



MORNING BRIEFING

February 17, 2021

'V' for Victory?

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

(1) The third wave of the pandemic has crested. (2) From a plague to a pest. (3) Stock market isn't disconnected from economy and earnings. (4) Earnings likely to be flat y/y during Q4. (5) Expecting a 25% increase in 2021 earnings over 2020. (6) Forward revenues and earnings almost back to pre-pandemic levels. (7) Impressive rebound in profit margin. (8) Hot commodity prices confirming V-shaped global recovery. (9) Solid recoveries in global PMIs and leading indicators. (10) Global bull market in stocks driven by upbeat fundamentals. (11) US Growth stocks are highly valued. (12) US Value stocks have about the same forward P/E as overseas stocks.

Earnings: V-Shaped Recovery. On the health front of the world war against the virus (WWV), the third wave of the pandemic, which started around Halloween, has been the worst by far ([Fig. 1](#)). However, it crested on January 15, when the 10-day moving average of hospitalizations peaked at 232,583. This series was down 56% to 101,407 on February 15. That's encouraging. Hopefully, there won't be another wave related to the Super Bowl. Meanwhile, the pace of vaccinations is picking up, which should change Covid-19 from a plague to a pest.

Notwithstanding the severity of the third wave of the pandemic during the fourth quarter of last year and early this year, a great deal of progress has been made on the economic front of WWV. The US continues to trace out a V-shaped recovery. The same can be said about the global economy, as we discuss below. That's showing up in the V-shaped recovery in S&P 500 earnings. So the V-shaped rebound in the S&P 500 stock price index has been justified by the rebound in earnings. The index hasn't been disconnected from the economy as widely believed.

Of course, the remarkable progress made on the financial front of WWV in both the stock and credit markets has been largely driven by the unprecedented stimulus provided by fiscal and monetary policies around the world. Credit-quality yield spreads have narrowed, and corporate and municipal bond yields have dropped to pre-pandemic readings. The financial system and global economy are awash in liquidity, resulting in elevated valuation multiples.

Let's review the V-shaped recovery in S&P 500 revenues, earnings, and profit margins:

(1) *Q4 earnings season*. Let's start with the Q4 reporting season. So far, 369 of the S&P 500 companies have reported. During the week of February 11, S&P 500 earnings for the quarter came in at \$42.26 per share using the blend of actual and estimated earnings ([Fig. 2](#)). That's up 14.6% from the estimate during the week of December 31, just prior to the latest season. Remarkably, the latest blended earnings number for Q4 is up 0.6% y/y! That follows the following declines during the previous three quarters: Q1 (-15.4%), Q2 (-32.3), and Q3 (-8.2) ([Fig. 3](#)).

That certainly was a V-shaped recovery in the quarterly earnings-per-share numbers last year, although 2020's total was down 14% to \$140 per share from \$163 in 2019. We are predicting \$175 for this year, which would be a 25% rebound from last year's total. (See [YRI S&P 500 Earnings Forecasts](#).)

(2) *Forward revenues and earnings*. Also showing V-shaped recovery formations are S&P 500's forward revenues and forward earnings, i.e., the time-weighted average of consensus estimates for this year and next year ([Fig. 4](#)). Both certainly stand out as V-shaped compared to their U-shaped recoveries during the Great Financial Crisis. (See our September 14, 2020 [S&P 500 Earnings, Valuation & the Pandemic](#).)

Forward revenues per share is a great weekly coincident indicator of actual S&P 500 revenues per share ([Fig. 5](#)). During the week of February 4, the former was only 0.5% below its record high during the week of March 5.

Forward earnings per share is a great weekly year-ahead leading indicator of actual S&P 500 operating earnings on a four-quarter trailing basis ([Fig. 6](#) and [Fig. 7](#)). Admittedly, it doesn't see recessions coming, but it works very well during economic recoveries and expansions. It was \$176.78 during the week of February 11, only 1.2% below its record high during the week of January 30, 2020. That latest number is about the same as our forecast for the year.

(3) *Profit margin*. Apparently, companies scrambled to cut their costs when the pandemic hit only to find that their sales recovered sooner than expected. That explains why the S&P 500 forward profit margin plunged from 12.0% at the start of 2020 to 10.3% during the week of May 28 and rebounded back to 11.9% during the week of February 4 ([Fig. 8](#)). Here are the latest

analysts' consensus profit margin estimates for 2020 (10.2%), 2021 (11.7%), and 2022 (12.7%) ([Fig. 9](#)).

Global Economy: Mostly V-Shaped Indicators. So far, concerns about a widespread global recession as a result of the third wave of the pandemic and renewed lockdowns in some regions have proven to be unfounded. The viral spread indeed has worsened during the latest wave across the globe, and social mobility restrictions once again have been tightened. However, unprecedented fiscal and monetary supports along with improvements in the speed of vaccine distribution are boosting global economic growth.

If the pandemic is prolonged, however, the recovery could be put into jeopardy. Meanwhile, policymakers continue to step on their growth accelerators, hoping that inflation remains subdued and financial stability remains under control. Some regions are doing worse than others. In the UK, for example, the latest lockdowns [pushed](#) the economy during 2020 into the worst slump in 300 years. China, meanwhile, is the only major economy that did not contract last year. The US, most of Europe, and Japan are managing to avoid a double dip thanks to their aggressive fiscal and monetary policies. Here are some of the latest global economic indicators, showing recoveries that remain mostly V-shaped:

(1) *Global Growth Barometer*. Commodity prices are among the most sensitive high-frequency indicators of global economic activity. Our favorite commodity index is the CRB raw industrials spot price index. It doesn't include energy or wood products, which tend to have their own unique supply/demand fundamentals that can be independent of global economic activity. The price of copper is our favorite of the 13 components of the CRB index ([Fig. 10](#)). Both the overall CRB and the copper price fell sharply early last year and bottomed during April. Both now are well above their pre-pandemic levels and at their highest readings since May 2014 and October 2012, respectively.

Debbie and I compile a Global Growth Barometer (GGB), which simply averages the CRB index with the price of a barrel of Brent crude oil ([Fig. 11](#)). It is similar to the S&P Goldman Sachs Commodity Index (GSCI), which gives energy commodities a combined weight of 61.7%; that compares with the 50.0% weight that our GGB gives to oil. Our GGB and the GSCI are up 55% and 76%, respectively, since March 23 through the end of last week. Both stalled a bit over the summer ahead of the vaccine authorizations as the second wave of the pandemic threatened the recovery, but they headed up again after that and have continued to rise through mid-February of this year.

(2) *Purchasing managers indexes*. The V-shaped global recovery is evident in the global composite PMIs (C-PMIs) since they bottomed during April ([Fig. 12](#)). They all fully recovered to their pre-pandemic readings during the summer and fall of last year. Leading on the way down was the NM-PMI (nonmanufacturing PMI) for advanced economies, reflecting their social-distancing restrictions. Here are the January 2020, April 2020, and January 2021 readings for the C-PMIs for the global economy (52.1, 26.2, 52.3), advanced economies (52.1, 22.2, 52.4), and emerging economies (52.2, 34.6, 52.1).

Selected countries composite PMIs for the same three months were as follows: US (53.3, 27.0, 58.7), Eurozone (51.3, 13.6, 47.8), Germany (51.2, 17.4, 50.8), France (51.1, 11.1, 47.7), Italy (50.5, 10.9, 47.2), Spain (51.5, 9.2, 43.2), UK (53.3, 13.8, 41.2), Australia (50.2, 21.7, 55.9), Japan (50.1, 25.8, 47.1), China (51.9, 47.6, 52.2), India (56.3, 7.2, 55.8), Brazil (52.2, 26.5, 48.9), and Russia (52.6, 13.9, 52.3).

(3) *Leading indicators*. The OECD's index of leading indicators confirms the V-shaped recession and recovery cycle for the advanced economies. It plunged from 99.3 during January of last year to a record low of 92.5 during April, then rebounded to 99.6 as of January 2021 ([Fig. 13](#)). That last reading was the ninth monthly increase.

Here are the three readings for January 2020, April 2020, and January 2021 for the US (99.3, 92.1, 99.5), Europe (99.4, 90.0, 99.2), and Japan (99.5, 98.4, 99.9). Europe broadly remains on a recovery path, but the series for the UK and Spain drifted slightly lower after recovering from April's lows and remain in relative flat trends. The OECD also compiles leading indicators for the BRIC countries. Here are their three readings: Brazil (102.5, 92.7, 104.2), China (97.6, 95.3, 101.4), India (99.7, 66.4, 98.0), and Russia (99.7, 91.2, 99.9) ([Fig. 14](#)).

(4) *Global production and exports*. The latest data for global industrial production and the volume of world exports through November show dramatic rebounds in both following steep declines from December 2019 through April 2020 of 12.4% and 18.2%, respectively. They've since recovered by 13.8% and 23.8% ([Fig. 15](#)).

Global Stock Markets: All Together Now. The global V-shaped economic recovery is attributable to the extraordinary amount of liquidity provided by the major central banks. And so is the global bull market in stocks. Consider the following:

(1) *Performance derbies*. Here is the performance derby of the major MSCI stock price indexes since March 23, 2020 through Friday, February 12 in local currencies: Emerging Markets Asia (84.9%), US (81.4), Emerging Markets (78.7), All Country World (70.5), Emerging Markets Latin America (67.6), All Country World ex-US (56.8), Japan (54.2), EMU (52.6), and UK (32.4).

Here it is in dollars: Emerging Markets Asia (95.2%), Emerging Markets (89.6), US (81.4), All Country World (78.4), Emerging Markets Latin America (74.7), All Country World ex-US (74.5), EMU (71.9), Japan (63.0), and UK (60.3).

(2) *Fundamentals*. Confirming the V-shaped global recovery are the MSCI forward earnings for the US, other developed economies, and emerging economies ([Fig. 16](#)). What seems odd is that the same only applies to the forward revenues of the US, since this metric is still weak for the other major global markets ([Fig. 17](#)). In any event, the rebound in the profit margin across the major markets has been uniformly V-shaped and impressive ([Fig. 18](#)).

(3) *Valuation*. The US MSCI forward P/E tends to be higher than the comparable series for the All Country World ex-US ([Fig. 19](#)). During the week of February 4, the divergence was especially wide, with the former at 22.4 and the latter at 16.6. Virtually all of the difference is attributable to highly valued Growth stocks in the US. There tends to be much less divergence between the forward P/Es of the S&P 500 Value index (17.7 currently) and the ACW ex-US MSCI (16.6 currently) ([Fig. 20](#)).

CALENDARS

US: 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. **Thurs:** Housing Starts & Building Permits 1.655mu/1.680mu, Initial & Continuous Jobless Claims 765k/4.435m, Philadelphia Fed Manufacturing Index 20, Import & Export Prices, EIA Crude Oil Inventories, EIA Natural Gas Stocks Change, Brainard. (DailyFX estimates)

Global: 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. **Thurs:** EU Car Registrations, Eurozone Consumer Confidence Flast -15, UK

Gfk Consumer Confidence -27, Japan Core CPI -0.7% y/y, ECB Monetary Meeting Accounts, ECB Financial Standards, Schnabel, Wuermeling. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings rose for all three of these indexes last week. MidCap was at a record high for the first time since October 2018. SmallCap was at a record for a second week and for the first time since October 2018. LargeCap's forward earnings is now 1.2% below its record high at the end of January 2020. In a typically V-shaped recovery, LargeCap's forward earnings has risen during 38 of the past 39 weeks, with the one down week in late December due to Tesla's addition to the index. MidCap's is up in 35 of the past 37 weeks, and SmallCap's posted its 36th gain of the past 38 weeks. LargeCap's forward earnings is now up 25.4% from its lowest level since August 2017; MidCap's has risen 51.4% from its lowest level since May 2015; and SmallCap's is up 87.1% from its lowest point since August 2013. These indexes had been on a forward-earnings uptrend from November 2019 until mid-February, before tumbling due to the Covid-19 economic shutdown. The yearly change in forward earnings soared to cyclical highs during 2018 due to the boost from the Tax Cuts and Jobs Act (TCJA) but began to tumble in October 2018 as y/y comparisons became more difficult. In the latest week, the yearly rate of change in LargeCap's forward earnings improved to an 11-month high of -1.0% y/y from -1.6%. That's up from mid-May's -19.3%, which was the lowest since October 2009, and down from 23.2% in September 2018, which was the highest since January 2011. The yearly rate of change in MidCap's forward earnings rose w/w to a 19-month high of 3.4% y/y from 2.4% y/y and is up from a record low of -32.7% at the end of May; that compares to a TCJA-boosted 24.1% in September 2018 (the highest since April 2011). SmallCap's rate turned higher too, rising to a 23-month high of 8.0% y/y from 5.1% y/y; it is up from a record low of -41.5% in early June. SmallCap's prior record low in its y/y percent change occurred during July 2009 and compares to the TCJA-boosted eight-year high of 35.3% in October 2018. Analysts' y/y earnings growth forecasts for 2020 are still down substantially since early March but have been improving since July as companies easily beat low-balled consensus estimates for Q2 and Q3. Here are the latest consensus earnings growth rates for 2020, 2021, and 2022: LargeCap (-13.7%, 23.5%, 15.4%), MidCap (-22.1, 46.1, 15.9), and SmallCap (-32.4, 76.3, 18.7).

S&P 500/400/600 Valuation ([link](#)): All three of these indexes had their valuations rise last week. LargeCap's forward P/E rose 0.1pt to 22.2. That's down from a 19-year high of 22.7 in early January and up from 13.3 in mid-March, which was the lowest since March 2013.

MidCap's increased 0.3pts to 20.2, which compares to 21-week high of 20.5 in early January. Its current level is 2.7pts below its record high of 22.9 in early June. SmallCap's rose 0.3pts w/w to 20.6. It's now down 6.1pts from its record high of 26.7 in early June. That compares to MidCap's 10.7 and SmallCap's 11.1 in mid-March, which were their lowest readings since March 2009. LargeCap's forward P/E in February 2020—before Covid-19 decimated forward earnings—was 18.9, the highest level since June 2002. Of course, that high was still well below the tech-bubble record high of 25.7 in July 1999. Last week's level compares to the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap's P/E was below LargeCap's P/E yet again last week, as it has been for most of the time since August 2018. In contrast, it was last solidly above LargeCap's from April 2009 to August 2017. SmallCap's P/E was below LargeCap's for a 26th week, the longest stretch since May and during 2002-03. SmallCap's P/E had been mostly below from May 2019 to May 2020 after being solidly above since 2003. SmallCap's P/E was at a premium to MidCap's for a fifth week after 11 weeks at a discount. At the beginning of the year, it had been at the steepest discount to that index since January 2006.

S&P 500 Sectors Quarterly Earnings Outlook ([link](#)): Since the Q2 earnings season—which came in substantially better than greatly reduced forecasts—analysts as a whole have been raising their consensus forecasts for all future quarters instead of lowering them as is the norm. In the latest week, the S&P 500's Q4 estimate jumped 56 cents to \$42.26, better than the typical positive surprise boost usually seen during the fourth week of the earnings season. That \$42.26 estimate for Q4-2020 represents a gain of 0.6% y/y on a frozen actual basis and a 3.4% y/y gain on a pro forma basis. That compares to a pro forma 6.5% decline in Q3-2020, a 30.6% decline in Q2-2020, a 12.8% decline in Q1-2020, a 3.1% gain in Q4-2019, a 0.3% decline in Q3-2019, and y/y gains of 3.2% in Q2-2019, 1.6% in Q1-2019, 16.9% in Q4-2018, and 28.4% in Q3-2018 (which marked the peak of the current earnings cycle). The last time earnings fell markedly y/y was during the four quarters through Q2-2016. All 11 sectors had been expected to record negative y/y earnings growth for Q2 and Q3 when their respective earnings seasons began. Three sectors recorded positive earnings growth in Q2, and six did so in Q3. That was a big improvement from Q1 when all 11 sectors posted a y/y decline in earnings. For Q4, six of the 11 sectors are expected to post positive y/y earnings growth. That's up from three just before the end of Q4, but four of the 11 sectors are still expected to post worse growth on a q/q basis. That shortfall likely reflects continued pessimism among the analysts despite the reopening of the US economy. Energy had been expected to return to a profit in Q4, but analysts now think the sector will record a third straight quarterly loss. Here

are the S&P 500 sectors' latest Q4-2020 earnings growth rates versus their Q3-2020 growth rates: Financials (20.7% in Q4-2020 versus -2.8% in Q3-2020), Materials (18.9, -1.5), Information Technology (18.8, 9.9), Health Care (10.0, 11.8), Communication Services (9.5, 3.7), Consumer Staples (5.5, 6.3), Consumer Discretionary (-2.2, -2.3), Utilities (-2.7, 0.9), Real Estate (-13.4, -12.8), Industrials (-39.2, -54.7), and Energy (-104.1, -108.2).

S&P 500 Q4 Earnings Season Monitor ([link](#)): With nearly 74% of S&P 500 companies finished reporting revenues and earnings for Q4-2020, revenues have beaten the consensus forecast by a well-above-trend 3.1%, and earnings have beaten estimates by 18.0%. The large surprises result from a lack of financial guidance from the companies that analysts follow during an economic rebound. At the same point during the Q3 season, revenues were 2.7% above forecast and earnings beat by 19.8%. For the 369 companies that have reported through mid-day Tuesday, aggregate y/y revenue and earnings growth have improved from their Q3 measures, but the percentage of companies reporting a positive revenue and earnings surprise has ticked down. The Q4 reporters so far collectively have 2.9% y/y revenue growth and a y/y earnings gain of 5.4%. Those results mark a big recovery from Q2-2020, which was the worst quarter for growth since Q1-2009 during the financial crisis. A whopping 83% of the Q4 reporters so far has reported a positive earnings surprise, and 76% has beaten revenues forecasts. Slightly more companies have reported positive y/y earnings growth in Q3 (63%) than positive y/y revenue growth (61%), which bodes well for profit margins. Excluding the FAANGM stocks, the earnings surprise drops to 15.4% from 18.0%, and the revenue surprise falls to 2.6% from 2.7%; earnings would decline 2.4% y/y without the FAANGMs instead of rising 5.4%, and revenues would be down 0.5% instead of up 2.9%. These figures will continue to change as more Q4-2020 results are reported in the coming weeks but less so, and we expect positive surprises like those seen so far to continue.

US ECONOMIC INDICATORS

Regional M-PMI ([link](#)): The New York Fed gives the first glimpse of manufacturing activity in February and shows growth in the region accelerated for the first time in five months, while inflationary pressures continued to heat up. Looking ahead, firms were optimistic conditions would improve over the next six months, with capital spending plans expanding noticeably. February's composite index climbed to 12.1 after falling steadily from 17.0 in September (which virtually matched last July's 20-month high of 17.2) to 3.5 this January. The new orders measure rose for the second month to 10.8 this month from 3.4 at the end of last year, while the shipments component fell for the second month to 4.0 from 12.1 in December. Orders and

shipments were at 22.1 and 18.9, respectively, a year ago. The employment gauge advanced from 11.2 to 12.1 this month, not far from December's two-year high of 14.2, while the average workweek lengthened for the second month, with the measure rising to 9.0 from 4.8 during the last two months of 2020. Delivery times lengthened for the third month to 9.1 this month from 0.4 last November, while inventories (to 6.5 from -0.7) expanded for the first time in 11 months. Both the prices-paid (to 57.8 from 45.5) and received (23.4 from 15.2) indexes accelerated to their highest readings since May 2011! In the meantime, the index for future business conditions (to 34.9 from 31.9) climbed this month, with both the new orders (to 35.6 from 34.8) and shipments (35.1 from 37.6) gauges at similar levels—down from recent highs of 52.9 and 53.1, respectively, last June. The employment (to 16.6 from 23.0) measure showed factories in the region are expected to hire at a slower pace, while the average workweek (14.3 from 11.7) is expected to expand at a faster pace. Meanwhile, the capital expenditures index climbed to 28.6—its highest level in over a year.

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