MORNING BRIEFING
July 14, 2020

Counting Chinese Yuan & US COVID-19 Cases

Check out the accompanying chart collection.

(1) Still in Rod Serling's *The Twilight Zone*. (2) The fifth dimension of the imagination. (3) A FANGMANT of our imagination. (4) From MAMU to MAMD, and back to MAMU again. (5) Joe Biden, soon to be the most progressive president since FDR? (6) A surreal future scenario: Fed pushes the federal funds rate below zero and buys stocks. (7) "Wizard of Oz" was Dorothy's *Twilight Zone* nightmare. (8) The Chinese government is inflating credit and stock prices. (9) Updates on challenged and challenging COVID-19 stats.

Strategy: Twilight Zone Scenario. *The Twilight Zone* television series, broadcast from 1959 to 1964, always started with Rod Serling's voice-over: "There is a fifth dimension, beyond that which is known to man. It is a dimension as vast as space and as timeless as infinity. It is the middle ground between light and shadow, between science and superstition, and it lies between the pit of man's fears and the summit of his knowledge. This is the dimension of imagination. It is an area which we call the 'Twilight Zone.'" I've previously observed: "That is a remarkably good description of the predicament that we humans are confronting during the current Great Virus Crisis (GVC)."

In this "dimension of the imagination," Joe and I can imagine lots of surreal scenarios. Submitted for your approval is one where the economy remains plagued by the virus, but the S&P 500 continues to melt up, and soon does so in record-high territory, on expectations that the Fed will continue to pump liquidity into the financial markets and a vaccine is on the way.

Leading the charge are the FANGMANT stocks (Facebook, Amazon, Netflix, Google, Microsoft, Apple, NVIDIA, and Tesla, which could soon be added to the S&P 500) that we discussed in yesterday's *Morning Briefing*, which are widely viewed as winners both during and after the GVC. They rise from 28.2% of the S&P 500 market's cap currently to 40% by the end of the summer (*Fig. 1* and *Fig. 2*). The collective forward P/E of this Magnificent Eight soars from 44.2 currently to over 60, which drives the S&P 500's forward P/E to 30 (*Fig. 3* and *Fig.*

4). (Of course, in the Twilight Zone, there is always the possibility that the FANGMANT stocks are a figment of our imagination.)

Then just in time for the September/October season, which has a history of occasional nasty meltdowns, the Mother of All Meltdowns (MAMD) occurs. The virus has a second wave that forces another round of business and school closings, aborting the economic recovery. Hopes for an imminent vaccine are frustrated. Joe Biden is expected to defeat Donald Trump during the upcoming presidential campaign, and does so though the election results are fiercely, albeit briefly, contested. In his acceptance speech, Biden confirms that he intends to move further to the left, as outlined in the recently released 110-page *Biden-Sanders Unity Task Force Recommendations*. By the way, immediately after it was released on July 8, Senator Bernie Sanders (D-VT) predicted that Biden could become the "most progressive president" since Franklin D. Roosevelt.

A week after the November 3 election, the S&P 500 plunges 30% as the Democrats sweep the White House, the House, and the Senate. But don't despair just yet. After all, the Fed is still in the Twilight Zone with us. Following an emergency meeting of the FOMC, Fed Chair Jerome Powell announces that the Fed will start buying equities. The Fed also lowers the federal funds rate slightly below zero. Stock prices soar again.

Or maybe this alternative scenario will happen: Like Dorothy in *The Wizard of Oz*, we all wake up from this bad dream. The election results in another two years of political gridlock, as the Republicans hold on to the Senate. A vaccine is discovered that helps to get us out of both the Twilight Zone and Oz. Until then, it would help a great deal if everyone wore masks.

China: Still on Monetary Steroids. China's experience with the GVC confirms that there is a way out of the Twilight Zone without a vaccine: strictly following widespread social distancing protocols, especially wearing masks, taking temperatures, and testing. The same can be said about the experiences of South Korea and Taiwan.

Meanwhile, the Chinese government continues to flood the Chinese economy with more and more credit during the GVC, as it has ever since the Great Financial Crisis (GFC). That's proven to be an effective treatment, so far, to overcome economic and financial ills. Consider the following:

(1) *Social financing.* Over the past 12 months through June, social financing totaled a record $4.5 trillion, led by a record $2.7 trillion in bank loans (*Fig. 5* and *Fig. 6*). Bank loans are up a whopping $18.9 trillion to a record $23.3 trillion from $4.4 trillion since the end of 2008, when the government started to respond to the GFC with massive credit expansion (*Fig. 7*).

(2) *Copper and stock prices.* The latest round of credit expansion is boosting China's economy, as evidenced by the dramatic 36% meltup in the price of copper since March 20 through Friday (*Fig. 8*). It also seems to have triggered a meltup in Chinese stock prices. The Chinese MSCI stock price index is up 41.2% since March 19 through July 10, while the Shanghai-Shenzhen 300 is up 32.4% over this same period.

Epidemiology I: Update on COVID-19 Data Challenges. In our July 1 *Morning Briefing*, we discussed the problems with the available COVID-19 data and our preference for data from *The Atlantic's* COVID Tracking Project (CTP). The problems persist, as hospitalizations and deaths continue to be undercounted, but some progress in improving the accuracy of the data has been made over the past two weeks. Here's an update:

(1) *Hospitalizations*. When we last wrote about COVID-19 data challenges, there was no series for the current number of COVID-19 patients hospitalized nationwide. Now there is a one that is nearly nationwide; it will cover 98% of the nation when Florida's current hospitalization become available soon, as a July 4, CTP blog post discussed.

However, the CTP wrote a follow-up July 8 blog post focused on data problems in Florida and indicated that the current hospitalizations series remained unavailable. For that reason, the hospitalization data discussed below are not comprehensive nationwide totals but remain the best data we have to see current hospitalization trends among the states reporting the data at this point. Florida's data are important not only because it is a populous state but also because it is one of the current epicenters of surging outbreaks.

(2) *Deaths*. Counting deaths has also been a challenge in Florida. The CTP noted: "When testing capacity is overwhelmed and it becomes harder to get lab confirmation for suspected cases of COVID-19, lab tests can no longer capture the full impact of an outbreak. In these circumstances, data on probable cases and deaths becomes crucial to understanding the full extent of the outbreak. Florida does not report probable cases or deaths."

More generally, deaths data may severely lag, not only because of how the virus works but also because there may be significant lags in reporting, as Bloomberg recently discussed. (Also see the "Approximate timeline for Covid-19 related deaths" at the top of the first CTP blog link.) The coding of cause of death on death certificates also happens to be quite subjective, according to our evaluation of the Centers for Disease Control's (CDC) website discussion on the completeness and accuracy of death certificates.

(See the CTP's separate blog post for more nationwide details on probable versus confirmed deaths.)

(3) *Alternative sources.* The White House chose the COVID Tracking Project as the best source to cite for daily US test numbers in its "Opening Up America Again" testing strategy. Johns Hopkins University & Medicine's (JH) Coronavirus Resource Center is frequently quoted in the media, especially for worldwide confirmed cases and deaths. But JH's website does not include hospitalizations, and it only recently began displaying the number of tests performed in the US. The CDC's COVID Data Tracker has improved since the pandemic began, but it doesn't seem to apply as consistent a methodology for data collection across series as the CTP does, and there are questions about its completeness and accuracy.

Epidemiology II: Update on COVID-19 National Trends. As we all know, the latest available national US COVID-19 trends are not heading in the right direction. Case counts have surged, and hospitalizations risen, albeit more slowly than cases. The question is whether these uptrends will show up in rising deaths in coming weeks. For now, let's have a look at what the available series are showing:

(1) *Cases*. The 10-day moving-average (ma) of new positive test results reached a record high of 53,179 as of the latest data, on July 10, which was well above the previous nationwide peak of 30,293 on April 17 (*Fig. 9*).

(2) *New tests*. Testing has also increased significantly. New tests rose to a record 653,103 on a 10-day ma basis through July 10. The positivity rate, which equals new positive tests as a percent of new tests, rose to 8.2% on July 10, the highest since May 14 (*Fig. 10*).

A June 25 CTP blog post reported that, at 500,000 tests per day, the US isn't testing anywhere near the 900,000 tests per day that the Harvard Global Health Institute estimated on May 9 it must do to get ahead of the virus; recommendations by other groups are even higher.

The July 9 *WSJ* reported that surging cases and growing demand for tests "are straining the ability of pharmacies and labs to deliver timely results to consumers, causing delays that hamper efforts to contain the spread of the virus."

(3) *Hospitalizations*. On the same 10-day ma basis, current hospitalizations climbed to 40,027 on July 10, after having steadily declined from the previous peak of 58,151 on April 24 to a recent low of 29,036 on June 23. The July 10 number is the highest since May 27, but it still doesn't include data from Florida, Hawaii, and Kansas. New hospitalizations also have increased since mid-June on a five-day ma basis (*Fig. 11*).

(4) *Deaths.* Deaths have trended down on a 10-day ma basis. However, the five-day ma has started to tick up again. Deaths are the ultimate lagging indicator, as we discussed above.

Epidemiology III: State of Hospitalizations. Since our previous update, the CDC's COVID Data Tracker has incorporated hospital impact data from its National Healthcare Safety Network (NHSN). The data come with lots of caveats (see note below) but represent a good step toward a comprehensive look at the impact of COVID-19 on hospitals. In addition to community spread, hospital capacity may be a critical decision factor for potential future community closures. (A hat tip to Goldman Sachs research cited in a July 11 Bloomberg article for pointing us to these newly available data.)

The CDC's NHSN enables hospitals to directly send data to the central repository including data on current inpatient and ICU bed occupancy, healthcare-worker staffing, and personal protective equipment supply status and availability. The CDC qualifies the data on its website with this caveat: "As more facilities submit data to NHSN, the data in the dashboard may change. Differences in how each facility implements this COVID-19 data collection, including variation in which staff collect the data on any given day, and changes in state and local reporting mandates, may affect the number and characteristics of healthcare facilities participating in NHSN's COVID-19 surveillance."

Not all hospitals participate yet. For example, in Texas, less than 50% of healthcare facilities are reporting, according to the website.

The CDC adds: "Estimates of hospital capacity measures are representative at the national and state levels. The estimates are based on data submitted by acute care hospitals to the

NHSN COVID-19 Module. The statistical methods used to make these estimates include weighting (to account for non-response) and multiple imputation (to account for missing data). The estimates (number and percentage) are shown along with 95% confidence intervals that reflect random error."

In any event, here's what the data show at this point:

(1) *Nationwide hospitalizations*. On April 1, about 10% of patients in an inpatient care location had suspected or confirmed COVID-19. That figure moved lower through June, but then crept back up slightly to 7% as of July 7 (*Fig. 12*).

(2) *State hospitalizations*. The picture is much different on a state level. For example: New York's percentage of COVID patients in hospitals peaked at around 45% and has steadily declined since, reaching just 4% on July 7. Arizona's increased from around 7% during mid-May to nearly 24% during early July. The percentages for both Florida and Texas rose from about 6% at the end of May to about 15% in early July.

(3) *Capacity*. Hospital capacity (or the percentage of inpatient beds occupied) for Arizona, Florida, and Texas are currently 79.1%, 74.8%, and 70.1% versus 69.2% for New York. Nationwide, hospitals are estimated to be 67.0% full.

Epidemiology IV: Jumping the Gun? Melissa and I are hoping that new treatments for the virus will reduce deaths over time even if cases continue to rise. Gilead Sciences' remdesivir is one of the drugs currently being used to treat COVID-19 on a widespread basis. However, it may have raised unrealistically optimistic expectations.

As *MarketWatch* explained on July 11, Gilead's encouraging news that remdesivir may reduce mortality risk by 62% caused Gilead's share price to pop on July 10. But curbing of investor enthusiasm might be in order. "The source for the analysis … is unorthodox," said the article. "It's not from a randomized, placebo-controlled clinical trial, which has long been considered the gold standard for medical research in the U.S. … [I]t compares clinical trial data to non-clinical trial data." Company management said that the findings need to be confirmed in a prospective clinical trial but didn't say whether it will be conducting one.

If confirmation isn't forthcoming, regulators may not continue to grant emergency-use access to the drug for COVID-19 patients. The Motley Fool explained that regulators are likely to have

other treatment options. For example, Regeneron "recently began phase 3 studies of REGN-COV2, a pair of antibodies that glom on to the surface of SARS-CoV-2 to prevent it from entering host cells." (Read more about Regeneron's progress in this July 9 *New York Times* article.) For now, supply of remdesivir is becoming an issue for hotspot regions, as CNN reported on Sunday.

In a wild trading session, the S&P 500 sold off late yesterday to close down 0.9%. It had been up as much as 1.6% on news that two experimental coronavirus vaccines jointly developed by German biotech firm BioNTech and Pfizer have received "fast track" designation from the Food and Drug Administration (FDA). The FDA grants fast-track status to speed up the review of new drugs and vaccines that show the potential to address unmet medical needs.

CALENDARS

US: Tues: NFIB Small Business Optimism Index, Headline & Core CPI 0.6%/1.1% y/y, API Crude Oil Inventories, Brainard. **Wed:** Headline & Manufacturing Industrial Production 4.3%/5.7%, Capacity Utilization Rate 67.4%, Empire State Manufacturing Index 7.85, Import PrIces 1.0%, EIA Crude Oil Inventories, Beige Book. (DailyFX estimates)

Global: Tues: Eurozone Industrial Production 13.4%m/m/-20.5%y/y, Eurozone ZEW Economic Confidence Index 60, Germany CPI 0.6%m/m/0.9%y/y, UK GDP -17.5% 3m/3m, UK Industrial Production 6.0%m/m/-21.0%y/y, Manufacturing Production 8.0%m/m/-24.0%y/y, BOJ Interest Rate Decision -0.1%, BOJ Quarterly Outlook Report. **Wed:** UK Headline & Core CPI 0.5%/1.2% y/y, China GDP 9.6%q/q/2.1%y/y, China Industrial Production 4.7% y/y, China Retail Sales 0.4% y/y, Australia Employment Change & Unemployment Rate 112.5k/7.4%, BOC Interest Rate Decision 0.25%, NBS Press Conference, Beermann, Tenreyro. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings (*link*): Forward earnings rose for all three of these indexes last week. LargeCap's forward earnings has risen for eight straight weeks, MidCap's is up in five of the past six weeks, and SmallCap's posted its fifth gain of the past seven weeks. LargeCap's forward earnings is now up 3.2% from its lowest level since August 2017; MidCap's has risen 7.2% from its lowest level since May 2015; and SmallCap's is up 5.2% from 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 18.7% below its record high at the end of January. MidCap's and SmallCap's are 28.8% and 42.4% below their October 2018 highs, with the former up from an 11-year low and the latter at a record low. 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 -17.3% y/y from -17.6%. 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. The yearly rate of change in MidCap's forward earnings rose w/w to -28.4% y/y from -29.0% y/y, and is up from a record low of -32.7% six weeks earlier; that compares to a TCJA-boosted 24.1% in September 2018 (the highest since April 2011). SmallCap's rate rose w/w to -38.9% y/y from -39.4% y/y and is up from a record low of -41.5% in early June. SmallCap's prior record low in its y/y percent change occurred 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 since early March, but have been relatively stable since late May as analysts await the Q2 earnings season. Here are the latest consensus earnings growth rates for 2020 and 2021: LargeCap (-23.4%, 30.9%), MidCap (-35.1, 49.2), and SmallCap (-52.7, 82.7).

S&P 500/400/600 Valuation (*link*): Valuations were mostly lower last week, and remain below their cyclical and record highs in early June. LargeCap's forward P/E rose 0.3pt w/w to 21.9 from 21.6. Its early June reading of 22.4 was the highest since May 2001 and up from 13.3 in mid-March, which was the lowest since March 2013. MidCap was down 0.2pts w/w to 20.0, which is down 2.9pts from its record high of 22.9, which dates back to 1999 when the SMidCap series began. SmallCap dropped 0.3pts w/w to 23.1, and is down 3.6pts from its 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 in mid-February, before COVID-19 decimated forward earnings, was18.9, 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 was below LargeCap's P/E again last week, where it mostly has 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 from May 2019 to May 2020 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 took a bigger haircut to their Q2 estimates last week amid a "withdrawn guidance" environment ahead. The Q2 S&P 500 EPS forecast dropped 40 cents w/w to $22.76, but the pace of decline in recent weeks is typical for this point in the quarter. That $23.16 estimate represents a decline of 44.9% y/y on a frozen actual basis and -44.0% y/y on a pro forma basis. That compares to a 12.8% 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 is 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 12.8% 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 S&P 500 sectors' latest Q2-2020 earnings growth rates versus their final Q1-2020 growth rates: Utilities (-4.8% in Q2-2020 versus 4.3% in Q1-2020), Information Technology (-8.0, 7.2), Real Estate (-15.1, -3.8), Consumer Staples (-16.8, 6.8), Health Care (-14.2, 6.5), Communication Services (-30.1, 2.1), Materials (-39.2, -12.3), Financials (-51.7, -37.8), Industrials (-89.1, -32.8), Consumer Discretionary (-116.2, -52.8), and Energy (-154.9, -30.1).

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