



MORNING BRIEFING

May 6, 2020

Earnings Fizzles & Fiscal Fireworks

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

(1) The big losers are boosting the P/E! (2) Industry analysts chopping earnings estimates. (3) An optimistic outlook for 2021 and 2022 could drive S&P 500 to new highs next year. (4) The CBO sees a depression during Q2 followed by a recovery during H2-2020. (5) YRI vs CBO. (6) CARES Act shows Washington really cares with big bucks. (7) Treasury expecting to get its money back from Fed's lending programs. (8) Round and round we go with more rounds of free money. (9) MMT's magical mystery tour. (10) No constituency left behind.

Earnings: Catching Up with Harsh Reality. Industry analysts finally got the recession memo around mid-March and have been slashing their earnings estimates for this year and next year since then. The biggest cuts have been occurring for industries that are most hurt by the lockdown of the economy, such as airlines, hotels, restaurants, and retailers. As Joe and I discussed yesterday, the remarkable jump in the S&P 500 forward P/E from 12.9 on March 23 to 19.8 on Monday largely reflects the plunge in those industries' forward earnings as analysts have chopped earnings estimates for this year and next.

Let's review the latest relevant data for the S&P 500:

(1) *Quarterly expected earnings.* At the start of this year, the consensus estimates of industry analysts for the y/y 2020 growth rates of S&P 500 operating earnings were: Q1 (3.7%), Q2 (6.1), Q3 (9.5), and Q4 (13.7) ([Fig. 1](#)). During the week of April 30, these estimates were down sharply: Q1 (-16.5), Q2 (-37.3), Q3 (-20.4), and Q4 (-9.9). They are getting closer to our numbers: Q1 (-23.4), Q2 (-51.6), Q3 (-28.8), and Q4 (-4.8). (See [YRI S&P 500 Earnings Forecast](#).)

(2) *Annual expected earnings.* We are estimating that earnings will fall 26.4% this year to \$120.00 per share; the analysts' latest estimate is \$130.90 ([Fig. 2](#)). For 2021, we estimate \$150 (up 25%), while the analysts now estimate \$168. For 2022, we project \$180 (up 20%).

(3) *Forward earnings.* When we calculate $P/E \times E$, we use forward earnings for “E.” So the question is what values for P/E and E does our S&P 500 target of 3500 by year-end 2021 assume? During good times, forward earnings tends to be higher and to be a remarkably accurate year-ahead leading indicator of actual earnings ([Fig. 3](#) and [Fig. 4](#)). We expect that good times will start making a comeback next year and be back in 2022. So forward earnings could be \$180 per share by the end of 2021. That would require a forward P/E of 19.4 to hit 3500. Optimistic? Sure. Possible? We think so.

US Economy: CBO’s Harsh Outlook. The Congressional Budget Office (CBO) is [projecting](#) a terrible outlook for Q2, with real GDP expected to plummet by about 40% (saar), the unemployment rate to soar to around 14%, and interest rates on 10-year Treasury bonds near zero. This is a shockingly bad outlook, but it isn’t surprisingly bad given the lockdown of the US economy since late March. The gradual opening of the US economy from May through summer will be rife with fits and starts.

The agency also estimates that the fiscal relief and emergency funding programs (detailed below) combined with a hit to federal revenues (as incomes and profits drop) will result in fiscal 2020 and 2021 federal budget deficits of \$3.7 trillion and \$2.1 trillion, respectively. In the CBO’s previous, March baseline projections—before the scope and impacts of the Great Virus Crisis (GVC) were as apparent—deficits were projected at just over \$1.0 trillion in each of those years ([Fig. 5](#)).

Likewise, the GVC has bumped up the CBO’s estimate of the federal-debt-to-nominal-GDP ratio significantly. In March, the agency saw a gradual increase from 79.2% during fiscal 2019 to 97.8% by fiscal 2030 ([Fig. 6](#)). Now, the CBO is projecting that the ratio will leap past that former 2030 estimate this year—to 101% by the current fiscal year-end!

The US Treasury Department plans to borrow nearly \$3 trillion between April and June to bankroll the federal response to the coronavirus pandemic. That’s an unprecedented level of deficit financing to match the historic economic hit caused by the virus. The Federal Reserve has promised to buy as much Treasury debt as necessary to sustain the US economy during the pandemic and thereafter. (This is Modern Monetary Theory in action, but that’s a story for another day.)

In any event, the CBO’s latest preliminary estimates of key economic variables, federal budget deficits, and debt for 2020 and 2021 take into account the estimated effects of the pandemic-

related congressional acts through April 24. The CBO will provide a comprehensive analysis of the recent legislation and updated baseline budget projections later this year.

Beyond Q2, the CBO is seeing a recovery:

(1) *Real GDP*. The CBO expects that economic activity will rebound, “as concerns about the pandemic diminish and state and local governments ease stay-at-home orders, bans on public gatherings, and other measures restraining economic activity.” During H2-2020, economic growth is expected to average an annual rate of about 17% after Q2’s sharp contraction. Consumer spending is expected to offset continued declines in business investment during that period. Next year, real GDP growth is projected to be 2.8% versus -5.6% during 2020 on a Q4-to-Q4 basis.

(2) *Labor market*. The increase in the unemployment rate in Q2 and Q3 “reflects the net effect of a projected loss of nearly 27 million” employed people and “the exit of roughly 8 million people from the labor force.” The labor force participation rate is projected to decline to 59.8% in Q3 from 63.2% in Q1 of this year. During H2-2020, the unemployment rate is expected to improve “with a rebound in hiring and a significant reduction in furloughs as the degree of social distancing diminishes—leading to an increase in business activity and an increase in the demand for workers.” By the end of 2021, the unemployment rate is projected to decline to 9.5%.

(3) *Interest rates*. Interest rates on Treasury securities are expected to remain low through 2021 due to “continued weakness in economic activity, actions taken by the Federal Reserve in response to that weakness, and an increase in demand for low-risk assets among financial market participants.” The massive increase in federal borrowing isn’t expected to push interest rates higher. Interest rates are expected to remain near 0.1% on the 3-month Treasury bill and average 0.7% on the 10-year Treasury bond in 2021.

(4) *Our view*. We agree with the basic contour of the CBO’s economic outlook. However, we see real GDP falling by less during Q2 (-25.5%) and continuing to decline during Q3 (-10.6%), while the CBO estimates a 23.5% rebound. We expect a rebound of 17.6% to occur during Q4, with real GDP falling 7.1% y/y that quarter, followed by a 3.5% y/y increase during Q4-2021. That would leave real GDP still 3.8% below its record high during Q4-2019.

Fiscal Policy I: Here To Help. As indicated by the CBO's forecasts, the federal government's massive stimulus programs in response to the GVC can't be expected to stimulate economic growth, but they should help to cushion the blow to the economy. To date, Congress has passed four bills that provide for emergency appropriations and fiscal aid in response to the GVC.

So far, Melissa and I have focused much of our attention on the Fed's monetary policy responses to the crisis. That's mostly because the Fed's aid is estimated to be much larger than the fiscal aid. Nevertheless, on March 27, Congress did pass the largest economic relief bill in history: The Coronavirus Aid, Relief, and Economic Security Act (i.e., the CARES Act). The CARES Act "provides funding, expands eligibility for existing programs, and establishes new programs to provide assistance to individuals, businesses, and state, local, tribal, and territorial governments in response to the coronavirus pandemic," according to the CBO's letter linked below.

Importantly, the CARES Act provides total assistance of about \$2 trillion, but some of that aid does not impact the federal budget. Specifically, the Secretary of the Treasury is authorized under the CARES Act to provide up to \$454 billion to fund the Fed's emergency lending facilities. That is a very important component of the CARES Act because this funding is expected to be leveraged by the Fed at a ratio of 10 times into \$4 trillion in loans for the US economy. The capital provided by the Treasury to the Fed does not impact the deficit, according to the CBO. That's because the Treasury is expecting eventually to recoup the capital it is providing to backstop the Fed's lending activities.

Preliminary CBO estimates (as revised on April 27) show that the CARES Act will increase federal deficits by about \$1.7 trillion over the period from 2020 to 2030 with most of the effects occurring in 2020 and 2021, including a \$1.3 billion increase in mandatory and discretionary outlays and about a \$400 billion decrease in revenues. That's according to the CBO's helpful [summary](#) of the Act and the agency's 35-page [Letter to US Senate Committee on the Budget](#) on the CARES Act, which we outline below.

The CBO qualifies its estimates with the uncertainties that could alter them, such as how the bill's programs are implemented, the effects of the pandemic on economic output and the labor market, the duration of the government lockdowns, and the number of COVID-19 hospitalizations and their effects on Medicare.

The provisions in the CARES Act with the largest deficit effects are the Paycheck Protection Program (PPP), the check rebates to individual taxpayers, and the expansion of unemployment insurance. Below, we provide the breakdown of the CBO's expected \$1.3 trillion expected increase in outlays from the CARES Act.

Division A of the CARES Act's estimated outlays are \$988 billion, with the significant provisions as follows:

(1) *Title I, "The Keeping American Workers Paid and Employed Act,"* appropriates \$377 billion in funding as follows: \$349 billion to small businesses through the PPP to cover payroll and other eligible costs over eight weeks; \$17 billion in debt relief to small businesses; and \$10 billion in economic injury disaster loans.

(2) *Title II, Assistance for American Workers, Families, and Businesses* expands eligibility and number of weeks of benefit for unemployment compensation as well as increases the weekly benefit amount by \$600; provides a refundable tax credit, "the recovery rebate," of \$1,200 per qualifying adult and \$500 per dependent child. The unemployment insurance and the recovery rebate outlays are expected to amount to \$266 billion and \$151 billion, respectively.

(3) *Title III, Supporting America's Health Care System* suspends payments on outstanding federal student loans, expands Medicare coverage, and provides funding to the Department of Health and Human Services (HHS). The total expected outlays under Title III are estimated to be \$8 billion.

(4) *Title IV, Economic Stabilization and Assistance to Severely Distressed Sectors of the United States Economy* provides \$454 billion in funding to the Secretary of the Treasury for loans to support businesses and state and local governments through the Treasury and the Federal Reserve, \$45 billion in direct loans from the Treasury to support businesses critical to national security, and \$32 billion in grants to the airline industry. These items total \$531 billion. However, expected outlays are estimated at \$25 billion for aviation workers. As noted above, funds provided to the Fed are expected to be deficit neutral.

(5) *Title V, Coronavirus Relief Funds* provides \$150 billion in grants to states, local, tribal, and territorial governments for spending related to the pandemic.

(6) *Title VI, Miscellaneous Provisions* increases the borrowing authority of the US Postal Service by \$10 billion.

Division B of the CARES Act, Emergency Appropriations for Coronavirus Health Response and Agency Operations, provides \$330 billion in supplemental appropriations, which is estimated to amount to \$326 billion in outlays, to federal agencies for pandemic spending under five main areas, as follow: i) \$127 billion for the HHS (\$100 billion of which is allocated to funding for healthcare providers such as hospitals); ii) \$44 billion for the FEMA Disaster Relief Fund to support state and local governments; iii) \$35 billion for the Department of Transportation; iv) \$31 billion for the Department of Education; and v) \$19 billion for the Department of Veterans Affairs.

Fiscal Policy II: Another Round. After quickly learning that all that was not enough, Congress passed a supplemental \$483 billion COVID-19 related economic relief bill on April 24. This follows the two preliminary emergency funding bills passed on March 18 (\$192 billion) and March 4 (\$8 billion). These three bills together with the CARES Act significantly hiked the CBO's updated preliminary budget deficit estimates for 2020 and 2021.

Here's more on those three pieces of legislation:

(1) *Paycheck Protection Program and Health Care Enhancement Act*. Enacted as public law on April 24, the Act provides additional appropriations for small business loans, healthcare providers, and COVID-19 testing. Division A increases the appropriations for the Small Business Administration's (SBA) PPP by \$321 billion in 2020. It requires the SBA to use at least \$60 billion of these funds to guarantee loans made by smaller depository institutions, credit unions, and community financial institutions. Division B provides \$75 billion in supplemental appropriations to reimburse healthcare providers for COVID-19 losses and \$25 billion for COVID-19 testing. It also provides for \$62 billion for salaries and expenses and for loan programs of the SBA, including \$10 billion for economic injury disaster loans. (For more on this round, see [CBO Link](#) and [Public Law No: 116-139](#).)

(2) *Families First Coronavirus Response Act*. Enacted as public law on March 18, the Act provides paid sick leave, tax credits, and free COVID-19 testing; expanding food assistance and unemployment benefits; and increasing Medicaid funding. The CBO and the Joint Committee on Taxation estimate the Act will increase federal deficits by \$192 billion over the 2020-30 period. That estimate includes: a \$2.4 billion increase in discretionary spending

stemming from emergency supplemental appropriations, a \$95 billion increase in mandatory outlays, and a \$94 billion decrease in revenues. (See [CBO Link](#) and [Public Law No: 116-127](#).)

(3) *Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020*. Enacted as public law on March 4, the Act provides \$8 billion in supplemental appropriations, designated as emergency funding, for federal agencies to respond to the coronavirus and direct spending to allow for broader use of and payment for telehealth services for Medicare beneficiaries during the emergency period. The lion's share of the \$6.4 billion increase in the budget authority is allocated to the Labor, Health and Human Services, Education Appropriations Subcommittee, which funds the Centers for Disease Control and Prevention and related organizations. (See [CBO Link](#) and [Public Law No: 116-123](#).)

Fiscal Policy III: More Help on the Way. Members of the Trump administration have said that they would like to see a “pause” before the next economic relief bill. That will provide time to see how the pandemic plays out as several states slowly reopen. It will also provide time to see how all the relief efforts thus far work throughout the US economy.

Nevertheless, to us it seems inevitable that, despite the massive first rounds of fiscal and monetary stimulus, there will be more to come. Politicians are taking advantage of the opportunity that the crisis presents to move their agendas forward. Here is a quick list of what might be included in the next rescue bill:

(1) *Infrastructure*. One of President Trump's campaign promises in 2016 was to focus on rebuilding our nation's infrastructure, both to support jobs and to repair critical public-use structures like roads and bridges. Like many of Trump's plans, that was sidelined as the emergency response to the pandemic became paramount. But at the end of March, Trump [tweeted](#) that he would like to see a big and bold \$2 trillion infrastructure package passed soon, with the emphasis on providing jobs for the pandemic's growing number of unemployed workers.

From the same side of the aisle, however, Senate Majority Leader Mitch McConnell (R-KY) [said](#) on Fox News on April 28 that infrastructure will not be part of Congress' package. McConnell said that he was interested in a modest infrastructure bill unrelated to the pandemic spending.

(2) *Payroll-tax cut*. The Trump administration also advocated for a payroll-tax cut for workers as part of its tax proposals pre-COVID-19 and is now looking to include that in the next round of stimulus. Many Democrats and more cost-conscious Republicans, however, are not so keen on the cuts, because they see them as a mistargeted benefit to employed individuals, who need the relief the least, as well as a threat to the Social Security Trust Fund.

(3) *Universal basic income (UBI)*. Prior to the outbreak, UBI was a pipe dream held by some progressive Democrats; in March, Senator Mitt Romney (R-UT) became a proponent. UBI would provide a baseline “salary” to all American’s to sustain basic living expenses. Already, the recovery relief program has provided large checks to lots of taxpayers. Now as another round of fiscal stimulus is being discussed, UBI is gaining more [attention](#) in Congress as legislators consider whether more of a recurring payment plan may be prudent given the large swaths of unemployed persons and need for demand-side economic stimulus.

(4) *Funding for state & local governments*. The financial condition of state and local governments was not so great leading into the GVC. Now the GVC has put many of them into an economic state of emergency. Fulfilling pension obligations for government workers are a big problem for many underfunded states. Many Democrats are arguing for funding for state and local municipalities to be included in the next round of stimulus. But most Republicans do not see it as the federal government’s job to bail out mismanaged state and local finances.

(5) *More for the PPP*. More funding for the SBA’s PPP seems to have broad bipartisan support. Already, the first two rounds of aid for small business do not seem to have been enough. The “first-come-first-served” funds were quickly gobbled up by larger entities due to an exception in the law that allowed them to come first (which we’ve previously discussed). A lot of them returned the funds for PR reasons, but many did not—leaving many smaller businesses out in the cold. Still, larger restaurant groups are lobbying for more funds too.

(6) *Liability protections for businesses*. Finally, corporate lobbyists are pushing for liability protections to be included in the next relief bill. Specifically, they want sweeping protections from “lawsuits that may result if companies and stores reopen and patrons or employees get sick—setting up a conflict with labor, which thinks that would lead companies to open more quickly, putting workers at risk,” [reported](#) the *WSJ*. McConnell strongly supports this idea.

CALENDARS

US: Wed: ADP Employment Change -20k, MBA Mortgage Applications, EIA Crude Oil Stocks.
Thurs: Jobless Claims 3.0m, Productivity & Unit Labor Costs -5.5%/4.0%, Consumer Credit \$15b, Challenger Job Cuts, EIA Natural Gas Storage, Harker. (DailyFX estimates)

Global: Wed: Eurozone Retail Sales -9.0%, Eurozone, Germany, France, and Italy C-PMIs 13.5/17.1/11.2, Eurozone, Germany, and France NM-PMIs 11.7/15.9/10.4, Italy & Spain NM-PMIs 9.0/10.0, Germany Factory Orders -10.0%. **Thurs:** Germany Industrial Production -7.4%, France Industrial Production -12.0%, BOE Interest Rate Decision 1.0%, BOE Inflation Report, ECB Annual Report 2019, RBA Statement on Monetary Policy. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Q1 Earnings Season Monitor ([link](#)): With nearly two-thirds of the S&P 500 companies finished reporting revenues and earnings for Q1-2020, revenues are beating the consensus forecast by 1.8% and earnings are 2.9% ahead of forecast. 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 lower at 0.5% and the earnings beat was sharply higher at 5.1%. For the 318 companies that have reported through mid-day Tuesday, aggregate y/y revenue and earnings growth and the percentage of companies reporting a positive revenue and earnings surprise have weakened relative to the same point during Q4. The Q1 reporters so far have a y/y revenue decline of 0.8% and earnings are down 14.0% in what's certain to be the worst quarter since Q1-2009 during the financial crisis. At the present time, fewer companies are reporting a positive revenue surprise (61%) than a positive earnings surprise (66%). However, more companies are reporting positive y/y revenue growth in Q1 (58%) than are reporting positive y/y earnings growth (48%). That's the lowest growth 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 improve, to 2.1% and 8.6%, respectively, from 1.8% and 2.9%. The y/y revenue decline improves only slightly without Financials & Real Estate to -0.6% from -0.8%, but the earnings decline is markedly better, improving to -5.2% from -14.0%. 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 is certain to 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.

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