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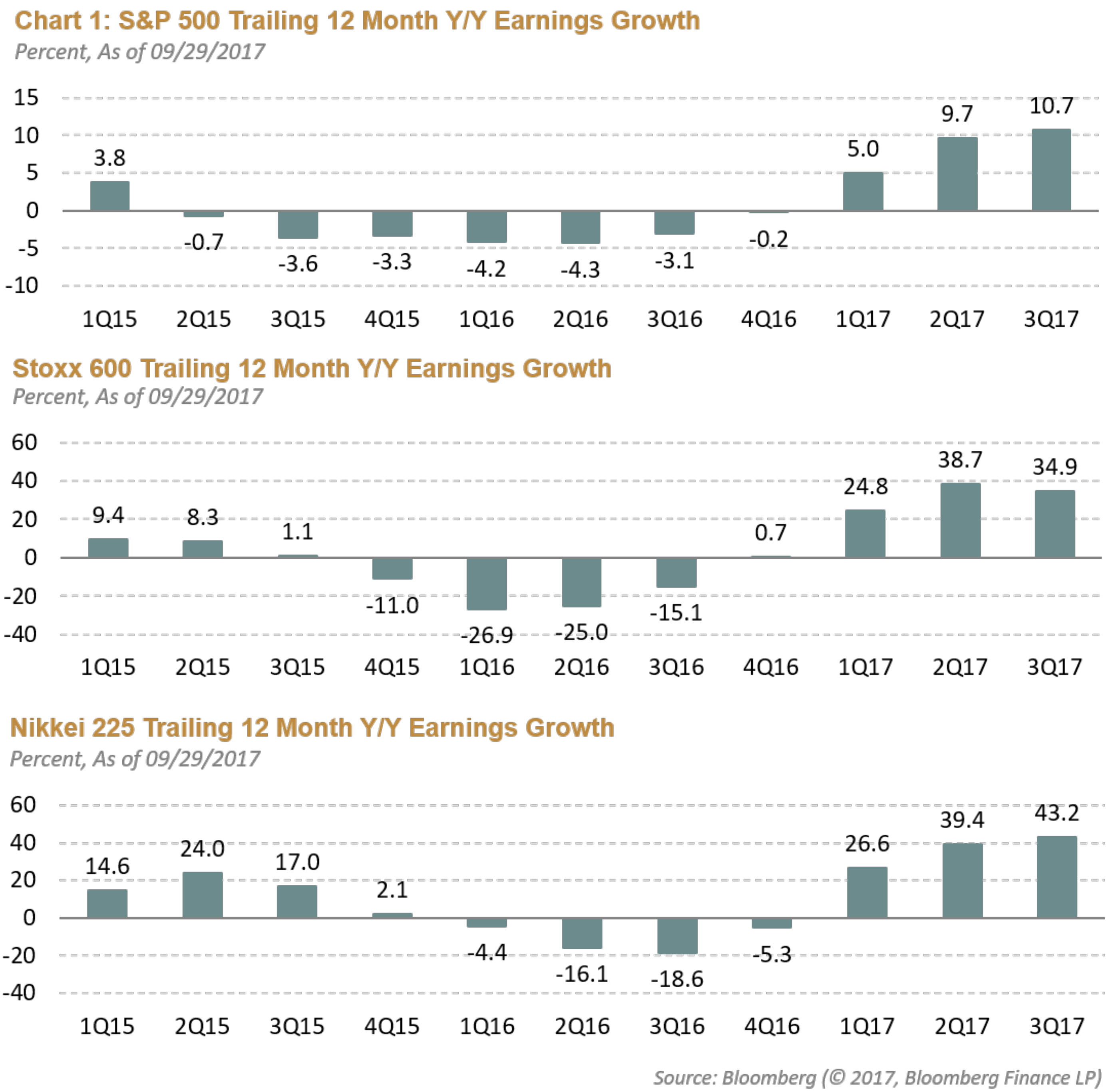
Featured G

Charts of the Moment: G3 Earnings and the Capex Cycle

Corporate earnings growth has rebounded in G3 economies. By looking at major equity indices in the U.S., Europe, and Japan, we can see that year-over-year (YoY) earnings growth has—to put in modestly—increased in 2017.



We believe the turnaround in corporate profits is not merely happenstance. If you are familiar with our work, then you know we firmly believe that interest rates and currencies are not just assets we invest in, but are actually functions of the underlying economy. Therefore, it is no coincidence that G3 corporate profits have turned around in 2017, since the U.S. dollar has come off its lofty valuations while the eurozone and Japan used a prolonged period of currency weakness to boost export-related sectors. Our outlook for the year has been predicated on the idea that the global economy is in a stage of slow, synchronized growth—an environment that helped end the era of a unilaterally strong dollar. We have also seen overall sentiment improve too, with the Organization of Economic Cooperation and Development's (OECD's) Business Confidence Index (BCI[1]) breaking through the 100 mark—a level not seen since 2011 within the G3. As a frame of reference, the BCI's high watermark has been 102 over the last 40 years, led by Germany in 2010 and Japan in 1990s. We think the G3 business climate is supported by both hard and soft data, which should encourage corporate capital deployment.

So what will G3 multinationals do with their embarrassment of riches? In the U.S.—where the business cycle is further along relative to Europe and Japan—companies have favored share buybacks and mergers and acquisitions for the last several years. Capital expenditures (capex) may be the next step for companies seeking a higher rate of return. Using the flow of capital goods as a proxy for global capex (Source: JP Morgan), we can see an upward trend within the G3:

The upturn in global growth should aid G3 capital flows, particularly as imports across Asia rebound and trade improves.

[1]*The business confidence index (BCI) is based on enterprises' assessment of production, orders and stocks, as well as its current position and expectations for the immediate future. Opinions compared to a "normal" state are collected and the difference between positive and negative answers provides a qualitative index on economic conditions.*

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