



MORNING BRIEFING

September 1, 2020

Lots of Liquidity Left

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

(1) A mad dash through recent events. (2) March's mad dash for cash left plenty still available, even now. (3) Bond yields near record lows, while liquid assets remain near record highs. (4) Central banks continue pumping liquidity. (5) Government social benefits boosted personal saving, which is still boosting consumer spending. (6) Comparative MAMUs. (7) July's consumer-spending report shows pandemic's winners and losers. (8) Housing-related industries are clear winners. (9) Used car sales getting a lift from new suburbanites. (10) Fed likely to continue to undershoot inflation target for the foreseeable future.

Strategy: Piles of Cash. The World Health Organization officially declared a pandemic on Wednesday, March 11. The next day, on Thursday, March 12, Joe and I pushed our 3500 year-end target for the S&P 500 to mid-2021. We observed that credit-quality spreads were widening dramatically, with corporate and municipal yields rising rapidly relative to Treasury yields, signaling a credit crunch. We expected that the Fed would respond with helicopter money and ask Congress for permission to buy corporate securities. On Sunday, March 15, the Fed lowered the federal funds rate by 100bps to zero and adopted QE4.

On Monday, March 16, we observed that a “mad dash for cash” was causing widespread illiquidity in the financial markets. That same day, the White House issued new guidelines “for every American to follow over the next 15 days as we combat the virus.” California issued a stay-in-place order on Thursday, March 19; New York followed on Friday, March 20; and the rest of the states did the same during the following few days. On Monday, March 23, the Federal Reserve announced QE4ever, including purchases of corporate bonds. On Friday, March 27, President Trump signed the CARES Act.

The monetary and fiscal policymakers responded to the pandemic by pouring trillions of dollars into the financial markets and the economy. That halted the mad dash for cash. Liquidity improved significantly in the financial markets, as evidenced by the rapid narrowing of credit-quality spreads and the drop in bond yields across the board. The stock market bottomed on

March 23 and proceeded to melt up to a new record high by August 18. The recession lasted two months (March and April), with most key economic indicators showing V-shaped recoveries during May, June, and July.

The point of this mad dash through recent events is to assess whether all the cash that was provided by the monetary and fiscal policy responses to the pandemic has been used, increasing the risks of a significant weakening of the economic recovery and limiting the upside for stock prices. We won't keep you in suspense: There's still plenty of cash to keep things going forward for a few more months. We continue to monitor the situation in our [Mad Dash for Cash In 2020](#) chart publication. Consider the following:

(1) *Bond yields & credit-quality spreads.* The 10-year US Treasury bond yield has been trading in record-low territory below 1.00% consistently since March 20 ([Fig. 1](#)). The yield on high-yield corporate bonds spiked from this year's low of 5.02% on February 19 to a recent peak of 11.38% on March 23 ([Fig. 2](#)). It was back down to 5.37% on Friday. Over this same period, the spread between this yield on corporate junk bonds and the Treasury bond yield jumped from 346bps to 1,062bps and back down to 463bps ([Fig. 3](#)).

(2) *Liquid assets & M2.* The mad dash for cash caused liquid assets (consisting of total savings deposits, small-time deposits, and total money-market mutual funds held by individuals and institutions) to soar \$2.7 trillion from \$13.6 trillion during the February 3 week to a record high of \$16.3 trillion during the June 1 week ([Fig. 4](#)). It remained near that record high during the August 17 week. The growth rate of M2 jumped from 6.5% y/y at the start of the year to 23.6% during the August 17 week ([Fig. 5](#)).

(3) *Central banks' balance sheets.* The major central banks continue to pour liquidity into the global financial system. Since the start of this year, the balance sheets of the three major central banks are up sharply to record highs as follows: the Fed (up \$2.9 trillion to \$7.0 trillion during the August 26 week), the European Central Bank (up \$2.4 trillion to \$7.6 trillion during the August 21 week), and the Bank of Japan (up \$1.0 trillion to \$6.3 trillion). The sum of their assets soared \$6.3 trillion to a record \$20.9 trillion from the start of this year through the August 21 week ([Fig. 6](#)).

(4) *Government social benefits & personal saving.* During July, personal income was \$20.0 trillion (saar), down from April's record high of \$21.1 trillion but still up from \$19.0 trillion during January ([Fig. 7](#)). Government social benefits payments continued to buoy personal income, as

personal income excluding those payments rose from \$14.5 trillion during April to \$15.2 trillion during July, but that was still below the record high of \$16.0 trillion during February. The sum of unemployment insurance plus support checks (included in “other” social benefits) jumped from \$538 billion (saar) during January to a record high of \$3.9 trillion during April and dropped to \$2.1 trillion during July ([Fig. 8](#)).

Personal consumption expenditures in current dollars rose to \$14.2 trillion (saar) during July as spending on goods rose to a new record high; spending on services regained 14.1% since April but remained 9.3% below its record high during February ([Fig. 9](#)).

Initially, much of the monetary and fiscal stimulus provided to cushion the economic impact of the pandemic boosted personal saving, which soared from \$1.3 trillion (saar) during January to peak at a record \$6.4 trillion during April ([Fig. 10](#)). The lockdowns limited consumers’ ability to shop for goods and services.

Personal saving subsequently has dropped to \$3.2 trillion during July, reflecting the easing of lockdown restrictions, which has enabled consumers to spend the piles of cash they had accumulated. There’s still room for personal saving to fall further in coming months, providing a lift to consumer spending. That should help to offset the end of the pandemic-related government benefits if they are not renewed. Hopefully, wages and salaries will continue to recover, providing the best support for consumer spending.

(5) *Stock market indexes*. In our May 26 [Morning Briefing](#), we explained that the rebound in stock prices since March 23 was enabled by the latest round of bond buying by the major central banks in response to the pandemic. That enabled investors to rebalance into stocks and out of bonds as those very same monetary policies drove bond yields to record lows. Nevertheless, as we noted above, liquid assets remain in record-high territory, suggesting that the rebalancing out of bonds continues and that liquidity remains amply available to drive stock prices higher.

The result has been a meltup in stock prices that has the potential to turn into the Mother of All Meltups (MAMU). As we noted yesterday, since March 23, the S&P 500 rose 56.8% to a new record high of 3508.01 on Friday. It did so in 158 calendar days. The last time it rebounded so much so fast was during September 1933 ([Fig. 11](#)).

The Nasdaq's 70.5% rally since March 23 through Friday is also impressive. While it pales by comparison to the 255.8% meltup from October 8, 1998 through March 10, 2000, this rally may be on the same trajectory as the one back then ([Fig. 12](#)).

US Consumers: Still Spending. The pandemic continues to be bad news for most of the services-producing industries of the economy. But it's been great for goods-producing industries, especially in the months since the easing of lockdown restrictions. Among the biggest winners have been housing and housing-related industries, owing to the huge increase in the demand for single-family homes in the suburbs and rural areas of the country.

The scramble to de-urbanize has been led by Millennials, who are moving out of rental apartments in cities, with their dense populations, to buy homes with backyards for their kid(s) and enough space for one or even two home offices. Housing-related consumer spending is booming. Demand for passenger vehicles is likely also getting a boost from de-urbanization.

All of these developments are confirmed by July's personal consumption expenditures (PCE) and PCE price deflators (PCED) data, released on Friday. Consider the following:

(1) *Services.* As noted above, PCE on services is up 14.1% over the past three months through July but remains 9.3% below its record peak during February. Leading the recovery has been PCE on health care services, up 43.2% over the past three months, and within 7.4% of its record high during February ([Fig. 13](#)). PCE on hospital services is down just 4.5% from its recent peak, as elective procedures delayed by the pandemic are getting done.

Here are the recent rebounds and current shortfalls from their recent highs in the PCEs for the other major services industries that have been hard hit by the pandemic: air transportation (769%, -48%), hotels & motels (163, -56), amusement parks, campgrounds, & related recreations (119, -54), and gambling (283, -28) ([Fig. 14](#) and [Fig. 15](#)). Not surprisingly, the PCEDs for airfares and for lodging away from home were down 18.9% and 15.3% y/y during July ([Fig. 16](#)).

Making no sense is that PCE on tenant-occupied rent has been rising to new record highs all year. It's been widely reported that many tenants haven't been able to make their rent payments and that many state and local governments have banned evictions for the duration of the pandemic. The PCED for tenant-occupied rent is down from 3.6% y/y during January to

3.2% during July. It's probably heading down to zero, as it did during the Great Financial Crisis.

The PCED for college educations has been outpacing the overall PCED for decades ([Fig. 17](#)). It was up 2.1% y/y during July. The pandemic has forced almost all colleges to go online. Lots of students and their parents are likely to question why tuitions are so expensive even after the pandemic is over.

(2) *Goods*. PCE on goods rose to a new record high during July. Here are some of the retail industries that either rebounded to their highs at the start of this year or hit new highs during June and July based on retail sales: building materials, garden equipment & supply dealers; furniture & home furnishing stores; electronic shopping & mail order houses; electronics & appliance stores; and sporting goods, hobby, book & music stores.

Even retail sales of motor vehicles & parts dealers rose to a new record high during July, which is odd since new motor vehicle sales totaled 14.5 million units (saar) during July, down from 17.0 million units during January. It could be that used car sales are getting a big lift from people moving out of cities. That's confirmed by the 10.2% y/y increase in the PCED for used car prices during July ([Fig. 18](#)).

US Inflation: Fed of La Mancha. Last Thursday, Fed Chair Jerome Powell announced that after a year-long review, the Fed has a new approach to targeting inflation. The Federal Open Market Committee (FOMC) first publicly declared its longer-run goal for inflation in a January 25, 2012 [press release](#), which stated: "The inflation rate over the longer run is primarily determined by monetary policy, and hence the Committee has the ability to specify a longer-run goal for inflation. The Committee judges that inflation at the rate of 2 percent, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the Federal Reserve's statutory mandate."

As we noted yesterday, the FOMC has been mostly undershooting its target ever since. That's rather embarrassing considering the numerous rounds of monetary easing since the Great Financial Crisis, including three QE programs. Rather than even questioning the premise that inflation is determined mostly by monetary policy, the FOMC instead has chosen to slightly amend its inflation-targeting approach. Rather than aiming to reach 2.0%, the FOMC will tolerate overshoots that offset undershoots as long as the overshoots and undershoots together average around 2.0%. Consider the following:

(1) *Keeping the same questionable assumption.* The amended “[Statement on Longer-Run Goals and Monetary Policy](#)” maintains the language and the conceit that “the inflation rate over the longer run is primarily determined by monetary policy, and hence the Committee has the ability to specify a longer-run goal for inflation.”

(2) *The definition of insanity.* The big-deal change in the amended statement is that the FOMC now “judges that, following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time.” There’s the rub: If the FOMC couldn’t get inflation up to 2.0% since January 2012, how will it get inflation to overshoot that mark long enough to average 2.0%?

(3) *Don’t hold your breath.* Perhaps the latest round of monetary easing will finally do the trick. However, don’t hold your breath. The prices of housing-related goods and services will likely come under upward pressure as a result of de-urbanization. Lumber prices have soared to new highs in recent weeks. Used car prices have been increasing at a faster pace too. On the other hand, for the foreseeable future, rent and college tuition inflation rates are likely to move lower, not higher. Inflation rates for airfares and lodging away from home are also likely to remain low.

(4) *Counting on inflation to make a comeback.* Inflation might move higher if manufacturers respond to trade tensions and the pandemic-related disruptions to their global supply chains by bringing supply chains home. That would be expensive and might force them to raise their prices. Then again, technological innovations in robotics, automation, artificial intelligence, and 3-D manufacturing could make coming home easier and cheaper.

Perhaps aging demographics will push up health care inflation. Perhaps record-low mortgage rates will drive up home prices, making rents look attractive, and also drive them higher. How does pushing health care and rental costs higher make any sense as a sensible goal for monetary policy?

CALENDARS

US: Tues: Construction Spending 1.0%, Motor Vehicle Sales, ISM & IHS Markit M-PMIs 54.5/53.6, API Crude Oil Inventories, Brainard. **Wed:** ADP Employment Change 900k, Factory Orders 6.0%, MBA Mortgage Applications, EIA Crude Oil Inventories, Beige Book, Williams,

Kashkari, Mester. (DailyFX estimates)

Global: **Tues:** Eurozone Headline & Core CPI 0.2%/0.9% y/y, Eurozone, Germany, France, Italy, and Spain M-PMIs 51.7/53.0/49.0/52.0/52.7, Germany Unemployment Change & Unemployment Rate 1k/6.4%, UK M-PMI 55.3, Australia GDP -6.0%q/q/-5.3%y/y, Guindos, Lane, Wakatabe. **Wed:** Broadbent, Haldane. (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 15 straight weeks, MidCap's is up in 12 of the past 13 weeks, and SmallCap's posted its 12th gain of the past 15 weeks. LargeCap's forward earnings is now up 9.6% from its lowest level since August 2017; MidCap's has risen 17.0% from its lowest level since May 2015; and SmallCap's is up 24.7% 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 forward earnings is now 13.7% below its record high at the end of January. MidCap's and SmallCap's are 22.3% and 31.7% below their October 2018 highs. 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 -12.8% y/y from -13.3%. That's up from mid-May's -19.3%, 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 -21.1% y/y from -22.1% y/y, and is up from a record low of -32.7% at the end of May; that compares to a TCJA-boosted 24.1% in September 2018 (the highest since April 2011). SmallCap's rate rose w/w to -26.8% y/y from -28.3% 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. Here are the latest consensus earnings growth rates for 2020 and 2021: LargeCap (-20.2%, 27.9%), MidCap (-33.1, 50.2), and SmallCap (-53.0, 107.6).

S&P 500/400/600 Valuation ([link](#)): Valuations rose across the board last week, but most remain below their cyclical and record highs in early June when forward earnings was bottoming. LargeCap's forward P/E rose to a 19-year high of 22.7 from 22.1. That's up from

13.3 in mid-March, which was the lowest since March 2013. MidCap's was up 0.2pts w/w to 20.1, which is down 2.8pts from its record high of 22.9 in early June. SmallCap's rose 0.1pt w/w to 21.7 and is down 5.0pts from its record high of 26.7 in early June. 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—was 18.9, 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 yet 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 was below LargeCap's for a second week and for the first time since May. SmallCap's P/E had been mostly below from May 2019 to May 2020 after being solidly above since 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 are sitting back now as the Q2 earnings season draws to a conclusion. They had been adjusting their future forecasts higher as Q2 earnings results came in substantially higher than forecasted. The S&P 500's Q2 blended EPS estimate/actual rose 32 cents w/w to \$28.02. That \$28.02 estimate represents a decline of 32.2% y/y on a frozen actual basis and -30.8% y/y on a pro forma basis. For Q3, the estimate rose 7 cents w/w to \$32.42, which represents an earnings decline of 23.1%, or 22.9% 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. Just three of the sectors have recorded positive y/y earnings growth during Q2: Health Care, Tech, and Utilities. That's a big improvement from Q1 when all 11 sectors posted a y/y decline in earnings. Looking ahead to Q3, six of the 11 sectors are expected to post less worse growth on a q/q basis, reflecting the reopening of the US economy. Energy is expected to report a second straight quarterly loss during Q3. Here are the S&P 500 sectors' latest Q3-2020 earnings growth rates versus their nearly final Q2-2020 growth rates: Information Technology (-0.9% in Q3-2020 versus 3.7% in Q2-2020), Health Care (-2.6, 6.7), Utilities (-3.4, 6.4), Consumer Staples (-7.0, -6.3), Real Estate (-14.7, -15.1), Materials (-19.8, -28.6), Communication Services (-20.8, -16.7), Financials (-23.5, -42.8), Consumer Discretionary (-39.2, -65.7), Industrials (-65.4, -82.7), and Energy (-106.8, -168.5).

US ECONOMIC INDICATORS

Regional M-PMIs ([link](#)): Five Fed districts now have reported on manufacturing activity for August (New York, Philadelphia, Richmond, Kansas City, and Dallas). They collectively show the manufacturing sector continued to expand at a solid pace this month, led by an acceleration of growth in the Richmond, Kansas City, and Dallas regions—with the latter region moving from contraction to expansion. The composite index climbed to 12.2 last month, soaring from a record low of -58.6 in April. The Richmond (to 18.0 from 10.0), Kansas City (14.0 from 3.0), and Dallas (8.0 from -3.0) regions showed a pickup in growth last month, while Philadelphia's (17.2 from 24.1) showed a slower, though still robust, rate. In the meantime, growth in the New York (3.7 from 17.2) region weakened substantially. August's new orders measure sped up for the fourth month, from a record-low -66.4 in April to a 21-month high of 13.6 in August. Billings accelerated in the Kansas City (to 26.0 from 9.0), Richmond (15.0 from 9.0), and Dallas (9.8 from 6.9) regions, slowed in Philadelphia (19.0 from 23.0), and contracted slightly in New York (-1.7 from 13.9). Meanwhile, factories stepped up hiring, with the employment measure improving for the fourth straight month, from a record-low -36.0 in April to a seven-month high of 9.6 last month; it had turned positive in July for the first time in five months. Richmond (to 17.0 from -3.0) manufacturers made an about-face last month—hiring for the first time since the start of the year—while Kansas City (9.0 from 3.0) and Dallas (10.6 from 3.1) manufacturers hired at triple July's pace. Meanwhile, Philadelphia (to 9.0 from 20.1) manufacturers hired at half of July's pace, while New York's (2.4 from 0.4) hiring remained around the breakeven point between contraction and expansion.

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