



MORNING BRIEFING

March 2, 2021

Operation Warp Speed II

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

(1) From OSW-I to OSW-II. (2) Overheating a hot post-pandemic economy. (3) Checks without balances. (4) From plague to pest. (5) J&J has a shot for that too. (6) Real GDP is on monetary and fiscal performance-enhancing drugs. (7) Two record increases in personal income since April; another this spring. (8) T-Fed sending helicopter money by check. (9) Bonfire of the insanities. (10) Great for profits. (11) Bad for bonds.

US Economy I: Pedal to the Metal. The Trump administration created a public-private partnership to facilitate and accelerate the development, manufacturing, and distribution of Covid-19 vaccines, cures, and tests. It was dubbed “Operation Warp Speed.” While there have been some missteps along the way, vaccines have been developed, are being manufactured, and are getting distributed in record time compared to previous pandemic responses.

Now, the Biden administration is pushing the Senate to enact the deficit-financed \$1.9 trillion [American Rescue Plan](#), which was passed by the House on Saturday. Treasury Secretary Janet Yellen said that the goal is to achieve full employment by next year. In effect, it is Operation Warp Speed II (OWS-II for short).

The combination of OWS-I and OWS-II should work to achieve Yellen’s goal. The former soon will have a very stimulative impact on the economy once more and more of us are vaccinated and go back about our normal personal and business lives. OWS-I could unleash a post-pandemic economic boom all by itself. A third round of stimulus cash provided by OWS-II could significantly accelerate the warp speed of our Starship Enterprise. The only question is whether it will overheat along the way.

US Economy II: Checks Without Balances. Washington’s lawmakers have discovered the joys of sending checks to their constituents during bad times. They’ve done it twice so far since the start of the pandemic and are likely to do it a third time shortly. The \$1,200-per-person checks sent during April did work to revive the economy from last year’s two-month recession during March and April. The \$600 checks sent during January certainly averted any stalling in

economic growth in the face of the third wave of the pandemic. It's not hard to guess what another round of \$1,400 checks will do to the economy. Consider the following:

(1) *Pandemic*. On a 10-day moving average basis, Covid-19 hospitalizations have plunged 55% from a record high of 130,386 during January 15 to 58,394 during February 26 ([Fig. 1](#)). That's the lowest pace since November 12, 2020. The Food and Drug Administration on Saturday authorized Johnson & Johnson's single-shot Covid-19 vaccine for emergency use. J&J will provide the US with 100 million doses by the end of June. When combined with the 600 million doses from the two-shot vaccines made by Pfizer-BioNTech and Moderna slated to arrive by the end of July, there will be more than enough shots to cover any American adult who wants one this summer.

The new vaccine's 72% efficacy rate in US clinical trials falls short of the roughly 95% rate found in studies testing the Moderna and Pfizer-BioNTech vaccines. Across all trial sites, the Johnson & Johnson vaccine also showed 85% efficacy against severe forms of Covid-19 and 100% efficacy against hospitalization and death. That sounds like a winner for sure! To repeat: 100% efficacy against hospitalization and death. That should turn the plague into a pest by the second half of this year.

In his February 23 [congressional testimony](#) on monetary policy, Fed Chair Jerome Powell said, "While we should not underestimate the challenges we currently face, developments point to an improved outlook for later this year. In particular, ongoing progress in vaccinations should help speed the return to normal activities." Melissa and I think that both monetary and fiscal policymakers underestimate the stimulative impact of the end of the pandemic.

(2) *Real GDP*. The V-shaped recovery in real GDP will remain V-shaped during the first half of this year and probably through the end of the year. However, it will no longer be a "recovery" beyond Q1 because real GDP will have fully recovered during the current quarter. Thereafter, GDP will be in an "expansion" in record-high territory.

Last year, real GDP rebounded 33.4% (saar) during Q3 and 4.1% during Q4 ([Fig. 2](#)). We are projecting 7.0% during Q1. Yesterday, we raised our Q2 estimate from 4.5% to 9.0%, mostly because we expect that President Biden's American Rescue Plan will be enacted in the next few weeks. (See [YRI Economic Forecasts](#).)

The plan will provide checks of \$1,400 per eligible person, mostly during April, we reckon, providing another big boost to consumer incomes and spending. Last year, consumer spending in real GDP rose 41.0% during Q3 and 2.4% during Q4. The Atlanta Fed's [GDPNow](#) model showed an 8.8% increase in such spending during Q1 as of March 1 (with real GDP up 10.0%). We forecast that real consumer spending will increase 7.9% during Q1 and 11.3% during Q2.

(3) *Personal income*. In current dollars, personal income jumped by a record 12.4% m/m during April 2020 as a result of a \$3.3 trillion (saar) increase in government social benefits that month, thanks to the \$1,200 checks and generous unemployment benefits ([Fig. 3](#) and [Fig. 4](#)). January's 10.0% increase in personal income was the second biggest ever in a month, as a result of a \$2.0 trillion increase in benefits attributable to the \$600 checks.

If the next round of \$1,400 checks goes out in April, it will undoubtedly boost personal income by a new record amount to another record high! The "other" component of government social benefits in personal income includes an item for "Economic Impact Payments" ([Fig. 5](#)). At an annual rate, these checks from the Treasury boosted benefits and total personal income by \$2.6 trillion and \$0.6 trillion, respectively, during April and May of last year. They boosted them both by \$1.7 trillion during January. So they accounted for virtually the entire \$1.9 trillion increase in personal income during January!

(4) *Personal consumption*. The government checks certainly contributed to the V-shaped recovery in consumer spending ([Fig. 6](#)). Another round of checks will do the same this spring. In current dollars, consumer spending rose 2.4% m/m during January, led by a 5.8% m/m increase in consumption of goods to a new record high. In coming months, consumers should be able to spend much more on services that have been limited by the pandemic's social-distancing protocols.

(5) *Personal saving*. During last year's lockdowns, consumers couldn't spend either their paychecks or government benefits as readily as usual since most stores and restaurants were closed. So personal saving soared to a record \$6.4 trillion (saar) during April ([Fig. 7](#)). It then fell to \$2.3 trillion by December, which was still well above the \$1.3 trillion pace of personal saving at the start of last year.

Interestingly, January's \$2.0 trillion jump in government social benefits coincided with a \$1.6 trillion increase in personal saving to \$3.9 trillion, suggesting that much of the month's stimulus

hasn't been spent yet. After the year-end holiday season, January is not a prime month for shopping.

So there is plenty of stimulus left over. In addition, consumer revolving credit outstanding dropped \$118 billion y/y through December to \$976 billion ([Fig. 8](#)). The ratio of consumer revolving credit to personal consumption (both in current dollars) dropped from 7.4% to 6.7% over this period ([Fig. 9](#)). This suggests that consumers aren't as reliant on their credit cards because they have plenty of cash. Moreover, once they spend their extra cash, they can always tap into their credit cards again.

(6) *Unemployment benefits*. The Biden plan will extend temporary pandemic relief programs for unemployed workers, expiring on March 14, to August 26. Benefit recipients would also get an extra \$400 a week. More than 19 million Americans were collecting benefits as of early February, according to the Labor Department. Last year, unemployment benefits in personal income totaled \$550.2 billion, up from \$27.7 billion during 2019.

Our February 9 [Morning Briefing](#) was titled "The Government Is Here To Help." We reviewed the recent *Washington Post* [op-ed](#) by economist Larry Summers in which he trashed President Biden's American Rescue Plan as too stimulative and too inflationary. He also strongly implied that the plan included overly generous unemployment benefits that would discourage the unemployed from taking jobs. In fact, there is mounting evidence that the pandemic-related unemployment benefits provided last year have been doing the same.

Our February 10 [Morning Briefing](#) was titled "Help Wanted." We wrote, "There actually seem to be lots of job openings, but fewer people willing to take them. That would explain why wages have been rising at a faster pace in recent months."

(7) *Bottom line*. There is plenty of stimulus left in the pipeline from last year's pandemic rescue programs. More rounds of government stimulus programs this year are likely to cause a boom that overheats the post-pandemic economy, which might result in higher inflation. The government's overly generous extended unemployment benefits could frustrate policymakers' goal of achieving full employment while driving up wage inflation.

Too much of a good thing is often just too much. The economy is hot and will get hotter with the bonfire of the fiscal and monetary insanities.

Profits: V-Shaped Recovery. While the scenario outlined above is not a happy one for bonds, it remains bullish for stocks. How can that be given that rising inflation and bond yields are bearish for stock market valuations? Because those negatives should be more than offset by a continuation of the V-shaped profits boom. Consider the following:

(1) *Forward revenues.* S&P 500 forward revenues per share rose during the week of February 18 to a new high for the year, putting it only 0.4% below its record high during the week of February 20, 2020 ([Fig. 10](#)). This series is a very good coincident indicator of actual quarterly S&P 500 revenues per share. Industry analysts currently expect revenues to increase 9.7% this year and 6.7% next year ([Fig. 11](#) and [Fig. 12](#)).

(2) *Forward earnings.* S&P 500 forward earnings per share also rose during the week of February 18 to a new high for the year, putting it only 0.7% below its record high during the week of March 5, 2020 ([Fig. 13](#)). This series is a very good leading indicator of actual quarterly S&P 500 earnings per share. Industry analysts currently expect earnings to increase 24.4% this year and 15.4% next year ([Fig. 14](#) and [Fig. 15](#)).

(3) *Forward profit margin.* Not surprisingly, the S&P 500 forward profit margin has also almost fully recovered to its pre-pandemic level. It was 11.9% during the week of February 18 ([Fig. 16](#)). The big surprise was that it bottomed at 10.3% last year during the week of May 28 and not a lot lower, as occurred during the Great Financial Crisis.

Its rebound is also impressive given that the costs of doing business have been rising rapidly in recent months. This suggests that productivity probably is also making a big comeback. Company managements are likely to focus on boosting their margins this year, knowing that the Biden administration is committed to raising the corporate tax rate next year.

Bonds: Bearish Correlations. We had been predicting that the 10-year Treasury bond yield would be heading toward 2.00% by the end of this year. It's already approaching 2.00%, a lot sooner than we'd expected. That's because we'd expected that the Fed would be purchasing lots of the Treasury's notes and bonds to keep a lid on the long end of the yield curve during the first half of the year. The Fed has been doing just that.

The surprise has been that the Bond Vigilantes have made a surprisingly strong comeback. So far, the Fed has resisted responding with a policy of yield-curve targeting. We thought they might respond that way; now that looks less likely, as we discussed yesterday. Consider the

following correlations suggesting that the yield is likely to have a “2” handle sooner rather than later:

(1) *Copper/gold ratio*. On Friday, the ratio of the nearby futures prices of copper to gold signaled that the bond yield should be 2.37% ([Fig. 17](#)). At the beginning of this year, when the bond yield rose just over 1.00%, the ratio was signaling that it should be closer to 2.00% than to 1.00%.

(2) *Copper and expected inflation*. Interestingly, the nearby futures price of copper has been closely tracking the expected inflation rate embedded in the yield spread between the 10-year bond and the comparable TIPS ([Fig. 18](#)). Both have risen dramatically from their 2020 lows.

(3) *Gold, TIPS, and real bond yield*. Another interesting correlation is the strong inverse one between the nearby futures price of gold and the TIPS yield ([Fig. 19](#)). The latter spiked higher last week, weighing on the gold price.

There is also a good tracking correlation between the 10-year TIPS yield and the inflation-adjusted bond yield, using the core Consumer Price Index inflation rate ([Fig. 20](#)).

CALENDARS

US: **Tues:** API Crude Oil Inventories, Brainard. **Wed:** ADP Employment 177k, C-PMI 58.8, ISM & IHS Markit NM-PMIs 58.7/58.9. (DailyFX estimates)

Global: **Tues:** Eurozone Headline & Core CPI Flash Estimates 1.0%/1.1% y/y, Germany Unemployment Change & Unemployment Rate -15k/6.0%, Germany Retail Sales -1.0% m/m/1.2% y/y, Canada GDP, Australia GDP 2.5% q/q/-1.8% y/y, Panetta, McCaul. **Wed:** Eurozone, Germany, France, and Italy C-PMIs 48.1/51.3/45.2/49.1, Eurozone, Germany, France, and Italy NM-PMIs 44.7/45.9/43.6/46.0, Spain NM-PMI 42.5, Italy GDP -2.0% q/q/-6.6% y/y, UK C-PMI & NM-PMI 49.8/49.7, Bundesbank Annual Report, Panetta, Guindos. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings rose for all three of these indexes last week. MidCap's was at a record high for a third week and the first time since October 2018. SmallCap's was at a record for a fourth week, also for the first time since

October 2018. LargeCap's forward earnings is now 0.4% below its record high at the end of January 2020. In what has shaped up to be a typical V-shaped recovery, LargeCap's forward earnings has risen during 40 of the past 41 weeks, with the one down week in late December due to Tesla's addition to the index. MidCap's is up in 37 of the past 39 weeks, and SmallCap's posted its 38th gain of the past 40 weeks. LargeCap's forward earnings is now up 26.4% from its lowest level since August 2017; MidCap's has risen 53.8% from its lowest level since May 2015; and SmallCap's is up 91.9% 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 -0.4% y/y from -0.9%. 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 22-month high of 5.8% y/y from 4.9% 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 24-month high of 10.7% y/y from 9.6% 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 (-13.2%, 23.0%, 15.3%), MidCap (-21.6, 46.2, 16.5), and SmallCap (-29.0, 71.0, 18.4).

S&P 500/400/600 Valuation ([link](#)): All three of these indexes had their valuations fall for a second straight week. LargeCap's forward P/E fell 0.6pt to 21.4. That's down from a 19-year high of 22.7 in early January and up from 13.3 in March 2020, which was the lowest since March 2013. MidCap's decreased 0.4pt to 19.6, which compares to a 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 fell 0.4pt w/w to 19.8. It's now down 6.9pts from its record high of 26.7 in early June. That compares to MidCap's 10.7 and SmallCap's 11.1 in March 2020, 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 28th 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 seventh 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 rose 36 cents to \$42.92, better than the typical positive surprise boost usually seen during the sixth week of the earnings season. That \$42.92 estimate for Q4-2020 represents a gain of 2.2% y/y on a frozen actual basis and a 4.2% 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, seven 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 three 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 ahead of the earnings season despite the reopening of the US economy. Before the Q4 earnings season began, Energy had been expected to return to a profit, but the sector recorded a third straight quarterly loss instead. Here are the S&P 500 sectors' latest Q4-2020 earnings growth rates versus their Q3-2020 growth rates: Materials (22.7% in Q4-2020 versus -1.5% in Q3-2020), Financials (20.8, -2.8), Information Technology (20.0, 9.9), Health Care (10.8, 11.8), Communication Services (10.1, 3.7), Consumer Staples (4.9, 6.3), Utilities (0.4, 0.9), Consumer Discretionary (-1.3, -2.3), Real Estate (-10.7, -12.8), Industrials (-36.9, -54.7), and Energy (-105.2, -108.2).

US ECONOMIC INDICATORS

Construction Spending ([link](#)): Construction expenditures in January climbed for the seventh time in eight months to yet another new record high—surpassing last February’s prior record by 5.6%—driven by private residential building. Total construction spending rose 1.7% in January and 11.1% during the eight months through January, with private construction expenditures up 1.7% and 14.8% over the comparable periods. Meanwhile, public construction spending rose for the fourth successive month, by 5.5% over the period, after sliding 4.5% during the four months through September. Within private construction spending, residential investment climbed 2.5% in January and 32.1% during the eight months through January to a new record high; nonresidential construction spending was little changed in January (up 0.4%) after sliding 10 of the prior 11 months by 10.5%. The rebound in residential construction has been widespread: Single-family (41.2%), home-improvement (25.8%), and multi-family (17.3) construction all posted big upswings during the eight months through January—with home-improvement and multi-family construction at new record highs and single-family construction at a new cyclical high.

GLOBAL ECONOMIC INDICATORS

Global Manufacturing PMIs ([link](#)): Global manufacturing in February expanded at its best pace in over three years and among the best registered over the past decade. The JP Morgan M-PMI climbed for the first time in three months to 53.9 last month after dipping slightly in January and holding steady in December. The index is up 14.3 points since bottoming at 39.6 last April. The M-PMI for the advanced economies has increased all 10 months since bottoming in April by 19.6 points (to 56.4 from 36.8), while the M-PMI for the emerging economies fell for third month, to 51.5 in February, after rising 11.2 points from 42.7 last April to 53.9 by November. Geographically, 23 out of the 29 nations for which February data were available had an M-PMI reading above the 50.0 mark, with Germany, the Netherlands, the US, Brazil, and Austria the strongest performers. Here’s a country ranking of February M-PMIs from highest to lowest: Germany (60.7), the Netherlands (59.6), the US (58.6), Brazil (58.4), Austria (58.3), EUROZONE (57.9), India (57.5), Australia (56.9), Italy (56.9), Czech Republic (56.5), France (56.1), UK (55.1), Canada (54.8), WORLD (53.9), Poland (53.4), Spain (52.9), Philippines (52.5), Ireland (52.0), Turkey (51.7), Vietnam (51.6), Russia (51.5), Japan (51.4), Indonesia (50.9), China (50.9), Colombia (50.2), Greece (49.4), Kazakhstan (48.5), Malaysia (47.7), Thailand (47.2), Mexico (44.2), and Myanmar (27.7).

US Manufacturing PMIs ([link](#)): Manufacturing activity in February remained robust according to both the ISM and IHS Markit M-PMIs as price pressures continued to escalate. ISM's M-PMI (to 60.8 from 58.7) climbed back above 60.0 to its highest reading since February 2018, while the prices-paid (to 86.0 from 82.1) measure soared to its highest reading since July 2008. Both the new orders (to 64.8 from 61.1) and production (63.2 from 60.7) measures improved in February, posting their eighth successive reading above 60.0%—though were slightly below their recent peaks of 67.5 and 64.7, respectively, at the end of 2020. The new export orders (to 57.2 from 54.9) sub-index held around recent highs. Meanwhile, the employment measure (54.4 from 52.6) shows factories expanded payrolls at their best pace since March 2019, after reducing payrolls all but one month from August 2019 through November 2020. The supplier deliveries component of the M-PMI moved up for the seventh month to 72.0, with some of the recent increase reflecting the difficulties suppliers continue to experience due to COVID-19 impacts, after falling from 76.0 last April to 55.9 last July. The inventory measure indicated inventories (to 49.7 from 50.8) contracted slightly last month after expanding the prior four months. Markit's M-PMI dipped negligibly from 59.2 in January to 58.6 in February; that was its second-strongest performance in almost 11 years—January's being the strongest. The manufacturing sector continues to operate on all cylinders, as production expanded at one of its fastest rates in six years last month, as new orders swelled at over a three-year high—with new export orders registering their second best advance since September 2014. Meanwhile, there has been a substantial lengthening of supplier delivery times due to supplier shortages and transportation delays as a result of Covid-19 restrictions—contributing to the steepest rise in material costs seen over the past decade.

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

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