



MORNING BRIEFING

February 16, 2021

Good vs Bad Endings

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

(1) Zooming worries. (2) A trillion dollars here, a trillion there. (3) Mission accomplished, so far. (4) Nasdaq partying like it's 1999 once again? (5) Home prices are also having a party. (6) Cost pressures mounting but not showing up in CPI, yet. (7) Pandemic has boosted some prices and depressed other prices. (8) Expect a post-pandemic reversal of pricing power. (9) Rent inflation continues to fall, and has lower to go. (10) The Fed keeps resuscitating Zombies, while trying to bury the Vigilantes. (11) Blue Angels for the government's net interest. (12) Movie review: "Promising Young Woman" (+ + +).

YRI Podcast. In our latest video [podcast](#), Dr. Ed discusses the main points of today's *Morning Briefing*.

Good vs Bad Endings I: What Could Possibly Go Wrong? Will this all end badly? I don't think so, but I am hearing more concerns that it might in my Zoom calls with our accounts. T-Fed is providing an unprecedented amount of fiscal and monetary stimulus. "T-Fed" is what Melissa and I call the new federal government department that in effect combines the Treasury and the Fed under one roof. Together they have embraced and implemented Modern Monetary Theory since the week of Monday, March 23, 2020. On that day, the Fed announced QE4ever. By the end of that week, the Coronavirus Aid, Relief, and Economic Security (a.k.a. CARES) Act provided \$2 trillion for the Treasury to spend on pandemic relief.

As a result, the Treasury's budget deficit swelled to a record \$3.5 trillion over the past 12 months through January, while the Fed's holdings of US Treasury securities soared by \$2.4 trillion ([Fig. 1](#)).

With all that help from the government, what could possibly go wrong? Before we go there, let's acknowledge that we've come through the pandemic in remarkably good shape considering how much worse the outcome might have been without all this support. Consider the following:

(1) *Financial front.* A terrible credit crunch was averted as the financial system was flooded with liquidity and backstops were provided by the Fed. There was a mad dash for cash during February and early March of last year. Credit-quality spreads widened dramatically as corporate and municipal bond yields soared. Even the 10-year Treasury bond yield jumped from a low of 0.54% on March 9 to 1.18% on March 18 ([Fig. 2](#)). Since March 23 of last year, credit-quality spreads have narrowed dramatically. Indeed, the yield on high-yield corporate bonds fell to a record low of 4.09% on Thursday and barely budged Friday at 4.10% ([Fig. 3](#)).

Granted, the US Treasury bond yield has risen from last year's low of 0.52% on August 4 to 1.20% on Friday. However, the Fed has purchased all of the notes and bonds issued by the Treasury since late March in an effort to keep the yield around 1.00%, in our opinion ([Fig. 4](#)).

(2) *Economic front.* All those government checks sent by the Treasury to provide support to consumers boosted their incomes and spending ([Fig. 5](#)). For the first time ever, personal income rose during a recession, as government benefits well exceeded the drop in wages and salaries. Record-low mortgage rates and deurbanization triggered by the pandemic caused home sales to soar. Technology spending also soared.

The result is that the unprecedented two-month recession during March and April was followed by an unprecedented V-shaped recovery that, by Q2-2021, could return real GDP to its previous record high during Q4-2019 ([Fig. 6](#)). Treasury Secretary Janet Yellen last week claimed that the economy could be back to full employment by 2022 if the administration's \$1.9 trillion [American Rescue Plan](#) is passed.

So what could possibly go wrong?

Good vs Bad Endings II: Meltups Happen. If nothing goes wrong, then stock prices might continue to melt up. They could be following a trajectory similar to the one from October 8, 1998 through March 10, 2000 ([Fig. 7](#)). Over that period—covering from the Nasdaq's bottom after the LTCM crisis through its tech-bubble peak—the Nasdaq soared 255.8%. Since its March 23, 2020 low, the Nasdaq is up 105.5% so far (through Friday, February 12).

In terms of the S&P 500, Joe and I are targeting 4300 for the end of this year and 4800 by the end of next year, which would be a 22% increase from Friday's close ([Fig. 8](#)). We are basing these forecasts on our projections that S&P 500 forward earnings per share will rise to \$190 at

the end of 2021 and \$205 by the end of 2022 ([Fig. 9](#)). That implies forward P/Es of 22.6 and 23.4 by the end of 2021 and 2022 ([Fig. 10](#)). (See [YRI S&P 500 Earnings Forecast](#).)

We would be increasingly concerned about a potential meltup/meltdown scenario if the S&P 500 rose to, let's say, 4800 by the end of this summer rather than the end of next year. By the way, a big difference between 1999 and now is that home prices are also melting up, as they did prior to the Great Financial Crisis (GFC). The median price of a single-family home climbed 14.9% to \$315,000 in Q4-2020. That was the biggest surge going back to 1990, according to the National Association of Realtors. Nearly 90% of metro areas saw double-digit y/y price gains in Q4.

Good vs Bad Endings III: Inflation Happens. As I have previously noted, the specific concern expressed most often during my Zoom calls in recent months is about a significant rebound in inflation resulting from excessively stimulative fiscal and monetary policies. Debbie and I are on top of this issue.

In our February 3 [Morning Briefing](#) titled "Watching Inflation: More Signs of Trouble?," we found plenty of inflationary pressures building among input materials and labor costs. But they haven't shown up in consumer prices, so far. Faster productivity growth offsetting the upward price pressure probably explains this development.

Profit margins could get squeezed if rising costs can't be passed through to prices. But so far, the forward profit margins of the S&P 500 and most of its 11 sectors have been recovering nicely from their declines during the first half of last year ([Fig. 11](#)).

Now consider these latest developments on the inflation front:

(1) *Prices received vs prices paid.* The mounting cost pressures can be observed in the spread between the prices-received and the prices-paid indexes that we compile from the five regional surveys conducted by the Fed ([Fig. 12](#) and [Fig. 13](#)). The latter has soared faster than the former over the past 10 months. So the spread between the two—which is highly correlated with the ratio of the Consumer Price Index (CPI) for goods to the Producer Price Index (PPI) for intermediate goods—has dropped to the lowest since July 2011, implying lots of pressure on margins unless productivity is cushioning the blow. If not, then there is likely lots of pressure building to raise prices of consumer goods.

(2) *CPI*. There's little evidence that the cost pressures showed up in January's CPI report, which was just released last Wednesday. Both the overall headline and core CPI measures of inflation (on a y/y basis) were 1.4% ([Fig. 14](#)). For goods, the headline and core CPI rose 1.5% and 1.7% ([Fig. 15](#)). For services, the headline and core CPI rose 1.4% and 1.3% ([Fig. 16](#)).

(3) *CPI goods*. One area where inflation has heated up recently is the durable goods CPI ([Fig. 17](#)). This sub-index was up 3.5% y/y during January. By comparison, the nondurable goods CPI was up only 0.7% last month. Leading the former higher has been used car prices in the CPI, up 10.0% during January. In the past, such spikes usually settled down rapidly, with used car prices falling more often than not.

Here are some of the goods categories showing above-average inflation rates in January: laundry appliances (23.1%), household paper products (9.1), cigarettes (7.0), household cleaning products (6.3), recreational reading material (4.3), food (3.8), and alcoholic beverages (2.4).

Here are some of the goods categories showing declining prices over the past year: energy commodities (-8.7%), toys (-4.1), IT commodities (-3.2), apparel (-2.5), prescription drugs (-2.4), and pets & pet products (-1.7).

The pandemic certainly has impacted some price changes in both lists. (You can see all of the items in [Table 2 of the CPI release](#).)

(4) *CPI services*. Rent of shelter accounts for 52.6% of the services CPI and 33.0% of the overall index. It includes three major categories that are all showing lower y/y inflation rates than a year ago: rent of primary residence (3.8% a year ago, 2.1% now), lodging away from home (-0.4%, -11.4%), and owners' equivalent rent of residence (3.3%, 2.0%) ([Fig. 18](#)). Rent of primary residence and owners' equivalent rent could continue to fall closer to zero, as they did during the GFC.

Medical care services account for 7.3% of the CPI. They were up 2.9% y/y in January, but that's down from a recent peak of 6.0% during June 2020 ([Fig. 19](#)).

Here are some of the other services categories with above-average inflation rates: moving & storage (6.7%), domestic services (6.4), personal care services (5.7), garbage collection (4.4),

pet services including veterinary (4.4), postage (4.0), telephone services (4.0), motor vehicle maintenance and repair (3.5), and cable & satellite TV services (3.3).

Here are some of the services with falling prices: admissions to sporting events (-21.4%), airline fares (-21.3%), intracity mass transit (-10.1%), financial services (-5.7), and leased cars and trucks (-3.6).

Again, it's not too hard to draw a line from the changes to their causes given the pandemic's obvious impacts on various categories of consumer spending. Arguably, when the pandemic is over, many of the prices that fell as a result of it will rebound. But many of those that have risen might fall or at least stop rising. In other words, there is likely to be a post-pandemic reversal of pricing power.

(5) *Bottom line.* We are in the lukewarm camp on the inflation outlook. We are predicting that the core CPI could rise to 2.5%-2.8% during the second half of this year. That wouldn't be too hot or too cold. (See [YRI Economic Forecasts](#).) Nevertheless, we are on inflation alert, looking out for signs of a more troublesome outlook.

Good vs Bad Endings IV: Bond Vigilantes vs Zombies. If inflation ever does make a serious comeback, so might the Bond Vigilantes. Since the GFC, the Fed has conducted increasingly ultra-easy monetary policy. The federal funds rate has been close to zero for most of the time since then, and QE1 through QE4ever were deemed by Fed officials to have a similar effect as negative interest rates. These policies were certainly aimed at burying the Bond Vigilantes so that bond yields would remain low.

By doing so, the Fed has allowed corporate "Zombies"—our name for companies that would have gone out of business but for policymakers' stimulative policies—to feast on cheap credit. If the Bond Vigilantes ever come back from the dead, the living dead companies that waxed and multiplied thanks to the Fed will be buried.

That would be a bad ending. But maybe we will be lucky and interest rates will remain subdued along with inflation.

Good vs Bad Endings V: MMT Madness. In her nomination hearing on January 19, Treasury Secretary Janet Yellen said, "Neither the President-elect nor I propose this relief package

without an appreciation for the country's debt burden. But right now, with interest rates at historic[al] lows, the smartest thing we can do is act big."

The problem with this notion is that it leads down the road to ruin endorsed by advocates of Modern Monetary Theory. They claim that the government can borrow without limit if it prints its own currency—as long as inflation remains subdued. If so, then that's what the government will do until inflation does make a comeback. By then, the amount of debt accumulated could be so large that even a modest increase in interest rates would inflate the government's budget deficit, thus compounding the debt. Consider the following:

(1) We can calculate the average interest rate the government pays by dividing the 12-month sum of net interest paid by the federal government by the outstanding amount of marketable Treasury debt held by the public ([Fig. 20](#)). It fell to a low of 1.6% during January, down from 2.3% a year ago.

(2) Over the past 12 months through January, the government's net interest costs totaled just \$326 billion since interest rates have been so low. We can construct a simple Blue Angels chart showing total publicly held Treasuries multiplied by interest rates of 1.00% to 5.00% ([Fig. 21](#)). It shows that the current level of debt would result in the following net annual interest costs at 2.00% (\$433 billion), 3.00% (\$649 billion), 4.00% (\$866 billion), and 5.00% (\$1,082 billion).

Let's hope we stay lucky.

Movie. "Promising Young Woman" (+ + +) ([link](#)) is an enlightening movie about a very dark subject. It stars Carey Mulligan as Cassandra. She deserves an Oscar for her performance. This movie explores the uglier consequences of the all-too-wild college party and dating scenes. In Greek mythology, Cassandra was a Trojan princess whose accurate prophecies were ignored.

CALENDARS

US: **Tues:** Empire State Manufacturing Index 6.2, Bowman. **Wed:** Retail Sales Total & Ex Autos 1.0%/1.0%, Headline & Manufacturing Industrial Production 0.4%/0.5%, Capacity Utilization 74.8%, Business Inventories 0.5%, Headline & Core PPI 0.9%/1.2% y/y, NAHB Housing Market Index 83, MBA Mortgage Applications, API Crude Oil Inventories, FOMC Minutes. (DailyFX estimates)

Global: **Tues:** Eurozone GDP -0.7%q/q/-5.1%y/y, Eurozone ZEW Economic Sentiment 57.0, Germany ZEW Economic Sentiment 59.5, France Unemployment Rate 9.1%, Japan Machine Orders -3.0%. **Wed:** UK Headline & Core CPI 0.5%/1.3% y/y, Canada CPI 0.4%m/m/0.8%y/y, Australia Employment Change & Unemployment Rate 40k/6.5%, ECB Non-Monetary Policy Meeting McCall. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance ([link](#)): Last week saw the US MSCI index rise 1.4% and rank 23rd of the 49 global stock markets we follow in a week when 30 of the 49 countries rose in US dollar terms and the AC World ex-US index gained 2.2%. Six countries traded at a record high during the week: China, India, Japan, the Netherlands, Sweden, and the US. BRIC was the best-performing region last week with a gain of 3.5%, followed by EM Asia (2.5%). EM Latin America was the biggest underperformer, albeit with a gain of 0.3%, followed by EM Eastern Europe (1.0), EMU (1.5), EMEA (1.6), and EAFE (2.1). Chile was the best-performing country last week, rising 5.9%, followed by the Netherlands (5.6), South Africa (5.5), China (4.3), and Argentina (4.2). Among the 33 countries that underperformed the AC World ex-US MSCI last week, New Zealand fared the worst with a decline of 5.5%, followed by Pakistan (-3.6), Austria (-3.5), Egypt (-2.5), and Sri Lanka (-2.2). BRIC leads so far in 2021 with a gain of 13.7%, ahead of EM Asia (12.5). The following regions are lagging the 6.0% gain for the AC World ex-US: EM Latin America (-1.4), EM Eastern Europe (2.7), EMU (3.0), EMEA (3.3), EAFE (3.7), and the US (5.2).

S&P 1500/500/400/600 Performance ([link](#)): All three of these indexes rose last week and ended the week at new record highs. SmallCap rose 3.6%, ahead of MidCap (2.7%) and LargeCap (1.2). Thirty of the 33 sectors rose last week compared to 32 rising a week earlier. Twenty-two of the sectors are out of a correction now, and seven finished the week at a record high. SmallCap Energy rose 7.5% and was the best performer for the week, followed by MidCap Energy (5.5), SmallCap Tech (5.2), SmallCap Materials (4.8), and LargeCap Energy (4.3). LargeCap Utilities was the biggest underperformer last week, with a decline of 1.8%, followed by LargeCap Consumer Discretionary (-1.3), LargeCap Consumer Staples (-0.1), MidCap Utilities (0.2), and SmallCap Utilities (0.5). SmallCap leads so far in 2021 with a gain of 16.0%, easily beating both MidCap (10.3) and LargeCap (4.8). All but two of the 33 sectors are higher ytd. The best sector performers so far in 2021: SmallCap Energy (38.1), SmallCap Consumer Discretionary (25.0), SmallCap Communication Services (20.8), SmallCap Tech (20.1), and MidCap Energy (19.7). The biggest laggards so far in 2021: LargeCap Consumer

Staples (-3.0), LargeCap Utilities (-0.5), MidCap Utilities (0.9), LargeCap Industrials (1.8), and SmallCap Utilities (1.9).

S&P 500 Sectors and Industries Performance ([link](#)): Eight of the 11 S&P 500 sectors rose last week and six outperformed the composite index's 1.2% gain. That compares to a 4.6% gain for the S&P 500 a week earlier when all 11 sectors rose and six outperformed the index. Energy's 4.3% rise made it the biggest gainer of the week, ahead of Tech (2.3%), Financials (2.0), Industrials (1.4), Health Care (1.4), and Communication Services (1.3). The worst performers: Utilities (-1.8), Consumer Discretionary (-1.3), Consumer Staples (-0.1), Materials (1.1), and Real Estate (1.1). The S&P 500 has risen 4.8% so far in 2021 with nine of the sectors higher ytd and six beating the broader index. The leading sectors so far in 2021: Energy (17.1), Communication Services (7.0), Financials (6.6), Tech (6.3), Consumer Discretionary (5.1), and Real Estate (4.8). This year's laggards to date: Consumer Staples (-3.0), Utilities (-0.5), Industrials (1.8), Materials (2.5), and Health Care (3.2).

Commodities Performance ([link](#)): Last week, the S&P GSCI index rose 3.0% for its 13th gain in the past 15 weeks. It's now trading at its highest level since October 2018 and is finally out of a correction at 7.7% below its four-year high on October 3, 2018. Eighteen of the 24 commodities that we follow moved higher last week. Unleaded Gasoline was the best performer last week with a gain of 8.6%, followed by Cotton (6.8%), Zinc (6.5), Lean Hogs (6.1), and Copper (5.3). Cocoa was the biggest decliner for the week with a drop of 5.1%, followed by Sugar (-3.9), Corn (-2.2), and Coffee (-1.5). The S&P GSCI Commodities index has risen 13.3% so far in 2021, propelled by gains in 21 of the 24 commodities in the index. The top-performing commodities so far in 2021: Unleaded Gasoline (28.6), Crude Oil (22.4), Lean Hogs (21.2), Brent Crude (19.5), and GasOil (19.1). The biggest laggards so far in 2021: Cocoa (-6.5), Coffee (-4.1), Gold (-3.8), Wheat (0.1), and Sugar (1.0).

S&P 500 Technical Indicators ([link](#)): The S&P 500 rose 1.4% last week and was above its short-term, 50-day moving average (50-dma) for a second week after dropping below a week earlier for the first time since November 3. It remained above its 200-dma for a 33rd straight week. It had been below its 200-dma for 13 weeks through late May, matching its prior streak that ended during February 2019. Turning to how the dmAs compare relative to one another, the index's 50-dma relative to its 200-dma edged down for the sixth time in seven weeks, as the index was in a Golden Cross (with 50-dmas higher than 200-dmas) for a 32nd week after 15 weeks in a Death Cross. Before the 2020 meltdown, the S&P 500 had last been in a Death Cross for 13 straight weeks, ending in March 2019. The index's 50-dma ended the week

10.2% above its 200-dma, down from 10.3% a week earlier. That's down from its mid-December reading of 11.0%, which was the highest since December 2009 when it was falling from its peak of 14.4% during October 2009. In mid-May, the 50-dma had been 9.9% below the 200-dma, which was the most that the former had lagged the latter since May 2009. Turning to the individual dmas, the S&P 500's 50-dma rose for a 15th week after falling a week earlier for the first time in 24 weeks. The price index improved to 4.3% above its rising 50-dma from 3.7% above a week earlier. That's down from a 13-week high of 6.0% above its rising 50-dma in mid-November. It has been mostly trading above its 50-dma since late April and peaked in early June at 11.7% above the index's 50-dma, which was the highest since May 2009, when it peaked at a record high of 14.0%. That compares to 27.7% below on March 23—its lowest reading since it was 29.7% below on Black Monday, October 19, 1987. The price index was above its 200-dma for a 33rd week and improved to 14.9% above its rising 200-dma from 14.4% a week earlier and a 13-week low of 10.1% the week before that. That's down from a 17.0% reading in early December, which was the highest since November 2009 and up from the 26.6% below registered on March 23—the lowest reading since March 2009. At its worst levels of the Great Financial Crisis, the S&P 500 index was 25.5% below its 50-dma on October 10, 2008 and 39.6% below its 200-dma on November 11, 2008.

S&P 500 Sectors Technical Indicators ([link](#)): Ten of the 11 S&P 500 sectors traded above their 50-dmas last week, unchanged from a week earlier; four did so the week before that. That compares to all 11 above at the end of November and just one sector above at the end of October. Consumer Staples is only sector that was still trading below its 50-dma last week--its fifth consecutive week of doing so. Looking at the longer term, all 11 sectors traded above their 200-dmas for a 12th straight week. Energy is the newest member of this club, trading above its 200-dma for a 12th week and for the first time since January 2020. That compares to just one sector (Health Care) above its 200-dma in early April. All 11 sectors are now in the Golden Cross club (50-dmas higher than 200-dmas), unchanged from the prior five weeks when Energy joined for the first time since November 2018. Ten sectors have a rising 50-dma, unchanged from a week earlier. Consumer Staples' 50-dma fell for a fourth week. In early June, the 50-dma had been rising for all 11 sectors for three straight weeks. That was a big improvement from the beginning of May, when all 11 had falling 50-dmas for ten straight weeks. Currently, all 11 sectors have rising 200-dmas, unchanged from a week earlier. Energy's 200-dma finally turned higher in mid-December after mostly falling since October 2018.

US ECONOMIC INDICATORS

Consumer Sentiment Index ([link](#)): “Consumer sentiment edged downward in early February, with the entire loss concentrated in the expectation index and among households with incomes below \$75,000,” noted Richard Curtin, chief economist of the survey. The Consumer Sentiment Index (CSI) has slumped the first two months of this year, sinking to 76.2 in mid-February from 79.0 in January and 80.7 in December, as the expectations component sank to a six-month low. The expectations component suffered its third loss in four months, falling from 79.2 in October to 69.8 this month, while the present situation component dipped to 86.2 from 90.0 at the end of last year, remaining in a volatile flat trend around recent highs. It bottomed at 74.3 in April. The headline index, along with the present situation and expectations components, remain well below pre-Covid levels of 101.0, 114.8, and 92.1, respectively. The report noted that when consumers were asked to assess their current financial position, the deep divisions became apparent—with only 23% (the lowest since 2014) of those in the bottom third reporting improved finances, while 54% of those in the top third mentioned their finances improved. When asked about income gains, just 17% in the bottom third responded positively, while 44% in the top third answered in the affirmative. Meanwhile, the expected inflation rate for next year climbed to 3.3%—the highest since July 2014. Curtin noted, “The expected strength in consumer spending in 2021 and 2022 critically depends on a significant reduction in precautionary motives, which in turn depend on progress against the pandemic as well as favorable trends in both inflation and employment.”

GLOBAL ECONOMIC INDICATORS

Eurozone Industrial Production ([link](#)): Output contracted in December after rising every month but one since bottoming in April. Industrial production slumped 1.6% during the final month of 2020 after soaring 37.0% during the seven months through November to within a fraction of its pre-Covid level; it's now 2.3% below. In December, production of capital goods dropped 3.1% and nondurable goods by 0.6%; energy (1.4%), intermediate goods (1.0), and consumer durable goods (0.8) output were all in the plus column. Here's a look at how the main industrial groups fared during the eight months through December and where they stand relative to their pre-pandemic levels: consumer durable goods (+106.3% & +1.0%), capital goods (+62.7 & -1.8), intermediate goods (+35.8 & 0.0), consumer nondurable goods (+11.5 & -4.4), and energy (+8.7 & -1.2). Here's the same exercise for total production among the top four Eurozone economies: Italy (+67.1% & -3.7%), France (+45.3 & -5.0), Spain (+47.4 & -0.4),

and Germany (+34.4 & -3.9). Worth noting, among these four economies, Germany's (0.6% in December) industrial production climbed for the eighth consecutive month during the final month of last year, while Spain's (0.7) was in the plus column for the seventh time since bottoming in April. Meanwhile, production in both France and Italy contracted for the second month by 1.6% during the two months through December

UK GDP ([link](#)): The UK economy expanded 4.0% (saar) during Q4 after a 64.5% rebound during Q3—though despite those gains, real GDP shrank 9.9% last year (the steepest decline since 1790's 13.0% plunge) as the pandemic sent the economy into a tailspin the first half of last year. The level of real GDP at the end of 2020 was 7.8% below the comparable 2019 pre-Covid reading, pushing it down to 2013 levels. The expansion in Q4 real GDP was driven by a double-digit gain in government spending (28.3%, saar), with business investment (8.6) adding a relatively small boost; real consumer spending (-0.6%, saar) contracted slightly last quarter after accounting for over 70% of Q3's 64.5% rebound. This quarter isn't looking good for the UK, as Prime Minister Boris Johnson imposed another nationwide lockdown early last month to combat a highly contagious variant of Covid-19, triggering forecasts of negative growth for Q1.

UK Industrial Production ([link](#)): Output rose for the eighth month in December, though momentum has slowed, with December's gain the lowest of the string. Headline production expanded 0.2% in December and 26.9% since bottoming last April, while factory output grew 0.3% and 38.2%, respectively, over the comparable periods. Here are the eight-month performances by the main industrial groupings, and where they stand relative to their respective pre-pandemic readings: capital (62.2% & -7.0%), intermediate (51.4 & +2.2), consumer durable (47.8 & -1.0), and consumer nondurable (4.8 & -2.6) goods—with the latter weakening four of the last five months of 2020.

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