***"3 Things"** is a weekly post of thoughts I am pondering, usually contrarian, with respect to the markets, economy or portfolio management. Comments and thoughts are always welcome via• email, •Twitter,•and/or•Facebook.*

Earnings: Everyone Gets A Trophy

The ongoing process of the **"*wussifcation of America*"** has now spread from Main Street to Wall Street. When I was growing up, we played sports. Coaches yelled at us, when we got hurt we were told to *"rub some dirt on it"* and *"walk it off."* When we won a game we were cheered by our parents and coaches, when we lost we were disappointed. **Guess what? We got over it.** Come the end of the year, the top three teams received trophies, the rest were relegated to realizing that next year they would have to practice harder, work harder and play harder in order to win. **What was learned is that the higher the bar was set, the more competitive we were and the better we became.•** Somewhere along the way, the liberal left infiltrated the heart of America. Dr. Spock took discipline out of homes and schools and replaced it with coddling and sensitivity training. **The concern over *"potentially offending"* someone became more important than the issues themselves.** Freedom of speech, religion and privacy have all deteriorated under this nauseous ideology that somehow, we as individuals, are just too stupid and weak to stand up for ourselves. *(Please don't send me nasty tweets, it hurts my feelings.)* When it came to sports, the *"wussification"* of America came to fruition with the idea there should be no *"winners"* or *"losers,"* and keeping *"score"* was simply a means to discriminate against those who•were*"athletically challenged."*•**Everyone gets a trophy.** Unfortunately, the same has become true with Wall Street. In the latest earnings season related nonsense, FactSet produced this gem of *"wussification of Wall Street."*

> **"Overall, 91% of the companies in the S&P 500 have reported earnings to date for the first quarter.** Of these•companies, 71% have reported actual EPS above the mean EPS estimate, 7% have reported actual EPS equal to•the mean EPS estimate, and 22% have reported actual EPS below the mean EPS estimate. **The percentage of•companies reporting EPS above the mean EPS estimate is above both the 1-year (69%) average and the 5-year•(67%) average."**

Of course, 71% of companies so far have beat their earnings. Why wouldn't they considering how much those estimates have been revised since the beginning of this year? As I showed previously, not only have estimates fallen sharply since the beginning of this year, they have continued to decline over the last two months.

SP500-Actual-Estimated-Earnings-Exuberance-051916 **If FactSet was intellectually honest in their analysis, rather than contributing to the *"wussification"* of the investing class,** a comparison to previous estimates would reveal that not only did **71% not beat their estimates**, but in reality, would have been a nearly•complete wipeout.**Combine that with a tempering of forward expectations by 33%, which is the average historical overestimation, and suddenly•companies are not being rewarded for merely*"showing up."*** Furthermore, remove *"operating"* and *"proforma"* estimates, which are almost complete fiction, •and hold Wall Street analysts accountable for their estimates, and investors would once again find an ability to truly *"invest"* for the long-term. **Such *"truth"* in reporting would quickly separate the *"winners"* from the *"losers"* and require CEO's to actually do their job of *"competing"*** in the global marketplace and returning true value to shareholders. **Why doesn't this happen?•**Because *"deep* *down in places that you can't talk about parties"* **you don't want to know the truth**. You want the obfuscation to keep asset prices elevated for longer than value would dictate. **You like the coddling that Wall Street provides you.** But the consequences are always the same in the end. So, *"just say 'Thank You' be on your way."* Oh, and here's your trophy.

Inflationary Reality

As I penned last week:

> "Just recently Rob Arnott and Lillian Wu via Research Affiliates•discussed this exact problem.
> 'Surveys suggest that the average American?s daily experience *[of inflation]* may be quite different. **One-year consumer inflation expectations have been consistently higher than trailing and realized inflation over the last 20 years,** and higher than more recent market-based inflation expectations, measured by one-year swap rates.• **Figure 1•shows how this divergence has grown larger since the financial crisis, suggesting the average household might have been feeling even greater pain during the recovery process than has been believed.'"**

Wheres-the-Beef_FIGURE-1_OVERLAY

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This week, we saw inflationary pressures continuing to build pushing the Fed's preferred measure of inflation towards their target of 2.0%. But exactly where is this inflation coming from?

Inflation can be both good and bad. Inflationary pressures can be representative of expanding economic strength if it is reflected in stronger pricing of both imports and exports. Such increases in prices would suggest stronger consumptive demand, which is 2/3rds of economic growth, and increases in wages allowing for absorption of higher prices. That would be the good.

The bad would be inflationary pressures in areas which are direct expenses to the household. Such increases curtail consumptive demand, which negatively impacts pricing pressure, by diverting consumer cash flows into non-productive goods or services.

If we take a look at import and export prices there is little indication that inflationary pressures are present.•

Import-Export-Prices-051916

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However, if we take a look at the breakdown of the Consumer Price Index we can clearly see where inflationary pressures have risen over the last 5-months.

(Thank you to Doug Short for help with the design)

As is clearly evident, the surge in *"health care"* related costs, due to the surging premiums of insurance due to the "Un-affordable Care Act" pushing both consumer-related spending measures and inflationary pressures higher. **Unfortunately, higher health care premiums do not provide a boost to production but drains consumptive spending capabilities.** •Housing costs, a very large portion of overall CPI, is also boosting inflationary pressures. But like *"health care"* costs, rising housing costs and rental rates also suppress consumptive spending ability.

> *"**For the middle-class and working poor, which is roughly 80% of households, rent, energy, medical and food comprise 80-90% of the aggregate consumption basket. "***

The problem for the Fed is that by pushing interest rates higher the suppression of demand will only be exacerbated as the costs of variable rate interest payments also rise. With households already ramping up debt just to make ends meet, another increased expense will only serve to further suppress *"consumer demand."*•

RCube - Small Business Warning Signs

Dennis Ouellet recently penned an interesting piece of work entitled *"Margin Call No Marginal Risk."*•The whole piece is worth a read, but the analysis of the NFIB Small Business Survey peaked my attention. Since small businesses make up roughly 80% of all employers, the analysis of that data•is crucially important to understanding what is happening economically as a whole. To wit:

> "Last week, I showed this smart chart to illustrate the margin squeeze currently impacting American small businesses."

small business margins_0

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> "Rcube, a French investment research boutique, has done excellent work on this concept. **It developed a *?Small Business Profit Indicator?* using NFIB data to show that small biz earnings are about to tank and drag down U.S. equities**

earnings along:"

Small-business-earnings-vs-optimism

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Small-business-profits-optimism

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Small-business-fwdearnings-optimism

"U.S. CEO confidence is directly related with Rcube?s SBPI:"

"Poor CEO confidence is certainly not positive for capex investments (remember Edwards above?)?"

"?nor is it, eventually, for employment:"

Small-business-employment

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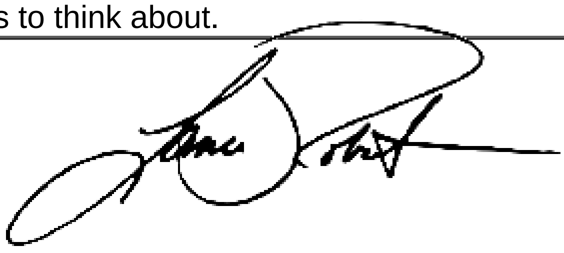
"**What these charts suggest is that profits are not about to turn up anytime soon unless something radically changes on the demand side of the economy.** This something radical needs to show up pretty soon, otherwise employment growth will begin to fade, taking us into a vicious state of slow growth and rising wages. **No wonder Mrs. Yellen is so cautious and uses the word 'uncertainty' so much these days."**

Just some things to think about.

Lance Roberts  Lance Roberts is a Chief Portfolio Strategist/Economist for Clarity Financial. He is also the host of ?The Lance Roberts Show? and Chief Editor of the ?Real Investment Advice? website and author of ?Real Investment Daily? blog and ?Real Investment Report?. Follow Lance on Facebook, Twitter, and Linked-In