MORNING BRIEFING
July 15, 2020

Getting Technical

Check out the accompanying chart collection.

(1) Shockingly awesome Fed response to GVC. (2) Now all we need is a shockingly awesome vaccine. (3) Fed is fighting the virus. (4) No choice but to rebalance out of bonds into stocks. (5) Powell: Not even thinking about raising interest rates. (6) Not even thinking about high asset prices. (7) YRI's in-house COVID-19 experts are on the cases and vaccines. (8) Technology solved the food shortages Malthus predicted. Now if it could just stop the virus. (9) Operation Warp Speed is spending lots of money to stop the virus. (10) The stock market is showing both bad breadth and a golden cross.

Strategy I: Powell, Malthus & COVID-19. Before Joe and I review some of the recent technical developments in the stock market, let's start with some fundamentals behind the meltup since March 23. First and foremost, of course, is the Fed's shock-and-awe monetary policy response to the Great Virus Crisis (GVC). It was shockingly awesome! Potentially even more important, are developments in finding vaccines and/or cures for this curse. Consider the following:

(1) *The Fed is our friend.* Technicians like to say "Let the trend be your friend." Joe and I agree; but from a fundamental perspective, our mantra has long been "Don't fight the Fed." Indeed, that's the main theme of my recently published book, *Fed Watching for Fun & Profit*.

One of the five-star reviews by our good friend Vineer Bhansali (who frequently writes for *Forbes*) observed: "If Sherlock Holmes was deciphering the mysteries of what the Fed is doing and what it is going to do, he would probably consult Ed Yardeni. As advertised, this is a book for investors who want to objectively analyze what the Fed is likely to do, and as such different than all the other books on what the Fed has done wrong and what it should do; and as such sticks out as a unique and valuable addition to my top shelf of references. Case in point: Ed and his crystal ball (which he shares in this book) predicted in December 2018 that the next move from the Fed was going to be the great pivot to an ease, even as the dot plot and markets were braced for more tightening."

My book concludes with the events of 2019. I'm working on a follow-up tentatively titled *The Fed Fights the Virus*. Enough has happened since the start of this year to write a second volume rather than an update to the first book. For now, let's cut to the chase: By pushing the yield curve close to zero in response to the GVC, the Fed left investors no choice but to either earn close to nothing on their fixed-income securities or rebalance into stocks, which is what many have done since March 23.

Ever since then, Fed officials repeatedly have stated that they intend to keep interest rates close to zero for a very long time. As Fed Chair Jerome Powell famously said at his June 10 press conference: "We're not thinking about raising rates. We're not even thinking about thinking about raising rates." In a Freudian slip, Powell said that monetary policy is in "a good place," as "we're continuing asset prices in coming months … at a relatively high level." A footnote in the transcript stated: "Chair Powell intended to say 'asset purchases' rather than 'asset prices.'"

When asked whether he is concerned about high asset prices, he made it clear that the Fed's main concern is getting through the GVC by "pursuing maximum employment and stable prices." He added: "we're not focused on moving asset prices in a particular direction at all. It's just we want markets to be working, and I think, partly as a result of what we've done, they—they are working. And, you know, we hope that continues." He clearly rejected "the concept that we would hold back because we think asset prices are too high."

In new projections released after the June 10 meeting of the FOMC, all 17 participants said they expect to hold rates near zero next year, and 15 of them projected that rates would stay there through 2022. As Powell concluded, "We're not thinking about raising rates. We're not even thinking about thinking about raising rates."

Officials made one policy change at the meeting by announcing they would maintain their recent pace of purchases of Treasury and mortgage securities, effectively ending gradual, weekly reductions. They will buy at least $80 billion in Treasuries and $40 billion in mortgage securities, net of maturing bonds, a month (*Fig. 1* and *Fig. 2*). Over the past year through the week of July 8, the Fed has purchased $2.1 trillion in Treasuries, financing 66% of the federal budget deficit (*Fig. 3* and *Fig. 4*).

The Fed isn't even thinking about the possibility that asset prices are too high. Yes, indeed, the Fed is truly our friend for the foreseeable future.

(2) *The virus is our enemy.* The stock market has been accentuating the positive, as recommended in the 1944 song "Ac-Cent-Tchu-Ate The Positive." It has been doing so ever since the S&P 500 bottomed on March 23. Some of the biggest up days occurred on news of a possible vaccine. That helps to explain why the market hasn't accentuated the negatives on the health front since March 23. There certainly have been plenty of negatives in recent weeks, but the market has been singing "eliminate the negative, latch onto the affirmative." As Melissa and I discussed yesterday, the case count in the US is soaring. Overseas, troubling flare-ups are occurring in countries that had seemed to have defeated the virus. Yet, the stock market continues to soar.

We have developed a strong in-house team to keep track of the pandemic. Melissa is our epidemiologist, and Jackie is our virologist. Melissa reviewed the latest US case data yesterday. Tomorrow, Jackie will update us on developments on the vaccine front. Today, I would like to remind you about Thomas Malthus, who was the original "dismal scientist" and perma-bear.

Between 1798 and 1826, Malthus published six editions of his widely read treatise *An Essay on the Principle of Population*. He rejected the notions about mankind's future advancements that were popular at the time, believing instead that poverty cannot be eradicated but is a permanent fixture in the economic firmament. He explained this supposed principle by arguing that population growth generally expanded too fast in times and regions of plenty, until the size of the population relative to the primary resources, particularly food, caused distress. Famines and diseases were nature's way of keeping population growth from outpacing the food supply.

Malthus was the original Malthusian, and his pessimistic outlook was probably the most spectacularly wrong economic forecast of all times and a classic for contrarian thinkers. Grain production soared during the 1800s thanks to new technologies, more acreage, and rising yields. During the first half of the century, chemical fertilizers revived the fertility of European soil, and the milling process was automated using steam engines. During the second half of the century, vast new farmlands were opened in the US under the Homestead Act of 1862, and agriculture's productivity soared with the proliferation of mechanical sowers, reapers, and threshers. Tremendous progress in agriculture continued during the 20th century, particularly during the Green Revolution of the 1950s and 1960s.

What does this have to do with COVID-19? Technology solves problems. It solved the Malthusian problem of food shortages. One of the greatest success stories in the history of technological innovation has been in agriculture. Malthus never saw it coming. Similarly, today's doomsters could be confounded by biotechnological innovations that deliver not only a vaccine for COVID-19 but for all coronaviruses. In the March 5 *Morning Briefing*, we discussed technology using messenger RNA (mRNA) to instruct our cells to make proteins that produce antibodies that provide immunity to viruses.

Here is an excerpt from a July 14 Verdict article on a possible revolution in rapidly testing for viruses: "CRISPR is a well-known biotechnological tool for gene editing due to its programmable ability to detect specific sequences of DNA within a gene of interest and subsequently 'snipping' it, using an enzyme effectively functioning as molecular scissors. By removing the latter enzyme, however, CRISPR can operate as a diagnostic tool for detecting specific sequences of DNA such as those that uniquely exist in the SARS-CoV-2 virus. Two startup companies have capitalised on this capability by developing their own CRISPR-based POC tests, specifically for rapid Covid-19 diagnosis."

The public and private sectors are spending billions of dollars to develop a vaccine. That's happening around the world. Companies with potential solutions are raising lots of money to accelerate their research and development on a vaccine. Introduced in April, Operation Warp Speed is a public–private partnership, initiated by the Trump administration, to facilitate and accelerate the development, manufacturing, and distribution of COVID-19 vaccines, therapeutics, and diagnostics. It is an interagency program that includes components of the Department of Health and Human Services, including the Centers for Disease Control and Prevention (CDC), Food and Drug Administration (FDA), the National Institutes of Health, and the Biomedical Advanced Research and Development Authority (BARDA); the Department of Defense; private firms; and other federal agencies, including the Department of Agriculture, the Department of Energy, and the Department of Veterans Affairs. The project has a budget of at least $10 billion.

Strategy II: Bad Breadth. Joe has been doing lots of great work on the breadth of the stock market rally since March 23. It is widely believed that broadly based stock market rallies are more sustainable than narrowly based ones. We agree with that assessment. The narrowness of the rally since March 23 is worrisome.

There are numerous ways to gauge the breadth of bull markets. These days, one of the most popular ones is to follow the market-cap share of the five biggest corporations in the S&P 500. There are other measures. Consider the following:

(1) *Magnificent Five suggests correction likelier than bear market.* Joe compiled a weekly series, starting in 1994, that tracks the market-cap share of the five biggest corporations in the S&P 500, i.e., the Magnificent Five (*Fig. 5*). Sure enough, this series tends to peak at the start of corrections and bear markets (*Fig. 6*).

Here are the cyclical peaks in the Magnificent Five's market-cap shares during the weeks of August 8, 1997 (12.4%), March 24, 2000 (18.5), November 21, 2008 (16.0), September 28, 2012 (13.9), and August 31, 2018 (17.5). During the July 10 week, this series rose to a record 25.2%. That strongly suggests that either a correction or a bear market is a high risk currently. A correction is more likely than a bear market, in our opinion. That's because bear markets tend to be triggered by credit crunches that cause recessions.

A credit crunch was certainly underway during late February through March 23. But on that fateful day, the Fed tossed away its bazookas, kept its helicopters grounded, and instead started to carpet-bomb the financial markets with B-52 bombers loaded with trillions of dollars of cash. That was the day the Fed announced QE4ever purchases of Treasuries and mortgage-backed securities and expanded its liquidity facilities to backstop numerous other areas of the capital markets in a No-Assets-Left-Behind campaign to stop the credit crunch.

The S&P 500 VIX spikes during credit crunches and recessions (*Fig. 7*). It did so again recently, jumping to a record 82.7 on March 17. But the Fed's massive liquidity programs since March 23 brought it back down sharply to 32.2 on Monday.

(2) *FANGMANT, with and without the "T."* We recently expanded the Magnificent Five (a.k.a. the FAANG stocks) to what we call the Magnificent Eight. These FANGMANT stocks are Facebook, Amazon, Netflix, Google, Microsoft, Apple, NVIDIA, and Tesla, which could soon be added to the S&P 500. Yesterday, we showed that the market-cap share of the broader group rose to a record 28.2% of the S&P 500's market-cap share during the July 10 week (*Fig. 8*). That's up from 17.2% at the end of 2018 and 9.4% at the end of 2013. Take out Tesla, which isn't actually in the S&P 500 (yet), and the market-cap share of Magnificent Seven is currently a record 27.1%.

(3) *Market-cap ratios.* There are other measures of breadth. The one that tracks the ratio of the S&P 500 market-cap-weighted stock price index and the comparable equal-weighted index is heavily influenced by the FANGMANT (*Fig. 9*). So is the ratio of the S&P 100 to the 500 (*Fig. 10*). Interestingly, while both have been moving higher since late 2018, they are still well below their peaks of 1999-2000, when a few large-cap technology stocks also had a great deal of market-cap share.

(4) *Mixed message.* On the other hand, the narrowness of the breadth of the current rally in the S&P 500 is confirmed by the percentage of its companies trading above their 200-day moving averages. Only 39.0% of them did so during the July 10 week (*Fig. 11*). Furthermore, only 38.4% of them are up on a y/y basis (*Fig. 12*). We're not sure those are actually bearish readings, since it is readings well above 50% that tend to have the most downside potential for both measures.

Strategy III: Golden Cross. There's a big difference between shamrocks and four-leaf clovers. The former are young sprigs of clover with three leaves. They have been a symbol of Ireland for centuries. The latter are four-leaf clovers and are widely associated with good luck because they are so hard to find. And while four-leaf clovers are in your box of Lucky Charms cereal, they're not at the heart of Irish culture.

Among the luckiest patterns discerned by technical analysts in their charts is the so-called golden cross. They're seeing one in the S&P 500 as its 50-day moving average crossed above its 200-dma on Friday (*Fig. 13* and *Fig. 14*). Just by coincidence, we found an article by Proinsias O'Mahony in yesterday's *The Irish Times* titled "Stocktake: A golden cross for stocks." Mr. O'Mahony observed that "the golden cross has a strong record in recent decades, with intermediate-term returns tending to be better than normal."

On the other hand, he reports: "Sceptics might note data doesn't support fears regarding the death cross, this indicator's bearish equivalent. Indeed, the S&P 500 soared after March 30th's death cross, so it's clear these are imperfect signals." In other words, bet on golden crosses and ignore death crosses.

The market is showing both bad breadth and a golden cross. In addition, on Monday, the Nasdaq had a bearish "outside day reversal," a leading indicator for a potential downward trend change or at least a near-term top. In any case, both the S&P 500 and Nasdaq had a good day yesterday. These certainly are confusing times on a fundamental basis; no wonder the technical indicators are also confusing.

CALENDARS

US: **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. **Thurs:** Retail Sales Total & Ex Autos 5.0%/5.0%, Initial & Continuous Jobless Claims 1,250k,/17,600k, Business Inventories -2.3%, Philadelphia Fed Manufacturing Index 20.0, NAHB Housing Market Index 60.0, EIA Natural Gas Inventories, Williams, Evans. (DailyFX estimates)

Global: **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. **Thurs:** European Car Registrations, UK Employment Change & Unemployment Rate -234k/4.2%, UK Gfk Consumer Confidence Flash Estimate -26, ECB Rate Decision & Deposit Facility Rate 0.0%/-0.5%, ECB Press Conference, Bailey. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Growth vs Value (*link*): The S&P 500 Growth price index leads ytd through Monday's close with a gain of 10.2% versus a 16.4% decline for Value. Since their lows for the year on 3/23, Growth's 48.0% gain is well ahead of the 31.8% rise for Value. Growth is just 1.6% below its 7/10 record high, and Value is back in a correction again at 11.3% below its 1/17 record high. Looking at the fundamentals, Growth is expected to deliver higher revenue growth (STRG) and earnings growth (STEG) than Value over the next 12 months. Specifically, 6.6% STRG and 10.5% STEG are projected for Growth, respectively, versus 1.2% and 0.8% for Value. Through Monday's close, Growth's P/E of 27.4 was down from 27.8 on Friday. Friday's reading was the highest since June 2001 and compares to an 18-year high of 24.2 on 2/19 and a 15-month low of 16.8 on 3/23. Value's forward P/E of 16.6 is down from 18.6 on June 8, which was then the highest since July 1999 and up from 10.0 on 3/23, which was its lowest reading since November 2011. Regarding NERI, Growth's was negative in June for an 11th straight month but improved to -27.9% from an 11-year low of -35.0% in May. That compares to a record high of 22.3% in March 2018. Value's NERI was negative in June for a 20th month, and up to -32.5% from an 11-year low of -39.0% in May; that compares to a record high of 21.2% in March 2018. The Tax Cuts and Jobs Act (TCJA) sharply boosted the consensus forward earnings estimates and the forward profit margin for both Growth and Value in 2018. Growth's forward profit margin improved from a low of 14.9% during May to 15.1% on 7/2. It remains above the 14.4% prior to the TCJA's passage but is down from its record high of 16.7% during September 2018. Value's forward profit margin of 8.2% is up from a low of 8.0% during May but is well below the 9.1% prior to the TCJA and down from a record high of 10.5% in December 2018.

US ECONOMIC INDICATORS

NFIB Small Business Optimism Index (*link*): Optimism continued to recover in June after plunging in March and April. "Small businesses are navigating the various federal and state policies in order to reopen their business and they are doing their best to adjust their business decisions accordingly," said Bill Dunkelberg NFIB chief economist. "We're starting to see positive signs of increased consumer spending, but there is still much work to be done to get back to pre-crisis levels." The Small Business Optimism Index (SBOI) climbed 4.7 points last month and 7.3 points during the two months through June to 101.1—after sliding 12.9 points during the two months through April to 93.8. In June, eight of the 10 index components contributed positively to the SBOI, while two contributed negatively, the same mix as May. Sales expectations once again led gainers, soaring 37ppts in June to 13%, and a whopping 55.0ppts from April's record low of -42%. The percentage of respondents expecting business to improve was the component with the longest string of gains, at three months, soaring 34ppts over the period—from 5% in March to 39% by June. There were a number of components recording back-to-back gains over the two months through June: hirings (+15ppts to 16%), plans to increase inventories (+11.0 to 7.0), good time to expand (+10 to 13.0), and current inventory (8.0 to 1.0). The weakest component was earnings trends, which has tumbled 32ppts the past five months to -35%.

Consumer Price Index (*link*): The core CPI in June rose for the first time in four months, after COVID-19 caused record declines in apparel and transportation services prices during the three months ending May. Core prices ticked up 0.2% last month after falling 0.6% during the three months through May—which pushed May's yearly rate down to a nine-year low of 1.2%, where it remained in June. It slowed steadily from February's 2.4% rate—which matched its recent peak rate posted last August and September. Here's a ranking of the 12-month core rates on a June-over-June basis, from lowest to highest, for goods: apparel (-7.3% y/y), used cars & trucks (-2.8), new vehicles (-0.2), medical care commodities (1.3), alcoholic beverages

(2.2), and tobacco & smoking products (5.1). Of those, only the rate for alcoholic beverages is on an accelerating trend. Here's the same drill for the core services rates: airfares (-27.2% y/y), motor vehicle insurance (-10.1), physicians' services (2.1), owners' equivalent rent (2.8), rent of primary residence (3.2), motor vehicle maintenance & repair (3.4), and hospital services (5.3). Only the hospital and physicians' services rates are on accelerating trends, while the shelter components are on a steep decelerating trends. The headline CPI rate edged up to 0.6% y/y after easing steadily 2.5% at the start of the year to 0.1% y/y in May—the lowest since mid-2015.

GLOBAL ECONOMIC INDICATORS

Eurozone Industrial Production (*link*): May production got a boost from the reopening following the lockdown, though not as big a boost as forecast. Output rebounded 12.4% (vs 15.0% expected) in May after the coronavirus-shutdown generated the biggest output declines in the history of the series going back to 1991 in April (-18.2%) and March (-11.8). May production bounced off April's record low, though remains a considerable 18.9% below its pre-crisis level. May's rebound was across the board. Here's a look at how the main industrial groups fared in May, and where they stand in relation to February levels: consumer durable goods (+54.2% & -24.6%), capital goods (+25.4 & -24.0), intermediate goods (+10.0 & -19.5), consumer nondurable goods (+2.8 & -12.8), and energy (+2.3 & -6.3). Here's the same exercise for the top four Eurozone economies: Italy (+42.1% & -19.2%), France (+20.0 & -21.4), Spain (+15.1 & -23,1), and Germany (+9.7 & -21.9). According to June's IHS Markit M-PMI, the Eurozone manufacturing sector moved toward stabilization as the M-PMI climbed to a four-month high of 47.4, up from 39.4 in May.

UK GDP (*link*): The expansion in real GDP was well short of expectations in May, leaving the economy a quarter smaller than before the crisis struck. Real GDP rose only 1.8% in May (vs 5.5% expected) after posting back-to-back record losses of 6.9% and 20.3%, respectively, in March and April. On a rolling three-month basis, GDP contracted a record 19.1% in May, "as government restrictions on movement dramatically reduced economic activity," ONS noted. Both the manufacturing (+8.4% from -24.4%) and construction (+8.2 from -40.2) sectors posted record gains in May after record losses in April, while the service sector—which accounts for 80% of real GDP—managed only a 0.9% uptick in May, after tumbling a record 18.9% in April. On a rolling three-month average basis, all three sectors posted record declines in May: construction (-29.8%), services (-18.9), manufacturing (-18.0).

UK Industrial Production (*link*): Output recovered only 6.0% in May (though it is a record gain) after COVID-19 precipitated the biggest monthly decline in industrial production on record in April. Output tumbled a historic 20.2% in April, following a 4.3% drop in March. Factory production rebounded an unprecedented 8.4% in May after plummeting 24.4% and 5.2%, respectively, in April and March. The main industrial groupings show production of intermediate (+12.4 in May % & -30.2% during the two months through April), capital (+10.9 & -39.1), and consumer durable (+9.8 & -27.2) goods posted record increases in May after record declines during the two months ending April. Meanwhile, output of consumer nondurable (+2.6 & -9.8) goods posted only a modest bounce in May. The UK's M-PMI (to 50.1 in June from 40.7) showed the manufacturing sector stabilized in June, following the recent steep downturn caused by COVID-19. Output edged back into growth territory as "factories restarted, lockdown restrictions were loosened and staff returned to work," according to the IHS Markit report.

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

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