



MORNING BRIEFING

August 2, 2021

S&P 5000!

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

(1) S&P 500 earnings still outpacing expectations. (2) Our target for S&P 500 is 5000 by year-end 2022. (3) Betting on continuation of elevated forward P/E. (4) Tech-related companies should continue to boost productivity and profit margins, and to prop up valuation too. (5) A bullish spin on US-China Cold War. (6) Industry analysts expect earnings winners in 2022 to be in S&P 500 Industrials, Consumer Discretionary, and Energy sectors. (7) 2023 earnings laggards expected to be Financials and Materials. (8) Normal forward P/E converging with normalized forward P/E. (9) Reversal of fortune for banks as loan loss reserves get back to normal. (10) Joe knocked down Tesla's LTEG earlier this year. (11) Joe explains why LTEG is so high again.

Earnings I: Raising Estimates. S&P 500 operating earnings per share continue to outpace the consensus expectations of industry analysts, and ours too. So Joe and I are raising our estimates by \$10.00 each to \$205.00 this year and \$215.00 next year from our previous forecasts of \$195.00 and \$205.00 ([Fig. 1](#)). We expect earnings to grow 46.7% this year and 4.9% next year.

We are now targeting the S&P 500 to hit 5000 by the end of next year ([Fig. 2](#)). That would be a 13.8% increase from Friday's close. Consider the following:

(1) *Valuation assumption.* Our outlook for the S&P 500 assumes that the forward P/E of the index remains around 22.0, as it has since last spring ([Fig. 3](#)). If it does so, then S&P 500 forward earnings (i.e., the time-weighted average of analysts' consensus estimates for this year and next year) would have to rise 10.5% from \$205.72 currently (during the week of July 22) to \$227.27 ([Fig. 4](#)).

Our forward earnings projection seems plausible, not requiring much explanation. However, the forward P/E assumption may seem like a bit of a stretch. It may be hard to imagine that the forward P/E can remain as elevated as 22.0 through the end of 2022. Then again, it has remained remarkably stable at this level since last spring, notwithstanding concerns that the Fed's next move will be to tighten monetary policy (eventually) as well as uncertainty over whether this year's jump in inflation will be transitory or longer lasting.

(2) *Valuation boosters.* We are counting on ample Fed-led liquidity to continue to prop up

the elevated forward P/E even once the Fed starts tapering (eventually). We also expect that a rebound in productivity growth will offset inflationary pressures up ahead, boost real wages, and lift profit margins.

In addition, the heating up of the Cold War between the US and China may convince more global investors to invest in the US rather than in China. That's especially so if the Chinese government continues to tighten its regulatory stranglehold on the country's businesses, as Jackie and I discussed in Thursday's [Morning Briefing](#).

Our Roaring 2020s outlook is largely based on a technology-led business revolution in the US. That should offset the weak growth of the labor force resulting from a slowdown in the growth of the working-age population. In addition, the US-China Cold War will force businesses to bring supply chains back home; lots of technology will be required to make that happen both efficiently and cost effectively.

All this suggests that technology stocks and technology-related stocks, which have relatively high valuation multiples, could continue to gain market-cap share of the S&P 500. Joe and I have recently suggested that more and more low-tech companies effectively will be transformed into high-tech ones as they use more and more technology to boost their productivity.

(3) *Forward earnings*. You might be wondering why we are using our forecast of forward earnings at the end of next year (\$227.27 per share) to derive our 5000 target for the S&P 500 at the end of next year rather than using our new forecast of \$215 per share for all of 2022. It's because the stock market discounts analysts' consensus forward earnings, not our annual forecasts for earnings.

By the end of next year, the market will be discounting forward earnings for 2023, which will be the same as analysts' consensus estimates for 2023. That could easily be \$227.27, or 5.7% above our 2022 estimate.

(4) *Profit margin*. We should mention that our calculations lead us to an even more bullish outlook for profit margins, since we are sticking with our S&P 500 revenues-per-share forecasts of \$1,600 this year and \$1,650 next year, i.e., growth rates of 17.7%% and 3.1% ([Fig. 5](#)).

As a result, our profit margin forecasts rise to 12.8% and 13.0% in 2021 and 2022 ([Fig. 6](#)). That's not outlandish given that the profit margin rose to a record 13.5% during Q1-2021.

Companies with higher valuation multiples and higher profit margins are gaining market-cap weight in the S&P 500. The result is a higher valuation multiple and a higher profit margin for the S&P 500. That's bullish for stocks. (See our [YRI S&P 500 Earnings Forecast](#).)

Earnings II: 2022 Is Coming. As we enter the dog days of summer, we decided to flip the calendar and look at what analysts expect for S&P 500 sector and industry earnings in 2022. A few things jump out. First, analysts remain optimistic about overall earnings growth. They're calling for the S&P 500 to grow earnings 10.4% in 2022, an admirable showing after the 40.8% surge expected this year. As mentioned above, we're calling for earnings per share to rise 4.9% next year.

Second, the earnings winners and losers amid the S&P 500 sectors change quite a bit next year. Analysts see earnings growth slowing sharply in the Materials sector and turning negative in the Financial Services sector, but remaining strong in Industrials, Consumer Discretionary, and Energy.

Here's the expected-earnings-growth derby for the S&P 500 and its 11 sectors' in 2021 and 2022: Industrials (87.4% in 2021, 35.8% in 2022), Consumer Discretionary (76.8, 30.9), Energy (returning to a profit, 28.9), Communication Services (24.2, 13.2), Information Technology (30.1, 11.3), S&P 500 (40.8, 10.4), Utilities (0.9, 7.7), Consumer Staples (8.3, 7.6), Health Care (19.4, 5.2), Real Estate (6.4, 4.7), Materials (71.5, 0.8), and Financials (53.7, -5.3).

Here's a quick look at the causes behind the expected leadership shuffle among the sectors next year:

(1) *Boeing's earnings takeoff.* The Industrials sector finds itself in a leading role thanks in part to the Aerospace & Defense industry, which is expected to grow earnings by 58.2% this year and 31.6% in 2022. Boeing, one of the industry's largest constituents, is bouncing back from the problems with its 737 MAX airplane and the lack of demand for large planes for international travel due to Covid-19. Analysts are calling for Boeing's earnings to rebound from a loss of \$0.92 a share this year to a profit of \$5.67 a share next year. Estimates have been rising in response to a surprise Q2 profit reported on Wednesday.

The S&P 500 Aerospace & Defense stock price index has rebounded from its 2020 lows, but it has yet to surpass the highs reached in February 2020 ([Fig. 7](#)). Analysts expect the industry's revenue to jump by 8.9% next year and its earnings to climb 31.6% ([Fig. 8](#) and

[Fig. 9](#)). The industry's forward P/E of 21.1 remains near its highest levels of the past 25 years, but we imagine it will fall as earnings continue to improve next year ([Fig. 10](#)).

Industrial Conglomerates—home to giants like GE, Honeywell International, and 3M—is also expected to enjoy an earnings rebound. The industry's earnings, which fell 36.6% last year, are expected to climb by 32.4% this year and 23.7% in 2022 ([Fig. 11](#)). Here too, the S&P 500 Industrial Conglomerates stock price index has rebounded sharply from its 2020 lows but has yet to surpass its June 2017 high-water mark ([Fig. 12](#)).

(2) *Amazon and cars lead.* The Consumer Discretionary sector stays on top in 2020, helped by the Internet & Direct Marketing Retail industry, Automobile Manufacturers, and Auto Parts & Equipment. Earnings in the apparel-related industries also are set to have solid 2022 earnings growth as we all emerge from our Covid-19 bunkers: Footwear (17.2%), Apparel & Accessories (17.1), and Apparel Retail (16.5).

In Amazon's first earnings report since Jeff Bezos stepped down as CEO, the company reported Q2 earnings that beat expectations but provided a Q3 forecast that disappointed, as consumers are finding things to do in a reopened economy besides shop online. The shares fell 7.6% on Friday, and analysts have been trimming their earnings forecasts. This year's earnings-per-share forecast is \$53.56, down from \$55.82 a month ago, and 2022 earnings are expected to come in at \$68.45 per share, down from \$73.04 a month ago. Even after recent estimate reductions, Amazon's earnings are forecast to rise 27.8% next year.

These moves do imply that the earnings growth forecasts for the S&P 500 Internet & Direct Marketing Retail industry of 33.2% this year and 29.4% in 2022 will also see trimming in upcoming weeks ([Fig. 13](#)). This industry's stock price index has fallen 10.5% ytd from its record high on July 8, officially placing it in correction territory ([Fig. 14](#)).

While the semiconductor chip shortage has been a headache for S&P 500 Automobile Manufacturers, it likely pushed the sales of vehicles that are currently unavailable into 2022. Industry earnings are expected to climb 78.8% this year and 22.2% in 2022, after falling 11.6% last year ([Fig. 15](#)).

(3) *Energy companies enjoy the bounce.* Energy-related industries are forecast to turn in some of the fastest earnings growth next year. The price of Brent crude oil futures, at a recent \$76.05, has held onto its gains from the past year even after news that OPEC+ plans to raise crude oil production ([Fig. 16](#)).

The S&P 500 industry expected to post the strongest earnings growth in 2022 is Oil & Gas Refining & Marketing (485.9%), as it continues to rebound from losses in 2020. Strong 2022 earnings growth is also expected from Oil & Gas Equipment & Services (60.4), Oil & Gas Exploration & Production (23.1), and Integrated Oil & Gas (17.7).

(4) *Materials & Financials reverse.* The strong earnings gains enjoyed by the S&P 500 Materials and Financials sectors in 2021 will end next year if analysts are right. Despite current signs of inflation, earnings in numerous commodity industries are expected to turn negative or slow to mid-single-digit growth in 2022.

After surging by 426.1% this year, the S&P 500 Steel industry's earnings are forecast to drop 49.5% in 2022. Likewise, Commodity Chemicals earnings are expected to tumble 19.1% next year after jumping 270.6% this year.

Here are the S&P 500 Materials industries with earnings growth projected to slow but stay in positive territory next year: Gold (32.8% in 2021, 5.1% in 2022), Diversified Chemicals (41.5, 5.8), and Fertilizers & Agricultural Chemicals (68.4, 5.8). One exception is the Copper industry. Even after earnings growth of 452.3% this year, the Copper industry is expected to turn in solid earnings growth of 17.1% in 2022.

The reserve releases that boosted Financials' earnings this year don't repeat in 2022. Instead, the sector continues to be plagued by perennially low interest rates, and it might face an even flatter yield curve if the market starts pricing in Fed tightening by the end of next year. Analysts are expecting Financials will be the worst performing S&P 500 sector next year.

Here are earnings growth forecasts for some of the sector's industries: Diversified Banks (97.4% in 2021, -14.9% in 2022), Investment Banking & Brokerage (53.8, -14.2), Consumer Finance (205.9, -8.8), and Regional Banks (33.9, -5.2).

Earnings III: Normal Forward P/E Has Normalized. When the US economy was shut down due to Covid-19 last year, analysts reacted by slashing their earnings forecasts. Forward P/Es based on estimated 12-months-ahead earnings jumped sharply, making valuations appear extremely elevated.

In the May 20, 2020 [Morning Briefing](#), we introduced a normalized forward P/E to show that the market wasn't as overvalued as it appeared. We looked past the depressed earnings

and calculated expected earnings for the 12-month period ending 18 months ahead. Twelve months' worth of earnings ending 18 months ahead are typically higher than those ending 12 months ahead. During September 2020, the forward P/E based on the latter was indeed a record-high 13% higher than our normalized P/E then ([Fig. 17](#)).

Today, with the US economy once again open for business, consensus earnings expectations are rebounding to new highs. The spread between the forward P/E and the normalized P/E based on earnings ending 18 months ahead is back to normal for the S&P 500 and for most sectors.

However, since the Q2 earnings season started, the spread has actually turned negative for the S&P 500 Financial Services sector due to higher-than-expected earnings from banks' reversal of loan loss reserves taken during 2020. With earnings expected to decline for Financials, its forward P/E of 13.8 rises to 14.0 on a normalized basis. Strange days, indeed ([Fig. 18](#)).

Earnings IV: Long-Term Growth Expectations Up, Again. The S&P 500's expected long-term earnings growth (LTEG) has been soaring again. During the week ending July 22, industry analysts collectively were expecting the 500 companies in the index to produce LTEG of 21.2% over the next five year. That's way up from 15.4% during the week of February 11 and almost back to its record high of 23.9% during the week of February 4 ([Fig. 19](#)). Why? Consider the following:

(1) *Joe's timely call.* Expected LTEG soared after Tesla was added to the S&P 500 on December 21, 2020. Following the February 4 record high for expected LTEG, Joe sent a note to his contacts at I/B/E/S. He questioned whether Tesla's consensus expected LTEG median forecast of 409% was still timely considering that the company was graduating from hyper-growth to fast growth and noted the impact of that consensus growth estimate on the S&P 500's LTEG.

I/B/E/S polled the analysts again, and they revised Tesla's LTEG much lower, to 45% from 409%. This revision, along with the decline in Tesla's market cap, caused the S&P 500's expected LTEG to drop to 15.4% during the February 11 week from its 23.9% record high the week before.

(2) *LTEG's NERI.* The rise since the February 11 week to the S&P 500's current 21.2% reading is impressive. But what accounts for the strength? To dig deeper into what was going on, Joe applied our NERI (net earnings revisions index) formula to the S&P 500's

LTEG estimate ([Fig. 20](#)). This index ignores the size of a company and compares the net number of the forecasts raised or lowered to the total number of forecasts.

The NERI for expected LTEG has racked up some impressive readings since it turned positive in August 2020 for the first time since late 2018. Last month, a record-high 20.9% of estimates were revised higher, which has since eased to a still-impressive 19.9% during July.

(3) *Roaring 2020s Earnings Boom Ahead?* A long-term earnings boom is very possible; it has happened before. Using I/B/E/S data from Refinitiv, we see that the actual trailing LTEG exceeded 15% from 1990-1991, 1995-2002, and 2006-2009 ([Fig. 21](#)). It has averaged at an annual rate of 12.6% since 1985 ([Fig. 22](#)).

Joe explains that the actual trailing LTEG is based on the annualized rate of change in the weighted average of I/B/E/S' operating earnings per share over the last five years, using the last 20 quarters of earnings per share. It is updated weekly because the time weighting changes each week.

Following the Covid-19 economic shutdown, companies went into crisis mode and reorganized their businesses to survive. This positioned companies for even greater profitability when the economy recovered, as witnessed by the S&P 500's surge to a record-high profit margin during Q1-2021. Consumers also have made notable changes to their living, working, and buying habits. The effects of these shifts bode well for future profitability; we believe that accounts for the recent strength in the S&P 500's LTEG.

(4) *Reasonable LTEG For Mag-5 Plus the Next Five.* Here are the current LTEG rates for the Mag-5 companies and the next five biggest, in descending market-cap order: Apple (19%), Microsoft (18), Amazon (40), Alphabet (21), Facebook (24), Berkshire Hathaway (not available), Tesla (45), Visa (19), NVIDIA (27), and JPMorgan Chase (3).

(5) *Did These Analysts Miss the LTEG Memo?* LTEG is meant to be a secular growth rate, normalized over course of business cycle, rather than based on a particular year's historical earnings. It appears that some analysts didn't get the memo given the gargantuan LTEG they estimate for these companies—the five S&P 500 firms with the highest LTEG: General Electric (330%), Hilton Worldwide (279), Booking Holdings (209), SBA Communications (179), and TJX (126).

Here are the lowest-LTEG firms: MGM Resorts (-175%), Wynn Resorts (-120), Marathon Oil

(-78), Expedia (-15), Philips 66 and Laboratory Corp (both at -11). Negative growth rates might suggest those companies will be out of business shortly, but that's hard to believe. More likely, the analysts got the sign wrong in their spreadsheet formula.

Calendars

US: Mon: Construction 0.4%, ISM M-PMI 60.9, Motor Vehicle Sales. **Tues:** Factory Orders 1.0%, API Weekly Crude Oil Inventories. (Bloomberg estimates)

Global: Mon: Eurozone, Germany, France, Italy, and Spain M-PMIs 62.6/65.6/58.1/61.5/59.5, Germany Retail Sales 2.0%/m/m/-2.2%/y/y. **Tues:** Australia Retail Sales -1.8%, RBA Interest Rate Decision 0.10%. (Bloomberg estimates)

Strategy Indicators

Global Stock Markets Performance ([link](#)): Last week saw the US MSCI index fall 0.5% and end the week 0.6% below its record high on Monday. The US ranked 31st of the 49 global stock markets that we follow in a week when 27 of the 49 countries rose in US dollar terms. The AC World ex-US index fell 0.3% as the regions were mixed. EMEA was the best-performing region last week with a gain of 2.2%, ahead of EM Eastern Europe (2.0%), EAFE (0.6), and EMU (0.6). BRIC (-4.2) was the biggest underperformer, followed by EM Asia (-3.5), and EM Latin America (-1.0). Turkey was the best-performing country last week with a gain of 5.7%, followed by Hungary (4.3), Greece (3.8), and the Czech Republic (3.3). Peru was the worst performer with a decline of 7.1%, followed by China (-6.1), the Philippines (-3.5), and Jordan (-3.5). In July, the US MSCI rose 2.3% and ranked 10/49 as the AC World ex-US index underperformed with a drop of 1.8%. Twenty-one of the 49 countries moved higher in July as nearly all regions fell. Egypt was the best performer with a gain of 7.0%, followed by Argentina (6.4), Turkey (6.4), and Finland (5.9). The worst-performing countries in July: China (-14.1), the Philippines (-11.7), Peru (-9.1), and Thailand (-6.9). EMU rose 1.2% in July, ahead of EAFE (0.7), EMEA (-0.1), EM Eastern Europe (-1.4), and the AC World ex-US (-1.8). BRIC was July's worst-performing region with a drop of 10.1%, followed by EM Asia (-8.4) and EM Latin America -4.2). The US remains the top-performing region so far in 2021 with a gain of 16.7%, ahead of EMEA (16.3), EM Eastern Europe (14.4), EMU (11.6), EAFE (8.1), and the AC-World ex-US (5.9). The following

regions are lagging: BRIC (-6.1), EM Asia (-3.6), and EM Latin America (2.4). The top-performing countries ytd: Jordan (26.7), the Netherlands (23.9), Austria (22.6), Sweden (21.3), and the Czech Republic (20.1). The biggest laggards of 2021 so far: Peru (-26.3), Colombia (-23.1), Turkey (-18.4), New Zealand (-16.4), and the Philippines (-15.7).

S&P 1500/500/400/600 Performance ([link](#)): LargeCap dropped 0.4% last week, trailing the gains for SmallCap (1.7%) and MidCap (1.2). LargeCap ended the week 0.6% below its record high on Monday, while MidCap and SmallCap improved to 2.4% and 5.2% below their respective record highs on May 7 and June 8. Twenty-eight of the 33 sectors were higher for the week, up from 26 rising a week earlier. MidCap Materials rose 3.9% for the best performance for the week, followed by SmallCap Materials (3.7%), SmallCap Tech (3.7), LargeCap Materials (2.8), and SmallCap Industrials (2.5). LargeCap Consumer Discretionary was the worst performer with a decline of 2.6%, followed by LargeCap Communication Services (-1.0) and LargeCap Tech (-0.7). LargeCap rose 2.3% during July, ahead of MidCap (0.3) and SmallCap (-2.4) as 17 of the 33 sectors rose. July's best performers: SmallCap Utilities (5.0), LargeCap Health Care (4.7), LargeCap Real Estate (4.6), LargeCap Utilities (4.2), and MidCap Real Estate (3.9). July's biggest decliners: SmallCap Energy (-15.4), LargeCap Energy (-8.4), MidCap Energy (-7.6), SmallCap Consumer Staples (-4.8), and SmallCap Communication Services (-4.6). SmallCap continues to lead so far in 2021 with a gain of 19.9%, ahead of MidCap (17.2) and LargeCap (17.0). Thirty-two of the 33 sectors are higher ytd, paced by these best sector performers: SmallCap Energy (54.1), MidCap Energy (39.9), SmallCap Consumer Discretionary (38.7), LargeCap Energy (30.4), and LargeCap Real Estate (27.3). The biggest laggards so far in 2021: MidCap Communication Services (-1.0), LargeCap Utilities (5.0), LargeCap Consumer Staples (6.1), MidCap Consumer Staples (6.6), and MidCap Tech (7.6).

S&P 500 Sectors and Industries Performance ([link](#)): Seven of the 11 S&P 500 sectors rose last week and eight outperformed the composite index's 0.4% decline. That compares to a 2.0% gain for the S&P 500 a week earlier, when nine sectors rose and four outperformed the index. Materials rose 2.8% for the biggest gain of the week, ahead of Energy (1.6%), Financials (0.7), Health Care (0.5), Utilities (0.3), Real Estate (0.3), Consumer Staples (0.2), and Industrials (-0.2). The worst performers this week: Consumer Discretionary (-2.6), Communication Services (-1.0), and Tech (-0.7). The S&P 500 rose 2.3% in July as nine sectors moved higher and six beat the broader index. That compares to six rising in June, when five beat the S&P 500's 2.2% gain. The leading sectors in July: Health Care (4.7), Real Estate (4.6), Utilities (4.2), Tech (3.8), Communication Services (3.4), and Consumer Staples (2.4). July's market underperformers: Energy (-8.4), Financials

(-0.6), Consumer Discretionary (0.5), Industrials (0.8), and Materials (2.0). With respect to 2021's performance, the S&P 500 has risen 17.0% so far, with all 11 sectors higher ytd and five beating the broader index. The leading sectors so far in 2021: Energy (30.4), Real Estate (27.3), Financials (23.7), Communication Services (23.2), and Tech (17.6). This year's laggards to date, albeit with gains: Utilities (5.0), Consumer Staples (6.1), Consumer Discretionary (10.5), Materials (15.7), Health Care (16.2), and Industrials (16.6).

S&P 500 Technical Indicators ([link](#)): The S&P 500 fell 0.4% last week and weakened relative to its 50-day (50-dma) and 200-day moving average (200-dma). It was above its 50-dma for a sixth week after dropping below a week earlier for the first time since February. It was above its 200-dma for a 57th straight week last week after being below for 13 weeks through late May of 2020. The S&P 500's 50-dma rose last week for a 38th straight week. The price index dropped to 2.5% above its rising 50-dma from 3.5% a week earlier. That compares to an eight-month low of 0.4% below its rising 50-dma during mid-June and is still down from its 19-week high of 5.8% above during mid-April. The index mostly has been trading above its 50-dma since late April 2020; in June 2020, it was 11.7% above, which was the highest since its record high of 14.0% in May 2009. That compares to 27.7% below on March 23, 2020—its lowest reading since it was 29.7% below on Black Monday, October 19, 1987. The price index was above its 200-dma for a 57th week, but dropped to 11.1% above its rising 200-dma from 12.2% above a week earlier. It had been at an eight-month low of 9.2% during mid-June. That compares to 17.0% above in early December, which was the highest since November 2009 and up from the 26.6% below registered on March 23—the lowest reading since March 2009. At its worst levels of the Great Financial Crisis, the S&P 500 index was 25.5% below its 50-dma on October 10, 2008 and 39.6% below its 200-dma on November 11, 2008.

S&P 500 Sectors Technical Indicators ([link](#)): Nine S&P 500 sectors traded above their 50-dmas last week, up from eight a week earlier and down from ten in early June. Materials moved back above in the latest week after six weeks below. Energy was below for a fourth week and Financials for a fifth week. That compares to all 11 sectors above at the beginning of May and just four above at the end of January. Three sectors have a falling 50-dma now, up from four a week earlier and up from just one sector with a falling 50-dma the week before that. Industrials has a rising 50-dma now, leaving these three sectors in the falling 50-dma doghouse last week: Energy, Financials, and Materials. Looking at the more stable longer-term 200-dmas, all 11 sectors traded above them for a 21st straight week, and all have had rising 200-dmas for a 20th straight week. For perspective, back in April 2020, just one sector (Health Care) was trading above its 200-dma. Energy's 200-dma finally turned higher in mid-December after mostly falling since October 2018.

US Economic Indicators

GDP ([link](#)): Real GDP growth for Q2 was weaker than expected, but strong enough to reach a new record high—0.8% above the previous record high during Q4-2019. Real GDP expanded 6.5% (saar)—below consensus estimates of an 8.4% increase—following a revised 6.3% gain during Q1, which was a tick below the previous estimate of 6.4%. Real GDP is up 12.2% since bottoming during Q2-2020. Inflation accelerated at its fastest pace in four decades during Q2, with the GDP deflator picking up from 2.2% (saar) during Q4-2020 to 6.0% last quarter—the biggest quarterly increase since Q4-1981. Consumer spending led real GDP growth last quarter, soaring 11.8% (saar), after a nearly identical gain of 11.4% during Q1. Real consumer spending on services accelerated 12.0% (saar)—triple Q1's gain, while goods consumption advanced 11.6%, less than half Q1's 27.4%. The former was led by food services & accommodations, while the latter was boosted by nondurable goods spending, notably on pharmaceutical products. Real nonresidential investment grew 8.0% (saar) during Q2, slower than Q1's 12.9%, though impressive since spending on structures contracted 7.0% (saar). Double-digit gains in spending on equipment (13.0%, saar) and intellectual property products (10.7) more than offset the decline in the structures component. In the meantime, real residential investment fell for the first time in four quarters, contracting 9.8% (saar) last quarter. As for trade, real exports rose 6.0% (saar) last quarter, while growth in real imports grew faster at 7.8%. The increase in real exports was led by non-automotive capital goods, while the 7.8% increase in services was driven by travel. Real inventory investment showed a further liquidation during Q2, falling to -\$165.9 billion from -\$88.3 billion during Q1, driven by a decline in retail inventories. Inventory investment was at \$88.8 billion during the final quarter of 2020. Real government spending contracted 1.5% (saar) during Q2, led by a 5.0% drop in federal government spending, primarily nondefense (-10.4%, saar) outlays; state & local government spending increased 0.8% (saar) after a 0.1% downtick during Q1.

Contributions to GDP Growth ([link](#)): Real consumer spending was by far the biggest positive contributor to Q2 real GDP growth, with capital spending the only other positive contributor; inventory investment was the biggest negative drag. 1) Real consumer spending added 7.78ppts to Q2 GDP—with services consumption contributing 5.10ppts and goods consumption contributing 2.68. Within goods consumption, nondurable (1.81ppt) goods had the biggest contribution, though durable goods (0.87ppts) added nearly a full percentage point. 2) Real nonresidential investment contributed 1.06ppt, as positive contributions from equipment (0.70ppt) and intellectual property products (0.54) more than

offset the negative contribution from structures (-0.18). 3) Government (-0.27ppt) spending subtracted from GDP growth for the third time in four quarters, with federal spending deducting 0.36ppt, while state & local government spending contributed 0.09ppt. 4) Real net exports (-0.44ppt) subtracted from GDP growth for the fourth consecutive quarter after adding to growth three of the prior four quarters, with real imports (-1.09ppt) accounting for all of the negative contribution from this component; exports added 0.64ppt. 5) Real residential investment (-0.49ppt) subtracted from GDP growth for the first time in four quarters, and only the second time since Q4-2018. 6) Inventory investment (-1.13ppts) was a big drain on real GDP growth for the second consecutive quarter after contributing positively the previous two quarters.

Personal Income & Consumption ([link](#)): Personal income unexpectedly increased in June as a gain in wages & salaries helped to offset a decline in government social benefits. Personal income edged up 0.1% in June after contracting 2.3% and 13.6% the prior two months. Wages & salaries rose for the 13th month since bottoming last April, expanding 0.8% in June and 16.1% over the period to a new record high. Meanwhile, overall government social benefits fell for the third month, by 2.7% m/m and 50.6% over the period—mainly reflecting declines in “other” social benefits and unemployment insurance. The pace has slowed from April’s 42.2% drop, which had dragged overall personal income down 13.6% that month. A 98.2% jump in these benefits in March had boosted personal income by 21.0% during that month. Meanwhile, the 0.8% increase in wages & salaries in June, coupled with the \$161.1 billion drop in personal saving, helped boost June consumer spending by 1.0% to yet another record high. Real consumer spending rebounded 0.5% in June from May’s 0.6% drop, back within a fraction of April’s record high. The personal consumption deflator rose 0.5% in June and 4.0% y/y, the highest yearly rate since August 2008, with goods and services up 5.2% and 3.3% y/y, respectively. Here’s a look at the components on a monthly and a yearly basis in June: durable goods (1.0% m/m & 7.2% y/y), nondurable goods (0.6 & 4.1), and services (0.4 & 3.3).

Consumer Sentiment Index ([link](#)): “Consumer sentiment edged upward at the end of July, although it still posted a monthly decline of 5.0%. The largest monthly declines remained concentrated in the outlook for the national economy and complaints about high prices for homes, vehicles, and household durables,” according to Richard Curtin, the Survey of Consumers’ chief economist. The one-year expected inflation rate soared to 4.7%—the highest since August 2008. It was at 3.0% a year ago. The five-year expected inflation rate remains on an accelerating trend, though the rate held at 2.8% in July, down from 3.0% in May; it was as low as 2.4% in October. The Consumer Sentiment Index (CSI) sank to a five-month low of 81.2 in July (up from 80.8 in mid-month) after climbing from 82.9 to 85.5 in

June. The present situation component of the CSI declined for the third month from 97.2 in April to a 11-month low of 84.5 this month, while the expectations component remains in a volatile flat trend, dropping to 79.0 (up from 78.4 mid-month) after advancing from 78.8 to 83.5 in June. The headline CSI is 19.8 points below its pre-pandemic level, while the present situation and expectations components are 30.3 points and 13.1 points below.

Pending Home Sales ([link](#)): “Pending sales have seesawed since January, indicating a turning point for the market,” said Lawrence Yun, NAR's chief economist. “Buyers are still interested and want to own a home, but record-high home prices are causing some to retreat. The moderate slowdown in sales is largely due to the huge spike in home prices.” The Pending Home Sales Index (which tracks sales when a contract is signed, but the transaction has not yet closed) fell 1.9% in June on both a monthly and year-over-year basis. June’s decline followed an 8.3% rebound in May from April’s 4.4% drop. Regionally, sales were mixed on a month-over-month basis, while only the Northeast saw an increase versus a year ago; here’s a look: Northeast (+0.5% m/m & +8.7% y/y), Midwest (+0.6 & -2.4), South (-3.0 & -4.7), and West (-3.8 & -2.6). Yun forecasts that mortgage rates will start to edge up toward the end of the year. “The rise will soften demand and cool price appreciation.”

Global Economic Indicators

Eurozone Economic Sentiment Indicators ([link](#)): Economic Sentiment Indexes (ESIs) for both the EU (+0.9 points to 118.0) and Eurozone (+1.1 points to 119.0) continued to climb in July, with both reaching new record highs! They were 14.1 points and 15.0 points, respectively, above their pre-pandemic levels. Four of the six largest EU economies saw gains in their ESIs last month, with France (+4.0 points to 116.7) posting the largest advance, followed by Italy (+1.7 to 119.6), Spain (+1.7 to 108.9), and Germany (+0.3 to 117.5), with Germany’s hitting a new record high. Meanwhile, ESIs for the Netherlands (-0.3 to 113.4) and Poland (-0.7 to 106.2) took a step back. For the overall Eurozone, at the sector level, industrial confidence has increased every month but one since bottoming in April 2020, rebounding 47.1 points over the period to a new record high of 14.6, while services’ confidence posted its sixth successive increase, climbing from -17.7 at the start of this year to 19.3 in July—the highest since April 2007. The remaining three sectors all remain on a steep upward trajectory, though dipped negligibly in July. Retail trade confidence was little changed at 4.6 after climbing steadily from -19.1 in February to 4.7 in June, which was the highest reading since December 2017. Construction sentiment slipped

to 4.0 in July after climbing the prior seven months from -9.0 in November to a 16-month high of 5.2 in June. Meanwhile, consumer confidence continues to improve, though more respondents are still reporting a decrease in sentiment rather than an increase. The measure started 2021 at -15.5 and was at -3.3 by June—the best reading since January 2018. It ticked down to -4.4 last month.

Eurozone GDP Flash Estimates ([link](#)): The Eurozone emerged from its pandemic-led recession during Q2, as an easing of Covid-related restrictions boosted growth. Economic activity in the Eurozone expanded at a larger-than-expected 2.0% last quarter, according to flash estimates, after a double-dip recession during Q4-2020 (-0.6%) and Q1-2021 (-0.3). Real GDP last quarter was 13.7% above a year ago but remains some 3.0% below pre-Covid levels. Portugal (+4.9) posted the biggest quarterly increase in economic growth last quarter, followed by Austria (+4.3) and Latvia (+3.7). Looking at the largest Eurozone economies, real GDP in Spain (2.8) and Italy (2.7) expanded at faster paces than in Germany (1.5) and France (0.9). Compared to a year ago, real GDP in Spain (19.8% y/y), France (18.7), and Italy (17.3) all posted double-digit gains, while Germany's (9.2) growth was in the high single digits, as supply-chain problems likely curbed Germany's growth given its large auto industry. Looking ahead, most forecasts are showing continued growth in the Eurozone during Q3 despite the Delta variant and continued supply-chain issues.

Eurozone CPI Flash Estimate ([link](#)): July's CPI headline rate is expected to accelerate 2.2% y/y, the highest since October 2018, after slowing from a then-30-month high of 2.0% in May to 1.9% in June. Looking at the main components, once again energy (to 14.1% from 12.6% y/y) is expected to post the biggest gain, posting its largest year-over-year increase since August 2008. Meanwhile, the yearly rate for food, alcohol & tobacco (to 1.6% from 0.5% y/y) is expected to triple from June's pace; the yearly increase in these prices had slowed steadily from 1.5% at the start of this year to 0.5% by May; they held at that rate in June. The services inflation rate is predicted to tick slightly higher in July, to 0.9% y/y, after slowing from 1.1% in May to 0.7% in June—which was the slowest since the end of 2020. The rate for non-energy industrial goods is expected to ease to 0.7% in July, after accelerating from 0.3% in March to 1.2% in June—the highest since the start of this year. This component has been extremely volatile.

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