



MORNING BRIEFING

May 27, 2020

Discounting a Vaccine

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

(1) Lots of important known unknowns about the virus. (2) One big known known about the Fed. (3) People are starting to socialize and party like the virus is gone. (4) Stock market is rallying like a vaccine is coming soon. (5) Q2 is so yesterday even though June hasn't even started. (6) Railcar traffic remains depressed. (7) TSA screening more passengers. (8) Urbanites seeking suburban homes. (9) Signs of a bottom in NY, Philly, and Dallas. (10) Copper price moving up recently. (11) Woodstock and the flu of 1969.

Strategy: Drowning the Virus with Liquidity. In most cases, the symptoms of COVID-19 are mild, if the infected person is symptomatic at all. In many cases, the symptoms are severe, and recovery can take a few weeks. In some cases, the disease can have longer-term adverse health consequences. Of course, the virus can also kill. So far, the only known knowns about the virus are that it is very contagious and can be spread by asymptomatic carriers. There remain lots of known unknowns. Melissa and I are working on compiling a list.

Meanwhile, the stock market continues to rebound from its March 23 low thanks to one big known known about the Fed. As we noted yesterday, the US central bank continues to pour liquidity into the financial system. During his May 17 [interview](#) on "60 Minutes," Fed Chair Jerome Powell said, "The asset purchases that we're doing are a multiple of the programs that were done during the last crisis."

Powell predicted that the Fed's policies should help to revive the economy: "I do think that over the next couple of months, you're going to be seeing the beginnings of the recovery ... as businesses reopen and people go back to work." His main concern is that Americans might throw caution to the wind as the economy reopens: "The big thing we have to avoid during that period is a second wave of the virus. But if we do, then the economy can continue to recover."

Powell acknowledged that the recovery is likely to be a slow one: "Sporting events and theaters will be doing more online performances and things like that. But it'll be quite

challenging for them. Lots of the rest of the economy, though, can move ahead. But we can't fully recover because those other parts of the economy matter. We can't fully recover ... until people feel confident that they're safe."

Apparently, based on news reports and our own observations around our neighborhoods, lots of people felt safe enough during the Memorial Day weekend to socialize and party like the virus is gone. The stock market continued to party yesterday like a vaccine is certain to be ready soon. The S&P 500 stock price index jumped 1.2% on news that Novavax said it started human testing of its experimental coronavirus vaccine. It soared 3.2% on Monday, May 18 on news of the development of a possible vaccine against COVID-19 by Moderna. There are 10 vaccines in preliminary clinical trials and 114 in pre-clinical evaluation.

If, in fact, too many Americans don't adhere to social distancing at least by wearing masks in public places, a second wave of infections could occur within the next few weeks. We'll see. For now, stock investors aren't concerned about that possibility. After closing at 2991.77 yesterday, the S&P 500 needs to rise only 11.7% to retest its record high on February 19. It is down 7.4% ytd and up 6.8% y/y. That's remarkable indeed. It only needs to rise 17.0% to get to our 3500 target for the end of next year. It could get there ahead of schedule, especially if an effective vaccine is discovered in coming months.

US Economy: On the Mend? Where does the US economy fall on the spectrum of impacts resulting from the Great Virus Crisis (GVC)? The US economy is showing signs of recovering from the illness as social-distancing lockdown restrictions are lifted. It is slowly creeping back to life, but it may be a while before it returns to full health. Consider the following:

(1) *GDP still on wrong track.* Last week, we presented our base-case scenario for real GDP, showing that it isn't likely to be back to its record high during Q4-2019 until the second half of 2022 ([Fig. 1](#)). That assumes that any second waves of infection won't trigger another wave of lockdowns, which would lengthen the time until full recovery. Then again, the recovery could happen sooner if vaccines and/or cures are developed before mid-2021, if possible.

The latest batch of economic indicators remains shockingly, but not surprisingly, bad. The Atlanta Fed's [GDPNow](#) tracking model projected on May 19 that real Q2 GDP would be down 41.9% (saar); that was just after the release of April's housing starts report showing a m/m plunge of 30.2% ([Fig. 2](#)). That projection is actually up from the model's -42.8% forecast on May 15. Confirming the abysmal outlook for Q2 is the Federal Reserve Bank (FRB) of New

York's Weekly Economic Index, which was -10.6% as of May 23 ([Fig. 3](#)). Debbie calculates that this implies a 35.7% q/q drop in real GDP (saar).

(2) *Truck and rail traffic remain depressed.* The truck tonnage index compiled by the American Trucking Association plunged 12.2% m/m during April to the lowest reading since April 2017 ([Fig. 4](#)). The y/y growth rate in the 26-week average of railcar loadings fell to -11.6% during the May 16 week, the weakest since January 2010 ([Fig. 5](#)). Some of that weakness was attributable to a plunge in the 26-week average of loadings of motor vehicles to the lowest since December 2009 ([Fig. 6](#)).

(3) *TSA counting more passengers.* The number of travelers passing through Transportation Security Administration security screening checkpoints fell to 87,534 on April 14, 96% below the same day a year earlier. But by May 24, the figure had more than tripled to 267,451, although that is still down 87% from the same day a year earlier ([Fig. 7](#)).

(4) *Rebuilding home sales.* The May 25 *WSJ* included an [article](#) titled "For Economy, Worst of Coronavirus Shutdowns May Be Over." The story observed: "Truck loads are growing again. Air travel and hotel bookings are up slightly. Mortgage applications are rising. And more people are applying to open new businesses."

In my neighborhood on Long Island, real estate agents reportedly are telling home sellers who took their houses off the market as a result of the GVC to relist now because demand is through the roof, as many residents of New York City are seeking to move to the suburbs, where social distancing is easier to accomplish. Mortgage applications to purchase a home plunged 34.9% from the week of March 6 through the week of April 10 ([Fig. 8](#)). They've rebounded 41.8% since then through the May 15 week.

(5) *Rebounding business indexes.* Also encouraging are the May regional business surveys conducted by the New York, Philly, and Dallas FRBs ([Fig. 9](#)). The average of their overall indexes moved up from -69.6 during April to -46.9 during May; their average new orders index rose from -68.6 to -32.9; their average employment index jumped from -41.3 to -11.0.

(6) *Global economy unlocked.* Global economic activity also seems to be bottoming, as evidenced by the recent rebound in the nearby futures price of copper from this year's low of \$2.12 per pound on March 23 to \$2.41 on Friday ([Fig. 10](#)). More muted so far has been the CRB raw industrials spot price index's upturn from the year's low on April 21.

As Debbie discussed yesterday, Germany's economy might have bottomed during April, when the IFO business confidence index plunged to a record low of 74.2 ([Fig. 11](#)). In May, it rose to 79.5.

Comparative Epidemiology: 1968 Hong Kong Flu. “Why American life went on as normal during the killer pandemic of 1969” was the title of a May 16 *New York Post* [article](#). It observed that schools largely remained open, people didn't wear face masks, and Woodstock went ahead even though the Hong Kong flu's first wave in the US had ended just months before and “had no known cure.”

Societal differences may in part explain why there was less of a reaction then to a deadly pandemic than there is now. An April 24 *WSJ* [article](#) explained: “In 1968-70, news outlets devoted cursory attention to the virus while training their lenses on other events such as the moon landing and the Vietnam War, and the cultural upheaval of the civil-rights movements, student protests and the sexual revolution.”

But we find that explanation—that the virus was allowed to run rampant in 1968 mainly because people were otherwise distracted or just didn't care—to be misleading. Life continued in a more “normal” fashion than it has during the current pandemic because of different characteristics of the two viruses: H3N2, cause of the Hong Kong flu, was both more readily prevented and treated, and less deadly, than COVID-19.

The *WSJ* article noted that a vaccine became available about four months after the 1968 pandemic surfaced, which is confirmed by the timeline from medical sources we discuss below. *The New York Post* article incorrectly reported that a vaccine was developed shortly after Woodstock during August 1969. However, a second wave of the virus hit the US during the 1969-70 flu season despite the availability of a preventative. (We're not sure why. Perhaps the virus would have been even more deadly than it was in the absence of a vaccine.)

In contrast, today we are roughly five months into the COVID-19 pandemic, and the earliest hope we have for a vaccine in limited quantities is October. But no preventative has been ruled to be safe and effective yet. And just one safe and effective anti-viral treatment is currently being used, Gilead's remdesivir, but it is costly and cumbersome to administer, as we discussed yesterday.

Moreover, as the *New York Post* pointed out, the body count from COVID-19 is expected to dwarf that of the 1968 Hong Kong flu even with all the “curve-flattening” measures put into place so far. The *WSJ* noted that, according to an academic expert, mortality rates for the 1968 pandemic were significantly lower than those of COVID-19. One reason: The Hong Kong flu was not a novel virus but a variant strain of the flu, so a baseline immunity in the population likely had developed, as discussed below.

Consider the following:

(1) *Anatomy of a virus*. The H3N2 flu was first identified in Hong Kong in July 1968. It followed soldiers returning from the Vietnam War to the US in September 1968. Around the world, about 1 million people died from the highly contagious virus surrounding its two peak waves ending in March and flaring up again late in the 1969-70 flu season. In the US, about 100,000 people were killed, [according](#) to the CDC. The virus was especially deadly for those over 65. It remains in circulation in the population as a seasonal type of influenza A.

“The 1968 pandemic was caused by an influenza A (H3N2) virus comprised of two genes from an avian influenza A virus, including a new H3 hemagglutinin, but also contained the N2 [enzyme] from the 1957 H2N2 virus,” according to the CDC. (Click [here](#) for a discussion on the genetics of COVID-19, which has some similarities to SARS [2003]. But there remains no [vaccine](#) for SARS and little population immunity.)

(2) *Smoldering virus*. Since H3N2 was closely related to an earlier outbreak in 1957, many people were immune. Compared to the 1918 Spanish flu, the H3N2 flu was relatively mild. In an article titled “Influenza Pandemics of the 20th Century,” Dr Edwin Kilbourne, emeritus professor of microbiology and immunology at New York Medical College, [wrote](#): “Researchers speculated that [H3N2’s] more sporadic and variable impact in different regions of the world were mediated by differences in prior N2 immunity. Therefore, the 1968 pandemic has been aptly characterized as ‘smoldering.’” He added evidence that “vaccination of Air Force cadets with an H2N2 adjuvant vaccine reduced subsequent influenza from verified H3N2 virus infection by 54%.”

(3) *Antiviral medications & vaccine*. “The advent of antiviral medications and expansion of influenza vaccine options” provided “a stronger arsenal to combat” the 1968 pandemic than had been available before, observed an [article](#) in the May 2020 *American Journal of Public Health*. Prior to the outbreak, in 1966, the FDA had approved an antiviral drug called

“amantadine” as a preventative for influenza A. During the pandemic, it proved effective in reducing the duration of fevers and had an overall statistically significant therapeutic effect for H3N2, although antiviral treatments were still considered largely experimental at that time.

Just as the outbreak began in the US, an H3N2 vaccine already became ready for production. Only about two months after the virus came to the US, “[v]accine manufacturers released a first lot of 110,000 pandemic vaccine doses on November 15, 1968. Subsequently, 15 million doses became available by the pandemic’s peak in January 1969,” according to the public health journal.

However, some question over the effectiveness of that pandemic’s vaccine remains. Even today, the seasonal flu vaccine is not 100% effective. Nevertheless, the presence of some public immunity must have been reassuring.

CALENDARS

US: **Wed:** Richmond Fed Manufacturing Index, MBA Mortgage Applications, API Crude Oil Stocks, Beige Book. **Thurs:** Real GDP -4.8%, Durable Goods Orders Total and Ex Transportation -18.5%/-14.0%, Jobless Claims 2.10m, Pending Home Sales -15%, Kansas City Fed Manufacturing Index, EIA Natural Gas Storage, Williams. (DailyFX estimates)

Global: **Wed:** France Consumer Confidence 96, Lagarde, Guindos. **Thurs:** Eurozone Economic Sentiment 70.3, Germany CPI -0.1% m/m/0.6% y/y, Japan Retail Sales -11.5% y/y, Japan Industrial Production -5.1% m/m. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): LargeCap’s forward earnings rose last week for the first time in 12 weeks, but MidCap’s and SmallCap’s continued to fall. The SMidCap’s rates of decline continued to decelerate from their peaks seven weeks ago. LargeCap’s forward earnings rose 0.2% from its lowest level since August 2017; MidCap’s fell 1.1% to its lowest level since March 2016; and SmallCap’s dropped 1.3% to the lowest point since August 2013. These indexes had begun a forward-earnings uptrend during March 2019 but stumbled from July to November before rising until mid-February. LargeCap’s improved to 21.1% below its record high at the end of January. MidCap’s and SmallCap’s are 33.1% and 44.7% below their October 2018 highs; that’s the most since June 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 yearly rate of change in LargeCap's forward earnings remained steady at -19.3% y/y. 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 a record low of -32.2% y/y from -31.4%, surpassing the prior record low from July 2009; that compares to a TCJA-boosted 24.1% in September 2018 (the highest since April 2011). SmallCap's dropped w/w to a record low of -40.8% y/y from -38.6%; that also surpasses the previous record low during 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 10 weeks, and further, albeit smaller, reductions are still ahead. Here are the latest consensus earnings growth rates for 2020 and 2021: LargeCap (-22.8%, 30.4%), MidCap (-35.2, 46.7), and SmallCap (-48.6, 68.6).

S&P 500/400/600 Valuation ([link](#)): Valuations moved broadly lower last week, but the SMidCaps had the biggest gains. LargeCap's forward P/E rose 0.6pts w/w to 20.9 from 20.3. 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 20.3 was up 1.6pts w/w to an 18-year high and SmallCap's soared 2.6pts to a record high of 22.8. 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 close to its record high of 20.6 in January 2002 but 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 now above LargeCap's. It has been mostly below since May 2019—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 season is now more than 90% complete, and analysts have drastically reduced their pace of estimate-cutting amid a “withdrawn guidance” environment. The Q2 EPS forecast dropped 15 cents w/w to \$23.63. That represents a decline of 42.8% y/y on a frozen actual basis and -42.4% y/y on a pro forma basis. That compares to a 12.6% decline in Q1-2020, 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). The last

time earnings fell markedly y/y was during the four quarters through Q2-2016. Five of the 11 sectors recorded positive y/y earnings growth in Q1, but none rose at a double-digit percentage rate. That compares to eight positive during Q4, when two rose at a double-digit percentage rate. Seven sectors beat the S&P 500's pro-forma 12.6% 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 due to the COVID-19 economic shutdown and two are expected to report a loss: Consumer Discretionary and Energy. Here are the latest Q2-2020 earnings growth rates versus their nearly final Q1-2020 growth rates: Utilities (-2.6% in Q2-2020 versus 4.2% in Q1-2020), Information Technology (-7.9, 6.8), Real Estate (-14.0, -3.8), Health Care (-16.0, 6.5), Consumer Staples (-16.2, 5.5), Materials (-36.7, -12.3), Financials (-46.8, -37.9), Industrials (-88.0, -29.5), Consumer Discretionary (-108.5, -51.3), and Energy (-156.2, -30.5).

US ECONOMIC INDICATORS

Consumer Confidence ([link](#)): "Following two months of rapid decline, the free-fall in Confidence stopped in May," said Lynn Franco, senior director of economic indicators at The Conference Board. The consumer confidence index edged up to 86.6 this month after plunging 46.9 points (to 85.7 from 132.6) the prior two months, as consumers turned more positive about the future. The expectations component improved for the second month to 96.9 this month, after slumping from 108.1 in February to 86.8 in March—recovering nearly half of March's decline. The impact from COVID-19 has primarily centered on the present situation component, which continued to slide this month, though at a considerably reduced pace. The present situation component has tumbled 102.8 points the past four months, to 71.1 this month (the lowest since August 2013) from 173.9 in January—with 93.7 points of that decline occurring in April alone. May's loss was a negligible 1.9 points. Looking ahead, consumers' short-term expectations for both the economy and labor market improved, likely boosted by stay-at-home restrictions loosening in many states—along with a measured reopening of the economy. The percentage of consumers expecting business conditions to get better skyrocketed from 18.7% in March to an all-time high of 43.3% in May, while the percentage expecting conditions to get worse slipped to 21.4% this month after jumping from 7.2% in February to 25.1% in April. The spread between the two widened to 21.9ppts—the largest since 1984. As for labor conditions, the job outlook was little changed from April's readings, with those expecting more jobs (to 39.3% from 41.2%) continuing to exceed those expecting fewer jobs (20.2 from 21.2); these readings were at 16.6% and 12.0%, respectively in

February.

New Home Sales ([link](#)): New single-family home sales stabilized in April after tumbling the prior two months. New home sales ticked up 0.6% last month, to 623,000 units (saar), after plunging 20.0% (to 619,000 units from 623,000 units in January) during the two months ending March. The Midwest continues to have the strongest sales (up 2.4% m/m & 26.5% y/y), while the West has the weakest (-6.3 & -33.5). Sales rose in both the Northeast (8.7 & -26.5) and the South (2.4 & 4.7) during April—though sales in the Northeast remain considerably below year-ago levels. NAHB's May Housing Market Index (HMI) was encouraging, climbing 7 points after plunging a record 42 points in April to 30—the lowest builder confidence since mid-2012 and the first reading in negative territory (below 50) since mid-2014. All three measures of the HMI moved off their lows: current sales (to 42 from 36), future sales (46 from 36), and traffic of prospective buyers (21 from 13).

Regional M-PMIs ([link](#)): Three Fed districts have now reported on manufacturing activity for May (New York, Philadelphia, and Dallas) and show a sharp drop in activity again—though at a slower pace than April's record contraction. The composite index (to -46.9 from -69.6) rebounded 22.7 points this month after plunging 86.4 points the prior two months. The coronavirus impacts remain severe in all three regions—New York (to -48.5 from -78.2), Philadelphia (-43.1 from -56.6), and Dallas (-49.2 from -74.0)—though not as intense as a month ago. Meanwhile, May new orders (to -32.9 from -68.6) contracted at half of April's pace, after plunging steadily from February's recent peak of 21.2. As with the composite, orders in the New York (-42.4 from -66.3), Philadelphia (-25.7 from -70.9), and Dallas (-30.6 from -68.7) regions all contracted at a fast pace, though the decline eased considerably from April. Meanwhile, factories cut payrolls at a much slower pace this month than last month—with the employment (-11.0 from -41.3) measure soaring 30.3 points, as manufacturers tamed their freefalls in all three regions: New York (-6.1 from -55.3), Philadelphia (-15.3 from -46.7), and Dallas (-11.5 from -22.0).

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