



MORNING BRIEFING

March 31, 2021

Impending Doom or Impending Boom?

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

(1) Who is that masked man? (2) Lady in distress. (3) Will March madness bring April's fourth wave? (4) Will vaccines protect us from UK's B.1.1.7 variant? (5) No doom, only boom in consensus earnings forecasts. (6) More boom than gloom in bond yields too. (7) Valuation multiples floating on a sea of liquidity. (8) Archegos is playing out like a Greek play. (9) S&P 500 forward earnings has fully recovered and points to profits boom this year. (10) How much will the taxman slice off of corporate profits in 2022? (11) That sinking feeling about fiscal excess.

Strategy I: The End Is Near. Is the end of the pandemic near or will it end life as we know it sooner rather than later? On Monday, President Joe Biden implored state and local officials to reinstate mask mandates after Dr. Rochelle Walensky, the director of the Centers for Disease Control and Prevention (CDC), shared her feelings of “impending doom” at a White House Covid-19 briefing.

Walensky is concerned about March madness. As the weather improved during the month following February's harsh winter storms, people generally became less careful about social distancing. College students, celebrating their spring breaks, were especially careless, and more people flew around the country. State and local leaders across the country prematurely eased restrictions, all while the B.1.1.7 variant—a more contagious and potentially more deadly strain—was spreading fast.

The pandemic's trajectory in the US now looks worryingly like the situation a few weeks ago in some European countries that are now struggling with third waves, Walensky said. “I know that travel is up, and I just worry that we will see the surges that we saw over the summer and over the winter again,” she added. The US averaged 63,239 daily cases over the seven days prior to Monday, up 16% since the previous week.

We may very well be seeing the start of a fourth wave of the pandemic's cases ([Fig. 1](#)). However, now that vaccinations are proceeding at a faster pace, it's likely that the pace of

hospitalizations and deaths may not rise as quickly or as high as they did during the first three waves of rising cases. The good news is that all three vaccines being distributed in the US appear to work well against the B.1.1.7 strain.

While Walensky is worrying about impending doom, the financial markets seem to be discounting an impending boom. Consider the following:

(1) Yesterday, the S&P 500 closed at 3958.55, only 0.4% below Friday's all-time high. It is up 5.4% ytd and 50.7% y/y. Industry analysts continue to predict that S&P 500 earnings-per-share growth will boom this year. As of the March 25 week, their y/y growth expectations for this year's four quarters are: Q1 (20.0%), Q2 (49.7), Q3 (17.7), and Q4 (12.8) ([Fig. 2](#)). They are expecting S&P 500 earnings per share will be up 25.9% this year and 15.1% next year to \$175.23 and \$201.92 ([Fig. 3](#)). We agree with the analysts. Last week, Joe and I raised our comparable earnings estimates to \$180 and \$200 per share ([Fig. 4](#)).

(2) Also yesterday, there were no signs of imminent doom in the bond market. The 10-year US Treasury bond yield held at 1.73%, matching its highest reading since January 22, 2020 ([Fig. 5](#)). The credit-quality yield spread between the corporate junk bond composite and the Treasury yield remained subdued at 269bps, which is near previous historical lows and consistent with past reach-for-yield levels ([Fig. 6](#)).

(3) Interestingly, notwithstanding the rapid rise in the bond yield since early last August, the forward P/E of the S&P 500 remains elevated around 22.0 ([Fig. 7](#)). That's because the flood of liquidity provided by fiscal and monetary policies over the past year is propping up valuations of all assets, notwithstanding the rise in bond yields. As of February, the M2 monetary aggregate is up 27.1% y/y, or \$4.2 trillion ([Fig. 8](#)). That's an unprecedented amount of liquidity!

Strategy II: *Adios, Archegos!* Goodbye, Archegos; we barely knew you. Actually, Joe and I never had heard of the firm until it blew up at the end of last week. Some of Wall Street's biggest players have heard of the firm, which blew a big hole in their Q1 earnings. The story of this debacle is very reminiscent of the LTCM debacle of 1998. A recent [Forbes analysis](#) by Antoine Gara reported:

"Archegos was a giant in U.S. financial markets, apparently holding tens of billions of dollars in securities, including massive exposures to companies like ViacomCBS, Discovery Communications and Baidu. It traded with Wall Street's largest brokerages, and was

headquartered at an expensive address housing many powerhouse investment firms. But when it came to routine financial disclosures, Archegos was virtually non-existent.”

Forbes searched for a trace of Archegos on the Securities and Exchange Commission’s (SEC) repository for securities filings called “EDGAR,” short for “Electronic Data Gathering, Analysis, and Retrieval.” Amazingly, despite its huge positions in some stocks that several Wall Street banks have been forced to unwind after the firm failed to meet margin calls, there was no trace of the firm. In 2012, the firm’s founder and co-CEO Sung Kook (Bill) Hwang was put out of business by the SEC when his hedge fund, Tiger Asia, was charged with insider trading and market manipulation. In 2013, he converted his firm into a “family office,” which allowed him to dodge SEC reporting requirements.

Archegos appears to have built its positioning almost exclusively through swap trades, which are an effective tool to take big risks without disclosing much. “They require a fraction of the cash of buying a stock outright, and they’re discreet. Swaps aren’t included in the SEC’s 13-f reporting requirements, thus Hwang’s monster portfolio was mostly hidden from plain sight,” according to Gara. When Archegos couldn’t meet margin calls from a handful of Wall Street brokers, it was forced to liquidate Hwang’s portfolio.

By the time Credit Suisse and Nomura, two prime brokers of Archegos, announced early Monday that they faced losses that could be “highly significant” to the banks, rival firms Goldman Sachs and Morgan Stanley had already finished unloading their positions, reported CNBC.

All this sounds like the LTCM crisis, déjà vu all over again. What’s different this time, so far, is that the market seems to be absorbing this debacle much better. Why is that? The obvious explanation is the unprecedented amount of liquidity!

By the way, “*archegos*” in Greek means “one who takes the lead in anything.” Now let’s look up the definition of “hubris,” which is also has a Greek origin. It means excessive self-confidence, and is often interpreted as “the pride that comes before the fall.”

Strategy III: Profits and Monetary Cycles. As of the March 25 week, S&P 500 forward earnings per share rose to a record \$181.39 (*Fig. 9*). That’s certainly consistent with the impending boom scenario. This series tends to be a great 52-week leading indicator for the

four-quarter trailing sum of S&P 500 operating earnings ([Fig. 10](#)). That's especially true during economic expansions, not so much during recessions.

Assuming, as we do, that the economy will continue to expand through at least the end of next year, we predict that forward earnings per share will rise from \$170 at the end of 2020 to \$200 at the end of 2021 and \$210 at the end of 2022 ([Fig. 11](#)).

Interestingly, there has been a remarkably good correlation between the yearly change in the federal funds rate and the yearly percent change in the S&P 500 forward earnings series since 1983 ([Fig. 12](#)). The Fed lowered the federal funds rate to zero on March 15, 2020. It has been unchanged since then. As a result, the y/y comparisons for this variable have been negative over the past year and are now unchanged. They are likely to remain that way given the Fed's commitment to keep the rate at zero through the end of this year and maybe next year too.

Meanwhile, the y/y growth rate in forward earnings, which was negative from March 26, 2020 through February 25, 2021, recently turned slightly positive and will continue increasingly to do so through May of this year since its level bottomed last year during the week of May 15.

According to this relationship, the Fed is way behind the curve on raising interest rates. That's all the more reason to expect an impending boom, with the bond yield doing the heavy lifting in the credit markets.

Strategy IV: Taxes & Profit Margins. President Biden would like to throw a wet towel on corporate earnings by raising the corporate tax rate by 33% from 21% to 28%. If that happens, it will probably be effective at the start of 2022. How big a hit might that be to S&P 500 earnings per share in 2022? Consider the following:

(1) *Trump's cut.* Let's start by reviewing the impact on profits of Trump's 40% cut in the corporate tax cut from 35% to 21% at the start of 2018. That year, S&P 500 revenues per share rose 9.0%, while earnings per share rose 22.7%. This implies that the tax cut boosted earnings by 13.7%, or \$22.18 per share.

(2) *Biden's hike.* We estimate that without a tax increase in 2022, S&P 500 earnings per share would increase from \$180 this year (up 28.8% from the 2020 level) to \$215 next year (up 19.4% from our 2021 estimate). We estimate that Biden's tax hike would reduce S&P 500 earnings per share by \$15 to \$200.

Fiscal Policy: A Sinking Kitchen Sink? So far, as Melissa and I discussed yesterday, roughly \$5.0 trillion has been appropriated for Covid-related fiscal aid, including the \$1.9 trillion American Rescue Plan Act (ARPA) enacted on March 11, which we covered in detail in our March 17 [Morning Briefing](#). The Biden administration would like to add several more trillions to federal spending on infrastructure, green new deals, education, and income equalization.

How likely is it that all this will come to pass given the Democrats' slim Senate majority? Our good friend James Lucier of [Capital Alpha](#) wrote on Monday that "Washington is on high alert following reports that Senate Majority Leader Chuck Schumer (D-NY) is looking at ways to pass an unusual second FY 2021 budget reconciliation bill," as a follow-up to the ARPA.

"Technically, Schumer would be following a procedure to amend the budget resolution in such a way that a second set of reconciliation instructions would be called for. This procedure remains on the books from the early days of the Budget Act in the 1970s. At the time, it was envisioned that Congress would have one budget reconciliation bill at the beginning of the year, and a second, if needed, to true up spending to fiscal targets at the end of the year. But that process has not been followed since 1980," Jim added.

He concluded: "What Schumer's reported research highlights for us is the disconnect we see in Washington between Biden's and the Democrats' lofty ambitions, and the limited number of vehicles available to enact them. There could be as few as only one more budget reconciliation bill that could pass before the 2022 midterm, in which case it becomes a veritable kitchen sink, and subject to sinking itself."

CALENDARS

US: **Wed:** ADP Employment Change 550k, Chicago PMI 60.7, Pending Home Sales -2.9%, MBA Mortgage Applications, EIA Crude Oil Inventories, Bostic. **Thurs:** Initial & Continuous Jobless Claims 680k/3.775, ISM & IHS Markit M-PMIs 61.3/59.0, ISM M-PMI Prices 85.0, Motor Vehicle Sales, Construction Spending -1.0%, EIA Natural Gas Storage, Baker-Hughes Rig Count, Harker. (DailyFX estimates)

Global: **Wed:** Eurozone Headline & Core CPI Flash Estimate 1.3%/1.1% y/y, Germany Unemployment Change & Unemployment Rate unchanged/6.0%, France CPI 0.8% m/m/1.1% y/y, Italy CPI 0.8% y/y, UK GDP 1.0% q/q/-7.8% y/y, Canada GDP 0.5% m/m,

China Caixin M-PMI 51.3, Japan Tankan Survey, Australia Retail Sales -1.1%. **Thurs:** Eurozone, Germany, France, and Italy M-PMIs 62.4/66.6/58.8/59.8, UK M-PMI 57.9, Germany Retail Sales 2.0%~~m/m~~/6.3%~~y/y~~. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Buybacks ([link](#)): S&P 500 quarterly buybacks rose 28.3% q/q during Q4-2020 to \$130.6 billion from \$101.8 billion during Q3. That's up from a 22-quarter low of \$88.7 billion during Q2-2020, when companies were seeking to preserve cash amid the highly uncertain economic outlook caused by Covid-19. Q4's buybacks level was 41.9% below the record high of \$223.0 billion during Q4-2018. The four-quarter sum of buybacks was down for a seventh straight quarter for the first time since it fell for eight quarters through Q4-2009. It fell 8.9% q/q to a 12-quarter low of \$519.8 billion from \$570.8 billion, and is down 36.9% from a record high of \$823.2 billion in Q1-2019. S&P 500 buybacks as a percentage of the S&P 500's total market capitalization improved to 0.41% in Q4 from 0.37% in Q3. That's up from an 11-year low of 0.35% during Q2, and compares to a recent 29-quarter high of 1.06% in Q4-2018 and the record high of 1.28% during Q3-2007.

S&P 500 Sectors Buybacks ([link](#)): Buybacks rose q/q during Q4-2020 for nine of the S&P 500's 11 sectors and fell for just two, Communication Services and Utilities. Among the 11 sectors, only Consumer Staples has returned to pre-pandemic levels, but Tech is close. Energy and Financials remain depressed. The Tech sector accounted for the biggest portion of total S&P 500 buybacks in Q2-2020 for a 13th straight quarter, making up 42.9% of the S&P 500's buybacks during the quarter. Financials' 10.4% share of the buyback total was down from 11.9% in Q3 and is well below its average 22% in the two years before Covid-19.

US ECONOMIC INDICATORS

Consumer Confidence ([link](#)): "Consumer Confidence increased to its highest level since the onset of the pandemic in March 2020," said Lynn Franco, senior director of economic indicators at The Conference Board. "Consumers' assessment of current conditions and their short-term outlook improved significantly, an indication that economic growth is likely to strengthen further in the coming months." The Consumer Confidence Index (CCI) improved in March for the third month, jumping 22.6 points (to 109.7 from 87.1) over the period—with 19.3 of those points occurring this month! Both the present situation (+20.4 points to 110.0) and expectations (+18.7 to 109.6) components of the CCI soared this month, with the former the

highest since last March and the latter more than recovering its Covid-related losses—climbing to its best level since July 2019. The percentage of consumers expecting business conditions to improve soared 10.1ppts (to 40.8% from 30.7%) this month—a nine-month high—while those expecting business conditions to worsen sank 6.7ppts (11.0 from 17.7) to a 13-month low. Consumers’ outlook regarding the job market also improved dramatically this month, with the percentage expecting more jobs (to 36.1% from 27.4%) 8.7ppts higher than February and the percentage expecting fewer jobs (13.4 from 21.3) 7.9ppts lower. It was the highest percentage for the former since last June and the lowest for the latter since last February. Meanwhile, consumers’ assessment of current conditions also improved for the second month in March after deteriorating the prior two months: The percentage of consumers claiming business conditions are good rose 2.4 ppts (to 18.5% from 16.1%) this month, while those claiming business conditions are bad plunged 9.2ppts (30.5 from 39.7)—the lowest percentage in a year. Consumers’ assessment of the labor market was also more favorable for the second month—with those saying jobs are plentiful (to 26.3% from 21.6) up 4.7ppts this month and those saying jobs are hard to get down 3.9ppts (18.5 from 22.4) to the lowest since last March.

GLOBAL ECONOMIC INDICATORS

Eurozone Economic Sentiment Indicators ([link](#)): Economic Sentiment Indexes (ESIs) for both the EU (+6.9 points to 100.0) and Eurozone (+7.6 to 101.0) climbed in March for the ninth month since bottoming last April, to within 3.9 points and 3.0 points, respectively, of their pre-Covid readings. For the first time since the outbreak of Covid-19, the ESI for the former is back up at its long-term average, while the latter is slightly above its long-term average. Among the largest Eurozone economies, Germany (+7.9 points to 103.7) posted the biggest jump this month, followed by Spain (+6.2 to 96.9), France (+5.4 to 96.8), Italy (+4.9 to 99.5), and the Netherlands (+4.4 to 97.9)—with Germany’s ESI moving above its long-term average. These ESIs were at 102.2, 103.2, 105.8, 102.1, and 102.8, respectively, before the pandemic hit. For the overall Eurozone, at the sector level, industry confidence increased for the fourth successive month in March—and the 10th time since bottoming last April—soaring 34.5 points (to +2.0 from -32.5) over the 11 months through March. This month, services (+7.7 points to -9.3) confidence posted its first big pickup since last September—driven by expectations—while retail trade (+6.9 to -12.2) confidence improved for the first time in five months. Meanwhile, consumer confidence climbed for the third time in four months, by 6.8 points to -10.8, its best reading since last February; construction (+4.8 points to -2.7) confidence got a big shot in the arm this month, though it has been steadily improving since last August.

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