MORNING BRIEFING
February 25, 2021

Consumers, Earnings, and Proteins

Check out the accompanying chart collection.

(1) Falling Covid-19 cases inspire dreams of hitting the mall. (2) Uncle Sam boosts personal income. (3) Consumers deleveraged a little, saved a little, and spent a lot. (4) Deferred rent, mortgage, and student loan payments help too. (5) Home retailers face tough comps this year. (6) Clothing retailers will have easier comparisons if we have occasions to dress up in 2021. (7) Burning our sweatpants. (8) Are positive forward earnings revisions slowing? (9) Scientists hoping proteins are the key to curing cancer, Parkinson's, and Alzheimer's.

Consumer Discretionary: Following the Money. The US consumer has plenty of cash to spend, and more on the way from the government. The question is: What will that cash be spent on 2021? Will there be a repeat of 2020, when home renovation and sweatpants were in and buying the latest fashion was out?

Our guess is that home renovation will continue apace; but for companies that benefit, comparisons to 2020 results will be so difficult that a flat year would be considered a win. Clothes shopping could revive, online and in stores, reflecting the release of pent-up demand for dining out and gathering with friends and family—presuming that Covid-19 vaccines continue to drive down infection rates and protect the most vulnerable (*Fig. 1*).

Let's take a look at consumers' financial position as well as the earnings results from Home Depot and Macy's:

(1) *More income, less debt, and forbearance.* The US unemployment rate may be 6.3%, but consumers are spending as if it's much lower (*Fig. 2*). US wages and salaries are up 2.3% y/y through December, and government social benefits are up 20.8% over the same period. As a result, despite a brief two-month recession and still elevated unemployment, personal income is up 4.1% y/y (*Fig. 3*).

Consumers spent some of that additional income, paid off some debt, and saved more than usual as well. Revolving consumer credit is 10.8% lower y/y as of December (*Fig. 4*). The personal savings rate was 13.7% during December, still well above 7.6% a year ago (*Fig. 5*).

And after paying down debt and putting more money in the bank, consumers still had money left over to go shopping. US retail sales jumped 7.4% y/y through January (*Fig. 6*).

There is one big unknown: How much of this spending is happening because rent, mortgage, and school loan payments are on hold for many while the economy is affected by Covid-19? As of late December, about 18% of US renters—roughly 10 million tenants—were behind on their rent payments, according to a report by Moody's Analytics and the Urban Institute. Only one in four still has the same income sources they used before the pandemic to pay rent and other expenses. President Joe Biden has extended the eviction moratorium for renters through the end of March.

The number of home mortgages in forbearance has declined for the third week in a row to 5.22% for the week ending February 14—or roughly 2.6 million mortgages, according to a Mortgage Bankers Association report. The March 20, 2020 Coronavirus Aid, Relief, and Economic Security (CARES) Act allowed borrowers to postpone mortgage payments for 360 days, i.e., until March 31, 2021. Now they are able to postpone payments until June 30, 2021. Likewise, forbearance on federal student loans was extended through the end of September 2021.

(2) *Home improvement facing tough comps.* Not all retailers had the same experience in 2020. Home Depot and Lowe's were allowed to keep their stores open in the US even during the height of the pandemic last spring. US same-store sales rose strongly for both companies each quarter last fiscal year (ended January 2021 for both). Lowe's y/y US same-store sales jumped 12.3%, 35.1%, 30.4%, and 28.6% during the four quarters of last fiscal year. The picture is similar for Home Depot: 7.5%, 25.0%, 24.6%, and 25.0%.

Those numbers reflect consumers' focus on home improvements while stuck at home and the boom in home sales helped by low interest rates and deurbanization. It's doubtful that we'll see 20%-plus y/y increases in sales again this year. Home Depot executives declined to give a specific 2021 forecast, but the company's CFO Richard McPhail did say in the company's Q4 earnings conference call on Tuesday that "if the demand environment during the back half of fiscal 2020 were to persist through fiscal 2021, it would imply flat to slightly positive comparable sales growth."

Both companies' shares have traded sideways since this fall, and both stocks are in negative territory based on their one-month returns through Wednesday's close—Home Depot's down 8.0% and Lowe's down 6.6%—while the S&P 500 has risen 2.0%.

(3) *Easier comps in clothing.* While Home Depot and Lowe's were open for business, many other retailers were forced to shutter their brick-and-mortar stores at various points last year. US retailers were shut last spring, and in Europe many stores were forced to close in Q4. With many Macy's stores located in malls, Macy's has had declining sales for numerous years. But last year was one that won't be forgotten.

Same-store sales, which includes stores closed for Covid-19 and online sales, were down 45.3%, 34.7%, 21.0% and 17.0% in the four quarters of last fiscal year (ended January). Macy's CFO Adrian Mitchell said in the company's February 23 conference call that Q4 soft home goods sales were up 11% y/y, sales of jewelry and fragrances jumped by double digits, and digital sales rose 21%. That helped to partially offset the huge 33% decline in total apparel sales. Macy's was hurt by the lack of demand for dresses and suits as well as the lack of tourists, who help its business.

This year, the company expects total sales to come in between $19.75 billion and $20.75 billion, up from $17.35 billion last year. Macy's isn't counting on the return of tourists to hit those numbers but is hoping the retailing environment will otherwise normalize in the second half of this year. Macy's shares are up 36.0% ytd through Wednesday's close, helping it to offset the declines of last spring. Over a one-year time period, Macy's shares are down 0.97%.

TJX, with its off-mall locations and its Home Goods division selling items for the home, is considered one of the industry's best operators. But its reputation for operational excellence didn't save the company from the US shutdowns last spring and European shutdowns in Q4.

TJX reported same-store sales for last fiscal year (ended January) only for open stores. But even those figures were negative: down 3% in Q2, down 5% in Q3, and down 3% in Q4. Total y/y sales for the company are more reflective of TJX's tough year: -52.4%, -31.8%, -3.2% and -10.3%. TJX shares have risen 2.3% ytd, but they are up 13.1% over the past year.

Earnings: Positive Revisions Topping? May 2020 marked the pandemic low in the S&P 500's forward revenues and forward earnings (*Fig. 7*). Analysts cut their estimates too much and since have scrambled to raise them following the latest three better-than-expected quarterly reporting seasons (*Fig. 8*).

Through February, the S&P 500's net earnings revisions index (NERI) has been positive for seven straight months and solidly ensconced in double-digit territory for the latest six months (*Fig. 9*). However, NERI ticked down m/m in February for the first time in nine months and from a 34-month high. However, the similar reading for the net revenues revisions index (NRRI) was positive for a seventh month and improved for a ninth month to a new record high (*Fig. 10*).

Here's what Joe reports about the NERI and NRRI readings for the S&P 500 and its 11 sectors:

(1) *Sector NERIs.* NERI was positive in February for 10 sectors (*Fig. 11*). However, just four of the 11 sectors improved m/m. That's a slowdown from six sectors improving in January, seven during November and December, and eight in October.

(2) *Sector NRRIs.* NRRI was positive for nine of the 11 sectors in February, a count that has been steady for six months (*Fig. 12*). Seven of the 11 sectors improved m/m, up from six improving during January, nine in December, 10 in November, and eight in September and October.

Disruptive Technologies: The Power of Proteins. We're used to thinking of diseases as being caused by viruses or by damaged DNA. But many companies are investigating the ability of proteins both to cause illness and to prevent it.

Covid-19 certainly has taught us the power of proteins. The virus enters our cells when spike proteins on its surface latch onto healthy cells, providing entry. Once inside, the virus replicates. The Pfizer/BioNTech and Moderna vaccines don't target the virus. They target the proteins. Using messenger RNA, the vaccines trick our bodies into creating antibodies to the proteins, thereby protecting our cells from the Covid-19 virus.

Scientists have been exploring how proteins cause various illnesses, including nerve disorders and cancers. Stronger computing power has led to recent advancements in understanding how proteins are structured and how they move. Let's take a look at some areas where proteins may hold the key to making our lives much better in the future:

(1) *Attacking cancers.* A number of companies are hoping to use proteins to inhibit the growth of cancer cells or to cure cancer. Cells have a protein that tells them when to grow or stop growing. The KRAS G12C mutation in 13% of non-small-cell lung cancer cells makes the protein stay in the "grow" mode. Scientists discovered a drug that would turn the mutated protein to the "off" position.

Now at least eight companies have KRAS inhibitors in clinical trials, including Johnson and Johnson and Amgen. "On average, tumors in the patients [taking the Amgen drug] stopped growing for seven months. In three out of 126 patients, the drug seems to have made the cancer disappear entirely, at least so far, although side effects included diarrhea, nausea and fatigue," a February 5 *NYT* article reported. The mutation is also found in some colorectal and pancreatic cancers.

Relay Therapeutics is using crazy strong computers and biology to understand how proteins move and to develop cancer treatments. It has developed RLY-1971 to bind to and inhibit the work of SHP2 proteins, which drive the growth of cancer cells and enable them to resist certain therapies. Relay's RLY-4008 aims to inhibit—with fewer side effects than existing treatments—FGFR2, a protein that's believed to be involved with several solid tumor cancers. Both substances are in early-stage human trials, according to the company's website.

(2) *Making proteins from scratch.* Baker Lab at the University of Washington and Google's DeepMind are leaders in the computer technology being used to understand existing proteins and develop new ones. Neoleukin Therapeutics is an upstart company that's using the Baker Lab technology to design new proteins. Its first, NL-201, is expected to treat renal cell carcinoma and melanoma.

In lab tests using mice, the drug induced a strong immune response with less toxicity than alternative drugs. The company's request to conduct human trials using the drug was put on hold by the Food & Drug Administration in January, when the agency asked for more preclinical data.

The University of Washington and Neoleukin also have used computers to design proteins that they say can attack the Covid-19 coronavirus just as well as a person's antibodies can. The University of Washington's molecule, a mini-binder, is in the very early stages of testing and potentially would be delivered through a self-administered nasal spray, a November 21 *NYT* article reported. Neoleukin has developed another protein, "a smaller, sturdier version of the human protein ACE-2," which would also grab onto the Covid-19 virus, preventing it from infecting other cells.

Both the mini-binders and the ACE-2 decoys have the benefits of being easy and inexpensive to make and able to be stored at room temperature. "[T]he Neoleukin team misted their ACE-2 decoy into the noses of hamsters, then exposed the animals to the coronavirus. The untreated hamsters fell dangerously ill, while the hamsters that received the nasal spray fared far better."

(3) *Proteins to blame for Parkinson's?* Parkinson's affects about one million people in the US, and scientists don't understand why it afflicts them and not others. There is no cure. Scientists have learned that the neurons in the part of the brain that controls movement stop working or die as a result of Parkinson's. Because of the disease, the brain produces less dopamine, a chemical that helps a person maintain smooth movement. And in some Parkinson's cases, there's the occurrence of Lewy bodies, "clumps primarily made up of misfolded forms of the protein alpha-synuclein," a January 29 article in Medical News Today explained.

Scientists at Ben-Gurion University discovered that bone morphogenetic proteins 5 and 7 (BMP5/7 protein) slowed or stopped some signs of Parkinson's in mice. They injected one group of mice with a viral vector that caused misfolded forms of alpha-synuclein to form in their brains. The second group of mice was the control group. The BMP5/7 protein was then injected into the mice. It prevented the movement impairments caused by the alpha-synuclein protein and reversed the loss of dopamine-producing brains cells. BGN Technologies, which is affiliated with the university, is seeking an industry partner to help it develop the discovery.

(4) *Proteins to blame for Alzheimer's?* The brain-derived neurotrophic factor (BDNF) is a protein found in the brain and central nervous system that supports the survival of neurons and promotes the growth of new neurons and synapses. Research in animals has suggested that delivering BDNF to the part of the brain affected earliest by Alzheimer's can slow, prevent, or reverse the progression of the disease, according to scientists at UC San Diego School of Medicine.

They are now conducting a trial where a harmless adeno-associated virus (AAV2) is modified to carry the BDNF gene and injected into targeted regions of the brain. They hope the AAV2 "will prompt the production of therapeutic BDNF in nearby cells," a February 22 article in Health IT Analytics reported. The trial will enroll 24 participants with either diagnosed

Alzheimer's or mild cognitive impairment; 12 would receive the treatment and 12, in the control group, would not.

CALENDARS

US: Thurs: Real GDP 4.2%, Durable Goods Total & Ex Transportations 1.1%/0.7%, Initial & Continuous Claims 838k/4.467m, Pending Home Sales 0.0%, Kansas City Fed Manufacturing Index, EIA Natural Gas Storage, Williams, Quarles, Bostic. **Fri:** Personal Income & Consumption 9.5%/2.5%, Core PCED 1.4% y/y, Consumer Sentiment Total, Current Conditions, and Expectations 76.5/86.2/69.8, Advanced Goods Trade Balance -$82.5b, Chicago PMI 61.1, Baker-Hughes Rig Count, Budget Plan FY 2022. (DailyFX estimates)

Global: Thurs: Eurozone Economic Sentiment 92.0, Germany Gfk Consumer Confidence -14.3, France Consumer Confidence 92, Italy Consumer & Business Confidence 101/96, Japan Leading & Coincident Economic Indicators 94.9/87.8, Japan Industrial Production 4.0%, Japan Retail Sales -2.6% y/y, European Council Meeting, Guindos, Lane. **Fri:** France CPI 0.3% y/y, European Council Meeting, Schnabel. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (to 3.04 from 3.27) sank to its lowest level since the end of October as bullish sentiment dropped to its lowest percentage in 16 weeks—with nearly all of the bulls stampeding to the correction camp. It was the 16th week the ratio was above 3.00, though barely. Bullish sentiment sank 2.8ppts this week to 56.3%, after climbing from 57.8% to 59.1% the prior two weeks—its fourth week below 60% after nine straight weeks above. The correction count (to 25.2% from 22.8%) jumped 2.4ppts to its highest reading since the end of October. Bearish sentiment (to 18.5% from 18.1%) barely budged this week, though it was the highest percentage in 15 weeks. The AAII Ratio advanced for the third week last week, from 49.6% to 65.0% over the period, with bullish sentiment climbing from 37.4% to 47.1% the past two weeks and bearish sentiment falling from 38.3% to 25.4% the past three weeks.

S&P 500 Q4 Earnings Season Monitor (*link*): With nearly 89% of S&P 500 companies finished reporting revenues and earnings for Q4-2020, revenues have beaten the consensus forecast by a well-above-trend 2.9%, and earnings have beaten estimates by 17.3%. 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 3.8%

above forecast and earnings beat by 19.6%. For the 443 companies that have reported through mid-day Wednesday, 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 3.0% y/y revenue growth and a y/y earnings gain of 4.2%. 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 81% of the Q4 reporters so far has reported a positive earnings surprise, and 75% has beaten revenues forecasts. Slightly more companies have reported positive y/y earnings growth in Q3 (61%) than positive y/y revenue growth (60%), which bodes well for profit margins. Excluding the FAANGM stocks, the earnings surprise drops to 14.7% from 17.3%, and the revenue surprise falls to 2.5% from 2.9%; earnings would decline 3.0% y/y without the FAANGMs instead of rising 4.2%, and revenues would be up just 0.1% y/y instead of up 3.0%. With a bit over 10% of the Q4-2020 results left to be reported in the coming weeks, we don't these figures to change much.

US ECONOMIC INDICATORS

New Home Sales (*link*): New single-family home sales (counted at the signing of a contract) have been showing signs of life, jumping 4.3% in January and 10.0% during the two months through January, to 923,000 units (saar)—after contracting 14.1% during the four months ending November—with most of the decline occurring in November (-13.1%). January's level is within 5.7% of last July's cyclical high of 979,000 units. Sales would be even higher if not for lack of inventory. Regionally, home sales in the South (40.4% y/y) and Midwest (10.3) posted double-digit gains versus a year ago, while the Northeast (-8.8) and West (-6.4) showed declines—though sales in the latter has increased during the two months ending January. The number of new home sales on the market is beginning to increase, climbing to 307,000 units in January after bottoming at 285,000 in September—which was the lowest since September 2017. Still, inventory is 5.5% below last January's 325,000 units. Inventory of available houses slipped to a four-month supply this January—there was a five-month supply last January. Meanwhile, homebuilders' confidence for February inched up, holding just below November's all-time high, as demand remains very strong, though rising lumber prices this year are impeding builders' confidence. NAHB's February Housing Market Index (HMI) shows builders' confidence ticked up to 84 after dipping by 7 points the prior two months—from November's record high of 90 to 83 in January. The three measures were mixed, with traffic of prospective buyers climbing to 72 this month—its first increase since reaching a record high of 77 in

November—while the future sales measure (at 80) fell for the third month since climbing to a record high of 89 last November; the current sales measure held at 90 in February after falling from a record-high 96 in November.

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