MORNING BRIEFING
August 12, 2021

Consumers, Valuation & mRNA

Check out the accompanying chart collection.

(1) Just as the party got started…Covid's back. (2) This wave may pass faster than the previous three. (3) Consumers have jobs and money to spare. (4) Southwest sees a Covid impact, but Wendy's and Sysco say all's good. (5) Strong earnings knocking most forward P/Es down. (6) Tech multiples rise slightly. (7) Surging oil and commodity prices send Energy and Materials forward P/Es falling. (8) Hoping mRNA can cure everything. (9) Moderna and BioNTech make much more than just Covid vaccines. (10) Personalized cancer cures may be in our future.

Consumer Discretionary: Delta vs Cabin Fever. Delta is a downer. The Covid-19 variant is causing cases to spike and leading consumers to change some of their behaviors once again. Southwest Airlines was the latest company to warn that there was a deceleration in "close-in" bookings and an increase in "close-in" trip cancellations in August. The company attributed these changes to the rise in Covid cases.

But with the US economy remaining open, not all industries are being equally affected. Recent news out of the restaurant industry has been more optimistic. Looking at its business through July, Sysco said its restaurant supply business in the US hadn't slowed down despite the spike in Covid cases. And on Wednesday, Wendy's increased its full-year earnings outlook and increased its dividend.

Consumers certainly have the wherewithal to spend on a meal out or clothing at the mall. And while the S&P 500 Airline industry is the second-worst S&P 500 industry performer with a 19.7% decline in its price index since it peaked on April 6, the S&P 500 Restaurants index has risen 6.3% and the S&P 500 General Merchandise Stores index has gained 18.5%. Over the same period, the S&P 500 is up 8.9% (*Fig. 1*, *Fig. 2*, and *Fig. 3*).

Let's take a look at how Delta, the US consumer, and S&P 500 Restaurants industry are faring:

(1) *Delta spiking.* Summer—and our return to normal social activities—has brought on a surge of Covid-19 cases. The seven-day average number of cases in the US hit 118,067 as of Tuesday, up sharply from 11,000-12,000 earlier this summer. While headed the wrong

direction, today's cases still aren't anywhere near January's seven-day average case count, which topped 200,000.

There are some signs of optimism. New case reports are leveling off or dropping in Missouri, Nevada, and Arkansas, states that were among the first to experience a jump in cases this summer, according to *data* from the *NYT*. Because the Delta variant is highly transmissible and because it's prompting some unvaccinated people to get vaccinated, Delta could run its course quickly.

While Covid cases could continue climbing over the next few months, "[w]e're going to reach some level of population-wide exposure to this virus, either through vaccination or through prior infection," Dr. Scott Gottlieb *told* CNBC on Monday. "I don't think Covid is going to be epidemic all through the fall and the winter. I think that this is the final wave, the final act, assuming we don't have a variant emerge that pierces the immunity offered by prior infection or vaccination."

(2) *Consumers able to spend.* US consumers have a little extra change in their pockets and they're ready, willing, and able to spend—assuming that Covid-19 doesn't get in the way.

More and more consumers are returning to work. The unemployment rate tumbled 9.4ppts from April 2020's record high of 14.8% to 5.4% in July, leaving it only moderately above the recent low of 3.5% last January and February (*Fig. 4*). The YRI Earned Income Proxy jumped 10.6% y/y in July and has continued climbing to new highs (*Fig. 5* and *Fig. 6*).

During the Covid lockdowns, consumers, unable to spend as much as they normally might, saved. The personal savings rate surged to an all-time high of 33.8% last April, falling to 13.0% by November, before rising again to 26.9% this March; it fell to 9.4% in June (*Fig. 7*). Meanwhile, consumer credit outstanding at $4.3 trillion, has only recently climbed back above its 2020 peak of $4.2 trillion (*Fig. 8*).

(3) *Food-at-home fatigue helps restaurants.* This round of Covid-19 might impact the economy in a more targeted fashion, assuming that there are no broad shutdowns. As we mentioned above, Southwest Airlines warned that "near-term" bookings had dropped, but Sysco, a large supplier to restaurants, said its business remained strong and hadn't been impacted by the Covid-19 surge.

"The restaurant sector of our business is near full recovery … The volume recovery has happened much faster than the industry predicted, despite the presence of the Delta variant," said Sysco CEO Kevin Hourican in the company's fiscal Q4 (June 30) *conference call* on Tuesday.

Many consumers are still getting over their pandemic-induced cabin fever by going out to shop and eat. Consumers continue to "seek relief from food-at-home fatigue," and the US restaurant industry recovery is in "full swing," explained CFO Sysco Aaron Alt. Meanwhile, other areas of the company's business, like international and business, are still in the early stages of recovery. Sysco was confident enough to both increase its sales forecast for fiscal 2022 and increase its dividend payout.

Wendy's also gave no signs that Covid was derailing its recovery. Wendy's stock rose 2.7% on Wednesday after the company reported adjusted Q2 earnings per share of 27 cents, exceeding analysts' forecast of 18 cents. Same-restaurant sales of 17.4% beat forecasts of 15.8%, an August 11 *Barron's* *article* reported. Wendy's upped its earnings-per-share forecast for 2021 by seven cents on both ends of its 79-81 cents range, and it boosted its dividend 20% to 12 cents a share.

The S&P 500 Restaurants stock price index is at an all-time high, and analysts are calling for revenue to jump 22.0% this year and 8.3% in 2022 (*Fig. 9*). Earnings are growing even faster, 70.2% in 2021 and 12.2% in 2022 (*Fig. 10*). Optimism is running high with the industry's forward P/E at at 29.1, near the highest levels of the past 25 years (*Fig. 11*).

Strategy: Taking a Look at P/Es. We noted in Monday's *Morning Briefing* that the S&P 500's forward earnings (i.e., the time-weighted average of consensus earnings-per-share estimates for this year and next) has been growing so quickly that despite the index's 18.4% ytd increase, its forward P/E based on these earnings has hardly budged since last fall, hovering around 21. As it turns out, the same is true for many of the sectors and industries that make up the broader index. And in those cases where the forward P/E did make a big move since last fall, the move was often to the downside. Let's take a look:

(1) *Sector forward P/Es on the move.* Among the S&P 500 sectors, Energy and Materials have experienced the biggest changes in forward P/E y/y. Their earnings jumped dramatically as the prices of oil and materials soared over the past year, and their forward P/Es accordingly plummeted.

Conversely, the forward P/E of the Information Technology sector was one of the few to increase over the past year, but the increase was small, less than two percentage points.

Here are the forward P/Es of the S&P 500 and its sectors as of August 5 and a year earlier: Real Estate (51.1, 49.6), Consumer Discretionary (29.9, 35.7), Information Technology (26.1, 25.8) Industrials (21.5, 23.4), Communication Services (21.3, 22.0), S&P 500 (21.0, 22.0), Consumer Staples (20.5, 20.5), Utilities (19.7, 18.4), Health Care (17.6, 16.3), Materials (16.8, 21.4), Financials (13.7, 13.9), and Energy (13.1, 50.3) (*Table 1*).

(2) *Tech industries see P/Es rise.* Among the industries that have seen the largest jumps in their forward P/Es, REITs feature prominently, with the Health Care, Residential, and Retail REITs all experiencing the top 10 largest y/y increases in forward P/Es. The forward P/E for Automobile Manufacturers has increased by the most of all the S&P 500 industries, 205.9% y/y to 32.2, as production slowed and earnings fell due to a lack of semiconductor chips (*Table 2*). The industry's shares, however, didn't fall, as investors appear to be looking through the temporary parts-induced slowdown and giving the car companies more credit for their electric vehicle offerings.

Some of the largest increases in forward P/Es occurred in industries that resided in the Technology sector, including Electronic Equipment & Instruments (37.8% y/y to 29.0), Semiconductor Equipment (23.7, 20.6), Communications Equipment (14.1, 17.6), Application Software (8.3, 49.2), Semiconductors (5.6, 20.4), and Systems Software (4.0, 31.5).

(3) *Materials and Energy earnings rise, P/Es fall.* Industries in the Energy and Materials sectors have seen their forward P/Es drop the furthest over the past year, including Oil & Gas Exploration & Production (-94.7% y/y to 9.8), Integrated Oil & Gas (-80.4, 13.3), Oil & Gas Equipment & Services (-55.5, 17.9), Commodity Chemicals (-55.4, 7.5), Steel (-48.1%, 8.7), Oil & Gas Refining & Marketing (-33.2, 19.2), and Copper (-33.2, 10.4). Other industries that have seen their earnings increase faster than their stock prices include Apparel Retail (-36.1, 20.8), Homebuilding (-29.5, 8.0), and surprisingly Internet & Direct Marketing Retail, home of Amazon (-21.2, 54.1).

Even though the forward P/E of the Internet & Direct Marketing industry has fallen sharply over the past year, the industry continues to have one of the loftiest P/Es among S&P 500 industries. Here are the industries with the 10 highest forward P/Es: Health Care REITs (131.2), Airlines (87.4), Residential REITs (81.0), Casinos & Gaming (73.4), Hotels (66.8), Industrial REITs (59.2), Internet & Direct Marketing Retail (54.1), Office REITs (53.2), Specialized REITs (50.5), and Application Software (49.2).

(4) *P/Es in the single digits.* Among the S&P 500 industry indexes with the lowest forward

P/Es are a couple of insurance industries and a number of very cyclical industries. Here are the 10 lowest P/E industries in the S&P 500: Oil & Gas Exploration & Production (9.8), Integrated Telecommunication Services (9.4), Drug Retail (9.2), Household Appliances (8.7), Steel (8.7), Life & Health Insurance (8.1) Reinsurance (8.1), Homebuilding (8.0), Alternative Carriers (8.0), and Commodity Chemicals (7.5).

Disruptive Technologies: Expanding mRNA Uses. Now that mRNA vaccines have proven to be effective against Covid-19, companies are investigating how to use mRNA and proteins to solve a diverse array of health problems. Under development are mRNA vaccines for the flu, HIV, and CMV. Scientists are also hoping that mRNA can be used to cure cancer, cystic fibrosis, and other ailments.

Moderna and BioNTech, known for their Covid-19 vaccines, are leading the way, followed by small biotech companies including Gritstone Oncology and Kernel Biologics as well as drug giants Pfizer, Sanofi, Gilead Sciences, and Merck.

Let's take a look at how these companies are harnessing our cellular biology:

(1) *Moderna: Curing Covid, cancer, and more.* Moderna is using mRNA to restore the activity of missing enzymes responsible for various rare diseases like propionic acidemia, methylmalonic acidemia, glycogen storage disease type 1a, and phenylketonuria. It's using mRNA to develop treatments for autoimmune diseases, and it plans to use mRNA to create vaccines for flu, HIV, and CMV, or cytomegalovirus, which leaves 6,000-7,000 babies with lifelong disabilities each year.

Moderna's most ambitious plan is to use mRNA to stimulate a patient's own immune system and fight cancer. First, it identifies the mutations in a patient's cancer cells. It then loads mRNA with instructions for up to 34 mutations and injects it into the patient. Cells respond to the mRNA by creating portions of the proteins on their surface that look like the mutations in the cancer. When the patient's immune cells come in contact with the mRNA-created proteins, the immune cells identify them as foreign. In the future, when the immune cells encounter the same proteins in the cancer cells, they know to kill the protein as well as the cancer cells. Moderna can create this personalized vaccine and deliver it in just a few weeks.

The company believes personalized cancer vaccines will work best when used when in combination of other treatments, so it's partnering with Merck, which makes Keytruda. It's also working with Merck on an mRNA vaccine that will generate and present KRAS neoantigens to the immune system in hopes of curing epithelial cancers, like non-small cell lung cancer, colorectal, and pancreatic cancers.

Moderna was added to the S&P 500 in July and has risen 534.3% over the past year.

(2) *BioNTech targets malaria, cancer and more.* Like Moderna, BioNTech is studying the use of mRNA to target and cure cancers including melanoma, prostate, breast, ovarian, and pancreatic cancers.

BioNTech is planning Phase 1 trials for a flu vaccine in Q3 using its Covid-19 technology and in partnership with Pfizer. By the end of 2022, it aims to begin trials for a malaria vaccine, which also uses mRNA technology. As part of that program, it plans to build vaccine production facilities in Africa. The company is also working with the Bill & Melinda Gates Foundation to develop therapies for tuberculosis and HIV.

(3) *Lots of little guys researching.* There are many startups working with mRNA to solve many different problems. Gritstone bio and Gilead Sciences are creating a mRNA vaccine to treat HIV. The company is conducting trials for its therapy treating colorectal, lung, and gastroesophageal cancers. Kernel Biologics is developing mRNA-based immunotherapies for cancer. Arcturus Therapeutics Holdings is using mRNA to develop vaccines for flu and Covid-19 as well as cures for cystic fibrosis and liver disease.

In some cases, the big drug companies are partnering with or buying these small biotech companies. Sanofi announced earlier this month that it plans to buy Translate Bio for $3.2 billion. The two companies are also looking at mRNA vaccines for several infectious diseases, and in June started a Phase I trial evaluating a possible mRNA-based vaccine against the flu. Translate is also testing an inhaled treatment for cystic fibrosis using mRNA.

Calendars

US: Thurs: Initial & Continuous Jobless Claims 375k/2.88m, Headline & Core PPI 7.3%/5.6% y/y, Natural Gas Storage, OPEC Monthly Report. **Fri:** Consumer Sentiment Index 81.2, Import & Export Prices 0.6%/0.8%, Baker-Hughes Rig Count. (Bloomberg estimates)

Global: Thurs: Eurozone Industrial Production -0.2%m/m/10.4%y/y, UK GDP

4.8%q/q/22.1%y/y, UK Industrial Production 0.3%m/m/9.4%y/y, UK Manufacturing Production 0.4%m/m/13.5%y/y, UK Trade Balance -£9.1b, Japan Industrial Production 6.2%. **Fri:** France CPI 0.1%m/m/1.6%y/y, Spain CPI -0.7%m/m/2.9%y/y, China FDI. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) this week increased for the third week, to 3.55, after falling from 4.00 (highest since late January 2018) to 3.18 three weeks ago. Bullish sentiment increased by 3.8ppts (to 56.4% from 52.6%) the past two weeks, after falling the prior two weeks by 8.6ppts (52.6 from 61.2), while the correction count fell 3.2ppts (27.7 from 30.9) the past two weeks after a two-week gain of 7.4ppts (30.9 from 23.5). Bearish sentiment eased for the third week to 15.9% this week after climbing the prior week from 15.3% to 16.7%; it's been fluctuating in a rather narrow band in recent months compared to the wide swings in bullish sentiment and the correction count. The AAII Ratio fell to 53.2% last week after increasing from 50.0% to 60.0% the prior week, as bearish sentiment climbed from 24.1% to 31.7% and bullish sentiment inched down from 36.2% to 36.1%.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin rose to a new record high of 13.2% last week from 13._% a week earlier. Since the end of April, it has exceeded its prior record high of 12.4% in September 2018. It's now up 2.9ppts 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 dropped 0.6ppt w/w to 8.8%. 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 tumbled 2.4ppts w/w to 17.2% 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

14.4% in 2021 (up 0.4ppts w/w) and 6.6% (unchanged w/w) in 2022 compared to the 2.1% decline reported in 2020. They expect earnings gains of 45.0% in 2021 (up 1.2ppts w/w) and 9.2% in 2022 (down 0.3ppt w/w) compared to a 13.3% decline in 2020. Analysts expect the profit margin to rise 2.7ppts y/y in 2021 to 12.9% (unchanged w/w) from 10.2% in 2020 and to improve 0.3ppt y/y to 13.2% in 2022 (unchanged w/w). The S&P 500's weekly reading of its forward P/E ticked down 0.3pt w/w to 21.0. 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 down 0.02pt w/w to 2.76, close to its 2.79 record high in mid-July. 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 rise for all 11 S&P 500 sectors. Forward earnings was higher all but the Financials sector. 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 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 (24.8%, a new record high this week), Financials (19.4, down from a record high 19.6% a week earlier), Communication Services (16.7, a new record high this week), Real Estate (16.0, down from 17.0), Utilities (14.4, down from its 14.8 record high in early May), Materials (13.2, a new record high this week), S&P 500 (13.2, a new record high this week), Health Care (11.0, down from 11.2), Industrials (10.1, down from its record high of 10.5% in mid-December), Consumer Staples (7.6, 7.7), Consumer Discretionary (7.9, down from 8.3), and Energy (7.4, 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 17.1% and 50.3%, respectively, since then to new record highs. The forward profit margin has risen 3.1ppts to a record high of 13.2%, exceeding its prior record high of 12.4% in late 2018. During the latest week, all 11 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 25.9%, forward earnings up 88.9%), Energy (25.8, 1,522.2), Communication Services (23.9, 54.7), Information Technology (23.8, 41.0), Industrials (21.1, 66.2), S&P 500 (17.1, 50.3), Financials (16.2, 67.4), Health Care (13.3, 24.7), Consumer Discretionary (12.2, 88.2), Consumer Staples (9.6, 17.0), Real Estate (8.2, 21.6), and Utilities (0.0, 3.5).

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