**MORNING BRIEFING**
**June 9, 2020**

### Across the Pond

*Check out the accompanying chart collection.*

(1) Free Fed Kindle book. (2) TINA is driving meltup. So is rebalancing. (3) TINA + MMT = MAMU. (4) Fed and ECB join forces to carpet-bomb their economies and financial markets with cash. (5) Lagarde's whatever-it-takes moments: APP-Forever + PEPP two-step. (6) Going down the credit-quality curve. (7) PEPP rally in Eurozone credit spreads and stock prices. (8) Eurozone economic indicators remain depressing, while business surveys may be bottoming. (9) 2021 has to be better than 2020.

**Free Fed.** Mark your calendars: This week on Wednesday and Thursday, the Kindle version of my book *Fed Watching for Fun & Profit* will be available for free. One five-star reviewer noted: "How timely can you be? With the Fed's actions over the past few weeks, Ed Yardeni publishes a book giving everyone, Wall Streeters and casual observers alike, a great historical overview of a major Washington institution."

**Strategy: Revisiting TINA.** During the bull market in stocks from 2009 through 2019, some bullish investment strategists claimed that "there is no alternative" to stocks. "TINA" was their stock market rallying cry. In fact, there was a good alternative to stocks, namely bonds. The 10-year Treasury bond yield was 2.89% on March 9, 2009, when the previous bull market started (*Fig. 1*). It fell to a record low of 0.54% on March 9 of this year.

Despite the swings along the way, that downward trend in yields added significant capital gains to the coupons on bonds, as evidenced by the weekly data provided by the Fed on "net unrealized gains (losses) on securities available for sale" held by all commercial banks (*Fig. 2*).

Let's have a closer look at the data compiled by the Investment Company Institute on equity mutual funds plus exchange-traded funds versus the comparable data for bonds:

(1) *Net assets*. From December 2008 through February 2020, the net assets of equity funds rose $9.5 trillion, while bond funds rose $4.1 trillion (*Fig. 3*).

(2) *Net inflows*. Over this same period, the net inflows into equity funds was $1.6 trillion, while bond funds attracted $3.5 trillion (*Fig. 4*).

The net inflows data clearly show that lots of investors viewed bonds as a good alternative to stocks during the previous bull market in stocks. That's no longer likely to be the case given that bond yields are so close to zero. The 10-year Treasury yield ranged between 4.01% and 1.47% from March 9, 2009 to February 19, 2020. It's been consistently below 1.00% since March 20.

TINA makes more sense during the current bull market than it did during the previous one. The embrace of Modern Monetary Theory (MMT) by US monetary and fiscal policymakers during the week of March 23, when the Fed announced QE4Ever, and on March 27, when the CARES Act was signed into law, triggered a huge wave of TINA rebalancing out of bonds and into stocks. It is likely to continue for the foreseeable future.

The stock market equation since March 23 has been: TINA + MMT = MAMU. As we discussed yesterday, MAMU = the Mother of All Meltups!

MMT ended the latest bear market in just 33 calendar days, from February 19 through March 23. During that period, there were 23 trading days, with the S&P 500 down by 20% or more during seven of those days. Technically, it was still in bear market territory, as the S&P 500 rocketed 18.9% for 11 more trading days after the March 23 bottom, through April 7, before entering correction territory. As we discussed yesterday, Joe and I aren't even convinced that the selloff should be classified as a bear market since it was so short. It was more like Panic Attack #66. Long live the bull market! Hopefully, MAMU won't lead to its demise.

**ECB I: Joining the Allied Campaign.** Yesterday, Melissa and I observed that the meltup in global stock markets started the day after the Fed announced QE4Ever on March 23, when it "started carpet-bombing the financial markets and the economy with B-52s full of cash. … The Fed actually started its bombing campaign on March 15, when it announced $700 billion of QE4 purchases of US Treasuries and mortgage-backed securities and lowered the federal funds rate by 100bps to zero."

The European Central Bank (ECB) joined the allied bombing campaign on March 18 with its Pandemic Emergency Purchase Programme (PEPP), committing to buy €750 billion of private- and public-sector Eurozone securities. On June 4, the ECB upped the ante by €600 billion to a total of €1,350 billion (*Fig. 5*). Recall that the ECB announced on September 12, 2019 the revival of its Asset Purchase Programme (APP), effective November 1, 2019, with an open-ended commitment to purchase €20 billion per month in net assets without setting any termination date, i.e., APP-Forever.

Recall also that Christine Lagarde replaced Mario Draghi as the head of the ECB on November 1, 2019. Before starting her new position, she said she hoped she wouldn't have to follow up Draghi's "whatever it takes" with more of the same. Yet here she is, doing just that!

Here is a brief review of the ECB's purchases so far and major actions since the March 18 pandemic-aid initiation:

(1) *Purchasing sovereigns & CP*. From the start of the program during mid-March through May 29, the bank has purchased €234.7 billion of debt securities under the PEPP, according to the ECB's update. Of the purchases to date, 80.0% has been allocated to public-sector securities, 20% to private-sector securities. About 70% of the €186.6 billion in the ECB's sovereign purchases went to the four largest Eurozone economies: Germany (€46.7 million, representing a 25.0% share), Italy (€37.4 million, 20.0%), France (€23.6 million, 13.0%), and Spain (€22.4 million, 12.0%).

The lion's share of private-sector purchases went to commercial paper (CP), at 74.0%, with most of the balance to corporate bonds (22.0%) and the rest to covered bonds.

(2) *More PEPP*. Last Thursday, June 4, the ECB increased the pandemic emergency purchase programme (PEPP) by €600 billion to a total of €1,350 billion. The policy statement noted: "[P]urchases will continue to be conducted in a flexible manner over time, across asset classes and among jurisdictions." No firm end date was set for the purchases, which are to be extended at least through the end of June 2021 but which won't end until the bank "judges that the coronavirus crisis phase is over." Proceeds from maturing securities will be reinvested at least until the end of 2022.

(3) *APP-Forever, for now.* Net asset purchases under the pre-existing APP will continue at a monthly pace of €20 billion in addition to €120 billion per month from the "temporary" PEPP for at least the rest of the year. Monthly net asset purchases under the APP will "run for as long as necessary" and end shortly before the ECB resumes rate increases. The ECB's key interest rates on the main refinancing operations (MRO), the marginal lending facility, and the deposit

facility (DFR) remained unchanged at 0.00%, 0.25% and -0.50%, respectively (*Fig. 6*). Interest rates are expected to remain "at their present or lower levels" until inflation "consistently" moves toward the ECB's 2.0% inflation goal.

(4) *PELTROs & more*. Following the bank's April 30 monetary policy meeting, the ECB decided to conduct a new series of seven additional longer-term refinancing operations called "pandemic emergency longer-term refinancing operations" (PELTROs) to provide liquidity to the euro area financial system and to preserve the smooth functioning of money markets by providing a backstop to the March refinancing operations (LTROs).

As detailed in a separate press release, the interest rate on the PELTROs is set at 25bps below the MRO (currently 0%). The PELTROs will be conducted from mid-May through December 2020 at maturities decreasing from 16 to 8 months. If needed, the ECB stands ready to provide more liquidity. Participants are also eligible for the collateral easing measures in place until the end of September 2021 that were announced on April 7 and April 23.

(5) *TLTRO III terms*. Also on April 30, the ECB reduced the rate on all of its targeted longer-term refinancing operations (TLTRO III) by 25bps to -0.50% from June 2020 to June 2021 "in order to support further the provision of credit to households and firms in the face of the current economic disruption and heightened uncertainty." For banks whose eligible net lending reaches a lending performance threshold (introduced on March 12), the interest rate will be as low as -1.00%, or 50bps below the DFR (currently -0.5%). The start of the lending assessment period was moved up to March 1 from April 1 to recognize "the funding support that banks have already provided to firms in March" at the start of the pandemic.

**ECB II: Lowering the Bar.** As the ECB has provided more aid, it has also lowered the standards on the credit quality of assets eligible for purchase and expanded the types. No doubt, the expansion of eligible credit instruments was necessary to prevent the ECB from owning a higher market share of previously eligible instruments than would be desirable.

Over the 45 months of the ECB's quantitative easing program from March 2015 following the Great Recession to December 2018, the ECB injected €2.6 trillion of liquidity into the euro-system. "The main addition to the ECB's balance sheet was €1.9tn of government bonds," observed a May 2019 *Financial Times* article. This represented 90% of the bonds issued by European governments, reported the article. From January 2015 to September 2018, over

15% of total Eurozone public debt moved onto the ECB's balance sheet, up from about 4.0% before the start of QE.

Here's more on the assets newly eligible for the ECB's purchase during the pandemic era:

(1) *More lower-quality assets*. On April 22, the ECB grandfathered until September 2021 the eligibility of marketable assets used as collateral in Eurosystem credit operations that fall below current minimum credit-quality requirements. Primarily, BBB- assets (except asset-backed securities) as of April 7 will remain eligible as collateral in the event of post-pandemic rating downgrades as long as certain other requirements are met. However, the central bank said that "appropriate haircuts" would apply to assets falling below that standard. The decision reinforced the broader package of collateral-easing measures adopted on April 7, which also remain in place until September 2021. These measures "aim to ensure that banks have sufficient assets" that they can mobilize as collateral with the Eurosystem.

On April 7, the ECB had adopted an "unprecedented set of collateral measures to mitigate the tightening of financial conditions across the euro area." It temporarily increased the Eurosystem's risk tolerance to support credit to the economy, eased the conditions for the use of credit claims as collateral, adopted "a general reduction of collateral valuation haircuts," and waived the minimum credit-quality requirements of Greek sovereign debt instruments eligible as collateral in Eurosystem credit operations.

(2) *More CP.* "[C]ommercial paper is an important instrument for euro area corporates to manage their short-term cash needs," ECB Vice President Luis de Guindos and Executive Board Member Isabel Schnabel explained in an April 3 ECB blog post on CP's role in monetary policy. During the pandemic, traditional private-sector CP investors (such as money market funds) have avoided investing in CP or have tried to sell it, favoring cash. Meanwhile, CP issuance at shorter durations has risen in response to companies' need for shorter-term funding during the crisis.

So the ECB has stepped in. FAQs on its website state: "Commercial paper has been eligible for purchases since the launch of the corporate sector purchase programme (CSPP) in March 2016. However, until March 2020 only commercial paper with a remaining maturity greater than six months was eligible for CSPP purchases." As part of the ECB's March 18 decision, "it was decided to extend the maturity range of non-financial commercial paper eligible for purchases under the CSPP" to CP with a minimum remaining maturity of 28 days, beginning with purchases made on March 27.

**ECB III: Damage Assessment.** The ECB's balance sheet has risen €904 billion since the end of February, to a record €5.6 trillion during the May 29 week. During the three-months through April, lending by monetary financial institutions (MFIs, excluding the ECB) totaled €864.2 billion (saar), led by lending to nonfinancial corporations, which soared €748.4 billion (saar) (*Fig. 7* and *Fig. 8*).

All that liquidity couldn't stop the plunge in economic activity as Eurozone governments imposed lockdowns to encourage social distancing. The liquidity should, however, help speed the recovery as lockdown restrictions are lifted. Meanwhile, as in the US, central bank liquidity has averted a widespread credit crisis and boosted asset prices. Let's review some of the relevant data:

(1) *Financial markets.* The yield spreads between both Italian and Spanish 10-year government bonds and the comparable German bond widened sharply during March, but have narrowed in recent weeks (*Fig. 9*). As of Friday's close, the EMU MSCI stock price index was up 35.2% since March 23, lagging behind the US (43.6%) but outpacing the UK (28.5), Emerging Markets (28.5), and Japan (25.4) (*Fig. 10*). The former has been outperforming the other four indexes in recent days, especially after the ECB expanded PEPP.

(2) *Business surveys.* The Eurozone's M-PMIs and NM-PMIs (purchasing managers indexes for manufacturing and nonmanufacturing industries) rebounded sharply during May as lockdown restrictions were lifted (*Fig. 11* and *Fig. 12*). However, they remained well below 50.0. Furthermore, the Eurozone Economic Sentiment Indicator, which is highly correlated with the growth rate of real GDP on a y/y basis, ticked up to 67.5 during May from 64.9 during April, which was the lowest in the history of the series going back to 1985 (*Fig. 13*). Similarly, Germany's IFO Business Confidence Index upticked from a record low of 74.2 during April to 79.5 last month (*Fig. 14*).

(3) *Economic indicators.* Eurozone industrial production plunged 11.3% m/m during March to the lowest reading since November 2009 (*Fig. 15*). It likely moved lower during April, along with Germany manufacturing output and orders (*Fig. 16*). Both probably started to recover in May.

**ECB IV: Not-So-Great Expectations.** The ECB has expanded its aid to stabilize markets in the face of the terrible economic outlook for the euro area. The bank expects economic growth to nosedive in 2020, recovering to a lackluster pace thereafter, and unemployment to rise significantly this year and recover only slowly afterwards. Here is a compilation of the ECB's latest assessments of current economic conditions and financial stability from recent press releases:

(1) *Economy weaker*. Professional forecasters responding to an ECB survey expect the effects of the pandemic to significantly impact inflation, growth, and unemployment. In the short term, inflation expectations for the HICP (Harmonised Index of Consumer Prices) inflation were revised "sharply down" from the prior survey (to 0.4%, 1.2%, and 1.4% for 2020, 2021 and 2022, respectively), while average longer-term inflation expectations remained unchanged at a historical slow pace (at 1.7%).

The real GDP growth expectation for this year was revised significantly downward (to -5.5%). Coming off the bad year, the growth comparison should be rosier next year (revised to 4.3%). Average longer-term real GDP expectations were unchanged at 1.4%. Unemployment rate expectations were revised sharply higher for 2020 (to 9.4%), with only a "gradual" recovery expected thereafter (to 8.9% and 8.4% for 2021 and 2022, respectively).

(2) *Financial stability riskier*. On May 26, the ECB warned in a press release summarizing the issues in its latest *Financial Stability Report* that the pandemic increases the risks to financial stability. These include "richly valued asset prices, fragile investment funds, the sustainability of sovereign and corporate debt, and weak bank profitability." Actions by the ECB helped to stabilize market conditions, the ECB stated. Fiscal packages introduced by all euro area countries should support the economy by helping corporations to sustain cash-flow strains, it added. However, increases in public debt levels could jeopardize sovereign entities.

## CALENDARS

**US: Tues:** NFIB Small Business Optimism Index 86.0, Job Openings 6.796m, Wholesale Inventories 0.4%, API Crude Oil Stocks. **Wed:** Headline & Core CPI 0.2%/1.3% y/y, MBA Mortgage Applications, Monthly Budget Statement -$650b, EIA Crude Oil Stocks, Fed Rate Decision 0.13% (0.00% to 0.25%), FOMC Economic Projections. (DailyFX estimates)

**Global: Tues:** Eurozone GDP -3.8%q/q/-3.2%y/y, Japan Machine Orders -8.6%m/m/-

14.0%y/y, China CPI & PPI 2.6%/-3.3% y/y, Cunliffe. **Wed:** France Industrial Production -20.0%, Guindos Schnabel. (DailyFX estimates)

## STRATEGY INDICATORS

**S&P 500/400/600 Forward Earnings** (*link*): LargeCap's forward earnings rose last week for a third week, and MidCap's was up for the first time in 13 weeks. SmallCap's was down after rising a week earlier for the first time in 13 weeks. LargeCap's forward earnings rose 1.0% and is now up 1.1% from its lowest level since August 2017; MidCap's rose 0.7% from its lowest level since May 2015; and SmallCap's dropped 0.8% to its lowest point since August 2013. These indexes had been on a forward-earnings uptrend from November until mid-February, before tumbling due to the COVID-19 economic shutdown. LargeCap's is now 20.4% below its record high at the end of January. MidCap's and SmallCap's are 33.1% and 45.2% below their October 2018 highs; those are up from an 11-year low for MidCap and at a record low 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 improved to -18.8% y/y from -19.3%. Last week's reading was the lowest since October 2009 and down from 23.2% in September 2018, which was the highest since January 2011. MidCap's improved w/w to -32.3% y/y from a record low of -32.7%; that compares to a TCJA-boosted 24.1% in September 2018 (the highest since April 2011). SmallCap's fell w/w to a record low of -41.5% y/y from -40.1%; that had surpassed 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 12 weeks, and further, albeit smaller, reductions are still ahead. Here are the latest consensus earnings growth rates for 2020 and 2021: LargeCap (-23.0%, 30.7%), MidCap (-36.9, 49.9), and SmallCap (-51.6, 77.9).

**S&P 500/400/600 Valuation** (*link*): Valuations moved broadly and sharply higher last week. LargeCap's forward P/E rose 0.9pt w/w to 22.4 from 21.5. That's the highest level since May 2001 and is up from 13.3 in mid-March, which was the lowest since March 2013. MidCap was up 1.6pts w/w to 22.9, a record high since the SMidCap series began in 1999. SmallCap was at a record high too, soaring 3.4pts to 26.7. 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 before COVID-19 decimated forward 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 techbubble 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 rose above LargeCap's P/E last week for most of the time since August 2018. It was last solidly above LargeCap's from April 2009 to August 2017. SmallCap's P/E is also now above LargeCap's. It had been mostly below since May 2019 after being solidly above from 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*): Analysts are beginning to focus on the pace of the reopening of the US economy and have drastically reduced their rate of estimate cuts amid a "withdrawn guidance" environment. The Q2 EPS forecast dropped just 7 cents w/w to $23.38. That represents a decline of 43.4% y/y on a frozen actual basis and -43.0% 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 but low-single-digit y/y earnings growth in Q1, but none are expected to be positive in Q2. 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's similar to the six that beat the index in Q4-2019 and seven in Q3-2019, but up sharply from just three 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 (-3.3% in Q2-2020 versus 4.2% in Q1-2020), Information Technology (-8.3, 7.0), Real Estate (-15.0, -3.8), Consumer Staples (-16.5, 6.0), Health Care (-17.9, 6.6), Materials (-37.3, -12.3), Financials (-47.2, -37.9), Industrials (-88.1, -29.5), Consumer Discretionary (-110.2, -53.7), and Energy (-154.8, -30.1).

## US ECONOMIC INDICATORS

**Merchandise Trade** (*link*): The real merchandise trade deficit in April widened for the second month, to -$80.0 billion, after narrowing from -$81.2 billion at the end of last year to a five-year low of -$68.3 billion in February. April's -$80.0 billion gap compares with an average Q1 deficit of -$73.9 billion, suggesting that trade will be a drag on real GDP growth for the first time since Q3-2019. (Trade added 1.32ppt to Q1 real GDP and 1.51ppt to Q4-2019's.) Real exports tumbled a record 20.4% in April after a 5.7% shortfall in March, while real imports fell roughly half that pace, down 11.5% and 0.5% over the respective periods. There were declines in both real exports and imports during the two months through April to auto vehicles, parts & engines (-71.6% in exports & -56.6% in imports), consumer goods, less autos (-34.5 & -13.8), and capital goods (-27.4 & -7.6). In the meantime, real exports of industrial supplies & materials plunged 11.5% over the two-month period, while real imports soared 21.1%; real exports and real imports of food rose 1.6% and fell 0.2%, respectively, over the time span.

## GLOBAL ECONOMIC INDICATORS

**Germany Manufacturing Orders** (*link*): Factory orders in April plunged a record 25.8% following March's previous record drop of 15.0%. "In view of the gradual easing (in coronavirus restrictions), however, the low point of the industrial recession should now have passed," the ministry said in a statement. Both foreign (-28.1% in April & -16.0% in March) and domestic (-22.3 & -13.7) orders posted back-to-back record declines, with foreign orders from both inside and outside the Eurozone collapsing 43.3% and 37.3%, respectively, over the two-month period. By industry grouping, capital goods (-46.2%) orders posted the biggest two-month decline, followed by intermediate (-27.4), consumer durable (-25.3), and consumer nondurable (-8.2) goods billings. The drop in capital goods orders over the two-month period showed declines north of 40.0% in both domestic (-41.7) and foreign (-48.8) orders—with the latter showing big contractions from both inside (-54.9) and outside (-45.9) the Eurozone. The drop in intermediate goods orders was fairly uniform, with domestic and foreign orders sliding 26.1% and 28.7%, respectively, over the two-month period—with declines in billings from inside (-33.6) the Eurozone steeper than those from outside (-24.3). The two-month loss in consumer durable goods orders was led by a 30.9% drop in domestic orders, with foreign orders down 21.8%—led primarily by a sharp decrease in orders from inside (-35.7) the Eurozone; foreign billings from outside slipped only 3.1%. Meanwhile, the decline in consumer nondurable goods orders pales in comparison to the ones for other orders: Domestic and foreign orders fell 7.3% and 8.6% during the two months though April. The latter was led by a16.9% drop in billings from within the Eurozone; those from outside tripped just 2.3%.

**Germany Industrial Production** (*link*): April data show the coronavirus triggered the largest declines in both headline and manufacturing production in the history of the series, surpassing those posted in March. Germany's headline production—which includes construction—plunged 18.0%, with manufacturing tumbling 22.1%, following declines of 8.9% and 11.0%, respectively, in March. Excluding construction, the decline was a steeper 21.0%, with the two-month decline at 29.5%. The main industrial groupings were a sea of deep red, with capital (-45.4%), intermediate (-20.0), and consumer (-15.4) goods orders all posting record declines over the two months through April. Within consumer goods, both durable (-25.8) and nondurable (-13.3) goods production also recorded record declines. While March and April data were horrific, May could show an easing in the record rate of contraction. Germany's May M-PMI climbed to 36.6 after tumbling to an 11-year low of 34.5 in April—on slower declines in both output and orders.

---

Contact us by email or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-775-6823