



MORNING BRIEFING

March 3, 2021

The Starship *Enterprise*

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

(1) Helicopter Ben's solution has been implemented. (2) Yield-curve targeting or Operation Twist? (3) Four Fed presidents' happy spin on the backup in bond yields. (4) Lots of fiscal spending in the pipeline. (5) Einstein's theory of relativity and the speed of light. (6) Going boldly where no man or woman has gone before. (7) M-PMI is bullish for S&P 500 revenues. (8) New orders at record high. (9) Construction spending at a record high. (10) Inflationary cost pressures heating up. (11) ESG disclosure could soon be mandatory.

Monetary Policy: More Helicopter Money Coming. Back in 1969, Milton Friedman coined the term “helicopter drop” in his book [The Optimum Quantity of Money](#). The term gained currency after then-Fed Governor Ben Bernanke referenced it in his famous 2002 preventing-deflation [speech](#), earning him the nickname “Helicopter Ben.” Bernanke revisited the subject in detail in an April 2016 Brookings series of [posts](#) titled “What tools does the Fed have left?”

He concluded that when monetary policy is inadequate—especially when interest rates are “stuck” near zero—fiscal policy could be a “powerful alternative.” He explained: “A money-financed tax cut is essentially equivalent to Milton Friedman’s famous ‘helicopter drop’ of money.” His solution has been implemented to offset the adverse economic consequences of the pandemic over the past 12 months. However, instead of a tax cut, the fiscal authorities have been dropping checks from the helicopters, mostly financed by the Fed’s money creation.

It has worked like a charm. But the rapid rise in bond yields since the start of the year has unnerved the financial markets and certainly has caught the attention of Fed officials. On Monday, Melissa and I listed three ways that they could respond. They could say and do nothing other than continuing to buy bonds. They could spin it as a positive development, signaling that they are on the right track toward full employment. Or they could announce an official target for the bond yield, a policy known as “yield-curve targeting” (YCT). Consider the following:

(1) *Operation Twist?* On Monday, CNBC's Jeff Cox discussed a fourth option in an [article](#) titled "Fed policy changes could be coming in response to bond market turmoil, economists say." He suggested that the Fed might bring back Operation Twist (OT), which involves selling shorter-dated government notes and buying about the same dollar amount in longer-duration securities.

(2) *Down Under.* Coincidentally on Monday as well, the Reserve Bank of Australia (RBA) announced plans to buy more than \$3 billion of longer-dated securities, following up on a surprise boost in purchases of shorter-maturity debt at the end of last week. The moves were aimed at stopping the rapid ascent of yields Down Under ([Fig. 1](#)). The RBA buying triggered bond and stock buying around the globe. In the US, the S&P 500 and the Russell 2000 recovered last week's losses, while the Nasdaq 100 retraced 60% of its decline—all on Monday.

(3) *Spinners.* The February 25 *WSJ* included an [article](#) titled "Fed Officials Upbeat on Outlook, Bond Yield Rise Not Source of Concern." Several Fed officials were busy last Thursday either spinning the backup in bond yields as a welcome development or benignly neglecting to acknowledge it.

Federal Reserve Bank of New York head John Williams said growth this year could be the "strongest we've seen in decades." He attributed that to vaccines and to the Fed's monetary policy over the past year.

Federal Reserve Bank of Atlanta President Raphael Bostic told reporters Thursday that long-term bond yields "have definitely moved at the higher end, the longer end, but right now I'm not worried about that." He added, "I'm not expecting that we'll need to respond in terms of our policy."

Federal Reserve Bank of St. Louis President James Bullard told reporters Thursday, "I think that the rise in yield is probably a good sign so far, because it does reflect a better outlook for US economic growth and inflation expectations." He added, "That naturally, to me, suggests that yields should be somewhat higher than they would have otherwise been."

Federal Reserve Bank of Kansas City President Esther George said she wasn't worried about a rise in long-term yields either, noting that she sees the increase as a sign that investors are confident the economy is set to recover strongly.

(4) *Meltup scenario*. If the Fed officially adopts either YCT or OT, the meltup in stock prices will continue, led by the Nasdaq, which remains on the same course as during late 1998 through early 2000 ([Fig. 2](#)). In any case, the Fed remains on course to monetize more of the deficit-financed checks that the Biden administration is likely to drop from helicopters in the spring.

Fiscal Policy: Another Big Deal Ahead. Treasury Secretary Janet Yellen has said that the Biden administration intends to “rebuild” the US economy. In her prepared remarks for her congressional nomination hearing on January 19, Yellen said she is ready to work on “rebuilding the American economy.” She concluded: “We have to rebuild our economy so that it creates more prosperity for more people and ensures that American workers can compete in an increasingly competitive global economy.” Keynesians like Yellen once aspired simply to moderate the business cycle. Now they want to rebuild the economy.

In a February 7 [interview](#) on CBS’s *Face the Nation*, Yellen promised that the \$1.9 trillion [American Rescue Plan](#) will be followed by “another bill that addresses job creation through infrastructure development, through investment in people, in education and training, addresses climate change, improves the competitiveness of our economy and is designed to create good jobs with good pay that involve ... careers for people.”

She didn’t say how much it would cost or how it would be paid for. The scuttlebutt is that the Democrats are working on Biden’s New Deal, aiming to spend around \$2 trillion and considering various taxes to pay for some of it.

US Economy: Warp Drive. In science fiction novels, a spacecraft equipped with a warp drive can travel faster than the speed of light. Einstein’s theory of relativity suggests that’s impossible, since it would require an infinite amount of kinetic energy. In other words, the spacecraft would get incinerated on the way to Warp 1.

Last year, the Treasury and the Fed (a.k.a. “T-Fed”) provided unprecedented stimulus energy to fuel the economic recovery from the pandemic. As a result, we achieved Warp 1, causing the economy to fully recover at the speed of light versus the gradual pace of previous recoveries. T-Fed is set to do more this year. Under Fed Chair Jerome Powell, the Fed’s motto has been “QE4ever to infinity and beyond!” The Treasury’s motto under Yellen is “Act big.” Together, they want to boldly take our economy where no man or woman has gone before by

rocketing it from Warp 1 to Warp 10 to achieve “broad-based and inclusive maximum employment” by next year.

Let’s hope they don’t incinerate our [starship Enterprise](#). The latest batch of economic indicators indicate that the economy is flying:

(1) *Purchasing managers and regional business surveys*. The surveys of national purchasing managers in manufacturing and regional business surveys conducted by five Federal Reserve district banks remained hot during February ([Fig. 3](#)). The M-PMI rose to 60.8 last month, matching February 2018’s reading, which was the highest since May 2004. The new orders (64.8) and employment components (54.4) of this index were also strong. Their strength was confirmed by the comparable survey data from the regional surveys.

By the way, the y/y growth rate of S&P 500 quarterly revenues per share is highly correlated with the national M-PMI ([Fig. 4](#)). The latter’s recent performance bodes well for the former’s outlook during Q1-2021.

(2) *New orders*. The M-PMI is also highly correlated with the y/y growth in nondefense capital goods orders excluding aircraft orders ([Fig. 5](#)). The latter was up 9.1% through January, remaining at a record high. The rebound in new orders has been broad based over the past year ([Fig. 6](#)).

(3) *Construction spending*. The value of total construction spending put in place is in outer space ([Fig. 7](#)). It has been rocketing to new record highs in recent months. It totaled \$1.52 trillion (saar) during January, up 5.8% y/y. Leading the way has been private residential construction, up 21.0% y/y to \$713 billion (saar) ([Fig. 8](#)).

(4) *Real GDP*. The economy should reach escape velocity during the current quarter. Q4’s real GDP was only 2.4% below its pre-pandemic record high during Q4-2019 ([Fig. 9](#)). The Atlanta Fed’s [GDPNow](#) tracking model showed it rising 10.0% (saar) during the current quarter as of the data available through March 1. A similar increase is likely during Q2 if Biden’s American Rescue Plan is enacted, as we discussed yesterday.

(5) *Inflation*. Now for some bad news. The cost of running our starship *Enterprise* so fast is that inflationary pressures are heating up. They aren’t showing up in consumer prices yet, but they

could do so at Warp 10. The heat shield consists of solid productivity growth and ample profit margins, but we are going where no man or woman has gone before.

February's M-PMI survey showed that the prices-paid index rose to 86.0, the highest since July 2008 ([Fig. 10](#)). A year ago, it was 45.9. The average prices-paid index of the five regional surveys also jumped to the highest reading since April 2011.

ESG: Mandatory Climate Disclosures? It may be time for investors to include environmental, social, and governance (ESG) metrics into their models, because companies may have to disclose any ESG-unfriendly business activities in the near future. When we wrote in last Wednesday's [Morning Briefing](#) about the Task Force on Climate-related Financial Disclosures (TCFD) and the Sustainability Accounting Standards Board (SASB), we sensed that mandatory ESG disclosures were coming. Sure enough, President Joe Biden's [appointed](#) acting chair of the US Securities and Exchange Commission (SEC), Allison Herren Lee, issued a February 24 [Public Statement](#) directing the SEC's Division of Corporation Finance to focus on the review of climate-related disclosure. Here's more:

(1) *Ready*. Current SEC climate guidance was developed over a decade ago. The SEC's current climate guidance broadly suggested that public companies disclose in their filings how severe weather, demand for carbon products, and environmental regulation could impact their business. But now, the SEC staff is considering standardizing disclosures for public companies, looking closely at disclosure developments in other regions, [reported](#) the *WSJ*.

(2) *Aim*. On February 1, the SEC signaled its climate focus with an [announcement](#) that Satyam Khanna would serve in a newly created role, senior policy advisor for climate and ESG for Lee's office. Khanna is to advise the agency on ESG matters and "advance related new initiatives across its offices and divisions," the announcement said.

In her February 24 statement, Lee wrote: "Now more than ever, investors are considering climate-related issues when making their investment decisions. It is our responsibility to ensure that they have access to material information when planning for their financial future. Ensuring compliance with the rules on the books and updating existing guidance are immediate steps the agency can take on the path to developing a more comprehensive framework that produces consistent, comparable, and reliable climate-related disclosures."

(3) *Fire*. Mary Schapiro, the former SEC Chair when the 2010 guidance was issued, said that the SEC may soon mandate climate change disclosures, according to the *WSJ*. Currently, Schapiro is deeply involved with climate disclosure matters in her current roles as [SASB vice chair](#) and [TCFD task force member - secretariat](#). She also currently happens to oversee Bloomberg's public policy and regulatory priorities globally. By no coincidence, Mike Bloomberg, the company's owner and founder, chairs the TCFD.

Schapiro said, "It's become obviously a much more urgent, much more important matter. ... There is this enormous force of inevitability, in my mind, that we will get to high-quality climate risk disclosures globally."

CALENDARS

US: **Wed:** ADP Employment 177k, C-PMI 58.8, ISM & IHS Markit NM-PMIs 58.7/58.9. **Thurs:** Initial & Continuous Jobless Claims 750k/4.3m, Productivity & Unit Labor Costs -4.7%/6.6%, Factory Orders 2.1%, EIA Natural Gas Storage. (DailyFX estimates)

Global: **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. **Thurs:** Eurozone Retail Sales -1.1%m/m/-1.2%y/y, Eurozone Unemployment Rate 8.3%, Japan Consumer Confidence. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Q4 Earnings Season Monitor ([link](#)): With nearly 97% of S&P 500 companies finished reporting revenues and earnings for Q4-2020, revenues have beaten the consensus forecast by a well-above-trend 2.8%, and earnings have beaten estimates by 17.1%. 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 3.7% above forecast and earnings beat by 19.7%. For the 483 companies that have reported through mid-day Tuesday, aggregate y/y revenue and earnings growth and the percentage of companies reporting positive y/y 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 2.8% y/y revenue growth and a y/y earnings gain of 3.8%. 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 80% of the Q4 reporters so far

has reported a positive earnings surprise, and 74% 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 14.6% from 17.1%, and the revenue surprise falls to 2.4% from 2.8%; earnings would decline 3.2% y/y without the FAANGMs instead of rising 3.8%, and revenues would be flat y/y instead of up 2.8%. With less than 4% of the Q4-2020 results left to be reported, we don't expect these figures to change much.

GLOBAL ECONOMIC INDICATORS

Eurozone CPI Flash Estimate ([link](#)): February's CPI headline rate is expected to hold steady, according to flash estimates, while the core rate is expected to ease a bit. February's rate is predicted to remain at January's 0.9% y/y, following a string of readings at -0.3% from October through December. The core rate is expected to slow to 1.1% y/y after accelerating sharply to 1.4% in January—which was the highest since October 2015—following record-low readings of 0.2% from September through December. Looking at the main components, rates for food, alcohol & tobacco (to 1.4% from 1.5% y/y), services (1.2 from 1.4), and non-energy industrial goods (1.0 from 1.5) all are predicted to slow, while the decline in energy (-1.7 from -4.2) prices is expected to narrow for the third month from November's -8.3%. Of the top four Eurozone economies, rates for Germany (1.6% y/y) and Italy (1.0) are expected to be above the February's headline rate of 0.9%, with France's (0.7) slightly below, while Spain's (-0.1) dipped back into negative territory after a brief blip above in January (0.4); there was deflation the last nine months of 2020.

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