



## MORNING BRIEFING

May 19, 2021

### Over-the-Top Earnings

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

(1) Are inflationary booms good for profits? (2) Winners and losers in an inflationary boom. (3) Nominal GDP and business sales confirm inflationary boom. (4) Bullish for S&P 500 revenues. (5) Q1 earnings rose twice as fast as expected. (6) S&P 500 forward earnings is flying. (7) Forward profit margin sets another record high despite rising costs. (8) What's behind the Baby Bust? (9) Unmarried Millennials. (10) Freaked out by the pandemic and climate change. (11) Too many singles, not enough babies.

**Strategy: Revenues & Earnings Booming.** What could be better for corporate profits than an economic boom, right? In fact, an inflationary boom isn't good for earnings if the costs of doing business are rising faster than selling prices. That situation squeezes profit margins, offsetting some of the positive contributions to earnings of strong unit sales.

Maybe so, but the current inflationary boom is boosting the profits of the S&P 500 significantly. That's because the composite includes lots of commodity producers that benefit from rising commodity prices. Apparently, the users of those more costly input materials are able either to pass the burden on to their customers by raising their selling prices or to offset the higher input cost burden by lowering labor costs via increased productivity. Either way, profit margins aren't squeezed. Consider the following:

(1) *Nominal GDP confirms inflationary boom.* Last year, nominal GDP growth plunged 3.4% and 32.8% during Q1 and Q2 (saar) ([Fig. 1](#)). It then rebounded 38.3% and 6.3% during Q3 and Q4. During Q1-2021, it rose 10.7% (saar) and is likely to exceed that during Q2. That's because real GDP rose 6.4% (saar) during Q1 and is currently on track to grow 10.1% during Q2, according to the Atlanta Fed's [GDPNow](#) tracking model. In addition, the GDP price deflator, which rose 4.1% (saar) during Q1, is likely to increase much more during Q2 given the big jumps in April's CPI and PPI measures of inflation.

(2) *Business sales off the charts.* Not surprisingly, the monthly series on business sales, compiled by the Census Bureau, is highly correlated with nominal GDP ([Fig. 2](#) and [Fig. 3](#)). However, keep in mind that the former includes the sales of all goods by manufacturers, wholesalers, and retailers, while the latter includes only the finished goods and services.

More important for this discussion is that business sales is highly correlated with S&P 500 aggregate revenues ([Fig. 4](#)). The former is wildly bullish for the latter. Business sales soared by a record 18.8% y/y through March ([Fig. 5](#)). S&P 500 revenues did recover during the second half of last year but rose only 1.2% y/y through Q4-2020. The business sales data suggest double-digit growth for S&P 500 quarterly revenues during the first half of 2021.

(3) *Forward revenues growth in the double digits.* Confirming this outlook is S&P 500 forward revenues per share, which is a great weekly coincident indicator of actual S&P 500 revenues per share ([Fig. 6](#)). The weekly series rose 11.7% y/y through the May 6 week ([Fig. 7](#)).

(4) *Q1 earnings up twice as fast as expected.* With over 91% of the S&P 500 companies having reported their Q1 earnings results, Q1's total earnings per share exceeded the estimate for Q3 during the May 13 week and could soon top Q4's estimate ([Fig. 8](#)). Keep in mind that in the past, more often than not, Q1 was the weakest of the four quarters for earnings. Here are the latest remarkable y/y growth rates for quarterly earnings: Q1 (45.9%), Q2 (57.5), Q3 (22.0), and Q4 (15.9) ([Fig. 9](#)). At the start of the current reporting season, earnings were expected to be up 20.4%.

(5) *Flying forward.* The much better-than expected results for Q1 have caused industry analysts to raise their 2021 and 2022 estimate for S&P 500 revenues and earnings ([Fig. 10](#) and [Fig. 11](#)). Consequently, both forward revenues and forward earnings are rising rapidly in record-high territory ([Fig. 12](#)). The analysts' consensus for S&P 500 earnings per share is now \$188.42 this year (up 35.0% y/y) and \$211.26 next year (up 12.1% y/y).

Just as impressive is that the forward profit margin of the S&P 500 jumped to another record high of 12.7% during the May 6 week ([Fig. 13](#)). That's quite remarkable given that cost pressures are rising faster than selling prices. We conclude that productivity must be rising rapidly.

**US Demographics I: Baby Bust by the Numbers.** Debbie and I believe that the slowdown in the growth rate of the labor force means that companies will have no choice but to boost their productivity to grow their businesses. They will have to use technology to do so. We asked Melissa to review the latest developments on the demographic front, as they will have a decisive impact on the availability of labor. Here is her report:

Over the last decade, the US population grew at the slowest pace since 1930. The single most important factor in population growth is the total fertility rate (TFR). TFR is the hypothetical average number of babies a woman would have over her lifetime based on current fertility patterns, explained a May 2019 Pew Research Center [analysis](#).

In the US, TFR reached a record low during 2020, which could depress future population growth. It also could lower the ratio of the younger working population to the older retired population. Here is more on the latest data:

(1) *Baby drop*. US women had about 3.61 million babies in 2020, down 4% from the 2019 level ([Fig. 14](#)). “This is the sixth consecutive year that the number of births has declined after an increase in 2014, down an average of 2% per year, and the lowest number of births since 1979,” according to a provisional 2020 [report](#) from the National Vital Statistics System of the Centers for Disease Control and Prevention (CDC) released this month.

(2) *Non-replacement rate*. A TFR of 2.1 is the replacement rate, i.e., the rate at which parents replace themselves upon death (it’s higher than 2.0 to account for childhood mortality). The TFR dropped well below that to a record-low 1.64 during 2020, according to the CDC report ([Fig. 15](#)).

The TFR consistently has dropped below the replacement rate since 2007. If fertility rates had remained at their 2008 levels, how many more babies would have been born through the end of 2019? The Institute for Family Studies [estimates](#) 5.8 million.

(3) *Falling birth rates*. The TFR is determined based on actual birth rates across age groups. From 2019 to 2020, provisional birth rates declined for women of childbearing age (15-44 years old) in all age groups. But since 2007, they’ve fallen significantly for just two cohorts—teens aged 15 to 19 and women in their early 20s—by 63% and 40%, both to record lows last year. This reflects both a reduction in unwanted teen pregnancies and the choice of many women to delay having children.

**US Demographics II: Why Aren’t Millennials Reproducing?** Millennials, born between 1981 and 1996, currently are the primary generation in their childbearing years. They entered adulthood during the 2008 Great Financial Crisis (GFC) and a decade later faced the Great Virus Crisis (GVC)—a crisis spanning health, economics, and public policy. The pandemic’s toll on the psyche of many Millennials has further weakened an already declining drive to start or expand their families.

Previously, we’ve attributed Millennials’ lower fertility rates than their parents’ generation to living with their parents for longer, marrying later, obtaining higher levels of education, and facing financial hurdles—including paying off student loans, high home prices, and expensive childcare. Now Melissa, our in-house Millennial (who is married and has two children), is adding the following new anecdotal developments:

(1) *Virus crisis*. When the lockdowns began, some presumed that a baby boom would occur as couples spent more time together. But it turns out that the opposite has occurred. By some estimates, the pandemic caused hundreds of thousands of fewer births owing to the economic and health uncertainty it created. Already, the provisional data noted above showed a 4.0% decline in births from 2019 to 2020. Births were down most sharply in [December](#), when babies conceived at the start of the health crisis would have been born, a May 5 *New York Times* [article](#) observed.

The connection between economic conditions and fertility revealed by the recession following the GFC became further pronounced during the GVC. Insecurity about income, childcare, social isolation, and even climate change contributed to many couples' decision to delay or forego having children.

"We were worried about income and just food scarcity and diaper scarcity," a young mother quoted in a May 5 *WSJ* [article](#) said about delaying having another child during the pandemic. She added: "When the [disposable] diapers ran out, we were like ... 'This is a really good reason for not having a kid right now.'"

According to a September 2020 Morning Consult [survey](#), "17 percent of 572 millennials (those ages 24 to 39) who don't have children said they would further delay having them because of the pandemic, and 15 percent said they are less interested in having children at all because of COVID-19. Only 7 percent of this group said they are more interested in having children due to the pandemic."

(2) *Family crisis*. Waiting for 30-somethings to have babies at historical rates may be a lost cause given that 25% of young adults may never even marry, predicted a 2014 Pew Research [report](#). The oldest Millennials turned 39 this year, well above the typical marital age, but only 44% of Millennials were married in 2019, compared with 53% of Gen Xers, 61% of Boomers, and 81% of Silents at Millennials' age, a May 2020 Pew Research [study](#) found.

Nontraditional families are more accepted today than in the past, so Millennials choosing to form them face less stigma than past generations did. Marriage among Millennials may be declining, but a significant share of them lives with romantic partners unmarried—12% in 2019, greater than the share of cohabitating Gen Xers (8%) in 2003.

Pew found that just 30% of Millennials lived in a traditional family structure including a spouse and child in 2019, compared with 40% of Gen Xers, 46% of Boomers, and 70% of Silents at Millennials' current age. Millennials with a bachelor's degree or more education are more likely than those with less education to live with a spouse and no child.

(3) *Climate crisis*. Some Millennials seem to be so freaked out about climate change that they don't want to have children. A July 2020 article in *The Guardian* [explored](#) "Why a Generation is Choosing to be Child Free." The author wrote: "Mostly, a child is so abstract to me, living with high rent, student debt, no property and no room, that the absence barely registers. [S]ometimes I suddenly want a daughter ... Then I remember the numbers. If my baby were to be born today, they would be ... 30 ... when half of all species on Earth are predicted to be extinct in the wild."

(4) *Bottom line*. The result of all the above is that the number of singles 16 years or older is now over 50% of the civilian noninstitutionalized population that is 16 years or older ([Fig. 16](#)). That's up from less than 40% during the mid-1970s. Almost all of the increase is attributable to never-married singles. Their percentage of the population is up from about 22% in the mid-1970s to 32% currently ([Fig. 17](#)).

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## Calendars

**US: Wed:** MBA Mortgage Applications, EIA Crude Oil Inventories, FOMC Minutes. **Thurs:** Leading Indicators, Initial & Continuous Jobless Claims, Philadelphia Fed Manufacturing Index 40, EIA Natural Gas Inventories. (DailyFX estimates)

**Global: Wed:** Eurozone Headline & Core CPI 1.7%/0.8% y/y, EU Car Registrations, UK CPI, Canada CPI, Japan Industrial Production, Japan Machinery Orders, Australia Employment Report. **Thurs:** UK Gfk Consumer Confidence, Japan CPI. (DailyFX estimates)

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## Strategy Indicators

**S&P 500 Q1 Earnings Season Monitor ([link](#)):** With 92% of S&P 500 companies finished reporting revenues and earnings for Q1-2021, revenues are beating the consensus forecast by a well-above-trend 3.7%, and earnings have crushed estimates by 23.5% due to loan loss reversals at the banks and stellar results from the Mag-5 stocks. Both of these surprise figures are on pace to match or exceed their prior record highs. At the same point during the Q4 season, revenues were 2.9% above forecast and earnings beat by 17.3%. The S&P 500's Q1 earnings surprise excluding Financials drops to 20.2% from 23.5%. For the 457 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 Q1 reporters so far have a y/y revenue gain of 9.9% and an earnings gain of 49.9%, which rises to 10.0% and drops to 33.6%, respectively, when Financials are excluded. A record-high 87% of the Q1 reporters so far has reported a positive earnings surprise, and a record-high 77% has beaten revenues forecasts. Slightly more companies have reported positive y/y earnings growth in Q1 (77%) than positive y/y revenue growth (76%). These figures won't change markedly as the retailers' Q1-2021 results are reported in the coming weeks.

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## US Economic Indicators

**Housing Starts & Building Permits** ([link](#)): Housing starts in April continued its recent up-and-down pattern, while homebuilders' confidence held steady in May despite growing concerns over the price and availability of most building materials, including lumber. According to NAHB's chairman, "Builder confidence in the market remains strong due to a lack of resale inventory, low mortgage interest rates, and a growing demographic of prospective home buyers." April housing starts sank 9.5% to 1.569mu (saar) after soaring 19.8% to 1.733mu in March—which was the best reading since July 2006. Severe winter weather in February caused starts to tumble 11.0%. Since reaching a cyclical high in December, at 1.315mu (saar), single-family housing starts contracted three of the first four months of 2021, sliding 13.4% in April and 17.3% over the period to 1.087mu (saar). Meanwhile, multi-family starts rose three of the first four months of this year by 0.8% in April and 39.3% over the four months through April to 482,000 units (saar). These starts peaked at 597,000 (saar) at the start of last year and have fluctuated in a volatile flat trend below this level ever since. Building permits—a good leading indicator of housing starts—reached a cyclical peak of 1.883mu (saar) at the beginning of this year; it has increased seven of the last eight months (with the exception of February's 8.3% weather-related drop) by 15.6% to 1.760mu. Since reaching a new cyclical high of 1.268mu (saar) this January, single-family permits have contracted two of the three months through April, by 9.4%, to 1.149mu. Meanwhile, volatile multi-family permits rebounded 8.9% last month, to 611,000 units (saar), after a two-month slide to within a fraction of January's 615,000 units—which was the highest since mid-2015. NAHB's May Housing Market Index (HMI) shows builders' confidence was unchanged at 83—and has been in a relative flat trend since the beginning of this year. It's 7 points below November's record high of 90. All the components have been in flat trends not far from their November record highs: traffic of prospective homebuyers (to 73 from 77 in November), current sales (88 from 96), and future sales (81 from 89).

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683  
Debbie Johnson, Chief Economist, 480-664-1333  
Joe Abbott, Chief Quantitative Strategist, 732-497-5306  
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967  
Mali Quintana, Senior Economist, 480-664-1333  
Jackie Doherty, Contributing Editor, 917-328-6848  
Valerie de la Rue, Director of Institutional Sales, 516-277-2432  
Mary Fanslau, Manager of Client Services, 480-664-1333  
Sandy Cohan, Senior Editor, 570-228-9102

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