MORNING BRIEFING
November 19, 2020

Looking Beyond the Pandemic

Check out the accompanying chart collection.

(1) Which underperforming sector this month has some of market's best-performing industries? Consumer Discretionary. (2) Forward-looking investors see consumers looking forward to fun times, post-pandemic. (3) Kohl's and TJX show optimism about the future by reinstating dividends. (4) Executives calling on Congress to push through a stimulus package now. (5) Project Warp Speed expands US manufacturing of vaccines and pharmaceuticals. (6) New vaccines based on mRNA save the day and may hold the key to the development of other vaccines and drugs in the future.

Consumer Discretionary: More Than Meets the Eye. On the surface, it looks like consumer-related stocks are having a tough November. The S&P 500 Consumer Discretionary stock price index is up 7.0% mtd, making it the second-worst-performing of the S&P 500's 11 sectors. Blame it on Amazon and its immense influence on the sector. Yet many of the industries in the Consumer Discretionary sector have been having a market-beating month as investors embrace the wonderful news about vaccines' efficacy and bet on a return to some semblance of normal before the end of next year. Let's take a look beneath the surface:

(1) *Consumer Discretionary lagging behind.* The performance derby for the S&P 500's sectors mtd through Tuesday's close clearly shows the Consumer Discretionary sector at the back of the pack: Energy (25.7%), Financials (15.5), Industrials (15.3), Materials (10.9), Real Estate (10.5), S&P 500 (10.4), Information Technology (9.7), Health Care (9.2), Communication Services (8.7), Consumer Staples (8.6), Consumer Discretionary (7.0), and Utilities (4.5) (*Fig. 1*).

Dragging down the Consumer Discretionary sector's performance this month have been Internet & Direct Marketing Retail (4.7%), Distributors (4.5), General Merchandise Stores (4.2), Household Appliances (3.3), Automotive Retail (2.9), and Home Improvement Retail (1.9). The biggest dragger in the sector is Amazon, a member of the Internet & Direct Marketing Retail industry. Amazon has fallen 2.4% this month, trimming its ytd gain to 69.7%. As Joe mentioned in yesterday's *Morning Briefing*, Amazon accounts for 47% of the sector's market capitalization as of Friday's close. So its performance has an outsized effect on the market—and of course on its sector.

The other industries dragging down the sector may be indicating that the surge of Covid-19-induced buying to fix up homes and buy washing machines and used cars has peaked. Optimistic news about successful vaccines has given investors renewed confidence to rotate out of the winners of the past year and start buying some of the retail stocks hardest hit by Covid-19. This willingness to look into the future is impressive given that the recent surge of Covid-19 cases across the country could mean a tough holiday season for retailers. No holiday parties means there's no need to run out and buy new clothes or lay out a holiday feast. But those willing to look six months out, when a vaccine should start having an impact on our behavior, have renewed confidence that consumers will start living the good life again.

Which leads us to the many industries in the Consumer Discretionary sector that are among the best-performing industries in the S&P 500 so far this month: Hotels, Resorts & Cruise Lines is up 27.4%, Casinos & Gaming (24.4%), Apparel Retail (22.6), Apparel, Accessories & Luxury Goods (21.2), and Automobile Manufacturers (18.2). Looks like investors think Americans are ready again to book hotel rooms, go gamble in Vegas, and buy new clothes before our trips.

(2) *A split reaction to retailers' earnings.* Investors' willingness to bet on a future where Covid-19 is vanquished was evident in the retail stocks' reaction to earnings news. Kohl's reported fiscal Q3 (ended October) same-store sales fell 13%, and at TJX the figure is a decline of 5%. Yet shares of Kohl's rose 7.8% after its earnings announcement, and TJX shares jumped 3.8%. For the month of November through Tuesday's close, Kohl's shares are up 33.9% and TJX shares are 18.2% higher.

The two retailers reaffirmed their financial stability. Kohl's had more than $1.9 billion in cash at the end of the quarter and announced plans to reinstate its dividend during the first half of 2021. Likewise, TJX ended the quarter with $10.6 billion of cash and announced that it too would reinstate its dividend, in March and at a 13% higher rate than it last paid out in March 2020. Home Depot reported a 25% jump in US same-store sales for its fiscal Q3, and Walmart boasted a 6.4% increase, but those retailers' shares have gained only 1.1% and 6.8% in November.

(3) *Pressure building for stimulus.* Investors appear to be betting that Congress will extend employment benefits beyond those offered by the Coronavirus Aid, Relief, and Economic Security (CARES) Act through December 31. The US unemployment rate remains elevated at 6.9% in October (*Fig. 2*). And spending has been supported by government benefits, which surged from $3.16 trillion (saar) in February to a record-high $6.55 trillion in April and subsequently fell to $4.11 trillion in September (*Fig. 3*). Government subsidies have helped bolster personal income, which was up 6.2% y/y in September even as wages and salaries were up only 0.5% y/y (*Fig. 4* and *Fig. 5*).

The call to extend benefits is getting louder from those outside the Beltway. JP Morgan CEO Jamie Dimon put it ever so colorfully in a CNBC interview Wednesday: "I know now we have this big debate. Is it $2.2 trillion, $1.5 trillion? You gotta be kidding me. I mean just split the baby and move on. This is childish behavior on the part of our politicians. We need to help the citizens of America."

Walmart's CEO Doug McMillon put it a bit more diplomatically in the company's Q3 conference call: "As various governments around the country tighten up to help keep people healthy, it will be imperative that elected officials in Washington work together to deliver the help so many small businesses need to get through this next phase of the pandemic."

And former Food & Drug Administration Chief Dr. Scott Gottlieb has urged Congress to get a deal done as well: "We need to think about what temporary sacrifices we're willing to make, including economically, with Congress stepping in for another round of [the Paycheck Protection Program] to support businesses that are going to be shut over the next two to three months because this may be the last time we have to do it," he told CNBC on Wednesday.

(4) *A look at forecasts.* Kohl's shares are no longer in the S&P 500, but TJX is a member of the S&P 500 Apparel Retail stock price index, which, as we mentioned above, is up 22.6% in November (*Fig. 6*). Analysts expect the industry to report a 20.8% drop in revenue this year, but post a 24.7% surge in 2021 (*Fig. 7*). Likewise, the industry's earnings are forecast to fall 93.8% in 2020, only to rebound by 1,402.5% next year (*Fig. 8*).

That's quite different than the S&P 500 Home Improvement Retail industry, which after posting a 22.7% earnings increase this year is expected to only grow earnings by 2.8% in 2021 (*Fig. 9*). Walmart and Costco make up the S&P 500 Hypermarkets & Super Centers industry in the Consumer Staples Sector. The industry is expected to have steady earnings growth--7.7% this year and 7.0% in 2021—but even that will be eclipsed by the earnings of retailers that were hurt the most by consumers staying out of the stores due to Covid-19 (*Fig. 10*).

Health Care: Moving at Warp Speed. The news about the spread of Covid-19 has been awful of late, with record numbers of people catching the disease. But thanks to the CARES Act, the US government is throwing $2.2 trillion at this ginormous problem, and improvements in science and manufacturing hopefully will result.

The CARES Act funded the expansion of unemployment benefits and research efforts toward understanding, preventing, and curing Covid-19. Less discussed is the funding it's providing to help expand the manufacturing needed to produce items related to healthcare and a Covid-19 vaccine for 300 million Americans.

The CARES Act gives $27.0 billion to the Department of Health and Human Services to fund activities that include developing and purchasing vaccines and therapeutics, according to a June 25 Government Accountability Office report. At least $3.5 billion of the funding is earmarked for the Biomedical Advanced Research and Development Authority (BARDA). Public Citizen does a nice job of breaking out what companies are getting what grants. As we mentioned in last Thursday's *Morning Briefing*, Becton Dickinson received $42.3 million from BARDA to expand its production of needles and syringes as part of the program.

Here's a quick look at some of the BARDA's grants relating to the manufacturing of goods needed to fight Covid-19. They hopefully will strengthen the domestic production of pharmaceuticals for years to come.

(1) *Lots of needles and vials needed*. In addition to Becton Dickinson's funding, the agency is also giving $20.7 million to Smiths Medical and another $53.7 million to Retractable Technologies to fund the expansion of manufacturing of safety needles and syringes.

Corning was granted $204.0 million to expand its domestic manufacturing of Corning Valor Glass tubing and vials/cartridges. And Si02 received $143.0 to develop/establish three US-based manufacturing systems for durable, high-performance glass/plastic vials.

BARDA has also focused on the materials going into the vaccines. It gave $31 million to Cytiva to expand the company's manufacturing capacity for products used to produce Covid-19 vaccines. The products include liquid and dry powder cell culture media, cell culture buffers, mixer bags, and XDR bioreactors, an October 13 press release states. BARDA has awarded Snapdragon Chemistry $691,878 to help develop an "innovative continuous manufacturing platform to produce ribonucleotide triphosphates (NTPs), a critical raw material for Covid-19 vaccines that use messenger RNA technology," a June 11 press release states.

(2) *Gotta fill the vials.* Vaccine developers typically hire their own fill finish facilities for their vaccines. But the US government is reserving capacity to ensure that Covid-19 vaccine producers have access to this capacity. It's also giving them money to expand their capacity.

Ology Bioservices received $106.3 million from BARDA to reserve production capacity to fill and finish about 15.6 million vials. Grand River Aseptic was given $1.6 million to expand capacity for filling and finishing vaccines and therapeutics. And Thermo Fisher Scientific received $49.2 million to expand its US facilities designed to fill individual vaccine doses under sterile conditions at high volumes.

Emergent BioSolutions won a $628 million contract with the government, most of which will be used to produce Covid-19 vaccines through 2021 and $85.5 million of which will be used to expand Emergent's vial-filling contract development and manufacturing capacity for vaccines and therapeutics.

Similarly, BARDA gave $264.7 million to the Texas A&M University System's Center for Innovation in Advanced Development and Manufacturing to reserve vaccine production capacity through 2021 and to "more rapidly expand production capacity for vaccine manufacturing" at their Texas facility, a July 27 press release stated.

(3) *Planning beyond Covid-19.* With many US drugs and drug ingredients made in China and other countries, the US government seems focused on beefing up US production. As we discussed in the May 7 *Morning Briefing*, politicians on both sides of the aisle understand that the ability to manufacture drugs domestically is a matter of domestic security.

Some of the funds earmarked to bolster the US manufacturing of pharmaceuticals is coming from BARDA. The agency entered into a $354 million contract with Phlow Corp. to build a generic medicine and API plant in Richmond, VA and to supply Covid-19 treatments produced there. The deal can expand to 10 years and $812 million.

BARDA also gave Paratek $285 million to build a second supply chain to make Nuzyra, an antibiotic, in the US. Its current supply line is in Europe. The funding will also go toward studying whether Nuzyra can be used to fight anthrax infection. The five-year agreement requires the company to give the US Strategic National Stockpile 10,000 treatment courses of Nuzrya.

"[T]he drug maker will onshore production of Nuzyra's active pharmaceutical ingredient (API) from U.S.-sourced raw materials," a June 8 article in Fierce Pharma reported. "The move to build its U.S. supply will come with 'incremental costs' of doing business, including higher wages and more stringent demands from BARDA, but Paratek is aiming to mitigate those new costs with a more streamlined production network."

"'We probably would not have been able to go to the U.S. based on the incremental costs unless we had this public-private partnership with BARDA," CEO Evan Loh told Fierce Pharma.

Disruptive Technologies: The Power of mRNA. The Covid-19 vaccine news has been decidedly positive in recent days, leading to speculation that vaccines could be available on an emergency basis to healthcare workers in the next month. The success of the vaccines and their rapid development owes much to a new technology for making vaccines based on messenger RNA (mRNA). It's a technology that could be used to develop other vaccines and is being explored as a way to treat cancers.

We've been encouraged by the development of mRNA vaccines since our March 5 *Morning Briefing*, in which we explained how the new technology worked: "Messenger RNA (mRNA) instructs our cells to make proteins. Moderna has used COVID-19's genetic code to create an mRNA that will instruct our cells to make a small amount of COVID19 proteins. These proteins trigger the production of COVID-19-specific antibodies that provide immunity to the virus. Since the mRNA never goes into the nucleus of cells, there's no concern about it changing the cell's genome."

And in our April 23 *Morning Briefing,* we noted that the mRNA technology could help develop vaccines for many different diseases besides Covid-19: "'We call mRNA the software of life,' Moderna CEO Stephane Bancel said in an April 3 MIT Management article. 'You can copy and paste the information into a lot of drugs by using the same technology.'" That speeds up vaccine development and reduces costs, because the same manufacturing processes and facilities can be used for different vaccines.

The company is already testing several other preventative mRNA vaccines in human studies. One aims to prevent cytomegalovirus, a virus that causes health problems in babies, a November 17 *WSJ* article reported. Moderna and BioNTech, which is working with Pfizer on the Covid-19 vaccine, are independently working on applying the mRNA technology to treat cancer. BioNTech is focused on using it to treat breast, skin, and pancreas cancers. It would be nice for something miraculous to emerge from the Covid-19 nightmare.

CALENDARS

US: **Thurs:** Leading Indicators 0.7%, Initial & Continuous Jobless Claims 707k/6.47m, Existing Home Sales -1.2%, Philadelphia Fed Manufacturing Index 22, Kansas City Fed Manufacturing Index. EIA Natural Gas Storage, Mester. **Fri:** Baker-Hughes Rig Count. (DailyFX estimates)

Global: **Thurs:** UK Gfk Consumer Confidence -34, Japan Headline & Core CPI Australia Retail Sales 0.3%, Lagarde, Mauderer, Buch, Wuermeling. **Fri:** Eurozone Consumer Confidence Flash -17.7, UK Retail Sales Headline & Ex Fuel 4.2%/5.9% y/y, Canada Retail Sales 0.2%, Weidmann. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) moved higher for the second week this week, to 3.27, after falling from 3.00 to 2.60 during the first week of November—as bullish sentiment approaches 60.0% again. Bullish sentiment jumped 6.0ppts (to 59.6% from 53.6%) the past two weeks after sliding 7.0pts two weeks ago—from 60.6% to 53.6%. Bearish sentiment fell for the second week from 20.6% to 18.2% over the period—it had been fluctuating in a range from 19.4% to 23.2% the prior two months. The correction count rose to 22.2% this month after falling from 25.8% to 21.4% last week; it was at 19.2% three weeks ago. The AAII Ratio advanced for the second week last week, rebounding from 50.0% to 69.2% over the period—the highest since mid-February 2018. Bullish sentiment jumped from 35.3% to 55.8% over the two-week period, while bearish sentiment sank from 35.3% to 24.9%.

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 2.5% below its record high in mid-February. Forward earnings is at its highest level since late March and is now 8.0% below its record high in early March. Forward revenues growth of 6.9% is down 0.2ppts w/w from its highest reading since August 2011 and up from 0.2% in April, which was the lowest reading since June 2009. Forward earnings growth of 18.7% was also down 0.2ppts w/w from its highest reading, but since August 2010. Forward earnings growth is up 24.3ppts from its record low of -5.6% at the end of April. Analysts expect revenues to decline 3.2% y/y in 2020 and rise 7.7% in 2021 compared to the 4.3% reported in 2019. Analysts expect an earnings decline of 15.6% y/y in 2020 and a 22.3% gain in 2021 compared to a 1.5% rise in 2019. The forward profit margin of 11.3% was steady w/w at 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 0.7pts w/w to 21.9 and is up from a six-month low of 20.6 at the end of October. 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 0.07pt w/w to 2.48. That's below its 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 revenues rise w/w for seven of the 11 S&P 500 sectors, and forward earnings rose 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, Real Estate's forward profit margin edged up from 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 (12.9, 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 6.0%, forward earnings has gained 16.9%, and the forward profit margin has risen 1.0pt to 11.3%. Among the 11 sectors, all but Real Estate 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 remains near a six-year low, and its profit margin is near 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 9.2%, forward earnings up 50.3%), Information Technology (7.7, 10.5), Materials (7.1, 27.0), Industrials (6.9, 23.4), Communication Services (8.1, 13.8), Financials (6.7, 20.1), S&P 500 (6.0, 16.9), Health Care (5.0, 12.6), Consumer Staples (2.9, 7.3), Energy (1.1, 341.1), Real Estate (1.0, -8.2), and Utilities (-1.6, 1.5).

US ECONOMIC INDICATORS

Housing Starts & Building Permits (*link*): Builders continue to build aggressively as their confidence hits yet another new record high. Both single-family starts and single-family permits (a good leading indicator of housing starts) rebounded to new cyclical highs in October—surpassing their pre-pandemic readings by 14.0% and 12.7%, respectively; multi-family measures have not joined the party. Total housing starts advanced for the fifth time in six months, up 4.9% last month and 63.8% over the period to 1.530mu (saar)—but remain 5.4% below its pre-pandemic reading. Single-family housing starts have continued to soar, jumping 6.4% last month and 73.6% during the six months through October to a cyclical high of 1.179mu (saar). Multi-family starts were flat in October at 351,000 units (saar) for the second month; this followed a volatile few months, with a plunge of 29.1% during August alone after a three-month surge of 94.1%. Building permits, in the meantime, were unchanged at their cyclical high of 1.545mu (saar) last month, after soaring 44.9% during the five months ending September. Single-family permits skyrocketed 68.2% from April through October, to 1.120mu (saar), its third reading above 1.00mu since before the Great Recession—August being the first. Multi-family permits are up 6.3% since April but have dropped 16.0% over the past three months to 425,000 units (saar). NAHB's Housing Market Index (HMI) climbed 60 points during the seven months through November to a new record high of 90, after plunging a record 42 points in April alone to 30—the lowest builder confidence since mid-2012 and the first reading in negative territory (below 50) since mid-2014. All three measures of the HMI are their highest levels in the 35-year history of the survey—moving sharply off their April lows: current sales (to 96 from 36 in April), future sales (89 from 36), and traffic of prospective buyers (77 from 13).

GLOBAL ECONOMIC INDICATORS

European Car Sales (*link*): EU passenger car registrations (a proxy for sales) slipped back into negative territory in October, after recording its first y/y increase of 2020 in September. Sales fell 7.8% y/y last month, following September's 3.1% gain, as several European governments reimposed restrictions to combat a second wave of Covid-19. Among the major markets, sales in Spain (-22.0% y/y) fell significantly, followed by more moderate declines in France (-9.5) and Germany (-3.6), while Italy's (-0.2) was basically flat compared to a year ago. (Ireland and Romania were the only EU countries posting y/y gains last month.) Over the first 10 months of this year, car sales contracted 26.8% y/y over the comparable 2019 period, with Covid-19 weighing heavily on the cumulative performance. Among the major markets, Spain (-36.8% y/y) posted the steepest decline, followed by Italy (-30.9), France (-26.9), and Germany (-23.4).

Eurozone CPI (*link*): October's CPI headline rate was negative for the third month, after moving into negative territory in August for the first time since May 2016. The rate was unchanged at -0.3% y/y last month. This followed a rise from 0.1% in May (which at the time was the lowest rate since June 2016) to 0.4% in July; for perspective, the rate was at 1.4% in January. The core rate dropped from a recent high of 1.2% in July to a record low of 0.2% y/y in September, where it remained in October. Looking at the main components, food, alcohol & tobacco once again posted the highest rate, at 2.0% y/y—accelerating for the second month; it had slowed sharply from 3.6% in April to 1.7% by August. Meanwhile, once again Energy had the lowest rate last month, holding at -8.2% y/y (the ninth consecutive negative reading); the rate had narrowed from -11.9% in May—which was the steepest decline since July 2009—to -7.8% by August. The rate for non-energy industrial goods rose to -0.1% y/y after falling to -

0.3% in September from -0.1% in August—which was the first negative reading since March 2015 and down from July's 1.6%. Of the top four Eurozone economies, only the CPI rate for France (0.1% y/y) was above the Eurozone's headline rate of -0.3%, while Germany's (-0.5), Italy's (-0.6), and Spain's (-0.9) were below.

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