



## MORNING BRIEFING

March 10, 2021

### A Most Remarkable Recovery

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

(1) A spring shower of cash could fuel meltup in stocks. (2) Is Panic Attack #69 over already? (3) More helicopter money on the way. (4) Personal savings bloated by government checks, boosting M2 and stock prices. (5) Go away in May if stocks melt up in April? (6) What might cause Panic Attack #70. (7) Q4-2020 data show complete V-shaped recovery in S&P 500 revenues, earnings, and profit margin. (8) S&P 500 forward earnings back in record-high territory. (9) Huge write-offs last year.

**Strategy I: Will April Showers Bring a Meltup?** Panic Attack #69 might have ended yesterday now that the 10-year US Treasury bond yield seems to be settling down around 1.50%. We still expect to see it around 2.00% by the end of the year. The recent rise in bond yields unnerved investors in Growth stocks with relatively high valuation multiples. The Nasdaq peaked at a record high on February 12. It fell 10.5% through Monday's close. Yesterday, it rose 3.7%. What makes us think that the correction may be over?

They say that April showers bring May flowers. April showers are coming again this year. No, Joe and I aren't predicting the weather: The US government is about to shower the economy with \$1,400 checks, which could fuel a springtime stock market meltup. "There will be growth in the spring," predicted the simple-minded gardener mistaken for an economist Chauncey Gardiner, protagonist of the novel and movie *Being There*. That's an understatement applied to this year, when economic growth in the spring is likely to be a boom.

Now that Biden's America Rescue Plan is about to be enacted, we know that the economy will be showered with more "helicopter money"—the third round of pandemic relief checks. The first round of checks was for \$1,200 and rained down on the economy during April and May of 2020. The second round of \$600 checks was sprinkled during January of this year. The third deluge will fall later this month and mostly in April.

Some of the first two showers certainly boosted consumer spending and overall economic activity. But not all of it was spent; some of it was saved. Personal saving totaled \$2,848 billion

last year, up from \$1,231 billion the year before. Personal saving during January was \$3,930 billion (saar). M2 is up \$3,978 billion y/y through January, the most on record.

Some of the cash that was saved from the checks undoubtedly contributed to the raging rally in stock prices since March 23, 2020. The third round of checks is likely to contribute to another meltup in stock prices during the spring, which starts on March 20.

In other words, April's shower of checks could bring MAMU, the Mother of All Meltups, during the month. We wouldn't be surprised if it is led by the tech-heavy Nasdaq and Cathie Wood's Ark ETFs (exchange-traded funds). If that happens, we may have to cash in the chips just in time to "go away in May," as the old saying goes. We can take a nice long post-pandemic vacation to tend to the flowers in the garden.

The old adage doesn't work every year. But this year, we know that the latest round of government checks could stimulate both economic activity and stock buying by retail investors during April. The economic indicators to be released that month, for March, won't reflect the impact of the checks on the economy just yet. But those released during May, for April, are likely to be very strong and could spook the bond market. That could trigger Panic Attack #70 in the stock market, especially if stock prices soar from now through the end of April.

**Strategy II: Impressive Comeback for Revenues & Earnings.** Joe reports that Standard & Poor's has released Q4 revenues and earnings data for the S&P 500. The V-shaped recovery in real GDP during the second half of last year is reflected in the V-shaped recoveries of S&P 500 revenues per share and earnings per share over the same period. We aren't surprised. We expected a V-shaped recovery in all three because that's what the weekly data on S&P 500 forward revenues and forward earnings, which we track closely each week, have foreshadowed. Consider the following:

(1) *Revenues.* During Q4, S&P 500 revenues per share was only 1.3% below its record high during Q4-2019 ([Fig. 1](#) and [Fig. 2](#)). That's a remarkable recovery from the 14.6% drop during the first half of last year. During the Great Financial Crisis (GFC), revenues dropped 20.4% over three quarters and then took 15 quarters to fully recover to a new record high.

During Q4, revenues per share rose to new record highs for three S&P 500 sectors: Consumer Staples, Health Care, and Information Technology ([Fig. 3](#)). The sales of companies in all three sectors clearly benefitted from the pandemic. Current-dollar consumer outlays on nondurable

goods excluding energy rose 5.5% y/y during December and climbed to a new record high in January ([Fig. 4](#)). Spending on health care goods and services was up 37.5% in January from last April's bottom to within 2.2% of last February's record high ([Fig. 5](#)). Industrial production of high-tech equipment rose 4.6% y/y through December 2020 and reached a new record high in January.

Here is the performance derby for the 11 sectors of the S&P 500 showing the y/y growth rates in revenues per share through Q4: Information Technology (12.8), Health Care (10.1), Consumer Staples (6.1), Communication Services (4.9), Materials (3.9), S&P 500 (-1.3), Utilities (-2.9), Real Estate (-6.9), Industrials (-7.2), Consumer Discretionary (-8.4), Financials (-9.0), and Energy (-31.1) ([Fig. 6](#)).

(2) *Earnings*. During Q4, S&P 500 operating earnings per share, using I/B/E/S data, was actually 2.0% above a year ago and exceeded the series' prior record high during Q3-2018 ([Fig. 7](#) and [Fig. 8](#)). During the GFC, earnings dropped 77.0% over six quarters and took 11 quarters to fully recover.

Standard & Poor's provides the dataset for the revenues of the S&P 500 and its sectors. It also compiles both reported and operating earnings for the composite and its sectors. We prefer the comparable operating earnings compiled by I/B/E/S. The two differ in their estimates for write-offs from reported earnings to derive operating earnings. The S&P analysts are more conservative than the consensus of industry analysts covered by I/B/E/S, as discussed below. That's why the S&P series tends often to fall below the I/B/E/S series for total earnings. The same can be said about most of the sectors of the S&P 500 ([Fig. 9](#)). The S&P operating earnings series was down 12.4% y/y through Q4. (For more on measures of earnings, see our [S&P 500 Earnings, Valuation & the Pandemic: A Primer for Investors](#).)

According to the I/B/E/S data, only the S&P 500 Financials and Information Technology sectors made new highs in their operating earnings per share during Q4. Here is the performance derby for the 11 S&P 500 sectors showing the y/y growth rates in I/B/E/S earnings per share through Q4: Materials (39.2%), Financials (20.6), Information Technology (18.8), Communication Services (10.0), Health Care (9.6), Consumer Staples (7.0), S&P 500 (2.0), Utilities (-2.5), Real Estate (-12.2), Consumer Discretionary (-19.7), Industrials (-33.2), and Energy (-105.1 to a loss) ([Fig. 10](#)).

(3) *Profit margins*. Also remarkable has been the V-shaped recovery in the S&P 500 profit margin ([Fig. 11](#)). Many companies scrambled to slash their costs and inventories when the pandemic hit. Many were surprised that their sales didn't plunge as much as they had feared. Some were surprised to see their sales get a boost from the pandemic. Once the lockdown restrictions were lifted last spring, sales continued to improve rapidly for many businesses that weren't challenged by social-distancing protocols.

The result was that the S&P 500 profit margin fell from 11.4% during Q4-2019 to 8.9% during Q2-2020. It then rebounded to 11.2% during Q3 and 11.8% during Q4. The V-shaped recession and recovery this time have been shallower and faster than the previous ones during the GFC. Back then, the profit margin fell from 9.5% during Q2-2007 to 2.4% during Q4-2008. It then took another 11 quarters to fully recover to a new high.

(4) *Forward revenues and earnings*. The outlook for the current quarter is upbeat based on forward revenues and forward earnings for the S&P 500 ([Fig. 12](#)). Both series have fully recovered from last year's lockdown recession through the end of February. The former is a great weekly coincident indicator of actual quarterly revenues per share, while the latter is a great leading indicator of actual operating earnings per share. The forward profit margin is also predicting that the actual profit margin will continue to improve during the current quarter.

Through the week of February 25, forward earnings rose to record highs for the following S&P 500 sectors: Consumer Staples, Health Care, Information Technology, and Utilities ([Fig. 13](#)). The other sectors haven't fully recovered but are in the process of doing so.

(5) *Forecasts*. We are still expecting that S&P 500 revenues per share will increase 10.3% this year and 6.7% next year to \$1,500 and \$1,600 ([Fig. 14](#)). We are still predicting that S&P 500 operating earnings per share will increase 22.7% this year and 8.6% next year to \$175 and \$190 ([Fig. 15](#)). Our S&P 500 targets for year-end 2021 and 2022 are still 4300 and 4800.

**Strategy III: Lots of Write-Offs During 2020.** Net write-offs are one-time losses (and gains) that are excluded from reported earnings to calculate operating earnings. As noted above, Standard & Poor's tends to be much more conservative than I/B/E/S, especially during recessions. So, for example, during 2020, net write-offs per share totaled \$48.67 according to I/B/E/S but \$24.57 according to S&P ([Fig. 16](#)). The I/B/E/S number almost matched the total at the height of the GFC. The spread in dollars between the I/B/E/S and S&P estimates of net write-offs was at a record high of \$24.10 per share last year ([Fig. 17](#)).

Write-offs tend to boost the operating earnings of all 11 sectors as measured by I/B/E/S compared to reported earnings ([Fig. 18](#) and [Fig. 19](#)). Last year, write-offs were especially large in the Energy, Health Care, and Materials sectors.

**Strategy IV: What's Up with LTEG and PEG?** In our January 13 [Morning Briefing](#), Joe reviewed the impact of Tesla's December 21 addition to the S&P 500. Back then, Tesla's consensus long-term earnings growth (LTEG) forecast of 409% was far and away the highest of any company in the index and caused the S&P 500's LTEG to soar. As a result, its PEG (forward P/E to LTEG) ratio tumbled sharply. A lot has changed since then, as Joe discusses below:

(1) *Soaring LTEG and diving PEG.* The S&P 500's LTEG jumped immediately from 12.2% to 19.2% when Tesla was added to the index on December 21 ([Fig. 20](#)). This caused the index's PEG ratio to tumble to 1.17 from 1.81 ([Fig. 21](#)). As Tesla's price soared over 30% from December 21 to February 4, its increased market-cap share of the S&P 500 caused the index's LTEG to rise even further to a record high of 23.9%. That move saw the PEG ratio drop further to 0.91—a level so low as to be misleading. That's because PEG readings below 1.00 typically have occurred at the market's bottom, when forward P/E ratios were at their lowest.

(2) *LTEG and PEG more realistic and less volatile now.* Following the February 4 record high for LTEG, Joe sent a note to his contacts at I/B/E/S. He questioned whether Tesla's consensus LTEG median forecast of 409% was still timely considering that the company was graduating from hyper-growth to fast growth and noted the impact of that consensus growth estimate on the S&P 500's LTEG and PEG.

I/B/E/S polled the analysts again, and they revised Tesla's LTEG much lower, to 32% from 409%. This revision, along with the decline in Tesla's market cap, has caused the S&P 500's LTEG to drop to 15.4% from 23.9% and sent its PEG ratio rising to 1.44 from 0.91. During the week ended February 25, the index's LTEG was back up to 16.0% and its PEG ratio was a more typical 1.39.

The bottom line is that Tesla's share price now can move higher without impacting the S&P 500's LTEG and PEG as greatly—or distorting market perceptions based on those measures quite so much.

## CALENDARS

**US: Wed:** Headline & Core CPI 1.7%/1.4% y/y, MBA Mortgage Applications, Monthly Budget Statement, EIA Crude Oil Inventories. **Thurs:** Initial & Continuous Jobless Claims 725k/4.22m, Job Openings 6.6m, EIA Natural Gas Storage. (DailyFX estimates)

**Global: Wed:** France Industrial Production 0.5%, BOC Interest Rate Decision 0.25%, China National People's Congress. **Thurs:** China New Yuan Loans ¥950b, China Total Social Financing, China M2 9.4% Y/Y, ECB Interest Rate Decision & Deposit Facility Rate 0.00%/-0.50%, ECB Macroeconomic Projections, Balz. (DailyFX estimates)

## US ECONOMIC INDICATORS

**NFIB Small Business Optimism Index** ([link](#)): The Small Business Optimism Index (SBOI) rose for the first time in five months in February, edging up to 95.8, after falling from 104.0 in both September and October to 95.0 this January. Despite the increase, February's SBOI remained below the 47-year average reading of 98.0. NFIB Chief Economist Bill Dunkelberg noted, "Small business owners worked hard in February to overcome unexpected weather conditions along with the ongoing COVID-19 pandemic. Capital spending has been strong, but not on Main Street. The economic recovery remains uneven for small businesses, especially those still managing state and local regulations and restrictions. Congress and the Biden administration must keep small businesses a priority as they plan future policy legislation." In February, five of the 10 components rose, four fell, while current inventory (5%) was unchanged. The biggest positive contributions last month came from current job openings (to 40% from 33%), earnings trends (-11 from -16), and owners' expectations of better business conditions (-19 from -23); the latter had dropped in January to its lowest percentage since November 2013. Hirings (to 18% from 17%) and capital spending plans (23 from 22) were minor contributors. Negative contributions were pretty uniform, down from 2 to 3 percentage points: expected credit conditions (to -6% from -3%), now is a good time to expand (6 from 8), sales expectations (-8 from -6), and plan to increase inventories (2 from 4). Of the owners surveyed, quality of labor (24%) remained the top business problem, followed by taxes (18), government requirements (15), and poor sales (11). Meanwhile, the Uncertainty Index continued to fall, dropping to a 10-month low of 75 from its recent peak of 98 last October.

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