



MORNING BRIEFING

March 24, 2020

The Lender of Last Resort

Check out the accompanying [chart collection](#).

(1) Let's not get depressed. (2) Martial law for seniors and others. (3) Great Virus Crisis versus Great Financial Crisis. (4) Social distancing should work. (5) Mass testing would help. (6) Adding makeshift hospital capacity. (7) The Fed is flying the money helicopter to infinity and beyond. (8) Commodity prices tanking now. (9) S&P 500 revenues growth estimates getting cut. (10) S&P 500 earnings growth estimates getting slashed for Q1-Q4, but remain too optimistic. (11) US railcar loadings bearish for industrial production and merchandise trade.

Editorial: The Alternatives to Martial Law. We are losing our minds and our freedoms to a virus. Our leaders decided to shut down the global economy to stop the virus from spreading. This could cause a global depression that could permanently destroy millions of our jobs and businesses if the shutdown lasts more than eight weeks, in my opinion. The result could be social and political chaos, and many more lives being lost and wasted than there would have been otherwise.

The alternative was to keep calm, carry on, and take some more vigilant health precautions while the virus spread. The available data show that at least 80% of those who are infected suffer mild symptoms and recover completely, also developing immunity to the virus. The most vulnerable segments of our population are very old people, especially those with pre-existing health issues. They could have been protected from the virus, and its asymptomatic hosts, through quarantines with lots of professional medical support. Such measures are being implemented now as assisted living facilities and nursing homes are restricting their residents to their rooms and apartments.

Granted, this isn't a perfect solution either. Left unchecked, overwhelmed hospitals and mounting deaths might have induced enough fear to keep many of us in our homes and out of public places without the government's proclamations.

However, as a result of the pandemic of fear stoked not just by the virus but also by government officials and the media, many of us are restricted to our homes, unable to go to work and carry on with our normal lives. While we've all been gripped by shock at how terrible the virus can be in some cases, we are just as fearful of the extreme measures that governments have chosen to take to protect us from the virus. They've done so on our behalf without seriously considering the trade-off between learning to live with the virus and, in effect, imposing martial law with 24/7 curfews.

We are told that such enforced "social distancing" should contain the pandemic and end it if we stick with it for just a few weeks. No one knows whether that's two weeks, four weeks, six weeks, or longer. It could take 18 months to win the war by developing a vaccine for the virus, according to some experts. The longer it takes, the longer will be the awful collateral damage to our economy and financial system. The longer it takes, the greater will be the calamity for our social and political fabric.

Who will decide when it is safe to go to work, to a movie theater, to a restaurant, and to the mall? How will they make that decision?

The immediate result of the governments' quarantines, lockdowns, and border closings is a global financial collapse, as evidenced by soaring credit quality spreads and plunging stock prices. In addition, unemployment is soaring as businesses are forced to shut down for the duration of the crisis. In recent weeks, there has been an unprecedented mad dash for cash as individuals and businesses anticipate that they will need cash to survive the freefall in their incomes and cash flow. The pandemic of fear is hitting our capital markets very hard as assets are sold indiscriminately to raise cash. The calamity resulting from the Great Virus Crisis could well exceed the calamity of the Great Financial Crisis.

That will be increasingly likely if the Great Virus Crisis lasts more than a few more weeks. Governments are scrambling to provide support to incomes, cash flows, and liquidity. That will balloon government deficits and the balance sheets of the central banks. That may buy us some time, but not much, given the unprecedented hemorrhaging of individual incomes and business cash flows.

For now, we are on the course set for us by our governments. Let's hope and pray that social distancing works well and quickly. There's a good chance that it might. Some period of flattening the infection curve through social distancing is essential for the sake of the people

who are most at risk of hospitalization, because overwhelmed hospitals will mean some patients can't be treated.

Let's hope and pray that the medical community's mad dash for cures and vaccines delivers a solution as soon as possible. If it doesn't, we should consider the alternatives, which might be worse for our health but much better for our lives. The healthiest alternative would be mass testing for the virus so that infected people can be isolated for their own good and for the good of the rest of us. We need to mobilize surveillance teams with the authority to conduct contact tracing. We can learn from countries that have done this well, especially South Korea.

Meanwhile, we need to ramp up hospital capacity and build ventilators as soon as possible now that hospitalizations for COVID-19 are soaring. The US government did not prepare properly for what is happening but is moving faster now. Hospital capacity is being expanded rapidly, partly by setting up makeshift medical facilities in convention centers, college dormitories, and hotels.

We will survive this crisis. But let's not lose our minds, our jobs, and our businesses without considering our options and the consequences of our actions. Stay home. Stay healthy.

The Fed: Free for All. I wrote the above editorial Monday early in the morning because I couldn't sleep. Fed officials apparently share my concerns. A week ago Sunday, they lowered the federal funds rate to zero and implemented a \$700 billion QE4 program without any monthly schedule specified. Yesterday, they upped the ante to infinity and beyond. In an 8:00 a.m. [press release](#), the Federal Open Market Committee (FOMC) announced that there would be no limit on QE4:

"The Federal Reserve will continue to purchase Treasury securities and agency mortgage-backed securities in the amounts needed to support smooth market functioning and effective transmission of monetary policy to broader financial conditions. The Committee will include purchases of agency commercial mortgage-backed securities in its agency mortgage-backed security purchases."

Additional details about the Fed's plan of action were provided in a [press release](#) issued at the same time, titled "Federal Reserve announces extensive new measures to support the economy."

While the healthcare system is scrambling to get more ventilators and medications to fight the virus, Fed Chair Jerome Powell has found lots more bazookas and ammo to fight the economic and financial consequences of the virus. A week ago Monday, the stock market sold off sharply following the Fed's QE4 announcement suggesting that the Fed is running out of ammo. The FOMC's actions yesterday suggest that Fed officials hope that they can still shock and awe us and convince us all that they have our backs in both the economy and financial markets:

"The Federal Reserve is committed to using its full range of tools to support households, businesses, and the U.S. economy overall in this challenging time. The coronavirus pandemic is causing tremendous hardship across the United States and around the world. ... While great uncertainty remains, it has become clear that our economy will face severe disruptions. Aggressive efforts must be taken across the public and private sectors to limit the losses to jobs and incomes and to promote a swift recovery once the disruptions abate."

We anticipated more Fed interventions coming in Monday's *Morning Briefing*, when we suggested that the Fed might soon purchase corporate and municipal bonds. That wasn't included in yesterday's package because the Fed needs congressional authorization to buy those securities. But that's likely to be the next bazooka to be loaded.

In the Epilogue of my new book, [*Fed Watching for Fun & Profit*](#), I wrote: "So what's next? The world's major central banks have tried numerous unconventional policies to boost inflation and stimulate faster economic growth, including zero interest rates, ultra-easy forward guidance, QE, and negative interest rates. These unconventional tools have become conventional since the Great Financial Crisis. Now there is chatter about the central banks considering 'helicopter money' and embracing Modern Monetary Theory (MMT)."

Both amount to the Fed providing the money through QE purchases of government bonds to finance either a tax cut or government spending. We are now there.

Global Economy: Freeze for All. It isn't a pretty thing to watch, but we are tracking lots of high-frequency indicators to assess how swiftly global economic activity is falling now that major cities, states, and entire countries are imposing lockdowns on their citizens in the US and Europe. Consider the following:

(1) *Commodity prices*. The shuttering of the global economy is weighing on commodity prices. On Friday, the CRB raw industrials spot price index was down 6.7% since the start of the year, little changed from last Wednesday's reading, which was the lowest since February 18, 2016 ([Fig. 1](#)). It's still 33.0% above its Great Recession low at the end of 2008. Also on Friday, the price of copper, which is included in the index, was down 21.6% ytd, near its lowest reading since October 26, 2016 but still up 76.0% since its Great Recession low ([Fig. 2](#)).

(2) *S&P 500 revenues*. Industry analysts didn't get the memo about the impending global recession or may just be seeing it now. There is no significant sign of a recession in analysts' latest 2020 estimates for S&P 500 revenues ([Fig. 3](#) and [Fig. 4](#)). However, during the March 19 week, they were estimating a y/y gain of 2.7%, down from their estimate of 4.9% at the beginning of the year.

(3) *S&P 500 earnings*. Industry analysts are finally starting to slash their quarterly estimates for S&P 500 earnings during 2020 ([Fig. 5](#) and [Fig. 6](#)). During the March 19 week, they expected the following y/y growth rates for Q1 (-2.9%), Q2 (-1.8), Q3 (4.7), and Q4 (8.4). All are down sharply from their expectations at the start of the year: Q1 (3.7), Q2 (6.1), Q3 (9.5), and Q4 (13.7).

(4) *US railcar loadings*. The y/y growth rate in the 26-week average of weekly total railcar loadings is tumbling ([Fig. 7](#)). It was down 7.7% through the week of March 14. That suggests that industrial production growth is about to turn significantly negative.

On a comparable basis, railcar loadings of intermodal containers fell 6.3% y/y during the March 14 week. That augurs for further declines in the sum of US real exports and real imports on a y/y basis ([Fig. 8](#)).

CALENDARS

US: **Tues:** M-PMI & NM-PMI Flash Estimates 44.0/42.0, Richmond Fed Manufacturing Index - 10, New Home Sales 750k. **Wed:** Durable Goods Orders Headline & Ex Transportation - 1.0%/-0.4%, Core Nondefense Capital Goods Orders & Shipments -0.3%/0.1%, Home Price Index 0.4%, MBA Mortgage Applications, DOE Crude Oil Inventories. (DailyFX estimates)

Global: **Tues:** Eurozone, Germany, and France C-PMI Flash Estimates 38.8/41.5/38.1, Eurozone, Germany, and France M-PMI Flash Estimates 39.5/40.0/41.0, Eurozone, Germany,

and France NM-PMI Flash Estimates 39.8/43.0/41.0, UK C-PMI, M-PMI, and NM-PMI Flash Estimates 45.1/45.0/45.0. **Wed:** Germany Ifo Business Confidence Survey, UK Headline & Core CPI 1.7%/1.5% y/y. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings fell last week for these three indexes at the fastest rate since the Great Financial Crisis. LargeCap dropped 2.0% to its lowest level since April 2019; MidCap's fell 1.7% to a four-month low; and SmallCap's tumbled 4.5% to a 24-month low. These indexes had begun a forward-earnings uptrend during March 2019 but stumbled from July to November before rising until mid-February. While LargeCap's is just 3.0% below its record high at the end of January, MidCap's and SmallCap's are 5.5% and 11.4% below their October 2018 highs. The yearly change in forward earnings soared to cyclical highs during 2018 due to the boost from the Tax Cuts and Jobs Act (TCJA) but began to tumble in October 2018 as y/y comparisons became more difficult. In the latest week, the rate of change in LargeCap's forward earnings dropped to a 43-month low of 0.9% y/y from 3.0%. That's down from 23.2% in September 2018, which was the highest since January 2011. MidCap's fell w/w to a 13-week low of -3.0% y/y from -1.0%. That compares to -5.5% in November, which was the lowest since December 2009 and a TCJA-boosted 24.1% in September 2018 (the highest since April 2011). SmallCap's dropped w/w to an 11-week low of -3.3% y/y from -0.8%; that's still up from -9.6% in mid-September, which was the lowest since December 2009 and compares to the TCJA-boosted eight-year high of 35.3% in October 2018. Analysts had been expecting double-digit percentage earnings growth for 2019 during late 2018, but those forecasts are down substantially since then. Here are the latest consensus earnings growth rates for 2019, 2020, and 2021: LargeCap (0.6%, 3.5%, 13.2%), MidCap (-5.1, 5.7, 12.1), and SmallCap (0.1, 1.7, 14.7).

S&P 500/400/600 Valuation ([link](#)): Valuations were sharply lower last week for these three indexes. LargeCap's forward P/E of 13.3 was its lowest since March 2013. MidCap's 10.7 and SmallCap's 11.1 were the lowest since March 2009. LargeCap's forward P/E had been at 18.9 during mid-February, which was the highest level since June 2002. Of course, that high was still well below the tech-bubble record high of 25.7 in July 1999. Last week's level compares to the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap's P/E is down from a 22-month high of 17.4 in mid-December and the record high of 20.6 in January 2002. However, MidCap's P/E has been at or below LargeCap's P/E for most of the time since August 2017—the first time that alignment has prevailed since 2009. SmallCap's P/E is down from mid-

December's 16-month high of 18.1 and a 15-year high of 20.5 in December 2016, when Energy's earnings were depressed. A week earlier, SmallCap's P/E was below MidCap's for the first time since July 2008. However, SmallCap's P/E is still below LargeCap's. It has been mostly below since last May—the first time that has happened since 2003.

S&P 500 Sectors Quarterly Earnings Outlook ([link](#)): With the March quarterly earnings books set to close in less than two weeks, analysts are taking a chainsaw to their estimates in what looks to be the worst season in many years. The Q1 EPS forecast fell 63 cents w/w to \$38.02. That represents a decline of 2.9% y/y on a frozen actual basis and -0.9% y/y on a pro forma basis. That compares to a 3.1% gain in Q4-2019, a 0.3% decline in Q3-2019, and y/y gains of 3.2% in Q2-2019, 1.6% in Q1-2019, 16.9% in Q4-2018, and 28.4% in Q3-2018 (which marked the peak of the current earnings cycle). Besides the small y/y decline in Q3-2019, the last time earnings fell markedly y/y was during the four quarters through Q2-2016. Seven of the 11 sectors are still expected to record positive y/y earnings growth in Q1, with one rising at a double-digit percentage rate. That compares to eight positive during Q4, when two rose at a double-digit percentage rate. The same seven sectors are expected to beat the S&P 500's pro-forma 0.9% decline in Q1, down from six in Q4 and seven in Q3 but up sharply from just three beating the S&P 500 during Q2-2019. Three sectors are expected to post improved (or less worse) growth on a q/q basis during Q1: Communication Services, Energy, and Materials. On an ex-Energy basis, the consensus expects earnings to drop 0.1% y/y in Q1. That compares to ex-Energy gains of 6.0% in Q4, 2.2% in Q3, 3.9% in Q2, and 3.0% in Q1 but is well below ex-Energy's 25.0% and 14.2% y/y gains in Q3-2018 and Q4-2018, respectively. Here are the latest Q1-2020 earnings growth rates versus their final Q4-2019 growth rates: Communication Services (11.6% in Q1-2020 versus 8.2% in Q4-2019), Information Technology (5.5, 9.2), Health Care (3.8, 10.0), Utilities (2.1, 17.8), Real Estate (2.1, 7.1), Financials (0.4, 10.3), Consumer Staples (0.1, 2.6), Materials (-9.9, -12.4), Consumer Discretionary (-14.0, 2.5), Industrials (-18.6, -9.3), and Energy (-20.9, -41.2).

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