



MORNING BRIEFING

April 28, 2021

Profitable Corporations

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

(1) Great fundamentals for S&P 500. (2) Earnings jumped about 50% during H2-2020, with revenues up about 15% and margin up 30%. (3) Impressive and surprisingly widespread rebound in profit margin. (4) Rising costs weigh on profit margins of users but boost margins of suppliers. (5) Analysts continue to raise their earnings estimates for this year. (6) Biden corporate tax hike likely to take a bite next year. (7) Floating on a sea of liquidity. (8) Capital markets wide open. (9) Government's visible lending hand averted widespread bankruptcies. (10) SPACs' shell game may be over now that there is a new sheriff at the SEC.

Corporate Finance I: Resilient Profit Margins. The underlying fundamentals of the S&P 500 companies are in great shape. Their collective forward revenues, forward earnings, and forward profit margin all rose to record highs during the April 15 week ([Fig. 1](#)). All three weekly series are great coincident indicators of actual quarterly revenues, earnings, and the profit margin. Joe and I were expecting a V-shaped economic recovery. So we are not surprised by the V-shaped recovery in these fundamentals.

We can certainly understand why actual and forward revenues have recovered much faster during the Great Virus Crisis than during the Great Financial Crisis. Fiscal and monetary stimulus programs have been much more stimulative this time both in scope and scale. Furthermore, the pandemic turned out to be good for lots of businesses. The 52% jump in S&P 500 operating earnings per share from Q2-2020 through Q4-2020 can be attributed to the 16% increase in revenues and the 30% rebound in the profit margin from 8.9% to 11.6% over this period.

The quick recovery in the profit margin has been especially impressive. After all, lots of pandemically challenged services industries had to limit their operating capacity to 25%-50% after the initial lockdown restrictions were eased. Demand for goods traced a V-shaped recovery, while demand for services was restrained by social-distancing regulations. Nevertheless, input costs soared widely as the economy recovered, including not only commodity prices and critical manufactured components but also shipping services. Shortages of skilled workers have been costly as well, especially for companies with booming demand that have been forced to extend delivery times.

Yet the profit margin data suggest that companies may have adapted rapidly to these challenges. They must have done so mostly by boosting the productivity of their available workforce. Of course, the S&P 500 includes plenty of companies that saw their margins soar along with costs, particularly commodity producers in the S&P 500 Energy and Materials sectors. Now consider the following:

(1) *Slicing and dicing by S&P 500 sectors.* On closer inspection, Joe and I found that the rebounds in the profit margins of the 11 S&P 500 sectors have been surprisingly widespread and mostly V-shaped. Here are the forward profit margins of the S&P 500 and its sectors during the April 15 week along with last year's troughs: S&P 500 (12.3%, 10.3%), Communication Services (14.8, 13.2), Consumer Discretionary (7.0, 4.7), Consumer Staples (7.6, 7.2), Energy (5.8, 0.2), Financials (18.4, 13.0), Health Care (10.9, 10.0), Industrials (9.0, 7.3), Information Technology (23.6, 21.6), Materials (11.8, 8.8), Real Estate (13.9, 12.4), and Utilities (14.8, 13.2) ([Fig. 2](#)).

(2) *Happy quarterly returns.* The Q1-2021 earnings reported so far by S&P 500 companies have boosted the anticipated final number for the quarter from \$37.59 per share at the start of this year to \$42.69 during the April 22 week, a 28.9% y/y increase ([Fig. 3](#) and [Fig. 4](#)). Also rising are the estimated levels and growth rates of earnings for Q2 (52.9% y/y), Q3 (19.6), and Q4 (14.5). So the consensus estimates for 2021 and 2022 continue to rise too ([Fig. 5](#)). During the week of April 15, they were \$177.77 and \$203.75, respectively. The growth rate for this year is currently expected to be 28.8% followed by 14.3% next year.

(3) *Spoiler alert.* While the 2021 estimates may turn out to be too low if companies continue to expand their profit margins, the 2022 estimates will take a hit if the Biden administration succeeds in raising the corporate tax rate by 33% from 21% to 28% next year. In the March 31 [Morning Briefing](#), we estimated that Trump's 40% cut in the corporate tax rate—from 35% to 21% at the start of 2018—boosted the profit margin by around 13% from 10.8% in 2017 to 12.1% in 2018, or \$22.18 per share ([Fig. 6](#)).

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.

Corporate Finance II: Easy Credit. The flood of liquidity provided by the Fed at the start of the pandemic last year averted what could easily have been a credit crunch as terrible as the one that occurred during the Great Financial Crisis. As a result, delinquencies and defaults have been remarkably low during the Great Virus Crisis. Instead, corporations have been able to issue lots of bonds and stocks. They've refinanced their debts at record-low interest rates and had plenty of

money to finance capital spending. Consider the following:

(1) *Bank credit*. Last year, provisions for loan losses at all FDIC-insured financial institutions well exceeded actual net charge-offs, which remained remarkably low ([Fig. 7](#)). As a result, bank earnings will get a big boost this year from lowering their allowances for losses ([Fig. 8](#)).

The big problem for banks in recent months has been a huge inflow of deposits and not enough loan demand to deploy these funds. Deposits at all commercial banks are up \$2,240 billion y/y through the April 14 week ([Fig. 9](#)). Over this same period, loans and leases at all commercial banks are down \$408 billion, with commercial and industrial loans down \$311 billion ([Fig. 10](#)). That's because nonfinancial corporations (NFCs) have been able to raise lots of money directly in the capital markets.

(2) *Nonfinancial corporate bonds & equities*. NFCs' equity issuance—including IPOs and SEOs (seasoned equity offerings)—surged by a record \$187.1 billion last year, according to Fed data ([Fig. 11](#)). A significant portion of that may have been driven by SPAC activity, as discussed below.

Furthermore, NFCs issued a record \$1.47 trillion in bonds over the 12-months through February ([Fig. 12](#)). Record-low corporate bond yields and credit-quality yield spreads certainly contributed to this development ([Fig. 13](#)).

The Fed's recently released [Financial Accounts of the United States](#) shows that during Q4-2020, NFC bonds outstanding totaled a record \$6.5 trillion ([Fig. 14](#)). NFC loans totaled \$3.9 trillion, with \$1.1 trillion financed by depository institutions, while "other loans" (including leveraged loans) totaled \$2.0 trillion and mortgages totaled \$0.7 trillion ([Fig. 15](#)).

(3) *Bankruptcies*. Some big-name companies were forced into their final chapters in 2020 because of Covid-19's economic toll. As we discussed in our August 12, 2020 [Morning Briefing](#), many of the companies that went bankrupt in 2020 were in distress leading up to the Covid-19, particularly in the retail and energy sectors.

Some companies (especially in the airlines industry), however, received direct fiscal support and indirect monetary support that served as a bridge through the pandemic. The Paychecks Protection Program undoubtedly also provided lots of relief to lots of companies. Now that the domestic economy is improving along with the rollout of vaccines, it is likely that US corporate defaults and bankruptcies may be peaking. Nevertheless, they may remain elevated for some time due to the lingering effects of the pandemic.

In the first six months of 2020, data from Epiq [revealed](#) that 3,604 companies filed for Chapter 11 bankruptcy, an annual increase of 26%. But the latest data show that commercial Chapter 11 filings were down 9% over February 2021, with 384 new filings in March.

“The decline in commercial chapter 11 filings is a direct reflection of both lenders and owners working with companies,” said a representative of Epiq. The firm added that the “economic recovery is gaining momentum that will accelerate the return to pre-pandemic new bankruptcy filings levels. We approach the second quarter of 2021 cautiously anticipating the bankruptcy backlog that emerged during the pandemic may be peaking.”

(4) *Global defaults*. However, S&P Global Ratings expects global corporate defaults to remain elevated in 2021. They surged by 91% in 2020, an 11-year high, driven mostly by US and European companies that were heavily affected by the coronavirus pandemic, according to an S&P Global Ratings January 8 [report](#).

Leading the default tally was the US, with 146 versus 78 in 2019. Oil and gas led global defaults among sectors in 2020, with consumer products and media and entertainment not far behind.

But Moody’s suspects that global corporate speculative-grade defaults peaked in December 2020. “First-quarter 2021 corporate defaults totaled 13 globally, compared with 30 in last year’s first quarter, as government and central bank actions have played a critical role in averting an otherwise more dire default cycle,” Moody’s stated in an April 2021 [report](#).

(5) *Delinquencies*. Interestingly, so far over the course of the pandemic, the delinquency rate on commercial and industrial loans has never even approached the 2009 peak of 4.39%; it ended Q4-2020 at just 1.30% ([Fig. 16](#)). That may be because lenders have been more lenient on their terms given the unique circumstances of the pandemic, as Epiq suggested. Another likely reason, in our opinion, is that many companies are flush with enough liquidity to cover short-term obligations, thanks to the massive government and central bank stimulus.

Corporate Finance III: Lost in SPACs. Investors still wondering what a special purpose acquisition company (SPAC) is for may be too late to the party. But missing out on the fun might not be such a bad thing for many. Insiders who get into a SPAC investment early usually profit big while individual investors coming in later risk getting burned.

Celebrity SPAC [sponsors](#)—from basketball star Shaquille O’Neal to former House Speaker Paul Ryan (R-WI)—may attract investors and are rewarded for doing so. Early investors get a good deal, as their downside is usually limited upfront and they’re typically [allowed](#) to buy a percentage

of the acquired company at a deep discount, with bankers' fees usually deferred until after a deal is done.

As we covered in our March 16 [Morning Briefing](#), the Securities and Exchange Commission (SEC) issued a March 10 [alert](#) titled "Celebrity Involvement with SPACs—Investor Alert" and a December 10, 2020 SEC [bulletin](#) titled "SPACS—What You Need to Know." The bottom line, we concluded, is that a few of the speculative excesses in the market are under scrutiny by the regulators. Indeed, the new leadership at the SEC is already taking a tougher stance on SPACs. Consider the following:

(1) *What the SPAC?* SPACs are a vehicle for young private companies to go public without the regulatory scrutiny that normally takes place with an initial public offering (IPO). SPACs raise money for the sole purpose of acquiring a business to take it public in a so-called reverse merger. They are publicly traded shell companies that hold nothing but cash.

SPAC offerings are usually priced at about \$10 per share because there is no basis for valuation. SPAC units typically consist of warrants (i.e., contracts that permit holders to buy shares in the future at a given price) and shares. IPO proceeds are typically placed into a trust. If a merger is approved, sponsors can either retain their shares of the combined company or redeem them for a share of the trust account. (For more, see the helpful infographic at the bottom of this March 29 [WSJ article](#).)

SPACs typically have about two years to find an acquisition target, or they are required to return the funds to investors. Once a deal is complete, the acquisition target takes the SPAC's place on a stock exchange. SPACs typically fund immature companies in growth industries like green energy. SPACs are a mature structure, but they have proliferated only recently, fueled by [social media](#) and celebrity campaigns.

(2) *SPACs on fire.* In 2020, proceeds raised by SPACs outperformed those raised by traditional IPOs, [observed](#) Nasdaq. That's saying something, because nonfinancial corporate equity issuance—including IPOs and SEOs (seasoned equity offerings)—surged at the end of last year, according to the Federal Reserve's US Financial Accounts.

Cash raised from IPOs and SPACs also are fueling the junk-bond market, explained an April 23 [WSJ article](#). For the first time since 2000, new stock sales exceeded junk-bond issuance. This year to date, \$180 billion of high-yield bonds has been raised.

"SPACs have raised about \$100 billion so far this year, more than last year's record of \$83.4

billion, which itself was more than the amount raised in the nearly 30-year history of these blank-check companies,” observed an April 16 *WSJ* [article](#) citing Dealogic data. SPACs account about 70% of all IPOs this year, the March 29 *WSJ* article reported. Some 300 SPACs have been [created](#) since the beginning of this year.

(By the way, we have a request out to the Fed to learn whether it accounts for SPAC activity as IPOs or SEOs given SPACs’ unique structure.)

(3) *SPACs on ice*. An April 21 CNBC [article](#) noted: “After more than 100 new deals in March alone, issuance is nearly at a standstill with just 10 SPACs in April, according to data from SPAC Research.” The slowdown followed the SEC’s new accounting guidance that would impact the value of SPACs, requiring reclassifying the value of warrants as liabilities instead of equity and periodic recalculating of their value in some cases. SPAC deals are usually done as a mix of shares and warrants.

(4) *From zero to billions*. Recently, the SEC has questioned the “optimistic revenue projections used by startups that are merging with SPACs,” reported the April 16 *WSJ* article. Under the traditional IPO process, companies generally do not make projections, but companies that use SPACs do. SPACs’ financials usually are audited by smaller accounting firms rather than one of the Big Four.

For example, in January, the SEC asked self-driving car component maker Ouster Inc. “to better explain how it projected to go from just \$12.5 million in revenue in 2020 to nearly \$1.6 billion by 2025.” Some SPAC acquisition targets have cut their revenue targets or changed strategies since going public.

Unrealistic and sometimes fraudulent SPAC claims have burned some investors. For example, electric truck startup Nikola’s founder and chairman reportedly [misled](#) investors by making fraudulent claims about its technology. Nikola’s [stock](#) peaked in June at around \$65.00 a share and now trades around \$11.00. But some SPAC acquisitions have gone exceedingly well—as speculative trends often do. Early investors to DraftKings, for example, may have seen [returns](#) as great as 400% if they got in and out at the right times.

(5) *Meet Gary Gensler*. Newly confirmed SEC Chairman Gary Gensler has taken an early stand on SPACs, demonstrating his prioritization of regulating speculative investments. As former chairman of the Commodity Futures Trading Commission, Gensler is known as a “hard-nosed regulator who succeeded in overhauling the swaps market after the financial crisis,” [observed](#) the April 14 *WSJ*.

Calendars

US: Wed: MBA Mortgage Applications, Goods Trade Balance Advance, Wholesale Inventories, EIA Crude Oil Inventories. **Thurs:** GDP 6.1%, GDP & Core PCE Price Deflators 2.5%/2.4%, Initial & Continuous Jobless Claims 549k/3.61m, Pending Home Sales 4.7%, EIA Natural Gas Inventories, Williams, Quarles. (DailyFX estimates)

Global: Wed: Germany Germany Gfk Consumer Confidence -3.5, France Consumer Confidence 94, Canada Retail Sales Total & Ex Autos 4.0%/3.7%, Fed Interest Rate Decision 0.25%. **Thurs:** Eurozone Economic Sentiment 102.2, Eurozone Consumer & Industrial Sentiment -8.1/4.0, Germany CPI 0.5% m/m/1.9% y/y, Germany Unemployment Change & Unemployment Rate -10k/6.0%, Spain Unemployment Rate 16.6%, Japan Unemployment Rate 2.9%, Japan Industrial Production -2.0%, China NBS M-PMI 51.7. (DailyFX estimates)

Strategy Indicators

S&P 500 Q1 Earnings Season Monitor ([link](#)): With nearly 27% of S&P 500 companies finished reporting revenues and earnings for Q1-2021, revenues are beating the consensus forecast by a well-above-trend 2.9%, and earnings have crushed estimates by 23.3% in large part due to loan loss reversals at the banks. At the same point during the Q4 season, revenues were 2.5% above forecast and earnings beat by 17.9%. The S&P 500's Q1 earnings surprise excluding Financials drops to 12.2% from 23.3%. For the 132 companies that have reported through mid-day Tuesday, aggregate y/y revenue and earnings growth and the percentage of companies reporting a positive revenue and earnings surprise have improved from their Q4 measures. The small sample of Q1 reporters so far has a y/y revenue gain of 6.0% and an earnings gain of 53.7%, which drops to 4.3% and 8.9%, respectively, when Financials are excluded. A whopping 84% of the Q1 reporters so far has reported a positive earnings surprise, and 78% has beaten revenues forecasts. Slightly more companies have reported positive y/y earnings growth in Q1 (74%) than positive y/y revenue growth (71%). These figures will change markedly as more Q1-2021 results are reported in the coming weeks, particularly the y/y earnings growth rate.

MSCI World & Region Net Earnings Revisions ([link](#)): Analysts' recent earnings revisions through April suggest substantially greater optimism about profits in the US than the rest of the world, but now they're improving. The US's NERI was positive in April for a ninth straight month after 14 negative readings but dropped to 12.7% from 13.2%. That compares to a 34-month high of 16.0% in January and an 11-year low of -36.9% in May 2020. It remains well below its corporate-tax-rate-

cut-boosted record high of 21.8% in March 2018. The AC World ex-US MSCI's NERI was positive for a sixth month after 30 straight negative readings and improved to 5.5% from 5.3%. That compares to an 11-year high of 5.7% in February and an 11-year low of -23.9% in May 2020. With the exception of the EMU, which had NERI turn positive in January, much of the world's regions have had positive NERI readings since September and October. Here are April's scores among the regional MSCIs: US (12.7% in April, down from 13.2% in March), AC World (7.4, 7.4), EAFE (7.0 [15-year high], 5.0), EM Eastern Europe (6.7, 6.0), Europe ex-UK (6.5 [46-month high], 2.9), Europe (6.0 [47-month high], 3.0), AC World ex-US (5.5, 5.3), EMU (4.4 [46-month high], 1.5), Emerging Markets (4.4, 5.5), EM Latin America (4.3, 3.3), and EM Asia (4.1, 5.4).

MSCI Countries Net Earnings Revisions ([link](#)): NERI was positive for 33/44 MSCI countries in April. That's unchanged from March and down from 35/44 in February, which was the most since December 2009. That compares to zero countries with positive NERI from April to June 2020. NERI improved m/m in April for 29/44 countries, up from 17/44 countries improving in March. Among the countries with improving or unchanged NERI in April, Austria and Hungary were at a record high, followed by Chile (25-year high), Australia (15-year high), Norway (15-year high), and Switzerland (14-year high). The United States has had positive NERI for nine straight months, followed by nine-month streaks for these six countries: Canada, China, Korea, Norway, Sweden, and Taiwan. Spain's NERI has been negative for 33 straight months, followed by 15-month negative streaks for Israel, Portugal, and the Philippines. Denmark and Mexico had NERI turn positive m/m while the Czech Republic and Greece turned negative. The highest NERI readings in April: Austria (26.9%), Hungary (24.1), Taiwan (17.7), Sweden (17.2), and Chile (16.1). The weakest NERIs occurred this month in Israel (-17.7), New Zealand (-11.8), Portugal (-6.2), Indonesia (-3.5), and Finland (-3.1).

US Economic Indicators

Consumer Confidence ([link](#)): Consumer confidence in April increased for the fourth successive month—with 90% of the gain occurring the past two months, as the continued rollout of vaccines has helped to open the economy. The Consumer Confidence Index (CCI) has soared 34.6 points during the four months through April, to 121.7 (the highest since February 2020), with the CCI in March and April climbing 18.6 points and 12.7 points, respectively. The present situation component jumped 52.4 points (to 139.6 from 87.2 in December) this year to date, with the expectations component up 22.8 points (109.8 from 87.0) over the same period. The former is the highest since March 2020, the latter since July 2019. Consumers' appraisal of current conditions improved significantly, with the percentage of consumers claiming business conditions are good

rising 5.0ppts (to 23.3% from 18.3%) to a 13-month high, while those claiming business conditions are bad fell 5.3ppts (24.8 from 30.1) to a 13-month low. Consumers' assessment of the labor market also continued to improve—with those saying jobs are plentiful (to 37.9% from 26.5) up 11.4ppts this month, while those saying jobs are hard to get are down 5.3ppts (13.2 from 18.5). It was the highest since March 2020 for the former and the lowest since January 2020 for the latter. In the meantime, short-term inflation expectations held steady in April, though remained elevated at 6.7%. The percentage of consumers expecting business conditions to improve (to 40.5% from 40.3%) was little changed this month—though added a bit to March's 9.6ppts surge—while those expecting business condition to worsen (11.9 from 11.8) was also little changed after March's 5.9ppts decline. The percentage was the highest for the former since mid-2020, while the latter's percentage was only a tick above March—which was the lowest since last February. Meanwhile, the consumers' outlook regarding the job market was slightly less upbeat than March, with the percentage expecting more jobs (to 34.5% from 35.9%) 1.4ppts lower this month, while those expecting less jobs (15.4 from 14.4) was a percentage point higher. March's reading for the former was the highest since June 2020, while it was the lowest since June 2020 for the latter.

Regional M-PMIs ([link](#)): Five Fed districts have now reported on manufacturing activity for April (Philadelphia, New York, Kansas City, Dallas, and Richmond) and show the manufacturing sector expanded at a record pace, with four of the five regions expanding at a better rate than March. Prices-paid and -received indexes are up sharply in all regions in recent months. The composite index (to 32.4 from 26.8) shows growth this month has nearly tripled since the end of last year (11.9), as the Philadelphia (to 50.2 from 44.5) region posted its strongest performance since the 1970s, while Kansas City's (31.0 from 26.0) was the best in the history of the series going back to July 2001. Meanwhile, activity in the New York (26.3 from 17.5) and Dallas (37.3 from 28.9) regions were the strongest since October 2017 and June 2018, respectively; Richmond's was unchanged at 17.0. The new orders measure also expanded at a record rate this month, accelerating for the fourth month to 29.3—up from 14.7 at the end of last year. Orders in the Dallas (to 38.5 from 30.5) region accelerated at a record pace this month, while billings in the New York (26.9 from 9.1) region grew at the fastest rate since October 2009, and Philadelphia's (36.0 from 38.2) was only a tad slower than March's rate—which was the best since 1973. In the meantime, the Kansas City (29.0 from 37.0) region saw orders growth slow from March's pace—which was the second strongest on record; billings growth in the Richmond (16.0 from 10.0) region remained subdued. As far as jobs are concerned, factories added to payrolls at the best pace on record—with the employment measure climbing from 18.9 to 24.8 this month. The Dallas (to 31.3 from 18.8), Philadelphia (30.8 from 27.4), Kansas City (29.0 from 17.0), and New York (13.9 from 9.4) regions all hired at a faster pace this month, while Richmond (19.0 from 22.0) manufacturers hired at a slightly slower pace than last month.

Regional Prices Paid & Received Measures ([link](#)): We now have prices-paid and -received data for April from the Philadelphia, New York, Kansas City, Richmond, and Dallas regions. The Philadelphia, New York, Kansas City, and Dallas measures are diffusion indexes, while Richmond's measures are average annualized inflation rates (which we multiply by 10 for easier comparisons to the other regional measures). All of the regions are showing a sharp acceleration in prices. The prices-paid measure climbed to a record high of 71.9 this month from -4.4 a year ago, with the Kansas City (to 73.0 from -16.0 a year ago) and Richmond (71.1 from 18.9) measures reaching new record highs. Meanwhile, New York's (to 74.7 from 5.8 a year ago) is fast approaching its record high of 77.9 posted during July 2008 and Dallas' (71.4 from -21.2) is fractionally below its record high of 71.7 during October 2004; Philadelphia's (69.1 from -9.3) prices-paid measure eased a bit from March's record high of 72.6. The prices-received measure also reached a new record high this month, accelerating to 39.6 from -9.5 a year ago—with the Kansas City (to 41.0 from -14.0 a year ago), Dallas (39.1 from -24.5), and New York (34.9 from -8.4) regions all at new record highs. Meanwhile, Richmond's (to 48.3 from 10.0 a year ago) prices-received measure is the highest since mid-2008, while Philadelphia's (34.5 from -10.6) remained close to January's record high of 36.3.

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