MORNING BRIEFING
June 4, 2020

The Great Reopening

Check out the accompanying chart collection.

(1) Could it be a V? (2) The worst may be behind Visa. (3) Jamie strikes an optimistic note. (4) The dice are rolling again in Vegas. (5) Aerospace & Defense investors betting on next year. (6) Semis get good news from Microchip. (7) Trump administration aims to lure semis back to US shores. (8) Exoskeletons overcoming disabilities.

Podcast. Check out our latest video podcast, "Q1 was ugly, Q2 will be uglier, but earnings may be starting to bottom."

Strategy: Certainly Looks Like a V. As the US economy slowly opens, the stock market is ignoring the ugly Q1 earnings results and looking beyond the even uglier Q2 results ahead. Instead, it is focusing on signs that a reopening recovery—juiced by federal spending and monetary easing—is taking hold. The market is treating the recent calamity as if it were a natural disaster rather than a severe recession.

The S&P 500 is now down only 3.3% ytd after an amazing 39.6% rebound from its March 23 low (*Fig. 1*). While it's still early days, the index's chart undoubtedly looks like a V on steroids. The rebound has taken hold even as roughly a third of S&P 500 industries' stock price indexes are down by more than 20% ytd and about half are down by 10% or more. Fortunately, the sectors and industries with above-market contributions to the index's earnings and market capitalization have rebounded the most.

Here's the stock price performance derby for the S&P 500 sectors ytd through Tuesday's close: Information Technology (7.7%), Consumer Discretionary (3.2), Communication Services (0.9), Health Care (0.4), S&P 500 (-4.6), Consumer Staples (-5.6), Utilities (-6.5), Materials (-7.6), Real Estate (-8.4), Industrials (-15.8), Financials (-22.7), and Energy (-33.3) (*Fig. 2*).

And here are the S&P 500 sectors' market-cap and earnings shares ranked by the sectors' ytd stock price performance: Information Technology (26.8%, 24.5%), Consumer Discretionary

(10.6, 5.9), Communication Services (11.2, 11.0), Health Care (15.1, 19.7) Consumer Staples (7.2, 7.8), Utilities (3.1, 3.9), Materials (2.5, 2.6), Real Estate (2.7, 1.4), Industrials (7.7, 7.4), Financials (10.1, 15.6), and Energy (3.0, 0.4) (*Fig. 3*).

While a V can quickly turn into a W, the S&P 500 could continue to improve if the S&P 500 Financials and Industrials sectors can rebound as they have recently. Recent comments and developments out of JPMorgan, Visa, and Boeing are reassuring. Let's take a look:

(1) *Consumers poised to charge?* Earlier this week, Visa reported that while still negative, payment volumes have started to improve from their March nadir. US credit payments volume fell 21% y/y in May compared to a 30% drop in April, and debit payments rose 12% last month compared to a 5% drop in April, according to a June 1 Visa Securities & Exchange Commission filing.

Visa attributed the improvement to the "continued distribution of Economic Impact Payments and the relaxing of shelter-in-place restrictions in a number of states." It also noted that payment volumes at food and drug stores, home improvement retailers, and retail services had increased by more than 20% last month. Even transactions in the automotive, retail goods, and telecom & utilities categories were flat to up 20%.

Up more than 4% ytd, Visa stock belongs to the S&P 500 Data Processing & Outsourced Services industry, which has risen 5% ytd through Tuesday's close (*Fig. 4*). The industry is expected to grow revenue 2.4% this year and 10.1% in 2021 (*Fig. 5*). While earnings per share is forecast to drop 5.1% this year, a rebound of 20.6% growth is targeted for 2021 (*Fig. 6*). The industry's forward P/E of 31.5 is at a record high, but it should decline as investors factor in better earnings prospects for next year (*Fig. 7*).

Visa's update was also good news for all the financial companies with credit card exposure. It followed optimistic comments made the prior week by JPMorgan's CEO Jamie Dimon at a financial services conference. Dimon is hopeful that his base case for the economy—including improving unemployment and other metrics in the second half of the year—will occur, a May 26 CNBC article reported. "You could see a fairly rapid recovery," he said. "I think that's got a good chance."

(2) *Vegas is open, Baby.* At long last, Las Vegas—land of neon, Elvises, and gambling—is reopening today for business with new rules governing just about everything. The number of

people who can stand around a craps table has been reduced to six from 14. Half of the slot machines are either turned off or removed. And buffets are a thing of the past. All restaurants will have sit down service and require reservations, according to a June 3 CNN article.

Will people get on planes to visit Sin City? Our guess is yes. Did you see the infamous video of crowds without masks partying shoulder to shoulder in a pool over Memorial Day in Missouri's Lake of the Ozarks region? In a positive sign, people snapped up 2,000 free one-way tickets to Vegas offered by Derek Stevens, who owns The D Las Vegas and the Golden Gate Casino properties. Increased air travel will go a long way toward buoying the business of airlines, industrial companies such as Boeing and General Electric, hotels, and restaurants.

Boeing shares have rallied by more than 35% over the past month, helped by news on several fronts. Perhaps most important is the continued progress on COVID-19 vaccine development, which should help make consumers more comfortable with flying. In addition, the company announced that it's resuming production of its troubled 737 MAX. And yesterday, activist hedge fund Third Point announced that it bought Boeing bonds, a June 3 *Barron's* article reported.

Boeing is a member of the S&P 500 Aerospace & Defense sector, which, despite a bounce from its lows, remains down 26.2% ytd (*Fig. 8*). The industry's revenue and earnings growth has dropped so much that Mali had to recalibrate our charts. Revenue is expected to drop 8.0% this year but rise 11.5% in 2021 (*Fig. 9*). The industry's earnings are forecast to plummet 30.7% this year, which follows a 25.8% decline in 2019. Recovery is expected in 2021, when analysts forecast a 48.4% jump in the bottom line (*Fig. 10*).

Technology: High Hopes for a Semi Rebound. The semiconductor industry has held up remarkably well despite the COVID-19-induced global economic shutdown. Global semiconductor sales, measured using a three-month moving average, have fallen 6.2% from their November peak through April, according to Semiconductor Industry Association (SIA) data. I asked Jackie to take a look at the association's most recent data and the tug of war being played out between the US and China over the important industry. Here are her findings:

(1) *Betting on China.* Worldwide sales of semiconductors fell 1.2% m/m in April to $34.4 billion, but sales were up 6.1% y/y (*Fig. 11*). The drop in m/m sales in April resumes the downward trajectory in sales, which was briefly broken by an uptick in March (0.9%). Otherwise, m/m sales have fallen in February (-2.4), January (-2.2), December (-1.7), and November (-1.7).

Those looking for signs of optimism should consider semiconductor sales in China. Sales there had been negative m/m from December through March but rose by 2.1% in April, the SIA reported (*Fig. 12*). China was the first to put its economy back to work after COVID-19 quarantines. As other countries reopen their economies, hopefully they'll follow China's rebound. April sales dropped by 0.9% in Japan, by 1.1% in the Americas, by 3.1% in Asia Pacific/All Other, and by 7.6% in Europe, an SIA June 1 press release reported.

(2) *Semi stock investors looking on bright side.* Despite the slide in sales, the S&P 500 Semiconductors industry stock price index is up 6.1% ytd through Tuesday's close and is only 4.3% off its February 19 high (*Fig. 13*). That makes the S&P 500 Semiconductors industry the 18th best-performing industry we cover based on ytd returns.

The industry's shares got a nice boost Wednesday after Microchip Technology said that Q2 business was better than the company expected when it reported Q1 results on May 7, a June 3 *Barron's* article reported. COVID-19 supply-chain disruptions have "erased," customers' factories in China are back to work, and those in Europe and North America are starting to reopen. The company now expects to earn adjusted earnings of $1.35-$1.53 a share, up from its previous range of $1.25-$1.45. The shares rose more than 12% on Wednesday.

Investors appear to be turning the calendar early and looking to improved revenue and earnings growth in 2021. This year, revenues are only expected to inch up by 0.7%, and earnings are expected to drop 8.8% (*Fig. 14* and *Fig. 15*). Those estimates have come down sharply over the past year. Meanwhile, 2021 forecasts have held tight or risen. Revenues next year are forecast to rise 9.7%, and earnings are expected to jump 19.0%. At a recent 18.6, the industry's P/E is relatively elevated compared to levels of the last decade (*Fig. 16*).

(3) *Keeping an eye on politics*. The semiconductor industry is ripe to become the rope in the tug of war between the US and China. The industry provides chips critical to many of the fastest-growing tech areas—whether it be gaming, 5G, artificial intelligence, or robots. And almost 70% of semiconductors are manufactured in or pass through Taiwan, the island that China purports to own and that the US has promised to defend.

The Trump administration has been working to bring semiconductor production back to the US and scored a victory last month when Taiwan Semiconductor Manufacturing, the world's largest contract manufacturer of semiconductors, announced that it would spend $12 billion to build a chip factory in Arizona. The company said the project had the "support of the federal government and the state of Arizona," but it didn't disclose any government incentives, a May 14 *WSJ* article reported. Construction begins next year and is expected to be completed in 2024. The plant will make the industry's most advanced 5-nanometer chips but only 20,000 wafers a month, which is relatively few compared to the company's 12 million wafer annual production last year.

The big win came on the same day that the "Commerce Department announced that any company selling chips to Huawei, an affiliate of the Chinese military, will require a license if the design and production process uses US intellectual property, software or equipment," a June 2 MarketWatch Opinion piece noted. And within three days of the order, TSMC stopped taking new orders from Huawei, even though it meant forfeiting about 14% of its revenue.

Well aware of the President's intentions, the Semiconductor Industry Association is lobbying for more US funding to go to its members. The SIA has made proposals worth $37 billion that include building another new chip factory in the US, increasing research funding, and aid for states seeking to attract semiconductor investment, a May 31 *WSJ* article reported.

"The Trump administration is committed to ensuring the United States has a secure, vibrant, and internationally competitive high-tech ecosystem, supported by domestic chip production," Secretary of Commerce Wilbur Ross told the *WSJ*. Stay tuned to see how China responds.

Disruptive Technologies: Big Strides in Baby Steps. We last discussed the wonders of exoskeletons in the October 10, 2019 *Morning Briefing*. These robotic devices are strapped onto Army soldiers to enhance their strength and endurance. Exoskeletons are also helping paralyzed adults walk. This week, we wanted to pass along a May 30 story by CNBC about exoskeletons that are helping kids who can't walk for various reasons get around.

Trexo Robotics' exoskeleton is a gait-training device resembling a baby's walker. It helps children move their legs in a motion that simulates walking, facilitating exercise and its many benefits. Trexo was founded by Manmeet Maggu and Rahul Udasi when Maggu's nephew was diagnosed with cerebral palsy in 2011. He and Udasi decided to create a device that would help the nephew walk and stand upright. The company is now working on a treadmill that can slide under the Trexo so kids can exercise inside when the weather is inclement. In the future, they hope to offer wearable robots to adults with disabilities.

The CNBC piece also highlights the exoskeletons developed by Wandercraft. It's being used by healthcare organizations to provide rehabilitation to adults who have problems walking due to spinal cord injuries, neuromuscular diseases, or stroke. Wandercraft's device is notable because the patient doesn't need crutches to walk. It's a hands-free device, and the hope is that one day it will replace the wheelchair. If you're in need of a smile, check out the CNBC article or the heartwarming stories on the Trexo website.

CALENDARS

US: **Thurs:** Jobless & Continuous Claims 1.8m/20.1k, Merchandise Trade -$49.0b, Productivity & Unit Labor Costs -2.6%/50%, EIA Natural Gas Stock. **Fri:** Payroll Employment Total, Private, and Manufacturing -4.25m/-5.98m/-400k, Unemployment Rate 19.7%, Average Hourly Earnings 1.0%m/m/8.6%y/y, Average Weekly Hours 34.3, Consumer Credit -$20b, Baker-Hughes Rig Count. (DailyFX estimates)

Global: **Thurs:** Eurozone Retail Sales -15.0%m/m/-22.3%y/y, UK Gfk Consumer Confidence -34, Japan Household Spending -8.7%m/m/-15.4%y/y, ECB Interest Rate Decision 0.00%, ECB Deposit Facility Rate -0.50%. **Fri:** Germany Factory Orders -19.7%, Canada Employment Change & Unemployment Rate -500k/15.0%. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) rose again this week, and was above 1.00 for the eighth week after three weeks below. The BBR climbed for the 10th straight week, to a 14-week high of 2.26, after falling from 2.89 to 0.72 (the lowest since February 2016) the prior five weeks. Bullish sentiment climbed for the ninth time in 10 weeks, by 23.4ppts to 53.5%, following a five-week plunge of 24.6ppts (to 30.1% from 54.7%)—to its lowest percentage since late December 2018. Meanwhile, bearish sentiment sank 18.0ppts the past 10 weeks to 23.7%, after shooting up 22.8ppts (41.7 from 18.9) the previous five weeks. The correction count slipped for the second week to 22.8% after holding at 26.9% two weeks ago; it had advanced the prior two weeks from 24.3%. The AAII Ratio last week increased for the third week from 31.0% to 44.0% over the period. Bullish sentiment rose for the second week to 33.1% last week after falling from 30.6% to 23.3% the previous two weeks, while bearish sentiment dropped from 52.7% to 42.1% the past three weeks.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): Analysts continued to slow their pace of COVID-19 estimate cuts during the latest week. The consensus S&P 500 forecasts previously had been falling at rates that paralleled the declines during the financial crisis of 2008-09. Forward revenues dropped 0.1% w/w to its lowest level since June 2018 and is now 8.0% below its record high in mid-February. Forward earnings fell 0.2% w/w to its lowest level since August 2017 and is now 21.3% below its record high in early March. The forward revenue growth forecast was steady w/w, but forward earnings growth ticked down. Analysts expect forward revenues growth of 0.6% and a forward earnings decline of 3.5%. The earnings measure was down 0.2ppts w/w. Forward revenues growth is up from the lowest reading since June 2009 and 5.8ppts below its seven-year high of 6.3% in February 2018. Forward earnings growth is up from its record low of -5.6% at the end of April, but remains 20.4ppts below its six-year high of 16.9% in February 2018. Prior to the passage of the Tax Cuts and Jobs Act (TCJA), forward revenues growth was 5.5% and forward earnings growth was 11.1%. Annual growth expectations for 2020 are starting to stabilize. Analysts expect revenues to decline 5.4% y/y in 2020 compared to the 4.2% reported in 2019. That's unchanged w/w and down 10.3ppts since the start of the year. They're calling for earnings to decline 22.8% y/y in 2020 compared to a 1.4% rise in 2019. The 2020 growth rate fell 0.2ppt w/w and is down 31.8ppt since the beginning of the year. The forward profit margin of 10.3% was steady for a fifth straight week at the lowest level since August 2013, but is down 2.1ppt from a record high of 12.4% in September 2018. That compares to 11.1% prior to the passage of the TCJA in December 2017 and the prior cyclical low of 10.4% in March 2016. Analysts now expect the profit margin to fall 2.2ppt y/y in 2020 to 9.4%—from 11.6% in 2019—and to improve 1.8ppt y/y to 11.2% in 2021. Valuations have been extremely volatile this year on both a daily and weekly basis. The weekly snapshot of the S&P 500's forward P/E was up 0.5pts to 21.7, which is the highest level since early 2002 and up from a 77-month low of 14.0 in mid-March. It's still well above the 14.3 bottom during the December 2018 selloff (that 14.3 bottom was the lowest reading since October 2013 and down 23% from the 16-year high of 18.6 at the market's valuation peak in January 2018). The S&P 500 price-to-sales ratio rose to a 14-week high of 2.23 from 2.18. That's up from the 49-month low of 1.65 in mid-March, which compares to mid-February's record high of 2.29. It's now back above the 1.75 trough during the December 2018 selloff, when it was the lowest since November 2016 and down 19% from its then-record high of 2.16 in January 2018.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins (*link*): Consensus forward revenues rose w/w for five of the 11 sectors, and forward earnings was higher for three of the 11 sectors. However, none of the sectors had both measures rise w/w. Due to sharply lower forward earnings, forward P/E ratios are now back above the recent record or cyclical highs prior to the bear market for all sectors except Health Care, Real Estate, and Utilities. However, forward P/S ratios remain below their highs. Utilities is the only sector expected to record higher margins y/y in 2020, down from eight expected to do so in early March. During 2019, just two sectors improved y/y: Financials and Utilities. The forward profit margin rose to record highs during 2018 for 8/11 sectors, all but Energy, Health Care, and Real Estate. Since 2018, it has moved lower for nearly all the sectors. Real Estate's profit margin dropped in the latest week as the rest of the 10 sectors were unchanged. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (21.7%, down from 23.0%), Real Estate (14.2, down from 17.0), Communication Services (13.4, down from 15.4), Utilities (13.9, back up to a record high), Financials (13.5, down from 19.2), S&P 500 (10.3, down from 12.4), Health Care (10.0, down from 11.2), Materials (8.8, down from 11.6), Industrials (7.3, down from its record high of 10.5% in mid-December), Consumer Staples (7.2, down from 7.7), Consumer Discretionary (4.7, down from 8.3), and Energy (0.6, down from 8.0).

US ECONOMIC INDICATORS

ADP Employment (*link*): "The impact of the COVID-19 crisis continues to weigh on businesses of all sizes," said Ahu Yildirmaz, co-head of the ADP Research Institute. "While the labor market is still reeling from the effects of the pandemic, job loss likely peaked in April, as many states have begun a phased reopening of businesses." The private sector slashed an additional 2.8 million jobs in May, drastically less than April's revised 19.6 million loss (vs -20.3 million). Here's a look at May and April declines for large (to -1.6 million in May from -9.3 million in April), medium (-722,000 from -5.0 million), and small (-435,000 from -5.3 million) companies. Looking at industries, the services-providing sector cut 2.0 million jobs in May (vs -17.2 million in April), while goods-producing payrolls were reduced by 794,000 (-2.4 million). Leisure & hospitality accounted for half of the drop in April jobs, though May's decline paled in comparison—slowing to -105,000 versus -7.7 million in April. The biggest decline last month occurred in trade, transportation & utilities (-826,000 in May vs -3.1 million in April), followed by health care & social assistance (-333,000 vs -2.1 million), professional & technical services (-221,000 vs 546,000), financial activities (-196,000 vs -262,000), information services (-115,000 vs -254,000), leisure & hospitality (-105,000 vs -7.7 million), and management of companies & enterprises (-70,000 vs -82,000); education (+166,000 vs -457,000) added jobs last month. Meanwhile, jobs in all other services dropped 307,000 following April's 1.3 million cutback.

Manufacturing Orders & Shipments (*link*): Factory orders in April tumbled a record 13.0%, building on March's previous record decline of 11.0%—as transportation orders plummeted 70.6% over the period. Excluding transportation, orders contracted 12.1% over the two-month period to its lowest level since March 2016. Both core capital goods orders and shipments posted sizable declines in April, following more modest losses the prior two months. Nondefense capital goods orders ex aircraft (a proxy for future business investment) fell for the third month, by 6.1% in April and 7.8% over the period. Core capital goods shipments (used in calculating GDP) fell 5.7% and 7.5% over the comparable periods. Looking forward, manufacturing activity in May declined at a slower pace than in April, with ISM's M-PMI climbing from 41.5 to 43.1—though remained in the midst of a severe downturn.

GLOBAL ECONOMIC INDICATORS

Global Composite PMIs (*link*): "Global economic downturn eases from record rate, but conditions remain challenging due to COVID-19 pandemic" was the headline of IHS Markit's May report. The JP Morgan Global Composite Output Index (C-PMI) rebounded 10.1 points in May, to 36.3, after tumbling the prior three months, by 25.9 points, from 52.2 in January to a record low of 26.1 in April—which was far below its previous low of 36.8 in November 2008. The service sector accounted for much of May's improvement as well as most of the recent declines. The Global NM-PMI jumped 11.5 points in May, to 35.2, after plunging 29.0 points the prior three months, from 52.7 at the start of the year to a record low of 23.7 in April. Meanwhile, the M-PMI climbed 2.8 points in May to 42.4 after a three-month decline of 10.7 points (to 39.6 in April from 50.3 in January). C-PMIs for both the emerging (to 42.7 from 34.6) and advanced (33.2 from 22.2) economies continued to contract, though the former's is considerably closer to the breakeven point of 50.0. China was the only nation that saw an expansion in May, with its rate of growth the fastest in over nine years. Rates of contraction eased in all of the other countries covered by the survey. Among the major economic regions, the steepest decline was in India and the slowest in the US. Here's a look at some country C-PMIs from highest to lowest: China (to 54.5 from 47.6), US (37.0 from 27.0), Italy (33.9 from 10.9), Germany (32.3 from 17.4), France (32.1 from 11.1), UK (30.0 from 13.8), Spain (29.2 from 9.2), Australia (28.1 from 21.7), Brazil (28.1 from 26.5), Japan (27.8 from 25.8), and India (14.8 from 7.2). (Note: Due to later-than-usual release dates, manufacturing PMI data for Ireland, Indonesia, and the Netherlands and services PMI data for Ireland were not included in the May Global PMI calculation.)

Global Non-Manufacturing PMIs (*link*): May saw the rate of growth in the global service economy continuing to decline, though easing from April's record rate. The report noted: "The downturns in business activity, new business, new export orders and employment in the global service sector were deeper than the equivalent contractions signaled at manufacturers. Business confidence was also lower at service providers than their manufacturing counterparts." May's NM-PMI climbed to 35.2 in May after plunging from 52.7 at the start of this year to a record-low 23.7 in April. Developed economies saw their NM-PMI advancing 12.1 points to 33.0 last month after sliding 31.8 points during the three months through April to 20.9. Meanwhile, the NM-PMI for the emerging economies climbed 9.9 points in May to 41.4 after a three-month slide of 21.0 points to 31.5.

US Non-Manufacturing PMIs (*link*): The US service sector contracted again in May, though at a slower pace, according to both the ISM and IHS Markit measures. ISM's NM-PMI improved to 45.4 in May after tumbling from 57.2 in February to 41.8 in April—which was its first reading below 50.0 since Q4-2009 and only 4.0 points above its all-time low of 37.8 recorded during November 2008. Three of the four components moved up in May from near-record lows in April: business activity (to 41.0 from 26.0), new orders (41.9 from 32.9), and employment (31.8 from 30.0). Meanwhile, the supplier deliveries (67.0 from 78.3) component fell from April's record high—which had shot up due to supply-chain problems caused by the coronavirus rather than strengthening demand. The IHS Markit NM-PMI rebounded from April's record low of 26.7 to 37.0 in May as the rate of decline softened considerably amid some reports of businesses returning to work. Still, May's reading reflected the second-sharpest decline in activity since data collection began in October 2009—April's being the steepest. According to the report, "While views about prospects for the year ahead remained negative on balance, the degree of pessimism has also moderated considerably since April, to hint that sentiment is improving as increasing numbers of companies see the worst of the lockdown being behind them."

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