



MORNING BRIEFING

August 9, 2021

Man of La Mancha

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

(1) *Buenos días*. (2) Finding relief in Spain from cabin fever at home. (3) The Running of the Bulls has been canceled in Pamplona, but not on Wall Street. (4) Soaring earnings continue to drive the stampede of the charging bulls. (5) SMidCaps are very cheap relative to LargeCaps. (6) Supply constraints weighing on M-PMI. (7) Lots of unfilled orders to keep economy growing. (8) Memo to Powell: Substantial progress in the labor market. (9) No sign yet that inflation rebound is transitory. (10) Wage inflation stampeding in two industries. (11) Movie review: "The Titans That Built America" (+ + +).

YRI Podcast. In our latest video [podcast](#), Dr. Ed discusses the main points of today's *Morning Briefing*.

Back from Spain. My wife and I vacationed in Spain last week. We both have had our Pfizer Covid-19 shots for a while now, which only intensified the cabin fever we contracted during last year's lockdowns. So notwithstanding the Delta variant, we ventured off to Spain. Before we flew back home, we had to take a Covid test, which we passed. So we are back in the USA. Our Plan B, had we flunked our tests and been denied reentry, was to rent a house on the beach in Porto, Portugal.

The first thing we did after landing in Madrid was to head to Zaragoza for a great tapas lunch. Zaragoza is the capital of Spain's Aragon region, which is very desert-like and very windy. Fields of wind turbines dotted both sides of the highways we took. Don Quixote would have had a field day. We then visited Pamplona, which is famous for the annual Running of the Bulls during the San Fermin festival. It was cancelled this year because of the pandemic. We might go back to see it next year during July 7-14. Given my year-end 2022 target of 5000 for the S&P 500, I expect to be running with the bulls next year.

Our tour included visiting Bilbao, León, Santander, and Segovia. They are all very beautiful cities, immaculately maintained, with magnificent old towns, cathedrals, palaces, plazas, and lots of outdoor cafés serving delicious *pinchos*. Segovia's ancient aqueduct is very impressive and a reminder of the ancient Romans' remarkable knack for building future tourist attractions in their empire.

Strategy: Running of the Bulls. While the Running of the Bulls was cancelled in Pamplona this summer, the bulls are still running on Wall Street. The S&P 500 rose to yet another record high on Friday. It closed at 4436.52, up 18.1% ytd and 98.3% from last year's March 23 low. A week ago, Joe and I did the math and came up with a year-end 2022 target of 5000 for the S&P 500. Let's take stock of the stock market's latest performance:

(1) *Blue Angels.* The S&P 500 price index is equal to S&P 500 forward operating earnings per share (E) multiplied by the S&P 500 forward price-to-earnings ratio (P/E). E is equal to S&P 500 forward revenues (R) multiplied by the forward profit margin ([Fig. 1](#)). During the week of July 29, R rose 13.6% y/y to another record high, while E jumped 42.2% y/y to another record high of \$212.68 per share. The forward profit margin was 13.1%, remaining at its recent record high.

The forward P/E was 20.9 on Friday ([Fig. 2](#)). It had soared from last year's low of 12.9 on March 23 to a high of 23.2 on September 2. It has been hovering around 21.0 since then.

Joe and I monitor the relationship between $PE \times E$ and the S&P 500 with our Blue Angels framework. It shows that last year's rebound in stock prices was led by the P/E until E bottomed during the week of May 15, 2020 ([Fig. 3](#)). E is up 50.8% since then, while the S&P 500 is up 54.9% over the same period. In other words, the remarkable rebound in forward earnings has been leading the bull market's charge since last spring and continues to do so. On a y/y basis, the S&P 500 is up 32.3%, with E up 42.2% and the P/E down 5.2% ([Fig. 4](#)).

(2) *Quarterly and annual earnings.* Meanwhile, this year's quarterly S&P 500 earnings continue to stampede over the consensus forecasts of industry analysts. The Q1 results were 23.6% better than they expected at the start of that quarter's earnings reporting season ([Fig. 5](#)). The latest blend of actual and estimated results for Q2 during the July 29 week is 13.5% above the consensus estimate before the start of the latest season. The latest y/y earnings growth rate for Q2 is 82.1% ([Fig. 6](#)).

As a result, industry analysts have been raising their Q3 (now up 26.9% y/y) and Q4 (19.8%) earnings-per-share estimates for this year as well as for each of 2022's quarters ([Fig. 7](#)). Here are their latest annual estimates: 2021 (\$200.53), 2022 (\$221.59), and 2023 (\$239.69) ([Fig. 8](#)). Industry analysts now are expecting earnings to grow 43.8% this year, 9.5% in 2022, and 8.2% in 2023 ([Fig. 9](#)). They are expecting revenues to grow 14.0% this

year, 6.6% next year, and 5.1% in 2023 ([Fig. 10](#)). As a result, they are projecting that the profit margin will increase from 12.9% this year to 13.2% in 2022 and 13.8% in 2023 ([Fig. 11](#)).

(3) *Sectors*. The rebound in forward earnings is widespread among the 11 sectors of the S&P 500 ([Fig. 12](#)). At new record highs during the July 29 week were Consumer Discretionary, Consumer Staples, Health Care, Information Technology, and Materials. Just as impressive has been the rebound in the forward profit margins of the sectors ([Fig. 13](#)). In our opinion, this confirms that companies have been responding to the pandemic by accelerating their use of technological innovations to boost productivity, offsetting the higher costs resulting from soaring commodity prices and shortages of labor and parts.

(4) *LargeCaps vs SMidCaps*. The rebound in the forward earnings of the S&P 400/600 SMidCaps has outpaced that of the S&P 500 since last spring ([Fig. 14](#)). However, the LargeCaps have outperformed the SMidCaps since March 15 this year. The recent spreads between the forward P/Es of the former to the latter have never been wider, at around 3.5ppts ([Fig. 15](#)). In our opinion, SMidCaps are very attractive.

(5) *Growth vs Value*. The ratio of the forward earnings of S&P 500 Growth to S&P 500 Value soared last year but has been relatively flat since last September ([Fig. 16](#)). That's reminiscent of what occurred during and after the Great Financial Crisis. That suggests that the currently very wide spread (11.7ppts) between the forward P/Es of Growth (28.4) and Value (16.7) may be too wide ([Fig. 17](#)). Growth includes lots of fast growing technology companies. But Value includes many companies that are using technology to boost their productivity and profit margins.

(6) *Stay Home vs Go Global*. While my wife and I ventured abroad last week for a sightseeing vacation in Spain, Joe and I continue to favor the Stay Home investment strategy over Go Global. It underperformed a bit last week, but the ratios of the US MSCI to the All Country World MSCI (in both dollars and local currencies) remain on solid upward trends that began in 2010 ([Fig. 18](#)).

US Economy: Not as Hot? The S&P 500 stock price index on a y/y basis is highly correlated with the manufacturing PMI ([Fig. 19](#)). That's because the M-PMI is highly correlated with the y/y growth rate in S&P 500 revenues ([Fig. 20](#)). The M-PMI peaked at a cyclical high of 64.7 during March. It was back down to 59.5 during July, in line with previous cyclical peaks in this index. The M-PMI is a diffusion index that reflects the m/m comparisons of business conditions by purchasing managers. Its recent weakness may be

reflecting a cooling in economic activity, though Debbie and I doubt that.

More likely, it reflects labor and parts shortages. That's confirmed by the M-PMI supplier deliveries and backlog of orders indexes, which remained elevated during July at 72.5 and 65.0 ([Fig. 21](#)). The M-PMI customer inventory index fell to a record low of 25.0 during the month ([Fig. 22](#)). The imbalance between supply constraints and strong demand is confirmed by the average of the unfilled orders or delivery times indexes in the five regional business surveys conducted by the Federal Reserve Banks ([Fig. 23](#)).

There's also plenty of forward momentum in durable goods orders excluding transportation ([Fig. 24](#)). It rose to yet another record high during June, exceeding the pre-pandemic February 2020 reading by 17.2%.

Oh, and by the way, the NM-PMI rose to a record high during July. It was 64.1, which topped the June reading by 4 percentage points and eclipsed the previous record of 64.0 in May 2021.

US Labor Market: Getting Hotter. Friday's employment report confirmed that the labor market—which has been one of the few laggards in the recovery from last year's lockdown recession—is getting hotter. Payroll employment jumped 943,000 during July, and June and May preliminary numbers were revised higher by a total of 119,000. The household measure of employment soared 1.0 million, led by a 1.3 million increase in full-time employment. The unemployment rate fell to 5.4% during July from 5.9% the month before. The number of unemployed fell 782,000 to 8.7 million, the lowest reading since March 2020. Job openings remain plentiful for those who remain jobless. Indeed, part-time employment for economic reasons fell to 4.5 million, the lowest since February 2020.

Importantly, our Earned Income Proxy (EIP) increased solidly by 0.9% m/m during July to another record high ([Fig. 25](#)). Our EIP is highly correlated with wages and salaries in personal income. Consumers have the wherewithal to keep spending. If many of them are still suffering the aftereffects of cabin fever from last year's lockdowns, then they should continue to spend.

US Inflation: Warming or Cooling? The 10-year US Treasury bond yield rose last week from a recent low of 1.19% on Tuesday and Wednesday to 1.31% on Friday. More Fed officials are distancing themselves from Fed Chair Jerome Powell's no-rush stance on tapering the Fed's bond purchases. Friday's employment report certainly suggests that enough "further substantial progress" has been made to start tapering sooner rather than

later.

Increasing the heat on the Fed to taper are plenty of inflation indicators, which have yet to confirm the “transitory” nature of the post-pandemic inflation story that Powell has been telling. Consider the following:

(1) *National prices-paid indexes*. The M-PMI prices-paid index edged down from a cyclical high of 92.1 during June to 85.7 during July ([Fig. 26](#)). That’s still very hot. The NM-PMI prices-paid index inched up to 82.3 last month, the highest reading since September 2005. The average of the five regional business surveys conducted by Federal Reserve Banks showed that the prices-paid index slipped from a record high of 84.1 during May to 81.9 during July ([Fig. 27](#)). On the other hand, the regional average of the five prices received indexes rose to a record high of 49.7 last month.

(2) *Commodity prices*. Both the CRB all commodities index and the CRB raw industrial spot price index remain on their near-vertical trajectories of the past year or so ([Fig. 28](#)).

(3) *Wages*. Notwithstanding the many stories about widespread labor shortages, most of the upward pressure on wages so far has been occurring in only two major industries, namely leisure & hospitality and transportation & warehousing. This can best be seen in the annualized three-month percent changes in average hourly earnings (AHEs) through July. The total index rose 4.9%, which isn’t particularly alarming, especially if productivity is making a comeback too ([Fig. 29](#)).

Here are the results for the major industries from highest to lowest: leisure & hospitality (15.7%), transportation & warehousing (12.1), professional & business services (7.1), manufacturing (5.6), other services (5.2), retail trade (4.8), financial activities (4.8), wholesale trade (4.6), construction (4.2), utilities (3.7), education & health services (3.4), natural resources (3.1), and information services (-0.3).

Movie. “The Titans That Built America” (+ + +) ([link](#)) is a History Channel docudrama series about the remarkable entrepreneurs who transformed American industry after World War I. The new generation of Titans included Pierre Du Pont, Walter Chrysler, JP Morgan Jr, Henry Ford, and William Boeing. They literally drove the prosperity of the Roaring 1920s by inventing the auto industry. However, FDR attacked them as “economic royalists” to get elected as president and blamed them for the Great Depression. He then had to do an about-face when he needed their skills to build an “arsenal of democracy” to defeat Hitler. They did so, producing tens of thousands of bombers and other weapons. One of the

remarkable heroes of this story is Edsel Ford.

Calendars

US: Mon: Job Openings 9.27m. **Tues:** Nonfarm Productivity & Unit Labor Costs 3.5%/1.2%, NFIB Small Business Optimism Index, MBA Delinquency Rates, API Crude Oil Inventories. (Bloomberg estimates)

Global: Mon: Eurozone Sentix Investor Confidence 29.0, Germany Trade Balance €13.4b. **Tues:** Germany ZEW Economic Sentiment & Current Conditions 57.0/30.0. (Bloomberg estimates)

Strategy Indicators

Global Stock Markets Performance ([link](#)): Last week saw the US MSCI index rise 0.9% and end the week at a new record high. The US ranked 22nd of the 49 global stock markets that we follow in a week when 31 of the 49 countries rose in US dollar terms. The AC World ex-US index gained 1.0% as nearly all regions rose. EM Asia was the best-performing region last week with a gain of 1.4%, ahead of EMU (1.3%), EMEA (1.2), and EAFE (1.0). EM Latin America (-0.7) was the biggest underperformer, followed by BRIC (0.5) and EM Eastern Europe (0.6). Argentina was the best-performing country last week with a gain of 6.9%, followed by the Philippines (4.0), Indonesia (3.9), Hungary (3.1), Korea (3.1), and Austria (3.1). Colombia was the worst performer with a decline of 3.2%, followed by Chile (-2.9), Jordan (-2.8), Israel (-2.0), and Thailand (-1.8). EMEA has risen 17.7% ytd and is now tied with the US as the top-performing region so far in 2021, ahead of EM Eastern Europe (15.1), EMU (13.1), EAFE (9.2), and the AC-World ex-US (7.0). The following regions are lagging: BRIC (-5.7), EM Asia (-2.2), and EM Latin America (1.6). The top-performing countries ytd: Austria (26.4), the Netherlands (25.6), the Czech Republic (23.5), Jordan (23.2), and Sweden (21.1). The biggest laggards of 2021 so far: Peru (-26.6), Colombia (-25.6), Turkey (-17.7), New Zealand (-14.7), and Malaysia (-14.5).

S&P 1500/500/400/600 Performance ([link](#)): SmallCap rose 1.1% last week, ahead of the gains for LargeCap (0.9%) and MidCap (0.5). LargeCap ended the week at a new record high, while MidCap and SmallCap improved to 1.9% and 4.1% below their respective record

highs on May 7 and June 8. Twenty-seven of the 33 sectors were higher for the week, down from 28 rising a week earlier. LargeCap Financials and MidCap Financials both rose 3.6% for the best performance for the week, followed by SmallCap Financials (3.3) and the 2.3% gain for these four sectors: SmallCap Communication Services, MidCap Utilities, SmallCap Utilities, and LargeCap Utilities. SmallCap Energy was the worst performer with a decline of 3.0%, followed by MidCap Health Care (-2.6), MidCap Materials (-1.6), and MidCap Consumer Staples (-1.1). SmallCap continues to lead so far in 2021 with a gain of 21.2%, ahead of LargeCap (18.1), and MidCap (17.8). All 33 sectors are higher ytd, paced by these best sector performers: SmallCap Energy (49.5), MidCap Energy (41.0), SmallCap Consumer Discretionary (38.0), LargeCap Energy (30.8), and SmallCap Communication Services (28.9). The biggest laggards so far in 2021: MidCap Communication Services (1.1), MidCap Consumer Staples (5.4), LargeCap Consumer Staples (5.5), LargeCap Utilities (7.4), and MidCap Tech (8.1).

S&P 500 Sectors and Industries Performance ([link](#)): Ten of the 11 S&P 500 sectors rose last week, but just two outperformed the composite index's 0.9% gain. That compares to a 0.4% decline for the S&P 500 a week earlier, when seven sectors rose and eight outperformed the index. Financials rose 3.6% for the biggest gain of the week, ahead of the 2.3% gain for Utilities. The worst performers this week: Consumer Staples (-0.5%), Materials (0.2), Industrials (0.2), Energy (0.3), Consumer Discretionary (0.4), Health Care (0.7), Real Estate (0.7), Communication Services (0.7), and Tech (0.9). With respect to 2021's performance, the S&P 500 has risen 18.1% so far, with all 11 sectors higher ytd and five beating the broader index. The leading sectors so far in 2021: Energy (30.8), Financials (28.2), Real Estate (28.2), Communication Services (24.1), and Tech (18.7). This year's laggards to date, albeit with gains: Consumer Staples (5.5), Utilities (7.4), Consumer Discretionary (10.9), Materials (15.9), Industrials (16.8), and Health Care (17.0).

S&P 500 Technical Indicators ([link](#)): The S&P 500 rose 0.9% last week and improved relative to its 50-day (50-dma) and 200-day moving average (200-dma). It was above its 50-dma for a seventh week after dropping below a week earlier for the first time since February. It was above its 200-dma for a 58th 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 39th straight week. The price index improved to 2.9% above its rising 50-dma from 2.5% a week earlier. That compares to an eight-month low of 0.4% below its rising 50-dma during mid-June; the index 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 58th week last week, as it improved to 11.4% above its rising 200-dma from 11.1% 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](#)): Ten of the 11 S&P 500 sectors traded above their 50-dmas last week, up from nine a week earlier and the highest count since June 10. Financials moved back above in the latest week after five weeks below, and Energy was below 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. Four sectors have a falling 50-dma now, up from three a week earlier. Industrials moved back below in the latest week and joined 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 22nd straight week, and all have had rising 200-dmas for a 21st 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

Employment ([link](#)): Employment in July was once again stronger than expected, with nonfarm payrolls rising at an 11-month high of 943,000 while there were upward revisions to both June (to 938,000 from 850,000) and May (614,000 from 583,000) payrolls for a net gain of 119,000! Total payroll employment has recovered 16.7 million jobs since bottoming last April, though is still 5.7 million jobs below its pre-pandemic level. Private payrolls expanded 703,000, with revisions in June (to 769,000 from 662,000) and May (555,000 from 516,000) adding 146,000 jobs. Service-providing companies added 659,000 jobs in July, while goods-producing firms added 44,000. In July, leisure & hospitality (380,000) employment once again led the pack—with two-thirds of the gain occurring in food services & drinking places (253,000). Education jobs were in the black, with jobs in local government education soaring 221,000, while private education ones rose by 40,000. Employment in professional and business services climbed by 60,000, led by a 43,000 jump in professional & technical services, which accounted for more than 70% of the increase. Also posting

impressive gains were transportation & warehousing (50,000), other services (39,000), health care (37,000), manufacturing (27,000), information services (24,000), and financial activities (22,000). Here's a tally of industry performances from strongest to weakest since bottoming last April, and where they stand relative to last February's pre-pandemic levels: leisure & hospitality (+6.5 million & -1.7 million), retail trade (+2.1 million & -270,300), professional & business services (+1.8 million & -556,000)—led by temporary-help services (+745,200 & -252,8000), health care (+1.1 million & -501,600), manufacturing (+952,000 & -433,000), construction (+886,000 & -227,000), transportation & warehousing (+534,800 & -40,600), social assistance (+456,300 & -245,100), education (+318,600 & -206,600), financial activities (+231,000 & -48,000), wholesale trade (+223,700 & -185,500), information services (+109,000 & -172,000), and mining & logging (+15,000 & -53,000). Here's the same exercise for both local (+252,300 & -205,400) and state (+52,900 & -169,100) government education jobs.

Earned Income Proxy ([link](#)): Our Earned Income Proxy (EIP), which tracks consumer incomes and spending closely, recorded its 14th increase in the past 15 months, up 0.9% in July and 19.0% over the period, to yet another new record high. The EIP has averaged monthly gains of 1.0% the past five months. The average hourly earnings component of the EIP climbed 0.4% during July though only 1.6% during the 15 months through July, with BLS noting "Since average hourly earnings vary widely across industries, the large employment fluctuations since February 2020 complicate the analysis of recent trends in average hourly earnings." Meanwhile, aggregate weekly hours, the EIP's other component, advanced for the 13th time in 15 months, by 0.6% m/m and 17.2% over the period.

Unemployment ([link](#)): July's unemployment rate sank to a 16-month low of 5.4%, as the number of unemployed plunged by 782,000 to 8.7 million! Still, they're above their pre-pandemic readings of 3.5% and 5.7 million, respectively. The participation rate was little changed at 61.7%, though could make a noticeable move up in August's report because 19 of the 25 states that announced an end of unemployment benefits weren't included in July's report due to the timing of the survey's collection of the data. By race, unemployment rates were down across the board in July, though the rates for African Americans (to 8.2% from 9.2%) and Hispanics (6.6% from 7.4%) dropped sharply to their lowest rates since March 2020 for both. Rates for Asians (to 5.3% from 5.8%) and Whites (4.8% from 5.2%) were also the lowest since last March, though the declines were not as sharp. Meanwhile, the rates for those with a high school degree (to 6.3% from 7.0%), some college (5.0% from 5.8%), and a bachelor's degree or higher (3.1% from 3.5%) also fell to their lowest percentages since last March, while the rate for those with less than a high school degree was 9.5%, moving in a volatile flat trend so far this year.

Global Economic Indicators

Germany Manufacturing Orders ([link](#)): German factory orders rebounded 4.1% in June, more than recovering from May's 3.2% loss, soaring to a new record high. June's increase was the 12th since bottoming last April. Domestic orders have been on a tear, jumping 9.6% in June and 17.4% during the five months ending June to a new record high. Capital goods orders are driving the boom in domestic demand, soaring 29.6% the past five months, followed by consumer durable (11.7%), consumer nondurable (7.1), and intermediate (6.0) goods orders. Meanwhile, foreign orders have softened the past couple of months, edging up only 0.4% in June following May's 6.0% plunge, as foreign orders from outside the Eurozone tumbled 9.4% during the two months through June. In the meantime, foreign orders from within the Eurozone accelerated 1.3% during June and 9.8% year to date to its highest level since October 2018, led by double-digit gains in capital (22.2) and consumer durable (10.2) goods billings over the six-month period; intermediate (-1.2) and consumer nondurable (-14.2) goods orders were in the red.

Germany Industrial Production ([link](#)): Supply problems continue to send industrial production south. "Bottlenecks for important intermediate products are now making themselves felt," according to Ifo. Germany's headline number, which includes construction, contracted the fifth time this year in June, down 1.3% m/m and 4.2% year to date. Chip shortages are depressing the auto industry, while a timber shortage is impacting the construction industry. Excluding construction, output fell 1.0% in June and 3.2% over the six months through June, with manufacturing down 1.1% and 3.5% over the comparable periods. Here's a snapshot of output in the main industrial groupings over the six months through June and where they stand relative to their pre-pandemic levels: nondurable goods (+5.3% & -1.7%), consumer durable goods (+1.5 & +1.6), intermediate goods (-0.1 & -1.0), and capital goods (-9.6 & -15.8).

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