MORNING BRIEFING
June 11, 2020

Green Shoots

Check out the accompanying chart collection.

(1) Cooped-up Americans hit the road and buy homes. (2) Vacationers cancel overseas travel plans and see the US instead. (3) Forward earnings may be bottoming. (4) Tech earnings push Nasdaq across the 10,000 threshold. (4) Vegas opened its doors, and people walked through. (5) Battle over the electric vehicle market breaks out. (6) Tesla becomes most valuable car company as it pushes forward with electric trucks. (7) Nikola bets on fuel cells. (8) Ford is in the EV game too.

Free Fed. The Kindle version of my book *Fed Watching for Fun & Profit* is available for free today. One five-star reviewer noted: "Dr Ed does it again! A super ride through all of the past Fed chairmen, stopping along the way to point out what is important for investors to watch."

Podcasts. Our latest video podcast is titled "A Brief Update on Growth vs Value." The previous one is titled "Consumers' huge cash stash set to fuel V-shaped recovery." Also see my recent Bloomberg interview.

US Economy: Bottom Fishing. The US economy is reopening, and there are more signs that it is recovering from the lockdowns imposed by state governors to enforce social distancing to reduce the spread of the COVID-19 virus. Consider the following:

(1) *On the road again.* Gasoline usage rose 40% since the four-week period ending April 24 from a low of 5.3mbd to 7.4mbd through the June 5 week (*Fig. 1*). It's still well below its old normal level this time of year around 9.5mbd. So far, it seems to be tracing out a Nike-swoosh recovery rather than a V-shaped one.

(2) *Buddy, can you spare a house?* More V-shaped is the recovery in mortgage applications for new purchases of new and existing homes (*Fig. 2*). This series plunged 41.8% from its recent high during the week of January 24 through the April 10 week. It has rebounded 70.7% since then through the June 5 week, almost back to the recent high. The June 4 *New York*

Post included an article titled "'Frantic' New Yorkers snatch up unwanted homes in the suburbs."

According to the story, "Some houses in suburban towns and rural areas outside of New York City sat on the market for years. But then the pandemic spurred cooped-up urbanites to run for the hills and sparked an uptick in property sales within a few-hour radius of Manhattan. Many say they'll never return to the city."

(3) *The cure for cabin fever.* There are also lots of reports that Americans, who have been suffering from cabin fever since mid-March, are snapping up summer vacation rental homes in the US and buying campers and boats. Summer vacations to Europe and other overseas tourist spots have been mostly cancelled or postponed. These developments should continue to boost gasoline demand and support the V-shaped US economic recovery scenario that Debbie and I reckon started in May and June.

(4) *Moving forward.* Joe and I are particularly encouraged that industry analysts have recently been lowering their earnings estimates at a slower pace. We are seeing that happening in their S&P 500/400/600 Q2-Q4 forecasts for this year (*Fig. 3*).

The same can be said about analysts' consensus annual earnings estimates for 2020 and 2021 (*Fig. 4*). The result may be that forward earnings are already starting to bottom. On Tuesday, Joe reported that LargeCap's forward earnings rose last week for a third consecutive week, and MidCap's was up for the first time in 13 weeks. However, SmallCap's was down after rising a week earlier for the first time in 13 weeks.

Strategy I: Tech Leads the Way. Nasdaq 10,000 shouldn't be any more or less important than Nasdaq 9,500, but somehow round numbers always capture headlines. And as the US continues to reopen after COVID-19, the new Nasdaq record symbolizes the continued growth of US technical prowess and provides a dose of optimism about the future. At 10020.35, the Nasdaq is up 11.7% ytd as of Wednesday's close and up 46.1% from its low of 6860.67 on March 23. It has far outpaced the S&P 500, which is down 1.3% ytd, and the Dow Jones Industrial Average, down 5.4% ytd (*Fig. 5*).

While there may be some pockets of froth, particularly among microcap names, the market is rewarding the S&P 500 Tech sector's strong earnings performance. Joe has been tracking the changes in earnings estimates for S&P 500 sectors and industries since COVID-19 hit the headlines on January 23. While analysts have reduced their consensus 2020 earnings estimate for the S&P 500 Tech sector by 6.5% since January 23, they've cut their earnings forecasts for nearly all other sectors more sharply: Utilities (-1.5%), Information Technology (-6.5), Consumer Staples (-8.2), Health Care (-9.6), Real Estate (-19.1), Communications Services (-21.6), S&P 500 (-28.8), Materials (-28.9), Financials (-40.6), Industrials (-52.4), Consumer Discretionary (-58.6), and Energy (not meaningful due to a projected 2020 loss) (*Table 1*).

In addition to holding up second best in terms of estimate cuts, the Tech sector is one of only two S&P 500 sectors that are expected to turn in earnings growth at all in 2020. Here's the projected earnings growth derby for the S&P 500 sectors in 2020: Utilities (1.7%), Information Technology (0.3), Health Care (-0.3), Consumer Staples (-2.4), Communications Services (-14.4), Materials (-20.7), S&P 500 (-22.8), Real Estate (-33.1), Financials (-37.1), Industrials (-48.9), Consumer Discretionary (-53.0), and Energy (-110.6) (*Table 2*).

While analysts see Tech sector earnings continuing to grow in 2021, other sectors are expected to post much stronger earnings growth next year, boosted by far easier comparisons to 2020's earnings. As you might expect, those sectors with stronger earnings growth in 2021 may see their stock prices benefit over the next few months as those improved earnings are factored in. Here's the ranking of the S&P 500 sectors' earnings growth forecasts in 2021: Consumer Discretionary (100.5%), Industrials (68.2), Financials (39.2), S&P 500 (29.4), Materials (28.2), Communications Services (22.3), Health Care (16.9), Information Technology (15.8), Real Estate (11.6), Consumer Staples (8.6), Utilities (5.9), and Energy (not meaningful due to a projected 2020 loss) (*Table 3*).

Strategy II: Betting on Reopening. Vegas is back, Baby. Well, almost back. Properties can operate at only half-capacity in accordance with the rules approved by the state Gaming Control Board. But according to reports, not even the threat of catching COVID-19 could keep diehard gamblers away from the Strip.

Here's a June 9 report from CNN: "The good news: Hotels and attractions were far busier than expected, prompting many local resort companies to accelerate plans to open more of their properties over the coming weeks. The bad news: According to field reports from casino floors and the busy sidewalks lining Las Vegas Boulevard, few visitors were wearing face coverings or practicing social distancing."

Roughly half of the tourists in pictures of the reopening weekend had masks on. That may bode ill for the future if COVID-19 returns. But until then, the party continues. Caesars Entertainment will reopen the casino floor and other amenities at the Linq on Friday following a "successful reopening" weekend at Caesar's Palace, the Flamingo, and Harrah's. At Caesar's Palace, more of the restaurants will reopen on Friday along with its venues for betting on races and sports and the Garden of the Gods Pool Oasis, a June 9 *Las Vegas Sun* article reported.

Meanwhile, MGM Resorts International—which opened the Bellagio, MGM Grand, New York-New York, and Signature properties last week—will reopen the Excalibur today. On July 25, it will resume operations at the Luxor and the Shoppes at Mandalay Bay Place, and on July 1, MGM will open the Aria, Mandalay Bay, and the Four Seasons Las Vegas.

Consumers appear to be very slowly returning to air travel, which will help the casinos' prospects. The daily number of travelers passing through TSA checkpoints has risen to 338,382 as of June 9, up from 87,534 on April 14 but still well off the 2 million-plus travelers a day seen in March (*Fig. 6*).

Casino operators' shares have rebounded with gamblers' return to Las Vegas. The S&P 500 Casino & Gaming stock price index is still down 26.8% ytd, but it's up 91.7% from the March 18 low (*Fig. 7*). This year's financial results have been decimated by COVID-19. Revenue is expected to fall 46.1%, and earnings are forecast to drop to a loss (*Fig. 8* and *Fig. 9*). Next year, revenue is expected to grow by 55.6%, and because the industry is expected to produce losses in 2020, its earnings growth and forward P/E can't be calculated.

Disruptive Technologies: EV Frenzy. We are as excited about the future of electric vehicles (EVs) as anyone. The new details about the million-mile battery that emerged this week were music to our ears. But investor enthusiasm about the prospect for EVs may be going into overdrive. Tesla's shares surged past $1,000 on Wednesday, making Tesla the world's most valuable auto manufacturer and bringing the shares' ytd gains up to 138.2% versus a 1.3% decline ytd for the S&P 500. The company is expected to earn $3.64 a share this year and $12.89 a share in 2021.

But at least Tesla is expected to be in the black. Nikola plans to manufacture trucks powered by hydrogen fuel cells or electric batteries; but as of today, the company has no revenue and expects to lose money through 2023. Nonetheless, it executed a reverse merger with a blankcheck company last week, and Nikola shares since have risen by more than 90%. Let's take a look at what the excitement is all about:

(1) *Million-mile battery.* Contemporary Amperex Technology Ltd.'s (CATL) Chairman Zeng Yuqun divulged more details about CATL's million-mile battery in a June 7 Bloomberg interview. The company today can produce a car battery that lasts 16 years and 1.24 million miles. It will cost about 10% more than existing EV batteries, which last an average of 150,000 miles.

A longer-lasting battery will reduce the cost of an EV because the battery is one of the most expensive elements of an electric car. A longer-lasting battery could be used in a second vehicle after the first vehicle's body wears out or it could be used to store energy in another application. CATL supplies Tesla with batteries for cars it produces in China, and it's building a factory in Germany to make batteries that will be used in BMW, Aud1i, and other cars.

(2) *Trucking along.* Tesla shares got a boost Wednesday after CEO Elon Musk wrote that it was time to bring the Tesla Semi to "volume production" in an email, a June 10 Reuters article reported. Tesla had unveiled the Semi in 2017, but the production start date had slipped to 2021, two years later than expected. "Tesla has secured thousands of orders for the new electric truck, which the company claims will have up to 500 miles of range and an industry-leading cost of operation of just $1.26 per mile," an April 29 article in Electrek reported.

(3) *Fuel cells anyone?* Not everyone is sure that batteries will be the technology to drive trucks. Nikola plans to manufacture trucks powered by hydrogen fuel cells, which will allow them to drive much farther and refuel much faster. Nikola, which boasts a $28.8 billion market capitalization, merged with VectoIQ Acquisition, a public special-purpose acquisition company set up to make acquisitions and headed by former GM Vice Chairman Steve Girsky. Girsky now sits on Nikola's board of directors.

Nikola's Chairman Trevor Milton took a page out of Elon Musk's marketing playbook this week by tweeting that Nikola would start taking reservations for its pickup truck, the Badger. The vehicle is expected to be able to run on fuel cell electric power or battery electric power, or a combination of the two. The company says the pickup can drive 300 miles using the battery or 600 miles using the blended fuel cell and electric battery. Nikola said Badger will be on display at Nikola World 2020, which is expected to be in September. The tweet's focus on Badger was unexpected because the company's May prospectus said Nikola "does not expect to develop production plans for the Badger unless we enter into a strategic partnership with an established OEM."

Nikola historically has played in the Class 8 truck market. It is expected to start producing a battery-operated truck, the Nikola Tre, in 2021. It envisions using the Tre in the short-haul trucking market, since it will have an estimated range of 250-300 miles.

The company also has the Nikola One and Nikola Two, which are also Class 8 trucks, but they run on hydrogen fuel cells and have a range of 400-700 miles. The fuel cells "convert hydrogen into electricity to power the electric motors which transmit power to the wheels. The fuel cell generates electricity through a chemical reaction, supplied from on-board tanks, and oxygen from the atmosphere. A much smaller battery (compared to our BEV) provides supplemental power to the drivetrain, and stores energy recovered during regenerative braking. The voltage and charge of the battery are maintained through a combination of power supplied from the fuel cell and energy captured through regenerative braking." Production is expected to start during Q1-2023.

In addition, the company is developing fueling and charging stations, with the goal of building with strategic partners 700 stations in North America and 70 in Europe. "Hydrogen will normally be produced on-site at each station via electrolysis. The electrolysis process occurs by passing electricity through water in an electrolyzer, thus breaking the water molecule into gaseous hydrogen and oxygen. Nikola's base station is expected to have a daily production capacity of 8,000 kg and will be capable of supporting approximately 210 (fuel cell electric vehicle) trucks per day." The first stations are expected to be rolled out in California in 2022-23.

Anheuser-Busch already has an order in to lease up to 800 Nikola Two FCEV trucks. Nikola's prospectus states that as of year-end it had reservations for 14,000 Nikola Two FCEV trucks. All of the reservations are subject to cancellation by the customer until the customer enters the lease agreement, but if the company does sell or lease all the trucks reserved, that would yield sales of $10 billion. The company estimates its $700 million of cash will last for the next 12-18 months, after which it will need additional funding to scale its manufacturing and build its refueling stations. Hopefully, the markets are as receptive then as they are today.

(4) *Don't count out Ford.* Not to be outdone, Ford COO Jim Farley told CNBC yesterday that it plans to have all-electric versions of the Ford F-150 pickup and Ford Transit van to market by

mid-2022. “We are No. 1 in the pickup and the van market in Western Europe and the U.S., and this is our chance,” Farley said. “We are electrifying and we’re a brand people trust.” The race is on.

CALENDARS

US: **Thurs:** Initial & Continuous Claims 1.55m/20.0m, Headline & Core CPI -1.2%/0.4% y/y, EIA Natural Gas Storage. **Fri:** Consumer Sentiment Total, Present Situation, and Expectations 75.0/85.0/70.0, Import Prices 0.6%, Baker-Hughes Rig Count. (DailyFX estimates)

Global: **Thurs:** Italy Industrial Production -24.0%m/m/-40.0%y/y, Japan Industrial Production -9.1m/m/-14.4%y/y. **Fri:** Eurozone Industrial Production -20.0%m/m/-29.5%y/y, UK GDP -18.4%m/m/-10.0%3m/3m/-22.6%y/y, UK NEISR GDP Tracker -15.7%, UK Headline & Manufacturing Industrial Production -19.3%/-19.9% y/y, UK Merchandise Trade -£ 11.6b. (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 ninth week and nearing 3.00. The BBR climbed for the 11th straight week, to a 16-week high of 2.76, after falling from 2.89 to 0.72 (the lowest since February 2016) the prior five weeks. Bullish sentiment climbed for the 10th time in 11 weeks, by 26.8ppts to 56.9% (the most since late January), 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 21.1ppts the past 11 weeks to 20.6% (the lowest since late February), after shooting up 22.8ppts (41.7 from 18.9) the previous five weeks. The correction count slipped for the third week to 22.5% after holding at 26.9% three weeks ago; it had advanced the prior two weeks from 24.3%. The AAII Ratio last week increased for the fourth week from 31.0% to 47.1% over the period. Bullish sentiment rose for the third week to 34.6% last week after falling from 30.6% to 23.3% the previous two weeks, while bearish sentiment dropped from 52.7% to 38.9% the past four 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 rose 0.6% w/w from its lowest level since June 2018 and is now

7.4% below its record high in mid-February. Forward earnings rose 2.1% w/w from its lowest level since August 2017 and is now 19.6% below its record high in early March. The forward revenue growth forecast rose 1.1pt to 1.7%, and forward earnings growth improved 4.1pts to 0.6%. Forward revenues growth is up from the lowest reading since June 2009 and 4.6ppts 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 16.3ppts 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 23.0% y/y in 2020 compared to a 1.4% rise in 2019. The 2020 growth rate fell 0.2ppt w/w and is down 32.0ppt since the beginning of the year. The forward profit margin edged up 0.1ppt to 10.4%. It had been steady for five straight weeks at 10.3%, which was the lowest level since August 2013. It's still down 2.0ppt 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 0.2pts to 21.9, 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 15-week high of 2.28 from 2.23. 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 all 11 sectors, and forward earnings was higher for ten of the 11 sectors. Real Estate was the only sector to have forward earnings decline w/w. Due to the sharp decrease in forward earnings this year, forward P/E ratios are now back above the recent record or cyclical highs prior to the bear market for nearly all sectors. However, forward P/S ratios remain below their highs for most sectors. 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. Seven of the 11 sectors had their forward profit margin tick higher in the latest week. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (21.8%, down from 23.0%), Real Estate (14.2, down from 17.0), Communication Services (13.4, down from 15.4), Utilities (13.9, steady at a record high), Financials (13.8, down from 19.2), S&P 500 (10.4, down from 12.4), Health Care (10.1, down from 11.2), Materials (9.0, down from 11.6), Industrials (7.6, down from its record high of 10.5% in mid-December), Consumer Staples (7.2, down from 7.7), Consumer Discretionary (4.9, down from 8.3), and Energy (0.9, down from 8.0).

US ECONOMIC INDICATORS

Consumer Price Index (*link*): The core CPI in May fell for the third month, as COVID-19 caused record declines in apparel and transportation services prices—pushing the yearly core rate down to more than a nine-year low. Core prices sank 0.6% during the three months through May, led by record declines in airfares (-29.5%) and apparel (-8.8) prices over the three-month period—with prices for motor vehicle insurance plunging 15.5% the past two months. The yearly core rate sank to 1.2% y/y (lowest since March 2011), slowing steadily from February's 2.4%—which matched its recent peak rate posted last August and September. Here's a ranking of the 12-month core rates on a May-over-May basis, from lowest to highest for goods: apparel (-7.9% y/y), used cars & trucks (-0.4), new vehicles (-0.3), medical care commodities (0.8), alcoholic beverages (2.2), and tobacco & smoking products (4.3). Of those, only the rate for alcoholic beverages is on an accelerating trend. Here's the same drill for the core services rates: airfares (-28.8% y/y), motor vehicle insurance (-14.3), physicians' services (1.8), owners' equivalent rent (3.1), motor vehicle maintenance & repair (3.7), rent of primary residence (3.5), and hospital services (4.9). Only the hospital and physicians' services rates are on accelerating trends, though the rate for the former eased slightly in May, while the latter's uptrend is modest. The headline CPI rate eased for the fifth month, from 2.5% at the start of the year to 0.1% y/y in May—the lowest since mid-2015.

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

Copyright (c) Yardeni Research, Inc. Please read complete copyright and hedge clause.