Yardeni Research

MORNING BRIEFING
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Strategy Matters

Check out the accompanying chart collection.

(1) Lots of V-shaped recoveries around the world, so far. (2) New record high for volume of non-auto retail sales in Eurozone. (3) CRB raw industrials spot prices on recovery track. (4) Weekly S&P 500 forward revenues auguring well for Q3 revenues recovery. (5) S&P 500 Growth has been beating Value since early June. (6) Longer term, Value's total return gets a bigger boost from dividends than Growth's. (7) With or without dividends, Value has lagged Growth during the bull market since 2009. (8) A vaccine might give Value a shot in the arm. (9) Next Generation EU fund moves Europe toward more fiscal unification. (10) NGEU is also the New Green EU.

US Strategy I: More 'V for Victory' Over Virus. Yesterday, Debbie and I reviewed the latest data on payroll employment and purchasing managers surveys in the US. We are still seeing a V-shaped recovery, which started during May, in the latest data for these indicators through September.

We are also seeing V-shaped recoveries in the global PMIs through September (*Fig. 1*). Here are their readings back in April and most recently, in September: Global Composite (26.2, 52.1), Global M-PMI (39.6, 52.3), and Global NM-PMI (23.7, 51.6). All three have been above 50.0 since July. Keep in mind that since they are very cyclical diffusion indexes, their ability to maintain a V-shaped recovery is limited. Nevertheless, it's easy to find plenty of other V-shaped economic indicators around the world and at home:

(1) *Eurozone indicators showing strong recovery.* For example, the volume of non-auto retail sales in the Eurozone soared 30.3% from April through August to a new record high (*Fig. 2*). This augurs well for manufacturing orders in the region, which are up 40.9% since April through July (*Fig. 3*). The Economic Sentiment Indicator for the European Union (EU) has rebounded from April's low of 63.8 to 90.2 through September (*Fig. 4*).

(2) *Firming commodity prices.* The CRB raw industrials spot price index has rebounded 12.3% from this year's low on April 21 through Monday's reading (*Fig. 5*). It's back to within 2.2% of

this year's high on January 17. Over this same period, the nearby futures price of copper is up 30.8%.

(3) *Rebounding S&P 500 forward revenues.* In the US, the outlook for quarterly S&P 500 revenues per share continues to improve. The y/y growth rate of this series is highly correlated with both the M-PMI and NM-PMI (*Fig. 6* and *Fig. 7*). This outlook is confirmed by the rebound in the weekly series for S&P 500 forward revenues per share. It is up 4.0% through the September 24 week from its recent bottom during the May 28 week (*Fig. 8*).

US Strategy II: Growth, Value & Dividends. Since the market's bottom on March 23, the S&P 500 Growth and Value stock price indexes rallied in tandem through June 8, with both gaining 44.6% (*Fig. 9*). They've diverged since then, with the former continuing to move higher while the latter stalled. As of Monday's close, Growth is up 62.4%, while Value is up 39.0% since March 23.

These statistics are based on widely followed stock price indexes provided by Standard & Poor's for S&P 500 Growth and Value. S&P also provides total-return indexes, which reflect the reinvestment of their dividends into their respective style indexes. Similarly, MSCI provides comparable stock price indexes for the US MSCI Growth and Value indexes as well as total-return indexes, but its total-return indexes come two ways—reflecting the reinvestment of dividends on both "gross" and "net" bases. The "net" reflects the dividends distributed to investors after foreign taxes are withheld.

In the following analysis, we focus on the S&P 500 and use "SPI" for the stock price indexes and "GTRI" for the gross total-return indexes, i.e., including dividends. To repeat, S&P provides SPIs and GTRIs, but does not supply "NTRIs," or net total-return indexes, for the S&P 500 Growth and Value indexes. MSCI provides all three for its indexes.

Here is the performance derby since March 23 through Monday's close for the relevant S&P indexes: S&P 500 SPI (52.3%), S&P 500 Growth SPI and GTRI (62.4, 63.3), S&P 500 Value STI and GTRI (39.0, 41.2). Over short periods of time, there isn't much difference between SPIs and their corresponding GTRIs. I asked Joe to compare the S&P 500 Growth and Value performance derbies of these SPI and GTRI measures over longer time periods. Here is what he found when he sliced and diced the available data:

(1) *Long-term performance of the S&P 500 Growth and Value SPIs and their GTRIs.* Based on weekly data through last Friday, the S&P 500 Growth SPI is up 752.5% since June 30, 1995, nearly 2.7 times the 283.3% gain for the S&P 500 Value SPI. A look at their respective GTRIs shows the S&P 500 Growth GTRI up 1,104.6%, only 1.8 times the 618.8% gain for the S&P 500 Value GTRI (*Fig. 10*).

While both Value indexes have underperformed both of Growth's, the reinvestment of dividends has given a bigger boost to Value's GTRI. Since the start of this period in 1995 through the end of September of this year, the ratios of the GTRIs to SPIs rose to 2.2 for Value and to 1.5 for Growth.

The long-term performance since 1995 shows that Growth has not always been in the lead. The Growth and Value GTRIs performed in line from 1995 until 1998, when the tech bubble started to fuel Growth's outperformance until 2002. Value's GTRI then took over the long-term lead from Growth during 2004 and outperformed until the bear market of 2009. Growth and Value's GTRI marched together from 2009 until 2015. In the five years since then, Growth's GTRI has tripled while Value's has only doubled.

(2) *Bull market performance since 2009.* Now let's do the same drill but since the start of the bull market on March 9, 2009 through Monday's close. Here is the performance derby for the S&P 500's Growth and Value SPIs and GTRIs over this period: S&P 500 Growth SPI and GTRI (548.6%, 684.9%) and S&P 500 Value SPI and GTRI (268.9, 396.2) (*Fig. 11*).

(3) *Since the end of last year.* Here's the performance derby since the end of last year through Monday's close: S&P 500 Growth SPI and GTR (20.9%, 22.0%) and S&P 500 Value SPI and GTRI (-11.9, -9.9) (*Fig. 12*).

(4) *Bottom line.* The bottom line is that any way Joe slices and dices the data, Growth has beaten Value so far this year and since 1995, but Value has had its times to shine. It might do so again in response to the development and widespread distribution of a vaccine that would allow us to get back to some semblance of pre-pandemic normal.

European Union: Forging a Fiscal Union. European Central Bank (ECB) President Christine Lagarde repeatedly has called upon European governments to help support the global economy, asserting that central banks cannot do it alone. During a March 12 press conference

Lagarde said: “I really would like all of us to join forces, and I very much hope that the fiscal authorities will appreciate that we will only deal with the shock if we come together.”

Since then, Lagarde’s wishes have been granted. Not only has national aid sizably grown, but an unprecedented effort is underway within the EU to sustain the region through the Great Virus Crisis. The bold initiative is boldly called the “Next Generation EU” (NGEU) fund, as Jackie discussed in our August 20 *Morning Briefing*.

As Melissa and I see it, “NGEU” could just as well stand for “Modern Monetary Theory” (MMT) if their initials matched. MMT posits that monetary sovereign governments can deficit spend as much as they please without concern for how to repay debts, as they can simply print more money to do so. The NGEU is a centralized EU funding facility, over half of which will be in grants and never need to be repaid. The service cost on the borrowed portion is bound to be extremely low, as the ECB is bound to maintain negative interest rates for a very long time—measured in years or possibly even the decades until the NGEU lending matures!

MMTers argue that the only potential roadblock to indefinite central bank-financed government spending would be overheating inflation. But neither the European monetary nor fiscal authorities show any signs of concern about that right now. At the ECB’s September 10 monetary policy meeting, the Governing Council decided to maintain its extraordinarily accommodative policy despite signs of recovery. Speaking in an interview ahead of *WSJ*’s CEO Council yesterday, Lagarde said that the ECB is prepared to add more stimulus to support the “shaky” European recovery. “We are not the only game in town anymore,” she added, indicating her appreciation for the recent government actions to provide stimulus.

Further, an analysis in the ECB’s September 24 *Economic Bulletin* promoted the NGEU. It emphasized that the “monetary and fiscal policies, although implemented independently in the euro area, are currently acting in a mutually reinforcing way.” Back in July, Lagarde strongly advocated for the NGEU in a July 23 ECB blog post, saying that she hoped to “forge a new Europe out of this crisis.”

Indeed, the precedent-setting NGEU represents no less than a new fiscal union of European nations, borne of the coronavirus crisis. Here’s more on it from the ECB’s perspective:

(1) *Welcoming NGEU*. The bulletin stated that the fiscal cost of the national pandemic policy measures has been “very substantial for all euro area countries, although both the burden and

the capacity to respond vary across countries. It is therefore highly welcome that Europe has responded with coordinated fiscal action" with the NGEU fund. The NGEU issuance will increase outstanding EU debt by around 15-fold, the largest ever euro-denominated issuance at the supranational level, according to the ECB's analysis. Loans will be repaid by the beneficiary member states. Grant repayments will be covered by gross national income-based contributions and new EU "own resources" (i.e., revenues from duties, levies, and taxes).

For the NGEU, the European Commission (EC) is authorized to raise up to €750 billion in the capital markets on behalf of the EU. The funds can be used to provide loans of up to €360 billion and grants of up to €390 billion. These will be disbursed up to the end of 2026 and repaid by the end of 2058. The NGEU comes in addition to the regular Multiannual Financial Framework of around €1 trillion over the next seven years and the three European "safety nets" worth €540 billion agreed to in April 2020. (Here is a helpful infographic that further details the NGEU.)

(2) *Setting a (green) precedent*. The NGEU undoubtedly sets a precedent for larger and longer-term coordinated fiscal funding and deficits. In the analysis, the ECB took the position that the "NGEU constitutes a new and innovative element of the European fiscal framework. It will result in the issuance of sizeable supranational debt over the coming years, and its establishment has [signaled] a political readiness to design a common fiscal tool when the need arises. This innovation, while a one-off, could also imply lessons for Economic and Monetary Union, which still lacks a permanent fiscal capacity at supranational level for macroeconomic [stabilization] in deep crises."

The EC was authorized by the European Council to raise capital for the NGEU fund on July 21, but it still needs to be ratified by each of the member states, according to a September 16 European Parliament press release. Final decisions then will need to be made about how the funds will be spent.

An interesting component of the NGEU is its commitment to fund climate-friendly technologies. Lagarde noted in her blog post that 30% of spending in both the NGEU fund and the EU budget "will have to be linked to the climate transition and all spending should be consistent with the Paris climate goals. This means that more than €500 billion will be spent on greening the European economy over the coming years—the biggest green stimulus of all time. Countries will only be able to receive money if they submit recovery and resilience plans that contribute to the green and digital transitions."

Perhaps the fund should be renamed the “New Green EU”?

(3) *Expanding national aid*. The funding is greatly needed to support the poorer member nations that have sustained significant deficits to carry on during the crisis. Lagarde observed back in March that fiscal aid from national governments (excluding the EC) had amounted to about a quarter of 1% of euro area GDP. Since then, the level of national fiscal support has substantially increased. The bulletin stated that as a result of the economic downturn and the substantial fiscal support, “the general government budget deficit in the euro area is projected to increase significantly to 8.8% of GDP in 2020, compared with 0.6% in 2019.”

It added: “Euro area countries also have provided envelopes of loan guarantees amounting to almost 20% of GDP to reduce risks in the corporate sector.” It further noted that the euro area aggregate public debt-to-GDP ratio is projected to surge to 100.7% of GDP in 2020, 16.6ppts above the 2019 level, largely owing to pandemic-related policy measures. And even more fiscal aid for Europe is coming.

(4) *Benefiting struggling nations*. The financial support to be provided under NGEU is expected to total 5% of euro area GDP by the end of 2023, estimates the ECB. NGEU is anticipated to provide for a debt-based fiscal expansion of around 1% of GDP on average from 2021 to 2024, assuming that the support is used to finance additional productive spending at the national level, noted the ECB’s recent analysis.

The funds will be distributed unevenly, with sizable support “for those euro area countries that face the biggest economic and fiscal challenges after the pandemic.” Relative to GDP, Greece will be the largest beneficiary, but Spain and Italy will also receive sizeable fiscal support. The largest net “losers” will be the “frugal four” countries—i.e., Austria, Denmark, the Netherlands, and Sweden—in addition to Germany.

(5) *Perpetually debating austerity*. The ECB’s bulletin says that the NGEU has the potential to “significantly support the regions and sectors hardest hit by the pandemic, strengthen the Single Market and build a lasting and prosperous recovery.” In other words, the fiscally stronger nations have committed to supporting the weaker ones in the interest of a stronger union. The September 23 *FT* reported that Fabio Panetta, an ECB executive board member, said in a September 22 speech that for heavily indebted countries “the sizeable funding provided at the European level presents a unique opportunity to address concerns of

competitiveness and long-term sustainability." He added: "Growth will be the only solution to the accumulation of public and private debt." That certainly sounds like a vote for MMT!

That view is not shared by all. Jens Weidmann, president of Germany's central bank, recently warned about the risk of "creating the impression that debt at the EU level somehow doesn't count or that it is a way of evading tiresome fiscal rules," according to the *FT*. He added that the recovery fund should "remain a clearly defined crisis measure and should not open the door to permanent EU debt." Good luck with that.

CALENDARS

US: Wed: Consumer Credit $14b, MBA Mortgage Applications, EIA Crude Oil Inventories, FOMC Minutes, Williams, Kashkari, Evans, Barkin. **Thurs:** Initial & Continuous Jobless Claims 820k/11.4m, EIA Natural Gas Storage, Barkin, Kaplan. (DailyFX estimates)

Global: Wed: Germany Industrial Production 1.5%, Japan Leading & Coincident Indexes, ECB Non-Monetary Policy Meeting, Lagarde, Kuroda. **Thurs:** Japan Household Spending -6.9% y/y, Caixin C-PMI & NM-PMI, ECB Monetary Policy Meeting Accounts, BOE FPC Statement, Mersch. (DailyFX estimates)

US ECONOMIC INDICATORS

Merchandise Trade (*link*): The real merchandise trade deficit widened for the second month in August to a record high, climbing to -$92.3 billion after narrowing dramatically from -$86.2 billion in May to -$80.3 billion in June. Both real exports and real imports rebounded, up 27.9% and 18.6%, respectively, during the three months through August. Real exports dropped 29.6% during the three months through May, while real imports fell 16.2% during the five months through May. The biggest gains in exports over the three-months through August occurred in autos (260.3%), consumer goods ex autos (37.0), industrial supplies & materials (19.9), capital goods ex autos (15.2), and food (6.3). Here's the same exercise for imports: autos (212.6%), consumer goods ex autos (26.1), capital goods ex autos (14.4), food (12.8), and industrial supplies & materials (-23.0).

JOLTS (*link*): Job openings in August fell for the first time in four months, down 204,000 to 6.493 million, after a three-month surge of 1.7 million. Openings were at 7.012 million at the start of the year, falling as low as 4.996 million by April. Hirings climbed 16,000 in August to 5.919 million—after sliding 1.3 million the prior two months—boosted by the addition of

250,000 workers hired for the Census survey. Private industry hirings dropped by 220,000 in August and 1.6 million the past three months. Hotels, restaurants, and health care providers hired fewer people in August than they did in July. Total separations—which includes quits, layoffs, and discharges—fell 394,000 in August to 4.594 million. In August, the number of quits fell 139,000, to 2.793 million, after rising 1.1 million during the three months through July, as employees felt less confident about the employment situation. The quit rate ticked down to 2.0% in August after jumping from 1.4% in April to 2.1% by July.

GLOBAL ECONOMIC INDICATORS

Germany Manufacturing Orders (*link*): Factory orders continued to ascend in August, climbing to within 4.7% of its pre-pandemic level. "The catch-up in factory orders continues at remarkable speed," the Economy Ministry said. "It's supported primarily by demand from abroad." Orders rose 4.5% in August and 53.4% over the four months through August, with foreign orders up 6.5% and 64.9% over the comparable periods; the recovery in domestic orders is solid, though not as impressive, up 1.7% and 39.1% over the same periods. Within foreign orders, billings from within the Eurozone soared 14.6% in August and 85.5% since April to a 10-month high—more than reversing its Covid-19-related losses. Orders from outside the Eurozone climbed 1.5% in August and 53.1% during the four months ending August to within 8.0% of its pre-pandemic level. Here's a look at the four-month performance by market group for total, foreign, and domestic orders, respectively—with capital goods the clear winner and consumer nondurable goods the loser: capital goods (86.6%, 104.8%, 58.8%), consumer durable goods (39.2, 33.4, 50.0), intermediate goods (27.3, 27.9, 26.4), and consumer nondurable goods (-0.2, -1.6, 1.7).

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