



MORNING BRIEFING

April 7, 2020

The Way Forward

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

(1) A happy Monday for a change. (2) A list of positives. (3) Getting worse at a slower pace. (4) CVS offering Abbott's test in two cities. (5) Bill Ackman and Neil Diamond don't have much in common. (6) Pandemic's theme song offers the way forward. (7) Analysts just got the GVC recession memo. (8) Bear-market rally or looking past the doom and gloom to good times again? (9) B-52 money: Bazooka and helicopter analogies seem so yesterday and puny. (10) The Great Rebalancing.

Strategy I: Accentuating the Positives. The S&P 500 soared 7.0% yesterday. Noteworthy is that Mondays have recently been mostly awful days in the stock market, with the S&P 500 performing as follows: March 9 (-7.6), March 16 (-12.0), March 23 (-2.9), and April 30 (3.4). That's because there was plenty of new bad news about the Great Virus Crisis (GVC) over the prior weekends ([Fig. 1](#)).

Yesterday, investors chose to accentuate the positives, as they have been mostly doing since the bear-market low of 2237.40 on March 23, assuming that's what it was ([Fig. 2](#)). The S&P 500 is up 19.1% since then, though still down 21.3% from the February 19 record high. Another sign of accentuating the positives is the rebound in the S&P 500 forward P/E from the recent low of 12.9 on March 23 to 16.3 yesterday ([Fig. 3](#)).

So far, the bear market has most likely discounted a depression-like recession packed into Q2 and Q3, in our opinion. It certainly hasn't discounted the possibility of an actual apocalyptic depression lasting through at least 2021 and beyond. On the contrary, the market's recent action suggests that investors are betting on an economic recovery starting during Q4 and continuing through 2021, as are we. Yesterday, a CNBC [article](#) listed the positives that investors decided to accentuate:

(1) While the White House acknowledged this week could be among the toughest for coronavirus hot spots like New York, the administration had a more optimistic tone overall at a press conference on Sunday, noting signs of stabilization in hospital rates and other factors.

(2) New York State reported 594 new coronavirus deaths on Sunday, fewer than 630 on Saturday—marking the first daily decline in coronavirus-related deaths, according to Governor Andrew Cuomo.

(3) Slowing daily death rates in Europe offered some hope that the US would be nearing its peak soon as well and that social-distancing measures are working. Bloomberg [reported](#) yesterday that Spain had the lowest number of new coronavirus cases in more than two weeks and German infections were the fewest in six days, tentative signs that the spread of the deadly disease is slowing in Europe's worst-hit countries.

(4) The price of a barrel of Brent crude oil cut its losses after Russia's sovereign wealth fund chief said that Russia and Saudi Arabia were very close to reaching a deal on production cuts.

There was more good news on testing yesterday when CVS Health announced two new drive-thru coronavirus testing locations using Abbott Laboratories' rapid COVID-19 test. The two sites will be in Georgia and Rhode Island, with large parking lots that can accommodate multiple lanes of cars. CVS Health said it hopes to perform up to 1,000 tests per day. The company is "working to add sites as quickly as possible," according to its [website](#). "If your state isn't listed, check back later."

Highly emotional Bill Ackman, CEO of Pershing Square Capital Management, tweeted on Sunday: "I am beginning to get optimistic. ... Cases appear to be peaking in NY. Almost the entire country is in shutdown." Other factors that made Ackman optimistic include the prospect of hydroxychloroquine and antibiotics as treatments, the scaling up of antibody tests, massive government stimulus, and low interest rates. Not too long ago, on March 18, Ackman [warned](#) on CNBC that "he!! is coming." (Misspelling intentionally ours to avoid getting blocked.) In an impassioned plea, he called on President Trump to shut down the country for 30 days. He got his wish and managed to turn \$27.0 million into \$2.6 billion by betting on his "he!!bent" scenario.

Ackman must be long now. He seems to be singing Neil Diamond's "[Sweet Caroline](#)," the pandemic's theme song (as we explained yesterday):

*Where it began
I can't begin to knowin'*

*But then I know it's growin' strong
Was in the spring
And spring became the summer
Who'd have believed you'd come along
Hands, touchin' hands
Reachin' out, touchin' me ...
Sweet Caroline
Good times never seemed so good
I've been inclined
To believe they never would*

Hold off on touching and reaching out for a while longer, wash your hands often, and wear a face mask when you go out. Good times will be back.

Strategy II: Singing the Earnings Blues. It's encouraging to see that the forward P/Es of the S&P 500/400/600 have rebounded from their March 23 lows just as industry analysts have started to cut their earnings estimates for both 2020 and 2021. Since March 23 through Monday's close, the S&P 500/400/600 stock price indexes are up 19.1%, 18.5%, and 13.3% ([Fig. 4](#)). That happened even though the three indexes' forward earnings have only just begun their inevitable plunges in coming weeks, as can be easily seen using our Blue Angels Framework ([Fig. 5](#)). Consider the following related developments:

(1) *Current-year quarterly earnings estimates.* Forward earnings is the time-weighted average of analysts' consensus expectations for the current year and the coming year. Current-year earnings estimates are coming down fast, but they have a lot lower to go, in our opinion ([Fig. 6](#) and [Fig. 7](#)).

Here are the y/y growth rates for analysts' consensus expected S&P 500 operating earnings per share during the four quarters of this year through the April 2 week: Q1 (-7.3%), Q2 (-12.9%), Q3 (-3.4), and Q4 (2.6). Here are our latest growth estimates based on a depression-like recession packed into the current quarter and the next one: Q1 (-23.4), Q2 (-51.6), Q3 (-28.8), and Q4 (-4.8). (See [YRI S&P 500 Earnings Forecasts](#).)

(2) *Annual earnings estimates.* Apparently, industry analysts received the GVC recession memo at the end of March. They whacked their consensus 2020 S&P 500 earnings-per-share estimate by 3.9%, down to \$156.88, during the April 2 week ([Fig. 8](#)). They cut their 2021

estimate by 2.5% to \$182.20. By comparison, Joe and I are projecting \$120 for this year and \$150 for next year.

Strategy III: The Great Rebalancing. The President has warned that the next couple of weeks could be terrible in the US on the healthcare front, with lots more casualties and deaths. Governor Andrew Cuomo has warned that the worst of the pandemic in New York is likely to occur over the next couple of weeks. Yet for the reasons mentioned above, the stock market has been moving higher since March 23, presumably looking for Neil Diamond's good times in the future beyond the doom and gloom up ahead.

Contributing greatly to the recent rebound in stock prices was the Fed's shock-and-awe show on March 23, when QE4ever was implemented along with the introduction of numerous liquidity facilities. The Fed announced an open-ended commitment to buy almost all financial assets, i.e., all but high-yield junk bonds and equities. Melissa and I call it "B-52 money." Bazooka and helicopter analogies seem so yesterday and puny.

In our March 25 [Morning Briefing](#), we wrote: "Joe and I think that Monday might have made the low in this bear market."

The Fed's fire power was also greatly expanded on March 27, when the President signed the CARES Act. Section 4003(b) of the act appropriates \$454 billion for the Treasury to backstop as much as \$4 trillion in Fed lending programs aimed at supporting credit flows to businesses, states, or municipalities in the midst of the coronavirus pandemic.

Since the March 23 stock-market low, contrarians have had a field day. Investors who chanted the mantra "Don't fight the Fed" have also done well. In our opinion, we are in the midst of a Great Rebalancing away from bonds and into stocks. In the March 30 [Morning Briefing](#), I wrote:

"In back-to-back conference calls with our institutional accounts in recent weeks, many told me that, while they were very concerned about the Great Virus Crisis (GVC), they viewed the resulting bear market since the February 19 record high in the S&P 500 as a buying opportunity but couldn't fully capitalize on it. The problem for many long-only equity accounts is that they hadn't raised cash at the market's top, so they didn't have much to invest in stocks as they got much cheaper. The problem faced by balanced funds is that they couldn't take advantage of the great opportunity they saw to rebalance away from bonds and into stocks

because the bond markets froze up, making it impossible to raise cash to buy stocks by selling bonds. ...

“Last week, institutional managers of balanced funds rushed to sell their bonds to the Fed and used the cash to rebalance into equities.”

We think investors still have plenty of bonds that they will sell to the Fed so they can buy stocks. If so, that would certainly support our thesis that the bear-market bottom was made on March 23. Stay tuned.

CALENDARS

US: **Tues:** Consumer Credit \$14.0b, Job Openings 6.500m. **Wed:** MBA Mortgage Applications, DOE Crude Oil Inventories, FOMC Meeting Minutes. (DailyFX estimates)

Global: **Tues:** Germany Industrial Production -0.9%*m/m*/-3.0%*y/y*, Japan Leading & Coincident Indexes 92.0/95.8, Japan Machine Orders -3.0% *y/y*, Japan Trade Balance ¥1213.6b, Mexico CPI 3.4% *y/y*. **Wed:** Kuroda. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): These three indexes' forward earnings fell last week at a steeper rate than in prior weeks, and the declines are the worst since the Great Financial Crisis. LargeCap's forward earnings dropped 3.2% to its lowest level since April 2018; MidCap's fell 4.4% to a 26-month low; and SmallCap's tumbled 5.8% to a 26-month low. These indexes had begun a forward-earnings uptrend during March 2019 but stumbled from July to November before rising until mid-February. LargeCap's is now 8.6% below its record high at the end of January; that's the most since December 2010. MidCap's and SmallCap's are 12.5% and 20.8% below their October 2018 highs; that's the most since Q2-2010. 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 -5.4% *y/y* from -1.9% the week before. That's the lowest since December 2009 and down from 23.2% in September 2018, which was the highest since January 2011. MidCap's fell *w/w* to -11.0% *y/y* from -6.1%. That was also the lowest since November 2009 and compares to a TCJA-boosted 24.1% in September 2018 (the highest since April 2011). SmallCap's dropped *w/w* to -14.3% *y/y* from -8.5%; that's also the lowest since November

2009 and compares to the TCJA-boosted eight-year high of 35.3% in October 2018. Analysts' y/y earnings growth forecasts for 2020 are down substantially in the past four weeks, and further declines are still ahead. LargeCap and MidCap had their y/y growth rates for 2020 turn negative in the latest week. Here are the latest consensus earnings growth rates for 2020 and 2021: LargeCap (-3.7%, 16.1%), MidCap (-3.6, 16.6), and SmallCap (-10.8, 20.4).

S&P 500/400/600 Valuation ([link](#)): LargeCap's valuation rose last week, but the SMidCaps were slightly lower. LargeCap's forward P/E rose 0.2pts w/w to 15.2, and is up from 13.3 the week before that, which was its lowest since March 2013. MidCap's 12.3 and SmallCap's 12.8 were both down 0.2pts w/w but are up from 10.7 and 11.1 the week before that in their lowest readings 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. 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. During mid-March, SmallCap's P/E was briefly below MidCap's for the first time since July 2008.

S&P 500 Sectors Quarterly Earnings Outlook ([link](#)): The March quarterly earnings books have been closed for a week now, but analysts continue to slash their estimates in what's sure to be the worst season in many years. The Q1 EPS forecast tumbled 95 cents w/w to \$36.28. That represents a decline of 7.3% y/y on a frozen actual basis and -5.5% 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. Five of the 11 sectors are still expected to record positive y/y earnings growth in Q1, but none are forecasted to rise at a double-digit percentage rate. That compares to eight positive during Q4, when two rose at a double-digit percentage rate. Six sectors are expected to beat the S&P 500's pro-forma 5.5% decline in Q1. That compares to six in Q4 and seven in Q3, and is still up sharply from just three beating the S&P 500 during Q2-2019. Two sectors are expected to post improved (or less worse) growth on a q/q basis during Q1: Communication Services and Energy. On an ex-

Energy basis, the consensus expects earnings to drop 4.3% y/y in Q1. That compares to ex-Energy gains of 6.1% 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 (8.5% in Q1-2020 versus 8.2% in Q4-2019), Information Technology (3.1, 9.2), Health Care (2.3, 10.1), Utilities (2.3, 17.8), Real Estate (1.6, 7.0), Consumer Staples (0.5, 2.6), Financials (-6.6, 10.2), Materials (-12.7, -12.4), Consumer Discretionary (-25.8, 2.5), Industrials (-26.6, -9.3), and Energy (-38.2, -41.2).

Contact us by [email](#) or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-775-6823

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