MORNING BRIEFING
July 22, 2021

Transports, Tech & Fintech

Check out the accompanying chart collection.

(1) Surging imports signal continued strong US economic recovery. (2) Demand is outstripping J.B. Hunt's capacity. (3) Supply chain in knots. (4) Delays at the ports and on the rails. (5) Truck drivers in demand and getting higher wages. (6) Tech's wide margins may attract regulatory scrutiny. (7) Traditional banks face growing fintech competition. (8) Square enters small business lending, and Robinhood goes public. (9) Defi uses no bankers, only blockchain. (10) The Wild West of banking.

Transports: Still Trucking Along. J.B. Hunt Transport Services reported strong earnings on Monday that benefitted from the economy's recovery and a surge of imports, while coping with the country's tangled supply chain and jump in employees' wages. The company's Q2 revenue excluding fuel surcharges rose 31% y/y to $2.6 billion, and its operating income jumped 38% y/y to $241.5 million.

On J.B. Hunt's earnings *conference call*, CEO John Roberts said the company enjoyed "strong momentum" that he expects will continue, and Shelly Simpson, the company's chief commercial officer, described demand that "far exceeds our capacity to serve."

Since the business momentum of transport companies like J.B. Hunt offers a glimpse into how the broader economy is faring, let's take a deeper look at what J.B. Hunt executives said in their earnings conference call as well as other telling transportation data:

(1) *Tangled supply chain.* A number of Hunt executives mentioned "challenges" with railroad velocity and fluidity that are affecting the company and industry. With new equipment ordered in Q1, the company had been expecting capital expenditures to be $1.25 billion this year. That may drop to $1.15 billion if the deliveries are pushed forward to 2022 "because of the congestion on the waterways and also at the ports," said CFO John Kuhlow.

Congestion was so bad at its Chicago terminal, Union Pacific suspended service between the West Coast and Chicago for a week starting July 18, an *article* in Supply Chain Dive reported on July 16. And on Monday, BNSF Railway said it's limiting the flow of international containers from the ports of Los Angeles and Long Beach to its Chicago intermodal terminal for two weeks to work off a backlog in Chicago, a July 19 *article* on Trains.com reported.

There are complaints that customers are taking too long to unload their containers and return them, causing backups in the system.

Trains.com also reported that an Eastern rail operator was restricting the flow of containers from the Port of New York and New Jersey to terminals in Chicago, Cleveland, and Indianapolis. And container terminals in Vancouver are backlogged due to fire-related track closures.

Intermodal railcar loadings rose 16.5% y/y during the July 17 week, based on the 26-week average, one of the largest jumps since the surge in 2010 (*Fig. 1*). The actual number of railcar loadings is little changed from its record high in early July, having fully recovered from the sharp Covid-related drop last year (*Fig. 2*). Railcar loadings of chemical and petroleum products and metals have rebounded strongly (*Fig. 3* and *Fig. 4*). Loadings of coal have even perked up, as utilities find the commodity more attractive now that the price of natural gas has jumped (*Fig. 5*). Loadings of motor vehicles had bounced back from Covid lows until recently, when the industry ran into trouble finding semiconductor chips, forcing it to stop producing many models (*Fig. 6*).

There is also congestion in the West Coast ports, where dwell times are near their peak of five days. Dwell time is the amount of time which cargo or ships spend within a port. Part of the problem is that imports are far surpassing exports, causing an imbalance of containers. At the West Coast ports, inbound container traffic hit 10.4 million TEUs (20-foot equivalent units), an all-time high in June using a 12-month sum (*Fig. 7*). Outbound containers remained depressed at 2.9 million in June, again using a 12-month sum (*Fig. 8*). Total container traffic for the West Coast ports hit a record high last month, up 2.2 million y/y to 13.3 million (*Fig. 9*).

Customers are concerned that their products may not be on shelves or in e-commerce warehouses in time for the holiday season, said J.B. Hunt’s Simpson. Some of her customers had ordered ahead of schedule and already have their Christmas inventory, which pulled demand forward. Others aren’t so fortunate, with inventory that has yet to start sailing across the ocean.

(2) *Workers in short supply.* The difficulty finding drivers and the higher wages required were referenced several times on J.B. Hunt’s conference call. The “current quarter was significantly impacted by labor shortages, putting a strain on our ability to service demand and effectively use our assets,” said Kuhlow.

Kuhlow noted that there were “increases across all pay items for both drivers and non-driver employees. The impact of the reopening on salaries and wages is widespread, and we see challenges in this area continuing because of the importance of attracting and retaining our people.” Fortunately, the wage increases were offset by a $10 million drop in Covid-related costs in Q2-2020, when the company incurred paid time off for employees needing to quarantine. Hunt also absorbed its wage increases by raising prices. In Q2, the operating margin was 9.3%, short of the company’s long-term 10%-12% target, based on revenue excluding fuel surcharges.

J.B. Hunt isn’t the only transport company facing labor shortages. “[W]e believe the availability of labor is having a meaningful impact across almost every part of the supply chain, ranging from the ports to rail terminal operations, warehouse operations, and certainly, [the] over the road driver market,” said COO Nick Hobbs.

Average hourly earnings for the truck transportation industry rose 4.1% y/y in May, the latest in a string of almost three years where wages jumped anywhere from 3%-6% (*Fig. 10*). Despite the rising wages, the industry’s payroll employment is far from fully recovered from the Covid-induced drop in 2020 (*Fig. 11*).

The ATA Truck Tonnage index had bounced back nicely early this year, rising 7.4% from its April 2020 low to a January 2021 high. The index slipped 3.1% by June and remains 6.8% off its August 2019 record high (*Fig. 12*). The index’s three-month average continued to rise by 3.4% y/y in June (*Fig. 13*). Industry executives appear relatively confident, however, with sales of medium-weight and heavy trucks recovering sharply from 2020 lows (*Fig. 14*). Buoying their confidence may be pricing power: In June, producer prices for truck transportation of freight jumped by 15.4% y/y, holding near May’s 15.8% record gain (*Fig. 15*).

The S&P 500 Trucking index, up 26.1% ytd through Tuesday’s close, is the strongest component of the S&P 500 Transportation composite, which has risen 12.9% ytd. The S&P 500 Air Freight & Logistics industry is also a strong performer (21.9%); however, Airlines (8.9%) and Railroads (6.1%) are having a tougher year and trail the S&P 500’s 15.1% ytd gains (*Fig. 16*).

Technology: When Good Profit Margins May Be Bad. Technology stocks are beloved for their fast earnings growth and wide margins. But when regulators in the US and abroad are alleging anticompetitive behavior, wide profit margins may just be a red flag that keeps them energized. The S&P 500 Information Technology sector has the widest margins of the 11

S&P 500 sectors by a wide margin.

Here's the performance derby for the S&P 500 and its sectors' forward profit margins: Information Technology (24.3%), Financials (19.3), Communication Services (15.9), Real Estate (15.3), Utilities (14.5), Materials (13.0), S&P 500 (12.9), Health Care (10.9), Industrials (9.8), Consumer Discretionary (7.7), Consumer Staples (7.7), and Energy (7.2) (*Fig. 17*).

Forward profit margins are even more conspicuously wide for some of the FAANGMs (i.e., Facebook, Amazon, Apple, Netflix, Alphabet [Google], and Microsoft) that have come under regulatory scrutiny. The FAANGMs excluding Amazon boast a collective forward profit margin of 25.3%, almost double the S&P 500's forward profit margin of 12.9% (*Fig. 18*).

Facebook and Google are part of the S&P 500 Interactive Media & Services industry (a member of the S&P 500 Communication Services sector), and that industry has a forward profit margin of 23.5%, nearly as high as the FAANGMs' (*Fig. 19*). Individually, Facebook's forward profit margin is 26.5%, and Google's is 21.2%.

Apple is a member of the Tech sector's Technology Hardware, Storage & Peripherals industry, which has a forward profit margin of 20.2% (*Fig. 20*). On a standalone basis, Apple's forward profit margin is 24.2%.

Amazon is in the Consumer Discretionary sector's Internet & Direct Marketing Retail industry, which has a forward profit margin of 6.1% (*Fig. 21*). Amazon's forward profit margin is 5.2%, depressed by skinny margins in retailing that are only somewhat offset by the wide margins in Amazon's cloud business. Microsoft hasn't attracted the antitrust regulators' spotlight recently, even though it boasts the highest profit margin of the FAANGM bunch at 33.8%. Among the non-retail FAANGMs, Netflix has the lowest profit margin at 16.1% (*Fig. 22*).

Certainly, calculating forward profit margins is an inexact science because analysts covering different companies include and exclude different expenses. Nonetheless, the data presents an interesting picture that we have no doubt regulators are watching as well.

Disruptive Technologies: Banking Goes High Tech. JPMorgan is the undisputed Gulliver of banking. The market giant has $3.7 trillion of assets, and investors hang on every word uttered by CEO Jamie Dimon. But you'd have to be blind not to notice that the banking industry has attracted the attention of tech wizards who are using technology to offer faster, easier, and cheaper banking services. Let’s take a look at some of the Lilliputians swarming underfoot:

(1) *Square gets into small business lending.* Square has come far from its humble beginnings facilitating small company card payments: On Tuesday, it announced that its industrial bank, Square Financial Services, will start offering small business lending, savings, and checking services.

This is occurring at the same time that Robinhood Markets is putting the finishing touches on its upcoming IPO, which is expected to value the company at about $33 billion. Retail investors flocked to Robinhood while stuck at home during the Covid pandemic, when trading stocks, cryptocurrencies, and options were high entertainment. The company doesn’t charge a fee for trading but instead generates revenue by selling its customer trading order flow to large market makers.

Robinhood doesn’t have the breadth of JPMorgan, but its Q2 revenue is expected to have more than doubled y/y to $574 million, a July 19 *WSJ* *article* reported. While Robinhood’s growth is decelerating, it still boasts growth rates that the money center bank can only dream of.

(2) *Introducing defi.* Decentralized finance takes fintech a giant step further. In defi, there is no banker acting as an intermediary, just lenders contributing a pool of capital and borrowers looking for funding. Borrowers and lenders transact directly, with their “loan” recorded in smart contracts housed on the Ethereum blockchain. This is the Wild West of finance. There’s no pretense of anyone knowing their customer, as regulators require of US banks. There’s no custodian or clearing house. If things go wrong—and they have—there’s no one to be held liable. A recent victim is none other than tech investor Mark Cuban, who was lending money using the Titan token on Quickswap. Titan crashed from $64 to almost zero, leaving Cuban and others emptyhanded.

One of the larger players in defi lending is *aave*, which has $17.7 billion in liquidity available for loans and roughly $5 billion of outstanding loans made in various cryptocurrencies.

In a conference, aave’s founder and CEO Stani Kulechov said he could see the market evolving such that companies managed two pools of capital—one with lenders and borrowers transacting anonymously, as they do today. A second pool would vet and clear borrowers and lenders. That would keep bad players out and give regulators and large institutions transparency. The risk is that regulators won’t allow companies to run two pools of capital because they oppose anonymous participation, which flouts conventional banking requirements.

Nonetheless, defi is the flavor of the day in the financial markets, generating substantial buzz. On Friday, Square announced in a tweet (of course) that it is building a business dedicated to “decentralized financial services” using bitcoin, a July 16 CNBC *article* reported. Square CEO Jack Dorsey said on Twitter that the company is “focused on building an open developer platform with the sole goal of making it easy to create non-custodial, permissionless, and decentralized financial services.”

(3) *If you can’t be ’em, buy ’em.* Over the past year, JPMorgan has gone on an acquisition spree of small, mostly high-tech finance companies, both domestically and abroad, that typically tuck into the large bank’s existing business lines. As a result, new integrated products and services will be rolled out in every quarter for the next two years, said Dimon on the company’s Q2 earnings *conference call*. He also noted the market’s changing landscape: “I think we have huge competition in banking and shadow banking, fintech and big tech and Walmart.”

JPMorgan is entering some foreign banking markets by offering its banking services digitally. In June, it acquired Nutmeg Saving and Investment, one of the UK’s leading digital wealth managers. Nutmeg will complement the digital bank that Chase is launching in the UK later this year. JPMorgan expanded its retail operations in Brazil in June by taking a 40% equity stake in C6 Bank, a Brazilian digital bank, which has more than seven million customers.

Also last month, the bank bought a stake in the data analytics company owned by the New England Patriots owner Robert Craft. It helps investors decide how to invest in sports teams and advises team owners how to earn more profit from their operations.

Another June purchase for the bank: OpenInvest, a fintech company that allows financial advisors to build manage and report on their environmental social and governance portfolios. It also provides ESG (environmental, social, and corporate governance) investment management products.

Gulliver is fighting back.

Calendars

US: 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. **Fri:** M-PMI & NM-PMI Flash Estimates 62.0/64.8, Baker-Hughes Rig Count. (Bloomberg estimates)

Global: 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. **Fri:** Eurozone, Germany, and France C-PMI Flash Estimates 60.0/60.8/58.5, Eurozone, Germany, and France M-PMI Flash Estimates 62.5/64.2/58.4, Eurozone, Germany, and France NM-PMI Flash Estimates 59.5/59.1/58.7, UK C-PMI, M-PMI, and NM-PMI Flash Estimates 61.9/62.7/62.0, UK Headline & Core Retail Sales 9.6%/8.2% y/y, Canada Headline & Core Retail Sales -3.0%/-2.2%. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) sank to 3.18 this week, on a sharp drop in bullish sentiment, after advancing in six of the prior seven weeks from 3.07 to 4.00 over the period—the highest since late January 2018. Bullish sentiment plunged 8.1ppts this week to 53.1% after soaring 9.7ppts (to 61.2% from 51.5%) the prior seven weeks. Meanwhile, the correction count, which fell 8.2ppts (to 23.5% from 31.7%) the prior seven weeks, jumped 6.7ppts this week to 30.2%. Bearish sentiment rose from 15.3% to 16.7% this week, fluctuating in a rather narrow band the past couple of months compared to the wide swings in bullish sentiment and the correction count. The AAII Ratio slipped last week for the second week to 57.4%, after climbing the prior two weeks from 61.1% to 68.7%, as bullish sentiment fell from 48.7% to 36.2% over the two-week period and bearish sentiment climbed from 22.2% to 26.8%.

MSCI World & Region Net Earnings Revisions (*link*): Analysts' recent earnings revisions through July continue to suggest substantially greater optimism about profits in the US than the rest of the world. Most regions were at record highs in July, with the exceptions of EM, EM Asia, and EM Latin America. The US's NERI was positive in July for a 12th straight month after 14 negative readings, and was the world's top-performing region as it rose to a near-record high of 21.1% from 20.6%. That compares to an 11-year low of -36.9% in May

2020. The AC World ex-US MSCI's NERI was positive for a tenth month after 30 straight negative readings, as it rose to a 12-year high of 6.4% from 5.9% in June. That compares to 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 July's scores among the regional MSCIs: US (21.1% in July [40-month high], up from 20.6% in June), Europe ex-UK (15.6 [record high], 14.3), Europe (14.8 [record high], 13.3), EMU (13.7 [record high], 12.8), EAFE (11.0 [record high], 10.3), AC World (10.2 [record high], 9.7), EM Eastern Europe (13.8 [record high], 9.6), EM Latin America (7.7, 8.1 [record high], 7.8), AC World ex-US (6.4 [12-year high], 5.9), Emerging Markets (3.0, 2.5), and EM Asia (2.4, 2.0).

MSCI Countries Net Earnings Revisions (*link*): NERI was positive for 35/44 MSCI countries in July. That's down from 36/44 in June and 38/44 during May, which had matched the record-high count from November 2009. That also compares to zero countries with positive NERI from April to June 2020. NERI improved m/m in July for 31/44 countries, up from 21/44 in June. Among the countries with improving NERI in July, seven were at record highs: Austria, France, Germany, Ireland, Norway, Poland, and Switzerland. Eleven other countries were at multi-year highs dating back to 2004. The US and the following five countries have had positive NERI for 12 straight months: Canada, Korea, Norway, Sweden, and Taiwan. The Philippines has the worst negative-NERI streak, at 18 months, followed by New Zealand (10), Indonesia (5), and Greece (4). China's NERI turned positive for the first time in three months. Portugal's NERI turned negative again in July following June's first positive reading in 34 months and Thailand was negative for the first time in six months. The highest NERI readings in July: Austria (29.2%), Norway (28.9), Hungary (27.6), Argentina (24.7), Ireland (24.3), and Sweden (23.9). The weakest NERIs occurred this month in New Zealand (-23.1), Egypt (-3.6), Indonesia (-2.8), the Philippines (-2.1), Hong Kong (-0.8), India (-0.8), Portugal (-0.3), Greece (-0.1), and Thailand (-0.1).

AC World ex-US MSCI (*link*): This index has dropped 3.1% in dollar terms so far in July and is up 4.5% ytd. In local-currency terms, the index is down a lesser 2.2% in July to a greater 7.7% gain for 2021 to date. Local-currency forward revenues has risen 4.3% since it bottomed in late January, but remains 8.9% below its record high of May 2019. Local-currency forward earnings has jumped 36.0% since it bottomed in July 2020, and is only 0.5% below its record high of October 2018. Revenues are expected to rise 12.3% in 2021 and 5.7% in 2022 following a decline of 6.2% in 2020, and earnings are expected to increase 44.8% (2021) and 9.5% (2022) after falling 13.6% (2020). The industry analysts' sales forecasts imply short-term 12-month forward revenue growth (STRG) of 8.5% and short-term 12-month forward earnings growth (STEG) of 20.4%, compared to 4.1% and

10.0% before Covid-19 hit the news. These measures bottomed at -0.1% and -0.3%, respectively, during May 2020. The profit margin implied by analysts' earnings and revenue estimates calls for a gain to 8.8% in 2021 from 6.8% in 2020, and an increase to 9.1% in 2022. The forward profit margin forecast of 8.9% is up from a 10-year low of 6.6% at the end of May but remains a tad below its 9.0% record high in September 2007. The Net Earnings Revision Index (NERI) for the AC World ex-US MSCI was positive in July for a tenth straight month following 30 negative readings. It rose to a 12-year high of 6.4% from 5.9% in June, which compares to an 11-year low of -23.9% in May 2020. The forward P/E of 15.3 is at a 14-month low and compares to an 18-year high of 17.1 in mid-February. The forward P/E drops to 14.7 using normalized forward earnings. Those readings are up from their March 2020 lows of 10.8 and 10.2, respectively. The index's current 18% discount to the World MSCI P/E is now back in line with its pre-Covid discount of 18%.

Emerging Markets MSCI (*link*): The EM MSCI price index has dropped 3.7% in US dollar terms so far in July to a gain of 3.0% ytd. In local-currency terms, EM is down a greater 4.6% in July to a lesser 1.5% ytd gain. Local-currency forward revenues has risen 3.8% since its bottom in late January but is still down 10.9% from its record high in May 2019. Local-currency forward earnings is up 35.3% since its bottom in June 2020 and now exceeds its prior record high from October 2018 by 4.7%. Revenues are expected to rise 16.5% in 2021 and 8.4% in 2022 after falling 1.1% in 2020. That's expected to lead to an earnings gain of 51.0% in 2021 and 9.7% in 2022, following a 2.7% drop in 2020. Forecasted STRG of 11.6% remains near an 11-year high, up from a five-year low of 3.6% at the end of April 2020. STEG has dropped to 22.2% from a record high of 33.7% in December, but that's up from a 14-month low of 7.5% in April 2020. The implied profit margin is expected to rise from 6.3% in 2020 to 8.2% in 2021 and 8.3% in 2022. The forward profit margin of 8.2% is up from a four-year low of 6.1% at the end of May 2020 and compares to its 10.3% record high in December 2007. NERI was positive in July for an 11th month after 30 straight negative readings, and improved to 3.0% from an eight-month low of 2.5% in June. That compares to an 11-year high of 6.0% in February and an 11-year low of -18.7% in May 2020. Emerging Markets' forward P/E of 13.7 is at a 13-month low and compares to a record high of 16.3 in mid-February. The P/E drops to 13.1 using normalized forward earnings. That's up sharply from those figures' March 2020 lows of 10.1 and 9.3, respectively. The index is trading at a 27% discount to the World MSCI P/E, which is in line with its discount since 2013.

China MSCI (*link*): The China MSCI price index has dropped 7.2% in US dollar terms so far in July to a decline of 6.2% ytd. In local-currency terms, China is the worst performing country so far in July, with a drop of 7.1% and is down 5.5% ytd. Local-currency forward revenues has risen 1.9% since its bottom in June 2021, but is still down 36.2% from its record high in October 2014. Local-currency forward earnings is up 8.1% since its bottom in June 2020, but remains 8.7% below its record high in June 2018. Revenues are expected to rise 16.1% in 2021 and 10.5% in 2022 after 0.2% growth in 2020. That's expected to lead to an earnings gain of 17.4% in 2021 and 18.1% in 2022, following a 4.0% gain in 2020. Forecasted STRG of 12.7% remains near an 11-year high, up from a five-year low of 5.0% at the end of April 2020. STEG has dropped to 16.8% from a 10-year high of 18.6% during December, but that's up from a four-year low of 8.0% in April 2020. The implied profit margin ranks as one of the lowest in the world; it's expected to remain unchanged y/y at 5.0% in 2021 and to rise to 5.3% in 2022. The forward profit margin is at a record high of 5.2%, up from a pandemic low of 4.5% in May 2020. NERI rose to 0.3% in July from -0.8% in June. That ranks 11th worst among the 44 MSCI countries that we follow. China's forward P/E of 15.0 is near an eight-month low and drops to 13.8 using normalized forward earnings. That's up sharply from those figures' March 2020 lows of 10.5 and 9.8, respectively. The index is trading at a 20% discount to the World MSCI P/E, which is in line with its discount since 2013.

S&P 500 Q2 Earnings Season Monitor (*link*): With nearly 15% of S&P 500 companies finished reporting revenues and earnings for Q2-2021, revenues are beating the consensus forecast by a well-above-trend 4.2%, and earnings have exceeded estimates by 16.9%. At the same point during the Q1 season, revenues were 2.9% above forecast and earnings beat by 25.4% in large part due to loan loss reversals at the banks. The S&P 500's earnings surprise appears to have weakened q/q, but has actually improved excluding the Financials. The S&P 500 earnings surprise excluding Financials is 11.7%, up from 9.9% during Q1. For the 73 companies that have reported Q2 earnings through mid-day Wednesday, 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 15.5% and an earnings gain of 114.4%. A whopping 88% of the Q2 reporters so far has reported a positive earnings surprise, but only 84% has beaten revenues forecasts. More companies have reported positive y/y earnings growth in Q2 (88%) than positive y/y revenue growth (82%). 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.

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