



MORNING BRIEFING

August 20, 2020

Broadening Earnings Optimism

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

(1) Analysts boost earnings growth estimates for wide array of industries. (2) Cyclical get the nod, as do any industries relating to the home. (3) Upward revisions not as strong for industries selling the staples we hoarded earlier this year. (4) Money falls from the sky in Europe. (5) ECB ups bond buying to €1.35 billion. (6) Furloughs keep European workers off the unemployment rolls. (7) EU countries show unified front with plans to sell €750 billion of bonds. (8) Eurozone July economic data have green shoots. (9) For the grass to grow, COVID-19 needs to stay at bay.

Strategy I: An Earnings Rotation Afoot. With the S&P 500 hitting new records this week, it's comforting to know that analysts have grown more optimistic about future earnings growth in a wider array of industries, including those hard hit by COVID-19 and other cyclical areas of the market. That's a major shift from earlier this year when earnings growth was expected only from a few sectors and industries, primarily those that benefitted from our needs to clean every surface possible and order groceries online.

Consider the change in “forward earnings”—or the time-weighted average of analysts’ consensus earnings estimates for this year and next year—from May 28, when earnings estimate revisions bottomed, through August 13. Many beaten-up cyclical S&P 500 sectors have enjoyed some of the best upward revisions to their forward earnings: Energy (238.8%), Consumer Discretionary (26.0), Materials (10.8), Industrials (10.2), Financials (9.5), S&P 500 (8.4), Health Care (7.1), Information Technology (5.3), Communications Services (5.2), Consumer Staples (3.4), Utilities (-0.3), and Real Estate (-5.0) ([Table 1](#)).

That's quite a change from earlier this year when analysts cut earnings estimates less for industries and sectors that benefitted from the COVID-19 pandemic and related lockdowns. Here's the change in forward earnings for the S&P 500 sectors from the day COVID-19 hit the news on January 23 through August 13: Information Technology (3.2%), Health Care (2.5), Utilities (0.2), Consumer Staples (-2.1), Communications Services (-10.4), Materials (-13.0), S&P 500 (-14.2), Real Estate (-20.0), Financials (-24.9), Consumer Discretionary (-27.4),

Industrials (-33.5), and Energy (-77.7) ([Table 2](#)). Let's take a look at how S&P 500 industries have been affected by this rotation:

(1) *Cyclicals get a second look*. Some of the industries hit hardest by the COVID-19 pandemic and resulting contraction of the economy are getting some new respect from analysts. Since earnings estimates stopped falling on May 28, there have been some surprising names among industries with the strongest improvements in forward earnings.

Here are a few of the names that have enjoyed the biggest upward revisions in forward earnings after suffering through some of the largest reductions in forward earnings earlier this year. We've listed the percentage changes of both their upward earnings estimate revisions enjoyed since May 28 and their revisions since COVID-19 hit the headlines on January 23: Automobile Manufacturers (2,382.0%, -55.7%), Apparel Retail (41.7, -46.6), Steel (23.2, -32.9), Investment Banking & Brokerage (20.0, -15.9), Construction & Farm Machinery (19.4, -29.3), Regional Banks (16.0, -30.4), Electronic Components (15.1, -11.1), Restaurants (14.3, -17.6), and Industrial Machinery (16.2, -15.6).

(2) *Work-from-home winners*. Another group that has enjoyed some of the strongest upward estimate revisions are industries that benefit from the surges in numbers of people working from home and city dwellers moving out to the suburbs. The trend has benefitted homebuilders, car manufacturers, retailers, and companies providing anything related to working or shopping from home.

Here are some of the S&P 500 industries related to working from home that have enjoyed the strongest upward earnings estimate revisions since May 28: Automobile Manufacturers (2382.0%), Home Furnishings (51.6), Internet & Direct Marketing Retail (42.7), Homebuilding (41.2), Household Appliances (33.2), Building Products (18.1), Consumer Electronics (18.1), Interactive Home Entertainment (14.4), Automotive Retail (12.6), and Interactive Media & Services (11.4).

(3) *From the front of the pack to the back*. Meanwhile, the earnings estimate revisions for industries that benefitted the most from COVID-19 earlier this year may still be positive, but they aren't large enough to land them at the top of our listing anymore. Analysts have boosted their earnings estimates for Hypermarkets & Super Centers (by 2.7%) since May 28, and the same is true for Packaged Foods (3.9) and Personal Products (3.4). But that puts those

industries on the bottom half of the earnings revisions listing. In the first half of the year, they were in the top half.

(4) *Winners still.* Perhaps the most interesting S&P 500 industries are those that had the strongest earnings revisions throughout this year. Here are the industries that have had the strongest earnings revisions since earnings bottomed on May 28 and since COVID-19 hit the headlines on January 23: Homebuilding (41.2%, 14.5%), Gold (35.2, 67.6), Life Sciences Tools & Services (13.2, 5.4), and Semiconductor Equipment (12.3, 13.7).

Strategy II: Helicopter Money in Europe. Money can't buy happiness. Nevertheless, governments around the world have been printing and spending money like crazy, hoping to make us all feel a little bit better during the COVID-19 pandemic. In Europe, even Germany and the other frugal northern states have opened their wallets to bolster their own economies as well as those of the poorer nations in the region. So far, all the fiscal and monetary support together with COVID-19 containment efforts have helped the European economy begin to recover this summer. Here's Jackie's report on how the European Central Bank (ECB) and the European Union (EU) have responded to one of the world's biggest crises:

(1) *ECB gives the economy some PEPP.* The European Central Bank (ECB) announced in June that it would buy up to €1.35 trillion of eurozone government and corporate debt through June 2021. The program—dubbed “PEPP,” or “Pandemic Emergency Purchase Program”—expanded an existing €750 billion bond-buying program.

Other steps taken by the ECB include leaving its key interest rate at -0.5% and calling on banks to freeze dividend payments until at least January to prepare for a wave of expected loan losses.

This follows the ECB's April announcement that it would offer three-year loans to banks at interest rates as low as -1.0%. To receive the below-market rate, banks have to agree to maintain their lending to households and business at the same level as the previous year, a June 18 *FT* [article](#) explained. The ECB reported in June that 742 banks had applied to borrow €1.31 trillion under the program, with plans to use about half of the funding to repay existing ECB loans and the remainder to buy bonds issued by their own governments.

(2) *The EU supports workers.* In April, the EU put forward a €540 billion emergency support package that targeted workers, businesses, and member states. To support workers, the EU

introduced SURE, temporary support to mitigate unemployment risks in an emergency. The program makes €100 billion of temporary EU loans available to fund countries' employment furlough programs.

Many European countries allow companies to furlough employees instead of firing them, which is expensive due to European labor laws. Furloughed employees are paid some percentage of their prior salary by their employers. In return, they work reduced hours or don't work but remain available to return to the company when better times arrive. The employers are reimbursed for their furlough payments by the government. The programs do not cover those who work off the books.

ERTE, Spain's temporary leave system, covers 70% of employees' salaries. Roughly 1.2 million Spanish workers are on furlough, down from a high of 3.4 million, an August 6 [FT article](#) reported. Spain has requested more than €20 billion from the SURE funds to finance the furloughs and to aid businesses and the self-employed.

As COVID-19 drags on, European countries have been extending their furlough benefits. In Spain, the duration of furloughs was extended through September, and it is expected to be extended again through the end of the year. Companies catering to tourists would prefer an extension through next spring when the tourist season hopefully resumes.

Because of the furlough program, the Eurozone unemployment rate has risen only slightly to 7.8% in June from 7.2% in February and March, which was a record low ([Fig. 1](#)). Without furloughs, that figure would be far higher. The ECB's July 30 [Economic Bulletin](#) includes a chart that compares the small increase in Eurozone unemployment to the major decline in the region's Purchasing Manager's Index (PMI) for employment, which fell to its lowest level on record in April before recouping about half of its losses in the following months. The PMI for employment likely presents a more accurate picture of Europe's employment situation.

(3) *EU supports businesses and governments too.* Another element of the EU emergency support package is the European Investment Bank Group's pan-European guarantee fund, which could support loans totaling up to €200 billion to companies, with a focus on small and medium-sized companies throughout the EU.

And to support governments, the EU set up the European Stability Mechanism. It can provide loans to all EU member states worth up to 2% of their GDP up to a total value of €240 billion. So far, no country has drawn on its credit lines.

(4) *More EU funding on the way.* EU leaders agreed in July to create a new €750 billion pandemic recovery fund. The deal is historic because the EU will issue bonds to raise the money for the fund. The EU has historically avoided issuing bonds and only has about €50 billion of debt currently outstanding. Member nations historically have funded themselves independently. But this deal recognized that the poorer nations need funding from their wealthier counterparts—without which the EU possibly could splinter apart.

The pandemic recovery fund can make €390 billion of grants to economically weak EU members, with the rest of the funding made available through loans. To repay the debt, which must be done by 2058, the EU will propose a “digital levy” for technology companies and consider a new tax on financial transactions.

In addition to the new recovery fund, EU leaders also agreed to a €1.1 trillion budget. Both the fund and the budget need approval by the EU Parliament, and that could lead to some changes. Parliament President David Sassoli has said he doesn’t want to cut the budget for research or for the Erasmus student-exchange program, as is currently envisioned by the budget. He also wanted the agreement to include a mechanism to limit recovery funds to countries that have failed to uphold media freedoms and human rights, such as Hungary and Poland, a July 22 Reuters’ [article](#) reported. But it’s unclear whether these changes can be made without putting the entire agreement in jeopardy.

Proceeds from the pandemic recovery fund will benefit the southern European nations far more than the wealthier northern nations. The southern nations, which were in weaker financial condition entering the current downturn, need the funding to supplement their own stimulus plans. Germany’s financial stimulus measures amount to 9.4% of its GDP, while the program announced by Italy is 3.5% of its GDP, and the financing plan announced by Spain 3.4% of GDP, a July 21 WSJ [article](#) reported.

(5) *Hope in July economic data.* The Eurozone’s economy was hit hard by COVID-19 in Q2, but there are glimmers that the economy may be edging toward recovery in the most recent economic data.

Eurozone GDP fell 15.0% in Q2 y/y, the largest drop on record, and it followed a 3.1% drop in Q1. The southern countries, which are among the most dependent on tourism, took the biggest hits. In Greece, Portugal, Italy, and Spain, 14% or more of jobs are related to tourism. GDP in Spain contracted by 22.1% in Q2 y/y, in France by 19.0%, in Italy by 17.3%, and in Germany by 11.6% ([Fig. 2](#)).

As COVID-19 cases have fallen and many companies have reopened for business, the economic data in July has improved. The Eurozone's manufacturing PMI rose to 51.8 in July, a sharp recovery from its low of 33.4 in April. The recovery in the nonmanufacturing PMI was even more impressive, jumping to 54.7 in July from 12.0 in April ([Fig. 3](#)). Eurozone retail sales excluding motor vehicles also rebounded, rising 1.5% y/y in June, up from the 19.6% drop in April ([Fig. 4](#)).

Enthusiasm about Europe's fiscal stimulus, its ability to tame COVID-19—so far—and its improving economy have helped bolster the euro. The EU currency relative to the dollar is up 6.2% ytd ([Fig. 5](#)). And yields on the government-issued bonds of Italy and Spain have fallen from their highs of 2.50% and 1.26% on March 18 down to 0.98% and 0.32% ([Fig. 6](#)).

Stocks too have responded. The Dow Jones Stoxx 50, which tracks the Eurozone's largest companies, has risen 39.1% off of its March 18 low but remains 14.2% off of its February 19 high ([Fig. 7](#)). To head higher, the Eurozone will need to keep COVID-19 cases to a minimum so that tourism and global trade can recover.

(6) *Keeping an eye on COVID-19 cases.* Of course, all of this monetary and fiscal spending will be for naught if there's a resurgence of COVID-19 cases in Europe that forces another economic shutdown. As in the US, the numbers are creeping up in some European countries as young adults socialize.

The seven-day average of new cases in France has jumped to more than 2,000 in August, after falling as low as 387 in June and peaking north of 4,000 in April, according to the *NYT's* handy [database](#). Likewise, Spain's seven-day average of new cases has jumped to north of 5,000 in August from 8,000 in April; while that's an improvement, the situation has worsened from Spain's best seven-day average of 248 cases in June. Fortunately, in both countries even as the numbers of cases have risen, the numbers of deaths have stayed incredibly low, with the seven-day average at 11 in France and 15 in Spain.

Europe has done a far better job than the US at containing COVID-19. The seven-day average of new cases in the US is 49,102, down from 70,000 or more in July but still stunningly high. The seven-day average deaths from COVID-19 also has fallen in the US, to 1,047. That's less than half the death rate we saw in April, but still far higher than death rates in Europe.

CALENDARS

US: **Thurs:** Leading Indicators 1.1%, Initial & Continuous Jobless Claims 925k/15.0m, Philadelphia Fed Manufacturing Index, EIA Natural Gas Storage, Daly. **Fri:** Existing Home Sales 5.38mu, M-PMI & NM-PMI Flash Estimats 51.9/51.0. (DailyFX estimates)

Global: **Thurs:** UK Gfk Consumer Confidence -25, Japan CPI, UK-EU Brexit Talks, ECB Monetary Policy Meeting Accounts. **Fri:** Eurozone Consumer Confidence Flash -15, Eurozone, Germany, and France C-PMI Flash Estimates 54.9/55.0/57.2, Eurozone, Germany, and France M-PMI Flash Estimates 52.9/52.5/53.7, Eurozone, Germany, and France C-PMI Flash Estimates 54.5/55.1/56.3, UK C-PMI, M-PMI, and NM-PMI Flash Estimates 57.1/53.8/57.0, Retail Sales Headline & Ex Fuel 0.0%/1.5% y/y, Canada Retail Sales 24.5% (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): The Bull/Bear Ratio (BBR) held at its highest level since mid-February 2018, as bullish sentiment was just shy of its high for this year, while bearish sentiment was little changed from last week's percentage—which was the lowest since March 2018. The BBR remained at 3.59 this week, after rising 18 of the prior 20 weeks from 0.72 during the March 24 week, which was the lowest since February 2016. Bullish sentiment climbed to 59.2% this week—the highest since the mid-January 2020 peak of 59.4%. Meanwhile, bearish sentiment inched up from 16.2% to 16.5% this week, down 25.2ppts from its 41.7% peak during the March 24 week. The correction count has been in a volatile flat trend for a while, fluctuating between 22.5% and 26.5%. It moved down for the second week to 24.3% this week from 26.0% two weeks ago. The AAI Ratio increased for the second week to 41.6% last week, after sliding the prior two weeks from 40.5% to 29.4%. Bullish sentiment rose for the second week to 30.0% after falling the prior two weeks from 30.8% from 20.2%, while bearish sentiment fell for the second week, to 42.1%, after climbing from 42.7% to 48.5% the previous three weeks.

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 down 0.1% w/w to its highest level since early April and is now 5.1% below its record high in mid-February. Forward earnings stalled w/w at its highest level since early April, and is now 10.3% below its record high in early March. Forward revenues growth remained steady w/w at 4.2%, and forward earnings growth of 9.5% was down 0.1ppt w/w. Forward revenues growth is 2.2ppts 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 7.4ppts below its six-year high of 16.9% in February 2018 but is up 15.1ppts from its record low of -5.6% at the end of April. Analysts expect revenues to decline 4.7% y/y in 2020 compared to the 4.3% reported in 2019. That's down 0.1ppt w/w and down 9.9ppts since the start of the year. Analysts expect an earnings decline of 19.9% y/y in 2020 compared to a 1.4% rise in 2019. Their 2020 growth rate was up 0.1ppt w/w and is down 28.9ppts since the beginning of the year. The forward profit margin remained steady w/w at 10.8%. That's up 0.5ppt from 10.3% during April and May, which was the lowest level since August 2013. It's still down 1.6ppt from a record high of 12.4% in September 2018. Analysts expect the profit margin to fall 1.9ppt y/y in 2020 to 9.6%—from 11.5% in 2019—and to improve 1.6ppt y/y to 11.2% in 2021. The S&P 500's weekly forward P/E rose 0.3pt to 22.3 from 22.0 and is down from 22.4 at the end of July, which was the 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 record high of 2.41. 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 rise w/w for four of the 11 S&P 500 sectors. Forward earnings was higher for five sectors. Health Care was the only sector to post gains in both measures. 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 have its profit margin improve in 2020, and Tech is expected to remain steady. That's 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 rose for Materials and fell for Consumer Discretionary and Real Estate. Here's how the sectors rank based on their current forward profit margin forecasts

versus their highs during 2018: Information Technology (22.1%, down from 23.0%), Financials (14.2, down from 19.2), Utilities (14.1, matching its record high from early July), Real Estate (13.5, down from 17.0), Communication Services (13.6, down from 15.4), S&P 500 (10.8, down from 12.4), Health Care (10.4, down from 11.2), Materials (9.5, down from 11.6), Industrials (7.8, down from its record high of 10.5% in mid-December), Consumer Staples (7.3, down from 7.7), Consumer Discretionary (5.6, down from 8.3), and Energy (1.9, 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, bottomed on May 28 after 14 weeks of COVID-19 declines. Since then, S&P 500 forward revenues has risen 3.2%, and forward earnings has gained 8.4%. The profit margin was steady w/w at 10.8%, which is the highest since early April and compares to a cyclical low of 10.3% during May and June. On a sector basis, all but Real Estate have been rising from the lows in their forward revenues, earnings, and profit margins. In the latest week, Real Estate made new lows in its forward earnings and profit margin. Here's how the sectors rank by their forward revenues changes and forward earnings changes since May 28: Consumer Discretionary (forward revenues up 5.3%, forward earnings up 26.0%), Financials (3.9, 9.5), Information Technology (3.8, 5.3), Communication Services (3.7, 5.2), Industrials (3.6, 10.2), Materials (3.3, 10.8), S&P 500 (3.2, 8.4), Health Care (2.7, 7.1), Consumer Staples (1.8, 3.4), Energy (0.8, 238.8), Real Estate (0.4, -5.0), and Utilities (-1.9, -0.3).

GLOBAL ECONOMIC INDICATORS

Eurozone CPI [\(link\)](#): July's CPI headline rate moved up slightly for the second month, to 0.4% y/y, after slowing the prior four months from 1.4% in January to 0.1% in May—which was the lowest rate since June 2016. It was the 20th consecutive month the headline rate was below 2.0%. Meanwhile, the core rate accelerated back up to February's recent peak rate of 1.2% y/y—after falling to a 13-month low of 0.8% in June. Looking at the main components, food, alcohol & tobacco once again posted the highest rate, at 2.0% y/y—though easing for the third month from April's peak rate of 3.6%, which was the highest since November 2009. Energy had the lowest rate, at -8.4% y/y; it eased for the second month from May's -11.9%, which was the steepest since July 2009. In the meantime, the rate for non-energy industrial goods accelerated to 1.6% y/y, from 0.2% the prior two months, while the services rate slowed for the second month from 1.3% in May to 0.9% y/y in July, the lowest since April 2016. Of the top four Eurozone economies, CPI rates for France (0.9% y/y) and Italy (0.8%) were above the

Eurozone's headline rate of 0.4%, while Germany's (0.0% y/y) was flat and Spain's (-0.7) moved further into negative territory.

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