MORNING BRIEFING
September 8, 2021

Around the World

Check out the accompanying chart collection.

(1) Spreading Covid for the holidays. (2) Comparative pandemic waves around the world. (3) Israel leads the way. (4) US fiscal and monetary easing leaked abroad through US trade deficit. (5) Are commodity prices peaking? (6) Global PMIs showing global slowdown. (7) Chip shortage is tapping on global auto industry's brakes. (8) US leading the global performance derby for forward revenues, forward earnings, and forward profit margins. (9) Comparing Go Global P/E to US Value P/E. (10) Stay Home still beating Go Global.

Pandemic: Learning To Live with Covid. The Covid virus loves American holidays (*Fig. 1*). That's when Americans love to get together, providing the virus with a great opportunity to spread. Last year, the first wave of the pandemic got a big boost from Memorial Day and Independence Day. The second wave coincided with 2020's year-end holidays. The third and current wave seems to have started on July 4 and might have just gotten a boost from Labor Day.

The good news is that nearly 80% of the adult population has been vaccinated at least once (*Fig. 2*). The bad news is that hospitals in the hot spots are running out of beds for the unvaccinated who get infected and must be hospitalized. However, so far, the number of deaths is well below those of the previous two waves (*Fig. 3*). Let's take a quick world tour of the pandemic:

(1) *Europe and Japan.* So far, the hospitalization data for France, Italy, and the UK show that their second waves of the pandemic are bottoming (*Fig. 4*). Their second waves started at about the same time as those in the US but lasted longer this year, into the spring and early summer months. Germany's data on new cases show three waves so far, with the latest one currently bottoming (*Fig. 5*). Japan's latest wave is its worst one so far.

(2) *India and Brazil.* India's first wave occurred last summer (*Fig. 6*). The country's second wave was a nightmare earlier this year. The number of new cases crested at 382,588 on May 10, based on the 10-day moving average. But then it plunged to around 40,000 currently. Brazil seems finally to be coming out of one long wave of pandemic misery.

(3) *Israel.* Israel has been the poster child for how to deal with the pandemic most

effectively, by rapidly vaccinating most of the adult population. However, a third wave started this summer, with new cases exceeding the previous two peaks (*Fig. 7*).

Bloomberg *reported* yesterday, "The nation of 9 million became the test case for reopening society and the economy in April when much of Europe and the U.S. were still in some form of lockdown. Yet Israel now shows how the calculus is changing in places where progress was fastest. …

"Following the spread of the Delta variant over the summer, Israel has seen cases climb, reaching an all-time high of 11,316 daily cases on Sept. 2. The number of people falling seriously sick and being hospitalized, though, has risen less than it did during the last coronavirus wave, peaking at 751 in late August, compared with 1,183 in mid-January. The trend is now downward."

(4) *Living with Covid.* The article quoted an Israeli professor of infectious diseases with the bottom line on the pandemic: "If you are able to maintain life without lockdown, and to avoid very high numbers of hospitalizations and death, then this is what life with Covid looks like."

World Economy I: Slowing but Growing. Policymakers in the US responded to the pandemic with much more monetary and fiscal stimulus than did policymakers elsewhere in the world. A significant portion of that stimulus "leaked" abroad through the US trade deficit. That boosted the global economic recovery from the pandemic lockdowns. Of course, other countries also responded with their own stimulative policies. Consider the following:

(1) *US trade.* During Q2, US current-dollar imports of goods rose to a record $2.8 trillion (saar) (*Fig. 8*). The trade deficit in goods widened to a record $1.1 trillion during Q2 (*Fig. 9*).

(2) *Commodity prices.* Debbie and I view broad commodity indexes as very good indicators of global economic growth. Both the CRB all commodities index and the CRB raw industrials spot price index have rebounded from their pandemic lockdown lows of last year back to their previous record highs during 2011 (*Fig. 10*). Their ascents during the Great Virus Crisis have been very similar to their ascents following the Great Financial Crisis.

Both of these indexes may be peaking now. If so, then the slowdown in US economic growth we discussed in yesterday's *Morning Briefing* may be contributing to a global growth slowdown. China's economy has also gotten a boost from an export boom to the US, but real US consumer spending on goods has dropped for the fourth month in a row, as we also discussed yesterday. In the August 23 *Morning Briefing*, we observed that China's retail sales have stopped growing as a result of the country's rapidly aging demographic profile. Furthermore, the global auto industry has been forced to tap on the production brakes as a result of semiconductor shortages.

(3) *Global PMIs.* The global composite purchasing managers index (C-PMI), which includes the global manufacturing (M-PMI) and nonmanufacturing (NM-PMI) indexes, peaked at 58.5 in May then fell for the next few months to 52.6 in August (*Fig. 11*). Leading the decline have been the PMIs for emerging economies. The M-PMI for advanced economies has been holding up better than that for emerging ones (*Fig. 12*). The NM-PMIs have been weakening across the board.

Here are August readings for selected advanced economies' M-PMIs and NM-PMIs: Eurozone (61.4, 59.0), UK (60.3, 55.0), US (59.9, 61.7), and Japan (52.7, 42.9).

Here is what we have for selected emerging market economies' M-PMIs and NM-PMIs during August: Brazil (53.6, 55.1), India (52.3, 56.7), China (50.1, 46.7), and Russia (46.5, 49.3).

(4) *Global real GDP.* On a y/y basis, global real GDP growth set a record for sure during Q2, since most economies were hit by pandemic lockdowns a year ago and have staged V-shaped recoveries since then through this year's Q2. However, all Vs come to an end. We aren't likely to see y/y growth rates in real GDP like these again in our lifetimes: UK (22.2%), Mexico (19.6), Singapore (14.6), Eurozone (14.3), Canada (12.7), Brazil (12.4), Australia (9.6), Taiwan (8.4), China (7.9, down from a peak of 18.3% during Q1), Japan (7.6), Indonesia (7.1), and South Korea (6.0). (See our *Comparative Global GDP Growth Rates* chart book.)

(5) *Global parts shortage.* The parts shortages, especially in the auto industry, may weigh on global economic growth more than widely anticipated. We can see this happening in Germany, where it appears that manufacturing orders can't be filled fast enough: German manufacturing orders—up 3.4% m/m during July to a record high—have been strong yet industrial production has been relatively weak, falling during the three months through June before July's 1.0% blip up (*Fig. 13*).

German auto production staged a brief recovery earlier this year but has also been slipping recently (*Fig. 14*). German technology and engineering group Bosch, which is the world's largest car-parts supplier, reports that semiconductor supply can't keep up with demand for chips in everything from cars to PlayStation 5s and electric toothbrushes.

The move to electric vehicles is exacerbating the problem. For example, a Ford Focus typically uses roughly 300 chips, whereas one of Ford's new electric vehicles can have up to 3,000 chips, *according* to CNBC. Ford also reported that lithium, plastics, and steel are all in relatively short supply. Malaysia, where many of Volkswagen's suppliers are based, has been hit hard by the coronavirus in recent weeks, leading to several factory shutdowns.

World Economy II: Forward Revenues, Earnings, and Margins. Joe and I also like to get a read on the global economy by tracking the forward revenues (FR) of the major MSCI stock price composites (*Fig. 15*). Through the week of August 26, they are showing that the All Country World FR fully recovered what it lost last year. That was all because the FR for the US has been rising in record territory since earlier this year. The FRs of Emerging Markets, EMU, Japan, and the UK bottomed last year and have recovered but remain below their pre-pandemic levels.

In other words, the forward revenues data confirm that the US economic recovery has been stronger than elsewhere around the world and that the US has "shared" some of this growth with the rest of the world through the widening US trade deficit.

A similar story is told by the forward earnings (FE) of the major MSCI composites (*Fig. 16*). The FE recoveries have been stronger than the FR recoveries because forward profit margins (FPMs) have snapped back from last year's lows around the world (*Fig. 17*). In fact, all of the major MSCI composites have FPMs above their pre-pandemic levels. Here they are for the week of August 26: US (13.0%), All Country World (10.7), UK (10.5), EMU (8.3), Emerging Markets (8.2), and Japan (7.1).

Around the world, companies are boosting productivity to offset labor shortages that are attributable to the increasingly geriatric demographic profile of the world's population and labor force. We discussed this development in the August 10 *Morning Briefing* titled "Voluntary Self-Extinction of the Human Race." The pandemic has exacerbated the labor shortages around the world. The result has been V-shaped recoveries in profit margins over the past year.

World Strategy: Stay Home or Go Global? The aforementioned metrics show that the US is outperforming the rest of the world. That's showing up in the extreme divergence between the forward P/Es of the US MSCI, which was 22.0 at the end of August, and the All Country World ex-US MSCI, which was 14.7 at the end of last month (*Fig. 18*).

However, as we have noted in the past, it makes more sense to compare the valuation multiple of the rest of the world to the forward P/E of the S&P 500 Value index (*Fig. 19*). It was 16.5 in early September. The rest of the world is still relatively cheap even on this basis. Nevertheless, the uptrends in the Stay Home vs Go Global ratios remain solidly intact, and we continue to recommend overweighting the US (*Fig. 20*).

Calendars

US: Wed: Job Openings 9.281m, Consumer Credit $25.0b, MBA Mortgage Applications, API Crude Oil Inventories, Beige Book, Williams. **Thurs:** Initial & Continuous Jobless Claims 336k/2.744m, Natural Gas Storage, Williams, Daly, Bowman. (Bloomberg estimates)

Global: Wed: China CPI & PPI 1.0%/9.0% y/y, BOC Interest Rate Decision 0.25%, Debelle. **Thurs:** Germany Trade Balance €13.0b, Japan Machine Tool Orders, China New Loans, ECB Interest Rate Decision & Deposit Facility Rate 0.00%/-0.50%, Enria, Debelle, Macklem. (Bloomberg estimates)

Strategy Indicators

S&P 500/400/600 Forward Earnings (*link*): Two of these three indexes had forward earnings at a record high last week, only SmallCap didn't. LargeCap's was at a record high for a second week after being out of this category briefly in early August following Amazon's negative earnings guidance. MidCap's was at a record high for a 30th straight week. But SmallCap's dropped from a record for the first time in 26 weeks. In what has shaped up to be an extraordinary V-shaped recovery, LargeCap's forward earnings has risen during 66 of the past 68 weeks, with the two down weeks due to Tesla's addition to the index last December and Amazon's earnings shortfall in August. MidCap's is up in 64 of the past 66 weeks, and SmallCap's posted 63 gains in the past 67 weeks. Forward earnings for these indexes had been on an uptrend from November 2019 until February 2020, before tumbling to a bottom by June 2020 due to the Covid-19 economic shutdown. LargeCap's forward earnings has risen 51.8% from its lowest level since August 2017; MidCap's is now up 97.9% from its lowest level since May 2015; and SmallCap's has soared 154.9% from its lowest point since August 2013. The yearly change in forward earnings soared to cyclical highs during 2018 due to the boost from the Tax Cuts and Jobs Act but began to tumble in October 2018 as y/y comparisons became more difficult. In the latest week, the yearly rate of change in LargeCap's forward earnings was 37.9%, down from a record-high 42.2% at the end of July. That's up from -19.3% in May 2020, which was the lowest since October 2009. The yearly rate of change in MidCap's forward earnings ticked down w/w to 67.8% y/y from 67.9%. That's down from a record high of 78.8% at the end of May and up from a record low of -32.7% in May 2020. SmallCap's rate fell to 101.8% from 104.6%; it's down from a record high of 124.2% in late June and up from a record low of -41.5% in June 2020. Companies have been beating consensus estimates quite handily since the Q2-2020 earnings season, causing analysts' y/y earnings growth forecasts for 2021 to improve instead of decline as is typical. Here are the latest consensus earnings growth rates for 2021 and 2022: LargeCap (44.0%, 9.6%), MidCap (74.5, 6.5), and SmallCap (112.2, 13.7).

S&P 500/400/600 Valuation (*link*): Valuations were little changed last week for all three of these indexes, and they remain close to their multi-month lows. LargeCap's forward P/E ticked up 0.1pt w/w to 21.2, just 0.5pts above its eight-month low of 20.7 at the end of July. LargeCap's forward P/E compares to a 19-year high of 22.7 in early January and is up from 13.3 in March 2020, which was the lowest since March 2013. MidCap's fell 0.2pts to 16.8, and is just 0.3pts above its 16-month low of 16.5 in mid-August. That compares to a seven-month high of 20.5 in early March and is 6.1pts below its record high of 22.9 in June 2020. SmallCap's was steady w/w at 16.0, just 0.4pts above its 16-month low of 15.6 in mid-August. It's now down 10.7pts from its record high of 26.7 in early June 2020. During March 2020, MidCap's 10.7 and SmallCap's 11.1 were their lowest readings since March 2009. LargeCap's forward P/E in February 2020—before Covid-19 decimated forward earnings—was 18.9, the highest level since June 2002. Of course, that high was still well below the tech-bubble record high of 25.7 in July 1999. Last week's level compares to the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap's P/E was below LargeCap's P/E yet again last week, as it has been for most of the time since August 2018. In contrast, it was last solidly above LargeCap's from April 2009 to August 2017. SmallCap's P/E was below LargeCap's for a 48th week. That's the longest stretch at a discount since 2002-03; SmallCap's current 25% reading is its biggest since 2001. SmallCap's P/E had been mostly above LargeCap's since 2003. Looking at SmallCap's P/E relative to MidCap's, it was at a discount for a 12th straight week; SmallCap's current 5% discount is near its biggest since 2003.

S&P 500 Sectors Quarterly Earnings Outlook (*link*): Since the Q2-2020 earnings season—which came in substantially better than greatly reduced forecasts—analysts as a whole have been raising their consensus forecasts for all future quarters instead of lowering them as is the norm. Those gains have endured even through the earnings warnings season, when forecasts typically decline. In the latest week, the S&P 500's Q2-2021 blended earnings-per-share estimate rose 3 cents to $52.74 due to positive earnings surprises. That $52.74 estimate for Q2-2021 represents a gain of 88.5% y/y on a frozen actual basis and a 95.6% y/y gain on a pro forma basis. That marks the second straight quarter of double-digit percentage growth and compares to a pro forma 52.8% gain in Q1-2021. All 11 sectors posted positive y/y earnings growth during Q2-2021, up from 10 during Q1-2021. Here are the S&P 500 sectors' latest expected earnings growth rates for Q2-2021 versus their final Q1-2021 growth rates: Industrials (697.5% in Q2-2021 versus 3.0% in Q1-2021), Consumer Discretionary (370.1, 226.1), Energy (244.4, 28.0), Financials (156.7, 138.0), Materials (139.2, 62.4), S&P 500 (95.6, 52.8), Communication Services (73.1, 53.1), Information Technology (49.6, 44.9), Real Estate (38.8, 5.8), Health Care (26.4, 26.7), Consumer Staples (19.9, 11.1), and Utilities (12.7, -0.9).

Global Economic Indicators

Eurozone GDP (*link*): The Eurozone emerged from its Covid-led recession during Q2, with an easing of Covid-related restrictions. Economic activity in the Eurozone expanded 2.2% (not annualized) last quarter, faster than the flash estimate of 2.0%, boosted by a surge in consumer spending. That follows a double-dip recession during Q4-2020 (-0.4%) and Q1-2021 (-0.3). Activity last quarter was 14.3% above a year ago, and is within 2.5% of pre-Covid levels. Ireland (6.3) and Portugal (4.9) posted the biggest quarterly increases in the Eurozone. Looking at the largest Eurozone economies, Spain (2.8) and Italy (2.7) expanded at a faster pace than Germany and France, which rose 1.6% and 1.1%, respectively. 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 (9.4) growth was in the high single digits, likely curbed by supply-chain problems given Germany's large auto industry.

Germany Industrial Production (*link*): Production rose for the first time in four months in July, as supply disruptions sent industrial production south during the first half of the year. Germany's headline number, which includes construction, climbed 1.0%—after falling five of the prior six months by a total of 3.9%—boosted by machinery (6.9%) and motor vehicle production (1.9). Chip shortages have depressed the auto industry in recent months, while a timber shortage has impacted construction. Excluding construction, output was also up 1.0% after contracting 3.0% during the six months through June, with manufacturing up 1.3% and down 3.2% over the comparable periods. There have been signs of life in consumer goods production recently, with consumer durable goods orders rebounding 12.4% during the four months through July and consumer nondurable goods up 7.2%

during the six months through July. Meanwhile, capital goods production jumped 3.2% in July, after falling 9.0% during the five months through June, while intermediate goods output remains in a volatile flat trend around recent highs.

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