Yardeni Research

MORNING BRIEFING
May 13, 2020

Looking for Bottoms

Check out the accompanying chart collection.

(1) The race for the cure. (2) Is remdesivir COVID-19's Tamiflu? (3) Even Howard Stern is a virologist now. (4) Mixed message from commodity pits. (5) Professor Copper signaling a bottom in global manufacturing? (6) More gasoline will be pumped as lockdowns wind down. (7) M-PMIs: China is up, while the rest of the world is down. (8) Comparing S&P 500 fundamentals in 2020 to 2009. (9) As each day passes, 2020 becomes less important and 2021 becomes more important for stock market outlook. (10) S&P 500 forward revenues, earnings, and profit margin could bottom by mid-year.

Virology 101: Is Remdesivir THE CURE? Yesterday, I wrote that the anti-viral drug remdesivir, produced by Gilead Sciences, might be a cure for COVID-19. I added that while critics acknowledge that it seems to reduce the number of days of hospitalization based on one study, it's not clear that it will reduce deaths.

One of our astute readers countered: "Common sense says it reduces deaths by a third. If time in hospital is reduced by 4 days from 15 to 11 days and assuming the last two days are recovery days after the danger of death has passed, then time in hospital is reduced by a third. So dying days are reduced by a third. The trial wasn't conclusive on this, with only a tentative 15% reduction, but the logic is overwhelming. Actual usage in a timely manner should reduce deaths further. Interestingly, the drug was as effective over 5 days as administered over 10."

Dr. David Agus, a Professor of Medicine and Engineering at the University of Southern California was interviewed on May 7 by Howard Stern. He acknowledged that remdesivir isn't a miracle cure. But he claimed that if the drug is taken as soon as symptoms appear and a test confirms the infection, the outcome for the patient is likely to be less severe and shorter illness and less chance of death. He compared it to taking Tamiflu right away when flu symptoms occur.

Yesterday, Gilead Sciences announced the signing of licensing agreements with five generic drug makers to manufacture remdesivir in 128 countries, including the US. The deal is "royaltyfree" until the World Health Organization says the COVID-19 outbreak is no longer a global health crisis or "until a pharmaceutical product other than remdesivir or a vaccine is approved to treat or prevent Covid-19, whichever is earlier," the company said.

Commodities: Signs of Life. Is the global economy in a depression? The message from the commodity markets is mixed. The price of oil has collapsed so far this year well below its 2008 low. Yet the CRB raw industrials spot price index remains above its 2015 low and well above its 2008 low. The plunge in the price of oil isn't surprising given that lockdowns have slammed the brakes on driving. National quarantines have halted international passenger flights. The demand for both gasoline and jet fuel has plummeted.

On the other hand, the relative resilience of industrial commodity prices is remarkable given the shuttering of factories around the world. The likely explanation is that the world's factories were still operating when Chinese manufacturers were shut down during January and February. Since March, factories in China have been opening up gradually while those outside of China have been in lockdown. Keep in mind also that Chinese factories usually close for a week or two during the Chinese Lunar New Year, which fell in late January and early February this year. Let's have a closer look at why the commodity pits aren't totally in the pits:

(1) *Commodity prices.* The price of a barrel of Brent crude oil plunged from $66.00 at the start of this year to a low of $19.33 on April 21 (*Fig. 1*). It seems to have bottomed, having rebounded to $29.63 on Monday. The recent low was $8.55 below its previous trough of $27.88 on January 20, 2016, which was below its December 24, 2008 low of $36.61.

The CRB raw industrials spot price index includes 13 commodity prices and excludes all petroleum, lumber, and food commodity prices. It fell 9.8% since the start of the year through its recent low of the year on April 21. It was up 3.5% as of Monday. The recent low exceeded the November 23, 2015 trough by 2.4% and the December 5, 2008 bottom by 28.9%. The index is one of our favorite high-frequency indicators of global economic activity. It tends to be a very good coincident indicator of the US business cycle as well (*Fig. 2*).

The most widely followed component of the CRB raw industrials spot price index is the price of copper, which tends to be especially sensitive to manufacturing developments in China. We track the nearby futures price of the red metal, which is highly correlated with both the price of crude oil and the CRB industrials spot price index (*Fig. 3* and *Fig. 4*). Copper's price fell 24% since the start of the year to its recent low on March 23 and has rebounded slightly since then.

(2) *Crude oil & petroleum products.* The world is awash in oil, with no vacancy signs posted in storage facilities around the world, including storage at sea on tankers. That is forcing oil producers to cut their output. That includes frackers in the US, where crude oil field production is down 1.2mbd from a record high of 13.0mbd during the October 11, 2019 week to 11.8mbd during the May 1 week (*Fig. 5*).

The good news is that weekly data on US petroleum products supplied, which is actually a good proxy for demand, may be starting to bottom after a 31% uninterrupted freefall from the week of March 13 through the week of April 24 (*Fig. 6*). It edged up 1.5% during the May 1 week.

Leading on the way down, and on the way up (maybe) is gasoline supplied (*Fig. 7*). That makes sense, since the drop in gasoline usage coincided with the lockdowns of the states by their governors, which greatly depressed driving activity. I haven't been at a gas station since mid-March; zero visits in two months compares with my usual frequency of once a week prior to the Great Virus Crisis (GVC). Now as the restrictions are gradually lifted, the demand for gasoline should rebound as people drive more.

Meanwhile, there is no sign yet of a bottom in demand for distillates, which include diesel fuels and fuel oils (*Fig. 8*). However, jet fuel demand may be starting to bottom (*Fig. 9*). (You can track these data series in our *US Petroleum Products Supplied*.)

(3) *Global manufacturing indicators.* While the CRB raw industrials spot price index and the price of copper may be bottoming, the latest global manufacturing indicators remain in freefalls. The global M-PMI plunged from 50.3 during January to 39.8 during April (*Fig. 10*). The one exception is China's M-PMI, which rebounded from 35.7 during February to 52.0 in March and 50.8 in April. That explains why the M-PMI for emerging economies, at 42.7 in April, wasn't as bad as the comparable index for developed economies at 36.8 during April.

Strategy: Update on 2020 vs 2009. Our Squiggles for S&P 500 revenues, earnings, and profit margins are in freefalls (*Fig. 11*). Every week, Joe and I update the charts showing analysts' consensus expectations for S&P 500 revenues and earnings, on a per-share basis, for the current year and the coming year. We then impute their estimated profit margins by dividing earnings estimates by revenues estimates.

We are using 2009 as a benchmark for what might happen during 2020 for these three variables. A few months prior to 2009, Lehman imploded (specifically on September 15, 2008), which caused industry analysts to slash their estimates for 2009. This time, the virus calamity hit early in 2020, causing analysts to slash their estimates for this year. Let's compare using a cookie cutter:

(1) *Revenues estimates* for 2009 fell 22.2% from the week of September 18, 2008 through the actual results for the year. The estimates for 2020 started their dives as a result of the GVC during the week of February 27. Since then, the year's revenues estimate has dropped 8.9% through the April 30 week.

(2) *Earnings estimates* for 2009 fell 42.1% from the week of September 18, 2008 until they were replaced by reports of actual results for the year in early 2010. The estimates for 2020 also started their dives as a result of the GVC during the week of February 27. Since then, the year's earnings estimate is down 25.5% through the April 30 week.

(3) *Profit margins estimates* for 2009 fell 2.3ppts from 9.2% during the week of September 18, 2008 to 6.9% through their replacement by actual results for the year. The estimates for 2020 started their dives as a result of the GVC during the week of March 12. Since then, the year's profit margin estimate is down from 11.8% to 9.7% through the April 30 week.

(4) *Levels for 2020.* As of the week of April 30, here are the consensus estimates for 2020's revenues ($1,333.42), earnings ($128.70), and the profit margin (9.7%). Joe and I are projecting $1,200, $120, and 10.0%, respectively. So the profit margin consensus estimate is already below our projection. Frankly, we are surprised that consensus revenues estimates aren't falling faster.

(5) *What really matters is 2021.* As we've previously argued, the Lehman collapse was more bearish than the GVC because the former occurred late in 2008, depressing 2009 estimates, which had a much greater weight in calculating forward earnings. The GVC occurred early this

year, which has weighed more on 2020 than 2021 consensus estimates. Next year will get more weight as the current year passes, which suggests that forward revenues, earnings, and the profit margin should bottom by the middle of this year and start to recover during the second half of this year (*Fig. 12*).

As of the week of April 30, here are the consensus 2021 estimates for S&P 500 revenues ($1,439.87), earnings ($163.60), and the profit margin (11.4%).

CALENDARS

US: **Wed:** Headline & Core PPI -0.2%/0.9% y/y, MBA Mortgage Applications, Powell. **Thurs:** Jobless Claims 2.5m, Import Prices -3.1% y/y, EIA Natural Gas Storage, Kaplan, Kashkari. (DailyFX estimates)

Global: **Wed:** Eurozone Industrial Production -12%m/m/-12%y/y, UK GDP -7.5%m/m/-6.6%y/y, UK Headline & Manufacturing Industrial Production -9.2%/-10.3% y/y, Lane, Guindos. **Thurs:** Germany CPI 0.3%m/m/0.8%y/y, France Unemployment Rate 8.4%, China Retail Sales -7.0% y/y, China Industrial Production 1.5% y/y, China Unemplyment Rate, Japan Machine Tool Orders, ECB Economic Bulletin, Guindos. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Growth vs Value (*link*): The S&P 500 Growth and Value price indexes were down sharply on March 23 from their record highs earlier in 2020, but have improved markedly since then. Growth has risen 33.9% since March 23 through Monday's close, ahead of the 27.1% gain for Value. On a ytd basis, Growth is down just 0.3% versus a 19.5% decline for Value. Value remains in a bear market at 20.4% below its January 17 record high, but Growth is out of a correction and just 8.2% below its February 19 record. Looking at the fundamentals, Growth is expected to deliver higher revenue growth (STRG) and earnings growth (STEG) than Value over the next 12 months. Specifically, 3.9% STRG and 3.0% STEG are projected for Growth, respectively, versus -1.5% and -12.2% for Value. Prior to the bear market bottom on March 23, Growth's valuation peaked at 24.2 on February 19, its highest level since April 2002 when the Tech bubble was deflating. Through Monday's close, Growth's P/E was up from a 15-month low of 16.8 on March 23 to 25.4, its highest reading since March 2002. Value's forward P/E was up from a 10-year low of 10.0 on March 23 to 16.8 on April 30, which was its highest reading since April 2002. It was down slightly to 25.4 on Monday. Regarding

NERI, Growth's was negative in April for a ninth straight month as it tumbled to an 11-year low of -25.1% from -9.2% in March. That compares to a record high of 22.3% in March 2018. Value's NERI was negative in April for an 18th month, and down to an 11-year low of -30.8% from -13.8%; that compares to a record high of 21.2% in March 2018. The Tax Cuts and Jobs Act (TCJA) in 2018 sharply boosted the consensus forward earnings estimates and the forward profit margin for both Growth and Value, but Value has now dropped below its pre-TCJA levels. Growth's forward profit margin of 15.0% is up from 14.4% prior to the TCJA's passage but down from its record high of 16.7% during September 2018. Value's forward profit margin of 8.0% is down from a record high of 10.5% in December 2018, and well below the 9.1% prior to the TCJA.

S&P 500 Q1 Earnings Season Monitor (*link*): With 89% 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 3.9% 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. However, the revenue measure has weakened due to mark-to-market losses at the later reporting insurance companies. At the same point during the Q4 season, the revenue and earnings surprises were higher at 0.9% and 5.5%, respectively. For the 445 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 (60%) than a positive earnings surprise (67%). However, more companies have reported positive y/y revenue growth for Q1 (55%) than positive y/y earnings growth (47%). 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 8.9%, respectively, from -1.1% and 3.9%. The y/y revenue growth rate improves markedly without Financials & Real Estate to 1.0% from -2.3%, and the earnings decline improves to -5.8% 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.

US ECONOMIC INDICATORS

NFIB Small Business Optimism Index (*link*): Optimism fell sharply in April for the second month, sliding to its lowest reading since March 2013. “The impact from this pandemic, including government stay-at-home orders and mandated non-essential business closures has had a devastating impact on the small business economy,” said NFIB Chief Economist William Dunkelberg. “Owners are starting to benefit from the PPP and EIDL small business loan programs as they try to reopen and keep employees on staff. Small business owners need more flexibility, though, in using the PPP loan to support business operations and liability protection so that all these efforts to support small businesses are not ultimately lost in costly litigation.” The Small Business Optimism Index (SBOI) sank 5.5 points in April and 13.6 points the past two months, to 90.9. Last month, nine of the 10 index components fell, with the one outlier—those expecting the economy to improve—rebounding 24ppts last month to an 18-month high of 29%, after dropping 17ppts in March. Meanwhile, sales expectations (-30ppts to -42%) was the biggest negative contributor, followed by earnings trends (-14 to -20) and now is a good time to expand (-10 to 3), with the labor market components filling the next two slots. In April, 24% of owners reported job openings they couldn’t fill, down 11ppts from March’s 35%. A third of all firms with job openings were in construction, 17% in non-professional services, and 12% in manufacturing and in retail. Job creation plans fell for the second month, by a total of 20ppts to 1%—as the government-ordered shutdown took hold. The remaining components posted declines from 1ppt to 5ppts.

Consumer Price Index (*link*): The core CPI in April posted its biggest monthly decline on record as COVID-19 caused record declines in apparel and transportation services prices—which pushed the yearly core rate down to a nine-year low. Core prices sank 0.4% in April, led by record monthly declines in airfares (-15.2%), motor vehicle insurance (-7.2), and apparel (-4.7) prices. The yearly core rate sank to 1.4% y/y (lowest since April 2011) from 2.1% in March and 2.4% in February—which matched its recent peak rate posted last August and September. Here’s a ranking of the 12-month core rates on an April-over-April basis, from lowest to highest for goods: apparel (-5.7% y/y), used cars & trucks (-0.7), new vehicles (-0.6), medical care commodities (0.7), alcoholic beverages (1.9), and tobacco & smoking products (4.9). Of those, only the rate for alcoholic beverages is accelerating. Here’s the same drill for the core services rates: airfares (-24.3), motor vehicle insurance (-6.2), physicians’ services (1.2), owners’ equivalent rent (3.1), motor vehicle maintenance & repair (3.1), rent of primary residence (3.5), and hospital services (5.2). Only the hospital services rates remains on an accelerating trend, reaching a 25-month high last month. The headline CPI rate eased for the third month, from 2.5% at the start of the year to 0.3% y/y in April—the lowest since October 2015.

GLOBAL ECONOMIC INDICATORS

Global Leading Indicators (*link*): In April, the OECD's composite leading indicators (CLIs)—designed to anticipate turning points in economic activity relative to trend six to nine months ahead—is still being viewed as a coincident rather than a leading indicator, as it was in March. The report notes that "uncertainty surrounding the duration of lockdown measures has complicated the ability of CLIs to provide those forward looking signals." That said, April's CLI sank to 95.8—the lowest since February 2009—slowing steadily from January's 99.5. While most major economies, as well as major emerging economies, have seen their CLIs collapse, China's CLI for its industrial sector (to 93.7 from 84.9 in February) is tentatively pointing toward a positive change in momentum, as its containment measures have already been eased. Meanwhile, here's what's been happening to CLIs in the major economies: the UK (to 91.1 from 100.1 in February), Germany (93.7 from 99.4), France (94.1 from 99.3), Italy (95.6 from 99.4), Canada (96.9 from 99.6), the US (97.4 from 99.3), and Japan (98.4 from 99.1). CLIs for the emerging countries of Russia (91.3 from 100.1 in December) and Brazil (93.9 from 102.5) have been falling steadily through the first four months of this year, while India's CLI dropped to 95.9 in April from 100.0 in February.

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