



MORNING BRIEFING

February 12, 2020

Powell's Vaccine

Check out [audio excerpts](#), [pdf](#), and [chart collection](#).

(1) So far, coronavirus is a minor panic attack for stocks. (2) Investors betting virus will soon go away or that Fed will inject liquidity if it infects global economic growth. (3) Powell is "closely monitoring" the situation. (4) No sign of virus in forward revenues or earnings, yet. (5) Industry analysts are cutting Q1-Q3 earnings, but boosting Q4. (6) FAANGMs remain immune to the virus and have been leading the meltup. (7) FAANGMs are not immune to government regulation. (8) There's no place like S&P 500 Homebuilders during the coronavirus outbreak. (9) Millennials starting to turn into homeowners.

Meet Leslie. We have a new employee at YRI. Her name is Leslie, and she will be reading audio excerpts from our *Morning Briefings*. The link to these podcasts is available above. Let us know if you like this new service.

Strategy I: Viral Meltup. I did a search on the bullet points of our 2019 [Morning Briefings](#) for the word "meltup." It came up four times:

Feb. 26: "The Cheerleader-in-Chief: Trump likes meltups more than meltdowns in the stock market."

Jul. 29: "Risking a meltup and running out of ammo next time it is really needed."

Nov. 26: "The case for a meltup."

Dec. 18: "Stock market meltup?"

Joe and I addressed that last question in our 12/18/19 [Morning Briefing](#) titled "2020 Vision." We wrote: "Another risk is that investors could conclude that there is nothing to fear but fear itself. That could lead to a meltup. When the S&P 500 rose to our 3100 target for this year on 11/15, we started to consider the possibility of a meltup scenario involving an advance to our 3500 year-end 2020 target well ahead of schedule in early 2020. We may be experiencing that meltup now given that the S&P 500 is getting close to 3200 already!"

We reiterated this view in our first [commentary](#) of 2020, dated 1/6 and titled “Nothing to Fear But Nothing to Fear (and Iran).” As it turned out, the crisis with Iran didn’t last long enough to merit adding it to our [Table of S&P 500 Panic Attacks Since 2009](#). However, we did add the coronavirus outbreak as #66 on our list with a 1/24 date, when the outbreak news first hit the tape. So far, it has turned out to be among the very short and minor selloffs, as the S&P 500 dropped only 3.0% from 1/23 through 1/31 ([Fig. 1](#)). Since then, the index is up 4.1%, closing at a new record high of 3357.75 yesterday. A gain of just 4.2% would put it at our 3500 target for year-end!

That’s quite a remarkable development. Recall that there were a couple of panic attacks in 2018 and again in 2019 triggered by Trump’s escalating trade war with China ([Fig. 2](#) and [Fig. 3](#)). One of the big worries was that the trade frictions would disrupt supply chains and force companies to spend money to move them out of China. It seems to us that the coronavirus outbreak in China poses a more immediate and greater threat to supply chains. Yet here we are at record highs in the S&P 500, DJIA, and Nasdaq.

There was also a minor panic attack when the yield curve inverted last summer ([Fig. 4](#)). But the Fed reversed that problem by cutting the federal funds rate for a second and then a third time last year on 9/18 and 10/30. The yield curve since has flattened again and may be about to invert again too. Yet this story is getting no play in the financial press as a pressing concern about an imminent recession the way it did last year.

The markets must figure that the coronavirus outbreak will be contained soon and go into remission, as did SARS, MERS, and Ebola. If that doesn’t happen, then there will be a vaccine that will make us feel better. It won’t be a miracle cure coming from a drug company. Rather, it will be injections of more liquidity into the global financial markets by the major central banks.

Fed Chair Jerome Powell yesterday implied that the Fed is on standby to do just that. In his [testimony](#) on monetary policy to Congress, he said, “Some of the uncertainties around trade have diminished recently, but risks to the outlook remain. In particular, we are closely monitoring the emergence of the coronavirus, which could lead to disruptions in China that spill over to the rest of the global economy.”

Meanwhile, Joe and I continue to monitor the weekly fundamental indicators for the S&P 500 for signs of the viral infection:

(1) *Forward revenues & earnings*. It's too soon to tell whether the virus outbreak is starting to weigh on S&P 500 revenues and earnings. S&P 500 forward revenues remained at a record high during the 1/30 week. Forward earnings edged down 0.3% during the 2/6 week from its \$179.01 record a week earlier ([Fig. 5](#)). The forward profit margin remained at 12.0% during the 1/30 week.

(2) *Q1-Q4 earnings*. Nevertheless, industry analysts may have just started to cut their Q1-Q3 earnings estimates during the 2/6 week to reflect the possible negative consequences of the virus on the companies they follow ([Fig. 6](#)). They seem to be doing their best to offset those cuts by boosting their Q4 estimates, by which time the virus problem should have passed, in their collective estimation.

Strategy II: Are FAANGMs Immune? The market has had more to worry about lately with the coronavirus, but the FAANGM stocks haven't suffered. Most among us have our daily lives intertwined in some fashion through Facebook, Amazon, Apple, Netflix, Alphabet (parent of Google), and Microsoft.

While these companies may be immune to the coronavirus, they are not immune to government regulation. Our good friend Mike O'Rourke, the Chief Market Strategist at Jones Trading, alerted us to the following reason for the selloff in these stocks yesterday:

"The market melt-up pressed on to new highs today, but then faded as the Federal Trade Commission (FTC) issued 6(b) Orders to the Fab 5, Apple, Microsoft, Google, Amazon and Facebook. As we frequently note, they are the 5 largest US companies and comprise approximately 20% of the S&P 500. The orders allow the agency to 'conduct wide-ranging studies that do not have a specific law enforcement purpose.' The agency is trying to identify whether the companies are making anticompetitive acquisitions of businesses below the Hart-Scott-Rodino filing threshold. FTC Commissioner Rohit Chopra provided good context when he tweeted, 'Many giant companies are convinced that their dominance is due to their genius and innovation. But the truth is that so many can get big by swallowing up or shutting down potential threats. They don't need to invent killer apps if they can stay on top through killer acquisitions.' There is some truth to the statement. While some companies serially acquire revenues to create the artificial appearance of growth, the smarter companies acquired the next generation technology. It was the business model that fueled Cisco Systems' strength in the late 1990s."

You can see the FANGs in our [Industry Indicators: FANGs](#) and the broader portfolio of FAANGMs in the [Stock Market Briefing: FAANGMs](#). They both contain charts of their performance, revenues, earnings, and valuations, and compare them to the broader S&P 500. I asked Joe to update us on the latest stats for these six companies. Here is his report:

(1) *Super-duper Q4 results.* With financial results now out for all six of the FAANGMs, we can aggregate how they did collectively as a group. All six beat their consensus Q4 earnings forecasts, and five (all but Google a.k.a. Alphabet) exceeded their consensus revenue estimates. In aggregate, they recorded a 14.3% earnings surprise and 21.6% y/y earnings growth. That compares to a sharply lower S&P 500 ex-FAANGM surprise of 3.9% and 0.5% earnings growth. On the revenue side, the FAANGMs exceeded forecasts by 1.9% and recorded whopping y/y revenue growth of 15.7%. Those were well above the S&P 500 ex-FAANGM figures of a 0.6% revenue surprise and 1.5% revenue growth.

(2) *Record-high market-cap share and valuations.* Following their strong results in Q4, it's not surprising to see investors rewarding these winners. The value of FAANGMs is now at a record-high market capitalization of \$5.6 trillion ([Fig. 7](#)). That puts it above a 20% share of the S&P 500's market cap for the first time ever ([Fig. 8](#)). Also moving to record highs were their share of the S&P 500's forward revenues (1.3%) and forward earnings (11.2%) ([Fig. 9](#)).

FAANGM traded at a forward P/E of 34.2 during 2/7, nearly matching its mid-January record of 34.3 ([Fig. 10](#)). However, its forward price-to-sales ratio exceeded its mid-January record high of 5.02 last week, rising to 5.10 ([Fig. 11](#)). Here are the latest valuation ratios among its components: Facebook (22.6 P/E, 6.8 P/S), Amazon (68.0, 3.0), Apple (21.9, 4.8), Netflix (57.3, 6.4), Google (26.8, 5.2), and Microsoft (30.5, 9.1) ([Fig. 12](#) and [Fig. 13](#)).

(3) *S&P 500 with and without FAANGMs.* During the week ending 1/30, the S&P 500 traded at a forward P/E of 18.5 ([Fig. 14](#)). We figure that FAANGM is adding a near-record 1.8 points to the latest forward P/E ratio and 0.26 points to the price-to-sales ratio ([Fig. 15](#)). That's not much below their respective record-high 1.9- and 0.27-point P/E and price-to-sales ratio contributions a few weeks ago in mid-January. Taking out the FAANGMs, the S&P 500's forward P/E of 16.7 remains below its peak of 17.4 during December 2017, but the forward price-to-sales ratio of 1.96 is about the same as the 1.97 recorded in January 2018.

Strategy III: Healthy Homebuilders. Despite a continued rise in home sales prices through late last year, housing affordability improved along with lower interest rates. But will low

mortgage rates continue to remain low? Even if they do, will low rates continue to propel buyers into the housing market?

Last Thursday, the National Association of Realtors (NAR) Chief Economist Lawrence Yun [said](#) at the association's policy forum that the real estate industry can't continue to rely on low mortgage rates to boost sales in the long term, as rates will eventually normalize. Yun added that low inventory is the biggest contributor to rising home prices, constraining home sales that could be even greater than they are now given the hot jobs market. Yun observed that the national homeownership rate continues to lag historical norms despite low mortgage rates.

But Melissa and I are not quite as pessimistic, and neither are investors: The S&P 500 Homebuilding stock price index is up 16.7% ytd through Monday, the third best performance among the 100+ industries we track in our [YTD Sectors & Industries Performance Derby](#). It needs to rise only 4.4% more to match its record high during July 2005 ([Fig. 16](#)).

Melissa reports from her home in North Georgia that there's an obvious homebuilding boom all around the area. New developments under construction are quickly sold out. Young families are moving in from more expensive areas up North and from abroad.

Some softening in housing units sold may be ahead, particularly for pricey existing homes in limited supply. But the good news is that mortgage rates likely will coast from here, as the Fed's monetary policy remains on pause or potentially becomes more accommodative if global growth weakens. And there are signs of life in homeownership rates, especially for younger buyers. Future growth in the housing market is likely to come from older Millennials, who may finally be taking the leap into homeownership.

There's also something to be said for investing in homebuilding stocks because they are relatively immune to global uncertainties. As long as the coronavirus remains a problem overseas, our mantra is "there's no place like home." Let's have a close look at the latest data:

(1) *Low mortgage rates boosting demand for homes.* When the 30-year mortgage interest rate began to fall during late 2018, prospective homebuyers jumped at the opportunity. The 2018 slump in existing home sales quickly reversed, and those sales have remained near their highest levels of the past four years, climbing to 5.54mu (saar) in December from a recent low of 4.93mu (saar) during January 2019 ([Fig. 17](#)).

While new single-family home sales dropped in December m/m, they were up 23.1% y/y. The average rate of these new home sales in 2019 was 682,000 units, which was 10.8% higher than the pace during 2018 ([Fig. 18](#)). “2019 will go down as the best year for new home sales since before the Great Recession,” stated Zillow Economist Matthew Speakman according to a November HousingWire [article](#). That should set the stage for 2020, Speakman indicated.

(2) *Low rates improved affordability.* Last year, the Fed cut interest rates on 7/31, 9/18, and 10/30. That pushed the interest rate on the 30-year fixed-rate mortgage down to 3.45% during the week of 2/6/20—its lowest rate since 7/7/16—and down from a high of 4.94% during the week of 11/15/18 ([Fig. 19](#)). The lower cost of borrowing helped improve home affordability.

The NAR Housing Affordability Index increased to 163.8 from 143.8 a year earlier, according to preliminary November data ([Fig. 20](#)). The index equals 100 when median family income qualifies for an 80% mortgage on a median-priced existing single-family home. A rising index indicates that more homebuyers can afford to enter the market.

Thanks to lower rates, however, preliminary NAR [data](#) for November 2019 show that the monthly principal-plus-interest payment dropped to \$1,015 from \$1,115 a year ago and that the payment as a percent of income dropped to 15.3% from 17.4%. The comparable median price of an existing single-family home over that timeframe rose to \$274,000 from \$259,900 in the year prior, according to the NAR.

(3) *Home prices continue to rise.* The 12-month moving average of the median single-family existing home price reached a record high of \$272,325 during December after coming back (and then some) from the slump during late 2008 to mid-2012 ([Fig. 21](#)). Comparable data for new home sales prices have leveled off more recently ([Fig. 22](#)).

(4) *Inventories remain low.* After reaching a record low of 1.22mu during December, the existing single-family homes available for sale are well off of their highs heading into the housing crisis and significantly below their lows of 2000 ([Fig. 23](#)). New single-family homes available for sale have slowly regained ground after the post-housing crisis dip, but still have room for improvement ([Fig. 24](#)).

(5) *But starts and permits rising.* Positive signals in the housing market—including significant improvements in housing starts, permits, and homebuilder confidence—surely are behind the increased investor confidence in the new-home market. Continued acceleration in single-family

starts and permits, as seen in recent months—to 12-year highs—should continue to propel the housing market this year ([Fig. 25](#)).

In addition, the National Association of Home Builders Housing Market Index, a gauge of builder opinion on the relative level of current and future single-family home sales, surged to a two-decade high of 76 in December, and remained around that level in January (at 75) . A survey reading above 50 indicates a favorable outlook. Traffic of prospective homebuyers, a component of the survey, has significantly picked up from the end of 2018 through January of this year ([Fig. 26](#) and [Fig. 27](#)).

(6) *Signs of life in homeownership.* As NAR's Yun points out, homeownership rates have indeed lagged historical norms across all age groups. But we observe that there are signs of life in younger age brackets. The latest data show that the rate for homeowners under 35 improved to 37.6% during Q4-2019, up from a low of 34.1% during Q2-2016.

CALENDARS

US: **Wed:** Monthly Budget Statement \$6.2b, MBA Mortgage Applications, DOE Oil Inventories, Powell, Harker. **Thurs:** Headline & Core CPI 2.5%/2.2% y/y, Jobless Claims 210k, EIA Natural Gas Storage, Williams. (DailyFX estimates)

Global: **Wed:** Eurozone Industrial Production -17%m/m/-1.9%y/y, Japan Machine Tool Orders, Lowe, Lane. **Thurs:** Germany CPI -0.6%m/m/1.7%y/y, Mexico Overnight Rate 7.00%, European Commission Publishes Winter Forecast, Lane, Panetta. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Q4 Earnings Season Monitor ([link](#)): With over two-thirds of S&P 500 companies finished reporting revenues and earnings for Q4-2019, revenues and earnings are beating the consensus forecasts by 0.8% and 5.7%, respectively. That compares to their respective 0.9% and 4.9% beats at the same point in Q3. The percentage of companies showing a positive revenue surprise in Q4 is higher than during Q3, but the percentage of positive earnings surprises is lower. On a positive note, y/y earnings growth is exceeding y/y revenue growth for the first time since Q4-2018. Of the 336 companies in the S&P 500 that have reported through mid-day Tuesday, 72% exceeded industry analysts' earnings estimates. Collectively, the small sample of reporters has a y/y earnings gain of 4.2%. On the revenue side, 65% of companies beat their Q4 sales estimates so far, with results 3.0% higher than a year earlier. Overall Q4

earnings growth results are positive y/y for 67% of companies, and revenues have risen y/y for 70%. The FAANGM aggregate has recorded a 14.3% earnings surprise and 21.6% y/y earnings growth. That compares to a sharply lower S&P 500 ex-FAANGM surprise of 3.9% and 0.5% earnings growth. On the revenue side, the FAANGMs exceeded forecasts by 1.9% and recorded whopping y/y revenue growth of 15.7%. Those were well above the S&P 500 ex-FAANGM figures of a 0.6% revenue surprise and 1.5% revenue growth. The S&P 500's figures will continue to change as more Q4-2019 results are reported in the coming weeks, but what companies say about their growth and margin prospects for 2020 amid the coronavirus will be investors' main focus.

US ECONOMIC INDICATORS

NFIB Small Business Optimism Index ([link](#)): "2020 is off to an explosive start for the small business economy," according to NFIB Chief Economist William Dunkelberg—with January's reading in the top 10% of all readings in the 46-year history of the survey. The Small Business Optimism Index (SBOI) rebounded 1.6 points to 104.3 last month, after dipping 2.0 points in December, as six of the 10 components improved, while two declined—with hiring plans (19%) and capital outlay plans (28) unchanged at high levels. Driving January's gain were big improvements in sales expectations (+7ppts to 23%), earnings trends (+5 to -3), and current job openings (+4 to 37), while those expecting better business conditions (-2 points to 14) and expected credit conditions (-1 to -4) were a minor drag on the SBOI. "Finding qualified labor continues to eclipse taxes or regulations as a top business problem," according to Dunkelberg, who went on to say that, "Compensation levels will hold firm unless the economy weakens substantially as owners do not want to lose the workers that they have already."

JOLTS ([link](#)): Job openings in December fell sharply for the second month, by a total of 938,000, to 6.423 million—the lowest level since the end of 2017. It's 1.2 million below its record high of 7.626 million recorded during November 2018. Still, December's ratio of unemployed workers per job opening was below 1.00 for the 22nd straight month, at 0.90, with job openings exceeding unemployed workers by 670,000. Hirings increased 80,000 in December, and 125,000 the final two months of 2019, to 5.907 million, with separations following a similar script, climbing 21,000 in December and 78,000 over the two-month period, to 5.730 million. The latest hiring and separations data yielded an employment advance 177,000 in December, 30,000 above December's payroll gain of 147,000—overstating the increase for the first time in six months. Those quitting jobs fell 80,000 in December to 3.488 million. The quit rate remained at 2.3%, just below its cyclical high of 2.4% during July and

August, while the hires rate was back up at 3.9%—fluctuating in a range from 3.8% to 4.0% for over a year. December's job openings rate sank to a two-year low of 4.0%, down from its record high of 4.8% at the start of 2019.

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