



## MORNING BRIEFING

April 13, 2021

### Outlook vs Outcome, Preempting vs Reacting

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

(1) Did you get the Fed's latest memo? (2) Here's the message again: We are in no rush to raise rates. (3) Reacting to outcomes rather than preempting outlooks. (4) Pandemic changed Fed's reaction function. (5) Forward-looking vs backward-looking guidance. (6) Powell's latest super-dovish interview. (7) Redefining a recovery. (8) Powell's latest spin on asset bubbles and the Archegos incident. (9) Is Powell channeling Greenspan's 2008 shocking admission? (10) Another Great Inflator? (11) Clarida explains it all. (12) QE4ever by the numbers. (13) Q1 earnings season by the numbers.

**The Fed I: Backward Looking.** Just in case we didn't get the Fed's memo on the change in its monetary framework, Fed Governor Lael Brainard explained it very clearly in a [speech](#) on March 23 titled "Remaining Patient as the Outlook Brightens." Throughout her talk, she stressed very important distinctions in meaning between "outlook" and "outcome" and between "preempting" and "reacting." She concluded her speech with her punchline: "By taking a patient approach based on *outcomes* [emphasis added] rather than a preemptive approach based on the *outlook*, policy will be more effective in achieving broad-based and inclusive maximum employment and inflation that averages 2 percent over time."

Brainard acknowledged that the efforts of public health, fiscal, and monetary policymakers "have contributed to a considerably brighter economic outlook." However, she stated that the Fed's "reaction function" had changed in response to the pandemic. The Fed governor explained: "The FOMC has communicated its reaction function under the new framework and provided powerful forward guidance that is conditioned on employment and inflation outcomes. This approach implies resolute patience while the gap closes between current conditions and the maximum-employment and average inflation outcomes in the guidance."

In effect, the Fed's policy responses will be backward looking rather than forward looking. In an April 11 [interview](#) on *CBS 60 Minutes*, Fed Chair Jerome Powell reiterated this message as follows:

(1) *Inflection point.* He started with a very upbeat outlook: “What we’re seeing now is really an economy that seems to be at an inflection point. And that’s because of widespread vaccination and strong fiscal support, strong monetary policy support. We feel like we’re at a place where the economy’s about to start growing much more quickly and job creation coming in much more quickly.” He concluded the interview by saying “I’m in a position to guarantee that the Fed will do everything we can to support the economy for as long as it takes to complete the recovery.”

(2) *Recovery redefined.* Got that? The Fed will keep policy ultra-easy until the recovery is complete. But wait a minute—real GDP is likely to be back in record-high territory by the second quarter. It is on the verge of a complete recovery. That’s true, but Powell and Brainard said that “broad-based and inclusive maximum employment” is one of the outcomes they want to see before the Fed starts tightening. Both also want to see inflation moderately above 2%. Powell explained: “And the reason for that is we want inflation to average 2% over time.”

(3) *Fed funds rate staying put.* Once the Fed achieves this outcome, “that’s when we’ll raise interest rates,” Powell said. When asked whether interest rates might remain unchanged around zero through year-end, Powell said, “I think it’s highly unlikely we would raise rates anything like this year, no.”

**The Fed II: Ghost of Greenspan Past.** What about asset inflation? In his interview, Powell was asked about it and responded: “[W]e do look at asset prices. And I would say, you know, some asset prices are elevated by some historical metrics. Of course, there are people who think that the stock market is not overvalued, or it wouldn’t be at this level. We don’t think we have the ability to identify asset bubbles perfectly. So ... what we focus on is having a strong financial system that’s resilient to significant shocks, including if values were to go down.”

What about Archegos? This hedge fund, disguised as a “family office,” blew up earlier this month when its speculative bets in the stock market crashed and burned, leaving billion-dollar craters in the earnings of a few of its brokers. Powell’s response gave me an unsettling sense of déjà vu all over again. He said:

“This is an event that we’re monitoring very carefully and working with regulators here and around the world to understand carefully. What’s concerning about it ... and surprising, frankly, is that a single customer, client, of one of these large firms could result in such substantial

losses to these large firms in a business that is generally thought to present relatively well understood risks.”

That reminds me of the following remarks by Alan Greenspan for his October 23, 2008 [testimony](#) before the House Committee on Oversight and Government Reform at a hearing on the role of federal regulators in the Great Financial Crisis:

“As I wrote last March: those of us who have looked to the self-interest of lending institutions to protect shareholders’ equity (myself especially) are in a state of shocked disbelief. Such counterparty surveillance is a central pillar of our financial markets’ state of balance. If it fails, as occurred this year, market stability is undermined.”

During his Q&A exchange, Greenspan acknowledged the error of his ways: “I made a mistake in presuming that the self-interest of organizations, specifically banks and others, [was] such [that] they were best capable of protecting their own shareholders and their equity in the firms.”

(For more thoughts regarding that testimony, see my 2020 book *Fed Watching for Fun and Profit*, particularly Chapter 5 titled “Alan Greenspan: The Great Asset Inflator.” Chapter 8 is titled “Jerome Powell: The Pragmatic Pivoter.” When and if I write a second edition, I might have to change that to “Jerome Powell: Another Great Inflator.” His policies have the potential to inflate not only asset prices but also consumer prices.)

**The Fed III: New Monetary Policy Approach.** All this amounts to a backward-looking, rather than a forward-looking, monetary policy approach. Ironically, all the talking Fed heads now are saying that their “forward guidance” is no longer relevant since that was based on their *outlook*, which has not been relevant since the pandemic started. What matters now is the *outcome*, which can only be known after it happens!

Forward-looking guidance has now morphed into backward-looking guidance. In effect, Fed officials are saying, “We’ll let you know when we are ready to raise interest rates after we get the outcome we were seeking.”

Confused? If not, you should be. Now take a deep breath and try to fathom the following Fed speak from a March 25 [speech](#) by Fed Vice Chair Richard Clarida:

“The changes to the policy statement that we made over the past few FOMC meetings bring our policy guidance in line with the new framework outlined in the revised Statement on Longer-Run Goals and Monetary Policy Strategy that the Committee approved last August. In our new framework, we acknowledge that policy decisions going forward will be based on the FOMC’s estimates of ‘*shortfalls* [emphasis added] of employment from its maximum level’—not ‘deviations.’ This language means that going forward, a low unemployment rate, in and of itself, will not be sufficient to trigger a tightening of monetary policy absent any evidence from other indicators that inflation is at risk of moving above mandate-consistent levels. With regard to our price-stability mandate, while the new statement maintains our definition that the longer-run goal for inflation is 2 percent, it elevates the importance—and the challenge—of keeping inflation expectations well anchored at 2 percent in a world in which an effective-lower-bound constraint is, in downturns, binding on the federal funds rate. To this end, the new statement conveys the Committee’s judgment that, in order to anchor expectations at the 2 percent level consistent with price stability, it will conduct policy to achieve inflation outcomes that keep long-run inflation expectations anchored at our 2 percent longer-run goal.”

You can come up for air now.

**The Fed IV: By the Numbers.** The Fed’s balance sheet continues to expand to infinity and beyond. That’s been happening since the Fed adopted QE4ever on March 23, 2020. Here are the mind-boggling relevant stats since then through the April 7 week:

(1) *Assets.* The assets side of the Fed’s balance sheet is up \$3.0 trillion over this period to a record \$7.7 trillion ([Fig. 1](#)). The Fed’s holdings of securities is up \$3.2 trillion to a record \$7.1 trillion. The difference between these two series is composed mostly of the assets held by the Fed’s emergency liquidity facilities, which has declined \$167 billion since March 23, 2020 ([Fig. 2](#)). It remains \$260 billion above last year’s low during the week of February 26.

(2) *MMT.* Over the past 12 months through March, the US federal budget deficit totaled \$4.1 trillion ([Fig. 3](#)). The Fed financed 51% of this deficit by purchasing \$2.1 trillion in US Treasury securities over this period. As of March, the Fed held a record 25.6% of the total of marketable US Treasury debt ([Fig. 4](#)). That’s Modern Monetary Theory (MMT) on speed and steroids.

(3) *Notes and bonds.* Over the past 12 months through March, the Treasury issued \$2,081 billion in notes and bonds ([Fig. 5](#) and [Fig. 6](#)). Over that same period, the Fed purchased \$1,615 billion in the Treasury’s notes and bonds. It bought them in an effort to keep a lid on

bond yields. The 10-year Treasury bond yield has rebounded nonetheless, but it would probably be higher today but for the Fed's purchases.

(4) *Reserve balances*. As a result of the Treasury's record budget deficit and the Fed's record purchases of securities, the total deposits at all US commercial banks has increased \$2.4 trillion y/y to a record \$16.7 trillion through the March 31 week ([Fig. 7](#)). Another result of T-Fed's MMT on speed and steroids is that reserve balances with the Fed has jumped \$1.2 trillion y/y to a record \$3.9 trillion during the April 7 week ([Fig. 8](#)). That well exceeds the impact of the previous three QE programs on reserve balances.

(5) *The others*. Meanwhile, the assets on the ECB's balance sheet also continue to soar. During the April 2 week, this series was up €2.3 trillion y/y to a record €7.5 trillion ([Fig. 9](#)). The BOJ's assets rose 18% y/y to a record ¥714 trillion during the March 26 week ([Fig. 10](#)).

Debbie and I also track the assets of the People's Bank of China (PBOC). However, we believe that China's bank loans data are a more useful measure of the PBOC's ultra-easy monetary policy since the Great Financial Crisis. From the end of 2008 through March 2021, they are up a staggering \$23.3 trillion from \$4.4 trillion to a record \$27.7 trillion ([Fig. 11](#)). Over the past 12 months through March, these loans are up a record \$3.1 trillion ([Fig. 12](#)).

All together in US dollars, the assets of the Fed, ECB, and BOJ are up \$6.9 trillion y/y through the March 26 week to a record-high \$23.1 trillion ([Fig. 13](#) and [Fig. 14](#)).

**Strategy: Q1's Earnings Season By the Numbers.** I asked Joe to compile an [Earnings Season Monitor: S&P 500 Sectors](#) crib sheet showing industry analysts' consensus expectations for S&P 500 revenues and earnings growth for the four quarters of this year. He did so as of the April 9 week. We intend to compare that to the results at the end of the current earnings-reporting season, for Q1-2021, to see where the actual results came in and how they affected expectations for the subsequent upcoming quarters. Consider the following:

(1) Here are the analysts' current projections for the four quarters' revenues and earnings y/y growth rates of the S&P 500: Q1 (8.8%, 25.0%), Q2 (15.4, 54.9), Q3 (9.2, 20.2), and Q4 (6.4, 14.1). They expect double-digit earnings growth during all four quarters. That adds up to a 9.7% revenue gain and a 26.5% earnings increase for 2021 over 2020.

(2) Here are their current expectations for the comparable revenue and earnings growth rates for Q1-2021 for the S&P 500's sectors: S&P 500 (8.8%, 25.0%), Communication Services (8.4, 13.6), Consumer Discretionary (14.8, 97.7), Consumer Staples (2.2, 0.9), Energy (-9.2, -10.0), Financials (25.7, 75.6), Health Care (9.4, 17.9), Industrials (-1.1, -13.8), Information Technology (15.8, 24.4), Materials (10.0, 45.4), Real Estate (-0.1, 1.0), and Utilities (5.2, 2.5).

## CALENDARS

**US: Tues:** Headline & Core CPI 2.5%/1.6% y/y, NFIB Business Optimism, API Crude Oil Inventories. **Wed:** Import & Export Prices 0.9%/1.0%, MBA Mortgage Applications, EIA Crude Oil Inventories, Fed Beige Book, Powell, Clarida. (DailyFX estimates)

**Global: Tues:** Eurozone ZEW Economic Sentiment, Germany ZEW Economic Sentiment 79.5, Italy Industrial Production 0.6%, UK GDP 0/6%/m/m/-1.9%3m/3m/-8.3%/y/y, UK Headline & Manufacturing Industrial Production -4.4%/-5.1% y/y, UK NIESR Monthly GDP Tracker, Japan Machinery Orders 2.8%/m/m/2.3%/y/y, Australia Westpac Consumer Confidence, Mauderer. **Wed:** Eurozone Industrial Production -0.9%/m/m/-0.9%/y/y, Australia Employment Change & Unemployment Rate 35k/5.7%, Guindos, Panetta, Schnabel, Kuroda. (DailyFX estimates)

## STRATEGY INDICATORS

**S&P 500/400/600 Forward Earnings ([link](#)):** Forward earnings rose for all three of these indexes last week and were at record highs simultaneously for a fifth week and the first time since October 2018. LargeCap's was at a record high for a sixth straight week; MidCap's for a ninth week; and SmallCap's for the ninth time in 10 weeks. In what has shaped up to be a typical V-shaped recovery, LargeCap's forward earnings has risen during 46 of the past 47 weeks, with the one down week in late December due to Tesla's addition to the index. MidCap's is up in 43 of the past 45 weeks, and SmallCap's posted 43 gains in the past 46 weeks. LargeCap's forward earnings is now up 30.3% from its lowest level since August 2017; MidCap's has risen 63.2% from its lowest level since May 2015; and SmallCap's is up 97.4% 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 a 27-month high of 16.9% y/y from 11.3%. 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 an 11-year high of 31.9% y/y from 23.3% 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 record high of 47.3% y/y from 36.5% 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 have been improving since July as companies easily beat low-balled consensus estimates for Q2, Q3, and Q4. Here are the latest consensus earnings growth rates for 2021 and 2022: LargeCap (26.4%, 15.1%), MidCap (44.8, 14.0), and SmallCap (70.6, 20.4).

**S&P 500/400/600 Valuation** ([link](#)): Valuations rose for two of these three indexes last week. LargeCap's forward P/E rose 0.4pt to 22.5. That's just 0.2pt below its 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 edged up 0.1pt to 19.8 but is down from a seven-month high of 20.5 in early March. Its current level is 3.1pts below its record high of 22.9 in early June. SmallCap's ticked down 0.2pt w/w to 20.1. It's now down 6.6pts 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 33rd week. That's the longest stretch at a discount 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 13th 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.**Second** ([link](#)): Content here

**S&P 500 Sectors Quarterly Earnings Outlook** ([link](#)): Since the Q2-2020 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 Q1-2021 estimate rose 23 cents to \$40.11, instead of declining as typically seen in the first week of the earnings season. That \$40.11 estimate for

Q1-2021 represents a gain of 21.1% y/y on a frozen actual basis and a 25.0% y/y gain on a pro forma basis. That marks the first quarter of double-digit percentage growth since Q4-2018 and compares to a pro forma 3.8% gain in Q4-2020. Nine sectors are currently expected to post positive y/y earnings growth in Q1-2021, but the final results are likely to be higher y/y for all but the Industrials sector. Here are the S&P 500 sectors' latest expected earnings growth rates for Q1-2021 versus their final Q4-2020 growth rates: Consumer Discretionary (97.7% in Q1-2021 versus -5.0% in Q4-2020), Financials (75.6, 20.4), Materials (45.4, 22.7), S&P 500 (25.0, 3.8), Information Technology (24.4, 20.4), Health Care (17.9, 10.6), Communication Services (13.6, 10.1), Utilities (2.5, -2.6), Real Estate (1.0, -10.7), Consumer Staples (0.9, 5.4), Energy (-10.0, -105.0), and Industrials (-13.8, -37.7).

## GLOBAL ECONOMIC INDICATORS

**Eurozone Retail Sales** ([link](#)): Retail sales in the Eurozone continued its up-and-down pattern for the eighth month, rebounding 3.0% in February after a 5.2% loss and a 2.0% gain the prior two months. There hasn't been a back-to-back gain in sales since May and June of last year. Sales are down 2.9% y/y. Of the three major components, only food, drinks & tobacco fell in February, but it was the only category up y/y. Here's a look at the three major categories on a m/m and y/y basis: non-food products ex fuel (+6.8% m/m & -5.5% y/y), automotive fuel (+3.7 & -13.0), and food, drink & tobacco (-1.1 & +1.9). Three of the top four Eurozone economies experienced an increase in sales in February, with France the only one showing a decline. Italy saw the biggest increase in sales, rebounding 8.4% during February, though it still posted a 5.6% shortfall y/y; Spain (+3.8% m/m & -6.2% y/y) and Germany (+1.2 & -5.3) showed a similar pattern—though Germany sales had plummeted 14.0% during the two month through January after reaching a new record high in November. Meanwhile, sales in France fell for the second month in February since hitting a new record high in December, falling 5.5% over the period; despite the decline, sales were 1.3% above year-ago levels.

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