



MORNING BRIEFING

April 29, 2020

Not Much Confidence Among Consumers & Analysts

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

(1) Rebound in S&P 500 to 2900 well ahead of schedule. (2) Forward P/E of 19.7 is a bit rich under the circumstances. (3) A hard road back to “normalized” earnings. (4) Lots of uncertainty on health front, and more bad news on economic and earnings fronts. (5) Due for some consolidation with less volatility. (6) Consumer Optimism Index falls off a cliff, and so do regional business indexes. (7) Industry analysts are adrift with no compass. (8) IMF working on assessing the damage from GVC. (9) Add another trillion to the rescue pot.

Strategy: Mission Accomplished (For Now). On the morning of Wednesday, March 25, after the S&P 500 stock price index closed at 2447.33 on Tuesday, Joe and I declared that it had bottomed on Monday, March 23 at 2237.40 and predicted that it would reach 2900 by year-end. It got there briefly yesterday on an intraday basis well ahead of schedule. We aren’t raising our target for this year for now, but we remain fundamentally bullish with a year-end 2021 target of 3500.

The near-term problem is that the S&P 500 forward P/E rose to 19.7 on Monday, slightly exceeding its high of 19.0 on February 19, the day before the 33-day-long bear market began ([Fig. 1](#) and [Fig. 2](#)). We understand that investors are looking past this year’s abyss in earnings to a recovery later this year and in 2021. While the forward P/E would be much lower based on “normalized” earnings, we are still in an abnormal Twilight Zone in all sorts of ways, as we discussed over the past two days. So we may be due for some sideways action with less volatility for a while until earnings do in fact start heading back up again along with the economy.

We know that there is still lots of uncertainty on the health front of the war against the virus (VWI). There is also plenty of challenges ahead on the economic and earnings fronts. On the former, the latest bad news includes yesterday’s Consumer Confidence Index (CCI) for April. Debbie and I average it with the Consumer Sentiment Index to derive our Consumer Optimism Index (COI). It’s not a pretty picture ([Fig. 3](#)). The COI dropped from 104.0 during March to 79.4 during April, led by a shocking (but not surprising) collapse in its current conditions component

from 135.2 to 75.4. Mildly encouraging was that the COI's expectations component had a modest dip (surprisingly so) from 83.3 to 82.0.

The freefall in the current conditions component of the COI reflected the collapse of the jobs market. The CCI survey found that 33.6% of respondents said that jobs were hard to get during April, up from 13.8% in March, while those reporting that jobs are plentiful dropped from 43.3% to 20.0% ([Fig. 4](#)). We know that initial unemployment claims have totaled 26.5 million over the past five weeks.

On the other hand, the percentage of respondents expecting more jobs six months from now jumped to a record high of 41.0% during April ([Fig. 5](#)). That explains why expectations are down less than current assessments. Americans clearly anticipate that we will get through the Great Virus Crisis (GVC) within a few months. They are not expecting a long depression. We agree with them.

Needless to say, the regional business surveys conducted by the Federal Reserve Banks of Dallas, Kansas City, New York, Philadelphia, and Richmond were also ugly in April, as Debbie discusses below ([Fig. 6](#)). The averages of their composite business, orders, and employment indexes all traced the same over-the-cliff declines as consumer confidence. They clearly augur for similar declines in April's national M-PMI and NM-PMI.

Speaking of over-the-cliff freefalls, let's review the latest (mostly bad) news on S&P 500 earnings:

(1) *Forward estimate declining at slower rates.* The S&P 500's forward revenues estimate declined 0.9% w/w during the April 16 week. That's an improvement from the 1.6% drop during the week of April 9, which was the biggest since January 2009 ([Fig. 7](#)). The forward earnings estimate followed suit during the April 24 week, dropping a sequentially lower 3.1% w/w from the 3.9% for April 17 and the 4.0% for April 10. Those are the worst declines since the start of this data series in 1994 ([Fig. 8](#)).

During the Great Financial Crisis (GFC), the S&P 500 forward revenues estimate dropped 20.0% (from September 2008 to September 2009); it is down just 5.4% so far during the GVC. The forward earnings estimates dropped a whopping 39.4% from its record high in October

2007 to its bottom in May 2009. It's down 18.1% so far during the GVC. We reckon both will continue to fall in coming weeks, but their fast speed of decline suggests they'll bottom by mid-year. That's assuming, as we do, that the economy will be opening up during the second half of this year.

(2) *Downward revisions abate, albeit briefly.* Our weekly net revenues revisions index (NRRI) and net earnings revisions index (NERI) suggest that the majority of the steep revenue and earnings estimate declines have already occurred. The indexes measure the number of forward estimates revised up less the number of forward estimates cut, expressed as a percentage of the total number of forward estimates. Despite the recent improvement from depressed levels, the revisions indexes could remain depressed if the re-opening of the US economy proves harder to implement than analysts expect.

During the April 16 week, the NRRI remained depressed but improved for a third week to -9.1% ([Fig. 9](#)). That's up from an 11-year low of -14.1% during the March 26 week. The NERI reading improved for a second week, to -8.8% from a 12-year low of -14.3% during the April 2 week ([Fig. 10](#)).

Joe calculates that more than three-quarters of analysts' estimates have been revised so far to reflect the new "stay-in-place" reality. We think the slightly slower pace of estimate cuts in recent weeks is a pause as analysts stepped back to await the release of Q1 results. In other words, more cuts are on the way. Indeed, during the GFC of 2008-09, there were two waves of estimate cuts. However, since NRRI and NERI reflect a net percentage of the number of estimates revised, they could worsen from recent levels while the actual percentage decline in the forecasts improves.

(3) *Confidence about to improve?* During normal times, analysts make their forecasts and companies nudge them closer together through guidance or pre-announcements. During the GVC, nearly all companies have completely withdrawn guidance, resulting in a wider-than-usual range of forecasts. Some analysts predict a snappy return to business, while others expect the recovery to drag out. This uncertainty has resulted in an extraordinarily huge gap between the low and high ends of analysts' consensus forecasts, which compares closely to what happened during the GFC. Joe's forward earnings confidence index (FECI) for the S&P 500 fell to an 11-year low of 86.7 ([Fig. 11](#)).

Joe recently created an (annual) AECl squiggles framework that focuses on the analysts' annual earnings forecasts rather than their forward earnings on a weekly basis ([Fig. 12](#)). Over time, it shows that confidence begins at a low level when earnings are first forecasted, then improves steadily over the following two years when earnings are eventually reported. During the GFC, which was a drawn-out decline compared to the fast and furious declines of the GVC, analysts remained uncertain about 2008 right up to the time earnings were reported. The ECI for 2009 and 2010 fell off a cliff and did not start to improve until the bear market ended in March 2009.

During the April 16 week, the AECl for 2020 earnings was down to about 85, close to the bottoms during the GFC for the 2009 and 2010 estimates, which bore the brunt of the uncertainty before returning to normal. If the past is prologue and March 23 was the end of the bear market, we may soon see the beginning of a recovery in the AECl, which would support valuations.

Financial Stability: IMF's Damage Assessment. Timing is everything, and the International Monetary Fund (IMF) released the first chapter of its latest [Global Financial Stability Report](#) on April 14. That's just in time to validate the rapid and massive responses to the GVC by fiscal and monetary policymakers around the world. To prevent a global financial system meltdown and revive economic growth, the report says, a "combination of monetary, fiscal, and financial sector policies will continue to be needed ... especially if economic activity remains paralyzed for longer than expected. ...

"The continued spread of COVID-19 globally may require imposition of tougher and longer-lasting containment measures, which might lead to a further tightening of global financial conditions ... While events are still unfolding, a further tightening may expose more 'cracks' in the global financial system," the report warned.

The IMF is relatively sanguine about the relative soundness of financial systems in the major developed economies. But the longer that the pandemic weighs on global economic activity, the greater is the risk of troubles in emerging markets (EMs), particularly commodity exporters. Stress fractures in the financial systems of developed economies could also lead to significant cracks. The IMF released only Chapter 1 of its report; the rest, due out in May, will provide a

detailed assessment of vulnerabilities in the global financial system.

The Chapter 1 preview includes a watchlist of areas where the first cracks in the system may occur as a result of the GVC. In all but the most vulnerable EMs, there are backstops in place to prevent the global financial system from crumbling. Outcomes for individual economies depend on how long the pandemic lasts, how deeply the associated containment measures penetrate the economy, and how long the pandemic of fear about the virus persists.

Financial vulnerabilities by sector and region are outlined in an important chart on page 17 of Chapter 1. China tops the list, with the most areas of high vulnerability (designated in red): non-financial firms, households, banks, and asset managers. US financial systems are relatively strong, with only asset managers classified among the vulnerable sectors. Also receiving the “worst” designation are euro area sovereign entities. On the list of low vulnerabilities are US banks and euro area households. Here are more takeaways from the IMF’s report:

(1) *Asset managers could be forced into fire sales.* The IMF is particularly concerned about the financial resiliency of asset managers (AMs), in the US and globally. Growing redemptions could result in fire sales. AMs in the US have a cash buffer of about 7.0% for the average open-ended fixed-income fund. Even so, AMs could be severely tested if investors demanded to sell managed holdings for cash, forcing AMs to sell into illiquid markets.

The good news is that a couple of illiquidity-mitigating factors exist: i) AMs could tap existing credit lines as a holdover until investors regained confidence; ii) central banks in the US, Europe, and Japan are improving market liquidity by ramping up their purchasing in what might otherwise be illiquid markets.

(2) *This is not a test: bank capital under real stress.* Banks globally (except in China) present a low to moderate financial stability risk. Repeat bank failures, as occurred during the 2008 financial crisis, are a danger, but banks’ capital positions have been strengthened since then by more stringent capital requirements and supervision. Average Tier 1 capital ratios for countries with large financial systems are 400 basis points higher, on average, than they were at the end of 2007. Nevertheless, just the prospect of large credit drawdowns could make banks unable or unwilling “to maintain the flow of credit to the economy.”

The ability of global banks to operate under stress repeatedly has been tested by officials since the previous crisis. The depth of the stress tests has been on par with the anticipated economic fallout from the GVC through 2021, according to the report's Figure 1.12, Panel 4. But a lot of uncertainty remains around the depth and persistence of the current shock.

The latest crisis may force banks to mark down asset values, absorb portfolio losses, and take credit hits on lending to households and businesses. If capital ratios were calculated based on market values rather than book values, many banks' capitalization would be as weak as during the financial crisis.

(3) *Emerging markets pressure building.* EM bond issuers are more levered than in 2008, according to the IMF's analysis. The global economic shutdown combined with portfolio outflows could pressure EMs that rely on foreign portfolio investors and external funding. Oil-exporting countries are especially vulnerable, as the twin oil crisis adds more "oil to the fire," noted the IMF.

Nonperforming loans and exposure to state-owned enterprises (SOEs) and government bonds make EMs vulnerable to an intensified "sovereign-financial sector feedback loop." The IMF provided India as an example where SOE banks' stock of bad loans have links to nonfinancial institutions. China's intertwined corporate- and shadow-banking sectors are at risk of further weakening.

To prepare for the potential of external funding sources drying up, EMs may require substantial capital-flow-management measures and contingency plans. Bilateral and multilateral coordination among nations could also aid EMs by removing or avoiding price controls, easing trade restrictions for essential medical supplies, and providing supportive cross-currency policies.

(4) *Bottom line.* The IMF stands ready to put up its \$1 trillion in available resources to help its member countries reduce the global economic impact of the GVC.

As we observed yesterday, a trillion here, a trillion there adds up to unprecedented fiscal and monetary stimulus.

CALENDARS

US: Wed: GDP -4.0%, GDP & Core PCE Price Deflators 1.2%/1.6%, Pending Home Sales -10.0%, EIA Crude Oil Inventories, FOMC Rate Decision 0.13% (0.00%-0.25%).

Thurs: Personal Income & Spending -1.5%/-5.0%, Core PCED 1.6% y/y, Jobless claims 3.5m, Employment Cost Index 0.6%, EIA Natural Gas Storage. (DailyFX estimates)

Global: Wed: Eurozone Economic Sentiment 74.4, Germany CPI 0.0%/m/m/0.5%/y/y, Japan Retail Sales -4.7% y/y, Japan Industrial Production -5.2% y/y, China M-PMI 51.0.

Thurs: Eurozone GDP -3.5%, Eurozone Headline & Core CPI Flash Estimate 0.1%/0.7% y/y, Eurozone Unemployment Rate 7.7%, ECB Interest Rate Decision 0.0%, ECB Deposit Facility Rate -0.5%, Germany Retail Sales -7.3%, Germany Unemployment Change & Unemployment Rate 76k/5.2%, France GDP -3.5%, Italy GDP -5.0%, Italy Unemployment Rate 10.5%, Spain GDP -4.4%, Japan Consumer Confidence, BOJ Monetary Policy Minutes. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Q1 Earnings Season Monitor ([link](#)): With one-third of the S&P 500 companies finished reporting revenues and earnings for Q1-2020, revenues are beating the consensus forecast by 0.9%, but earnings have missed by 1.7%. Both measures are improving now and diluting the results from the early reporting Financials, which had boosted their credit and loan loss reserves. At the same point during the Q4 season, the revenue surprise was slightly lower at 0.7% and the earnings beat was sharply higher at 4.1%. For the 157 companies that have reported through mid-day Tuesday, aggregate y/y revenue growth and the percentage of companies reporting a positive revenue surprise actually improved relative to the same point during Q4. However, all of the earnings measures were markedly weaker. The Q1 reporters so far have a y/y revenue gain of 1.6%, but earnings are down 17.5% in what's sure to be the worst quarter since Q1-2009 during the financial crisis. At the present time, fewer companies are reporting a positive revenue surprise (62%) than a positive earnings surprise (67%). However, more companies are reporting positive y/y revenue growth in Q1 (60%) than are reporting positive y/y earnings growth (43%). That's the lowest rate for earnings since Q3-2009. S&P 500 results excluding the Financials & Real Estate sectors are markedly better. The revenue and earnings surprises both improved, to 1.2% and 7.3%, respectively, from 0.9% and -17%. Earnings growth is markedly better too, improving to 0.0% from -17.5%. While these figures will change markedly as more Q1-2020 results are reported in the coming weeks, the earnings results are expected to remain dismal, and earnings growth could trail revenue

growth for the fourth time in the past five quarters. Now more than ever, what companies say about the state of their business and their plans to ride out the COVID-19 crisis will be investors' main focus.

US ECONOMIC INDICATORS

Consumer Confidence ([link](#)): Confidence tumbled to its lowest level since mid-2014 this month, on an unprecedented drop in the present situation component—however, there might be a light at the end of the tunnel. The expectations component improved slightly this month, possibly a sign that consumers perceive the impact from the coronavirus is temporary. The consumer confidence index dropped 31.9 points this month, and 45.7 points the past two months, to 86.9—with the present situation component plummeting a record 90.3 points this month alone, to 76.4; it was at 173.9 at the start of this year. Meanwhile, the expectations component climbed 7.0 points this month to 93.8, retracing one-third of March's 21.3-point decline; it was at 101.4 at the beginning of the year. Looking ahead, consumers' short-term expectations for both the economy and labor market six months from now improved, likely boosted by hopes that stay-at-home restrictions will loosen soon, along with a re-opening of the economy. The percentage of consumers expecting business conditions to get better (to 40.0% from 18.7%) skyrocketed to its highest percentage on record this month, while the percentage expecting conditions to get worse (25.7 from 16.4) also rose—though the former exceeded the latter by 14.3ppts. As for labor conditions, the job outlook was also significantly more optimistic, with those expecting more jobs (41.0 from 16.9) surging 24.1ppts, while those anticipating fewer jobs (20.8 from 17.6) edged up only 3.2ppts. Meanwhile, consumers were less optimistic about their financial prospects and this could have repercussions for spending as the recovery takes hold, according to the report. This month, the percentage of consumers expecting their incomes to increase (to 16.7% from 20.0%) over the next six months fell, while those expecting their incomes to decrease (18.5 from 10.1) rose; nearly two-thirds expected their incomes to remain the same. The Conference Board cautioned: "The uncertainty of the economic effects of COVID-19 will likely cause expectations to fluctuate in the months ahead."

Regional M-PMIs ([link](#)): Five Fed districts have now reported on manufacturing activity for April—New York, Philadelphia, Kansas City, Dallas, and Richmond—and show growth in all five regions in a freefall. The composite index sank to a record-low -58.3 from -23.8 in March and 10.8 in February—which was the best rate since November 2018. New York's measure tumbled 56.2 points this month—and 91.1 points the past two months—to a series low of -78.2! (By way of comparison, the lowest level this indicator had reached prior to this month

was -34.3 during the Great Recession.) Manufacturing activity in the Kansas City (to -30.0 from -17.0), Dallas (-73.7 from -70.0), and Richmond (-53.0 from 2.0) regions also contracted at record rates, while growth in the Philadelphia (-56.6 from -12.7) region contracted at its fastest pace since the Great Recession. New orders also tanked this month, plunging to a record-low -65.8 from -20.8 in March and a 15-month high of 12.4 in February. All five regions—New York (-66.3 from -9.3), Philadelphia (-70.9 from -15.5), Kansas City (-64.0 from -38.0), Dallas (-67.0 from -41.3), and Richmond (-61.0 from 0.0)—saw record declines in billings. The employment (-35.6 from -11.9) measure shows factories are slashing jobs, with manufacturers in both the New York (-55.3 from -1.5) and Philadelphia (-46.7 from 4.1) areas cutting jobs at a record pace. Meanwhile, factories in the Kansas City (-34.0 from -32.0) and Richmond (-21.0 from -7.0) regions reduced payrolls at their fastest rate since spring 2009, while Dallas' (-21.2 from -23.0) cut jobs at roughly the same pace as in March—which was the sharpest since July 2009.

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