



MORNING BRIEFING

July 29, 2020

V-Shaped Indicators

Check out the accompanying [chart collection](#).

(1) A two-month recession? (2) Millions remain unemployed. (3) Flash estimates and regional business surveys point to strong July PMIs. (4) Orders indicators rebounded in May, June, and July. (5) Economic surprise index remains elevated. (6) Dow Theory is bullish. (7) ATA Truck Tonnage Index shows more truckers on the road again. (8) Gasoline stalls in latest week. (9) Railcar loads bottoming, maybe. (10) Forward earnings bottoming for sure. (11) Debating unemployment insurance schemes. (12) Test marketing a Universal Basic Income?

US Economy I: Like a Natural Disaster. The latest available data confirm that the US economy started to recover during May and continued to do so through July from its freefall during March and April. It's hard to call that a recession since it lasted only two months. On the other hand, millions of people remain unemployed and thousands of businesses are struggling. So far, the impact of the Great Virus Crisis (GVC) on the economy has been more like a natural disaster than a man-made recession. Then again, the virus is still out there, and the recovery could slow or even stall in coming months. For now, the latest batch of economic indicators are consistent with a V-shaped recovery. Consider the following:

(1) *Purchasing managers.* Markit's flash estimate for the US M-PMI has rebounded from a low of 36.1 during April to 51.3 during July ([Fig. 1](#)). The comparable NM-PMI is up from an abysmal reading of 26.7 during April to 49.6 during July. The services-providing side of the economy was hit harder by the GVC than the goods-producing side. Nevertheless, both of their recoveries have been impressive so far. The Markit data augur well for July's PMIs, which will be reported by the Institute for Supply Management (ISM) in early August.

(2) *Regional business surveys.* The average of the five regional composite business indicators (compiled by the Federal Reserve Banks of Dallas, Kansas City, New York, Philadelphia, and Richmond) rose from a low of -58.6 during April to 10.3 during July ([Fig. 2](#)). This too augurs well for the ISM's July PMI reports too.

The average of the regional orders indexes is up from a low of -66.4 during April to 12.4 in July, the highest since November 2018 ([Fig. 3](#)). The comparable average employment index is up from -36.0 to 4.7 over the same period.

(3) *Durable goods orders*. Durable goods orders plunged 32.0% during the two months through April to the lowest reading since the end of 2009 ([Fig. 4](#)). Much of that weakness was in orders for motor vehicles and aircraft. Excluding transportation, durable orders fell 10.0% over this period to the lowest since October 2016. The total has rebounded 23.5% since the low through June, and 7.0% excluding transportation. Nondefense capital goods fell 7.8% during the two months ending April and are up 5.0% since then.

(4) *Economic Surprise Index*. The Citigroup Economic Surprise Index plunged from 73.8 on March 13 to a record low of -144.6 on April 30 ([Fig. 5](#)). Since then, it has rocketed to a record high of 270.8 on July 16. It edged down to 238.5 on Monday, which remains a surprisingly high reading.

US Economy II: Transports on Recovery Road. The S&P 500 stock price index fell 33.9% from February 19 through March 23. Over that same period, the S&P 500 Transportation stock price index plunged 37.3% ([Fig. 6](#)). Since March 23 through Monday's close, the former is up 44.8%, while the latter is up 43.9%. This relationship is mirrored in the Dow Jones Industrials Average and the Dow Jones Transportation Average ([Fig. 7](#)). In other words, Dow Theory is currently bullish since both indexes have rebounded together.

Also rebounding are some economic indicators of transportation activity:

(1) *Trucking*. For example, the ATA Truck Tonnage Index fell 11.2% from a record high of 119.5 during March to 106.1 through May ([Fig. 8](#)). That was the lowest reading since July 2017. It rebounded to 115.3 during June. So the index represents another V-shaped economic indicator at this point; its recovery could stall, of course.

(2) *Gasoline*. Interestingly, the weekly gasoline usage series that Debbie and I track rebounded smartly from a low of 5.3mbd during the April 24 week to 8.6mbd during the April 10 week ([Fig. 9](#)). However, it stalled there during the April 17 week.

(3) *Railroads*. What about railcar loadings? We track the 26-week average of the data to smooth out the volatility in the series for railcar loadings ([Fig. 10](#)). The total has dropped 11.9%

since the start of this year through the week of July 18. It might be starting to bottom now, maybe. It is the lowest since August 2009 but has been brought down that low by plunging railcar loadings of coal ([Fig. 11](#)). Excluding coal, railcar loadings are down 9.1% so far this year to the lowest since June 2012. Intermodal railcar loadings are down 8.5% so far this year and may also be bottoming.

Strategy: Bottoming Forward Earnings. While there's no sign yet of a V-shaped recovery in corporate earnings, there are plenty of signs that earnings have bottomed. Let's review the latest data for the S&P 500 operating earnings per share:

(1) *Quarterly.* Analysts' consensus expected earnings per share for Q2-Q4 plunged sharply after the World Health Organization (WHO) declared on March 11 that COVID-19 had turned into a pandemic ([Fig. 12](#)). However, the estimates for Q2 (recently blended with reported earnings) along with those for Q3 and Q4 started to level out in recent weeks.

(2) *Annually.* The consensus earnings-per-share estimates for 2020, 2021, and 2022 all have dropped sharply after the WHO's declaration, but also have started to level out in recent weeks ([Fig. 13](#)). The latest readings, for the week of July 23, show \$124.79 for this year, \$163.61 for next year, and \$186.12 for 2022. Our targets are still \$120, \$150, and \$175.

(3) *Forward.* S&P 500 forward earnings per share, the time-weighted average of consensus estimates for this year and next year, rose to \$147.01 during the July 24 week ([Fig. 14](#)). It bottomed at \$141.00 during the May 15 week and has been up every week since then.

US Fiscal Policy: A Precedent for a Universal Basic Income? Congressional leaders are debating whether the \$600 per week in Federal Pandemic Unemployment Compensation may be extended beyond its July 31 expiration date. It was included in the Coronavirus Aid, Relief, and Economic Security (CARES) Act with the aim of fully replacing lost income during the pandemic when combined with traditional state unemployment insurance (UI). The CARES Act also expanded unemployment benefits to certain individuals who would not typically receive state aid.

Democrats are fighting for the full amount of the fixed benefit to be extended. They argue that a new program suggested by Republicans is not enough aid and is too complicated to implement in a timely manner. Republicans have argued for a new program supplementing the benefits of those on pandemic aid such that they'd receive around 70% of their prior income for

a period, capped at \$500 per week. But the new supplemental payment would start at \$200 until the more complex program could be implemented, which could take several months for some states. That's all according to a July 27 *Washington Post* [article](#) on the subject.

Both sides of the aisle have valid concerns. Lots of workers have lost their jobs, businesses, and childcare options due to the pandemic. Unemployed workers have lost not only income but also health insurance and other benefits. Without the aid, not only would unemployed workers suffer but so would the broader economy, owing to lower consumer spending.

But there is a good chance that some workers either have turned down available work or refrained from looking for work because they stand to receive *more* from UI than they would in the workforce and in some cases even more than they had earned before the pandemic hit. Some recent research suggests that taking advantage of the benefit program in these ways isn't widespread, though the opportunity to do so exists. Here is a quick summary of some recent research on the matter:

(1) *Earning more than before.* As intended, the average replacement rate under CARES is roughly 100%, according to a [working paper](#) from the National Bureau of Economic Researchers (NBER). However, the distribution of aid relative to lost income is uneven among the population receiving the benefits.

Unemployed workers are receiving an income expansion, replacing lost income by a median of 134% with the program benefits. Two-thirds of eligible workers can receive benefits exceeding lost earnings, and one-fifth can receive benefits at least double lost earnings. Low-income workers have received the brunt of the lost income, which is why the math for the \$600 per week comes out to such a generous replacement rate.

The NBER researchers identified significant variation in the effects of the CARES Act across occupations, which may promote unfair distribution of income for “essential” and “nonessential” workers: While laid-off workers receiving UI benefits have been reimbursed for lost earnings and then some, essentially receiving a “bonus,” their still-working “essential” counterparts have been putting themselves and households at risk while receiving the same amount of income as before the pandemic.

(2) *Disincentive is there.* That unfairness aside, however, a recent Yale study [found](#) that the supplemental federal aid did not reduce return to employment. There was not much disparity in

return to employment by early May between workers whose UI benefits were relatively generous relative to what they had earned in the labor market and those whose benefits were not. Those in the former category returned to work at a slightly faster pace than those in the latter.

Possible reasons for this: Under the CARES Act, people who quit their job for no other reason than concern about contracting COVID-19 are not eligible for UI. Further, once an individual receives a “suitable offer of employment,” they no longer qualify for UI even if they reject the offer. However, the researchers admit that it is plausible that “employers and workers could cooperate to lay off workers who would receive higher incomes from UI benefits than from earned wages.”

(3) *Solution is a rate.* But the incentive to remain unemployed could be removed while still supporting the legitimately unemployed. Even if the fixed payment were halved (i.e., to \$300), 42% of unemployed workers would see benefits representing income-replacement rates above 100%, estimate the NBER researchers, and a quarter of them would receive benefits representing replacement rates below 60%, they say. To solve for the distributional disparity with a fixed amount of aid, the researchers suggest implementing a supplemental replacement rate to better target lost income.

(4) *Universal Basic Income.* As a result of the GVC, our nation may have just taken one small step toward providing a Universal Basic Income. In addition to the federal UI supplement, the CARES Act provided for stimulus checks. The next stimulus package may include another round of them. These developments are setting precedents for a Universal Basic Income. As Obama administration Chief of Staff Rahm Emanuel famously said in 2008 and reiterated in a March 25 *Washington Post* [op-ed](#): “Washington needs to make sure this crisis doesn’t go to waste.”

CALENDARS

US: Wed: Merchandise Trade Deficit Advance Estimate -\$74.3b, Pending Home Sales 15.3%, MBA Mortgage Applications, EIA Crude Oil Inventories, Fed Interest Rate Decision 0.13% (0.00% to 0.25%). **Thurs:** Real GDP -34.1%, GDP & PCE Core Price Indexes 1.1%/1.0%, Initial & Continuous Jobless Claims 1.45m/16.2m, EIA Natural Gas Inventories. (DailyFX estimates)

Global: **Wed:** France Consumer Confidence, ECB Non-Monetary Policy Meeting. **Thurs:** Eurozone Economic Sentiment 81, Eurozone Unemployment Rate 7.7%, Germany GDP -9.0%q/q/-11.3y/y, Germany Unemployment Change & Unemployment Rate 43k/6.5%, Germany CPI -0.2%m/m/-.2%y/y, Italy Unemployment Rate 8.6%, Japan Unemployment Rate 3.1%, Japan Industrial Production 1.2%, China NBS M-PMI 50.7, ECB Economic Bulletin. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Q2 Earnings Season Monitor ([link](#)): With about one-third of S&P 500 companies finished reporting revenues and earnings for Q2-2020, revenues are beating the consensus forecast by a whopping 3.0%, and earnings have crushed estimates by 13.5%. The large upside surprises are primarily due to a lack of financial guidance from the companies that analysts follow, which mirrors the experience of the Q2-2009 earnings season on the heels of the Great Financial Crisis. At the same point during the Q1 season, revenues were 0.9% above forecast, but earnings missed by 1.7%. For the 163 companies that have reported through mid-day Tuesday, aggregate y/y revenue and earnings growth are below the similar Q1 measures, but the percentages of companies reporting positive revenue and earnings surprises actually improved. The Q2 reporters so far have a y/y revenue decline of 7.2%, and earnings are down 38.6% in the worst quarter since Q1-2009. The percentage of companies reporting a positive revenue surprise (71) is well below those reporting a positive earnings surprise (79). However, more companies are reporting positive y/y revenue growth in Q2 (36) than are reporting positive y/y earnings growth (28). That's the lowest rate for earnings growth since Q2-2009. These figures will change markedly as more Q2-2020 results are reported in the coming weeks, but the y/y revenue and earnings growth results are expected to remain dismal. Now more than ever, what companies say about the state of their business and their plans to ride out the COVID-19 crisis will be investors' main focus. However, many companies still are not providing guidance about their future financial periods.

US ECONOMIC INDICATORS

Consumer Confidence ([link](#)): Confidence declined in July as a resurgence in COVID-19 in Michigan, Florida, Texas, and California caused consumer expectations to retreat. The Consumer Confidence Index (CCI) sank to 92.6 this month after jumping 12.4 points in June to 98.3; it had plummeted 46.9 points during the two months through April (to 85.7 from 132.6). The expectations component of the CCI fell for the first time in four months, to 91.5 this month,

after rebounding 19.3 points during the three months through June (to 106.1 from 86.8). Meanwhile, the present situation component climbed for the second month by 7.5 points this month—and 25.8 points the past two months—to 94.2 from 68.4. Consumers' short-term outlook deteriorated in July: The percentage of consumers expecting business conditions to improve (to 31.6% from 42.4%) over the next six months fell, while those expecting business conditions to worsen (19.3 from 15.2) rose; 49.1% expected things to remain the same. The consumers' six-month outlook for jobs showed the percentage expecting more jobs (to 30.6% from 38.4%) declined this month, while the percentage expecting fewer jobs (20.3 from 14.4) advanced; 49.1% also expected employment conditions to remain the same. (Worth noting, those expecting more jobs has dropped steadily since reaching a record-high 41.2% in April.) Meanwhile, consumers' assessment of present-day conditions improved a bit in July. The percentage of consumers claiming business conditions are good (to 17.3% from 17.4%) was basically unchanged, while those claiming business conditions are bad (39.1 from 42.5) fell. Consumers' appraisal of the job market was also more favorable. The percentage of consumers saying jobs are plentiful (to 21.3% from 20.5%) increased, while those claiming jobs are hard to get (20.0 from 23.3) decreased; the former was at 47.2% at the start of the year, and the latter at 11.9%.

Regional M-PMIs ([link](#)): The manufacturing sector continued to expand this month, with impressive gains posted by the Philadelphia, New York, and Richmond Fed districts—three of the five, along with Kansas City and Dallas, that so far have reported on manufacturing activity for July. The composite index improved for the third month since plunging to a record low of -58.6 April, climbing to 10.3 this month—with activity in the Philly (to 24.1 from -56.6 in April) region continuing to grow at a solid pace and the New York (17.2 from -78.2) and Richmond (+10.0 from -54.0) regions expanding for the first time in five months. The recovery in the Kansas City (3.0 from -30.0) region pales in comparison to those of Philly, New York, and Richmond; the Dallas (-3.0 from -74.0) region continued to contract. Meanwhile, July's new orders measure climbed from a record-low -66.4 in April to 12.4 this month as Philadelphia (to 23.0 from -70.9 in April), Kansas City (9.0 from -64.0), Richmond (9.0 from -62.0), and Dallas (6.9 from -68.7) billings expanded for the second month and New York's (13.9 from -66.3) moved into the plus column for the first time since February. In the meantime, factories added to payrolls for the first time since February, with the employment measure climbing to 4.7 this month from April's record low of -36.0. Manufacturers in the Philly (20.1 from -46.7 in April) region boosted payrolls for the first time since March—and at the region's fastest pace since October—while Kansas City (3.0 from -34.0) and Dallas (3.1 from -22.0) began hiring for the

first time since the start of the year, though barely. In the meantime, New York (0.4 from -55.3) manufacturers didn't cut jobs for the first time since before the pandemic, while Richmond's (-3.0 from -22.0) cut payrolls for the fifth straight month.

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