Yardeni Research

MORNING BRIEFING
November 11, 2020

It Ain't Over 'Til It's Over

Check out the accompanying chart collection.

(1) Gridlock isn't locked in yet. (2) Ray Charles and Chuck Schumer. (3) If the Dems win the two Senate races in Georgia on Jan. 5, a Blue Wave tsunami could still happen. (4) Trump has 70 Days of Revenge if he so chooses. (5) Next shocker: The Durham report? (6) Yogi Berra's wisdom. (7) Vaccine countdown brings light at the end of the tunnel for pandemic-challenged companies, potentially broadening stock market rally. (8) Breadth of fresh air: The stock market starts rotating from indoors to outdoors. (9) Plenty of room to broaden bull market.

US Politics I: Georgia on My Mind. I might have declared victory for gridlock too soon on Monday. "Georgia on My Mind" is a 1930 song written by Hoagy Carmichael and Stuart Gorrell. It was first recorded that year by Hoagy Carmichael. Ray Charles, who was born in Georgia, recorded the song for his 1960 album. In 1979, the State of Georgia designated Ray Charles's version the official state song. Georgia will be on America's collective mind until the runoff elections occur on January 5 for the state's two Senate seats.

On Monday, I wrote: "The Republicans seem to have held onto their Senate majority, though the final outcome depends on a couple of Senate seats in Georgia that won't be decided until early January. On November 6, The Hill reported: 'Democrats are pinning their hopes on being able to force a 50-50 Senate on a narrow, uphill path that requires them to win both seats in the typically red state. If Democratic nominee Joe Biden wins the White House, a 50-50 margin would hand them the majority because Vice President Kamala Harris could break a tie.'"

In politics, nothing is a slam dunk. By some estimates, Georgia is about to be inundated with as much as $1 billion from the rest of the country to influence the two elections. What's at stake is worth much more than a measly billion dollars. An editorial in the November 8 *WSJ* explained:

"If incumbents in North Carolina and Alaska hold their current leads, Republicans will have 50 Senate seats in the next Congress. But they need 51 for a majority to organize the body because Vice President-elect Kamala Harris will preside over the Senate. She would cast the deciding vote in a 50-50 Senate. What difference would a single vote make? Republicans would lose their committee chairmanships and thus the power to serve as a check on the Biden Administration. Joe Biden deserves the Cabinet he wants in most cases, but a GOP Senate could deter appointments like Elizabeth Warren at Treasury. Oversight Chairman Ron Johnson's probe of FBI and other abuses would cease.

"Or consider the Democrats poised to run key committees if they organize the Senate. Bernie Sanders would run Budget, which means a squeeze on the Pentagon. Sherrod Brown of Ohio would run Banking, and Ms. Warren would run the financial institutions subcommittee. Have fun, bankers. Oregon's Ron Wyden would run Finance. He supports the $4 trillion Biden tax increase plus he wants to tax even unrealized capital gains as ordinary income. That means taxing the appreciation in the value of assets even if they aren't sold during the year. He isn't kidding."

On Saturday, Chuck Schumer (D-NY), the Senate Minority Leader, gloated: "Now we take Georgia, then we change the world. Now we take Georgia, then we change America." Also on Saturday, Georgia Secretary of State Brad Raffensperger (R) announced that he was sending a team of investigators to State Farm Arena in Fulton County to "secure the vote and protect all legal votes" after a ballot "issue" was discovered. The county is one among those most responsible for giving former Vice President Joe Biden the lead over President Donald Trump.

US Politics II: Scorched Earth? We might have seen the year's Santa Claus rally on Monday. The January 5 runoff elections in Georgia could weigh on the stock market as they approach. If the Democrats pull upset wins in both, James Madison's constitutional system of "checks and balances" will be broken for at least the next two years through 2022 mid-term elections. The Democrats will have the unchecked power to raise taxes, increase federal spending, provide a universal basic income, nationalize healthcare, pack the Supreme Court, implement their Green New Deal, and so on.

Meanwhile, despite recounts and legal challenges, President Trump probably lost the election. However, he will be slow to concede and will proceed during his remaining days in the White House to do what he can to prove that the election was stolen from him, or at least to raise doubts about the voting system.

Furthermore, Senator Lindsey Graham (R-SC), the chairman of the Senate Judiciary Committee, said on Sunday that US Attorney John Durham will release a report on his inquiry into the Russia investigation that will warrant indictments. Here is what he said on Fox News to host Maria Bartiromo:

“We’ve learned there was Russian collusion, but it was between the Clinton campaign, and it was between Russia. … Clinton and Russia, not Trump and Russia, and we learned that Crossfire Hurricane was the most corrupt investigation, maybe in the history of the FBI. Durham is all over this. After the election, you’re going to get a report, and I’ll be shocked if people are not indicted.”

Our friends at The Political Forum yesterday observed: “Add to all of this the fact that Trump still has 71 days to order the declassification of anything he thinks might be of interest, and it’s not outside the realm of possibility that the President, coming to grips with the fact that he’ll be unable to change the outcome of the election, has decided to burn Washington to the ground on his way out. Between the ‘proof’ of voter fraud that everyone admits is out there, whatever damaging information might be contained in the Durham report, and whatever else we might not know about other matters, like the content of Hunter Biden’s hard drive or Hillary Clinton’s emails, Trump could make an enormous mess out of a great many people’s lives if that’s what he chooses to do.”

As Yogi Berra famously once said, “It ain’t over ’til it’s over.” Sadly, deranged partisanship is probably here to stay. Gridlock would allow the stock market to tune out the noise. The alternative might not be so easy for the stock market to ignore.

Strategy: Better Breadth? Monday’s announcement by Pfizer that a vaccine may soon be available for Covid-19 was a shot in the arm for S&P 500 Value stocks (4.0%), while the S&P 500 Growth stocks (-0.5%) took a hit because they’ve mostly benefitted from the Work From Home (WFH) impact of the pandemic (*Fig. 1*). SMidCaps had a good day on Monday: S&P 500 (up 1.2%), S&P 400 (2.8), and S&P 600 (4.9) (*Fig. 2*).

The market capitalization of the Magnificent Five stocks (AAPL, MSFT, AMZN, GOOGL, and FB) fell 2.8% on Monday (*Fig. 3*). The Mag-5 are the five S&P 500 stocks with the biggest market capitalizations. They still had a market-cap share of 24.4% on Monday, down from the record high of 26.5% on September 1 (*Fig. 4*). They’ve accounted for most of the outperformance of Growth relative to Value and LargeCaps relative to SMidCaps since 2017.

Bears have been warning that the market's narrow breadth was setting the stage for a nasty correction if not a bear market. Monday's action showed that the S&P 500 could move higher even as investors rotated out of Growth and into Value. Indeed, there is enough cash on the sidelines to allow market breadth to broaden without taking down the Mag-5 down much (if at all) and allow the S&P 500 to climb into record-high territory over the rest of the year. Liquid assets jumped from $13.6 trillion at the beginning of the year to $16.2 trillion by the end of May, remaining around there through the end of October (*Fig. 5*). Consider the following:

(1) *Sectors.* Here is Monday's performance derby for the 11 sectors of the S&P 500: Energy (14.2%), Financials (8.2), Industrials (3.3), Real Estate (2.6), Materials (2.2), Utilities (1.8), S&P 500 (1.2), Health Care (0.7), Communication Services (-0.3), Consumer Staples (-0.5), Information Technology (-0.7), and Consumer Discretionary (-1.6). (See *Performance Derby: S&P 500 Sectors & Industries, Monday, November 11*.)

The outperformance of Energy and Financials boosted the Value stock price index Monday, while the Mag-7 weighed on Growth in Communications Services (FB, GOOGL, NFLX), Technology (AAPL, MSFT, NVDA), and Consumer Discretionary (AMZN).

(2) *WFH stocks underperform.* The vaccine news also weighed on the performance of the following WFH stock industries on Monday: Household Appliances (-10.4%), Computer & Electronics Retail (-9.8), Homebuilding (-6.9), Food Retail (-6.5), Home Improvement Retail (-6.2), Interactive Home Entertainment (-4.3), Internet & Direct Marketing Retail (-3.8), Household Products (-3.7), General Merchandise Stores (-3.7), Hypermarkets & Super Centers (-3.3), Air Freight & Logistics (-3.1), and Trucking (-2.5).

(3) *Laggards starting to catch up.* The pandemic-challenged companies rallied Monday on expectations that the vaccine will revive employment, travel, leisure, and amusement activities once social distancing is no longer required to reduce the spread of the virus. Here is a selection of Monday's winning S&P 500 industries: Hotel & Resort REITs (30.1%), Retail REITs (21.3), Hotels, Resorts & Cruise Lines (18.6), Food Distributors (16.8), and Casinos & Gaming (14.9).

(4) *Breadth of fresh air.* Joe and I track the percentage of S&P 500 companies with positive y/y stock price comparisons (*Fig. 6*). At the end of last year, this measure of breadth suggested that the index was extremely overvalued when it rose to 90.2% during the week of December

20. It then indicated extreme undervaluation when it fell to 11.8% during the March 20 week. In recent weeks, it's been around 50%, suggesting that there is plenty of room for better breadth.

(5) *Broad-based forward earnings recovery.* Since early June through the November 5 week, forward earnings continued to trace out V-shaped recoveries for the S&P 500/400/600 (*Fig. 7* and *Fig. 8*). The forward earnings of Growth continued to outpace that of Value, as it has since the beginning of the year (*Fig. 9* and *Fig. 10*).

(6) *Valuations.* The Mag-5 has been boosting the relative forward P/Es of LargeCaps and Growth since early 2018. Here are the latest as of Monday's close: S&P 500 (21.7), S&P 400 (18.8), S&P 600 (18.9), S&P 500 Growth (27.9), and S&P 500 Value (17.1) (*Fig. 11* and *Fig. 12*).

CALENDARS

US: Wed: MBA Mortgage Applications, Veterans Day. **Thurs:** Headline & Core CPI 1.3%/18% y/y, Initial & Continuous Jobless Claims 735k/6.9m, EIA Crude Oil Inventories, Williams, Evans. (DailyFX estimates)

Global: Wed: Japan Machinery Orders -11.6% y/y, Lagarde, Guindos, Lane, Adachi. **Thurs:** Eurozone Industrial Production 0.7%m/m/-5.8%y/y, Germany CPI 0.1%m/m/-0.2%y/y, UK GDP 1.5%m/m/15.8%3m/3m/-8.4%y/y, UK NIESR GDP Tracker 20.1%, UK Headline & Manufacturing Industrial Production -6.1%/-7.4% y/y, UK Goods Trade Balance -£9.5b, ECB Economic Bulletin, Guindos, Lagarde, Panetta, Mersch, Schnabel, Mauderer, Bailey. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Q3 Earnings Season Monitor (*link*): With 90% of S&P 500 companies finished reporting revenues and earnings for Q3-2020, revenues are beating the consensus forecast by a record-high 3.8%, and earnings have crushed estimates by 19.6%. The large surprises are primarily due to a lack of financial guidance from the companies that analysts follow. At the same point during the Q2 season, revenues were 3.0% above forecast and earnings beat by 23.6%. For the 451 companies that have reported through mid-day Tuesday, aggregate y/y revenue and earnings growth and the percentage of companies reporting a positive revenue and earnings surprise have improved from their Q2 measures. The Q3 reporters so far collectively have a y/y revenue decline of 1.6%, and their earnings are down 8.0%; those results mark a huge recovery from Q2, the worst quarter since Q1-2009 during the financial crisis. More than 84% of companies are reporting a positive earnings surprise, and 78% have beaten their revenues forecast. Slightly fewer companies are reporting positive y/y earnings growth in Q3 (50%) than are reporting positive y/y revenue growth (51), but those readings are up sharply from their respective Q2 readings of 37% and 33%. Taking a look at the Q3 shares outstanding tallied so far, companies outside of the Tech sector have put the brakes on share buybacks and are letting their share counts stabilize or edge higher. Basic shares outstanding are up 0.1% q/q and down just 0.1% y/y. At the same point during the Q2 season, the share count was down 0.1% q/q and 0.5% y/y. We don't expect the Q3-2020 figures to change much as more results are reported in the coming weeks. With more companies providing guidance about their future financial periods during the Covid-19 crisis, the revenue and earnings surprises should become smaller in future reporting periods.

US ECONOMIC INDICATORS

NFIB Small Business Optimism Index (*link*): "Leading up to the presidential election, small businesses continued to focus on stabilizing their businesses but were uncertain about the future economic conditions due to COVID-19 government regulations on all levels," said Bill Dunkelberg, NFIB's chief economist. "We see solid momentum going into the 4th quarter, and another good quarter could get the GDP back to its 2019 closing levels." The Small Business Optimism Index (SBOI) held at 104.0 in October, unchanged from September's historically high reading. Four of the 10 components of the SBOI rose last month, five fell, while the those saying now is a good time to expand was unchanged at 13% (it was at 3% in April). Earnings trends (to -3% from -12%) was the biggest positive contributor to October's SBOI—improving steadily from June's -35%, climbing into record territory—followed by sales expectations (11 from 8), plan to increase inventories (12 from 11), and expected credit conditions (-4 from -5). The biggest negative contributions came from owners expecting better business conditions over the next six months (27 from 32), along with the two employment-related components—hirings (18 from 23) and current job openings (33 from 36)—though both remained around historically high levels. Of the owners surveyed, quality of labor (22) remained the top business problem, followed by taxes (17), government requirements (14), and poor sales (13). The report notes that while the data were collected prior to Election Day, the 6-point increase in the uncertainty index to 98% (the highest reading since November 2016), was "likely driven by the election and uncertain conditions in future months due to the COVID-19 pandemic and possible government mandated shutdowns."

JOLTS (*link*): Job openings in September increased a smaller-than-expected 84,000 to 6.44 million—up 1.44 million since April, but still 576,000 below pre-Covid levels. There were 12.6 million unemployed in September, leaving roughly two unemployed workers competing for every job opening during that month. The number of hires (which includes rehired employees) fell 81,000 to 5.87 million in September, back around pre-pandemic levels after a brief spike to a record high of 7.20 million in May. Total separations—which includes quits, layoffs & discharges—slipped 25,000 in September and 324,000 the past two months to 4.66 million. The number of quits resumed its climb, rising 179,000 in September after a brief dip in August; quits rose during four of the past five months by a total of 1.14 million, to 3.02 million—with the most occurring in accommodation & food services, construction, and professional & business services. Meanwhile, layoffs & discharges fell during five of the past six months, falling 200,000 in September and a whopping 10.16 million over the period, to a record-low 1.33 million, after spiking 9.64 million in March to a record 11.49 million. The quit rate rose to 2.1%, matching July's rate, which was the highest since before the pandemic, while the rate for layoffs & discharges sank to 0.9%—a record low going back to 2000.

Contact us by email or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-775-6823