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Earnings Should Bounce in 2016; More Thoughts on the Productivity Collapse

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Chartists should be bullish: both equities and commodities rallied sharply last week and appeared to have double bottomed despite little economic news (as usual) in the week following the employment report. Hints from more Fed officials indicate they want to hike in December – I am sure they have processed the feedback from the markets that that their pass in September was not well appreciated. Historically, higher oil prices have not been good US stocks, but with US production up sharply, the stocks now seem to welcome stability in oil prices. Estimates are that the lower oil prices will subtract $8 for S&P 500 earnings this year, and the strong dollar subtracts another $5. It is not hard to see why estimated 2015 earnings have fallen 2% short of 2014 levels. But if oil can stabilize around current levels, we should see a snapback in energy sector earnings as write-downs of the value of oil reserves shrinks dramatically. Ditto if the dollar can stabilize around current levels – foreign earnings can resume their upward trend. 2016 S&P 500 earnings of $125 are quite possible next year. In fact, we would have seen those earnings this year if oil prices had not fallen or the dollar risen. With the Index up to 2000, $125 makes for a nice even 16 P-E ratio for the world's most replicated index, below the 16.5 average over the last 60 years.

As Q3 GDP growth estimates are now in the low one percent range, it looks like another year of 2 to 2.5% growth. Over the last 4 years GDP has grown at most as quickly as the increase in the number of hours worked, yielding zero or negative labor productivity growth. In fact, given that over 10 million new jobs were created over the past four years, we should have seen GDP growth in the 4.5% to 5% range, twice as high as experienced, if historical productivity growth had prevailed. There are number of explanations for this productivity collapse. One is that job growth has been in areas that do not directly increase measured GDP, such as compliance, human resources, health care bureaucracy, etc. Another is that the new workers do not have the skills and/or motivation to achieve higher wages. A more positive explanation is that we are understating true GDP because smart phones have taken on so many functions that were once handled by other devices (such as point-and-shoot cameras, GPS, etc.) and this transition has not been recorded by the GDP counters. Also missing from GDP calculations is the dramatic increase in the amount and quality of information available that increases consumer efficiency but has not yet had an impact on firm productivity. Hopefully as more data come available, economists will be able to tease out the most important factors contributing to the productivity slowdown