



MORNING BRIEFING

May 12, 2020

VWW-II

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

(1) WW-I was followed by VWW-I. (2) Far fewer casualties so far during VWW-II than VWW-I, but the economic toll from lockdowns is mounting rapidly now. (3) If the stock market is the scorekeeper, then there will be peace in our time from the virus. (4) 2900 or so might be a good place for the S&P 500 to consolidate for a while. (5) Opening season could be full of hits and misses. (6) Brief update on COVID-19 tests, cures, and vaccines. (7) Q2 real GDP tracking down 34%. (8) Head count: 46 million distressed workers during April. (9) Government unemployment benefits are generous while they last, beating many workers' usual pay.

Strategy: War Jitters. We are still in the midst of VWW-II, the second world war against the coronavirus. VWW-I occurred from 1918-19 as the world battled the Spanish Flu pandemic. It is estimated that about 500 million people, or one-third of the world's population, became infected with the Spanish Flu virus. The number of deaths is [estimated](#) at 50 million worldwide, with about 675,000 in the US. In some ways, the damage from VWW-I exceeded the destruction resulting from WW-I.

So far during VWW-II, 4.1 million people have been infected globally and more than 283,000 have died. Potentially just as deadly is the economic impact of the government-imposed shutdowns around the world to enforce social distancing to reduce the spread of the virus. Millions of people are out of work, and hundreds of thousands of businesses are at risk of going out of business. The resulting human toll in poverty, mental illness, suicides, spousal and child abuse, murders—as well as deaths from non-COVID-related diseases going untreated now—could easily exceed the case count and death count directly attributable to the virus once the war is over.

The stock market is probably the best scorekeeper in the battle between humans and the coronavirus. The virus outbreak in China first made the headlines on Friday, January 24. The S&P 500 dropped 2.5% by the following Monday's close, but then moved higher to peak at a record 3386.15 on February 19 ([Fig. 1](#)). It then plunged 33.9% in just 33 days to 2237.4 on

March 23 ([Fig. 2](#)). That was the fastest bear market in history, assuming that it ended on March 23, as Joe and I believe. It certainly correctly anticipated the economic retreat and calamity that have resulted from the government-imposed lockdowns around the world.

The question now is whether the 30.9% rally in the S&P 500 since the March 23 low through Friday's close of 2929.80 is correctly predicting a remarkable victory against the virus in coming months. VWW-I has been a three-front war, with a health, economic, and financial front. Lots of progress was made on the financial front since the Fed launched its B-52 bombers and carpet-bombed the markets with liquidity starting on March 23. Undoubtedly, that explains most of the rally in stock prices since then.

Joe and I believe that the S&P 500 may consolidate for a while around 2900 until we see significant signs of progress on the health and economic fronts. The lockdowns have successfully imposed social distancing, resulting in the flattening of the case and death curves. Now, as governments are starting to open their economies, there are likely to be flare-ups in so-called hot spots or even widespread second waves of infection. Progress on the health and economic fronts is likely to be in fits and starts, giving investors the jitters.

We saw a bit of those jitters yesterday, when South Korea's capital closed down more than 2,100 bars and other nightspots Saturday because of a new cluster of coronavirus infections, Germany scrambled to contain fresh outbreaks at slaughterhouses, and Italian authorities worried that people were getting too friendly at cocktail hour during the country's first weekend of eased restrictions.

Meanwhile, the best way to win VWW-II would be to discover a weapon of mass destruction to destroy the virus. Progress is being made on the health front in devising tests, cures, and vaccines. Consider the following recent developments:

(1) *Tests*. The Food and Drug Administration (FDA) granted emergency-use authorization for Abbott Laboratories' new coronavirus test that detects COVID-19 antibodies, the company announced Monday. Abbott plans to ship nearly 30 million tests—which can indicate whether a person has had COVID-19 in the past and was either asymptomatic or recovered—in May and will have the capacity to ship 60 million tests in June, the company announced in a press release.

(2) *Cures*. The S&P 500 rallied 2.7% on April 29, when Gilead Sciences released a study conducted by the National Institute of Allergy and Infectious Diseases. It found that the company's experimental drug, remdesivir, was the first treatment shown to have even a small effect against COVID-19. The median time that hospitalized COVID-19 patients on remdesivir took to stop needing oxygen or exit the hospital was, at 11 days, four days shorter than those who were on placebo. Critics argue that the reason we have shut our whole society down is not to prevent COVID-19 patients from spending a few more days in the hospital. It is to prevent patients from dying, which the study did not address. (See the May 11 [article](#) on statnews.com, "Inside the NIH's controversial decision to stop its big remdesivir study.")

(3) *Vaccines*. There are more than 100 different COVID-19 vaccine candidates in various stages of development. So far, eight are already in human trials. Experts are "cautiously optimistic" that the world will get a vaccine, according to a May 9 Deseret News [article](#), which added: "They just don't know when." It also reported: "But there's a big difference between identifying a successful COVID-19 vaccine in a lab and having a studied-at-length, licensed vaccine available in every corner pharmacy. The entire process is laden with potential setbacks—not the least of which is finding enough vials to hold the life-saving serum."

Here is the real problem with fast-tracking a vaccine: "The next step would be getting emergency use authorization from the FDA, which would allow policymakers to offer the vaccine to health care workers, first responders and essential workers like grocery store clerks and delivery truck drivers. Yet never before has the US vaccinated millions under emergency use authorization." In the past, vaccine development was "measured in decades—not months, with each step taking years, not weeks."

US Economy I: The Wasteland. Meanwhile, we remain in full retreat on the economic front, as evidenced by Friday's payroll employment report. As a result, the Atlanta Fed's [GDPNow](#) slashed the outlook for Q2 as follows:

"The GDPNow model estimate for real GDP growth (seasonally adjusted annual rate) in the second quarter of 2020 is -34.9 percent on May 8, down from -17.6 percent on May 5. After this morning's releases of the employment report by the U.S. Bureau of Labor Statistics and the wholesale trade report from the U.S. Census Bureau, the nowcasts of second-quarter real

personal consumption expenditures growth and second-quarter real gross private domestic investment growth decreased from -21.7 percent and -22.1 percent, respectively, to -33.9 percent and -62.8 percent, respectively. Also, the nowcast of second-quarter real government spending growth decreased from 1.9 percent to -6.7 percent, while the nowcast of the contribution of the change in real net exports to second-quarter real GDP growth increased from 0.82 percentage points to 1.62 percentage points.”

No wonder that state governors in the US and governments around the world are under lots of pressure to open their economies. Moreover, the lockdowns are killing their revenues, which will force them to slash their budgets by cutting their own payrolls unless they gradually reduce lockdown restrictions.

It is widely recognized that Friday’s employment report was even worse than suggested by the headline data. Let’s have a closer look:

(1) *Unemployed*. The number of unemployed soared to 23.1 million during April ([Fig. 3](#)). The official unemployment rate (U-3) jumped from 3.5% during February to 4.4% in March to 14.7% in April ([Fig. 4](#)). Job losers during April totaled 20.6 million, up from 3.9 million during March.

(2) *Part-time for economic reasons*. The number of employed persons working part time for economic reasons jumped from 4.3 million during February to 5.8 million during March and to 10.9 million in April ([Fig. 5](#)). The U-6 unemployment rate—defined as total unemployed, plus all persons marginally attached to the labor force, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all persons marginally attached to the labor force—jumped from 7.0% during February to 8.7% during March to 22.8% during April ([Fig. 6](#)). The numerator of this rate reflected 36.2 million workers in distress ([Fig. 7](#))!

(3) *Labor force*. The labor force dropped 6.4 million during April as the number of persons counted as not in the labor force jumped 6.6 million, with the number of them currently wanting a job (but not looking for one) increasing by 4.4 million to 9.9 million ([Fig. 8](#)). That brings the headcount of distressed workers to 46.1 million.

US Economy II: Jobless Benefits in America. While April’s jobs report was terrible, the government provided remarkably generous short-term unemployment benefits, which offered

an incentive for employers to temporarily lay off workers and a reason for their employees to welcome the change. On the other hand, the government's Paychecks Protection Program (PPP), administered by the Small Business Association (SBA), was designed to encourage small businesses to pay their workers for eight weeks until stay-in-place orders were gradually lifted. Consider the following:

(1) *Beats working for some.* The CARES Act, signed into law on March 27, added an incremental \$600 a week from the federal government to state unemployment benefits through July 31. An April 28 [WSJ article](#) noted that roughly half of American workers are eligible to receive more pay on unemployment compensation than they earned at their jobs prior to the pandemic's shuttering of businesses. Doing the math, the article observed that the average weekly payment for an unemployed worker could rise to about \$978 from nearly \$378 paid on average at the end of last year, according to the Labor Department. The new average payment could equate to about \$24 per hour over the standard workweek and compares to substantially lower minimum wages in most states. The federal benefit alone equates to about \$15 per hour.

Quitting a job to [access](#) unemployment benefits is considered fraud. But it is not hard to find anecdotal stories that laid-off employees are refusing to return to their jobs once reoffered in favor of the higher unemployment pay, such as this [story](#) from Real Clear Markets. To maintain good standing on PPP loans, the SBA has guided employers to document both rehire offers and any employee refusals in writing, [according](#) to the May 4 *Journal of Accountancy*. Employees who reject these offers may become ineligible for unemployment compensation.

(2) *Stimulating checks.* Add the unemployment compensation to the stimulus check that many Americans received, and it adds up to a boost to incomes for many earning low incomes prior to the pandemic. Part of the CARES Act was an automatic one-time cash deposit, dubbed by Congress a "recovery rebate," which many American tax-filers with deposit accounts received during April.

Business Insider [provided](#) an overview: Non-dependent single filers, heads of household, or married filers earning less than \$99,000, \$136,500, or \$198,000 annually, respectively, were eligible. The maximum payment allotted was \$1,200 for single filers and single heads of household, or \$2,400 for married couples filing jointly. The payments phased out at higher income levels. There was also an additional \$500 allotted to parents who have children

younger than 17 and earned within the phaseout range.

Some stimulus checks were legally seized by banks to offset a negative account balance or overdraft charges, but many banks put collections like this on hold to allow consumers to access the stimulus. About 45% of stimulus money has already been spent, an April 22 Business Insider [article](#) reported, according to surveys. Consumers largely have put the funds toward food, paying bills, gas, and savings. But some of the money undoubtedly has gone toward more frivolous spending such as on video games.

(3) *Tax-free tips vs taxable benefits*. Curiously, after a 20+ million jobs were lost in April, withheld income and employment taxes ytd as of the third day of May 2020 exceeded that of the third day of May 2019, according to the Daily Treasury Statement—as an astute account of ours wondered about. Since unemployment benefits are taxable, some of those recently laid off must be earning more on unemployment during the pandemic period than they did before.

But many of these folks when working may have earned cash tips, which aren't typically declared to the Internal Revenue Service (IRS). Most of those now collecting unemployment insurance are restaurant and hospitality workers who typically earn at or around minimum wage, [reported](#) CNBC. US food-service workers earned just over a median of \$12 per hour in 2019, noted the *WSJ*, which we assume excludes tips. The IRS's new approach to withholdings may be another reason for tax-withholding increases, said a Kiplinger [post](#).

CALENDARS

US: **Tues:** NFIB Small Business Optimism Index, Headline & Core CPI 0.4%/1.7% y/y, Monthly Budget Statement, Harker, Kashkari, Mester, Quarles. **Wed:** Headline & Core PPI - 0.2%/0.9% y/y, MBA Mortgage Applications, Powell. (DailyFX estimates)

Global: **Tues:** None. **Wed:** Eurozone Industrial Production -12%/m/-12%y/y, UK GDP - 7.5%/m/-6.6%y/y, UK Headline & Manufacturing Industrial Production -9.2%/-10.3% y/y, Lane, Guindow. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings fell for all three indexes yet again last week, but the rates of decline are decelerating. LargeCap's forward earnings

dropped 1.3% to its lowest level since September 2017; MidCap's fell 3.7% to its lowest level since August 2016; and SmallCap's dropped 5.1% to the lowest point since March 2014. 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 20.7% below its record high at the end of January; that's the most since March 2010. MidCap's and SmallCap's are 30.2% and 41.8% below their October 2018 highs; that's the most since August 2009 for MidCap and the most below on record for SmallCap. 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 -18.7% y/y from -17.4% the week before. That's the lowest since October 2009 and down from 23.2% in September 2018, which was the highest since January 2011. MidCap's fell w/w to -29.6% y/y from -26.8%. That was the lowest since August 2009 and compares to a TCJA-boosted 24.1% in September 2018 (the highest since April 2011). SmallCap's dropped w/w to -37.9% y/y from -34.3%; that's the lowest since July 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 eight weeks, and further declines are still ahead. Here are the latest consensus earnings growth rates for 2020 and 2021: LargeCap (-21.4%, 29.7%), MidCap (-29.2, 37.1), and SmallCap (-41.7, 50.7).

S&P 500/400/600 Valuation ([link](#)): Valuations moved higher last week, but the gains were primarily due to lower forward earnings. LargeCap's forward P/E rose 0.9pts w/w to 20.6 from 19.7. That's the highest level since March 2002 and is up from 13.3 in mid-March, which was the lowest since March 2013. MidCap's 19.3 and SmallCap's 21.6 were up a markedly higher 1.7pts and 2.0pts w/w. That compares to MidCap's 10.7 and SmallCap's 11.1 in mid-March, which were their lowest readings since March 2009. LargeCap's forward P/E based on pre-COVID earnings 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 six weeks now, but analysts continue to slash their estimates for the remaining quarter amid a “withdrawn guidance” environment in the worst earnings season in many years. The blended Q1 EPS forecast/actual rose 49 cents w/w to \$33.19. That represents a decline of 15.2% y/y on a frozen actual basis and -12.1% 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. Five sectors are expected to beat the S&P 500's pro-forma 12.7% 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. Looking ahead to Q2, all sectors are expected to post worse growth on a q/q basis during Q2 and two are expected to report a loss: Consumer Discretionary and Energy. Here are the latest Q2-2020 earnings growth rates versus their blended Q1-2020 growth rates: Utilities (-0.2% in Q2-2020 versus 4.9% in Q1-2020), Information Technology (-8.2, 6.6), Real Estate (-11.2, -3.4), Consumer Staples (-15.2, 5.4), Health Care (-16.0, 6.7), Materials (-36.0, -12.1), Financials (-45.9, -38.1), Industrials (-85.9, -29.7), Consumer Discretionary (-104.1, -44.9), and Energy (-155.9, -30.5).

S&P 500 Q1 Earnings Season Monitor ([link](#)): With 88% of the S&P 500 companies finished reporting revenues and earnings for Q1-2020, revenues have missed the consensus forecast by 1.1% and earnings are 4.0% ahead of forecast. The earnings measure has improved since the disappointing 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 and earnings surprises were higher at 0.9% and 5.5%, respectively. For the 440 companies that have reported through mid-day Monday, aggregate y/y revenue and earnings growth and the percentage of companies reporting positive revenue and earnings surprises have weakened relative to the same point during Q4. The Q1 reporters so far have a y/y revenue decline of 2.3%, and their earnings are down 12.9% in what's certain to be the worst quarter since Q1-2009 during the financial crisis. At the present time, fewer companies have reported a positive revenue surprise (61%) than a positive earnings surprise (68%). However, more companies

have reported positive y/y revenue growth for Q1 (55%) than 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 2.2% and 8.9%, respectively, from -1.1% and 4.0%. The y/y revenue growth rate improves markedly without Financials & Real Estate to 1.0% from -2.3%, and the earnings decline improves to -4.8% from -12.9%. We expect these figures to continue to change markedly as more Q1-2020 results are reported in the coming weeks, particularly by the retailers. Earnings results will 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.

GLOBAL ECONOMIC INDICATORS

France Industrial Production ([link](#)): The coronavirus pandemic triggered a record 16.2% plunge in headline production in March to its lowest level since 1989, as manufacturing output tumbled 18.2% to a new record low! Looking at the main industrial groupings, consumer durable goods (-45.4%) production posted the biggest monthly decline in March, while consumer nondurable goods (-4.1) output recorded the smallest—with the former sinking to a new record low. Both capital (-24.4) and intermediate (-21.0) goods production also posted record declines in March, with the latter falling to a new record low. In the meantime, IHS Markit's M-PMI (to 31.4 from 43.2) for April showed business conditions in France contracted at the fastest pace in the 22-year history of the survey—driven by fresh record lows for production and new business, along with a drastic reduction in employment. Looking forward, firms were severely pessimistic toward the business outlook amid expectations for a prolonged economic downturn.

Italy Industrial Production ([link](#)): Italy's industrial production in March collapsed 28.4% in response to COVID-19, while manufacturing output tumbled 30.7%—with record monthly declines in both pushing these measures down to new record lows. Production of consumer durable (-57.1%), capital (-39.9), intermediate (-27.3), and consumer nondurable (-21.4) goods all posted record declines in March—with all four measures tumbling to new record lows. IHS Markit's April survey revealed the decline in manufacturing activity deepened further last month, with the M-PMI (to 31.1 from 40.3) contracting at its steepest pace since the survey began in June 1997—as output and new orders also declined at their fastest rates in the survey's more than 22-year history.

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