MORNING BRIEFING
June 16, 2020

Sensitive Prices

Check out the accompanying chart collection.

(1) Commodities showing less manic depression than stocks. (2) Less dramatic swings in commodity prices than in stock prices. (3) Commodity prices have actually held up surprisingly well under the circumstances. (4) Boom-Bust Barometer goes bust. (5) Copper didn't crash along with global auto production. (6) S&P 500 forward revenues is down, but not out. (7) Gasoline demand leading the rebound in petroleum usage, but inventories continue to build. (8) Lumber price prospects turning bullish. (9) Why isn't gold soaring even higher?

Commodities I: Industrials Bottoming. While stock prices have been remarkably volatile so far this year, commodity prices have been less so, with the obvious exception of West Texas Intermediate crude oil prices. While the stock market has been showing signs of extreme manic depression, the mood swings in the commodity markets have been less intense.

So it is hard to get a good read on the stock market's "message" about the economic outlook. Are stock investors mostly discounting a short, but deep recession followed by a V-shaped recovery? It seemed so until the sharp selloff since last Thursday. The S&P 500 plunged 33.9% from February 19 through March 23 (*Fig. 1*). It then soared 44.5% through June 8. Since then, it is down 5.1% through Monday's close.

The initial meltdown was triggered by the pandemic of fear caused by the viral pandemic. The subsequent meltup was attributable to the remarkably rapid and robust stimulus provided by fiscal and monetary policymakers along with expectations of the gradual reopening of the US economy as lockdown restrictions have been lifted. Now that reopening is happening, there's fear of suboptimal results: less social distancing triggering a second wave of the virus, followed by another round of lockdowns.

Given the emotionally-driven volatility in stocks, Debbie and I are looking for steadier guidance from the commodity markets. While commodity prices have mirrored the underlying movements in stock prices this year, they have done so with less volatility. This is especially true for the CRB raw industrials spot price index, which remains one of our favorite indicators of global economic activity. Let's have a closer look at it:

(1) *Down and up.* The CRB All Commodities Index includes a basket of 19 commodities, with 39% allocated to energy contracts, 41% to agriculture, 7% to precious metals and 13% to industrial metals (*Fig. 2*). We prefer to focus on the CRB raw industrials spot price index (CRB-IPI) separately from the other categories, which have their own unique supply and demand fundamentals in addition to the fundamentals they all share in varying degrees, i.e., their sensitivity to global economic activity.

The CRB-IPI, which includes 13 component prices, has been on a downtrend since June 12, 2018 (*Fig. 3*). It had a strong rebound during 2016 and 2017 as the global economy strengthened. It moved lower during 2018 and 2019 as a result of increasing trade tensions between the United States and China. Just as those tensions started to dissipate, the Great Virus Crisis (GVC) began at the start of this year. Governments around the world responded by mandating lockdowns, imposing social distancing to slow the spread of the virus. The result has been a depression-like plunge in the world's economy during the first half of this year. It is showing some signs of recovering already as governments have been gradually lifting those restrictions in recent months.

We can see these recent developments in the CRB-IPI. It peaked this year at 468.36 on January 17. It fell 13.0% to 407.63 through April 21. It is up 2.9% since then through June 12. Those are far less dramatic swings than the ones in the major stock market indexes so far this year.

Interestingly, the index hasn't fallen below its recent cyclical low of 371.17 on December 28, 2015. It remains 19.8% above its March 18, 2009 low of 305.59. Under the circumstances, it's been remarkably resilient. After all, the entire global economy has been depressed by the GVC.

(2) *From bust to upturn.* We can see the unprecedented magnitude of this depression in our Boom-Bust Barometer (BBB). It is simply the ratio of the CRB-IPI to US initial unemployment claims (*Fig. 4*). The four-week moving average of our BBB plunged 96.6% from its 2020 high of 221.77 during the week of February 15 to its record low of 7.43 during the week of April 18. It edged up to 21.7 through the week of June 6. Its freefall was attributable almost entirely to soaring US jobless claims. Nevertheless, its freefall coincided with the collapse in industrial

production indexes around the world. For example, from January through April, US manufacturing output plunged 18.5% (*Fig. 5*). Over this same period, Eurozone industrial production (excluding construction) dropped 27.0% (*Fig. 6*).

China's economy was the first to be hit by the GVC and the first to recover from it. China's output index plunged 13.5% y/y through February (*Fig. 7*). By May, it was up 4.4%. The relatively unsynchronized "virus cycle" might explain why industrial commodity prices didn't fall more steeply during the first half of this year. China's M-PMI dropped sharply during January and February, and started recovering in March (*Fig. 8*). The US and Eurozone M-PMIs troughed during April.

(3) *Professor Copper agrees.* The scrap price of copper, which is also known as the commodity with a PhD in economics, is one of the 13 components of the CRB-IPI. It is highly correlated with the overall index (*Fig. 9*). Its nearby futures price fell 26.4% from $2.88 per pound on January 14 to $2.12 on March 23. It is up 22.6% since then as of June 12.

It's remarkable that it didn't crash along with global automobile production, and that it has already recovered so much. In the US, auto assemblies collapsed from 10.8 million units (saar) during January to 0.2 million units during April (*Fig. 10*). Here are the percent declines in auto output indexes around the world from January through April: European Union (-79%), Germany (-83), France (-93), Spain (-92), Japan (-41), South Korea (-9), Mexico (-85), and Brazil (-92) (*Fig. 11*).

(4) *S&P 500 revenues take a relatively small hit.* S&P 500 revenues per share are usually, though not always correlated with the CRB-IPI (*Fig. 12*). That makes sense since both are driven by global economic activity. In addition, commodity producers are included in the S&P 500 and their revenues are obviously driven by commodity prices.

S&P 500 revenues fell 1.9% y/y during Q1 and undoubtedly fell at a faster pace during Q2. Nevertheless, once again, we are surprised that S&P 500 forward revenues per share isn't falling more steeply. This weekly series is a time-weighted average of analysts' consensus estimates for this year and next year (*Fig. 13*). It is a great coincident indicator of actual S&P 500 revenues per share. Since it is available weekly with a lag of about two weeks, it is actually a great leading indicator of the quarterly series which is usually available about nine or 10 weeks after the end of each quarter.

So far, the weekly series is down only 7.4% from its record high during the week of February 20 through the June 4 week. Given the lockdown/shutdown of so many businesses, this is a remarkably modest decline. For comparison, the weekly series fell 20.0% during the Great Recession of 2008-09. We are hard pressed to explain its recent performance. More understandable is that the weekly series may be starting to bottom as economies reopen in the US and abroad.

Commodities II: Oil Getting A Lift. As economies reopen for business, people are driving more, boosting the demand for gasoline and pushing up the price of gasoline. As a result, there has been a significant rebound in the price of oil in recent weeks. However, the glut of crude oil supply continues to pump up petroleum inventories. So the price rally may be running out of steam for now. This development is consistent with a Nike swoosh-shaped economic recovery rather than a V-shaped one. That's certainly better than an L-shaped non-recovery. Consider the following:

(1) *Demand.* A good proxy for petroleum products demand in the US is the four-week moving average of petroleum products supplied (*Fig. 14*). This series plunged 31% from 21.1mbd during the March 13 week to a low of 14.5mbd during the April 24 week. It rebounded to 16.2mbd during the May 22 week, but it's stalled around that level through the June 5 week.

Leading the way higher has been gasoline usage, which rose from 5.3mbd during the April 24 week to 7.4mbd during the June 5 week (*Fig. 15*). That's a good move in the right direction, but still well below the 9.5mbd pace at this time of the year over the past four years. Still hovering near their GVC lows are the demands for distillates and jet fuel. (See our *US Petroleum Products Supplied*.)

(2) *Inventories.* Notwithstanding the efforts of oil exporters to reduce their global supplies in response to the plunge in demand caused by the GVC, the US inventories of crude oil and petroleum products rose by 182,000 since mid-March to a record 1,440 million barrels during the June 5 week (*Fig. 16*).

(3) *Prices.* The glut of oil supplied and a shortage of storage facilities led to an unprecedented drop in the price of a barrel of West Texas Intermediate (WTI) crude oil into negative territory last month for a few days. Meanwhile, the nearby futures price of a barrel of Brent has rebounded from a recent low of $19.33 on April 21 to $38.73 on Monday. The price of WTI crude was back to $37.06 on Monday.

Commodities III: Lumber Is Limbering Up. While there's a glut of oil inventories, there's a shortage of inventories of existing homes for sale. That should be very good for homebuilders. Indeed, the S&P 500 Homebuilding Index has rebounded 80.0% since March 23 through Friday's close (*Fig. 17*). However, the nearby futures price of lumber is up only 11%. It should move higher as homebuilders respond to rising demand for new homes.

Commodities IV: Gold's Alter Ego. I've fielded lots of questions about the outlook for the price of gold in recent Zoom video meetings. A few accounts are wondering why it hasn't moved much higher in response to the implementation of Modern Monetary Theory by the Fed and the Treasury during the week of March 23. I typically pull out two charts in these discussions:

(1) *Gold vs TIPS*. There has been a very good inverse correlation between the gold price and the 10-Year TIPS yields since 2006 (*Fig. 18*). One possible explanation for this relationship is that the yield is a proxy for the inflation-adjusted cost of borrowing money to buy gold and store it. When the yield is falling (rising), the price of gold rises (falls).

The TIPS yield has fallen from a recent high of 1.17% on November 8, 2018 to -0.50% on Friday of last week. Over this same period, the price of an ounce of gold has increased 42%, in line with the TIPS yield.

We have yet to come up with a good way to model, let alone to explain the TIPS yield. It seems to us that it tends to weaken when the economy is getting weaker and to strengthen when the economy is getting stronger. If so, then it should move higher in coming months as the economy reopens and recovers. That could put a lid on the price of gold.

(2) *Gold vs CRB-IPI*. The price of gold seems to follow the underlying trend in the CRB raw industrials spot price index (*Fig. 19*). It's been doing so since 1981. However, the two have diverged significantly over the past year or so. We are expecting a modest rebound in the CRB-IPI in coming months as the economy recovers, not enough to be meaningfully bullish for gold.

CALENDARS

US: Tues: Retail Sales Total & Ex Autos 8.0%/5.1%, Headline & Manufacturing Industrial Production 3.0%/3.9%, Capacity Utilization 66.9%, Business Inventories -0.8%, NAHB Housing Market Index 45, API Crude Oil Inventories, Powell, Clarida. **Wed:** Housing Starts & Building Permits 1.093mu/1.225mu, MBA Mortgage Applications, EIA Crude Oil Inventories, Mester. (DailyFX estimates)

Global: Tues: Eurozone ZEW Economic Sentiment Index, Germany ZEW Economic Sentiment Index 60, Germany CPI -0.1%m/m/06%y/y, UK Employment Chance & Unemployment Rate -65k/4.5%. **Wed:** European Car Registrations, Eurozone Headline & Core CPI 0.1%/0.9% y/y, UK Headline & Core CPI 0.5%/1.3% y/y, Canada Headline & Core CPI 0.0%/1.4% y/y, Australia Employment Change & Unemployment Rate -125k/7.0%, Guindos, Mersch. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings (*link*): All three of these indexes had their forward earnings rise together for the first time in 19 weeks. LargeCap's forward earnings has risen for four straight weeks, MidCap's was up for a second week, and SmallCap's has risen in two of the past three weeks. LargeCap's forward earnings is now up 1.6% from its lowest level since August 2017; MidCap's has gained 2.5% from its lowest level since May 2015; and SmallCap's has risen 2.0% 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 20.0% below its record high at the end of January. MidCap's and SmallCap's are 31.9% and 44.6% 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 -18.5% y/y from -18.8%. That's up from mid-May's -21.2% which 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 -31.9% y/y from a record low of -32.7% two weeks earlier; that compares to a TCJA-boosted 24.1% in September 2018 (the highest since April 2011). SmallCap's improved w/w to -44.6% y/y from a record low of -41.5%; 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 13 weeks. Here are the latest consensus earnings growth rates for 2020 and 2021: LargeCap (-23.0%, 30.7%), MidCap (-36.2, 49.4), and SmallCap (-51.6, 77.7).

S&P 500/400/600 Valuation (*link*): Valuations dropped sharply last week after soaring to mostly record highs a week earlier. LargeCap's forward P/E fell 0.8pt w/w to 21.2 from 22.4. It had been at the highest level since May 2001 and is up from 13.3 in mid-March, which was the lowest since March 2013. MidCap was down 2.2pts w/w to 20.7 from a record high of 22.9, which dates back to 1999 when the SMidCap series began. SmallCap was down 2.9pts w/w to 23.9 from a record high of 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 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 dropped below LargeCap's P/E last week, where it has mostly been since August 2018. It was last solidly above LargeCap's from April 2009 to August 2017. SmallCap's P/E is still above LargeCap's though. 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.

US ECONOMIC INDICATORS

Regional M-PMI (*link*): The New York Fed—the first district to report on manufacturing activity for June—showed manufacturing activity in the region stopped declining, while expectations skyrocketed. June's composite index soared 78.0 points since hitting bottom in April—climbing from a record low of -78.2 in April to -48.5 in May and -0.2 this month. The shipments (to 3.3 from -68.1 in April) measure returned to positive territory this month, while the new orders (-0.6 from -66.3) gauge is fast approaching the breakeven point. Employment (to -3.5 from -55.3 in April) continued to decline this month, though at a considerably slower pace, with the average workweek (-12.0 from -61.6) following a similar pattern. Both delivery times and inventories held fairly steading, with the former rising to 1.3 from -4.1 in May and inventories to -0.6 from -3.4. Looking at pricing, input (to 16.9 from 4.1) price increases picked up in June while selling (-0.6 from -7.4) prices stabilized. Firms were substantially more optimistic than recently, with the index for future business condition soaring to 56.5—its highest in a decade—from 7.0 in April (which was the lowest since the great recession). New orders and shipments shot up 41.2 points and 40.0 points, respectively, over the two-month period, to 52.9 and 53.1. The future employment measure improved to 19.0 from 10.4 in May and 5.2 in April.

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