



MORNING BRIEFING

July 30, 2020

De-Urbanization in US, Plagues Made in China

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

(1) Urbanites in search of home offices and backyards send home sales surging. (2) Dropping mortgage rates help too. (3) We're betting new homeowners will need to buy a car—or two. (4) Low auto inventories should help manufacturers too. (5) The Chinese Communist Party is cursed and is a curse. (6) Watching for cracks in the Three Gorges Dam. (7) The latest accusations of Chinese stealing US intellectual property.

Autos: De-Urbanization Should Boost Car Sales. The housing market continues to be on fire as city dwellers look to the suburbs for more room in this era of COVID-19. The need for one or even two home offices and a backyard provides a strong incentive to make a move.

Home purchases have a strong ripple effect on the economy, because they result in so many other, related purchases. New homeowners may need furniture to fill up rooms or lawn equipment and patio furniture to make the backyard look good. We're speculating that ex-urbanites migrating to more open spaces will also need to buy a car—or two—to get around their new suburban neighborhoods. That possibility certainly doesn't appear to be factored into the S&P 500 Automobile Manufacturers stock price index, which has fallen 27.9% ytd through Tuesday's close. Let's take a look at both housing and autos:

(1) *More good housing news.* The strength in the housing market continued last month as pending home sales in June soared 16.6% m/m and 6.3% y/y, the National Association of Realtors (NAR) [reported](#) on Wednesday ([Fig. 1](#)). The y/y increase is the first positive reading since before the pandemic, Debbie observes below.

Sales undoubtedly were helped by the drop in the 30-year fixed mortgage rate to 3.28% by the end of June from 3.57% near the end of May. The 30-year mortgage rate is currently 3.16% ([Fig. 2](#)).

The jump in activity looks likely to continue. The four-week average of home mortgage applications is up 63.5% since bottoming during the April 24 week, at its lowest level since late

October 2015 ([Fig. 3](#)). Recent housing activity has been so strong that the NAR raised its 2020 projection for existing home sales to a 3% decline from an 8% decline previously. The association forecasts a 3% rise in new home sales this year, up from its previous forecast of a 1% rise.

(2) *Need a car too?* Auto sales have bounced off their low, but nothing like the rebound in the housing industry. There were 13.2 million (saar) new light vehicles sold in June, up from the 8.7 million-units low in April. But auto sales remain well off the 17.1 million units (saar) at the start of this year ([Fig. 4](#)). The two industries' stock price indexes reflect the differences. As we mentioned above, the S&P 500 Automobile Manufacturers stock price index has fallen 27.9% ytd through Tuesday's close, while the S&P 500 Homebuilding stock price index is up 19.5% ytd ([Fig. 5](#) and [Fig. 6](#)).

Might new home buyers provide a boost to the auto industry that few investors expect? If so, they'll be buying cars off dealer lots that are still light on inventory. Auto production fell far more sharply than sales earlier this year due to COVID-19-related factory shutdowns ([Fig. 7](#), [Fig. 8](#), and [Fig. 9](#)).

GM's Q2 earnings report, announced Wednesday, noted that its plants were working to replenish "thinly stocked dealership lots, a sign that its bottom line could rebound in coming quarters as the company tries to make up for weeks of lost production this spring from the pandemic," a July 29 [WSJ article](#) reported. The company did report a \$758 million Q2 loss, primarily due to the US market, where its factories were closed for almost half the quarter. But GM's 50 cents per-share earnings loss beat analysts' forecasts of a \$1.77 loss.

China I (an Editorial): Is the CCP Plagued? The Chinese Communist Party (CCP) seems to be causing plagues of biblical proportions. In the Bible, there were 10 all told. So far, we can count four such calamities:

(1) *Second borns*. China's first plague was the CCP's one-child policy imposed on their people from 1979 through 2015. Previously, I've observed that China's one-child policy has created a demographic nightmare for the country. This first plague was the subject of "One Child Nation," an extremely disturbing 2019 documentary about China's horrible policy aimed at population control. It resulted in the mass forced sterilization of women and involuntary late-term abortions. It led to the human trafficking of babies, who were placed with adoptive families in

overseas homes under the false pretense that the babies hadn't been bought and sold prior to placement.

The government campaign to control the population's growth rate was deemed necessary to avoid nationwide starvation. It was a brutal Orwellian response to a questionable Malthusian problem. It included incessant propaganda, a widespread network of informants, and the conscription of medical professionals to execute the government's dirty deeds. Among the people interviewed in the documentary, a few condoned it, but most did not and seemed to have been deeply traumatized by it. Everyone involved in some capacity said they had no choice. The legacy of that policy is that China is rapidly turning into the world's largest nursing home as the population ages without enough young adults to support the elderly.

(2) *Ethnic cleansing*. An Alaska-sized chunk of western China known as "Xinjiang" is the homeland of approximately 11 million Uighurs, an ethnic Turkic and largely Muslim population. Chinese officials have been accused of launching a plague of ethnic cleansing against the population, involving "re-education camps" and other Orwellian measures. The resulting horrors have been reported by numerous media outlets around the world. The Chinese government denies the accusations.

(3) *Virus*. Everyone agrees that the COVID-19 pandemic originated in Wuhan, China. US officials claim that China failed to alert the world about the severity of COVID-19 so that it could accumulate necessary medical equipment. A May 1 report by the US Department of Homeland Security (DHS) states that Chinese leaders held off telling the World Health Organization (WHO) that COVID-19 was a contagion for much of January so that it could boost its medical supplies, a May 4 AP [article](#) reported. DHS noted that during that time, China's imports of face masks and surgical gowns and gloves increased, and its exports of those items decreased. China counters that US officials are using the country as a scapegoat.

(4) *Floods*. The second-highest rainfall that has swamped China in more than a half-century has fueled new questions about the Three Gorges Dam, the world's biggest hydroelectric facility. It was designed to help to tame floodwaters. The state-owned operator of the dam has denied rumors that it is showing signs of structural stress.

What's next? How about bad seeds? The July 28 *Boston Herald* [reported](#): "State and federal authorities both put out news releases on Tuesday warning Bay Staters that it appears that 'suspicious, unsolicited packages of seed' from China are suddenly showing up on people's

doorsteps—and that people should call the plant police if one shows up. ‘While the exact types of seeds in the packages are unknown, the seeds are thought to be invasive plant species, and not believed to be harmful to humans or pets but could pose a significant risk to agriculture or the environment,’ the Massachusetts Department of Agricultural Resources said.” Similar warnings have been issued in several other states.

(The views expressed in this editorial are solely my own.)

China II: Spy Games Continue. The Cold War between the US and China grew frostier last week. The US forced China to close its Houston consulate amid accusations of Chinese theft of US intellectual property. China retaliated by forcing the US to close its Chengdu consulate.

These are just the latest developments in the US government’s efforts to prevent the Chinese government from stealing US intellectual property. We first pointed out the numerous cases that the Department of Justice (DOJ) was bringing against US and Chinese citizens who had been stealing information for the Chinese government in the *Morning Briefings* of [February 7, 2019](#) and [February 21, 2019](#). Now the problem is publicly discussed on a regular basis by the most senior members of the Trump administration.

In a July 16 [speech](#), US Attorney General William Barr warned that China was using any means possible to achieve “Made in China 2025,” the country’s extensive plan to dominate key industries—including advanced technology, robotics, aircraft, new energy vehicles, electrical generation and transmission equipment, agricultural machinery, new materials, pharmaceuticals, and advanced medical devices. And Barr explained in a February 6 [speech](#) that the DOJ has brought trade-secret-theft cases in eight of the 10 sectors that China aims to dominate by 2025.

The DOJ’s effort dates back to 2018, when then-US Attorney General Jeff Sessions established the China Initiative to identify and prosecute those engaged in trade-secret theft, hacking, and economic espionage, according to a DOJ [report](#) listing many of the agency’s ongoing cases. Expect the list to grow longer. The FBI reportedly has 2,000 active cases related to Chinese counterintelligence operations in the US, a July 26 American Military News [article](#) reported.

Here’s Jackie’s look at some of the recent DOJ allegations, which read more like spy novels than press releases:

(1) *Hacking away.* Li Xiaoyu and Dong Jiazhi, Chinese nationals and residents, were indicted after allegedly hacking into the computer systems of hundreds of companies, governments, non-governmental organizations, individual dissidents, clergy, and democratic and human rights activists in the US and abroad.

Many of the industries they targeted are those China has focused on in its Made in China 2025 program. “Targeted industries included, among others, high tech manufacturing; medical device, civil, and industrial engineering; business, educational, and gaming software; solar energy; pharmaceuticals; defense,” according to the July 21 DOJ [press release](#). More recently, the duo has targeted companies developing COVID-19 vaccines, tests, and treatments. The DOJ claims the hackers acted for their own financial gain and for the benefit of the Chinese government’s Ministry of State Security.

This follows the February indictment of four members of the Chinese People’s Liberation Army for hacking into the computer systems of Equifax and stealing Americans’ personal data and Equifax trade secrets. To avoid detection, the hackers routed traffic through about 34 servers in nearly 20 countries, the DOJ’s February 10 [press release](#) stated.

(2) *Chinese stealing for the motherland.* There have been many charges against Chinese citizens working as researchers in US universities who have failed to disclose their ties to the Chinese military. Some are also accused of taking knowledge gained in the US and giving it to China.

Yanqing Ye was charged with visa fraud, making false statements, acting as an agent of a foreign government, and conspiracy earlier this year. Yi identified herself as a student on her J-1 visa and lied about her ongoing military service at the National University of Defense Technology (NUDT), a military academy directed by the CCP. She is a lieutenant of the People’s Liberation Army and a member of the CCP. She studied at Boston University’s Department of Physics, Chemistry and Biomedical Engineering from October 2017 to April 2019.

“[A]t the direction of one NUDT professor, who was a PLA Colonel, Ye had accessed U.S. military websites, researched U.S. military projects and compiled information for the PLA on two U.S. scientists with expertise in robotics and computer science. Furthermore, a review of a WeChat conversation revealed that Ye and the other PLA official from NUDT were

collaborating on a research paper about a risk assessment model designed to decipher data for military applications,” a January 28 DOJ [press release](#) stated.

The same press release claimed that Zaosong Zheng entered the US on a J-1 visa and conducted cancer cell research at Beth Israel Deaconess Medical Center in Boston from September 2018 to December 2019. “Zheng stole 21 vials of biological research and attempted to smuggle them out of the United States aboard a flight destined for China. Federal officers at Logan Airport discovered the vials hidden in a sock inside one of Zheng’s bags ... [Zheng] stated that he intended to bring the vials to China to use them to conduct research in his own laboratory and publish the results under his own name.”

(3) *Americans can be bought by China too.* In March, Xuehua Peng, a US citizen, was sentenced to four years in prison and fined \$30,000 for acting as an agent of the People’s Republic of China’s (PRC) Ministry of State Security. Peng, who pled guilty, said that in 2015 an official from the PRC introduced himself when Peng was in China on business. The official had an offer. Peng was hired to make dead drops to exchange money for items to deliver to the PRC. He would locate and reserve hotel rooms where he would leave money and then depart for several hours. During that time, a source would leave a small electronic storage device in the room. Peng would retrieve the device, fly to China, and deliver it to the PRC official. He completed six dead drops and received \$30,000 from the PRC official before being arrested, the DOJ March 17 [press release](#) stated.

(4) *Thousand Talents plan.* Many DOJ cases involve US or Chinese researchers who have accepted US research funding and failed to disclose their receipt of funding from China. In the worst cases, there’s evidence that the scientists intended to give China the fruits of their US research.

The National Institutes of Health (NIH) has been investigating scientists who received undisclosed foreign funding since 2018. So far, 54 scientists have resigned or been fired due to the investigation. NIH is finding that most of the undisclosed funding comes from China—that’s the case for 93% of the 189 scientists, working in 87 institutions, who’ve been investigated so far, a June 22 *Science* [article](#) reported.

Perhaps the highest-profile scientist targeted by the DOJ is Dr. Charles Lieber, Chair of Harvard University’s Chemistry and Chemical Biology Department. He was indicted by a federal grand jury for making false statements to federal authorities. Lieber, who specialized in

nanoscience, has received more than \$15 million in grants from the NIH and Department of Defense, but allegedly failed to disclose his funding from Chinese organizations.

Beginning in 2011, Lieber allegedly became a “Strategic Scientist” at Wuhan University of Technology and was a contractual participant in China’s Thousand Talents Plan from at least 2012 to 2015. China’s Thousand Talents plan aims to attract, recruit, and cultivate high-level scientific talent, both at home and abroad, a June 9 Justice Department [press release](#) stated. As part of his Thousand Talents contract, Lieber was paid \$50,000 a month, living expenses of almost \$160,000, and more than \$1.5 million to establish a research lab at Wuhan University of Technology. He was to work for the Chinese university for not less than nine months a year.

Song Guo Zheng was charged with fraud for not disclosing that he was a member of the Chinese Talent Plan while accepting about \$4.1 million in grants from the NIH to develop expertise in rheumatology and immunology. He is also charged with making false statements about maintaining employment in China while employed by universities in the US, including the Ohio State University. He was arrested in May as he was about to board a flight from Alaska to China while carrying bags containing two laptops, three cellphones, several USB drives, and several silver bars.

“We allege that Zheng was preparing to flee the country after he learned that his employer had begun an administrative process into whether or not he was complying with rules governing taxpayer-funded grants,” said David M. DeVillers, US Attorney for the Southern District of Ohio in a July 9 DOJ [press release](#).

CALENDARS

US: 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. **Fri:** Personal Income & Spending -0.5%/5.5%, Core PCED 0.2%^{m/m}/1.0%^{y/y}, Consumer Sentiment Index Total, Current Conditions, and Expectations 73.0/84.2/66.2, University of Michigan Expected Inflation Rates 1-Year & 5-Year 3.1%/2.7%, Employment Cost Index 0.6%, Chicago PMI 43.9, Baker-Hughes Rig Count. (DailyFX estimates)

Global: Thurs: Eurozone Economic Sentiment 81, Eurozone Unemployment Rate 7.7%, Germany GDP -9.0%^{q/q}/-11.3%^{y/y}, Germany Unemployment Change & Unemployment Rate 43k/6.5%, Germany CPI -0.2%^{m/m}/-0.2%^{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. [Fri](#): Eurozone GDP Flash Estimate -12.0%q/q/-14.5%y/y, Eurozone CPI Flash Estimate 0.8% y/y, France, Italy, and Spain GDP -15.2%/-15.0%/-16.1%, Germany Retail Sales -3.3%m/m/3.0%y/y, Japan Consumer Confidence. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Earnings, Revenues, Valuation & Margins ([link](#)): The rapid pace of COVID-19 estimate cuts has abated, and forecasts are showing increasing signs of recovery now. Consensus S&P 500 forecasts previously had been falling at rates paralleling the declines during the 2008-09 financial crisis. Forward revenues ticked up 0.1% w/w to a 14-week high and is now 6.0% below its record high in mid-February. Forward earnings rose 0.9% w/w, also to a 14-week high, and is now 17.7% below its record high in early March. Forward revenues growth remained steady for a third week at 2.9% after jumping 1.2ppts the week before that. Forward earnings growth of 5.2% was up 0.1ppt w/w. Forward revenues growth is 3.4ppts below its seven-year high of 6.3% in February 2018, but is up from 0.2% in April, which is the lowest reading since June 2009. Forward earnings growth remains 11.7ppts below its six-year high of 16.9% in February 2018, but is up 10.8ppts from its record low of -5.6% at the end of April. Analysts expect revenues to decline 5.0% y/y in 2020 compared to the 4.3% reported in 2019. That's up 0.1pt w/w and down 10.2ppts since the start of the year. Analysts expect an earnings decline of 21.9% y/y in 2020 compared to a 1.4% rise in 2019. Their 2020 growth rate was up 1.1ppt w/w and is down 30.9ppts since the beginning of the year. The forward profit margin rose 0.1ppt to 10.5%. That's up just 0.2ppt from 10.3% during April and May, which was the lowest level since August 2013. It's still down 1.9ppt from a record high of 12.4% in September 2018. Analysts expect the profit margin to fall 2.1ppt y/y in 2020 to 9.4%—from 11.5% in 2019—and to improve 1.7ppt y/y to 11.1% in 2021. The S&P 500's weekly forward P/E rose 0.1pt to 22.4, matching early June's highest level since early 2002, and up from a 77-month low of 14.0 in mid-March. The S&P 500 price-to-sales ratio rose 0.04pt w/w to a new record high of 2.36. That's up from the 49-month low of 1.65 in mid-March and compares to the previous record high of 2.29 in mid-February.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins ([link](#)): Last week saw consensus forward revenues and earnings rise w/w for eight of the 11 S&P 500 sectors. Real Estate and Utilities had both measures decline w/w. Due to the sharp decrease in forward earnings this year, forward P/E ratios for nearly all sectors now are back above their recent record or cyclical highs prior to the bear market. Utilities is the only sector expected to maintain

its profit margin in 2020, down from eight sectors expected to improve on a y/y basis 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. In the latest week, the forward profit margin fell for Communication Services and Real Estate. However, it rose for five sectors: Consumer Discretionary, Energy, Financials, Health Care, and Tech. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (21.9%, down from 23.0%), Real Estate (13.9, down from 17.0), Communication Services (13.2, down from 15.4), Utilities (14.0, down from a record high of 14.1% in early July), Financials (13.9, down from 19.2), S&P 500 (10.5, down from 12.4), Health Care (10.3, 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 (5.0, down from 8.3), and Energy (1.5, down from 8.0).

S&P 500 Sectors Forward Revenues and Earnings Recovery from COVID-19 Trough

[\(link\)](#): The S&P 500's forward revenues and earnings as well as its implied forward profit margin appear to have bottomed on May 28 after 14 weeks of COVID-19 declines. Since then, S&P 500 forward revenues has risen 2.2%, and forward earnings has gained 4.6%. The profit margin improved 0.1ppt w/w to 10.5%, which compares to a cyclical low of 10.3% during May and June. On a sector basis, all but three sectors have been rising from the lows in their forward revenues, earnings, and profit margins. Communication Services and Real Estate marked new post-COVID-19 lows in their forward profit margins in the latest week. Utilities posted new lows in their forward revenues and earnings, and Real Estate marked a new low in forward earnings. Here's how the sectors rank by their forward revenues change since May 28, along with their forward earnings change: Financials (revenues up 3.8%, forward earnings up 6.9%), Energy (3.5, 763.4), Communication Services (2.6, 1.8), Materials (2.6, 5.2), Consumer Discretionary (2.5, 9.7), Information Technology (2.4, 3.6), Industrials (2.3, 5.5), S&P 500 (2.2, 4.6), Health Care (1.4, 4.1), Consumer Staples (1.1, 1.6), Real Estate (-0.2, -2.5), and Utilities (-1.9, -0.8).

Stock Market Sentiment Indicators [\(link\)](#): The Bull/Bear Ratio (BBR) barely budged this week as both bullish and bearish sentiment were little changed. The BBR inched down to 3.27 this week, after increasing 16 of the prior 17 weeks, climbing to 3.28 last week (which was the highest since the January 21 week); it had dropped from 2.89 to 0.72 (the lowest since February 2016) over the prior five weeks. Bullish sentiment ticked up to 57.3% this week, after dipping to 56.7% last week and edging up to 58.1% (the highest percentage since mid-

January) two weeks ago. This week's advance was the 14th in the past 18 weeks, climbing by 27.2ppts (to 57.3% from 30.1%) over the period. Meanwhile, bearish sentiment edged up to 17.5% this week, after falling 24.4ppts (to 17.3% from 41.7%) the prior 17 weeks—indicating the fewest bears since January last week. The correction count has been in a volatile flat trend for a while, fluctuating between 22.5% and 26.5%. It edged down to 25.2% this week from 26.0% last week. The AAI Ratio slipped to 35.8% last week after increasing the prior two weeks from 32.6% to 40.5%. Bullish sentiment took a step back to 26.1% after rising from 22.2% to 30.8% the previous two weeks; bearish sentiment rose last week for the second week, to 46.8%, after declining the prior two weeks from 48.9% to 42.7%.

US ECONOMIC INDICATORS

Pending Home Sales ([link](#)): “It is quite surprising and remarkable that, in the midst of a global pandemic, contract activity for home purchases is higher compared to one year ago,” said Lawrence Yun, NAR’s chief economist. “Consumers are taking advantage of record-low mortgage rates resulting from the Federal Reserve’s maximum liquidity monetary policy.” The Pending Home Sales Index continued its dramatic comeback in June, jumping 16.6% to 116.1, after skyrocketing by a record 44.3% in May. The year-over-year comparison for June was 6.3% above a year ago—the first positive reading since before the pandemic. The report notes that the South has consistently outperformed the rest of the country, while the big move up in the Northeast reflects a strong bounce back after a lengthier lockdown. All regions have posted massive gains the past two months, with only sales in the Northeast still below year-ago levels. Here’s a look: Northeast (+123.9% two months ending June & -0.9% y/y), West (74.4 & 4.7), South (60.2 & 10.3), and Midwest (54.0 & 5.1). According to Yun, “While the outlook is promising, sharply rising lumber prices are concerning. A reduction in tariffs—even if temporary—would help increase home building and thereby spur faster economic growth.”

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