



## MORNING BRIEFING

January 13, 2021

### Not in Kansas Anymore

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

(1) Dorothy and Stephanie. (2) The power of myths. (3) Surreality. (4) The sky is the limit for T-Fed in MMT world. (5) Ease on down the yellow brick road to socialism. (6) The central bank wizards. (7) Free money for all. (8) Are the Bond Vigilantes making a comeback? (9) Yield-curve targeting coming? (10) Bitcoin: the official currency of Oz. (11) Managing money in Oz. (12) More style rotation in 2021. (13) Tesla is in outer space.

**Oz I: MMT's Dreamworld.** We live in surreal times. Previously, I've compared them to the TV series *The Twilight Zone*. However, a more apt comparison would be with the land that Dorothy and her dog Toto visited in the movie *The Wizard of Oz*. When a tornado ripped her house from its foundation, causing it to crash-land in Oz, she emerged safe and sound, looked around in wonder, and famously marveled, "Toto, I've a feeling we're not in Kansas anymore." Oz was very colorful and had a colorful cast of characters—including assorted Munchkins, the Good Witch of the North, the Bad Witch of the West and her Winkie Guards, and a blustery wizard—not unlike Washington today. And the news these days showcases plenty of national and local leaders behaving like cowardly lions, heartless tin men, and brainless straw men.

The analogy with Oz was recently provided by none other than the Wizard of Modern Monetary Theory (MMT), Professor Stephanie Kelton. In her June 2020 book [The Deficit Myth: Modern Monetary Theory and the Birth of the People's Economy](#), she wrote: "Like Dorothy and her companion in The Wizard of Oz, we need to see through the myths and remember once again that we've had the power all along."

In my opinion, MMT is a myth. However, as a result of the pandemic, it has become our collective surreality. The pandemic has ripped our economy from its foundation, causing us to crash-land in Kelton's dreamworld. So here we are with no limits on Treasury budget deficits or on Fed purchases of Treasury securities. The sky is the limit for T-Fed in MMT land. Kelton does concede one limit on MMT: the comeback—if and when it happens—of consumer price inflation. However, she believes that taxes can be raised to beat down any such outbreak, allowing us to ease on down the yellow brick road of MMT.

That road leads to bigger and bigger government. The result is less entrepreneurial capitalism and more crony capitalism. Arguably, the yellow brick road leads to socialism now that progressives have surfed the Blue Wave into power. (As we observed above: Oz is very colorful.)

Here are a few of the relevant lyrics from “[Ease on Down the Road](#),” the song from the 1975 Broadway musical *The Wiz*: “Come on, ease on down / Ease on down the road / Cause there maybe times / When you think you lost your mind.”

**Oz II: Free Money.** Kelton isn’t the only MMT wizard in Oz. Joining her are the wizards at the major central banks. Melissa and I continue to pay close attention to these men and women behind the curtain. They continue to flood Oz with liquidity. The total assets of the Federal Reserve, the European Central Bank, and Bank of Japan rose to a record \$22.7 trillion at the end of 2020, up \$7.5 trillion (50%!) since the week of March 11, when the World Health Organization declared the pandemic ([Fig. 1](#) and [Fig. 2](#)).

The Fed purchased \$2.9 trillion in Treasuries and mortgage-backed securities over this period through the end of 2020 ([Fig. 3](#)). At the same time, US commercial banks purchased \$0.6 trillion of these securities. We might as well consolidate the balance sheets of the Fed and the banks. The result is that collectively, they purchased \$3.5 trillion of Treasuries and agencies since the start of the pandemic ([Fig. 4](#)).

Consequently, mortgage rates and corporate bond yields are at record lows in the US. Government bond yields are at record lows in the Eurozone and Japan. In the US, gross issuance of nonfinancial corporate bonds totaled a record \$1.4 trillion over the 12 months through November ([Fig. 5](#)). About half of the proceeds have been used to refinance debt at record-low yields. Some of the proceeds have been used to pay down bank loans and commercial paper debt ([Fig. 6](#) and [Fig. 7](#)).

All this free money may be starting to stir the Bond Vigilantes. They have to be concerned that unlimited MMT will cause the supply of bonds issued by the public and private sectors to continue to swell. All that free money could trigger an economic boom as soon as the second half of this year, assuming the pandemic will be over by then thanks to widespread vaccinations. What if it turns out to be an inflationary boom? That’s not our scenario, but we have to acknowledge the potential inflationary consequences of MMT on steroids and speed.

The 10-year US Treasury bond yield rose from a record-low 0.52% on August 4, 2020 to 1.13% yesterday. It's up 20bps since the end of last year. It's been rising despite the Fed's unofficial policy of pegging the bond yield, as evidenced by the Fed's significant purchases of Treasury notes and bonds since late March. Previously, we've suggested that the Fed might officially adopt yield-curve targeting (YCT) to keep a lid on the bond yield. Such a move could be "the event" that could trigger a 1999-style blowoff in the stock market. That's why we think it's more important than ever to pay close attention to the wizards behind the curtain.

**Oz III: Unearthly Valuation.** For investors, unlimited MMT has led to a dreamworld for valuation, especially for cryptocurrencies. The yellow brick road is paved with bitcoins, which soared 305% last year from \$7,180 to \$29,112 ([Fig. 8](#)). There's no way to value the cryptocurrency since it doesn't generate earnings, distribute dividends, yield coupons, or pay rent. It is similar to gold in that respect. In addition, the supply of bitcoins—like the supply of gold—is limited and can't be manipulated by central banks (unless they start doing open-market operations in the cryptocurrency). Nevertheless, the ratio of the price of bitcoin to the spot price of gold has been just as volatile as the price of the digital currency ([Fig. 9](#)).

The ratio of the price of bitcoin to the S&P 500 stock price index has also been volatile ([Fig. 10](#)). The former's increase of 249.8% last year far outpaced the 16.3% increase in the S&P 500.

Valuation metrics for the S&P 500 all rose to either record or near record levels at the end of last year and have continued to rise so far this year. They can be justified by record-low bond yields. However, the 10-year US Treasury bond yield is no longer at a record low and has been trending higher since last August. In any event, let's review the latest valuation metrics for the S&P 500:

(1) *Weekly Buffett Ratio.* A very good weekly proxy for the quarterly Buffett Ratio is the ratio of the S&P 500 stock price index to the S&P 500 forward revenues per share (P/S) ([Fig. 11](#)). The latter rose to a record 2.54 at the end of last year, well exceeding the tech-bubble peak of 1.88 during Q1-2000.

(2) *Weekly forward P/E.* The S&P 500 forward P/E is highly correlated with the S&P 500 forward P/S ([Fig. 12](#)). The former ended up 2020 at 22.7, approaching the Buffett Ratio's tech-bubble peak of 25.7.

I asked Joe to run a chart of the percentage of the S&P 500 with forward P/Es exceeding 20.0 ([Fig. 13](#)). The resulting weekly series rose to 52.9% during the first week of the year, just below the record high of 53.3% in early June of last year. The series is available since 2006 and is based on the current components of the S&P 500.

(3) *Forward earnings yield and inflation.* The forward earnings yield of the S&P 500 hovered around 4.50% during the final six months of 2020 ([Fig. 14](#)). That's the lowest since the 1999 tech bubble. Back then, core CPI inflation was around 2.4%, not much above November's 1.6%.

However, the 10-year US Treasury bond yield was around 5.6% during 1999, well above today's near record-low yield ([Fig. 15](#)). This is the one valuation model suggesting that valuation multiples aren't stretched at all but justified by the low bond yield.

The problem is that the central bank wizards are distorting the pricing mechanism in the bond market. So everything is just fine in Oz as long as the wizards keep the bond yield down with either unofficial or official YCT. If the Fed makes it official, the result is likely to be a 1999-style meltup.

**Oz IV: Managing Money in Oz.** So are the rules of investing in Oz much different than in Kansas? Maybe not. Last year, the unprecedented two-month recession favored LargeCap growth stocks that had quality balance sheets and earnings. They actually benefitted from the pandemic as demand for their goods and services surged for various pandemic-related reasons.

SMidCaps and Value stocks were crushed during the selloff from February 19 through March 23. Then they lagged the rebound. Many of them remained pandemic challenged. Occasionally, they would briefly outperform on encouraging news about progress on the vaccine front. Since November, when it became clear that vaccines were on the way, there was a relatively typical rotation away from LargeCap Growth toward both LargeCap and SMidCap Value. That rotation is likely to continue this year. Consider the following:

(1) *LargeCaps vs SMidCaps.* The "S&P 5"—i.e., the five companies in the S&P 500 with the highest market capitalizations—started to outperform the "S&P 495" during the second half of 2016 ([Fig. 16](#)). Their collective market cap actually rose to a record high of \$7.5 trillion during

the January 8 week ([Fig. 17](#)). However, their relative outperformance peaked on August 28, 2020.

(2) *Growth vs Value*. The Mag-5 also accounted for most of the outperformance of S&P 500 Growth relative to S&P 500 Value since late 2016 ([Fig. 18](#)). Sure enough, the latter has been outperforming the former since September 1. Nevertheless, the market's climb to a new record high on Friday pushed the forward P/E of Growth up to 29.7, well above Value's 18.5 ([Fig. 19](#)).

(3) *Stay Home vs Go Global*. In recent years, Stay Home outperformed Go Global largely because the Mag-5 were best-in-show in all the major style categories. Go Global has outperformed Stay Home since September 2, in dollars ([Fig. 20](#)).

**Oz V: It Was All a Bad Dream.** Kelton's book leaves no doubt about what MMT is all about: It's an agenda for more big government and higher taxes. Kelton's views must strike many conservatives as unrealistic. They must see her as another utopian promising Heaven on Earth—a people's economy where everything is provided for free thanks to MMT.

Ironically, Kelton failed to notice that *The Wizard of Oz* was all about a bad dream Dorothy had after getting hit on the head. Proponents of free-market capitalism might exclaim: "Pay no attention to the professor behind the curtain!"

For now, the central banks continue to pour liquidity into global financial markets. Fiscal policymakers have joined the stimulus party, resulting in the global implementation of MMT, i.e., massive fiscal deficits financed by massive quantitative easing.

Kelton has won the debate, for now, with the assistance of the Great Virus Crisis.

**Oz VI: Tesla on the Yellow Brick Road.** On February 6, 2018, Business Insider [reported](#) that Tesla launched its first Falcon Heavy rocket with a unique payload, a Tesla Roadster. A dummy named "Starman" was in the driver's seat, and a dashboard display read "Don't Panic" (nods to a David Bowie song and the sci-fi series of novels *The Hitchhiker's Guide to the Galaxy*, respectively).

Tesla's stock price has risen over 1,200% from \$66.79 then to its record high of \$880.02 last Friday. Tesla's addition to the S&P 500 index on December 21 was notable in that it was the largest company ever added to the index. It has risen 26.6% since then. Furthermore, Tesla

replaced Facebook last week as the fifth largest company in the Magnificent Five, which tracks the five biggest companies by market cap in the S&P 500. Its mammoth market-cap payload has had marked impacts on the S&P 500 aggregate data that are calculated by I/B/E/S.

Since Starman entered outer space in 2018, Tesla's manufacturing operations have achieved critical mass, and its growth prospects have become substantial. The analysts' consensus currently calls for earnings per share to rise to \$2.35 in 2020 from \$0.04 in 2019 and to jump to \$4.02 in 2021 and \$5.23 in 2022. The analysts' consensus median three- to five-year *annual* long-term earnings growth (LTEG) forecast of 409% is far and away the highest of any company in the S&P 500 index. Consider the following:

(1) *A short primer on calculating aggregates.* The bottom-up forward revenues and earnings for the S&P 500 are derived by summing up each company's free-float shares outstanding times their per-share forecast. However, that formula can't be used for a non-per share forecast such as LTEG, which is expressed in percentage terms. Using free-float shares outstanding times the LTEG forecast would overweight companies that have large shares outstanding. As a workaround to this quandary, I/B/E/S instead aggregates LTEG by weighting each company's LTEG by its free-float market-capitalization share of the index.

(2) *LTEG and PEG before and after Tesla.* While Tesla's addition to the S&P 500 index had a relatively small impact on forward revenues and earnings as well as growth and valuation, it launched LTEG into the stratosphere and depressed the PEG ratios for the following indexes: the S&P 500, S&P 500 Growth, S&P 500 Pure Growth, S&P 500 Consumer Discretionary sector, and S&P 500 Automobile Manufacturers industry.

Here are the LTEG figures before and after Tesla was added to the S&P 500: S&P 500 (up to 19.5% from 12.2%), S&P 500 Growth (30.0% from 15.9%), S&P 500 Consumer Discretionary (74.8% from 22.2%), and S&P 500 Automobiles Manufacturers (352.3% from 9.7%).

And here are the similar changes for the forward PEG (forward P/E divided by LTEG) ratio: S&P 500 (down to 1.16 from 1.81), S&P 500 Growth (0.99 from 1.74), S&P 500 Consumer Discretionary (0.49 from 1.44), and S&P 500 Automobiles Manufacturers (0.12 from 0.78).

## CALENDARS

**US:** **Wed:** Headline & Core CPI 1.3%/1.6% y/y, Monthly Budget Statement, MBA Mortgage

Applications, Beige Book, Brainard, Clarida, Harker. **Thurs:** Initial Claims 780k, Import & Export Prices 0.6%/0.5%, EIA Natural Gas Storage, Powell, Kaplan, Bostic. (DailyFX estimates)

**Global:** **Wed:** Italy Industrial Production -0.4%m/m/-3.3%y/y, China Trade Balance \$72.4b, Japan Machine Orders -15.4% y/y, Lagarde, Kuroda. **Thurs:** Germany Full Year GDP Growth (2020) -5.1%, China FDI, ECB Monetary Policy Meeting Accounts. (DailyFX estimates)

## US ECONOMIC INDICATORS

**JOLTS** ([link](#)): Job openings dipped a bit in November to 6.527 million after increasing five of the prior six months from 4.996 in April to 6.632 million in October—with November's count 447,000 below its pre-Covid level. There were 10.7 million unemployed in November, leaving less than two unemployed workers competing for every job opening during that month. The number of hires (which includes rehired employees) edged higher for the second month by 93,000 over the period to 5.979 million; however, it's down 1.22 million since its record high of 7.199 million in May. Total separations—which includes quits, layoffs & discharges—increased for the fifth time in six months, by 271,000 in November and 1.18 million over the period to 5.413 million. The number of quits increased 6,000 in November and 1.28 million since bottoming in April to 3.156 million—a sign that employees likely feel more confident about the employment situation, though the pace did slow considerably in November. Meanwhile, layoffs & discharges increased 534,000 during the two months ending November to 1.971 million—with the number of layoffs & discharges in leisure & hospitality up 263,000 in November alone. The quit rate remained at 2.2% in November—just shy of the 2.3% reading before the pandemic hit, while the layoff & discharges rate was at 1.4%—holding around September's record low of 1.0%; the rate was at 7.6% in March.

---

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

Copyright (c) Yardeni Research, Inc. Please read complete [copyright and hedge clause](#).