



MORNING BRIEFING

June 23, 2021

Peak Earnings Growth

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

(1) Q2 marked the peak in GDP and earnings growth. (2) Decelerating gains. (3) S&P 500 has had a V88.8 rebound. (4) Our updated S&P 500 targets for this year and next year: 4300-4700 and 4400-4800. (5) Lower wages up twice as fast as higher wages over the past 24 months. (6) Existing home prices up 24.4% y/y, frustrating would-be buyers. (7) No shortage of price increases. (8) Powell is ready to talk about tapering at next FOMC meeting. (9) ECB on autopilot while awaiting fiscal stimulus. (10) ECB hits 2% inflation target. (11) Inflation remains MIA in Japan.

Strategy: The V88.8 Rally. The so-called base effect isn't limited to inflation. It also applies to all the major business-cycle indicators, including corporate profits. The lockdown recession caused a 31.4% drop in real GDP during Q2-2020. Year-over-year comparisons for the major business cycle indicators undoubtedly are peaking during Q2-2021.

As a result, Joe and I reckon that stock market gains will decelerate along with revenues and earnings growth rates. Let's see what we can see in the metrics that drive stock prices:

(1) *V-shaped recovery.* Since the S&P 500 bottomed on March 23, 2020, the remarkable 88.8% V-shaped rebound in this stock price index through Monday's close has been driven by a 43% V-shaped recovery in forward earnings per share since its May 15, 2020 bottom to a record \$200.95 and a 63% jump in the forward P/E from 12.9 on March 23, 2020 to 21.0 on Monday ([Fig. 1](#) and [Fig. 2](#)).

(2) *Revenues and earnings.* The 43% rebound in forward earnings is attributable to a 14% upturn in S&P 500 forward revenues through the June 17 week ([Fig. 3](#)). Over this same period, the S&P 500 forward profit margin increased from 10.3% to a record high 12.8% ([Fig. 4](#)).

(3) *Peaking growth.* Both forward revenues and earnings should continue to rise in record-high territory, but their y/y growth rates may have just started to peak during the June 17 week at 13% and 40% ([Fig. 5](#) and [Fig. 6](#)).

(4) *Q2 was the peak.* On a quarterly basis, S&P 500 earnings per share rose 48% y/y during the June 17 week ([Fig. 7](#) and [Fig. 8](#)). Industry analysts currently estimate that it will be up 60% during Q2, but then slow during Q3 (23%) and Q4 (16%).

(5) *Earnings targets.* Our S&P 500 earnings-per-share targets are still \$195 for this year and \$205 for next year ([Fig. 9](#)). We may have to raise them a bit given that industry analysts are already up to \$191 for this year and \$213 for next year. We are assuming an increase in the corporate tax rate next year. Industry analysts won't do so until it is actually raised.

(6) *S&P 500 targets.* We are still predicting that S&P 500 forward earnings per share will rise to \$210 by the end of this year and \$215 by the end of next year ([Fig. 10](#)). Using the current 20.5-to-22.5 range for the forward multiple produces comparable year-end S&P 500 targets of 4300-4700 and 4400-4800.

US Labor Market: Higher vs Lower Wages. Every month, the Employment Situation report compiled by the Bureau of Labor Statistics includes data series for the average hourly earnings (AHE) of all workers and of production & nonsupervisory workers; both groups collectively tend to account for around 82% of employment ([Fig. 11](#)).

Using these three data series, Debbie and I can derive a series for AHE of higher-wage workers ([Fig. 12](#)). Here are the May readings for AHE and the two-year percentage change in the AHEs for higher-wage workers (\$51 per hour, 4.8%), all workers (\$30, 8.8%), and lower-wage workers (\$26, 9.3%). We use the 24-month growth rates to eliminate the pandemic's y/y base effect. They show that lower wages increased at double the pace of higher wages. We won't be surprised if the former continues to outperform the latter given the shortage of skilled and unskilled workers.

US Inflation: More of It. Buddy, can you spare a house? A shortage of existing homes for sale combined with very strong demand have caused existing single-family home prices to soar. The median and average prices jumped 24.4% y/y and 17.5% in May ([Fig. 13](#)). As a result, existing single-family home sales have declined 14.2% over the past five months ([Fig. 14](#)).

There are plenty of other shortages in our economy that are pushing prices higher. June's averages of the prices-paid and prices-received indexes compiled by the Federal Reserve Banks of New York, Philadelphia, and Richmond remain at their recent record highs ([Fig. 15](#)). The average of their backlog of orders or delivery times remain at elevated levels ([Fig. 16](#)).

Central Banks I: View from the Top. At his June 16 [press conference](#) following the latest FOMC meeting, Fed Chair Jerome Powell said, “But you can think of this meeting that we had as the talking about talking about meeting, if you like. And I now suggest that we retire that term, which has served its purpose well...” Now that Fed officials are talking about tapering, markets are beginning to wonder when other central banks may follow.

Global central bankers are publicly grappling with the issue of when and how to unwind the mountain of assets on their balance sheets and raise interest rates as the global economy recovers from the pandemic and inflation becomes a concern. Total assets on the balance sheets of the Fed, ECB, and BOJ combined climbed \$9.0 trillion to a record \$23.9 trillion since March 11, 2020 (the official start of the pandemic) through the June 18 week ([Fig. 17](#)).

The first bank to chip away at the massive asset load on its balance sheet before raising interest rates likely will be the Fed, followed by the ECB. The BOJ likely won’t reduce its assets until much later. Below is a short update on what central banks around the world have been up to.

Central Banks II: The PEPP Continues. The ECB’s [Survey of Monetary Analysts](#) has been [compiled](#) by the bank’s staff since April 2019. June’s survey this year shows that the ECB is expected to continue its Pandemic Emergency Purchase Programme (PEPP) through March 2022, as originally planned. As the PEPP expanded, so did assets on the ECB’s balance sheet, which rose to a record €7.7 trillion during the June 18 week, up €3.0 trillion since the March 11 week ([Fig. 18](#)). Here’s what may be next for the ECB:

(1) *Inflation hits the mark.* Headline CPI inflation in the Eurozone was 2.0% y/y during May ([Fig. 19](#)). It now exceeds the ECB’s inflation target of “below but close to” 2.0% for the headline CPI for 2021. That means that the ECB could begin to discuss tapering as early as its [September 9](#) Governing Council meeting, when the ECB will next release [economic projections](#).

On Monday, however, ECB Governor Mario Centeno said that the recent rise in inflation in the Eurozone is temporary and unlikely to have permanent effects. Speaking at a banking conference in Lisbon, he [confirmed](#) the 2022 timeframe for the end of the bank’s current asset purchase program. Centeno explained that accelerating inflation in Europe was a result of temporary supply-chain difficulties and fiscal policy changes.

(2) *ECB likely to follow the Fed with a lag.* Last week, the ECB’s Chief Economist Philip Lane [told](#) Bloomberg TV that it is still “premature” to talk about reducing its bond purchases. Lane’s comments intentionally followed Powell’s comments that it was time to retire the

phrase “talking about talking about tapering” to signal that the ECB won’t act as quickly as the Fed might to reduce pandemic-era stimulus. The ECB’s dovish June meeting and subsequent action last week to [extend](#) bank capital relief further confirmed that the ECB is taking a slower approach to tapering than the Fed.

Lane highlighted that economic data need to be assessed as the rollout of the [Next Generation EU](#) (NGEU), the historic €750 billion European multinational “green” pandemic relief fund, commences. Individual country “recovery and resilience” plans are in the process of being [endorsed](#) by the European Commission. Funds are to be disbursed from the NGEU Recovery and Resilience Facility soon.

(3) *Lagarde warns about premature tightening.* Repeating the June 10 policy statement, ECB President Christine Lagarde said during her [press conference](#) the same day: “A sustained rise in market rates could translate into a tightening of wider financing conditions that are relevant for the entire economy.” She added: “Such a tightening would be premature and would pose a risk to the ongoing economic recovery and the outlook for inflation.”

Nevertheless, Lagarde also said that “an even stronger recovery could be predicated on brighter prospects for global demand and a faster-than-anticipated reduction in household savings once social and travel restrictions have been lifted.” On the other hand, Covid virus mutations could be a source of downside risk, she said.

Central Banks III: Post-Kuroda Policy. BOJ economic projections anticipate that the bank’s price stability [target](#) will not be reached even by 2023 (see page 8 of the [Outlook for Economic Activity and Prices](#), April 2021), when Governor Haruhiko Kuroda’s term [ends](#). So it makes sense that at its June monetary policy meeting, the BOJ [decided](#) to extend the deadline for its corporate funding support by six months until March 2022, hold short-term interest rates at -0.1%, and maintain its yield-curve control policy of pegging 10-year Japanese government bond yields near 0%. The BOJ’s balance sheet rose to a record ¥725 trillion during May, up 24% since February 2020 ([Fig. 20](#)).

Former central bank policymaker Makoto Sakurai [told](#) Reuters that the BOJ eventually will need to unload its huge holdings, especially its exchange-traded funds (ETFs). “Eventually” might not be until 2024 or 2025, he suggested. For now, the bank is still actively buying ETFs. Sakurai thinks that Japan’s economy could take until 2024 to fully recover from the pandemic. Another former bank executive, Eiji Maeda, recently [told](#) Reuters: “If the BOJ is lucky, debate (on raising rates) could begin from around 2023.” That would be after Kuroda’s term ends.

The bottom line is that the courses of the Fed and ECB likely will diverge from that of the BOJ in the coming months, as the BOJ is unlikely to shift its policy stance until the post-Kuroda monetary era. Here's more on why a change is a long way off:

(1) *State of emergency*. In Japan, the state of emergency for Covid-19 was [extended](#) from April to June in many regions, especially urban ones. Kuroda [said](#) at a post-meeting press conference that it is expected to “take some time for the economy to emerge from the pandemic, during which corporate funding will remain under stress.” During the pandemic, the BOJ instituted funding to banks that aid firms struggling to cope.

(2) *Inflation outa sight*. “Even if the pandemic subsides, I believe we would have to keep bold monetary easing for a while to attain the price target,” Kuroda said. In contrast to the US and Eurozone, Japan's CPI has remained well below its target. The headline and core CPI inflation rates were 0.0% y/y and 0.1% during May ([Fig. 21](#)).

Kuroda added that there is “nothing strange” about diverging policies among global central banks, as their economic and price conditions can be different. Nevertheless, Kuroda said (like Lagarde) that a brighter outlook than anticipated is possible. He stated: “If vaccinations gather speed at this pace, it is possible that we can expect a much earlier recovery in face-to-face (services) consumption.”

(3) *From Covid to climate stimulus*. The BOJ recently joined the ranks of other global central bankers in the effort to combat climate change with a new program that would provide funds to financial institutions for investments or loans focused on climate. Kuroda said: “Climate change issues could exert an extremely large impact on developments in economic activity and prices as well as financial conditions from a medium- to long-term perspective.”

An outline of the new measure will be unveiled at the next policy meeting in July. In other words, the BOJ will leverage climate change as a reason to extend stimulus, as the governing fiscal bodies in Europe have done. Climate change will remain in focus for US central bankers as well, but the brisk pace of the US recovery may mean less leeway in climate stimulus than the ECB and BOJ have.

Calendars

US: Wed: M-PMI & NM-PMI Flash Estimates 61.5/70.0, New Home Sales 875k, Current

Account -\$206.2b, MBA Mortgage Applications, Crude Oil Inventories, Bowman, Bostic.
Thurs: Real GDP & Price Index 6.4%/4.3%, Headline & Core Durable Goods Orders 2.8%/0.8%, Kansas City Fed Manufacturing Index, Goods Trade Balance, Corporate Profits, Initial & Continuous Jobless Claims 380k/3.47m, Natural Gas Storage, Fed Bank Stress Test Results, Williams. (Bloomberg estimates)

Global: Wed: Eurozone, Germany, and France C-PMI Flash Estimates 58.8/57.5/59.0, Eurozone, Germany, and France M-PMI Flash Estimates 62.1/63.0/59.0, Eurozone, Germany, and France NM-PMI Flash Estimates 57.8/55.5/59.4, UK C-PMI, M-PMI, and NM-PMI Flash Estimates, Canada Retail Sales -5.0%, Japan Leading & Coincident Indicators.
Thurs: Germany Ifo Business Climate, Current Assessment, and Expectations 103.9/97.8/100.6, Spain GDP -0.5%q/q/-4.3%y/y, UK Interest Rate Decision 0.10%, ECB Economic Bulletin. (Bloomberg estimates)

Strategy Indicators

S&P 500 Sectors Net Earnings Revisions ([link](#)): The S&P 500's NERI was at a record high in June for the first time in 39 months, rising to 22.5% from 21.4% in May. It rose for a second straight month and was positive for an 11th month following 13 straight negative readings. June's reading compares to its prior tax-cut-induced record high of 22.1% in March 2018 and an 11-year low of -37.4% in May 2020. All 11 sectors had positive NERI in June for a second straight month. Eight of the 11 sectors had NERI improve m/m in June, down from ten in May. Still, many sectors had NERIs at multi-year or record highs during the month. Here are the sectors' June NERIs compared with their May readings: Financials (34.5% in June, down from 36.1% in May [record high]), Materials (31.3 [record high], 30.2), Energy (30.0, 33.3 [16-year high]), Industrials (27.6 [39-month high], 26.2), Information Technology (23.8 [11-year high], 23.6), S&P 500 (22.5 [record high], 21.4), Consumer Discretionary (24.3 [11-year high], 18.5), Health Care (15.5, 14.9), Real Estate (12.8 [11-year high], 5.7), Communication Services (11.9, 12.0), Consumer Staples (9.8, 8.2), and Utilities (1.4, 0.6).

S&P 500 Earnings, Revenues, Valuation & Margins ([link](#)): The S&P 500's forward profit margin was steady last week at a record high of 12.8%. Since the end of April, it has exceeded its prior record high of 12.4% in September 2018. It's now up 2.5ppts from 10.3% during April 2020, which was the lowest level since August 2013. Forward revenues and earnings both rose w/w. They've both been making new record highs since the beginning of

March and for the first time since February 2020. Since the Q2-2020 earnings season came in way better than expected, analysts have been playing catch-up with their lowball estimates from the Covid-19 shutdown. Consensus S&P 500 forecasts had been falling at rates paralleling the declines during the 2008-09 financial crisis. Forward revenues growth rose 0.1ppt w/w to 9.3%. That's down from a record high of 9.6% at the end of May, and should continue to move lower due to base effects. Still, that's up from 0.2% during April 2020, which was the lowest reading since June 2009. Forward earnings growth was steady w/w for a third week at 21.2%, and should also move lower due to base effects. That's down from its 23.9% reading at the end of April, which had been its highest since June 2010 and up substantially from its record low of -5.6% at the end of April 2020. On a positive note, analysts have been raising their 2021 forecasts for revenues and earnings growth and the profit margin. They now expect revenues to rise 12.3% in 2021 and 6.7% in 2022 compared to the 2.2% decline reported in 2020. They expect earnings gains of 37.2% in 2021 and 11.6% in 2022 compared to a 13.3% decline in 2020. Analysts expect the profit margin to rise 2.3ppts y/y in 2021 to 12.5%—from 10.2% in 2020—and to improve 0.6ppt y/y to 13.1% in 2022. The S&P 500's weekly reading of its forward P/E was 21.2, relatively unchanged for a fourth week. That compares to 23.1 in early September, which was the highest level since July 2000 and up from a 77-month low of 14.0 in March 2020. The S&P 500 weekly price-to-sales ratio was also steady for a fourth week at 2.72. That compares to a record high of 2.77 in late April and a 49-month low of 1.65 in March 2020.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins ([link](#)): Last week saw consensus forward revenues rise w/w for nine of the 11 S&P 500 sectors, and seven posted a gain in their forward earnings. Six sectors have both their forward revenues and earnings at or near record highs: Communication Services, Consumer Discretionary, Consumer Staples, Health Care, Information Technology, and Materials. Energy, Industrials, and Real Estate have both measures well below record highs. Financials and Utilities have record-high forward earnings, but their forward revenues are lagging. Only three sectors posted a higher profit margin y/y in 2020: Consumer Staples, Tech, and Utilities. For 2021, a y/y improvement is expected for all but two sectors: Real Estate and Utilities. The forward profit margin was at record highs during 2018 for 8/11 sectors, all but Energy, Health Care, and Real Estate. Currently, four sectors are at record highs, down from five in early May. Here's how they rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (24.3%, record high), Financials (19.3, record high), Communication Services (15.9, record high), Utilities (14.6, down from its 14.8 record high in early May), Real Estate (15.2, down from 17.0), S&P 500 (12.8, record high), Materials (12.8, a new record high), Health Care (10.9, down from 11.2), Industrials (9.6, down from its record high of 10.5% in mid-December), Consumer Staples (7.7, matches its prior

cyclical high in May 2018), Consumer Discretionary (7.6, down from 8.3), and Energy (6.6, down from 8.0).

S&P 500 Sectors Forward Revenues and Earnings Recovery from Covid-19 Trough

[\(link\)](#): The S&P 500's forward revenues and earnings as well as its implied forward profit margin bottomed at cyclical lows on May 28, 2020 after 14 weeks of Covid-19-related declines. Forward revenues and earnings have risen 13.9% and 42.6%, respectively, since then to new record highs. The forward profit margin has risen 2.7ppt to 12.8%, which now exceeds its prior record high of 12.4% in late 2018. During the latest week, all but the Utilities sector posted gains to new highs in either their forward revenues, earnings, or profit margin. Here's how the 11 sectors rank by their changes in forward revenues and forward earnings since May 28, 2020: Materials (forward revenues up 21.6%, forward earnings up 76.3%), Communication Services (19.9, 42.7), Information Technology (19.8, 33.9), Energy (17.8, 1253.7), Industrials (16.7, 52.3), S&P 500 (13.9, 42.6), Financials (13.7, 62.3), Health Care (12.0, 22.3), Consumer Discretionary (9.2, 77.6), Consumer Staples (7.5, 15.4), Real Estate (5.9, 13.2), and Utilities (-2.1, 2.6).

US Economic Indicators

Existing Home Sales [\(link\)](#): "Home sales fell moderately in May and are now approaching pre-pandemic activity," said Lawrence Yun, NAR's chief economist. "Lack of inventory continues to be the overwhelming factor holding back home sales, but falling affordability is simply squeezing some first-time buyers out of the market." The median existing-home price for all housing posted a record 23.6% y/y gain in May. Existing home sales—tabulated when a purchase closes—fell for the fourth month, by 0.9% in May and 12.9% over the period, to a 11-month low of 5.80mu (saar). Single-family sales declined for the sixth time in seven months, dropping 1.0% m/m and 15.5% over the period to 5.08mu (saar), a level still 39.2% above a year ago. Inventories for both total (to 1.23mu from 1.15mu) and single-family homes (1.05mu from 980,000) edged higher for the third month, though held near their February record lows of 1.03mu and 870,000 units, respectively—down 20.7% y/y and 22.8% y/y. Multi-family sales were flat at 720,000 units (saar) after climbing 2.9% during the two months through April; these sales had dropped 6.7% in February from January's cyclical high of 750,000 units. Regionally, total sales fell in three of the four regions in May but remain significantly above year-ago levels in all: West (-4.1% m/m & +61.6 y/y), Northeast (-1.4 & +46.9), South (-0.4 & +47.2), and Midwest (+1.6 & +27.2). The lack of inventory has boosted existing home prices at a double-digit pace in all regions over the

past 12 months, with record year-over-year gains in the South (22.6% y/y) and Midwest (18.1) and near-record ones in the Northeast (17.1) and West (24.4). Yun is optimistic about the housing market going forward: “The market’s outlook, however, is encouraging. Supply is expected to improve, which will give buyers more options and help tamp down record-high asking prices for existing homes.”

Regional M-PMIs ([link](#)): Three Fed districts have now reported on manufacturing activity for June (Philadelphia, New York, and Richmond) and show the manufacturing sector expanded at a steady pace just below April’s record rate. The composite index (to 23.4 from 24.6) eased for the second month, after accelerating steadily from 11.7 at the end of last year to a record high 31.2 in April, as the Richmond (to 22.0 from 18.0) measure showed an acceleration in activity, while Philadelphia’s (to 30.7 from 31.5) held around May’s robust pace and New York’s (17.4 from 24.3) slowed a bit. The new orders (to 24.5 from 26.5) measure saw billings expand close to October’s 30.0 rate, which was just a shade below its record pace of 30.4 posted during March 2004; Richmond (35.0 from 18.0) billings accelerated at double May’s pace, while both Philadelphia (22.2 from 32.5) and New York (to 16.3 from 28.9) billings slowed to still-respectable paces. In June, manufacturers continued to hire at a robust pace (to 20.7 from 19.3), with Philadelphia’s (to 30.7 from 19.2) hiring at an accelerated rate and Richmond’s (19.0 from 25.0) at a slower though solid rate; New York (12.3 from 13.6) factories have hired at a fairly steady pace over the past three months.

Regional Prices Paid & Received Measures ([link](#)): We now have prices-paid and -received data for June from the Philadelphia, New York, and Richmond regions, and they all show inflationary pressures remain intense. The Philadelphia and New York measures are diffusion indexes, while Richmond’s measures are average annualized inflation rates (which we multiply by 10 for easier comparison to the other regional measures). Philadelphia’s prices-paid (to 80.7 from 76.8) measure accelerated at a record pace this month, while both New York’s (79.8 from 83.5) and Richmond’s (90.0 from 98.2) slowed slightly from their May record rates. The story is similar for prices received, with Philadelphia’s (to 49.7 from 41.0) measure posting a new record high, while New York’s (33.3 from 37.1) held near May’s record reading; Richmond’s (50.0 from 54.1) wasn’t far from May’s pace—which was the fastest since mid-2008’s record rate of 57.6.

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