MORNING BRIEFING
November 12, 2020

Ob-la-di, Ob-la-da

Check out the accompanying chart collection.

(1) Life goes on as playing fields shift for the pandemic, the nation, the Industrials sector, and fintech. (2) Financials, Materials, and Industrials pay catch-up. (3) Better earnings getting closer as 2021 nears. (4) Covid-19 and the US-China trade war have manufacturers looking to come home. (5) US manufacturing also benefitting from automation and connections to the cloud. (6) It's time to pay more attention to fintech companies. (7) Fintech making inroads in personal loans, online banking, and mortgages, with their sights set on credit cards.

Strategy: An Election and a Miracle Vaccine. The S&P 500 has risen 9.5% since bottoming on September 23 through Tuesday's close. It's truly an unusual market when the S&P 500 Automobile Manufacturers stock price index (34.3%) outperforms Internet & Direct Marketing Retail (2.3) and when Industrial Conglomerates (21.0) trounces Application Software (4.5). Most of the market's recent gains occurred since Election Day, November 3, and continued after the announcement of a vaccine on Monday, November 9.

Since the market's recent low on September 23, there has been a vicious rotation, with Financials, Utilities, Materials, and Industrials posting the strongest returns. Here's the S&P 500 performance derby from September 23 through Tuesday's close: Financials (16.8%), Utilities (15.9), Materials (14.1), Industrials (13.6), Energy (11.8), Communication Services (11.1), S&P 500 (9.5), Health Care (9.0), Real Estate (8.1), Information Technology (6.9), Consumer Staples (6.0), and Consumer Discretionary (5.3) (*Table 1*).

Optimism that our collective Covid-19 nightmare could end sometime next year may have given investors the confidence to peer into 2021, when y/y earnings comparisons show double-digit percentage growth starting in Q1 and continuing throughout the year. Here are analysts' consensus forecasts for the S&P 500 sectors' y/y earnings growth in 2021: Industrials (75.1%), Consumer Discretionary (59.3), Materials (29.0), S&P 500 (22.6), Financials (19.1), Communications Services (14.1), Information Technology (15.0), Health Care (12.8), Consumer Staples (6.4), Utilities (4.7), Real Estate (-5.5), and Energy (a return to profitability).

Joe reports that the S&P 500 Industrials' earnings are inflated by the Airlines industry, which is expected to lose a huge amount of money this year ($29.7 billion) and lose only a bit of money next year ($3.8 billion). Excluding Airlines, earnings are slated to grow 22.9% for the Industrials sector and 19.8% for the S&P 500 in 2021. Such an outcome would certainly make for a happy New Year!

Industrials: Positive Trends. The convergence of some very large trends should boost American manufacturing in coming years. Covid-19 and the US-Chinese trade war have prompted manufacturers to explore moving their production back to the US. To remain competitive while doing so will mean running lean operations, using robots, and harnessing the Internet throughout the factory floor.

Companies' focus on their manufacturing resiliency was discussed on Tuesday by Rockwell Automation's executives in their fiscal Q4 (ended September) earnings conference call. If these trends come to pass, it will be good for employment and manufacturing.

Here's Jackie's look at some of the trends:

(1) *Onshoring gaining momentum.* The move to bring manufacturing back to North America is gaining momentum, according to a survey by Thomas, a company that helps manufacturers with product sourcing, supplier selection, and marketing. Almost 70% of 746 respondents said they were either "likely," "very likely," or "extremely likely" to reshore their manufacturing operations, according to the survey, which occurred from May 16 through June 17. That's an improvement from the 54% of respondents in the February survey, the company's July 14 press release states.

Rockwell CEO Blake Moret is also seeing companies moving toward reshoring their operations. "We continue to see our customers take steps to increase their resilience, agility, and sustainability. Resilience includes investments to reduce single points of failure, with a growing list of companies announcing plans to build or expand North American operations," he said. "Other measures to increase resilience include increased automation, traceability, and remote monitoring, which are all Rockwell strengths."

The pandemic has pushed manufacturers of medical goods to increase their manufacturing capacity in the US. Becton Dickinson announced a joint partnership with the Biomedical

Advanced Research and Development Authority (BARDA) to develop new manufacturing lines for injection devices. It will provide priority access to the US government for hundreds of millions of syringes and needles to support vaccination efforts, a July 8 company press release stated. As part of the partnership, BARDA will invest about $42 million into a $70 million capital project to expand Becton Dickinson's operations and manufacturing capacity in Nebraska. The capacity was expected to come on line within 12 months.

(2) *Electric vehicles and semis growing.* Rockwell highlighted a number of other industries that were helping its business. The move to produce electric vehicles and batteries has meant companies are rolling out new or adjusted manufacturing lines. Rockwell's automotive organic sales, which fell 20% y/y in fiscal Q4, is expected to grow 10% in fiscal 2021. Likewise, the semiconductor industry is benefitting from the adoption of smart devices, faster data centers, and 5G wireless technology. That segment's sales rose by "high single digits" last quarter and are expected to climb by "mid-single digits" in fiscal 2021. And finally, the expansion of e-commerce has filled distribution facilities with advanced technology and automation.

(3) *Internet of Things on the factory floor.* In addition to becoming more automated, manufacturing floors are also increasingly connected to the cloud. Microsoft and Rockwell extended their partnership by five years to "deliver edge-to-cloud-based solutions that connect information between development, operations and maintenance teams through a singular, trusted data environment. This will allow development teams to digitally prototype, configure and collaborate without investing in costly physical equipment," a October 6 Microsoft press release states. It also allows teams to securely access and share data across the organization and with business partners.

(4) *Cost cutting.* Like many other companies, Rockwell cut costs when the pandemic hit. Some cuts will be reversed, but others will remain and help improve the bottom line. Rockwell plans to reverse wage cuts and restore 401(k) matches at the end of November. However, other cuts are expected to result in $15 million in additional annualized cost savings starting in fiscal 2021. At the end of the day, Rockwell was confident enough about the future to provide an earnings forecast—a 10% increase at the midpoint of the range--and to increase its dividend. The shares sold off almost 3% on Wednesday, but they're up almost 20% ytd.

(5) *The numbers.* Rockwell Automation is a member of the S&P 500 Electrical Components & Equipment stock price index. After moving sidewise for much of 2018, 2019, and the first half of this year, the index rallied sharply. It's up 13.8% ytd and up 19.5% since the market's

September 23 low (*Fig. 1*). Revenues and earnings peaked in 2019 and are expected to bottom this year before growing once again. Revenues are forecast to tumble 12.3% in 2020 and rise by 3.3% in 2021 (*Fig. 2*). Likewise, earnings are expected to fall 15.0% this year only to bounce 8.4% in 2021 (*Fig. 3*). After being negative for much of the past year and change, net earnings revisions have turned positive, rising to 19.2% in August, 23.9% in September, and 27.4% last month (*Fig. 4*). Investors are optimistic, with the industry's forward P/E at 22.6, near the highest levels of the past 25 years (*Fig. 5*).

Disruptive Technologies: Fintech Making Inroads. The recent demise of the planned Ant Financial IPO made us wonder just how large the fintech players in the US would have to be before US regulators enacted tougher rules on the burgeoning industry. Fortunately, the thought hit just as the Federal Reserve Bank of Philadelphia held its fourth Fintech Conference this week.

Loretta Mester, president of the Federal Reserve Bank of Cleveland, described how quickly the industry has grown: "According to the U.S. Treasury, from 2010 to the third quarter of 2017, more than 3,330 new technology-based firms serving the financial services industry have been founded. The global market capitalization of fintech firms grew to $22 billion in 2017, 13 times what it was in 2010. Lending by these firms accounts for over 36 percent of personal loans in the U.S., up from under 1 percent in 2010."

But the US fintech market remains much more fractured than the Chinese one. Chime is considered the most valuable US fintech company, valued at $14.5 billion in its September private fund raising. While that's up 900% since its March 2019 fundraising, it's still far smaller than $313 billion valuation Ant would have enjoyed if its IPO had been successful. The fractured nature of the US fintech market may have kept the regulators at bay so far. But the sum of the parts is getting large enough that regulators are sure to become more proactive.

Here's a quick look at some of the largest areas of the fintech market:

(1) *Fintech in mortgage lending.* Fintech companies have made major inroads into mortgage lending. In 2015, Quicken Loan's Rocket Mortgage introduced the ability to apply for a mortgage online in less than 10 minutes. By Q4-2017, Quicken was the largest US mortgage originator by volume, surpassing Wells Fargo, a January 2 *Business Insider* article reported.

Here's the Consumer Financial Protection Bureau's list of originators of all mortgages, whether made online or in person, during 2019: Quicken Loans, United Wholesale Mortgage, Wells Fargo, JPMorgan Chase, LoanDepot, Caliber Home Loans, Bank of America, Freedom Mortgage, and US Bank, according to a June 25 HousingWire article.

Some of the private mortgage companies are using the strong housing market to go public. United Wholesale Mortgage is merging with Gores Holdings IV, a special purpose acquisition company, in a deal that values the lender at $16.1 billion. The merger follows Rocket Companies' IPO in August and precedes an expected IPO from Caliber Home Loans and LoanDepot.

(2) *Fintech in personal loans.* Fintech lenders have also made headway in the personal loan market, according to a 2019 report by DBRS. Their share jumped from just 5% in 2013 to 38% in 2018 as a percentage share of all personal loans outstanding. Conversely, banks' market share has decreased from 40% in 2013 to 28% in 2018. Similarly, traditional finance companies' share has decreased from 24% to 13%, and credit unions' share has declined from 31% to 21% over the same time period.

Some online lenders use their own capital to make loans, but many don't have a banking license and depend on banks that do have licenses to actually make the loans. As they grow, some of the online lenders are looking to become more like traditional banks. This summer, Varo Money was the first fintech company to be granted a national bank charter by the US Office of the Comptroller of the Currency (OCC). It was followed by Social Finance's (SoFi) application for a national bank charter, which received preliminary, conditional approval from the OCC last month. If SoFi Bank receives a license, it will be able to hold customer deposits and make loans without relying on a bank partner. And earlier this year, Square's application for an industrial loan company bank charter received FDIC approval. It's expected to lend to small and medium-sized business and offer deposit products.

"With a [banking] charter, a fintech can lower its funding costs, gain access to Federal Reserve payments systems, and operate more uniformly on a nationwide basis with federal preemption of many state laws, including state licensing requirements," an August 4 article in McGuire Woods's Consumer FinSights blog explained.

(3) *Fintech in auto loans.* Fintech providers of personal loans have been branching out into auto loans. Upgrade, which offers personal loans and credit cards, announced in August plans

to enter the auto financing market. With more than 10 million users and originations exceeding $3 billion, Upgrade uses Cross River Bank to underwrite, originate, and service the loans. Another fintech company, Upstart, is also expanding from personal loans into the auto loan market.

Many fintech players have partnered with auto manufacturers' captive lenders. For example, Ford dealerships are working with AutoFi, and Motor Acceptance works with Modal, a car shopping and financial platform.

As online auto sales grow, so should online auto lending. Carvana offers online auto loans to customers looking to purchase new or used cars online. And Chase Auto partnered with online used-car retailer Vroom to create Vroom Financial Services Powered by Chase.

(4) *Fintech in credit cards.* The traditional credit card business is still dominated by large banks. The top five are Chase, Citi, AmEx, Bank of America, and Capital One, a September 1 Cardrates.com article reported. Goldman Sachs broke into the top 25 issuers with the launch of the Apple Card in August 2019. Apple Card works as a physical card or as a part of Apple Pay, the iPhone's digital wallet.

A number of private fintech startups are looking to expand into the world of credit cards. Brex is a corporate credit card for tech companies that allows them to access much higher credit limits, automate expense management, eliminate receipt tracking, and integrate with accounting systems, according to a March 26, 2019 article on Crunchbase. Zero offers a debit card that gives users cash back (or other rewards) like a credit card. Extend allows business cardholders to share their credit card with employees and freelancers without exposing the card number or losing control.

Cred.ai offers a full banking platform that includes a credit card with Visa. It targets the Millennial and Gen Z generations with offers to help raise credit scores via its artificial-intelligence-enabled credit optimizer tool. In the same category is online bank Chime's Credit Builder Visa credit card. Chime shares on-time payment information with credit bureaus, which helps improve its customers' credit scores.

"Unlike traditional banking players, cred.ai is foregoing fees, interest, and rewards. For revenue, the platform relies on merchant transactions and deposits, as well as its plans to license its underwriting system and compliance infrastructure technology to small banks and other fintechs in the future," an August 13 CNBC article reported. We don't expect the disruption to end anytime soon.

CALENDARS

US: **Thurs:** Headline & Core CPI 1.3%/1.8% y/y, Initial & Continuous Jobless Claims 735k/6.9m, EIA Crude Oil Inventories, Williams, Evans. **Fri:** Consumer Sentiment Index Total, Present Situation, Expectations 82.0/87.5/78.6, Headline & Core PPI 0.4%/1.2% y/y, Baker-Hughes Rig Count, EIA Natural Gas Inventories, Williams. (DailyFX estimates)

Global: **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. **Fri:** Eurozone GDP 12.7%q/q/-4.3%y/y, Eurozone Balance of Trade €22b, France CPI -0.1%m/m/0.0%y/y, Spain CPI 0.9%m/m/-1.0%y/y, China FDI (ytd) 2.5% y/y, Mauderer, Weidmanm, Tenreyro, Bailey. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) this week rebounded along with bullish sentiment, moving above 3.00. The BBR climbed to 3.05 this week after dropping from 3.00 to 2.60 last week on a sharp pullback in bullish sentiment. Bullish sentiment jumped 5.6ppts this week, to 59.2%, after sliding 7.00pts, to 53.6%, last week. Before last week's plunge, bullish sentiment had a five-week surge of 9.1ppts (to 60.6% from 51.5%). The rebound in bullish sentiment this week came primarily from the correction camp, with its percentage falling to 21.4% after jumping 6.6ppts last week to 25.8% from 19.2%—which was the lowest percentage since September 2018. Bearish sentiment slipped to 19.4% after edging up from 20.2% to 20.6% last week; it's been fluctuating in a range from 19.4% to 23.2% the past eight weeks. The AAII Ratio rebounded to 54.7% last week—the highest since mid-February—after slipping from 52.0% to 50.0% the prior week. Bullish sentiment jumped to an eight-month high (to 38.0% from 35.3%) last week, while bearish sentiment (31.5 from 35.3) sank to a nine-month low.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The rapid pace of Covid-19 estimate cuts has turned into a V-shaped recovery as analysts continue to play catch-up from their lowball estimates prior to the better-than-expected Q2 and Q3 earnings seasons.

Consensus S&P 500 forecasts previously had been falling at rates paralleling the declines during the 2008-09 financial crisis. Forward revenues is at its highest level since mid-March and is now just 2.6% below its record high in mid-February. Forward earnings is at its highest level since late March and is now 8.2% below its record high in early March. Forward revenues growth surged 0.9ppts w/w/ to 7.1%. That's the highest reading since August 2011 and is up from 0.2% in April, which was the lowest reading since June 2009. Forward earnings growth of 18.9% was up 2.5ppts w/w to its highest reading since August 2010. Forward earnings growth is up 24.5ppts from its record low of -5.6% at the end of April. Analysts expect revenues to decline 3.5% y/y in 2020 and rise 8.0% in 2021 compared to the 4.3% reported in 2019. Analysts expect an earnings decline of 16.1% y/y in 2020 and a 22.6% gain in 2021 compared to a 1.5% rise in 2019. The forward profit margin of 11.3% was up 0.2ppt to its highest reading since early April. That's up a full point from 10.3% during April and May, which was the lowest level since August 2013. It's still down 1.1ppt from a record high of 12.4% in September 2018. Analysts expect the profit margin to fall 1.5ppt y/y in 2020 to 10.0%—from 11.5% in 2019—and to improve 1.4ppt y/y to 11.4% in 2021. Valuations dropped for a second straight week from six-week highs in mid-October. The S&P 500's weekly forward P/E rose 0.6pts w/w to 21.2 from a 24-week low of 20.6. That compares to 23.1 in early September, which was the highest level since July 2000 and up from a 77-month low of 14.0 in mid-March. The S&P 500 price-to-sales ratio gained 0.10pt w/w to 2.39 from a five-week low of 2.29. That's down from a record high of 2.53 at the beginning of September and up from the 49-month low of 1.65 in mid-March.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins (*link*): Last week saw consensus forward earnings rise w/w for all 11 S&P 500 sectors and forward revenues rise for all but Energy. 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. Tech and Utilities are the only sectors expected to have an improved profit margin in 2020, whereas back in early March eight sectors were expected to see margins improve y/y. During 2019, just two sectors' margins 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 shifted noticeably higher for nine sectors. Utilities was unchanged, and Real Estate fell to its lowest level since March 2012. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (22.3%, down from 23.0%), Financials (15.2, down from 19.2), Utilities (14.3, record high), Communication Services (14.1, down from 15.4), Real Estate (12.8, down from 17.0), S&P 500 (11.3, down from 12.4), Health Care (10.7, down from 11.2), Materials (10.5, down from 11.6), Industrials (8.5, down from its record high of 10.5% in mid-December), Consumer Staples (7.5, down from 7.7), Consumer Discretionary (6.4, down from 8.3), and Energy (2.5, 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, bottomed at cyclical lows on May 28 after 14 weeks of Covid-19 declines. Since then, S&P 500 forward revenues has risen 5.9%, forward earnings has gained 16.6%, and the forward profit margin has risen 1.0pt to 11.3%. All of the 11 sectors posted new post Covid-19 highs last week in either their forward revenues, earnings, or profit margin. The laggards: Energy's revenues and Real Estate's earnings and profit margin. Energy's forward revenues remains near a 15-year low. Energy's forward revenues is falling from its post-Covid-19 high in July. Real Estate's forward earnings have worsened to a six-year low, and its profit margin is at an eight-year low. Here's how the 11 sectors rank by their changes in forward revenues and forward earnings since May 28: Consumer Discretionary (forward revenues up 9.0%, forward earnings up 49.3%), Information Technology (7.7, 10.4), Materials (6.9, 27.0), Industrials (6.9, 23.4), Communication Services (7.9, 13.6), Financials (6.5, 19.8), S&P 500 (5.9, 16.6), Health Care (4.7, 11.8), Consumer Staples (2.8, 7.2), Energy (1.8, 343.9), Real Estate (1.2, -8.6), and Utilities (-1.5, 1.4).

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