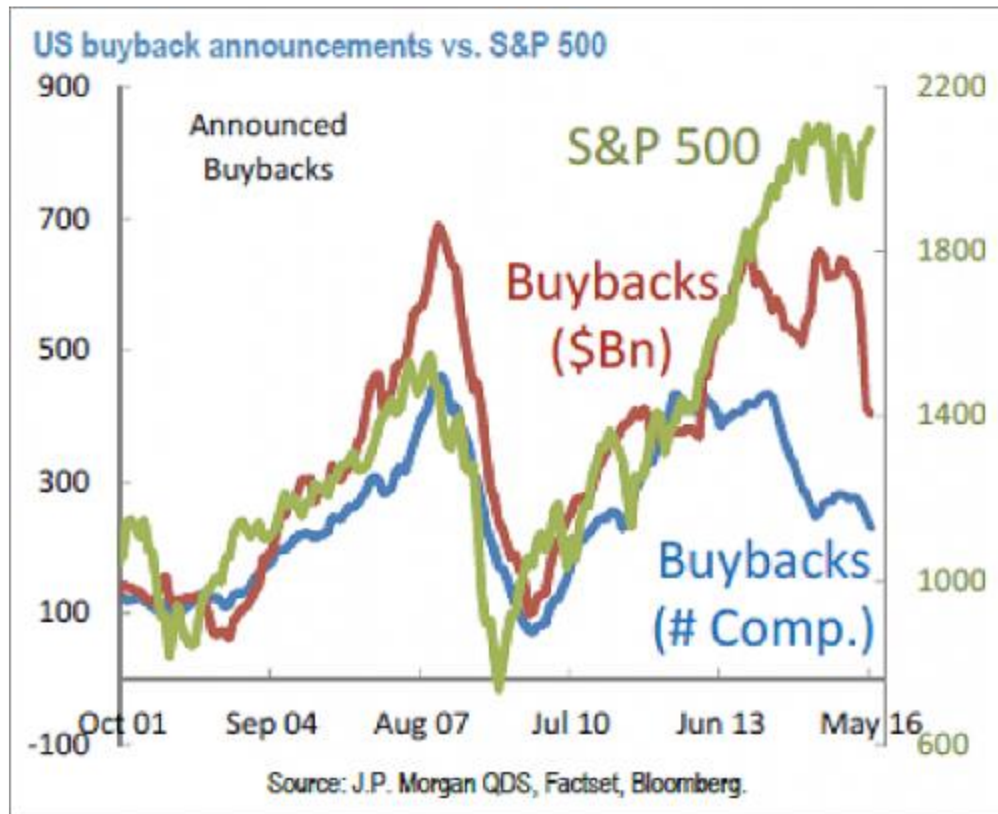
First, we can look at earnings (the E in P/E.) Earnings have stalled. Yet prices (the P in P/E) have still rallied. This pushes the P/E ratio upward.

This metric is a simple way of saying that something has to break. Usually, it means that prices must fall back to earth. However, this cycle is different.

Today, we're in a zero-interest rate (ZIRP) environment.

This is forcing money to flood the stock markets for two reasons. First, because market yields are sexier than 1% in CDs. And second, because companies can borrow billions of dollars in debt at lowest interest rates. This allows them to buy back their own shares.

(Note: Executives are mostly compensated in shares. They'll do whatever they can to boost share prices.)



Corporate buybacks are boosting shares in a couple ways. First, it can create the illusion of earnings-per-share (EPS) growth. When earnings aren't growing, share buybacks reduce the number of shares. With a lower number of outstanding shares, earnings magically seem better on a per-share basis.

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Second, because companies can borrow billions of dollars in debt at super low-interest rates, this allows them to buy back their own shares with minimal capital risk. It's a cheap way to boost the stock price. And the market has loved it.

Take a look at the buyback chart again above.

Notice the stock market started getting shaky precisely when buybacks themselves stopped rising.

This wasn't a coincidence.

But now, the central banks are propping up the market as earnings drift lower and buybacks stall.

Japan's central bank formally announced it was buying foreign equities earlier this year. And the Bank of Switzerland was just revealed to have added tens of billions of US equities to its portfolio.

The ***central banks*** are replacing corporate buyers.

Consider one more dimension…

Smart money knows a recession is coming… but it nevertheless is buying equities that are obviously overpriced. Why? Because they know interest rates are heading even lower.

Sure, the Fed talks a good game about raising rates. But they aren't serious.

Lower interest rates are what happens when the economy slows. Since we're already at zero, we're likely headed to negative interest rates. There is already more than $13 trillion in negative yielding government debt. The US is next. And the smart money knows it.

Stock markets look more attractive the lower interest rates fall.

Personally, I've already exited the market based on current fundamentals. Maybe I was early… especially if the Federal Reserve (Fed) plays their games as the economy continues to slow.

But it's not wise to fight the tide.

The Fed can bail out the sinking economic ship all it wants. But it's still sinking.

I may have missed the run-up in the market as stocks broke out to all-time highs (Oh well). I might have missed more gains. But when the market turns and drops 15%, I'll have remained safe and dry.

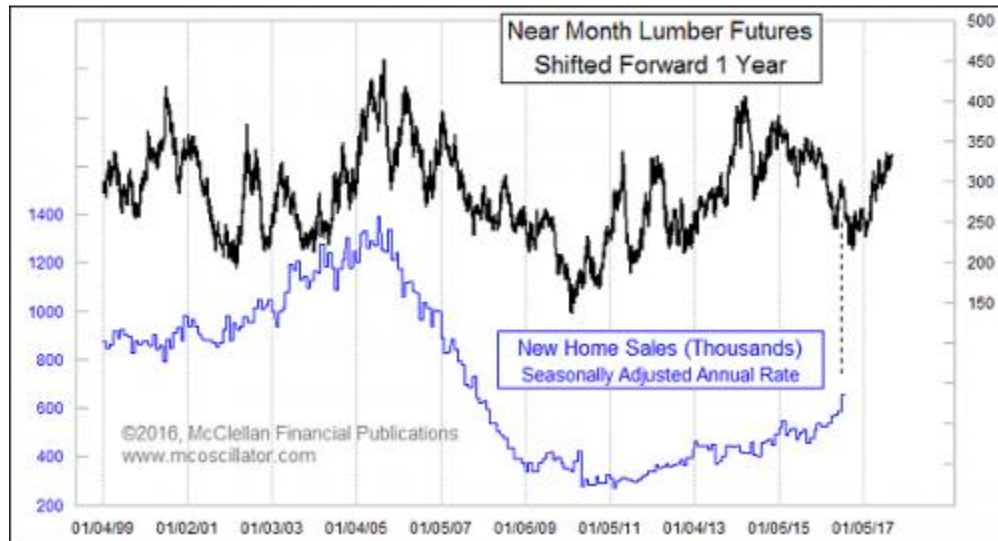
Echo Boomers Will Fire Up Housing Market

Tom McClellan

Housing-related stocks are seeing an earlier than called for a push to a higher high. But if lumber prices are right, there are lots more gains to come.

By that, I am referring to the way that lumber prices tend to give a 1-year leading indication for the share prices of housing-related stocks, like those which make up the HGX Index. In the chart above, the plot of lumber prices is shifted forward by 1 year to reveal how the up and down movements seen in lumber futures prices tend to get echoed a year later in the housing sector stocks. It is not a perfect relationship; it is merely very good.

One reason for this relationship is that lumber prices also give a leading indication for new home sales. There is a decent amount of lumber involved with the construction of a new home, so it makes sense that there should be a correlation. But why it works out to be exactly a year is a bit of a mystery. Chalk it up to the market being smarter than the economists.



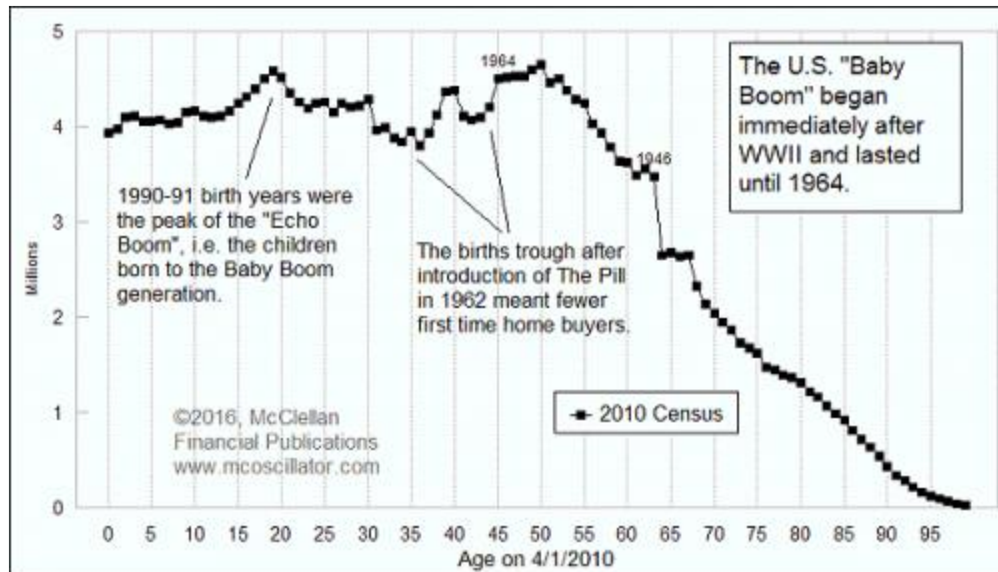
The latest data on new home sales for July 2016 showed the highest rate since 2007. It is still a long way from the peak years of the early 2000s when all of the Baby Boomer generation were buying McMansions, but a new multiyear high is still a good thing.

And this new multiyear high is coming earlier than lumber said it should. Perhaps all of that pent up demand during the early 2010s is finally getting to work on the housing data. Lumber's message is that we should really see a big rise in the new home sales data, and in the housing sector stock prices, after the echo of the September 2015 bottom in lumber prices. How much of that big upcoming rally is getting taken up by this earlier than expect surge is hard to say.

What I can say is that there is a good reason why new home purchases have been lagging in the past 8 years, and it is not all about the financial crisis and the central banks' response.

According to Zillow, the average age of a first-time home buyer is 33 years old. That number has been creeping higher from a low of 29 in the late 1970s, but it is an important concept. When there is a dip in an age cohort, there are fewer people at the right age to be buying their first home.

Here are data from the 2010 census, showing the numbers of each age cohort as of April 1, 2010. If you think back to how old you were on that day, you can find the bar for your own age cohort.



After the introduction of oral contraceptives in 1962, births still stayed high for a couple of years as women were slow to adopt that new medical technology. But beginning in 1965, births dropped off sharply, and stayed lower than trend until recovering in 1980. So all of those babies who were not born in the late 1960s and all during the 1970s did not grow up to become people who could buy their first home in their early 30s.

In 2009, at the bottom of the financial crisis when new home sales were also bottoming, the 33-year-olds were people who were born in 1976. That was a big low in the age demographic curve. Now we are seeing the babies born in the more hopeful 1980s hitting their stride and starting to buy homes. But the crest of this wave is still coming.

The peak birth years for the “Echo Boom” generation (kids of Baby Boomers) were 1990-91. So the babies born in those years are now just 25-26 years old, and still a few years away from hitting that 33-year-old sweet spot for buying their first homes. In other words, **the wave is coming, and it should be bullish for real estate prices**.

The question now is how fast are the Baby Boomers going to start trying to move out of their McMansions (and trying to unload their Fed-inflated bond portfolios), and how quickly will the Echo Boom generation pick up that slack. Lumber’s message says that after September 2016, we should at least see a 1-year up move for new home sales and for housing sector stocks.

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THE ONE MAJOR CENTRAL BANK THAT IS TAKING AWAY THE PUNCH BOWL.

Tom Orlik and Fielding Chen,Bloomberg

Five Signs China Authorities Pulling Back on Stimulus

In May this year, a front-page story in the Communist Party's flagship People's Daily grabbed the attention of the markets. The article — which featured an interview with an "authoritative person" widely believed to be a senior adviser to President Xi Jinping — called for an end to the unsustainable credit boom.

Did that signal a shift in policy, or was it merely one voice attempting to influence a larger debate? Five signs since then suggest it was the former:

Loan growth has slowed. Looking at the total social finance data, the annual expansion in outstanding credit came in at 10.9 percent in July, down from 12.5 percent in March and the lowest level in the history of the series.

The central bank has tweaked its open market operations, reintroducing 14-day reverse repos — instruments with a longer maturity and a higher cost than seven-day reverse repos. The PBOC appears to be to applying a gentle squeeze on investors, making it harder to rely on low short-term borrowing costs to make leveraged bets in the bond market.

The China Banking Regulatory Commission is proposing tighter rules on the 23.5 trillion yuan ($3.5 trillion) wealth management product industry, according to news reports. Higher capital requirements and other controls would make it harder for banks to raise funds through WMP issuance — tamping down on inflows into shadow finance and leveraged bond market bets.

Real estate policy has shifted from a nationwide free for all to a differentiated approach, with major cities introducing controls in an attempt to curb runaway prices.

Chatter from central bank officials suggests resistance to further rate cuts. Sheng Songcheng, the head of the People's Bank of China's statistics and analysis department, has warned of the risks of a liquidity trap and said rate reductions would not be effective in supporting growth.

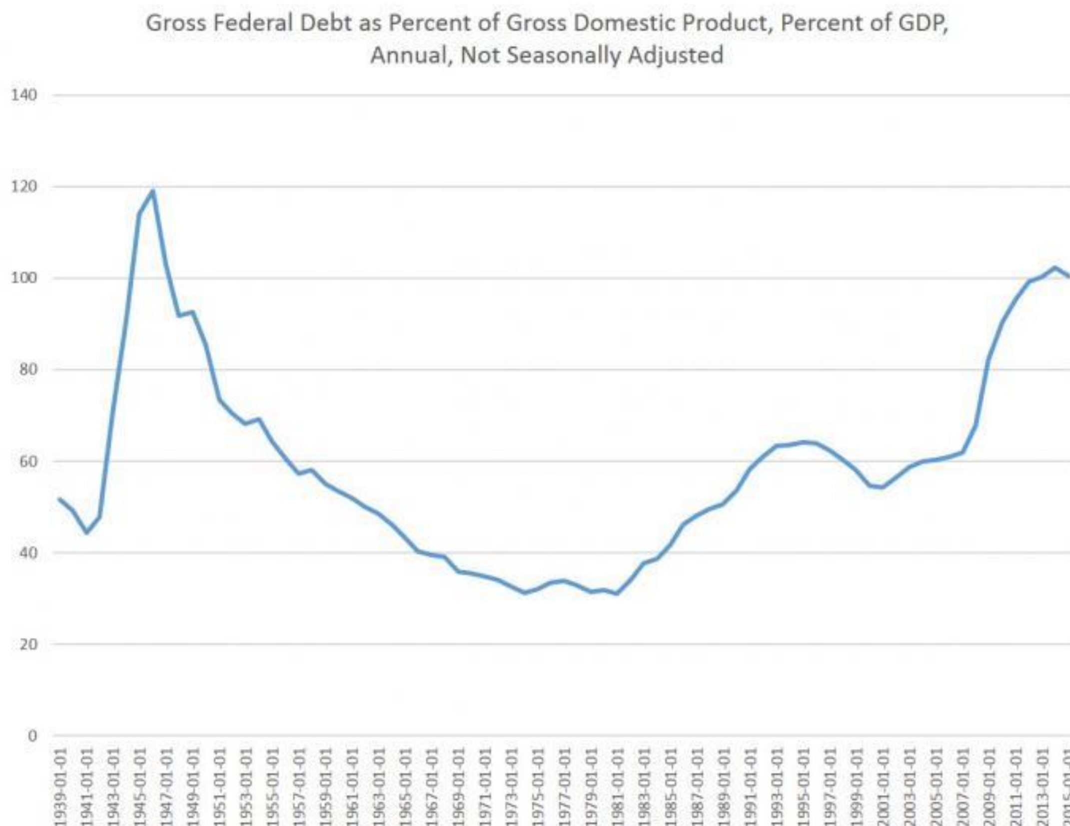
Why the shift? The most obvious explanation is that stimulus has done its job. Based on Bloomberg Intelligence Economics' monthly GDP tracker, growth hit a nadir of 6.3 percent year on year in February, and since then has rebounded comfortably back into the 6.5 percent to 7 percent target range. With growth on track, the government can start to shift its focus toward medium-term sustainability.

The US National Debt Load Is Second-Worst In The World

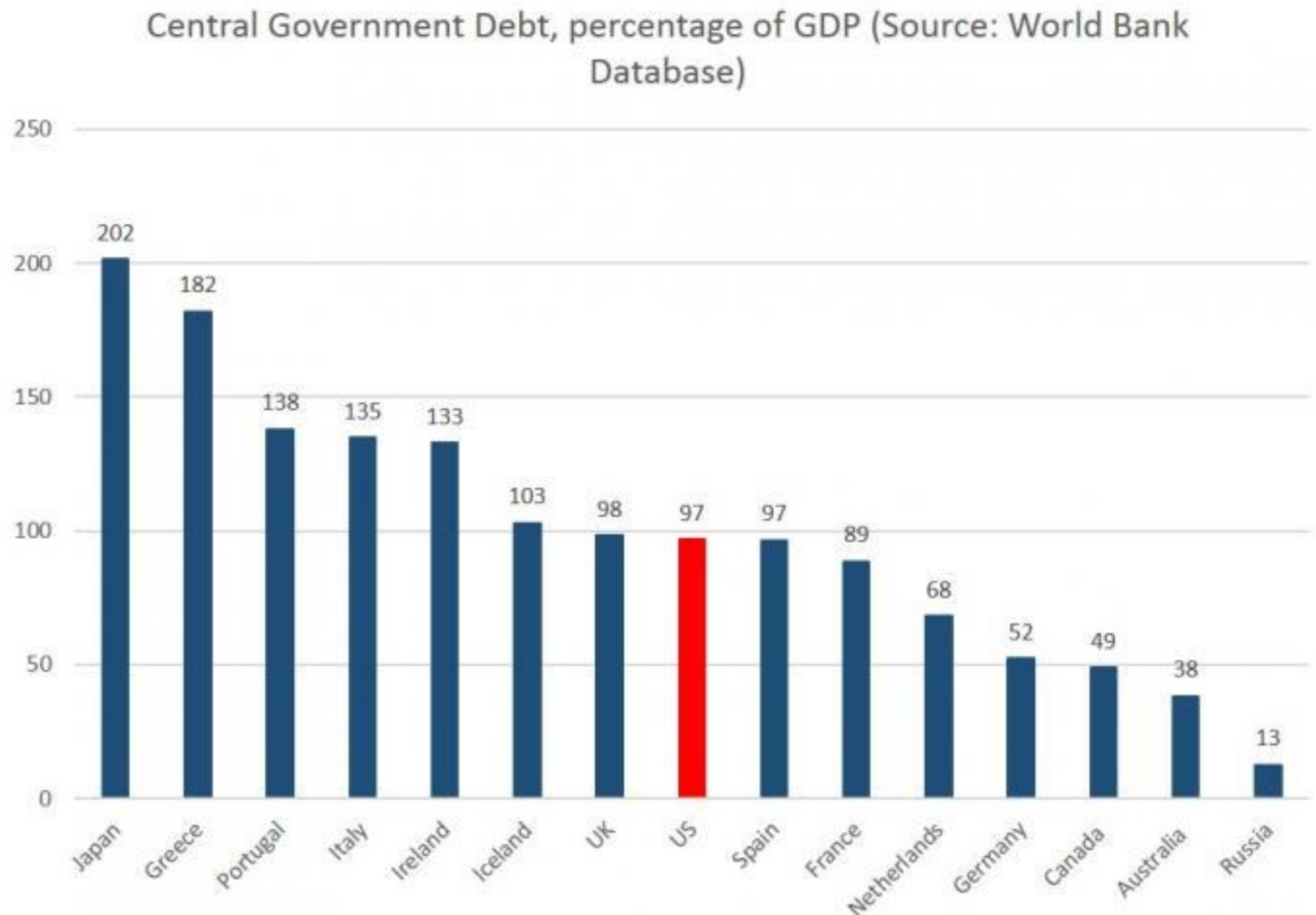
by Ryan McMaken, Mises Institute

The US Office of Management and Budget last month released its latest numbers of US federal debt as a percentage of gross domestic product. According to the OMB, the federal debt is now at 100 percent, which makes it similar to debt levels reached during the aftermath of the second world war when the US was still dealing with its massive war debt.

Indeed, since 2008, federal debt levels have been at 50-year highs and at levels one would expect from a country in crisis or at war:



Defenders of deficit spending, however, claim that 100 percent of GDP is not particularly alarming, and some point to the fact that, in comparison to other wealthy nations, a debt level of 100 percent is not anything special. For example, if we use the World Bank's data on central government debt, we find that the US falls below Japan, Italy, and even the UK:



While Japan, Greece, and Portugal all certainly have their budget challenges, the deficit-spenders say, none of these places are on the verge of collapse. Moreover — it is often pointed out— the US benefits from the fact that it controls the global reserve currency and can thus monetize its debt more freely than other states.

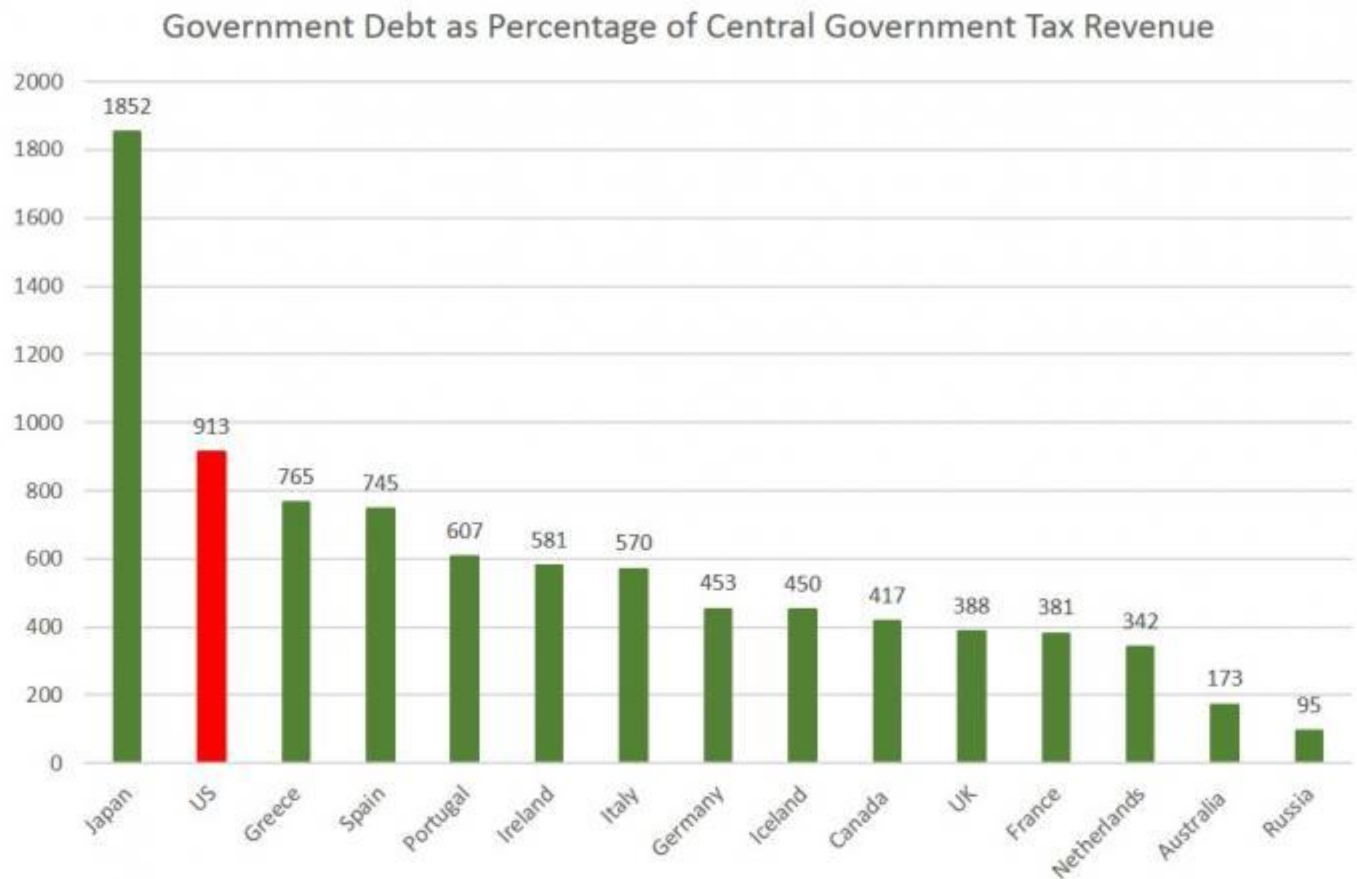
Soothe-saying comparisons to places like Japan and Italy are becoming less convincing as time goes on — considering the flat-lining economy in Japan and the looming banking crisis in Italy — but the claim nevertheless persists that the US is not exactly first in line when it comes to debt loads. As long as Portugal and Italy appear stable, it seems, the US has little reason to worry.

But, there is a problem with this measure.

Calculating debt levels as a percentage of GDP don't really tell us all we want to know about a state's ability to manage debt.

If we want to know the extent to which a debt load is concerning, we must look instead at a state's revenue, rather than just its GDP.1

When we make comparisons of debt as a percentage of tax revenue, the US is no longer in the middle of the pack. Now, the US has the second-largest debt in the world:



Comparing tax receipts across national states, and comparing to total debt, we find that Japan still leads with a debt load that's more than 18 times its tax receipts.2 The US is right behind Japan with a debt load that is more than eight times the size of its tax receipts.3

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Why We Need to Look at Tax Revenue

Looking at debt in terms of government revenue is key because GDP does not really reflect all the resources to which governments have access. After all, only totalitarian states have direct access to nearly *all* resources produced by an economy. (Even in totalitarian economies, there are black markets.) That is, only a *portion* of GDP can be used by states to make debt-service payments.

Moreover, attempts to increase revenue — i.e., raise taxes — come with both political and economic downsides. Not only is raising taxes politically unpopular, but the act of collecting more revenue can actually cause economic growth and GDP to go down, since taxes act as a disincentive for economic activity.

As powerful as they are, states are constrained in their ability to raise taxes at will, and even if they gain the political will, raising taxes doesn't mean more revenue will be collected. Thus, GDP by itself cannot really tell us how feasible it is for a state to handle its debt loads.

Government Revenue, not Assets Are most Important

Also implausible is the claim that the US government could simply sell off assets to pay off its debt.

The Trump campaign, for example, has made this claim, and has even claimed Trump could pay off the $19 trillion dollar national debt (not including unfunded commitments to programs like Social Security, apparently) by simply selling off national forest land, and other assets. Even if Trump were able to unilaterally sell off all this land, the US government's land assets total only about one to three trillion dollars. As explained here, selling off gold assets — assuming they exist — wouldn't go very far either.

But, of course, the whole idea is pure fantasy. Were the US to attempt to sell off its assets — especially the more valuable land that isn't a salt flat in Nevada — it would be met with immense political opposition. The opposition wouldn't just come from hard-core environmentalists, but would come also from right-wing sportsmen and middle-class types who have become accustomed to using public lands. Moreover, ranchers who have become used to cushy leases with federal agencies would also resist.

There is also about a trillion dollars more in land and equipment controlled by the US military. Will Republicans line up to sell off military bases and equipment? That's seems unlikely.

Thus, the US is not going to be paying off its debt by selling assets.

That leaves us with tax revenue (and monetary inflation) as our only reliable means of dealing with debt.

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Causes for Concern

When we make a revenue-based comparison, we find that the US is, in fact, a world leader in debt among wealthy nations. Moreover, a cause for concern is the fact that any attempt to raise taxes would likely disrupt an already shaky and lackluster economy. If the Federal Reserve is too afraid to even raise the target rate to even 0.75 percent, it would seem unwise to raise taxes to address the national debt.

If the US can't raise taxes, and it can't sell off assets, what can it do?

In theory, of course, the US can maintain a large debt *indefinitely*. Nowadays, interest on the debt is "only" six percent of the federal budget. But, what happens when interest rates must increase? Unfortunately, the low-interest situation is not likely to last forever, and foreign governments are already selling off US debt, suggesting a slow decline in interest for US debt. All things being equal, this would mean the US will eventually have to pay more in interest on its debt to attract investors. When that happens — and a larger share of the US federal budget must go to interest payments — what federal programs will be abandoned so the US can devote greater portions of the budget to interest payments? Politicians and their constituents won't want to abandon *any* of them.

That's where the central bank comes in.

Rather than cut back on its commitments to holders of US debt, social security recipients and others on the US dole, the US will simply inflate the money supply to make all its payments in devalued currency. Many taxpayers won't understand what is happening — and the politicians know this — which is why policymakers prefer monetary inflation over raising tax rates.

With a debt load already many times larger than its revenue stream, the US faces a choice: repudiate the debt or make massive cutbacks in government programs. With baby boomers retiring and demanding their welfare programs more than ever, few will bet on the latter.

Instead, the US will repudiate its debt by continuing to pay off its debt in devalued currency. The process has already begun and is likely to continue.