MORNING BRIEFING
July 1, 2021

Jobs, Drought & Commodities

Check out the accompanying chart collection.

(1) Lots of help-wanted signs may mean 4% unemployment is around the corner. (2) Few say jobs are hard to get. (3) Our bet: Tapering starts after September Fed meeting. (4) Heat wave exacerbates drought in the West. (5) Farmers opt not to farm. (6) Watching fruit and veggie prices. (7) Wells running dry, towns sinking, and price of water skyrocketing. (8) San Fran Fed watching impact of climate on economy. (9) Lumber and copper prices drop, while steel holds at the highs.

US Labor Market: Getting Closer to Full Employment. Yes, we know: During May, there were still 9.3 million unemployed workers, and the unemployment rate was 5.8%. That's 3.6 million more unemployed workers than there were during February of last year when the unemployment rate was down to 3.5%. During May, payroll employment and the labor force were still 7.6 million and 3.5 million below their February 2020 levels. That would seem to suggest that the labor market remains a long way from the Fed's maximum employment goal. Then again, consider the following:

(1) *Lots of help wanted.* During April, there were as many job openings as there were unemployed workers and quits rose to a record high (*Fig. 1*). Here is a list of job openings by major industries during April from highest to lowest:

Professional & business services (1.5 million), accommodations & food services (1.3 million), health care & social assistance (1.3 million), retail trade (965,000), durable goods manufacturing (471,000), transportation, warehousing & utilities (386,000), nondurable goods manufacturing (380,000), construction (357,000), wholesale trade (320,000), finance & insurance (310,000), arts, entertainment & recreation (248,000), educational services (121,000), real estate (120,000), information services (110,000), and mining & logging (23,000).

(2) *Payrolls rising.* ADP private payrolls rose 692,000 to 122.6 million during June, though that's still 6.8 million below the record high of 129.4 million during February 2020 (*Fig. 2*).

(3) *Less joblessness ahead.* The latest batch of unemployment rate indicators suggests that

it should fall below 4.0% in coming months. For example, the ratio of unemployed to job openings was down to 1.1 during April, the lowest since February 2020 when the jobless rate was 3.5% (*Fig. 3*). In June's consumer confidence survey, the percent saying that jobs are hard to get was only 10.9%, the lowest reading since September 2000 (*Fig. 4*).

(4) *Fed's wishes will come true.* Fed officials want to see "broad-based and inclusive maximum employment" before they will consider tapering their balance sheet and hiking the federal funds rate. Melissa and I think that will happen sooner rather than later. We expect the FOMC to start talking about tapering at the July 27-28 meeting of the committee and to implement this program at the September 21-22 meeting.

Food Prices: Western Drought Worsens. Temperatures are sizzling, topping 100 degrees, in many areas out West. There are debates in Utah about whether fireworks can or should be banned over Independence Day due to the risk of fire. Seattle residents scrambled to book hotel rooms because only 44% of homes in the normally rainy city have air conditioning, a June 28 *article* in the *Seattle Times* reported. The heat forced Portland, Oregon to stop its light rail service on Monday because the heat melted power cables, CBS News *reported*. And heat in Everson, Washington caused the pavement to expand and buckle, closing the road and requiring detours.

The heat wave is exacerbating the drought that's plaguing the West and affecting the water available for agriculture, as we discussed in the May 27 *Morning Briefing*. Here's an update on the latest measures being taken as the situation intensifies:

(1) *Drought brings tough decisions.* The economics of insufficient water are forcing farmers to make some harsh decisions. Some farmers have opted not to grow anything on their land this season due to the lack of water, as we discussed in May. A June 28 *NYT* *article* reports that other farmers are letting their land lie fallow not because they lack water but because others do: They're making more money by selling their water to other farmers than they would farming their land. The article also described how one farmer is considering replacing his almond trees with solar panels.

Drought is prompting farmers to harvest their crops earlier even if it means their pickings will be smaller. In Washington, cherry farmers are harvesting their crops sooner than normal due to the heat and wheat farmers will have an early and smaller harvest. South Dakota has declared a statewide state of emergency owing to drought conditions, which allows farmers to harvest their hay earlier than normal. And cattle ranchers from California to Arizona and North Dakota are slaughtering or selling parts of their herds to farms in areas where drought hasn't dried up pastures, a June 29 *National Geographic* article reports.

(2) *California: Grocer to the country.* It's often noted that California alone supplies two-thirds of the country's fruits and nuts and more than a third of our vegetables, but the country's reliance on the Golden State for food can't be emphasized enough. According to a March 22 Fruitgrowers.com *blog post*, California produces 99% of all the table grapes sold in the US, 99% of the US pistachio crops, 90% of the lettuce in the US, 90% of the processed tomato products sold in the US, and more than 80% of the fresh citrus fruits in the US.

Neither can the importance of these crops to the state be overstated: Also according to that blog post, the top 10 grossing agricultural commodities in California as of 2018 are: dairy products and milk $6.4 billion, grapes $6.3 billion, almonds $5.5 billion, cattle and calves $3.2 billion, pistachios $2.6 billion, strawberries $2.3 billion, lettuce $1.8 billion, flowers $1.2 billion, tomatoes $1.2 billion, and oranges $1.1 billion.

(3) *Wells running dry.* The drought has reduced the amount of water available to farmers from rivers and rain. Normally, they'd use wells to pump water from underground. But wells have been running dry in some areas, and the amount of underground water that can be used is now restricted by the state's Sustainable Groundwater Management Act. There are stories of the town of Teviston, California running out of municipal water and Corcoran, California sinking because the aquifers have been depleted.

Buying supplemental water has gotten extremely expensive. According to one California farmer, water now sells for $2,000 an acre foot versus the normal price of $200-$250 an acre foot, a Reuters *article* reported on June 26.

(4) *Keeping an eye on food prices.* Food prices have been rising but more slowly than most other prices. The price of food in the CPI rose 3.7% in May using the three-month percent change (saar), while the overall CPI excluding food and energy rose 8.0% (*Fig. 5*).

So far, food prices have been pushed higher to reflect higher fuel and labor expenses resulting from Covid-19. But going forward, food prices could rise further as farmers need to factor in the higher cost of water and the smaller harvests. And importing food from our southern neighbors may be tough as both Brazil and Mexico face drought conditions as well.

(5) *Fed is watching.* Regulators are watching and studying climate change. The Bank of England has launched an "experimental" climate risk stress test of major UK banks and

insurers. And last year, the European Central Bank included climate risk in its supervisory guidance to financial institutions, noted San Francisco Federal Reserve Bank President Mary Daly in a June 28 *speech* about the Fed's climate initiatives titled "Climate Risk and the Fed: Preparing for an Uncertain Certainty."

Daly explained the steps the Fed is taking to evaluate climate risk: "Earlier this year, we created a new Supervision Climate Committee to ensure the resilience of financial firms under our supervision. The Federal Reserve Board is also establishing a Financial Stability Climate Committee to identify, assess, and address climate-related risks to financial stability. The Federal Reserve's Supervision and Regulation Report (Board of Governors 2020a) and Financial Stability Report (Board of Governors 2020b) discuss these issues from microprudential and macroprudential perspectives, respectively."

At the regional level, San Francisco Fed officials are collecting data and talking to CEOs to understand how climate change is affecting decision making and planning, hosting conferences on the subject, and assembling a team to study how these issues are likely to impact the Fed's mandates and the economy in the future. For example, climate change may prompt people to save more in anticipation of greater uncertainty and risk. It could also reduce labor productivity if rising temperatures impede outdoor work.

Commodities: Prices on the Move. The CRB commodity price index is near its highest levels since Covid-19 struck, helped by the surge in energy prices this year. The price of Brent crude oil is up 44% ytd, recovering sharply now that drivers have returned to the roads and fliers to the air. It doesn't hurt that OPEC has kept its quotas restricting production in effect (*Fig. 6*).

The CRB has remained elevated even as lumber and copper prices have fallen sharply from their recent peaks. Conversely, steel prices remain near their highest levels, perhaps bolstered by tariffs. Here's a quick look at some of the recent action in commodity prices:

(1) *Watching lumber.* Home renovations took off during the Covid-19 pandemic, as did new home sales, as we all aimed to improve our personal jails/surroundings. Lumber futures spiked to a high of $1,686 on May 7, 2021, up from $405 at the end of 2019. But now that we've been let loose, going to restaurants and shopping have replaced home renovations, though the new home market remains on fire. The change in behavior has sent the price of lumber tumbling. The lumber futures price has fallen 55% from its May 7 peak but is still roughly twice as high as it was in 2019. Its decline may still be in early innings, though (*Fig. 7*).

(2) *Watching copper.* The price of copper has also come off its highest levels. The price of copper futures has dropped 10.5% from its May 11 peak, but also remains almost twice as high as it was in 2019 (*Fig. 8*). The S&P 500 Copper industry stock price index has fallen more than the commodity price. The S&P 500 Copper stock price index is down 16.8% from its May 11 high and up 601.9% from its 2020 low (*Fig. 9*). The industry holds only one constituent, Freeport McMoRan, which mines copper, gold, and molybdenum. Analysts remain optimistic about future growth, with revenue expected to surge 59.9% this year and another 10.4% in 2022, while earnings soar 446.2% in 2021 and another 21.3% in 2022 (*Fig. 10* and *Fig. 11*).

Likewise, the prices of platinum and palladium are off their peaks but remain elevated relative to 2019 levels (*Fig. 12* and *Fig. 13*).

(3) *Watching steel.* Unlike lumber and copper, steel is holding onto its post-Covid-19 gains. The price of hot rolled steel has surged 65.4% ytd and remains near its highs (*Fig. 14*). The S&P 500 Steel industry's stock price index is 14.5% off its June 1 high after rallying by 233.0% from its low last year (*Fig. 15*).

Despite the price action, industry analysts aren't as optimistic that the price increases will stick around. Collectively, they are calling for the S&P 500 Steel industry's earnings to fall by 52.5% in 2022 after rising by 340.5% this year (*Fig. 16*). Much may depend on whether the Biden administration opts to retain the Trump-era tariffs on imports of the metal.

Calendars

US: Thurs: ISM M-PMI & Price Index 61.0/87.0, Motor Vehicle Sales, Initial & Continuous Jobless Claims 393k/3.38m, Natural Gas Storage**. Fri:** Payroll Employment Total, Private, and Manufacturing 700k/600k/28k, Average Hourly Earnings 0.4%m/m/3.6%y/y, Average Weekly Hours 34.9, Unemployment Rate 5.7%, Trace Balance -$71.4b, Factory Orders 1.6%, Baker-Hughes Oil Rig Count. (Bloomberg estimates)

Global: Thurs: Eurozone Unemployment Rate 8.0%, Eurozone, Germany, France, Italy, and Spain M-PMIs 63.1/64.9/58.6/62.2/59.3, UK M-PMI 64.2, Germany Retail Sales 5.0%, Bailey. **Fri:** Germany Retail Sales 5.0%m/m/10.1%y/y, Lagarde. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) advanced for the fourth time in five weeks this week, from 3.07 to 3.68 over the period. Bullish sentiment climbed 8.1ppts (to 59.6% from 51.5%) over the period, while the correction count fell 7.50ppts (to 24.2% from 31.7%). Meanwhile, bearish sentiment climbed back up to 16.2% this week after dipping to 15.8% last week—the fewest bears since early 2018—after fluctuating in a narrow band (from 16.2% to 17.5%) the prior couple of months. The AAII Ratio increased to 63.4% last week after decreasing the prior two weeks from 69.0% to 61.1% over the period. Bullish sentiment slipped from 41.1% to 40.4% last week, while bearish sentiment fell from 26.2% to 23.3%.

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 was steady w/w at 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 ticked up 0.1ppt w/w to 21.3%, but 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 continue to raise their 2021 forecasts for revenues and earnings growth and the profit margin. They now expect revenues to rise 12.4% in 2021 and 6.7% in 2022 compared to the 2.1% decline reported in 2020. They expect earnings gains of 37.6% 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 21.3, relatively unchanged for a fifth 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 fifth week at 2.73. 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 and earnings rise w/w for nine of the 11 S&P 500 sectors. 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, two 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 (24.2%, down from its 24.3% record high several weeks earlier), Financials (19.2, down from a record 19.3 a week earlier), Communication Services (15.9, record high), Utilities (14.6, down from its 14.8 record high in early May), Real Estate (15.3, 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 (6.8, 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 14.2% and 42.9%, 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 22.0%, forward earnings up 76.9%), Communication Services (20.2, 42.8), Information Technology (20.1, 33.9), Energy (17.5, 1287.1), Industrials (16.9, 52.3), Financials (14.2, 62.5), S&P 500 (14.2, 42.9), Health Care (12.1, 22.2), Consumer Discretionary (9.5, 78.3), Consumer Staples (7.9, 15.5), Real Estate (5.7, 13.8), and Utilities (-2.0, 2.8).

US Economic Indicators

ADP Employment (*link*): “The labor market recovery remains robust, with June closing out a strong second quarter of jobs growth,” said Nela Richardson, chief economist, ADP. Once again, service providers, which was the hardest hit sector during the pandemic, continued to do the “heavy lifting” according to the report. Private payroll employment has risen the past four months through June, jumping 692,000 m/m and 2.72 million over the period. Service-providing jobs soared 624,000 in June and 2.38 million the past four months—accounting for just shy of 90% of the gain in private payrolls the past four months; goods-producing jobs are up 68,000 and 338,000 over the comparable periods. Here’s a tally of industry performances from strongest to weakest during the past four months, since bottoming last April, and where they stand relative to last February’s levels: leisure & hospitality (+1.2 million, +4.9 million, -2.8 million), trade transportation & utilities (+340,000, +2.0 million, -1.1 million), health care & social assistance (+320,000, +1.6 million, -468,000), construction (+169,000, +894,000 & -59,000), other services (+168,000,+914,000, -361,000), manufacturing (+147,000, +864,000, -438,000), administrative & support services (+139,000, +797,000, -751,000), professional & technical services (+102,000, +355,000, -178,000), education (+75,000, +279,000, -170,000), financial activities (+46,000, +158,000, -107,000), natural resources & mining (+21,000, 8,000, -44,000), management of companies & enterprises (+8,000, -12,000, -94,000), information services (-8,000, -46,000, -309,000). Here’s the same exercise by company size: medium (+932,000, +3.5 million, -1.4 million), small (+894,000, +4.5 million, -899,000), and large (+892,000, +4.8 million, -4.5 million) businesses.

Pending Home Sales (*link*): “May's strong increase in transactions—following April's decline, as well as a sudden erosion in home affordability—was indeed a surprise,” said Lawrence Yun, NAR's chief economist. “The housing market is attracting buyers due to the decline in mortgage rates, which fell below 3%, and from an uptick in listings.” The Pending Home Sales Index (which tracks sales where a contract is signed, but the transaction has not yet closed) rebounded 8.0% in May from April’s 4.4% shortfall, to 114.7—the highest reading for May since 2005. These sales are 13.1% above year-ago levels. Regionally, sales rose in every region in May, led by the Northeast and West. Here’s a look at sales on both a monthly and yearly basis: Northeast (+15.5% m/m & +54.6% y/y), West (+10.9 & 12.5), Midwest (+6.7 & 7.8), and South (+4.9 & 6.1). Yun noted that while the pandemic led to record-low inventory and record-high prices, there’s still lots of demand. “While these hurdles have contributed to pricing out some would-be buyers, the record-high aggregate wealth in the country from the elevated stock market and rising home prices are evidently providing funds for home purchases,” Yun said. “More market listings will appear in the second half of 2021, in part from the winding down of the federal mortgage forbearance program and from more home building."

Global Economic Indicators

Eurozone CPI Flash Estimate (*link*): June's CPI headline rate is expected to slow a bit to 1.9% y/y from May's 30-month high of 2.0%, according to flash estimates, while the core rate is expected ease from 1.0% to 0.9%. Looking at the main components, once again energy (to 12.5% from 13.1% y/y) is expected to post the biggest gain, though ease for the first time since late last year. The services inflation rate is expected to slow to 0.7% y/y in June—the lowest since the end of 2020, after accelerating in May for the first time in four months, from 0.9% to 1.1%. The rate for non-energy industrial goods rate is predicted to accelerate for the third month, to 1.2%y/y, after easing from 1.5% in January to 0.3% by March. The price measure for food, alcohol & tobacco is expected to inch up to 0.6% y/y, after slowing steadily from 1.5% in January to 0.5% by May. Of the top four Eurozone economies, rates for Spain (2.4) and Germany (2.1) are expected to be above the headline rate of 1.9%, while Italy's (1.3) is expected to be below; the rate for France is predicted to match the overall rate.

Contact us by *email* or call 480-664-1333.

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