



MORNING BRIEFING

July 21, 2021

Taking Stock

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

(1) A weak panic attack over the past week. (2) A fourth Delta-led wave of the pandemic would boost vaccination pace. (3) Oil price dropped on Monday on OPEC+ deal to supply more oil, not on weak demand. (4) US petroleum usage back at 2019 record high. (5) Financials have more earnings power stashed in loan loss reserves. (6) Economic reopening fundamentals remain bullish. (7) Industrial production of technology hardware still soaring in record-high territory. (8) Industrials have record orders. (9) Record highs for S&P 500 forward revenues, earnings, and profit margin. (10) Bond yield is influencing stock market investment styles. (11) The jobless benefits vs jobs debate. (12) Kids just got more affordable.

Strategy I: Panic Attack #70? The S&P 500 peaked at a record high of 4384.63 on Monday, July 12 ([Fig. 1](#)). One week later, it was down 2.9%. A few of our accounts started asking Joe and me whether this might be the beginning of Panic Attack #70, triggered by fears of the rapidly spreading Delta variant of Covid-19. It might be, but we doubt it given that earnings are so strong. Besides, we expect that any fourth wave of the pandemic might boost the pace of vaccinations, which has lapsed in recent weeks ([Fig. 2](#)). (See our updated table of [US Stock Market Panic Attacks](#), 2009-2021.)

The drop in the bond yield over the past week certainly did follow the script of a potential Delta-induced economic slowdown, as we discussed in yesterday's [Morning Briefing \(Fig. 3\)](#). The same can be said for the performance of the S&P 500. Let's have a closer look at the past week's action:

(1) **Energy.** The S&P 500 Energy sector had the worst performance of the index's 11 sectors. It was down 10.9% from July 12-19. That makes sense since oil demand would certainly be depressed by yet another wave of the pandemic. However, the sector also fell 3.6% on Monday, July 19, on the announcement by OPEC+ that the cartel had agreed to increase production. Oil prices dropped sharply on the news ([Fig. 4](#)). That should have been good news for the S&P 500 Airlines industry, but its price index was down 11.2% from July 12-19.

Also good news for Energy is that US petroleum usage fully recovered in early July to its record highs during the comparable week of 2019 ([Fig. 5](#)). Gasoline usage was back at

9.5mbd during the July 9 week.

(2) *Financials*. The second worst performing S&P 500 sector during July 12-19 was Financials, down 5.2%. That makes sense since the 10-year US Treasury bond yield fell from 1.38% to 1.19% over this period, and the yield-curve spread narrowed by 19bps.

On the other hand, commercial banks still had \$175.6 billion in allowances for loan losses during the July 7 week, or \$62 billion more than they had just before the pandemic during the March 4 week of 2020 ([Fig. 6](#)). In other words, they can continue to boost their profits over the rest of this year by reducing their loan loss provisions.

(3) *Consumer Discretionary & Staples*. Also hard hit since the S&P 500's peak a week ago have been so-called "reopening trade" stocks in the Consumer Discretionary sector: Apparel, Accessories & Luxury Goods (-9.7%), Casinos & Gaming (-9.6), Hotels, Resorts & Cruise Lines (-9.0), and Apparel Retail (-6.2).

From a fundamental perspective, both the TSA checkpoint travel numbers and US hotel occupancy rates have rebounded back to their pre-pandemic levels ([Fig. 7](#) and [Fig. 8](#)). In addition, retail sales at clothing and accessory stores rose to a record high during June, exceeding the pre-pandemic record high during December 2019 by 12.7% ([Fig. 9](#)).

The move out of risk-on trades into risk-off trades benefitted the Consumer Staples sector, which was the best performing sector during the July 12-19 period, gaining 1.1%, with solid increases in the following industries: Food Retail (7.2%), Soft Drinks (3.1), and Household Products (2.4).

(4) *Technology*. The Information Technology sector was down 2.0% during the July 12-19 period. It was one of the six sectors that outperformed the S&P 500. Communication Services managed to be in this group with a 2.8% decline.

Meanwhile, the fundamentals of the Information Technology sector remain very strong. That was apparent in June's industrial production report released last Thursday. Output of computer-related business equipment jumped 3.1% m/m and 29.6% y/y to a new record high ([Fig. 10](#)). Also rising to new record highs were communications equipment and semiconductors ([Fig. 11](#)). In addition, industrial production of electronic gear for consumers (i.e., computers, video, and audio equipment) rose 2.5% m/m and 25.0% y/y during June, also to a new record high.

(5) *Industrials*. The Industrials sector was among the underperforming ones during the July 12-19 period, with a loss of 3.7%. The S&P 500 Transportation stock price index (which is in the sector) was down 3.3%.

Again, the fundamentals of the sector are strong. New orders of nondefense capital goods ex aircraft reached a new record high in May ([Fig. 12](#)). Orders for industrial machinery were especially strong, rising 2.3% m/m and 58.7% y/y to the highest level on record.

(6) *S&P 500 sectors*. Here is the performance derby of the S&P 500 and its 11 sectors from July 12-19: Consumer Staples (1.1%), Utilities (0.6), Health Care (-1.4), Real Estate (-1.8), Information Technology (-2.0), Communication Services (-2.8), S&P 500 (-2.9), Industrials (-3.7), Consumer Discretionary (-4.3), Materials (-4.7), Financials (-5.2), and Energy (-10.9) ([Table 1](#)).

(7) *Growth vs Value*. Once again, the Magnificent Five (Mag-5)—the S&P 500's five stocks with the highest market capitalizations, i.e., Facebook, Amazon, Apple, Microsoft, and Google—have dominated the various investment styles. Collectively, their market capitalization fell 2.1% from July 12-19. Over that same period, S&P 500 Growth (-2.2%) outperformed S&P 500 Value (-3.7), as it has been doing since March 8 ([Fig. 13](#)). And the S&P 500 LargeCaps (-2.9) outperformed the S&P 400/600 SMidCaps (-5.2 and -6.8) over that period.

Strategy II: Revenues, Earnings & Margins. The S&P 500's forward P/E (i.e., with the "E" representing the time-weighted average of consensus earnings estimates for this year and next) has been stalled around 22.0 for the past year. In other words, the bull market over the past year has been led by forward earnings. This continues to be its modus operandi. Consider the following:

(1) *Revenues*. S&P 500 forward revenues bottomed last year during the May 28 week ([Fig. 14](#)). It is up 15.1% since then to a record high during the July 15 week.

(2) *Earnings*. S&P 500 forward earnings bottomed last year during the May 14 week and is up 44.8% since then, also to a record high during the July 15 week.

The Q2 earnings reporting season has started with the traditional upward earnings hook as actual results are stronger-than-expected by industry analysts ([Fig. 15](#) and [Fig. 16](#)). During the July 15 week, the actual/estimated blend for earnings was up to 66.0% from 61.6% the prior week.

(3) *Margins*. Joe and I calculate the S&P 500 forward profit margin by dividing forward earnings by forward revenues. It rose to a record high of 13.0% during the July 1 week, and was down slightly to 12.9% during the July 15 week.

Strategy III: Valuation and Styles. The decline in the 10-year US Treasury bond yield from this year's high of 1.74% on March 31 has had a big impact on the relative performances of S&P 500 Growth versus Value and S&P 500 LargeCaps versus SMidCaps.

As we discussed in yesterday's *Morning Briefing*, we think the drop in the yield is mostly attributable to the Fed's QE4ever purchases of bonds. However, investors seem to be increasingly concerned that the drop may be anticipating a significant growth slowdown—the chances of which may have been upped by the recent rapid spread of the Delta variant of Covid-19.

This scenario favors Growth and LargeCaps. Since the yield peaked through Monday's close, here is the performance derby for Mag-5 (17.0%), Growth (12.5), Value (1.6), LargeCaps (7.2), MidCaps (-1.5), and SmallCaps (-3.5). Let's dissect these moves focusing on their forward earnings and forward P/Es:

(1) *LargeCaps vs SMidCaps*. Since they bottomed last spring through the July 15 week, the forward earnings of the S&P 500/400/600 are up 44.8%, 85.4%, and 132.4%—all to record highs ([Fig. 17](#)). Based on this metric, SMidCaps have outperformed LargeCaps.

However, while the S&P forward P/E was 20.9 on Monday—down slightly from 21.9 the day that the bond yield peaked—the forward P/E of the S&P 400 dropped from 19.4 to 16.7 and the forward P/E of the S&P 600 dropped from 20.2 to 16.3 ([Fig. 18](#)).

(2) *Growth vs Value*. Since the bond yield peaked, the forward P/E of S&P 500 Value has declined from 18.1 to 16.3 on Monday, while the S&P 500 Growth P/E rebounded from a recent low of 26.0 on May 12 to 28.0 on Monday ([Fig. 19](#)). The ratio of the forward earnings of Growth to Value has been relatively stable for the past year ([Fig. 20](#)).

US Labor Market: Jobless Benefits vs Jobs. The federal pandemic unemployment program is set to expire on September 6. Just over a month ago, three states—Iowa, Mississippi, and Missouri—opted out ahead of schedule, terminating the \$300-per-week benefit along with the other emergency programs on June 12 largely to address labor shortages arising out of the US economic recovery from the pandemic induced recession.

Now 26 states have followed suit, halting some or all the emergency benefits created during the pandemic, including the \$300 weekly supplemental benefit, extended benefits, and coverage for gig workers and others who would not typically receive benefits, [reported](#) the June 15 *NYT*. The specific programs impacted are the Federal Pandemic Unemployment Compensation (provides \$300 per week on top of regular state benefits for eligible individuals), Pandemic Unemployment Assistance (provides coverage for freelancers, part-time hires, seasonal workers, and others), and Pandemic Emergency Unemployment Compensation (extends benefit timeframes). Lawsuits fighting the benefit cuts are pending in a handful of states.

Many Republican senators have blamed the slow decline in unemployment since the lockdowns ended to the incremental federal benefits, especially in view of plentiful job openings. Looking at the states that have ended benefits the earliest, evidence supports that claim. We expect to have a better handle on post-Covid unemployment in America after benefits expire nationally in September and most children return to school in person this fall. Many stay-at-home parents may have opted to receive benefits longer due to childcare challenges.

In any event, our early review of unemployment in the three early terminating states that eliminated all the major emergency unemployment programs suggests that further recovery of the national labor market is likely once the emergency benefits are fully eliminated nationwide. Here are the national and state unemployment rates for the three states as of December 2019, April 2020, and June 2021: Mississippi (5.5%, 15.7%, 6.2%), national (3.6, 14.8, 5.9), Missouri (3.5, 12.5, 4.3), and Iowa (2.8, 11.1, 4.0).

Mississippi's unemployment rate historically has run higher than the national rate. However, the state's rate has recovered faster than the national rate following the height of the pandemic. From the peak to June, Mississippi's rate fell 9.5ppts, returning to just 0.7ppt from its pre-pandemic rate. Nationally, the rate fell 8.9ppts from the peak to June but remains 2.3ppts higher than the December 2019 rate.

Missouri's rate fell 8.2ppts from the peak, returning to just 0.8ppt above the December 2019 rate. Iowa's rate fell 7.1% following the peak and remains just 1.2ppts higher than December 2019.

US Taxes: Making Kids More Affordable. The advance payments of the child tax credit may have a mild stimulative effect on the US economy, but not for long. On July 15, \$250-

\$300 per child was direct deposited into parents' bank accounts and will be granted again monthly through the next six months. The remaining portion of the credit owed to parents will be paid at tax time.

The credit was expanded up to \$3,600 per child under age six and \$3,000 per child aged six to 17. Parents previously received up to \$2,000 per child up through age 16.

The credit previously was designed to support working families. As such, it was not fully refundable, meaning that families with little or no income could receive up to only \$1,400 per child (i.e., free money). More than 26 million children were ineligible for the full credit because their families' earnings were too low, [*reported Time*](#) on July 16. Now that the credit is fully refundable, more low-income parents will receive the full credit (i.e., more free money). Many of them may be lifted above the poverty line because of the credit.

This year, the credit phases out for heads of household earning up to \$112,500 per year and married joint filers earning up to \$150,000. Families that earn up to \$400,000 may be eligible for up to the amount of child credit they received the previous year in monthly advance payments. Parents can opt out of advance payments, choosing to receive the full credit against their 2021 tax return.

Calendars

US: Wed: MBA Mortgage Applications, Crude Oil Inventories. **Thurs:** Leading Indicators 0.9%, Initial & Continuous Jobless Claims 350k/3.10m, Kansas City Fed Manufacturing Index, Existing Home Sales 5.90m, Chicago Fed National Activity Index, Natural Gas Storage. (Bloomberg estimates)

Global: Wed: Australia NAB Quarterly Business Confidence. **Thurs:** Eurozone Consumer Confidence -2.5, French Business Survey 107, UK Gfk Consumer Confidence -8, ECB Interest Rate Decision & Deposit Facility Rate 0.00%/-0.50%, RBA Monetary Policy Statement, Lowe, Broadbent. (Bloomberg estimates)

Strategy Indicators

S&P 500 Earnings, Revenues, Valuation & Margins ([link](#)): The S&P 500's forward profit margin remained steady last week at 12.9%, down from a record high of 13.0% at the beginning of July. Since the end of April, it has exceeded its prior record high of 12.4% in September 2018. It's now up 2.6ppts from 10.3% during April 2020, which was the lowest level since August 2013. Forward revenues and earnings per share 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 ticked up 0.1ppt w/w to 9.0%. 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 down 0.1ppt w/w to 19.5%, and should also continue to 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 12.7% in 2021 and 6.7% in 2022 compared to the 2.1% decline reported in 2020. They expect earnings gains of 38.9% in 2021 and 11.1% in 2022 compared to a 13.2% decline in 2020. Analysts expect the profit margin to rise 2.4ppts y/y in 2021 to 12.6%—from 10.2% in 2020—and to improve 0.5ppt y/y to 13.1% in 2022. The S&P 500's weekly reading of its forward P/E remained steady w/w at an 11-week high of 21.6. 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 ticked up 0.01pt w/w to a new record high of 2.79. That compares to 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 for eight 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 still have both measures well below record highs. Financials and Utilities have forward earnings at or near record-highs, 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, five sectors are at record highs. 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, a new record high this week), Communication Services (15.9, record high), Utilities (14.5, down from its 14.8 record high in early May), Real Estate (15.3, down from 17.0), S&P 500 (12.9, down from a record high 13.0 in early July), Materials (13.0, a new record high this week), Health Care (10.9, down from 11.2), Industrials (9.8, 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 (7.7, down from 8.3), and Energy (7.2, 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 15.1% and 45.1%, respectively, since then to new record highs. The forward profit margin has risen 2.8ppt to 12.9%, down from a record high 13.0% in early July but still exceeding its prior record high of 12.4% in late 2018. During the latest week, all but the Health care and Utilities sectors 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 22.8%, forward earnings up 80.8%), Information Technology (21.1, 35.6), Communication Services (21.0, 44.3), Energy (19.1, 1393.0), Industrials (18.5, 57.4), S&P 500 (15.1, 45.1), Financials (15.1, 65.0), Health Care (12.5, 22.3), Consumer Discretionary (11.3, 82.6), Consumer Staples (8.5, 16.2), Real Estate (6.4, 14.9), and Utilities (-1.2, 3.2).

S&P 500 Sectors Net Earnings Revisions [\(link\)](#): The S&P 500's NERI was at a record high in July for a second straight month, rising to 23.1% from 22.5% in June. It rose for a third straight month and was positive for a 12th month following 13 straight negative readings. July'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. Ten of the 11 sectors had positive NERI in July, down from all 11 with positive readings during May and June. Eight of the 11 sectors had NERI improve m/m in July, the same as in June and down from ten in May. Still, many sectors had NERIs at multi-year or record highs during the month. Here are the sectors' July NERIs compared with their June readings: Energy (33.6 in July [16-year high], up from 30.0% in June), Materials (32.2 [record high], 31.3), Financials (31.1, 34.5), Industrials (30.0 [record high], 27.6), Consumer Discretionary (25.7 [11-year high], 24.3), Information Technology (24.1 [11-year high], 23.8), S&P 500 (23.1 [record high], 22.5), Real Estate

(19.7 [record high], 12.8), Health Care (14.2, 15.5), Communication Services (14.1, 11.9), Consumer Staples (11.8, 9.8), and Utilities (-1.1, 1.4).

S&P 500 Q2 Earnings Season Monitor ([link](#)): With over 11% of S&P 500 companies finished reporting revenues and earnings for Q2-2021, revenues are beating the consensus forecast by a well-above-trend 4.5%, and earnings have exceeded estimates by 18.8%. At the same point during the Q1 season, revenues were 3.2% above forecast and earnings beat by 30.3% in large part due to loan loss reversals at the banks. The S&P 500's earnings surprise excluding Financials is 12.8%, up from 10.0% during Q1. For the 56 companies that have reported Q2 earnings through mid-day Tuesday, the aggregate y/y revenue and earnings growth rates and the percentage of companies reporting a positive revenue and earnings surprise have improved significantly from their Q1 measures due to the low base a year earlier when the US economy was shut down due to Covid-19. The small sample of Q2 reporters so far has a y/y revenue gain of 13.9% and an earnings gain of 134.0%. A whopping 91% of the Q2 reporters so far has reported a positive earnings surprise, but only 82% has beaten revenues forecasts. More companies have reported positive y/y earnings growth in Q2 (88%) than positive y/y revenue growth (79%). These figures will change markedly as more Q2-2021 results are reported in the coming weeks. The y/y growth rates will more than likely mark the peak of the recovery from the Covid-19 shutdown.

US Economic Indicators

Housing Starts & Building Permits ([link](#)): Housing starts in June were stronger than expected, while building permits sank to an eight-month low. Homebuilders' confidence continued to drift lower in July, influenced by high housing costs, along with land and labor shortages. June housing starts jumped 6.3% to 1.643mu (saar) after a downwardly revised 2.1% (from 3.6%) gain in May—with starts revised from 1.572mu to 1.546mu. Starts were at 1.725 mu in March, which was the highest level since mid-2006. Single-family starts rose 6.3% in June and 9.3% the past two months to 1.160mu (saar), after falling three of the first four months of this year by 19.3% from December's cyclical peak of 1.315mu. Multi-family starts remain in a volatile flat trend, near the top of the range, climbing 6.6% during the two months through June to 483,000 units (saar). Meanwhile, building permits—a good leading indicator of housing starts—contracted 5.1% last month to 1.598mu (saar), down 15.1% from January's cyclical peak of 1.883mu. Single-family permits sank 6.3% and 16.2% over the comparable period to 1.063mu (saar); it was at a cyclical high of 1.268mu in January. Multi-family permits are down 13.0%, to 535,000 units (saar), from January's recent peak of

615,000 units. Housing completions fell to a seven-month in June, reflecting the headwinds that builders are battling due to shortages in both materials and labor. NAHB's July's Housing Market Index (HMI) shows builders' confidence continued to drift lower since reaching a record high in November, dropping from 90 to 80 over the period. All the components are trending lower, though remain at elevated levels: traffic of prospective homebuyers (to 65 from 77 in November), current sales (86 from 96), and future sales (81 from 89), though the latter ticked up from June's 79.

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

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